

# Daiwa's View

## Update on basic supply/demand factors for the yen

- Leeway for further Improvement seems limited

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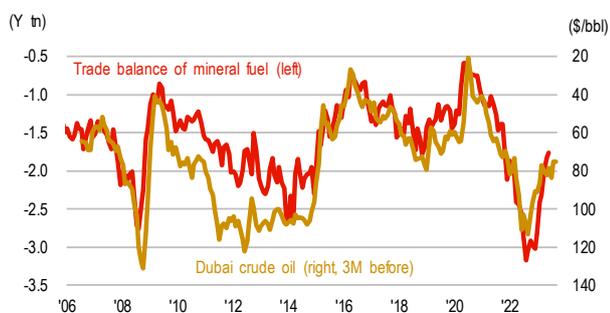
Since 2022, the biggest factor behind yen depreciation in the forex market has been the differential in monetary policies in line with the differences in inflation trends at home and abroad. Meanwhile, basic supply/demand factors for the yen have also worked in the direction of yen depreciation (Refer to our 30 Nov 2022 report [Daiwa's View: Things to watch for in 2023 \(2\): Shifts in two major drivers of yen depreciation](#)). In this report, we provide an update on the situation with Japan's trade balance and travel balance, both of which have seen particularly significant changes following the COVID-19 pandemic.

#### ◆ Trade balance

The trade deficit for June came in at Y550bn on a seasonally adjusted basis, shrinking substantially from the over Y2tn seen in the latter half of 2022. The trade balance with mineral fuels (with a deficit of Y1.8tn in Jun), which is the largest item pushing down the trade balance, has been improving due to a decline in the price of energy, mainly crude oil (Chart 1). In 2022, the trade deficit with raw materials also widened, although the deficit was less than that with mineral fuels. It appears that this was also caused by a rise in the price of commodities, mainly energy, but that rise has already peaked out. Similar to mineral fuels and raw materials, foodstuffs have been pushing down Japan's trade balance, but the trade balance with foodstuffs has also improved compared to last year (Chart 2).

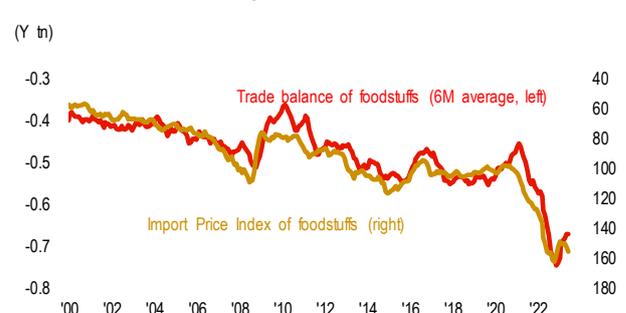
A major factor behind the improved trade balance is the decrease in the price of imported goods due to the drop in the cost of imports, as mentioned above. Meanwhile, the increase in the value of exports is also contributing to an improvement in the trade balance. Although the Export Volume Index, which is announced by the Ministry of Finance (MOF), has not yet recovered to pre-pandemic levels, it has been on an uptrend since the beginning of 2023. Japan's Export Price Index is at a high level, but growth is slowing. Therefore, the increase in the volume of exports is the major factor behind the increase in the total value of exports.

Chart 1: Crude Oil Price, Trade Balance of Mineral Fuel



Source: MOF, Bloomberg; compiled by Daiwa Securities.

Chart 2: Trade Balance, Import Price Index of Foodstuffs



Source: MOF; BOJ; compiled by Daiwa Securities.

Looking at exports by item, we found that growth in automobile exports is particularly high. In Japan, demand for automobiles recovered as the country recovered from the pandemic, but production wasn't able to fully satisfy demand due to shortages with semiconductors and parts. Insufficient auto production had an impact on auto exports, which pushed down the trade balance with transport equipment. With supply constraints gradually easing of late, auto production and exports have been trending towards recovery (Chart 3). With the price of automobile exports being more solid than the value of exports overall, automobiles are boosting the total export value in terms of both volume and price.

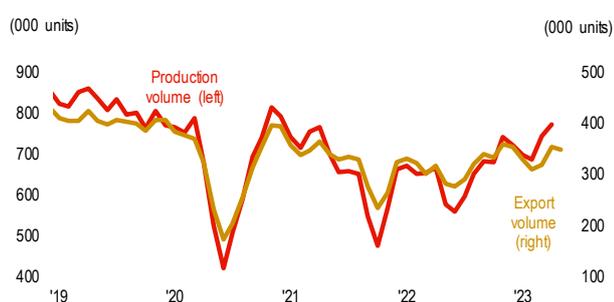
However, the improvement in the trade balance with both exports and imports might not continue as well going forward. Energy prices, which are the largest factor in boosting the price of imports, are now rebounding, partly due to the firmness of overseas economies. Wheat prices have also risen because Russia withdrew from the export agreement that guaranteed the safety of grain transportation from Ukraine via the Black Sea. As such, global grain prices may rise going forward, which should serve as a factor in increasing imports. While supply constraints with exports have been resolved, the sentiment among overseas manufacturers has been worsening. Therefore, it may be difficult for exports to see further growth. The rapid widening of the trade deficit since 2021 was partly influenced by temporary factors, and resolution of those issues is leading to improvement in the trade deficit. However, there are no clear factors to drive improvement beyond current levels.

#### ◆ Travel balance

Although the number of foreigners visiting Japan has been recovering, it has not returned to the pre-pandemic levels seen in 2019. The number of visitors from certain nations, such as South Korea and Taiwan, has already exceeded pre-pandemic levels. However, the number of visitors from China, which accounted for 30% of the total of foreign visitors before the pandemic, is still about 200,000/month (vs. about 1 million/month before the pandemic) because there are still restrictions on group tours. The number of visitors from Europe has also not yet recovered to pre-pandemic levels, partly because flights between Japan and Europe are operating on routes that avoid Russian airspace in order to ensure safety (Chart 4).

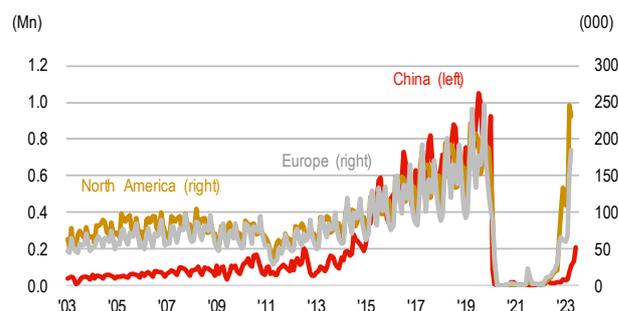
Although the number of foreign visitors to Japan has not yet recovered to pre-pandemic levels, Japan's travel balance has already recovered to pre-pandemic levels on a single month basis (Chart 5 on next page). This is probably influenced by (1) an increase in travel expenditures per visitor to Japan due to yen depreciation and (2) the number of Japanese traveling outside the country remaining at a low level. The cumulative travel balance during Jan-May 2023 came in at ¥1.3tn, already exceeding the ¥1.1tn during Jan-May 2019. Although the number of foreign visitors to Japan has not yet recovered to pre-pandemic levels, it can be said that the travel balance has already normalized.

**Chart 3: Automobile Production Volume, Export Volume**



Source: Japan Automobile Manufacturers Association; compiled by Daiwa Securities.  
 Note: 3-month average figures.

**Chart 4: Number of Foreign Visitors to Japan by Region**

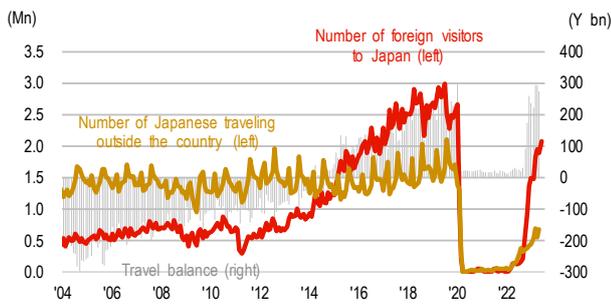


Source: Japan Tourism Agency; compiled by Daiwa Securities.

As mentioned above, the trade balance and travel balance have recovered substantially since late 2022. That said, this recovery was largely due to the disappearance of temporary factors that had been brought about by the pandemic and circumstances that came in its aftermath. It is uncertain whether these balances will continue to improve going forward. If the price of energy, such as crude oil, stays at current levels due to the firmness of overseas economies, the improvement in the trade balance won't continue as it has thus far, at the very least. While restrictions remain on group tours from China, leeway for further improvement in the travel balance may be limited.

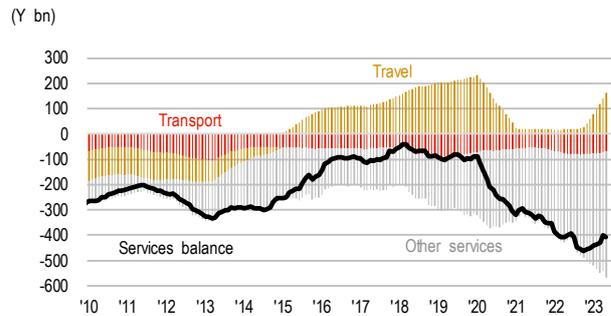
In particular, the trend towards a trade balance deficit has been worsening since 2011, serving as the biggest factor in pushing down the current account balance. The trade deficit took hold because of a decrease in the volume of exports from Japan due to an increase in the number of Japanese companies producing goods at overseas locations. This situation will not change right away. Although some manufactures are moving their production facilities back to Japan due to the weak yen and in response to geopolitical risks, it will take time before the underlying tone of the trade balance shifts towards a surplus. In fact, while it has been a development that has existed since before the pandemic, the balance with other services has been becoming an item substantially pushing down the service balance, offsetting the surplus with the travel balance (Chart 6). It would be difficult to see major improvement occurring right away with regards to basic supply/demand factors for the yen.

**Chart 5: Travel Balance, Number of Passengers**



Source: MOF, Japan Tourism Agency; compiled by Daiwa Securities.

**Chart 6: Services Balance**



Source: MOF; compiled by Daiwa Securities.  
Note: Backward 12-month moving average figures.

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