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Envisioning the World's Next Great Market:
Korea and the Economic Future of Northeast Asia

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KWR Advisor Economic Survey

Please take a moment to participate in the first KWR Advisor Economic Survey. To register your views on the questions below, please click on the following link. This should take no more than about 5 minutes of your time. Results will be published in the next edition.

Click THIS LINK to answer the following questions:

1) How do you believe the Chinese economy will perform over remainder of year? (Please rate on a scale of 1-10, 1 indicating extreme slowdown and 10 indicating 10 extreme growth)

2) How do you believe the U.S. economy will perform over remainder of year? (Please rate on a scale of 1-10, 1 indicating extreme slowdown and 10 indicating 10 extreme growth)

3) How do you believe the Japanese economy will perform over remainder of year? (Please rate on a scale of 1-10, 1 indicating extreme slowdown and 10 indicating 10 extreme growth)

4) Do you think government policymakers and investors should be more concerned with deflation or inflation? (Please rate on a scale of 1-10, 1 indicating strong concern about deflation and 10 indicating strong concern about inflation)

5) Are their any economic issues that you think may have a major positive or negative impact on global financial markets that you think are not being adequately recognized today?

U.S. Markets – Is the Paradigm Changing?

By Scott B. MacDonald

The backdrop to the U.S. stock and corporate bond markets is currently defined by relatively good fundamentals. The earnings season is generally positive, ratings trends are allowing for more upgrades than downgrades, economic data is supportive that growth will continue, and new issuance in both debt and equity remains limited. Yet, change is in the air – there is a growing likelihood that interest rates are going up in 2004. In the short-term this is likely to be bad for markets as there is a degree of uncertainty as to what higher rates will mean. The passage to a higher interest rate regime will clearly bring more spread volatility for bonds and make the Dow trend sideways, probably with a negative bias. And casting a long shadow over this less-than-settled environment is the impact of China – which has already shown some signs that its dynamic growth has begun to stall.

First, the good news. About a half of the S&P 500 companies have reported earnings and almost three quarters of them beat consensus expectations. Mind you, comparisons to last year make this quarter look very strong. Companies such as Boeing, Ford, General Motors, JP Morgan Chase and Wyeth easily beat expectations. Accounting upsets as occurred with Nortel are the exception, not the rule. What shines through the current earnings season is that stronger economic growth is being translated into higher revenues and profits. Companies are also beginning to show greater pricing traction – something that has been missing for the last two years. This was evident in earnings from pulp and paper companies such as Abitibi and MeadWestVaco.

This newfound pricing traction also represents the beginnings of new inflationary pressures. Added with higher commodity prices, such as oil, natural gas and various metals, the case could be made that inflationary pressures are already starting to build. Fed Chairman Alan Greenspan stated before the U.S. Congress that deflation was no longer an issue and that: "The federal funds rate must rise at some point to prevent pressures on price inflation from eventually emerging." This implies that at some point the Fed will raise rates. This also implies a healthier economy, which is able to sustain a higher cost of money. Considering that U.S. real GDP growth is likely to be 4% for 2004, the inflation story is gaining ground within policy circles. The period of low rates and cheap money is over. The next move will be to raise rates. This is a logical progression.

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While higher interest rates may be a positive development over the long-term, the initial period of change can have a negative impact on markets. Concerns over a change in direction on the interest rate front have already rippled through REITs (with analyst calling April's sell-off in REIT equity names "carnage") and Emerging Markets (with Brazilian bonds being particularly hard hit). In 1994, rate increases caused a much higher degree of spread volatility. Consequently, we acknowledge that credit fundamentals are better, but that the short-term looks choppy as the market digests the implications of higher rates.

It is important to clarify two things about the looming change in the U.S. interest rate regime. First, any increase in interest rates is likely to be gradual – with one, possibly two actions in 2004. Second, the place where the Fed now has rates is at the lowest level since 1958. Even with an increase of 25 or 50 bps in 2004 (possibly in August), the environment is still low on a historical basis. The Fed must be careful in raising interest rates for the very simple reason that by moving too quickly, it can choke off growth.

And there are reasons for caution - consumer demand and housing are set to decline. In contrast to Corporate America, the U.S. consumer has not reduced debt. Continued spending has come from the positive impact of tax cuts and lower interest rates. Now, the impact of the tax cuts is diminishing and interest rates are expected to go up. At the same time, higher interest rates are casting a shadow over the housing market. The days of cheap money are coming to an end. What all of this means is that economic growth and employment generation will, in part, be balanced by slower consumer demand and housing. The Fed can begin the next phase of monetary policy with a view to keep inflation under control, though much will depend on job creation. It should be added that without job creation, the scenario could become dire.

Look for interest rates to go up in 2004, but at a gradual pace, which could still be marked by considerable volatility as the market over-reacts. At some point, good earnings and economic growth will eventually trump interest rates. It is the passage from low rates to higher rates that remains the challenge. Until then, our advice is to reduce exposure and sell into any rallies.

While interest rates have emerged as a dominant theme for U.S. corporate and stock markets, the worry about China is not far behind. In recent years massive amounts of foreign direct investment have poured into the country and portfolio investors have not been far behind. First quarter growth was a sizzling 9.7%, by far the fastest of any major economy. After two decades of sweeping

industrialization, China’s economy has outstripped many domestic resources and led to a massive surge in commodity imports. The concern about China is that the economic miracle has the potential to rapidly deteriorate into an economic nightmare, which will ripple outward through the rest of Asia and the global economy in the form of an international commodity bust. Reality is likely to be a little more boring – China’s growth will slow, not crater; international commodities will see less demand from China, but the market is not likely to see a brutal price collapse (though the fate of individual companies will vary).

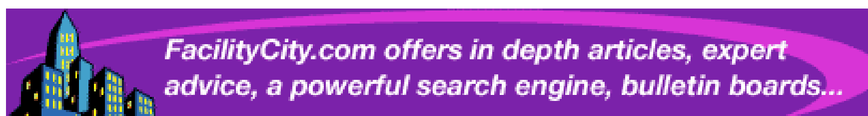
China’s role in the global economy has changed drastically over the past 20 years. GDP growth has been at an average pace of 9% and the country is witnessing the expansion of a new middle class that is beginning to buy imported consumer goods. At the same time, China’s share of world trade has risen from less than one percent to almost 6%. Consequently, China is now one of the largest economies in the world and Asia’s second biggest behind Japan. It is also the world’s fourth largest trading nation.

China’s growth spurt is not without problems. Much of its banking system lacks a professional credit culture, is politicized and carries a substantial bad loan burden. Transportation bottlenecks undermine efficient industrial development and raises costs. The country’s fast growth is rapidly outstripping natural resources such as oil, natural gas, iron and copper. China used to have enough oil for its own needs; and the Asian giant’s major oil companies are now competing for critical energy sources throughout Asia, the Middle East and Africa. Local governments have built up large debts, but there is little transparency about the extent of the problem. In addition, the country faces shortages of water, while there has been considerable environmental damage.

The Chinese government is concerned that the pace of growth must be slowed to a more manageable 6-7% range. The danger is that government efforts to slow the economy overshoot, causing a severe downturn in growth and imports. The ripple effects would be considerable, especially if growth falls under 5%, opening the door to social turmoil as rising expectations are not met. Instead of a government-guided soft landing for the Chinese economy, the situation could be one of a hard landing, with multiple negative consequences for the global economy. A major economic crash in China would not only pull the rest of Asia down, it would ripple into the U.S. corporate bond market – at least that is what many investors are worried about.

Although we have concerns over China, we do not think that it will collapse. What is most likely is that the government will increasingly apply pressure on the banks to limit further credit. Raising interest rates is a likely policy action. At the same time, a more concerted effort will be made to sell off bad loans into the market and clean up the major four government-owned banks. This implies that China will have to provide greater transparency and disclosure, which is likely to make many investors more cautious about buying local assets (as well they should be). Although the authorities are tightening credit in 2004, the slowdown in real GDP growth is likely to be more evident in 2005. We see China going through a “recessionary period”, with GDP growth slowing to the 6-8% range and industrial expansion cooling from 20% levels to levels closer to 10%. China’s slower pace

of growth will have a negative impact on global commodity markets, but it will not be massively disruptive (due in part to still rising levels of demand from India) – a pause in what is likely to be a multi-year commodities bull market.



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The Case for Higher Oil Prices

By Bill Powers, Editor, Canadian Energy Viewpoint

When I was in Calgary last year visiting several oil and gas companies, the CEO of one of Canada's best run junior oil and gas companies looked across the conference table and said something that stuck in my mind: "Get ready for $50 oil!" Such a bold prediction, made when nearly every Wall Street and Bay Street analyst was lowering his 2004 oil price prediction, underscores the massive divide in opinion on the future price of oil.

There is a growing belief among the geologists who study world oil supply that world oil production is soon headed into an irreversible decline. The geologist who has most eloquently laid out the argument for higher oil prices is Dr. Colin J. Campbell. Dr. Campbell, author of the book "The Coming Oil Crisis," holds a doctorate from Oxford University and spent decades working as an international exploration geologist for major oil companies. After a long career in the oil industry, Dr. Campbell worked for Petroconsultants, based in Geneva, Switzerland. At Petroconsultants, he was instrumental in assembling what has become widely recognized as the world's leading hydrocarbon database. Dr. Campbell is now a Trustee of the Oil Depletion Analysis Centre ("ODAC"), a charitable organization in London that is dedicated to researching the date and impact of the peak and decline of world oil production due to resource constraints, and raising awareness of the serious consequences.

I found Dr. Campbell's thesis on the future of world oil production in a speech he gave to a German university in 2000 entitled "Peak Oil: A Turning Point for Mankind". (To watch a replay of this speech go to the following URL: http://www.globalpublicmedia.com/SECTIONS/ENERGY/oil.depletion.php and click on the RealVideo presentation. The beginning of the lecture might be a little blurry.) Below is a summary of his findings.

Dr. Campbell believes worldwide production of conventional oil will head into permanent and irreversible decline in the 2005 to 2010 timeframe.

The term "conventional oil" is used to refer to oil that is produced from

conventional reservoirs and does not include oil from tar sands, polar areas, deepwater areas or oil from coal or shale. Conventional oil accounts for 95% of all oil produced today and will remain the determining factor in world production for the foreseeable future. According to Dr. Campbell, world oil discovery peaked in the 1960's and has declined steadily since. We are now to a point where we produce four barrels for every one we discover. Clearly, this is an unsustainable situation since long-term discovery and production must mirror each other to some degree.

Dr. Campbell is also far from sanguine about the current state of world oil reserves. He provides significant evidence that oil reserves are being grossly overstated by OPEC. Dr. Campbell notes that the two most used estimates of world oil reserves, which are prepared by the Oil and Gas Journal and the BP Statistical Review, are flawed. Both publications rely on reserve estimates provided to them by governments and industry and make no effort to verify accuracy. The below table (data from the Oil and Gas Journal) supports Campbell's view that OPEC's reserve figures are not based on any reliable estimate of total recoverable reserves. Notice how several countries report the same reserve figures for several consecutive years. Constant reserves figures are very unlikely considering that production and discovery would have to match each other exactly.

OPEC Reserves (In Billion Barrels)

Year	Abu Dubai	Dubai	Iran	Iraq	Kuwait	Neutral Zone	Saudi Arabia	Venezuela
1980	28.0	1.4	58.0	31.0	65.4	6.1	163.4	17.0
1981	29.0	1.4	57.5	30.0	65.9	6.0	165.0	18.0
1982	30.6	1.3	57.0	29.7	64.5	5.9	164.6	20.3
1983	30.5	1.4	55.3	41.0	64.2	5.7	162.4	21.5
1984	30.4	1.4	51.0	43.0	63.9	5.6	166.0	24.9
1985	30.5	1.4	48.5	44.5	90.0	5.4	169.0	25.0
1986	30.0	1.4	47.9	44.1	89.8	5.4	168.8	25.6
1987	31.0	1.4	48.8	47.1	91.9	5.3	166.6	25.0
1988	92.2	4.0	92.9	100.0	91.9	5.2	167.0	56.3
1989	92.2	4.0	92.9	100.0	91.9	5.2	170.0	58.1
1990	92.2	4.0	92.9	100.0	91.9	5.0	257.5	59.1
1991	92.2	4.0	92.9	100.0	94.5	5.0	257.5	59.1
1992	92.2	4.0	92.9	100.0	94.0	5.0	257.9	62.7
1993	92.2	4.0	92.9	100.0	94.0	5.0	258.7	63.3
1994	92.2	4.0	89.3	100.0	94.0	5.0	258.7	64.5
1995	92.2	4.0	88.2	100.0	94.0	5.0	258.7	64.9
1996	92.2	4.0	93.0	112.0	94.0	5.0	259.0	64.9
1997	92.2	4.0	93.0	112.5	94.0	5.0	259.0	71.7
1998	92.2	4.0	89.7	112.5	94.0	5.0	259.0	72.6
1999	92.2	4.0	89.7	112.5	94.0	5.0	261.0	72.6

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Campbell contends that OPEC reserve estimates are politically motivated. Kuwait is an excellent example of what is wrong with the way OPEC countries report reserves. The country reported a gradual decline in its reserve base from 1980 to 1984. This should be expected from a mature producing country. However, in 1985 the country reported a 50% increase in reserves with no corresponding discovery. The Kuwaiti government increased its reserve estimate due to the implementation of an OPEC production quota system that set country production levels based on country reserves. Kuwait was not alone in increasing its reserve estimates for political reasons. In 1988, Abu Dubai, Dubai, Iran and Iraq all significantly increased their reported reserves for political reasons. Even OPEC heavyweight Saudi Arabia reported a massive increase in reserve estimates in 1990 for similar reasons.

While OPEC has consistently overstated their reserves, Campbell contends that industry has understated its reserves. The pressure on companies to understate reserves by the analyst community has created a gross misunderstanding of how much oil is actually being discovered. Campbell argues that most company estimates create the illusion of growing reserves when in fact; previously discovered oil is merely being reclassified into the proven category for reporting purposes.

[Note: At least one major oil company is not understating reserves. Royal Dutch/Shell (NYSE:RD) reported a whopper of a reserve write down in January. The company reported that its reserves were overstated by an incredible 20%. The company contends that it acted "in good faith" when preparing its reserve estimates. Such a large write down has attracted the attention of SEC Commissioner Roel Campos, who is considering launching an investigation into the matter].

According to Dr. Campbell, we are likely to face a sea change in the world's oil production capacity. Campbell maintains that peak production comes close to the midpoint of depletion. According to Dr. Campbell's estimate of the world's oil endowment, we are right at the halfway mark.

How might this crisis unfold? Dr. Campbell makes it clear that the crisis will not look anything like the oil price shocks of the 1970's. Instead, Campbell refers to those politically motivated disruptions in supply as merely "tremors" compared to the "earthquake" that is about to hit the oil consuming world. The first phase of the crisis, which has already arrived, will bring about price shocks. In the nearly three years since Dr. Campbell made this prediction, the world has witnessed several rounds of high oil prices. However, the onset of chronic shortages will begin around 2010 when the Middle East will be required to supply 50% of total worldwide oil production. More importantly, it is at this time the Middle East will have reached its production midpoint and will head into decline also.

Clearly the scenario laid out by Dr. Campbell is not a pretty one. However in every crisis lies opportunity. Astute investors should recognize the implications of declining worldwide oil production and adjust their portfolios accordingly.

Japan – The Gods of Credit Are Smiling?

By Scott B. MacDonald

While some of the glow may be coming off of China's "economic miracle", Japan is looking better. The Nikkei is up for the year, the banks are slowly beginning to lend again and reduce bad loans, and exports are robust. Equally important, the fundamental credit story for corporate Japan is finally improving. In the first three months of 2004, Standard & Poor's raised its ratings on seven Japanese corporations and financial institutions and lowered four, continuing the trend from 2003, the first year in which upgrades exceeded downgrades since 1990. Equally significant, the number of upward outlook revisions was 28, compared with only one downward revision. S&P even changed the outlook on its sovereign rating (AA) for Japan from negative to stable.

S&P was not alone in indicating improving credit quality for Japan. In early April Moody's raised Japan's sovereign ratings from Aa1 to Aaa, due to improving economic conditions as well as a rise in foreign exchange reserves to $770 billion. Later in April Moody's placed four major Japanese banks on review for possible upgrades. Fitch also released a Special Report on Japanese banks, in which it applauded the improving credit quality of the sector.

Moody's, Standard & Poor's and Fitch share a view that Japan is probably on the right track economically. The key word here is "probably". The three agencies fully recognize that the banking sector is making headway in reducing nonperforming and troubled loans and that the Koizumi reforms are even trickling down into local government. Yet, they also recognize that problems remain – ranging from weak public finances, export dependence and a yet to fully restructure domestic sector.

On April 19 investors were made to remember that despite the improving creditworthiness of the Japanese corporate world, problems are not far from the surface. It was revealed in the press that UFJ, the country's fourth largest bank, was told by the Financial Services Agency that it needed to set aside an extra Y300 billion (($2.8 billion) to cover bad loans. This news promptly resulted in a major sell-off of bank and financial stocks on the Nikkei and raised fears that other institutions could have similar problems. The problems at UFJ were followed by the decision of DaimlerChrysler Corp. not to proceed with a bailout plan of $6.5 billion for Mitsubishi Motor Corps, Japan's only non-profitable major automaker. The events at UFJ and Mitsubishi Motor underscore that tough challenges still remain.

We believe that the Japanese corporate world is making progress. At the same time, the passage to self-sustainable economic growth cannot be taken for granted. Significant parts of the economy continue to have substantial problems

and are still dragging their feet over making any meaningful changes. Consequently, we have a positive outlook for the short-term, but remain cautious about the medium term. It is easy to forget in good times, that further reforms are still needed. Without those reforms, the good times will not continue – an important message for both the government and the private sector.

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Japan – Another Election on the Horizon

By Scott B. MacDonald

In July Japan will go the polls to re-elect half of the 242 seats in the upper house of the Diet. We do not expect any major changes. Although the Democratic Party of Japan (DPJ) is seeking to capture more seats than the LDP (which now holds 50 seats), Koizumi remains a skillful player in the political game. The DPJ's battle plan is to convince the public that Prime Minister Koizumi's economic reforms have failed and that the sending of Self Defense Force troops to Iraq is a mistake. Although the success of Koizumi's reforms is indeed questionable, the Japanese economy is on the upswing and Nikkei is trading well above the lows of recent years. Unemployment is down to 5% from a high of 5.5%. In addition, Koizumi's attention to raising Japan's standing in international affairs has been one of the more significant areas of success.

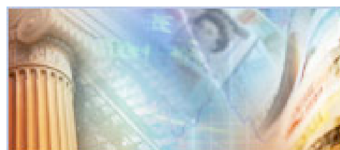
The decision to send troops to Iraq was a well-calculated decision on the part of Koizumi. On one hand it signaled to the rest of the world that Japan was ready and willing to assume a more active international role. On the other hand, Tokyo's engagement in Iraq had a payoff with the United States, which Japan wants to be fully engaged in regard to North Korea. After all, it was North Korea that fired a test missile over the Home Islands in 1998. It was a North Korean spy ship that exchanged gunfire with and was sunk by Japanese patrol boats in 2001 (inside Japanese waters) and it was the regime of Kim Il-jong that acknowledged that North Korea had in the past kidnapped Japanese citizens. North Korea is Japan's most immediate security concern. Considering the need to keep North Korea engaged, Tokyo wants to make certain that Washington maintains the pressure on Kim's government to eventually disarm its nuclear

weapons program.

Tokyo also needs to keep Washington involved in East Asia as an important balancing power to China. China and Japan are already competing for scarce energy resources around the world and in the future this is likely to extend to markets. There are also disputes over various pieces of real estate in the waters intersecting the two countries.

However, the sending of troops and other personnel to Iraq is not without risks. The taking of five Japanese nationals as hostages heightened public worries about their country's Middle Eastern involvement.

Although Koizumi refused to deal with the hostage takers (who released their prisoners), the Middle Eastern exposure has also opened Japan to the possibility of terrorist attacks. There is a danger that Japan's upcoming July election could attract a similar attack as occurred in Madrid, with the strategic objective of punishing the LDP-led coalition government for its support of the United States in Iraq. A major terrorist incident in Japan would also hurt Koizumi in the one area where he has been very successful – foreign affairs. For al-Qaeda hitting hard against the LDP in July could bring big dividends. Japan's next lower house election is not set until 2007. A major loss in the upper house election could force an earlier electoral contest. In such an environment, Koizumi could be forced to retreat from his Iraq policy (due to considerable opposition within his own party) or be forced to resign due to a loss of public confidence. In addition, the DJP has already stated that it would withdraw Japanese troops from Iraq. Short of a major terrorist attack, Koizumi's major opposition, the DJP, should be manageable. The situation will decidedly test the Prime Minister's skills.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Mexico: A Stable Credit in an Unstable Time

By Jonathan Lemco

From an investor's point of view, Mexico has made tremendous economic and political strides in recent years. Economic growth has surged, in part because Mexico has benefited from its membership in the North American Free Trade Agreement. Mexico's crippling debt load of the 1980s and early 1990s has been reduced substantially. Employment is at an all time high with unemployment at only a 3.1% level in September. Inflation has been contained at approximately 4.9% year-on-year. Education levels are slowly improving. And President Fox was elected in the freest vote in Mexico's modern history.

As a consequence of this improvement, Mexico's interest rate spreads have

narrowed throughout 2002, unlike several other Latin American sovereign credits. Furthermore, the credit rating agencies rate Mexico at investment grade levels (Baa2 with "Moody's" and "BBB-" with Standard & Poor's). As of December 2002, only Chile is higher rated in the entire Latin American region. As its credit fundamentals have improved, Mexico has become an investor darling, and has issued well-received debt throughout this past years. We expect the sovereign, Pemex, Telmex, Cemex and other Mexican issuers to return to the marketplace in 2003.

There are problems along the way of course. Mexico's economic future, more than ever before in its history, is intimately tied to the United States. As the US economy slows at year-end, so has Mexico's such that earlier growth economists' forecasts for the year have been recently reduced from 1.7% GDP growth to 1.2% GDP growth. This deceleration, not surprisingly, is directly related to a decline in export-oriented industrial production. Ironically, one of the consequences of the improvement in recent years is that Mexico is now having trouble competing with certain lower wage sites. Most notably, there have been several media stories recently noting how Mexican industry and jobs in selected low-tech industries are leaving for lower wage China. We think that this is a natural development in a rapidly modernizing economy however. Mexican industry will have to adapt to worker demands for higher wages and improved benefits, but there will be an economic cost to this as well as lower wage countries compete effectively.

It is also worth noting that the structural reform agenda of the Fox Administration is hindered by a tense relationship between the executive branch and the PRI, the main opposition party. Structural reforms in the areas of electricity, labor and education are needed to improve competitiveness and to promote economic growth.

In the next month, investors should pay attention to the political wrangling associated with the next federal Budget. We think that the Budget, when it is finally passed by year-end, will include fiscally prudent provisions. Although President Fox's administration is assuming a 3.0 % growth rate in Mexico in 2003, it is also proposing a modest 1.9 % real increase in expenditures. Overall revenues are expected to outpace expenditures slightly. Also, projected oil revenues, which are critical to the Mexican economy, are based on a $17.00 per barrel price for the Mexican oil basket. This is almost $5 below the estimated average for 2002. Currently, the Mexican oil mix is hovering near the $20 level. Unless prices collapse, which is unlikely given the uncertainty surrounding a potential war in Iraq, it is difficult to imagine hat the average oil price in 2003 will be substantially below the budget assumption.

Further, we think that the 2003 Budget will include a provision whereby the deficit target will be increased to 0.65% from 0.5%. This slight increase should not be alarming to investors. Away from the budget, investors will also be focused on electricity reform negotiations. If these discussions go well in the next few months, this will send a very positive sign to the financial community.

In short, we expect that Mexico will continue to grow at a steady pace while maintaining fiscally prudent policies. President Fox will have to expend political capital to pass much needed structural reforms, but we think that he will be able to do so. The 2003 Budget assumptions are conservative and achievable. At a time of economic and political uncertainty in much of Latin America, Mexico stands out as a positive model.

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Emerging Market Briefs

By Scott B. MacDonald

China – Energy Thirst Leads to Iranian Deal: China last thursday said it has signed a multibillion dollar deal with Iran to import liquefied natural gas from Iran. The plan calls for Beijing-based Zhuhai Zhenrong Corp. to buy 2.5 million metric tons of LNG a year from Iran starting in 2008. The volume will then be increased to 5 million tons annually, with the agreement to last for 25 years, Zhenrong said. The agreement follows the recent renewal of a term contract, which allows Tianbao (Hong Kong) Energy Co., a Zhenrong unit, to buy 80,000 tons/month of straight-run fuel oil from National Iranian Oil Co. from next month to March 2005. Zhenrong also plans to expand its business into Iran's upstream sector, and is expected soon to finalize terms for the development of three oil fields in Iran, the company said. Zhenrong, a spinoff of China's weapon manufacturer, China North Industries Corp, or Norinco, was established in 1994, with the task of importing crude from Iran. It is now China's sole Iranian crude buyer.

Norinco is among Chinese companies that are actively seeking more opportunities to buy oil and gas reserves outside China. Chinese state-owned energy companies are investing abroad heavily, in response to the government's call to build up overseas assets of hydrocarbons to ensure security of supplies, bridge a widening energy deficit and fuel the country's runaway economy. Iran is currently under U.S. trade sanctions and the Washington administration actively discourages foreign companies from entering Iran's energy business. The fact that Zhenrong was previously part of Norinco could provoke some speculation

about China-Iran arms sales.

The U.S. State Department announced in May 2003 the imposition of sanctions against Norinco for supplying specialty steel used in an Iranian missile program. The sanctions included a ban on exports of defense articles and services to Norinco, a ban on U.S. government procurement of Norinco products, and a two-year ban on U.S. imports of Norinco products. Norinco, and the Chinese government, rejected the allegation, saying that it was completely unjustified and groundless. China's largest oil refinery, Sinopec Corp. (SNP), is also active in Iran's oil and gas business, despite U.S. opposition.

Zhenrong imported 12.4 million tons of crude oil from Iran last year, accounting for 14% of China's total crude imports. Most of Zhenrong's Iranian crude imports are processed in Sinopec refineries.

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Hong Kong: Hong Kong's unemployment rate fell slightly to 7.2 percent in the three months ending February on improved job prospects in the restaurant and finance sectors, officials said Thursday. Economists had expected the jobless rate to be 7.1 percent for the period until Feb. 29, compared to 7.3 percent in the November-January period. Unemployment declined across a wide variety of business sectors, including financing, insurance, restaurants, communications and recreational services, the government said. It said total employment grew by 9,500, to 3.25 million during the period. Hong Kong is continuing its recovery from the severe acute respiratory syndrome crisis, which devastated the economy by keeping tourists away, pushing joblessness to a record 8.7 percent in May-July last year.

WHAT DO DECISION MAKERS READ?

Indonesia – the Cost of Illegal Logging: There are always trade offs between activities in the legal and black market economies. In Indonesia a heavy price is being paid for illegal logging, as legally established firms are suffering. Around 70 per cent or 322 of 460 companies operating in the upstream sector of the timber processing industry in the country have collapsed over the past few years mainly as a result of rampant illegal logging. There are many factors but illegal logging was the main culprit causing the bankruptcy of the companies said Agung Nugraha, deputy secretary of the Indonesian association of forestry companies (APKI). Rampant illegal logging a caused big shortage in the supply of log raw material for the country's plywood, sawn timber and pulp factories, Nugraha said. He said the industries need around 20 million cubic meters of logs a year and supply from natural forests is much less than 10 million m3. He said illegal logging has caused damage to 43 million hectares of natural forests in the

country reducing the country's tropical forests from 153 million hectares to 98 million hectares over the past year.

Malaysia – The March 29th Elections: On March 29th, Malaysia voters went to the polls to elect a new government. As was the case over the last several decades, the ruling multi-ethnic coalition, the Barison Nasional or BN, won handily, reasserting the dominant role of the United Malays National Organization (UMNO) within the majority Malay community. The BN captured 198 of the 210 (90%) seats in the federal parliament or 64.4% of all votes cast (up from 56.6% in 1999 and just below the 65% it scored in 1995). This was decidedly good news for the standing Prime Minister Abdullah Badawi, who had earlier assumed the leadership role from longstanding Prime Minister Mohammad Mahathir. Despite considerable speculation as the strength of the Islamic issue in swaying voters to opt to non-BN parties, Badawi marked his first outing as national leader with a sweeping victory, which should provide him the opportunity to further put his own personal stamp on the direction of the country.

Pakistan – Foreign Exchange Down: Pakistan's foreign exchange reserves slipped slightly to $12.560 billion in the week to March 13, down $5 million from the previous week, the State Bank of Pakistan said on Thursday. The central bank gave no reason for the fall, but bankers said the slide was mainly due to quarter-end repayments of foreign debt. The central bank said its direct holdings were $10.764 billion and those of commercial banks were $1.796 billion. The central bank changed the method it uses to calculate foreign reserves in 2002. It now monitors the total liquid foreign reserves, including previously undisclosed foreign exchange deposits by banks.

AsiaLinks

Philippines – Less Money in Reserve: The Philippines' gross international reserves are expected to fall to $15 billion at the end of this year from $16.9 billion as of end 2003, the central bank said on Thursday. The central bank uses the reserves to intervene "from time to time" to support the weak peso, but "we will not use up our gross international reserves to defend an unrealistic FX rate",

Governor Rafael Buenaventura told Reuters on Wednesday. The international reserves comprise the foreign currency holdings of the central bank, including gold and International Monetary Fund special drawing rights.

Turkey – A Little Less Change in the Pocket: Turkey's central bank foreign currency reserves fell $946 million to $31.853 billion in the week ending on March 12. Gold reserves were unchanged at 1.558 billion. Turkey's total gross reserves on February 27, the latest available data, were $47.126 billion, of which $12.187 billion was with private institutions, including commercial banks. The central bank held the rest.

Travel – Something to Do In London:

The Braham Museum of Tea and Coffee

By Scott B. MacDonald

For anyone with a sense of history and an interest in good cup of tea or coffee while in London, the place to go is the Bramah Museum of Tea and Coffee. Located on 40 Southwark Street, Bankside (London SE1 1UN phone: 020 7403 5650), this compact museum provides a comprehensive view of the world of coffee and tea, brought to life in a walk-through exhibition of ceramics, metal and graphic arts. The tearoom serves traditional afternoon teas and coffees. And if you are lucky, you might well meet Mr. Edward Braham, the museum's founder and tea industry veteran.

Mr Braham himself is well worth the visit. Among his relations are Joseph Braham, the 18th century engineer who made tea caddies as a boy in the 1760s and Sir Joseph Banks who suggested the feasibility of growing tea in North East India in 1788. The modern Mr. Braham started work on a tea plantation in Africa in 1950. From that point he was hooked on tea, working in London as a tea taster. He also gained experience working with Chinese teas. It was this early exposure to tea in different cultures, and the complexity of its production and marketing that gave Mr. Braham the idea to one day the tell the story of tea in a specialized museum. This became a reality in 1992 when he opened the museum's doors at Butler's Wharf by Tower Bridge. He subsequently moved the

museum to its current location, which is a growing tourist destination due to the presence of the Tate Modern Art Museum and the Globe Theater.

The tea part of the museum covers the older history of tea from 1600-1950, which encompasses the East India Company, the London Tea Gardens, ceramics, smuggling, tea auctions, the Boston Tea Party, opium trading, clipper ships, tea growing in India and Ceylon and English afternoon tea. The coffee part of the museum covers coffee growing, how it spread around the world and how it is harvested and processed.

Considering the hurly-burly of today's commodity trading, the Braham Museum of Tea and Coffee is a very worthwhile opportunity to it all into a historical perspective and enjoy a good hot cup of tea or coffeed by Jamie Smiles.

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

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