LIVERPOOL INVESTMENT LETTER

April 2014

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

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TIME TO TIGHTEN

The latest data is supporting a UK forecast for 2014 of around 3% growth. Services are growing strongly, business investment is kicking in, and even exports are beginning to look stronger. The housing market boom has triggered tututting noises from the Financial Policy Committee. The current account of the balance of payments has gone to a deficit of over 5% of GDP.

None of this is a reason for embarking on heavy monetary restraint. The current account deficit is partly related to a drop in returns on foreign investments, related to sell-offs in emerging market stocks during the recent 'Fed taper' furore. Anyway measurement of invisible net exports is notoriously unreliable. Real house prices are still well below their past peaks.

The point really is that the data suggest it is time to move away from massive and unprecedented monetary ease. It would be pathetic if the Bank, out of fear of a 'renormalising' of monetary conditions, turned instead to direct controls on house lending for example- which is now being broadly hinted at. We know that such controls distort the market and are liable to be ineffective because of market ingenuities- when money is plentiful it finds its way into many channels.

About the only reason left for not tightening money somewhat in the direction of 'normal' is that bank lending is still being weighed down by the regulative backlash from Whitehall and the international community led by Basel. Yet we know that large corporations are deliberately reducing their take-up of bank loans on grounds of expense. SMEs are another matter but here too there are the stirrings of revolution: 'peer-to-peer lending' is growing rapidly as it becomes better organised and more familiar. Their needs are now high on the political radar and may well get the same Osborne treatment as housing did with Help to Buy. As so often markets are undermining regulation, in this case by bypassing the banking system, in the process building up a western 'shadow banking system' in the west, to rival the one in China.

Critical as we have been of the bank regulative backlash, in common with many colleagues on the Shadow Monetary Policy Committee, we do not feel that we can any more use it as a reason for holding back on moving monetary conditions back towards normal. The Bank's ideas on forward guidance, which amount to a desire to keep money as loose as possible for as long as possible, have been a recipe for monetary disaster in past historical episodes. They are the classic cliché of too little too late in tightening that marked so many episodes back in the 1960s and 1970s; each time a Keynesian central bank was reluctant to slow a recovery because it got too close to its political masters, nervously longing for a recovery as strong as possible. Today's politicians and central bankers will scornfully reject any analogy with those highly inflationary periods. But they are foolish to do so, because at the start of the 1960s too there was no inflation to speak of. Our policies today remind one of the excesses of stimulation after the 1970s oil crisis against a 1960s background of low inflation.

Table 1: Summary of Forecast

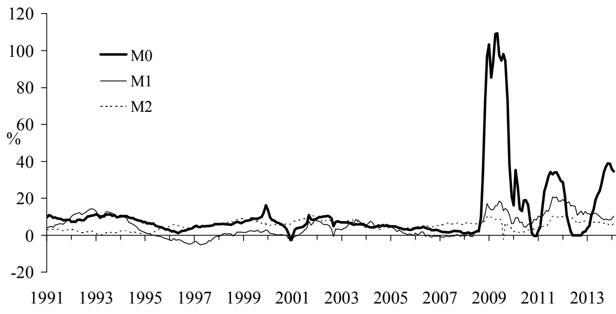
	2010	2011	2012	2013	2014	2015	2016
GDP Growth[1]	1.7	1.1	0.2	1.4	2.6	2.4	2.6
Inflation CPI	3.3	4.5	2.7	2.4	2.5	2.2	2.0
RPIX	4.8	5.3	3.2	3.2	3.1	2.8	2.7
Unemployment (Mill.)							
Ann. Avg.[2]	1.5	1.5	1.6	1.5	1.3	1.3	1.2
4th Qtr.	1.5	1.6	1.6	1.4	1.3	1.3	1.1
Exchange Rate[3]	80.4	80.0	83.1	82.6	83.0	82.3	82.5
3 Month Interest Rate	0.7	0.9	0.9	0.6	1.8	2.1	2.2
5 Year Interest Rate	2.4	2.0	0.9	1.2	1.6	2.1	2.3
Current Balance (£bn)	−40.0	−22.5	−59.2	−60.7	−62.9	−63.5	−62.0
PSBR (£bn)	139.6	118.5	115.0	112.3	109.4	94.6	84.5

[1]Expenditure estimate at factor cost
[2]U.K. Wholly unemployed excluding school leavers (new basis)
[3]Sterling effective exchange rate, Bank of England Index (2005 = 100)

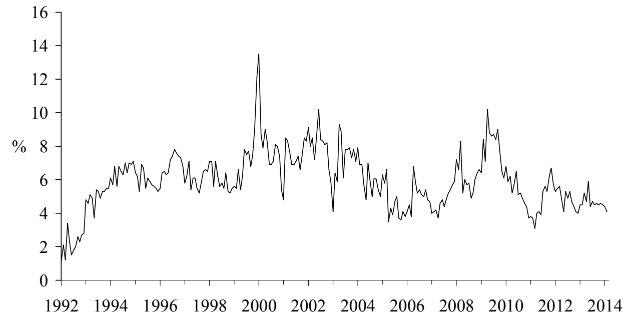
Thus again we would suggest that we should move to a raising of Bank Rate, by 0.5% now because of past delays; followed by a bias to further small moves of 0.25% each in the following months. By the end of this year we would expect rates to be over 2%.

Turning to QE, it seems to us that the total Bank holding of gilts must be steadily reduced. There are two main reasons for this. The first is simple monetary arithmetic: bank reserves are excessively high and conducive to poor lending practices. As the recovery turns into boom, banks will be sucked in by these vast reserves. The second is political: too many commentators are attracted by the idea of 'consolidating' the Bank's holdings with the Treasury's debts, on the fiscal grounds that such a 'monetisation' tax would be harmless and reduce the pressure of debt on future spending and taxation. The longer this Bank holding lies around, apparently without dire consequences, the more traction this argument will gain. This directly parallels the arguments of the Weimar politicians before the great hyper-inflation that engulfed them. It is essential in our view that this holding be got rid of fairly fast now to stall such a frightening set of possibilities.

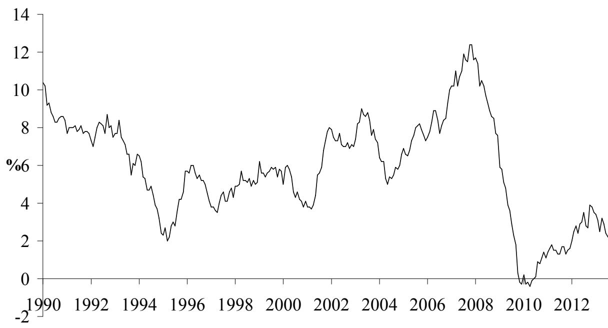
U.S.: Growth in Monetary Aggregates (Yr - on - Yr)



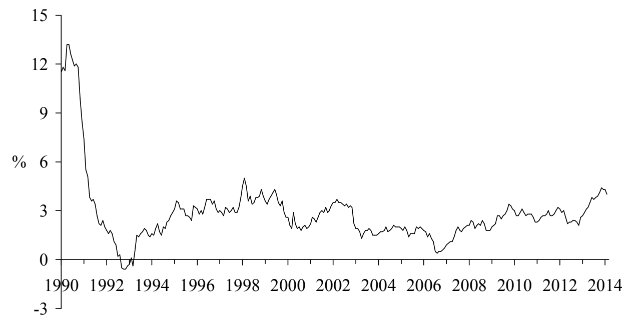
UK: Notes and Coins in Circulation Growth



Eurozone M3 Growth



Japan: Growth of M2+CD's



FOCUS ON JAPAN

Francesco Perugini

Challenges ahead for BOJ Governor

The 20th of March marked the first year for Haruhiko Kuroda as Bank of Japan (BOJ) governor. He was handpicked by Prime Minister Shinzo Abe from the Asian Development Bank where he served as President for more than eight years to help lead Tokyo's bid to jumpstart growth and reverse years of deflation.

Within weeks of stepping into the job, Kuroda had unleashed a vast asset-buying program which sought to pump huge amounts of money into the financial system. The move, which sharply weakened the yen, was meant to jerk the economy out of its slumber and create lasting inflation in a country where falling prices had become the norm. The BOJ program — a cornerstone of Abe's growth blitz dubbed Abenomics — was aimed at changing that psychology. Deflationary "expectations became entrenched," Kuroda said in a recent speech. "In order to escape such a situation, it has become necessary to pursue a policy that quickly and drastically changes people's sense that prices will not increase."

The conservative Abe, who swept to power in late 2012, had openly criticized Kuroda's predecessor Masaaki Shirakawa for not doing enough to stimulate growth, a rare public rebuke that sparked fears the BOJ's independence was under attack. Kuroda gave some credit to his BOJ predecessors, saying that earlier policy has yielded results "to some extent" during 15 years of deflation. But he added that it "was not sufficient" to keep falling prices from becoming entrenched. "One difference between the current BOJ policy and past measures taken by the BOJ and other central banks is the focus on public expectations. We're engaging directly with public expectations to lead people to anticipate inflation", he said.

According to a consumer confidence survey by the Cabinet Office, the number of households of two or more that expect price increases in the next year has risen gradually since March 2013, when it stood at 71.8% — that figure rose to 89.3% in February, but that may reflect the influence of the upcoming tax hike.

Since Kuroda took office, Japan has watched stock prices rise. Over the past year, the 225-issue Nikkei Stock Average rose by almost 15%. Currency markets have seen changes as well. Shortly before Kuroda took office as BOJ chief, the US dollar traded at around ¥95. But after aggressive easing steps the yen softened, crossing the ¥100 per US dollar line in May, and remaining weaker since. At the same time, businesses have enjoyed brisk recoveries, with automakers in particular posting strong earnings.

The aggressive monetary policy engineered by the BOJ had some effect on consumer prices too. They have been rising over the past year although very slowly, marking their first annual rise for five years in 2013, and land prices are up in major cities for first time since the global financial crisis in 2008. "Generally speaking, the market has given high marks to Kuroda's BOJ, and I agree with the consensus view," said Yoshiki Shinke, chief economist at Dai-ichi Life Research Institute. "There were some who were sceptical about the effectiveness of his massive easing measures, but actually the yen fell while stock prices rallied. This is in sharp contrast to the BOJ's past policies that were often criticized as too little, too late".

The question however is how far can BOJ policy measures go. Economists cast doubt on whether the BOJ's attempts to pump money into the financial system through reserve-rich commercial banks was having much impact. "What is in theory supposed to happen is that, as the central bank expands its balance sheet, the commercial banks expand theirs, thereby expanding the money supply, which stimulates the real economy. But when commercial banks already have massive excess reserves, this does not happen", said David Beim, a finance professor at New York's Columbia University.

What we have seen so far is that, outstanding bank loans were up modestly, in spite of massive buying of Japanese government bonds by the BOJ. And the weaker yen has done little to bring about the export growth that the BOJ had counted on. In its March economic report, the central bank lowered its view on exports, citing temporary factors. Other observers see structural causes at work, such as corporate Japan's declining competitiveness.

There is also growing scepticism among analysts and even some bank board members about the BOJ's ambitious target to hit 2% inflation by the end of next year. A recent poll by Kyodo News showed nearly three-quarters of Japanese people felt no effect from Abe's spending-and-easy-money blitz, as they brace for the first sales take hike since the late nineties. The tax increase has boosted speculation the BOJ would be forced to further expand its easing plan to protect the economy amid fears consumers will be scared off by higher prices. "How to deal with market expectations that the BOJ will announce fresh easing is a delicate matter. If the BOJ holds off, that may disappoint markets," Dai-ichi's Shinke said. "On the other hand, if the bank announces additional easing, that means the current easing program was not sufficient and that the economy is not living up to the bank's expectations."

With the weak yen's limits growing apparent, some at the BOJ have pinned their hopes on tightness in the labour market and an upswing in service prices, the latter owing to

wage hikes. But central bank watchers seem sceptical that this will be enough. Around 80% of non-government economists expect additional easing from the BOJ by August, a Japan Center for Economic Research survey found. By around July, it should become clear whether the dip in demand likely to follow the April 1 consumption tax hike has derailed Japan's economic recovery. If the rebound the central bank is expecting proves elusive, the case for additional easing will grow stronger.

Looking at the whole Abenomics experiment one feels that the failure of the Third Arrow of supply-side reform and deregulation has undermined the whole thing. All first year students know that Keynesian stimulus via money and budgets cannot shift the productivity of an economy. The only possible case for such stimulus is as an offset to a bad negative shock or as accompaniment to supply-side stimulus. There was no such negative shock and there is no supply-side stimulus. In their absence it looks as if Abenomics is doomed to fail in stimulating the Japanese economy; with the sole exception that it will indeed have raised prices and lowered the exchange rate. To what end?

MARKET DEVELOPMENTS

With the Fed still printing money vigorously (though 'tapering') and the Bank of England having printed money worth a third of GDP, and pressure on the ECB to start doing so on top of its past loans to struggling Southern banks, money is loose around the world on a startling scale. This cannot be a time to buy government bonds. Investors must seek the protection of equity markets which should be proof against the inflationary effects of such loose money. In the short to medium term world growth should be sustained- again an argument for equities. The only argument against is the threat of severe tightening; but this threat seems quite nugatory given the extreme dovishness of both the new Fed Chair of Governors Janet Yellen and new Bank Governor Carney. Only German traditional worry about inflation holds the ECB Chairman Draghi back from further money printing; yet he too may well break free. In short, equities have to remain at the centre of any investment strategy today.

Table 1: Market Developments

	Market Levels		Prediction for Mar/Apr 2014	
	Mar 3	Mar 31	Previous Letter	Current View
Share Indices				
UK (FT 100)	6708	6598	10063	9964
US (S&P 500)	1846	1872	2377	2411
Germany (DAX 30)	9359	9556	13336	13522
Japan (Tokyo New)	1197	1203	1683	1679
Bond Yields (government long-term)				
UK	2.72	2.73	2.00	2.00
US	2.66	2.72	2.10	2.10
Germany	1.63	1.57	1.50	1.50
Japan	0.59	0.65	0.70	0.70
UK Index Linked	–0.09	–0.10	0.10	0.10
Exchange Rates				
UK ($ per £)	1.68	1.67	1.56	1.56
UK (trade weighted)	86.3	85.9	82.3	82.3
US (trade weighted)	86.7	87.0	85.5	85.5
Euro per $	0.72	0.73	0.79	0.79
Euro per £	1.21	1.21	1.23	1.23
Japan (Yen per $)	102.0	103.0	98.0	98.0
Short Term Interest Rates (3-month deposits)				
UK	0.52	0.52	2.10	2.10
US	0.31	0.24	0.70	0.70
Euro	0.24	0.28	0.50	0.50
Japan	0.14	0.09	0.70	0.70

Table 2: Prospective Yields[1]

Equities: Contribution to £ yield of:

	Dividend Yield	Real Growth	Inflation	Changing Dividend Yield	Currency	Total
UK	3.50	2.6	2.4	46.00		54.50
US	1.90	2.8	2.0	24.00	6.42	37.12
Germany	2.70	1.5	2.0	38.00	−1.83	42.37
Japan	1.80	1.6	2.0	36.00	10.96	52.36
UK indexed[2]	−0.10		2.4	−6.00		−3.70
Hong Kong[3]	2.50	7.0	2.0	6.00	6.42	23.92
Malaysia	2.90	5.2	2.0	54.00	6.42	70.82
Singapore	3.70	4.0	2.0	38.00	6.42	54.62
India	1.60	7.0	2.0	23.00	6.42	40.02
Korea	1.20	4.0	2.0	−1.00	6.42	12.62
Indonesia	2.40	6.1	2.0	43.00	6.42	59.92
Taiwan	2.50	3.0	2.0	23.00	6.42	36.92
Thailand	3.40	4.1	2.0	40.00	6.42	55.92

Bonds: Contribution to £ yield of:

	Redemption Yield	Changing Nominal Rates	Currency	Total
UK	2.73	7.30		10.03
US	2.72	6.20	6.42	15.34
Germany	1.57	0.70	−1.83	0.44
Japan	0.65	−0.50	10.96	11.11

Deposits: Contribution to £ yield of:

	Deposit Yield	Currency	Total
UK	0.52		0.52
US	0.24	6.42	6.66
Euro	0.28	−1.83	−1.55
Japan	0.09	10.96	11.05

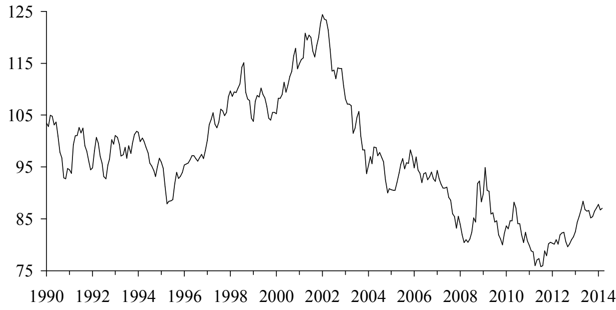
[1] Yields in terms of €s or $s can be computed by adjusting the £-based yields for the expected currency change.
[2] UK index linked bonds All Stocks
[3] Output based on China.

Table 3: Portfolio(%)

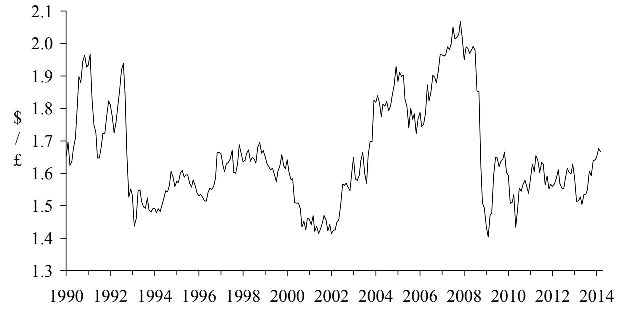
	Sterling Based Investor		Dollar Based Investor		Euro Based Investor	
	March Letter	**Current View**	**March Letter**	**Current View**	**March Letter**	**Current View**
UK Deposits (Cash)	5	5	5	5	1	1
US Deposits	-	-	-	-	-	-
Euro Deposits	-	-	-	-	-	-
Japanese Deposits	-	-	-	-	-	-
UK Bonds	-	-	-	-	-	-
US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

INDICATORS AND MARKET ANALYSIS
FOREIGN EXCHANGE MARKETS

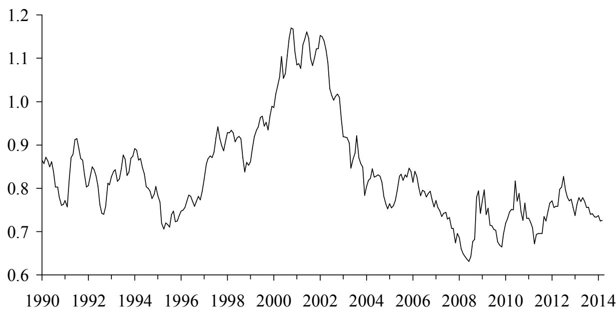
US : Trade Weighted Index
(Bank of England 1990 = 100)



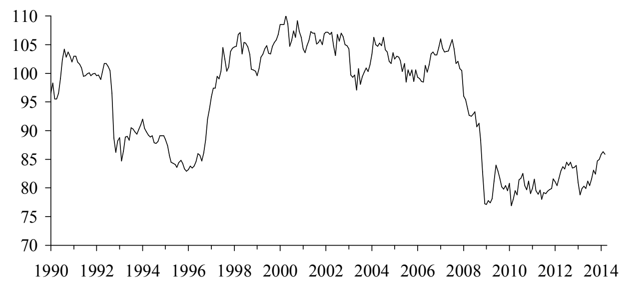
UK: Dollars Per Pound Sterling



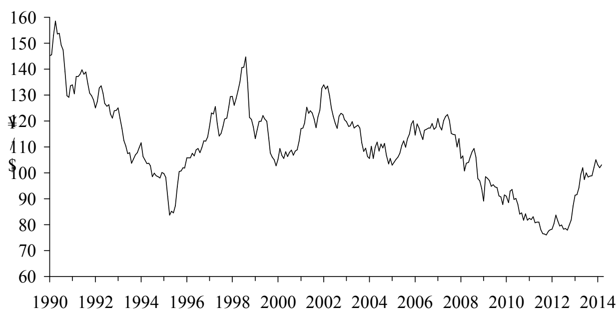
Euro per US dollar



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



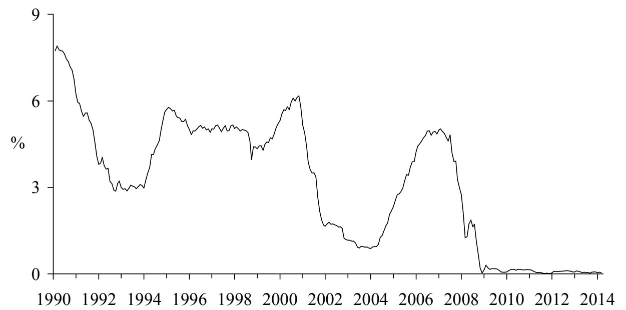
Japan : Yen Per U.S. Dollar



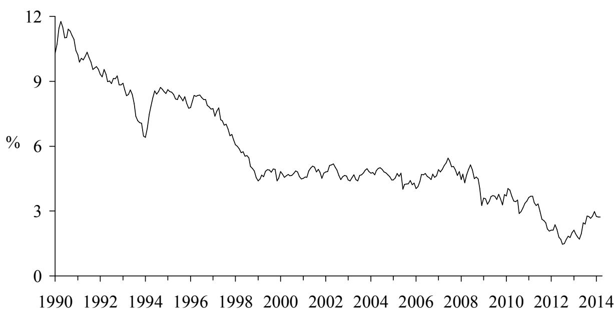
GOVERNMENT BOND MARKETS

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

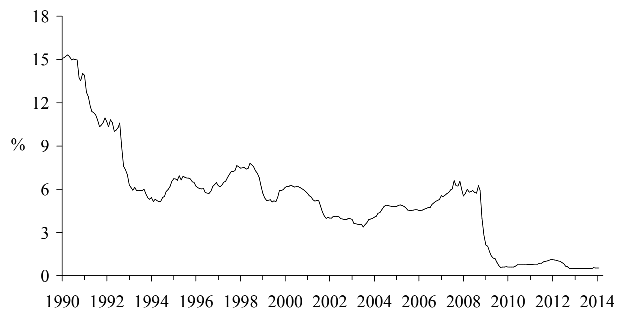
U.S. : 3-Month Treasury Bill



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

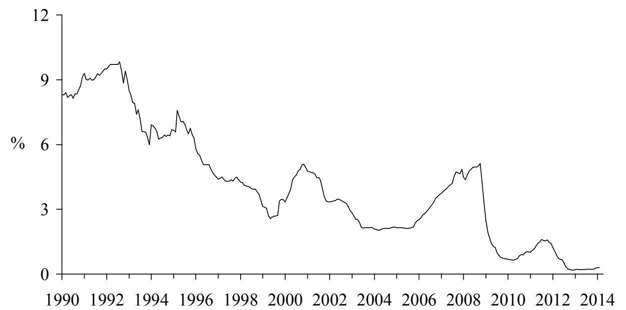


U.K. : 3-Month Interbank Rate

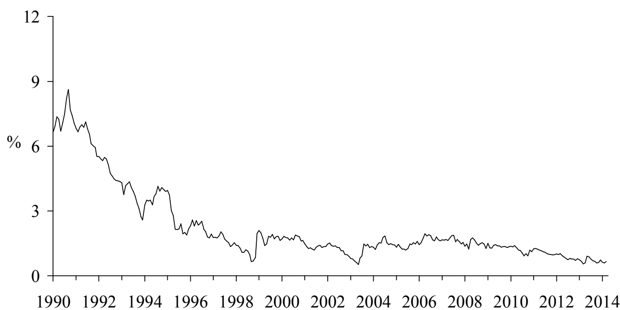


Germany: Yield on Public Authority Bonds

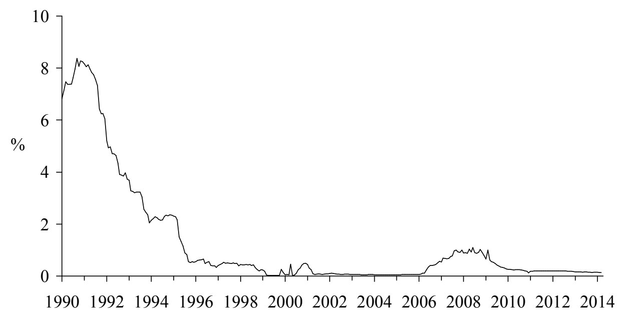
Germany : 3-Month Interbank Deposit Rate



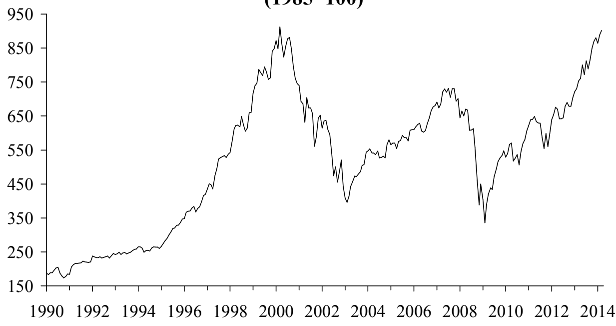
Japan: Yield on Long-Term Government Bonds

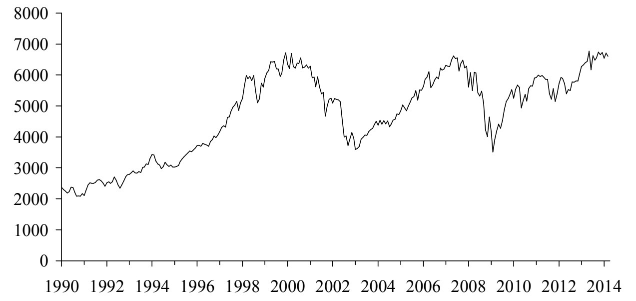


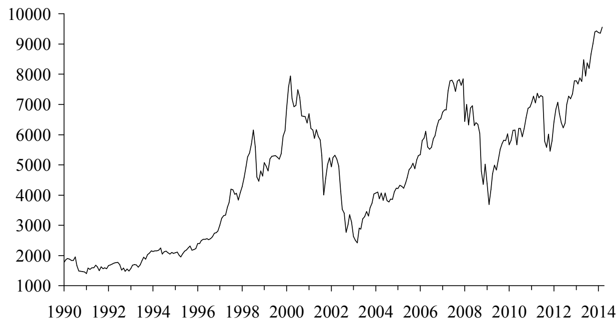
Japan : 3 Month Money Market Rate

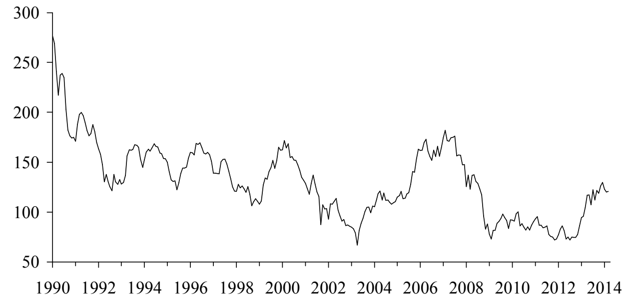


MAJOR EQUITY MARKETS









EMERGING MARKETS

Anupam Rasogi

India

India is in a sweet spot. There is an influx of money in Indian stock markets as Indian stocks are going to do well in the coming 12 months; the corporate sector has deleveraged its balance sheet and has aggressively cut costs. The Indian rupee has appreciated almost 5% in the last three months. Besides this, there are high expectations that a business friendly government will be installed on May 16 when the general election results are announced.

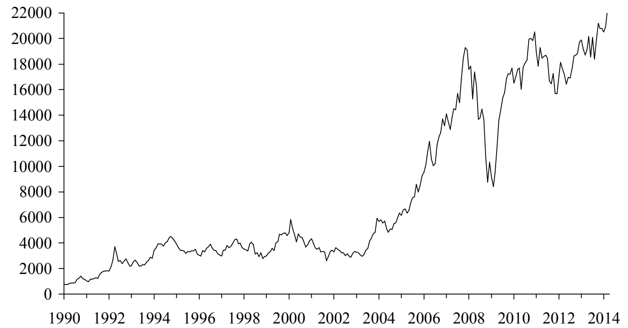
The Indian economy grew just 4.7% in the last quarter of 2013, but the seasonally adjusted India Manufacturing Purchasing Managers' Index, prepared by Markit, rose to 52.5 in February from 51.4 in January. The increase in PMI points to a bigger increase in new orders, both from the export and home markets.

Inflation, the long-standing bugbear of policy makers and investors, is returning to more sustainable levels. Wholesale price index inflation slowed to 4.68% in February from 5.05% in January, spurring hopes that the central bank will hold the repo lending rate steady in the First Bi-monthly Monetary Policy meeting of the new fiscal year scheduled on April 1. The slowing WPI follows a similar decline in consumer price inflation that fell to a new two-year low of 8.10% in February. The Reserve Bank of India has said it would like to see WPI inflation below 5% and would like to bring down CPI inflation to 8% by January 2015.

India's current account deficit (CAD) narrowed sharply to 0.9% of GDP in 3QFY14. For the month of February, the absolute trade deficit was down to a 5 month low of US$ 8.1 billion. This was predominantly due to restrictions on gold imports and not due to rising exports. In fact export growth, as a measure to tame CAD, is likely to face challenges in the future due to the appreciation of the rupee. The February growth number for exports already reflects that. In the month of February, exports declined 3.7% year-on-year. This is expected to decline for months to come. This is because the EU's scheme, which gives preference to exports from developing countries, will no longer be applicable to India. This obviously will hurt export volumes, however, there is a high probability of a current account surplus in Q4FY14 on the back of gold import restrictions.

The expectations of a Narendra Modi led NDA government continue to be priced into the market. Recent opinion polls suggest 230+ seats for the BJP-led National Democratic Alliance (NDA). The election frontrunner's manifesto is more about making the economic pie bigger than slicing it up fairly. The present government has prioritized redistribution over expansion. Its profligacy on subsidies and social programmes has obliged the central bank to tighten monetary policy, thereby choking growth. Their manifesto suggests more of redistribution and market distortions in the labour market. Educated but unemployed young people have been swayed by the BJP promise to create 10 million jobs. Opinion polls indicate the BJP will emerge as the single largest party in national polls, picking up more seats that it ever has since it was founded in 1980 as a right-wing alternative to the independence-era Congress party. It is unlikely to win a full majority on its own, but could sail over the half-way mark with the support of regional allies to form a coalition government. It is widely hoped that they will stimulate investments by hastening project clearance, faster decision making, revitalizing progress on the railway corridor projects and linking of the rivers in India. Investors also seem to believe that a potential Modi government will work towards resolving the mess in the banking sector more actively.

India: BSE Sensitive



The benchmark Sensex index is hovering above the psychological threshold of 22,000 and the Nifty closing above 6,600. The current pre-election rally is being propelled by foreign investors, who own roughly half the freely traded shares in India. But markets should temper their exuberance. The chances of Mr. Modi implementing the sweeping policies needed to return India's growth to the double-digit rates it enjoyed until a few years ago depend on two unknowns: the nature of the coalition he will lead, and his willingness to go beyond the relatively cautious positions he has offered on the campaign trail.

	11-12	12-13	13-14	14-15	15-16
GDP (%p.a.)	6.2	4.5	4.8	6.0	7.0
WPI (%p.a.)	7.5	7.0	6.5	6.0	6.0
Current A/c(US$ bill.)	-40.0	-88.0	-50.0	-50.0	-50.0
Rs./$(nom.)	49.5	54.5	62.0	62.0	63.0

China

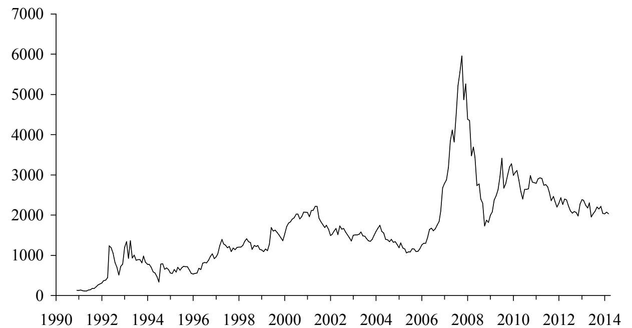
China is passing through a challenging phase of adjusting its export oriented economy to one more driven by domestic demand, and an assertive Chinese leadership would now like to play an important role in the world economy and international relations.

The March HSBC flash purchasing managers' survey PMI fell to an eight-month low of 48.1 in March from 48.5 in February. The March data is particularly important because it's free of distortions from the long Lunar New Year holiday that make January–February data suspect. This suggests that China's manufacturing activity slowed further in March and that first-quarter growth for the world's No. 2 economy will be disappointing. Weakening economic growth will test the leadership's seriousness about rebalancing China's economy.

China's Premier Li Keqiang has said that employment is the government's key concern. Beijing wants to create 10 million new urban jobs this year and keep urban unemployment below 4.6%. Hence, we believe that a loosening of monetary policy is underway to get the economy going again — as has been done routinely over recent years.

Consumer prices rose a modest 2% year over year, underscoring the weakness of demand. In January, prices rose 2.5%. China recorded a sharp decline in exports and a rare $22.98 billion deficit in February. Exports fell 18.1% from a year ago, following a strong 10.6% expansion in January. Imports clocked in 10.1% growth over a year ago, after a 10% gain in January. This has moved the Premier Li Keqiang to say that China faces "more difficulties" this year than last. But Communist Party officials want to give market forces a "decisive" role in the economy.

Foreign exchange market is witnessing their determination. The yuan is down 2.8% so far this year, nearly wiping out its 2.9% gain against the dollar for all of last year. If we compare this fall to the double digit currency devaluation of emerging markets, it might look small, but the importance of it cannot be ignored. With the economy slowing down, putting more Yuan into the hands of foreigners to boost exports is a much more appealing option for China, given the control it provides the Central bank in both chasing away speculative capital and managing export demand. But the recent sharp decline of the Chinese currency is threatening to exacerbate China's trade tensions with the U.S. and raising concerns over a potential currency war in Asia.



In mid-March China widened the permissible trading band from 1% to 2% on either side — part of efforts to liberalize the financial system. Before widening the trading range, the central bank squeezed the speculators. The People's Bank of China argues that the depreciation is needed to drive out speculators, who were betting the yuan would continue to rise. The bank has argued that the yuan is approaching its fair-market value, pointing to the country's shrinking trade surpluses. We are of the opinion that In the long run, the yuan is still likely to appreciate because China still runs a large trade surplus and the recent bout of yuan weakening is transitory.

China has signed a memorandum with the Bank of England where financing and trade in Chinese yuan would be cleared and settled in London for the currency outside Asia. In another move, Chinese regulators have started to approve a handful of privately owned banks as a way to bring more capital into the system and focus lending on smaller firms. Both these are significant as they point to liberalization of the yuan on its way to capital account convertibility. According to researchers from an Australian government-sponsored think tank — Australia's Center for International Finance and Regulation — China is poised to accelerate liberalization of its capital and foreign exchange markets, a move that will turn the yuan into a major reserve currency within 10 years and catapult Chinese stock and bond markets into the ranks of the world's two biggest.

	11	**12**	**13**	**14**	**15**
GDP (%p.a.)	9.2	7.7	7.7	7.5	7.0
Inflation (%p.a.)	4.3	2.6	3.5	2.5	2.5
Trade Balance(US$ bill.)	210	214	220	220	200
Rmb/$(nom.)	6.3	6.3	6.2	6.1	6.0

South Korea

With growth stabilizing in the main export markets of South Korea, namely the US and China, South Korea is confident that economic growth will accelerate to 3.8% in 2014 compared to 2.8% in 2013. President Park Geun-hye has proposed a reform package over a period of the next three years which seeks to wean Korea off its dependence on manufacturing exports. Under this plan the government would end tax policies that favour large exporters over other companies and would push ahead with deregulation to remove hurdles for domestic service firms. The government would rein in large state-owned enterprises by limiting their ability to borrow. If her plan works domestic consumption would be a significant component of economic growth.

South Korea's consumer prices in February rose at a slower pace than the previous month as food and agricultural-product prices stabilized and kept inflation subdued. The consumer price index rose 1% on the year in February after a 1.1% gain in January. The Bank of Korea expects the CPI to rise 2.3% for all of 2014, well within an inflation target band of 2.5% to 3.5%. CPI increased 1.3% in 2013.

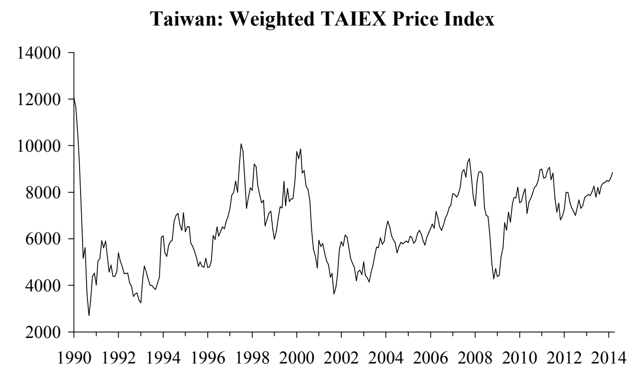
South Korea's exports rose 8.2% in the first 3 weeks of March compared to a 0.7% gain for the combined January–February period according to customs. Imports during the same period rose by 2% in annual terms to $29.9 billion giving rise to a trade surplus of $176 million. This was a trade surplus for 25 straight months as exports managed to grow.

South Korea and Canada signed an agreement to remove tariffs on most goods they trade, aimed at reversing a decline in business between the two. The agreement covers sensitive items such as cars and beef. The agreement is yet to be ratified by parliaments of both countries. The implementation of the agreement will see phasing out all tariffs on 98% of bilaterally traded goods within a decade. Total trade volume between the two countries fell to $9.9 billion in 2013 from $11.5 billion in 2011.

	11	12	13	14	15
GDP (%p.a.)	3.6	2.0	2.8	3.8	4.0
Inflation (%p.a.)	4.0	2.2	1.3	2.5	2.5
Current A/c(US$ bill.)	27.0	44.0	71.0	80.0	80.0
Won/$(nom.)	1100	1100	1100	1080	1060

Korea: Composite Index

Taiwan: Weighted TAIEX Price Index



Taiwan

Taiwan's economic prospects have brightened as the United States and Europe are recovering steadily and China has set its economic growth target at 7.5%. The economy is likely to grow 3% in 2014. With local consumer prices remaining stable Taiwan's central bank is expected to keep its key interest rates unchanged. For the time being Taiwan's central bank does not see necessary to tighten liquidity as the US Fed rolls back its quantitative easing.

The protest by students opposing a controversial trade deal has come as a surprise to many Taiwan watchers because the service trade pact — signed with Beijing last June — has improved trade relations with Mainland China. The protesters want a legally binding mechanism to monitor all agreements across the Taiwan Strait in the future. The government has argued that the pact is an essential step to further liberalize cross-Strait trade flow. It is considered an important achievement of Mr. Ma's presidency and his policy of fostering closer economic ties between mainland China and Taiwan. At the bottom of this protest is a long-standing fear that closer economic ties would diminish Taiwan and, sooner rather than later, the political freedom enjoyed by Taiwan would be gone as China annexed the island. To some extent China is watching closely the reaction of the US and Europe to the annexation of Crimea by Russia. Developing economic ties and internationalizing the yuan market suggest that China is unlikely to do anything which would upset international community.

	11	12	13	14	15
GDP (%p.a.)	4.0	1.3	2.1	3.0	3.0
Inflation (%p.a.)	1.2	1.9	1.2	1.1	1.0
Current A/c(US$ bill.)	18.0	41.7	50.6	57.4	60.0
NT$/$(nom.)	30.0	29.5	30.0	30.5	30.5

Brazil

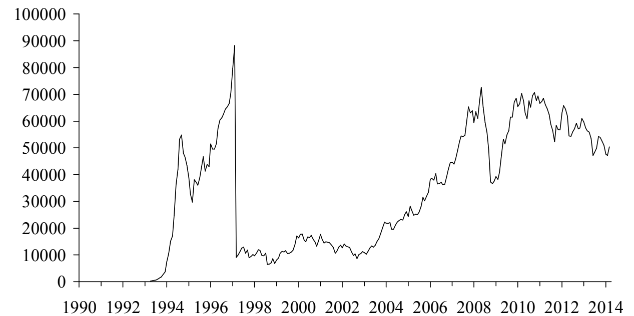
The slump in commodity markets has slowed down economic growth of Brazil. Moreover, the Brazilian economy in the past benefitted from domestic consumption supported by rising employment and cheap credit. Industrial growth, on the other hand, was suffering due to the slump in commodity prices and investment has been far below what is needed. The slowdown in consumption has led to modest growth in Brazil's economy in the fourth quarter. The agriculture sector and investment have not picked up despite huge government incentives that have stretched public expenditure. The economy faces other headwinds too; low unemployment and plentiful public spending have fuelled inflation which — despite monetary tightening — remains far above the government's target of 4.5%.

Inflation is likely to flare up in Brazil with food prices spiralling up due to one of the worst droughts in four decades, and with higher tuition fees providing an extra jolt to families. Monthly inflation in February is likely to increase to 0.64% from 0.55% in January, which implies that inflation would rise to 5.63% for the 12 months ended February, up from 5.59% at the end of January.

Brazil's current account deficit hit a record monthly high last month, suggesting that the weakening in the real over the past year has not helped exports as commodities prices are falling. As long as the deficit remains above 3% Brazil will face challenges paying its foreign debts.

Standard & Poor's has already cut the credit rating on Brazil's long-term bonds to just one notch above junk, citing deteriorating government accounts, rising debt and weakening growth. Brazil's sovereign-credit rating stands at triple-B-minus from triple-B and with stable outlook. Moody's Investors Service and Fitch Ratings both have investment-grade ratings on Brazil with stable outlooks. As expected, the Brazilian government has dismissed the

Brazil: Bovespa



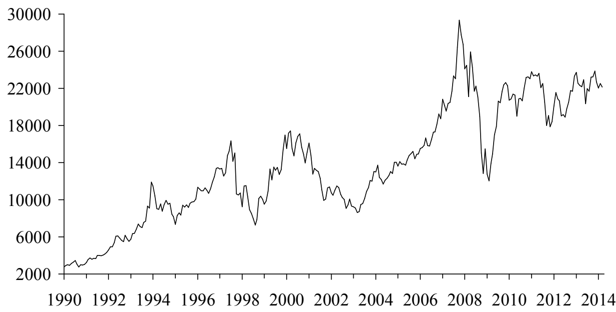
Standard & Poor's downgrade and blamed its "inconsistent" analysis of the economy. The government has pointed out that it has promised $18.5 billion budget cuts this year to rein in fiscal deficit.

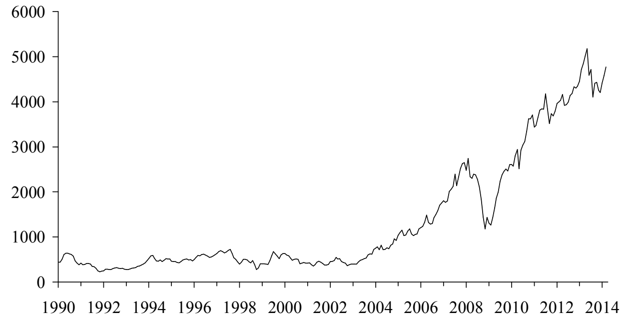
With the S&P downgrade, the real will weaken below 2.45 per dollar but this is unlikely to help exports as Brazil is a price-taker in both agriculture and industrial commodities markets.

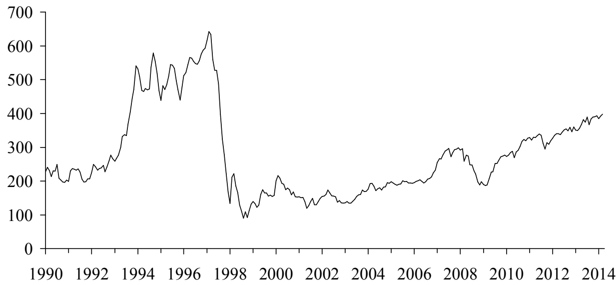
The Fifa and the International Olympic Committee are not satisfied with Brazilian preparations for the games. Three stadiums for the World Cup, which begins on June 12, remain unfinished, and several public transportation projects linked to the tournament have been abandoned. We wonder if we are going to see the replay of the Commonwealth games held in New Delhi in 2010.

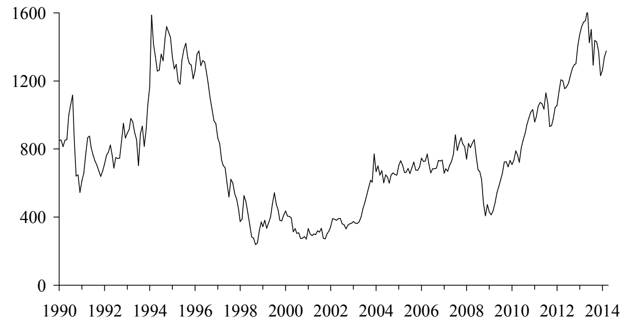
	11	**12**	**13**	**14**	**15**
GDP (%p.a.)	2.7	0.9	2.3	2.0	3.0
Inflation (%p.a.)	6.5	5.8	5.9	5.6	5.0
Current A/c(US$ bill.)	-52.6	-60.0	-75.0	-70.0	-70.0
Real/$(nom.)	1.5	2.0	2.3	2.45	2.50

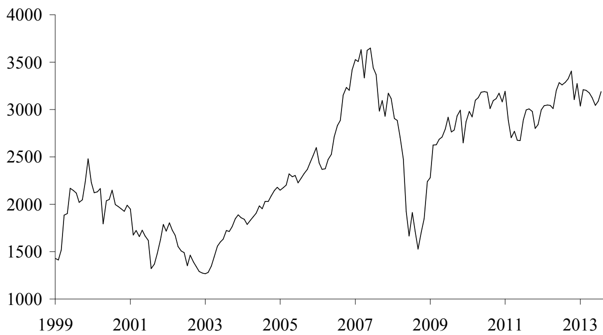
Other Emerging Markets

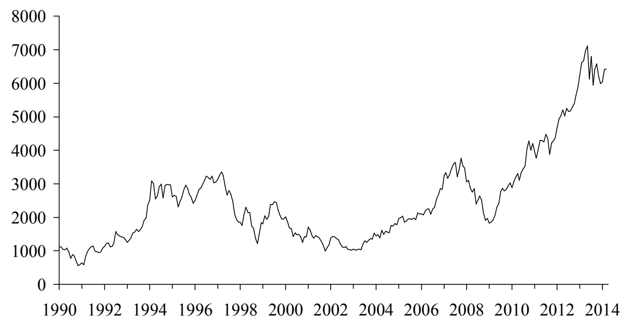






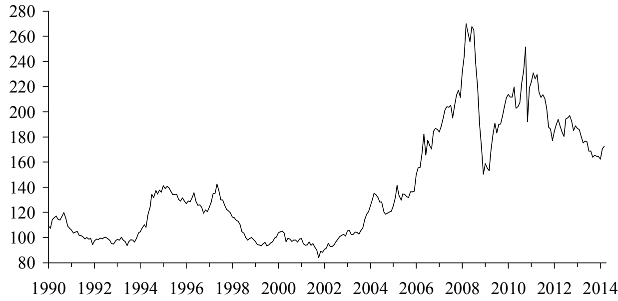




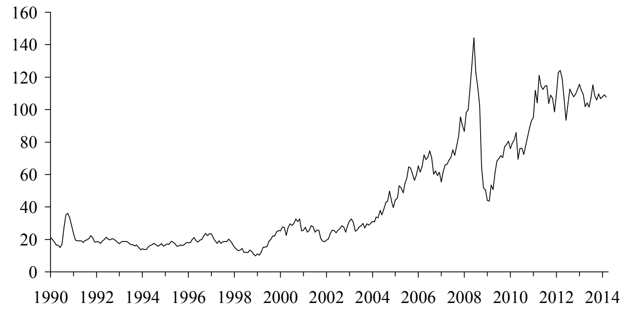


COMMODITY MARKETS

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

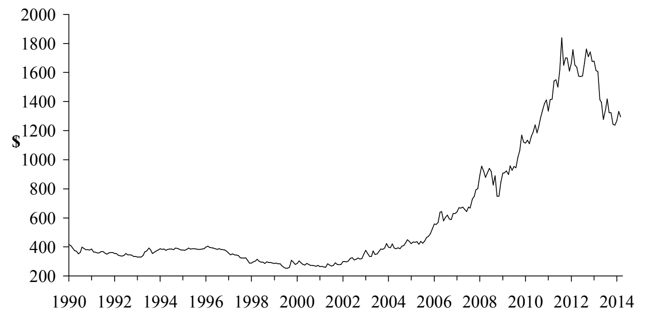


Oil Price: North Sea Brent (in Dollars)

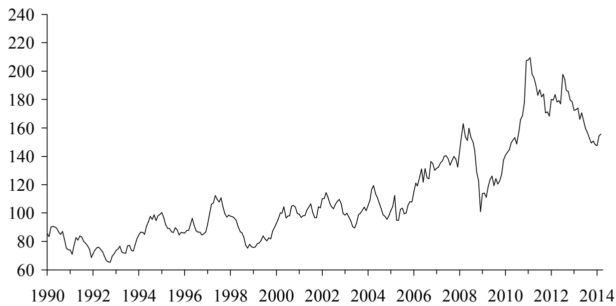


Commodity Price Index (Sterling)
(Economist, 2000=100)

Gold Price (in Dollars)



Commodity Price Index (Euro)
(Economist)



UK FORECAST DETAIL

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

	Inflation %[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]
2010	3.3	2.4	0.7	80.4	88.6	−3.5	4.8	−0.2
2011	4.5	2.0	0.9	80.0	89.8	−2.8	5.3	−0.2
2012	2.7	0.9	0.9	83.1	93.9	−1.8	3.2	−1.4
2013	2.4	1.2	0.6	81.4	92.5	−1.7	3.2	−1.0
2014	2.5	1.6	1.8	83.0	94.1	−1.6	3.1	−0.5
2015	2.2	2.0	2.1	82.3	95.4	0.1	2.8	0.1
2012:1	2.7	1.1	1.1	81.2	91.6	−1.9	3.8	−1.3
2012:2	3.1	0.9	1.1	83.1	94.2	−1.4	3.2	−1.4
2012:3	2.5	0.7	0.8	84.1	95.2	−1.8	2.9	−1.6
2012:4	2.5	0.8	0.6	83.6	94.8	−2.0	3.0	−1.5
2013:1	2.6	1.0	0.6	80.3	90.9	−1.7	3.3	−1.3
2013:2	2.3	1.0	0.6	80.6	92.6	−1.9	3.1	−1.3
2013:3	2.4	1.5	0.5	81.2	93.2	−1.5	3.2	−0.7
2013:4	2.5	1.5	0.7	83.5	93.2	−1.9	3.2	−0.7
2014:1	2.6	1.6	1.2	82.9	93.7	−1.7	3.1	−0.6
2014:2	2.5	1.6	1.6	82.8	94.0	−1.6	3.1	−0.6
2014:3	2.4	1.7	1.9	82.9	94.0	−1.6	3.1	−0.4
2014:4	2.4	1.7	2.2	83.4	94.6	−1.5	3.0	−0.4

[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)
2010	227.1	2.4	4.6	1.50	135.6
2011	232.7	2.5	4.6	1.53	133.5
2012	237.0	1.9	4.7	1.59	132.4
2013	240.2	1.4	4.3	1.45	131.0
2014	246.3	1.6	3.9	1.33	131.1
2015	251.0	2.2	3.9	1.31	133.3
2012:1	236.6	0.7	4.8	1.61	132.6
2012:2	238.1	1.8	4.8	1.59	132.2
2012:3	238.1	1.9	4.7	1.57	132.9
2012:4	236.6	3.3	4.6	1.56	131.8
2013:1	238.2	0.6	4.5	1.54	130.1
2013:2	239.5	2.4	4.4	1.50	132.3
2013:3	240.6	0.8	4.1	1.39	130.8
2013:4	242.5	1.7	4.0	1.37	130.8
2014:1	243.6	3.1	4.0	1.36	130.7
2014:2	245.5	1.6	3.9	1.34	131.1
2014:3	247.4	2.7	3.8	1.31	131.1
2014:4	248.6	2.8	3.8	1.30	131.2

[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
2010	143.2	685816.8	412464.1	222982.1	180596.2	−35977.3	94248.2
2011	144.8	693480.0	405707.9	232196.6	179249.7	−24641.9	99032.3
2012	145.0	694345.6	405044.8	241788.1	182996.5	−31204.8	104279.0
2013	147.1	704061.8	408532.0	244321.9	181864.1	−32814.9	102184.1
2014	150.8	722173.8	414751.1	266188.7	175499.7	−38621.7	95765.2
2015	154.4	735702.5	414580.1	250992.1	193479.8	−31157.8	92210.8
2010/09	1.7		0.3	11.0	0.1		8.3
2011/10	1.1		−1.6	3.8	−0.8		4.5
2012/11	0.2		−0.1	2.5	3.0		3.0
2013/12	1.4		0.9	1.1	−0.6		−2.0
2014/13	2.6		1.5	9.0	−3.5		−6.3
2015/14	2.4		1.5	7.0	2.3		3.1
2012:1	145.2	173789.2	101182.0	58927.4	47960.2	−6985.4	27295.1
2012:2	144.5	172990.1	101166.9	58367.1	44720.2	−8453.9	22810.2
2012:3	145.4	174050.5	100983.7	61663.0	45063.8	−7626.9	26033.1
2012:4	145.0	173515.9	101712.2	62830.6	45252.2	−8138.6	28140.5
2013:1	145.5	174176.5	101809.6	58031.1	47399.5	−7067.3	27132.5
2013:2	146.5	175320.9	101767.6	58214.8	45564.9	−7180.1	24182.3
2013:3	147.6	176705.8	102549.0	61992.2	45788.6	−9285.0	25475.0
2013:4	148.6	177858.6	102405.8	66084.0	43111.1	−9282.6	25394.2
2014:1	149.3	178747.9	103029.0	66015.6	43049.0	−9664.1	23431.4
2014:2	150.2	179820.4	103449.6	66632.0	43319.2	−9655.3	23693.8
2014:3	151.4	181259.0	103898.6	64834.9	45886.2	−9650.6	24248.6
2014:4	152.3	182346.5	104373.9	68706.1	43245.3	−9651.8	24391.5

[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)
2010	10.5	1319.8	139.6	36.6	−40.0
2011	8.4	1399.3	118.5	43.0	−22.5
2012	8.0	1429.6	115.0	46.4	−59.2
2013	7.6	1482.5	112.3	48.0	−60.7
2014	7.1	1549.3	109.4	52.8	−62.9
2015	5.9	1613.2	94.6	60.3	−63.5
2012:1	5.9	356.4	21.0	11.5	−12.5
2012:2	10.5	350.3	36.7	11.4	−17.3
2012:3	7.2	358.6	25.7	11.8	−14.8
2012:4	10.6	364.3	38.6	11.8	−13.1
2013:1	3.8	364.3	14.0	12.0	−14.0
2013:2	9.3	363.3	33.7	11.6	−16.7
2013:3	6.2	369.4	23.1	12.0	−15.5
2013:4	7.6	374.6	28.3	12.3	−12.8
2014:1	7.2	375.2	27.3	12.7	−15.9
2014:2	6.9	379.8	26.2	13.1	−17.3
2014:3	7.1	384.4	27.3	13.5	−16.0
2014:4	7.1	390.1	27.9	13.6	−13.3

[1] GDP at market prices (Financial Year)

WORLD FORECAST DETAIL

Growth Of Real GNP

	2009	2010	2011	2012	2013	2014
U.S.A.	–2.6	2.4	1.8	2.2	2.2	2.8
U.K.	–3.9	1.7	1.1	0.2	1.4	2.6
Japan	–6.3	4.7	–0.5	1.9	1.8	1.6
Germany	–4.7	4.2	3.0	0.7	0.6	1.5
France	–2.5	1.6	2.0	0.0	0.2	0.7
Italy	–5.1	1.7	0.5	–2.4	–1.8	0.4

Real Short-Term Interest Rates

	2009	2010	2011	2012	2013	2014
U.S.A.	–1.6	–3.0	–1.8	–1.9	–1.3	–1.2
U.K.	–0.3	–3.5	–2.8	–1.8	–1.7	–1.6
Japan	1.1	0.4	0.4	0.3	–1.6	–1.6
Germany	–0.4	–1.9	–0.5	–1.5	–1.5	–1.4
France	–0.8	–1.7	–0.5	–1.4	–1.5	–1.4
Italy	–0.8	–2.4	–1.5	–2.6	–2.0	–1.4

Real Long-Term Interest Rates

	2009	2010	2011	2012	2013	2014
U.S.A.	1.3	1.0	0.9	–0.2	0.1	0.6
U.K.	–0.3	–0.2	–0.2	–1.4	–1.0	–0.5
Japan	1.2	0.4	–0.2	–0.8	–1.3	–1.1
Germany	2.2	1.8	–0.1	–0.4	–0.5	–0.1
France	2.2	1.9	–0.1	–0.4	–0.5	–0.1
Italy	1.5	1.2	–0.7	–0.8	–0.6	–0.1

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

	2009	2010	2011	2012	2013	2014
U.S.A.	88.7	87.4	85.7	90.4	97.3	99.1
U.K.	76.7	88.6	89.8	93.9	92.5	94.1
Japan	89.0	92.0	97.1	98.3	119.7	122.0
Germany	105.8	102.9	105.5	104.3	107.4	108.2
France	104.3	103.1	105.5	104.9	107.9	108.6
Italy	105.4	103.6	106.9	107.4	111.8	113.2

[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

	2009	2010	2011	2012	2013	2014
U.S.A.	–0.3	1.6	3.1	2.1	1.6	2.0
U.K.	1.3	3.3	4.5	2.7	2.4	2.5
Japan	–1.4	–0.7	–0.3	0.0	0.0	2.0
Germany	0.4	1.2	2.0	2.0	1.7	2.0
France	0.1	1.5	2.1	2.0	1.1	1.5
Italy	0.8	1.5	2.8	3.0	1.4	1.6

Nominal Short-Term Interest Rates

	2009	2010	2011	2012	2013	2014
U.S.A.	0.2	0.1	0.3	0.1	0.7	0.8
U.K.	1.1	0.7	0.9	0.9	0.6	1.8
Japan	0.1	0.1	0.4	0.3	0.4	0.4
Germany	0.7	0.4	1.5	0.2	0.5	0.6
France	0.7	0.4	1.5	0.2	0.5	0.6
Italy	0.7	0.4	1.5	0.2	0.5	0.6

Nominal Long-Term Interest Rates

	2009	2010	2011	2012	2013	2014
U.S.A.	3.2	3.1	1.9	1.8	2.1	2.6
U.K.	2.8	2.4	2.0	0.9	1.2	1.6
Japan	1.3	1.1	1.0	0.8	0.7	0.9
Germany	4.0	3.8	1.8	1.5	1.5	1.9
France	4.0	3.8	1.8	1.5	1.5	1.9
Italy	4.0	3.8	1.8	1.5	1.5	1.9

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

	2009	2010	2011	2012	2013	2014
U.S.A.[1]	85.98	83.73	78.08	80.90	85.50	85.40
U.K.	1.57	1.58	1.61	1.59	1.55	1.55
Japan	93.54	87.48	79.36	80.51	98.00	98.00
Eurozone	0.72	0.75	0.71	0.78	0.79	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