LIVERPOOL INVESTMENT LETTER

February 2014

Cardiff Business School
Cardiff University

Julian Hodge Institute of Applied Macroeconomics

LIVERPOOL RESEARCH GROUP IN MACROECONOMICS

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Editorial and Research Direction: Patrick Minford[†].

Senior Research Associates: Kent Matthews[†], Anupam Rastogi, Peter Stoney, Bruce Webb[†], John Wilmot.

Research Associates: Vo Phuong Mai Le[†], David Meenagh[†], Francesco Perugini.

[†] Cardiff Business School

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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THE UK RECOVERY

Commentators have gone seamlessly from gloom about the UK's prospects to breathless wonder at the UK as 'fastest grower in the West'. Yet the truth is that the ONS numbers were always misleadingly weak and inconsistent with what we were seeing in the industrial surveys of purchasers and so on. Nor is the 'productivity puzzle' at all convincing when the GDP numbers remain quite suspect.

The story of the last five years is of three sharp contractions: in North Sea oil, in banking and in construction. There has also been a general contraction in real disposable income as world commodity price surges took a big bite out of UK real income — around 6%. However in spite of all this the service sector still managed reasonable growth. The North Sea story is one of the UK government's greed and mismanagement of a natural resource; now HMG is talking turkey to the industry again and one hopes it will not again turn round and play extortioner. The banking story is one of regulative excess after regulative nonchalance; now we have the Treasury engineering backtracking schemes to subsidise lending, offsetting its own regulative mania. This has had some success and at least mortgage lending is growing again much more convincingly; SMEs are still out in the cold but it may well be that peer-to-peer lending will increasingly come to the rescue. As for construction, the ONS figures were badly over-pessimistic; probably much unreported construction activity has substituted for the headline losses of work (public sector contracts get done much faster in recessions). Now the surge in housing activity has restored the industry to growth. Finally, the big cut in real disposable incomes is coming to a halt and gently being reversed, by rising employment if not yet by real wage rises.

So growth is now occurring, in the 2–3% range. If the eurozone were to recover in 2014 this would add to UK export growth. If businesses would start investing more strongly that too would push growth up and we could see it surge above 3%.

Internationally, we are seeing troubles in China as it grapples with massive over-capacity (funded by bank loans that are now turning sour); this will reduce China's growth, at least to 7% and possibly below that. The government wants to liberalise finance and is loath to bail out these bad loans. However, the chances are there will be bail outs as future lending policy is tightened.

The other element causing turbulence is the reduction in the US central bank's money printing programme. In the absence of strong growth in the US this money was being channelled into emerging market equities to a large extent. They are now suffering if they were big recipients; as it happens many were not, so that there is not an 'emerging market crisis'. Rather some exposed countries like Brazil and South Africa are suffering while others ride out the storm.

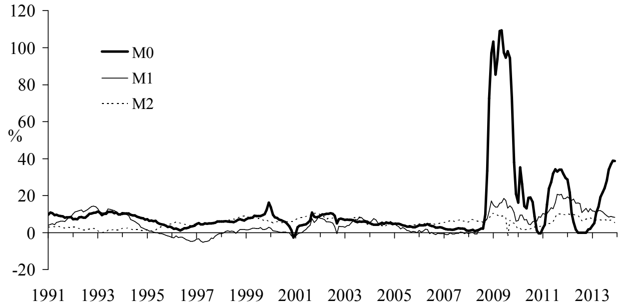
The good news for western economies is that the commodity price peak is well and truly over. Non-oil commodities are well (some 30%) below their peaks. Oil prices are still around the $100 a barrel mark; but look vulnerable to progress on fracking and US rapprochement with Iran. It looks as if we are going into the commodity cheap phase that occurred in the 1950s and the 1980s and then encouraged the early leg of the long world upswings of 1949–74 and 1982–2007. The upswing will be further strengthened by new technological progress in such things as making transport more fuel-efficient and materials stronger. We could therefore well be on the verge of another long upswing from 2014.

Table 1: Summary of Forecast

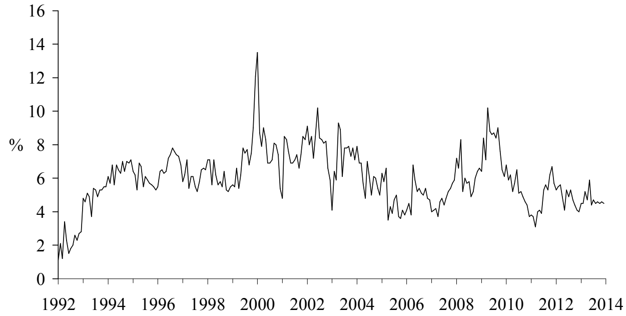
		2010	2011	2012	2013	2014	2015	2016
GDP Growth[1]		1.7	1.1	0.2	1.4	2.6	2.4	2.6
Inflation	CPI	3.3	4.5	2.7	2.4	2.5	2.2	2.0
	RPIX	4.8	5.3	3.2	3.2	3.1	2.8	2.7
Unemployment (Mill.)								
	Ann. Avg.[2]	1.5	1.5	1.6	1.5	1.3	1.3	1.2
	4th Qtr.	1.5	1.6	1.6	1.4	1.3	1.3	1.1
Exchange Rate[3]		80.4	80.0	83.1	82.6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

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

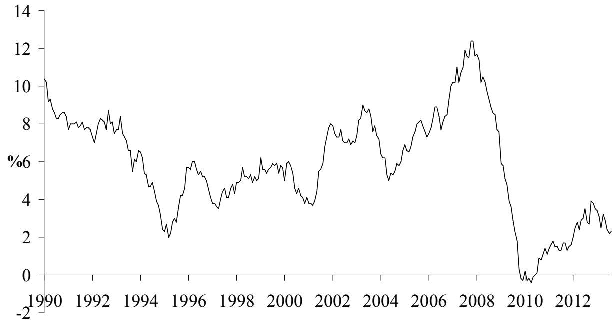
U.S.: Growth in Monetary Aggregates (Yr - on - Yr)



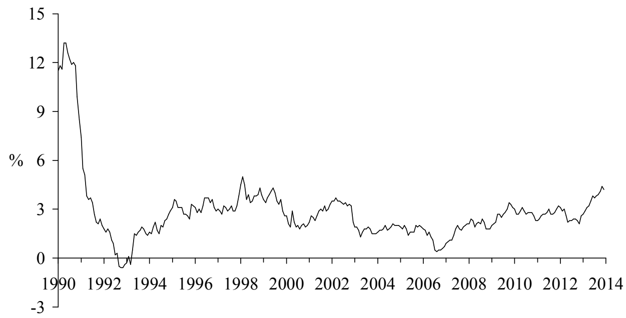
UK: Notes and Coins in Circulation Growth



Eurozone M3 Growth



Japan: Growth of M2+CD's



FOCUS ON JAPAN

Francesco Perugini

Trade Deficit Keeps Widening

There is economic news this month that is worth underlining. It is about foreign trade: for the third straight year in 2013 Japan imported more products than it exported. The country's trade deficit grew to a record almost ¥11.5 trillion (2.4% of GDP), ¥4.5 trillion larger than in 2012, according to the Ministry of Finance (MOF) latest data. The deterioration is largely related to the sharp depreciation of the yen which helped exporters to regain competitiveness, but on the other hand burdened the country's energy bill.

Nuclear reactor shutdowns have driven fuel imports higher, contributing more than ¥2.8 trillion yen to the deterioration. The economic recovery has boosted consumer demand for imported products as well. Clothing imports swelled 21.1%, while those for smart phones and other telecommunications equipment rose 24.6%.

Domestic demand fuelled by government spending has concealed the slump in exports. Global exports in 2013 reflect changes in Japanese companies' standing as well as world trends. Japan logged an electrical equipment trade surplus of ¥1.7 trillion, down ¥1.2 trillion, as waning competitiveness spurred a shift to overseas production. Meanwhile, Japan grew even more dependent on vehicle exports as the auto trade surplus climbed ¥1 trillion to ¥9.3 trillion. Emerging markets are playing less of a role. Exports to the US, particularly vehicles, have soared thanks to a stronger economy and softer yen. US-bound exports totalled ¥12.9 trillion, topping shipments to China, which reached ¥12.6 trillion, for the first time in five years.

At the same time the yen has lost about a quarter of its value against the US dollar since late 2012 owing to the policy pushed forward by Prime Minister Shinzo Abe that meshes government spending with a programme of central bank monetary easing. But while the weaker yen has boosted the bottom line at exporters such as Sony and Toyota, most have not slashed overseas prices to boost demand. When compared to past currency movements, the decline in export prices has so far lagged the downward trend in the yen's value. The yen rate of decline is almost double the yen's weakening in the 2000–2002 and the 2005–2007 periods. Export prices in the importer's currencies have generally declined by around 2% this time. In the 2000–2002 period, they dropped as much as 6%, and in the 2005–2007 period 3.3%.

There are reasons other than the slow pace of price declines for sluggish exports. "When the yen has weakened in the past, exports have basically been boosted by the strong US economy", said Masayuki Kichikawa, chief Japan economist at Merrill Lynch. "Things are different this time because the currency's movement was led by the Bank of Japan's monetary easing". The US economy is only recovering slowly. Demand is also weak in emerging countries. They are preparing for an outflow of funds as the US Federal Reserve slows down the pace of its quantitative easing.

Another problem is deindustrialization in Japan. As companies have shifted operations overseas, potential export volume is lower than in the past. According to an estimate by the Itochu Economic Research Institute, an estimated 76.8% of Japanese corporate operations are carried out domestically, down about 10 percentage points from a decade ago. "There is a strong tendency to focus on increasing sales through overseas production rather than export from Japan", said Yoshimasa Maruyama, chief economist at the Itochu Economic Research Institute.

"The weak yen's ability to boost the domestic economy is not the same as before", said Shunsuke Kobayashi, an economist at Daiwa Institute of Research. Reflecting the expansion in overseas investment, royalties such as dividends and patent payments received from local subsidiaries are increasing. According to MOF statistics, "other non-operating income" and "interest received, etc." at large manufacturing companies is expected to exceed ¥9 trillion in fiscal 2013, 20% since fiscal 2008. The figure is at its highest level for the past 20 years. Balance of payments statistics also indicate a similar trend. The surplus on the foreign income balance, which shows profits such as dividends obtained from overseas investment, from January through November last year was ¥15.6 trillion, up 15% compared to the same period a year before. However, the trade deficit has also been ballooning because of the increase in fuel import costs. Net foreign income surpluses are no longer able to cover the trade deficit.

Many private-sector research groups expect the deficit to contract from 2014 on as the spring consumption tax hike cools consumer demand, pushing down imports. Exports may also rise gradually if the yen stays around 100 to the US dollar. "We will return to a trade surplus around 2016", said Junichi Makino at SMBC Nikko Securities. But beyond car shipments to the US, few other potential export drivers exist. As long as Japan lacks innovative products to export, regaining its status as an export juggernaut could prove difficult. Higher corporate earnings, thanks to a competitive edge sharpened by a soft yen, have lifted Japan's economy. But a continued trade deficit may cause side effects, such as higher priced imports.

MARKET DEVELOPMENTS

Some emerging equity markets have been routed by the 'tapering' of the Fed's QE programme. However there is no general emerging market crisis. With world growth now looking well founded on the basis of reviving commodity plenty it is still right to stay invested in a good spread of world equities.

Table 1: Market Developments

	Market Levels		Prediction for Jan/Feb 2014	
	Jan 6	Jan 30	Previous Letter	Current View
Share Indices				
UK (FT 100)	6731	6538	10029	9808
US (S&P 500)	1827	1794	2535	2311
Germany (DAX 30)	9428	9373	13435	13357
Japan (Tokyo New)	1292	1224	1804	1721
Bond Yields (government long-term)				
UK	2.98	2.75	2.00	2.00
US	2.96	2.69	2.10	2.10
Germany	1.91	1.72	1.50	1.50
Japan	0.73	0.62	0.70	0.70
UK Index Linked	0.55	–0.01	0.10	0.10
Exchange Rates				
UK ($ per £)	1.64	1.65	1.56	1.56
UK (trade weighted)	85.0	85.9	82.3	82.3
US (trade weighted)	87.1	87.8	85.5	85.5
Euro per $	0.73	0.74	0.79	0.79
Euro per £	1.20	1.22	1.23	1.23
Japan (Yen per $)	105.0	103.0	98.0	98.0
Short Term Interest Rates (3-month deposits)				
UK	0.58	0.52	2.10	2.10
US	0.26	0.33	0.70	0.70
Euro	0.25	0.36	0.50	0.50
Japan	0.09	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	2.6	2.4	45.00		53.40
US	1.90	2.8	2.0	24.00	5.45	36.15
Germany	2.80	1.5	2.0	39.00	–1.34	43.96
Japan	1.90	1.6	2.0	37.00	10.04	52.54
UK indexed[2]	–0.01		2.4	–6.00		–3.61
Hong Kong[3]	2.60	7.0	2.0	7.00	5.45	24.05
Malaysia	3.00	5.2	2.0	52.00	5.45	67.65
Singapore	3.80	4.0	2.0	34.00	5.45	49.25
India	1.60	7.0	2.0	23.00	5.45	39.05
Korea	1.20	3.6	2.0	–5.00	5.45	7.25
Indonesia	2.60	5.5	2.0	39.00	5.45	54.55
Taiwan	2.60	2.7	2.0	21.00	5.45	33.75
Thailand	3.70	4.2	2.0	44.00	5.45	59.35

Bonds: Contribution to £ yield of:

	Redemption Yield	Changing Nominal Rates	Currency	Total
UK	2.75	7.50		10.25
US	2.69	5.90	5.45	14.04
Germany	1.72	2.20	–1.34	2.58
Japan	0.62	–0.80	10.04	9.86

Deposits: Contribution to £ yield of:

	Deposit Yield	Currency	Total
UK	0.52		0.52
US	0.33	5.45	5.78
Euro	0.36	–1.34	–0.98
Japan	0.10	10.04	10.14

[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

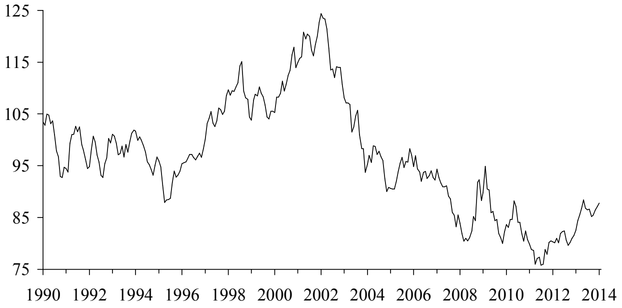
[3] Output based on China.

Table 3: Portfolio(%)

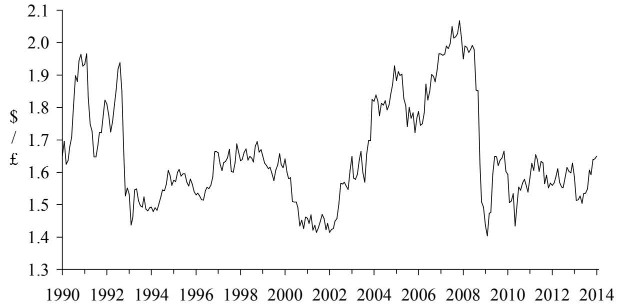
	Sterling Based Investor		Dollar Based Investor		Euro Based Investor	
	January Letter	Current View	January Letter	Current View	January Letter	Current View
UK Deposits (Cash)	5	5	5	5	1	1
US Deposits	-	-	-	-	-	-
Euro Deposits	-	-	-	-	-	-
Japanese Deposits	-	-	-	-	-	-
UK Bonds	-	-	-	-	-	-
US Bonds	-	-	-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

INDICATORS AND MARKET ANALYSIS
FOREIGN EXCHANGE MARKETS

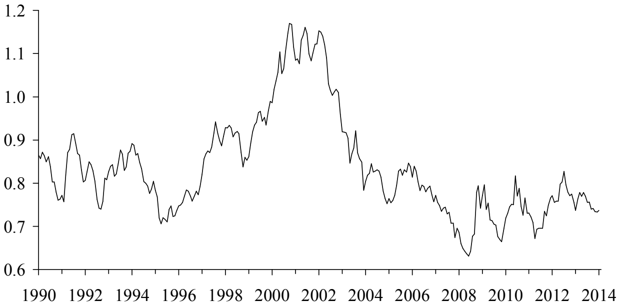
US : Trade Weighted Index
(Bank of England 1990 = 100)



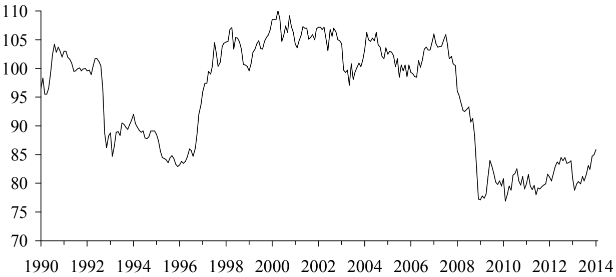
UK: Dollars Per Pound Sterling



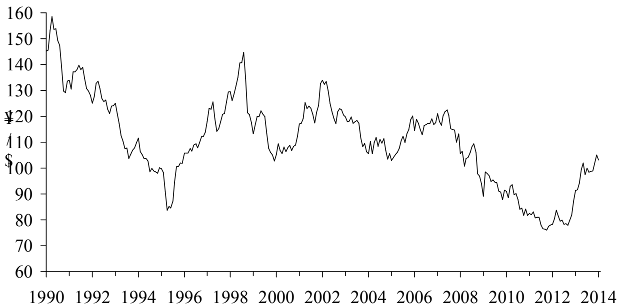
Euro per US dollar



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



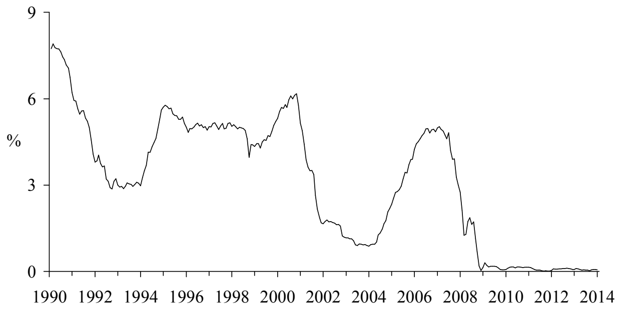
Japan : Yen Per U.S. Dollar



GOVERNMENT BOND MARKETS

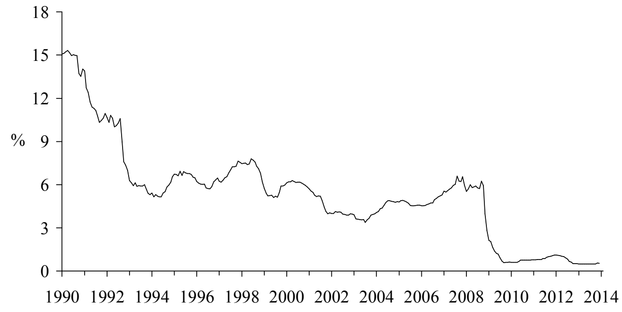
U.S.: Yield on Long-Term Government Bonds

U.S. : 3-Month Treasury Bill



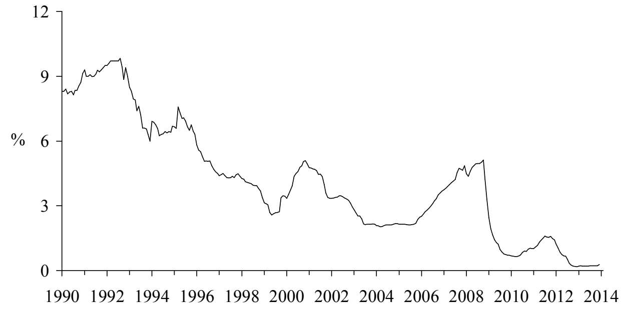
U.K. : Yield on Long-Term Government Bonds

U.K. : 3-Month Interbank Rate



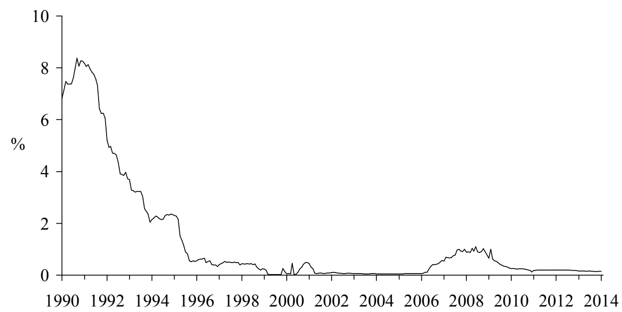
Germany: Yield on Public Authority Bonds

Germany : 3-Month Interbank Deposit Rate

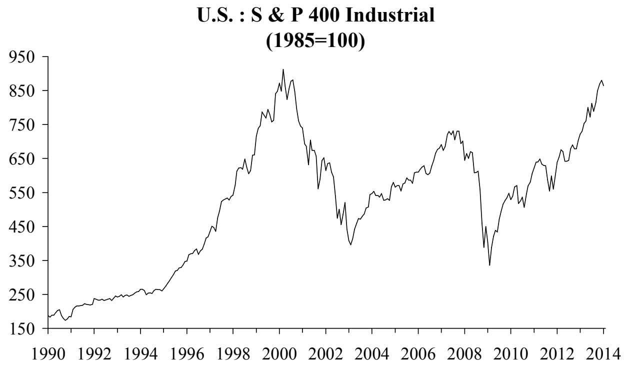


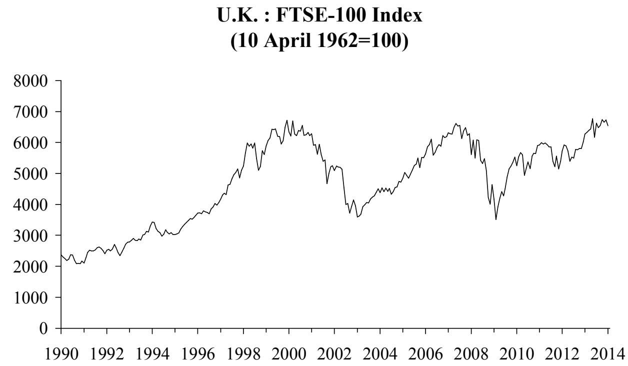
Japan: Yield on Long-Term Government Bonds

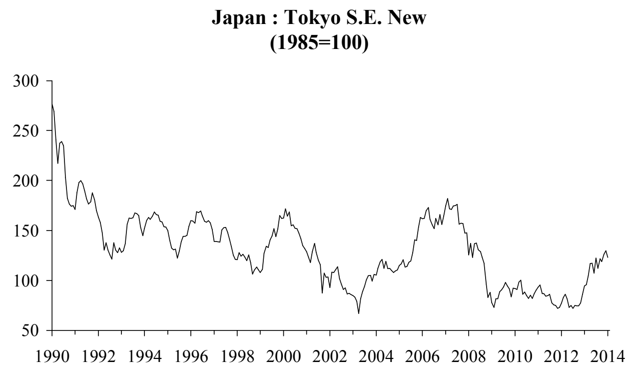
Japan : 3 Month Money Market Rate



MAJOR EQUITY MARKETS







EMERGING MARKETS

Anupam Rasogi

India

As expected, India was not the flavour of the month at Davos. Investors are focused on India's coming economic data and the outcome of May's national elections. The stock market has already priced-in that the next government is likely to be led by BJP and, thus, by the BJP nominated prime minister candidate Narendra Modi. That is why the stock market is touching all time highs despite bad news.

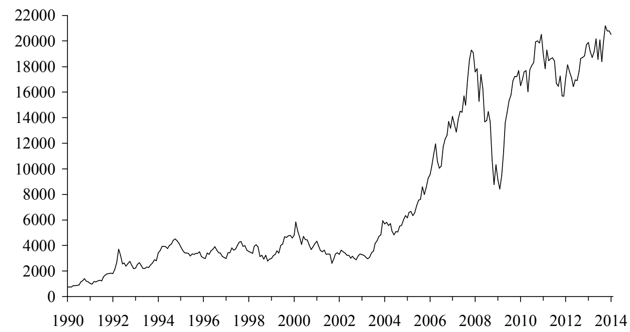
The manufacturing sector contracted 3.5% during the month of December. WPI inflation came in at 6.16% year on year for December compared to 7.5% in November. Credit-ratings company Standard & Poor's said in November that it would wait for the new government to unveil plans for boosting growth and curbing spending, before deciding whether to lower India's rating, now just one notch above speculative-grade.

While the Indian currency was one of the worst performers last summer, when global investors dumped emerging market assets, the rupee has been relatively robust in the latest round of dumping of developing world assets. The Indian rupee has remained strong due to deft handling of the domestic economy and external sector. India's central bank raised interest rates, restricted gold imports and lured funds by subsidising banks' cost of raising dollars funds from non-resident Indians. Investors say India has taken more action than other emerging economies, evidence that the country is paying attention and is willing to address their concerns.

India's efforts to bring down its current account deficit appear to be paying dividends in the form of increased confidence about Asia's third largest economy. The rupee has weakened by around 2% against the U.S. dollar in the last three months, a sharp contrast from the nearly 26% fall in the Argentine peso and an as much as 13% decline in the Turkish lira.

To bolster confidence in the economy, contrary to the market expectations of status quo, the Reserve Bank of India raised the repo rate by 25 basis points in its third quarter review of monetary policy. This rate now stands at 8%. The Cash Reserve Ratio (share of deposits banks have to park with the RBI) is still at 4%. The central bank has cut the growth forecast to less than 5% for 2013–14. But the elevated inflationary levels remain a daunting challenge. The rupee rose 1% against the dollar on the rate move and remains far above its weakest levels from last August. Mr Rajan says he is more interested in seeing the

India: BSE Sensitive



rate increase stabilise the rupee's internal value. Despite some encouraging signs, inflation (consumer price) is still hovering at around 10%.

Although this was not widely expected, it reflects the shift in inflation rate benchmark to CPI inflation from WPI and suggests the acceptance of the monetary policy committee recommendation. Under the new framework the central bank would be establishing a target for consumer-price inflation. The committee has suggested a 4% target with a band of ±2% around it. The RBI previously targeted "multiple indicators" — a jumble of inflation, growth, financial stability and exchange rates that confused investors about the bank's intentions. But this implies that interest rates will remain high, as the RBI seeks to gradually curb the inflation rate which is way above the target band.

The central bank governor Raghuram Rajan has predicted that India's current account deficit will almost halve this fiscal year to under $50 billion, or around 2.5% of gross domestic product, down from about $88 billion, or 4.8% of gross domestic product, last year. As a result, the rupee remains one of favoured high-yielding currencies for investors.

The renewed confidence in India's monetary policy has enticed global investors back into India's bond and currency markets, spurred by a shrinking trade deficit and the central bank's efforts to bolster Asia's third-biggest economy. Money managers have bought a net $3.2 billion of Indian debt in the first three weeks of this year, after yanking out a net $8.7 billion last year. Those heavy inflows have pushed up bonds, sending yields (which move inversely to prices) on the 10-year notes to the lowest in three months. The rupee has been steady against the dollar this year, beating out most other emerging-market currencies, which have been falling.

India's upstart Aam Aadmi party, the champion of the "common man", propelled unexpectedly into power in Delhi State, could upset the anticipated formation of a new government under BJP. But many of its supporters find themselves dismayed by the party's leftist economic policies, which they say are either incoherent or hostile to the free market. The markets believe that they will vote for BJP as it would be able to provide a stable, right of centre government.

	11-12	12-13	13-14	14-15	15-16
GDP (%p.a.)	6.2	5.0	5.0	6.5	7.0
WPI (%p.a.)	7.5	7.0	6.5	6.0	6.0
Current A/c(US$ bill.)	-40.0	-88.0	-50.0	-50.0	-50.0
Rs./$(nom.)	49.5	54.5	62.0	64.0	65.0

China

Lunar New Year week long holidays started on January 31 and presented global markets with something to digest. As usual, the first quarter will be a bit bumpy.

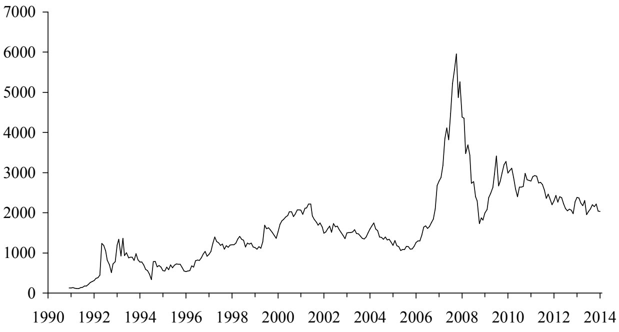
China's gross domestic product grew 7.7% in 2013, matching 2012's rate. The second half of the year brought reassurance that the world's second-largest economy had avoided a hard landing. We expect economic growth to remain flat around 7.5% in 2014. Premier Li Keqiang is scheduled to announce the 2014 growth target at the National People's Congress in March. Recently, he indicated that 7.2% growth would be sufficient to ensure employment, setting off speculation that he might be getting ready to unveil a lower target, possibly of 7%.

Fears of a slowdown in China resurfaced in the last week of January after the first estimate of January's HSBC–Markit purchasing manager survey on the manufacturing sector indicated a contraction in activity. HSBC Purchasing Managers' Index — released by HSBC Holdings PLC and financial data provider Markit — slipped to 49.6 in January from 50.5 in December, the first time below 50 in six months. A figure below 50 signals a contraction, while a figure above that level indicates growth.

China aims to rebalance its economy amidst the apprehension of rising capital costs and slowing investment as monetary conditions tighten. China's manufacturing sector faces still-sluggish demand from traditional markets such as the U.S. and Europe because appreciation of the yuan and rising labour costs have made its products less competitive overseas.

Over the long term, China is seeking to rely less on exports and investment in big projects such as highways and property developments, and more on consumer activity. But a slowdown in manufacturing could hurt the government's goal of sustaining employment. Chinese exporters would feel the pressure this year as the yuan continues to appreciate. The World Bank expects world

China: SSE Composite Index



trade to grow 4.6% this year, compared to a 3.1% increase in 2013, and this may cheer up Chinese exporters.

Exports grew 7.9% in 2013 compared with the year-ago period. The total value of China's imports and exports in 2013 was $4.16 trillion, a 7.6% increase from a year earlier on a renminbi-adjusted basis, according to the Chinese government, compared to $3.57 trillion in the 11 months from January to November 2013 of the US. China is poised to become the world's largest trader in 2014.

There has also been an enormous shift in the kinds of things China exports — from textiles, apparel and oil products to high-tech machinery and electronics. For the full year, exports totalled $2.21 trillion, an increase of 7.9% on a renminbi-adjusted basis. Imports rose 7.3% from a year earlier to reach $1.95 trillion in 2013. The country's trade surplus widened 12.8% to $260 billion as exports to its largest traditional markets in the US and Europe recovered.

Global investors poured more money into China last year, signalling optimism in the prospects of the world's No. 2 economy despite slowing growth. According to the People's Bank of China, the country recorded its fifth straight month of capital inflows in December, reflecting a strong trade surplus and rising foreign investment. For the year, China's central bank and financial institutions bought a total of 2.84 trillion yuan of foreign currency, compared with 650 billion yuan in 2012.

The yuan rose 2.9% against the dollar last year despite the central bank's controls on the exchange rate. The PBOC allows the yuan to move 1% above or below a daily reference exchange rate it sets against the dollar each day. The daily trading limit could go up to 2% this year. China's central bank accumulated foreign-exchange reserves of $3.82 trillion by the end of 2013, up from $3.66 trillion at the end of September. We expect China's foreign-exchange reserves to reach $4 trillion by the end of this year which would continue to put pressure on the yuan to appreciate amid the strong capital inflows. Foreign exchange inflows also reflect inflows of speculative funds, or hot money.

China's shadow banking is coming to haunt it again. One of the country's biggest and most profitable banks, notably the Industrial and Commercial Bank of China (ICBC) had been marketing a US$500 million trust called Credit Equals Gold. The trust was issued by China Credit Trust Company and offered a return of 10% to investors. The fund would have collapsed by the end of the month on account of loan given to a troubled coal mining company which has gone bankrupt if a bailout package had not been offered to investors.

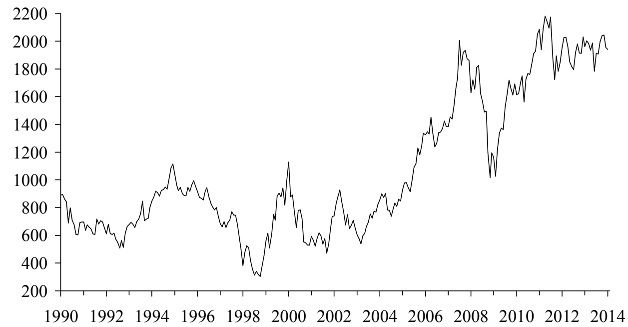
Shadow banking activities in China have been rising in recent times. Although no one knows the exact size of this activity, it is estimated that the shadow banking sector accounts for roughly 60% of China's GDP. The popularity of this sector has been rising on account of higher returns offered to investors.

A few investment analysts are warning that the big story of 2014 in the emerging world is the black cloud of debt hanging over China. The billionaire hedge fund manager George Soros reckons that China's giant banks and their shadow banking activities are wildly under estimated. According to Ruchir Sharma of Morgan Stanley, the most reliable signal of a looming financial crisis is the "credit gap", or the increase in private sector credit as a proportion of economic output over the most recent five-year period. He says that Thailand, Malaysia, Chile, Zimbabwe and Latvia, before their financial crises, had a gap higher than 60 points. All those binges ended in a severe credit crisis. If China follows that path, its growth rate over the next five years would average between 4% and 5%.

The popularity of China's renminbi surged last December, consolidating the currency's meteoric rise past 22 others over the past three years to rank as the eighth-most used money for payments in the world. Several factors — including renminbi appreciation, China's ballooning trade volumes and the Chinese currency's increasing attractiveness as a conduit for portfolio investments — contributed to an upsurge in usage that SWIFT, the payments company, put at 15% between November and December last year. Some 74% of renminbi payments are concentrated in Hong Kong, according to SWIFT, but the UK, Singapore and Taiwan are also seeing strong growth in renminbi settlement.

President Xi Jinping will head a new National Security Commission that will tighten his control of the military, domestic security and foreign policy, and attempt to enhance coordination over sometimes competing bureaucracies.

Korea: Composite Index



	11	12	13	14	15
GDP (%p.a.)	9.2	7.7	7.7	7.5	7.0
Inflation (%p.a.)	4.3	2.6	3.5	3.0	2.5
Trade Balance(US$ bill.)	210	214	220	220	200
Rmb/$(nom.)	6.3	6.3	6.2	6.1	6.0

South Korea

South Korea's economic growth slowed marginally to 0.9% in the final quarter of 2013 compared to 1.1% in the third quarter of 2013, but a strong rebound in exports and improving domestic demand point to a recovery in Asia's fourth-largest economy this year.

For the whole of 2013 the economy expanded 2.8%. The Bank of Korea expects the economy to pick up through this year, especially on the back of an international recovery, forecasting growth of 3.8% for 2014 and 4% for 2015. South Korea's industrial output in December grew at its quickest pace in more than four years.

The current account surplus doubled last month to a record, on the back of reviving exports. The Bank of Korea said the seasonally adjusted current account surplus nearly doubled to a record $8.07 billion in December from November, with the full-year surplus jumping 47% to a record $70.73 billion. In 2013, exports — accounting for more than half the GDP — increased by a revised 2.1% after a 1.3% drop in 2012.

The won rose steadily in the final three months of last year to its strongest level since the second quarter of 2008, raising alarm from authorities and exporters. South Korea's central bank governor is concerned about further depreciation of the Japanese yen but he ruled out a competitive devaluation of the Korean won. The won's 17% rise against the yen since June has come as Tokyo has sought to weaken its currency to help kick-start the Japanese economy. But the record current account surplus suggests that its adverse impact on many exporters would not be as severe as feared due to the increasing demand for Korean products from key export markets.

The BOK kept its policy rate steady at 2.5% for an eighth consecutive month in January, citing uncertainty over a possible U.S. Federal Reserve exit from its stimulus program and slower growth in emerging markets and volatile capital flows.

The currency decline is spilling over into the stock market. South Korea's benchmark index has declined in part because of fears that the won's strength will hurt corporate profits.

South Korean President Park Geun-hye visited India in January. Korea is pushing hard to get more nuclear-power contracts abroad and President Park, has vowed to support local companies' exports of nuclear plants and equipment as part of efforts to boost the economy further. India and South Korea, two of Asia's biggest economies, struck a civilian nuclear agreement in 2011 and now Seoul is exploring possibilities for a nuclear project.

	11	**12**	**13**	**14**	**15**
GDP (%p.a.)	3.6	2.0	2.8	3.8	4.0
Inflation (%p.a.)	4.0	2.2	1.3	2.3	2.7
Current A/c(US$ bill.)	27.0	44.0	71.0	80.0	80.0
Won/$(nom.)	1100	1100	1100	1080	1060

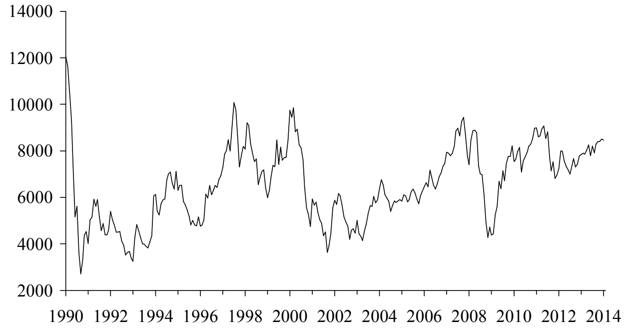
Taiwan

Taiwan's economy expanded at a faster-than-estimated pace in the fourth quarter of 2013, as a recovery in Europe and the U.S. boosted the island's exports. Gross domestic product rose 2.92% from a year earlier after increasing 1.66% in the third quarter. Taiwan's finance ministry last week revised its exports figures for the fourth quarter and full year to reflect missing data, showing sales climbing 1.4% in 2013 after shrinking 2.3% the previous year. But Taiwan is worried about the sharp depreciation of the yen, because Taiwan faces direct competition from Japan in the machine tool export market.

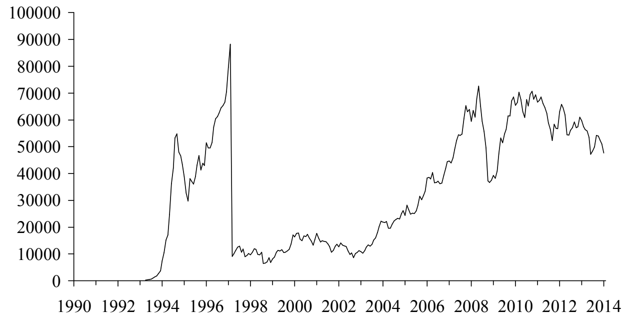
Taiwan had a trade surplus of US$116 billion with China in 2013, up by an annual 21.6%. Taiwan imported US$40.64 billion worth of products from China in 2013, up 10.5%.

Taiwan's dollar declined 0.3% to NT$30.511 against the US dollar, which is the weakest level since October 2011. The Taiwan dollar has weakened by about 2% this year. The central bank held the benchmark interest rate for a 10th straight meeting in December, the longest period of inaction according to its data going back to 1980. The monetary authority has said it would maintain order if excessive volatility endangers financial stability, after the Federal Reserve said it would reduce its monthly bond purchases.

Taiwan: Weighted TAIEX Price Index



Brazil: Bovespa



	11	**12**	**13**	**14**	**15**
GDP (%p.a.)	4.0	1.3	2.0	2.5	2.7
Inflation (%p.a.)	1.2	1.9	0.6	1.0	1.0
Current A/c(US$ bill.)	18.0	20.0	22.0	23.0	24.0
NT$/$(nom.)	30.0	29.5	30.0	30.5	30.5

Brazil

Brazil's economy is poised for acceleration from recent disappointing growth rates amid a still gradual global recovery, said the Finance Minister Guido Mantega. We expect Brazil's economy to grow about 2% in 2013 and 2014, compared to 1% in 2012. With commodity prices on decline, prospects for the economy are not bright. Moreover, windfall gains obtained by the government from the commodity boomed has been spent on welfare schemes and encouraging consumption based on credit. Brazil posted a decline in auto sales in 2013, as a sluggish economy eroded consumer demand and the effect of extended tax breaks wore off. Not surprisingly, the business confidence index measured of Brazil's National Industry Confederation, or CNI, has tumbled down to 54 points now from almost 70 in 2010.

Consumer prices rose 5.91% in 2013, up from the 5.84% gain registered in 2012. Brazil introduced inflation-targeting in 1999, the central bank has met the target of 4.5% just four times.

Brazil has raised its benchmark interest rate for the seventh straight time in a bold move to contain the country's highest inflation in over a decade.

The central bank raised the Selic rate by 50 basis points to 10.5% extending the world's most aggressive tightening cycle. It has raised interest rates by 325 basis points over the past nine months.

Finance Minister Guido Mantega said in Davos, Switzerland, that the country had taken measures to fortify the domestic demand and was preparing to attract growing investment from abroad as global conditions improve. He said that recent actions to stimulate investment including infrastructure concession auctions and tax breaks would help boost the country's investment rate from below 20% of gross domestic product to around 24% in coming years.

Brazil registered a trade surplus of $2.65 billion in December compared with a $1.74 billion surplus recorded in November. For all of 2013, Brazil squeezed out a trade surplus of $2.56 billion compared to $19.4 billion surplus registered in 2012. Brazil's exports of important commodities such as iron ore and soy were undercut by record harvests and falling prices for the products. The country also imported heavy volumes of crude oil, gasoline and diesel fuel throughout 2013 to meet growing domestic demand that state-run energy giant Petro Bras was unable to meet because of declining oil production and a refining shortfall.

Brazil's real, which has had to deal with slowing exports to China, fell 3.1% in the last week of January to R$2.415 as the devaluation of the Argentinian peso hit the market. Brazil's central bank, which has been intervening to stem currency depreciation in a way similar to Argentina, had come in for extra scrutiny. Alexandre Tombini, Brazil's central bank governor, said in Davos that the "vacuum cleaner" of rising interest rates in the developed world would suck money out of emerging markets and force other central banks to tighten policy to beat inflation. He added that Brazil was ahead of the curve. Brazilian currency depreciated about 15% in 2013. The Brazilian response has been very classic — tightening policy, using foreign reserves as buffers. Brazil used its $360 billion of foreign reserves to smoothen exchange rate volatility. The governor has tried to calm the market by disclosing that foreign direct investment covers 79% of the trade deficit and the economy is rebalancing towards investment and away from consumption.

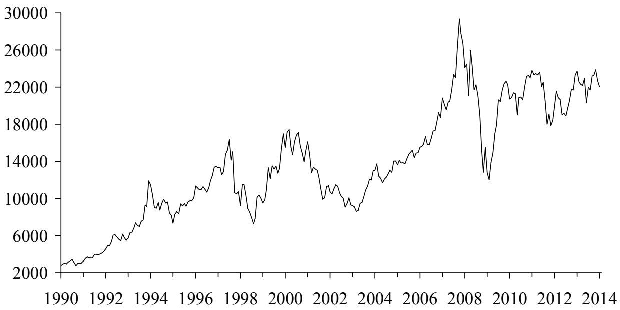
Standard & Poor's Ratings Services in June changed its outlook for Brazil to negative from stable, while Moody's changed it to stable from positive back in September. Another firm, Fitch Ratings, has had a stable outlook for Brazil since 2011.

Dilma Rousseff went to Davos, Switzerland, for the first time as Brazil's president and delivered a plea for foreign investment, underscoring the urgency of finding antidotes for its sluggish economy. She promised a lot but did not impress investors as she is unlikely to change her social agenda even though she reaffirmed her country's commitment to economic fundamentals like a free-floating currency and fiscal stability, and promised Brazil would become more competitive. Prior to 2014 Davos meeting she used to attend the World Social Forum. She went to visit Cuba on her way to Brazil from Davos. She vowed the country would be ready to host soccer's 2014 World Cup — even though stadium construction had faced delays.

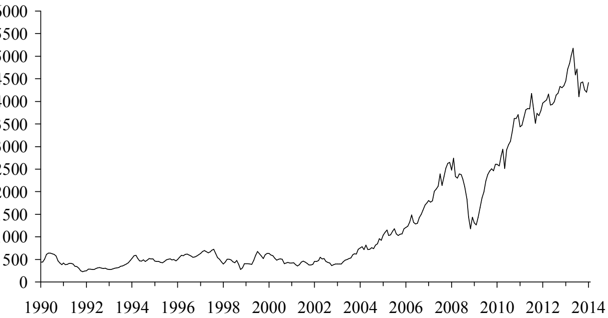
	11	**12**	**13**	**14**	**15**
GDP (%p.a.)	2.7	0.9	2.0	2.0	3.0
Inflation (%p.a.)	6.5	5.8	5.9	6.0	6.0
Current A/c(US$ bill.)	-52.6	-60.0	-75.0	-70.0	-70.0
Real/$(nom.)	1.5	2.0	2.3	2.4	2.4

Other Emerging Markets

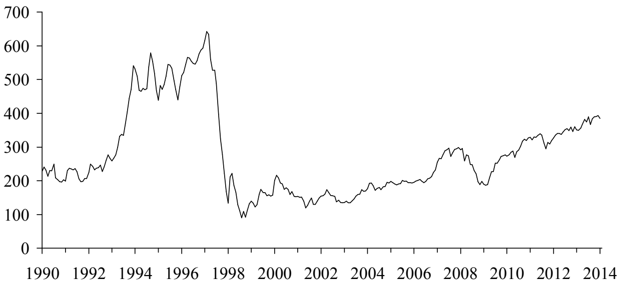
Hong Kong: FT-Actuaries



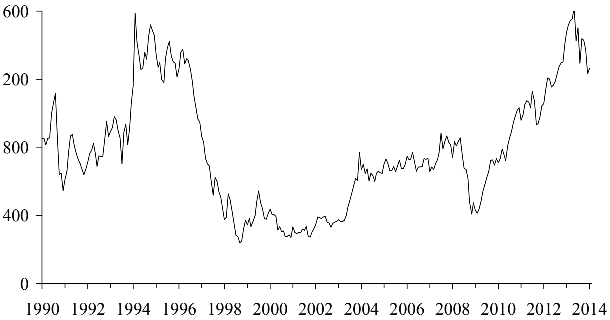
Indonesia: Jakarta Composite



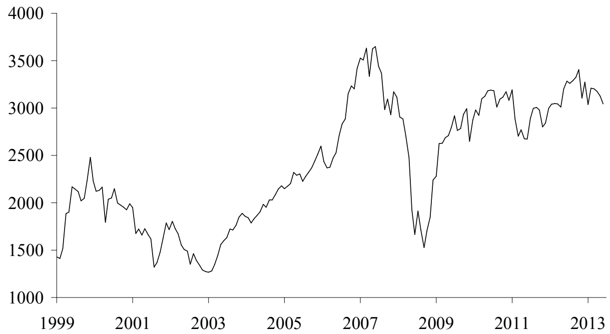
Malaysia: FT-Actuaries
(US$ Index)



Thailand: Composite Index



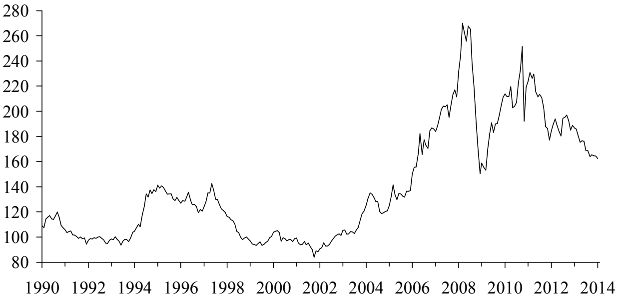
Singapore: Straits Times Index



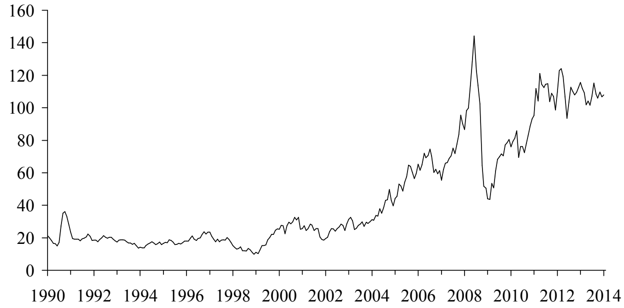
Philippines: Manila Composite

COMMODITY MARKETS

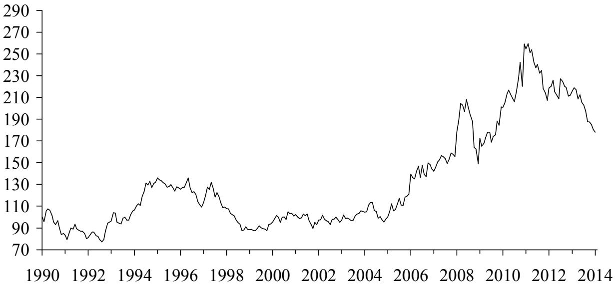
Commodity Price Index (Dollar)
(Economist, 2000=100)



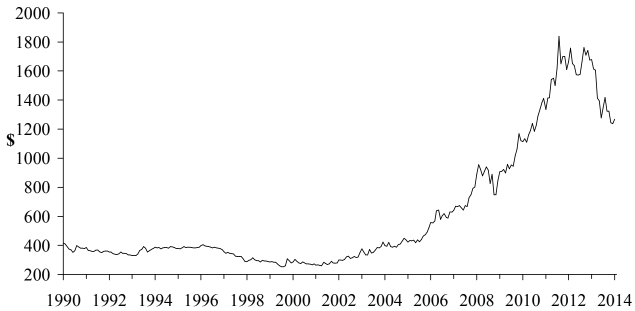
Oil Price: North Sea Brent (in Dollars)



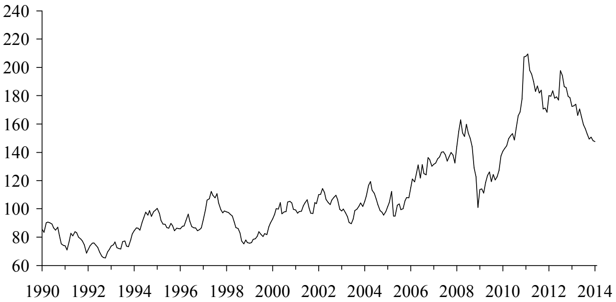
Commodity Price Index (Sterling)
(Economist, 2000=100)



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

1 Consumer's Expenditure Deflator
2 Sterling Effective Exchange Rate Bank of England
3 Ratio of UK to other OECD consumer prices adjusted for nominal exchange rate
4 Treasury Bill Rate less one year forecast of inflation
5 Short Dated 5 Year Interest Rate less average of predicted 5 year ahead inflation rate

Labour Market and Supply Factors (Seasonally Adjusted)

	Average Earnings (1990=100)[1]	Wage Growth[2]	Unemployment (New Basis) Percent[3]	Millions	Real Wage Rate[4] (1990=100)
2010	227.1	2.4	4.6	1.50	135.6
2011	232.7	2.5	4.6	1.53	133.5
2012	237.0	1.9	4.7	1.59	132.4
2013	240.2	1.4	4.3	1.45	131.0
2014	246.3	1.6	3.9	1.33	131.1
2015	251.0	2.2	3.9	1.31	133.3
2012:1	236.6	0.7	4.8	1.61	132.6
2012:2	238.1	1.8	4.8	1.59	132.2
2012:3	238.1	1.9	4.7	1.57	132.9
2012:4	236.6	3.3	4.6	1.56	131.8
2013:1	238.2	0.6	4.5	1.54	130.1
2013:2	239.5	2.4	4.4	1.50	132.3
2013:3	240.6	0.8	4.1	1.39	130.8
2013:4	242.5	1.7	4.0	1.37	130.8
2014:1	243.6	3.1	4.0	1.36	130.7
2014:2	245.5	1.6	3.9	1.34	131.1
2014:3	247.4	2.7	3.8	1.31	131.1
2014:4	248.6	2.8	3.8	1.30	131.2

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

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

	Expenditure Index	£ Million '90 prices	Non-Durable Consumption[2]	Private Sector Gross Investment Expenditure[3]	Public Authority Expenditure[4]	Net Exports[5]	AFC
2010	143.2	685816.8	412464.1	222982.1	180596.2	−35977.3	94248.2
2011	144.8	693480.0	405707.9	232196.6	179249.7	−24641.9	99032.3
2012	145.0	694345.6	405044.8	241788.1	182996.5	−31204.8	104279.0
2013	147.1	704061.8	408532.0	244321.9	181864.1	−32814.9	102184.1
2014	150.8	722173.8	414751.1	266188.7	175499.7	−38621.7	95765.2
2015	154.4	735702.5	414580.1	250992.1	193479.8	−31157.8	92210.8
2010/09	1.7		0.3	11.0	0.1		8.3
2011/10	1.1		−1.6	3.8	−0.8		4.5
2012/11	0.2		−0.1	2.5	3.0		3.0
2013/12	1.4		0.9	1.1	−0.6		−2.0
2014/13	2.6		1.5	9.0	−3.5		−6.3
2015/14	2.4		1.5	7.0	2.3		3.1
2012:1	145.2	173789.2	101182.0	58927.4	47960.2	−6985.4	27295.1
2012:2	144.5	172990.1	101166.9	58367.1	44720.2	−8453.9	22810.2
2012:3	145.4	174050.5	100983.7	61663.0	45063.8	−7626.9	26033.1
2012:4	145.0	173515.9	101712.2	62830.6	45252.2	−8138.6	28140.5
2013:1	145.5	174176.5	101809.6	58031.1	47399.5	−7067.3	27132.5
2013:2	146.5	175320.9	101767.6	58214.8	45564.9	−7180.1	24182.3
2013:3	147.6	176705.8	102549.0	61992.2	45788.6	−9285.0	25475.0
2013:4	148.6	177858.6	102405.8	66084.0	43111.1	−9282.6	25394.2
2014:1	149.3	178747.9	103029.0	66015.6	43049.0	−9664.1	23431.4
2014:2	150.2	179820.4	103449.6	66632.0	43319.2	−9655.3	23693.8
2014:3	151.4	181259.0	103898.6	64834.9	45886.2	−9650.6	24248.6
2014:4	152.3	182346.5	104373.9	68706.1	43245.3	−9651.8	24391.5

1 GDP at factor cost. Expenditure measure; seasonally adjusted
2 Consumers expenditure less expenditure on durables and housing
3 Private gross domestic capital formation plus household expenditure on durables and clothing plus private sector stock building
4 General government current and capital expenditure including stock building
5 Exports of goods and services less imports of goods and services

Financial Forecast

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

1 GDP at market prices (Financial Year)

WORLD FORECAST DETAIL

Growth Of Real GNP

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

Real Short-Term Interest Rates

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

Real Long-Term Interest Rates

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

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

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

[1] The real exchange rate is the domestic price level relative to the foreign price level converted into domestic currency. A rise in the index implies an appreciation in the real exchange rate.

Growth Of Consumer Prices

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

Nominal Short-Term Interest Rates

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

Nominal Long-Term Interest Rates

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

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

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

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

* Forecasts based on the Liverpool World Model