LIVERPOOL INVESTMENT LETTER

July 2019

Cardiff Business School
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Julian Hodge Institute of Applied Macroeconomics

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LIVERPOOL RESEARCH GROUP IN MACROECONOMICS

LIVERPOOL RESEARCH GROUP IN MACROECONOMICS

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The Julian Hodge Institute was launched in autumn 1999 in a new 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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HOW HAS THE UK ECONOMY MANAGED TO KEEP GROWING IN SPITE OF BREXIT UNCERTAINTY?

There can be little doubt that finally in the middle of 2019 the signs are that the economy is slowing. In the first quarter of the year heavy stocking led to a surge in growth, as businesses prepared for a possible WTO-based Brexit. In the second quarter that has been reversed; and the latest purchasing manager indices are close to the zero growth point on a quarterly basis. Yet even now growth is nearly 2% up on a year ago and retail spending remains strong.

With a new government taking charge that is committed to leaving, one way or another, at end-October, Brexit uncertainty is likely to end. Common-sense suggests that both the EU and the UK will wish to get some sort of Brexit deal over the line rather than move to no deal. The EU now wants the UK out of the bloc, given the difficult decisions on euro-zone structure to be taken, decisions that a UK presence in the Council and the Parliament could complicate. Both sides would like a Free Trade Agreement as opposed to none. The Irish border, it is now well documented, can be 'soft' within an FTA because of numerous well-tried border procedures. Though Remainer Conservative politicians mutter on about assisting a vote of no confidence to avoid no deal, they are likely to be persuaded against such suicidal plans as the Conservative Party at large unites behind a new leader.

With the public finances strengthening and real interest rates negative, there are good reasons for the government to propose a strong fiscal expansion. The direct effects of tax cuts and infrastructure spending will stimulate growth as Brexit occurs; as important will be the effects on interest rates, pushing them away from the zero bound where monetary policy has become impotent and worse, distortionary, making it too easy for the big companies to borrow cheaply to reinforce their growing monopoly power while their small competitors still face difficult bank lending terms enforced by 'anti-risk' bank regulations.

This will happen against the background of an economy that has kept growing in spite of dire Brexit uncertainty. With this lifting that negative will be lifted too.

How has it kept growing through it all?

First, two thirds of spending is consumption, responding to current needs; another 20% is government spending, responding similarly. Only 15% of the economy is investment, forward-looking and vulnerable to uncertainty, because of the option to defer. Investment has been hit by Brexit uncertainty; probably 5–10% off cumulatively. But this is max 1.5% of GDP. In the long run this investment will happen; it is just deferred.

Table 1: Summary of Forecast

	2016	2017	2018	2019	2020	2021	2022
GDP Growth[1]	1.9	1.8	1.4	1.6	2.0	2.1	2.3
Inflation CPI	1.1	2.6	2.5	2.0	2.1	2.0	2.0
Wage Growth	2.4	2.9	3.1	3.1	3.1	3.0	3.0
Unemployment (Mill.)[2]	0.8	0.8	0.8	0.8	0.7	0.7	0.6
Exchange Rate[3]	82.1	77.4	78.5	76.6	76.1	76.3	75.6
3 Month Interest Rate	0.5	0.4	0.7	0.9	1.3	2.4	3.1
5 Year Interest Rate	0.7	0.6	1.0	1.4	1.6	2.5	3.4
Current Balance (£bn)	-90.9	-66.3	-62.9	-48.8	-41.2	-30.6	-18.4
PSBR (£bn)	45.1	39.4	30.9	22.3	6.9	-6.9	-18.5

[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 = w

Also, there will be more investment with Brexit because the growth prospects will be better, as pro-growth policies are pursued.

The growth we have seen over the past few years has come from a big labour supply expansion. The UK's flexible labour market and easy entry for small firms creates jobs and new products by wage movement. So rising labour supply has created labour market strength, with new jobs and new demand creation, as people with jobs have consumer confidence.

UK growth has been powered by a supply-side surge in labour market supply, especially by old, female and self-employed.

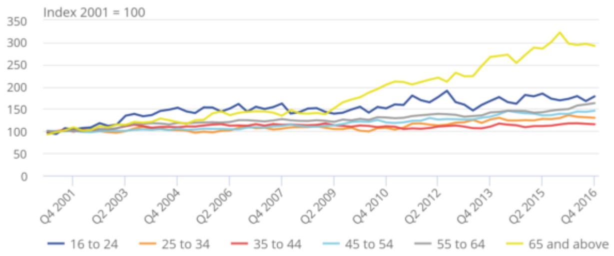
Here are some figures:

	Growth in the past 2 years	
	Thousands	Percent
Employment	790	+2.5%
Self-employment	106	+2.2%
Full time	650	+2.8%
Part time	141	+1.7%
Aged 50+	572	+5.7%
Women	504	+3.4%
Share of Part time now		21.5%
Share of self-employed now		15.0%
Share of 50+ now		32.1%
Share of women now		47.0%

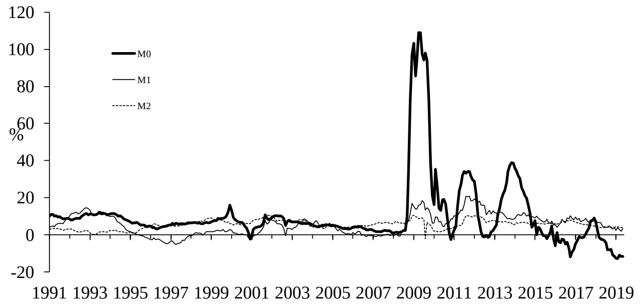
As the table shows, this supply surge has come from women, the self-employed and the old, over 50s, many over 65. The older self-employed have collateral in the form of housing and pension wealth; typically, they are well educated. One can see underlying all this the rise in longevity (the 'hundred-year life') spurring the need for higher income to save for a longer old age and working longer to improve the assets in final retirement; the response includes women joining in the earning flow, and older people working longer, and using their experience to start new firms. A striking chart shows how old people dominate self-employment growth:

Figure 11: The increase in self-employment by age

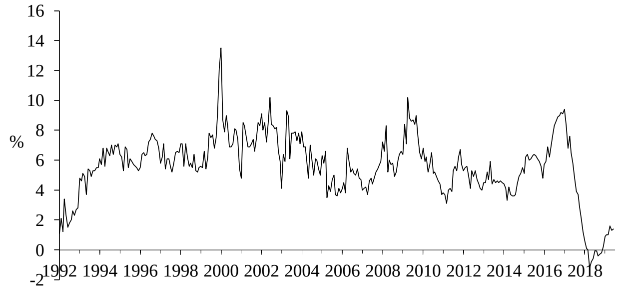
Quarter 1 (Jan to Mar) 2001 to Quarter 4 (Oct to Dec) 2016



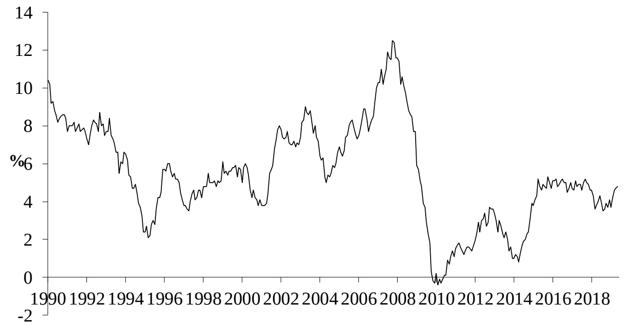
U.S.: Growth in Monetary Aggregates (Yr - on - Yr)



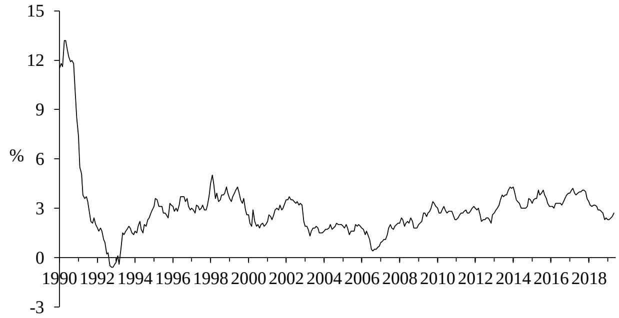
UK: Notes and Coins in Circulation Growth



Eurozone M3 Growth



Japan: Growth of M2+CD's



FOCUS ON JAPAN

Francesco Perugini

Japan Entered a New Era

On May 1, Japan restarted its clock, drawing the curtain on the Heisei era (‘achieving peace’) of Emperor Akihito and waking to a new and hopefully brighter Reiwa era (‘beautiful harmony’) of 59-year-old Emperor Naruhito, as revealed by the Prime Minister Shinzo Abe Cabinet to an eagerly awaiting Japanese public on 1 April. “The name Reiwa was intended to portray a Japan where every person can have hope for tomorrow and their flowers can blossom fully”, said Abe at a press conference. Many now expect Naruhito to follow his father as a champion of pacifism, civil liberties and the welfare of the people. But as the Prime Minister Shinzo Abe government continues to pursue constitutional revision to recognise the Self-Defence Forces, the new Emperor may be standing at a crossroads. Given the constitutional limitations on Japanese Emperors it is hard to tell what Naruhito can or will do, but compared with his father’s mild manner and humility, the Oxford-educated Naruhito is known to be more individualistic, independent and outspoken.

The Heisei era began in 1989 at a time when the economy was booming and Japan felt on top of the world. That same year, Sony acquired Hollywood’s Columbia Pictures and Mitsubishi Estate bought New York’s iconic Rockefeller Center, both symbols of the country’s amazing recovery after rising from the ashes of World War II. However, the good times soon ended. The bubble economy collapsed and the country endured the “lost decades” — nearly 20 years of economic stagnation starting around 1992. When the global recession of 2008 hammered the economy, the Nikkei 225 Index dropped to 7,054 points in March 2009, more than 80% off its historic peak in 1989. The Heisei has been also blighted by two awful disasters like the 1995 Kobe earthquake that killed over 6,400 people, and the 2011 Fukushima tsunami and nuclear disaster that killed over 15,000 and resulted in damage of more than US$150 billion.

In many other fronts Japan went through a profound socio-economic transformations during the Heisei era. The keiretsu system has changed gradually, while foreign direct investment overtook the export model. Less reliance on exports and a greater need for speed to market diminished the competitive advantage of the traditional convoy system under public sector leadership. Domestic sector-wide coordination became too time-consuming and much less effective. As for the labour market, women are now an important part of the labour force — 50.3% of it in 2017 — and working mothers are the norm.

But the most notable phenomenon was ageing. Japan’s population was among the youngest in the developed world at Heisei’s start, but is now the oldest. The population is declining at almost 400,000 people a year and the proportion of people over 65 increased from 15% in 1989 to 36% in 2019. It may not quite be the “oldest” economy in the world (Hong Kong boasts that honour, with an average life expectancy of 84.2), but it is haunted by the reality that from an economy in 1990 where an average six workers supported every retiree, by 2025 the country is forecast to have two workers per retiree. These changes paint a picture of a quietly sinking sun. While Japan’s real GDP grew by 59% from 1989–2017, it pales in comparison to the US’ 243% and China’s astounding 3419%. In 1989, there were 32 Japanese names in the global top 50 companies. In 2018 there was only one, Toyota.

What can the Reiwa era bring to the Japanese economy? The new era has the potential to redefine Japan and its role in the world in a very positive way. “During the Heisei Era, Japan was, for many decades, the sick man of the world. Now at the start of Reiwa, Japan has got what it takes to become a true global leader. If some fundamental policy challenges are addressed in the early years of Reiwa, Japan will impress by positive example and become the envy of global policy makers” said Jesper Koll, a long-time observer of Japanese politics and economics.

Japan could leverage its existential demographic crisis. The population is forecast to decrease to around 100 million by 2050, down from today’s 127 million. The best lever to maintain the economy’s size is improved productivity by implementing structural reforms. Improving productivity has two sides organizing and revamping fraying existing infrastructure and injecting new technology. Rather than making new infrastructure investments, the public sector may re-organize the old. Once reorganized into a compact and liveable model, communities should use available technologies from smart homes to autonomous vehicles.

However, structural reforms to address long-term challenges such as the falling and aging population and generate new avenues of growth are still lagging. The severe environment surrounding the economy will not change with the transition from Heisei to Reiwa. The coming change of era should prompt the nation to think again what needs to be done, including painful reforms, to overcome those challenges. But Japan is now a mature country with considerable experience; perhaps no longer a living miracle, but a country with strength and past failures to learn from. It also has the fortune of political stability and the chance to maintain its competitive strength and economic power.

MARKET DEVELOPMENTS

The Trump tariff war with China has mainly raised consumer prices, for imports and competing home product getting protection. Like a general tax rise it has weakened demand. But with raw material capacity still abundant, world growth keeps going in the 3–4% range, with emerging economies contributing most of it. This remains a good climate for equities. The prospect of fiscal expansion pushing up demand and ending the zero interest rate era, only adds to the equity attraction.

Table 1: Market Developments

	Market Levels		Prediction for Jun/Jul 2020	
	Jun 10	**Jul 3**	**Previous Letter**	**Current View**
Share Indices				
UK (FT 100)	7220	7609	9617	10136
US (S&P 500)	2816	2996	3151	3352
Germany (DAX 30)	11981	12616	18846	19845
Japan (Tokyo New)	1530	1580	2030	2096
Bond Yields (government)				
UK	0.86	0.69	3.00	3.00
US	2.11	1.95	3.80	3.80
Germany	−0.30	−0.45	1.00	1.00
Japan	−0.11	−0.15	0.10	0.10
UK Index Linked	−1.96	−2.02	1.00	1.00
Exchange Rates				
UK ($ per £)	1.27	1.26	1.32	1.32
UK (trade weighted)	77.47	76.54	76.1	76.1
US (trade weighted)	101.76	100.98	102.5	102.5
Euro per $	0.89	0.89	0.88	0.88
Euro per £	1.13	1.11	1.16	1.16
Japan (Yen per $)	108.01	107.77	112.5	112.5
Short Term Interest Rates (3-month deposits)				
UK	0.89	0.77	2.10	2.10
US	2.55	2.39	3.00	3.00
Euro	−0.33	−0.29	0.00	0.00
Japan	0.00	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	2.1	2.1	29.00		36.80
US	1.99	1.9	2.1	7.90	−5.07	8.82
Germany	3.30	1.6	1.7	54.00	−0.76	59.84
Japan	1.90	0.5	1.2	31.00	−9.68	24.92
UK indexed[2]	−1.69		2.2	5.00		5.09
Hong Kong[3]	2.60	5.6	2.1	−17.00	−5.07	−11.97
Malaysia	3.30	4.8	2.1	43.00	−5.07	48.13
Singapore	3.50	2.7	2.1	10.00	−5.07	13.23
India	1.40	8.0	2.1	19.00	−5.07	25.03
Korea	1.10	2.9	2.1	−23.00	−5.07	−22.17
Indonesia	2.20	5.4	2.1	26.00	−5.07	30.63
Taiwan	2.80	2.1	2.1	12.00	−5.07	14.12
Thailand	3.20	3.8	2.1	27.00	−5.07	31.03

Bonds: Contribution to £ yield of: −

	Redemption Yield	Changing Nominal Rates	Currency	Total
UK	0.69	−23.10		−22.41
US	1.95	−13.50	−5.07	−16.62
Germany	−0.45	−14.50	−0.76	−15.71
Japan	−0.15	−2.50	−9.68	−12.33

Deposits: Contribution to £ yield of:

	Deposit Yield	Currency	Total
UK	0.77		0.77
US	2.39	−5.07	−2.68
Euro	−0.39	−0.76	−1.15
Japan	0.05	−9.68	−9.63

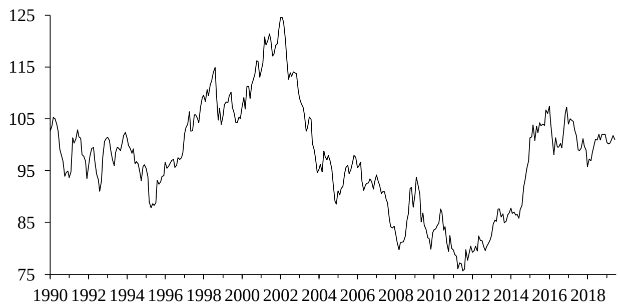
[1] Yields in terms of €s or $s can be computed by adjusting the £-based yields for the expected currency change.
[2] UK index linked bonds All Stocks
[3] Output based on China.

Table 3: Portfolio(%)

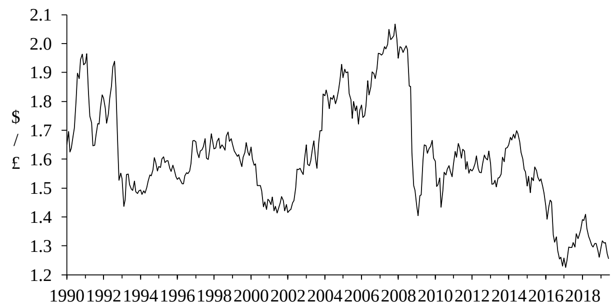
	Sterling Based Investor		Dollar Based Investor		Euro Based Investor	
	June Letter	Current View	June Letter	Current View	June Letter	Current View
UK Deposits (Cash)	5	5	5	5	1	1
US Deposits	-	-	-	-	-	-
Euro Deposits	-	-	-	-	-	-
Japanese Deposits	-	-	-	-	-	-
UK Bonds	-	-	-	-	-	-
US Bonds	-	-	-	-	-	-
German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

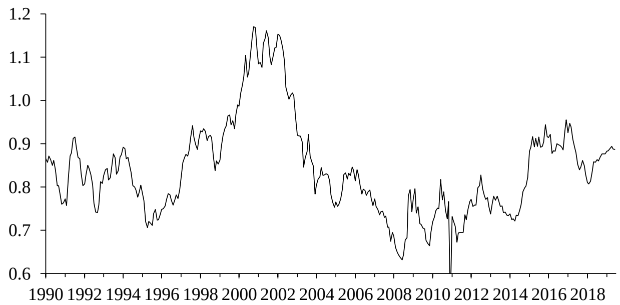
US : Trade Weighted Index
(Bank of England 1990 = 100)



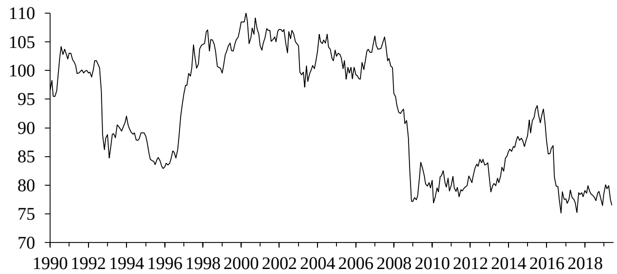
UK: Dollars Per Pound Sterling



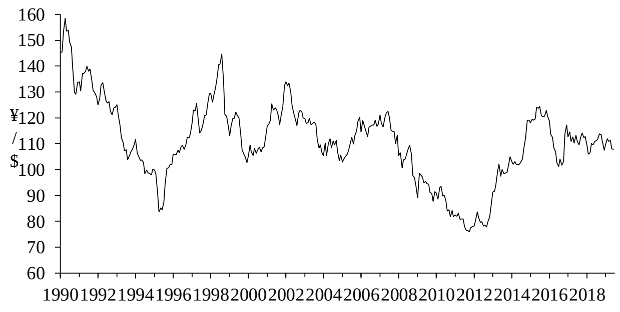
Euro per US dollar



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



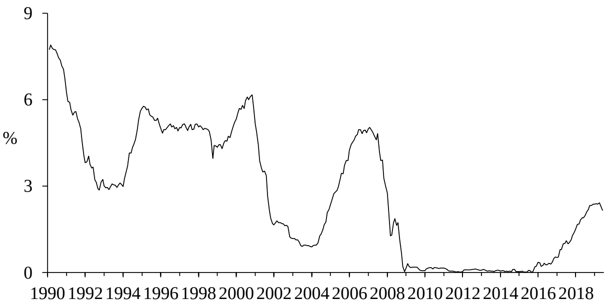
Japan : Yen Per U.S. Dollar



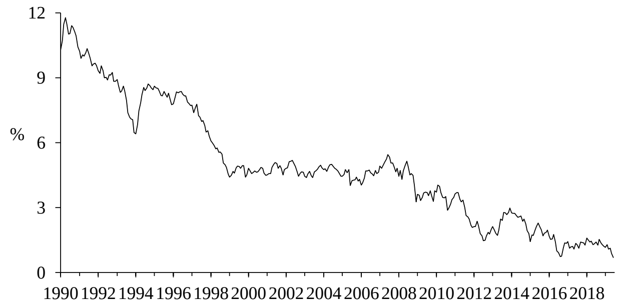
GOVERNMENT BOND MARKETS

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

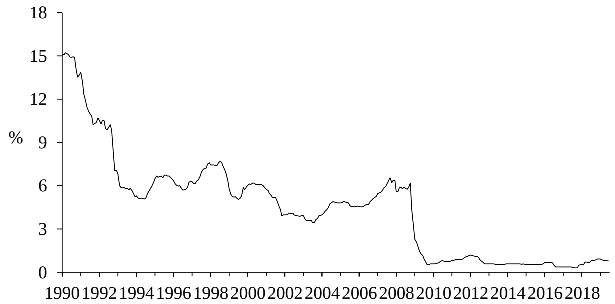
U.S. : 3-Month Treasury Bill



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

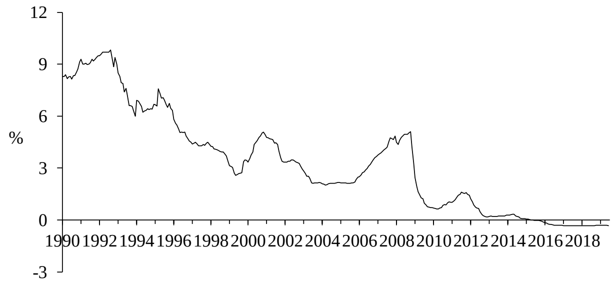


U.K. : 3-Month Certificate of Deposit Rate

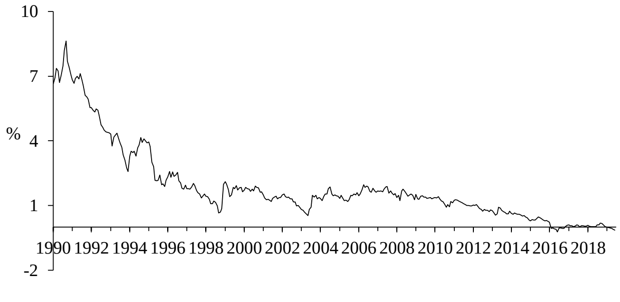


Germany: Yield on Public Authority Bonds

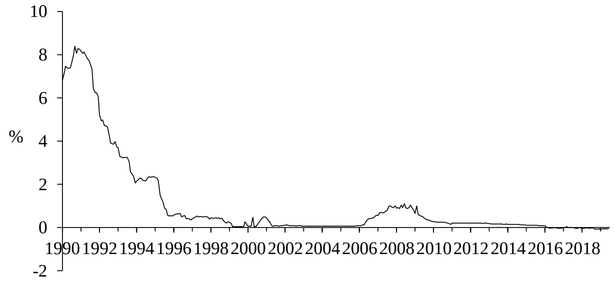
Germany : 3-Month Interbank Deposit Rate



Japan: Yield on Long-Term Government Bonds

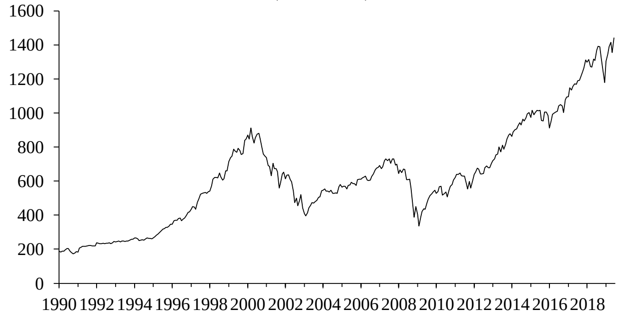


Japan : 3-Month Money Market Rate

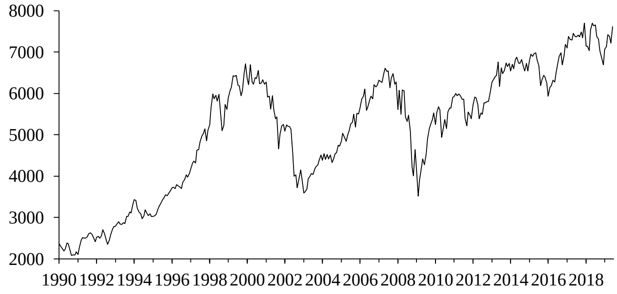


MAJOR EQUITY MARKETS

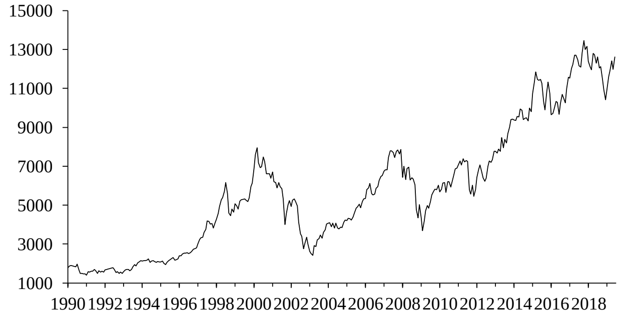
U.S. : S & P 400 Industrial
(1985=100)



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



Germany : DAX 30



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

EMERGING MARKETS

Anupam Rastogi

India

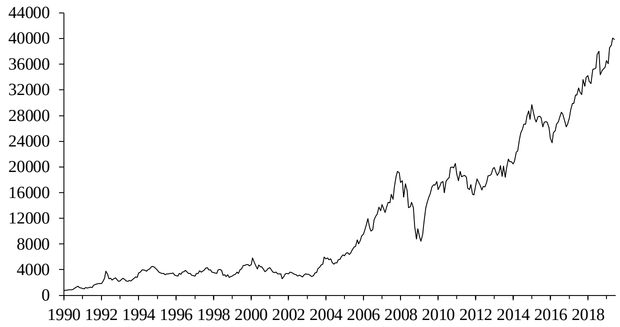
India's GDP growth hit a five-year low of 6.8% in 2018–19, primarily due to lower growth in agriculture, trade, transport, communication and services related to broadcasting. Global rating agency Fitch Ratings has slashed India's gross domestic product (GDP) growth forecast to 6.6% for the current fiscal 2019–20, from 6.8% projected earlier, citing persistent slowdown in manufacturing and agriculture sectors. The rating agency, however, retained its GDP growth forecast for FY21 and FY22 at 7.1% and 7%, respectively. Is the much-hyped Indian economy in trouble? Not really, but the structural changes brought about through the Insolvency and Bankruptcy Code and the government's effort to get rid of black money from the system have put the brakes on the animal spirit of entrepreneurs. The small and medium businesses are restructuring themselves and learning the rules of the game under the present regime. Moreover, Modi government's emphasis on welfare economics, its first priority, is taking its toll as well.

The government is serious about its second priority as well which is economic growth and employment. It created two new cabinet committees, one on investment and growth and another on employment and skill development. The main threats to India's growth are a global slowdown caused by trade tensions, and a slowdown in lending by India's nonbanking financial companies, which lend to real-estate companies and medium-and-small businesses,

India's inflation (consumer price index) has been under check and has been continuously hovering below the 4% level since August 2018. With a normal monsoon in the current year, the outlook for inflation looks largely benign and even the global inflation rate has not shown signs of prices going up. The Reserve Bank of India has cut rates three times since Governor Shaktikanta Das took the helm of the central bank in December. We expect another 25 basis point cut later in 2019, which will push the policy repo rate down to 5.50%. Monetary and regulatory easing from the RBI, along with a recovery in portfolio inflows, should support a recovery in credit to the private sector.

India's trade deficit increased to $180.3 billion in 2018–19 from $160.0 billion in 2017–18. Net invisible receipts were higher in 2018–19, mainly due to an increase in net services earnings and private transfer receipts. Net FDI inflows at $30.7 billion in 2018–19 were marginally higher than $30.3 billion in 2017–18. Portfolio investment recorded a net outflow of $2.4 billion in 2018–19 against an inflow of $22.1 billion a year ago. India's current account deficit narrows sharply to 0.7% of GDP in Q4. However, it rose to 2.1% of GDP in FY19 from 1.8% in FY18. The deficit remains well under control as well.

India: BSE Sensitive



The Indian rupee is consolidating in the range of 69 and 70 for last five weeks and will remain stable so long as crude prices remain stable.

The government has set the target of reaching the $5 trillion mark by 2024 from the current GDP of $2.7 trillion. The budget presented on July 5th should be seen as an attempt to achieve that. The budget was constrained by disappointing tax revenues and potential inflationary effects of big spending drive. Hence, the government made all the right noises and produced a reasonable budget. Important announcements included increased spending on infrastructure, increase in income tax on those earning more than $300,000 per annum and reduction in fiscal deficit to 3.3% compared to 3.4% achieved in the last fiscal.

The budget, however, failed to live up to the Prime Minister's earlier promise that "The government has no business being in business." Combining targeted welfare programs, muscular nationalism and Hindu identity politics have earned the backing of voters, but the government needs to embrace the reforms it has so far resisted. Newly appointed Finance Minister Nirmala Sitharaman was expected to boost spending and provide tax relief to consumers, which she could not. With the global outlook turning gloomy, and the Reserve Bank of India having already cut interest rates three times this year, the focus is shifting to the government playing its part. There is some increase in government spending as a reduction in fiscal deficit target reduced the headroom available to the government. The stock markets gave a thumbs down to the budget and crashed almost 0.7% after the budget.

Mr. Trump met with Prime Minister Narendra Modi at the Group of 20 summit in Osaka, Japan. India recognizes that America has legitimate grievances, but both sides have a strategic interest in avoiding a serious conflict. The US Secretary of State, Mike Pompeo, has called for "a new age of ambition" between the two democracies. But in a tweet President Trump called high Indian tariffs on U.S. exports, imposed last month, "unacceptable." The U.S. trade negotiators have long battled to increase market access, lower tariffs, and strengthen protection for intellectual property.

India is likely to benefit from the Sino-US trade spat as India can boost exports of 300 products to US. Products such as diesel, X-ray tubes and certain chemicals have an outright advantage to displace the US exports to China. The benefit to India is estimated to be 0.2% of GDP.

	18–19	19–20	20–21	21–22	22–23
GDP (%p.a.)	6.8	7.0	7.2	7.3	7.4
WPI (%p.a.)	3.9	3.9	4.0	4.0	4.0
Current A/c(US$ bill.)	-70.0	-64.0	-64.0	-65.0	-65.0
Rs./$(nom.)	79.5	69.5	71.0	72.0	72.5

China

China is targeting 6% to 6.5% growth for its economy this year and is confident of achieving this. As many indicators are flashing amber, Beijing is all set to cut taxes and other fees of nearly $300 billion and support small companies by easing reserve requirements for banks. The official stand as of now is that China would refrain from massive stimulus measures, like its credit pumping after the global financial crisis.

The Caixin China manufacturing purchasing managers index fell to 49.4, below the critical 50.0 threshold for the first time in four months. A PMI reading above 50 indicates expansion while those below that figure signal contraction. China is at risk of a substantial slowdown after an apparent improvement in growth prospects early this year. Therefore, monetary and fiscal support is all but inevitable to achieve the growth target of 6% in 2019.

The PMI indicates that demand is too weak to absorb production at current levels. Prices will fall further unless Beijing jump-starts the economy. Consumer inflation hit 2.7%, its highest level in more than a year, in May, driven by surges in pork and fruit prices caused by the African swine fever epidemic and bad weather. But while prices are increasing, demand remains weak because of the trade war with the United States and economic uncertainty.

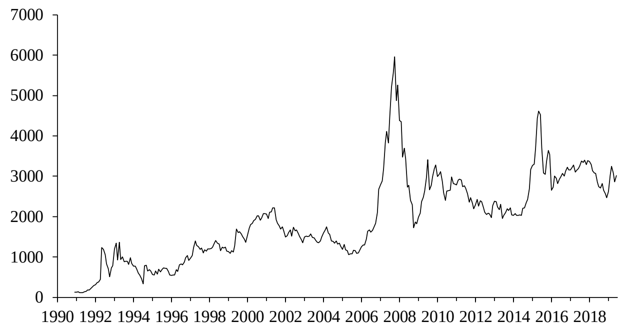
China has already cut banks' reserve requirements six times since early 2018 and guided interest rates lower, while keeping ample liquidity in the banking system.

China's exports in May have declined 3.8% from a year earlier, worsening from a 2.7% fall in March. Import orders also contracted at a quicker pace in May.

The Chinese onshore yuan softened to approximately 6.9 to the dollar and a gradual decline in the yuan is expected in the coming year as well.

In targeting China's export machine, President Trump seems to have hit the country's imports. Chances that growth will slow further, or the yuan will sink below the totemic level of seven to the dollar — or both — are rising.

China: SSE Composite Index



President Trump and President Xi Jinping of China managed to get trade talks back on track in the G20 summit in Kyoto. Mr. Trump agreed to hold off on new tariffs and let Huawei buy American high-tech equipment. Many in China believe that the US is out to demolish the government-led economic model that is responsible for China's emergence as a global power. The trade cease-fire would help in reaching some solution on disputes over China's expansive hold on the South China Sea and the U.S. campaign against Chinese technology firms over security concerns, which has expanded beyond Huawei, the world's largest maker of telecommunications gear.

In the Democratic primary debate, four of 10 candidates picked China as the greatest threat facing the U.S. This suggests that there is a broad consensus in the US on trade and other sanctions against China.

China, on the other hand is not averse to opening up its economy but she does not want to be seen as opening its economy under pressure. China is to speed up the opening of its financial sector in an effort to attract more business and investment. China would let foreigners freely invest in futures, securities and life insurance in 2020, one year ahead of Beijing's previous schedule, to show its commitment to opening up.

President Xi Jinping made his first state visit to North Korea, a trip seen as bolstering Beijing's bargaining position. The Chinese leader appears to be highlighting China's influence with North Korea and the vital role Beijing could play in pressuring Pyongyang to eliminate its nuclear programs.

China has been rattled by the protesters in Hong Kong. The protesters had demanded that the bill which allows repatriation of Hong Kong nationals be formally withdrawn. They want charges dropped against those arrested in earlier extradition-bill-related protests, a probe into police misconduct and for Mrs. Lam to resign. The government has acceded to none of these demands. As a rising world power, China does not want the world to know that the country has many dissenters and that its 'one country, two systems' policy has failed.

	18	19	20	21	22
GDP (%p.a.)	6.6	6.0	5.6	5.4	5.2
Inflation (%p.a.)	2.2	2.3	2.3	2.0	1.8
Trade Balance(US$ bill.)	50	60	40	20	0
Rmb/$(nom.)	6.8	6.9	7.0	7.1	7.1

South Korea

South Korea's gross domestic product contracted by a seasonally adjusted 0.4% in the January–March period from the previous quarter and from a year earlier, the economy grew 1.7% during the first quarter. We maintain that GDP will grow 2% in 2019. Exports continued to slump due to worsening external conditions such as the US-China trade war. With the truce declared by the US and China leaders, growth should resume.

Korea's CPI rose 0.6% in May from a year earlier. The index excludes volatile food and energy prices. Inflation has stayed below 1% for the last six straight months to June on lower oil product price and the expanded welfare policy such as free school meals and school uniforms etc. The central bank has been under growing pressure to ease policy partly due to the subdued inflation. The bank has held the base rate steady since its November rate increase. In the next review of policy on July 18, the central bank will also release a revised economic growth forecast for this year. In the meeting we expect the base rate to be cut.

Exports, which accounts for about half of the economy, kept sliding for the seventh consecutive month through June. However, the Sino-US trade spat is going to benefit Korea's exports.

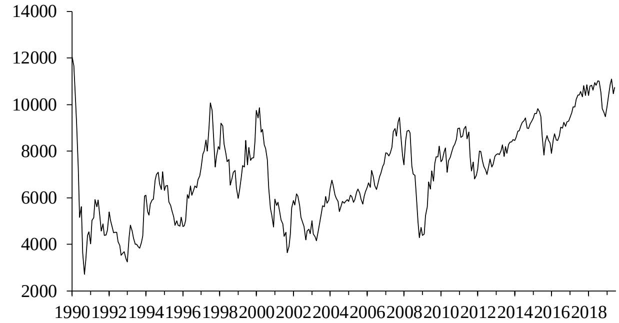
In October, South Korea's Supreme Court ruled that Japan's Nippon Steel Corp. must compensate South Koreans for forced labour during the Second World War. Japan says any claims arising from the forced labour were resolved in 1965 when the two countries restored diplomatic ties. In response, Japan has tightened controls on exports to South Korea in an unexpected blow to the global technology supply chain that also marks a new low point in relations between the two U.S. allies. By restricting access to Japanese materials, Tokyo's crackdown could make it harder for South Korean companies like Samsung Electronics Co. to make semiconductors and other components that are used in smartphones. The move follows frequent clashes between the governments of Prime Minister Shinzo Abe and President Moon Jae-in over World War II history.

It seems that Mr. Abe took a page from President Trump's playbook by hitting a perceived rival nation not just with political or diplomatic actions but also with economic punishment against the rival's core industry.

	18	19	20	21	22
GDP (%p.a.)	2.7	2.0	2.5	2.7	2.7
Inflation (%p.a.)	1.5	1.1	1.5	1.5	1.5
Current A/c(US$ bill.)	86.0	80.0	78.0	70.0	70.0
Won/$(nom.)	1130	1190	1200	1200	1200

Korea: Composite Index

Taiwan: Weighted TAIEX Price Index



Taiwan

We continue to keep our GDP growth forecast of Taiwan for 2019 and 2020. The Taiwan Research Institute has lowered its forecast for Taiwan's gross domestic product (GDP) growth in 2019 to 2.08%, citing uncertainty from the trade standoff between the United States and China. As world trade is going to be disrupted in the short-term, it will have an adverse impact on Taiwan's growth rate. However, Taiwan is going to be one of the largest beneficiaries as US businesses source their inputs/products from other countries. Taiwanese official forecast of 2019 GDP growth is 2.2%. Helped by the government's efforts to push infrastructure development, capital formation for 2019 is expected to grow 5% this year.

Taiwan's consumer price inflation rose to the highest level in seven months in May. The CPI index rose 0.94% year-on-year in May, following a 0.66% increase in April. This is much below the target rate and the monetary policy would remain accommodative in the coming year.

New Taiwan dollar has appreciated to 31.1 to the US dollar. It is gaining as production capacities stabilize in near term.

	18	19	20	21	22
GDP (%p.a.)	2.6	2.1	2.4	2.4	2.2
Inflation (%p.a.)	1.2	1.0	1.0	1.0	1.0
Current A/c(US$ bill.)	68.0	70.0	71.0	70.0	60.0
NT$/$(nom.)	29.8	31.0	31.0	31.0	31.0

Brazil

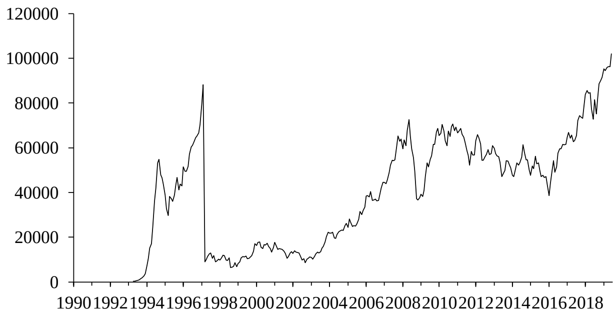
The probability of Brazil slipping into recession is heightened as the economy shrank in the first quarter of 2019 by 0.2%, the first contraction since 2016. This weakness is set to reverberate into the remainder of 2019 and leading to recession in 2019, a reality. We are still hopeful that the economy may not grow at all and does not slip into recession this year and quickly rebounds to 2% in 2020. The central bank expects Brazil's gross domestic product to expand by 0.8% this year.

Inflation is likely to remain subdued through 2021. Annual inflation is likely to remain below 4.0% throughout. The central bank has declared that the monetary policy would be accommodative and, thus, we expect the Selic rate to reach a new record low of 5.5% by December and to remain at that level throughout 2020. Selic rate was left at 6.5% by the central bank in its March meeting. The rates have remained at that level since March 2018.

Brazil's trade surplus in the first half of 2019 reached 27.1 billion U.S. dollars, down by 9.6% year on year. In June, the trade surplus narrowed to $5 billion as imports rose and exports fell. The fall in net trade is affecting the GDP growth. China's import substitution by the US should benefit soybeans exports, but it is unlikely to boost the economy as long as crude oil prices remain weak.

Brazil's privatization process got a shot in the arm. Brazil's Supreme Court voted to allow the government to sell subsidiaries of state companies without congressional approval, making it easier for President Jair Bolsonaro's administration to raise money, cut debt and attract private investment as the economy struggled. The decision allows the country's largest state enterprise, oil major Petróleo Brasileiro SA, or Petrobras, to continue its sale of noncore assets.

Brazil: Bovespa

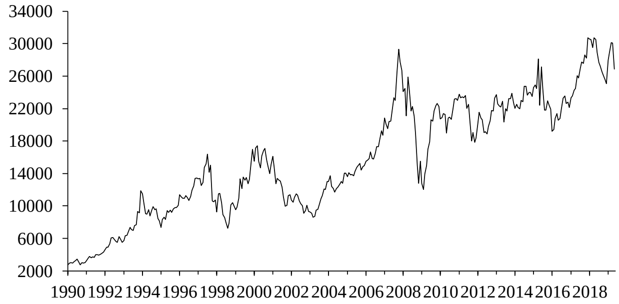


With the decision, the Bolsonaro administration will now be able to carry out its plan to sell as many as 100 businesses more quickly than would have been possible if had to go through the country's splintered Congress. The cash-strapped government aims to raise $20 billion through asset sales this year apart from the sale of Petrobras' assets.

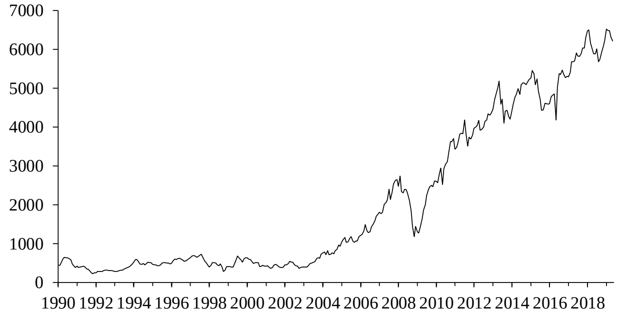
	18	**19**	**20**	**21**	**22**
GDP (%p.a.)	1.1	0.0	2.2	2.5	2.5
Inflation (%p.a.)	3.8	4.0	3.9	4.0	4.0
Current A/c(US$ bill.)	-14.6	-16.0	-16.0	-16.0	-16.0
Real/$(nom.)	3.8	3.9	4.0	4.1	4.1

Other Emerging Markets

Hong Kong: FT-Actuaries

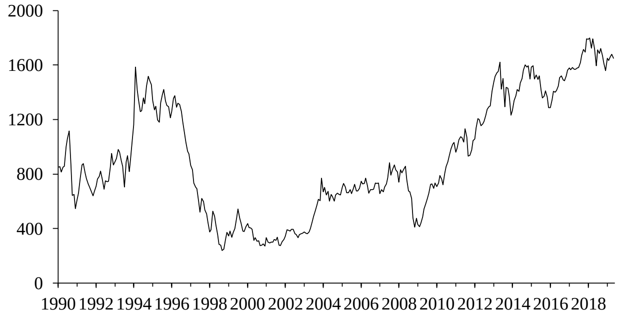


Indonesia: Jakarta Composite

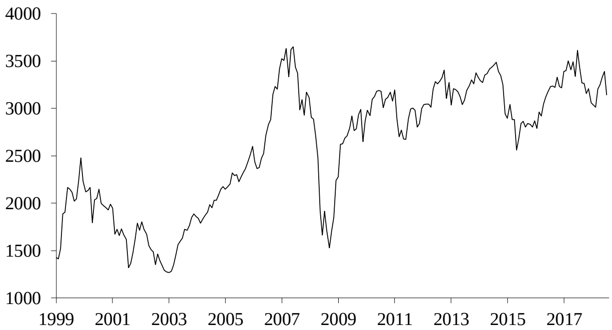


Malaysia: FT-Actuaries (US$ Index)

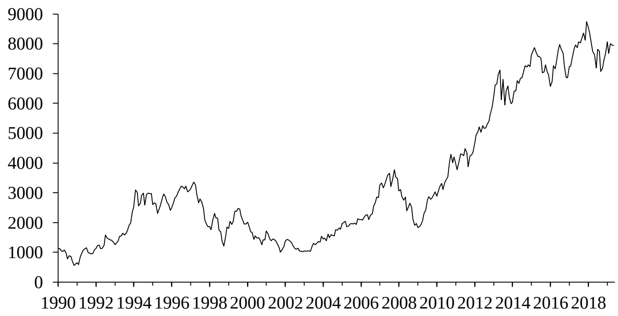
Thailand: Composite Index



Singapore: Straits Times Index

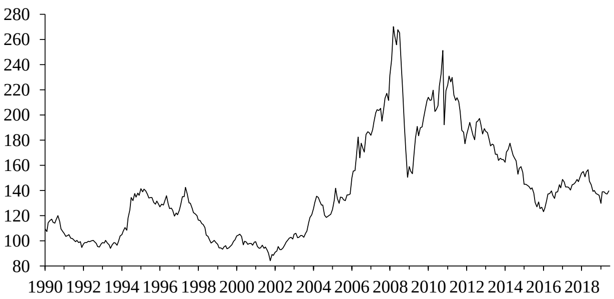


Philippines: Manila Composite

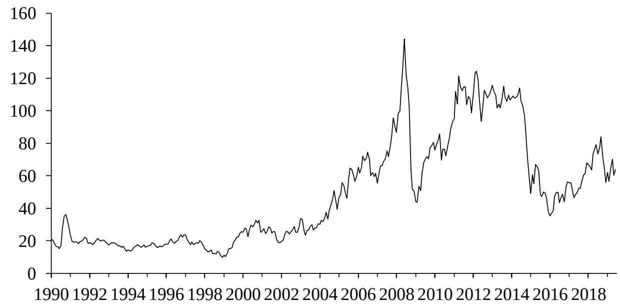


COMMODITY MARKETS

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

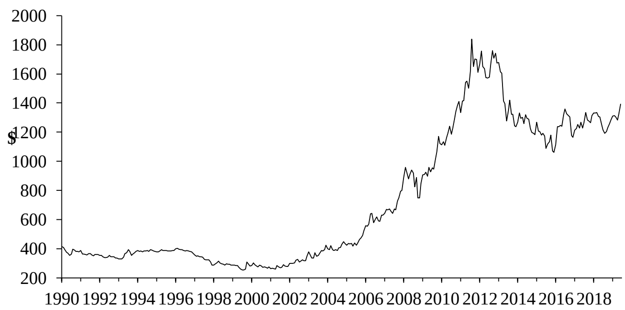


Oil Price: North Sea Brent (in Dollars)

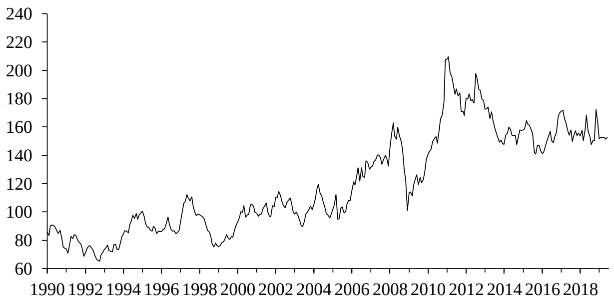


Commodity Price Index (Sterling)
(Economist, 2000=100)

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]
2017	2.6	0.6	0.4	77.4	75.5	-1.6	3.8	-1.5
2018	2.5	1.0	0.7	78.5	76.7	-1.5	3.4	-0.5
2019	2.0	1.4	0.9	76.6	74.6	-0.7	2.9	0.5
2020	2.1	1.6	1.3	76.1	74.3	0.4	2.7	1.4
2021	2.0	2.5	2.4	76.3	75.1	1.1	2.6	0.9
2022	2.0	3.4	3.1	75.6	74.6	1.1	2.5	0.6
2018:1	2.5	1.0	0.5	79.2	77.9	-1.7	3.7	-1.1
2018:2	2.5	1.0	0.7	79.3	77.7	-1.7	3.4	-1.1
2018:3	2.5	1.0	0.8	78.0	75.9	-1.3	3.3	-1.1
2018:4	2.4	1.0	0.8	77.6	75.4	-1.2	3.1	-0.3
2019:1	2.1	1.4	0.8	77.2	75.4	-1.0	2.9	0.5
2019:2	2.0	1.4	1.0	76.6	74.4	-0.8	2.9	0.5
2019:3	2.0	1.4	1.0	76.4	74.4	-0.6	2.9	0.5
2019:4	2.0	1.4	1.0	76.3	74.3	-0.5	3.0	0.5
2020:1	2.1	1.5	1.1	76.1	74.3	0.1	2.8	1.0
2020:2	2.1	1.5	1.2	76.2	74.3	0.1	2.8	1.0
2020:3	2.0	1.6	1.3	76.1	74.3	0.1	2.6	1.5
2020:4	2.0	1.7	1.6	76.0	74.3	1.3	2.5	1.8

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

Labour Market and Supply Factors (Seasonally Adjusted)

	Average Earnings (1990=100)[1]	Wage Growth[2]	Unemployment (New Basis) Percent[3]	Millions	Real Wage Rate[4] (1990=100)
2017	259.1	2.9	2.2	0.8	142.2
2018	265.9	3.1	2.2	0.8	142.6
2019	274.2	3.1	2.1	0.8	143.4
2020	282.6	3.1	1.9	0.7	144.6
2021	291.1	3.0	1.6	0.7	145.7
2022	299.8	3.0	1.3	0.6	146.9
2018:1	264.6	3.0	2.3	0.8	142.9
2018:2	266.3	2.8	2.2	0.8	141.8
2018:3	266.3	3.0	2.1	0.8	143.5
2018:4	266.3	3.5	2.1	0.7	142.3
2019:1	272.3	2.9	2.0	0.7	143.7
2019:2	274.4	3.0	2.0	0.7	142.6
2019:3	274.0	2.9	2.0	0.7	144.3
2019:4	276.1	3.7	2.0	0.7	143.0
2020:1	280.8	3.1	2.0	0.7	144.8
2020:2	282.9	3.1	2.0	0.7	143.8
2020:3	282.2	3.0	2.0	0.7	145.5
2020:4	284.4	3.0	1.9	0.7	144.2

1 Whole Economy
2 Average Earnings
3 Wholly unemployed excluding school leavers as a 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
2017	163.3	781822.0	441518.3	307415.9	200522.0	-60310.0	107324.2
2018	165.5	792539.6	445984.1	319781.0	201140.2	-63640.2	110725.5
2019	168.2	805404.2	453119.8	326324.6	201447.8	-58242.8	117162.2
2020	171.5	821280.9	460369.7	333407.0	202656.5	-55242.8	119776.8
2021	175.1	838480.8	467735.5	343510.3	203872.4	-54230.9	122210.0
2022	179.1	857546.9	475219.3	347723.2	205095.9	-46650.6	125369.9
2017/16	1.8		0.6	0.7	0.1		-3.7
2018/17	1.4		1.0	4.0	0.3		3.2
2019/18	1.6		1.6	2.2	0.2		6.3
2020/19	2.0		1.6	2.2	0.6		2.2
2021/20	2.1		1.6	3.0	0.6		2.0
2022/21	2.3		1.6	1.2	0.6		2.6
2018:1	164.4	196809.2	110809.6	75521.2	51591.3	-14814.1	26298.9
2018:2	165.1	197627.5	111248.1	78876.0	49253.6	-16094.0	25656.2
2018:3	166.1	198830.2	112094.9	80893.8	49822.6	-16001.3	27979.8
2018:4	166.4	199272.8	111831.4	84490.1	50472.7	-16730.8	30790.6
2019:1	167.1	200092.8	112582.6	79927.5	51669.7	-14722.0	29365.1
2019:2	167.9	201028.5	113028.1	82320.0	49760.1	-15266.8	28782.1
2019:3	168.5	201759.7	113888.4	80427.4	49875.0	-13130.2	29276.1
2019:4	169.2	202523.3	113620.7	83649.7	50143.1	-15123.7	29738.9
2020:1	170.4	204031.8	114383.9	81327.8	51979.7	-13822.0	29823.9
2020:2	171.2	204988.8	114836.5	84335.8	50058.7	-14366.8	29831.2
2020:3	171.8	205741.0	115710.6	82502.0	50174.2	-12630.2	29980.0
2020:4	172.5	206519.4	115438.7	85241.3	50443.9	-14423.7	30141.7

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)
2017	2.0	2047.3	39.4	79.9	-66.3
2018	1.5	2117.0	30.9	80.0	-62.9
2019	1.0	2206.6	22.3	84.7	-48.8
2020	0.3	2297.2	6.9	91.0	-41.2
2021	-0.3	2394.8	-6.9	94.2	-30.6
2022	-0.7	2500.2	-18.5	95.4	-18.4
2018:1	-2.8	515.6	-14.3	20.2	-16.7
2018:2	3.3	518.6	16.9	19.7	-18.7
2018:3	0.7	527.9	3.8	19.8	-13.5
2018:4	1.9	532.3	10.2	20.1	-14.0
2019:1	0.0	538.2	0.1	20.4	-13.7
2019:2	2.2	541.9	11.9	20.7	-13.8
2019:3	1.7	548.8	9.2	20.9	-9.4
2019:4	1.5	554.3	8.3	21.2	-11.9
2020:1	-1.3	561.6	-7.1	21.9	-12.2
2020:2	1.3	565.4	7.5	22.0	-12.0
2020:3	0.9	570.9	5.1	22.1	-7.6
2020:4	1.0	576.9	5.5	23.5	-9.4

1 GDP at market prices (Financial Year)

WORLD FORECAST DETAIL

Growth Of Real GNP

	2015	2016	2017	2018	2019	2020
U.S.A.	2.9	1.6	2.2	2.9	2.6	1.9
U.K.	2.3	1.9	1.8	1.4	1.6	2.0
Japan	1.3	0.6	1.9	0.8	1.1	0.5
Germany	1.7	2.2	2.2	1.5	1.4	1.6
France	1.1	1.1	2.3	1.5	1.5	1.4
Italy	0.9	1.1	1.6	0.9	0.5	0.7

Growth Of Consumer Prices

	2015	2016	2017	2018	2019	2020
U.S.A.	0.1	1.3	2.1	2.4	2.1	2.2
U.K.	0.2	1.1	2.6	2.5	2.0	2.1
Japan	0.8	–0.1	0.5	1.0	1.1	1.2
Germany	0.3	0.5	1.8	1.8	1.8	1.7
France	0.0	0.2	1.0	1.3	1.3	1.5
Italy	0.1	–0.1	1.2	1.2	1.2	1.4

Real Short-Term Interest Rates

	2015	2016	2017	2018	2019	2020
U.S.A.	–1.1	–1.6	–1.0	0.3	0.4	0.8
U.K.	–0.5	–2.1	–1.9	–1.3	–1.2	–0.7
Japan	0.3	–0.4	–0.9	–1.0	–1.1	–1.1
Germany	–0.6	–2.1	–2.2	–2.1	–2.0	–1.7
France	–0.3	–1.3	–2.2	–1.6	–1.8	–1.5
Italy	0.0	–1.5	–1.5	–1.5	–1.7	–1.4

Nominal Short-Term Interest Rates

	2015	2016	2017	2018	2019	2020
U.S.A.	0.2	0.5	1.4	2.4	2.6	3.0
U.K.	0.6	0.5	0.4	0.7	0.9	1.3
Japan	0.2	0.1	0.1	0.1	0.1	0.1
Germany	–0.1	–0.3	–0.3	–0.3	–0.3	0.0
France	–0.1	–0.3	–0.3	–0.3	–0.3	0.0
Italy	–0.1	–0.3	–0.3	–0.3	–0.3	0.0

Real Long-Term Interest Rates

	2015	2016	2017	2018	2019	2020
U.S.A.	0.2	0.3	0.6	0.8	1.2	1.4
U.K.	–0.7	–1.5	–1.5	–1.0	–0.6	–0.4
Japan	–0.4	–1.0	–1.1	–1.4	–1.4	–1.6
Germany	–0.9	–1.7	–1.5	–1.7	–1.3	–1.0
France	–0.2	–0.8	–0.8	–0.9	–0.8	–0.7
Italy	0.6	0.4	0.5	1.2	1.5	1.6

Nominal Long-Term Interest Rates

	2015	2016	2017	2018	2019	2020
U.S.A.	2.2	2.5	2.8	3.0	3.5	3.8
U.K.	1.3	0.7	0.6	1.0	1.4	1.6
Japan	0.3	0.0	0.1	0.0	0.1	0.1
Germany	0.6	0.1	0.4	0.2	0.6	1.0
France	1.0	0.7	0.8	0.7	1.0	1.2
Italy	1.6	1.7	1.9	2.8	3.3	3.5

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

	2015	2016	2017	2018	2019	2020
U.S.A.	93.0	94.0	94.5	94.8	95.0	95.2
U.K.	92.2	81.4	75.5	76.7	74.6	74.3
Japan	56.0	58.4	58.3	58.1	58.4	58.3
Germany	94.7	95.0	94.3	94.9	95.1	95.0
France	96.2	96.0	95.3	95.1	95.5	95.4
Italy	102.1	102.0	101.2	101.1	101.1	101.0

[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)

	2015	2016	2017	2018	2019	2020
U.S.A.[1]	103.08	101.91	102.20	102.40	102.50	102.50
U.K.	1.53	1.35	1.30	1.29	1.30	1.32
Japan	121.11	108.61	112.18	114.10	112.00	112.50
Eurozone	0.90	0.90	0.88	0.85	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