2005 World Economic Outlook

January 2005

Marubeni Research Institute

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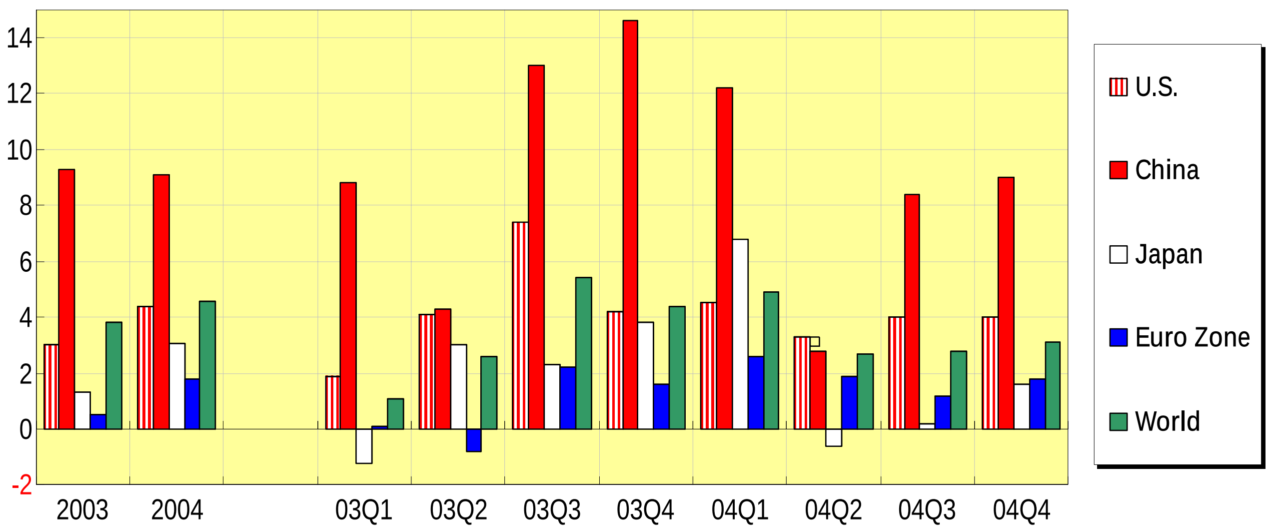
- **Unless otherwise noted, all forecasts in this report are the product of the Marubeni Research Institute.**

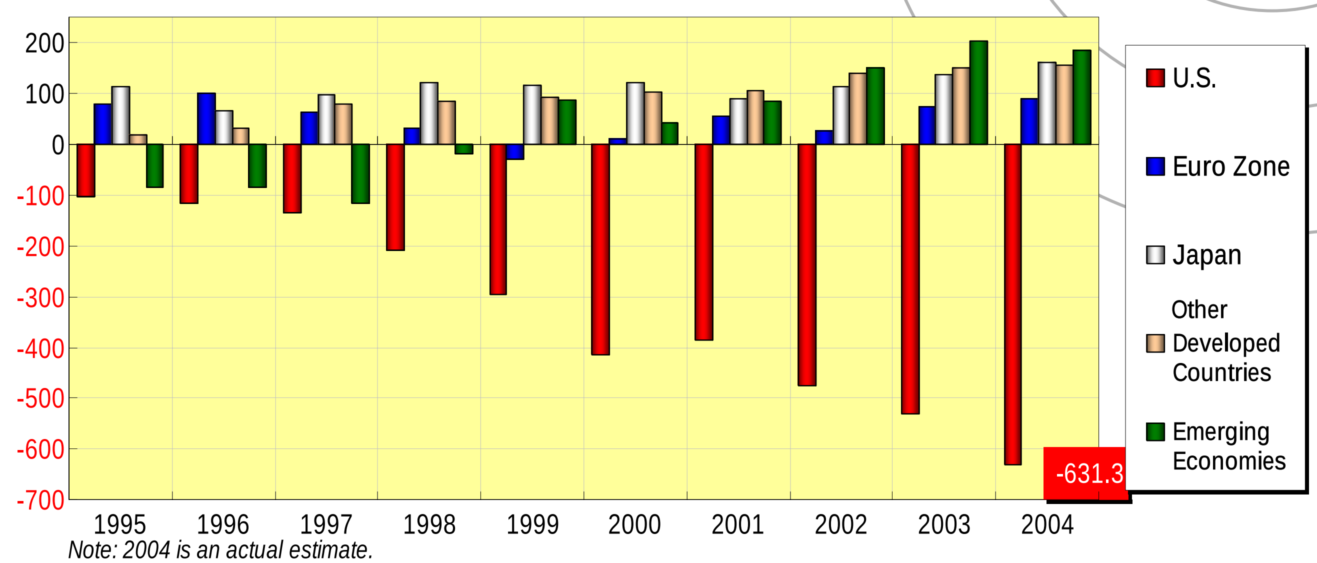
1. Retrospect: World Economy Booms, U.S. Twin Deficits Problematic

Change in Economic Growth in Main Regions



Note: 1. Seasonally adjusted based on the same period the previous year. 2. 2004 and the 4th quarter of 04 are estimates.
Sources: IMF, U.S. Commerce Dept., European Commission, Japan Cabinet Office, China National Bureau of Statistics

Change in Current Account Balances in Main Regions



Note: 2004 is an actual estimate.
Sources: IMF, U.S. Commerce Dept., European Comission, Japan Finance Ministry

- The world economy in 2004 was largely a continuation of the smooth U.S./China driven growth of 2003, with the recovery of the relatively stagnant economies of Japan/Europe/Latin America leading to largely bullish world economic growth.
- Signs of tightening in the U.S./Chinese economies appeared from the spring of 2004 and both economies experienced slowdowns in the second half impacting the Japanese and Asian economies as well as with the general effect being a fall off in the torrid pace of growth in the first half of the year to a slower, but steadier world economic growth track (cruise speed). Stock markets worldwide were stable with stock price levels at the end of 2004 reflecting the outlook for economic growth in 2005.
- The reverse side of the strong global economy is the record U.S. current account deficit, as the world economy's reliance on U.S. domestic demand became ever more evident in 2004. At the same time the U.S. budget deficit continued its climb the result being downward pressure on the dollar in the foreign exchange markets as attention focused on the U.S. twin deficits. The weakening of the dollar and U.S. twin deficits will remain the most pressing concerns for the world economy in 2005.

I. World Economy - General Overview

2. Forecast: Tapers Off to Steadier Growth Pace (Cruise Speed)

Standard Scenario	In the world economy, the influence of slowdowns in the U.S./China economies due to monetary tightening spread to other regions. In 2005 soft landings are expected in both the U.S./Chinese economies, and the world economy, including Japan, will see a return to a lower pace of growth.
U.S.	▪ The economy slows to a moderate level. Personal consumption/capital investment hold steady. Consumer prices stable. Monetary policy goes from gradual relaxation to a more neutral stance. ▪ Dollar depreciation due to the twin deficits and steep oil price rises present risks.
Europe	▪ Exports prop up economy on lagging domestic demand. UK economy ebbs, but growth stable. ▪ Fears over strong euro, sharp oil prices rises remain.
Japan	▪ Sense of stagnation strengthens in fist half of 2005, recovery momentum builds in 2nd half led by business spending. Still, supply and demand gap persists, and deflation lingers. ▪ Risks in aggressive dollar weakening, yen strengthening
Asia	▪ China's succeeds in bringing investment under control and a good balance of exports/personal consumption/capita investment in the economy allows for a soft landing in the 8% growth range. Current exchange rate system maintained, but preparations start for future floating exchange rate. ▪ Other East Asian countries, with the exception of Korea, should maintain stable growth paths. Thailand/Indonesia and other ASEAN countries may be impacted to some extent by the Sumatra earthquake and Indian Ocean tsunami. ▪ The 3 main drivers of India's economy; service, manufacturing and agriculture, should all do well in 2005 with personal consumption and investment expansion providing for sound growth.
Emerging Markets	▪ For Russia, the effect of high oil prices will help maintain economic growth at a high level. But, limits to the amount oil production can be boosted should slow the pace of growth a bit. ▪ In Brazil, the investment/personal consumption led economic recovery will continue. Government fiscal/public debt and other structural problems are improving, advance country business/investor confidence should continue to rise.
Risk Factors	▪ Downward pressure on the dollar from expanding U.S. twin deficits. ▪ Sharp rises in oil prices. ▪ Investment induced re-overheating in China and ensuing inventory adjustments. ▪ Possibility of expanded terrorism worldwide and worsening in the Iraq/Middle Eastern situation.

2005 World Economic Forecast

(%)

	World Ratio	2002	2003	2004	2005
World	100.0	2.9	3.8	4.6	4.0
Developed	52.2	1.4	2.0	3.1	2.4
U.S.	21.0	1.9	3.0	4.4	3.5
Euro Zone	15.8	0.9	0.5	1.8	1.8
Germany	4.5	0.1	-0.1	1.6	1.6
France	3.2	1.1	0.5	2.2	2.1
Italy	3.2	0.4	0.3	1.4	1.6
Japan (Fiscal)	7.0	-0.3	1.3	3.1	0.8
(Cal.)	-	0.8	1.9	2.1	1.0
UK	3.2	1.8	2.2	3.0	2.5
Other Developed	5.2	3.1	1.5	1.5	1.5
Emerging Econ.	47.8	4.7	5.8	6.3	5.7
Africa	3.2	3.5	4.3	4.5	4.5
C/E Europe	3.3	4.4	4.5	5.5	4.8
CIS	3.7	5.4	7.8	8.0	6.6
Russia	2.6	4.7	7.3	7.0	6.0
Asia	27.1	6.4	7.1	7.4	6.7
China	12.6	8.3	9.3	9.1	8.2
NIEs	3.3	5.0	3.1	5.7	4.1
ASEAN 5	3.9	4.4	5.1	5.5	4.8
India	5.7	5.0	7.2	6.4	6.4
Middle East	2.8	4.3	6.0	3.0	3.0
Latin America	7.6	-0.1	1.8	3.7	3.5
Brazil	2.8	1.9	0.5	5.1	3.8

Note: 1. The world ratio is based on the purchasing power parity GDP of each country/region in 2003. 2. 2004 is an actual estimate, 2005 is forecasted.

Sources: IMF, U.S. Commerce Dept., European Commission, Japan Cabinet Office

II. Current Economic Situation/Forecast by Region

1. U.S.: Lower, Steady Growth Pace, Downward $ Pressures Remain

Current — Overcomes economic lull that began in 2nd quarter of 2004.

- Economic growth rate was +3.3% in 2004Q2 over 03Q2 and rose to +4.0% in 2004Q3 over 2003Q3.
  High levels of capital investment maintained, gasoline prices fall, consumer spending recovers.
- Mild expansion in employment, consumer prices stable.
  Business cost control stance unchanged and wage rises remain dull. So prices remain steady even though international commodity costs have climbed. Accordingly, the pace of FRB interest rate rises has been moderate.

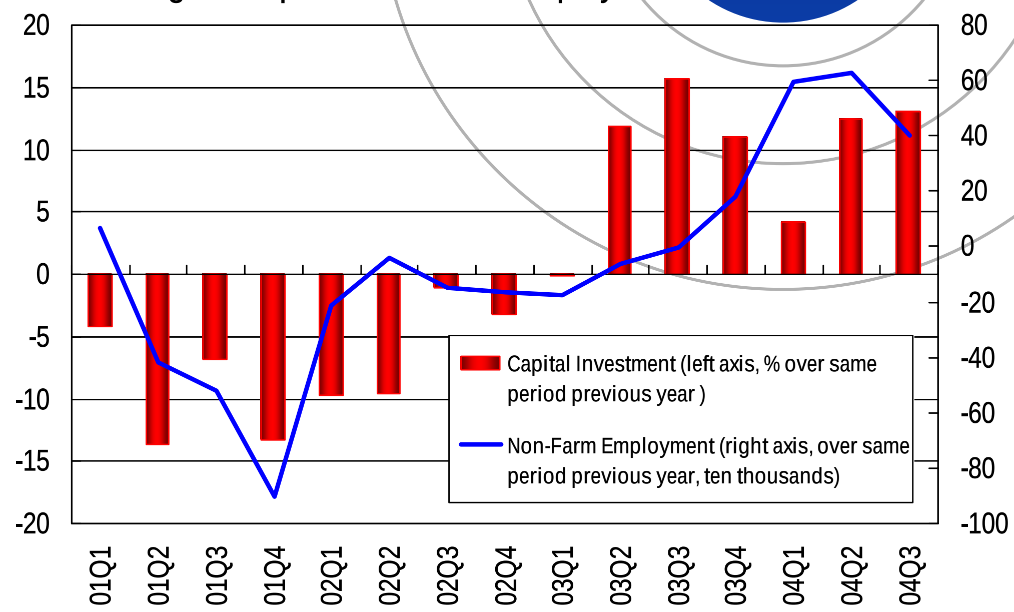
Forecast — Economic growth should settle near the potential growth rate (roughly 3.5%), **and** downward pressure on dollar to continue.

- Personal consumption remains steady.
  Lessening effect of tax reductions/interest rates hikes offset by rises in employment and wages.
- Capital investment by business stays stable.
  Reflection of good corporate performance/expanded personal consumption.
- Moderate rise in consumer prices.
  FRB's FF rate stance moves from easing approach to a more neutral approach.
- Twin deficits continue to create downward pressure on the dollar .
  A solution requires: 1. shrinking the fiscal deficit, 2. increasing savings and, 3. growth in the Japanese/European economies
  Until the market is persuaded otherwise, depreciation pressures on the dollar will continue.

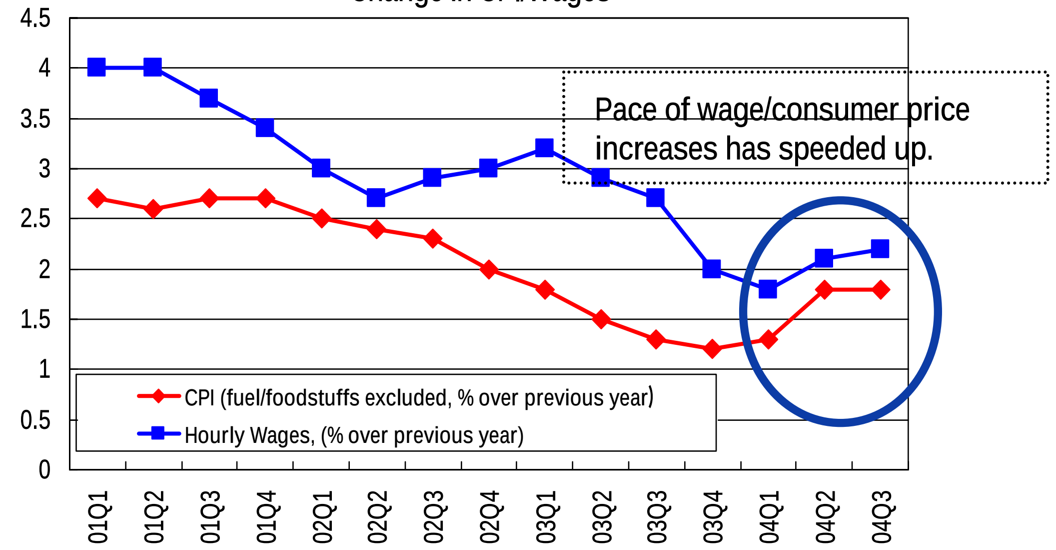
– *Risk Factors*

1. *As the dollar depreciates due to the twin deficits, investment inflows to the U.S. rapidly decrease. Interest rates rise sharply, stock/bond prices fall.*
2. *Oil prices climb sharply.*
3. *Asset effect reverses.*

Change in Capital Investment/Employment



Change in CPI/Wages



<U.S. Economic Indicators>

	2003	2004 (Actual Estimate)	2005 (Forecasted)
Nominal GDP	$11.0 trillion	*$11.7 trillion*	*$12.3 trillion*
Real Growth Rate*	3.0%	*4.4%*	*3.5%*
Personal Consumption*	3.3%	*3.7%*	*3.2%*
Capital Investment*	3.3%	*10.1%*	*8.7%*
CPI*	2.3%	*2.6%*	*2.4%*
Unemployment Rate	6.0%	*5.5%*	*5.3%*
Current Account Balance	-$530.7 billion	*$-579.2 billion*	*$-587.2 billion*
as (% of GDP)	-4.8%	*-5.0%*	*-4.8%*
Fiscal Balance (accg. year)	$-377.1 billion	*$-41.26 billion*	*$-331.2 billion*
(as % of GDP)	-3.5%	*-3.5%*	*-2.7%*

*Note: * Compared to growth rate the previous year.*

Sources: U.S. Department of Commerce, Department of Labor, FRB

II. Current Economic Situation/Forecast by Region

2. Europe: No World Economic Engine as Domestic Demand Lags

Current — Recovery hits ceiling as domestic demand lags, exports slow.

- Domestic demand structurally weak.
  Restructuring ongoing in corporate sector, unemployment rate is high, wages stagnant .
- External demand (exports) sluggish.
  Slowdown in world economy, high oil prices, strong euro.
- Inflation concerns low.
  High unemployment rate, wage hikes unlikely.
- UK economy
  Interest rate rise due to mild overheating of the economy/housing market.

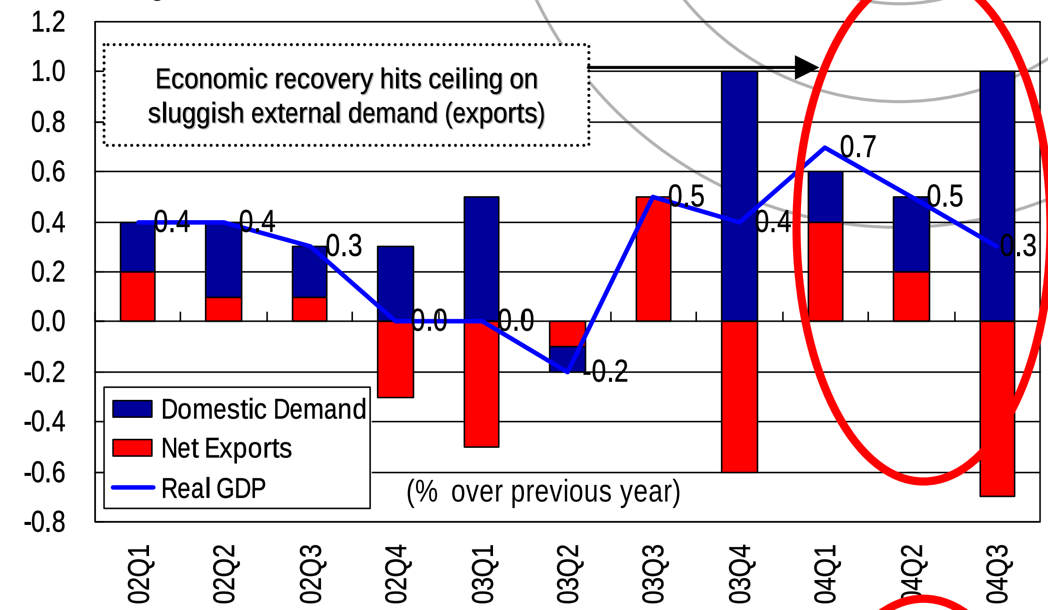
Forecast — Weak domestic demand, net exports prop up economy.

- Sluggish consumption/investment continues.
  Due to excess corporate debt/capacity/labor business spending and employment will remain weak.
- Exports regain vibrancy on overseas demand.
  World economy emerging from flat growth, as oil prices slumber. Although fears over a strong euro remain.
- Probability of ECB (European Central Bank) maintaining current interest policy high.
- UK economy
  Effect of public sector spending should bring soft landing, stable growth.
  BOE (Bank of England) will carefully monitor effect of interest rate stance (hike).

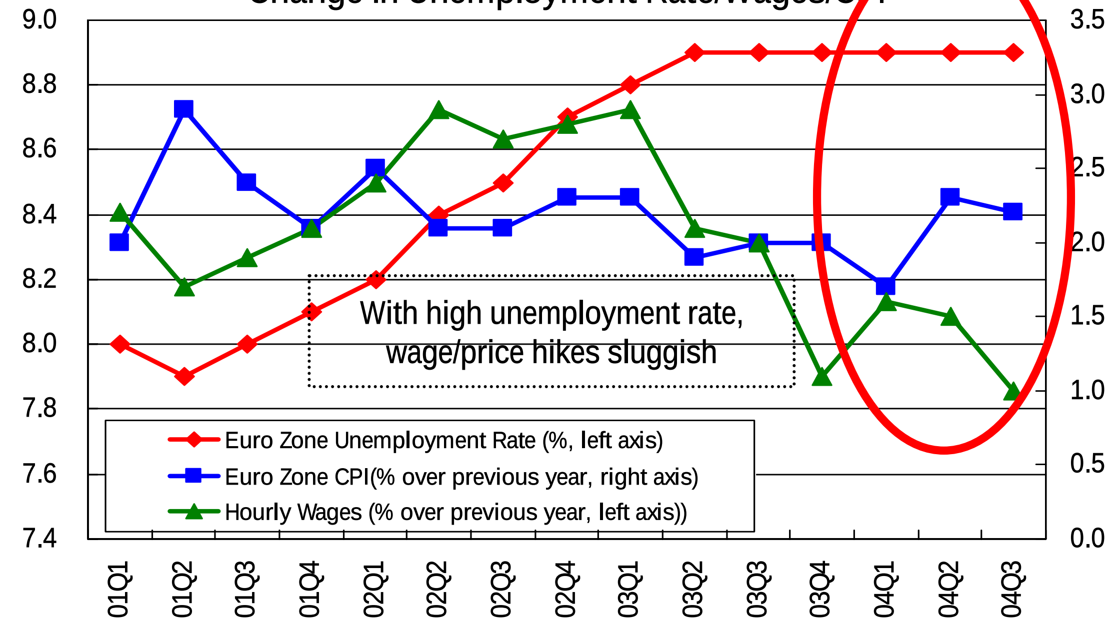
Important Topic: Progress in labor conditions/regulation reform.

- Since expanding the EU, wage freezes/working hour extensions have grown among EU member nations.

Change in Euro Zone Real GDP-Internal/External Demand's Contribution



Change in Unemployment Rate/Wages/CPI



ECB Euro Zone Economic Forecast
(as of Nov. 2004, % over previous year)

	04	05	06
CPI	2.2	2.0	1.6
Growth Rate	1.8	1.9	2.2

3. China: Soft Landing on Slowing Investment, Exchange Rate Debate

Current

China represses investment to escape effects of economic overheating.

- From the beginning of 2004, the Chinese government moved to decelerate investment on warnings of excess investment, however in the January to March period growth was high and investment expanded, inflation speeded up, and international financial markets showed concerns over an overheating economy.
- From spring the government began to place investment curbs on the steel/aluminum/real estate and other sectors using such measures as window guidance and financial regulation to directly reduce investment. By summer investment in fixed assets had slowed moderately and inflation pressures began to subside.
- Personal consumption was strong, while exports gained steam again during the 2nd part of the year, leading to a final estimate of 9% growth for 2004. The increasingly popular view is that macro controls have been mostly successful and the Chinese economy is headed for a soft landing.

- Conversely, banks' have been reluctant to loan money (credit squeeze) restricting the money supply more than the government anticipated, so businesses began turning to unofficial lenders (informal financing) for their capital needs at high interest rates. In October the government/central bank raised the interest rate for the first time in 9 years in response to the lifting of the upper limit of interest on loans.
- Increasing downward pressures on the dollar in the 2nd half of 2004 and the large U.S. trade deficit with China raised expectations of an upward adjustment of the renminbi, however, with only a partial lifting of capital controls by the Chinese government, moves to a more flexible exchange rate system will, in all likelihood, not take place until sometime after 2005.

Forecast

Investment slowdown, export/personal consumption-led soft landing with 8% growth to be achieved.

- Investment cutbacks in overheated industries through regulation replaced by investment in infrastructure and strong personal consumption and exports, lead to balanced demand and an 8% economic growth rate in 2005.
- Current exchange rate regime maintained, it is anticipated that China will gradual ease capital controls/ regulations with the of intention of moving to a floating exchange rate system by 2007.
  - ➡ As far as a risk scenario, if the dollar drastically depreciates, measures may have to be approved to allow for wider exchange rate fluctuations so the renminbi can be revalued upward to its true level.

China's Main Economic Indicators

(% over prior year)

	2000	2001	2002	2003	2004	
Real GDP	8.0	7.5	8.3	9.3	9.5	Jan.-Sept
Retail Sales	9.7	10.1	11.8	9.1	13.2	Jan.-Nov.
Fixed Asset Investment*	10.3	13.1	17.7	28.4	28.9	Jan.-Nov.
Industrial Output	11.4	9.9	12.6	17.0	16.8	Jan.-Nov.
CPI	0.4	0.7	-0.8	1.2	4.0	Jan.-Nov.
Money Supply	12.3	17.6	16.9	19.6	14.0	end Nov.
Exports	27.8	6.8	22.4	34.6	35.7	Jan.-Nov.
Imports	35.8	8.2	21.2	39.9	37.3	Jan.-Nov.
Trade Balance ($ million)	241.1	225.5	304.3	254.7	208.4	Jan.-Nov.
Foreign Exchange Reserves ($ million)	1,613.4	2,121.7	2,864.1	4,032.5	5,145.4	end Sept.

*Note: * Until 2003 state run companies, from 2004 all industrial investment in urban areas, residential housing in industrial zones. Sources: China National Bureau of Statistics, People's Bank of China*

- The crux of the problem is that reform of the financial/ exchange rate systems are far behind development in the actual economy. Due to the fact that China's financial system doesn't function as a true market mechanism, interest rate and other indirect financing policy options are not put to use. Speeding up financial reform, including the strengthening of national banks, will be a major issue in 2005.

Change in China's Investment in Fixed Assets

(over same period prior year)

	2003	04/1-4	04/1-6	04/1-9	04/1-11
Fixed Asset Investment	28.4	42.8	31.0	29.9	28.9
Manufacturing	39.1	65.1	42.0	41.7	39.2
Textiles	66.7	61.5	33.2	28.9	27.6
Chemicals	61.3	73.5	47.1	51.0	42.0
Minerals/Ores	54.1	97.3	53.8	48.7	45.2
Iron/Steel	87.2	90.1	51.5	34.2	33.9
Non-Ferrous Metals	68.7	82.9	40.9	32.6	24.4

Source: China National Bureau of Statistics

4. Asia: Growth Lower on High Oil Prices/China Slowdown

NIEs	Economic growth slows as high oil price fears materialize.
Korea	▪ Exports strong, but sluggish private consumption causes economy to cool. Government employs special repeal of consumption tax, Bank of Korea lowers interest rate in August and November to spur economy. ▪ Still, as households place priority on paying off debt, interest rate cuts have little effect. In all probability a real recovery in consumption will require more time, so the economy will likely lack punch in 2005.
Taiwan	▪ Driven by business investment, Taiwan's economy performed well throughout 2004. Exports and personal consumption were also bright spots. However, as adjustments to IT related production/investment in the 1st half of 2005 are unavoidable, the economy will slow somewhat.
HK	▪ Due to the effect of the economic partnership agreement with China (CEPA), HK's growth rate was 8% in 2004. With a minor economic slowdown expected in China, HK's economy should level off a bit, but maintain a stable growth path.
Singapore	▪ Both Singapore's manufacturing and service industries performed very well, while personal consumption/investment/exports were all up as Singapore's enjoyed high growth in 2004. With IT production corrections, a slowdown in the world economy and high oil prices expected in 2005, the pace of economic growth in Singapore should decline to a more moderate level (mild expansion).

Economic Forecast - Main Countries of Asia

	1998	1999	2000	2001	2002	2003	2004 Estimate	*2005 Forecast*
Asia Total	3.2	6.3	6.9	4.9	6.4	7.1	7.4	*6.7*
NIEs	-2.4	8.0	8.5	0.8	5.0	3.1	5.7	*4.1*
Korea	-6.9	9.5	8.5	3.8	7.0	3.1	4.8	*4.0*
Taiwan	4.6	5.4	5.9	-2.2	3.6	3.3	5.9	*4.3*
HK	-5.0	3.4	10.2	0.5	1.9	3.2	8.0	*4.5*
Singapore	-0.9	6.9	9.7	-1.9	2.2	1.1	8.5	*3.7*
ASEAN 5	-8.4	3.0	5.3	2.6	4.4	5.1	5.5	*4.8*
Thailand	-10.5	4.4	4.8	2.1	5.4	6.8	6.0	*5.0*
Malaysia	-7.4	6.1	8.9	0.3	4.1	5.3	7.2	*6.0*
Indnesia	-13.1	0.8	4.9	3.5	3.7	4.1	4.7	*4.5*
Philippines	-0.6	3.4	4.4	1.8	4.3	4.7	5.7	*4.0*
Vietnam	3.5	4.2	5.5	5.0	5.8	6.0	5.0	*5.0*
China	7.8	7.1	8.0	7.5	8.3	9.3	9.1	*8.2*
India	5.8	6.7	5.4	3.9	5.0	7.2	6.4	*6.4*

Source: IMF, National Statistics

ASEAN	Demand-led growth maintained. Slowdown possible on high oil prices.
Thailand	▪ High growth sustained in 2004 on the wheels of domestic demand and exports. In 2005, due to high oil prices, inflation pressures may increase making monetary tightening unavoidable and slowing economic growth.
Malaysia	▪ Private consumption and exports drove economic expansion in 2004 to highest level in 4 years. Domestic demand should remain healthy in 2005, though the effect of high oil prices and adjustments to IT production levels may slow economic growth prospects.
Indonesia	▪ Personal consumption showed vigor, but exports and capital spending were stagnant in 2004, so Indonesia's economic recovery lacked strength. Even with high expectations for the new Yudhoyono government and a possible recovery in investment levels in 2005, stagnation will likely continue.
Philippines	▪ 2004 brought a consumption-led recovery supported by income remittances from overseas ($7 billion for the year). There are concerns though over high oil prices and the slow pace of structural reform, which has resulted in low investor confidence toward the Philippines. 2005 should see mild economic growth levels.

- The Sumatra earthquake and Indian Ocean tsunami, which mostly affected Thailand and Indonesia among the ASEAN countries, could have a damaging effect on the tourism industry throughout ASEAN. However, the general viewpoint is the effect will be short-term and limited.

India	India on steady growth track spurred by the 3 central sectors of agriculture, heavy industry and services.

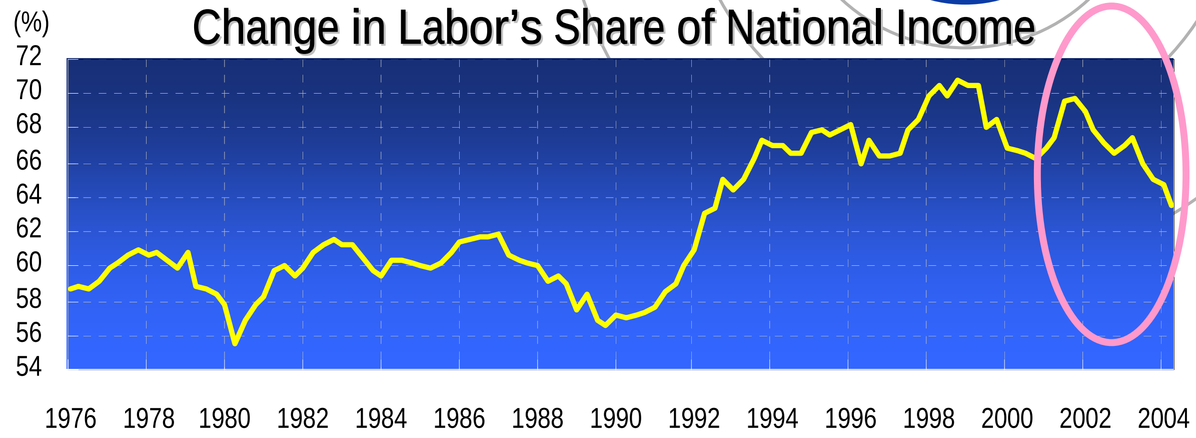
- Growth was lower in 2004 as agricultural production slowed (2003 harvest was much better than the average year), but manufacturing and services were bright and economic growth was generally steady as consumption/investment grew on strong demand.
- Heavy industry and services will likely continue their strong performance in 2005. If agricultural production just reaches levels for an average year, an economic growth rate of 6% should be reachable. The service industry, with IT (software, telecom, financial services) at the core, should enjoy high growth in 2005.

1. Current: Economy on Flat Track, Corporate Sector Strong

Current Exports/capital investment led recovery continues, but on flatter path.

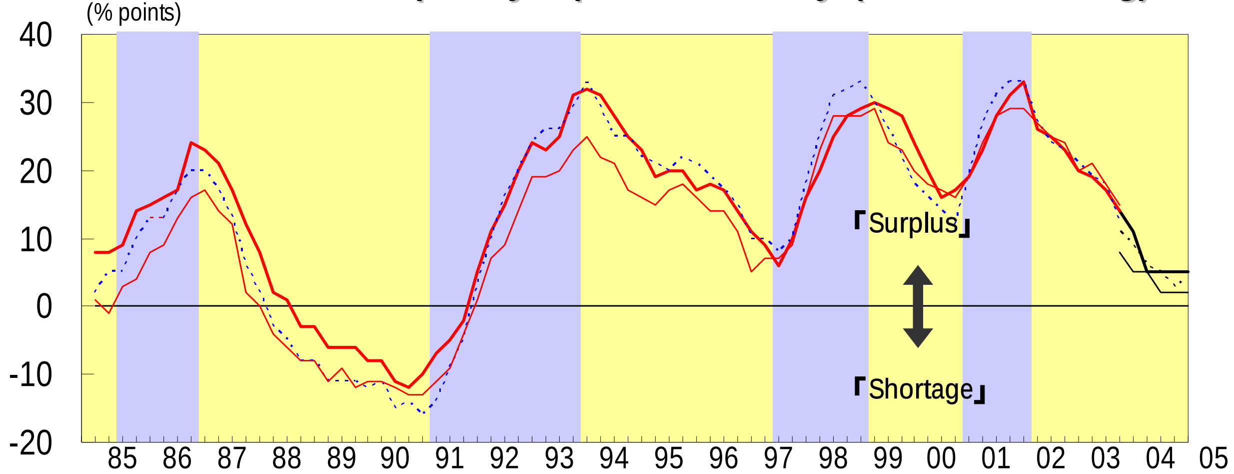
- Exports showing signs of deceleration, leading production sectors of electronic parts and devices bracing for inventory adjustments, the economy currently on a flatter track.
  - Industrial output: For two consecutive quarters, the July to Sept. and Oct. to Dec. periods of 2004, output was estimated to have fallen compared with the previous period.
    Real GDP growth rate: For the July to Sept. period 2004 it was up a paltry 0.2% compared to the same period the year before.
    BOJ short-term survey: A corporate survey taken in Dec. 2004 showed that the business sentiment at large manufacturers had dropped to the lowest point in 1 year and 9 months.
- However, corporate sector is generally bullish due to progress made on the problem of the excessive surpluses of "labor, capacity and debt".
  - Since 2000, the primary drag on Japan's economy has been the problem of surplus labor/capacity/debt held by Japan's businesses, with the attempt to eliminate these excesses exacerbating the recession further by creating deflationary pressures on the economy.
  - However, through the restructuring process, the elimination of excessive labor and capacity is currently close to completion and the reduction of bad debt by companies is making rapid progress. In fact, restructuring has resulted favorably in lowering the break even point and greatly improving the poor financial condition of Japanese companies, which has even help limit the effect of high oil prices.
- Possibility of temporary slowdown in exports high.
  - A lower tempo of growth in the U.S./Chinese economies is dulling Japanese exports, however as the world economy, led by these economies, settles into a steadier growth pace, Japan's exports should regain luster.
- Electronic parts/devices to see production correction as risk measure.
  - Due to the bursting of the IT bubble in the latter half of 2000 and resulting poor conditions, the current standard is to maintain low inventory levels by carrying out inventory adjustments often as a preventive measure, reflecting prudent production planning based on supply side risk effects.
- Stable personal consumption.
  - The rise in national pension premiums and elimination of the spouse tax deduction, etc., has increased households' tax burden, but brighter consumer sentiment based on expectations of economic recovery has pushed up the propensity to consume, plus a moderate improvement in the employment and income climate have brought about a recovery in personal consumption. The rise in oil prices has had slight effect on consumption.

Change in Labor's Share of National Income



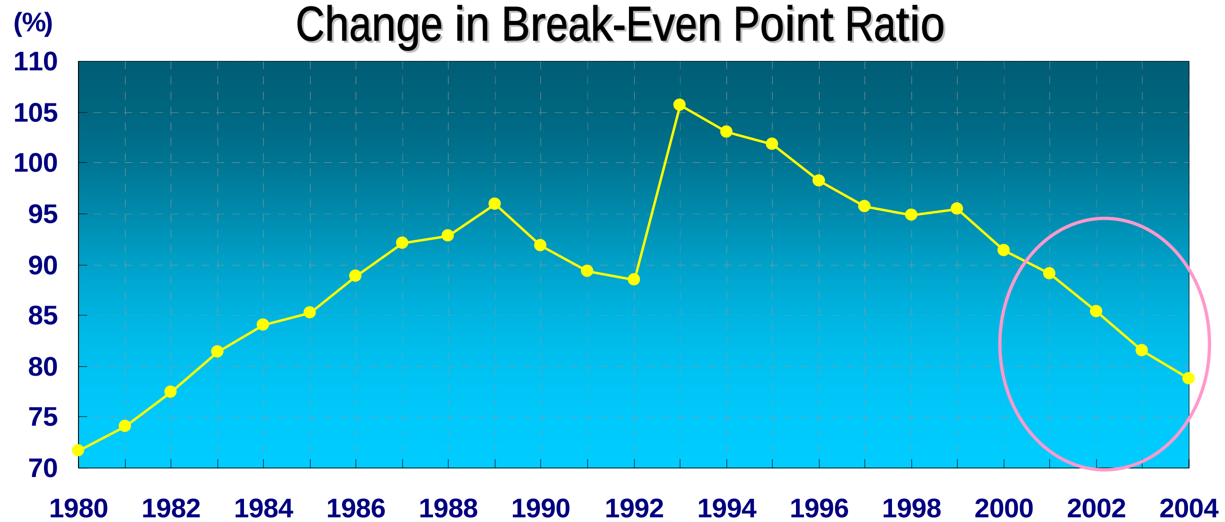
Source: Japan Ministry of Finance

Production Capacity Opinion Survey (Manufacturing)



Source: Bank of Japan

Change in Break-Even Point Ratio



Source: Japan Ministry of Finance

2. Forecast: Corrections in 1st Half of Fiscal Year to Rally Economy

View of Main Demand Factors

Exports	The economy slowed from fiscal 2004, but strong demand in Asia, led by China, should support resurgent exports, which in turn will buttress economic recovery.
Capital Investment	1st half of 2005 saw a fall off in digital electronic device-related capital spending, however business investment in many other industries was strong, so capital spending overall increased. By the 2nd half of the fiscal year, digital electronic device-related capital investment adjustments should be completed and companies, with expected ample cash flow, should become active again on the spending front, pulling the economy along in the process.
Personal Consumption	Although dull, the recovery should be maintained. The burden on households will increase as up to 50% of tax cuts are eliminated, and business continues its cautious stance toward wage rises, however, employment will be better than expected and the possibility of consumer sentiment growing cold is slim.

Standard Economic Scenario for Fiscal 2005

- There is a strong likelihood of temporary economic stagnation in the 1st half of fiscal 2005, however, momentum for a recovery will build in the 2nd half led by business spending.
- The real GDP growth rate for fiscal 2005 will be 1% (2.1% in fiscal 2004). The growth rate will be especially low in the 1st half of fiscal 2005, but should recover to 1.6% in the 2nd half.
- Because growth will fall under the potential economic growth rate (about 1.5%) for most of this period, slight deflation will continue, with a nominal GDP growth rate of around 0.3%. The conditions to allow the Bank of Japan to do away with its quantitative easing policy, "a stable CPI in the plus range", will not occur and the bank will not abandon this policy until sometime after fiscal 2006

Risk Factors	The effect of the U.S. twin deficits on the foreign exchange market is a major concern, especially a drastic strengthening of the yen and weakening of the dollar. This could have a recessionary effect on a Japanese economy being pulled along by exports.

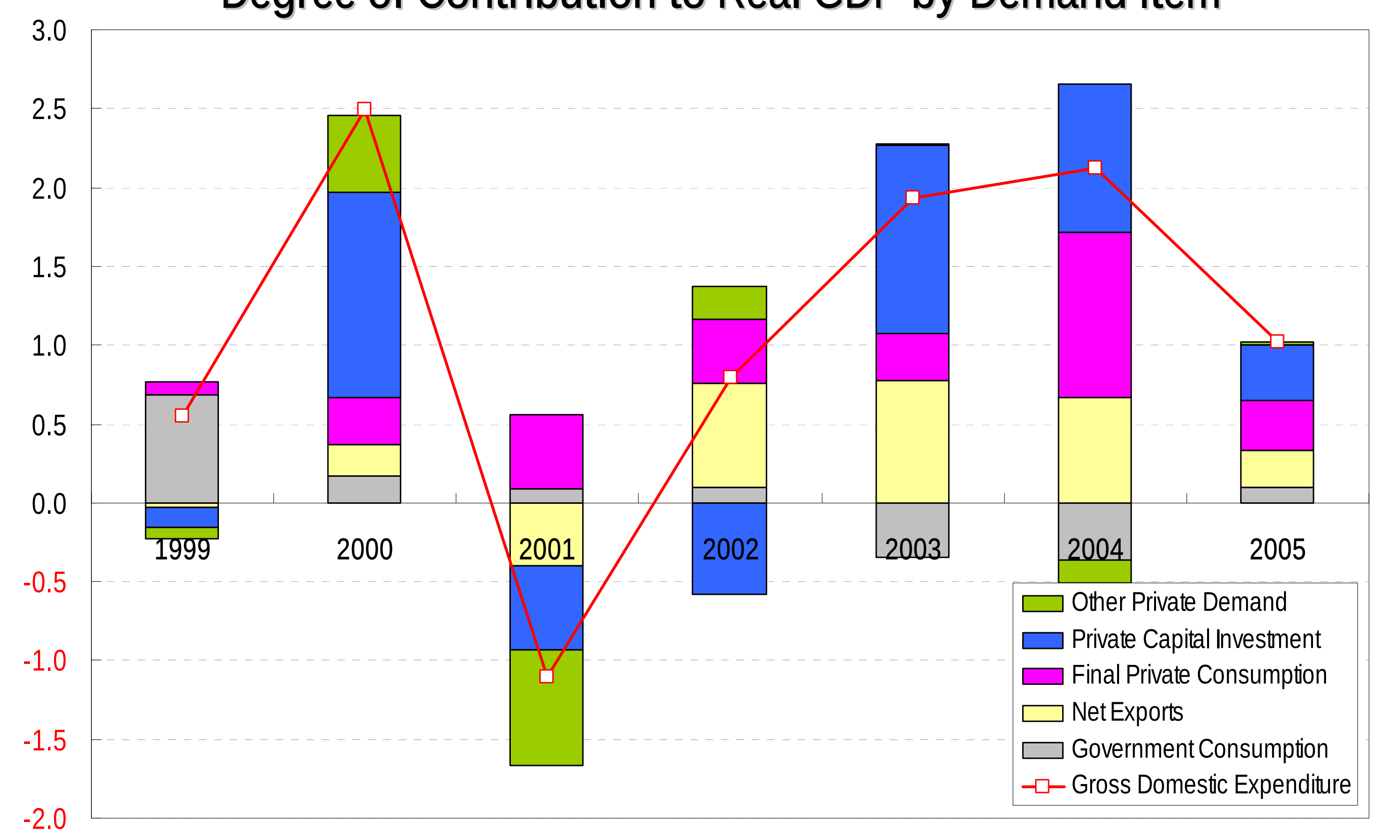
Change in Real GDP

(Compared to previous period year before at annualized rate)

	Fiscal 01	Fiscal 02	Fiscal 03	Fiscal 04			Fiscal 05		
					1st Half	2nd Half		1st Half	2nd Half
Real GDP	-1.1	0.8	1.9	*2.1*	1.4	*1.1*	*1.0*	*0.7*	*1.6*
Final Private Consumption	0.8	0.7	0.5	*1.9*	1.7	*0.8*	*0.6*	*0.5*	*0.5*
Residential Investment	-7.9	-2.3	-0.5	*1.8*	3.0	*0.6*	*-1.7*	*-3.6*	*-0.2*
Private Capital Investment	-3.4	-3.8	8.2	*6.0*	7.4	*2.7*	*2.2*	*1.1*	*3.9*
Increases to Private Inventories*	(-0.4)	(0.3)	(0.1)	*(-0.3)*	(-0.4)	*(-0.3)*	*(0.1)*	*(-0.0)*	*(0.6)*
Final Government Consumption	2.8	2.4	1.1	*2.3*	3.1	*0.7*	*1.1*	*0.9*	*1.8*
Fixed Capital Formation	-5.1	-5.1	-9.2	*-14.3*	-26.5	*0.6*	*-3.8*	*-2.0*	*-11.6*
Net Goods /Services Exports*	(-0.4)	(0.7)	(0.8)	*(0.7)*	(0.7)	*(0.2)*	*(0.2)*	*(0.2)*	*(0.3)*
Goods /Services Exports	-7.1	11.0	9.9	*12.4*	12.5	*5.4*	*4.8*	*3.9*	*6.0*
Goods /Services Imports	-3.9	4.9	3.4	*8.4*	8.8	*5.1*	*3.8*	*2.7*	*4.6*
Nominal GDP	-2.4	-0.7	0.8	*0.7*	-0.0	*0.7*	*0.3*	*-0.1*	*0.9*
Nominal GDP (amount, triliions)	501.0	497.2	501.3	*504.9*	504.1	*505.7*	*506.7*	*505.6*	*507.8*

*Note: 1. * Degree of contribution compared to prior year. 2. Italics represent Marubeni Research Institute forecasts. Source: Japan Cabinet Office*

Degree of Contribution to Real GDP by Demand Item



1. Keywords: BRICs, Notably China - Links, Price Pressures, Potential

① ***Raw/intermediate material supply links to China and other BRICs for "making goods" to remain strong*** ***(steel, non-ferrous metals, petrochemicals, electronic parts, etc.)***

② ***Pricing/cost pressures from rising raw/intermediate materials, freight/shipping costs an issue*** ***(foodstuffs, apparel, steel, petrochemicals, etc.)***

③ ***Even within the same industries, it is an era of winners or losers, depending on how well technology and other potential are developed/employed.***

Textiles/Apparel

- Textiles for industrial use strong. Effect of mild winter and rising yarn prices have pressured earnings in apparel. 3 years have passed since China joined the WTO, and depending on the progress in lifting quotas Chinese exports of functional textiles and fabrics, etc., should expand.

Steel/Non-Ferrous Metals

- Steel exports to China continue to be strong, robust domestic/overseas demand has production running at full capacity. Sharp price rises of iron ore, coking coal, other main steel materials seen. Steel material supply/price pressures a concern. Healthy demand for non-ferrous metals, motor vehicles, digital appliances expected to continue.

Oil

- Sharp oil price rise has receded somewhat, but the influence of tight world oil demand and supply should keep prices in the upper range. Price pressures on oil products for industry a worry for refineries.

Petrochemicals

- Has been a temporary fall off in IT related demand. But, with the Beijing Olympics approaching, exports to China will remain strong. The high price of raw materials will be an issue in the industry.

Paper/Pulp

- Domestic demand has been weak. Cheaper paper imports are expected to expand share of the market to around 20%. The question is whether Japan's industry will shift production as consumption grows in China and other Asian countries.

Cement

- Cuts in public work projects to continue. Although exports are healthy, the rise of fuel coal prices has dampened earnings. Domestic and overseas reorganization in the industry likely, including Japan's 3 largest domestic producers.

Food Products/Food Services

- Shift to customer driven low prices in the eat-out market and competitive shakeout trend in the ready-to-eat (delivery, etc.) market. Sharp jumps in vegetable and other foodstuff prices subsides. Beverage industry bullish.

Distribution

- Even with an excess of stores in the industry, there was a growth of new businesses outside the framework of general retailers, specialty stores, etc., with a "survival of the fittest" scenario taking place as structural change in the industry continues.

Motor Vehicles

- Domestic sales show some increase on new model releases. Rise in unit sales prices. Exports to U.S. and Asia good, but the strong yen and steel shortages have raised some concern. The question now is the Chinese market, which is headed toward becoming a 10 million vehicle market.

Appliances/Electrical Machinery/Electronics

- The digital appliance (digital cameras, flat panel TVs, etc.) boom is in a lull, so a short-term inventory adjustment phase is required. However, digitalization is still advancing in the motor vehicle industry, so semiconductor demand will be bullish. A recovery in telecom infrastructure is also foreseen.

Telecom

- Both fixed line and cellular phones are in the throes of a price war. With the spread of broadband (high speed/large capacity) and with "number portability (possible to change telecom companies but keep same phone number)", nearing realization, valued-added competition is intensifying as well.

Industrial Machinery/Machine Tools

- Domestic demand has slowed, the digital appliance boom is in the midst of a lull. And, while exports to China are also down due to China's curbs on inward investment, capital investment by the auto industry and small and medium enterprises in Japan has revived and is strong.

Construction/Housing

- As public work projects decrease, investment in the construction industry remains stagnant. A rise in private demand is expected on the back of demand related to the revitalization of large cities. Strong probability of realignment among mostly mid-size general contractors due to implementation of asset impairment accounting (obligation to record the current value of fixed assets). Although, demand for condominiums remains steady, the reduction in tax breaks may have a negative effect. So, there is some concern of oversupply in part of the industry.

Leasing

- Due to a come back in capital investment in the IT industry, so integral to the leasing industry where information-related machinery leasing contracts make up 40% of the market, demand has recovered. Office equipment and machine tool leasing are also up.

IV. Japan's Main Industry Trends/Topics

2. Bright Spots from Raw Materials to Manufacturing and Services

Hashimoto government increases consumption tax (3%➔5%)

Koizumi government announces 「Structural Reform Without a Sanctuary」

Direction of Japan's Main Industries

Industry	Index	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004 (estimate)	2005 (forecast)	comparison 1990 = 100
Textiles	synthetic fiber production (thousand tons)	1,812	1,826	1,841	1,748	1,773	1,804	1,802	1,822	1,723	1,634	1,623	1,564	1,415	1,179	1,150	1,200	66
Steel	crude steel production (10 thousand tons)	11,034	10,969	9,813	9,962	9,829	10,164	9,880	10,454	9,355	9,418	10,644	10,370	10,774	11,051	1,200	11,200	102
	steel exports (thousand tons)	1,702	1,803	1,898	2,351	2,395	2,299	2,061	2,350	2,765	2,821	2,916	2,950	3,634	3,538	3,600	3,600	212
Non-Ferrous Metals	aluminum ingot consumption (10 thousand tons)	2,270	2,348	2,218	2,080	2,277	2,259	2,312	2,358	1,996	2,024	2,162	1,965	1,620	2,250	2,330	2,390	105
Petrochemicals	ethylene production (thousand tons)	5,810	6,142	6,103	5,773	6,125	6,944	7,137	7,416	7,075	7,687	7,613	7,362	7,152	7,367	7,520	7,600	131
Oil	domestic fuel oil sales (10 thousand kiloliters)	21,717	22,034	22,771	22,550	23,742	24,287	24,681	24,526	23,890	24,471	24,445	23,950	23,762	24,387	23,500	24,000	111
Paper・Pulp	paper/paper board production (thousand tons)	2,809	2,907	2,831	2,777	2,852	2,966	3,001	3,101	2,989	3,064	3,183	3,073	3,068	2,928	2,970	3,000	107
Cement	cement production (thousand tons)	8,444	8,956	8,825	8,805	9,162	9,047	9,449	9,194	8,133	8,012	8,110	7,655	7,635	7,150	6,500	6,500	77
Food	scale of retail food consumption (\1billion)			27,943	27,982	27,926	28,097	28,955	29,678	28,877	28,150	27,177	26,912	26,000	25,027	25,000	24,900	-
Motor Vehicles	domestic production (thousand units)	13,487	13,245	12,499	11,228	10,554	10,195	10,347	10,975	10,050	9,895	10,141	9,777	10,257	10,300	10,530	10,550	78
	domestic sales (thousand units)	7,777	7,525	6,959	6,467	6,527	6,865	7,078	6,725	5,879	5,861	5,963	5,906	5,794	5,829	5,850	5,900	76
	exports (thousand tons)	5,832	5,753	5,668	5,018	4,460	3,791	3,711	4,553	4,529	4,409	4,455	4,166	4,698	4,756	4,800	4,850	83
Appliances	refrigerator sales (thousand tons)	5,114	5,135	4,607	4,469	4,900	4,983	5,309	5,424	5,168	4,880	4,874	4,793	4,196	4,300	4,660	4,660	91
Electrical Machinery	PCs shipped domestically (thousand units)	2,066	1,903	1,766	2,382	3,348	5,704	7,192	6,851	7,538	9,941	12,102	10,686	9,643	9,450	9,600	9,500	460
	value (|100 million)	5,859	5,713	4,942	7,190	9,249	13,916	17,506	16,543	16,327	19,739	21,442	21,253	16,167	16,450	16,600	16,000	273
Telecommunications	cell phone subscriptions (10 thousand units)	87	138	171	213	433	1,020	2,691	3,826	4,731	5,113	6,094	6,912	7,351	7,979	8,770	9,600	11,034
Electronics	semiconductor IC production (\100 million)	26,728	28,798	25,458	26,917	30,940	36,866	36,576	35,507	31,873	34,249	42,546	31,331	29,129	31,696	34,300	36,500	137
Industrial Machinery	industrial equipment orders (\100 million)	86,270	83,655	90,374	83,740	84,630	86,545	89,862	92,715	70,821	65,620	73,084	65,805	60,925	71,000	69,000	70,000	81
	machine tool orders (\100 million)	14,121	11,412	7,102	5,318	5,731	7,755	9,382	11,306	9,890	7,566	9,750	7,889	6,758	8,500	11,500	12,000	85
Construction	construction orders (\100 million)	255,511	260,536	241,233	197,317	191,983	194,524	203,812	188,683	167,747	155,242	159,439	143,383	129,863	128,000	131,500	131,500	51
	private sector portion (|100 million)	192,065	188,776	159,578	121,075	114,195	110,954	121,077	116,190	103,361	96,192	101,397	90,656	88,516	80,800	90,000	90,000	47
Housing	new housing star (thousand units)	1,707	1,370	1,403	1,486	1,570	1,470	1,643	1,387	1,198	1,215	1,230	1,174	1,151	1,160	1,165	1,150	67
Real Estate	metropolitan apartment sales (thousand units)	39.5	25.9	26.2	44.3	79.9	84.9	82.8	70.5	67.3	86.3	95.6	89.2	88.4	83.1	78.0	75.0	190
Distribution	discount store sales (\100 million)	114,561	120,852	119,303	112,635	110,249	108,248	110,390	111,091	106,573	102,854	110,115	96,278	83,447	81,117	78,000	77,000	67
	supermarket sales (\100 million)	94,859	100,790	102,736	102,262	107,679	115,149	119,372	123,039	125,911	128,390	126,224	127,085	126,693	126,526	124,000	123,500	130
	convenience store sales (\100 million)		31,252			40,169			52,234	60,492	63,833	66,804	68,789	69,800	70,967	72,640	73,000	-
Leasing	leasing contracts （\100 million）	84,152	88,016	77,742	71,825	71,164	74,796	81,197	80,770	75,232	73,054	76,515	80,434	75,494	73,300	74,100	75,000	89
	IT related equipment portion (|100 million)	35,670	36,204	32,683	30,053	29,065	29,945	33,706	34,568	32,710	32,461	31,184	31,859	30,150	27,000	27,000	27,500	77

Units/value figures for PCs shipped based on fiscal year. Digital cell phone (PHS included) subscriptions based on figures at fiscal year end.

2003 estimate, 2004 forecast by Marubeni Research Institute based on data taken from each industry.

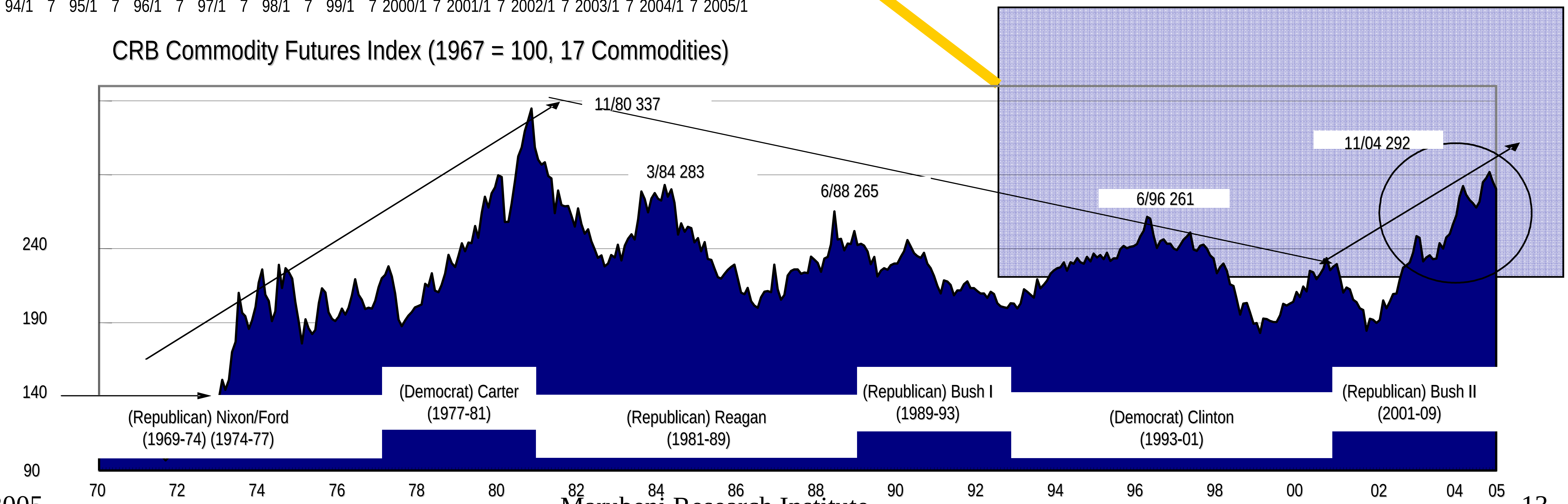
Note: Blue (shadowed) areas show decrease compared to previous year.

1. International Commodity Prices to Continue Climb

CRB Commodity Futures Index (1967 = 100, 17 Commodities)

- In looking at the general movement of commodity prices in the international market in the CRB's (Commodity Research Bureau) Commodity Futures Index we see that in November the index broke through the 290 point mark, the highest price level in 23 years, since 1981. The price level softened a bit from that high by year's end as speculators adjusted position.
- In 2005, due to an expected slowdown in the world economy, the strong pace of commodity price rises should weaken somewhat. Still, with "buy China" and "geopolitical risk" as background, prices should still remain on an upward trajectory. We predict that the CRB price index will reach its highest point in 80 years sometime in 2005.

CRB Commodity Futures Index (1967 = 100, 17 Commodities)

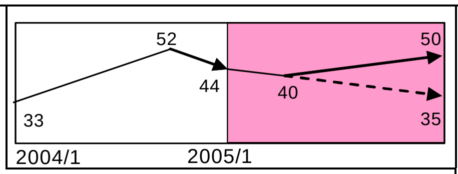


V. Review of Domestic/International Commodity Markets

2. Led by International Commodities, Upward Price Trends Remain

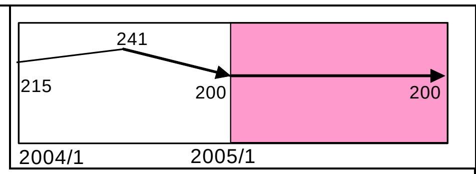
*The colored portion of the graphs are estimates based on the opinions of the Marubeni Research Institute. * Denotes domestic commodities*

Crude Oil
(WTI Futures, $/barrel)



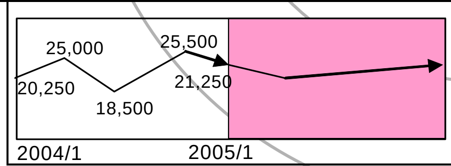
Crude oil – Expanding global demand, declining ability to raise production, falls in OPEC production, geopolitical risks, lead to oil prices in the 40$ p/b range

Natural Rubber
(Singapore Futures, RSS1,



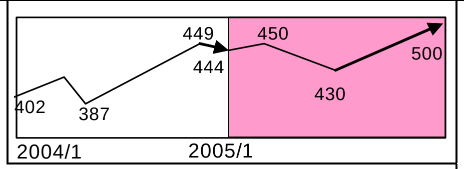
Rubber– Production up in rubber bases of Thailand. Indonesia, etc., but global tire demand robust led by China, so prices should remain at relatively high level。

Scrap Iron*
(H2, maker's purchase price, ¥/ton)



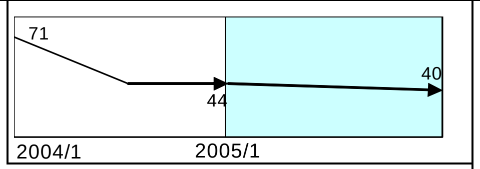
Scrap Iron – China/Asia demand robust, tight supply situation to continue with prices expected to remain high.

Gold
(NY Futures, $/troy oz.)



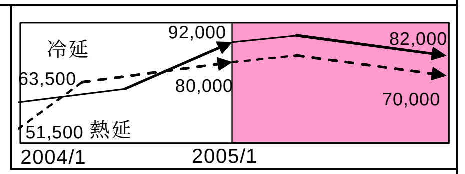
Gold – mining firms purchase trend (stopped hedging), cheaper $, geopolitical risks/etc.., will probably push price to $500 (1 troy oz.)

Cotton
(NY futures, cent/lb.)



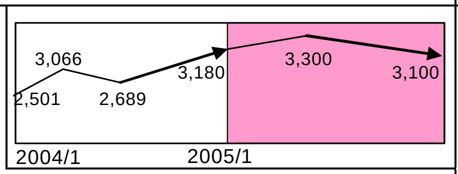
Cotton – Strong harvests in U.S./China in FY04/05 to bring large supply/demand correction. Lower prices increase cotton's competitiveness, but base still fragile.

Steel Sheet/Coil*
(cold- rolled/hot-rolled, 1.6 mm,



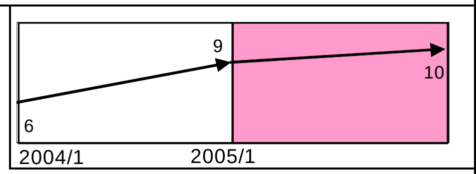
Steel Sheet/Coil – Led by motor vehicle/urban construction demand, supply continues to be tight throughout year. Imports difficult as Asian demand strong.

Copper
(LME Spot, $/ton)



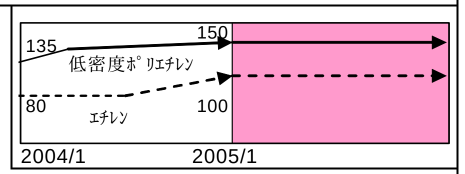
Copper – With Chinese demand rising, supply shortages likely in 2005, prices should stay above the $3000/ton level.

Sugar
(NY futures, cent/pound)



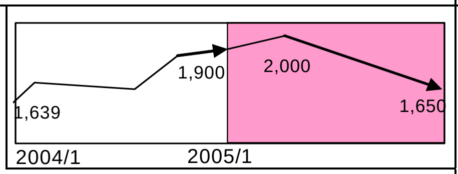
Sugar – Expanding world demand, expected production drops in India, Thailand = surplus demand. Rising demand for alcohol based fuels in Brazil strengthens price.

Ethylene/LDPE*
(Low Density Polyethylene)



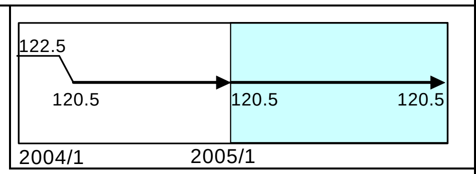
Ethylene – Crude naptha prices rising, upward price pressure on Chinese demand. LDPE – Not only demand in China/Asia, but domestic demand bullish too.

Aluminum
(LME Spot, $/ton)



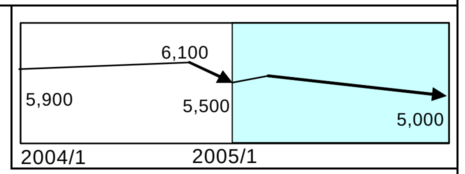
Aluminum – Increased demand from China, etc., could lead to shortages in 2005, prices in the $2000/ton level possible in 1st half 2005.

Fine Paper *
(Publishing A, Tokyo, ¥/ton)



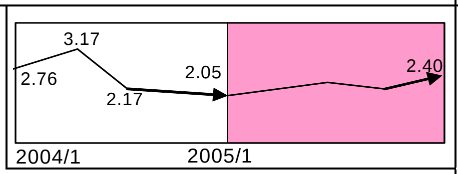
Fine Paper – Demand to strengthen as high fuel/material prices weaken, China's increasing supply capacity/high yen creating importation pressures.

Tropical Lumber*
(Sarawak, Malaysia, ¥/cord)



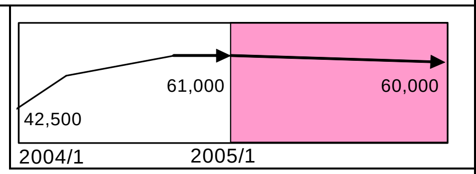
Tropical Lumber – Cutting restrictions, local plywood demand (overseas) constrict supply, but depressed domestic demand/increased conifer production ease prices.

Corn
(Chicago futures, $/bushel)



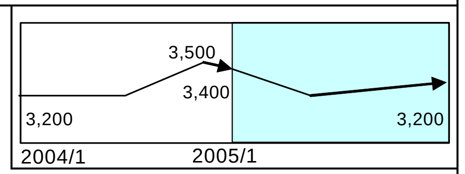
Corn – Strong global harvests in FY 04/05. Demand for corn in fertilizer up, but inventories rise by period end = loose supply/demand. Price climate-dependent.

Steel Bar *
(19 mm. Tokyo, ¥/ton)



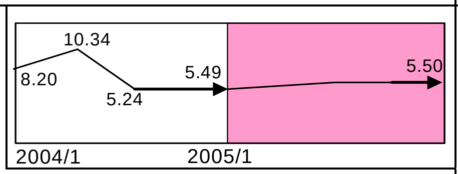
Steel Rod – Higher material prices remain on strong urban construction demand, even though price competitiveness in Asia falling and imports rise.

Frozen Shrimp*
(Indonesian White 8/12, ¥/4lbs.)



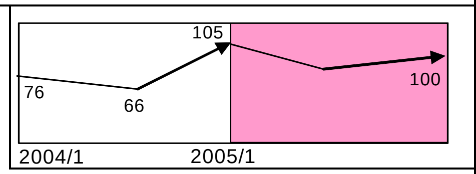
Frozen Shrimp– Demand/supply situation eases in large consuming regions, US/Japan. Anti-dumping tariffs on Asian products weaken downward price pressures.

Soybeans
(Chicago futures, $/bushel)



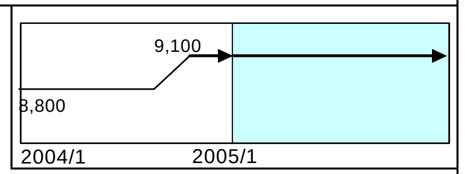
Sotbeans – FY04/05 harvests in U.S./South America at record levels. 5% cut in U.S. inventories in FY 03/04 to rise by nearly 15%. Expected drag on prices

Coffee
(NY futures, cent/lb.)



Coffee – Brazil production increases did not meet expectations in FY 04, quality also off as prices rise. Further fall in Brazilian production in 1st half FY 05 predicted.

Cement*
(Bulk Cargo, Tokyo, ¥/ton)



Cement – Facing a gloomy outlook of ever falling demand, high material costs absorbed by makers, and severely competitive situation continues.

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