LIVERPOOL INVESTMENT LETTER

October 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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THE BATTLE OVER REGULATION RESURFACES AS MORTGAGE CREDIT IMPROVES

A fault line is opening up between Conservative politicians keen not to bring the economy to another grinding halt and the 'Taliban tendency' among the regulatory establishment, to use Vince Cable's delightful and for once quite accurate phrase.

It had begun to dawn on the Conservatives and maybe also the Lib Dems, around a year and a half ago, that the economy's previously glacial recovery had something to do with the lack of credit for small businesses and first-time home buyers. This in turn could be traced to the new regulatory rules, especially the burdensome capital-raising requirements; these, combined with general post-crisis nervousness, were causing the banks to shrink their balance sheets and particularly the 'risky' parts that carried the biggest capital-raising penalty. Longer term these requirements raise the cost of making loans; short term they stopped them altogether. So the Coalition government came up with two ways of undoing the regulations by the back door: 'Funding for lending' and 'Help to Buy', both in effect subsidising loans, respectively to business and first-time house buyers.

Lending to small businesses has not yet started to recover. But mercifully for the Coalition lending to house buyers has done so with a vengeance and the house market is now starting to recover quite reasonably. London has been strong throughout and must be kept out of this picture — as it is a special market, dominated by an ongoing influx of foreign buyers. But the rest of the country is now improving markedly, if from a low base; real house prices are still well below the pre-crisis peaks. This is true of the national average including London; and strikingly more so for non-London regions of which a few are shown below. In these charts the grey line plots our latest forecasts; the scale is on natural logs so that an upward movement of 0.1 is approximately a 10% rise.

What can be seen from these charts is that on our forecasts at any rate even the whole country average does not get back to the pre-crisis level until after 2016. It is true the market is now turning and it could of course move faster. But it does have a long way to go before it reaches what the usual suspects are calling 'bubble' levels. Indeed all it is doing is remedying extremely depressed conditions as credit once again begins to flow.

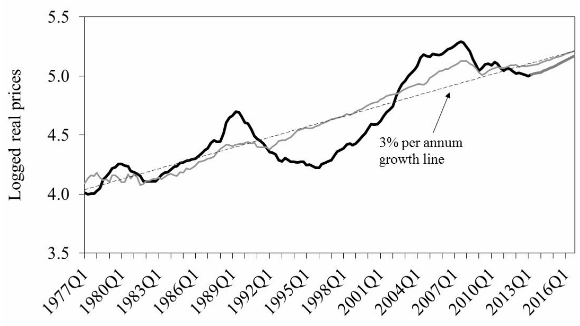
While Mark Carney's forward guidance is not in our view of much significance, it is good news that he and the Bank are treating these 'bubble' remarks with scepticism. The moral that should be drawn from these events is not that renewed credit is a bad thing but rather that the regulatory framework should be adjusted to allow it to get back to its

Table 1: Summary of Forecast

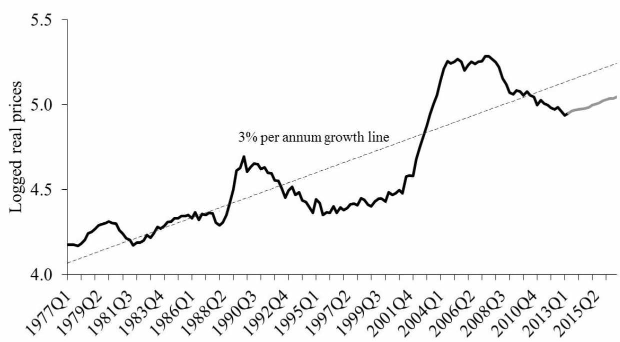
		2010	2011	2012	2013	2014	2015	2016
GDP Growth[1]		1.7	1.1	0.2	1.2	2.2	2.4	2.6
Inflation	CPI	3.3	4.5	2.7	2.7	2.5	2.2	2.0
	RPIX	4.8	5.3	3.2	2.5	3.1	2.8	2.7
Unemployment (Mill.)								
	Ann. Avg.[2]	1.5	1.5	1.6	1.5	1.4	1.3	1.2
	4th Qtr.	1.5	1.6	1.6	1.5	1.3	1.2	1.1
Exchange Rate[3]		80.4	80.0	83.1	82.6	83.0	82.3	82.5
3 Month Interest Rate		0.7	0.9	0.9	0.9	1.6	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)		−40.0	−22.5	−59.2	−60.7	−62.9	−63.5	−62.0
PSBR (£bn)		112.6	91.0	68.4	119.7	106.0	94.6	74.5

[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)

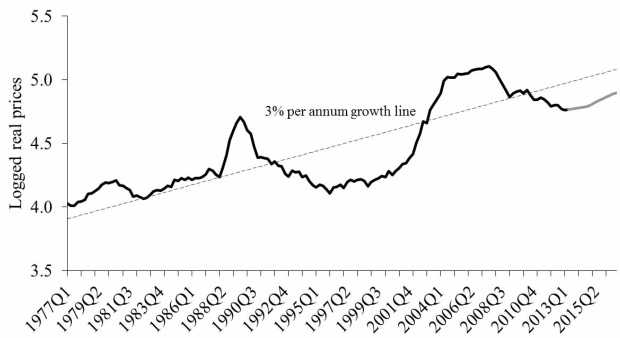
UK Real House Prices, Forecast and Underlying



North: Real House Prices



Yorkshire and Humberside: Real House Prices



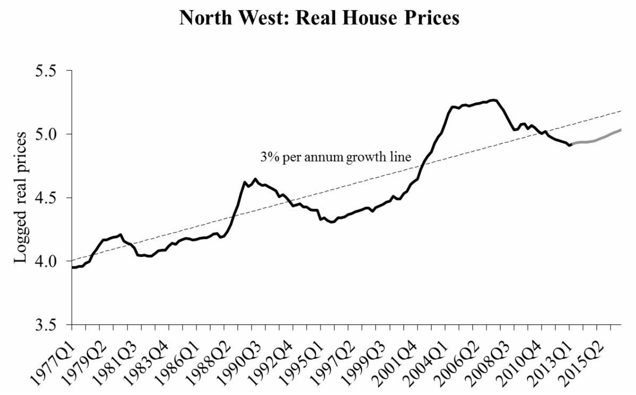
old vigour. At this point these various special schemes should be withdrawn.

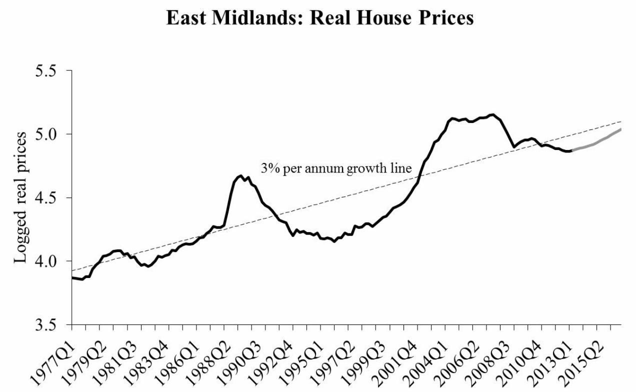
In practice what seems most likely is that the schemes will be left in place and some lip service paid to the need to monitor developments down the road. What we can say is that the economy is at last recovering as credit starts recovering, at least in parts. A housing recovery is a particularly strong driver of the business cycle. Already construction is growing strongly again, led by housing. We can also expect consumer durable spending to pick up with new house construction. Meanwhile real living standards are levelling off after a long decline; this is the result of steadier raw material prices, improving employment and rising tax thresholds. Investment is picking up also, with large companies sensing that the economy's corner has been turned and new improved capacity will be needed. While export markets in the emerging countries have cooled a bit, those to the eurozone are at last levelling off after their long decline and in some cases improving.

QE continues to advance in the US and is not reversed in the UK

To all these positives can be added the decision by the US Fed to keep monetary conditions continuously loose. The Fed warned recently that it would 'taper off' its programme of buying assets in the market with printed money. However this led to a big sell-off in bond and equity markets all over the world, which took the Fed aback. In the past few days Bernanke has announced that the taper is temporarily off the table; and markets have instantly bounced back somewhat.

As in the UK the Fed's programme of asset-buying ('QE3) is really an antidote to the new regulatory mania sweeping Washington as it has London. As this episode of 'taper and then not to taper' shows, it is going to be hard to withdraw this stimulant. For now it is needed to keep some sort of credit growth going in the US, thus offsetting the headwinds from regulation. The Fed, unlike the Bank, buys assets across a wide range of classes and so to some extent competes directly with bank lending by lending direct on mortgages and corporate bonds. The Bank has found that its QE buying of UK government bonds only has had



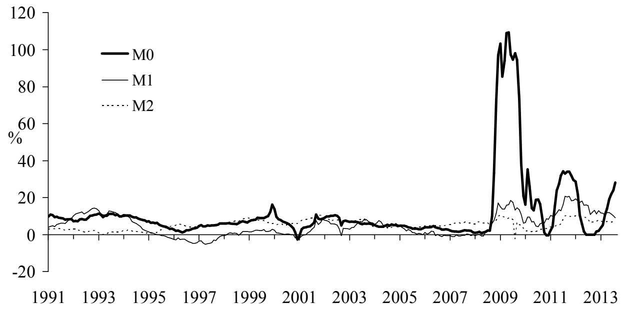


precious little, if any, effect on credit conditions; hence the need for those special schemes.

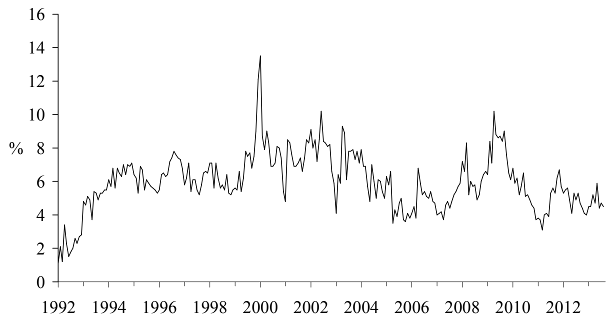
At some point in the future the banks will be back in the full flow of business; no doubt they will eventually lobby regulators to ease back and as the economy improves their share prices will rise allowing them to acquire new capital more cheaply. Once this has happened QE will need to be reversed rapidly to avoid excess credit and money expansion. But the recent episode highlights the risk that this will not happen quickly enough, given the pressures withdrawal creates.

For now inflation remains muted while growth is picking up. Noone in the Coalition is going to want to stop that combination. Meanwhile markets are calm about longer-run inflation, somehow trusting that policy will reverse when needed. While we are not so calm, that is also our basic view.

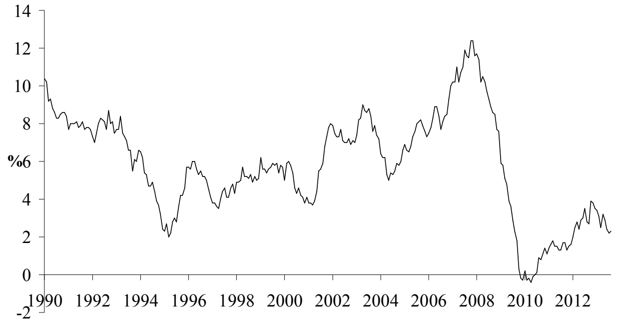
U.S.: Growth in Monetary Aggregates (Yr - on - Yr)



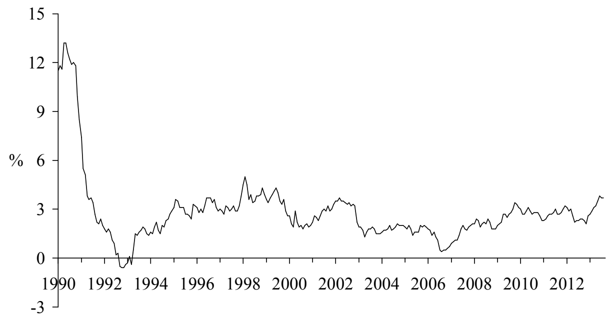
UK: Notes and Coins in Circulation Growth



Eurozone M3 Growth



Japan: Growth of M2+CD's



FOCUS ON JAPAN

Francesco Perugini

The Tax debate is taking centre stage

As discussed in our previous Letter, Prime Minister Shinzo Abe and his government were looking forward to the release of revised second quarter GDP data in order to go ahead with the plan to raise the consumption tax to 8% from the current 5% level. The first GDP figure came in lower than expected but the revised data showed Japan's economy grew more than initially thought, clearing the way for the contentious move — real GDP growth rate was upgraded to 0.9% over the previous quarter, 0.3 percentage points higher than the preliminary estimate issued in August. "Now we have another positive factor supporting the tax hike", Akira Amari, state minister for economic and fiscal policy, said after the release while Takeshi Noda, chairman of the Liberal Democratic Party's tax panel, concurred: "We have no reason to change the plan".

The tax hike plan was approved last year by Parliament but it included a provision allowing the Prime Minister to delay or scrap the tax hike if he judged the economy to be too weak to sustain the action. A final decision is now expected to be taken by early October.

Looking at demand components, the biggest GDP revision came from capital investment which rose 1.3% from the previous three months —it was down 0.1% in the first GDP release — marking the first uptick in six quarters, suggesting that improving business sentiment is prompting companies to spend more on plant and equipment. The government also upgraded its economic assessment in its monthly report, issued September 13, taking into account improvements in key areas, including capital investment, employment and income. It marked the government's first upward reassessment in two months. The report states that the nation's "economy is on the way to recovery at a modest pace", whereas the August report said the economy was "picking up steadily and shows some movements on the way to recovery".

Some areas of uncertainty still remain. The Cabinet Office's consumer confidence index for August dropped 0.6 of a point from July to 43, falling for a third month in a row, while in the Economy Watchers Survey, which features the opinions of shop clerks and others who are in constant contact with consumers, the index for August declined for the fifth consecutive month, to 51.2. Higher raw materials costs are showing up in retail prices and weighing on consumer sentiment.

Most importantly, opponents say that raising taxes on spending is premature, especially because it could dampen consumer spending, considered the weakest link in Japan's nascent recovery. If spending slumps, Japan could slide back into the deflationary morass that has dogged it for 15 years. "It's nonsense. Japan is only midway to recovery, and hasn't fully escaped deflation," said Goushi Kataoka, chief economist at Mitsubishi UFJ. "Just as we are beginning to see the light, we're threatening to snuff it out", Kataoka said. "We're trying to roast the pig before it's fat enough to eat".

Still, the government argue the tax increase is needed to stabilize the rapidly aging country's social welfare system and to maintain the confidence of overseas and financial markets that Japan is committed to fixing its fiscal situation — Japan's debt-to-GDP ratio is the highest among the world's advanced economies.

To soften the blow, Abe is considering putting together a stimulus package of as much as ¥5 trillion, a sum that would return the equivalent of 2 percentage points of the tax rate increase to consumers and companies. The package is expected to include a small cut in the corporate-tax rate, a move long-waited by the business lobby. Indeed, with an effective rate topping out at 38%, Japan's corporate tax is high by global standards. Abe economic adviser Koichi Hamada, a Yale University professor emeritus, argued that Japan "would lose global competitions if the government fails to slash the rate". The government is considering a reduction to 35.64% which would reduce companies' annual tax burden by ¥900 billion, according to official calculations. It would be achieved by ending a disaster-reconstruction surcharge, established after the 2011 earthquake and tsunami, a year earlier than planned. The sales-tax increase, meanwhile, is expected to take ¥8 trillion a year from consumer's pockets.

But corporate tax-cut proponents face strong opposition from the finance ministry. "Abe is very committed to cutting the corporate-tax rate, and the focus is how he will convince the finance ministry", a senior government official said recently. The ministry, headed by Taro Aso, has argued against the tax cut for a government already carrying debt more than twice the country's GDP and he is also sceptical of the power of a corporate tax cut to invigorate businesses.

It is clear that the tax debate has reached a crucial moment. Observers believe that Abe, with solid support, could be the last prime minister in a while to be able to push through unpopular changes. "The optimal policy is to wait to raise the consumption tax, maybe a year. But given Japan's political dysfunction, many people are afraid that if you wait too long, that will never get done," Noah Smith, a professor at Stony Brook University at New York State and long-time observer of Japan politics said. "The idea is that if we see a chance to make unpopular structural reforms, we need to take it now, even though it's not the optimal time."

Besides the tax plan, Abe should also push forward with those supply-side measures invoked by the “third arrow” strategy, including the plan of creating special economic zones in the country in order to achieve the goal to boost the economy. The idea of special strategic zones is similar to that in China, where the government selected major undeveloped cities and opened them to foreign investment through bold regulatory reforms and tax breaks. However, the plan is still in its early stages.

MARKET DEVELOPMENTS

The Fed's backing-off over its proposed taper has revived sentiment in the equity markets. Financial volatility remains ever-present across all asset classes in these circumstances, as at some point the Fed will have to taper. However, if in a year or so banks start to regain confidence and regulations on them ease, such tapering may be a lot easier to do than now, as there will be alternative sources of credit and liquidity. As for so long now bonds offer a lot of risk and poor returns; cash offers tiny returns; and equities remain the best vehicle for those who are proof against likely volatility.

Table 1: Market Developments

	Market Levels		Prediction for Sep/Oct 2014	
	Aug 29	Sep 25	Previous Letter	Current View
Share Indices				
UK (FT 100)	6483	6552	9511	9546
US (S&P 500)	1638	1693	2094	2163
Germany (DAX 30)	8915	8666	11268	11829
Japan (Tokyo New)	1117	1211	1583	1693
Bond Yields (government long-term)				
UK	2.77	2.75	1.70	1.70
US	2.75	2.62	2.10	2.10
Germany	1.86	1.82	1.50	1.50
Japan	0.71	0.68	0.70	0.70
UK Index Linked	–0.07	0.03	–0.30	–0.30
Exchange Rates				
UK ($ per £)	1.55	1.61	1.56	1.56
UK (trade weighted)	81.6	83.1	83.1	83.1
US (trade weighted)	86.6	85.2	85.5	85.5
Euro per $	0.76	0.74	0.79	0.79
Euro per £	1.17	1.19	1.23	1.23
Japan (Yen per $)	98.4	98.7	98.0	98.0
Short Term Interest Rates (3-month deposits)				
UK	0.58	0.50	1.80	1.80
US	0.32	0.24	0.70	0.70
Euro	0.15	0.19	0.50	0.50
Japan	0.08	0.15	0.70	0.70

Table 2: Prospective Yields[1]

Equities: Contribution to £ yield of:

	Dividend Yield	Real Growth	Inflation	Changing Dividend Yield	Currency	Total
UK	3.40	2.2	2.5	41.00		49.10
US	2.00	2.2	1.6	24.00	2.92	32.72
Germany	3.00	0.8	1.7	34.00	–3.63	35.87
Japan	1.80	1.6	0.0	38.00	3.61	45.21
UK indexed[2]	0.03		2.5	–10.00		–7.47
Hong Kong[3]	2.50	7.4	1.6	15.00	2.92	29.42
Malaysia	2.90	5.2	1.6	56.00	2.92	68.62
Singapore	3.40	3.7	1.6	32.00	2.92	43.62
India	1.60	6.1	1.6	19.00	2.92	31.22
Korea	1.10	3.4	1.6	–3.00	2.92	6.02
Indonesia	2.60	5.9	1.6	48.00	2.92	61.02
Taiwan	2.70	3.0	1.6	30.00	2.92	40.22
Thailand	3.10	4.7	1.6	48.00	2.92	60.32

Bonds: Contribution to £ yield of:

	Redemption Yield	Changing Nominal Rates	Currency	Total
UK	2.75	10.50		13.25
US	2.62	5.20	2.92	10.74
Germany	1.82	3.20	–3.63	1.39
Japan	0.68	–0.20	3.61	4.09

Deposits: Contribution to £ yield of:

	Deposit Yield	Currency	Total
UK	0.50		0.50
US	0.24	2.92	3.16
Euro	0.19	–3.63	–3.44
Japan	0.15	3.61	3.76

[1] Yields in terms of €s or $s can be computed by adjusting the £-based yields for the expected currency change.

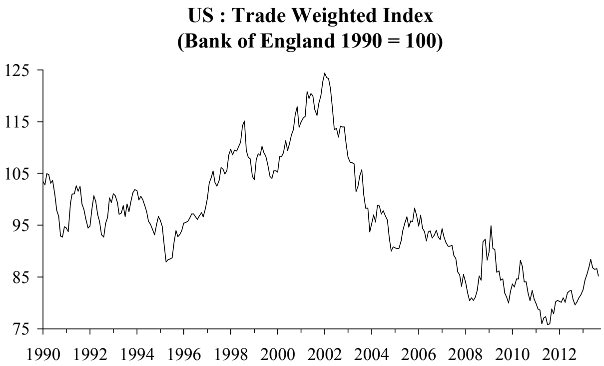
[2] UK index linked bonds All Stocks

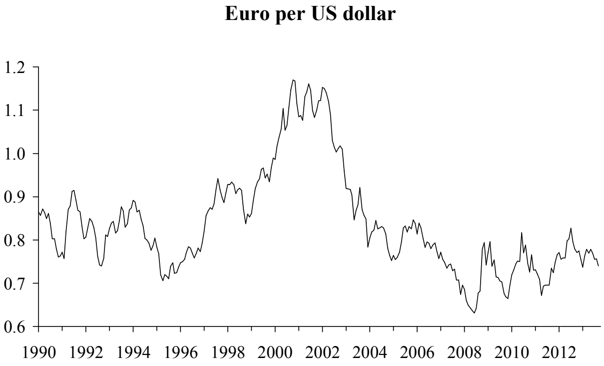
[3] Output based on China.

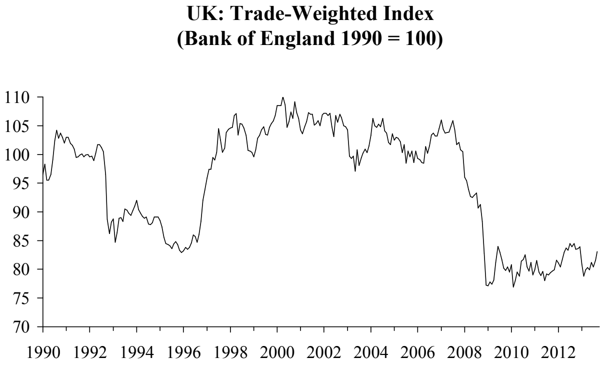
Table 3: Portfolio(%)

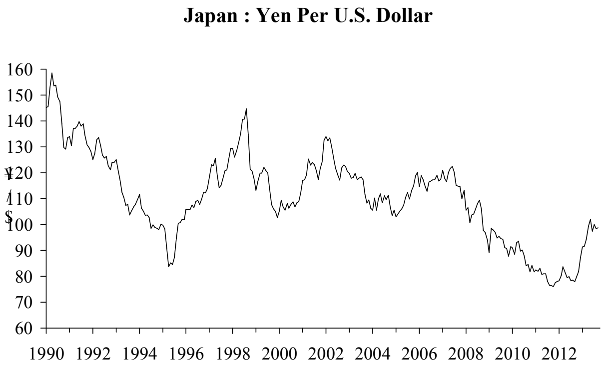
	Sterling Based Investor		Dollar Based Investor		Euro Based Investor	
	September Letter	Current View	September Letter	Current View	September Letter	Current View
UK Deposits (Cash)	5	5	5	5	1	1
US Deposits	-	-	-	-	-	-
Euro Deposits	-	-	-	-	-	-
Japanese Deposits	-	-	-	-	-	-
UK Bonds	-	-	-	-	-	-
US Bonds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

INDICATORS AND MARKET ANALYSIS
FOREIGN EXCHANGE MARKETS



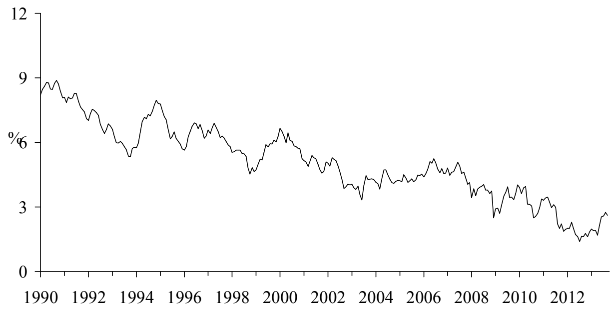




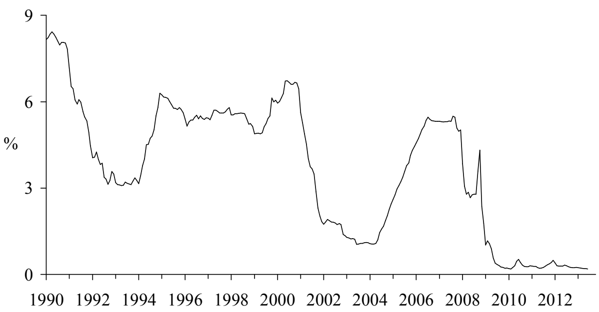


GOVERNMENT BOND MARKETS

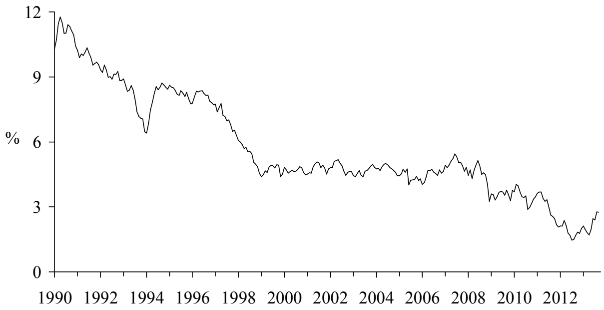
U.S.: Yield on Long-Term Government Bonds



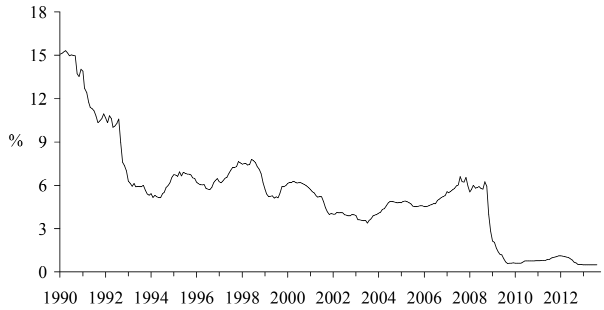
U.S. : 3-Month Certificate of Deposit



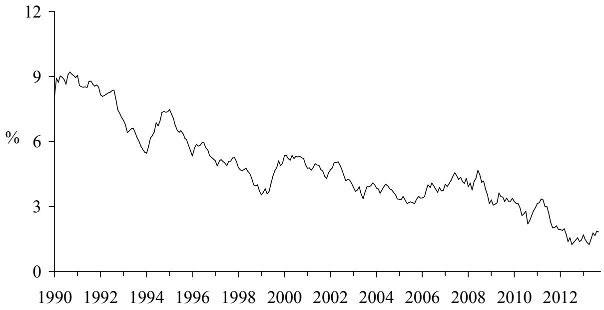
U.K. : Yield on Long-Term Government Bonds



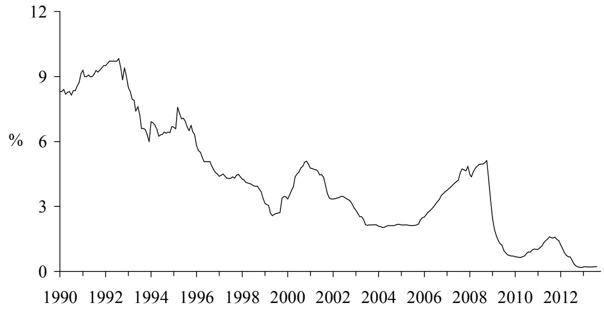
U.K. : 3-Month Interbank Rate



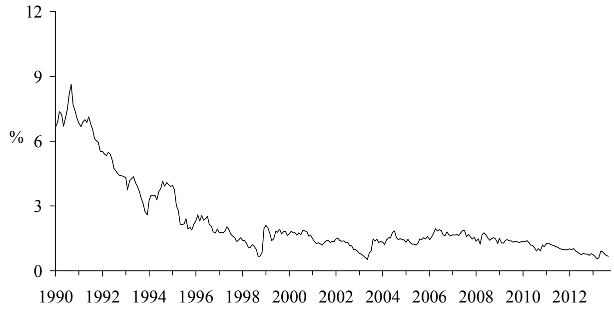
Germany: Yield on Public Authority Bonds



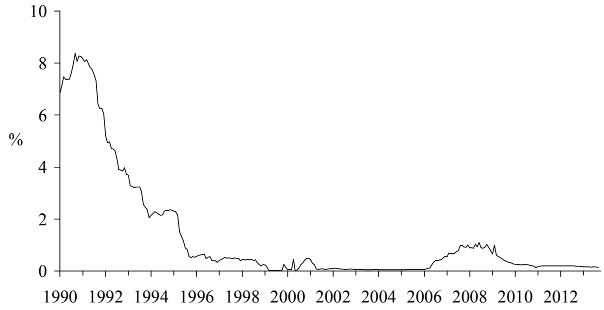
Germany : 3-Month Interbank Deposit Rate



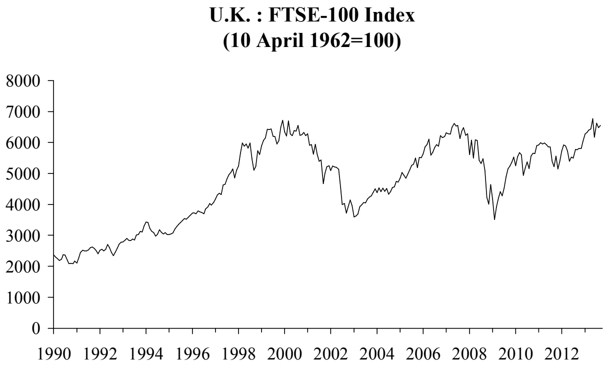
Japan: Yield on Long-Term Government Bonds

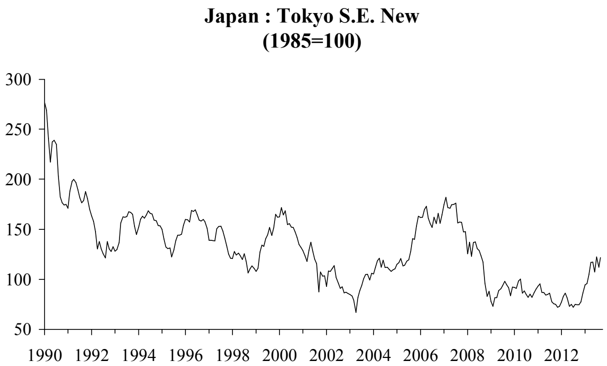


Japan : 3 Month Money Market Rate



MAJOR EQUITY MARKETS





EMERGING MARKETS

Anupam Rastogi

India

India's economy is expected to expand by less than 5% in the financial year ending March 2014. The spectre of a rating downgrade is forcing the government to take some action on the fiscal front; they would like to spend their way to re-election in the next elections due in mid-2014. The country's industrial production climbed 2.6% in July from a year earlier, beating the median forecast of a 0.5% contraction in a survey of 16 economists carried out by The Wall Street Journal. The government kept the borrowing target for the fiscal year through March unchanged at 5.79 trillion rupees ($92.49 billion) for the second half of the fiscal year, or the October-March period.

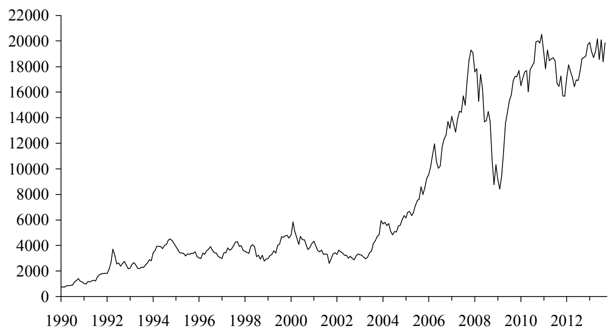
India's wholesale inflation hit a six-month high of 6.1% in August as food and fuel prices soared. Consumer inflation already has been hovering near double-digit levels for months, and was at 9.52% in August.

India's central bank surprised markets, by raising its key lending rate for the first time in two years in its post-US Fed meeting held on September 20, demonstrating its commitment to fighting inflation even as the country struggles with a slowdown and a world-wide sell off in emerging-market assets. The central bank hiked the repo rate by 25 basis points to 7.5%.

Considering the deepening slowdown and heightened risks to growth, the Reserve Bank of India (RBI) is unlikely to further raise the repo rate in Fiscal Year 2014. If the rupee continues to appreciate and stabilizes below Rs60/US$ then temporary measures taken by the central bank to squeeze liquidity could be withdrawn. These measures are taken to ensure that inflationary expectations built in the economy are brought down. However, newly appointed RBI Governor Raghuram Rajan took measures to ease short-term borrowing costs. We expect interest rates to remain firm through 2013–14.

The policy shift by the central bank has confirmed Raghuram Rajan's position as one of the most high-profile figures in the global battle to protect growth and financial stability during the current period of capital flight from major emerging markets, and was also hailed as a sign of his willingness to press forward with potentially politically unpopular measures. His belief is that if inflation is brought under control, other things will sort themselves out. Anything other than this would have been an insult to the Chicago School of economics.

India: BSE Sensitive



India's trade deficit narrowed to a five-month low in August as slowing gold demand helped cool imports, while the government's efforts to encourage exporters to tap newer markets drove merchandise exports higher. Exports rose for the second successive month — up nearly 13% from a year earlier at $26.14 billion in August. In July, exports had totalled $25.83 billion. India's current-account gap was $87.8 billion in the last fiscal year ended March 31.

In August 2013, merchandise imports declined by 0.7% year on year. Non-oil imports fell by 10.4%, led by a plunge in gold imports. In contrast, oil imports rose by around 18%. With imports falling and exports rising sharply, the trade deficit narrowed by 23% year on year to US$ 10.9 billion, the lowest in the last six months. The gap was $12.27 billion in July.

The Indian rupee has witnessed tumultuous times during the current year. It plunged over 20% to hit an all-time low of Rs 68.81 against the US dollar on August 28, 2013. However, there has been a sharp recovery in the last three weeks with the USD/INR exchange rate currently around Rs 62 per US dollar.

	10-11	**11-12**	**12-13**	**13-14**	**14-15**
GDP (%p.a.)	7.5	6.2	5.0	6.0	6.0
WPI (%p.a.)	9.0	7.5	7.0	6.0	6.0
Current A/c(US$ bill.)	–31.0	–40.0	–80.0	–80.0	60.0
Rs./$(nom.)	49.0	49.5	54.5	62.0	64.0

China

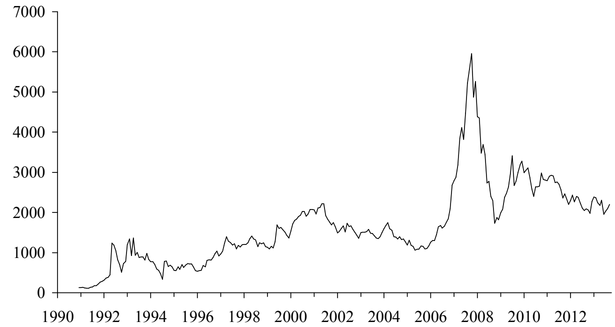
China's economy is growing, and is growing at the pace desired by the new leadership to achieve a sustainable growth of 7.5%; this also implies that China will not introduce a major new stimulus policy. Chinese factory output expanded for a second month in September. A preliminary HSBC Holdings Plc and Markit Economics' purchasing manager's index rose to 51.2 against 50.1 in August.

Inflation in August remained subdued, with the consumer-price index edging down to 2.6% year-on-year, from 2.7% in July. The overall picture which is emerging is that Chinese economy is benefiting from progressive strengthening of demand in the U.S. and other important export markets.

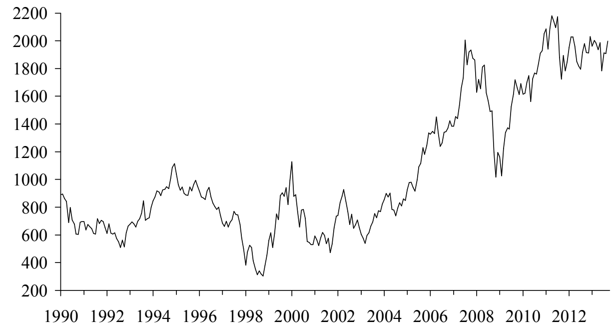
August's trade numbers are showing signs of improvement after the positive signal given out by July figures. Exports have gathered steam, rising 7.2% in August from a year earlier. This was up from a 5.1% rise in July and a contraction of 3.1% in June. Imports rose 7% from a year earlier in August, down from 10.9% in July. China's trade surplus grew to $28.5 billion, up from $17.8 billion in July, marking its highest level since January.

On the currency front also yuan is steady and in the derivatives market, sentiment toward the currency is becoming bullish as the Chinese economy improves. After rising 1.8% in the first half of the year, the yuan ground to a halt in June when liquidity was squeezed by the central bank and global funds started pulling out of Asia. But a series of positive economic data over the past two months has strengthened Chinese stocks and the offshore currency markets in Hong Kong.

China: SSE Composite Index



Korea: Composite Index



China is making good use of the current financial situation by protecting its reserves and converting incremental reserves into yuan. To do that, China has taken a step forward in its plan to open up its capital account and internationalise its currency with a trial program that allows foreign hedge funds to raise money, denominated in yuan for overseas investment. The trial — officially known as the Qualified Domestic Limited Partner, or QDLP program — allows selected Chinese financial institutions and foreign banks' units in China to raise funds locally and invest overseas.

In September China, for the first time, joined the ranks of the most-traded international currencies, underscoring the rise of the world's second-largest economy and the growth of the global foreign-exchange market. The Chinese yuan is the ninth most traded currency in the Bank for International Settlements' latest report on foreign-exchange turnover, surpassing the Swedish krona and New Zealand dollar.

The yuan has gained 1.8% against the dollar so far this year. This is in contrast with other Asian currencies, many of which have lost more than 10% against the U.S. currency over the same period.

Besides opening up the yuan market, China is pushing for more financial reforms that would advance the cause of capital market liberalisation. Regulators have tripled the size of a trial programme that allows investors to short shares. They also have taken steps to support the issuance of local government bonds and opened the country's closely guarded capital account a little wider.

China is seeking to join US-led talks aimed at updating the ageing rules on the $4 trillion annual trade in global services. This is raising concerns in Washington over Beijing's motives. Frustrated with a lack of progress in the World Trade Organization, the US, EU and almost two dozen other largely rich-world countries last year launched talks towards a new Trade in Services Agreement, or TiSA. The talks cover about 70% of global services and are one of the main pillars of President Barack Obama's trade strategy. The reason for the US to be worried is that China may sabotage the TiSA as it is being discussed outside the WTO, where China has influence.

	10	**11**	**12**	**13**	**14**
GDP (%p.a.)	10.3	9.2	7.8	7.5	7.0
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

With record current-account surpluses, shrinking offshore debt and growing foreign-exchange reserves, the country's finances are strong and are attracting global investors and so shielding the won from the steep declines seen in India. South Korea has emerged unscathed from the market turmoil that rocked other Asian countries; stock markets reached their highest levels since June 2013 and the economy is humming along at its fastest pace in two years. The optimism of fund managers has spilled over into the country's debt markets. South Korea sold its first global dollar bond in four years, a $1 billion 10-year bond, as investors are attracted by the country's better fiscal position than its Asian peers. South Korea's foreign-exchange reserves rose to a record high of $331.09 billion at the end of August, further bolstering its defences against potential external shocks. Its ratio of short-term debt to reserves — another measure of vulnerability — fell to a seven-year low of 36.6% in the second quarter.

South Korean inflation slowed to 1.3% in August after a level of 1.4% in July. The inflation rate has remained between 1.0 and 2.0% for the past 10 months. This is well below the central Bank of Korea's target range of 2.5 to 3.5%.

South Korea logged a trade surplus for the 19th straight month in August, thanks to improving export figures. South Korea's exports came to US$46.38 billion last month, up 7.7% from the same period a year earlier. Imports grew 1% year on year to $41.53 billion. South Korea ran a current-account surplus for the 18th consecutive month in July and the central bank expects another record-high surplus of $53 billion this year, up from a record $43.14 billion last year.

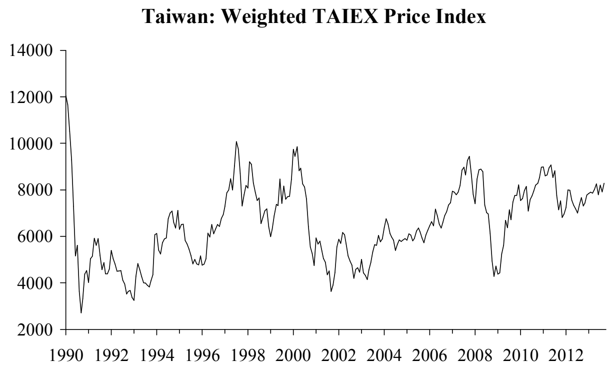
The South Korean won rose to a strong level on the back of the current-account surplus, and is forecast to reach a record this year. The current account surplus will support the currency in the coming months.

	10	**11**	**12**	**13**	**14**
GDP (%p.a.)	6.3	3.6	2.0	2.0	2.8
Inflation (%p.a.)	2.9	4.0	2.2	1.1	1.6
Current A/c(US$ bill.)	28.2	27.0	44.0	55.0	50.0
Won/$(nom.)	1150	1100	1100	1120	1150

Taiwan

Taiwan's economy has begun to pick up and will continue through 2014, thanks to the growth impetus in the US and EU and expanding business opportunities in China.

Taiwan's exports grew more quickly in August, another sign that Asian exporters — particularly of high-tech products — are starting to feel the pull from the gradual strengthening of demand in the U.S. and other major markets. Taiwan, with cutting-edge technology in semiconductors and electronic components and its close ties to China's economy, is the bellwether of global demand for high tech products.



The island's exports rose 3.6% August from a year earlier to $25.64 billion, picking up from July's 1.6% rise, but it will not be able to achieve its goal of 5.5% export growth in 2013. During the first eight months of this year exports grew only 2.5%, far slower than the previously expected pace amid sluggish global trade. Taiwan recorded a current account surplus of US$13.8 billion in the second quarter.

As the Southeast Asian countries have been suffering more capital outflows, so the economies such as Taiwan, with healthy trade surpluses, are benefitting from foreign investments.

The Taiwanese dollar strengthened 0.5% to NT$29.751 against the US dollar in Taipei. It touched NT$29.705 earlier, its strongest since June 7.

	10	**11**	**12**	**13**	**14**
GDP (%p.a.)	10.8	4.0	1.3	2.4	2.5
Inflation (%p.a.)	1.3	1.2	1.9	0.6	1.0
Current A/c(US$ bill.)	16.0	18.0	20.0	22.0	23.0
NT$/$(nom.)	31.0	30.0	29.5	30.0	29.5

Brazil

Brazil's economy expanded by 3.3% in the second quarter from the year-earlier period, and was up a solid 1.5% from the first quarter. However, the second-quarter performance will be difficult to sustain because business confidence was on the ebb in July. The government is quite optimistic about the next year's gross domestic product growth. It expects GDP growth to be at 4% and inflation at 5% in 2014 compared to market expectations of GDP growth at just 2.4%, and inflation at 5.84%.

The second quarter growth was helped by a rise in the agriculture sector due to a record harvest. Significant growth in the collection of sugar cane, corn, beans and wheat etc., is expected in the third quarter as well.

Strong growth in the agriculture sector helped push up exports in the second quarter, which received little support from the depreciation of the Brazilian real. The currency has weakened far more sharply since the end of June, which could help exports in the third quarter. Exports in the second quarter grew 6.9% compared with the previous three months, while imports rose only 0.6%.

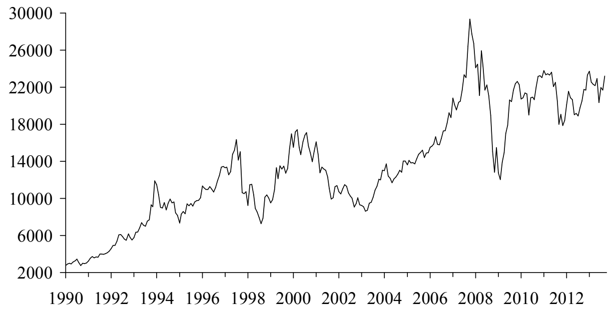
In spite of a record low level of unemployment, the Central Bank raised its key interest rate to choke inflation, which is running uncomfortably high. Brazil's central bank raised its key lending rate by half a percentage point to curb worrisome inflation. In a widely expected move, the central bank's monetary-policy committee voted unanimously to raise the Selic interest rate to 9.0% from the previous 8.5%, the fourth increase since April. Notwithstanding the continuation of loose US monetary policy, the Selic rate may rise to 9.50% in October and remain at that level through the end of 2014. The central bank's next interest rate decision is expected on October 9.

Brazil's President Dilma Rousseff took her campaign against US spying to the UN. In the opening session of the organisation's annual general assembly she strongly attacked foreign espionage carried out over the internet. Brazil is seeking a formal explanation, apology and a pledge not to repeat the activity from the US. She has also postponed what would have been Brazil's first state visit to Washington in nearly two decades over the issue.

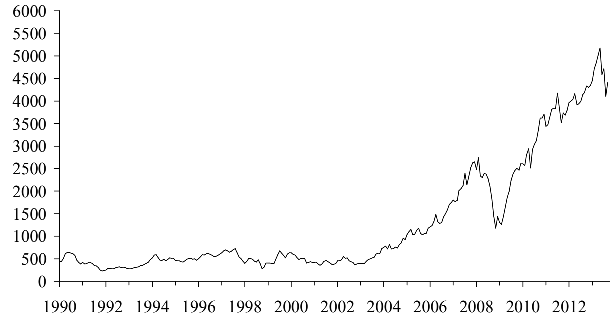
	10	**11**	**12**	**13**	**14**
GDP (%p.a.)	7.5	2.7	0.9	2.0	3.5
Inflation (%p.a.)	5.9	6.5	5.8	6.5	6.0
Current A/c(US$ bill.)	−47.3	−52.6	−60.0	−75.0	−70.0
Real/$(nom.)	1.7	1.5	2.0	2.3	2.4

Other Emerging Markets

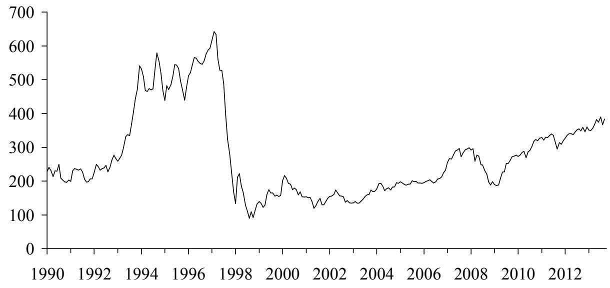
Hong Kong: FT-Actuaries



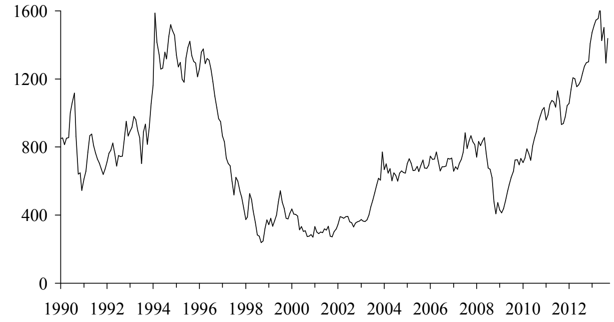
Indonesia: Jakarta Composite



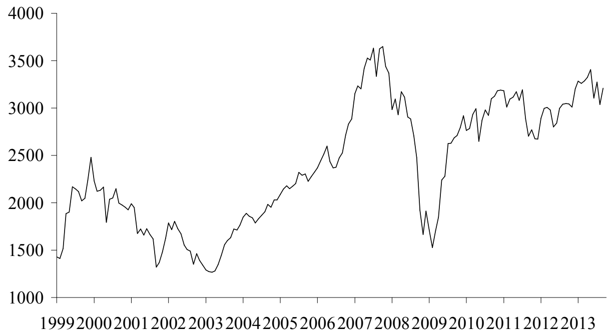
Malaysia: FT-Actuaries (US$ Index)



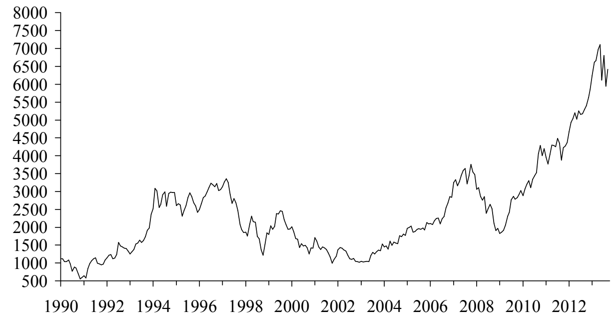
Thailand: Composite Index



Singapore: Straits Times Index

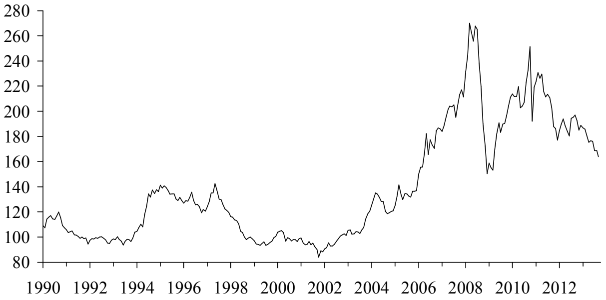


Philippines: Manila Composite

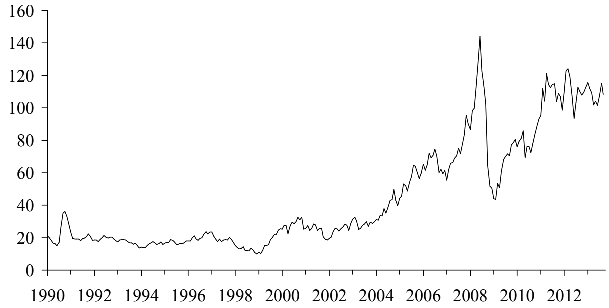


COMMODITY MARKETS

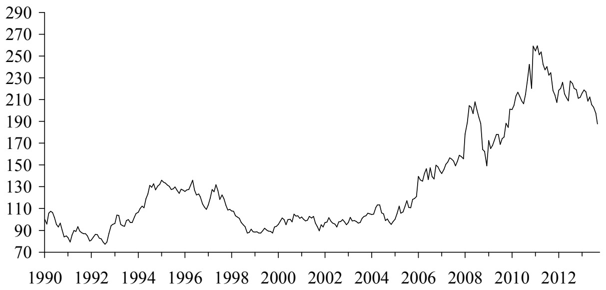
Commodity Price Index (Dollar)
(Economist, 2000=100)



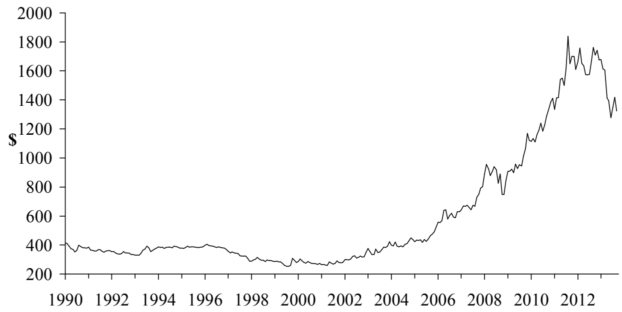
Oil Price: North Sea Brent (in Dollars)



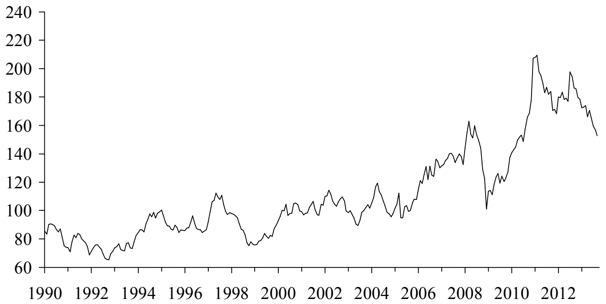
Commodity Price Index (Sterling)
(Economist, 2000=100)



Gold Price (in Dollars)



Commodity Price Index (Euro)
(Economist)



UK FORECAST DETAIL

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

	Inflation %[1] (CPI)	Short Dated (5 Year) Interest Rates	3 Month Int. Rates	Nominal Exchange Rate (2005=100)[2]	Real Exchange Rate[3]	Real 3 Month Int. Rates %[4]	Inflation (RPIX)	Real Short Dated Rate of Interest[5]
2010	3.3	2.4	0.7	80.4	88.6	–3.5	4.8	–0.2
2011	4.5	2.0	0.9	80.0	89.8	–2.8	5.3	–0.2
2012	2.7	0.9	0.9	83.1	94.0	–1.7	3.2	–1.5
2013	2.7	1.3	0.9	82.6	94.3	–1.6	2.5	–0.9
2014	2.5	1.8	1.6	83.0	95.7	–0.6	3.1	–0.3
2015	2.2	2.1	2.1	82.3	95.4	0.1	2.8	0.1
2012:1	2.7	1.1	1.1	81.2	91.6	–1.8	3.8	–1.3
2012:2	3.0	0.9	1.1	83.2	94.3	–1.4	3.2	–1.4
2012:3	2.5	0.7	0.8	84.1	95.2	–1.7	2.9	–1.6
2012:4	2.5	0.8	0.6	83.7	94.9	–2.0	3.0	–1.5
2013:1	2.6	1.0	0.6	80.5	91.1	–2.0	3.0	–1.3
2013:2	2.8	1.3	0.9	83.2	95.2	–1.6	3.3	–0.9
2013:3	2.8	1.5	0.9	83.5	95.5	–1.6	3.3	–0.7
2013:4	2.7	1.5	1.1	83.2	95.4	–1.3	3.2	–0.6
2014:1	2.6	1.8	1.3	83.6	96.0	–1.1	3.1	–0.3
2014:2	2.5	1.8	1.6	83.0	95.8	–0.6	3.1	–0.3
2014:3	2.5	1.7	1.8	83.1	95.8	–0.3	3.1	–0.4
2014:4	2.4	1.8	1.8	82.4	95.2	–0.3	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	135.6
2011	232.7	2.5	4.6	1.53	133.5
2012	237.1	1.9	4.7	1.59	132.5
2013	242.3	2.2	4.5	1.53	131.8
2014	248.5	2.6	4.2	1.43	131.9
2015	256.6	3.2	3.9	1.31	133.3
2012:1	234.7	0.7	4.8	1.61	132.4
2012:2	235.8	1.8	4.8	1.59	131.9
2012:3	237.4	1.9	4.7	1.57	132.5
2012:4	240.5	3.3	4.6	1.56	133.2
2013:1	241.8	3.0	4.6	1.54	133.0
2013:2	242.1	2.7	4.6	1.55	131.7
2013:3	242.0	2.0	4.5	1.54	131.4
2013:4	243.1	1.1	4.5	1.51	131.0
2014:1	245.1	1.3	4.4	1.48	131.4
2014:2	248.1	2.5	4.3	1.45	131.7
2014:3	249.4	3.0	4.2	1.42	132.1
2014:4	251.5	3.4	4.1	1.39	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	143.2	685816.8	412464.1	222982.1	180596.2	−35977.3	94248.2
2011	144.8	693480.0	405707.9	232196.6	179249.7	−24641.9	99032.3
2012	145.1	694662.2	405184.0	235764.3	184689.2	−30801.2	100173.9
2013	146.8	702861.9	405176.8	223498.2	188405.4	−30067.7	84149.4
2014	150.0	718141.3	408306.9	241326.9	189177.7	−31205.7	89481.4
2015	153.6	735702.5	414580.1	250992.1	193479.8	−31157.8	92210.8
2010/09	1.7		0.3	11.0	0.1		8.3
2011/10	1.1		−1.6	3.8	−0.8		4.5
2012/11	0.2		−0.1	2.5	3.0		3.0
2013/12	1.2		0.0	−5.3	2.0		−16.0
2014/13	2.2		0.8	8.6	0.4		7.3
2015/14	2.4		1.5	4.0	2.3		3.1
2012:1	145.2	173777.2	101162.8	53040.9	48062.2	−6746.9	21741.9
2012:2	144.4	172906.5	101177.7	59892.9	44993.0	−8401.7	24755.4
2012:3	145.5	174189.9	101200.0	60648.4	45617.7	−7536.4	25739.8
2012:4	145.2	173788.7	101643.4	62182.0	46016.3	−8116.2	27936.9
2013:1	145.5	174253.1	101590.2	48881.4	48201.0	−6636.6	17782.9
2013:2	146.5	175446.1	101360.9	56536.5	45914.8	−7812.6	20545.8
2013:3	147.2	176195.9	101183.7	57185.3	48587.9	−7810.2	22948.1
2013:4	147.8	176966.8	101041.9	60894.9	45701.7	−7808.3	22872.6
2014:1	148.7	177984.2	101428.2	59849.8	46404.1	−7808.4	21893.9
2014:2	149.5	179011.0	101842.3	60408.6	46695.4	−7801.3	22139.1
2014:3	150.4	180074.6	102284.4	58779.4	49462.5	−7797.5	22657.5
2014:4	151.2	181071.5	102752.0	62289.0	46615.7	−7798.5	22791.0

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	8.5	1319.8	112.6	36.6	−40.0
2011	6.5	1399.3	91.0	43.0	−22.5
2012	4.8	1425.0	68.4	46.9	−59.2
2013	8.1	1471.0	119.7	51.2	−60.7
2014	6.9	1541.7	106.0	56.6	−62.9
2015	5.9	1613.2	94.6	60.3	−63.5
2012:1	4.1	346.6	14.4	11.5	−12.5
2012:2	1.3	353.4	4.6	11.4	−17.8
2012:3	5.7	358.3	20.3	11.8	−15.3
2012:4	8.9	364.3	32.6	11.8	−13.6
2013:1	3.1	349.1	10.9	12.0	−14.5
2013:2	8.2	360.4	29.6	12.5	−17.1
2013:3	8.8	367.0	32.4	12.6	−15.9
2013:4	7.3	370.7	27.0	12.9	−13.2
2014:1	8.2	372.9	30.7	13.3	−16.3
2014:2	7.2	379.2	27.4	13.7	−17.3
2014:3	8.4	383.1	32.4	14.1	−16.0
2014:4	6.9	387.4	26.6	14.2	−13.3

1 GDP at market prices (Financial Year)

WORLD FORECAST DETAIL

Growth Of Real GNP

	2009	2010	2011	2012	2013	2014
U.S.A.	–2.6	2.4	1.8	2.2	2.2	2.8
U.K.	–3.9	1.7	1.1	0.2	1.2	2.2
Japan	–6.3	4.7	–0.5	1.9	1.8	1.6
Germany	–4.7	4.2	3.0	0.7	0.6	1.5
France	–2.5	1.6	2.0	0.0	–0.4	0.7
Italy	–5.1	1.7	0.5	–2.4	–1.8	0.4

Growth Of Consumer Prices

	2009	2010	2011	2012	2013	2014
U.S.A.	–0.3	1.6	3.1	2.1	1.6	2.0
U.K.	1.3	3.3	4.5	2.7	2.7	2.5
Japan	–1.4	–0.7	–0.3	0.0	0.0	2.0
Germany	0.4	1.2	2.0	2.0	1.7	2.0
France	0.1	1.5	2.1	2.0	1.6	1.5
Italy	0.8	1.5	2.8	3.0	2.8	1.6

Real Short-Term Interest Rates

	2009	2010	2011	2012	2013	2014
U.S.A.	–1.6	–3.0	–1.8	–1.9	–1.3	–1.2
U.K.	–0.3	–3.5	–2.8	–1.7	–1.6	–0.6
Japan	1.1	0.4	0.4	0.3	–1.6	–1.6
Germany	–0.4	–1.9	–0.5	–1.5	–1.5	–1.4
France	–0.8	–1.7	–0.5	–1.4	–1.5	–1.4
Italy	–0.8	–2.4	–1.5	–2.6	–2.0	–1.4

Nominal Short-Term Interest Rates

	2009	2010	2011	2012	2013	2014
U.S.A.	0.2	0.1	0.3	0.1	0.7	0.8
U.K.	1.1	0.7	0.9	0.9	0.9	1.6
Japan	0.1	0.1	0.4	0.3	0.4	0.4
Germany	0.7	0.4	1.5	0.2	0.5	0.6
France	0.7	0.4	1.5	0.2	0.5	0.6
Italy	0.7	0.4	1.5	0.2	0.5	0.6

Real Long-Term Interest Rates

	2009	2010	2011	2012	2013	2014
U.S.A.	1.3	1.0	0.9	–0.2	0.1	0.6
U.K.	–0.3	–0.2	–0.2	–1.5	–0.9	–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

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	1.8
Japan	1.3	1.1	1.0	0.8	0.7	0.9
Germany	4.0	3.8	1.8	1.5	1.5	1.9
France	4.0	3.8	1.8	1.5	1.5	1.9
Italy	4.0	3.8	1.8	1.5	1.5	1.9

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

	2009	2010	2011	2012	2013	2014
U.S.A.	88.7	87.4	85.7	90.4	97.3	99.1
U.K.	76.7	78.9	80.0	83.7	84.0	85.2
Japan	89.0	92.0	97.1	98.3	119.7	122.0
Germany	105.8	102.9	105.5	104.3	107.4	108.2
France	104.3	103.1	105.5	104.9	107.9	108.6
Italy	105.4	103.6	106.9	107.4	111.8	113.2

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

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

	2009	2010	2011	2012	2013	2014
U.S.A.[1]	85.98	83.73	78.08	80.90	85.50	85.40
U.K.	1.57	1.55	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