LIVERPOOL INVESTMENT LETTER

December 2015

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

INDEFINITE ZERO RATES COULD LEAD TO RE-EMBEDDING INFLATIONARY PRESSURE

In last month's issue we reported on our forecast for housing. House prices look set to rise around 7% a year until the end of the decade.

However, more interesting than our main forecast was the variant we did on a policy of endless 'zero' interest rates which seems to be the current intention, with Mr. Carney suggesting that the Bank will use 'macro-prudential' methods to stop monetary overheating in the housing market. Here is a reminder of the two sets of housing figures (Table 2).

It has to be said that if the Bank really intends to use what amounts to credit controls to deal with general monetary overheating, then it represents a huge betrayal of what monetary policy is supposed to be and calls into question the whole idea of Bank of England independence. That was supposed to ensure that monetary policy was taken out of politics and used to stabilise inflation and the economy.

There is a double error in the current announced Bank plans. The first is this abrogation of the task of monetary policy in favour of credit controls. The second is the damage and futility of using credit controls as the substitute. Controls do not deal with fundamentals but instead distort markets and create avenues whereby controls are avoided in the longer term, while generating timing shifts in the short term in particular channels of response. There are distortion costs associated with the controls and these responses, as people are forced into inconvenient and more expensive ways of doing business.

Unfortunately, just as this Conservative, notionally free market, government has resorted to some distortionary measures for political reasons — the most egregious example being the new 'Living Wage' — so Mr.Carney, Mr. Osborne's political appointee as Bank Governor, is obligingly playing a political game with monetary policy, even though the Bank's independence law specifically stated its aim was to ensure that politics was taken out of money. Convenient aspects are that this policy keeps down the cost of public debt so making Mr. Osborne's task easier in containing the budget deficit.

The latest Autumn Statement from the Chancellor contained a series of policy reversals in the face of mounting 'austerity fatigue'. These were justified by the extra resources coming from a better tax revenue forecast from the Office of Budget responsibility and yes, a lower debt interest prospect. Extra revenues are also to be raised by taxing business more heavily through the new apprenticeship levy, and through a more distortionary stamp duty set-up with discrimination against buy-to-let and second homes. It is clear one should not take this Chancellor's announced intentions any more seriously than those of his Canadian Bank Governor. Unfortunately the imploding Labour Party has removed any opposition and we currently have a one-party state, with rebels in some devolved regions.

In spite of all this the economy is continuing to do well, largely because small businesses appreciate the relative stability in the UK environment; for all its faults, one only has to look at the governmental chaos in the US and the EU to appreciate matters can be far worse. It is possible that UK policy will muddle through, with decisions down the road offsetting this Chancellor's discretionary mistakes. Much could yet change, with the decision on EU membership the biggest issue for the coming year. If the UK votes to leave, this government may have to find new leadership, unless David Cameron adroitly redefines himself and Mr. Osborne in good time. If it votes to stay, then these two will need to justify their advice to do so by making the well-functioning economy their priority. Currently they are taking risks with it.

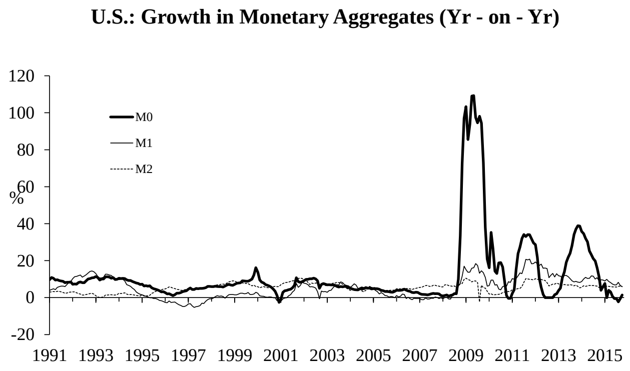
Table 1: Summary of Forecast

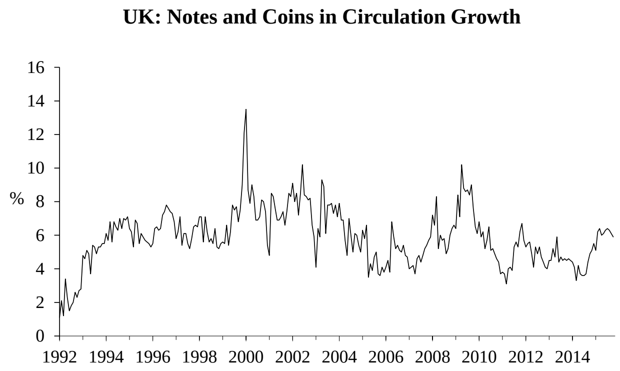
		2012	2013	2014	2015	2016	2017	2018
GDP Growth[1]		0.7	1.7	2.8	3.0	2.5	2.4	2.4
Inflation	CPI	2.1	1.9	1.6	0.1	1.0	1.0	2.0
	RPIX	3.2	3.1	2.4	1.3	1.9	1.9	2.7
Unemployment (Mill.)								
	Ann. Avg.[2]	1.6	1.4	1.0	0.8	0.7	0.7	0.6
	4th Qtr.	1.6	1.3	0.9	0.7	0.7	0.7	0.6
Exchange Rate[3]		83.0	81.6	87.1	91.1	91.9	92.5	92.2
3 Month Interest Rate		0.9	0.6	0.6	0.6	1.0	1.6	2.1
5 Year Interest Rate		0.9	1.3	1.8	1.8	2.2	2.5	2.5
Current Balance (£bn)		−53.2	−65.9	−84.2	−77.5	−77.4	−77.3	−78.1
PSBR (£bn)		110.6	92.5	88.6	83.6	78.7	57.6	38.5

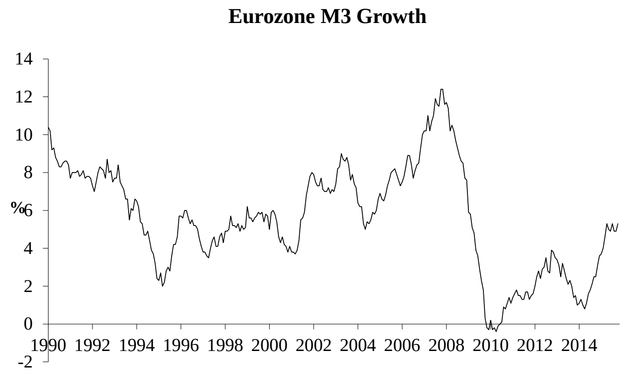
[1]Expenditure estimate at factor cost
[2]U.K. Wholly unemployed excluding school leavers (new basis)
[3]Sterling effective exchange rate, Bank of England Index (2005 = 100)

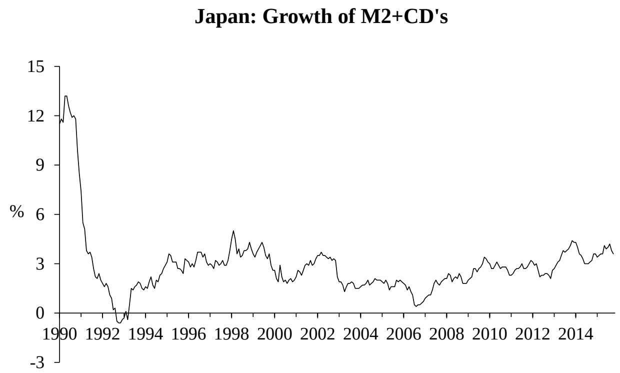
Table 2: Nominal Annual Growth in house prices, Base and Variant Scenarios

	Base	Variant
2014	9.88%	9.88%
2015	4.54%	4.65%
2016	4.39%	6.93%
2017	6.72%	11.46%
2018	7.04%	11.47%
2019	6.99%	10.45%
2020	6.90%	9.10%


U.S.: Growth in Monetary Aggregates (Yr - on - Yr)
M0
M1
M2
%
120
100
80
60
40
20
0
-20
1991 1993 1995 1997 1999 2001 2003 2005 2007 2009 2011 2013 2015


UK: Notes and Coins in Circulation Growth
%
16
14
12
10
8
6
4
2
0
1992 1994 1996 1998 2000 2002 2004 2006 2008 2010 2012 2014


Eurozone M3 Growth
%
14
12
10
8
6
4
2
0
-2
1990 1992 1994 1996 1998 2000 2002 2004 2006 2008 2010 2012 2014


Japan: Growth of M2+CD's
%
15
12
9
6
3
0
-3
1990 1992 1994 1996 1998 2000 2002 2004 2006 2008 2010 2012 2014

FOCUS ON JAPAN

Francesco Perugini

Trans-Pacific Partnership to play big role in Abenomics

After more than five years of negotiations and concessions all around, last October Japan and other eleven Pacific Rim countries, including the US, reached a broad agreement on the Trans-Pacific Partnership (TPP) initiative, a deal that will lower or eliminate tariffs on 99.9% of manufactured products. The TPP, once ratified by all member countries before any of its provisions can come into force, will represents the largest trade agreement in over two decades, encompassing some 40% of global GDP and a combined population of 800 million.

But the TPP is about more than trade. The wide-ranging deal sets rules also on investment and the handling of intellectual property such as new biologic drug patents, it will cover environmental conservation and labour protection, as well as restrictions on the favourable status of state-owned enterprises, in a bid to revitalize economic activities in the Asia-Pacific region. “We have come to an agreement that will support jobs, drive sustainable growth, foster inclusive development, and promote innovation across the Asia-Pacific region,” ministers of the 12 countries said in a joint statement released after the repeatedly extended negotiations.

Japan will clearly be the largest national beneficiary of the TPP. Tariffs will be lifted immediately for about 87% of the 6,500 types of industrial products that Japan exports. In terms of value, 76.6% of the roughly ¥19 trillion in industrial goods that Japan ships to the other 11 nations would be free from tariffs as soon as the trade deal takes effect. This includes fields in which Japanese manufacturers are highly competitive, such as appliances, industrial machinery and chemicals. For instance, tariffs would be dropped immediately on 98% of Japanese industrial goods shipped to New Zealand and 94% of those exported to Australia, in value terms. The 2.1% tariff that the US levies on Japanese video cameras will be eliminated right away. In the materials field, the US has imposed tariffs ranging from 2.4% to 6% on aluminium, but most types of aluminium will have duty-free access to that market right after the trade accord goes into force. Other products that will have tariffs lifted immediately include plastic goods — of which Japan exports almost ¥200 billion worth to the US a year — nylon and other synthetic fibres, and materials for making carbon fibre. The 2.4% tariff that the US levies on Japanese motorcycles larger than 700cc will be eliminated five years after the TPP takes effect. Roughly 30% of the large motorbikes built in Japan are exported to the US. Since large motorcycles are popular among affluent Americans now, the trade deal will likely lead to increased domestic production by Japanese companies. Japan exports more than ¥230 billion in machine tools to North America every year. The US will end current tariffs ranging from 2.2% to 4.4% on such products in the fifth year.

Small and midsize Japanese companies are seen as benefiting from the trade pact as well. When the 9.1% tariff that the US imposes on towels is dropped in five years, major towel manufacturing centres in Japan will likely enjoy a chance to boost exports. Among industrial products, passenger car exports to the US will have tariffs in force for the longest period. The 2.5% duty will start decreasing in the 15th year, reaching zero in the 25th year. At that point, all Japanese industrial products will be entering the US duty-free.

The TPP will also open some of the protected areas of the Japanese market, leading to an increase in imports and exposing domestic players to greater competitive pressure. This will help improve overall productivity through two channels. First, contractions in output in uncompetitive industries will unleash hoarded human and financial resources, prompting a shift of labour and capital to competitive industries and thereby lifting the productivity of the entire economy. Second, faced with greater competition, Japanese companies will be spurred to develop new technologies and products for the sheer purpose of survival, which in turn will also lead to a rise in productivity.

In substance, the overall consensus is that the TPP will accelerate the international flow of goods and promote efficiency in a variety of industries. “The trade deal will likely shift capital and labour away from low-productivity industries to more productive ones, strengthening the structure of the economy,” said Tetsuhide Mikamo, director at Marubeni Research Institute. Virtually all economists agree that this shift toward freer trade greatly benefited the world’s citizens and enhanced global growth. The economists Jeffrey Frankel and David Romer estimate that, in general, trade has a sizable positive effect on growth.

Private think tanks have assessed potential benefits for the Japanese economy in joining the TPP. For instance, a study conducted by economists at the Peterson Institute for International Economics, a private non-profit institution based in Washington, shows that by 2025 Japanese exports and imports will each grow by ¥17 trillion annually and its national income by more than ¥12 trillion. These absolute increases are greater than for any other member country. In percentage terms, only much smaller Vietnam and Malaysia will enjoy larger gains. Japan’s percentage gains will be two-and-a-half to five times those of the US. These benefits will grow significantly when other countries join the TPP in the second stage, as half a dozen (including Indonesia and South Korea) are already hoping to do.

Furthermore, economists at RIETI, a Japanese policy think tank, estimated that the TPP would raise Japan's per capita GDP growth rate by about 1.5 percentage points, which would enable Japan to easily meet the Shinzo Abe administration's nominal GDP goal of ¥600 trillion around fiscal 2020 from the current ¥491 trillion as part of the "new three arrows". However the report also warned that if Japan adopts protectionist policies for protecting agriculture and other domestic industries, the TPP will be of limited effect.

Indeed, Japan's political challenge will be to sell the TPP to its voters, especially the farm lobby. Under the TPP, Japan has agreed to abolish tariffs on 81% of 2328 agricultural, forestry and fisheries imports — more than in any other free trade agreement concluded by Japan so far but lower than any other participating country. Tariffs will be abolished on 30% of imports in the so-called five 'sensitive' categories — rice, wheat and barley, beef and pork, dairy products, and sugar. This means that 10% more foreign rice without tariffs would be entering Japan, where rice consumption has been shrinking by 80,000 tons annually. Consequently, industry insiders fear a major blow to Japanese farmers. The Japan Agricultural Cooperative (JA) organisation said that farmers will face tougher competition with major exporters such as the US; and that great concern and anger are spreading at the grassroots.

To counteract negative impacts from market liberalization, particularly on the sensitive farm sector, and to expand exports of agricultural products, the Abe administration plans to compile a supplementary budget of just over ¥3 trillion for the rest of fiscal 2015. "We will fortify our agricultural industry's strength as a growth sector, and the budget will switch from defence to offense", said Akira Amari, minister of economic and fiscal policy, regarding the TPP action plan. But all indications are that the Abe administration efforts, like previous Liberal Democratic Party (LDP) administrations, are aimed at securing votes and winning the election next July 2016 in the Diet Upper House, where the agricultural interests are disproportionately represented.

Instead of cushioning Japanese producers from the impact of any import liberalisation, which will help keep small-scale, inefficient farmers in business, Abe should take the TPP as a means to push aside the lobbies and vested interests that have been so effective in slowing down or diverting piecemeal reforms. And Japan's farmers should use the trade agreement as a way to secure their futures, rather than hoping that protective subsidies continue ad infinitum. But the TPP's ratification is far from certain. As we have seen so many times in the past, the concentrated interests that oppose the agreement may turn out to be more influential than the diffuse interests of all Japanese.

MARKET DEVELOPMENTS

The bond market keeps on being reprieved by the world's central banks. The ECB is busy printing lots more money; the Bank is wedded to zero rates. Only the Fed threatens to raise rates but we have yet to see whether the threat means anything, particularly with an election year upcoming. Inflation is staying low, as commodity prices sag under slow growth and massive excess capacity. Past experience warns that such sagging can be the lull before the inflationary storm; if anti-inflation credibility goes, inflation will rise again. Equities remain the only defence against the uncertainties of this environment.

Table 1: Market Developments

	Market Levels		Prediction for Oct/Nov 2016	
	Oct 29	Nov 27	Previous Letter	Current View
Share Indices				
UK (FT 100)	6438	6393	9148	9046
US (S&P 500)	2090	2089	2730	2728
Germany (DAX 30)	10832	11321	15046	15725
Japan (Tokyo New)	1547	1602	2110	2186
Bond Yields (government				
UK	1.80	1.85	2.20	2.50
US	2.06	2.24	2.10	2.10
Germany	0.44	0.47	1.50	1.50
Japan	0.29	0.30	0.70	0.70
UK Index Linked	–0.81	–0.85	0.10	0.10
Exchange Rates				
UK ($ per £)	1.53	1.51	1.50	1.50
UK (trade weighted)	92.4	93.3	90.6	91.7
US (trade weighted)	104.0	106.5	100.0	100.0
Euro per $	0.90	0.94	0.91	0.91
Euro per £	1.38	1.42	1.37	1.37
Japan (Yen per $)	120.6	122.8	120.5	120.5
Short Term Interest Rates (3-month deposits)				
UK	0.60	0.60	1.30	1.20
US	0.30	0.40	1.10	1.10
Euro	–0.13	–0.15	0.10	0.10
Japan	–0.10	0.00	0.20	0.20

Table 2: Prospective Yields [1]

Equities: Contribution to £ yield of:

	Dividend Yield	Real Growth	Inflation	Changing Dividend Yield	Currency	Total
UK	3.40	2.5	1.0	38.00		44.90
US	1.90	3.0	1.6	26.00	0.37	32.87
Germany	2.60	1.4	1.5	36.00	3.95	45.45
Japan	1.70	1.4	2.0	33.00	2.21	40.31
UK indexed[2]	–0.81		1.6	1.00		0.15
Hong Kong[3]	2.60	6.8	1.6	2.00	0.37	13.37
Malaysia	3.30	5.5	1.6	58.00	0.37	68.77
Singapore	3.50	4.5	1.6	36.00	0.37	45.97
India	1.40	8.0	1.6	31.00	0.37	42.37
Korea	1.10	3.0	1.6	–12.00	0.37	–5.93
Indonesia	2.20	6.1	1.6	41.00	0.37	51.27
Taiwan	2.80	3.4	1.6	29.00	0.37	37.17
Thailand	3.20	4.1	1.6	38.00	0.37	47.27

Bonds: Contribution to £ yield of:

	Redemption Yield	Changing Nominal Rates	Currency	Total
UK	1.85	–6.50		–4.65
US	2.24	1.40	0.37	4.01
Germany	0.47	–10.30	3.95	–5.88
Japan	0.30	–4.00	2.21	–1.49

Deposits: Contribution to £ yield of:

	Deposit Yield	Currency	Total
UK	0.60		0.60
US	0.40	0.37	0.77
Euro	–0.15	3.95	3.80
Japan	0.00	2.21	2.21

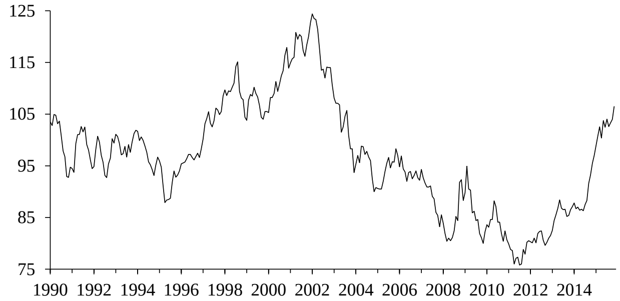
[1] Yields in terms of €s or $s can be computed by adjusting the £-based yields for the expected currency change.
[2] UK index linked bonds All Stocks
[3] Output based on China.

Table 3: Portfolio(%)

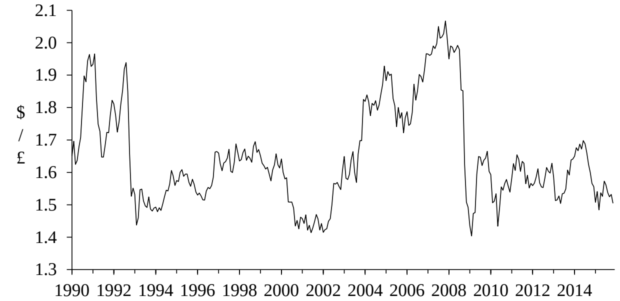
	Sterling Based Investor		Dollar Based Investor		Euro Based Investor	
	November Letter	Current View	November Letter	Current View	November Letter	Current View
UK Deposits (Cash)	5	5	5	5	1	1
US Deposits	-	-	-	-	-	-
Euro Deposits	-	-	-	-	-	-
Japanese Deposits	-	-	-	-	-	-
UK Bonds	-	-	-	-	-	-
US Bonds	-	-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

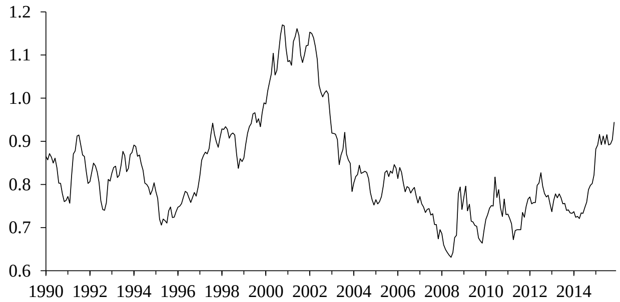
US : Trade Weighted Index (Bank of England 1990 = 100)



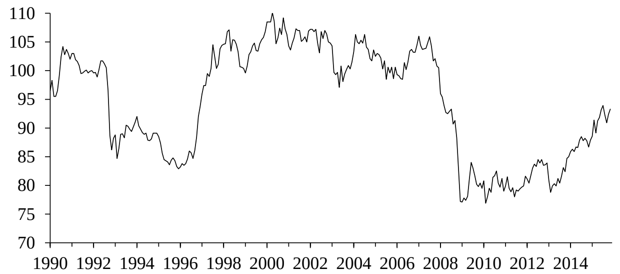
UK: Dollars Per Pound Sterling



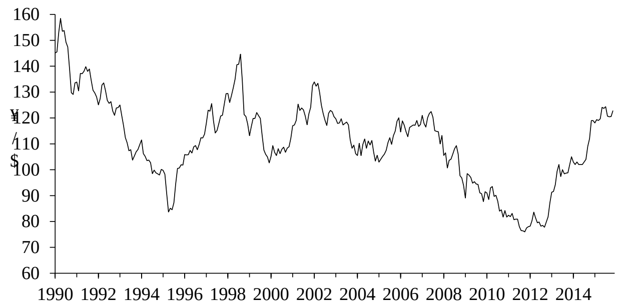
Euro per US dollar



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

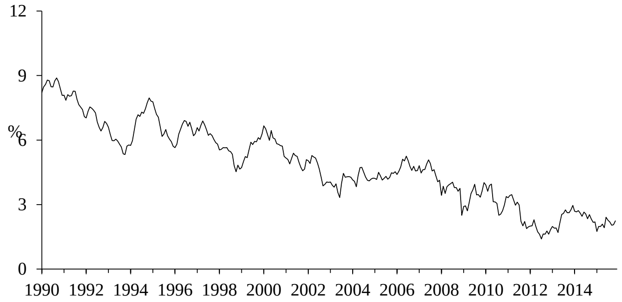


Japan : Yen Per U.S. Dollar

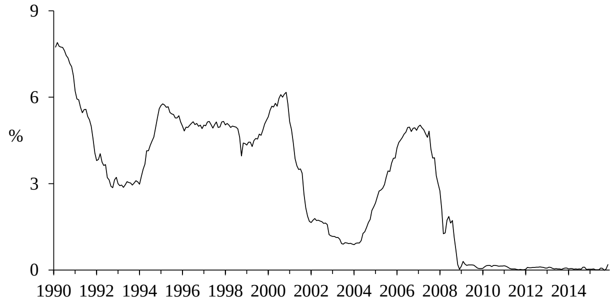


GOVERNMENT BOND MARKETS

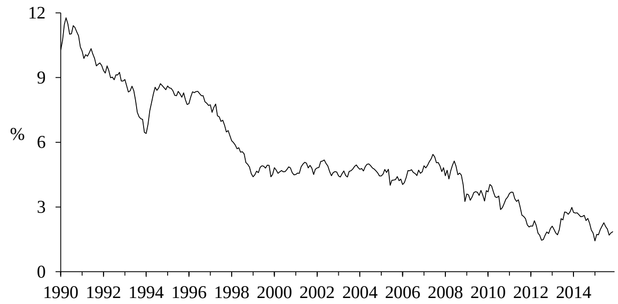
U.S.: Yield on Long-Term Government Bonds



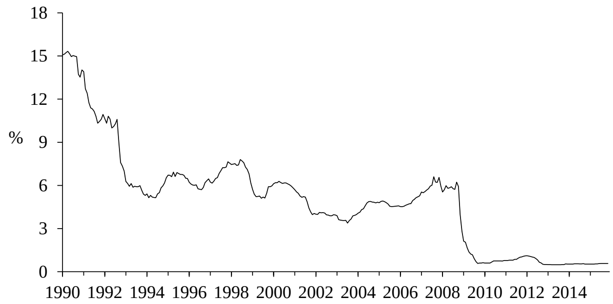
U.S. : 3-Month Treasury Bill



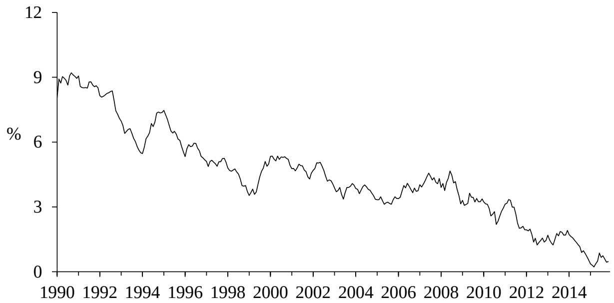
U.K.: Yield on Long-Term Government Bonds



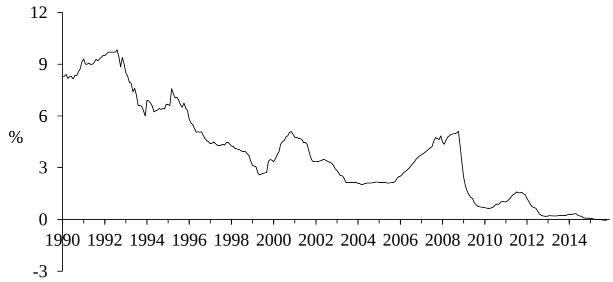
U.K. : 3-Month Interbank Rate



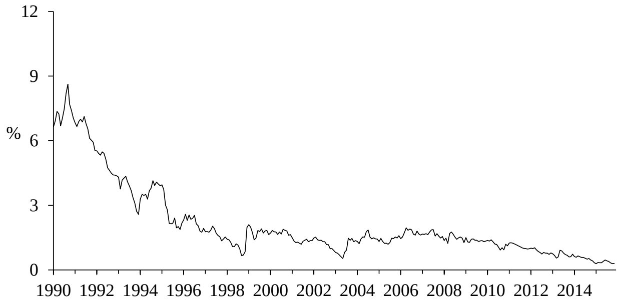
Germany: Yield on Public Authority Bonds



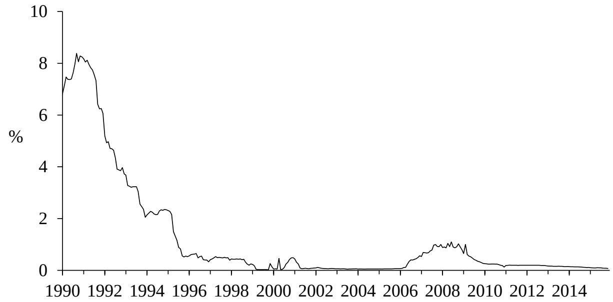
Germany : 3-Month Interbank Deposit Rate



Japan: Yield on Long-Term Government Bonds

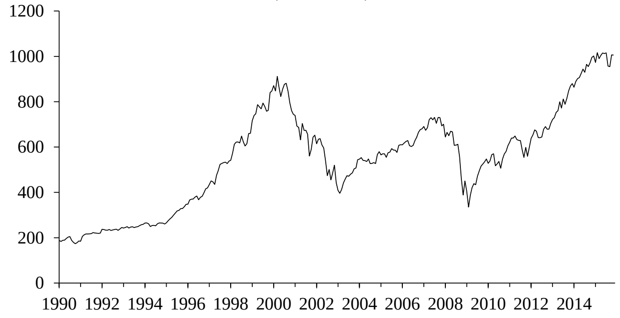


Japan : 3 Month Money Market Rate

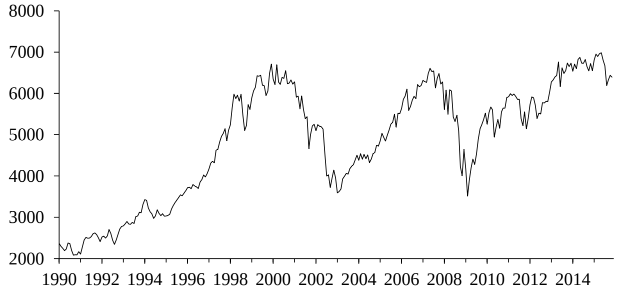


MAJOR EQUITY MARKETS

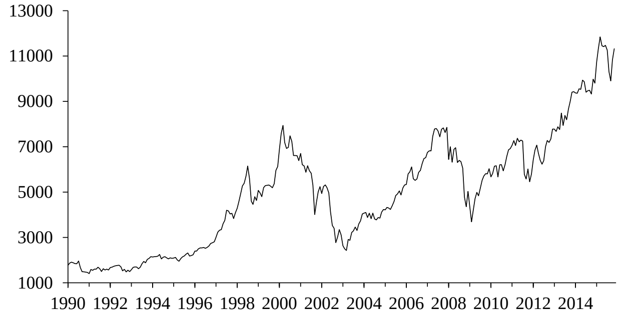
U.S. : S & P 400 Industrial (1985=100)



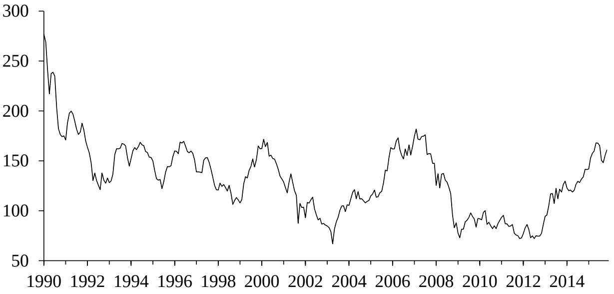
U.K. : FTSE-100 Index (10 April 1962=100)



Germany : DAX 30



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



EMERGING MARKETS

Anupam Rastogi

India

The Indian government is confident that it would be able to achieve an economic growth rate of 8% in the current fiscal year of 2015–16. The IMF is confident about India's prospects and views the economy being on an increasingly stable footing, though it may not be able to grow at the rate which the government hopes.

Business sentiment took a knock as the government was not able to push through the reforms it had promised and the party in power was defeated in provincial polls. Moreover, the belligerent stance taken by the government against the main opposition party in parliament suggested that the bills which are essential for economic growth to reach in higher orbit would not be passed. Things have changed dramatically in the last two weeks of November and once again hope is rekindled that the crucial bills, which shall ease doing business in India, would get passed and implemented quickly.

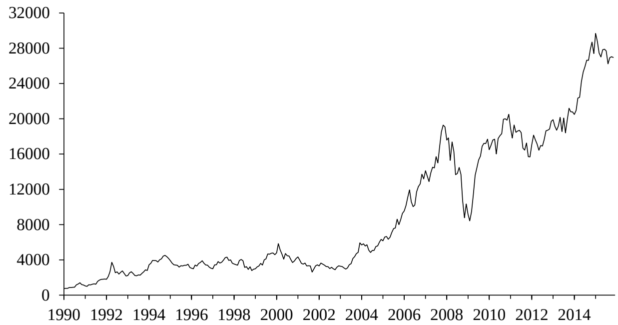
Consumer price inflation remains well below 6%. However, a recently-announced near 24% increase in salaries of government employees effective from January 2016 could prompt the Reserve Bank of India to be cautious. We expect the RBI to maintain status quo in its fifth bi-monthly policy review for 2015–16, scheduled on December 1.

China's economic slowdown is hurting India's exports to China and the slowdown in Europe is seeing a lower demand for India's exports but low commodity prices have compensated for the loss in export revenue. Thanks to remittances, the current account deficit is likely to be just above one percent of GDP.

India's benchmark S&P BSE Sensex index is down more than 6% so far this year. Overhang of the US Fed raising interest rate, weak earnings growth as companies haven't seen much pickup in demand for their goods and services and a shortfall in expected policy changes made Indian equities go out of favour in the last one month.

To wipe out all the negative sentiments, the government announced a slew of measures in the third week of November largely in order to prop up sagging revenues in the face of a global demand slump. The Cabinet approved a proposal to sell a 10% equity stake in Coal India that could raise as much as Rs200bn (approx. US$3bn). Some important decisions were taken with respect to the infrastructure sector, which will boost exports. The government has approved a 3% interest subvention for small and medium enterprise exporters and cheaper bank loans facility to exporters which will have a financial implication of about Rs27bn.

India: BSE Sensitive



The most surprising event which occurred in the last week of November was that the government reached out to the main opposition party and leaders had a face-to-face meeting to complete legislative agenda in the winter session of the parliament and passing of the goods and services tax (GST). The national GST would replace a plethora of different state and local taxes and turn India into a genuine single market for the first time, which business leaders say would make it easier to do business, and boost gross domestic product. It could add as much as two percentage points to India's gross-domestic-product growth.

The government may well buy into the argument of the Congress party and accept a revenue neutral rate of 18% for GST. The government is, however, keen to push a rate between 20–22%. The GST can be crucial for GDP growth against a very difficult global economic scenario, affected by demand slowdown, uncertain geo-political situation after the Paris terror attacks, and an unprecedented crash in vital commodities affecting countries to whom India exports its goods and services. After the GST is passed which is seen as potentially transformative of the country's business climate, the Prime Minister may enjoy a surprising second honeymoon as it will indicate Mr. Modi's newfound willingness to push a reform agenda and he may go for an ambitious budget at the end of February.

Prime Minister Narendra Modi attracted a large crowd in Singapore and London where he addressed India's great global diaspora. The gatherings were on a scale unheard of for foreign leaders visiting these countries whereas official trips are typically sedate, formal affairs.

Mr Modi feels that he is on a mission to attract foreign capital into India because India is short of capital and needs an inflow of foreign investment.

	13-14	14-15	15-16	16-17	17-18
GDP (%p.a.)	6.9	7.3	7.4	8.0	8.5
WPI (%p.a.)	7.0	6.0	5.2	4.2	4.0
Current A/c(US$ bill.)	-50.0	-34.0	-24.0	-28.0	-32.0
Rs./$(nom.)	60.0	62.0	65.5	66.0	67.0

China

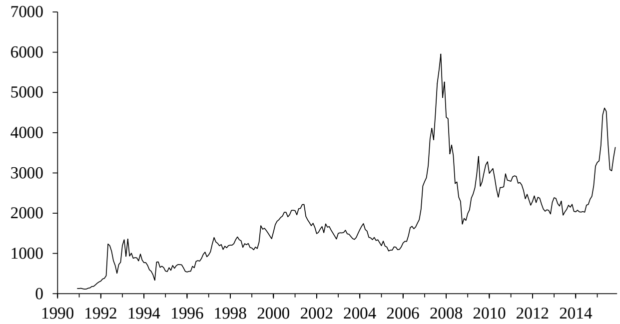
China's economy grew 6.9% in the third quarter, despite pro-growth efforts taken by Beijing to prop up the world's second-largest economy. President Xi Jinping asserted that 6.5% growth is needed for the nation to realize its economic and social goals by 2020. However, a government official has clarified that this is not the growth target for the next five years set by the government. China's two tier economy is growing at a different rate. A McKinsey survey of 1,200 Chinese consumers found that 71% expected their pay to increase this year, and 84% expect to spend more. This supports retail sales growth of 11% in October from a year earlier, up from September's 10.9% expansion. Meanwhile, industrial production decelerated to a 5.6% rise from September's 5.7%. But China's property market and its shadow-banking system both showed more weakness, as the country's economic growth is slowing.

China's commercial banks recorded a total of 1.19 trillion yuan ($186.9 billion) outstanding bad loans at the end of September, up 94.4 billion yuan from a quarter earlier, according to the government. The China Banking Regulatory Commission said commercial lenders' bad-loan ratio rose to 1.59% at the end of September, compared with a 1.5% level recorded at the end of June.

Consumer prices in China rose just 1.3% year-on-year in October compared to the 1.6% year-over-year rise in September, despite a series of interest rate cuts by the central bank aimed at boosting demand. Chinese producer prices had fallen 5.9% in October over the same month last year. The producer price index has recorded deflation for 44 straight months, showing the stress on the investment and manufacturing sectors as the government attempts to "rebalance" the economy.

The People's Bank of China plans to adopt a new, more market-oriented benchmark interest rate to replace its current guide, which is the one-year deposit rate controlled

China: SSE Composite Index



by the central bank. To prevent too much volatility in the new benchmark rate, the PBOC intends to put a ceiling and a floor — together called a corridor — to the rate.

China's currency is once again on a downward path, trading near its weakest point of the year at around 6.39 yuan per dollar. China's currency strategy has been to elevate Beijing's role in the international economy at a time when the Asian powerhouse is trying to challenge U.S. political and economic dominance around the world. The IMF is set to decide on November 30 whether to include the yuan in the basket that makes up Special Drawing Rights. Inclusion is a mere formality. This move may lend support to the currency. With the euro, yen and many emerging-markets currencies falling faster, China's trade-weighted real effective exchange rate is 7% stronger than it was at the start of the year.

China's exports fell 6.9% year-over-year in dollar terms in October after a drop of 3.7% in September for the fourth consecutive month in the face of weak global demand. Imports in October fell by a sharper-than-expected 18.8% from a year earlier, following a 20.4% decline in September. China's trade surplus widened in October to $61.64 billion from $60.3 billion in September. China is on track for a record trade surplus this year, which should give some support for the yuan

Shanghai shares tumbled 5.5% in the last week of November after authorities launched investigations into two major Chinese brokerages over suspected violations of securities rules.

	13	14	15	16	17
GDP (%p.a.)	7.7	7.4	6.3	6.0	6.0
Inflation (%p.a.)	3.5	2.0	1.3	1.5	2.0
Trade Balance(US$ bill.)	260	382	550	420	400
Rmb/$(nom.)	6.2	6.2	6.4	6.5	6.6

South Korea

The government hopes that South Korea is able to grow 3% in 2016. This objective has driven its policies to boost domestic demand over the next year as the global economy shows no signs of restoring strong growth. Moody's Investors Service has warned that South Korea's economic growth would fail to post any meaningful rebound next year and stay below 3%. The central bank cut its forecast for this year's economic growth to 2.7% from the previous 2.8%, compared to an actual 3.3% rise recorded in 2014. The Bank of Korea's 2016 growth forecast is 3.2%.

Inflation in South Korea unexpectedly increased at the fastest pace in almost a year as domestic consumption and industrial production improved. The consumer price index rose 0.9% in October from a year earlier, after a 0.6% advance in September. But, inflation is still well below the central bank's target of 2.5% to 3.5%, and has been since late 2012. The central bank has left the benchmark interest rate unchanged at a record low 1.5%.

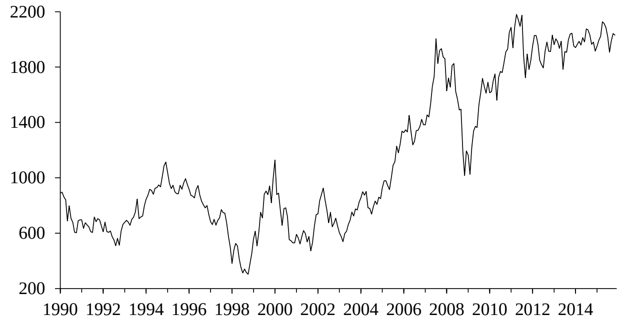
South Korea posted a trade surplus for the 45th month in a row in October as imports dropped at a faster pace than exports. Exports dropped 15.9% on-year to $43.42 billion in October, while imports fell a sharp 16.6% to $36.77 billion. In the first 10 months of 2015, South Korea's cumulative exports reached $440.2 billion, down 7.6% from a year earlier, while imports came to $367.3 billion, representing a 16.6% drop.

In the January–October period, the country's trade surplus stood at $72.9 billion, much larger than the $36.3 billion posted for the same period in 2014.

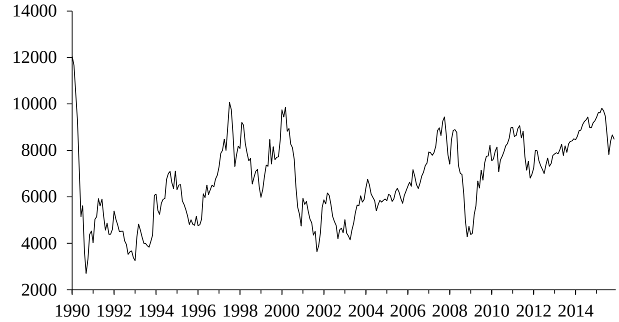
The won is trading around 1,147 to a dollar after rising to 1142 earlier. The Bank of Korea is in no hurry to raise interest rates even if the Federal Reserve normalizes its monetary policy, unless South Korea's economic recovery becomes strong. The BOK held its benchmark interest rate at a record low of 1.5% for a fifth month.

South Korea is bracing for a wave of tough corporate restructuring as the government finally gets serious about targeting zombie companies, alarmed by slowing economic growth and ballooning losses in major export industries. The problem of companies that fail to service debt with income and instead stays afloat on cheap state loans has long plagued South Korea, but the need to address the issue has become urgent in the face of intensifying competition from lower-cost China and cash-rich Japan. Generous government subsidies have kept ailing companies in business as Seoul has delayed restructuring, fearful of denting economic growth and of the potential job losses.

Korea: Composite Index



Taiwan: Weighted TAIEX Price Index



	13	**14**	**15**	**16**	**17**
GDP (%p.a.)	3.0	3.3	1.9	2.5	2.5
Inflation (%p.a.)	1.3	2.0	0.7	1.8	2.0
Current A/c(US$ bill.)	71.0	80.0	90.0	88.0	88.0
Won/$(nom.)	1100	1080	1180	1200	1220

Taiwan

Taiwan's export-focused economy shrank by 1% on an annual basis in the third quarter. Despite falling world trade and weak world demand the economy will avoid a technical recession — two consecutive quarters of negative growth — and grow by more than 2% next year, compared with forecasts of less than 1% this year.

As Taiwan's export-focused economy suffers its worst slump for six years, the government wants to boost its prospects by signing up to trade pacts such as the US-backed Trans-Pacific Partnership and the Southeast Asia-led Regional Comprehensive Economic Partnership. But Beijing has repeatedly used its clout with other countries to stop Taipei from joining international organizations and agreements.

The most significant event for Taiwan in the month of November was the meeting of its leaders in a hotel in Singapore. "One China" as a common goal is now as good as dead.

Mr. Ma is nearing the end of two terms in office. His key policy of economic opening to China has been rejected by angry young Taiwanese who stormed the legislature last year to block a trade bill. The Kuomintang (Mr Ma's party) is in disarray, and the likely victor in presidential elections in January would be Tsai Ing-wen of the Democratic Progressive Party. Her party espouses independence, although she is not a hard liner.

Mr. Xi is in a hurry. He would like to resolve the Taiwan issue. He has said, "the Taiwan question cannot be passed from generation to generation." China had hoped that closer economic integration would hasten a political deal, but it hasn't.

It is widely believed that the KMT suffered in the local polls earlier in the year because it is already seen by the electorate as too pro-China and pro-authoritarian.

	13	14	15	16	17
GDP (%p.a.)	2.1	3.7	1.0	1.6	2.0
Inflation (%p.a.)	1.2	1.5	0.0	1.0	1.0
Current A/c(US$ bill.)	50.6	57.4	60.0	64.0	68.0
NT$/$(nom.)	30.0	31.0	32.8	33.0	32.0

Brazil

The effect of the collapse in commodity prices on Brazil is severe. GDP growth is most likely to contract more than 3% this year and next year as well. Urban unemployment is at a five-year high of 7.6%. Inflation is running more than 10% and industrial production has plunged.

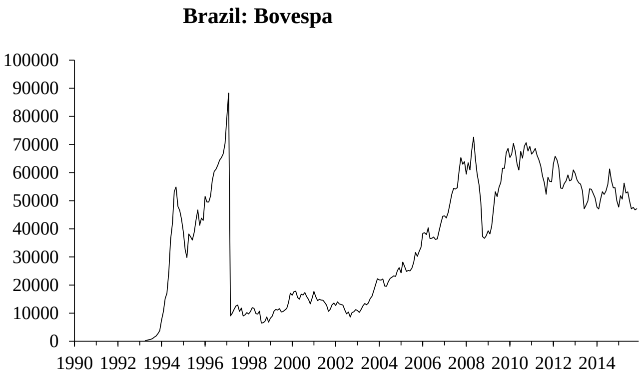
The rolling 12-month IPCA increased 10.28% through mid-November, from 9.77% in mid-October and well above the 6.5% increase ceiling set by the central bank. Inflationary pressure is one of the challenges confronting the Brazilian government, amid poor economic performance.

Brazil's central bank has kept its benchmark interest rate unchanged at a nine-year high at 14.25%, to control inflation, as the country's economy sinks deeper into recession. The central bank's inflation target was 6% and it has indicated that the target is unlikely to be reached until 2017. Business, consumer and investor confidence have collapsed.

Exports totalled $16bn in October, while imports added up to $14.1bn. So far this year, Brazil has exported $160.5bn of goods and services, 15.2% less than in the same period in 2014. Imports fell 22% to $148bn.

Brazil's trade surplus over the 12 months through October grew to $10.12bn, compared with a $2.45bn surplus in the same period a year ago. The government may meet its target of a $15bn surplus for the full year. The surplus would be a substantial improvement from the $4bn deficit recorded last year.

Lawmakers approved Ms. Rousseff's veto of a bill passed earlier this year that would have raised all retirement payments in tandem with the minimum wage, which is usually raised above inflation. The measure would have wreaked havoc on Brazil's social security system. Another bill that would have given hefty salary increases to public servants in the judiciary also was vetoed. By approving the presidential vetoes, lawmakers granted Ms. Rousseff a rare political victory in a year when Congress turned against the administration in most instances.



Brazil's senate gave the final approval to a bill aimed at attracting bidders interested in operating some of the country's largest hydroelectric plants. The bill, known as MP 688, makes it easier for operators to pass along to customers extra costs originated from prolonged droughts, among other things. Its approval is the key to the success of a major auction scheduled for December 1. The government wants to sell contracts to operate 29 hydroelectric plants for the next 30 years.

They are all existing plants that won't necessarily increase generation capacity. But the auction is important because it is expected to bring in around 11bn Brazilian reais ($2.97bn) in upfront payments from successful bidders, money that could help balance the government's accounts.

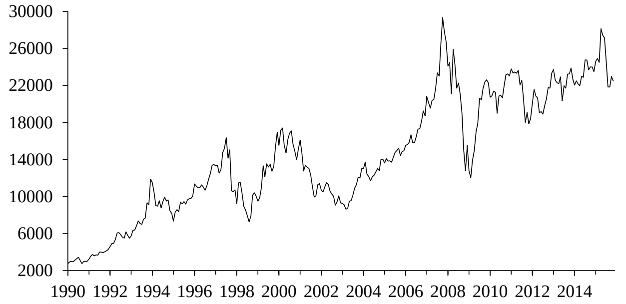
Standard & Poor's has already downgraded Brazil to below investment grade and other agencies could do it in the next few months.

Brazil's preparation to hold the Olympics in 2016 in Rio is going well unlike the last-minute preparations for the 2014 World Cup. Not only are the projects running on time, but also are within budget. The scenario is very different from the World Cup in which costly blowouts sparked mass protests in 2013 against the event. The secret is heavy private sector funding for the Olympics and the use of a number of innovative techniques including temporary stadiums that can be dismantled and turned into other public facilities such as schools after the games. Let us hope, it brings some cheer to Brazilians next year.

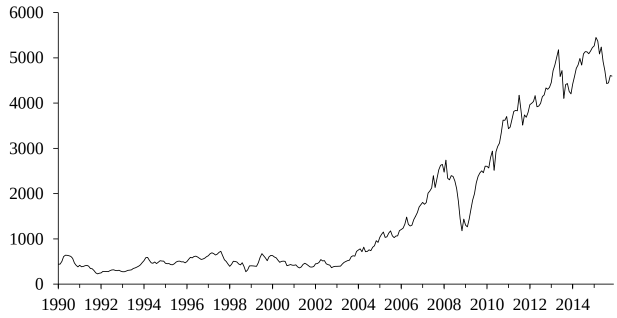
	13	14	15	16	17
GDP (%p.a.)	2.5	0.1	-3.1	-3.0	1.2
Inflation (%p.a.)	5.9	6.5	10.2	8.2	6.0
Current A/c(US$ bill.)	-75.0	-104.0	-70.0	-60.0	-50.0
Real/$(nom.)	2.3	2.4	3.9	4.0	4.0

Other Emerging Markets

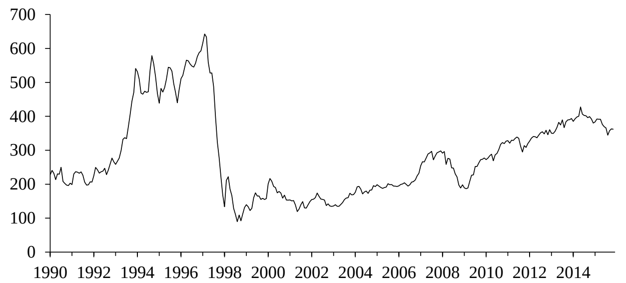
Hong Kong: FT-Actuaries



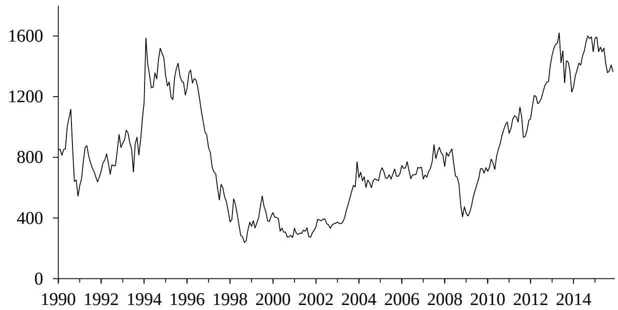
Indonesia: Jakarta Composite



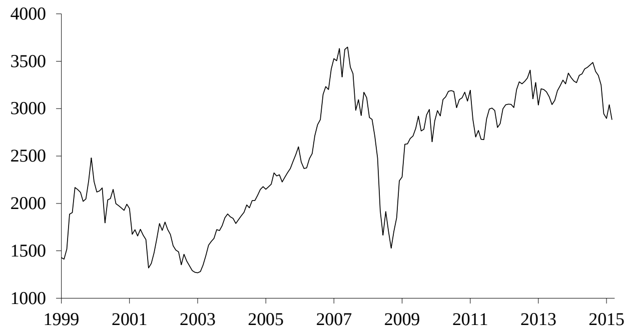
Malaysia: FT-Actuaries (US$ Index)



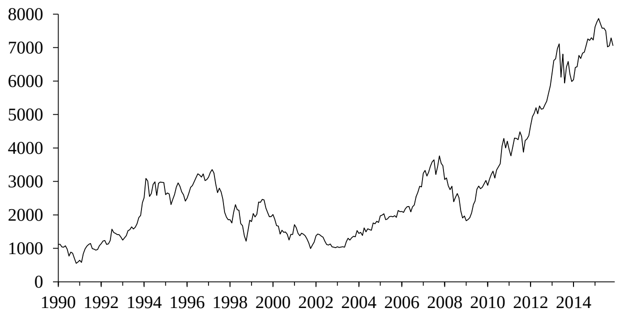
Thailand: Composite Index



Singapore: Straits Times Index

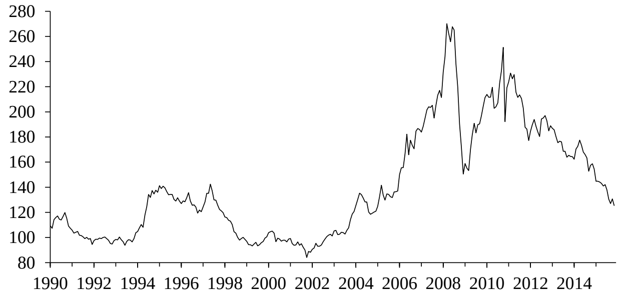


Philippines: Manila Composite

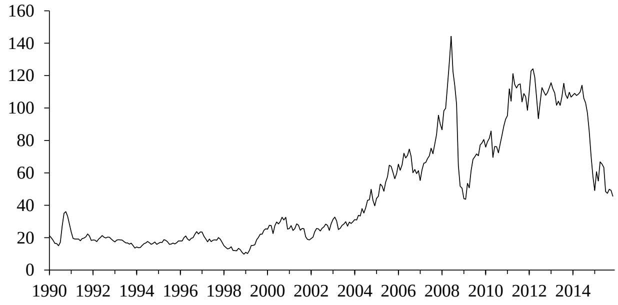


COMMODITY MARKETS

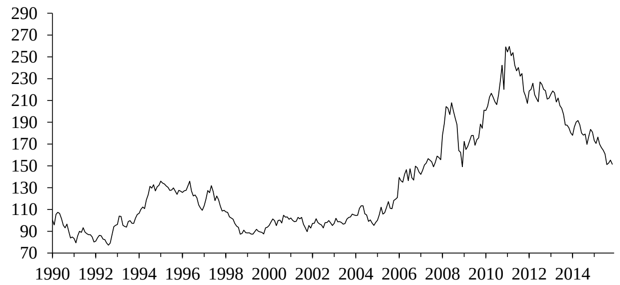
Commodity Price Index (Dollar)
(Economist, 2000=100)



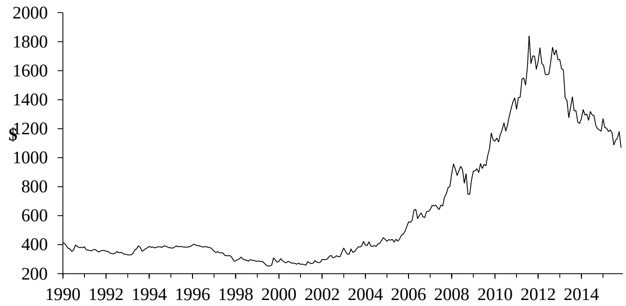
Oil Price: North Sea Brent (in Dollars)



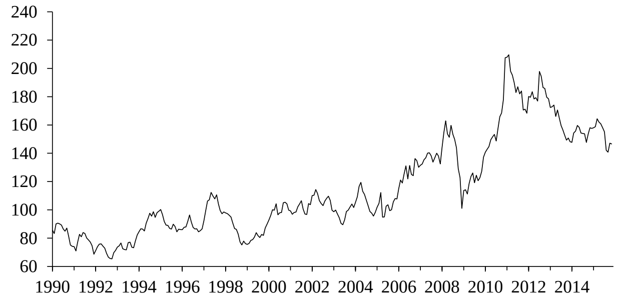
Commodity Price Index (Sterling)
(Economist, 2000=100)



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]
2013	1.9	1.3	0.6	81.6	85.6	-1.3	3.1	0.2
2014	1.6	1.8	0.6	87.1	92.0	-1.0	2.4	0.6
2015	0.1	1.8	0.6	91.1	95.6	-0.3	1.3	0.2
2016	1.0	2.2	1.0	91.9	95.8	0.0	1.9	0.5
2017	1.0	2.5	1.6	92.5	95.8	-0.4	1.9	0.4
2018	2.0	2.5	2.1	92.2	95.8	0.0	2.7	0.2
2014:1	1.7	1.8	0.6	85.7	90.6	-1.2	2.7	0.9
2014:2	1.8	1.9	0.6	87.1	91.6	-1.0	2.6	1.3
2014:3	1.6	1.9	0.6	88.2	93.0	-0.7	2.5	1.5
2014:4	1.3	1.4	0.5	87.5	92.9	-1.0	2.0	1.1
2015:1	-0.1	1.8	0.5	91.2	95.4	-0.5	1.1	1.3
2015:2	0.0	1.6	0.6	91.0	95.4	-0.4	1.2	0.9
2015:3	0.1	1.8	0.7	91.5	96.0	-0.3	1.3	0.9
2015:4	0.5	2.0	0.8	90.9	95.7	-0.2	1.6	1.0
2016:1	1.0	2.0	0.9	92.1	95.8	-0.1	1.9	1.0
2016:2	1.0	2.2	1.0	91.7	95.5	0.0	2.0	1.2
2016:3	1.0	2.3	1.1	91.9	95.8	0.1	1.9	1.3
2016:4	1.0	2.5	1.2	91.7	95.9	0.1	1.9	1.3

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)
2013	238.6	1.1	4.2	1.4	132.1
2014	241.6	1.3	3.0	1.0	131.6
2015	246.4	2.0	2.2	0.8	134.1
2016	252.6	2.5	2.0	0.7	136.1
2017	258.3	2.3	1.9	0.7	137.8
2018	266.1	3.0	1.7	0.6	139.2
2014:1	241.4	1.9	3.4	1.2	132.4
2014:2	240.4	-0.1	3.1	1.1	131.2
2014:3	241.5	1.0	2.8	1.0	131.3
2014:4	243.0	2.1	2.6	0.9	131.6
2015:1	245.3	1.6	2.3	0.8	134.6
2015:2	244.7	1.8	2.2	0.8	133.5
2015:3	246.0	1.9	2.2	0.8	133.6
2015:4	249.6	2.7	2.1	0.7	134.5
2016:1	251.4	2.5	2.1	0.7	136.6
2016:2	250.1	2.2	2.1	0.7	135.1
2016:3	252.0	2.4	2.0	0.7	135.5
2016:4	256.8	2.9	1.9	0.7	137.0

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

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

	Expenditure Index	£ Million '90 prices	Non-Durable Consumption[2]	Private Sector Gross Investment Expenditure[3]	Public Authority Expenditure[4]	Net Exports[5]	AFC
2013	149.7	716792.3	422942.6	280112.3	186839.5	-43986.8	129115.4
2014	153.9	737015.5	427963.1	304158.8	190713.6	-49433.4	136386.5
2015	158.6	759484.7	437481.6	315704.1	193150.9	-45651.0	141219.7
2016	162.6	778854.3	447600.9	324156.2	197878.0	-45648.1	145147.9
2017	166.5	797163.4	458510.3	331324.9	201835.6	-45657.5	148856.2
2018	170.4	815990.8	469801.9	338663.8	205872.3	-45677.8	152671.5
2013/12	1.7		0.8	6.9	-0.8		6.5
2014/13	2.8		1.2	9.2	2.1		6.0
2015/14	3.1		2.2	3.8	1.3		3.6
2016/15	2.5		2.3	2.7	2.5		2.8
2017/16	2.4		2.4	2.2	2.0		2.6
2018/17	2.4		2.5	2.2	2.0		2.6
2014:1	152.2	182265.5	106436.3	74892.1	48266.6	-12641.4	34688.1
2014:2	153.5	183784.4	106421.7	75257.3	46811.9	-12072.8	32633.8
2014:3	154.5	184921.4	106888.2	77659.4	47749.3	-13346.2	34029.3
2014:4	155.4	186044.2	108216.9	76350.0	47885.7	-11373.0	35035.4
2015:1	157.1	188034.4	108559.6	76029.5	49960.4	-11418.3	35098.7
2015:2	158.9	190241.3	109098.3	80658.7	47084.9	-11415.5	35194.9
2015:3	159.0	190344.1	109639.8	79601.1	47855.5	-11410.3	35342.2
2015:4	159.4	190864.9	110183.9	79414.9	48250.2	-11407.0	35584.0
2016:1	160.6	192312.5	110866.2	77636.8	51059.5	-11412.4	35838.0
2016:2	162.6	194632.4	111552.7	82466.0	48262.0	-11414.0	36241.2
2016:3	162.9	195085.9	112243.5	81553.8	49051.9	-11412.7	36353.4
2016:4	164.4	196823.5	112938.5	82499.6	49504.7	-11409.0	36715.4

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)
2013	6.0	1550.9	92.5	47.1	-65.9
2014	5.5	1614.5	88.6	51.8	-84.2
2015	5.0	1669.3	83.6	53.8	-77.5
2016	4.6	1730.9	78.7	57.0	-77.4
2017	3.2	1794.5	57.6	61.4	-77.3
2018	2.1	1874.7	38.5	64.4	-78.1
2014:1	2.7	395.7	10.6	12.4	-17.7
2014:2	7.8	396.7	31.0	12.8	-21.0
2014:3	4.9	402.8	19.6	13.0	-23.8
2014:4	7.1	408.3	29.2	13.1	-21.8
2015:1	2.1	406.7	8.7	12.9	-15.9
2015:2	8.6	413.2	35.6	13.1	-19.8
2015:3	4.3	415.7	17.7	13.4	-20.1
2015:4	8.0	420.4	33.5	13.7	-21.6
2016:1	-0.8	419.9	-3.2	13.6	-15.8
2016:2	6.9	427.5	29.5	13.9	-19.8
2016:3	5.8	430.7	25.1	14.2	-20.1
2016:4	7.2	437.9	31.4	14.5	-21.6

1 GDP at market prices (Financial Year)

WORLD FORECAST DETAIL

Growth Of Real GNP

	2011	2012	2013	2014	2015	2016
U.S.A.	1.6	2.3	2.2	2.3	3.0	3.0
U.K.	1.6	0.7	1.7	2.8	3.1	2.5
Japan	–0.4	1.7	1.6	0.3	1.2	1.7
Germany	3.6	0.4	0.1	1.4	1.7	1.8
France	2.1	0.4	0.4	0.4	0.8	1.3
Italy	0.6	–2.3	–1.9	–0.3	0.4	1.0

Real Short-Term Interest Rates

	2011	2012	2013	2014	2015	2016
U.S.A.	–1.5	–1.5	–1.5	–1.6	–1.4	–0.5
U.K.	–2.4	–1.1	–1.3	–1.0	–0.3	0.0
Japan	–0.9	–1.3	–1.6	–1.6	–1.7	–1.8
Germany	0.1	–0.7	–1.2	–1.4	–1.4	–1.8
France	0.6	0.0	–0.6	–0.9	–1.3	–1.7
Italy	0.4	0.0	–0.6	–1.0	–1.4	–1.7

Real Long-Term Interest Rates

	2011	2012	2013	2014	2015	2016
U.S.A.	0.0	–0.1	1.1	0.3	0.2	0.8
U.K.	0.2	–0.8	0.2	0.6	0.2	0.5
Japan	–0.8	–1.1	–1.3	–1.6	–1.6	–1.5
Germany	0.0	–0.3	–0.9	–1.4	–1.7	–1.4
France	0.2	–0.1	–0.7	–1.3	–1.6	–1.4
Italy	0.1	–0.2	–0.7	–1.3	–1.6	–1.4

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

	2011	2012	2013	2014	2015	2016
U.S.A.	79.8	81.6	82.1	83.0	83.2	83.0
U.K.	88.7	92.4	81.6	87.7	91.1	91.3
Japan	80.6	79.6	63.5	61.1	60.7	60.4
Germany	100.1	96.7	99.0	100.5	100.2	100.5
France	102.9	99.5	100.7	101.7	101.4	101.7
Italy	107.2	105.2	106.9	107.8	107.0	107.3

[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

	2011	2012	2013	2014	2015	2016
U.S.A.	3.1	2.1	1.5	1.7	0.5	2.0
U.K.	3.5	2.1	1.9	1.6	0.1	1.0
Japan	–0.3	0.0	0.4	2.8	1.0	1.4
Germany	2.1	2.0	1.5	1.0	0.5	1.7
France	2.1	2.0	0.9	0.6	0.2	0.1
Italy	2.8	3.0	1.2	0.2	0.2	0.6

Nominal Short-Term Interest Rates

	2011	2012	2013	2014	2015	2016
U.S.A.	0.1	0.1	0.1	0.1	0.6	1.5
U.K.	0.9	0.9	0.6	0.6	0.6	1.0
Japan	0.2	0.2	0.2	0.1	0.2	0.2
Germany	1.4	0.6	0.2	0.2	0.1	0.1
France	1.4	0.6	0.2	0.2	0.1	0.1
Italy	1.4	0.6	0.2	0.2	0.1	0.1

Nominal Long-Term Interest Rates

	2011	2012	2013	2014	2015	2016
U.S.A.	1.9	1.8	3.0	2.2	2.2	2.8
U.K.	2.0	0.9	1.3	1.8	1.8	2.2
Japan	1.0	0.8	0.7	0.3	0.4	0.5
Germany	1.8	1.5	1.0	0.5	0.3	0.6
France	1.8	1.5	1.0	0.5	0.3	0.6
Italy	1.8	1.5	1.0	0.5	0.3	0.6

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

	2011	2012	2013	2014	2015	2016
U.S.A.[1]	78.08	80.90	86.00	89.40	100.50	100.00
U.K.	1.61	1.59	1.55	1.65	1.53	1.50
Japan	79.36	80.51	98.20	106.70	120.00	120.50
Eurozone	0.71	0.78	0.75	0.76	0.90	0.91

[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