having drastically reduced their holdings the previous year.

In addition, while dollar currencies (U.S., Cdn and Australian) all appreciated significantly vis-a-vis the yen beginning in July 1995, Japanese institutional investors remained very cautious. Notwithstanding considerable encouragement from the Japanese Ministry of Finance[14] to increase their foreign currency (in particular, U.S. dollar) investments, many large investors continued to reduce their foreign currency holdings. There does, however, appear to have been a significant increase in investments in yen denominated foreign bonds[15] as investors sought to diversify their portfolios but opted to avoid foreign exchange risks. The other phenomenon that grew significantly in fiscal year 1995 was a large increase in retail (small individual investors) investment in foreign bonds, both foreign currency and yen denominated issues. With Japanese interest rates falling to record low levels, Japanese individual investors sought to increase their yields and appeared more willing to assume foreign risks than institutional investors plagued with balance sheet problems. Indeed, a wide variety of shorter term (2 and 3 year) and yen and dual currency (usually yen and Australian dollar) issues emerged during this period in order to capture this market.

The Embassy's Survey of Japanese holdings of Canadian securities and loans clearly mirror the general trends with respect to Japanese portfolio investment abroad. Japanese holdings of Canadian debt assets in fiscal year 1995 declined modestly and the currency composition of those holdings has continued to shift into yen denominated assets. In addition, as noted earlier, there were a number of Canadian provincial bond issues that were targeted at Japanese retail investors.

The outlook for the future remains somewhat uncertain. Clearly the investment environment within Japan has improved significantly since starting the fiscal year. The dollar currencies have appreciated and appear to have stabilized with the U.S. dollar around yen 105-110. The Japanese stock market, while still volatile, has recovered to a Nikkei 225 stock index level above 20,000 and the domestic economic outlook has improved. With respect to Canada, there appears to be growing recognition within Japan that Canada has made very important progress in dramatically reducing its fiscal deficit, both at the federal and provincial levels. In addition, with constitutional issues moving into the back-burner for the time being, yields on Canadian bonds for yen based investors have improved significantly[16].

Nonetheless, Japanese financial institutions are faced with the need to strengthen their

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[14] Indeed, a number of regulatory changes were introduced by MOF in August of 1995 which were intended to encourage further outward portfolio investment.

[15] Bank of Japan, op.cit., Table 6.1, Financial Account, p.34.

[16] CIBC Wood Gundy, Historical Total Returns in the Canadian Fixed Income Market from the Perspective of Canadian and International Investors: 1980 to 1995, February 1996, Table 4, Historical Annual Returns on Government of Canada Bonds in Japanese Yen.