LIVERPOOL INVESTMENT LETTER

September 2015

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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CONTENTS

	Page
Monetary Policy and the Panic Over China China wobbles are pushing out the time for interest rate cuts but really the world economy is growing at a respectable rate. Talk of People's QE by Mr. Corbyn and other proposed abuses of money printing are so alarming that the Bank ought to liquidate existing QE as fast as possible.	3
Focus on Japan	5
Market Developments **Summary and Portfolio Recommendations**	6
Indicators and Market Analysis	
Foreign Exchange	8
Government Bond Markets	9
Major Equity Markets	10
Emerging Equity Markets	11
Commodity Markets	17
UK Forecast Detail	18
World Forecast Detail	20

MONETARY POLICY AND THE PANIC OVER CHINA

We are finally seeing some hard-headed ideas prevailing on monetary policy. The US Fed has announced it will raise rates fairly soon. The Monetary Policy Committee has made similar noises finally; it will not be able to ignore US policy given the close connection of the UK to the US economy. As the world economy warms up over the next three years, world real interest rates will rise and inflation will return to 2%. Interest rates will probably get back to 4–5% by the end of that time.

Unfortunately at present there is a panic over China's problems. Yet a China that grows more slowly in order to address its internal problems does not mean that the world will go into recession. On the contrary it releases resources that can encourage growth elsewhere. Commodity prices being low and even continuing to fall in some cases act as a stimulus to growth; input costs fall, profits rise in a wide range of enterprises, and new investments will result. Yet policymakers, ever reliving the recent past, are calling for more monetary stimulus as well.

Consider the latest global data. World growth is running in the range of 3–4%. World trade is in the same range which is lower than usual relative to world growth (traditionally it has grown up to twice as fast). This may partly reflect covert protectionism against goods trade in the face of the recent crisis but is probably main reflects 'resourcing' as opposed to 'outsourcing' as Chinese costs have risen with ageing and the drying-up of cheap labour. It may also reflect a shift to service trade which is less well measured.

Really these rates of growth may reasonably mirror the growth and pattern of resource availability. It is one of the fallacies promoted by Keynesianism that the world economy should always be growing flat out, with no excess capacity and very low unemployment rates. Yet economies need to allow weak industries to contract and growing industries to find staff, land and capital. The 'natural' rates of unemployment and capacity utilisation take into account existing misallocations of capital, labour and land; creating stimulus via fiscal and monetary policy is both potentially inflationary and can prolong the misallocation. It also needs to be remembered that misallocation includes the degradation of the environment, especially obvious in China but also occurring in other emerging market economies.

It does appear that the latest panics will put off the raising of interest rates yet again. However the dangers of leaving 'QE' assets dormant in central banks have been illustrated by the calls by left-wing politicians such as Jeremy Corbyn for QE to be used as a printing press in place of bond issue, specifically to pay for infrastructure investments. This is fiscal deficit spending financed by printing money — a totally toxic idea, which was last tried by Edward Heath's Conservative government, with massive inflationary consequences. It was due to that crazy period that we got first monetarism and then the idea of independent monetary policy set largely by the Bank of England to hit inflation targets. Inflation, we all finally discovered then, is a monetary phenomenon: Corbynomics would guarantee to bring it back.

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

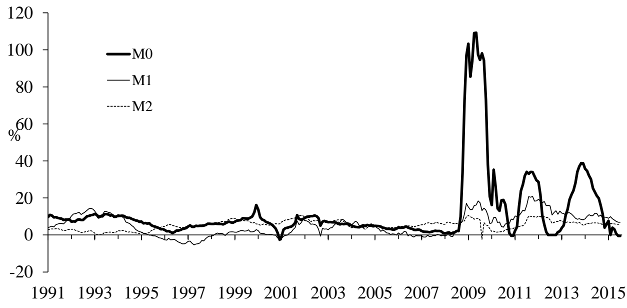
[1]Expenditure estimate at factor cost
[2]U.K. Wholly unemployed excluding school leavers (new basis)
[3]Sterling effective exchange rate, Bank of England Index (2005 = 100)

Also there are demands for the bonds held by central banks to be 'liquidated' by central government which owes them. This would hobble future monetary policy since the money printed under QE could never be liquidated; also any printing of more money would again amount under these terms to pure fiscal deficit creation.

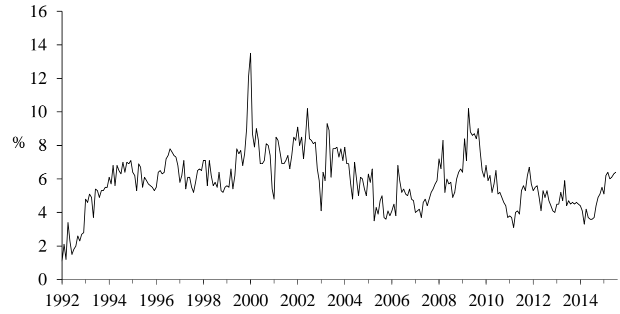
Given these pressures, now is the time for the Bank of England to begin selling off its bond portfolio, with a view to eliminating it over say two years. Leaving it as it is, with a view to letting the bonds run off on maturity, invites an ongoing debate on fiscal profligacy by the back door which we can ill afford to have.

In sum we would as before like to see interest rates rise, but even though this now seems unlikely in the very near future, we would certainly urge an immediate move to reversing QE by the sale of Bank bond holdings into the open market.

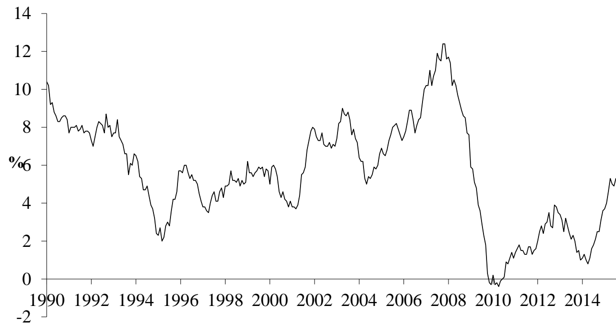
U.S.: Growth in Monetary Aggregates (Yr - on - Yr)



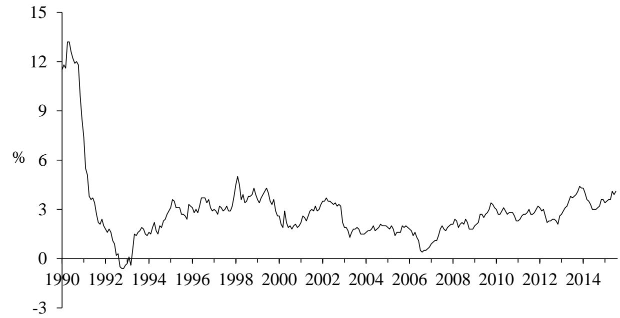
UK: Notes and Coins in Circulation Growth



Eurozone M3 Growth



Japan: Growth of M2+CD's



FOCUS ON JAPAN

Francesco Perugini

The Economy Shrinks in the Second Quarter

Japan's economic recovery is losing steam, putting pressure on Prime Minister Shinzo Abe to return his focus to his economic policies, "Abenomics". Preliminary GDP data for the April–June quarter shows GDP shrank a seasonally adjusted 0.4% quarter-on-quarter in the three months to June 30, down from an upwardly revised 1.1% in the March quarter. This was slightly better than the 0.5% contraction the market was looking for. It was the weakest pace of growth since a 0.5% contraction in the September quarter last year, when the economy dipped back into recession. Compared with a year earlier the economy was 1.6% down in the second quarter.

Private consumption, business investment and net exports all fell in the second quarter. The weakness of private consumption — which knocked 0.4 percentage points off growth — is especially disappointing. It was the first decline since the same quarter a year earlier when consumption fell after the government instituted a sales tax increase. With personal consumption making up 60% of Japan's economic activity, it appears the economy is standing still. "If weak private consumption persists, that would be a further blow to Abe's administration, which is facing falling support rates ahead of next year's Upper House election," said Hiromichi Shirakawa, chief Japan economist at Credit Suisse. "This could raise chances of additional fiscal stimulus." A recent survey also shows that domestic companies are becoming increasingly concerned about the slump in private consumption. The adverse impact of the consumption tax hike to 8% from 5% in April 2014 is continuing to hurt automakers and other sectors. "We've been unable to overcome slumping sales as the tax hike impacts linger," Honda Motor Co. Executive Vice President Tetsuo Iwamura said.

Similarly, business spending was down 0.1% from an upwardly revised 2.8% in the March quarter, and weaker than the flat result economists were looking for.

Despite a weaker yen, Japan's exports were also sluggish in the April–June period, due to the unexpected harshness of economic conditions in China and other countries. The volume of exports to Asia, the US and Europe declined. The outlook remains uncertain for the July–September quarter, as China's recent devaluation of the yuan may hinder exports by Japanese companies. Indeed, preliminary data for July shows Japan's trade deficit widened to its largest level in five months — measured in dollar terms, demand for imports of electronic devices, a mainstay of Japanese manufacturing, was nearly flat while exports of machinery fell 12.3% and exports of chemicals fell nearly 11%.

Those areas of weakness were offset by public spending and a higher than expected inventory build-up. The latter contributed 0.3 percentage points to growth but could be reversed in future quarters since it probably reflects unsold goods. "More than expected inventory accumulation looks to have stemmed from the remaining sluggish personal consumption," noted analysts at Credit Suisse.

The stumble comes as China — Japan's biggest trading partner — is fighting off its own slowdown, with a currency devaluation last week that triggered convulsions in global markets and adds to challenges for Japanese officials in reflating the economy.

Private-sector economists predict that if the economic slowdown continues in the July–September quarter, the government could draft measures that will directly spur consumer spending, such as direct transfers to households. "A contraction would cause huge damage to Abe's popularity," Kazuhiko Ogata, an economist at Credit Agricole SA, said after the GDP data release. "Abe has had support because he'd improved the economy. It's possible that he compiles an economic package." This is also believed by Etsuro Honda, an economic adviser to Prime Minister Shinzo Abe, who recently said that "Japan needs an economic injection of as much as ¥3.5 trillion to shore up consumption and stave off further economic contraction". He suggested it should be delivered via subsidies such as child-care support or coupons, rather than spending on public works. Additional spending can be funded from higher-than-expected tax revenues, rather than issuing new government bonds, he said. However, since Abe took office in December 2012, fiscal stimulus has had limited effect — since 2012 the economy has only grown 2% while the government has provided fiscal stimulus equal to 3% of GDP.

Economists also believe that the weakness of demand could raise the chance that the Bank of Japan (BOJ) will have to downgrade both its growth and inflation forecasts in October. Therefore BOJ Governor Kuroda may judge more stimulus is needed to maintain the BOJ's credibility. "We remain convinced that the Bank of Japan will announce more easing in October", said Marcel Thieliant, Japan economist at Capital Economics in Singapore. The BOJ has been aggressively buying assets for the past two years in an effort to eliminate the deflationary mindset brought about by two decades of on-and-off price falls — last October BOJ accelerated the pace of purchases to ¥80 trillion a year. However, Kuroda said last month he does not think Japan's slowdown will continue from July, and earlier this month said recent weakness in industrial production and exports will be temporary. Also, Japan "need not worry" about China's currency devaluation of the yuan because it can always offset the effects by easing monetary policy, said Koichi Hamada, an adviser to Abe.

MARKET DEVELOPMENTS

There has been panic over China. Certainly as we have been forecasting for some time China has financial problems and its growth rate must slow, probably now to below its target 7%. But it has plenty of scope to ease monetary conditions which it tightened until quite recently; interest rates are still over 4%. It is trying to steer a path between tightening plus deregulation and excessive slowdown. This is not easy; for all the criticisms from the West, it would not be easy here either. Look at Japan — a complete basket case. In spite of all the panic it is hard to believe bonds can revive; interest rates must rise. World growth will continue, even if at a modest rate of 3–4%. The global business cycle is doing its usual thing; the wails of the commodity producers are par for this stage of the cycle.

Table 1: Market Developments

	Market Levels		Prediction for Aug/Sep 2016	
	Jul 30	Aug 28	Previous Letter	Current View
Share Indices				
UK (FT 100)	6669	6192	9476	8799
US (S&P 500)	2109	1988	2754	2596
Germany (DAX 30)	11257	10316	15636	14328
Japan (Tokyo New)	1647	1500	2247	2047
Bond Yields (government				
UK	2.09	1.98	2.00	2.20
US	2.27	2.19	2.10	2.10
Germany	0.66	0.74	1.50	1.50
Japan	0.42	0.39	0.70	0.70
UK Index Linked	–0.83	–0.86	0.10	0.10
Exchange Rates				
UK ($ per £)	1.56	1.54	1.56	1.50
UK (trade weighted)	93.9	92.3	90.6	90.6
US (trade weighted)	104.0	102.6	100.0	100.0
Euro per $	0.92	0.89	0.79	0.91
Euro per £	1.43	1.37	1.23	1.37
Japan (Yen per $)	124.3	120.7	98.0	120.5
Short Term Interest Rates (3-month deposits)				
UK	0.50	0.60	1.10	1.30
US	0.43	0.30	1.10	1.10
Euro	–0.08	–0.08	0.10	0.10
Japan	0.00	0.00	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	2.44	34.94
Germany	2.60	1.4	1.5	36.00	0.43	41.93
Japan	1.70	1.4	2.0	33.00	2.60	40.70
UK indexed[2]	–0.86		1.6	1.00		1.75
Hong Kong[3]	2.60	6.8	1.6	2.00	2.44	15.44
Malaysia	3.30	5.5	1.6	58.00	2.44	70.84
Singapore	3.50	4.5	1.6	36.00	2.44	48.04
India	1.40	8.0	1.6	31.00	2.44	44.44
Korea	1.10	3.0	1.6	–12.00	2.44	–3.86
Indonesia	2.20	6.1	1.6	41.00	2.44	53.34
Taiwan	2.80	3.4	1.6	29.00	2.44	39.24
Thailand	3.20	4.1	1.6	38.00	2.44	49.34

Bonds: Contribution to £ yield of:

	Redemption Yield	Changing Nominal Rates	Currency	Total
UK	1.98	–2.20		–0.22
US	2.19	0.90	2.44	5.53
Germany	0.74	–8.60	0.43	–6.43
Japan	0.39	–3.10	2.60	–0.11

Deposits: Contribution to £ yield of:

	Deposit Yield	Currency	Total
UK	0.60		0.60
US	0.30	2.44	2.74
Euro	–0.08	0.43	0.35
Japan	0.00	2.60	2.60

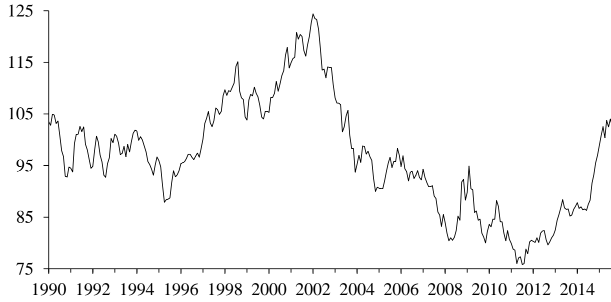
[1] Yields in terms of €s or $s can be computed by adjusting the £-based yields for the expected currency change.
[2] UK index linked bonds All Stocks
[3] Output based on China.

Table 3: Portfolio(%)

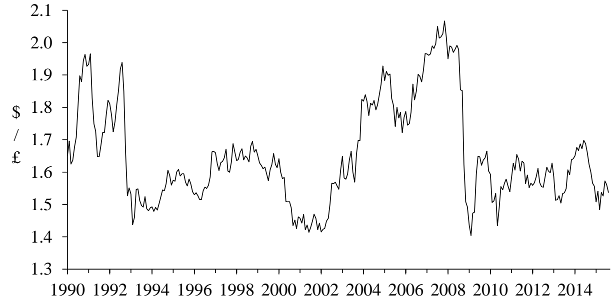
	Sterling Based Investor		Dollar Based Investor		Euro Based Investor	
	August Letter	Current View	August Letter	Current View	August Letter	Current View
UK Deposits (Cash)	5	5	5	5	1	1
US Deposits	-	-	-	-	-	-
Euro Deposits	-	-	-	-	-	-
Japanese Deposits	-	-	-	-	-	-
UK Bonds	-	-	-	-	-	-
US Bonds	-	-	-	-	-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

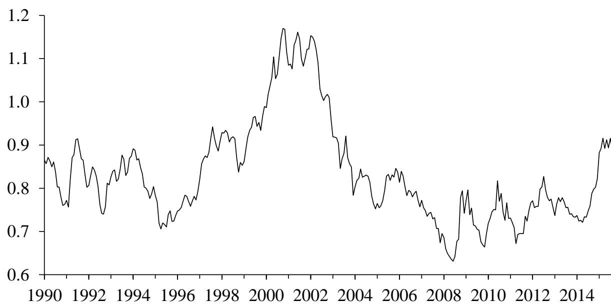
US : Trade Weighted Index
(Bank of England 1990 = 100)



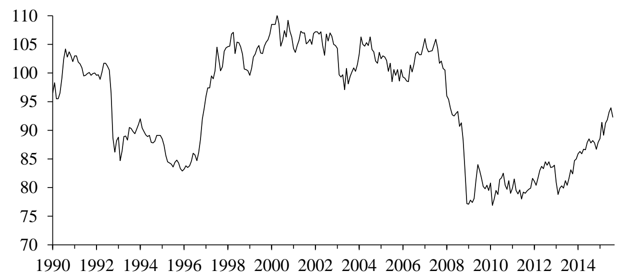
UK: Dollars Per Pound Sterling



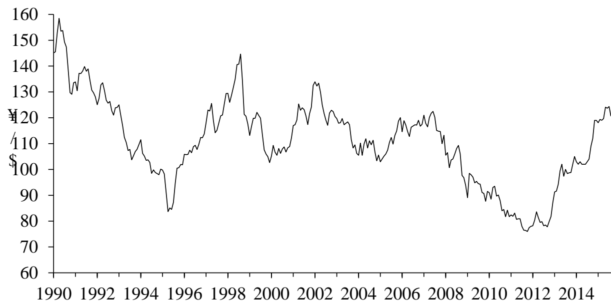
Euro per US dollar



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



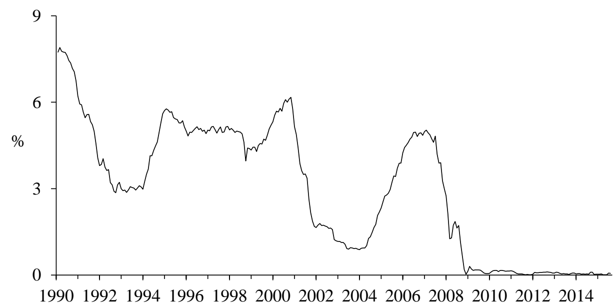
Japan : Yen Per U.S. Dollar



GOVERNMENT BOND MARKETS

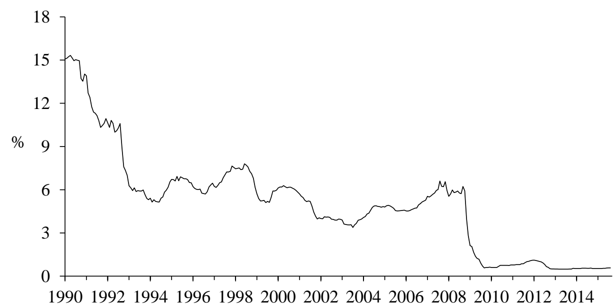
U.S.: Yield on Long-Term Government Bonds

U.S. : 3-Month Treasury Bill



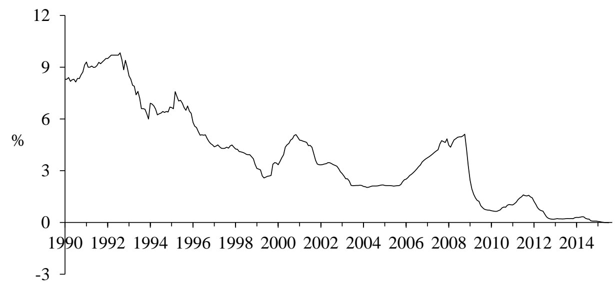
U.K.: Yield on Long-Term Government Bonds

U.K. : 3-Month Interbank Rate



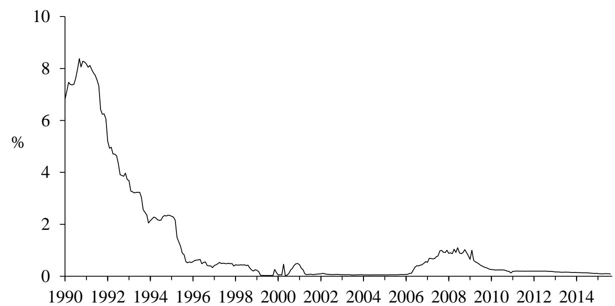
Germany: Yield on Public Authority Bonds

Germany : 3-Month Interbank Deposit Rate



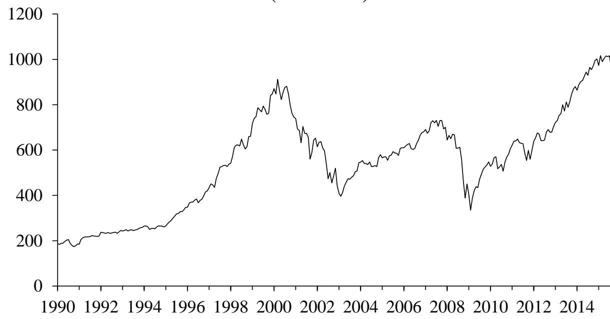
Japan: Yield on Long-Term Government Bonds

Japan : 3 Month Money Market Rate

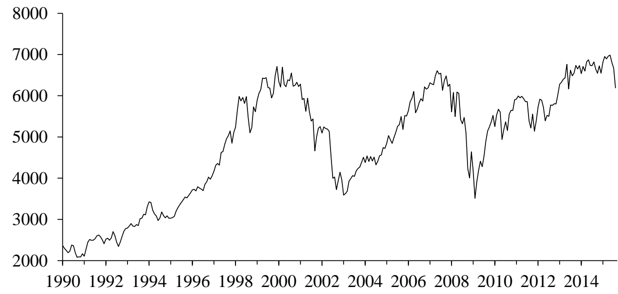


MAJOR EQUITY MARKETS

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

The devaluation of the yuan and the expected slowdown of the Chinese economy has heightened the risk perception of the emerging markets. But, India is likely to attract more capital in the years to come. According to the Reserve Bank Governor, Raghuram Rajan, macroeconomic fundamentals of Indian economy have improved gradually over the past year and the outlook of growth has improved over the last one year. Further, he is likely to follow an accommodative monetary policy which shall boost economic growth in medium term having slain the inflation dragon.

Notwithstanding, a 12% deficit in cumulative rainfall during monsoon season in the country, India is expected to grow 7.6% in 2015–16 and 8% next year. Consumer price inflation is most likely to undershoot the central bank target of 6% by January 2016. However, to keep inflationary expectations under control the RBI held its key policy interest rate steady at 7.25% in its bimonthly policy statement, which warned of a "worrisome … sustained hardening of inflation, excluding food and fuel" after higher than expected inflation in June.

India's deft handling of its foreign currency reserves and keeping a tight monetary policy since the Taper Tantrum in 2013, the country has built up foreign-currency reserves and narrowed the trade deficit. India has more than $355 billion of foreign currency reserves now to deal with any eventuality. The trade deficit has been further helped by falling commodity prices as India is a net commodity importer.

Foreign direct investment between October and May was up 40% to $23.7 billion from the same period a year earlier. Net investments by foreign institutional investors, or the money coming through financial markets, totalled $40.92 billion in the fiscal year ended March 31, roughly seven times as much as in the prior year. Net withdrawal by FIIs in the month of August was $2.6 billion in equity market and $110 million in debt market.

The macroeconomic strength is reflected in a less than 4% depreciation of INR to 66 rupees against the U.S. dollar since the yuan devaluation on August 11, 2015 and well short of its all-time low of 68.80, reached in August 2013. The rupee is likely to settle around Rs 66 to a US dollar. The rupee stood up best against the U.S. dollar over the past few months as foreign portfolio investors pulled out a little from Indian markets. More than 6% fall of India's benchmark S&P BSE Sensex index on August 24–25, 2015, mirrored declines in global markets but recouped half of it later in the week.

India: BSE Sensitive

On the economic reforms front political realities are putting the brakes on Prime Minister Narendra Modi's plans for economic revitalization. Opposition parties are in no mood to go along with the ruling party. Much advertised legislative bills on indirect tax and land acquisition have to wait for another year or so until the ruling party gets more seats in the upper house of the parliament. In the meantime, strategy of the ruling party is to bring in economic reforms which do not need parliament nod and try to push economic reforms in labour market and land market through the provincial governments which have the government of the ruling party. Besides this, government has increased fiscal expenditure on infrastructure such as roads, ports, mines and urban infrastructure.

Two large states in North India are going to the polls in the next nine months and the ruling party hopes to capture them from opposition. Recent victories in local government elections have given a boost to the ruling party.

The government is unlikely to call lawmakers back for a vote on the indirect tax proposals and it will wait until the winter session, making it all but impossible for the government to meet its mid-2016 target to implement the changes. This and shelving of the land bill for the time being are big disappointments to industrialists and government in India.

	13-14	**14-15**	**15-16**	**16-17**	**17-18**
GDP (%p.a.)	6.9	7.3	7.8	8.0	8.5
WPI (%p.a.)	7.0	6.0	4.8	4.0	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

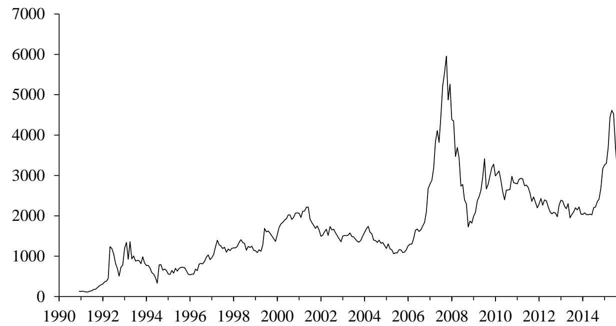
China's crash landing is a lesson to members of Chinese politburo that a ten trillion dollar Chinese economy cannot be managed by diktat. One of the essential elements of market economies is trust. The stock market is a visible sign when people lose trust and fear psychosis takes them over. In the past one year, China faced many man-made disasters such as capsizing of boat at Yangtze which killed 434 people in June, explosion at Tianjin port that killed more than 145 people and so on which have shaken people's faith in its leadership. The economy is still growing, and growing at a healthy pace of at least 5%, but the rest of the world which is a part of the value chain of Chinese unsustainable growth rate is likely to suffer more if they do not find a vent elsewhere. Unfortunately for Chinese people this growth was stimulated by domestic debt. It required more than two units of debt to create one unit of GDP. The one unit of GDP was in building roads leading to nowhere, bridges connecting isolated places and railways where nature does not allow even pathways to stay very long.

China's economy is still growing around 5% and official target of 7% in 2015 may not be achieved except in national government documents. In order to have a semblance of stability before the September 3 grand parade, China's central bank cut interest rates and flooded its banking system with liquidity via a cut to banks' reserve ratio requirements. In the meantime China's leaders have warned their people that they need to accommodate a "new normal" of economic growth far slower than the rate that propelled the economy into the world's second-largest in the past two decades. In the 'new normal economy' China is pushing services, consumer spending and private entrepreneurship as new drivers of growth that rely less on debt and more on the stock market for funding. Officially, China grew at a robust 7% pace in the second quarter but it is not supported by data on freight activity, electricity, property development, passenger travel and sea shipments.

On August 11, 2015 the People's Bank of China (PBOC) told the world that new currency trading rules would give market forces a greater role in setting the exchange rate. It turns out that was an eyewash, but it served a dual purpose. It informed the IMF that yuan is very near to a freely traded currency and it provided political cover for a devaluation. But, it is the exposure of Chinese companies unsettled the currency markets because they have borrowed more than $1 trillion abroad denominated in dollars. In 2009, Chinese companies exposure was about $200 billion only. A yuan devaluation coupled with expected the US Fed "lift off," will find it difficult to roll over loans. Markets, in turn, just crashed.

Contagion, followed after the Chinese stock market crash, is due to China's weight in the world economy. Chinese GDP represents 15% of world economic output and contributed up to half of global growth in recent years. It is a major export market for industrialized countries such as Japan and Germany as well as for commodity exporters like Brazil and Australia. Its economy contributes a sizable chunk of the profit growth of many Western multinationals.

China: SSE Composite Index



After spending more than $300 billion dollars, Chinese realized the futility of its interventions, as the Shanghai Composite fell more than 5% ten times this year. Earlier in 2015, Beijing hoped to use a rallying stock market to channel funds to indebted companies. But when stocks fell in June and July, a flurry of interventions to prop up the market just exacerbated the impression of leaders losing control. As noted earlier the government's slow response to a chemical disaster at Tianjin port added to a perception of ineffective governance.

Exports fell 8.3% year-over-year in July, factory orders are down, and construction starts fell 16.8% over the first seven months of 2015 from a year earlier. Chines factories of General Motors Co. and Volkswagen AG are running their plants in China below their full capacity for the first time. With many construction projects halted this year, number of people without work is rising. Exports for the first seven months of the year were down 0.8% in dollar terms compared with a year ago, while imports were down 14.6% over the same period.

The consumer price index was up 1.6% in July compared to 1.4% year-over-year rise in June while the producer price index dropped 5.4%. This is posing a deflation threat and adding to pressure for further more stimulus measures. China's forex reserves fell to $3.65 trillion at the end of last month from a peak of $3.99 trillion in June 2014.

Now, what to expect from China? China's economic transition will be difficult and developments this year corroborate this. The centralization of power is proving to be a double-edged sword for reforms, the anti-corruption campaign is choking off initiative and growth and the economy cannot be kept on an unrealistic expansionary path by unending stimulus. In previous booms and busts,

China's markets were not connected with the real economy. But that has changed now as the current crash coincides with a growth slowdown and capital outflows. Until the stock market finds its bottom, and the real economy shows convincing signs of health, the fear of crisis will remain. But, China enjoys two key advantages: first, a foreign exchange reserves of $3.7 trillion to defend against a balance-of-payments crisis, and, second, a high savings rate that has kept the banking system liquid even when it was probably insolvent from bad loans.

As of now, the PBoC has entered a new phase of aggressive monetary easing, call it CQE1 (Chinese Quantitive Easing 1) with the combination of an exchange rate devaluation, interest rate cut and reduction in the required reserve ratio. The problem is that these measures may not be effective at a time of slipping confidence and weakening growth momentum.

Chinese President Xi Jinping is going to Washington in September on his first state visit to the US. What he says there will be watched carefully. China will do whatever it takes to stabilize growth at 6.5–7%, with the focus continuing to be on mobilizing resources for and implementing infrastructure investment, even if it means providing funds at negative interest rates after adjusting for inflation through the two new multi-lateral institutions it has founded in the last one year.

Strange as it may sound, the genuine winner in the Chinese crash lending is markets as the Chinese Communist Party has to cede large part of its power to control economy and markets to markets now. Great uncertainty is whether the party would be able to find a meaningful role for itself?

	13	14	15	16	17
GDP (%p.a.)	7.7	7.4	6.8	6.5	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

South Korea's rate of economic growth has slowed significantly since the 1997 Asian financial crisis suggesting a structural impediment to growth. The pace of economic growth is slower in Korea than in many other countries lately. From April to June this year, the quarter-on-quarter economic growth rate of Korea was lower than those of fiscal crisis-stricken countries such as Greece and Spain. South Korea's economic growth is entirely driven by the export sector. After the burst of the credit card lending boom from 1999–2002, growth in domestic demand has been close to zero and has even dropped into the negative zone mainly due to high indebtedness of the household sector and the aging population.

Consumer prices in South Korea were up 0.7% on year in July, food price growth remained below 1.0% for the eighth straight month and continues to fuel concerns of deflation.

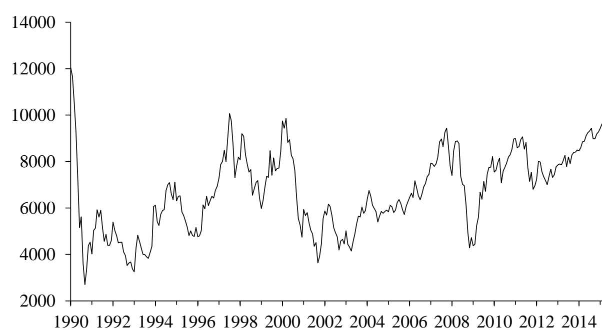
South Korean companies are grappling with high wages and low productivity amid a slowing economy, the country's youth unemployment hit a 16-year high of 10.2% in June, compared with an overall jobless rate of 3.9%.

South Korea hit a record first-half current account surplus of $52.4bn as a result of low oil prices. South Korean exports have declined relentlessly this year and shipments to China, the US, Japan and Europe are all contracting. Exports to China account for 39% of South Korea's overall exports. After the yuan depreciation, electronics companies will lose competitiveness to Chinese rivals.

The Korean won hit its five-year low against the U.S. dollar in August before recovering a bit on expectation that the US may not hike interest rate in September. The local currency is hovering around 1,195 won to the US dollar.

	13	14	15	16	17
GDP (%p.a.)	3.0	3.3	2.7	3.0	3.0
Inflation (%p.a.)	1.3	2.0	1.0	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

Taiwan



Taiwan's GDP rose by 0.64% in the second quarter and is unlikely to meet its forecast of 2% in 2015. Visitors from China, an important source of growth for Taiwan's tourism industry, fell 2.7% in second quarter from a year ago, the first decline in more than three years.

Taiwan inflation moved into the negative territory at –0.66% year on year in July. The fall in international oil prices has put downward pressure on prices and the shock to food prices due to excess rainfall last month subsided.

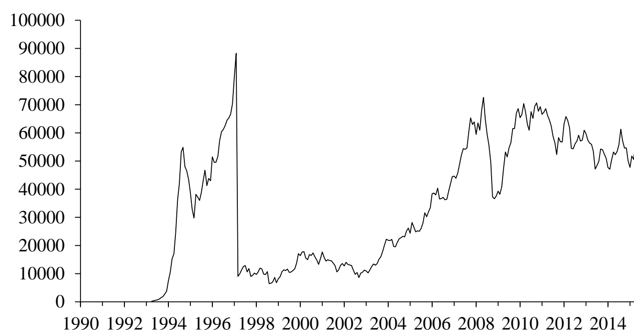
Taiwan is trying a 10% increase in exports to Indonesia this year as it aims to form a more "balanced" trade relation with Southeast Asia's biggest economy.

China maintains a trade deficit with Taiwan and imports more from Taiwan than it exports. Taiwan's exports to China are worth 30% of its economic output. Exports tumbled 12% in July from a year earlier, largely due to a drop in shipments of petrochemical products to China.

The Taiex index has hit a two-year low and recorded its cheapest valuation in nine years and is offering a 4.2% dividend yield.

	13	**14**	**15**	**16**	**17**
GDP (%p.a.)	2.1	3.7	2.0	2.0	2.6
Inflation (%p.a.)	1.2	1.5	1.0	1.6	1.6
Current A/c(US$ bill.)	50.6	57.4	60.0	64.0	68.0
NT$/$(nom.)	30.0	31.0	30.8	31.0	31.5

Brazil



More than economic turmoil, Brazil is in the midst of a political chaos and there is a possibility that President Dilma Rousseff may not be able to complete the rest of her term. The slowdown in the economy is partially to be blamed but more than that the fact that when the going was good in the era of rising commodity prices, Brazil government spent all its money on social welfare schemes rather than building a competitive economy. Brazil is paying for that now and in the near term there is no sign of improvement.

Chinese demand for commodities has hit Brazil's economy hard, but it is a massive graft scandal at state-run oil giant Petróleo Brasileiro S. A. affecting the investment climate in the critical oil-and-gas sector and sending shock waves through the rest of the economy.

The government's attempt to boost economic growth by cutting taxes and encouraging state-controlled banks to lend more has backfired. That stimulus led to growing budget deficits and ballooning debt. Brazilian Finance Minister Joaquim Levy is trying to balance the budget by reining in spending, but Congress is in no mood to give in. He had to backtrack on aggressive 2015 fiscal targets, increasing the risks that Brazil could lose its investment-grade status.

After growing just 0.1% in 2014, Brazil's economy is expected to contract 1.8% this year and post no growth in 2016. Brazil's economy has slipped into recession in the second quarter as gross domestic product contracted 1.9% from the previous quarter. The first quarter data is officially revised from a 0.2% reduction in GDP to a 0.7% decline.

Consumption has been hurt by adverse labour market conditions. To make things worse, the fall in the Real has increased the price of imports and fuelled inflation. Consumer confidence sank to a record low and unemployment climbed to 8.3% in the second quarter. Reduction in real wages have put a dent in household spending power.

Brazil's inflation has hit 9.56% for the past 12 months through July, way above the central bank's target of 4.5% with a two-point margin in either direction. This level of inflation was not seen since 2003. The benchmark Selic interest rate of 14.25% seems to be working, but changes in fiscal policy aren't helping.

Brazil's currency, the real, is weaker by more than 30% against the dollar a year ago. Coupled with political uncertainty, markets have responded by punishing Brazil's currency, the real, which is now valued at 3.50 to the dollar, versus 2.25 a year ago.

The current-account deficit was $6.2 billion in July, up from a deficit of $2.5 billion in June. But, there has actually been a big improvement in the 12-month accumulated figure since the start of the year. Brazil's 12-month current-account deficit narrowed to $89.4 billion through July, from $104.7 billion in 2014.

Brazil's unemployment rate surged to a five-year high in July. The jobless rate in six major metropolitan areas jumped to 7.5% in July from 6.9% in June. Rising unemployment could ramp up the pressure on Brazil's embattled president, Dilma Rousseff, whose approval ratings have plunged to a record-low 8% just 10 months after she was elected to a second term. Millions of people across Brazil took to the streets and demanded for the impeachment of President Dilma Rousseff, whose administration has been crippled by a corruption scandal and a badly faltering economy.

Moody's lowered Brazil's government bond rating to Baa3 from Baa2, and changed its outlook to stable from negative. The downgrade puts the rating agency in line with Standard & Poor's Ratings, which also has Brazil's rating one notch into investment-grade territory.

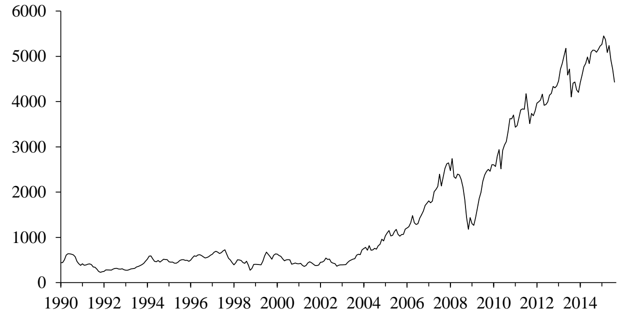
Brazil's Ibovespa equity index has lost 15% of its value in the last three months.

	13	**14**	**15**	**16**	**17**
GDP (%p.a.)	2.5	0.1	-2.0	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	3.5	3.6	3.7

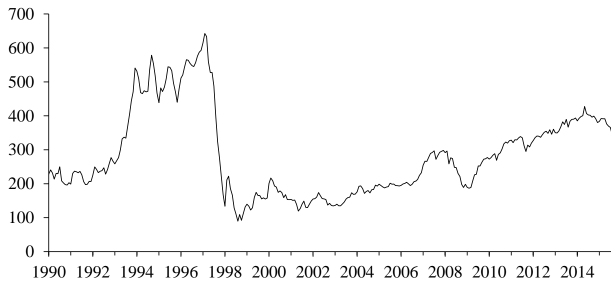
Other Emerging Markets

Hong Kong: FT-Actuaries

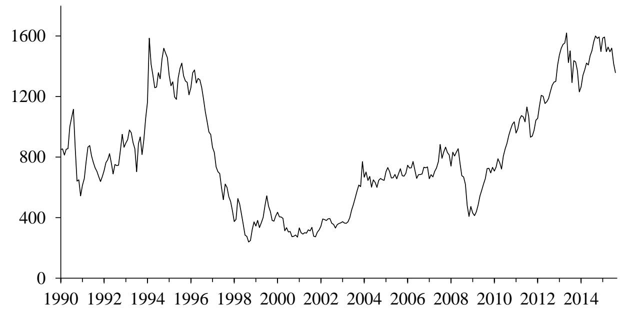
Indonesia: Jakarta Composite



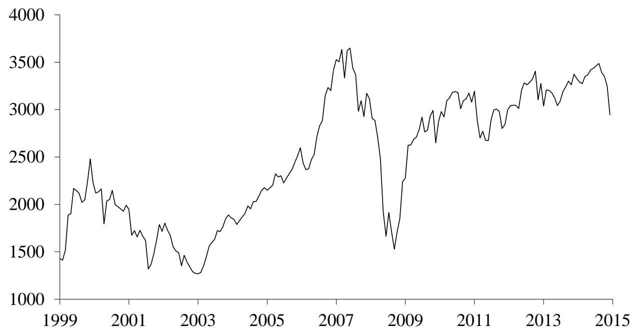
Malaysia: FT-Actuaries (US$ Index)



Thailand: Composite Index



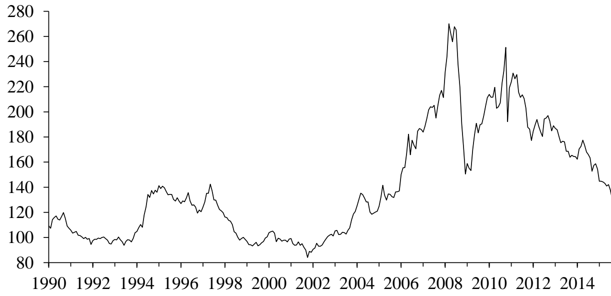
Singapore: Straits Times Index



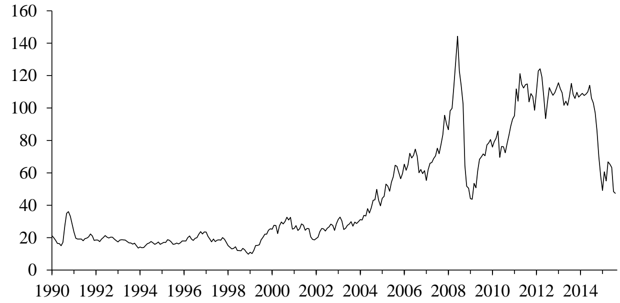
Philippines: Manila Composite

COMMODITY MARKETS

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

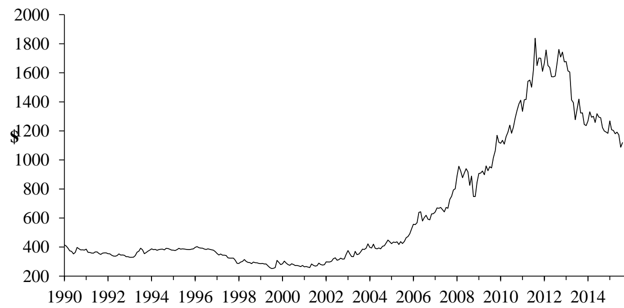


Oil Price: North Sea Brent (in Dollars)

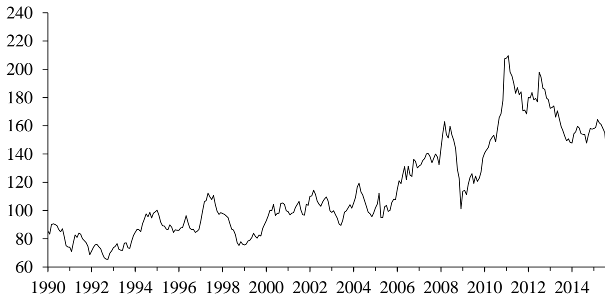


Commodity Price Index (Sterling)
(Economist, 2000=100)

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

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

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

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

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

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

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.

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