LIVERPOOL INVESTMENT LETTER

December 2016

Cardiff Business School
Ysgol Busnes Caerdydd

Julian Hodge Institute of Applied Macroeconomics

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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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IS THE EUROPEAN PROJECT UNRAVELLING?

So much political capital has been sunk into the centralising European Project that it has always seemed most unlikely that it could be stopped or derailed sufficiently to make it change its nature fundamentally. M. Delors set it off in the late 1980s on that mission of centralisation: the Social Market with a Uniform Regulative System policed by Qualified Majority Voting (so making member state objections generally futile), followed by the setting up of the euro in the Maastricht Treaty, and finally solidified into place by the Lisbon (Constitutional) Treaty. The whole process has been breath-taking in its audacity. Proud nation-states have been turned into vassals by a machinery that has simply rolled on, partly by trickery, partly by inertia, in the creation of a new European Empire, ruled by a neo-Hapsburg civil elite.

Often on this side of the Channel British commentators used to democratic checks and balances, and popular jettisoning of failing economic policies have said that the euro 'would collapse' or that the EU would have to abandon its centralising dream. But they have underestimated the sheer dogged perseverance of that elite and the timidity of the people of the different nation-states when faced with the question of departure from either the euro or the EU's direction.

However, so bad has been the experience of countries to the south of Europe, including both France and Italy, both economically with unemployment rising threateningly again and with the migration and terrorism crisis, that things are changing. Brexit, the election of Trump as US President, the Renzi referendum Now, the upcoming French Presidential elections with Marine Le Pen looking strong, and perhaps even after that a threat to Angela Merkel from disappointed supporters on the German right; all these events look like a new political environment. The first casualty could be the euro-zone which has failed southern Europe, creating misery on an epic scale. It may well shrink back to a core of northern states that do not need fiscal union to coexist inside a monetary union. Elsewhere the old currencies will start to reappear.

Following that will come proper borders inside the EU and possibly the abandonment of free movement of labour, always a doubtful economic component of the Single Market where trade is sufficient to achieve efficient resource allocation.

Finally, we will surely see increasingly more competition in tax and regulation, as nation states get back regulative powers and the Single Market gradually defaults to the original idea of competing regulative systems under mutual recognition.

These changes will again preoccupy the EU and will make the Brexit negotiations with the UK less hostile, since ironically the UK wants a relationship of friendly cooperation in a sea of other countries which are increasingly unfriendly to the EU. When one adds to this the Trump plans for more disengagement from Europe, the implication is that Eastern Europe will be much more inclined than before to accept UK demands for migration control, since the UK is now a key guarantor of NATO's eastern borders.

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)

Where will this push the UK outlook? We already saw this as promising stronger growth. With a more cooperative Brexit that outlook improves. With the euro in more and more trouble sterling will continue to recover from its post-Brexit shock fall. We have suggested that the necessary fall in sterling's effective rate by 2020 was more like 6% than the 16% or so of recent weeks. It is likely to move back up over the next few years.

One of the accompaniments of Brexit is more freedom to reform the clunky UK tax system, side by side with the freedom to improve the inherited top-down Brussels regulative system. We are now discovering in field after field how restrictive that system was — whether in medicines, in finance or industrial standards. Taken with tax reform, the market environment in the UK is likely to be entering a golden era.

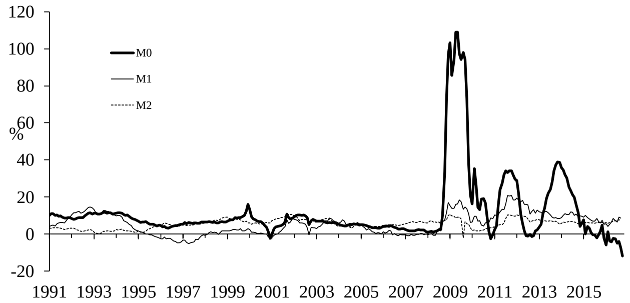
With growth strong and stimulated by the large fall in sterling — a massive unscheduled monetary stimulus — monetary policy needs to tighten. QE should be reversed and interest rates raised, both in a gradual manner.

Unfortunately, both the Bank and the Treasury/OBR have not caught up with this outlook. They are still mired in pre-referendum fallacies about 'uncertainty' and long-term Brexit 'damage'. Official forecasts, and with them too many private forecasts, will take time to adjust to the truth about Brexit and the manifest absence of 'uncertainty damage' — the only uncertainty in UK policy is the extent to which Brexit will be dominated by world free trade rather than the 'soft Brexit' status quo option, viz the extent of the upside, hardly a damaging sort of uncertainty!

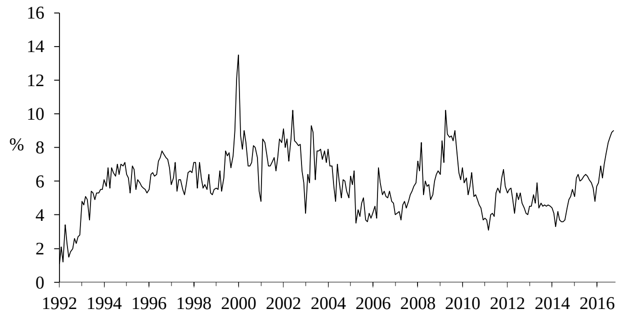
Can this 'official downbeat' attitude actually damage confidence? No, because we can assume that people and firms in the market place will judge the outlook rationally. Already we see that business confidence is strong, with manufacturing investment intentions, that officials thought would be dampened, strongly positive in the latest CBI survey.

With Trump's proposed infrastructure, tax cut and deregulation programme boosting the US economy, joining the UK's better growth prospects post-Brexit reforms. This is a good time to hold and buy equities and to dump over-priced bonds.

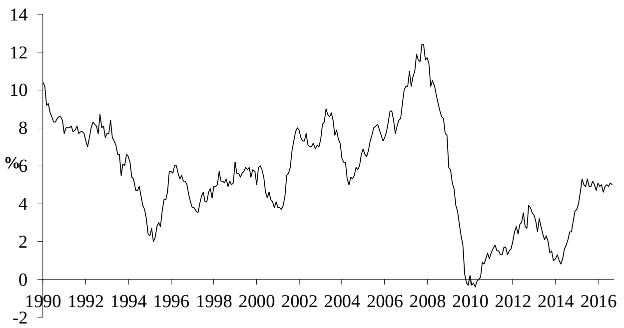
U.S.: Growth in Monetary Aggregates (Yr - on - Yr)



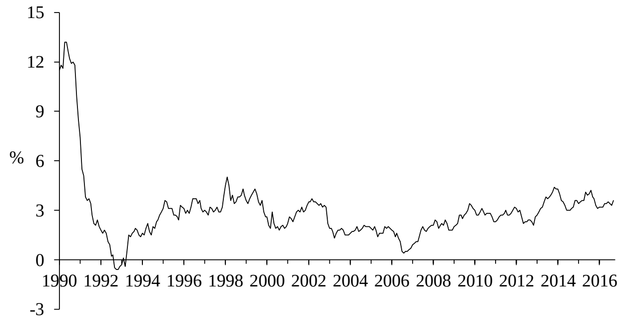
UK: Notes and Coins in Circulation Growth



Eurozone M3 Growth



Japan: Growth of M2+CD's



FOCUS ON JAPAN

Francesco Perugini

Japan GDP Growth Smashes Expectations

Japan's economy has continued its solid run in 2016, expanding during the third quarter and at a faster rate than the market had expected. Real GDP expanded by 2.2% year-on-year and 0.5% from the previous quarter — following a 0.7% increase in April–June, marking the third straight quarter of expansion. Overall, Japan's economy seems to have performed well this year so far, despite the higher yen, numerous tweaks to monetary policy and disruptions by earthquakes. Previously, growth in the March quarter had been revised solidly higher, while the final revision to the June quarter growth, which had initially disappointed, brought it in line with first-time expectations.

In the third quarter private consumption, which accounts for roughly 60% of GDP, rose 0.1%, a low growth rate, unchanged from the second quarter, a sign the effects of Prime Minister Shinzo Abe's stimulus drive dubbed Abenomics are yet to spread to households due to weak wage growth. Capital expenditure, a key component of GDP, was flat, following a 0.1% decline in the second quarter, with worries about the global outlook and renewed yen gains weighing on business investment. The boost came from a surprise 0.5% pick-up in exports, which rebounded from a 1.5% drop in the June quarter, as well as government consumption, which rose 0.4% quarter-on-quarter from a 0.3% decline the previous quarter.

A survey of 10 private-sector economists has GDP growing at an annualized 0.5% rate in the October–December quarter and 1.2% in January–March 2017. Many respondents think that Japan's ¥28 trillion stimulus package will give the economy a boost next year via greater public works investment. Growth in personal consumption and private-sector investment, on the other hand, is seen as staying stuck at the current low rates.

U.S. President-elect Donald Trump's administration could further spur growth in Japan's economy if it implements the stimulus measures promised on the campaign trail, including massive infrastructure investment and tax cuts. Many market players think speedier growth in the U.S. will push up American interest rates, and have started selling yen for dollars. This has buoyed the Japanese stock market in turn, with investors expecting a weaker yen to provide a tailwind behind exports. "If the U.S. economy grows, it will benefit Japan as well," Bank of Japan (BOJ) Gov. Haruhiko Kuroda told a recent news conference.

But expansionary fiscal policy under the Trump administration could also stoke inflation. If the Federal Reserve Board hikes interest rates too quickly, the economy as a whole could suffer for it. Trump's protectionist stance on trade, including his pledge to pull out of the Trans-Pacific Partnership trade pact, could also lead the global economy to contract, some worry. Japan may also lose anticipated benefits from that trade deal. Thus, the country's economy would be impacted negatively should the agreement not take effect, Kuroda said. "A collapse of the Trans-Pacific Partnership would be a disappointment for Japan", echoed Randall Jones, head of the OECD's Japan-Korea desk, at a recent OECD briefing.

As a result, observers believe that at the current stage Japan is highly exposed to U.S. economic developments, so that the economy should shift from external to internal growth drivers. Wage growth will be the key to fortifying demand at home. Conditions are ripe for pay rises when labour and management negotiate in the spring "based on corporate earnings and the strength of the labour market," Kuroda said. "It is essential for the health of Japan's economy that employers tackle wage hikes and other decisions with the central bank's 2% price-growth target in mind", Kuroda told a gathering of local business leaders prior to the news conference last month.

The OECD said sustained growth will require achievement of the targeted "virtuous cycle" of higher corporate profits, wages and prices, with the "major uncertainty" being wage growth. Also, structural reforms are essential to boost productivity and bring more people, especially women, into the workforce, the OECD said. It noted that faster growth was critical to stopping and reversing the nation's swelling public debt.

Abe came to office in late 2012 and launched a growth plan — a mix of massive monetary easing, government spending and structural reforms. The program sharply weakened the yen and set off a stock market rally that spurred hopes for a once-soaring economy caught in a deflationary spiral of falling prices and lacklustre growth. But the promises to cut through red tape and produce structural reforms have been slower, and Abe's plan to buoy Japan's once-booming economy appeared increasingly unrealistic. His spend-for-growth policies have set Japan apart from some of its rich nation counterparts, including Germany, which has been reluctant to endorse them, seeing it as an ineffective way to stimulate the economy. Latest GDP data seems to suggest that the economy has regained some momentum after a long lull, but the hope is that the figures are not revised downwards on the second official release, as they are notoriously unreliable. Meanwhile the basis for Japan's growth still seems largely to be demand stimulus and not underlying growth in productivity and labour supply.

MARKET DEVELOPMENTS

The long-awaited collapse in the bond market has finally arrived thanks to Donald Trump's election. The collapse has further to go as the US fiscal stimulus from infrastructure spending and tax cuts works through to higher inflation and interest rates. Hasta la vista, the Zero Bound! And good riddance. Let us hope the lessons for central banks echo down the years. Equities will be king for some time to come.

Table 1: Market Developments

	Market Levels		Prediction for Oct/Nov 2017	
	Nov 4	**Dec 7**	**Previous Letter**	**Current View**
Share Indices				
UK (FT 100)	6693	6902	10943	11285
US (S&P 500)	2085	2241	2565	2757
Germany (DAX 30)	10259	10987	15891	17018
Japan (Tokyo New)	1347	1491	1897	2099
Bond Yields (government				
UK	1.13	1.36	1.20	1.20
US	1.78	2.35	2.80	2.80
Germany	0.06	0.26	0.70	0.70
Japan	–0.06	0.02	0.10	0.10
UK Index Linked	–1.78	–1.60	0.10	0.10
Exchange Rates				
UK ($ per £)	1.25	1.26	1.40	1.40
UK (trade weighted)	75.13	78.79	77.30	77.30
US (trade weighted)	101.25	105.21	102.0	102.0
Euro per $	0.90	0.93	0.93	0.93
Euro per £	1.13	1.17	1.30	1.30
Japan (Yen per $)	103.0	113.6	112.0	112.0
Short Term Interest Rates (3-month deposits)				
UK	0.40	0.40	1.00	1.00
US	0.80	0.95	1.30	1.30
Euro	–0.36	–0.36	–0.20	–0.20
Japan	–0.20	–0.30	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	–11.02	13.88
Germany	2.60	1.8	1.1	52.00	–11.15	46.35
Japan	1.70	1.2	0.6	39.00	–9.46	33.04
UK indexed[2]	–1.39		1.5	2.00		2.31
Hong Kong[3]	2.60	6.0	1.5	–5.00	–11.02	–5.92
Malaysia	3.30	5.4	1.5	55.00	–11.02	43.18
Singapore	3.50	2.0	1.5	23.00	–11.02	4.98
India	1.40	8.0	1.5	24.00	–11.02	28.88
Korea	1.10	3.0	1.5	–19.00	–11.02	–24.42
Indonesia	2.20	5.2	1.5	31.00	–11.02	27.88
Taiwan	2.80	3.4	1.5	14.00	–11.02	9.68
Thailand	3.20	3.1	1.5	35.00	–11.02	22.78

Bonds: Contribution to £ yield of:

	Redemption Yield	**Changing Nominal Rates**	**Currency**	**Total**
UK	1.36	1.60		2.96
US	2.35	–4.50	–11.02	–13.17
Germany	0.26	–4.40	–11.15	–15.29
Japan	0.02	–0.80	–9.46	–10.24

Deposits: Contribution to £ yield of:

	Deposit Yield	**Currency**	**Total**
UK	0.40		0.40
US	0.95	–11.02	–10.07
Euro	–0.36	–11.15	–11.51
Japan	–0.30	–9.46	–9.76

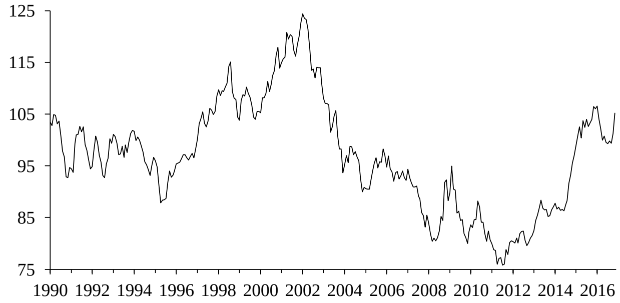
[1] Yields in terms of €s or $s can be computed by adjusting the £-based yields for the expected currency change.
[2] UK index linked bonds All Stocks
[3] Output based on China.

Table 3: Portfolio(%)

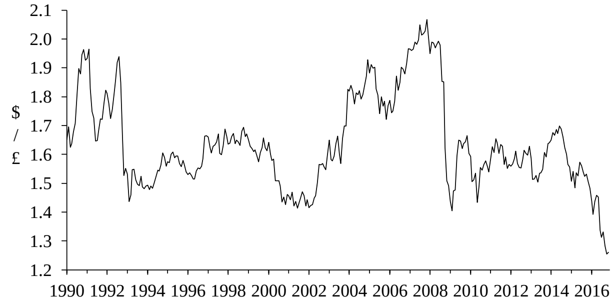
	Sterling Based Investor		Dollar Based Investor		Euro Based Investor	
	November Letter	Current View	November Letter	Current View	November Letter	Current View
UK Deposits (Cash)	5	5	5	5	1	1
US Deposits	-	-	-	-	-	-
Euro Deposits	-	-	-	-	-	-
Japanese Deposits	-	-	-	-	-	-
UK Bonds	-	-	-	-	-	-
US Bonds	-	-	-	-	-	-
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

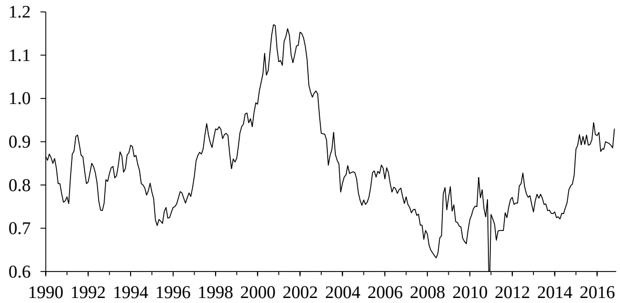
US : Trade Weighted Index
(Bank of England 1990 = 100)



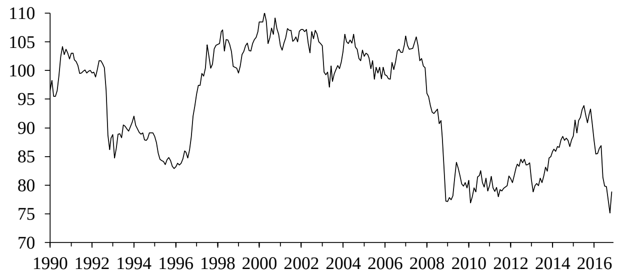
UK: Dollars Per Pound Sterling



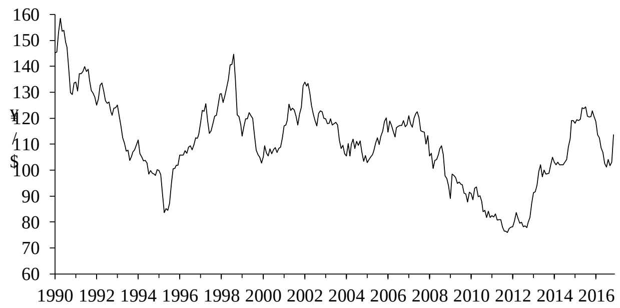
Euro per US dollar



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

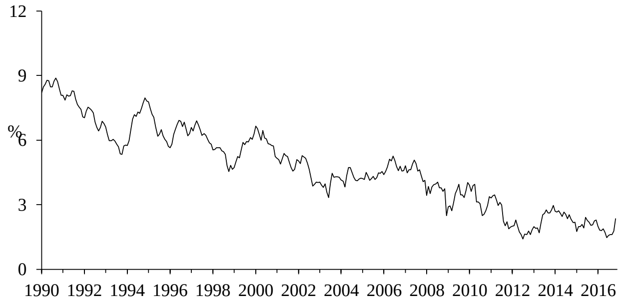


Japan : Yen Per U.S. Dollar

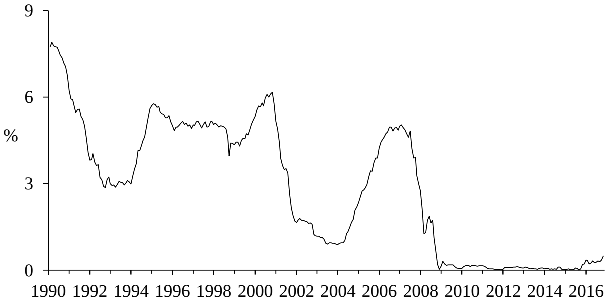


GOVERNMENT BOND MARKETS

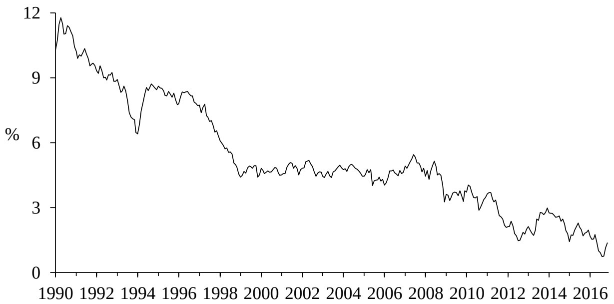
U.S.: Yield on Long-Term Government Bonds



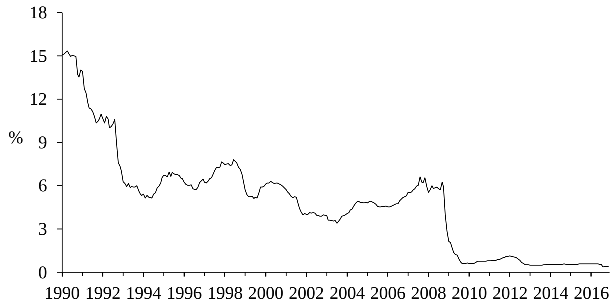
U.S. : 3-Month Treasury Bill



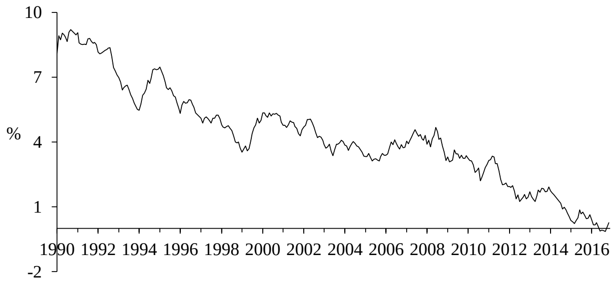
U.K.: Yield on Long-Term Government Bonds



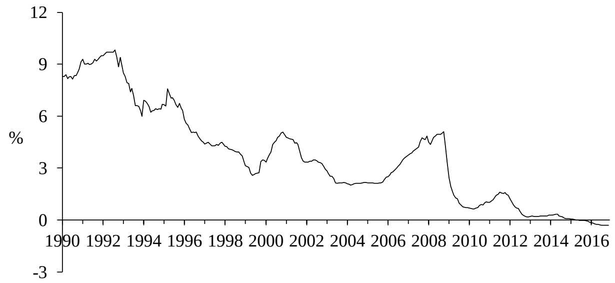
U.K. : 3-Month Interbank Rate



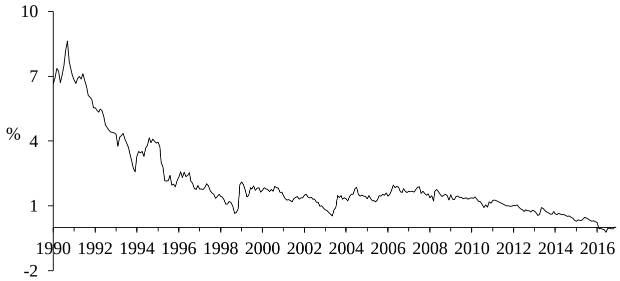
Germany: Yield on Public Authority Bonds



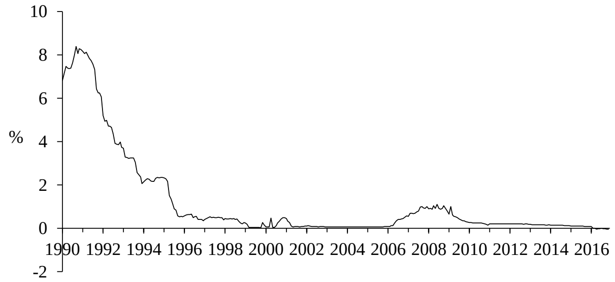
Germany : 3-Month Interbank Deposit Rate



Japan: Yield on Long-Term Government Bonds

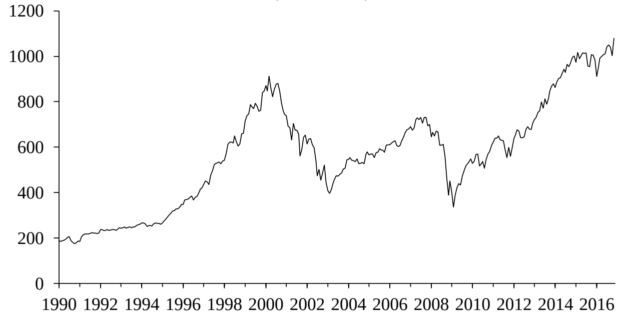


Japan : 3 Month Money Market Rate

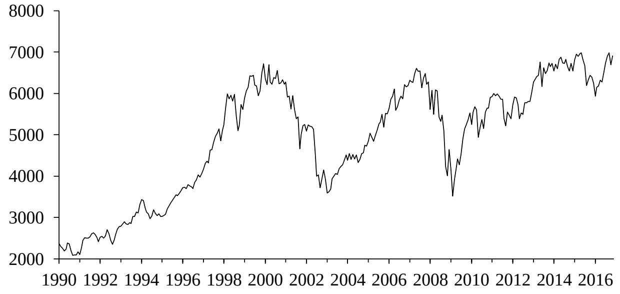


MAJOR EQUITY MARKETS

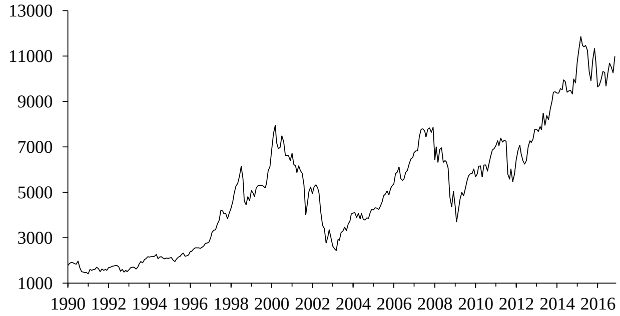
U.S. : S & P 400 Industrial
(1985=100)



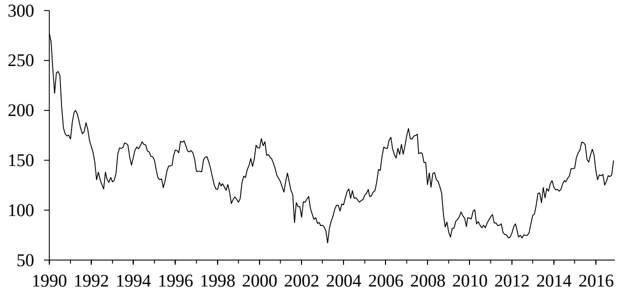
U.K. : FTSE-100 Index
(10 April 1962=100)



Germany : DAX 30



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



EMERGING MARKETS

Anupam Rastogi

India

The present government under the leadership of Prime Minister Narendra Modi was accused of not initiating bold economic reforms. After PM Modi's announcement, on November 8, to replace 500 rupees ($7.30) and 1,000 rupees ($14.60) notes as illegal tender with immediate effect, he cannot be censured as a cautious reformer. These notes approximately account for 86% of currency in circulation. The informal or underground economy comprises an estimated 45% of GDP and employs 80% of the workforce. In the underground economy, transaction are done in cash. The stealth decision to abruptly cancel and replace most of India's currency is a radical economic experiment, and political gamble, with few precedents. With this move, he has reinforced his image as a strong, decisive leader, willing to take bold decisions.

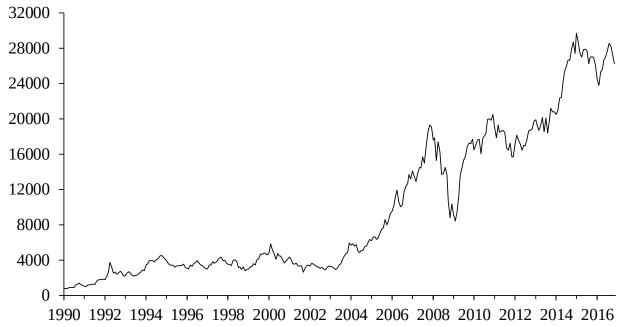
The rationale given by him was to root out corruption, counterfeit money used by terrorists and tax evasion. He has announced upfront that people should use digital wallets and do all transactions through banking channels. He has told the populace that there would be inconvenience until the end of December. With tongue in cheek, he has said that it is like a mother going through labour pains but she forgets all her pain after she has her baby, hinting that after December end, all will be normal and a new 'nation' would be born.

In the midst of this unprecedented monetary experiment, the impact on the economy is difficult to estimate. However, it is a big risk for Mr Modi, whose supporters include wholesale and retail traders, known for their non-transparent cash dealings. Motivation of Mr Modi seems to be that for India to be a meaningful player on the world economic stage, tough measures are required. His aim is to have India ready to do business with anyone in the world and to attract investment in manufacturing sector.

Surprisingly, ordinary Indians believe Mr Modi's shock therapy will yield long-term benefits. Higher levels of bank deposits can facilitate lower interest rates and greater lending, while traditional businesses will be under pressure to find alternatives to cash and come under the tax net. No one can estimate, as of now, how much cancelled cash will return to the banks, and how much will be purged from the system. Post December 2016, online payment providers are sure to benefit as the government pushes to collect taxes on goods and services after the landmark "GST" bill was passed earlier this year.

In the near term, there would be a trade-off from a near-term weakening impact on consumption growth. India's economy expanded at an annual rate of 7.3% in the three months to September. India's economic growth is expected to slow in the current quarter as a result of the liquidity squeeze. We expect the economy to grow 7% in the fiscal year ending in

India: BSE Sensitive



March 2017. Thereafter, economy would return to its normal path. The government remains extremely growth-biased.

Inflation would remain subdued. The consumer price index-based inflation eased to 4.2% in October as against 4.3% in the previous month, a 14-month low. Wholesale Inflation was 3.39% for October compared to 3.57% in the previous month. The Monetary Policy Committee of the central bank is held on December 6 and 7, 2016 chose to play safe and did not cut the repo rate which is the policy rate in India. Markets had expected at least a 25 basis point cut in the repo rate. However, the central bank has reiterated its accommodative policy stance.

Indian export were up 9.6% to $23.51 billion in October. Trade deficit widened to $10.16 billion as India's imports also rose by 8.11 % to $33.67 billion in October, compared with the year-ago period when it was $31.14 billion. Cumulative import in the current financial year reached $208 billion, compared with $233.4 billion the previous year which is just one percent of GDP.

British PM Mrs. May attended a tech summit and had bilateral talks with Mr. Modi in the beginning of November. The talks focused on shoring up economic, defence and security ties between the two countries. She was keen to gain improved access to India for U.K. legal services, especially, international arbitration.

India's investment grade borrower status has been confirmed by S&P Global Ratings, which praised improvements in economic policymaking under the government of Prime Minister Narendra Modi. S&P praised India's "improved monetary credibility". It said it expects inflation to fall within the central bank's 5% target by early next year.

	14–15	**15–16**	**16–17**	**17–18**	**18–19**
GDP (%p.a.)	7.3	7.6	7.0	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's GDP growth is forecast to remain stable around 6.6% in 2016 and 6% in 2017. There is a perceptible shift in managing of the yuan now. The yuan depreciated 6.2% against the dollar this year in onshore markets, reaching 6.9 against the dollar. More than a third of the drop has occurred in the last three weeks of November. The People's Bank of China is not keen to let the currency slide too far, too fast, for fear that might lead to destabilizing capital flows out of the country. Its intervention in the market can be gauged from the depletion in the foreign currency reserves.

Data shows that depreciation of the yuan is not able to push exports. Even though the yuan has depreciated 6.9% against the U.S. dollar this year, China's exports have not picked up due to a weak global economy. Although the yuan weakened against the U.S. dollar, it has not appreciated and has remained stable against other currencies. Hence, the renminbi's persistent weakness appears to be the mirror image of the dollar's strength. We expect the yuan at Rmb7 against the dollar by the end of 2017. Forward contracts, a measure of market bets imply it will reach Rmb7.12.

Chinese exports fell in October for the seventh consecutive month as weak demand continued to weigh on the world's second-largest economy. Imports in October fell by 1.4% from a year earlier. China's trade surplus widened in October by a smaller-than-expected $49 billion compared with a surplus of $42 billion in September.

The country's foreign-exchange reserves plunged $45.7 billion in October from September to $3.12 trillion. The Institute of International Finance, Washington estimates that net outflows doubled to $207 billion in the third quarter from the previous three months. Beijing's plan to stem capital flight disguised as FDI. China's restrictions on outbound acquisitions will be a significant shift in policy. It will override its 1990s directive for companies to acquire expertise and brands. According to Commerce Ministry data, Chinese companies' overseas purchases have surged past last year's record of $121bn for non-financial outbound investments, reaching $146bn in the first 10 months of 2016. The flow of money out of China is creating downward pressure on the renminbi.

Targeted for particular scrutiny would be "extra-large" foreign acquisitions valued at $10 billion or more per deal, property investments by state-owned firms above $1 billion and investments of $1 billion or more by any Chinese company in an overseas entity unrelated to the investor's core business.

China and Hong Kong markets will have a trading link connecting the Shenzhen and Hong Kong Stock Exchanges from December 5. This will open up over 800 of China's fastest-growing companies to foreign investors.

In a surprise move, China removed its reform-minded finance minister, Lou Jiwei, and replaced him with a President Xi Jinping's loyalist Xiao Jie. This change raises the chance of further fiscal easing in 2017. This should lead to higher macro leverage, more credit expansion, and depreciation pressure on RMB.

	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	6.7	7.0	7.0

South Korea

In the last one month or so, South Korea saw policy paralysis as South Korea's President Park Geun-hye got embroiled into controversies. There was a growing sense in the country that Ms Park had lost her mandate to rule and lacked the strength to take on the chaebol and carry out the reforms she promised while campaigning for the presidency in 2012. Park Geun-hye faced calls for impeachment after a friend was indicted and the president was accused of giving her access to government documents. Ms Park is willing to relinquish power now and she has requested parliament to come up with a way for a stable regime change. The lawmakers, however, would like her to be impeached.

In a vote on December 9 the South Korean parliament voted to impeach President Park Guen-hye. Hwang Kyo-anh, the prime minister, has taken over the reins temporarily. It is now up to the Constitutional Court to make a final decision on whether Ms Park should stand down. The Constitutional

Court, whose judges tend to be conservative, must decide on the legality within 180 days after receiving the parliamentary proposal. Six out of its nine judges would have to uphold the impeachment to remove Ms Park from office. It seems that the country has to go through the pain for at least six months.

The country's economy grew at an annual rate of 2.7% in the third quarter, down from 3.3% in the previous three months. Key industries, such as shipbuilding, are undergoing deep restructuring process. The economy will struggle to grow faster than 2.5% this year and next. South Korea's industrial output shrunk 1.6% year-on-yaer in October. The country will miss its long-held ambition of hitting a GDP per capita of $30,000 in 2017.

South Korea's annual inflation in October accelerated to an eight-month high, led by a spike in fresh food costs. The consumer price index rose 1.3% in October from a year earlier. In September, prices increased by 1.2%. We expect an interest rate cut by the Bank of Korea early next year to support growing consumption.

Exports, which account for about 45% of gross domestic product, shrank 3.2% year on year in October after a 5.9% drop in September. Exports are expected to rise 1.2% in November from a year ago. Imports are expected to gain 2.9% over the same period versus a 4.8% drop in October.

South Korea and a group of six Central American countries — Nicaragua, El Salvador, Honduras, Costa Rica, Guatemala and Panama — have agreed on a free-trade pact after a year of negotiations to cut tariffs and increase commerce. The formal signing of the deal to take place next year after legal and technical reviews. This deal will help South Korean companies to increase trade with Central America and "sustain growth momentum in exports to the U.S. amid growing concerns about protectionism" by establishing a new "strategic bridgehead" in the region

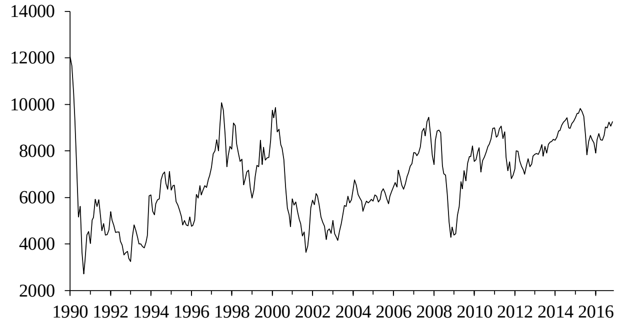
South Korean stocks and the won strengthened as Park Geun-hye, the country's embattled president, said she was willing to relinquish power in the last week of November.

	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

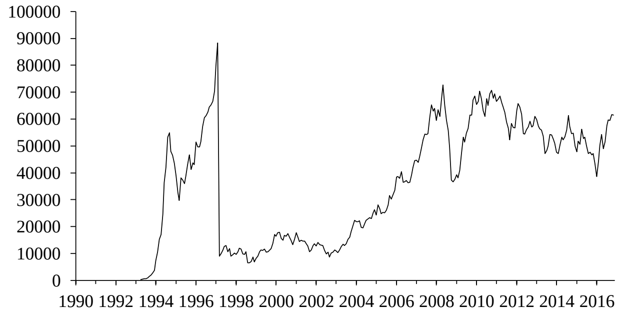
Taiwan

Taiwan's gross domestic product grew marginally higher than 2% in the third quarter. Taiwan may post 1.3% growth in GDP for 2016 on the back of a recovery in exports. Taiwan's economy went through three consecutive contractions before growing 1.13% in the second quarter this year. It is estimated that the GDP will grow 1.9% in 2017. Domestic demand remains the biggest driver of the island's economic growth.

Taiwan: Weighted TAIEX Price Index



Brazil: Bovespa



Exports of merchandise posted the first expansion since the first quarter last year, although growing at just 0.11% year on year, as global demand for Taiwan-made electronics and machinery rebounded. Export growth is expected to continue in the fourth quarter as well. In the first 10 months of the year, Taiwan's exports were still down 4.5% from a year earlier at US$229 billion, and imports were also down 4.7% at US$189 billion. That left a trade surplus of US$40 billion during the January–October period, down US$1.5 billion from a year earlier.

Despite the depreciation of the Chinese yuan, the Taiwan dollar remained stable around 22 NT$ to a US dollar.

	14	15	16	17	18
GDP (%p.a.)	3.7	0.8	1.3	1.9	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

The Brazilian economy is finding it difficult to recover from the deep recession it is having in the current year. The government has decreased its 2017 annual GDP forecast to 1.0% from 1.6%. Unemployment hit 11.8% in the June to August period. Around 12 million Brazilians are unemployed. Rising joblessness and falling incomes have cut consumption, while sales of homes and cars have plummeted.

The country's poor economic performance is likely to ease the pressure on prices further. We expect consumer price inflation to reduce to 5% in 2017 compared to 6.9% in 2016. With a benign inflationary outlook, the year-end outlook for the Selic benchmark interest rate is at 13.75% this year and 10.75% next year. The central bank cut its benchmark Selic rate to 14% from 14.25% in October, the first rate cut in four years.

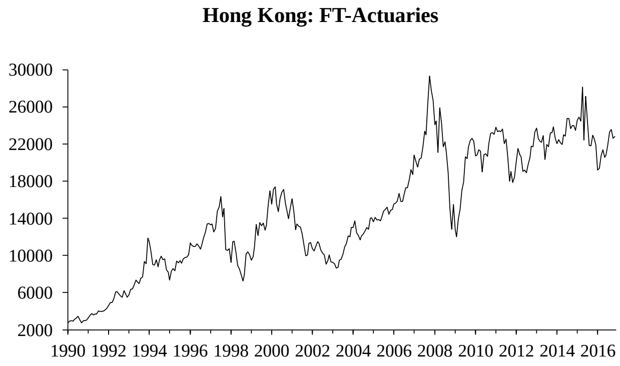
Brazil Central Bank President Ilan Goldfajn has urged the government for fiscal discipline to achieve price stability and said the election of Donald Trump as U.S. President adds uncertainty to the economy.

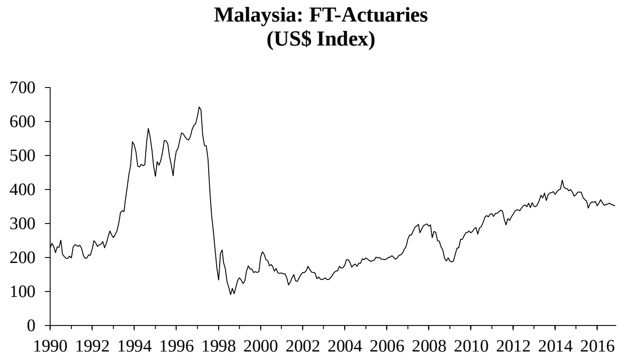
Brazil's Congress is considering public-spending limits for at least next 10 years. A final vote in the Senate is expected in December. Other potentially controversial measures, including changes to Brazil's generous retirement system, are expected for next year. Brazil's government is hopeful that pension reform will pass Congress in the first half of 2017, leaving room for other reforms in the country's labour and tax systems, possibly in the second half of 2017.

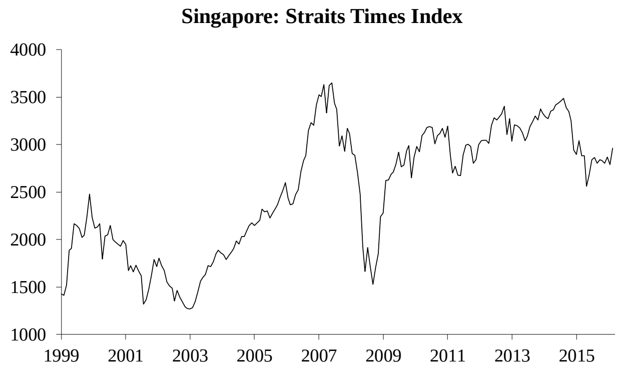
Fitch Ratings affirmed its default ratings on Brazil government debt at BB with a negative outlook on the country's struggling economy.

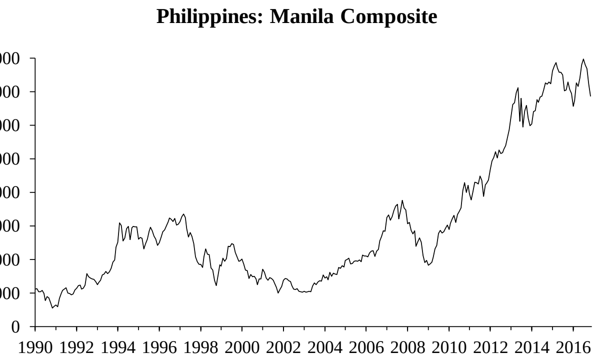
	14	**15**	**16**	**17**	**18**
GDP (%p.a.)	0.1	-3.8	-3.2	1.0	1.5
Inflation (%p.a.)	6.5	10.3	6.9	5.0	5.0
Current A/c(US$ bill.)	-104.0	-70.0	-48.0	-40.0	-44.0
Real/$(nom.)	2.4	3.9	3.5	3.4	3.2

Other Emerging Markets



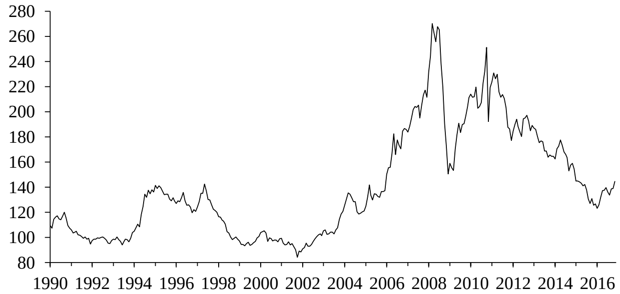




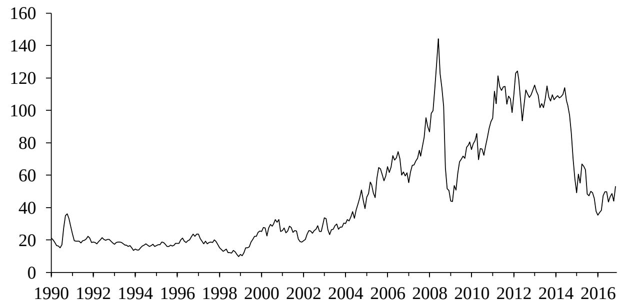


COMMODITY MARKETS

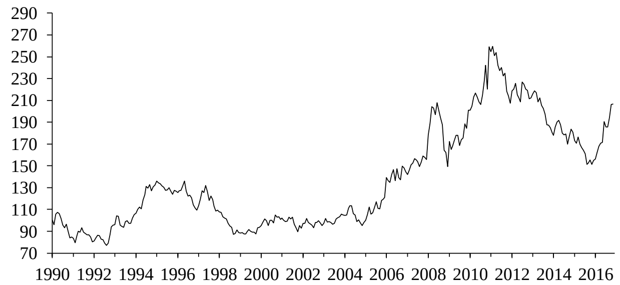
Commodity Price Index (Dollar)
(Economist, 2000=100)



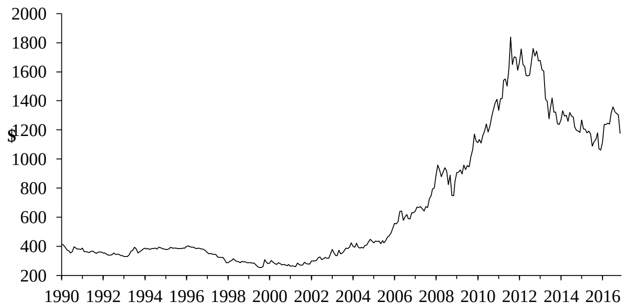
Oil Price: North Sea Brent (in Dollars)



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

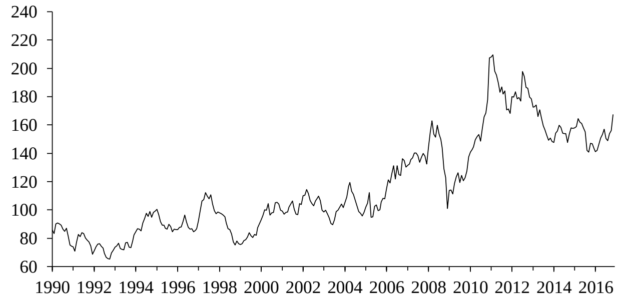


Gold Price (in Dollars)



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		3.1	3.4	3.0		16.3
2017/16	2.6		2.9	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