

Commodities market fall tells us something.

Primary products market upward trend reversal.

Commodities market fall is accelerating. In August natural gas registered a sharp decline, it has been rumored that some large hedge funds which invested heavily in this product went broke. And this does not relate only to energy prices, grain and metal prices also registered heavy falls. After registering a historic high of 365 back in May the CRB futures index (the most representative commodities index) declined to 304 at some point last week, a new low since July 2005.

There are several reasons behind market expectations reversal. First Oil prices did not benefit from Iran nuclear affair, the Lebanon situation had a temporary lull and OPEC production increase was delayed.

Last week the World Energy Institution revised down global demand. Gold lost its glitter due to rates increase expectation and US\$ fall fears.

Grain prices also show weakness. Due to year 2004 abundant crop the grain market had been quite until 2005. It rose strongly this year discounting specialist funds purchases and production cost rise. Gasoline substitute's commodities offer (like corn and sugar used in ethanol production) increased and supply demand became tight. But oil fall triggered a chain reaction.

As a natural result the stock price of industries which benefited from oil producing countries infrastructure boom declined fast. If the Japanese market has been sidelined contrary to US stock market trading close to historic high it is probably because the weight of those stocks is comparatively high. However commodities price impact on Japanese economy is subtle. A slow upward trend in commodities price is not that negative, apart from industries penalized by raw materials costs. Japanese industries lead the world in terms of energy savings technology therefore this translates into a plus for Japanese economy. However too sudden a rise reduces worldwide demand and is consequently negative (apart from industries earnings directly linked to high oil price).

Long term commodities price fall translates into a tax rebate for Japanese

economy however short term steep decline has a negative impact on all the above mentioned stock prices. Furthermore considering that world economy slowdown is prices fall main cause this translates in a negative premium for most equity markets growth.

Last week US and China announced slowing growth rates and world economy growth rate was revised down by 0.5%, this is still far from being a real slowdown.

### Chinese economy Achilles' heel: food and water.

Should US economy slow down then it is natural that export geared Asian countries growth rate slows down in turn. However it will not be on a large scale. The non ferrous metals commodities market (like copper and Nickel in heavy demand from infrastructure investments) has not shown any weakness yet. In addition the semiconductors DRAM market rose nearly 40 % for the past half year. There is currently no bearish sentiment.

However looking at the market association game, I feel that we are starting to see a delayed response from investors who held positions similar to the hedge funds which made money on the back of commodities markets.

LDP party internal election and US FOMC will both take place on the 20<sup>th</sup> of September ( there won't be much surprise though), as soon as the result is known most analysts and economists will start to show their prospective outcome scenarios. US economy shows a wide range of opinions like 'have we entered a real slowdown' or 'new rate increase is necessary to kill off inflationary pressures etc. It remains difficult to have a real sense of direction or fluctuation rate therefore it is best not to increase positions in the next three weeks or so.

On a medium term basis the consensus remains that Asian will be the world growth engine. Asian population is increasing, industrialization is advancing and living standards are improving. I do not believe that this can disappear on the sole basis of US economy slowdown factor and I fully agree with the consensus stating that Japan is the prime beneficiary of Asian dynamism. Now whether we can expect blindly Asian growth; I am at a loss for the answer. There are still a lot of pending problems. First can Asian economies absorb the soaring energy prices, second the problem of natural resources like food and water which has not yet been recognized may become acute.

In addition environmental protection problem which has been deferred make come back with a vengeance. Recently in China liquids wasted from factories impact has made drinkable water scarce in some provinces.

But this is just the tip of the iceberg.

China grain crop has gone down from year 1998 3 billion 900 million tons to year 2003 3 billion 200 million tons. China then benefited from good weather conditions and crop recovered to 3 billion 700 million tons by year 2005 but China started to import wheat form year 2004. Sooner than later China will urgently need a massive 400 million tons of grain imports. Chinese wheat retail price is 20 000 Yen per ton but world market price is 17300 Yen per ton. On the other hand industrial productivity added value for water used in industrial plants if 50 times higher. Consequently in China underground water is pumped using highly powerful equipments and farmlands appropriation is growing fast. It is just a matter of time before a severe water shortage occurs.