LIVERPOOL INVESTMENT LETTER

August 2016

Cardiff Business School
Cardiff University

Julian Hodge Institute of Applied Macroeconomics

LIVERPOOL RESEARCH GROUP IN MACROECONOMICS

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The Julian Hodge Institute was launched in autumn 1999 in a new collabouration 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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CONTENTS

THE POST-BREXIT FANDANGO

In the referendum debate Remain claimed that not only would the economy go into recession if voters foolishly chose Brexit but even the second quarter would be hit by the polls showing a good chance of Brexit. This last is now conveniently forgotten by Remainers, now that the second quarter has shown a 50% rise in growth on the first quarter.

This second quarter is the only hard data on 'Brexit uncertainty effects until now. We will not have any hard data on the third, post-Brexit, quarter until the autumn. The surveys we have so far show that actual output and orders remain on their previous track but that 'confidence' has taken a hit. Experience with past surveys when the media are full of gloom and doom is that there is a disconnect between 'confidence' about the general economy and what people do in reaction to their own circumstances. Today ordinary households' situation has never been better: real disposable incomes are rising at over 3% and employment levels are at a record. Credit is easily available; and the Bank has just made that easier still. The pound has dropped around 15%, as it usually does when the UK hits a bump in the road, and this represents a far bigger monetary stimulus than the Bank's 0.25% cut in interest rates. There should be no need for Philip Hammond to deviate from fiscal prudence in the autumn.

The UK economy will certainly survive any short term bumpiness; most forecasts have become more optimistic already. The real focus of debate should be on where Theresa May's government is taking our trade and other economic policies in the long term. She and her ministers have made some good noises about free trade and pro-business regulation, admittedly larded with some talk about less attractive intervention in corporate affairs. Current talks with small business highlight the key fact that smaller firms are less able to carry the heavy costs of social regulation so favoured by the EU Single Market; for them a UK-run regulative system that has always understood small business is much to be desired. Large businesses can lobby and have the staff resources to cope with endless 'compliance'. But in the UK over half of our employment is in small businesses; this too is the most dynamic and innovative part of our economy.

Our future trade framework is the heart of the matter; on it depends how far the UK can pursue the road of self-government, the control of laws and borders demanded by the Brexit majority. It is good to see Liam Fox getting off to a strong start negotiating draft free trade agreements, FTAs, with countries around the world. These countries will then lower their tariffs and trade barriers against us, and we ours against them.

But the gain that we get from this does not come from their lowering their barriers against us, contrary to what is generally thought. When they do that there is a negligible effect on the world prices of the things we sell, because even the largest of these countries, such as the US, buys only a small proportion of the world supply of these products; when they buy a bit more from us, and a bit less from some other countries due to some new FTA, their total demand for the product barely changes, so nor does the world price of what we sell. So we gain nothing and sell the same output overall.

Table 1: Summary of Forecast

	2014	2015	2016	2017	2018	2019	2020
GDP Growth[1]	2.9	2.2	2.3	2.7	2.7	2.8	3.4
Inflation CPI	1.7	0.1	1.3	2.9	3.3	2.8	2.1
Wage Growth	1.2	2.7	3.4	4.8	5.1	3.1	3.4
Unemployment (Mill.)[2]	1.1	0.9	0.8	0.8	0.7	0.7	0.7
Exchange Rate[3]	87.1	91.6	81.8	77.7	76.1	74.8	73.6
3 Month Interest Rate	0.6	0.5	0.7	2.2	2.9	3.0	3.2
5 Year Interest Rate	1.8	1.4	2.2	3.1	3.2	2.9	2.7
Current Balance (£bn)	−99.9	−91.0	−79.1	−77.7	−67.3	−48.3	−34.4
PSBR (£bn)	83.3	74.6	58.0	58.6	21.0	15.1	15.4

[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)

No, the gain we get from these FTAs is that we remove our tariffs and other trade barriers on them; this means that our consumers pay less for them and so enjoy a rise in their standard of living. Once these high-visibility trade agreements are signed we should make sure that we trade freely with all the rest of the world, however we can arrange it. Our ultimate aim should be to achieve unilateral free trade with all countries of the world. As this implies we could actually short circuit all these FTAs and simply go at once to unilateral free trade, as has been done by countries such as New Zealand and Singapore; even China has unilaterally brought down its tariffs to aid its development.

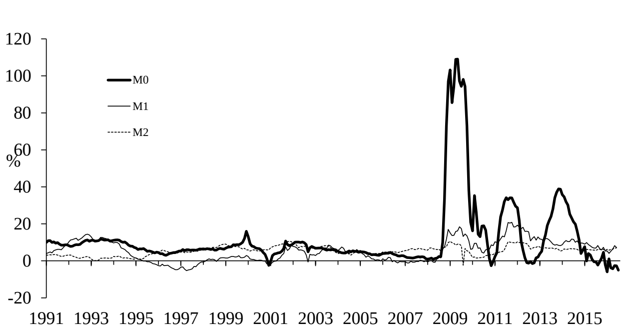
It is this that lies at the heart of our EU trade relationship. The EU Single Market is highly protectionist which of course is why there has been so much fuss about being outside it. This protectionism raises the prices of both food and manufactures by around 20% to UK consumers, implying an 8% rise in their overall cost of living. While this is nice for farmers and manufacturing firms who make higher profits, the losses of consumers are far greater. When we leave the EU, protected prices are replaced by world prices. This generates healthy competition which pushes up productivity, forcing firms to go 'up the value chain' towards more hi-tech methods; we can also help them to access the Single Market from the outside as the US and Japan do. The gain in GDP and living standards according to my standard world trade model is about 4%; on top of that there are the gains from replacing EU regulation with our own and from regaining control of mass unskilled immigration which is costly to the economy and politically toxic.

As for the City, it too will gain greatly from having its regulations made in free market London instead of a Brussels hostile to 'Anglo-Saxon finance'. The City fears

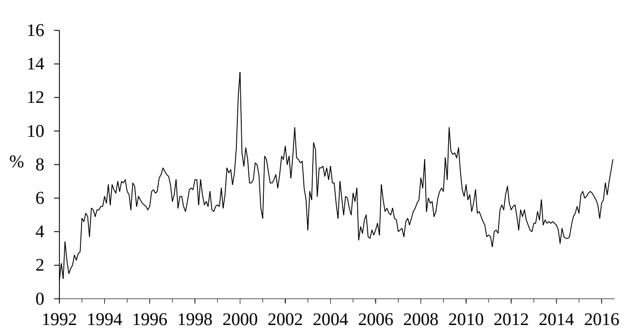
EU protectionism but it need not worry. Suppose Brussels withdraws 'passporting' and the ECB declares that euro-bonds must be cleared in Frankfurt. Just as with an FTA, the City will sell less in the EU and more elsewhere.

The implication of all this is that the main remaining task of Brexit policy is for the Ministry of Brexit under David Davis to withdraw us from the Single Market and take us to unilateral free trade, to reap these huge gains from eliminating EU protectionism and regulation. Mr. Davis would like to sign some broader FTA with the EU; I would like to wish him luck but the bald truth is that, as David Cameron found out, the EU has virtually no flexibility when each of 27 countries wields a veto. He should save us all time and policy delays by simply walking away from the EU, lock, stock and barrel.

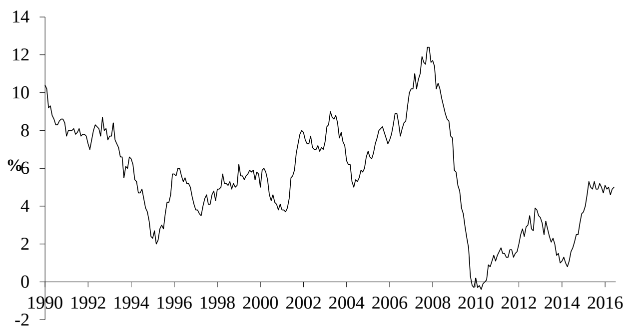
U.S.: Growth in Monetary Aggregates (Yr - on - Yr)



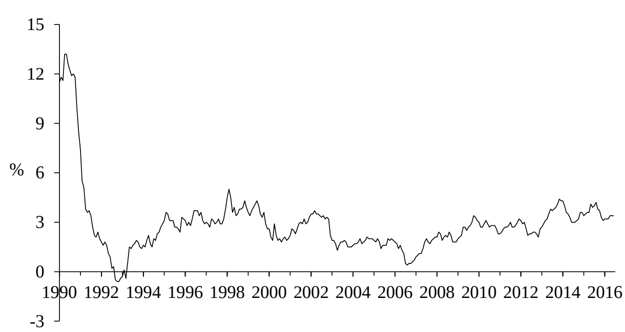
UK: Notes and Coins in Circulation Growth



Eurozone M3 Growth



Japan: Growth of M2+CD's



FOCUS ON JAPAN

Francesco Perugini

Japan Increases Political Stability

Japanese Prime Minister Shinzo Abe's Liberal Democratic Party (LDP) and its junior coalition partner, Komeito, have won 70 of the 121 seats up for grabs in the upper house triennial elections held on the 10th of July. The seats obtained in the upper house are not only many more than the ruling coalition's 61 seat target, but deliver a two-thirds majority in the upper house for constitutional revision when taking into account other pro-revision political parties — every three years, half of the 242 seats in the upper house of the Diet, Japan's parliament, are contested. In the more powerful lower house, the coalition had already attained the required two-thirds majority in the general election in December 2014.

It is the fourth and most remarkable unbroken national-level electoral success for the ruling party since the second Abe administration took office in December 2012. The ruling party has gone from strength to strength and has achieved what was previously thought to be an almost unachievable political outcome. This is partly the result of an extremely weak and directionless opposition.

Now that the ruling coalition and pro-amendment groups have the required two-thirds majority, the chances are good that constitutional revision will be pushed ahead on the political agenda of the government. An exit poll conducted by the Asahi Shimbun, a Japanese leading newspaper, in conjunction with the upper house election found more voters favoured (unspecified) constitutional change than opposed it, albeit by a narrow margin. An exit poll by the Jiji news agency obtained the opposite result, although one-third of its respondents were 'unsure'. These surveys sampled the 55% of the electorate who actually turned out to vote — the politically active component of the population the LDP would need in a referendum. If there has been a shift in the public mood, it could be because a lot has happened since last September: more Japanese have died in terrorist atrocities abroad, China has stepped up its belligerent approach to territorial disputes, North Korea has test-fired ballistic missiles, and US presidential candidate Donald Trump has put Japan on notice to provide for its own defence. The US–Japan alliance was further frayed by the murder of a young woman by a US base employee in Okinawa. At a time of great unease, public approval for the Abe cabinet has rebounded 11 percentage points (to 48%) from its low point of a year ago.

The task to revise the constitution, never formally amended since 1947, will not be smooth sailing though. First, even when a proposed revision to the constitution is endorsed by both chambers of the Diet, it must be approved by a vote of majority in a national referendum to become part of the fundamental law. There still is strong aversion within the Japanese public against changing the constitution, especially Article 9, the so-called pacifist clause. Second, there is hardly any consensus between the two ruling coalition parties — the LDP and Komeito — as to what clauses need revisiting and how to go about amending them. Third and most importantly, it is questionable whether the Abe administration should tackle the matter as its top-priority challenge. As Abe acknowledges himself, Abenomics is still only halfway realized. For now, it will make sense for the government to focus its energy on revitalization of the Japanese economy, while tackling constitutional revision as a matter of debate.

However, observers are puzzling on how he wants to push ahead with his economic reform agenda, in particular it is unclear when and how Abe will take out the third arrow of structural reform from the Abenomics quiver and how he will hit the target successfully. The first two arrows of Abenomics — fiscal stimulus and monetary easing — seemed to have had some successes, but have been unable to produce the desired results on a sustainable basis. The Japanese stock market has lost much of its shine and the economic outlook does not seem to be very bright. Domestic consumption is stagnant as consumers continue to tighten their belts, and exports may slow down with the rising yen. Moreover, Japan has yet to achieve the elusive virtuous cycle in which companies improve earnings on sustained price rises while pay hikes encourage increased spending. The government will work out a large package of economic stimulus measures this month. But it will primarily consist of public works projects and other short-term measures reliant on fiscal spending.

What the country needs most is the political resolve to create a new growth path based on radically new and different ideas. Despite being a time-consuming, laborious process, structural reforms will raise the level of growth. But hard-nosed structural reforms are making little headway because of the strong influence of entrenched interest groups within the government, which are resistant to reform. In a period of such political stability, now is the time for Japan to carry them through. One thing is clear, despite their resounding victory in the upper house elections, the task for Abe and his ruling coalition is only just beginning.

MARKET DEVELOPMENTS

How should investors react to the current situation? Yes, there is ‘policy uncertainty’. There is much talk among those who opposed Brexit of the ‘EEA’, ‘two step’ and other such ‘solutions’. If these were to happen they would amount essentially to the status quo; they would not achieve the objectives voted for by the Brexit majority, namely the control of our laws and borders. This would store up political trouble and instability, including a possible Conservative party split. But it would buy short term happiness among manufacturers, whose interests have a big hold on our political classes.

The alternative is what we talk about above: straightforward departure to free trade. This would be enormously stimulative to the economy, acting like a large tax cut financed by the abandonment of the large inefficiencies of the EU. It would bring big investment opportunities in the restructured UK economy. As the UK re-orientates itself towards the world market, with the gains in productivity this would enforce, it will offer good returns to well-placed equity investment.

Table 1: Market Developments

	Market Levels		Prediction for Jul/Aug 2017	
	Jul 1	**Aug 4**	**Previous Letter**	**Current View**
Share Indices				
UK (FT 100)	6504	6740	9295	9632
US (S&P 500)	2099	2164	2582	2662
Germany (DAX 30)	19680	10228	14994	15843
Japan (Tokyo New)	1246	1283	1754	1806
Bond Yields (government				
UK	1.00	0.92	2.10	2.10
US	1.46	1.56	2.80	2.80
Germany	–0.13	–0.09	0.70	0.70
Japan	–0.23	–0.05	0.10	0.10
UK Index Linked	–1.39	–1.39	0.10	0.10
Exchange Rates				
UK ($ per £)	1.34	1.31	1.40	1.40
UK (trade weighted)	81.34	79.82	90.80	90.80
US (trade weighted)	99.54	99.27	102.0	102.0
Euro per $	0.90	0.90	0.93	0.93
Euro per £	1.20	1.18	1.30	1.30
Japan (Yen per $)	102.6	101.1	112.0	112.0
Short Term Interest Rates (3-month deposits)				
UK	0.55	0.48	1.00	1.00
US	0.80	0.80	1.30	1.30
Euro	–0.28	–0.33	–0.20	–0.20
Japan	–0.20	–0.20	0.00	0.00

Table 2: Prospective Yields [1]

Equities: Contribution to £ yield of:

	Dividend Yield	Real Growth	Inflation	Changing Dividend Yield	Currency	Total
UK	3.40	2.4	1.5	39.00		46.3003
US	1.90	2.5	1.5	19.00	–6.67	18.23
Germany	2.60	1.8	1.1	52.00	–10.49	47.01
Japan	1.70	1.2	0.6	39.00	–18.18	24.32
UK indexed[2]	–1.39		1.5	1.00		1.12
Hong Kong[3]	2.60	6.0	1.5	–5.00	–6.67	–1.57
Malaysia	3.30	5.4	1.5	55.00	–6.67	58.53
Singapore	3.50	3.4	1.5	23.00	–6.67	24.73
India	1.40	7.5	1.5	24.00	–6.67	27.73
Korea	1.10	3.0	1.5	–19.00	–6.67	–20.07
Indonesia	2.20	5.3	1.5	31.00	–6.67	33.33
Taiwan	2.80	3.4	1.5	14.00	–6.67	15.03
Thailand	3.20	4.0	1.5	35.00	–6.67	3

Bonds: Contribution to £ yield of:

	Redemption Yield	Changing Nominal Rates	Currency	Total
UK	0.92	–11.80		–10.88
US	1.56	–12.40	–6.67	–17.51
Germany	–0.09	–7.90	–10.49	–18.48
Japan	–0.05	–1.50	–18.18	–19.73

Deposits: Contribution to £ yield of:

	Deposit Yield	Currency	Total
UK	0.48		0.48
US	0.80	–6.67	–5.87
Euro	–0.33	–10.49	–10.82
Japan	–0.20	–18.18	–18.38

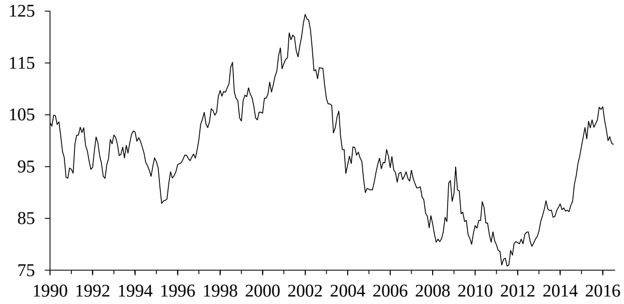
[1] Yields in terms of €s or $s can be computed by adjusting the £-based yields for the expected currency change.
[2] UK index linked bonds All Stocks
[3] Output based on China.

Table 3: Portfolio(%)

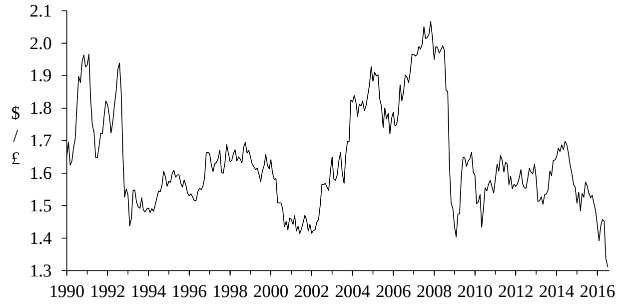
	Sterling Based Investor		Dollar Based Investor		Euro Based Investor	
	July Letter	Current View	July Letter	Current View	July Letter	Current View
UK Deposits (Cash)	5	5	5	5	1	1
US Deposits	-	-	-	-	-	-
Euro Deposits	-	-	-	-	-	-
Japanese Deposits	-	-	-	-	-	-
UK Bonds	-	-	-	-	-	-
US Bonds	-	-	-	-	-	-
German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

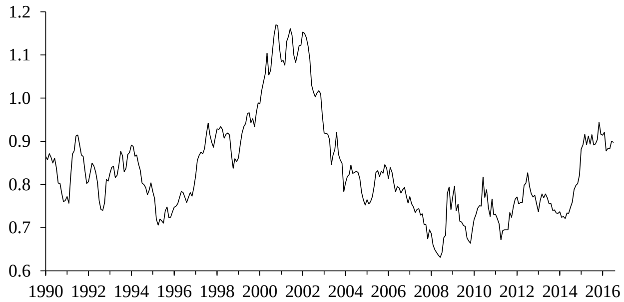
US : Trade Weighted Index (Bank of England 1990 = 100)



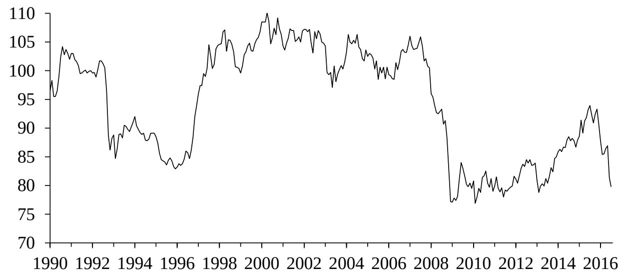
UK: Dollars Per Pound Sterling



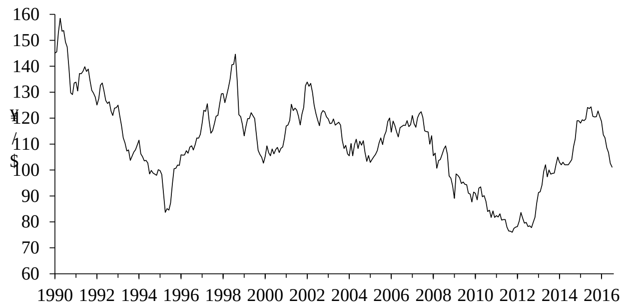
Euro per US dollar



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

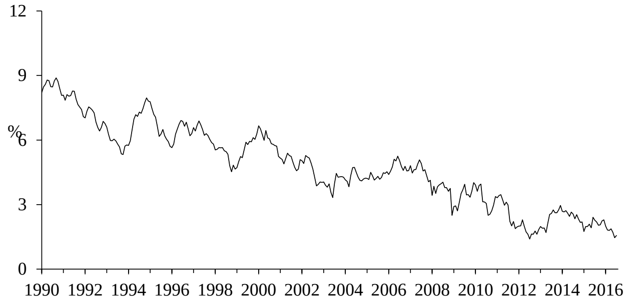


Japan : Yen Per U.S. Dollar

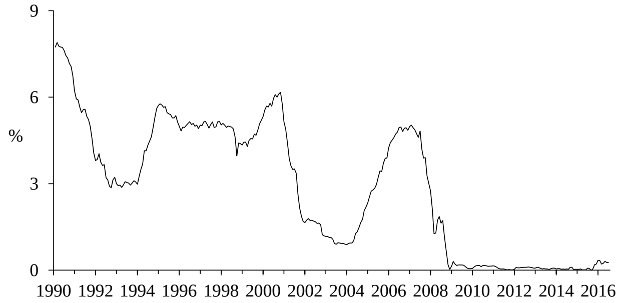


GOVERNMENT BOND MARKETS

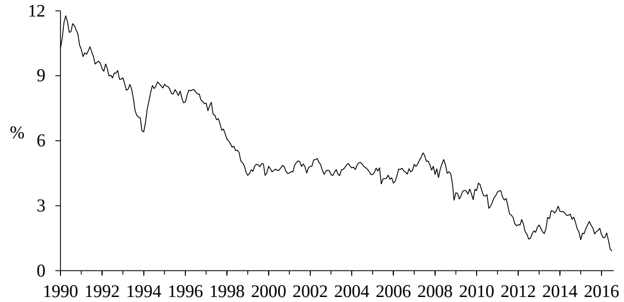
U.S.: Yield on Long-Term Government Bonds



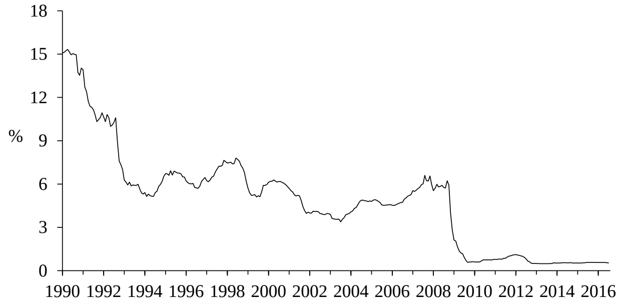
U.S. : 3-Month Treasury Bill



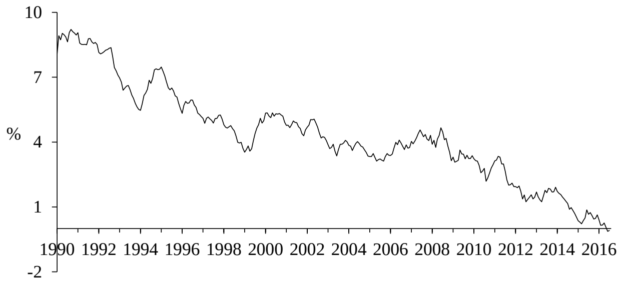
U.K.: Yield on Long-Term Government Bonds



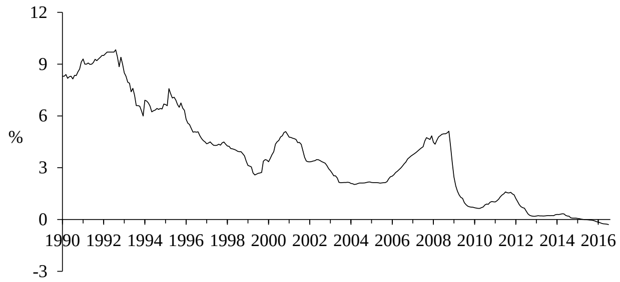
U.K. : 3-Month Interbank Rate



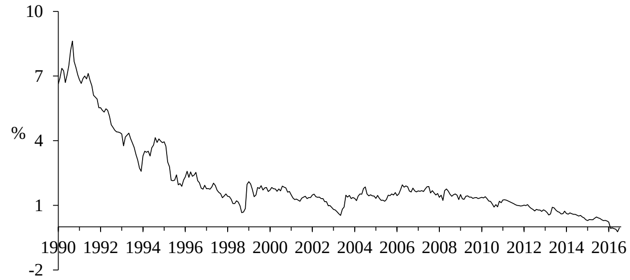
Germany: Yield on Public Authority Bonds



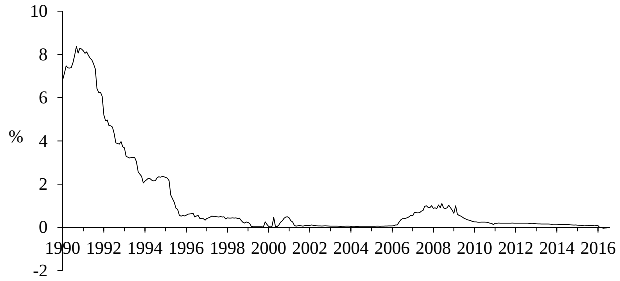
Germany : 3-Month Interbank Deposit Rate



Japan: Yield on Long-Term Government Bonds

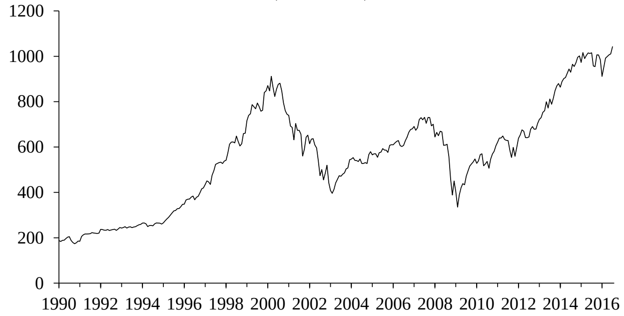


Japan : 3 Month Money Market Rate

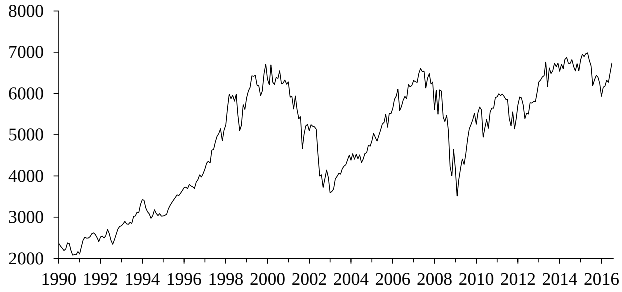


MAJOR EQUITY MARKETS

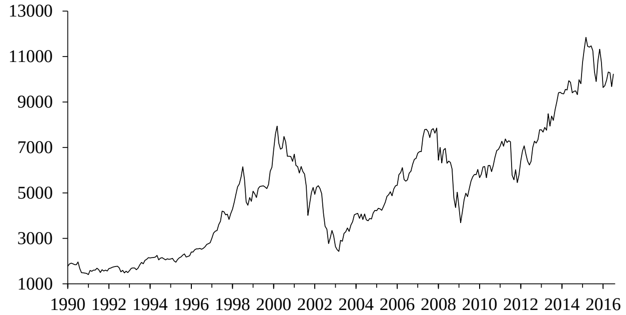
U.S. : S & P 400 Industrial (1985=100)



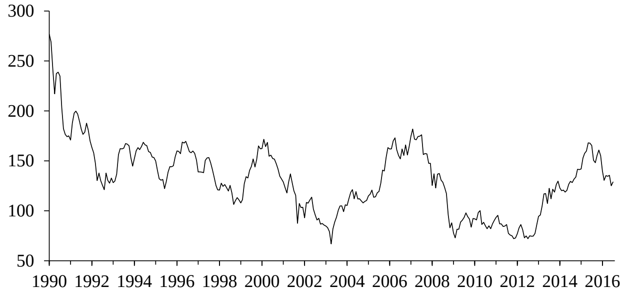
U.K. : FTSE-100 Index (10 April 1962=100)



Germany : DAX 30



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



EMERGING MARKETS

Anupam Rastogi

India

News on the Indian economy is encouraging, as a better than normal monsoon is going to boost rural demand and a once-in-a-decade pay increase for about 10 million government workers, effected in the last month, would add to domestic demand from urban areas as well. The stabilizing exports and restrain on crude prices would further help the economy to grow with declining consumer inflation. The investment demand is subdued and would remain sluggish because of the central bank's strict norms related to provisioning of non-performing loans. In the wake of implementation of the Bankruptcy law, corporates are not only cautious in borrowing from banks, but also actively restructuring their balance sheet. We believe that incipient moves on part of industrial sector would lead to a very competitive industrial sector in coming years in the economy.

The Confederation of Indian Industry's Business Confidence Index rose to 57.2 from 54.1 for the three months ended June 30. More than 60% of businesses expect India's GDP to grow between 7% and 8% in the fiscal year 2016–17. However, a majority of the firms have put their investment plans on hold even though they were optimistic about their profit and sales growth.

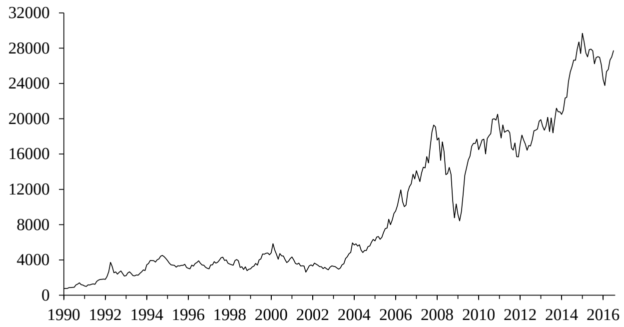
We expect GDP to grow 7.7% this year and more than 8% in fiscal year 2017–18. Rating agency Fitch has also upgraded India's growth projection.

India's budget deficit is forecast to shrink to 3.5% of GDP this year, and the current account deficit is estimated to be 1.5% of GDP. Inflation is well below 6% and likely to fall further as good monsoon puts a break on price rise of agricultural commodities and deflationary trend coming from crude prices.

In the currency market, the Indian rupee is holding steady against the U.S. dollar around INR 67 to a US dollar. But there is a murmur that a gradual devaluation is required to boost exports. The central bank governor Raghuram Rajan has indicated that the rupee is fairly valued. No rate action is expected at the central bank policy meeting on August 9, which will be the last meeting under the chairmanship of Raghuram Rajan.

The month of July saw issuance of an offshore "masala bond" by an Indian company but this asset class faces scepticism from investors over liquidity and tax concerns. The leading mortgage company of India, HDFC, issued Rs30bn ($447m) of three-year rupee bonds in London at an

India: BSE Sensitive



annualised yield of 8.33% gave a badly needed boost to sentiment around masala bonds. If masala bond market picks up and is able to attract foreign participation, it will be able to provide capital to India's capital-hungry development plans — $1.5tn of infrastructure spending over the next decade. At the same time opening a source of higher returns for investors faced with flat or negative yields in developed markets.

In May, India's parliament passed a new bankruptcy law that will, if fully implemented, radically overhaul the country's insolvency system, mandating resolution of bankruptcy proceedings within 180 days. This strengthening of creditor rights could over time help to boost investor appetite for masala bonds — particularly those issued by lower-rated corporations who have the greatest need for the offshore market because they struggle to issue bonds at home.

Another crucial legislation related to Goods and Services Tax, which shall convert India as a single market, is likely to be passed by the parliament. Importance of the legislation lies in dramatically altering India's indirect tax structure by replacing a string of central and local levies such as excise, value added tax and city-entry tax into a single unified tax and stitch together a common national market.

The stock market is inching towards an all-time high in INR terms as well. Foreign investors pumped in more than $1 billion into Indian equities in July. Even though India is more insulated from global volatility it's not completely immune from the headwinds that prevent the engines of global growth from picking up momentum. Like all emerging markets, India is not a haven — but a compelling and stable alternative.

	14–15	**15–16**	**16–17**	**17–18**	**18–19**
GDP (%p.a.)	7.3	7.6	7.7	8.0	8.0
WPI (%p.a.)	6.0	5.2	4.5	4.0	4.0
Current A/c(US$ bill.)	-34.0	-24.0	-24.0	-26.0	-28.0
Rs./$(nom.)	62.0	66.5	67.5	69.0	70.0

China

A steady GDP growth rate in the second quarter has taken the economists by surprise as it suggests that China is not willing to restructure its economy from an investment and export-led growth to a domestic consumption-led sustainable growth. Divergence of views related to structuring of state owned enterprises (SOEs) between president Xi Jinping and premier Li Keqiang has further sown confusion among economists. Whereas president Xi would like to see a strong state sector, premier Li would like to see less of zombie SOEs and more entrepreneurial-led private enterprises.

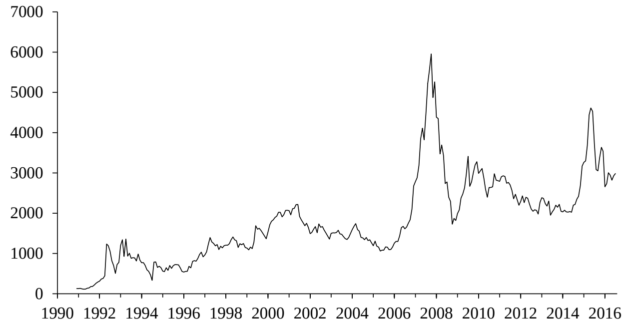
China announced that GDP growth was unchanged from the first quarter at 6.7%. Industrial production grew at the rate of 6.2% year over year and retail sales grew 10.6% year over year. Chinese growth was led by a boost given to infrastructure sector and to housing sector which, in turn, drove construction activity. Fixed-asset investment — which includes both infrastructure and manufacturing investment — grew at 9%. The International Monetary Fund warned last month that China's corporate debt was a "serious and growing problem that must be addressed immediately", the reason being that government spending is likely to fuel overcapacity and see private companies crowded out by risk-averse state banks and bloated state companies. Most of the credit is channelled into the less productive state sector, real-estate speculators and struggling industries at the expense of the entrepreneurs and private companies that leaders have looked up to for job creation.

The Finance Ministry reported that government spending rose 19.9% year-over-year in June compared with a 17.6% increase in May.

Consumer inflation in China decelerated in June as food prices increased at a slower pace, giving the central bank more leeway to ease monetary policy. China's Consumer Price Index rose 1.9% in June from a year earlier, a little less than May's 2.0% increase. China's Producer Price Index declined 2.6% year-over-year in June, which was a little weaker than expected, compared with a 2.8% drop in May. The index has lingered in deflationary territory for more than four years, although it has decelerated less rapidly in recent months.

China's export performance is likely to keep worsening. June exports were down 4.8% in dollar terms from a year earlier, according to the data released by the customs administration compared to drops of 4.1% in May and 1.8% in April. Imports fell 8.4%, compared with a 0.4% drop in May, as China's appetite for goods from its Pacific neighbors shrank. The trade surplus has narrowed to $48.11 billion from $49.98 billion.

China: SSE Composite Index



For the first six months of 2016, China's trade with the Association of Southeast Asian Nations, the EU and the U.S. was off 8.1%, 4% and 10.9% respectively from a year earlier.

A series of bond defaults in north-east China is exposing creditors' frustration at the lack of a transparent process for resolving bad debt as cash-strapped local governments step back increasingly from taxpayer bailouts. These bonds carried an implicit sovereign guarantee. That perception is changing following a series of SOE defaults over the past year. Overall, 17 Chinese companies have defaulted on domestic bonds in 2016 compared with 18 in 2015.

China's non-performing loans (NPLs) have risen from a very low base of 0.96% three years ago to 1.75% as of March 2016. The IMF has estimated that loans at risk in the banking system could be as high as $1.3 trillion. The IMF's assumption of a 60% loss ratio would yield total losses equivalent to 7% of GDP. NPLs could go much higher if the economy slows and banks decide to no longer support the loss-making SOEs.

Beijing has managed to let the yuan slide against the U.S. dollar without sparking strong protests from its trading partners this year. Yuan has depreciated about 3% against the dollar since the beginning of 2016, but it depreciated nearly 6% against a basket of 13 currencies that include the dollar, the euro and the yen in the same period.

Now the Chinese currency's bigger depreciation against a broader group of currencies is increasingly getting attention. After the last year's sudden depreciation of yuan, China is likely to depreciate its currency only gradually because the export sector needs a more competitive currency. But the yuan's continued depreciation could renew capital outflows. At the end of July, the offshore renminbi hit Rmb6.7045 against the dollar, its weakest level in more than five years.

The renminbi slipped in the global league tables for cross-border payments in the first half of 2016, as concern over depreciation dented investors' willingness to hold the Chinese currency. The Canadian dollar holds the fifth place among all currencies for use in international payments. Despite its drop in the league tables, the long-term trend of increased international use of the renminbi remains intact.

	14	15	16	17	18
GDP (%p.a.)	7.4	6.9	6.6	6.0	5.8
Inflation (%p.a.)	2.0	1.4	2.0	2.0	2.0
Trade Balance(US$ bill.)	382	550	420	400	380
Rmb/$(nom.)	6.2	6.4	6.6	6.7	6.8

South Korea

The South Korean economy grew at a 3.2% year-on-year pace in the second quarter, up from 2.8% in the first quarter. The government's fiscal stimulus and monetary easing is able to offset weak exports. The economy may be able to sustain the momentum in the second half of the year as well, as the government has unveiled another KRW11 trillion in spending. The 11-trillion-won ($9.7 billion) additional budget will mostly be funded by surplus tax revenue and state funds left over from the previous fiscal year, according to the finance ministry. It will focus on financing corporate restructuring by bolstering a capital buffer against bad loans and creating jobs for laid-off workers in the affected industries such as ship building.

These stimuli are likely to be short-lived until global trade picks up. In early July, the central bank trimmed its growth forecast to 2.7% for 2016. The Korean economy expanded 2.6% in 2015, slowing from 3.3% in 2014.

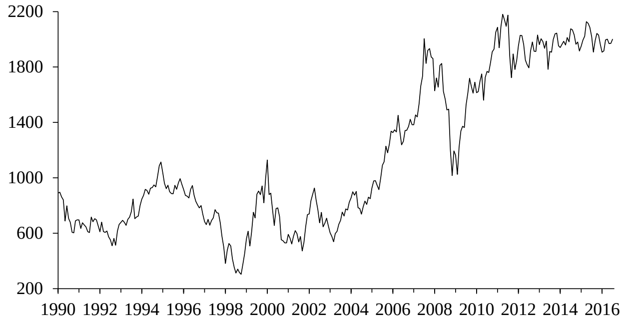
Consumer prices in South Korea were up 0.8% on year in June — unchanged from the previous month and below expectations for 0.9%. Core inflation, which excludes the volatile prices of fresh food, climbed an annual 1.7% — slowing from 1.9% a month earlier.

The Bank of Korea, at its July policy meeting, kept its main base rate unchanged at a record low of 1.25%, suggesting the central bank is opting to take time to assess the effects of the government stimulus, followed by a quarter-of-a-percentage-point rate cut in June. There is very little room with the central bank to ease policy further if the economy does not respond to fiscal stimulus.

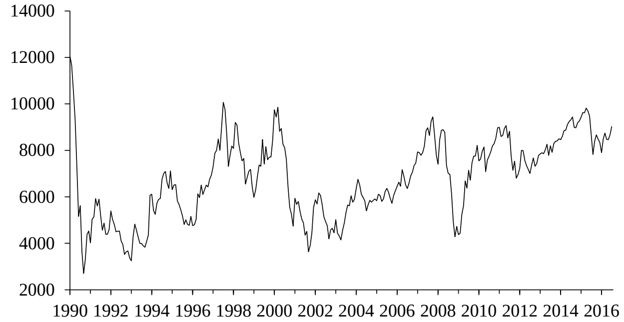
The export-driven economy is frail due to weak global trade. Shipments overseas shrank for an 18th straight month in June, with the pace of decline moderating since May. The country also is preparing for the negative impact on the job market of the industrywide overhaul of shipbuilding and shipping companies. Seoul fears as many as 63,000 jobs could disappear from shipyards by next year.

South Korea's trade surplus hit an all-time high in June as imports shrunk at a faster pace than exports. The country's trade surplus came to a record US$11.5 billion in June, up sharply from $6.99 billion in the month of April. Exports fell 2.6 percent on-year to $45.3 billion in June, while imports

Korea: Composite Index



Taiwan: Weighted TAIEX Price Index



retreated 7.7% to $33.8 billion. The won has appreciated against the US Dollar and is trading around KRW 1134.

	14	15	16	17	18
GDP (%p.a.)	3.3	2.6	2.7	2.5	2.3
Inflation (%p.a.)	2.0	0.7	1.0	1.2	1.2
Current A/c(US$ bill.)	80.0	90.0	88.0	88.0	86.0
Won/$(nom.)	1080	1180	1180	1200	1200

Taiwan

The Taiwan Institute of Economic Research (TIER) has tapered down its forecast for Taiwan's 2016 GDP growth to 0.77%, its third downward revision this year, the main reason being prolonged weakness in the country's exports amid a slow global economic recovery. Moreover, economic growth in 2017 is likely to be 1.8% compared to our forecast of 2% estimated previously.

Taiwan's consumer price inflation slowed to 0.9% year-over-year in June, slower than the 1.2% climb in May. With subdued economic growth, consumer price increase has remained below their target. Taiwan's dollar has remained stable around NT$32 against the US dollar and the central bank's foreign-exchange operations do not show a bias for depreciation.

The Taiex index is hovering around 9000 mark but its 4.13% dividend yield is the second-highest among benchmarks in Asia. The high dividend yield is luring foreign investors and they are buying local equities amid confidence that the Federal Reserve will keep interest rates on hold.

	14	15	16	17	18
GDP (%p.a.)	3.7	0.8	0.8	1.8	2.0
Inflation (%p.a.)	1.5	0.7	1.0	1.0	1.0
Current A/c(US$ bill.)	57.4	60.0	64.0	68.0	68.0
NT$/$(nom.)	31.0	32.8	32.5	32.0	32.0

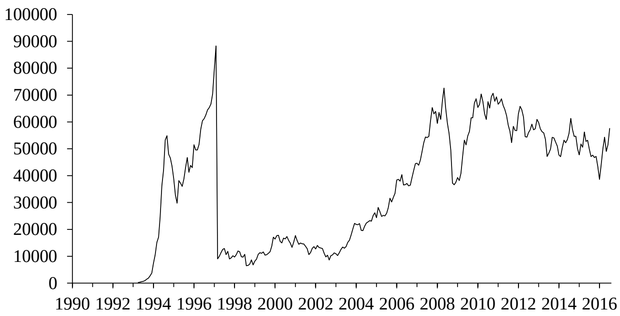
Brazil

Brazil is in the news as the Olympic Games starts in Rio de Janeiro, and it seems that Brazil is on the path of putting the worst behind it. There are signs that investment and industrial production have stopped declining. The end to Brazil's worst downturn, since the Great Depression, is in sight. Some leading economic indicators have ticked up slightly in recent weeks, or at least stopped deteriorating, raising prospects for a return to growth.

Brazil's gross domestic product is estimated to contract 3.3% this year and expand by about 1% in 2017 compared to an earlier estimate of 3.5% contraction in 2016 and expansion of only 0.5% in 2017. Brazil's government expects its budget deficit to shrink in 2017 from this year.

Consumer confidence in Brazil rose in July for the third-consecutive month, as Brazilians are less pessimistic about the country's economy in the medium term. Brazil's main consumer-confidence index was at 76.7 points, up from 71.3 points in June according to the Getulio Vargas Foundation (FGV). With prices easing, the Selic interest rate may drop to 13.25% by year-end and to 11% by end of 2017. The central bank held its benchmark Selic rate unchanged at 14.25% in its July meeting, where it has been since July 2015, as inflation remained well above its 4.5% target. The central bank governor Mr. Ilan Goldfajn has pledged to bring inflation down to 4.5% by next year.

Brazil: Bovespa



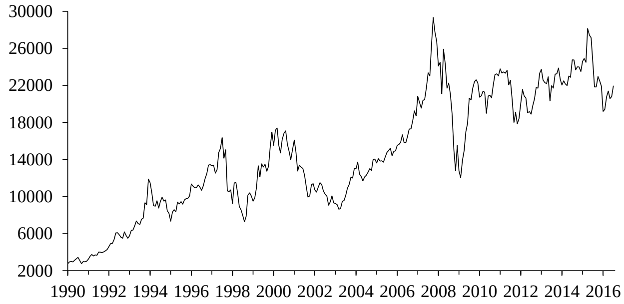
Brazil's government is formulating a constitutional amendment that would provide autonomy to the central bank, according to the central bank governor. The law would give the central bank authority to use whatever instruments it considered necessary to meet its objectives, which include financial stability and meeting an inflation target set in consultation with the government. This is an important milestone as it was rumoured that the central bank was pressurized not to raise rates even when inflation had breached the central bank's target.

Brazil BOVESPA Index increased 12.36% in the month of July and +14.85% during the last one year.

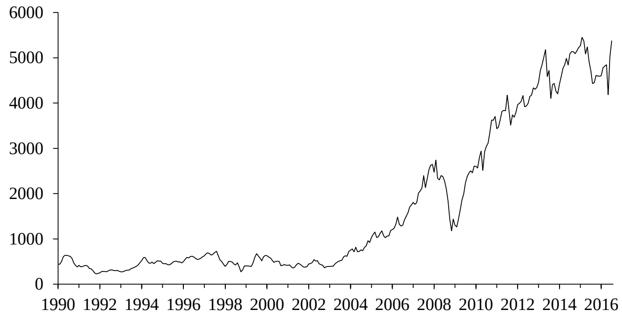
	14	15	16	17	18
GDP (%p.a.)	0.1	-3.8	-3.3	1.0	1.5
Inflation (%p.a.)	6.5	10.3	7.0	5.8	6.0
Current A/c(US$ bill.)	-104.0	-70.0	-50.0	-40.0	-44.0
Real/$(nom.)	2.4	3.9	3.8	3.5	3.6

Other Emerging Markets

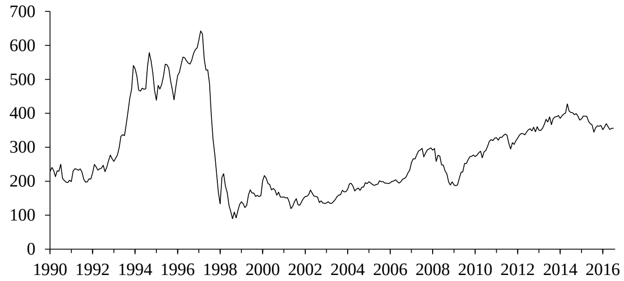
Hong Kong: FT-Actuaries



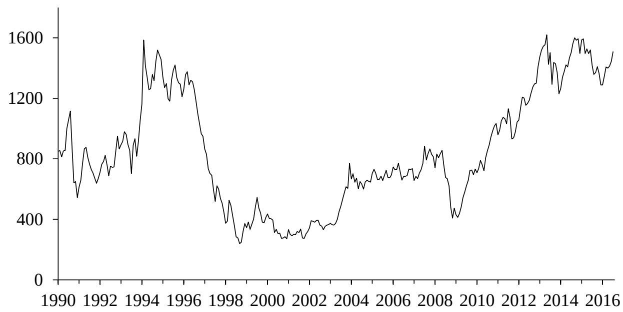
Indonesia: Jakarta Composite



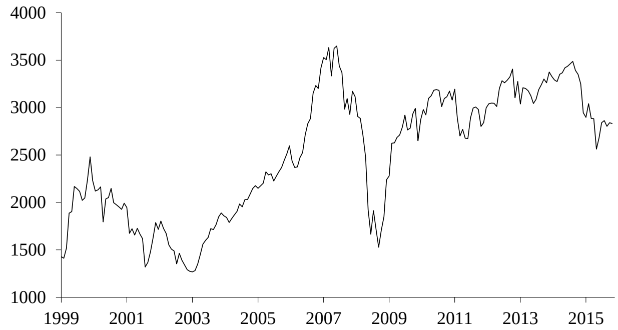
Malaysia: FT-Actuaries (US$ Index)



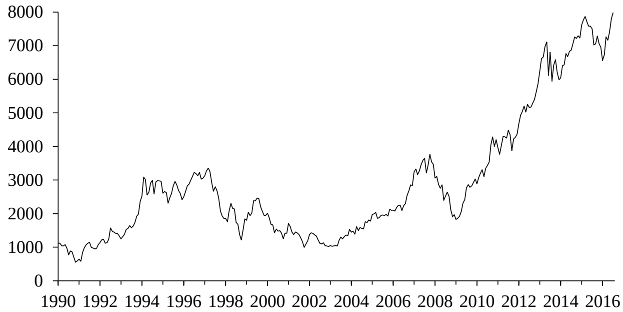
Thailand: Composite Index



Singapore: Straits Times Index

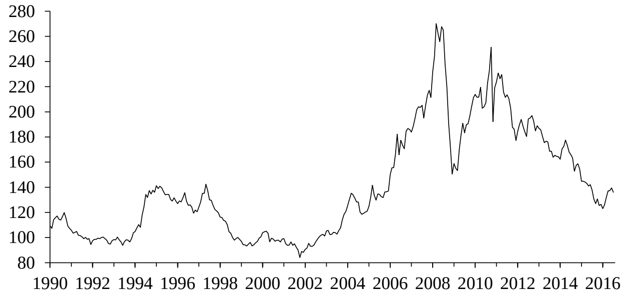


Philippines: Manila Composite

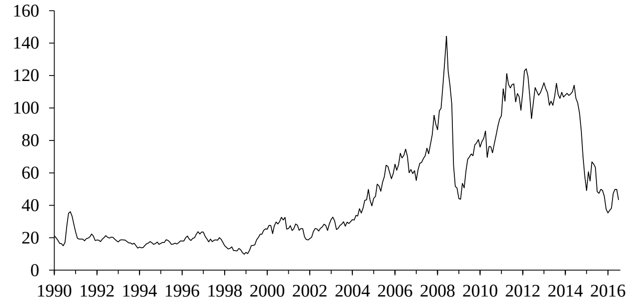


COMMODITY MARKETS

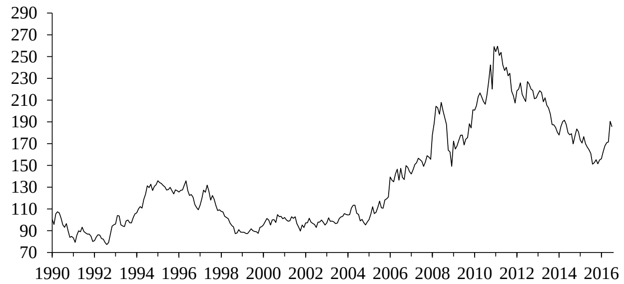
Commodity Price Index (Dollar)
(Economist, 2000=100)



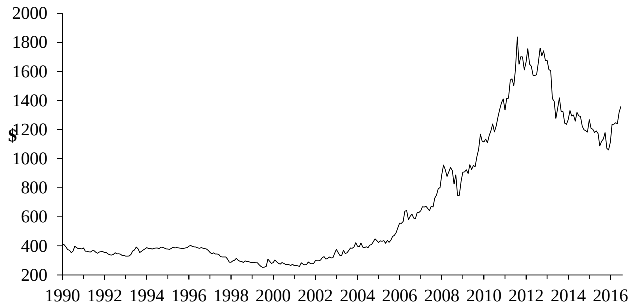
Oil Price: North Sea Brent (in Dollars)



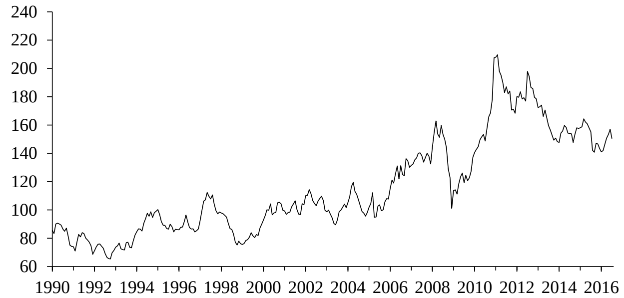
Commodity Price Index (Sterling)
(Economist, 2000=100)



Gold Price (in Dollars)



Commodity Price Index (Euro)
(Economist)



UK FORECAST DETAIL

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

	Inflation %[1] (CPI)	Short Dated (5 Year) Interest Rates	3 Month Int. Rates	Nominal Exchange Rate (2005=100)[2]	Real Exchange Rate[3]	Real 3 Month Int. Rates %[4]	Inflation (RPIX)	Real Short Dated Rate of Interest[5]
2015	0.1	1.4	0.5	91.6	97.6	0.4	1.0	-1.0
2016	1.3	2.4	1.1	81.8	90.2	-0.9	2.1	-1.2
2017	1.9	3.7	4.0	77.7	87.5	0.0	2.6	-1.0
2018	3.2	3.4	4.0	76.1	86.2	-0.4	3.6	-0.1
2019	3.0	2.9	3.0	74.8	84.8	0.2	3.3	0.8
2020	2.1	2.8	3.4	73.6	83.3	0.7	2.8	0.8
2015:1	0.7	1.1	0.5	89.6	96.1	0.3	1.0	0.0
2015:2	0.2	1.3	0.5	91.5	97.2	0.7	1.0	-0.8
2015:3	-0.2	1.4	0.5	93.1	99.0	0.7	1.0	-1.0
2015:4	-0.2	1.8	0.5	92.4	98.2	0.0	1.0	-1.3
2016:1	0.5	2.0	0.5	90.6	95.8	-0.8	1.5	-1.3
2016:2	1.3	2.0	0.5	79.4	88.4	-1.0	2.2	-1.3
2016:3	1.5	2.1	1.0	79.6	88.7	-0.8	2.4	-0.9
2016:4	1.8	3.8	2.4	77.7	87.9	-0.8	2.6	-1.1
2017:1	1.8	3.8	3.8	78.7	88.5	0.3	2.6	-0.7
2017:2	1.8	3.8	4.1	77.7	87.7	0.3	2.6	-0.8
2017:3	1.9	3.7	4.5	77.1	86.7	-0.1	2.7	-1.2
2017:4	2.1	3.9	5.4	77.2	87.2	-0.3	2.8	-1.2

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)
2015	247.6	2.7	2.4	0.9	133.3
2016	256.0	3.4	2.1	0.8	136.1
2017	268.4	4.8	2.0	0.8	137.9
2018	282.0	5.1	1.8	0.7	139.4
2019	290.8	3.1	1.7	0.7	140.1
2020	300.7	3.4	1.6	0.7	141.9
2015:1	246.4	2.3	2.5	0.9	132.9
2015:2	246.1	2.6	2.5	0.9	132.7
2015:3	248.3	3.0	2.4	0.9	133.6
2015:4	249.7	2.7	2.1	0.9	134.0
2016:1	254.5	3.3	2.1	0.8	136.6
2016:2	254.0	3.2	2.1	0.8	135.1
2016:3	255.6	2.9	2.1	0.8	135.5
2016:4	260.0	4.1	2.1	0.8	137.0
2017:1	263.0	3.3	2.1	0.8	137.9
2017:2	266.3	4.8	1.9	0.8	137.4
2017:3	269.0	5.3	2.0	0.8	137.5
2017:4	275.3	5.9	1.9	0.8	138.7

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
2015	157.4	753770.6	436595.2	298648.7	197430.6	-54148.4	124757.4
2016	160.8	770055.7	445695.9	297068.1	197125.4	-42461.3	127367.1
2017	165.1	790816.9	455364.6	308041.5	199245.4	-40776.5	131044.4
2018	169.7	812428.2	466130.4	320355.6	198882.9	-38062.1	134876.0
2019	174.1	833565.5	477699.4	326332.4	202570.1	-34364.1	138667.4
2020	180.1	862130.2	490658.3	338625.4	213457.6	-36882.7	143710.4
2015/14	2.2		1.9	1.9	1.5		-2.3
2016/15	2.3		2.1	0.0	0.2		2.6
2017/16	2.7		2.2	3.7	1.1		2.9
2018/17	2.7		2.4	4.0	-0.2		3.0
2019/18	2.8		2.5	1.9	1.9		2.9
2020/19	3.4		2.7	3.8	5.5		3.6
2015:1	156.2	186964.7	107966.1	77826.4	50385.0	-15573.3	33639.5
2015:2	157.0	187977.5	108889.7	70313.2	48635.4	-11413.2	28447.6
2015:3	157.7	188823.0	109697.1	74552.3	49279.4	-14082.0	30623.8
2015:4	158.7	190005.4	110042.3	75956.7	49130.9	-13080.0	32046.5
2016:1	160.6	192288.6	110866.2	74555.9	51059.5	-12075.9	32120.6
2016:2	162.6	194619.7	111552.7	78788.9	48262.0	-12079.2	31908.8
2016:3	162.9	195077.1	112243.5	78004.2	49051.9	-12079.8	32142.0
2016:4	162.9	194982.0	112399.2	76874.2	48752.1	-10695.9	32348.1
2017:1	165.3	197774.0	112863.5	78105.7	51270.0	-11661.6	32803.2
2017:2	165.2	197838.0	113468.8	79596.3	48527.4	-11020.5	32742.5
2017:3	164.9	197442.5	114154.3	75797.5	49559.6	-9359.0	32701.2
2017:4	165.2	197762.3	114878.0	74542.0	49888.4	-8735.4	32797.4

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)
2015	4.6	1641.6	74.6	55.2	-91.0
2016	3.4	1735.3	58.0	62.1	-79.1
2017	3.2	1822.7	58.6	74.6	-77.0
2018	1.1	1899.4	21.0	73.5	-67.3
2019	0.7	1999.0	15.2	73.4	-48.3
2020	0.7	2096.2	15.4	57.1	-34.4
2015:1	0.6	409.1	2.3	13.3	-25.1
2015:2	6.5	401.7	26.2	13.6	-18.9
2015:3	4.1	407.8	16.9	13.8	-18.9
2015:4	6.5	414.0	26.8	13.9	-28.1
2016:1	1.1	418.2	4.8	13.9	-17.9
2016:2	5.3	426.0	22.6	14.0	-20.0
2016:3	3.5	428.7	15.0	14.6	-15.2
2016:4	4.4	433.5	19.1	16.2	-26.0
2017:1	0.3	447.2	1.3	17.4	-20.7
2017:2	4.0	449.0	18.0	17.9	-21.2
2017:3	2.4	449.6	10.8	18.3	-12.6
2017:4	6.7	452.9	30.3	19.5	-22.5

1 GDP at market prices (Financial Year)

WORLD FORECAST DETAIL

Growth Of Real GNP

	2013	2014	2015	2016	2017	2018
U.S.A.	1.5	2.4	2.4	2.1	2.4	2.5
U.K.	2.2	2.9	2.2	2.3	2.7	2.7
Japan	1.4	–0.1	0.5	1.0	0.8	0.8
Germany	0.3	1.6	1.7	1.8	1.5	1.6
France	0.7	0.2	1.1	1.4	1.5	1.6
Italy	–1.7	–0.3	0.8	1.1	1.3	1.5

Real Short-Term Interest Rates

	2013	2014	2015	2016	2017	2018
U.S.A.	–1.5	–0.1	–1.1	–1.2	–0.7	–0.5
U.K.	–0.8	–2.2	–1.1	–2.2	–1.1	0.2
Japan	–2.5	–0.6	0.0	–1.8	–2.0	–1.8
Germany	–0.6	–0.2	–0.6	–1.8	–2.2	–2.2
France	–0.2	0.1	–0.5	–1.4	–2.0	–2.0
Italy	0.1	0.0	–0.3	–1.3	–1.9	–1.9

Real Long-Term Interest Rates

	2013	2014	2015	2016	2017	2018
U.S.A.	1.6	0.7	0.3	0.4	0.8	1.0
U.K.	–0.8	–0.7	–0.7	–0.5	0.5	0.3
Japan	–0.8	–1.1	–1.3	–2.0	–1.9	–1.7
Germany	0.8	–0.8	–1.0	–1.5	–1.3	–1.1
France	1.1	–0.5	–0.8	–1.3	–1.1	–0.9
Italy	1.2	–0.5	–0.7	–1.2	–1.0	–0.8

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

	2013	2014	2015	2016	2017	2018
U.S.A.	82.1	83.9	93.0	94.0	94.5	94.8
U.K.	86.5	93.1	97.6	90.2	87.5	86.2
Japan	63.5	59.8	56.0	58.4	58.5	58.6
Germany	99.0	99.9	94.7	95.0	95.2	95.1
France	100.7	100.8	96.2	96.0	95.9	95.7
Italy	106.9	107.5	102.1	102.0	101.8	101.7

[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

	2013	2014	2015	2016	2017	2018
U.S.A.	1.5	1.6	0.1	1.3	2.2	2.0
U.K.	2.3	1.7	0.1	1.3	2.9	3.3
Japan	0.4	2.7	0.8	0.2	1.8	2.0
Germany	1.5	0.9	0.3	0.5	1.6	2.0
France	0.9	0.5	0.0	0.4	1.2	1.8
Italy	1.2	0.2	0.1	0.2	1.1	1.7

Nominal Short-Term Interest Rates

	2013	2014	2015	2016	2017	2018
U.S.A.	0.1	0.0	0.2	1.0	1.3	1.5
U.K.	0.6	0.6	0.5	0.7	2.2	2.9
Japan	0.2	0.2	0.2	0.0	0.0	0.2
Germany	0.3	0.1	–0.1	–0.2	–0.2	–0.2
France	0.3	0.1	–0.1	–0.2	–0.2	–0.2
Italy	0.3	0.1	–0.1	–0.2	–0.2	–0.2

Nominal Long-Term Interest Rates

	2013	2014	2015	2016	2017	2018
U.S.A.	3.0	2.2	2.2	2.4	2.8	3.0
U.K.	1.3	1.8	1.4	2.2	3.1	3.2
Japan	0.7	0.3	0.3	0.0	0.1	0.3
Germany	1.9	0.5	0.6	0.4	0.7	0.9
France	1.9	0.5	0.6	0.4	0.7	0.9
Italy	1.9	0.5	0.6	0.4	0.7	0.9

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

	2013	2014	2015	2016	2017	2018
U.S.A.[1]	86.00	89.40	99.94	102.10	102.00	102.20
U.K.	1.55	1.65	1.53	1.36	1.30	1.27
Japan	98.20	106.70	120.00	118.40	112.00	113.00
Eurozone	0.75	0.76	0.90	0.95	0.93	0.92

[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