# LIVERPOOL INVESTMENT LETTER

**April 2013** 







#### LIVERPOOL RESEARCH GROUP IN MACROECONOMICS

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The Julian Hodge Institute was launched in autumn 1999 in a new collaboration between the Cardiff Business School of Cardiff University and 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, 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 David Meenagh and Bruce Webb and published on behalf of the group by Liverpool Macroeconomic Research Limited, which holds the copyright

ISSN 0951-9262

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<sup>†</sup>Cardiff Business School

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#### AFTER THE BUDGET

While there has been criticism of the Chancellor's decision to subsidise mortgages, for us this is a most significant step for monetary policy. As we have argued in previous Letters, excessively harsh regulation of the banks— and especially the heavy new capital requirements which are expensive to meet now when banks are unattractive to investors— have raised the costs of credit to SMEs and personal borrowers, the two sets of clients who have no effective alternative to banking. So the credit channel is blocked by regulation.

By subsidising mortgages which are widely used by both these client sets, the Treasury is directly offsetting this distortion. It remains to be seen how effective the subsidy is in practice; as so often with these bureaucratic interventions one cannot know until the detail is laid out of how it is all accessed, what side-conditions and so on. However, what is becoming clear is that the Treasury and the Bank may at last be taking action to relieve the effects of their other, regulative, actions on monetary conditions; the Funding for Lending scheme (FLS) is another one of this type that may be having a modest effect. QE, as I have argued and shown in the data, is not doing the job; it is merely reducing returns to savers, cheapening the cost of credit to government and possibly preserving 'zombie' clients.

It would be better to reverse the regulations and allow the market to work freely. But with the great and the good determined to regulate, as seen in the Parliamentary Committee and the Vickers Report, the only avenue left is this sort of offset.

Our view therefore is that this latest mortgage offset, together with the FLS, should be consolidated and strengthened as necessary to eradicate the distortion and get the cost of credit down to these two sets of clients. QE should be stopped and steadily reversed. Interest rates should be raised towards normal levels, starting with 0.5% this month, with a bias to continue upwards. The object should be to return general rates to normal, while eradicating the abnormal premium on SME/personal lending.

#### The Post-budget outlook

The UK growth outlook for 2013 was downgraded by the Treasury to 0.6%. As usual the GDP numbers look strange beside employment growth; they will almost certainly be revised up in due course. But for now we are stuck with the ONS' figures. What is clear is that investment is flat or falling as large firms refuse to move and SMEs are simply unable to borrow. Hence the significance of the Chancellor's attempt to break the mortgage deadlock just discussed. If only he would recant the whole regulative

**Table 1: Summary of Forecast** 

	2010	2011	2012	2012	2014	2015	2017
	2010	2011	2012	2013	2014	2015	2016
GDP Growth <sup>1</sup>	1.8	0.9	0.1	1.5	2.0	2.4	2.6
Inflation C	PI 3.7	4.7	2.8	2.8	2.6	2.2	2.0
RPI	X 4.8	5.3	3.3	3.3	3.1	2.8	2.7
Unemployment (Mill.)							
Ann. Avg	$g.^2$ 1.5	1.5	1.6	1.5	1.4	1.3	1.2
4th Q	tr. 1.5	1.6	1.6	1.5	1.3	1.2	1.1
Exchange Rate <sup>3</sup>	80.4	80.0	83.0	83.5	82.7	82.1	81.5
3 Month Interest Rate	0.7	0.9	0.9	0.9	1.7	2.1	2.2
5 Year Interest Rate	2.4	2.0	0.9	1.3	1.8	2.1	2.4
Current Balance (£bn)	-37.3	-20.4	-51.9	-52.2	-52.8	-53.0	-52.0
PSBR (£bn)	115.1	94.2	95.4	98.2	84.7	72.2	60.5

<sup>&</sup>lt;sup>1</sup>Expenditure estimate at factor cost

mania that he and the rest of the establishment have espoused since the crisis...

The effects of the eurozone's problems continue to be severe. The euro crisis, as we have said repeatedly, will go on and on. It will not break the euro, for all the wishes of eurosceptics; this is because it is a political project in which massive capital has been invested by the euro elite and whose forsaking is desperately opposed by public opinion in all parts of the eurozone. It is not that they like austerity but rather that the fear of the political unknown outside the euro is far greater. The two possible exceptions are public opinion in German and Holland; but things will have to get terrible indeed for them to abandon the euro and the implied commitment to the European Union project. Even then their own elite will resolutely oppose any attempt of public opinion to push this issue that way. In Germany in particular referenda are unconstitutional so that policy is dominated by the elite's consensus.

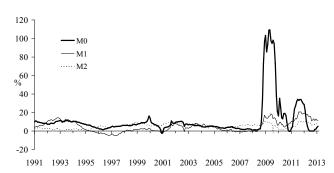
Given that the crisis will continue in this way, even if muted by ECB monetary support, the world background is unfavourable for the UK. China too is slowing deliberately. Brazil is in trouble. India is facing hostility to further reform. The US is growing fairly weakly. To break out of its own slow growth scenario, policy in the UK has to be much bolder. The credit channel must be unblocked, by sending the regulators back into their dugouts for another decade. Banks must be broken up and competition reinstated. Infrastructure decisions must be brought forward - such as the expansion of Heathrow. Labour market regulation must be cut back sharply, at least for small firms. Taxes could be remodelled; a much flatter tax system is possible if a consumption tax, inclusive of owner-occupied rental income, is brought in. All these ideas are possible with this coalition government but the will to pursue them seems to have gone. Instead the government is just praying for something to turn up and relying on Labour's ultimate economic unelectability.

<sup>&</sup>lt;sup>2</sup>U.K. Wholly unemployed excluding school leavers (new basis)

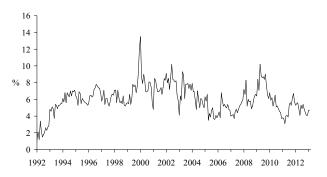
<sup>&</sup>lt;sup>3</sup>Sterling effective exchange rate, Bank of England Index (2005 = 100)

#### Liverpool Investment Letter — April 2013

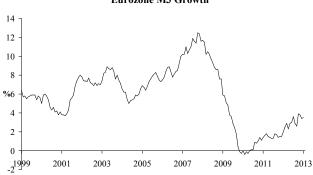
#### U.S.: Growth in Monetary Aggregates (Yr - on - Yr)



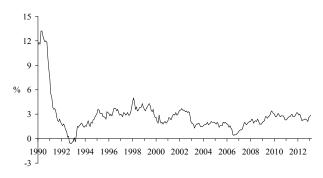
#### UK: Notes and Coins in Circulation Growth



Eurozone M3 Growth



Japan: Growth of M2+CD's



#### **FOCUS ON JAPAN**

Francesco Perugini

#### Japan appointed a new central bank governor

On March 15, Japan's parliament approved the man who runs the Asian Development Bank, Haruhiko Kuroda, as the Bank of Japan's (BOJ) next governor, and government nominees Kikuo Iwata and Hiroshi Nakaso as his deputies.

Kuroda was handpicked by Prime Minister Shinzo Abe, who was looking for support from the central bank to extend his vigorous stimulus measures presented as a "three arrows" strategy: bold monetary policy, flexible fiscal policy and growth strategy. "We want the BOJ to press ahead with policy steps to achieve its 2% inflation target as early as possible", Chief Cabinet Secretary Yoshihide Suga told reporters, adding that the government would work closely with the central bank.

Kuroda is an opponent of deflation who ran the nation's currency policy from 1999 to 2003 when he became vice finance minister for international affairs, the senior official in charge of foreign exchange issues. He has been a longtime critic of insufficient easing at the BOJ. In his appearances before parliament about his appointment, he reiterated his view, saying that the BOJ alone had the power to pull Japan out of deflation — striking a contrast to the incumbent, Masaaki Shirakawa, who always claimed that the government shared responsibility. By contrast, Kuroda called for an inflation target a decade before the bank agreed to one in January, and for years has spoken in favour of quantitative easing. "He's the right person to enhance the role of communication strategy at the BOJ." said Masaaki Kanno, chief Japan economist at JPMorgan in Tokyo. "He has already said in press interviews that the 2% inflation target should be achieved in two years — this is a very important message to the market", he added.

Kuroda will be supported in his conviction by Iwata, a professor of economics and hard-line reflationist who, in a hearing at the upper house of parliament, said that the BOJ must proceed with quantitative easing to ensure that the current positive market trend of yen weakness and stock price gains continue on expectations of higher inflation.

All eyes are now on what policy action the BOJ will take when it meets for the first time under the new leadership. The main argument of Kuroda is that the central bank should change its mindset by being much more aggressive in expanding its balance sheet. However, as many observers and economists have been arguing over the years, the question is how will doing more of the same make a difference. "There's no clear explanation from Kuroda yet on how and to what degree expanding the BOJ's balance sheet further could push up prices", said Hideo Kumano, a former central banker and now chief economist at Dai-ichi Life Research Institute.

Under normal circumstances, monetary policy is effective in changing deflationary expectations into inflationary expectations. With two decades of economic stagnation and a prolonged period of deflation, the ability of BOJ governors to make policy successfully has clearly vanished because of lack of credibility. "The BOJ has to do something more aggressive — or at least tell the market they'll do something aggressive to tackle the deflation problem. And I don't think they have done that", says Stanford University economist Takeo Hoshi.

However, many observers now believe that Abe's choice is likely to make open-ended asset purchasing a reality, a plan that previous governor, Masaaki Shirakawa, postponed until next year, and this will send a strong signal on how serious he is about reversing Japan's price declines. "Kuroda has certainly been out there for a decade saying more could be done by the BOJ, so he's got credibility," said Richard Jerram, chief economist at Bank of Singapore Ltd. "What Abe has been trying to achieve — that type of monetary policy — is a move in the right direction" echoed Takeo Hoshi while Hugh Patrick, professor at Columbia University said "It's just the beginning of 'Abenomics'. It's all about expectations rather than results".

During his five-year term, Shirakawa resisted calls from successive governments to be more aggressive, warning that loose money would only lead to unchecked government spending and runaway inflation. Now Abe has said he would reopen the 1998 BOJ independence law if the central bank does not comply with his demands, a threat that runs counter to modern economic orthodoxy, which favours central-bank independence. Economists expect the change to have an impact on market expectations. "I think the only thing that kept Japan from getting back to inflation, leaving aside the recession most recently, was inactivism and defeatism by the BOJ", said Adam Posen, a former member of the Bank of England's policy board and long-time observer of Japanese monetary policy.

The BOJ has taken various measures to step up its purchasing of debt, such as a plan to include bonds with longer maturity dates. But unless companies begin to invest more aggressively in their plants and households stop postponing consumption so that banks come under pressure to release more loans and thus feel the need for greater funds, monetary easing measures by the BOJ will not, by themselves, have much effect. We have seen in both the US and the UK that OE will not stimulate the necessary bank money creation when banks refuse to lend. Their refusal in the West has been partly because of the bank crisis has led to a desire to hoard liquidity and capital but largely because the authorities have imposed stringent new capital regulations that make lending to risky businesses unprofitable. The BOJ traditionalists may be saved from Abenomics and Kuroda by bank passivity.

### MARKET DEVELOPMENTS

In spite of growth weakness almost wherever one looks, equities remain the 'only game in town'. The main government bond yields remain at rock bottom in spite of rating agencies' complaints about the US and UK. They are surely not for investors but for central banks to gorge on

with their endless QE. If ever bank lending resumes central banks will have to get rid of these bonds smartly or risk an inflationary explosion but we are a long way from that because of the regulative overhang from Basel and most capitals.

**Table 1: Market Developments** 

		arket evels	Prediction for Feb/Jan 2014		
	Feb 27	Mar26	Previous (		
			Letter Vie	w	
Share Indices					
UK (FT 100)	6326	6399	8945	9049	
US (S&P 500)	1516	1564	1705	1759	
Germany (DAX 30)	7676	7880	9533	9708	
Japan (Tokyo New)	954	1044	1094	1177	
Bond Yields (governme	ent long-term	)			
UK	1.96	1.80	1.80	1.80	
US	1.90	1.91	4.00	4.00	
Germany	1.47	1.33	4.00	4.00	
Japan	0.67	0.55	1.50	1.50	
UK Index Linked	-0.28	-0.41	-0.40	-0.40	
Exchange Rates					
UK (\$ per £)	1.51	1.52	1.58	1.58	
UK (trade weighted)	78.8	79.9	83.1	83.1	
US (trade weighted)	84.4	85.5	80.5	80.5	
Euro per \$	0.76	0.78	0.79	0.79	
Euro per £	1.15	1.18	1.25	1.25	
Japan (Yen per \$)	91.6	94.2	81.0	81.0	
Short Term Interest Ra	ates (3-month	deposits)			
UK	0.59	0.52	1.30	1.30	
US	0.23	0.40	0.60	0.60	
Euro	0.15	0.15	2.50	2.50	
Japan	0.14	0.18	0.40	0.40	

**Table 2: Prospective Yields** <sup>1</sup>

Equities: Co	ntribution	to £ yiel	d of:		
•	Dividend	Real	Inflation		Currency Total
	Yield	Growth		Dividend Vield	
UK	3.40	1.8	2.6	37.00	44.80
US	2.00	2.5	2.0	8.00	$-4.29  ext{ } 10.21$
Germany	3.00	1.5	1.7	20.00	-5.90 20.30
Japan	2.00	1.7	0.0	11.00	10.32 24.82
UK indexed <sup>2</sup>	-0.41		2.6	-8.00	-5.81
Hong Kong <sup>3</sup>	2.40	7.5	2.0	-4.00	-4.29 3.61
Malaysia	2.90	4.5	2.0	30.00	-4.29 35.11
Singapore	3.30	2.9	2.0	4.00	-4.29 7.91
India	1.50	6.5	2.0	3.00	-4.29 8.71
Korea	1.20	3.5	2.0	-20.00	-4.29 - 17.59
Indonesia	2.00	6.4	2.0	28.00	-4.29 34.11
Taiwan	3.30	3.2	2.0	19.00	-4.29 23.21
Thailand	2.90	4.2	2.0	22.00	-4.29 26.81
<b>Bonds: Cont</b>					
	Redemp		Changing	Currenc	y Total
	Yield	1	Nominal Rates		
UK	1.8	0	0.00		1.80
US	1.9	1	-20.90	-4.29	-23.28
Germany	1.3	3	-26.70	-5.90	-31.27
Japan	0.5	5	-9.50	10.32	1.37
Deposits: Co	ntribution	to £ yiel	d of:		
-	Depos		Currency	Total	
1.117	Yield			0.53	
UK	0.5		4.20	0.52	
US	0.4		-4.29	-3.90	
Euro	0.1		-5.90	-5.75	
Japan	0.1	ð	10.32	10.50	

<sup>&</sup>lt;sup>1</sup> Yields in terms of €s or \$s can be computed by adjusting the £-based yields for the expected currency change.

<sup>&</sup>lt;sup>2</sup> UK index linked bonds All Stocks

<sup>&</sup>lt;sup>3</sup> Output based on China.

Table 3: Portfolio(%)

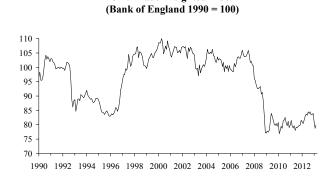
	Sterling Based Investor		Dollar Base	ed Investor	<b>Euro Based Investor</b>	
	March Letter	Current View	March Letter	Current View	March Letter	Current View
UK Deposits (Cash)	5	5	5	5	1	1
US Deposits	-	-	-	-	-	-
Euro Deposits	-	-	-	-	-	-
Japanese Deposits	-	-	-	-	-	-
UK Bonds	-	-	-	-	-	-
US Bonds	-	-	-	-	-	-
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









**UK: Trade-Weighted Index** 

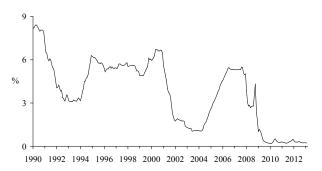


# **GOVERNMENT BOND MARKETS**

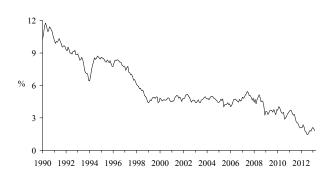
**U.S.: Yield on Long-Term Government Bonds** 



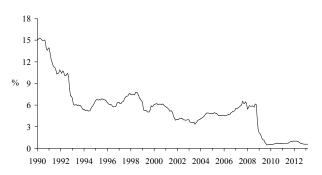
U.S.: 3-Month Certificate of Deposit



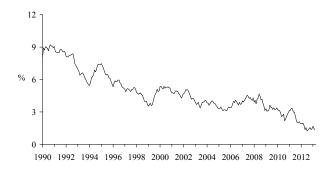
U.K.: Yield on Long-Term Government Bonds



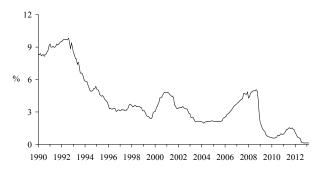
U.K.: 3-Month Interbank Rate



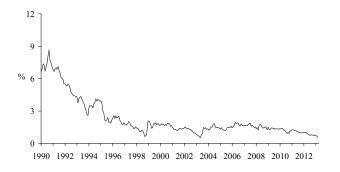
Germany: Yield on Public Authority Bonds



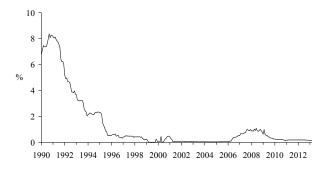
Germany: 3-Month Interbank Deposit Rate



Japan: Yield on Long-Term Government Bonds

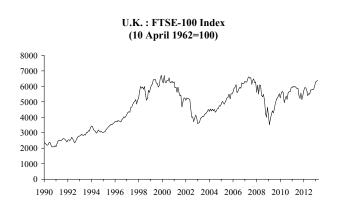


Japan: 3 Month Money Market Rate



# **MAJOR EQUITY MARKETS**









#### **EMERGING MARKETS**

Anupam Rastogi

#### India

The euphoria of growth picking up as the government moves to economic activism died quickly as the government is engulfed in many scandals and its coalition partners are looking at an opportune time to extract their pound of flesh before the general elections are called. We may see elections being held as early as October 2013. Hardly anyone expects a coalition led by the Congress party to return to power. With this kind of political uncertainty, no economic decisions are going to be taken this year. The country is running on an auto pilot now.

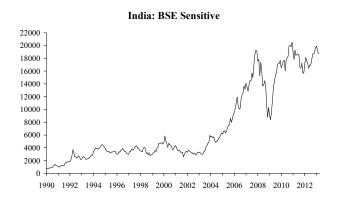
The much speculated expansionary change in the Reserve Bank of India (RBI) monetary stance did happen but it turned out to be a non-event amidst political drama. RBI cut the Repo rate by 25 basis points. According to RBI, an improvement in trade deficit, drop in WPI based inflation and control over the fiscal deficit prompted RBI to reduce the interest rate to support growth. The RBI left the cash reserve ratio unchanged, disappointing many who had expected a slight reduction. The RBI has warned that the high food price inflation and a widening current account deficit do not leave room for further monetary relaxation. It is for the government to revive investors' confidence.

The finance minister, Chidambaram Palaniappan, has reduced subsidies for diesel, sold equity in public sector undertakings to curb the budget and current account deficits, and eased restrictions on foreign investment in retail and airlines. But, such changes take time to bear fruit and Indian economic expansion remains sluggish. GDP growth is expected to grow 6% in the fiscal year 2013–14 after clocking 5% in 2012–13, its lowest pace for a decade.

At present, India seems to be in the midst of stagflation with below potential economic growth in 2012–13 and consumer inflation remaining just below 10%.

India's trade deficit in February narrowed to its lowest level in 10 months as exports grew for the second successive month, raising expectations that demand in Western economies is improving, which should help bridge India's wide current account deficit. The trade deficit narrowed to \$14.92 billion in February, down sharply from \$20.08 billion in January. Exports rose to \$26.26 billion from \$25.5 billion in January. However, India may see current account deficit of 6% of GDP in the fiscal year ending on March 31. Exporters are awaiting the annual trade policy for new measures including incentives, to be announced by the government to boost exports.

There are suggestions for a single regulator for the financial sector. A merger of capital market, commodity, insurance



and pension regulators is being envisaged, while leaving the banking business regulation under the Reserve Bank of India, intact.

Foreign companies are now focusing on three main issues: new local content rules for high-tech products that favour domestic producers; the intellectual property rights of drugs companies; and finally, tax disputes, including retrospective levies introduced in last year's budget, to be addressed by the government to improve foreign direct investment sentiment in the country.

Indian markets closed their lowest in nearly four months as investors remained cautious because of political worries and doubts over a recovery of the economy. Foreign banks in India, however, are set to enjoy a rare boost in capital market activity this year, as domestic companies raise fresh funds to restructure finances and repair balance sheets.

Dubai is launching the first MSCI India equities futures contract as the Gulf emirate builds on its financial ties to India and offers a new offshore instrument to investors looking to hedge their risk or increase exposure to the market. It would be competing with the SGX Nifty index futures traded in the Singapore Exchange.

	10-11	11-12	12-13	13-14	14-15
GDP (%p.a.)	7.5	6.2	5.0	6.5	6.5
WPI (%p.a.)	9.0	7.5	7.0	6.8	6.0
Current A/c(US\$ bill.)	-31.0	-40.0	-80.0	-60.0	-60.0
Rs./\$(nom.)	49.0	49.5	54.5	55.0	54.0

#### China

The HSBC China Manufacturing Purchasing Managers' Index registered 51.7 in March, up from a final reading of 50.4 in February. The rise contradicts the negative indicators, from retail sales to electricity consumption, which showed growth slowing in the first two months of the year.

According to the OECD, China is on track for a fourth consecutive decade of rapid growth and will overtake the US as the world's biggest economy in 2016 after accounting for price differences. The economy slowed down to 7.8%, its slowest in more than a decade, is set to rebound to 8.5% growth in 2013 and 8.9% in 2014. The OECD forecast is more optimistic than the Beijing's official target of 7% average growth in the five years to the end of 2015. The number isn't considered a forecast, but a signal to provinces that the central government is convinced that the years of double-digit growth are over. China routinely exceeds its GDP target; GDP grew 7.8% in 2012.

China's National Bureau of Statistics reported that consumer inflation jumped to 3.2% year-on-year in February, up from 2% in January, for the highest increase since April last year, though prices were impacted by the Lunar New Year, which often sees a spike in food prices and other goods.

Li Keqiang, China's new premier, has promised to make urbanization a centerpiece of his economic policy. Chinese government stated that policy is to cool down the urban property market and nudge people to consume more. Keeping this in mind the State Council, China's cabinet, said that it would enforce a 20% capital gains tax, and raise down payment and mortgage rates for buyers purchasing second homes in cities where prices are rising too quickly.

China posted a surprise trade surplus in February, thanks to stronger-than-expected exports as the global economy recovered, and a drop in imports further helped the surplus. Exports were up 21.8% from a year earlier — slower than January's 25% pace but well above economists' expectations of 5%, and a positive sign for the world's second largest economy. One needs to be careful in interpreting this as shipments to Hong Kong are counted as exports, even if they are then shipped back to China for finishing.

Imports fell 15.2% in February compared with a year-earlier, another sign suggesting a slowdown in domestic demand, though the steepness of the trade could reflect the timing of the Lunar New Year.

China's yuan appreciated against the U.S. dollar, after the central bank guided the currency stronger via a daily reference. It is trading around CNY6.2135 for a dollar.

Chinese policy makers are worried about expected capital loss on its \$3.3 trillion reserves. A member of China's monetary policy committee says the country's foreign-exchange reserves are like a slab of meat on the block in the U.S. To have a diverse portfolio, China will give offshore money managers more freedom in deciding where to invest their renminbi holdings, in the latest step to boost the currency's global appeal. Previously, they could only invest 20% of their assets in Chinese stocks and could only

offer their clients exchange traded funds and fixed-income products.

Leaders of the BRICs nations announced that they would like to establish a development bank to challenge supremacy of the World Bank and IMF, but did not give any details further. It all depends on China, how it wants to hedge its foreign exchange reserves.

China reappointed Mr. Zhou as the central bank governor. This is a signal of Beijing's desire to stay on course with the kind of financial reforms championed by Mr. Zhou, including a more flexible Chinese currency. China also appointed Lou Jiwei, currently chairman of the country's giant sovereign-wealth fund, as finance minister and Xu Shaoshi, currently minister of land and resources, will be head of the National Development and Reform Commission, the country's top economic planning agency. These appointments are part of a broad shuffle of government posts under the new leadership headed by Mr. Li and Communist Party chief Xi Jinping, who was also ratified by the NPC as the country's president.

The two men who are expected to lead the country for the next decade exude a confidence and composure that their predecessors lacked and they talk about their country in a subtly different way. Under Mr. Xi, we are going to witness a more assertive China and a more muscular vision of China's future, stressing the "dream" of national rejuvenation, and urging the military to be ready to "fight and win battles."

Prior to attending the BRIC nations meeting in South Africa, Chinese President, Xi Jinping defended China's role in Africa and promised increased investment, countering growing criticisms from African officials who say China's role is "predatory" with echoes of colonialism. He reaffirmed China's pledge of \$20bn in loans to Africa over the next three years. He also signed an agreement to build a major port and industrial zone in Tanzania, which officials say could cost up to \$10bn. China's bilateral trade with Africa hit \$198bn last year. There is a growing criticism from African officials who fear that Chinese exports to Africa undermine the continent's manufacturing sector.

Soon after taking over as Party Chief, Mr. Xi Jinping, when meeting the new US Treasury secretary, spoke about China and the US as if they are equals and acted as if China is, at least, the second most powerful and important country in the world. Many observers in Asia and the rest of the world view a more assertive Beijing with trepidation and worry that Chinese overconfidence could lead to confrontation and even war.

	10	11	12	13	14
GDP (%p.a.)	10.3	9.2	7.8	8.0	7.5
Inflation (%p.a.)	5.9	4.3	2.6	3.5	3.0
Trade Balance(US\$ bill.)	183	210	214	220	220
Rmb/\$(nom.)	6.6	6.3	6.3	6.2	6.1

#### South Korea

South Korean export sector is facing heat from the Japanese 'quantitative easing' as the South Korean exports directly compete with the Japanese products in overseas markets. Exports account for about half of Korea's gross domestic product. For the first two months of the year, Korean export growth was 0%. The Korean central bank lowered its economic growth forecast for 2013 to 2.8% from 3.2%, and predicted 3.8% growth for 2014. Inflation remains subdued, staying well below the BOK's target range of 2.5–3.5% for several months.

The central bank is waiting to assess the stimulus package which the new government is widely expected to unveil in the near future. The Bank of Korea left the base rate at 2.75%, as expected, at its first rate review meeting on March 14 since the inauguration of President Park Geunhye. This was the fifth consecutive month when the central bank kept its benchmark interest rate unchanged but noted risks to future growth, fuelling expectations for a rate cut in the near future.

The South Korean won is declining among emergingmarket currencies. It was dragged down by continued geopolitical tensions. Heightened rhetoric from North Korea in recent weeks has left investors on edge about South Korean assets, particularly the won.

Ms. Park Geun-hye witnessed the sixth resignation of top officials nominated by her a month after she took office. The official was to be the state competition watchdog. This followed the withdrawals of Ms. Park's choices for prime minister, defence minister and constitutional court chief justice, among others. The current political trouble has made people lose their confidence in the president and her way of running the country. South Korean media is increasingly critical of Ms. Park, suggesting that the early personnel problems reflect a stubborn leadership style, and a failure to give her aides enough time to check her nominated officials.

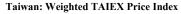
The U.S. and South Korea signed a military contingency plan to respond to possible attacks from North Korea, this is Washington's latest step to reassure its Asian ally as Pyongyang's increasing provocations and China's growing territorial ambitions fuel anxieties in the region. Details of the plan are classified,

	10	11	12	13	14
GDP (%p.a.)	6.3	3.6	2.0	2.8	3.0
Inflation (%p.a.)	2.9	4.0	2.2	2.5	2.8
Current A/c(US\$ bill.)	28.2	27.0	44.0	28.0	28.0
Won/\$(nom.)	1150	1100	1100	1100	1050

#### **Taiwan**

On the back of the US and Chinese economic growth, the Taiwanese economy is expected to do well in 2013. China accounts for 40% of Taiwanese exports. Taiwan's economy







has been showing signs of recovery since the fourth quarter of last year, when it recorded higher-than-expected growth of 3.72%. In 2013, the economy may grow more than 3% compared to 1.26% economic growth for the whole of 2012.

The country's exports contracted year-on-year in February, largely due to a distortion caused by the fact that the Lunar New Year fell in February this year and in January last year.

Taiwan's positive outlook will help attract foreign fund inflows as well. Taiwan is now the second major market after Hong Kong, able to clear renminbi as China slowly internationalizes its currency. Though Taipei is not a hub of finance, the island is China's fifth largest trade partner, and thousands of local companies, both large and small, work throughout the mainland. Currently, renminbi bonds issued in Hong Kong, known as "dim sum" bonds, are almost exclusively short in tenor. As many issuers opt to raise money in renminbi and transfer those funds back into US dollars, the maximum maturity is restricted by the liquidity in the currency swap market. A lack of clarity on when China might liberalize its capital account and provide international investors with greater access to onshore assets has also kept the typical duration to just two or three years. However, the addition of Taiwan's market, thanks to the longer-term investment needs of its large insurance industry, could change that. Borrowers tapping into Taipei's offshore market may be able to hit much longer

tenors, such as 10 or 15 years. Taiwanese companies are also more likely to use the renminbi for investment rather than swap it. Most Taiwanese corporations will probably prefer to use the renminbi if they want to make any foreign direct investments.

The Taiwanese market has not proved to be profitable to many private equity funds. Some of the world's biggest private-equity firms and hedge funds are struggling to exit Taiwan's crowded banking sector more than five years after betting on greater ties between the island and China. But despite improved ties between Taiwan and China, their respective banking sectors still face tough restrictions across the Taiwan Strait. Meanwhile, the investors face declining valuations and regulatory hurdles.

Taiwan's president has an unprecedented opportunity to visit Europe in his capacity as head of state, prompting a call from Beijing for the Vatican to cut diplomatic ties with Taipei. The Holy See recognizes the Taiwan leadership—the only European state and one of the only 23 globally to do so.

	10	11	12	13	14
GDP (%p.a.)	10.8	4.0	1.3	3.0	3.2
Inflation (%p.a.)	1.3	1.2	1.9	1.3	1.5
Current A/c(US\$ bill.)	16.0	18.0	20.0	22.0	23.0
NT\$/\$(nom.)	31.0	30.0	29.5	29.5	29.0

#### **Brazil**

Brazil's economy expanded 0.9% in 2012 and in 2013 growth is expected to be around 3.0%. Brazil's economy grew at a slightly faster pace than expected in January but the recovery could be hurt by inflationary pressures. The Brazilian government is taking fiscal measures to fuel investment, mainly in infrastructure areas. It has also moved to cut taxes.

The economic activity index, or IBC-Br, rose 1.29% in March from the previous month on a seasonally adjusted basis and is up 2.73% from the year-earlier period. The index is widely considered a leading indicator for gross domestic product but has been criticized recently for not capturing a slowdown in the second half of 2012.

Inflation may make it necessary for the central bank to raise the Selic interest-rate. In the 12 months through February, the IPCA official consumer price index rose 6.31%, compared with a 6.15% advance in the 12 months through January. Inflation remained above the government's official year-end 2013 inflation target of 4.5%, but within a tolerance band of plus or minus two percentage points. Inflation ended 2012 at 5.84%. There is hope that inflation would taper off as the harvest typically begins in April, helping pull down food prices starting in May. Lower utility rates are already in force.

Opinion of the two leading credit rating agencies, Fitch and Moody's, on Brazil's long-term growth are divided. Whereas, Fitch feels that slowing of the economy and fiscal stimulus are drag on the long-term growth of the economy, Moody's feels that sustained reduction in interest rate would help in reduction of public debt. Fitch may prove to be right if the central bank is forced to increase the interest rate.

Brazil's base interest rate has declined to an all-time low of 7.25%. Central bank officials insist price pressures will retreat in the second half of 2013 on the strength of a robust grain and oilseeds harvest, as well as government-ordered cuts in electricity rates. Notwithstanding the lowering of inflationary expectations, we expect Selic rate hike to come in April.

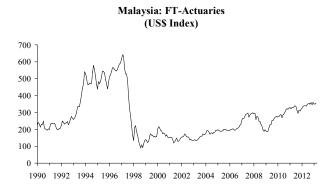
The currency has appreciated considerably this year after briefly hovering around BRL2.1 to the dollar at the end of 2012. Brazil's central bank is trying to keep the real in a range of BRL1.95–2.00 to the dollar. The Central bank president Alexandre Tombini has told that the bank doesn't have a target range for the currency, but it is ready to act to reduce volatility, as well as to continue building up its foreign-currency reserves as the market allows.

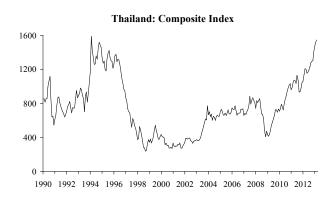
	10	11	12	13	14
GDP (%p.a.)	7.5	2.7	0.9	3.2	3.5
Inflation (%p.a.)	5.9	6.5	5.8	6.3	6.0
Current A/c(US\$ bill.)	-47.3	-52.6	-60.0	-65.0	-60.0
Real/\$(nom.)	1.7	1.5	2.0	2.0	2.0

#### **Other Emerging Markets**











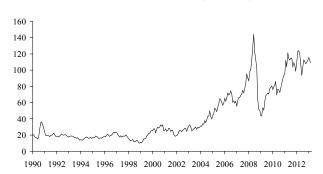


# **COMMODITY MARKETS**

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



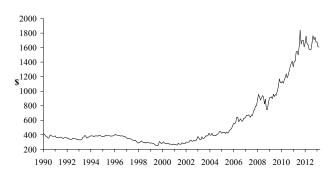
#### Oil Price: North Sea Brent (in Dollars)



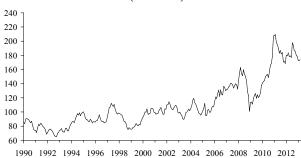
#### Commodity Price Index (Sterling) (Economist, 2000=100)



#### Gold Price (in Dollars)



#### Commodity Price Index (Euro) (Economist)



# **UK FORECAST DETAIL**

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

	Inflation % <sup>1</sup> (CPI)	Short Dated (5 Year) Interest Rates	3 Month Int. Rates	Nominal Exchange Rate (2005=100) <sup>2</sup>	Real Exchange Rate <sup>3</sup>	Real 3 Month Int. Rates % <sup>4</sup>	Inflation (RPIX)	Real Short Dated Rate of Interest <sup>5</sup>
2010	3.7	2.4	0.7	80.4	87.9	-3.6	4.8	-0.2
2011	4.7	2.0	0.9	80.0	89.7	-3.1	5.3	-0.2
2012	2.8	0.9	0.9	83.0	94.0	-1.9	3.3	-1.3
2013	2.8	1.3	0.9	83.5	95.7	-1.6	3.3	-0.8
2014	2.6	1.8	1.7	82.7	95.5	-0.5	3.1	-0.3
2015	2.2	2.1	2.1	82.1	95.5	0.1	2.8	0.0
2012:1	2.7	1.1	1.1	81.2	91.4	-2.0	3.8	-1.1
2012:2	3.1	0.9	1.1	83.2	94.3	-1.6	3.2	-1.2
2012:3	2.7	0.7	0.8	84.1	95.3	-2.0	2.9	-1.4
2012:4	2.8	0.8	0.6	83.6	95.2	-2.0	3.3	-1.4
2013:1	2.9	1.0	0.8	83.7	95.5	-1.8	3.4	-1.2
2013:2	2.8	1.3	0.9	83.2	95.4	-1.6	3.3	-0.8
2013:3	2.8	1.5	0.9	83.7	96.0	-1.6	3.3	-0.6
2013:4	2.7	1.5	1.1	83.3	95.8	-1.3	3.2	-0.6
2014:1	2.6	1.8	1.3	83.1	95.8	-1.1	3.2	-0.3
2014:2	2.5	1.8	1.7	82.3	95.2	-0.6	3.1	-0.2
2014:3	2.6	1.7	1.8	82.4	95.2	-0.3	3.1	-0.3
2014:4	2.5	1.8	1.9	82.7	95.8	-0.2	3.0	-0.2

Consumer's Expenditure Deflator

Labour Market and Supply Factors (Seasonally Adjusted)

Average Earnings (1990=100) <sup>1</sup>		Wage Growth <sup>2</sup>	Unemployment (New Basis) Percent <sup>3</sup>	Millions	Real Wage Rate <sup>4</sup> (1990=100)
2010	227.1	2.4	4.6	1.50	136.7
2011	232.7	2.6	4.6	1.53	133.7
2012	236.9	1.8	4.7	1.58	132.4
2013	242.0	2.2	4.4	1.49	131.6
2014	248.9	2.8	4.0	1.37	131.9
2015	257.0	3.3	3.7	1.26	133.3
2012:1	234.7	0.7	4.8	1.61	132.7
2012:2	235.8	1.8	4.8	1.60	132.0
2012:3	237.4	1.9	4.7	1.58	132.4
2012:4	239.6	2.9	4.6	1.56	132.4
2013:1	240.4	2.4	4.6	1.54	132.1
2013:2	242.0	2.6	4.5	1.51	131.7
2013:3	242.2	2.0	4.4	1.48	131.4
2013:4	243.6	1.6	4.3	1.45	131.0
2014:1	245.5	2.1	4.2	1.42	131.4
2014:2	248.1	2.5	4.1	1.39	131.7
2014:3	249.7	3.1	4.0	1.36	132.1
2014:4	252.1	3.5	3.9	1.33	132.4

Whole Economy

Sterling Effective Exchange Rate Bank of England

Ratio of UK to other OECD consumer prices adjusted for nominal exchange rate

Treasury Bill Rate less one year forecast of inflation

Short Dated 5 Year Interest Rate less average of predicted 5 year ahead inflation rate

Average Earnings

Wholly unemployed excluding school leavers as percentage of employed and unemployed, self employed and HM Forces Wage rate deflated by CPI

#### Estimates and Projections of the Gross Domestic Product<sup>1</sup> (£ Million 1990 Prices)

	Expenditure Index	£ Million '90 prices	Non-Durable Consumption <sup>2</sup>	Private Sector Gross Investment Expenditure <sup>3</sup>	Public Authority Expenditure <sup>4</sup>	Net Exports <sup>5</sup>	AFC
2010	145.1	694701.4	411042.6	234029.9	182002.2	-34548.2	97825.1
2011	146.4	701060.5	402885.3	243646.3	177479.4	-23548.2	99402.3
2012	146.5	701719.7	401183.5	249576.1	183170.0	-31081.5	101129.7
2013	148.7	712270.2	404503.8	255592.0	187385.7	-31240.0	103971.4
2014	151.8	726827.7	411964.1	261350.6	191244.9	-31189.9	106537.5
2015	155.4	744363.4	421121.2	267868.0	195837.6	-31120.2	109344.0
2010/09	1.8		0.5	7.6	0.5		0.8
2011/10	0.9		-2.0	4.1	-2.5		1.8
2012/11	0.1		-0.4	2.5	3.2		1.9
2013/12	1.5		0.8	2.4	2.3		3.2
2014/13	2.0		1.8	2.3	2.1		2.5
2015/14	2.4		2.2	2.5	2.4		2.6
2012:1	146.2	175013.2	100300.2	59839.5	47225.9	-6742.4	25610.0
2012:2	145.6	174362.8	100083.3	61272.9	44458.8	-8868.5	22583.7
2012:3	147.0	176010.2	100053.3	64467.5	45567.2	-7659.5	26418.3
2012:4	147.3	176333.5	100746.7	63996.2	45918.1	-7811.1	26517.8
2013:1	147.9	177029.8	100900.2	61159.6	48592.6	-7807.4	25814.7
2013:2	148.4	177664.5	101049.5	64387.0	45700.5	-7814.6	25658.4
2013:3	149.0	178426.4	101202.4	64777.0	46404.9	-7811.4	26147.4
2013:4	149.6	179149.4	101351.7	65268.4	46687.6	-7806.7	26350.8
2014:1	150.5	180168.3	102004.1	62894.2	49472.8	-7807.8	26397.0
2014:2	151.3	181177.2	102658.7	66223.1	46613.4	-7802.0	26513.8
2014:3	152.2	182248.0	103319.1	66062.4	47385.6	-7791.4	26725.9
2014:4	153.1	183234.3	103982.2	66171.0	47773.1	-7788.7	26900.8

#### **Financial Forecast**

	PSBR/GDP % <sup>1</sup>	GDP <sup>1</sup> (£bn)	PSBR (£bn) Financial Year	Debt Interest (£bn)	Current Account (£ bn)
			Tinanciai Teai		(& DII)
2010	8.7	1336.3	115.1	36.4	-37.3
2011	6.7	1406.4	94.2	42.9	-20.4
2012	6.5	1451.6	95.4	47.0	-51.9
2013	6.5	1519.3	98.2	50.6	-52.2
2014	5.3	1592.8	84.7	55.8	-52.8
2015	4.3	1666.2	72.2	59.0	-53.0
2012:1	4.6	355.1	16.3	11.5	-11.8
2012:2	1.7	351.8	6.0	11.3	-17.4
2012:3	6.2	363.1	22.7	11.8	-12.8
2012:4	9.9	367.2	36.5	11.8	-9.8
2013:1	8.2	369.5	30.2	12.0	-13.9
2013:2	6.2	373.6	23.1	12.3	-15.5
2013:3	5.9	377.2	22.1	12.4	-13.1
2013:4	5.9	382.1	22.7	12.8	-9.8
2014:1	7.8	386.3	30.3	13.1	-14.0
2014:2	5.4	391.4	21.0	13.6	-15.7
2014:3	5.6	395.4	22.1	13.8	-13.2
2014:4	5.6	400.4	22.5	14.0	-9.8

GDP at market prices (Financial Year)

GDP at factor cost. Expenditure measure; seasonally adjusted
Consumers expenditure less expenditure on durables and housing
Private gross domestic capital formation plus household expenditure on durables and clothing plus private sector stock building
General government current and capital expenditure including stock building

Exports of goods and services less imports of goods and services

# WORLD FORECAST DETAIL

Growth Of Real GNP								
	2008	2009	2010	2011	2012	2013		
U.S.A.	0.0	-2.6	2.6	1.7	2.5	2.6		
U.K.	-0.9	-3.9	1.8	0.9	0.1	1.5		
Japan	-1.2	-6.3	4.3	-0.7	2.1	1.6		
Germany	1.0	-4.7	3.6	3.0	1.1	2.0		
France	0.1	-2.5	1.5	1.7	1.0	1.2		
Italy	-1.3	-5.1	0.9	0.5	0.1	0.3		

<b>Growth Of Consumer Prices</b>								
	2008	2009	2010	2011	2012	2013		
U.S.A.	3.8	-0.3	1.8	3.1	2.0	2.0		
U.K.	3.3	1.3	3.7	4.7	2.8	2.8		
Japan	1.4	-1.4	-1.0	-0.3	-0.2	0.0		
Germany	2.6	0.4	1.1	2.3	1.8	1.7		
France	2.8	0.1	1.5	2.1	1.6	1.6		
Italy	3.4	0.8	1.5	2.8	2.7	2.8		

Real Short-Term Interest Rates									
	2008	2009	2010	2011	2012	2013			
U.S.A.	1.8	-1.6	-1.8	-1.7	-1.5	-1.3			
U.K.	2.3	-0.3	-3.6	-3.1	-1.9	-1.6			
Japan	1.8	1.1	0.5	0.4	0.4	0.4			
Germany	3.5	-0.4	-1.3	-0.3	0.8	0.5			
France	3.8	-0.8	-1.4	-0.3	0.9	0.5			
Italy	3.1	-0.8	-1.4	-0.3	-0.3	0.0			

Nominal Short-Term Interest Rates								
	2008	2009	2010	2011	2012	2013		
U.S.A.	1.5	0.2	0.1	0.3	0.5	0.7		
U.K.	5.5	1.1	0.7	0.9	0.9	0.9		
Japan	0.4	0.1	0.1	0.4	0.4	0.4		
Germany	3.9	0.7	0.4	1.5	2.5	2.5		
France	3.9	0.7	0.4	1.5	2.5	2.5		
Italy	3.9	0.7	0.4	1.5	2.5	2.5		

Real Long-Term Interest Rates									
	2008	2009	2010	2011	2012	2013			
U.S.A.	2.2	1.3	1.1	1.2	2.0	2.0			
U.K.	1.3	-0.3	-0.2	-0.2	-1.3	-0.8			
Japan	2.0	1.4	1.1	1.1	1.3	1.5			
Germany	3.0	2.3	1.9	1.8	2.0	2.0			
France	3.0	2.2	1.9	1.8	2.0	2.0			
Italy	2.8	2.2	1.9	1.8	2.0	2.2			

Nominal Long-Term Interest Rates								
	2008	2009	2010	2011	2012	2013		
U.S.A.	3.7	3.2	3.1	3.2	4.0	4.0		
U.K.	4.3	2.8	2.4	2.0	0.9	1.3		
Japan	1.5	1.3	1.1	1.2	1.5	1.5		
Germany	4.4	4.0	3.8	3.8	4.0	4.0		
France	4.4	4.0	3.8	3.8	4.0	4.0		
Italy	4.4	4.0	3.8	3.8	4.0	4.0		

Index Of	Index Of Real Exchange Rate(2000=100) <sup>1</sup>								
	2008	2009	2010	2011	2012	2013			
U.S.A.	80.1	88.7	81.7	81.8	82.0	82.1			
U.K.	87.6	76.7	78.9	80.5	84.4	85.9			
Japan	87.9	89.0	80.2	79.8	79.7	80.0			
Germany	105.1	105.8	99.3	99.0	99.1	99.0			
France	106.4	104.3	101.7	102.0	102.0	102.1			
Italy	106.6	105.4	100.5	100.8	101.0	101.1			

**Nominal Exchange Rate** (Number of Units of Local Currency To \$1) 2008 2009 2010 2011 2012 2013  $U.S.A.^{1}$ 86.07 85.98 83.73 78.08 80.50 80.20 U.K. 1.85 1.57 1.55 1.61 1.58 1.58 Japan 103.40 93.54 87.48 79.36 81.00 81.00 0.75 Eurozone 0.68 0.72 0.720.78 0.79

<sup>&</sup>lt;sup>1</sup> 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.

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

<sup>\*</sup> Forecasts based on the Liverpool World Model