CEO CONFIDENTIAL

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Stronger CEO Confidence Suggests a More Durable Economic Recovery

Inside:

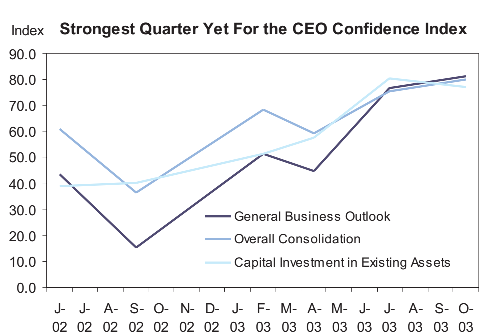
Further gains in our CEO Confidence Index—after a spike this summer—bode well for consolidation, capital spending and job creation in coming months

Improving economic data out of the US, Euroland and Japan in recent weeks has boosted confidence in the strength and durability of the global recovery. While we have become increasingly optimistic, the reliance on consumer spending and the absence of meaningful job creation and capital spending remain potential trouble spots. Better business confidence is a vital prerequisite to a more sustainable and broadly based recovery—but one that has been largely absent until now.

One early sign of corporate optimism came in our third-quarter CEO Confidence Index, released in August, which showed a sharp spike.

Our just-released fourth-quarter CEO Confidence Index now shows solid gains from this already high level, driven largely by progress in Europe. Supported by improving signals from other GS proprietary and key external surveys, this suggests that corporations will become increasingly willing to invest and to hire.

Our CEO Confidence survey also shows that prospects for global consolidation continue to improve, driven again by a sharp increase in Europe. While our bankers caution that the recent spate of merger announcements does not constitute the start of another merger boom, it is clearly a sign that CEOs are feeling more positive about both the economic outlook and corporate prospects. We also see ample grounds to expect a pickup in capital spending over coming months.



Gains in Confidence, Tinged With Caution

The GS CEO Confidence Index, our quarterly survey of investment bankers, shows strong momentum at the start of the fourth quarter, with a global reading of 81.4, up considerably even after a spike to 76.8 in July. In this diffusion index, 50 indicates an equal balance between those who think the situation is improving and those who think it is deteriorating. For the first time in our survey, none of the respondents indicated that conditions are worse than last quarter. *The full results are in a table on page 2.*

We have seen a marked change from the start of the year, when caution prevailed and concerns about the war in Iraq and SARS took their toll on confidence. With these concerns having eased, and the flow of economic data steadily positive, CEOs are now increasingly confident that the global economic recovery will be sustainable.

This is particularly true in Europe, where the index rose to 73.5 from 71.2 in July. The recovery has been slower to take hold in Euroland, but October saw a stream of good news, and we expect momentum to accelerate in coming months. In the US, our reading remains steady at a very high 86.7.

Caution has not been abandoned, even in Europe, where bankers note that 'significant concerns about the strength and sustainability of the recovery' remain. One says 'margin structures are good as a result of cost cutting, but the revenue outlook is flat given continuing competitive pressures.' But overall the tone is positive.

Other Surveys Echo the Upturn

The results of our CEO Confidence Index chime with impressions from our GS Analyst Indices, in which we survey our equity research analysts about current economic conditions. These too show a strong pickup around the globe. And the GSAI readings, in turn, have been echoed by releases from key external business surveys.

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Stronger CEO Confidence Suggests a More Durable Economic Recovery

CEO Confidence Index																					
index	General Business Outlook			Overall Consolidation			Vertical Consolidation			Horizontal Consolidation			Capital Investment in Domestic M&A			Capital Investment in International M&A			Capital Investment in Existing Assets		
	Global	US	Europe	Global	US	Europe	Global	US	Europe	Global	US	Europe	Global	US	Europe	Global	US	Europe	Global	US	Europe
Oct-03	**81.4**	**86.7**	**73.5**	**80.0**	**80.0**	**82.4**	**31.4**	**60.0**	**11.8**	**82.9**	**73.3**	**88.2**	**68.6**	**66.7**	**76.5**	**54.3**	**46.7**	**64.7**	**77.1**	**93.3**	**64.7**
Jul-03	76.8	86.7	71.2	75.6	80.0	73.1	36.6	53.3	26.9	78.0	73.3	80.8	70.7	73.3	69.2	43.9	39.0	54.9	80.5	93.3	73.1
Apr-03	45.0	51.7	49.2	59.2	54.2	51.7	32.5	37.5	49.2	74.2	64.2	54.2	32.5	42.5	44.2	12.5	29.2	37.5	57.5	54.2	52.5
Feb-03	51.5	58.3	51.9	68.5	72.2	72.2	35.4	33.3	40.7	83.1	86.7	77.8	38.5	43.3	29.6	20.0	16.7	25.9	51.5	43.3	56.7
Sep-02	15.4	20.0	13.9	36.5	40.0	33.3	34.6	46.7	27.8	63.5	60.0	63.9	21.2	13.3	22.2	13.5	20.0	11.1	40.4	33.3	41.7
Jun-02	43.5	33.3	41.7	61	55.6	66.7	--	--	--	--	--	--	39.1	33.3	33.3	26.1	22.2	33.3	39.1	22.2	41.7

Continued from page 1

In the US, the GSAI reached 60.6 in October, with analysts noting improved demand and stronger profits, although many cited cost-cutting as the primary cause of stronger profits. This reading was followed by a strong report from the manufacturing ISM, which in October posted its highest reading since January 2000. Several sub-indices reached multi-year highs.

Sentiment has risen notably in Euroland, where our GSAI reached 51.7 in October—its first move above 50 since February 2001. This was a sharp increase from September, and it boosts the underlying trend significantly, though this remains considerably below the historical average. This optimism was largely mirrored by the October Reuters PMI index, which posted its fourth consecutive monthly rise and its best reading since July 2002.

News from the UK is even more encouraging, with our GSAI up to 63.8, the highest level since November 2000. The index is comfortably above its historic average and is consistent with above-trend growth.

Anecdotal comments in our European surveys indicate that the recovery is not yet broad-based across all sectors, and that exports, rather than domestic demand, are prompting a moderate production upturn. Our forecast is for domestic demand to pick up in coming months, which should solidify confidence and the upswing.

In Japan, our September GSAI (the most recent reading) produced a third consecutive score above 50. The last time the Japanese index topped 50 for three straight months was in late 1999. With a string of strong economic data in September, the October GSAI should at least sustain this positive momentum. Again, we see confirmation of this uptick in confidence in the Bank of Japan's Tankan business condition reading, which moved into positive territory in September for the first time since December 2000.

Consolidation Outlook at a Record High—But Not the Start of a Boom

A key component of our CEO Confidence Index is the consolidation reading. As was the case last quarter, the outlook is very promising, with our global reading coming in at a record 80.0, up from 75.6 in July. Europe drives the marginal improvement, up sharply at 82.4 from 73.1, while the US score is flat on the quarter.

In July, we noted that it was still too early to see significant deal volume. Since then, data have begun to bear out the results of our survey. The spate of mergers announced in recent weeks has pushed year-to-date merger volumes to \$1.1 trillion—already close to the full-year 2002 level of \$1.2 trillion. October's global merger volume reached the highest monthly levels seen since July 2001. Cross-border volumes have yet to rise, although our survey suggests that we may see more in coming months. More data on the state of the M&A market is available on page 4.

Survey comments suggest that bankers and their clients are confident but not exuberant. 'People are definitely thinking more about doing deals. A number of companies are actively looking for international takeover candidates in a number of sectors.' A CMT banker sees 'some focus on geographic expansion.' We also see positive signs in Japan, including 'the first notable transaction where a profitable (not desperate) retailer accepted a takeover bid by a foreign retailer.'

Despite 'better market receptivity to M&A deals,' one European banker notes that companies are 'still very conservative regarding the use of cash.'

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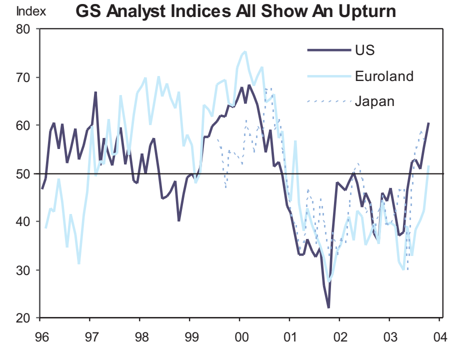
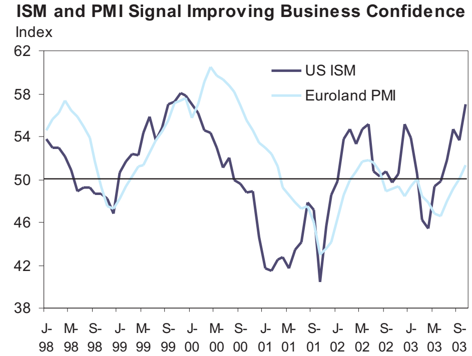
GS Analyst Indices All Show An Upturn



ISM and PMI Signal Improving Business Confidence



Further information on the topics in this report is available on the GS Financial Workbench[sm]. For access, please go to www.gs.com/ceoconfidential

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Solid Gains in CEO Confidence Suggest a More Durable Economic Recovery

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Tellingly, our global head of M&A says that 'over the next three to six months we should witness, as opposed to imagine, a pickup. At the moment, the M&A business for the Fortune 100 is at best episodic.'

As is usual in our survey, prospects for horizontal consolidation look much better (82.9) than those for vertical consolidation (31.4). Most notable was the swing in the Europe for horizontal consolidation (mergers of firms selling similar products), to 88.2 from 80.8. The Europe reading is now considerably higher than the US figure and is among the highest of the survey.

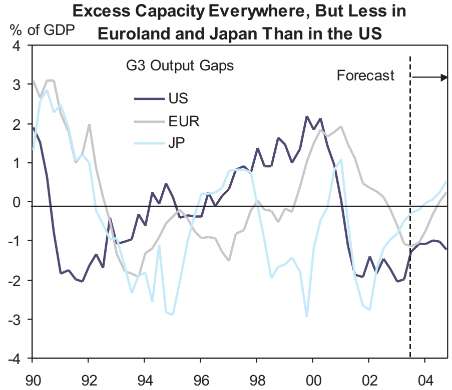
While the overall score for vertical consolidation (between firms at different stages of the production process) is a weak 31.4, the data are mixed: the US posts a respectable 60.0, but Europe's poor 11.8 drags down the total.

Capex: Potentially the Most Upside

Capital spending is perhaps the most important source of upside risk to the global economy over the next few months.

Earlier this year, we discussed five reasons why we expected a muted recovery in capital spending throughout 2003: low capacity utilization; limited scope for demand acceleration; weak stock markets; tight financing conditions; and ongoing balance sheet repairs.

Since we wrote that report in March, the outlook has improved dramatically.



Excess Capacity Everywhere, But Less in Euroland and Japan Than in the US

- The growth outlook has improved, particularly in Europe and Japan, where our forecasts are now well above consensus. Demand growth has already been much stronger than we expected six months ago, especially in the US and Japan. Consumers have held up better than expected around the world.

- Equity markets have risen sharply, signalling rising expectations of future returns and profits.

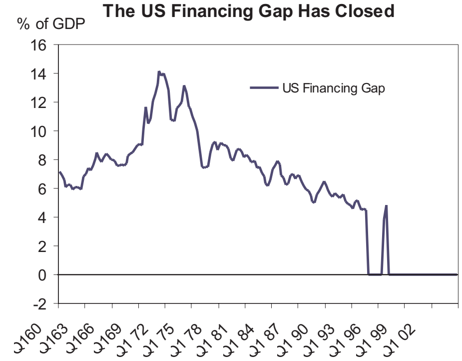
- Profits and cashflow have improved, and credit conditions have eased. The availability of financing is now much less of a constraint on investment than it has been recently. Credit spreads are unlikely to widen significantly as long as equity markets continue to perform well and the global economy grows in line with our forecasts.

- Balance sheets are in better shape. Latest data shows that the US corporate financing gap—the difference between income and spending—stood at just 0.1% of GDP in the second quarter, down from 0.6% in the first and an average 0.9% in the second half of 2002. At the same time, rising equity markets and declining credit spreads have relieved some of the pressure to deleverage, and low corporate borrowing rates since May have allowed some refinancing.

- Although capacity utilization in manufacturing remains well below average in the US, broad measures of spare capacity elsewhere look more favorable. Euroland and Japan could actually eliminate their remaining spare capacity in 2004 under our current growth forecasts. This means that the need for new investment may come more rapidly as long as demand growth is maintained.

In fact, investment spending in much of the world has already begun to recover. G3 investment growth picked up from -1.2% (annualized) in the first quarter to 4.6% in the second, driven mainly by a 7% rise in business investment in the US and a 20% increase in Japan.

The US Financing Gap Has Closed



Our Survey Points to an Upturn

Recent forward-looking indicators, including the capital expenditure readings on our CEO Confidence Index, provide further signs that the investment outlook is improving. Our survey's capex readings are generally very positive:

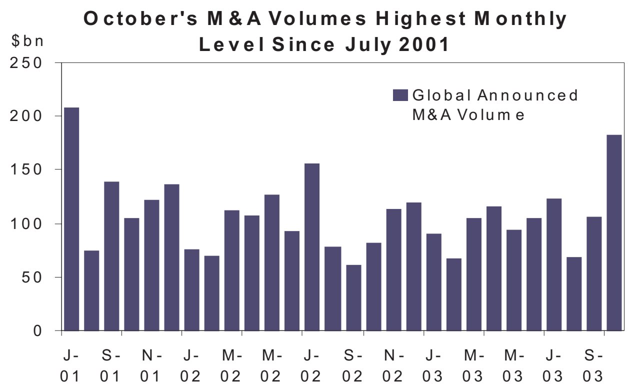
- Expectations for capital investments in existing assets have come down slightly (to 77.1 globally from 80.5 last quarter), driven by a fall in Europe to 64.7 from 73.1 The US reading, however, remains extremely high at 93.3.

- Scores for capital investment in international M&A, while markedly lower than the 'existing assets' reading, have risen sharply, to 54.3 from 43.9. The reading is significantly higher in Europe (64.7) than in the US (46.7).

- The score for capital investment in domestic M&A is off slightly from last quarter, but the fall in the US is offset by a strong rise in Europe to 76.5 from 69.2.

Anecdotal comments again reflect caution. 'CEOs will wait to see evidence of a recovery before increasing capital expenditures,' notes one banker. Another says that while CEOs may not be planning much capex now, 'constraints on budget spending are less tight' than last quarter.

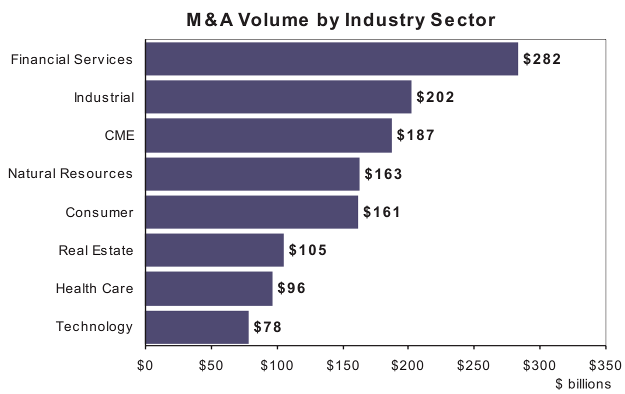
Significant risks remain, including uncertainty over the sustainability of spending growth; overcapacity in some sectors; and the potential desire to reduce leverage. Continued economic growth is essential, especially in Euroland and Japan. But we are optimistic that momentum will continue to improve. ■



October M&A Volumes Hit a High Spot

- The spate of mergers announced in recent weeks has pushed year-to-date merger volumes to $1.1 trillion—already close to the full-year 2002 level of $1.2 trillion.

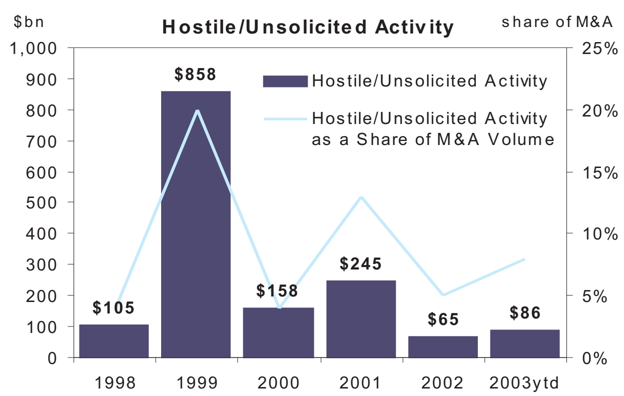
- Especially striking is October's global merger volume, which reached the highest monthly volume seen since July 2001.



Financial Services Dominate M&A Activity This Year

- Financial services have dominated the M&A market this year. Over the past 12 months, the volume of mergers in financial services has risen 78%. Communications, media and entertainment activity posts the second largest gain, up 22% over the past 12 months.

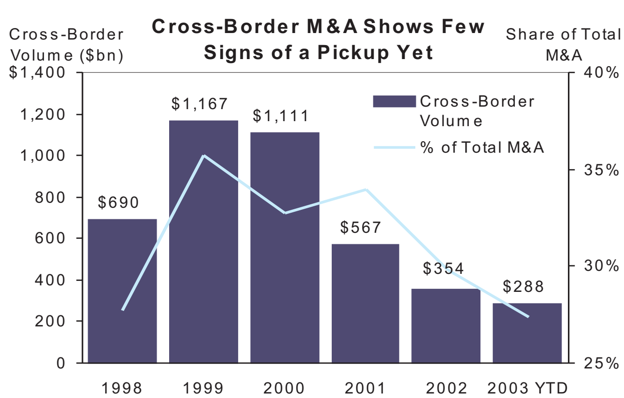
- In contrast, mergers in natural resources and health care are down 28% and 22% respectively over the past 12 months.



Hostile Activity Sees a Resurgence in 2003

- Hostile and unsolicited merger activity has picked up significantly this year. At $86 billion so far, hostile activity already exceeds the full-year 2002 volume by 32%.

- While much of last year's unsolicited activity was focused on minority squeeze-outs, 2003 has seen something of a resurgence in traditional M&A activity, much of which has been geared toward European target firms.



Cross-Border M&A Volume Has Yet to Record a Pickup

- Our M&A pipeline indicates that US investments abroad are likely to exceed foreign investments in the US. Interestingly, cross-border M&A activity by North American companies is double the volume of European companies this year.

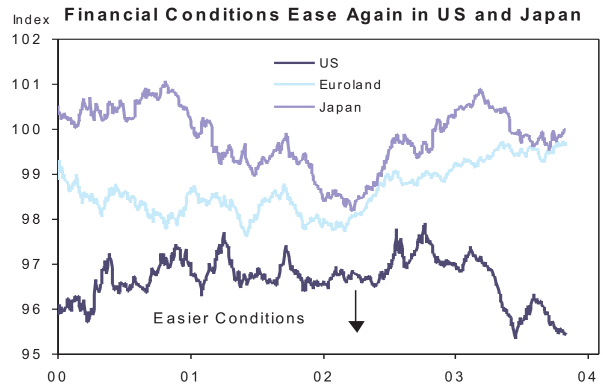
- Cross-border M&A tends to be longer in gestation than domestic deals, and so the pickup in confidence is likely to take longer to translate into significant cross-border activity.

Source: Thomson Financial Securities Data; Goldman Sachs.

Easing Financial Conditions Underpin Global Recovery

- US financial conditions have reversed a significant part of their tightening between June and August. Our US Financial Conditions Index has reversed 90bp of its 100bp rise. This is positive for the US economy: easing of financial conditions earlier this year was a crucial reason for our optimism about the US and global outlook.

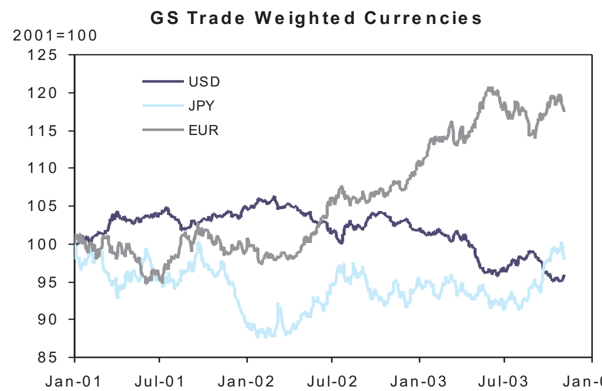
- Euroland financial conditions have tightened slightly since the ECB last cut rates on 6 June. While financial conditions in Japan are 45bp easier than they were in January 2003, they have tightened since the September G7 meeting on the back of Yen appreciation.



Dollar Depreciation Only a Drop in the Bucket

- The recent 8% fall in the US dollar is only a drop in the bucket against its steady appreciation since the mid-1990s. The G7's call for more flexible exchange rates has contributed to the most recent episode of dollar weakening against its major trading partners.

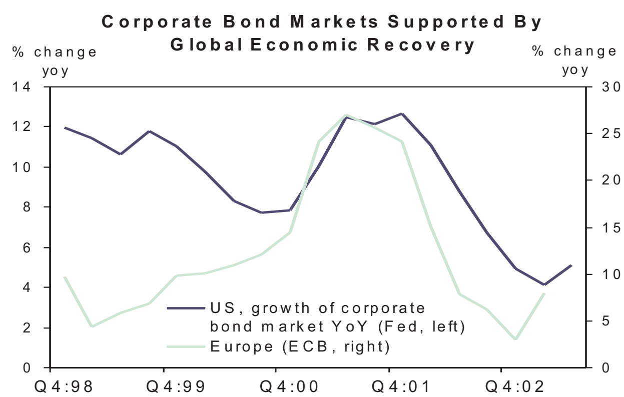
- We think the next significant leg of dollar weakness could occur following a move by China to adopt a more flexible exchange rate policy. We expect the Chinese Yuan trading band to be progressively widened, to +/-2.5% in 3 months and +/-5% in 6 months.



Corporate Bond Market Gains Momentum

- Improvements in fundamental credit and global economic conditions justify the dramatic tightening seen in the credit market since October 2002. On our models, credit spreads are currently trading close to fair value.

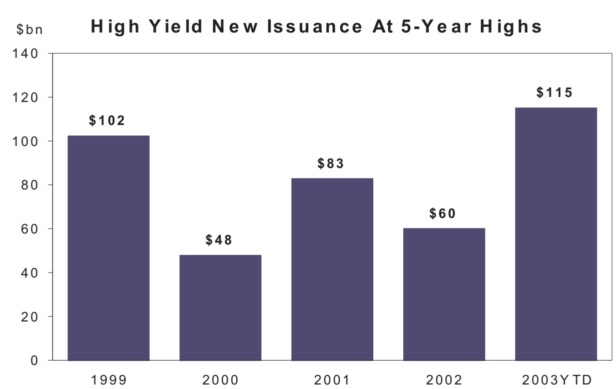
- We forecast investment grade spreads to remain close to current levels, in line with our expectation of a gradual acceleration in global economic growth. The recovery is expected to provide continued support for equity markets and keep risk premia in check, all of which should be positive for credit.



High Yield a Bright Spot in 2003

- With two months left in 2003, high yield new issuance has reached its highest levels in five years. We maintain our overweight recommendation on the back of our bullish view on defaults, corporate profits and strong technicals.

- We are comfortable with our strategy of overweighting high yield, even though we think US growth will fade late next year. The main risks to our view are a collapse of confidence in the dollar, a stall in the global recovery and a fresh sell-off in the equity market with higher volatility. At this point, we think these risks are low.



Source: Goldman Sachs.

THE WORLD IN A NUTSHELL

	Outlook	Key Issues
United States	We are finally getting the long-awaited improvement in the labor market. With payrolls of 126K in October, plus upward revisions in the prior two months, we now have three months of moderate payroll gains in a row. We see two soft spots in the recent labor market data. First, sluggish rises in average hourly earnings means that there is not much income growth. Second, numbers suggest that job gains are not that broadly based.	We do not expect the Fed to tighten monetary policy until mid-2005 at the earliest. Plenty of slack remains in the economy, and momentum will slow once the fiscal stimulus wears off and the impact of the drop in mortgage financing curbs consumer spending. Inflation should continue to decline as long as the economy has excess labor and capital. Labor market improvement is still tentative and data suggest companies are still reluctant to hire.
Japan	We have raised our July-September GDP forecast to +2.2% annualized. An economic recovery is under way, led by exports and private capex. Corporate profits are reviving, driven partly by sales but largely by the effects of restructuring, which is most pronounced in the manufacturing sector. A declining savings rate is helping sales to remain firm by offsetting the impact of restructuring on incomes.	Deflationary pressures are easing. The pace of decline in the Consumer Price Index has slowed considerably and individual price declines are narrowing. But we do not expect an immediate termination of quantitative easing. Unless the BOJ sees sustained growth in core CPI, it is unlikely to raise rates. This is unlikely before the second half of 2005.
Europe	Recent data from Euroland strongly suggests that activity is fast gathering momentum. The pick-up in the European PMI indices has been impressive, particularly in the service sector and in the UK, where it reached the highest level since June 1997. These indicators are among the most reliable, justifying our forecast of 2.6% GDP growth in Euroland next year.	The ECB has confirmed its wait-and-see stance by keeping rates on hold at 2%. New ECB Governor Trichet appears more optimistic about the ongoing recovery. Aligned with our views, the ECB sees price inflation as moderating in the medium term and is therefore unlikely to cut rates before mid-2004, once it is sure that the recovery is firmly established.
Non-Japan Asia	Improving G3 activity herald a sustainable domestic-demand led recovery for Asia. We expect the export rally to continue, led by Taiwan, China and Korea. Sentiment is picking up in Hong Kong, where we expect further improvements in retail sales. China's domestic demand continues to accelerate. Our real GDP forecast for Asia is above consensus (6.4% for 2003, 7.4% for 2004).	China can realign its undervalued real exchange rate through a nominal appreciation of the renminbi. For the rest of Asia, it makes sense to adjust for now via price reflation, on the back of stronger domestic demand growth. From an investment perspective, this conclusion implies that the Asian real exchange rate revaluation trade remains more an equities story than a currency story for now.
Latin America	Argentina's economy is on track, although it still needs fiscal and banking reforms. Bondholders widely disagree with the controversial debt-restructuring plan announced in Dubai. Mexican growth should rebound with the US in Q4, and we expect Congress to approve the needed tax reforms by year-end. Chile's economy is clearly on an upswing. GDP and financial indicators in Uruguay are recovering.	Despite sensible economic policies, sentiment seems to be deteriorating in Brazil. There is growing discomfort with high unemployment and weak economic activity, despite recent data indicating a gradual recovery. Brazil must still reduce regulatory uncertainty, though we have seen a higher trade surplus and a slight recovery in FDI and portfolio flows.
Central and Eastern Europe, Middle East and Africa	EU expansion in May 2004 will allow further growth and investment opportunities in the 10 accession countries, but governance of a 25-member EU will be complicated. All of the Central Europeans are struggling with unduly large fiscal deficits and inadequate fiscal transparency. In its annual progress report, the EU called for Poland to accelerate public finance reforms and privatization.	Russia's Yukos situation has widespread implications and potentially poses a major setback for the economy. Until this conflict is resolved, capital flight is likely to rise and FDI to be postponed, and we expect Russia's investment reputation to suffer. We continue to see little risk to sovereign creditworthiness, however, although headline risk may raise short-run volatility.

KEY ECONOMIC AND MARKET FORECASTS

	GDP (%)	Consumer Prices (%)	3M Rate Forecasts* (%)	Bond Yields** (%)	Exchange Rate Forecasts
US	2003: 2.9 2004: 3.7	2003: 2.4 2004: 1.4	3m: 1.2 12m: 1.2	Current: 4.4 12m: 3.6	-- --
Japan	2003: 2.8 2004: 1.8	2003: (0.2) 2004: (0.1)	3m: 0.1 12m: 0.1	Current: 1.5 12m: 1.5	3m $/JPY: 111 12m $/JPY: 108
Euroland	2003: 0.5 2004: 2.6	2003: 2.1 2004: 1.7	3m: 2.2 12m: 2.8	Current: 4.4 12m: 4.6	3m EUR/$: 1.14 12m EUR/$: 1.26
UK	2003: 2.0 2004: 2.9	2003: 2.9 2004: 2.6	3m: 4.0 12m: 5.0	Current: 5.1 12m: 5.0	3m GBP/$: 1.61 12m GBP/$: 1.70
Non-Japan Asia	2003: 6.4 2004: 7.3	2003: 1.7 2004: 2.0	3m: 4.0 12m: 3.8	Current: 7.4	3m $/KRW: 1110 12m $/KRW: 1050
Latin America	2003: 1.3 2004: 3.7	2003: 10.8 2004: 8.0	3m: 5.0 12m: 5.2	Current: 8.7 12m: 10.1	3m $/MXN: 11.15 12m $/MXN: 11.50
Central and Eastern Europe	2003: 3.5 2004: 3.9	2003: 3.6 2004: 4.6	3m: 5.3 12m: 5.3	Current: 6.6 12m: 7.0	3m EUR/PLN: 4.45 12m EUR/PLN: 4.40

* 3-Month Rates: Euroland: average of Germany and France; Non-Japan Asia: Korea; Latin America: Mexico; Emerging Central Europe: Poland.
** Bond Yields: US: 10-year Treasury note; Japan: 10-year JGB; Euroland: average of Germany 10-year Bund and France 10-year OAT; UK: 10-year Gilt; Non-Japan Asia: Korea 5-year sovereign; Latin America: Mexico 5-year sovereign; Emerging Central Europe: Poland 5-year sovereign.

2004 US Election Preview: It's a Horse Race

Continued from page 8

On trade policy, Democrats generally favor 'fair' rather than 'free' trade, arguing that US trading partners should uphold labor and environmental standards. Opinion varies, with some candidates more protectionist than others. Most are unlikely to disagree strongly with Bush's calls for China and Japan to allow their currencies to appreciate against the dollar.

Republicans Should Retain Control of Congress

The Democrats face an uphill fight in both the House and the Senate in 2004, with the Republicans likely to retain control of both chambers. In the Senate, 34 seats are up for election; of those 19 are currently in Democratic hands and 15 are held by Republicans. Several Senators, many Democrats, have already announced that they will not run for reelection, which could benefit the Republicans.

Senate Democrats are likely to keep 15 of their 19 seats up for reelection, and the Republicans 14 of their 15. The remaining races are too close to call at this point. Assuming the parties split these evenly, Republicans would increase their current 51-seat majority to 52 or 53.

In the House, the 2000 census contributed to more Republican-leaning districts. Coupled with the fact that incumbents almost always win, we expect the Republicans to pick up a few seats there.

Composition of the US House and Senate by Party, 2003

	Republican	Democrat
House	229	206*
Seats up for reelection	229	206*
Senate	51	49*
Seats up for reelection	15	19

* Counts one independent as a Democrat.

Source: Clerk of the House of Representatives; US Senate.

Implications for Financial Markets

If President Bush wins reelection, we are unlikely to see much in the way of new policy initiatives. A second Bush administration would seek to make the first-term tax cuts permanent and might make a renewed effort at creating private savings accounts as part of a Social Security reform effort. Medicare reform might also find its way onto the agenda.

If a Democrat captured the White House, gridlock is apt to prevail, because Congress would likely remain under Republican control. This would be similar to the situation under the Clinton presidency in the 1990s. We doubt a Democratic president would be able to convince a Republican Congress to roll back tax cuts —especially the lower marginal rates.

However, those tax cuts that are due to expire (due to 'sunset' provisions), such as the reduction in the tax on dividends and capital gains, might be enforced by presidential veto. Because we would expect pressure for higher spending, especially on entitlement programs such as healthcare, large budget deficits would likely persist—Democratic rhetoric notwithstanding. Foreign policy would probably shift back to a more multilateral approach, though this would require Congressional approval.

Although the Democrats appear less committed to free trade and globalization than the Republicans, we believe some of this is just political posturing. We think a Democratic administration would not reverse the long-standing US push toward trade liberalization. ■

2004 US Election Preview: It's a Horse Race

The weak labor market and difficulties in Iraq make the 2004 presidential election a horse race. Because the Republican and Democratic agendas differ significantly, gridlock is likely to prevail if the Democrats capture the White House

US President Bush's honeymoon is over. In the immediate aftermath of September 11, 2001, he appeared unbeatable, with approval ratings topping 90%. Since then, his popularity has declined, with only a slight pickup recently. Currently, about 55% of voters think he is doing a good job. Although his ratings are still at levels that imply victory next November, a further decline would clearly be problematic.

The Bush administration faces two major difficulties: a very slow recovery in the labor market and difficulties in securing the peace in Iraq. Although the US expansion will soon reach the two-year mark, until recently this has been a jobless recovery. Democrats will note that the Bush administration has overseen the worst performance on the jobs front since Herbert Hoover and the Great Depression. Republicans will counter that this is mainly do to the after-effects of the bursting of the stock-market bubble.

There are few levers left for the Bush administration to push at this point. Fiscal policy has already shifted sharply toward stimulus. Although the tax cuts have lifted spending, payrolls have been weak, and this has hurt consumer confidence.

Recent data indicate that we are now finally getting the long-awaited improvement in the labor market. If this improvement continues, it will boost President Bush's reelection prospects. But if the improvement flags—as we think is possible if consumer spending stalls, capping jobs creation, and unemployment remains sticky as formerly discouraged workers re-enter the labor force—he is likely to have great difficulty in winning the election.

By now, voters have mostly forgotten the quick combat victory in Iraq and are focused on the difficulties of winning the peace. Democrats are likely to try to keep President Bush on the defensive by second-guessing the policy of conducting the campaign without broader multinational backing.

Democrats in Search of a Candidate

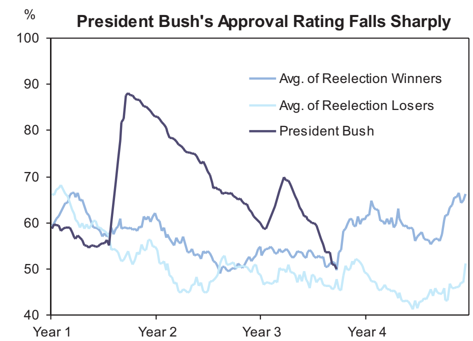
Nine Democrats are currently seeking the presidential nomination, with Senator Hillary Clinton a potential tenth (although we do not think she will run). While the contest is still in its early days, three hopefuls seem to be pulling away from the rest. Former Vermont Governor Howard Dean leads in many of the major polls and dominates in fund-raising. General Wesley Clark is the favorite of those opposed to the conduct of the Iraq war and its aftermath. Massachusetts Senator John Kerry appears to be leading a group of Washington insiders who are also seeking the nomination.

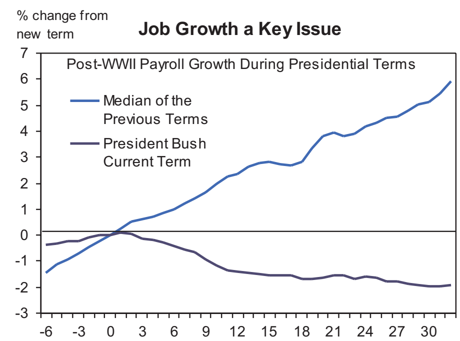
The long selection contest gets underway in earnest in January and is unlikely to generate a clear front-runner until the Super Tuesday primaries on 2 March. Fund-raising abilities will be extremely important, and being a Washington insider ha been a curse rather than a blessing in presidential races over the past 40 years.

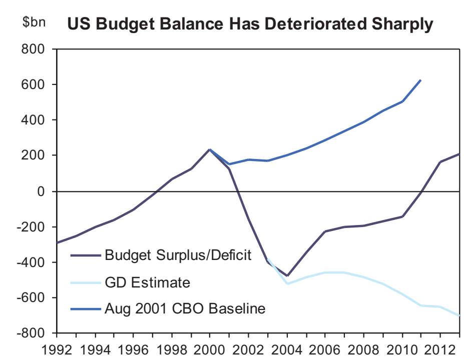
The Democratic Agenda

On the domestic policy front, Democrats will argue that President Bush's tax cuts turned the historic budget surpluses into significant deficits. Of course, the economy's persistent weakness and the bursting of the stock market bubble had more to do with the sharp deterioration in the budget outlook than with the tax cuts. Nonetheless, the administration is vulnerable to criticism that the tax cuts could have been better crafted to provide more economic stimulus and that more care could have been taken to the limit the sharp deterioration in the long-term budget outlook.

All the Democratic candidates would roll back at least some parts of the Bush tax cuts to pay for higher spending on healthcare—especially for a prescription drug benefit for Medicare and help for moderate income households to purchase healthcare insurance. Some would use a portion of the savings for deficit reduction. But the Democrats are in a tight spot, facing the ongoing tension between talking tough on deficit reduction and proposing an expansion of entitlement programs.







Democrats are actively criticizing Bush's unilateralism, while carefully saying they 'support our troops' in fighting terrorism and working toward peace in Iraq.

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