LIVERPOOL INVESTMENT LETTER

February 2024

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Julian Hodge Institute of Applied Macroeconomics

LIVERPOOL RESEARCH GROUP IN MACROECONOMICS

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Editorial and Research Direction: Patrick Minford[†].

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

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

[†] Cardiff Business School

[‡] Centre for Innovation and Entrepreneurship, Università Politecnica delle Marche

[⁑] School of Business Management, NMIMS University, Mumbai

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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CONTENTS

INFLATION, MONETARY POLICY AND FORECASTING

Across the developed world we have seen largescale instability in the growth of money and credit. We measure these every month in this Letter. The charts below show how these growth rates surged during the pandemic to rates of 10-30%, and have since fallen sharply as central banks reversed their interest rate policies dramatically in the wake of the resulting inflation; now growth year on year is negative across the developed world. This means the money and credit are actually contracting month on month.

This instability is highly dangerous to general economic stability. First, it has given us a Big Dipper in inflation, first surging to over 10%, causing societal dislocation, as people try to cope with huge unexpected falls in living standard. Second, as inflation plunges under the pressure of greatly tightening policy, there is a severe threat to private sector balance sheets as asset prices plunge — led by long term bonds, with equities following intermittently. The problem with this balance sheet contraction is that it threatens another financial crisis; we simply do not know if and when the financial fabric will tear, with a serious bankruptcy or banking run. We are already seeing a property crisis play out in China, with the collapse of Ever Grande, owing unrecoverable debts all over the world. Three regional banks have gone bust in the US, and Credit Suisse, one of the world's big banks, collapsing in Switzerland. Where will the next rupture show up?

It was to avoid this sort of uncertainty that Milton Friedman advocated stabilising the growth rate of money and credit. This would both stabilise inflation and dampen the business cycle. We have just had an object lesson in the dangers of losing this monetary stability and we must pray that we escape from the current episode without another crisis.

How did central banks get into this mess? The reason seems to be that they focused too narrowly on the day-to-day inflation numbers, forgetting that there are in Friedman's phrase 'long and variable lags'. If they had looked more carefully at the trends emerging in money and credit, their warning signals could have been heeded. Instead, central bankers thought they could control

Table 1: Summary of Forecast

	2019	2020	2021	2022	2023	2024	2025
GDP Growth[1]	1.6	-10.4	8.7	4.3	0.6	0.9	1.9
Inflation CPI	1.7	0.9	2.5	9.1	7.5	3.5	2.0
Wage Growth	3.5	1.6	5.9	6.0	7.2	4.2	3.4
Survey Unemployment	3.8	4.5	4.5	3.7	4.1	3.0	2.9
Exchange Rate[2]	78.3	78.2	81.4	79.1	80.4	79.7	79.4
3 Month Interest Rate	0.8	0.2	0.1	2.0	5.0	4.3	3.0
5 Year Interest Rate	0.6	0.1	0.8	2.5	4.1	4.2	3.0
Current Balance (£bn)	-63.3	-60.3	-10.8	-77.3	-42.7	-14.7	1.5
PSBR (£bn)	64.3	312.9	121.5	130.5	112.2	42.3	29.9

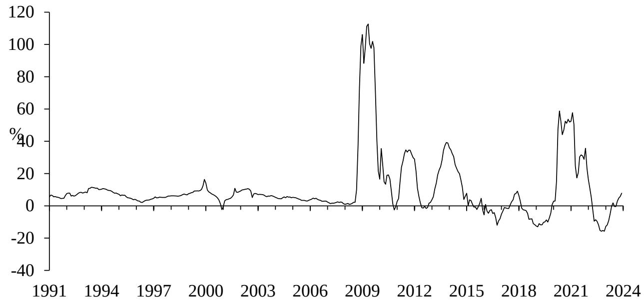
[1]Expenditure estimate at factor cost
[2]Sterling effective exchange rate, Bank of England Index (2005 = 100)

emerging inflation through expectations and 'forward guidance' about what they would 'tolerate' in inflation and the markets. This method of control is heavily reliant on central bank credibility for delivering its intended results. The trouble is once central banks lose this credibility in the sort of disaster rampant inflation has produced, this method loses its powers. Confidence then has to be regained, so that calm can return to the markets.

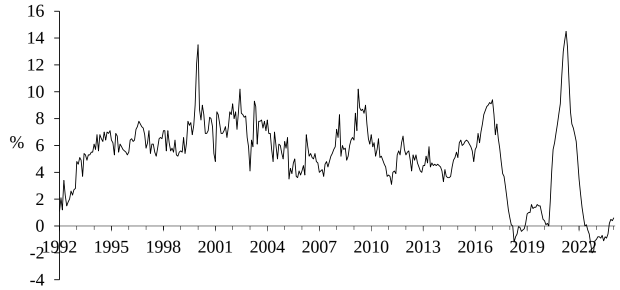
What should central banks do now? They must stop pushing down the money and credit growth rates in a foolish attempt to stamp on the head of inflation when the body is already buried. It will take time for inflation to fall all the way back to 2% but fall it will, given the ferocious squeeze that has been administered. Markets must be allowed to recover now, and crisis averted. Once re-entry into low inflation has occurred and the economy recovered from the squeeze, central banks must regain stability in money and credit growth.

Finally, governments also have a role to play through fiscal policy. This can stabilise output while central banks focus their powers on money and inflation. This will prevent headlong rushes into zero interest rates as money is forced into excessive looseness against deflation; and it will strengthen the central bank hand in slowing credit growth, with less worry that this will damage growth. Fiscal policy can also keep growth-damaging tax rates down when there are shocks to public spending and revenues.

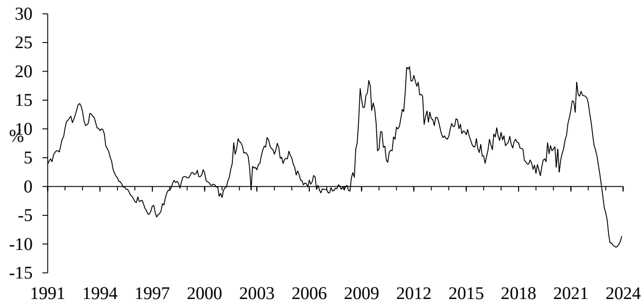
U.S.: Growth in M0 (Yr - on - Yr)



UK: Notes and Coins in Circulation Growth

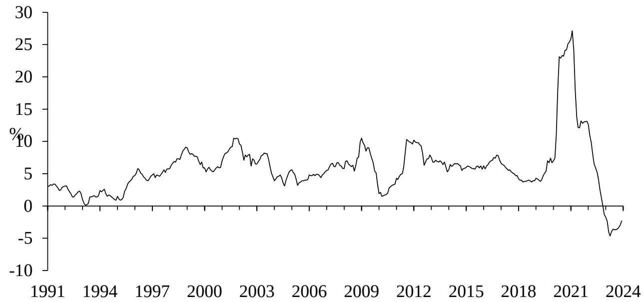


U.S.: Growth in M1 (Yr - on - Yr)

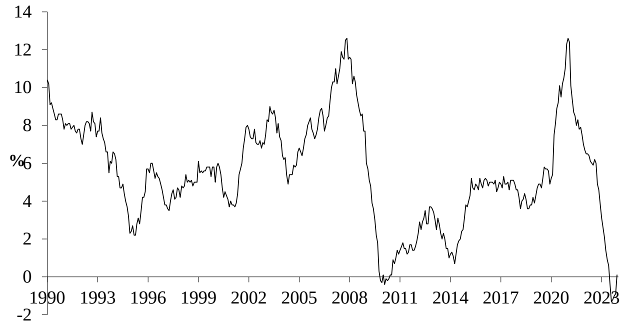


UK: M4 Growth

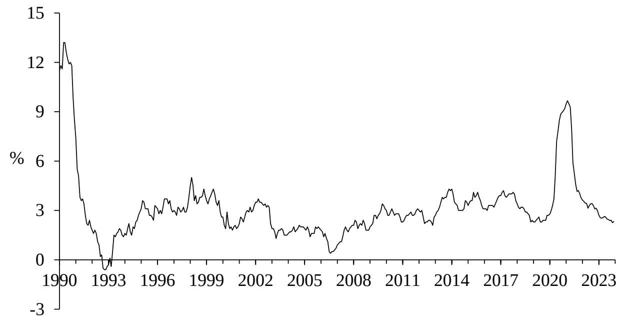
U.S.: Growth in M2 (Yr - on - Yr)



Eurozone M3 Growth



Japan: Growth of M2+CD's



FOCUS ON JAPAN

Francesco Perugini

Wage Negotiations Begin

Recent government data shows that last year Japan's average core consumer prices rose 3.1% from the previous year, marking their fastest increase in 41 years. This was mainly due to higher food prices. The consumer price index (CPI), which excludes volatile fresh food prices, stood at 105.2 against the 2020 base of 100. In 2022, the index gained 2.3%. Prices rose for nearly 90% of products surveyed. Nonperishable food prices climbed 8.2%, the most in 48 years, due to surging raw materials and logistics costs, while prices of household goods such as laundry detergent increased 7.9%. However, data also show that at the end of 2023 there was a slowing trend in inflation. Indeed, in December core inflation slowed for a second straight month, as food price hikes from 2022 — driven by higher costs for imports, domestic logistics and labour — have subsided.

According to economists, steady rises in services prices and growing prospects of solid wage hikes will likely keep alive market expectations the central bank will pull short-term interest rates out of negative territory around April. "Japan's economy isn't in very good shape with weak signs seen in consumption and capital expenditure. But that doesn't seem to be affecting companies' wage-hike momentum," said former top Bank of Japan (BOJ) economist Seisaku Kameda.

The latest inflation figures come as Japan's government urges businesses to raise wages ahead of annual spring negotiations between employers and labour unions. The Japanese Trade Union Confederation (Rengo), the country's largest group representing various industry unions, is demanding a wage increase of 5% or more in the negotiation that started effectively last month, while the Japan Business Federation, also known as Keidanren, is urging its member companies to offer pay increases larger than last year's 3.99% hike during this year's wage talks. Kanako Nakamura, an economist at Daiwa Institute of Research, said she expects that "this year's wage increase rate will be higher than last year's," adding that there will be a "cycle in which both wages and prices rise." Koya Miyamae, a senior economist at SMBC Nikko Securities, said there is "a possibility that real wages will leave the negative range" by the latter half of 2024. With this year's goal of surpassing last year's levels in the spring negotiations, the wage rise trend is most likely "not temporary," he added.

This year's negotiations are attracting heightened attention in several ways. First, both labour and management are on the same page about moving Japan out of its long deflationary state to create a society in which wages and consumer prices both increase. This is because as wage growth starts to increase it might stimulate growth in household consumption, and thus affect domestic demand and economic growth. Second, the BOJ is also paying attention to the negotiations as a positive spiral of rising wages and consumer prices would be a major factor for the central bank in deciding whether to exit a decade-long ultra-loose monetary policy.

While the consumer price index last year increased by more than the 2% inflation goal set by the BOJ as the benchmark for revising its monetary policy, central bank officials attributed that mainly to higher import costs due in large part to the Russian invasion of Ukraine. At the latest news conference, BOJ Governor Kazuo Ueda noted that labour unions were preparing wage hike demands that exceeded last year's. "Company executives, especially at major companies, have been making positive comments about such demands," Ueda said. He added that the likelihood of achieving the BOJ's price hike goal had increased.

Since Ueda took over as BOJ governor last April, interest has focused on when the central bank would move away from the ultra-loose monetary policy instituted by his predecessor, Haruhiko Kuroda, for a 10-year period. After taking over, Ueda has modified the price hike goal to one that accompanied a similar increase in wages. In September, Ueda said at a news conference that wage hikes would be one of the most important factors in determining if the increase in consumer prices was a continual one.

The focus on wage hikes reflects the central bank's stance that consumer price hikes should occur within a larger expansion of the economy brought on by rising wages and more money being spent by consumers on products and services. But the BOJ has not set an indicator for what level of wage growth would prompt a change of course in monetary policy. Ueda has said that such wage growth would have to extend to even smaller companies, even if the rate of increase was not the same as at large firms and if not, all companies raised their pay. However, even though last year's wage hike was the largest in 30 years, higher consumer prices meant that real wages continued to lag. In November 2023, real wages decreased year-on-year for the 20th straight month.

MARKET DEVELOPMENTS

Financial markets are still full of uncertainty, as interest rates stand at unexpectedly high levels, destroying credit and money. Central banks are likely to ease off rates as the year proceeds, if only for fear of huge political reprisals from incoming new governments. This easing should defuse an ugly situation, reviving equities and bond prices.

Table 1: Market Developments

	Market Levels		Prediction for Jan/Feb 2025	
	Jan 8	Feb 9	Previous Letter	Current View
Share Indices				
UK (FT 100)	7694	7595	8225	8120
US (S&P 500)	4726	4992	5048	5332
Germany (DAX 30)	16716	16964	19893	20187
Japan (Tokyo New)	2394	2563	3164	3388
Bond Yields (government				
UK	3.78	4.05	4.00	3.00
US	4.02	4.16	3.40	4.00
Germany	2.20	2.35	2.20	2.40
Japan	0.58	0.73	0.50	1.00
UK Index Linked	0.96	1.16	1.00	1.00
Exchange Rates				
UK ($ per £)	1.27	1.26	1.20	1.22
UK (trade weighted)	82.13	82.35	77.3	77.3
US (trade weighted)	108.87	110.79	113.2	113.2
Euro per $	0.91	0.93	0.98	0.98
Euro per £	1.16	1.17	1.18	1.18
Japan (Yen per $)	143.90	149.42	140.0	140.0
Short Term Interest Rates				
UK	5.32	5.32	4.00	3.00
US	5.59	5.58	4.30	4.30
Euro	3.94	3.90	3.00	3.30
Japan	–0.03	–0.03	0.10	0.20

Table 2: Prospective Yields [1]

Equities: Contribution to £ yield of:

	Dividend Yield	Real Growth	Inflation	Changing Dividend Yield	Currency	Total
UK	2.10	0.9	3.0	3.00		9.00
US	2.00	1.2	2.6	3.00	3.22	12.02
Germany	2.10	0.4	2.6	16.00	–2.07	19.03
Japan	1.90	0.9	2.3	29.00	9.32	43.42
UK indexed[2]	0.96		3.0	16.00		20.16
Hong Kong[3]	2.60	4.8	2.6	–21.00	3.22	–7.78
Malaysia	3.30	3.8	2.6	35.00	3.22	47.92
Singapore	3.50	0.7	2.6	–8.00	3.22	2.02
India	1.40	7.2	2.6	17.00	3.22	31.42
Korea	1.10	2.0	2.6	–28.00	3.22	–19.08
Indonesia	2.20	4.7	2.6	21.00	3.22	33.72
Taiwan	2.80	1.8	2.6	8.00	3.22	18.42
Thailand	3.20	2.6	2.6	17.00	3.22	28.62

Bonds: Contribution to £ yield of:

	Redemption Yield	Changing Nominal Rates	Currency	Total
UK	4.05	10.47		14.52
US	4.16	1.60	3.22	8.98
Germany	2.35	–0.52	–2.07	–0.24
Japan	0.73	–2.75	9.32	7.30

Deposits: Contribution to £ yield of:

	Deposit Yield	Currency	Total
UK	5.32		5.32
US	5.58	3.22	8.80
Euro	3.90	–2.07	1.82
Japan	–0.03	9.32	6.30

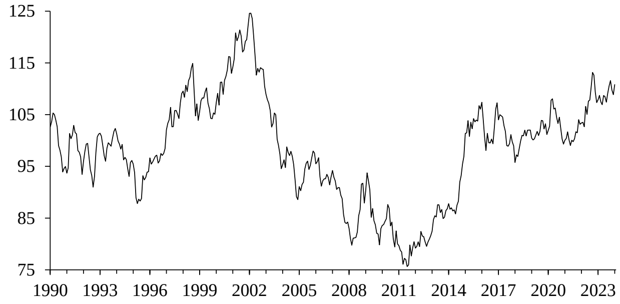
[1] Yields in terms of €s or $s can be computed by adjusting the £-based yields for the expected currency change.
[2] UK index linked bonds All Stocks
[3] Output based on China.

Table 3: Portfolio(%)

	Sterling Based Investor		Dollar Based Investor		Euro Based Investor	
	January Letter	Current View	January Letter	Current View	January 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)	-	-	-	-	-	-

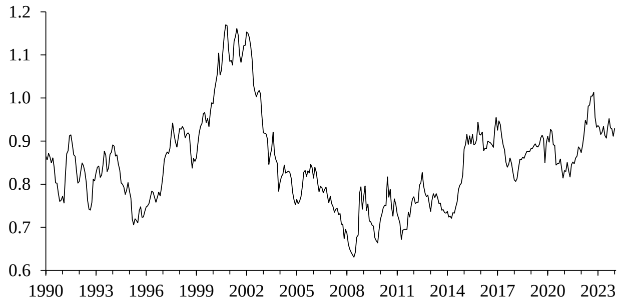
INDICATORS AND MARKET ANALYSIS
FOREIGN EXCHANGE MARKETS

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

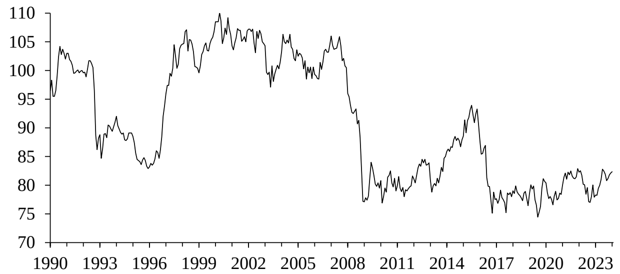


UK: Dollars Per Pound Sterling

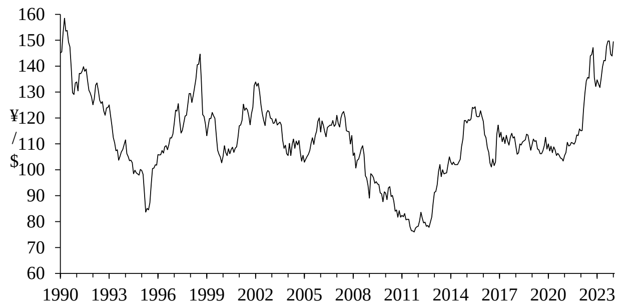
Euro per US dollar



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



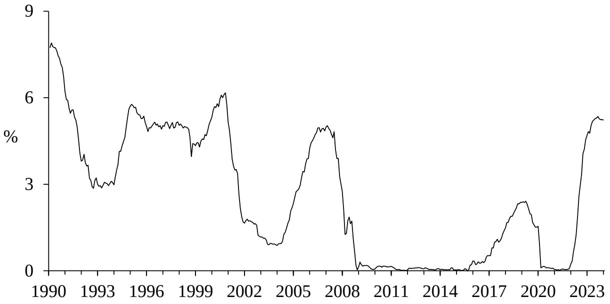
Japan : Yen Per U.S. Dollar



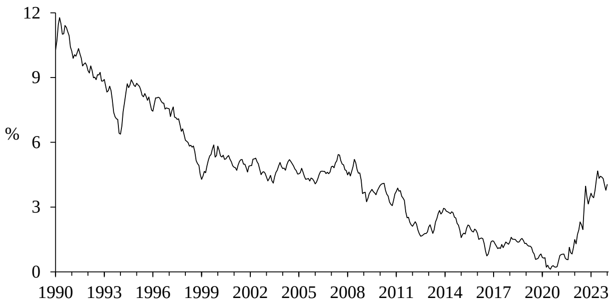
GOVERNMENT BOND MARKETS

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

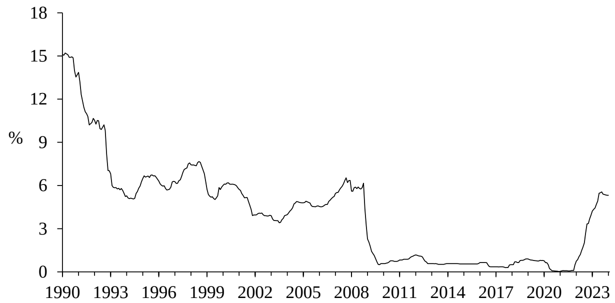
U.S. : 3-Month Treasury Bill



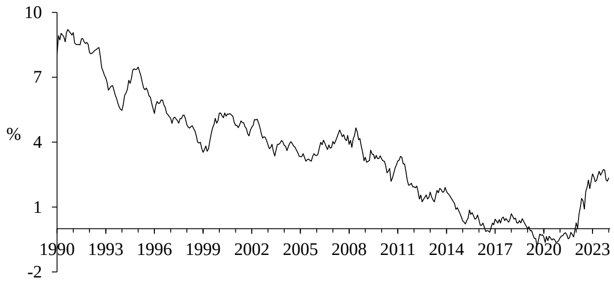
U.K.: Yield on Long-Term Government Bonds



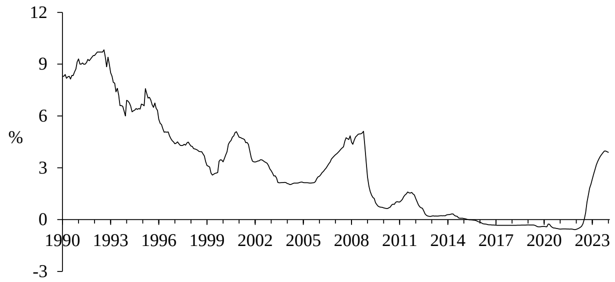
U.K. : 3-Month Certificate LIBOR Rate



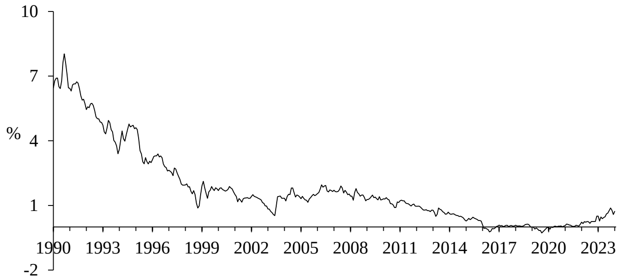
Germany: Yield on Public Authority Bonds



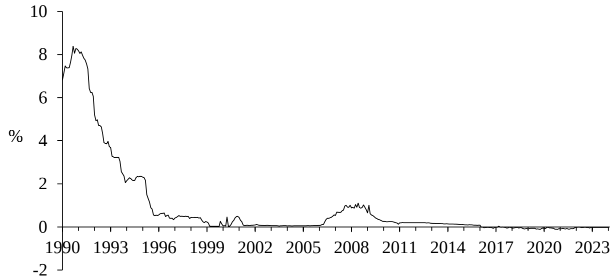
Germany : 3-Month Interbank Deposit Rate



Japan: Yield on Long-Term Government Bonds

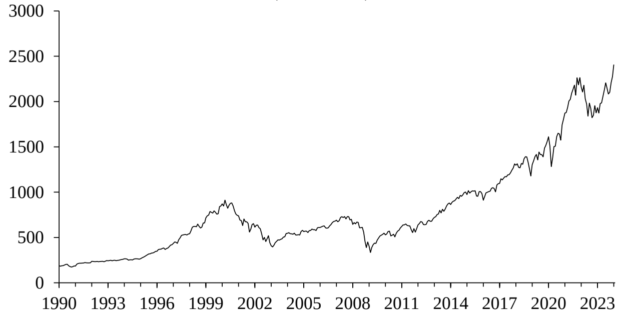


Japan : 3-Month Money Market Rate

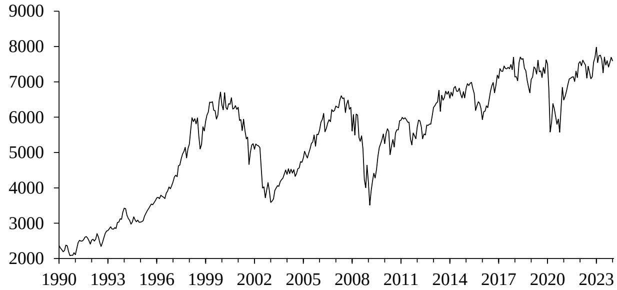


MAJOR EQUITY MARKETS

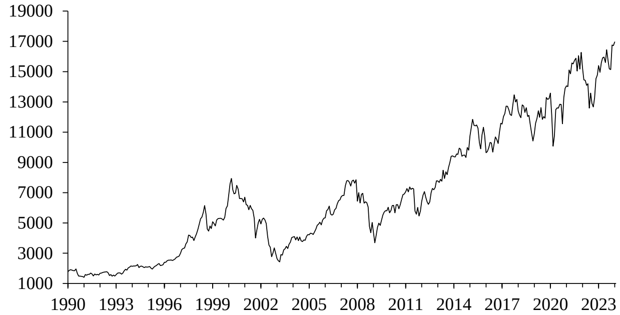
U.S. : S & P 400 Industrial (1985=100)



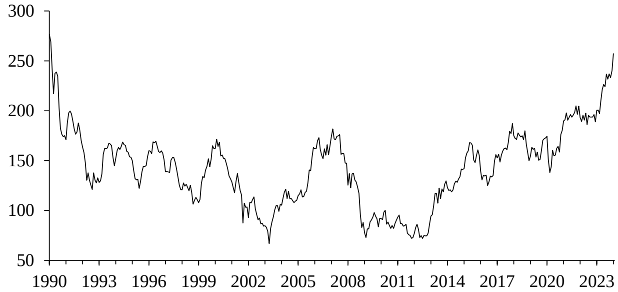
U.K. : FTSE-100 Index (10 April 1962=100)



Germany : DAX 30



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



EMERGING MARKETS

Anupam Rastogi

India

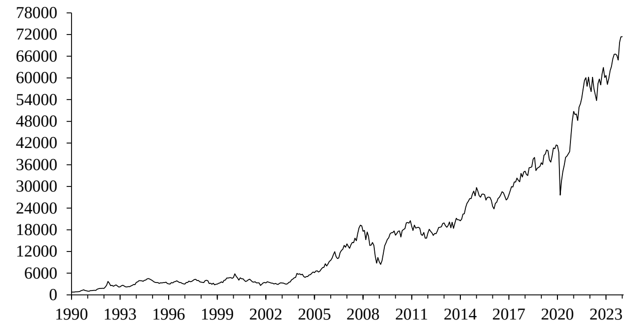
India is all set to achieve the third straight year of more than 7% growth through FY 24 (Fiscal Year 2024, which runs from April 2023 to March 2024), even as the global economy struggles to expand at over 3%. The government's Covid management, "mature" stimulus measures and the successful vaccination are touted for the economy's swift return to a high-growth orbit after the slump in the pandemic year of FY21.

In January, India's services sector reached a six-month peak, propelled by increased demand, improved productivity, and increased intake of new projects. The HSBC India Services PMI climbed to 61.8, marking the most rapid expansion in six months, up from December's 59. Underlying data also showed a notable upturn in new export orders at Indian service. Monitored firms signalled gains from clients across the globe, including Afghanistan, Australia, Brazil, China, Europe, the UAE and the US. The HSBC India Composite PMI, a weighted average of comparable manufacturing and services PMI indices, rose from 58.5 in December to 61.2 in January. It was the sharpest upturn since mid-2023.

We expect the Indian economy to experience a consistent growth of 7% annually from 2024 to 2031. The development is supported by a growth in capital expenditure, highlighting the government's investment-driven approach when the private sector hesitated to make substantial investments. The government's notable increase in capital expenditure, supporting infrastructure projects and offering interest-free loans to states, is a pivotal factor. India is primed to continue its upward growth trajectory due to stable and robust domestic demand, expanding private consumption and investments, and structural reforms. Anecdotal evidence of the Mumbai capacity utilisation running at 125% of its capacity and the Indian railway's booking at an all-time high suggests that the economy is on a roll. The government's all-inclusive welfare approach (a euphemism to provide a minimum level of food, fuel, and shelter at a subsidised rate to vulnerable sections of society) is expected to contribute to the enlargement of the consumption base by expanding the middle class.

The government aspire to become a $7 trillion economy by 2030, adding that in the next three years the country is expected to become a $5 trillion economy, the third largest in the world, and the government has set a higher goal of becoming a developed country by 2047. The government believes that it can successfully handle the challenge of global turmoil, lower logistics costs, and invest in product quality to hold on to and expand market share in areas where India has an advantage, make good use of Artificial Intelligence to advance growth in services trade and employment and can trade-off between economic growth and energy transition.

India: BSE Sensex



India's retail inflation has notably decreased from an average of 6.8% in April–December 2022 to 5.5% in the corresponding period of 2023. The retail inflation rate remains stable and falls within the notified tolerance band of 2% to 6%. For almost a year, the Reserve Bank has kept the short-term lending rate or repo rate stable at 6.5%. The benchmark interest rate was last raised in February 2023 to 6.5% from 6.25% to contain inflation driven mainly by global developments. The government's attitude to inflation is that it is potentially the most disruptive economic force regarding a government's political fortunes. The government has helped monetary policy fight inflation, driven mainly by food prices and where raising interest rates is of little consequence.

Hence, the RBI's Monetary Policy Committee (MPC) decided to keep the policy repo rate unchanged at 6.5% and retain the 'withdrawal of accommodation'. The central bank's commentary remains hawkish. The bank reiterated its commitment to aligning inflation to the target and highlighted the need to stay vigilant on the last mile of disinflation. The bank will maintain the "nimble and flexible" approach to manage liquidity, holding the money market rate around the policy repo rate of 6%.

The government took vote-on-account for the FY25 as the general elections are due by May 2024. The budgetary numbers hint that the government expects a benign inflation environment over the next fiscal year. Given that the budget assumes a nominal GDP growth rate of 10.5% and the government has been talking about the real GDP growth rate being closer to 7% next year, the GDP deflator, which closely tracks the wholesale price index, will likely stay under 4%. The support for growth and welfare has come without compromising on fiscal restraint. A sign that Prime Minister Narendra Modi is confident his government can return to power without resorting to populist programs.

India's current account deficit (CAD) for the July–September quarter of fiscal 2023–24 narrowed to $8.3 billion, constituting 1% of the GDP. It is a decline from the $9.2 billion or 1.1% GDP reported in the preceding quarter. The improvement is attributed to a reduced merchandise trade deficit, which contracted to $61.0 billion from $78.3 billion in the same quarter the previous year. Services exports grew by 4.2% on a y-o-y basis due to rising exports of software, business and travel services. Net services receipts increased both sequentially and on a y-o-y basis.

There are plenty of reasons for optimism. The country's population surpassed China's last year. More than half of Indians are under 25. And at current growth rates, it could become the world's third-largest economy in less than a decade, having recently overtaken the U.K. for the number 5 spot. India's equity market has now seen eight straight years of gains. Worsening trade relations between the West and China help India's secular growth in capital markets and exports. Demographically, India is where China was when its growth was taking off in the 1990s. According to the U.N., almost one-fifth of the world's 15- to 64-year-olds will be Indian by 2030. India's age-dependency ratio — a measure of the burden of child and elderly care on households — has fallen to 47 in 2022 from 82 in 1967, according to the World Bank. Low dependency ratios often help lift savings and investment: Plentiful workers keep labour costs for companies in check while households themselves invest excess income rather than spending it supporting children or parents.

India's growth trajectory is now outpacing China. The bond market supports the view that India is about to accede to the prosperity of the past. India commands the world's 5th largest economy if the bond market's growing appetite for Indian debt is rising. At least $1 trillion of government securities is traded multiple times annually in India, and it is poised to become the darling of international investors. The annualised return of publicly traded Indian companies was 16 percentage points greater than the MSCI Emerging Market Index. Indian companies also appreciated at a faster, unprecedented rate relative to their Chinese counterparts.

Two decades after betting on China as the world's biggest growth story, Wall Street giants like Goldman Sachs Group Inc. and Morgan Stanley are endorsing India as the prime investment destination for the next decade.

Morgan Stanley predicts India's stock market will become the third-largest by 2030. Its weight in the MSCI Inc.'s benchmark for developing-market equities is at an all-time high of 18%, even as China's share has shrunk to its lowest on record at 24.8%. The inclusion of India in the JPMorgan index is the most vital sign that India is leading the global growth club.

The historic shift has investors paying close attention to the contrasting trajectories of two of Asia's greatest powers. While the bullish sentiment about India isn't new, investors are more likely now to see a market that resembles China of times past, a vast, dynamic economy that's opening up to global money in novel ways. Nobody expects a smooth ride. But most are making the crossover anyway, calculating that the risks of betting against India are more significant.

A momentous shift is underway in global markets as investors pull billions of dollars from China's sputtering economy two decades after betting on the country as the world's biggest growth story. Much of that cash is now heading for India, with Wall Street giants like Goldman Sachs Group Inc. and Morgan Stanley endorsing the South Asian nation as the prime investment destination for the next decade.

Investors are paying close attention to the contrasting trajectories of two of Asia's greatest powers. India, the world's fastest-growing major economy, has vastly expanded infrastructure under Prime Minister Narendra Modi in his bid to lure global capital and supply lines away from Beijing. Conversely, China is grappling with chronic economic woes and a widening rift with the Western-led order.

The outcome of the financial stability, macroeconomic stability and return of capital flows has ensured the rupee's stability. India is also stepping up efforts to globalise the rupee, albeit at a more modest scale than China's yuan expansion. Still, the potential is there when combined with the government's development of GIFT City — a free market pilot project in western India that aspires to become a global financial hub unhampered by rules and taxes. The prospect echoes Shenzhen's opening up in 1980 as a special economic zone.

	22–23	**23-24**	**24-25**	**25-26**	**26-27**
GDP (%p.a.)	7.2	7.3	7.0	7.0	7.0
WPI (%p.a.)	6.5	5.4	5.0	4.2	4.0
Current A/c(US$ bill.)	-67.0	-60.0	-13.0	0.0	0.0
Rs./$(nom.)	81.0	83.0	83.0	83.5	84.0

China

A $7 trillion stock rout coupled with the worst deflation in decades has forced Chinese President Xi Jinping to pay more attention to an economy that in recent years has lurched from one crisis to another, unable to shake fears of a slowdown in growth. Battered equity markets have become the most acute symbol of crushed confidence within the world's second-largest economy. The market capitalisation of China's stocks has plunged to multi-year lows amid slumping valuations. The West has fallen out of love with China.

China has fallen into a vicious cycle in which falling prices and weak demand reinforce one another, as they did in Japan in the 1990s. President Xi Jinping has an ideologically-rooted reluctance to shower the economy with fiscal stimulus or helicopter money as was done in the past. He has preached to the public to weather economic hardships and become strong. People, in turn, seem to accept that there is no alternative.

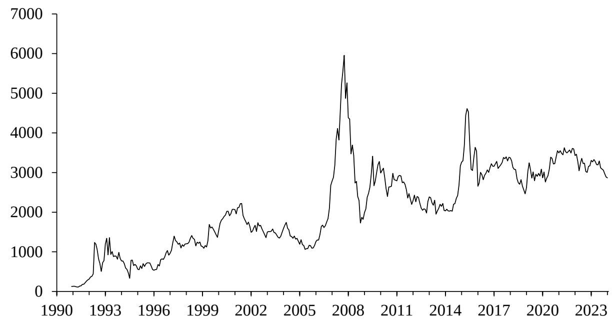
In the immediate future, weakness in the real estate sector, increased unemployment, and a lacklustre government stimulus package have led to powerful negative wealth effects and weak consumer demand. Demand for pork during the Chinese New Year celebrations has fallen by almost one-third. Due to the negative wealth effect, households and companies have become less responsive to economic stimulus.

The government has trimmed vital interest rates, cut home buyers' mortgage costs, and prodded banks to lend more to distressed property developers. However, these measures have done little to reverse downward pressure on the economy. It shows how deep China's economic woes run, particularly in the beleaguered property sector.

The implosion from population decline seems unstoppable. The number of newborns has gone into free fall over the past several years. Official figures showed that China had fewer than half the number of births in 2023 than in 2016 after China abolished the one-child policy. The latest number points to a fertility rate — the number of children a woman has over her lifetime — that is close to 1.0, a level demographers consider as "ultralow." That means that each generation will be less than half the size of the previous generation. The worsening demographic gloom has taken on increasing urgency for Beijing. The country hit a historic turning point in 2022, marking the first year the population shrank since the starvation years in the early 1960s.

Many women are reluctant to marry and have children, putting their own life goals ahead of what Beijing and relatives want, a situation that has prompted the Communist Party, which desperately needs to rejuvenate China's ageing population, to embark on a campaign for a "birth-friendly culture." Local governments have tried everything from matchmaking to cash incentives to encourage more births. Last year, a district of Wuhan offered couples with a third child 10,000 yuan, equivalent to $1,395, a year for the child's first six years. The new demographic reality means that demand, especially household consumption, has increasingly become a persistent constraint on economic growth.

China: SSE Composite Index



Amid all these structural changes, China's economy expanded 5.2% last year. That was a speedier pace than it achieved in 2022 but still one of the weakest growth rates in decades, excluding the troubled years of the pandemic. China's official manufacturing purchasing managers index rose to 49.2 in January from 49.0 in December. Although slightly improved from the previous month, the index remained below 50, indicating a contraction. It has been in contractionary territory for nine of the past ten months.

China's consumer prices extended their decline for a fourth month in January while producer prices dropped, underscoring deflationary risks facing the world's second-biggest economy as it struggles to recover. The consumer price index (CPI) fell 0.8% in January from a year earlier, after a 0.3% drop in December. The downward pressure on the CPI may let up slightly in February due to a boost in demand around the Lunar New Year.

Outside of property, investment looks to be stabilising. That is good news. But until the property market, services sector employment and income growth find a firmer footing, China's growth will remain plodding by the standards of yesteryear.

Exports rose 2.3% year-on-year, and imports rose 0.2% in December from a year ago in U.S. dollar terms. China's annual exports fell for the first time in seven years in 2023, even as shipments in December beat expectations. For 2023, exports fell 4.6%, the first such annual drop since a 7.7% decline in 2016, according to Wind Information. Imports dropped by 5.5% last year. Their previous decline was in 2020, the year the Covid-19 pandemic began. China's trade with its major partners declined in 2023 as demand for Chinese goods fell amid slower global growth.

Last year, the US trade deficit with China shrank to the smallest since 2010, with Chinese imports facing higher tariffs since former President Donald Trump imposed protectionist measures against the country.

China's measures to stabilise the stock market may not go very far. Appointment of "broker butcher" — Wu Qing, chairman of the China Securities Regulatory Commission (CSRC), will fail to stabilise a floundering stock market.

China's equity market has more than 200 million retail investors, many of whom have traditionally looked to stocks and the property market as ways to grow their money amid rock-bottom savings rates — only to find their wealth shrinking from both. The hit to mom-and-pop investors is sizeable. If an individual pumped 100,000 yuan ($13,950) into China's benchmark CSI 300 index at the beginning of 2021, it would have shrunk 36% by now. The money invested in Chinese tech companies listed in Hong Kong would have lost more than 60% of its value. By contrast, putting those funds to work in the S&P 500 or the Nikkei 225 would have returned at least 30%.

No wonder big investors doubt the feasibility of the rescue package and the government's ability to put a floor under this market right now. Foreign portfolio managers are fleeing the market. The reason is not difficult to find. There is an assumption inherent in international business that as long as you don't break the law, life should be relatively uneventful. Not in China anymore. Executives can fall foul of vague and opaque rules within the hard-to-navigate legal system of China — with devastating consequences.

There are no official figures for how many people are detained in China yearly, but some accounts put it as high as 30,000. Human rights groups say foreigners could number as many as 5,000 of that. Many end up in what are known as "black jails," languishing for years with few answers and even less information. Under President Xi Jinping, the business environment has become even less conducive. The most significant change was announced last April and implemented in July when the government broadened the powers of the anti-espionage law. The result is that now nobody, and no business, is safe.

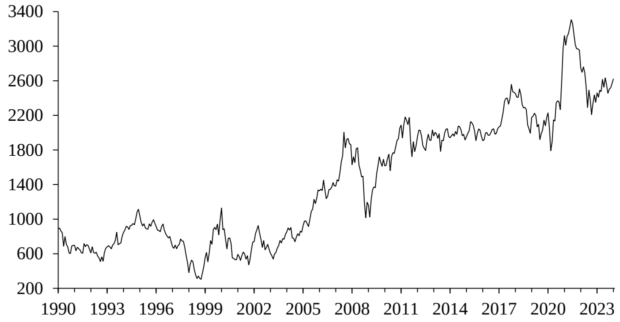
	22	23	24	25	26
GDP (%p.a.)	3.0	5.0	4.4	4.0	3.5
Inflation (%p.a.)	2.0	2.2	0.8	2.0	2.2
Trade Balance(US$ bill.)	420.0	255.0	150.0	100.0	50.0
Rmb/$(nom.)	6.8	7.3	7.2	7.4	7.6

South Korea

South Korea's economy expanded 1.4% in 2023 after posting 2.2% year-on-year growth in the fourth quarter. Growth in the fourth quarter was stronger than expected, supported by the semiconductor-led export recovery. It was a three-year low after gains of 2.6% in 2022 and 4.3% in 2021. The economy is expected to grow 2% in 2024.

South Korea's inflation eased for the first time in four months in November, relieving policymakers worried about

Korea: Composite Index



persistent inflation risks. Consumer prices rose 3.2% from a year earlier, decelerating from 3.3% in November. South Korea's slowing inflation may nudge the central bank to start paring back a restrictive policy that has also put pressure on corporate finances. We expect the bank to start easing policy from the third quarter of 2024 as cooling inflation makes restrictive borrowing costs challenging to justify to the public.

South Korean exports maintained growth momentum in January, with a positive start to 2024, as demand for semiconductors continued to improve and shipments to China returned to an expansion. Exports from Asia's fourth-largest economy rose 18% from a year earlier to $54.69 billion in January, following a revised 5% gain in December. A higher number of work days during the first month of 2024 also helped drive growth.

Imports fell 7.8% from a year earlier to $54.39 billion in January, resulting in a monthly trade surplus of $300 million. Having additional work days in January due to shifting dates for the Lunar New Year holidays could make the trade data look stronger than in the same month last year. However, exports of computer chips, cars and other Korean goods remained strong. Shipments adjusted for working-day differences increased 5.7% from a year earlier.

Considering technology's significant role in exports, South Korea should be among the biggest beneficiaries of the rebound in global technology sectors this year. South Korea's exports to the US increased 26.9% from a year earlier, and those to Japan rose 10.6%. India imported 5.6% more from South Korea, while the European Union bought 5.2% more.

A South Korean company provides monetary benefits to its employees to help fix the country's abysmally low birth rate. Booyoung Group, a construction firm based in Seoul, plans to pay employees 100 million Korean won ($75,000) each time they have a baby. The company has spent 7 billion Korean won ($5.25 million) in cash to employees who have had 70 babies since 2021. South Korea has the world's lowest fertility rate, which was 0.78 in 2022 — which indicates the average number of children a woman will have in her lifetime — and that ratio is expected to drop further to 0.65 in 2025. The data underscores the demographic time bomb that South Korea and other East Asian nations are facing as their societies rapidly age just a few decades after their dramatic industrialisation.

The movement of the Korean won against the U.S. dollar was varied. The mixed currency performance reflects uncertainty in forex markets, even as equity markets showed a positive trend.

	22	23	24	25	26
GDP (%p.a.)	2.6	1.0	2.0	2.5	2.4
Inflation (%p.a.)	5.1	3.6	3.0	2.5	2.5
Current A/c(US$ bill.)	50.0	40.0	35.0	30.0	30.0
Won/$(nom.)	1450	1340	1300	1300	1400

Taiwan

Taiwan's trade-dependent economy grew faster than expected in the fourth quarter due to strong domestic consumption and a rebound in exports, expanding 1.4% for the entire year of 2023. Gross domestic product in the October–December period grew by a preliminary 5.12% from a year earlier. IMF is optimistic for 2024 trade as Taiwan's electronics exports skyrocket after 2023's challenges of war, inflation, inventory issues, reduced export orders, and a slowdown in machinery and equipment imports.

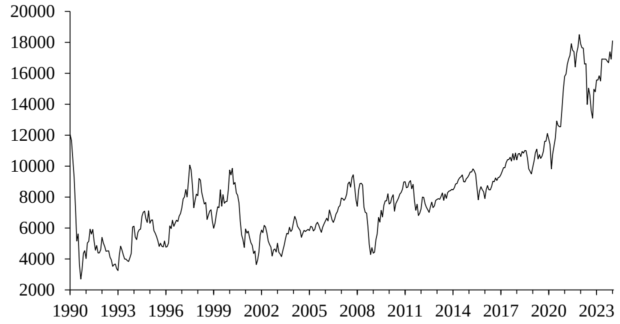
Fourth-quarter exports rose 3.4% versus the same period in 2022, compared with the third quarter's annual contraction of 5.1%, while the island's trade surplus leapt an on-year 131% in the final three months of the year. Taiwan's trade surplus soared 56.9% to hit an all-time high of US$80.6 billion in 2023, reflecting the success of the government's various investment promotion projects, enhancing local supply chain resilience and boosting the overall economy. But a fall in orders for Taiwan's exports in December was of a concern.

After the election, the currency is stable at around NT$31.5 to the US dollar.

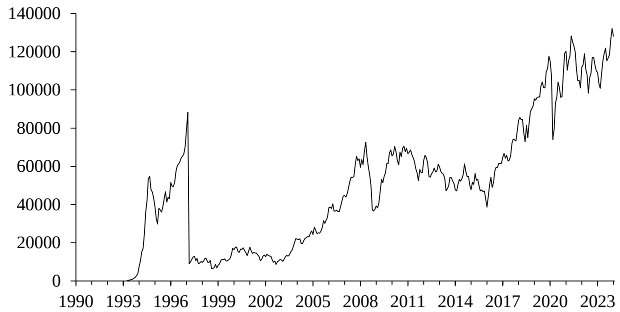
The island's vibrant exercise in democracy led to the ruling Democratic Progressive Party vice president, Lai Ching-te, becoming the new president. Taiwan has shown the world how much it cherishes democracy. The people have told Beijing that its democracy is here to stay.

Lai has to unite a divided electorate. He secured a historic third term for his party but received just above 40% of the vote, the lowest winning percentage since a previous three-way race in 2000. Lai will have to work with his rivals to deliver what citizens say they want from their next government: Not just safeguarding their democracy but also delivering better economic outcomes and addressing issues like jobs, mortgages, and mental health, which are priorities for young voters. Volatile cross-strait relations will no doubt preoccupy much of his time in office. Lai has pledged to continue Tsai's policies and maintain peace and stability in the Taiwan Strait. It will undoubtedly go some way toward reassuring partners in Washington and Tokyo, who had been worried about his tendency to push the issue of independence — a red line for President Xi. Lai will need to convince the US as much as Beijing that he will be a steady hand in maintaining the status quo, the uneasy zone that Taipei has placed itself in to ensure its survival.

Taiwan: Weighted TAIEX Price Index



Brazil: Bovespa



	22	23	24	25	26
GDP (%p.a.)	2.6	1.4	1.8	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	31.5	31.5	31.0

Brazil

The economy will decelerate to 1.6% growth in 2024 from 3.0% in 2023, and forecasts for 2025 show a 2% growth. The Lula government's announcement of providing fiscal stimulus with environmental, social and fiscal responsibility met market scepticism. Similar large industrial policy programs in 1964 were spectacular failures. Fiscal proliferation triggered a coup in 1964 when inflation ran at 90%. The resilience of household consumption supported by the monetary easing will keep the economy growing slowly.

Brazil's central bank has a target of 3% inflation, plus or minus 1.5 percentage points. Brazil's central bank cut its key interest rate by half a percentage point to 11.25%. It promised to keep the same easing pace in the next few meetings after inflation slowed within the tolerance range and new signs of a weakening economy emerged. It was the fifth time when Central bankers cut the benchmark rate. We believe the rate will end the year at 9%.

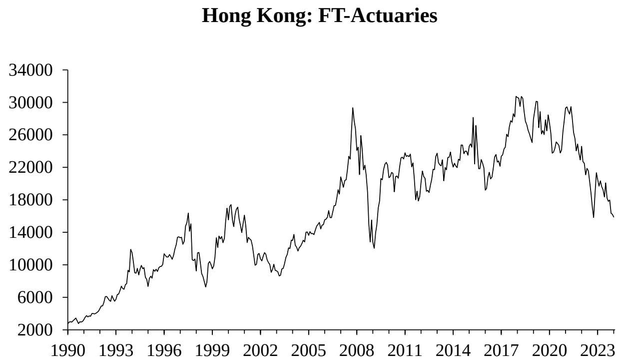
Central bankers led by Roberto Campos Neto are sticking with a gradual pace of monetary easing days after a report showed annual inflation slowed for a third straight month in early January, much more than economists expected. The Central Bank's primary concern is possible price increases driven by the services sector — the Monetary Policy Committee believes that the dynamism of the labour market and the expansion of real incomes could lead to inflation in the services sector.

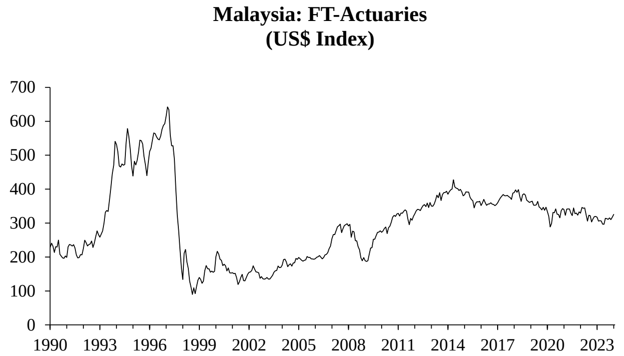
As expected, Brazil's trade balance ended 2023 with a record surplus — of USD 98.8 billion, 60.6% higher than the previous year and almost USD 6 billion higher than the government's projections in October. The result was mainly due to trading record volumes of agricultural commodities, which offset the drop in prices and global demand.

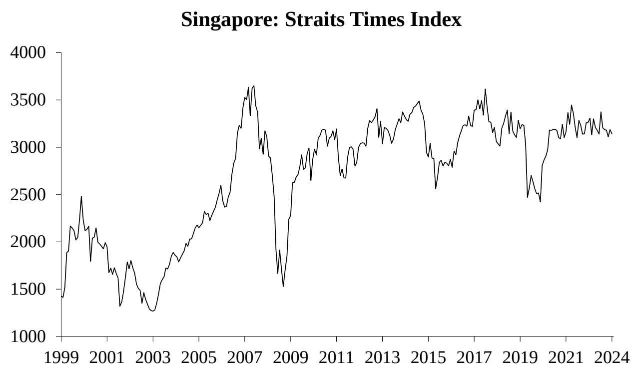
In the last week of January, the Brazilian real dropped to its weakest against the dollar since November. The worry is all this spending will put at risk Finance Minister Fernando Haddad's pledge to eliminate Brazil's primary budget deficit, which excludes interest payments.

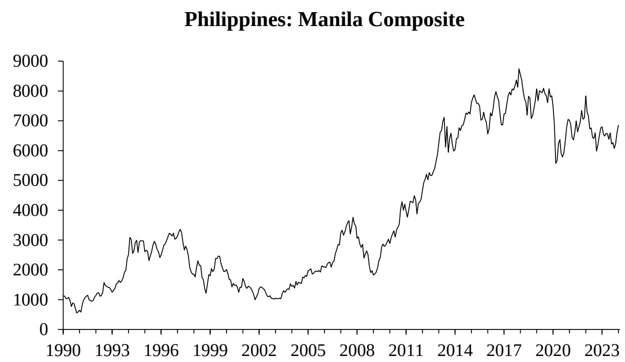
	22	**23**	**24**	**25**	**26**
GDP (%p.a.)	2.9	3.0	1.6	2.0	3.0
Inflation (%p.a.)	8.0	4.8	3.6	3.2	3.2
Current A/c(US$ bill.)	-10.0	-12.0	-20.0	-10.0	-10.0
Real/$(nom.)	5.2	4.7	4.8	4.8	4.8

Other Emerging Markets



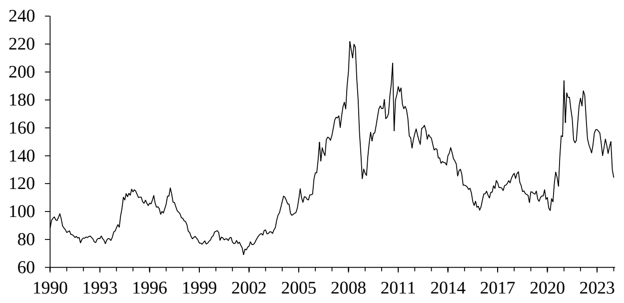




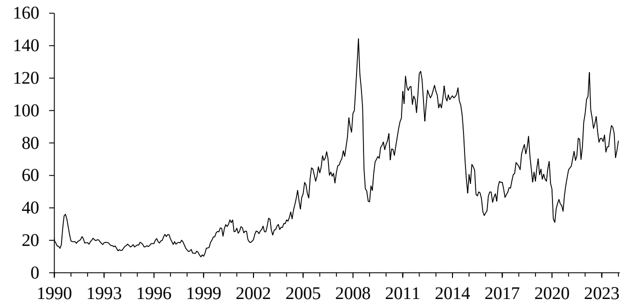


COMMODITY MARKETS

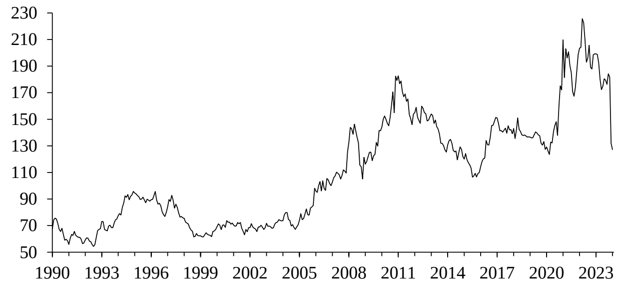
Commodity Price Index (Dollar)
(Economist, 2015 = 100)



Oil Price: North Sea Brent (in Dollars)

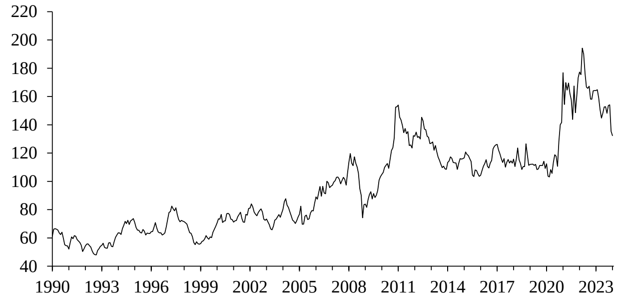


Commodity Price Index (Sterling)
(Economist, 2015 = 100)



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]
2020	0.9	0.1	0.2	78.2	72.9	-1.3	1.5	-1.4
2021	2.5	0.8	0.1	81.4	78.0	-6.4	4.1	-5.8
2022	9.1	2.5	2.0	79.1	82.4	-7.2	11.6	-6.7
2023	7.5	4.1	5.0	80.4	89.5	0.5	10.5	-0.4
2024	3.5	4.2	4.3	79.7	90.6	1.8	5.5	1.7
2025	2.0	3.0	3.0	79.4	90.6	1.0	2.8	1.0
2023:1	10.3	3.5	4.2	78.1	85.4	-1.8	13.6	-2.5
2023:2	8.6	4.1	5.2	80.4	89.8	0.5	11.2	-0.7
2023:3	6.8	4.5	5.5	82.2	92.3	1.7	9.0	0.7
2023:4	4.2	4.4	5.3	81.0	90.5	1.8	8.2	0.9
2024:1	4.5	4.3	5.0	79.7	90.5	2.1	7.3	1.4
2024:2	3.5	4.2	4.0	79.4	90.5	1.5	5.4	1.7
2024:3	3.0	4.1	4.0	79.6	90.6	1.8	4.6	1.9
2024:4	3.0	4.0	4.0	80.0	90.6	2.0	4.6	2.0
2025:1	2.0	3.0	3.0	79.5	90.6	1.0	2.8	1.0
2025:2	2.0	3.0	3.0	79.1	90.6	1.0	2.8	1.0
2025:3	2.0	3.0	3.0	79.3	90.6	1.0	2.8	1.0
2025:4	2.0	3.0	3.0	79.7	90.6	1.0	2.8	1.0

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]	Survey Unemployment Percent	Millions	Real Wage Rate[3] (1990=100)
2020	279.1	1.6	4.5	1.3	149.7
2021	300.5	7.7	4.5	1.3	157.4
2022	318.6	6.0	3.7	1.1	152.5
2023	341.6	7.2	4.1	1.2	152.0
2024	355.8	4.2	3.0	0.8	153.1
2025	367.9	3.4	2.9	0.7	155.2
2023:1	332.0	6.3	3.9	1.1	150.2
2023:2	340.5	7.9	4.2	1.3	151.6
2023:3	346.6	8.2	4.1	1.2	153.0
2023:4	347.2	6.4	4.0	1.2	153.3
2024:1	349.0	5.1	3.3	0.9	151.2
2024:2	355.1	4.3	3.0	0.8	152.8
2024:3	359.3	3.7	2.9	0.7	154.0
2024:4	359.8	3.6	2.9	0.7	154.3
2025:1	363.3	4.1	2.9	0.7	154.4
2025:2	367.1	3.4	2.9	0.7	154.9
2025:3	370.1	3.0	2.9	0.7	155.5
2025:4	371.2	3.2	2.9	0.7	156.1

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	150.6	721243.1	427576.4	250934.6	199232.3	-33095.4	123404.8
2021	163.8	784427.3	459674.3	271390.0	224535.7	-36903.3	134269.4
2022	170.9	818549.1	482283.2	270493.2	228365.7	-23824.9	138768.1
2023	171.8	822732.7	484026.0	270479.3	225317.6	-18636.8	138453.4
2024	173.5	831109.5	490083.0	264416.0	232155.7	-15891.4	139653.8
2025	176.8	846524.9	501723.3	266448.1	239198.5	-18462.9	142382.1
2020/19	-10.4		-10.1	-18.6	-4.8		4.1
2021/20	8.7		7.5	8.2	12.7		8.8
2022/21	4.3		4.9	-0.3	1.7		3.4
2023/22	0.6		0.4	0.0	-1.3		-0.2
2024/23	0.9		1.3	-2.2	3.0		0.9
2025/24	1.9		2.4	0.8	3.0		2.0
2023:1	171.6	205455.5	120624.7	74958.6	55700.5	-11224.5	34603.8
2023:2	172.0	205908.0	121111.1	66062.6	56116.4	-2756.3	34625.8
2023:3	171.6	205452.3	121001.2	64805.4	56537.9	-2250.2	34642.0
2023:4	172.0	205917.0	121289.1	64652.7	56962.8	-2405.7	34581.9
2024:1	172.7	206813.2	121214.6	72589.9	57390.1	-9648.0	34733.4
2024:2	173.2	207306.4	122257.0	64506.6	57820.4	-2454.1	34823.5
2024:3	173.8	208022.3	123117.0	63437.5	58254.2	-1824.1	34962.3
2024:4	174.5	208967.6	123494.4	63881.9	58691.1	-1965.2	35134.6
2025:1	175.6	210179.7	124017.7	74853.5	59131.3	-12471.5	35351.3
2025:2	176.3	211103.5	124954.1	64240.4	59574.2	-2221.0	35444.2
2025:3	177.0	211938.9	125899.8	63519.6	60021.5	-1821.7	35680.3
2025:4	178.2	213302.9	126851.6	63834.5	60471.6	-1948.6	35906.2

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	15.5	2090.9	312.9	-60.3
2021	5.0	2467.1	121.5	-10.8
2022	4.7	2776.0	130.5	-77.3
2023	3.8	2963.7	112.2	-42.7
2024	1.4	3088.9	42.3	-14.7
2025	0.9	3220.4	29.9	1.5
2023:1	3.1	718.1	22.5	-15.7
2023:2	7.6	733.0	55.7	-24.0
2023:3	4.2	736.1	30.6	-17.2
2023:4	2.0	738.3	14.9	-1.5
2024:1	1.5	756.3	11.0	-7.3
2024:2	1.4	764.1	10.9	-8.6
2024:3	1.4	768.8	11.1	0.1
2024:4	1.3	772.1	10.2	1.1
2025:1	1.3	784.0	10.1	0.8
2025:2	1.1	794.0	9.0	0.5
2025:3	1.1	798.8	8.4	0.1
2025:4	1.0	803.8	8.0	0.1

1 GDP at market prices (Financial Year)

WORLD FORECAST DETAIL

Growth Of Real GNP

	2020	2021	2022	2023	2024	2025
U.S.A.	–2.8	5.9	2.1	0.7	1.2	1.7
U.K.	–10.4	8.7	4.3	0.6	0.9	1.9
Japan	–4.3	2.2	1.0	1.1	1.1	1.0
Germany	–3.7	2.6	1.9	–0.3	0.3	1.2
France	–7.9	6.8	2.5	0.3	0.6	1.3
Italy	–9.1	6.6	3.3	–0.1	0.3	0.9

Growth Of Consumer Prices

	2020	2021	2022	2023	2024	2025
U.S.A.	1.3	4.7	8.0	3.9	2.5	2.3
U.K.	0.9	2.5	9.1	7.5	3.5	2.0
Japan	0.0	–0.2	2.5	2.1	1.9	1.5
Germany	0.5	3.1	7.9	6.2	2.7	2.2
France	0.4	1.7	5.4	4.0	2.5	2.0
Italy	–0.1	1.9	7.6	5.0	2.0	1.8

Real Short-Term Interest Rates

	2020	2021	2022	2023	2024	2025
U.S.A.	–4.6	–7.1	–1.7	2.4	1.9	1.5
U.K.	–1.3	–6.4	–7.2	0.5	1.8	1.0
Japan	0.3	–2.4	–2.1	–1.8	–1.4	–0.8
Germany	–3.6	–8.5	–5.9	0.4	1.3	0.7
France	–2.2	–6.0	–3.7	0.6	1.5	0.7
Italy	–2.4	–8.2	–4.7	1.1	1.7	0.7

Nominal Short-Term Interest Rates

	2020	2021	2022	2023	2024	2025
U.S.A.	0.1	0.1	2.2	4.9	4.2	3.5
U.K.	0.2	0.1	2.0	5.0	4.3	3.0
Japan	0.1	0.1	0.0	0.1	0.1	0.2
Germany	–0.5	–0.6	0.3	3.1	3.5	2.7
France	–0.5	–0.6	0.3	3.1	3.5	2.7
Italy	–0.5	–0.6	0.3	3.1	3.5	2.7

Real Long-Term Interest Rates

	2020	2021	2022	2023	2024	2025
U.S.A.	–3.3	–2.1	1.3	1.5	1.5	1.3
U.K.	–1.4	–5.8	–6.7	–0.4	1.7	1.0
Japan	–1.3	–1.7	–1.5	–1.1	–1.0	–0.5
Germany	–5.0	–4.4	–0.9	0.1	0.3	0.2
France	–3.3	–2.9	–0.6	0.9	0.9	0.7
Italy	–3.3	–2.6	0.3	2.3	2.2	2.1

Nominal Long-Term Interest Rates

	2020	2021	2022	2023	2024	2025
U.S.A.	0.9	1.6	3.8	3.6	3.5	3.3
U.K.	0.1	0.8	2.5	4.1	4.2	3.0
Japan	0.0	0.1	0.2	0.5	0.8	0.9
Germany	–0.6	–0.2	2.1	2.3	2.3	2.0
France	–0.3	0.2	1.8	2.9	2.9	2.7
Italy	0.5	1.2	3.0	4.4	4.2	4.1

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

	2020	2021	2022	2023	2024	2025
U.S.A.	118.7	116.1	128.3	128.0	128.5	128.8
U.K.	99.6	106.6	112.6	122.3	123.8	123.8
Japan	77.8	71.0	59.9	59.2	59.3	
Germany	97.1	97.9	95.0	95.1	95.4	
France	94.7	94.0	89.6	89.5	89.0	
Italy	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)

	2020	2021	2022	2023	2024	2025
U.S.A.[1]	124.77	119.77	127.34	126.90	127.40	
U.K.	1.28	1.38	1.24	1.24	1.23	1.22
Japan	106.60	110.45	133.10	136.20	137.80	
Eurozone	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