

Golden investment opportunities

- The Golden Age of the dollar is over
- China – a fierce dragon



Jyske Markets – 2005 Outlook

Jyske Markets' Outlook for the foreign-exchange, equities and fixed-income markets is published mid-December. This Outlook summarises Jyske Markets' assessment of what 2005 may bring and the resulting investment and borrowing opportunities in the financial markets.

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Jyske Markets – 2005 Outlook is also available for Equities and Fixed Income

Equities

2004 has been a year with unusually small fluctuations. Now, on the threshold of 2005, it is tempting to say that the coming year will offer a similar development. However, if anything, the markets have demonstrated their ability to surprise as well as the need for investors to be mentally flexible. In 2005, these qualities will undoubtedly come in handy. Therefore, be prepared to take advantage of the opportunities offered by the coming year.

Fixed Income

Despite the declining value of USD, we are very much in doubt whether the Americans will be able to hold their own throughout 2005. The twin deficit, high consumer spending and large debts will force the Americans or the investors to take action. Moreover, religious conflicts intensify. That will lead to surprises. China and the remaining parts of Asia are – in addition to being the world's workshop – the areas where growth takes place. And Europe is left behind like the kid nobody wants to play with.



At the crossroads

We are now at the threshold of 2005 and about to wave goodbye to 2004. The past year turned out to be the most difficult year in the period when Jyske Bank has prepared systematic FX analyses. In the major part of the year, all major currencies were dominated by range trading. Following the bumper year of 2003, the FX markets and Jyske Bank realised that all good things come to an end.

2004 was dominated by the development in Iraq. A development which led many people to accept that the US-headed involvement will last longer than first assumed. Moreover, the year was influenced by the US presidential election. Up to the spring of 2004, the Bush administration set all sails in an effort to ensure sharp economic growth and a positive labour market. The combination of an expansionary fiscal policy, a relaxation of the monetary policy and a weaker US dollar did also succeed in paving the way for impressive economic growth whereas the labour market turned out to be alarmingly fragile.

It was China which was given the blame for the loss of US jobs. It was also China which was

given the blame for the skyrocketing oil prices. Consequently, China became the focus of strong attention in the course of 2004.

This takes us to 2005. For the first time in Jyske Bank we have coordinated the general scenario across asset categories to ensure a governing trend in the recommendations which are also included in this 2005 outlook. Without giving the show away, I can say that China vs. the US and the US imbalances play an important role in our scenario for 2005.

Following a problematic year in 2004, we believe that in 2005 we will see foreign-exchange and commodities markets which will offer plenty of good investment openings. On the following pages we will focus on some of them.

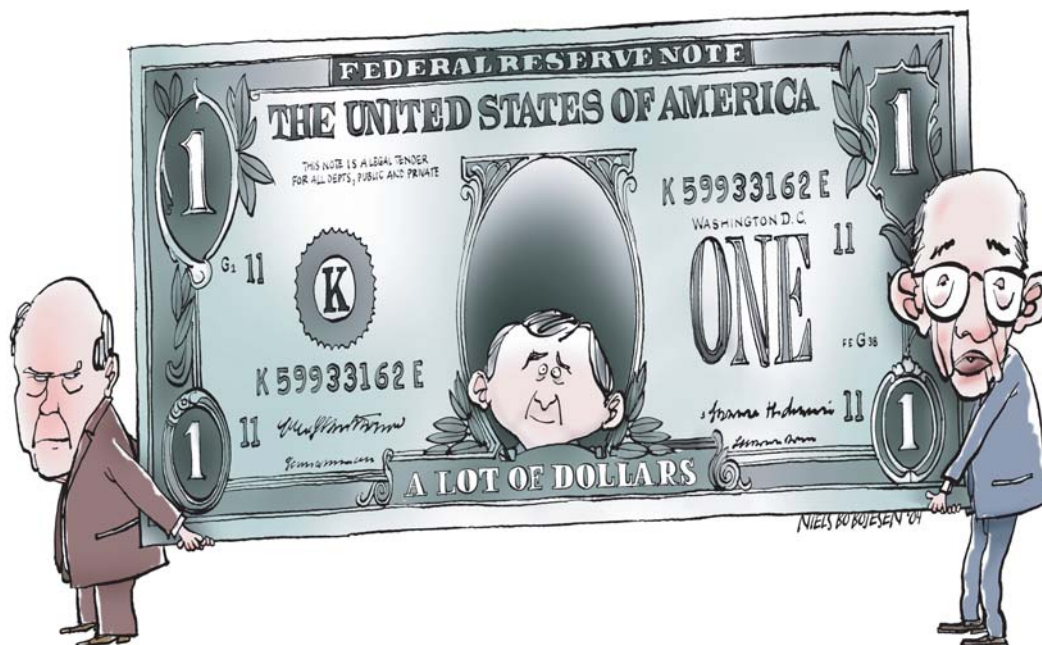
We hope you will enjoy reading our 2005 outlook.

Henning Mortensen
Head of Foreign Exchange

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Fall of an empire



Never before has an empire such as the United States been this dominant. Economically, culturally and especially militarily, the US influence exceeds even that of the Roman empire.

However, like the Romans the Americans must constantly struggle to keep up the illusion of their empire. The price of maintaining a world empire is high.

With its runaway imbalances, the US economy is like an image with feet of clay. In our opinion, the countdown for the economic superpower has already started. In an attempt at keeping the US growth engine going, both public and private consumption have accelerated to record highs. The Americans have had to sell their family silver, chiefly to the Asian central banks which still buy the bulk of new US T-bonds. Many find this to be a natural division of labour: the Americans consume, and the Asians produce. It won't last, we say.

We expect 2005 to be the year when the newly-elected president will be forced to tighten the economy by budget cuts. This will throw grit into the growth engine, which may cause Alan Greenspan to think twice about new interest-rate hikes. An austerity programme is anathema to

American politicians. But can they avoid it? Will they choose to let inflation rise, abandoning the dollar to its fate? 2005 may well be the year when the outline of a plan will be discernible.

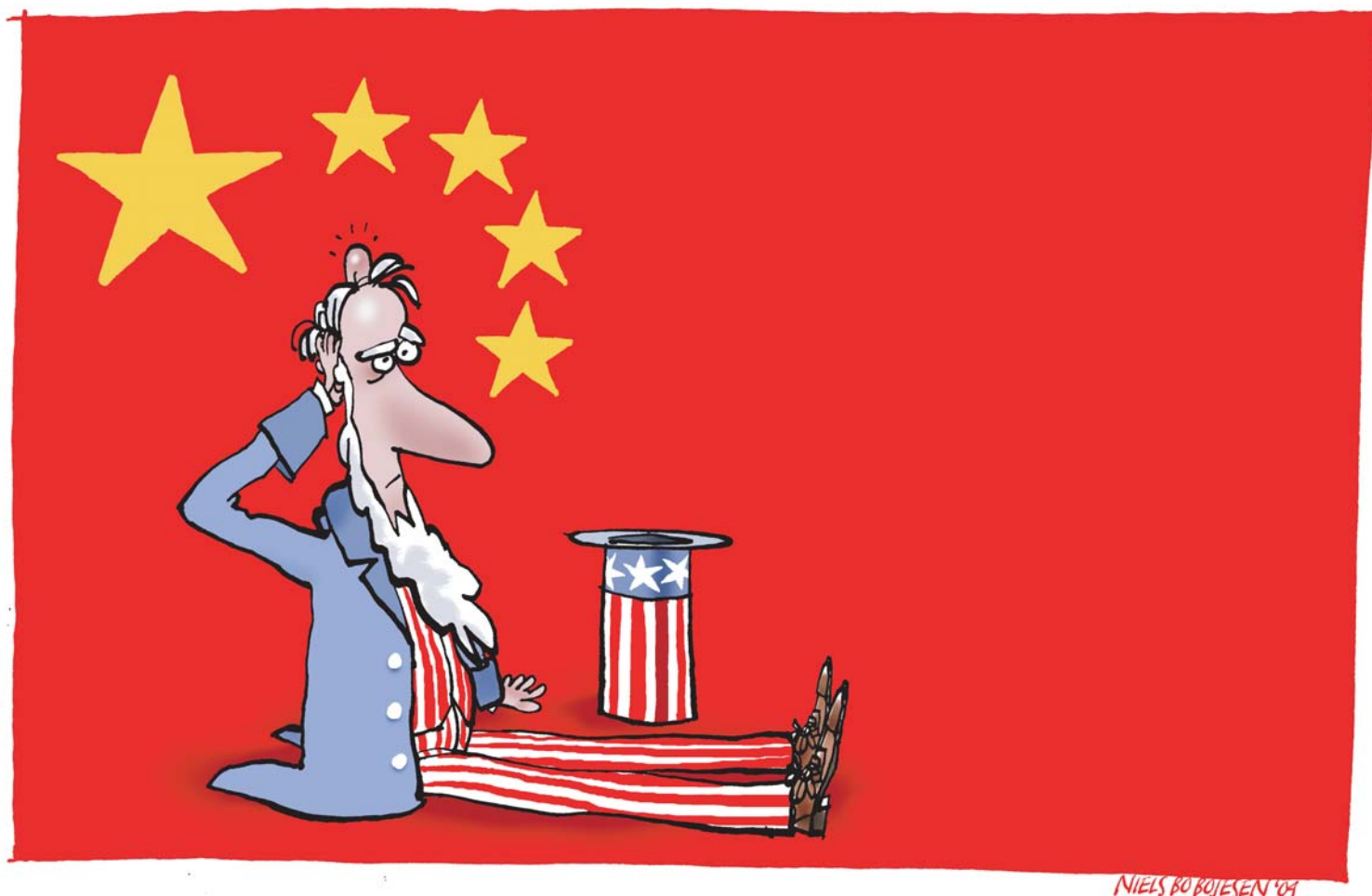
The heirs to the throne are ready

In the shadow of the ailing US empire, a new empire is rising over the horizon. China – the “Middle Kingdom” – is winning more and more attention in the financial markets. As yet, there has been no official transfer of power, but the process is in full swing. The US is haemorrhaging day by day, chiefly to the economic benefit of the Chinese. However, also the inhabitants of the Land of the Rising Sun – Japan – are sensing the dawn of better things. Optimism in the world's second-largest industrial nation is buoyant, and this bodes well for the future.

Commodities are also given much attention by the financial markets, after years out of the limelight. We expect 2005 to be the year when commodities will be reinstated as an attractive asset class.

The Americans, like the rest of us, will probably realise in 2005 that “the times they are a-changing”, as Bob Dylan sang.

The scenario was prepared by Jyske Markets' three strategists: Lone Olesen, Foreign Exchange, Henning Jeppesen, Fixed Income, and Henrik Henriksen, Equities.



Once upon a time

By Lone Olesen

This is how a real fairy tale begins. Even the fairy tale about the “empire”, which developed into the biggest empire in the world, but which in its attempt at maintaining the illusion of world supremacy ended up paying an incredibly high price.

Never in history has the world seen an “empire” as powerful as the US. Economically, politically and not least from a military point of view the US holds a key position of unprecedented strength. But just like the Romans, the Americans have come to realise that the price for this position has been – and is – incredibly high.

The role as global policeman and engine driver on the world’s foremost growth engine have caused the empire’s economic foundations to become increasingly unstable. To keep up steam, the Fed headed by Alan Greenspan has lowered the official rate of interest to the lowest level ever, and has thus in practice pumped a huge amount

of cheap liquidity into the surrounding society. And just as fast as the mint has been printing new dollar notes, just as fast has President Bush generously distributed the money in the form of previously unheard-of fiscal relaxations. So far, so good.

The US policeman still goes around the world trying to maintain law and order, and the growth engine is still pulling. But the US policeman’s image as a guardian angel has been tainted. The imperial “subjects” have started to object. In the course of the past years, the Americans have suffered a drop in popularity, and like the Romans they may come to realise that the empire’s political power was in fact undermined by internal strife and not least pinprick raids.

As for the highly acclaimed economic growth of the US, things are once again looking a bit discouraging. Most analysts agree that US growth has probably peaked this time around, and that

instead we will have to accept increasingly moderate growth rates.

Many financial experts and analysts watch Greenspan's current attempt to normalise the record-low level of interest rates through interest-rate hikes with bated breath.

The Maestro is performing a dangerous balancing act. If he falls, he may take the entire world economy down with him.

If he raises the rate of interest too quickly, he may bring growth to a complete standstill causing the already frail equity markets to plunge. If, eventually, he is forced to lower the official rate, the result will be a regular outcry in the financial markets. In that case, what remains of the market's confidence in Alan Greenspan will disappear like morning dew.

But the real price of political and economic supremacy, however, has been the ensuing huge imbalances. To keep the illusion of the empire alive, America has had to sell the family silver. The level of US debt is record high.

The ordinary US consumer has nothing stacked away. For every 100 dollars he makes, he only saves 90 cents at the moment. Today, total non-public US debt amounts to no less than 302% of GDP. Given the considerable public sector deficit, it seems obvious to ask who will eventually foot the bill?

Who holds the economic power to topple the US empire?

The investors who continue to send funds to the US. Investors, the majority of whom have for long been international central banks. International private investors pulled out of the US equity and T-bond market a long time ago. Thus, the central banks, the Asian central banks in particular, have until now been financing the US spending spree.

But whereas a traditional fairy tale usually ends with everyone living happily ever after, it is far from certain how the tale of the world's largest empire will end.

The Emperor's New Clothes by H.C. Andersen readily comes to mind.

One thing is for certain, however, the new "emperor" is ready in the wings – ready for his economic empire to spread to the rest of the world. Like the bird Phoenix, we expect China to rise from the ashes and take over from the US. The question is how long will the US be able to pull the wool over the eyes of the rest of the world?

The world wants to be fooled, but don't you think that one day, a little boy will cry: "But he is not wearing anything"?

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Jacta alea est

By Lone Olesen

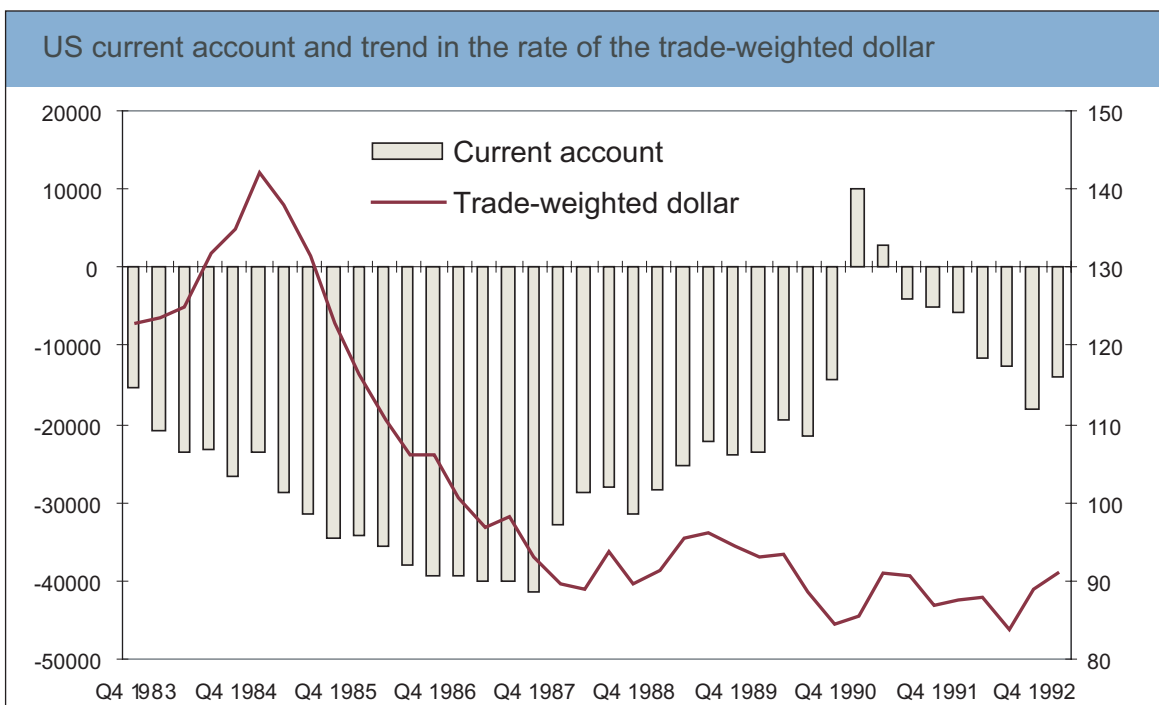
Julius Caesar was well aware of the consequences when in 49 BC he crossed the river Rubicon in northern Italy. Any prediction of the future trend of the US dollar requires equally careful considerations. America needs a significantly weaker dollar – whatever the cost, whatever the price. But where Caesar's crossing of the Rubicon resulted in the formation of the Roman Empire, the US attempt to undermine its own currency is expected to mark the beginning of the end of the US economic empire.

As for the future trend of the US dollar, the die is cast. The facts speak for themselves. The record-high current account deficit of currently 5.7% of GDP is unsustainable and portends a significant depreciation of the currency. The longer this trend continues, the more in debt and the more

dependent the US will become on the mercy of the rest of the world.

The gravity of the current situation is best illustrated by referring to the state of affairs in 1985-1988. Back then, the US current-account deficit was 3.5% of GDP. It took a 40% depreciation of the trade-weighted US dollar to even slightly correct the situation.

When expressing our negative view on the dollar, we are often met with the comment "But, the value of the dollar has declined for almost three years now". Correct. But the value of the trade-weighted dollar has declined by only 15% primarily because of the fixed-rate policy vis-à-vis the dollar adopted by the economies in Asia. The trend in international trade has made the situation even worse as the economies in Asia and Latin America account for more than half of US trade. So, what the US really needs is a revaluation of the Asian currencies in particular. But one thing is what you want, another is what you end up getting.



Ernest Hemingway, the famous American author, has very aptly described what could be the current state of the US economy:

"The first panacea for a mismanaged nation is inflation of the currency; the second is war. Both bring temporary prosperity; both bring a permanent ruin. Both are the refuge of political and economic opportunists."

Ernest Hemmingway

Harsh words, but still... There is no other plausible solution than a depreciation of the currency. The principal question is of course, how fast it is going to happen. A gradual depreciation of the currency tops the want list, but a significant decline in the dollar rate cannot be ruled out at all. The US trading partners will no doubt complain – in particular the rest of the G10 countries, which have so far paid their share of the price of a declining US dollar. At the end of the day, however, it is the Americans' currency, and our problem. Given the gravity of the current state of the US economy, we wouldn't put it past them if they looked after themselves first.

The fact that the US depends to such a large extent on international willingness to finance its record-high current-account deficit is in itself a serious threat to the future trend of the US dollar. So far, the rest of the world – primarily foreign central banks – has supported the US spending spree by purchasing the majority of the T-bonds, which the US Treasury Department continues to issue.

Lately, however, indications are that foreign interest in continued debt financing is abating. Quite a serious problem if it develops into a trend. In that case, investors may demand a premium if they are to continue to foot the bill. A premium in the form of a lower dollar rate, which will make US assets cheaper, or in the form of a significantly higher rate of interest. A lower dollar rate is definitely a problem, because the depreciation may come too soon or initially get out of control. As for a significantly higher rate of interest, it would be nothing short of a catastrophe considering the record-high level of debt. Were the debt-ridden US consumer to pay a significantly higher rate of interest, he may end up refusing to consume at

all. In that case, growth may take a nosedive. Not only in the US, but in the rest of the world as well given the US position as growth engine. In fact a choice between the lesser of two evils. We think that the Fed and the Treasury Department will pin their faith on a weaker dollar.

Since EUR/USD touched the psychological level of 130, the players in the financial market have far from agreed on the coming trend. Many, primarily US experts, are of the opinion that we are witnessing the last movements before EUR/USD once again goes south, whereas others see this as the beginning of the end of the US dollar for some time to come. That the experts disagree, suits us fine. We are not all in the same boat – yet. To us, the 130 level means that EUR/USD is headed towards even higher levels in 2005.

We are, however, well aware that all good things come to an end. Even though we expect EUR/USD to reach 150 in 2005, we will see occasional corrections and should not let ourselves be fooled. We expect 135 to be the first stop on the rising curve of EUR/USD. But be sure to take advantage of any setback to buy EUR/USD once more.

Predicting the future may be dangerous – not least the future of the dollar. Exchange rates may prove treacherous. Just as you think that you have them where you want them, they turn on you with brute force. Still, we venture to make a guess, knowing well that we may suffer a fate similar to that of Caesar: "Et tu Brute?"

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Who picks up the tab?

By Lone Olesen

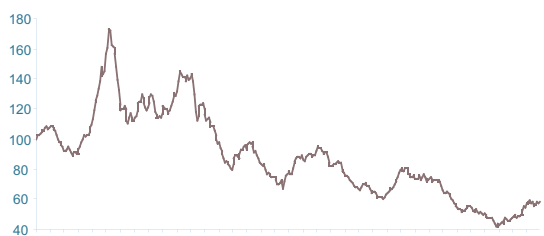
Yes, who will indeed be picking up the tab or carry the burden of a significantly depreciating US dollar in 2005? As described on a previous occasion, EUR will be carrying its share of the load, but we have to turn to Asia as well as to Canada to find the rest of the answer. For quite some time now, Japan has been sitting on the fence with an artificially weak trade-weighted JPY, and thanks to the generally positive outlook for the commodity market, commodity based currencies such as AUD, NZD and CAD will be doing the hard work.

But first things first: At first glance, our positive outlook for the commodity market in 2005 may seem somewhat out of place. If, as we expect, the US growth engine slows down, and if China takes a breather before the economy continues to expand, why then be so positive on commodities as we in fact are?

Well, we claim that in keeping with a general downgrading of old asset classes such as shares

and bonds, market focus will shift towards commodities as a new and attractive asset class. Historically, the level of real commodity prices is very attractive, and in a world dominated by considerable economic uncertainty, commodities including gold and silver have traditionally been considered a safe haven. A role, which we expect they will play with renewed strength in 2005. Economic tensions will run high in 2005, and the commodity complex is considered an excellent bulwark.

The trend in CRB Raw Industrial adjusted for inflation (US CPI) 1969 = 100

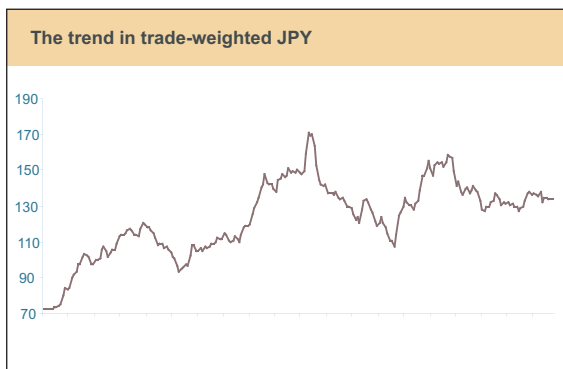


Having said that, we already have part of the answer to the question of who will be pulling the load of a weaker US dollar. Not only because of the high rate of interest, but indeed because of the excellent correlation to commodities. AUD, NZD

and CAD will attract investors as honey attracts bees. No good thing lasts forever, though. Not even commodities or commodity based currencies, which have historically been very volatile. No doubt the monetary authorities will act up as will their European counterparts, but by year-end we are convinced that AUD, NZD and CAD will have appreciated significantly against the US dollar.

For 2005, our AUD/USD target area is 90.00, for NZD/USD 80.00 and for USD/CAD 110.00.

The yen will assume a leading role as well in 2005. Recently, Japan and the BoJ in particular have fought strongly to keep the yen artificially weak vis-à-vis the currencies of its trading partners. The Japanese economy is still in a deflationary iron grip, and a weaker currency and resulting imported inflation have for long been at the top of the Japanese agenda. Furthermore, it has been paramount to the highly export-dependent Japanese economy to maintain the competitiveness of JPY against the other often fixed Asian currencies.



Like a samurai, the BoJ has therefore over the past couple of years tried to contain the market's attack on the weak JPY by staging intense intervention raids. Lately, however, the BoJ has become less aggressive. Whether the samurai is losing his strength or whether he has actually seen the writing on the wall when it comes to the future sad fate of the US dollar, is probably too early to say, but it is worth noting that recently the bank has been very reserved on the intervention front. We are, however, confident that BoJ with Fukui at the helm will be back in action once USD/JPY starts moving into no man's land between 101 and 103. Recent economic bulletins from Tokyo, however,

have not made for pleasant reading. The previously positive tone is beginning to sound slightly strained, and if this situation is maintained, "the last samurai" may be tempted to intervene once more. Accordingly, we expect sellers of USD/JPY in 2005 to occasionally come face to face with the BoJ, but in light of the strained US economy, JPY, too, will share the dollar load in 2005.

Therefore, our target area for USD/JPY in 2005 is 90.00.

Readers may consider our 2005 dollar vendetta somewhat exaggerated. We are, however, concerned that many market players do not realise the gravity of the economic situation in which the US has put itself. The current financial system is based exclusively on trust. As long as everyone has confidence in the US dollar as a means of payment and savings and not least as a reserve currency, there is nothing to worry about, but once trust evaporates, all hell breaks loose, and everyone will take refuge. The below quote by the Irish playwright George Bernhard Shaw (1856 – 1950) is not only very precise, but describes the situation in a nutshell.

"The most important thing about money is to maintain its stability... You have to choose (as a voter) between trusting to the natural stability of gold and the natural stability and intelligence of the members of the Government. And with due respect to these gentlemen, I advise you, as long as the Capitalistic system lasts, to vote for gold."

George Bernhard Shaw

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The housing market – the obvious victim

By Jørgen M. Rasmussen

Our scenario for 2005 has an obvious victim: the housing market. In recent years exactly this market has been one of the main drivers of the massive over-consumption we have seen in large parts of the industrial world. This is also exactly why there is a risk that this market could exacerbate and amplify developments in our scenario.

Many readers would probably point out that house prices have risen significantly in recent years, and that stagnation or, if the worst comes to the worst, a fall in house prices should be no cause for concern. Such a conclusion could hardly be more wrong!

Why the housing market?

Does it follow that the housing market will be hit if economic growth slows down, seeing that the economic down-turn after the equity market bubble had burst in the first years of the millennium, did not have any significant effect on house prices?

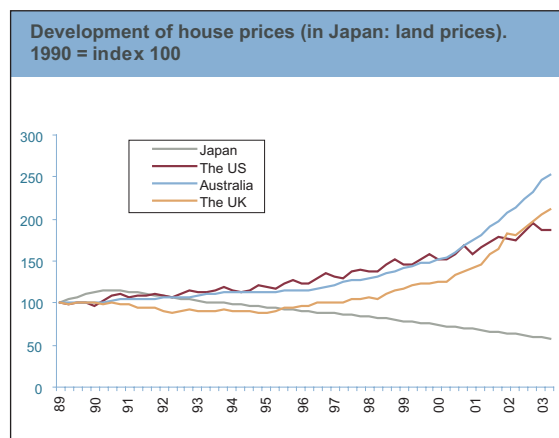
Of course, there is no single answer to that question. It is a fact, however, that the market has turned even more sensitive over the past three or four years due to the inflated prices and to violent borrowing by households. As a matter of fact, falling prices could start off a snowball effect that could amplify the negative trend of the economy in general.

Recent developments

Before looking at the possible consequences for the housing markets across the world in the light of our scenario, it will be useful to investigate how house prices have developed in various places.

The higher the increases recorded by individual economies, the more serious the possible conse-

quences for those economies and hence for their currencies.



The chart shows the rises in house prices in several of the world's largest economies. We have been unable to obtain data about developments in Germany, but other sources (e.g., The Economist) indicate that house prices in Germany have fallen by about 3% since 1997. A look at the chart reveals that it was exactly in the late 90s that house prices really took off. Obviously, there are great differences from country to country. Economies like the US, the UK and Australia have seen significant price rises, which have naturally supported the fair growth rates recorded for those economies through the 90s.

German house prices have shown no significant rise, and Japanese house prices have actually fallen, which may help to explain why the economic upturn of those very countries has been moderate.

In justice, it must be said that there are countries in the euro zone where house prices have risen robustly. The largest increases were recorded in Spain and Ireland, where house prices have risen by more than 50% since 1997. Even if Spain is – by European standards – a large country, it is a small nation from an economic point of view compared with the largest economy of the region, Germany.



Within the euro zone, several countries now have artificially low interest-rate levels after joining the euro, which would have been impossible if they had remained independent currency areas, and exactly Ireland and Spain are good examples of this.

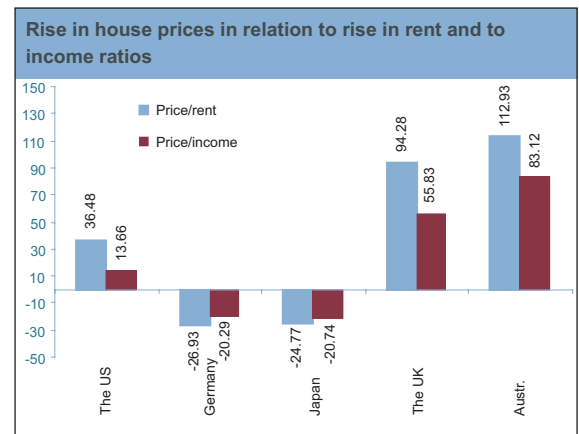
Various points of departure

Many critics will no doubt point out that, even if real-estate prices have risen, interest rates have fallen. This means that the real costs of owning a house as opposed to renting and as a percentage of earned income has probably not risen.

The IMF has made some calculations on this.

The figures speak for themselves. In the US, the UK and Australia, it has become significantly

more expensive to own a house than to rent, and the extra expense more than offsets the rise in disposable income in those countries. This has happened despite significant falls in interest rates over the past twenty years, which have resulted in higher disposable income.



In Germany and Japan, by contrast, house prices have fallen in comparison with disposable income (by about 20%-25% in relative terms).

It is evident that critics cannot claim much backing on that head. The figures leave a clear impression of countries that have been pepped up by this rise in house prices and countries that have been subjected to the opposite effect – did anyone say imbalances?

Economic consequences

Need we worry about this issue and the effect it may have on the currencies of the involved countries?

In fact, the IMF is quite incisive:

“Housing is the main asset and mortgage debt the main liability held by households in these countries, and therefore large house price movements, by affecting households’ net wealth and their capacity to borrow and spend, have important economic implications.”

The value of assets will rise and fall, and even if a house is less easily negotiable than, e.g., shares and bonds, it is not very costly these days to borrow against the equity of a property.

Moreover, a number of investigations into the effect on equity and bond prices indicate that house price rises tend to stimulate the economies more because the rises affect a broader section of the populace. Also, this part of the populace traditionally spends a larger proportion of their income on consumption.

There are no analyses available of what the money borrowed against equity is spent on. Generally, there are three main objects:

1. Repayment of other, more expensive, debt
2. Home improvements
3. Private consumption in general

A report prepared some time ago by the Fed indicates that US citizens spend about 50% on item 1 and about 25% on each of the two other items. In the US there is a strong incentive to replace other debt by mortgage debt, because the latter type is eligible for tax deduction.

A look at household indebtedness in the countries in question, however, shows that debt is not falling – rather the opposite.

Exactly this heavy borrowing against equity in real estate, which has been rendered possible by the skyrocketing house prices and by traditional bank loans, will in our scenario for 2005 act as a boomerang for the relevant central banks.

An example:

In 2003, British consumers increased their debt by GBP 120bn (no less than a gigantic 16% of their income). In 2004, as indicated by the latest estimates, the Britons will have borrowed an additional GBP 125bn. This means that the Britons have increased their purchasing power by GBP 5bn in 2004, and this naturally boosts the economy.

The increased possibilities of borrowing were caused by the rise in house prices (UK house prices have risen by 15%-20% this year). What will happen if prices rise less fast or even begin to fall?

The immediate consequence will be a drastic reduction in household borrowing possibilities and hence in consumption. If, for instance, Britons increased their debt by 'only' GBP 100bn in 2005, this would reduce the purchasing power by GBP

25bn. This equals a 3% reduction of total purchasing power, and this would in all likelihood suffice to do away with the positive effect of higher real wages.

If so, Britons would just begin to save less and spend the means available on maintaining their level of consumption, wouldn't they?

No, that is unlikely. First of all, in both the US and the UK, the part of income allocated to savings is negligible. Secondly, the psychological factor that should not be overlooked is that the propensity to consume will be affected. It is not unusual to see a rise in savings when the economic climate begins to tighten.

We regard a turn-around in the housing market as a latent bombshell under the FX market. This is a bombshell that could amplify and exacerbate a slowdown of the economy. It is therefore a bombshell that must be recognised when investors plan their strategy for covering exposure to the countries in question.

Where countries such as the UK, the US and Australia are concerned, the housing market should be an important element of investors' assessment of the potential of the relevant currencies.

There is an old saying: "all good things come to an end" – and this also applies to house prices.

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NOK - the northern light

By Jørgen M. Rasmussen

An important consequence of our scenario for 2005 will be that countries and economies offering investors a safe haven when things look gloomy may be some of the great winners in the new year. In this connection, Norway and the Norwegian krone look like the “light to the north”.

Norway's enormous oil wealth, which means that today Norway is the world's third-largest oil producer (surpassed only by Saudi Arabia and Russia), has turned the country into a true creditor nation in line with other oil-producing countries and Japan.

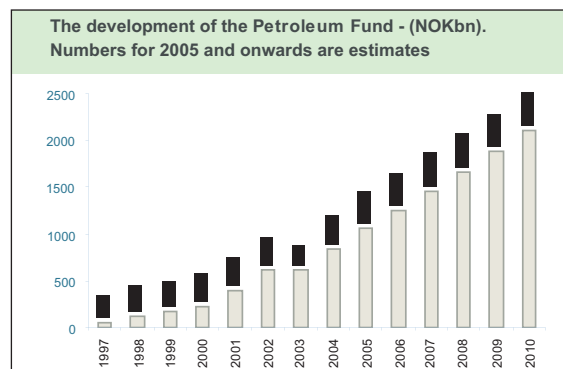
That the Norwegian economy, if adjusted for oil effects, is not performing very well is hardly a significant factor when investors in troubled waters are looking for a hideaway.

Norway's wealth

In brief, the Norwegian government places all its oil revenues in the Petroleum Fund – almost. The

government has allowed itself to spend up to 4% of the fund's holdings on the budget; this is also known as *Handlingsreglen* (The Guideline).

Due to the rising oil prices and returns from investments, the fund has grown to be enormous. The latest statements from Norges Bank (as of 30.6.04) show assets worth NOK 942.4bn, and expectations are that it will reach a gigantic NOK 1,000bn before the end of 2004.

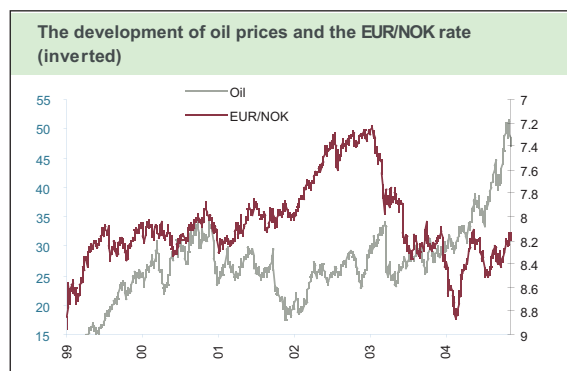


As appears from the chart, the fund has recorded almost explosive growth over the past five years during which the assets have increased fivefold.

Oil and the Norwegian krone

In our scenario for 2005, we expect sharply increased demand for commodities from China and India, in particular, but also from other parts of Asia. The demand for oil will of course also be on the rise and be supportive of the tension on the oil market.

On numerous occasions, we have argued against equating rising oil prices and a stronger krone. We will not change our view on this as the entire set-up of the Petroleum Fund means that the real effect of oil revenues remains currency neutral. As appears from the chart, the long-term connection is non-existent. It is primarily due to two factors that after all it has a positive effect on the Norwegian economy when oil prices rise.



Firstly, increasing wealth of the Petroleum Fund will mean an opportunity to increase the budget. The government is in fact already today spending more than the 4% (currently approx. 6.5%) but as the wealth increases it will extend the scope for consumption and thus raise activities in the Norwegian economy.

Secondly, rising oil prices also led to an increased need of investments in the industry (search for new oil wells, establishment of new wells, renewal of old wells, etc.). This will also increase the demand among a number of subcontractors to the industry, and rising oil prices may thus result in what is called "side effects".

The activity level will usually decline in countries which are net importers of oil but in Norway developments will to a certain extent be offset by the positive effects of rising oil prices.

NOK – the northern light

Whether Norges Bank with central-bank governor Svein Gjedrem at the helm will resist this development is more or less irrelevant in this

connection. The bank will have severe difficulties avoiding a much stronger krone in 2005, and as we see it, also if it turns to the "interest-rate weapon" and lowers the rates.

The name "creditor nation" and the mitigating circumstances for the Norwegian economy due to the rising oil prices will make investors crowd round the krone like an ice-cream stall in the summer heat.

Gjedrem and interest rates or not – we believe that when our scenario starts to unfold we will see an appreciation of the Norwegian krone against the euro and the Danish krone by at least 10%. This means that we will see levels around 720-730 again (DKK 102) which were last seen at the end of 2002.

If you ask an investor during this upturn how he can remain confident that there is value to be gained by buying at such high levels, I could easily imagine that the standard answer would be: "But in Norway – I know what I am getting!"

In a turbulent world, investors will be searching for the light. In Norway, they will find what they are looking for.

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SEK – a currency of potential

By Jørgen M. Rasmussen

Range trading has characterised the Swedish krona in the past two years (890-930/ 80-84) – at least against the euro and the Danish krone. But 2005 may very well be the year when we will see an actual trend in this currency since Sweden has a number of positive things to offer in the somewhat turbulent world which we present in our general scenario for 2005.

Despite impressive growth rates and economic indicators which easily compare with numbers from the US and the UK, for instance, the Swedish krona has not been able to establish a convincing trend in the past two to three years.

Therefore we find it difficult to finally conclude that this era is over and that the krona will now establish an uptrend against the euro and the Danish krone.

However, with respect to the value against USD and GBP, we have no doubts that in line with EUR and DKK, SEK is facing a golden period. Let us focus on some of the things we believe determine the value of the Swedish krona, and which we believe will be in focus in 2005.

A healthy economy

As mentioned, Sweden has presented impressive economic indicators in recent years.

Growth rates have quietly edged up and are today around 3.5% y-o-y, and inflation is low around 1.5%. Moreover, Sweden has budget surpluses and runs fair trade-balance and current-account surpluses.

In this connection, it is particularly important to emphasise that Sweden has seen rising growth and at the same time maintained a surplus on its balances. This is one area which is currently a cause for concern in both the US and the UK.

The only real "gloomy" spot in the economy is getting employment to pick up. But compared to other countries, a Swedish unemployment rate at 5.8% is not very alarming.

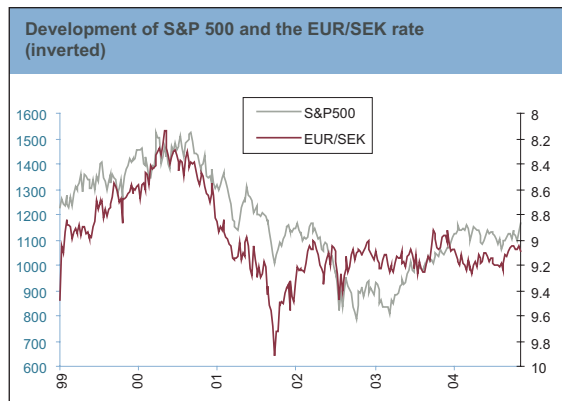
Unlike BoE and the Fed, Riksbanken has not yet started raising interest rates, and this is primarily ascribed to the weak development on the Swedish labour market. We can only conclude that for Riksbanken there is no reason for concern as long as the inflation rate and the inflation outlook stay as moderate as is the case today. So far, so good!

Consequences for the Swedish krona

We will hardly avoid falling growth rates in our part of the world now China and the Far East take over the role as the world's growth engine. And this will of course also affect the Swedish economy.

As we see it, the largest risk factor for the Swedish krona is the relatively strong correlation with

the equity market and thus the sensitivity to changes in economic trends.



In comparison with the other Nordic countries, Sweden has a very high proportion of large multinational companies, and this may explain a large part of the high correlation with the equity market.

Our expectations of the equity market are not so gloomy that they completely overshadow the positive aspects which Sweden and the Swedish economy offer. We expect that periods of turbulence in the equity market throughout the year will still hit the krona but that the year as a whole will not have a major impact on the krona.

Instead we imagine that the krona may receive status as "a safe haven in turbulent times" like gold and the Swiss franc.

This can be attributed to the fact that after all the outlook in Sweden is somewhat brighter than in the euro zone in general and the US and the UK in particular.

As mentioned, Sweden also runs a surplus on its balances. Consequently, the country has a stronger position than the US and the UK, and since it also offers high growth rates the country has a solid position in comparison with the euro zone.

Strategy

As mentioned in the introduction, we have to admit that despite all the positive factors the Swedish krona is still struggling to leave its established range.

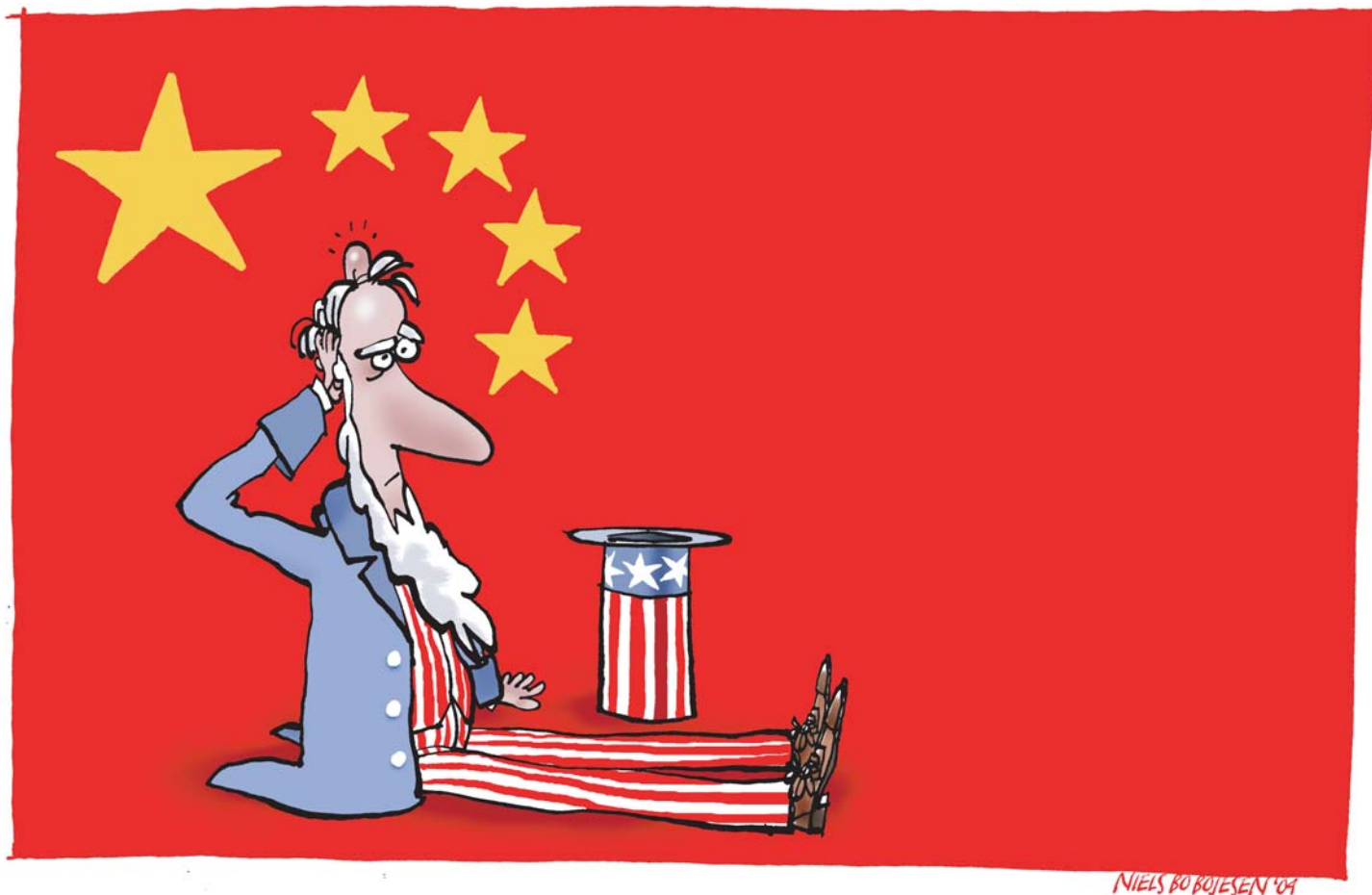
Fulfilment of our scenario is one thing that might trigger such a breach. Therefore our strategy for

2005 is to continue trading the range of the Swedish krona against the euro and the Danish krone.

If we see a breach down to 880-885 (SEK/DKK 84), it will be the first important sign that something bigger is in store, and if this happens together with the "unfolding" of our scenario, we clearly recommend buying Swedish kronor.

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Seminar:

Fall of an empire

– an inspiring evening seminar on investment

Prospects for the US economy in 2005 are bleak. The country's golden age as an economic superpower is rapidly waning, and the US is getting close to falling into a bottomless pit of debt. Resistance among foreign investors to go on financing the record-high current-account deficit is growing fast in the financial markets.

China to take the leading part

China is waiting in the wings to take over the position as the world's new economic superpower and this situation increasingly highlights the transition that has been going on for quite some time from the US to the East.

This succession of power in the financial realm will not be a quiet one. And as a result, 2005 will offer many interesting funding and investment opportunities.

Faber, Rogoff and Ellegaard

An international panel consisting of Dr Marc Faber, the internationally acclaimed economist and analyst; Professor Kenneth Rogoff; and Lasse Ellegaard, senior correspondent and writer, will discuss the transformation process from the point of view of the US as well as China. The panel will also focus on the new attractive asset class: commodities.

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China – a lively dragon

By Lars Skriver

There is no doubt that the gentleman mentioned below was a great military strategist, but it is somewhat surprising that he also predicted the current global trends.

"When China awakens, the world will tremble"

Napoleon Bonaparte

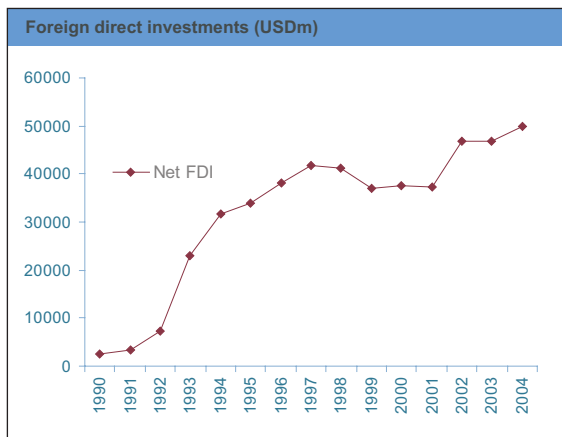
Superlatives are currently raining on China. Rarely has a country been described in more detail in almost every medium across the world, and rarely have there been more opinions about the "Middle Kingdom". There is no doubt that China is changing fast; this change process picked

up after the first reforms were implemented in 1978. According to many, the country's leader at that time, Deng Xiaoping, made a genius move by promoting economic freedom for even the smallest farms by giving them the opportunity to sell some of their own crop. The political process, on the other hand, was not subject to change.

China – a nation of businessmen

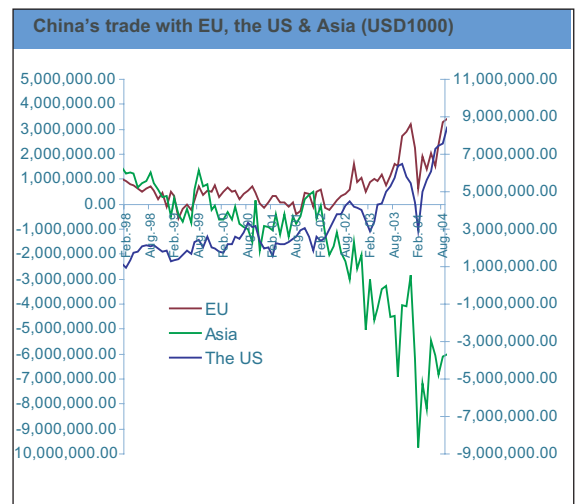
Some may claim that history only repeats itself; 500 years ago, China was a superpower. Gunpowder and silk are only some of the things which China brought into our world ages ago, and the country was also immensely well-organised in all areas of society. So now that the country is about to become a superpower again, some will just nod and say that this was inevitable. If the current trends continue, China will be the world's largest economy around 2040!

Just look at the chart below of FDIs, i.e. foreign direct investments in the country. Funds are pouring into China which reflects the keen interest among investors to be part of the upturn. It is very important for a country to be able to attract foreign capital – particularly in a development phase – and indications are that China has no problems in that respect. This capital flow will decline in future as the Chinese will be spending more money abroad, for instance on travels, due to the increased wealth. There are currently approx. 250,000 USD millionaires in China – and the number is rising!



There is also heavy focus on growth in China. It has been estimated that growth must be around seven per cent for China to absorb the enormous amount of labour which is currently relocating from the agricultural sector to the major cities. This growth target has been reached over the past ten years, and average growth has even been higher. Such growth rates are something which we can only dream of in the western countries. True, a few emerging-market countries also show strong growth rates but none is even close to China's level. It is impressive that China has maintained such growth rates, and some even believe that growth is much higher. The "grey" economy is not included in the statistics, and this market is estimated to be very large.

A very interesting aspect of this fairy tale is the so-called "Robin Hood effect". As we know, the legendary character from Nottingham stole from the rich to help the poor. However, this thesis must be rewritten slightly to fit the picture. The US, as the one part, is in many ways a rich country but if you look at the debt ratio, the description does not match. Asia is the other part, namely the poor, and China is Robin Hood.



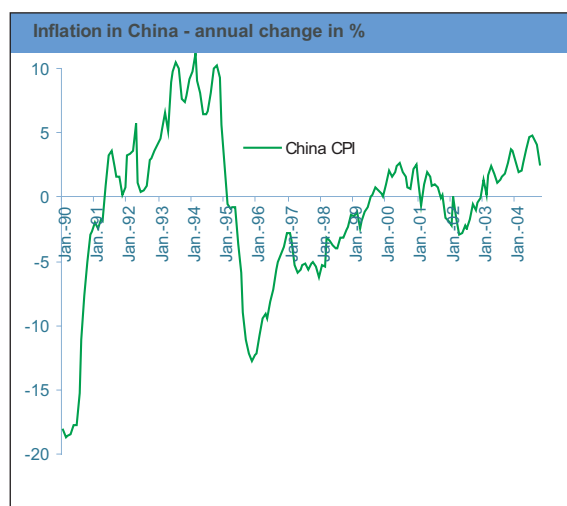
In recent years, China has had high exports to the US but has primarily imported goods from the other Asian countries. This has been sharply criticised by American politicians who are convinced that many Americans lose their jobs at this expense, particularly when China stands firm on keeping the yuan pegged to the dollar. Beyond doubt it is simplifying the problems if you only mention China as the reason for the problems in the US. In the past few years, China has been buying investment goods, for instance, in the US, and this trend will continue in the coming years due to the increased wealth in the country. Therefore some of the flow into China will be reversed and counteract this imbalance.

Europe has also recorded a rising deficit in its trade with China in the past few years. In light of the vast depreciation of CNY against EUR caused by the rising EUR/USD rate and by CNY being pegged to USD, it is obvious that China has been given a competitive advantage.

China has a current population of 1.3bn. Most people still live in the countryside. The majority of the labour force (totalling approx. 780m) is still employed in the agricultural sector, but employment in the manufacturing and service industries is rising fast.

While the Chinese current account has recorded increasing surpluses in the past ten years, the trade balance has been in the red for a short period. This is due to a real investment boom in 2003, which caused the government and the central bank to implement certain lending restrictions in selected areas.

The positive development, which China is currently undergoing, is not without its "costs". Inflation is on the rise, and this has led to an interest-rate hike of 0.27 percentage point from the central bank. It is not unlikely that we will see more interest-rate hikes in the coming period. But if you take a closer look at inflation, it shows that the rise is mainly caused by higher food prices and much less by the rising prices on oil and commodities. With the prospect of a good harvest this year, inflation will slowly but surely edge down again.



China – friend or enemy

Not surprisingly, it has given complications in other countries that China is again about to become a dominating factor in the global economy. The influence of the "Middle Kingdom" on other continents is tremendous. On one hand, China drives global growth, and on the other hand we are losing market share and jobs to the Chinese. If we look at the US, for instance, knowing that not all Americans are happy about a strong China, it must be admitted that the Chinese do in fact support the US economy. Without the Chinese purchase of US government bonds, the US cannot finance its current-account deficit. So in other words, the Americans are to a certain extent dependent on China, and we would not have thought this possible only a few years ago.

The other Asian countries have really benefited from the upturn in China. Following the Asia crisis in 1997, many Asian countries were afraid of a repetition. Now that China has entered the scene, optimism has returned among the "tiger countries", and growth rates have again shown a rising trend. There is even budding optimism to be seen in Japan. Japan and China are not known to have the best relations but the Japanese need the Chinese "engine" right now.

No matter what, it is hard not to admire the Chinese for their will-power and energy, characteristics which many believe were created and formed by Confucius – one of the greatest and most admired men of learning in China's history. Very simplified, his philosophy is about creating harmony between people and society. It is not a religion but rather a very extensive "code of conduct for life itself". True, he lived about 2500 years ago and there have been many other "great" men in China since then – but only one Confucius!

**I hear and I forget.
I see and I remember.
I do and I understand.**
Confucius

Lately, the economic slowdown in China has been much debated. Will it be a hard or a soft landing – or no landing at all? In light of the above description, we remain bullish about the Chinese economy. The road ahead for China will probably not be completely straightforward – there will be "bumps" on the way and possibly also stops, but one thing is certain – a superpower is on the way. Again!

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A Chinese rocket

By Lars Skriver

Belief in a revaluation of the Chinese currency dominates the market at the moment. But is it realistic to believe that the Chinese will change their fixed-rate system. Yes – a revaluation is lurking round the corner.

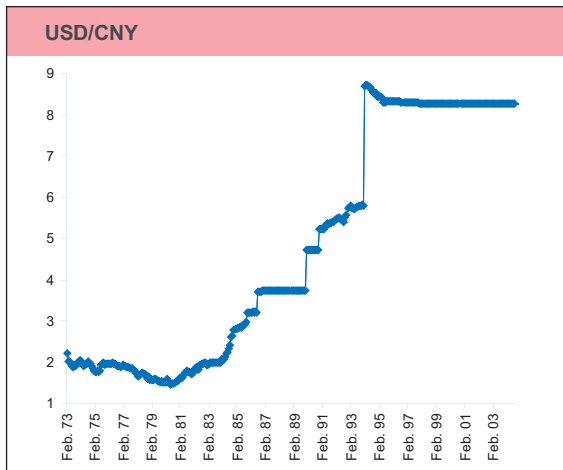
Historically, exchange rates have been kept firm in many different ways. One of them was the Bretton Woods agreement: a system used to fix the value of the currencies to the value of gold. One characteristic of all of these agreements is that "they do not last forever". In other words; these agreements are abandoned sooner or later.

We still see many forms of keeping a currency firm against another currency in today's FX

market but there is a trend towards free floating currencies. It is typically the emerging-market countries which fix their currencies in some way or other. Malaysia, Hong Kong and China all do it. It is obvious to turn to China and its currency since all eyes are on the "Middle Kingdom" at a time when the Chinese dominate newspaper headlines.

There are several options of linking or fixing a currency to one or more currencies. It may be a peg, a managed float, a currency board, a basket or a band. Since we focus on China, we will look at the fixed-rate regime of CNY against USD.

CNY was pegged or fixed to the dollar in 1994. As is evident from the chart below, the period before 1994 was characterised by a long depreciation of the Chinese currency against the US dollar.



After the peg was set in 1994 at around 870, there have been a few adjustments, most recently in 1995, but since then the exchange rate has been fixed at 828.

What does pegged mean

The peg to the dollar is currently at 828.00, and no deviation from this exchange rate against the dollar is allowed. This means that there are no fluctuations in the exchange rate. The Chinese central bank, PBoC, determines and controls the exchange rate unilaterally. This combined with the existing capital restrictions mean that all CNY trading is made with the central bank and that neither CNY nor amounts in foreign currencies may be transferred abroad. In other words, all domestic companies are obliged to exchange their foreign-currency holdings to CNY on receipt of payment. In this way, the central bank controls all FX transactions in the country.

Why was CNY pegged to the dollar in 1994

Typically the reason behind fixing a currency to another is extensive trade. It is a fact that China has other trading partners than the US, but historically the US and China have always had a high volume of trade. Moreover, the dollar's status as the only "reserve currency" in the world has influenced the decision, although the introduction of EUR brought a competitor to the world market.

Whether a currency should be fixed to another currency or be allowed to float freely is one of the oldest topics for discussion among economists. Of course this discussion is important, since countries experienced economic crises due to wrong decisions. But so far China is comfortable with its foreign-exchange policy, which has not resulted in any kinds of crises.

There have probably been several reasons why China fixed its currency to the dollar. Including of course speeding up growth. Up through the 1990s, China saw rapid growth resulting in a veritable economic boom. Such a development would take the breath away from most other countries. The previous stronghold of Communism has now suddenly become oriented towards the west. But it has not always been like this. After a period of domination by the agricultural sector, the manufacturing industry has taken over, especially the export-oriented industry. Suddenly, the exchange rate has become an important parameter for China in its endeavour to maintain its large export trade.

Other reasons may be:

- A small and open economy.
- Trade with the US. It is not so important whether trade with another country is 40% or 50% of the total volume – only that the trade is relatively extensive.
- The development of inflation is at the same level in both countries.

It can be discussed whether these prerequisites are fulfilled at the moment for China to maintain its fixed-rate regime. But it is difficult to maintain the fixed-rate regime when economic trends are so dynamic.

Can the peg be abandoned

Yes, it can. But not, as most would think, through international pressure and intervention. At the last G7 meeting, which China attended as a guest, the Americans, among others, commented on the development of the Chinese currency. The fact is that it is a politically hot topic these days, also after the election in the US, but no matter how much pressure the Americans put on the Chinese to act, the decision to change or abandon the peg will remain strictly Chinese. Due to the capital restrictions imposed by China, there are no direct methods for other countries to make China abandon the peg. One good example is the attack on the Hong Kong dollar in 1997. During 1997 many Asian countries ran into problems, and their currencies came under pressure. Foreign market participants tried to force down HKD against the dollar. HKD is pegged to the dollar through a currency board (the domestic money supply equals the USD currency reserves). But the means were very limited with a currency board in the back-

ground since HKMA, the central bank of Hong Kong, did not want a change against the dollar. As a last attempt to force down HKD, the market tried to sell down the equities but HKMA bought up the equities. In the end, HKD was still linked to USD, and the market lost.

So when we talk about the possibilities of changing CNY against USD, it can only be done by the central bank changing the fixed-rate regime.

When will China change the peg

As the observant reader may have noticed, I mentioned in the introduction that pegs “do not last forever”. This also applies to China. There is no longer any doubt that China will make a change in the coming period. When this happens depends on the Chinese and thus indirectly on the development of the economy. Opinions vary as to whether China will experience a hard or soft landing. There are prospects of a soft landing after the initiatives from the central bank to dampen lending growth, for instance, in the country and due to the inflation rate which has probably topped this year.

With the prospect of a soft landing, we believe that the Chinese will slowly but surely turn their attention to the currency.

But one thing is certain: China and the central bank, in particular, will have considered things carefully before they act. Such an initiative requires careful consideration. Moreover, the Chinese will use all means to avoid giving the impression that they act after pressure from overseas, as this would put China in a bad light.

In any case, it is inevitable that China changes the peg and thus revaluates its currency. We believe it will happen within the next six months. The capital restrictions will not be abandoned this time round, but only when China introduces a freely floating currency.

Since CNY is inconvertible, an off-shore market has been established – a so-called NDF market. This shows that currently expectations are of a revaluation of approx. 5% of CNY the next year.

As we see it, there are two possibilities:

- Abandonment of the peg to USD and a revaluation by up to 10%. This will be followed up by

linking CNY to a “basket” of currencies, and the contents of this “basket” will not be made public. CNY will fluctuate around this basket, depending on the fluctuation band introduced by China.

- Introduction of a “shadow currency”. This will give China an opportunity to experiment with the change little by little. This “shadow currency” will be implemented against the entire export sector or parts of the sector at a rate above USD.

The first possibility is the most likely solution, but the latter should not be entirely rejected, as it would give the Chinese the possibility of gaining some experience before their currency is allowed to float freely.

Will it have any effect at all?

Yes, the dollar will depreciate, both against EUR and the other Asian currencies.

Since CNY is inconvertible, it may be an idea to buy Chinese equities to profit from a stronger currency. We do not recommend buying HKD as the HKMA will continue holding the Hong Kong Dollar close to the peg around 780 to USD. Instead we recommend buying SGD, this being almost the only convertible currency left in Asia.

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A basket of currencies means that the exchange rate of CNY will depend on the development of the currencies which China decides to include in this “basket”. There are no restrictions with respect to the number of currencies included in the “basket”.





Metal fatigue or new highs?



By Jakob Larsen

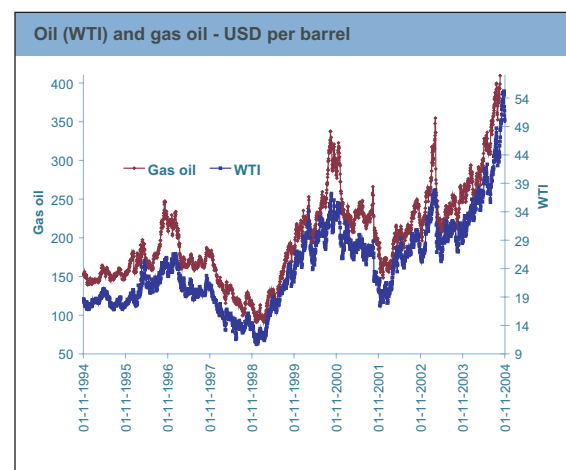
Commodities have been quite the rage of the financial markets this year. Soaring commodity prices have made some investors cry and some investors laugh. The central banks are concerned about the inflationary effects of rising commodity prices. Investors holding commodity exposed portfolios, on the other hand, have been having a ball. But will the positive trend continue, or will commodities lose steam?

The positive trend of the commodity markets will continue in 2005. Base metals, energy and gold will see yet another year of rising prices. The factors which have contributed to the price increases will still prevail in 2005.

Energy

The energy complex has seen considerable price increases, and the price of crude oil has set a new record. The factors behind this trend are of a fundamental nature – such as rising demand driven by global growth.

Demand has accelerated, and the US, China and the rest of Asia in particular have benefited from

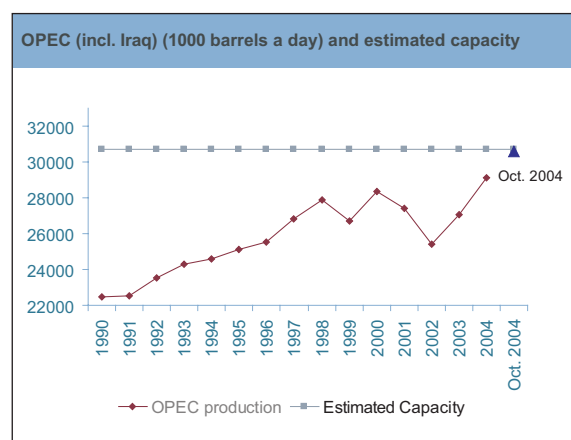


rising oil consumption. China and India in particular have become important players in the energy market. The rapidly increasing Chinese economy gulps up huge amounts of oil for transportation and industrial purposes. Chinese net imports of oil declined by almost 4% in the third quarter compared with the second quarter, but in September the rise in net imports was back at the level of earlier this year. Even if the Chinese economy slows down, the country still holds the key to the increase in global demand for oil.

The supply of oil has barely been able to keep up with demand; with a subsequent drain on global reserves.

Given rising demand, global excess capacity has significantly decreased. It is estimated that since September 2002, global excess capacity has dropped from 6.5 million barrels a day to almost 1 million barrels at the time of writing.

OPEC, which has traditionally tried to adjust supply and demand by means of excess capacity, has its back against the wall.



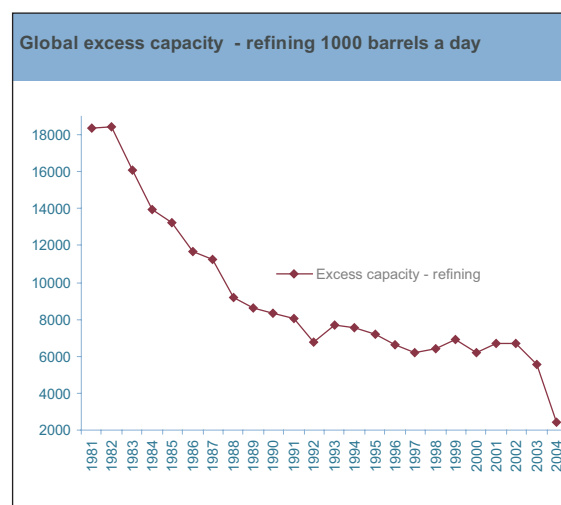
Remaining excess capacity within OPEC – reserved for a sudden increase in demand or production stoppage in the oil producing countries – is thus extremely limited. A fact that has contributed to the high price of oil.

Focus has been on Russian production as a source of rising global supply. But the increase in Russian production is a disappointment, and according to some experts Russian production will probably peak in 2005.

The high price of oil is accounted for primarily by the limited degree of flexibility in the oil market

– the result of rising demand for oil and a level of global supply close to the limit (without any increase in extraction and refining capacity). Estimated supply and demand in 2005 indicate a further pressure on excess capacity and reserves. Demand is expected to increase by almost 2% and supply by almost 1%, cf Barclays Capital.

Current flexibility restrictions are the result of under-investment in the oil industry in the past. Global production capacity is just not large enough.



One country in particular which has suffered capacity problems is the US where petrol and fuel prices have reached record-high levels in the past two years because of undersized refineries. The fact is that they have not built a new refinery in the US in the past 25 years.

When supply and demand are under pressure, the oil price is highly sensitive to geopolitical unrest which may affect supply. And geopolitical unrest is not uncommon! The situation in Iraq, political unrest in Venezuela, unrest in Nigeria (the US's third-largest supplier of oil), the conflict between the Israelis and the Palestinians, fear of political unrest and terror in Saudi Arabia and uncertainty as regards the supply of oil from Russia's large oil companies are some of the factors exerting pressure on the oil price.

A particular place where the temperature may soon start to rise is Iran, which may be the US's next target under the new "strike first" foreign policy doctrine. Iran is OPEC's second-largest producer with daily production reaching almost 4 million barrels.

Unfortunately, these are troubled times, and international political unrest remains a joker in the oil market.

Overall, we expect the positive trend of the energy complex to continue in 2005. We believe in an average price of WTI crude of 40-45 US dollars per barrel in 2005. If oil prices decline in the second and third quarter, perhaps all the way down to 30 dollars, we may even see prices of approx. 60 dollars a barrel later in the year.

The risk scenario is that the high price of oil ...

1. results in a significant slowdown in global growth
2. inspires energy-saving initiatives
3. results in a sudden increase in supply by non-OPEC countries.

However, we expect the price of oil and volatility to remain high. Ways of profiting from this case:

1. Buy oil futures falling due later in 2005. Buy at a price below 40 US dollars per barrel.
2. Buy oil products such as petrol futures before summer or fuel futures before winter.

Gold

Precious metals in particular have benefited from the booming commodity markets. Since 2001, gold has increased tremendously as the US dollar has continued to depreciate. In 2004, gold reached the highest level in more than 16 years.

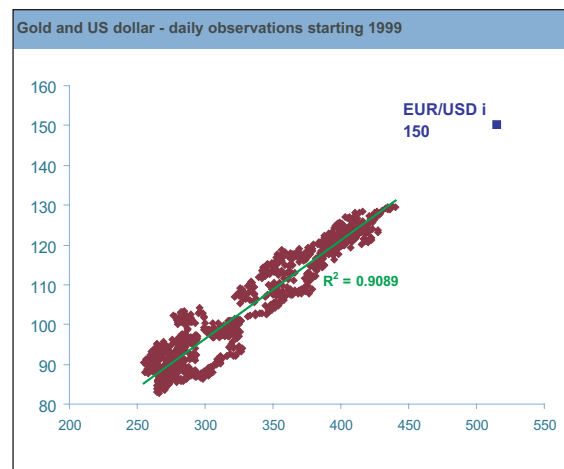
Gold is considered a reserve currency. When the world's foremost reserve currency (the US dollar) depreciates, the financial markets turn to gold.

The imbalance of the US economy, which has driven the dollar to its knees, is one of the primary reasons for the increase in the value of gold. Furthermore, in times of uncertainty gold is considered a safe asset.

It is quite some time ago that investors first discovered gold as an attractive investment, and recent figures from the US stock exchange authorities indicate that net long gold future positions acquired by speculative investors have reached a record-high level.

Judging from the dollar movements, gold has far from peaked. Based on the correlation of the past

five years between gold and the US dollar, a dollar at 150 will result in a gold price of 515.



The next target area is the psychologically important level of 460 dollars. The subsequent target is 475 dollars on the way towards 500 dollars per ounce.

Base metals

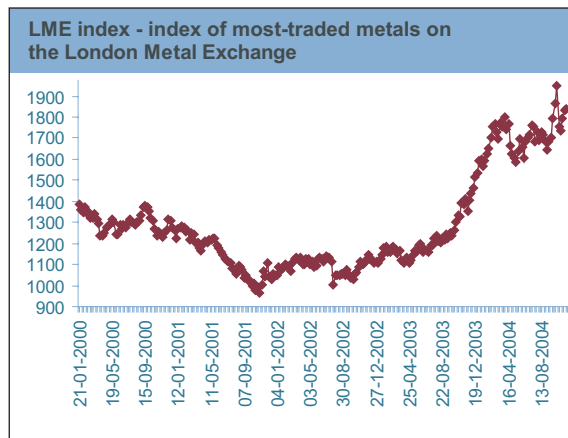
In the course of the past years, demand for base metals has increased because of rising global growth. The expanding Asian economies headed by Japan and China play an increasingly important role when it comes to demand for base metals. China alone accounts for almost 20% of the global supply of base metals. Rising growth has made the price of base metals soar – driven by fundamental conditions as well as speculation.

The slowdown in US growth and increasingly restrictive Chinese credit policies introduced in May give rise to some concern in the market. Developments in China over the summer in particular caused considerable reactions in the metal markets. Prices fell by approx. 12% because of a slowdown in Chinese demand.

There is no doubt, however, that even in a situation of slow growth, fundamental conditions still speak in favour of a further increase in the price of base metals on a global scale.

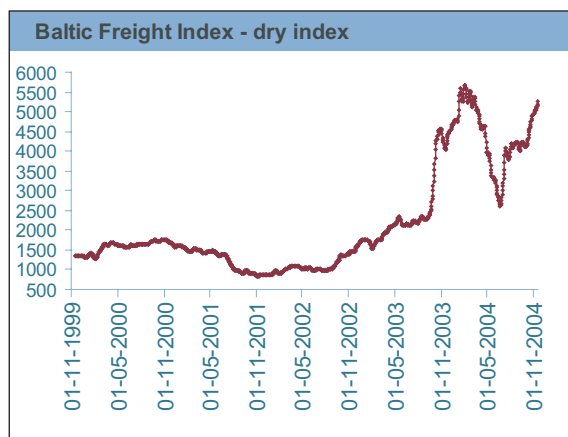
Overall, demand for base metals is expected to increase, whereas short-term demand will not be able to keep up. Likewise, base metals have established themselves as an asset class, attracting investors and their money. As clearly indicated by price movements in 2004. The volatility of important metals such as copper and aluminium is

in part the result of investors holding positions in said metals. Substantial investor interest in base metals has caused an upward pressure on prices.



In China, indications are that demand for base metals will start rising again. The initiatives introduced in China in the second quarter to restrict lending activities and growth were successful and resulted in a decline in demand for copper and aluminium. Lately, however, we have seen signs that Chinese appetite for base metals has started to increase again.

Despite a considerable production of base metals in China, indications are that production is not quite able to meet demand. Therefore, the premium on physical metals (metal for actual delivery – not just securities trading) is rising.



One effect of the rising demand for metals in China is a renewed increase in global freight rates.

Most analysts agree that the Chinese economy is set for a soft landing with an annual rate of growth in the neighbourhood of 10-12%. Even with a lower rate of growth, Chinese demand for

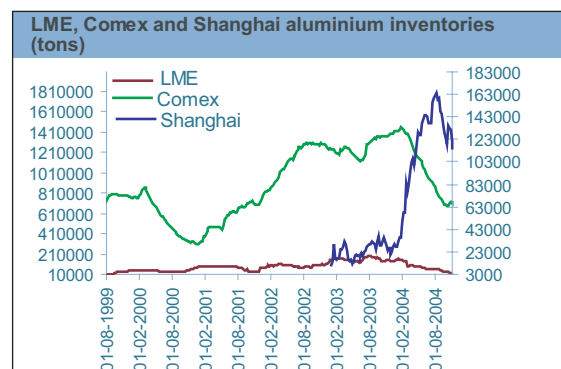
metals will continue to increase in response to its rising industrialisation.

The trend of rising premiums on physical metals is also reflected in the US, Europe and Japan. This is especially true of aluminium and copper – an indication of strong demand.

The supply side, however, has a hard time keeping up with demand. Rising metal prices have led to an increase in production, but the increase is primarily the result of temporary initiatives such as the start-up of idle mining capacity and previously closed mines, etc. Like in the oil industry, the mining industry has been reluctant to invest as underlined by the fact that the cost of extraction and development on a global scale is the lowest in more than 25 years. Consequently, it is impossible to increase global metal production in the short term – supply cannot keep track of demand. The result is a further decline in metal reserves.



Global inventories are extremely low, and thus we see a subsequent upward pressure on metal prices. We do not expect supply to increase considerably compared with demand. Thus, indications are that the supply/demand situation will grow increasingly worse in 2005.





As for copper, demand is strong in the US, Japan, Europe and China despite the economic slowdown. Rising prices have led to an increase in copper production, but it will be some time before refined products reach the markets. Thus, 2005 will be yet another year of a supply deficit and high copper prices.

Demand for nickel is strong in the US and Europe, and supply has a hard time keeping up with demand. Global reserves of refined nickel are low, thus the outlook for rising nickel prices is good.

All in all, there is nothing to indicate that base metals will suffer from metal fatigue next year. The major risk, however, is that the Chinese economy is heading for a hard landing or that we

see a significant slowdown in global growth. One way of profiting from rising metal prices is to invest in the LMEX index or metal derivatives. Overall, we expect the positive trend of the energy complex to continue in 2005. Base metals and gold will not suffer from metal fatigue, and oil seems set for further increases. Therefore, we recommend that investors buy commodities whenever the opportunity arises.

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- various credit products



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