Summary of the Result of 2008 JETRO Survey on Business Conditions of Japanese Companies in the U.S. and Canada

- Japanese companies' business confidence is the worst in the past 17 years in the U.S. -

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Introduction

During the period between July and August 2008, JETRO conducted an annual survey with Japanese companies in the U.S. and Canada through JETRO's six offices in the U.S. (New York, San Francisco, Los Angeles, Chicago, Houston and Atlanta) and two offices in Canada (Toronto and Vancouver). 789 companies in the U.S. (only manufacturers) and 202 companies in Canada (both manufacturers and non-manufacturers) responded to the survey. This year's survey was the 27th in the U.S. (the first was conducted in 1981) and the 19th in Canada (the first was in 1989).

This survey was conducted before September 2008 when the financial crisis in the U.S. deepened. Since September, the U.S. government took control over Fannie May and Freddie Mac, leading security companies stumbled, and major insurance companies faced financial instability. Economic prospects have increasingly become uncertain since we conducted the survey, and Japanese companies should have increased their concern since then.

[Method of survey, remarks, etc.]

1. Coverage of survey

"Japanese company" is defined as a company which is directly or indirectly "owned by a Japanese parent company with more than 10% of its capital." For example, if a Japanese parent company owns 20% of the capital of its U.S. subsidiary ("X company") and "X company" owns 50% of the capital of its subsidiary company ("x company"), the Japanese parent company's ownership in "x company" is deemed to be 10% (= 0.2 multiplied by 0.5 and multiplied by 100) and therefore "x company" is considered to be a "Japanese company" ("x company" is a grand-daughter company of the Japanese parent). The great-granddaughter company is also considered to be included in the "Japanese company."

2. Method of survey

The internet address (URL) where a questionnaire form was located was sent to the respondent's email address. Respondents entered their responses directly into the form on the screen of the computer and sent it to JETRO through the internet.

3. Period of survey

Between July and August 2008

4. Collection of responses

(1) The U.S.

1,274 representative companies (controlling companies) of the Japanese manufacturers in the U.S. were requested to reply to the survey via email. 789 companies responded. The response rate was 61.9%.

(2) Canada

291 representative companies (controlling companies) of the Japanese companies (both manufacturers and non-manufacturers) in Canada were requested to reply to the survey via email. 202 companies responded. The response rate was 69.4%.

Note: Each JETRO office in the U.S. and Canada counted the number of companies in the U.S. and Canada on the basis of the information obtained from sources, which are considered reliable. Japanese companies cooperated with such tallying. However, JETRO does not guarantee the accuracy of the number of companies in each country.

Executive Summary

○ **Due to an economic downturn and higher costs of energy and raw materials, business confidence of Japanese companies in the U.S. and Canada is worst in the history since JETRO started the survey. It is worse than the level of 2001, when IT bubble burst and terrorists attacked the U.S. on 9/11. In particular, a significant slowdown is found in the automobile industry.**

In 2008, Japanese companies in the U.S. and Canada are being hit by a double blow of (i) slowing economy and (ii) inflationary pressure caused by increasing prices of energy and raw materials. Business confidence of Japanese companies is below the level of 2001 when the U.S. economy fell in a recession after the collapse of the IT bubble and the terrorist attacks on 9/11. The situation is the worst in the past 17 years in the U.S. and in the past 11 years in Canada (i.e. the worst since the JETRO's first survey was conducted). The impact is seen in the decrease of the number of companies making "profit" and in the companies' cautious stance on employment and capital investment.

Companies have replied to the survey that deterioration of Japanese companies' earnings is directly caused by decrease in sales in the domestic and overseas markets and increase of domestic and importing procurement costs. 97.2% of the companies in the U.S. and 91.0% in Canada have replied to the survey that they are somehow negatively affected by the increase of energy prices, which causes higher transportation costs and increased price of raw materials. This suggests that procurement costs have increased. Sales have decreased due to the cooling of consumption resulting from the economic downturn.

In particular, a significant slowdown is apparent in the industries of transportation machines (motor vehicles and two-wheeled vehicles) and the parts for transportation machines, in which many Japanese companies have established their subsidiaries in the U.S. and Canada. In 2008, more than 60% of the companies in the industries of transportation machines and the parts for transportation machines in the U.S. have forecast a "decrease" in their operating profit from the previous year (while the average of all sectors is 44.7%). In Canada, the situation is worse. More companies in the industry of the parts for transportation machines have forecast to make a "loss" (44.0%)

than those that have forecast to make “profit” (40.0%) in 2008. This shows a clear contrast with response in 2007 when 75% of the companies made “profit.” This resulted from deterioration of consumer confidence due to slowdown in the economy and high gasoline price, together with an increase of raw material costs. U.S. annual car sales in 2008 should further decrease from 16.5 million units in 2007 when it was the lowest in the past 9 years.

However, some companies expanded their sales in the domestic and overseas markets, have successfully gained operating profit. Such companies increased their efficiency, improved productivity, decreased their cost by slashing workers and administration costs, and quickly transferred the increased cost of raw materials and energy to the prices of products and services.

○ **While the Japanese companies are concerned with cost increase in addressing climate change and environmental issues, many companies also expect to take advantage of their strength in these issues and expand PR activities. A wide range of industries including the transportation machine industry has expressed their concern over the U.S. trend of “anti-globalization.”**

With regard to the rising interest in climate change and environmental issues, many companies, particularly those in the transportation machines industry and the parts industry for transportation machines, express concern over possible increase in costs. However, there are also many companies considering positively that the rising interest may lead to “expand PR activities for environmentally-friendly business image” and to “increase competitiveness against other companies.” This suggests the strength of the Japanese companies in environmental technologies.

It is pointed out that “anti-globalization” (such as trade protectionism) is on the rise in the U.S., but the Japanese companies have not been negatively affected by such trend at the moment. However, an overwhelming concern exists in a wide range of industries, including the transportation machines industry which expresses the biggest concern.

1. Japanese companies' business confidence is the worst in history. It is worse than the level of 2001, when IT bubble burst and terrorists attacked the U.S. on 9/11. Dark clouds are cast over the companies' earnings, employment and investment.

Operating profit of Japanese companies in the U.S. and Canada in 2008 is forecast to decrease from the previous year in nearly all industries. DI value (value of the percentage of companies forecast to increase their operating profit in the surveyed year from the previous year, from which the percentage of companies forecast to decrease their operating profit is subtracted), which represents the companies' business confidence, turns from 23.9 in 2007 to minus 16.6 in 2008 in the U.S. and from 8.6 to minus 5.1 (minus 10.9 only for manufacturers) in Canada. This level is below the level of 2001 when the U.S. economy fell in a recession after the collapse of the IT bubble and the terrorist attacks on 9/11. The situation is the worst in the past 17 years in the U.S. and in the past 11 years in Canada (i.e. the worst since JETRO's first survey was conducted) (Refer to Figures 1 and 2).

Decline in business confidence is reflected in the companies' earnings, employment and investment. The percentage of the companies that replied to the survey that they will make an operating profit in 2008 decreased by 16.6 points from the previous year in the U.S., which represents the largest decrease in the history of this survey. It also decreased in Canada for the first time in these four years.

The employment situation has drastically changed in the U.S. With regard to the changes in the number of employees for the past one year, the companies that "increased" the number of employees decreases to 28.6%, which is 8.6-point lower than the previous year, and the companies that "decreased" the number of employees increases to 26.0%, which is 6.4-point higher than the previous year. As a result, the number of companies that increased their employees turns out to be equal to the number of companies that decreased their employees, which shows a clear change in the situation where the former have consistently exceeded the latter since 2003.

It is clear both in the U.S. and Canada that dark clouds are cast over capital investment in the manufacturing industries. In the U.S., the companies that "increased their capital investment if compared to the previous year" decreased from 41.9% in 2007 to 30.3% in 2008, and the companies that "decreased their capital investment" increased from 19.0% in 2007 to 26.7% in 2008. In Canada, the companies that "increased their capital investment" decreased by 5.6 points to 24.1%, and the companies that "decreased their capital investment" increased by 12.2 points to 22.2%. The number of companies that "increased their capital investment" is at the same level as the number of companies that "decreased their capital investment." It makes a clear contrast to the

non-manufacturing industries where the number of companies that “increased their capital investment” has consistently exceeded the number of companies that “decreased their investment” since 2004.

2. Japanese companies are hit by a double blow of “slowing economy” and “inflationary pressure.” Appreciation of currency causes a negative effect in Canada.

Deterioration of earnings of Japanese companies is directly caused by decrease in sales due to the cooling of the market resulting from the downturn in the U.S. economy and the rise of procurement costs due to sharp increase of transportation costs and material costs caused by higher energy prices. A double blow of “slowing economy” and “inflationary pressure” has affected the Japanese companies' earnings.

The top three reasons given by the companies in the U.S. for their “decrease” of operating profit from the previous year are the “decrease of sales in the domestic market” (64.3%), “increase of domestic procurement cost” (55.3%), and “increase of importing procurement cost” (50.1%) (Refer to Figure 3). These situations are arguably caused by “fluctuation of energy prices” (73.6%) and “downturn in economy (repercussion of the subprime loan crisis, etc.)” (65.8%), which most of the companies have raised as obstacles or risks for the U.S. businesses (Refer to Figure 4).

Companies in Canada responded that “increase of importing procurement cost” (44.1%) and “decrease of sales in the domestic market” (39.7%) as the main two reasons for their “decrease” of operating profit forecast (Refer to Figure 5). In addition, many companies mention “decrease of sales in the overseas market” (36.8%), and this should have resulted from the negative impact on export caused by appreciation of the Canadian dollar. Exchange rate risk is also raised by many companies as one of the business risks in Canada (Refer to Figure 6).

Finally, 97.2% of the companies in the U.S. and 91.0% in Canada (94.7% of manufacturers alone) have replied to the survey that they are somehow negatively influenced by the increase of energy prices. More specifically, companies responded they are concerned with “increase of transportation cost” and “increase of petrochemical raw material prices.”

3. Companies have successfully gained operating profit, if they increased their productivity, quickly transferred an increased cost onto prices and expanded their sales in domestic and overseas markets, despite the pressure of high costs of energy and raw materials.

Although many companies foresee their earnings to worsen, nearly 30% of the

companies in the U.S. and Canada are forecasting that their operating profit will "increase" from the previous year. These companies have common characteristics in that they are taking actions for "sales expansion in the domestic and overseas markets," "increase of productivity" and "increase of prices" (Refer to Figures 7 and 8).

High costs of energy and raw materials provide favorable conditions to the upstream industries, such as the steel industry and non-ferrous metals industry. Although other industries are under severe economic conditions, some of the companies in such other industries are making good efforts. Companies, which increased their efficiency through improvement in their productivity, decreased their costs by decreasing their personnel and administration costs, quickly transferred the increased cost of raw materials due to high energy prices onto the prices of their products and services, and which expanded their sales in the domestic and overseas markets, have successfully gained operating profit.

4. Companies predict that economy will hit bottom in 2008, and will not worsen in 2009. However, the deepening of financial crisis after September makes the future economic outlook uncertain.

During the period between July and August 2008 when the survey was conducted, most of the Japanese companies have forecast that their operating profit in 2009 and thereafter would reverse from the worsening situation in 2008. The average DI value is predicted to improve from minus 16.6 in 2008 to 28.5 in 2009 in all of the U.S. manufacturers, and from minus 5.1 to 25.3 in all Canadian industries (Refer to Figures 1 and 2).

The companies' responded that although there is no strong prospect in employment and investment, the economy seems to have hit bottom in 2008 and will not worsen next year. Firstly, with regard to the forecast of employment, the companies (only manufacturers) in the U.S. foreseeing that the number of employees will "decrease" during the past one year decreased by 11.6 points, while the companies foreseeing that the number of employees will be "no change" increased by 14.3 points. Thus, the restructuring of the workforce caused by the present slowdown in economy seems to have ended for the time being. Replies of the companies in Canada do not show any distinguishing characteristics that set them apart from the U.S., and the number of companies which foresee that the number of employee will remain "no change" is expected to increase, in proportion to the number of companies which foresee that the number of employee will "decrease." Secondly, with regard to capital investment in 2009, there are more companies in the U.S. forecasting that capital investment will "increase"

(23.4%) than those forecasting that it will “decrease” (19.1%). In Canada, although there are more companies in manufacturing industries forecasting that capital investment will “decrease” than those forecasting that it will “increase,” the average of all industries, led by non-manufacturers, such as trading companies and sales companies, shows that there are more companies forecasting that capital investment will “increase” (20.3%) than those forecasting that it will “decrease” (15.9%).

WTI spot crude oil price, which was approaching almost 150 dollars per barrel and was at a peak in the middle of July when this survey was initiated, came down to a range of 110 dollars in late August when the survey was completed. Although the price level remains high in a historical context, concerns over inflation are gradually diminishing. Many companies both in the U.S. and Canada have raised the fluctuation of energy prices as a business risk, and the decline in crude oil price will give advantages to many of the industries. This may have contributed to improving the DI value despite the continuation of economic slowdown.

However, in addition to the high energy prices, there are many risk factors, such as downturn of the U.S. economy, the deepening U.S. financial crisis after September 2008 and appreciation of the Canadian dollar, which cast uncertainty over the economies in the U.S. and Canada in 2009 and thereafter.

5. Automobile industry is under difficult conditions in 2008 and there is no good prospect in 2009.

Significant slowdown is found in the industries of transportation machines (motor vehicles and two-wheeled vehicles) and the parts for transportation machines, in which many Japanese companies have established their subsidiaries in the U.S. and Canada. In 2008, more than 60% of the companies in the industries of transportation machines and the parts for transportation machines in the U.S. have forecast that their operating profit will “decrease” from the previous year (while the average of all sectors is 44.7%). The situation is worse in Canada where more companies in the industry of the parts for transportation machines are forecasting that they will make a “loss” (44.0%) than those forecasting that they will make a “profit” (40.0%) in 2008,although 75% of the companies actually made a “profit” in 2007. This resulted from decline in consumer confidence due to slowdown in the economy and high gasoline price, which is combined with the increase of raw material costs.

During the period between July and August of 2008 when this survey was conducted, companies have forecast their operating profit in 2009 as equal to or a little more than that of 2008. Different from 2008, there are more companies both in the U.S.

transportation machines industry and the parts industry predicting that their operating profit will “increase” than those predicting that it will “decrease.” However, there are many companies (66.7%) in the transportation machines industry predicting that their operating profit will “remain the same” as that in 2008. In the parts industry, if compared to the average of all sectors, there are less companies forecast that their operating profit will “increase” in 2009 and there are more companies forecasting that their operating profit will “decrease” in 2009. In the parts industry for transportation machines alone in Canada, the number of companies forecasting that their operating profit will “increase” is equal to the number of companies forecasting that their operating profit will “decrease” (both 32.0%), although in almost all industries in Canada there are more companies foreseeing that their operating profit will “increase” than those foreseeing that it will “decrease.” Both in the U.S. and Canada, the prospect of the automobile market in 2009 remains uncertain.

6. With regard to the rising interest in climate change and environmental issues, many companies express concern over possible increase in costs. However, there are also many companies considering positively, which suggests the strength of the Japanese companies in environmental technologies.

With regard to the effect of climate change issues and growing concern over environmental issues, many companies in the U.S. and Canada are concerned about “increased costs for related measures” (38.9% in the U.S. and 35.2% in Canada. Refer to Figures 9 and 10), and among major industries, overwhelming concern exists in the transportation machines industry (84.2% in the U.S.), the parts industry for transportation machines (64.0% in Canada) and the industry of food, agriculture and fishery process (47.8% in the U.S.). In the U.S., state/local governments and private sectors have been taking actions to reduce greenhouse gas emission, taking faster initiatives than federal government. Companies consider it inevitable that they should take actions to cope with the requirements of the states, etc. as well as from the viewpoint of their corporate social responsibility.

On the other hand, with regard to the effects brought by the growing concern over environmental issues, many companies consider that it will lead to expand their “PR for environmental-friendly business image,” taking advantage of Japanese companies' strength in environmental technologies (26.6% in the U.S. and 33.2% in Canada). Both in the U.S. and Canada, there are far more companies thinking that the issues would “increase their competitiveness against other companies” than those thinking that the issues would “decrease their competitiveness against other companies.” Confidence of

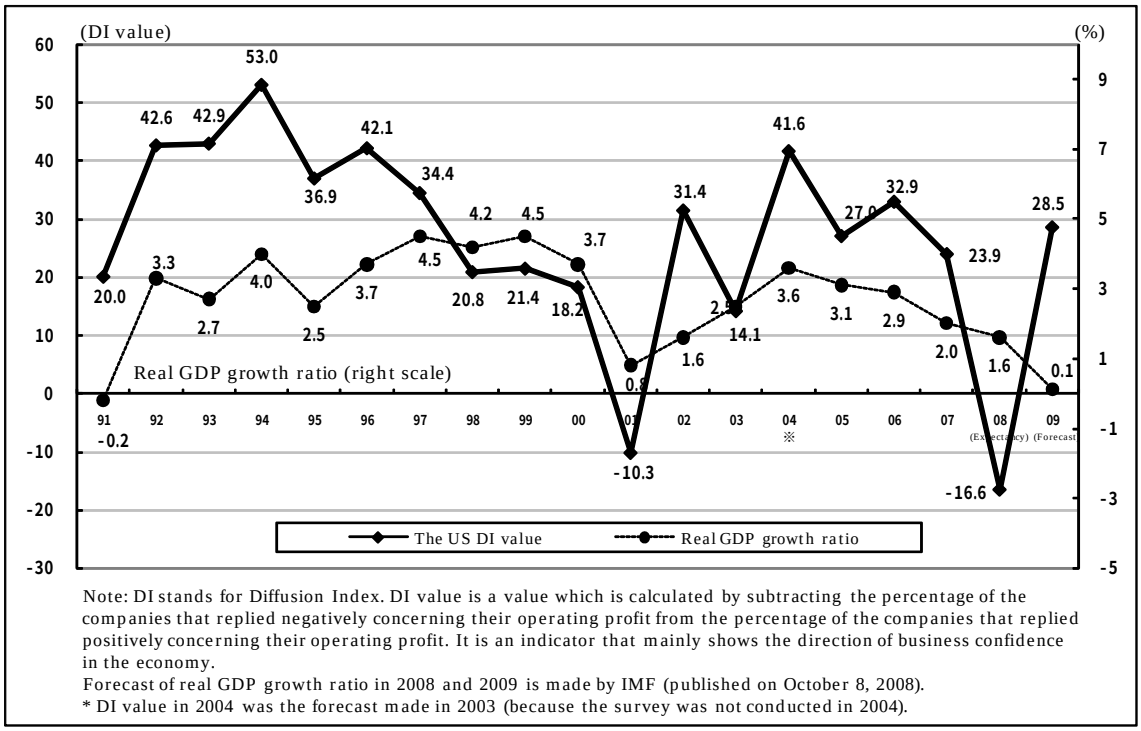
many Japanese companies can be found in their responses that there is “no specific effect” brought by these issues (29.3% in the U.S. and 30.6% in Canada). Interestingly enough, many of the trading companies in Canada chose “expansion of opportunities for alternate energy related business” as one of the effects of these issues, over other options concerning increased costs and PR activities.

7. Japanese companies have not been negatively affected by the trend of “anti-globalization” in the U.S., but their experiences during the period of trade friction are traumatically recalled in the automobile industry and many other industries.

The Democratic Party, currently controlling both the Senate and House of Representatives, is expected to make major gains in the elections scheduled in November 2008. It blows strongly against the promotion of free trade in the U.S. at the moment, and “less trade-friendly environment” will continue in 2009.

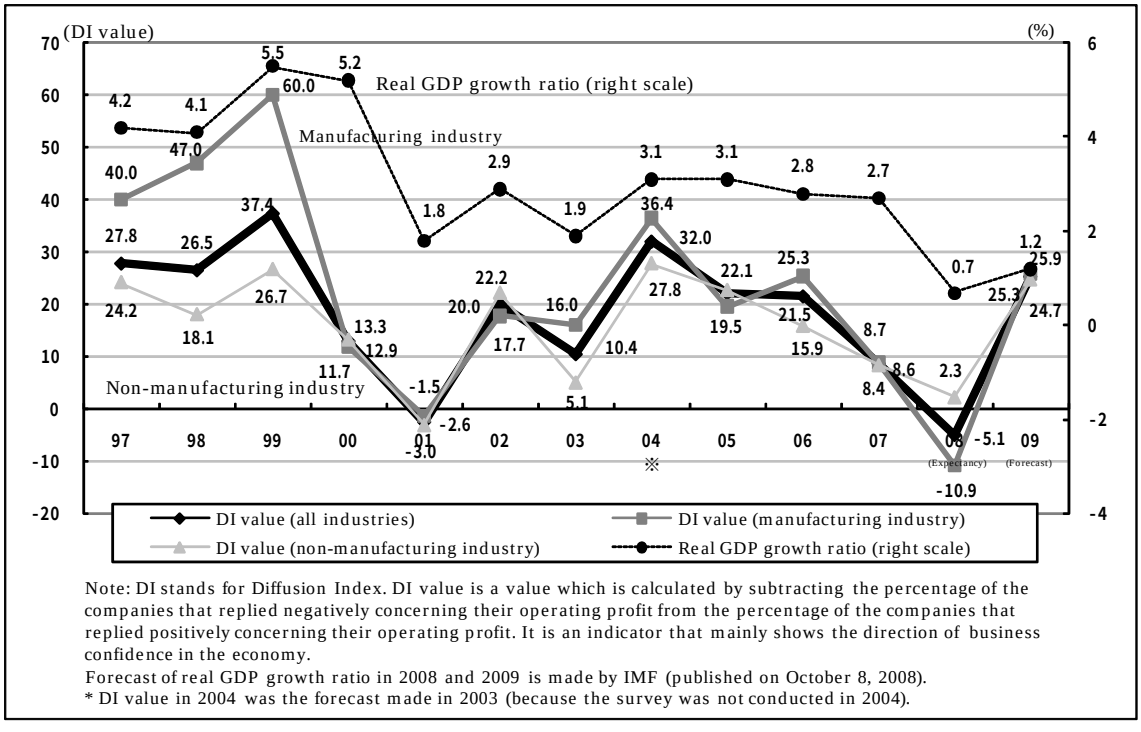
A very low number of Japanese manufacturers in the U.S. (1.5%) replied that the trend of anti-globalization “affects their business negatively” (Refer to Figure 11). However, there are many companies that are “not currently affected but concerned about the future.” The transportation machines industry is at the top of such industries (78.9 %), and more than 40% of the companies in a wide range of industries, including clothes and textiles, pharmaceuticals, ceramic, earth and stone, machines (including mold and power tools), electric and electronic machines, electric and electronic parts, and parts for transportation machines, express their concern. Since Japanese manufacturing companies have already significantly localized, and the U.S. trade deficit is mainly attributed to Chinese exports, “a boycott of Japanese products or any other Japan-bashing” is unlikely. However, it seems the Japanese companies that had been through many hardships in the period of trade friction cannot easily forget their traumatic experience.

Figure 1: [USA] Changes in DI value focusing on companies' operating profit and real GDP growth ratio



Note: DI stands for Diffusion Index. DI value is a value which is calculated by subtracting the percentage of the companies that replied negatively concerning their operating profit from the percentage of the companies that replied positively concerning their operating profit. It is an indicator that mainly shows the direction of business confidence in the economy.
Forecast of real GDP growth ratio in 2008 and 2009 is made by IMF (published on October 8, 2008).
* DI value in 2004 was the forecast made in 2003 (because the survey was not conducted in 2004).

Figure 2: [Canada] Changes in DI value focusing on companies' operating profit and real GDP growth ratio in Canada



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Forecast of real GDP growth ratio in 2008 and 2009 is made by IMF (published on October 8, 2008).
* DI value in 2004 was the forecast made in 2003 (because the survey was not conducted in 2004).

Figure 3: [USA] Reasons why the company's operating profit in 2008 will "decrease" from the previous year (multiple answers allowed)

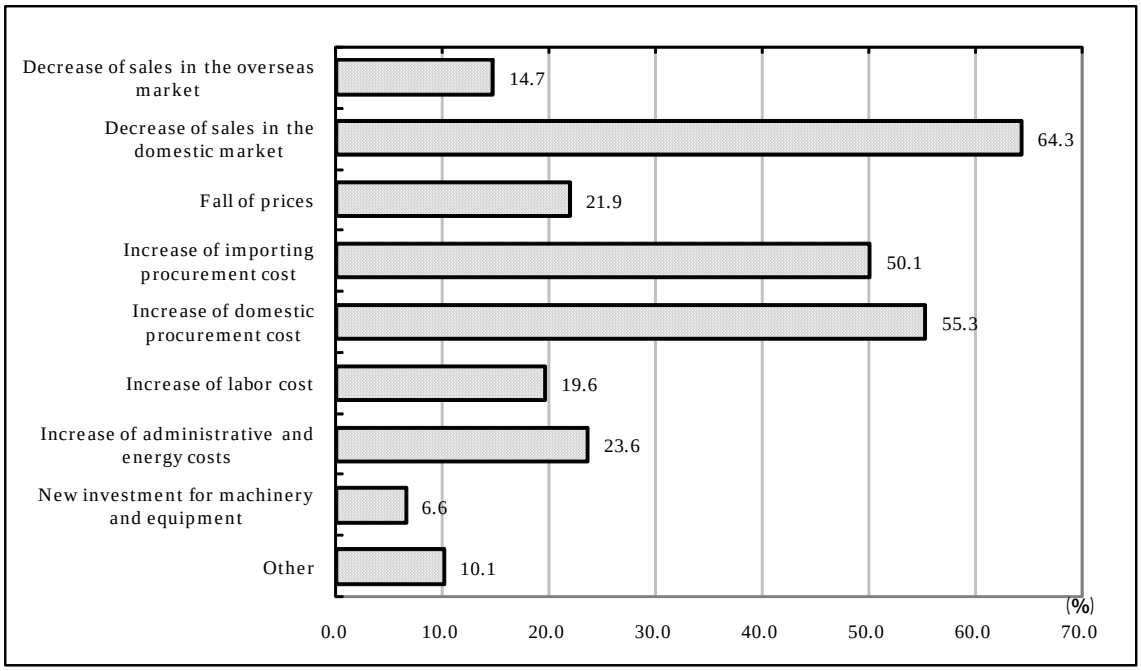

Figure 4: [USA] Issues that are considered obstacles, problems or risks in the domestic business

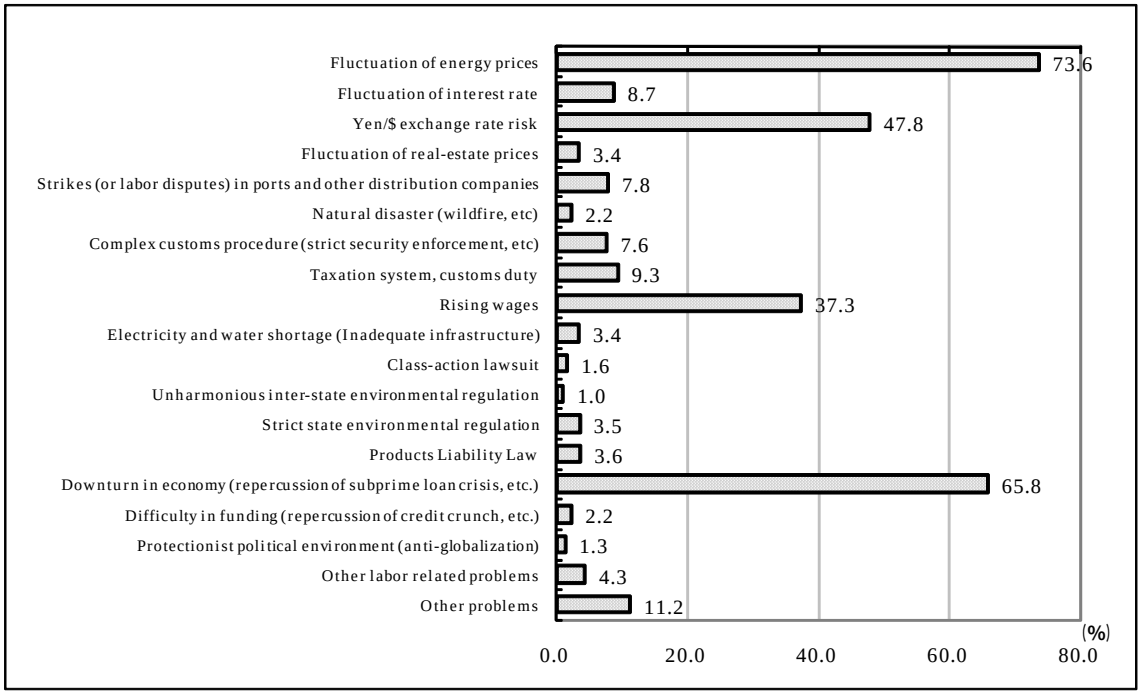

Figure 5: [Canada] Reasons why the company's operating profit in 2008 will "decrease" from the previous year (multiple answers allowed)

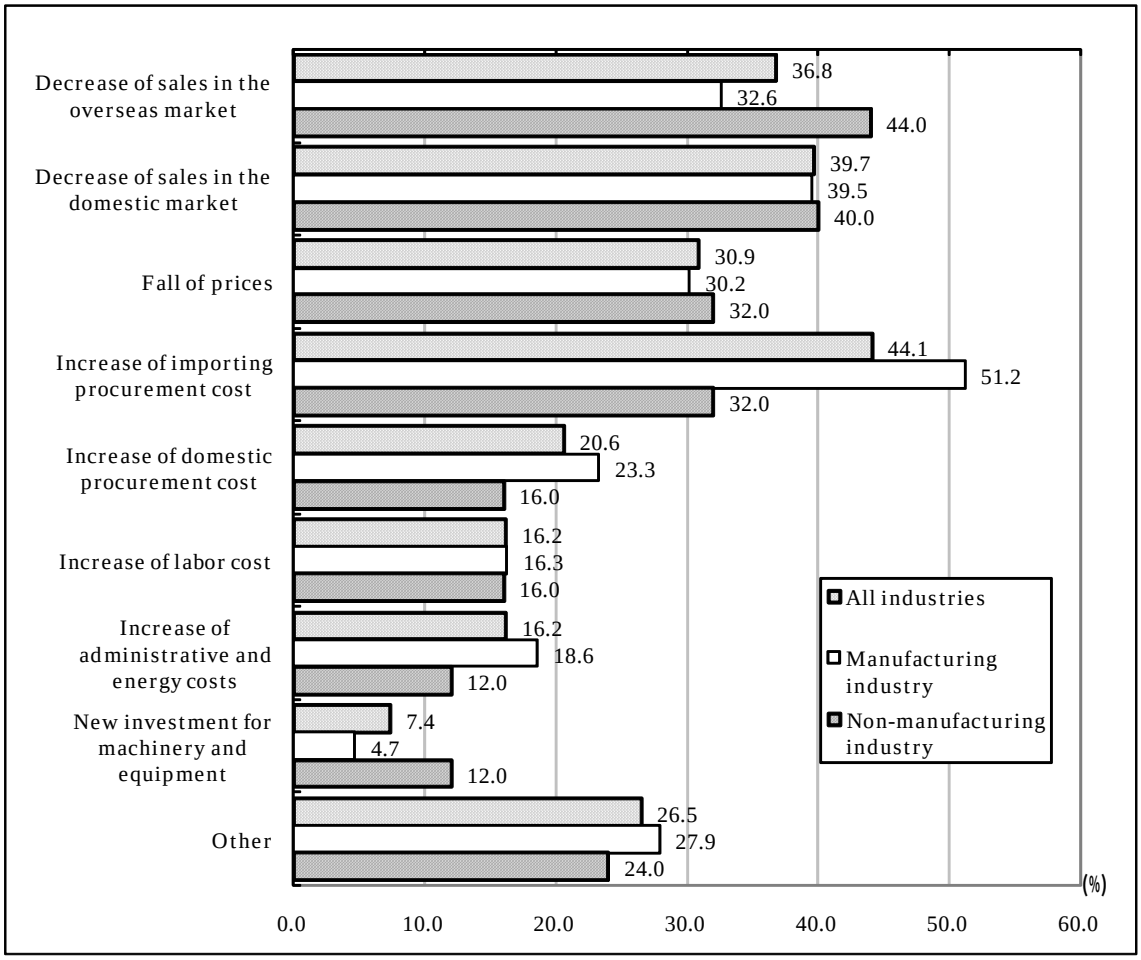

Figure 6: [Canada] Issues that are considered obstacles, problems or risks in the domestic business

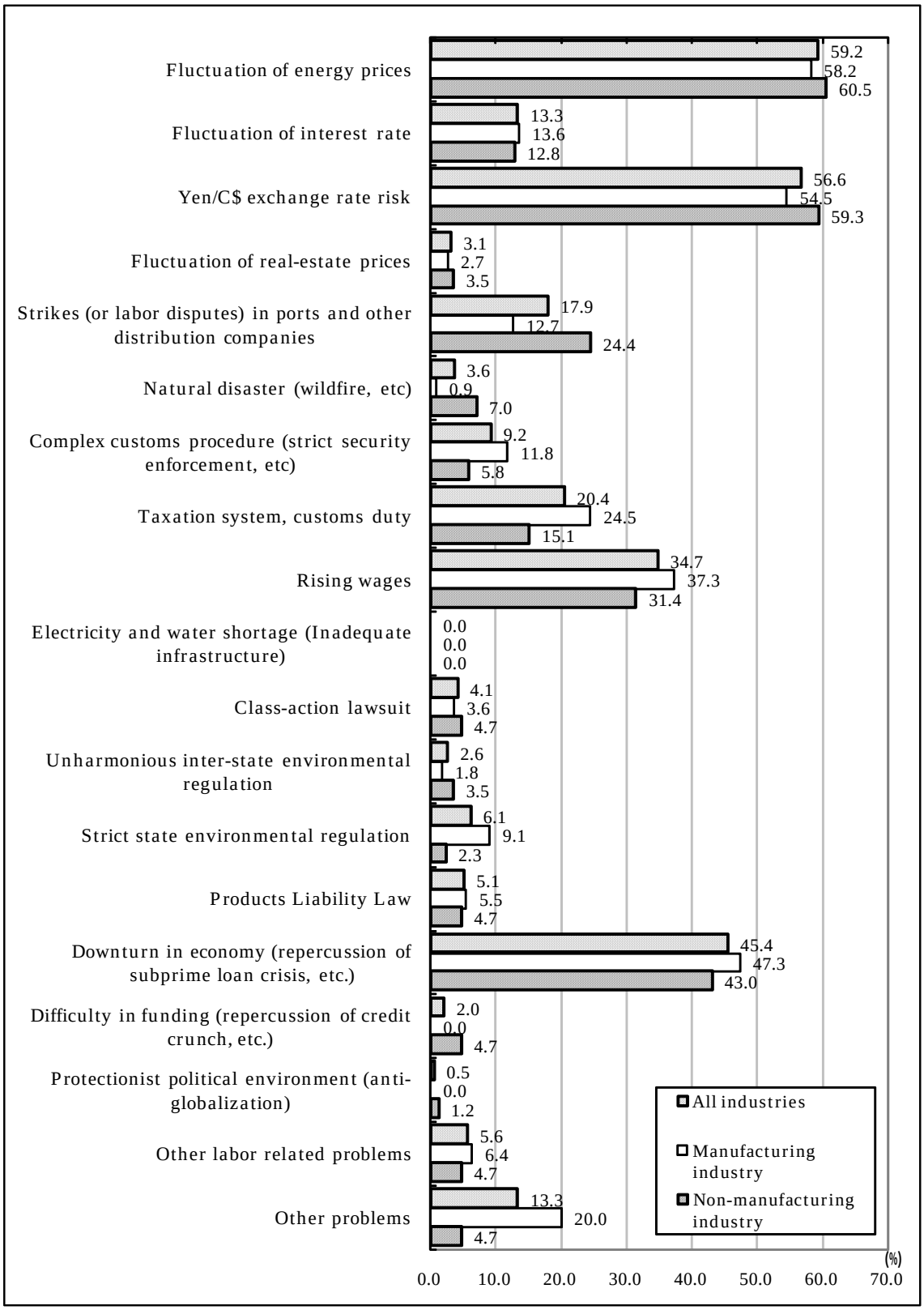

Figure 7: [USA] Reasons why the company's operating profit in 2008 will "increase" from the previous year (multiple answers allowed)

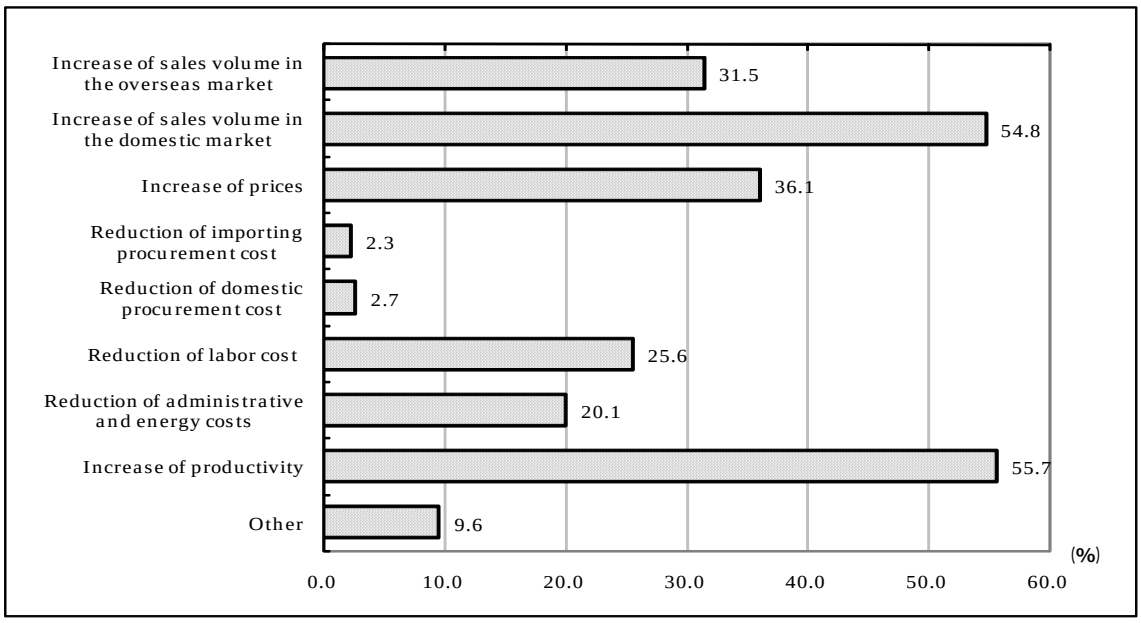

Figure 8: [Canada] Reasons why the company's operating profit in 2008 will "increase" from the previous year (multiple answers allowed)

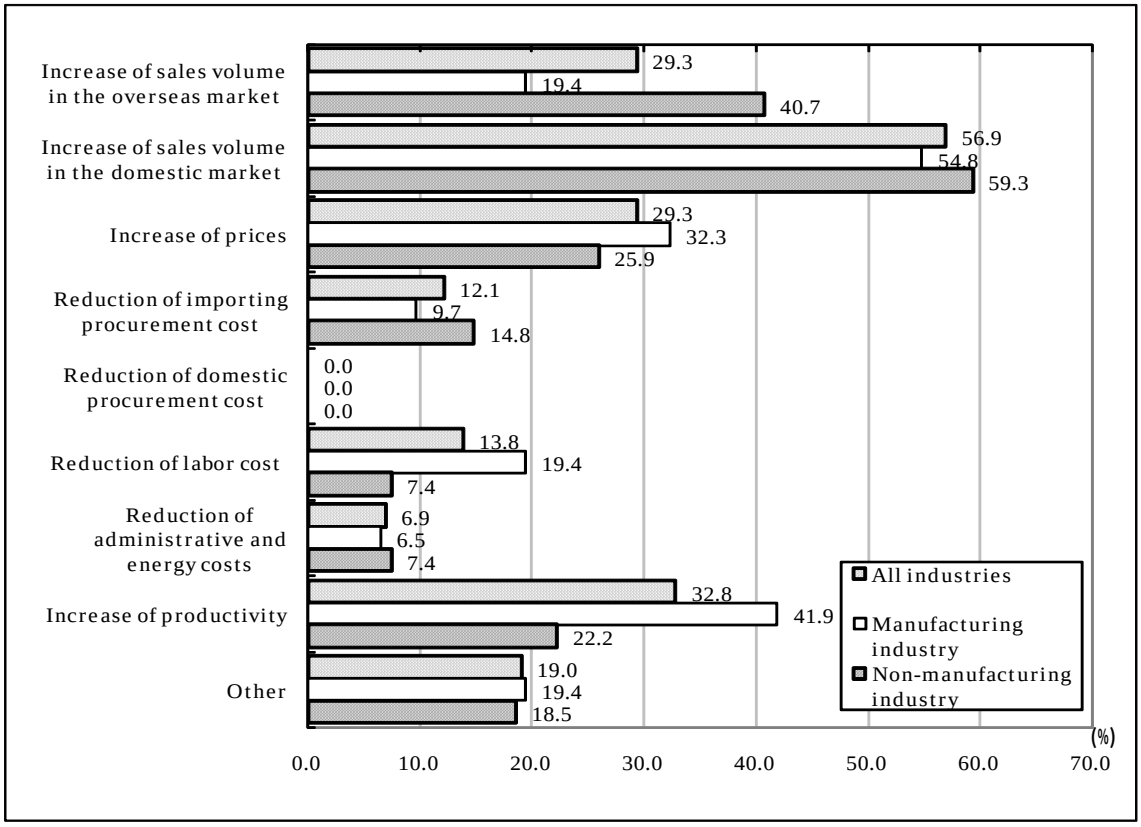

Figure 9: [USA] Effects of climate change and environmental issues on future business

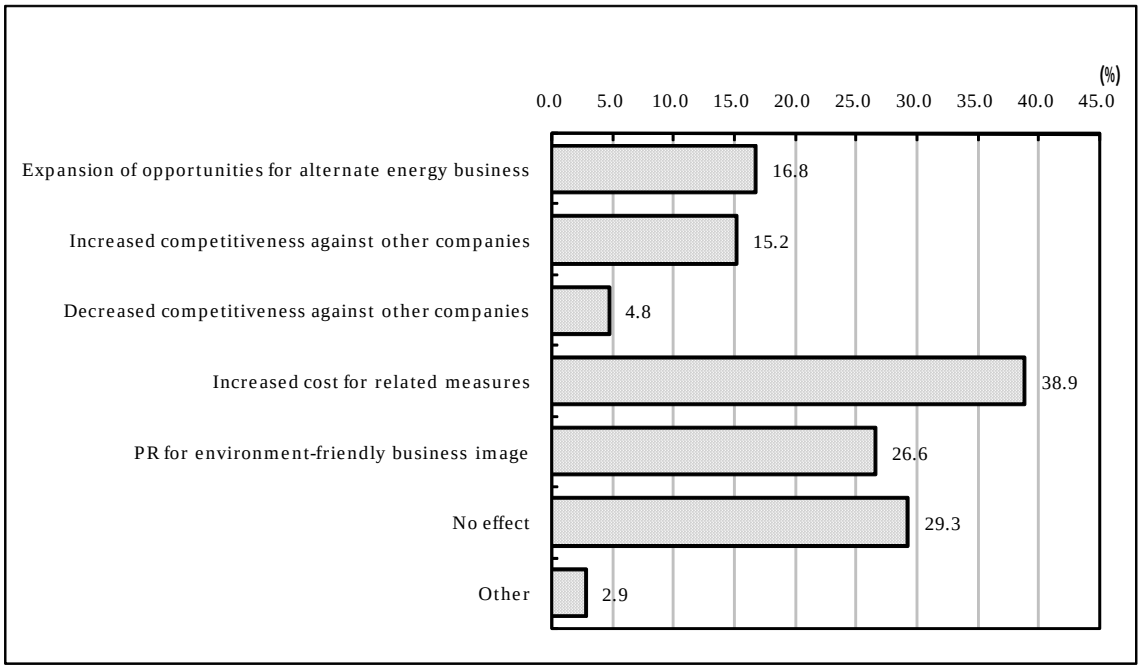

Figure 10: [Canada] Effects of climate change and environmental issues on future business

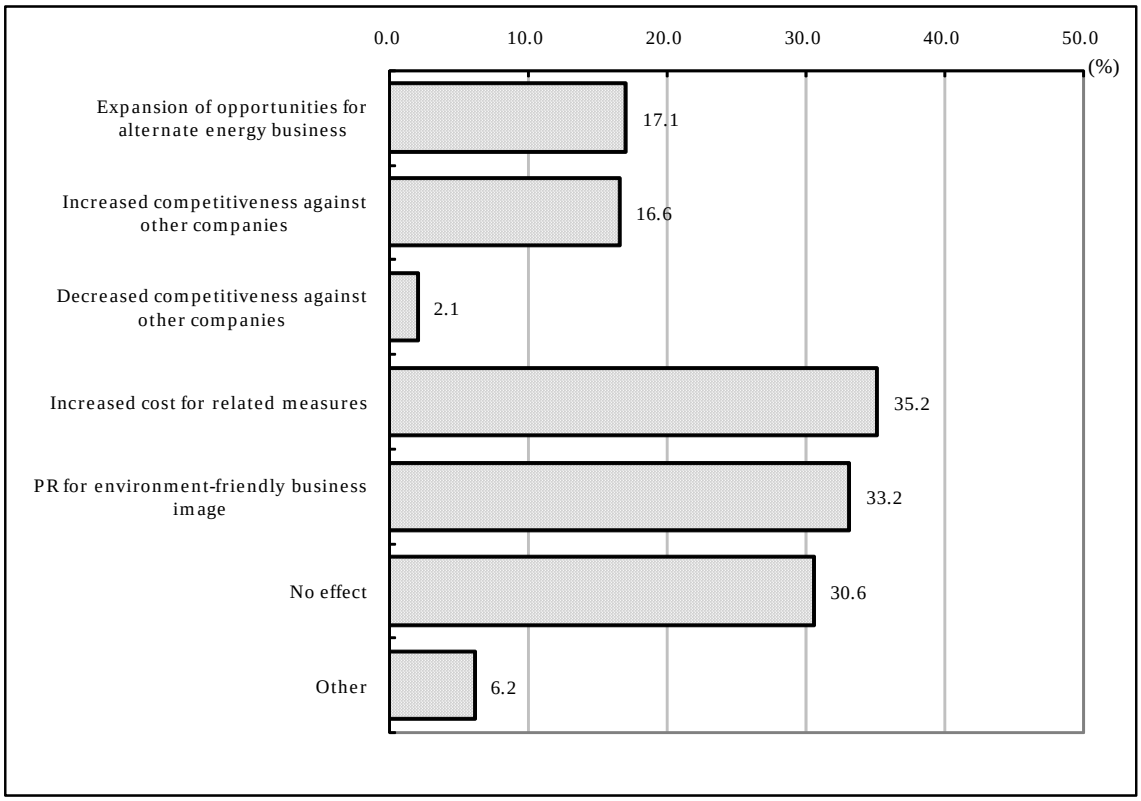

Figure 11: [USA] Effects of the trend of trade protectionism (anti-globalization)
Upper row: Number of companies that responded

Upper row: Number of companies responded
Lower row: Percentage (%)

	Valid responses	Negatively affected	Currently not affected but concerned about the future	Not affected	Other
Total	779	12	297	463	7
	100.0	1.5	38.1	59.4	0.9
Food, agriculture, and fishery process	71	1	19	49	2
	100.0	1.4	26.8	69.0	2.8
Textile (yarn, woven and chemical products)	7	-	1	6	-
	100.0	-	14.3	85.7	-
Clothes and textiles	2	-	2	-	-
	100.0	-	100.0	-	-
Timber and wooden goods (excluding furniture and interior design products)	2	-	-	2	-
	100.0	-	-	100.0	-
Furniture and interior design products	3	-	1	2	-
	100.0	-	33.3	66.7	-
Paper and pulp	3	-	-	3	-
	100.0	-	-	100.0	-
Chemical products	77	-	23	53	1
	100.0	-	29.9	68.8	1.3
Oil products	2	-	-	2	-
	100.0	-	-	100.0	-
Plastic products	20	1	7	12	-
	100.0	5.0	35.0	60.0	-
Pharmaceuticals	5	-	2	3	-
	100.0	-	40.0	60.0	-
Rubber goods	17	-	3	14	-
	100.0	-	17.6	82.4	-
Ceramic, earth and stone	9	-	4	5	-
	100.0	-	44.4	55.6	-
Steel (including cast and wrought products)	30	1	6	22	1
	100.0	3.3	20.0	73.3	3.3
Non-ferrous metals	14	-	4	10	-
	100.0	-	28.6	71.4	-
Metal goods (including plated products)	33	-	13	18	2
	100.0	-	39.4	54.5	6.1
Machines (including mold and power tools)	60	2	27	31	-
	100.0	3.3	45.0	51.7	-
Electric machines	49	1	20	28	-
	100.0	2.0	40.8	57.1	-
Electric and electronic parts	59	-	24	34	1
	100.0	-	40.7	57.6	1.7
Transportation machines (motor vehicles and two-wheeled vehicles)	19	-	15	4	-
	100.0	-	78.9	21.1	-
Parts for transportation machines (motor vehicles and two-wheeled vehicles)	201	3	94	104	-
	100.0	1.5	46.8	51.7	-
Precision machines and apparatuses	25	1	6	18	-
	100.0	4.0	24.0	72.0	-
Other	71	2	26	43	-
	100.0	2.8	36.6	60.6	-