LIVERPOOL INVESTMENT LETTER

July 2023

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Julian Hodge Institute of Applied 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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POLICY STILL IN PANIC MODE

We have commented before on the generally poor economic reasoning behind current fiscal and monetary policy. Once inflation has been precipitated by major monetary expansion as occurred during Covid with massive money printing, it will take time to get it down again. But come down it will, as now we have had a sharp tightening of monetary policy, with money supply growth reduced to just over zero year-on-year (yoy), with monthly falls. A further element bringing it down is the reversal of commodity prices after their big spikes a year ago. Producer wholesale prices are now (May) up 2.9% yoy, while input prices are up only 0.5% yoy, compared with a 23% rise a year ago. The process of falling inflation is in train, but patience is needed with the unpredictability of the lags involved.

Instead, the Bank of England is continuing to raise interest rates in what seems like a blind panic at inflation being above its long run 2% target. To worsen matters, the Treasury is also reacting irrationally, by promising more fiscal tightening, on top of the tax rises already in hand that have contributed to low growth expectations. Yet the Bank is already over-tightening, and inflation set to come down steadily.

These policymakers have focused on wages as a source of ongoing inflation. Yet wages have simply been catching up with unexpected inflation, so restoring real wage equilibrium. That process has a bit further to go, so wages will keep rising until catch-up is complete. This will also happen in the public sector and must be allowed to preserve public services. But this catch-up is not causing fresh inflation. As inflation comes down, wages will grow at the newly expected inflation rate, slowing in line with falling inflation.

Table 1: Summary of Forecast

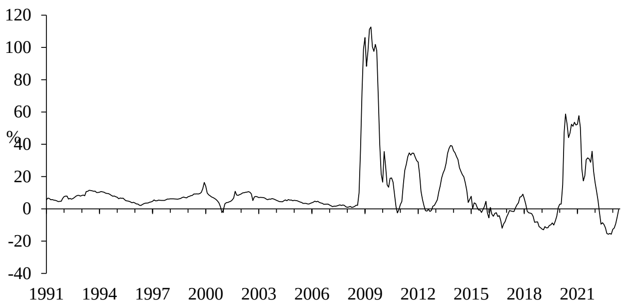
	2019	2020	2021	2022	2023	2024	2025
GDP Growth[1]	1.4	-11.0	7.5	4.2	-0.4	2.0	2.0
Inflation CPI	1.7	1.0	2.5	9.1	6.4	3.2	2.0
Wage Growth	3.5	1.6	5.8	6.0	6.4	3.4	3.0
Survey Unemployment	3.8	4.5	4.5	3.6	3.5	2.8	2.8
Exchange Rate[2]	78.3	78.2	81.5	79.4	78.1	77.4	76.8
3 Month Interest Rate	0.8	0.2	0.1	1.8	4.4	4.0	3.0
5 Year Interest Rate	0.6	0.1	0.4	2.3	4.3	4.0	3.0
Current Balance (£bn)	-63.3	-67.5	-34.3	-93.9	-24.2	-14.7	1.5
PSBR (£bn)	64.3	312.7	122.3	150.5	125.9	59.4	2.8

[1]Expenditure estimate at factor cost
[2]Sterling effective exchange rate, Bank of England Index (2005 = 100)

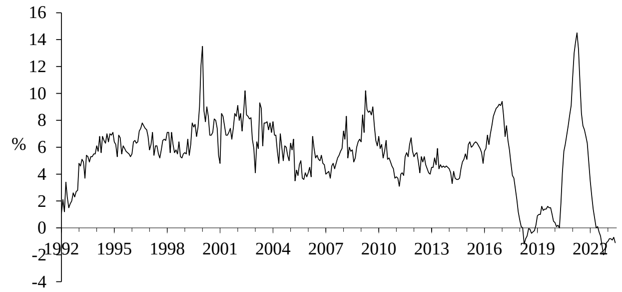
The public finances have been over-tightened by rising taxes. Solvency requires that in the long run debt rises more slowly than the real rate of interest; this in turn implies that the government should eventually run a primary surplus (revenue less non-interest spending). This would be well in hand without the tax rises we have seen. Ironically, by hitting growth via rising taxes, the prospect has been damaged, as growth is the engine of rising revenue.

Sadly, the government ignores these basic economic principles and stumbles on with worsening mistakes. We must hope that as inflation gradually falls, panic subsides and policies improve.

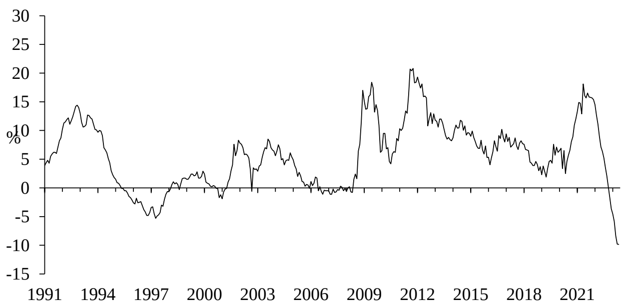
U.S.: Growth in M0 (Yr - on - Yr)



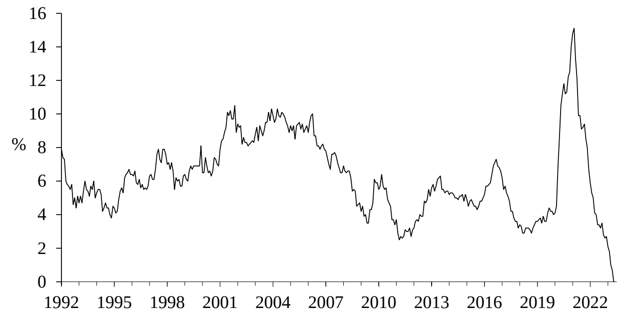
UK: Notes and Coins in Circulation Growth



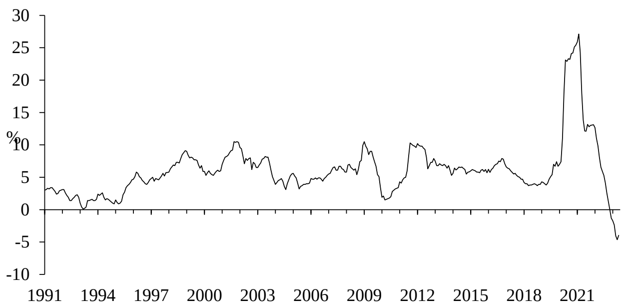
U.S.: Growth in M1 (Yr - on - Yr)



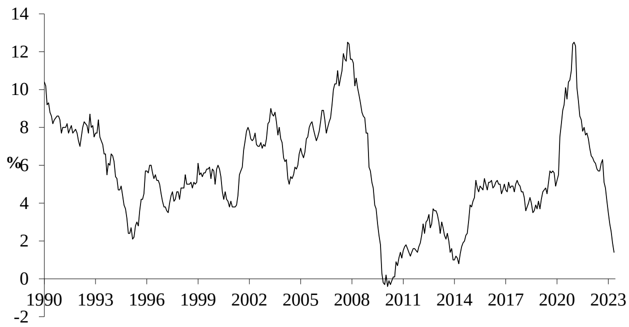
UK: M4 Growth



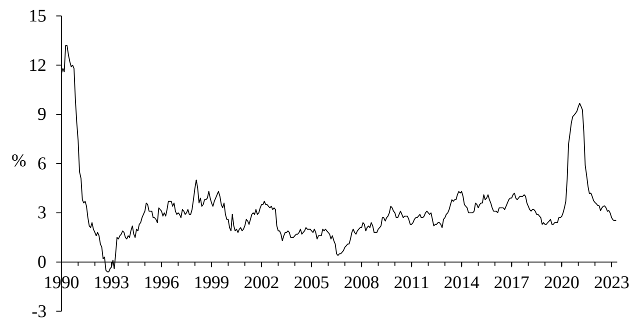
U.S.: Growth in M2 (Yr - on - Yr)



Eurozone M3 Growth



Japan: Growth of M2+CD's



FOCUS ON JAPAN

Francesco Perugini

Japanese yen is weakening

The yen plunged to a 15-year low against the Euro at the end of last month after the Bank of Japan (BOJ) kept its ultra-low interest rate policy unchanged (-0.1% short-term rate target and a 0% cap on the 10-year bond yield set under its yield curve control policy) and forecast that inflation will slow later this year. “We expect inflation to moderate, but the pace of decline is somewhat slow”, BOJ Governor Kazuo Ueda said at a press conference after the monetary policy board meeting. “We are closely watching currency moves with a strong sense of urgency, we will respond appropriately if it becomes excessive” he added. The yen also weakened about 12% against the US dollar. That’s the weakest it has been since November 19th, about a month before the BOJ “tweaked” its interest rate policy to allow 10-year Japan Government Bonds to rise to a maximum of 0.5%.

However, the prospect of it staying longer at current levels is already a cause for alarm for Japanese companies and consumers. While Japanese authorities say they are closely monitoring forex developments due to the importance of stable currency moves that reflect economic fundamentals, the yen’s recent weakness is largely due to the divergence of monetary policies between Japan and its peers in the US and Europe. Mr Ueda has been taking a neutral stance on the yen’s fall of late, calling it “positive for some sectors but negative for others”. But consumers are feeling the lagging effects of the yen’s precipitous fall since last year, as companies continue to pass on higher import costs to consumers, and Ueda has acknowledged that rising prices are “big burdens” on households. Indeed, a weak currency should improve exports while reducing imports and favour domestic growth. However, so far, the trade deficit in both real — price-adjusted — and nominal terms has increased in the last few quarters. This means that consumers are paying higher prices for needed imports of raw materials, energy, and other goods. This is also the main reason for the rise in consumer inflation.

So far, the yen’s depreciation (see chart below) has not been as rapid as when the Japanese authorities intervened in late 2022 when the currency yen breached 145 to the US dollar in September — on that occasion, the Japanese authorities carried out three yen-buying, dollar-selling operations spending over ¥9 trillion. However, analysts say the weak trend will likely persist in the coming months, at least until financial markets are convinced that the US Federal Reserve and the European Central Bank will pause raising interest rates. Some say the weaker yen can prompt the BOJ to tweak its monetary policy if the nation’s inflation becomes more entrenched. “For the time being, the yen is expected to stay at current levels relative to the other two (euro and dollar), and it won’t be until October or later that we will see a reversal of the trend and the yen will rise,” said Koji Fukaya, a fellow at consulting firm Market Risk Advisory Co. “The Fed’s policy stance (to seek higher interest rates) can keep the momentum for yen weakness. With that in mind, we should be on guard against the scrapping of yield curve control in July when the BOJ releases its quarterly outlook report and likely revises upward its inflation forecast,” echoed Yoshimasa Maruyama, chief economist at SMBC Nikko Securities Inc. However, firms expect the yen to strengthen against the US dollar. According to research firm Teikoku Databank, Japanese firms expect the dollar to average around 127 yen for fiscal 2023, while in the BOJ’s Tankan quarterly business survey — covering around 9,200 firms — the assumed rate for the dollar-yen pair was at around 131 yen as of March. The BOJ is set to release its next survey in July.

The dollar staying around 140 yen is also a headache for many Japanese firms, particularly importers. Inflation may slow, but relative price levels will be high, and this is a severe blow to households. So, there is increasing speculation that authorities may intervene in the market to support the currency. “Any rapid yen weakening, like toward 145 (to the U.S. dollar) in the short-term, might trigger an early (policy) adjustment as the BOJ is in favour of a stable yen move in tandem with the fundamentals,” said Daiju Aoki, chief investment officer for Japan, at UBS SuMi TRUST Wealth Management. Adam Cole, head of FX strategy at RBC Capital Markets, also believes that “the risk of an intervention is high, as the Japanese authorities were most concerned about import prices and the country’s high reliance on imported energy”.

Overall, for many years the weak yen was supportive of Japan’s export-oriented businesses, with many auto companies and manufacturers (primarily large-caps) benefiting significantly from increased competitiveness. But Japan is also a net energy importer and so started to import inflation as energy costs soared, putting pressure on the domestic consumer and undermining spending. As inflation has ticked higher in Japan, it remains to be seen if and what kind of measure the BOJ will take in the next monetary policy meeting in mid-July.

Yen watching

The yen touched a more than seven-month low versus the dollar on June 29, prompting concern about possible intervention in the currency market from the Bank of Japan.

Source: Refinitiv Eikon | Reuters, June 29, 2023 | By Pasit Kongkunakornkul

MARKET DEVELOPMENTS

With interest rates too high in this general policy panic, shared widely in the developed world, bond yields may well be peaking, offering good potential returns as an alternative to equities.

Table 1: Market Developments

	Market Levels Jun 7	Market Levels Jul 7	Prediction for Jul/Aug 2024 Previous Letter	Prediction for Jul/Aug 2024 Current View
Share Indices				
UK (FT 100)	7624	7257	7784	7409
US (S&P 500)	4272	4418	4579	4736
Germany (DAX 30)	15961	15603	20302	19848
Japan (Tokyo New)	2206	2255	3020	3087
Bond Yields (government				
UK	4.29	4.68	4.00	4.00
US	3.81	4.07	3.50	3.40
Germany	2.46	2.65	2.20	2.20
Japan	0.44	0.47	0.50	0.50
UK Index Linked	0.89	1.12	1.00	1.00
Exchange Rates				
UK ($ per £)	1.25	1.28	1.20	1.20
UK (trade weighted)	81.02	82.79	77.9	77.3
US (trade weighted)	108.69	108.48	113.2	113.2
Euro per $	0.93	0.91	0.98	0.98
Euro per £	1.16	1.17	1.18	1.18
Japan (Yen per $)	139.74	142.20	140.0	140.0
Short Term Interest Rates				
UK	4.92	5.46	4.00	4.00
US	5.51	55.4	4.30	4.30
Euro	3.48	3.61	3.00	3.00
Japan	–0.03	–0.03	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	2.10	1.1	3.0	–2.00		4.20
US	2.00	1.2	3.0	3.00	6.42	15.62
Germany	2.10	1.2	3.0	23.00	–0.42	28.88
Japan	1.90	1.1	1.8	34.00	7.86	46.66
UK indexed[2]	0.66		3.0	16.00		20.12
Hong Kong[3]	2.60	3.0	3.0	–39.00	6.42	–23.98
Malaysia	3.30	5.4	3.0	51.00	6.42	69.12
Singapore	3.50	3.0	3.0	15.00	6.42	30.92
India	1.40	6.5	3.0	10.00	6.42	27.32
Korea	1.10	0.0	3.0	–48.00	6.42	–37.48
Indonesia	2.20	4.5	3.0	19.00	6.42	35.12
Taiwan	2.80	3.0	3.0	20.00	6.42	35.22
Thailand	3.20	2.5	3.0	16.00	6.42	31.12

Bonds: Contribution to £ yield of:

	Redemption Yield	Changing Nominal Rates	Currency	Total
UK	4.68	6.67		11.44
US	4.07	6.66	6.42	17.14
Germany	2.65	4.51	–0.42	6.74
Japan	0.47	–0.29	7.86	8.04

Deposits: Contribution to £ yield of:

	Deposit Yield	Currency	Total
UK	5.46		5.46
US	5.54	6.42	11.96
Euro	3.61	–0.42	3.20
Japan	–0.03	7.86	7.84

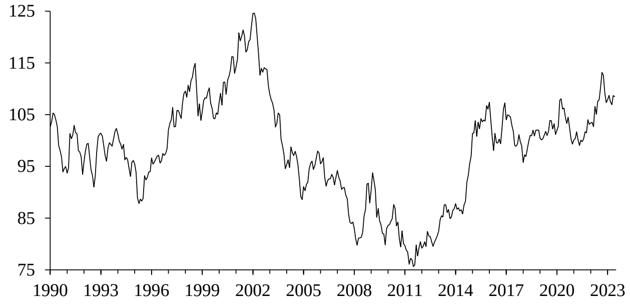
[1] Yields in terms of €s or $s can be computed by adjusting the £-based yields for the expected currency change.
[2] UK index linked bonds All Stocks
[3] Output based on China.

Table 3: Portfolio(%)

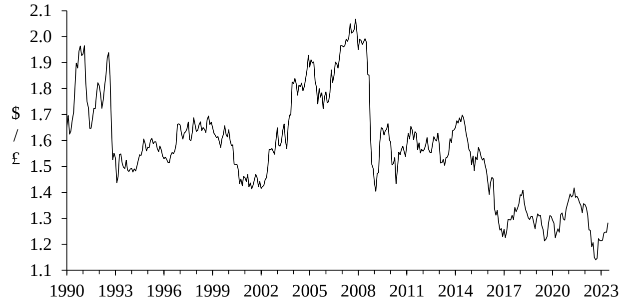
	Sterling Based Investor		Dollar Based Investor		Euro Based Investor	
	June Letter	Current View	June Letter	Current View	June Letter	Current View
UK Deposits (Cash)	5	5	5	5	1	1
US Deposits	-	-	-	-	-	-
Euro Deposits	-	-	-	-	-	-
Japanese Deposits	-	-	-	-	-	-
UK Bonds	-	-	-	-	-	-
US Bonds	-	-	-	-	-	-
German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

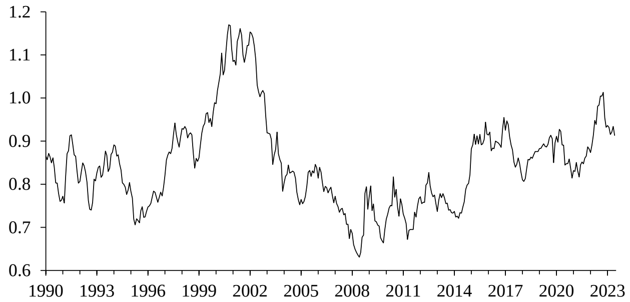
US : Trade Weighted Index
(Bank of England 1990 = 100)



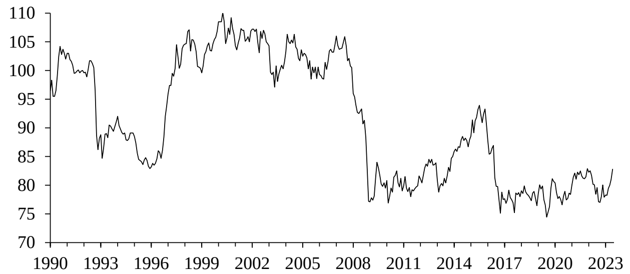
UK: Dollars Per Pound Sterling



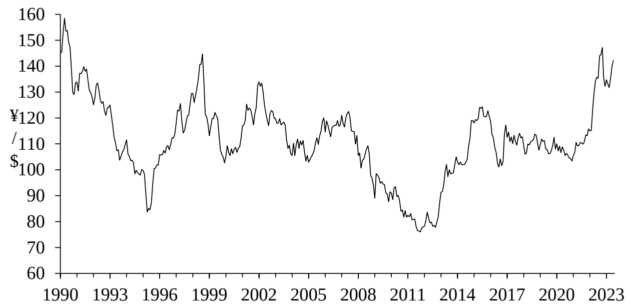
Euro per US dollar



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



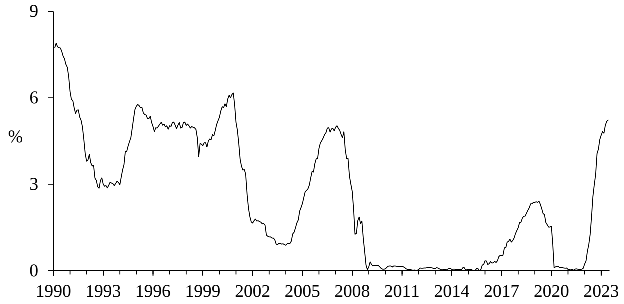
Japan : Yen Per U.S. Dollar



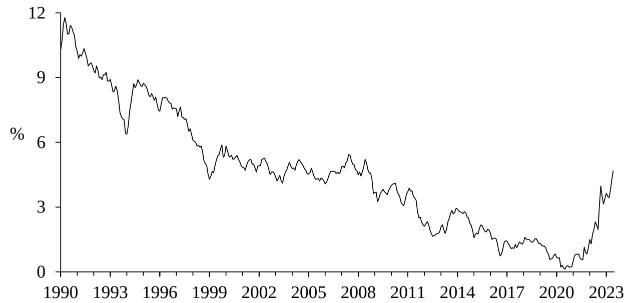
GOVERNMENT BOND MARKETS

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

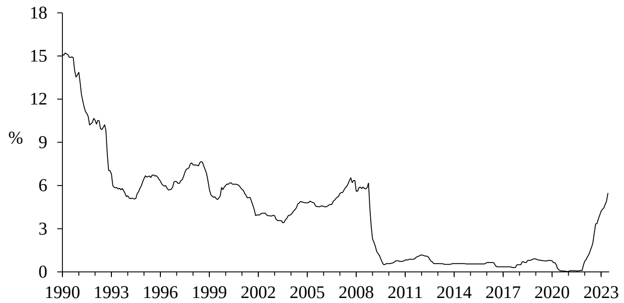
U.S. : 3-Month Treasury Bill



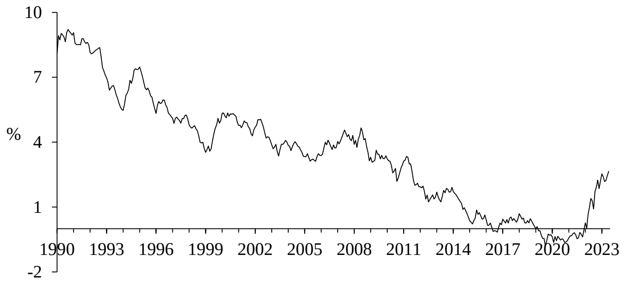
U.K.: Yield on Long-Term Government Bonds



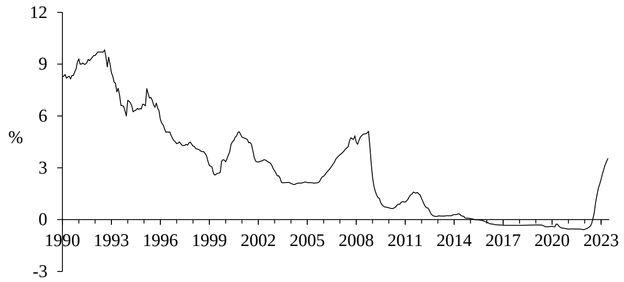
U.K. : 3-Month Certificate LIBOR Rate



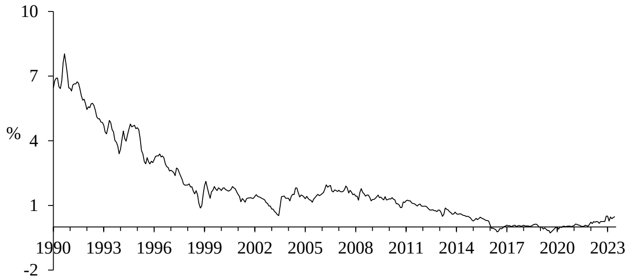
Germany: Yield on Public Authority Bonds



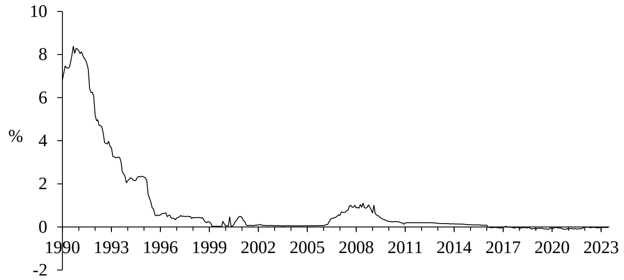
Germany : 3-Month Interbank Deposit Rate



Japan: Yield on Long-Term Government Bonds

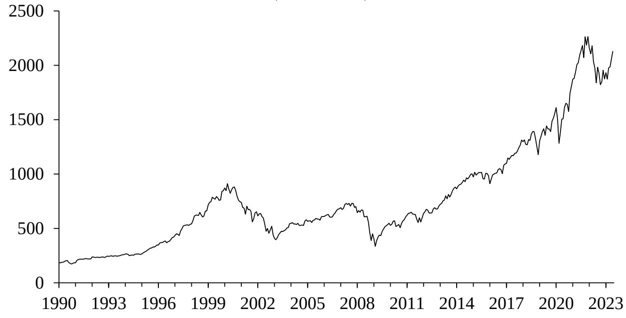


Japan : 3-Month Money Market Rate

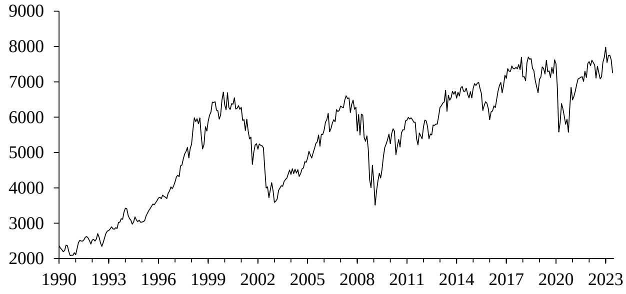


MAJOR EQUITY MARKETS

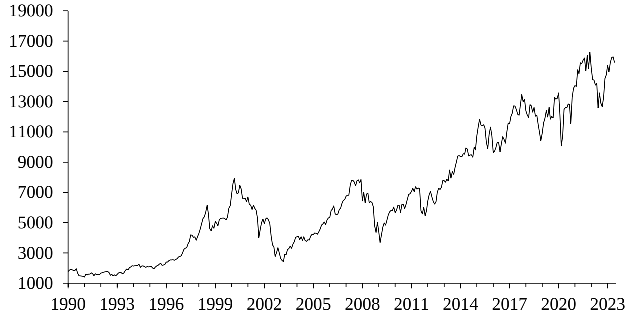
U.S. : S & P 400 Industrial
(1985=100)



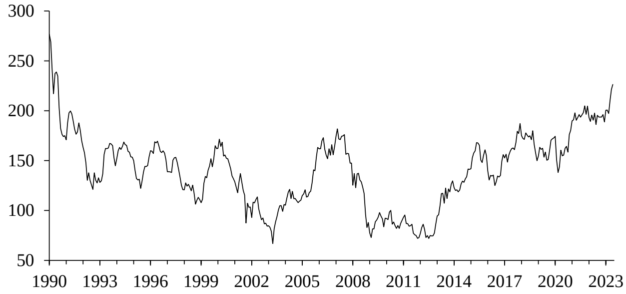
U.K. : FTSE-100 Index
(10 April 1962=100)



Germany : DAX 30



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



EMERGING MARKETS

Anupam Rastogi

India

India's economy is experiencing rapid growth and is ranked among the fastest-growing economies globally. Western companies seeking to decrease their reliance on China have presented a significant opportunity for Indian businesses. The government has swiftly introduced production-linked incentives and other schemes to support manufacturing. The introduction of the Goods and Services Tax (GST), a consumption tax, has led to fiscal buoyancy, with monthly collection figures consistently surpassing expectations.

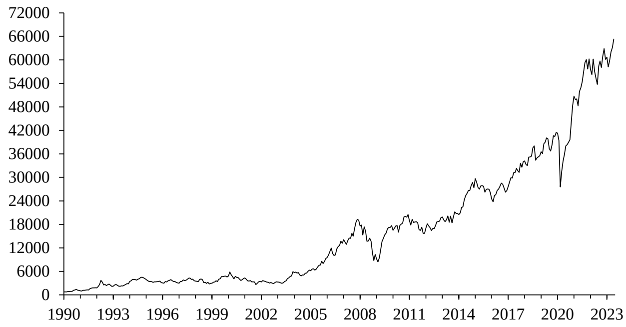
India is in the spotlight. It's difficult to stay out of the limelight with a gross domestic product of roughly $3.2 trillion and the world's biggest population of 1.4 billion people. Prime Minister Narendra Modi's first official state visit to the US, shaking hands with President Joe Biden and high-profile executives like Tesla Inc.'s Elon Musk, has caught the world's attention.

The S&P Global India Manufacturing Purchasing Managers' Index softened to 57.8 in June from 58.7 in May. The manufacturing PMI has now spent 24 consecutive months above the key level of 50 that separates expansion and contraction in activity. Positive client interest continued to support the manufacturing industry, driving the growth of output, employment, quantities of purchases and input stocks. India's manufacturing sector is being aided by the strength of its domestic economy, driving its outperformance.

India's service sector Purchasing Managers' Index declined to 61.2 in May from April's 62.0. It held at a pace as demand remained strong despite high inflationary pressures. The S&P Global India Services PMI outstripped the Reuters poll expectation of 60.0, according to a report published by Reuters. It marks the longest expansion streak in almost 12 years, with the index above the 50-mark that separates growth from expansion for 22 months.

The anticipated economic growth for the current fiscal year is approximately 6.5%, slightly lower than the 7.2% growth recorded in 2022–23. Several factors contribute to this slowdown, including a weaker external environment, decreased pent-up demand, and a softening of private consumption activity. Looking ahead, we expect India's average growth rate to be 6.7% until FY27, with consumer activity as the primary driver. In June, India experienced a 12% growth in gross GST collections, marking six years since the implementation of the GST in 2017. The direct tax collection in FY2022–23 increased 16% over the previous year. The investment sector is experiencing a

India: BSE Sensex



strong tailwind, and the investment outlook appears considerably more promising.

In May, retail inflation in India reached a low of 4.25%, the lowest in over two years, despite the influence of a high base effect. This decline was primarily driven by a significant decrease in food inflation, which reached an 18-month low of 2.9%. Notably, this marked the third consecutive month in which the rate of price increase remained below the Reserve Bank of India's (RBI) critical level of 6%. The inflation rate was 4.70% in April and 7.04% in May 2022. The RBI has been assigned to maintain inflation at 4% with a tolerance band of (+/-) 2%. As inflation is moderating, we do not anticipate the RBI rushing to reduce interest rates. It is likely that the central bank will wait until the end of 2023 before considering rate cuts, ensuring that inflation expectations are fully stabilized.

Furthermore, the wholesale price index (WPI) remained subdued for the second consecutive month, at 3.5% in May. It is also expected to have a lagged impact on retail price inflation. In terms of India's current account, as anticipated, it contracted to a seven-quarter low of US$1.4 billion or 0.2% of GDP in Q4FY23, compared to US$18.2 billion or 2% of GDP in the previous quarter. A significant decline in the merchandise trade primarily drove this contraction. However, the capital account surplus experienced a sharp decrease in Q4FY23, falling to US$6.5 billion from US$30.2 billion in the previous quarter. The external situation is projected to improve in FY24, supported by a reduced merchandise trade deficit due to lower commodity prices and sustained growth in services exports. However, subdued external demand may weigh on overall exports. The current account deficit (CAD) is expected to average around -1.5% of GDP in the current fiscal year and -1.8% in the following year, compared to -2.0% in the previous fiscal year. While there have been strong foreign capital inflows in FY24 thus far, these inflows may remain volatile due to heightened uncertainty in the financial markets. This, in turn, may exert pressure on the Indian rupee, although the buildup of foreign exchange reserves over the past few months should provide the necessary support.

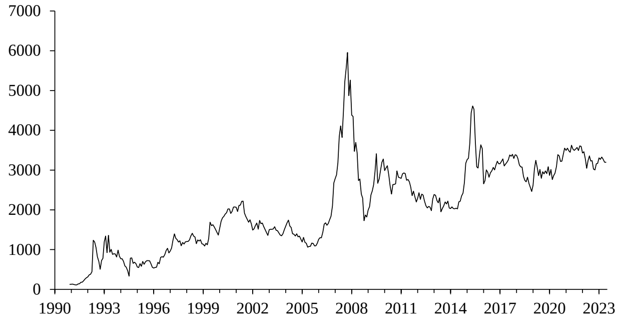
Indian equities have attracted almost $10 billion in net foreign inflows since March, on track to be the most in any quarter since the end of 2020. The Indian market's fundamentals are solid enough to continue to attract long-term investors. The FPIs have turned buyers in the current fiscal year after selling a combined ₹1.78 trillion ($21.6bn) in FY22 and FY23. We expect the Sensex to test its record high soon. For the first time in four years, FPIs are net buyers in the Indian markets. Low volatility in bond yields, a stable currency, and expectations of an upgrade to India's sovereign rating are driving the inflows. The bull run continues.

S&P in May affirmed its 'BBB–' long-term and 'A-3' short-term, unsolicited foreign and local currency sovereign credit ratings on India while retaining the outlook on the long-term rating at stable. Currently, India's rating remains constrained because of its weak fiscal performance. India's rating upgrade hinges on sustainable fiscal consolidation and low inflation. The government aims to cut its fiscal deficit to 5.9% of gross domestic product by the end of the current financial year.

India held reservations about its relationship with the United States for a considerable period, primarily due to the US's close military and security ties with Pakistan, which is India's arch rival. However, the dynamics between the two countries have significantly improved, primarily due to China's emergence as a new and formidable rival to the US. In recognition of India's strategic importance, the US has included India as a member of the Quad grouping, an alliance of the US, Japan, India, and Australia. Prime Minister Narendra Modi's US visit has proven successful, extending beyond mere symbolic gestures. One of the most significant concrete outcomes of the visit is the agreement signed between India's Hindustan Aeronautics Ltd (HAL) and the American industrial giant GE. This agreement aims to jointly produce GE's F414 jet engine for HAL's upgraded light combat aircraft, Tejas Mk 2. As part of the deal, GE has committed to increasing the transfer of technology for jet engine manufacturing from the initial 58% agreed upon in the 2012 deal to 80%. While some critical components will still be produced in the US and supplied to HAL, this partnership marks a significant step forward in the collaboration between India and the US in the aerospace sector.

Many observers often consider India's friendly relationship with Russia perplexing. This relationship is primarily founded on economic and military interests. The military bond between the two countries extends to areas such as spare parts and maintenance, and severing this bond would come at a significant cost. Ongoing border tensions with both Pakistan and China further emphasize the importance for New Delhi to preserve its supply chain. Understanding this backdrop is crucial in comprehending why India is considered a crucial ally for the United States in the evolving global landscape. The US views China as a systemic rival and aims to curb it is rapidly expanding strategic capabilities. In this context, Washington sees India as a key partner to counterbalance China's influence in the Indo-Pacific region. India possesses substantial economic, technological, and military capabilities, positioning it as a potential counterweight to China in the Indo-Pacific. Furthermore, India's assertiveness under Prime Minister Narendra Modi has proactively pursued alliances that advance its interests. In the eyes of countries in the Indo-Pacific, India is perceived as a non-threatening force that can counter China, making it an attractive partner for collaboration.

China: SSE Composite Index



The concept of "Indimerica" is evolving, and only time will reveal its true nature and extent. However, the United States sees India as an indispensable partner in various domains, including the future of artificial intelligence (AI), quantum computing, and the establishment of robust supply chains for clean energy technologies, semiconductors, and other critical emerging technologies. The US considers India as the most significant partner both presently and in the future in these areas. Similar to the US partnerships formed with China, Japan, South Korea, and Taiwan in the past to counter the Soviet Union, the growing camaraderie between the US and India is primarily directed at China. From India's perspective, there is also a convergence of interests with the US. The objective is not only to contain China but also to foster economic development within India. Both countries see mutual benefits in this partnership, aligning their interests and aspirations. However, whether this partnership will ultimately lead to an "Indimerica" alliance or a different form of collaboration remains uncertain and can only be determined with time.

	22–23	23-24	24-25	25-26	26-27
GDP (%p.a.)	7.0	6.5	6.6	6.7	6.8
WPI (%p.a.)	6.5	5.3	5.0	4.2	4.0
Current A/c(US$ bill.)	-100.0	-70.0	-40.0	0.0	0.0
Rs./$(nom.)	81.0	82.0	83.5	85.0	85.0

China

Despite expectations of a robust economic recovery in China this year following the easing of strict Covid-19 controls, the reality has been quite different. The country is grappling with several challenges, including sluggish consumer spending, a troubled property market, declining exports, high levels of youth unemployment, and significant local government debt. President Xi Jinping's government faces a complex situation with limited viable solutions. As we reach the midpoint of 2023, the confluence of these issues is amplifying their impact, not only within China but also reverberating globally. These strains affect various aspects, including commodity prices and equity markets, signalling the interconnectedness of the global economy and the influence on China's economic performance.

The weakening consumer sentiment in China can be attributed mainly to the state of the property market. The decline in the market came after the government's efforts in 2020 to address the issue of high debt among real estate developers and mitigate risks. These measures decreased housing prices and resulted in several financially vulnerable companies defaulting. Additionally, many developers halted construction on homes that had been sold but not yet delivered, causing some homeowners to stop making mortgage payments. This situation has created uncertainty and financial strain among consumers, impacting their confidence and willingness to spend.

Our GDP growth forecast for China remains unchanged at 5% for 2023 and 4.8% for 2024. The manufacturing sector in China contracted for the third consecutive month in June, accompanied by a weakening nonmanufacturing sector, which experienced a decline in new orders. The official manufacturing Purchasing Managers' Index (PMI) increased slightly to 49 in June from 48.8 in May. However, activities in the services sector, which has been a significant driver of China's post-pandemic recovery, further softened in June, with a PMI reading of 52.8, down from 53.8 in May.

China's consumer inflation rate eased to zero in June, and factory-gate prices continued to decline, indicating persistent weakness in demand and raising concerns about potential deflationary pressures in the economy. China's major banks have reduced interest rates for the country's $453 billion corporate US dollar deposits for the second time in weeks. Furthermore, producer prices experienced a 5.4% decrease in June, compared to a 4.6% decline in the previous month. These trends underscore the ongoing challenges facing China's economy and the need for continued efforts to stimulate growth and address weak demand.

The People's Bank of China (PBOC) has made several key monetary policy adjustments. Firstly, it has lowered the rate on one-year medium-term lending facility (MLF) loans to financial institutions from 2.75% to 2.65%. The MLF interest rate is a guide for the loan prime rate, the benchmark lending rate for households and businesses. Additionally, the PBOC has reduced the interest rate on seven-day reverse repurchase operations from 2.0% to 1.9%, marking its first cut in short-term lending rates since August 2022. To support liquidity, the central bank has injected 2 billion yuan (approximately $280 million) into the banking system at the revised lower rate.

Regarding personnel changes, Pan Gongsheng has been appointed as the top Communist Party official at the People's Bank of China, setting the stage for his potential promotion to the position of governor.

The Chinese yuan has depreciated, approaching a seven-month low against the dollar. It has declined by nearly 5% against the dollar this year, making it one of the worst-performing currencies in Asia. Last year, the yuan experienced a significant drop, breaking the 7.30 mark against the dollar for the first time since 2007. The factors influencing the yuan's performance against the dollar are the interest rate differential between China and the US and the growth trajectory of the Chinese economy, both of which are currently unfavourable for the yuan. China's central bank, the PBOC, has pledged to curb speculation and utilize various tools, such as adjusting macroprudential factors and foreign-exchange risk reserves to stabilize the currency.

The MSCI China Index initially showed promise with a 12% rally in January but has given up all of its gains for the year and is currently down approximately 6% in 2023. It is anticipated to face challenges in reclaiming previous levels seen earlier in the year.

The visit of US Secretary of State Antony Blinken to Beijing was deemed a limited success, as it signalled a resumption of high-level discussions between the US and China. Chinese President Xi Jinping indicated a shared interest in stabilizing the relationship between the two powers. However, it is important to note that this does not suggest China is abandoning its long-term goal of asserting its primacy. While Xi's meeting with Blinken indicates a reluctant acceptance of the new status quo, tensions and competition between the two nations persist.

China has also faced difficulties in disrupting the growing network of security cooperation established by the US in the region. American allies and swing states in Asia welcome US engagement but express concerns about excessive competition and its potential to disrupt the regional economy. Blinken's visit to Beijing aimed to demonstrate Washington's intent to limit and manage the consequences of US-China competition. The refusal to engage with Blinken would hold Beijing responsible for any further deterioration in the regional environment.

During a trip to Beijing, US Treasury Secretary Janet Yellen expressed the US's desire for mutually beneficial economic competition and sought to find common economic ground while opening communication channels amidst the turbulent US-China relations.

The National Counterintelligence and Security Center has cautioned US companies about the vagueness of China's revised law regarding espionage, which grants the government increased access and control over companies' data. It raises concerns that normal business activities could be considered criminal acts. The Chinese government has stated that foreign businesses' rights are protected under Chinese law as long as they abide by the regulations. China has implemented a series of national cybersecurity and data privacy laws and regulations that expand its oversight of foreign companies operating within the country.

	22	23	24	25	26
GDP (%p.a.)	3.0	5.0	4.8	4.0	3.5
Inflation (%p.a.)	2.0	2.2	1.5	2.0	2.2
Trade Balance(US$ bill.)	420.0	255.0	150.0	100.0	50.0
Rmb/$(nom.)	6.8	7.1	7.2	7.3	7.4

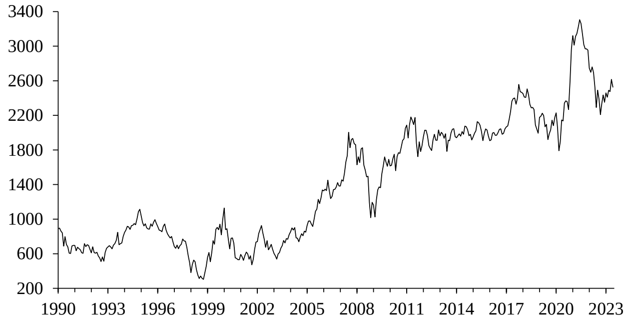
South Korea

South Korea has revised its growth outlook for 2023, citing uncertainties surrounding the momentum of China and the US, the world's two largest economies. The country's finance ministry predicts a GDP expansion of 1.4% this year, down from the 1.6% forecast in December. However, our GDP growth forecast remains at 1% for 2023 and 2.5% for 2024. The anticipated rebound in 2024 will be driven by a realignment of trade world-wide as China's exports decrease. Private consumption is expected to gradually recover in 2023, with a 2.5% rise, supported by increased outdoor activities, robust job growth, and improved consumer sentiment. The ministry's downward revision in growth projections follows a sluggish first half of the year, characterized by a drop in export demand due to a weaker-than-expected recovery in China's economy and a global economic slowdown. Government analysts foresee South Korea bouncing back in 2024, driven by increased worldwide demand for semiconductors and sustained growth in private consumption.

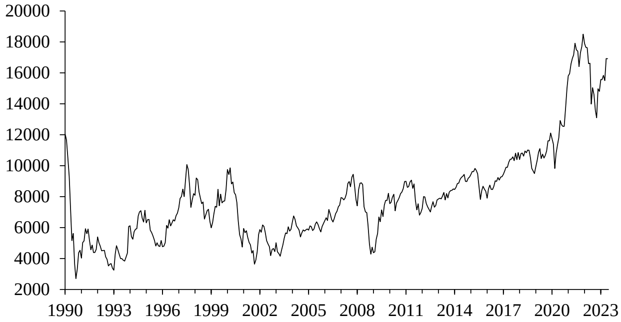
Inflation in South Korea eased for the fifth consecutive month in June, while the Consumer Sentiment Index reached its highest level since May 2022. However, the Bank of Korea (BOK) warned of a potential increase in inflation later in the year. The slowdown in June's inflation is unlikely to influence the BOK's policy stance, as it is expected to maintain its restrictive policy until there is a clear indication that the Consumer Price Index is safely within its target range. The BOK has kept its policy rate unchanged at 3.5% in its recent meetings, waiting for a sustained deceleration in price increases.

South Korea's export decline slowed in June, with auto exports experiencing robust growth and semiconductor exports narrowing their decline. It resulted in the country's first trade surplus since early 2022. Shipments from South Korea fell by 6.0% in June compared to the previous year, a narrower decline than the 15.2% drop in May. Imports also fell by 11.7% in June, a smaller decrease than the 14% fall in the previous month. Consequently, South Korea achieved a trade surplus of $1.13 billion in June, ending 15 months of deficits for the export-dependent economy.

Korea: Composite Index



Taiwan: Weighted TAIEX Price Index



In other news, the Biden administration plans to allow top semiconductor manufacturers from South Korea and Taiwan to maintain and expand their chip-making operations in China without facing retaliatory actions from the US. Additionally, after its annual review, South Korea will remain on MSCI's list of emerging markets, thwarting its bid to upgrade to developed-market status. This decision was widely anticipated after MSCI identified nine market accessibility issues in the country's economy. Furthermore, South Korea will allow new domestic players to enter its banking industry for the first time in 30 years.

	22	23	24	25	26
GDP (%p.a.)	2.6	1.0	2.5	2.5	2.4
Inflation (%p.a.)	5.1	4.0	3.0	2.5	2.5
Current A/c(US$ bill.)	50.0	40.0	35.0	30.0	30.0
Won/$(nom.)	1450	1300	1300	1350	1400

Taiwan

Taiwan has revised its economic growth forecast for the year to 2%, the slowest pace in nearly eight years, following its entry into a recession in the first quarter. The island's economy contracted by 2.9% in the January-to-March period, marking its worst performance since the global financial crisis. However, there have been signs of a consumption pickup, with shopping, dining, and travel rebounding as post-pandemic tourism recovers. We anticipate that the economy will shrink by half a percentage point as the trade-dependent nation grapples with slowing demand for its tech exports.

The central bank has raised its 2023 inflation forecast to 2.24%. As the economy continues to contract, prices will ease in the year's second half. We anticipate that the central bank will shift its focus towards supporting demand, and it is likely to reduce the base rate by 12.5 basis points in September as part of its efforts to revive the economy. In its latest meeting, the bank maintained its benchmark discount rate at 1.875%, marking its first pause since December 2021. Governor Yang Chin-long downplayed the need for further rate hikes this year. The secured loan rate remained unchanged at 2.250%, and the unsecured loan rate remained at 4.125%.

In January 2024, New Taipei City Mayor Hou Yu-ih, representing the opposition Kuomintang, will face off against Lai Ching-te, the head of the ruling Democratic Progressive Party and Taiwan's vice-president, in the presidential race. President Tsai Ing-wen will step down after completing eight years in office, as she is barred from running for a third term. The upcoming presidential elections raise questions about how Taiwan, an island democracy, will strengthen its defences against potential military aggression from China. Russia's recent invasion of Ukraine provides Taiwan with essential lessons, as some view the possibility of defeating an invincible foe by standing firm. In contrast, others believe Taiwan should avoid provoking Beijing, even if it means making painful compromises. The CIA estimates that China has set 2027 as the deadline to be prepared for a potential takeover of the island, home to a significant portion of the world's advanced semiconductor production capacity.

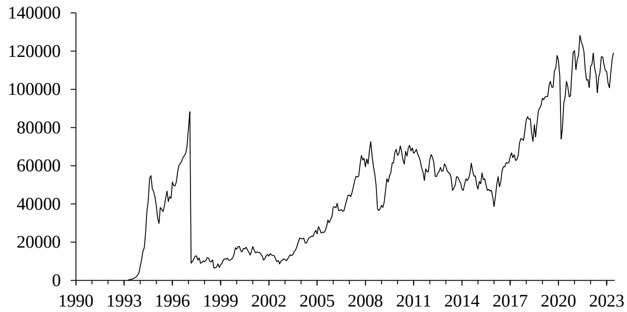
China has imposed restrictions on the exports of gallium, germanium, and over three dozen related metals and materials used in high-performance chips. These minerals and materials will be subject to unspecified export controls starting August 1. Industry executives perceive this export ban as a retaliatory measure, with the Biden administration making it challenging for China to purchase lithography machines required for producing high-performance chips. The US House of Representatives has passed legislation to implement a new trade initiative between the United States and Taiwan to enhance bilateral trade. The legislation is now awaiting consideration in the Senate.

	22	**23**	**24**	**25**	**26**
GDP (%p.a.)	2.5	-0.5	1.5	2.0	2.3
Inflation (%p.a.)	2.9	2.2	1.6	1.4	1.2
Current A/c(US$ bill.)	90.0	65.0	60.0	60.0	60.0
NT$/$(nom.)	32.0	31.0	30.5	30.5	30.5

Brazil

Brazil is experiencing more substantial growth than initially expected, and we hope the country to achieve a GDP growth rate of 2% in 2023 and 2024. This forecast aligns with the central bank's projection.

Brazil: Bovespa



In early June, annual inflation in Brazil slowed to its lowest level since September 2020, rising by 3.4% compared to the previous year. Monthly inflation stood at 0.04%. Brazil's long-term inflation outlook has improved for the third consecutive week, as the government has announced its commitment to maintaining a 3% inflation target through 2026. This decision to keep the target unchanged instils confidence in monetary policy. We expect interest rates to decrease to 12.25% this year and decline to 9.5% by the end of 2024. The two nominees for the central bank's board chosen by President Lula, including former deputy Finance Minister Gabriel Galipolo, are likely to participate in the rate decision meeting in August. Galipolo is expected to advocate for lower borrowing costs.

The central bank's dovish stance follows its decision in June to maintain benchmark rates at a six-year high of 13.75% for the seventh consecutive meeting, which drew criticism from government officials who believed it hindered economic growth.

Brazil's lower house has also approved a proposal to overhaul the country's complex tax rules, leading to a rally in the local stock and currency markets. The tax reform, a longstanding goal of President Lula da Silva's administration, still needs to clear several hurdles. As a proposed constitutional amendment, it must pass two votes in the Senate, and there is a possibility that it may have to return to the lower house if senators make changes to the bill. Lula and his economic team view this tax reform as crucial to their broader efforts to strengthen Brazil's public finances.

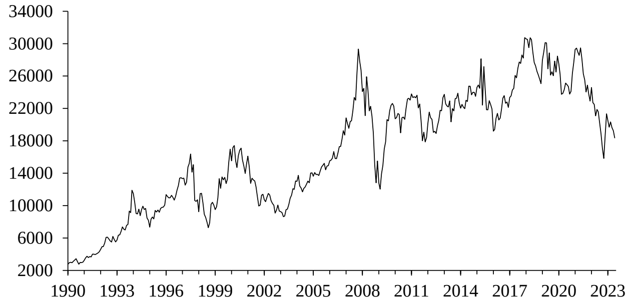
It should be noted that if the tax reform becomes law, full implementation will take several years. According to the current proposal, the new tax structure would begin in 2026, but the complete transition is not expected to be finalized until 2033. The plan aims to consolidate five existing consumption levies into two new value-added taxes (VATs), one administered by the federal government and the other collecting revenues for states and municipalities. The proposal also includes provisions to compensate states that may experience revenue losses due to the overhaul.

Furthermore, the administration of President Lula da Silva is working on a proposal to establish a regulated cap-and-trade system for carbon emissions. This approach differs from the approach taken by his predecessor Jair Bolsonaro, who relied on the private sector to develop the basis for a carbon market, which did not materialize. The proposed system would set emission caps for certain industries and allow companies to offset excess pollution by purchasing allowances from those exceeding their emission reduction requirements. Each credit would represent the removal or prevention of one million metric tons of carbon dioxide from the atmosphere. Over time, the cap would be progressively lowered to reduce emissions.

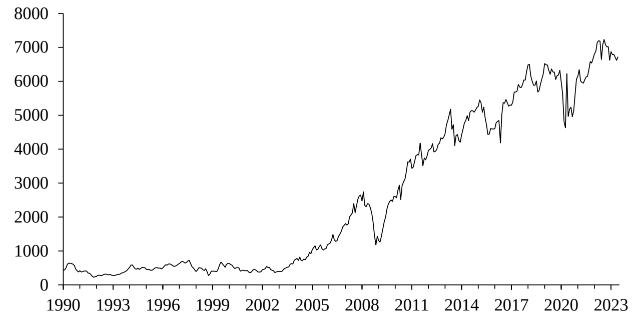
	22	**23**	**24**	**25**	**26**
GDP (%p.a.)	2.9	2.0	2.0	2.5	3.0
Inflation (%p.a.)	8.0	4.0	4.0	4.2	4.2
Current A/c(US$ bill.)	-10.0	-12.0	-20.0	-10.0	-10.0
Real/$(nom.)	5.2	5.0	5.2	5.2	5.2

Other Emerging Markets

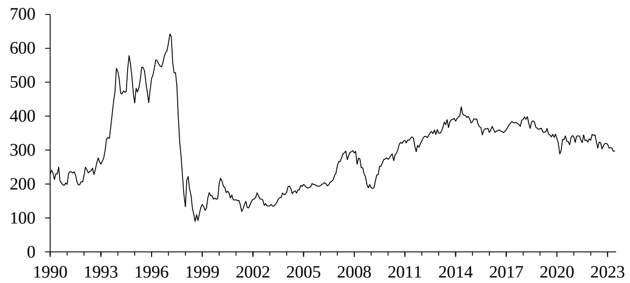
Hong Kong: FT-Actuaries



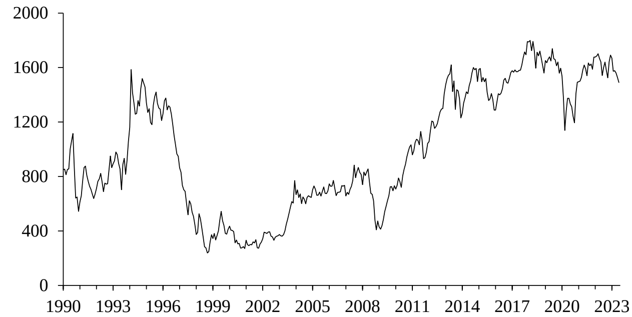
Indonesia: Jakarta Composite



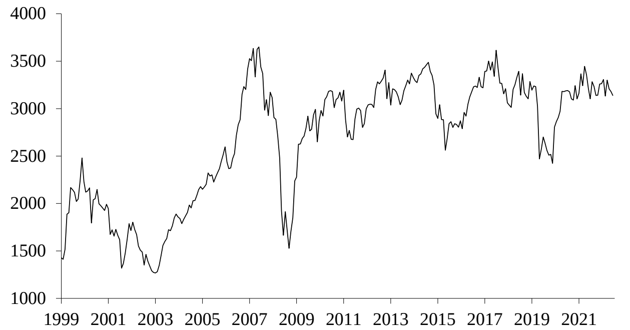
Malaysia: FT-Actuaries (US$ Index)



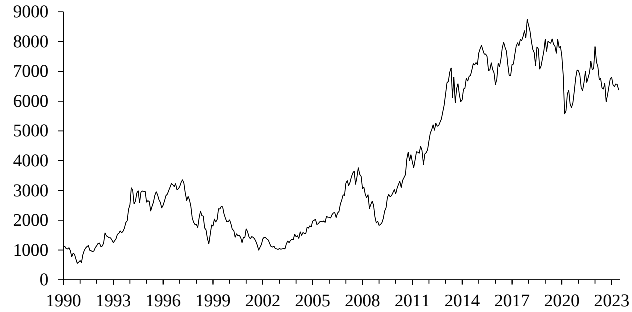
Thailand: Composite Index



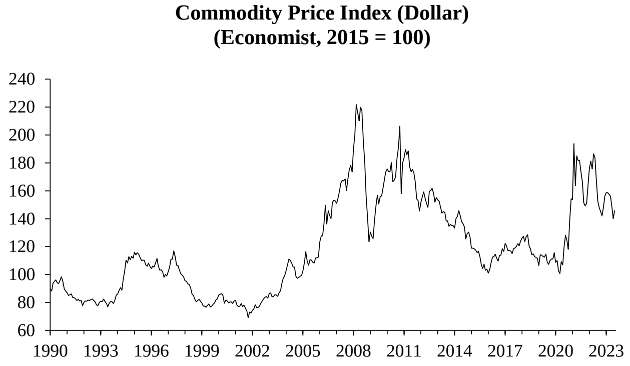
Singapore: Straits Times Index

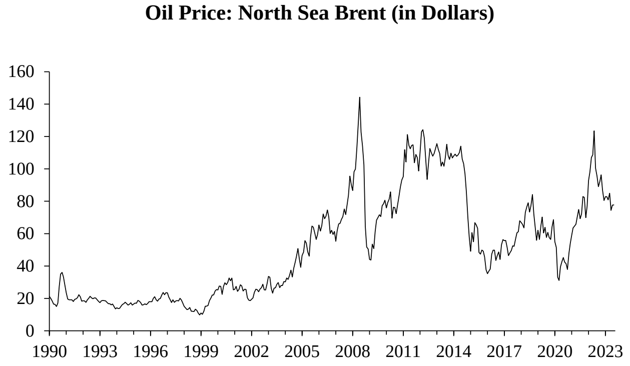


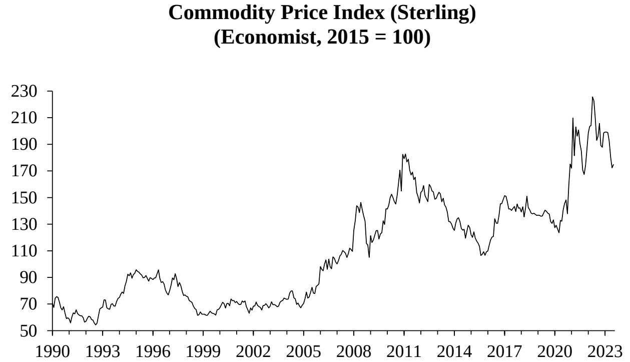
Philippines: Manila Composite

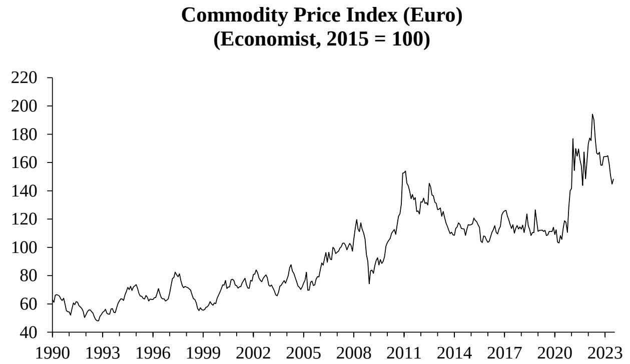


COMMODITY MARKETS









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]
2020	1.0	0.1	0.2	78.2	72.9	-1.3	1.5	-1.4
2021	2.5	0.4	0.1	81.4	78.0	-6.4	4.1	-5.7
2022	9.1	2.3	1.8	79.7	81.8	-6.7	11.4	-6.2
2023	6.4	4.3	4.4	78.1	82.7	0.6	9.3	0.5
2024	3.2	4.0	4.0	77.4	84.2	1.6	4.6	1.6
2025	2.0	3.0	3.0	76.8	84.9	1.0	2.8	1.0
2022:1	6.2	1.4	0.8	82.3	81.9	-9.3	8.4	-8.7
2022:2	9.2	2.1	1.4	80.2	81.8	-8.0	11.5	-7.3
2022:3	10.1	2.8	2.0	78.2	81.7	-6.1	12.4	-5.3
2022:4	10.8	3.0	3.0	78.1	81.6	-3.4	13.9	-3.4
2023:1	10.3	4.0	4.2	78.0	81.1	-0.7	13.5	-0.7
2023:2	6.3	4.1	4.5	77.5	82.6	0.6	9.0	0.1
2023:3	5.0	4.5	4.5	77.9	83.7	1.1	8.4	1.1
2023:4	4.1	4.5	4.5	77.5	83.6	1.3	6.3	1.3
2024:1	3.5	4.0	4.0	77.9	83.5	1.2	5.5	1.2
2024:2	3.2	4.0	4.0	77.3	84.3	1.5	5.0	1.5
2024:3	3.0	4.0	4.0	77.3	84.5	1.8	4.0	1.8
2024:4	3.0	4.0	4.0	77.1	84.3	2.0	4.0	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)
2020	279.1	1.6	4.5	1.3	149.7
2021	295.0	5.9	4.5	1.3	154.8
2022	314.5	6.0	3.6	1.0	150.2
2023	327.5	5.4	3.5	0.9	150.7
2024	338.9	3.4	2.8	0.7	151.0
2025	338.9	3.0	2.8	0.7	152.6
2022:1	308.5	5.9	3.7	1.0	154.8
2022:2	307.5	6.2	3.8	1.1	149.0
2022:3	315.5	5.8	3.7	0.9	149.0
2022:4	317.2	6.3	3.7	0.9	147.8
2023:1	323.9	5.9	3.8	1.0	153.8
2023:2	321.0	5.6	3.6	1.0	149.2
2023:3	329.3	5.0	3.4	0.9	150.4
2023:4	329.9	5.1	3.2	0.9	149.4
2024:1	335.9	3.9	2.9	0.8	154.4
2024:2	331.3	3.7	2.8	0.7	150.0
2024:3	339.2	2.9	2.8	0.7	150.3
2024:4	339.8	3.1	2.8	0.7	149.5

[1] Whole Economy
[2] Average Earnings
[3] 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
2020	149.0	713432.6	427576.4	244157.8	199232.3	-33095.4	124438.5
2021	160.2	767344.3	453969.6	258155.2	224537.2	-36883.0	132434.5
2022	166.8	798577.4	473683.2	257528.5	228362.6	-23838.4	137158.1
2023	166.1	795317.2	475719.5	248799.5	225311.5	-18632.0	135881.3
2024	169.5	811597.0	489778.6	243503.8	232154.4	-15890.1	137949.7
2025	172.9	827988.2	505714.4	242189.8	239194.3	-18456.2	140654.2
2020/19	-11.0		-10.1	-16.2	-4.8		5.0
2021/20	7.5		6.2	-1.0	4.8		6.4
2022/21	4.2		4.3	-5.6	3.1		3.6
2023/22	-0.4		0.4	-1.5	3.0		-0.9
2024/23	2.0		3.0	9.9	3.0		1.5
2025/24	2.0		3.3	-16.2	-4.8		2.0
2022:1	167.2	200167.8	118589.6	68746.5	56345.5	-9205.1	34308.7
2022:2	167.4	200403.4	118225.6	62024.6	57458.7	-2866.9	34438.6
2022:3	165.2	197801.6	118034.3	62937.1	56975.0	-6092.0	34052.8
2022:4	167.2	200204.7	118833.7	63820.2	57583.3	-5674.5	34358.0
2023:1	165.8	198481.4	118824.7	69129.5	55701.1	-11222.9	33951.0
2023:2	166.4	199201.0	118812.9	60935.7	56116.4	-2756.3	33907.7
2023:3	166.3	199048.6	118801.0	59953.0	56538.3	-2249.7	33994.0
2023:4	165.9	198586.2	119280.9	58781.4	56955.7	-2403.2	34028.6
2024:1	167.7	200740.0	120213.3	67069.4	57389.5	-9638.5	34293.7
2024:2	169.4	202819.3	122254.5	59537.5	57819.9	-2462.3	34330.3
2024:3	170.2	203787.8	123116.9	58859.8	58254.1	-1824.2	34618.8
2024:4	170.6	204249.9	124193.9	58037.1	58690.9	-1965.1	34706.9

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	Current Account (£ bn)
2020	15.6	2068.0	312.7	-67.5
2021	5.2	2412.6	122.3	-34.3
2022	5.6	2695.1	152.0	-93.9
2023	1.6	2831.6	45.9	-24.2
2024	1.3	2982.6	38.8	-14.7
2025	0.6	3133.2	19.6	1.5
2022:1	0.0	633.6	-0.1	-50.5
2022:2	6.4	656.3	41.9	-28.2
2022:3	4.0	660.4	26.5	-12.7
2022:4	8.1	685.2	55.5	-2.5
2023:1	4.1	693.1	28.1	-9.6
2023:2	1.9	696.3	13.2	-9.8
2023:3	1.8	700.8	12.3	-3.3
2023:4	1.5	709.8	10.3	-1.5
2024:1	1.4	724.8	10.1	-7.3
2024:2	1.4	732.3	10.0	-8.6
2024:3	1.3	739.4	9.8	0.1
2024:4	1.3	753.1	9.5	1.1

1 GDP at market prices (Financial Year)

WORLD FORECAST DETAIL

Growth Of Real GNP

	2019	2020	2021	2022	2023	2024
U.S.A.	2.2	–2.8	5.9	2.1	0.7	1.2
U.K.	1.4	–11.0	7.5	4.2	–0.4	2.0
Japan	–0.4	–4.3	2.2	1.0	1.1	1.1
Germany	1.1	–3.7	2.6	1.9	–0.3	1.4
France	1.9	–7.9	6.8	2.5	0.3	0.6
Italy	0.5	–9.1	6.6	3.3	–0.1	0.3

Growth Of Consumer Prices

	2019	2020	2021	2022	2023	2024
U.S.A.	1.8	1.3	4.7	8.0	3.9	2.5
U.K.	1.7	1.0	2.5	9.1	6.4	3.2
Japan	0.5	0.0	–0.2	2.5	2.1	1.2
Germany	1.4	0.5	3.1	7.9	6.2	2.7
France	1.1	0.4	1.7	5.4	4.0	2.0
Italy	0.6	–0.1	1.9	7.6	5.0	2.4

Real Short-Term Interest Rates

	2019	2020	2021	2022	2023	2024
U.S.A.	0.2	–4.6	–7.1	–1.7	2.4	2.0
U.K.	–0.7	–1.3	–6.4	–6.7	0.6	1.6
Japan	0.1	0.3	–2.4	–2.1	–1.1	–1.4
Germany	–0.9	–3.6	–8.5	–5.9	0.4	0.5
France	–0.8	–2.2	–6.0	–3.7	1.1	0.8
Italy	–0.3	–2.4	–8.2	–4.7	0.7	0.7

Nominal Short-Term Interest Rates

	2019	2020	2021	2022	2023	2024
U.S.A.	1.5	0.1	0.1	2.2	4.9	4.0
U.K.	0.8	0.2	0.1	1.8	4.4	4.0
Japan	0.1	0.1	0.1	0.0	0.1	0.1
Germany	–0.4	–0.5	–0.6	0.3	3.1	2.8
France	–0.4	–0.5	–0.6	0.3	3.1	2.8
Italy	–0.4	–0.5	–0.6	0.3	3.1	2.8

Real Long-Term Interest Rates

	2019	2020	2021	2022	2023	2024
U.S.A.	–2.2	–3.3	–2.1	1.3	1.5	1.2
U.K.	–0.4	–1.4	–5.7	–6.2	0.5	1.6
Japan	–1.1	–1.3	–1.7	–1.5	–1.1	–1.3
Germany	–4.3	–5.0	–4.4	–0.9	0.1	0.0
France	–2.6	–3.3	–2.9	–0.6	0.9	0.7
Italy	–2.0	–3.3	–2.6	0.3	2.3	2.2

Nominal Long-Term Interest Rates

	2019	2020	2021	2022	2023	2024
U.S.A.	1.9	0.9	1.6	3.8	3.6	3.2
U.K.	0.6	0.1	0.4	2.3	4.3	4.0
Japan	0.0	0.0	0.1	0.2	0.5	0.5
Germany	–0.2	–0.6	–0.2	2.1	2.3	2.1
France	0.1	–0.3	0.2	1.8	2.9	2.7
Italy	1.4	0.5	1.2	3.0	4.4	4.2

Index Of Real Exchange Rate (2010=100)[1]

	2019	2020	2021	2022	2023	2024
U.S.A.	117.1	118.7	116.1	128.3	128.0	128.5
U.K.	99.5	99.6	106.5	111.8	111.6	113.7
Japan	77.0	77.8	71.0	59.9	59.2	59.3
Germany	96.0	97.1	97.9	95.0	95.1	95.4
France	93.9	94.7	94.0	89.6	89.5	89.0
Italy	95.0	95.4	95.1	91.6	91.3	89.9

[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)

	2019	2020	2021	2022	2023	2024
U.S.A.[1]	122.52	124.77	119.77	127.34	126.90	127.40
U.K.	1.28	1.29	1.37	1.22	1.21	1.24
Japan	109.10	106.60	110.45	133.10	136.20	137.80
Eurozone	0.89	0.87	0.85	0.95	0.98	0.99

[1] The series for the USA is a nominal broad U.S dollar index (2010=100); the series for the UK is $ per £

* Forecasts based on the Liverpool World Model