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Overseas Profits Pad Surplus Preserving Yen Haven: Japan Credit
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By Keiko Ujikane and Shigeki Nozawa

Feb. 9 (Bloomberg) -- Japanese investors' overseas earnings rose the most in five years in 2011, more than compensating for the first annual trade deficit in 48 years and supporting the nation's status as a haven.

Japan's income surplus rose 20 percent to 14 trillion yen ($181 billion) last year, according to Ministry of Finance data yesterday. That preserved a surplus in the current account, which combines trade and investment tallies, offsetting a decline in exports after a record earthquake and gains in the yen to a post-World War II high.

The net inflow of funds enhances the attractiveness of the nation's debt, helping the government pay for its budget deficits. As a fiscal crisis swept from Greece to Europe's larger economies last year, overseas investors bought 20.9 trillion yen of Japanese bonds, finance ministry data showed, triple the 2010 level and the most on record going back to 2005.

Japan pays 0.985 percent to borrow for 10-years, the second- lowest rate in the world after Switzerland.

"Japanese government bonds are trusted like Treasuries and German bunds, and yen investors would carry foreign-exchange risks if they flee to foreign bonds," said Takafumi Yamawaki, chief rates strategist at JP Morgan Chase & Co.

The current-account surplus shrank 44 percent from a year earlier to 9.63 trillion yen, the lowest since 1996, the finance ministry said yesterday. The income balance increased the most since the 21 percent advance in 2006, as earnings from direct investments and dividends rose, it said. Japan had a 1.6 trillion yen trade deficit last year, the first since 1963 based on the current-account data.

Turn to Deficit

"It's premature to say, as some have, that the current account will turn into a deficit in the next five years," said Soichi Okuda, chief economist at Sumitomo Shoji Research Institute in Tokyo. "The thinking is that Japan's saving rate will fall, making it hard to finance bonds domestically and causing bonds to be sold. That won't happen for a while."

Japan will still have a current-account surplus of $141 billion in 2016, equivalent to 2.1 percent of gross domestic product, the International Monetary Fund forecasts.

The yield on Japan's 10-year benchmark government bond fell half a basis point, or 0.005 percentage point, to 0.985 percent at 4:03 p.m. in Tokyo. The Nikkei 225 Stock Average slid 0.2 percent to 9,002.24, after closing above 9,000 for the first time since October yesterday.

The gap between yields on 10-year and 20-year bonds was at 76 basis points today compared with this year's high of 80 on Jan. 13, signaling reduced investor expectations of interest rate increases.

Bank Bond Sale

Elsewhere in Japan's credit markets, Senshu Ikeda Bank Ltd. registered to sell as much as 40 billion yen of bonds, according to a filing yesterday with Japan's finance ministry. The registration takes effect on Feb. 16 and is valid for two years.

A shelf registration allows for bond sales without obligating the company or country to borrow.

Nomura Real Estate Residential Fund Inc. sold 5 billion yen of 1.03 percent five-year bonds, according to an e-mailed statement from Nomura Holdings Inc. yesterday. Sumitomo Mitsui Finance & Leasing Co. hired SMBC Nikko Securities Inc., Mizuho Financial Group Inc., Shinkin Central Bank, and Sumitomo Mitsui Financial Group Inc. for a 10 billion yen sale of five-year bonds, SMBC Nikko said in a statement.

Kewpie Corp. will sell 10 billion yen of seven-year, 0.777 percent bonds, according to a statement yesterday from Daiwa Securities Capital Markets Co.

Japan sold 400 billion yen in 40-year 2.2 percent bonds, with investors bidding for 3.6 times the amount on offer, down from 3.9 times at the previous sale in November. The yield on the securities rose one basis point to 2.11 percent.

The extra yield investors demand to hold Japanese corporate bonds instead of government securities was 48 basis points yesterday, compared with 222 basis points globally, according to indexes compiled by Bank of America Merrill Lynch.

Trade Deficit

Japan's trade deficit last year was caused by falling exports as the yen traded near postwar highs and rising imports on increased energy demands after the March 11 earthquake. The temblor in the northeast killed more than 15,000 people, according to Japanese police data, and caused the worst nuclear crisis since Chernobyl.

Exports slid 1.9 percent and imports advanced 15 percent in 2011, yesterday's report showed.

The yen fell 0.2 percent to 77.18 per dollar in Tokyo. The Japanese currency outperformed all but two of its 16 major counterparts over the past 12 months.

UBS AG doesn't expect a "sustained" current-account deficit in Japan until 2050 as the nation will continue to generate income surpluses, Cameron Umetsu, an economist in Tokyo, said in a report on Feb. 1.

Goldman's View

Jim O'Neill, chairman of Goldman Sachs Asset Management Co., said Japan's 10-year bond yield may rise in the next couple of years to 3.5 percent, converging with Italy's rate, as the Asian nation's current account approaches a deficit. "The Japanese situation is deteriorating quite markedly," he said in a report last month.

Five-year credit-default swaps on Japanese government bonds were 118 basis points yesterday, compared with the all-time high of 154.8 on Oct. 4, according to CMA, which is owned by CME Group Inc. and compiles prices quoted by dealers in the privately negotiated market.

Japan will have a current-account surplus for "at least" the next three to five years, suggesting the nation's debt will continue to be paid domestically, said Tomoya Masanao, head of portfolio management for Japan at Pacific Investment Management Co., which runs the world's biggest bond fund.

"Capital flight is unlikely to be sustained, even if it happens, seeing as Japan is the world's largest net creditor," Masanao said in an interview in Tokyo on Jan. 31.

Public Debt

Japan's public borrowings will climb 10 percent in the year starting April to a record 1,086 trillion yen as the government pays for rebuilding after the quake, the finance ministry said last month. Prime Minister Yoshihiko Noda plans to double the nation's sales tax to 10 percent by the middle of the decade, an increase his government said won't be enough to balance the budget by 2020.

Standard & Poor's has had Japan's debt rating on a negative outlook since April after lowering it to AA- in January 2011. It said in November that Noda's administration hasn't made progress in tackling the public debt burden.

"It's hard to tell when the market may cause a fiscal collapse -- it could be three years from now, or five years, or ten years, or tomorrow," said Yuichi Kodama, chief economist at Meiji Yasuda Life Insurance Co. in Tokyo. "It's like trying to predict an earthquake, though the magnitude may be bigger the further in the future it strikes."

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