



Japanese Current Account Structure: Its Regional Features and Implications

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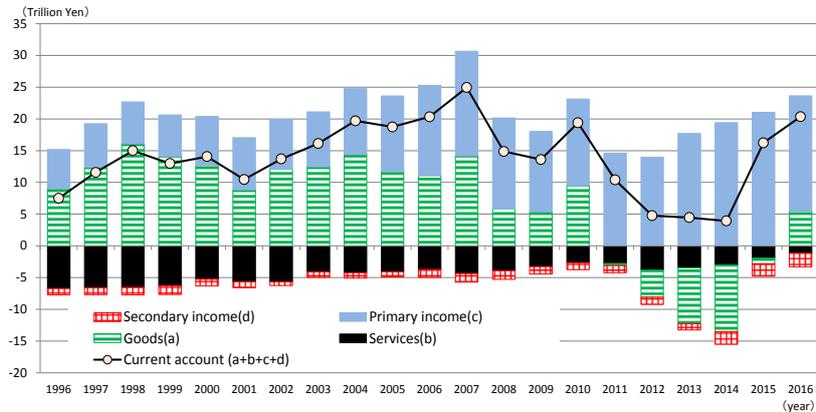
1. Japanese Current Account Surplus Increases Again-What are the Factors behind?

Japanese current account (CA) surplus tended to decrease since 2011, but it began to increase in 2015 for the first time in 5 years, continuing to increase in 2016. The main contributor was the goods trade balance. It had recorded deficits every year since 2011 but the deficit narrowed considerably in 2015, turning to a surplus in 2016. The deficits in the services balance continued to decline, contributing to the increase in the CA surplus.

Meanwhile, although the surplus in the primary income balance decreased in 2016 for the first time in 4 years, the primary income balance is still the biggest surplus component in Japan's CA balance¹. The surplus on the primary income balance showed a marked increase in 2004, accounting for the largest share in the CA since 2005. The goods trade balance that once used to be a main source of the CA surplus turned to a surplus for the first time in 6 years in 2016, but remained at around 30% of the primary income surplus. (Chart 1)

¹ The balance on primary income is a net of payments and receipts of interest and dividends, etc. on financial assets and liabilities that are traded between residents and non-residents. Main components include direct investment income, portfolio investment income, and other investment income. The secondary income balance is a net of provision and receipt of assets without a return of corresponding item of an economic value between residents and non-residents. Main components include public and private grant aids, contributions, gifts, etc.

Chart 1 : Development of Japanese Current Account Balance



(Source) Ministry of Finance: “Balance of Payments Statistics”

2. Japanese Current Account Balance by Region

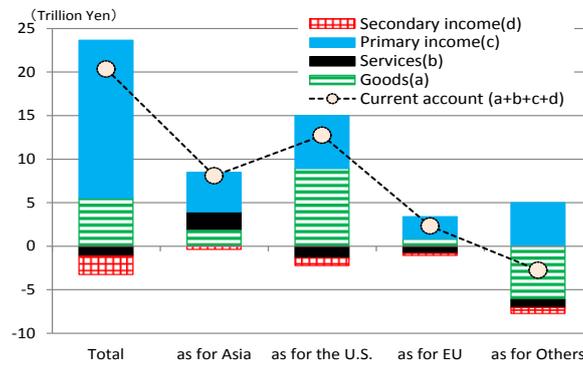
As is seen above, in the current account of Japan, the surplus in primary income balance has been growing to a substantial magnitude, while the goods trade balance remains relatively small although it turned to a surplus from deficits in the previous several years. Such a feature of the current account is not necessarily seen in all the regions, however.

Chart 2 depicts the pattern of the CA balance in 2016 broken down into four regions of the U.S., Asia, the EU, and other. Among the regions Japan has a CA surplus with, the primary income surplus accounted for the largest share for Asia and the EU with the good trade surplus accounting for less than half of the CA surplus, respectively. They show almost the same pattern as the aggregated balance for the world.

On the other hand, as for the U.S with which Japan has the largest CA surplus, the goods trade surplus of ¥8.9 trillion far exceeded the primary income surplus of ¥6.1 trillion, accounting for about 70% of the CA surplus. In contrast to the pattern for Asia and the EU, the current account with the U.S. shows a pattern similar to that Japan used to have before early 2000s.

The other region is represented by Middle East, Africa, Latin America, and the Pacific region which embrace many exporters of natural resources, and the current account with this region registered a deficit mainly due to a large deficit in the goods trade balance despite a surplus in the primary income balance.

Chart 2 : Current Account by Region (2016)

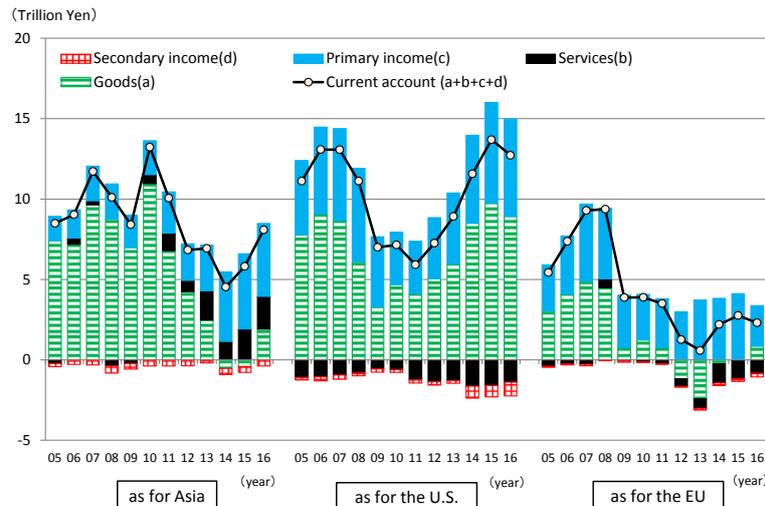


(Source) Ministry of Finance: “Balance of Payments Statistics”

3. Current Account Development with Major Trading Regions

The characteristic aspects seen in the components of the CA surplus with the U.S. have little changed for the past 10 years. Let us look at the development since 2005 for each region of the U.S., Asia, and the EU. For the U.S., the primary income surplus exceeded that of the trade surplus only except in 2009 when exports slowed down affected by the global financial crisis. In other years, the trade surplus continued to exceed the primary income surplus by around 40% on average. Although the primary income balance tended to increase, its pace remained slow, while the trade surplus continued to increase more rapidly. In contrast, for Asia and the EU, the share of the primary income surplus in the CA surplus expanded as it tended to increase (with Asia) or remained stable (with the EU), while the trade surplus tended to narrow, albeit in a fluctuating way.

Chart 3 : Current Account development by major regions



(Source) Ministry of Finance: “Balance of Payments Statistics”

4. Development of Local Sales by the Japanese Manufacturing Subsidiaries

Japan's goods trade surplus with the U.S. is on a rising trend since 2010, still maintaining a relatively large magnitude. It is noteworthy, however, that the shift of production base to the U.S. by the Japanese manufacturers has made a significant progress pushed by the trade frictions that gained momentum in the 1970s and after.

Table 1 compares the exports from Japan with the local sales of subsidiaries of Japanese manufacturers by region. The local sales of Japanese subsidiaries of manufacturing industry in the U.S. have reached 1.5 times of Japanese exports to the U.S. and this ratio of local sales to exports largely exceeds that of 1.0 times for Asia and 0.6 times for the EU. The Japanese manufacturers have promoted local production in all over the world, but such a move has been especially pronounced in the U.S.

Especially among the three machinery categories which account for 76% of Japanese exports to the U.S., the ratio of local sales to exports of electrical machinery and transportation machinery reached a significant 1.7 times (Table 2). It means that in the electrical machinery and transportation machinery the local sales have shown a notable progress to reach almost twice their exports from Japan, with local production and sales substantially substituting Japanese exports.

Table 1 : Japanese Exports and Local Sales of Japanese Subsidiaries (FY2015)

	Total	U.S.	Asia	Asia			EU
				China	ASEAN4	NIEs4	
Exports from Japan ① (Trillion Yen)	74.1	15.1	39.2	13.0	7.1	15.9	8.1
Local Sales of Subsidiaries of Japanese Manufacturers ② (Trillion Yen)	73.6	22.8	40.1	17.7	12.7	6.4	4.6
Comparison of Local Sales of Subsidiaries of Japanese Manufacturers with the Exports from Japan ((②)/①)	1.0	1.5	1.0	1.4	1.8	0.4	0.6

(Note) Exports represent only goods without services. Based on "Trade Statistics" (Customs Clearance Basis).
 (Sources) Ministry of Economy, Trade and Industry: "Survey on Overseas Business Activities" and Ministry of Finance: "Trade Statistics."

Table 2 : Japanese Exports to the U.S. and Local Sales of Japanese Subsidiaries
 (in Three categories of Machinery, FY2015)

	Total	General Machinery	Electrical Machinery	Transportation Machinery
Exports from Japan ① (Trillion Yen)	15.1	3.3	2.1	6.0
Share of Total Exports (%)	-	21.8	14.1	39.8
Local Sales of Subsidiaries of Japanese Manufacturers ② (Trillion Yen)	22.8	2.1	3.7	10.4
Comparison of Local Sales of Subsidiaries of Japanese Manufacturers with the Exports from Japan ((②)/①)	1.5	0.6	1.7	1.7

(Note) Exports represent only goods without services. Based on Trade Statistics (Customs Clearance Basis)
 (Sources) Ministry of Economy, Trade and Industry: "Survey on Overseas Business Activities" and Ministry of Finance: "Trade Statistics."

5. Conclusion—Be Cautious for the Market Opening Pressures by the U.S.

As the profits earned by the Japanese subsidiaries in the U.S. have been increasingly recycled to Japan reflecting their expanded business activities in the U.S., the surplus in primary income balance with the U.S. has tended to gradually increase. Although the goods trade balance still constitutes a main portion of the CA surplus with the U.S., an increase in direct investment income also has steadily contributed to the increase of the primary income surplus.

However, as the production shift from Japan to the U.S. has been actively promoted especially in the categories of electrical machinery and transportation machinery which account for a lion's share in the exports to the U.S., it will be hard to expect for the Japanese companies to further substitute their exports by the local production. On the other hand, it is reported that even President Trump who advocates a protectionist trade policy has given a certain appraisal to the business activities and employment by the Japanese manufacturers in the U.S.

If so, the point of contention will be surely on the expansion of Japanese imports from the U.S. when the U.S. seeks Japan for a correction of trade imbalances and apparently is going to start a full-scale negotiation on trade. As a matter of fact, the Japanese imports from the U.S. remain less than half of Japanese exports to the U.S. Therefore, it is highly possible that the U.S. is going to demand Japan for import liberalization on specified items as the U.S. used to do in the past. Special caution should be taken to the market liberalization demand for the automobiles and agricultural products on which the actual moves are already going to be seen.

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