LIVERPOOL INVESTMENT LETTER

February 2018

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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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THE TRUMP EFFECT

Times and mores change; today we have social media prominent in politics. But the way Trump is simultaneously criticised and patronised by the 'liberal' commentariat is similar to the way Reagan was criticised and patronised by it. However, Reagan achieved a major conservative revolution in policy and also stimulated the economy with a major tax-cutting package; he famously pretended to be not very smart but this was for him the secret of his electoral success, as being seen as 'smart' is no way to win votes in the USA. Fast forward from the 1980s to today and Trump embodies similar tactics, updated for social media and today's tiny attention spans. He produces a daily theatre for his core supporters, designed to entertain them and keep them in the loop, convinced that he has not become a Washington swampy. Meanwhile he has managed at last to create a cadre of loyal and highly competent administrators around him, led by vice-president Mike Pence. He has also used the bland arts of political good fellowship to strike up rapports with Republican Congress people. This is all out of the classic Reagan playbook, merely updated.

The Trump tax package is highly significant and cuts taxes all the way down the scale, cutting back on deductions and mostly doubling thresholds. The bullet points below give a bald summary of it all. The achievement of finally getting sense into the US corporate tax, and jettisoning its 'worldwide' tax base in favour of simply taxing US corporate profits, is a big one. Personal tax cuts are less dramatic but they confirm the US as a low marginal tax rate economy: they are being cut, not raised as almost everywhere else.

Trump Tax Act Key Elements:

- Corporate tax now 21% from 35%: 'territorial' so foreign income untaxed; concessionary rate on cash returned from abroad; all building/equipment deductible*
- Income tax changes*: double tax thresholds: rates fall to 10/12/22/24/32/35/37 from 10/15/25/28/33/35/39.6
- Child tax credit doubles; state and local tax/mortgage interest deductions capped; medical expenditure deductible if above 7% of income; no tax penalty if no health insurance (v. Obamacare)
- IHT threshold doubled to $11.2million*
- Estimated stimulus to demand (various): 0.6–1% GDP, raise public debt $1 trillion (5% of $20 tr. GDP) on top of existing $20 tr. Debt (c100% of GDP)
  *expire mid-2020s

In a concession to concerns about the US public debt, now 100% of GDP, and due to rise by $1 trillion (5% of GDP) from the tax package, some of the tax cuts are supposed to lapse in the mid-2020s. But they will almost certainly be renewed, as taking away personal gains from people is impossible politics. How worried should investors be about US government solvency? Not very. First of all the Federal Reserve, America's central bank, holds assets of $4.5 trillion, nullifying nearly a quarter of the US public debt. That will gradually be sold off but until it is, the public debt/GDP ratio is correspondingly reduced. Also the 'secular stagnation thesis' is well and truly buried now by the obvious surge in US growth, accompanied by finally stronger wage rises. Growth in nominal GDP could reach 5–6% a year which will reduce the debt burden.

Table 1: Summary of Forecast

	2016	2017	2018	2019	2020	2021	2022
GDP Growth[1]	1.8	2.2	2.0	1.9	1.9	2.2	2.3
Inflation CPI	1.1	2.6	2.5	2.1	2.0	2.1	2.8
Wage Growth	2.4	2.0	2.3	1.8	1.8	2.6	3.6
Unemployment (Mill.)[2]	0.8	0.8	0.8	0.7	0.7	0.6	0.5
Exchange Rate[3]	80.6	74.9	75.0	74.5	73.1	72.4	71.7
3 Month Interest Rate	0.5	0.4	0.6	1.2	2.4	3.1	3.1
5 Year Interest Rate	0.7	1.1	1.4	2.5	3.5	2.9	2.6
Current Balance (£bn)	-87.4	-65.6	-54.3	-49.4	-39.0	-26.4	-15.4
PSBR (£bn)	45.1	40.1	33.4	24.2	6.6	-6.6	-10.8

[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)

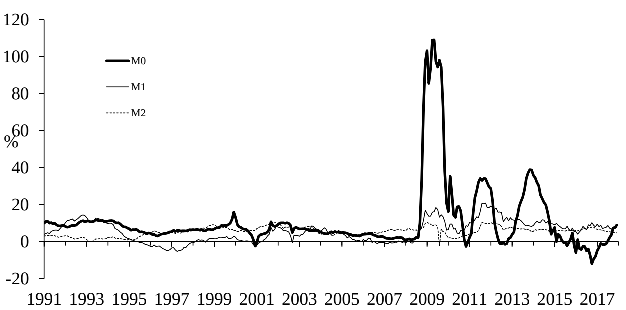
At the same time the Trump administration is moving strongly on a deregulation agenda. The result is that growth is becoming stronger particularly in energy-producing and financial sectors.

We have yet to see how the infrastructure and Obamacare-reform programmes roll out. Fortunately for the Trump administration a new triad of Amazon, Berkshire Hathaway and JP Morgan are moving into the healthcare sector which is ripe for disruption, with inefficient and monopolistic practices rife throughout it. Against this background reform and even abolition of Obamacare looks more promising. On infrastructure there are major possibilities for using private sector arrangements that allow charging or shadow-charging systems so that government does not have to do it itself. Even road pricing these days has become technologically feasible via satellite tracking.

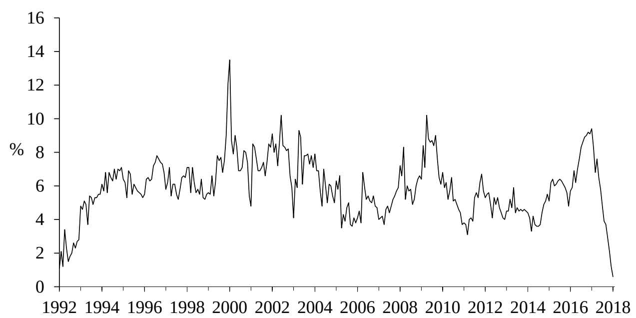
Much is made of Trump's supposed stance against free trade. However, this is more to be seen through the lens of a large trade player retaliating against unfair trading practices which worsen its terms of trade. We are in the realms of 'optimal tariff theory' here, especially with some of China's practices in areas such as intellectual property rights. We should not confuse the interests of a large player in resisting bad foreign practices, with the interests of small players like the UK in a generally robust WTO system. The WTO is not well set up to deal with the large bilateral abuses with which the US is concerned. Court cases between large players such as the US and the EU (on GM foods for example) have been long and tedious and have failed to lead to resolution, even when there has been a judgement (as on GM foods in 2006).

In sum, it does seem fair to say that America is back as a strong source of growth that will now strengthen world growth generally. With raw material capacity still large and overshadowing commodity markets, we see a long period of world expansion ahead. The main risk to the world economy is that central banks repeat the past mistakes of the 2000s in excessively loose monetary policy. Our hope is that progressive reversal of the financial regulation backlash following the financial crisis will allow interest rates to rise, central banks to sell off their huge portfolios of bonds, and so lead to a normal monetary environment that will permit moderate continued growth for a long time.

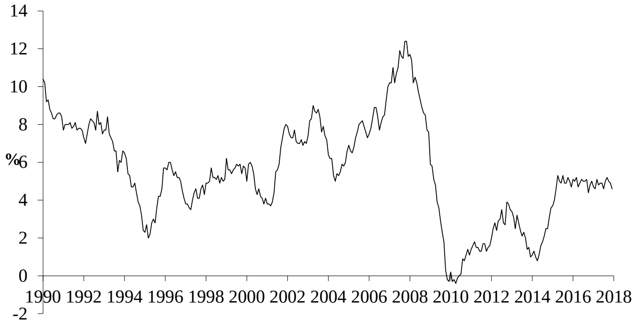
U.S.: Growth in Monetary Aggregates (Yr - on - Yr)



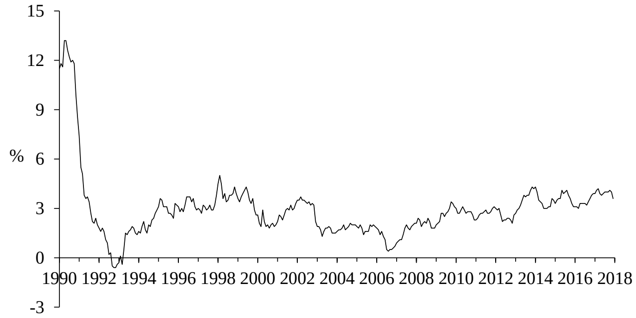
UK: Notes and Coins in Circulation Growth



Eurozone M3 Growth



Japan: Growth of M2+CD's



FOCUS ON JAPAN

Francesco Perugini

Japan Plans Record Budget Spending

Last month, the Japanese government approved and then submitted to the regular session of the Diet a record draft budget of ¥97.7 trillion for the fiscal year starting in April. The government also submitted a ¥2.71 trillion supplementary budget proposal partly to pay for reconstruction in areas devastated by heavy rain in northern Kyushu last July. The extra budget is also intended to cover costs for supporting farmers who would be affected by an economic partnership agreement between Japan and the EU.

The size of the general account budget was up 0.3% from the initial budget for fiscal 2017. The proposed fiscal 2018 budget includes ¥58.90 trillion in general spending for policy measures, up 0.9% from the initial figure for 2017. Spending on social security services such as medical and nursing care, will rise 1.5% to ¥32.97 trillion due to the ageing population, according to the plan. Projected annual growth in social security spending was capped at ¥500 billion, as targeted by the government's fiscal reconstruction program, mainly by sharply cutting drug prices.

The plan projects tax revenue in fiscal 2018 to rise 2.4% to ¥59.08 trillion, the highest level in 27 years, thanks mainly to more money coming in from income tax. New government bond issues are set at ¥33.69 trillion, down 2.0% from 2017 and falling for the eighth straight year.

The plan also includes measures aimed at boosting human resource development and productivity, both key policy initiatives for Prime Minister Shinzo Abe, and it allocates funding for childcare facilities to help working parents.

In the press conference Abe said that the government intends to produce a new set of fiscal management policies by next June, based on economic projections by the Cabinet Office. Typically, these plans set targets for primary spending — that is government spending excluding debt-service costs — for the next three to five years, in a way that moves Japan closer to a primary budget surplus. Abe also indicated a new timeline for achieving a surplus. The ruling Liberal Democratic Party (LDP) has effectively abandoned the goal of a balanced budget in fiscal 2020, having promised in the run-up to last autumn's Lower House election to spend a large part of funds previously meant for debt reduction on expanding social programs. Now, the target date for a surplus will land sometime after autumn 2021, when Abe's tenure as prime minister will end, assuming he wins a third consecutive term as LDP chief this autumn.

Of greater concern to Abe is keeping the economy strong through to the end of his term. That itself could be a challenge. Japan plans to raise its consumption tax from 8% to 10% in October 2019, and overall demand in the economy is expected to plunge after the Tokyo Olympics wrap up in 2020.

However, creative use of the supplementary budget process could let Abe pursue economic stimulus regardless of how the fiscal policy plan turns out, as rules for fiscal discipline apply more harshly to the first budget in each fiscal year. A hefty dose of extra spending this fall could help prepare the economy for next year's tax rise. In 2019, a second spending plan could head off the negative impacts of that increase, such as a drop in personal consumption. The following year, a supplementary budget could help stoke demand in the wake of the Olympics.

It is hardly ideal for a prime minister to be pulling hard for more spending as his government draws up plans for fiscal consolidation. But there is not much the finance ministry can do to stop him. The coming tax increase has already been postponed twice, and few at the ministry are willing to risk a third delay by urging Abe to reconsider his spending plans.

There is no denying that the Japanese economy is looking healthier today than it was a few years ago. This is partly attributable to the expansionary fiscal and monetary policies of "Abenomics." But the government has reached a limit on what it can accomplish through fiscal policy. The government's own forecast also acknowledges that raising the consumption tax to 10% is not going to be sufficient for fiscal consolidation. Even with that additional revenue, only a dramatic increase in economic growth could erase the primary deficit. So, Japan will need to increase tax revenues further, not necessarily through the consumption tax, cut back on spending, but most importantly create the kind of economy that can sustain a moderate level of inflation. To do so it needs to tackle difficult reforms Abe promised and that Japan so obviously needs. That would require expending political capital and taking on the vested interests in society and within his own government that resist them. Their agenda is well known and accepted. Without action the current good news story cannot last in the face of Japan's demographic time bomb and the government's fiscal position.

MARKET DEVELOPMENTS

There is a growing fashion in calling a slump in share prices as the bull market has rolled on. However, the background of US tax and regulatory reform is fuelling world growth and burying the ‘secular stagnation’ thesis. Our own forecasts are that world growth has a good decade at least still to run because of the overhang of massive raw material capacity from the previous 2000s boom. While bond prices must continue to fall, equity prices look well underpinned by these growth prospects.

Table 1: Market Developments

	Market Levels		Prediction for Jan/Feb 2019	
	Jan 4	**Feb 6**	**Previous Letter**	**Current View**
Share Indices				
UK (FT 100)	7696	7141	10659	9891
US (S&P 500)	2724	2695	3301	3267
Germany (DAX 30)	13168	12393	20871	19642
Japan (Tokyo New)	1864	1743	2311	2162
Bond Yields (government				
UK	1.26	1.58	1.50	1.50
US	2.45	2.79	3.00	3.00
Germany	0.44	0.69	0.80	0.80
Japan	0.04	0.07	0.10	0.10
UK Index Linked	–1.68	–1.51	–1.00	–1.00
Exchange Rates				
UK ($ per £)	1.36	1.39	1.30	1.30
UK (trade weighted)	78.01	79.02	76.10	76.10
US (trade weighted)	98.87	96.67	102.4	102.4
Euro per $	0.83	0.81	0.85	0.85
Euro per £	1.12	1.13	1.11	1.11
Japan (Yen per $)	112.8	109.3	114.1	114.1
Short Term Interest Rates (3-month deposits)				
UK	0.49	0.52	0.70	0.70
US	1.70	1.82	1.80	1.80
Euro	–0.41	–0.41	–0.20	–0.20
Japan	–0.15	–0.25	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	2.0	2.5	34.00		42.10
US	1.99	2.4	1.9	16.90	6.52	29.71
Germany	3.30	1.9	1.6	55.00	1.92	63.72
Japan	1.90	1.2	0.8	22.00	2.40	28.30
UK indexed[2]	–1.68		2.5	1.00		1.99
Hong Kong[3]	2.60	6.0	1.9	–7.00	6.52	10.02
Malaysia	3.30	5.3	1.9	52.00	6.52	69.02
Singapore	3.50	2.4	1.9	11.00	6.52	25.32
India	1.40	8.1	1.9	28.00	6.52	45.92
Korea	1.10	2.6	1.9	–20.00	6.52	–7.88
Indonesia	2.20	5.3	1.9	29.00	6.52	44.92
Taiwan	2.80	2.3	1.9	15.00	6.52	28.52
Thailand	3.20	3.0	1.9	23.00	6.52	37.62

Bonds: Contribution to £ yield of:

	Redemption Yield	Changing Nominal Rates	Currency	Total
UK	1.58	0.80		2.38
US	2.79	–2.10	6.52	7.02
Germany	0.69	–1.10	1.92	1.51
Japan	0.07	–0.30	2.40	2.17

Deposits: Contribution to £ yield of:

	Deposit Yield	Currency	Total
UK	0.52		0.52
US	1.82	6.52	8.34
Euro	–0.41	1.92	1.51
Japan	–0.25	2.40	2.15

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

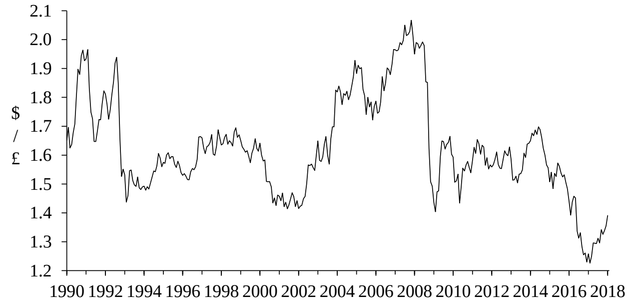
Table 3: Portfolio(%)

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

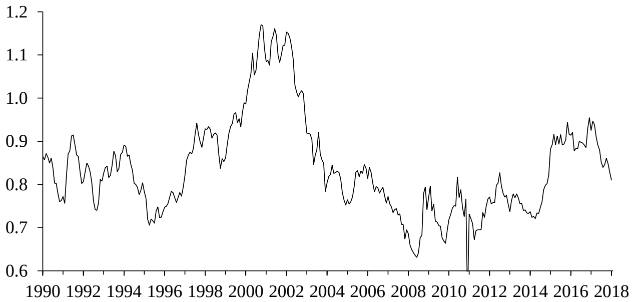
INDICATORS AND MARKET ANALYSIS
FOREIGN EXCHANGE MARKETS

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

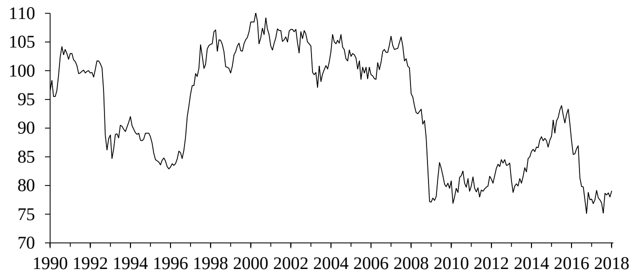
UK: Dollars Per Pound Sterling



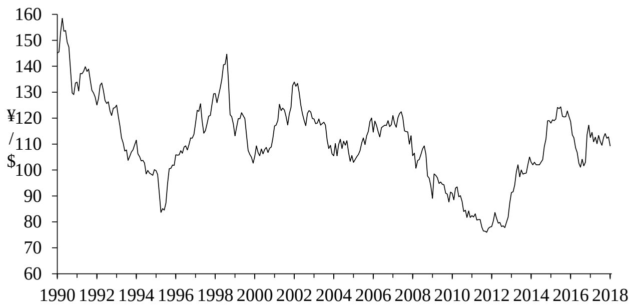
Euro per US dollar



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



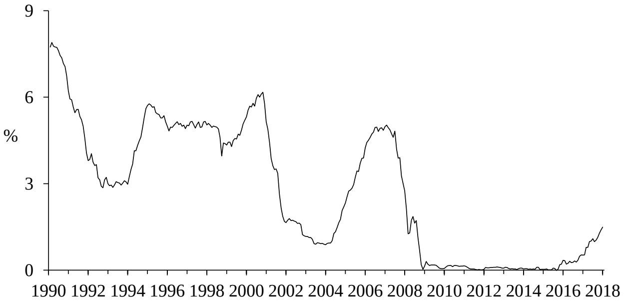
Japan : Yen Per U.S. Dollar



GOVERNMENT BOND MARKETS

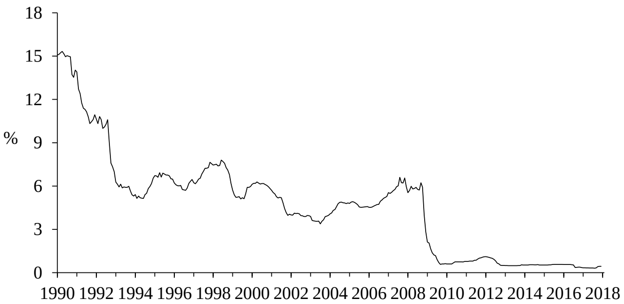
U.S.: Yield on Long-Term Government Bonds

U.S. : 3-Month Treasury Bill



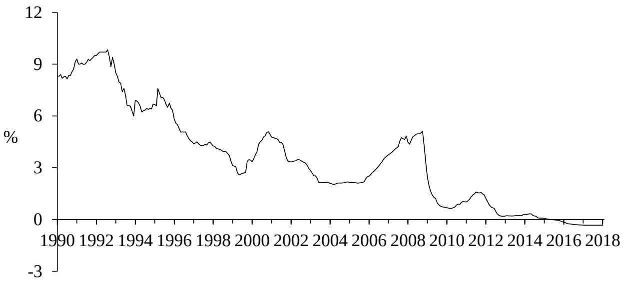
U.K.: Yield on Long-Term Government Bonds

U.K. : 3-Month Interbank Rate

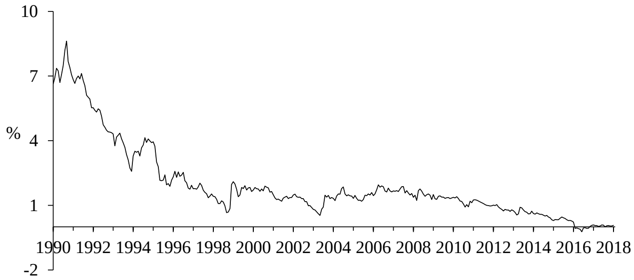


Germany: Yield on Public Authority Bonds

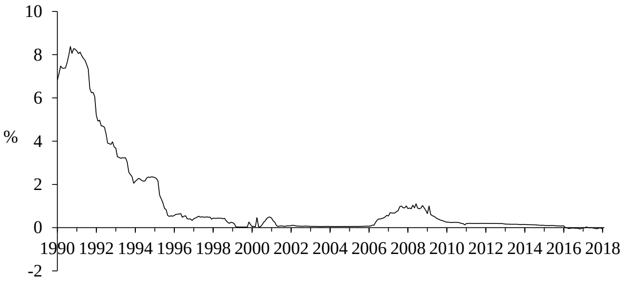
Germany : 3-Month Interbank Deposit Rate



Japan: Yield on Long-Term Government Bonds

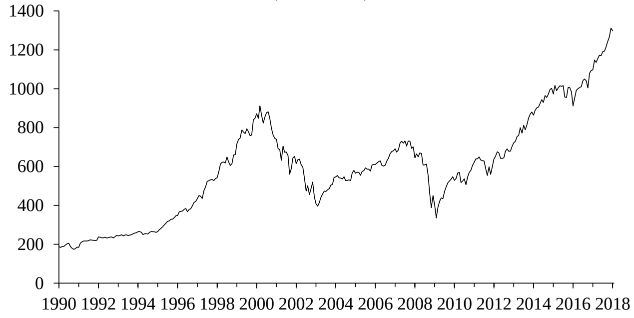


Japan : 3 Month Money Market Rate

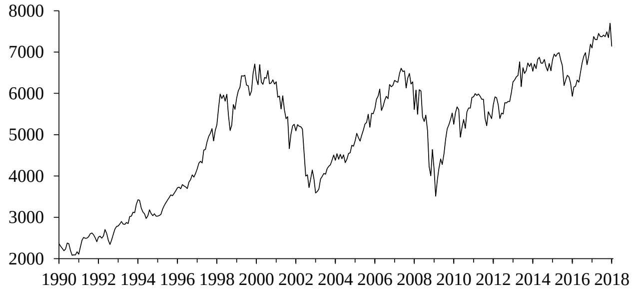


MAJOR EQUITY MARKETS

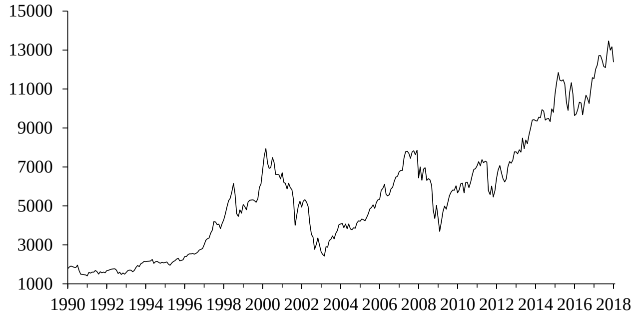
U.S. : S & P 400 Industrial
(1985=100)



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



Germany : DAX 30



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

EMERGING MARKETS

Anupam Rastogi

India

The International Monetary Fund and other multi-lateral institutions remain bullish on India's growth potential and expect GDP growth rate to accelerate to approximately 7.5% in 2018. We maintain a similar growth rate for India in the next fiscal year and increasing marginally thereafter, if there is no change in the regime.

Consumer inflation may start receding from February onwards, partly due to base effect. The year on year inflation, measured by the monthly CPI-IW, stood on 4% for December 2017 as compared to 3.97% for the previous month. Hardening fuel and vegetable prices could complicate matters for the economy. The Reserve Bank of India did not cut interest rates in meeting on February 7th. The central bank does not want to take any chance which will fuel inflationary expectations. The benchmark yield is expected to correct to 7% by the end of the fiscal year despite additional supply of government paper. The fiscal deficit for 2016–17 will be 3.5% in place of 3.2%. The finance minister has pledged to keep the fiscal deficit at 3.3% of GDP in 2018–19.

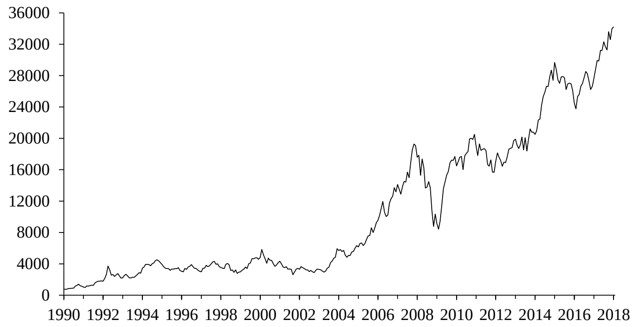
India's trade deficit in December was at its widest in three years as a surge in import of gold, precious jewellery and crude oil offset the rising exports. India's import bill went up 21.12% over last year to $41.9 billion. The rise in imports was due to the higher prices of gold and crude oil, as the two commodities form nearly one-third of the country's inbound shipments. Exports increased 12.36% to $27.03 billion as India continued to ship engineering goods, organic and inorganic chemicals and petroleum products in large quantities. Overall, the trade data suggest that even as the global recovery should benefit exports, higher commodity prices and the ongoing cyclical recovery will keep the trade deficit elevated.

In order to attract more business to India, the government relaxed rules on investment in defence, construction, insurance, pension and other sectors resulting in the highest ever foreign investment inflows in the year ended March 2017. This theme was also followed by Prime Minister Modi, in Davos, where he engaged business leaders with charm and hard sell.

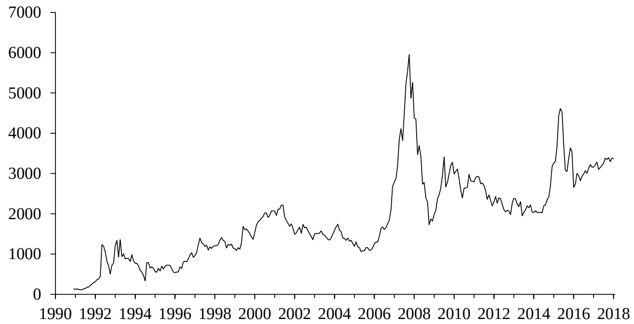
The rupee appreciated nearly 5.5% against US dollar during 2017. The year ended with the highest ever forex reserves for the economy at more than $405 billion and rose further in the month of January to USD 415 billion. The rupee may trade between $63.50 and $64.50 this year

The Government tabled the Economic Survey which is the last year's report card. The survey highlights rising crude oil prices as one of the key risks for the economy. It also enumerated the positive impact of GST, as there has been 50% increase in number of indirect taxpayers in the economy. It projected exports and private investment to pick up in the country, delivering higher economic growth.

India: BSE Sensitive



China: SSE Composite Index



The Budget for 2018–19 was presented to the parliament on February 1. It has a focus on jobs, labour reforms and healthcare sector. It is an election budget but the finance minister managed to maintain fiscal prudence with some populist measures. The finance minister introduced tax on long-term capital market gains which is not liked by the stock market participants. Markets tanked after the budget. Roads, ports, railways and power got special attention which signals that the sector would be the primary vehicle for job creation.

	16–17	**17–18**	**18–19**	**19–20**	**20-21**
GDP (%p.a.)	7.1	6.5	7.6	8.1	8.2
WPI (%p.a.)	4.5	3.5	4.0	4.1	4.0
Current A/c(US$ bill.)	-24.0	-26.0	-20.0	-24.0	-26.0
Rs./$(nom.)	68.2	65.0	64.5	65.5	66.5

China

Economic growth accelerated in 2017 for the first time in seven years, reaching 6.9% on rising demand from both home and abroad. China's economic growth is expected to be around 6.5% in 2018 — marginally lower than in 2017. The slowing investment growth suggests weakening momentum for the current year. Investment in buildings, factories and other fixed assets — a traditional fuel for expansion — which rose 7.2% last year, grew at the lowest pace in more than a decade.

China's consumer inflation grew at a slower pace in 2017 and is expected to continue at a mild rate this year, allowing room for policy manoeuvres to realize high-quality development.

The consumer price index, a main gauge of inflation, rose 1.6% year on year in 2017, down from 2% for 2016 and well below the government's target of around 3%. In 2018, we expect inflation to be marginally lower than 2017 as the government's continuing efforts to prevent property speculation are hitting house prices in megacities such as Beijing and Shenzhen. Household consumption is also expected to slow as high property prices and increased borrowing leave consumers with little discretionary expenditure.

China's 2017 exports rose 7.9% in dollar terms and imports jumped 15.9%. China's overall trade surplus for 2017 was $422.5 billion. While solid global growth is likely to provide some support for Chinese exports in 2018, there will be headwinds later this year as we expect an appreciation of the real effective exchange rate and an increase in US protectionism which could weigh on Chinese export growth, narrowing the trade surplus further. In the near-term, however, little can be done to reduce the trade imbalance, given that the strong U.S. economy is likely to translate into heftier demand for Chinese goods. Solar and washing-machine tariffs won't ignite a trade war but broader action on intellectual property might.

In the Davos meeting, China has pledged that it will "substantially" open up the services industry, particularly the financial sector, to foreign companies. Late last year, Beijing unveiled a plan to let foreign securities firms own majority stakes in their Chinese ventures and to scrap foreign ownership limits on Chinese banks.

The People's Bank of China set the dollar's daily reference rate at 6.4920 yuan per dollar in the first week of January, meaning that the Chinese currency was at its strongest since May 2016. Driven by an unexpectedly prolonged softening of the dollar, the Chinese currency has surged to around its strongest level against the dollar since its surprise devaluation in August 2015. The yuan is now on track for its best monthly performance since April 1980, rising 3% against the dollar in January. The yuan's move is roughly in line with the euro's 3.5% gain and yen's 3.8% gain against the dollar in January. The yuan may rise further this year due to a weakening U.S. dollar. The likelihood of interest rate hikes by the Chinese central bank would continue to support the exchange rate of the yuan against the dollar.

China's forex reserves ended the downward trajectory of the previous two years and reserves increased by $129 billion in 2017. The world's largest foreign currency stockpile fell below $3 trillion for the first time in almost six years at the start of 2017 after the central bank propped up the yuan. But in the months since, the currency has come roaring back. Authorities are keeping a tight grip on money flowing out of the country.

Korea: Composite Index

China started the year 2018 with a flurry of rules that may tighten financing for less-creditworthy borrowers, as policy makers prioritize efforts to limit broader risks to the financial system. The nation's top regulators announced rules governing banks' involvement in entrusted lending, barred insurance firms from extending loans in the guise of equity investment and tightened supervision on leveraged bond trading.

	16	**17**	**18**	**19**	**20**
GDP (%p.a.)	6.5	6.9	6.5	6.0	5.6
Inflation (%p.a.)	2.0	2.2	1.5	2.0	2.0
Trade Balance(US$ bill.)	510	400	380	350	300
Rmb/$(nom.)	6.7	6.6	6.5	6.6	6.7

South Korea

South Korea's GDP expanded 3.1% in 2017, the first expansion of over 3% in three years, due to brisk exports of locally-made semiconductors. Exports, which account for about half of the export-driven economy, grew 2% mainly due to the strong demand for memory chips. But the export for goods was offset by the weakness of services exports, which declined 9.2% last year. Outlook for the South Korean economy will continue to be bright this year as well and we expect the 2018 growth rate to be at 3%. Standard & Poor's has also upgraded South Korea's economic growth outlook for this year to be 2.8%. The continued recovery in the global economy and trade will positively affect South Korea, which is open and dependent on trade.

Fiscal spending increased 3.7%, with investment in the construction sector growing 7.5% in 2017. Government spending will continue to grow at the same pace. A possible resurgence in visitors from China is expected as tension is easing between the two nations about the U.S. missile defence system installed in South Korea.

Private consumption rose 2.6% in 2017, the highest figure in six years. The growth rate of consumer spending continued to gain from 1.7% in 2014 to 2.5% in 2016 and 2.6% in 2017 respectively.

Inflation will continue to lag behind a 2% annual target. The Bank of Korea (BoK) left its key interest rate unchanged in its mid-January meeting as inflation remains below target and the nation's currency trades near a multi-year high. The BoK has maintained the seven-day repurchase rate at 1.5%. The Bank of Korea Governor Lee has announced that monetary policy will remain accommodative. The growth figures favour a gradual approach to tightening policy at the central bank.

South Korea's exports are expected to show robust annual growth of 22.9% on a yearly basis in January, jumping from December's 8.9% annual gain. The January's full-month imports are also expected to rise 19.5%, considerably faster than December's 13.6% growth, driven mainly by higher global oil prices.

In 2017, exports, which accounts for about half of the export-driven economy, reached a new yearly high of US $573.9 billion. Imports advanced 17.7% over the year to 478.1 billion dollars, sending last year's trade surplus to 95.8 billion dollars. The country's trade, including both export and import, was 1.05 trillion dollars in 2017, topping the 1-trillion-dollar mark for the first time in three years.

President Trump's long-anticipated unfair trade call landed against Korean washing machines. The U.S. government-imposed safeguard tariffs has hit South Korean washing machine makers. The negotiators from the two nations met in Seoul to discuss how to revise their free-trade deal. The negotiations are likely to focus on resolving barriers to American exports.

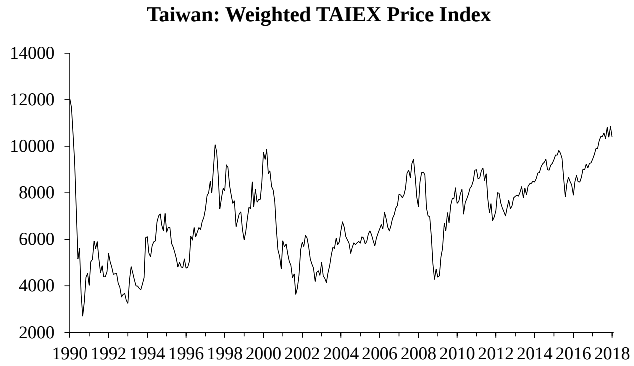
The South Korean won posted the second highest appreciation against the U.S. dollar last year among currencies of G-20 nations. Won appreciated approximately 13% in 2017.

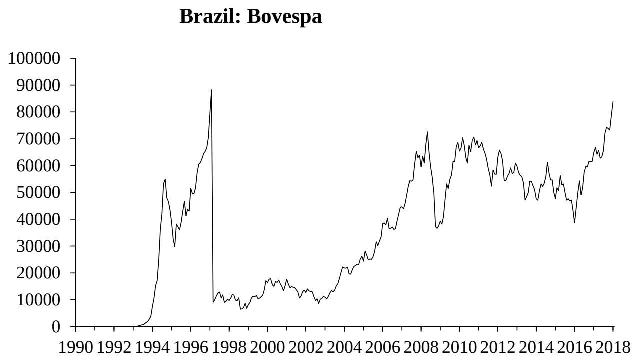
	16	**17**	**18**	**19**	**20**
GDP (%p.a.)	2.8	3.2	3.0	2.6	2.5
Inflation (%p.a.)	1.0	1.9	1.7	1.8	1.9
Current A/c(US$ bill.)	88.0	88.0	86.0	80.0	78.0
Won/$(nom.)	1160	1100	1120	1140	1150

Taiwan

Taiwan GDP growth for 2017 was 2.6%. Taiwan is expected to continue to benefit from a global economic recovery and grow 2.3% in 2018. Exports are expected to keep pushing up Taiwan's GDP growth this year on the back of global demand.

Taiwan's consumer price index is expected to grow 1.2% in 2018 after a 0.7% increase in 2017. The benchmark interest rate has been unchanged at 1.375% since June 2016. Taiwan's next central bank governor would face challenges including monetary tightening this year from neutral stance last year on the global front. Present governor Perng Fai-nan will step down in February. Yang Chin-long, deputy governor of Taiwan's monetary authority, is most likely to be the next chief of Taiwan's central bank.





Taiwan's exports in 2017 totalled 317.4 billion U.S. dollars, up 13.2% from a year earlier, and imports rose 12.6% year on year, both registering the highest growth rate in seven years. Taiwan's trade surplus reached 57.9 billion dollars in 2017, up 8.13 billion dollars from 2016. In 2018, growth of exports is expected to slow down to about 4% to 5%.

The Taiwanese dollar appreciated 11.3% against the US$ in 2017. Taiwan received US$8.6 billion in net fund inflows from foreign institutional investors in 2017. This is the most that the Taiwan dollar has appreciated against the US dollar in a single year since 1989.

	16	**17**	**18**	**19**	**20**
GDP (%p.a.)	1.4	2.6	2.5	2.3	2.3
Inflation (%p.a.)	1.0	1.0	1.2	1.2	1.2
Current A/c(US$ bill.)	64.0	68.0	68.0	70.0	71.0
NT$/$(nom.)	32.5	32.0	29.6	30.0	30.5

Brazil

The rebound in the economy is not as swift as expected due to the presidential election and domestic politics. We have trimmed our GDP growth forecast to 2.5% for the current year and maintain 3% growth rate for 2019. The uptick in the world economy and commodity prices should benefit the economy. The International Monetary Fund (IMF) expects Brazil's economic growth in 2018 to be 1.9%. However, Brazilian Finance Minister Henrique Meirelles maintains that GDP will grow more than 3% in 2018.

Inflation in 2017 fell to 2.95%, driven by a sharp decline in food prices due to an exceptional harvest. For 2018, inflation is expected to be a little higher at 4% and for 2019 the forecast is 4.1%. As of now inflation will remain below the central bank's range of 3% to 6%.

Brazil registered a record-high trade surplus of 67 billion U.S. dollars in 2017. Exports rose 18.5% to US$ 217.8 billion — the highest figures in three years. The increase in exports was due more to the rise of prices of Brazilian products than to the actual volume of exports. Imports rose 10.5% to US$150.7 billion U.S. dollars, the highest figures since 2015. Interestingly, China has become Brazil's largest trade partner and the United States ranked second, followed by Argentina and the Netherlands.

Brazil's Workers' Party has proclaimed that former President Luiz Inácio Lula da Silva will be its candidate in the October presidential election despite a court ruling that confirmed his conviction for corruption and put a significant legal hurdle on his path to the presidency.

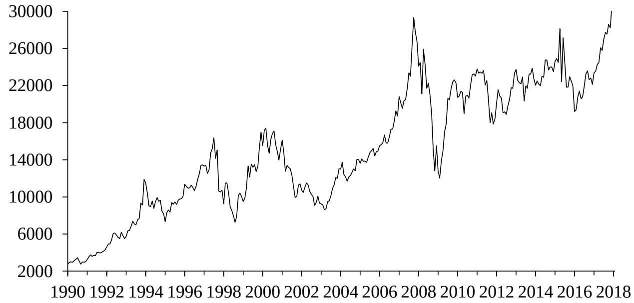
His lawyers are expected to challenge the appeals-court ruling but legal experts believe that the verdict will ultimately prevent the former president, who currently stands at the top of pre-election polls, from running. Under Brazil's Clean Record election law, politicians convicted of corruption are barred from public office for eight years once the verdict is upheld by an appeals court.

With Mr. da Silva likely in wilderness the PT faces an uphill battle to regain political power. The party has failed to groom young leaders to take up its banner. Lula had promised, if elected, to roll back market-friendly reforms, and in the wake of the judges' ruling, Brazilian markets soared to a record in the last week of January.

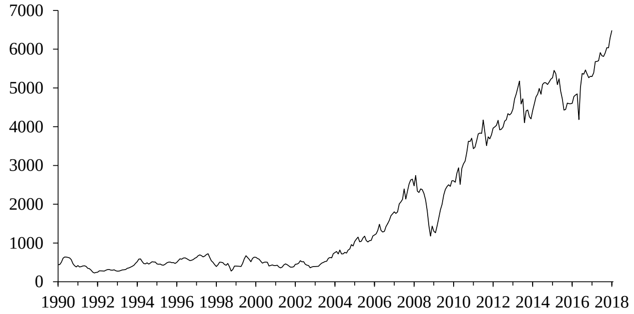
	16	**17**	**18**	**19**	**20**
GDP (%p.a.)	-3.6	1.1	2.5	3.0	3.2
Inflation (%p.a.)	6.3	2.8	4.0	4.1	4.2
Current A/c(US$ bill.)	-28.0	-4.0	-5.2	-8.0	-8.5
Real/$(nom.)	3.5	3.2	3.2	3.2	3.2

Other Emerging Markets

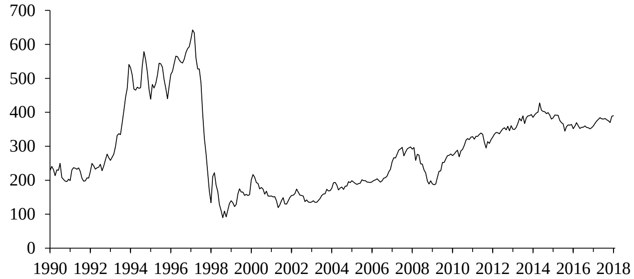
Hong Kong: FT-Actuaries



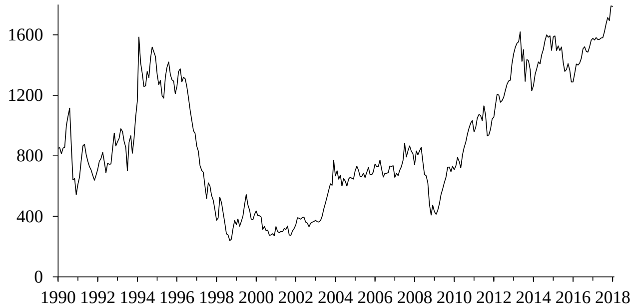
Indonesia: Jakarta Composite



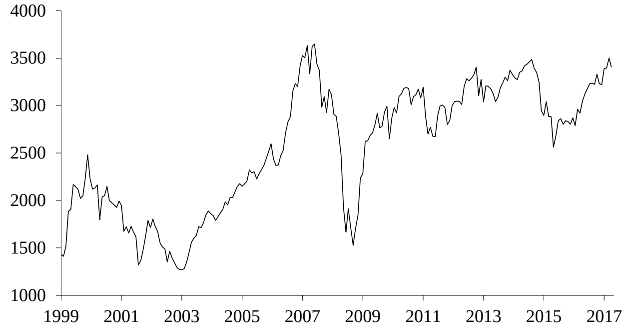
Malaysia: FT-Actuaries (US$ Index)



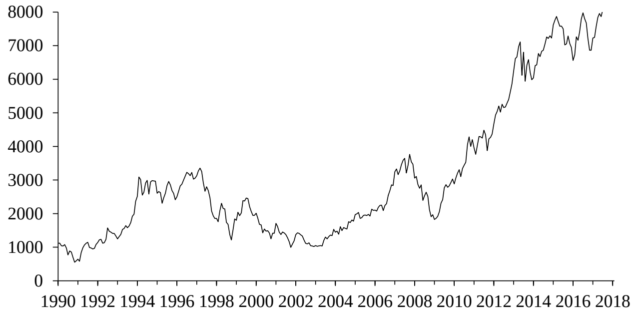
Thailand: Composite Index



Singapore: Straits Times Index

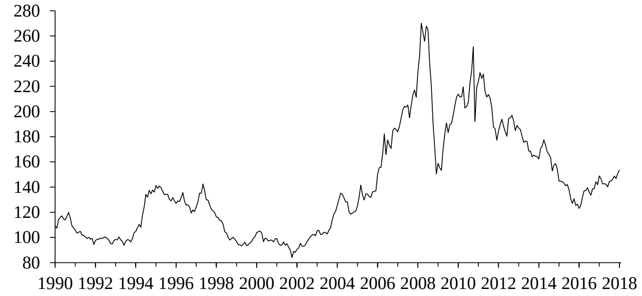


Philippines: Manila Composite

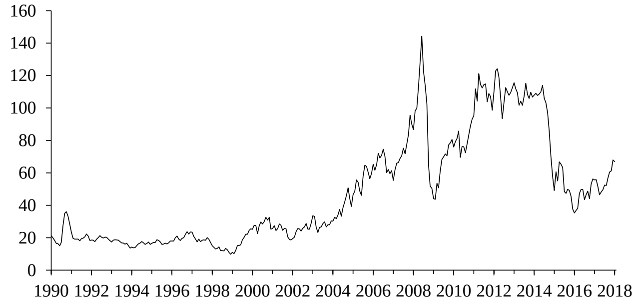


COMMODITY MARKETS

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

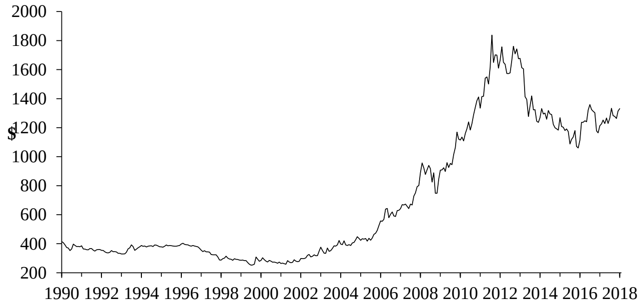


Oil Price: North Sea Brent (in Dollars)

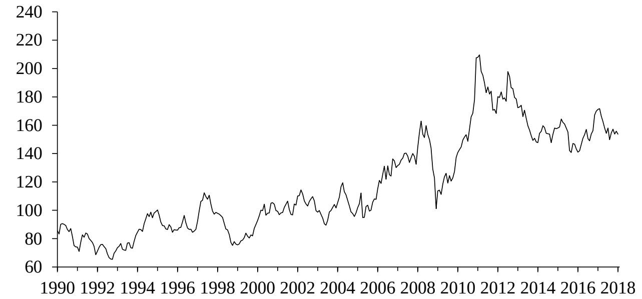


**Commodity Price Index (Sterling)
(Economist, 2000=100)**

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]
2016	1.1	0.7	0.5	82.1	80.6	-1.0	1.9	-1.7
2017	2.6	1.1	0.4	77.1	74.9	-2.0	3.3	-1.4
2018	2.5	1.4	0.6	76.4	75.0	-1.5	3.1	-1.0
2019	2.1	2.5	1.2	75.6	74.5	-0.9	2.8	0.2
2020	2.0	3.5	2.4	74.1	73.1	0.2	2.7	1.2
2021	2.1	2.9	3.1	73.0	72.4	0.2	2.8	0.5
2017:1	1.9	0.6	0.3	76.8	73.9	-2.1	3.3	-0.3
2017:2	2.6	1.2	0.4	77.3	75.3	-2.0	3.2	-1.1
2017:3	2.8	1.2	0.4	77.2	75.3	-2.0	3.3	-0.5
2017:4	2.9	1.2	0.5	76.9	75.3	-1.9	3.4	-0.4
2018:1	2.6	1.3	0.5	77.1	75.3	-1.5	3.1	-0.3
2018:2	2.5	1.5	0.6	76.6	75.2	-1.5	3.1	0.6
2018:3	2.5	1.5	0.6	75.7	74.2	-1.4	3.1	-0.1
2018:4	2.5	1.5	0.7	76.1	75.2	-1.4	3.1	0.4
2019:1	2.1	2.5	0.8	76.6	75.2	-1.3	2.8	-0.5
2019:2	2.1	2.5	0.8	75.5	74.3	-1.2	2.8	-0.4
2019:3	2.1	2.5	1.1	75.3	74.2	-1.0	2.8	-0.4
2019:4	2.1	2.5	1.8	75.1	74.3	-0.2	2.8	-0.1

[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)
2016	253.2	2.4	2.2	0.8	142.9
2017	257.8	2.0	2.2	0.8	142.1
2018	263.9	2.3	2.1	0.8	141.7
2019	268.7	1.8	2.0	0.7	141.2
2020	273.2	1.7	1.9	0.7	140.6
2021	281.4	3.0	1.6	0.6	141.9
2017:1	255.8	2.4	2.1	0.8	143.9
2017:2	256.3	1.7	2.2	0.8	141.2
2017:3	259.8	2.1	2.2	0.8	142.3
2017:4	259.5	2.0	2.2	0.8	141.1
2018:1	261.2	2.1	2.1	0.8	142.9
2018:2	262.8	2.6	2.1	0.8	141.1
2018:3	265.6	2.2	2.1	0.8	141.7
2018:4	266.2	2.6	2.0	0.7	141.0
2019:1	265.3	1.6	2.0	0.7	142.1
2019:2	268.5	2.1	2.0	0.7	141.1
2019:3	270.0	1.7	2.0	0.7	141.1
2019:4	271.1	1.9	1.9	0.7	140.6

[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
2016	159.4	763130.9	440238.4	292912.0	198473.7	-55145.2	113348.0
2017	162.8	779568.4	447220.8	297451.9	199478.8	-49716.2	115424.6
2018	165.9	794590.2	455625.1	299857.2	200245.3	-43280.0	117858.2
2019	169.0	809541.5	465605.1	303926.7	200695.7	-40400.3	120284.1
2020	172.3	825206.6	476269.2	305305.4	201423.9	-34950.6	122842.0
2021	176.1	843441.4	485909.2	309134.3	202752.9	-28559.5	125795.9
2017/16	2.2		1.6	1.6	0.5		2.0
2018/17	2.0		1.9	1.0	0.4		2.1
2019/18	1.9		2.2	1.4	0.2		2.1
2020/19	1.9		2.3	0.5	0.4		2.1
2021/20	2.2		2.0	1.3	0.7		2.4
2022/21	2.3		2.0	2.7	-0.4		2.4
2017:1	161.6	193453.0	111073.9	73556.2	51435.0	-14278.1	28888.6
2017:2	162.3	194338.3	111485.4	73924.4	49462.3	-11901.3	28633.8
2017:3	163.3	195457.5	111947.0	74780.4	49336.1	-11847.1	28760.0
2017:4	164.0	196319.7	112714.5	75190.9	49245.4	-11689.6	29142.1
2018:1	164.8	197254.3	112852.8	74349.1	50854.4	-11513.1	29289.0
2018:2	165.6	198214.1	113552.8	74664.3	49963.7	-10595.0	29371.9
2018:3	166.4	199176.7	114256.6	74949.1	49779.7	-10289.0	29520.2
2018:4	167.0	199945.0	114962.8	75894.7	49647.5	-10882.9	29677.2
2019:1	167.8	200919.0	115328.3	75359.1	50223.8	-10152.1	29839.5
2019:2	168.6	201889.2	116041.1	75576.5	50207.6	-9947.7	29987.7
2019:3	169.4	202869.6	116756.5	75564.6	50155.0	-9460.6	30145.5
2019:4	170.3	203863.7	117479.2	77426.5	50109.3	-10840.0	30311.4

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)
2016	2.3	1960.1	45.1	58.7	-87.4
2017	2.0	2040.6	40.1	61.5	-65.6
2018	1.6	2132.8	33.4	63.8	-54.3
2019	1.1	2221.1	24.2	67.6	-49.4
2020	0.3	2312.7	6.6	65.2	-39.0
2021	-0.3	2419.2	-6.6	62.0	-26.4
2017:1	-3.0	493.2	-14.6	15.0	-17.5
2017:2	2.4	501.6	12.0	15.2	-18.9
2017:3	1.6	507.5	8.4	15.3	-17.7
2017:4	1.4	514.1	7.4	15.5	-11.5
2018:1	2.4	517.7	12.4	15.5	-12.3
2018:2	1.8	525.4	9.6	15.7	-16.8
2018:3	1.6	531.2	8.4	15.9	-15.2
2018:4	1.3	537.5	7.3	16.0	-10.0
2019:1	1.5	539.1	8.0	16.3	-9.8
2019:2	1.3	547.1	7.0	16.4	-15.8
2019:3	1.1	553.1	6.2	16.7	-13.7
2019:4	1.0	560.1	5.6	17.2	-10.1

1 GDP at market prices (Financial Year)

WORLD FORECAST DETAIL

Growth Of Real GNP

	2014	2015	2016	2017	2018	2019
U.S.A.	2.6	2.9	1.5	2.2	2.7	2.4
U.K.	2.9	2.2	1.8	2.2	2.0	
Japan	0.3	1.4	0.9	1.6	1.4	1.1
Germany	1.9	1.7	1.9	1.9	2.3	1.8
France	1.0	1.0	1.1	1.6	1.9	1.7
Italy	0.1	1.0	0.9	1.3	1.4	1.1

Real Short-Term Interest Rates

	2014	2015	2016	2017	2018	2019
U.S.A.	–0.1	–1.1	–1.5	–0.9	–0.3	0.5
U.K.	–2.2	-0.5	–1.0	–2.0	–1.5	–0.9
Japan	–0.6	0.1	–0.4	–0.8	–1.0	–1.1
Germany	–0.2	–0.6	–2.0	–2.0	–2.0	–2.1
France	0.1	–0.2	–1.3	–1.6	–1.7	–2.1
Italy	0.0	0.0	–1.7	–1.4	–1.6	–2.1

Real Long-Term Interest Rates

	2014	2015	2016	2017	2018	2019
U.S.A.	0.7	0.3	0.5	0.8	1.0	1.5
U.K.	–0.7	–1.0	–1.7	–1.4	–1.0	0.2
Japan	–0.4	–0.5	–1.0	–1.1	–1.3	–1.5
Germany	–0.7	–0.9	–1.7	–1.4	–1.4	–1.1
France	0.0	–0.7	–0.9	–0.9	–0.8	–0.6
Italy	1.1	0.4	0.1	0.3	0.4	0.6

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

	2014	2015	2016	2017	2018	2019
U.S.A.	83.9	93.0	94.0	94.5	94.8	95.0
U.K.	93.1	91.6	80.6	74.9	75.0	74.5
Japan	59.8	56.0	58.4	58.3	58.1	58.4
Germany	99.9	94.7	95.0	94.3	94.9	95.1
France	100.8	96.2	96.0	95.3	95.1	95.5
Italy	107.5	102.1	102.0	101.2	101.1	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.

Growth Of Consumer Prices

	2014	2015	2016	2017	2018	2019
U.S.A.	1.6	0.1	1.3	2.0	2.1	2.1
U.K.	1.7	0.2	1.1	2.6	2.5	2.1
Japan	2.8	0.8	0.1	0.5	0.9	1.1
Germany	0.9	0.3	0.5	1.7	1.7	1.8
France	0.5	0.0	0.1	1.0	1.3	1.5
Italy	0.2	0.1	–0.1	1.4	1.1	1.4

Nominal Short-Term Interest Rates

	2014	2015	2016	2017	2018	2019
U.S.A.	0.0	0.2	0.5	1.2	1.8	2.5
U.K.	0.6	0.6	0.5	0.4	0.6	1.2
Japan	0.2	0.2	0.1	0.1	0.1	0.1
Germany	0.1	–0.1	–0.3	–0.3	–0.2	–0.1
France	0.1	–0.1	–0.3	–0.3	–0.2	–0.1
Italy	0.1	–0.1	–0.3	–0.3	–0.2	–0.1

Nominal Long-Term Interest Rates

	2014	2015	2016	2017	2018	2019
U.S.A.	2.2	2.2	2.5	2.8	3.0	3.5
U.K.	1.8	1.3	0.7	1.1	1.4	2.5
Japan	0.3	0.3	0.0	0.1	0.1	0.1
Germany	0.5	0.6	0.1	0.5	0.6	0.9
France	0.8	0.5	0.7	0.9	1.1	1.4
Italy	1.9	1.6	1.7	2.0	2.3	2.6

Nominal Exchange Rate
(Number of Units of Local Currency To $1)

	2014	2015	2016	2017	2018	2019
U.S.A.[1]	89.04	103.08	101.91	102.20	102.40	102.50
U.K.	1.65	1.53	1.35	1.30	1.29	1.28
Japan	106.67	121.11	108.61	112.18	114.10	114.30
Eurozone	0.76	0.90	0.90	0.88	0.85	0.86

[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