LIVERPOOL INVESTMENT LETTER

June 2016

LIVERPOOL RESEARCH GROUP IN MACROECONOMICS

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Editorial and Research Direction: Patrick Minford†.

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

Research Associates: Vo Phuong Mai Le†, David Meenagh†, Francesco Perugini, Yongdeng Xu†.

† Cardiff Business School

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

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

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

ISSN 0951-9262

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The Brexit debate is moving in the direction of Leave and everyone is taking it calmly in their stride. There is little sign of any plans changing or of much notice being taken of the flawed Treasury Doom and Gloom scenarios. The main challenge if Brexit occurs would be keeping monetary policy on track in the face of stronger growth and a naturally weaker pound.

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THE POST-BREXIT OUTLOOK AND THE ECONOMY UP TO THEN

The hubbub of the referendum has taken over the UK nation and inevitably everything is dominated by it. But on June 24th it will be over.

Recent polling has moved in favour of the Leave campaign and there are definite signs that Remain is losing the debate. The huge effort by the Treasury, accompanied by domestic and international modellers all of whom are Treasury allies, to instil terror about Brexit economic disaster has both seemed over-dramatic and been shown to have a key flaw, in failing to accompany leaving the Single Market with the abolition of EU protectionism or even reductions in regulation. Since the whole point of leaving the EU is to get rid of EU protectionism and over-heavy regulation, this omission has undermined the 'consensus' of doom and gloom. Indeed when we have simulated the whole package, as discussed in our last issue, we have found material gains from leaving both in the long term and the short term. Actually it is obvious from basic economic theory that a move to global free trade from a customs union — protected regional free trade — must be beneficial, and when further accompanied by more free market-orientated regulation, better still.

Popular opinion is also impressed by the need to return to democratic control of UK policy, mostly lost to overweening EU intervention. This is particularly seen over the crucial border issue, where unlimited entry threatens both social harmony and security.

There are vociferous contributions from 'losing' groups in this debate. But the public no doubt takes the view that if they have a good enough case to get UK money direct from the Treasury instead of indirectly via the EU then they can make it after Brexit.

Table 1: Summary of Forecast

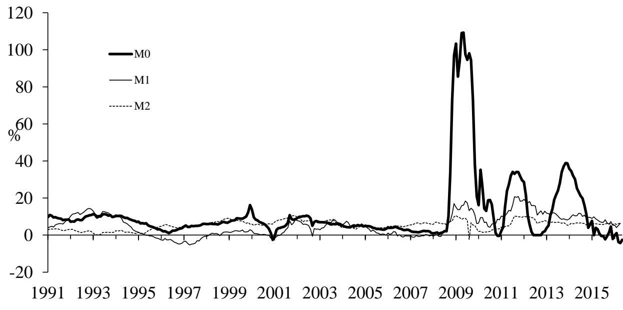
	2014	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**
GDP Growth[1]	2.9	2.2	2.3	2.4	2.5	2.5	2.5
Inflation CPI	1.7	0.1	1.1	1.6	2.0	2.0	2.0
Wage Growth	1.2	2.7	3.2	2.9	3.0	2.5	2.9
Unemployment (Mill.)[2]	1.1	0.9	0.8	0.8	0.7	0.7	0.7
Exchange Rate[3]	87.1	91.6	90.4	90.5	90.1	91.8	91.3
3 Month Interest Rate	0.6	0.5	0.7	1.1	1.7	2.1	2.5
5 Year Interest Rate	1.8	1.4	2.0	2.2	2.5	2.5	2.5
Current Balance (£bn)	−99.9	−91.0	−70.4	−66.0	−66.2	−64.7	−64.5
PSBR (£bn)	83.3	78.1	65.5	56.6	36.1	31.4	23.8

[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)

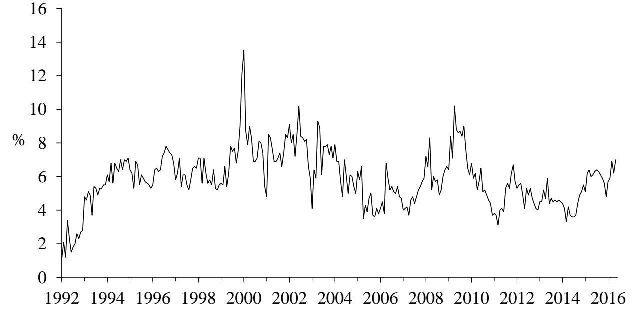
While all these shifts have been going on the economy has remained pretty stable. There have been some moderate exchange rate movements and reports of slowing spending have not really been borne out by the actual spending estimates. Most businesses appear to be rather phlegmatic about the outcome in the end. Few seem impressed by the Treasury's doom and gloom scenarios, with good reason as we have said.

In the enormous excitement that has greeted the economics of Brexit one is reminded somewhat of the same excitement over the Millennium Bug. There was no bug to mention; instead after 2000 the world economy continued to grow solidly and as we now know the main problem in the succeeding decade was excessive money supply and credit growth. Brexit, if it occurs, will be an important further free market reform of the UK; it will lead to more growth. But we will need to see that monetary policy is handled responsibly when that occurs. We have argued that monetary policy will be forced to be 'normalised' more rapidly than currently intended by the Bank of England. That will be the major challenge.

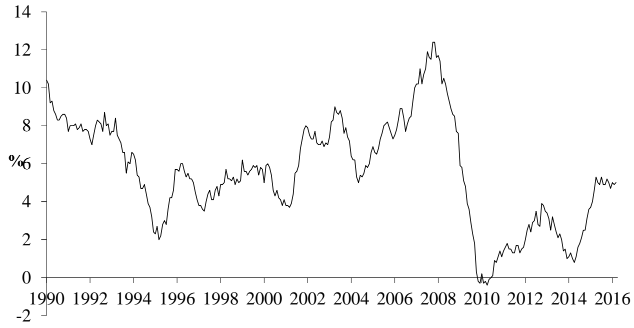
U.S.: Growth in Monetary Aggregates (Yr - on - Yr)



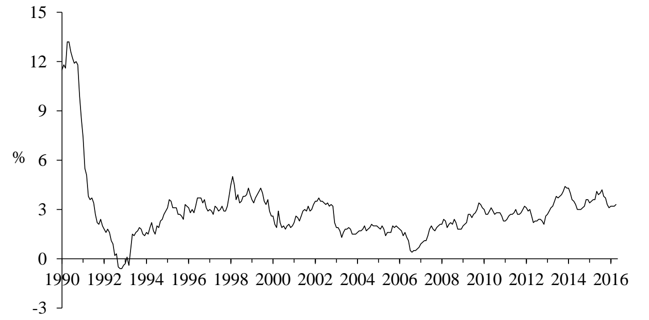
UK: Notes and Coins in Circulation Growth



Eurozone M3 Growth



Japan: Growth of M2+CD's



FOCUS ON JAPAN

Francesco Perugini

Policy Makers' Intentions for Reviving the Economy

In a significant policy turnaround, Japanese Prime Minister Shinzo Abe held a meeting at the end of last month with Taro Aso, deputy prime minister and finance minister; Yoshihide Suga, his chief cabinet secretary; and Sadakazu Tanigaki, the LDP's secretary general to convey his intention to push back the planned consumption tax hike by two and a half years, to October 2019, government sources said.

At least one of them objected and called for the increase to go ahead as planned next April, the sources said. Accordingly, the senior official said that if Abe postpones the planned tax hike, he should dissolve the Lower House as he did in late 2014. After meeting with Abe, LDP Vice President Masahiko Komura told reporters that "the Prime Minister seemed quite determined" to delay the tax increase. An official from the ruling coalition said "the Prime Minister's plan will not change." However, LDP Policy Chief Tomomi Inada told Abe that "the tax rate should be raised next year, if only by 1%, and if Abe is to delay the hike, he should seek public understanding," indicating that he should call a snap election.

The sales tax was last raised in April 2014, from 5% to 8%. Abe decided in November 2014 to postpone a planned second increase, to 10%, by one and a half years, to next April, and dissolved the lower house for general elections.

Abe apparently wants to avoid negatively impacting the flat domestic economy as well as the ruling coalition's prospects in regular elections for the upper house of Japan's parliament in the summer of 2019. Indeed, Japan's economy has been limping along amid a stronger yen and weak stock prices since the beginning of the year. Consumer spending, which accounts for about 60% of the country's GDP, remains flat. Some officials close to Abe said the last sales tax increase more than two years ago has continued to hit consumer spending longer than expected. Abe is apparently concerned that if the sales tax is raised again, the Japanese economy might lose further steam, making it even more difficult for his government to achieve its most important policy task — pulling the economy out of a decades-long stagnation.

Abe is also worried about the strong yen. The currency has gained 9% against the dollar so far this year, eroding the competitiveness of the nation's products overseas and hurting the earnings of exporters. Recent data showed Japan's exports fell 10.1% in April from a year earlier — for the seventh consecutive month — the fastest decline in three months as a stronger yen and weakness in China and other emerging markets take their toll on the country's shipments.

Concern about the impact of the yen was also on show over the last Group of Seven meeting held in Tokyo as Finance Minister Taro Aso and his US counterpart, Treasury Secretary Jack Lew, disagreed over the seriousness of recent moves in the foreign-exchange market. Japanese officials threatened to intervene in foreign exchange markets to halt "disorderly, one-sided" moves of the yen. "What we need to be conscious of is that excessive volatility and disorderly movements will have an adverse impact on economic stability", Masatsugu Asakawa, a top Japanese currency official, said in a recent interview with Nikkei.

According to a recent survey of market players Japanese authorities will likely intervene to halt the yen's appreciation once the currency reaches around 100 yen to the US dollar. Japan last intervened in currency markets around November 2011, when it tried to stem the yen's rise against the US dollar to keep an economic recovery on track after the earthquake-tsunami disaster earlier that year.

Exchange rate intervention is a legitimate part of the Bank of Japan (BOJ) toolkit, but the use of that tool would be an unfortunate admission that it has failed to employ the other instruments adequately. The BOJ has continued to loosen monetary policy this year, but it has moved in fits and starts. Haruhiko Kuroda, its governor, appears to be engaged in a cat-and-mouse game of expectations about policy announcements with the markets rather than meeting the threat of stagnation and deflation with overwhelming firepower. More importantly, unilateral exchange rate interventions do not have a lasting impact on the exchange rate. For the strategy to work, the BOJ would need to ease monetary policy massively.

It is not the time to abandon fiscal and domestic monetary policy and go back to the old game of currency intervention. That can only inflame international relations, while having no more than a limited effect on the economy, unless interventions in the foreign markets are massive, sustained over a long period of time and lead to an increase in the supply of money. Most of Japan's economic problems are on the supply-side front. Structural reforms have lagged the first two arrows of monetary and fiscal stimulus; therefore more is required to boost growth in the face of a rapidly ageing population and very high government debt.

MARKET DEVELOPMENTS

Our forecasts in the event of Brexit call for a lower pound and a faster move towards ‘normalisation’ of monetary policy: i.e. rather higher interest rates. This will be necessary to contain the effects of stronger growth and higher inflation.

Such a prospect is much to be welcomed. It would also spell the end of ridiculously low yields on long term government bonds and usher in a better equity market.

Table 1: Market Developments

	Market Levels		Prediction for May/Jun 2017	
	Apr 29	Jun 3	Previous Letter	Current View
Share Indices				
UK (FT 100)	6322	6210	9035	8873
US (S&P 500)	2076	2099	2553	2582
Germany (DAX 30)	10321	10103	15987	15650
Japan (Tokyo New)	1341	1337	1887	1883
Bond Yields (government				
UK	1.74	1.41	2.00	2.10
US	1.87	1.71	2.10	2.80
Germany	0.26	0.07	0.70	0.70
Japan	–0.08	–0.11	0.40	0.40
UK Index Linked	–0.83	–0.99	0.10	0.10
Exchange Rates				
UK ($ per £)	1.46	1.45	1.50	1.50
UK (trade weighted)	86.44	86.92	90.40	90.80
US (trade weighted)	100.01	100.76	100.0	100.0
Euro per $	0.88	0.88	0.91	0.93
Euro per £	1.29	1.28	1.37	1.40
Japan (Yen per $)	112.4	106.8	120.5	121.2
Short Term Interest Rates (3-month deposits)				
UK	0.60	0.60	1.00	1.00
US	0.60	0.60	1.20	1.30
Euro	–0.29	–0.31	0.00	–0.20
Japan	–0.20	–0.20	0.20	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	−3.32	21.58
Germany	2.60	1.8	1.1	42.00	−8.89	48.61
Japan	1.70	1.2	0.6	39.00	−17.30	25.20
UK indexed[2]	−0.83		1.5	1.00		1.52
Hong Kong[3]	2.60	6.0	1.5	−5.00	−3.32	1.78
Malaysia	3.30	5.4	1.5	55.00	−3.32	61.88
Singapore	3.50	3.4	1.5	23.00	−3.32	28.08
India	1.40	7.5	1.5	24.00	−3.32	31.08
Korea	1.10	3.0	1.5	−19.00	−3.32	−16.72
Indonesia	2.20	5.3	1.5	31.00	−3.32	36.68
Taiwan	2.80	3.4	1.5	14.00	−3.32	18.38
Thailand	3.20	4.0	1.5	35.00	−3.32	40.38

Bonds: Contribution to £ yield of:

	Redemption Yield	Changing Nominal Rates	Currency	Total
UK	1.41	−6.60		−5.49
US	1.71	−10.90	−3.32	−12.51
Germany	0.07	−6.30	−8.89	−15.12
Japan	−0.11	−2.10	−17.30	−19.51

Deposits: Contribution to £ yield of:

	Deposit Yield	Currency	Total
UK	0.60		0.60
US	0.60	−3.32	−2.72
Euro	−0.31	−8.89	−9.20
Japan	−0.20	−17.30	−17.50

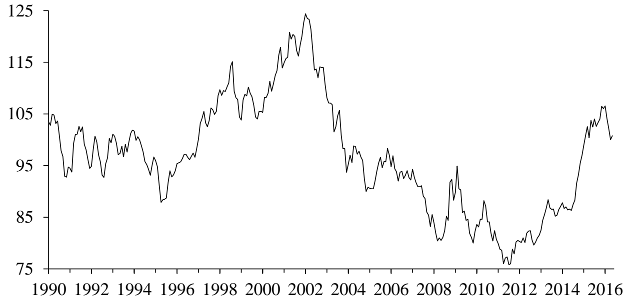
[1] Yields in terms of €s or $s can be computed by adjusting the £-based yields for the expected currency change.
[2] UK index linked bonds All Stocks
[3] Output based on China.

Table 3: Portfolio(%)

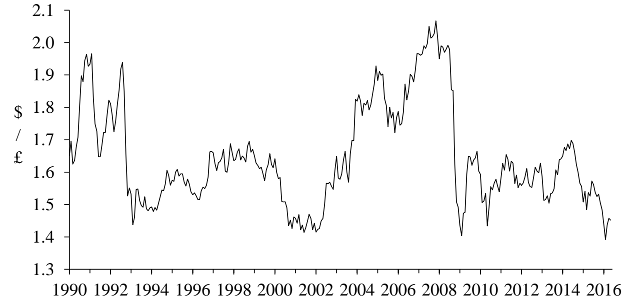
	Sterling Based Investor		Dollar Based Investor		Euro Based Investor	
	May Letter	Current View	May Letter	Current View	May Letter	Current View
UK Deposits (Cash)	5	5	5	5	1	1
US Deposits	-	-	-	-	-	-
Euro Deposits	-	-	-	-	-	-
Japanese Deposits	-	-	-	-	-	-
UK Bonds	-	-	-	-	-	-
US Bonds	-	-	-	-	-	-
German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

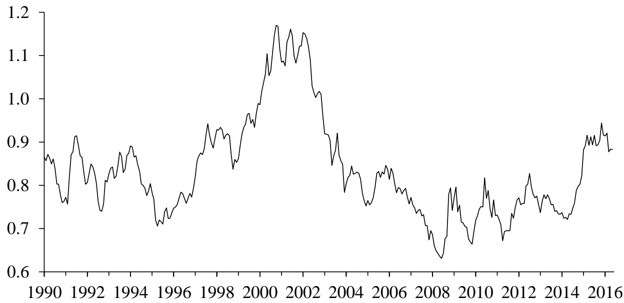
US : Trade Weighted Index
(Bank of England 1990 = 100)



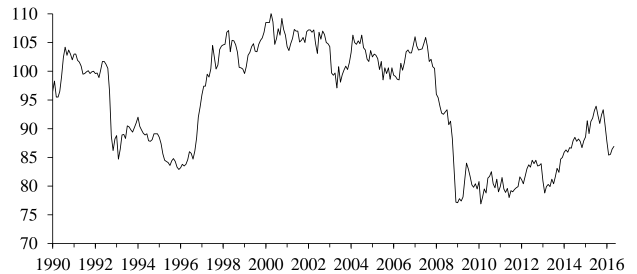
UK: Dollars Per Pound Sterling



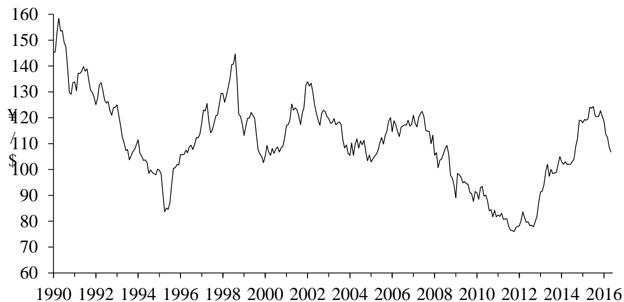
Euro per US dollar



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

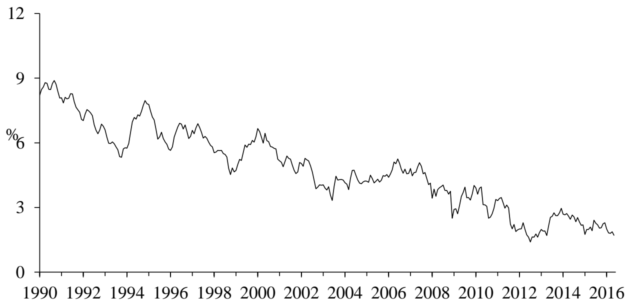


Japan : Yen Per U.S. Dollar

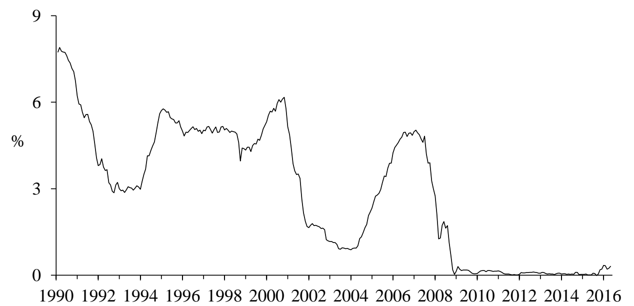


GOVERNMENT BOND MARKETS

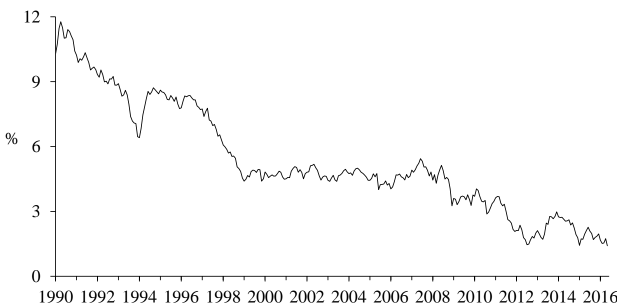
U.S.: Yield on Long-Term Government Bonds



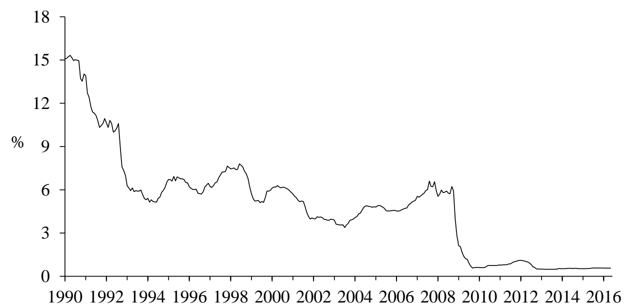
U.S. : 3-Month Treasury Bill



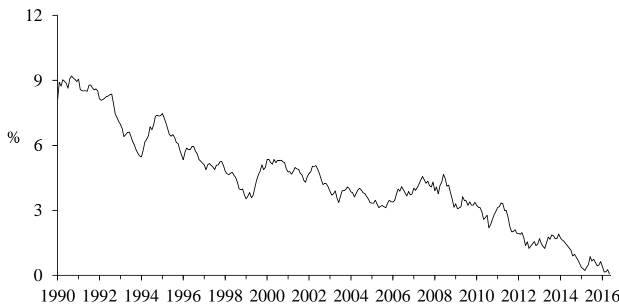
U.K.: Yield on Long-Term Government Bonds



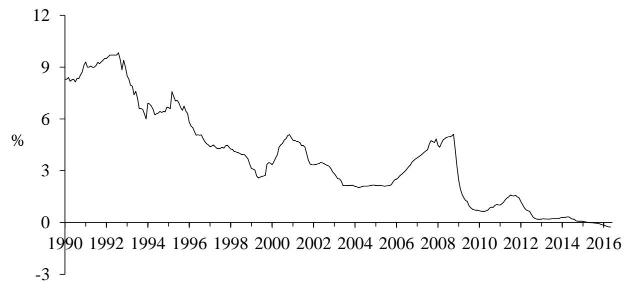
U.K. : 3-Month Interbank Rate



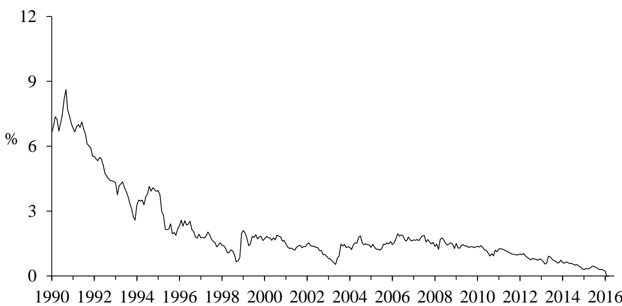
Germany: Yield on Public Authority Bonds



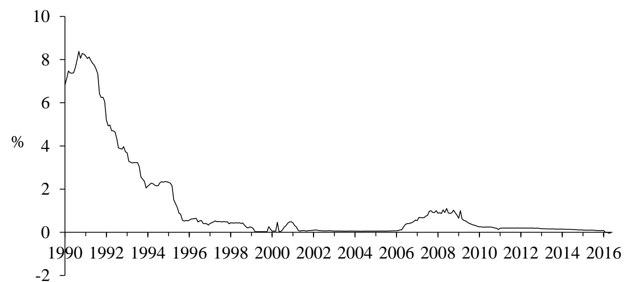
Germany : 3-Month Interbank Deposit Rate



Japan: Yield on Long-Term Government Bonds

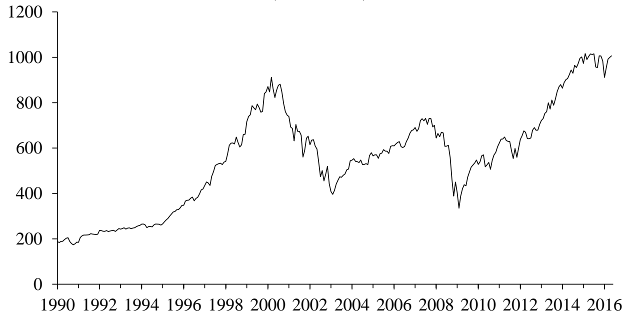


Japan : 3 Month Money Market Rate

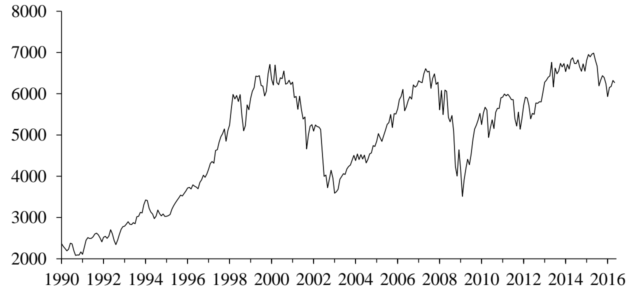


MAJOR EQUITY MARKETS

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

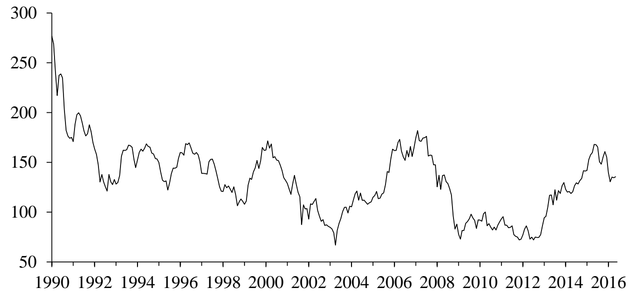


U.K. : FTSE-100 Index
(10 April 1962=100)



Germany : DAX 30

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



EMERGING MARKETS

Anupam Rastogi

India

India's pace of economic expansion will exceed the government's initial projection of 7.5% to about 8% in the fiscal year 2016–17, if the country receives above normal levels of seasonal rainfall. India's economy grew 7.6% in the last fiscal year, and the finance ministry has projected growth will be between 7% and 7.75% the current fiscal year which ends in March 2017.

Inflation remains well under control and within the RBI's set limit. But, RBI's Governor, Mr. Rajan is unlikely to lower interest rates as long as the currency remains weak and inflation may raise its ugly head once again as the energy prices appear to be moving up once again.

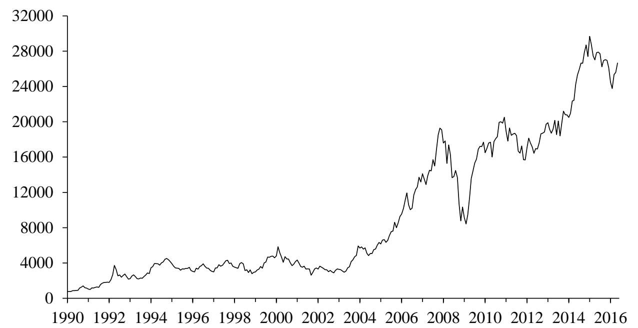
India has struggled for years to deal with the problems of bad debt in the absence of any genuine national bankruptcy law and a legal system that was once heavily tilted towards company owners and the mission of saving businesses for the sake of their workers. India has passed the Insolvency and Bankruptcy Bill 2015 and it will be easier for lenders to recover their dues. It will take another 12 months or so for rules to be written and implemented.

It is two years now for the most business friendly government to be in power under the leadership of Mr. Modi. On its second anniversary, Prime Minister Modi, in pomp and show tried to convince its growing sceptics that his government record is very good. In the last two years, he has set a path for accelerated growth that India's states now need to help navigate. He said he had opened up more of the economy to foreign investment and made changes to curb corruption, fill gaps in rural infrastructure and make it easier to do business.

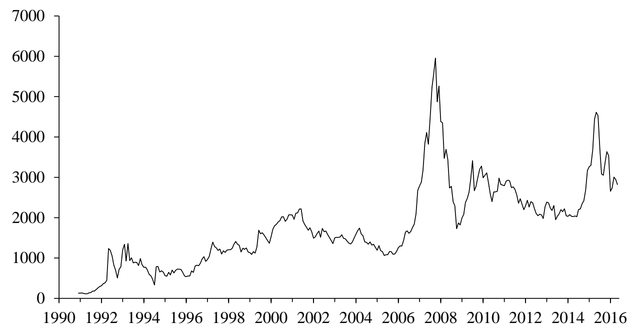
To be fair to him, there is no doubt that except disinvestment and exports growth, his government is doing better in terms of GDP growth, inflation, depreciation of rupee, industrial production, forex reserves etc. compared with what his government inherited. Corruption at a high level is non-existent now. Mr. Modi's projection of India is par-excellence. Many hurdles have been put in his policy making by the opposition party but his government is tackling them by brute force rather than a bipartisan manner. His party's good show in recent state election shows that his strategy is working.

He is making full use of the U.S.'s inclination to see India becoming economically and militarily strong enough to serve as a credible counterweight to a rising China, which is remaking the balance of power in Asia.

India: BSE Sensitive



China: SSE Composite Index



Overall, we would say that policy changes have been gradual and incremental, and they are moving in the right direction.

India signed an agreement with Tehran for a transport corridor designed to open up a new route to Afghanistan via the Iranian port of Chabahar, circumventing Pakistan. Chabahar port, which India will partially develop just across the border from Pakistan's Chinese-run Gwadar port, is the centerpiece of the corridor. With the development of Chabahar port, Pakistan will lose out on trade with Afghanistan and possibly even central Asia.

Indian shares jumped more than five percent in the last week of May as companies have declared good results and weather forecasters have predicted more monsoon rains than initially estimated. Moreover, Morgan Stanley upgraded India to 'overweight' from 'equal weight'.

	14–15	15–16	16–17	17–18	18–19
GDP (%p.a.)	7.3	7.6	7.0	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	-28.0	-32.0	-30.0
Rs./$(nom.)	62.0	66.5	67.5	69.0	70.0

China

Chinese growth again looks increasingly uncertain. Industrial production and retail sales turned out to be below

expectations and the People's Bank of China (PBoC) is guiding renminbi to its lower limit. We do not expect big moves in yuan as China craves for stability. The see-sawing changes in China with respect to renminbi is described by HSBC as the PBoC strategy of "ease and squeeze" — greater FX flexibility if underlying pressures are reduced, less flexibility if market conditions start to look uncomfortable and disorderly. In the words of Eswar Prasad, a China scholar at Cornell University and the IMF's former top official in China, the "uneven and haphazard approach to making the exchange rate more flexible highlights the tensions between the government's desire to free up markets and its tendency to override markets when they do not produce the results it wants."

Industrial output rose 6.0% year-over-year in April, compared with 6.8% growth in March, and below an expectation of 6.6% growth. Fixed-asset investment in urban areas grew 10.5% year-over-year in the January-to-April period, compared with an annual increase of 10.7% for the first three months of 2016. Retail sales grew by a less-than-expected 10.1% in April compared with a year earlier. In March, retail sales had posted a growth of 10.5% year-over-year.

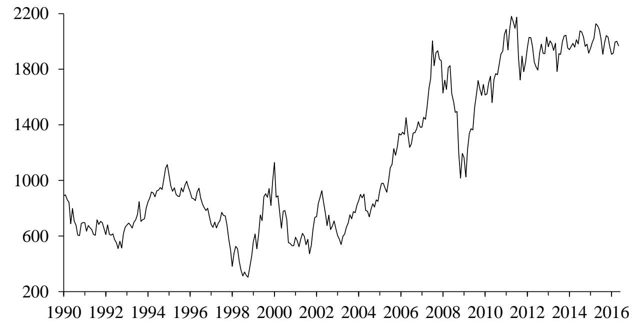
The Chinese government is to pump almost Rmb 5tn — almost 7% of China's 2015 GDP — into transport infrastructure over the next three years. China is ready to use fiscal stimulus to keep the economy humming.

China's consumer-price index rose 2.3% from a year earlier in April, marginally lower than expected growth of 2.4%. China's producer-price index decelerated by 3.4% in April compared with a 4.3% deceleration in March. PPI, a measure of prices at the factory gate, has remained in deflationary territory for more than four years.

China's exports and imports also performed worse than expected in April. Exports fell 1.8% from a year ago, compared with a surprising increase of 11.5% in March, while imports fell 10.9% from a year earlier. China's trade surplus widened to $45.56 billion from $29.86 billion in March.

China's capital outflow has slowed down a bit. In April, only $21.5 billion got drawn out of the economy. It seems that domestic investors are less willing to purchase foreign currencies and most of them moved to convert their foreign currencies into the yuan.

China's central bank set its daily currency "fix" at the lowest level in five years, tracking a weaker market price as the dollar rally took its toll on the renminbi. The People's Bank of China set the midpoint of its currency trading band for its loose peg against the dollar at Rmb6.5693 in the last week of May, a level not touched since March 2011. After trading flat since February, the renminbi has fallen 1.3% against the dollar — a sizeable move for China's currency. The market's initial reaction has been to look the other way. A rising dollar hits China's exporters and puts pressure on the PBoC to weaken its currency. The renminbi may to fall to 6.80 in the coming months if the Fed hikes rates two or three times in 2016.



The powerful State-Owned Assets Supervision and Administration Commission was instrumental in convincing Chinese leaders to stop the sliding of the renminbi. The more the renminbi is allowed to weaken, the more expensive it will be for the already struggling state firms to service their loans. A one percent depreciation of the yuan could add $8.5 billion to Chinese companies' annual interest payments on dollar debts.

	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	1.5	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

South Korea's economy is losing steam. South Korea's economic growth continued to slow in the first quarter on sagging exports and sluggish consumption. The central bank in April trimmed its annual growth estimate to 2.8% from 3% this year, the underlying inflation rising by 1.8% year-on-year last month. The consumer price index rose 0.1% month-on-month in April, up from a 0.3% fall in March. But, South Korea's central bank resisted market pressure and kept its base rate unchanged for the 11th consecutive month, as widely expected. The cautious approach by the Bank of Korea came as four new policy makers made their debut at a monthly rate-setting meeting in May after taking office on the seven-member board. The base rate remains 1.5% for the time being.

We expect a rate cut to come as early as June or July — along with fiscal steps to support the industrywide restructuring and spur anemic growth. The central bank and the government are currently in talks to recapitalize state-run policy lenders and provide a better buffer for the overhaul by

the end of June. Uncertainty over the financial-market impact of Brexit and the U.S. Federal Reserve's own rate-setting meeting in June, has kept the Bank of Korea in a wait-and-see mode for now.

South Korea's exports increased by 2.1% in the first 20 days of May from a year earlier, raising hopes of an end to negative growth that lasted for more than a year.

South Korea’s won rose the most in a month, as a rebound in oil spurred a rally in global stocks. The MSCI’s Korea index has put in a decent performance relative to the broader emerging market index over the past five years, outpacing it by about 6%. But, Korean shares could face a headwind soon. The make-up of the EM index could change in the year ahead. MSCI, still the key benchmark, has debated whether to add China A shares (from Shanghai and Shenzhen) to its EM index. The change will be decided on 14 June. If the China A shares are included, China’s weighting would rise over time and weights for South Korea and Taiwan would fall.

South Korea and Taiwan are stepping up their efforts to be promoted from the MSCI EM index to its developed world equivalent. The fear of an exodus of foreign capital in the wake of China’s admittance appears to be a driving factor. Seoul has been slow in addressing the MSCI’s concerns related to its markets.

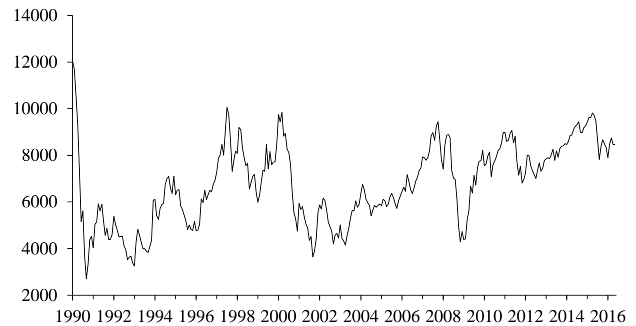
	14	**15**	**16**	**17**	**18**
GDP (%p.a.)	3.3	2.6	2.5	2.5	2.3
Inflation (%p.a.)	2.0	0.7	1.4	1.4	1.2
Current A/c(US$ bill.)	80.0	90.0	88.0	88.0	86.0
Won/$(nom.)	1080	1180	1220	1240	1240

Taiwan

Taiwan’s industrial output contracted in April after showing a sign of improvement in March. The Taiwanese economy has been shrinking since the middle of last year and exports are falling as trade with China slows. This is a challenge that lies ahead for the new president Tsai Ing-wen. Industrial production shrank for the eleventh consecutive month at a rate of 4.06% year-on-year in April. The building and construction volume contracted 23.01% year-on-year in April. This year's GDP growth will grow around 1%, well below the target range of 2.1–2.7% set by the National Development Council in December 2015. The economy shrank 0.84% in the first quarter-on quarter.

Taiwan’s export orders fell at more than double the expected rate in April, underscoring the difficulties faced by the country as it seeks to diversify away from dependence on shipments to China. Export orders dropped 11.1% year-on-year in April. This is the 13th month of contraction for orders. The main reason for the contraction is that demand for Taiwan’s goods has declined.

Taiwan: Weighted TAIEX Price Index



Besides the short-term contraction, the economy faces a deeper malaise with graduate starting salaries having stagnated for years despite sharp rises in housing and other living costs.

President Tsai Ing-wen has pledged to boost the island’s prospects through trade deals, upgrading industry and fostering innovation. According to the island’s new economic affairs minister, Taiwan must seek more diverse trade partners apart from China, increase its presence in Southeast Asia and India, and seek to join regional agreements such as the Trans-Pacific Partnership.

Diversifying Taiwan's economy away from its reliance on trade and investment with the mainland has been a key plank in the platform of Ms. Tsai's party, reflecting fears that Beijing's influence over the island is already too great.

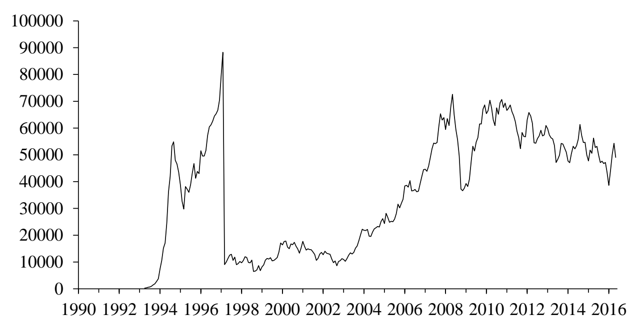
President Tsai Ing-wen has called for Taipei and Beijing to “set aside the baggage of history” and “engage in positive dialogue.” But, Beijing is having none of it. Behind Beijing’s rhetoric is the demand that Ms. Tsai embrace the “1992 consensus.” The tacit acceptance is that Taiwan and the mainland both belong to “one China,” even if they disagree on its definition. The consensus was the basis of cross-Strait talks in the early 1990s and to a large extent economic development of Taiwan along with China. The consensus is another way of saying that Taiwan must sooner or later unify with China. But Taiwanese people increasingly reject that prospect given Beijing’s enduring authoritarianism.

The Nationalist Party (KMT) government of Ma Ying-jeou revived the 1992 consensus over the past eight years and used it as the rubric for more than 20 cross-Strait economic agreements. But fear of Chinese influence over Taiwan led to a backlash that fueled the popularity of Ms. Tsai and her opposition Democratic Progressive Party (DPP), which now holds a parliamentary majority for the first time. Ms. Tsai has consistently promised to maintain the cross-Strait status quo and not pursue formal independence. But for Beijing it isn’t enough.

In the four months since the elections, China has shown its displeasure with the DPP's unprecedented double victory by resuming a battle with Taiwan for diplomatic allies and curbing the number of tourists travelling to the island.

	14	15	16	17	18
GDP (%p.a.)	3.7	0.8	1.3	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



At present, Brazil is enduring the worst economic crisis since the Great Depression. Brazil's gross domestic product is expected to shrink 3.9% this year after contracting 3.80% in 2015. Following that, in 2017 we expect an expansion of just 0.2%. We maintain our forecast of inflation rate, as measured by the consumer-price index, at 7% in the current year and 5.8% in 2017. There are some voices to shift the site of the Olympics because of the Zica virus, but it is too late to do so.

However, the consumer confidence index improved slightly. It clocked 67.9 points, up from 64.4 points in April. The index has a one-to-200-point range, with 100 considered an indicator of neutral sentiment.

Brazil's congress approved a revised budget plan for the rest of this year, which projected a worse-than-expected fiscal picture. The congress allowed a government deficit worth 170.5 billion reais ($48 billion), marking a political victory for acting President Michel Temer. The projected deficit is the result of falling tax revenues caused by the economic contraction and by increased spending.

Brazil's acting President Michel Temer is facing many challenges setting the nation's finances on the right path. One of the most controversial and divisive reforms he intends to take is fixing the nation's pension system. He has set a 30-day deadline for his administration to unveil a pension overhaul plan. To shore up Brazil's precarious finances Brazil's interim president has proposed an unusual, and potentially far-reaching, constitutional change to cap the government's surging expenditures: limiting federal spending growth to the previous year's inflation rate.

To do this job, Mr. Temer nominated banker Henrique Meirelles as the country's finance minister. And he picked the chief economist of a Brazilian bank Itau Unibanco Holding SA, Ilan Goldfajn, to replace current central bank President Alexandre Tombini. Mr. Goldfajn was a director of the central bank from 2000 to 2003 during the presidency of Fernando Henrique Cardoso, the architect of Brazil's famed Real Plan that tamed hyperinflation. Finance Minister Henrique Meirelles is seen as an inflation hawk and earlier he was the head of the central bank.

Mr. Meirelles and Mr. Goldfajn are both adherents of Brazil's so-called tripod — restrained public spending, tough inflation targeting and floating exchange rates — that put Brazil's economy back on track in the early 1990s and ushered in a long period of stability.

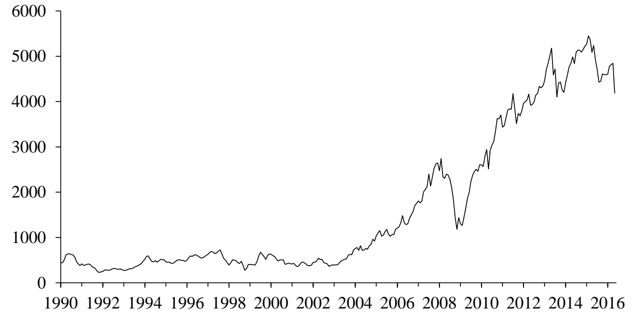
Brazil's real defied the downbeat mood in emerging market currencies, strengthening against the dollar as the market clung on to hope that the appointment of interim president Michel Temer would herald a change in the country's economic fortunes.

	14	15	16	17	18
GDP (%p.a.)	0.1	-3.8	-3.9	0.2	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

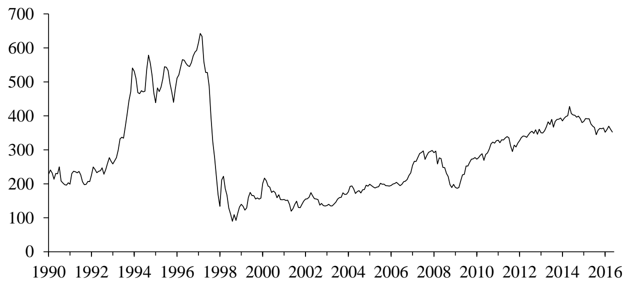
Other Emerging Markets

Hong Kong: FT-Actuaries

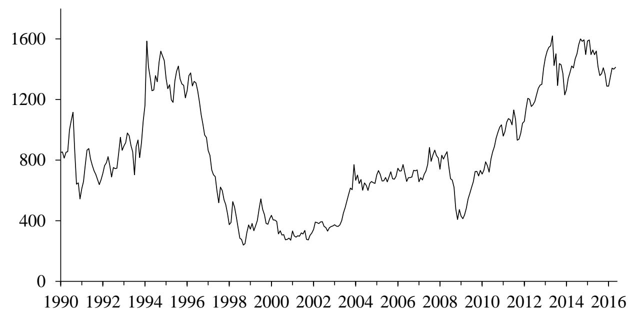
Indonesia: Jakarta Composite



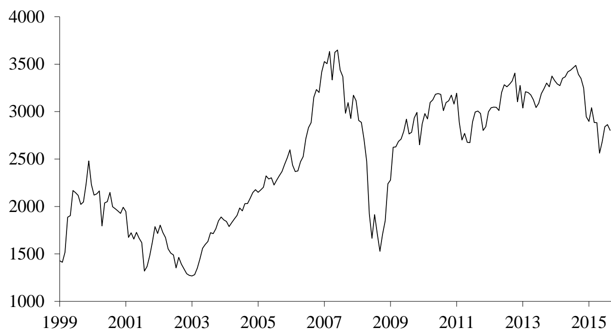
Malaysia: FT-Actuaries (US$ Index)



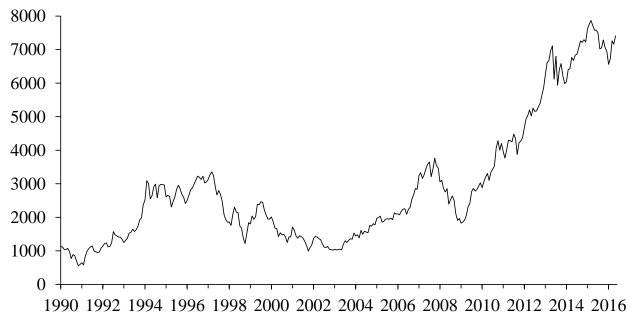
Thailand: Composite Index



Singapore: Straits Times Index

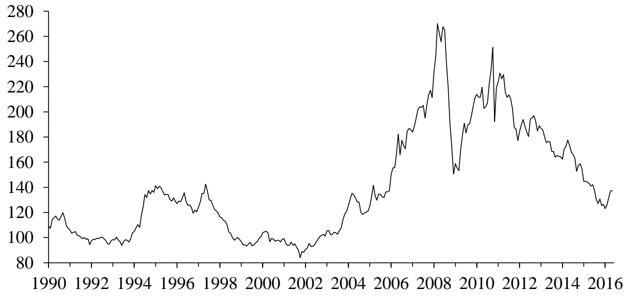


Philippines: Manila Composite

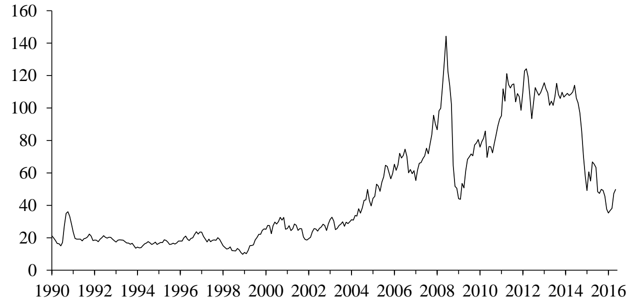


COMMODITY MARKETS

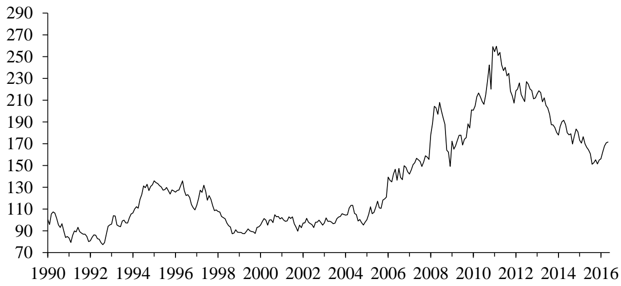
Commodity Price Index (Dollar)
(Economist, 2000=100)



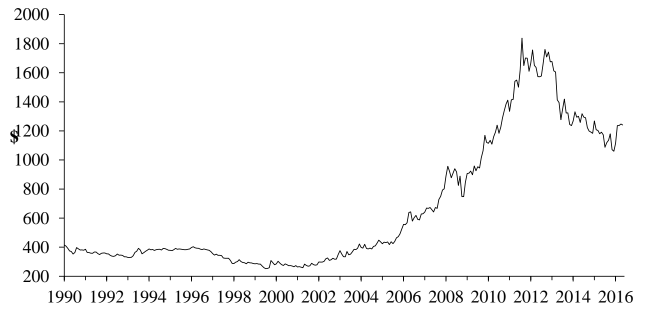
Oil Price: North Sea Brent (in Dollars)



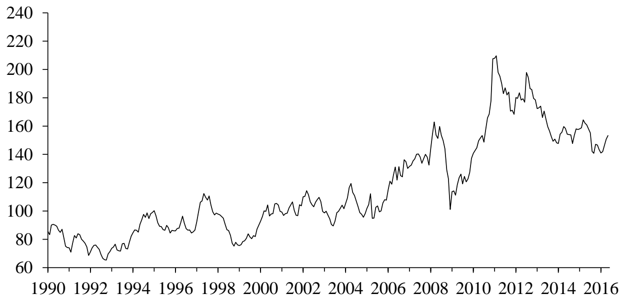
Commodity Price Index (Sterling)
(Economist, 2000=100)



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]
2015	0.1	1.4	0.5	91.6	97.6	-0.2	1.0	-0.3
2016	1.1	2.0	0.7	90.4	95.8	-0.9	2.0	0.1
2017	1.6	2.2	1.1	90.5	95.8	-0.9	2.4	0.2
2018	2.0	2.5	1.7	90.1	95.8	-0.2	2.7	0.5
2019	2.0	2.5	2.1	91.8	95.8	0.1	2.7	0.5
2020	2.0	2.5	2.5	91.3	95.7	0.0	2.7	0.5
2015:1	0.7	1.1	0.5	89.6	96.1	0.3	1.0	-0.6
2015:2	0.2	1.3	0.5	91.5	97.2	0.8	1.0	-0.4
2015:3	-0.2	1.4	0.5	93.1	99.0	-0.7	1.0	-0.3
2015:4	-0.2	1.8	0.5	92.4	98.2	-1.0	1.0	0.1
2016:1	0.5	2.0	0.5	90.6	95.8	-1.0	1.5	0.1
2016:2	1.0	2.0	0.5	90.2	95.5	-1.0	1.9	0.1
2016:3	1.2	2.1	1.0	90.5	95.8	-0.6	2.1	0.2
2016:4	1.5	2.1	1.0	90.4	95.9	-0.8	2.3	0.2
2017:1	1.5	2.1	1.0	90.8	95.9	-1.0	2.3	0.1
2017:2	1.5	2.1	1.0	90.4	95.7	-1.0	2.3	0.1
2017:3	1.6	2.2	1.0	90.4	95.7	-1.0	2.4	0.2
2017:4	1.8	2.5	1.5	90.4	96.0	-0.5	2.5	0.5

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	255.4	3.2	2.1	0.8	136.1
2017	262.7	2.9	2.0	0.8	137.8
2018	270.6	3.0	1.9	0.7	139.2
2019	277.3	2.5	1.8	0.7	139.8
2020	285.4	2.9	1.8	0.7	141.1
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	254.6	3.3	2.1	0.8	136.6
2016:2	253.2	2.9	2.1	0.8	135.1
2016:3	254.7	2.6	2.1	0.8	135.5
2016:4	259.2	3.8	2.1	0.8	137.0
2017:1	260.6	2.4	2.1	0.8	137.8
2017:2	261.1	3.1	2.0	0.8	137.3
2017:3	262.2	2.9	2.0	0.8	137.3
2017:4	266.8	2.9	1.9	0.8	138.6

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	753730.5	436512.0	298617.2	197430.6	-54076.9	124749.3
2016	161.0	771083.7	445700.6	297926.9	197878.0	-42875.6	127540.2
2017	164.9	789900.1	455410.4	303956.2	201835.6	-40412.1	130882.3
2018	169.1	809642.0	466208.9	312287.4	205872.3	-40317.6	134398.2
2019	173.3	829875.0	477782.5	319506.5	209989.8	-39376.3	138026.9
2020	177.6	850628.3	490729.8	326536.5	214189.6	-39055.7	141760.5
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	2.4		2.2	2.1	2.0		2.6
2018/17	2.5		2.4	2.8	2.0		2.7
2019/18	2.5		2.5	2.3	2.0		2.7
2020/19	2.5		2.7	2.2	2.0		2.7
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	189965.3	109959.1	75925.2	49130.9	-13008.5	32038.4
2016:1	157.6	188690.6	110498.7	69165.2	51059.5	-10512.9	31517.3
2016:2	160.8	192550.4	111077.7	75256.6	48262.0	-10476.7	31566.8
2016:3	161.9	193832.6	111720.2	75772.2	49051.9	-10775.8	31934.9
2016:4	163.7	196010.0	112403.9	77733.0	49504.7	-11110.3	32521.2
2017:1	161.8	193656.9	112869.0	71040.2	52080.7	-10216.7	32114.9
2017:2	164.9	197438.1	113483.4	77708.6	49227.3	-10305.9	32674.6
2017:3	166.0	198764.8	114165.1	77247.9	50032.9	-9761.5	32918.1
2017:4	167.1	200040.3	114892.8	77959.4	50494.7	-10128.0	33174.6

[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	4.8	1637.5	78.1	55.8	-91.0
2016	3.8	1715.1	65.5	58.7	-70.4
2017	3.2	1789.8	56.6	61.6	-66.0
2018	1.9	1870.4	36.1	65.9	-66.2
2019	1.6	1952.2	31.4	68.6	-64.7
2020	1.2	1529.0	23.8	52.7	-64.5
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	6.6	415.4	27.3	14.3	-28.2
2016:1	1.9	412.6	7.7	14.1	-15.2
2016:2	5.7	422.5	23.9	14.2	-17.2
2016:3	3.7	427.0	16.0	14.7	-12.9
2016:4	4.4	435.2	19.2	15.0	-25.1
2017:1	1.5	430.5	6.4	14.9	-14.7
2017:2	4.0	441.2	17.7	15.0	-16.9
2017:3	1.8	445.9	8.1	15.1	-11.0
2017:4	5.7	452.0	25.9	15.8	-23.5

[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	2.4	2.5
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

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	1.1	1.6	2.0
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

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.	–1.5	–0.9	–0.2	–0.9	–0.9	–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

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	1.1	1.7
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

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.	0.0	0.4	–0.3	0.1	0.2	0.5
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

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	2.0	2.2	2.5
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

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.	81.6	87.1	91.6	90.4	90.5	90.1
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.

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	1.50	1.50	1.50
Japan	98.20	106.70	120.00	118.40	121.20	121.00
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