LIVERPOOL INVESTMENT LETTER

February 2015

LIVERPOOL RESEARCH GROUP IN MACROECONOMICS

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The Julian Hodge Institute was launched in autumn 1999 in a new collaboration between the Cardiff Business School of Cardiff University and Julian Hodge Bank. The aim of the Institute is to carry out research into the behaviour of the UK economy, and to study in particular its relationship with the other economies of Europe. This research has been given especial relevance by the ongoing discussions on the extra powers regularly requested by the European Union and also by the recent crisis in the eurozone.

The Liverpool Investment Letter is written by Patrick Minford, with the assistance of other members of the Group; in particular the emerging markets section is written by Anupam Rastogi, and the focus on Japan is written by Francesco Perugini. The Investment Letter is published monthly.

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WHY IS IT SO DIFFICULT TO MOVE MONETARY POLICY SETTINGS BACK TO NORMALITY?

We are faced with a conundrum: the economy is recovering strongly, employment is growing strongly too and unemployment plunging, almost reaching the 'full employment' rate (of around 5%, we would say, against an actual of 5.8%). There are now also signs that wages are rising faster, and with inflation temporarily low, probably substantially faster than prices. And yet the two 'hawks' on the Bank's MPC have withdrawn to the dovish end of the spectrum and the MPC is unanimous once more not raising rates, while leaving on hold Quantitative Easing (the purchases by the Bank of UK government bonds, which now stand at £375 billion, about a third of the total government debt outstanding).

It seems that the joker in the pack is inflation which is temporarily low — the latest figure, for the December 2014 CPI, is 0.5%. This is fuelling fears of 'deflation' which has become a fear word, on the grounds that deflation in the 1930s created rising real debt and held back the recovery, according to some accounts. Yet this threat is to be honest quite empty; the situation is not at all like that of the 1930s.

Another element causing the unwillingness to tighten is the still slow growth of money and credit. Indeed the banking system is still under huge pressure from regulators, and still trying to shrink its balance sheet, it would seem.

We would argue that there are great dangers to leaving money so utterly loose in these circumstances, especially with an election looming whose results are quite unpredictable and a public deficit still at 5% of GDP. Furthermore the current inflation figures are dominated by the collapse in oil and other material prices — a one-off phenomenon. Money and credit growth is reflecting the excesses of past-crash bank regulation; this in turn is leading to explosive growth in the new 'shadow banking' of peer-to-peer lending — even though statistics on this are patchy, its rapid growth is undeniable.

Without moving too sharply, the backdrop indicates a need to move monetary policy towards normality.

However, we also need to probe why we have reached this state where monetary policy is endlessly easy while the supply of credit and money has been so restrained. Of course the answer lies in the great reaction of regulative enthusiasm to the banking crisis. The irony of all this is that the crisis itself was caused by central bank failure to coordinate the supply of liquidity to the international banking system. It is true that we had a strong credit boom in the run up to the crisis — itself also permitted by excessively easy monetary policy. Yet a credit boom should not lead to a banking crisis. So we are constantly led back to the villains of the piece — the central banks themselves. First, a failure of excessive monetary ease; followed by a failure to ensure the liquidity of the world banking system. The political classes closed ranks around the central banks whom they effectively directed in their tasks; then they turned on the world's commercial banks, alleging that all was due to their cupidity and stupidity in taking outsize risks. It is true that some banks made bad decisions — certainly so in the light of later events. When things go wrong in the world economy, it is often the case that decisions made by individual actors turn out poorly. Like ants rolled over by a large tractor, they lie there, squashed and victims of tragic error. But could they have foreseen the tractor would suddenly roll down the road?

Table 1: Summary of Forecast

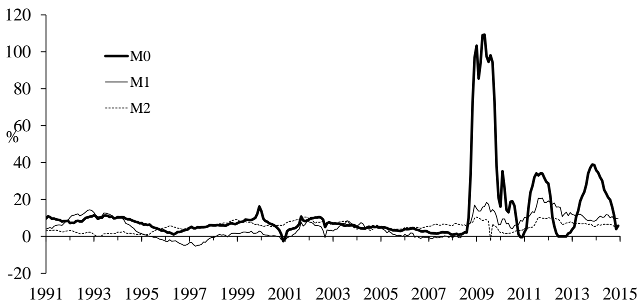
		2012	2013	2014	2015	2016	2017	2018
GDP Growth[1]		0.7	1.7	2.6	2.8	2.5	2.5	2.5
Inflation	CPI	2.1	1.9	1.7	1.4	1.7	1.7	2.0
	RPIX	3.2	3.1	2.5	2.3	2.4	2.5	2.7
Unemployment (Mill.)								
	Ann. Avg.[2]	1.6	1.4	1.1	0.9	0.8	0.8	0.7
	4th Qtr.	1.6	1.3	1.0	0.9	0.8	0.7	0.7
Exchange Rate[3]		83.0	81.5	87.7	90.3	90.4	90.4	90.1
3 Month Interest Rate		0.9	0.6	0.6	1.0	1.6	2.0	2.1
5 Year Interest Rate		0.9	1.3	1.9	2.2	2.5	2.5	2.5
Current Balance (£bn)		−53.2	−65.9	−80.9	−72.0	−72.3	−72.7	−73.3
PSBR (£bn)		110.6	91.1	91.5	75.8	56.5	24.3	3.7

[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)

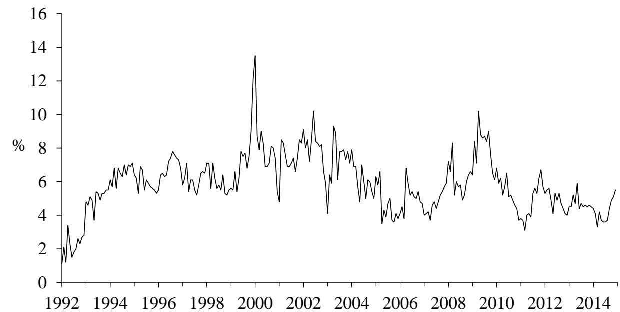
At any rate, we now have the regulative reaction to these events; and as many of us warned they have worsened the state of the economy. We have argued in recent work that they will not stop another crisis because crises stem from large-scale world shocks (usually to commodity prices) and the best hope of controlling crises is through active monetary policy, both in boom and slump. In the UK and the US there has been some attempt to dilute the new regulative excess. Here there have been the Funding for Lending Schemes (that subsidised lending to banks that expanded their balance sheets) and the Help to Buy scheme (that subsidised first-time home owner mortgages). In the US the regional banks have been less intruded upon than the big money-centre banks; and competition and new lending has come from them. In the euro-zone unfortunately the banks have been quite unable to recover from a series of hammer blows — first the collapse of the economy, then the impulse from the ECB for them to buy southern countries' government debt to help resolve the run on euro debt, and finally the ECB's misguided vilifying of their balance sheet weakness (much of which resulted from this very impulse). So eurozone credit and money show no signs of life.

It is against this background that monetary ease has become totally entrenched. Yet the irony is that the situation is caused directly by government regulative action. The logical way forward would be to dismantle this excess regulation and to move monetary policy back to normal. Instead we have a moribund banking system, increasingly being replaced by a new banking order via the internet — but like all such ‘shadow’ systems we cannot discover exactly how fast it is developing. Monetary policy is desperately trying to replace banks, but instead is feeding a whole substitute financial system. The outcome of this process is highly unpredictable.

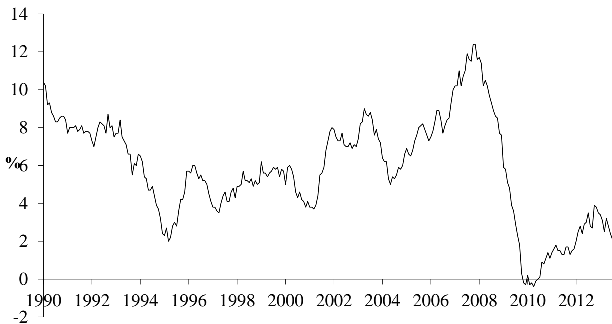
U.S.: Growth in Monetary Aggregates (Yr - on - Yr)



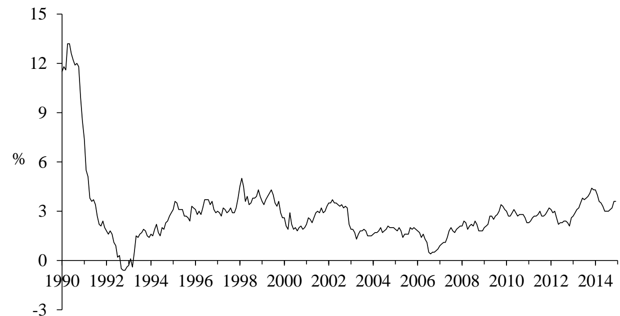
UK: Notes and Coins in Circulation Growth



Eurozone M3 Growth



Japan: Growth of M2+CD's



FOCUS ON JAPAN

Francesco Perugini

Abe urges companies to create a wages boost

Two years into so-called Abenomics, a mix of aggressive monetary and fiscal policy plus structural reform, the Bank of Japan (BOJ) is struggling to reach an ambitious inflation target and convince Japanese that years of deflation are in the past. Instead, inflation is slowing, the economy is only slowly emerging from recession and confidence among the economy's bed-rock manufacturers is slipping. Despite all these efforts, last week the BOJ sharply cut its inflation forecast and BOJ governor Kuroda conceded it may take longer than expected to hit 2% inflation, underlining the challenges of meeting the target as oil prices continue to slump. "The target date may change slightly", Kuroda told a news conference after the policy board meeting.

Economists are also increasingly sceptical that the BOJ will hit the target: they believe consumer prices (CPI) will rise an average 1.4% in the fiscal year through March 2017, say a recent poll. "The BOJ's monetary stimulus was enough to pull CPI to a positive from a negative, but it's not enough to achieve the 2% inflation goal stably," said Tomo Kinoshita, chief economist at Nomura Holdings Inc., the nation's largest securities company.

Why hasn't inflation picked up more quickly so far? Several long-term factors are behind the trend but the main reason advanced by Governor Kuroda is that wage growth has fallen behind the price increases that have been driven by the BOJ's aggressive easing, sapping consumers' purchasing power. The government and the BOJ hope wage growth will eventually filter through the economy and start a virtuous cycle of higher private spending and increased production and investment. "Wage growth is more important than anything", said Kuroda at a recent press conference.

Abe has also tried to exhort companies to raise wages. He wants to see a bigger share of corporate profits, which are at a record high thanks to early benefits of Abenomics such as a stock market rally and the yen's decline, being passed on to workers to rejuvenate sluggish consumer spending and end deflation. So officials are focused on the spring wage talks between management and labour. The negotiations, known as the Shunto, have been a tradition since the 1950s, where wage agreements reached at big manufacturers set the tone for other industries. However, some economists play down the impact of the Shunto negotiations on broader wage and price trends because those talks affect union workers only at relatively large companies and account for just 17% of the nation's total workforce.

Looking at the labour market data, the Japanese economy is probably pretty much at full employment. Unemployment is at 3.7% — matching the lowest since 1997 and one of the lowest among OECD countries — and companies have been complaining about labour shortages. The BOJ governor noted that the gap between supply capacity and actual demand is "almost zero". However, the price of labour has refused to rise, at least not on an economy wide basis. The conundrum has its roots in the altered structure of the labour market. In the late 1990s and early 2000s, governments responded to squeals by Japanese employers about declining competitiveness by making it easier to hire workers cheaply on short-term and part-time contracts. The share of these "non-regular" workers in Japan, which was below 20% before the burst of the bubble in the early 1990s, has now reached 35%. As a result, today Japan has an exceptionally flexible workforce. They work in poorly paid jobs for hourly rates. Benefits are all but non-existent. For most of these workers, sometimes referred to as the "precariat", unemployment is a mere "sayonara" away.

This has helped increase labour-force participation by women and by the over-65s (20% of whom remain in work, compared with 5–10% in Europe). But it has left two huge problems. First, the rest of the labour market is as rigid as ever: typically, the law entitles laid-off employees to compensation of 24–36 months of pay, which is a big disincentive to restructuring. Second, neither employers nor non-regular workers have much incentive to increase skills. The result is stagnation: gradually, employment is rotating into insecure, untrained jobs. Wages for irregular workers are rising, but from a low base. Overall household consumption is stagnant.

There are some solutions to this. For instance, one could be to narrow the gap between over-protected permanent workers and under-protected non-permanent ones. An open labour market would help allocate resources to productive parts of the economy. "What is needed is to replace the dual system with a single labour law, which reduces the cost of firing workers to far more reasonable levels, so the market can adjust, while offering equal rights to all workers, full or part-time. This would restore the incentive for workers to learn skills", said Bill Emmott, a former editor of The Economist.

But the question, which has re-emerged in recent periods among Japanese economists, especially since the re-elected Abe has been pressuring companies to lift wages, is whether stagnant wages have been a cause, or a result, of deflation. In other words would lifting wages cure the disease, or, absent other fixes, just create more ailments? Hiroshi Yoshikawa, a professor from Tokyo University "believe that wages hold the key". In most economies, wages don't fall the way they have in Japan, because of

workers' reluctance to accept pay cuts, and that helps prevent deflation even though it causes layoffs, economists say. "But in Japan, where layoffs are generally seen as worse than salary cuts, the opposite has happened", Yoshikawa told The Wall Street Journal recently.

Macroeconomics tells us that BOJ monetary easing can shift the aggregate demand curve to the right, while pushing up prices and real GDP growth in the short-run. However, Abe's attempt at increasing wages can only be seen as negative supply shock, which if successful will push the aggregate supply curve to the left. This would result in a higher price level but would also probably leave long-run GDP level unaltered. "I do not understand at all what he is thinking right now," says Koichi Hamada, a professor from Yale University and one of the economists credited with shaping Abenomics, about Yoshikawa's theories. "If you just force wages higher — be they real or nominal — the supply side would become unable to maintain the current level of employment." Hamada said. To put it another way, Messrs. Abe and Yoshikawa are confused between ending deflation which can be done by monetary means and ending low growth which requires supply-side reforms that raise productivity growth — this productivity growth in turn would spur faster wage and consumption growth.

This is the reason why other economists hope that Abe should not concentrate his efforts on pushing up wages — other than what is the natural and desirable consequence of higher demand growth — but rather push much harder to implement the announced labour market reforms such as reducing long working hours, reinforcement of flexible working practices, and reform of the wage payment system based upon performance rather than seniority.

MARKET DEVELOPMENTS

Though many commentators complain about the threat to world growth is weakness in China and other emerging market countries such as Turkey and Russia, world growth is lying in a solid 3–4% range, which is perfectly adequate and also sustainable. Excessive regulation of banks has led to super-ease in monetary policy all over the developed world; for now the two factors offset each other roughly. But if shadow banking via the internet gallops away, monetary policy will be forced to tighten to stop inflation taking off. However you look at it the factors involved favour equities.

Table 1: Market Developments

	Market Levels		Prediction for Jan/Feb 2016	
	Dec 30	Jan 30	Previous Letter	Current View
Share Indices				
UK (FT 100)	6547	6811	9460	9841
US (S&P 500)	2080	2021	2717	2640
Germany (DAX 30)	9806	10738	13620	14915
Japan (Tokyo New)	1408	1414	1920	1928
Bond Yields (government				
UK	1.79	1.43	2.00	2.00
US	2.19	1.75	2.10	2.10
Germany	0.54	0.36	1.50	1.50
Japan	0.44	0.29	0.70	0.70
UK Index Linked	–0.74	–0.93	0.10	0.10
Exchange Rates				
UK ($ per £)	1.56	1.51	1.56	1.56
UK (trade weighted)	87.9	88.6	82.3	88.6
US (trade weighted)	97.0	98.9	85.5	85.5
Euro per $	0.82	0.88	0.79	0.79
Euro per £	1.28	1.33	1.23	1.23
Japan (Yen per $)	119.0	118.1	98.0	98.0
Short Term Interest Rates (3-month deposits)				
UK	0.60	0.56	2.10	1.10
US	0.19	0.25	0.70	0.70
Euro	0.10	0.03	0.50	0.50
Japan	0.05	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	2.5	2.0	40.00		47.90
US	1.90	3.0	1.6	26.00	–3.48	29.02
Germany	2.60	1.4	1.5	36.00	7.32	48.82
Japan	1.70	1.4	2.0	33.00	14.11	52.21
UK indexed[2]	–0.93		2.4	–5.00		–3.93
Hong Kong[3]	2.60	6.8	1.6	7.00	–3.48	14.52
Malaysia	3.30	5.5	1.6	58.00	–3.48	64.92
Singapore	3.50	4.5	1.6	36.00	–3.48	42.12
India	1.40	7.0	1.6	21.00	–3.48	27.52
Korea	1.10	3.0	1.6	0.00	–3.48	2.22
Indonesia	2.20	6.1	1.6	41.00	–3.48	47.42
Taiwan	2.80	3.4	1.6	26.00	–3.48	30.32
Thailand	3.20	4.1	1.6	38.00	–3.48	43.42

Bonds: Contribution to £ yield of:

	Redemption Yield	Changing Nominal Rates	Currency	Total
UK	1.43	–5.70		–4.27
US	1.75	–3.50	–3.48	–5.23
Germany	0.36	–11.40	7.32	–3.72
Japan	0.29	–4.10	14.11	10.30

Deposits: Contribution to £ yield of:

	Deposit Yield	Currency	Total
UK	0.56		0.56
US	0.25	–3.48	–3.22
Euro	0.03	7.32	7.35
Japan	0.10	14.11	14.21

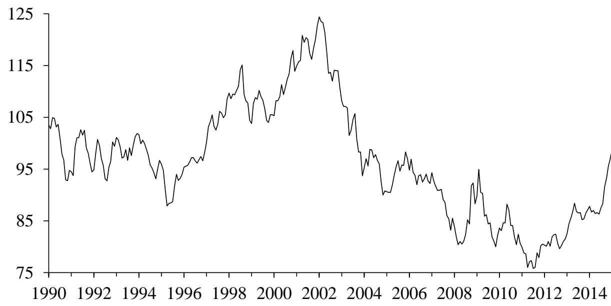
[1] Yields in terms of €s or $s can be computed by adjusting the £-based yields for the expected currency change.
[2] UK index linked bonds All Stocks
[3] Output based on China.

Table 3: Portfolio(%)

	Sterling Based Investor		Dollar Based Investor		Euro Based Investor	
	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)	-	-	-	-	-	-

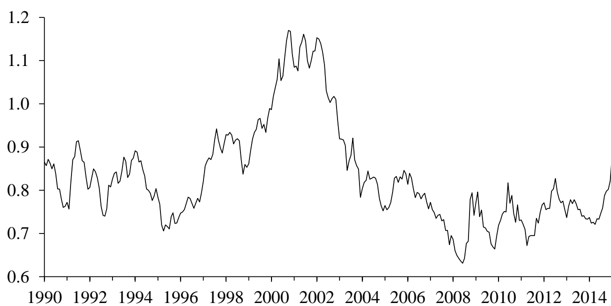
INDICATORS AND MARKET ANALYSIS
FOREIGN EXCHANGE MARKETS

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



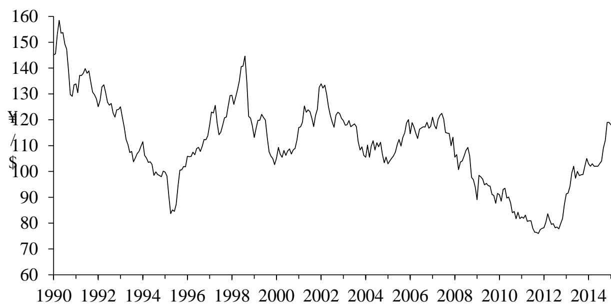
UK: Dollars Per Pound Sterling

Euro per US dollar



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

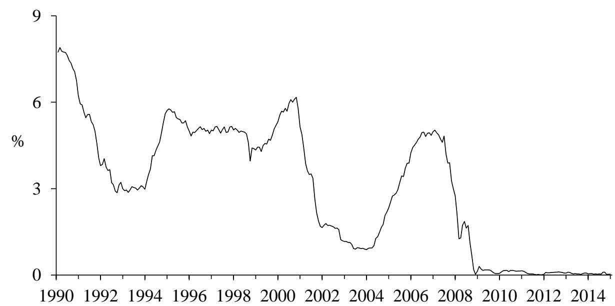
Japan : Yen Per U.S. Dollar



GOVERNMENT BOND MARKETS

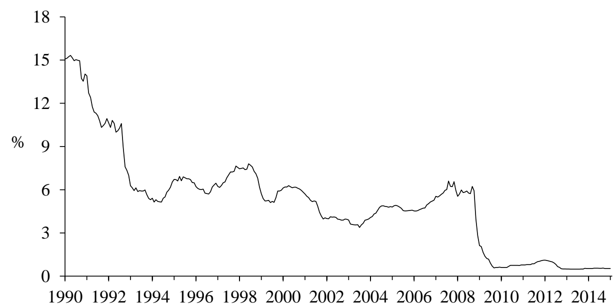
U.S.: Yield on Long-Term Government Bonds

U.S. : 3-Month Treasury Bill



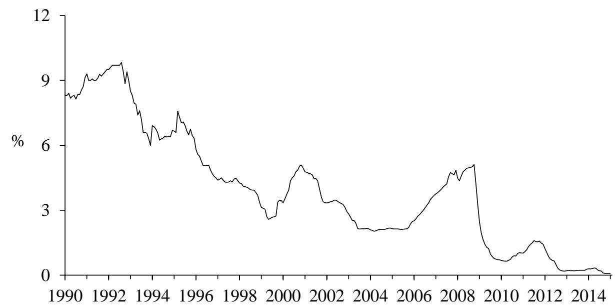
U.K. : Yield on Long-Term Government Bonds

U.K. : 3-Month Interbank Rate



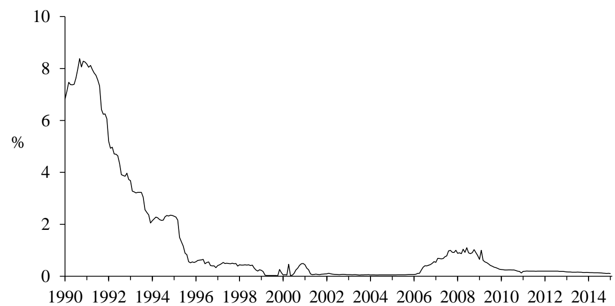
Germany: Yield on Public Authority Bonds

Germany : 3-Month Interbank Deposit Rate

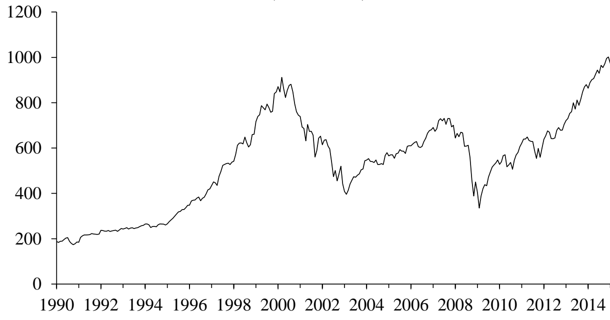


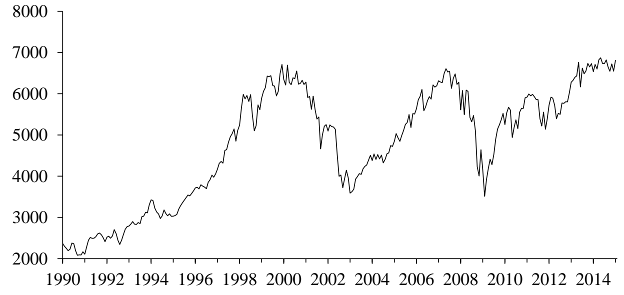
Japan: Yield on Long-Term Government Bonds

Japan : 3 Month Money Market Rate



MAJOR EQUITY MARKETS





EMERGING MARKETS

Anupam Rastogi

India

India abandoned its 'non-aligned' status as India sees itself as a "multi-aligned" country that eschews formal military alliances. President Barack Obama became the first American president to preside as the chief guest at India's Republic Day parade on the last January 26th, an annual spectacle that celebrates the country's democracy by showcasing its cultural diversity and military might. The present government under Prime Minister Modi regards the U.S. as a critical partner in his effort to revive India's economy and modernize its large but creaky military. His mantra to all problems is 'development', and, therefore, his goal is to attract foreign investment in almost all sectors of the economy.

The World Bank has predicted that India would expand by 7% in 2017, overtaking China's growth rate in the process. We expect the economy to grow 6% in fiscal year 2015 and 7% in fiscal year 2016.

The government is keen that rating agencies push India's rating higher. To achieve that, the government is striving to meet its fiscal deficit objective of 4.1% of GDP by March 2015, and 3.6% of GDP by March 2016. Following that it would like to maintain fiscal deficit at 3% of GDP. It seems that the government will meet its fiscal deficit target this year.

Inflation is well under control and inflationary expectations have been curbed. The consumer inflation rate was 5% year-on-year in December from 4.38% in November, driven by higher food prices. Consumer inflation is expected to stay close to the current 5% level for most of 2015.

Consumer inflation, which is the main measure guiding the RBI's monetary policy, has declined sharply from a peak of 11.16% in November 2013 as food supplies have improved, while a 55% drop in global oil prices since June has helped to reduce local fuel costs. Thus, the central bank surprised markets with a cut to its key lending rate on January 15. The RBI is scheduled to announce its latest review of monetary policy on February 3. We do not expect the central bank to lower the interest rate it charges banks. At present the policy rate is 7.75%.

February is going to see two more important events. First is the local election in Delhi. A clear mandate for the ruling party would give new confidence to embark on more ambitious changes before an election in Bihar at the end of the year. The second event — the federal budget for the

India: BSE Sensitive

year beginning April 1 — is scheduled to be released on February 28.

The Reserve Bank of India is intervening more in the currency market's spot segment than it did in 2014. The changed strategy has helped RBI to maintain liquidity in the system at a comfortable level, at a time when a squeeze in spending by the government for meeting its fiscal deficit target is keeping the money market tight. In the current financial year, RBI has added a little more than $18 billion to the reserves, which currently stand at $322 billion.

The government announced on January 30 that its benchmark measure of economic growth will henceforth be based on market prices, not on factor costs. The latter method, which India had previously preferred, tabulates economic activity based on the costs of production, whereas the other method is based on the amounts paid by consumers. Most countries and international bodies calculate GDP based on market prices. The last two year's GDP figures show that India was doing better than what was reported earlier.

To show to foreign investors that India wants to welcome more foreign investment, the government has said it won't appeal a court order that ruled in favour of Vodafone Group PLC in one of its long-running, multimillion-dollar tax disputes. This is a signal to create a more predictable tax regime to attract foreign investment.

India auctioned off a 10% stake in Coal India Ltd. for $3.6 billion suggesting that investors are confident that India's Prime Minister Narendra Modi will be able to get the country's economy and its state-run companies back on the path to high growth. Right now, India is clearly among the favourite markets for foreign investors. As per the latest data, foreign institutional investors (FIIs) have pumped in nearly Rs213.3 billion into the Indian capital markets till January 23, 2015. The investments in equities stood around

Rs59.9 billion, while the debt market witnessed inflows of about Rs153.7 billion. The markets are having second honeymoon with Mr. Modi.

	11-12	12-13	13-14	14-15	15-16
GDP (%p.a.)	6.2	5.1	6.9	6.0	7.0
WPI (%p.a.)	9.0	7.5	7.0	6.5	6.0
Current A/c(US$ bill.)	-40.0	-88.0	-50.0	-34.0	-20.0
Rs./$(nom.)	49.5	54.5	60.0	62.0	64.0

China

In 2014, China grew 7.4% — its slowest pace in nearly a quarter century — as the economy weathered a real-estate slump, rising debt and slower demand for its products at home and abroad. Its growth prospects are hazy as Purchasing Managers Index published by the government fell below 50 for the first time since September 2012, indicating a contraction in manufacturing activity. We expect Beijing to set an annual-growth target for 2015 of 7.0% during its annual legislative session in March. The ruling party has said it wants to focus on the quality rather than just the quantity of economic growth.

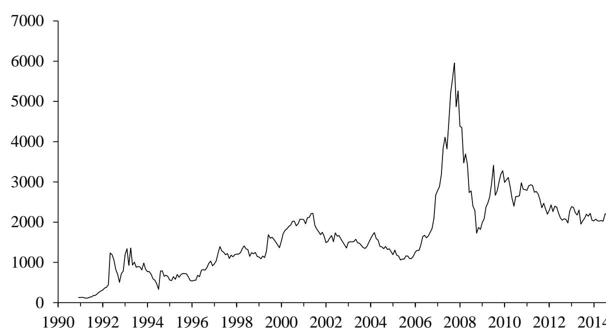
The IMF has cut its 2015 growth forecast for China from 7.1% to 6.8%, and predicted the country would grow at a slower pace than India next year for the first time in decades.

According to Chinese Prime Minister Li Keqiang, China's economy is entering a "new normal" of slower but healthier growth. He assured that the slowdown won't cause a systemic crisis and the economy won't have a hard landing. The government released unemployment rate of 5.1% in December, slightly higher than the 5% rate declared in August. This suggests that there is no direct impact on employment with the slowdown of the economy. Demographics is keeping the labour market tight, with the working-age population shrinking for the third year in a row.

People's Bank of China Governor Zhou Xiaochuan told the World Economic Forum in Davos that the central bank would keep its monetary policy stable. China is willing to sacrifice a little growth to make its economic expansion more sustainable.

The consumer price index gained 2% for all of 2014 — well below the government's 3.5% target and representing its smallest increase in five years.

Notwithstanding the decline in growth rate, China became the world's top destination for foreign direct investment in 2014, edging the U.S. out of that position for the first time since 2003, according to the United Nations Conference on



Trade and Development. Foreign businesses invested $127.6 billion in China, up from $123.9 billion in 2013, while their investments in the U.S. fell to $86 billion from $230.8 billion.

For all of 2014, China reported a trade surplus of $382.5 billion, compared with a surplus of $259.8 billion for 2013. Exports rose 6.1% year-over-year in 2014, down from an increase of 7.9% in 2013. Imports rose 0.4% year-over-year, down from growth of 7.3% in 2013. China, as the world's largest oil importer, has benefited from lower global energy and reduced commodity prices, reducing its payments.

China's currency fell nearly 3% in 2014, the first annual drop since it became a more-or-less convertible currency in the 1990s. Yet in trade-weighted, inflation-adjusted terms — the kind that matters for economies — the yuan rose 5% in the first 11 months of 2014. China has allowed investors to push the yuan's value 2% in either direction from the so-called parity rate in daily trading. We expect the 2% trading band to be further widened to enhance flexibility. A weaker currency should help ease two concerns confronting China: weakening exports and softening inflation.

The government's project to globalize the renminbi could move up another gear later this year. In June, index complier MSCI will decide whether it will include Chinese equities in its emerging markets benchmark, potentially drawing in billions of dollars of new investment. Also, at the end of this year, the IMF will carry out a review of its Special Drawing Rights system, which could lead to the renminbi being declared an official reserve currency.

	11	12	13	14	15
GDP (%p.a.)	9.2	7.7	7.7	7.4	6.8
Inflation (%p.a.)	4.3	2.6	3.5	2.0	2.0
Trade Balance(US$ bill.)	210	214	220	220	200
Rmb/$(nom.)	6.3	6.3	6.2	6.2	6.3

South Korea

For 2014, Korea's economy expanded 3.3% compared with 3% growth in 2013. The Bank of Korea has cut its growth forecast from 3.9% to 3.4% for 2015 and slashed its inflation outlook from 2.4% to 1.9% for this year.

The reason for such a pessimistic view is that both exports and domestic demand were tepid, dampening manufacturing output in the fourth quarter. Lower cost producers in China and a weaker yen have increased competition for Korean manufacturers.

In order to stimulate economy, two 25 basis-point cuts in interest rates — one in April and the other in July — are expected. That could come sooner if new data indicates that the growth prospects are decreasing sharply.

Lower global oil prices have reduced costs for businesses and put more money in consumers' pockets. Moreover, the U.S. economy's pickup should help Korean exports of electronics and other goods. But, weak demand in China, Europe and at home is dragging growth. High household debt is causing a headache for policy makers, who need to check the problem without undermining domestic growth momentum, as exports show signs of faltering. Weak consumer spending and fast-growing household debt are among "the fragile spots" in the Korean economy.

Consumer prices are expected to rise 1.9% this year — down from a previous forecast of the central bank of 2.4%. This is well below the central bank's annual inflation target band of 2.5–3.5%.

South Korean stocks look tantalizingly cheap. It is one of the few global markets trading on a single-digit multiple of next year's expected earnings. And there are good companies such as Samsung, Hyundai and SK Hynix. Last year, the Kospi index was one of the worst performers worldwide, with negative returns in both won and dollar terms. Currency is part of the problem. Without an infusion of new investment, they are likely to stay that way.

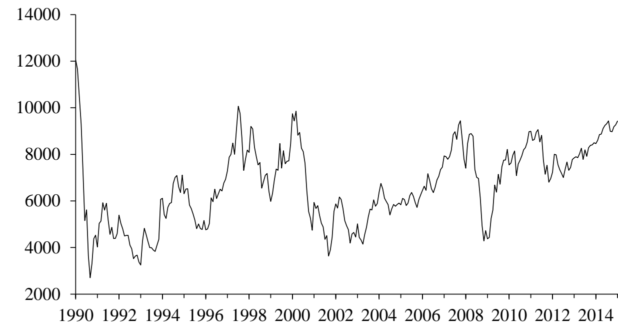
	11	12	13	14	15
GDP (%p.a.)	3.6	2.0	3.0	3.3	3.0
Inflation (%p.a.)	4.0	2.2	1.3	2.0	1.9
Current A/c(US$ bill.)	27.0	44.0	71.0	80.0	80.0
Won/$(nom.)	1100	1100	1100	1080	1130

Taiwan

Taiwan's gross domestic product rose 3.17% from a year earlier in the final quarter of 2014. The economy expanded 3.63% in the third quarter of 2014. The export-driven economy faces headwinds, despite the recent increase in U.S. demand, as the eurozone slows and demand cools in China — Taiwan's biggest trading partner.

Korea: Composite Index

Taiwan: Weighted TAIEX Price Index



Export growth has not been very robust. Plummeting crude-oil prices hit overseas sales of petrochemical products, which comprise 20% of total exports. Electronics exports, however, posted good gains. Exports grew 0.5% from a year earlier, compared with a 6.7% rise in the third quarter of 2014. Falling oil prices have been beneficial to the island economy.

Taiwan's monetary policy will remain accommodative to support growth, and the central bank will allow the local currency to depreciate more against the U.S. dollar to remain competitive in its export markets.

The ruling party KMT is trying to remain relevant after voters rejected it in local elections. The party's leadership has been passed to Mr. Chu who is the mayor of New Taipei City. Beijing has, in the past, found it easier to work with the KMT, rather than the opposition. Beijing is waiting to see what Mr. Chu can actually do in his capacity as the KMT head to push for closer cross-strait ties given that he has no control of the central government.

	11	12	13	14	15
GDP (%p.a.)	4.0	1.3	2.1	3.2	3.4
Inflation (%p.a.)	1.2	1.9	1.2	1.5	1.5
Current A/c(US$ bill.)	18.0	41.7	50.6	57.4	60.0
NT$/$(nom.)	30.0	29.5	30.0	31.0	32.0

Brazil

The Brazilian economy is in poor shape and this commodity based economy has taken the brunt of falling commodity prices and the prolonged fiscal stimulus programs of President Lula and Dilma Rousseff. The economy grew by an estimated 0.15% in 2014 and is unlikely to grow more than 0.5% in 2015. The country is at risk of electricity rationing as it grapples with a severe, multiyear drought.

Brazil's President Dilma Rousseff is struggling to prevent a downgrade of Brazil's investment grade credit rating and it seems that she has time until the US Federal Reserve raises the US interest rates.

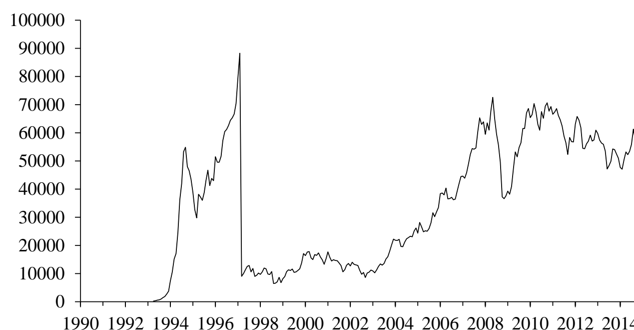
In order to bring some fiscal discipline Finance Minister Joaquim Levy embarked on a series of tax increases and spending cuts. Brazil announced its first primary budget deficit in more than a decade, underlining the vast challenges faced by him and to take the economy on a growth path. The country had a primary budget deficit of R$32.5 billion ($13.8 billion), equivalent to 0.63% of gross domestic product. The primary deficit is the gap between the government's revenues and spending on goods and services. Brazil had posted a primary surplus of 1.9% in 2013 and a 2.4% surplus in 2012.

Brazil's overall budget deficit, which includes debt payments, doubled in 2014 from the previous year to R$343.9 billion or 6.7% of GDP. Mr Levy has promised to achieve primary fiscal surplus of 1.2% of gross domestic product this year and at least 2% next year through tax rises and spending cuts. Brazil has recently raised taxes on a range of items from cosmetics to fuel, after unveiling cuts to pensions and unemployment benefits.

The central bank lifted the Selic rate by 50 basis points to 12.25%, extending a monetary tightening cycle that began only three days after President Dilma Rousseff was re-elected in October last year. The interest rates have touched the highest level in more than three years to combat expectations for surging inflation.

Brazil's official IPCA consumer-price index rose 6.41% in 2014 compared to 5.91% in 2013. Annual inflation was driven up by an 8% increase in food prices and an 8.8% surge in housing-related prices. Administered prices — those controlled by the government — are set to jump higher this year after being allowed to rise little in the past year, and that will push inflation back above the ceiling early in 2015. Increases in taxes on gasoline and on personal loans have come into effect from Feb. 1. A different tax on fuels will rise after 90 days and taxes on imported goods and cosmetics will increase, starting in June. These tax increases are intended to restore confidence in the economy,

Brazil: Bovespa



Brazil's official unemployment rate decreased in December, tying the lowest level on record even as the broader economy remains stagnant.

Brazil has posted its first annual trade deficit in more than a decade for 2014 due to a global commodities slump and an economic downturn in neighbouring Argentina. The trade deficit was $3.93 billion, compared with a surplus of $2.5 billion in 2013. It was the country's first annual trade deficit since 2000, when it posted a deficit of $731.7 million.

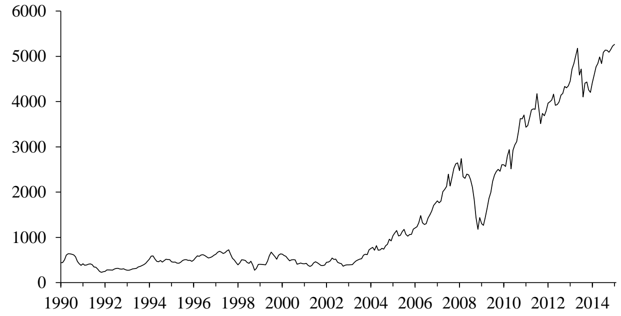
The Brazilian real was valued at 2.42 to the dollar a year ago, but has fallen to 2.56 now.

	11	**12**	**13**	**14**	**15**
GDP (%p.a.)	2.7	0.9	2.5	0.2	0.5
Inflation (%p.a.)	6.5	5.8	5.9	6.5	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	2.6

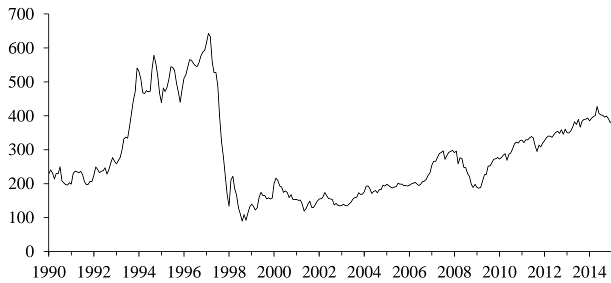
Other Emerging Markets

Hong Kong: FT-Actuaries

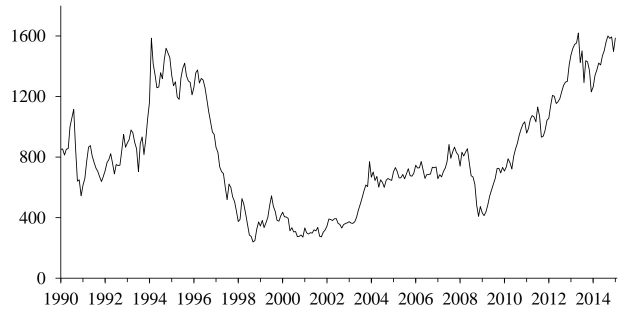
Indonesia: Jakarta Composite



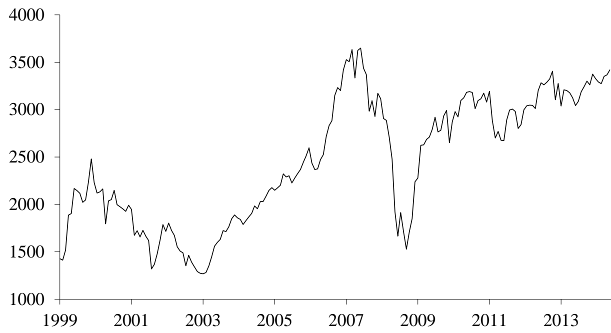
Malaysia: FT-Actuaries (US$ Index)



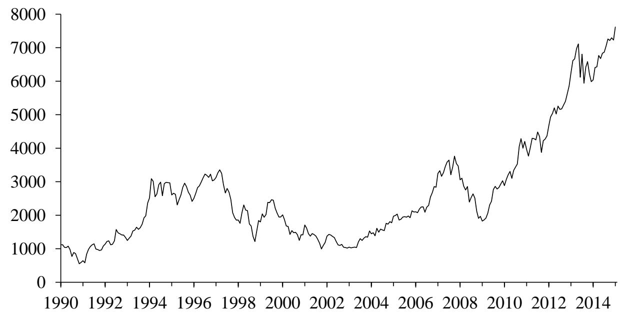
Thailand: Composite Index



Singapore: Straits Times Index



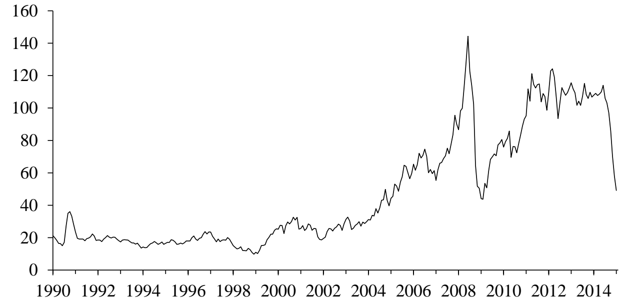
Philippines: Manila Composite



COMMODITY MARKETS

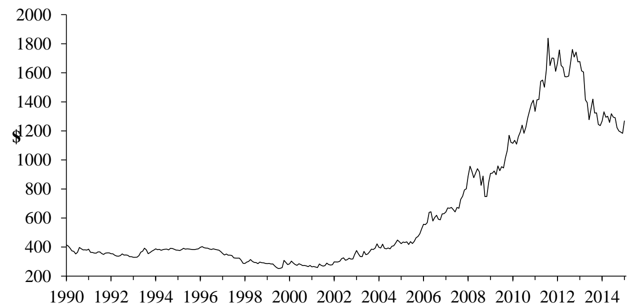
Commodity Price Index (Dollar)
(Economist, 2000=100)

Oil Price: North Sea Brent (in Dollars)

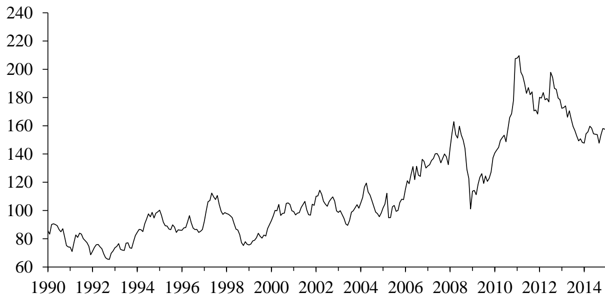


Commodity Price Index (Sterling)
(Economist, 2000=100)

Gold Price (in Dollars)



Commodity Price Index (Euro)
(Economist)



UK FORECAST DETAIL

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

	Inflation %[1] (CPI)	Short Dated (5 Year) Interest Rates	3 Month Int. Rates	Nominal Exchange Rate (2005=100)[2]	Real Exchange Rate[3]	Real 3 Month Int. Rates %[4]	Inflation (RPIX)	Real Short Dated Rate of Interest[5]
2013	1.9	1.3	0.6	81.5	85.4	-1.3	3.1	-0.4
2014	1.7	1.9	0.6	87.7	92.7	-1.0	2.5	0.1
2015	1.4	2.2	1.0	90.3	95.4	-0.7	2.3	0.3
2016	1.7	2.5	1.6	90.4	95.6	-0.1	2.4	0.6
2017	1.7	2.5	2.0	90.4	95.7	0.0	2.5	0.5
2018	2.0	2.5	2.1	90.1	95.7	0.1	2.7	0.5
2013:1	1.9	1.0	0.6	80.4	84.0	-1.1	3.3	-0.8
2013:2	1.7	0.9	0.5	80.6	84.1	-1.5	3.1	-0.9
2013:3	2.1	1.5	0.5	81.3	85.1	-1.4	3.2	-0.2
2013:4	1.9	1.7	0.5	83.6	88.6	-1.1	2.7	0.1
2014:1	1.7	1.8	0.6	85.6	90.4	-1.1	2.7	0.3
2014:2	1.7	1.9	0.6	86.9	91.3	-1.2	2.6	0.4
2014:3	1.7	1.9	0.6	88.0	93.1	-0.8	2.5	0.5
2014:4	1.5	1.9	0.6	90.3	95.8	-1.0	2.3	0.4
2015:1	1.4	2.2	0.7	90.2	95.2	-0.9	2.3	0.7
2015:2	1.4	2.1	0.9	90.3	95.2	-0.8	2.2	0.5
2015:3	1.4	2.2	1.1	90.7	95.8	-0.5	2.2	0.6
2015:4	1.5	2.3	1.2	90.2	95.6	-0.5	2.3	0.6

[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	239.8	1.1	4.2	1.42	132.7
2014	242.3	1.0	3.0	1.05	131.9
2015	247.0	1.9	2.6	0.90	132.6
2016	255.3	3.4	2.4	0.83	134.8
2017	264.9	3.8	2.2	0.77	137.6
2018	277.2	4.7	2.0	0.73	141.3
2013:1	236.4	0.7	4.6	1.54	131.8
2013:2	242.0	1.9	4.4	1.49	134.5
2013:3	240.0	0.7	4.1	1.39	132.6
2013:4	240.8	1.1	3.7	1.27	132.1
2014:1	241.0	1.9	3.4	1.17	132.1
2014:2	241.8	-0.1	3.1	1.08	132.2
2014:3	242.6	1.1	2.8	0.98	131.7
2014:4	243.8	1.2	2.8	0.95	131.7
2015:1	244.4	1.4	2.7	0.93	132.1
2015:2	245.6	1.6	2.6	0.91	132.4
2015:3	247.8	2.2	2.5	0.89	132.8
2015:4	250.2	2.6	2.5	0.87	133.1

[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	153.5	735082.7	424682.2	303904.9	189743.4	-47874.8	135373.4
2015	157.8	755636.4	429872.6	315514.3	193150.9	-42988.5	139912.9
2016	161.7	774498.7	439815.9	323556.4	197878	-42985.8	143766.2
2017	165.8	793916.4	450535.5	332193.9	201835.6	-42994.6	147654.4
2018	169.9	813828.5	461630.8	340980.7	205872.3	-43013.8	151641.9
2013/12	1.7		0.8	6.9	-0.8		6.5
2014/13	2.6		0.4	9.0	1.6		5.2
2015/14	2.8		1.2	3.8	1.8		3.5
2016/15	2.5		2.3	2.6	2.5		2.8
2017/16	2.5		2.4	2.7	2.0		2.7
2018/17	2.5		2.5	2.6	2.0		2.7
2013:1	148.3	177519.5	105980.9	63263.4	48156.3	-9136.5	30744.6
2013:2	149.2	178660.4	105506.8	65944.1	45724.2	-8941.9	29572.8
2013:3	150.3	179940.8	105672.5	73909.9	46393.6	-13073.1	32962.1
2013:4	150.9	180671.6	105782.4	76994.9	46565.5	-12835.3	35835.9
2014:1	151.8	181776.6	105866.5	74932.1	48251.1	-12765.7	34507.4
2014:2	153.1	183257.9	106231.6	73897.9	46774.2	-11870.1	31775.8
2014:3	154.2	184619.2	106439.4	77309.5	47552.7	-12488.8	34193.7
2014:4	154.9	185429.0	106144.7	77765.3	47165.3	-10750.2	34896.5
2015:1	155.8	186559.3	106671.4	75321.1	49960.4	-10752.3	34641.4
2015:2	156.9	187849.0	107200.8	78870.5	47084.9	-10749.7	34557.4
2015:3	158.9	190255.7	107732.8	80635.2	47855.5	-10744.9	35222.9
2015:4	159.5	190972.3	108267.5	80687.6	48250.2	-10741.7	35491.2

[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	5.9	1549.7	91.1	47.1	-65.9
2014	5.7	1613.9	91.5	52.2	-80.9
2015	4.5	1685.8	75.8	55.9	-72.0
2016	3.2	1758.3	56.5	60.5	-72.3
2017	1.3	1835.2	24.3	63.2	-72.7
2018	0.2	1919.5	3.7	64.9	-73.3
2013:1	3.5	373.6	13.0	11.9	-14.1
2013:2	8.1	374.9	30.5	11.2	-8.4
2013:3	5.0	385.5	19.4	11.5	-22.2
2013:4	8.1	394.8	32.1	11.9	-21.1
2014:1	2.3	394.6	9.1	12.4	-19.3
2014:2	8.0	393.5	31.6	12.8	-20.9
2014:3	5.1	403.1	20.6	13.0	-23.2
2014:4	7.4	407.9	30.0	13.1	-17.4
2015:1	2.3	409.4	9.2	13.3	-15.7
2015:2	6.8	412.5	28.1	13.6	-18.9
2015:3	5.0	421.0	20.9	13.9	-19.9
2015:4	5.4	425.8	22.9	14.2	-17.5

[1] GDP at market prices (Financial Year)

WORLD FORECAST DETAIL

Growth Of Real GNP

	2010	2011	2012	2013	2014	2015
U.S.A.	2.5	1.6	2.3	2.2	2.3	3.0
U.K.	1.9	1.6	0.7	1.7	2.6	2.8
Japan	4.7	–0.4	1.7	1.6	0.3	1.2
Germany	4.1	3.6	0.4	0.1	1.4	1.3
France	1.9	2.1	0.4	0.4	0.4	0.8
Italy	1.7	0.6	–2.3	–1.9	–0.3	0.4

Real Short-Term Interest Rates

	2010	2011	2012	2013	2014	2015
U.S.A.	–3.0	–2.0	–1.4	–1.6	–1.2	–0.8
U.K.	–3.6	–2.4	–1.1	–1.3	–1.0	–0.7
Japan	0.5	0.2	–0.2	–2.6	–1.3	–1.3
Germany	–1.3	–0.6	–0.9	–0.8	–1.0	–1.4
France	–1.3	–0.6	–0.3	–0.4	–0.4	–0.9
Italy	–2.0	–1.6	–0.6	–0.2	–0.2	–0.9

Real Long-Term Interest Rates

	2010	2011	2012	2013	2014	2015
U.S.A.	1.2	0.3	0.2	0.4	0.7	1.5
U.K.	0.3	0.2	–0.8	–0.4	0.1	0.3
Japan	0.3	–0.2	–0.7	–1.2	–1.3	–1.1
Germany	1.2	1.2	0.2	0.1	–0.5	–0.7
France	1.6	1.7	0.7	0.5	–0.2	–0.5
Italy	1.2	1.5	0.7	0.5	–0.2	–0.5

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

	2010	2011	2012	2013	2014	2015
U.S.A.	84.0	79.8	81.6	82.1	83.0	83.2
U.K.	88.6	88.7	92.4	90.8	98.6	101.4
Japan	79.5	80.6	79.6	63.5	61.1	60.7
Germany	101.3	100.1	96.7	99.0	100.5	100.2
France	103.5	102.9	99.5	100.7	101.7	101.4
Italy	107.4	107.2	105.2	106.9	107.8	107.0

[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

	2010	2011	2012	2013	2014	2015
U.S.A.	1.6	3.1	2.1	1.5	1.7	1.3
U.K.	4.5	3.5	2.1	1.9	1.7	1.4
Japan	–0.7	–0.3	0.0	0.4	2.8	1.4
Germany	1.1	2.1	2.0	1.5	1.0	1.2
France	1.5	2.1	2.0	0.9	0.6	0.6
Italy	1.5	2.8	3.0	1.2	0.2	0.4

Nominal Short-Term Interest Rates

	2010	2011	2012	2013	2014	2015
U.S.A.	0.1	0.1	0.1	0.1	0.1	0.6
U.K.	0.7	0.9	0.9	0.6	0.6	1.0
Japan	0.2	0.2	0.2	0.2	0.1	0.2
Germany	0.8	1.4	0.6	0.2	0.2	0.1
France	0.8	1.4	0.6	0.2	0.2	0.1
Italy	0.8	1.4	0.6	0.2	0.2	0.1

Nominal Long-Term Interest Rates

	2010	2011	2012	2013	2014	2015
U.S.A.	3.1	1.9	1.8	2.1	2.5	3.4
U.K.	2.4	2.0	0.9	1.3	1.9	2.2
Japan	1.2	1.0	0.9	0.7	0.5	0.8
Germany	2.8	2.7	1.6	1.6	1.2	1.2
France	2.8	2.7	1.6	1.6	1.2	1.2
Italy	2.8	2.7	1.6	1.6	1.2	1.2

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

	2010	2011	2012	2013	2014	2015
U.S.A.[1]	83.73	78.08	80.90	85.50	88.60	89.00
U.K.	1.58	1.61	1.59	1.55	1.56	1.55
Japan	87.48	79.36	80.51	98.00	104.50	104.00
Eurozone	0.75	0.71	0.78	0.79	0.74	0.75

[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