LIVERPOOL INVESTMENT LETTER

May 2013

Cardiff Business School
Cardiff University

Julian Hodge Institute of Applied Macroeconomics

LIVERPOOL RESEARCH GROUP IN MACROECONOMICS

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

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

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

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A GENERAL SLOWDOWN IN WORLD GROWTH

One of our recurring themes has been the brake exerted on world growth by raw material resource constraints. This braking effect has shown up most clearly in developed countries as emerging countries like China have powered on ahead with their 'structural transformation'. However, now the malaise is spreading to these emerging countries too.

The problems they face lie in achieving growth in a balanced way that can be sustained along an equilibrium path. With the developed countries slowing, the traditional growth of export demand has slowed too. Emerging countries are largely organised around the supply of exports. This in turn creates a demand for investment and government spending on infrastructure so that exports, investment and government spending are the main components of growth. The slowing of export demand has thrown this model into disarray. China for example now finds it has substantial excess capacity in the wake of the huge beefing-up of investment spending it carried out in response to the crisis. It cannot continue to create new employment hubs based on more and more investment, to fill in the hole left by slower export growth. Hence it has announced a slowdown in its growth target — to around 7%. It is also trying to encourage consumer spending, raising the share of consumption more into line with developed economies. However, this is not easily done when the institutional structure (such as no welfare state) and ingrained saving habits underpin the status quo.

With raw material supplies improving (with fracking especially) and technology lowering material intensity as it did in the 1980s, this slowdown in growth among emerging countries is further helping to bring raw material prices down. This is bringing some relief to the majority of developed countries that import raw materials in a big way. World growth should be able to be more evenly distributed, with the west improving and the emerging countries slowing.

The UK and the GDP figures

The slight growth in GDP (0.3%) shown by the figures for the first quarter underlines the weak nature of the UK recovery. In fact other than construction, North Sea oil and banking, the economy has growing at a modest rate, a bit over 1%, for three years, much in line with the employment picture. There are signs now that North Sea oil is picking up, the worst may be over for construction, and even banking may improve as the government moves to subsidise the lending it has penalised through excessive bank regulation. So we are looking for a gradual improvement of growth in the coming months. As the economy improves, investment by large firms should finally come to life, as they stop deferring plans in the light of uncertainty about demand.

Table 1: Summary of Forecast

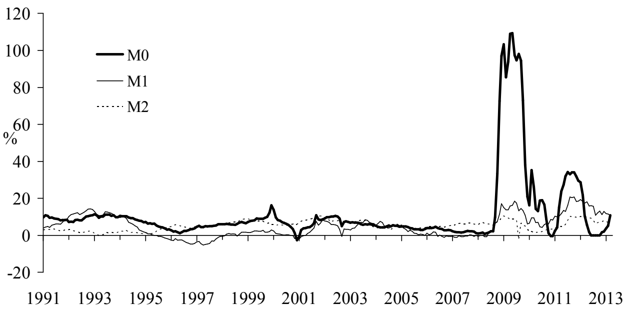
		2010	2011	2012	2013	2014	2015	2016
GDP Growth[1]		1.8	0.9	0.1	0.8	2.0	2.4	2.6
Inflation	CPI	3.7	4.7	2.8	2.8	2.6	2.2	2.0
	RPIX	4.8	5.3	3.3	3.3	3.1	2.8	2.7
Unemployment (Mill.)								
	Ann. Avg.[2]	1.5	1.5	1.6	1.5	1.4	1.3	1.2
	4th Qtr.	1.5	1.6	1.6	1.5	1.3	1.2	1.1
Exchange Rate[3]		80.4	80.0	83.0	83.5	82.7	82.1	81.5
3 Month Interest Rate		0.7	0.9	0.9	0.9	1.7	2.1	2.2
5 Year Interest Rate		2.4	2.0	0.9	1.3	1.8	2.1	2.4
Current Balance (£bn)		−37.3	−20.4	−51.9	−52.2	−52.8	−53.0	−52.0
PSBR (£bn)		115.1	94.2	95.4	98.2	84.7	72.2	60.5

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

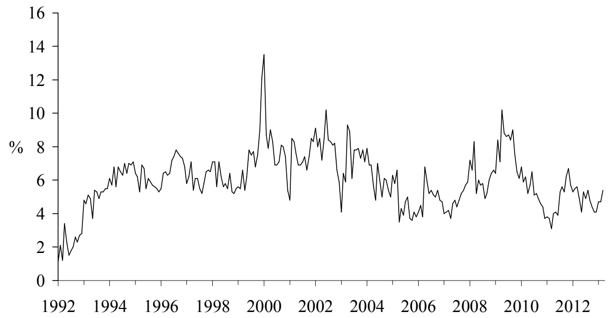
Other stimulants could come into play if the bank lending situation eases. There is now yet another Funding for Lending Scheme coming in, on top of a mortgage subsidy scheme from the Budget. The penny appears to have dropped in the Treasury and the Bank that it is they who have blocked the credit channel with their enthusiasm for new regulation; hence the reaching for tools to unblock it. These schemes are no substitute for free markets but they could have an effect. If so, the housing market should pick up, with knock-on effects for spending on furniture and other durables. Investment by SMEs could also benefit; this in turn will put competitive pressure on larger firms to invest.

Overall, the easing of world raw material prices, better western growth and slowing emerging growth are promising trends for the 2000s.

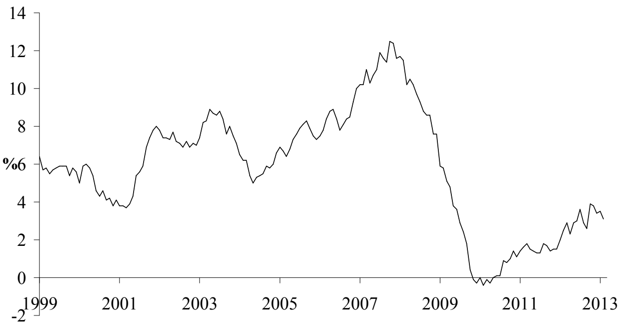
U.S.: Growth in Monetary Aggregates (Yr - on - Yr)



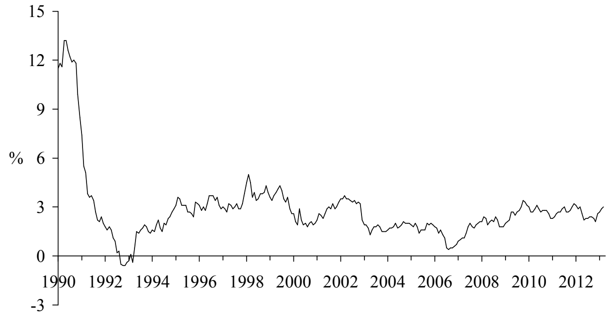
UK: Notes and Coins in Circulation Growth



Eurozone M3 Growth



Japan: Growth of M2+CD's



FOCUS ON JAPAN

Francesco Perugini

The new monetary policy regime of the Bank of Japan

On April 4, exactly 100 days from the launch of the Abe administration, the Bank of Japan (BOJ) came out with a new set of "quantitative and qualitative monetary easing" policies in response to the prime minister's agenda. Kuroda Haruhiko, the new BOJ governor appointed by Abe, announced some radical measures: the BOJ will change the target for money-market operations. Instead of keeping the overnight call rate close to zero, the BOJ will now directly target the monetary base, i.e. cash in circulation and the reserves that financial institutions hold with the central bank. In order to achieve the target of 2% inflation within two years, the central bank will double the monetary base to ¥270 trillion by the end of 2014 (or 55% of GDP), will double the pace of its purchases of Japanese government bonds (JGBs) to over ¥7 trillion a month, and will double its total holdings of these bonds to ¥190 trillion, which is around 30% of all JGBs, compared with 10% at the moment.

The bank will also expand the scope of government debt purchases to all JGBs including the longest 40-year instruments. Under the previous policy, bond buying was limited to those maturing between one to three years. The new policy will extend the average remaining maturity of the BOJ's JGB holdings to roughly seven years from slightly less than three years now. The qualitative aspect of the new policy has to do with the fact that the BOJ now plans to push down long-term interest rates by buying more bonds with longer terms to maturity. Under previous central bank Governor Masaaki Shirakawa, the focus was on lowering interest rates on bonds maturing in less than three years. By bringing down long-term rates, the BOJ hopes to encourage individuals to take out mortgages and businesses to make capital investments.

Furthermore, the BOJ will increase purchases of more risky assets such as Exchange Traded Funds (ETF) and Japan real estate investment trusts (J-REIT) at an annual pace of ¥1 trillion and ¥30 billion respectively. It hopes these efforts will raise stock and property prices and create a wealth effect spurring consumer spending and business investment.

The BOJ has also clarified the relationship between easing and the price target saying that it "will continue…aiming to achieve the price stability target of 2%, as long as it is necessary for maintaining that target in a stable manner". Up to now, there has been a problem of dynamic inconsistency in the highly discretionary commitment to easing "as long as the Bank judges it appropriate".

Markets have responded favourably to the BOJ decision and to the policy change promoted by Abe. Since Abe's election, late last year, the Nikkei 225 has outperformed the MSCI World All-Country Index by about 27% in Yen terms and by between 6% and 14% when measured in US dollars or in Euro. Also, yields are sharply lower across the board. 10-year JGB yields collapsed 35 basis points before retreating to about 0.6%, while 30-years fell initially by 74 basis points to 1.22% before scaling back to 1.59%.

Japan's currency reacted sharply too. The yen has weakened against the dollar since mid-November, while portfolio investment flows data suggests increasing confidence in Japan, as overseas funds continue to flock into the country's equity market and Japanese investors are exiting international markets.

Most importantly, a range of indicators show signs that the public's inflation expectations are rising. For instance, a recent government survey showed household spending rose 2.4% on year in January, after a 0.7% fall in December, supported by spending on overseas tours and hotels. "Much of the spending was on optional items rather than essentials, indicating that consumers may be feeling a little richer", said Koya Miyamae economist at SMBC Nikko Securities. In January, a closely watched government consumer-confidence survey posted the biggest monthly gain since the survey began in 2004, prompting Abe to tell parliament, "it's proof that the people's predictions about the future are changing more and more from expectations for deflation to those for inflation".

On the investment side, the most frequently cited metric of inflation expectations is the so-called break-even inflation rate, which measures the difference between the yield on the benchmark 10-year JGBs and the yield on an equivalent 10-year inflation-linked bond — a bond whose payouts are linked to inflation. Although economists say the break-even inflation rate isn't too reliable since Japan hasn't issued inflation-indexed bonds since October 2008 and the market lacks liquidity, this indicator shows an upward trend since Abe's election. The rate became positive in February 2012 for the first time since September 2008, indicating that investors have begun to discount a rise in prices.

Alternative market-based measures of inflation expectations appear to have been quite responsive to recent monetary policy innovations by the BOJ. For instance, by using the thirty-year yen/dollar forward rate, economists at Goldman Sachs showed how this indicator has scaled back dramatically since just before the BOJ meeting. However, they also noted that the indicator remains below the level registered in the second week of February, when the market was pricing higher long-term inflation expectations. So they concluded that the market remains a long way off pricing a credible 2% inflation target, even though it has responded to the BOJ actions.

It is too early to declare likely success in conquering deflation. Certainly for the public, weary of years of political indecision and gridlock, the fulfilment of Abe's campaign pledge to get an inflation target adopted represented a welcome sign of change in action. However, even if inflation is raised and an asset price boom manufactured, this in itself will not create growth; growth can only come from faster productivity growth which requires supply-side policies such as greater competition and freer entry into service industries. Thus in the months to come the BOJ must first prove that its policy is credible and it can really do "whatever it takes" to hit the inflation target. Then other policies are needed to create sustained confidence on the part of households, companies and investors. The July Upper House elections are an important milestone and will frame the political motivation for aggressive policy support of the BOJ initiative.

MARKET DEVELOPMENTS

The extraordinary action by the Abe government and the Bank of Japan has stimulated Japanese asset prices and pushed the yen down. This is not yet a sign that Japan will grow faster as matching the inflationary surge there has to be improvement in productivity growth from supply-side policies especially directed at the massive service sector. Prospects for growth still look strongest in emerging countries even though they are slowing.

Table 1: Market Developments

	Market Levels		Prediction for Feb/Jan 2014	
	Mar 26	Apr 24	Previous Letter	Current View
Share Indices				
UK (FT 100)	6399	6432	9049	8741
US (S&P 500)	1564	1579	1759	2024
Germany (DAX 30)	7880	7759	9708	10669
Japan (Tokyo New)	1044	1164	1177	1579
Bond Yields (government long-term)				
UK	1.80	1.71	1.80	1.80
US	1.91	1.70	4.00	2.10
Germany	1.33	1.24	4.00	1.50
Japan	0.55	0.60	1.50	0.70
UK Index Linked	–0.41	–0.48	–0.40	–0.20
Exchange Rates				
UK ($ per £)	1.52	1.53	1.58	1.56
UK (trade weighted)	79.9	80.3	83.1	82.3
US (trade weighted)	85.5	86.8	80.5	85.5
Euro per $	0.78	0.77	0.79	0.79
Euro per £	1.18	1.17	1.25	1.23
Japan (Yen per $)	94.2	99.4	81.0	98.0
Short Term Interest Rates (3-month deposits)				
UK	0.52	0.61	1.30	1.70
US	0.40	0.41	0.60	0.70
Euro	0.15	0.15	2.50	0.50
Japan	0.18	0.18	0.40	0.70

Table 2: Prospective Yields [1]

Equities: Contribution to £ yield of:

	Dividend Yield	Real Growth	Inflation	Changing Dividend Yield	Currency	Total
UK	3.40	1.4	2.6	32.00		39.30
US	2.00	2.2	2.0	24.00	–2.16	28.04
Germany	3.10	0.8	1.7	35.00	–4.95	35.65
Japan	1.60	1.6	0.0	34.00	–0.72	36.48
UK indexed[2]	–0.48		2.6	–5.00		–2.98
Hong Kong[3]	2.40	7.5	2.0	15.00	–2.16	24.74
Malaysia	2.90	4.5	2.0	49.00	–2.16	56.24
Singapore	3.30	2.9	2.0	23.00	–2.16	29.04
India	1.50	6.5	2.0	22.00	–2.16	29.84
Korea	1.20	3.5	2.0	–1.00	–2.16	3.54
Indonesia	2.00	6.4	2.0	47.00	–2.16	55.24
Taiwan	3.30	3.2	2.0	38.00	–2.16	44.34
Thailand	2.90	4.2	2.0	41.00	–2.16	47.94

Bonds: Contribution to £ yield of:

	Redemption Yield	Changing Nominal Rates	Currency	Total
UK	1.71	–0.90		0.81
US	1.70	–4.00	–2.16	–4.46
Germany	1.24	–2.60	–4.95	–6.31
Japan	0.60	–1.00	–0.72	–1.12

Deposits: Contribution to £ yield of:

	Deposit Yield	Currency	Total
UK	0.61		0.61
US	0.41	–2.16	–1.75
Euro	0.15	–4.95	–4.80
Japan	0.18	–0.72	–0.54

[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.

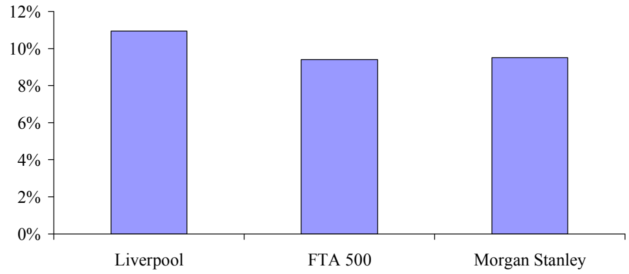
Table 3: Portfolio(%)

	Sterling Based Investor		Dollar Based Investor		Euro Based Investor	
	April Letter	Current View	April Letter	Current View	April 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)	-	-	-	-	-	-

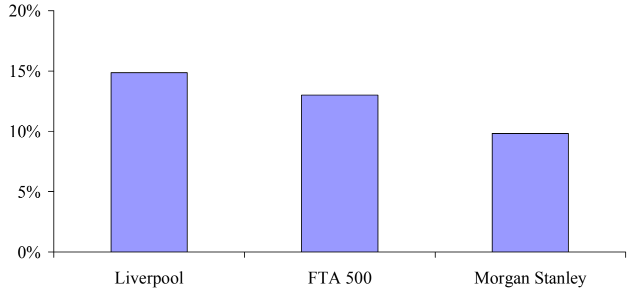
PORTFOLIO PERFORMANCE

The charts below, and the Table opposite, measure the performance of the Liverpool Model Portfolio against the FTA Non-financials share index, and the Morgan Stanley World Capital International index, over the period from June 1992 to end-April 2013.

3 Month Growth



12 Month Growth



3 Year Annualised Growth

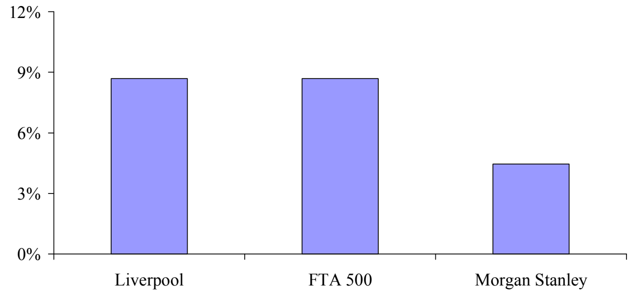
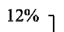


Table 4: Liverpool Portfolio Evaluation (End-June 1992 = 100)

Date	Index of Liverpool Portfolio	FTA Non Financials Index Total Return	Morgan Stanley World Capital International Index Total Return
2007			
1st Jan	332.81	361.22	382.93
Apr	344.58	376.53	389.99
Jul	365.53	403.07	403.44
Oct	379.22	401.46	405.04
2008			
1st Jan	396.02	411.25	403.19
Apr	389.00	367.01	365.34
Jul	387.93	381.90	355.90
Oct	400.53	324.99	335.11
2009			
1st Jan	439.02	314.73	323.33
Apr	424.38	294.99	283.79
Jul	441.61	315.62	295.72
Oct	508.20	375.37	355.96
2010			
1st Jan	526.64	408.79	365.52
Apr	564.11	436.43	399.80
Jul	531.62	382.77	351.60
Oct	572.20	435.61	378.02
2011			
1st Jan	620.58	476.51	413.02
Apr	621.29	481.43	420.69
Jul	631.17	494.36	418.86
Oct	548.00	437.69	358.02
2012			
1st Jan	575.91	482.11	384.40
Apr	630.65	495.88	414.96
Jul	605.43	480.40	398.13
Oct	631.88	507.18	410.42
2013			
1st Jan	652.78	512.06	416.11
Feb	694.31	541.61	446.54
Mar	716.63	549.73	466.31
Apr	724.23	560.28	455.72

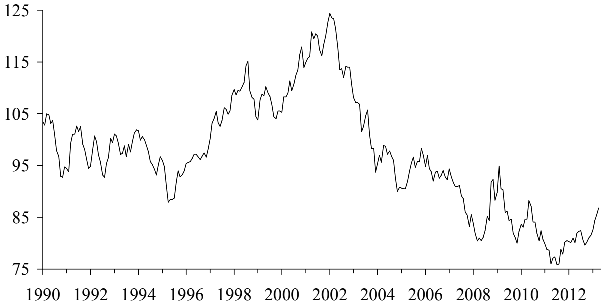
Source: Rensburg Sheppards Investment Management Limited, Liverpool Stock Exchange

3 Year Annualised Growth

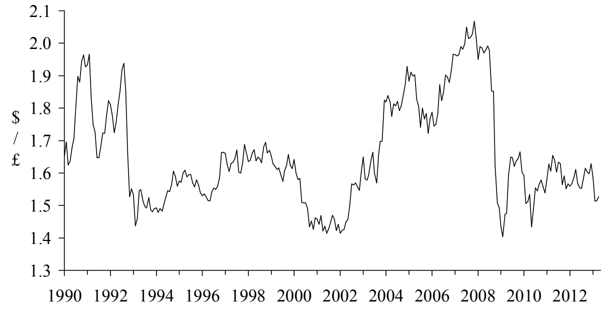


INDICATORS AND MARKET ANALYSIS
FOREIGN EXCHANGE MARKETS

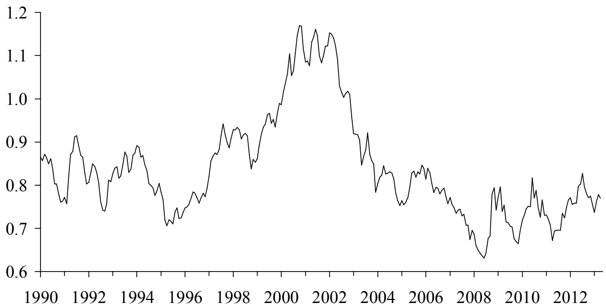
US : Trade Weighted Index
(Bank of England 1990 = 100)



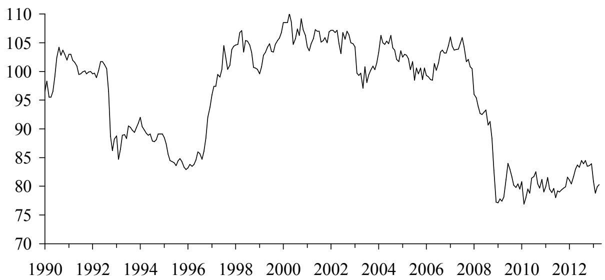
UK: Dollars Per Pound Sterling



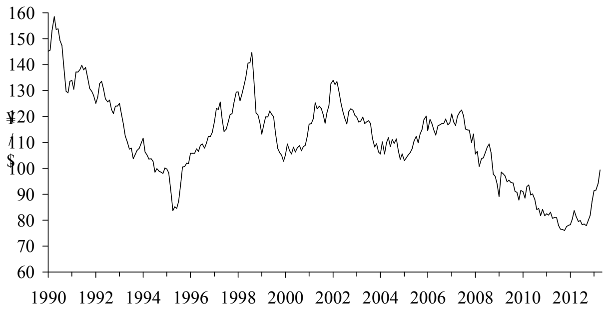
Euro per US dollar



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

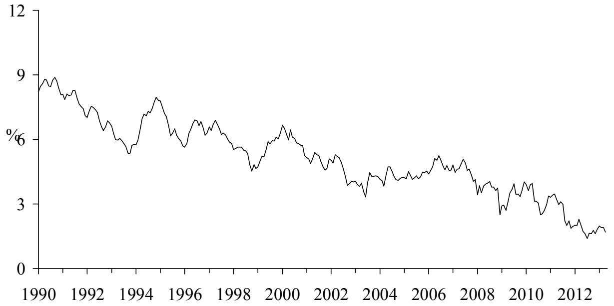


Japan : Yen Per U.S. Dollar



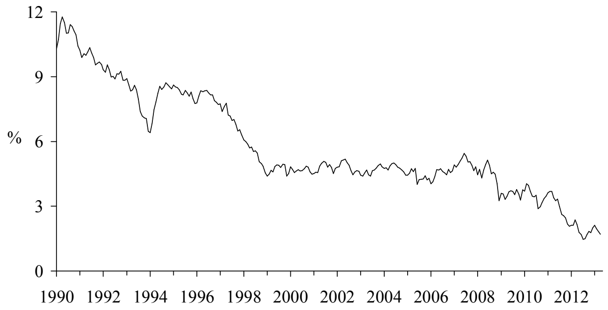
GOVERNMENT BOND MARKETS

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

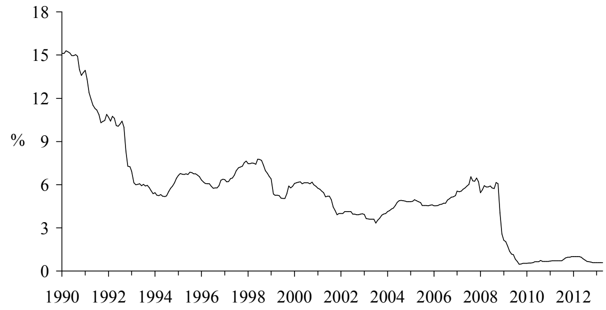


U.S. : 3-Month Certificate of Deposit

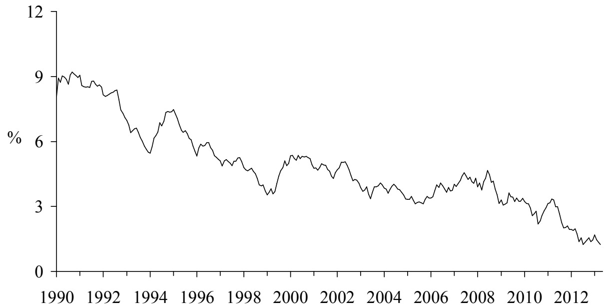
U.K. : Yield on Long-Term Government Bonds



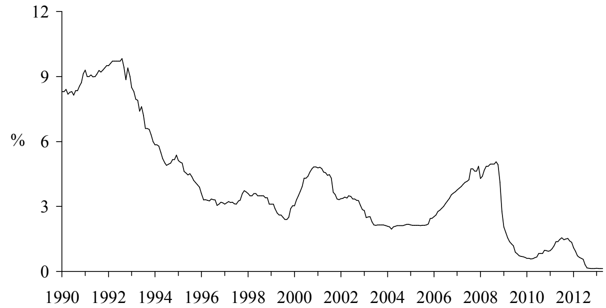
U.K. : 3-Month Interbank Rate



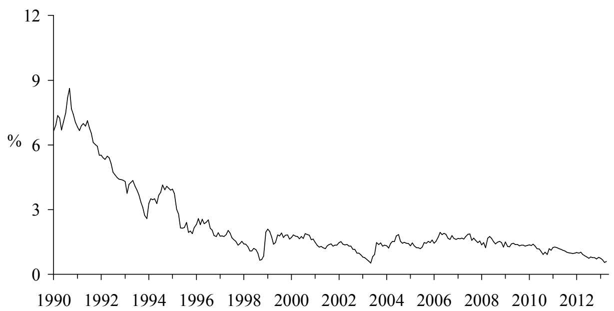
Germany: Yield on Public Authority Bonds



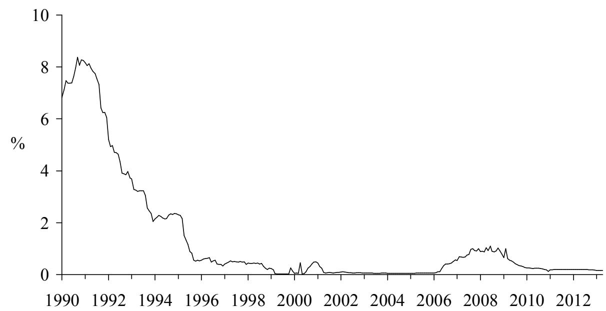
Germany : 3-Month Interbank Deposit Rate



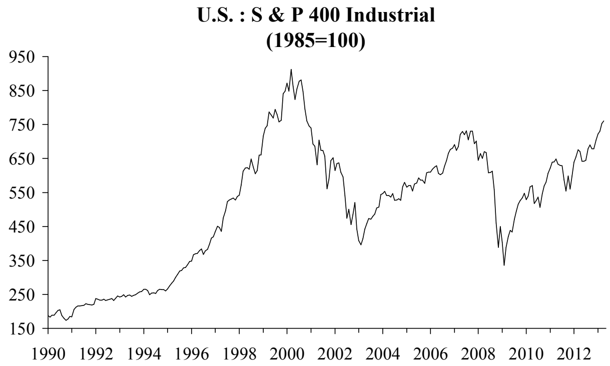
Japan: Yield on Long-Term Government Bonds

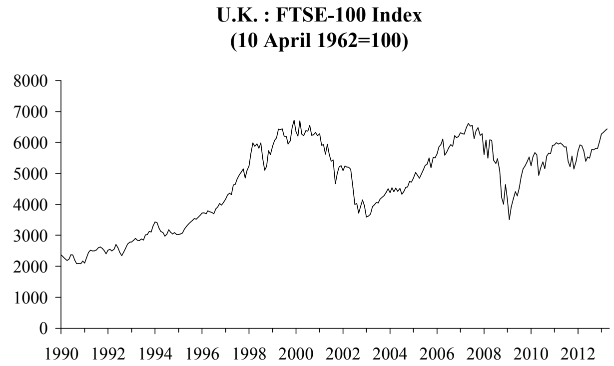


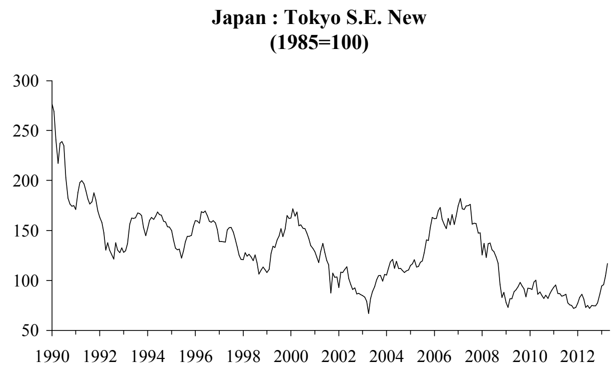
Japan : 3 Month Money Market Rate



MAJOR EQUITY MARKETS







EMERGING MARKETS

Anupam Rastogi

India

Indian stock market and politics are on a divergent path. Stock markets expect a lower than budgeted fiscal and current account deficit due to falling crude oil and gold prices. India is likely to get normal monsoon rains this year, which will both bring relief to large swathes of the country gripped by drought and be deflationary. A hope of a rate cut by the Reserve Bank of India on May 3 is a key driver of the surging stock market. Politics, on the other hand, is facing an election at any time. Hence, there is little enthusiasm for policy reform to revive industry.

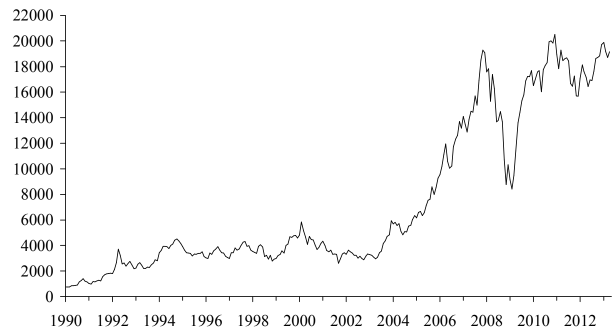
The International Monetary Fund expects Indian economic growth of 5.7% for 2013 and 6.2% in 2014. The Asian Development Bank expects the economy to grow by 6% and hopes that India addresses infrastructure and policy bottlenecks if it wants to return to growth of 8% or more. The Prime Minister's Economic Advisory Group expects the economy to grow by 6.4% and surpass US$ 2 trillion this year.

With gold imports contributing to over 50% of the current account deficit in 2012, clearly a drop in gold prices will help lower India's current account deficit. This should in turn provide a significant boost to risk perceptions surrounding the rupee. Uncertainty in developed markets has impacted on India's exports, which account for about a fifth of its gross domestic product.

The index of industrial production rose 0.6% from a year earlier in February, whereas the market was expecting a 1% fall. India's wholesale inflation slowed to below 6% for the first time since November 2009, comforting authorities and brightening prospects for an interest-rate cut at the RBI's next policy review on May 3. Food inflation eased to 8.7% in March from 11.4% in February.

Japan is keen to explore Indian markets for investments and joint ventures. Japan has been India's largest source of foreign direct investment from a major industrialised nation over the past two years, investing a record $3 billion in 2011 — part of a trend that is also likely to see bilateral trade increase to $25 billion by 2014, roughly double the level of four years before. Territorial disputes over islands in the East China Sea have spawned not just rising diplomatic tensions, but also heightened business fears in the face of often violent Chinese public demonstrations and boycotts of Japanese goods. The anti-Chinese feeling is driving a wedge into Japanese investment in India and other Southeast Asian countries.

India: BSE Sensitive



The forthcoming parliamentary election is taking the air of a presidential of election. There is a fight between Mr. Narendra Modi, present Chief Minister of Gujarat State and Mr. Rahul Gandhi, anointed PM candidate of the Congress party. Mr. Modi is widely credited for rapid economic growth in his home state and is one of the BJP's most popular politicians. But critics point to his ties with Hindu nationalist groups and argue that he is unfit to rule a country as religiously diverse as India. He regularly cites examples of entrepreneurial achievement in Gujarat as evidence of the power of individual choice as an economic driver. By comparison, Rahul Gandhi touts inclusive growth and wealth redistribution, the present government's policy initiatives. These initiatives have raised labour cost and raised inflationary expectations. People all over the country are hankering for a leader who can put them on a higher growth path once again.

	10-11	**11-12**	**12-13**	**13-14**	**14-15**
GDP (%p.a.)	7.5	6.2	5.0	6.5	6.5
WPI (%p.a.)	9.0	7.5	7.0	6.8	6.0
Current A/c(US$ bill.)	-31.0	-40.0	-80.0	-60.0	-60.0
Rs./$(nom.)	49.0	49.5	54.5	55.0	54.0

China

China's new premier Li Keqiang is uncertain about the economic outlook even though the economy remains on track to expand 8% this year. A stronger start to 2013 did not materialise as GDP grew only 7.9% in the final quarter of last year. Remarkably, domestic consumption contributed 4.3 percentage points to China's growth in the first quarter, compared to a 2.3 percentage point contribution from investment. Industrial production grew 9.5%, half a percentage point lower than last year and retail sales rose 12.4% in the first quarter, 1.9 percentage points lower than last year. Consumer inflation fell back to 2.1% in March after a spike in February induced by the Lunar New Year holiday.

Concerns over the shadow banking system and its intimate link to property prices is raising many apprehensions ranging from quality of data to sustainability of total debt in the economy. Bank credit extended to the private sector was equivalent to 135.7% of China's gross domestic product at the end of 2012, the highest level of any emerging-market economy according to Fitch Ratings. Local-government debt could exceed 20 trillion yuan, although former Chinese Finance Minister Xiang Huaicheng is confident that the problem is manageable. He said that "Local-government debt lacks transparency, but the overall debt ratio is not very high".

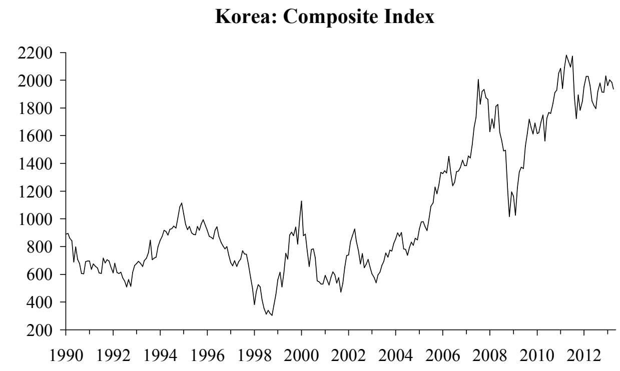
Even so, Fitch Ratings has lowered its rating on China's local-currency government debt, warning of a credit build-up. It kept China's foreign-currency debt rating unchanged at A+, saying that it is well supported by China's foreign-exchange reserves, worth $3.387 trillion at the end of 2012.

Many analysts have started comparing the Chinese economy with that of the Japan's. Both Japan's postwar economic recovery and China's recent growth were based on exports and low-cost labour. Undervalued currencies gave exporters a competitive advantage, and exports were promoted at the expense of household income and consumption. Analysts point out that China's response to the global financial crisis, which triggered a sharp decline in Chinese exports and slowdown in economic activity, is akin to that of Japan following the Plaza Accord.

China's reliance on overvalued assets as collateral, and infrastructure projects with insufficient cash flows to service the debt means that many loans will not be repaid. These bad loans may trigger a banking crisis or absorb a significant portion of China's large pool of savings and income, thus reducing the economy's growth potential.

China's central bank plans to widen the yuan's trading band in the near future according to Yi Gang, Director of the State Administration of Foreign Exchange and Deputy Governor of the People's Bank of China. This suggests that China's leaders will press ahead with change despite the surprise slowing of the economy. China is keen to introduce capital-account convertibility reform gradually.

Exports growth has moderated to 10% in March, leading to a trade deficit as imports surged after a holiday-induced lull, following strong surpluses in recent months. The country posted a trade deficit of $884 million for March, after reporting a $15.25 billion surplus in February. Imports surged 14.1% in March, compared with a year-on-year drop of more than 15% the previous month. It isn't unusual for the country to post a monthly deficit early in the year as manufacturers stock up on imported raw materials that are assembled into exports later in the year.



Chinese President Xi Jinping countered a rising tide of criticism and debate among African officials about China's role on the continent. He said that Beijing aims to be a good partner in the continent's development and emphasized that the relationship is actually mutually beneficial.

China's reserves reached $3.44 trillion in the first quarter, an indication that the economy is once again facing heavy and unwanted capital inflows. The $128 billion jump in the first quarter was the biggest quarterly increase since the second quarter of 2011.

	10	11	12	13	14
GDP (%p.a.)	10.3	9.2	7.8	8.0	7.5
Inflation (%p.a.)	5.9	4.3	2.6	3.5	3.0
Trade Balance(US$ bill.)	183	210	214	220	220
Rmb/$(nom.)	6.6	6.3	6.3	6.2	6.1

South Korea

South Korea's government has reduced its 2013 growth forecast from its earlier projection of 3% to 2.3% and committed to additional stimulus as the economy faces headwinds from both a weaker global demand and a weaker Japanese yen. South Korea's economy expanded 2% in 2012 — the slowest growth in three years — after growing 3.6% in 2011.

The central bank hopes that the economy will rebound to 3.8% growth in 2014. It also cut its forecast for consumer price inflation in 2013 from 2.5% to 2.3% and expects consumer inflation to accelerate to 2.8% in 2014.

The reason for this change in the growth and inflation forecasts is the weaker yen, which is impacting the value of South Korea's exports to Japan, and also making Japanese products more competitive with South Korean products among overseas buyers.

To ameliorate the yen-led squeeze, South Korea announced $15.44 billion extra government spending to spur growth, the first such fiscal stimulus in four years. The government has room to expand its fiscal spending as the country's fiscal deficit remains low at just 1.8% of its gross domestic product. Under the supplementary budget, the government will issue Won15.8 trillion of additional debt this year, increasing the stock of public debt from 34.3% to 36.2% of GDP. The bulk of the supplementary budget is aimed at compensating for lower revenues this year: tax income is expected to be Won 6 trillion lower than anticipated due to slow growth, while delays to the attempted sale of government stakes in two banks will reduce revenues a further Won 6 trillion. The additional government spending is in line with newly-elected President Park Geun-hye's promise to boost economic growth.

The Bank of Korea left the base rate at 2.75% despite low inflation. It also expanded a program of soft loans for small businesses from 9 trillion won to 12 trillion South Korean won ($11 billion).

South Korea introduced a package of measures to boost home sales, as prices in greater Seoul continue to fall and transactions have hit their lowest level on record. These measures are taken by the president to meet a campaign pledge to reduce household debt, most of which is related to homeownership. It is true that South Korean consumers remain reluctant to open their wallets due to high household debt and flagging house prices. They are among the world's most heavily indebted, with a household debt pile equivalent to about 160% of annual incomes.

South Korea's current-account surplus was wider in February than January, at $2.71 billion compared with $2.33 billion, but exports to Japan were down 17% partly because of the weaker yen.

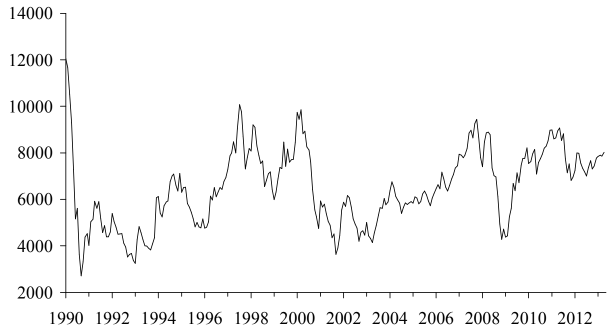
	10	11	12	13	14
GDP (%p.a.)	6.3	3.6	2.0	2.4	3.0
Inflation (%p.a.)	2.9	4.0	2.2	2.3	2.8
Current A/c(US$ bill.)	28.2	27.0	44.0	28.0	28.0
Won/$(nom.)	1150	1100	1100	1100	1050

Taiwan

The IMF has lowered its projection of Taiwan's gross domestic production growth rate for 2013 from 3.9% to 3%, but hopes that growth will rise to 3.9% in 2014 as US economic growth firms up. Inflation in Taiwan eased in March as expected due to the Lunar New Year holiday effect. The annual rate of change in the consumer price index was 1.39% in March, down from 2.96% in February. But Taiwan is facing a long-term structural decline in potential growth: with a fertility rate below that of Japan or South Korea — at 1.1 children per woman, the third lowest globally — its potential workforce will start shrinking as early as 2015.

In the wake of the depreciating yen, exports to Japan are declining. It recorded 10% decline in export orders from Japan in the first quarter of this year. A sustained revision in the yen could weaken Taiwan's exports substantially.

Taiwan: Weighted TAIEX Price Index



The Chinese military threat to Taiwan has not disappeared. China has deployed more than 1,000 missiles across the Strait and bases many of its most sophisticated military weapons near the channel. It has not renounced the use of force if Taiwan, for example, declared independence. According to some defence analysts, the continued Chinese military build-up indicates that the cross-strait relationship Mr Ma has built is not enough to ensure Taiwan's safety. Notwithstanding the military threat, Taiwan is likely to relax some restrictions on Chinese investment into its financial sector, a key part of the island's push to boost its economy by encouraging more investment from the mainland.

	10	11	12	13	14
GDP (%p.a.)	10.8	4.0	1.3	3.0	3.2
Inflation (%p.a.)	1.3	1.2	1.9	1.3	1.5
Current A/c(US$ bill.)	16.0	18.0	20.0	22.0	23.0
NT$/$(nom.)	31.0	30.0	29.5	29.5	29.0

Brazil

Brazil's economy disappointed investors again as it grew by just 0.9% in 2012 after a dismal growth of 2.7% in 2011. It may expand about by 3% in 2013 only if exports pick up and the confidence of both consumers and businesses returns. Due to pressure on commodity prices and a bumper crop of sugar, economic growth may disappoint investors once again.

Tighter monetary and fiscal policy to bring inflation under control is required to rein in inflation. Inflation may touch 6% in 2013, as inflation is currently running at 6.59%. Stubborn food and fuel prices have kept inflation above the country's 2.5–6.5% target range. In order to douse inflationary expectations the central bank raised the Selic rate to 12.50% from 12.25% in nearly two years. The central bank does not want to tighten monetary policy further as the bank feels that external uncertainties surround the prospective scenario for inflation, and so monetary policy should be administered with caution.

Fortunately for Brazil, net debt as a percentage of GDP hardly changed at all in 2013, even though growth was sluggish. Brazil's net debt was 35.1% for 2012 compared to 36.4% for 2011. In 2013, the debt-to-GDP ratio in 2013 and 2014 may reduce, to 34.1% and 33.25% respectively.

The currency is quoted just below 2 real to the dollar, but it is quite steady around this rate. The central bank still maintains that the exchange rate is determined by markets. But since investor interest eased off in mid-2011, the Brazilian real–dollar value has been partly guided by policy makers. With the pressure of appreciation gone, the government at first experimented with a weaker exchange rate to try to boost industry, but it was later forced to bring it back to below R$2 per dollar to contain rising inflation.

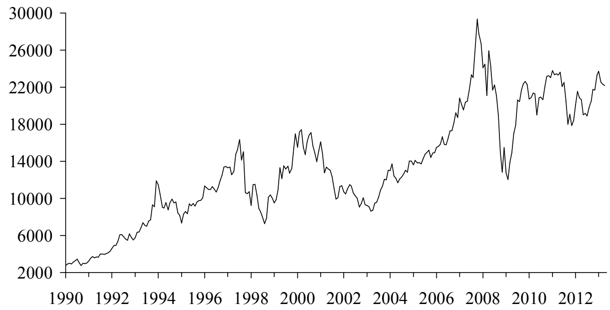
The stock market index — the Bovespa — is down more than 14.5% this year, pricing in concerns over weaker than expected Chinese and US economic growth.

The rating agency Fitch Ratings has warned that the country's difficulties in kick-starting its flagging economic growth is "weighing" on its rating. Fiscal consolidation is becoming difficult due to a lower than expected growth rate.

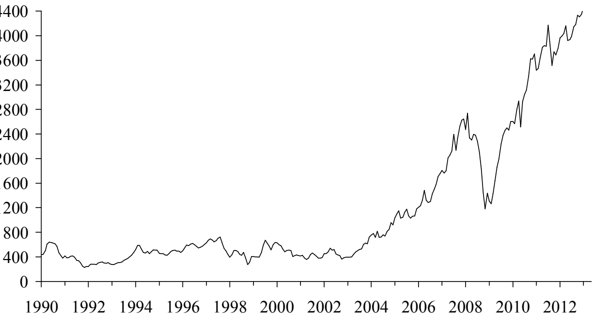
	10	**11**	**12**	**13**	**14**
GDP (%p.a.)	7.5	2.7	0.9	3.0	3.5
Inflation (%p.a.)	5.9	6.5	5.8	6.0	6.0
Current A/c(US$ bill.)	-47.3	-52.6	-60.0	-65.0	-60.0
Real/$(nom.)	1.7	1.5	2.0	2.0	2.0

Other Emerging Markets

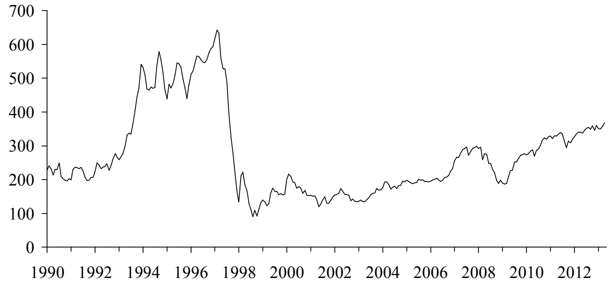
Hong Kong: FT-Actuaries



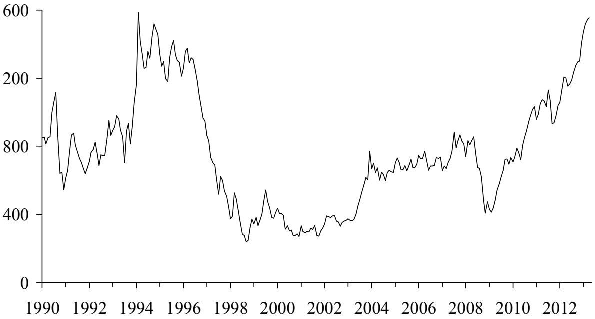
Indonesia: Jakarta Composite



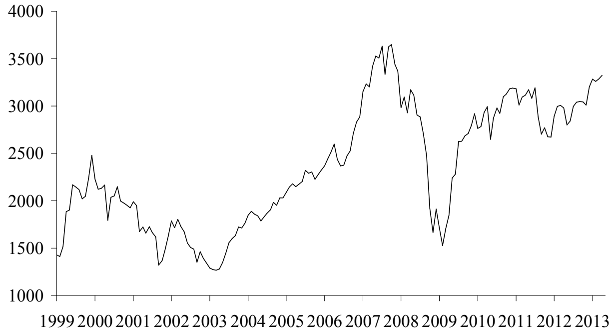
Malaysia: FT-Actuaries (US$ Index)



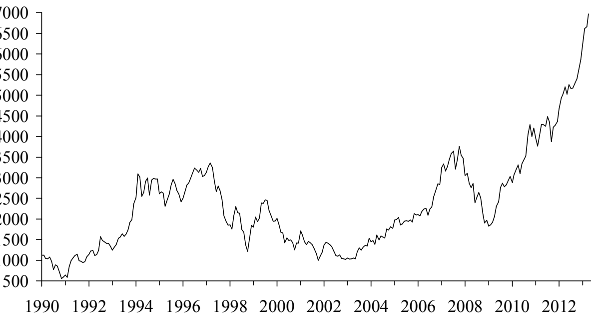
Thailand: Composite Index



Singapore: Straits Times Index

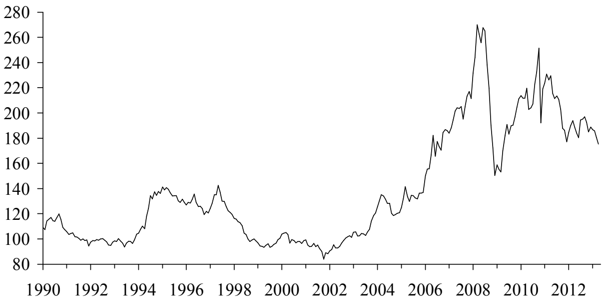


Philippines: Manila Composite

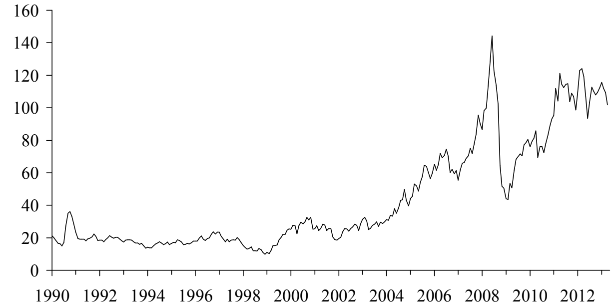


COMMODITY MARKETS

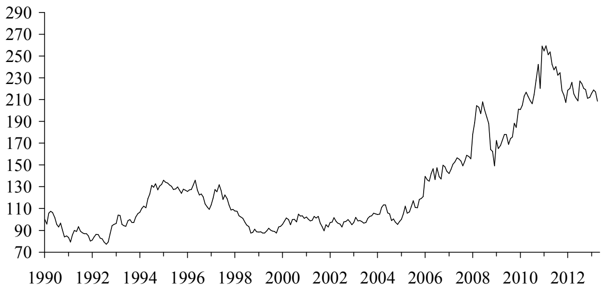
Commodity Price Index (Dollar)
(Economist, 2000=100)



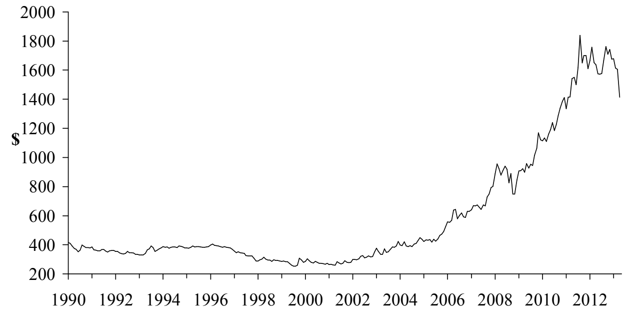
Oil Price: North Sea Brent (in Dollars)



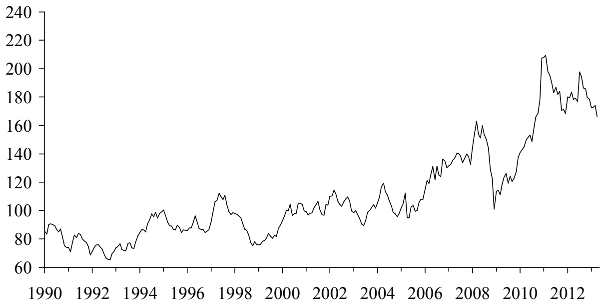
Commodity Price Index (Sterling)
(Economist, 2000=100)



Gold Price (in Dollars)



Commodity Price Index (Euro)
(Economist)



UK FORECAST DETAIL

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

	Inflation %[1] (CPI)	Short Dated (5 Year) Interest Rates	3 Month Int. Rates	Nominal Exchange Rate (2005=100)[2]	Real Exchange Rate[3]	Real 3 Month Int. Rates %[4]	Inflation (RPIX)	Real Short Dated Rate of Interest[5]
2010	3.7	2.4	0.7	80.4	87.9	-3.6	4.8	-0.2
2011	4.7	2.0	0.9	80.0	89.7	-3.1	5.3	-0.2
2012	2.8	0.9	0.9	83.0	94.0	-1.9	3.3	-1.3
2013	2.8	1.3	0.9	83.5	95.7	-1.6	3.3	-0.8
2014	2.6	1.8	1.7	82.7	95.5	-0.5	3.1	-0.3
2015	2.2	2.1	2.1	82.1	95.5	0.1	2.8	0.0
2012:1	2.7	1.1	1.1	81.2	91.4	-2.0	3.8	-1.1
2012:2	3.1	0.9	1.1	83.2	94.3	-1.6	3.2	-1.2
2012:3	2.7	0.7	0.8	84.1	95.3	-2.0	2.9	-1.4
2012:4	2.8	0.8	0.6	83.6	95.2	-2.0	3.3	-1.4
2013:1	2.9	1.0	0.8	83.7	95.5	-1.8	3.4	-1.2
2013:2	2.8	1.3	0.9	83.2	95.4	-1.6	3.3	-0.8
2013:3	2.8	1.5	0.9	83.7	96.0	-1.6	3.3	-0.6
2013:4	2.7	1.5	1.1	83.3	95.8	-1.3	3.2	-0.6
2014:1	2.6	1.8	1.3	83.1	95.8	-1.1	3.2	-0.3
2014:2	2.5	1.8	1.7	82.3	95.2	-0.6	3.1	-0.2
2014:3	2.6	1.7	1.8	82.4	95.2	-0.3	3.1	-0.3
2014:4	2.5	1.8	1.9	82.7	95.8	-0.2	3.0	-0.2

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

Labour Market and Supply Factors (Seasonally Adjusted)

	Average Earnings (1990=100)[1]	Wage Growth[2]	Unemployment (New Basis) Percent[3]	Millions	Real Wage Rate[4] (1990=100)
2010	227.1	2.4	4.6	1.50	136.7
2011	232.7	2.6	4.6	1.53	133.7
2012	236.9	1.8	4.7	1.58	132.4
2013	242.0	2.2	4.4	1.49	131.6
2014	248.9	2.8	4.0	1.37	131.9
2015	257.0	3.3	3.7	1.26	133.3
2012:1	234.7	0.7	4.8	1.61	132.7
2012:2	235.8	1.8	4.8	1.60	132.0
2012:3	237.4	1.9	4.7	1.58	132.4
2012:4	239.6	2.9	4.6	1.56	132.4
2013:1	240.4	2.4	4.6	1.54	132.1
2013:2	242.0	2.6	4.5	1.51	131.7
2013:3	242.2	2.0	4.4	1.48	131.4
2013:4	243.6	1.6	4.3	1.45	131.0
2014:1	245.5	2.1	4.2	1.42	131.4
2014:2	248.1	2.5	4.1	1.39	131.7
2014:3	249.7	3.1	4.0	1.36	132.1
2014:4	252.1	3.5	3.9	1.33	132.4

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

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

	Expenditure Index	£ Million '90 prices	Non-Durable Consumption[2]	Private Sector Gross Investment Expenditure[3]	Public Authority Expenditure[4]	Net Exports[5]	AFC
2010	145.1	694701.4	411042.6	234029.9	182002.2	-34548.2	97825.1
2011	146.4	701060.5	402885.3	243646.3	177479.4	-23548.2	99402.3
2012	146.5	701719.7	401183.5	249576.1	183170.0	-31081.5	101129.7
2013	148.7	712270.2	404503.8	255592.0	187385.7	-31240.0	103971.4
2014	151.8	726827.7	411964.1	261350.6	191244.9	-31189.9	106537.5
2015	155.4	744363.4	421121.2	267868.0	195837.6	-31120.2	109344.0
2010/09	1.8		0.5	7.6	0.5		0.8
2011/10	0.9		-2.0	4.1	-2.5		1.8
2012/11	0.1		-0.4	2.5	3.2		1.9
2013/12	0.8		0.6	2.4	2.3		6.7
2014/13	2.0		1.4	2.3	2.1		0.6
2015/14	2.4		2.2	2.5	2.4		2.6
2012:1	146.2	175013.2	100300.2	59839.5	47225.9	-6742.4	25610.0
2012:2	145.6	174362.8	100083.3	61272.9	44458.8	-8868.5	22583.7
2012:3	147.0	176010.2	100053.3	64467.5	45567.2	-7659.5	26418.3
2012:4	147.3	176333.5	100746.7	63996.2	45918.1	-7811.1	26516.4
2013:1	147.5	176575.7	100799.5	61159.6	48592.6	-7807.4	26168.6
2013:2	147.6	176695.9	100847.8	64387.0	45700.5	-7814.6	26424.9
2013:3	147.8	176933.2	100899.6	64777.0	46404.9	-7811.4	27336.9
2013:4	148.0	177167.9	100947.5	65268.4	46687.6	-7806.7	27928.9
2014:1	149.2	178552.7	101496.4	62894.2	49472.8	-7807.8	27502.9
2014:2	150.2	179823.2	102046.2	66223.1	46613.4	-7802.0	27257.5
2014:3	151.4	181216.6	102600.6	66062.4	47385.6	-7791.4	27040.7
2014:4	152.1	182614.3	103156.5	66171.0	47773.1	-7788.7	26697.6

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)
2010	8.7	1336.3	115.1	36.4	-37.3
2011	6.7	1406.4	94.2	42.9	-20.4
2012	6.5	1451.6	95.4	47.0	-51.9
2013	6.5	1519.3	98.2	50.6	-52.2
2014	5.3	1592.8	84.7	55.8	-52.8
2015	4.3	1666.2	72.2	59.0	-53.0
2012:1	4.6	355.1	16.3	11.5	-11.8
2012:2	1.7	351.8	6.0	11.3	-17.4
2012:3	6.2	363.1	22.7	11.8	-12.8
2012:4	9.9	367.2	36.5	11.8	-9.8
2013:1	8.2	369.5	30.2	12.0	-13.9
2013:2	6.2	373.6	23.1	12.3	-15.5
2013:3	5.9	377.2	22.1	12.4	-13.1
2013:4	5.9	382.1	22.7	12.8	-9.8
2014:1	7.8	386.3	30.3	13.1	-14.0
2014:2	5.4	391.4	21.0	13.6	-15.7
2014:3	5.6	395.4	22.1	13.8	-13.2
2014:4	5.6	400.4	22.5	14.0	-9.8

1 GDP at market prices (Financial Year)

WORLD FORECAST DETAIL

Growth Of Real GNP

	2009	2010	2011	2012	2013	2014
U.S.A.	–2.6	2.6	1.7	2.2	2.2	2.8
U.K.	–3.9	1.8	0.9	0.1	0.8	2.0
Japan	–6.3	4.3	–0.7	2.0	1.6	1.6
Germany	–4.7	3.6	3.0	0.7	0.8	2.0
France	–2.5	1.5	1.7	0.0	–0.1	1.1
Italy	–5.1	0.9	0.5	–2.4	–1.3	0.7

Real Short-Term Interest Rates

	2009	2010	2011	2012	2013	2014
U.S.A.	–1.6	–3.0	–1.8	–1.9	–1.3	–1.2
U.K.	–0.3	–3.6	–3.1	–1.9	–1.6	–0.5
Japan	1.1	0.4	0.4	0.3	–1.6	–1.6
Germany	–0.4	–1.9	–0.5	–1.5	–1.5	–1.4
France	–0.8	–1.7	–0.5	–1.4	–1.5	–1.4
Italy	–0.8	–2.4	–1.5	–2.6	–2.0	–1.4

Real Long-Term Interest Rates

	2009	2010	2011	2012	2013	2014
U.S.A.	1.3	1.0	0.9	–0.2	0.1	0.6
U.K.	–0.3	–0.2	–0.2	–1.3	–0.8	–0.3
Japan	1.2	0.4	–0.2	–0.8	–1.3	–1.1
Germany	2.2	1.8	–0.1	–0.4	–0.5	–0.1
France	2.2	1.9	–0.1	–0.4	–0.5	–0.1
Italy	1.5	1.2	–0.7	–0.8	–0.6	–0.1

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

	2009	2010	2011	2012	2013	2014
U.S.A.	88.7	87.4	85.7	90.4	97.3	99.1
U.K.	76.7	78.9	80.5	84.4	85.9	85.7
Japan	89.0	92.0	97.1	98.3	119.7	122.0
Germany	105.8	102.9	105.5	104.3	107.4	108.2
France	104.3	103.1	105.5	104.9	107.9	108.6
Italy	105.4	103.6	106.9	107.4	111.8	113.2

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

Growth Of Consumer Prices

	2009	2010	2011	2012	2013	2014
U.S.A.	–0.3	1.8	3.1	2.1	2.0	2.0
U.K.	1.3	3.7	4.7	2.8	2.8	2.6
Japan	–1.4	–1.0	–0.3	0.0	0.0	2.0
Germany	0.4	1.1	2.3	2.0	1.7	2.0
France	0.1	1.5	2.1	2.0	1.6	2.0
Italy	0.8	1.5	2.8	3.0	2.8	2.5

Nominal Short-Term Interest Rates

	2009	2010	2011	2012	2013	2014
U.S.A.	0.2	0.1	0.3	0.1	0.7	0.8
U.K.	1.1	0.7	0.9	0.9	0.9	1.7
Japan	0.1	0.1	0.4	0.3	0.4	0.4
Germany	0.7	0.4	1.5	0.2	0.5	0.6
France	0.7	0.4	1.5	0.2	0.5	0.6
Italy	0.7	0.4	1.5	0.2	0.5	0.6

Nominal Long-Term Interest Rates

	2009	2010	2011	2012	2013	2014
U.S.A.	3.2	3.1	1.9	1.8	2.1	2.6
U.K.	2.8	2.4	2.0	0.9	1.3	1.9
Japan	1.3	1.1	1.0	0.8	0.7	0.9
Germany	4.0	3.8	1.8	1.5	1.5	1.9
France	4.0	3.8	1.8	1.5	1.5	1.9
Italy	4.0	3.8	1.8	1.5	1.5	1.9

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

	2009	2010	2011	2012	2013	2014
U.S.A.[1]	85.98	83.73	78.08	80.90	85.50	85.40
U.K.	1.57	1.55	1.61	1.59	1.56	1.56
Japan	93.54	87.48	79.36	80.51	98.00	98.00
Eurozone	0.72	0.75	0.71	0.78	0.79	0.78

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

* Forecasts based on the Liverpool World Model