LIVERPOOL INVESTMENT LETTER

October 2015

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

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

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

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NERVOUSNESS OVER INTERNATIONAL PROSPECTS

It is astonishing how jumpy central banks and general comment have become in recent weeks. This is the China effect. Everyone seems to assume that because China has contributed so much of world growth in the past and will now cut that contribution back to around half, therefore the world could go into recession. So every weaker current number is carefully turned over for signs of this effect.

Yet the world economy is a web of relationships which are constantly shifting under the pressures of incentives and relative prices. The most dramatic developments are in commodity prices which have collapsed, as frequently happens at this stage of the world cycle. They are fuelling ‘deflation’, but this is ‘virtuous’ because it represents a huge tax cut from producers for consumers. The way this works is that producing countries can do little except borrow their way through their cash collapse, while consuming countries find profits and real incomes rising, stimulating investment, consumption and innovation.

In spite of its grim overhang from the investment splurge of 2009–10 China is also participating in this tax-cut environment. Consumption and services investment are growing strongly even as manufacturing investment is being cut to reduce excess capacity. The US and the UK are both growing well, pace the usual sighs and groans whenever US job creation disappoints — since when did everyone forget the old adage about ‘one month’s figures’? Even the euro-zone is now recovering; its recession was recently dated by the euro business cycle group as having ended in early 2013: well, possibly, but certainly now we are seeing some lift. Also, as one looks around the emerging market economies (see below) most are growing respectably if not joyously. So, yes, China is slowing; but no, the world is not going into recession, yes there is more slack and yes, other areas are rising to take up this slack.

This general world behaviour should not come as a huge surprise. It is more or less mimicing behaviour after the early 1950s until the period from mid-70s to the early 1980s; and from the early 1980s until the period from 2007 to 2011. Each of these constituted an upswing of around 25 years, followed by a Great Recession lasting some five years or so. Each time commodity prices started low and rose to a spike towards the upswing’s end, then crashed down during the recession to fall into a trough beginning the next upswing. It seems that the main motor of this cycle is the terms of trade swings between consuming and producing countries created by demand and supply for commodities. Monetary policy contributes to the mix by whether it augments or counters this cycle. Typically it has augmented it, creating credit booms in the upswing and failing to supply enough liquidity in the Recessions. The only exception to this was the mid-1970s attempt to stop recession in the teeth of a roaring commodities boom; the money supply exploded and with it inflation. In the end money had to be stood on to stop this inflation, as it was in 1979–80, and the recession then completed its course.

Table 1: Summary of Forecast

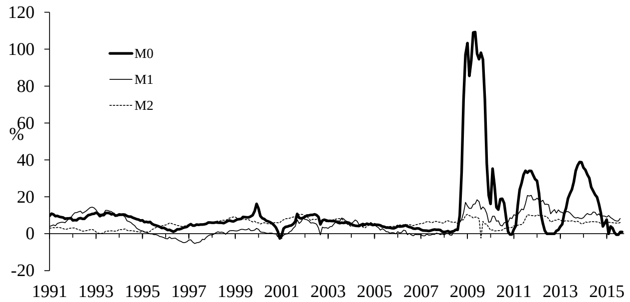
		2012	2013	2014	2015	2016	2017	2018
GDP Growth[1]		0.7	1.7	2.8	3.0	2.5	2.4	2.4
Inflation	CPI	2.1	1.9	1.6	0.6	1.6	1.7	2.0
	RPIX	3.2	3.1	2.4	1.6	2.4	2.5	2.7
Unemployment (Mill.)								
	Ann. Avg.[2]	1.6	1.4	1.0	0.8	0.7	0.7	0.6
	4th Qtr.	1.6	1.3	0.9	0.7	0.7	0.7	0.6
Exchange Rate[3]		83.0	81.6	87.1	90.7	90.8	90.7	90.3
3 Month Interest Rate		0.9	0.6	0.6	0.6	1.0	1.6	2.1
5 Year Interest Rate		0.9	1.3	1.8	1.8	2.2	2.5	2.5
Current Balance (£bn)		–53.2	–65.9	–84.2	–77.8	–78.2	–78.8	–79.5
PSBR (£bn)		110.6	92.5	88.6	84.0	79.6	58.7	39.1

[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)

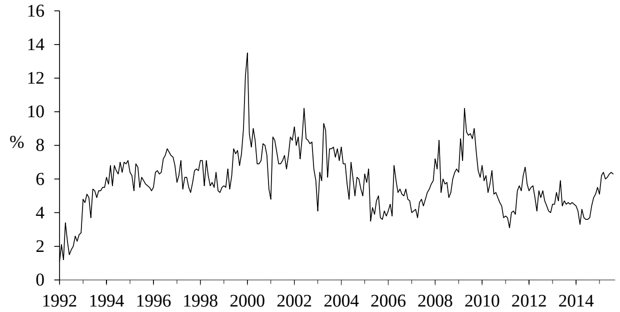
In this Great Recession central banks failed badly to control the bust. We had the Lehman bankruptcy and the great liquidity freeze, followed by massive reregulation which further contracted bank lending. Eventually huge fiscal deficits and money printing which largely bypassed the banks managed to warm the freeze up sufficiently for recovery. Money supply growth is currently moderate to tepid, which is appropriate. But the concern as we look ahead is whether the current policies of zero interest rates combined with QE risk setting off another credit boom down the road. Our judgement for some time has been that they do and that the response should be to cool down the regulators while returning monetary conditions towards normal.

For the investor we believe the need is to remember the nature of this long cyclical process. It does imply that the world is most unlikely to have a recession for a long time. Individual countries are not immune to one of course if they are badly mismanaged (Brazil e.g.) or have particular cash problems (some commodity producers for example). But it looks as if it will be a good environment for equities for quite a long while.

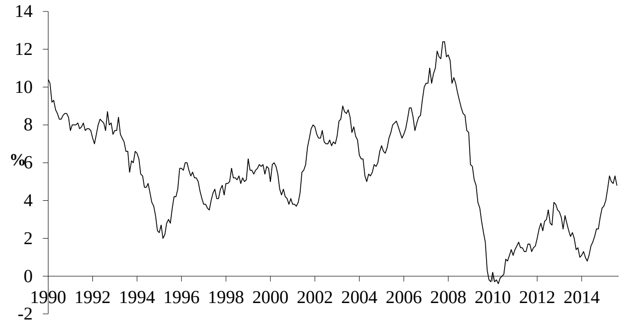
U.S.: Growth in Monetary Aggregates (Yr - on - Yr)



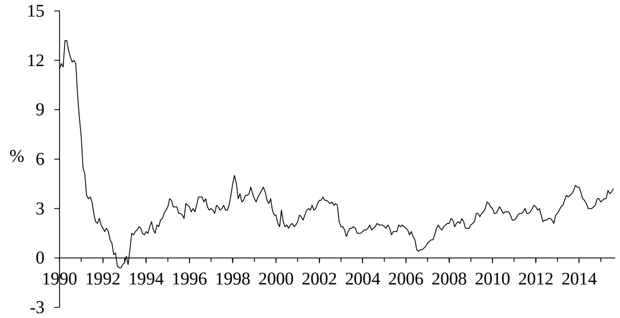
UK: Notes and Coins in Circulation Growth



Eurozone M3 Growth



Japan: Growth of M2+CD's



FOCUS ON JAPAN

Francesco Perugini

Downside Risks From Overseas Economies

Japan's government lowered its recent economic assessment and highlighted risks posed by China and a US interest rate hike, adding to signs that a shock from overseas could hurt Japan's outlook. The Cabinet Office said in its September report that Japan's economy was on track to recover but acknowledged some parts of the economy had slowed, striking a less optimistic tone than last month as consumer spending, exports and capital expenditure all proved disappointing.

Prime Minister Shinzo Abe is trying to breathe new life into his economic agenda, and the monthly economic report suggests this task is becoming more urgent as obstacles to achieving strong economic growth multiply. "There are downside risks to Japan, because China and other emerging Asian countries are slowing as the US heads toward normalizing monetary policy. We need to keep an eye on developments in financial markets", said Abe at a recent press conference.

The last time the Cabinet Office downgraded its assessment was in October last year. It left unchanged an assessment that consumer spending had reached a plateau, but noted capital expenditure is showing signs of recovery, an assessment also unchanged from last month. In addition, the Cabinet Office expressed concern that consumer spending and business investment have been slow to respond to an improving labour market and record corporate earnings. Labour demand is the highest in decades, but rising food prices have caused households to cut back on other spending.

Some economists also worry that Japan's economy is likely to continue to suffer slowed growth due to waning demand for its exports in emerging economies, especially in China. China's growth remains the key in this respect, because it was the largest importer of commodities and goods from key emerging countries. As its economy slows from two-digit figures just five years ago to about 7% projected for 2015, its appetite for imports begins to decrease as it looks to shore up domestic spending.

The economic link between Japan and China is mainly through foreign direct investment and trade. China is the biggest destination for Japanese foreign direct investment, while China is Japan's second-largest trade partner, accounting for 18.3% of exports in 2014, closely behind the US, at 18.6%. The volume of Japan's exports to China fell 9.2% in August from a year earlier, and industrial production and machinery orders have also come in much weaker than expected. Reverberations from China's slowing demand could exacerbate this trend. A full 54% of Japan's exports last year went to Asian countries. Given the close trade ties between China and the rest of the region, it is clear that China is of greater importance to Japan's exporters than the US. As a result, Japanese companies that have strong business ties with China have led the stock market lower over the past month.

Concern over the impact of the Chinese economic slowdown is also rising among the corporate sector. Recently the Nikkei newspaper, surveyed 148 top managers. A whopping 64.1% of them said China's woes would have a negative impact on their companies. Only around 20% expected no impact.

As if this were not bad enough, the yen's weakening trend that was previously aiding exporters has been reversed as its status as a safe haven comes back to the fore for investors rushing out of emerging markets: the yen has weakened about 30% since Prime Minister Shinzo Abe came to power at the end of 2012. China alone has already lost close to $500 billion in reserves in a little more than a year. "The greenback cannot absorb such an outflow on its own, and unless the Bank of Japan reacts with more quantitative easing, yen appreciation may well continue. Any significant devaluation of the Chinese yuan would further exacerbate the pain for Japanese exporters, both by making their sales to China even dearer and by giving Chinese competitors an edge in certain markets", said Alicia Garcia-Herrero, chief economist for Natixis.

Former vice finance minister Eisuke Sakakibara, now a professor at Aoyama Gakuin University, also sees an end to the era of the weaker yen. "The period of the cheap yen is beginning to be over and I think gradually the yen-dollar rate will move toward the range of 115 to 120," said Sakakibara. It is unlikely that the Japanese currency will decline toward 125 for "some time to come," he added.

Overall, the impact of China's deceleration is a huge shock for Japan, not only because it is happening much more quickly than had been expected but also because the bilateral relationship is a key pillar of the Japanese economy. The Bank of Japan (BOJ) can help, and probably will soon intervene. Indeed, market expectations for additional monetary easing in Japan are growing, spurred by a recent meeting between BOJ Governor Haruhiko Kuroda and Prime Minister Shinzo Abe. But the central bank's bullish outlook on economic and price growth could leave those waiting on further easing disappointed. "Core prices remain strong," Kuroda told reporters after the meeting with Abe. The consumer price index excluding fresh food and energy grew 1.1% on the year in August, the central bank chief explained. This marks the sharpest growth since October 2008.

However, simulations recently carried out by the IMF show that the response of exports to the yen's depreciation can be much weaker than in ordinary cases due to of a number of "Japan-specific factors." The IMF noted that "real goods exports from Japan have remained broadly flat during the past few years despite a sharp depreciation of the yen since late 2012". The IMF attributed Japan's sluggish exports to the acceleration in production off-shoring since the global financial crisis in 2008 and uncertainty about the domestic energy supply after the massive 2011 earthquake and ensuing tsunami that hit northeastern Japan. It also cited Japan's deeper involvement in global value chains, making the world's third-largest economy "a more important intermediate-input supplier for other countries' exports." This leaves Japanese policymakers to speed up the implementations of structural reforms.

MARKET DEVELOPMENTS

If we are right in locating 2015 quite near the beginning of the cyclical upswing set off by very low commodity prices, then the outlook for investment is dominated as far as the eye can see by the implied favourable climate for equities.

Table 1: Market Developments

	Market Levels		Prediction for Aug/Sep 2016	
	Aug 28	Oct 5	Previous Letter	Current View
Share Indices				
UK (FT 100)	6192	6326	8799	8989
US (S&P 500)	1988	1983	2596	2589
Germany (DAX 30)	10316	9903	14328	13755
Japan (Tokyo New)	1500	1476	2047	2013
Bond Yields (government				
UK	1.98	1.70	2.00	2.20
US	2.19	2.04	2.10	2.10
Germany	0.74	0.60	1.50	1.50
Japan	0.39	0.33	0.70	0.70
UK Index Linked	–0.86	-0.86	0.10	0.10
Exchange Rates				
UK ($ per £)	1.54	1.51	1.56	1.50
UK (trade weighted)	92.3	90.9	90.6	90.6
US (trade weighted)	102.6	103.3	100.0	100.0
Euro per $	0.89	0.89	0.79	0.91
Euro per £	1.37	1.35	1.23	1.37
Japan (Yen per $)	120.7	120.5	98.0	120.5
Short Term Interest Rates (3-month deposits)				
UK	0.60	0.58	1.10	1.30
US	0.30	0.32	1.10	1.10
Euro	–0.08	–0.04	0.10	0.10
Japan	0.00	0.08	0.20	0.20

Table 2: Prospective Yields [1]

Equities: Contribution to £ yield of:

	Dividend Yield	Real Growth	Inflation	Changing Dividend Yield	Currency	Total
UK	3.40	2.5	1.6	38.00		45.50
US	1.90	3.0	1.6	26.00	0.96	33.46
Germany	2.60	1.4	1.5	36.00	–0.84	40.66
Japan	1.70	1.4	2.0	33.00	0.93	39.03
UK indexed[2]	–0.86		1.6	1.00		1.79
Hong Kong[3]	2.60	6.8	1.6	2.00	0.96	13.96
Malaysia	3.30	5.5	1.6	58.00	0.96	69.36
Singapore	3.50	4.5	1.6	36.00	0.96	46.56
India	1.40	8.0	1.6	31.00	0.96	42.96
Korea	1.10	3.0	1.6	–12.00	0.96	–5.34
Indonesia	2.20	6.1	1.6	41.00	0.96	51.86
Taiwan	2.80	3.4	1.6	29.00	0.96	37.76
Thailand	3.20	4.1	1.6	38.00	0.96	47.86

Bonds: Contribution to £ yield of:

	Redemption Yield	Changing Nominal Rates	Currency	Total
UK	1.70	–5.05		–3.36
US	2.04	–0.62	0.96	2.38
Germany	0.60	–9.01	–0.84	–9.25
Japan	0.32	–3.71	0.93	–2.45

Deposits: Contribution to £ yield of:

	Deposit Yield	Currency	Total
UK	0.58		0.58
US	0.32	0.96	1.29
Euro	–0.04	–0.84	–0.89
Japan	0.08	0.93	1.01

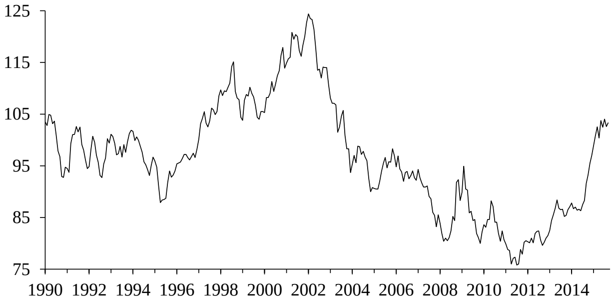
[1] Yields in terms of €s or $s can be computed by adjusting the £-based yields for the expected currency change.
[2] UK index linked bonds All Stocks
[3] Output based on China.

Table 3: Portfolio(%)

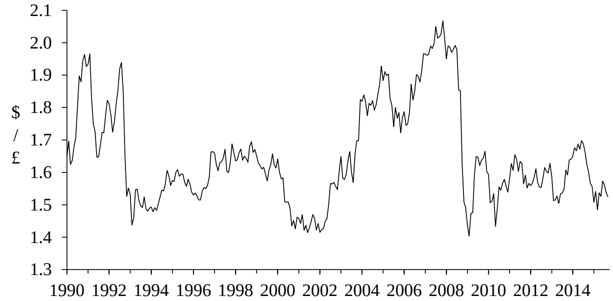
	Sterling Based Investor		Dollar Based Investor		Euro Based Investor	
	September Letter	Current View	September Letter	Current View	September Letter	Current View
UK Deposits (Cash)	5	5	5	5	1	1
US Deposits	-	-	-	-	-	-
Euro Deposits	-	-	-	-	-	-
Japanese Deposits	-	-	-	-	-	-
UK Bonds	-	-	-	-	-	-
US Bonds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

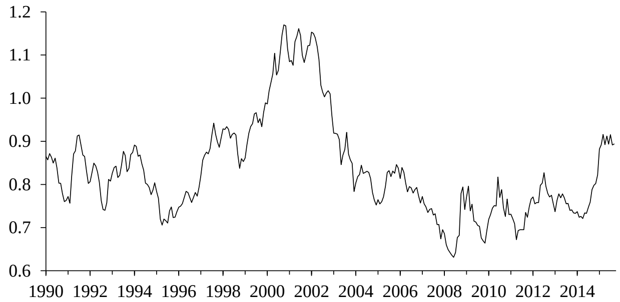
US : Trade Weighted Index
(Bank of England 1990 = 100)



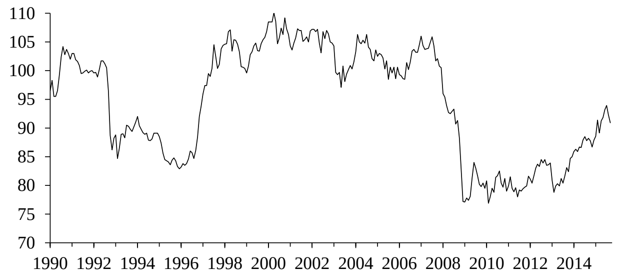
UK: Dollars Per Pound Sterling



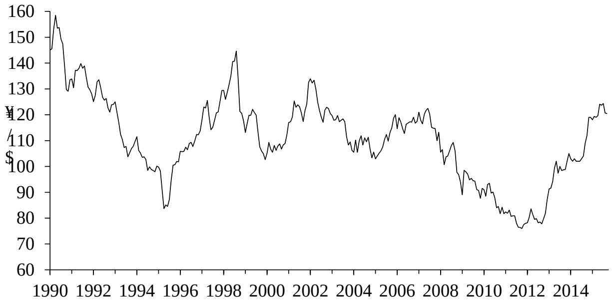
Euro per US dollar



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

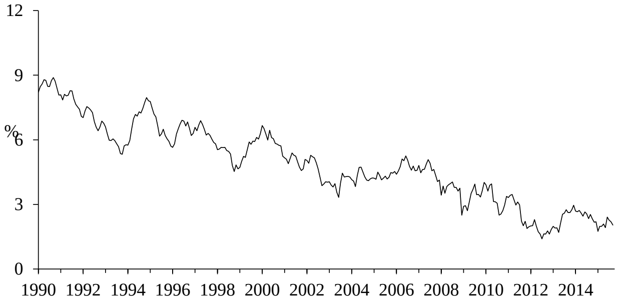


Japan : Yen Per U.S. Dollar

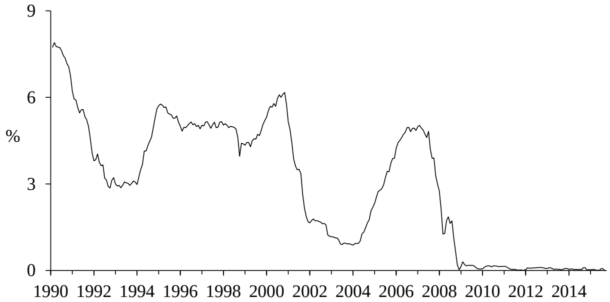


GOVERNMENT BOND MARKETS

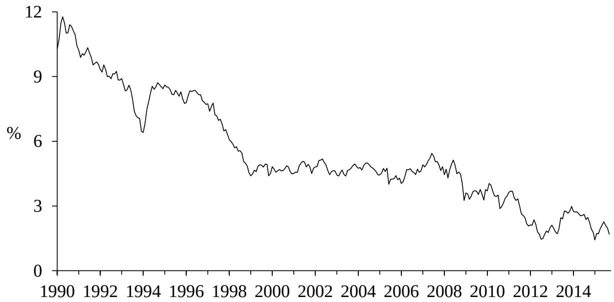
U.S.: Yield on Long-Term Government Bonds



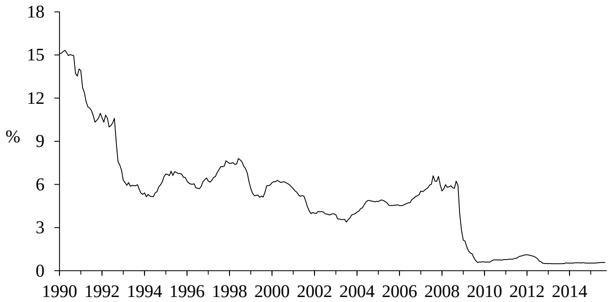
U.S. : 3-Month Treasury Bill



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

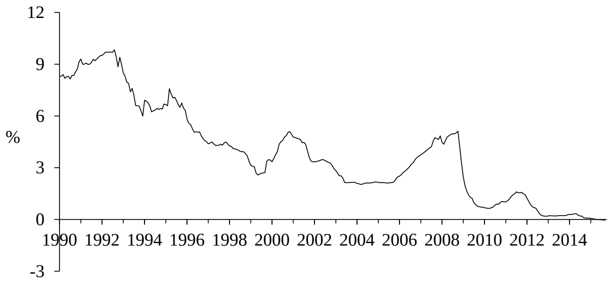


U.K. : 3-Month Interbank Rate

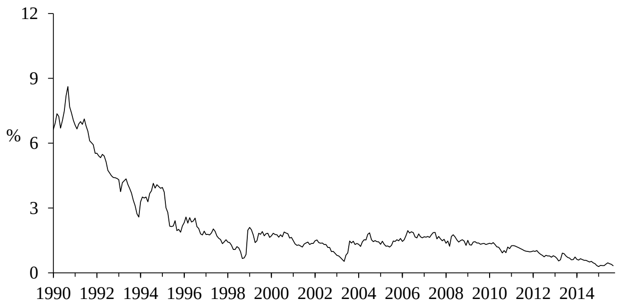


Germany: Yield on Public Authority Bonds

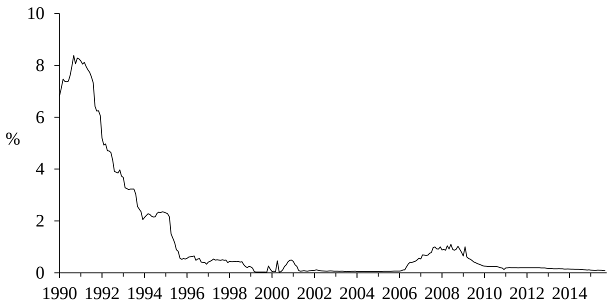
Germany : 3-Month Interbank Deposit Rate



Japan: Yield on Long-Term Government Bonds

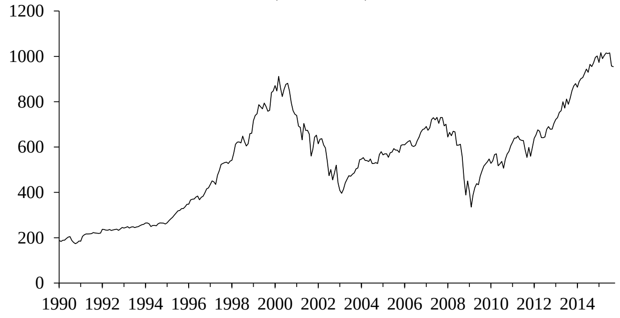


Japan : 3 Month Money Market Rate

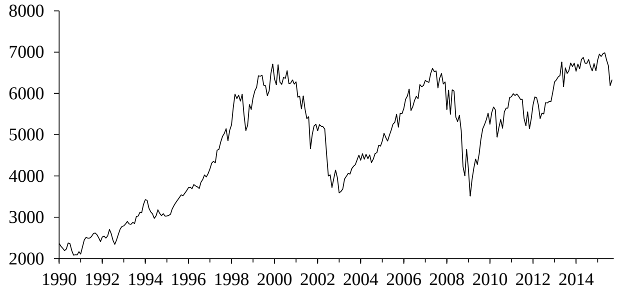


MAJOR EQUITY MARKETS

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

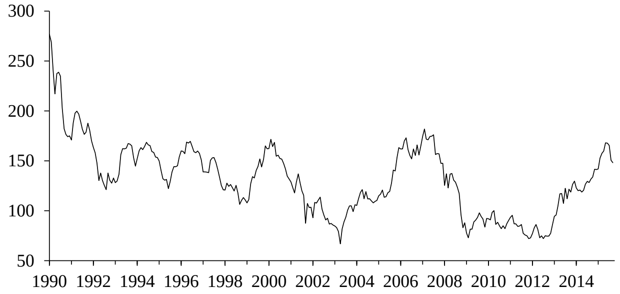


U.K. : FTSE-100 Index
(10 April 1962=100)



Germany : DAX 30

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



EMERGING MARKETS

Anupam Rastogi

India

India registered 7% growth in the second quarter of 2015 and is expected to achieve 7.4% growth in fiscal year 2015–16. In the next fiscal year growth is likely to be around 8%. The probability of a better rainfall following a below average rainfall in the current year would see rebound in domestic consumption.

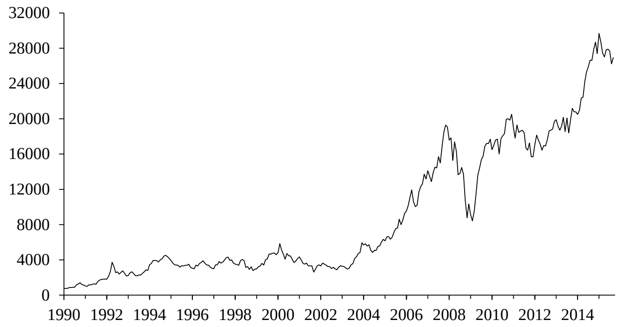
Retail inflation for the month of August was 3.66%, marginally lower than 3.69% in July. Wholesale inflation contracted sharply for the 10th straight month to −4.95% in August versus −4.05% in July influenced by global deflationary trend in commodity prices. The Reserve Bank of India (RBI) expects inflation to be 5.8% by January 2016, which is below its target of 6%.

The RBI cut the benchmark repo rate by 50 basis points to a four-year low of 6.75%. The rate cut, the fourth this year, will help boost economic growth, which showed signs of slowdown in the June quarter. The rationale provided by the central bank governor, Raghuram Rajan, is that a consistent downtrend in the consumer inflation in the recent months made the conditions right for the rate cut. Further, given the deflationary bias due to falling commodity prices and falling international demand, the central bank will follow accommodative monetary policy to support economic growth and domestic demand. However, further accommodation would be data dependent.

India registered a 20.6% fall in exports in August from a year earlier. India’s current account deficit (CAD) narrowed to US$ 6.2 billion (1.2 % of GDP) in Q1 of 2015–16 from US$ 7.8 billion (1.6 % of GDP) a year ago, while it widened from 0.2% of GDP of previous quarter, reflecting the worsening global economy as exports were sluggish while foreign investments fell.

Prime Minister Mr Modi visited the US ostensibly to attend the UN General Assembly but the visit was mostly commercial. Along with his digital theme, he pushed his “Make in India” campaign which aims to boost manufacturing investment to create millions of jobs in India. In the Silicon Valley of the US, Google confirmed plans to launch free WiFi in 500 Indian railway stations, and Microsoft pledged to help bring low-cost broadband to 500,000 Indian villages.

India: BSE Sensitive



India had one of best FDI growth rates in 2014 when many major destinations posted declines and with midyear data on greenfield FDI now in, 2015 looks to be a milestone year for India following its impressive performance in 2014. It has more than doubled its midyear investment levels, attracting $30bn by the end of June 2015 compared with $12bn in the first half of last year. There is no doubt that it is very hard to penetrate the Indian market and it is difficult to do business in India. But as the government keeps reducing red tape, there is huge opportunity for US companies and US start-ups and that is what FDI wants to achieve.

To shore up portfolio investment, India announced that it wouldn’t go through with plans to apply a controversial tax to international portfolio investors. The announcement will help address the concerns of foreign institutional investors, who pulled a total of $2.5 billion out of Indian stocks in August 2015. That was one of the largest monthly withdrawals from the market since the global financial crisis.

	13-14	**14-15**	**15-16**	**16-17**	**17-18**
GDP (%p.a.)	6.9	7.3	7.4	8.0	8.5
WPI (%p.a.)	7.0	6.0	5.2	4.2	4.0
Current A/c(US$ bill.)	-50.0	-34.0	-24.0	-28.0	-32.0
Rs./$(nom.)	60.0	62.0	65.5	66.0	67.0

China

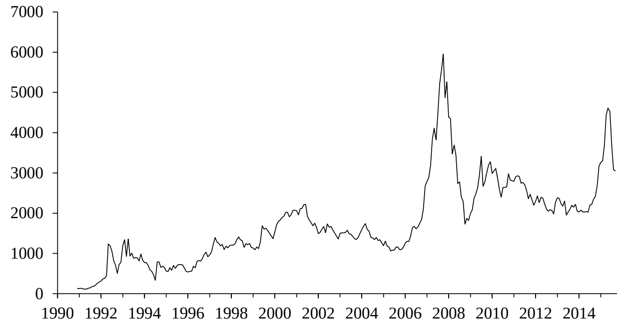
Given the difficulty of forecasting the Chinese economy, once again there is a wide range of economic growth predictions. It ranges from 3.7% by the Lombard Street Research to 7% by the Asian Development Bank for 2015. We predict that China will grow 6.3%, roughly half a percent lower than our earlier prediction of 6.8% in 2015. The reason for such a dispersion is due to accounting of financial services in the first and second quarters which have fallen off the cliff subsequently.

China is trying very hard to shift its economy from an export oriented Juggernaut to a domestically driven economy. It will achieve its goal and growth will decelerate gradually. China's industrial production grew 6.1% year-over-year in August, according to the National Bureau of Statistics of China which was marginally faster than July's 6.0% level. But, Caixin's purchasing manager index for manufacturing for September came out to be at 47, suggesting a contraction in the manufacturing sector. Retail sales in China increased by a better-than-expected 10.8% year-over-year in August, accelerating from a 10.5% year-over-year increase in July.

Global investors have adopted an excessively negative view of China's prospects in the wake of the mid-June stock market collapse and the unexpected devaluation of its currency in August. We do not share this view. China's exports dropped 5.5% in August from a year earlier. Meanwhile, China's imports dropped 13.8% in August after decreasing 8.1% on year in July. The trade surplus has widened to $60.2 billion in August from $43.03 billion in July. The trade surplus is at a new historical high, but this is mainly due to weak imports, driven by global commodity price decline. The impact of the August yuan devaluation is limited as it takes about six months for the yuan's movement to affect exports.

The yuan has fallen by about 2.9% against the dollar but it is just 1.5% lower against the U.S. dollar when adjusted for inflation. On a nominal basis, Beijing's depreciation was more about addressing a key concern for the International Monetary Fund as it considers whether to include the Chinese yuan in its basket of currencies that comprise its lending reserves than it was about boosting exports and revive economic growth. Therefore, we do not expect a further big move in yuan this year. An official devaluation of the yuan would be an admission by China that their economic shift from export-led economy to a domestic consumption led economy has failed. China is keen to join the SDR club despite a tough deadline. The SDR basket is subjected to a review every five years and IMF officials have repeatedly said they are committed to concluding the current iteration by the end of this year.

China: SSE Composite Index



China's $6.5tn onshore bond market has become an increasingly important funding source for the country's banks and companies in recent years, but foreign fundraising and investment in the market has been severely limited. That is changing as Beijing strives to promote international use of the yuan and win the International Monetary Fund's endorsement of the yuan as an international reserve currency. HSBC and an offshore unit of Bank of China will be the first foreign commercial banks to issue bonds in China, a milestone for the internationalization of the yuan and the opening of the country's capital markets. The People's Bank of China has approved HSBC's Hong Kong unit and Bank of China (Hong Kong) to sell Rmb1bn ($157m) and Rmb10bn, respectively.

In 2005, the PBoC allowed the International Finance Corporation to sell the so called panda bonds. The Asian Development Bank followed in 2013. In March 2015, German automaker Daimler became the first foreign non-financial company to sell bonds in China.

Standard & Poor's Ratings Services said it has revised its assessment of the economic risks facing China's banking industry to negative from stable.

China is about to unveil a new Five-Year Plan development blueprint from 2016 to 2020. For China's industrial sector, it may auger a five-year pain. Environmental initiatives are likely to be among the most emphasized portions of the Five-Year Plan and are likely to carry some of the most aggressive targets. The need for such reforms is evident and pollution represents one of the populace's greatest complaints.

	13	**14**	**15**	**16**	**17**
GDP (%p.a.)	7.7	7.4	6.3	6.0	6.0
Inflation (%p.a.)	3.5	2.0	1.3	1.5	2.0
Trade Balance(US$ bill.)	260	382	550	420	400
Rmb/$(nom.)	6.2	6.2	6.4	6.5	6.6

South Korea

GDP growth of South Korea slowed to 2.2% in the second quarter and as exports are unlikely to pick up in coming months, GDP growth is expected to fall below 2% in 2015. In July, industrial output fell 3.3% from a year earlier. Inflation remained benign at 0.7% in August, helped by lower oil prices.

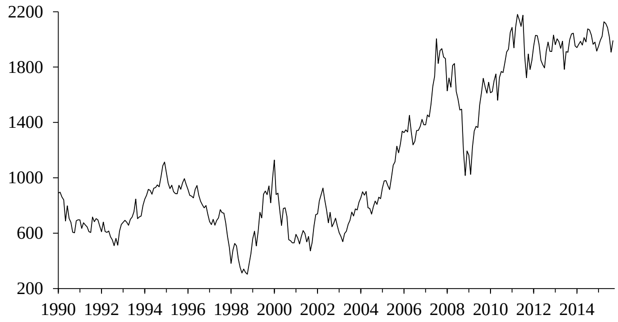
Korea has cut next year's economic growth forecast to 3.3% from 3.5% previously due to the deterioration of the Chinese economy. We expect GDP growth in 2016 to be just 2.5%. The central bank in June slashed the base rate for a second time this year to a record-low 1.5%.

Concerns about the Chinese economy are particularly acute in Korea, because South Korea sends around a quarter of its overseas shipments to China. South Korean exports fell 14.7% from a year earlier in August — the sharpest drop in six years — as exports to China slid 8.8%. Close trade inter-linkage between China and South Korea also means a sharp deterioration of the Chinese economy would have an adverse impact on South Korea in the coming quarter.

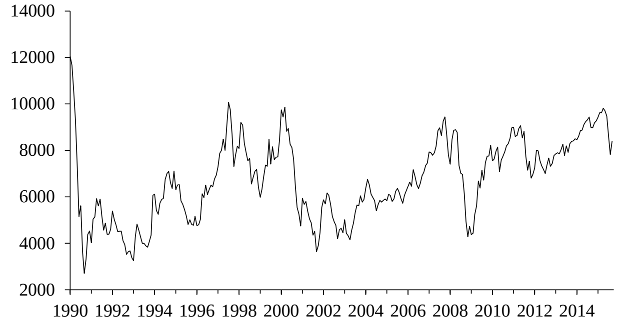
South Korea's economic squeeze is affecting employment of senior managers. Hundreds of top-ranked positions have been eliminated by the country's biggest companies over the past 18 months, as an export dip slowed growth rates. It does not augur well for the economy if Korea is not able to regain its competitiveness against Japanese and Taiwanese products.

	13	14	15	16	17
GDP (%p.a.)	3.0	3.3	1.9	2.5	2.5
Inflation (%p.a.)	1.3	2.0	0.7	1.8	2.0
Current A/c(US$ bill.)	71.0	80.0	90.0	88.0	88.0
Won/$(nom.)	1100	1080	1180	1200	1220

Korea: Composite Index



Taiwan: Weighted TAIEX Price Index



Taiwan

Taiwan's GDP growth for 2015 is unlikely to achieve the earlier prediction of 1.8% due to worsening exports to China. We predict that Taiwan would be able to grow 1% in 2015 and 1.6% in 2016. The government hopes that Taiwan's GDP growth for 2016 will grow 2.7%. Industrial production contracted 5.5% in the year to August and exports fell more than 8% over the same period. The Taiwan dollar has depreciated less rapidly than either the Korean won or until recently, the Japanese yen, giving manufacturers from those countries an advantage over their Taiwanese producers. Inflation in Taiwan remains very subdued.

In order to boost domestic consumption, Taiwan's central bank cut its benchmark interest rate for the first time in more than six and a half years. With elections looming next January and the opposition leading in the opinion polls, the central bank was under pressure from government to do something to shore up growth. The bank has reduced rates by 12.5 basis points to 1.75%. Would it help in increasing business investment or household consumption, is doubtful. The weak outlook on Taiwan's growth and inflation suggests another reduction in borrowing costs in December.

	13	14	15	16	17
GDP (%p.a.)	2.1	3.7	1.0	1.6	2.0
Inflation (%p.a.)	1.2	1.5	0.0	1.0	1.0
Current A/c(US$ bill.)	50.6	57.4	60.0	64.0	68.0
NT$/$(nom.)	30.0	31.0	32.8	33.0	32.0

Brazil

The Brazilian economy seems to be in a free-fall. Its GDP is expected to contract 2.7% in 2015 and consumer inflation growing at 9.4%. In 2014, the economy expanded just 0.1%. There may be some respite from inflation next year as it drops to around 6% if the central bank keeps its word and fights inflation by keeping the Selic rate at 14.25%, and reduce it as inflation comes under control.

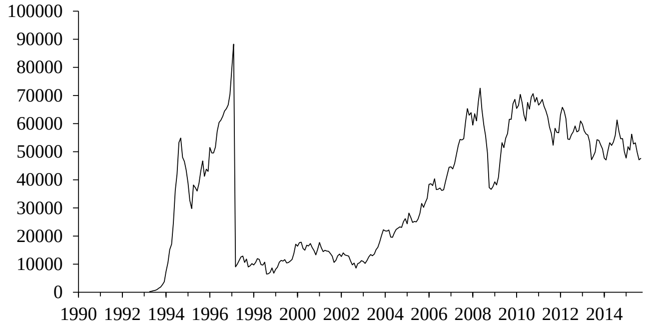
Consumer confidence in Brazil fell to the lowest level ever in September, as the country's economic conditions show no signs of recovery.

After Standard & Poor's Ratings Services downgraded the country's rating to below investment grade, Brazil announced new austerity measures which shall bridge the gap in its budget to $17 billion. The central bank would now be monitoring "structural primary result," which is the primary deficit minus one-off revenue sources such as sales of government assets. Turning it into a surplus would be the main aim of controversial austerity measures for federal lawmakers.

Brazil's real which is the worst performer of any major global currency so far this year, hit a new low of 4.24 reals per dollar in the last week of September. It recovered from the low but remains under pressure. The real has lost around 35% of its value this year.

In the eighth consecutive monthly increase, the unemployment rose to 7.6% in August and political pressure is brewing to impeach President Dilma Rousseff.

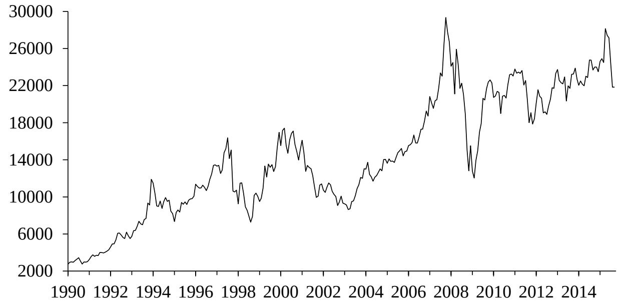
Brazil: Bovespa



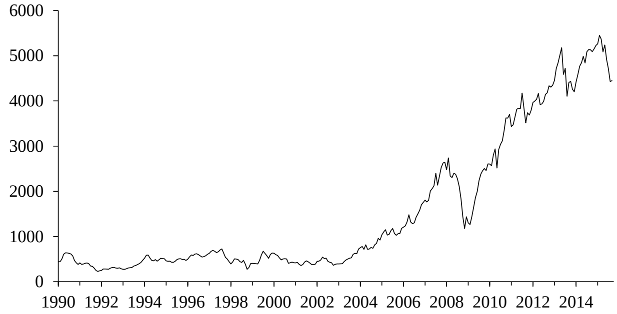
	13	**14**	**15**	**16**	**17**
GDP (%p.a.)	2.5	0.1	-2.7	0.0	1.2
Inflation (%p.a.)	5.9	6.5	8.2	6.8	6.0
Current A/c(US$ bill.)	-75.0	-104.0	-90.0	-90.0	-95.0
Real/$(nom.)	2.3	2.4	3.9	4.0	4.0

Other Emerging Markets

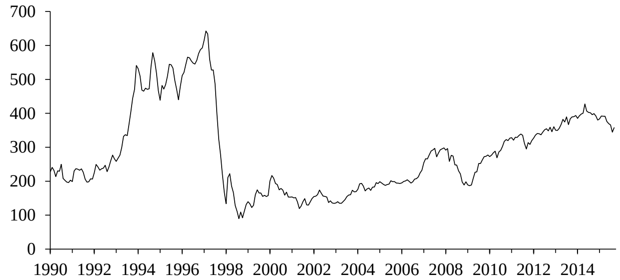
Hong Kong: FT-Actuaries



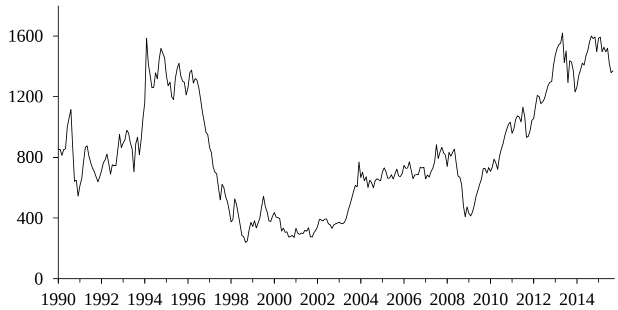
Indonesia: Jakarta Composite



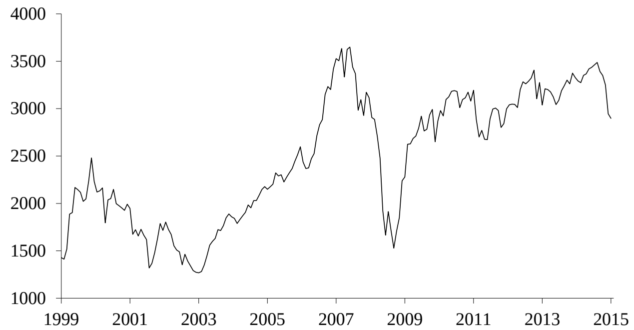
Malaysia: FT-Actuaries (US$ Index)



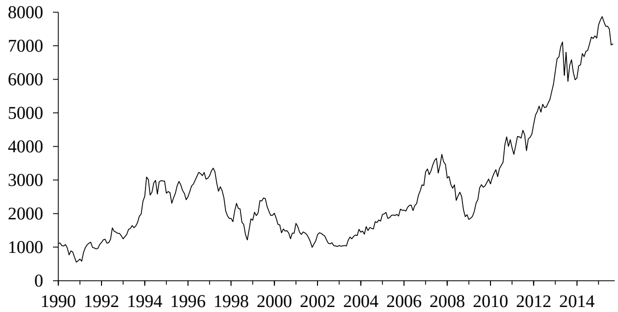
Thailand: Composite Index



Singapore: Straits Times Index

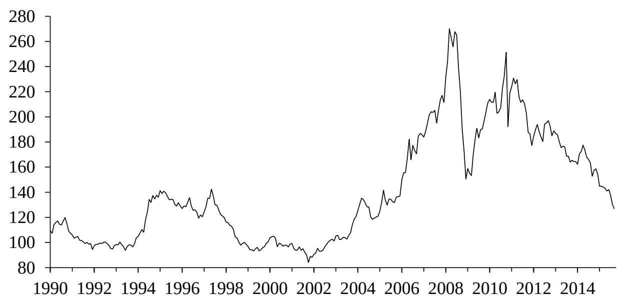


Philippines: Manila Composite

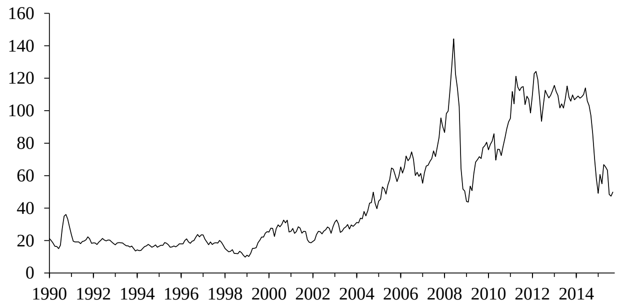


COMMODITY MARKETS

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

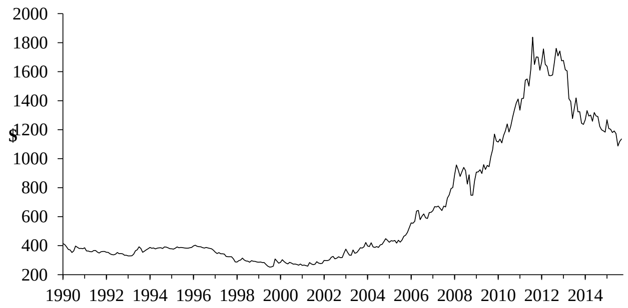


Oil Price: North Sea Brent (in Dollars)

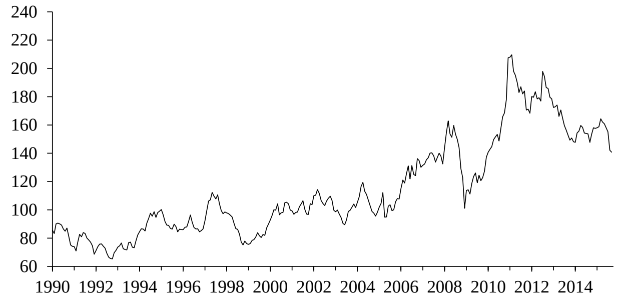


Commodity Price Index (Sterling)
(Economist, 2000=100)

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]
2013	1.9	1.3	0.6	81.6	85.6	-1.3	3.1	-0.2
2014	1.6	1.8	0.6	87.1	92.0	-1.0	2.4	0.2
2015	0.6	1.8	0.6	90.7	95.6	-1.0	1.6	-0.1
2016	1.6	2.2	1.0	90.8	95.8	-0.7	2.4	0.3
2017	1.7	2.5	1.6	90.7	95.8	-0.4	2.5	0.4
2018	2.0	2.5	2.1	90.3	95.8	0.0	2.7	0.2
2013:1	1.9	1.0	0.6	80.5	84.1	-1.1	3.3	-0.8
2013:2	1.7	0.9	0.5	80.7	84.2	-1.5	3.1	-0.9
2013:3	2.1	1.5	0.5	81.4	85.3	-1.4	3.2	-0.2
2013:4	1.9	1.7	0.5	83.7	88.7	-1.1	2.7	0.4
2014:1	1.7	1.8	0.6	85.7	90.6	-1.2	2.7	0.7
2014:2	1.8	1.9	0.6	87.1	91.6	-1.0	2.6	1.0
2014:3	1.6	1.9	0.6	88.2	93.0	-0.7	2.5	1.2
2014:4	1.3	1.4	0.5	87.5	92.9	-1.0	2.0	0.6
2015:1	0.1	1.8	0.5	91.0	95.4	-1.1	1.3	0.7
2015:2	0.5	1.6	0.6	90.6	95.4	-1.1	1.6	0.3
2015:3	0.8	1.8	0.7	90.8	96.0	-0.9	1.8	0.3
2015:4	1.0	2.0	0.8	90.5	95.7	-0.9	1.9	0.3

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

Labour Market and Supply Factors (Seasonally Adjusted)

	Average Earnings (1990=100)[1]	Wage Growth[2]	Unemployment (New Basis) Percent[3]	Millions	Real Wage Rate[4] (1990=100)
2013	238.6	1.1	4.2	1.4	132.1
2014	241.6	1.3	3.0	1.0	131.6
2015	247.5	2.4	2.2	0.8	134.1
2016	255.3	3.2	2.0	0.7	136.1
2017	262.9	3.0	1.9	0.7	137.8
2018	270.9	3.0	1.7	0.6	139.2
2013:1	236.8	0.6	4.6	1.5	131.6
2013:2	240.7	2.3	4.4	1.5	133.3
2013:3	239.0	0.8	4.1	1.4	134.0
2013:4	238.0	1.1	3.7	1.3	134.7
2014:1	241.4	1.9	3.4	1.2	132.4
2014:2	240.4	-0.1	3.1	1.1	131.2
2014:3	241.5	1.0	2.8	1.0	131.3
2014:4	243.0	2.1	2.6	0.9	131.6
2015:1	245.7	1.8	2.3	0.8	134.6
2015:2	245.9	2.3	2.2	0.8	133.5
2015:3	247.6	2.5	2.2	0.8	133.6
2015:4	250.8	3.2	2.1	0.7	134.5

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
2013	149.7	716792.3	422942.6	280112.3	186839.5	-43986.8	129115.4
2014	153.9	737015.5	427963.1	304158.8	190713.6	-49433.4	136386.5
2015	158.6	759444.4	437481.6	315661.6	193150.9	-45651.0	141194.8
2016	162.6	778752.4	447600.9	324004.5	197878.0	-45648.1	145082.7
2017	166.5	797118.0	458510.3	331200.7	201835.6	-45657.5	148775.7
2018	170.4	815975.2	469801.9	338544.2	205872.3	-45677.8	152572.1
2013/12	1.7		0.8	6.9	-0.8		6.5
2014/13	2.8		1.2	9.2	2.1		6.0
2015/14	3.0		2.2	3.8	1.3		3.6
2016/15	2.5		2.3	2.6	2.4		2.8
2017/16	2.4		2.4	2.2	2.0		2.5
2018/17	2.4		2.5	2.2	2.0		2.6
2013:1	148.3	177519.5	105980.9	63263.4	48156.3	-9136.5	30744.6
2013:2	149.2	178660.4	105506.8	65944.1	45724.2	-8941.9	29572.8
2013:3	150.3	179940.8	105672.5	73909.9	46393.6	-13073.1	32962.1
2013:4	150.9	180671.6	105782.4	76994.9	46565.5	-12835.3	35835.9
2014:1	152.2	182265.5	106436.3	74892.1	48266.6	-12641.4	34688.1
2014:2	153.5	183784.4	106421.7	75257.3	46811.9	-12072.8	32633.8
2014:3	154.5	184921.4	106888.2	77659.4	47749.3	-13346.2	34029.3
2014:4	155.4	186044.2	108216.9	76350.0	47885.7	-11373.0	35035.4
2015:1	157.1	188027.6	108559.6	76022.9	49960.4	-11418.3	35097.0
2015:2	158.9	190219.7	109098.3	80639.9	47084.9	-11415.5	35185.9
2015:3	159.0	190337.9	109639.8	79590.1	47855.5	-11410.3	35336.8
2015:4	159.4	190859.2	110183.9	79408.7	48250.2	-11407.0	35575.2

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)
2013	6.0	1550.9	92.5	47.1	-65.9
2014	5.5	1615.2	88.6	51.8	-84.2
2015	5.0	1679.3	84.0	53.9	-77.8
2016	4.6	1752.9	79.6	57.6	-78.2
2017	3.2	1827.4	58.7	62.4	-78.8
2018	2.1	1909.0	39.1	65.4	-79.5
2013:1	3.5	373.6	13.3	11.9	-14.1
2013:2	8.0	374.9	30.0	11.2	-8.4
2013:3	5.0	385.5	19.3	11.5	-22.2
2013:4	8.3	394.8	32.7	11.9	-21.1
2014:1	2.7	395.7	10.6	12.4	-17.7
2014:2	7.8	396.7	31.0	12.8	-21.0
2014:3	4.9	402.8	19.6	13.0	-23.8
2014:4	7.1	408.3	29.2	13.1	-21.8
2015:1	2.1	407.4	8.7	12.9	-16.0
2015:2	8.6	415.2	35.8	13.2	-19.9
2015:3	4.3	418.5	17.8	13.4	-20.2
2015:4	8.0	422.4	33.7	13.7	-21.7

1 GDP at market prices (Financial Year)

WORLD FORECAST DETAIL

Growth Of Real GNP

	2011	2012	2013	2014	2015	2016
U.S.A.	1.6	2.3	2.2	2.3	3.0	3.0
U.K.	1.6	0.7	1.7	2.8	3.0	2.5
Japan	–0.4	1.7	1.6	0.3	1.2	1.7
Germany	3.6	0.4	0.1	1.4	1.7	1.8
France	2.1	0.4	0.4	0.4	0.8	1.3
Italy	0.6	–2.3	–1.9	–0.3	0.4	1.0

Real Short-Term Interest Rates

	2011	2012	2013	2014	2015	2016
U.S.A.	–1.5	–1.5	–1.5	–1.6	–1.4	–0.5
U.K.	–2.4	–1.1	–1.3	–1.0	–1.0	–0.7
Japan	–0.9	–1.3	–1.6	–1.6	–1.7	–1.8
Germany	0.1	–0.7	–1.2	–1.4	–1.4	–1.8
France	0.6	0.0	–0.6	–0.9	–1.3	–1.7
Italy	0.4	0.0	–0.6	–1.0	–1.4	–1.7

Real Long-Term Interest Rates

	2011	2012	2013	2014	2015	2016
U.S.A.	0.0	–0.1	1.1	0.3	0.2	0.8
U.K.	0.2	–0.8	–0.2	0.2	–0.1	0.2
Japan	–0.8	–1.1	–1.3	–1.6	–1.6	–1.5
Germany	0.0	–0.3	–0.9	–1.4	–1.7	–1.4
France	0.2	–0.1	–0.7	–1.3	–1.6	–1.4
Italy	0.1	–0.2	–0.7	–1.3	–1.6	–1.4

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

	2011	2012	2013	2014	2015	2016
U.S.A.	79.8	81.6	82.1	83.0	83.2	83.0
U.K.	88.7	92.4	81.6	87.1	90.7	90.8
Japan	80.6	79.6	63.5	61.1	60.7	60.4
Germany	100.1	96.7	99.0	100.5	100.2	100.5
France	102.9	99.5	100.7	101.7	101.4	101.7
Italy	107.2	105.2	106.9	107.8	107.0	107.3

[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

	2011	2012	2013	2014	2015	2016
U.S.A.	3.1	2.1	1.5	1.7	0.5	2.0
U.K.	3.5	2.1	1.9	1.6	0.6	1.6
Japan	–0.3	0.0	0.4	2.8	1.0	1.4
Germany	2.1	2.0	1.5	1.0	0.5	1.7
France	2.1	2.0	0.9	0.6	0.2	0.1
Italy	2.8	3.0	1.2	0.2	0.2	0.6

Nominal Short-Term Interest Rates

	2011	2012	2013	2014	2015	2016
U.S.A.	0.1	0.1	0.1	0.1	0.6	1.5
U.K.	0.9	0.9	0.6	0.6	0.6	1.0
Japan	0.2	0.2	0.2	0.1	0.2	0.2
Germany	1.4	0.6	0.2	0.2	0.1	0.1
France	1.4	0.6	0.2	0.2	0.1	0.1
Italy	1.4	0.6	0.2	0.2	0.1	0.1

Nominal Long-Term Interest Rates

	2011	2012	2013	2014	2015	2016
U.S.A.	1.9	1.8	3.0	2.2	2.2	2.8
U.K.	2.0	0.9	1.3	1.8	1.8	2.2
Japan	1.0	0.8	0.7	0.3	0.4	0.5
Germany	1.8	1.5	1.0	0.5	0.3	0.6
France	1.8	1.5	1.0	0.5	0.3	0.6
Italy	1.8	1.5	1.0	0.5	0.3	0.6

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

	2011	2012	2013	2014	2015	2016
U.S.A.[1]	78.08	80.90	86.00	89.40	100.50	100.00
U.K.	1.61	1.59	1.55	1.65	1.50	1.50
Japan	79.36	80.51	98.20	106.70	120.00	120.50
Eurozone	0.71	0.78	0.75	0.76	0.90	0.91

[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