

Disconnecting from US dependence.

In any case US policy change is needed.

Next month is the Koizumi Cabinet deadline; a new cabinet will be in place. Odds are largely in favor of Abe I believe, however even if Abe who will continue the Koizumi line becomes prime minister there will be changes in the US unilateral doctrine similar to Koizumi's excesses.

One cannot deny that the economic policy of Koizumi cabinet (as widely published by the Medias) was to deregulate in order to expand business chances of US financial institutions. It was not done from choice and therefore we can forgive him on such basis. It was the only existing viable strategy to exit the crisis and the Japanese American security treaty.

However on a long term basis US economy worldwide share is trending downward, on the contrary newly developed countries (with Asia the main focus) percentage is rising fast. For now America is playing the world's policeman at substantial cost but I think the next political leader will greatly change the political course. Japan has been sticking to USA for everything regarding political matters but in a distant future unnecessary costs will need to be tackled, on the other hand energy and human resources must not be wasted and I hope the new prime minister will handle this carefully.

The surge in resources and energy prices is acting like a tax increase for an absolute consuming country like the US. Furthermore the US is going to experience a severe hangover after the housing boom burst. In short consumption will fall as economic downturn bites in reaction to excess consumption. The US family budget debt ratio is still rising fast therefore payment burden will increase... On the other hand it won't be easy to reduce the cost implied by terrorist ever rising skillfulness. In the USA also ageing population is expanding. With time the financial unbalance will become more severe. To say it strongly Bush administration was reduced to highhanded hostile actions. If this administration was so brute force politically tinged it is obviously because they had deep pockets and strength. Terrorists never accepted the US firmness toward them.

I think that the USA will eventually turn into an energy savvy society and this will improve relationship with Islamic countries. US themselves are piling up anti terrorist

costs and high oil price, if finances tighten then attitude is bound to change. It looks possible to reduce the associated costs by improving the dialogue and searching for compromises. The whole world, not only US, would welcome this. I expect the next president to stir such change.

The export rate toward USA has gone down but both economies are still strongly connected together.

What triggered the current Japanese economic recovery were exports, in fact since Koizumi formed his cabinet in 2001 exports ballooned from 51,5 trillion Yen toward 73,5 trillion Yen in 2005. The net exports amount increased from 3 trillion to 15 trillion Yen. Such a rise is the highest in 20 year's time. Stocks went up discounting such a move, investment in equipment and employment improved. Bad loans problem was settled, and finance improved also thanks to this. My impression is that Koizumi cabinet benefited from the world economy recovery rather than initiating the recovery itself.

Coming to the point of companies' earnings volume is not sufficient prices and profitability improvement have a lasting impact. Materials industry specially benefited from volume increase and profitability upward trend, from the second half of 2004 to full 2005 Yen weakness plus rise in shipments were remarkable. On the reverse processing industries suffered from heavy price competition and margins shrunk however volume expansion was sufficient to outweigh this. Processing industry shipments increase and last year gain and loss were balanced by gain and loss in exports. The increasing dependence with Asia is the next boost.

The Asian ex Japan industrial production variation seems to correlate with the variation of US Asian imports. Therefore if US consumption is vigorous Asian imports increase which in turn stimulates all Asian economies. Japanese exports toward US did not change a lot for the past 10 years but exports toward Asia shoot up since 2002 and this correlates with Asia industrial production. To summarize there is little doubt that even if we talk about exports to Asia the pattern has changed to exporting to US through Asia.

Consequently if US economy slows down it looks inevitable that Japanese exports to Asia will suffer. This is negative for investment equipment related stocks and high techs, the current semiconductor and heavy industries poor showing is discounting such a move. However Asian domestic demand itself is powerful (7% growth rate on average) therefore correction period should be limited.

According to Daiwa research institute breakdown of sales by area for TSE 1st section industrial stocks was in 2001 ; domestic, USA, Europe, Asia 60.8, 18.6, 7.8, 12.8 %. In

2005 the same breakdown was 52.7, 17.6, 9.6, and 20.1. Exports toward Asia and Europe increased noticeably. It could be said that the risk for a company boasting dominant market share or lacking a specific product increases by not expanding overseas.