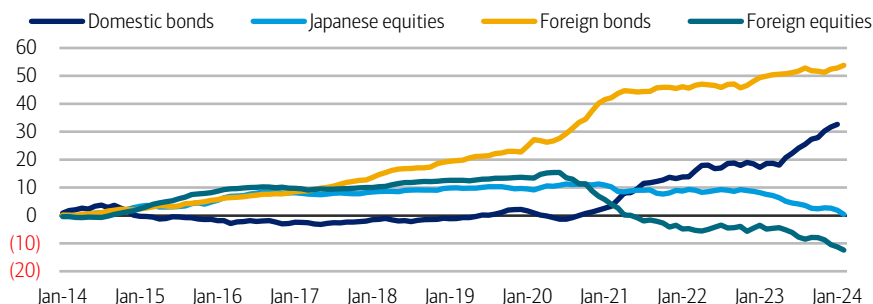


FX Watch

Japan BoP: yen's spring rally

Exhibit 1: Cumulative investment by Japanese trust accounts by asset class (¥tn)

Public pension funds likely rebalancing out of stocks into bonds



Source: BofA Global Research, INDB

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Structural outflow, pension rebalancing, hedged inflow

On Mar 8, Japan's MoF released BoP data for Jan and a preliminary portfolio investment report for Feb.

- **Structural outflow intact:** Japan's structural outflows continue with FDI deficit, service deficit, and outward equity investments by retail investors.
- **Pension funds rebalance:** Trust accounts continued to sell equities and buy bonds in Feb and the rebalancing is likely to continue given the estimated allocation of public pension funds.
- **Banks accumulating UST:** Japanese banks continued to buy foreign bonds and have likely been accumulating exposure to UST.
- **Inward equity investment with FX hedge:** Foreign investors continued to buy Japanese equities and short yen in Feb.

JPY view: yen short may meet policy resistance

We remain structurally bearish on the yen given structural outflows. However, we think the yen can rebound in the spring due to positioning, the BoJ's likely policy changes, and the MoF's potential FX intervention to stop the yen's slide beyond 152 vs USD (see: [USD/JPY may face policy resistance in spring 27 February 2024](#)).

The correlation between Japanese equities and USD/JPY has risen to the highest since May 2023 (Exhibit 9) likely on rising currency-hedged investments in Japanese equities (Exhibit 10). Given the high level of uncertainty around the BoJ's normalization measures on YCC and QE, there is a scope for yen shorts to be unwound (Exhibit 11).

Shorting yen could become attractive again with USD/JPY < 145 given still elevated carry and structural outflow. For now, the market is likely to sell USD/JPY's rise into the BoJ's March MPM (Mar 18-19). The JGB market has likely been supported by rebalancing by public pension funds. The rebalancing can go on for a while, but once it is done, the yields may become more responsive to the BoJ's potential policy shift.

Trading ideas and investment strategies discussed herein may give rise to significant risk and are not suitable for all investors. Investors should have experience in relevant markets and the financial resources to absorb any losses arising from applying these ideas or strategies.

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Refer to important disclosures on page 16 to 17.

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Timestamp: 07 March 2024 11:52PM EST

08 March 2024

G10 FX Strategy
Global

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MoF: the Ministry of Finance

BoP: Balance of Payments

BoJ: Bank of Japan

MPM: Monetary Policy Meeting

FDI: Foreign direct investment

NISA: Nippon Individual Savings Account

Toshin: Japan's investment trust funds

YCC: Yield curve control

QE: Quantitative easing
UST: US Treasuries

Structural outflow intact

Japan's structural outflow remains intact, weighing on the basic balance of payments, and should exert downward pressure on the yen over the long-term (Exhibit 2):

- **Outward FDI likely to accelerate in 2024:** Japan's FDI account registered a ¥3.4tn deficit (net outward investment) in Jan, most since Jul 2023, as foreign companies sold Japanese assets (Exhibit 3). Outward FDI decelerated somewhat in Jan but rising outward M&A announcements imply an expansion in outward FDI in 2024 (Exhibit 4).
- **Japan's service deficit expanding again:** Japan's service balance registered a ¥307bn deficit in Jan. Japan's service balance recovered last fall due to a one-off factor (see: [Japan BoP: Signs of acceleration in Japan's structural outflow 12 January 2024](#)), but appears to be expanding again as a rising deficit in high value-added service industries offset a recovery in the travel balance (Exhibit 5).
- **Outward equity investment by retail investors:** Investment trust accounts bought ¥1.0tn in foreign equities in Feb, only slightly below the Jan number (Exhibit 25). Foreign equity Toshins continue to attract steady inflows since the beginning of the year when the new NISA scheme started (Exhibit 6).

Pension rebalancing from equities to bonds

Trust accounts sold ¥1.2tn in foreign equities and ¥1.5tn in domestic equities, while they added ¥1.0tn in foreign bonds given the rally in US and Japanese equities (Exhibit 1). They may have bought JGBs in Feb, contributing to a tight supply/demand balance. We estimate the public pension funds to be still underweight bonds (¥3.0tn underweight in foreign bonds, ¥1.3tn in domestic bonds) and overweight equities (¥1.6tn in foreign equities, ¥2.6tn in domestic equities), implying continued rebalancing activity (Exhibit 12). However, rebalancing into domestic bonds may run its course soon, which may make the JGB market more responsive to the BoJ's policy change.

Banks buying UST

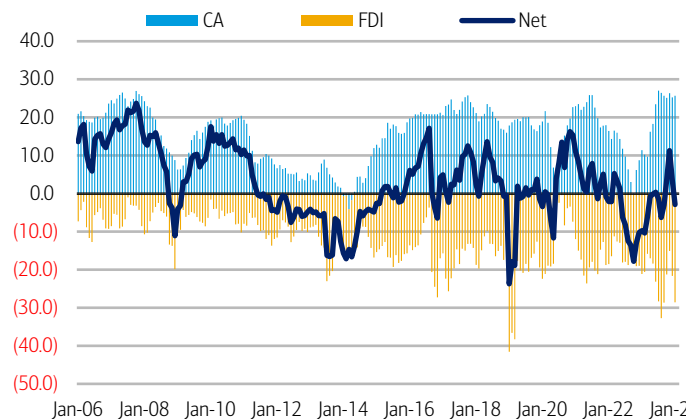
Japanese banks have also been buying foreign bonds since 1Q23 (Exhibit 7). During this period Japanese investors have accumulated UST, implying banks may now be long UST (Exhibit 8).

Inward equity investment with FX hedge

Foreign investors bought net ¥708bn in Japanese equities after ¥2.8tn net buying in Jan. Shorting in yen futures among non-commercial traders at CFTC extended in Feb to the highest level since Nov 2017, implying rising FX-hedged investments into Japanese equities (Exhibit 11). Japanese equity ETFs listed in offshore markets have seen net inflows, and inflows to hedged ETFs seem to be accelerating (Exhibit 10). This may have increased the correlation between Japanese equities and USD/JPY to the highest level since May 2023 as foreign investors have to adjust FX hedges on fluctuations in equity prices (Exhibit 9). These dynamics may make USD/JPY vulnerable to a hawkish policy shift by the BoJ in the spring.

Exhibit 2: Japan's basic balance of payments (annualized rolling 3m, ¥tn)

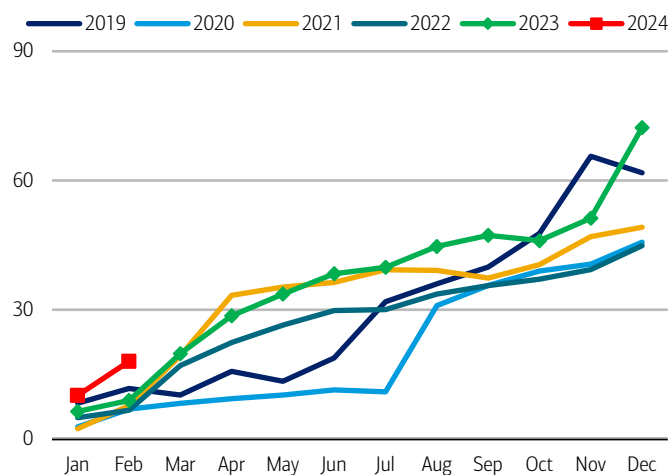
Balance back to deficit as the service balance normalized from one-off factor leading to strong surplus in Oct/Nov.



Source: BofA Global Research, Haver
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Exhibit 4: Japan Inc.'s cumulative outward M&A announcements by calendar year* (\$bn, net of disposition)

Japan's outward M&A accelerating



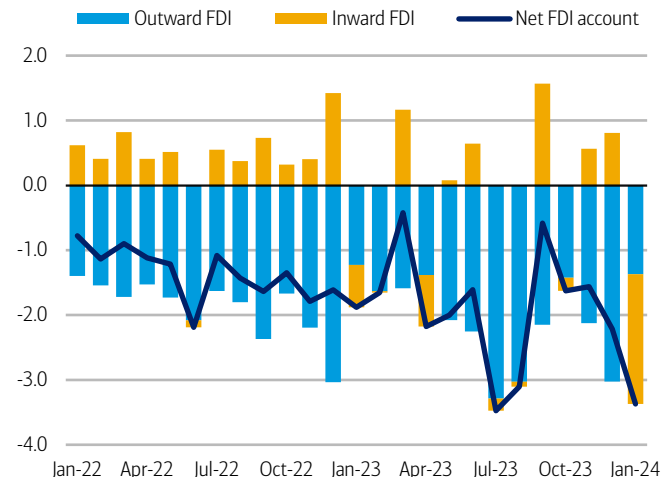
Source: BofA Global Research, Bloomberg

*Excluding Softbank related deals

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Exhibit 3: Monthly FDI account balance (¥tn)

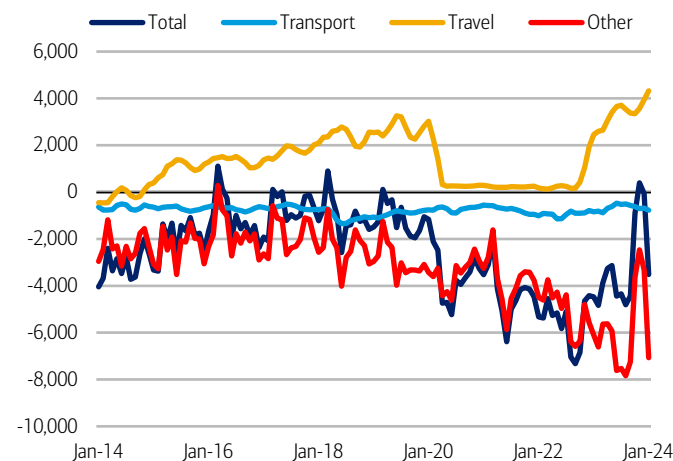
FDI deficit continues



Source: BofA Global Research, Haver
BofA GLOBAL RESEARCH

Exhibit 5: Japan service balance (annualized rolling 3m, ¥bn)

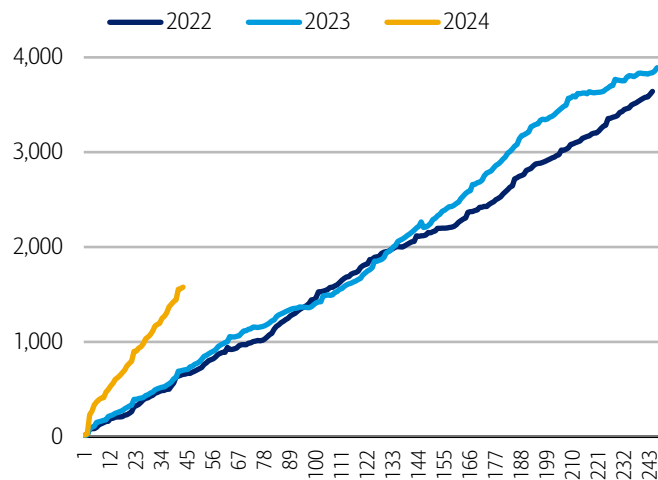
Oct/Nov service balanced boosted by one-off rise in intellectual property surplus



Source: BofA Global Research, Haver.
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Exhibit 6: Cumulative net flow into largest Japanese investment trusts (Toshin) invested in foreign equities (incl. REIT, fund of funds) by calendar year* (¥bn, number of business days, our estimate)

YTD flow is up +125% YoY



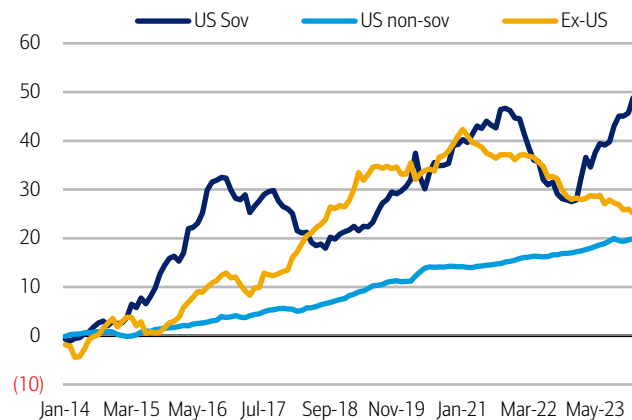
Source: BofA Global Research, Bloomberg

*We screen 100 largest investment trusts by assets under management (AUM) available in Japan and invested in foreign assets with price and AUM history since 2022 by Bloomberg's screening function (excluding bond and commodity funds, balance funds which also invest in domestic assets; including real estate investment trusts (REITs), fund of funds)

We estimate net daily flow as AUM change not explained by price change
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Exhibit 8: Cumulative investment in foreign bonds by Japanese investors (¥tn)

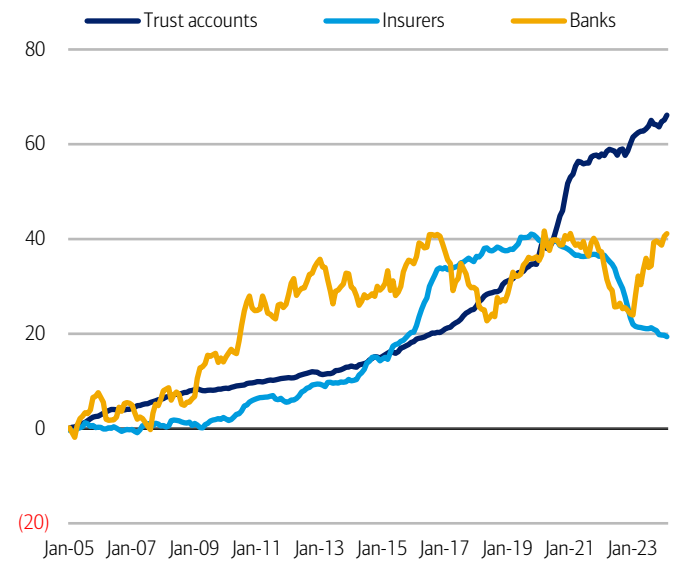
Japanese investors have been buying US sovereign bonds while unwinding non-US bonds



Source: BofA Global Research, Haver, MoF
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Exhibit 7: Cumulative investment in foreign bonds by Japanese institutional investors (¥tn)

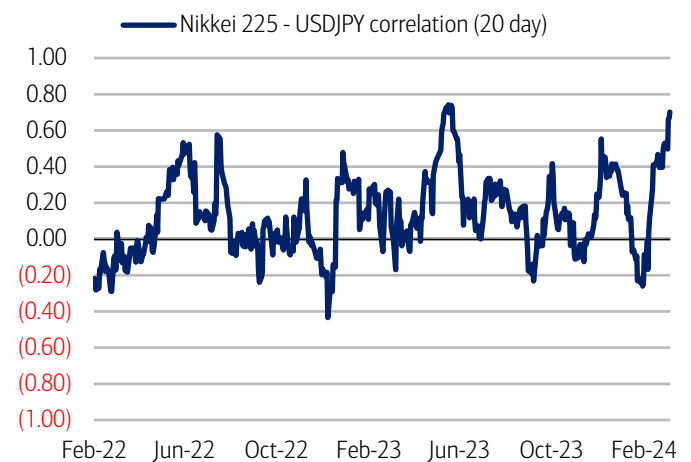
Trust accounts and banks have been buying foreign bonds



Source: BofA Global Research, Haver
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Exhibit 9: Nikkei 225 index – USD/JPY correlation (rolling 20 days)

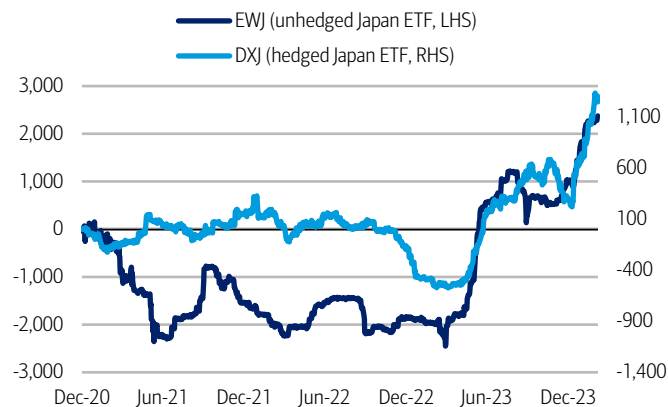
Correlation highest since May 2023



Source: BofA Global Research, Bloomberg
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Exhibit 10: Estimated net cumulative flow* to major Japan ETF (EWJ = unhedged, DXJ = hedged, \$mn)

Both unhedged and hedged Japanese equity ETF attracting inflow

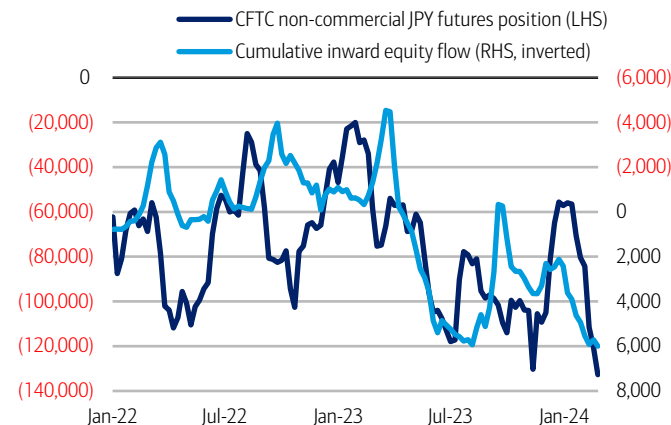


Source: BofA Global Research, Bloomberg

*We estimate net daily flow as AUM change not explained by price change
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Exhibit 11: Spec JPY positioning vs inward equity investment

Foreign investors may have increased hedged Japan equity investments



Source: BofA Global Research, Bloomberg
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Exhibit 12: Simulation of public pension rebalancing

Allocation of assets under management (AUM) for Government Pension Investment Fund (GPIF) and three other public pension funds (estimation methodology cited below)

GPIF

	Allocation estimate as of Mar 8 (%)	Model portfolio (%)	Rebalancing to be done (¥bn)
Domestic bond*	24.8	25	533
Domestic equity	25.7	25	-1,649
Foreign bond (unhedged)	24.1	25	2,207
Foreign equity	25.4	25	-1,091

AUM (bn JPY) 243,092

3 Funds

	Allocation estimate as of Mar 8 (%)	Model portfolio (%)	Rebalancing to be done (¥bn)
Domestic bond*	23.9	25	759
Domestic equity	26.4	25	-993
Foreign bond (unhedged)	23.9	25	744
Foreign equity	25.7	25	-510

AUM (bn JPY) 70,833

GPIF + 3 other public pension funds

	Allocation estimate as of Mar 8 (%)	Model portfolio (%)	Rebalancing to be done (¥bn)
Domestic bond*	24.6	25	1,291
Domestic equity	25.8	25	-2,642
Foreign bond (unhedged)	24.1	25	2,951
Foreign equity	25.5	25	-1,601

AUM (bn JPY) 313,924

Source: BofA Global Research, Government Pension Investment Fund (GPIF), Chikyoren, KKR, Shigaku Kyosai

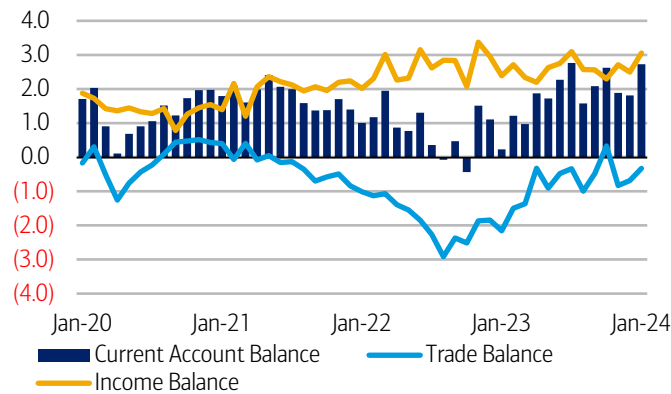
*Domestic bonds include hedged foreign bonds and short-term liquidity

For estimation methodology, please see [FX Watch: Japanese pension-fund rebalancing progressing 09 March 2020](#)

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Exhibit 13: Japan's monthly current account balance

(seasonally adjusted, ¥tn)



Source: BofA Global Research, MoF, Haver

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Exhibit 15: Japan's outward investment

Country breakdown of sovereign bonds (Japan BoP, ¥bn)

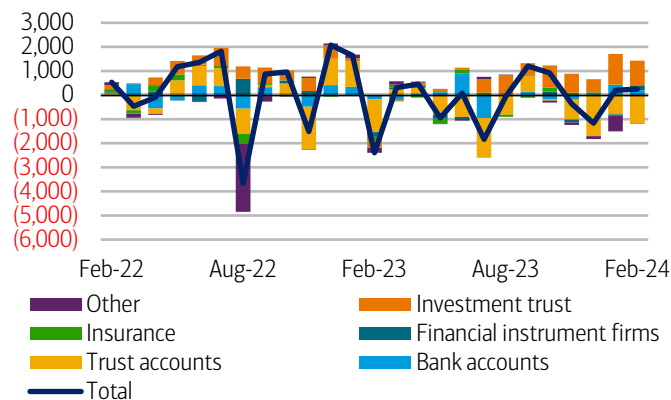
	US	Australia	Germany	France	Italy	Netherlands	UK	Canada
Q1 '23	9,419	-4	638	-614	213	-146	316	-224
Q2 '23	6,851	477	269	-319	61	-44	117	-127
Q3 '23	3,574	143	-63	-191	-241	-64	253	-388
Q4 '23	2,642	-89	774	-351	75	-275	419	-127
Feb-23	4,595	-38	0	-87	-49	14	-60	-5
Mar-23	4,383	188	365	-692	116	-36	112	-118
Apr-23	-2,127	327	-96	460	-7	-22	65	-5
May-23	3,115	213	-471	313	-254	38	5	-32
Jun-23	1,779	25	-426	51	90	190	161	103
Jul-23	-161	14	-43	-541	35	-56	242	-204
Aug-23	557	150	192	152	-77	57	95	-28
Sep-23	3,178	-22	-212	198	-199	-64	-84	-155
Oct-23	1,726	101	644	-312	299	25	114	-14
Nov-23	-27	-223	20	-38	-240	-304	43	-31
Dec-23	943	34	110	-2	17	4	261	-82
Jan-24	3,056	-8	298	93	-53	-27	40	-199

Source: BofA Global Research, MoF, Haver

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Exhibit 17: Outward equity investment

By investor type (¥bn)

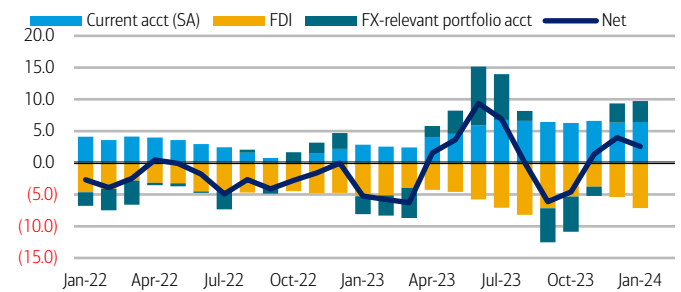


Source: MoF, BoJ, BofA Global Research, Preliminary figure for most recent month

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Exhibit 14: Major components of Japan's BoP

(rolling 3 months sum, ¥tn)



Source: BofA Global Research, MoF, Haver.

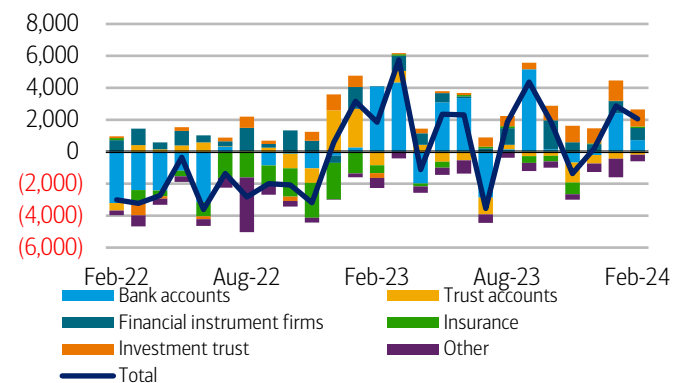
*BBoP (Basic balance of payment = Current account + FDI account + FX relevant part of portfolio flow

*FX relevant part of portfolio flow = equity flow, trust accounts' foreign bond investment, 1/3 of life insurers' foreign bond investment

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Exhibit 16: Outward portfolio investment

By investor type (¥bn)



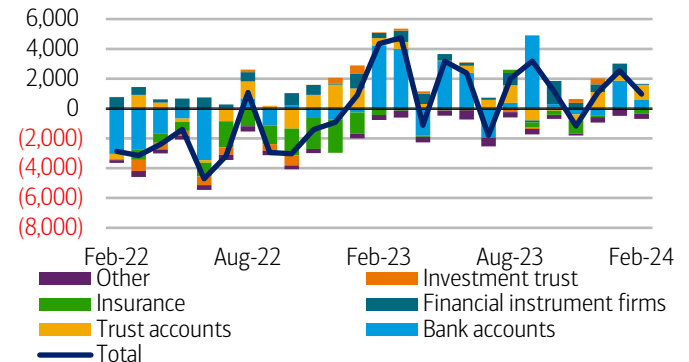
Source: BofA Global Research, MoF, Haver.

Preliminary figure for most recent month

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Exhibit 18: Outward long-term debt investment

By investor type (¥bn)



Source: MoF, BoJ, BofA Global Research,

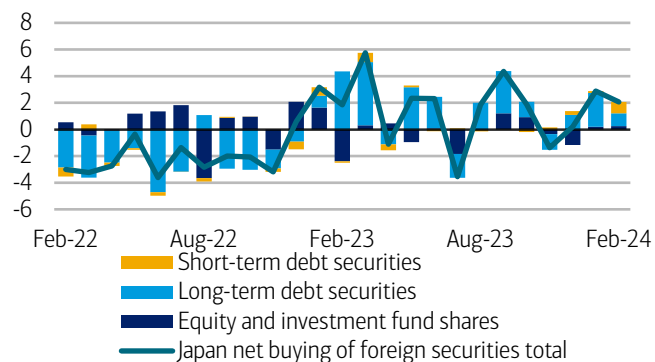
Preliminary figure for most recent month

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Portfolio investment assets/liabilities

Exhibit 19: Portfolio investment assets

(net: trillion yen)

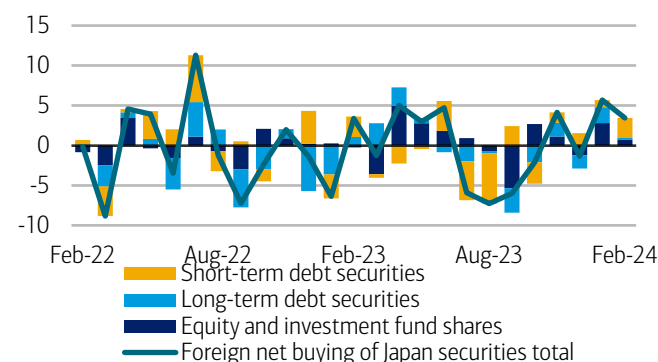


Source: MoF, BoJ, BofA Global Research

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Exhibit 20: Portfolio investment liabilities

(net: trillion yen)



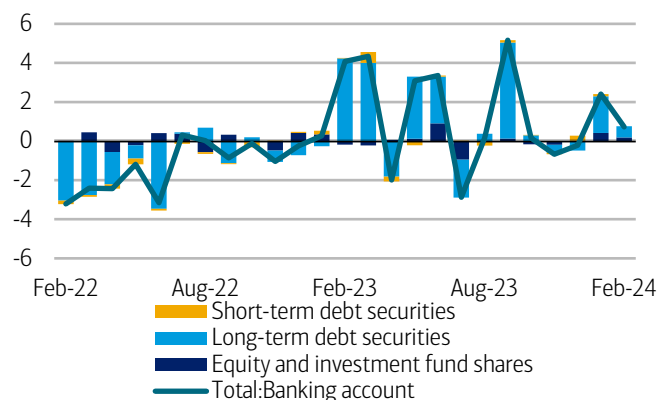
Source: MoF, BoJ, BofA Global Research

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Portfolio investment assets by investor type

Exhibit 21: Outward portfolio investment: Banks

(net: trillion yen)

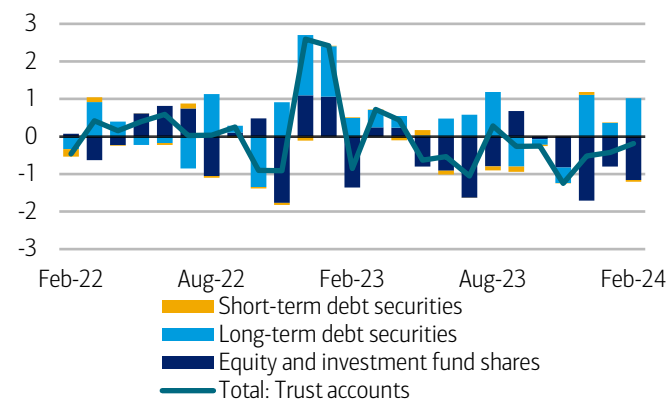


Source: MoF, BoJ, BofA Global Research

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Exhibit 22: Outward portfolio investment: Trust accounts

(net: trillion yen)

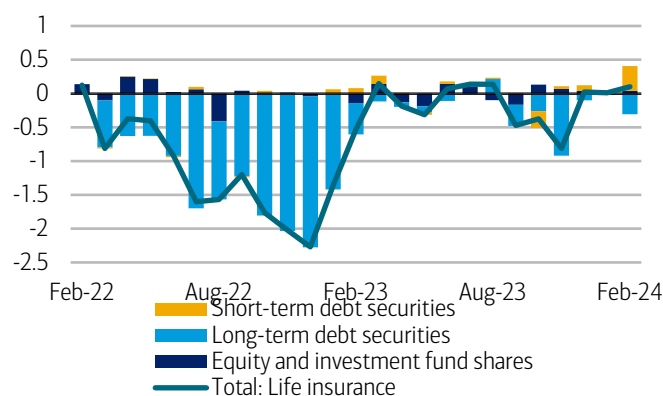


Source: MoF, BoJ, BofA Global Research

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Exhibit 23: Outward portfolio investment: Life insurance companies

(net: trillion yen)

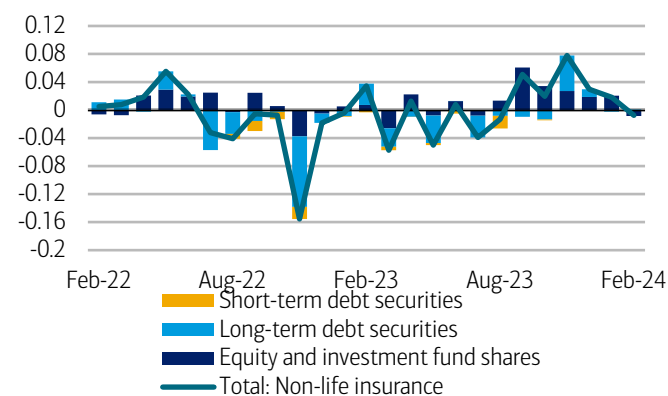


Source: MoF, BoJ, BofA Global Research

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Exhibit 24: Outward portfolio investment: Non-life insurance companies

(net: trillion yen)

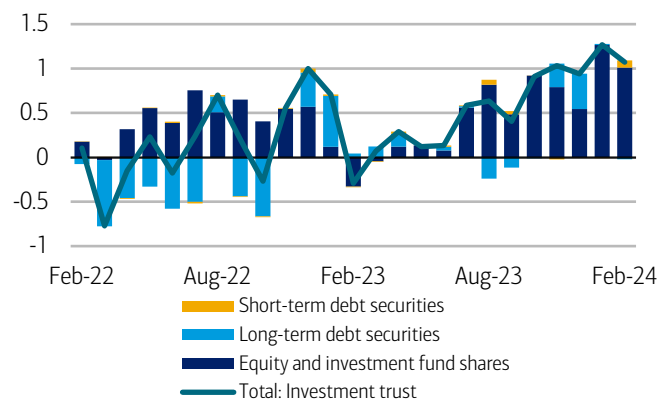


Source: MoF, BoJ, BofA Global Research

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Exhibit 25: Outward portfolio investment: Investment trust management companies

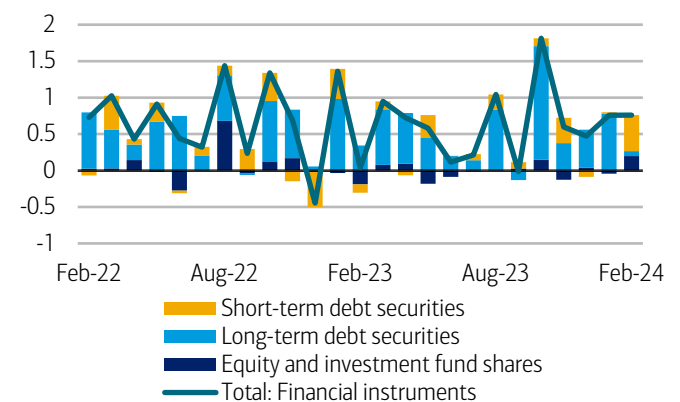
(net: trillion yen)



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Exhibit 26: Outward portfolio investment: Financial instruments firms

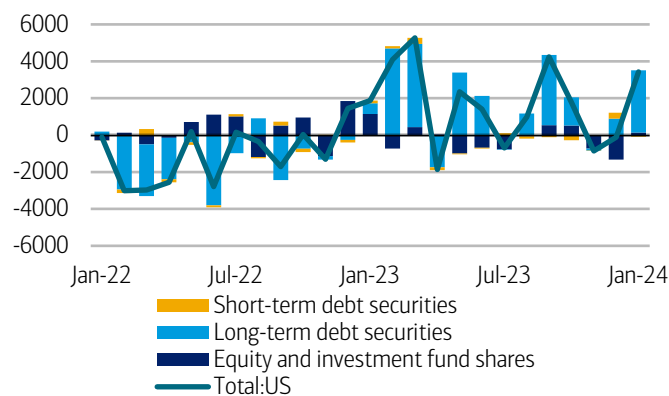
(net: trillion yen)



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Outward portfolio investment, country breakdown**Exhibit 27: Outward portfolio investment: US**

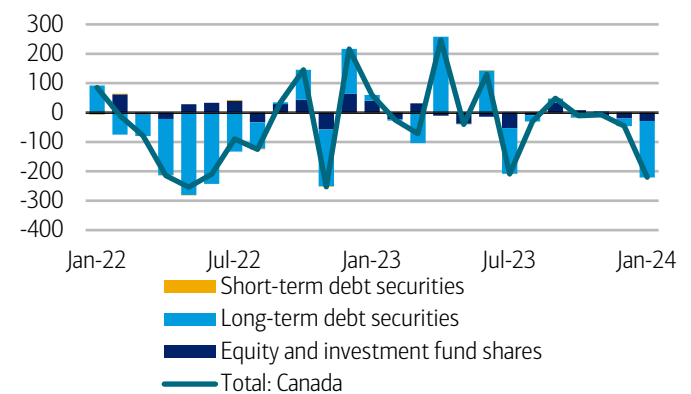
(net: billion yen)



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Exhibit 28 Outward portfolio investment: Canada

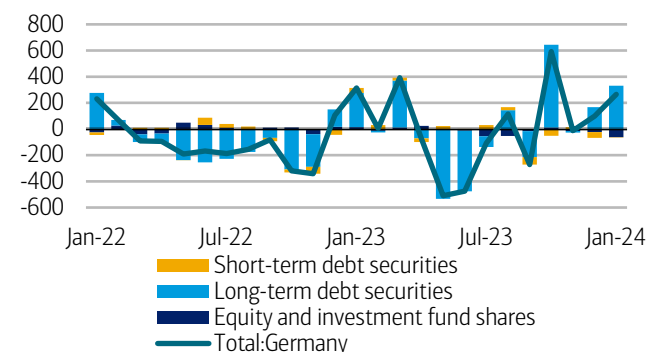
(net: billion yen)



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Exhibit 29: Outward portfolio investment: Germany

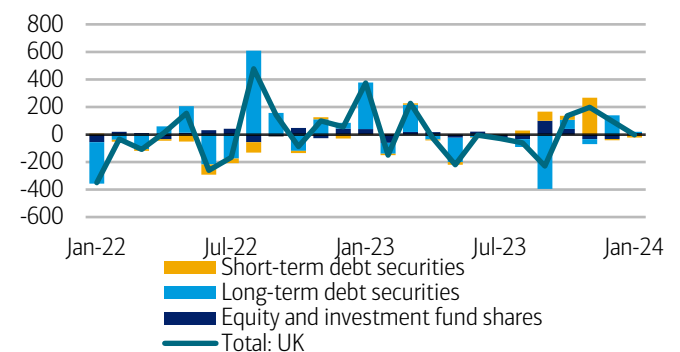
(net: billion yen)



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Exhibit 30: Outward portfolio investment: UK

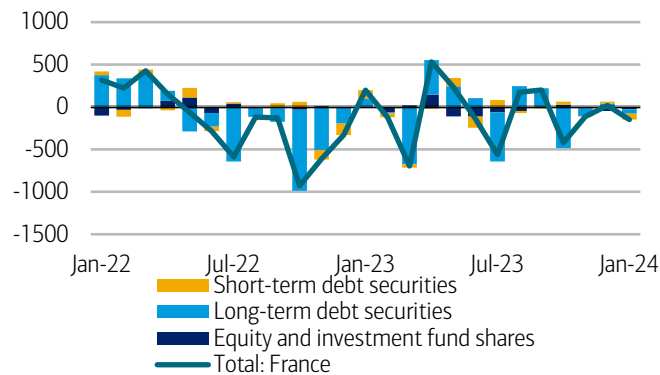
(net: billion yen)



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Exhibit 31: Outward portfolio investment: France

(net: billion yen)

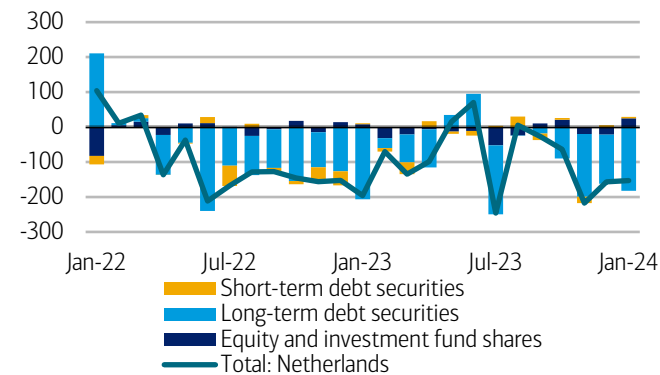


Source: MoF, BoJ, BofA Global Research

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Exhibit 32: Outward portfolio investment: The Netherlands

(net: billion yen)

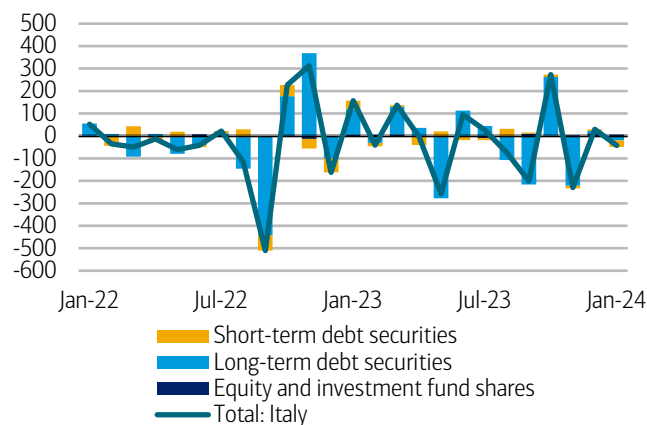


Source: MoF, BoJ, BofA Global Research

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Exhibit 33: Outward portfolio investment: Italy

(net: billion yen)

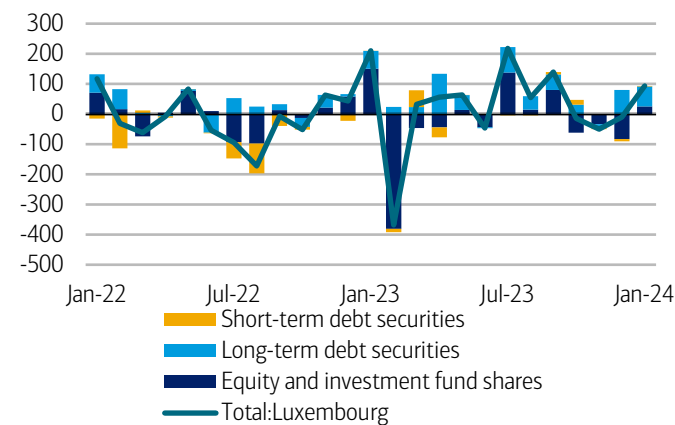


Source: MoF, BoJ, BofA Global Research

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Exhibit 34: Outward portfolio investment: Luxembourg

(net: billion yen)

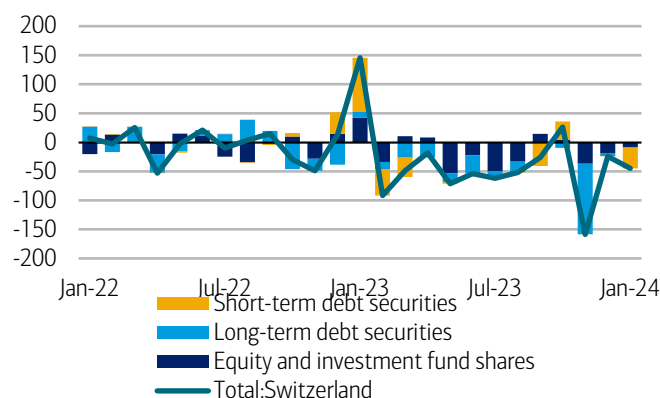


Source: MoF, BoJ, BofA Global Research

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Exhibit 35: Outward portfolio investment: Switzerland

(net: billion yen)

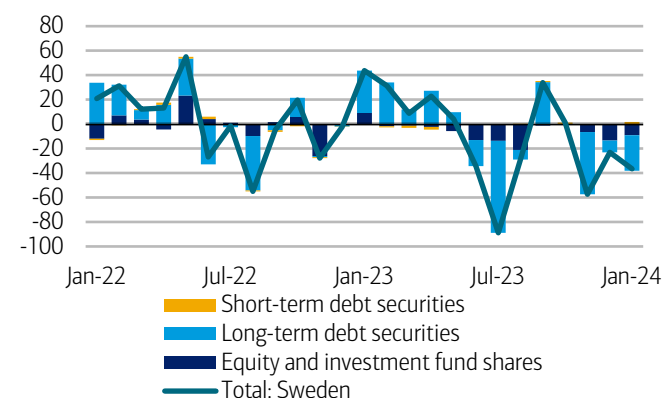


Source: MoF, BoJ, BofA Global Research

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Exhibit 36: Outward portfolio investment: Sweden

(net: billion yen)

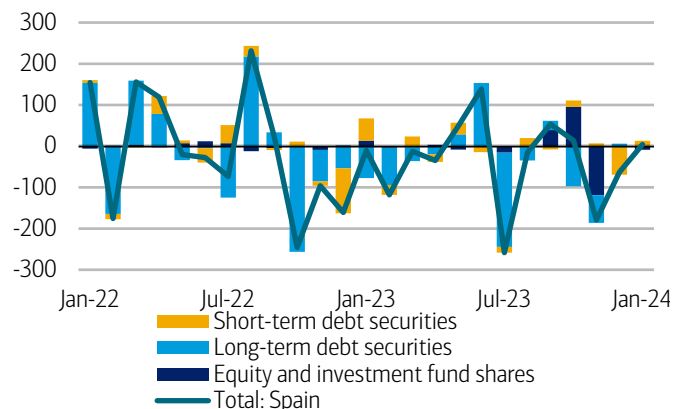


Source: MoF, BoJ, BofA Global Research

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Exhibit 37: Outward portfolio investment: Spain

(net: billion yen)

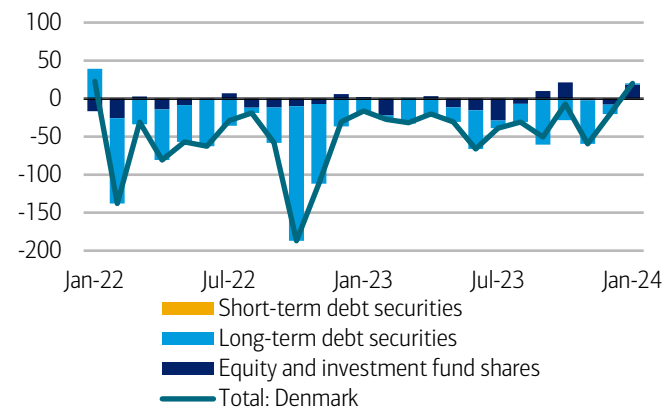


Source: MoF, BoJ, BofA Global Research

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Exhibit 38: Outward portfolio investment: Denmark

(net: billion yen)

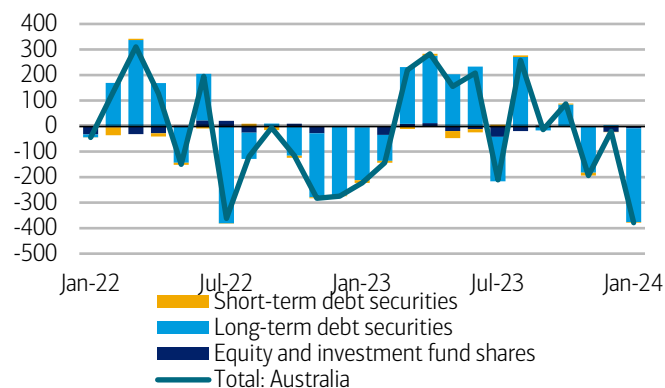


Source: MoF, BoJ, BofA Global Research

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Exhibit 39: Outward portfolio investment: Australia

(net: billion yen)

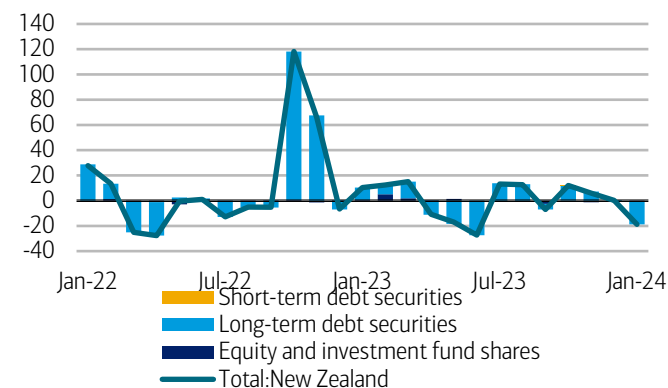


Source: MoF, BoJ, BofA Global Research

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Exhibit 40: Outward portfolio investment: New Zealand

(net: billion yen)

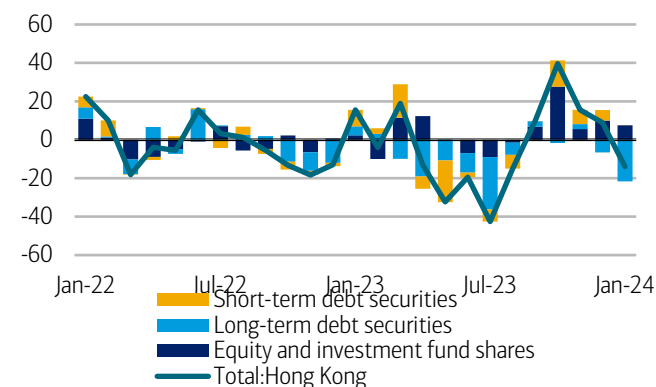


Source: MoF, BoJ, BofA Global Research

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Exhibit 41: Outward portfolio investment: Hong Kong

(net: billion yen)

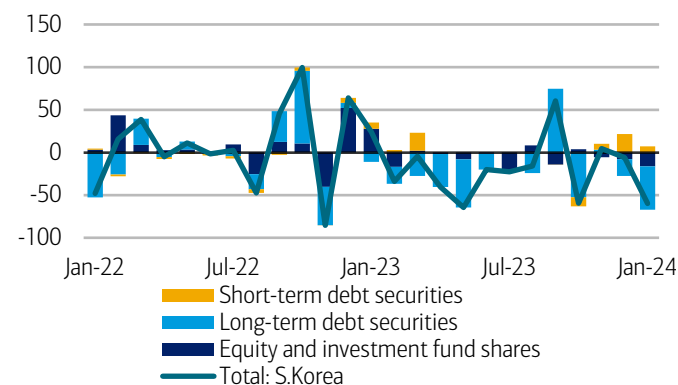


Source: MoF, BoJ, BofA Global Research

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Exhibit 42: Outward portfolio investment: S. Korea

(net: billion yen)

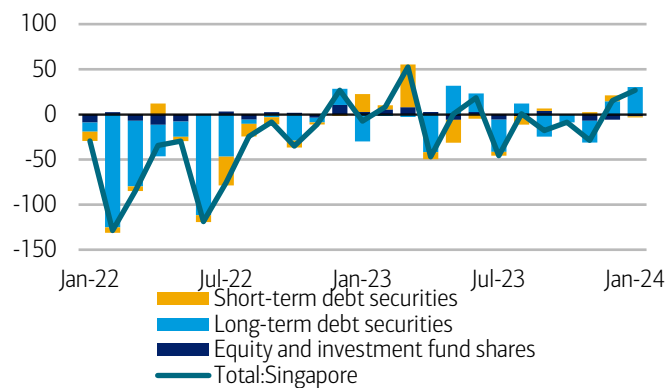


Source: MoF, BoJ, BofA Global Research

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Exhibit 43: Outward portfolio investment: Singapore

(net: billion yen)

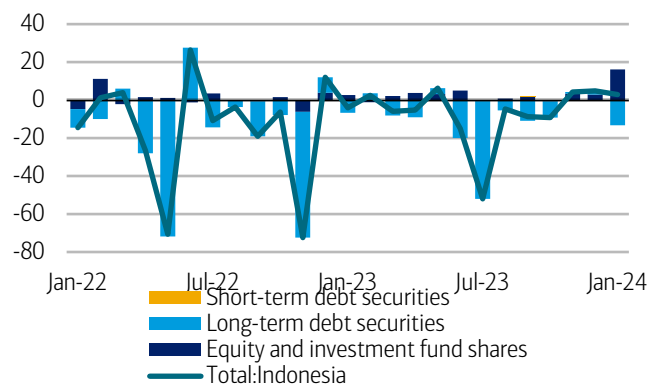


Source: MoF, BoJ, BofA Global Research

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Exhibit 44: Outward portfolio investment: Indonesia

(net: billion yen)

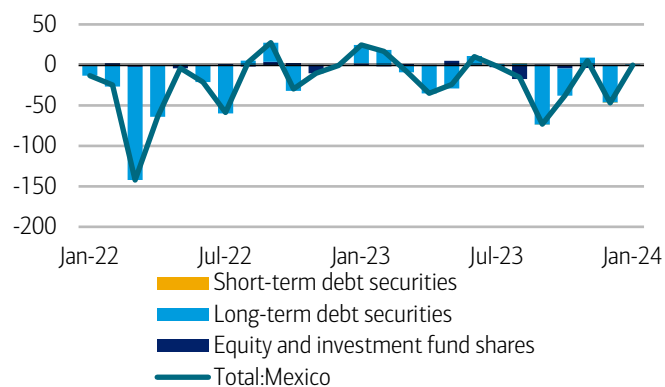


Source: MoF, BoJ, BofA Global Research

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Exhibit 45: Outward portfolio investment: Mexico

(net: billion yen)

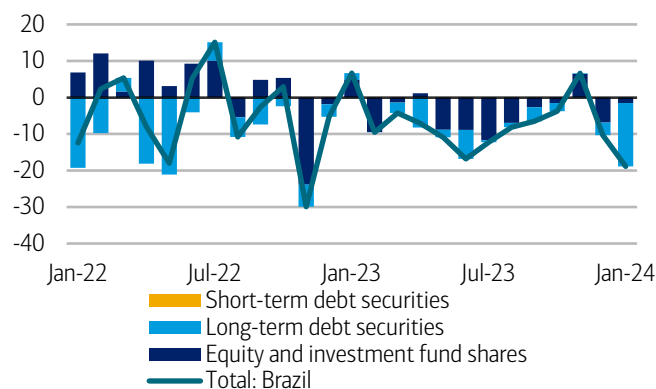


Source: MoF, BoJ, BofA Global Research

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Exhibit 46: Outward portfolio investment: Brazil

(net: billion yen)

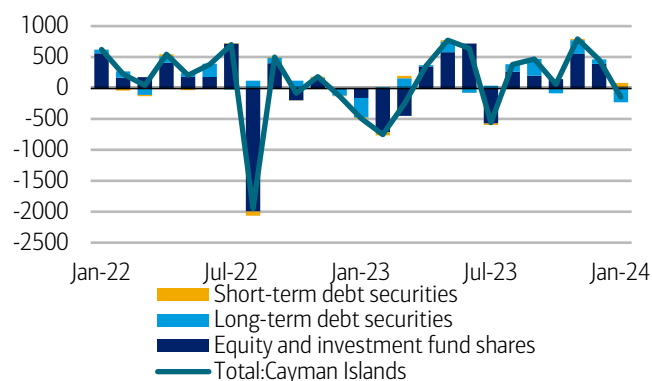


Source: MoF, BoJ, BofA Global Research

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Exhibit 47: Outward portfolio investment: Cayman Islands

(net: billion yen)

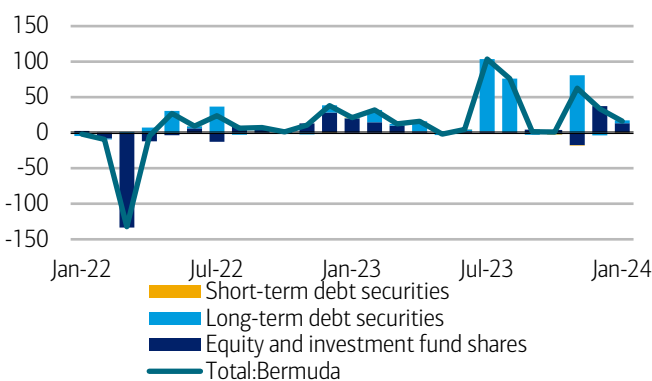


Source: MoF, BoJ, BofA Global Research

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Exhibit 48: Outward portfolio investment: Bermuda

(net: billion yen)

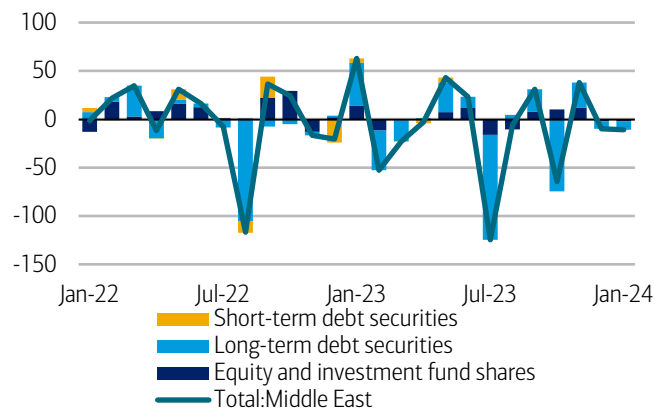


Source: MoF, BoJ, BofA Global Research

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Exhibit 49: Outward portfolio investment: The Middle East

(net: billion yen)

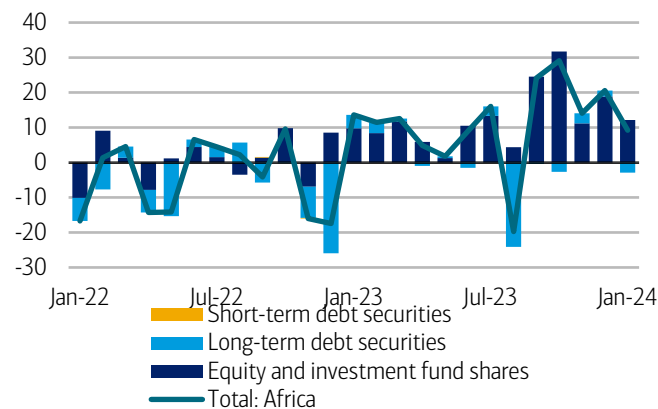


Source: MoF, BoJ, BofA Global Research

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Exhibit 50: Outward portfolio investment: Africa

(net: billion yen)



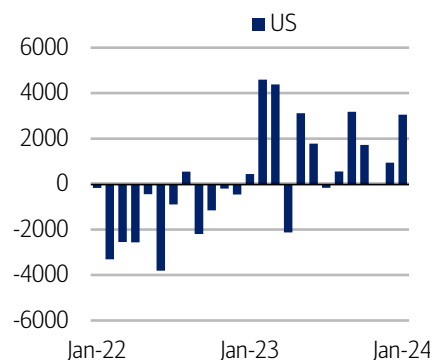
Source: MoF, BoJ, BofA Global Research

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Portfolio investment assets, country breakdown of sovereign bonds

Exhibit 51: Sovereign bonds: US

(net: billion yen)

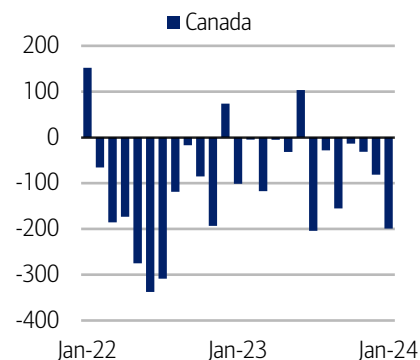


Source: MoF, BoJ, BofA Global Research

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Exhibit 52: Sovereign bonds: Canada

(net: billion yen)

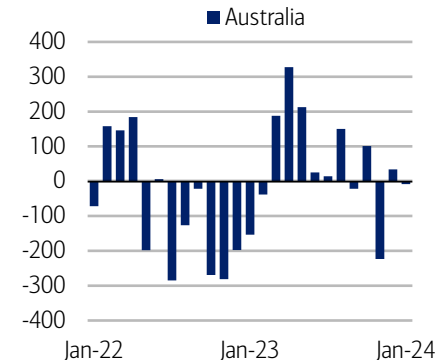


Source: MoF, BoJ, BofA Global Research

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Exhibit 53: Sovereign bonds: Australia

(net: billion yen)

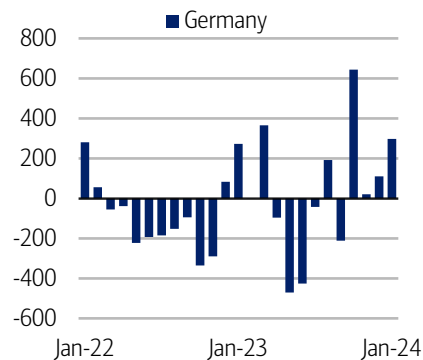


Source: MoF, BoJ, BofA Global Research

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Exhibit 54: Sovereign bonds: Germany

(net: billion yen)

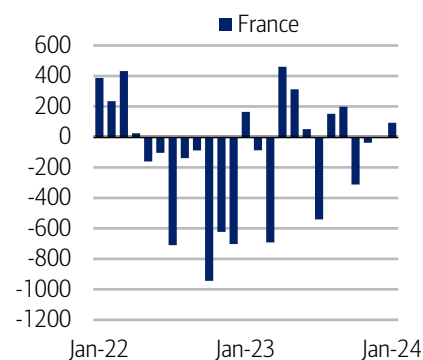


Source: MoF, BoJ, BofA Global Research

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Exhibit 55: Sovereign bonds: France

(net: billion yen)

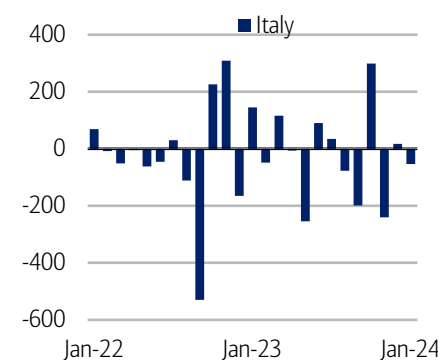


Source: MoF, BoJ, BofA Global Research

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Exhibit 56: Sovereign bonds: Italy

(net: billion yen)

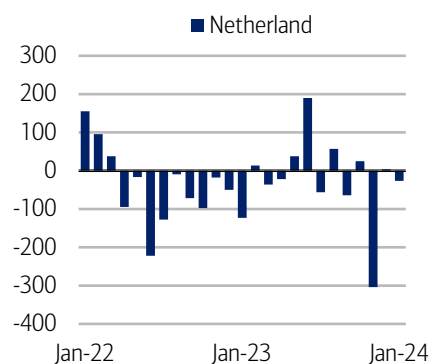


Source: MoF, BoJ, BofA Global Research

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Exhibit 57: Sovereign bonds: The Netherlands

(net: billion yen)

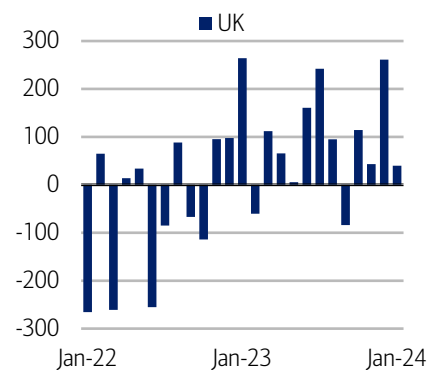


Source: MoF, BoJ, BofA Global Research

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Exhibit 58: Sovereign bonds: The UK

(net: billion yen)

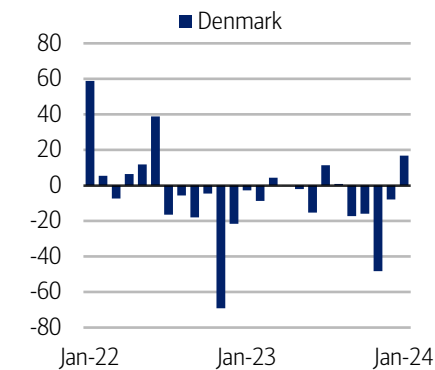


Source: MoF, BoJ, BofA Global Research

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Exhibit 59: Sovereign bonds: Denmark

(net: billion yen)

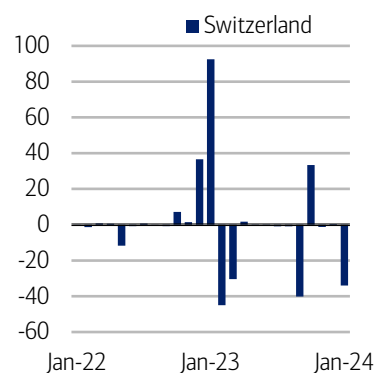


Source: MoF, BoJ, BofA Global Research

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Exhibit 60: Sovereign bonds: Switzerland

(net: billion yen)

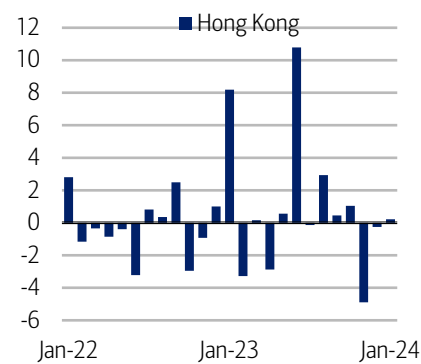


Source: MoF, BoJ, BofA Global Research

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Exhibit 61: Sovereign bonds: Hong Kong

(net: billion yen)

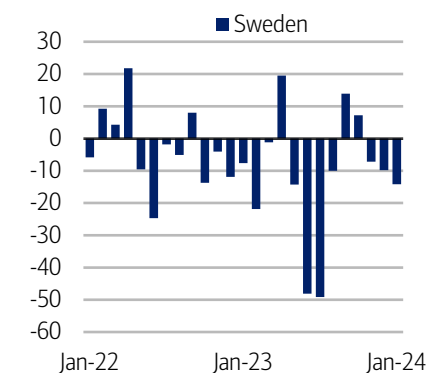


Source: MoF, BoJ, BofA Global Research

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Exhibit 62: Sovereign bonds: Sweden

(net: billion yen)

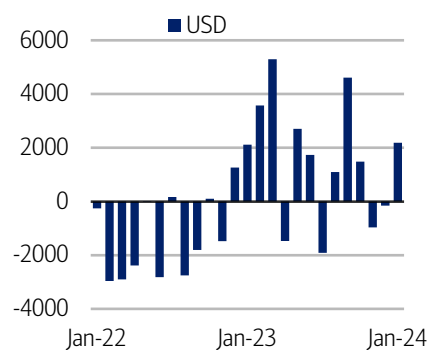


Source: MoF, BoJ, BofA Global Research

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Outward portfolio investment by quotation currency**Exhibit 63: Outward portfolio investment: USD**

(net: billion yen)

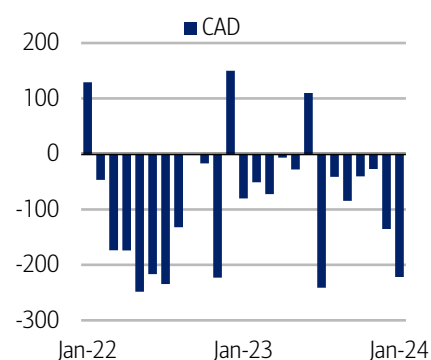


Source: MoF, BoJ, BofA Global Research

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Exhibit 64: Outward portfolio investment: CAD

(net: billion yen)

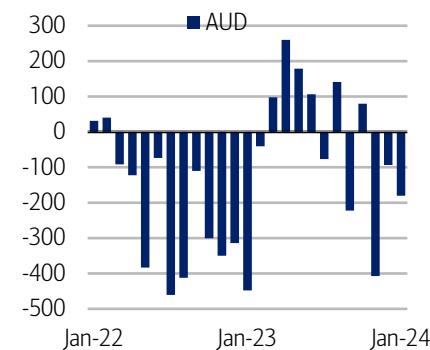


Source: MoF, BoJ, BofA Global Research

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Exhibit 65: Outward portfolio investment: AUD

(net: billion yen)

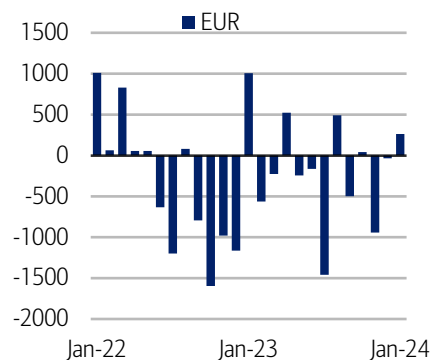


Source: MoF, BoJ, BofA Global Research

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Exhibit 66: Outward portfolio investment: EUR

(net: billion yen)

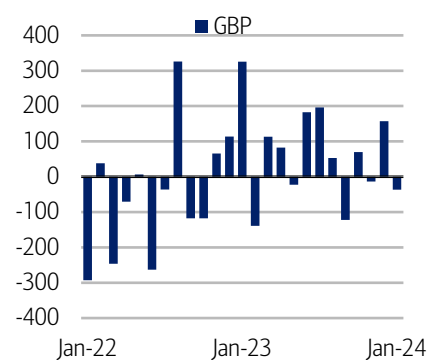


Source: MoF, BoJ, BofA Global Research

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Exhibit 67: Outward portfolio investment: GBP

(net: billion yen)

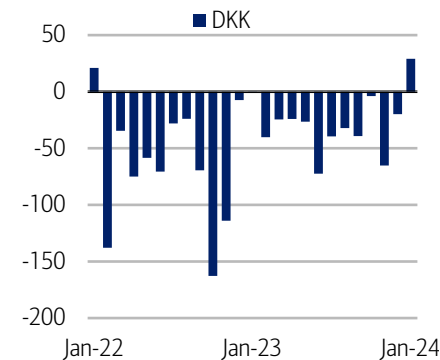


Source: MoF, BoJ, BofA Global Research

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Exhibit 68: Outward portfolio investment: DKK

(net: billion yen)

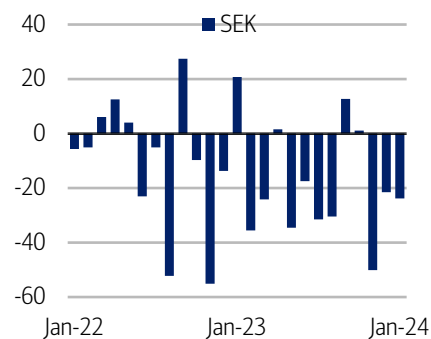


Source: MoF, BoJ, BofA Global Research

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Exhibit 69: Outward portfolio investment: SEK

(net: billion yen)

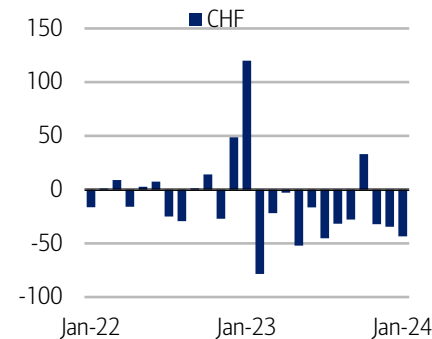


Source: MoF, BoJ, BofA Global Research

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Exhibit 70: Outward portfolio investment: CHF

(net: billion yen)

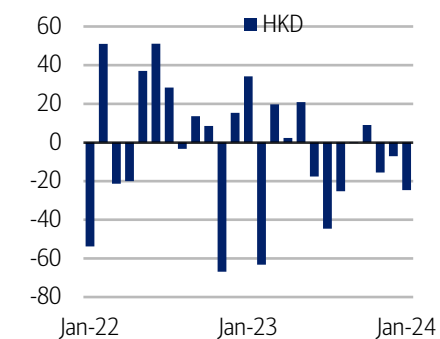


Source: MoF, BoJ, BofA Global Research

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Exhibit 71: Outward portfolio investment: HKD

(net: billion yen)

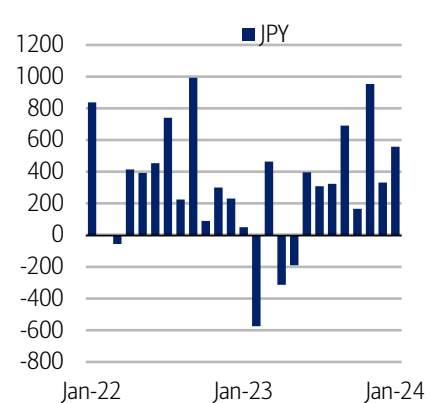


Source: MoF, BoJ, BofA Global Research

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Exhibit 72: Outward portfolio investment: JPY

(net: billion yen)

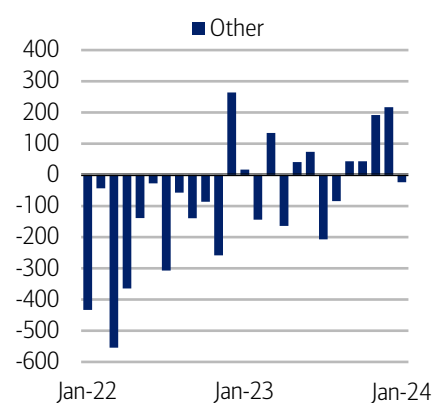


Source: MoF, BoJ, BofA Global Research

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Exhibit 73: Outward portfolio investment: Other

(net: billion yen)

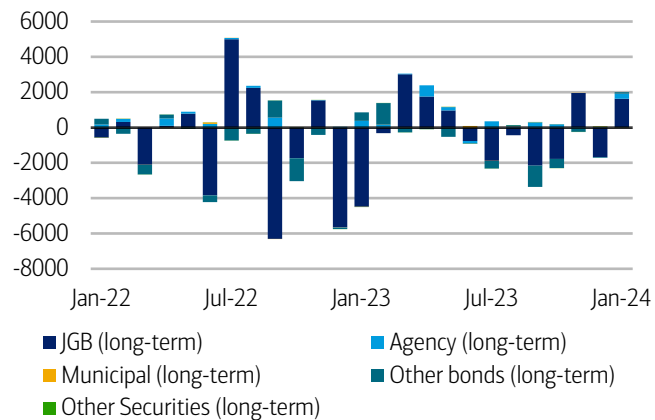


Source: MoF, BoJ, BofA Global Research

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Portfolio investment liabilities by type of debt security

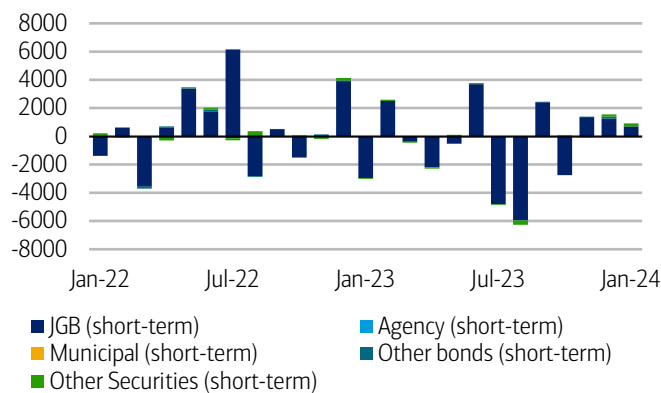
Exhibit 74: Portfolio investment liabilities: Long-term debt
(net: billion yen)



Source: MoF, BoJ, BofA Global Research

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Exhibit 75: Portfolio investment liabilities: Short-term debt
(net: billion yen)



Source: MoF, BoJ, BofA Global Research

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