LIVERPOOL INVESTMENT LETTER

November 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

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 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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CONTENTS

	Page
The economy reacts to the Brexit devaluation according to the textbook — so why the endless 'Remoaning'?	3
The ONS now reckons the economy to have grown a bit faster in the third quarter against wide expectations and has also slightly revised up growth in the first half. Business investment is now estimated to have grown since last year and manufacturing is booming. This fits well with the textbook reaction to the much-needed Brexit devaluation, designed to correct a large current account deficit. Policy now needs to be clarified and the government united around a clean Brexit, to avoid further policy uncertainty.	
Focus on Japan	6
Market Developments	8
Summary and Portfolio Recommendations	
Indicators and Market Analysis	
Foreign Exchange	10
Government Bond Markets	11
Major Equity Markets	12
Emerging Equity Markets	13
Commodity Markets	18
UK Forecast Detail	19
World Forecast Detail	21

THE ECONOMY REACTS TO THE BREXIT DEVALUATION ACCORDING TO THE TEXTBOOK — SO WHY THE ENDLESS 'REMOANING'?

A number of commentators of the 'Remoaner' camp argue that Brexit is 'damaging the economy' by producing a slowdown in consumer spending as well as a fall in business investment.

Inconveniently for this story business investment has grown by 2.4% on a year ago, according to recently revised ONS figures. This is not fast but then the economy is not growing fast either and is well away from full capacity, besides still having access to a labour market also apparently with spare capacity. Then also the third quarter ONS estimates of GDP have come in higher than widely expected, at 0.4%, with manufacturing growing strongly at 1% and finally coming into line with other indicators for the sector. The huge service sector has continued to grow moderately well at 0.4% in spite of some consumer slowdown. The ONS have now revised the first half growth rate upwards to 0.3%. It still looks out of line with other indicators, like purchasing managers' surveys and the ever-expanding labour market; and I expect it to be revised up further in due course. All this latest data has persuaded the Bank of England to raise its rate back to 0.5% which, as we argued last time, is overdue but still welcome.

The other problem with this story is that we have been running the economy at a huge current account deficit in recent years, of the order of 5–8% of GDP. This deficit seems to have emerged on the back of a very weak European economy to which our exports have accordingly slowed; and low returns on foreign investment, also perhaps connected to poor European profits, whereas UK profits have done fairly well with the recovery from the 2009 recession. This asymmetry of returns has soured our investment income account.

But whatever the reasons it was necessary for this external deficit to be corrected. Hence the Brexit devaluation has come in handily for this purpose. At a substantial 15% or so it is likely in time to correct this problem. The method by which it will do so entails a slowing of consumption as prices rise faster than wages, and an improvement in profits of exports and import-substitutes; this is known as 'expenditure-switching' designed to 'rebalance' the economy towards net exports. The very same commentators who have bemoaned the consumer slowdown as an evil Brexit effect have spent years in the past bemoaning our current account deficit and excessive consumer spending financed by over-fast credit growth. So now that Brexit has brought about a corrective, they should explain its corrective effects, not attack it. Is it too much to ask for some mature self-restraint and honesty among our commentariat?

Table 1: Summary of Forecast

	2014	2015	2016	2017	2018	2019	2020
GDP Growth[1]	2.9	2.2	2.3	2.1	2.6	2.9	3.5
Inflation CPI	1.7	0.2	1.2	2.6	2.7	3.0	3.0
Wage Growth	1.2	2.4	2.9	2.2	2.7	3.2	3.5
Unemployment (Mill.)[2]	1.1	0.8	0.7	0.8	0.8	0.7	0.7
Exchange Rate[3]	87.1	91.6	81.5	77.0	76.3	74.9	73.7
3 Month Interest Rate	0.6	0.6	0.4	0.4	0.6	1.1	2.8
5 Year Interest Rate	1.8	1.3	0.9	1.1	1.5	2.5	3.0
Current Balance (£bn)	−99.9	−103.7	−87.4	−64.3	−45.0	−37.3	−28.6
PSBR (£bn)	83.3	71.2	45.1	51.6	45.4	21.1	22.7

[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)

Our forecast therefore shows the current account improving, the PSBR steadily going into surplus and the economy growing rather moderately at or around 2%, with inflation settling at 2%. Employment growth continues with the labour market yielding continued increases in participation, and measured productivity growth improves on the back of Brexit. Interest rates slowly rise to return monetary conditions towards normality. And this is only in the early years of the Brexit revolution!

Uncertainty redux

But there is a cloud on the horizon, as yet no larger than a man's hand…

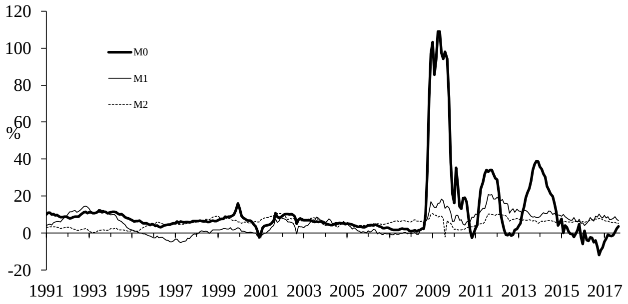
It is right to focus squarely again on the issue of uncertainty. During the Brexit Referendum the Remain side advanced the argument that Brexit uncertainty would cause a recession if there was a vote to Leave. Plainly this was wrong; there has been no recession. The uncertainty surrounding Brexit amounted to whether it would be a 'soft Brexit', close to the status quo, or a 'clean Brexit'. Since a 'clean' Brexit would mean moving the country to general free trade, its own regulation and restoration of control over unskilled immigration, all of which we have calculated would give the economy a substantial gain, this uncertainty amounted to possible outcomes that ranged from no change to large gains — uncertainty on the upside, hardly likely to inspire fear. This uncertainty could be assumed to be eliminated quickly by a clear government choice of one or the other.

Nevertheless, we are now, a year and half on from the Referendum, facing a different sort of uncertainty: that of a government seemingly unable to resolve internal disagreement about which choice to make. One group favours soft Brexit which is essentially the status quo, a negation of what was decided in the Referendum, namely to return power over trade, regulation, and migration to the UK; the other favours clean Brexit. It could well be that this disagreement will continue for several years, with the ultimate decision being constantly kicked down the road. This sort of uncertainty is potentially extremely damaging. It resembles ‘planning blight’ where a road is marked as due to be developed but the development is constantly deferred as the council authority argues over future plans. Here the existing residents will not invest and nor will any developers invest either; the road rots and falls into squatting and decay. The UK also faces this blight if the government does not take firm decisions on these policies. Those who see a bright future in free trade will not commit; those who want the status quo but fear it will not continue will also not commit.

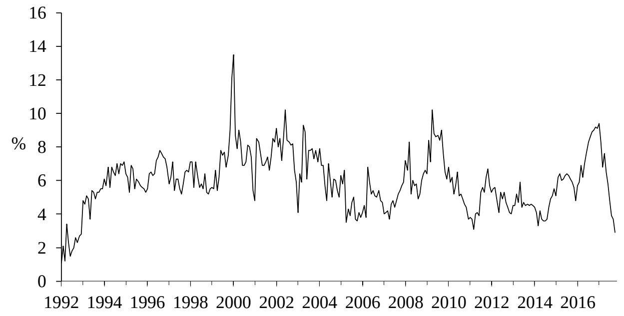
Those, like the supposed ‘Hammond Treasury faction’ in the Cabinet, who want a soft status quo Brexit, justify their stance as not going against the people’s will in the Referendum but rather as implementing Brexit in the national economic interest: ‘people did not vote for an impoverishing Brexit’ is their cry. However, this is pure sophistry for two reasons. The first is that the Referendum was indeed about ‘taking back control’ of laws, trade and borders; this simply cannot be denied, as this was the debate in terms. The second is that the claims of ‘impoverishment’ by a clean Brexit have simply not stood up to the facts since the Referendum, as we have noted above. There has not been the claimed recession and the slight slowdown the ONS has so far estimated is based on soft data and reflects the much-needed adjustment away from the consumer towards profits and net exports. On the long term effects of the Brexit regime change the Treasury’s calculations look increasingly threadbare: they are based on the idea that the ‘gravity model’ is against free trade with the world as a whole, which is untrue. Furthermore, UK trade facts support the broader classical model against the gravity model, in any case. For the Treasury to range itself against global free trade, some deregulation and the elimination of a large subsidy to EU unskilled workers is a bizarre policy position. The Chancellor and his Treasury team would be doing themselves and the Treasury a big favour in putting an end to it.

By doing so most importantly of all they will end the blight with which the current policy uncertainty threatens to sandbag the economy.

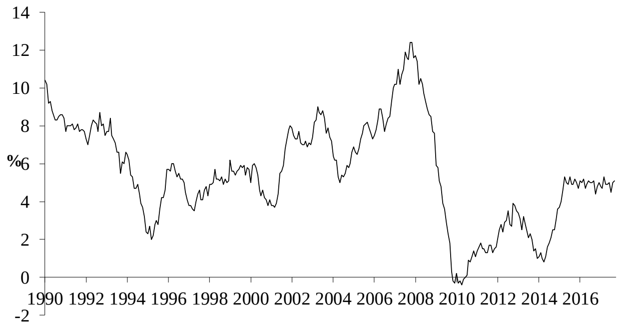
U.S.: Growth in Monetary Aggregates (Yr - on - Yr)



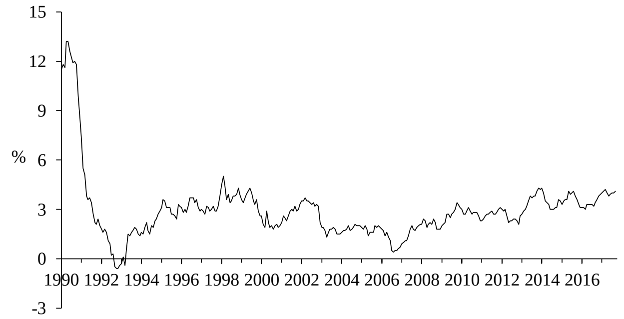
UK: Notes and Coins in Circulation Growth



Eurozone M3 Growth



Japan: Growth of M2+CD's



FOCUS ON JAPAN

Francesco Perugini

Abe secures strong mandate in Japan's general election

Japanese Prime Minister Shinzo Abe's Liberal Democratic party (LDP) and its junior coalition partner Komeito scored a big win in last month's election, keeping its two thirds "super majority" in the 465-member lower house (see chart below). A hefty win raises the likelihood that Abe, who took office in December 2012, will secure a third three-year term as LDP leader next September and go on to become Japan's longest-serving premier. It also means his "Abenomics" growth strategy centred on the hyper-easy monetary policy will likely continue.

The last thing Shinzo Abe expected when he launched Japan's general election was what he got: a sweeping electoral victory and a personal mandate to pursue his lifelong political goal, revising the pacifist constitution. Plagued by a series of minor scandals, the prime minister started the campaign with a negative approval rating. Most aides thought he would win but lose seats. Instead, he triumphed, but less due to his own brilliance than a disastrous miscalculation by Yuriko Koike, governor of Tokyo and his principal opponent: instead of welcoming deserters from other parties with open arms she had them vetted and also angled her policies towards the conservative end of the spectrum, too close to Abe's, so alienating many voters. Abe called the election to take advantage of the opposition's weakness. He knew Koike was preparing to run and deliberately called the election for October to strike before she was ready. But his aides were still uneasy about the media frenzy after she set up her new Party of Hope.

What does the LDP/Komeito victory mean for economic policies? Prime Minister Shinzo Abe's economic agenda is now shaping up with a focus on steering firms to hike wages and keeping the economic recovery going with loose fiscal and monetary policies. Details emerged recently of policymakers' plans to push businesses to use their huge cash piles to boost salaries and moves to shift fiscal prudence targets, a sign Abe will continue to prioritize growth over austerity.

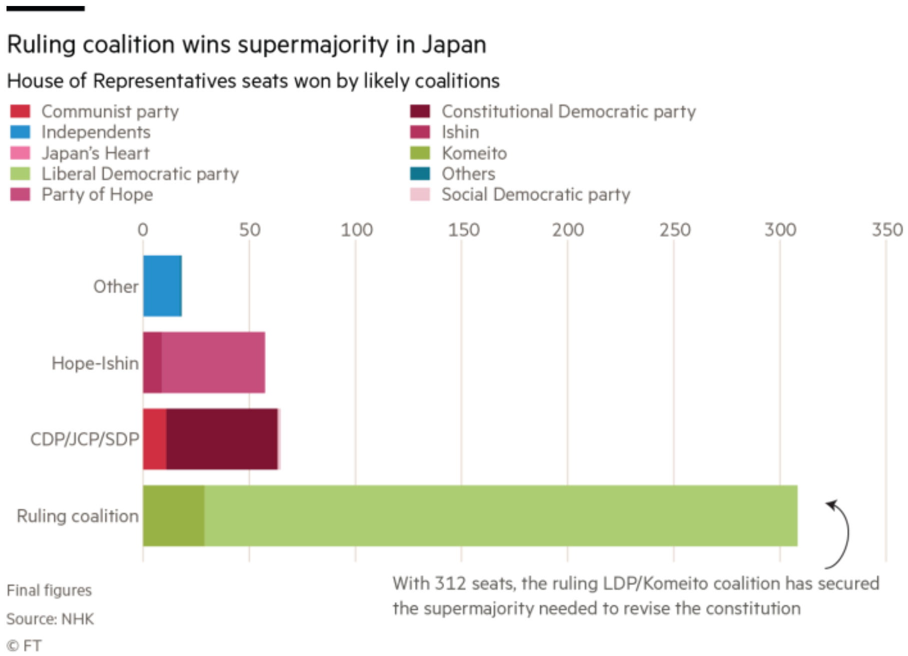
To encourage more growth, the government is considering expanding tax breaks for companies that raise salaries to achieve a 3% increase in overall salaries, sources said. That would be higher than a roughly 2% increase in big firms' wages in 2017. The move reflects the government's frustration over slow wage growth that has weighed on private consumption, even as companies reap record profits thanks to an improving economy: total earnings of employees rose a revised 0.9% in August compared with the same month last year, labour ministry data showed, but adjusted for inflation they edged up 0.1%. "The government will continue to shift more spending to policies that directly affect households," said Norio Miyagawa, senior economist at Mizuho Securities. "Companies have a lot of reserves, so it makes sense to try to get them to spend that money on capital expenditure and wages."

More spending for households, however, comes at the expense of further delays in reducing the nation's debt burden which, at twice the size of the economy, is the worst among advanced economies. Abe has pledged to proceed with a twice-delayed sales tax hike to 10% from 8% in 2019. But he decided to divert more tax proceeds into added spending instead of debt payment, forcing the government to abandon its original fiscal 2020 deadline for balancing the budget. "We can never repay debt without economic growth," he said. "We'll work to restore fiscal health while helping economic growth and steadily making necessary investments." Indeed, Abe promised to offer free pre-school for all children aged three to five and for children aged two or below from low-income households — if free pre-school education is applied to all children, it would cost ¥1.2 trillion, government estimates show.

One major decision for Abe over the next few months will be whether to retain Haruhiko Kuroda as Bank of Japan (BOJ) governor when his term expires in April. Some LDP members have expressed concern about the central bank's unprecedented easing, which included surprise moves to introduce negative interest rates and an innovative yield-curve control program. However, the probability that BOJ Governor Haruhiko Kuroda will be reappointed next spring seems to majority of observers higher. "The economy is growing, the yen is weak, and so Abe wants to keep the status quo on the economy without any disruptions," Takuji Okubo, Tokyo-based chief economist at Japan Macro Advisors.

Given the dual goals of promoting economic growth with more spending and achieving fiscal reconstruction, Abe's policy-steering capability will be put to the test, analysts say. Business circles welcomed the election outcome and expressed hope that the government will put more effort into tackling economic issues. "The business sector greatly welcomes" the election victory of the LDP and its Komeito ally, Sadayuki Sakakibara, chairman of the Japan Business Federation, or Keidanren, said in a statement. "The election results strengthened the foundation of the Abe government and will help it carry out policies steadily and without interruption," he said. Akio Mimura, chairman of the Japan Chamber of Commerce and Industry, also hopes that the government will "strive to help overcome labour shortages and improve productivity, and also build a strong economic foundation by carrying out structural reforms."

Economic indicators point to better conditions, and the positive outcome of the election gives Abe a stronger mandate to pursue his agenda. Will Abe's re-election jump-start Abenomics? Analysts including the IMF have given Abe a long list of reforms to implement, should the reformist leader seek to leave a lasting economic legacy, including labour market, childcare, and social welfare reforms. But so far, he has not delivered on his reform promises.



MARKET DEVELOPMENTS

The Bank of England has raised interest rates, signalling some very gradual 'normalisation' of monetary policy. It has begun to realise that the serious distortions in the savings market, causing under-valuation of pension funds, cannot any longer be justified by a need for 'emergency looseness' of money. As interest rates rise corporate pensions deficits will get smaller and the government will have to properly fund itself as its debt attracts more cost. Equities of companies that are well founded and not simply propped up by cheap money should do well, as bond market prices fall.

Table 1: Market Developments

	Market Levels		Prediction for Sep/Oct 2018	
	Sep 29	Nov 1	Previous Letter	Current View
Share Indices				
UK (FT 100)	7373	7488	11966	12153
US (S&P 500)	2519	2579	3053	3126
Germany (DAX 30)	12829	13466	20334	21343
Japan (Tokyo New)	1675	1787	2077	2216
Bond Yields (government				
UK	1.41	1.38	2.00	2.00
US	2.32	2.36	3.00	3.00
Germany	0.47	0.38	0.80	0.80
Japan	0.05	0.06	0.10	0.10
UK Index Linked	–1.52	–1.56	–1.00	–1.00
Exchange Rates				
UK ($ per £)	1.34	1.33	1.27	1.27
UK (trade weighted)	78.63	78.35	75.50	75.5
US (trade weighted)	99.44	101.14	102.4	102.4
Euro per $	0.85	0.86	0.85	0.85
Euro per £	1.13	1.14	1.08	1.08
Japan (Yen per $)	112.6	114.1	114.1	114.1
Short Term Interest Rates (3-month deposits)				
UK	0.30	0.48	0.60	0.60
US	1.37	1.39	1.80	1.80
Euro	–0.40	–0.41	–0.20	–0.20
Japan	–0.05	–0.05	0.10	0.10

Table 2: Prospective Yields [1]

Equities: Contribution to £ yield of:

	Dividend Yield	Real Growth	Inflation	Changing Dividend Yield	Currency	Total
UK	3.60	2.4	2.9	57.00		65.90
US	1.99	2.4	1.9	16.90	4.19	27.38
Germany	3.30	1.9	1.6	55.00	5.40	67.20
Japan	1.90	1.2	0.8	22.00	4.15	30.05
UK indexed[2]	–1.52		2.9	1.00		2.34
Hong Kong[3]	2.60	6.3	1.9	–4.00	4.19	10.99
Malaysia	3.30	4.8	1.9	49.00	4.19	63.39
Singapore	3.50	2.0	1.9	8.00	4.19	19.69
India	1.40	8.0	1.9	23.00	4.19	38.09
Korea	1.10	3.0	1.9	–21.00	4.19	–10.81
Indonesia	2.20	5.4	1.9	30.00	4.19	43.69
Taiwan	2.80	3.4	1.9	12.00	4.19	24.29
Thailand	3.20	2.6	1.9	24.00	4.19	36.39

Bonds: Contribution to £ yield of:

	Redemption Yield	Changing Nominal Rates	Currency	Total
UK	1.38	–6.20		–4.82
US	2.36	–6.40	4.19	0.15
Germany	0.38	–4.20	5.40	1.58
Japan	0.06	–0.40	4.15	3.81

Deposits: Contribution to £ yield of:

	Deposit Yield	Currency	Total
UK	0.48		0.48
US	1.39	4.19	5.58
Euro	–0.41	5.40	4.99
Japan	–0.05	4.15	4.10

[1] Yields in terms of €s or $s can be computed by adjusting the £-based yields for the expected currency change.

[2] UK index linked bonds All Stocks

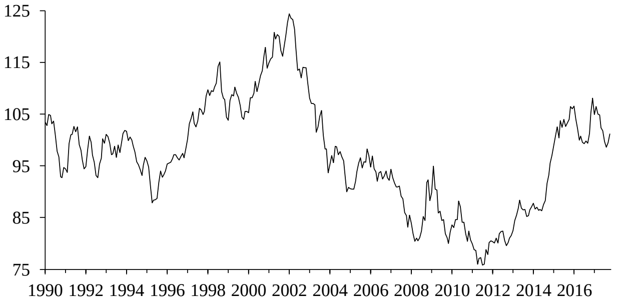
[3] Output based on China.

Table 3: Portfolio(%)

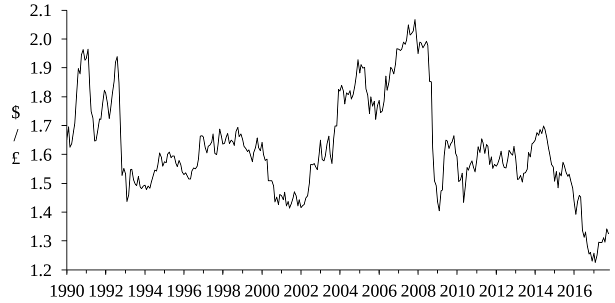
	Sterling Based Investor		Dollar Based Investor		Euro Based Investor	
	October Letter	**Current View**	**October Letter**	**Current View**	**October Letter**	**Current View**
UK Deposits (Cash)	5	5	5	5	1	1
US Deposits	-	-	-	-	-	-
Euro Deposits	-	-	-	-	-	-
Japanese Deposits	-	-	-	-	-	-
UK Bonds	-	-	-	-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

INDICATORS AND MARKET ANALYSIS
FOREIGN EXCHANGE MARKETS

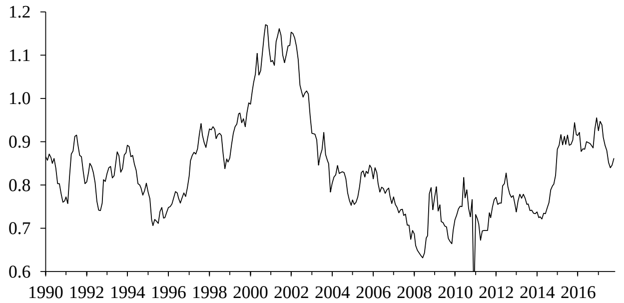
US : Trade Weighted Index
(Bank of England 1990 = 100)



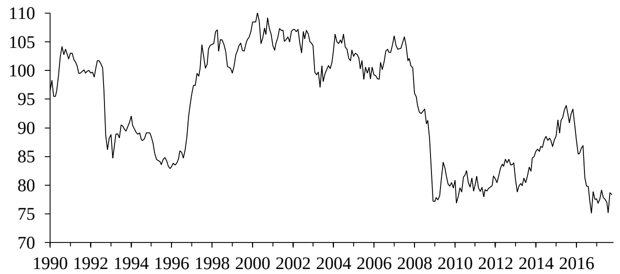
UK: Dollars Per Pound Sterling



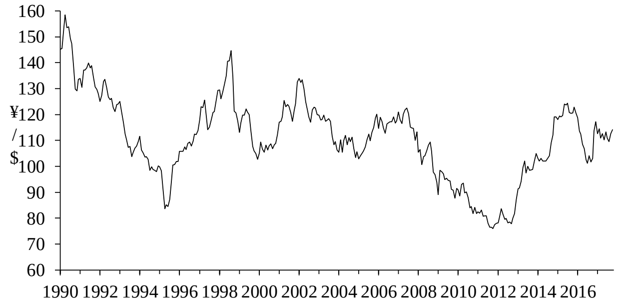
Euro per US dollar



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



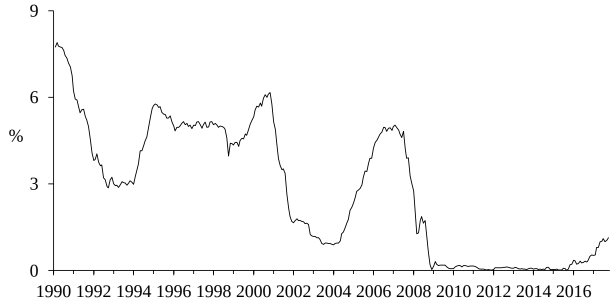
Japan : Yen Per U.S. Dollar



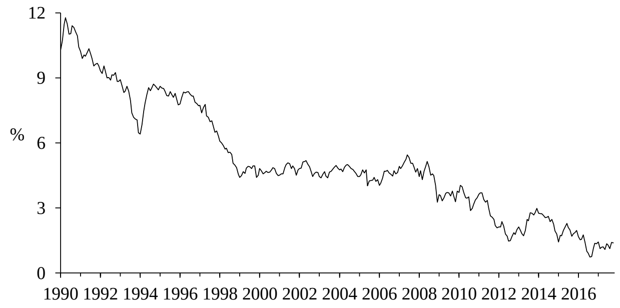
GOVERNMENT BOND MARKETS

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

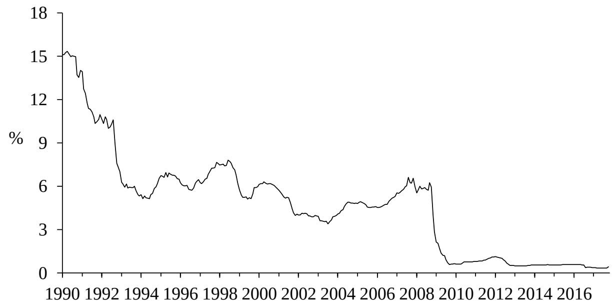
U.S. : 3-Month Treasury Bill



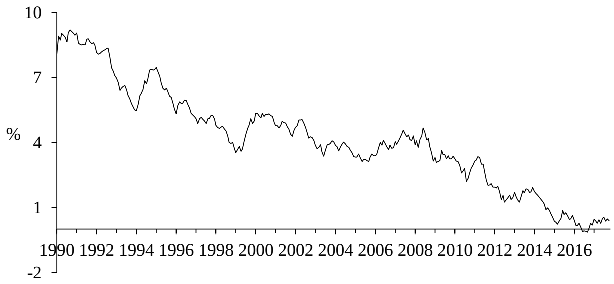
U.K.: Yield on Long-Term Government Bonds



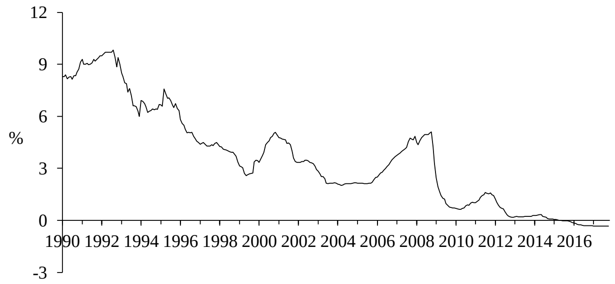
U.K. : 3-Month Interbank Rate



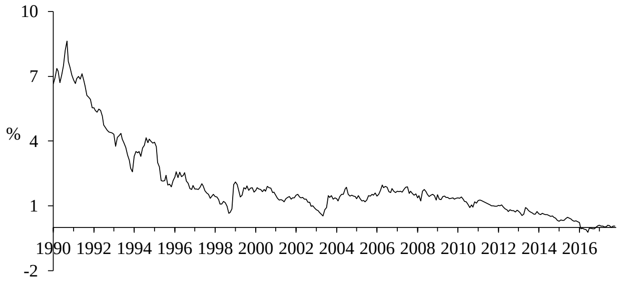
Germany: Yield on Public Authority Bonds



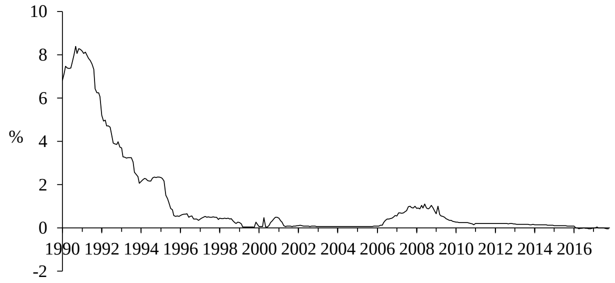
Germany : 3-Month Interbank Deposit Rate



Japan: Yield on Long-Term Government Bonds

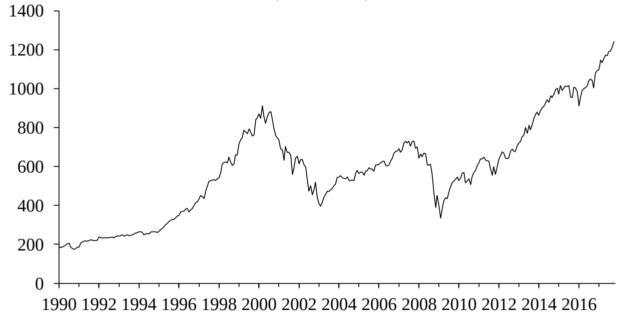


Japan : 3 Month Money Market Rate

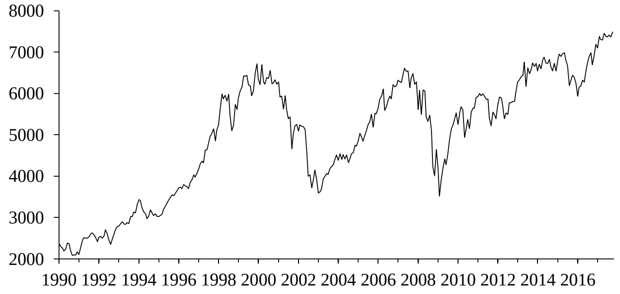


MAJOR EQUITY MARKETS

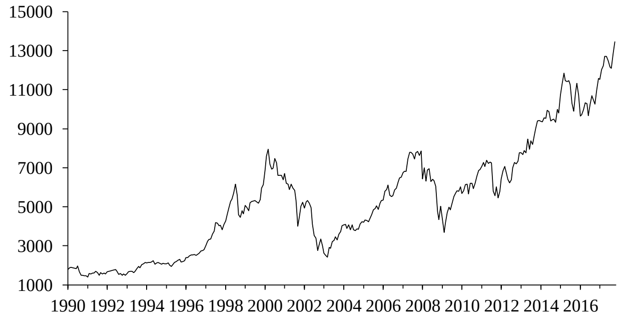
U.S. : S & P 400 Industrial
(1985=100)



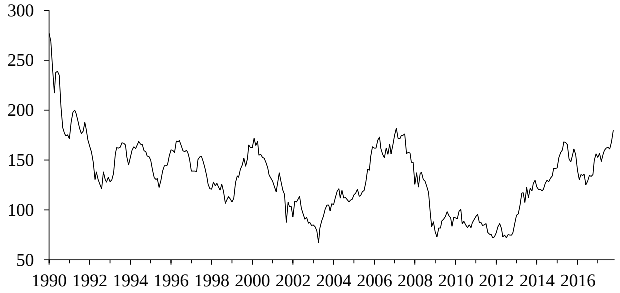
U.K. : FTSE-100 Index
(10 April 1962=100)



Germany : DAX 30



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



EMERGING MARKETS

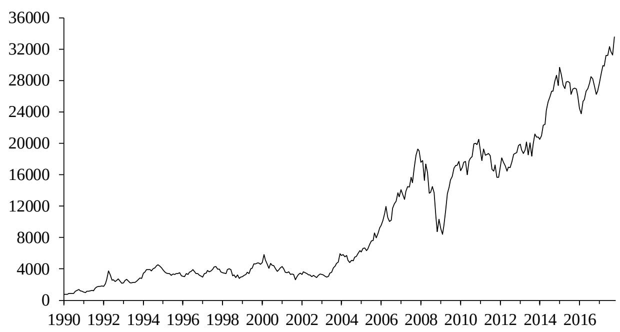
Anupam Rastogi

India

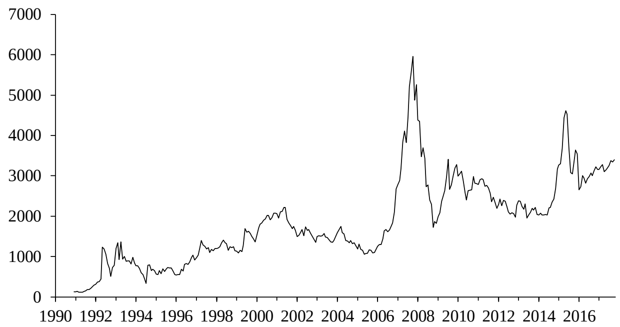
India's growth slowed to a three-year low of 5.7% in the April–June quarter, largely due to weak consumer demand and dragging private investments. Some analysts believe that Modi's pursuit of black money along with implementation of Goods and Services Tax is a hindrance to India's economy and his anti-corruption drive is incompatible with the economic growth ambitions. The government has taken some corrective measures, but the private sector is not coming in a big way to invest in the economy. The government, in turn, has stepped on government capital expenditure.

Despite higher capital expenditure planned toward building new infrastructure and capitalizing the banks, the government is confident of maintaining the fiscal deficit target of 3.2% for the current fiscal year through March. It is also hopeful that the economic growth will pick up from the next quarter. As of now, India's macroeconomic fundamentals continue to be strong. Inflation and the current-account deficit has come down, while foreign exchange reserves are at an all-time high of over $400 billion.

India: BSE Sensitive



China: SSE Composite Index



One of the big reforms taken up by the government was of cleaning up of commercial banks' balance sheet by recognizing assets which had become non-performing assets as bad assets. The government would inject 2.11 trillion rupees ($32.4 billion) to recapitalize heavily indebted public-sector banks over the next two years.

Investors have poured into Indian markets this year on the belief that Prime Minister Narendra Modi's government reform would buoy growth, improve infrastructure and reduce poverty. Investors still believe that. The world would know in less than one and half months' time when results of legislative assembly elections of Gujarat and Himachal Pradesh are declared in mid-December whether people of India have bought Modi's vision or not.

	15–16	16–17	17–18	18–19	19–20
GDP (%p.a.)	8.0	7.1	6.5	7.6	8.1
WPI (%p.a.)	5.2	4.5	3.5	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	65.5	66.5	67.5

China

China's economy grew 6.8% in the third quarter which may have helped Xi's plan to consolidate power at the Communist Party Congress. Despite strong growth, long-term risks remain due to over-dependence on debt-fuelled investment. With year-on-year growth of 6.9% through the first three quarters of 2017, China is all but certain to exceed its full-year target of "around 6.5%". However, economic indicators, including industrial output, retail sales, foreign trade and fixed-asset investment, slowed noticeably in July and August.

Chinese export companies are also less upbeat as order growth has slowed in October and companies are less optimistic about the export orders in coming months. The U.S. Treasury, in its semi-annual report on international exchange rates, gave China credit for allowing the yuan to rise this year.

Notwithstanding short-term economic cycle, China's bet on clean energy is likely to put Beijing in position to dominate the global auto industry. China is betting on electric cars in a move that is likely to leave global auto makers with little choice but to transfer their know-how to China. Electric-car sales in China are booming — the country already has more charging stations than the U.S. — sceptics note that so far hefty subsidies have been needed to persuade consumers to buy. There are many doubters about the dominance of China in the car industry, but there was similar disbelief about the solar industry, which China now dominates after raising the panels' performance and using economies of scale to drive down the cost of making them. The solar power is all set to rattle energy sector in the coming decade.

Donald Trump is going to visit China in November. A monumental struggle is under way to control the industries of the future from robotics to medical equipment and artificial intelligence. In new-energy vehicles, China is already in the driving seat.

The 19th congress kicked off on October 18, and the Communist Party has edged closer to resurrecting one-man rule, four decades after the death of Chairman Mao. It has given President Xi Jinping authority not seen in decades. It set the stage for him to stay in power after his second five-year term expires in 2022. Concentrating such power in Mr. Xi — who can now make policy and personnel choices virtually uncontested — draws to an emphatic end an era of collective leadership. His three and half hour speech to the congress has sent a "signal for lower growth" that could foreshadow a big deleveraging effort next year. Detailing his 2035 goal, Mr. Xi said China should become an innovative economy with a modernized military, a large middle class, and "significantly reduced" disparities in incomes and urban-rural development. That, he said, would position China to become a "global leader in terms of composite national strength and international influence" by mid-century.

Mr. Xi has already declared the start of a new era defined by strong leadership and more balanced development, instead of the unbridled growth under Deng, as a way to preserve party rule far into the 21st century. To eulogise further, the Renmin University in Beijing, one of China's top schools, has established a new research centre dedicated to the study of "Xi Jinping Thought on Socialism With Chinese Characteristics for a New Era" — the political theory that was just inscribed in the party charter.

The main take-away from the party congress is that China is ready to assert itself more in world affairs and it has found a development model which is different from the western model. The following two examples is just the beginning.

First, China has challenged the Trump administration's plans for a new "Indo Pacific" strategy to counter Beijing's growing economic and security hold on the region, warning that the world's two biggest powers should not be treating their rivalry as a "zero-sum game". In recent weeks, senior US officials have been pointing to India and Japan as allies in an "Indo-Pacific" alliance as a bulwark against China, in both security and economic terms.

Second, China sold $2 billion in bonds at record-low interest rates that were slightly above what the U.S. pays to borrow in the debt markets, a sign of investors' confidence in the financial health of the world's second-largest economy. A surge of investor demand for the country's first U.S. dollar-denominated debt sale in 13 years enabled China to price its five-year bonds to yield 2.196%, or just 0.15 percentage points over comparable U.S. Treasury notes at the time of the pricing. The bond sale was carefully managed to achieve an outcome that would send a strong message about China to the global markets that it is an equal power to the U.S.

Korea: Composite Index

The main goal of the bond sale was to create low interest-rate benchmarks that Chinese state-owned enterprises and private corporations, which are more-regular issuers of offshore debt, can reference when tapping the global bond markets for funding needs.

The bond sale follows credit-rating downgrades of China this year by international ratings firms Moody's Investors Service and S&P Global. Both grade the country the equivalent of an A+ rating, which is several notches below their rating on the U.S., and the raters have pointed to what they consider rising economic and financial risks in China. The bond sale was engineered to be successful, and "proves a point to the world" that China can sell its debt cheaply without credit ratings.

	15	**16**	**17**	**18**	**19**
GDP (%p.a.)	6.9	6.5	6.7	6.3	6.0
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	6.6	6.5	6.6

South Korea

In the third quarter, South Korean exports grew 6.1% quarter on quarter, with rises in exports of semiconductors, chemical products and motor vehicles. Imports rose 4.5% on greater shipments of chemical products and petroleum. Both imports and exports had contracted in the second quarter. With international trade growing, the South Korean GDP grew 1.4% in the third quarter compared to 0.6% in the second quarter. South Korea may clock more than 3% growth in 2017.

Korean inflation also jumped to 2.6% in August before easing back to 2.1% in September. The yield on benchmark 10-year bonds closed at 2.39% on Thursday, up from just 1.36% in July 2016.

South Korea's trade surplus jumped to USD 13.8 billion in September of 2017 from USD 6.9 billion in September 2016, mainly supported by double-digit growth of exports. South Korea's finance minister said Seoul should lessen its trade reliance on the U.S. and China as it seeks to resolve economic spats with its two largest trading partners.

President Trump's threat of unilaterally terminating the free-trade deal with South Korea appears to have worked. South Korea has agreed to negotiations to review key areas of U.S. concerns, notably large bilateral trade imbalances in autos and steel, rather than risking deal altogether.

The South Korean won edged up to an eight-week high on raised expectations for an interest rate hike in November following the release of economic data showing the economy grew at its fastest pace in seven years in the third quarter. As robust exports offset weakness in consumption and rising inflation, it reinforces the case for higher interest rates.

	15	**16**	**17**	**18**	**19**
GDP (%p.a.)	2.6	2.8	3.0	2.8	2.5
Inflation (%p.a.)	0.7	1.0	2.3	1.8	1.8
Current A/c(US$ bill.)	90.0	88.0	88.0	86.0	80.0
Won/$(nom.)	1180	1160	1125	1140	1145

Taiwan

With world trade growing, Taiwan is expected to report a 2.07% increase in GDP for the third quarter, while the fourth-quarter growth will moderate to some extent due to base effect of the last year. Taiwan's central bank has forecast GDP to grow 2.15% in 2017 and 2.2% in 2018. Good news for Taiwan is that the Nikkei-Markit manufacturing purchasing managers' index for Taiwan came in at 54.2 in September, remaining well above the 50-point level separating expansion from contraction.

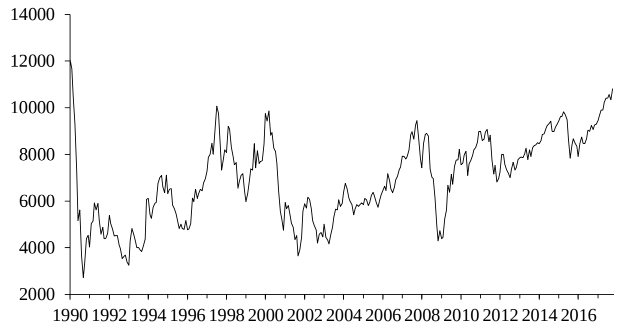
Taiwan's consumer price inflation eased more-than-expected in September and the consumer price index rose 0.5% year-over-year only in September, slower than the 0.96% climb in August.

The trade surplus increased to $6.69 billion in September from $5.71 billion in August. Exports surged 28.1% year-on-year to a record $28.9 billion. Likewise, annual growth in imports advanced to 22.2% from 6.9%. For 2017, exports are expected to grow 3.54% from a year earlier.

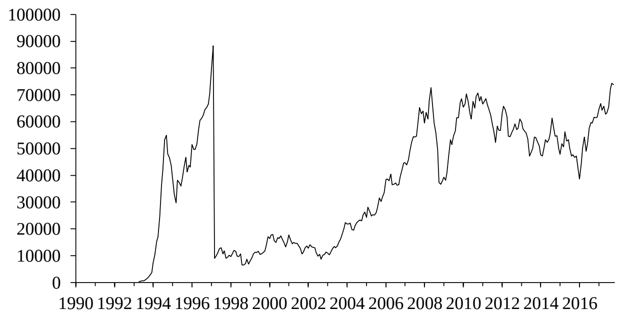
What is going to give sleepless nights to Taiwan's political elite is that Chinese president Xi Jinping has delivered a stern message to democratic Taiwan in an address at the 19th Communist party congress in Beijing. Mr Xi said China had the "resolve, confidence and ability" to defeat Taiwan independence. "We will never allow anyone, any organisation or any political party, at any time or in any form, to separate any part of Chinese territory from China". Mr Xi, who was marking the start of his second five-year term as head of the Chinese Communist party at the congress, said that China must also uphold the principles of peaceful "reunification" and "one country, two systems".

	15	**16**	**17**	**18**	**19**
GDP (%p.a.)	0.8	1.4	2.2	2.0	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 seems to have turned the corner and economic growth in 2017 is expected to be around 0.7% and in 2018 GDP may grow as much as 2.5%.

Inflation seems to have touched the bottom. Consumer prices as measured by the IPCA index rose 2.54% from the year before, down from 2.56% through mid-September. The annual rate of inflation remained far below the bottom-end of the central bank's target range of 4.5% plus or minus 1.5 percentage points. An unexpectedly strong agricultural harvest has driven food prices sharply lower, helping to pull down inflation from double digits as Brazil moves out of deep recession. For 2017 we expect consumer inflation to be a shade below 3% and for 2018 around 4%.

The central bank has cut its benchmark interest rate to 7.5% from 8.25%. which is near its lowest level ever, to boost a feeble economy that has begun to recover despite political paralysis in the country.

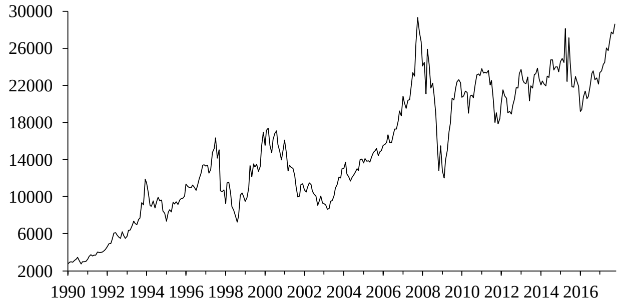
Brazil posted a trade surplus of $5.2 billion in September, down from $5.6 billion in August. It exported $18.7 billion worth of goods and services in September, compared with $19.5 billion of exports in August. Imports reached $13.5 billion in September, down from $13.9 billion in August. For the year 2017 through September, Brazil is running a trade surplus of $53.3 billion.

Investors in Brazil exude complacency despite political risks. The country is facing one of the most unpredictable presidential elections in its history in October next year. A vote in Brazil's Congress, extending a lifeline to embattled President Michel Temer, was welcomed by markets eager for stability, but doubts remain about his capacity to advance market-friendly reforms as general elections draw near. Mr. Temer is slated to hand over the post in 2019 to a president to be elected in October 2018. Given the generous protections, Brazil's Constitution grants to elected officials, getting elected may be the best hope of staying out of jail for many politicians.

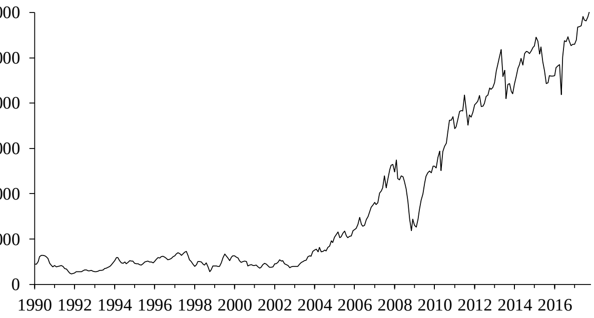
	15	**16**	**17**	**18**	**19**
GDP (%p.a.)	-3.8	-3.6	0.7	2.5	3.0
Inflation (%p.a.)	10.7	6.3	3.0	4.0	4.0
Current A/c(US$ bill.)	-70.0	-28.0	-25.0	-25.0	-32.0
Real/$(nom.)	3.9	3.5	3.2	3.2	3.2

Other Emerging Markets

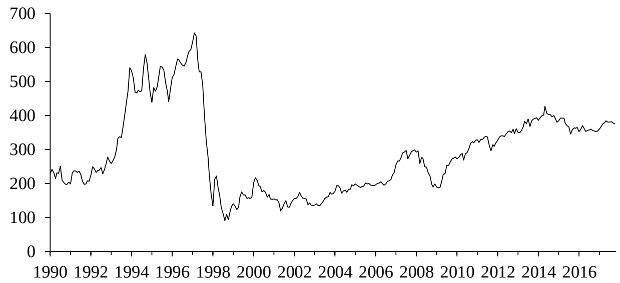
Hong Kong: FT-Actuaries



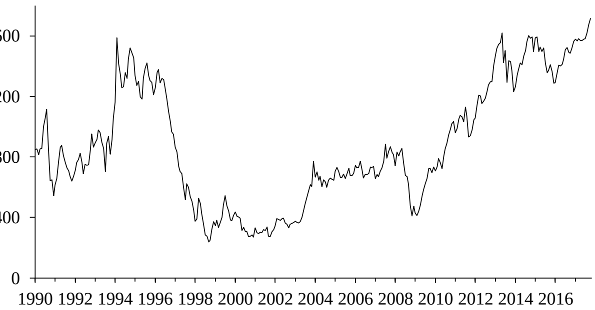
Indonesia: Jakarta Composite



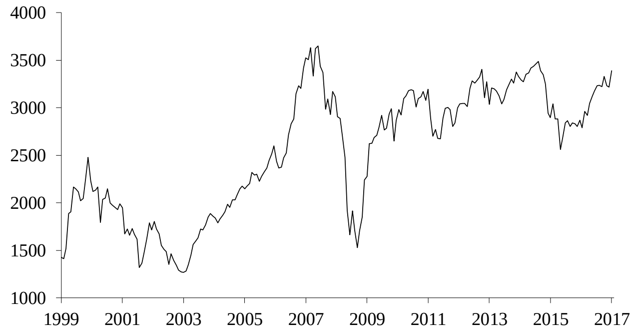
Malaysia: FT-Actuaries (US$ Index)



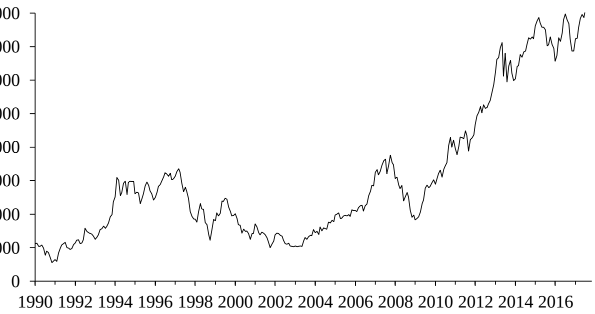
Thailand: Composite Index



Singapore: Straits Times Index

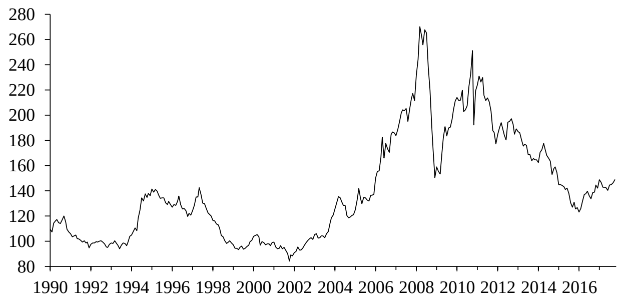


Philippines: Manila Composite

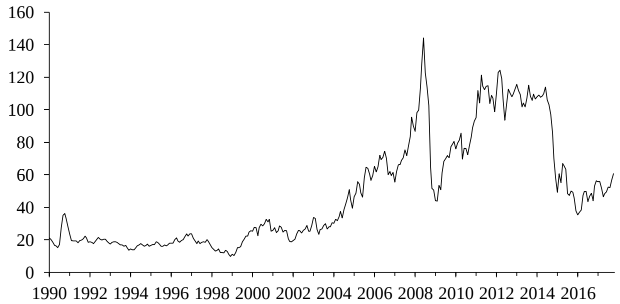


COMMODITY MARKETS

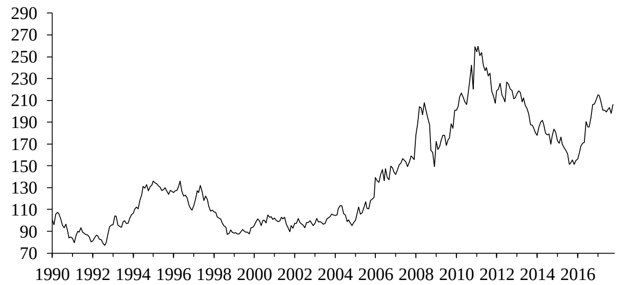
Commodity Price Index (Dollar)
(Economist, 2000=100)



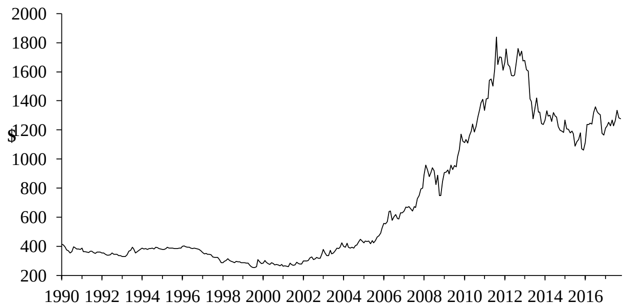
Oil Price: North Sea Brent (in Dollars)



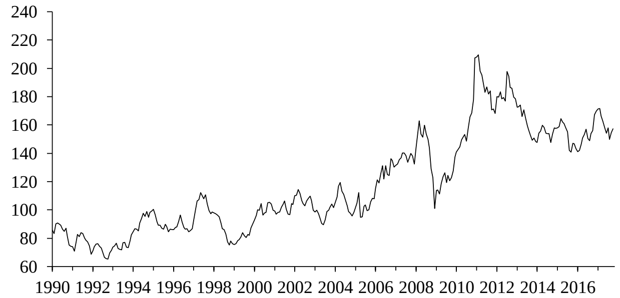
Commodity Price Index (Sterling)
(Economist, 2000=100)



Gold Price (in Dollars)



Commodity Price Index (Euro)
(Economist)



UK FORECAST DETAIL

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

	Inflation %[1] (CPI)	Short Dated (5 Year) Interest Rates	3 Month Int. Rates	Nominal Exchange Rate (2005=100) [2]	Real Exchange Rate[3]	Real 3 Month Int. Rates %[4]	Inflation (RPIX)	Real Short Dated Rate of Interest[5]
2015	0.2	1.3	0.6	91.6	91.6	0.5	1.0	-1.0
2016	1.2	0.9	0.4	81.5	80.4	-1.5	2.1	-1.6
2017	2.6	1.1	0.4	77.0	74.9	-2.2	3.3	-1.7
2018	2.7	1.5	0.6	76.3	75.1	-2.4	3.2	-1.3
2019	3.0	2.5	1.1	74.9	74.6	-1.9	3.5	0.0
2020	3.0	3.0	2.8	73.7	74.3	0.3	3.5	0.9
2016:1	0.3	0.9	0.7	87.2	86.8	-1.1	1.4	-0.7
2016:2	1.3	0.9	0.5	81.8	81.2	-1.3	2.2	-0.9
2016:3	1.5	0.9	0.2	79.4	77.8	-1.7	2.3	-1.0
2016:4	1.8	0.9	0.2	77.6	75.9	-1.8	2.5	-1.2
2017:1	1.9	0.6	0.3	76.8	73.9	-2.1	3.3	-2.1
2017:2	2.7	1.2	0.4	77.3	75.2	-2.0	3.2	-1.6
2017:3	2.9	1.2	0.4	77.2	75.3	-2.5	3.3	-1.6
2017:4	3.0	1.2	0.5	76.9	75.3	-2.3	3.5	-1.6
2018:1	2.5	1.3	0.5	77.2	75.3	-2.5	3.1	-1.6
2018:2	2.5	1.5	0.5	76.7	75.3	-2.5	3.0	-1.5
2018:3	2.9	1.5	0.6	75.5	74.3	-2.4	3.3	-1.5
2018:4	2.9	1.5	0.6	75.9	75.3	-2.4	3.3	-1.5

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

Labour Market and Supply Factors (Seasonally Adjusted)

	Average Earnings (1990=100)[1]	Wage Growth[2]	Unemployment (New Basis) Percent[3]	Millions	Real Wage Rate[4] (1990=100)
2015	247.1	2.4	2.3	0.8	141.1
2016	254.3	2.9	2.1	0.7	143.5
2017	257.3	2.2	2.2	0.8	142.5
2018	268.7	2.7	2.1	0.8	144.3
2019	275.6	3.2	2.0	0.7	143.7
2020	283.7	3.5	1.9	0.7	145.0
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	255.8	2.4	2.1	0.75	144.0
2017:2	257.0	2.0	2.2	0.79	141.8
2017:3	260.0	2.2	2.2	0.78	142.6
2017:4	259.8	2.2	2.2	0.78	141.3
2018:1	262.0	2.4	2.1	0.77	143.9
2018:2	263.8	2.6	2.1	0.76	142.0
2018:3	266.9	2.6	2.1	0.75	142.2
2018:4	267.6	3.0	2.0	0.74	141.5

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	156.6	749967.5	431566.6	302272.7	196715.2	-55478.9	125108.2
2016	159.4	763130.9	440238.4	297248.0	198473.7	-55145.2	117683.9
2017	162.8	779503.7	447129.1	294837.8	200378.8	-47979.4	115414.0
2018	166.9	799242.7	455346.1	297328.4	202045.3	-36926.0	118548.5
2019	171.8	822594.8	465272.4	305534.8	206495.7	-32481.6	122225.6
2020	177.9	851997.5	475937.7	320453.0	210383.9	-27942.6	126832.3
2015/14	2.2		1.4	3.8	1.1		-2.3
2016/15	2.3		2.3	-6.3	1..0		-3.7
2017/16	2.1		1.6	0.7	1.0		2.0
2018/17	2.6		1.8	0.8	0.9		2.7
2019/18	2.9		2.2	2.8	2.2		3.1
2020/19	3.5		2.3	4.9	1.9		3.8
2016:1	158.1	189138.4	108678.4	72398.4	50736.1	-13542	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	161.6	193453.0	111073.9	73556.2	51435.0	-14278.1	28888.6
2017:2	162.4	194410.6	111468.9	73625.5	49462.3	-11502.3	28644.4
2017:3	163.2	195400.1	111916.5	73833.9	49636.1	-11233.9	28751.2
2017:4	163.9	196240.1	112669.9	73822.1	49845.4	-10965.1	29129.9
2018:1	165.1	197636.6	112796.0	73615.4	50354.4	-9784.9	29345.9
2018:2	166.5	199357.8	113486.2	74811.3	49863.7	-9260.8	29541.3
2018:3	167.2	200125.4	114181.2	73873.7	50679.7	-8946.9	29660.8
2018:4	168.8	202122.9	114882.7	75028.0	51147.5	-8933.4	30000.5

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	2.4	1866.5	45.1	52.0	-87.4
2017	2.6	1964.1	51.6	54.1	-64.3
2018	2.2	2076.5	45.4	56.6	-45.0
2019	0.9	2204.1	21.1	60.8	-37.3
2020	1.0	1748.4	22.7	50.8	-28.6
2016:1	-0.6	458.0	-2.7	13.1	-26.6
2016:2	4.8	460.4	22.0	13.1	-21.7
2016:3	3.1	460.1	14.1	12.9	-26.6
2016:4	5.0	471.8	23.7	12.9	-12.5
2017:1	-3.1	474.1	-14.6	13.1	-17.5
2017:2	2.8	482.0	13.3	13.3	-18.8
2017:3	3.0	487.5	14.4	13.4	-17.2
2017:4	2.6	494.4	12.6	13.7	-10.8
2018:1	2.5	497.2	12.4	13.7	-9.7
2018:2	2.6	507.1	13.0	13.9	-14.9
2018:3	2.6	514.3	13.4	14.1	-13.3
2018:4	2.2	524.1	11.6	14.2	-7.1

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	2.2	2.4
U.K.	2.2	2.9	2.2	2.3	2.1	2.6
Japan	1.4	–0.1	0.5	1.0	1.6	1.2
Germany	0.3	1.6	1.7	1.8	1.9	1.9
France	0.7	0.2	1.1	1.4	1.6	1.6
Italy	–1.7	–0.3	0.8	1.1	1.3	1.1

Growth Of Consumer Prices

	2013	2014	2015	2016	2017	2018
U.S.A.	1.5	1.6	0.1	1.3	2.0	1.9
U.K.	2.3	1.7	0.2	1.2	2.6	2.7
Japan	0.4	2.7	0.8	0.2	0.5	0.8
Germany	1.5	0.9	0.3	0.5	1.7	1.6
France	0.9	0.5	0.0	0.4	1.0	1.1
Italy	1.2	0.2	0.1	0.2	1.4	1.2

Real Short-Term Interest Rates

	2013	2014	2015	2016	2017	2018
U.S.A.	–1.5	–0.1	–1.1	–1.4	–0.7	–0.2
U.K.	–0.8	–2.2	-0.5	–1.5	–2.2	–2.4
Japan	–2.5	–0.6	0.0	–0.7	–0.7	–0.8
Germany	–0.6	–0.2	–0.6	–2.0	–1.9	–1.8
France	–0.2	0.1	–0.5	–1.5	–1.4	–1.3
Italy	0.1	0.0	–0.3	–1.6	–1.5	–1.4

Nominal Short-Term Interest Rates

	2013	2014	2015	2016	2017	2018
U.S.A.	0.1	0.0	0.2	1.0	1.2	1.8
U.K.	0.6	0.6	0.6	0.4	0.4	0.6
Japan	0.2	0.2	0.2	0.0	0.1	0.1
Germany	0.3	0.1	–0.1	–0.2	–0.3	–0.2
France	0.3	0.1	–0.1	–0.2	–0.3	–0.2
Italy	0.3	0.1	–0.1	–0.2	–0.3	–0.2

Real Long-Term Interest Rates

	2013	2014	2015	2016	2017	2018
U.S.A.	1.6	0.7	0.3	0.3	0.6	1.1
U.K.	–0.8	–0.7	–1.0	–1.5	–1.7	–1.0
Japan	–0.8	–1.1	–1.3	–1.2	–0.7	–0.8
Germany	0.8	–0.8	–1.0	–1.6	–1.1	–0.8
France	1.1	–0.5	–0.8	–1.4	–0.2	0.1
Italy	1.2	–0.5	–0.7	–1.3	1.1	1.4

Nominal Long-Term Interest Rates

	2013	2014	2015	2016	2017	2018
U.S.A.	3.0	2.2	2.2	2.4	2.5	3.0
U.K.	1.3	1.8	1.3	0.9	1.1	1.5
Japan	0.7	0.3	0.3	0.0	0.1	0.0
Germany	1.9	0.5	0.6	0.4	0.5	0.8
France	1.9	0.5	0.6	0.4	0.9	1.2
Italy	1.9	0.5	0.6	0.4	2.3	2.6

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

	2013	2014	2015	2016	2017	2018
U.S.A.	82.1	83.9	93.0	94.0	94.5	94.8
U.K.	86.5	93.1	91.6	80.4	74.9	75.1
Japan	63.5	59.8	56.0	58.4	58.3	58.1
Germany	99.0	99.9	94.7	95.0	94.3	94.9
France	100.7	100.8	96.2	96.0	95.3	95.1
Italy	106.9	107.5	102.1	102.0	101.2	101.1

[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	1.28	1.27
Japan	98.20	106.70	120.00	118.40	112.60	114.10
Eurozone	0.75	0.76	0.90	0.95	0.86	0.85

[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