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The Dollar's Descent: Likely to Continue

By Scott B. MacDonald

NEW YORK (KWR) -- Foreign exchange markets had an interesting 2003 and it appears that 2004 will perhaps be even more challenging. The combination of U.S. economic policies and improving European and Japanese economic performance add up to an ongoing downward track for the U.S. Dollar. We expect a soft landing, but clearly recognize there is a risk of a hard landing, especially if protectionist sentiment is not controlled. China remains a potentially disruptive X-factor. The Bush administration's backing down on steel tariffs was an important step in avoiding a costly trade war with Europe and Japan and helps to maintain a gentle downward trajectory – at least for the short term. Trade tensions, however, continue as reflected by the Bush administration's tariffs on Chinese textiles and its search for other measures to protect the domestic steel industry.

For the Yen/Dollar, we look to 105-108 over the next 6-8 weeks. The primary pressures on appreciating the Yen are a weak dollar policy on the part of the Bush administration, no increases in U.S. interest rates in the near-term, and improved sentiment about the Japanese economy. In the recent Tankan report, Japanese business sentiment was at its highest level in six years, indicating a sustained improvement in headline sentiment. At the same time, the Bank of Japan is likely to maintain a rearguard action opposed to the Yen rising too quickly. In 2003, the Bank of Japan sold a record Y17.8 trillion ($165.2 billion) in an effort to slow the Yen's appreciation. A few billion more Yen is likely to be deployed in the weeks ahead if it appears that the dollar is set to fall further. If these trends continue, there is talk that the Yen could strengthen to 100 by year-end 2004.

The dollar/Euro relationship has also been one of dollar depreciation. While the Euro was initially a weak currency with a questionable future, it has steadily gained in strength as the dollar declined. Thus far, the dollar has declined 17% in 2003 against the Euro (now trading around $1.23). We think the dollar could weaken to $1.30 per Euro by mid-2004, perhaps sooner. There is even some speculation that the dollar could weaken to $1.40 by year-end 2004 if present trends continue.

While a weaker dollar (pushed along by a soft landing policy) is helpful in bringing the U.S. current account down to more prudent levels, current trends in international currency markets carry a number of risks. First and foremost, the combination of a weaker dollar and no increase in interest rates is likely to make investing in United States financial instruments less attractive (which reinforces our earlier view of a growing chance that the Fed will act before the summer). The U.S. needs foreign investment flows to help pay the current account imbalance.

Secondly and equally important, a rapid strengthening of the Euro and Yen will not be a help to the economic recovery of either Europe or Japan. In both cases, economic growth is sitting heavily on the slender pillar of exports. The Euro is more vulnerable than the Yen because the Bank of Japan is much more willing to intervene. Hiroshi Watanabe, head of the Ministry of Finance's international department, stated late last week that the government is "looking to stablize the currency in the range of 108 to 110 to the dollar." All things considered, we look to a weaker dollar and strong Euro and Yen in the weeks ahead.

A more medium-term concern is China. Asia's largest country has emerged as the workshop for the world, pegging its currency, the Remnimbi, to the Dollar, the currency of its major trade partner. China is clearly in a sprint to make the transformation from a backward agricultural economy into a modern industrial power, a process that began in earnest in 1978 and is still continuing. While Beijing is seeking to pull China up the economic ladder, part of the cost is being carried by the United States, where consumers eagerly buy cheap Chinese-made products, pumped into retail distribution outlets, such as WalMart. Where U.S. consumers benefit, U.S. workers in the manufacturing sector suffer – some 2.6 million jobs have been lost in the United States over the last three years. This loss has been largely attributed to China's low costs and, increasingly, an undervalued currency. It has been said more than once among U.S. labor unions: "Not everyone wants to work at WalMart." In response, Washington has put China under pressure to appreciate the Remnimbi by imposing tariffs on textiles and trade issues are always a topic of conversation during high-ranking government-to-government talks.

What complicates matters for foreign exchange markets is that China is also a major holder of U.S. treasury bonds and government agency paper (i.e. Fannie Mae and Freddie Mac). If the U.S. pushes too hard, China could feel compelled to dump these securities into the market – not a net positive considering the Bush administration's reliance on deficit financing. In addition, a rapid appreciation of the Remnimbi could brake China's strong economic growth (7.5% in 2003). This would ripple through commodity markets (not good news for countries like Canada, Australia and South Africa), slow economic expansion through the rest of Asia and Latin America (Brazil, Chile and Peru are big suppliers of commodities to China), and ultimately clip U.S. exports to China (which is already one of the world's most significant consumer markets). What all of this means is that the Bush administration must carefully balance how hard its pushes for China to appreciate the Remnimbi as it reaches out to the manufacturing heartland of America for the 2004 election and its own medium and long-term national interests. Pushing China into a recession could precipitate a global economic slowdown and make it more difficult for U.S. companies to take part in the world's most rapidly growing consumer market.

One of the ironic twists in the globalization process is that the U.S. is still the global economic locomotive, but China increasingly is emerging as an interrelated partner, badly needed to pick up the slack left by the slower moving European and Japanese economies. In foreign currency terms this means that China's undervalued currency at some point must adjust. The trick is going to be exactly the same issue facing the Dollar's devaluation – how to find a soft landing. If China is forced to appreciate too quickly, there is a hard landing scenario that is no one's interest. We do not see China appreciating the Remnimbi in 2004, but interest rates could go up, leaving 2005 as the year of foreign currency adjustment.

The dominant theme in foreign currency markets in 2004 will most likely be the ongoing depreciation of the Dollar, the appreciation of the Euro and Yen, and ongoing pressure on China to allow the Remnimbi to appreciate, to help reduce Sino-American trade tensions. The key variables will U.S. weak Dollar policy, complemented by further appreciations in the Euro and Yen, while the

Remnimbi is likely to remain in a status quo though Chinese interest rates could go up. If political pressures mount, which they could, the soft landing for the Dollar could shift to a hard landing.

Site-By-Site !
Global and Domestic Investment Information

Does China Represent a Threat or Opportunity for the United States?

(This article is adapted from comments delivered at the recent ***Sino-US Investment Summit*** *in New York.)*

By Keith W. Rabin

NEW YORK (KWR) -- Two years ago there was a lot of anxiety in Asia about the emergence of China. Neighboring countries were worried that China's rise would diminish their national competitiveness. During one meeting in Tokyo I was asked by a senior official whether people in the U.S. were also concerned. At the time people here did not seem overly worried and I answered I did not really think so. He was surprised and asked why not. I answered the U.S. had already faced its China about twenty years ago and it was called Japan.

We both laughed, however, two years later it seems I was wrong. I go to a lot of conferences, though most are internationally-focused and don't really reflect public opinion. Therefore, when I attended a retail investment conference a few months ago, I was amazed when person after person got up during a Q&A session to complain with great passion about job losses and the threat they believed that China represented. In the mid-1990s, KWR International used to do a lot of trade issue work helping Asian government and industry associations to communicate their perspective on autos, semiconductors and steel. This reflected the substantial concern that existed in the U.S. at that time over our rising trade deficit and the loss of manufacturing jobs overseas.

As U.S. economic performance improved during the latter half of the decade, the environment began to change. Asian nations, particularly after the onset of the Asian financial crisis, were no longer seen to be a serious threat. Investor and corporate attention shifted toward the opportunities presented by the dotcom and U.S. productivity "miracle", and trade relations became less confrontational. Now, however, we are starting to see similar rhetoric and pressures being directed toward China. While it is not clear how this will turn out -- with the run-up to the presidential election before us, it would not be surprising to see things continue to heat up -- at least over the coming year.

Interestingly, the Asian countries now seem to have made their peace with China. The anxiety that could be sensed two years ago seems to have transformed itself into a recognition of China's potential. While many in the U.S. complain about an unfair trading environment, Japanese exports to China surged 27.8 percent last October. When trade with Hong Kong is figured in, Japan registered a $778 million surplus for the month, accounting for 63 percent of Japan's export growth in October. In comparison, Japanese exports to the United States fell by 6.2 percent -- their 10th consecutive monthly decrease. Korea has also begun to more fully embrace China. This year Korean trade with China surpassed that with the U.S., and China is now its largest trading partner.

What does this mean in terms of China-related investment opportunities for U.S. companies and investors? The main point is China is here to stay and Americans are going to have to more fully recognize, understand and embrace China if they are to benefit from its emergence as an economic power.

In a recent **KWR International Advisor** article Marc Faber notes statistics that China now ranks as the world's largest producer of cereals, meat, fruits, vegetables, rice, zinc, tin, and cotton. It is the world's second-largest producer of wheat, coarse grains, tea, lead, raw wool, major oil seeds, and coal, the world third-largest producer of aluminum and energy (measured in million tons of coal equivalent), and ranks between fourth and sixth in the production of sugar, copper, precious metals, and rubber. It is also the world's largest manufacturer of textiles, garments, footwear, steel, refrigerators, TVs, radios, toys, office products and motorcycles, just to mention a few of many product lines. He goes on to note that Asia, including China, Japan, South and South East Asian countries have a combined PPP-adjusted GDP of $14 trillion -- 50% larger than the US's PPP-adjusted GDP of $9.6 trillion.

Without going into details about specific China-related companies, ADRS and mutual funds, it should be noted there are many interesting opportunities that allow U.S. and other foreign investors – both institutional and retail – to take advantage of growth in these markets. The same is true for companies seeking to establish new sourcing and manufacturing platforms as well as new consumer and industrial markets.

Put another way, Asia, with China at the center, now has a combined population of 3.6 billion. It also has more favorable demographics than the U.S. and Europe and one of, if not the most, dynamic trading environments in the world. At the same time, Asia's combined equity weighting now totals about 3.4% of world market capitalization excluding Japan. It seems relatively safe to assume while there will certainly be volatility, this will expand over time.

In terms of trade and investment from China to the United States, the New York Times recently reported that China is expected to achieve a trade surplus of some $120 billion this year. U.S. exports to China, however, are not insignificant and during the first ten months of 2002, Chinese exports to the United States stood at $56.5 billion while imports from the U.S. totaled $21.9 billion. Chinese imports include agricultural products, airplanes and aviation, power generation and oil equipment, machinery and electronics, etc.

Resources are especially important. China has become the biggest customer for U.S. soybeans with imports running at levels equivalent to the total production of soybeans in China. The China International Trust and Investment Company (CITIC) has also been active. It owns a steel mill in Delaware and a timber and has owned a timberland company in Washington State for almost twenty years.

U.S. and Chinese firms are also forming cooperative arrangements, though most seem directed toward China and Asia rather than the U.S. China's Shanghai Automobile Company and General Motors, for example, are working together to develop light and heavy automobile models. This joint venture plans to export high performance engines to Canada. Sinopec and Exxon Mobil also formed a strategic alliance and Tsingtao Brewery signed a strategic investment cooperation agreement with Anheuser-Busch. In addition, China's Shanghai Soap Group acquired the bankrupt Moltech, which produces rechargeable batteries in the United States.

According to the Chinese Consulate General in Houston, by the end of 1999, Chinese entities invested in nearly 600 trade and non-trade companies in the United States, involving total investment of US $5.5 billion. One would imagine this figure has gone up since that time. Chinese investments include businesses related to garment making, appliance manufacturing, project contracting, restaurants, transportation, resources, travel service, banking and insurance.

Two notable transactions, which may be seen as harbingers of the future are those by the Haier Group, China's largest white goods manufacturer. It plans to increase U.S. sales to $1 billion in 2004 from $200 million in 2000. Before raising our eyebrows and bemoaning a further loss of jobs in the U.S., it should be noted that Haeir plans to produce most of the extra output from a $30 million plant it opened in South Carolina – which employs a substantial number of local workers. In 2001 Haier also bought a $14 million converted bank building in Manhattan to serve as its U.S. headquarters.

Information on fixed Chinese investment into the U.S. is not easy to come by --though it seems fair to say the total is currently far below that made by U.S. firms into China. Inflows into the U.S., however, are likely to accelerate over time. Chinese firms have become far more active overseas and Chinese tourists represent a dramatically increasing revenue source for many countries.

One Chinese investor Li Yuanhao, is overseeing the U.S. expansion for Holley Group, China's largest producer of electric power meters. He was quoted about two years ago in the L.A. Times about the need for Chinese firms to begin moving offshore, noting "Chinese companies have to decide whether they want to be aggressive and come out of China to get new technologies or sit there passively and be eaten by foreign competition". Holley purchased three U.S.-based firms in 2001 and initiated plans to move to larger quarters in California.

It will be interesting to see whether increased Chinese investment in the U.S. will be seen as positive steps that strengthen the U.S. economy in an environment where there is great concern over plant closures and job cutbacks, or if we will see the same kind of opposition as when Japanese entities began to purchase assets such as Rockefeller Center, the golf course at Pebble Beach and the Seattle Mariners.

Resources and technology, however, are not the only attractions for Chinese companies in the U.S. Chinese executives are seeking to learn more about Western management techniques and to facilitate industrial sourcing. Hangzhou Reliability Instrument Factory, for example, was cited a few years ago for its plans to acquire a U.S. producer of the direct current power modules used in telecom and data transmission. Their plan was to export these products back to China, where a construction and communications boom has created a huge demand for these modules. Lu Qian, chief engineer for the 300-employee firm was also quoted in the L.A. Times noting "The reason we are interested in buying a company in the U.S. is the slowing economy. We think the price of buying a U.S. company is reasonable now."

With the downturn of VC funding in the U.S. Chinese-born Silicon Valley entrepreneurs have also begun to seek their funding back home. The co-founders of ServGate Technology, for example, returned to the mainland to raise funds for their computer network security firm. Beijing Tsinghua Unisplender Group, a leading Chinese high-tech firm invested $500,000 and provided the U.S. start-up with valuable contacts.

In conclusion, KWR International has been seeing more interest in our work from U.S. firms that are seeking to better understand and to develop strategies that will enable them to explore and to enter the Chinese market and to address problems they are having within their established operations. To a lesser extent, we are also talking with Chinese entities seeking the reverse. That is an encouraging trend, which we hope reflects greater interest in the market as a whole. The basic facts dictate that China will represent an increasingly important source of investment, growth and trade in the world economy and any entity that wishes to benefit must adapt accordingly.

Finally, we would be remiss if we did not point out that perhaps the most important Chinese investment in the U.S. is in U.S. treasury bills and other fixed income securities. This dwarfs anything else we have mentioned by a large margin. It has profound implications, and must be examined within the context of global macroeconomics, politics and exchange rates -- as well as the tensions we now see surfacing as a result of the current push by Treasury Secretary Snow and other U.S. policymakers, labor groups and corporate entities to persuade China to revalue its currency.

Given the level of complexity and multitude of issues that must be examined to understand this problem, however, this is something best left for another day. It should be noted, however, that it is far from clear whether a revaluation of China's currency would prove to be beneficial to the U.S. economy and as highlighted in the previous article many analysts and experts predict that it could have a deleterious effect.

Buyside
IDEAS FOR TODAY'S INSTITUTIONAL INVESTORS

Part III - "Zaibatsu" and "Keiretsu" - Understanding Japanese Enterprise Groups

By Andrew H. Thorson

TOKYO (KWR) -- This Article is Part III of a series that discusses the origins of the Japanese corporate complexes and groups that have characterized Japan's modern economy. Part I, explained the origins of pre-WWII zaibatsu. Part II, explained the dissolution of the zaibatsu and the origins of current company groups known as keiretsu. This Part III, will explain typical structures of the current company groups.

Current Company Group Types: As explained in earlier articles of this series, keiretsu is a vague term. The company relationships in Japan that we often hear referred to with this term are probably more diverse in their structure than is generally understood. For example, unlike the zaibatsu, current company groups include not only vertical company relationships, but also horizontal relationships tied together by capital, and company groups tied by transactional rather than capital relationships. These post-WWII intercompany relationships generally can be categorized into three groups:

> (i) the "Big Six" enterprise complexes (Mitsui, Mitsubishi, Sumitomo, Fuyo, Sanwa and Dai-ichi Kangyo, known as the Rokudai Kigyo Shudan in Japanese); provided that some these groups have intermingled during the recent restructuring of the banks and banking systems in Japan;
>
> (ii) vertical company groups, which are held together by capital ties and are typical of large manufacturer company groups; and
>
> (iii) companies tied to groups by business relationships, such as assembler - supplier relationships.

The Big Six – Typical of the Horizontal Type: The Big Six constitute what many people think of when the term keiretsu is mentioned. These company groups are said to typify the horizontal-type keiretsu because the group's business interests extend into diverse fields. Over the years these groups have been characterized by stable vertical cross-shareholding relationships, horizontal affiliations that reach to diverse markets, and possession of large-scale economic resources. Shareholding and other ties of affiliation may be held together through strategies such as cross-stockholding, the dispatch of executives and regular meetings of the companies' presidents (shacho kai).

Common denominations of the Big Six include that each has (or had) a central city bank, general trading company, and insurance company within the complex. It remains to be seen how the recent consolidation of these banks, trading companies and other institutions will affect the longstanding ties within these complexes going forward.

The Big Six have historically had great influence upon the Japanese economy. A 1992 study of the Big Six indicated that while only 0.007% of the registered corporations in Japan were members of the Big Six, this small percentage of the company population controlled 19.29% of the capital, 16.56% of total assets, and 18.37% of sales revenue among such corporations. The typical percentage of intra-group stockholdings among companies in the Big Six has been calculated at approximately 20%. Traditionally, approximately one-third of the cross-shareholding relationships have been coupled with not only capital ties but also transactional business relations. A large number of the vertical company groups (explained below) are also found to be aligned within the Big Six.

Vertical Company Groups: The typical vertical company group is held together in an umbrella-like form with a large-scale enterprise at its apex. In contrast to the zaibatsu and Big Six, the scope of business of these vertical company groups tends to be more closely connected to the original industry of the leading enterprise. Matsushita, ITOCHU, Hitachi, Toshiba, NTT, Tokyo Electric Power and Toyota could be pointed out as examples of this type of vertical company group.

In addition to capital ties, long-term contracts, financial and technological support have all been more or less a part of the foundation that holds together these company groups. Spin-offs have in certain cases led to the expansion of these groups whereby individual plants or divisions became separate legal entities, which entities remained wholly-dependant upon the leading enterprise. One study indicated that in 1995 the largest 30 groups were comprised of approximately 12,577 subsidiaries and affiliated entities.

Overview and Summary: It has been said that the extent of control that members of keiretsu actually hold over other members is difficult to quantify. Some have pointed out that the relationships of control are not necessarily unilateral because subsidiary companies have also been known to exercise de facto influence over parent companies; for example, as suppliers of production units. It may, therefore, be an over-simplification to view the keiretsu as simply top-to-bottom relationships. There can be no doubt, however, that the financial, technological, transactional and managerial ties among companies in the Big Six and the vertical company groups have had a central role in defining not only the economic landscape within Japan but also the advance of Japanese interests overseas.

As a result of recent consolidation in the Japanese market, there is some speculation that the ties that bind company groups in Japan could be loosening. Foreign investors hope that this phenomenon will provide opportunities for foreign financial investors, lenders, foreign suppliers of goods and services, etc., to develop business relationships with companies who previously tended to transact primarily with their corporate groups. If these hopes become reality, the ability of foreign investors and suppliers to offer better prices, innovative solutions, quality, etc., will be important in markets where relationships were once the supreme competitive advantage. If the traditional ties among company groups continue to weaken, the need for consolidation and rationalization of supplier relationships, etc., may also lead to domestic and strategic foreign M&A opportunities as the members of corporate groups seek to consolidate to meet the requirements of an increasingly competitive market place.

This is the last of a three-part series that provided a summarial overview of a topic that has filled volumes. Readers interested in recent works on the history and function of Japanese corporate groups might be interested in the following books and articles:

- Beyond the Firm (Business Groups in International and Historical Perspective), edited by Takao Shiba and Masahiro Shimotani (Oxford 1997)
- The Japanese Firm (Sources of Competitive Strength), edited by Masahiko Aoki and Ronald Dore (Oxford 1994)
- The 1997 Deregulation of Japanese Holding Companies, Vol. 8 Pacific Rim Law & Policy Journal, No.2 by Andrew H. Thorson and Frank Siegfanz

(1999 Pacific Rim Law & Policy Journal Association)

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Investing in Mexico: Still a Bet on the United States

By Jonathan Lemco

NEW YORK (KWR) -- Mexico is the second largest trading partner of the United States, after Canada. As such, its economic future is almost entirely dependent on the fortunes of the behemoth to the north. The relative strength of the US economy is a necessary, but not sufficient, condition for Mexico's economic recovery. Not only must the US economy be strong, but also Mexico must continue to put its fiscal house in order.

Since Mexico's fiscal crisis in 1994, it has demonstrated admirable fiscal prudence. The Central Bank and various Finance Ministers have proven capable managers of the nation's economy. Public debt/GDP is a low 25% of GDP, which has not been seen since the 1970s. Further, the Mexican financial system has been able to withstand various shocks. Not surprisingly, the leading credit ratings agencies have rewarded Mexico by upgrading its credit ratings to the highly desirable "investment grade" status. In turn, Mexico's borrowing costs have dramatically decreased and institutional investors have jumped at the opportunity to hold Mexican debt in their portfolios.

This positive economic and financial evolution has been accompanied by the emergence of a viable and competitive multi-party political system. The judiciary is relatively independent of political machinations as well, although we would not push that point too far. Since 1990, a series of major reforms affecting liberalized trade, more open domestic capital markets, tax reform, pension reform, bankruptcy law reform, and others have been implemented. In short, the Mexican political and economic system has matured in the last few years, and investors have rewarded Mexico for that. But much remains to be done.

Mexico remains a developing country, and its infrastructure needs are huge. To that end various structural reforms and revenue enhancing policies are needed. This will not be an easy matter to bring about however, because President Fox has had difficulty passing legislation through the divided Congress. Further, Mexico faces competitive challenges from other developing countries, notably China. But the first priority is to revive the economy and to attain sustained growth.

Many Wall Street economists are forecasting Mexican GDP growth in the 1-2% range in the fourth quarter of 2003. This is consistent with the anemic growth of earlier this year. Also, manufacturing production, and especially automobile production, remains in the doldrums and is expected to decline 0.3% in the fourth quarter. Unemployment is expected to rise. But inflation is no longer a serious problem and at 4% is at its lowest level in forty years.

Mexican labor markets are far too rigid and regulations are excessive. Corruption is a factor in different aspects of public life, although there is evidence to suggest that this has lessened slightly in the past two years. Some analysts question why Mexico has not grown as rapidly as its largest trading partner, the United States. Beyond the obvious answers relating to productivity and development differences, it is worth noting that that which links the two economies is concentrated in the manufacturing sector. But this sector is one of the weakest in the US. Mexico's economic future should not be tied to the manufacture of textiles, shoes, clothing etc. When Mexico emerges from a "developing" to a "developed" status, it will be because it has created a large, productive and profitable service sector.

In the North American mass media, much is made of the competitive threat to Mexico posed by China. Without dwelling too much on this issue, we should acknowledge that the competition is real, but it is not entirely one sided. Chinese competition has hurt the Maquilladora sector and foreign direct investment in general. But China also imports finished goods from Mexico, and Mexican suppliers would be well advised to see China as a vast and attractive market. The more interesting question is will US manufacturing output increase in the near term? If it does, then Mexican exporters will get a boost.

Going forward in the next few months, a central issue from an investor's point of view is the likelihood of tax and/or electricity reform passage through the Congress. At the moment it is an even bet at best. But if these reforms pass with most of their provisions intact, it will be a victory for President Fox and a victory for investors in Mexico. In the case of fiscal reform, tax collection is a modest 12% of GDP at present. This is below most other investment grade sovereigns. Currently oil revenues account for about 30% of total revenues. Should oil prices fall, the consequences for Mexico will be particularly negative. A substantial fiscal reform package could increase tax revenues by approximately 0.75% to 1% of GDP in the short run, and by another 2% in the next four years. Business and consumer sentiment would also improve.

The electricity reform effort is also important from an investment perspective, because it could lead to an increase in FDI of about US $2 billion per year for the next ten years and an increase of 1.3% GDP growth, according to the Mexican Ministry of Finance. Should the reforms pass within the next six months, I think that the credit ratings agencies will reward the Mexico sovereign credit.

Mexico continues to make strides to modernize its economy and polity. Although a majority of Mexicans would assert that their lives are not substantially better today than they were when Vincente Fox was elected President three years ago, the passage of the tax and electricity reforms, should they occur, would go a long way to improve domestic consumer sentiment and to promote foreign direct investment.

Is the Asia Bet Still On?: Some Thoughts About Putting Money to Work in 2004

By Scott B. MacDonald

NEW YORK (KWR) -- During the 1980s and 1990s up until 1997, non-Japan Asia demonstrated dynamic growth and sucked in billions of dollars and yen of investment. The ensuing financial crisis, which rocked the region from 1997-1998 and threatened to pull down an already wobbly Japan, drove many foreign investors away – both from the equity and bond sides of the business. The investment terrain was left to vulture investors, hardy funds with local expertise looking at direct foreign investment and a smattering of entrepreneurial individuals. In 2003 Asia once again beckoned for both bond and equity investors. That trend is likely to continue in 2004.

The question is – how do investors find compelling stories?

Although some investors look for investments by making a bet on macroeconomic conditions, smart money usually finds a compelling investment story based on key developments in a particular company. What we mean by key developments can be translated into finding a company that has a "story" to tell. That story can be one based on restructuring, a new product, regulatory changes, or a merger and/or acquisition. Free cash flow is also important as well as how transparent are a company's financial statements. Consequently, one is left looking for triggers – major developments that will determine the company's performance. Good investment opportunities can be found even in difficult economic and political conditions.

Consider the banking sector in Asia. Although investors have demonstrated little interest in banks in China and Vietnam (for good reasons), there has been and continues to be interest in largely private sector banks in India, Thailand, Malaysia, Hong Kong and Indonesia. The reason for this is this is that in each case, the regulatory environment has improved and measures have been taken which are more constructive for banks to operate. Within these countries the bank stocks likely to do the best are those tied into the regional dynamics of a growing middle class (with their demands for mortgage financing), key consumer goods, ongoing implementation of technology (helping introduce greater cost efficiencies) and improved transportation (which is encouraging the greater use of autos).

Two of India's major commercial banks, ICICI and HDFC Bank, had a strong year in 2003 and are benefiting from important reforms in the banking sector as well as in the rise of a middle class, needy of mortgage loans. Last year the Indian parliament passed a law enabling lenders to seize and sell the assets of deadbeat borrowers to help them recoup non-performing loans. Another law allowed the formation of asset reconstruction companies to which the banks would be able to transfer their bad loans, to be repackaged and sold as pools of debt-backed securities. All of this has made Indian banks a much more interesting play for investors. Stronger economic growth also helped. Both banks' stocks increased considerably in value in 2003.

Japanese banks (we are talking about the major institutions) are also something that investors, both for bonds and equities, have gained more investor attention, considering that they are on their way to their most profitable year in a long time. The ADR for Mitsubishi Tokyo Financial Group, for example, has more than doubled off its low earlier this year. This is not to argue that Japanese banks are without their own set of challenges. There remains considerable work to be done in dealing with the legacy of bad debts and zombie companies that still are taking bank loans but are technically bankrupt. However, the Koizumi government is making an effort to deal with the non-performing loan problem and the upswing in the Nikkei during 2003 has helped the banks' capitalization. This was something of a worry when the Nikkei kept plunging earlier in the year.

Another interesting stock for investors has been Korea's Hanaro Telecom. The company provides nationwide local telephone communication services and high-speed Internet services. It also offers services hosting, Internet roaming, web hosting and mail hosting services. What makes Hanaro an interesting prospect is that it emerged from financial distress in November with two large foreign owners, AIG and Newbridge, which together own close to 40% of outstanding shares. This has meant Hanaro now has an improved balance sheet, new management, operating leverage for rapid profit growth and am emerging cash flow story. For Hanaro, these positive developments were enough to capture the attention of foreign investors and lift the stock from its lows. Although the Korean telecom market is dominated by KT, Harano is the second largest broadband operator in Korea and is moving to expand market-share.

What about new triggers to send Hanaro's stock higher? A Morgan Stanley equity report recently stated: "We believe Hanaro's restructuring story has a strong appeal." The report argues that for the stock (traded in Korea and via an ADR on the NASDAQ) to go higher it will have to attract Korean domestic investors. The trigger here is "…Hanaro will have to prove it could take local telephone market share away from KT beyond market expectations." Pending the outcome of the contest to take over Thrunet, a failed Korean Internet company, Hanaro could generate enough interest. First, it must take on LG Group, its rival, which is also seeking to purchase Thrunet. Thrunet holds 11.6% of the Korean broadband market, to Hanaro's 24.5% and KT's 49.8%. All of this puts Hanaro stock in play and no doubt it will be closely watched by investors, both Korean and foreign.

While the company-by-company approach is probably the best way to find worthwhile investments, one still must be aware of where Asia is heading. A more positive economic environment does not hurt anyone looking to Asia for investment possibilities. The International Monetary Fund recently stated: "Despite the slowdown since early 2003, the Asia-Pacific countries are again set to be the world's fastest growing region this year and growth is expected to pick up further in 2004." Japan is expected to have grown by 2% in 2003, with 1.5-1.7% growth expected for 2004, a far better trend than the previous decade of relative economic stagnation. Emerging Asia is expected to grow by 6.2% in 2004, up from the expected 5.8% in 2003. China, which has emerged as the regional locomotive of growth, is forecast to duplicate 2003's 7.5% real GDP growth in 2004, while strong performances are expected from Thailand, Malaysia and India. Even Hong Kong, which suffered through a difficult recession over the last couple of years, is expected to gain momentum in 2004 (2.8% real GDP expansion). Singapore is also expected to rebound strongly (4.2% for 2004, compared to 0.5% for 2003). The two countries with the most uncertainty hanging over them are the Philippines and Indonesia, both of which will be holding presidential elections in 2004.

Another factor supportive of investment in Asia during 2004 is Asia's growing self-reliance and interdependence. Although the region remains very much integrated with the global economy, regional trade and investment linkages have expanded considerably over the last 10 years. This provides some buffering from the economic cycles in North America and Europe. Along these lines, many Japanese companies have hollowed out their industrial operations in Japan and established newer ones in China, some of which export back to the island-nation as well as the United States and Europe. Japanese companies are hardly alone in this – Singaporean and Taiwanese firms have also done the same.

At the same time, the region will benefit from the U.S. economic recovery, especially in terms of export markets. Although the long-term prospects for strong growth in the United States cannot be taken for granted, through most of 2004 the North American economy will have strong enough growth to pull in Asian exports – even with a weaker dollar.

Other factors that should make Asia an attractive place for investment in 2004 include relative political stability. Despite the ongoing tensions caused by North Korea's hermit kingdom and occasional pro-independence outbursts in Taiwan, East Asia is not marked by any wars, regime threatening rebellions, or restless military establishments. Southeast Asia does have political concerns – Islamic terrorism, upcoming presidential elections in the Philippines and Indonesia, separatist movements in Indonesia, and Burma's harsh military junta. Yet, none of these political concerns are likely to through the region into massive turmoil in 2004.

While there is a lot to recommend playing the Asian investment card in 2004, there are potential spoilers. We see the major risks being geopolitical disruptions potentially including major radical Islamic terrorist attacks within the region targeting Americans, Europeans, Japanese and Australians, as well as North Korean and Pakistani-Indian tensions. Other potential problems include a further rise in protectionism (mainly from the United States), the potential for a slowdown in U.S. economic growth in the second half of 2004, and a higher interest rate environment (starting off in the U.S. with an earlier than expected move by the Fed to raise rates). At a more micro-level, bad earnings performances from companies could also disappointment investors.

Yes, the Asia bet is still on. We believe that companies in Asia will offer good investment opportunities for investors during 2004. To find the best returns, investors should become much like Sherlock Holmes, making a careful investigation into a number of companies, looking for clues in the form of the triggers what will make stock and bonds prices improve.

VIEWPOINTS & INTERVIEWS

Interview with William Battey, President of CSFB Data and Analytics LLC.

William Battey is a Managing Director of Credit Suisse First Boston and President of CSFB Data and Analytics LLC. This business has been set up to organize and distribute fundamental and securities data and analytical tools generated by CSFB. Mr. Battey joined Credit Suisse First Boston in 1979. He was hired into the New Business Group within the Investment Banking Division. In 1986, he was given responsibility to create a Medium-Term Note product capability and over a three-year period built a team that was ranked number two in the world. From 1989 to 1992, Mr. Battey ran the Pacific Investment Banking Unit in New York. In 1993, he was asked to build a new business team in New York to develop and execute all "Yankee" fixed income new issue business for the Firm, building market share from 7th to 3rd over a three-year period. Following this assignment, Mr. Battey's moved to Hong Kong to run the Firm's Asia/Pacific debt new issue and syndicate business. In 2000, he returned to New York and built the Credit Research and Structured Products teams to over 100 professionals worldwide. Prior to assuming this position, the firm was not ranked in the top 10 by Institutional Investor and other relevant polling organizations, however by 2001, the Firm ranked in the top 3 worldwide. Earlier this year, Mr. Battey established a new data and analytics business for CSFB. Mr. Battey has been the lead banker on "Deals of the Year" for a range of CSFB clients including Australian Wheat Board, Asia Pulp and Paper, General Motors Acceptance Corp, Korea Development Bank, General Foods Corp, Hewlett-Packard Co., PepsiCo., Petronas, People's Republic of China and Samsung Electronics. Mr. Battey received a B.A., cum laude, from Williams College and an M.B.A. from Columbia University.

Hello Bill, Can you give us some background about CSFB Data & Analytics?

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In June of this year, Credit Suisse First Boston ("CSFB") established a new, non-broker dealer company, called CSFB Data & Analytics, LLC ("CSFB DNA"). This firm will house and distribute, directly and through third party partners, economic and company data and information on trader priced securities combined within an integrated analytic and technology platform. CSFB DNA will not house or distribute any research product of CSFB and all services will be offered on a direct cash-paying basis.

Whether you are a manager of securities, loan assets or a direct investor -- no matter where you are situated in the world, CSFB DNA products will better enable your organization to arrive at its own decisions on how best to manage the company's risk position.

Could you tell us a little bit about some of CSFB DNA's product offering?

The first product available is a sovereign risk management tool called "Sovereign Data+™" (SD+™). CSFB has combined its economists' forecasts with World Bank and IMF data to offer 10 years of history and 2 years of projections, covering approximately 100 countries. CSFB's quantitative team has provided tools to interpret country ratings and the fair value of a given country's fixed income risk. The site provides straightforward country reports and comparisons as well as fixed income, FX and equity market information and major news. This service is provided in one convenient location at roughly half the price of the major competitors. Just this month, we added a company website to allow customers to access an extensive database of company level financial information. Utilizing the judgment of CSFB's credit analysts, we offer derived financial information, which in the analyst's opinion, more fairly reflect the financial position of a given company in its sector. The company website, "Company View+™" (CV+™), is divided into 17 different major sectors, covering over 30,000 companies, located in approximately 75 counties. We include debt maturity schedules, benchmark bond data, equity prices, news and top holders of bonds and stocks. We also include credit risk scores calculated every day by CSFB's proprietary risk model, the Credit Underlying Securities Pricing Model (CUSP). So in one platform, customers will have access to fundamental data and analytics on countries (SD+) and companies (CV+), worldwide. We see this as a tremendous value for customers and a competitive advantage versus other data providers in this space.

The third series of products now available provides full access to all fixed income and convertible over the counter securities data in 6 currencies worldwide, priced by CSFB traders. This universe of government, credit and structured products comprises the 25-30,000 securities that most major investors utilize for pricing their portfolios or for use within their quantitative analysis.

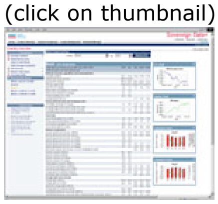
CSFB has also released our quantitative credit risk tool, CUSP™, as a stand-alone product. Fully integrated with our credit data (initially, High Grade and ultimately High Yield and Emerging Markets), CUSP offers a risk profile of each major, rated company. In addition to the credit risk scores available in CV+, the complete CUSP product provides model input data, volatility sensitivity metrics, and tools for risk reports and graphic analysis. This will be useful for credit, equity and lending risk managers concerned with monitoring company specific risk events and trading opportunities.

The fifth series of products is our Global Relative Value Calculator‰, which is a securities search engine that fully integrates CSFB's data platform. An investor can define the selection process by currency, credit rating, industry sector, or maturity sector across all of our liquid fixed income indices in US Dollar, Euro, Sterling, Swiss Franc, or Yen. The results page lists the bonds specified by the selection process and provides spread to LIBOR levels in a common chosen currency creating a basic cheap/rich comparison. The time series for cross currency data of individual bonds is also available and downloadable to Excel. The Global Relative Value Calculator provides one-stop-shopping for comprehensive relative value analysis of the corporate bond market.

Many sovereign data services are geared towards equity investors. From our discussions you have noted CSFB DNA is gearing itself to reach out to a far wider audience. Can you give us more details about the sovereign product?

Since CSFB's inception, the firm has been known for its excellence in economic analysis. This fundamental interpretation of macroeconomic data and trends facilitate our clients' ability to make direct investment and portfolio management decisions. Taking advantage of this global intellectual resource, CSFB Data & Analytics has established the SD+ website.

(click on thumbnail)



SD+ covers close to 100 developed and developing countries. We have wrapped a useable online application around macroeconomic history from the World Bank, economic forecasts from CSFB's global economists and the IMF, current and historical equity data from Reuters, and CSFB's own fixed income data. We are particularly proud of our financial market data, which includes 10 years of history, and is current as of the previous days close. This is true for even the most exotic instruments being traded that nonetheless have a significant effect on the risk profile of a country and region. Our fixed income data, which includes emerging market sovereign credits, is priced daily by CSFB traders and will be of particular interest, especially given that most vendors do not offer this type of information.

We also offer a company database where a client will be able to directly link country economic statistics to company data. This back and forth capability should make access to fundamental data - economic and company – quite easy. All website access will also be offered jointly through one or more of our distributors.

CSFB has also developed three major analytical tools for sovereign risk assessment. The first tool tries to assess the direction of credit ratings in a given country. This model does not try to answer what the rating is – S&P and Moody's already provide this view – but rather which way the credit is going – up or down. The second tool tries to assess the risk-adjusted cost of fixed income in a given country by arriving at a "fair value" spread versus LIBOR in U.S. dollars. The third tool is an econometric FX model that forecasts the return probabilities from going long or short local currencies on a one-month forward exchange rate basis in the emerging markets. None of these tools provide "the answer" but can be used with different data assumptions to review "what if" scenarios designed by the client.

Can you tell us a little about your target audience?

We believe any organization with international exposure will have an interest in the Sovereign Data+ website. Within the financial sector, this includes research analysts, portfolio managers and economists in both the Equity and Fixed Income sectors. On the corporate side, multinational firms (CFO, CIO, Treasury Department, Credit Department, Cash Management, FX groups, Risk Management, Corporate Planning, Corporate and Library Department) and government officials (Ministry of Trade, Finance, Investments, Funding, Central Banks) can all benefit from this service provided at a cost effective price.

One of the interesting parts of the DNA service is the multitude of service providers and information sources that can be accessed. In KWR International's case this includes offering commentary and consulting services that helps subscribers to "move beyond the data" they access through the site. Can you tell us how you went about selecting your team and the range of information and services they can provide?

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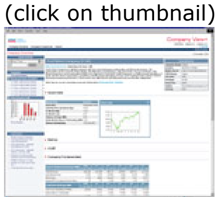


Yes, in the case of the SD+ website, we purposely sought out "best-in-class" institutions to not only enhance our platform with alternative sources of information but also to include alternative points of view. Having information and data from the World Bank, IMF, Reuters and CSFB gives customers the ability to better make their own decisions with respect to risk and investments.

After issuing our press release announcing KWR's alliance with CSFB DNA, we received several inquiries from potential subscribers wondering whether this service was limited to existing CSFB banking clients. CSFB DNA's products are not limited to existing CSFB clients.

I understand that you are offering no obligation trial subscriptions to the CSFB DNA service for potential subscribers who want to try out the system and determine whether it meets their specific needs and requirements. Can you tell us a little more about this offer and how our readers might take you up on this offer?

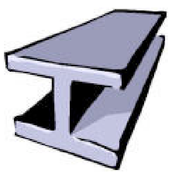
For qualified purchasers, we are offering a two-week free trial for all of our products. Please go to www.csfbdna.com to register.

Thank you Bill for your taking this time to speak with our readers.

KWR International is distribution partner for the CSFB DNA SD+ information service. For more information on KWR's alliance with CSFB DNA, please click here:

The Steel Tariffs and U.S. Trade Negotiations: Reasons for Hope and Despair

by Russell L. Smith, Willkie Farr & Gallagher



WASHINGTON (KWR) -- In June 2001 the Bush Administration set in motion a sweeping and politically-charged trade investigation by the U.S. International Trade Commission under Section 201 of U.S. trade law concerning virtually all steel imports entering the United States. The result was a March 2002 decision by President Bush to impose prohibitive tariffs and other trade restraints on billions of dollars of steel imports from a wide range of U.S. trading partners. It was one of the most significant acts of trade protection undertaken by a U.S. President since the last major round of comprehensive steel protection was effected almost two decades ago.

Twenty-one months later, this episode in U.S. protectionism came to an abrupt end. On December 4, 2003, President Bush proclaimed that the steel tariffs would be terminated immediately. The decision was no doubt facilitated by a finding of the World Trade Organization Appellate Body that the U.S. steel measure was inconsistent with U.S. international obligations, threats of WTO-sanctioned retaliation by key U.S. trading partners and, more cynically, a change in the White House political calculus ahead of the 2004 elections. The White House would only state that the last twenty-one months had provided the breathing space needed for the U.S. steel industry to adjust to import competition, and that the decision to terminate the steel tariffs was not founded on these other considerations.

Is there a deeper significance to the termination of steel safeguard tariffs? Where does the Bush Administration go from here on trade? To the former question the answer is probably "maybe," and to the latter perhaps "from the frying pan into the fire." The termination of the steel tariffs, with no other concrete assistance of any kind to replace them save an administrative import monitoring system, appears to be a dramatic repudiation of the political power of "Big Steel," that army of executives, lobbyists, lawyers, and their political allies in Congress and the bureaucracy that speak for the U.S. domestic steel industry and the steelworkers unions. The history of Big Steel in Washington over the last-quarter century has been one of virtually uninterrupted success in obtaining import protection in one form or another.

The apex of that power was the 2002 steel safeguards. The domestic industry worked for months to define imports as the sole cause of their financial and operational problems, and import protection as the key to solving those problems. Once the Administration initiated the steel safeguards investigation, the industry and the Congressional Steel Caucus brought enormous pressure to bear on the International Trade Commission to ignore the facts, the basic requirements of U.S. law, and the WTO rules to produce a finding of injury. This created a drumbeat for protection that resulted in a determination by the President to embrace a remedy at the extreme end of the spectrum.

At that point, Big Steel claimed that the 30 percent tariffs were insufficient to revive the industry. The domestic industry complained that the exceptions granted to exports from developing countries and the exemptions for products in short supply would undermine the tariffs. They demanded that the Federal government finance the medical insurance coverage of all troubled steel companies, at an estimated cost of $12 billion. This latter demand came at the same time the U.S. Pension Benefit Guaranty Corporation was reporting that steel companies' abandonment of their pension plans had drained its multi-billion dollar reserves. Big Steel also sought extensions and expansions of the steel loan guarantee program.

When it came time for the statutory mid-term review of the tariffs, and the International Trade Commission report assessing whether the tariffs had helped achieve industry restructuring, Big Steel threw itself into a new frenzy of letters, speeches, press conferences, meetings with the Administration and Congressional hearings to condemn even the hint that the tariffs might be adjusted at the mid-term. It is this author's opinion that the unrelenting post-safeguard demands of the U.S. steel industry and labor unions ultimately produced the fabled syndrome of "steel fatigue." In short, key opinion leaders and decision makers in Washington came to understand that the United States was risking a trade war over steel, coupled with continuing adverse economic effects of import restrictions in the United States. When this situation was coupled with the realization that no amount of trade protection and economic assistance would satisfy Big Steel the political impetus to do so vanished.

This is the deeper significance of the end of the steel tariffs--that powerful sectoral interests may finally be wearing out their welcome in Washington. As a further example, while many observers regarded the announcement of the Bush Administration of its intention to limit exports of certain textile and apparel products from China as a negative development, they failed to take into account that the domestic textile industry demanded such protection many months before the Administration took action, and that the demand was for much broader import restrictions than those finally proposed. China had a significant period in which to increase its exports, and at this writing is still in negotiation with the United States as to the terms of any import quotas. This is a far cry from the automatic quota system that has been in place for textiles and apparel for decades and is now being phased out pursuant to the Uruguay Round agreements. While these sectoral-specific developments are certainly not definitive, they present a hopeful prospect that the United States is emerging for the syndrome of preaching free trade in theory and embracing sectoral protection in reality whenever the political pressure becomes too great.

If the United States now may have lost its stomach aggressive sectoral / unilateral trade actions, where is the trade issue headed? Unfortunately this potentially positive development is now being overwhelmed by a set of adverse circumstances. In recent months, the Bush Administration's initiatives for reaching multilateral and bilateral trade liberalization have come upon extraordinarily hard times. The Cancun Ministerial a few months ago demonstrated that the United States is no longer in a position to move the international community to accept its trade positions, and that many countries, particularly those in the developing world, are willing to walk away from multilateral negotiations that they perceive as inadequately protecting their interests. While U.S. negotiations on a free trade agreement with Australia seem to be progressing, the outcome is not certain. Other FTA negotiations, particularly those with Central and South American nations, are not going well, and U.S. trading partners in these regions have also become bolder and more demanding with regard to U.S. market access issues.

At home, the deterioration of the broad national consensus that supported free trade in the past has continued and has accelerated. The claim is now that international trade is to blame for changes in the overall U.S. manufacturing sector. This attack incorporates a variety of allegations, including currency manipulation, labor and environmental issues, and lack of reciprocal market access. No amount of empirical analysis of the conditions that have resulted in a loss of U.S. manufacturing jobs (increased productivity through technology, domestic price pressures from customers, recession, etc.) has so far changed the minds of those who have seized on this issue as a basis for attacking any new U.S. trade agreement.

The reasons for this are far more complex than the factors that led to the imposition of steel tariffs and to their removal. Decades of attacks on open trade, U.S. losses in the WTO, and certainly competitive pressures from imports have cumulatively soured U.S. policymakers, especially those in Congress, on the idea that open trade is beneficial for the overall United States economy, despite the temporary dislocations it may cause in some discrete cases. The prevailing point of view is now highly suspicious of trade liberalization, and extremely reluctant to accept regional and bilateral free trade agreements, and certainly multilateral agreements, as inherently “good” for the United States.

The steel tariffs have highlighted just how detrimental unilateral trade protectionism can be, but if some key politicians are turning away from this approach, they are instead turning to a form of economic isolationism that is more subtle, but ultimately just as harmful, as product-specific trade restrictions. It may require a long period of strong economic performance, nationally and globally, before the national consensus again supports multilateral, regional and bilateral free trade.

Emerging Market Briefs

By Scott B. MacDonald

Azerbaijan – Changing of the Guard: OChange in leadership of the former Soviet republics is gradually occurring as reflected by the early December ouster of the president of Georgia. Now Azerbaijan's former President, Heydar Aliyev, has died at the age of 80 in a US hospital in Cleveland, Ohio, where he was being treated for heart and kidney problems. Aliyez had stepped down as president of Azerbaijan in October, being succeeded by his son Ilham Aliyev, following elections that were widely regarded as questionable. Aliyev was a former Soviet Communist leader who reinvented himself in the 1990s as a post-independence political strongman. His record on human rights and media freedom was frequently criticized in the West. At the same time he was credited with bringing stability to the oil-rich country, and helping to attract foreign investment.

Brazil – Lula Wins One on Pension Reform: On December 12th, President Luiz Inacio Lula da Silva won an important legislative victory after the Senate approved controversial pension system reforms. Reforming the pension system was discussed in the early 1990s, but various attempts to pass legislation were defeated. This time around, the reforms sparked large protests. However, Lula stood by his pledge to reform the pension system. The new measures include raising the age of retirement and limiting civil servants' pensions, all of which should help the government to reduce the huge deficit in Brazil's pension system.

Pension system reform has been the hardest challenge facing Lula since he assumed office last year. Brazil's Senate voted by 51-24 to give final approval to proposals to raise the retirement age to 60 for men and 55 for women, phased in over seven years. Civil service pensions will also be capped and subject to taxes. The aim is to bring pensions for government workers into line with those in the private sector, and reduce a system which last year cost 4.3% of gross domestic product, or 56bn reais ($19bn; £12bn). The Lula administration's next major reform is to overhaul the tax system.

Egypt – After Mubarak?: In mid-November the issue of political succession unexpectedly came into the living rooms of Egyptians as President Hosni Mubarak was noticeably ill during a televised broadcast while addressing a new parliamentary session. One moment the president was seen at the podium, sweating and looking unwell. The next moment the camera of the state-owned television zoomed out as Mubarak stood at the podium, and seconds later, it tilted to show the fixed picture of the Egyptian flag. Ten minutes later, Egyptian television resumed its live broadcast, showing the country's highest Islamic religious authority, Sheikh Mohamed Sayed Tantawi, the Grand Imam of Al-Azhar, and Pope Shenouda, Patriarch of the Coptic Christian church, praying to God to "save Mubarak". Although the Egyptian leader was to return to the podium and was given a long applause by the parliament, the incident underscored the issue that Mubarak has long been in power, and while healthy he is aging and no one stands out immediately as the heir apparent. The government comment that he had the "flu" did little to stop speculation about the arcane world of Egyptian politics and who will head it.

During his time in power, Mubarak has survived at least six assassination attempts. Since he took over power in 1970, he has refused to appoint a vice president. In recent years, the Egyptian leader has reportedly been grooming his son, Gamal, to take over power. The 40-year-old graduate of an American university, suddenly rose to high ranks within the ruling party, and now accompanies his father on all his external official trips. Although President Mubarak denies he wants his son to inherit his power, many Egyptians have their doubts. Traditionally political successors have come from the army, which remains the most powerful institution in Egypt. This has been the custom since the army overthrew the monarchy in 1952. Although few fear chaos in Egypt once Mubarak's rule ends, the incident in parliament has also renewed demands by opposition parties to press for democratic reforms. After all, Mubarak has run unopposed in four referendums to renew his presidency. Each time he has won with at least a 96% majority. Opposition parties have been pressing to change the system, demanding multi-presidential elections. Thus far, Mubarak has resisted. After Mubarak maybe the political system will open.

Indonesia – International Assistance Please: IThe Consultative Group on Indonesia (CGI), the Asian country's longstanding donor country group, pledged in mid-December to provide $2.8 billion in loans and grants, most of which will be used for Indonesia's government budget in 2004. The international donor group also renewed calls to accelerate reform measures and to improve the investment climate. The amount was higher than the $2.7 billion promised for the current 2003 state budget, partly due to higher spending for debt repayment, as the expiration of the International Monetary Fund program later this month deprives the country of a debt relief facility from the Paris Club of creditor nations. In addition to the $2.8 billion, donors set aside $600 million in the form of credit exports and technical assistance to regional governments and non-governmental organizations (NGOs), bringing the total loan pledge from the CGI to $3.4 billion.

During the CGI meeting, while praising the country's macroeconomic and monetary stability, donors emphasized the need for Indonesia to address corruption, which retards the inflow of investment, slows economic growth and puts a brake on poverty eradication drives. "If the government can deliver on the commitments it has made ... then growth in Indonesia is set to take off," World Bank East Asia and the Pacific vice president Jemal-ud-in Kassum said in a written statement. To this he added: "But significant slippage, especially in improving the investment climate and governance, would put emerging gains in market confidence at risk."

The Asian Development Bank (ADB), which provided around $900 million of the loan pledges, also urged intensified action to reduce corruption to boost investment. The ADB's Southeast Asia deputy director Shamshad Akhtar stated: "Weak governance has acted as a major barrier to sound development in Indonesia, nurturing corruption and rent-seeking and weakening the impact and effectiveness of development projects." This message has resonance as foreign direct investment approvals are currently at only a quarter of the pre-economic crisis levels. The Japanese government contributed $660 million in the CGI loan pledge. In addition, Tokyo also set aside $220 million in export credit, bringing the total lending from Japan to $880 million.

Mexico – One More Time!: In mid-December, Guillermo Ortiz was approved by the Mexican Senate by a vote of 84-17 for a second six-year term as the governor of the central bank of Mexico. There was some concern that his re-appointment would be held back by political infighting between Mexico's major political parties, who have been more interested in blocking each others legislative agenda than advancing any meaningful reform for the country. Ortiz's reappointment was a positive development as he is widely respected as one of the key forces behind Mexico's fall in inflation (below 4%). If his re-appointment had failed, it would have sent a very negative signal to domestic and international investors.

Nauru – Back to Being In the Club: In early December 2003, the Organization for Economic Co-operation and Development (OECD) acknowledged that the government of Nauru is improving transparency and has established effective exchange of information for tax matters with OECD countries which will be fully effective by December 31, 2005. Consequentially, Nauru becomes the second country to be removed from the OECD's list of uncooperative tax havens (frequently referred to as a black list) published in April 2002.

Along these lines, Nauru joins OECD countries and more than 30 other jurisdictions in working toward implementing international standards and achieving a level playing field in the areas of transparency and international co-operation in tax matters. In addition, Nauru will be invited to join OECD member countries and other participating countries in meetings of the OECD's Global Forum to discuss the design of standards related to its commitment. Only 5 jurisdictions remain on the OECD's list of uncooperative tax havens: Andorra, Liberia, Liechtenstein, the Marshall Islands and Monaco.

Book Reviews:
The End of Detroit:

Michelle Maynard, The End of Detroit: How the Big Three Lost Their Grip on the American Car Market (New York; Doubleday; 2003) ; $24.95; 314 pps.

Reviewed by Jamie Smiles (*Mr. Smiles is the auto analyst for Aladdin Capital Management LLC in Stamford, Connecticut*).

Click here to purchase Michelle Maynard's book, The End of Detroit: How the Big Three Lost Their Grip on the American Car Market (New York; Doubleday; 2003) ; $24.95; 314 pps.

Michell Maynard's The End of Detroit is an account of the American loss of market share to Japanese and German automakers. The author is a reporter for the New York Times, who follows the airline and automobile industries. She has also written for Fortune, USA TODAY, Newsday, and U.S. News & World Report. Her book argues that GM, Ford, and Chrysler have lost their influence over American consumers because of a lack of quality, misunderstanding of customer needs, and a high cost structure. Ms. Maynard documents how Toyota and Honda grew from offering cheap, energy efficient cars in the 1970s to becoming full-line automobile manufacturers. Her writing style is readable, yet it lacks in-depth research as it pertains to the US automakers. Maynard may be correct in attributing significant market share losses to US hubris, but she fails to recognize Detroit's history of financial and industrial innovation. The End of Detroit is a worthwhile read, but Ms. Maynard's strong anti-US bias is underscored by the books title, and makes any reader question her objectivity.

Maynard's anti-domestic bias is not subtle, and it detracts from the overall enjoyment of the book. She invites reader skepticism by mentioning that BMW's CEO served her chocolate cake and champagne in his hotel room, and that Japan's Big Three granted her top management interviews (in the case of Toyota, both CEO and COO, as well as top US officers). She criticizes Detroit as being unresponsive to globalization and changing trends, and presents a stark picture of the culture of arrogance and insularity that led American car manufacturers astray. Nor does she give any credit to prior American industrial or financial innovation.

Ms. Maynard's case would have been bolstered had she focused more on the importance of legacy costs such as pension and health care retirement benefits and how these high costs are making the US uncompetitive. Recently, Gary Laepidus, a Goldman II ranked analyst was quoted as saying, "there is more health expense in an automobile than there is steel." By not spending more time focusing on crucial non-operating expenses such as health care and pensions, Ms. Maynard detracts from the importance of the subject.

On the positive side, Ms. Maynard's book does provide an overview of the last two decades, commenting on which vehicles have been top sellers and why. Her journalistic style makes it easy to track the transition from larger, gas-guzzling automobiles in the '70's to the more energy efficient, compact cars of the mid-to-late eighties. It also provides other interesting facts. For instance, foreign-owned companies have built 17 plants in the United States and currently employ 85,000 people to produce cars and trucks many Americans assume to be "imports."

That the US has been losing market share for the last 10 years is a well-known fact. According to Ward's Automotive, the US market share for the Big 3 in 1980 was 73%, vs. 57% last September. There is no denying that loss of market share is a serious issue for the US automobile manufacturers. The growing number of vehicles sold in the US, however, has significantly mitigated its effect on the Big 3's profitability. In 2002, there were 15.8mm cars sold in the US, far more than the 9.8mm that were sold in 1980. Analysts are expecting 16.8mm in '03 and 17.2mm in '04. Also, Ms. Maynard does not mention the awesome cash cushion the Big 3 have amassed in case the US faces a difficult recession. Combined, the Big 3 have on balance sheet cash positions of more than $35B, enabling them to endure several years of operating losses in excess of those experienced in the '90-91 recession.

Ms. Maynard provides impressive examples of Japanese innovation, but fails to mention past US successes. Toyota, for example, built car plants in the U.S. and trained local employees, including Spanish-speaking workers, who would later be able to work in Toyota plants in Mexico, South America and elsewhere. Yet there is no comment on the introduction of the SUV or the advent of the Ford Taurus, two important US innovations. Someone needs to remind Ms. Maynard that within two and half years of its introduction, the Taurus was the US's best-selling vehicle and brought record profitability to the Ford Corporation. Also, the introduction of the minivan and the SUV revitalized the industry, leading to continued American dominance.

Many insiders believe the real battle in the future will revolve around technological innovation, and Ms. Maynard's failure to cover this topic is a disappointment. Hybrids, electronic and fuel-efficient cars will be the key to winning future battles in Detroit, especially if the price of gasoline climbs above $2 a gallon. The players who can fully understand and exploit their full potential hold the key to long-term survival in the new paradigm. For this important future battle, Detroit is positioned well.

Her book does serve as an important reminder that American car manufacturers have seen their market share erode due to a ceaseless flood of import vehicles, mostly from Japan, Germany, and South Korea. At first, the Big 3 ignored the competitors, as they operated in what Detroit considered fringe markets (e.g. low-cost, high fuel mileage compacts and high end luxury models). The Big 3 mistakenly maintained a firm hold on the cars they considered most important, specifically the gas guzzling, V-8 powered, family car. But, Detroit has responded, announcing major restructurings that are likely to result in improved financial performance.

Maynard begrudgingly admits that there is still hope for American auto companies, but she refuses to discuss possibilities for American improvement. In the wake of 9/11 and unparalleled patriotic feelings, US consumers are likely to respond positively to reliable and inexpensive American products. The Big 3 have generated particularly strong loyalty among US construction workers. Building or renovation sites are full of GMC, FORD, and Dodge trucks, and US "light trucks" are generally considered to be more reliable than Asian imports. Importantly, these light trucks tend to be more profitable than regular cars, providing a benefit to Detroit's profitability.

The End of Detroit is a worthwhile read for anyone who follows the auto industry closely. It is concise, journalistic, and full of amusing anecdotes. Unfortunately, Ms. Maynard's anti-US bias is fully apparent, and her title choice immediately calls into question her objectivity. Indeed the US auto industry is challenged on many fronts. Its cost structure is far higher than its international competitors; non-operating costs, including pension and health expenses have grown rapidly; and a dearth of new products has resulted in a loss of market share. But the big three have faced adversity before, and foreign dominance in the US car market is not a foregone conclusion. Her method of extrapolating current conditions and predicting a financial restructuring by at least one of the Big 3 is naïve. US carmakers realize that regaining their customers will be a struggle, but they appear up to the challenge. In fact, it is quite possible that readers will look back on the publication date of this book with amusement.

Since the publication of her book, the share prices Ford and GM have risen by 17% and 14% respectively, in anticipation of an improved earnings profile and innovative products.

Asian Business Watch
Japan Views You Can Use

Richard Katz, Japanese Phoenix: The Long Road to Economic Revival (Armonk, New York: M.E. Sharpe, 2003). 351 pages.

Reviewed by Scott B. MacDonald

Click here to purchase Richard Katz's book, The Long Road to Economic Revival directly from Amazon

Richard Katz, the author Japan: The System that Soured, has written an excellent new book on Japan tackling the nagging question about whether Asia's largest economy will recover from the legacy of problems caused during the 1980s. The short answer to that question is yes, but he admits that the process will be long and painful and will require a transformation of the Japanese political landscape. The core problem is as follows: "Japan's economic crisis is basically a crisis of governance – in both government and corporations. And so revival requires a fundamental overhaul." In addition: "There is now an unprecedented gap between the interests of the party and the nation. In a democracy, that gap cannot be sustained indefinitely."

According to Katz, a major part of the problem is the Liberal Democratic Party (LDP), which has overstayed its welcome in history. As he states: "Once a regime, no matter how seemingly strong loses its raison d'etre, it sooner or later loses its etre. So it was with the Communist Party of the Soviet Union, the Christian Democratic Party of Italy, dictatorships in Taiwan and South Korea, and single-party rule by the Labor Party of Sweden. So it will be with Japan's single-party democracy." Katz argues that the LDP began with good intentions, helped rebuild Japan into an economic powerhouse and long rules as a catchall coalition. Over time, however, the system soured as "the system that allows all the special interest Lilliputians – from gas station owners and construction firms to small retailers and even veterinarians – to hog-tie the national interest in millions of tiny threads."

In a sense, the system soured in the early 1990s when it was unable to effectively respond to changing international economic conditions due to strong and binding domestic interests that reinforced an earlier tendency for a dual economy. On one side was a highly competitive export-oriented economic sector and on the other, hiding behind tariff and non-tariff barriers and supplied with more than ample credit, was a poorly competitive domestic sector. What complicated making any meaningful adjustment was that the domestic sector had strong political ties to the ruling LDP, which in turn worked closely with a national bureaucracy oriented toward maintaining the status quo. Consequently, Japan has ended up with a political landscape in which the reformers are confronted by an opposition that firmly believes that adjustment is not necessary as the economy will eventually right itself. The solution is to keep injecting credit into the system, either through the banking system or government spending. Both have had a highly negative impact on the country's economy.

Enter Junichiro Koizumi, Japan's current prime minister and leader of the reform wing of the LDP. Katz comments: "Koizumi's entire appeal, and the way he came to power, was based on the population's yearning and hope for reform." Indeed, popular support for Koizumi reflects the public's keen interest in reform – the pressing need to overhaul the state and make things work again.

While Koizumi is clearly important in moving Japan in the right direction, Katz ultimately regards the Japanese leader much like Mikhail Gorbachev, the failed last leader of the Soviet Union, who was able to unleash the forces of change, but unable to ride the course, eventually being swept aside as one of the history's critical, yet bypassed transitional figures. The author reflects that "… like his Soviet counterpart, Koizumi is a sincere reformer who faces two very large obstacles: his own political party and a tragically self-defeating economic strategy."

Katz expects that Koizumi will eventually be bypassed by some else, but that he will contribute to death of the LDP and its system. What this leads us to is that the "death throes of LDP rule will continue for several more years, passing through several episodes of political realignment, with a series of new parties and new personalities rising and falling."

Katz is confident that Japan is changing and that "we have little doubt that the era from 1990 to 2010 will be seen as one of the country's major turning points, not the beginning of is demise." The bottom line in all of this is that the pain of muddling through will eventually provoke action, some of which is already occurred. As Katz states, "Japan is a great nation currently trapped in obsolete institutions." It has a well-educated population, which only needs a program and institutional vehicle to coalesce around in order to replace the failed state. After finishing Japanese Phoenix, one can almost hear Katz whisper, "Don't count Japan out." Japanese Phoenix is critical reading for anyone interested in Japan.

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