LIVERPOOL INVESTMENT LETTER

July 2016

LIVERPOOL RESEARCH GROUP IN MACROECONOMICS

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

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

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BREXIT AND THE OUTLOOK

Now that the Brexit vote is over and the people have voted to leave we have had the 'great disaster' predicted by all the pro-EU doomsters. However doom has refused to materialise except in the minds of a number of forecasters.

The pound has fallen as widely expected, by around 10%. This represents its workings as an automatic stabiliser. It did the same after the financial crisis and after we left the ERM. As we know from both these events it is a helpful to growth and recovery in the face of shocks.

In the case of Brexit it will provide a powerful stimulant in the coming months. Judging from the UK equity market reactions the economic prospects have not changed much since Brexit; equities fell sharply at first but then recovered all their losses. It is widely said that investment will be negatively affected, but this depends on the progress of plans for Brexit policy.

There are two possible outcomes. At one extreme there is Brexit-lite where the UK goes for a Norway-type arrangement, and attempts to square this with a limit on unskilled immigration, as demanded in the referendum. This would be more or less the status quo from the economy's point of view.

At the other extreme the UK could leave the EU entirely and go (optimally) to unilateral free trade. This would lower consumer prices sharply, ending EU protection of food and manufacturing, and act like a large tax cut, boosting spending and the economy at large outside these protected areas. It would also boost competition in these protected areas, stimulating productivity growth. Very likely the EU would want some free trade agreements for EU industries highly integrated with the UK, such as cars, where EU producers would find their margins squeezed badly in the UK market; these would certainly be agreed by the UK over some transitional period. In the long run the EU would have to loosen up its protectionist approach to these industries to match the UK's liberalisation programme.

Table 1: Summary of Forecast

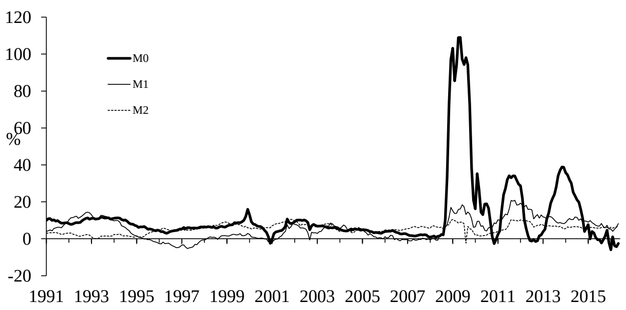
	2014	2015	2016	2017	2018	2019	2020
GDP Growth[1]	2.9	2.2	2.3	2.7	2.7	2.8	3.4
Inflation CPI	1.7	0.1	1.3	2.9	3.3	2.8	2.1
Wage Growth	1.2	2.7	3.4	4.8	5.1	3.1	3.4
Unemployment (Mill.)[2]	1.1	0.9	0.8	0.8	0.7	0.7	0.7
Exchange Rate[3]	87.1	91.6	81.8	77.7	76.1	74.8	73.6
3 Month Interest Rate	0.6	0.5	0.7	2.2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

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

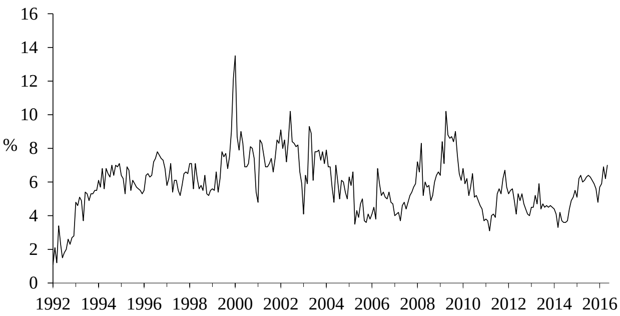
There may be attempts by the EU to raise protectionist barriers against the City. But these need to be viewed against the background of a huge world market in financial products whose prices would not be affected by EU demand-switching that would have an insignificant effect on total world demand for these products and so on world prices. The City would simply divert its product to other markets.

Weighing up all these possible outcomes, it looks as if the growth outlook is either much the same, with Brexit-lite, or somewhat better with the unilateral free trade option. We think the last is more probable, because it is most clearly in line with the demands emerging from the referendum vote — for autonomy from the EU, for immigration control through a green card system and for reduced prices from free trade — and our new forecast is based on it.

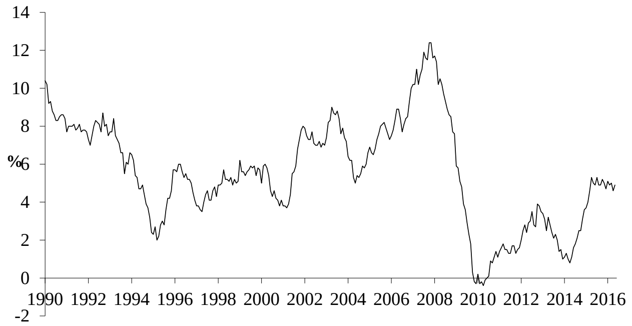
U.S.: Growth in Monetary Aggregates (Yr - on - Yr)



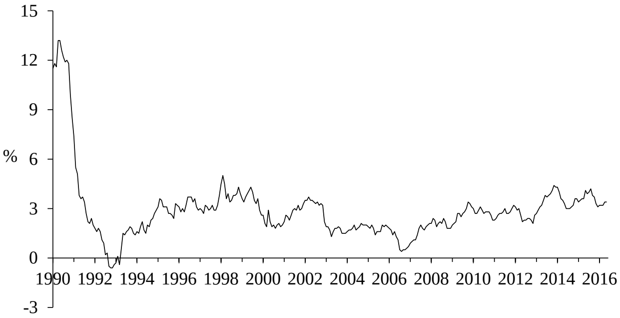
UK: Notes and Coins in Circulation Growth



Eurozone M3 Growth



Japan: Growth of M2+CD's



FOCUS ON JAPAN

Francesco Perugini

Japan and Brexit

On June 23, the British voted in a referendum to leave the European Union. The Brexit vote sent the Japanese yen shooting up in value — it soared above 100 against the dollar for the first time in 31 months — as risk averse investors turned to this traditionally “safe” currency. Also, the Japanese stock market saw the largest single day drop since the year 2000 — the benchmark Nikkei 225 tumbled by 1,286 points, or 7.92%, to close the day’s trading on the Tokyo Stock Exchange at 14,952.

A few days after the vote, Japanese Prime Minister Shinzo Abe held an emergency meeting with the Bank of Japan (BOJ) and Ministry of Finance. At the meeting, he gave instructions for policymakers to “continue to work toward market stability.” Finance Minister Taro Aso indicated that the ministry was ready to intervene in the markets if necessary. “We are very concerned about the risks this will have on the world economy, finance, currency markets and other areas,” Aso told reporters. Separately, BOJ Governor Haruhiko Kuroda said the central bank will do its utmost to stabilize financial markets in cooperation with its overseas counterparts.

Some economists said the rising yen and tumbling Nikkei average were expected and so were the negative effects on the economy. But they also warned that these effects could remain in the long term too, depending on how Britain’s exit from the EU will affect the global economy. However, these concerns are overdone. As for the UK, where Brexit will herald a major growth-boosting period, the Japanese economy will be affected only marginally and probably only those Japanese companies based in the UK will be interested most.

Experts believe that with Brexit some Japanese firms may start to run down their investments in the country and probably turn to other EU countries. Britain is currently home to £38.2 billion ($55.4 billion) of Japanese investment — more than anywhere else in Europe — with more than 1,300 firms providing 140,000 jobs. Since the 1980s Japan has invested heavily in Britain with manufacturers like Nissan Motor Co., Toyota Motor Corp. and Honda Motor Co. setting up large production bases here. More recently Hitachi Ltd. has made the country its base for train manufacturing in Europe. Japanese firms now account for 49.5% of car production in Britain with a majority of cars made in Britain exported to the EU.

However, moving major plants outside the UK would be difficult. “Nissan and other major Japanese investments in Britain were often in heavy industry, all costing money to close or move” said Nick Woodford, partner responsible for PwC’s Japanese business network in the UK. Other manufacturing industries, such as Hitachi Rail’s railway equipment or the NuGen, a nuclear energy joint venture, have made significant investments in terms of money, but also in infrastructure and in nuclear plant and physical presence, so these could not be easily or quickly moved.

Britain’s decision to divorce with the EU could also threaten the existing financial setup. Japanese banking and brokerage companies will likely have to rethink their business strategies for European operations. Many set up their bases for European operations in the City on the basis of the “single passport” system that allows financial services operators legally founded in an EU member nation to establish or provide their services in the other member countries without further authorization requirements. “It would be an option to move our base (out of London) before the outcome of negotiations between Britain and the EU over the exit is made formal, especially if those talks are dragged out,” said a senior official at Sumitomo Mitsui Banking Corp., one of Japan’s three megabanks.

However, all these issues are entirely subject to the upcoming negotiations on exit that will take place between the UK and the EU once a new government is in place, expected by early September. There are various possible outcomes between ‘Brexit-lite’ which would be similar to the status quo, as in the Norway relationship, and full exit to unilateral free trade, which would undoubtedly lead to free trade arrangements similar to the status quo for particular highly integrated industries such as cars. As for the City too much fuss is made of passporting which can easily be sidestepped by local offices or by ‘equivalence’. Besides it must be remembered that the world prices of financial products will not be affected by EU protectionism of Frankfurt or Paris: the City will simply divert production to other markets at the same world prices.

Overall, in Japan in the short term the strengthening of the yen and the decline in Japanese equity prices may erode exporters’ profits, slow wage growth and dampen consumer sentiment — some estimates are for a reduction of Japanese GDP growth by 0.1 to 1 percentage points. However, the real issue for Japan is the slow economic growth that has beset the country since the early 1990s. Aggressive structural reforms are essential to pull Japan out of decades of malaise, but economists say the flaws in Abe’s piecemeal approach are evident in the lack of progress after more than three years of “Abenomics”. “Abenomics has made progress in revitalizing the Japanese economy but sustained higher growth and inflation remain elusive,” the IMF said in a report at the conclusion of annual talks in Tokyo. It added that in order to achieve those targets a “more substantial, coordinated policy upgrade”, including steps to boost incomes and achieve labour reforms, are needed. “Abenomics needs to be reloaded,” it said, adding that monetary and fiscal policies alone cannot realize the government’s two percent inflation target.

MARKET DEVELOPMENTS

Mainstream opinion has been bearish on Brexit. This has usefully driven down the exchange rate, enabling inflation to move up towards its 2% target, and stimulating the trade balance which has become unsustainably negative. With the most likely policy being unilateral free trade the UK looks in line for a major supply-side boost. This should be good for equities long term. With inflation tracking higher we may also soon see the end of the very low interest rates that have so wrecked the market for savings. Though bonds have done well as a safe haven in recent bumpy conditions, they will on this outlook lose their lustre.

Table 1: Market Developments

	Market Levels Jun 3	Jul 1	Prediction for Jun/Jul 2017 Previous Letter	Current View
Share Indices				
UK (FT 100)	6210	6504	8873	9295
US (S&P 500)	2099	2099	2582	2582
Germany (DAX 30)	10103	9680	15650	14994
Japan (Tokyo New)	1337	1246	1883	1754
Bond Yields (government				
UK	1.41	1.00	2.10	2.10
US	1.71	1.46	2.80	2.80
Germany	0.07	–0.13	0.70	0.70
Japan	–0.11	–0.23	0.10	0.10
UK Index Linked	–0.99	–1.39	0.10	0.10
Exchange Rates				
UK ($ per £)	1.45	1.34	1.50	1.40
UK (trade weighted)	86.92	81.34	90.80	90.80
US (trade weighted)	100.76	99.54	102.0	100.0
Euro per $	0.88	0.90	0.93	0.93
Euro per £	1.28	1.20	1.40	1.30
Japan (Yen per $)	106.8	102.6	121.2	112.0
Short Term Interest Rates (3-month deposits)				
UK	0.60	0.55	1.00	1.00
US	0.60	0.80	1.30	1.30
Euro	–0.31	–0.28	–0.20	–0.20
Japan	–0.20	–0.20	0.00	0.00

Table 2: Prospective Yields [1]

Equities: Contribution to £ yield of:

	Dividend Yield	Real Growth	Inflation	Changing Dividend Yield	Currency	Total
UK	3.40	2.4	1.5	39.00		46.30
US	1.90	2.5	1.5	19.00	–4.73	20.17
Germany	2.60	1.8	1.1	52.00	–8.21	49.29
Japan	1.70	1.2	0.6	39.00	–14.33	28.17
UK indexed[2]	–1.39		1.5	1.00		1.12
Hong Kong[3]	2.60	6.0	1.5	–5.00	–4.73	0.37
Malaysia	3.30	5.4	1.5	55.00	–4.73	60.47
Singapore	3.50	3.4	1.5	23.00	–4.73	26.67
India	1.40	7.5	1.5	24.00	–4.73	29.67
Korea	1.10	3.0	1.5	–19.00	–4.73	–18.13
Indonesia	2.20	5.3	1.5	31.00	–4.73	35.27
Taiwan	2.80	3.4	1.5	14.00	–4.73	16.97
Thailand	3.20	4.0	1.5	35.00	–4.73	38.97

Bonds: Contribution to £ yield of:

	Redemption Yield	Changing Nominal Rates	Currency	Total
UK	1.00	–11.00		–10.00
US	1.46	–13.40	–4.73	–16.67
Germany	–0.13	–8.30	–8.21	–16.64
Japan	–0.23	–3.30	–14.33	–17.86

Deposits: Contribution to £ yield of:

	Deposit Yield	Currency	Total
UK	0.55		0.55
US	0.80	–4.73	–3.93
Euro	–0.28	–8.21	–8.49
Japan	–0.20	–14.33	–14.53

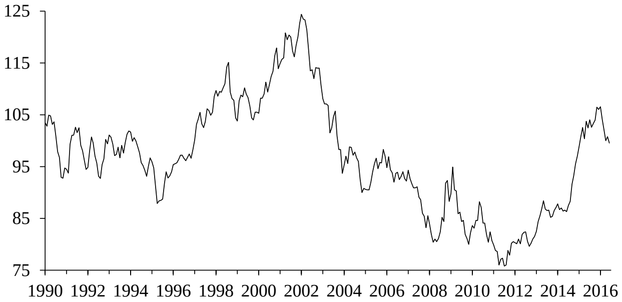
[1] Yields in terms of €s or $s can be computed by adjusting the £-based yields for the expected currency change.
[2] UK index linked bonds All Stocks
[3] Output based on China.

Table 3: Portfolio(%)

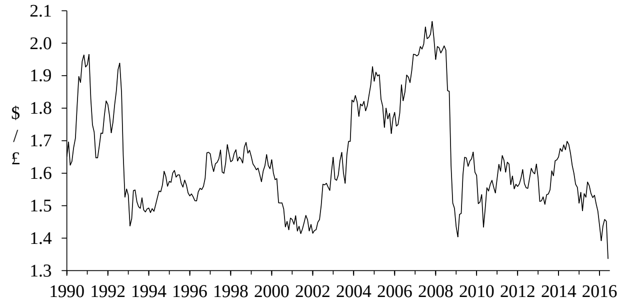
	Sterling Based Investor		Dollar Based Investor		Euro Based Investor	
	June Letter	Current View	June Letter	Current View	June Letter	Current View
UK Deposits (Cash)	5	5	5	5	1	1
US Deposits	-	-	-	-	-	-
Euro Deposits	-	-	-	-	-	-
Japanese Deposits	-	-	-	-	-	-
UK Bonds	-	-	-	-	-	-
US Bonds	-	-	-	-	-	-
German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

INDICATORS AND MARKET ANALYSIS
FOREIGN EXCHANGE MARKETS

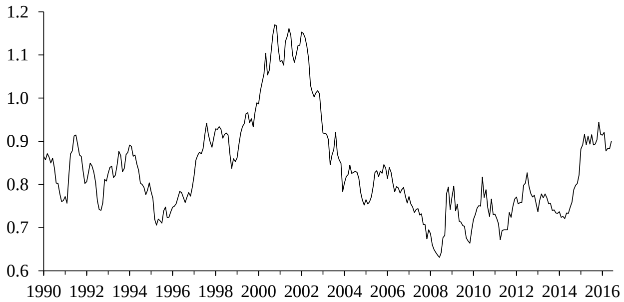
US : Trade Weighted Index
(Bank of England 1990 = 100)



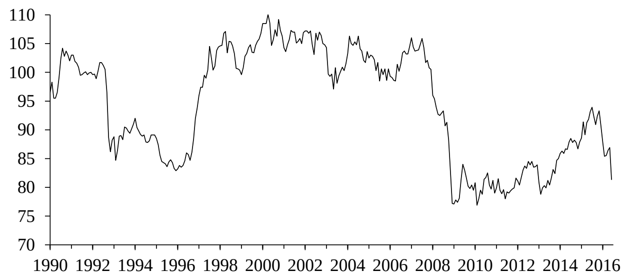
UK: Dollars Per Pound Sterling



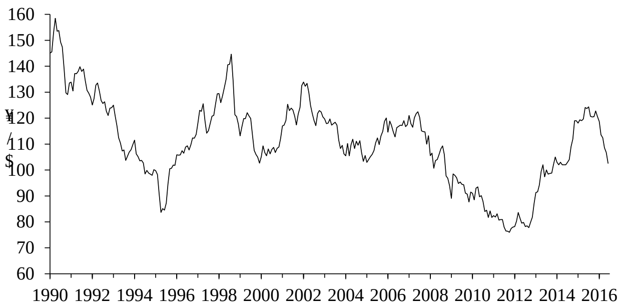
Euro per US dollar



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

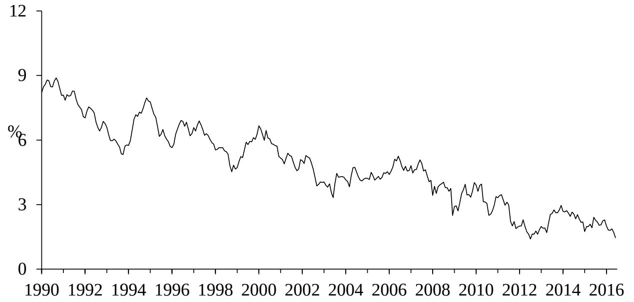


Japan : Yen Per U.S. Dollar

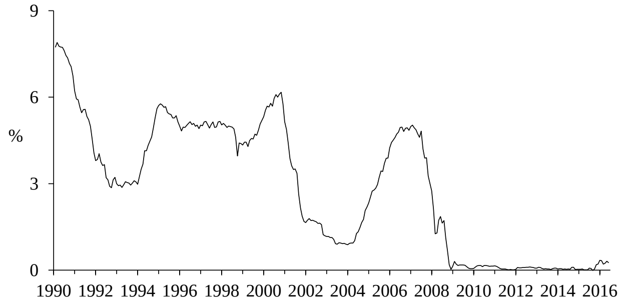


GOVERNMENT BOND MARKETS

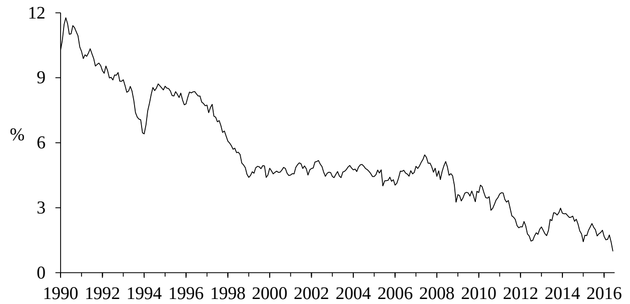
U.S.: Yield on Long-Term Government Bonds



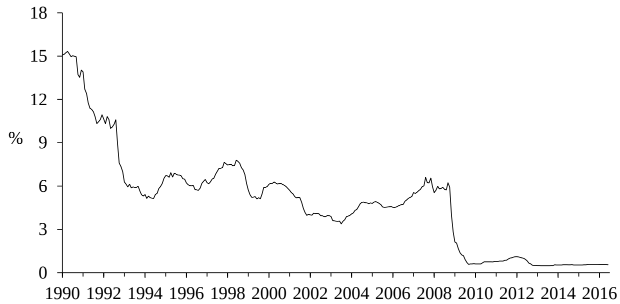
U.S. : 3-Month Treasury Bill



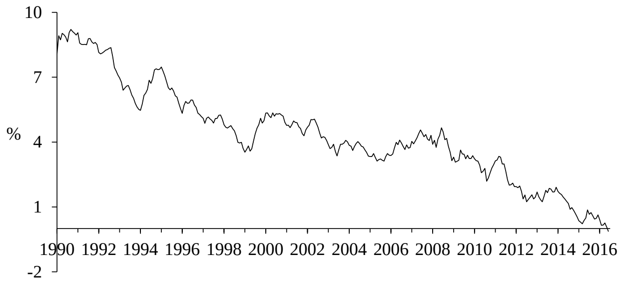
U.K.: Yield on Long-Term Government Bonds



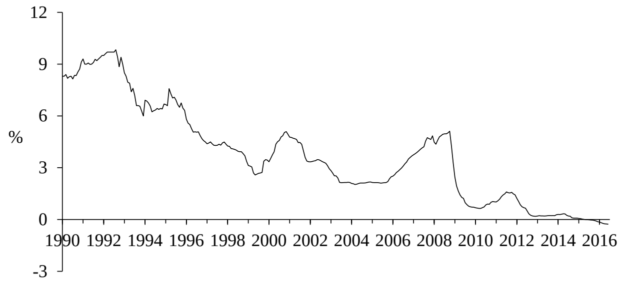
U.K. : 3-Month Interbank Rate



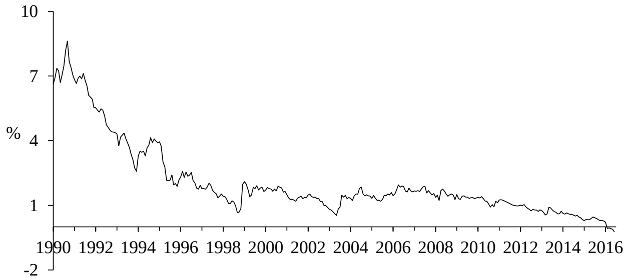
Germany: Yield on Public Authority Bonds



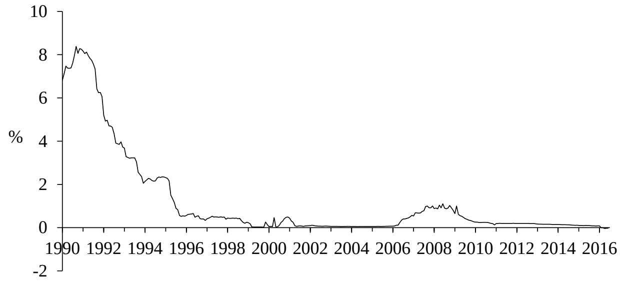
Germany : 3-Month Interbank Deposit Rate



Japan: Yield on Long-Term Government Bonds

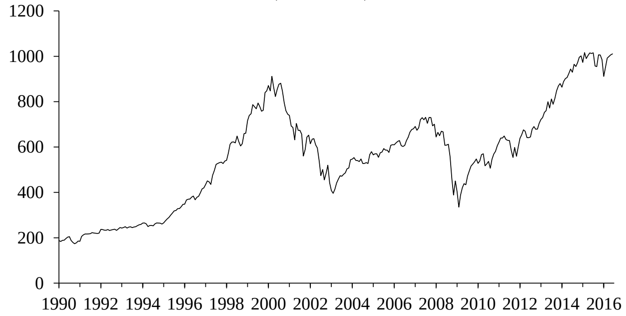


Japan : 3 Month Money Market Rate

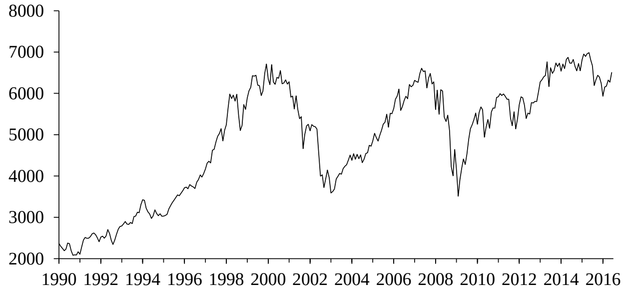


MAJOR EQUITY MARKETS

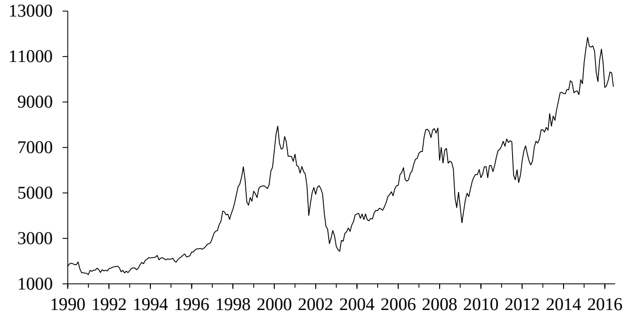
U.S. : S & P 400 Industrial
(1985=100)



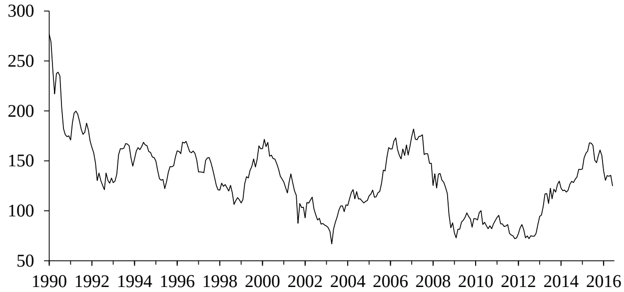
U.K. : FTSE-100 Index
(10 April 1962=100)



Germany : DAX 30



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



EMERGING MARKETS

Anupam Rastogi

India

The Indian economy is growing at a healthy pace of 7.5%. With good monsoon underway, India faces tailwinds such as a revival in rural consumption and a large pay increase to the government employees. According to the India Ratings and Research consumption would rise by 451.1 billion rupees ($6.7 billion), or 0.3% of gross domestic product. Savings too would increase by 0.2% of GDP.

The Nikkei Manufacturing PMI in India rose to 51.7 in June of 2016 from 50.7 in May. It was the highest reading since April, as both production and new export orders rebounded. The World Bank expects the Indian economy to grow 7.7% in the current financial year and the next.

Consumer prices in May increased 5.8% from a year earlier, the fastest rise in nearly two years. However, core inflation still remained in negative territory at -0.5% in May as compared to -0.8% a month ago. Keeping in mind the uptick in inflation, the central bank left its main interest rate unchanged in June.

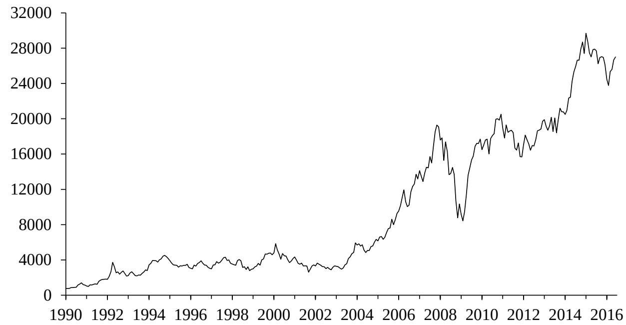
The government is expected to announce a successor to Raghuram Rajan by July 15 before the monsoon session of Parliament starts on July 18. The unexpected announcement by the central bank governor, Raghuram Rajan, questioned the direction of Prime Minister Narendra Modi's economic agenda and his political will to pursue it. The Modi government responded to it with vigour. India's government eased foreign-direct investment restrictions in several sectors to increase inflows, a move that could also pave the way for Apple Inc. to open its own stores in one of its main growth markets. The policy changes relax foreign direct investment thresholds in the retail, defence and civil-aviation sectors among others. The move signalled the government was pushing ahead with its effort to liberalize its economy.

India attracted $55bn in foreign direct investment in the year to end-March, up from $44bn in 2015, a 25% increase.

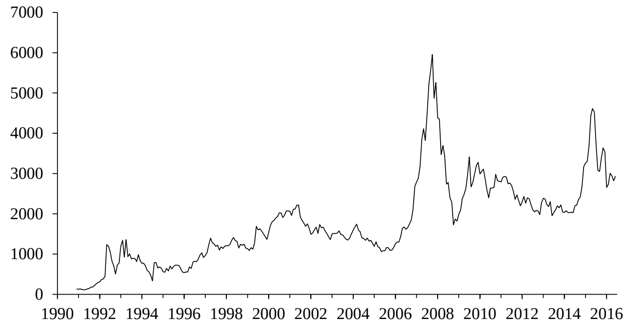
The Indian stock market put behind the fear of a slowing world economy due to Brexit as good progress of monsoon rainfall raised expectations of stronger domestic demand, corporate earnings improving and prospects of the Goods and Services Tax getting approved in the monsoon session of the parliament.

The rupee has fallen only 2% against the U.S. dollar so far in 2016 indicating that the economy is fairly stable.

India: BSE Sensitive



China: SSE Composite Index



	14–15	15–16	16–17	17–18	18–19
GDP (%p.a.)	7.3	7.6	7.5	7.5	8.0
WPI (%p.a.)	6.0	5.2	4.5	4.0	4.0
Current A/c(US$ bill.)	-34.0	-24.0	-24.0	-26.0	-28.0
Rs./$(nom.)	62.0	66.5	67.5	69.0	70.0

China

Beijing targets average annual economic growth of 6.5% until 2020, and reported 6.7% year-on-year growth in the first quarter. The chief economist for China's central bank is more optimistic and hopes that the economy will grow 6.8% in 2016, well ahead of our forecast of 6%. China's Premier Li Keqiang is confident that the country could maintain stable growth within its target range this year.

Fixed-asset investment grew 9.6% in the first five months of the year against the same period in 2015. The investment led economy is showing signs of moving sideways, if not sputtering.

China's central bank acknowledged difficulty in dealing with overcapacity and corporate-debt problems. The bank, in its annual financial-stability report, said that Beijing will maintain ample liquidity in the financial markets, amid slower growth, by utilizing tools such as open-market operations and relending, among others. It will also strengthen proactive fiscal policy and boost fiscal deficits to support the economy. It said China will expand fiscal spending and government investment, as well as cut taxes and fees for companies.

China's currency is largely fairly valued but Beijing needs to speed up financial reform to head off the risk of systemic shock according to the IMF. However, Chinese officials maintain that the country's debt is manageable.

The consumer price index rose 2.0% in May from a year earlier, compared with a 2.3% increase in April. Inflation is far short of the government's target ceiling of 3% inflation for 2016.

China's exports declined in May for the second consecutive month while imports fell slightly as weak demand further weighed on the world's second-largest economy.

Exports slid 4.1% last month from the previous year, after declining 1.8% in April. China's trade surplus widened to $49.98 billion in May from $45.56 billion in April.

Officially, the central bank has announced that China will continue to keep the yuan stable, step up financial regulation and guard the markets against systemic financial risks.

Chinese bankruptcies have surged this year as the government uses the legal system to deal with "zombie" companies and reduce industrial overcapacity as part of a broader effort to restructure the economy. Courts in China accepted 1,028 bankruptcy cases in the first quarter of 2016, up 52.5% from a year earlier, according to the Supreme People's Court. Most legal bankruptcies involve small or medium-sized enterprises where the social impact is limited. Liquidation-style bankruptcies also far outweigh restructurings in terms of absolute numbers. But courts face strong incentives to keep larger enterprises operating.

Chinese companies agreed to $121.1bn in cross-border deals between January and June, smashing the country's all-time record for full-year outbound M&A, which was set at $111.5bn in 2015. This aggressive buying by some of China's largest state-owned and private enterprises contrasted sharply with the slowest first-half for global M&A since 2013.

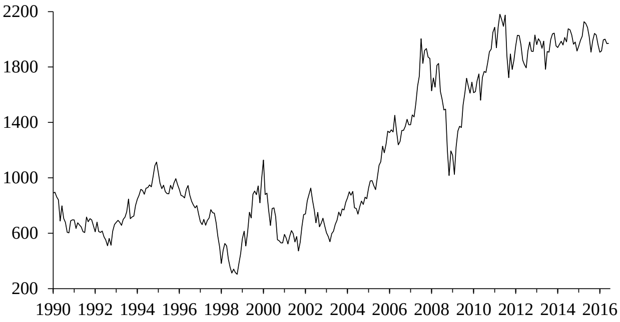
China's first multilateral development bank, Asian Infrastructure Investment Bank (AIIB) approved its maiden loan last month. So far, AIIB has "co-finance" projects such as a slum redevelopment in Indonesia with the World Bank, an ADB highway in Pakistan and an EBRD road connecting Tajikistan and Uzbekistan.

China badly wanted inclusion in the MSCI index. It had set up a special working group of its securities commission to work with the indexers on enacting the necessary reforms. MSCI said that Chinese stocks won't be included this year in its benchmark emerging markets index. MSCI said that for investors, getting money in and out of Chinese stocks easily remains a big problem. International investors still need to access the market through the qualified investor or "QFII" scheme. Under the QFII, there is a 20% limit on the monthly repatriation of funds, which makes it harder for investors to quickly cash out. MSCI says the limit must be "removed or substantially increased with a shorter repatriation horizon".

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

South Korea

Korea: Composite Index



The central bank has trimmed its annual growth estimate to 2.8% from 3% this year. We expect the bank to lower its growth outlook again in coming months. Weak consumer prices indicate Korea's lacklustre economy is still struggling with weak consumer spending. The country's inflation slowed to 0.8% in May from 1% in the prior month. The inflation is well below the central bank's annual target of 2%, allowing room to cut interest rates more.

South Korea is pulling out all the stops to give a boost to the economy and providing support to industries such as shipbuilding, which are reeling from weak demand. We expect the government to unveil further fiscal stimulus, possibly in the month of July.

South Korea's central bank has cut its main policy rate to a record low, in a move to support the economy, as diminished expectations of a U.S. rate increase over the summer gave the bank room to ease. The Bank of Korea lowered its base rate by a quarter of a percentage point to 1.25%, in response to growing pressure to spur growth. It was the first rate cut for the BOK in a year. The bank cited sluggish exports, weak domestic demand and corporate restructuring as the reasons for cutting interest rate. The next 25 basis-point rate cut is a matter of time and it may happen as early as October.

The government and the central bank agreed to jointly create a fund to recapitalize state-run banks so they can absorb bad debts from ailing shipping and shipbuilding firms. In return, the firms promised to streamline their businesses by cutting jobs and reducing costs. These actions will weaken employment and consumption.

Exports — which account for about half of Korea's output growth — contracted 6% from a year earlier in May, following the previous month's 11.2% drop, according to the Ministry of Trade, Industries and Energy. Imports dropped 9.3% from a year earlier in May, following a 14.9% decline in April. The trade surplus narrowed to $7.08 billion in May from the previous month's revised surplus of $8.82 billion.

Seoul responded smartly to Britain's vote to leave the European Union, with top diplomat Yun Byung-se saying he wanted a bilateral free-trade agreement with London. This is evidence of South Korean trade leadership in Asia, and a model for the U.S. and others. South Korea's economy has signed such deals with the U.S. (signed in 2007), the EU (2010) and China (2015). These deals expand market access for Korean exports, ease investment hurdles and open sheltered industries to foreign competition.

South Korea is overhauling its capital controls, making it easier to tap overseas markets in a partial reversal of its battle against hot money inflows since the global financial crisis.

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

Taiwan

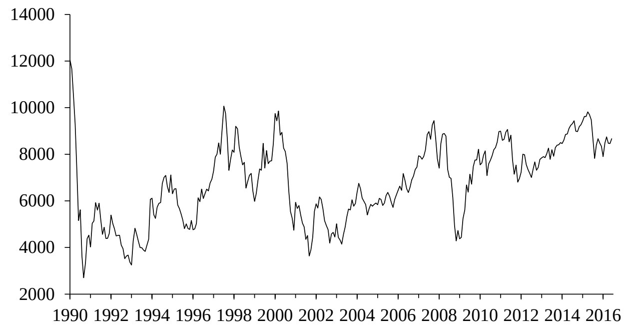
The Taiwan Research Institute expects Taiwan's 2016 economic growth to be between 0.67% and 1.83%. However, for this export oriented country there is some good news. The Nikkei Taiwan manufacturing PMI has climbed to 50.5 in June from a seven-month low of 48.5 in May.

The consumer price index rose 1.24% in May from a year earlier. Consumer prices increased for the ninth straight month due to higher food prices. Taiwan's central bank has cut interest rates further to support the economy amid slow international growth and expressing concern about the possible global aftereffects of the U.K.'s Brexit decision.

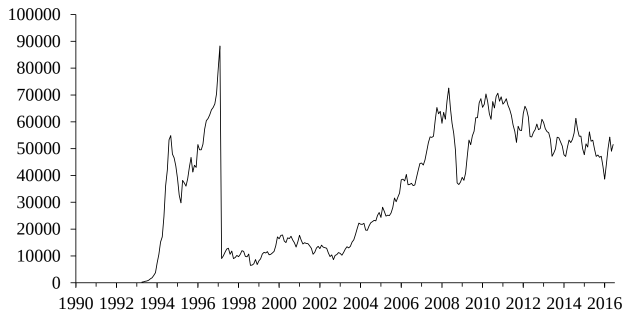
A central bank rate cut had seemed inevitable, once the government lowered its growth forecast for 2016 last month.

The Taiwan dollar is trading around 32.25 against the U.S. dollar and may depreciate marginally in coming months.

Taiwan: Weighted TAIEX Price Index



Brazil: Bovespa



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

Brazil

Brazil's economy is expected to shrink by 3.5% this year, after contracting by 3.8% last year. However, consumer confidence in Brazil has improved in June for the second consecutive month. Brazilians are less pessimistic about the country's economy in the medium term now. The consumer-confidence index polls 2,046 families in Brazil's seven largest cities. It measures their willingness to purchase various consumer goods and gauges expectations about employment, income and economic opportunities.

The Brazilian central bank expects consumer price index, or IPCA, for this year to increase 6.9% compared to its earlier forecast of 6.6% and expect it to reduce to 4.7% in 2017. We expect inflation to touch 7% in 2016 and slowing down to 5.8% in 2017.

Due to the uptick in IPCA, we expect the central bank to delay its decision to reduce the benchmark interest rate. The total amount of credit in Brazil's financial system increased slightly in May, while the nonperforming loan rate continues to deteriorate as the country struggles with an economic recession. The level of nonperforming loans rose to 5.9%

last month, versus 5.7% in April, according to the central bank.

Brazil's fiscal situation has worsened in May, and its primary budget deficit, or the budget balance before interest payments, widened to 2.5% of GDP in May. An ambitious constitutional amendment is considered by the new finance minister which will freeze budget spending and remove the uncertainty over public finances that is the root cause of Brazil's deep recession.

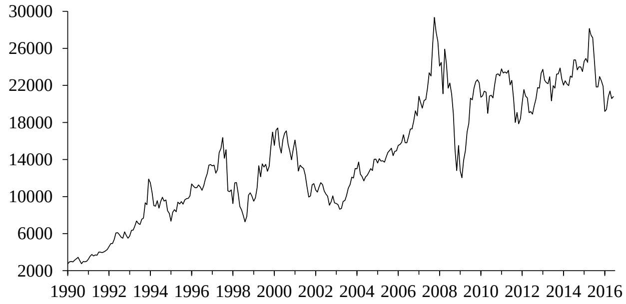
Brazil's trade surplus widened in May to $6.4 billion as exports increased more than imports. The trade surplus was $4.9 billion in April. The country exported $17.6 billion and imported $11.1 billion of goods and services in May. The local currency, the real, lost about 30% of its value against the dollar last year, which helped in boosting exports. The real has regained some of the lost ground in recent months, but rising unemployment means imported goods are still too expensive for many Brazilian consumers.

Brazilian market has grown more than 30% in the last six months.

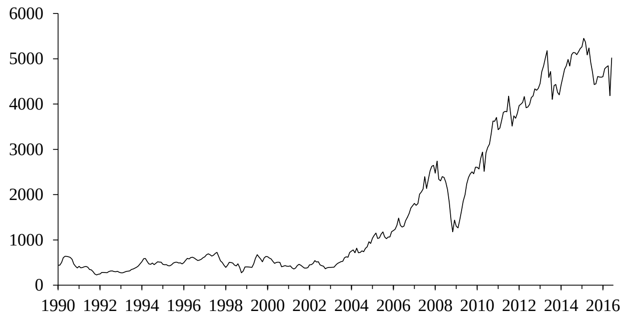
	14	**15**	**16**	**17**	**18**
GDP (%p.a.)	0.1	-3.8	-3.5	0.5	1.5
Inflation (%p.a.)	6.5	10.3	7.0	5.8	6.0
Current A/c(US$ bill.)	-104.0	-70.0	-50.0	-40.0	-44.0
Real/$(nom.)	2.4	3.9	3.8	3.5	3.6

Other Emerging Markets

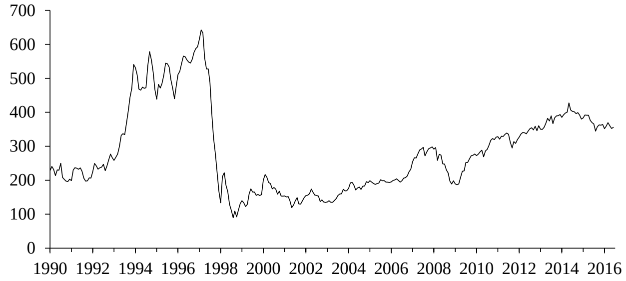
Hong Kong: FT-Actuaries



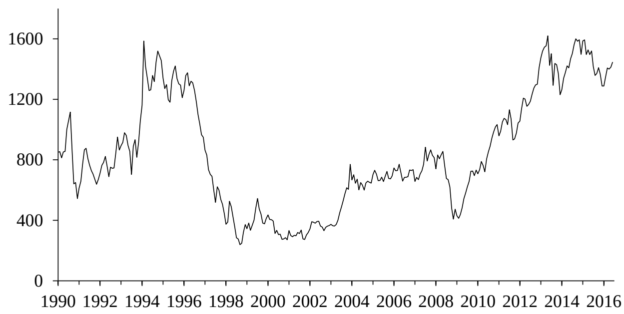
Indonesia: Jakarta Composite



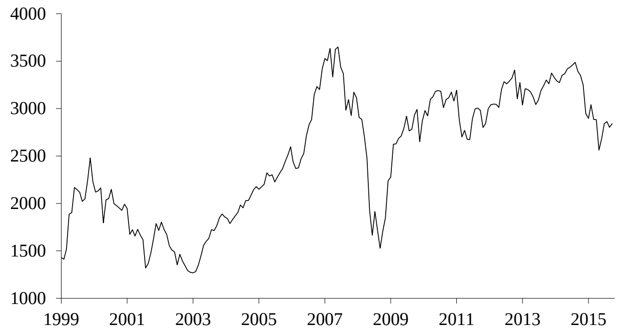
Malaysia: FT-Actuaries (US$ Index)



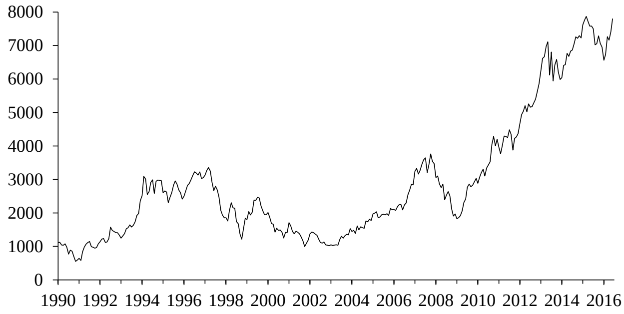
Thailand: Composite Index



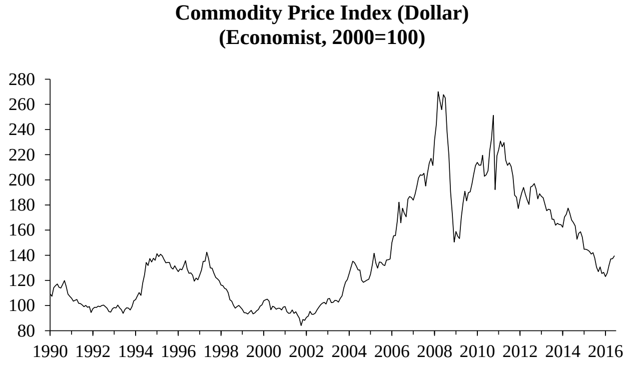
Singapore: Straits Times Index

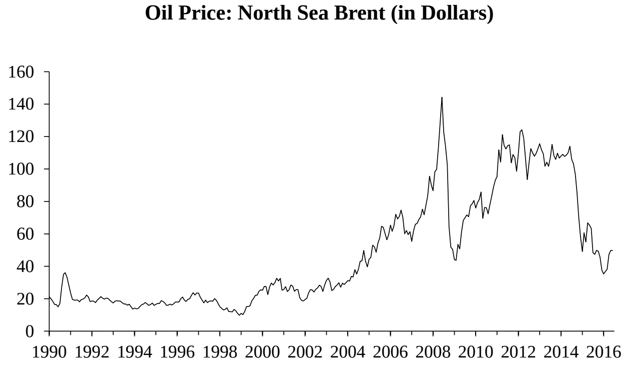


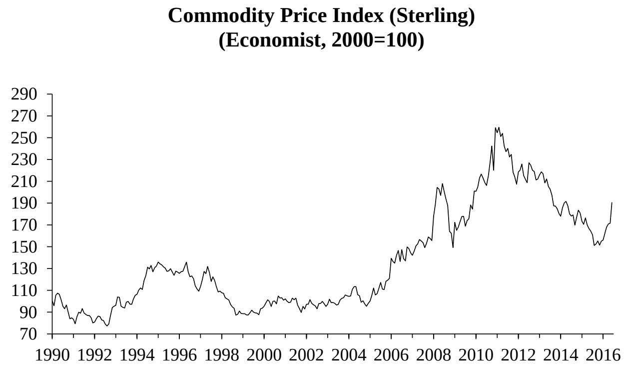
Philippines: Manila Composite

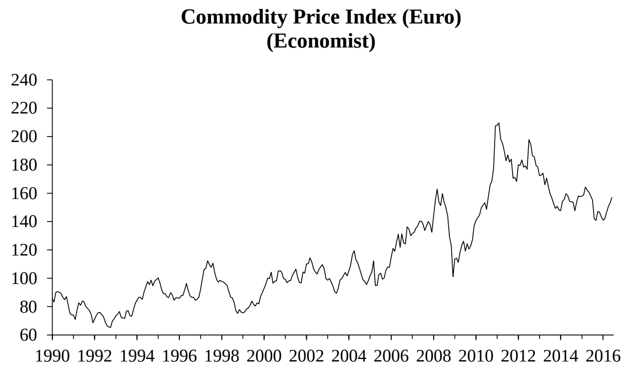


COMMODITY MARKETS









UK FORECAST DETAIL

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

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

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

Labour Market and Supply Factors (Seasonally Adjusted)

	Average Earnings (1990=100)[1]	Wage Growth[2]	Unemployment (New Basis) Percent[3]	Millions	Real Wage Rate[4] (1990=100)
2015	247.6	2.7	2.4	0.9	133.3
2016	256.0	3.4	2.1	0.8	136.1
2017	268.4	4.8	2.0	0.8	137.9
2018	282.0	5.1	1.8	0.7	139.4
2019	290.8	3.1	1.7	0.7	140.1
2020	300.7	3.4	1.6	0.7	141.9
2015:1	246.4	2.3	2.5	0.9	132.9
2015:2	246.1	2.6	2.5	0.9	132.7
2015:3	248.3	3.0	2.4	0.9	133.6
2015:4	249.7	2.7	2.1	0.9	134.0
2016:1	254.5	3.3	2.1	0.8	136.6
2016:2	254.0	3.2	2.1	0.8	135.1
2016:3	255.6	2.9	2.1	0.8	135.5
2016:4	260.0	4.1	2.1	0.8	137.0
2017:1	263.0	3.3	2.1	0.8	137.9
2017:2	266.3	4.8	1.9	0.8	137.4
2017:3	269.0	5.3	2.0	0.8	137.5
2017:4	275.3	5.9	1.9	0.8	138.7

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

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

	Expenditure Index	£ Million '90 prices	Non-Durable Consumption[2]	Private Sector Gross Investment Expenditure[3]	Public Authority Expenditure[4]	Net Exports[5]	AFC
2015	157.4	753770.6	436595.2	298648.7	197430.6	-54148.4	124757.4
2016	160.8	770055.7	445695.9	297068.1	197125.4	-42461.3	127367.1
2017	165.1	790816.9	455364.6	308041.5	199245.4	-40776.5	131044.4
2018	169.7	812428.2	466130.4	320355.6	198882.9	-38062.1	134876.0
2019	174.1	833565.5	477699.4	326332.4	202570.1	-34364.1	138667.4
2020	180.1	862130.2	490658.3	338625.4	213457.6	-36882.7	143710.4
2015/14	2.2		1.9	1.9	1.5		-2.3
2016/15	2.3		2.1	0.0	0.2		2.6
2017/16	2.7		2.2	3.7	1.1		2.9
2018/17	2.7		2.4	4.0	-0.2		3.0
2019/18	2.8		2.5	1.9	1.9		2.9
2020/19	3.4		2.7	3.8	5.5		3.6
2015:1	156.2	186964.7	107966.1	77826.4	50385.0	-15573.3	33639.5
2015:2	157.0	187977.5	108889.7	70313.2	48635.4	-11413.2	28447.6
2015:3	157.7	188823.0	109697.1	74552.3	49279.4	-14082.0	30623.8
2015:4	158.7	190005.4	110042.3	75956.7	49130.9	-13080.0	32046.5
2016:1	160.6	192288.6	110866.2	74555.9	51059.5	-12075.9	32120.6
2016:2	162.6	194619.7	111552.7	78788.9	48262.0	-12079.2	31908.8
2016:3	162.9	195077.1	112243.5	78004.2	49051.9	-12079.8	32142.0
2016:4	162.9	194982.0	112399.2	76874.2	48752.1	-10695.9	32348.1
2017:1	165.3	197774.0	112863.5	78105.7	51270.0	-11661.6	32803.2
2017:2	165.2	197838.0	113468.8	79596.3	48527.4	-11020.5	32742.5
2017:3	164.9	197442.5	114154.3	75797.5	49559.6	-9359.0	32701.2
2017:4	165.2	197762.3	114878.0	74542.0	49888.4	-8735.4	32797.4

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

Financial Forecast

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

1 GDP at market prices (Financial Year)

WORLD FORECAST DETAIL

Growth Of Real GNP

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

Real Short-Term Interest Rates

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

Real Long-Term Interest Rates

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

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

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

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

Growth Of Consumer Prices

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

Nominal Short-Term Interest Rates

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

Nominal Long-Term Interest Rates

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

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

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

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

* Forecasts based on the Liverpool World Model