LIVERPOOL INVESTMENT LETTER

October 2019

Cardiff Business School

Ysgol Busnes Caerdydd

Julian Hodge Institute of Applied Macroeconomics

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LIVERPOOL RESEARCH GROUP IN MACROECONOMICS

LIVERPOOL RESEARCH GROUP IN MACROECONOMICS

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The Julian Hodge Institute was launched in autumn 1999 in a new 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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In all the political chaos one thing seems inevitable: a general election, say by the year end. If either Tories or Labour won, there will be fiscal expansion which we have advocated to end the zero lower bound on interest rates and restore monetary policy potency. Labour will be hamstrung by EU law which its policies support continuing under. The Tories after the Brexit they espouse will pursue the new supply-side reform programme of free trade and pro-innovation regulation.

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POLITICAL CHAOS AT WESTMINSTER STRAINS BUSINESS AND POPULAR SENTIMENT

The public at large and businesses large and small fume at the Westminster shenanigans. ‘Get it done!’ is heard across the land. Whichever political group is seen to have caused or prolonged the hold-up will suffer the most in the inevitable election that will come, sooner or later.

With so many political interests clashing on a Parliamentary knife-edge, and two ‘top courts’ — the Supreme Court and the European Court of Justice — with claims of ultimate jurisdiction, it requires supreme boldness to forecast the political outcome for Brexit in this pre-election period.

An EU Deal has suddenly become more likely as the dangers of No Deal to the EU and Ireland in particular have hit home — they stand to lose a lot of money due to new tariff barriers. For the UK we calculate that No Deal will produce little if any disruption, while bringing agreeably more quickly the benefits of EU departure — free trade generally, UK-based regulation of business and borders, and zero EU budget contributions.

Again, if an EU Deal is not reached, No Deal is the next most likely outcome, reached in some way with an EU also anxious to see Brexit done. It could even be No Deal plus, with a side agreement to pursue a Free Trade Agreement under GATT Article 24, leaving all current trading relationships unchanged meanwhile. This would avoid the worst damage to the EU.

Much else is possible — we have grown used to the unexpected on a weekly basis. However, it cannot be possible to avoid an election for too long. Labour now says it will only provide the two-thirds majority needed for one once No Deal has been clearly prevented. It also fears an election fought over Brexit where its supporters are passionately divided between Brexit and Remain. Ironically, it is best off if Brexit somehow happens before an election which it can then fight on domestic issues. So for Labour either No Deal Brexit or an EU Deal would solve its problem and allow it to back the election it has repeatedly called for but dares not have now.

For the Lib Dems, now swollen to 18 MPs, an election pre-Brexit is best, as their platform is Remain; Brexit shoots their fox. They would support an election now. The SNP also wants an election as polls suggest it could make gains at the expense of both big parties.

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

If we assume we get an election before the year end, what are the possibilities for policy changes?

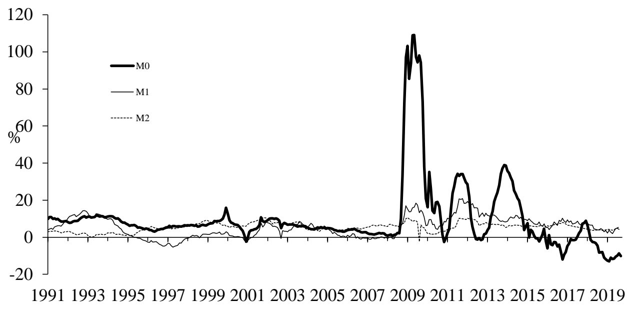
If Labour won, and the UK stayed in the EU due to its referendum on Remain vs its renegotiated soft Brexit — effectively also staying under EU rule — (Leavers would widely abstain), it would find its programme of nationalisation via confiscation of shares and other property quite illegal under EU law. In effect it would be left as just a high-spending high-borrowing government.

If the Tories won, they too under Boris Johnson have committed to high spending and higher borrowing, though on a smaller scale. But they would do so under a full Brexit which they would have campaigned on. This would simultaneously push the economy to free trade, lower prices and more competition/productivity; accompanied by moves toward more pro-business/pro-innovation regulation; and a new immigration policy based on importing skills. This promises a new supply-side reform process, similar to the Thatcher revolution.

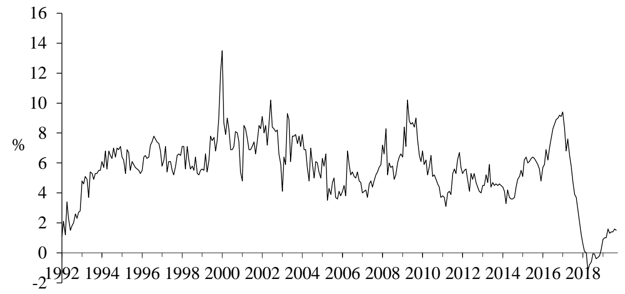
We have argued in recent Letters that a burst of fiscal expansion is now needed to push interest rates well away from the Zero Bound, so that monetary policy can become effective again with normalised interest rates where financial markets cease to be badly distorted by the zero bound and massive QE.

In the end UK democracy has tended to give the people what they wanted. As we look ahead, we should assume that once again they will get what they want. As we and they look at the two scenarios above, it seems most likely that they will prefer the Tory offering. But only time will tell us for sure.

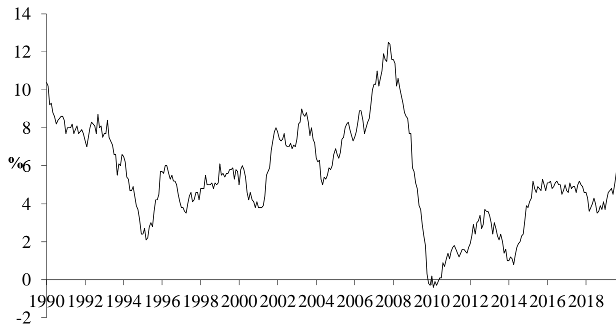
U.S.: Growth in Monetary Aggregates (Yr - on - Yr)



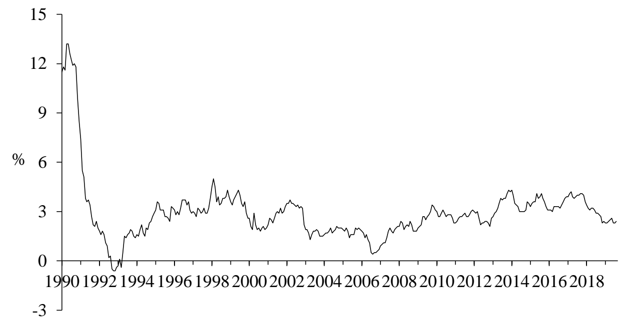
UK: Notes and Coins in Circulation Growth



Eurozone M3 Growth



Japan: Growth of M2+CD's



FOCUS ON JAPAN

Francesco Perugini

Japan Hikes Consumption Tax

After being delayed twice, Japan's consumption tax has been raised to 10% from 8% on October 1. The consumption tax was introduced in Japan during the height of the bubble economy in 1989 at the rate of 3% to finance social welfare spending, as Tokyo was becoming increasingly cognizant of the country's future demographics. The tax was later raised to 5% in 1997. And yet, government spending continued to snowball as the country continued to fight deflation and a stagnant economy, feeding the perennially grim outlook on Japan's aging society and dwindling population. In order to cover the nation's ballooning social welfare costs, a deal was made in 2012 among the then-ruling Democratic Party, the Liberal Democratic Party and New Komeito. The agreement paved the way for a rise in the tax rate to 8% in April 2014 (which went ahead) and 10% in October 2015, though this last was repeatedly delayed, until now.

This new 10% tax rate is one of several measures by Prime Minister Shinzo Abe's government to help ease the burden of an aging population. There are significantly less citizens working and contributing to social welfare systems than previous decades, and it shows. By 2025, all baby boomers will be over the age of 75, and the system needs more capital to be able to support this new normal. According to official projections, the extra 2% tax will create almost 14 trillion yen (1.3 billion USD) in new revenue, covering basic expenses, childcare, and early education, and decreasing an ever-present national debt. This isn't the first tax hike Abe has pushed through an often-reluctant Diet.

The government has introduced several fiscal countermeasures to help relieve some of the negative pressure and reassure consumers. Ranging from permanent items, such as tax reform, reduced tax rates and increases in welfare benefits, to temporary strategies, such as tax deductions, sale of discount shopping vouchers and rebates for cashless payments, these measures are expected to lessen the increased tax burden on Japanese households from the VAT hike.

However, the move remains unpopular among the public, and now attention has turned to how it will affect the already wobbly economy. The government, hoping to avoid a repeat of the economic hit following the previous tax hike in 2014, is hoping to prop up consumption with the big-spending programs.

Some economists predict that the array of measures will absorb the impact to some extent. But they also caution that consumption will take a hit amid weakening consumer sentiment, which in turn could stunt broader economic growth. "Raising the consumption tax will naturally impose a burden on households. There are various views on whether the impact will be quite light or somewhat deep, like what happened in 2014," said Shinichiro Kobayashi, an economist at Mitsubishi UFJ Research and Consulting Co. However, he also predicts that the increase this time will affect consumption for the immediate October–December quarter, but "the drop will be relatively mild and won't last until the beginning of next year."

Takayasu Kudo and Izumi Devalier of Merrill Lynch Japan are not optimistic about the outlook. In their July report they said that consumer confidence "is likely to stay weak after the tax hike, resulting in a sluggish household spending recovery. The consumption tax hike represents a permanent shock to real household disposable incomes and is likely to depress households' income expectations accordingly," they said. Yasunari Ueno, chief market economist at Mizuho Securities, forecasts that the tax hike will lead to a downturn in the economy and that the various government measures to offset the burden will have limited effect.

When the government raised the consumption tax to 8% from 5% in April 2014, the first jump in 17 years, the economy was dealt a serious blow, with GDP contracting two quarters in a row between April to September that year. The damage was enough for Abe to delay the planned increase to 10% in 2015.

The Abe administration, seeking to limit the tax hike's impact, has turned to big-spending fiscal policy moves. The 2 percentage point boost is estimated to inflict about a ¥5.7 trillion burden on households. However, making preschool education free of charge, keeping the 8% rate for food and non-alcoholic beverages and beefing up social welfare are expected to lessen that burden to around ¥2 trillion — about a quarter of the ¥8 trillion cost of the 2014 hike, according to the government and the Bank of Japan. Moreover, a report released in September by Daiwa Institute of Research estimated that the benefit from the free preschool program could outweigh the effects of the tax increase on households of two or more people aged 49 or younger who have one or more children aged 3 to 5, while older or single households will shoulder more. The report also warned that while the ¥2 trillion burden from the tax increase is indeed smaller than that from the 2014 hike, consumption will see a moderate dip until next fiscal year. Other economists also believe that the negative impact on economic growth would be limited. They argue that compared with 2014, the nation has a lower unemployment rate, higher incomes and more overall workers.

Overall, we will be seeing the effects in the coming few months. But the real problem for Abe's government remains how to promote sustainable growth that can help to finance its ballooning debt.

MARKET DEVELOPMENTS

For all the excess leverage in business due to zero interest rates, the world continues to grow and support equity values. Raw material capacity, the ultimate bar to growth, remains abundant, ensuring growth can continue for a decade or more.

Table 1: Market Developments

	Market Levels		Prediction for Sep/Oct 2020	
	Sep 4	Oct 2	Previous Letter	Current View
Share Indices				
UK (FT 100)	7311	7123	9739	9487
US (S&P 500)	2938	2888	3287	3231
Germany (DAX 30)	12025	11925	18915	18758
Japan (Tokyo New)	1507	1596	2000	2118
Bond Yields (government)				
UK	0.29	0.36	3.00	3.00
US	1.45	1.63	3.80	3.80
Germany	–0.81	–0.81	1.00	1.00
Japan	–0.30	–0.17	0.10	0.10
UK Index Linked	–2.17	–2.22	1.00	1.00
Exchange Rates				
UK ($ per £)	1.22	1.23	1.32	1.32
UK (trade weighted)	75.29	76.28	76.1	76.1
US (trade weighted)	103.89	103.81	102.5	102.5
Euro per $	0.91	0.91	0.88	0.88
Euro per £	1.11	1.12	1.16	1.16
Japan (Yen per $)	106.20	107.35	112.5	112.5
Short Term Interest Rates (3-month deposits)				
UK	0.77	0.80	2.10	2.10
US	2.17	2.07	3.00	3.00
Euro	–0.48	–0.53	0.00	0.00
Japan	–0.05	–0.20	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	–7.27	6.62
Germany	3.30	1.6	1.7	54.00	0.19	60.79
Japan	1.90	0.5	1.2	31.00	–12.42	22.18
UK indexed[2]	–2.10		2.1	5.00		4.89
Hong Kong[3]	2.60	5.6	2.1	–17.00	–7.27	–14.17
Malaysia	3.30	4.8	2.1	43.00	–7.27	45.93
Singapore	3.50	2.7	2.1	10.00	–7.27	11.03
India	1.40	8.0	2.1	19.00	–7.27	22.83
Korea	1.10	2.9	2.1	–23.00	–7.27	–24.37
Indonesia	2.20	5.4	2.1	26.00	–7.27	28.43
Taiwan	2.80	2.1	2.1	12.00	–7.27	12.03
Thailand	3.20	3.8	2.1	27.00	–7.27	28.83

Bonds: Contribution to £ yield of: –

	Redemption Yield	Changing Nominal Rates	Currency	Total
UK	0.36	–26.40		–26.04
US	1.63	–16.70	–7.27	–22.34
Germany	–0.81	–18.10	0.19	–18.72
Japan	–0.17	–2.70	–12.42	–15.29

Deposits: Contribution to £ yield of:

	Deposit Yield	Currency	Total
UK	0.80		0.80
US	2.07	–7.27	–5.20
Euro	–0.53	0.19	–0.34
Japan	–0.20	–12.42	–12.62

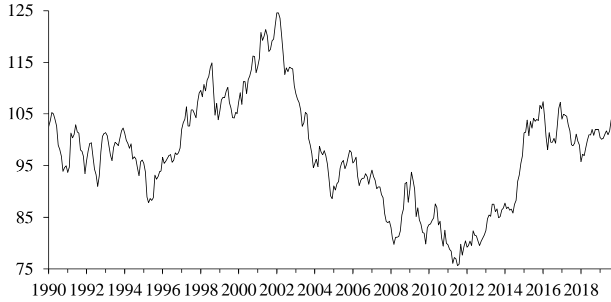
[1] Yields in terms of €s or $s can be computed by adjusting the £-based yields for the expected currency change.
[2] UK index linked bonds All Stocks
[3] Output based on China.

Table 3: Portfolio(%)

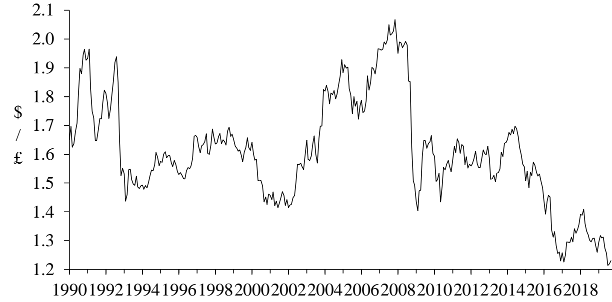
	Sterling Based Investor		Dollar Based Investor		Euro Based Investor	
	September Letter	Current View	September Letter	Current View	September Letter	Current View
UK Deposits (Cash)	5	5	5	5	1	1
US Deposits	-	-	-	-	-	-
Euro Deposits	-	-	-	-	-	-
Japanese Deposits	-	-	-	-	-	-
UK Bonds	-	-	-	-	-	-
US Bonds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

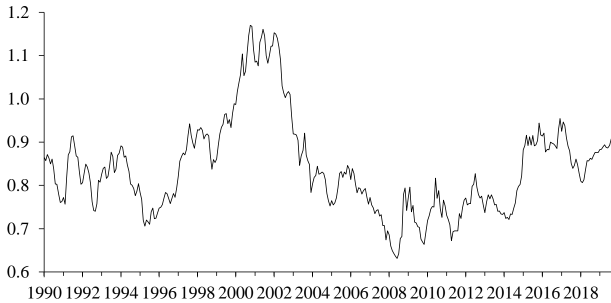
US : Trade Weighted Index
(Bank of England 1990 = 100)



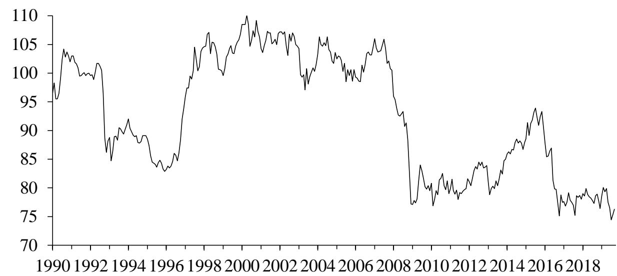
UK: Dollars Per Pound Sterling



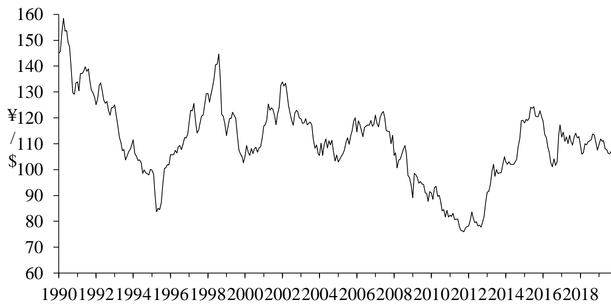
Euro per US dollar



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



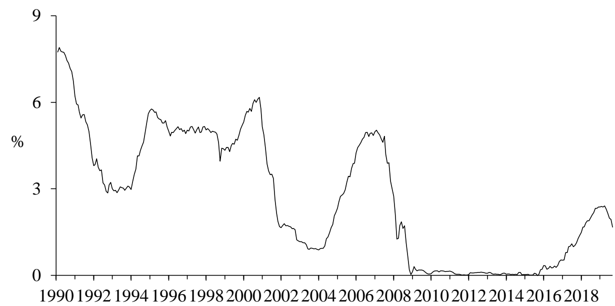
Japan : Yen Per U.S. Dollar



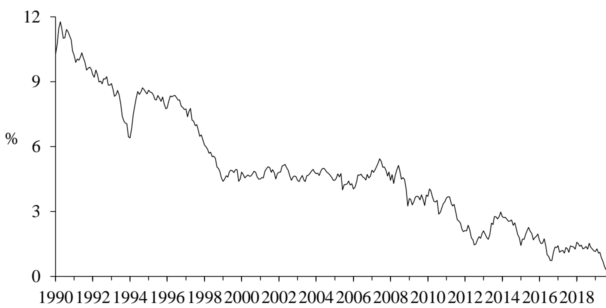
GOVERNMENT BOND MARKETS

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

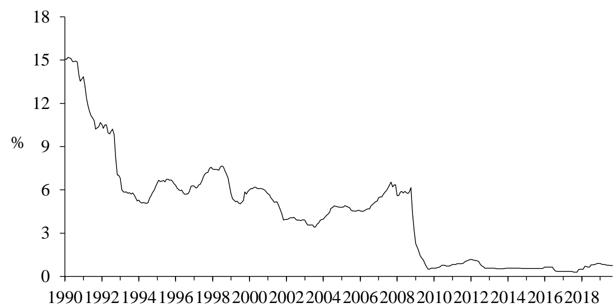
U.S. : 3-Month Treasury Bill



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

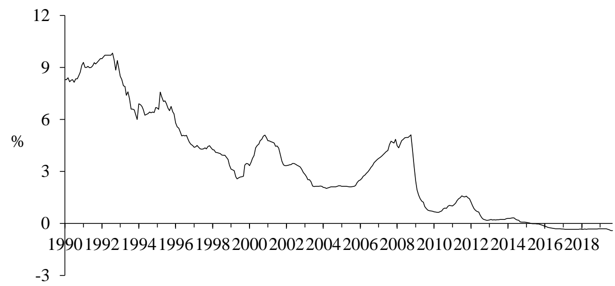


U.K. : 3-Month Certificate of Deposit Rate

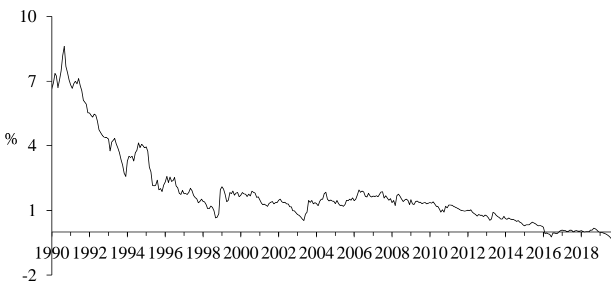


Germany: Yield on Public Authority Bonds

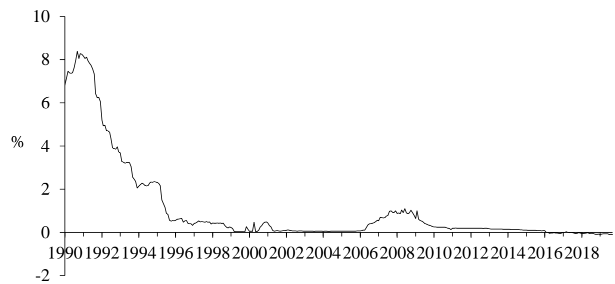
Germany : 3-Month Interbank Deposit Rate



Japan: Yield on Long-Term Government Bonds

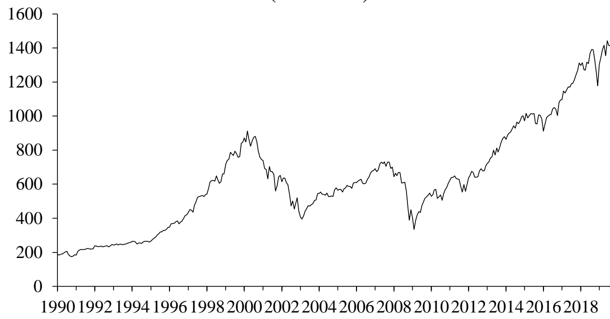


Japan : 3-Month Money Market Rate

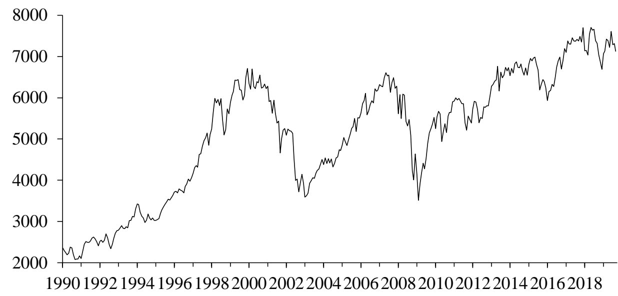


MAJOR EQUITY MARKETS

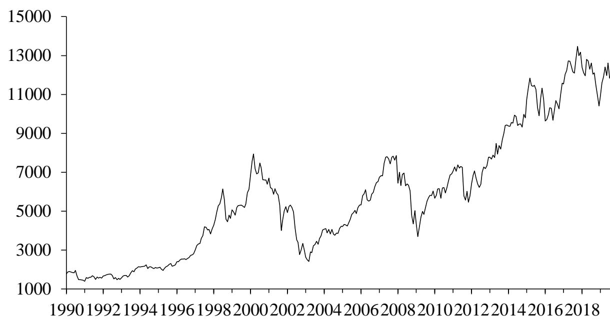
U.S. : S & P 400 Industrial
(1985=100)



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



Germany : DAX 30



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

EMERGING MARKETS

Anupam Rastogi

India

Indian Prime Minister Narendra Modi wants a $5 trillion economy by 2025. But the country's slowdown and a simmering shadow banking crisis mean that the target is at risk, and global investors are heading for the exit. To lure the foreign investors, the Indian government reduced the headline corporate tax rate to 22% from 30%, effective from the start of the current tax year in April. The cut will boost the earnings growth of companies in the MSCI India index by around 6 percentage points this calendar year and next. The sectors that will benefit the most are raw materials, financials and industrials, which currently have the highest effective tax rates.

The stimulus will restore confidence amongst both domestic and foreign investors that the Indian government is committed to promoting private enterprise and make them the principle driving force of economic growth. It will strongly rekindle investors' animal spirits. Moreover, it is aimed to improve India's chances of attracting investors moving out of China and looking for alternative locations. Prime Minister Modi's visit to the US was to woo the US large corporations to India and to invite them to take part in the massive privatization programme underway in India.

On the other hand, the structural adjustments which have far reaching consequences for corporates, is having its ripple effects on economic growth. Comparatively, an insipid GDP growth figure is drowning the expected bright future, better corporate governance, better fiscal and disciplined credit and lending culture without corruption.

GDP growth hit 5% in the three months to June which is the weakest since March 2013, and well below the 8% plus annual expansion needed to achieve Modi's 2025 goal. The external shocks from trade wars to surging oil prices are exacerbating the economy's woes. Our growth forecast for 2019 is kept unchanged as India had above normal monsoon and this would lead to bumper agriculture growth and rural consumption in the second half of the fiscal year.

While economic activities are showing signs of sluggishness, the policy makers are drawing solace from the fact that retail inflation remains in the comfort zone of the central bank. Retail inflation inched up to 3.21% in August but remained within the RBI's target of 4%, with deviation of 2% on either side. The CPI inflation was at 3.2% in August. The low inflation provides enough headroom for the RBI to further lower the policy rate.

The central bank has already slashed the repo rate (short-term borrowing rate) four times aggregating to 1.35 percentage points since January. At its meeting in August,

India: BSE Sensitive

the Monetary Policy Committee had reduced the benchmark lending rate by an unusual 35 basis points to 5.40%, followed by a further 25 basis point cut in the recent meeting on October 4. Besides this, the central bank announced a slew of measures aimed at unclogging liquidity to kick-start lending and confidence.

India's current account deficit (CAD) for the first quarter ended June contracted to 2% of the gross domestic product (GDP) on a year-on-year basis, primarily on account of higher invisible receipts at $32 billion, as compared with $30 billion a year ago. India's merchandise exports in August declined for the second time in the current financial year, which began in April, while imports dropped for the third consecutive month, signalling that rising protectionism and trade tensions between the US and China are impacting India's trade prospects as well.

The CAD could ease to $52 billion or 1.8% of the GDP in FY20 from $57.2 billion or 2.1% of GDP in FY19 as crude oil prices have returned on their downward path.

Indian rupee (INR) has depreciated roughly 3% this year so far and the central bank is happy to see it that way as it helps in maintaining competitiveness for exports sector.

In the first leg of Modi's U.S. visit, he was joined by Mr. Trump to address tens of thousands of Indian-Americans. The symbolism of Modi and Trump addressing a joint rally should not be underestimated. It puts into perspective how significantly India-U.S. ties have grown in the last few years and how important New Delhi is for Washington today. Energy and defence issues are being leveraged by India, and thorny trade issues are being addressed bilaterally.

India will host President Xi in October and it may cut duties on 80% of Chinese imports under the Regional Comprehensive Economic Partnership (RCEP). The RCEP is a proposed free trade agreement between the ten member states of the Association of Southeast Asian Nations (ASEAN) (Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, Vietnam)

and its six FTA partners (China, Japan, India, South Korea, Australia and New Zealand).

	18–19	19–20	20–21	21–22	22–23
GDP (%p.a.)	6.8	6.5	6.8	7.2	7.4
WPI (%p.a.)	3.9	3.6	3.8	3.9	4.0
Current A/c(US$ bill.)	-70.0	-64.0	-64.0	-65.0	-65.0
Rs./$(nom.)	79.5	70.5	71.5	72.5	73.5

China

On October 1st, Chinese President Xi Jinping presided over a grandiose military parade marking the 70th anniversary of Communist rule in China, in a projection of strength as the country wrestles with a challenge from President Trump. President Xi Jinping declared China's rise unstoppable. In Hong Kong, black-clad protesters occupied roads, set fires and clashed with riot police around the financial hub in the 17th week of protests opposing Beijing's increased grip over the city. This was in the stark contrast to celebrations in Beijing and shows the challenges Xi faces in convincing people in Hong Kong and Taiwan of the benefits of Beijing having greater control over their political systems and paths to prosperity.

President Trump believes that the U.S. tariffs are battering the Chinese economy and millions of Chinese workers are out of jobs and pressuring the country's president, Xi Jinping, to strike a trade deal.

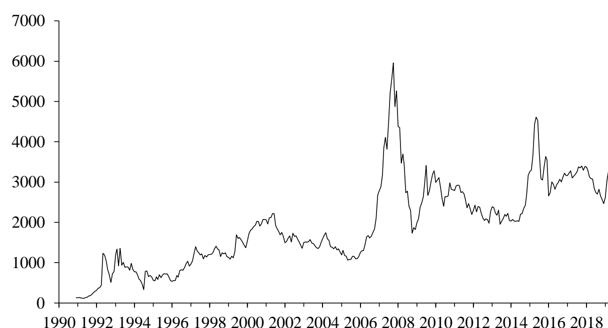
The reality is somewhat different. China, after decades of rapid development, is grappling with a slowing growth pace and weaker sentiment among businesses and consumers. Urban unemployment is high as a result of the Chinese economy's shift over the past decade from one reliant on manufacturing and exports to one where services and domestic consumption have gained importance as pillars of growth. However, the government remains confident that it can meet its goal of keeping growth within a range between 6% and 6.5% this year. China's economy expanded 6.3% in the first half of the year. China's government has sought to support the economy this year through tax cuts, and by taking measures to boost liquidity in the financial system.

China's industrial output grew at its slowest pace since 2002 in August. China is witnessing slowdown in retail sales as well. We forecast that 6% growth in China this year slowing to 5.6% next year as U.S. tariff on all Chinese imports starts affecting the real economy.

China's consumer inflation rate expanded its pace in August as the price of pork rose due to the swine flu. China's overall consumer price index rose 2.8% from a year earlier — matching the July level, which was the fastest pace in 17 months. Rising CPI and falling PPI has put the central bank in a dilemma. The central bank believes that the country's interest rates were appropriate and that it wouldn't aggressively ease monetary policy, even as other central banks lower borrowing rates in a bid to spur growth.

Chinese exports fell in August by 1% from a year earlier, and by a sharp 16% to the US — a clear sign that the dispute

China: SSE Composite Index



with the US is hurting bilateral trade. China's imports fell for a fourth straight month in August as a drop-off in exports to the U.S. steepened. Exports during August decreased 1% in dollar terms from a year earlier, while imports declined 5.6%, leaving a trade surplus of $34.8 billion only. Exports would grow 2.2%, while imports would shrink by 6.4% in 2019.

American companies are downshifting in China as its economy slows and trade tensions with the U.S. persist. Western businesses have been shifting production out of China, even though the numbers have not been large enough. Many firms will keep some production in China to cater for its important domestic market, investments in increasing capacity is moving to other countries.

China's progress in boosting international use of the yuan is stalling. According to data published by the Bank for International Settlements, the yuan remained as the eighth most traded currency this year, unchanged from the previous survey done three years ago. Beijing has promoted the yuan as a core element of its international political engagement and officials talk of positioning it as an alternative to the U.S. dollar for trade and finance.

The yuan has crossed the sacred red line of 7 per dollar and China will allow its currency to fall further and may even risk U.S. anger by using it as a bargaining chip in trade talks. The currency's 3.8% decline in August was its sharpest monthly fall in 25 years. We do not expect Beijing to hem in the yuan in a defined range this time. The currency is likely to end 2019 at 7.2.

The yuan's depreciation is having its greatest impact in the emerging markets. Most emerging market currencies have depreciated in line with the yuan to maintain competitiveness.

The U.S. and China trade war remains at an impasse in more than a year long trade war and widening a chasm between the two countries. High-level trade talks between the two countries are scheduled to resume in Washington in October.

The Trump administration is considering measures including delisting Chinese companies from U.S. stock exchanges, limiting Americans' exposure to the Chinese market through government pension funds, and putting caps

on the Chinese companies included in stock indices managed by U.S. firms. As another round of high-level trade talks looms, a U.S. crackdown on capital flows would create a new pressure point in the economic dispute and could cause disruption well beyond it.

As noted in previous Liverpool Investment Letters that the US-China trade war's pivot is 5G. President Trump has said 5G is a race that the U.S. must win. But while American wireless carriers are leading in early deployment of the technology, some telecom-industry leaders say that Beijing is poised to vault ahead in the coming months. Just as America's trailblazing 4G networks helped Uber Technologies Inc. and Instagram reach global heights, 5G could turbocharge some Chinese companies. It might also help China's efforts to stem a scientific brain drain that has led some of its brightest students to study abroad and then stay there. But, Beijing is known for wasteful, debt-fuelled spending on massive infrastructure projects leading to ghost cities across China.

	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.)	50.0	60.0	40.0	20.0	0.0
Rmb/$(nom.)	6.8	7.0	7.1	7.3	7.3

South Korea

The South Korean central bank has confirmed that 2019 GDP growth will miss its GDP growth forecast of 2.2%. In July, the central bank had trimmed its forecast for economic growth this year to 2.2% from 2.5% previously. We continue to keep the GDP growth rate of 1.6% in the current year and 1.8% in 2020. The outlook for the economy is not bright, as it is hampered by trade battles and weakening global demand. The composite consumer sentiment index has edged up to 96.9 in September from 92.5 in August. The reading below 100 means that consumer sentiment is weaker than the long-term average, which currently covers 2003-2018.

The impact of the trade war between Japan and South Korea will have its ripple effect far longer than anticipated. The trade war would disrupt the technology supply chain starting with China. Even if it is resolved now, the potential for long-term trust deficit would remain. In our opinion, South Korea would fare worse than Japan.

The U.S.-China trade war, on the other hand, is beginning to crimp the economies of China's neighbours. South Korea's exports to China fell 21.3% in August compared with the same month a year earlier, driving an overall 13.6% decline in exports. South Korea's exports have dropped for nine consecutive months since December, plunging 13.6% on-year to $44.2 billion in August.

The real value of the South Korean won versus other major currencies hit the lowest level in three and a half years amid growing concerns over the country's economy that heavily relies on export due to prolonged trade disputes between the world's two biggest economies, the U.S. and China.

Tokyo has removed Seoul from its list of trusted trade partners in early August, about one month after it began imposing tougher restrictions on South Korea-bound shipments of three key materials used to produce semiconductors and display panels, both key export items of South Korea.

President Moon is at about the midpoint of his five-year term. His approval rating last week fell to 40%, according to Gallup Korea, the lowest of his presidency. Last year, when the relationship with the North was warming, it was above 80%. At the U.N., Mr. Moon said his country and North Korea are moving toward not just peace, but also economic cooperation, and he pledged to continue a dialogue.

	18	19	20	21	22
GDP (%p.a.)	2.7	1.6	1.8	2.2	2.2
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	1220	1240	1260	1260

Taiwan

Taiwan is one of the countries which is benefitting from the US-China trade war. Taiwan's gross domestic product forecast, for 2019, is maintained to grow 2.5% in 2019 as there is an increase in private investment as more Taiwanese companies have pledged to invest at home to avoid trade tensions between the United States and China. The central bank has also raised its full-year forecast on to 2.4% from

2.06% estimated in June. It expects GDP to grow around 2.34% in 2020.

The central bank expects 2019 core inflation to be 0.56% and added that the outlook for inflation remained stable. Our forecast has not changed and it is more than the central bank's forecast as we expects that food and pork prices would raise the inflation in coming two years.

On the back of a stable demand for semiconductors, Taiwan's export momentum is expected to pick up. Taiwan's exports of merchandise and services for 2019 is expected to grow 3.6% and more than 3% in 2020.

The Taiwan dollar rose 1.3% against the U.S. dollar last month and is expected to remain stable in the near future.

Kiribati has become the second Pacific nation in less than a week to end diplomatic relations with Taipei and switch allegiance to Beijing, reflecting China's strategic gains in the region while squeezing an increasingly isolated Taiwan. It happened after the Solomon Islands cut ties with Taiwan. Taiwan now has diplomatic partnerships with only 15 countries, as Beijing steadily ratchets up pressure on the self-ruled island ahead of its presidential election in January.

According to President Ms. Tsai, Beijing's goal is to interfere with the outcome of next year's election. They are trying to tell the Taiwan people that Taiwan can't buy jet fighters, they can't support Hong Kong and that they can only choose a president who bows his head to China.

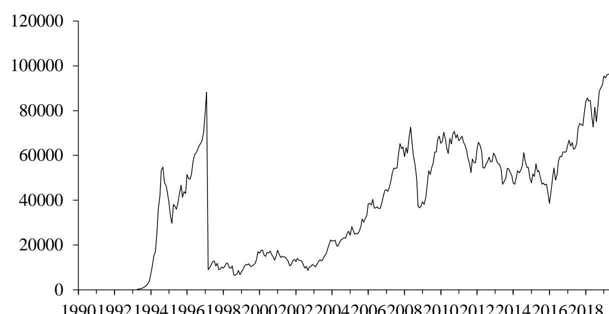
China halted its campaign to poach Taiwan's diplomatic allies during the eight-year administration of Ms. Tsai's predecessor, President Ma Ying-jeou of the Nationalist Party. Beijing resumed its efforts in 2016 after Ms. Tsai was elected. Beijing has accused Ms. Tsai of fanning unrest in Hong Kong, where mass demonstrations erupted in June against a government plan to introduce legislation allowing extradition to mainland China.

	18	19	20	21	22
GDP (%p.a.)	2.6	2.5	2.6	2.6	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

There is confirmation that the economy has turned around and the worst seems to be over. The economy grew by 0.4% in the April–June period after contracting in the first quarter. We forecast a growth rate of 0.5% in 2019 and accelerating to 1.8% in 2020. The central bank is marginally more optimistic about the growth rates.

The central bank expects inflation to be around 3.3% this year and 3.6% next year. That's significantly below the central bank's official targets of 4.25% and 4.00%, respectively. Inflation was 3.43% in the 12 months through August, up from 3.22% in the previous month but still well below the central bank's annual target of 4.25%. We expect inflation to be slightly higher than the central bank forecast as the fuel prices etc. work through the year.



The Central bank chief, Roberto Campos Neto, is confident that inflation will remain contained just below the annual target of 4.25%. The bank has cut the benchmark Selic rate to a record low of 5.5% from 6% in September. Lower than expected inflation rate would encourage Copom (the bank's policy-making committee) to cut its benchmark Selic rate by 50 basis points further. This would see the Selic rate equal to 5% by the end of 2019. Mr Neto is confident that carrying out reforms will ensure the sustainable growth of the country's economy. With more participation of the private sector and more liberal policies, economic growth is expected to be more sustainable. According to him, the central bank would contribute to economic growth by keeping the inflation rate stable.

Brazil's pension reform bill, which rewrites the rules on how and when public employees can retire, will finally be approved by the Senate on October 2. It looks like 66 Senators out of 81 will approve the bill, enough to give investors the security that the bill will be passed. According to the financial press, the government would like to boost the economy further by cutting taxes.

Brazil's current account deficit this year is expected to widen to $36.3 billion, or 2.0% of gross domestic product, from an earlier forecast of $19.3 billion, or 1.0% of GDP, owing to statistical revisions and updated forecasts of financial flows.

The real is trading at about 4.10 to the dollar, after reaching 3.74 in July. The depreciation is part of a global weakening among emerging-market currencies as noted earlier.

Brazil has opened up its economy like never before. A Wave of tariff cuts are aimed at jump-starting one of the world's largest closed economies. Brazil is slashing import tariffs on more than 2,300 products, a significant shift in a country long accustomed to protectionism.

With little fanfare, President Bolsonaro's conservative government has reduced tariffs mostly on items which Brazil

doesn't make. The new opening is a central feature of the Economy Minister Paulo Guedes's plans to make the country of 210 million more competitive, part of an effort to rekindle a moribund economy historically shielded from foreign competition and bogged down by bureaucracy. Slashing tariffs is an essential step in the implementation of a trade deal with the EU that was clinched in June after years of negotiations spanning the administration of four of Mr. Bolsonaro's predecessors.

Brazil has sold international reserves for the first time in 10 years to meet demand for dollars. The bank's policy-making committee, known as 'Copom' under Campos Neto, is far less concerned with the spillover effect on the exchange rate.

Brazilian President Jair Bolsonaro defended his country's sovereign right to develop the Amazon, in a defiant speech before the U.N. General Assembly. His agenda looks like a game changer for millions of impoverished Brazilians. He accused global leaders and the media of spreading lies and treating indigenous people as if they were cavemen. Mr. Bolsonaro also said Brazil was protecting the environment and clamping down on illegal deforestation. He said much of the Amazon is practically untouched and many of the fires that sparked global dismay in August were set by indigenous groups or local communities who should have the right to exploit the richness of the land.

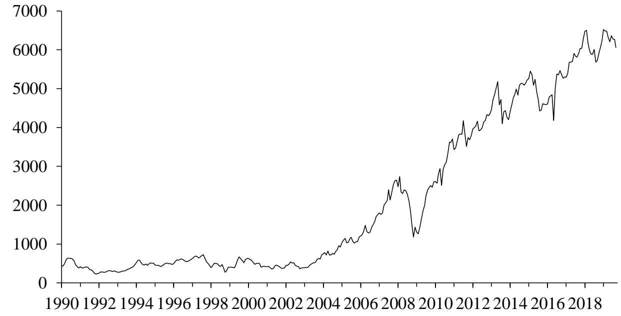
He has pledged to reform Brazil's national development bank, BNDES, founded in 1952. Like many development banks, BNDES has largely served the politically powerful and has played an outsize role in the country's recurring economic debacles. Economic reforms like this come at an important time in global trade history. The U.S. is trying to decouple from China. Brazil is close by and would be a good spot to source part of the supply chain instead of China. But in order to be attractive, Brazil has to lower its government overhead so it can cut taxes like India did. Then it can improve its logistics in order to eradicate the bottlenecks that make exporting from Brazil more efficient than it is from China. Pension reform means lower government spending, which allows for tax cuts, an important move to get Brazil on par with what multinational corporations are paying in corporate taxes in China and India.

	18	**19**	**20**	**21**	**22**
GDP (%p.a.)	1.1	0.5	1.8	2.5	2.5
Inflation (%p.a.)	3.8	4.0	3.9	4.0	4.0
Current A/c(US$ bill.)	-14.6	-36.0	-30.0	-26.0	-26.0
Real/$(nom.)	3.8	4.1	4.0	4.1	4.2

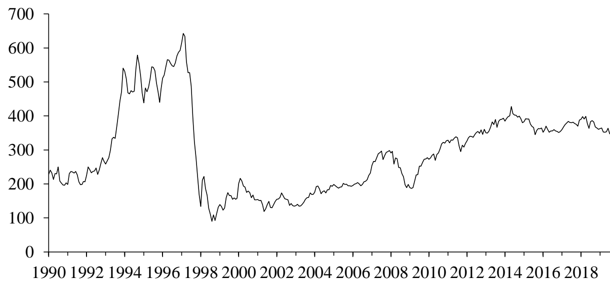
Other Emerging Markets

Hong Kong: FT-Actuaries

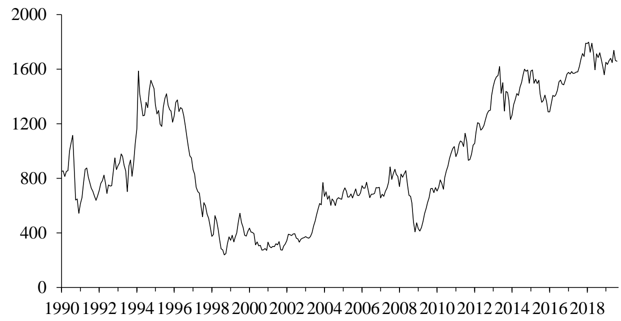
Indonesia: Jakarta Composite



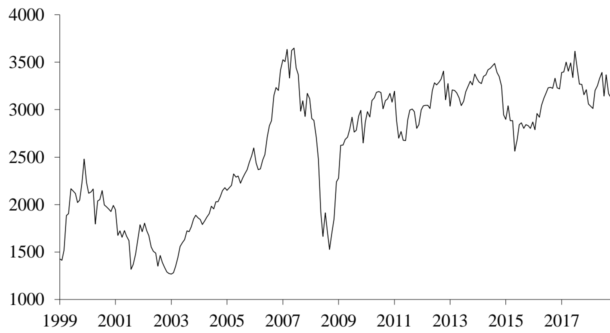
Malaysia: FT-Actuaries (US$ Index)



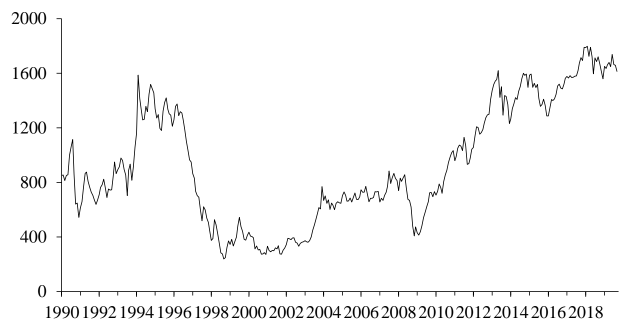
Thailand: Composite Index



Singapore: Straits Times Index

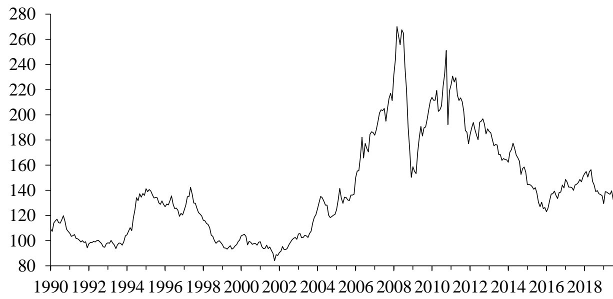


Thailand: Composite Index

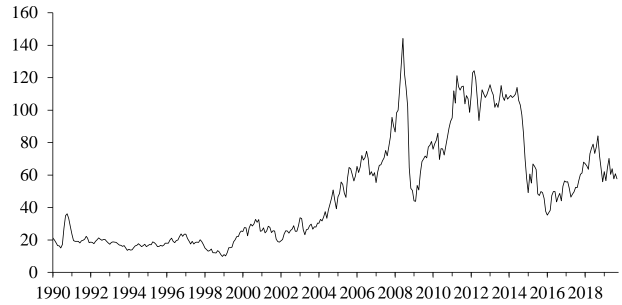


COMMODITY MARKETS

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

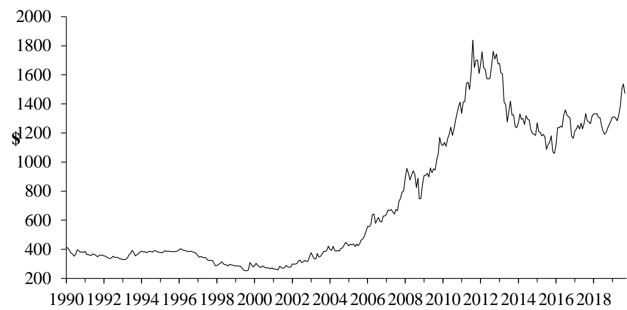


Oil Price: North Sea Brent (in Dollars)

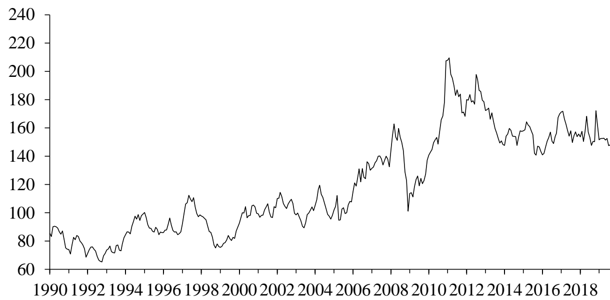


Commodity Price Index (Sterling)
(Economist, 2000=100)

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