LIVERPOOL INVESTMENT LETTER

February 2017

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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 published on behalf of the group by Liverpool Macroeconomic Research Limited, which holds the copyright

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THE BANK OF ENGLAND COMES CLEAN

Courageously and honestly the chief economist of the Bank of England, Andy Haldane, publicly admitted they had got the post-Brexit forecast completely wrong. Now in the latest Inflation Report the Bank has massively upped its forecast for 2017 into a credible range of 2–3%, if still admittedly at the very bottom of it with 2%. By so doing the Bank has taken the wind out of the sails of the other forecasters who have flapped along on its coat tails.

Andy Haldane still thought the Bank was right that Brexit would cause a longer term slowdown; and in our view he is again quite wrong about that because the UK's future with free trade all around the world and regulated by its own Parliament can only be a vast improvement on the current protectionism and fussy socialist intervention we enjoy inside the EU.

But, of course the longer term is another kingdom which we will gradually learn more about over the next decade. The key point is that the immediate 'doom and gloom' emanating from the Bank and the rest of the 'establishment consensus' was quite wrong.

The world economy is moving into a new phase, in which the Trump presidency will champion deregulation, tax cuts and spending on defence and infrastructure. It will also do a variety of 'deals' with other countries whose content are still obscure but will be aimed at getting allies to pay more for defence, and pursue 'fair trade'. One deal however has been fleshed out somewhat: a trade deal with the UK. This chimes well with the new May strategy of making the UK a leader in free trade around the world, striking trade deals with new partners, including the US, Australia and New Zealand. Whether a free trade deal with the EU without unacceptable strings attached on migration and EU regulation can or cannot be reached, a US trade deal would at a stroke enable the UK to buy good food and manufactures at world prices — from the US, replacing many expensive EU sources. The US is the OECD's most competitive supplier of a wide range of manufactures, from furniture through all types of machinery to printing and publishing products. It is by far the world's largest exporter of food, with 10% of world exports. In exchange for the UK dropping its trade barriers on all these US products the UK will further strengthen its position in the US services markets. If nothing else this prospect should put the wind up EU negotiators, as at a stroke French farmers and German manufacturers may lose the bulk of their UK market.

Table 1: Summary of Forecast

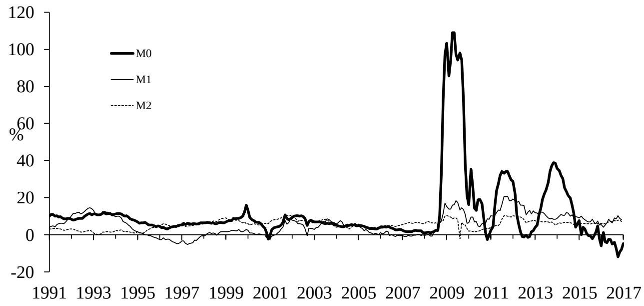
	2014	2015	2016	2017	2018	2019	2020
GDP Growth[1]	2.9	2.2	2.0	2.3	2.5	3.0	3.4
Inflation CPI	1.7	0.2	1.2	1.9	2.6	2.9	2.3
Wage Growth	1.2	2.5	2.8	3.9	5.7	6.2	5.5
Unemployment (Mill.)[2]	1.1	0.8	0.8	0.8	0.8	0.7	0.7
Exchange Rate[3]	87.1	91.6	82.4	78.3	76.6	75.1	73.9
3 Month Interest Rate	0.6	0.6	0.5	0.9	2.0	2.8	3.0
5 Year Interest Rate	1.8	1.3	0.8	1.2	1.5	2.6	3.0
Current Balance (£bn)	–99.9	–103.7	–99.6	–55.8	–42.6	–20.5	–9.9
PSBR (£bn)	83.3	71.2	57.1	43.7	30.3	16.9	3.4

[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)

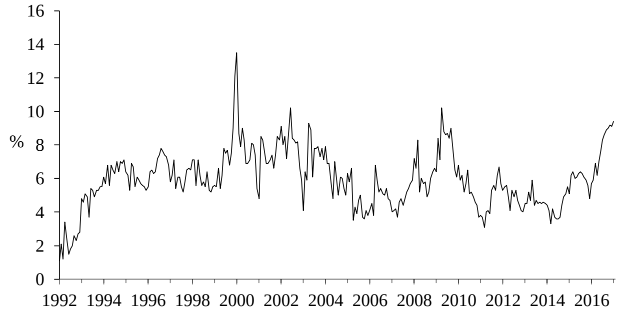
The world economy is already growing somewhat faster. The EU is managing growth in the 1–2% range after a long crisis. The US is creating jobs at a record rate. The beginning of bank deregulation and the unwinding of the Dodd-Frank legislation by the Trump regime will help return banking and credit creation to health. Banks in both the US and the UK have begun to be restored to health after large increases in capital; and credit growth has become stronger. However, the capital requirements against a variety of 'risky' lending continue to prevent proper bank behaviour — as if lending against risky projects were not the essential justification of banking.

As bank deregulation goes forward, we will need to ensure that world monetary policy does not become too expansionary as it did in the noughties. However, that is a problem we do not yet enjoy. For now the outlook for the world economy looks benign. The UK outlook is similar; but with growth strong and the recent inflationary impulse from a large depreciation still working through the economy, monetary policy here will need to tighten.

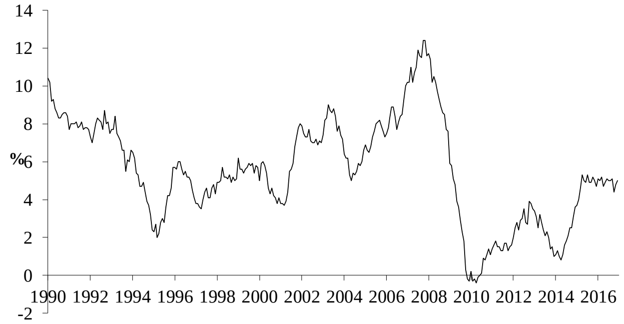
U.S.: Growth in Monetary Aggregates (Yr - on - Yr)



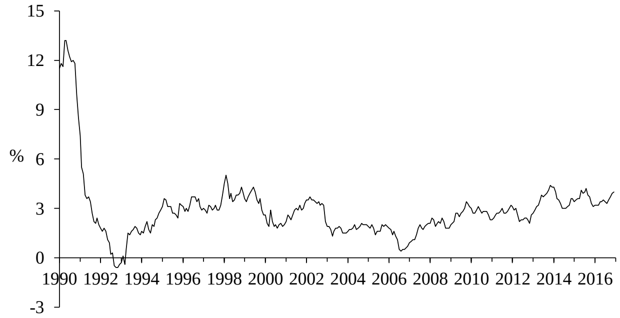
UK: Notes and Coins in Circulation Growth



Eurozone M3 Growth



Japan: Growth of M2+CD's



FOCUS ON JAPAN

Francesco Perugini

Trump's pulling out of TPP complicates Japan's growth options

US President-elect Donald Trump has announced his intention to withdraw from the Trans-Pacific Partnership (TPP). The TPP, the largest regional trade accord in history, would have set new terms for trade and business investment among the US and 11 other Pacific Rim nations — a far-flung group with an annual GDP of nearly $28 trillion that represents roughly 40% percent of global GDP and one-third of world trade. The TPP was the product of years of negotiations that culminated in late 2015 with the endorsement of the 12 nations' trade chiefs. It was a hallmark achievement for President Obama, who had pushed for a US foreign policy "pivot" to the Pacific rim. The goal was to bind Pacific nations closer through lower tariffs while also serving as a buttress against China's growing regional influence.

Within the US supporters said that TPP would have been a boon for all the nations involved — it would "unlock opportunities" and "address vital 21st-century issues within the global economy" — and argued that it was written in a way to encourage more countries, possibly even China, to sign on. Opponents in the US saw the pact as mostly a giveaway to business, encouraging further export of manufacturing jobs to low-wage nations while limiting competition and encouraging higher prices for pharmaceuticals and other high-value products by spreading American standards for patent protections to other countries. According to estimates by Professor John Gilbert of Utah State University and others, the benefits of the TPP to the US are not particularly large: US GDP would only increase by 0.02%. This is because while US agricultural production would increase, production in industries like textiles and automobiles would decline.

But no country fears the consequences of TPP's demise more than Japan. Prime Minister Shinzo Abe viewed the TPP as a way to advance two cherished goals: drawing the US closer to Japan and other friendly Pacific Rim countries and bolstering Japan's lacklustre economy. Abe's signature economic recovery package has had some measure of success, with stimulative monetary and fiscal policies boosting asset prices and consumer confidence. But the so-called third arrow of Abenomics — structural reforms to increase Japan's competitiveness — has stalled. TPP would provide the impetus for implementing those reforms. Such is Abe's enthusiasm for the deal that his government finished ratifying it just before Trump's inauguration, despite Trump's promise to withdraw.

Economists and observers in Japan believe that in addition to strategic and intangible benefits, Japan profits concretely from the TPP for a number of reasons. First of all, regulations over foreign companies entering markets have been relaxed, and this will make it easier for Japanese companies to expand overseas into new opportunities. Second, the auto industry would benefit from a phase-in in the reduction of tariffs on their exports. Also, they would be allowed to buy more parts for their products from Asia, including, significantly, from countries not in the TPP. The "rule of origin" requires only 45% of the vehicle to be made in the TPP zone; in the North America Free Trade Agreement (NAFTA), the equivalent figure is 62.5%. Being able to buy cheaper parts from countries such as China, and then sell vehicles with reduced tariffs to markets such as the US is good for the Japanese auto industry. Third, the lowering of tariffs on farm, dairy, and other goods would help lower the costs of these items to Japanese consumers. Even though tariffs on such farm goods are only reduced and not eliminated, opposition to the TPP could still be rallied by farmers who may see their products being undercut by cheaper imports. Fourth, the completion of the TPP will give Japan leverage to quickly conclude trade agreements with other countries. For example, Japan's negotiations with the EU may be sped up by the EU's desire to not be left out.

Economists at RIETI, a policy think tank based in Tokyo, forecasts Japan's participation in the TPP to increase its real GDP by around 0.8% (or ¥4 trillion), as TPP will lower barriers for trade and investment, thereby increasing export and FDI and, in turn, domestic production.

These are the reasons why the Japanese government has arranged a summit between President Trump and Prime Minister Shinzo Abe in February 10, following Trump's aims to strike a trade deal with Japan directly, rather than through the broader TPP. "Japan will continue to stress to the US the importance of the TPP, but it is not contradictory to hold talks on bilateral agreements," Japanese Prime Minister Shinzo Abe told parliament at the end of January. "The most important thing is to settle down and work on the TPP. We will explain to the Trump administration the strategic and economic value of the trade deal", echoed Hiroshige Seko, the minister of economy, trade and industry.

However, observers believe that the focus will more likely be on bilateral trade deals and how Abe would convince his citizens to buy American cars, a dilemma that has plagued Japanese leaders since the 1980s. Trump said that Japan does "things to us that make it impossible to sell cars in Japan, and yet, they sell cars (in the US) and they come in like by the hundreds of thousands on the biggest ships I've ever seen." He described the situation as "unfair."

Japan has the fourth-largest trade surplus with the US after China, Mexico and Germany. It exported more than 1.6 million vehicles to America in 2015, while the U.S. sold less than 19,000 vehicles to Japan. Japan eliminated all tariffs on auto imports in 1978, but US officials still brought up the issue of non-tariff barriers regarding imported cars. They argued during TPP negotiations that Japan's safety standards constituted such a barrier and asked that US vehicles that meet US safety standards be allowed in. While that request was eventually dropped due to strong resistance from Japan, Washington did get Tokyo to agree to a provision that would allow the US to raise the automobile tariff if Japanese imports rose rapidly. With that as background, a senior bureaucrat in the Ministry of Economy, Trade and Industry said, "There is the possibility of severe requests being made at the very start of bilateral negotiations."

Other officials are concerned about fallout in other trade areas. For example, Japan agreed to a major reduction in tariffs on beef and pork imports during the TPP negotiations. Washington could now demand the total elimination of such tariffs. A high-ranking farm industry official said, "We would never make a concession that goes beyond the TPP."

Abe is in search of ways to increase its political approval, but it seems that such bilateral US-Japan negotiations would likely put renewed pressure on politically vocal farmers and automakers in Japan.

MARKET DEVELOPMENTS

The world economy is improving and the advent of Trump with policies of supply-side renewal via tax cuts and deregulation will usher in yet stronger growth. Interest rates will rise around the world and bond prices will go on falling. The strategy of being long in equities remains correct.

Table 1: Market Developments

	Market Levels Jan 4	Market Levels Feb 6	Prediction for Jan/Feb 2018 Previous Letter	Prediction for Jan/Feb 2018 Current View
Share Indices				
UK (FT 100)	7190	7172	11755	11791
US (S&P 500)	2271	2293	2793	2840
Germany (DAX 30)	11584	11826	17944	18634
Japan (Tokyo New)	1554	1520	2189	2171
Bond Yields (government				
UK	1.34	1.32	1.20	1.20
US	2.45	2.43	2.80	2.80
Germany	0.18	0.37	0.70	0.70
Japan	–0.07	0.10	0.10	0.10
UK Index Linked	–1.64	–1.64	0.10	0.10
Exchange Rates				
UK ($ per £)	1.23	1.24	1.40	1.40
UK (trade weighted)	77.50	77.00	77.30	77.00
US (trade weighted)	108.11	104.01	102.0	102.0
Euro per $	0.95	0.93	0.93	0.93
Euro per £	1.17	1.16	1.30	1.30
Japan (Yen per $)	117.3	112.4	112.0	112.0
Short Term Interest Rates (3-month deposits)				
UK	0.35	0.32	1.00	1.50
US	1.10	1.10	1.30	1.30
Euro	–0.36	–0.38	–0.20	–0.20
Japan	–0.20	–0.10	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	3.60	2.5	2.4	60.00		68.50
US	1.99	2.5	1.5	19.00	–12.49	13.40
Germany	3.30	1.8	1.1	59.00	–12.35	52.85
Japan	1.90	1.2	0.6	41.00	–12.13	32.57
UK indexed[2]	–1.64		1.5	2.00		2.77
Hong Kong[3]	2.60	6.0	1.5	–5.00	–12.49	–7.39
Malaysia	3.30	5.4	1.5	55.00	–12.49	41.71
Singapore	3.50	2.0	1.5	23.00	–12.49	3.51
India	1.40	8.0	1.5	24.00	–12.49	27.41
Korea	1.10	3.0	1.5	–19.00	–12.49	–25.89
Indonesia	2.20	5.2	1.5	31.00	–12.49	26.41
Taiwan	2.80	3.4	1.5	14.00	–12.49	8.21
Thailand	3.20	3.1	1.5	35.00	–12.49	21.31

Bonds: Contribution to £ yield of:

	Redemption Yield	Changing Nominal Rates	Currency	Total
UK	1.32	1.20		2.52
US	2.43	–3.70	–12.49	–13.76
Germany	0.37	–3.30	–12.35	–15.28
Japan	0.10	0.00	–12.13	–12.03

Deposits: Contribution to £ yield of:

	Deposit Yield	Currency	Total
UK	0.32		0.32
US	1.10	–12.49	–11.39
Euro	–0.38	–12.35	–12.73
Japan	–0.10	–12.13	–12.23

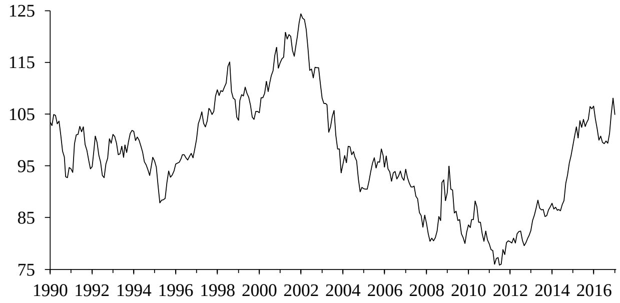
[1] Yields in terms of €s or $s can be computed by adjusting the £-based yields for the expected currency change.
[2] UK index linked bonds All Stocks
[3] Output based on China.

Table 3: Portfolio(%)

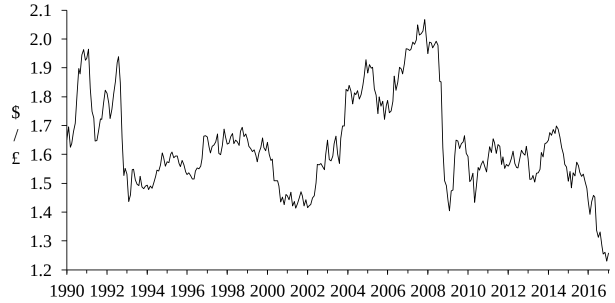
	Sterling Based Investor		Dollar Based Investor		Euro Based Investor	
	January Letter	Current View	January Letter	Current View	January Letter	Current View
UK Deposits (Cash)	5	5	5	5	1	1
US Deposits	-	-	-	-	-	-
Euro Deposits	-	-	-	-	-	-
Japanese Deposits	-	-	-	-	-	-
UK Bonds	-	-	-	-	-	-
US Bonds	-	-	-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

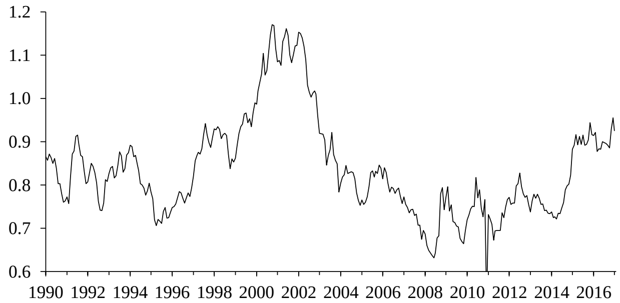
US : Trade Weighted Index
(Bank of England 1990 = 100)



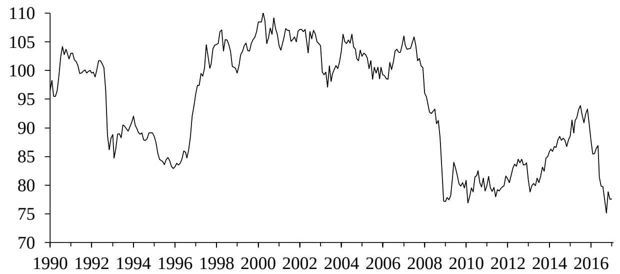
UK: Dollars Per Pound Sterling



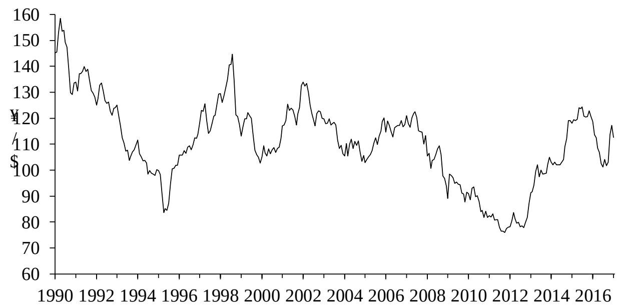
Euro per US dollar



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

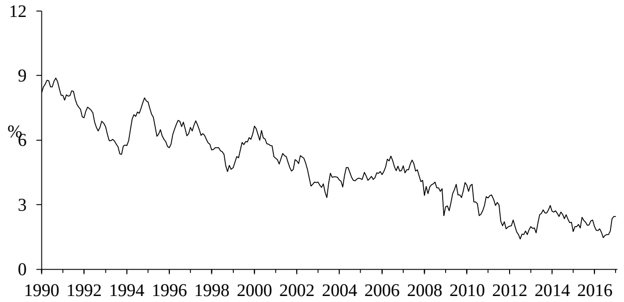


Japan : Yen Per U.S. Dollar

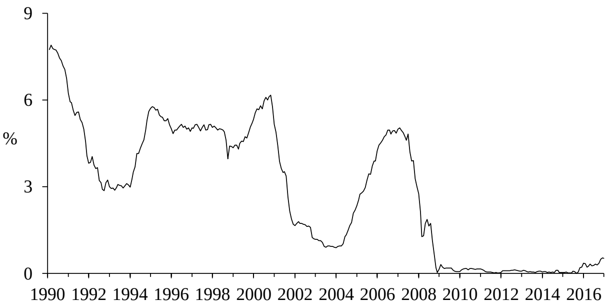


GOVERNMENT BOND MARKETS

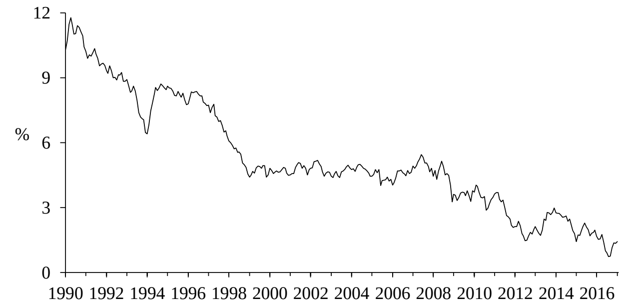
U.S.: Yield on Long-Term Government Bonds



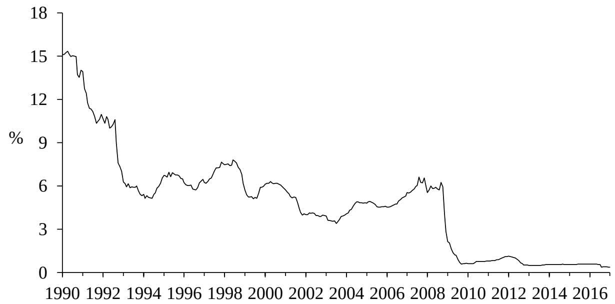
U.S. : 3-Month Treasury Bill



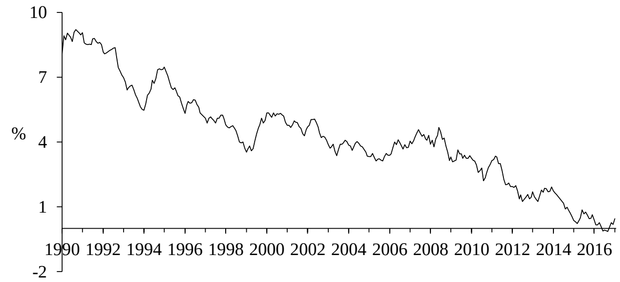
U.K.: Yield on Long-Term Government Bonds



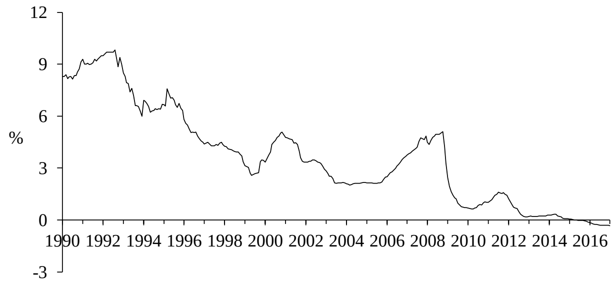
U.K. : 3-Month Interbank Rate



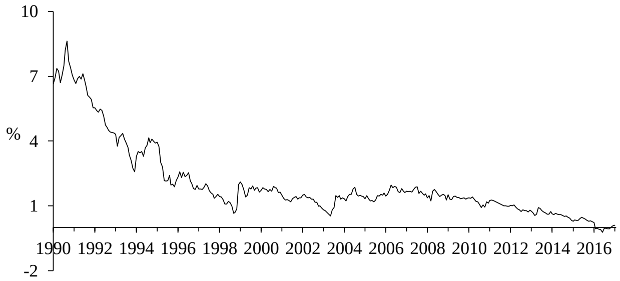
Germany: Yield on Public Authority Bonds



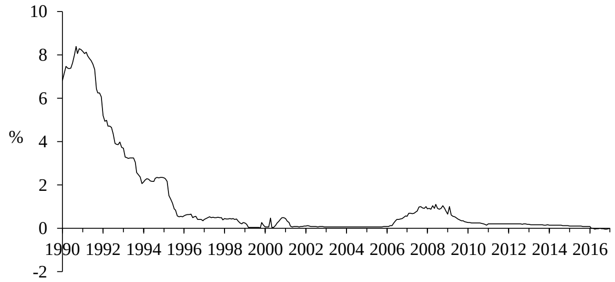
Germany : 3-Month Interbank Deposit Rate



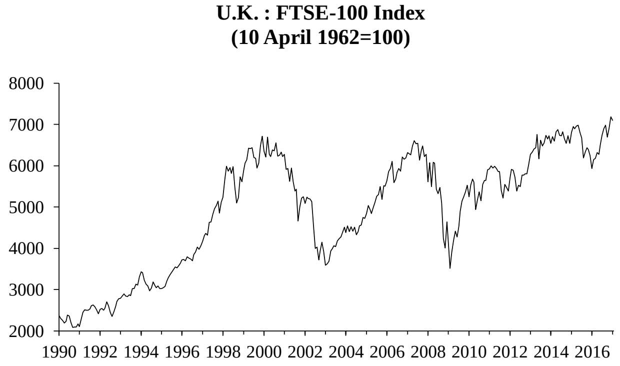
Japan: Yield on Long-Term Government Bonds

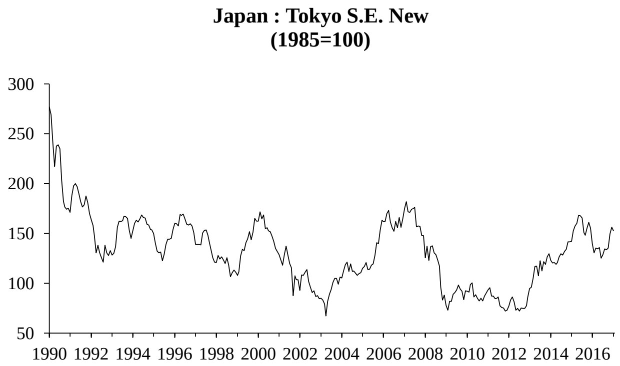


Japan : 3 Month Money Market Rate



MAJOR EQUITY MARKETS





EMERGING MARKETS

Anupam Rastogi

India

The Juggernaut of economic reforms is rolling down. Even before the dust could settle on demonetization of high valued notes in India, the government is ready to implement the country-wide Goods and Services Tax in the country. The debate on demonetization has just disappeared from media and all the talk is about provincial elections where the ruling party is set to achieve substantial gains. This will pave the way for the ruling party to implement some tough economic reforms.

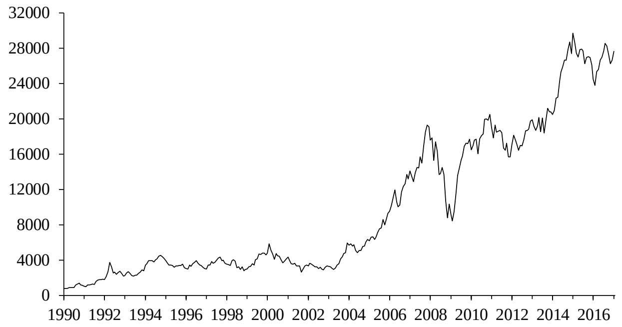
The IMF expects India's 2016 growth to be 7.0% — down from its earlier prediction of 7.6% but still ahead of China's 6.7% growth. The growth projections are in line with the government estimates. India's industrial output grew more than expected in November while inflation slowed to a new 2-year low in December. Output of manufacturing, mining and utilities firms rose 5.7% from a year earlier in November, rebounding strongly from a 1.8% fall in October. The benchmark consumer inflation rate, on the other hand, fell to 3.4% from a year earlier in December, compared with 3.6% in November. As inflation is well within its March 2017 target of 5%, the RBI has room to cut rates by 25 basis points on 8 February.

India is now facing a similar problem to China, in that it has a sizeable market share in the sectors in which it specializes, constraining its attempts to export still more. India's largest export, accounting for a fifth of its merchandise revenues, is petroleum.

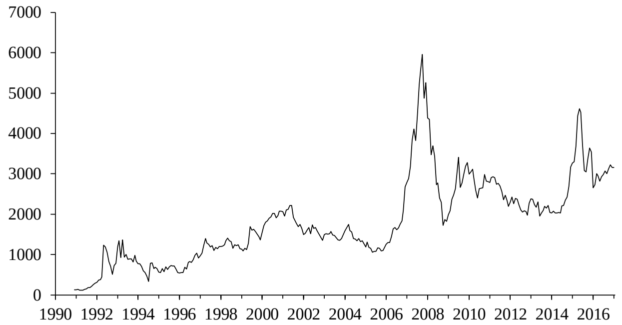
The Union Budget 2017–18 is expected to be quite different from many of the previous ones as it will put an end to various age-old conventions, including a sweeping retreat from the date on which it was presented. The Budget is going to be presented on February 1. Further, incorporation of the Railway Budget into the general Budget, and dropping the distinction between plan and non-plan expenditure for the first time, makes this year's Budget truly different.

It was the first time that the Indian budget was presented on February 1. The budget has tried to boost rural income and has given a big boost to affordable housing. The aim is to provide 10 million home over the next two years. Affordable housing is given the status of infrastructure sector which shall help mortgage companies to access cheaper and long-term funds. The markets have given thumbs up to the budget as it did not have any nasty surprises in terms of tax proposals. Some income tax relief by middle income people has been welcomed. Capital expenditure in transport and power sectors has been welcomed as well. The most notable aspect of the budget was to peg fiscal deficit at 3.2% of GDP and government's overall borrowing will be lower than the last year borrowing. The market expects a rate cut from the central bank in the coming weeks as inflation is well under control and within the RBI's set band.

India: BSE Sensitive



China: SSE Composite Index



We are of the opinion that demonetization and now GST are two huge reforms and that will improve tax compliance and will alter trajectory of India's long-term economic growth prospects.

The Indian stock market has surpassed the level it had before demonetization was declared. Despite a slower economic growth forecast by the government, the markets are on their way of scaling a new high.

	14–15	**15–16**	**16–17**	**17–18**	**18–19**
GDP (%p.a.)	7.3	7.6	6.5	7.5	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	68.2	70.2	72.0

China

China's economic growth rate of 6.8%, in 2016 Q4, reversed a downward trend in quarterly growth figures after more than two years, ensuring the world's second-largest economy hit 6.7% growth in 2016. Notwithstanding, the solid growth fuelled by easy-money policy and massive government spending last year, Chinese economy still faces downward risks.

Industrial financial data released in January 2017 shows that the economy is still growing — but also hints that it could be winding down soon. Profits grew a mere 2.3% on the year in December, sharply down from a three-month high of 14.5% in November. It is not reasonable for China to grow at 6% or 7%, but the government has doubled the amount of debt to GDP over the past five years. The growth could go on for a quarter or two, but there is an end here to this growth pace. We think 5.5% GDP is where China is headed by 2020.

According to the Financial Times, China Consumer Price Index slipped in January as measures of discretionary spending, household income and economic sentiment eased. China's consumer price index rose 2.1% in December from a year earlier compared with 2.3% in November. The producer price index, meanwhile, rose 5.5% last month, compared with November's 3.3%, continuing the inflationary upswing that began in September after being stuck in a deflationary trend for more than four years. For all of 2016, producer prices dropped 1.4% on average from a year ago, while consumer prices rose 2.0%.

Chinese New Year 2017 was celebrated on January 28th, 2017 which should keep consumer prices in uptrend. China's central bank pumped 1.13 trillion yuan (roughly $165 billion) into domestic money markets in the last week of January.

In 2016, the common fear was deflation and a hard landing, now the concerns are inflation and financial risks. We expect consumer inflation to average 2.2% in 2017.

China has announced plans to restructure the economy to avoid the middle-income trap, in which fast-growing economies fail to make the transition from low-cost, export-led manufacturing to domestic consumption and services. New drivers of growth Beijing wants to nurture — consumption, high-tech and advanced manufacturing — still aren't large enough or growing fast enough to compensate for a downturn in cement, steel and the other heavy industries that have powered the economy for years. Incidentally, growth of domestic consumption accounted for 64.6% of economic growth in 2016. But, growth in consumption decelerated to 10.4% year on year in 2016, from 10.7% in 2015.

Exports slipped 6.1% in December from a year earlier compared with a 0.1% gain in November. Imports in December rose 3.1% from a year earlier, roughly in line with expectations, compared with a 6.7% gain in November. China's trade surplus narrowed last month more than expected to $40.8 billion from $44.6 billion in November. Overall in 2016, exports fell 7.7% and imports declined 5.5%, resulting in an annual trade surplus of $510 billion, below the $594.5 billion trade surplus in 2015.

Beijing has allowed China's currency to fall against the dollar — it depreciated 7% last year — but the yuan appreciated 1% in 2016 against a trade-weighted basket of currencies. China's foreign-currency reserves shrank by $350 billion in 2016 and are now one quarter below their June 2014 peak of $3.99 trillion. The People's Bank of China sold a net 317.80 billion yuan ($46.05 billion) of foreign exchange last month to support yuan. As long as capital controls remain in place, the IMF estimates that $1.8trn would be an adequate amount of reserves for China. This is sometimes presented as the minimum that China needs.

China's State Council, or cabinet, gave its backing to earlier pledges to open up more of the country's economy to foreign investors as foreign investment into the country slows. The government will give foreign investors easier access to the country's services, manufacturing and mining sectors.

Chinese President Xi Jinping offered a full-throated defence of economic globalization at a time of global uncertainty fuelled by Britain's decision to leave the European Union and the U.S. election victory of Donald Trump. In a speech at the World Economic Forum in Davos, Switzerland, Mr. Xi said, "Some people blame economic globalization for the chaos in our world." Mr. Xi dismissed that idea and said the international financial crisis of 2008 wasn't an inevitable outcome of economic globalization. Rather, it was the consequence of excessive profit chasing and the "grave failure of financial regulation." Mr. Xi sought to present China as the new champion of free trade and investment.

By scrapping the Trans-Pacific Partnership, Mr. Trump has given opportunity to China to become the leader of trade expansion in the world's fastest-growing region.

Trump's tough talk on hitting China with tariffs and naming it a currency manipulator looms as a risk to investors in China. More than China, South Korea, Japan and Taiwan would be hurt more as they are the largest trading partners of China.

China is treating Mr. Trump as a heaven-sent opportunity. China is prepared to take the helm of the global economy "if it's necessary." China is prepared to take the helm of the global economy if Western nations abdicate their leadership role, a top Chinese diplomat said, days after new U.S. President Donald Trump pledged in his inaugural speech to put "America first" during his presidency. A stream of commentary in Chinese state media has since sought to portray Mr. Xi as an internationalist and China as the new standard-bearer for free trade.

	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	7.2	7.4

South Korea

For the full year, the South Korean economy grew 2.7% in 2016, compared with 2.6% in 2015 and 3.3% in 2014. Gross domestic product expanded a seasonally adjusted 0.4% in the fourth quarter from the previous three months as private consumption turned weaker and construction investment shrank despite the gains in facility investment. Consumer sentiment has been hit by political confusion stemming from the impeachment of President Park Geun-hye, who is awaiting a Constitutional Court decision on the matter. Korea's central bank expects GDP to grow 2.5% in 2017, slower than a previous estimate of 2.8%.

Korea's exports are showing some signs of strengthening but the US, turning protectionist under the administration of Donald Trump, may limit growth in external demand over the coming quarters. In fact, any trade war between China and the US is going to impact South Korea more than China itself. About half of Korea's growth comes from exports.

The U.S. decision to pull out of the Trans-Pacific Partnership won't directly affect South Korea, which wasn't part of the 12-nation trade pact, but Mr. Trump has also denounced the U.S.-Korea free trade deal as it is depriving Americans of jobs.

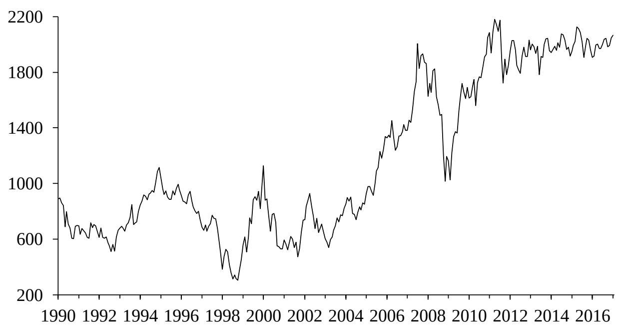
The country's benchmark stock market has climbed to an 18-month high. Foreigners have poured $1 billion into Korean stocks already this year. The Korean won has been the second-best performing currency in the world so far in 2017, behind the Russian ruble.

To investors, South Korean stocks look cheap, and they hope that South Korea is poised to benefit from a recovering global economy. South Korean stocks are trading at much lower valuations than their counterparts in Taiwan, whose companies compete in many of the same industries.

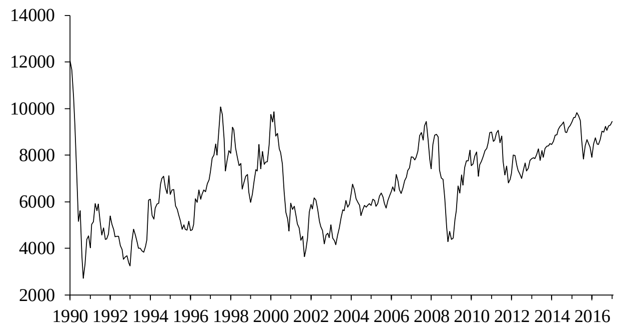
Some money managers are optimistic that the current political crisis could also pave the way for more governance reforms at the country's sprawling conglomerates, known as chaebols, which could result in higher dividends and more transparency. But, they also worry that the prosecutor will fail to convince Korea's Constitutional Court to uphold the impeachment and force out of office a President who steadfastly maintains her innocence. Korea's highest and highly cautious court has never yet upheld a presidential impeachment and its justices will want incontrovertible proof to do so.

If it reaches a verdict to oust Ms Park before the expected mid-March timeline, that would lead to snap presidential elections in May and favour current frontrunner Moon Jae-in, former chair of the opposition Minjoo party and the most conservative of the contenders. But if the court delays until early June (its deadline), that would perhaps give former UN Secretary-General Ban Ki-moon, who has just returned to Korea, time to assemble a large-enough coalition to mount a proper challenge. Backed by centre-left and anti-Park MPs, Mr Ban is likely to be more radical. That will boost innovation, employment and growth and can only be good for Korea and Korean financial assets.

Korea: Composite Index



Taiwan: Weighted TAIEX Price Index



	14	15	16	17	18
GDP (%p.a.)	3.3	2.6	2.5	2.5	2.5
Inflation (%p.a.)	2.0	0.7	1.0	1.6	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 in the last quarter of 2016 came below expectations despite continued improvement by export-driven manufacturing. GDP rose 2.6% year-on-year in the fourth quarter that brought GDP growth for the whole of 2016 to 1.4%, roughly double the rate achieved in 2015.

Private sector consumption growth almost halved to 1.27% as public sector consumption contracted 1.09%.

Taiwan's trade trends in December were better than expected. Due to the output of expansion of semiconductor, basic metal and chemical material products and an increase in exports, the trade balance was positive. Exports grew 14% year on year in December to $25.7bn, almost 2 percentage points better than expected. The growth brought exports for the full year to $280.4bn. The annual imports was $230.9bn and made for the annual import contraction of 2.6%.

With the call and other statements made by Mr. Trump, he showed a willingness to break with decades of convention and confront Beijing over its policy of politically isolating the rival government in Taiwan. However, Taiwanese fear the new U.S. administration will use the island as a bargaining chip with China. China has over the past year stepped up pressure on Ms. Tsai's government to be more accommodating to its interests. China has already cut a formal communications channel with Taiwan.

	14	**15**	**16**	**17**	**18**
GDP (%p.a.)	3.7	0.8	1.5	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

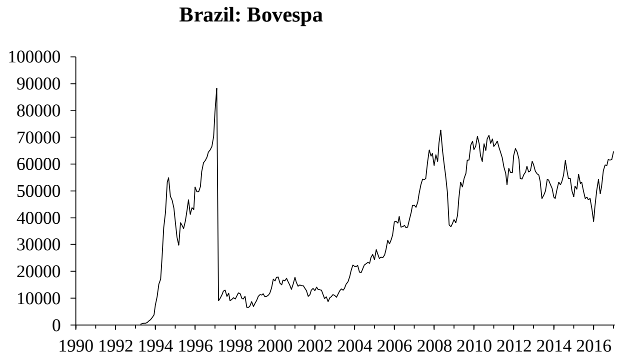
Brazil

The economic data is not very encouraging as far as growth is concerned. A high degree of idle capacity remains in the economy and evidence suggests that the recovery in economic activity will be slower and more gradual than previously anticipated. Unemployment continues to rise as the formal sector continues to shed jobs. We expect economy to expand a meagre 0.5% in 2017 and 1.5%. Unemployment, now at 12%, is likely to keep growing this year.

Brazil's retail sales increased in November as Brazilians made purchases for the year-end holiday season, taking advantage of discounts implemented by retailers. Sales picked up 2% in November from October in seasonally adjusted terms.

As growth remains anaemic, inflation rate in 2017, as measured by the consumer price index, is expected to end marginally lower than 5%. In 2016, the rate of inflation ended at 6.3%.

The central bank's monetary committee, known as the Copom, cut the benchmark Selic rate to 13% from 13.75%, in mid-January, a larger cut than most economists expected. The bank's two previous rate cuts in this easing cycle were a quarter point each. The bank said that inflation is slowing more quickly than expected, a change that is "compatible" with faster monetary easing. The faster pace of easing comes as the inflation rate has moved closer to the central bank's 4.5% target.



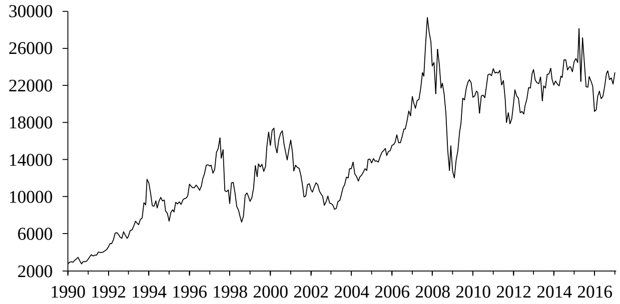
Brazil's central bank has expressed concern about the country's weak economy. They may go for a faster monetary easing as inflation is within their target. The bank expects Brazil to post a $46 billion trade surplus in 2017.

Markets, however, expect economy to turn around quickly. The Bovespa equities index is up more than 9% this year, while the currency has gained about 3.5% against the dollar. Last year, as the economy tanked, Brazilian stocks outperformed emerging markets as a whole by 55%, according to MSCI index. The impeachment of leftist President, Dilma Rousseff, and her replacement in August with pro-business, former Vice-President Michel Temer, gave optimism among market participants. But now, some fear that the rally is running on fumes.

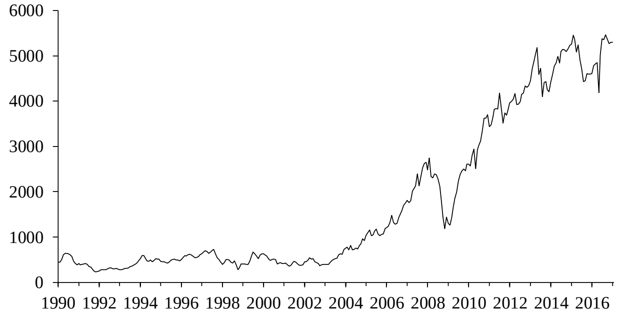
	14	**15**	**16**	**17**	**18**
GDP (%p.a.)	0.1	-3.8	-3.2	1.0	1.5
Inflation (%p.a.)	6.5	10.3	6.4	5.0	5.0
Current A/c(US$ bill.)	-104.0	-70.0	-28.0	-25.0	-25.0
Real/$(nom.)	2.4	3.9	3.5	3.4	3.2

Other Emerging Markets

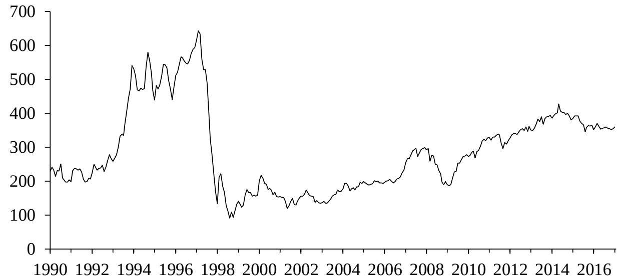
Hong Kong: FT-Actuaries



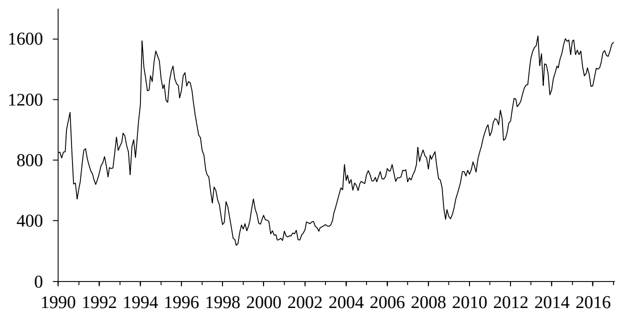
Indonesia: Jakarta Composite



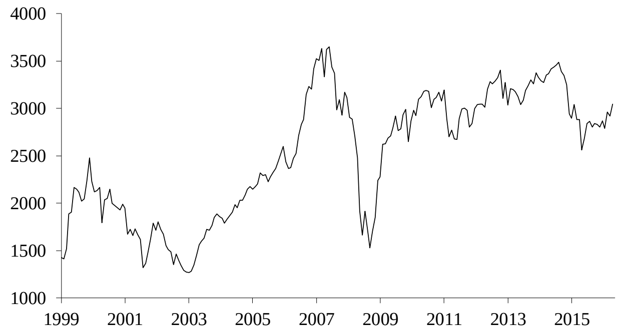
Malaysia: FT-Actuaries (US$ Index)



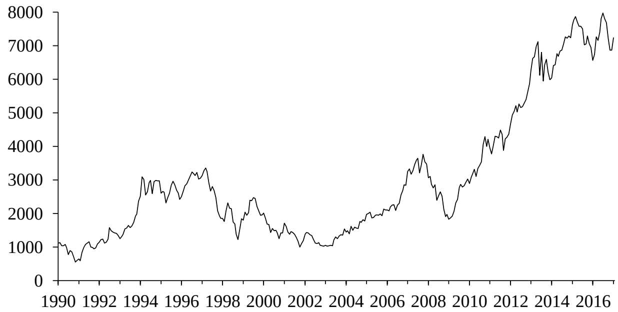
Thailand: Composite Index



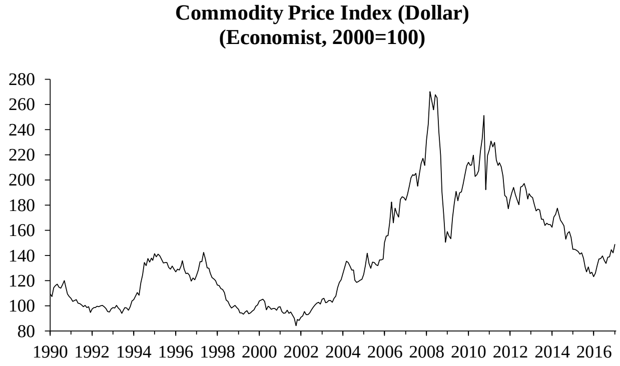
Singapore: Straits Times Index

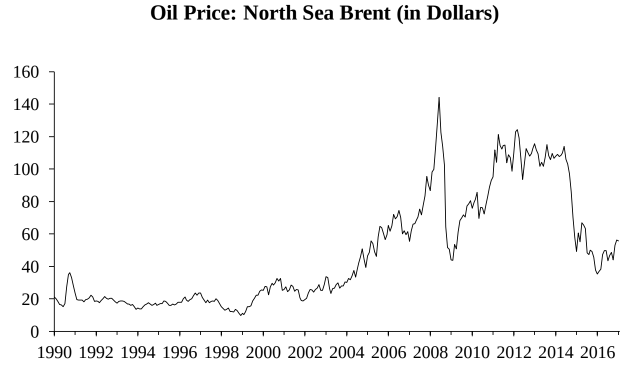


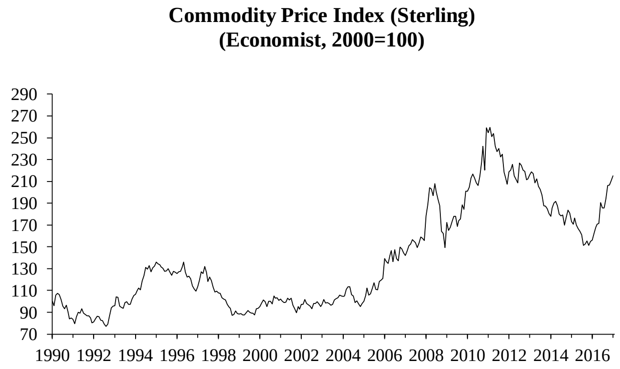
Philippines: Manila Composite

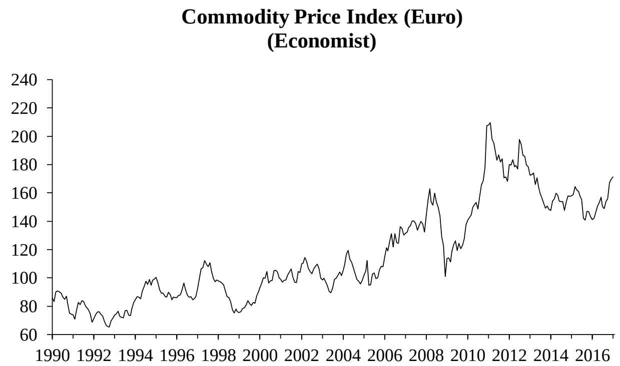


COMMODITY MARKETS









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	0.4	1.0	-1.0
2016	1.2	0.8	0.5	82.4	81.1	-1.1	1.9	-1.5
2017	1.9	1.2	0.9	78.3	76.5	-1.8	2.6	-1.2
2018	2.6	1.5	2.0	76.6	75.2	-0.9	3.2	-0.9
2019	2.9	2.6	2.8	75.1	74.7	0.5	3.5	0.5
2020	2.3	3.0	3.0	73.9	74.5	1.0	3.5	1.0
2016:1	0.6	0.9	0.7	87.2	87.1	-0.2	1.4	-1.3
2016:2	0.9	0.8	0.7	85.6	84.6	-0.8	1.6	-1.5
2016:3	1.4	0.6	0.4	78.9	76.6	-1.5	2.0	-1.7
2016:4	1.8	0.9	0.3	78.0	75.9	-1.8	2.5	-1.4
2017:1	1.8	1.0	0.5	79.2	77.5	-1.9	2.5	-1.4
2017:2	1.8	1.2	0.5	79.3	77.5	-2.0	2.5	-1.2
2017:3	1.9	1.2	1.0	77.6	75.4	-1.8	2.6	-1.2
2017:4	2.1	1.2	1.5	77.1	75.5	-1.3	2.8	-1.2
2018:1	2.4	1.3	1.5	77.0	75.5	-1.5	3.0	-1.1
2018:2	2.4	1.5	2.0	77.2	75.5	-1.0	3.0	-0.9
2018:3	2.8	1.5	2.0	75.9	74.6	-0.8	3.3	-0.8
2018:4	2.8	1.5	2.5	76.2	75.4	-0.3	3.3	-0.8

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	247.3	2.5	2.3	0.8	141.2
2016	254.2	2.8	2.2	0.77	143.5
2017	264.0	3.9	2.2	0.78	146.3
2018	279.0	5.7	2.1	0.75	150.8
2019	296.3	6.2	2.0	0.73	155.6
2020	312.5	5.5	1.9	0.72	159.5
2016:1	252.0	2.1	2.1	0.74	143.1
2016:2	252.1	2.5	2.2	0.77	142.9
2016:3	254.4	2.4	2.2	0.79	143.5
2016:4	258.2	4.1	2.2	0.78	144.5
2017:1	261.2	3.7	2.2	0.78	145.7
2017:2	260.1	3.2	2.2	0.79	144.9
2017:3	264.7	4.0	2.2	0.78	146.5
2017:4	270.1	4.6	2.2	0.78	148.1
2018:1	273.6	4.7	2.1	0.77	149.1
2018:2	276.1	6.1	2.1	0.76	150.2
2018:3	280.8	6.1	2.1	0.75	151.4
2018:4	285.7	5.8	2.0	0.74	152.5

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	156.5	749593.1	430478.9	302953.3	196562.0	-50539.3	129861.8
2016	159.7	764884.7	440989.7	291942.7	198146.5	-50493.6	115700.9
2017	163.4	782270.2	458510.3	271594.3	201835.6	-31228.2	118441.5
2018	167.4	801747.2	469801.9	270784.6	205872.3	-23275.3	121434.6
2019	172.4	825316.6	481547.0	269609.6	209989.8	-11175.3	125137.9
2020	178.2	853470.1	493585.6	281097.0	214189.6	-5675.3	129723.2
2015/14	2.2		1.4	4.0	1.0		1.3
2016/15	2.0		2.4	-3.6	0.8		-10.8
2017/16	2.3		4.0	-6.8	1.9		2.4
2018/17	2.5		2.5	-0.3	2.0		2.5
2019/18	3.0		2.5	-0.4	2.0		3.1
2020/19	3.4		2.5	4.3	2.0		3.7
2016:1	158.3	189484.5	108439.3	72922.4	50700.0	-13273.4	29303.9
2016:2	159.3	190701.5	109534.3	74622.5	48658.8	-12532.0	29582.1
2016:3	160.2	191772.1	110077.5	75935.4	49283.1	-15879.9	27643.9
2016:4	161.1	192926.6	112938.5	68462.4	49504.7	-8808.3	29171.0
2017:1	162.0	193975.7	113610.1	65697.2	52080.7	-7810.2	29602.1
2017:2	162.8	194936.9	114285.7	68754.0	49227.3	-7808.3	29521.9
2017:3	163.8	196090.5	114965.4	68406.0	50032.9	-7808.4	29505.3
2017:4	164.8	197267.1	115649.0	68737.0	50494.7	-7801.3	29812.3
2018:1	166.0	198778.8	116365.2	65511.1	53122.3	-6097.5	30122.2
2018:2	167.1	200001.7	117085.7	68792.4	50211.8	-5798.5	30289.0
2018:3	167.6	200680.2	117810.8	67504.2	51033.6	-5290.7	30377.1
2018:4	169.0	202286.5	118540.3	68976.9	51504.6	-6088.6	30646.2

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	3.6	1576.1	57.1	52.0	-99.6
2017	2.7	1646.3	43.7	55.8	-55.8
2018	1.7	1738.2	30.3	62.2	-42.6
2019	0.9	1842.5	16.9	68.0	-20.5
2020	0.2	1460.0	3.4	52.9	-9.9
2016:1	0.2	385.4	0.6	13.1	-24.4
2016:2	5.7	388.7	22.3	13.1	-22.8
2016:3	4.3	389.1	16.8	12.9	-26.4
2016:4	5.4	397.2	21.5	12.9	-26.0
2017:1	-0.9	401.0	-3.5	13.2	-15.8
2017:2	4.4	403.3	17.8	13.2	-15.3
2017:3	3.8	407.7	15.7	13.8	-12.1
2017:4	4.3	414.7	17.8	14.4	-12.6
2018:1	-1.8	420.6	-7.6	14.5	-13.1
2018:2	3.1	423.8	13.3	15.0	-12.0
2018:3	4.1	429.5	17.7	15.2	-7.7
2018:4	2.4	437.5	10.7	15.9	-9.8

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	2.0	2.3	2.5
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	1.9	2.6
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	0.4	–1.1	–1.8	–0.9
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	0.5	0.9	2.0
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	–1.5	–1.2	–0.9
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	0.8	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	81.1	76.5	75.2
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]	85.61	89.04	103.08	101.91	102.20	102.40
U.K.	1.55	1.65	1.53	1.35	1.27	1.26
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