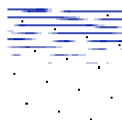
LIVERPOOL INVESTMENT LETTER

March 2012



LIVERPOOL RESEARCH GROUP IN MACROECONOMICS

LIVERPOOL RESEARCH GROUP IN MACROECONOMICS

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The combination in the UK of regulative overkill on the banks and massive Quantitative Easing by the Bank of England is mimicking the financial repression so often found in developing countries where by various controls private savings are channelled into funding government debt at low cost. The credit shortage, especially to relatively dynamic SMEs, is stunting growth. What is needed is a rollback of this regulative blanket, with encouragement to bank competition; meanwhile a negative interest rate on bankers' balances with the Bank would force banks to lend, more effectively than the Treasury's stalled 'credit easing' scheme.

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FINANCIAL REPRESSION IN THE UK AND ITS DANGERS

Superficially it may seem as if the Bank of England is getting away with its policy of allowing inflation to breach the target so badly for two years in a row. Inflation is falling, so far to 3.6%. Most forecasts expect it to fall at least close to 2% over the next year or so. So what is not to like?

There are two main concerns that I have. The Bank has now undertaken to do £325 billion of QE. This means that nearly three years' budget deficits' worth of finance will have been provided by printing money. This represents about a third of outstanding public debt. Its objective is to stimulate growth by stimulating credit.

However, there is no growth in credit and this may now be a key factor in holding back growth in output, since small business credit is in steep decline, as is SME credit to a slightly lesser extent. The SME sector, around half of GDP, is the key source of innovation and competition which in turn spur productivity growth. Productivity growth has stalled.

As I have argued before, the reason for this failure to achieve credit growth lies in the regulative onslaught on the UK banks. This will not achieve its objective to stopping future crises but it is stopping banking doing its job of lubricating the capitalist engine. The bureaucracy, having failed to prevent the crisis, is now taking its revenge on the supposed authors of the crisis, the banks. Yet they seem, on our analysis of the data through the lens of a model with banking processes in it, to be more the victims of crisis than its authors. The fact that some banks needed bail-outs reflects on the slackness of regulators in the run-up to the crisis; these regulators failed to apply 'speed limits' suggested in Basel II, speed limits that some foreign regulators (e.g. Spain and Australia) fortunately did apply. The problem with our UK regulators' revenge is that it is damaging the UK economy and causing, together with QE, what resembles 'financial repression' whereby the nation's savings are directed at the lowest possible interest cost into the government's coffers.

Now consider the dangers the Bank is running into. It will meet its inflation targets if growth continues to fail to recover — because monetary stimulus is neutralised by regulative overkill. Thus it will succeed if it fails.

Now suppose the economy does recover and credit somehow takes off with it. The banks will have a massive amount of liquidity to make loans with — around one fifth of GDP in the form of reserves and other claims held at the Bank. How quickly will the Bank be able to retake control and liquidate its bond holdings?

Suppose finally that the economy does not recover but that there is a renewed spike in oil and commodity prices as world growth picks up in 2012. The private sector, feeling more buoyant, notices and bids up wages, finally to compensate for huge real wage cuts; the inflation target is regarded as lost. Credit demands rise to pay for these target-busting wage demands. How easy will it be for the Bank to cut its bond holdings when so doing will reduce aggregate demand and return the economy to stagnation?

Table 1: Summary of Forecast

		2008	2009	2010	2011	2012	2013
GDP Growth[1]		–1.1	–4.3	1.8	1.0	1.4	2.0
Inflation	CPI	3.3	1.3	3.9	4.4	3.2	2.2
	RPIX	4.3	2.0	4.8	4.7	3.6	2.8
Unemployment (Mill.)							
	Ann. Avg.[2]	0.9	1.5	1.5	1.5	1.5	1.3
	4th Qtr.	1.1	1.6	1.5	1.6	1.4	1.2
Exchange Rate (2005=100)[3]		91.2	80.7	80.6	81.2	81.0	80.5
3 Month Interest Rate		5.1	0.8	0.6	1.0	2.3	2.5
5 Year Interest Rate		4.0	2.8	2.3	2.4	2.7	2.8
Current Balance (£ Billions)		–22.0	–26.1	–30.8	–5.8	–8.1	-7.4
PSBR (£ Billions)		73.8	127.8	110.8	121.9	100.6	97.2

[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

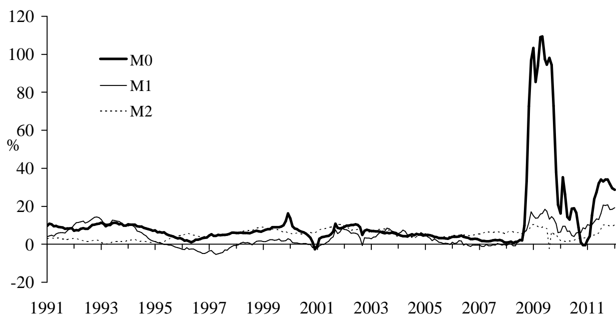
In the early stages of the Weimar Republic politicians congratulated themselves on their sagacity in printing money to meet their bills. Unfortunately they lost control of expectations and of prices and of the money printing process in one big descent into chaos. I believe it is now time for the Bank to become more traditionally cautious — about QE and its balance sheet and about the breaching of the inflation target. It is vulnerable to the shocks I have described and needs to become less vulnerable. The eurozone crisis is in remission and can no longer be used as an excuse for permanent loosening of policy; clearly it will stay with us for months, even years, but is now becoming part of the normal backgound.

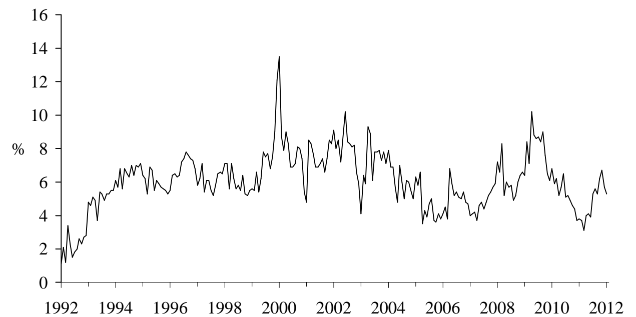
So our policy conclusion is that interest rates should be raised at the earliest opportunity. The latest indicators are more positive; a signal needs to be given about monetary intentions. We would raise Bank rate by 0.25%; actual rates are in fact above 0.75% already so little would change in the market but the signal would be understood. We would also abandon the extra £50 billion of QE; merely keep it in reserve and announce that every opportunity will now be taken to run down QE.

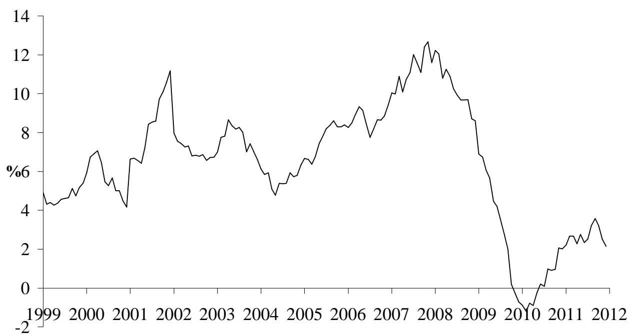
On the 'macro-prudential' side, it is time the Bank takes a stand on behalf of the banks in the regulative mess that is now emerging; it must stop overkill — defer Vickers sine die, stop the bonus populism (explain that banks are the closest we have to John Lewis) and encourage new bank entry and competition.

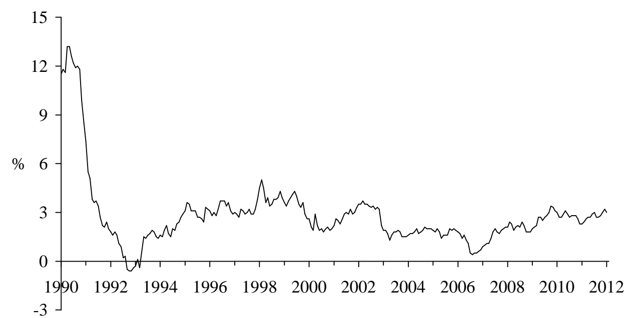
Finally, what can be done to kickstart lending? We see the Treasury struggling with a scheme of 'credit easing' which

is already bogged down with problems to do with being illegal state aid under EU rules. A simpler route would be to levy a tax (in the form of a negative interest rate, payable to HMRC) on banks' income from balances at the Bank (and also bank holdings of government debt); this could be offset by a reduction in the 'bank levy' or by a simple lump sum transfer to all banks. The measure would therefore be revenue-neutral for both banks as a whole and the Treasury. The consequence however would be that by extra lending to the private sector each bank individually would seek to avoid the tax by switching its Bank balances into lending. Of course we know that at the aggregate level of all banks there would be no change in bankers' balances since the extra credit to the private sector must be matched by extra deposits, which in turn will be redeposited in the banks and thence into bankers' balances. However, this is not the point; each bank will still wish to switch, making such an expansion of credit take place and with it an expansion in bank deposits. Within the banks, those banks that lend most aggressively could succeed in offloading their bankers' balances onto other banks, hence obtaining a net reward from their switching at the expense of others that do less. Until banks can be forced into greater competition and the regulations can be eased off, this negative interest rate measure (which has also been used in the context of foreign depositors in Switzerland for example) can be used to encourage banks into lending.









FOCUS ON JAPAN

Francesco Perugini

Japan posted its biggest ever trade deficit last year

Latest statistics released by the Ministry of Finance show Japan slipped into a trade deficit in 2011, by about ¥2.5 trillion on a customs clearance basis. The last time Japan logged a deficit in its trade balance —exports minus imports — was in 1980, while in terms of international payments, the trade deficit was the first in 48 years — this is obtained when transportation and insurance costs are deducted from the former trade balance. Data also showed that the current account surplus — which also includes the net amount received for domestically-owned factors of production used abroad — was ¥9.6 trillion (2% of GDP) in 2011, 43.9% smaller than in 2010 and the smallest since 1996.

The drastic fall in Japan's trade balance has been attributed to a decline in exports in the automobile, home electronics and other flagship industries and to an increase in imports of crude oil and liquefied natural gas for thermal power plants in the wake of the Fukushima Daiichi nuclear disaster, which has led to a freeze of many of the country's reactors — 50 out of 54 are currently offline. The volume of liquefied natural gas imports rose 12% in 2011, hitting a record 78.5 million metric tons, while general exports recorded the first year-on-year drop in two years, falling 2.7%, to ¥65.5 trillion yen. Exports to the European Union remained about the same as in 2010, but those to other Asian nations plunged. Meanwhile, imports spiked 12% on the year, to ¥68.1 trillion — the second-straight year of growth.

Japan's first full-year trade deficit in 31 years reflects broader changes in its economy as manufacturers shift production overseas to escape the strong yen and be closer to their markets, while the earthquake slammed the brakes on production and the European debt crisis sent shock waves across the planet.

Despite being well anticipated, the news generated a substantial number of comments and questions among economists and observers. In part, this is because it represents a potential sea-change in people's thinking. We are used to seeing Japan as an export-driven, trade-surplus economy. Indeed, in seasonally adjusted terms, Japan has run a trade surplus every month from the end of 1980 until mid 2008, at times representing 4% of GDP. But the surplus has trended lower since the mid 80s, dipping briefly into deficit territory in 2009 in the wake of the Lehman Brothers debacle and again in the last nine months following the earthquake.

It is also of interest because of the fiscal question. One of the key reasons behind the attitude to Japan's public sector debt problem is that the country runs a current account surplus — and national saving exceeds national investment. Headlines of a trade deficit raise questions about whether this picture also needs to be reassessed.

Since many of the problems that caused the trade deficits are unlikely to disappear anytime soon, Japan may be staring at a chronic trade deficit, and eventually a deficit on its current account. This is still in surplus as Japan remains the world's biggest net foreign creditor — income from its assets more than offset the trade gap. "Japan can continue to export goods, but if you focus exclusively on the trade balance, then the days as an exporter are ending", said Seiji Adachi, senior economist at Deutsche Securities. "It is hard to consider that Japan will become a deficit country in the current account in the medium term", echoed Tatsushi Shikano, a senior economist at Mitsubishi UFJ Morgan Stanley Securities in Japan. "But there is a risk if the yen sharply appreciates and the nation loses global competitiveness, the timing to become a deficit country may come sooner than expected".

Indeed, energy imports will likely increase as long as the country hesitates to restart idle nuclear reactors. Also, the idea of paying more for electricity could prompt still more domestic exporters to flee to foreign production bases. The stronger yen and high corporate taxes are already encouraging manufacturers to shift production abroad. JP Morgan forecasts that by 2014, 76% of Japanese car firms' production will be based overseas, up from 49% in 2003. As well as curbing exports, this could lift imports if some car models are only made abroad. Also, if the European countries cannot resolve their crisis, as seems likely, export demand from Europe will continue to be weak.

If Japan's trade deficit widens, the fate of its current-account surplus will depend on foreign-investment income, i.e., interest payments, profits and dividends. This income rose sharply until 2007 but has since fallen as a result of low interest rates and the global downturn.

There are powerful structural reasons to expect Japan's current account to move towards deficit. A nation's current-account balance reflects the gap between domestic saving and investment. Historically, the Japanese have been keen savers, with national saving greater than investment. But a rapidly ageing population saves less because people draw down their assets when they retire. Japan's household-saving rate has fallen from 14% of disposable income in the early 1990s to only 2% in the past couple of years. The current account has remained in surplus because shrinking household saving has been offset by a surge in corporate saving. Since 1990 Japanese firms have swung

from being big borrowers to big savers as they sought to repay debts.

As the population continues to age, the household savings rate is likely to turn negative. Firms are also unlikely to keep piling up cash as much as they are now. Profits are being squeezed and they may invest more abroad. If private saving shrinks while the government borrows heavily, Japan will inevitably move into current-account deficit and become a net importer of capital.

A shrinking surplus would be good news for Japan if it were caused by a strong rebound in domestic consumption and investment. Instead, it mainly reflects weaker exports and higher energy imports, which will weaken Japan's growth. More worrying are the implications for financing Japan's government debt. Its net debt-to-GDP ratio — more than 130% in 2011 — is second only to that of Greece. Yet Japanese bond yields are among the world's lowest largely because it has a big current-account surplus and willing domestic investors, who own around 95% of Japan's sovereign debt. But if Japan's current account moves into deficit the government will need to rely more on foreign investors, who are likely to demand higher yields, and this would put more pressure on the public finances.

MARKET DEVELOPMENTS

Equities have picked up as the eurozone crisis has eased, going into a long-term phase of uncertainty over whether the weaker countries will be forced out. The ECB's aggressive lending to eurozone banks has made markets more confident that any such exits will not be allowed by the ECB to create another banking crisis. With leading indicators picking up in the US, the UK and even in the eurozone, nerves in the equity market have been calmed. This has meant a rally and justifies our continued commitment to equities. Another factor is the arrival of extra natural gas from the new 'fracking' technology; this is part of the technological fightback against the raw material shortage holding back world growth. We think the global gloom has therefore been overdone and have kept our weighting in equities unchanged.

Table 1: Market Developments

	Market Levels		Prediction for Feb/Mar 2013	
	Jane 25	Feb 22	February Letter	Current View
Share Indices				
UK (FT 100)	5723	5917	7417	7607
US (S&P 500)	1326	1358	1479	1514
Germany (DAX 30)	6422	6844	8085	8411
Japan (Tokyo New)	767	825	958	1023
Bond Yields (government long-term)				
UK	2.12	2.11	3.40	3.40
US	2.00	2.01	4.00	4.00
Germany	1.94	1.89	4.00	4.00
Japan	1.01	0.99	1.50	1.50
UK Index Linked	-0.14	-0.14	1.40	1.40
Exchange Rates				
UK ($ per £)	1.56	1.57	1.58	1.58
UK (trade weighted)	81.1	80.4	80.7	80.7
US (trade weighted)	80.3	80.1	84.0	84.0
Euro per $	0.77	0.76	0.78	0.78
Euro per £	1.20	1.18	1.23	1.23
Japan (Yen per $)	78.2	80.3	87.0	87.0
Short Term Interest Rates (3-month deposits)				
UK	1.04	1.00	2.50	2.50
US	0.37	0.37	0.50	0.50
Euro	1.18	0.92	2.50	2.50
Japan	0.23	0.18	0.40	0.40

Table 2: Prospective Yields [1]

Equities: Contribution to £ yield of:

	Dividend Yield	Real Growth	Inflation	Changing Dividend Yield	Currency	Total
UK	3.30	1.8	2.8	24.00		31.90
US	1.90	2.5	2.0	7.00	−0.83	12.57
Germany	3.40	1.1	1.8	20.00	−4.17	22.13
Japan	2.30	2.1	−0.2	22.00	−9.24	16.96
UK indexed[2]	−0.14		2.8	−9.00		−6.34
Hong Kong[3]	2.50	8.0	2.0	2.00	−0.83	13.67
Malaysia	3.20	5.5	2.0	43.00	−0.83	52.87
Singapore	3.50	4.8	2.0	25.00	−0.83	34.47
India	1.40	7.0	2.0	7.00	−0.83	16.57
Korea	1.20	3.8	2.0	−17.00	−0.83	−10.83
Indonesia	2.20	6.2	2.0	28.00	−0.83	37.57
Taiwan	4.20	4.4	2.0	40.00	−0.83	49.77
Thailand	3.30	4.8	2.0	32.00	−0.83	41.27

Bonds: Contribution to £ yield of:

	Redemption Yield	Changing Nominal Rates	Currency	Total
UK	2.11	−12.90		−10.79
US	2.01	−19.90	−0.83	−18.72
Germany	1.89	−21.10	−4.17	−23.38
Japan	0.99	−5.10	−9.24	−13.35

Deposits: Contribution to £ yield of:

	Deposit Yield	Currency	Total
UK	1.00		1.00
US	0.37	−0.83	−0.46
Euro	0.92	−4.17	−3.25
Japan	0.18	−9.24	−9.06

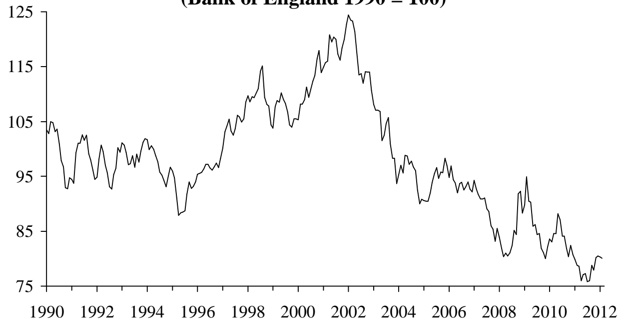
[1] Yields in terms of €s or $s can be computed by adjusting the £-based yields for the expected currency change.
[2] UK index linked bonds All Stocks
[3] Output based on China.

Table 3: Portfolio(%)

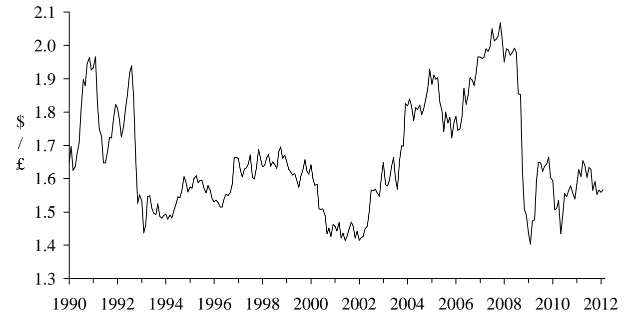
	Sterling Based Investor		Dollar Based Investor		Euro Based Investor	
	February Letter	**Current View**	**February Letter**	**Current View**	**February Letter**	**Current View**
UK Deposits (Cash)	15	15	8	8	3	3
US Deposits	-	-	3	3	3	3
Euro Deposits	-	-	5	5	-	-
Japanese Deposits	-	-	-	-	-	-
UK Bonds	-	-	-	-	-	-
US Bonds	-	-	-	-	-	-
German Bonds	-	-	-	-	-	-
Japanese Bonds	-	-	-	-	-	-
UK Shares	15	14	15	14	18	17
US Shares	15	14	15	14	17	16
German Shares	15	14	15	14	17	16
Japanese Shares	10	9	9	8	12	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	3	3	3	3	3	3
Brazilian Shares	2	3	2	3	2	3
Chilean Shares	2	3	2	3	2	3
Mexican Shares	2	3	2	3	2	3
Peruvian shares	2	3	2	3	2	3
Other:						
Index-linked bonds (UK)	-	-	-	-	-	-

INDICATORS AND MARKET ANALYSIS FOREIGN EXCHANGE MARKETS[1]

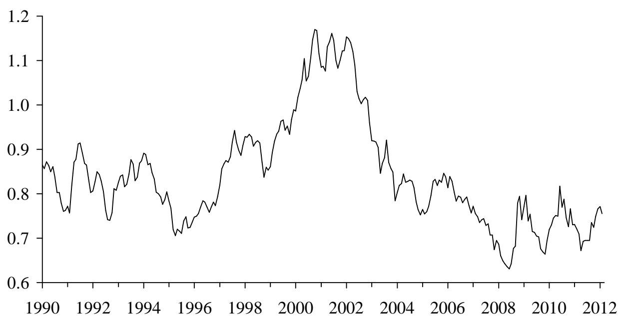
US : Trade Weighted Index (Bank of England 1990 = 100)



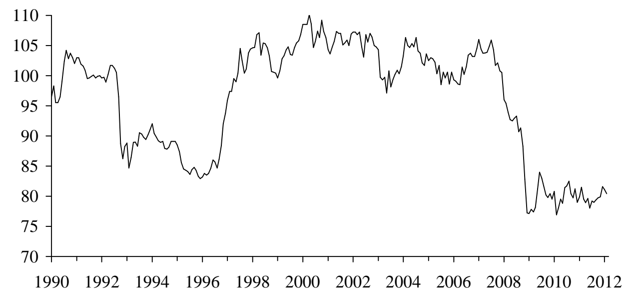
UK: Dollars Per Pound Sterling



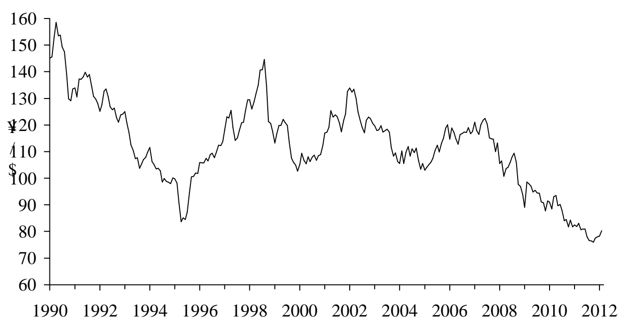
Euro per US dollar



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



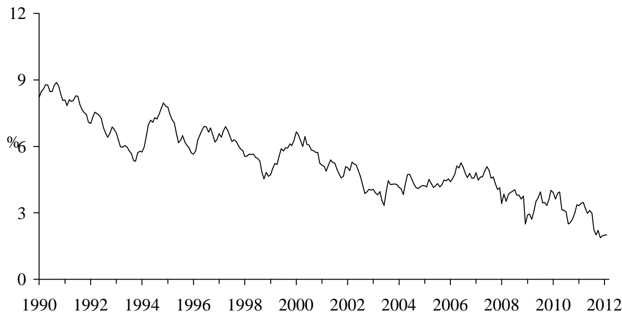
Japan : Yen Per U.S. Dollar



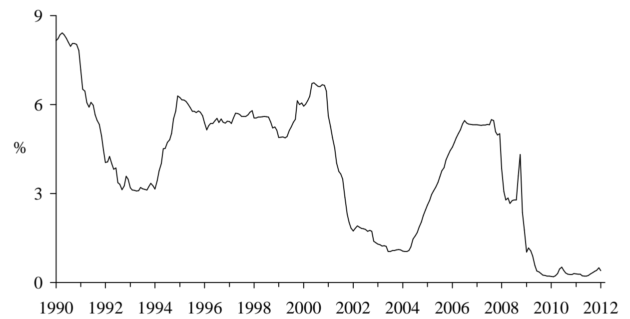
[1] John Wilmot, who has written these sections since this Letter began, is indisposed. We are issuing the charts without his commentary this month. We wish him a speedy recovery.

GOVERNMENT BOND MARKETS

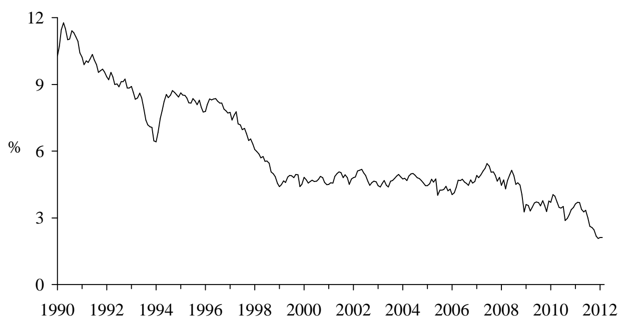
U.S.: Yield on Long-Term Government Bonds



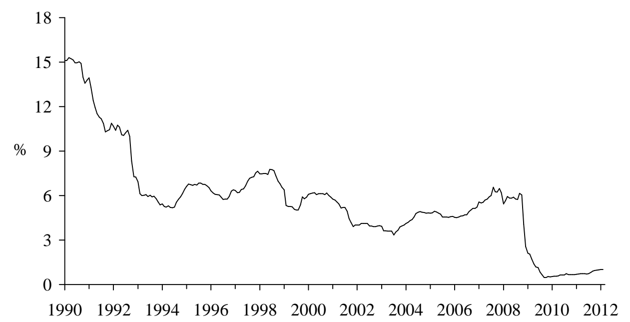
U.S. : 3-Month Certificate of Deposit



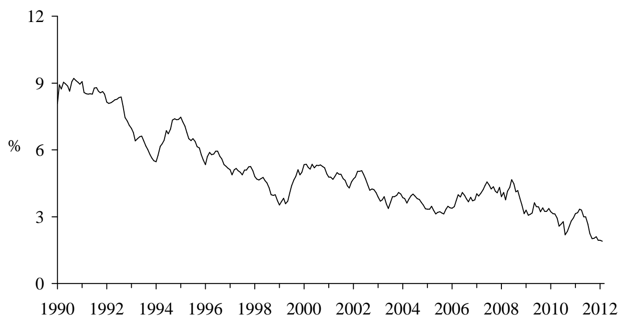
U.K. : Yield on Long-Term Government Bonds



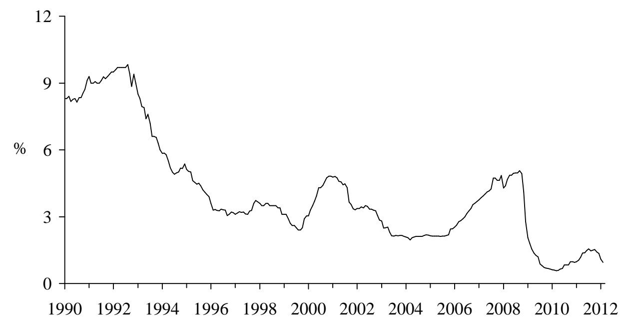
U.K. : 3-Month Interbank Rate



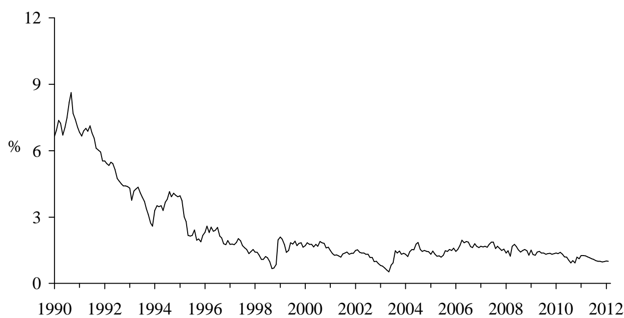
Germany: Yield on Public Authority Bonds



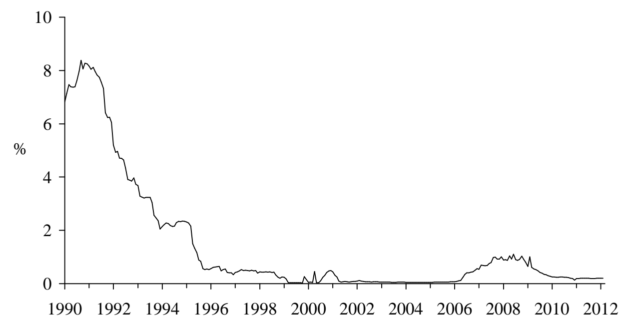
Germany : 3-Month Interbank Deposit Rate



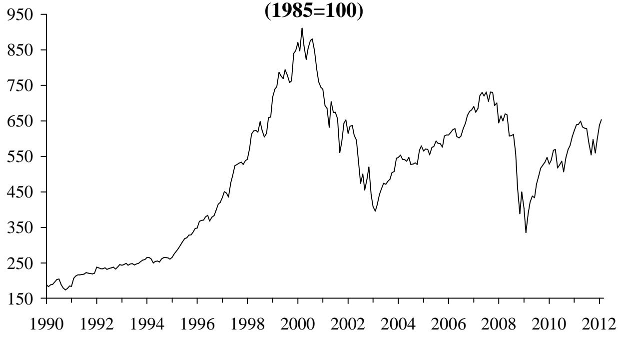
Japan: Yield on Long-Term Government Bonds

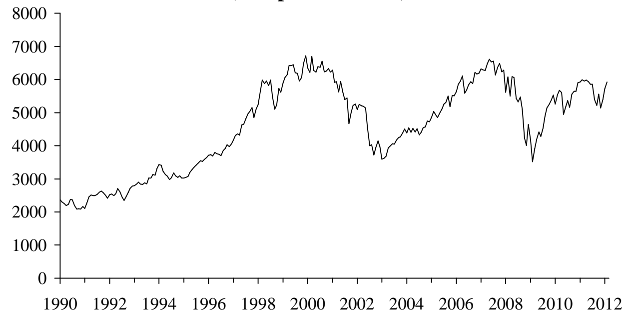


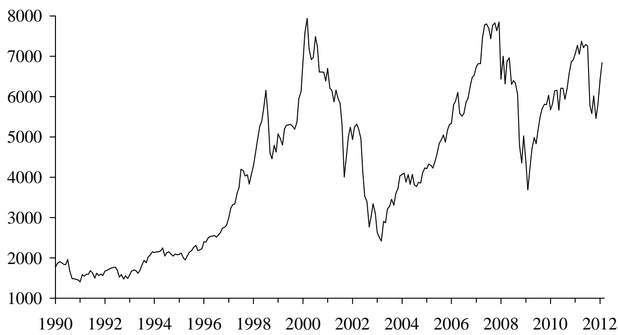
Japan : 3 Month Money Market Rate

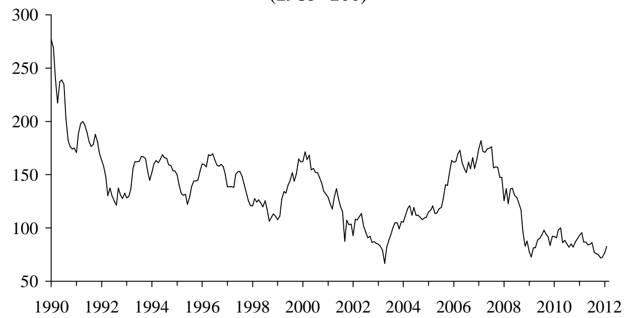


MAJOR EQUITY MARKETS









EMERGING MARKETS

India

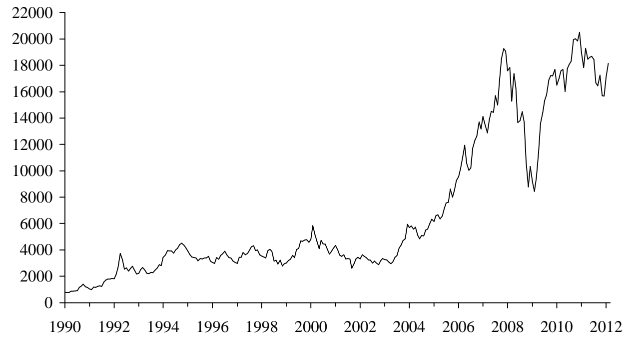
The Indian economy is expected to register growth of 6.9% for the year to March 2012, the slowest rate in three years. Manufacturing output this year is expected to grow 3.9%, compared with a 7.6% expansion a year earlier, while farm output is expected to rise 2.5%, compared with 7.0% last year. However, brisk growth returning after this fiscal year cannot be ruled out. The government has emerged from its slumber and is now taking decisions which point towards a reform agenda being back on the tracks. Politically, the flexibility that the ruling government is willing to show will be decided when the provincial government's results are out in the first week of March. It is widely expected that the results would strengthen the hands of the ruling party so that it would be able to bring long-standing reforms related to FDI in the retail, insurance and land acquisition sectors.

However, India's ballooning deficit needs to be controlled, and the political class needs to remember about the of prioritising distributive policies over productive investment incentives. Uncharacteristically, India's central bank chief heightened his criticism of government spending, saying that without a credible plan to rein in debt, it will be hard to bring down inflation and accelerate the country's disappointing growth rate. He has asked the government to do away with hand-outs on liquefied natural gas and electricity. Moreover, he opined that India's potential growth level is now closer to 7%. The Prime Minister's Economic Advisory Council has made direct reference to what should be done in the forthcoming budget of the Union Government, which will be tabled on March 16.

India's consumer prices in January rose 7.65% from a year earlier, raising concerns that a much-awaited central bank rate cut may be delayed and the country will wait for the government to show fiscal prudence in the budget before interest rates can be cut. If the election results are in favour of the ruling government then we expect the first cut to come as early as March, just before the budget is presented.

India's trade deficit widened for the first time in three months in January as imports surged, but the gap is expected to narrow over the remainder of this fiscal year through March as export orders from new markets have gained pace. The trade deficit totalled $14.7 billion in the past month, compared with $12.7 billion in December. India's merchandise export is likely to be between $295 billion and $305 billion in the current fiscal year and imports to total $460 billion.

Indian stocks are among the best-performing in the world this year, but whether this rally has legs could depend on three key events next month, namely election results of the provincial government, the union government budget and



the central bank's stand on interest rates. The Sensex has rallied more than 20% so far in 2012. This rally, like the temporary late-2010 recovery, is driven by central bank liquidity and this time may be more sustainable.

	08-09	**09-10**	**10-11**	**11-12**	**12-13**
GDP (%p.a.)	6.7	7.4	7.5	7.0	7.0
WPI (%p.a.)	5.5	9.5	9.0	7.5	7.5
Current A/c(US$ bill.)	–56.0	–14.0	–31.0	–40.0	–35.0
Rs./$(nom.)	48.5	48.0	49.0	49.5	48.0

China

The Chinese economy is likely to grow by 8% in 2012 and there are signs of it cooling down. The preliminary HSBC China Manufacturing Purchasing Managers Index, a gauge of nationwide manufacturing activity, rose to 49.7 in February compared with 48.8 in January. Manufacturing activity continues to fall as the index has been below 50 for the last four months. However, economy-wide numbers for January month went haywire due to the New Year: a one-week New Year holiday induces a seasonal pattern in the economic numbers. A long-term trend, however, is visible coming from the gradual appreciation of the Yuan. Chinese companies that have headquarters in the US are starting to move manufacturing operations to the US. China are not too worried about it as the Chinese companies are focusing on domestic consolidation to build market share.

China's inflation rose 4.5% year-on-year in January, as the Lunar New Year holiday boosted consumer prices. The main cause of the rebound was the New Year holidays, an effect which has regularly been seen in the past and is likely to be temporary. China's inflation will average 3.5% this year as slowing economic growth, stable commodity prices and easing food inflation will reduce pressures on price inflation. However, from a longer-term perspective price pressures are likely to flare up again. One major reason for this is demographic change, with China's one-child policy leading to a reduction of the number of workers in the country and pushing up wages. Even as the

economy has slowed this year, business has had to increase pay packets, often by as much as 15%.

China's central bank has cut banks' reserve requirement ratio by 0.5 percentage point, effective February 24, in a move to help boost liquidity and support the economy. This cut shows that stimulating economic growth is currently the government's priority.

Foreign direct investment into China fell in January for the third straight month. FDI fell 0.3% in January from a year earlier to $10 billion. In 2011, China attracted actual FDI of $116 billion, up 9.7% over the previous year's figure.

Export growth turned out to be –0.5% year-on-year in January — down from 13.4% in December and there was 15.3% year-on-year decline in imports giving rise to a trade surplus of $27.3 billion. It is worth noting that China's trade surplus peaked at nearly $300 billion in 2008 and has been narrowing since then. The surplus may reduce to $41 billion this year compared to $155 billion in 2011.

Now it is hard to make the case that the renminbi is hugely undervalued given China's falling trade and current account surplus and the minimal reserve accumulation in the latter half of 2011. To some extent China is moving from the product market to financial markets. One can argue that it would like to protect the value of its accumulated surpluses. China increased its presence in the Japanese debt market in 2011 and has reduced its exposure marginally to US treasuries. China has moved gradually to internationalize the yuan, but capital regulations remain in place and foreign investment in Chinese debt is restricted.

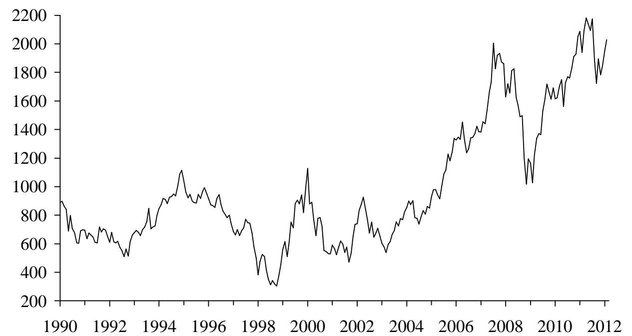
	08	09	10	11	12
GDP (%p.a.)	13.0	8.7	10.3	9.2	8.0
Inflation (%p.a.)	6.8	–0.8	5.9	4.3	3.1
Trade Balance(US$ bill.)	330	180	183	155	140
Rmb/$(nom.)	6.7	6.8	6.6	6.3	6.1

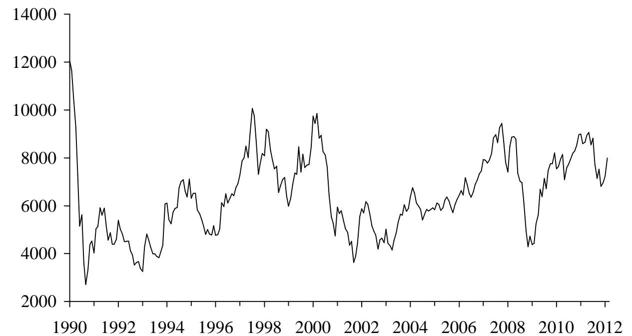
South Korea

South Korea is facing a triple whammy of slowing economic growth, falling exports and weakening consumer demand. South Korea is bracing itself for a tough year and has reduced its 2012 growth forecast to 3.7% from an earlier 4.5%. Further stimulus is ruled out as the government has already front-loaded its 2012 budget to bring spending forward.

As much as 60% of government spending will be done in the first half of the year. Welfare and health spending will increase 7% to Won 93 trillion ($83 billion).

As South Korea will be holding parliamentary elections on April 11 and political parties are vying for the votes of the less well off, South Korean President Lee Myung-bak has said that the government must target price stability firmly at the top of the administration's economic priorities even as December's industrial output unexpectedly contracted.





Another limitation on the country's ability to sharply boost spending is that South Korea must rely on international markets to buy its government bonds — its domestic market is too small to absorb government debt

South Korea's exports fell 6.6% in January, producing the first trade deficit since October 2009. Final figures could see even a steeper drop, possibly around 8%. In the final quarter of 2011, exports of goods grew only 5.2% year-on-year. The finance ministry has forecast that export growth would slow to about 7.4% in 2012 from nearly 20% last year.

South Korea and the U.S. said that their free-trade agreement will take effect March 15 after a negotiation process and ratification of the treaty that took more than five years. The pact will expand the $90 billion two-way trade relationship by 10% within five years. The deal eliminates most tariffs on goods between South Korea and the U.S. This will narrow South Korea's trade surplus with the U.S. because South Korea is likely to sharply increase its imports of U.S. agricultural products.

	08	09	10	11	12
GDP (%p.a.)	2.2	0.2	6.1	3.6	3.5
Inflation (%p.a.)	5.0	2.6	2.9	4.2	3.8
Current A/c(US$ bill.)	–7.9	42.7	28.2	27.0	13.0
Won/$(nom.)	1250	1200	1150	1100	1100

Taiwan

The global slowdown — and fragile consumer sentiment — have forced Taiwan's government to lower its economic growth forecast for this year. The island had slipped into a technical recession in the fourth quarter of 2011 and then registered an economic growth rate of 4.04% for 2011. In 2012 GDP is likely to grow by only 3.85% as exports falter.

Taiwan's inflation rate accelerated to a more than three-year high in January due to strong Lunar New Year holiday demand, but inflationary pressure is moderate and the rise in consumer prices will be around 1.5% in 2012.

The main reason for lower growth in Taiwan is the subdued performance of the export sector, which contributes more than two-thirds of gross domestic product. Since late last year Europe and China have cut back on orders amid fears of a global slowdown. The encouraging data from the U.S. will help maintain exports growth.

	08	**09**	**10**	**11**	**12**
GDP (%p.a.)	1.9	–1.9	10.8	4.0	3.1
Inflation (%p.a.)	3.8	0.0	1.3	1.2	1.3
Current A/c(US$ bill.)	29.0	16.0	16.0	18.0	20.0
NT$/$(nom.)	32.0	32.0	31.0	30.0	29.5

Brazil

The Brazilian government expects GDP to expand 4.5% in 2012 while maintaining inflation at 4.7%. The IPCA consumer price index has declined to around 5.4% this year, from 6.5% in 2011. To achieve an inflation rate of 4.7% will be a herculean task. On GDP growth also, government is seeking to reduce its proposed budget by R$55 billion as part of a bid to permanently lower its historically high real interest rates. The government has already announced the cuts, equal to about 3.3% of the proposed budget, in order to meet its primary budget surplus — the surplus before interest payments.

Brazil's central bank has said that the benchmark Selic rate could be lowered to single digits after a sharp slowdown in domestic economic growth in the second half of 2011. Brazilian President Dilma Rousseff also wants to keep interest rates in Brazil lower to make Brazilian bonds less attractive to foreign investors.

To meet its budget deficit target, Brazil raised $14 billion in a privatization of three major airports. By doing so the modernisation of airport hubs will be speeded up before the country hosts soccer's 2014 World Cup and the 2016 Olympic Games.

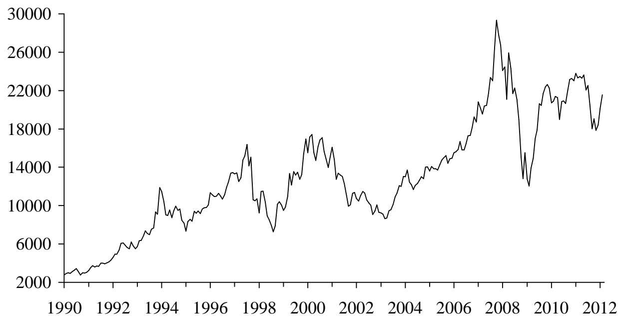
After falling to a low of 48,668.29 points in August in 2011, the benchmark Bovespa index is hovering above 66,000 points – a gain of 35.6%. In dollar terms it gained more than 22% in January alone compared with December and 13% in local currency terms, in line with appetite for global risk.

The Brazilian real touched 1.7254 per U.S. dollar before retreating a little. Since February 2009, the real has gained 34%, making it one of the world's best performing currencies against the dollar.

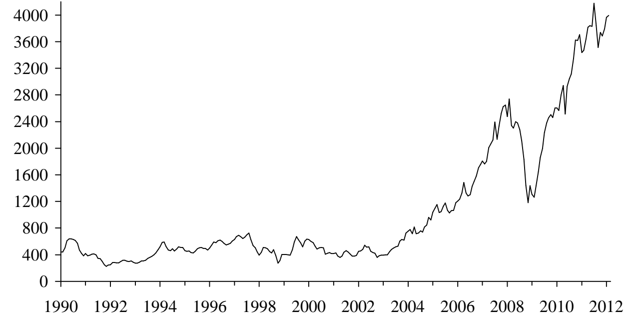
	08	**09**	**10**	**11**	**12**
GDP (%p.a.)	5.1	–0.2	7.5	3.0	3.0
Inflation (%p.a.)	6.0	4.1	5.9	6.5	5.6
Current A/c(US$ bill.)	–25.0	–20.0	–47.3	–52.6	–60.0
Real/$(nom.)	2.2	1.8	1.7	1.5	1.7

Other Emerging Markets

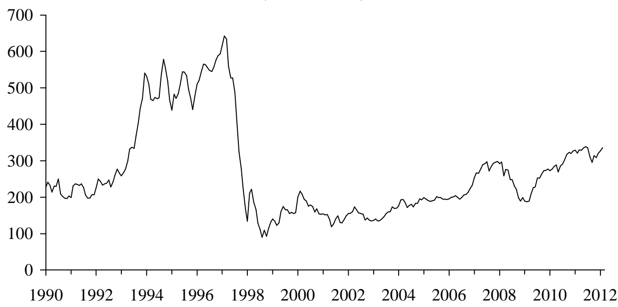
Hong Kong: FT-Actuaries



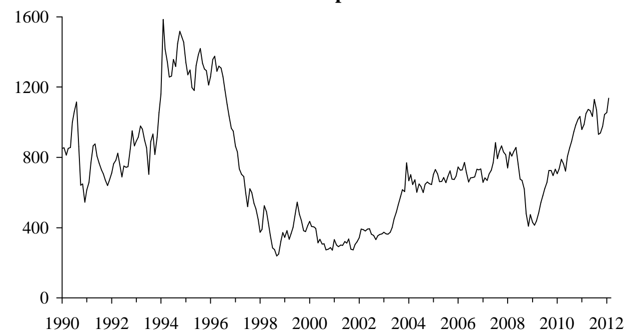
Indonesia: Jakarta Composite



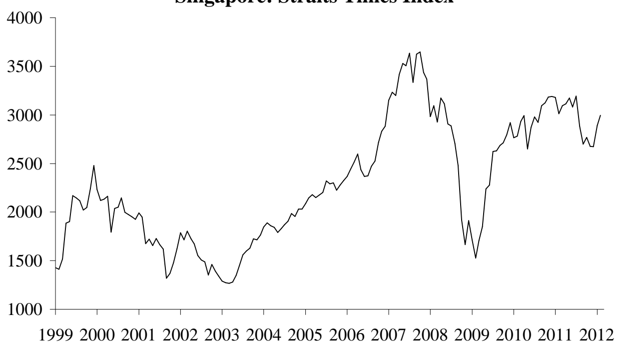
Malaysia: FT-Actuaries (US$ Index)



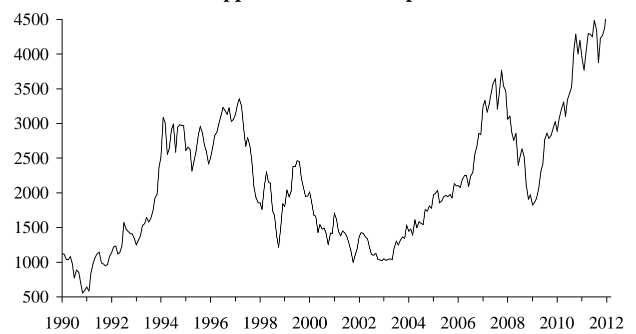
Thailand: Composite Index



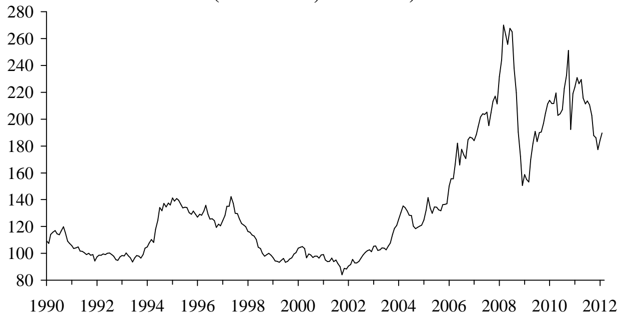
Singapore: Straits Times Index

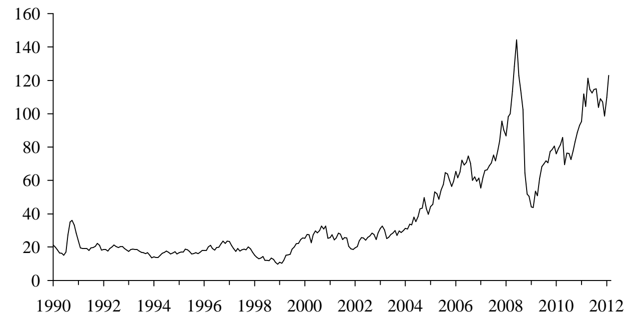


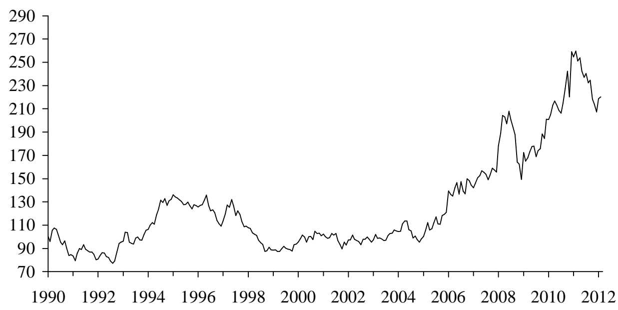
Philippines: Manila Composite

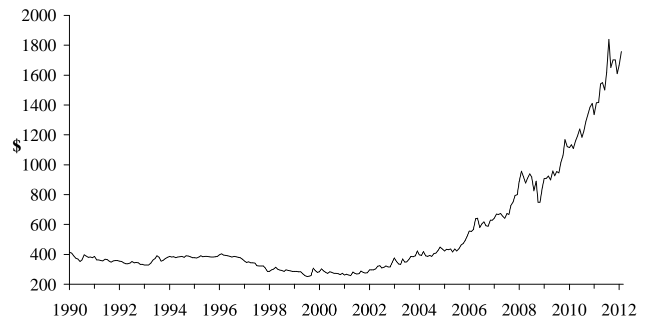


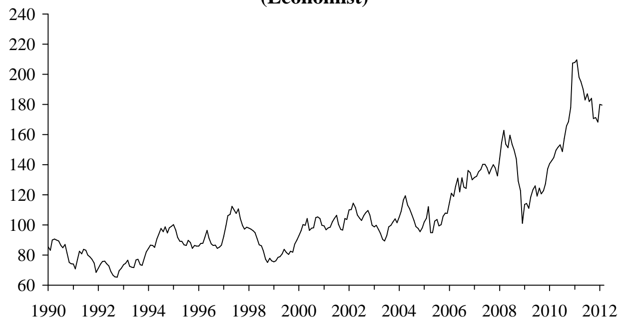
COMMODITY MARKETS











UK FORECAST DETAIL

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

	Inflation %[1] (CPI)	Short Dated (5 Year) Interest Rates	3 Month Int. Rates	Nominal Exchange Rate (2005=100)[2]	Real Exchange Rate[3]	Real 3 Month Int. Rates %[4]	Inflation (RPIX)	Real Short Dated Rate of Interest[5]
2008	3.3	4.0	5.1	91.2	100.3	3.7	4.3	1.0
2009	1.3	2.8	0.8	80.7	89.5	-3.1	2.0	-0.3
2010	3.9	2.3	0.6	80.6	91.2	-3.8	4.8	-0.5
2011	4.4	2.4	1.0	81.2	94.5	-2.2	4.7	0.1
2012	3.2	2.7	2.3	81.0	95.8	0.1	3.6	0.7
2013	2.2	2.8	2.5	80.5	95.7	0.5	2.8	0.8
2010:1	2.8	2.8	0.5	79.9	89.8	-4.3	4.5	-0.1
2010:2	4.1	2.2	0.7	80.2	90.3	-3.8	5.1	-0.6
2010:3	4.2	1.8	0.6	82.0	92.9	-3.6	4.7	-0.9
2010:4	4.4	2.3	0.7	80.5	91.6	-3.3	4.7	-0.3
2011:1	4.8	2.7	0.8	81.1	93.8	-2.8	5.3	0.2
2011:2	4.5	2.2	0.8	79.6	92.4	-2.5	5.0	-0.2
2011:3	4.2	2.4	1.1	82.2	95.8	-2.0	4.3	0.1
2011:4	4.0	2.5	1.6	82.0	95.9	-1.2	4.2	0.3
2012:1	3.6	2.6	2.0	80.7	95.4	-0.5	3.9	0.5
2012:2	3.3	2.6	2.2	81.3	96.1	0.0	3.7	0.6
2012:3	3.1	2.8	2.5	81.0	95.8	0.4	3.5	0.8
2012:4	2.8	2.8	2.5	80.9	95.7	0.5	3.3	1.4

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

Labour Market and Supply Factors (Seasonally Adjusted)

	Average Earnings (1990=100)[1]	Wage Growth[2]	Unemployment (New Basis) Percent[3]	Millions	Real Wage Rate[4] (1990=100)
2008	220.4	3.5	2.8	0.91	138.9
2009	220.2	0.0	4.6	1.53	136.9
2010	225.2	2.4	4.6	1.50	134.8
2011	230.5	2.4	4.7	1.53	132.2
2012	239.9	4.1	4.4	1.47	133.4
2013	249.0	3.8	3.8	1.27	135.5
2010:1	224.2	4.4	4.8	1.57	136.3
2010:2	222.9	1.0	4.6	1.49	133.9
2010:3	225.3	2.2	4.5	1.47	134.3
2010:4	228.4	1.9	4.5	1.46	134.8
2011:1	229.8	2.6	4.4	1.45	133.2
2011:2	228.8	2.7	4.6	1.50	131.5
2011:3	229.9	2.0	4.8	1.58	131.5
2011:4	233.5	2.2	4.8	1.59	132.5
2012:1	237.3	3.3	4.6	1.54	132.8
2012:2	239.1	4.5	4.5	1.49	133.2
2012:3	240.5	4.6	4.3	1.44	133.5
2012:4	242.7	3.9	4.2	1.39	134.0

[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
2008	147.3	705312.2	421176.1	253264.5	176727.6	-46562.6	99293.5
2009	140.8	674466.5	405440.7	218144.6	178391.0	-33226.3	94283.5
2010	143.3	686345.3	405565.3	241422.1	180777.4	-42021.1	99398.4
2011	144.8	693331.3	400381.9	236752.2	182398.0	-31348.2	94851.3
2012	146.8	703170.7	401572.0	247757.1	184603.4	-33345.2	97417.6
2013	149.8	717526.3	407987.9	255148.0	187436.1	-33320.4	99720.5
2008/07	-1.1		-1.5	-2.2	3.4		8.7
2009/08	-4.3		-3.7	-13.4	0.9		-5.0
2010/09	1.8		0.0	10.7	1.3		5.6
2011/10	1.0		-1.3	-1.7	0.9		-3.9
2012/11	1.4		0.3	4.7	1.2		2.8
2013/12	2.0		1.6	3.0	1.5		2.4
2010:1	141.9	169929.6	101035.9	54839.4	47326.4	-10076.3	23195.7
2010:2	143.4	171724.0	101994.9	57226.4	43888.6	-9819.2	21566.7
2010:3	144.3	172787.0	101409.9	65728.6	44640.8	-11710.3	27282.0
2010:4	143.6	171904.6	101124.6	63627.7	44921.5	-10415.2	27354.0
2011:1	144.2	172584.4	100688.1	55175.7	47489.5	-7019.6	23749.4
2011:2	144.3	172761.4	99684.3	58473.2	44536.4	-7695.8	22236.7
2011:3	145.6	174351.0	99891.2	61928.1	45087.9	-8312.5	24243.0
2011:4	145.0	173634.6	100118.2	61175.2	45284.1	-8320.4	24622.2
2012:1	145.7	174471.0	100187.7	58861.3	47967.7	-8338.6	24207.2
2012:2	146.2	174997.3	99883.8	62474.5	45027.4	-8332.2	24056.9
2012:3	147.8	176953.2	100387.2	63758.7	45681.0	-8335.7	24538.7
2012:4	147.6	176749.1	101113.3	62662.6	45927.2	-8338.7	24614.9

[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)
2008	5.8	1262.4	73.8	33.2	-22.0
2009	10.3	1244.4	127.8	32.4	-26.1
2010	8.3	1333.7	110.8	36.6	-30.8
2011	8.8	1391.3	121.9	43.1	-5.8
2012	6.9	1457.5	100.6	49.6	-8.1
2013	6.4	1519.8	97.2	52.7	-7.4
2010:1	8.1	317.8	25.9	8.4	-6.9
2010:2	10.2	321.7	32.7	8.8	-10.1
2010:3	7.8	335.7	26.2	8.9	-9.7
2010:4	11.3	337.6	38.3	9.2	-4.1
2011:1	4.0	338.7	13.6	9.7	-2.0
2011:2	8.5	339.2	28.9	10.1	-1.1
2011:3	4.7	347.4	16.3	10.4	-2.8
2011:4	12.2	349.5	42.5	11.0	0.1
2012:1	9.6	355.2	34.2	11.6	-4.0
2012:2	6.4	357.8	23.1	12.0	-1.6
2012:3	6.5	363.5	23.7	12.4	-2.8
2012:4	6.7	364.9	24.5	12.5	0.2

[1] GDP at market prices (Financial Year)

WORLD FORECAST DETAIL

Growth Of Real GNP

	2007	2008	2009	2010	2011	2012
U.S.A.	1.9	0.0	–2.6	2.6	1.9	2.5
U.K.	3.5	–1.1	–4.3	1.8	1.0	1.4
Japan	2.3	–1.2	–6.3	4.3	–0.4	2.1
Germany	2.7	1.0	–4.7	3.6	2.9	1.1
France	2.3	0.1	–2.5	1.5	1.6	1.0
Italy	1.4	–1.3	–5.1	0.9	0.6	0.1

Growth Of Consumer Prices

	2007	2008	2009	2010	2011	2012
U.S.A.	2.9	3.8	–0.3	1.8	2.9	2.0
U.K.	2.5	3.3	1.3	3.9	4.4	3.2
Japan	0.0	1.4	–1.4	–1.0	–0.3	–0.2
Germany	2.3	2.6	0.4	1.1	2.3	1.8
France	1.5	2.8	0.1	1.5	2.1	1.6
Italy	1.8	3.4	0.8	1.5	2.7	2.0

Real Short-Term Interest Rates

	2007	2008	2009	2010	2011	2012
U.S.A.	0.6	1.8	–1.6	–1.8	–1.7	–1.5
U.K.	2.9	3.7	–3.1	–3.8	–2.2	0.1
Japan	–0.8	1.8	1.1	0.5	0.4	0.3
Germany	1.3	3.5	–0.4	–1.3	–0.3	0.5
France	1.1	3.8	–0.8	–1.4	–0.3	0.5
Italy	0.5	3.1	–0.8	–1.4	–0.3	0.5

Nominal Short-Term Interest Rates

	2007	2008	2009	2010	2011	2012
U.S.A.	4.4	1.5	0.2	0.1	0.3	0.5
U.K.	5.9	5.1	0.8	0.6	1.0	2.3
Japan	0.6	0.4	0.1	0.1	0.4	0.4
Germany	3.9	3.9	0.7	0.4	1.5	2.5
France	3.9	3.9	0.7	0.4	1.5	2.5
Italy	3.9	3.9	0.7	0.4	1.5	2.5

Real Long-Term Interest Rates

	2007	2008	2009	2010	2011	2012
U.S.A.	2.8	2.2	1.3	1.1	1.2	2.0
U.K.	2.3	1.0	–0.3	–0.5	0.1	0.7
Japan	2.0	2.0	1.4	1.1	1.1	1.3
Germany	2.8	3.0	2.3	1.9	1.8	2.0
France	2.7	3.0	2.2	1.9	1.8	2.0
Italy	2.4	2.8	2.2	1.9	1.8	2.0

Nominal Long-Term Interest Rates

	2007	2008	2009	2010	2011	2012
U.S.A.	4.6	3.7	3.2	3.1	3.2	4.0
U.K.	5.0	4.0	2.8	2.3	2.4	2.7
Japan	1.7	1.5	1.3	1.1	1.2	1.5
Germany	4.3	4.4	4.0	3.8	3.8	4.0
France	4.3	4.4	4.0	3.8	3.8	4.0
Italy	4.3	4.4	4.0	3.8	3.8	4.0

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

	2007	2008	2009	2010	2011	2012
U.S.A.	83.4	80.1	88.7	81.7	81.8	82.0
U.K.	98.9	87.6	78.2	79.7	82.5	83.7
Japan	81.2	87.9	89.0	80.2	79.8	79.7
Germany	104.6	105.1	105.8	99.3	99.0	99.1
France	104.9	106.4	104.3	101.7	102.0	102.0
Italy	105.0	106.6	105.4	100.5	100.8	101.0

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

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

	2007	2008	2009	2010	2011	2012
U.S.A.[1]	89.38	81.72	81.61	82.12	83.97	83.94
U.K.	2.00	1.85	1.57	1.55	1.61	1.58
Japan	117.75	103.40	93.56	87.76	87.10	87.00
Eurozone	0.73	0.68	0.72	0.75	0.78	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