LIVERPOOL INVESTMENT LETTER

June 2017

Cardiff Business School
Ysgol Busnes Caerdydd

Julian Hodge Institute of Applied Macroeconomics

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LIVERPOOL RESEARCH GROUP IN MACROECONOMICS

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Editorial and Research Direction: Patrick Minford[†].

Senior Research Associates: Kent Matthews[†], Anupam Rastogi, Peter Stoney.

Research Associates: Vo Phuong Mai Le[†], David Meenagh[†], Francesco Perugini, Yongdeng Xu[†], Zheyi Zhu[†].

[†] Cardiff Business School

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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BREXIT AND OTHER ECONOMIC POLICY POST-ELECTION

The election result was a shock and much could and has been written about the weakness of the Conservative campaign after beginning from such a promising opening position. But it has had several important results on the policy landscape.

The first is on Brexit policy. It is true that the government of the Conservatives and the Democratic Unionist Party of Northern Ireland has only a tiny working majority which will make it difficult to carry through controversial decisions. However, in other ways the position is stronger than before the election.

First, the Labour Party under Jeremy Corbyn pledged in its manifesto to back Brexit and in various campaign statements backed control of EU immigration; in this way Mr. Corbyn made it possible for UKIP voters to back Labour in the election. While he also backed a deal with the EU and said he wished to remain in the Single Market, this position remains vague, given that it conflicts with control of EU immigration. Should Theresa May come back from Brussels, having rejected an EU deal in which the UK stays in the Single Market and loses control of immigration, it will be difficult for Mr. Corbyn and his party to oppose her.

Second, the Conservatives who won seats campaigned on a manifesto that pledged to withdraw totally from the Single Market and the Customs Union, no longer be governed by European Court of Justice edicts, regain control of EU immigration and establish free trade widely with all our trading partners. Again, while individual MPs may be less enthusiastic about these pledges, they are bound by this manifesto.

To summarise, it seems to be true that the election clarified the general desire on all sides about Brexit: that it should be dealt with efficiently and according to the wishes of the population to regain control of the border and the law and to sign widespread free trade deals with the EU and the rest of the world. In this sense it is true that it became a ‘Brexit-less election’. The main party that opposed this, the Liberal Democrats, did not appear to benefit from it. Therefore provided the Conservative Unionist government pursues Brexit in a reasoned and principled way it should get support in the House of Commons; and the House of Lords will have no basis on which to oppose it, given that support, endorsed in a general election.

It is usually true in policy programmes that only one major initiative gets full attention in a Parliament. There is simply not enough energy available in the governmental process to do more than one major thing at a time. However in this coming Parliament it will be true in the most simple terms. Both the Conservative manifesto and the Labour manifesto had anti-market proposals — whether an ‘industrial strategy’ or interventionist labour market ideas from the first or pure left-wing throwbacks like nationalisation and high top tax rates in the second. None of these will have any hope of getting through the Commons with such a tiny working majority. Even if Mr. Corbyn got power in a broad left coalition, which looks impossible under the current seat arithmetic, he could not get any of his programme through.

Table 1: Summary of Forecast

	2014	2015	2016	2017	2018	2019	2020
GDP Growth[1]	2.9	2.2	1.8	2.3	2.7	2.9	3.5
Inflation CPI	1.7	0.2	1.1	1.9	2.6	3.0	3.0
Wage Growth	1.2	2.5	2.4	3.0	3.6	4.6	4.2
Unemployment (Mill.)[2]	1.1	0.8	0.8	0.8	0.8	0.7	0.7
Exchange Rate[3]	87.1	91.6	82.1	78.4	76.6	75.2	74.0
3 Month Interest Rate	0.6	0.6	0.5	0.9	2.0	2.9	3.0
5 Year Interest Rate	1.8	1.3	0.7	1.1	1.5	2.5	3.0
Current Balance (£bn)	−99.9	−103.7	−99.6	−43.8	−29.9	−17.1	−12.3
PSBR (£bn)	83.3	71.2	66.9	54.6	51.1	44.8	20.1

[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)

So this will be a Parliament solely devoted to Brexit and its members are largely bound by promises to the people to deliver Brexit in the way described above. It will also be watched like a hawk by the two thirds of the public who the pollsters tell us want to see Brexit happen in this way.

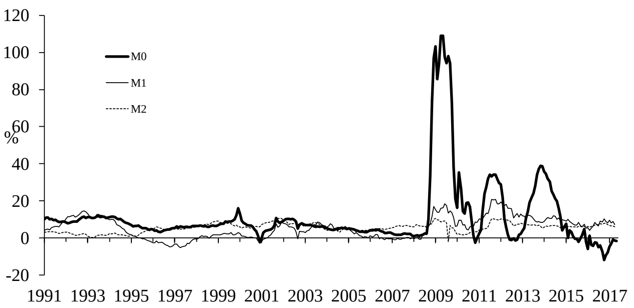
Of course in the familiar way with the great British debating tradition there will be articulate Remainers, including once again an economic consensus, that this is wrong and bad for the UK economy. That argument has already been engaged both in the referendum and in the year since, and lost in the popular debate. But of course these protagonists will continue their opposition; and academic debate will also flourish and, one must hope, lead to more intellectual progress in this area. But the policy process has definitely moved on to delivering the Brexit the majority of people have now endorsed.

The main uncertainty that will gradually be resolved in coming months is what the EU’s demands will be and whether it has any willingness to compromise in the interests of finding an acceptable deal. It is this that will decide the ‘softness’ of any ‘Brexit deal’. It is simply not possible to rule out a collapse in the talks and ‘no deal’. If so, given the way that most UK voters have come together behind Brexit, and that both major parties support Brexit, it seems overwhelmingly likely that Parliament will back no deal and that UK public opinion will become extremely hostile to the EU.

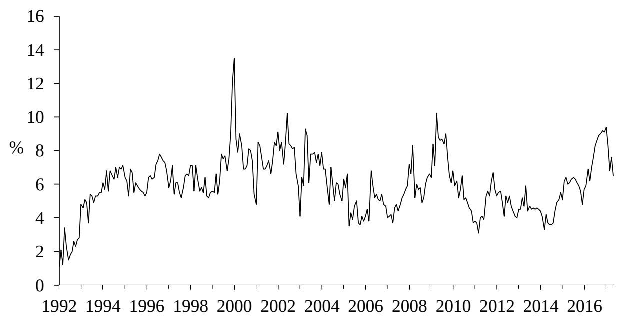
Meanwhile the economy will continue with business as normal. As we have argued repeatedly in this Letter the devaluation brought on by Brexit is acting as a powerful stimulus to the economy, switching demand away from consumers to net exports and business investment, and boosting corporate profits. This is a normal exchange rate response to large regime change like Brexit. As capacity gets used up, business investment will strengthen further. As labour availability gets used up, wages will start to rise faster. Once immigration controls bite on unskilled EU immigration this situation will get closer; so far the labour market still seems to be somewhat slack, with many workers working less hours than they would like.

With the economy still not tight on either plant or labour capacity, we have some leeway on monetary tightening. However, the zero interest rate economy underpinned by massive printing of money is causing widespread problems; government, large and inefficient corporations and so-called 'safe' borrowing like mortgages and car loans, are artificially subsidised while savers get negative real returns and small businesses get poor access to credit and even then on tough terms. It is time to withdraw slowly from this distorted situation, by raising interest rates in a studied gradual way and slowly withdrawing with it the vast pool of printed money; at the same time regulations on the banks' lending should be eased to help restore credit growth to small firms. In doing this it will be joining the US Fed and probably quite soon also the ECB.

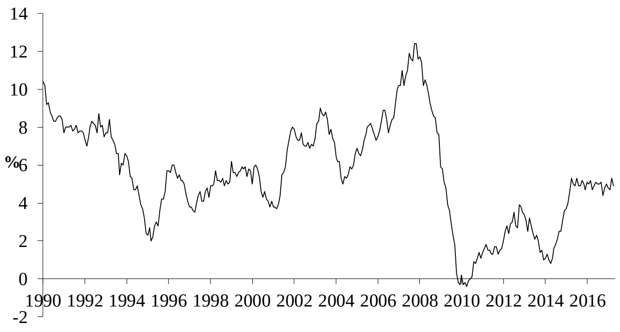
U.S.: Growth in Monetary Aggregates (Yr - on - Yr)



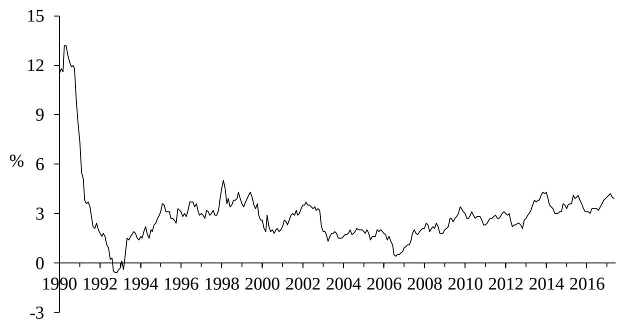
UK: Notes and Coins in Circulation Growth



Eurozone M3 Growth



Japan: Growth of M2+CD's



FOCUS ON JAPAN

Francesco Perugini

The Japanese Economy Continues to Expand

Japan real GDP came in higher than expected at 1.6% year-on-year (yoy) growth in the first three months of 2017, according to the first preliminary estimate released by the Government of Japan's Economic and Social Research Institute. This marks the fifth consecutive quarter of real GDP growth, the longest episode since 2006. During that period, the economy expanded for six successive quarters. This time around, growth was fuelled by an increase in household expenditure and higher export levels.

Indeed, GDP growth benefited from household consumption, which grew 1% quarter-over-quarter. The strength in consumption came as something of a surprise to observers as some other indicators, such as the recent household survey results released by the Ministry of Internal Affairs and Communications, are showing a much less upbeat picture. According to the household surveys, Japan's household living expenditures, for example, dropped by 1.6% yoy in the first quarter of 2017 in real terms, which is in sharp contrast with the 0.9% growth in private consumption in the GDP report. Also the surveys show that the growth in Japanese household incomes was lacklustre. Japanese workers' average cash earnings rose by only 0.1% yoy in the first quarter of 2017, and actually declined by 0.3% yoy in real terms once inflation is taken into consideration. One possible reason for such divergence could be the underestimation of expenditures on durable goods in the household surveys. For instance, the sales of automobiles have been much stronger in the past few quarters than other consumption items. In the first quarter of 2017, for instance, sales of motor vehicles (in nominal terms) rose by 6.2% yoy in Japan, while the retail sales value of all other items only grew by 0.4% (in nominal terms) during the same period. Stronger durable goods consumption is also consistent with the pick-up in consumer loans (excluding mortgages) since late 2016. Since turning negative in the third quarter of 2016, there has been a rebound in new loans taken up by Japanese consumers, which rose by 10.8% yoy in the last quarter of 2016 and by 8.2% in the first quarter of 2017.

Net trade also added to first quarter real GDP growth as exports (+6.1% yoy) continued to be one of the key drivers. On the back of improving global demand and a weakening of the yen, Japan's exports have rebounded strongly since mid-2016, having declined sharply in 2015. The rise in Japanese exports was widely distributed, with growth especially strong in exports to China and the rest of Asia, followed by the US and the European Union. Thanks to the rebound in exports, Japan's trade surplus remained in positive territory for most of 2016. As a result, net exports have been a positive contributor to Japan's headline GDP growth since the third quarter of 2016, accounting for 0.8 percentage points of the 1.6% headline yoy growth in the first quarter of the 2017.

Residential investment, business investment and government consumption each contributed 0.1 percentage points to growth. However, public investment — which was expected to rise given fiscal stimulus plans announced by the government last year- came in flat.

Looking ahead, economists and observers expect the Japanese economy to continue its moderate recovery for the rest of 2017, although growth rates may ease in the near term. Japan's economy minister, Mr. Nobuteru Ishihara, pointed out that the country was yet to overcome sluggish inflation levels. His concerns are justified, since the economy actually contracted by 0.1% in nominal terms. Most corporations remain reluctant to raise price levels. Such a tendency persists despite the fact that a soft yen and rising fuel prices are driving up the cost of imported materials. However, the increase in household expenditure, which contributes nearly 60% of GDP, comes as a welcome development. Such increases are crucial for Abenomics' future success. Prime Minister Shinzo Abe's stimulus programme seeks to increase wages, expenditure and prices and this chain of increases is seen by his government as the key to Japan's future economic success.

However, minutes from last month's Bank of Japan (BOJ) policy meeting revealed fears that labour shortages would prove slow to generate inflation, suggesting the central bank is unlikely to back away from highly stimulative monetary policy in 2017 and highlighting Japan's struggle to escape from two decades of flat or falling prices. Crucially, the BOJ's monetary policies hinge on the observed rate of inflation, which was 0.2% in March, far below the BOJ's 2% target for core inflation. So far inflation in Japan has been mainly driven by external factors such as the rebound in global commodity prices (oil prices in particular) and weakening of the Yen. But domestic drivers of inflation remain weak. The yoy changes in consumer price index (CPI) excluding fresh food and energy, a measure preferred by the BOJ to gauge underlying inflation trends, dropped below zero again in March, having been positive since mid-2013. Hence, it is possible that the BOJ will continue its quantitative and qualitative easing, including yield curve control, for the time being, most likely through the remainder of 2017.

Overall, sustained expansion signals the Japanese economy has regained some momentum following the consumption tax rise of 2014 and emerging market weakness in 2015 that led to a prolonged slowdown. The data will boost the government of Prime Minister Shinzo Abe and give BOJ governor Haruhiko Kuroda renewed hope of eventually hitting his 2% inflation objective. However, even though

Japan has recorded its longest run of sustained growth in more than a decade, growth remains uneven and fragile. Much still needs to be done on the supply side of the economy, the Abe administration needs to carry out more structural reforms through deregulation to generate new sources of demand -which was promised to be the “third arrow” of Abenomics but has yet to bear much fruit.

MARKET DEVELOPMENTS

In spite of Donald Trump's troubles over Russia talks, it still seems likely the Republicans will be unwilling to unseat him and will also deliver a tax reform package. Deregulation is proceeding by Presidential pen. Spending on infrastructure may well be parlayed via the private sector, publicly underwritten. No doubt some creative 'dynamic scoring' will enable defense spending also to rise. With the world economy growing faster anyway and massive excess capacity still available in raw materials, the prospects for continued world growth around the 3% mark look good. This will continue to underpin equities.

Table 1: Market Developments

	Market Levels		Prediction for Apr/May 2018	
	Apr 6	**May 5**	**Previous Letter**	**Current View**
Share Indices				
UK (FT 100)	7297	7450	12033	11913
US (S&P 500)	2399	2434	2973	3074
Germany (DAX 30)	12717	12714	20589	20049
Japan (Tokyo New)	1550	1590	2214	2169
Bond Yields (government				
UK	1.20	1.08	1.20	1.50
US	2.35	2.21	2.80	3.00
Germany	0.42	0.26	0.70	0.90
Japan	0.02	0.04	0.10	0.30
UK Index Linked	−1.66	−1.69	0.10	−1.20
Exchange Rates				
UK ($ per £)	1.30	1.29	1.40	1.26
UK (trade weighted)	79.13	77.84	77.00	77.10
US (trade weighted)	104.84	102.40	102.0	102.4
Euro per $	0.91	0.89	0.93	0.93
Euro per £	1.18	1.15	1.30	1.17
Japan (Yen per $)	112.6	110.1	112.0	112.0
Short Term Interest Rates (3-month deposits)				
UK	0.30	0.28	1.50	1.50
US	1.15	1.15	1.30	1.50
Euro	−0.40	−0.40	−0.20	−0.20
Japan	−0.05	−0.15	0.00	0.20

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	55.00		63.50
US	1.99	2.9	1.5	21.90	2.69	30.98
Germany	3.30	1.6	1.1	55.00	−1.56	59.44
Japan	1.90	0.8	0.6	35.00	1.04	39.34
UK indexed[2]	−1.69		2.4	3.00		3.71
Hong Kong[3]	2.60	6.3	1.5	−4.00	2.69	9.09
Malaysia	3.30	4.8	1.5	47.00	2.69	59.29
Singapore	3.50	2.0	1.5	7.00	2.69	16.69
India	1.40	7.6	1.5	23.00	2.69	36.19
Korea	1.10	3.0	1.5	−20.00	2.69	−11.71
Indonesia	2.20	5.4	1.5	30.00	2.69	41.79
Taiwan	2.80	3.4	1.5	4.00	2.69	14.39
Thailand	3.20	2.6	1.5	19.00	2.69	28.99

Bonds: Contribution to £ yield of:

	Redemption Yield	Changing Nominal Rates	Currency	Total
UK	1.08	−4.20		−3.12
US	2.21	−7.90	2.69	−3.00
Germany	0.26	−6.40	−1.56	−7.70
Japan	0.04	−2.60	1.04	−1.52

Deposits: Contribution to £ yield of:

	Deposit Yield	Currency	Total
UK	0.28		0.28
US	1.15	2.69	3.84
Euro	−0.40	−1.56	−1.96
Japan	−0.15	1.04	0.89

[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

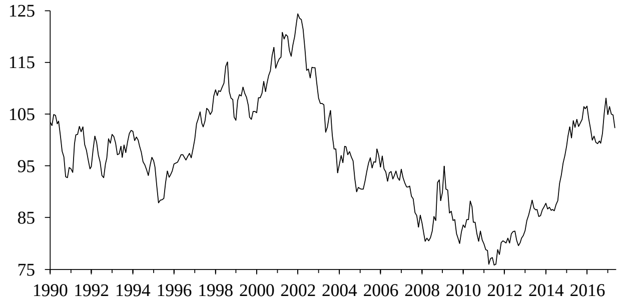
[3] Output based on China.

Table 3: Portfolio(%)

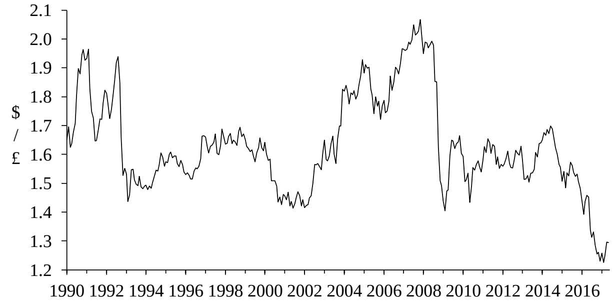
	Sterling Based Investor		Dollar Based Investor		Euro Based Investor	
	May Letter	Current View	May Letter	Current View	May Letter	Current View
UK Deposits (Cash)	5	5	5	5	1	1
US Deposits	-	-	-	-	-	-
Euro Deposits	-	-	-	-	-	-
Japanese Deposits	-	-	-	-	-	-
UK Bonds	-	-	-	-	-	-
US Bonds	-	-	-	-	-	-
German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

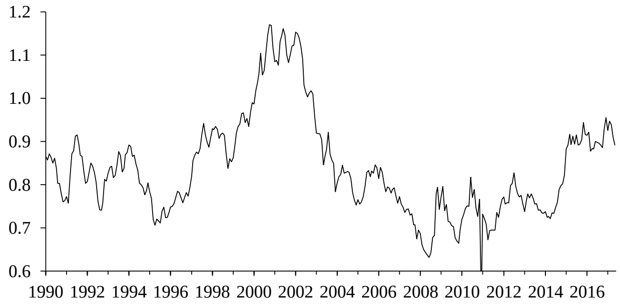
US : Trade Weighted Index
(Bank of England 1990 = 100)



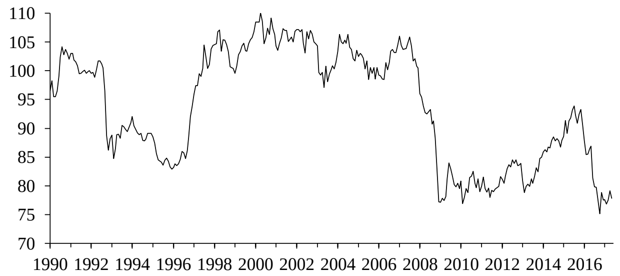
UK: Dollars Per Pound Sterling



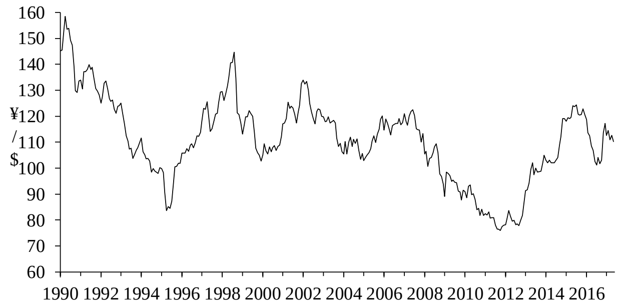
Euro per US dollar



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



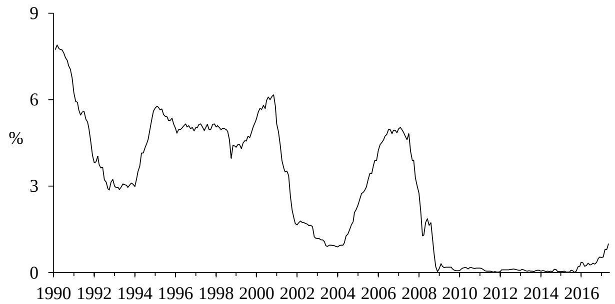
Japan : Yen Per U.S. Dollar



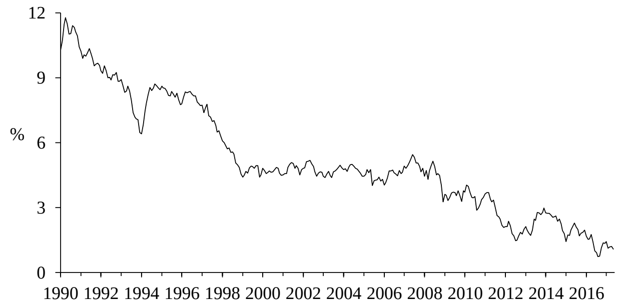
GOVERNMENT BOND MARKETS

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

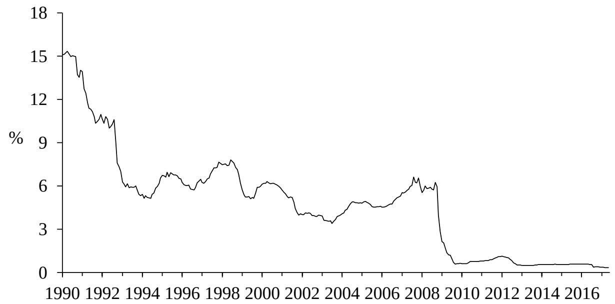
U.S. : 3-Month Treasury Bill



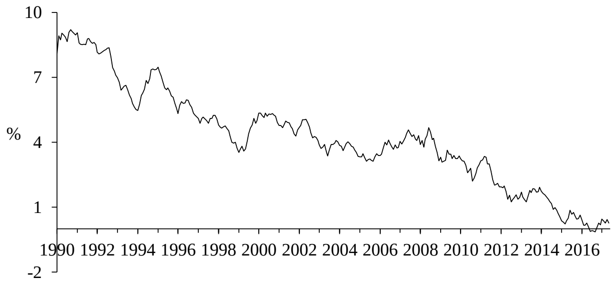
U.K.: Yield on Long-Term Government Bonds



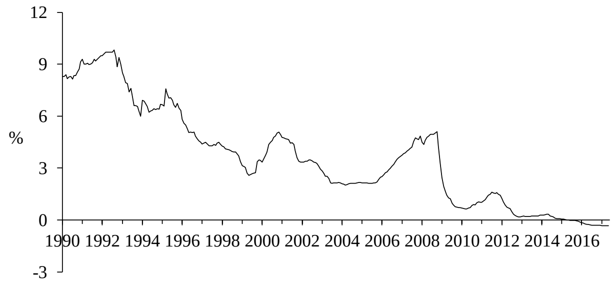
U.K. : 3-Month Interbank Rate



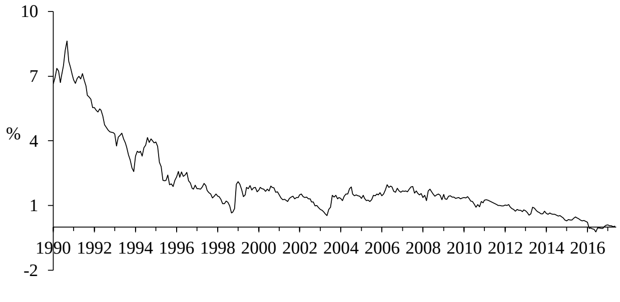
Germany: Yield on Public Authority Bonds



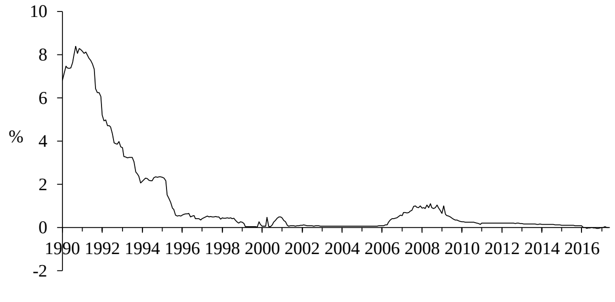
Germany : 3-Month Interbank Deposit Rate



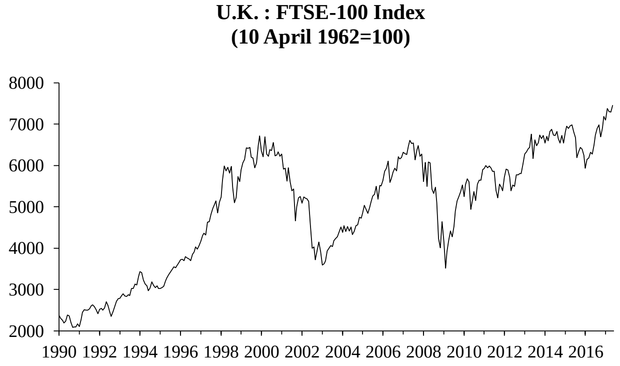
Japan: Yield on Long-Term Government Bonds

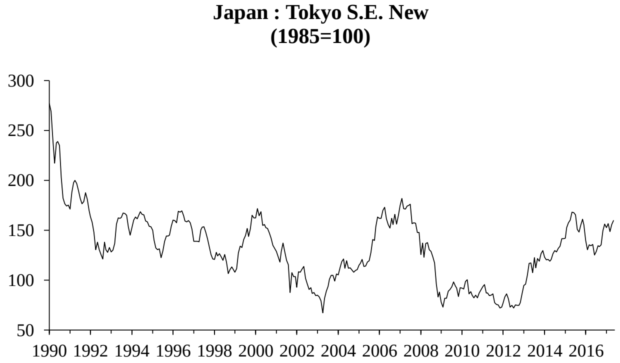


Japan : 3 Month Money Market Rate



MAJOR EQUITY MARKETS





EMERGING MARKETS

Anupam Rastogi

India

The Indian economy grew 6.1% in the first three months of the year compared with the same period last year. This compared with 7% growth in the previous quarter. The economy was hurt by weaker manufacturing and construction activity. GDP growth for the fiscal year ended March 31, however, was in line with the government's 7.1% projection made in February 2017. The economy grew 8% in the previous year. We expect the economy to grow 7.5% in the current fiscal year despite introduction of the nationwide Goods and Services Tax (GST) which may disrupt the economy marginally.

The optimism related to the Government continues as the BJP-led government enters the 4th year. Electorates have given the Government a pat on the back, applauded them for GST — a major tax reform. There is enough political stability and investors are hoping that the present government will continue for another five years after 2019. Markets are going up sensing the long-term political stability in India. FIIs are exuding confidence in the Indian economy. Corporate earnings in some sectors have been encouraging. Prediction of normal monsoon has further boosted optimism. Moreover, the US Federal Reserve is not in a hurry to raise interest rates.

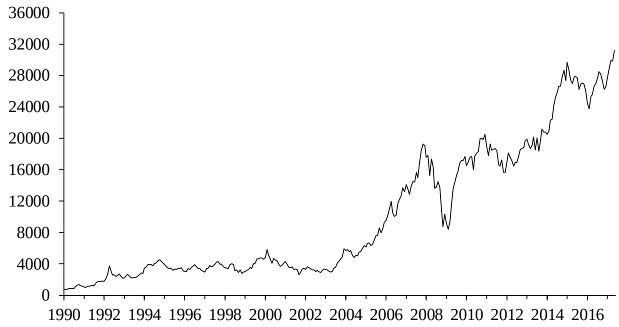
The central bank expects retail inflation to fall to 2–3.5% in the first half of the current fiscal and move up to 4.5% in the second half. In its bi-monthly Monetary Policy Committee meeting, warned the government that rush for farm loan waivers might have inflationary spillovers. The rise in the rupee is helping the central bank to control inflation.

Exports grew 17% during the quarter and the agricultural area sown during the winter crop rose about 6%.

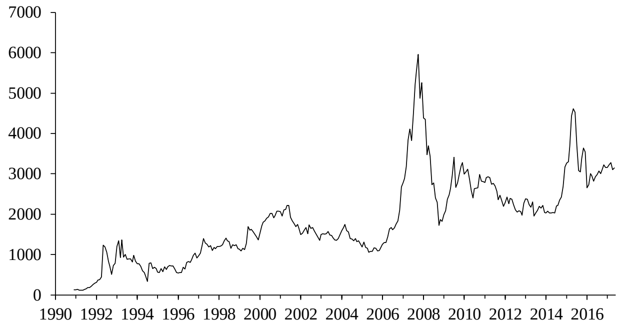
In order to deal with the stressed assets' in the banking system, the government has amended some sections of the Banking Regulations Act, empowering the Reserve Bank of India to issue directives to commercial banks to resolve the issue of nonperforming assets in a "time-bound manner". The new law also permits the RBI to prod banks to initiate insolvency proceedings against debtors in an effort to speed up debt recovery.

Indian equities have been performing well since Modi's party won state elections in April. Investors are now looking forward to the rollout of India's new goods-and-services tax on July 1. The tax neutral rates and simplification of the tax structure may boost India's growth rate by as much as 2 percentage points.

India: BSE Sensitive



China: SSE Composite Index



	15–16	16–17	17–18	18–19	19–20
GDP (%p.a.)	8.0	7.1	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 is preparing for its next National Congress in October 2017, where a reshuffle in the Politburo and further consolidation in the hands of President and Party Chairman Xi Jinping is expected. China may exceed the six and a half percent growth target this year as the government seeks to create a very positive backdrop ahead of this important political event. However, for the time being we maintain our forecast for GDP growth at 6.3%. The Caixin China manufacturing purchasing managers index fell to 49.6 in May from 50.3 in April, indicating a decline in manufacturing activity.

There are many signs on the horizon indicating that China's massive economic engine is losing steam after achieving 6.9% growth in the first quarter. Industrial metal prices have fallen in recent weeks; auto sales declined at twice the pace in April as in March; Official purchasing managers' indexes weakened last month; and inventory restocking has slowed.

Property sales also decelerated sharply in April year on year, increasing at their slowest pace in over two years, and construction starts have weakened.

Besides short-term fluctuations, Beijing is grappling with two thorny structural problems: soaring property prices and debt levels after years of fiscal spending and easy-money policies.

Moody's Investors Service cut China's sovereign credit rating for the first time in nearly three decades, citing expectations that the country's financial strength will deteriorate in the coming years as debt keeps rising and the economy slows. Moody's downgraded China's rating to A1 from Aa3, while changing its outlook to stable from negative. In March 2016, it had cut China's outlook to negative from stable.

An accommodative monetary policy and robust state spending over many years have also fuelled excess production capacity in industries such as glass and steel, which has diverted funding to "zombie" companies rather than to promising firms in the real economy. Once Chinese companies run into trouble with their overseas debt, the yuan will be under pressure.

Moody has highlighted that the problems faced by China today are the same Japan faced in the early 1990s. Like Japan, heavy capital-spending levels have been central to China's growth — investment accounted for nearly half of China's annual growth by 2010, up from a third in 1990. A sharp run-up in real-estate prices, far outpacing any rises in family income or office rents, is one common point between China of today and Japan of the late 1980s. After Moody's decision to downgrade China, the two countries at least now have sovereign credit ratings, at A1, to match.

On June 1, the central bank set the dollar's daily midpoint for trading at 6.8090 yuan, the strongest level since November 10. The sharply higher "fix," which came on top of the currency's surge a day earlier, has helped the yuan register a 2% gain against the dollar so far this year. Keeping the yuan relatively stable versus the dollar, is critical for Beijing prior to the congress meet in October. The central bank's move suggests that "coping with capital outflows remains a key challenge for Chinese authorities".

Consumer inflation in China remained mild in April, edging up on higher costs for rent, education and other nonfood items, while producer prices rose at a slower pace in a sign of weak underlying demand. The consumer-price index was up 1.2% from a year earlier. China's trade surplus widened in April, though both exports and imports grew less than expected. Exports rose 8% from a year earlier compared with 16.4% in March. Imports climbed 11.9%, also below forecasts, after a 20.3% rise in March. China's trade surplus increased to $38.05 billion from $23.93 billion the previous month. Nevertheless, China remained the world's largest exporter in 2016 for the eighth consecutive year, accounting for 13% of the global total even as exports become a less-important growth driver for the country. Exports accounted for 18% of China's economy last year, down from a peak above 32% in 2006.

	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

The economy is forecast to grow 2.5% this year after expanding 2.8% in 2016. The economy is gaining from strength in exports, but its domestic demand remains weak. The extra budget spending may add 0.2 percentage point to annual growth this year and next. Funding for the extra budget will mainly come from surplus tax revenue and state funds from the previous fiscal year. South Korea's new liberal administration under President Moon Jae-in announced a $10 billion supplement to its national budget to create more jobs and spur economic growth. The slightly bigger-than-expected additional government spending plan, which is scheduled to be sent to the National Assembly for approval, comes as job creation takes centre stage in Mr. Moon's economic policy.

The left-leaning leader was elected last month on a pledge to create 810,000 new public-sector jobs during his five-year term, underlining a bigger government role in boosting soft domestic demand and reversing high youth unemployment. Mr. Moon wants to raise taxes on the wealthy and large companies, increase the minimum wage, and force companies to give temporary workers permanent status and reduce working hours.

The Bank of Korea left interest rates unchanged for the time being, maintaining its support for the economy for now. The bank in April said it expects gross domestic product to expand 2.6% in 2017, slightly faster than its earlier estimate of 2.5% growth. But, the U.S. policy tightening points toward an eventual rate increase in the coming months.

Exports, which account for around half of the country's economy, jumped 24% year over year in April for a sixth-straight month of growth. Overseas shipments are likely to expand in May.

South Korea's new president has appointed an outspoken critic of the country's family-controlled business empires to a key government post, a move that signals a tougher regulatory approach to conglomerates such as Samsung, Hyundai Motor and LG. He will head the Korea Fair Trade Commission, the country's antitrust watchdog. Under Mr. Kim, the regulator is expected to aggressively curb common chaebol practices, such as internal deals within conglomerates and the use of cross-shareholdings by family owners to expand their hold over companies

Mr. Moon's desire to appease North Korea marks a return to the Sunshine Policy that failed in the mid-2000s when he was an aide to centre-left President Roh Moo-hyun. Mr. Moon wants to pursue reunification based on economic integration, offering a formal peace process if the North will give up its nuclear weapons.

The Kospi Composite Index has been performing strongly this year. It has gained more than 13% since January 1, 2017.

	15	**16**	**17**	**18**	**19**
GDP (%p.a.)	2.6	2.8	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

The Nikkei-Markit manufacturing purchasing managers' index dipped to 53.1 in May, down 1.3 points from April's reading. However, Taiwan is benefitting from the improvement of world trade and we expect it to expand 2.5% in 2017.

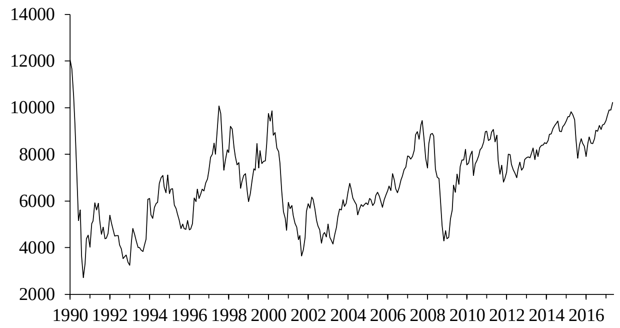
Inflation in Taiwan slowed down further in April as price growth for fuels, lubricants, tobacco and betel nuts were offset by falling food prices. The consumer price index rose 0.12% year on year in April, slowing from a 0.18% pace in March.

Taiwan's central bank acknowledged in March that a stronger new Taiwan dollar "has put domestic financial conditions under strains," and said it would step in if capital flows lead to extreme volatility or disorderly moves.

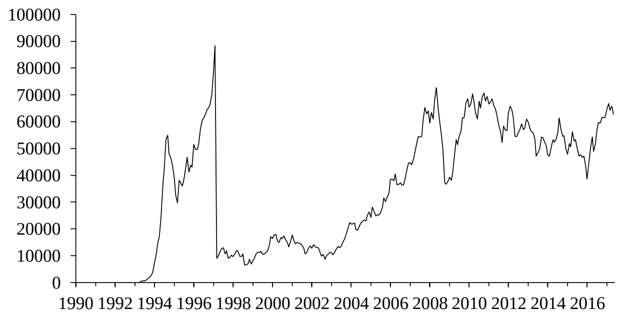
The Taipei stock market index breached 10,000 and it remains to be seen if it would sustain it. Of the Taiex's previous periods above that level — in 1990, 1997, 2000 and 2015 — the latter three lasted no more than 20 days and all gave way to corrections or bear markets. The most dramatic of those saw it shed four-fifths of its value in just eight months after hitting its all-time high at 12,495.3 in February 1990.

	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

Taiwan: Weighted TAIEX Price Index



Brazil: Bovespa



Brazil

Brazil's economy expanded 1.0% quarter on quarter in the three months of 2017, even though the economy shrank 0.4% in the first quarter from a year earlier. With this the economy has emerged from its worst recession on record. A rebound in trade growth from post-Lehman crisis lows should help perk up the Brazilian economy in 2017. Stabilized commodity prices are allowing Brazil pull out of a two-year long recession.

The outlook for other parts of the economy is still poor. Joblessness hit 13.6% in the three-month period through April, compared with 7.1% in the same period in 2015. Household spending fell 0.1% in the first three months of the year. Business investment declined 1.6%, and government spending shrank 0.6%. Services were stagnant in the quarter.

Brazil's central bank continues its cycle of rate cuts as a political crisis threatens to cripple a budding economic recovery. The bank cut its benchmark Selic rate to 10.25% from 11.25%, continuing a reduction in borrowing costs started in October. The year-end Selic rate may be as low as 8.5%.

Moody's Investors Service lowered its outlook on Brazil credit to negative from stable. The credit rating agency maintained its Brazil issuer rating of Ba2, two notches below investment grade. The S&P Global Ratings has warned Brazil that that it may cut the country's sovereign debt rating because of its troubled political situation. S&P currently rates Brazil at BB, two steps below investment grade.

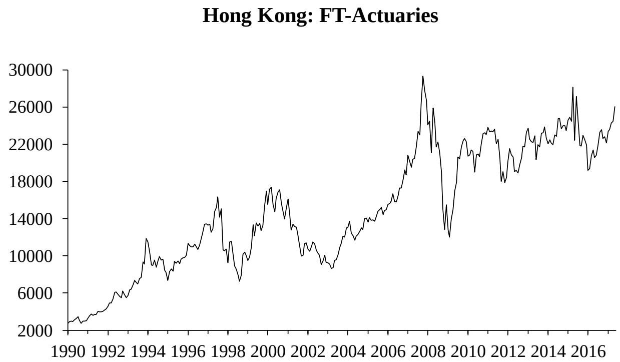
President Michel Temer faces his biggest test as Brazil's top electoral court begins a landmark trial to rule on whether to strip him of the presidency over alleged illegal campaign financing. It is widely believed that the conservative court was reluctant to topple the business-friendly president and plunge Brazil into a new crisis just as the country emerges from its worst recession on record. Jury is out whether Mr. Temer can survive politically and win public opinion.

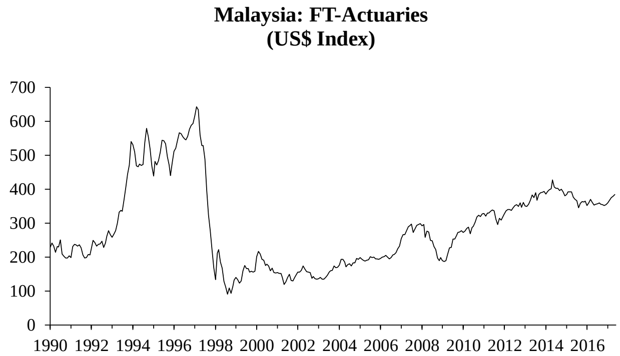
The pension plan, though unpopular with many Brazilians, won the approval of financial markets, and investment money has flowed into the country's stock market this year, helping it to lift the benchmark Ibovespa stocks index by 14% from the start of the year through May 16.

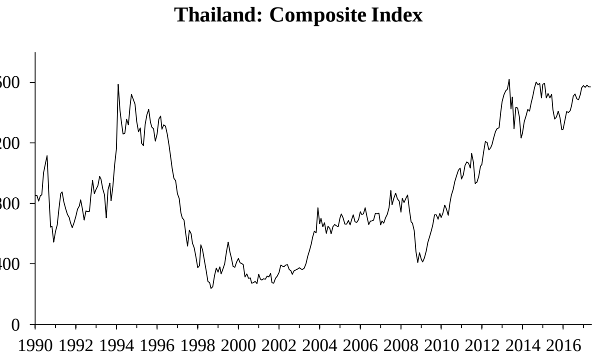
The real weakened 7% against the dollar on fears that the political crisis would torpedo the government's crucial reform programme to overhaul Brazil's sinking public finances.

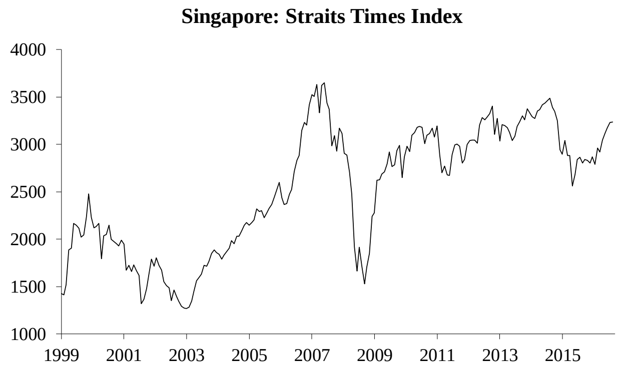
	15	**16**	**17**	**18**	**19**
GDP (%p.a.)	-3.8	-3.6	0.5	1.5	3.0
Inflation (%p.a.)	10.7	6.3	4.4	4.5	4.0
Current A/c(US$ bill.)	-70.0	-28.0	-25.0	-25.0	-32.0
Real/$(nom.)	3.9	3.5	3.4	3.2	3.2

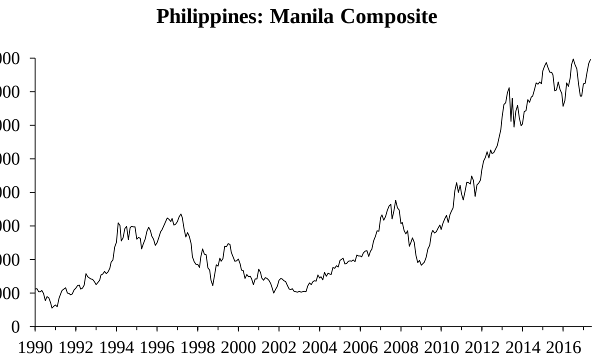
Other Emerging Markets



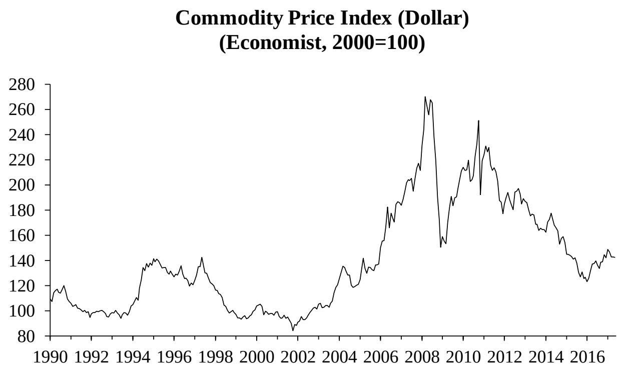


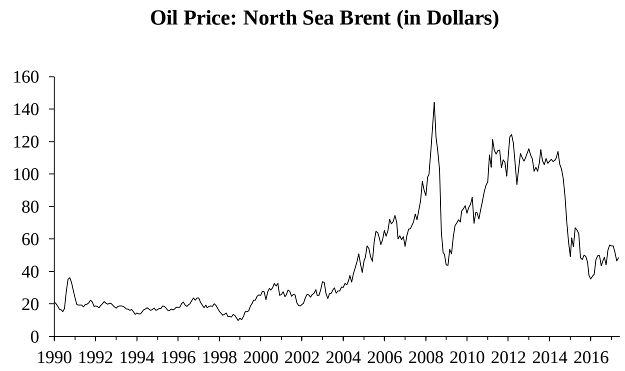


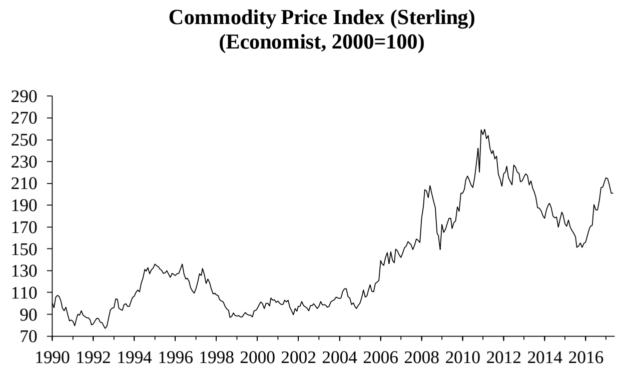


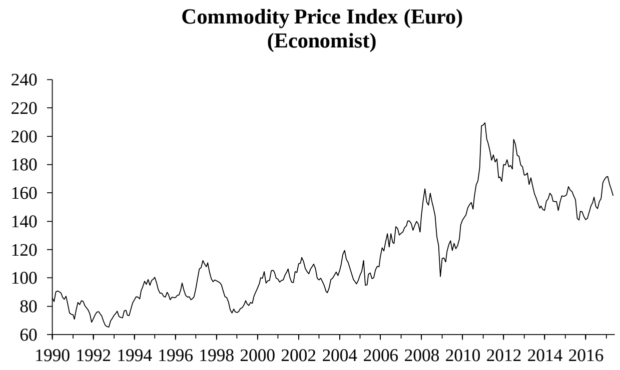


COMMODITY MARKETS









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	1.1	0.7	0.5	82.1	80.6	-1.0	1.9	-2.0
2017	1.9	1.1	0.9	78.4	76.4	-1.7	2.6	-1.7
2018	2.6	1.5	2.0	76.6	75.1	-1.0	3.1	-1.2
2019	3.0	2.5	2.9	75.2	74.6	-0.1	3.4	0.0
2020	3.0	3.0	3.0	74.0	74.4	0.5	3.4	0.7
2016:1	0.6	0.9	0.6	87.2	87.0	-0.3	1.4	-1.5
2016:2	1.0	0.8	0.6	85.6	84.7	-0.8	1.6	-1.7
2016:3	1.4	0.3	0.4	78.9	76.6	-1.2	2.0	-2.3
2016:4	1.6	0.6	0.4	76.6	73.9	-1.8	2.5	-2.1
2017:1	1.8	1.0	0.5	79.2	77.4	-1.9	2.5	-1.7
2017:2	1.8	1.2	0.5	79.3	77.4	-1.9	2.5	-1.5
2017:3	1.9	1.2	1.0	77.6	75.4	-1.8	2.6	-1.6
2017:4	2.1	1.2	1.5	77.3	75.4	-1.3	2.8	-1.6
2018:1	2.4	1.3	1.5	77.0	75.4	-1.5	3.0	-1.5
2018:2	2.4	1.5	2.0	77.1	75.4	-1.0	3.0	-1.2
2018:3	2.8	1.5	2.0	76.0	74.4	-1.0	3.3	-1.2
2018:4	2.8	1.5	2.5	76.4	75.4	-0.5	3.3	-1.2

[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	253.2	2.4	2.2	0.8	143.0
2017	260.7	3.0	2.2	0.8	144.5
2018	270.1	3.6	2.1	0.8	145.9
2019	282.6	4.6	2.0	0.7	148.3
2020	295.3	4.2	1.9	0.7	150.5
2016:1	252.0	2.1	2.1	0.7	143.2
2016:2	252.1	2.5	2.2	0.8	142.7
2016:3	254.4	2.4	2.2	0.8	143.5
2016:4	254.3	2.5	2.3	0.8	142.5
2017:1	257.7	2.3	2.2	0.8	143.8
2017:2	259.8	3.1	2.2	0.8	144.6
2017:3	261.9	3	2.2	0.8	145.0
2017:4	263.4	3.6	2.2	0.8	144.6
2018:1	266.0	3.2	2.1	0.8	145.0
2018:2	267.9	3.1	2.1	0.8	145.6
2018:3	271.4	3.6	2.1	0.8	146.2
2018:4	275.0	4.4	2.0	0.7	147.0

[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	159.4	763130.9	440238.4	297248.0	198473.7	-55145.2	117683.9
2017	163.1	781039.6	458510.3	276002.6	201835.6	-31228.2	124080.0
2018	167.4	801728.0	469801.9	276816.4	205872.3	-23275.3	127485.1
2019	172.2	824788.8	481547.0	275786.6	209989.8	-11175.3	131356.0
2020	178.2	853457.0	493585.6	287525.6	214189.6	-5675.3	136174.4
2015/14	2.2		1.4	4.0	1.0		1.3
2016/15	1.8		2.3	-1.9	1.0		-9.4
2017/16	2.3		4.2	-7.1	1.7		5.7
2018/17	2.7		2.5	0.3	2.0		2.8
2019/18	2.9		2.5	-0.3	2.0		3.0
2020/19	3.5		2.5	4.3	2.0		3.7
2016:1	158.0	189138.4	108678.4	72398.4	50736.1	-13542.0	29132.6
2016:2	158.9	190275.7	109825.3	73785.0	48907.3	-12813.4	29428.6
2016:3	159.7	191226.4	110456.6	75298.0	49388.4	-16711.1	27205.5
2016:4	160.8	192490.5	111278.1	75766.5	49441.8	-12078.7	31917.3
2017:1	161.4	193261.7	113610.1	66698.9	52080.7	-7810.2	31318.4
2017:2	162.4	194423.2	114285.7	69287.3	49227.3	-7808.3	30569.0
2017:3	163.8	196090.1	114965.4	69663.1	50032.9	-7808.4	30762.2
2017:4	164.8	197264.6	115649.0	70353.2	50494.7	-7801.3	31430.4
2018:1	166.0	198774.2	116365.2	67079.5	53122.3	-6097.5	31695.0
2018:2	167.1	199998.0	117085.7	70251.4	50211.8	-5798.5	31752.0
2018:3	167.6	200675.4	117810.8	68977.3	51033.6	-5290.7	31854.7
2018:4	169.0	202280.4	118540.3	70508.2	51504.6	-6088.6	32183.3

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

Financial Forecast

	PSBR/GDP %[1]	GDP[1] (£bn)	PSBR (£bn) Financial Year	Debt Interest (£bn)	Current Account (£ bn)
2015	4.6	1533.1	71.2	52.0	-103.7
2016	4.3	1576.1	66.9	52.0	-99.6
2017	3.3	1655.6	54.6	55.3	-43.8
2018	2.9	1748.5	51.1	61.4	-29.9
2019	2.4	1853.2	44.8	66.6	-17.1
2020	1.0	1468.8	20.1	51.6	-12.3
2016:1	-0.1	385.4	-0.4	13.1	-24.4
2016:2	6.3	388.7	24.3	13.1	-22.8
2016:3	4.2	389.1	16.4	12.9	-26.4
2016:4	6.2	397.2	24.4	12.9	-26.0
2017:1	4.3	404.0	17.5	13.1	-14.2
2017:2	2.9	405.7	11.7	13.1	-13.4
2017:3	3.1	410.0	12.7	13.6	-11.1
2017:4	3.2	416.8	13.2	14.2	-5.0
2018:1	4.0	423.1	17.0	14.3	-11.5
2018:2	2.6	426.9	11.1	14.9	-10.0
2018:3	2.8	432.2	12.3	15.0	-6.7
2018:4	2.8	439.5	12.4	15.6	-1.7

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	1.8	2.3	2.7
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

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	–1.0	–1.7	–1.0
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

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	–1.9	–1.8	–1.5
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

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

	2013	2014	2015	2016	2017	2018
U.S.A.	82.1	83.9	93.0	94.0	94.5	94.8
U.K.	86.5	93.1	91.6	80.6	76.4	75.1
Japan	63.5	59.8	56.0	58.4	58.5	58.6
Germany	99.0	99.9	94.7	95.0	95.2	95.1
France	100.7	100.8	96.2	96.0	95.9	95.7
Italy	106.9	107.5	102.1	102.0	101.8	101.7

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

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	0.1	1.1	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

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

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	0.7	1.1	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

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