LIVERPOOL INVESTMENT LETTER

July 2020

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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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BRAVE LOCKDOWN EASING

The government has gone ahead with lifting the lockdown, bravely overruling the medical scientists wanting to keep it largely in place. It has now even reduced the required social distance to one metre, so allowing the hospitality industry the chance to restore some revenues. There has been some bounce back in retail sales and industrial activity, with the manufacturing flash PMI rising to 50.1 in May from 40.7 in April; the services PMI rose to 47 from 29. Retail sales rose 12% in May, having fallen 18% in April. Similar bounce back is being seen in the US.

We think this easing is sustainable because of our forecast of steadily falling deaths, both here and globally (see the figures at the bottom of the page). The damage to the economy has been so great from lockdown, that easing was urgent. People are still naturally fearful of returning to normal activities, but we think this fear will wear off as the downward trend in deaths continues.

There is natural concern over possible new outbreaks — such as reported in Leicester. However, it needs to be seen if these involve severe or weak infections. It is the former that largely cause deaths; social distancing should be effective in reducing the spread of severe infections, which generally require the transmission of a large viral load by someone with severe symptoms. We know that a large proportion of the population has had a weak infection and also has broad existing immunity to coronaviruses. So it is quite possible that new outbreaks of infection are not threatening a renewed rise in deaths; the trend in our forecasts of deaths is firmly downwards.

Based on this assessment, our forecast is for a V-shaped recovery. With money and credit growing rapidly, there is a strong policy stimulus to spending, besides the huge fiscal support programmes around the world. Sectors that are still being closed down by quarantine, namely the travel and hospitality sectors, are due for relief in the near future as quarantine-free corridors are being arranged between major tourist origins and destinations.

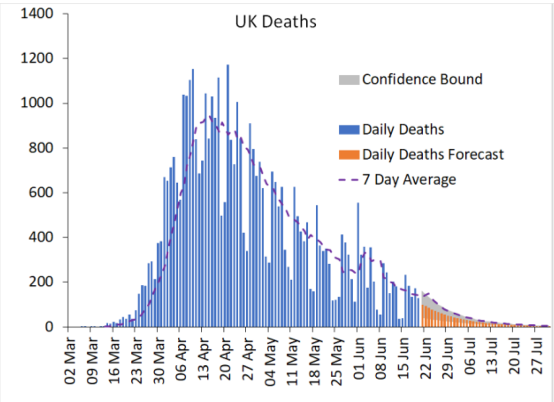
Judging by the bounce back in the May indicators, when lockdown was still mostly in place, we should expect a bigger bounce in June and July, with its effective abandonment. Some economists are talking about weak demand. But this makes little sense, given the huge fiscal stimulus and the sharp growth in money — with M3 currently (Q2) up 8.7% on a year earlier. The government is keeping household incomes up via furlough and benefits (tax credits); credit is easy. Spending is likely to be strong as people recover their desire to get out and about. As we have seen from the crowded scenes on beaches over the weekend, many people are very impatient with further restriction. The polls, it is true, suggest about half the population is cautious about lifting the lockdown. However, given its lifting, the vast majority are not vulnerable to serious infection provided they take moderate care; they are likely to actively go out and spend. Nor should we assume in a facile way that companies will be inactive. There are investment opportunities in new ways of doing business, with weaker companies vulnerable to takeover and makeover.

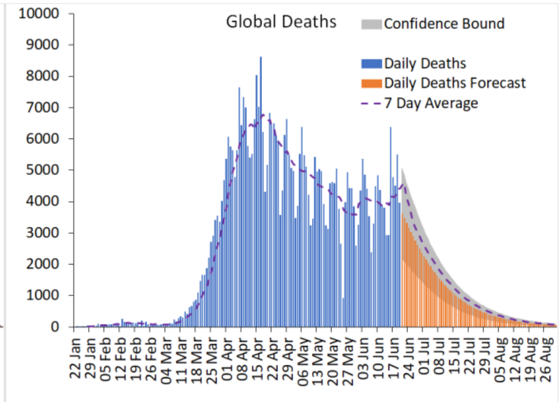
As we look ahead to the beginning of 2021, we foresee the need for a policy shift in which fiscal support continues with re-entry to normality but monetary policy is tightened, with QE being withdrawn. The Bank of England governor, Andrew Bailey has, rightly in our view, noted the need to sell off as soon as possible the £300 billion of gilts that will have been taken onto the BoE balance sheet this year. Otherwise with so much money and fuel for credit sloshing around the economy, control of inflation could prove impossible.

Table 1: Summary of Forecast

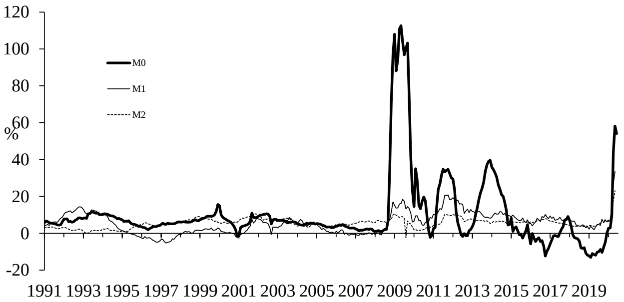
	2017	2018	2019	2020	2021	2022	2023
GDP Growth[1]	1.8	1.3	1.4	-6.6	6.2	2.9	3.1
Inflation CPI	2.6	2.4	1.8	1.7	2.0	2.0	2.0
Wage Growth	2.8	3.0	3.5	3.0	3.2	3.1	3.3
Unemployment (%)[2]	4.4	4.2	4.1	7.2	5.6	3.5	2.8
Exchange Rate[3]	77.4	78.6	78.1	78.9	77.9	77.7	77.6
3 Month Interest Rate	0.4	0.7	0.8	0.4	1.9	4.5	5.0
5 Year Interest Rate	0.6	1.0	0.6	0.4	2.6	5.0	5.0
Current Balance (£bn)	-68.3	-82.9	-83.8	-64.3	-54.1	-45.5	-40.3
PSBR (£bn)	53.7	39.3	43.2	239.1	101.9	51.0	7.6

[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)

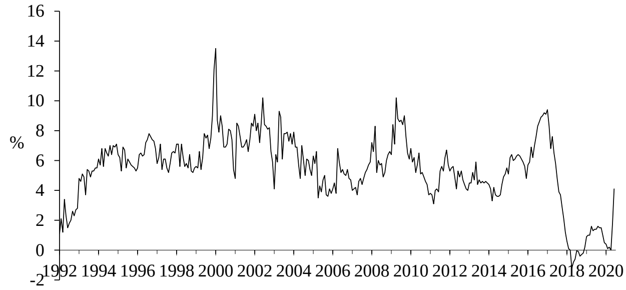




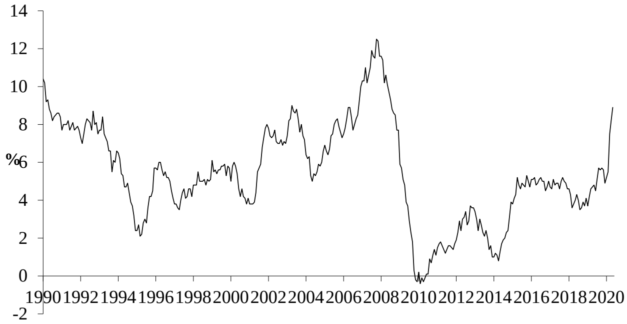
U.S.: Growth in Monetary Aggregates (Yr - on - Yr)



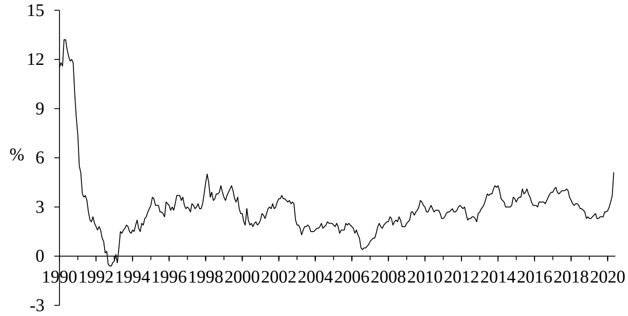
UK: Notes and Coins in Circulation Growth



Eurozone M3 Growth



Japan: Growth of M2+CD's



FOCUS ON JAPAN

Francesco Perugini

Japan Returning Gradually to Normality

Japan's economy is opening cautiously, following the plan set out on May 25 when the national state of emergency was fully lifted. On that occasion, the government set a "transition period" through the end of July, planning to lower the level of restrictions in a phased manner, and fully restart the economy as early as August 2020. The month of July will be a transitional period for people to adjust to the new way of life and the ongoing precautions against Covid-19 coronavirus infections. Japan's reopening plan was different from Tokyo's own city-wide reopening plan, which moved into stage one on May 26, the day after the state of emergency was lifted. Stage two of the Tokyo plan, which includes opening gyms and cinemas, started at the beginning of June. On June 11 Tokyo moved into the final phase of its reopening roadmap, "where all economic and social activities can be carried out," Tokyo Governor Yuriko Koike said at a press conference.

While the pandemic continued to be closely monitored, observers and practitioners are concerned about the economic consequences of COVID-19. Yoshimasa Maruyama, chief market economist at SMBC Nikko Securities, said although Japan's coronavirus restrictions were never as strict as the lockdowns in the US, Europe and some other parts of Asia, the economic damage was still considerable. Japan's economy was already hurting from a tax increase last year. Then auto exports to the US and Europe plunged when the coronavirus hit. Consumer spending is unlikely to recover quickly. "Americans may feel happy and go splurging after the lockdown is lifted. But the Japanese mind set tends to become even more cautious about spending because of uncertainties about the future," Maruyama said. A return to pre-pandemic levels of economic activity is not expected for Japan until 2023, a year after a likely recovery in the U.S., he said.

Also, the Government and the Bank of Japan (BOJ) are worried about the economic situation. The former seems more optimistic about future economic trends. "Japan's economy nearly ceased worsening as it began to reopen following the complete lifting of a nationwide state of emergency over the coronavirus pandemic", the government said in its monthly economic report for June released recently. The government, which said the economy was "worsening rapidly" in its May report, revised its monthly assessment upward for the first time since January 2018. "The Japanese economy is still in an extremely severe situation due to the novel coronavirus, but it almost stopped deteriorating," the Cabinet Office said, citing improving private consumption in line with the reopening of economic activities across the country. The upward revision in consumer spending assessment was also the first since January 2018. However, with consumption recovering only slowly and businesses still facing a long road to full recovery, the government maintained its cautious view on corporate capital spending, exports, production and employment, among others. "The current economic condition is far from what we can describe by using the word 'recovery' and its direction is still downward, but we are no longer seeing a situation where the economy is expected to continue worsening," a government official told reporters.

On the other hand, BOJ policymakers are less optimistic. As for the economic outlook, one member of the board said at the latest June meeting that "it seems inevitable that the negative impact on the global economy, including Japan, will become prolonged without effective vaccines and medicines." Demand is expected to be pushed down by deterioration in the labour market and "a new lifestyle" that could negatively impact conventional services because of concerns about the risk of COVID-19, another BOJ policy board member said. There is also concern among members that the coronavirus pandemic could tip the country back into deflation. A return to deflation would be "a considerable obstacle" to eventually achieving the central bank's 2% price stability target, one of the nine Policy Board members said. "Thus, considering this risk, it is necessary to conduct additional easing at this point," the member said.

So far, economic data releases are not encouraging. Japan's April factory output fell at a much faster-than-expected pace and retail sales tumbled the most in more than two decades. Factory output slipped 9.1% in April from the previous month, the biggest drop since comparable data became available in 2013 as automakers and iron and steel manufacturers suffered sharp output declines due to weak global demand. That was a much larger decline than the 5.1% drop in a Reuters forecast. Separate data showed retail sales tumbled at their fastest pace since March 1998 as the nationwide state of emergency led service-sector businesses such as restaurants to close and encouraged consumers to stay home. Retail sales plunged 13.7% in April from a year earlier, weighed down by slumping demand for general merchandise and clothing as well as motor vehicles. Other government data further highlighted the widening hit to the jobs market from the outbreak. The April jobless rate rose to 2.6%, its highest since December 2017, while the number of non-regular workers posted the biggest year-on-year drop on record. The jobs-to-applications ratio, i.e. the ratio of job seekers to job openings, slipped to 1.32, its lowest since March 2016.

At the end of May the government approved a second fiscal package, bringing the total pledged to save the economy from the pandemic to about 40% of gross domestic product. The BOJ maintained monetary policy unchanged, keeping short-term interest rates at minus 0.1% while guiding long-term rates to around zero%. It also decided to expand its ¥75 trillion corporate support measures to ¥110 trillion, in line with the government’s second extra budget to bolster the country’s economy including new programs focusing on assistance for small businesses.

The number of people confirmed to have become infected with the virus and the numbers of hospitalized patients and patients in a severe condition are flattening off; deaths have fallen off close to zero. Therefore, it seems likely that recovery will continue as the lockdown is eased, much as is occurring in Europe, the US and China.

MARKET DEVELOPMENTS

With a V-shaped recovery the increasing optimism in equity markets looks well founded.

Table 1: Market Developments

	Market Levels		Prediction for Jun/Jul 2021	
	Jun 3	Jul 2	Previous Letter	Current View
Share Indices				
UK (FT 100)	6382	6240	7812	7638
US (S&P 500)	3123	3130	3220	3227
Germany (DAX 30)	12487	12608	18544	18724
Japan (Tokyo New)	1599	1543	1970	1901
Bond Yields (government)				
UK	0.31	0.18	2.30	2.30
US	0.81	0.67	2.80	2.80
Germany	−0.35	−0.44	−0.20	−0.20
Japan	−0.03	0.04	−0.00	−0.00
UK Index Linked	−2.31	−2.31	1.00	1.00
Exchange Rates				
UK ($ per £)	1.26	1.25	1.32	1.32
UK (trade weighted)	77.53	76.59	79.4	78.2
US (trade weighted)	106.10	106.26	102.5	102.5
Euro per $	0.89	0.89	0.85	0.85
Euro per £	1.12	1.11	1.12	1.12
Japan (Yen per $)	108.83	107.63	112.5	112.5
Short Term Interest Rates				
UK	0.82	0.83	1.80	1.70
US	0.27	0.27	1.80	1.80
Euro	−0.37	−0.47	−0.50	−0.30
Japan	0.00	0.00	−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	1.4	2.0	19.00		26.00
US	1.99	1.1	2.1	−0.10	−5.89	−0.80
Germany	3.30	0.8	1.7	46.00	−1.06	50.74
Japan	1.90	−0.3	0.5	23.00	−10.68	14.42
UK indexed[2]	−2.31		2.0	8.00		7.70
Hong Kong[3]	2.60	4.0	2.1	−31.00	−5.89	−28.19
Malaysia	3.30	2.0	2.1	15.00	−5.89	16.51
Singapore	3.50	1.0	2.1	−7.00	−5.89	−6.29
India	1.40	5.0	2.1	−7.00	−5.89	−4.39
Korea	1.10	0.8	2.1	−42.00	−5.89	−43.89
Indonesia	2.20	3.0	2.1	2.00	−5.89	3.41
Taiwan	2.80	1.0	2.1	−2.00	−5.89	−1.99
Thailand	3.20	1.5	2.1	4.00	−5.89	4.91

Bonds: Contribution to £ yield of: −

	Redemption Yield	Changing Nominal Rates	Currency	Total
UK	0.18	−18.23		−18.05
US	0.67	−21.29	−5.89	−26.51
Germany	−0.44	−2.44	−1.06	−3.94
Japan	0.04	0.36	−10.68	−10.29

Deposits: Contribution to £ yield of:

	Deposit Yield	Currency	Total
UK	0.83		0.83
US	0.27	−5.89	−5.62
Euro	−0.47	−1.06	−1.53
Japan	0.00	−10.68	−10.68

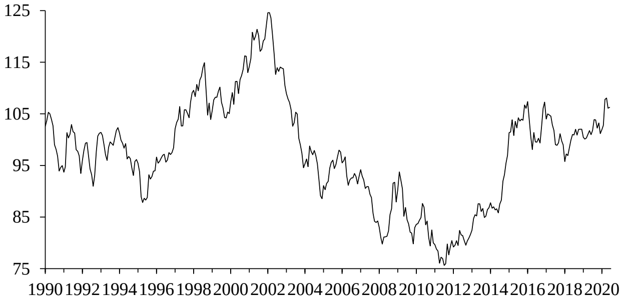
[1] Yields in terms of €s or $s can be computed by adjusting the £-based yields for the expected currency change.
[2] UK index linked bonds All Stocks
[3] Output based on China.

Table 3: Portfolio(%)

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

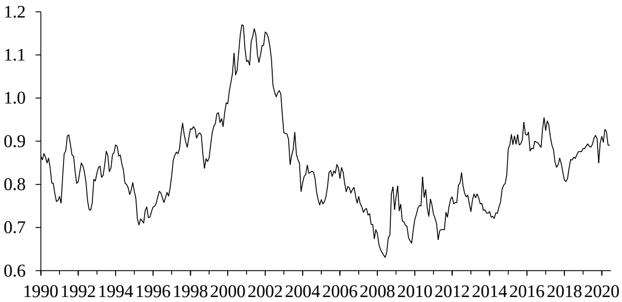
INDICATORS AND MARKET ANALYSIS
FOREIGN EXCHANGE MARKETS

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

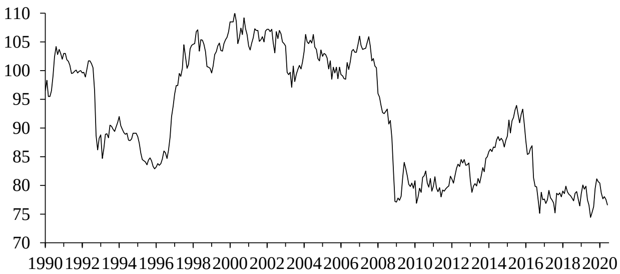


UK: Dollars Per Pound Sterling

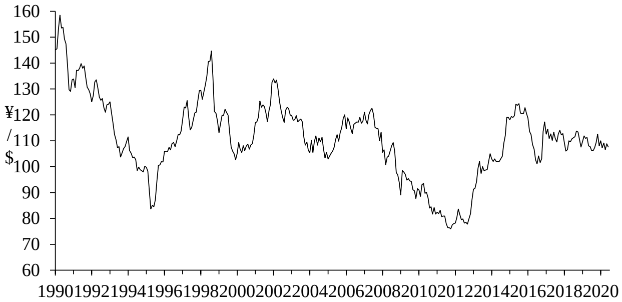
Euro per US dollar



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

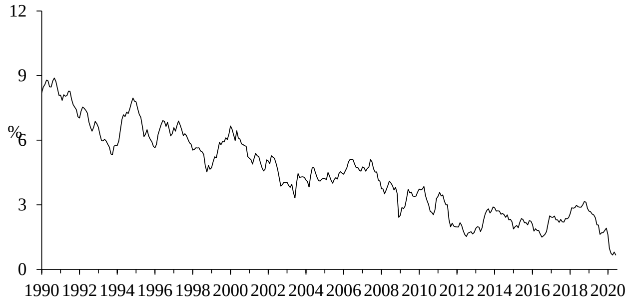


Japan : Yen Per U.S. Dollar

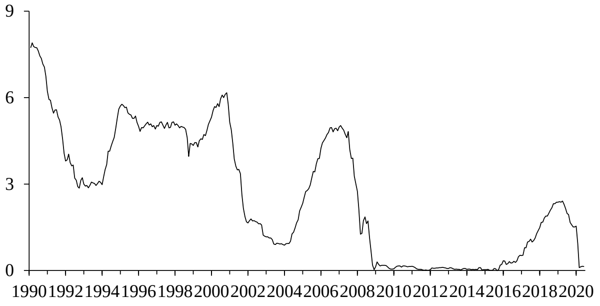


GOVERNMENT BOND MARKETS

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

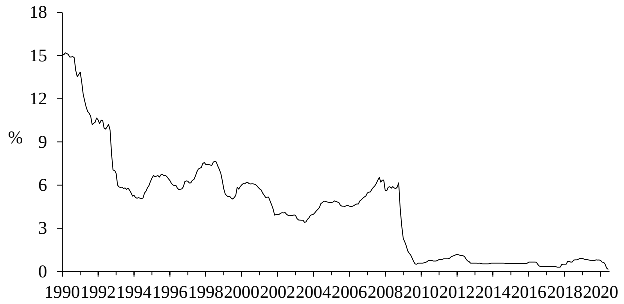


U.S. : 3-Month Treasury Bill

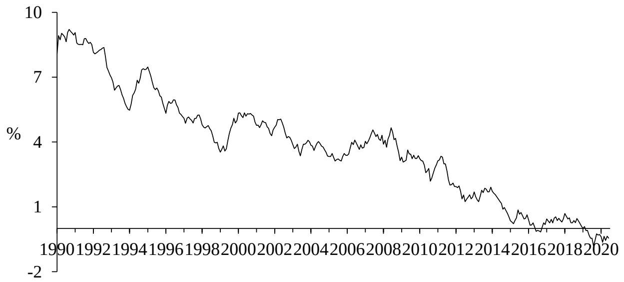


U.K.: Yield on Long-Term Government Bonds

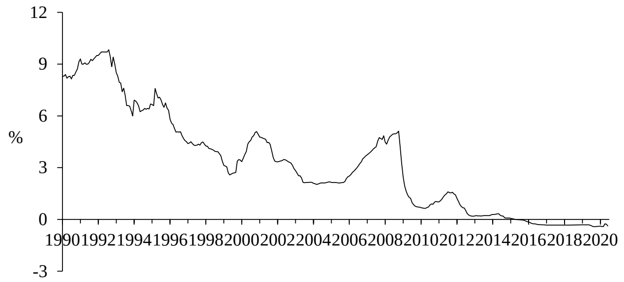
U.K. : 3-Month Certificate LIBOR Rate



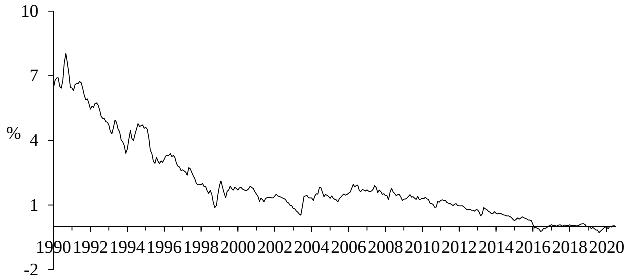
Germany: Yield on Public Authority Bonds



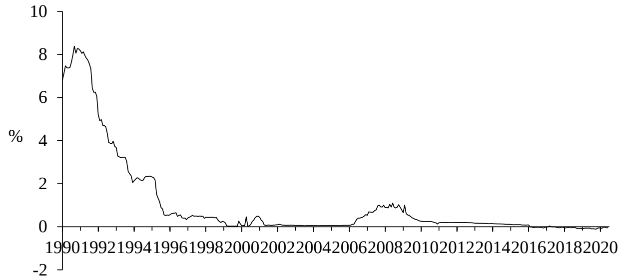
Germany : 3-Month Interbank Deposit Rate



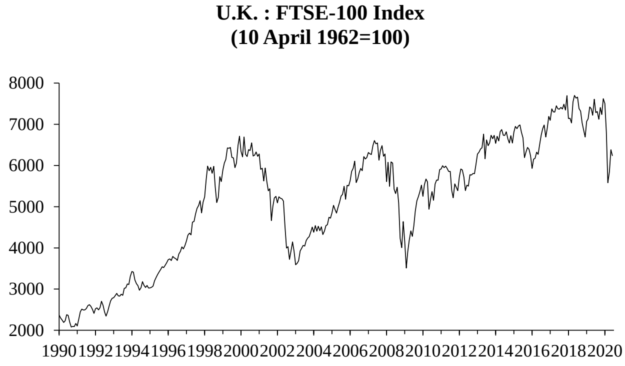
Japan: Yield on Long-Term Government Bonds

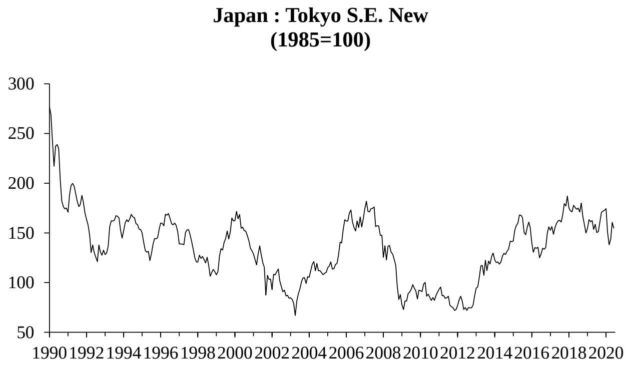


Japan : 3-Month Money Market Rate



MAJOR EQUITY MARKETS





EMERGING MARKETS

Anupam Rastogi

A V-shaped recovery, or for that matter any other shape recovery, starts with vaccine. Vaccine development has become a Sputnik moment for China. The Covid-19 pandemic may see multiple waves of outbreaks in the coming period and sovereign debt and financial crises cannot be ruled out in developing countries. In this write-up, however, only Brazil is in that situation.

Emerging markets in East Asia are leading the global economic recovery. Three of the giants in the MSCI Emerging Markets Index — China, South Korea and Taiwan — organized the most successful containment efforts. By doing so, they demonstrated that government competence ensures trust in institutions. By contrast, faith in public institutions in Latin America has been plunging for years due to government corruption. Covid-19 has exposed it further.

Paradoxically, the more rich countries spend to pull themselves out of the abyss, the lower the interest rates they have to pay on their colossal debt. However, interest rates for emerging economies are rising as their currencies plunge. Hence, Brazil faces a debt crisis and another “lost decade.” The coronavirus’s economic damage may last longer than that of the Spanish Flu of 1918. First, international supply chains are unwinding across the globe. The pandemic probably will spur countries to offshore less production in the future now that they know the risk; that it will be a costly and painful transition. Second, both consumers and businesses are more highly leveraged than they were a century ago, and that debt may combine with the economic shock of the pandemic to cause a balance-sheet recession.

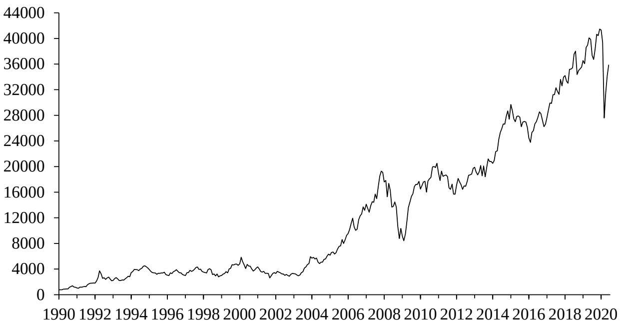
One hears that the pandemic has given opportunity to China to get its “rightful” place. China believes that it deserves to be recognized as a great power. This has propelled its leaders to “make China great again.” That quest continues ever more aggressively under President Xi Jinping. China’s action in Hong Kong, in Southern China Sea and on Indo-China border points to gathering clouds.

India

India’s GDP growth slowed down to 3.1% for the quarter ending March 2020, while its growth for the full financial year FY20 stood at 4.2%. This is the lowest growth that India has recorded in the past 11 years.

According to the International Monetary Fund, India will be the large economy worst hit by the Covid-19 pandemic. The Fund says that Indian GDP in the ongoing financial year, which began in March 2020, will contract by 4.5%. A few weeks ago, it had been predicting 2% growth for the year. We maintain our forecast of the economy contracting 3% in FY 2020–21 and rebounding to 7.5% in the next fiscal year.

India: BSE Sensitive



In our opinion, the full realization of the stimulus package announced by the government could significantly stem the decline in GDP. The Goods and Services Tax collection in the month of June was just 14% short of the GST collection of February, 2020, the last full month of working of the economy. Moreover, the disruptions in the agricultural sector in the first phase of the covid-19 lockdown, have been sorted out and better than average monsoon rainfall augurs well for the sector. The agriculture sector is expected to grow at 3% in 2020-21.

Even though direct fiscal impact of the government’s economic package after excluding the monetary measures and existing proposals in the Union Budget is small, it would double fiscal deficit to 7.6% of GDP, compared to the budgeted 3.5%, with the majority of fiscal slippage from the revenue side.

The government has put off the release of consumer price inflation numbers for April and May, a period that includes a more-than two-month lockdown imposed to combat the coronavirus pandemic, due to inadequate data collection. However, limited data released by the ministry showed that annual retail food inflation has slowed down and inflation based on wholesale price index (WPI) contracted by 3.21% in May. We expect CPI to remain around 3.8% in the current fiscal year as fuel prices have gone up due to taxes.

We expect the RBI to cut its policy rate by at least another 25 basis points this fiscal, currently at 4%, as the spike in food prices is receding and some price movements are displaying a disinflationary scenario in the current environment.

India’s current account balance contracted sharply for the third time in a row to turn into a surplus of US$0.6bn or 0.1% of GDP in Q4FY20 — the first in 13 years. This was primarily led by a sharp drop in non-oil imports, strong growth in remittances, steady software earnings and lower overseas investment income payments. On the capital account, huge foreign portfolio outflows amid a strengthened risk-off environment in the wake of COVID-

19 outbreak were largely offset by a higher FDI (foreign direct investment) and ECB (external commercial borrowings) inflows, resulting in a Balance of Payments (BoP) surplus of US$18.8bn in Q4FY20.

Exports are likely to fare better than imports, as an aggressive policy response globally should help revive global demand faster. We expect a current account surplus in FY21 for the first time in 17 years (on an annual basis), partly offset by lower remittances. This would translate into a BoP surplus for yet another year, supported by strong FDI inflows.

The Indian rupee remained under pressure in May owing to mounting growth concerns. The rupee will end the year at 75 per dollar. The currency hit a record low of 76.9088 in April. The currency has dropped 5.6% so far in 2020. India's forex reserves near $500bn. The central bank is enhancing reserves to guard against a likely downgrade in India's credit rating. RBI will continue to buy dollars at every opportunity to guard against contagion

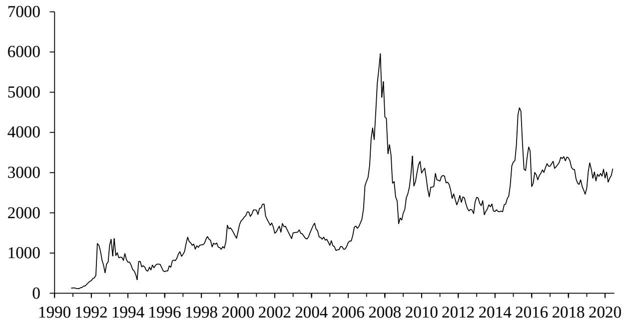
The market rally resumed in June amid positive global cues and a sustained global risk-on environment. The benchmark Index fell by 2.8% in the month of May, followed by a rebound in June, up 8.4%.

India is being drawn into the wider rivalry between Beijing and Washington. If trade and investment suffer as a result, the deteriorating relationship could lead to problems decades down the line. Economic nationalism is on the rise in India — and China looks to be the most visible loser.

India banned 59 Chinese mobile apps in the last week of May, including TikTok and WeChat, after a border clash that killed 20 Indian soldiers in the month of May. Across sectors from pharmaceuticals to telecommunications and automobiles, industry associations have been speaking up against a complete boycott of Chinese imports. Indian companies feel that US, Vietnam, Japan, Mexico and certain European countries could be tapped as alternate import sources for some critical electronic, vehicular and pharmaceutical components. It is likely that the costs of the raw materials from these alternate sources will be higher and may get passed on to consumers if the manufacturers cannot absorb them. The government's "Atmanirbhar" (self-reliant) focus is expected to be helped by ministries where self-reliance needs to be built.

Defence analysts opine that China's calculus is complicated. India needs to be reminded of its place, but not so harshly that it seeks out the embrace of the United States. That's proving an impossible balance to strike. From India's point of view, China has been nothing but trouble. It remains the main international backer of the Pakistani military establishment, and a perpetual threat to regional stability. It has pushed further into the Indian Ocean and subverted India's relations with neighbours such as Nepal. It constantly seeks to change facts on the ground along the long border.

China: SSE Composite Index



This has resulted in an unspoken but unmistakable swing for India toward the U.S., particularly in terms of defence cooperation; most Indians view the U.S. as India's most important partner. In recent years, India has signed various agreements that make military co-operation with the U.S. far easier — steps that would have been unthinkable a decade ago.

	18–19	**19–20**	**20–21**	**21–22**	**22–23**
GDP (%p.a.)	6.8	4.2	-3.0	7.5	6.0
WPI (%p.a.)	3.9	3.6	3.8	4.5	5.0
Current A/c(US$ bill.)	-70.0	-22.0	0.6	2.0	-10.0
Rs./$(nom.)	79.5	73.0	76.0	77.0	78.0

China

China's manufacturing PMI in June rose to 50.9 from 50.6 the previous month, signalling the country's steady recovery from the virus slump remains on track. The economy will be able to escape a technical recession but it is unlikely to have a positive growth as households are still wary and consumption remains in contraction. The industry has returned to growth but it is facing collapse in demand in its export markets. The government has pledged a record amount of government debt sales to help boost domestic demand, and banks have been told to extend more credit to businesses as well as offer interest-payment holidays. China Beige Book, which surveyed more than 3,300 firms in the country, said the economy contracted again in the three months to June and is heading for a full-year recession.

China's price pressures eased further in May due to reduced demand and lower commodity and energy prices. Purchase Price Index growth slowed to 2.7% from 3.3% as pork prices are stabilizing. China's consumer inflation dropped to a 14-month low in May because of easing food inflation. The consumer price index rose 2.4% from a year earlier. However, the onset of a new Swine flu may put pressure on PPI again in the coming months.

We expect the People's Bank of China to cut the nominal reserve ratio for major banks to 11.5% from the current 12.5% in the third quarter, as well as slashing the key 7-day reverse repo interest rate to 2.05% from the current 2.2%. The focus of monetary policy is shifting to credit easing from the rapid reduction of interest rates previously.

China posted a trade surplus of $63 billion as exports in May fell less than expected, 3.3% compared with a year earlier, but imports plunged 16.7%. China ran a current account deficit of $33.7 billion in the first quarter of 2020, compared with a surplus of $40.5 billion in the fourth quarter.

China may report a current account deficit in 2020. For the first time China reported a current account deficit in the first half of 2018.

Yuan has moved away from testing its 2008 low versus the dollar, but that has not stopped the yuan from weakening against its peers. The yuan slumped more than 4% versus the euro and Australian dollar in the month of May, while it has strengthened about 0.4% versus the USD. Beijing will likely allow such broad weakening by the yuan to continue, giving its exporters some relief amid the global economic shutdown.

China's top legislative body has passed a national security law for Hong Kong which abandons the "one country, two systems" theory. China's Communist Party is squeezing companies to support its national security law for Hong Kong to outlaw secession, sedition, and treason. It coincides with increasingly assertive messaging by China as it seeks to counter pushback from the U.S., the U.K., and others, which say the law violates the "one country, two systems" autonomy of Hong Kong that China promised through 2047.

The legislation has triggered countermeasures from the US and the UK. The UK promised to provide citizenship to British National Overseas Passport holder in Hong Kong and their dependents. President Trump has sanctioned individual Chinese officials and declared Hong Kong as another communist ruled state which may undermine Hong Kong's financial stability. The U.S. is inching towards a "complete decoupling from China".

In the post-Mao era, the Chinese people and the CPC have adhered to an implicit social contract: The people tolerate the party's political monopoly, as long as the party delivers sufficient economic progress and adequate governance. The CPC's poor handling of the COVID-19 outbreak threatens this tacit pact. In this sense, China's one-party regime may well be in a more precarious position than it realizes.

	18	**19**	**20**	**21**	**22**
GDP (%p.a.)	6.6	6.1	0.0	5.5	5.5
Inflation (%p.a.)	2.2	2.3	2.0	2.0	1.8
Trade Balance(US$ bill.)	50.0	40.0	20.0	40.0	40.0
Rmb/$(nom.)	6.8	7.1	7.3	7.2	7.2

South Korea

The Bank of Korea predicted that the economy will shrink at least 2.0% in the April–June period over the previous three months as the coronavirus outbreak hits consumer demand and economic activity even harder. We maintain our forecast of degrowth of 1% in 2020 before rebounding in 2021. The International Monetary Fund (IMF) has predicted that South Korea's economy will shrink 1.2% this year. Stimulus spending has added up to more than 12% of gross domestic product — on a par with packages in the U.S. and Europe. The government also stoked growth by accelerating spending from the regular budget when infections spiked in mid-February. The government has committed to inject an additional $28 billion into the economy through the country's largest-ever single supplementary budget.

South Korea's inflation is expected to rise at a slow pace even after the coronavirus pandemic recedes as the virus has caused unprecedented shock to the entire global economy.

South Korea's consumer prices are likely to fall 0.5% in 2020, falling short of BOK's inflation target of 2%. Massive production setback caused by the pandemic is expected to lead companies to rush automation for better productivity, which in result would cut labour costs dragging down inflation rate not only in 2020 but in 2021 as well.

South Korea's exports fell 10.9% on year in June amid the fallout from the coronavirus pandemic. Imports fell 11.4% in June. South Korea's exports and imports have fallen 10.9% and 8.9% on-year, respectively. The current account surplus is likely to shrink to USD 38 billion from USD 60 billion.

South Korea's won is maintaining its value following a rally in local stocks.

	18	**19**	**20**	**21**	**22**
GDP (%p.a.)	2.7	1.8	-1.0	2.0	2.2
Inflation (%p.a.)	1.5	0.4	-0.5	0.2	1.2
Current A/c(US$ bill.)	86.0	60.0	38.0	40.0	40.0
Won/$(nom.)	1130	1200	1230	1260	1260

Taiwan

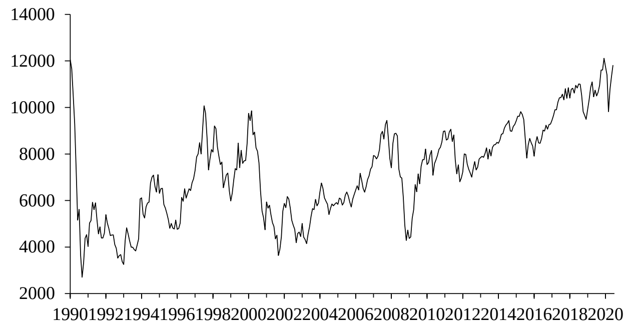
ADB expects Taiwan to grow 1.8% in 2020 and in Asia, besides China, Taiwan is the only other country whose economy would not contract. However, we are circumspect and continue to maintain our forecast of 1% degrowth. Taiwan's financial authority has downgraded its forecast of GDP to 1.52% from 1.92% in March. The authority said that the COVID-19 epidemic in the first half has weakened local consumption and exports.

Taiwan's consumer price index for 2020 is expected to deflate by 0.5%. Taiwan's central bank unexpectedly left its policy rate unchanged as the coronavirus pandemic threatens to deal a further blow to the trade-reliant economy.

Taiwan's exports in May fell for a third straight month but at a slower pace than expected. Total exports in May shrank 2% year on year to 27 billion U.S. dollars, making the third consecutive monthly fall. The island's total imports in May fell 3.5% year on year to 22.28 billion U.S. dollars.

Taiwan's forex reserves as of May totalled US$484.5 billion, up US$2.73 billion from a month earlier, helping the country retain its position as having one of the largest forex assets in the world.

Taiwan: Weighted TAIEX Price Index



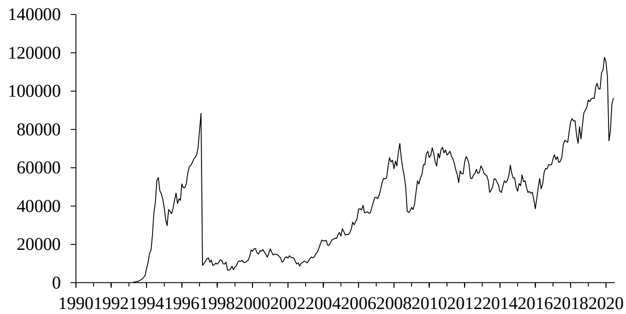
	18	19	20	21	22
GDP (%p.a.)	2.6	2.0	-1.0	2.0	2.2
Inflation (%p.a.)	1.2	1.0	-1.0	1.0	1.0
Current A/c(US$ bill.)	68.0	70.0	71.0	70.0	60.0
NT$/$(nom.)	29.8	31.0	30.0	30.5	31.0

Brazil

The Brazilian economic and fiscal position has led the rating agency Fitch to revise the Rating Outlook to 'BB-' with Negative outlook. We maintain a 5.5% contraction, largely due to the coronavirus health crisis. With 1.45 million cases and 60,713 deaths in the first week of July we expect social distancing measures to weigh on domestic activity not only this year but in 2021 also. We continue to maintain zero growth rate in 2021. With the implementation of additional fiscal stimulus measures, Brazil's general government deficit will likely widen to 14% of GDP in 2020. Most of the fiscal expansion is attributable to Brazil's stimulus package. The authorities estimate its direct fiscal impact at around 6% of GDP (assuming some of its elements, such as tax deferments, are eventually recouped) and expect around 3% of GDP's worth of quasi-fiscal measures to support credit expansion by public banks

Brazil's National Monetary Council has set the central bank's 2023 inflation target at 3.25%, with a tolerance margin of 1.5 percentage points on either side. Annual inflation is currently under 2%, not only below the central bank's 4% target for this year but also below the 2.5% floor allowed for by the 1.5 percentage point margin of error. The output gap is huge and high unemployment shows there is considerable slack, so it is hard to see inflation hitting the economy soon.

Brazil: Bovespa



Brazil posted a current account surplus for the third month in a row in May, while foreign direct investment rebounded slightly and the outflow from stocks and bonds slowed further from the record sell-off in March. Brazil's $1.3 billion surplus was mainly due to a fall in the investment income and services deficits to $2.1 billion and $1.5 billion, respectively. In the 12 months to May, Brazil's current account deficit, as a share of gross domestic product, narrowed slightly to 2.5% from 2.6%.

The Real has weakened more than its peers, with room to recover further. Over the past 12 months, its relative depreciation has been steeper. The Brazilian real recovered against the dollar as the current account deficit narrowed.

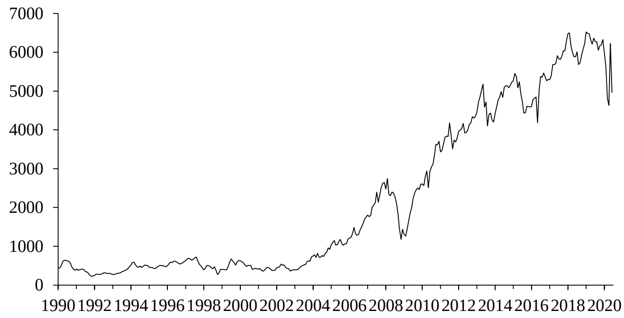
Brazil's President Jair Bolsonaro, who once dismissed Covid-19 as "the sniffles" and mentioned that death "is everyone's destiny", is facing rising unrest over his handling of the pandemic, with rallies in several cities. Protesters ignored social distancing recommendations to carry signs supporting democracy and opposing racism. As the nation's Covid-19 toll rises, the government is being criticized for its decision to limit the release of data about the virus.

	18	19	20	21	22
GDP (%p.a.)	1.1	0.8	-5.5	0.0	2.5
Inflation (%p.a.)	3.8	4.3	1.0	1.0	2.0
Current A/c(US$ bill.)	-14.6	-36.0	-40.0	-40.0	-36.0
Real/$(nom.)	3.8	4.2	5.5	5.7	5.8

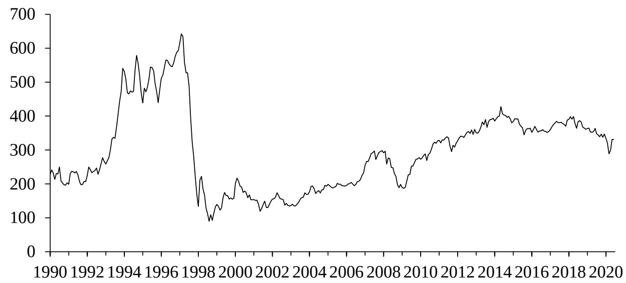
Other Emerging Markets

Hong Kong: FT-Actuaries

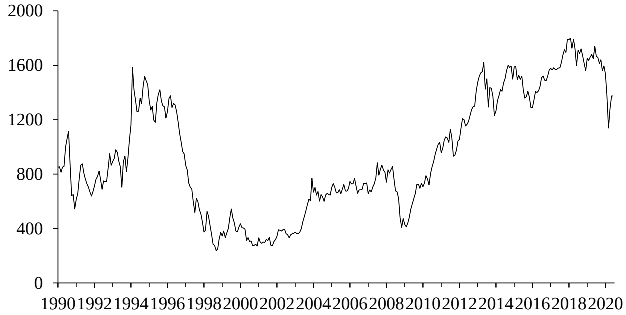
Indonesia: Jakarta Composite



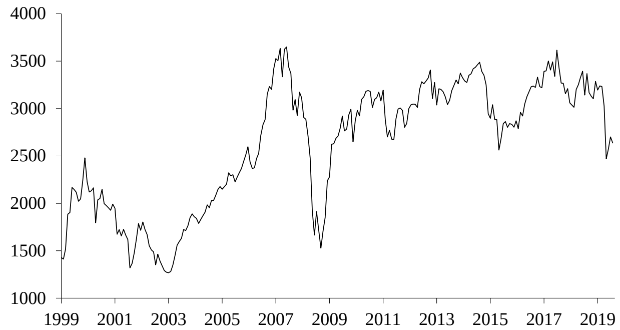
Malaysia: FT-Actuaries
(US$ Index)



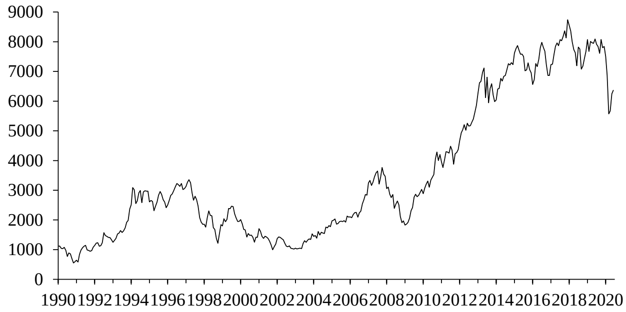
Thailand: Composite Index



Singapore: Straits Times Index

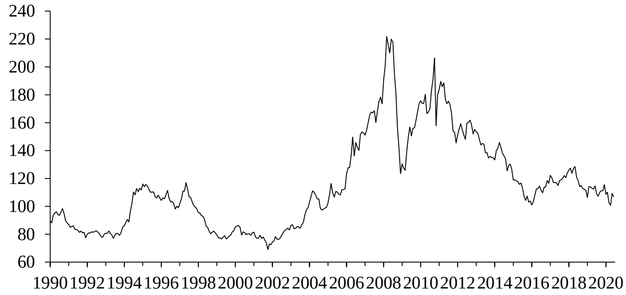


Philippines: Manila Composite

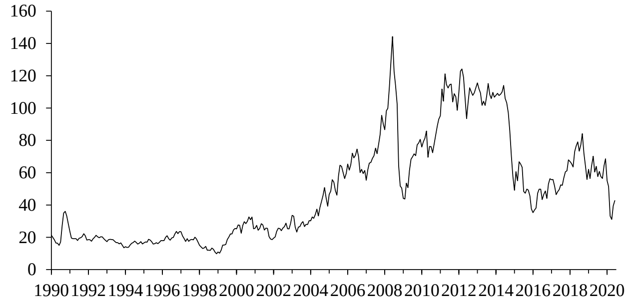


COMMODITY MARKETS

Commodity Price Index (Dollar)
(Economist, 2015 = 100)

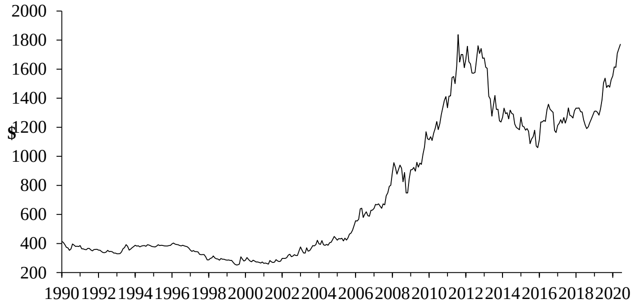


Oil Price: North Sea Brent (in Dollars)

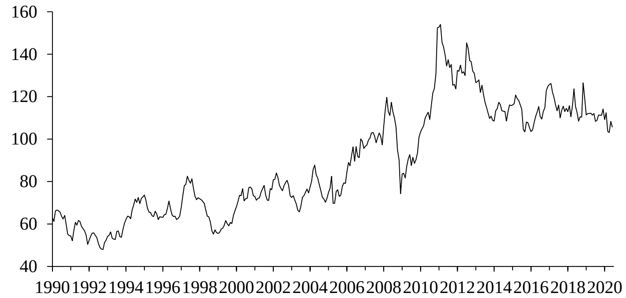


Commodity Price Index (Sterling)
(Economist, 2015 = 100)

Gold Price (in Dollars)



Commodity Price Index (Euro)
(Economist, 2015 = 100)



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	2.4	1.0	0.7	78.6	76.9	-1.4	3.3	-1.0
2019	1.8	0.6	0.8	78.1	75.9	-0.9	2.5	-1.1
2020	1.7	0.4	0.4	78.9	77.0	-1.8	2.2	-1.2
2021	2.0	2.6	1.9	77.9	76.3	-1.0	2.8	1.0
2022	2.0	5.0	4.5	77.7	76.6	2.2	2.8	3.0
2023	2.0	5.0	5.0	77.6	76.8	2.9	2.7	3.0
2019:1	1.8	0.9	0.9	78.8	77.4	-0.5	2.4	-0.9
2019:2	2.0	0.7	0.8	78.4	76.0	-0.5	3.0	-1.1
2019:3	1.8	0.4	0.8	75.8	72.7	-1.4	3.0	-1.4
2019:4	1.4	0.5	0.8	79.5	77.7	-1.3	1.7	-1.2
2020:1	1.7	0.4	0.7	79.2	77.5	-1.4	2.2	-1.4
2020:2	1.5	0.3	0.4	79.0	76.9	-1.8	1.8	-1.6
2020:3	1.7	0.3	0.3	78.7	76.8	-1.8	2.2	-1.7
2020:4	1.8	0.5	0.3	78.6	76.8	-2.4	2.4	-1.5
2021:1	2.0	1.8	1.5	77.6	76.0	-1.1	2.7	-0.2
2021:2	2.0	2.0	1.7	78.2	76.5	-1.1	2.8	0.0
2021:3	2.0	2.5	2.0	78.0	76.5	-1.2	2.8	0.5
2021:4	2.1	4.0	2.5	77.7	76.3	-0.5	3.0	2.0

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	3.0	4.2	1.1	142.8
2019	275.0	3.5	4.1	1.1	145.3
2020	283.3	3.0	7.2	2.3	147.2
2021	292.3	3.2	5.6	1.7	148.9
2022	301.4	3.1	3.5	1.0	150.5
2023	311.3	3.3	2.8	0.7	152.4
2019:1	273.4	3.4	3.9	1.0	144.9
2019:2	273.5	4.0	4.0	1.1	144.4
2019:3	275.5	3.7	4.2	1.2	146.0
2019:4	277.6	2.7	4.3	1.2	145.9
2020:1	280.8	2.7	4.4	1.2	146.4
2020:2	282.0	3.1	9.4	3.1	146.7
2020:3	283.8	3.0	7.8	2.5	147.8
2020:4	286.7	3.3	7.3	2.4	148.0
2021:1	289.4	3.1	6.6	2.1	147.9
2021:2	290.8	3.1	5.8	1.8	148.3
2021:3	292.9	3.2	5.3	1.6	149.6
2021:4	296.1	3.3	4.7	1.4	149.8

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	792330.9	445721.1	307723.0	201029.6	-41308.9	120833.9
2019	167.8	803514.4	450773.6	292071.6	205398.3	-40522.1	104207.0
2020	156.8	750778.9	422139.3	240438.5	206633.2	-38602.0	79830.1
2021	166.0	794785.5	447070.2	256907.5	207875.4	-32873.3	84194.3
2022	170.7	817684.4	453552.8	270703.1	209119.3	-29141.1	86549.7
2023	176.0	842924.6	460358.0	287932.7	210372.2	-26815.4	88922.9
2018/17	1.3		1.0	2.3	0.2		-4.6
2019/18	1.4		1.1	-4.7	2.2		-12.4
2020/19	-6.6		-6.3	-15.3	0.6		-4.1
2021/20	6.2		6.1	8.3	0.6		6.1
2022/21	2.9		1.4	5.4	0.6		2.7
2023/22	3.1		1.5	6.4	0.6		3.0
2019:1	167.5	200481.1	112289.5	83278.3	52683.0	-18452.8	29316.9
2019:2	167.1	200009.6	112720.4	81082.1	50775.9	-13738.5	30830.3
2019:3	168.3	201443.7	113162.0	72473.6	51076.1	-12057.3	23210.7
2019:4	168.4	201579.9	112601.6	55237.5	50863.3	3726.5	20849.0
2020:1	164.9	197481.6	111026.5	70478.2	52999.1	-16221.6	20800.6
2020:2	145.3	173993.2	99094.4	48913.3	51084.8	-6531.1	18568.2
2020:3	151.8	181697.2	101536.5	58727.3	51380.8	-10262.3	19685.1
2020:4	165.1	197607.0	110482.0	62319.7	51168.6	-5587.1	20776.2
2021:1	165.8	198469.1	112273.3	69471.6	53317.1	-15598.6	20994.3
2021:2	165.9	198582.2	111099.5	62447.0	51391.3	-5280.0	21075.6
2021:3	166.0	198749.7	111236.0	64731.7	51690.8	-7856.1	21052.7
2021:4	166.2	198984.5	112461.4	60257.2	51476.2	-4138.6	21071.7

[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)
2018	1.9	2092.5	39.3	22.4	-82.9
2019	2.0	2127.5	43.2	24.0	-83.8
2020	12.4	2030.1	239.1	25.0	-64.3
2021	4.7	2203.2	101.9	27.4	-54.1
2022	2.2	2316.3	51.0	31.0	-45.5
2023	0.4	2436.6	7.6	33.8	-40.3
2019:1	-2.8	520.1	-14.7	6.1	-34.5
2019:2	4.5	532.3	23.8	6.0	-27.3
2019:3	1.8	531.3	9.4	6.0	-15.6
2019:4	4.0	536.5	21.3	6.0	-6.3
2020:1	-2.1	527.5	-11.2	6.0	-29.6
2020:2	28.6	467.1	133.6	6.1	-12.2
2020:3	14.3	487.2	69.9	6.2	-11.1
2020:4	8.0	534.4	42.6	6.3	-11.4
2021:1	-1.3	541.4	-7.0	6.3	-29.2
2021:2	8.0	541.9	43.2	6.5	-10.3
2021:3	3.6	544.7	19.6	6.7	-6.0
2021:4	8.3	549.2	45.4	7.0	-8.5

[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	–6.5	6.0	2.5
U.K.	1.8	1.4	1.4	–6.4	6.0	2.9
Japan	2.2	0.3	1.0	–6.0	2.3	1.0
Germany	2.5	1.5	0.5	–6.5	5.8	2.0
France	2.4	1.7	1.3	–8.1	2.1	2.0
Italy	1.7	0.8	0.2	–9.9	6.4	1.9

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	2.4	1.8	1.7	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	–1.4	–0.9	–1.8	–1.0	2.2
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	0.8	0.4	1.9	4.5
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	–1.0	–1.1	–1.2	1.0	3.0
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	0.6	0.4	2.6	5.0
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	93.5	96.3	96.2	95.5	94.9
U.K.	75.5	76.9	75.9	77.0	76.3	76.6
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	10.96	104.31	106.53	105.84	104.43
U.K.	1.29	1.34	1.28	1.26	1.28	1.30
Japan	112.10	110.40	109.02	108.90	109.50	109.30
Eurozone	0.89	0.85	0.89	0.92	0.91	0.90

[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