LIVERPOOL INVESTMENT LETTER

January 2020

Cardiff Business School
Ysgol Busnes Caerdydd

Julian Hodge Institute of Applied Macroeconomics

supported by

LIVERPOOL RESEARCH GROUP IN MACROECONOMICS

LIVERPOOL RESEARCH GROUP IN MACROECONOMICS

Editorial and Research Direction: Patrick Minford†.

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

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

† Cardiff Business School

The Julian Hodge Institute was launched in autumn 1999 in a new 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

ISSN 0951-9262

Disclaimer

The Liverpool Investment Letter is a publication intended to provide information to investors and investment managers acting on their own initiative. No responsibility can be taken by Liverpool Macroeconomic Research Limited for decisions made by our readers. Whilst every attempt is made to ensure the accuracy of the contents, no guarantee of such accuracy is given.

LIVERPOOL INVESTMENT LETTER

January 2020

CONTENTS

Page

Avoiding Conventional Prudence Post-Brexit 3
The UK is moving into its post-Brexit transition period. It will be important for the government to get its courage up and launch a sharp fiscal expansion. This will both jolt the economy into action again, with Brexit uncertainty now much dispelled; and also start the process of driving up interest rates away from the Zero Lower Bound, so restoring some normality to monetary conditions.

Focus on Japan 6

Market Developments 7
Summary and Portfolio Recommendations

Indicators and Market Analysis
Foreign Exchange 9
Government Bond Markets 10
Major Equity Markets 11
Emerging Equity Markets 12
Commodity Markets 17

UK Forecast Detail 18
World Forecast Detail 20

AVOIDING CONVENTIONAL PRUDENCE POST-BREXIT

No-one can accuse the British people of opting for conventional prudence. They opted for Brexit, against a wave of advice from the mass of conventional economists not to do it because it would be imprudent to put the existing EU market relationships at risk. Instead they saw the point of reforging relationships around the world, while aiming to remain friends with EU neighbours. In this judgement the Brits got it right, just as they did when they opted for Mrs. Thatcher's reforms over the status quo of the 1970s — again the 'prudent' option prescribed to them by the establishment of that time, who feared Britain would be ungovernable without the continued pact with big firms and union barons under the 'social compact' of those times.

So, now that Brexit will happen, government policy needs to adapt to the new environment.

First, there will be the parallel negotiations over trade with the EU and the non-EU. If the EU has any sense it will try to offer reasonable terms for continued zero barriers, so as to persuade the Johnson government to negotiate rather less close relationships with the non-EU world. The government should not fall for this, as the major gains come from free trade with the non-EU. Prices here would then fall to world best levels, and the resulting competition will force not just home firms to greater efficiency but also force EU firms to drop prices here competitively. The ex-Remain lobby here will oppose this, wrongly again arguing for 'soft Brexit' deals. As we have said before, these would simply prolonging the protectionist policies the EU have forced on us all these years. But then Remain is a neo-protectionist lobby, supporting high EU prices.

Second, there is the challenge of fiscal and monetary policy. It is vital that the Johnson government carries out a strong fiscal expansion that will boost the economy, and drive up interest rates, so that monetary policy can return to normal. We really need an end to emergency monetary loosening, which, apart from losing effectiveness as a stimulus, is distorting our savings market against SMEs and small savers, in favour of large monopoly and government borrowers.

How large would this fiscal stimulus need to be to raise interest rates to the required 5%? According to our models, in the baseline forecast interest rates should rise to around 2%, and in our Fiscal-Reform case will rise to 5% p.a.. This last involves a big expansion, of around £100 billion a year, consisting of both tax cuts and spending increases — as set out in our last Quarterly Bulletin. According to our calculations this would be extremely safe from a solvency view point, pushing the market value of government debt to 55% of GDP by 2027, and allowing further tax cuts in that year consistently with a constant debt ratio from then on.

Here are both the Baseline projection on existing plans and the projection with the Reform programme.

The implication of these scenarios is clear: to get the economy growing firmly and to restore power to monetary policy with interest rates around 5% again, the Chancellor needs to embrace a solid fiscal expansion like our Reform scenario, or at least move firmly in that direction.

Table 1a: Forecast Summary — Baseline

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
GDP Growth[1]	1.4	1.5	1.9	1.9	2.1	2.1	2.0	2.0	2.0	2.0	2.1	2.1	2.0
Inflation CPI	2.5	1.9	2.1	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Wage Growth	3.1	3.6	3.1	3.1	3.1	3.2	3.2	3.3	3.3	3.3	3.4	3.3	3.2
Unemployment (Mill.)[2]	0.9	0.9	0.8	0.7	0.7	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Exchange Rate[3]	78.6	80.1	80.7	80.6	80.5	80.4	80.3	80.2	80.1	79.9	79.8	79.7	79.5
3 Month Interest Rate	0.7	0.9	1.1	1.9	2.4	3.1	3.1	2.6	2.3	2.0	2.0	2.0	2.0
5 Year Interest Rate	1.0	1.0	1.3	2.4	3.3	3.4	3.3	2.6	2.4	2.2	2.0	2.0	2.0
Current Balance (£bn)	-81.3	-86.5	-41.3	-3.14	-23.3	-15.0	-11.9	-11.3	-14.5	-9.4	-59.	-0.1	3.0
PSBR (£bn)	40.8	37.8	20.7	8.2	3.9	0.5	-3.2	-5.4	-17.4	-30.2	-45.1	-58.6	-71.9

[1] Expenditure estimate at factor cost
[2] U.K. Wholly unemployed excluding school leavers (new basis)
[3] Sterling effective exchange rate, Bank of England Index (2005 = 100)

Table 1b: Forecast Summary — Fiscal-Reform

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
GDP Growth[1]	1.4	1.5	2.7	3.1	3.2	3.1	3.0	3.0	3.0	3.1	3.1	3.1	3.3
Inflation CPI	2.5	2.0	2.1	2.1	2.1	2.0	2.0	2.1	2.1	2.1	2.0	2.0	2.1
Wage Growth	3.1	3.6	3.5	3.7	3.7	3.8	3.8	3.9	3.9	3.8	3.9	3.8	3.8
Unemployment (Mill.)[2]	0.9	0.9	0.8	0.7	0.7	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Exchange Rate[3]	78.6	80.1	80.6	80.5	80.4	80.3	80.3	80.2	80.1	80.1	80.0	79.9	79.9
3 Month Interest Rate	0.7	0.9	3.7	4.6	5.0	5.1	5.0	5.0	5.0	5.0	5.0	5.0	5.0
5 Year Interest Rate	1.0	1.0	4.3	4.9	5.3	5.3	5.1	5.0	5.0	5.0	5.0	5.0	5.0
Current Balance (£bn)	-81.3	-84.1	-35.3	-26.6	-22.3	-13.2	-9.8	-8.9	-11.9	-5.9	-1.7	4.3	7.6
PSBR (£bn)	40.8	40.6	52.4	40.9	39.8	39.9	42.4	50.9	46.9	40.6	35.0	29.0	19.9

[1] Expenditure estimate at factor cost
[2] U.K. Wholly unemployed excluding school leavers (new basis)
[3] Sterling effective exchange rate, Bank of England Index (2005 = 100)

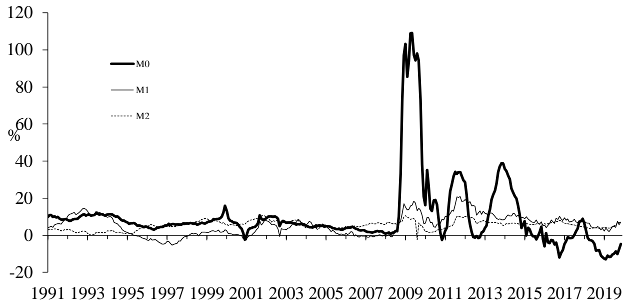
Here too are our balance sheet projections for the various cases we looked at:

Terminal public sector balance sheets for each forecast — values projected 2027

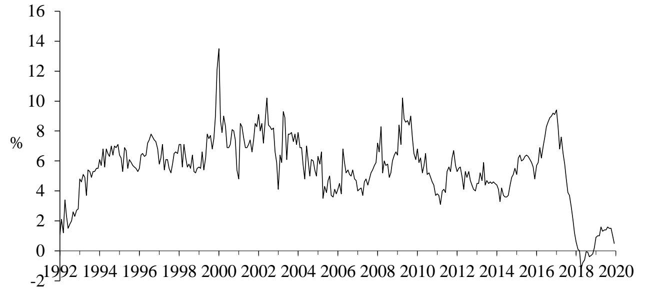
	Baseline	Cons.	Lab.	Reform
Debt[†]/GDP ratio (%)	50.7	62.6	90	55
Ongoing 2027 spending and revenue:				
Govt. Spending (inc. debt interest)/GDP	40	40	53	40
Ongoing Tax Revenue/GDP (%)	40	40	42	41
Required Future Tax Rise/GDP (%)	0	0	11	-1

[†]Debt valued after effect of long term interest rates on capital value

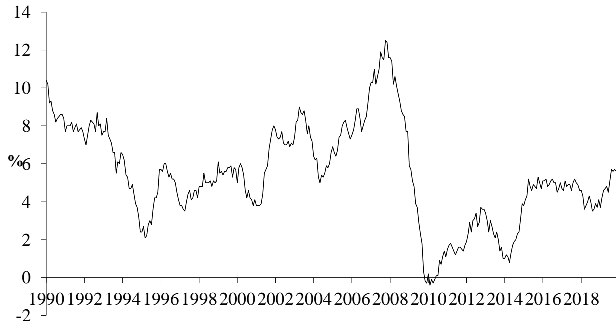
U.S.: Growth in Monetary Aggregates (Yr - on - Yr)



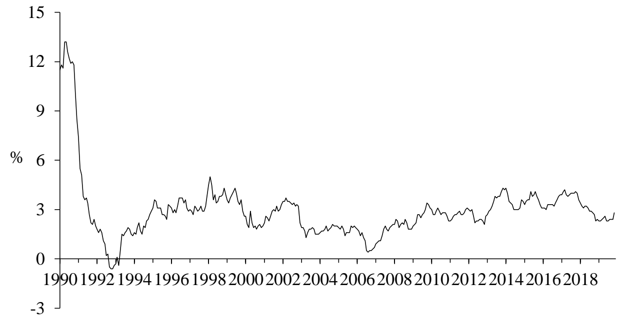
UK: Notes and Coins in Circulation Growth



Eurozone M3 Growth



Japan: Growth of M2+CD's



FOCUS ON JAPAN

Francesco Perugini

Japan government approves record budget spending plan for next fiscal year

At the end of last December, the Japanese government approved a record massive ¥102.66 trillion draft budget for fiscal 2020. The spending plan for the year starting next April topped ¥100 trillion for the second consecutive year (around a fifth of nominal GDP, now running at around 550 trillion Yen) on ballooning medical, public pension and other social security costs, while it is the eighth straight year that Japan has compiled a record initial general account budget. “The budget is aimed at achieving both economic recovery and fiscal consolidation by improving social security through the use of increased revenue from the consumption tax hike” from 8% to 10% implemented in October, said Finance Minister Taro Aso at a news conference after the Cabinet approved the draft budget.

The draft budget, which will be submitted to the Diet at the end of this month, consists of ¥79.31 trillion for policy spending, including record-high defence expenditures, and ¥23.35 trillion in debt-servicing costs. Among the policy spending ¥35.86 trillion will cover social security, accounting for more than a third of the total budget and up ¥1.73 trillion from the previous year. As part of the government’s efforts to realize a social security system that benefits all generations, ¥488.2 billion will be allocated for free higher education, including grants and scholarships for college and training school students from low-income households. Defence spending stands at ¥5.31 trillion, including outlays linked to hosting US military bases. It marks a sixth consecutive record high amid threats from North Korea’s missile and nuclear development, and China’s growing maritime assertiveness. Spending on public works projects comes to ¥6.86 trillion, including ones to prevent and mitigate natural disasters.

Based on the government’s assumption that the nation’s economy will grow a nominal 2.1% in fiscal 2020, and other factors, tax revenue is estimated at a record ¥63.51 trillion including proceeds from the higher consumption tax — up ¥1.02 trillion from the initial budget for fiscal 2019. As part of efforts to improve its battered fiscal health, the government plans to cut new bond issuance by about ¥100 billion to ¥32.56 trillion, down for the 10th consecutive year.

One of the main reasons for all this spending is the rising cost of social security. This is linked to the population ageing, which is expected to accelerate in the near future. According to estimates from the Ministry of Health, Labour and Welfare, Japan’s social security costs will rise sharply come 2022, when post-war baby boomers reach age 75. Therefore, the government must act quickly to reform the social security system to ensure that it remains sustainable. Recently, the government announced a policy to raise the proportion of medical expenses paid by people age 75 and above with a certain level of affluence to 20% from the current 10%. Though the parameters of the new policy have yet to be decided, it is a first step in reducing the burden facing future generations. Long-term debts owed by the national and local governments will hit ¥1,122 trillion, or about 200% of GDP, by the end of fiscal 2019. The so-called primary balance — tax revenue minus expenses other than debt-servicing costs — has also worsened compared with the initial fiscal 2019 budget and the deficit will be ¥9.204 trillion for this fiscal year. The government has already extended the target year to achieve the primary balance from 2020 to 2025. But given the expected increase in social security costs, it is questionable whether the government can meet the 2025 target, either. Abe has said the consumption tax will not be raised for another 10 years. But unless the government cuts spending on low-priority projects and spends taxpayer money more wisely to focus on long-term sustainability, which we regard as both unlikely and — see below — undesirable, Japan’s fiscal consolidation will never be achieved.

In fact, Japan’s real problem is sustainable economic growth. As we argued in the December Letter when we analysed the biggest-ever supplementary budget approved by the government for the current fiscal year, fiscal policy must play a key role in supporting Japan’s economy if overseas risks threaten to derail a fragile recovery, as the Bank of Japan (BOJ) has little left in its policy tool kit.

The essential problem facing Japan, as also many other developed countries, is the impotence of monetary policy now at the Zero Lower Bound. To get monetary policy leverage again interest rates must rise. Hence the calls for expansionary fiscal policy across the OECD, most recently in the EU from outgoing ECB President Draghi; its aim would be to stimulate demand and raise interest rates to a more normal 5% region, offsetting the current worldwide excess of savings over investment. With the US having under Trump launched a large fiscal expansion, and the UK about to act similarly, Japan will be joining a wide policy shift across developed countries. With this draft budget for fiscal 2020, Prime Minister Shinzo Abe is a standout amongst G7 leaders — the only government capable and willing to enact rational, pragmatic and decisive countercyclical fiscal policies. Where US and European political leaders appear stuck and forced to compensate for their own inability to actually design and implement targeted, innovative and timely fiscal policy by constantly insisting that it is the central bankers who need to do more, Japan wastes no time.

MARKET DEVELOPMENTS

Though interest rates should now start to rise as fiscal policy becomes more expansionary across the developed world, led by Trump's US and Johnson's UK, equity markets should be able to withstand the rising discount rate because growth too will become more entrenched.

Table 1: Market Developments

	Market Levels		Prediction for Dec/Jan 2020/21	
	Dec 6	Jan 3	Previous Letter	Current View
Share Indices				
UK (FT 100)	7240	7622	9419	9917
US (S&P 500)	3146	3235	3520	3620
Germany (DAX 30)	13167	13219	19842	19921
Japan (Tokyo New)	1713	1721	2236	2246
Bond Yields (government)				
UK	0.67	0.67	1.30	1.30
US	1.63	1.92	2.00	2.00
Germany	–0.30	–0.28	–0.40	–0.40
Japan	–0.08	–0.02	–0.10	–0.10
UK Index Linked	−1.86	−1.96	1.00	1.00
Exchange Rates				
UK ($ per £)	1.31	1.31	1.32	1.32
UK (trade weighted)	81.13	80.66	80.7	80.7
US (trade weighted)	103.23	101.17	102.5	102.5
Euro per $	0.91	0.90	0.85	0.85
Euro per £	1.19	1.17	1.12	1.12
Japan (Yen per $)	108.66	108.03	112.5	112.5
Short Term Interest Rates (3-month deposits)				
UK	0.83	0.83	2.00	2.00
US	1.88	1.88	1.80	1.80
Euro	–0.46	–0.41	–0.50	–0.50
Japan	–0.20	–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	2.0	26.00		33.70
US	1.99	1.9	2.1	7.90	–0.99	12.90
Germany	3.30	1.0	1.7	48.00	4.17	58.17
Japan	1.90	0.3	1.2	29.00	–5.17	27.23
UK indexed[2]	−1.86		2.0	5.00		2.05
Hong Kong[3]	2.60	5.6	2.1	−15.00	–0.99	–5.69
Malaysia	3.30	4.4	2.1	39.00	–0.99	47.81
Singapore	3.50	1.0	2.1	−7.00	–0.99	–1.39
India	1.40	6.5	2.1	8.00	–0.99	17.01
Korea	1.10	1.8	2.1	−32.00	–0.99	–27.99
Indonesia	2.20	5.1	2.1	23.00	–0.99	31.41
Taiwan	2.80	2.6	2.1	14.00	–0.99	20.51
Thailand	3.20	2.1	2.1	10.00	–0.99	16.41

Bonds: Contribution to £ yield of: −

	Redemption Yield	Changing Nominal Rates	Currency	Total
UK	0.67	−6.30		−5.63
US	1.92	−0.80	−0.99	0.13
Germany	−0.28	1.20	4.17	5.09
Japan	−0.02	0.80	−5.17	−4.39

Deposits: Contribution to £ yield of:

	Deposit Yield	Currency	Total
UK	0.83		0.83
US	1.88	−0.99	0.89
Euro	−0.41	4.17	3.76
Japan	−0.05	−5.17	−5.22

[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(%)

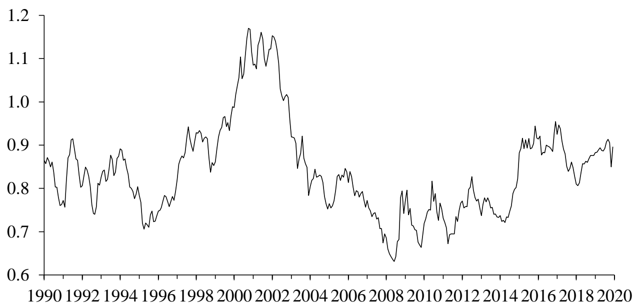
	Sterling Based Investor		Dollar Based Investor		Euro Based Investor	
	December Letter	Current View	December Letter	Current View	December Letter	Current View
UK Deposits (Cash)	5	5	5	5	1	1
US Deposits	-	-	-	-	-	-
Euro Deposits	-	-	-	-	-	-
Japanese Deposits	-	-	-	-	-	-
UK Bonds	-	-	-	-	-	-
US Bonds	-	-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

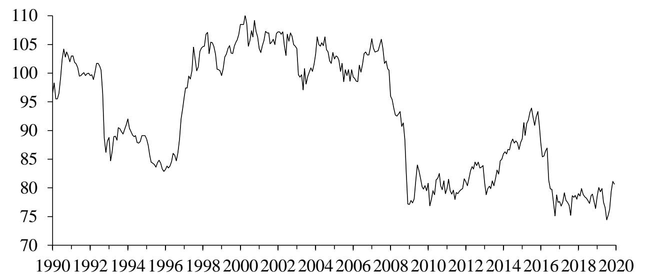
US : Trade Weighted Index
(Bank of England 1990 = 100)

UK: Dollars Per Pound Sterling

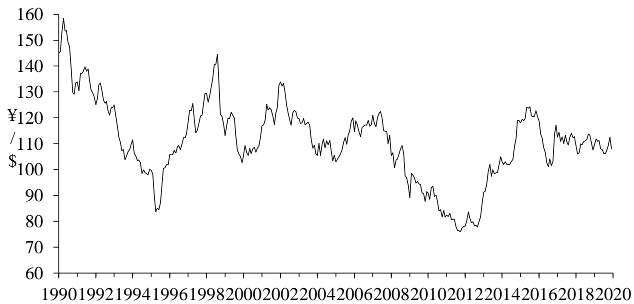
Euro per US dollar



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



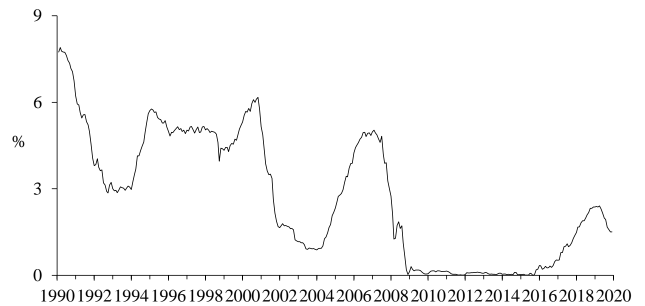
Japan : Yen Per U.S. Dollar



GOVERNMENT BOND MARKETS

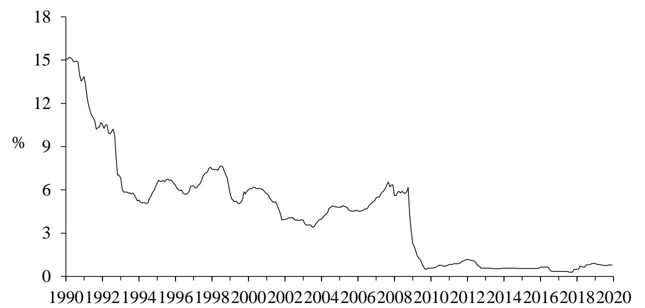
U.S.: Yield on Long-Term Government Bonds

U.S. : 3-Month Treasury Bill

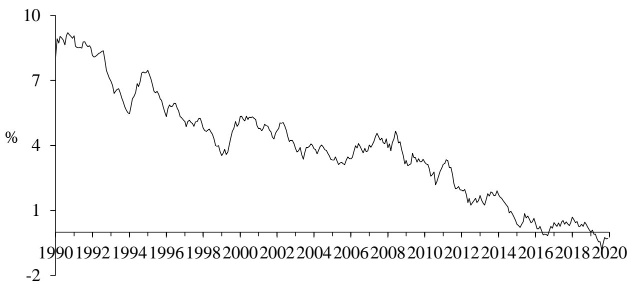


U.K.: Yield on Long-Term Government Bonds

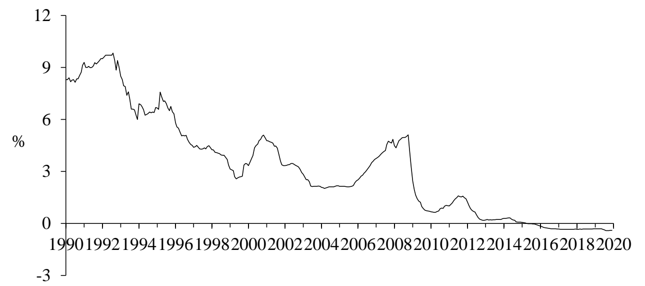
U.K. : 3-Month Certificate of Deposit Rate



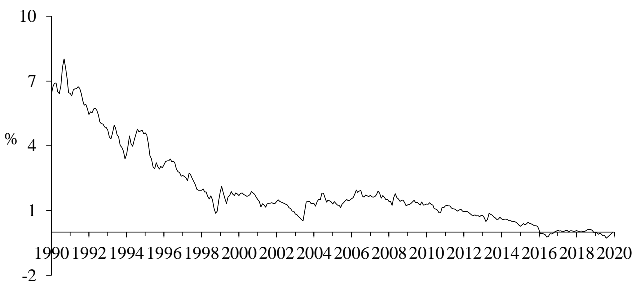
Germany: Yield on Public Authority Bonds



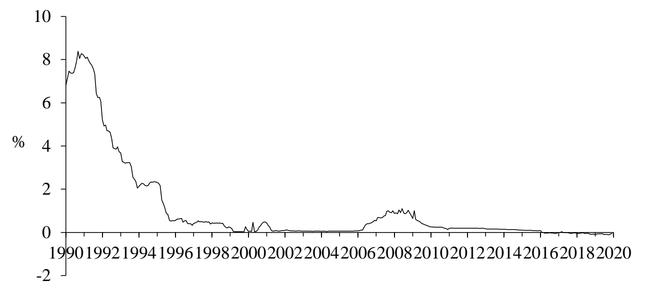
Germany : 3-Month Interbank Deposit Rate



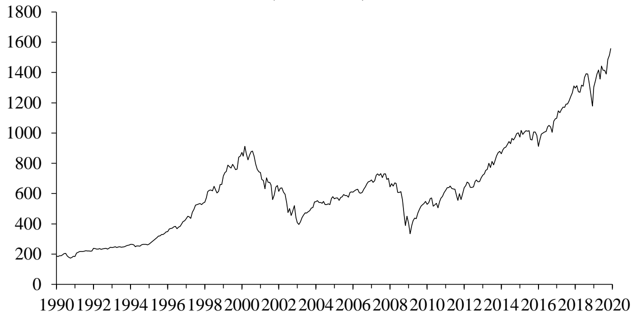
Japan: Yield on Long-Term Government Bonds

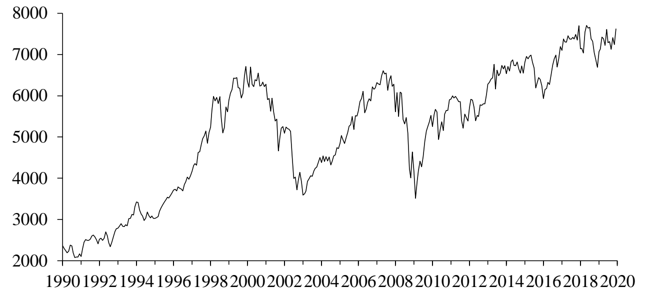


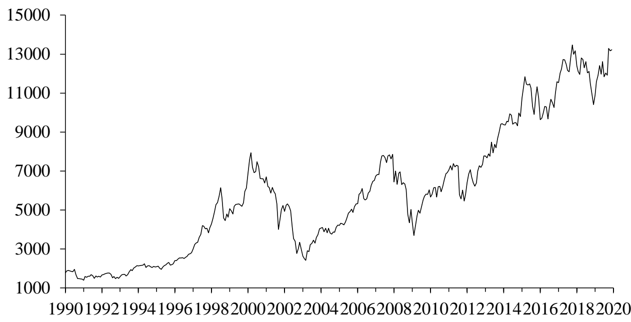
Japan : 3-Month Money Market Rate



MAJOR EQUITY MARKETS







EMERGING MARKETS

Anupam Rastogi

India

The first advance estimates of gross domestic product by the National Statistical Office showed that India will grow at the rate of 5% in the current financial year 2019–20. In nominal terms, the economy is expected to grow by just 7.5%. This has created quite a bit of a flutter in India as people have been fed on a steroid diet of 8–9% GDP growth. After massive structural changes brought about in the last two years which pulled the economy down slightly, the Business Activity Index improved from 52.7 in November to 53.3 in December, shrugging off the weakness recorded in September and October. The agricultural sector is also all set to post a new record in the coming months. Goods and services tax collections grew by about 9% YoY in December 2019 to Rs.1.03 trillion, from Rs.947.26 bn a year earlier. Moreover, the IHS Markit India Manufacturing PMI rose to 52.7 in December from 51.2 in November. The green shoots have started appearing. We forecast the economy to grow 6.5% in the next financial year.

Blackstone report, titled Ten Surprises for 2020, says, "Fears of an economic crisis in India are allayed. The emerging markets continue to have uneven performance but India recovers from decelerating growth. The Narendra Modi government continues business-friendly growth reforms, the economy grows at 6% and the market rises 20%",

Finance Minister, Nirmala Sitharaman, unveiled Rs.102 trillion of infrastructure projects across energy, road, ports, airports, urban infrastructure, telecom, irrigation & rural infrastructure and agriculture and social sectors. With the fiscal stimulus along with improvement in business sentiment, the economy is on the path of higher growth rate. However, elevated crude oil prices for a prolonged period remain a hidden risk to the economy.

CPI growth turned out to be 5.54%, faster than the 4.62% rate in October. The RBI cited concerns about rising prices, given that headline inflation breached its 4% medium-term target in October. Food prices have skyrocketed as a result of heavy rainfall in 2019.

The current account deficit declined to 0.9% of gross domestic product in the second quarter of the fiscal year ending March 2020 from 2.9% in the same period a year ago. On a quarterly basis, it shrank from 2.0% of GDP in the June quarter. The trade deficit stood at $12.12 billion in November compared with $16.67 billion a year earlier. Private transfer receipts, mainly representing remittances by Indians employed overseas, rose to $21.9 billion, up 5.2% from a year ago. This has enabled the forex reserves to be more than USD$350 billion.

India: BSE Sensitive

India's political turmoil in the last one month and economic slowdown are visible everywhere except the country's stock market. The Sensex index touched record highs in the run-up to the end of 2019. Though a 12% increase in dollar terms for the year leaves it slightly behind the 15% rise of emerging-market stocks. Foreigners poured more than 1 trillion rupees ($14 billion) into the country's equity market in 2019, the most since 2013 in spite of India being one of the most expensive emerging-market equities on offer. Only the Brazilian and South Korean markets are trading at a higher premium to their average forward price-earnings ratios over the last decade's average.

The government of India is moving at a break neck speed to privatise Air India, BPCL and three other public sector entities.

The rupee was among the worst performing currencies in Asia. After weakening 8.46% in 2018, the rupee fell a further 2.25% in 2019. Among developing countries currencies, only South Korea's won weakened the most, falling 3.49% against the dollar in 2019.

S&P reaffirms India's sovereign rating at BBB– with a stable outlook. S&P's reiteration of India's rating and outlook is good news for the government as it fights multiple fires on the economic front. This comes less than a month after Moody's downgraded India's outlook to "negative" from "stable". S&P expects the Indian economy to continue to out perform its peers and the growth will remain strong over the next 2 years.

	18–19	19–20	20–21	21–22	22–23
GDP (%p.a.)	6.8	5.0	6.5	7.2	7.4
WPI (%p.a.)	3.9	3.6	3.8	3.9	4.0
Current A/c(US$ bill.)	-70.0	-52.0	-64.0	-65.0	-65.0
Rs./$(nom.)	79.5	71.0	72.0	72.5	73.5

China

The Markit/Caixin Purchasing Managers' Index (PMI) for China's manufacturing activity came in at 51.5 in December, compared to 51.8 in November, but China's industrial output growth accelerated to 6.2% and retail sales gained 8.0%. The domestic economy should do well as a December tariff hike is off the table. China's economic indicators show that the economy may have turned the corner. The official manufacturing PMI for December was slightly above expectations at 50.2.

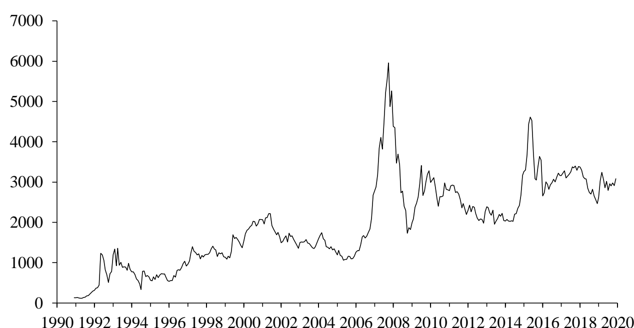
China's top economic policy makers have held meetings to decide what targets to set for GDP growth, inflation and the size of the fiscal deficit in the coming year. Though these numbers won't be publicly announced until March at the annual sessions of the parliament. As of now the government has pledged to avoid systemic financial risks while keeping growth within a "reasonable range". We expect the target to be marginally lower than 6% for 2020. Hence, there's nothing ambiguous in Chinese Premier Li Keqiang's warning that the country "may encounter larger downward pressure and a more complex situation," so "governments at all levels will face more difficult tasks and bigger responsibilities".

It is true that the trade war with the United States has put enormous pressure on China and Beijing is not hiding it. Still, putting all the blame for economic woes on Trump is a lame excuse. Alongside the implications of the drawn-out dispute with Washington, the Communist Party top brass need to have a sincere debate about key structural challenges deriving from the very complexion of the Chinese economy and its development model.

China's cumulative debt now tops 300% of GDP and International Monetary Fund experts warned as early as January 2018 of the dangerous trajectory of the country's credit growth. The biggest chunk of that is corporate debt, nearly twice the size of China's GDP, which highlights the risks of overleveraging.

China's central bank has cut the amount of cash banks must hold in reserve, releasing an estimated 800 billion yuan ($115 billion) in funds for lending effective from January 6. Adjustments to reserve requirement ratios have been the central bank's favoured monetary tool to combat slowing growth since early 2018. The reserve ratio cut may be interpreted as a tacit admission that things aren't quite as rosy as some of the recent data seemed to indicate. While there is increasing evidence that China's export machine is on the mend, other important parts of the economy are weaker than they were six months ago. China's housing market is cooling rapidly, and construction activity along with it. In December, China's official construction purchasing managers index logged its weakest reading since early 2016.

Despite rising tariffs, China's exports are little changed from their level 12 months ago, while imports are down by around 5%. Less demand for imported goods will weigh on South Korea and Taiwan, both of which have large trade surpluses with China. China's imports rose YoY for only two months in 2019. Weak imports signal a slowdown in China's domestic economy.



The People's Bank of China (PBOC) is holding RMB just below 7 per dollar. Fears of a sharp one-off RMB depreciation after breaking above the psychological level of 7 had receded in 2019 while ample China FX reserves outstanding above $3 trillion should help anchor foreign investors' confidence on RMB assets.

China is using its vast reserves to acquire assets in foreign countries as the One Belt One Road initiative is not going anywhere. China's state grid will acquire 49% of Oman's state-owned power transmission company, the first major privatization by the Middle East's largest non-OPEC oil producer. The transaction values Oman Electricity Transmission at about $2 billion.

	18	19	20	21	22
GDP (%p.a.)	6.6	6.1	5.8	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	7.1	7.2

South Korea

South Korea's economy is expected to grow 1.9% in 2019, the slowest pace in a decade. In 2020, GDP growth is likely to do marginally better on the back of rising investment and fiscal stimulus. The Finance Ministry predicts the South Korean economy will grow 2.4% in 2020, helped by

recovery in the global economy, an improved outlook for semiconductors and expansionary policies.

The South Korean government plans to boost investment and exports and anticipates investment projects worth almost 100 trillion won (US$85 billion) in both the public and private sectors. It will also undertake 4.5 trillion won worth of funding programs for facility investments, applying low lending rates and enhancing tax benefits. The government also plans to ease investment regulations, including regulations in free economic zones, in the first half of 2020.

To boost consumption, the government plans to attract 20 million tourists to South Korea, taking advantage of K-pop and K-beauty. In 2018, the last year for which full numbers are available, 15.3 million tourists visited the country.

An expansionary fiscal policy is also expected to help push growth northward as Seoul will increase its fiscal spending to 512.3 trillion won ($440.2 billion), marking a hefty 9.1% rise from this year.

Seoul is aiming for fast results — the government plans to spend 62% of next year's total budget in the first half.

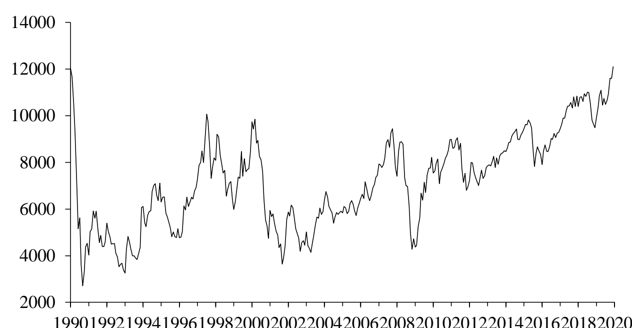
South Korea's inflation came in at 0.4% in 2019, the weakest since data going back to 1966, as uncertainties from a trade war and a slowdown in the global tech cycle hit consumer demand. The Bank of Korea expects inflation to pick up gradually to 1% in 2020. The central bank pledged to keep policy accommodative as inflationary pressure from the demand side is likely to remain weak. South Korea's aging population and falling potential growth are two challenges that raise the risk of structural deflation in the long term.

The finance ministry expects exports to rise 3.0% in 2020, recovering from an estimated 10.6% fall this year. Korea's monthly export numbers had been falling since December 2018, but have risen 7.7% in the first 10 days of December 2019, lifting expectations for a recovery.

Imports dropped 0.7% in December from the year-earlier month, beating both a 13.0% loss in November and a 4.6% expected decline. That brought the month's trade balance to a $2.02 billion surplus versus a $3.34 billion profit in November.

President Trump has demanded that South Korea pay substantially more for the help it gets from America's military, presenting a challenge to his own negotiators. To get the money, the U.S. must first show how it plans to spend it. Washington began cost-sharing negotiations in September asking for about $5 billion for 2020, U.S. officials said — more than five times last year's $930 million price tag. No agreement in nearly three decades has increased Seoul's payments by more than 35%. Seoul retains some control over how its cost-sharing funds get used, first at the negotiating table and later through the line-item disbursements. The setup is intended to provide transparency and show that the U.S. isn't misusing funds from Seoul, an apprehension of some South Korean lawmakers.

Taiwan: Weighted TAIEX Price Index



	18	19	20	21	22
GDP (%p.a.)	2.7	1.9	2.0	2.2	2.2
Inflation (%p.a.)	1.5	0.4	1.1	1.2	1.2
Current A/c(US$ bill.)	86.0	80.0	78.0	70.0	70.0
Won/$(nom.)	1130	1220	1240	1260	1260

Taiwan

We maintain our growth forecast of 2.6% for 2019 and of 2.6% for 2020 as we expect the computer chip market to remain buoyant in 2020. Taiwan's central bank has joined the growing ranks of economic forecasters raising their growth outlooks for the economy as hopes grow that the US and China could bring an end to the trade war.

Taiwan's headline inflation remained tame just above 1% year-on-year in 2019, owing to the stable labour market conditions and the strengthening of Taiwan Dollar countering higher oil prices.

Taiwan's exports rose 3.3% in November, the most in more than a year as shipments to China recovered, helped by companies gearing up for the roll-out of 5G telecommunications in 2020.

The bottoming-out of the electronics cycle, a rise in 5G demand, as well as the trade diversion effects of the China-U.S. trade/Japan-South Korea trade tensions, should continue to underpin Taiwan's exports, production and investment growth in 2020.

The Taiex index is within touching distance of its all-time high from 1990, a milestone that market analysts expect to be in the current year, as increased US orders and companies moving manufacturing back home from China have helped make Taiwan a surprise trade-war winner.

Taiwan watchers are keenly watching the upcoming presidential election due to be held on January 11. The Tsai government is indeed forcefully playing the anti-China card. With the catalysis of the protests and demonstrations over the extradition bill, the Fugitive Offenders Ordinance, in

Hong Kong, it has all the more been pandering "a sense of losing one's country," while commenting here and there on the Hong Kong question. China's largely rubber stamp parliament revised a law to simplify investment procedures for Taiwan companies, in another attempt by Beijing to show goodwill to the Chinese-claimed island ahead of elections on January 11. China has opened further sectors to Taiwanese investors, with the ultimate goal of enticing the island to accept Beijing's control. Taiwan has been trying to wean itself off its reliance on China and to encourage Taiwan companies to come back home or to shift their investments to other parts of the world, notably Southeast Asia.

It's easy to look at Taiwan's presidential election in terms of its relationship with China. In reality, the contest is less about its neighbour than ever before. The economy is front and centre for voters, and the data looks good for incumbent Tsai Ing-wen. China won't be voter's main concern. Instead, it will be something far more common to democracies: the economy.

	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

The Brazilian economy has at last turned around. But its upturn is fragile as of now. The manufacturing purchasing managers' index (PMI) dropped to 50.2 as employment shrank and new export orders slumped to their lowest in over a decade. We expect the economy to grow by 1.8% this year. Brazil's central bank, however, is more optimistic and expects growth to be 2.2%, but cautioned that its forecast was conditional on continued progress on economic reforms.

The bank has held the inflation outlook stable with a forecast of 3.5% inflation for 2020 and 3.4% for 2021 based on the market outlook for interest rates and the foreign exchange. Our forecast is marginally higher due to spike in crude oil prices which is likely to persist for some time.

Inflationary pressures in the services sector picked up in December, with the input prices index rising above 60.0 for the first time since October 2018. The central bank cut interest rates to a new low of 4.50% in mid-December. Real interest rates, taking into account inflation, are now below 2%, one of the lowest levels in two decades. The next Copom meeting, due on February 4 and 5, may decide to lower the Selic rate by 0.25%. The Central Bank is keen to support fiscal stimulus with accommodative monetary policy.

Brazil's trade surplus shrank 20% to $46.67 billion last year as upwardly revised exports in recent months failed to mask a widespread slump in overseas demand for Brazilian goods over the course of 2019. For 2019 as a whole, exports were $224 billion and imports were $177.3 billion, resulting in the surplus of $46.67 billion. In 2018, Brazil had posted a trade surplus of $58 billion.

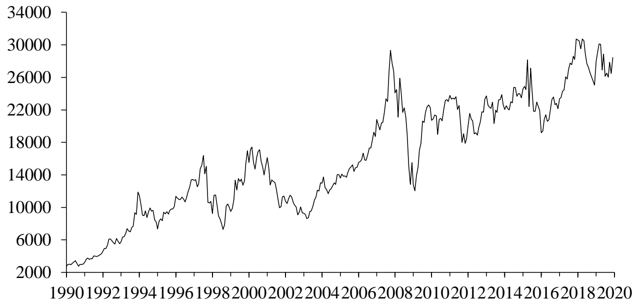
Ratings agency S&P has raised its outlook on Brazil's sovereign credit to positive from neutral, a step toward an eventual upgrade that would lift Brazil back toward investment-grade status.

The stock-market rally that made Brazil one of the world's best performers last year has yet to persuade foreign investors to invest in Brazil. Foreigners pulled 4.7 billion reais ($1.2 billion) out of local equities in 2019. Brazil equities' benchmark index Ibovespa climbed more than 30% in 2019.

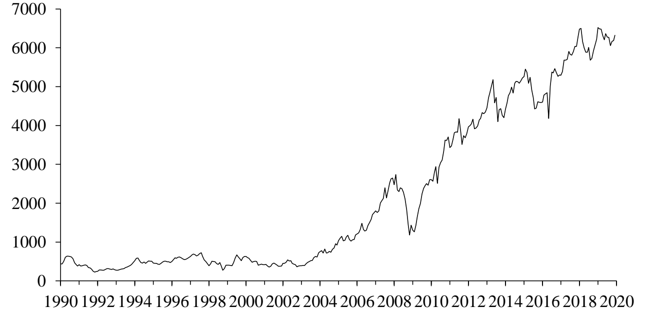
	18	**19**	**20**	**21**	**22**
GDP (%p.a.)	1.1	0.8	1.8	2.5	2.5
Inflation (%p.a.)	3.8	3.3	3.9	4.0	4.0
Current A/c(US$ bill.)	-14.6	-36.0	-30.0	-26.0	-26.0
Real/$(nom.)	3.8	4.1	4.2	4.3	4.3

Other Emerging Markets

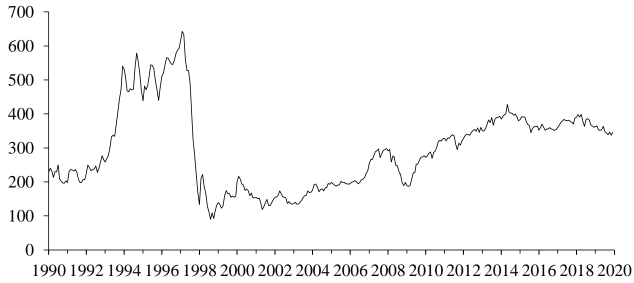
Hong Kong: FT-Actuaries



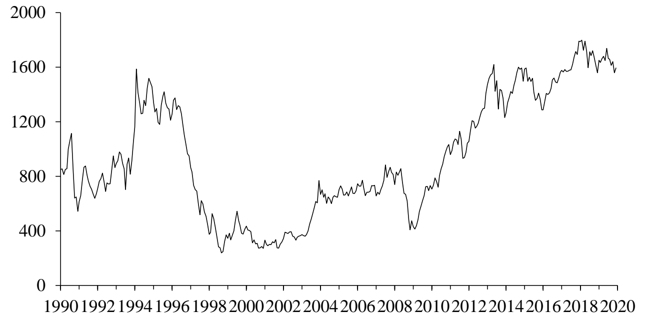
Indonesia: Jakarta Composite



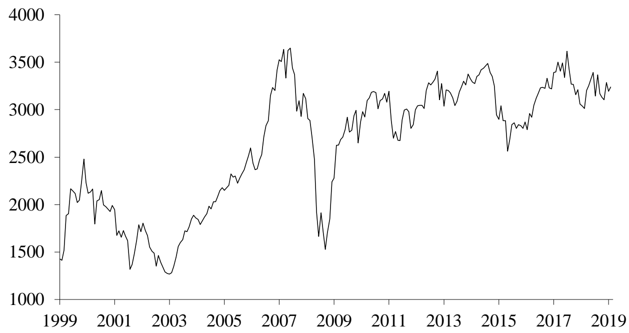
Malaysia: FT-Actuaries (US$ Index)



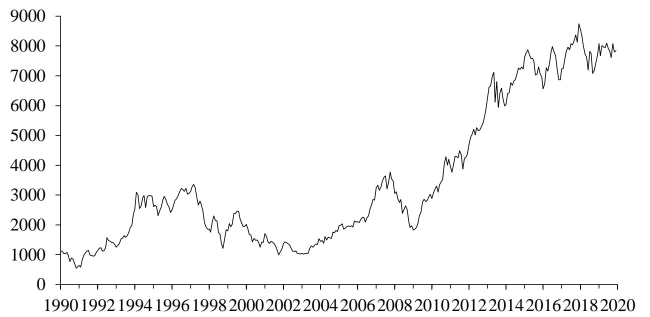
Thailand: Composite Index



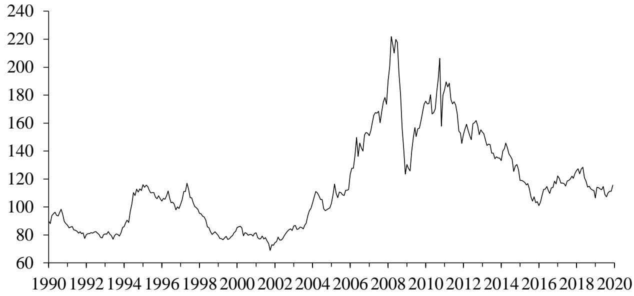
Singapore: Straits Times Index

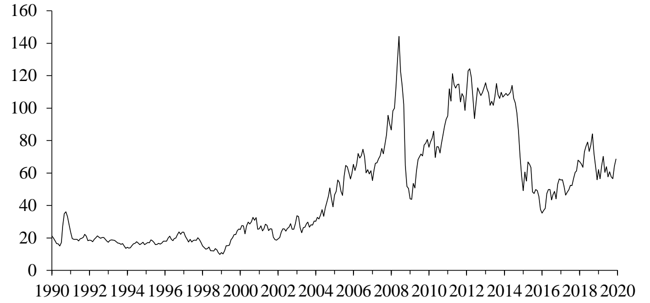


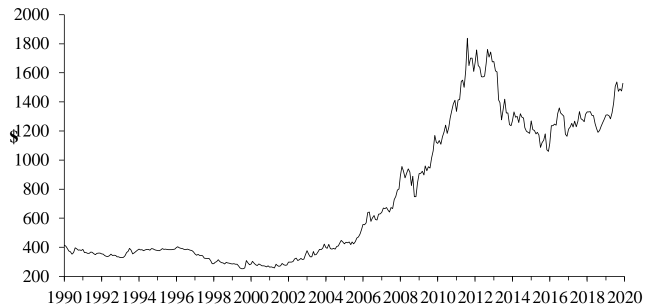
Philippines: Manila Composite



COMMODITY MARKETS







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]
2018	2.5	1.0	0.7	78.6	76.5	-1.3	3.3	-1.0
2019	1.9	1.0	0.9	80.1	74.7	-1.0	2.6	-1.0
2020	2.1	1.3	1.1	80.7	76.0	-1.1	2.9	-0.7
2021	2.0	2.4	1.9	80.6	76.3	-1.0	2.8	0.4
2022	2.0	3.3	2.4	80.5	76.6	0.1	2.7	0.4
2023	2.0	3.4	3.1	80.4	76.8	1.0	2.7	0.4
2019:1	1.9	0.9	0.8	79.0	72.8	-0.6	2.4	-1.1
2019:2	2.0	1.0	0.8	80.4	75.3	-1.2	2.7	-1.0
2019:3	2.0	1.1	1.0	80.3	75.3	-1.2	2.6	-0.9
2019:4	1.9	1.1	1.0	80.6	75.5	-1.1	2.6	-0.9
2020:1	2.1	1.1	1.0	80.7	75.5	-1.0	2.9	-0.9
2020:2	2.0	1.2	1.1	80.9	76.3	-1.0	2.8	-0.8
2020:3	2.0	1.3	1.1	80.7	76.2	-1.0	2.8	-0.7
2020:4	2.1	1.7	1.2	80.6	76.1	-1.4	3.0	-0.3
2021:1	2.0	2.3	1.8	80.7	76.0	-0.8	2.7	0.3
2021:2	2.0	2.5	1.9	80.8	76.5	-0.9	2.7	0.5
2021:3	2.0	2.4	2.0	80.6	76.5	-1.2	2.7	0.4
2021:4	2.1	2.5	2.0	80.4	76.3	-1.0	2.8	0.5

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

Labour Market and Supply Factors (Seasonally Adjusted)

	Average Earnings (1990=100)[1]	Wage Growth[2]	Unemployment (New Basis) Percent[3]	Millions	Real Wage Rate[4] (1990=100)
2018	266.6	3.1	2.5	0.9	142.8
2019	275.8	3.6	2.4	0.9	145.2
2020	284.4	3.1	2.2	0.8	146.7
2021	293.3	3.1	1.9	0.7	148.4
2022	302.4	3.1	1.8	0.7	150.0
2023	312.2	3.2	1.6	0.6	151.9
2019:1	273.4	3.9	2.9	1.0	145.4
2019:2	273.4	3.8	2.2	0.8	144.1
2019:3	276.9	3.3	2.2	0.8	145.2
2019:4	279.3	3.4	2.2	0.8	146.1
2020:1	282.1	3.2	2.3	0.9	147.0
2020:2	281.8	3.1	2.2	0.8	145.6
2020:3	285.5	3.1	2.2	0.8	146.7
2020:4	288.2	3.2	2.2	0.8	147.6
2021:1	290.7	3.1	2.0	0.8	148.6
2021:2	290.9	3.2	2.0	0.8	147.4
2021:3	294.5	3.2	1.9	0.7	148.5
2021:4	297.1	3.1	1.9	0.7	149.1

[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
2018	165.5	792730.9	445869.9	310567.1	201139.6	-41308.9	106758.3
2019	168.0	804347.9	451568.4	303830.7	204617.4	-52551.8	103116.9
2020	171.2	820012.3	457805.4	294079.0	207575.4	-30702.2	108745.3
2021	174.6	835951.9	464216.7	297988.4	210896.4	-25838.3	111311.2
2022	178.3	853622.4	470251.4	305835.5	214271.0	-22730.0	114005.6
2023	182.0	871244.7	476835.8	312486.6	217699.0	-19317.0	116459.8
2018/17	1.4		1.0	3.2	0.3		22.7
2019/18	1.5		1.3	-1.8	1.7		-18.0
2020/19	1.9		1.4	-3.0	1.5		6.0
2021/20	1.9		1.4	1.3	1.6		2.3
2022/21	2.1		1.3	2.6	1.6		2.1
2023/22	2.1		1.4	2.2	1.6		2.1
2019:1	167.6	200618.5	111589.5	85538.7	52691.8	-27678.5	21523.0
2019:2	167.8	200870.1	113657.2	74871.8	50827.1	-14036.4	24449.6
2019:3	167.9	201001.6	113170.0	70256.8	50222.0	-5107.9	27539.3
2019:4	168.6	201857.7	113151.8	73163.4	50876.5	-5729.0	29605.0
2020:1	170.9	204650.4	113061.1	79372.3	53218.7	-14821.9	26179.8
2020:2	170.6	204203.2	115141.3	70795.9	51640.8	-7012.1	26362.7
2020:3	171.3	205098.3	114754.0	70595.7	51025.1	-4284.8	26991.7
2020:4	172.1	206060.4	114849.0	73315.1	51690.8	-4583.4	29211.1
2021:1	174.3	208707.0	114530.9	79879.0	54070.2	-12598.7	27174.4
2021:2	173.8	208060.4	116753.6	71214.3	52466.7	-5258.2	27116.0
2021:3	174.7	209116.9	116475.3	72045.6	51841.5	-3856.3	27389.2
2021:4	175.4	210067.6	116456.9	74849.5	52517.9	-4125.1	29631.6

[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)
2018	1.9	2111.8	40.8	23.4	-81.3
2019	1.8	2177.6	37.8	26.5	-86.5
2020	0.9	2268.0	20.7	28.9	-41.3
2021	0.4	2358.8	8.2	33.1	-31.4
2022	0.2	2457.4	3.9	36.9	-23.3
2023	0.0	2558.3	0.5	39.5	-15.0
2019:1	-3.6	527.1	-18.8	6.3	-37.8
2019:2	2.9	535.6	15.5	6.4	-25.4
2019:3	2.9	540.4	15.6	6.7	-10.1
2019:4	2.7	548.5	15.0	6.7	-13.2
2020:1	-1.5	553.0	-8.4	6.7	-11.3
2020:2	1.9	557.1	10.5	6.9	-11.0
2020:3	1.5	562.6	8.3	7.0	-8.3
2020:4	1.3	572.3	7.3	7.1	-10.7
2021:1	-0.9	575.9	-5.3	7.9	-6.8
2021:2	1.1	579.5	6.5	8.1	-7.6
2021:3	0.7	585.1	4.4	8.3	-7.5
2021:4	0.7	595.3	4.3	8.3	-9.5

[1] GDP at market prices (Financial Year)

WORLD FORECAST DETAIL

Growth Of Real GNP

	2017	2018	2019	2020	2021	2022
U.S.A.	2.2	2.9	2.3	1.9	1.9	2.0
U.K.	1.8	1.4	1.5	1.9	1.9	2.1
Japan	2.2	0.3	1.0	0.3	0.8	1.0
Germany	2.5	1.5	0.5	0.9	1.1	1.2
France	2.4	1.7	1.3	1.2	1.3	1.4
Italy	1.7	0.8	0.2	0.4	0.5	0.6

Growth Of Consumer Prices

	2017	2018	2019	2020	2021	2022
U.S.A.	2.1	2.4	1.8	2.0	2.0	2.0
U.K.	2.6	2.5	1.9	2.1	2.0	2.0
Japan	0.5	1.0	0.6	0.7	0.5	0.5
Germany	1.5	1.8	1.4	1.4	1.5	1.7
France	1.0	1.9	1.2	1.2	1.3	1.5
Italy	1.2	1.2	0.7	0.9	1.0	1.3

Real Short-Term Interest Rates

	2017	2018	2019	2020	2021	2022
U.S.A.	–1.5	0.1	0.1	–0.3	0.0	0.0
U.K.	–1.7	–1.3	–1.0	–1.1	–1.0	0.1
Japan	–1.0	–0.7	–0.8	–0.5	–0.4	–0.4
Germany	–2.1	–1.7	–1.8	–1.9	–2.0	–2.0
France	–2.2	–1.5	–1.7	–1.7	–1.8	–1.9
Italy	–1.5	–1.0	–1.4	–1.4	–1.6	–1.7

Nominal Short-Term Interest Rates

	2017	2018	2019	2020	2021	2022
U.S.A.	0.9	1.9	2.1	1.7	2.0	2.0
U.K.	0.4	0.7	0.9	1.1	1.9	2.4
Japan	0.0	–0.1	–0.1	0.0	0.1	0.1
Germany	–0.3	–0.3	–0.4	–0.4	–0.3	–0.1
France	–0.3	–0.3	–0.5	–0.4	–0.3	–0.1
Italy	–0.3	–0.3	–0.5	–0.4	–0.3	–0.1

Real Long-Term Interest Rates

	2017	2018	2019	2020	2021	2022
U.S.A.	0.4	0.9	0.1	0.3	0.8	1.0
U.K.	–1.5	–0.5	0.5	1.4	0.9	0.6
Japan	–0.6	–0.5	–0.6	–0.6	–0.5	–0.4
Germany	–1.3	–1.1	–1.9	–2.1	–1.9	–1.7
France	–0.6	–0.5	–1.2	–1.5	–1.4	–1.3
Italy	1.1	1.6	0.9	0.1	0.1	0.2

Nominal Long-Term Interest Rates

	2017	2018	2019	2020	2021	2022
U.S.A.	2.4	2.9	2.1	2.3	2.8	3.0
U.K.	0.6	1.0	1.0	1.3	2.4	3.4
Japan	0.1	0.1	–0.1	–0.1	0.0	0.1
Germany	0.3	0.4	–0.3	–0.4	–0.2	0.0
France	0.8	0.8	0.2	0.0	0.1	0.2
Italy	2.1	2.6	2.1	1.3	1.4	1.5

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

	2017	2018	2019	2020	2021	2022
U.S.A.	94.5	93.6	94.0	94.2	94.1	94.4
U.K.	75.5	76.9	77.0	77.2	77.5	77.7
Japan	58.3	57.8	56.3	54.2	51.4	48.0
Germany	94.3	96.5	95.6	94.1	92.2	90.0
France	95.3	97.4	96.3	94.5	92.1	89.4
Italy	101.2	102.8	104.5	105.2	103.8	101.7

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

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

	2017	2018	2019	2020	2021	2022
U.S.A.[1]	101.68	99.38	102.74	103.56	103.04	103.56
U.K.	1.30	1.33	1.28	1.31	1.33	1.35
Japan	112.18	110.00	109.10	111.20	111.50	111.30
Eurozone	0.87	0.85	0.89	0.88	0.89	0.88

[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