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Ministry of Finance
Bank of Japan

Revision of the Method for Calculating Reinvested Earnings

The Ministry of Finance and the Bank of Japan have revised the method for calculating credits of reinvested earnings for January 2005 figures henceforth. Those earnings are classified under credits in “income,” and the same amount is recorded under assets in “direct investment.” The outline of the revision and estimated figures for 2004 calculated using the new method are presented below.

I. Outline of the Revision

Reinvested earnings refer to direct investors’ shares (in proportion to equity participation) of earnings that subsidiaries and associated companies do not distribute as dividends (changes in the internal reserves at the end of the accounting period). In the balance of payments (BOP) statistics, the changes in earnings are recorded under both “income” and “direct investment.” This is based on the assumption that the internal reserves are to be paid out to the direct investors as dividends and reinvested in subsidiaries or associated companies by them.

Reinvested earnings are compiled based on the reports on the internal reserves of direct investment enterprises by aggregating the direct investors’ portion to the changes in the internal reserves of direct investment enterprises as of the end of the accounting period (internal reserves at the end of the current accounting period minus internal reserves at the end of the previous accounting period). In this process, figures reported in foreign currencies are converted into yen. Previously, figures at the end of the accounting period T_0 were first converted into yen by using the exchange rate at the end of the accounting period T_0 , then figures at the end of the accounting period T_{0-1} were converted into yen using the exchange rate at the end of the accounting period T_{0-1} , and then differences between the accounting period T_0 and T_{0-1} were recorded as changes in the internal reserves. Under this method, the exchange conversion might cause inconvenience to data users. For example, changes in internal reserves in yen might increase when those in terms of foreign currency decrease (Chart 1). To solve such a problem, the method was revised to first calculate the differences in the internal reserves on a foreign currency basis and then convert the resulting figures into yen by using the exchange rate at the end of the accounting period T_0 (Chart 2). The new

method has been used for compiling figures for January 2005 onward.

- Notes: 1. Debits in reinvested earnings (liabilities in “direct investment”) are not affected by exchange rates because source data are all reported in yen.
 2. Reinvested earnings are equally divided into twelve and recorded over twelve months. This is because internal reserves have been accumulated throughout the accounting period.

Chart 1: An Example of the Impact of Exchange Rate Changes--Different Results for Figures in Foreign Currency and Yen

	The end of the accounting period T ₀₋₁	The end of the accounting period T ₀	Changes in the internal reserves
Exchange rates	100 yen against the U.S. dollar	120 yen against the U.S. dollar	
Internal reserves			
U.S. dollar basis	5.5 billion	5 billion	-0.5 billion
After conversion to yen	550 billion	600 billion	+50 billion

Chart 2: Method for Calculation of Reinvested Earnings

<i>P₀</i> : Internal reserves at the end of the current accounting period
<i>P₀₋₁</i> : Internal reserves at the end of the previous accounting period
<i>FX₀</i> : The exchange rate at the end of the current accounting period
<i>FX₀₋₁</i> : The exchange rate at the end of the previous accounting period
<i>S₀</i> : The percentage of ownership of direct investors at the end of the current accounting period

A. Previous Method

$$\{(P_0 \times FX_0) - (P_{0-1} \times FX_{0-1})\} \times S_0 / 12$$

B. New Method

$$(P_0 - P_{0-1}) \times FX_0 \times S_0 / 12$$

II. Estimated Figures for 2004 Using the New Method

The estimated figures for 2004 of reinvested earnings using the new method are shown in Chart 3. Disparities between “released figures” using the previous method and “estimated figures” using the new method are indicated as “changes due to the revision.”

Chart 3: Estimated Figures for 2004 of Reinvested Earnings in 2004 Using the New Method

100 million yen

	Previous method (released figures)			New method (estimated figures)			Changes due to the revision		
	Credit	Debit	Net balance	Credit	Debit	Net balance	Credit	Debit	Net balance
2004 Jan.	457	180	278	725	180	546	268	0	268
Feb.	456	179	277	724	179	545	268	0	268
Mar.	462	179	283	731	179	552	269	0	269
Apr.	458	181	277	728	181	547	270	0	270
May	458	169	289	728	169	559	270	0	270
June	576	152	424	841	152	689	265	0	265
July	568	152	416	831	152	679	263	0	263
Aug.	569	169	400	833	169	664	264	0	264
Sep.	613	187	427	1,034	187	848	421	0	421
Oct.	613	187	426	1,034	187	847	421	0	421
Nov.	611	187	424	1,031	187	844	420	0	420
Dec.	608	182	427	1,030	182	849	422	0	422
2004 CY	6,452	2,104	4,348	10,270	2,104	8,169	3,821	0	3,821

Reference: Analysis of Year-on-Year Changes in Reinvested Earnings (Net) in 2005

100 million yen

	2005/Q1	Q2	Q3	Q4 (preliminary figures)	2005 CY (preliminary figures)
Year-on-year changes (a)	1,734	1,777	2,173	2,715	8,399
Changes due to the revision (b)	805	805	948	1,263	3,821
(a) – (b)	929	972	1,225	1,452	4,578