LIVERPOOL INVESTMENT LETTER

April 2012

Cardiff Business School
Cardiff University

Julian Hodge Institute Of Applied Macroeconomics

LIVERPOOL RESEARCH GROUP IN MACROECONOMICS

LIVERPOOL RESEARCH GROUP IN MACROECONOMICS

The Julian Hodge Institute was launched in autumn 1999 in a new collaboration between the Cardiff Business School of Cardiff University and Julian Hodge Bank. 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. This research has been given especial relevance by the ongoing discussions on the extra powers regularly requested by the European Union and also by the recent crisis in the eurozone.

The Liverpool Investment Letter is written by Patrick Minford and John Wilmot, 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 Jane 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 Bruce Webb and published on behalf of the group by Liverpool Macroeconomic Research Limited, which holds the copyright, and is available on subscription at £325 per annum.

The Group also produces a Quarterly Economic Bulletin which contains forecasts and commentary on the state of the world and British economy. It is available at the following rates: (Corporate and Institutional) £325 per year; (Personal) £90 per year. Special rates are available for teachers and students. Individual issues may be purchased: Corporate and Institutional, £90 per copy; Personal, £60 per copy.

Cheques for subscription to the Liverpool Investment Letter and/or the Quarterly Economic Bulletin should be made payable to Liverpool Macroeconomic Research Limited and mailed to

Mrs Jane Francis
16 Goldsworth Fold
Beckett's Wood
Rainhill
Liverpool L35 9LT

Tel / Fax: 0151 431 5710
Email: janefrancis04@btinternet.com
ISSN 0951-9262

LIVERPOOL INVESTMENT LETTER

April 2012

CONTENTS

THE BEGINNINGS OF A TAX-REFORMING BUDGET

The fundamental budget plan is correct: to cut spending steadily and raise taxes as needed across a broad tax base, until the government's debt ratio to GDP is stabilized and brought back down towards a less dangerous level of below 60%. The problem has been the lack of policies so far to cut taxes that deter the growth of enterprise. In this Budget the Chancellor, George Osborne, made a start in addressing this problem.

It is never easy to reform tax when there is no spare money to buy out losers. This is the situation today. So George Osborne is to be congratulated on making some progress in changing the tax system in beneficial ways.

First, he managed to cut the damaging 50 pence top tax rate, which HMRC confirmed was raising virtually no revenue. These calculations are tricky since they depend on assumptions about responses to alternative tax structures, but on previous work for the UK, it seems most likely that actually this rate reduced tax revenue because of evasion and negative supply responses, whether by net emigration or by reduced labour supply. HMRC's assumptions were cautious and so found less dramatic effects. But the tax is damaging activity as well; indeed that is how the revenue loss comes about, lowering the tax base, offsetting any gain from the higher tax rate on a constant tax base. So when that is put into the equation it is ludicrous to raise such a small amount of revenue from better-off people in this way.

Forty five pence is still too high. But the cut is important as a signal of priorities being given to incentives for business and business people. Presumably it will be followed by further reform, we are led to expect.

Second, there was an added 1% cut in corporation tax, with an eventual move to 22 pence; capital allowances are somewhat reduced. This is again very welcome. Capital allowances distort investment decisions towards greater capital-intensiveness; while leaving the marginal tax rate on new profitable projects unaffected, since at the margin the extra activity or business expansion may not use these allowances. Cutting corporation tax does cut this marginal tax rate and so encourages expansion.

Further budget tax cuts come from raising personal allowances to £9000 — this is a Lib Dem priority. It is not really a good idea when one considers it against the yardstick of marginal tax rates. The best schedule of MRTs is flat; a higher personal tax allowance creates a bigger band where it is zero which has to be paid for by higher MRTs elsewhere. 'Taking people out of tax' sounds attractive administratively; but again it is something of an illusion because many of the people 'taken out' go back in for tax credits and welfare benefits.

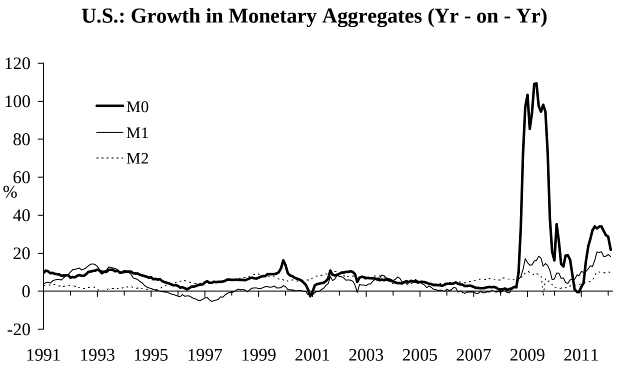
Table 1: Summary of Forecast

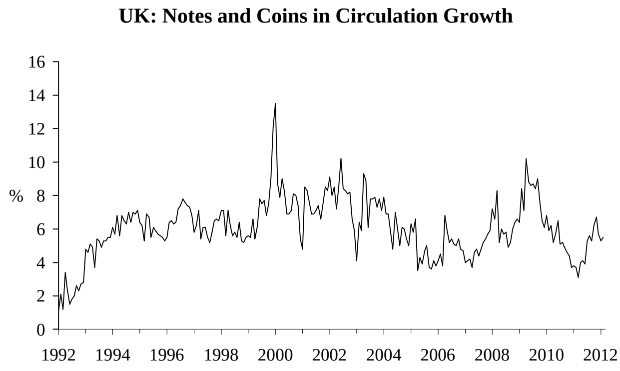
		2008	2009	2010	2011	2012	2013
GDP Growth[1]		–1.1	–4.3	1.8	1.0	1.4	2.0
Inflation	CPI	3.3	1.3	3.9	4.4	3.2	2.2
	RPIX	4.3	2.0	4.8	4.7	3.6	2.8
Unemployment (Mill.)							
	Ann. Avg.[2]	0.9	1.5	1.5	1.5	1.5	1.3
	4th Qtr.	1.1	1.6	1.5	1.6	1.4	1.2
Exchange Rate (2005=100)[3]		91.2	80.7	80.6	81.2	81.0	80.5
3 Month Interest Rate		5.1	0.8	0.6	1.0	2.3	2.5
5 Year Interest Rate		4.0	2.8	2.3	2.4	2.7	2.8
Current Balance (£ Billions)		–22.0	–26.1	–30.8	–5.8	–8.1	-7.4
PSBR (£ Billions)		73.8	127.8	110.8	121.9	100.6	97.2

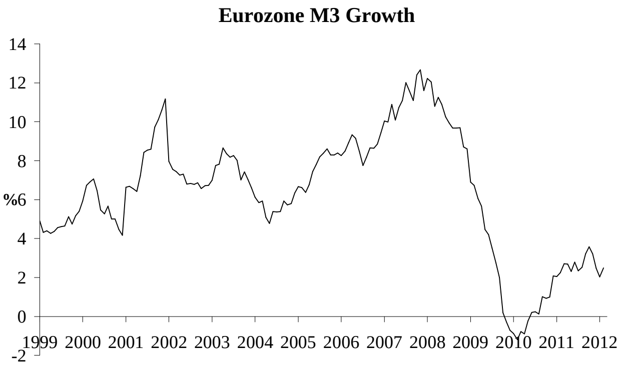
[1]Expenditure estimate at factor cost
[2]U.K. Wholly unemployed excluding school leavers (new basis)
[3]Sterling effective exchange rate, Bank of England Index

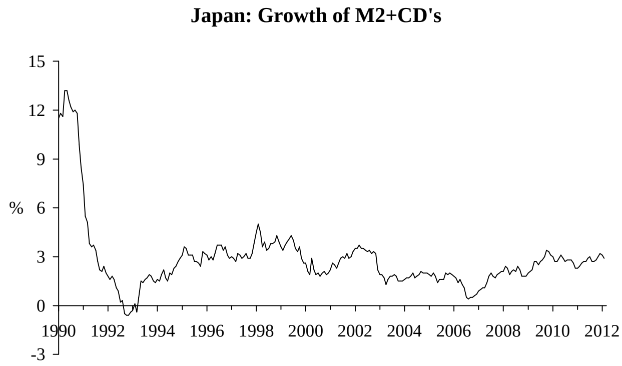
The costly rise in the allowance is balanced by extra taxes of various sorts: the extra 7% stamp duty band on properties over 2 million pounds is the main one. Another is the freezing of the allowances for pensioners and higher rate bands. On MRT grounds this whole package is poor. Stamp duty in particular is a tax that damages mobility and should in any case be repealed in favour of a proper consumption tax on the imputed rent of owner-occupied housing. But it is mandated by the politics of the coalition and as tax goes is relatively harmless. There has been a big fuss about the freezing of the pensioner allowance but in the context of the full indexation of pensions themselves over the last few years when real wages for other groups were falling dramatically, they have not been badly treated.

The latest news from the economy has been more upbeat, with purchasing surveys suggesting revival, much as they are in the US. The Osborne budget should add to business confidence. With the euro-zone crisis currently relegated to the backburner as a result of the ECB's €1 trillion injection of liquidity into the banking system, it should now be possible for the Bank to focus on getting interest rates up and unwinding its dangerously high holdings of UK government debt.


U.S.: Growth in Monetary Aggregates (Yr - on - Yr)
120
100
80
60
40
20
0
-20
%
M0
M1
M2
1991 1993 1995 1997 1999 2001 2003 2005 2007 2009 2011


UK: Notes and Coins in Circulation Growth
16
14
12
10
8
6
4
2
0
%
1992 1994 1996 1998 2000 2002 2004 2006 2008 2010 2012


Eurozone M3 Growth
14
12
10
8
6
4
2
0
-2
%
1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012


Japan: Growth of M2+CD's
15
12
9
6
3
0
-3
%
1990 1992 1994 1996 1998 2000 2002 2004 2006 2008 2010 2012

FOCUS ON JAPAN

Francesco Perugini

For the First Time Ever the Bank Of Japan Targets Inflation

At the Monetary Policy meeting in February, the Bank of Japan (BOJ) stepped up its monetary easing measures, breaking with precedent to announce an explicit consumer price inflation target of 1%, while ploughing a further ¥10 trillion into its asset purchase program — the Bank's main policy tool since the policy rate is already close to zero — solely for the purchase of Japanese government bonds. "For the time being, the Bank will pursue powerful monetary easing by conducting its virtually zero interest rate policy and by implementing the Asset Purchase Program … with the aim of achieving the goal of 1% in terms of the year-on-year rate of increase in the CPI", the BOJ said. The BOJ also defines desirable long-term price growth as consumer inflation of 2% or lower with the target to be reviewed once a year in principle.

The central bank's moves come after recent signs of weakness in the domestic economy — real GDP fell 0.9% in 2011, from a 4.5% rise in 2010. "There is high degree of uncertainty over the outlook for Japan's economy", BOJ Governor, Masaaki Shirakawa, said at the press conference. "The measures are intended to support growth amid the unfavourable global economic climate", he added, hinting the BOJ could be willing to inject massive amounts of the now ¥65 trillion asset purchase program into the market to spur the economy.

The new framework marked a break from the central bank's previously ambiguous definition of price stability. Setting the 1% inflation target "demonstrates the BOJ's will" and determination to revive the domestic economy, and will increase the impact of the central bank's policies in the market, Shirakawa said. But analysts pointed out that the BOJ avoided using the term for "target" in Japanese. "This is more a linguistic change than a monetary policy change," said Kyohei Morita, economist at Barclays Capital. "Politically, this meant something, but economically it meant nothing."

Others observers and practitioners noted that the change is, at least in part, the result of listening to a variety of opinions, including those of Diet members and key economists. The BOJ's decision "shows the BOJ bowed to political pressure," said Hiroaki Muto, a senior economist at Sumitomo Mitsui Asset Management in Tokyo. "It is obvious that mounting political pressure urged the BOJ to take radical action," echoed Masaaki Kanno, chief economist at JPMorgan.

Also, analysts speculated that the BOJ had acted following threats to revive legislation to strip away its independence since under governor Masaaki Shirakawa, appointed in April 2008, the Bank has never eased policy while simultaneously upgrading its economic outlook. "The BOJ never succumbs to political pressure when it implements monetary policy," Shirakawa replied. "If the independence of a central bank is not respected, it will eventually have a negative effect through rises in long-term interest rates."

In recent years, the Bank has tended to shrug off overt political pressure. A 1998 revision of the BOJ law strengthened its operational autonomy by removing the government's authority to dismiss the governor and deputy chiefs. Only under prime ministers with very solid popular support, such as Junichiro Koizumi between 2001 and 2006, has the BOJ appeared to bend to the government's will. It has put up a particularly strong defence of its independence under Shirakawa, promoted from deputy governor in 2008. The difference now is twofold, say analysts. First, politicians are worried about their own job security, thanks to a persistently strong yen and the related "hollowing out" of Japan's manufacturing sector. "The linkage between the exchange rate and deflation is now clearer in the minds of politicians," said Robert Feldman, senior economist at Morgan Stanley MUFG Securities. "As long as we have deflation the yen gets stronger".

The second reason for the unusual degree of political pressure is that Shirakawa's five-year term expires in April next year. The governor, deputy governors and six members of the nine-member policy board are officially nominated by the cabinet, and approved by the Diet. Internal candidates for promotion will be anxious not to rule themselves out of contention by appearing too hawkish, say analysts. "Senior BOJ officials are aware that the government could be trying to exclude them from selection. That is why they are trying to improve relations," said Hiromichi Shirakawa, chief Japan economist at Credit Suisse.

Economists also doubt that the BOJ's decision will have a substantial impact in lifting the economy. "A clearer price goal and additional monetary easing will probably help to prevent a strengthening of the yen and a deterioration of the economy," said Hiromichi Shirakawa. "But the two measures are not expected to be strong enough to make the yen's value fall or push up the economy." First of all, a 1% target might be "too low" and not a substantial change from existing policy. "Compared to the ECB's definition of price stability or the Fed's price target, the BOJ's clarification still seems vague," said Junko Nishioka, a Tokyo-based analyst at RBS Securities Japan Ltd.

Second, though other central banks' inflation targets are periodically reviewed, in practice, advanced economies have proven reluctant to fiddle with them. By setting its initial target at a lower rate than it hopes to achieve in the medium to longer term, the BOJ is implying that its approach to inflation targeting will be more flexible. The annual target allows for the sort of flexibility that BOJ Governor Shirakawa desires.

Finally and most importantly, for inflation targeting to be effective, businesses and consumers must be confident that the BOJ will relax monetary policy thoroughly to achieve that target, i.e., inflation targeting is supposed to work by influencing expectations. The BOJ's decision, may be seen as simply a response to increased political pressure to follow the Fed's example, therefore it could do little to convince markets and the public that the central bank is hell-bent on boosting growth and defeating deflation. If the BOJ really wants to signal its intent to fight deflation, then it needs a credible commitment to expand not only the current but also future money supplies, and it should announce that it will do whatever is necessary to achieve that. This will raise expected future prices and raise the equilibrium current price level and hence current output. In other words, setting an inflation target alone, although necessary, is not a sufficient condition for enhancing credibility. Japanese policymakers should start to build a history of matching deeds to words in order for their actions to be credible. However, Shirakawa himself has long been vocally sceptical about inflation targeting. He also makes clear in unambiguous terms that the BOJ still believes it cannot and should not try to defeat deflation with monetary policy alone. Price falls, he says, are a macroeconomic problem that can be solved only by action to "strengthen Japan's growth potential and growth expectations".

With deflation firmly entrenched for over a decade and a chronically overvalued currency, the BOJ's decision to print money in the pursuit of an inflation target does not appear credible and is likely to have no effect on the prospect of continuing deflation.

MARKET DEVELOPMENTS

The equity market is recovering its robustness as the eurozone crisis has gone into remission thanks to the massive liquidity boost created by the ECB. Green shoots are appearing here and in the US. Our confidence in the equity market has been justified by this latest turn of events. We are moving a further 5% of our portfolios out of cash and into equities; for each portfolio we have moved the 5% into their own-currency equities..

Table 1: Market Developments

	Market Levels		Prediction for Mar/Apr 2013	
	Feb 22	Mar 21	March Letter	Current View
Share Indices				
UK (FT 100)	5917	5892	7607	7636
US (S&P 500)	1358	1403	1514	1564
Germany (DAX 30)	6844	7071	8411	8691
Japan (Tokyo New)	825	859	1023	1055
Bond Yields (government long-term)				
UK	2.11	2.36	3.40	3.40
US	2.01	2.29	4.00	4.00
Germany	1.89	1.97	4.00	4.00
Japan	0.99	1.03	1.50	1.50
UK Index Linked	-0.14	-0.05	1.40	1.40
Exchange Rates				
UK ($ per £)	1.57	1.59	1.58	1.58
UK (trade weighted)	80.4	81.7	80.7	80.7
US (trade weighted)	80.1	81.0	84.0	84.0
Euro per $	0.76	0.76	0.78	0.78
Euro per £	1.18	1.20	1.23	1.23
Japan (Yen per $)	80.3	83.6	87.0	87.0
Short Term Interest Rates (3-month deposits)				
UK	1.00	0.67	2.50	2.50
US	0.37	0.36	0.50	0.50
Euro	0.92	0.74	2.50	2.50
Japan	0.18	0.25	0.40	0.40

Table 2: Prospective Yields [1]

Equities: Contribution to £ yield of:

	Dividend Yield	Real Growth	Inflation	Changing Dividend Yield	Currency	Total
UK	3.40	1.8	2.8	25.00		33.00
US	1.90	2.5	2.0	7.00	0.32	13.72
Germany	3.40	1.1	1.8	20.00	–2.58	23.72
Japan	2.20	2.1	–0.2	21.00	–3.74	21.36
UK indexed[2]	–0.05		2.8	–9.00		–6.25
Hong Kong[3]	2.50	8.0	2.0	2.00	0.32	14.82
Malaysia	3.10	5.5	2.0	42.00	0.32	52.92
Singapore	3.50	4.8	2.0	25.00	0.32	35.62
India	1.40	7.0	2.0	7.00	0.32	17.72
Korea	1.20	3.8	2.0	–17.00	0.32	–9.68
Indonesia	2.20	6.2	2.0	28.00	0.32	38.72
Taiwan	4.10	4.4	2.0	39.00	0.32	49.82
Thailand	2.90	4.8	2.0	28.00	0.32	38.02

Bonds: Contribution to £ yield of:

	Redemption Yield	Changing Nominal Rates	Currency	Total
UK	2.36	–10.40		–8.04
US	2.29	–17.10	0.32	–14.49
Germany	1.97	–20.30	–2.58	–20.91
Japan	1.03	–4.70	–3.74	–7.41

Deposits: Contribution to £ yield of:

	Deposit Yield	Currency	Total
UK	0.67		0.67
US	0.36	0.32	0.68
Euro	0.74	–2.58	–1.84
Japan	0.25	–3.74	–3.49

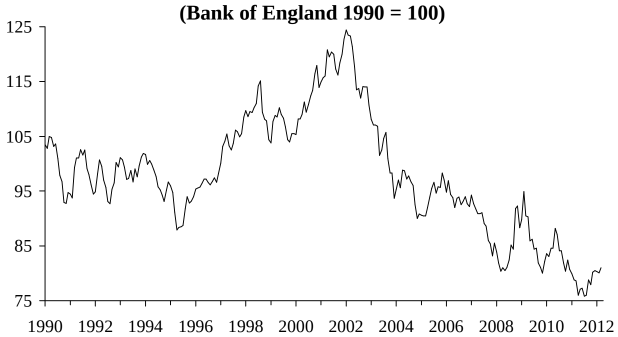
[1] Yields in terms of €s or $s can be computed by adjusting the £-based yields for the expected currency change.
[2] UK index linked bonds All Stocks
[3] Output based on China.

Table 3: Portfolio(%)

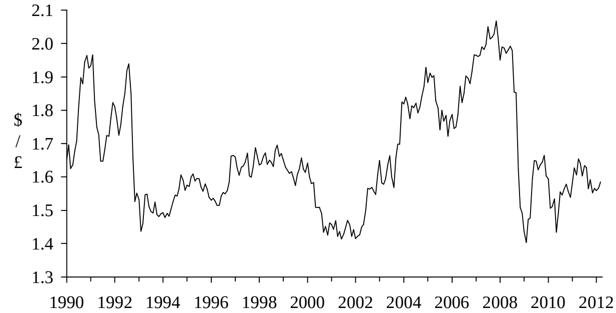
	Sterling Based Investor		Dollar Based Investor		Euro Based Investor	
	March Letter	Current View	March Letter	Current View	March Letter	Current View
UK Deposits (Cash)	15	10	15	10	3	1
US Deposits	-	-	-	-	3	-
Euro Deposits	-	-	-	-	-	-
Japanese Deposits	-	-	-	-	-	-
UK Bonds	-	-	-	-	-	-
US Bonds	-	-	-	-	-	-
German Bonds	-	-	-	-	-	-
Japanese Bonds	-	-	-	-	-	-
UK Shares	14	19	14	14	17	17
US Shares	14	14	14	19	16	16
German Shares	14	14	14	14	16	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	3	3	3	3	3	3
Brazilian Shares	3	3	3	3	3	3
Chilean Shares	3	3	3	3	3	3
Mexican Shares	3	3	3	3	3	3
Peruvian shares	3	3	3	3	3	3
Other:						
Index-linked bonds (UK)	-	-	-	-	-	-

INDICATORS AND MARKET ANALYSIS
FOREIGN EXCHANGE MARKETS[1]

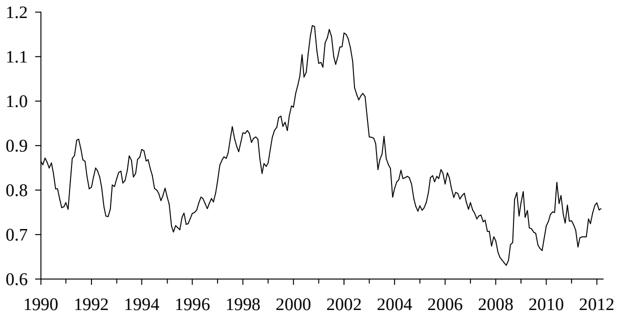
US : Trade Weighted Index
(Bank of England 1990 = 100)



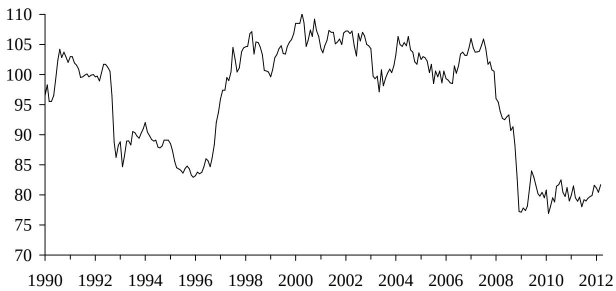
UK: Dollars Per Pound Sterling



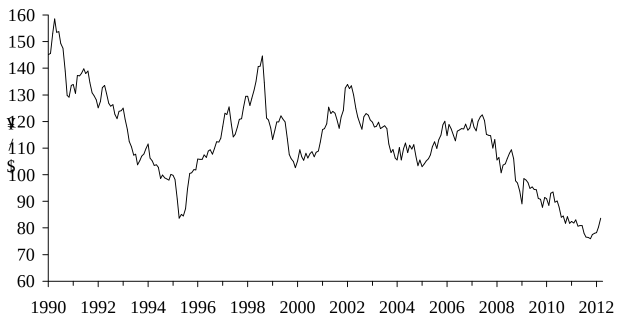
Euro per US dollar



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



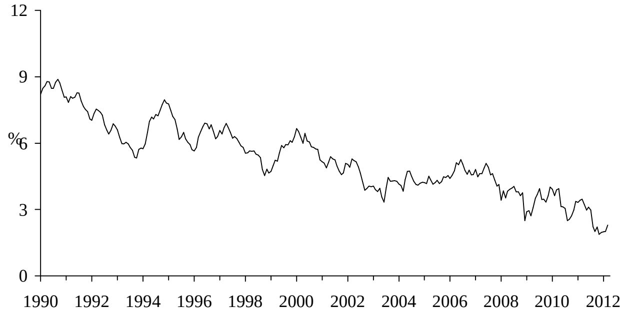
Japan : Yen Per U.S. Dollar



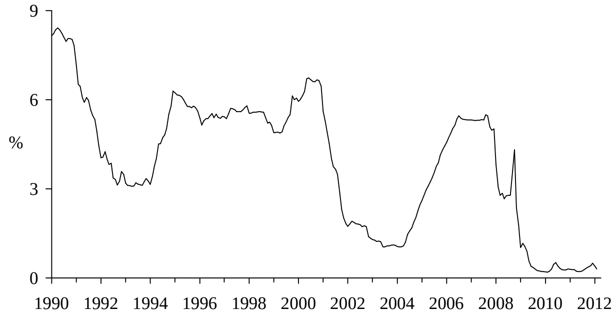
[1] John Wilmot, who has written these sections since this Letter began, is indisposed. We are issuing the charts without his commentary this month. We wish him a speedy recovery.

GOVERNMENT BOND MARKETS

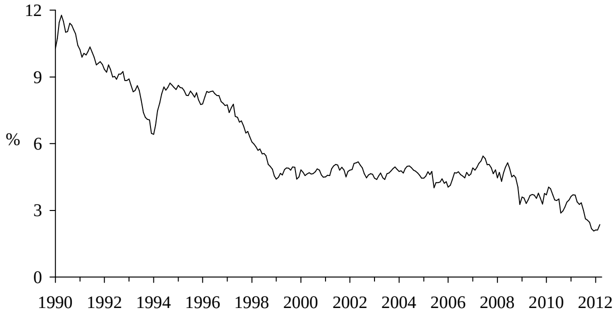
U.S.: Yield on Long-Term Government Bonds



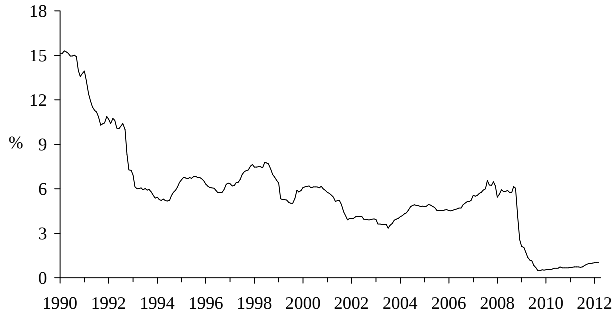
U.S. : 3-Month Certificate of Deposit



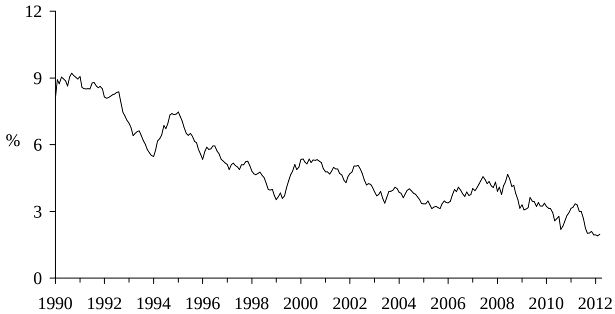
U.K. : Yield on Long-Term Government Bonds



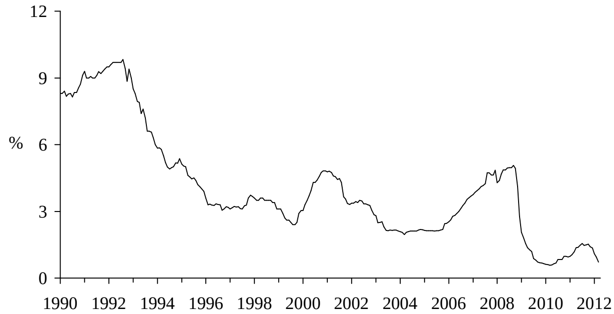
U.K. : 3-Month Interbank Rate



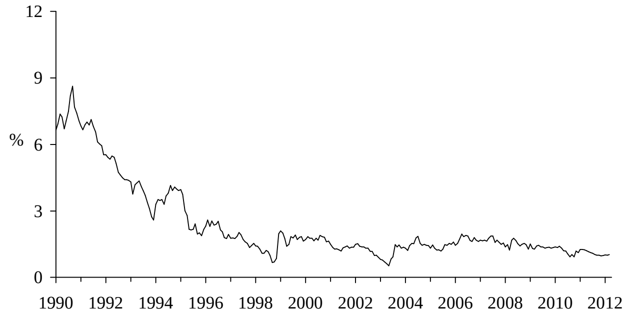
Germany: Yield on Public Authority Bonds



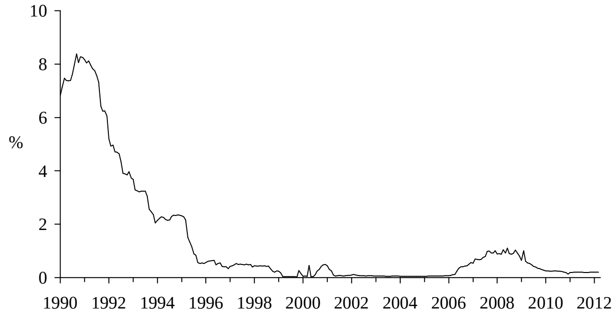
Germany : 3-Month Interbank Deposit Rate



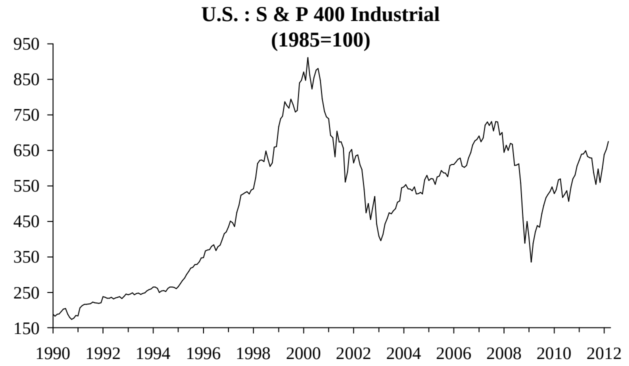
Japan: Yield on Long-Term Government Bonds

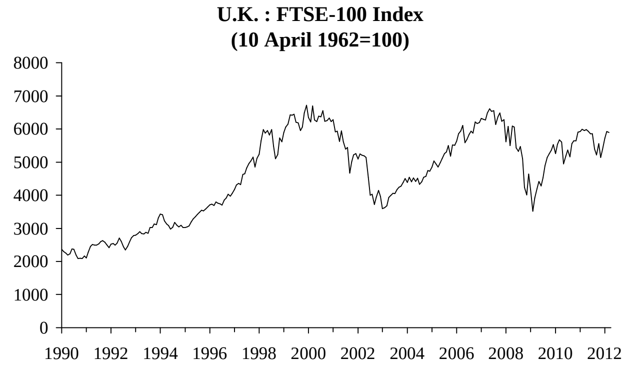


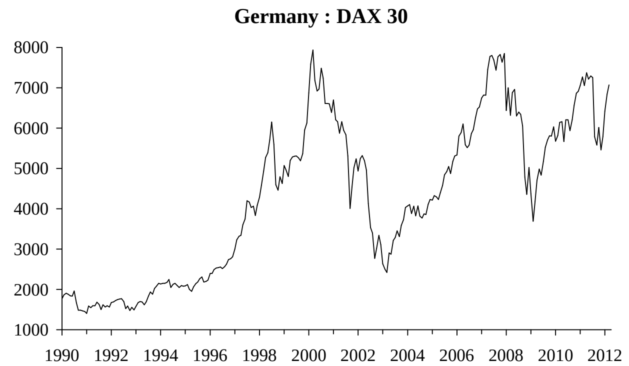
Japan : 3 Month Money Market Rate

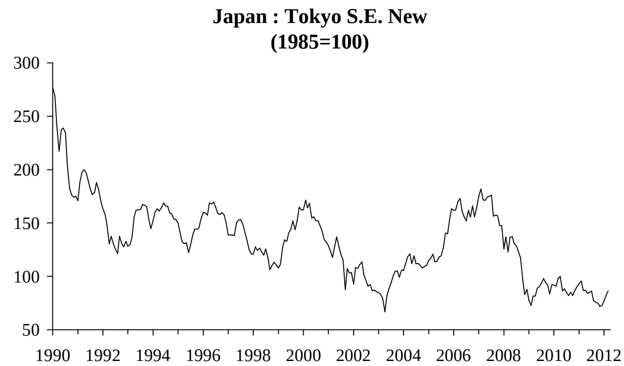


MAJOR EQUITY MARKETS









EMERGING MARKETS

India

The country's gross domestic product is expected to expand by 6.9% this year, sharply down from 8.4% in the previous year. The central bank is steadfast in keeping interest rates high as its focus remains on controlling prices. But it loosened its tight monetary policy to ease a credit squeeze in the banking system in mid-March.

The government hopes that growth will recover to 7.6% next year. However, there is a sharp drop-off in investment by the private sector — corporate investment has slipped 400 basis points to 14% of GDP from its pre-global crisis level. Manufacturing grew only 0.4% in the December quarter. Mining, which provides crucial inputs for infrastructure sectors like steel and power, contracted 3.1%. India's fiscal deficit, meanwhile, will be about 6% of GDP this year.

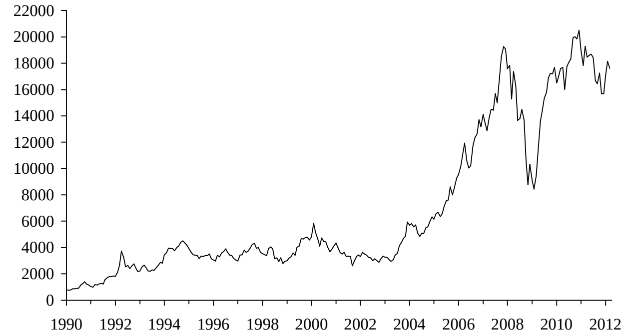
India's trade deficit widened for the second straight month in February as weakening global demand hurt export growth. The trade gap in February widened to $15.2 billion from $14.7 billion in January. The Indian economy faces a severe deficit problem due to its heavy dependence on imports to meet its oil needs — India imports three-quarters of the crude oil it requires. Exports for the fiscal year are expected to be between $290 billion and $298 billion, marginally missing the government's initial estimate of $300 billion.

Imports also have been slowing, although not as much as exports, as a weak Indian rupee has added to import costs. The local currency fell about 16% against the U.S. dollar in 2011, though it is up about 6% so far in 2012.

With this economic background, the government presented its budget on March 16th. The government missed the opportunity to give a fillip to economic activity in the country as the emphasis remained on how to divide a small pie rather than how to grow it. The ruling party, having lost provincial elections, chose to have a populist budget as a "political survival strategy". The budget showed no inclination towards bringing down expenditure in the form of subsidies.

The budget has set a fiscal deficit target of 5.1% of the gross domestic product. This is lower than the 5.9% expected in the current year, but may turn out to be 6% as subsidies are under-provided and, thus, will crowd out private sector investment. According to the government, it is banking on share sales in state assets to meet its fiscal gap but will have to keep its fingers crossed and pray that the markets support the government's disinvestment programme.

India: BSE Sensitive



There was no progress on long pending reforms on issues like allowing higher foreign direct investment in the retail and aviation industries, or introducing a transparent and uniform tax on goods and services.

	08-09	09-10	10-11	11-12	12-13
GDP (%p.a.)	6.7	7.4	7.5	7.0	7.0
WPI (%p.a.)	5.5	9.5	9.0	7.5	7.5
Current A/c(US$ bill.)	–56.0	–14.0	–31.0	–40.0	–35.0
Rs./$(nom.)	48.5	48.0	49.0	49.5	48.0

China

Chinese Premier Wen Jiabao gave a rude jolt to the world when he announced the government is targeting only 7.5% growth for 2012. With a lower target, Beijing will feel less compelled to over-feed the economy with forced credit to meet or exceed its desired growth rate. A preliminary report suggests that Chinese manufacturing activity contracted for a fifth month in March. The lowering of China's growth target will have profound implications for countries like Australia and Brazil that have prospered from the Chinese demand for commodities. The International Monetary Fund, however, forecasts Chinese growth of 8.2% this year.

Consumer inflation in China increased 3.2% from a year ago in February, down from 4.5% in January and the slowest pace since June 2010. The policy-induced property slowdown is stressing the finances of local governments, which rely on land sales for revenue. Some local governments have tried easing policy in recent months, despite repeated pledges by China's top leaders to stick to the country's two-year property tightening campaign.

China has cut banks' reserve requirements twice since late last year, freeing up funds for lending — but has not cut interest rates, which could risk reigniting inflation or reinflating property prices.

The country's exports are likely to rise at a single-digit pace this year, having risen 20.3% last year. Exports rose 18.4% in February from a year earlier after falling 0.5% in

January. Imports rose 39.6% from a year earlier, compared to a 15.3% decline in January. For January and February combined, exports rose 6.9% while imports rose 7.7%. The January–February trade deficit came to $4.25 billion, compared with a slight deficit of $890 million in the first two months of last year.

With deteriorating trade data, Chinese officials now argue that the yuan is less undervalued. China has signalled that it might suspend its long-standing policy of allowing the yuan to rise gradually against the U.S. dollar. The yuan has depreciated roughly 0.5% against the dollar since the beginning of 2012, after gaining 4.7% last year. We expect the currency to appreciate by only 2% to 3% in 2012.

Foreign companies with major Chinese operations, such as Ford, are now turning more to the offshore yuan debt market, even though raising dollar-debt remains cheaper, in part to minimize foreign-exchange risks. Beijing's recent decision to ease channels for yuan fund transfers into mainland China is also supporting the market. Caterpillar, which has construction and mining equipment businesses in China, sold 1.26 billion yuan (US$200 million) worth of offshore yuan debt in its third issuance of dim sum bonds in February.

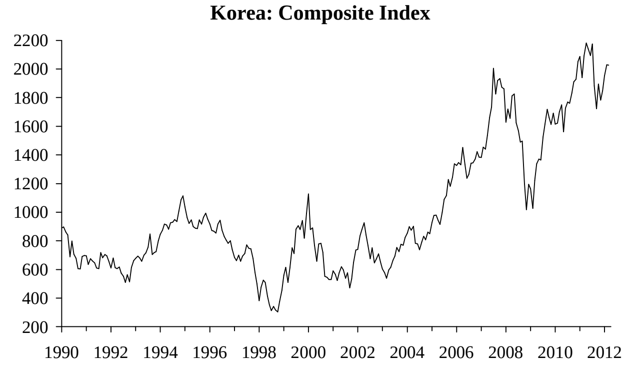
Further, the China Development Bank is seeking an agreement with its counterparts in Brazil, Russia, India and South Africa, which will make available loans denominated in their own currencies. This is a concrete step by China towards expanding renminbi settlement of China's imports and exports. It seems that Beijing is taking baby steps on the road to what could end up with full convertibility of yuan.

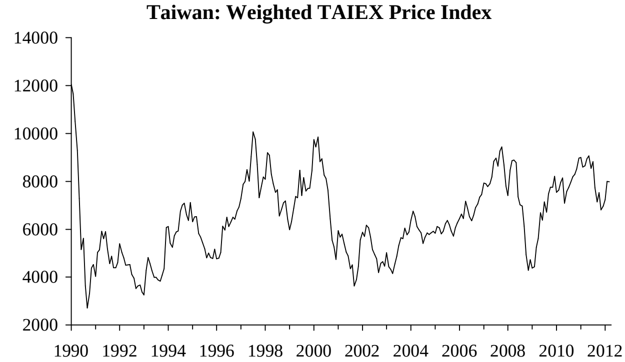
	08	09	10	11	12
GDP (%p.a.)	13.0	8.7	10.3	9.2	8.0
Inflation (%p.a.)	6.8	–0.8	5.9	4.3	3.1
Trade Balance(US$ bill.)	330	180	183	155	140
Rmb/$(nom.)	6.7	6.8	6.6	6.3	6.1

South Korea

The government forecast of economic growth of 3.7% for the country in 2012 this year is likely to be breached due to rising oil prices feeding into higher costs for exporters, which will erode domestic consumption. Domestic annual inflation eased to a 14-month low of 3.1% in February, but the price of gasoline at filling stations has been hitting all-time highs.

Consumers' inflation expectations remained at or above the upper end of the BOK's 2–4% target band for an eighth straight month in February. The Bank of Korea kept its benchmark interest rate on hold for a ninth straight month as it balances risks to the economy from inflation and signs of slowing growth. The policy rate is at 3.25% since June last year. The BOK is likely to keep the base rate unchanged throughout this year.





South Korea's jobless rate hit an 11-month high in February, due mainly to an increase in the number of job seekers as new graduates entered the market, but overall conditions indicate that the economy remains steady.

South Korea's trade balance returned to a surplus in February from a deficit in the previous month. Preliminary government data shows February exports up 23% from a year earlier, to $47.2 billion, led by brisk sales of ships and cars, and imports up 24%, to $45 billion. The resulting $2.2 billion trade surplus for the month of February was a sharp reversal January's $2.03 billion deficit, the country's first monthly trade deficit in two years.

The free trade agreement between South Korea and the U.S. was implemented on March 15, which took four years of political battling to complete. The pact is generally expected to contribute to faster growth in trade as by much as 10% in value terms within five years.

	08	09	10	11	12
GDP (%p.a.)	2.2	0.2	6.1	3.6	3.5
Inflation (%p.a.)	5.0	2.6	2.9	4.2	3.8
Current A/c(US$ bill.)	–7.9	42.7	28.2	27.0	13.0
Won/$(nom.)	1250	1200	1150	1100	1100

Taiwan

Taiwan's gross domestic product is likely to expand at a rate of 3–4% in 2012. The Government hopes that the economy will do better in the second half as the US, its main exports market, grows.

Inflation in Taiwan decelerated in February, but rising global fuel costs could stoke inflation in coming months. The island's consumer price index rose 0.25% in February from a year earlier. Consumer prices in the January–February period combined rose 1.31% from a year earlier.

Taiwan's dollar has strengthened on speculation that the central bank will keep interest rates unchanged as the economy recovers. Businessmen are positive on their business outlook in the current month, however, most of the companies surveyed saw economic uncertainty as the biggest risk to their outlook.

A Chinese attempt to develop a special economic zone with joint Taiwanese management is in trouble, as the government sees it as an attempt by Beijing to make political inroads on the democratic island. The Pingtan Experimental Zone, an industrial park to be built on a fishing village in China's Fujian Province, faces Taiwan across the 100-mile Taiwan Strait. Beijing is touting it as an opportunity for Taiwanese business people to stand shoulder to shoulder with their mainland cousins, developing, managing and operating the project on a joint basis.

	08	**09**	**10**	**11**	**12**
GDP (%p.a.)	1.9	–1.9	10.8	4.0	3.1
Inflation (%p.a.)	3.8	0.0	1.3	1.2	1.3
Current A/c(US$ bill.)	29.0	16.0	16.0	18.0	20.0
NT$/$(nom.)	32.0	32.0	31.0	30.0	29.5

Brazil

Brazil's sharp slowdown in 2011, down to 2.7% in 2011 from 7.5% in 2010, is a sharp reminder of its dependence on growth in the developed world. In January industrial production showed a 2.1% nominal decline from December. It may turn out that Brazil will eke out around 3.5% growth in 2012, but still far below its potential for an economy with rich stores of iron ore, oil, soy, beef and other commodities. However, it faces a downside risk if China does slow down to 7.5% in 2012.

Brazil blames slow growth on its strong currency, which has made locally made goods uncompetitive. According to Brazil, aggressive monetary easing by the U.S. and Europe weakens the dollar and the euro, while sending a speculative flood of money toward Brazil, which strengthens the real. Brazil's central bank is taking a dovish stand on interest rates. Unexpectedly, it has cut the Selic base rate three-quarters of a point to 9.75%. It is the first time for Brazilians to enjoy a single-digit base rate since 2010. The central bank may cut the rate further to boost growth. But Brazilian inflation remains high, running at an annual rate of 6.0%, down only slightly from 6.5% for calendar year 2011.

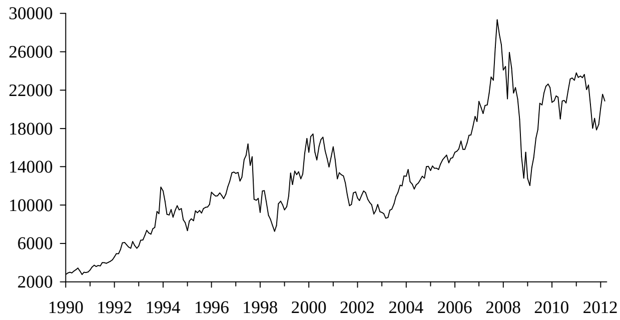
Brazil's government has promised to deploy more regulatory and financial weapons to keep its currency from appreciating too much against the dollar. The government believes that Brazil's high interest rates and solid economy are attracting money and causing the real to strengthen against the dollar. The real has gained more than 9% against the U.S. currency since the start of the year. Brazil has embarked on a new offensive to suppress gains in the real. It extended a tax on foreign loans for the second time in February. The government would like to see trading in the range R$1.75 to R$1.80 per dollar for most of 2012.

In order to protect Brazilian industry from unfair competition the government is taking some unusual steps. Brazil forced Mexico to renegotiate a 10-year-old car trade agreement. Brazil is using its muscle as Latin America's largest domestic market to protect local industry. Moreover, measures such as stringent local content rules in the oil industry, increased taxes on imported cars and currency controls are fuelling suspicions that Brazil is reverting to old protectionist instincts.

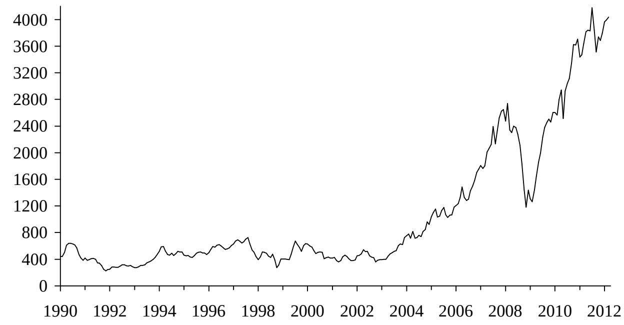
	08	**09**	**10**	**11**	**12**
GDP (%p.a.)	5.1	–0.2	7.5	3.0	3.0
Inflation (%p.a.)	6.0	4.1	5.9	6.5	5.6
Current A/c(US$ bill.)	–25.0	–20.0	–47.3	–52.6	–60.0
Real/$(nom.)	2.2	1.8	1.7	1.5	1.7

Other Emerging Markets

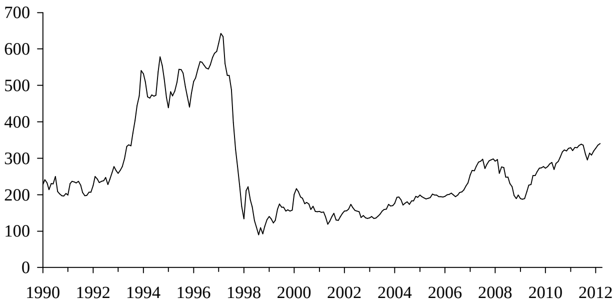
Hong Kong: FT-Actuaries



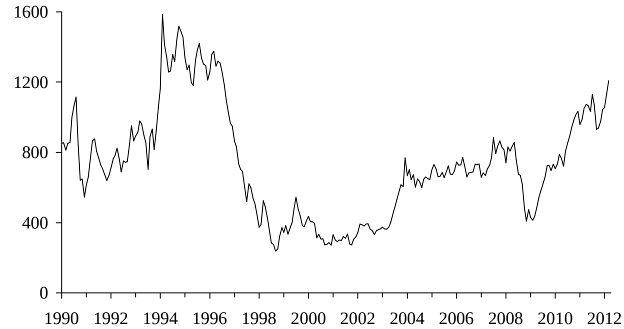
Indonesia: Jakarta Composite



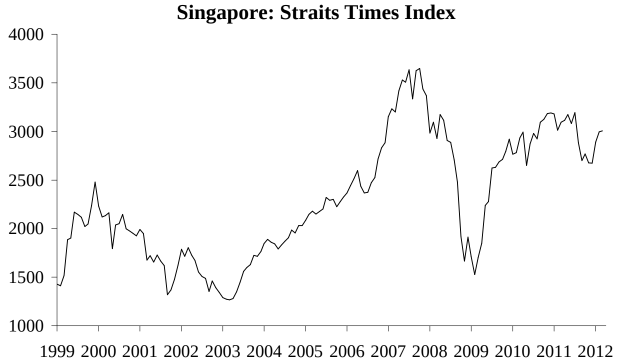
Malaysia: FT-Actuaries (US$ Index)



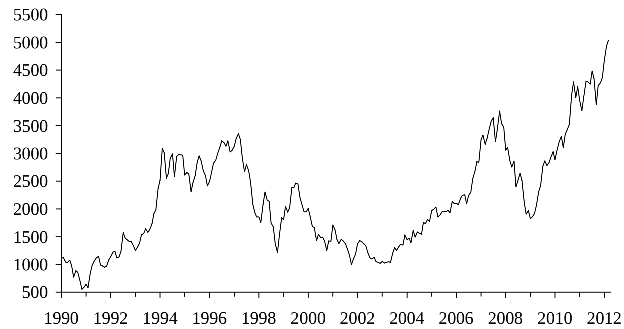
Thailand: Composite Index



Singapore: Straits Times Index

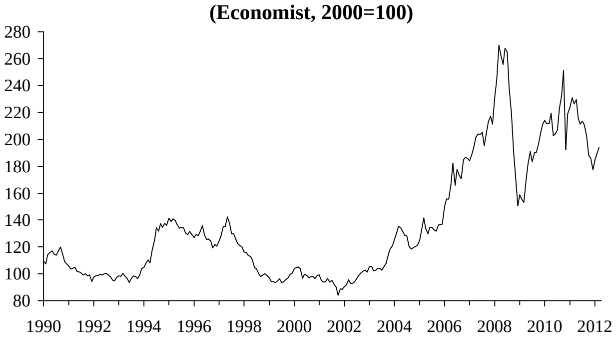


Philippines: Manila Composite

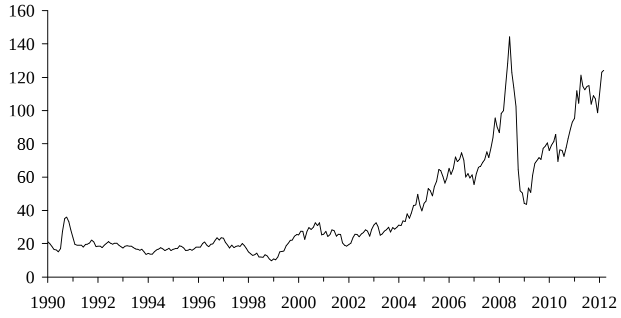


COMMODITY MARKETS

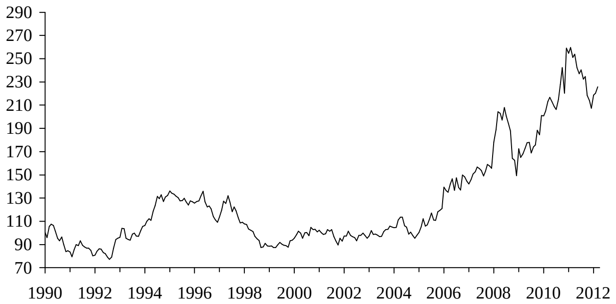
Commodity Price Index (Dollar)
(Economist, 2000=100)



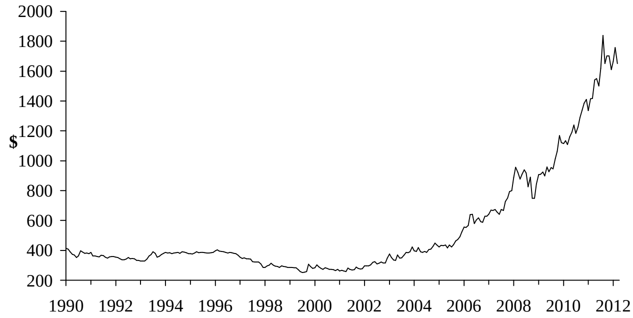
Oil Price: North Sea Brent (in Dollars)



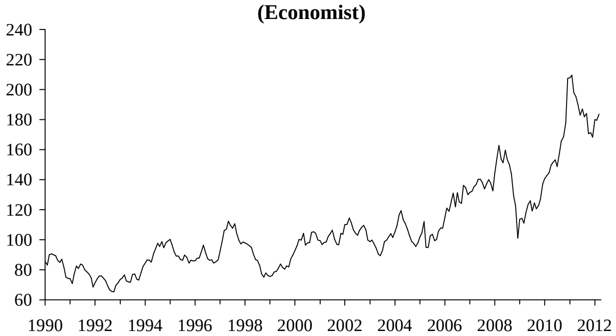
Commodity Price Index (Sterling)
(Economist, 2000=100)



Gold Price (in Dollars)



Commodity Price Index (Euro)
(Economist)



UK FORECAST DETAIL

Prices, Wages, Interest Rates and Exchange Rate Forecast (Seasonally Adjusted)

	Inflation %[1] (CPI)	Short Dated (5 Year) Interest Rates	3 Month Int. Rates	Nominal Exchange Rate (2005=100)[2]	Real Exchange Rate[3]	Real 3 Month Int. Rates %[4]	Inflation (RPIX)	Real Short Dated Rate of Interest[5]
2008	3.3	4.0	5.1	91.2	100.3	3.7	4.3	1.0
2009	1.3	2.8	0.8	80.7	89.5	-3.1	2.0	-0.3
2010	3.9	2.3	0.6	80.6	91.2	-3.8	4.8	-0.5
2011	4.4	2.4	1.0	81.2	94.5	-2.2	4.7	0.1
2012	3.2	2.7	2.3	81.0	95.8	0.1	3.6	0.7
2013	2.2	2.8	2.5	80.5	95.7	0.5	2.8	0.8
2010:1	2.8	2.8	0.5	79.9	89.8	-4.3	4.5	-0.1
2010:2	4.1	2.2	0.7	80.2	90.3	-3.8	5.1	-0.6
2010:3	4.2	1.8	0.6	82.0	92.9	-3.6	4.7	-0.9
2010:4	4.4	2.3	0.7	80.5	91.6	-3.3	4.7	-0.3
2011:1	4.8	2.7	0.8	81.1	93.8	-2.8	5.3	0.2
2011:2	4.5	2.2	0.8	79.6	92.4	-2.5	5.0	-0.2
2011:3	4.2	2.4	1.1	82.2	95.8	-2.0	4.3	0.1
2011:4	4.0	2.5	1.6	82.0	95.9	-1.2	4.2	0.3
2012:1	3.6	2.6	2.0	80.7	95.4	-0.5	3.9	0.5
2012:2	3.3	2.6	2.2	81.3	96.1	0.0	3.7	0.6
2012:3	3.1	2.8	2.5	81.0	95.8	0.4	3.5	0.8
2012:4	2.8	2.8	2.5	80.9	95.7	0.5	3.3	1.4

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)
2008	220.4	3.5	2.8	0.91	138.9
2009	220.2	0.0	4.6	1.53	136.9
2010	225.2	2.4	4.6	1.50	134.8
2011	230.5	2.4	4.7	1.53	132.2
2012	239.9	4.1	4.4	1.47	133.4
2013	249.0	3.8	3.8	1.27	135.5
2010:1	224.2	4.4	4.8	1.57	136.3
2010:2	222.9	1.0	4.6	1.49	133.9
2010:3	225.3	2.2	4.5	1.47	134.3
2010:4	228.4	1.9	4.5	1.46	134.8
2011:1	229.8	2.6	4.4	1.45	133.2
2011:2	228.8	2.7	4.6	1.50	131.5
2011:3	229.9	2.0	4.8	1.58	131.5
2011:4	233.5	2.2	4.8	1.59	132.5
2012:1	237.3	3.3	4.6	1.54	132.8
2012:2	239.1	4.5	4.5	1.49	133.2
2012:3	240.5	4.6	4.3	1.44	133.5
2012:4	242.7	3.9	4.2	1.39	134.0

1 Whole Economy
2 Average Earnings
3 Wholly unemployed excluding school leavers as percentage of employed and unemployed, self employed and HM Forces
4 Wage rate deflated by CPI

Estimates and Projections of the Gross Domestic Product[1] (£ Million 1990 Prices)

	Expenditure Index	£ Million '90 prices	Non-Durable Consumption[2]	Private Sector Gross Investment Expenditure[3]	Public Authority Expenditure[4]	Net Exports[5]	AFC
2008	147.3	705312.2	421176.1	253264.5	176727.6	-46562.6	99293.5
2009	140.8	674466.5	405440.7	218144.6	178391.0	-33226.3	94283.5
2010	143.3	686345.3	405565.3	241422.1	180777.4	-42021.1	99398.4
2011	144.8	693331.3	400381.9	236752.2	182398.0	-31348.2	94851.3
2012	146.8	703170.7	401572.0	247757.1	184603.4	-33345.2	97417.6
2013	149.8	717526.3	407987.9	255148.0	187436.1	-33320.4	99720.5
2008/07	-1.1		-1.5	-2.2	3.4		8.7
2009/08	-4.3		-3.7	-13.4	0.9		-5.0
2010/09	1.8		0.0	10.7	1.3		5.6
2011/10	1.0		-1.3	-1.7	0.9		-3.9
2012/11	1.4		0.3	4.7	1.2		2.8
2013/12	2.0		1.6	3.0	1.5		2.4
2010:1	141.9	169929.6	101035.9	54839.4	47326.4	-10076.3	23195.7
2010:2	143.4	171724.0	101994.9	57226.4	43888.6	-9819.2	21566.7
2010:3	144.3	172787.0	101409.9	65728.6	44640.8	-11710.3	27282.0
2010:4	143.6	171904.6	101124.6	63627.7	44921.5	-10415.2	27354.0
2011:1	144.2	172584.4	100688.1	55175.7	47489.5	-7019.6	23749.4
2011:2	144.3	172761.4	99684.3	58473.2	44536.4	-7695.8	22236.7
2011:3	145.6	174351.0	99891.2	61928.1	45087.9	-8312.5	24243.0
2011:4	145.0	173634.6	100118.2	61175.2	45284.1	-8320.4	24622.2
2012:1	145.7	174471.0	100187.7	58861.3	47967.7	-8338.6	24207.2
2012:2	146.2	174997.3	99883.8	62474.5	45027.4	-8332.2	24056.9
2012:3	147.8	176953.2	100387.2	63758.7	45681.0	-8335.7	24538.7
2012:4	147.6	176749.1	101113.3	62662.6	45927.2	-8338.7	24614.9

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	Debt Interest (£bn)	Current Account (£ bn)
2008	5.8	1262.4	73.8	33.2	-22.0
2009	10.3	1244.4	127.8	32.4	-26.1
2010	8.3	1333.7	110.8	36.6	-30.8
2011	8.8	1391.3	121.9	43.1	-5.8
2012	6.9	1457.5	100.6	49.6	-8.1
2013	6.4	1519.8	97.2	52.7	-7.4
2010:1	8.1	317.8	25.9	8.4	-6.9
2010:2	10.2	321.7	32.7	8.8	-10.1
2010:3	7.8	335.7	26.2	8.9	-9.7
2010:4	11.3	337.6	38.3	9.2	-4.1
2011:1	4.0	338.7	13.6	9.7	-2.0
2011:2	8.5	339.2	28.9	10.1	-1.1
2011:3	4.7	347.4	16.3	10.4	-2.8
2011:4	12.2	349.5	42.5	11.0	0.1
2012:1	9.6	355.2	34.2	11.6	-4.0
2012:2	6.4	357.8	23.1	12.0	-1.6
2012:3	6.5	363.5	23.7	12.4	-2.8
2012:4	6.7	364.9	24.5	12.5	0.2

1 GDP at market prices (Financial Year)

WORLD FORECAST DETAIL

Growth Of Real GNP

	2007	2008	2009	2010	2011	2012
U.S.A.	1.9	0.0	–2.6	2.6	1.9	2.5
U.K.	3.5	–1.1	–4.3	1.8	1.0	1.4
Japan	2.3	–1.2	–6.3	4.3	–0.4	2.1
Germany	2.7	1.0	–4.7	3.6	2.9	1.1
France	2.3	0.1	–2.5	1.5	1.6	1.0
Italy	1.4	–1.3	–5.1	0.9	0.6	0.1

Real Short-Term Interest Rates

	2007	2008	2009	2010	2011	2012
U.S.A.	0.6	1.8	–1.6	–1.8	–1.7	–1.5
U.K.	2.9	3.7	–3.1	–3.8	–2.2	0.1
Japan	–0.8	1.8	1.1	0.5	0.4	0.3
Germany	1.3	3.5	–0.4	–1.3	–0.3	0.5
France	1.1	3.8	–0.8	–1.4	–0.3	0.5
Italy	0.5	3.1	–0.8	–1.4	–0.3	0.5

Real Long-Term Interest Rates

	2007	2008	2009	2010	2011	2012
U.S.A.	2.8	2.2	1.3	1.1	1.2	2.0
U.K.	2.3	1.0	–0.3	–0.5	0.1	0.7
Japan	2.0	2.0	1.4	1.1	1.1	1.3
Germany	2.8	3.0	2.3	1.9	1.8	2.0
France	2.7	3.0	2.2	1.9	1.8	2.0
Italy	2.4	2.8	2.2	1.9	1.8	2.0

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

	2007	2008	2009	2010	2011	2012
U.S.A.	83.4	80.1	88.7	81.7	81.8	82.0
U.K.	98.9	87.6	78.2	79.7	82.5	83.7
Japan	81.2	87.9	89.0	80.2	79.8	79.7
Germany	104.6	105.1	105.8	99.3	99.0	99.1
France	104.9	106.4	104.3	101.7	102.0	102.0
Italy	105.0	106.6	105.4	100.5	100.8	101.0

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

Growth Of Consumer Prices

	2007	2008	2009	2010	2011	2012
U.S.A.	2.9	3.8	–0.3	1.8	2.9	2.0
U.K.	2.5	3.3	1.3	3.9	4.4	3.2
Japan	0.0	1.4	–1.4	–1.0	–0.3	–0.2
Germany	2.3	2.6	0.4	1.1	2.3	1.8
France	1.5	2.8	0.1	1.5	2.1	1.6
Italy	1.8	3.4	0.8	1.5	2.7	2.0

Nominal Short-Term Interest Rates

	2007	2008	2009	2010	2011	2012
U.S.A.	4.4	1.5	0.2	0.1	0.3	0.5
U.K.	5.9	5.1	0.8	0.6	1.0	2.3
Japan	0.6	0.4	0.1	0.1	0.4	0.4
Germany	3.9	3.9	0.7	0.4	1.5	2.5
France	3.9	3.9	0.7	0.4	1.5	2.5
Italy	3.9	3.9	0.7	0.4	1.5	2.5

Nominal Long-Term Interest Rates

	2007	2008	2009	2010	2011	2012
U.S.A.	4.6	3.7	3.2	3.1	3.2	4.0
U.K.	5.0	4.0	2.8	2.3	2.4	2.7
Japan	1.7	1.5	1.3	1.1	1.2	1.5
Germany	4.3	4.4	4.0	3.8	3.8	4.0
France	4.3	4.4	4.0	3.8	3.8	4.0
Italy	4.3	4.4	4.0	3.8	3.8	4.0

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

	2007	2008	2009	2010	2011	2012
U.S.A.[1]	89.38	81.72	81.61	82.12	83.97	83.94
U.K.	2.00	1.85	1.57	1.55	1.61	1.58
Japan	117.75	103.40	93.56	87.76	87.10	87.00
Eurozone	0.73	0.68	0.72	0.75	0.78	0.78

[1] The series for the USA is a trade weighted index (1990=100); the series for the UK is $ per £

* Forecasts based on the Liverpool World Model