



How Asian Countries have Affected Composition of Japan's Current Account Surplus

Akira Nakamura

Deputy General Manager and Senior Economist

akira_nakamura@iima.or.jp

Economic Research Department

Institute for International Monetary Affairs

1. Changes in the composition of Current Account

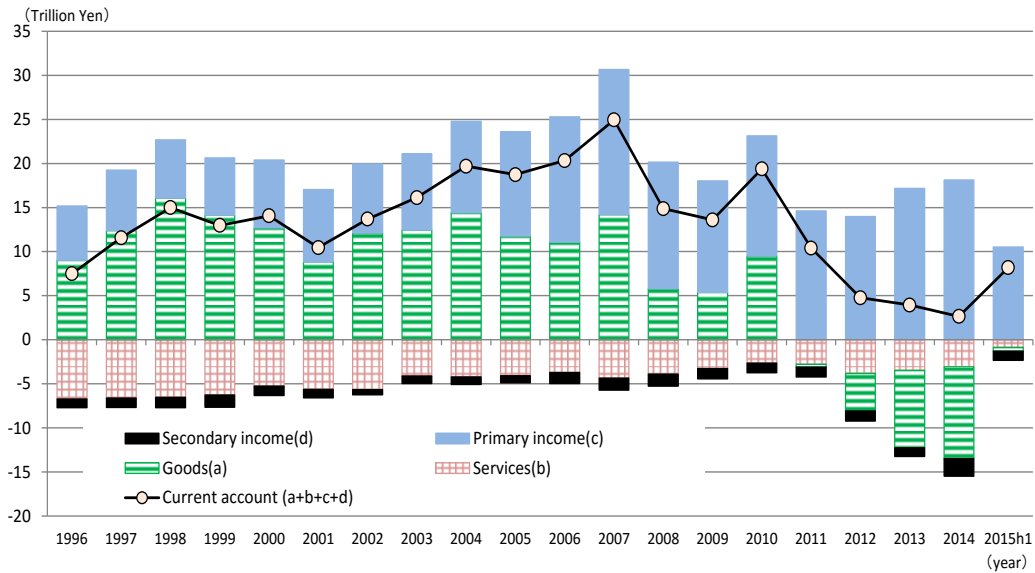
The current account of Japan has maintained its surplus position for a long time but its composition has been changing (Chart 1). The breakdown of its components reveals that although the trade balance (balance on goods) used to dominate Japan's current account surplus, it fell into deficit in 2011 mainly influenced by the Great East Japan Earthquake, and has been in the red since then.

The trade balance had been a major factor comprising a big current account surplus of Japan for a long time, but the surplus on goods began to decrease at around 2008 when the global financial crisis occurred and turned into red in 2011 with a deficit mounting since then (Chart 1). This reflected the changing environment where growth in exports slowed down due to (i) continuing offshoring of production facilities of manufacturing industries, (ii) increased international competition in such former leading industries as electric equipment, (iii) deceleration of growth of the world economy centering around the emerging market, while imports strengthened its increasing trend reflecting expanded demand for fossil fuels for the

thermal power generation after the Great East Japan Earthquake¹.

Meanwhile, the deficit on services, which includes transport, travel, charges for intellectual property rights and financial services, has tended to narrow gradually in the past 20 years. Furthermore, the surplus on primary income, which is a net of receipts and payments of investment income with nonresidents, has been on a rising trend since the middle of 1990s, recording the highest amount in 2014. The continuation of current account surplus has thus been supported mainly by a decreasing deficit on services and an increase of surplus on primary income. In this article, I will overview the developments in these services and primary income balances, and then examine the background factors in the overseas regions with a special focus on Asia.

Chart 1 : Development of Japanese current account



(Note) The latest data is for the first half of 2015.
 (Source) Ministry of Finance: "Balance of Payments Statistics"

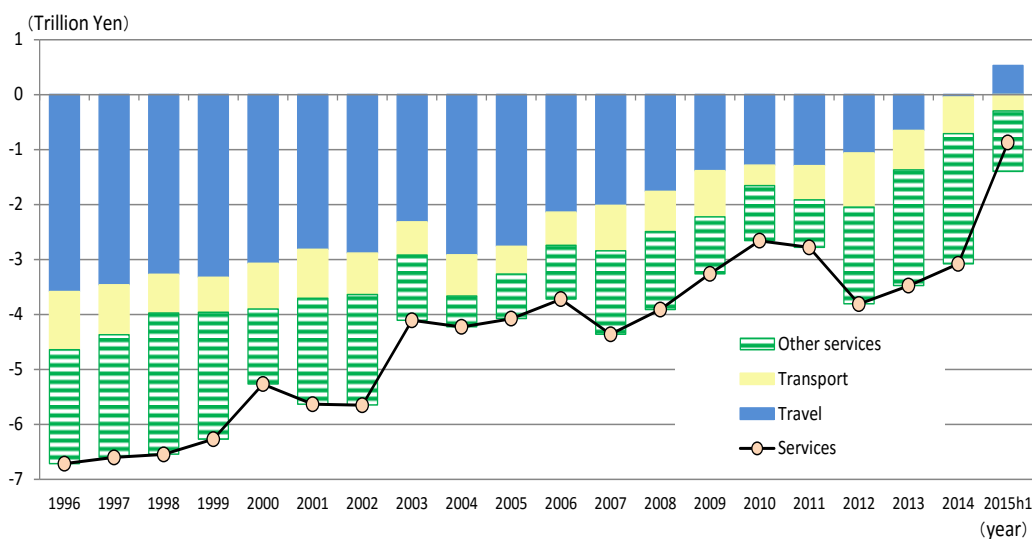
2. Developments in the Services and Primary Income Balances

(1) Services balance

The deficit on services has been broadly on a narrowing trend in the past 20 years. Looking into its components of (i) travel, (ii) transport, (iii) other services, decline of deficit on travel has been a biggest contributor to the shrinkage of the deficit of the whole services account (Chart 2).

¹ In the first half of 2015, however, the trade deficit largely shrank mainly due to a big decline in imports that mainly reflected a decrease in payments for crude oil and related products following the decline in crude oil prices, thus contributing to the continuation of the current account surplus.

Chart 2 : Developments of Services account



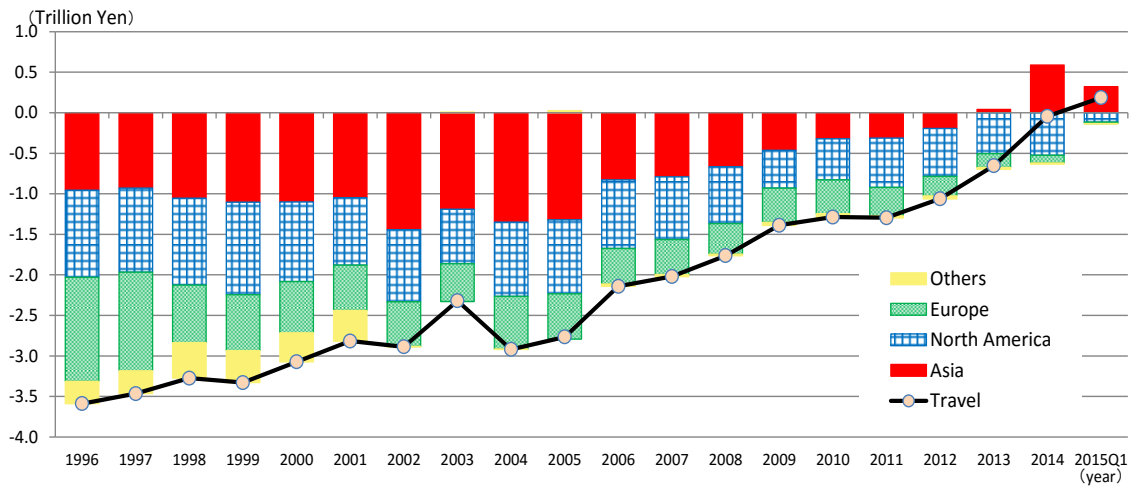
(Note) Other services include 10 component items such as charges for intellectual property rights, financial services, communications. The latest data is for the first half of 2015.

(Source) Ministry of Finance: "Balance of Payments Statistics"

Travel balance markedly narrowed its deficit since the middle of 2000s and turned to surplus in the first half of 2015. Travel balance is a difference of the amount consumed in Japan by foreign visitors to Japan (receipt) and the amount consumed by the Japanese travelers abroad (payment). The shift to a surplus on travel account mainly reflected the increasing number of foreign travelers visiting Japan which exceeded the pace of increase of Japanese travelers abroad, as well as the increased per capita consumption of foreign travelers in Japan.

The regional breakdown of travelers shows that deficit narrowed in all the main regions of (i) Asia • Oceania, (ii) North America and (iii) Europe, contributing to a turnaround of the travel account to a surplus (Chart 3). Especially notable is Asia and Oceania region, with which the deficit began to rapidly decrease in the middle of 2000s to achieve a surplus in 2013 and after. The deficit with Europe also has been generally on a declining trend in the past 20 years and the amount has recently come down to significantly small. The deficit with North America has also been narrowing throughout the period, although the improvement has leveled off in the past few years.

Chart 3 : Travel Balance by Region



(注) Others refer to Central and South America and the Middle East. The latest data is for the first quarter of 2015.

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

Table 1 shows the country breakdown of travel account within Asia and Oceania region, which recorded an eminent improvement from deficit to surplus. The data shows that among the Northeast Asian countries, Japan had a consistent surplus with Taiwan in the period reviewed, while with China and Hong Kong it has remained in the black since 2012. It recorded the first surplus with Korea in the first quarter of 2015. Among the Southeast Asian countries, the travel account has been in surplus with Malaysia and Thailand since 2013 and 2014 respectively. In addition, the deficits with Indonesia and the Philippines are narrowing. In the Oceania, the travel balance has been in surplus in the past few years both with Australia and New Zealand.

Table 1 : Travel balance by country (with Asia and Oceania)

| | (100 million Yen) | | | | | | | | | | |
|----------------|-------------------|-------|-------|-------|-------|-------|-------|-------|------|------|--------|
| | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015Q1 |
| Total | -13212 | -8283 | -7914 | -6648 | -4616 | -3215 | -3136 | -1921 | 418 | 5885 | 3217 |
| China | -3069 | -78 | -217 | 7 | -1094 | -319 | -82 | 949 | 807 | 3204 | 1878 |
| Hong Kong | -1395 | -668 | -662 | -467 | 52 | 7 | -127 | 55 | 317 | 655 | 329 |
| Taiwan | 210 | 334 | 277 | 350 | 277 | 543 | 399 | 770 | 1322 | 2421 | 747 |
| South Korea | -1511 | -1209 | -1002 | -1000 | -124 | 111 | -1160 | -1319 | -831 | -181 | 155 |
| Singapore | -548 | -436 | -445 | -397 | -255 | -316 | -261 | -419 | -478 | -436 | -139 |
| Thailand | -1317 | -1024 | -1065 | -974 | -1178 | -979 | -893 | -893 | -308 | 3 | 37 |
| Indonesia | -675 | -513 | -547 | -506 | -374 | -377 | -203 | -491 | -243 | -171 | -59 |
| Malaysia | -166 | -205 | -211 | -194 | -80 | -79 | -69 | -17 | 82 | 169 | 28 |
| The Philippine | 210 | -347 | -390 | -372 | -265 | -276 | -206 | -236 | -174 | -136 | -49 |
| Vietnam | -304 | -124 | -128 | -111 | -167 | -220 | -197 | -241 | -220 | -156 | 58 |
| India | 88 | -9 | -16 | -11 | -27 | -42 | -29 | -24 | -20 | 23 | -3 |
| Australia | -1531 | -1483 | -1036 | -716 | -690 | -610 | -50 | 178 | 313 | 595 | 227 |
| New Zealand | -328 | -264 | -217 | -163 | -87 | -87 | -38 | -2 | 15 | 43 | 12 |

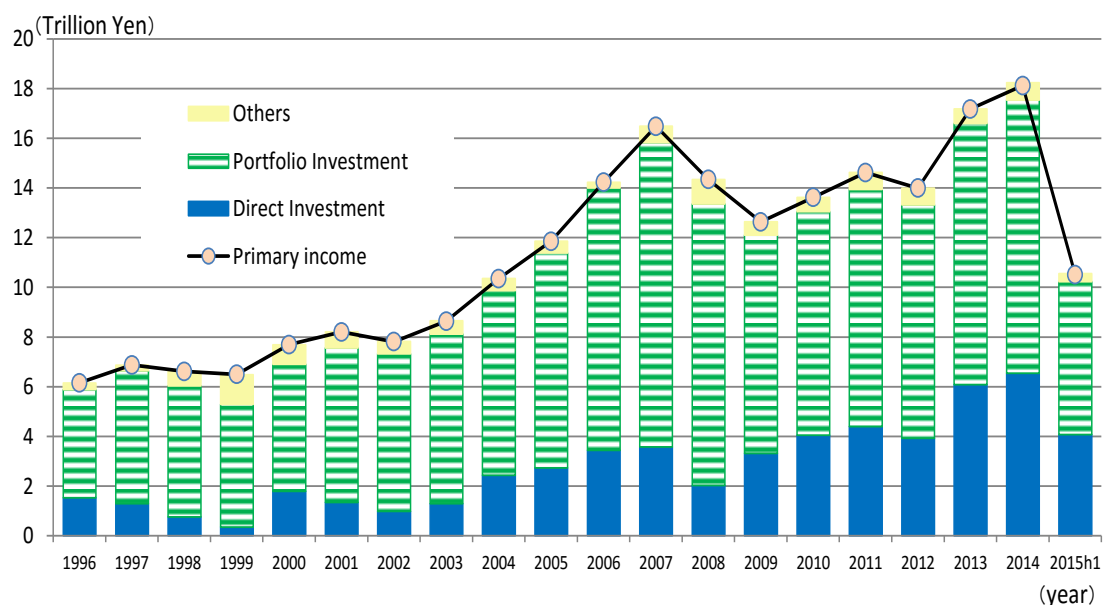
(Note) The latest data is for the first quarter of 2015.

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

(2) Primary Income Account

The primary income mainly comprises of direct investment income and portfolio investment income. Portfolio investment income has accounted for the majority of the total income balance but in the past 10 years the direct investment income has been noticeably increasing to account for more than 30% of the balance since 2013 (Chart 4).

Chart 4 : The Primary Income Balance of Japan



(Note) The latest data refers to the first half of 2015.

(Source) Ministry of Finance "Balance of Payments Statistics"

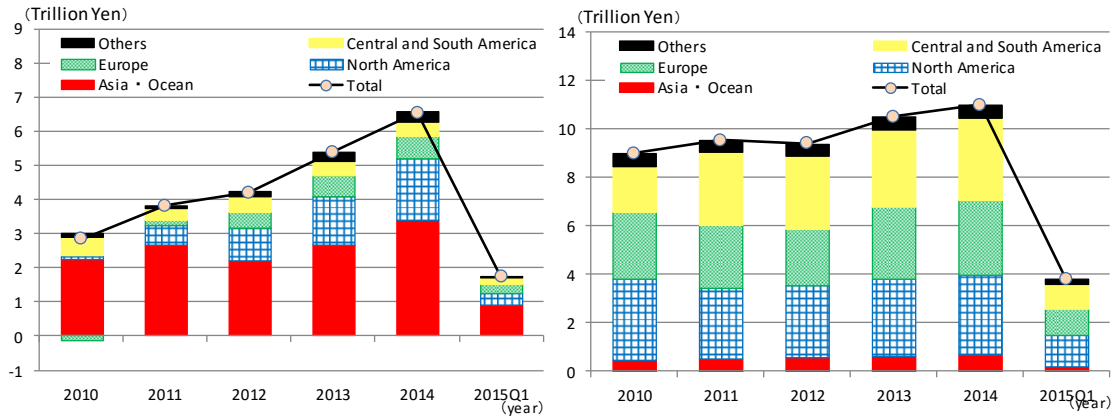
Let's see the regional breakdowns for direct investment income and portfolio investment income (Chart 5). It is Asia and Oceania regions that account for the majority of net receipt of direct investment income. Their weights remain still large although in the past few years there has been a rapid catchup by North America and Europe.

On the other hand, the share of Asia and Oceania is quite small in portfolio investment income while 3 other regions of North America, Europe and Central and South America share almost evenly the remaining portion. I will have a closer look below of direct investment income from Asia and Oceania.

Chart 5 : Primary Income Balance of Japan by Region

Direct Investment Income

Portfolio Investment Income



(Note) Latest data refers to the first quarter of 2015.

((Source) Ministry of Finance "Balance of Payments Statistics

The regional breakdown of the direct investment income for Asia and Pacific reveals that China and Thailand are the main contributors to the surplus and have been increasing their impact recently (Table2). Especially income from China has remained at a high and stable level. Both countries are the main targets of Japanese direct investment abroad where the Japanese companies have most intensively accumulated their production facilities. It can be assumed that the abundant existence of their production and sales networks, which constitute the basis for sales and profits, has been one of the factors that have brought a huge amount of receipts on direct investment income from these countries.

Table2 : Direct Investment Income by Country (Asia and Oceania)

(100 million Yen)

| | 2010 | 2011 | 2012 | 2013 | 2014 | 2015Q1 |
|----------------|--------|---------|---------|---------|---------|--------|
| Total | 22,502 | 26,568 | 21,904 | 26,580 | 33,739 | 8,869 |
| China | 5,193 | ↗ 6,627 | ↗ 6,883 | 6,720 | ↗ 8,973 | 2,868 |
| Hong Kong | 1,541 | 1,829 | 1,395 | 1,969 | 1,648 | 465 |
| Taiwan | 319 | 898 | 1,025 | 1,156 | 1,885 | 298 |
| South Korea | 775 | 1,254 | 1,229 | 1,909 | 2,372 | 865 |
| Singapore | 2,081 | 2,281 | 1,621 | 613 | 2,906 | 383 |
| Thailand | 3,523 | 2,930 | 586 | ↗ 5,548 | ↗ 7,285 | 1,162 |
| Indonesia | 1,581 | 2,064 | 2,047 | 1,706 | 1,932 | 438 |
| Malaysia | 969 | 1,096 | 1,009 | 1,507 | 1,729 | 440 |
| The Philippine | 383 | 655 | 594 | 640 | 1,067 | 215 |
| Vietnam | 189 | 238 | 262 | 437 | 825 | 205 |
| India | -73 | 434 | 424 | 21 | 38 | 4 |
| Australia | 5,836 | 5,945 | 4,445 | 4,014 | 2,750 | 1,425 |
| New Zealand | -35 | 70 | 85 | 72 | 124 | 25 |

(Note) Latest data refers to the result in the first quarter of 2015

(Source) Ministry of Finance: Balance of Payments Statistics

3. Significance of Asia in the Change of Japan's Current Account Composition

As was seen above, the main contributors to the current account surplus have been shifting from trade to primary income and services account, among which the surplus on travel account and direct investment income account is heavily dependent on Asia. Let us review here the contribution of Asia to travel account and direct investment income account.

The recent improvement of travel account with Asia is considered to reflect not only the rise of income levels in the Asian countries but also such factors as (i) active promotion efforts to invite visitors to Japan, (ii) expansion of airline networks to Japan, (iii) creation and improvement of attractive tourist spots and areas, (iv) depreciation of the yen, and (v) relaxation of visa requirements, as are pointed out in the Trade White Paper 2015.

Actually, the travel account started to post a solid surplus with China, Hong Kong and Taiwan when and after the sightseeing visas started to be issued to individuals, or the visas were exempted. Among the Southeast Asian countries, the account started to be in surplus with Thailand and Malaysia after 2013 when the visa requirement to enter Japan was lifted, and the impact of introduction of multiple-entry visas² has been felt with Vietnam, Indonesia, and the Philippines.

In the ahead, the scheduled relaxation of the visa requirements to the Asian countries as set out in the government's Growth Strategy will contribute to the continued surplus on travel

² The visa that allows a visitor to enter Japan as many times as he likes within the period of validity.

account with the Asian region. On the other hand, if the economy in this region happens to stall or the depreciating yen makes a reverse turn, surplus on travel account will be adversely affected and therefore the developments of the Chinese yuan and other Asian currencies should be closely watched.

The net receipt of direct investment income has gradually increased and the receipts from China and Thailand are especially outstanding. The two countries have attracted the investment of many Japanese companies, forming extensive manufacturing production networks with their neighboring countries. In recent years, many of the multinational manufacturing companies, mainly in transportation machinery and electric machinery, have segmentalised their production process to adopt the division of operation on a country by country base and locate the different and most suitable part of the production process in each country depending on the stage of the economic development of the country they locate the process. In this regard, Asia is the most developed region in the world of this international division of labor of the manufacturing production. Some of the companies that had invested in China and Thailand have started to shift their labor intensive parts of production process to the neighboring countries due to rising labor costs in both countries. This movement of shifting production process is also one of the division of production process.

The increased division of production process largely reflects the fact that declining costs for communication and transportation, lift of tariff and nontariff barriers and other factors have enabled the manufacturing companies to consolidate their production process on an international scale thereby to enjoy the profits of large-scale production. The rise of profit ratio resulting from the division of production process, in addition to the expansion of production and sales points that make the basis for the total amount of sales, apparently has contributed to the increase of receipts on direct investment income. In the environment where various efforts including the Trans-Pacific Partnership (TPP) to liberalize trade and progress in economic integration such as AEC (ASEAN Economic Community) are expected to continue, whether the division of production process will be further promoted or not in the ahead, as well as the development of direct investment flows and economic development of the countries that receive the direct investment, will have an important key in forecasting the sustainability of the expanding direct investment income receipts.

The total amount of travel surplus and net direct investment income with rising China

reached about 1.2 trillion yen or 46% of the total surplus (about 2.7 trillion yen) of the current account in 2014. The importance of China has been increasing not only in the context of shrinking current account surplus in the past few years but also in the contribution to the continuation of the surplus on current account through the travel surplus with and increasing direct investment income from China.

References

METI: White Paper on International Economy and Trade 2015, July 2015

Kimura, Fukunari: East Asia viewed through Spatial Economics and Fragmentation Theory, Economic Seminar August 2015, Nihon Hyoronsha

David Atkinson: New theory on Tourism-Oriented Nation, June 2015, Toyokeizai

This report is intended only for information purposes and shall not be construed as solicitation to take any action such as purchasing/selling/investing financial market products. In taking any action, each reader is requested to act on the basis of his or her own judgment. This report is based on information believed to be reliable, but we do not guarantee its accuracy. The contents of the report may be revised without advance notice. Also, this report is a literary work protected by the copyright act. No part of this report may be reproduced in any form without express statement of its source.

Copyright 2015 Institute for International Monetary Affairs (公益財団法人 国際通貨研究所)

All rights reserved. Except for brief quotations embodied in articles and reviews, no part of this publication may be reproduced in any form or by any means, including photocopy, without permission from the Institute for International Monetary Affairs.

Address: 3-2, Nihombashi Hongokuchō 1-chōme, Chūō-ku, Tokyo 103-0021, Japan

Telephone: 81-3-3245-6934, Facsimile: 81-3-3231-5422

〒103-0021 東京都中央区日本橋本石町 1-3-2

電話 : 03-3245-6934 (代) ファックス : 03-3231-5422

e-mail: admin@iima.or.jp URL: <http://www.iima.or.jp>