LIVERPOOL INVESTMENT LETTER

November 2016

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LIVERPOOL RESEARCH GROUP IN MACROECONOMICS

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The Julian Hodge Institute was launched in autumn 1999 in a new collaboration between the Cardiff Business School of Cardiff University and Hodge. The aim of the Institute is to carry out research into the behaviour of the UK economy, and to study in particular its relationship with the other economies of Europe. The research has been particularly germane in recent years and has proved to be of significant social and political relevance as Europe has navigated the difficulties of the global financial crash, the Eurozone crisis and most recently the UK referendum on EU membership. The Liverpool Investment Letter is written by Patrick Minford, with the assistance of other members of the Group; in particular the emerging markets section is written by Anupam Rastogi, and the focus on Japan is written by Francesco Perugini. The Investment Letter is published monthly.

The Liverpool Research Group in Economics is pursuing a research programme involving the estimation and use of macroeconomic models for forecasting and policy analysis. The Group is now mainly based in Cardiff Business School, Cardiff University, and is indebted to the School and to the Hodge Foundation for their support. The Group's activities contribute to the programmes being pursued by the Julian Hodge Institute of Applied Macroeconomics. This Liverpool Investment Letter is typeset by David Meenagh and Bruce Webb and published on behalf of the group by Liverpool Macroeconomic Research Limited, which holds the copyright

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CONTENTS

ENDING THE POLICY UNCERTAINTY OVER BREXIT

First, the Treasury-led consensus said the second quarter when Brexit uncertainty was at its maximum, was going to be horrible: GDP was estimated to have grown first at 0.6% and then revised up to 0.7%.

Second, no, they said when that turned out to be wrong, it was the uncertainty unleashed by the Brexit Vote that was going to destroy the economy in the third quarter: the Treasury predicted growth of between -0.1% and -1.0%. But GDP grew by 0.5% on the first estimate; and this will very likely be revised upwards as the estimates for manufacturing and construction, at -1% and -1.4%, look quite inconsistent with the Purchasing Managers Indices which were 55.4% and 52.3% respectively in September.

Apparently now the same doomsters are moving the same scenario to next year when apparently it will dawn on people that Brexit will happen and the uncertainty it provokes will finally strike. The consensus forecast for next year is 0.9% against ours of 2.6%.

This uncertainty effect is supposedly two-pronged: first, the worries about the long-term effect of a ‘hard’ Brexit and second, the short-term reaction to this uncertainty in the form of cancelled investment and consumption plans.

Yet as we have said before the optimal long-term policy is a hard or ‘clean’ Brexit where we adopt unilateral free trade under WTO rules (and also take over regulation and immigration control): if the EU refuses to abolish its tariffs on our manufacturing then we can help our manufacturers to get over this modest loss (around £3 billion per year, for an average tariff of 3.5%) by some general assistance for training or R&D for example and indeed indirectly via the large devaluation that has occurred since Brexit. This WTO policy brings a long-term benefit of an extra 4% on GDP and on top of this there are gains from switching to UK regulation and immigration control: this can hardly depress the economy once anticipated. The alternative ‘soft Brexit’ implies no change compared with no Brexit. The very worst outcome would be WTO rules where we maintain EU manufacturing tariffs ourselves on all the world. But as these tariffs are so low, the effects would be small and we would still gain from not having the EU non-tariff barriers and exiting from the CAP; so still a positive. Why should this spectrum of outcomes be worrying?

Table 1: Summary of Forecast

	2014	2015	2016	2017	2018	2019	2020
GDP Growth[1]	2.9	2.2	2.2	2.6	2.7	2.8	3.2
Inflation CPI	1.7	0.2	1.2	1.9	3.1	3.0	2.1
Wage Growth	1.2	2.4	2.9	3.9	6.2	6.2	4.6
Unemployment (Mill.)[2]	1.1	0.8	0.7	0.8	0.8	0.7	0.7
Exchange Rate[3]	87.1	91.6	80.4	76.4	75.1	74.6	74.4
3 Month Interest Rate	0.6	0.6	0.4	1.0	2.5	3.5	3.0
5 Year Interest Rate	1.8	1.3	0.9	1.2	1.5	2.5	3.0
Current Balance (£bn)	–99.9	–103.7	–89.0	–77.7	–65.1	–43.2	–32.6
PSBR (£bn)	83.3	71.2	69.0	54.7	38.7	28.3	13.0

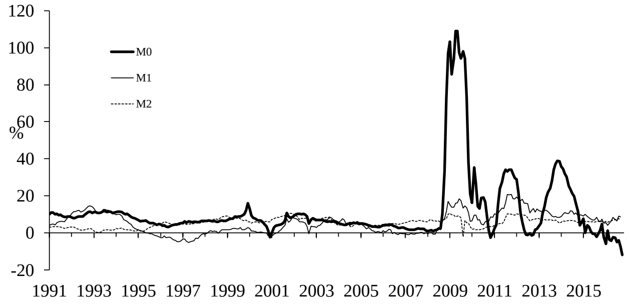
[1]Expenditure estimate at factor cost
[2]U.K. Wholly unemployed excluding school leavers (new basis)
[3]Sterling effective exchange rate, Bank of England Index (2005 = 100)

As for the supposed short-term reaction to this uncertainty, the evidence is quite against the extreme reactions assumed to what is admittedly a big policy regime change. Like death and taxes, uncertainty is always with us with policy changes so frequent in modern economies. We agree that it is desirable to ‘get on with Brexit’ to make uncertainty as small as possible as quickly as possible. But the uncertainty is not great given the spectrum of outcomes and its effects are modest, as events have proved.

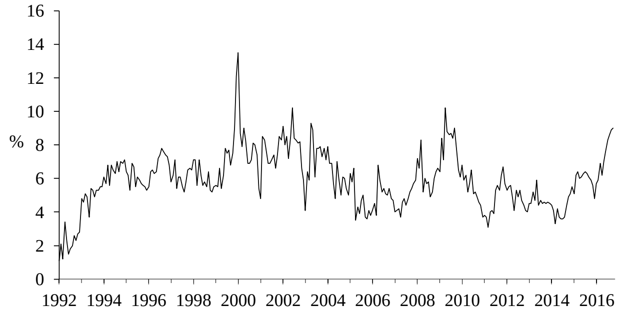
Turning to our forecast, we think that with the labour market tight wages will start to grow faster as inflation rises. Therefore the Bank will be unable to ignore the rise in inflation that lies ahead. Interest rates will have to rise gently and QE will need to be reined in and reversed. With the economy growing well the PSBR should be falling along the Treasury’s target trajectory; but there is little scope for the Chancellor to give money away, as prudence dictates that he should get the debt/GDP ratio well down by 2020. It is a sobering thought that if long term interest rates rise 2%, with the debt/GDP ratio around 80% as now taxes would need to rise by 1.6% of GDP, around £27 billion a year — the equivalent of a 4.5% rise in the standard VAT rate. This is a serious hostage to fortune.

Our assessment is that the economy is growing rather too fast and needs to be slowed by tighter monetary policy therefore, while fiscal policy should continue on its current track to a zero PSBR. We are concerned that if the Bank and Treasury both loosen policy we risk rekindling serious inflation as happened in the Heath government of the early 1970s when the government panicked over rising unemployment.

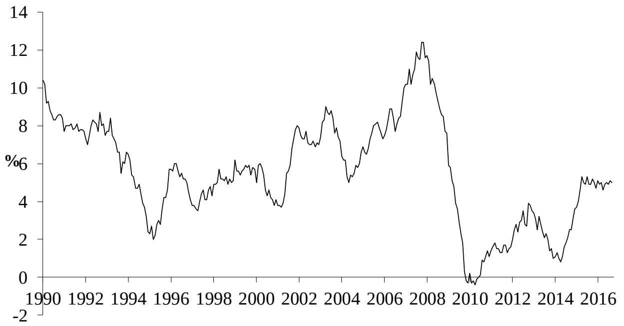
U.S.: Growth in Monetary Aggregates (Yr - on - Yr)



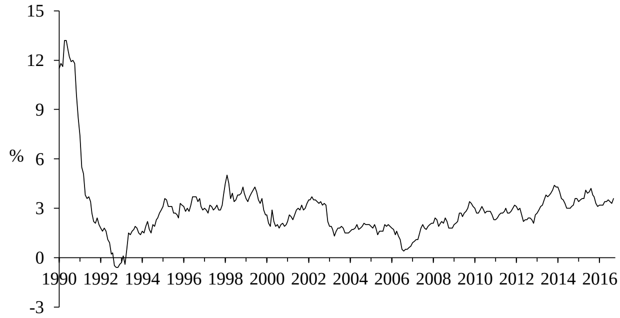
UK: Notes and Coins in Circulation Growth



Eurozone M3 Growth



Japan: Growth of M2+CD's



FOCUS ON JAPAN

Francesco Perugini

Japan Parliament Approves Supplementary Budget to Stimulate Economy

On October 11 Japan's House of Representatives approved a second supplementary budget for this fiscal year through March of ¥4.11 trillion to support the domestic economy. The supplementary budget will be sent to the House of Councillors, where the ruling Liberal Democratic Party (LDP) and its coalition partner Komeito party hold a majority of seats.

The extra budget reflects Prime Minister Shinzo Abe's efforts to lift the economy out of chronic deflation, but the government's reliance on debt cast a shadow over its pledge to improve the nation's fiscal health, the worst among major developed countries. "Maintaining the right balance is difficult," Abe told the Upper House's Budget Committee at a press conference in making the case for the extra budget. Even when the government has excess tax revenue, using it to pay down debts "would dampen inflation expectations," he said. Most of the fresh expenditure will be used to fund part of a roughly ¥28 trillion economic stimulus package approved in August by the Cabinet, including infrastructure investment and enhanced welfare services.

Under the extra budget, some ¥710 billion will be used to reinforce the prime minister's key policy of enhancing welfare measures such as supporting child rearing, as well as distributing cash to low-income earners to bolster consumer spending. The government will also set aside around ¥1.41 trillion for infrastructure improvement to attract foreign tourists to Japan and promote agricultural exports. A total of about ¥430 billion will be allocated to facilitate fundraising by small and medium-sized companies, and revitalize local economies. The government will also earmark around ¥1.44 trillion for disaster reduction and reconstruction of southwestern Japan hit by strong earthquakes in April and northeastern Japan devastated by the massive earthquake and tsunami in March 2011. Finally, to cover a revenue shortfall, the government will issue ¥2.75 trillion worth of construction bonds.

However, although these measures have been approved, the latest data shows that the economy has not recovered from the shock it experienced when the consumption tax rate was raised to 8% in April 2014, and recovery of both consumer spending and investment remains sluggish. Real GDP for the April–June period was up 0.7% over the previous quarter, but this slightly positive growth was achieved because of public works. The advancing to the first half of the fiscal year (April-September 2016) of some works that received appropriations in the initial budget for fiscal 2016 had a major effect. Without this, it is highly likely growth would have been negative.

To solve the problem of deflation, the gap between supply capacity and aggregate demand needs to be filled. At present, it appears to be substantial. Some economists believe that a third supplementary budget should be considered and the initial budget for fiscal 2017 should be enlarged by utilizing additional tax revenues gained through Abenomics. This would allow for uninterrupted public spending that would pull Japan out of deflation faster. We are now at a crucial point where we will either remain in deflation or break free of it — the last time Japan compiled three extra budgets was fiscal 2011, when the government rushed to fund recovery from the devastating March 2011 earthquake and tsunami. "Compared to breaking out of deflation, two or three years of government spending are no problem at all. Whether or not deflation continues into the future is far more important than the question of the present debt", said Nobel Prize winner Paul Krugman.

Takero Doi, a professor at Keio University, said that "as businesses fail to consistently raise wages, there is virtually no increase in consumption, so the Japanese economy has not yet broken free of deflation. Nevertheless, the government must stop scattering budgetary funds around in the hope of freeing the economy from deflation. The latest economic measures contain urgent items such as improved compensation for childcare and nursing-industry workers, so I don't reject everything in the package, but a lot of old-fashioned public works items have been included, similar to those that have repeatedly been carried out since the 1990s. I'm worried they will have only a temporary effect." The common view here is that structural reforms are far more important for boosting Japan's productivity and labour supply and it was also the 'arrow' that most observers were awaiting most anxiously since Abe announced his economic plans. Indeed, Abe has long vowed to destroy what he calls "bedrock regulations." Last month he launched a new advisory panel of experts to the government with the aim of promoting such reforms. But a quick look at the names of the 14 members of the panel — they are all close associates of Abe — gives rise to scepticism that Abe is merely seeking to keep the stock market afloat by feigning an image of his administration willing to tackle regulatory reforms, and that he has no resolve at all to fight the rigid government regulations.

In that sense, Abe calling for the elimination of bedrock regulations contradicts what he is actually pursuing. Yet he has no choice but to keep advocating the reforms — in order to keep shoring up the stock market. Share prices would plummet if investors give up on Abe as not serious about implementing a strategy to generate growth — that is what he fears most. In fact, the stock market plunged in June 2013 when his administration released the outline of its growth strategy, triggering disappointment among market players that he failed to touch on difficult reforms. On the other hand, should the panel of experts propose such drastic reforms that Abe could not implement them, his leadership would be thrown in doubt and share prices could go down again. That is why members of the reform panel have been chosen from among people who Abe and his office can control — so that they would come up with half-hearted proposals that would both sustain Abe's leadership credibility and his reformist image.

Overall, regulatory reform has been on the political agenda for the past quarter century. It now seems that the menu for reforms has been fully explored, with a wait for political decisions to implement them. There does not seem to be much sense in the government organizing talks in advisory panels whose members are politically chosen to help avoid any implementation.

MARKET DEVELOPMENTS

With growth looking strong and inflation and wage growth rising, equity markets in the UK should do well. Monetary policy is highly stimulative from the fall in sterling so interest rates will need to rise to dampen the stimulus. This return to a more normal monetary environment, healthy inflation and growth, together with a stronger balance of payments, represents an economic rebalancing that will underpin longer term prospects. Bond yields will rise and so bonds should be avoided until this transition is over.

Table 1: Market Developments

	Market Levels		Prediction for Oct/Nov 2017	
	Oct 3	Nov 4	Previous Letter	Current View
Share Indices				
UK (FT 100)	6984	6693	11418	10943
US (S&P 500)	2161	2085	2658	2565
Germany (DAX 30)	10511	10259	16282	15891
Japan (Tokyo New)	1331	1347	1874	1897
Bond Yields (government				
UK	0.74	1.13	1.20	1.20
US	1.62	1.78	2.80	2.80
Germany	−0.16	0.06	0.70	0.70
Japan	−0.07	−0.06	0.10	0.10
UK Index Linked	−1.87	−1.78	0.10	0.10
Exchange Rates				
UK ($ per £)	1.28	1.25	1.40	1.40
UK (trade weighted)	77.52	75.13	77.30	77.30
US (trade weighted)	99.36	101.25	102.0	102.0
Euro per $	0.89	0.90	0.93	0.93
Euro per £	1.14	1.13	1.30	1.30
Japan (Yen per $)	101.6	103.0	112.0	112.0
Short Term Interest Rates (3-month deposits)				
UK	0.39	0.40	1.00	1.00
US	0.85	0.80	1.30	1.30
Euro	−0.36	−0.36	−0.20	−0.20
Japan	−0.25	−0.20	0.00	0.00

Table 2: Prospective Yields [1]

Equities: Contribution to £ yield of:

	Dividend Yield	Real Growth	Inflation	Changing Dividend Yield	Currency	Total
UK	3.40	2.6	1.9	59.00		66.90
US	1.90	2.5	1.5	19.00	−11.57	13.33
Germany	2.60	1.8	1.1	52.00	−15.42	42.08
Japan	1.70	1.2	0.6	39.00	−21.30	21.20
UK indexed[2]	−1.39		1.5	2.00		2.13
Hong Kong[3]	2.60	6.0	1.5	−5.00	−11.57	−6.47
Malaysia	3.30	5.4	1.5	55.00	−11.57	53.63
Singapore	3.50	3.4	1.5	23.00	−11.57	19.83
India	1.40	7.5	1.5	24.00	−11.57	22.83
Korea	1.10	3.0	1.5	−19.00	−11.57	−24.97
Indonesia	2.20	5.3	1.5	31.00	−11.57	28.43
Taiwan	2.80	3.4	1.5	14.00	−11.57	10.13
Thailand	3.20	4.0	1.5	35.00	−11.57	32.13

Bonds: Contribution to £ yield of:

	Redemption Yield	Changing Nominal Rates	Currency	Total
UK	1.13	−0.70		0.43
US	1.78	−10.20	−11.57	−19.99
Germany	0.06	−6.40	−15.42	−21.76
Japan	−0.06	−1.60	−21.30	−22.96

Deposits: Contribution to £ yield of:

	Deposit Yield	Currency	Total
UK	0.40		0.40
US	0.80	−11.57	−10.77
Euro	−0.36	−15.42	−15.78
Japan	−0.20	−21.30	−21.50

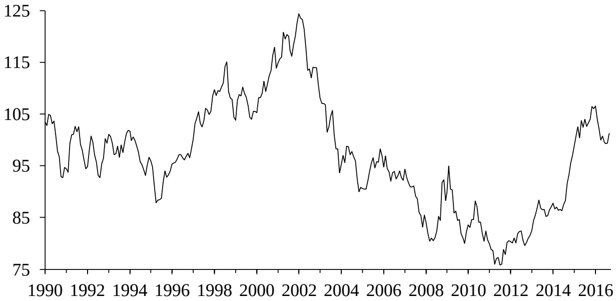
[1] Yields in terms of €s or $s can be computed by adjusting the £-based yields for the expected currency change.
[2] UK index linked bonds All Stocks
[3] Output based on China.

Table 3: Portfolio(%)

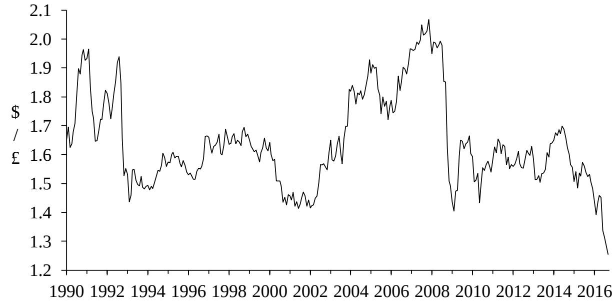
	Sterling Based Investor		Dollar Based Investor		Euro Based Investor	
	October Letter	Current View	October Letter	Current View	October Letter	Current View
UK Deposits (Cash)	5	5	5	5	1	1
US Deposits	-	-	-	-	-	-
Euro Deposits	-	-	-	-	-	-
Japanese Deposits	-	-	-	-	-	-
UK Bonds	-	-	-	-	-	-
US Bonds	-	-	-	-	-	-
German Bonds	-	-	-	-	-	-
Japanese Bonds	-	-	-	-	-	-
UK Shares	19	19	14	14	17	17
US Shares	14	14	19	19	16	16
German Shares	14	14	14	14	21	21
Japanese Shares	9	9	9	9	11	11
Hong Kong/Chinese Shares	4	4	4	4	4	4
Singaporean Shares	4	4	4	4	4	4
Indian Shares	4	4	4	4	4	4
Thai Shares	3	3	3	3	3	3
South Korean Shares	4	4	4	4	4	4
Taiwanese Shares	4	4	4	4	3	3
Brazilian Shares	4	4	4	4	3	3
Chilean Shares	4	4	4	4	3	3
Mexican Shares	4	4	4	4	3	3
Peruvian shares	4	4	4	4	3	3
Other:						
Index-linked bonds (UK)	-	-	-	-	-	-

INDICATORS AND MARKET ANALYSIS
FOREIGN EXCHANGE MARKETS

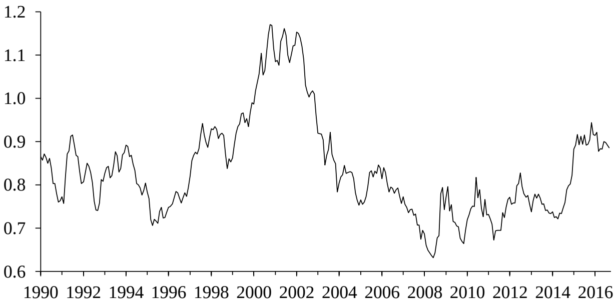
US : Trade Weighted Index
(Bank of England 1990 = 100)



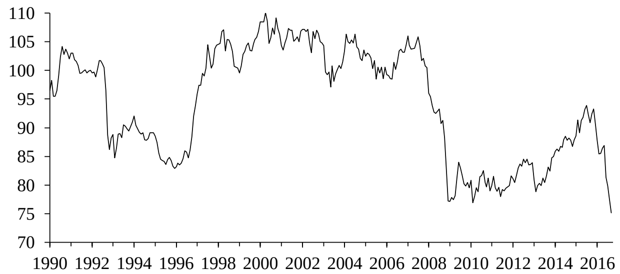
UK: Dollars Per Pound Sterling



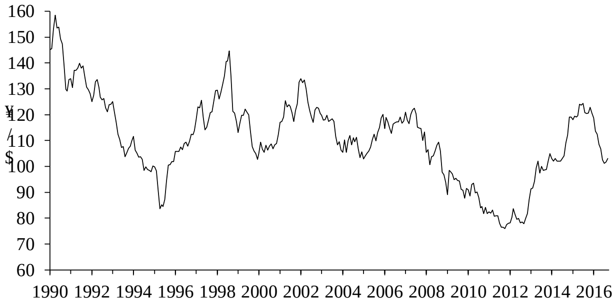
Euro per US dollar



UK: Trade-Weighted Index
(Bank of England 1990 = 100)

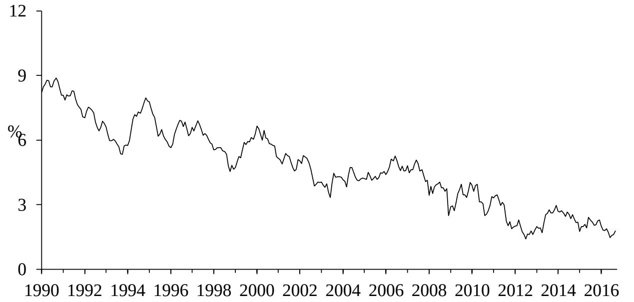


Japan : Yen Per U.S. Dollar

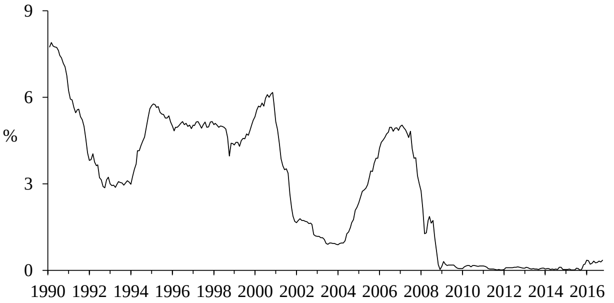


GOVERNMENT BOND MARKETS

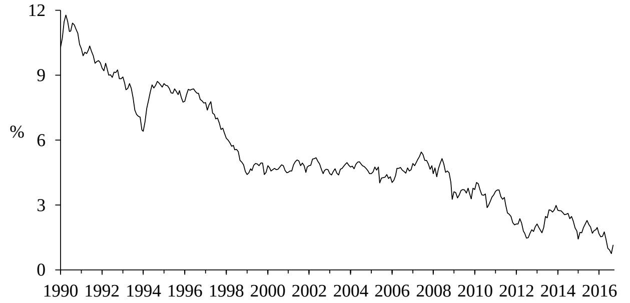
U.S.: Yield on Long-Term Government Bonds



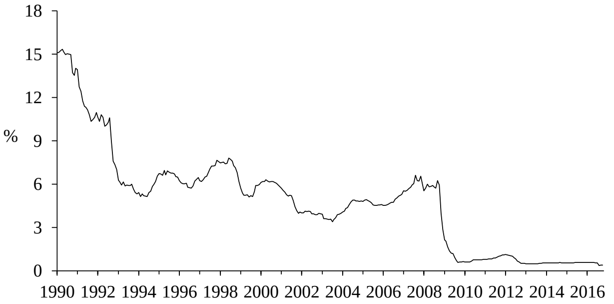
U.S. : 3-Month Treasury Bill



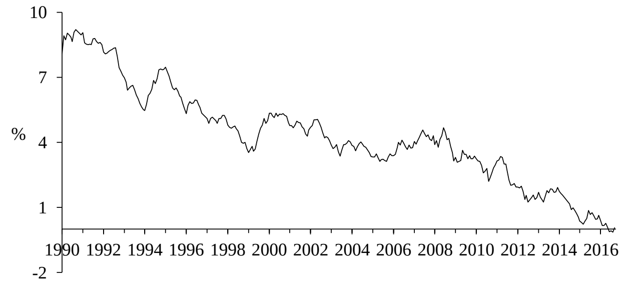
U.K.: Yield on Long-Term Government Bonds



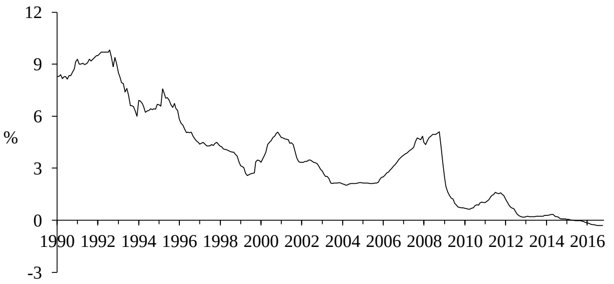
U.K. : 3-Month Interbank Rate



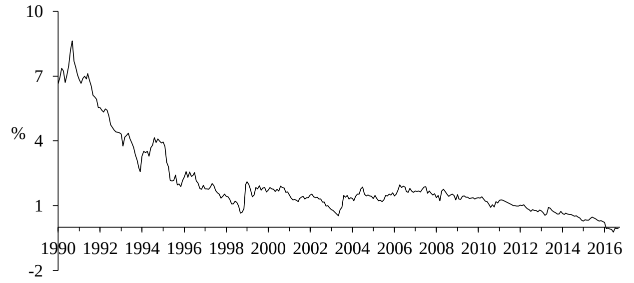
Germany: Yield on Public Authority Bonds



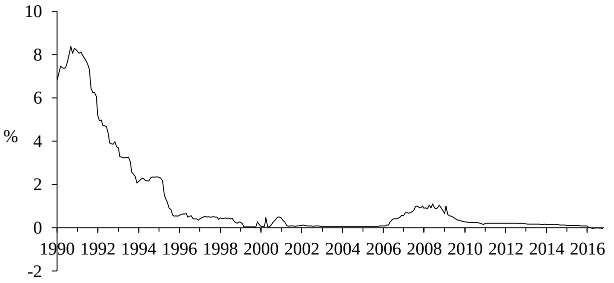
Germany : 3-Month Interbank Deposit Rate



Japan: Yield on Long-Term Government Bonds

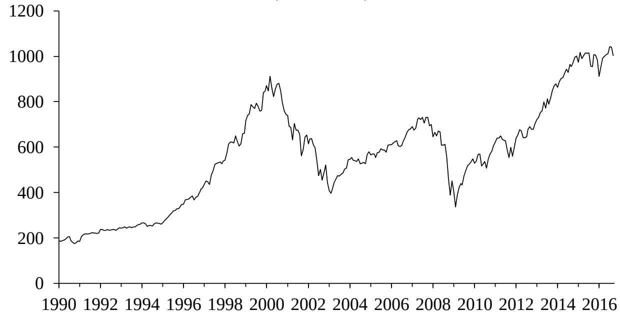


Japan : 3 Month Money Market Rate

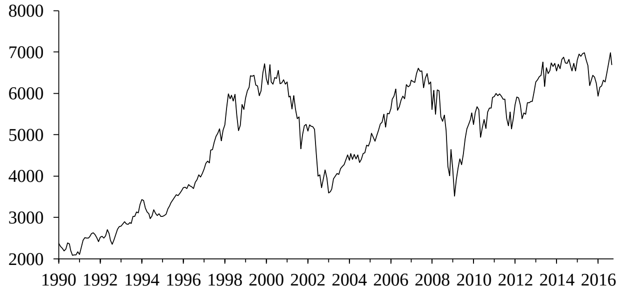


MAJOR EQUITY MARKETS

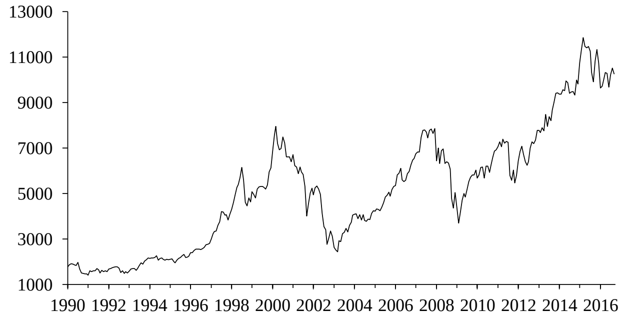
U.S. : S & P 400 Industrial (1985=100)



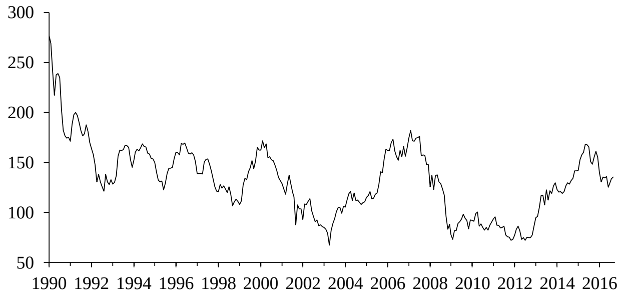
U.K. : FTSE-100 Index (10 April 1962=100)



Germany : DAX 30



Japan : Tokyo S.E. New (1985=100)



EMERGING MARKETS

Anupam Rastogi

India

The World Bank has reiterated that India's GDP growth will remain strong at 7.6% in 2016 and 7.7% in 2017. As government spending picks up, GDP growth would be sustained in the coming years.

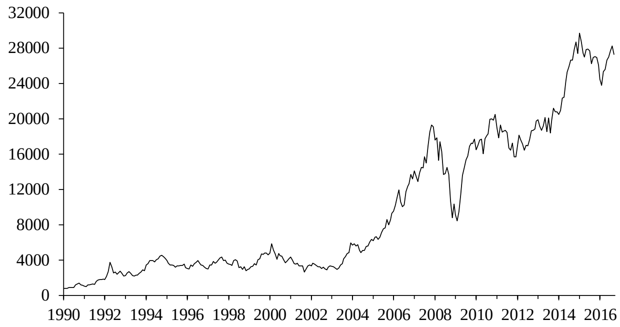
Wholesale prices rose by 3.57% on the year in September, down from the 3.74% annual pace reached in August. Prices softened as food inflation moderated markedly to 5.75% year on year from 8.23% a month prior, but rising global oil prices pushed fuel and power costs up 5.58% for the period. The central bank has warned of upcoming "cost push pressures" as recent increases in salaries and housing allowances for India's millions of central government employees is set to push up headline inflation this year. India had adopted an inflation target of around 4% for the next five years. The target until March 31, 2021, is fixed with an upper tolerance level of 6% and lower limit of 2%.

In an unexpected move, India's central bank cut its key lending rate in its October meeting. The repurchase rate is cut by a quarter percentage point to 6.25%, the lowest in more than five years. The decision comes as India finds itself in a sweet spot as it is one of the fastest-growing economies in the world and its once-chronic inflation seems to be under control. We expect two rate cuts of 25 bps to follow in February and October 2017 as the central bank has decidedly turned towards boosting growth rather than remain an inflation hawk. The decision to cut the interest rate was taken for the first time in the bank's history by a six-member monetary policy committee. The committee is full of socialist leaning economists who are more likely to sing to the government tune than to maintain the value of rupee.

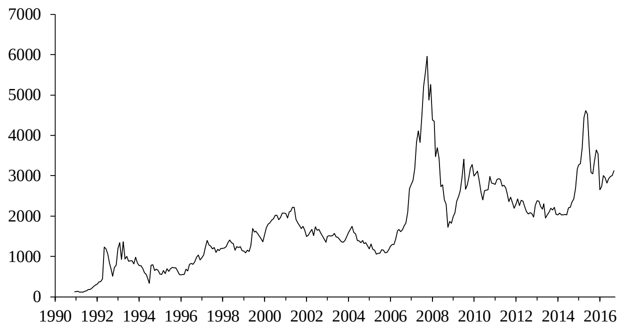
Exports grew by 4.62% to $22.9 billion in September as engineering, gems and jewellery, handicrafts, textiles and chemicals exports grew. However, the country's imports contracted by 2.54% to $31.22 billion, leaving a trade deficit of $8.33 billion in the month of September. The trade gap is, however, the highest in the last nine months. It was $11.66 billion in December 2015.

The World Bank published its annual ranking of countries by the ease of doing business which has disappointed the government. This year the country advanced only one slot to 130th out of 190 nations compared to the government's target of being in the top 50 nations in the next few years. One of the reasons is that labour regulations make it difficult to fire or lay off employees, which makes companies more reluctant to hire. Companies also face difficulties in buying land.

India: BSE Sensitive



China: SSE Composite Index



The Indian stock market corrected marginally. Foreign portfolio investors have poured in $7 billion this year and India remains a favoured destination for foreign funds.

	14–15	15–16	16–17	17–18	18–19
GDP (%p.a.)	7.3	7.6	7.7	8.0	8.0
WPI (%p.a.)	6.0	5.2	4.5	4.0	4.0
Current A/c(US$ bill.)	-34.0	-24.0	-24.0	-26.0	-28.0
Rs./$(nom.)	62.0	66.5	67.5	69.0	70.0

China

China grew 6.7% in the third-quarter of 2016. China has managed to grow at a steady pace of 6.7% quarter after quarter in the current year. Data of a comprehensive survey of 3,100 companies, suggests that the country's growth has become less sustainable in the third quarter. In the third quarter, manufacturing, property and commodities did well while the services and retail did worse as compared to both, the previous quarter as well as last year.

The economy is being propped up by a property bubble, deteriorating cash flow in the economy is of concern. There are going to be problems next year.

The service sector continues to grow more rapidly than the overall economy, increasing 7.6% year over year (YoY) compared to the Secondary Sector which increased 6.1% YoY. The Service economy now represents a record 53.4% of GDP (using a 4 quarter average), up from 48.4% three years ago. Industrial production is weak at 6.1%, below the 6.4% expected growth rate, while retail sales remain healthy at 10.7%. The massive increase in state infrastructure spending has been partly funded by a fiscal deficit which reached 861.4 bn CNY in September.

China's headline consumer inflation rose for the first time in four months, year on year, to hit a three-month high of 1.9% in September from August's 1.3%. China's producer-price index — a gauge of factory-gate prices — edged up 0.1% in September from a year earlier, compared with a 0.8% decline in August and the first time the index was positive in 54 months. Stronger coal and metals prices were the main forces behind China's industrial price gains, according to the National Bureau of Statistics.

Chinese exports fell more steeply than expected in September, highlighting the persistent weakness in global demand that is weighing on the world's second-largest economy. The 10% decline in exports year-over-year was the sixth consecutive monthly decline.

Imports also shrank 1.9% in September from a year earlier, reversing a 1.5% increase in August. Declining imports and exports resulted in China's trade surplus narrowing to a less-than-anticipated $42 billion in September from $52 billion in August.

China's foreign-exchange reserves fell by $18.8 billion in September to $3.17 trillion, according to figures from the PBOC, a steeper drop than expected. Concerns that China is depleting its foreign-exchange reserves have weighed on the yuan in the past.

The yuan has declined 1.6% versus the dollar in October, while the yuan has gained against other major currencies like the euro and yen. The yuan's declines is more about dollar strength than yuan weakness. The yuan closed at 6.78 per dollar after being fixed at its lowest level since September 2010 by the Chinese central bank. As the yuan approaches 6.83, the level at which China held the currency throughout the financial crisis is a crucial level to watch. The yuan's slide against the dollar, within its narrow trading band, has been driven largely by growing confidence that the Federal Reserve will raise interest rates after months of holding steady. The weaker yuan and relative calm among investors is good news for China's central bank. A falling currency makes Chinese exports more competitive and could boost an economy struggling with slowing growth. Morgan Stanley predicts that the yuan will weaken to 7.26 per dollar by the end of 2017. We expect yuan to depreciate but not so precipitously.

Chinese overseas acquisitions are facing resistance from recipient countries. Signs of resistance are mounting in the US, Australia and recently in Europe too. Nearly $40bn in planned Chinese deals have been scuppered since mid-2015, mostly because of tightened scrutiny over competition and national security concerns. The main reason is that there can be no reciprocal treatment between a highly restrictive authoritarian state and open industrialized democracies. Probably no western company can ever buy an important state-owned Chinese corporation or even a privately owned one in a restricted industry.

China is loosening restrictions on the way local governments dispose of bad loans, opening new avenues that may speed up disposal but obscure how the country is writing off a surge of souring corporate debt. New rules from banking regulators aim to help deal with debt that is now nearly three times the size of the economy and that threatens to derail long-term economic stability. Alarmed by double-digit annual growth in impaired loans among state-owned industries, regulators have rolled out policies to help companies tide over retrenchment and pressure banks to forgive debt by accepting equity. Under the new rules, provincial governments would be allowed to set up more locally owned bad-loan management companies, and expand the geographic reach of such firms in selling repackaged bad loans.

China's local pension funds will launch a first wave of investment in the domestic stock market before the end of 2016, in the hope of boosting returns before an ageing population becomes a drain on regional finances. According to the human resources ministry a number of local governments have finalized contracts to transfer assets to the central National Social Security Fund, where professional managers have broader latitude to invest in riskier assets, including up to 40% in equities and stock funds.

The party's Central Committee, which met in the last week of October, emerged from its closed-door plenum with stricter standards for officials' performance and accountability. It has bestowed on Mr. Xi "core" status of the party's leadership. This strengthens his pre-eminent status, as the party prepares for a pivotal congress a year from now that is expected to give Mr. Xi a second five-year term. According to Wu Qiang, a former political-science lecturer at Tsinghua University, "It's a clear statement that any dissent or resistance to Xi's authority, even coming from the highest levels, can and will be punished." Mr. Xi, in the last four years, has taken personal charge of the military, the economy and most other levers of power, by centering decision-making in committees that he heads.

	14	**15**	**16**	**17**	**18**
GDP (%p.a.)	7.4	6.9	6.6	6.0	5.8
Inflation (%p.a.)	2.0	1.4	2.0	2.0	2.0
Trade Balance(US$ bill.)	382	550	420	400	380
Rmb/$(nom.)	6.2	6.4	6.6	6.7	6.8

South Korea

South Korea's gross domestic product grew 2.7% year-over-year in the third quarter, down from a 3.3% gain in the prior three-month period, according to the Bank of Korea. The fourth quarter is facing headwinds from external and domestic uncertainties. Government expects the annual growth rate to stagnate at about 2.5% this year and next, lower than the Bank of Korea's forecasts of 2.7% and 2.8% respectively.

South Korea's CPI inflation jumped in September due to a sharp increase in food prices. The nation's consumer prices rose 1.2% year-on-year after slowing to 0.4% in August. South Korea's central bank held its key interest rate unchanged for a fourth month as policy makers are worried about huge household debt. We expect the Bank of Korea to consider cutting its rate by 25 basis points in November, especially if increasing household debt is properly addressed. The central bank is keeping a close watch on the rate of household debt growth with caution.

Business investment declined on frail private consumption and weak exports in the third quarter after an improvement in the second quarter, while construction investment expanded and contributed greatly to supporting the sagging economy.

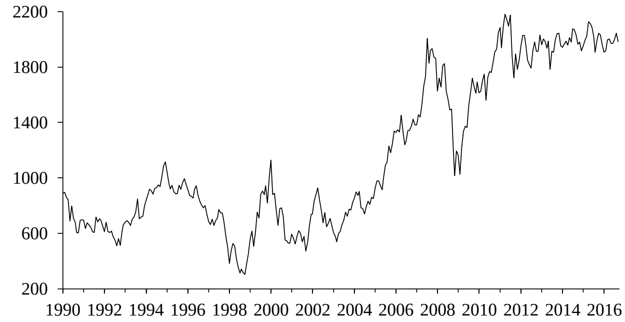
In October the government introduced a fresh fiscal stimulus package on top of the existing 11 trillion won (about $10 billion) supplementary budget spending in place since September.

The export-driven Korean economy is suffering from weak global trade. Shipments overseas, which account for half the country's growth, had shrunk in 21 of the last 22 months until September. The ongoing corporate restructuring of shipbuilding, shipping and other indebted industries is impacting the job market. The massive layoffs are also likely to put a dent on consumer sentiment.

South Korean exports are expected to fall in the Q4 on the back of Samsung Electronic Co Ltd's decision to discontinue its flagship phone and now-ended strikes at Hyundai Motor that disrupted manufacturing. The Korean won remains susceptible to external and domestic uncertainties.

	14	15	16	17	18
GDP (%p.a.)	3.3	2.6	2.5	2.5	2.3
Inflation (%p.a.)	2.0	0.7	1.0	1.2	1.2
Current A/c(US$ bill.)	80.0	90.0	88.0	88.0	86.0
Won/$(nom.)	1080	1180	1160	1140	1140

Korea: Composite Index



Taiwan: Weighted TAIEX Price Index

Taiwan

Taiwan's economic recovery is picking up, with real gross domestic product growing 2% on the year in the third quarter, led by strong semiconductor exports supported by smartphone demand. Corporate investment is also growing, with gross fixed capital formation posting 3.24% growth. Private consumption rose 2.37%.

Taiwan's consumer price index (CPI) rose 0.33% in September from a year earlier largely because of higher prices for fruit caused by bad weather during the month. In the first nine months of the year, Taiwan's CPI was up 1.27% from a year earlier and the core CPI was 0.82% higher. The wholesale price index, however, fell for the 25th consecutive month in September as prices for industrial and agricultural raw materials continue to fall.

In the first nine months of 2016, exports totalled US$202 billion, a decline of 6.1% from the same period of last year. But, export orders grew 3.9% year on year in September.

This follows a marked jump in August to growth of 8.3% responsible for ending a 16-month streak of annualized contraction. However, export markets remain weak. Exports to China accounted for 40.5% of all exports in the July-September quarter, up 1.6 percentage points on the year.

Fitch has upgraded Taiwan's sovereign debt to high grade, praising the government's strong fiscal management despite slowing economic growth and worsening relations with mainland China. Taiwan's long-term foreign and local currency default ratings have been upgraded from A+ to AA–. According to Fitch "fiscal profile has continued to steadily improve despite the challenges presented by lower economic growth". But, economic growth is likely to remain sluggish in the medium-term. The island's economy faces a double challenge from mainland China, with improvements to China's domestic supply chain threatening the competitiveness of Taiwanese exports, and diplomatic tensions hitting cross-strait tourism.

The ratings agency said it believes "further rapprochement over the rating horizon is unlikely but existing economic and trade linkages will continue to operate uninterrupted."

The economic recovery is creating conducive environment for President Tsai Ing-wen's administration. Taiwan's benchmark stock market index has risen roughly 15% since May, before Tsai took office. At the same time, the China-reliant recovery is a mixed blessing for a government aiming to curb Beijing's growing influence on the island.

	14	**15**	**16**	**17**	**18**
GDP (%p.a.)	3.7	0.8	0.8	1.8	2.0
Inflation (%p.a.)	1.5	0.7	1.0	1.0	1.0
Current A/c(US$ bill.)	57.4	60.0	64.0	68.0	68.0
NT$/$(nom.)	31.0	32.8	32.5	32.0	32.0

Brazil

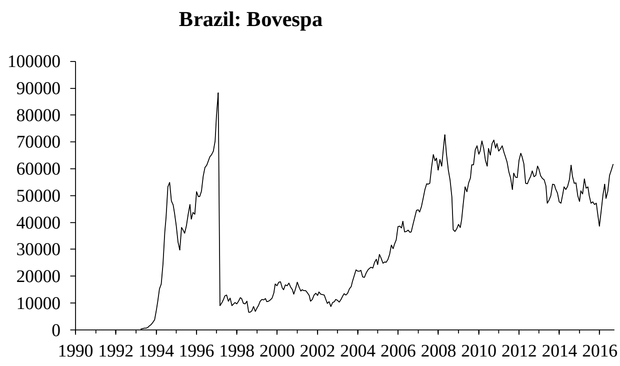
Consumer confidence in Brazil improved in October for the sixth consecutive month, reaching the highest level since December 2014. Consumer confidence in Brazil is at its highest point in almost two years, marking an end of the two-year recession that plagued Latin American's largest economy.

Brazil's economy is on the mend even though it is expected to contract 3.2% in 2016, it should post 1.2% growth next year. Inflation, as measured by the consumer-price index, will slide to 6.9% this year compared with last year's runaway inflation of 10.3%. In 2017, inflation would be around 5%.

Rapid improvement in the inflationary expectations prompted Brazil's central bank to cut its benchmark interest rate the first time in four years. The bank cut its Selic rate to 14.0% from 14.25%, the nine-year high it reached in July 2015 while inflation continued to climb. The bank's monetary policy committee indicated in its post-meeting statement that additional cuts depend on further improvements in the inflation trend and progress in cutting the government's budget deficit. It noted that indicators suggest a gradual improvement in the economy, while pointing out that the country still has a high degree of idle productive capacity.

The level of nonperforming loans have increased to 5.9% September 2016, up from 4.9% in September 2015. The outlook for the year-end Selic benchmark interest rate is at 13.5% and at 11% for the end of the next year.

The government is confident that the economy would continue to recover. The trade surplus in 2016 is expected to be $48 billion — slightly less than previous estimate of $50 billion.



Joblessness, however, shows steady upward march during the three months through September, as stabilization in the economy has not been felt in the labour market. The unemployment rate rose to 11.8% from 11.3% in the previous three months compared to 8.9%.

It was the nation's bloated public accounts that alarmed investors in 2015 and economists warned that the nation's spending is unsustainable. Now, the government under President Temer is bringing about constitutional changes to ensure that Brazil does not go on the binge again under any government. Brazil's lower house of Congress has approved a constitutional amendment that would cap government spending. Mr. Temer is also pushing unpopular pension and labor reforms. Mr. Temer's plans for the spending cap and the expected reform to rein in spending on pensions have been welcomed by investors. The markets consider the measures essential to rolling back a widening budget deficit and restoring growth.

Brazil has emerged from global pariah among investors to emerging market favourite in less than 12 months — and many analysts believe Latin America's biggest economy could be set for further gains. Further upside is likely as the new market-friendly government of President Michel Temer pushes ahead with promised economic reforms.

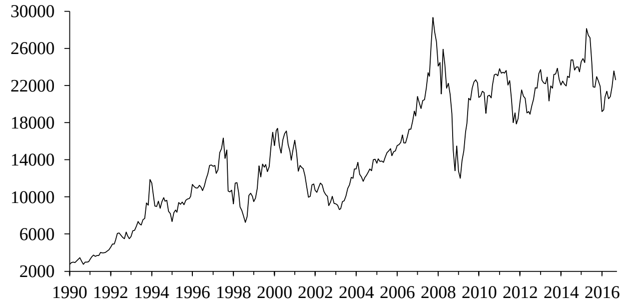
Brazil's real has already strengthened nearly 23% against the dollar this year while the benchmark equities index Ibovespa has gained nearly 41% on the impeachment in August of former leftist president Dilma Rousseff for budgetary violations.

In the recent local elections victories by renegade candidates and new parties — suggest voter anger and disgust directed across the political status quo.

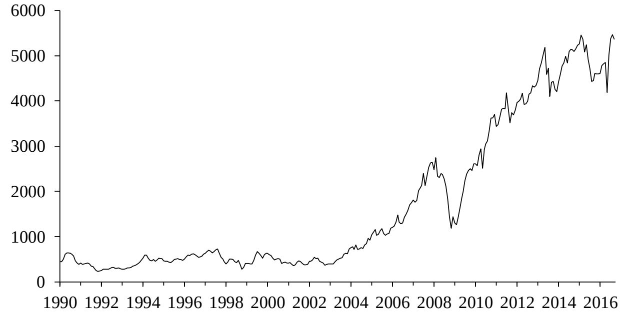
	14	**15**	**16**	**17**	**18**
GDP (%p.a.)	0.1	-3.8	-3.2	1.2	1.5
Inflation (%p.a.)	6.5	10.3	7.0	5.0	5.0
Current A/c(US$ bill.)	-104.0	-70.0	-48.0	-40.0	-44.0
Real/$(nom.)	2.4	3.9	3.5	3.0	3.0

Other Emerging Markets

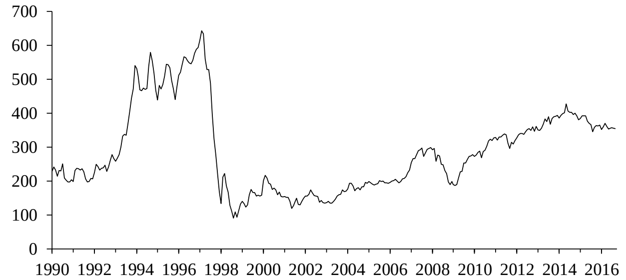
Hong Kong: FT-Actuaries



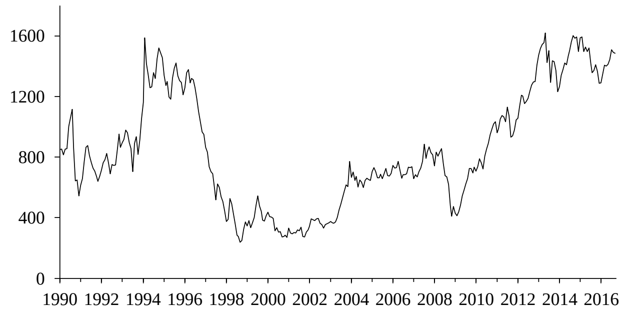
Indonesia: Jakarta Composite



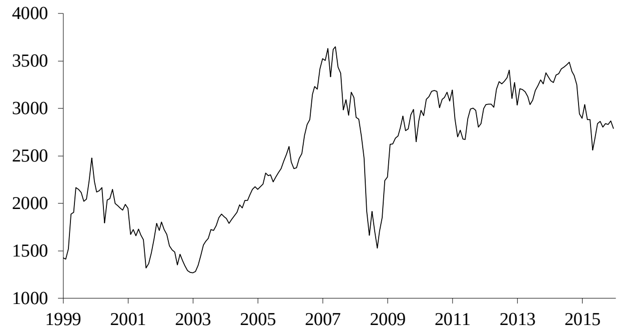
Malaysia: FT-Actuaries (US$ Index)



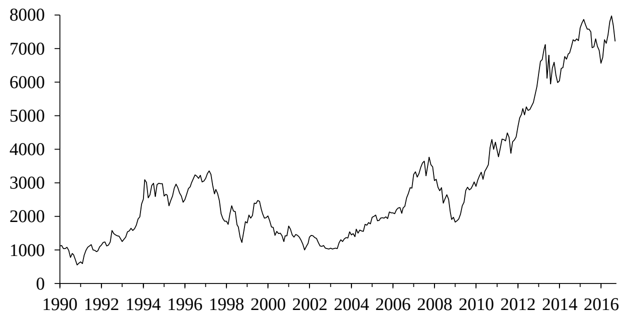
Thailand: Composite Index



Singapore: Straits Times Index

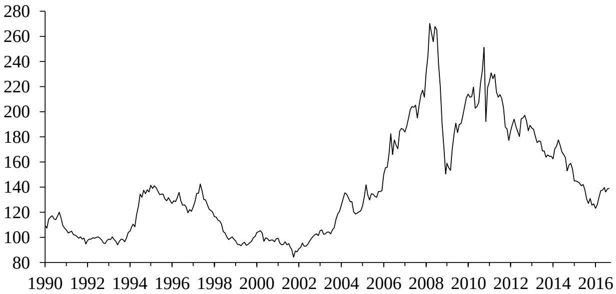


Philippines: Manila Composite

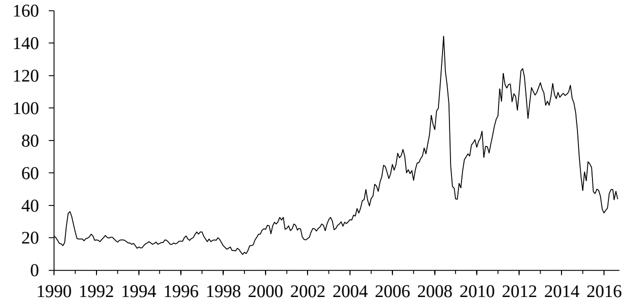


COMMODITY MARKETS

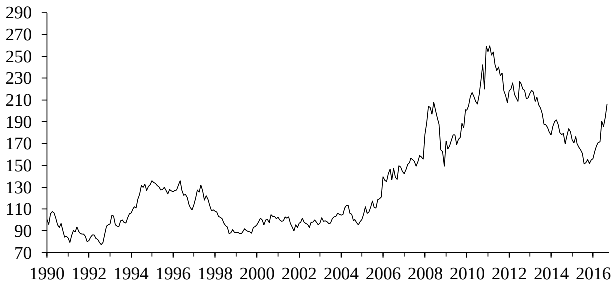
Commodity Price Index (Dollar)
(Economist, 2000=100)



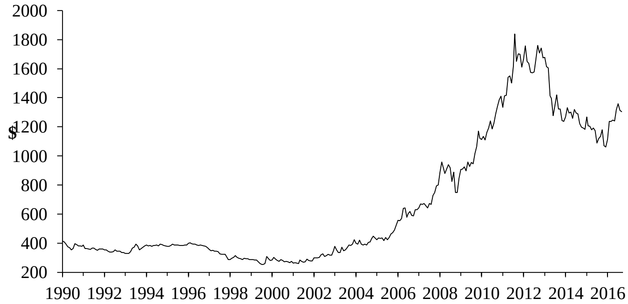
Oil Price: North Sea Brent (in Dollars)



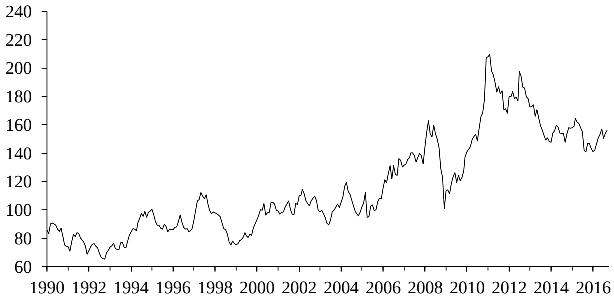
Commodity Price Index (Sterling)
(Economist, 2000=100)



Gold Price (in Dollars)



Commodity Price Index (Euro)
(Economist)



UK FORECAST DETAIL

Prices, Wages, Interest Rates and Exchange Rate Forecast (Seasonally Adjusted)

	Inflation %[1] (CPI)	Short Dated (5 Year) Interest Rates	3 Month Int. Rates	Nominal Exchange Rate (2005=100)[2]	Real Exchange Rate[3]	Real 3 Month Int. Rates %[4]	Inflation (RPIX)	Real Short Dated Rate of Interest[5]
2015	0.2	1.3	0.6	91.6	91.6	0.5	1.0	-1.0
2016	1.2	0.9	0.4	81.5	80.4	-1.5	2.1	-1.6
2017	1.9	1.2	1.0	77.9	76.4	-2.1	2.6	-1.5
2018	3.1	1.5	2.5	75.7	75.1	-0.5	3.6	-1.1
2019	3.0	2.5	3.5	74.3	74.6	1.5	3.5	0.3
2020	2.1	3.0	3.0	73.8	74.4	0.5	2.7	0.9
2015:1	0.9	1.1	0.5	89.6	90.3	0.2	1.0	0.8
2015:2	0.4	1.3	0.5	91.4	91.1	1.0	1.0	0.7
2015:3	-0.4	1.4	0.5	93.0	92.5	0.5	1.0	0.4
2015:4	0.1	1.3	0.6	92.3	92.4	0.3	1.1	0.0
2016:1	0.3	0.9	0.7	87.2	86.8	-1.1	1.4	-0.7
2016:2	1.3	0.9	0.5	81.8	81.2	-1.3	2.2	-0.9
2016:3	1.5	0.9	0.2	79.4	77.8	-1.7	2.3	-1.0
2016:4	1.8	0.9	0.2	77.6	75.9	-1.8	2.5	-1.2
2017:1	1.8	1.0	0.5	78.9	77.4	-2.5	2.5	-1.4
2017:2	1.8	1.2	1.0	78.5	77.4	-2.2	2.5	-1.5
2017:3	1.9	1.2	1.0	77.3	75.4	-2.2	2.6	-1.7
2017:4	2.1	1.2	1.5	76.7	75.4	-1.7	2.8	-1.9

1 Consumer's Expenditure Deflator
2 Sterling Effective Exchange Rate Bank of England
3 Ratio of UK to other OECD consumer prices adjusted for nominal exchange rate
4 Treasury Bill Rate less one year forecast of inflation
5 Short Dated 5 Year Interest Rate less average of predicted 5 year ahead inflation rate

Labour Market and Supply Factors (Seasonally Adjusted)

	Average Earnings (1990=100)[1]	Wage Growth[2]	Unemployment (New Basis) Percent[3]	Millions	Real Wage Rate[4] (1990=100)
2015	247.1	2.4	2.3	0.8	141.1
2016	254.3	2.9	2.2	0.8	143.5
2017	264.1	3.9	2.1	0.7	146.3
2018	280.5	6.2	2.1	0.7	150.8
2019	297.8	6.2	2.0	0.7	155.6
2020	311.4	4.6	1.9	0.7	159.5
2015:1	246.5	2.4	2.4	0.8	140.7
2015:2	245.7	2.4	2.3	0.8	140.4
2015:3	248.3	3.0	2.3	0.8	142.2
2015:4	247.7	1.9	2.2	0.8	141.1
2016:1	251.5	2.0	2.2	0.8	143.1
2016:2	252.5	2.8	2.2	0.8	142.5
2016:3	254.9	2.7	2.2	0.8	143.9
2016:4	258.1	4.2	2.1	0.7	144.5
2017:1	260.5	3.6	2.1	0.7	145.7
2017:2	261.3	3.5	2.1	0.7	144.9
2017:3	264.4	3.7	2.1	0.7	146.5
2017:4	270.0	4.6	2.1	0.7	148.1

1 Whole Economy
2 Average Earnings
3 Wholly unemployed excluding school leavers as percentage of employed and unemployed, self employed and HM Forces
4 Wage rate deflated by CPI

Estimates and Projections of the Gross Domestic Product[1] (£ Million 1990 Prices)

	Expenditure Index	£ Million '90 prices	Non-Durable Consumption[2]	Private Sector Gross Investment Expenditure[3]	Public Authority Expenditure[4]	Net Exports[5]	AFC
2015	156.6	749923.7	431522.8	302272.7	202850.7	-55478.9	125108.2
2016	160.0	766181.1	444845.4	312701.0	209007.0	-44482.0	145527.8
2017	164.1	786002.9	457714.2	323871.4	217609.3	-32648.1	169393.1
2018	168.6	807345.9	468986.2	338700.7	221961.4	-28471.5	184156.4
2019	173.4	830294.1	480710.9	358611.6	226400.7	-24594.0	203029.4
2020	178.9	856877.5	492728.6	380617.3	230928.7	-20309.5	220638.7
2015/14	2.2		1.6	3.8	1.1		-2.3
2016/15	2.2		3.3	3.4	3.0		16.3
2017/16	2.6		2.8	3.6	4.1		16.4
2018/17	2.7		2.5	4.6	2.0		8.7
2019/18	2.8		2.5	5.9	2.0		10.2
2020/19	3.2		2.5	6.1	2.0		8.7
2015:1	155.5	186173.7	106852.9	76506.7	50170.8	-14587	32769.7
2015:2	156.3	187104.6	107659.4	77424.8	50522.0	-11925.0	36576.6
2015:3	156.7	187665.9	108265.9	77811.9	50926.2	-14036.0	35302.1
2015:4	157.8	188979.5	108744.6	77033.8	51231.7	-13444.0	34586.6
2016:1	158.5	189735.5	108993.6	76956.8	51590.4	-14141.0	33664.2
2016:2	159.6	191063.6	111350.1	78034.1	52054.7	-15661.0	34714.3
2016:3	160.4	192018.9	112275.8	78658.4	52471.1	-13089.0	38297.4
2016:4	161.5	193363.1	112225.9	79051.7	52890.9	-11953.5	38851.9
2017:1	162.6	194716.6	113412.9	79526.0	53472.7	-11395.3	40299.7
2017:2	163.6	195884.9	114087.3	80639.4	54060.9	-11303.5	41599.1
2017:3	164.6	197060.2	114765.8	81445.8	54709.6	-10680.5	43180.4
2017:4	165.7	198341.1	115448.1	82260.2	55366.1	-10419.5	44313.9

1 GDP at factor cost. Expenditure measure; seasonally adjusted
2 Consumers expenditure less expenditure on durables and housing
3 Private gross domestic capital formation plus household expenditure on durables and clothing plus private sector stock building
4 General government current and capital expenditure including stock building
5 Exports of goods and services less imports of goods and services

Financial Forecast

	PSBR/GDP %[1]	GDP[1] (£bn)	PSBR (£bn) Financial Year	Debt Interest (£bn)	Current Account (£ bn)
2015	4.6	1533.1	71.2	52.0	-103.7
2016	4.3	1592.4	69.0	52.3	-89.0
2017	3.3	1669.4	54.7	58.2	-77.7
2018	2.2	1770.8	38.7	65.4	-65.1
2019	1.5	1874.6	28.3	70.3	-43.2
2020	0.7	1473.0	13.0	52.7	-32.6
2015:1	0.8	383.9	3.1	12.6	-25.8
2015:2	7.1	379.3	26.9	12.8	-20.2
2015:3	4.7	382.0	17.8	13.0	-22.6
2015:4	7.0	387.2	26.9	13.1	-35.1
2016:1	-0.1	384.6	-0.5	13.1	-33.7
2016:2	5.8	392.0	22.9	13.1	-14.0
2016:3	2.4	394.5	9.5	12.9	-13.1
2016:4	5.8	402.2	23.2	13.0	-28.2
2017:1	3.3	403.7	13.4	13.3	-23.3
2017:2	5.6	408.9	22.7	13.9	-14.1
2017:3	2.2	412.1	8.9	13.9	-13.4
2017:4	3.9	421.3	16.4	14.6	-26.8

1 GDP at market prices (Financial Year)

WORLD FORECAST DETAIL

Growth Of Real GNP

	2013	2014	2015	2016	2017	2018
U.S.A.	1.5	2.4	2.4	2.1	2.4	2.5
U.K.	2.2	2.9	2.2	2.3	2.7	2.8
Japan	1.4	–0.1	0.5	1.0	0.8	0.8
Germany	0.3	1.6	1.7	1.8	1.5	1.6
France	0.7	0.2	1.1	1.4	1.5	1.6
Italy	–1.7	–0.3	0.8	1.1	1.3	1.5

Growth Of Consumer Prices

	2013	2014	2015	2016	2017	2018
U.S.A.	1.5	1.6	0.1	1.3	2.2	2.0
U.K.	2.3	1.7	0.2	1.2	3.1	3.0
Japan	0.4	2.7	0.8	0.2	1.8	2.0
Germany	1.5	0.9	0.3	0.5	1.6	2.0
France	0.9	0.5	0.0	0.4	1.2	1.8
Italy	1.2	0.2	0.1	0.2	1.1	1.7

Real Short-Term Interest Rates

	2013	2014	2015	2016	2017	2018
U.S.A.	–1.5	–0.1	–1.1	–1.2	–0.7	–0.5
U.K.	–0.8	–2.2	0.5	–1.5	–2.1	–0.5
Japan	–2.5	–0.6	0.0	–1.8	–2.0	–1.8
Germany	–0.6	–0.2	–0.6	–1.8	–2.2	–2.2
France	–0.2	0.1	–0.5	–1.4	–2.0	–2.0
Italy	0.1	0.0	–0.3	–1.3	–1.9	–1.9

Nominal Short-Term Interest Rates

	2013	2014	2015	2016	2017	2018
U.S.A.	0.1	0.0	0.2	1.0	1.3	1.5
U.K.	0.6	0.6	0.6	0.4	2.5	3.5
Japan	0.2	0.2	0.2	0.0	0.0	0.2
Germany	0.3	0.1	–0.1	–0.2	–0.2	–0.2
France	0.3	0.1	–0.1	–0.2	–0.2	–0.2
Italy	0.3	0.1	–0.1	–0.2	–0.2	–0.2

Real Long-Term Interest Rates

	2013	2014	2015	2016	2017	2018
U.S.A.	1.6	0.7	0.3	0.4	0.8	1.0
U.K.	–0.8	–0.7	–1.0	–1.6	–1.5	–1.1
Japan	–0.8	–1.1	–1.3	–2.0	–1.9	–1.7
Germany	0.8	–0.8	–1.0	–1.5	–1.3	–1.1
France	1.1	–0.5	–0.8	–1.3	–1.1	–0.9
Italy	1.2	–0.5	–0.7	–1.2	–1.0	–0.8

Nominal Long-Term Interest Rates

	2013	2014	2015	2016	2017	2018
U.S.A.	3.0	2.2	2.2	2.4	2.8	3.0
U.K.	1.3	1.8	1.3	0.9	1.2	1.5
Japan	0.7	0.3	0.3	0.0	0.1	0.3
Germany	1.9	0.5	0.6	0.4	0.7	0.9
France	1.9	0.5	0.6	0.4	0.7	0.9
Italy	1.9	0.5	0.6	0.4	0.7	0.9

Index Of Real Exchange Rate(2000=100)[1]

	2013	2014	2015	2016	2017	2018
U.S.A.	82.1	83.9	93.0	94.0	94.5	94.8
U.K.	86.5	93.1	91.6	80.4	76.4	75.1
Japan	63.5	59.8	56.0	58.4	58.5	58.6
Germany	99.0	99.9	94.7	95.0	95.2	95.1
France	100.7	100.8	96.2	96.0	95.9	95.7
Italy	106.9	107.5	102.1	102.0	101.8	101.7

[1] The real exchange rate is the domestic price level relative to the foreign price level converted into domestic currency. A rise in the index implies an appreciation in the real exchange rate.

Nominal Exchange Rate
(Number of Units of Local Currency To $1)

	2013	2014	2015	2016	2017	2018
U.S.A.[1]	86.00	89.40	99.94	102.10	102.00	102.20
U.K.	1.55	1.65	1.53	1.36	1.30	1.27
Japan	98.20	106.70	120.00	118.40	112.00	113.00
Eurozone	0.75	0.76	0.90	0.95	0.93	0.92

[1] The series for the USA is a trade weighted index (1990=100); the series for the UK is $ per £

* Forecasts based on the Liverpool World Model