LIVERPOOL INVESTMENT LETTER

September 2012

Cardiff Business School
Cardiff University

Julian Hodge Institute of Applied Macroeconomics

LIVERPOOL RESEARCH GROUP IN MACROECONOMICS

LIVERPOOL RESEARCH GROUP IN MACROECONOMICS

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The Liverpool Investment Letter is written by Patrick Minford and John Wilmot, 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.

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The UK economy remains mired in weak growth, even if the ONS figures for GDP will certainly be revised upwards in time to show there was no 'double dip'; the statisticians should develop cross-checks with other data like employment through some sort of data modelling and accounting. To get growth going in the UK, when the traditional EU market is in disarray and world growth elsewhere is slowing, there should be an overhaul of policy towards business especially banking business. The crisis has turned the UK government into a nanny state. It needs to de-nannify and set the banking sector free again — it could start by burying Vickers and selling off parts of the state-owned banks to create smaller competing banks.	
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THE PHONEY WAR

The latest statistics on GDP, employment and unemployment, business surveys and most recently public sector borrowing have created an unending debate between supporters of Plan A and those who want to see 'Plan A abandoned' in favour of extra spending on infrastructure. Yet there is no real controversy here. The truth is that worthwhile infrastructure projects with a good long-term return are always welcome. Traditionally they are entered in the public accounts below the line, so recognising that they are a) temporary and b) to some degree self-financing in the intertemporal government budget constraint.

What Plan A rules out is permanent extra spending and capital spending with no proper return. It therefore cannot be 'general stimulus' which often in practice seems to amount to printing as much money through QE as left-wing politicians are demanding. The trouble is that such infrastructure spending would probably be going on anyway under existing plans. The main difficulty at present with infrastructure spending is that the coalition government cannot agree on what is necessary — witness disputes over HS2 (clearly about to be dropped as the white elephant it is) and the third runway at Heathrow.

The economy itself is growing weakly; GDP figures will eventually be revised upwards to reflect this. There has been no 'double-dip'. This weak growth comes three years after the end of the recession proper and it is astonishing that people are still calling for continuously loose monetary policy. Macroeconomic theory and the models we have that fit the facts suggest that monetary policy moves lose effects on output once they are well-anticipated and long standing. Instead if they affect anything, they affect prices.

In the present context, it seems that they are not affecting anything since as fast as QE money is printed it winds up in the Bank of England as bankers' balances. Banks are unwilling to make extra loans except to non-risky borrowers (i.e. some large companies) who have no demand for it, enjoying surplus cash and with low investment plans. When it comes to SMEs the new capital regulations force large costs on banks if they lend.

But while QE has not affected bank lending and therefore has failed to increase the money supply, and by implication has not reduced the cost of credit, it has succeeded in reducing the returns to savers. This has happened two ways. First, QE has added massively to demand for gilts, taking by now nearly 40% of available gilts, even after the large increase in public issue to meet its borrowing; this demand from the Bank must have driven down the yield to persuade institutions that would normally require gilts for their balance sheet ratios to part company with them. Secondly, QE has driven down the banks' cost of funds and hence its offers of returns to savers.

Table 1: Summary of Forecast

		2010	2011	2012	2013	2014	2015	2016
GDP Growth[1]		2.1	0.7	0.8	2.0	2.3	2.5	2.6
Inflation	CPI	4.1	3.9	2.8	2.3	2.0	2.0	2.0
	RPIX	4.8	5.3	3.5	2.9	2.7	2.7	2.7
Unemployment (Mill.)								
	Ann. Avg.[2]	1.5	1.5	1.5	1.3	1.2	1.2	1.2
	4th Qtr.	1.5	1.6	1.5	1.3	1.2	1.1	1.1
Exchange Rate[3]		80.4	79.9	81.7	81.5	81.0	80.7	80.5
3 Month Interest Rate		0.7	0.9	1.2	1.4	2.1	2.5	2.5
5 Year Interest Rate		2.4	2.0	1.6	2.4	2.6	2.8	2.8
Current Balance (£bn)		–48.6	–29.0	–31.6	–32.5	–32.3	–32.2	–32.0
PSBR (£bn)		110.3	120.1	107.6	97.1	58.0	36.3	20.3

[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)

This distortion of the savings market is further encouraged by the very low Bank Rate. Banks can obtain funds from the Bank at this rate, and their bankers' balances also attract a rate related to this. Thus this is the rate at which the massive QE is available to the banks as a funding source. Yet the banks will not lend it to extra (i.e. SME) borrowers because of other regulatory costs. Hence what this QE and low Bank Rate do is to depress what they offer to savers, and build up bank profit margins on existing business.

So we now have a monetary policy that is not boosting output via increased lending and lower lending rates, but is depressing returns to savers, and with it the cost of funds to the government. This is essentially what 'financial repression' does in developing countries via controls designed to force savings resources cheaply to government. Here the repression is occurring through the new controls on banking, combined with the massive printing of (government-backed) money.

The Treasury has begun to realise that its new banking regulations are causing these effects and its latest gambit has been the new Incentives for lending scheme, under which 'extra lending' is rewarded by the government/Bank with a subsidy to the cost of bank funds. There is no reason to believe this bureaucratic scheme will work to expand lending, as opposed to expanding 'extra lending' as lending that would have occurred anyway will be diverted into the scheme.

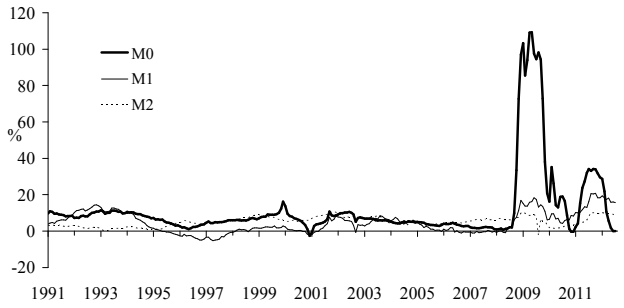
Unfortunately the only way to reverse the malign effects of the new bank regulation is to reverse the regulations themselves. Furthermore, to force the banks to compete and not to continue as an effective cartel, with only a few players, the government should force the break-up of RBS and Lloyds into several competing units; it should not hang on to its stakes in their present form and build up their profits for a share sale. It would be better to have less

capital return and a growing economy with a healthy credit supply.

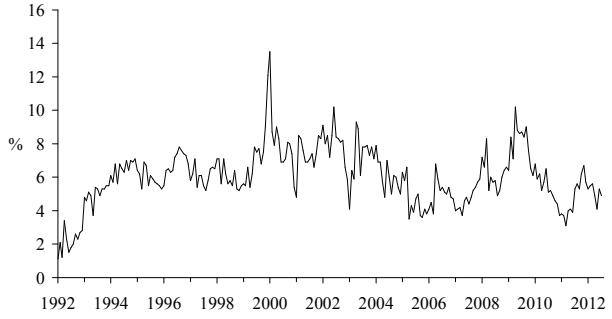
Alas, in the present political climate both in and outside the coalition, these actions are not likely. So the economy is stuck with a distorted savings market, a controlled credit supply, and an impotent monetary policy.

Our recommendations for monetary policy are first for bank regulations to be greatly eased and the banks broken up. But second, whether this is done or not (as seems more likely), interest rates should be raised and QE reversed to remove the distortion from the savings market.

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

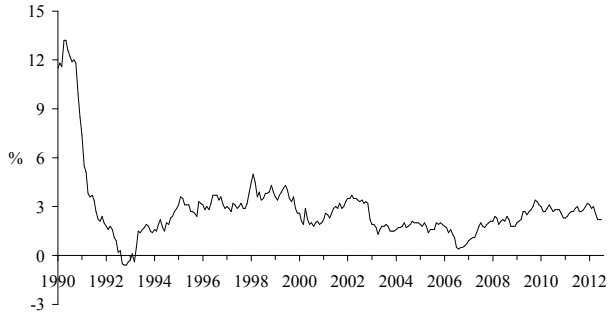


UK: Notes and Coins in Circulation Growth



Eurozone M3 Growth

Japan: Growth of M2+CD's



FOCUS ON JAPAN

Francesco Perugini

Japan GDP points to a slowdown

Japan's Gross Domestic Product (GDP) grew 0.3% over the previous quarter during the April–June period for the fourth straight quarter but less than the median forecast of 0.6% growth and sharply below the revised 1.3% expansion of the January–March period.

The unexpected growth deceleration is mainly related to the cooling of global demand which has weighed on the nation's exports and to lower domestic demand. During the previous quarters, domestic demand has been boosted by reconstruction spending following the earthquake in March 2011. This can be most clearly seen in public investment, which grew by 3.6% in Q1 and slowed to 1.7% in Q2, and in household consumption, which grew by 1.2% in Q1 stimulated by the reintroduction of subsidies for eco-friendly cars and slowed to just 0.1% in Q2.

Meanwhile, exports grew by 1.2% in Q2, compared with 3.4% in Q1. The latter was partly due to a rebound in exports following the disruptions caused by the flooding in Thailand. However, it is also related to the slowing of world trade. In Q1, world exports increased by 1.5%, whereas in May the three-month growth slowed to 0.9%. As Japanese imports only slowed to 1.6% in Q2 (from 2.2% in Q1), the net contribution of foreign trade turned marginally negative (0.1 percentage points).

Despite the slowdown Motohisa Furukawa, the economy minister, expected growth to hold up into the next quarter. "Japan's economic growth should continue in a gradual uptrend, supported by construction demand", he said at a recent press conference after the data release. More cautious were authorities at the Bank of Japan (BOJ). During the last board meeting, the BOJ cut its outlook for exports and output, citing global economic risks, and it signalled that it was ready to stimulate again if needed. "Japan's economic activity has started picking up moderately as domestic demand remains firm mainly supported by reconstruction-related demand," the bank said in a report, even as it added that there "remains a high degree of uncertainty about the global economy."

Forecasters expect the pace of recovery to slow in the second half of this year. According to the average estimates of 10 economists surveyed by The Nikkei, a leading economic newspaper, the economy will grow by 0.2% in the July–September quarter and 0.1% in the subsequent three-month period, which means a 2.6% GDP growth for this year. They see support from fiscal policy gradually decreasing from now on and personal spending slipping in the October–December period. With subsidies for environmentally friendly cars expected to run out this month or next — this one-off measure helped to spark an unusual 53% increase in car sales in the first seven months of the year — they predict individual consumption will shrink 0.3% in the next quarter. "A drop in car sales cannot be avoided because demand was propped up by the subsidies", said Yoshiki Shinke of the Dai-ichi Life Research Institute.

In autumn and beyond, economic growth will depend on whether foreign demand can offset weak consumption in Japan. Asian production is falling gradually as a result of sluggish demand in Europe, which is still reeling from the debt crisis. Consequently, Japan's exports to China and other parts of Asia have slid. Especially hard hit were exports of machine tools. The value of orders from China, which accounts for 30–40% of exports from Japan, slipped 3% on the year in the April–June quarter. In June alone, the figure tumbled 18.5%. "European machine tool makers strengthened marketing in China and Southeast Asia" because of slow demand back home, said Yukio Iimura, president of Toshiba Machine Co. According to latest data, the rumbling debt crisis in Europe, the strong yen and slowing demand in Asia are taking their toll on the beginning of the second half of the year too. Japan's trade with the rest of the world in July showed a shortfall of ¥517.4 billion, the largest ever deficit for the month and nearly double the ¥275 billion deficit that analysts had forecast.

The key to future growth hinges on figuring out ways to orient growth with more supportive policy measures other than fiscal policy, given the country's high public debt/GDP ratio. Effectively this means supply-side measures that raise productivity and the rate of return on capital. The Japanese economy's potential growth rate has declined sharply over the years to an estimated 0.7% per annum, from roughly 2.5% in 1990, due to years of government protection of low-productivity sectors. Much has been asked of the BOJ but there is no support in macroeconomic theory or evidence for the idea that monetary policy can affect long-run growth. Unfortunately supply-side policy is code for more competition, less protection, less regulation, and the elimination of subsidies to loss-making firms. All these things are resisted by strong vested interests in Japan and have been for many years, at least since the 'bursting of the bubble' in 1989. It is difficult to see how this can change, given that Japan is an ageing society where the key (older) voters are against upheavals.

At the end of July, the Japanese government adopted a new strategy aimed at reviving the economy. It calls for average annual growth of 3% in nominal terms and 2% growth in real terms until fiscal 2020. Under its new economic strategy, the government aims to create more than 6.3 million jobs in areas such as medical care and energy. But

the authorities have yet to make any significant progress on regulatory reforms, and there is still no clear plan for following this new economic strategy. This is not surprising.

MARKET DEVELOPMENTS

Markets have stabilised in response to the comments of the ECB president, Mario Draghi, that the ECB would do 'what it takes' to save the euro. There was disappointment when it did not lead immediately to large-scale bond buying but that was not the point. The point is that it makes clear that the ECB will be active in the markets as it sees fit. It has laid to rest the idea that the ECB 'could not buy bonds'.

The result of this is that the euro crisis is not over but has entered a new phase in which bond yields of southern euro countries will fluctuate in a range below some upper limit the ECB regards as dangerous. This phase will be easier for the rest of the world to live with. The eurozone will remain weak but will not threaten the implosion many have feared till now. We therefore continue to see a new normal of weak growth in the west which will weakly favour equities.

Table 1: Market Developments

	Market Levels		Prediction for Aug/Sep 2013	
	Jul 24	Aug 28	August Letter	Current View
Share Indices				
UK (FT 100)	5499	5776	8155	8508
US (S&P 500)	1338	1409	1519	1600
Germany (DAX 30)	6390	7003	8384	8977
Japan (Tokyo New)	718	746	866	893
Bond Yields (government long-term)				
UK	1.46	1.49	2.10	2.10
US	1.40	1.63	4.00	4.00
Germany	1.24	1.35	4.00	4.00
Japan	0.74	0.81	1.50	1.50
UK Index Linked	–0.11	–0.12	–0.40	–0.40
Exchange Rates				
UK ($ per £)	1.55	1.58	1.58	1.58
UK (trade weighted)	84.5	83.9	81.3	81.3
US (trade weighted)	82.4	80.6	80.5	80.5
Euro per $	0.83	0.80	0.79	0.79
Euro per £	1.28	1.26	1.25	1.25
Japan (Yen per $)	78.2	78.5	81.0	81.0
Short Term Interest Rates (3-month deposits)				
UK	0.85	0.73	1.40	1.40
US	0.50	0.50	0.60	0.60
Euro	0.40	0.20	2.50	2.50
Japan	0.25	0.33	0.40	0.40

Table 2: Prospective Yields [1]

Equities: Contribution to £ yield of:

	Dividend Yield	Real Growth	Inflation	Changing Dividend Yield	Currency	Total
UK	3.70	2.0	2.3	43.00		51.00
US	2.10	2.5	2.0	9.00	0.19	15.76
Germany	3.50	1.5	1.7	25.00	0.94	32.64
Japan	2.50	1.7	0.0	18.00	–2.99	19.21
UK indexed[2]	–0.12		2.2	–8.00		–5.82
Hong Kong[3]	2.70	7.5	2.0	–1.00	0.19	11.39
Malaysia	3.00	5.2	2.0	38.00	0.19	48.39
Singapore	3.60	4.4	2.0	22.00	0.19	32.19
India	1.60	6.5	2.0	4.00	0.19	14.29
Korea	1.20	3.5	2.0	–20.00	0.19	–13.11
Indonesia	2.40	6.5	2.0	33.00	0.19	44.09
Taiwan	3.70	3.5	2.0	26.00	0.19	35.39
Thailand	3.10	4.4	2.0	26.00	0.19	35.69

Bonds: Contribution to £ yield of:

	Redemption Yield	Changing Nominal Rates	Currency	Total
UK	1.49	–6.10		–4.61
US	1.63	–23.70	0.19	–21.88
Germany	1.35	–26.50	0.94	–24.21
Japan	0.81	–6.60	–2.99	–9.08

Deposits: Contribution to £ yield of:

	Deposit Yield	Currency	Total
UK	0.73		0.73
US	0.50	0.19	0.69
Euro	0.20	0.94	1.14
Japan	0.33	–2.99	–2.66

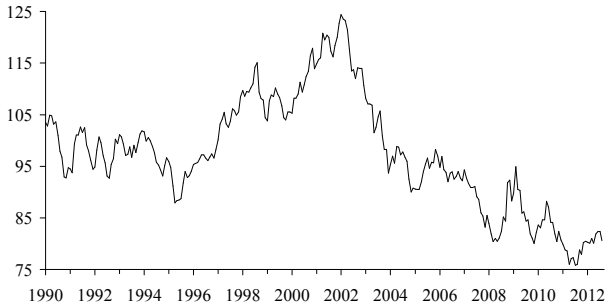
[1] Yields in terms of €s or $s can be computed by adjusting the £-based yields for the expected currency change.
[2] UK index linked bonds All Stocks
[3] Output based on China.

Table 3: Portfolio(%)

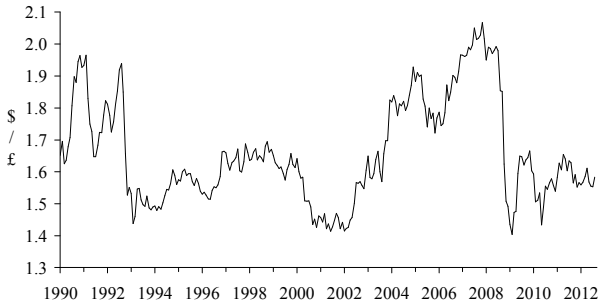
	Sterling Based Investor		Dollar Based Investor		Euro Based Investor	
	August Letter	**Current View**	**August Letter**	**Current View**	**August Letter**	**Current View**
UK Deposits (Cash)	10	10	10	10	1	1
US Deposits	-	-	-	-	-	-
Euro Deposits	-	-	-	-	-	-
Japanese Deposits	-	-	-	-	-	-
UK Bonds	-	-	-	-	-	-
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	3	3	3	3	3	3
Brazilian Shares	3	3	3	3	3	3
Chilean Shares	3	3	3	3	3	3
Mexican Shares	3	3	3	3	3	3
Peruvian shares	3	3	3	3	3	3
Other:						
Index-linked bonds (UK)	-	-	-	-	-	-

INDICATORS AND MARKET ANALYSIS
FOREIGN EXCHANGE MARKETS[1]

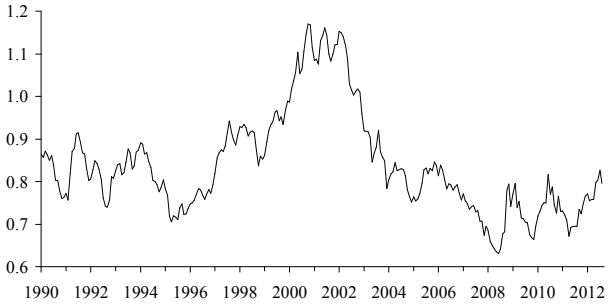
US : Trade Weighted Index
(Bank of England 1990 = 100)



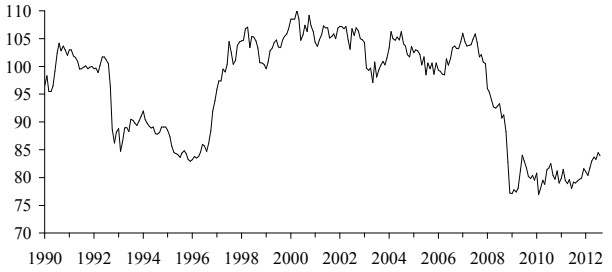
UK: Dollars Per Pound Sterling



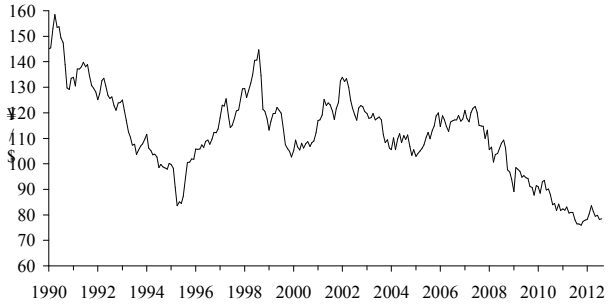
Euro per US dollar



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



Japan : Yen Per U.S. Dollar

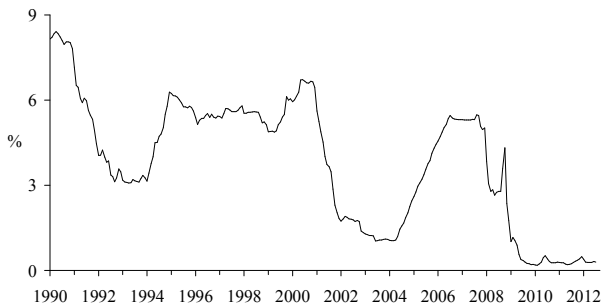


[1] John Wilmot, who has written these sections since this Letter began, is indisposed. We are issuing the charts without his commentary this month. We wish him a speedy recovery.

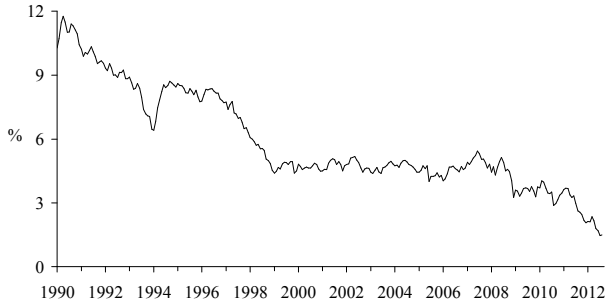
GOVERNMENT BOND MARKETS

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

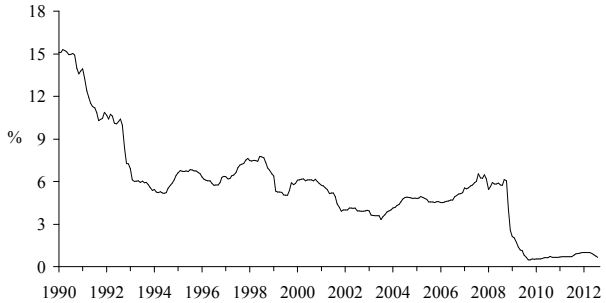
U.S. : 3-Month Certificate of Deposit



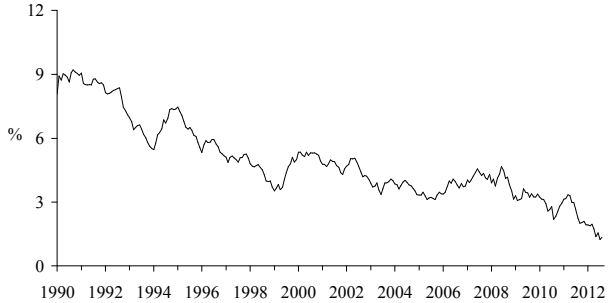
U.K. : Yield on Long-Term Government Bonds



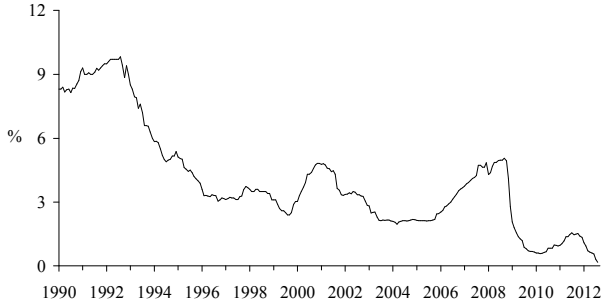
U.K. : 3-Month Interbank Rate



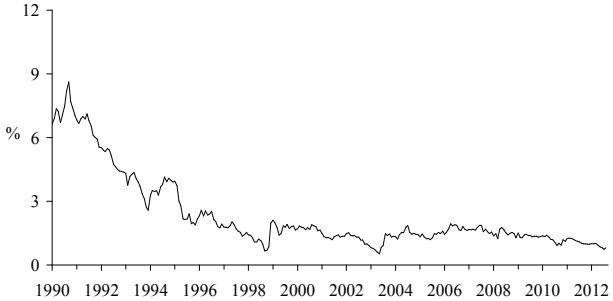
Germany: Yield on Public Authority Bonds



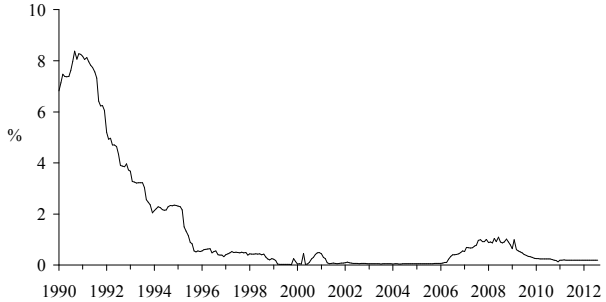
Germany : 3-Month Interbank Deposit Rate



Japan: Yield on Long-Term Government Bonds

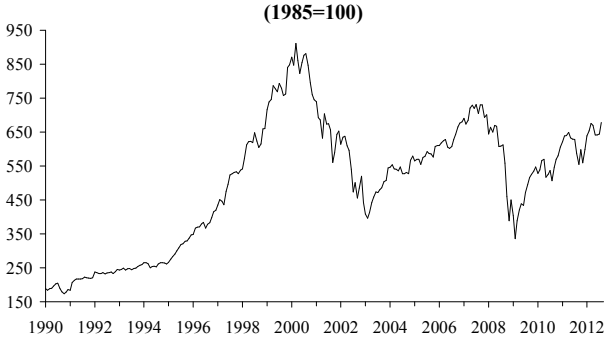


Japan : 3 Month Money Market Rate

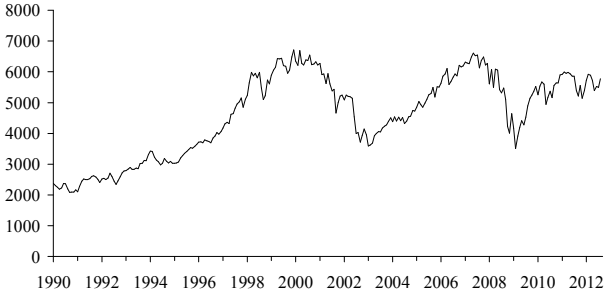


MAJOR EQUITY MARKETS

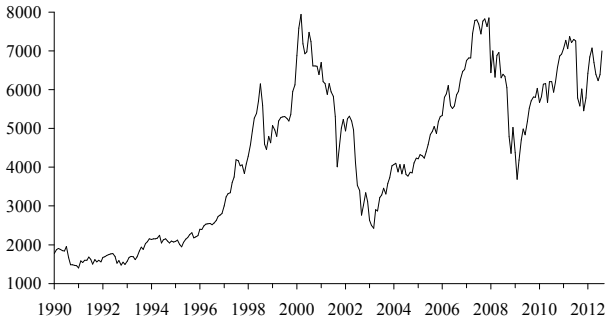
U.S. : S & P 400 Industrial
(1985=100)



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



Germany : DAX 30



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

EMERGING MARKETS

Anupam Rastogi

India

As the ruling party got around amending its mistakes, the opposition party realised that it could go in for the kill and reap some electoral benefit. The political gridlock in New Delhi over the coal block allocations and telecom spectrum auction has more or less ruled out any progress on reforms in the immediate future. One has to wait and see what stand the Government will take on reforms post-monsoon session of parliament. This has left policy decisions hanging in the air.

Dr. Raghuram Rajan, the former International Monetary Fund chief economist, took charge as chief economic adviser. To start with he wants the government to raise fuel prices in quick steps and eventually deregulate them. He may not be able to do much due to the political gridlock, but his advice to the government on budget deficit and subsidy issues is now unequivocal.

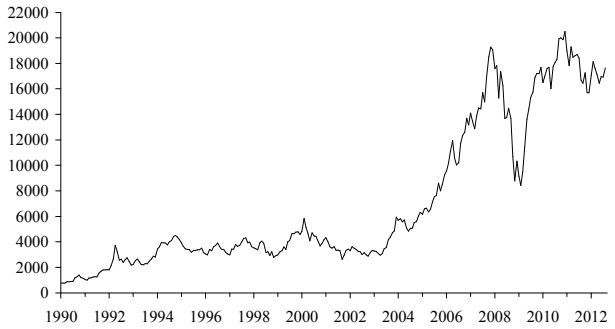
Economic growth has tapered off to its slowest rate in nearly a decade amid stubbornly high inflation and widening budget and current-account deficits. The central bank slashed its GDP growth forecast for the current fiscal year to 6.5% from 7.3%, citing the weak southwest monsoon and the continued slowdown in industrial activity. Most economists believe that this forecast is on the high side. We are keeping our forecast of 5.8% unchanged and believe that there may be a positive surprise as heavy rains in August would be beneficial to the agricultural sector.

India's inflation in July was at its lowest level in nearly three years, at 6.87% and there is relative stability of the rupee, trading between 55 and 56 rupees for one U.S. dollar in recent weeks, after declining sharply in the months before that. But the RBI Governor has reiterated his hawkish stance on inflation, ruling out any rate cuts in the near term even as there is persistent demand from industry to seek a cut 'for growth's sake'.

Exports fell 14.8%, to $22.4 billion, while imports fell 7.61% to $37.9 billion in July. We expect current account deficit to fall from 4.2% of GDP in 2011–12 to 3.2% in the current financial year. A fall in the current account deficit may boost the rupee.

Foreign direct investment into India slumped 78% in June, reflecting the weakening confidence of overseas investors. For the April–June period — the first quarter of the fiscal year — FDI fell 67% to $4.42 billion. But, FIIs too have been pumping money into Indian equities during the past couple of months on optimism about the Centre pushing through a few key reforms. Long-only funds have brought the year-to-date net inflow to $11.5 billion, compared with a net withdrawal of around $358 million in 2011 from the markets.

India: BSE Sensitive



Not all is well on all fronts. The central bank is concerned about a possible rating downgrade after both Standard & Poor's and Fitch Ratings changed their outlook on India to negative. A downgrade would put India into the junk category.

	09-10	10-11	11-12	12-13	13-14
GDP (%p.a.)	7.4	7.5	6.9	5.8	6.5
WPI (%p.a.)	9.5	9.0	7.5	7.5	7.0
Current A/c(US$ bill.)	-14.0	-31.0	-40.0	-25.0	-24.0
Rs./$(nom.)	48.0	49.0	49.5	56.0	54.0

China

Premier Wen Jiabao's announcement of 7.5% growth rate for China in 2012 in March was taken as unduly modest, and assumed that the world's second-largest economy would actually expand much faster. But in recent months that 7.5% target is starting to look ambitious. Some analysts believe that the economy is in for a much rougher time. Moreover, the current slowdown is more structural than cyclical as labour-intensive manufacturing competitiveness is slipping due to higher wages. Sluggish global growth has eased the world's once-surging demand for Chinese goods this year, and the head of the world's biggest shipping line believes the slowdown suggests more permanent challenges to China's export sector.

The HSBC China Manufacturing Purchasing Managers' Index dipped to 47.8 for August from July's 49.3, continuing a 10-month string of results below the 50 level that separates growth from contraction.

Some of the provinces in China have embarked on an enormous stimulus programme to boost rapidly cooling growth. The Chinese megacities of Tianjin and Chongqing, each unveiled plans for investments of Rmb1.5 trillion ($236 billion) in large industries such as petrochemicals, automobiles, electronics and advanced equipment, over the next few years.

German Chancellor Angela Merkel visited China in August, underscoring Germany's growing economic dependence on the world's most populous nation amid Europe's economic stagnation. Ms. Merkel's second trip to China this year was mostly revolved around economic ties.

Exports rose one percent year on year in July, a six-month low and down from an 11.3% pace in June. The figure corroborates flagging external demand. Imports were up 4.7%, dipping from June's 6.3% pace and pointing to a slackening in China's appetite for commodities. China was left with a $25.1 billion surplus in July.

The yuan is down almost one percent against the dollar this year, and a full-year decline would be the first for the Chinese currency since China ended a decade long peg against the dollar in 2005. The yuan has surged since then, including a 4.5% rise last year. A further depreciation of the yuan over the next year cannot be ruled out because corporate financials in China are deteriorating dramatically.

	09	10	11	12	13
GDP (%p.a.)	8.7	10.3	9.2	7.5	7.5
Inflation (%p.a.)	-0.8	5.9	4.3	2.2	2.7
Trade Balance(US$ bill.)	180	183	155	140	130
Rmb/$(nom.)	6.8	6.6	6.3	6.3	6.3

South Korea

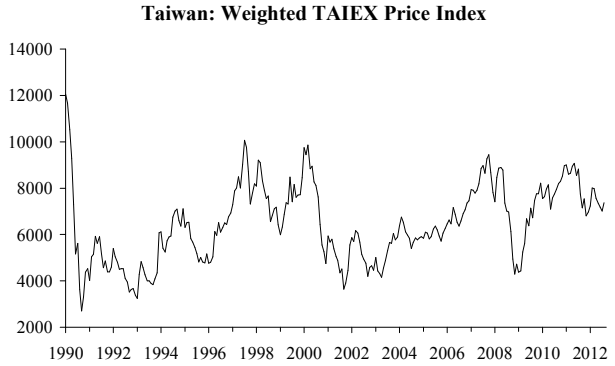
South Korea's economic growth rate this year is slowing with the downturn in global growth. But the competitiveness gained as won has depreciated against all the major currencies. It will help to rebound as the global economy recovers according to Moody' services.

South Korea's central bank kept its benchmark interest rate steady at 3% and offered an optimistic economic outlook than the previous month. The chances for a rate cut in September have reduced now. The Bank of Korea eased monetary policy as it faced the deteriorating economic outlook. It reduced its full-year growth forecast for the year from 3.5% to 3%.

Inflation eased to 1.5%, the lowest in more than 12 years, reducing concerns about upward price pressures. South Korea's imports fell nearly 6% in July, highlighting flagging domestic demand that reflects the economic headwinds facing the region. This has resulted in South Korea's current account surplus growing 62% to $6.1bn.

Moody's Investors Service raised South Korea's sovereign credit rating by one notch to Aa3, on par with that of China and Japan, citing the country's strong fiscal fundamentals and resilience to external shocks amid growing concerns about Europe's financial crisis and a global slowdown. The company also assigned a stable outlook to its latest rating.

	09	10	11	12	13
GDP (%p.a.)	0.2	6.3	3.6	3.0	3.0
Inflation (%p.a.)	2.6	2.9	4.0	2.2	2.5
Current A/c(US$ bill.)	42.7	28.2	27.0	20.0	18.0
Won/$(nom.)	1200	1150	1100	1140	1140



Taiwan

Taiwan has cut its growth forecast for its gross domestic product in 2012 to 1.66%, from a previous estimate of 2.08% within a month in the midst of a weakening global economy. The government expects Taiwan's economic growth for 2013 to hit 3.67%, with a 1.08% rise in the consumer price index.

The local high-tech sector, which drives Taiwan's economic growth, has been faced with strong competition not only from international brands but also from Chinese exporters. Taiwan's exports and imports for 2012 in U.S. dollar terms are both expected to fall from 2011, by 1.7% and 1.5%, respectively. Exports in the January–July period totalled US$171.6 billion, an annual decline of 5.8%, while the trade surplus was US$12.1 billion.

With economic growth sputtering, there is some hope that the island's central bank will ease monetary conditions further, including cutting already low policy interest rates later this year, to boost the economy.

	09	10	11	12	13
GDP (%p.a.)	-1.9	10.8	4.0	1.6	2.8
Inflation (%p.a.)	0.0	1.3	1.2	1.3	1.2
Current A/c(US$ bill.)	16.0	16.0	18.0	20.0	22.0
NT$/$(nom.)	32.0	31.0	30.0	29.5	29.5

Brazil

The Brazilian economy is expected to grow by less than 2% this year. However, the central bank governor, Alexandre Tombini, feels that in the second half the economy may grow at a rate of 4% per annum. This seems to be an optimistic forecast as the stock of household debt has nearly doubled over the past six years to about 45% of income and credit service consumed 22% of household income. This leaves little money for the household sector to consume.

Another pillar of the Brazilians economic success has been high commodity prices. Rising exports of commodities such as iron ore and soyabeans gave boost to the economy. With the world economy adjusting to new realities of Euro-zone and China, the Brazilian economy will not return to high growth for some time to come.

Brazil's central bank has cut interest rates to an historic low to revive the country's moribund economy. The central bank reduced its benchmark Selic interest rate by 50 basis points to 7.5% and signalled another possible cut to provide monetary boost to the economy. Over the past year, rates have fallen from 12.5% to 7.5%.

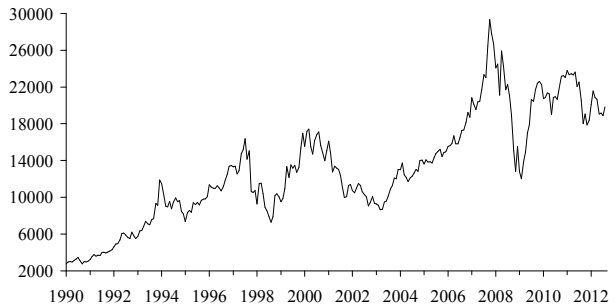
To provide fiscal stimulus, President Dilma Rousseff has unveiled several stimulus packages this year. In the first phase $66 billion of private concessions will be granted to build new roads and railways. Finance will also be provided, Chinese-style, by Brazil's state development bank.

The Brazilian real is holding around 2 real to the US dollar. At this rate, domestic industries are getting protected and exports remain competitive.

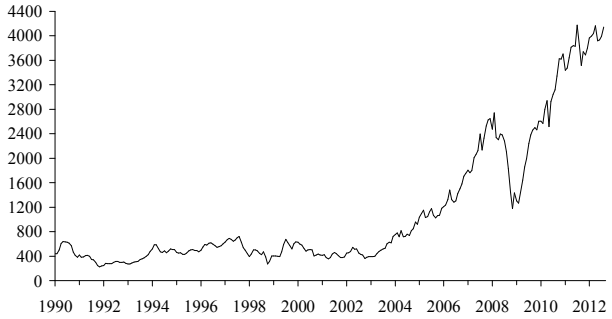
	09	**10**	**11**	**12**	**13**
GDP (%p.a.)	-0.2	7.5	2.7	2.0	3.0
Inflation (%p.a.)	4.1	5.9	6.5	5.6	5.0
Current A/c(US$ bill.)	-20.0	-47.3	-52.6	-60.0	-65.0
Real/$(nom.)	1.8	1.7	1.5	2.0	2.1

Other Emerging Markets

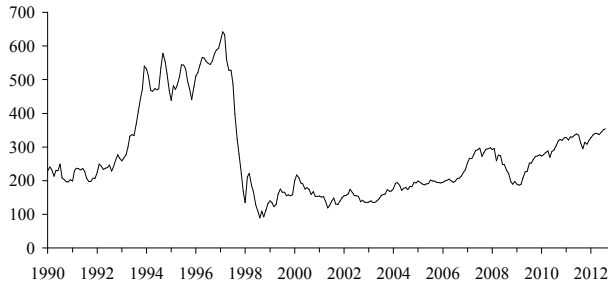
Hong Kong: FT-Actuaries



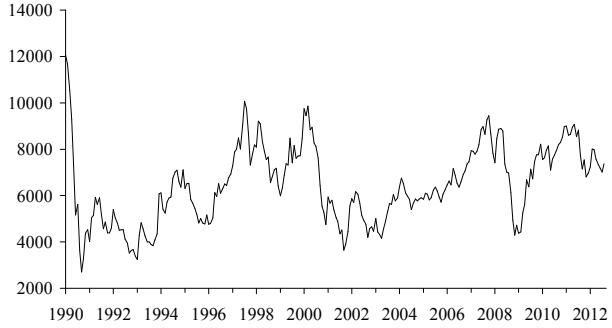
Indonesia: Jakarta Composite



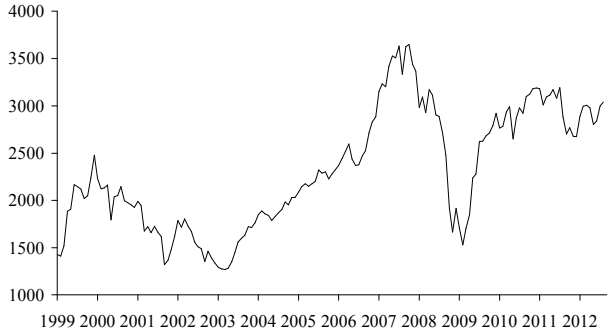
Malaysia: FT-Actuaries (US$ Index)



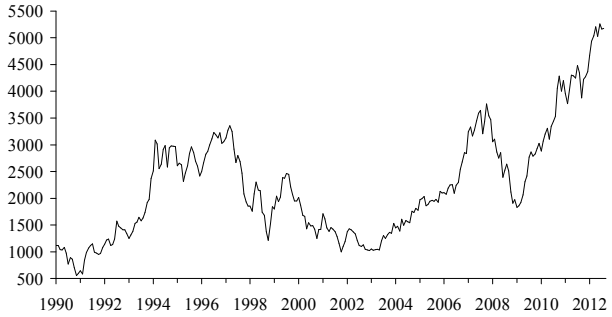
Taiwan: Weighted TAIEX Price Index



Singapore: Straits Times Index

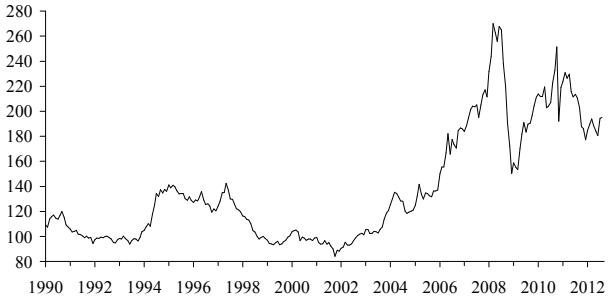


Philippines: Manila Composite

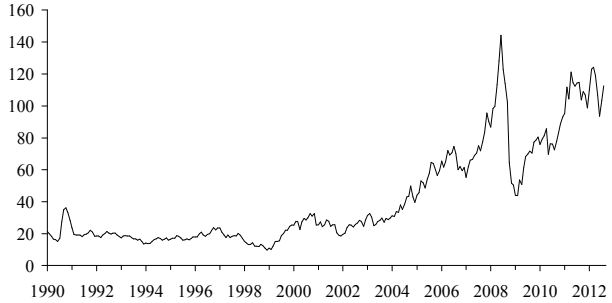


COMMODITY MARKETS

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

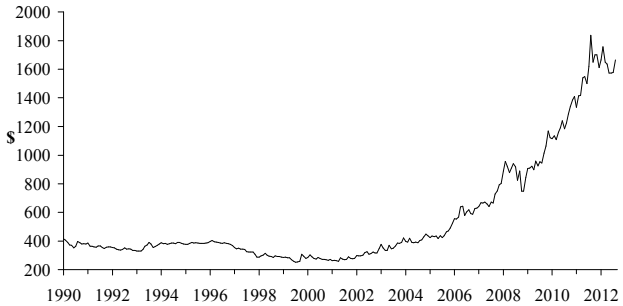


Oil Price: North Sea Brent (in Dollars)

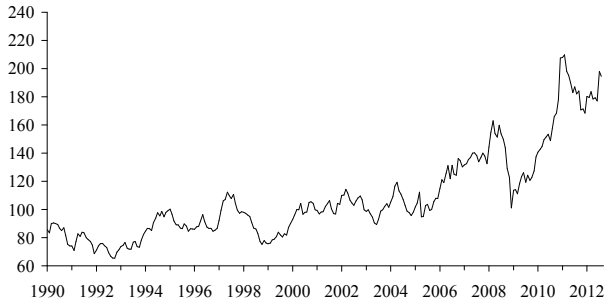


Commodity Price Index (Sterling)
(Economist, 2000=100)

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]
2009	1.3	2.8	1.1	80.6	89.3	-0.4	2.0	-0.2
2010	4.1	2.4	0.7	80.4	91.2	-3.8	4.8	-0.3
2011	3.9	2.0	0.9	79.9	92.4	-2.5	5.3	-0.4
2012	2.8	1.6	1.2	81.7	95.4	-1.6	3.5	-0.5
2013	2.3	2.4	1.4	81.5	95.7	-0.7	2.9	0.4
2014	2.0	2.6	2.1	81.0	95.6	0.2	2.7	0.6
2011:1	4.5	2.6	0.8	80.8	93.3	-2.9	5.3	0.2
2011:2	3.7	2.3	0.9	79.4	91.8	-2.8	5.2	-0.1
2011:3	3.7	1.6	0.9	79.2	91.5	-2.7	5.3	-0.7
2011:4	3.6	1.3	1.1	80.2	93.0	-1.5	5.3	-0.9
2012:1	2.6	1.1	1.1	81.1	94.3	-2.0	3.8	-1.1
2012:2	3.1	1.6	1.0	82.3	96.1	-1.9	3.6	-0.5
2012:3	2.9	1.8	1.4	81.9	95.7	-1.3	3.3	-0.3
2012:4	2.7	1.9	1.4	81.6	95.6	-1.0	3.2	-0.1
2013:1	2.4	2.1	1.4	81.5	95.5	-0.9	3.0	0.1
2013:2	2.3	2.4	1.4	81.3	95.4	-0.8	2.9	0.4
2013:3	2.2	2.6	1.4	81.7	96.0	-0.7	2.8	0.6
2013:4	2.1	2.6	1.6	81.4	95.9	-0.5	2.8	0.6

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)
2009	227.3	0.0	4.6	1.53	141.3
2010	232.4	2.3	4.6	1.50	138.8
2011	237.9	2.3	4.7	1.53	136.6
2012	243.2	2.1	4.6	1.53	135.6
2013	251.7	3.5	4.0	1.34	137.3
2014	262.8	4.4	3.7	1.24	140.6
2011:1	237.6	2.9	4.5	1.46	138.0
2011:2	237.2	2.6	4.6	1.50	136.8
2011:3	238.2	2.1	4.8	1.57	136.1
2011:4	238.8	1.6	4.8	1.60	135.4
2012:1	239.8	0.5	4.8	1.61	135.1
2012:2	242.1	2.1	4.7	1.56	135.4
2012:3	244.3	2.6	4.5	1.51	135.7
2012:4	246.7	3.3	4.4	1.46	136.3
2013:1	247.9	3.4	4.2	1.41	136.4
2013:2	250.6	3.5	4.1	1.36	137.0
2013:3	252.9	3.5	3.9	1.31	137.6
2013:4	255.6	3.6	3.8	1.26	138.3

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
2009	140.8	674466.5	405440.7	218144.6	178391.0	-33226.3	94283.5
2010	143.8	688577.5	406544.7	238231.9	181470.9	-39127.8	98542.3
2011	144.7	693085.7	400020.3	240745.2	180361.1	-30475.0	97565.8
2012	145.9	698805.6	401772.6	254854.4	182833.9	-32881.9	107764.8
2013	148.8	712538.5	407982.4	260043.9	187329.0	-33205.7	109610.1
2014	152.1	728596.4	417155.4	265696.3	191131.8	-33153.8	112235.9
2009/08	-4.3		-3.7	-13.4	0.9		-5.0
2010/09	2.1		0.3	9.2	1.7		4.6
2011/10	0.7		-1.6	1.1	-0.6		-0.9
2012/11	0.8		0.4	6.1	1.5		11.1
2013/12	2.0		1.5	2.1	2.5		1.7
2014/13	2.3		2.2	2.2	2.0		2.4
2011:1	144.5	172985.8	100710.9	55274.0	47260.2	-6814.0	23445.3
2011:2	144.4	172880.5	100098.9	58650.3	43772.3	-7894.5	21746.5
2011:3	145.2	173866.2	99417.2	64048.0	44431.3	-8082.7	25947.6
2011:4	144.8	173353.2	99793.3	62772.8	44897.4	-7683.8	26426.5
2012:1	144.3	172790.5	100021.7	62533.0	45654.3	-7956.4	27462.2
2012:2	144.0	172361.5	100252.8	61076.7	45598.3	-8306.1	26258.6
2012:3	147.8	176935.9	100386.7	66094.5	45669.6	-8309.4	26902.2
2012:4	147.6	176717.7	101111.5	65150.2	45911.6	-8310.0	27141.8
2013:1	148.0	177154.1	101483.0	62722.2	48586.9	-8307.4	27326.9
2013:2	148.5	177778.4	101479.0	66229.2	45693.1	-8302.0	27320.6
2013:3	149.1	178446.3	101989.4	65774.3	46384.9	-8301.7	27401.8
2013:4	149.6	179159.7	103031.0	65318.2	46664.1	-8294.5	27560.8

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)
2009	10.3	1247.8	128.3	32.4	-26.1
2010	8.3	1335.1	110.3	36.6	-48.6
2011	7.3	1394.9	120.1	43.0	-29.0
2012	7.4	1463.3	107.6	48.1	-31.6
2013	6.4	1524.1	97.1	51.6	-32.5
2014	3.6	1591.8	58.0	56.8	-32.3
2011:1	3.9	338.3	13.2	9.7	-6.6
2011:2	8.4	337.4	28.4	10.0	-3.4
2011:3	5.7	349.7	19.8	10.4	-10.5
2011:4	9.3	352.3	32.9	11.0	-8.5
2012:1	5.6	355.5	39.0	11.5	-7.0
2012:2	7.5	355.2	26.5	11.6	-3.8
2012:3	6.8	367.1	24.9	12.0	-11.0
2012:4	7.0	369.2	25.7	12.2	-9.8
2013:1	8.2	371.8	30.5	12.3	-8.0
2013:2	6.2	375.5	23.4	12.5	-3.7
2013:3	6.0	378.9	22.6	12.7	-11.0
2013:4	6.1	382.5	23.1	13.0	-9.8

1 GDP at market prices (Financial Year)

WORLD FORECAST DETAIL

Growth Of Real GNP

	2008	2009	2010	2011	2012	2013
U.S.A.	0.0	–2.6	2.6	1.7	2.5	2.6
U.K.	–1.1	–4.3	2.1	0.7	0.8	2.0
Japan	–1.2	–6.3	4.3	–0.7	2.1	1.6
Germany	1.0	–4.7	3.6	3.0	1.1	2.0
France	0.1	–2.5	1.5	1.7	1.0	1.2
Italy	–1.3	–5.1	0.9	0.5	0.1	0.3

Growth Of Consumer Prices

	2008	2009	2010	2011	2012	2013
U.S.A.	3.8	–0.3	1.8	3.1	2.0	2.0
U.K.	3.3	1.3	4.1	3.9	2.8	2.3
Japan	1.4	–1.4	–1.0	–0.3	–0.2	0.0
Germany	2.6	0.4	1.1	2.3	1.8	1.7
France	2.8	0.1	1.5	2.1	1.6	1.6
Italy	3.4	0.8	1.5	2.8	2.7	2.8

Real Short-Term Interest Rates

	2008	2009	2010	2011	2012	2013
U.S.A.	1.8	–1.6	–1.8	–1.7	–1.5	–1.3
U.K.	4.2	–0.4	–3.8	–2.5	–1.6	–0.7
Japan	1.8	1.1	0.5	0.4	0.4	0.4
Germany	3.5	–0.4	–1.3	–0.3	0.8	0.5
France	3.8	–0.8	–1.4	–0.3	0.9	0.5
Italy	3.1	–0.8	–1.4	–0.3	–0.3	0.0

Nominal Short-Term Interest Rates

	2008	2009	2010	2011	2012	2013
U.S.A.	1.5	0.2	0.1	0.3	0.5	0.7
U.K.	5.5	1.1	0.7	0.9	1.2	1.4
Japan	0.4	0.1	0.1	0.4	0.4	0.4
Germany	3.9	0.7	0.4	1.5	2.5	2.5
France	3.9	0.7	0.4	1.5	2.5	2.5
Italy	3.9	0.7	0.4	1.5	2.5	2.5

Real Long-Term Interest Rates

	2008	2009	2010	2011	2012	2013
U.S.A.	2.2	1.3	1.1	1.2	2.0	2.0
U.K.	1.4	–0.2	–0.3	–0.4	–0.5	0.4
Japan	2.0	1.4	1.1	1.1	1.3	1.5
Germany	3.0	2.3	1.9	1.8	2.0	2.0
France	3.0	2.2	1.9	1.8	2.0	2.0
Italy	2.8	2.2	1.9	1.8	2.0	2.2

Nominal Long-Term Interest Rates

	2008	2009	2010	2011	2012	2013
U.S.A.	3.7	3.2	3.1	3.2	4.0	4.0
U.K.	4.3	2.8	2.4	2.0	1.6	2.4
Japan	1.5	1.3	1.1	1.2	1.5	1.5
Germany	4.4	4.0	3.8	3.8	4.0	4.0
France	4.4	4.0	3.8	3.8	4.0	4.0
Italy	4.4	4.0	3.8	3.8	4.0	4.0

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

	2008	2009	2010	2011	2012	2013
U.S.A.	80.1	88.7	81.7	81.8	82.0	82.1
U.K.	87.6	77.5	77.3	76.8	79.6	78.4
Japan	87.9	89.0	80.2	79.8	79.7	80.0
Germany	105.1	105.8	99.3	99.0	99.1	99.0
France	106.4	104.3	101.7	102.0	102.0	102.1
Italy	106.6	105.4	100.5	100.8	101.0	101.1

[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)

	2008	2009	2010	2011	2012	2013
U.S.A.[1]	86.07	85.98	83.73	78.08	80.20	80.50
U.K.	1.85	1.57	1.55	1.61	1.58	1.58
Japan	103.40	93.54	87.48	79.36	81.00	81.00
Eurozone	0.68	0.72	0.75	0.72	0.78	0.79

[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