

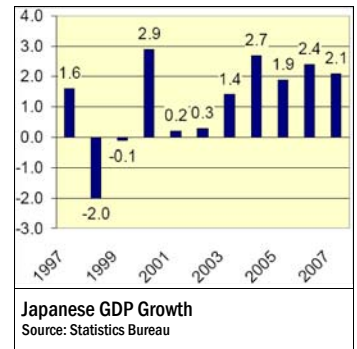
Japan's current economic situation

Although the economic situation in the United States raises concerns about the impact on the Japanese economy, some good news were announced in the past month. The main one is that Japan's economy grew 3.7% in the fourth quarter of 2007, twice as much as expected, thanks to increased exports. This announcement led to the Nikkei growing 4.3% on Feb. 14, the highest one-day rise since March 2002. For the whole of 2007 GDP rose 2.1%, compared with 2.4% in 2006.

The other better-than-expected figure was that of household spending, which grew 2.2% in real terms in December from a

year earlier, beating the 0.2% decline forecast by economists.

These figures, however, need to be analyzed carefully. Trade figures show that exports to emerging markets such as China and the Middle East should help mitigate a US slowdown. However, a significant proportion of exports to countries like China are parts for products that are then shipped to the US. Economists say that the effect of the US subprime mortgage crisis should therefore be felt more strongly in the first quarter of this year. Meanwhile, high oil prices helped push Japan's wholesale inflation to a quarter-century high of 3%, putting pressure on



consumer spending. Overall inflation has been hit hard by higher oil prices too, adding to the dilemma facing the Bank of Japan, under pressure to lower interest rates to boost a faltering economy at a time when some board members are increasingly concerned about inflation. The rate is expected to stay at 0.5% for a while.

Special points of interest:

- GDP grew twice as fast as expected in Q4 2007
- Prime Minister Fukuda's grand plans to combat global warming with Japanese technology
- Special reports: the Blu-ray vs. HD DVD battle and the Tornos-Tsugami alliance

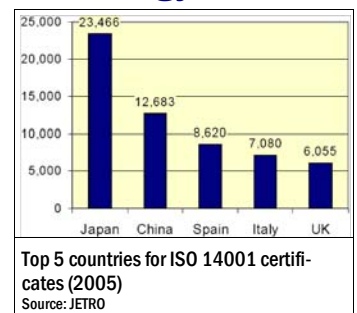
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What role for Japan's environmental technology?

During his address to the Annual Meeting of the World Economic Forum in Davos on Jan. 26, Prime Minister Yasuo Fukuda introduced fresh initiatives to combat climate change, a move that underlined Japan's willingness to re-

gain what some fear may be its waning reputation as an environmental leader. It also came as a prelude to this year's G8 summit, which will be held in July in the northern Japanese island of *Continued on page 2*



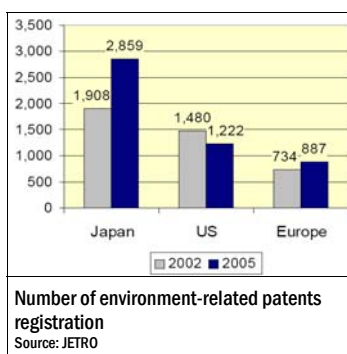
What role for Japan's environmental technology?

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Japanese companies control about 50% of the global solar panel market, with Sharp the world leader

The adoption by the US, China and India of Japanese environmental technologies could lead to carbon dioxide reductions of 1.3 billion tons



Hokkaido, where Fukuda is eager to show Japan's strong leadership credentials, notably by beginning negotiations for a post-Kyoto framework (the Kyoto Protocol is due to expire in 2012).

In his Davos speech, Mr. Fukuda proposed that the method of setting reduction targets "... be based on a bottom-up approach by compiling on a sectoral basis energy efficiency [...] that would be based on the technology to be in use in subsequent years". He also affirmed that Japan would make efforts with other major emitters to set volume reduction targets by country. Furthermore, he called for a revision to the base year for the calculation of reductions, which is now fixed at 1990 under the Kyoto Protocol.

The prime minister also unveiled a \$10 billion aid package from Japan to support developing countries' efforts to counter global warming over the next five years. In addition, Japan is working alongside the US and the UK to create a fund to ensure the adoption of clean technologies in the developing world. He stated that the adoption by the US, China and India of Japanese environmental technologies could lead to carbon dioxide reductions of 1.3 billion tons – the equivalent of Japan's annual emissions – and help reach his proposed target

of a 30% improvement in global energy efficiency by 2020.

However, he did not refer to any specific targets or time frames for carbon emission reductions, as he was expected to do. This highlights the bumpy road that lies ahead of him, mainly because of the widely different ideas held by the United States, the European Union and developing countries on how to deal with the challenges of climate change. Domestically, he also faces an industrial lobby that fiercely opposes such numerical targets. They say the pledge under the Kyoto Protocol to cut emissions by 6% from 1990 levels fails to take into account the fact that Japan is already the world's most energy-efficient country.

The Davos speech, however, emphasized the topic that everybody is most certainly pleased with in Japan: the use and propagation of Japanese environmental technology. This comes at a time when the fight among countries over what to do about global warming is entering a new stage: it isn't just about who will foot the cleanup bill, but about who will snag the profits from new clean-energy markets. And with its already strong position, Japan knows that its potential to become a leader in this market is big.

Japan has a reputation as a world leader in recycling and in designing energy-

efficient buildings, and it remains a leader in low-emissions power generation and manufacturing. In addition, the country's image has benefited from having the name of its former capital associated to the Kyoto Protocol, as well as from the success of some green products such as Toyota's Prius hybrid car.

In fact, Japanese industries have a long history of investing in environmental technologies compared to other countries. After the first oil shock of 1973, the government encouraged business to cut down on energy use, prompting large R&D efforts into energy-saving technologies. Since then, Japan has been at the cutting edge in this area.

From this experience, the Japanese government also knows that R&D must be triggered by regulations, subsidies and all sorts of schemes. It is now investing heavily in R&D and is providing information on how to patent the results of R&D. It also operates a "top runner" scheme that encourages companies to match the most energy-efficient products and technologies in their industry, and offers subsidies for households installing energy-efficient fuel cells.

Mr. Fukuda, however, knows that improving the state of our planet will require more than technology, and he may well have to take some painful decisions in the near future.

Blu-ray vs. HD DVD: a verdict at last

After two years, the battle over which technology would become the standard of high-definition DVDs has finally given its verdict, with Toshiba's announcement, on Feb. 19, that it will no longer develop, make or market HD DVD players and recorders, handing a victory to its rival, Sony's Blu-ray technology.

In fact, that move seemed almost inevitable since Warner Brothers, Hollywood's largest player in the home video market, announced in early January that it would support Blu-ray exclusively, handing it about 70% of Hollywood output. Speculation mounted until the final big blow arrived in mid-

February with Wal-Mart, the world's largest retailer, making a similar decision. From then on, Toshiba was left with no other choice but to surrender. The end of the war is actually good news for the whole business, as it will now allow the DVD market to grow once again. Indeed, DVDs had been a cash cow for studios for a long time, but the market started slowing in 2006, and even shrank by 4% in 2007. With the war over, consumers will now be able to switch from regular to high-definition DVDs without the fear of being stuck with an obsolete format. Sony figures show that 40% of potential buyers have been holding

back because of that uncertainty.

Toshiba has invested millions of dollars in HD DVD and sold about 1m players. However, observers say that it neglected its marketing, which led to its failure. Meanwhile, Sony managed to get the support of five of the seven major Hollywood studios thanks to its strong industry connections.

Some say that this war lasted too long, and that consumers will bypass Blu-ray altogether, favoring increasingly popular digital downloads. Sir Howard Stringer, Sony's chief executive, however, dismissed such concerns, claiming that downloads are still five years away.



Sony managed to get the support of five of the seven major Hollywood studios

Tornos expands in Asia through alliance with Tsugami

Established in 1914, Swiss machine-tool manufacturer Tornos has recently begun expanding abroad. Following its successful alliance with US manufacturer Hydromat, the company announced on Feb. 15 that it signed a partnership agreement with Japanese manufacturer Tsugami.

The alliance, which will bring about cooperation in areas such as R&D, procurement, production and distribution, is attractive for both companies, as they are complementary both in terms of product range and geographical markets.

Tornos mainly produces single- and multispindle lathes, which are positioned in the middle to upper end of range; almost 80% of its sales are made on the European market. In contrast, Tsugami is mainly active in automatic lathes, machining centers and grinding machines that are positioned at entry-level and mid-range; over 80% of its sales are made in Asia.

So far, two contracts have been negotiated. Under the first one, Tornos will provide the specification for Tsugami to produce entry-level single-spindle machines, which Tsugami

will then distribute through its own sales network. It will give Tornos access to a complementary line of entry-level single-spindle products, and will enable Tsugami to leverage its production capacity more intensively.

The second one will entail Tsugami distributing multispindle machines in Japan and Asia, which will allow Tornos to reinforce its penetration in Asia while optimizing Tsugami's distribution channels in Asia.

Both companies have decided to acquire 1 million shares off each other.



80, Rue de Lausanne
1202 Genève
Phone: 022/732 13 04
Fax: 022/732 07 72
E-mail: webmaster@jetroge.ch

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WWW.JETRO.GO.JP/
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Foreign companies aggressively accelerate their arrivals and expansion in Japan

Foreign direct investment into Japan during 2007 grew at a much faster pace than since the current statistical system was adopted in 1985, according to a projection by Ministry of Finance Japan. Its preliminary report shows foreign direct investment reaching 15 trillion yen through the end of September and well on track to achieving the government's goal of 5 per cent of GDP by 2010. Investments from the United States accounted for 57.3 per cent of the total, followed by the Cayman Islands, Singapore, Switzerland, and Germany.

Meanwhile, according to a survey by JETRO of 864 foreign companies in Japan during last September and October, a higher-than-ever 63.1 per cent said they plan to expand their business in Japan. Specifically, their growth strategies included strengthening their sales power, introducing new products and services, and expanding their existing production capacity and services. This shows that many foreign companies are taking a positive stance toward growing their scale in Japan.

JETRO hopes these foreign entries will bolster the accretion of industry in Japan and spawn new technologies and innovative management. The organization will continue to aggressively support foreign direct investment into Japan.

For more information, please contact: invest-japan@jetro.go.jp