November 2012
Japan Securities Dealers Association

Japanese Economy and Securities Market

I. Japanese Economy

(Macroeconomic trends)
Entering 2011, Japan's economy showed signs of escaping from a lull that occurred after it hit bottom in the first quarter of 2009 and resuming its recovery. Supported by the momentum of economic recovery worldwide, Japan's industrial production index rose for the fourth consecutive month. Then, the major earthquake disaster struck in March. The disaster damaged factories and equipment, caused production levels to drop substantially because of electric power shortages, and dampened personal consumption because of shortages of goods and self-imposed consumption restraint among the public. During the second quarter, domestic demand finally began to recover, but external demand was shackled, resulting in the real gross domestic product (GDP) falling for the second quarter in a row.

The major earthquake disaster did spike an increase in domestic demand. There was a temporary increase in demand for food and beverages, heavy electrical equipment, and other goods. And there were increased imports of oil and gas to fuel the thermal electric power generation plants being substituted for the shutdown nuclear power plants. While disaster-oriented production decline improved, overseas demand sharply fell in the second quarter, exports were stagnant because of the slowdown in overseas economies. Consequently, the trade balance fell into the red as did the services account because of the decline in tourist business against the backdrop of the uncertainty in the wake of the major disaster and the strong yen.

In the third quarter, exports also made a recovery after its sudden drop against the backdrop of the post-disaster re-building of the supply chain that took place over the summer. Many demand categories contributed positively to real GDP, resulting in it rising for the first time in four quarters.

Following up on that growth, domestic demand firmed up, enabling Japan to post real GDP growth for four consecutive quarters up to the second quarter of 2012. The benefits of fiscal measures, such as the eco-car subsidy and post-disaster reconstruction demand underpinned this growth. However, real GDP growth was strongly affected by the major earthquake disaster on an annual basis, coming in at minus 0.8% for 2011.

Moreover, the outlook for growth in the Japanese economy also suggests that the country may face an economic slowdown. Overseas economies are slowing under the influence of the sovereign debt crisis in Europe and the fall off of economic growth in China. With Japan unable to expect a full-scale recovery in exports as a result, the domestic demand that has driven economic growth up to this point may weaken along with the stagnation in personal consumption, such as the decline in automobiles sales in reaction to the end of eco-car subsidies.

(Trends in employment conditions)
Although employment conditions continued to suffer from the harsh business environment in 2011, the unemployment rate and the job-offers to seekers ratio showed some signs of improvement, demonstrating a mild but positive recovery trend.

The unemployment rate stayed in the 4% range throughout the year, and ended the year down 0.5% compared with 2010, at 4.6%, posting a little improvement. Entering 2012, the unemployment rate remained level straight through until the most current figure of July, which was 4.3%, about the same as the previous month.

The job-offers to seekers ratio also was in a mild but positive upswing, rising from 0.52 times to 0.65 times. The 0.13 point annual increase suggested a slight improvement in the job demand and supply balance. The ratio continued to move upward in 2012, and the most current figure of July was 0.83 times, rising 0.01 points from June.

Looking at a breakdown of the employment figure, there was a marked increase in employment in the construction industry. A factor in the improved employment conditions previously mentioned was the sharp increase in public works construction arising from the full-scale start to recovery and restoration operations for the major earthquake disaster. However, compared with the improvement in the job-offers to seekers ratio, the improvement in the unemployment rate was slower paced. One of the underlying causes of this difference is thought to be a mismatch of job seekers and job openings. Moreover, in the construction industry where there has been a large increase in employment related to the major disaster, the volume of work by region has varied dramatically depending on recovery and restoration capital investment, resulting in a regional mismatch of job seekers and job openings.

While employment conditions remain in a recovery trend, there are many concerning factors regarding the future. Reflecting the slump in production driven by low personal consumption, it seems highly likely that the decline in employment in the manufacturing industry will continue. In addition, it is also possible that the growth in employment will peak along with the end to recovery and restoration demand.

(Price Trends)
In 2011, the Corporate Goods Price Index (CGPI) increased 1.5% from a year earlier, to 101.5 (2010 as base value), rising for the first time in three years. Entering 2012, the CGPI remained practically flat, and the most current figure of August increased 0.3%, to 100.3 (preliminary report basis). Higher crude oil prices driven by greater demand primarily from Asia were thought to be behind the increase in CGPI.

The Consumer Price Index (CPI; excluding fresh produce) had been in a continuously declining trend since 2009 amid the relaxed demand-supply balance of the overall economy. However, higher electricity rates and gasoline prices, an increase in cigarette prices because of a tax hike, and other factors put the brakes on the decline in consumer prices. On an annual basis, the CPI was down 0.2% year on year, at 99.8 (2010 as base value), hovering at almost the same level as in the previous year. In 2012, CPI has so far stayed relatively flat, and July figure was 99.5 down 0.2 % from the previous month.

<Table 1> Major Economic Indicators
Change from the previous period(Quarterly is seasonally adjusted)

(%)

	2011 1-3	2011 4-6	2011 7-9	2011 10-12	2012 1-3	2012 4-6	CY2010	CY2011
GDP	-2.0	-0.3	1.7	0.1	1.3	0.2	4.5	-0.8
Domestic Demand	-1.8	0.6	1.0	0.8	1.1	0.2	2.8	0.1
(Contribution ratio)	-1.8	0.6	1.0	0.8	1.2	0.2	2.8	0.1
Private Demand	-2.2	0.2	1.4	1.0	1.0	0.2	3.1	-0.1
(Contribution ratio)	-1.6	0.1	1.0	0.8	0.8	0.1	2.3	-0.1
Private Consumption	-1.5	0.6	1.1	0.7	1.2	0.1	2.6	0.1
Private Residential Investment	1.7	-3.0	4.8	0.1	-1.6	0.9	-4.2	5.7
Private Non-Resi. Investment	-0.1	-0.9	0.3	5.5	-1.6	1.4	0.8	1.3
Public Demand	-0.6	1.9	0.0	0.1	1.5	0.5	1.9	1.0
(Contribution ratio)	-0.1	0.5	0.0	0.0	0.4	0.1	0.5	0.2
Government Consumption	0.3	0.6	0.2	0.4	1.1	0.2	2.2	2.0
Public Investment	-4.4	7.4	-1.1	-1.0	3.6	1.8	0.9	-3.5
Net Exports of Goods & Servicies(Contribution ratio)	-0.3	-0.9	0.7	-0.7	0.1	-0.1	1.7	-0.9
Exports of Goods & Services	-0.4	-5.8	7.8	-3.6	3.4	1.2	24.3	-0.1
Imports of Goods & Services	1.5	0.0	3.4	1.0	2.2	1.6	11.2	6.3

(source) Cabinet Office

<Table 2> *Employment Conditions*

	2011 1-3	2011 4-6	2011 7-9	2011 10-12	2012 1－3	2012 4－6	CY2010	CY2011
Unemployment Rate(%)	4.8	4.7	4.4	4.5	4.5	4.4	5.1	4.6
Job-offers to Seekers Ratio(Ratio(Times))	0.61	0.62	0.66	0.69	0.75	0.81	0.52	0.65

(Note) 1. Data are seasonally adjusted.
2. Unemployment rate figures exclude figures for Iwate, Miyagi, and Fukushima prefectures, which were unavailable because of the earthquake and tsunami disaster.

(source) Ministry of Internal Affairs and Communications, Ministry of Health, Labour and Welfare

<Table 3> Price Trends

(Corporate Goods Price and Consumer Price)

		2011 1-3	2011 4-6	2011 7-9	2011 10-12	2012 1-3	2012 4-6	CY2010	CY2011
Corporate Goods Price	index	100.9	102.0	102.1	101.0	101.2	101.1	100.0	101.5
	(YoY Change, %)	0.9	1.8	2.2	1.1	0.3	-0.9	-0.1	1.5
Consumer Price（excluding fresh food)	index	99.5	100.0	99.9	99.7	99.6	99.9	100.0	99.8
	(YoY Change, %)	-0.8	-0.3	0.2	-0.2	0.1	0.0	-1.0	-0.2

(source) Ministry of Internal Affairs and Communications, Bank of Japan

Financial Assets of Households

Looking at the trends in individual investors portfolios, total value of household financial assets in fiscal 2011 increased ¥11 trillion from fiscal 2010, to ¥1,513.3 trillion. The investment climate remained unfavorable during the year in review, with the market value of household financial assets declining ¥8 trillion against the backdrop of depressed stock prices, the strong yen, and other factors. Nevertheless, the positive impact of the flow of new capital into this asset class supported an overall increase on a fiscal year-end basis for the third consecutive year.

Looking at a breakdown, stocks and other equities contracted ¥1.7 trillion, or 1.8% year on year, to ¥97.7 trillion while investment trusts fell ¥2.8 trillion, or 4.4% from last year, to ¥60.8 trillion. Both these categories placed downward pressure on the balance of household financial assets. On the other hand, cash and deposits expanded ¥18.7 trillion, or 2.3%, to ¥835.0 trillion, continuing to rise from a year earlier to post a record high on a year-end basis. Furthermore, the breakdown of cash and deposits showed a trend toward liquid deposits. In the wake of the major earthquake disaster there has been a heightened preference for liquid deposits. Given the low interest rate on time deposits and other factors, there has continued to be a notable flow of money into ordinary accounts and other liquid deposits. In addition, the flow of funds into foreign securities continued, with foreign securities becoming the main destination for the flow of household financial assets among all major asset classes. As a result, investment in foreign securities rose ¥1.2 trillion, or 11.1% year on year, to a historical high. The flow of household financial assets into foreign securities underscores a trend among households toward looking at a diverse selection of assets, including foreign securities, when they are prepared to take some risk in choosing where to invest.

In terms of the composition of household financial assets, the proportions of stocks and other equities and investment trusts declined to 6.5% and 4.0%, respectively, reflecting the drop in stock prices. In contrast, cash and deposits further increased its share of overall household financial assets to 55.2%. This result indicates that households still maintain a strong preference for low risk, secure assets when investing.

<Table 4> Composition of Financial Assets of Households

	FY2009	FY2010	FY2011(E)	FY2011 (E) (Amount) (¥ trillion)
Financial Assets of Household	1,490.9	1,502.1	1,513.3	1,513.3
Currency and deposits	54.0%	54.3%	55.2%	835.0
Bonds	2.6%	2.4%	2.2%	32.8
Investment trusts	4.1%	4.2%	4.0%	60.8
Trust beneficiary rights	0.2%	0.2%	0.1%	2.1
Shares & Other Equities	6.5%	6.6%	6.5%	97.7
Insurance and pension reserves	28.1%	28.0%	27.9%	421.7
Overseas Portfolio Investment	0.7%	0.7%	0.8%	12.3
Others	3.7%	3.7%	3.4%	50.6

(source) Bank of Japan

II. Securities Market

1. Equities

(1) Primary and Public Capital Increases
In 2011, 50 companies went public on the Tokyo Stock Exchange (TSE), including the 1st and 2nd Sections and the Mothers market, increasing year on year for the second consecutive year. During the first half, unlisted companies tended to wait for the proper timing to go public because of general sense of uncertainty in the market about the outlook for corporate performances arising from the major earthquake disaster and concern about public finance in Europe. As a result, there was little sense of recovery in the initial public offering (IPO) market. In the second half, the market turned around after getting a feel for the impact of those concerns and growing interest among investors for high growth potential IPOs, such as social network services (SNS) related issues. Signs of a recovery in the number of newly listing companies began to emerge. The proportion of new listings by companies in the category of information and telecommunications businesses increased, accounting for 11 of the 50 companies.

With the market struggling against the backdrop of the European sovereign debt problem, the flooding in Thailand, the strong yen, and other negative factors, a limited number of companies were seeking to raise capital in the stock market in 2011. Looking at the total capital raised, equity financing amounted to ¥1,014.0 billion in fiscal 2011, compared with ¥3,320.0 billion in fiscal 2010. Another reason for the low level of equity financing was the decline in large-scale capital increases to strengthen capital bases by major banks and trust banks seen during the period from 2009 to 2010.

In the first quarter of 2012, four of the seven companies newly listing on the TSE were Internet-related companies. One of the recently spotlighted topics in the Japanese market was the re-listing of Japan Airlines (JAL) on the Tokyo Stock Exchange in September. The re-listing was the second biggest IPO in the world this year, next to Facebook. After filing bankruptcy in 2010, JAL had turned its performance around under control and support from a government-related fund, the Enterprise Turnaround Initiative Corp., achieving a historically high group operating profit of ¥204.9 bn for fiscal 2011. JAL's IPO price per share was set at ¥3,790 reflecting strong demand for the offered 175 million shares, and its market capitalization reached ¥663 bn ($8.5 bn) at the end of the re-listing day.

(2) Secondary Market
In overview, the stock market in 2011 can be characterized as moving upward in the first quarter on expectations of a recovery in the economy, then collapsing after the March 11 major earthquake disaster, then moving within a tight range during the second quarter, and following a downward trend in the last two quarters.

In more detail, the stock market kicked off the first quarter of 2011 on January 4 with the Nikkei 225 Stock Average at 10,352, which rose gradually to 10,891 on February 17. Contributing to the upswing were the second round of monetary easing (QE2) in the

United States by the Federal Reserve Board (FRB), strong corporate performances in Japan, and a lull in the appreciation of the yen. Then the major earthquake hit on March 11, followed by the Fukushima nuclear plant accident. In response, the market collapsed from 10,434 on March 10, to 8,227 on March 15. After the initial drop, there was a rebound as the market began to see stocks as undervalued. After the Bank of Japan's further monetary easing, joint currency intervention by the G7, and absorption of the impact of reactions by the U.S. market and others, the stock index recovered to 9,755 by the end of March.

In the second quarter of 2011, the stock index moved within a range of 9,300 to 10,000. On May 2, it broke through to 10,017, but after a while was back down to around 9,500. When the process of buying back into the market after the sharp drop in the wake of the major earthquake disaster ended, a sense of lack of direction developed because of the continued uncertainty about corporate performances and where the economy was headed. With a certain amount of doubt remaining in the market because of the slow recovery of supply chains and other factors, the market struggled upward with little success.

In the third quarter, particularly during September, the market continued to hit successive annual lows. In the United States, August employment figures showed that non-agricultural sector employment had not grown from the previous month and concern about an economic slowdown was heightening. In addition, the market got tired of the uncertainty over the European sovereign debt problem after such incidents as the European Union and the International Monetary Fund (IMF) ceasing their inspections regarding providing Greece assistance. This sentiment resulted in the market falling than the first annual low of 8,605 recorded on March 15 after the major earthquake disaster, to 8,590 on September 6. Furthermore, the G7 finance ministers and central bank governors met in France on September 12, 2011, agreeing to cooperate in measures to deal with the slowdown in the global economy. However, because no new measures were introduced, the crisis in Greece was seen as worsening, resulting in further depreciation in the Euro against the yen and a sell off of export-related stocks in Japan. On September 14, the dollar strengthened to ¥76 and the Euro to ¥104 in currency markets. Consequently, the stock index fell to a new low for the year. And on September 26 the market declined to its lowest level since April 2009.

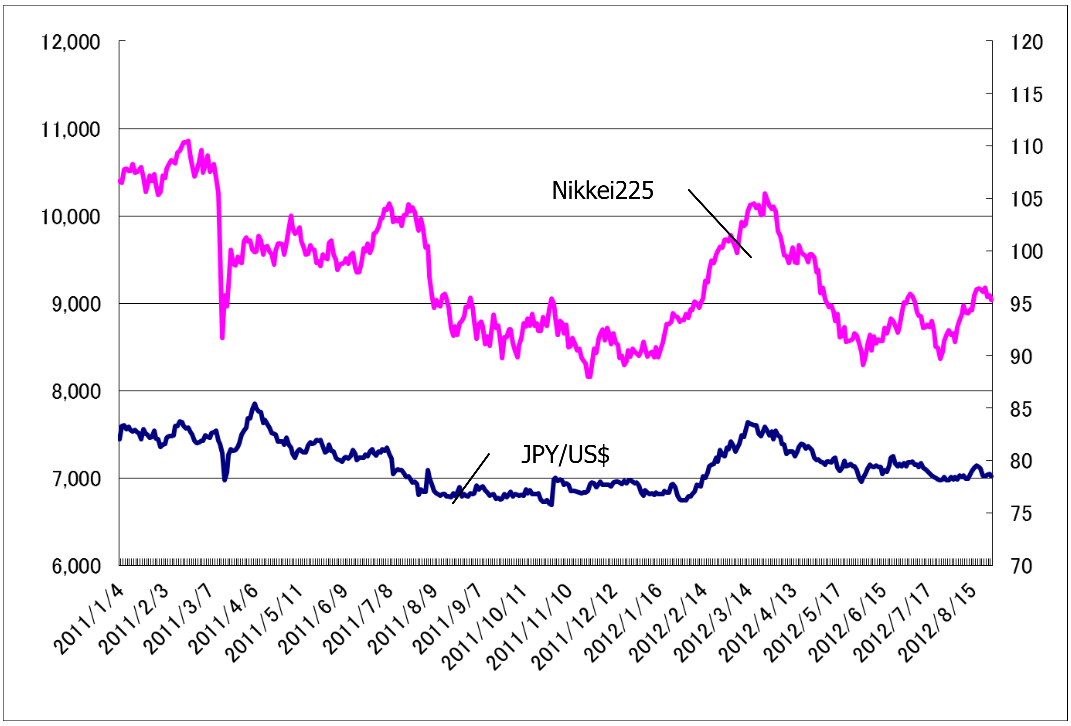
The bear market continued in the fourth quarter as well, amid concern over the jump in the yield on Italian sovereign debt and a growing mistrust of corporate governance in Japanese corporations after the Olympus scandal, which resulted in the company's stock being designated as a supervised issue by the TSE. On November 25, the market slipped to 8,135 at one point. However, it rebounded on a positive monitoring report on aid support for Italy by the IMF and news of the robust Christmas shopping season in the United States, ending the year at 8,455 on December 30.

Summarizing the first and second quarters of 2012, the market rose during the first quarter on the strength of receding anxiety over the debt issue in Europe and expectations of improvement in the U.S. economy, but turned downward again in the second quarter after entering the new fiscal year.

Considering market movement in more detail, after bottoming out at 8,135 in November 2011, the market fought back to 8,466 on January 17, 2012. Factors in the market recovery included successful auctions of public debt by Spain and other Southern European countries and strong economic indicators showing improvement in the economies of the United States and Europe. Moreover, the Bank of Japan's decision on February 14 to undertake further monetary easing in combination with global credit relaxation prompted by Japan, U.S., and European financial policies helped attract funds back into the stock market. On March 27, 2012, the stock index had surged to 10,255.

Nevertheless, the market began to decline in the second quarter, heading into a downward trend after hitting a high of 10,255 on March 27. Factors contributing to the reverse in fortunes included weaker than expected employment statistics in the United States, declining expectation of the further quantitative easing by the Federal Reserve Board in the United States, a resurgence in concerns about the European sovereign debt problem after a jump in the yield on Spanish government bonds, and signs of decline in the economic growth rates of China and other emerging countries. On April 11, the Nikkei 225 fell to 9,388 at one point, and during the long national vacation period in May lost 261 points. The rising opposition to the austere fiscal policies of France and Spain during their general elections and the progressive strengthening of the yen against the U.S. dollar and the Euro contributed to the stock market slump. At the start of May, the yen appreciated to ¥100 against the Euro, having been ¥105, and strengthened to the ¥79 level against the U.S. dollar.

Nikkei 225 Stock Average and JPY/USD Exchange Rate



<Table 5> Key Statistics for Stocks (TSE 1st, 2nd & Mothers)

Year	No. of Listed Companies*	Newly Listed	Total Market Value* (¥ trillion)	Trading Volume (billions of shares)	T. Volume. (daily avg) (millions of shares)	Trading Value (¥ trillion)	T. Value. (daily avg) (¥ billion)	TOPIX*
2009	2,319	23	307.8	563.6	2,319	373.8	1,538	907.59
2010	2,280	26	310.5	520.1	2,123	359.2	1,466	898.80
2011	2,279	50	255.9	536.8	2,191	347.1	1,417	728.61

(Note) *as of end of year

(Source) TSE Monthly Statistics Report

<Table 6> Market Share & Trading Balance by Types of Investors
-Tokyo, Osaka, Nagoya -

Year	Member Account*	Individuals	Foreigners	Investment Trusts	Business Cos.	Life & Non-life	Citi BK & Regional BK	Trust BK	Other Financial Institutions
Market Share									
2009	26.5%	21.5%	39.0%	2.4%	1.2%	0.3%	0.1%	5.7%	0.1%
2010	24.2%	17.6%	47.2%	2.0%	1.0%	0.4%	0.1%	5.0%	0.1%
2011	19.5%	16.0%	54.5%	1.8%	0.9%	0.4%	0.1%	4.9%	0.1%
Net Selling (-)/Buying (+) (¥billion)									
2009	-1,987	-866	1,777	76	-184	-418	-277	1,440	-184
2010	-1,299	-2,277	3,210	17	-273	-631	-245	962	-34
2011	- 3,150	5	1,972	- 138	617	-575	-81	789	30

(Note) *Proprietary trading by exchange members
(Source) TSE Monthly Statistics Report

2. Bond Market

(1) Primary Market
In 2011, public and corporate bond issuance in Japan decreased ¥5.1 trillion, or 2.5%, from 2010, to ¥193.3 trillion. Accounting for the largest share of the market, JGB issuance totaled ¥164.0 trillion, remaining almost the same as last year. Among general bond issuance other than JGBs, municipal bonds amounted to ¥6.7 trillion compared with ¥7.6 trillion in 2010; Government-guaranteed bonds were ¥3.2 trillion compared with ¥4.5 trillion last year; Fiscal Investment and Loan Program (FILP) agency bonds totaled ¥5.6 trillion compared with ¥5.0 trillion the year before; and straight corporate bonds were ¥8.5 trillion compared with ¥9.7 trillion last year. Overall, bond issuance in this category declined in 2011 except for FILP agency bonds.

Looking at corporate bond issuance by comparing figures of April each year, a total of ¥1.2 trillion was issued during April 2010. In comparison, issuance dropped more than 50% to ¥0.5 trillion in April 2011 because of the successive cancellation of planned issues in the wake of the March 2011 major earthquake disaster and the Fukushima nuclear plant accident. Issuance continued to fall year on year even after that period with the exception of September 2011. Some of the reasons behind this trend are that electric power company bond issuance has yet to make a full-scale recovery and corporate demand for capital remains low.

<Table 7> Public and Corporate Bonds

(¥ trillion)

Year	Trading Volume(face value)			Issuing Amount			
	JGB	Others	Total	Public Debt Securities (JGB)(1/)	Corporate Bonds (2/)	Non-Resident Issues (Yen-denominated)	Total (3/)
2009	8,458	105	8,563	162.6(145.6)	11.6	1.3	180.0
2010	7,453	100	7,553	182.9(165.8)	9.8	1.7	198.4
2011	7,860	104	7,964	179.5(164.0)	8.5	1.8	193.3

(Source) Japan Securities Dealers Association

Notes: 1. JGBs do not include bonds placed in the public sector or financial bills (financial bills included in treasury bills). Public bonds other than JGBs comprise municipal, government-guaranteed, and FILP agency bonds (including regional public corporation bonds).

2. Corporate Bonds comprise straight corporate bonds (including investment company bonds), convertible-type bonds with subscription rights (CBs), and asset-backed corporate bonds.

3. The total figures are not equal to the sum of individual categories because they include bank bonds, private placement corporate bonds and private placement government bonds.

(2) Secondary Market

In overview, in 2011 the long-term interest rate moved slightly upward in the first quarter amid expectations of improvement in the economy, but slid downward in the second quarter following the decline in rates overseas and other factors. The decline continued through July and August, then moved in a tight 1% range through the third and fourth quarters.

In greater detail, during the first quarter of 2011, the long-term interest rate climbed higher in anticipation of the Japanese economy breaking out of a lull. After the March 11 major earthquake disaster, however, the Nikkei 225 Stock Average plunged to 8,200. Capital flowed into the bond market, driving the long-term interest rate, which had been testing the 1.3% mark, down to 1.145% at one point. The rate then followed the movement in the U.S. long-term interest rate at around 1.2%.

In the second quarter, a variety of factors combined to put upward pressure on the long-term interest rate. Entering the new fiscal year, the market observed the increase in JGB issuance to fund recovery and restoration after the major earthquake disaster, long-term interest rates were rising overseas, and the central banks of Europe raised their rates—all these factors created a sense of rates climbing in future. Entering May, the U.S. long-term rate was around 3.3%, but sunk suddenly, falling to the 3% level by the end of the month. The Greek sovereign debt problem caused a flight to quality that sent yields on German government bonds tumbling. Japan's long-term interest rate also declined, falling to 1.105% at one point on May 16.

In the third quarter, the drop in rates in July and August stood out. National debt problems in the United States and Europe fueled a continued flight to quality, resulting in capital flowing into Japanese and German government bonds. Incidents included the raising of the national debt ceiling in the United States and the sell off in Europe of Italian government bonds, which had previously been considered safe.

The long-term interest rate in Japan seesawed back and forth throughout the fourth quarter. After falling below the 1% mark, fear of higher bond prices heightened, and the Japanese market interest rates followed the European rates upward at one point. However, after the long-term interest rate had risen, there was a robust round of purchasing by pension plans, life insurance companies, and other investors.

Outlining concrete movement during January to the most recent period in August, the long-term interest rate stayed around 0.9% during the first quarter of 2012. However, after the start of April, the interest rate movement fell into decline.

More concretely, in 2012, after the start of the new calendar year, there was upward pressure on the long-term interest rate from the progressive weakening of the yen and rising stock prices. Nevertheless, long-term interest rates in Japan remained stable at a low level along with those in the United States and Germany despite some movement toward dealing with the sovereign debt issue in Europe, particularly Greece.

In March 2012, the market's risk appetite dissipated because of weaker than expected employment statistics in the United States, the declining expectation of further quantitative easing by the U.S. Federal Reserve Board, resurgence in concerns about the European sovereign debt problem after a jump in the yield on Spanish government bonds. As a result, long-term interest rates declined, dropping all the way to 0.885% on April 27 despite once having been 1.01% on April 2. The backdrop to this reversal in the optimistic mood of financial markets was a heightened reemergence of concerns about the European debt problem caused by the difficulties in reducing Spain's fiscal debt. In addition, the pace of growth in employment in the United States had slowed as had China's economic growth rate. Amid the change in market sentiment to "risk off" in reaction to the additional quantitative easing by the Bank of Japan and the uncertainty in Greece's political situation, the long-term interest rate fell substantially up to mid-May and had declined to 0.8% by June 27. The market swung down sharply again up to the latter part of July, falling to 0.72% at one point on July 25, the lowest level since June 2003. The long-term interest rate then recovered back to the 0.8% level, but failed to stabilize because of the uncertainty about the European debt problem, direction of the U.S. economy, and other issues.

3. Investment Trust

At the end of 2011, the net assets of investment trusts amounted to ¥57,327.4 billion, falling from ¥63,720.0 billion last year. Stock investment trusts performance was dragged down; sales of stock investment trusts amounted to ¥23,531.8 billion, but value of stock investment trusts under management fell ¥9,082.0 billion. Net assets of stock investment trusts, therefore, contracted to ¥46.761.9 billion. Sales of bond investment trusts declined to ¥35,969.3 billion. As a result, net assets of bond investment trusts declined to ¥8,536.5 billion compared with ¥9,026.0 billion in 2010.

Looking at the composition of household holdings in investment trusts, the balance of net assets held at the end of 2010 was ¥61,846.2 billion. At March 31, 2011, the balance had risen to ¥63,635.6 billion and at June 30, 2011, to ¥64,161.2 billion, for an overall increase of ¥2.315.0 billion from the end of 2010. By the end of September 2011, however, the balance had fallen to ¥56,759.0 billion and further to ¥56,156.2 billion by December 31, 2011.

In terms of capital flows, there was a net inflow of ¥867.1 billion in the first quarter of 2011, of ¥2.391 trillion in the second quarter, and of ¥876.2 billion in the third quarter. There was a net outflow of capital in the fourth quarter of ¥501.0 billion.

Looking at the popularity of individual types of investment trust products, real-estate investment trusts (REITs) and currency-select-type investment trusts were the most popular in the first quarter of 2011. Directly after the major earthquake disaster, there was a movement of funds out of these products, but funds later began to flow back in, resulting in only a temporary decline. In the second quarter, REITs offering high return income dividends were the most targeted by investors. The flow of capital into gold-related investment trusts continued.

In the second half of 2011, the slowdown in the global economy, European sovereign debt crisis, and strong yen created a backlash in the market, which was also reflected in the choices of investors. Some REITs that up to that point had enjoyed great popularity because of their high income dividends began to lower their dividends and see movement out of their funds. Instead, Nikkei 225- and Topics-linked funds gained popularity. The previously popular currency-select-type investment trusts also experienced a change in fortunes. Up to mid-2011, these funds had enjoyed growth driven by the Brazilian real. However, against the backdrop of the sovereign debt crisis in Europe, global investors began to move out of emerging markets, causing the depreciation of the Brazilian real, and in turn movement of funds out of currency-select-type investment trusts. In the choice of currency-select-type funds, investors began to shift into Australian dollars. The increase in the Australian dollar’s share of these funds is thought to be the result of Australia’s position as a developed, natural resource-rich nation that has no record of currency restrictions compared with Brazil’s record of frequent imposition of currency restrictions.

<Table 8> Changes in Assets of Investment Trusts (¥ trillion)

Year	Total	Stock Investment Trusts			Bond Investment Trusts			MMFs		
		Sales	Repurchases	Assets	Sales	Repurchases	Assets	Sales	Repurchases	Assets
2009	61.4	17.8	14.5	50.2	36.5	36.4	8.7	0.9	1.1	2.4
2010	63.7	23.9	17.5	52.4	37.0	36.8	9.0	0.6	0.9	2.2
2011	57.3	23.5	19.7	46.7	35.3	35.8	8.5	0.6	0.8	2.0

(Source) The Investment Trusts Association, Japan

III. Legislative and Regulatory Reforms

1. Partial Revision of the Financial Instruments and Exchange Act

In September 2012, the Japanese Diet passed a bill for amendment of the Financial Instruments and Exchange Act to enhance the international competitiveness of Japan's markets as well as the convenience of those markets for users. The amendment is also intended to improve the financial system in the light of the turmoil in global financial and capital markets and to develop appropriate regulations assuring users of secure transactions. The following are the major amendments being introduced.

• Legal and regulatory frameworks to facilitate the establishment of a comprehensive exchange

Currently, the operators and regulators of securities and financial products and commodity products are separated. To facilitate the establishment of a comprehensive exchange that trades all of these products, the amended act has prepared the way for new systems, including 1) enabling Financial Instruments Exchanges to trade commodity derivatives, 2) integrating the regulatory and oversight functions for a comprehensive exchange under the Prime Minister (Financial Services Agency acts on behalf of), and 3) developing a framework enabling intermediaries and central counterparty (CCP)- to comprehensively handle securities and financial products and commodity products.

• Improving the fairness and transparency of OTC derivatives and related transactions

In accordance with the international consensus for OTC derivative market reforms, the amended act 1) requires the obligatory use of electronic trading platforms for certain OTC derivatives transactions, 2) requires public announcement by the operators of electronic trading platforms of trading and other information, such as price and quantity, and 3) develops an approval framework to enable foreign electronic trading platform operators to offer their services in Japan (Systems for mandatory use of CCPs for clearing and for data storage and reporting of trading information have already been established through the 2010 amendment to the FIEA.).

• Ensuring appropriate regulations to prevent market misconduct

To enhance deterrents to market misconduct, the amendment expanded the scope of the administrative monetary penalty and the authority for necessary investigations. On the other hand, to facilitate the smooth management of company groups, the amendment exempted certain transactions related to reorganization of companies from the scope of insider trading regulations.

2. Self-Regulations

Among methods of increasing corporate capital, the dilution of ownership ratios of existing shareholders that occurs with public or third-party allotment (private placement) capital increases has raised issues regarding investor protection. Amid this debate, the 2011 and 2012 amendments to the FIEA established a system to promote rights offering as an option for corporations raising capital. In response, the JSDA revised its self-regulatory rules, establishing, among others, rules to ensure the implementation of proper underwriting examinations, etc., and to ensure the liquidity of stock subscription rights. In addition, the JSDA announced a list of issues regarding practical implementation based on a consideration of disclosure regulations in the United States.

3. Recent misconducts which undermined investors' trust and deliberation to tackle these issues

Over the recent years, there have been some cases that created mistrust in securities investment as well as the securities industry among the general public. In a few cases, JSDA member firms allegedly involved with insider trading had insufficient management systems for corporate information. In another case, a JSDA member that had diverted assets from customers' accounts failed, resulting in the invocation of the indemnification provided by the Japan Investor Protection Funds.

Under these circumstances, following a resolution by the JSDA Code of Conduct Committee, the JSDA Self-regulation Board and related bodies have started to examine the root causes of such incidents, identify the underlying problems, and deliberate measures for preventing re-occurrences and recovering investor confidence. These bodies will re-examine corporate information management systems, segregation of clients' assets, and ethics and responsibilities among member firm management, targeting a conclusion by the end of 2012.

4. Revision of Financial and Securities-Related Taxation System

Guided by the slogan, "From Savings to Investment," Japan introduced a preferential tax rate of 10% on dividends and capital gains from publicly listed stock and some other securities in 2003. Under the difficult economic and financial conditions in ensuing years, this preferential tax treatment has been extended, but is scheduled to end in 2013, resulting in the tax rising to 20% in the following year.

Despite this situation, basically Japan's government is proceeding with establishing a securities taxation system that will promote securities investment. Specifically, plans call for the 2014 introduction of a tax exemption measure (Japan version ISA) for small amounts of dividends and capital gains from listed stocks and some other securities up to a maximum of ¥3 million over three years. In addition, the government plans to consider expanding the scope of the allowable netting of income and losses on public and corporate bonds, etc., in the tax revisions for fiscal 2013.

Furthermore, the JSDA is requesting the Japanese government to provide a tax treatment measure that supports the formation of education savings for children. The measure would make income on funds invested in an account that can only be used for paying higher education expenses tax free.

IV. Topics in 2011 and 2012

1. Merger of Stock Exchanges

With the advance of electronic transactions and globalization, Japan’s stock exchanges have been facing fierce competition from the electronic trading systems of foreign exchanges and proprietary trading systems (PTSs). Under these circumstances, in November 2011, the Tokyo Stock Exchange (TSE) and the Osaka Securities Exchange (OSE) announced a merger of their operations with a target date in January 2013. The merger of the TSE with its large share of the stock market and the OSE with its strengths in the Nikkei 225 futures and the derivatives markets would give birth to an exchange group with a good balance of strengths in both cash and derivatives transaction markets.

2. Measures to Improve Corporate Governance

In the fall of 2011, there were a series of scandals uncovered about Japanese listed companies that caused severe damage to investor confidence in Japanese capital markets. The scandals included fraudulent accounting methods used to hide investment losses over a prolonged period of time and improper loans made to related parties.

Noting the concern in the market, measures are being implemented from various aspects to improve corporate governance in Japan. Specific issues being addressed are implementing corporate governance that utilizes the function of highly independent directors and improving corporate governance by expanding, reinforcing, and increasing the effectiveness of audit procedures. For the former approach, the TSE has introduced a requirement that companies listed on the exchange have outside directors in their exchange rules despite the government shelving plans to introduce such a requirement in Japan’s Companies Act. For the latter approach, the Japanese Institute of Certified Public Accountants (JICPA) established a study group to examine the state of audits and corporate governance in December 2011. Furthermore, since May 2012, the Audit Committee of the Business Accounting Council has been discussing current methods of dealing with the risk of fraudulent accounting practices, and plans to examine the content, of audit reports in future.

3. Measures to Vitalize the Corporate Bond Market

Japan's corporate bond market is still small compared with the markets in the United States and Europe. Moreover, the issuance of corporate bonds in Japan is still limited to fairly high-rated companies in specific sectors. It is difficult for companies with lower credit ratings to issue corporate bonds. Moreover, the liquidity of the secondary market is low, and compared with measures taken in overseas markets to improve investor confidence in recent years, the price information structure in Japan have not really been adequate. In addition to this background, corporate bond issuance suffered dramatic declines after the occurrence of the major earthquake disaster.

Amid these circumstances, the JSDA set up a Study Group to Vitalize the Corporate Bond Market in July 2009. The study group used sub-committees to focus its deliberations on the four key issues of 1) a review of underwriting examination by securities companies, 2) granting of covenants and information disclosure, 3) corporate bond management, and 4) development of infrastructure for disseminating corporate bond price information. The study group made public its report "Work Toward Vitalization of the Corporate Bond Market" on July 30, 2012. The Study Group is continuing its deliberations, focusing now on measures to realize a more efficient, transparent, and highly liquid corporate bond market.