LIVERPOOL INVESTMENT LETTER

June 2014

Cardiff Business School
Cardiff University

Julian Hodge Institute of Applied Macroeconomics

LIVERPOOL RESEARCH GROUP IN MACROECONOMICS

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

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

The Liverpool Research Group in Economics is pursuing a research programme involving the estimation and use of macroeconomic models for forecasting and policy analysis. The Group is now mainly based in Cardiff Business School, Cardiff University, and is indebted to the School and to the Jane Hodge Foundation for their support. The Group's activities contribute to the programmes being pursued by the Julian Hodge Institute of Applied Macroeconomics. This Liverpool Investment Letter is typeset by David Meenagh and Bruce Webb and published on behalf of the group by Liverpool Macroeconomic Research Limited, which holds the copyright

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UK politics is changing sharply as UKIP releases traditional Tory and Labour voters to push for curbs on unskilled immigration from all over the world. The link to Brexit is palpable; without it immigration curbs are impossible on the major source, the EU.

This will cause economic uncertainty but the long-term consequences will be good: the UK outside the EU will complete its reversion to a free trade, free market economy last seem 100 years ago.

Another source of uncertainty is Labour's anti-business platform. But its chances of gaining power are still remote: a coalition with the LibDems is unlikely and its voters may well betray if for UKIP.

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UK POLITICS AND IMPLICATIONS FOR ECONOMIC PROSPECTS

Politics is now beginning to impinge on economic prospects as the election is now only one year away. There are two main developments: the rise of UKIP and the threat of new Labour policies.

UKIP's rise can be dismissed as something that will not last into the general election. But this is a complacent reaction. UKIP are offering relief on one of the most pressing issues of the current time in the UK: immigration. Owing to Labour's free and easy approach to this in its government from 1997–2010, and before that the willingness of all three major parties to ignore popular protests against immigration, this issue has now acquired huge importance in the eyes of a large segment of popular opinion. This segment includes both Conservative and Labour voters — probably also Lib Dem voters. The issue also links to EU membership because this makes control of EU immigration impossible. In brief the agenda of UKIP and their supporting voters on immigration is to put strong limits on immigration of unskilled workers and to permit relatively free immigration of workers for whom the UK has a skill shortage, as well as for 'kith and kin' who have been appallingly treated under the coalition's attempt to tighten inflows. The prospect of this issue being grasped by dint of voters switching to UKIP will act as a powerful magnet for support of UKIP. The EU issue is tightly bound up with it.

How will policy proposals from the other parties react to this? It seems that if they are to stem the flood of departing voters they will need to offer UKIP-style policies: limits on unskilled immigration from all countries and a flexible green card system for skilled workers and relatives. These policies are impossible within the EU and so a creeping commitment to leave the EU seems inevitable.

The business establishment is against leaving the EU, as one would expect because the EU is a protectionist organisation that benefits existing businesses — i.e. those that have expanded due to this protection. Businesses that would benefit from the withdrawal of protection and the consumers that would enjoy the lower world prices also resulting, these two groups either do not yet exist or are largely unaware of these potential benefits. Marshalling them in favour of the argument for leaving and free trade is politically difficult.

However business is powerless in the face of the strong political tide against immigration. So we will see a rise in business uncertainty which will hinder growth in the near and medium term until the new environment outside the EU has been set up and understood.

When institutions change, even if this is for the better, such transitional uncertainty is inevitable. Fortunately it comes against a rising tide of optimism about economic prospects and so should not prevent growth continuing, but merely slow it for a time.

Table 1: Summary of Forecast

	2010	2011	2012	2013	2014	2015	2016
GDP Growth[1]	1.7	1.1	0.2	1.7	2.8	2.7	2.6
Inflation CPI	3.3	4.5	2.7	2.4	2.0	2.2	2.0
RPIX	4.8	5.3	3.2	3.2	2.5	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)

What then of the second factor: Labour's prospects of power on an increasingly shrill anti-business and anti-free-market agenda. Present projections have Labour being the largest party after the general election so its policies must be taken seriously.

There are several points to be made. The first is that given the UKIP factor these projections are highly uncertain. Secondly, it is doubtful that the Lib Dems will do a coalition deal with Labour; even with a new leader, such as Vince Cable, Labour's populist anti-market agenda looks difficult for Lib Dems to swallow. The third point is that Labour's policies are internally inconsistent; thus Ed Miliband talks of market interventions as necessary but 'temporary' because as an economist he knows they make little sense. Therefore even if Labour gains power its policies will be muddled left-centre rather than 'hard left'.

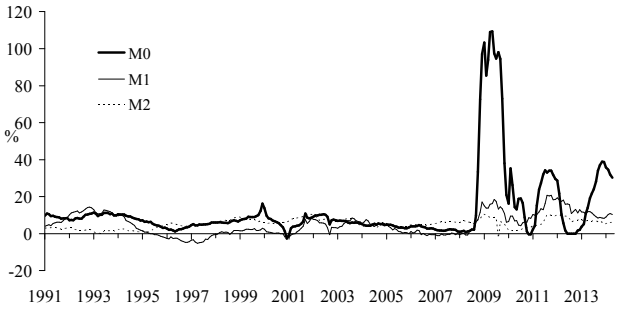
All this adds to the short-term economic uncertainty. Investment plans will be delayed as a result. However growth should continue largely because consumers are confident again. Exports too will continue to recover as the euro-zone improves. Some investment will need to go ahead anyway.

Longer term the most important aspect of the economy is membership of the EU. If 'Brexit' goes ahead, it will represent the final completion of the free market agenda that was begun by Margaret Thatcher. The basic instincts of the UK majority are for free markets and a limited government with a mandate to support only the weak who really cannot manage. These instincts have been offended by an immigration free-for-all; and they have been overridden by EU policies brought in by social democratic

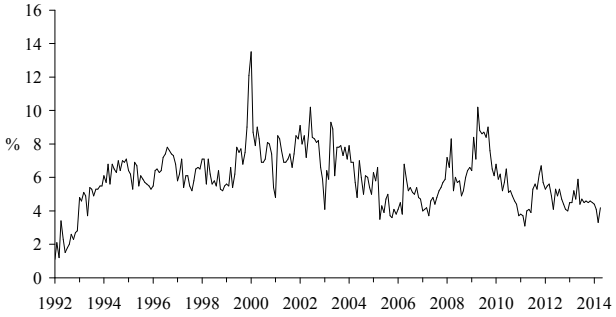
continental governments, mostly supported by the EU Commission.

Adam Smith once remarked to a young aristocratic correspondent that 'there is much ruin in a nation'. He meant by this that nations can live through difficult economic circumstances and emerge stronger at the end. The next few years in the UK will be full of economic uncertainty and a degree of 'ruin'. But within a decade the economy will be likely to be far stronger than it is today.

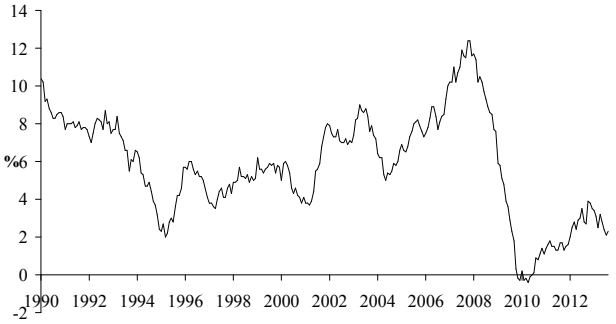
U.S.: Growth in Monetary Aggregates (Yr - on - Yr)



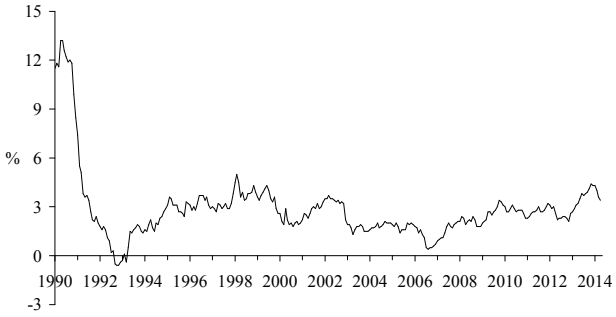
UK: Notes and Coins in Circulation Growth



Eurozone M3 Growth



Japan: Growth of M2+CD's



FOCUS ON JAPAN

Francesco Perugini

Japan's GDP Rise Signals (Temporary) Recovery

Japan's economy grew in the opening quarter of 2014 at its fastest pace since the recovery period from the 2011 earthquake and tsunami, buoyed by a rush in demand ahead of the first consumption tax hike in 17 years on April 1. The expansion of GDP corresponds to a 1.5% increase from the previous three months, the sixth straight quarter of increase. In nominal terms, or unadjusted for price changes, the economy expanded 1.2% on the previous quarter.

The stronger-than-expected results came amid concern that the economy would stall following the 3-percentage-point tax hike to 8% from last month, as it remains uncertain whether wages will grow fast enough to offset the adverse effects of the tax change on consumer spending and investment. Economic and fiscal policy minister Akira Amari pledged that the government will take necessary measures to avoid a severe economic downturn, saying at a press conference that skyrocketing sales prior to the tax hike in the January–March period were "bigger than projected" and that the negative reaction may be "short-lived".

Looking at demand components, consumer spending, which accounts for about 60% of Japan's GDP, increased 2.1% in the January–March period thanks to strong demand for high-priced durable consumer goods, such as electronics, personal computers and cars. Sales of consumer durables as a whole grew 13.7% — much faster than the 4.5% rise registered in the January–March period of 1997 just before the previous consumption tax hike. But the strong sales of those products are more a reflection of one-off consumer sentiments to buy before the tax hike than improvement in disposable income of households. Although some major firms offered the biggest pay raises in years for their workers, such wage increases are confined to a limited portion of the economy.

Corporate capital spending climbed 4.9%, suggesting Prime Minister Shinzo Abe's policies dubbed "Abenomics" — based on drastic monetary easing and massive fiscal spending — has helped shore up corporate profits and prompted companies to aggressively build plants and introduce new equipment.

On the external front, exports rose a real 6.0%, soaring from a 0.5% climb in the October–December period, due partly to increased auto exports. Imports, meanwhile, surged 6.3% with demand for natural gas and oil growing as utility firms now depend far more on fossil fuel-based power generation than on nuclear power in the wake of the Fukushima nuclear crisis in March 2011. Consequently external demand pulled down GDP growth 0.3 percentage points — the third quarter in a row in which external demand was a negative factor for growth.

The GDP deflator, a wider price gauge than the consumer price index, was up 0.01% from a year earlier, compared with a 0.4% fall in the previous period, signalling the economy is on the verge of beating nearly two decades of deflation. Wages for employees, however, dropped for the third straight quarter, down 0.3% from the October–December period, which some economists say may weigh on future consumer spending and in turn the economy across the board.

The implications of the spike in consumer spending have been interpreted in different ways by analysts. Pessimists see it as the prelude to an equal or even more pronounced decline, now that the tax increase has taken hold, while optimists say it could signal a broad and sustainable strengthening of consumer appetites. "Consumer spending is expected to grow again in the July–September quarter", said Mitsumaru Kumagai, chief economist at the Daiwa Institute of Research. "As capital spending is set to continue growing, Japan's economy is forecast to return to a growth track after the July–September period in 2014", he added. Among the optimists is also the government which says the decline will be within the range of expectations and the economy will enter a virtuous circle after recovering in the July–September period.

But the government should be cautious about latent risks that may negatively impact the economy for years to come. For instance, the government should realize that many households continue to suffer net declines in wages due to the rising prices caused by the weak yen driving up the cost of imports and the consumption tax hike. The overall effect could depress consumer sentiment over a long period unless wage increases exceed price hikes. Also, the government needs to carefully monitor whether capital investments will remain steady after the one-off factor of heightened demand before the tax hike.

The picture of overseas demand is mixed too. While the US economy appears to be picking up, opaqueness continues to prevail in Europe and in emerging economies, especially China. Real estate investments that drove the Chinese economy in recent years are shrinking. A longer-term negative impact on the Japanese economy could come from the continuing relocation of the nation's manufacturing operations abroad. Many Japanese manufacturers had already moved their production overseas during the long period of the strong yen, and they do not seem ready to shift their operation back home because they see more market potential abroad. So it is imperative that the government take measures to help Japanese companies keep their manufacturing operations at home and attract

more foreign investments. Most importantly, to lay a solid foundation for growth, the government should pay more attention to reforming the supply side of the economy through deregulation and structural reforms, which has been postponed for too long.

MARKET DEVELOPMENTS

The continuing monetary ease unleashed by Quantitative Easing is destined to continue- central banks are unwilling to withdraw the ongoing stimulus which has its effect on parts of the financial markets that bank regulation cannot reach- mainly equity and bond markets. The stimulation of these markets benefits governments as they borrow in bond markets and hold extensive equity in firms they have bailed out, mostly but not only banks.

So from an investment viewpoint it makes sense to maintain our main position in equities. Bonds are more risky as they have reached such high prices already. the position of equities is also buttressed by the return of growth. Many refer to growth as 'fragile' and 'vulnerable'; but they are missing a key point. The crisis was largely brought about by a shortage of commodities. Five years on, commodities are benefiting from extra investment and improving technology- two things that always kick in after commodity crises. Commodity prices are accordingly coming down. This will support a long upswing in the world economy- until the next commodity crisis twenty years hence.

Table 1: Market Developments

	Market Levels		Prediction for May/Jun 2015	
	May 5	May 29	Previous Letter	Current View
Share Indices				
UK (FT 100)	6822	6871	10234	9936
US (S&P 500)	1882	1920	2424	2473
Germany (DAX 30)	9530	9939	13484	13965
Japan (Tokyo New)	1182	1201	1663	1688
Bond Yields (government long-term)				
UK	2.64	2.55	2.00	2.00
US	2.60	2.45	2.10	2.10
Germany	1.46	1.36	1.50	1.50
Japan	0.61	0.58	0.70	0.70
UK Index Linked	–0.16	–0.17	0.10	0.10
Exchange Rates				
UK ($ per £)	1.69	1.67	1.56	1.56
UK (trade weighted)	86.7	86.6	82.3	82.3
US (trade weighted)	86.4	86.6	85.5	85.5
Euro per $	0.72	0.73	0.79	0.79
Euro per £	1.22	1.23	1.23	1.23
Japan (Yen per $)	102.0	102.0	98.0	98.0
Short Term Interest Rates (3-month deposits)				
UK	0.50	0.64	2.10	2.10
US	0.22	0.20	0.70	0.70
Euro	0.32	0.27	0.50	0.50
Japan	0.05	0.14	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	2.1	40.00		48.00
US	1.90	2.8	2.0	24.00	6.70	37.30
Germany	2.60	1.5	2.0	37.00	–0.42	42.68
Japan	1.90	1.6	2.0	37.00	10.36	52.86
UK indexed[2]	–0.17		2.4	–5.00		–3.07
Hong Kong[3]	2.50	7.0	2.0	6.00	6.70	24.20
Malaysia	2.90	5.2	2.0	54.00	6.70	71.10
Singapore	3.60	4.5	2.0	37.00	6.70	53.80
India	1.40	7.0	2.0	21.00	6.70	38.10
Korea	1.10	4.2	2.0	0.00	6.70	14.00
Indonesia	2.30	6.1	2.0	42.00	6.70	59.10
Taiwan	2.40	3.0	2.0	22.00	6.70	36.10
Thailand	3.40	4.1	2.0	40.00	6.70	56.20

Bonds: Contribution to £ yield of:

	Redemption Yield	Changing Nominal Rates	Currency	Total
UK	2.55	5.50		8.05
US	2.45	3.50	6.70	12.65
Germany	1.36	–1.40	–0.42	–0.46
Japan	0.58	–1.20	10.36	9.74

Deposits: Contribution to £ yield of:

	Deposit Yield	Currency	Total
UK	0.64		0.64
US	0.20	6.70	6.90
Euro	0.27	–0.42	–0.15
Japan	0.14	10.36	10.50

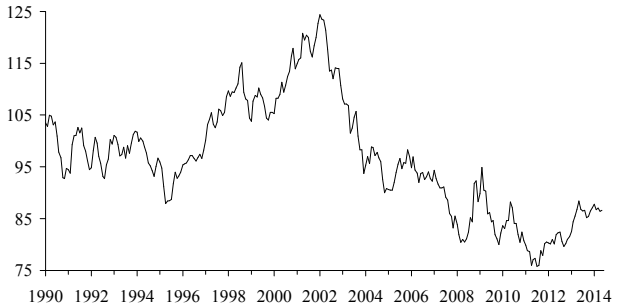
[1] Yields in terms of €s or $s can be computed by adjusting the £-based yields for the expected currency change.
[2] UK index linked bonds All Stocks
[3] Output based on China.

Table 3: Portfolio(%)

	Sterling Based Investor		Dollar Based Investor		Euro Based Investor	
	May Letter	**Current View**	**May Letter**	**Current View**	**May 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)	-	-	-	-	-	-

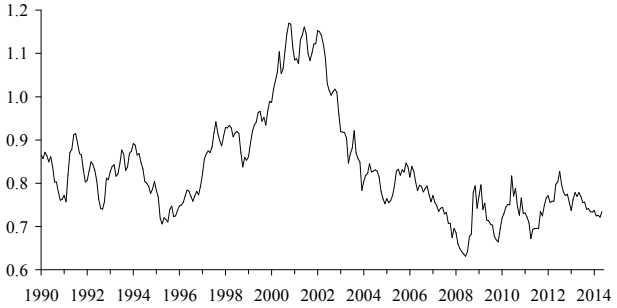
INDICATORS AND MARKET ANALYSIS
FOREIGN EXCHANGE MARKETS

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

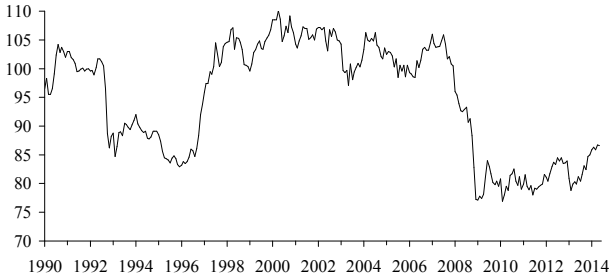


UK: Dollars Per Pound Sterling

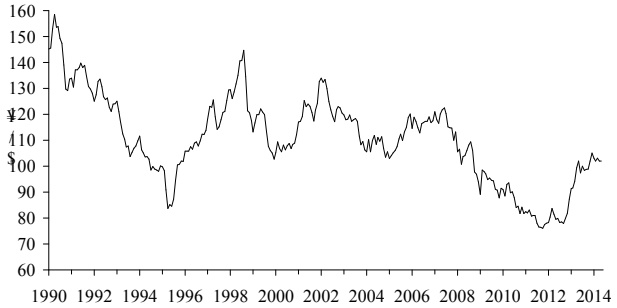
Euro per US dollar



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



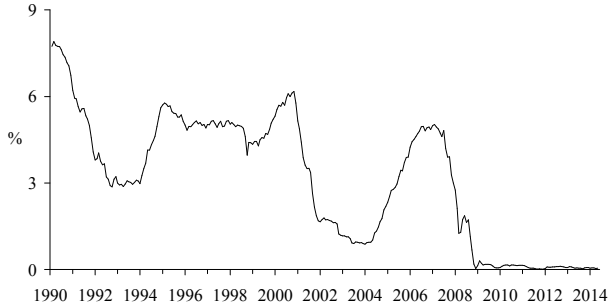
Japan : Yen Per U.S. Dollar



GOVERNMENT BOND MARKETS

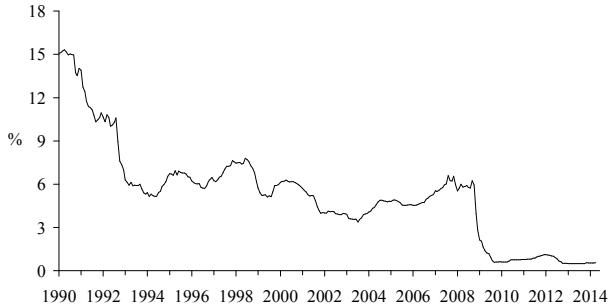
U.S.: Yield on Long-Term Government Bonds

U.S. : 3-Month Treasury Bill



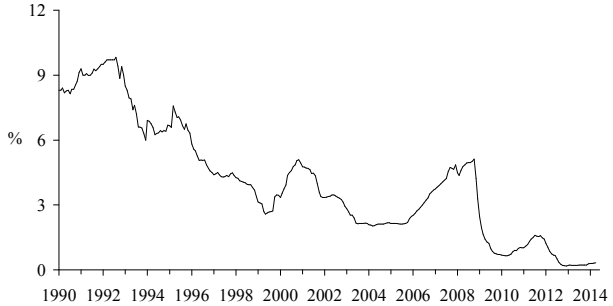
U.K. : Yield on Long-Term Government Bonds

U.K. : 3-Month Interbank Rate



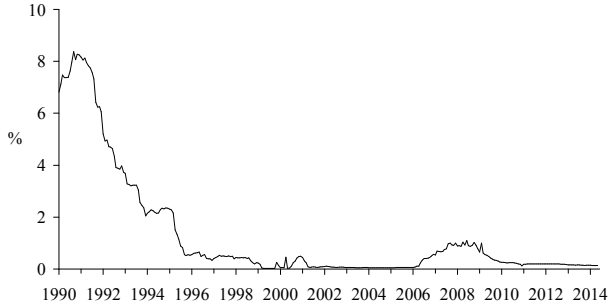
Germany: Yield on Public Authority Bonds

Germany : 3-Month Interbank Deposit Rate



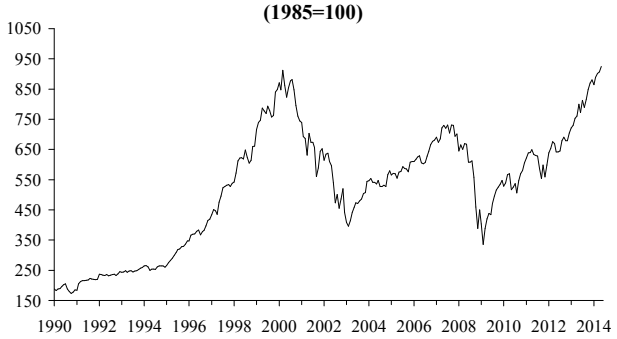
Japan: Yield on Long-Term Government Bonds

Japan : 3 Month Money Market Rate

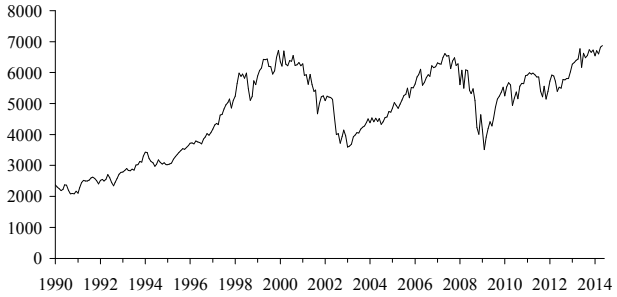


MAJOR EQUITY MARKETS

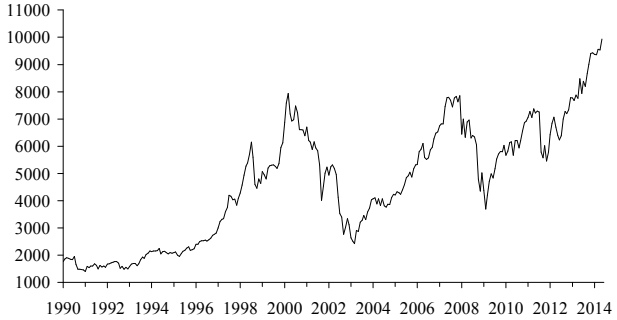
U.S. : S & P 400 Industrial
(1985=100)



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



Germany : DAX 30



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

EMERGING MARKETS

India

Narendra Modi's rise to the Prime Minister's office represents a decisive break from Indian politics of the past. With GDP growth having fallen below 5% a year — from more than 9% as recently as 2011 — India desperately needs a leader with a commitment to reform. Millions of young and restless voters who have placed their faith in Mr Modi's highly vaunted administrative skills now expect something akin to a quick transposition of these two figures. Indian voters have given the most definitive election verdict in the last three decades to Mr Modi to pursue growth oriented economic policies and do away with handouts. India has turned to the right, both economically and culturally.

Mr. Modi will be taking charge at a time when India faces daunting challenges, including not only high inflation but also a sluggish economy, slow job growth and a bureaucratic government-approval system that has held up important industrial and development projects. The problems could increase if India sees worse-than-usual monsoon rainfall, which some forecasters are predicting due to global "El Nino" weather patterns that influence monsoon precipitation.

Modi's cabinet is much leaner than that of the previous administration, a move aimed at increasing administrative efficiency and facilitating quick decision making. Three energy-related ministries, often-quarrelling, are now under one minister who is hoping to crank up the supply of power that the country needs to generate rapid economic growth.

Modi's first real test will come when the government presents an annual budget before the end of July. It will show how the government intends to contain the fiscal deficit, manage prices, simplify taxes and simplify rules for foreign investors. Industry groups have a long wish-list for the present government. The government's intention is to de-bottleneck the system.

April HSBC manufacturing PMI was 51.3, unchanged from March, for the sixth consecutive month above the 50-point mark, a reading above which indicates expansion. But retail inflation jumped up to 8.6% in April from 8.3% in the past month as food inflation rose to 9.8%. On the external front, external demand helped revive exports in the month while imports continued to decline. India's exports were up 5.3% in April. HSBC's survey of purchasing managers shows companies receiving more export orders, meaning more manufacturing exports in the future. That's good news for the overall economy, since every 10% increase in exports tends to boost GDP growth by 2.25 percentage points

India: BSE Sensitive

While the rupee has been on a hot streak, jumping to an 11-month high against the dollar on the hope that a new government will usher in a new era of growth for Asia's third-largest economy, India's central bank has been trying to cool the currency down. The Reserve Bank of India has been raking in dollars from the market, hoping to slow any sharp upward moves in the local currency. Too much appreciation of the rupee erodes the competitiveness of the country's exporters, which could lead to a widening of the country's stubborn current-account deficit. The rupee has climbed close to 6% since March, and is trading at around 58.70 to the dollar. The RBI has been taking opposite positions in the forwards market to offset the impact of its dollar buying. That means that when the RBI buys dollars in the spot market, it enters into a forward contract to sell the greenback, offsetting the impact of the intervention.

India's stock market has been on a bull run since September, when the BJP named Mr. Modi as its prime ministerial candidate. The Sensex has jumped 28% since September. The sectors mired with bureaucracy have seen strong gains over expectations that decisive leadership at the Centre will unleash a slew of reforms to revive a sagging economy. Brokerages have been coming out with optimistic Sensex targets, and there is a renewed optimism on the street. Long-term investors feel that India is at the cusp of a structural bull market. The real economy's challenges, however, persist, and the revival will be more gradual than sharp.

Fitch Ratings will wait to see if the next Indian government takes decisive policy actions to improve governance and remove infrastructure bottlenecks and red tape before revising its view of India's credit worthiness.

	11-12	12-13	13-14	14-15	15-16
GDP (%p.a.)	6.2	4.5	4.9	6.0	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	60.0	61.0	62.0

China

The Chinese economy expanded 7.4% in the first quarter of the year, down from a rise of 7.7% last year. The central government has set a growth target of around 7.5% for 2014. Chinese Premier Li Keqiang has reaffirmed that the country's economy has stabilized but still faces downward pressure.

HSBC's "flash" manufacturing PMI for China rose to 49.7, which inspired optimism that China's economy could still reach the 7.5% growth target policy makers have set for the year. The bigger worry is that average home prices grew just 0.1% in April compared with a month earlier, according to data provider China Real Estate Index Systems. Many fear this all-important sector, a significant driver of the overall economy, is nearing a troubling tipping point of falling prices and overcapacity. Demand weakened in more Chinese cities as banks continued to tighten mortgage lending and buyers stood on the sidelines, expecting developers to cut prices further. The slowdown in the property market is having a knock-on effect on factory output, retail sales, and investment in machinery, land and other physical assets, all of which posted slower growth rates compared with a year ago. Authorities hope to reverse a downturn that has led to a 9.9% nationwide decline in housing sales by value in the first four months of the year, compared with a year earlier. Construction starts for housing have fallen 24.5% over the same period.

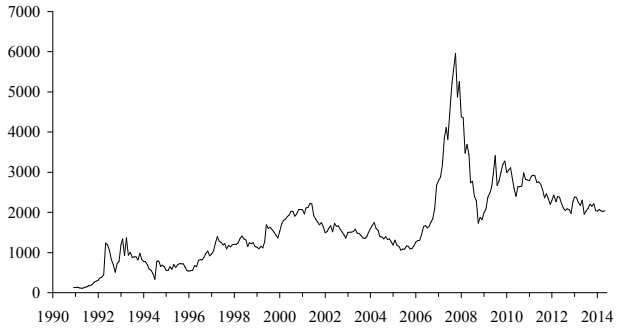
The National Development and Reform Commission, China's top economic planning agency, has listed 80 projects covering railways, gas pipelines, telecommunications and clean energy as part of Beijing's plan to let private capital in sectors of the economy that have long been dominated by state companies.

Further, China's Finance Ministry has asked local governments to speed up spending on infrastructure and other budgeted investments to give sluggish economic growth a shot in the arm.

China recorded very low consumer inflation in a year and a half in April. The consumer-price index rose 1.8% April from a year earlier compared to the 2.4% increase recorded in March, and it is well beneath the government's inflation ceiling of 3.5% for the year. Producer prices have been sliding for 26 months, highlighting the weakness in domestic demand for some key industrial materials. Prices at the factory level slipped 2% in April after a 2.3% decline in March.

Exports in April rose by a modest 0.9% from a year earlier, compared with a 6.6% decline in March. Shipments to the U.S. in April rose 12.0% on the year, while those to the European Union jumped 15.1% and those to Southeast Asia

China: SSE Composite Index



3.8%. By contrast, exports to Taiwan fell 13.9% for the month and those to Hong Kong dropped 31.4%.

China's overall imports, meanwhile, rose 0.8% in April from a year earlier, compared with an 11.5% drop the prior month. The trade surplus in April was $18.5 billion, broadly unchanged from a year ago.

Chinese President Xi Jinping and his Russian counterpart, Vladimir Putin, have signed a $400 billion contract to supply Russian gas. There is a profound shift in China's foreign policy as it challenges the legacy of the Cold War era. For China, the deal provides another source of gas for the country's resource-hungry economy. For Mr Putin, the value of the agreement is much broader as he can argue — both to the international community as well as to his own people — that he has a powerful new alliance in the east. After the eruption of the crisis in Ukraine, the US and the EU targeted sanctions to punish Russian aggression in the country.

China's yuan hit a four-week low in the last week of May against the dollar sparking fears that the surprising slump this year that has taken it to levels last seen in 2012 may go down further. The yuan fell to as low as 6.2639, and close to this year's low of 6.2676 that it hit in late April. The central bank has also been guiding it lower by setting a daily reference rate weaker, which typically sets the direction of trade. The yuan may fall more at the end of June as the mainland companies listed in Hong Kong will need dollars to pay stock dividends.

The Chinese authorities are happy as it will help Chinese exporters at a time when China's economy is broadly losing momentum. The trend of a weaker yuan seems likely to continue to support exports.

The GSK case is a warning to the international business community in China not to fall foul of the authorities. The detailed and damning allegations of corruption were laid against GlaxoSmithKline's Chinese subsidiary and travel well beyond the offices of one of the world's largest drug

makers. According to the economic crime investigation bureau of the Ministry of Public Security, "All departments and pharmaceutical production subsidiaries of GlaxoSmithKline (China) Investment were fully engaged" in bribery. The problem for companies that have adapted to the local ecosystem is that the climate has now clearly changed, and the new administration under President Xi Jinping is much less willing to tolerate blatant corruption.

	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	2.5	2.5
Trade Balance(US$ bill.)	210	214	220	220	200
Rmb/$(nom.)	6.3	6.3	6.2	6.3	6.3

South Korea

The Bank of Korea said in April that it expects the economy to expand 4% this year and 4.2% next year, up from a revised 3% growth in 2013. The bank's forecast is in line with the OECD growth forecast for this year.

South Korea's exports grew faster than expected in April, suggesting that Asia's fourth-largest economy is on track for recovery despite faltering signs elsewhere in Asia.

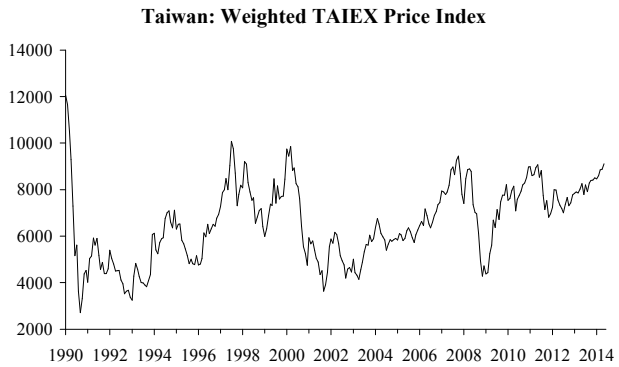
South Korean inflation in April hit an eight-month high, with the consumer price index up 1.5% from a year earlier, the fastest pace since August 2013 — adding to pressure to tame prices. The Bank of Korea may begin normalizing interest rates in the second half of this year when we expect Korea's negative output gap to have closed. The rate has been kept steady at 2.5% since May 2013.

Exports grew 9% compared to the same month a year before. However, South Korea's exports to China remained weak in April due to the slowing of Chinese growth. The increase of the won against the Chinese yuan also may have kept exports subdued. In won terms, exports in April grew only 2.2% from the same month of 2013, and exports in the first quarter of this year shrank 2.1%. Exports to China declined by 1.4% on the year.

The trade surplus widened to $4.46 billion in April from the previous month's revised $4.17 billion, beating the poll's projection of $3.79 billion. South Korea's trade balance has been in the black since February 2012.

South Korea's currency, the won, has climbed 2.4% this year to its highest level against the U.S. dollar since August 2008. What's worse for the exporters is that it has climbed 5.5% against the currency of its biggest export market, China, as Beijing has pushed the yuan lower.

	11	12	13	14	15
GDP (%p.a.)	3.6	2.0	2.8	4.0	4.2
Inflation (%p.a.)	4.0	2.2	1.3	2.5	2.5
Current A/c(US$ bill.)	27.0	44.0	71.0	80.0	80.0
Won/$(nom.)	1100	1100	1100	1020	1000



Taiwan

This year we expect GDP to grow just 2.6% as a result of a slowdown of China. The projected GDP growth would be the strongest in three years; it's still below its potential growth rate of 5%. Taiwan's growth has slowed with China's and the slowdown in advanced nations such as the U.S. and Europe. As much of U.S. growth in GDP is powered by capital investment, and consumers there haven't significantly stepped up spending, Taiwan is not benefitting from the upsurge in US growth. Besides, Taiwan has been losing global market share in smartphones, personal computers and televisions to South Korean and Chinese competitors in the recent years, while China's increasing reliance on locally made raw materials and parts has also hit Taiwanese manufacturers.

The government expects its gross domestic product to increase 2.98% in 2014, up slightly from the previously estimated 2.82% and the actual 2.11% increase in 2013. The forecast of exports growth, a key driver of the economy, was trimmed to 3.10% from 3.33%.

Unfortunately, the government does not have much room to pump additional dollars into infrastructure projects to create jobs as it did in the past two decades as the administration is already very close to its debt ceiling. Moreover, an aging population and high savings rates do

not encourage growth in household spending. Hence, to boost growth, Taiwan is looking for other drivers, including a service's trade pact with China. But political protests this year against closer trade with China, a political rival, have delayed the deal.

Inflation, in the the consumer-price index, is forecast to increase 1.53% in 2014, up from 1.07% previously, but it is still one of the lowest rates in Asia.

Export orders, an early indicator of actual exports, rose 8.9% in April from a year earlier to US$38.87 billion, after a 5.90% increase in March. The April figure is not an aberration; the export order figure suggests that Asian economies should pick up pace as the year goes on after a poor performance in the first quarter of the year. But growth of exports has been slowing for decades, from an average of near 9% in 1991–2000 to slightly over 7% in 2001–2010 and less than 4% since 2011, the data show.

	11	**12**	**13**	**14**	**15**
GDP (%p.a.)	4.0	1.3	2.1	2.6	3.0
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	30.5	30.5

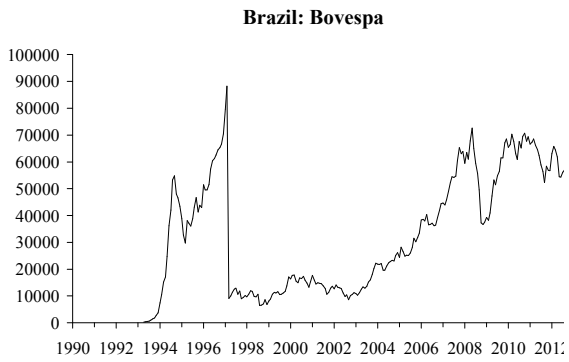
Brazil

Brazil's economy barely grew in the first quarter from the fourth quarter of 2013. The outlook for 2014 is 1.7% in 2014 from 2.3% for all of last year. Because slowing down in growth is due to a combination of weak industrial production, tepid investment and low consumer and business confidence.

Brazil's main consumer confidence index fell in May to its lowest since April 2009, and the Brazilian Central Bank's IBC-Br economic activity index fell 0.11% in March from the previous month on a seasonally adjusted basis. Consumer spending has been weak as household debt has climbed.

The weak economy prompted the central bank to focus monetary policy on boosting economic activity. According to the finance minister Mantega, inflation is coming down. The bank ended its year-long cycle of interest rate increases in its last policy-setting council and held the benchmark Selic rates steady. The central bank has raised the benchmark Selic rate nine times over the past year, from a record low of 7.25% to the current level of 11%, as it tries to tame inflation, which has stubbornly remained above the 6% level.

Export gains helped Brazil to reduce its external deficit last month, but on a per-GDP basis the annual deficit remains above 3%. With tepid growth rate, there are concerns about the country's vulnerability to external financing shortfall. And that will weigh on the Brazilian real.



Brazil is most likely to suffer the consequences of the so-called "tapering" by the Fed, and the Brazilian currency has depreciated sharply over the last two years. The central bank followed a deft currency policy to stabilize the exchange rate during last year's turmoil in emerging market. Since October 2013, the bank has been holding pre-announced auctions of futures contracts to provide a way out for investors in case their bets on the Brazilian real went sour. After falling to 2.45 reais per dollar, the currency strengthened to a 2.30 per dollar level, and in December the bank extended the program until June. As the currency-swap contracts came due, the bank rolled them over. But now, with the currency just above 2.20 per dollar, there have been signs of change.

Brazil's well developed futures market permits future contracts to be traded into spot dollars relatively easily. The central bank is exploring this tool to avoid tapping its foreign-currency reserves of over $370 billion. The reserves work as a buffer to curb any potential speculative attack against the real.

Brazil, Russia, India, China and South Africa are set to launch a contingency fund during a July summit in Brazil. The $100 billion fund is meant to be a buffer for the group of emerging economies known as the BRICs countries.

Brazilians are disillusioned with the hosting of the World Cup, which begins June 12. According to an opinion poll less than one in two say hosting it is a good idea. The Cup has become a symbol of the unfulfilled promise of an economic boom. A list of unfinished construction projects have become reminders of the shortcomings that many believe keep Brazil poor: overwhelming bureaucracy, corruption and short-sighted policy-making that prioritizes grand projects over needs like education and health care.

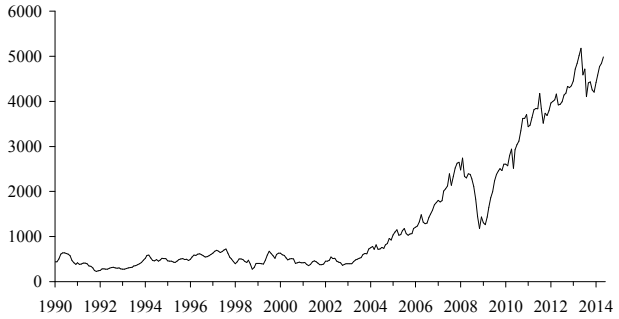
Brazil's presidential election is set for October 5, with a second round if needed, scheduled for October 26. So far, President Dilma Rousseff is favoured to win. But her main contender Aecio Neves of the Brazilian Social Democracy Party, or PSDB, is gaining ground.

	11	**12**	**13**	**14**	**15**
GDP (%p.a.)	2.7	0.9	2.3	1.7	3.0
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	2.35	2.40

Other Emerging Markets

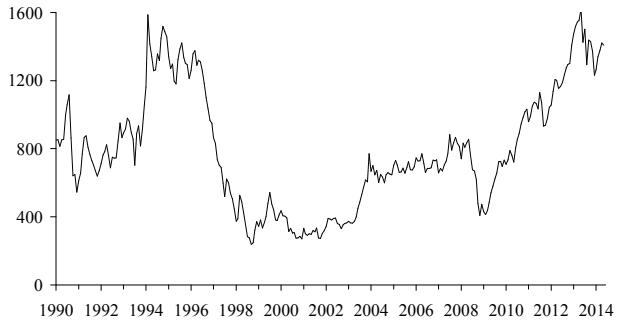
Hong Kong: FT-Actuaries

Indonesia: Jakarta Composite

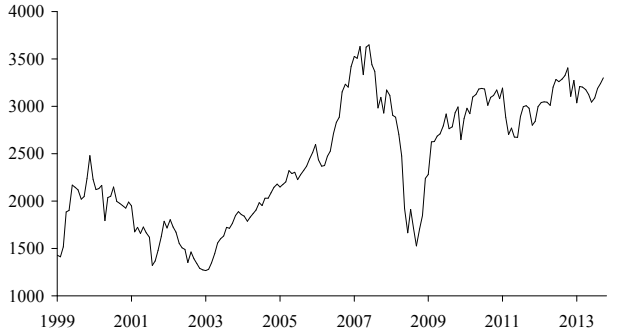


Malaysia: FT-Actuaries (US$ Index)

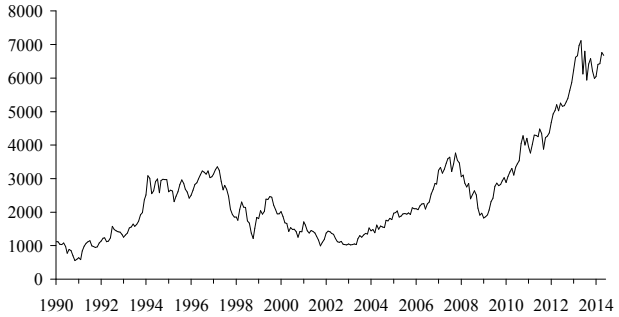
Thailand: Composite Index



Singapore: Straits Times Index

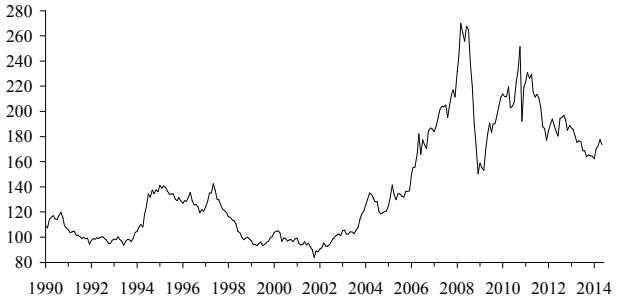


Philippines: Manila Composite

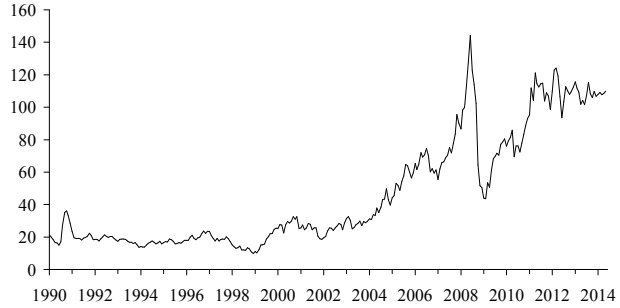


COMMODITY MARKETS

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

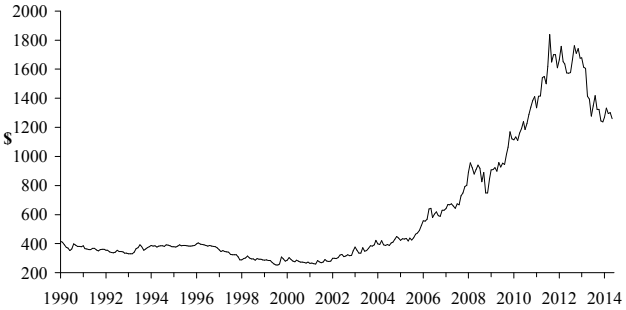


Oil Price: North Sea Brent (in Dollars)

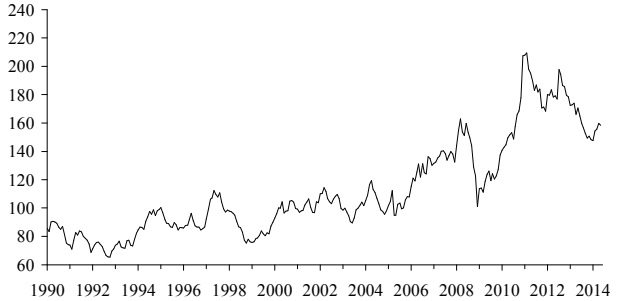


Commodity Price Index (Sterling)
(Economist, 2000=100)

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	2.0	1.6	1.8	83.0	94.1	–1.1	2.5	–0.4
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	1.8	1.6	1.2	82.9	93.7	–0.9	2.5	–0.5
2014:2	2.0	1.6	1.6	82.8	94.0	–1.1	2.5	–0.4
2014:3	2.0	1.7	1.9	82.9	94.0	–1.2	2.5	–0.4
2014:4	2.1	1.7	2.2	83.4	94.6	–1.2	2.6	–0.3

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

Labour Market and Supply Factors (Seasonally Adjusted)

	Average Earnings (1990=100)[1]	Wage Growth[2]	Unemployment (New Basis) Percent[3]	Millions	Real Wage Rate[4] (1990=100)
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	147.5	706149.6	409500.3	244931.3	182264.4	-32815.0	102184.0
2014	151.6	725921.8	416052.3	266975.2	176432.0	-38621.8	95765.3
2015	155.3	743343.9	422293.1	285663.4	180489.9	-31157.8	98734.0
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	1.7		1.1	1.3	-0.4		-2.0
2014/13	2.8		1.6	9.0	-3.2		-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	147.7	176743.6	102295.0	59693.5	47768.4	-7067.3	27132.5
2013:2	147.0	175930.9	102279.7	59125.9	44541.3	-7180.1	24182.3
2013:3	147.9	177009.4	102094.5	62464.6	44883.5	-9285.0	25475.0
2013:4	147.5	176465.7	102831.0	63647.4	45071.2	-9282.6	25394.2
2014:1	151.8	181692.4	103931.7	65065.9	46239.8	-9664.1	23431.4
2014:2	151.1	180857.0	103916.2	64447.2	43116.0	-9655.3	23693.8
2014:3	152.0	181965.6	103728.0	68086.4	43447.3	-9650.6	24248.6
2014:4	151.6	181406.7	104476.3	69375.7	43628.9	-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	1.7	2.8
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

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	2.0
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

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

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

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

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

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.

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