The Relationship between Japan's Growing Income Balance and Private Investor Asset Management Patterns

By Kojima Hidekazu

THE White Paper 2006 indicates why increasing Japan's income balance is important to ensure sustainable growth. It also states that the income should be raised by expanding Japan's foreign investment and boosting external asset profit ratios. The White Paper's discussions on foreign investment focus primarily on foreign direct investments made by companies for their overseas operations, and foreign securities held by financial institutions and other institutional investors. Any discussion of Japan's foreign investments, however, cannot neglect the importance of private investors, even though their total invested capital is considerably smaller than that of other types of investors. This article therefore examines the investment patterns of private investors.

It is often said that capital invested by Japanese private investors tends to shun risk. As Figure 1 shows, their risk assets are worth less than their savings in financial institutions. When Japan's speculative bubble burst in the early 1990s, the hardship private investors endured caused them to shy away from risk assets for a while and seek shelter in the safety of savings.

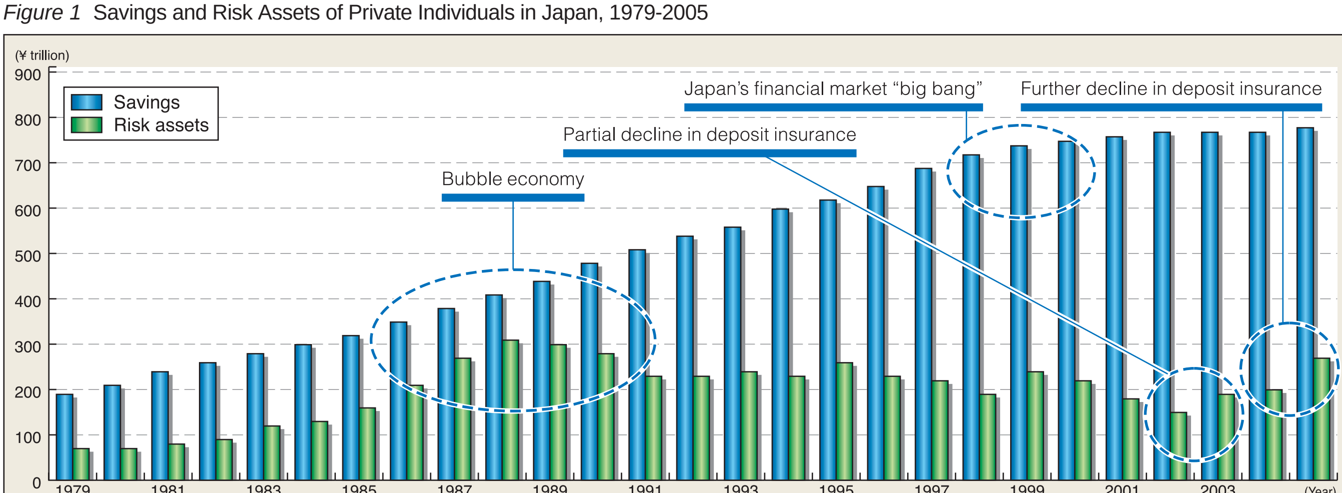
Since 2002 there has been a big shift in private investors' views on safe money management. This shift was due to a number of factors: (1) the widening choice of financial products for the general public beginning in the late 1990s, because of Japan's own "big bang" in financial markets; (2) the decline in Japanese interest rates for savings, as interest policies kept rates at zero for many years; and (3) most of all, by changes to the "payoff" system under which deposits were backed by government insurance – deposit insurance on long-term deposits became less attractive in April 2002, and since April 2005 ordinary savings (principal and interest) above the ¥10 million mark are also no longer guaranteed. These changes reduced the security of savings and this has been reflected in stagnating savings since 2002, (Fig. 1) and an energetic climb in risk assets.

As you can see in Figure 1, the risk assets of private individuals in Japan have recently soared. The largest component in this growth is foreign currency assets. These latter assets contribute more than one would think to the increase in Japan's income balance.

Figure 2 shows the total capital placed with Japanese investment trusts and one component of that total, the amount denominated in foreign currencies. The total amount of capital in investment trusts began rising sharply in 2002, reflecting the newfound willingness of private investors to accept risk. This amount has reached about the same level as the peak during Japan's bubble economy. Since 2002, the amount of foreign denominated capital placed with investment trusts has risen quite dramatically, to more than three times the level seen during the bubble economy. The main reasons for this rise are a slowdown in yen value trends, and the higher yields (in yen terms) offered by foreign assets.

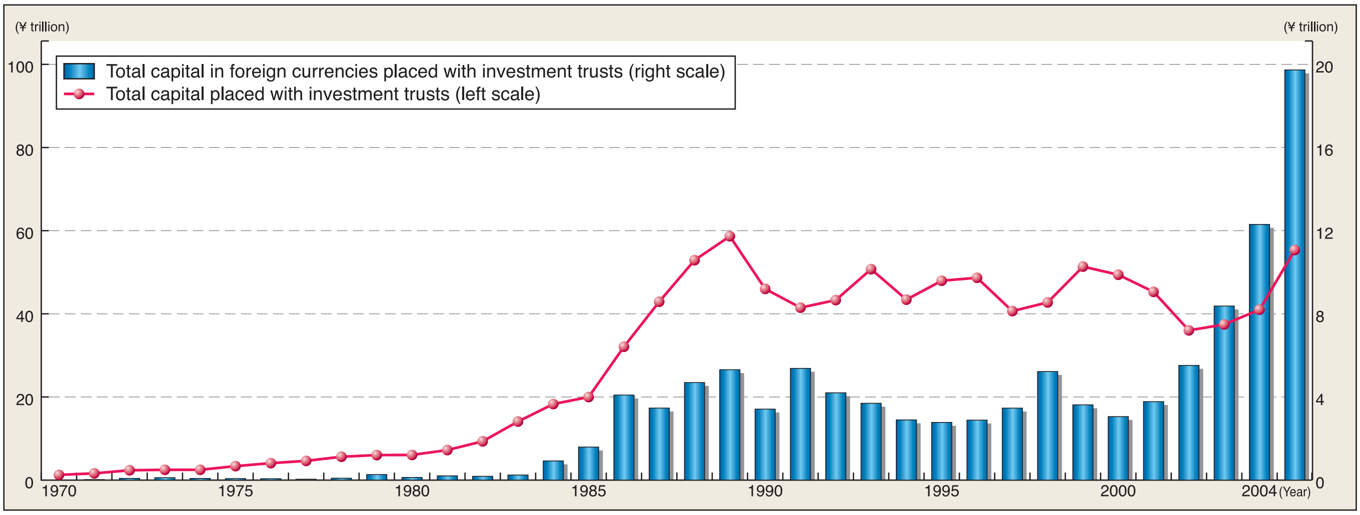
Since the 1971 "Nixon Shock" (which led to a major increase in the yen's

Figure 1 Savings and Risk Assets of Private Individuals in Japan, 1979-2005



Source : Compiled from *Flow of Funds*, Bank of Japan
Note : Savings = Cash + deposited savings. Risk assets = Total of domestic stocks, unsecured investments, securities and foreign securities.

Figure 2 Publicly Offered Investments Placed with Japanese Investment Trusts (contractual type investment trusts, securities investment trusts), 1970-2005



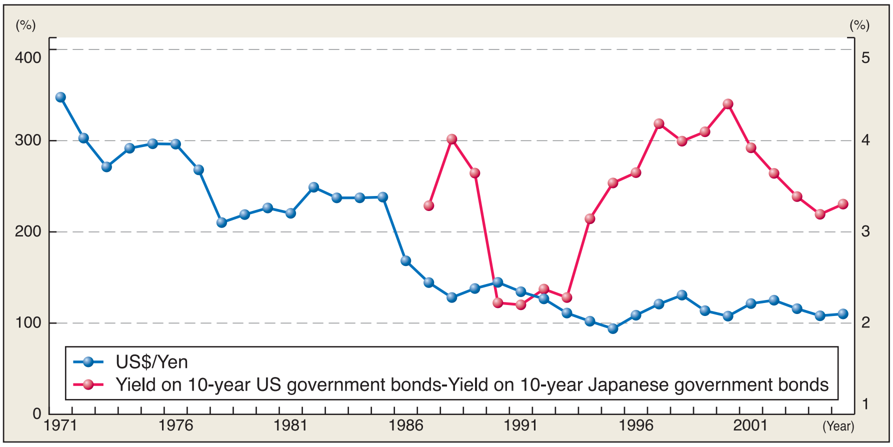
Source : Compiled from data on website of The Investment Trust Association, Japan

value), the yen generally experienced one appreciation after another. As a result, Japanese investors' yen-denominated assets generally continued to increase in value, in foreign currency terms, and the value of assets denominated in a foreign currency generally continued to decline in value, in yen terms. But since the mid-1990s yen revaluation trends have faltered. (Fig. 3) Yields from Japanese bonds have been the lowest in the world, and this has led to a wider gap between the yields Japanese can earn from foreign investments and the ones they can earn from domestic investments, in yen terms.

Private investors have gone after the higher yields offered by foreign investments, and they have often avoided placing a foreign exchange hedge because of their dislike of the accompanying costs. Compared with the situation seen with the foreign investments of institutional investors, the increased demand of private investors for foreign currency assets has put downward pressure on the yen, and these yen devaluations have further increased their yield from foreign investments, in yen terms.

However, as the White Paper points out, the global current account imbalance could push down the value of the US dollar, so investors must carefully consider whether the value of the Japanese yen will remain stable vis-à-vis other currencies.

Figure 3 Gap between Japanese and US Long-Term Interest Rates, and US$/¥ Exchange Rates, since 1971



Source : Compiled from Bloomberg L.P. statistics

Japanese private investors are increasing the weight of foreign assets in their portfolios, and as the White Paper points out, in recent years they have looked very favorably on funds investing capital in rapidly growing Asian regions. This meshes with the White Paper's contention that an increase in Japan's income surplus is linked to an increase in Japanese investments in other Asian countries.

The financial assets of Japan's private investors were valued at more than ¥1.5 quadrillion at the end of 2005, so any change in their investment patterns would most certainly impact on Japan's drive to expand its income balance. For this reason, too, the government should carefully analyze private investor trends and tune its policies accordingly. JS

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