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Economic Letter from Asia: Japan's Balance of Payments

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Japan's Balance of Payments

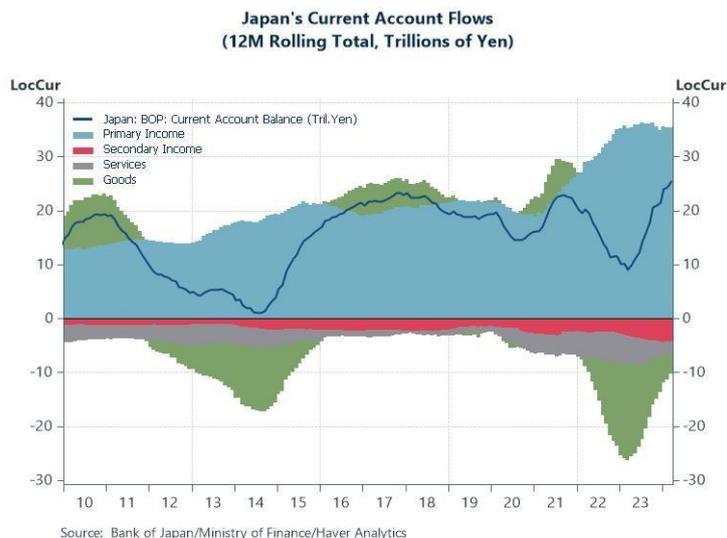
In this week's newsletter, we assess the recent trends and factors shaping Japan's balance of payments. Notably, Japan has witnessed a substantial improvement in its current account surplus in recent months, with an improved goods balance a primary driver. We attribute Japan's improved goods balance in part to a favorable trend in its terms of trade, although we also acknowledge the rise in export volumes for certain key products. Additionally, we highlight Japan's significant net primary income flows, which have played a crucial role in bolstering its current account balance. These substantial primary income flows are arguably a consequence of Japan's long-standing accumulation of overseas assets through both direct and portfolio investments.

This discussion naturally leads us to Japan's substantial net international investment position, which stands as the largest globally. Upon closer examination, we observe a pronounced shift within Japan's investment portfolio, with direct investment holdings progressively displacing its portfolio investment holdings in relative significance. Lastly, we explore recent patterns in Japan's outbound direct investment flows, with a pronounced increase in investments directed towards the US. In contrast, investments into China and the European Union have experienced a downturn in recent times.

Japan's current account

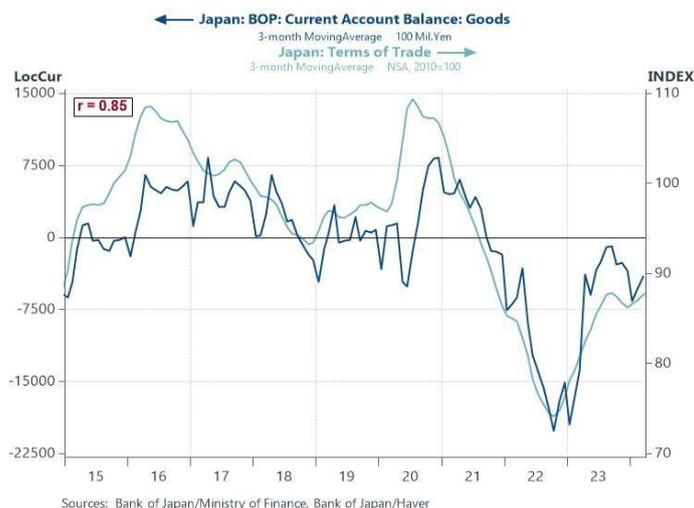
Japan's current account surplus has surged since early 2023, surpassing 25 trillion yen (\$160 billion) in March 2024 on a rolling 12-month basis (Chart 1). A significant portion of this improvement stems from the easing of its goods trade deficit, which decreased to about 3.6 trillion yen (\$23 billion) over the period. Concurrently, Japan's net primary income has remained the primary driver behind the economy's overall current account surplus, hovering around 35 trillion yen (\$220 billion) in recent months. This unique characteristic distinguishes Japan from many other Asian economies, where goods and services exports typically play a more dominant role in current account inflows.

Chart 1: Japan's current account flows



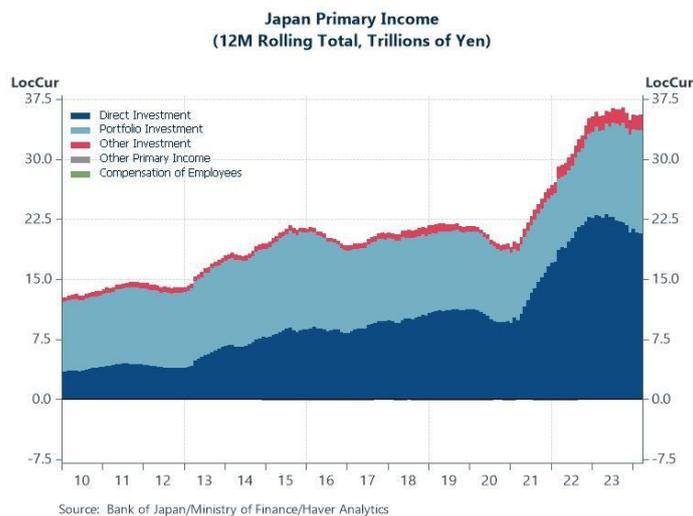
Examining the catalysts behind Japan's recent improvement in its goods trade balance, Chart 2 reveals a strong and positive correlation with the substantial rebound in its terms of trade. While both export and import prices in Japan have experienced an uptick, export prices have climbed at a swifter pace compared to imports, consequently bolstering Japan's terms of trade. It is noteworthy that Japan's goods trade balance would have improved solely due to this factor, even if export and import volumes had remained constant. That being said, it is also worth mentioning that the actual volumes of Japan's key exports, such as motor vehicles, motor vehicle parts, and integrated circuits, have also seen growth.

Chart 2: Japan's goods trade balance and terms of trade



We now turn our attention to the recent factors shaping Japan’s net primary income, which stands as the primary force behind the nation's substantial current account surplus. Chart 3 underscores the post-pandemic upswing in Japan's primary income, which was driven mainly by direct investment income, while portfolio investment income was a secondary driver. Japan derives a significant portion of its direct investment income from its substantial stock of investments in assets abroad, a subject we will delve into further below. On the flip side, income from other investments, additional primary sources, and employee compensation played a comparatively smaller role.

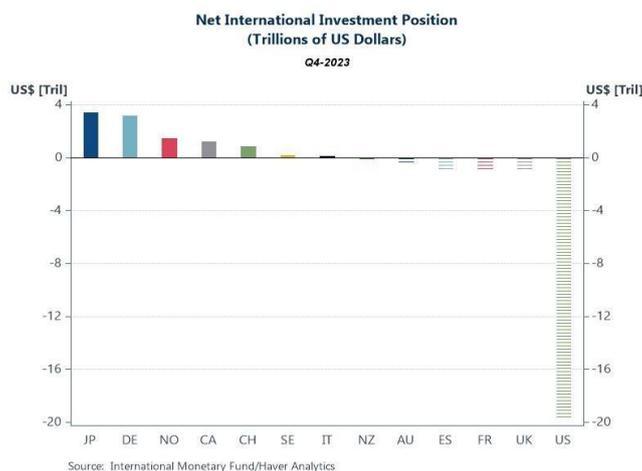
Chart 3: Drivers of Japan’s primary income flows



Japan’s net international asset holdings

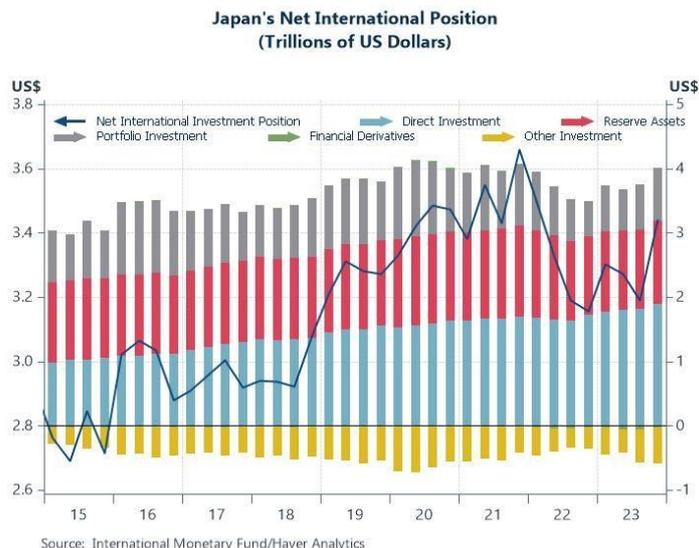
Turning our attention to Japan's net international investment position in comparison to those of other major economies allows us to comprehend the immense scale of its net asset holdings. According to Chart 4, as of Q4 2023, Japan holds the largest net asset position globally, amounting to \$3.4 trillion, with only Germany’s holdings coming close in terms of magnitude. As discussed in last week’s letter, Japan’s substantial international asset holdings stem from decades of significant outward foreign direct investment (FDI) and portfolio investment. In contrast, several other major economies, including the UK, France, Spain, and Australia, find themselves in net liability positions. The US stands out with a net liability position of nearly \$20 trillion, underscoring the significant level of indebtedness of the economy.

Chart 4: Japan’s net international investment position



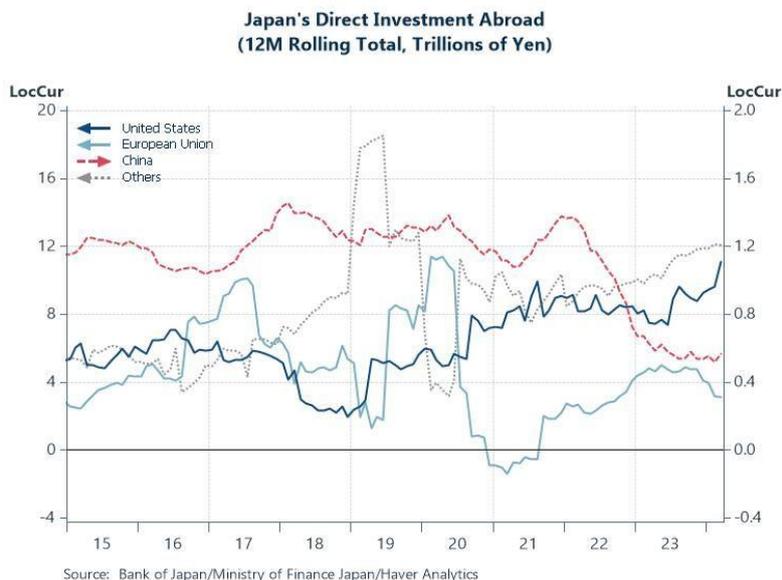
Delving further into the breakdown of Japan's net international assets, Chart 5 reveals that the economy's holdings of net direct investment assets have exhibited steady growth over the past decades, gradually becoming a dominant component of its overall net holdings. Meanwhile, Japan's reserve assets underwent a decline from late 2021, primarily influenced by the securities component of its foreign currency reserves. Moving on to Japan's net portfolio assets, their value witnessed a decline between 2020 and 2022 but has been steadily rebounding since. The significant proportion of Japan's net direct and portfolio investment holdings partially accounts for the substantial contributions to Japan's primary income, as discussed earlier.

Chart 5: Breakdown of Japan's net international investment position



We now turn our attention to the trends shaping Japan's outbound direct investment, offering deeper insights into the evolving landscape of Japan's economic engagements across borders. Chart 6 illustrates a significant surge in Japan's direct investment outflows towards the United States, totaling 11.1 trillion yen by March 2024, based on a rolling 12-month aggregate. Conversely, a discernible trend emerges as Japan's investment into China has shown a steady decline since early 2022, potentially reflective of geopolitical realignments and evolving global alliances among major economies. Equally noteworthy is the recent downturn in Japan's investments within the European Union, perhaps signaling a shift in its investment priorities in recent months.

Chart 6: Japan's financial account flows



About the author



Haver Analytics is pleased to bring [Tian Yong Woon's](#) commentaries on the state of the global economy to its clients.

Tian Yong joined Haver Analytics as an Economist in 2023. Previously, Tian Yong worked as an Economist with Deutsche Bank, covering Emerging Asian economies while also writing on thematic issues within the broader Asia region. Prior to his work with Deutsche Bank, he worked as an Economic Analyst with the International Monetary Fund, where he contributed to Article IV consultations with Singapore and Malaysia, and to the regular surveillance of financial stability issues in the Asia Pacific region. Tian Yong holds a Master of Science in Quantitative Finance from the Singapore Management University, and a Bachelor of Science in Banking and Finance from the University of London.

Data featured in this commentary:

Chart 1: Japan's current account flows

- Series 1: [movt\(BNCB@JAPAN,12\)](#) [Japan: BOP: Current Account Balance (100 Mil.Yen)]
- Series 2: [movt\(BNI@JAPAN,12\)](#) [Japan: BOP: Current Account Balance: Primary Income (100 Mil.Yen)]
- Series 3: [movt\(BNCT@JAPAN,12\)](#) [Japan: BOP: Secondary Income (100 Mil.Yen)]
- Series 4: [movt\(BNS@JAPAN,12\)](#) [Japan: BOP: Current Account Balance: Services (100 Mil.Yen)]
- Series 5: [movt\(BNG@JAPAN,12\)](#) [Japan: BOP: Current Account Balance: Goods (100 Mil.Yen)]

Chart 2: Japan's goods trade balance and terms of trade

- Series 1: [movv\(BNG@JAPAN,3\)](#) [Japan: BOP: Current Account Balance: Goods (100 Mil.Yen)]
- Series 2: [movv\(N158PFTT@G10,3\)](#) [Japan: Terms of Trade (NSA, 2010=100)]

Chart 3: Drivers of Japan's primary income flows

- Series 1: [movt\(JPNBCYD@JAPAN,12\)](#) [Japan: BOP: Direct Investment Income: Net (100 Mil.Yen)]
- Series 2: [movt\(JPNBCYP@JAPAN,12\)](#) [Japan: BOP: Portfolio Investment Income: Net (100 Mil.Yen)]
- Series 3: [movt\(JPNBCYO@JAPAN,12\)](#) [Japan: BOP: Other Investment Income: Net (100 Mil.Yen)]
- Series 4: [movt\(JPNBCYX@JAPAN,12\)](#) [Japan: BOP: Primary Income: Other Primary Income: Net Balance (100 Mil.Yen)]
- Series 5: [movt\(JPNBCE@JAPAN,12\)](#) [Japan: BOP: Current Account: Compensation of Employees: Net (100 Mil.Yen)]

Chart 4: Japan's net international investment position

- Series 1: [B158B00Y@IMFBOP](#) [Japan: Net International Investment Position: All Sctrs & Mat Bal(EOP,Bil.US\$)]
- Series 2: [B134B00Y@IMFBOP](#) [Germany: Net International Investment Position: All Sctrs & Mat Bal(EOP,Bil.US\$)]
- Series 3: [B142B00Y@IMFBOP](#) [Norway: Net Intl Investment Position: All Sec & Mat Balance(EOP,Mil.US\$)]
- Series 4: [B156B00Y@IMFBOP](#) [Canada: Net International Investment Position: All Sctrs & Mat Bal(EOP,Mil.US\$)]
- Series 5: [B146B00Y@IMFBOP](#) [Switzerland: Net International Invest Position: All Sctrs & Mat Bal(EOP,Mil.US\$)]
- Series 6: [B144B00Y@IMFBOP](#) [Sweden: Net International Investment Position: All Sctrs & Mat Bal(EOP,Mil.US\$)]
- Series 7: [B136B00Y@IMFBOP](#) [Italy: Net International Investment Position: All Sctrs & Mat Bal(EOP,Mil.US\$)]
- Series 8: [B196B00Y@IMFBOP](#) [New Zealand: Net International Invest Position: All Sctrs & Mat Bal(EOP,Mil.US\$)]
- Series 9: [B193B00Y@IMFBOP](#) [Australia: Net International Invest Position: All Sctrs & Mat Bal(EOP,Mil.US\$)]
- Series 10: [B184B00Y@IMFBOP](#) [Spain: Net International Investment Position: All Sctrs & Mat Bal(EOP,Mil.US\$)]
- Series 11: [B132B00Y@IMFBOP](#) [France: Net International Investment Position: All Sctrs & Mat Bal(EOP,Bil.US\$)]
- Series 12: [B112B00Y@IMFBOP](#) [United Kingdom: Net Intl Invest Position: All Sctrs & Mat Balance(EOP,Bil.US\$)]
- Series 13: [B111B00Y@IMFBOP](#) [US: Net International Investment Position: All Sctrs & Mat Balance(EOP,Bil.US\$)]

Chart 5: Breakdown of Japan's net international investment position

Series 1: **B158B00Y@IMFBOP** [Japan: Net International Investment Position: All Sctrs & Mat Bal(EOP,Bil.US\$)]

Series 2: **(A158E00Y@IMFBOP - L158E00Y@IMFBOP)**

A158E00Y@IMFBOP [Japan: Direct Investment: All Sctrs & Mat Assets (EOP,Bil.US\$)][M]

L158E00Y@IMFBOP [Japan: Direct Investment: All Sctrs & Mat Liabilities (EOP,Bil.US\$)][M]

Series 3: **A158M00Y@IMFBOP** [Japan: Reserve Assets: All Sctrs & Mat Assets (EOP,Bil.US\$)]

Series 4: **(A158H00Y@IMFBOP - L158H00Y@IMFBOP)**

A158H00Y@IMFBOP [Japan: Portfolio Investment: All Sctrs & Mat Assets (EOP,Bil.US\$)]

L158H00Y@IMFBOP [Japan: Portfolio Investment: All Sctrs & Mat Liabilities (EOP,Bil.US\$)]

Series 5: **(A158J00Y@IMFBOP - L158J00Y@IMFBOP)**

A158J00Y@IMFBOP [Japan: Fin Derivatives&Employee Stock Options: All Sctrs&Mat Asts(EOP, Bil.US\$)]

L158J00Y@IMFBOP [Japan: Fin Derivatives&Employee Stock Options: All Sctrs&Mat Liabs(EOP,Bil.US\$)]

Series 6: **(A158L00Y@IMFBOP - L158L00Y@IMFBOP)**

A158L00Y@IMFBOP [Japan: Other Investment: All Sctrs & Mat Assets (EOP,Bil.US\$)]

L158L00Y@IMFBOP [Japan: Other Investment: All Sctrs & Mat Liabilities (EOP,Bil.US\$)]

Chart 6: Japan's financial account flows

Series 1: **movt(BNDIOUS@JAPAN,12)** [Japan: BOP: Outward Direct Investment: Residents: USA (100 Mil.Yen)]

Series 2: **movt(BNDIOEU@JAPAN,12)** [Japan: BOP: Outward Direct Investment: Residents: EU (100 Mil.Yen)]

Series 3: **movt(BNDIOCN@JAPAN,12)** [Japan: BOP: Outward Direct Investment: Residents: China (100 Mil.Yen)]

Series 4: **movt((BNDIO@JAPAN - ((BNDIOEU@JAPAN + BNDIOUS@JAPAN) + BNDIOCN@JAPAN)),12)**

BNDIO@JAPAN [Japan: BOP: Outward Direct Investment: Residents: Total (100 Mil.Yen)]

BNDIOEU@JAPAN [Japan: BOP: Outward Direct Investment: Residents: EU (100 Mil.Yen)]

BNDIOUS@JAPAN [Japan: BOP: Outward Direct Investment: Residents: USA (100 Mil.Yen)]

BNDIOCN@JAPAN [Japan: BOP: Outward Direct Investment: Residents: China (100 Mil.Yen)]

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