LIVERPOOL INVESTMENT LETTER

December 2013

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 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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TAKING STOCK OF MONETARY POLICY AT YEAR END 2013

This past year has been an eventful one in monetary and regulation policy. The key events have been politicians' realisation that the regulative mania had gone too far and was stopping the flow of credit to small businesses and housing — the flow to large businesses was being reversed anyway by their unwillingness to invest in the uncertain climate and the lack of competitive rivalry from new small business entry. It was clear that the UK recovery had stalled and the lack of credit flow was a key cause. With this realisation came a series of back-door offsets to the regulative obstruction to credit: a second Funding for Lending Scheme and the Help to Buy scheme.

Close on the heels of these offsets came the new Bank of England Governor, Mark Carney, with a mission from the Chancellor to revive the UK banking system. Mr. Carney has by now started to talk about his support for UK banking and the build-up of its balance sheet; as far as he is concerned, he said, he saw no reason to complain if its balance sheet reached higher multiples of GDP in coming years, as long as it was done safely and ethically. Thus has the Bank moved to restore its relations with UK banks, and about time too. The Bank is supposed to be the banks' friend at court, as well as the institution that casts a weather eye over its behaviour.

We are now beginning to see some fruits from this new approach to regulation. Credit is starting to flow — notably to the housing market, and not just to the ever-hot London market but all around the country. The stories are coming in of shortages of builders, bricks and so forth; mothballed sites are springing into development and there is the start of a housing recovery. For those that see this as a 'bubble' it is worth reminding them that real house prices are about 30% below their peak — chart opposite. However, it is clear that the deregulation we are seeing is lopsided. Housing and through it, construction, is seeing the benefit of new credit, SMEs are not.

This is because, besides being subsidised by these Treasury schemes, mortgage finance has a low risk-weighting in the regulation capital requirement, whereas SME loans have a high weighting. Banks are fine-tuning their credit to avoid raising more capital — especially as this is currently very expensive for them given the poor equity rating for banks.

This suggests regulation will have to be rethought. It is penalising the very sort of credit that banks are uniquely capable of providing, viz to SMEs. Large firms can issue equity and bonds; SMEs basically cannot. There are business angels, there is peer-to-peer lending, there are venture capital firms and private equity; but fundamentally these are quite marginal to SMEs — though if banks continue to shun them, this will be forced to change.

Table 1: Summary of Forecast

	2010	2011	2012	2013	2014	2015	2016
GDP Growth[1]	1.7	1.1	0.2	1.2	2.2	2.4	2.6
Inflation CPI	3.3	4.5	2.7	2.7	2.5	2.2	2.0
RPIX	4.8	5.3	3.2	2.5	3.1	2.8	2.7
Unemployment (Mill.)							
Ann. Avg.[2]	1.5	1.5	1.6	1.5	1.4	1.3	1.2
4th Qtr.	1.5	1.6	1.6	1.5	1.3	1.2	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	0.9	1.6	2.1	2.2
5 Year Interest Rate	2.4	2.0	0.9	1.3	1.8	2.1	2.4
Current Balance (£bn)	−40.0	−22.5	−59.2	−60.7	−62.9	−63.5	−62.0
PSBR (£bn)	112.6	91.0	68.4	119.7	106.0	94.6	74.5

[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)

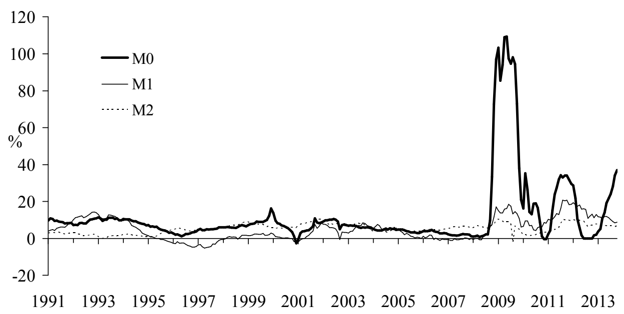
From the viewpoint of macroeconomic welfare we should have institutions that keep the cost of credit for SMEs as close to the social cost of credit as possible — which is the safe rate of interest plus the cost of diversified investment risk (the equity risk premium). Current regulations are driving it well above this level.

Yet when we reflect on what went wrong in the pre-crisis period it seems fairly clear that a) the world had an over-strong boom, fuelled by extremely stimulative monetary policy through most of the 2000s; b) banks were not properly supervised in several countries where central banks had been given 'independence' and had had their supervisory role curtailed or removed (the UK being a prime example); c) larger banks acquired a size and market power that was excessive. This points to the need for more bank competition and smaller banks; and for central banks to resume their supervisory role. It also points to the need for new operating rules for monetary policy, including for QE — the newly revived Open Market Operations of central banks.

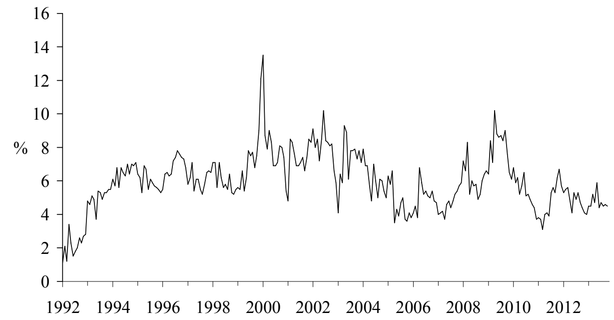
These new operating rules should prevent future credit booms and busts; inflation targeting alone has failed to do this. I would suggest a new rule for the setting of the monetary base that explicitly targets credit/money growth and the credit premium — as important an interest rate as the one now being targeted, for government short-term bonds. With such new rules we can allow the new regulative system to ensure general safety with the minimum of intrusion into commercial decisions on loans.

Turning finally to UK monetary policy today, I believe we need to plan for 're-entry' to a normal monetary environment. The UK recovery is now strong, fuelled by a fast-recovering housing market, owing to the partial pullback of regulation and the competitive drive this has created among banks. Banks have vast liquid reserves, thanks to QE. There is little to restrain them from pouring a mass of credit into this channel. The housing recovery will fan outwards into the rest of the economy, creating a typical if much delayed recovery spike, all of this in a pre-election period when politicians will be strongly against any tightening. The Bank needs to move pre-emptively to prevent money and credit getting out of control. At the same time it needs to get the regulative balance back more in favour of SMEs.

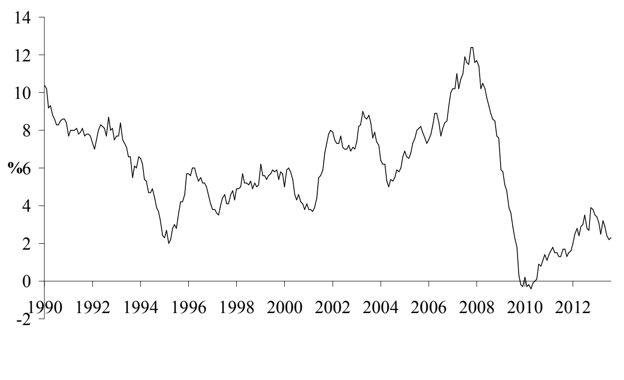
U.S.: Growth in Monetary Aggregates (Yr - on - Yr)



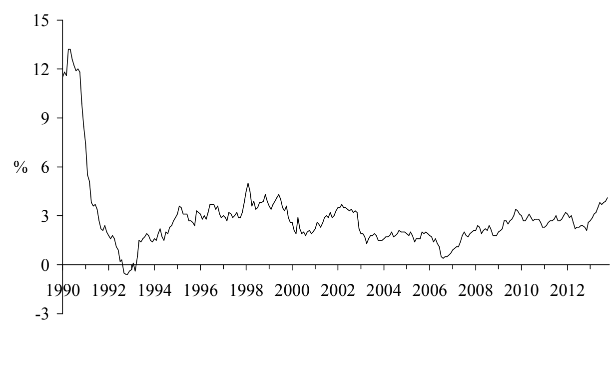
UK: Notes and Coins in Circulation Growth



Eurozone M3 Growth



Japan: Growth of M2+CD's



FOCUS ON JAPAN

Francesco Perugini

A critical look at Abe's deregulation package

Along with the creation of special economic zones, the third arrow is designed to reform the labour market and increase productivity in several key industries: three have been identified, agriculture, health and medical care, and energy.

Regarding labour market reform, it includes a plan to raise the labour force participation rate of the 20–64 age group and measures to mobilize the female labour force. To address these issues, the capacity of childcare facilities will be expanded to accommodate 400,000 children by end-2017. The scarcity of such facilities and waiting lists, especially in metropolitan areas, has been discussed for years but never solved. Also, strong support will be given to firms that increase the employment of women and expand the capacity of childcare facilities in their office buildings. The government expect that these measures will rise the labour participation rate of women aged 25–44 by 5 percentage points from the current 68%.

Another important issue is to enhance labour market mobility. To do so, the government will incentivise firms to relocate workers to reduce the mismatch of labour demand and supply in certain regions using subsidies or tax cuts. Facilitating the process of headcount reduction remains the top agenda in this category. However, it will take time to change the current employment system, in which firms face substantial legal barriers to firing full-time workers. Many workers are employed as generalists, meaning employment contracts are not specified for specific skills or functions. As a result, job elimination is not a valid reason for firms to lay off workers. While some progress can be expected, the issue of clarifying the process of headcount reduction will likely still be slow.

Regarding the agriculture sector, various measures have been proposed to increase productivity, to lower production costs, and to induce young people to take up farming and enlarge the scale of farm operation. In particular, according to the reform plan, prefectures will establish local agencies to consolidate unused farmland and lend it to firms that engage in agricultural business; the process of examining applications from firms will be transparent — with the central government able to override decisions made by local agencies; the eligibility conditions for applicants will be lowered substantially to prompt firms to apply. However, critics expect more to be done in favour of a sector that remains heavily subsidized and whose production has fallen by ¥3 trillion over the past 20 years. Although Japan joined the negotiations for the Trans-Pacific Partnership (TPP) Agreement last July — a free-trade grouping — the agriculture sector needs to be modernized. The average Japanese farmer is 66 years old, his farm is less than five acres in size, and he is the beneficiary of his share of about ¥5 trillion of annual government subsidies. According to observers it would be advisable, for instance, to undertake domestic reform in the direction of reducing/lifting tariffs, or allowing the entry of non-agricultural firms and encouraging large scale operations. Other measures such as allowing low-cost producing areas/farmers to produce more (rather than imposing quotas) and spurring the exit of high-cost producers are necessary.

However, it is not easy for the government to implement drastic policies because farmers wield political influence, through the national network of local farm co-operatives called Japan Agriculture (JA). With its tight links to the ruling Liberal Democratic Party (LDP) and the agriculture ministry, and employing an astonishing 240,000 staff in Tokyo and around the country, the JA is probably Japan's most powerful lobby. It campaigns to keep high import tariffs on farm goods: the tariff on rice is 777%, that on butter is 360%, while sugar attracts a 328% levy. Last autumn, when former Prime Minister Yoshihiko Noda raised the possibility of Japan joining the TPP, the farm lobby promptly delivered a counter-petition with 11 million signatures; there is therefore good reason to doubt that the TPP will deliver on agricultural reform.

The health and medical care is also an industry under regulation for which Abe plans to introduce substantial reforms. The plan includes changes to the country's universal health insurance system in order to boost growth by increasing demand for innovative drugs and medical devices. In particular, the reforms aim to: shorten the approval process for new medicine; expand the scope of advanced medical treatment that is compatible with public health insurance system; promote the commercialization of regenerative medicine; and establish the Japanese version of the US National Institute of Health to promote medical research.

Reformers say the changes would give patients more choice and allow doctors more discretion. However, the Japan Medical Association (JMA), the largest doctors' group in the country, which represents most private practices and local clinics, opposes the reforms of the universal healthcare system proposed by the government. The JMA counters that the reforms would widen the healthcare gap between rich and poor. Critics also question just how much economic growth the changes proposed would generate.

On the energy sector, Abe proposes to deregulate an industry that produces power mostly from fossil fuels, as well as to boost competition among generators and make it easier for wind and solar energy to be distributed to consumers. In theory, deregulation can stimulate competition and cause prices to decline. Empirically, economists have found that the deregulation of electricity industries generally makes power generation more efficient and lowers operation costs. Abe's government has already submitted a bill to Parliament which was supposed to be passed in June 2013. Unfortunately, deliberation on the bill was postponed for an unrelated political reason, but the bill was resubmitted on October 15, and will most likely be passed this year. Abe's bill calls for three steps toward the deregulation of Japan's electricity industry. First, the government plans to establish an independent system operator (ISO) by 2015. The ISO controls the flow of electricity in the entire national grid and plays an important role in deregulation. Second, the government aims to deregulate the retail electricity market, including the retail market for residential customers, by 2018. This step would allow consumers to freely choose their retail electricity providers. Third, the government plans to unbundle transmission from the regional monopolies by 2020 in order to improve access to transmission lines.

It is clear that the energy sector needs reforming and strategically re-thinking, especially after the tsunami and the Fukushima nuclear power plant disaster. Since the 1990s, there have been three major attempts by the Japanese government to deregulate the electricity market. On each attempt, however, a complete overhaul did not happen because of strong opposition and political pressure from the power companies. The current situation does not look different from the past. Although the regional power companies lost public support, they still have very strong connections with politicians. Power companies have been among the largest monetary contributors to political parties in Japan, and their labour unions have been playing an important role in political discussions. In fact, an explicit goal for unbundling transmission lines, found in the original bill, was replaced with a weak statement because of pressure from politicians who have connections with the regional monopolies.

To Reform, Abe Must Take On Vested Interests

A growth strategy is not new in Japan. In each of the last seven years, a growth strategy paper was issued by the government and many of the items for change have been proposed regularly on each occasion. Each time there has been huge disappointment. Global investors certainly thought so this time too — the Nikkei slid after Abe's much-anticipated speech. Critics say the list of reforms that Abe has put forward contained no surprises, mainly because LDP members, who represent vested interests, notably farmers, doctors and businesses, pressed forcefully to make sure Abe did not announce anything too radical.

Abe knows that deregulation necessarily involves confronting special-interest groups and the ministries and policymakers with ties to them but he is also aware that structural reform is not a choice. Now that he controls parliament, after a landslide victory in last July elections, there is no excuse to delay a structural overhaul of the Japanese economy. He must take on tough vested interests or Abenomics will fail.

MARKET DEVELOPMENTS

The situation remains one in which desperate QE is failing to stimulate credit as intended but instead is flowing straight into asset markets where it is driving up asset prices. Bond prices should on our forecasts go no higher. However, equity prices should be supported by the strengthening recovery in the US and the UK, even though QE is likely to be gradually 'tapered' in the US and also, but later, in the UK. Japan and the euro-zone are as usual a special case where monetary policy will continue stimulative but against serious head winds. In the developing world growth is slower but still firm. We continue to keep our portfolios in equities, with minimum cash.

Table 1: Market Developments

	Market Levels		Prediction for Oct/Nov 2014	
	Nov 1	Nov 29	Previous Letter	Current View
Share Indices				
UK (FT 100)	6735	6651	9745	9690
US (S&P 500)	1717	1806	2177	2290
Germany (DAX 30)	9008	9405	12206	12650
Japan (Tokyo New)	1183	1259	1666	1760
Bond Yields (government long-term)				
UK	2.66	2.77	1.70	1.70
US	2.62	2.75	2.10	2.10
Germany	1.69	1.70	1.50	1.50
Japan	0.60	0.61	0.70	0.70
UK Index Linked	–0.10	–0.08	–0.30	–0.30
Exchange Rates				
UK ($ per £)	1.59	1.64	1.56	1.56
UK (trade weighted)	82.4	84.7	83.1	83.1
US (trade weighted)	85.7	86.5	85.5	85.5
Euro per $	0.74	0.73	0.79	0.79
Euro per £	1.18	1.20	1.23	1.23
Japan (Yen per $)	98.8	102.0	98.0	98.0
Short Term Interest Rates (3-month deposits)				
UK	0.51	0.50	1.80	1.80
US	0.24	0.23	0.70	0.70
Euro	0.26	0.19	0.50	0.50
Japan	0.07	0.10	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	3.40	2.2	2.5	41.00		49.10
US	1.90	2.2	1.6	23.00	4.76	33.46
Germany	2.80	0.8	1.7	32.00	–2.50	34.80
Japan	1.80	1.6	0.0	38.00	8.50	50.10
UK indexed[2]	–0.08		2.5	–10.00		–7.58
Hong Kong[3]	2.40	7.4	1.6	14.00	4.76	30.16
Malaysia	2.90	5.2	1.6	56.00	4.76	70.46
Singapore	3.50	3.7	1.6	33.00	4.76	46.56
India	1.50	6.1	1.6	18.00	4.76	31.96
Korea	1.10	3.4	1.6	–3.00	4.76	7.86
Indonesia	2.70	5.9	1.6	49.00	4.76	63.96
Taiwan	2.70	3.0	1.6	30.00	4.76	42.06
Thailand	3.30	4.7	1.6	50.00	4.76	64.36

Bonds: Contribution to £ yield of:

	Redemption Yield	Changing Nominal Rates	Currency	Total
UK	2.77	10.70		13.47
US	2.75	6.50	4.76	14.01
Germany	1.70	2.00	–2.50	1.20
Japan	0.61	–0.90	8.50	8.21

Deposits: Contribution to £ yield of:

	Deposit Yield	Currency	Total
UK	0.50		0.50
US	0.23	4.76	4.99
Euro	0.19	–2.50	–2.31
Japan	0.10	8.50	8.60

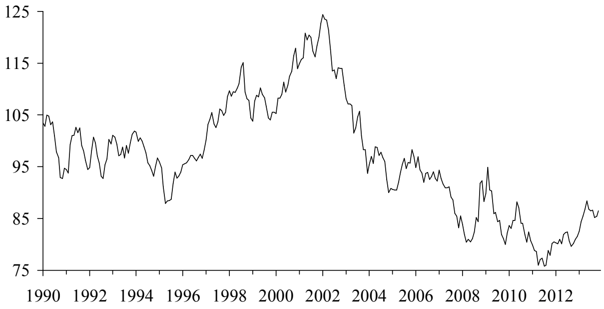
[1] Yields in terms of €s or $s can be computed by adjusting the £-based yields for the expected currency change.
[2] UK index linked bonds All Stocks
[3] Output based on China.

Table 3: Portfolio(%)

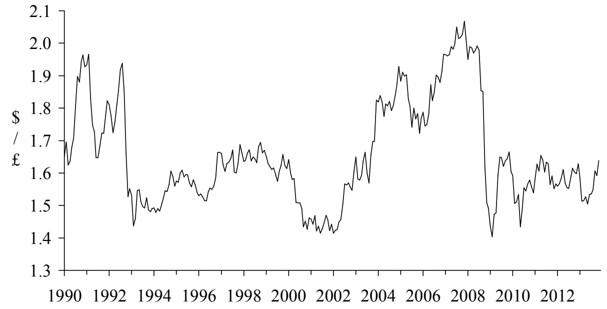
	Sterling Based Investor		Dollar Based Investor		Euro Based Investor	
	November Letter	Current View	November Letter	Current View	November Letter	Current View
UK Deposits (Cash)	5	5	5	5	1	1
US Deposits	-	-	-	-	-	-
Euro Deposits	-	-	-	-	-	-
Japanese Deposits	-	-	-	-	-	-
UK Bonds	-	-	-	-	-	-
US Bonds	-	-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

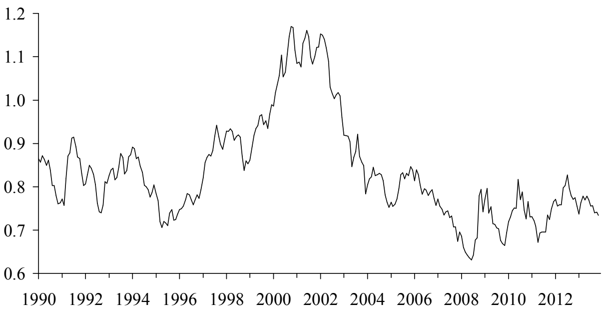
US : Trade Weighted Index
(Bank of England 1990 = 100)



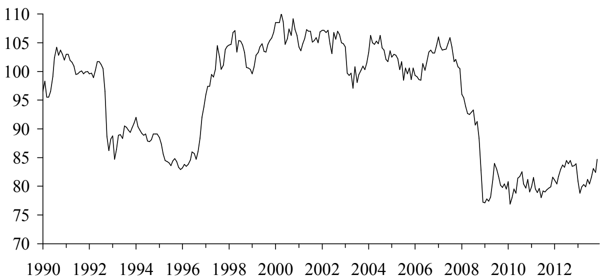
UK: Dollars Per Pound Sterling



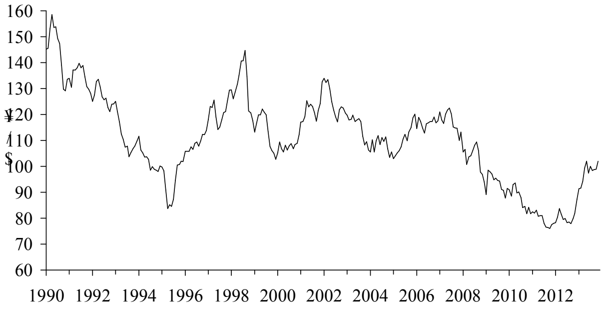
Euro per US dollar



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

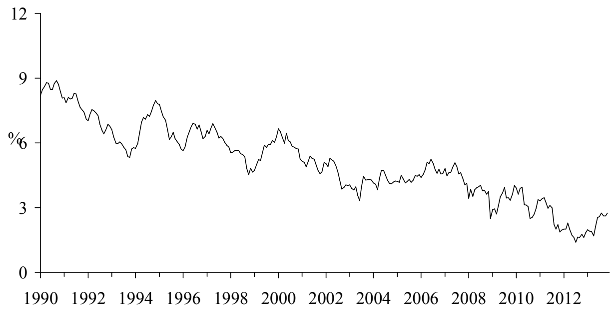


Japan : Yen Per U.S. Dollar

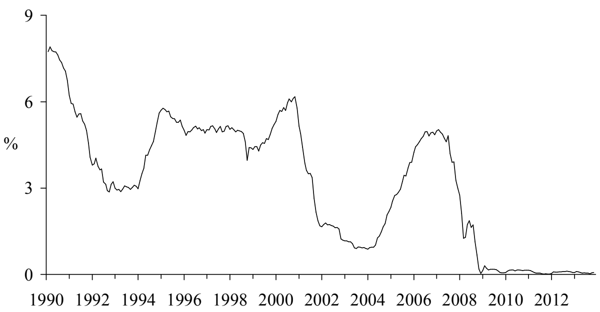


GOVERNMENT BOND MARKETS

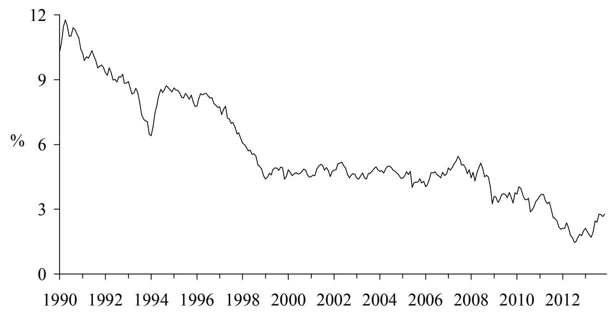
U.S.: Yield on Long-Term Government Bonds



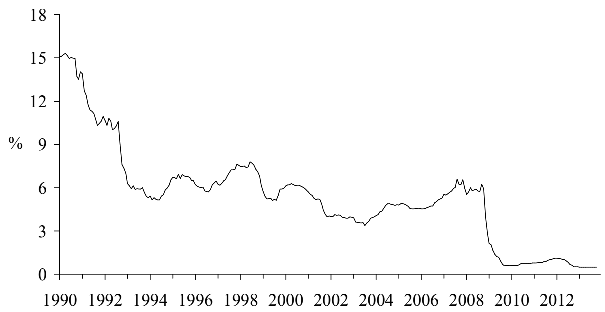
U.S. : 3-Month Treasury Bill



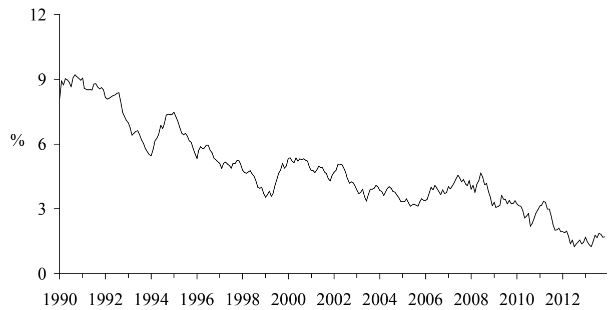
U.K. : Yield on Long-Term Government Bonds



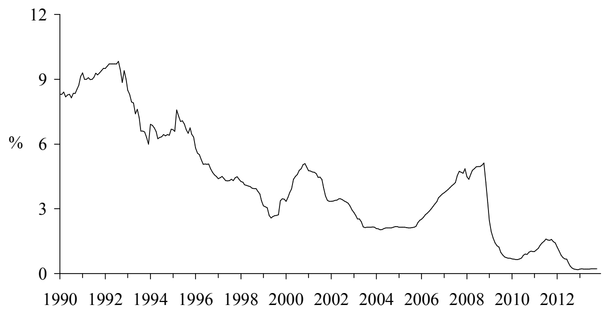
U.K. : 3-Month Interbank Rate



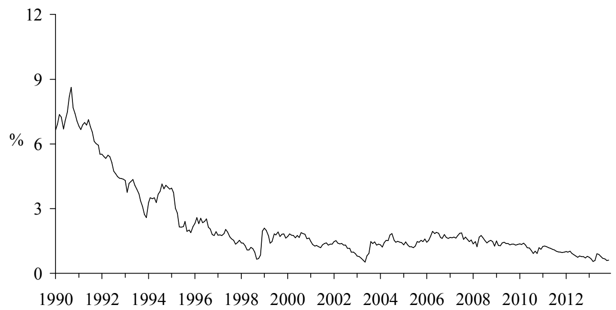
Germany: Yield on Public Authority Bonds



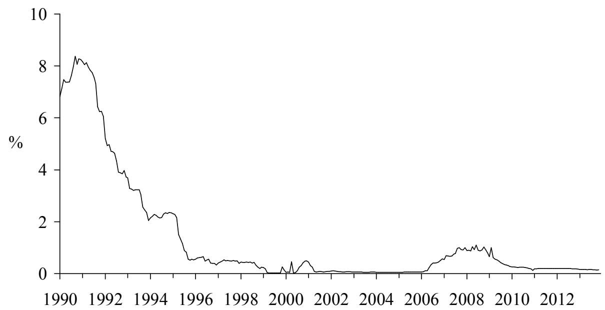
Germany : 3-Month Interbank Deposit Rate



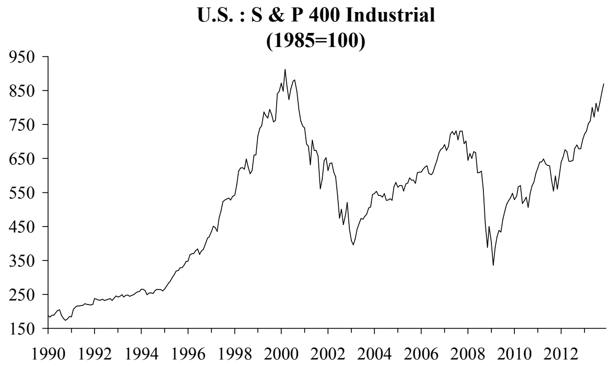
Japan: Yield on Long-Term Government Bonds

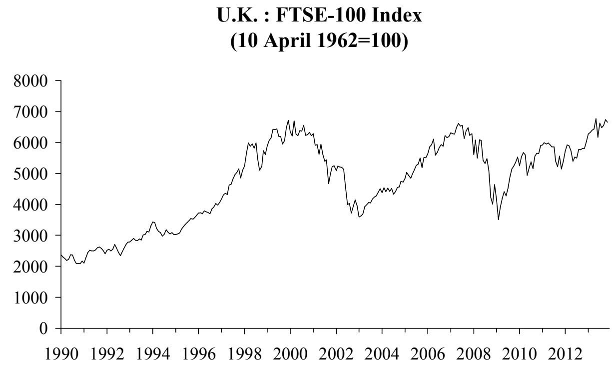


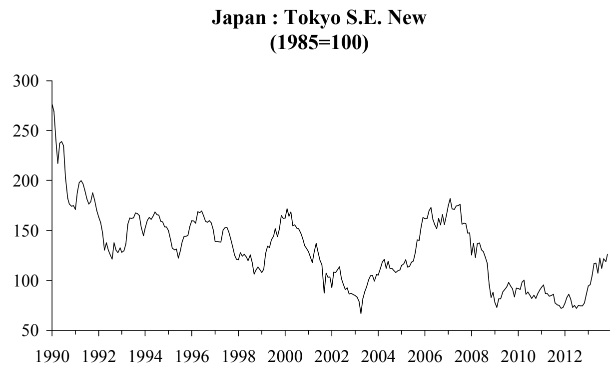
Japan : 3 Month Money Market Rate



MAJOR EQUITY MARKETS







EMERGING MARKETS

Anupam Rastogi

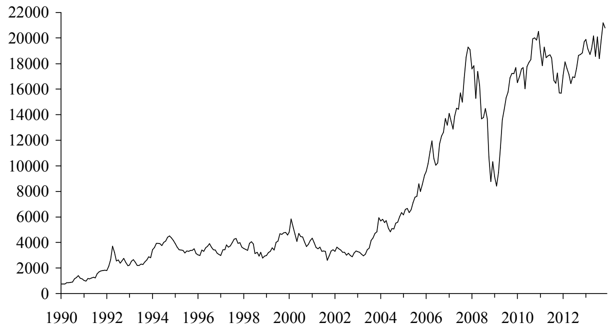
India

India is likely to grow by just 5% this year. But it seems that the worst is over, as fresh indicators such as exports and industrial production have perked up. Hopes are that a price decline in oil — India's biggest import product — will narrow the current-account deficit and contain inflation.

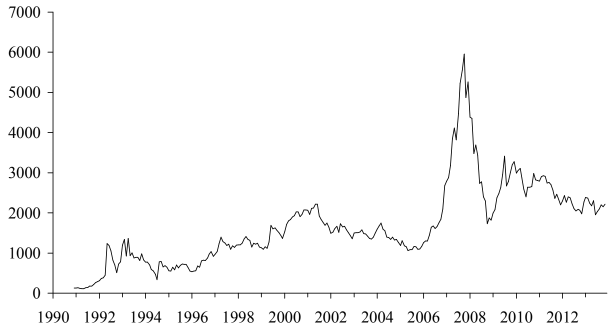
India is considering cutting government spending by nearly 600 billion rupees, or $9.64 billion, in the current financial year to rein in its ballooning fiscal deficit. The Indian government has committed to keeping its fiscal deficit at 4.8% of gross domestic product, but the gap in the first six months has already reached 76% of its target for the financial year. It is likely that the government will slash capital spending.

The government raised August's inflation to 6.99% from 6.10% reported earlier. India's consumer price inflation has soared to a double-digit rate of 10.09% in October, the highest reading since March. Indian industry is worried that the sustained rise in inflation could lead the central bank to increase borrowing costs further, in an effort to douse demand and this could exacerbate a slowdown in investments.

India: BSE Sensitive



China: SSE Composite Index



The Reserve Bank of India had raised interest rates in September and October and it is expected that it will raise the rates by another 25 basis points in the next review monetary policy around mid-December.

According to the central bank governor, India is much better prepared now than it was a few months ago, to handle a rollback of U.S. policies, which is looming over the horizon. The central bank expects the impact of the narrowing trade deficit to be reflected on the country's current account and India's current-account deficit may fall to $56 billion, or less than 3% of gross domestic product in the fiscal year ending March 31. The gap was 5% of GDP last year.

In a remarkable turnaround, after a bad summer, foreign capital has rushed back into India, pushing stocks to all-time high. The talk is now of how the economy may be on the mend. The new central bank Governor Raghuram Rajan has instilled confidence by stabilizing the currency and tackling inflation.

In our opinion, deep reforms, especially liberalising land and labour, would help make it possible for India to grow fast again. For now, any Indian rebound is temporary. The markets are hoping that with the change in leadership after mid-2014, India would see a decisive change in pro-business activities.

Standard & Poor's has put a safe tag on India's investment-grade rating until next year's general election, giving a reprieve to authorities as it placed the onus of stimulating economic activity on the next government. But it also warned that it could lower the rating within a year if it saw "continued policy drift."

	10-11	**11-12**	**12-13**	**13-14**	**14-15**
GDP (%p.a.)	7.5	6.2	5.0	5.0	6.5
WPI (%p.a.)	9.0	7.5	7.0	6.5	6.0
Current A/c(US$ bill.)	-31.0	-40.0	-80.0	-70.0	-60.0
Rs./$(nom.)	49.0	49.5	54.5	62.0	64.0

China

China's economy rebounded in the third quarter and posted year-on-year growth of 7.8% after two quarters of slower growth. The economy is expected to grow by more than 7.5% for the full year. However, China is most likely to cut its growth target to 7% next year in a sign of the government's determination to push through structural reforms and steer the economy on to a more sustainable path. The HSBC preliminary Purchasing Managers' Index slipped to 50.4 in November from 50.9 in October.

Consumer prices were up 3.2% in October compared with the year earlier. Vegetable prices, an important component of China's inflation basket have surged and property prices remain at an elevated level.

China's exports showed a stronger-than-expected performance in October. Exports in October were up 5.6% from a year earlier, after registering a 0.3% fall in September.

After a somewhat hazy announcement of reform plans, China's top leaders laid out a blueprint for reform which is a sweeping plan to remake the Chinese economy over the next decade. It pledged to open the financial sector and relax curbs on other sectors closed to investors, allow prices of natural resources to reflect market demand and put more money in the pockets of rural residents who were often left out of the boom of the last decade.

The Chinese leaders also relaxed China's one-child policy and signalled that they plan to dismantle the country's controversial labour-camp network. This has put a seal on Mr. Xi as a reformist within the party.

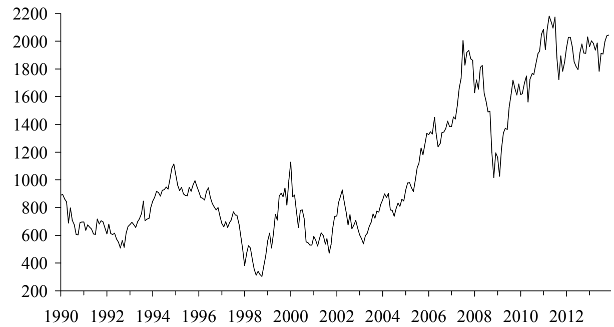
What is to be seen is that how Mr. Xi will implement the plan's goals, including whether they will be introduced in coming months or more gradually. Many of the goals adopted by China's previous leadership, under former President Hu Jintao, were never completed. China is considering letting private investors take larger stakes in state-controlled firms.

China and the EU have agreed to negotiate a bilateral investment treaty to boost access to each other's markets in a sign that their relationship remains steady despite recent trade tensions. Under the deal — announced by Chinese Premier Li Keqiang, European Council president Herman Van Rompuy and European Commission president José Manuel Barroso at the end of an annual bilateral summit in Beijing — leaders pledged to increase bilateral trade from about $580 billion in 2012 to $1trillion by 2020.

A final pact is likely to take two or three years to hammer out and it will be the first such EU-wide investment agreement negotiated by the bloc since it gained powers to do so under the Lisbon Treaty, enacted in 2009.

	10	11	12	13	14
GDP (%p.a.)	10.3	9.2	7.8	7.5	7.0
Inflation (%p.a.)	5.9	4.3	2.6	3.5	3.0
Trade Balance(US$ bill.)	183	210	214	220	220
Rmb/$(nom.)	6.6	6.3	6.3	6.2	6.1

Korea: Composite Index



South Korea

South Korea's export led economy has benefitted from an uptick in economic growth in the U.S., Europe and China. Exports jumped sharply in October to a record $50.5 billion. The rising exports have bolstered South Korea's trade surplus and foreign-exchange reserves. These are seen by investors as supportive of asset prices. Moreover, faster growth in China in the second half will prove to be a boon for South Korea.

South Korea's Kospi Composite Index is trading near a two-year high, and this year South Korea's won is performing well against the U.S. dollar. South Korea has benefited from the U.S. Federal Reserve's stimulus measures put in place after the financial crisis. When the Fed begins to pare back its bond purchases it may affect the markets adversely. Another risk being faced by South Korea is its strengthening won, which could make the country's exports less competitive.

The much-vaunted US trade deal came into force in March 2012 following a prolonged debate in both nations over its ratification, and cut tariffs across a range of goods so long as a certain amount of production costs are incurred in the US. But a growing number of US exporters in the automotive, chemicals and agricultural sectors are complaining of qualitative restrictions being put by custom officials in giving the US products "country of origin" status. This may lower US imports and see fewer American manufacturers benefit from the low tariffs promised by last year's trade pact between the two countries.

	10	11	12	13	14
GDP (%p.a.)	6.3	3.6	2.0	2.4	3.2
Inflation (%p.a.)	2.9	4.0	2.2	1.6	2.6
Current A/c(US$ bill.)	28.2	27.0	44.0	55.0	50.0
Won/$(nom.)	1150	1100	1100	1100	1080

Taiwan

The government's prediction for the full-year growth forecast of 2.3% may undergo an upward revision as the country sees an expansion in manufacturing activity and uptick in exports. Inflation, however, would remain below 1% for 2013.

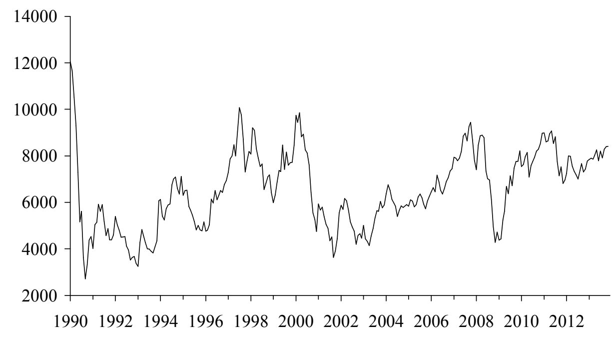
Taiwan is allowing Chinese companies to issue yuan bonds on the island following a similar move by Hong Kong that increases the use of the Chinese currency in offshore markets, and Chinese banks are set to be the first issuers.

Even though economic news is good for Taiwan, President Ma Ying-jeou is not going ahead with further political talks with China as he feels that any potential peace treaty with China would first have to gain the support of the Taiwan public through a referendum. This is despite a remark made by Chinese President Xi Jinping that political talks can't be delayed indefinitely.

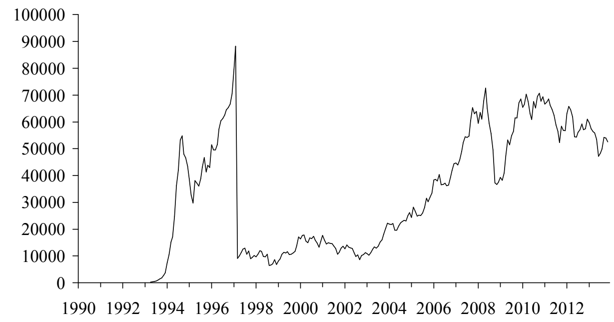
The West African nation of Gambia has cut off relations with Taiwan, deepening the small island's diplomatic isolation and jeopardizing the stability of recent improvements in its relationship with Beijing. Taiwan believes that China twists the arms of small nations to follow its policy.

	10	11	12	13	14
GDP (%p.a.)	10.8	4.0	1.3	2.4	2.5
Inflation (%p.a.)	1.3	1.2	1.9	0.6	1.0
Current A/c(US$ bill.)	16.0	18.0	20.0	22.0	23.0
NT$/$(nom.)	31.0	30.0	29.5	30.0	29.5

Taiwan: Weighted TAIEX Price Index



Brazil: Bovespa



Brazil

In an unusual way, President Dilma Rousseff announced that Brazil grew 1.5% last year and not the earlier estimates of 0.9%. We do not have any reason to dispute this, but some academics have suggested that the revision is due to new accounting rules. We shall await IBGE (the body that calculates GDP) to confirm it when it releases the country's third quarter GDP results on December 3. The gross domestic product data is expected to show that Brazil's economy contracted in the third quarter.

Brazil has raised its benchmark interest rate by 50 basis points to 10% as the country grapples with stubbornly high inflation. Annual inflation broke through the 6.5% ceiling of the country's tolerance band in both March and June this year, and still stands around 5.8% — far from the country's 4.5% target level. This could lead the central bank to increase the Selic rate by another 25 basis points at its next meeting in January.

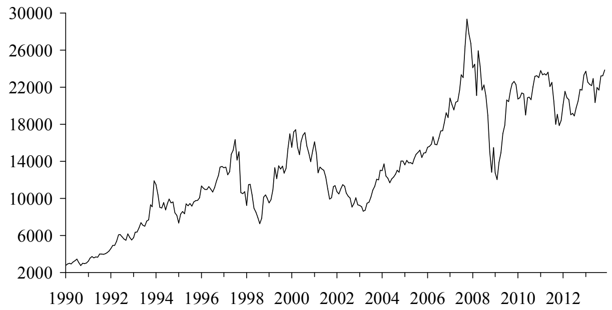
Brazilians remain concerned about nagging inflation and a sluggish economy, but that has not dented popularity of the President Rousseff for a second four-year term next year, according to a poll conducted by the MDA research institute in November. Her approval rating continued to recover from the lows it hit amid street demonstrations earlier this year. She remains by far the leading candidate going into the 2014 campaign.

During June's street protests, stirred by deteriorating public services and alleged government corruption, the president's approval sank to just above 30%.

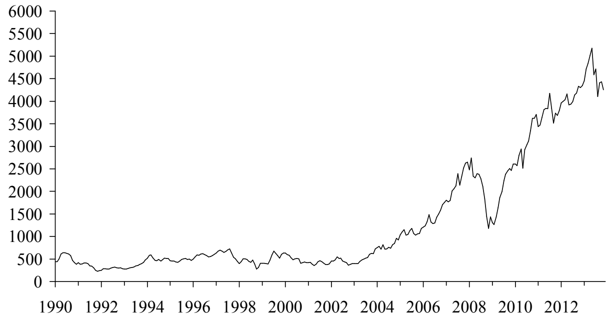
	10	11	12	13	14
GDP (%p.a.)	7.5	2.7	0.9	2.5	3.5
Inflation (%p.a.)	5.9	6.5	5.8	6.5	6.0
Current A/c(US$ bill.)	-47.3	-52.6	-60.0	-75.0	-70.0
Real/$(nom.)	1.7	1.5	2.0	2.3	2.4

Other Emerging Markets

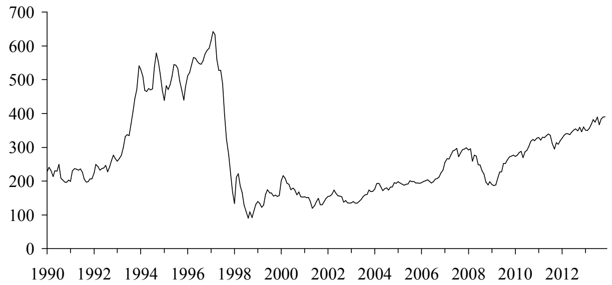
Hong Kong: FT-Actuaries



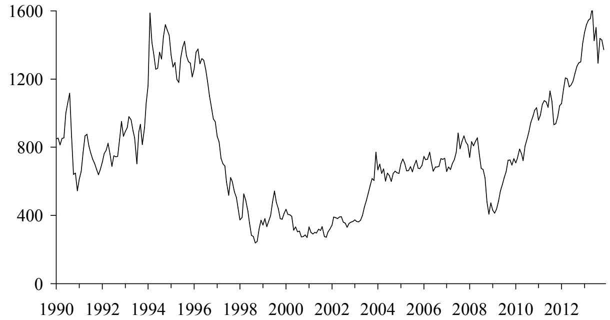
Indonesia: Jakarta Composite



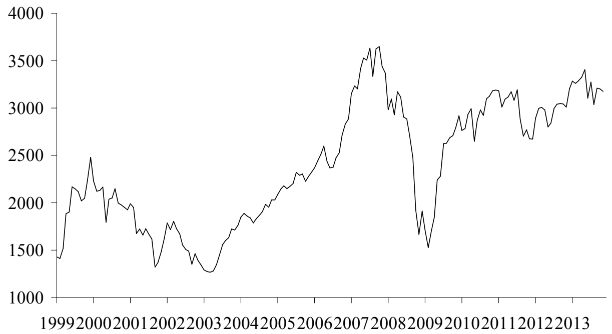
Malaysia: FT-Actuaries (US$ Index)



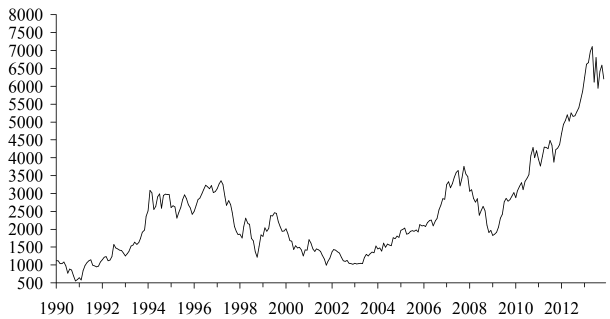
Thailand: Composite Index



Singapore: Straits Times Index

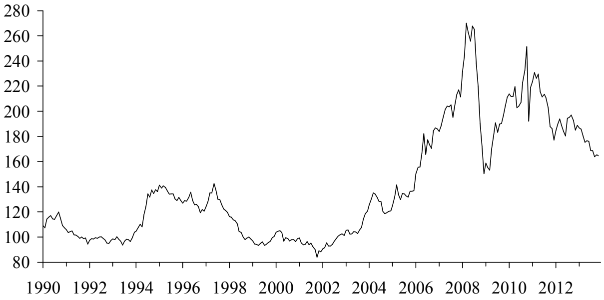


Philippines: Manila Composite

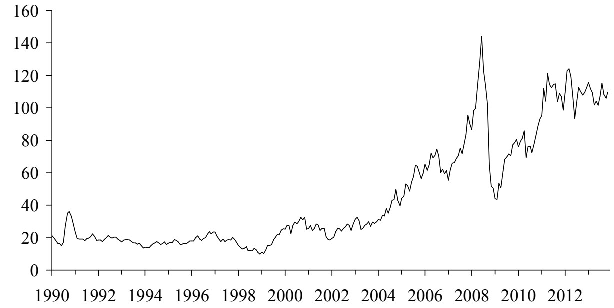


COMMODITY MARKETS

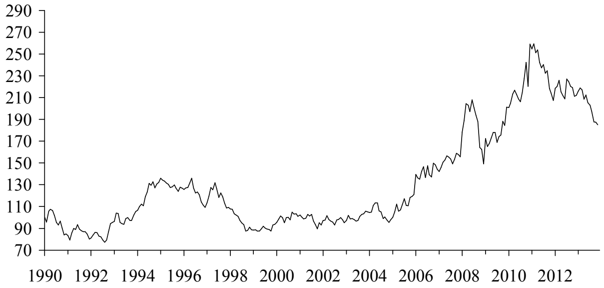
Commodity Price Index (Dollar)
(Economist, 2000=100)



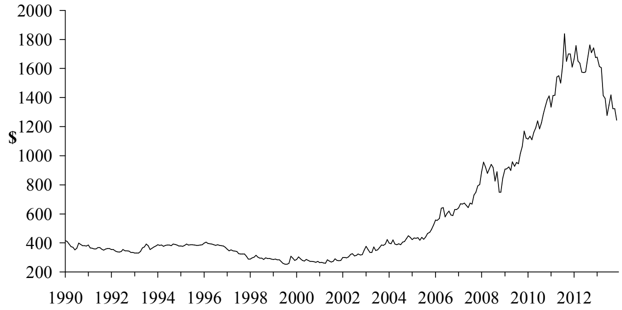
Oil Price: North Sea Brent (in Dollars)



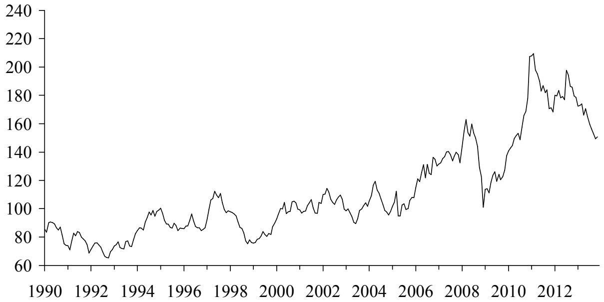
Commodity Price Index (Sterling)
(Economist, 2000=100)



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]
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	94.0	−1.7	3.2	−1.5
2013	2.7	1.3	0.9	82.6	94.3	−1.6	2.5	−0.9
2014	2.5	1.8	1.6	83.0	95.7	−0.6	3.1	−0.3
2015	2.2	2.1	2.1	82.3	95.4	0.1	2.8	0.1
2012:1	2.7	1.1	1.1	81.2	91.6	−1.8	3.8	−1.3
2012:2	3.0	0.9	1.1	83.2	94.3	−1.4	3.2	−1.4
2012:3	2.5	0.7	0.8	84.1	95.2	−1.7	2.9	−1.6
2012:4	2.5	0.8	0.6	83.7	94.9	−2.0	3.0	−1.5
2013:1	2.6	1.0	0.6	80.5	91.1	−2.0	3.0	−1.3
2013:2	2.8	1.3	0.9	83.2	95.2	−1.6	3.3	−0.9
2013:3	2.8	1.5	0.9	83.5	95.5	−1.6	3.3	−0.7
2013:4	2.7	1.5	1.1	83.2	95.4	−1.3	3.2	−0.6
2014:1	2.6	1.8	1.3	83.6	96.0	−1.1	3.1	−0.3
2014:2	2.5	1.8	1.6	83.0	95.8	−0.6	3.1	−0.3
2014:3	2.5	1.7	1.8	83.1	95.8	−0.3	3.1	−0.4
2014:4	2.4	1.8	1.8	82.4	95.2	−0.3	3.0	−0.2

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)
2010	227.1	2.4	4.6	1.50	135.6
2011	232.7	2.5	4.6	1.53	133.5
2012	237.1	1.9	4.7	1.59	132.5
2013	242.3	2.2	4.5	1.53	131.8
2014	248.5	2.6	4.2	1.43	131.9
2015	256.6	3.2	3.9	1.31	133.3
2012:1	234.7	0.7	4.8	1.61	132.4
2012:2	235.8	1.8	4.8	1.59	131.9
2012:3	237.4	1.9	4.7	1.57	132.5
2012:4	240.5	3.3	4.6	1.56	133.2
2013:1	241.8	3.0	4.6	1.54	133.0
2013:2	242.1	2.7	4.6	1.55	131.7
2013:3	242.0	2.0	4.5	1.54	131.4
2013:4	243.1	1.1	4.5	1.51	131.0
2014:1	245.1	1.3	4.4	1.48	131.4
2014:2	248.1	2.5	4.3	1.45	131.7
2014:3	249.4	3.0	4.2	1.42	132.1
2014:4	251.5	3.4	4.1	1.39	132.4

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	145.1	694662.2	405184.0	235764.3	184689.2	−30801.2	100173.9
2013	146.8	702861.9	405176.8	223498.2	188405.4	−30067.7	84149.4
2014	150.0	718141.3	408306.9	241326.9	189177.7	−31205.7	89481.4
2015	153.6	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	1.2		0.0	−5.3	2.0		−16.0
2014/13	2.2		0.8	8.6	0.4		7.3
2015/14	2.4		1.5	4.0	2.3		3.1
2012:1	145.2	173777.2	101162.8	53040.9	48062.2	−6746.9	21741.9
2012:2	144.4	172906.5	101177.7	59892.9	44993.0	−8401.7	24755.4
2012:3	145.5	174189.9	101200.0	60648.4	45617.7	−7536.4	25739.8
2012:4	145.2	173788.7	101643.4	62182.0	46016.3	−8116.2	27936.9
2013:1	145.5	174253.1	101590.2	48881.4	48201.0	−6636.6	17782.9
2013:2	146.5	175446.1	101360.9	56536.5	45914.8	−7812.6	20545.8
2013:3	147.2	176195.9	101183.7	57185.3	48587.9	−7810.2	22948.1
2013:4	147.8	176966.8	101041.9	60894.9	45701.7	−7808.3	22872.6
2014:1	148.7	177984.2	101428.2	59849.8	46404.1	−7808.4	21893.9
2014:2	149.5	179011.0	101842.3	60408.6	46695.4	−7801.3	22139.1
2014:3	150.4	180074.6	102284.4	58779.4	49462.5	−7797.5	22657.5
2014:4	151.2	181071.5	102752.0	62289.0	46615.7	−7798.5	22791.0

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	8.5	1319.8	112.6	36.6	−40.0
2011	6.5	1399.3	91.0	43.0	−22.5
2012	4.8	1425.0	68.4	46.9	−59.2
2013	8.1	1471.0	119.7	51.2	−60.7
2014	6.9	1541.7	106.0	56.6	−62.9
2015	5.9	1613.2	94.6	60.3	−63.5
2012:1	4.1	346.6	14.4	11.5	−12.5
2012:2	1.3	353.4	4.6	11.4	−17.8
2012:3	5.7	358.3	20.3	11.8	−15.3
2012:4	8.9	364.3	32.6	11.8	−13.6
2013:1	3.1	349.1	10.9	12.0	−14.5
2013:2	8.2	360.4	29.6	12.5	−17.1
2013:3	8.8	367.0	32.4	12.6	−15.9
2013:4	7.3	370.7	27.0	12.9	−13.2
2014:1	8.2	372.9	30.7	13.3	−16.3
2014:2	7.2	379.2	27.4	13.7	−17.3
2014:3	8.4	383.1	32.4	14.1	−16.0
2014:4	6.9	387.4	26.6	14.2	−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	1.2	2.2
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	–0.4	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	–1.7	–1.6	–0.6
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	–1.5	–0.9	–0.3
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	78.9	80.0	83.7	84.0	85.2
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	2.7	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	1.6	1.5
Italy	0.8	1.5	2.8	3.0	2.8	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	0.9	1.6
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	1.3	1.8
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	1.55	1.61	1.59	1.56	1.56
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