LIVERPOOL INVESTMENT LETTER

May 2017

Cardiff Business School
Ysgol Busnes Caerdydd

Julian Hodge Institute of Applied Macroeconomics

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LIVERPOOL RESEARCH GROUP IN MACROECONOMICS

LIVERPOOL RESEARCH GROUP IN MACROECONOMICS

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The Julian Hodge Institute was launched in autumn 1999 in a new collabouration 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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UK growth continues steadily under the impact of the Brexit devaluation. This is boosting net exports, somewhat at the expense of consumption; but this is necessary as the UK prepares to expand its output and its markets beyond the EU, besides correcting a large prior current account deficit. Investment growth will only kick in as capacity is filled up: so far employment has run ahead strongly as the flexible labour market has priced people into jobs.

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THE ECONOMY AFTER THE BREXIT DEVALUATION

The sharp devaluation that followed Brexit was a response in some degree to uncertainty but mainly to the need to penetrate new markets in order to sell more goods.

The uncertainty concerns policy on many aspects of the economy which after Brexit will be determined by the relatively unknown preferences of the UK government instead of the well-known ones of the EU. Nevertheless as Mrs. May's government has got more and more into the saddle it has become clear that it will pursue free trade abroad and be rather sensitive to worker needs at home — a mixture that is easy for markets to appreciate. The uncertainty now arises most from what exactly the EU is up to. Until negotiations get under way we will remain in the dark on this. Even so, as we have argued before, the UK is in a strong position to have no agreement with the EU and still pursue free trade. This policy will boost consumer welfare, competition and growth. Most indicators now suggest that companies, workers and markets are all rather calm about any remaining uncertainty.

The main reason for devaluation was the need to penetrate new markets in the medium term for various reasons. First, productivity will rise and more goods and services produced; these must be sold. Second, there may well be some protectionist action from the EU which will reduce EU demand for UK products; this will need to be diverted to new markets. Third, there is the existing current account deficit which needs correcting and since this is on top of the first two factors, it has swum into focus after some years of neglect. Fourth, this deficit will worsen in the short run as free trade policies lower import barriers and so encourage imports.

All four factors point to the need to make UK products more attractive worldwide to generate bigger export sales. In our longterm trade model we forecast this as happening without any need for export prices to fall in the long run, because world markets are highly competitive and in principle will easily absorb the extra UK supply of exports; so in the long run we expect the exchange rate to revert to its previous level. Nevertheless in the short and medium term there has to be a factor pushing open this door; this is the exchange rate. It is playing its necessary role in the UK economy as vigorously as ever.

All the evidence from recent indicators tells us that the devaluation has indeed stimulated the economy substantially. A 15% devaluation is the external equivalent of a 15% surge in the money supply: indeed the two things should accompany each other over time. It is a strong monetary stimulus which works through the external channel in the first instance: whereas a monetary stimulus in the form of lower interest rates and more money printing works through the domestic spending channel.

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)

We are seeing strong CBI export survey returns and also strong Purchasing Managers Index reports in all sectors. Thus demand is coming from exports and from import substitution, and the domestic consumption component that was strong in 2016 is weaker in 2017, again a result of devaluation which transfers income from consumer pockets into corporate profits. Given that we wish to divert output into export markets and away from imports we should expect this pattern of demand and supply. Output growth remains strong; even if the first quarter may have slowed a bit. April surveys suggest the second quarter will be stronger and also we expect some upward revision of the first quarter as more data comes in on net exports.

Some ink has been spilt on the sluggishness of investment. But this is not surprising as capacity is under used; until capacity is used up, there will be little pressure to invest. Since the financial crisis the labour market has picked up fast, with people pushing to get jobs and forcing employment upwards. We have a flexible labour market and this has shown itself in the form of real wages falling during the crisis and staying low since. This in turn has produced poor productivity figures: but these need to be seen as the other side of the labour flexibility coin. As is now well known, productivity is in any case poorly measured in an economy dominated by services and new goods such as smart phones; price measures simply do not allow properly for quality from the new consumption possibilities.

In our forecast for the UK we see continued steady growth, with demand shifting more towards net exports. Investment growth will wait until current capacity is absorbed. Monetary policy will remain relatively easy but we have long argued that interest rates need to be raised to allow money markets to work properly, without the discrimination against savers that we have been seeing since the crisis.

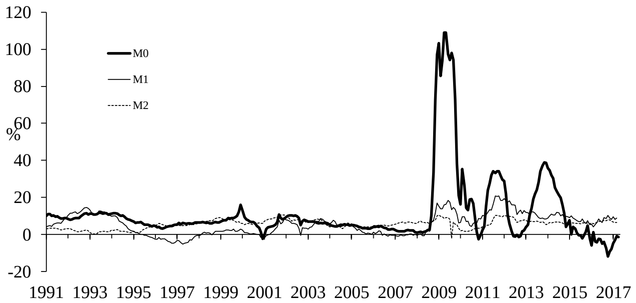
Fortunately in the US growth continues to be steady, with the first quarter's sluggishness a regular feature suggesting something is wrong with the seasonal adjustment. A taxcut package is likely in due course as the Republicans reach some consensus on its shape and on the repeal of Obamacare. Meanwhile President Trump is busy repealing a large swathe of regulations passed under President Obama.

Among them are the Dodd-Frank regulations of banking which continue to cramp bank lending and money growth.

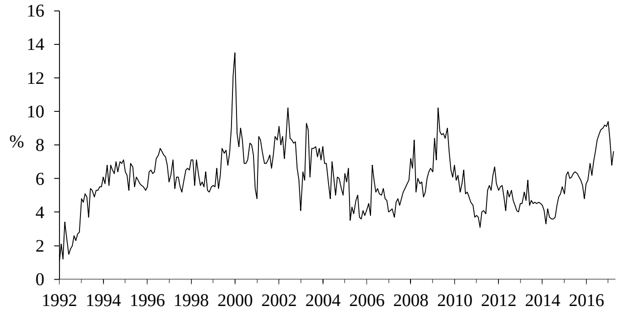
The Fed is continuing to raise interest rates which suggests that we will be seeing some normalisation of money markets over the next two years.

As we have argued before the continued excess capacity in raw material supply will keep raw material prices down and this bids fair to maintain a good growth climate for the next decade.

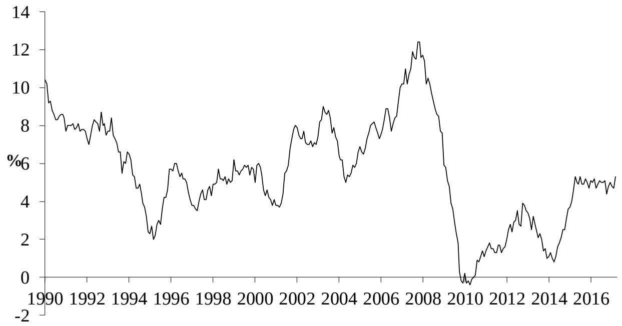
U.S.: Growth in Monetary Aggregates (Yr - on - Yr)



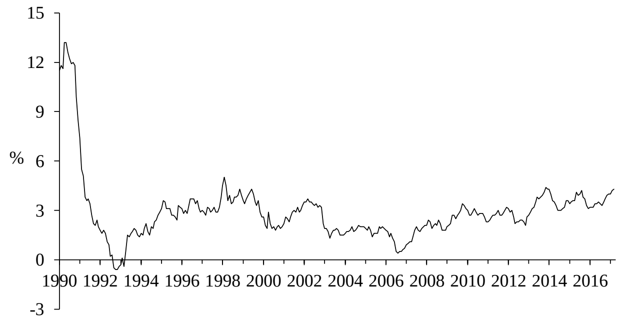
UK: Notes and Coins in Circulation Growth



Eurozone M3 Growth



Japan: Growth of M2+CD's



FOCUS ON JAPAN

Francesco Perugini

An Action Plan for Japan employment system

Over the last several months Prime Minister Shinzo Abe held meetings of the "Council for the Realization of Work Style Reform" to discuss reforms to Japan's labour law system with experts from both the management and labour sides. At the latest meeting held on March 28, 2017, the "Action Plan for the Realization of Work Style Reform" ("Action Plan") was approved. The Action Plan covers a broad range of topics including wage increases, the promotion of side jobs, and re-employment support for women. The most noteworthy elements of the Action Plan, are the introduction of the Overtime Work Regulation with Punishment and equal pay for equal work.

The proposed reforms also includes calls for the introduction of a more flexible work environment such as teleworking, measures to support people working while raising children or caring for ailing relatives, and the promotion of elderly people's participation in the labour market. Legislative steps to be based on the action plan, including an amendment to the Labour Standards Law, will be compiled and submitted to the Diet by the year's end, so that some of the steps will take effect in early 2019.

According to observers the Action Plan includes measures and steps in the right direction, but much more needs to be done by all parties involved to make sure that the conditions of irregular workers are effectively improved and the chronically long working hours of company employees are significantly curbed. Many of the planned government steps included in the plan will only provide bare minimum standards, and a lot is left up to the efforts by individual businesses and their unions to substantially correct long-standing labour problems. The government needs to take further measures to facilitate such efforts by companies and their workers, and should be ready to constantly review the steps if necessary, economists believe.

But the key features of the plan are the legal cap on overtime hours, which Prime Minister Shinzo Abe has sought as a crucial step to reduce the working hours of corporate employees, and the measures to realize Abe's stated drive for the introduction of an "equal work, equal pay" principle.

The total annual working hours of full-scale corporate employees, including overtime, has remained nearly flat at over 2,000 hours on average for the past 20 years, and efforts to curb overtime hours are seen as crucial to reducing the overall work hours of employees. The issue took an urgent note as the deaths and suicides of overworked company employees came under renewed spotlight following the 2015 case of a 24-year-old employee at Dentsu Inc. who killed herself after suffering from depression — and revelations that illegal overtime practices were rampant even in a blue-chip company like the nation's top advertisement agency.

The plan calls for amending the Labour Standards Law to set legal limits on overtime hours, with penalties on violators. That in itself is progress, given that the current labour laws effectively set no ceiling on workers' monthly overtime hours. The problem is that the proposed cap — up to 45 hours a month and 360 hours annually in principle — can be extended to just shy of 100 hours a month during a busy period and 80 hours on average if the period stretches over two to six months, within a total of 720 hours a year. That is almost equal to the Health, Labour and Welfare Ministry criteria linking workers' fatal heart and brain diseases to overwork under the labour accident compensation scheme. There is already criticism that the proposed cap can be taken as the government's endorsement of excessively long overtime hours that could endanger workers' health.

Under the plan, the overtime cap will be reviewed in five years. But economists believe that the government should not wait that long to introduce more stringent rules that will effectively reduce the work hours of corporate employees.

The action plan also incorporated a guideline spelled out by the administration in December to eliminate "irrational" disparities in wages and other conditions between regular full-time employees and workers on irregular contracts who engage in the same work. The steep wage gap has become an increasingly serious problem as people on irregular statuses such as part-timers, term-contract workers and temporary dispatch staff have come to account for about 40% of the nation's workforce. Workers on irregular contracts earn roughly 60% of the hourly wages of their regular full-time counterparts, and the government seeks to narrow the gap to about 80%.

Overall, observers think that the Action Plan is set to prove painful for many companies, with half saying labour costs will rise and two-thirds considering ways to lift productivity to offset the impact of the reforms. Moreover, the impact of Japan's labour shortage is already pressuring earnings at some firms, and at others, management has found it no longer has the bargaining power it used to have as failure to reward employees sufficiently can result in less staff.

Labour shortages ultimately limit growth and increase costs. Now, as Japanese companies face a looming demographic crisis, their focus will need to shift away from competing on price to enhancing productivity, improving profit margins and creating new product categories. Japan's labour shortage is structural in nature, and the working population is set to continue shrinking over the coming years, so companies and policymakers will need to find a solution to the depleting workforce, and promote sustainable and fast economic growth.

The Abe proposals are well-intentioned but clearly they will add to labour shortages and costs. They seem to be motivated more by a paternal approach to health and safety than by the desire to promote labour market flexibility. Breaking up company restrictive practices and discriminatory policies can best be done by introducing far more competition into home product markets; this the Abe government has been unwilling to do.

MARKET DEVELOPMENTS

Trump's and the Republicans' plans for tax cuts have been delayed by Congressional wrangling. But they will come through in some shape or form before too long. They promise to generate more momentum as meanwhile do reductions in regulation which can be carried out by presidential fiat. The Fed is continuing to raise interest rates. With bank regulation being eased we should be seeing a gradual normalisation of monetary conditions.

Table 1: Market Developments

	Market Levels Apr 6	Market Levels May 5	Prediction for Apr/May 2018 Previous Letter	Prediction for Apr/May 2018 Current View
Share Indices				
UK (FT 100)	7303	7297	12043	12033
US (S&P 500)	2357	2399	2921	2973
Germany (DAX 30)	12231	12717	19802	20589
Japan (Tokyo New)	1480	1550	2114	2214
Bond Yields (government				
UK	1.18	1.20	1.20	1.20
US	2.36	2.35	2.80	2.80
Germany	0.26	0.42	0.70	0.70
Japan	0.06	0.02	0.10	0.10
UK Index Linked	−1.84	−1.66	0.10	0.10
Exchange Rates				
UK ($ per £)	1.25	1.30	1.40	1.40
UK (trade weighted)	77.51	79.13	77.00	77.00
US (trade weighted)	105.00	104.84	102.0	102.0
Euro per $	0.94	0.91	0.93	0.93
Euro per £	1.17	1.18	1.30	1.30
Japan (Yen per $)	110.9	112.6	112.0	112.0
Short Term Interest Rates (3-month deposits)				
UK	0.30	0.30	1.50	1.50
US	1.25	1.15	1.30	1.30
Euro	−0.39	−0.40	−0.20	−0.20
Japan	−0.05	−0.05	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	−8.02	17.87
Germany	3.30	1.8	1.1	59.00	−10.39	54.81
Japan	1.90	1.2	0.6	41.00	−7.42	37.28
UK indexed[2]	−1.66		1.5	2.00		2.74
Hong Kong[3]	2.60	6.0	1.5	−5.00	−8.02	−2.92
Malaysia	3.30	5.4	1.5	45.00	−8.02	46.18
Singapore	3.50	2.0	1.5	9.00	−8.02	7.98
India	1.40	8.0	1.5	29.00	−8.02	31.88
Korea	1.10	3.0	1.5	−19.00	−8.02	−21.42
Indonesia	2.20	5.2	1.5	30.00	−8.02	30.88
Taiwan	2.80	3.4	1.5	13.00	−8.02	12.68
Thailand	3.20	3.1	1.5	26.00	−8.02	25.78

Bonds: Contribution to £ yield of:

	Redemption Yield	Changing Nominal Rates	Currency	Total
UK	1.20	0.00		1.20
US	2.35	−4.50	−8.02	−10.17
Germany	0.42	−2.80	−10.39	−12.77
Japan	0.02	−0.80	−7.42	−8.20

Deposits: Contribution to £ yield of:

	Deposit Yield	Currency	Total
UK	0.30		0.30
US	1.15	−8.02	−6.87
Euro	−0.40	−10.39	−12.77
Japan	−0.05	−7.42	−8.20

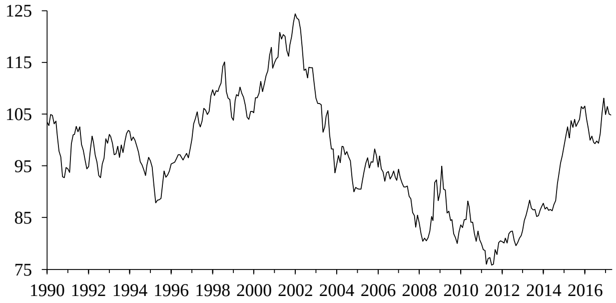
[1] Yields in terms of €s or $s can be computed by adjusting the £-based yields for the expected currency change.
[2] UK index linked bonds All Stocks
[3] Output based on China.

Table 3: Portfolio(%)

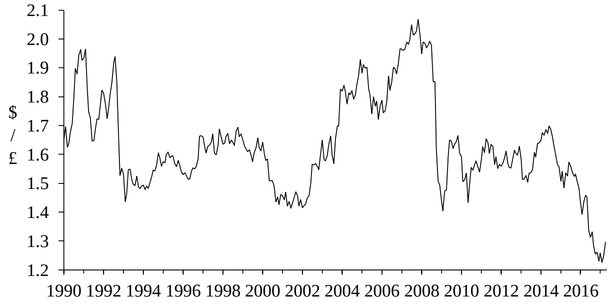
	Sterling Based Investor		Dollar Based Investor		Euro Based Investor	
	April Letter	Current View	April Letter	Current View	April Letter	Current View
UK Deposits (Cash)	5	5	5	5	1	1
US Deposits	-	-	-	-	-	-
Euro Deposits	-	-	-	-	-	-
Japanese Deposits	-	-	-	-	-	-
UK Bonds	-	-	-	-	-	-
US Bonds	-	-	-	-	-	-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

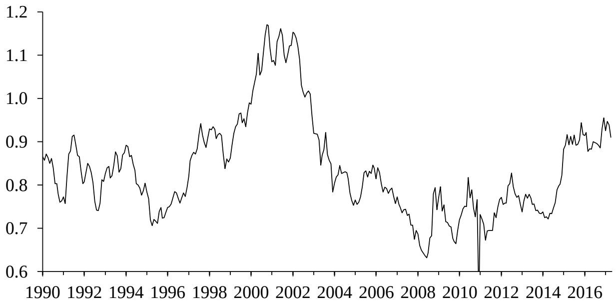
US : Trade Weighted Index
(Bank of England 1990 = 100)



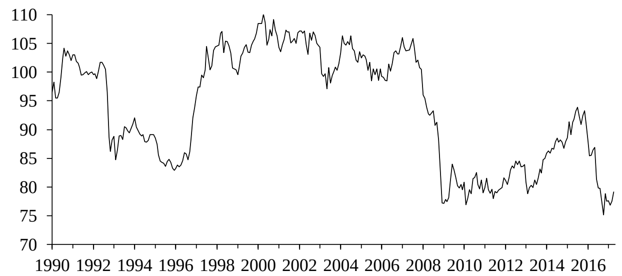
UK: Dollars Per Pound Sterling



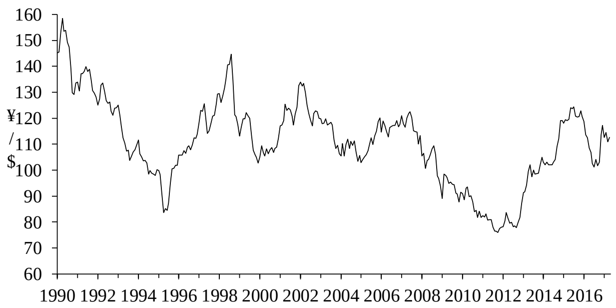
Euro per US dollar



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



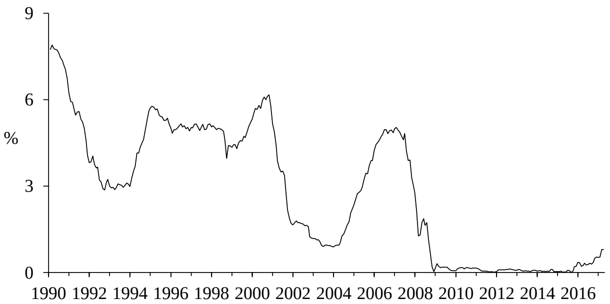
Japan : Yen Per U.S. Dollar



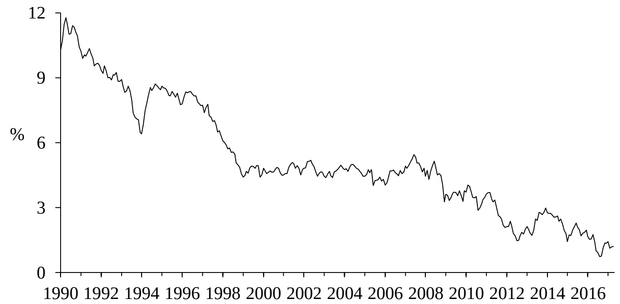
GOVERNMENT BOND MARKETS

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

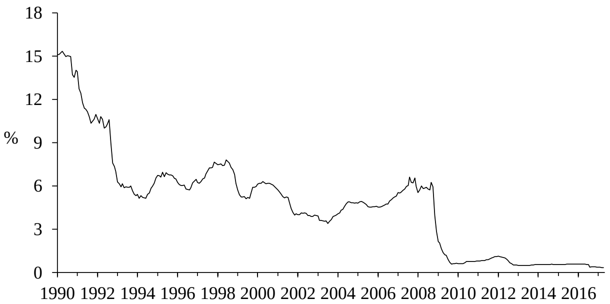
U.S. : 3-Month Treasury Bill



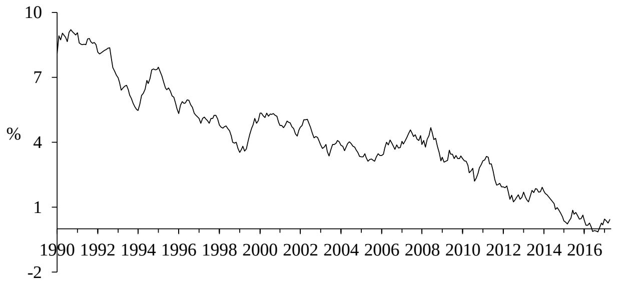
U.K.: Yield on Long-Term Government Bonds



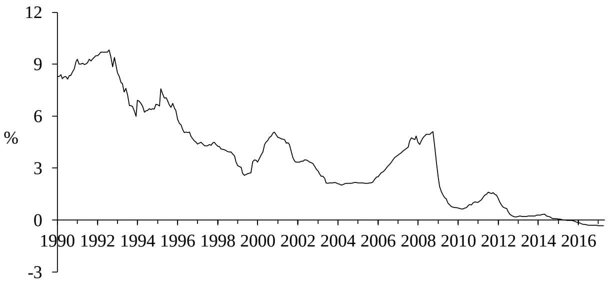
U.K. : 3-Month Interbank Rate



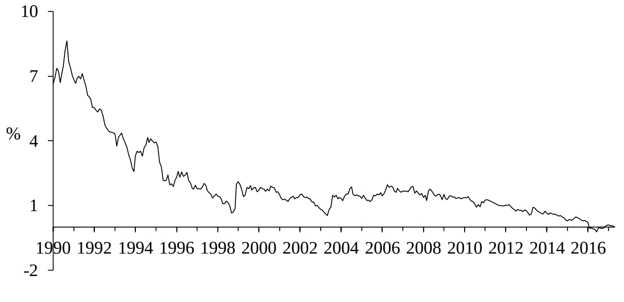
Germany: Yield on Public Authority Bonds



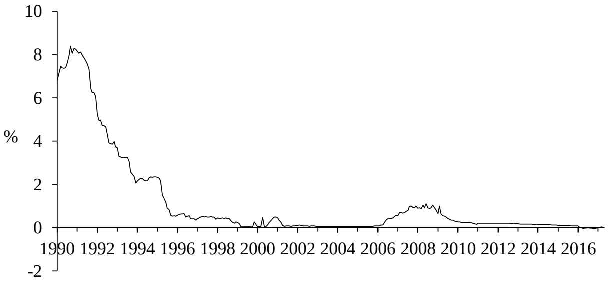
Germany : 3-Month Interbank Deposit Rate



Japan: Yield on Long-Term Government Bonds

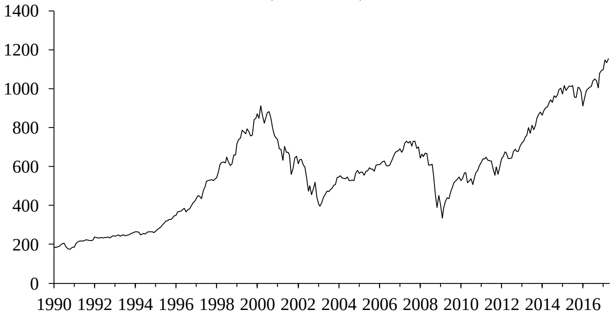


Japan : 3 Month Money Market Rate

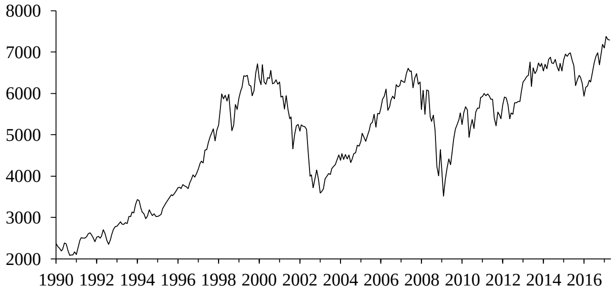


MAJOR EQUITY MARKETS

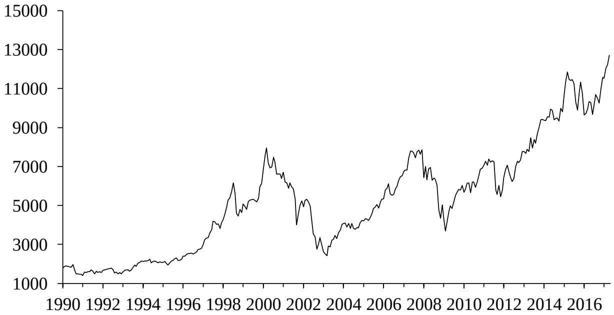
U.S. : S & P 400 Industrial
(1985=100)



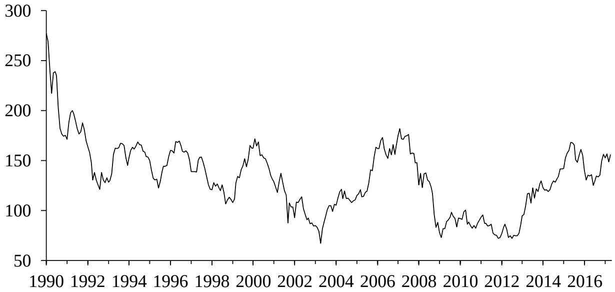
U.K. : FTSE-100 Index
(10 April 1962=100)



Germany : DAX 30



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



EMERGING MARKETS

Anupam Rastogi

India

The monsoon is likely to be just normal at 96% of the Long Period Average (LPA) this year for the second year in a row, the India Meteorological Department (IMD) said on Tuesday, giving rise to expectations of 3–4% farm gross domestic product (GDP) growth, which would fuel rural demand and ease food inflation.

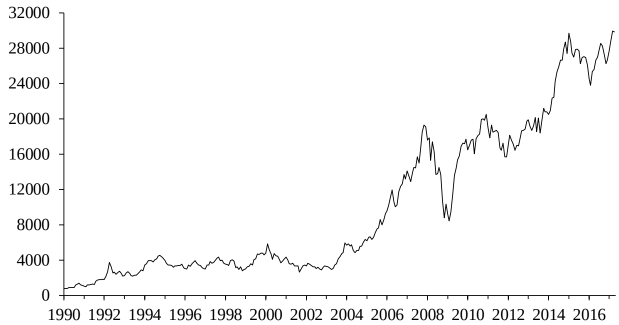
With slightly less than normal monsoon rains, India is expected to achieve GDP growth of 7.5% in the current fiscal year. However, the central bank has hinted at a looming inflation threat over the next 6–12 months, obliquely leaving the door ajar for an interest rate hike in 2017–18. The central bank left its main lending rate unchanged, as it waited for further proof that inflation is under control.

The central bank said it expects consumer inflation to average around 4.5% in the first half of this financial year and then rise to 5% in the second half. This is higher than the 3.65% consumer inflation recorded in February.

India's exports grew at its fastest pace in five years by 4.7% to $274.65 billion during the financial year 2016–17. In March, exports grew 27.6% to $29.23 billion, after clocking a 17.5% jump in February. Imports, however, grew even faster at 45.3% to $39.67 billion in March as crude oil imports doubled while gold imports grew 329%.

Indian stocks reached a new high as foreign funds are optimistic that the country's Prime Minister, Narendra Modi, will use his growing popularity to accelerate the pace of change and keep Asia's third-largest economy expanding. India is being seen as a relatively resilient place to invest by fund managers because quite a bit of the economy is driven by domestic consumption. They have argued that India may not become the next China, but it is proving to be a more decentralized, politically stable and service-oriented economy. Over and above, they believe that India has a strong-willed reformer which makes India's economic future growth visible. Modi's Bharatiya Janata Party has won a sweeping victory in local elections in New Delhi, further assuring investors the party's dominance over Indian politics. The results from the local elections in New Delhi are further evidence of Mr Modi's popularity after last month's landslide victory in elections in Uttar Pradesh, India's most-populous state.

India: BSE Sensitive



Not surprisingly, the S&P BSE Sensex crossed the 30,000 barrier and hit a new closing high. The index has been hitting record closing highs since the beginning of April. A healthy corporate earnings and a strengthening in the Indian economy are driving optimism and helping attract foreign as well as domestic investors. Investors' perceptions of India is supported by expectations of post-2014 election economic reform and a reduction of the current account deficit, which resulted in a surge of inbound capital flows. Since late 2014, a halving of global oil prices has further boosted economic activity in India, lowered inflation, and improved its trade position. The current account deficit fell sharply from 4.8% of GDP in 2012 to about 1.1% of GDP in 2016 and it is expected to remain compressed in near future.

This optimism has rubbed off on India's currency as well, with the rupee gaining about 6% against the U.S. dollar this year. The currency is nearing 64 rupees to one U.S. dollar now.

The deft legislation of a national Goods and Services Tax to replace at least 15 different tax codes at the central and state level is a good example. The new GST represents the most ambitious tax reform in India since independence 70 years ago. It could also be the most significant economic development in the country since deregulation and privatisation began in the early 1990s.

	15–16	**16–17**	**17–18**	**18–19**	**19–20**
GDP (%p.a.)	7.6	7.0	7.5	8.0	8.1
WPI (%p.a.)	5.2	4.5	4.0	4.0	4.1
Current A/c(US$ bill.)	-24.0	-24.0	-26.0	-28.0	-30.0
Rs./$(nom.)	66.5	68.2	67.0	68.0	69.0

China

China's economy has started 2017 with its strongest quarterly performance in 18 months, on the back of a surge in industrial activity, property investment and credit growth. The economy grew 6.9% in the first quarter as a result of a stimulus-fuelled economic boost in the first half of 2017. In the second half, the stimulus is expected to taper off and 2017 growth achieving its annual growth target of 6.3%. But this relatively robust performance is increasing the likelihood of a financial and economic reckoning in the early years of Mr Xi's second term. Credit continues to grow at more than twice the rate of the underlying economy. The country's overall indebtedness is creeping towards 300%, most of it concentrated in the corporate sector. The China Consumer Index dipped slightly in April but remained well above the historical average.

Short-term borrowing costs in China have climbed to their highest level in two years as Guo Shuqing, chair of the China Banking Regulatory Commission, has issued a stream of directives aimed at, among other issues, clamping down on shadow banking practices and raising lending standards in the interbank market.

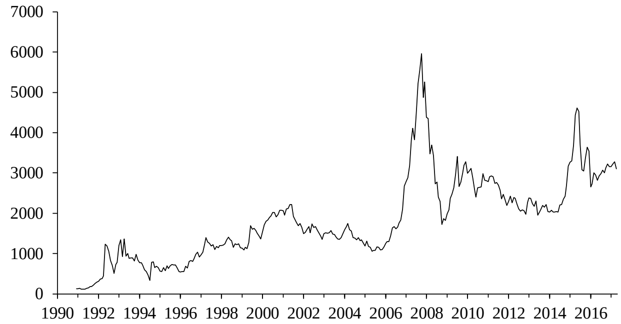
China, this year, has tightened monetary policy and launched a regulatory assault on off-balance sheet and interbank lending, squeezing financing for speculative vehicles. In the past, China's crackdowns on shadow banking have proved temporary, but Guo Shuqing has more credibility than his predecessors. Nevertheless authorities won't do anything to risk upsetting the economy before Xi Jinping's expected second term as president is signed off by the Communist Party Congress in the fall. Economic stability is assured, the argument goes, because anything else would be unthinkable.

China's exports and trade surplus increased more than expected in March on improved global demand. Exports increased 16.4% in March from a year earlier, reversing a 1.3% decline in February, while imports rose by 20.3% compared with February's 38.1% increase. This has resulted in trade surplus of $23.93 billion in March, compared with February's $9.15 billion deficit.

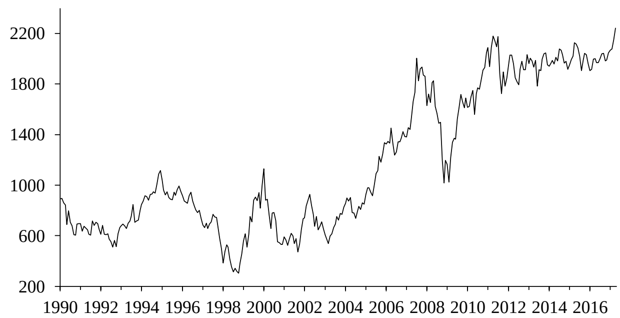
Mr. Trump has indicated that the US would not call China a currency manipulator. This has removed one headache for Mr Xi. His meeting with President Trump went well. Beijing is ready to lift a hygiene-related ban on American beef imports, which has been in place since 2003, and remove some restrictions on foreign companies investing in its financial services sector. China hopes that these measures will forestall some of the wilder protectionist acts the US President has been threatening.

China's foreign exchange reserves rose again in March but by less than expected, as authorities have tried to stabilize the renminbi this year. Total FX reserves hit $3.009 trillion in March, up from $3.005 trillion in February.

China: SSE Composite Index



Korea: Composite Index



China has scrapped a restriction on cross-border capital movement imposed in January, in what is believed to be the first concrete move to loosen capital controls since authorities began imposing curbs designed to shield the renminbi from downward pressure last year. Chinese restraints on capital outflows had started to discourage inbound investment into the country, the opposite of the intended effect of the measures.

The People's Bank of China is following currency-first policy to gain political mileage at home. But China's currency-first policy is risky because the country now faces the "trilemma," the theory that a country cannot have a controlled exchange rate, free capital flow and an independent monetary policy at the same time. In a rare acknowledgment by China's central bank, the bank has proposed an alternative model called the "scalene impossible trinity". Under this framework, the bank says it is possible to calculate the "optimal level" for managing cross-border capital flow as well as "international monetary policy coordination" under differing foreign-exchange rate regimes.

	15	**16**	**17**	**18**	**19**
GDP (%p.a.)	6.9	6.5	6.3	5.8	5.5
Inflation (%p.a.)	1.4	2.0	2.2	2.0	2.1
Trade Balance(US$ bill.)	550	510	400	380	350
Rmb/$(nom.)	6.4	6.7	7.1	7.3	7.5

South Korea

South Korea's economy grew at a faster pace than expected in the first three months on a sharp recovery in exports and construction. Gross domestic product grew a seasonally adjusted 0.9% in the first quarter from the previous three months. Compared with a year earlier, GDP was up 2.7% in the first quarter, again accelerating from the fourth quarter's 2.4%. The latest figures indicate that the recent improvement in overall exports largely outweighed softness in private consumption.

The Bank of Korea earlier this month also increased its growth and consumer-inflation forecasts for the full year, to 2.6% and 1.9%, respectively. But the bank left interest rates unchanged for a ninth straight meeting in mid-April. The decision to hold the main policy rate at a record-low 1.25%, highlights the central bank's intention to keep policy accommodative to support the economy, despite a recent uptick in exports and inflation, and policy tightening in the U.S. The central bank now expects South Korea's gross domestic product to expand 2.6% in 2017, slightly faster than its January estimate of 2.5% growth. The bank projects 2.9% growth in 2018.

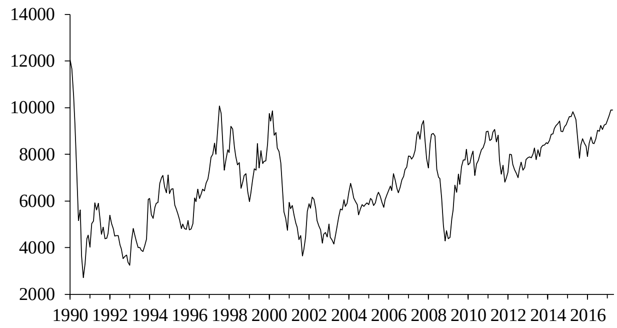
South Korea's headline consumer-price index rose 1.9% from a year earlier in April, with inflation easing after reaching a near-five-year high in the previous month. The April reading was sharply slower than the previous month's 2.2% gain. Inflation averaged 1% in 2016, following a record-low 0.7% for the whole of 2015. The Bank of Korea expects inflation to average 1.9% this year and the next - near its annual target of 2%. Though the U.S. Federal Reserve's decision to raise rates in March has weakened the case for further rate cuts in South Korea, higher U.S. rates could trigger capital outflows from South Korea. The bank is also wary of high levels of household debt, for which cheaper loans have been blamed.

After the May 9 presidential election, a fiscal stimulus from the new administration is expected. The economy still faces headwinds from corporate restructuring and a cooling housing market.

South Korean exports grew for the fifth consecutive month in March on a recovery in global trade and brisk demand overseas. Exports rose 24.2% from a year earlier to $51.01 billion in April after the prior month's revised 13.6% increase. Imports gained 16.6% from a year earlier to $37.75 billion in April following the previous month's revised 27.7% increase. The trade surplus widened to $13.25 billion in April from a revised $6.27 billion in March, beating the median forecast of $8 billion.

In the midst of a snap election that looks set to elevate to the presidency Moon Jae-in, a candidate has called for more distance from Washington and an immediate halt to the deployment of Thaad. Mr. Moon says any decision on deploying Thaad should be made by the next South Korean administration, in consultation with the public. He may benefit from President Donald Trump declaration that he would make South Korea pay $1bn for a US-owned and operated missile shield. His administration's intention to "renegotiate or terminate" the Korea-US Free Trade Agreement are likely to lend support to Moon Jae-in, a liberal candidate whose Democratic party has historically been more wary of the US than the ruling Conservative party. Mr. Trump also drew public derision in South Korea with comments following his summit with Chinese president Xi Jinping that "Korea actually used to be a part of China" — a notion most Koreans reject and is deeply offensive to Koreans.

Taiwan: Weighted TAIEX Price Index



	15	16	17	18	19
GDP (%p.a.)	2.6	2.5	2.5	2.5	2.5
Inflation (%p.a.)	0.7	1.0	1.6	1.2	1.3
Current A/c(US$ bill.)	90.0	88.0	88.0	86.0	80.0
Won/$(nom.)	1180	1160	1140	1140	1130

Taiwan

Taiwan's economy expanded for a fourth consecutive quarter in the three months to March, lifted by domestic consumption and an increase in exports driven by overseas demand for electronic components. Gross domestic product for the first quarter grew 2.56% year-on-year. The island's economy grew 2.88% year on year in the three months to December.

GDP could grow 2.5% in 2017 and increase to 2.6% in 2018. An upswing in Taiwan's manufacturing sector is on the horizon. Even though the Nikkei-Markit Taiwan manufacturing purchasing managers' index slipped to 54.4 in April from its March level of 56.2, the index remained well above the 50-point line separating expansion from contraction. The promising global economic outlook should benefit Taiwan and it could accelerate the pace of economic growth.

Taiwan's consumer prices continued to show weakness in March, rising only fractionally from a year earlier as falls in food prices weighed on the overall index. The consumer price index rose 0.18% in March compared with a year earlier, according to the Directorate General of Budget, Accounting and Statistics.

Taiwan's trade surplus increased to a 3-month high in March. The annual growth in exports was 13.2% compared to 27.7% in February. Likewise, imports recorded only

19.8% growth following February's 42.1% expansion. Economists had forecast a 25% rise for March. The trade surplus in March shrunk marginally.

	15	16	17	18	19
GDP (%p.a.)	0.8	1.4	2.5	2.6	2.3
Inflation (%p.a.)	0.7	1.0	1.0	1.0	1.2
Current A/c(US$ bill.)	60.0	64.0	68.0	68.0	70.0
NT$/$(nom.)	32.8	32.5	32.0	32.0	32.0

Brazil

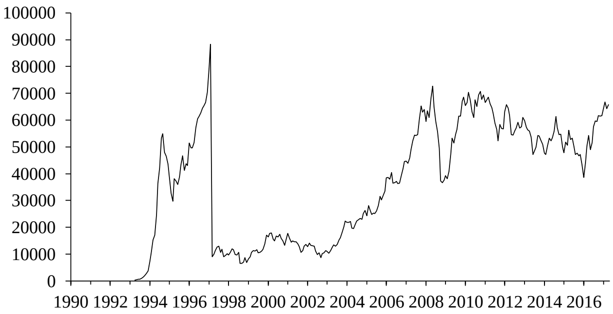
Brazil's ailing economy is moving haltingly. Gross domestic product which shrank in 2015 and 2016, is forecast to expand an anaemic 0.41% this year. The conservative government of President Michel Temer is hoping to kickstart the economy through an ambitious reform programme that includes capping runaway fiscal spending and overhauling the pension system. But corruption investigation into members of his ruling coalition is likely to slow the reform programmes. At the heart of reform programme is pension reform which would put Brazil's finances on a sustainable basis. Retirement outlays will eat up 43% of the $422-billion national budget this year.

Lawmakers face general elections next year and are wary of angering voters. A poll suggests that 101 of 513 legislators would approve the reform, while 275 would vote against it. The President needs 308 votes in the lower house to amend the constitution.

The 12-month inflation rate slowed to 4.57% in March, after a steady decline from a 12-year high inflation of 10.71% in January 2016. Inflation is expected to be 4.5% for 2018 — in line with the bank's own forecasts. This has provided the central bank to step up the size of its interest-rate cuts. The central bank has cut the Selic interest rate by 100 basis points to 11.25%. Another 100 bps cut seems likely in May. After that a reduction in the pace of easing may be hinted.

Brazil's currency, the real, stepped up its slide against the dollar on Wednesday after the Supreme Court ordered

Brazil: Bovespa



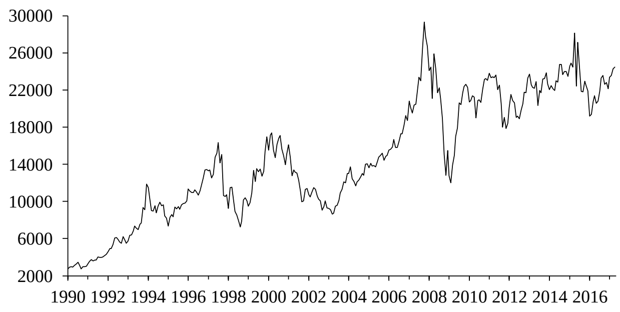
investigations into alleged corruption by 74 politicians, including 8 ministers of the government of President Michel Temer. President Temer is fighting for political survival after the Supreme Court ordered investigations into a third of his cabinet as part of the vast Car Wash corruption probe. The real weakened to R$3.1509 against the dollar, depreciating 2% in a week in mid-April.

The labour sector reforms are deeply unpopular. A general strike in Brazil, called to protest proposed labour and pension changes on April 28, 2017, disrupted public transportation around the country. Protesters are trying to stop President Michel Temer from cutting back the generous pension system and from reducing some worker protections. Both changes are needed to put the economy back on rails. The pension proposal, which is in a committee in the lower house of Congress, would close loopholes that for decades have allowed Brazilians to retire in their mid-50s with pensions as high as their latest salary. This flaw in the pension system has led to social-security costs eating up about half of the nation's budget.

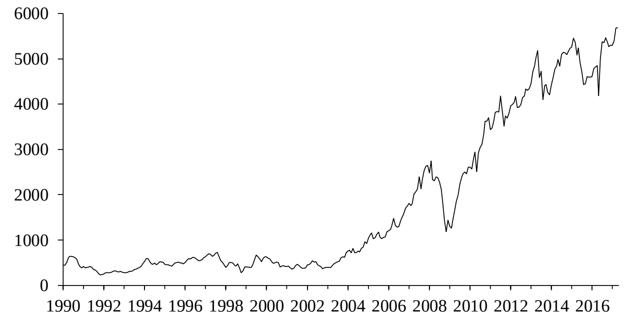
	15	16	17	18	19
GDP (%p.a.)	-3.8	-3.6	0.5	1.5	3.0
Inflation (%p.a.)	10.7	6.3	4.4	4.5	4.0
Current A/c(US$ bill.)	-70.0	-28.0	-25.0	-25.0	-32.0
Real/$(nom.)	3.9	3.5	3.4	3.2	3.2

Other Emerging Markets

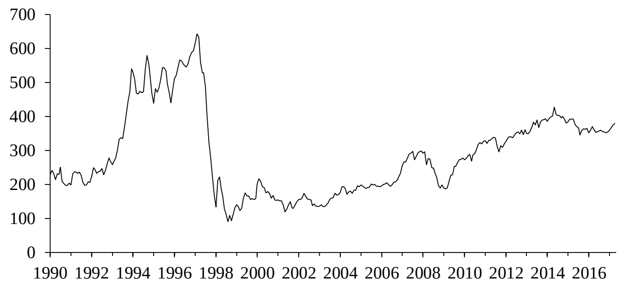
Hong Kong: FT-Actuaries



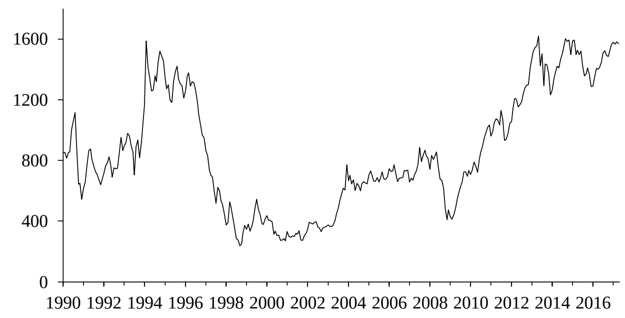
Indonesia: Jakarta Composite



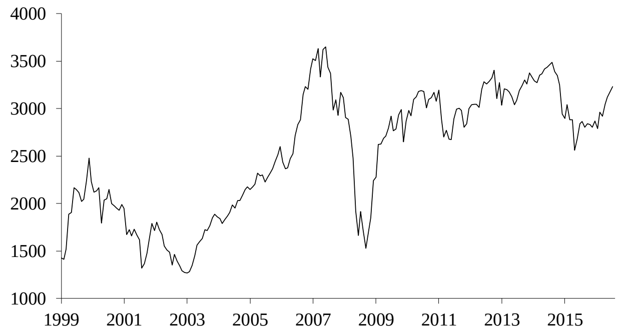
Malaysia: FT-Actuaries (US$ Index)



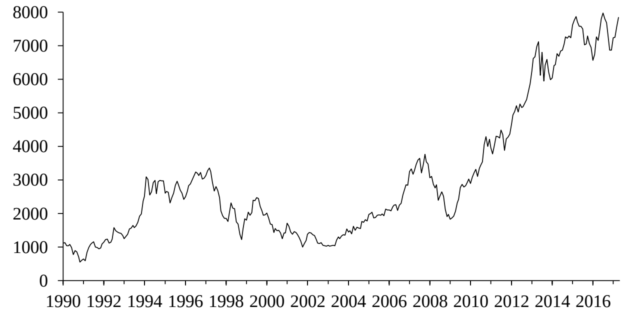
Thailand: Composite Index



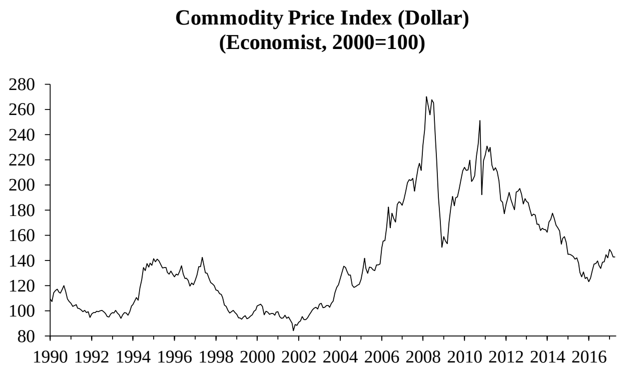
Singapore: Straits Times Index

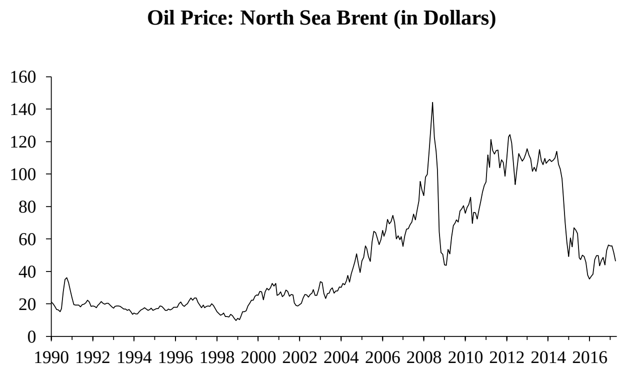


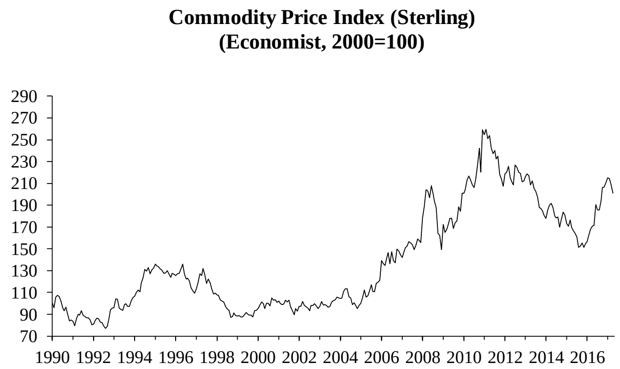
Philippines: Manila Composite

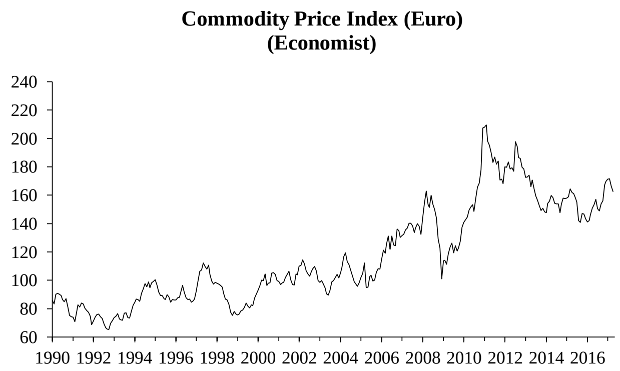


COMMODITY MARKETS









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