LIVERPOOL INVESTMENT LETTER

August 2014

Cardiff Business School
Cardiff University

Julian Hodge Institute of Applied Macroeconomics

LIVERPOOL RESEARCH GROUP IN MACROECONOMICS

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

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

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

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HOW SHOCK-PROOF IS THE GROWTH PROSPECT?

Central banks have remained extremely nervous about the strength and self-sustaining power of the recovery. The Fed still maintains it will keep printing money if at a slower rate while interest rates remain on the floor. The Bank of England has stopped printing money but is loath to raise rates, though some members of the MPC are muttering that it should make a start. The ECB is faced by falling inflation and ongoing weakness of the euro-zone (fuelled by problems with the banks and credit supply) and so is thinking of ways to increase monetary stimulus now that rates cannot be driven any lower. It is no wonder that equity markets are so buoyant, with growth proceeding (even in the euro-zone to a small degree) and yet no prospect of monetary tightening.

Into this picture have stepped the sanctions on Russia over Ukraine, virtually mandated by the tragic shooting down of flight MH17; and problems in China continue to fester, with bad debts accumulating, growth slowing and a destabilising campaign by the new leadership of Xi Jingping against 'corruption' (among his old guard opponents). In this environment there will be setbacks to world growth.

The parallel to consider is the early 1980s. Then too there had been bad recession, the oil crisis of the mid-1970s and then the recession of 1980-82 as world inflation was tamed by tight money. Unemployment was high around most of the West; in the UK it reached 12%. World commodity prices, both oil and non-oil, had reached huge peaks in real terms and were just beginning to come off them. Then from around 1982 until 2006 the world economy grew relentlessly, year in year out, with no general recession until the global crisis starting in 2008. Of course there were regional recessions and difficulties such as: a small US pause in 2001 on collapse of the dotcom boom, in the UK the ERM-provoked recession of the early 1990s and the Asian crisis of 1998. But individual countries and regions will always have their own particular episodes of difficulty or overreach. The point is that was an astonishing quarter-century of uninterrupted world growth, which was then due to come to a brutal stop in the following crisis.

Why the long expansion and why the following stop? It is usual to treat expansion as if it is normal and the stop as due to bank bust after credit excesses. Whatever the role of banks in worsening the crisis, this reading is naïve. Could we really expect world growth to barrel on regardless for another quarter century- some 'normal' continuation of rapid global growth? Surely not, as commodity prices were signalling that the world was running out of resources. When this commodity scarcity started to slow growth down, would one not expect banks to lose money on bets made when growth was fast and unchecked? Thus the bank crisis was as much brought on by world slowdown as world slowdown worsened by bank problems. The charts tell the story rather plainly.

Table 1: Summary of Forecast

	2010	2011	2012	2013	2014	2015	2016
GDP Growth[1]	1.7	1.1	0.2	1.7	2.8	2.7	2.6
Inflation CPI	3.3	4.5	2.7	2.4	2.0	2.2	2.0
RPIX	4.8	5.3	3.2	3.2	2.5	2.8	2.7
Unemployment (Mill.)							
Ann. Avg.[2]	1.5	1.5	1.6	1.5	1.3	1.3	1.2
4th Qtr.	1.5	1.6	1.6	1.4	1.3	1.3	1.1
Exchange Rate[3]	80.4	80.0	83.1	82.6	83.0	82.3	82.5
3 Month Interest Rate	0.7	0.9	0.9	0.6	1.8	2.1	2.2
5 Year Interest Rate	2.4	2.0	0.9	1.2	1.6	2.1	2.3
Current Balance (£bn)	−40.0	−22.5	−59.2	−60.7	−62.9	−63.5	−62.0
PSBR (£bn)	139.6	118.5	115.0	112.3	109.4	94.6	84.5

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

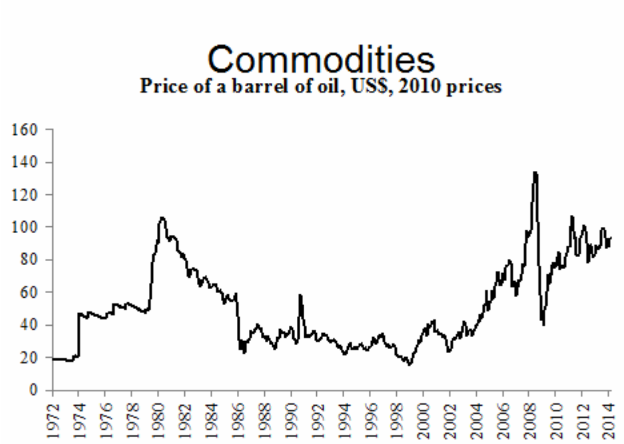
What is noticeable is that the post-1982 expansion mirrored rather faithfully the post-WWII expansion; it too was largely uninterrupted for 25 years and came to halt in a commodity crisis- of the 1970s.

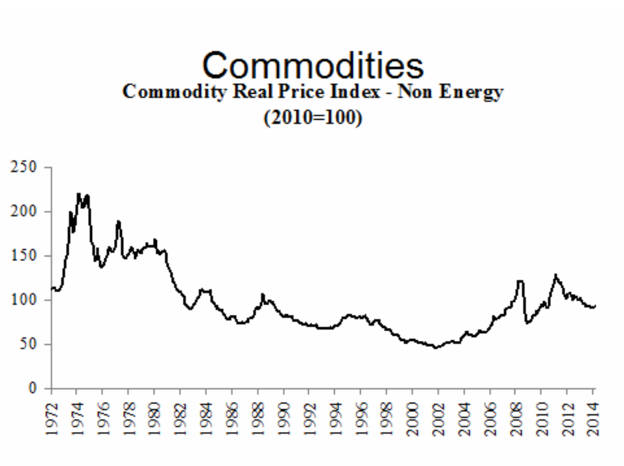
We think these developments also mirror earlier business cycles going back to the late 19th century- this is the subject of ongoing work. Meanwhile it seems that since WWII a pattern can be seen in the behaviour of the world economy and the commodities that ultimately power it. It takes time and high prices to generate the large-scale capital and research effort needed to increase the supply and economise on the demand for commodities as growth proceeds. There seems to be a cycle of plenty fuelling fast productivity growth in the non-commodity economy- this plenty arising from previous large investments in commodity production and associated technology. Then as growth proceeds capacity in commodities is used u, prices rise until shortages become acute again. There is then a stop on growth, and a 'crisis'. With prices so high commodity investment resumes and the cycle repeats itself.

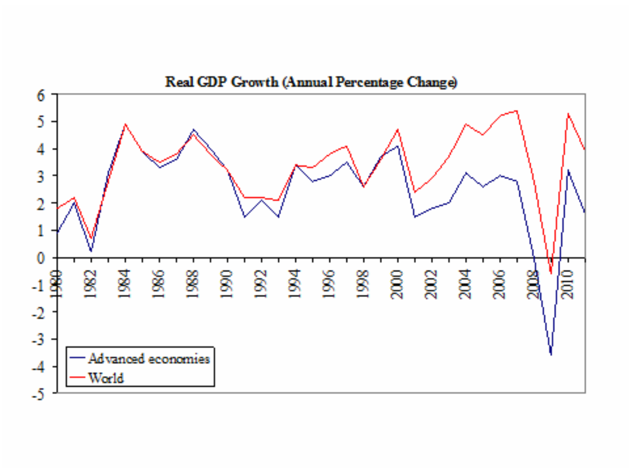
Today we appear to be at the start of such a cycle. Prices of commodities have peaked but are coming down as investment in plant and technology begins to occur. With the Great Recession non-commodity output is well below its previous trend, helping commodity prices to fall. Growth is thereby encouraged but the commodity bind may well not be repeated for another quarter century.

This means that for all the concerns that equity prices have been inflated by Quantitative Easing and generally loose monetary policy their long-term prospects should be assured. Money will be tightened worldwide in 2015-17 and this will slow equity prices. But there is a further factor helping profits and so equities in Western countries: labour markets are chronically weak and wages hardly rising in money terms, falling in real terms. This is because of the massive competition for labour from emerging market economies still entering the world market with large cheap labour supplies. Africa is now well into emergence; Asia still has countries with massive employment possibilities from people previously engaged in low-productivity activities like subsistence agriculture; so does central America. This will be a golden era for capital.

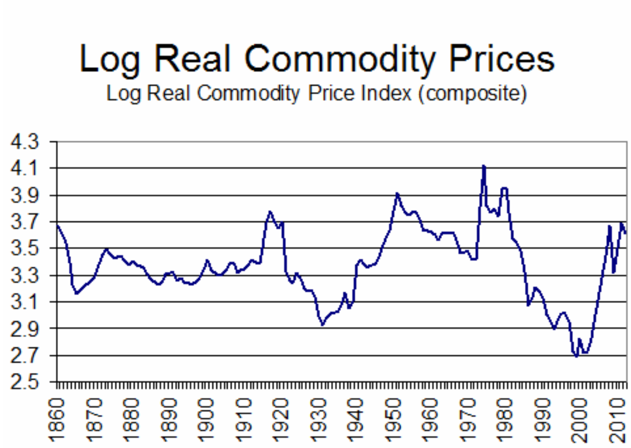
The last few decades:

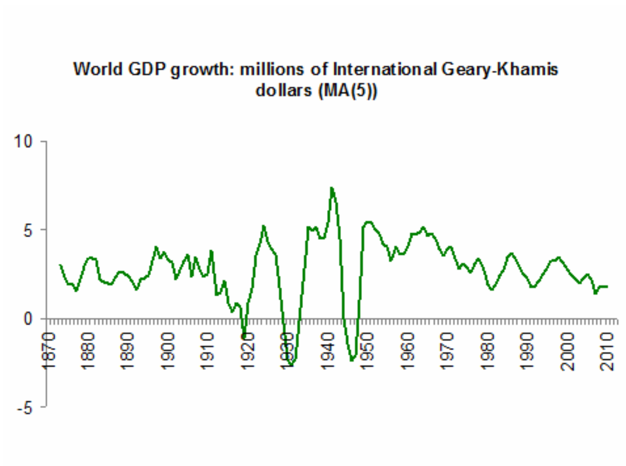




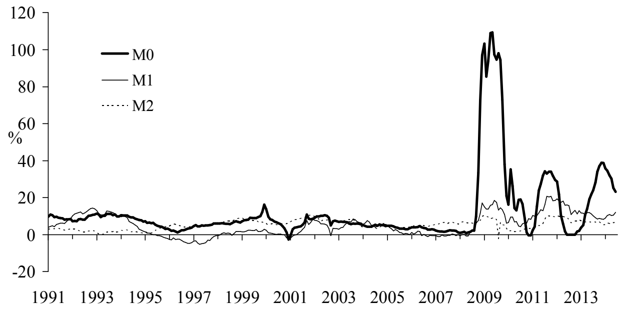


The previous century too:

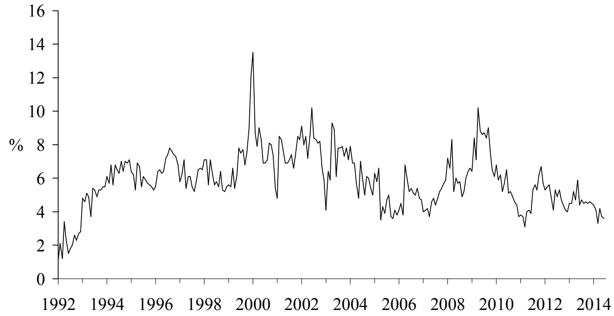




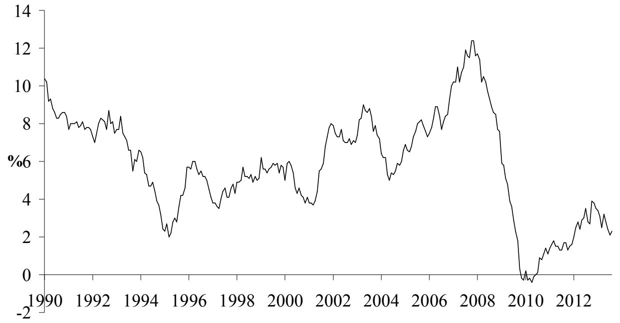
U.S.: Growth in Monetary Aggregates (Yr - on - Yr)



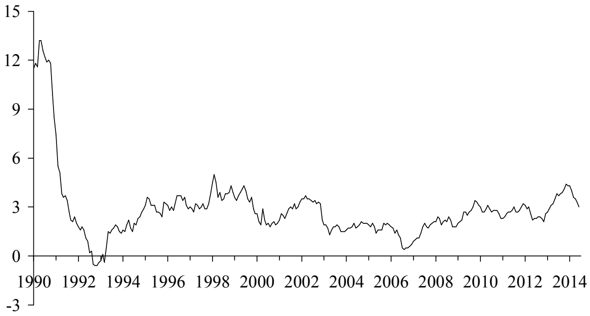
UK: Notes and Coins in Circulation Growth



Eurozone M3 Growth



Japan: Growth of M2+CD's



FOCUS ON JAPAN

Francesco Perugini

The State of the Economy

Soon after coming into office in December 2012, Prime Minister Shinzo Abe launched a set of policies consisting of three pillars, dubbed "the three arrows". The goal of his policies was twofold: to generate inflation and to increase the pace of economic growth — for the past 20 years, Japan's growth has averaged only 0.8% per annum, compared with 1.3% for Germany, 2.3% for the UK, 2.6% for the US, 4.9% for South Korea and 10.4% for China. So far two of the three arrows — a massive fiscal stimulus and more aggressive monetary easing from the Bank of Japan (BOJ) — have been fired with some reasonable effect. The measures have resulted in a weakening of the yen and about a 65% rise in the Japan's stock market index since Abe's election — almost entirely on buying by foreign investors.

However, the "third arrow", the regulatory reforms, has been much more difficult to implement, being blocked by the vested interests of Japan's "iron triangle" of big business, stubborn bureaucrats and squabbling politicians. Measures include increasing private-sector investment (both domestic and inward), infrastructure expenditure (both private and public), increasing farmland, encouraging more women to work by improving day-care facilities for children, and deregulation of goods, capital and labour markets. With the third arrow Abe wants to boost capacity and productivity; however critics say it is long on rhetoric and short on specifics as critical details of the reforms are missing and, most importantly, the measures do not really take aim at vital sectors of the economy (see the July Letter for more details on the implementation of the third arrow).

Overall, Abe's much-ballyhooed growth strategy failed to impress economists and investors alike due to its absence of crucial economic reforms and its small impact on economic growth. In 2013 GDP growth was only 1.2% while in the first quarter of 2014 GDP increased by 1.6% on the previous quarter, only spurred by last-minute purchases ahead of the 3-point consumption tax hike on 1 April. The economy should remain on a soft path of growth for the rest of the year too — with the expected plunge in private consumption and sluggish exports, the government sees real GDP growth at 1.2% in fiscal year 2014, versus 1.4% forecast earlier this year.

Moreover, disenchantment is already appearing in Japan's stock market. Over the last few months, it has lost a third of the gains accumulated since December 2012 as foreign investors sold on their fears that Abe is not spending his political clout on reform.

Meanwhile the yen depreciation has turned into more costly imports for consumers and companies. The real volume of exports — tons of steel, number of cars, and so on — has barely risen since the start of Abe's term. "Sony's problem is not that the yen is overvalued but that the company is no longer creating the innovative products that people want (such as smart-phones and tablets). Likewise, auto exports are flat because automakers continue to shift production offshore rather than exporting from Japan. The fact that Japan now runs a trade deficit despite a currency exchange rate that, in price-adjusted terms, is the cheapest since the 1970s, suggests that it has suffered a deep loss in underlying competitiveness. This requires a real cure, not a chimerical quick fix", says Richard Katz, a long time observer of the Japanese economy.

We have seen many efforts in the last decade or two to try and restart the Japanese economy. But without an overhaul of Japan's bureaucracy and its agricultural, industrial and labour policies, economists say Abenomics is bound to provide only a temporary boost to growth while vastly increasing the country's public debt burden. All agree that reforms are needed to break Japan free of the deflationary malaise that has stymied growth since its bubble economy collapsed more than 20 years ago and sustain growth in the future.

It is the first time in years a Prime Minister has a majority in both houses of the Parliament and is in a position to implement change. Eighty percent of Japanese polled say that Abe's policies have failed to improve their lives at all. Abe remains popular because people still expect Abenomics to start working. Sooner or later, however, its failures will become impossible to ignore, and Abe will lose the political power to make necessary reforms.

MARKET DEVELOPMENTS

Equities remain the must-have part of investors' portfolio even though monetary stimulus will be withdrawn. Labour remains highly plentiful as merging market countries continue to enter the world market. To this is being added renewed investment in commodities- another commodity cycle upswing. Governments meanwhile will be licking their wounds for a decade or more, as they try to reduce the debt/GDP ratio they have run up to deal with the crisis. Bond yields should rise towards normality over the coming two years, with tightening money and continuing growth.

Table 1: Market Developments

	Market Levels Jun 25	Market Levels Jul 31	Prediction for Jul/Aug 2015 Previous Letter	Prediction for Jul/Aug 2015 Current View
Share Indices				
UK (FT 100)	6734	6730	9669	9732
US (S&P 500)	1960	1931	2524	2487
Germany (DAX 30)	9868	9407	13864	13312
Japan (Tokyo New)	1261	1289	1760	1800
Bond Yields (government long-term)				
UK	2.65	2.61	2.00	2.00
US	2.56	2.56	2.10	2.10
Germany	1.26	1.16	1.50	1.50
Japan	0.58	0.54	0.70	0.70
UK Index Linked	–0.14	–0.16	0.10	0.10
Exchange Rates				
UK ($ per £)	1.70	1.69	1.56	1.56
UK (trade weighted)	87.9	88.5	82.3	82.3
US (trade weighted)	86.3	87.5	85.5	85.5
Euro per $	0.73	0.75	0.79	0.79
Euro per £	1.24	1.26	1.23	1.23
Japan (Yen per $)	102.0	103.0	98.0	98.0
Short Term Interest Rates (3-month deposits)				
UK	0.59	0.60	2.10	2.10
US	0.29	0.38	0.70	0.70
Euro	0.17	0.16	0.50	0.50
Japan	0.11	0.11	0.70	0.70

Table 2: Prospective Yields [1]

Equities: Contribution to £ yield of:

	Dividend Yield	Real Growth	Inflation	Changing Dividend Yield	Currency	Total
UK	3.40	2.5	2.1	40.00		48.00
US	1.90	2.8	2.0	24.00	7.58	38.28
Germany	2.70	1.5	2.0	38.00	2.26	46.46
Japan	1.80	1.6	2.0	36.00	12.07	53.47
UK indexed[2]	–0.16		2.4	–5.00		–3.06
Hong Kong[3]	2.40	7.0	2.0	5.00	7.58	23.98
Malaysia	2.90	5.2	2.0	54.00	7.58	71.98
Singapore	3.60	4.5	2.0	37.00	7.58	54.68
India	1.40	7.0	2.0	21.00	7.58	38.98
Korea	1.10	4.2	2.0	0.00	7.58	14.88
Indonesia	2.30	6.1	2.0	42.00	7.58	59.98
Taiwan	2.70	3.0	2.0	25.00	7.58	40.28
Thailand	3.20	4.1	2.0	38.00	7.58	54.88

Bonds: Contribution to £ yield of:

	Redemption Yield	Changing Nominal Rates	Currency	Total
UK	2.61	6.10		8.71
US	2.56	4.60	7.58	14.74
Germany	1.16	–3.40	2.26	0.02
Japan	0.54	–1.60	12.07	11.01

Deposits: Contribution to £ yield of:

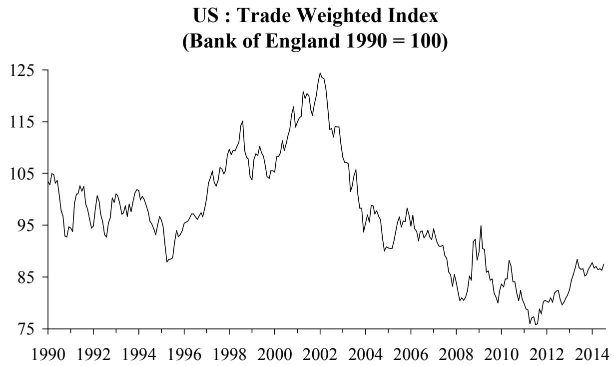
	Deposit Yield	Currency	Total
UK	0.60		0.60
US	0.38	7.58	7.96
Euro	0.16	2.26	2.42
Japan	0.11	12.07	12.18

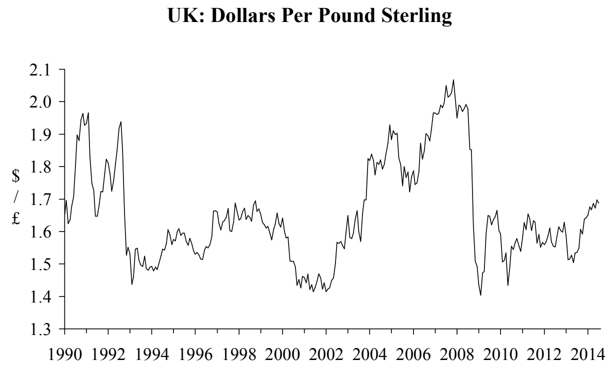
[1] Yields in terms of €s or $s can be computed by adjusting the £-based yields for the expected currency change.
[2] UK index linked bonds All Stocks
[3] Output based on China.

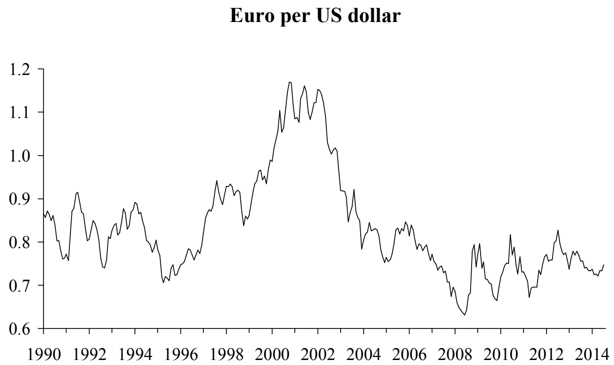
Table 3: Portfolio(%)

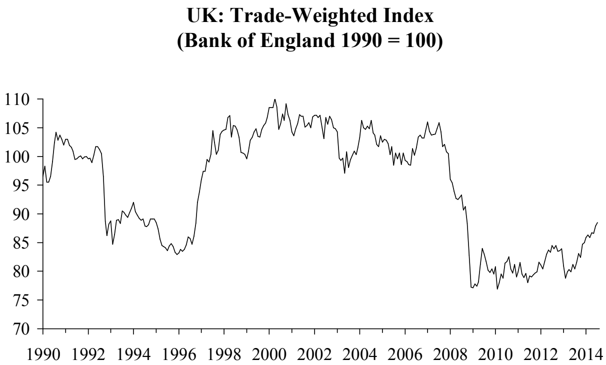
	Sterling Based Investor		Dollar Based Investor		Euro Based Investor	
	July Letter	Current View	July Letter	Current View	July Letter	Current View
UK Deposits (Cash)	5	5	5	5	1	1
US Deposits	-	-	-	-	-	-
Euro Deposits	-	-	-	-	-	-
Japanese Deposits	-	-	-	-	-	-
UK Bonds	-	-	-	-	-	-
US Bonds	-	-	-	-	-	-
German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

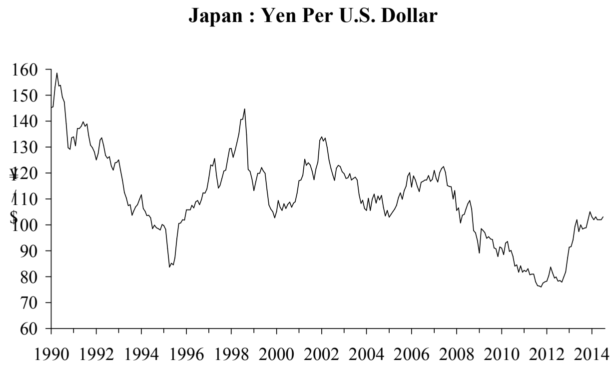
INDICATORS AND MARKET ANALYSIS
FOREIGN EXCHANGE MARKETS







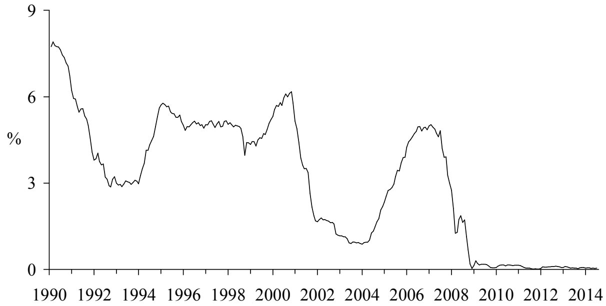




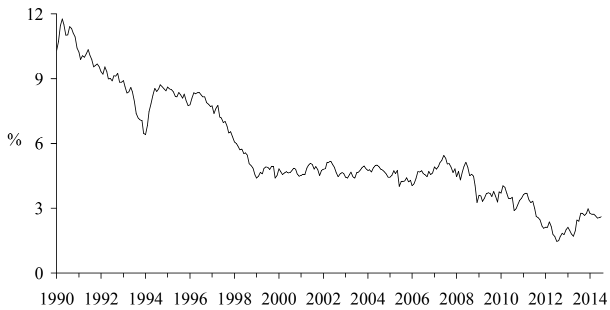
GOVERNMENT BOND MARKETS

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

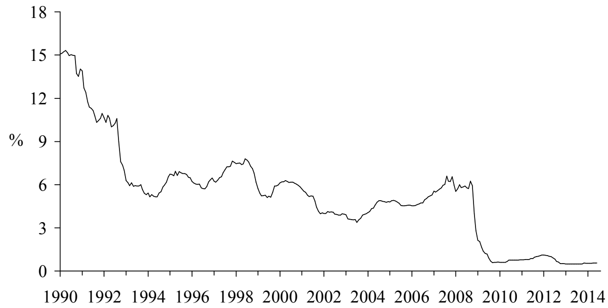
U.S. : 3-Month Treasury Bill



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

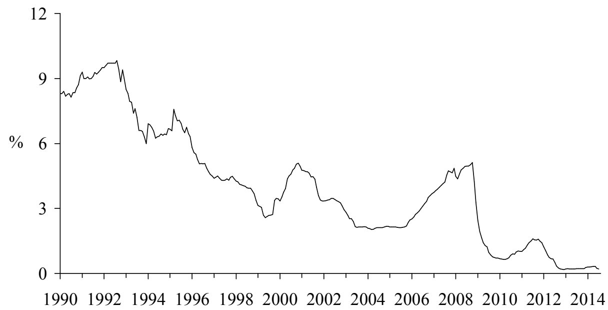


U.K. : 3-Month Interbank Rate



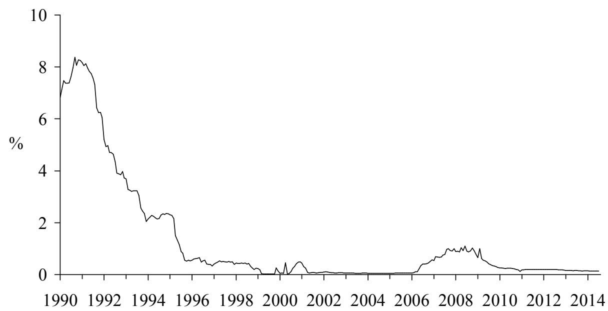
Germany: Yield on Public Authority Bonds

Germany : 3-Month Interbank Deposit Rate



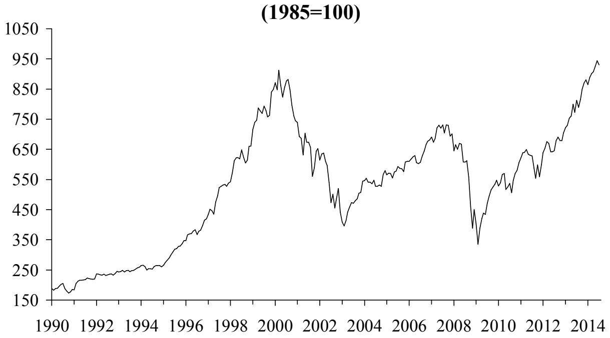
Japan: Yield on Long-Term Government Bonds

Japan : 3 Month Money Market Rate

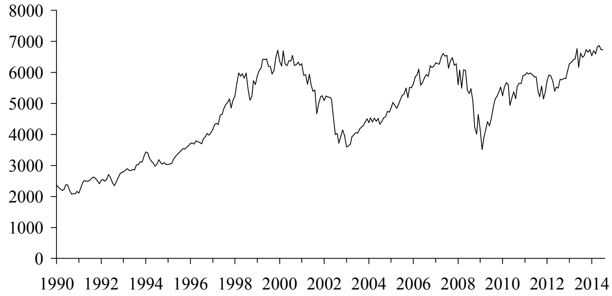


MAJOR EQUITY MARKETS

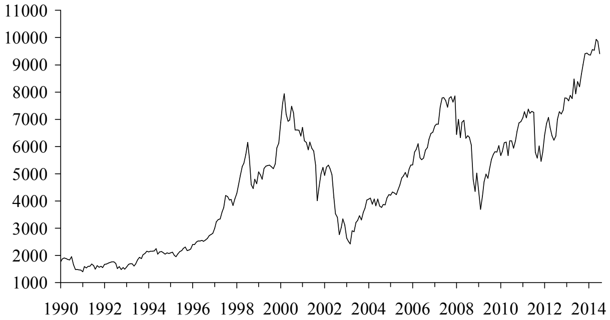
U.S. : S & P 400 Industrial (1985=100)



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



Germany : DAX 30



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

EMERGING MARKETS

Anupam Rastogi

India

India's industrial output grew at its strongest pace in 19 months in May, the latest sign that the optimism generated by India's new government is helping boost business. Consumer inflation dropped to its lowest level in more than two years and as dark clouds of droughts and high crude oil prices are receding, the confidence in the country is growing.

The Narendra Modi government missed a big bang budget but all attempts are being made to ensure that the PM's speech on 15th August, Independence Day, will have some announcements of the proposals, promised during the election campaign, implemented in record time.

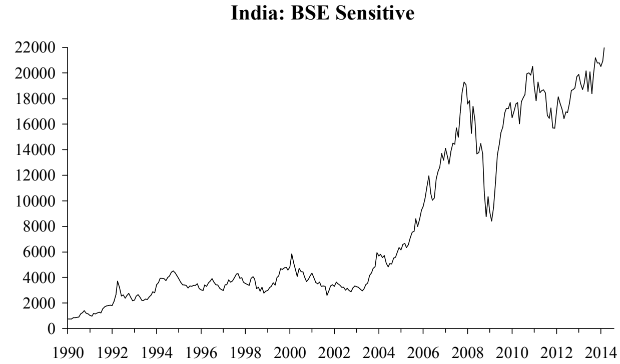
Mr. Jaitley, the finance minister, unveiled a blizzard of grants, exemptions, rebates and allocations to micromanage the economy and build "smart cities" to rural toilets in his first budget. Some of these no doubt have political motives; the ruling Bharatiya Janata Party has its eye on state elections later this year. The Finance Minister also offered some reform commitments, such as reductions in fuel and other subsidies. Privatization of state-owned enterprises is slated to bring in $13 billion, almost four times of what was achieved in the last year. If he can replace overlapping indirect taxes with a single goods and services tax as planned, businesses should benefit from lower compliance costs and find it easier to trade between states. All in all he tried fiscal consolidation, provided for much needed expenditure on infrastructure, boosted job creation by providing incentives to industry and promised not to bring retrospective amendments to tax laws.

Overall the budget is pragmatic and directionally sound. He has implicitly set a high target of raising $13 billion through disinvestment. There is a particular focus on government-owned banks, which need $40 billion by 2018 to meet Basel capital standards. A booming stock market should help the government achieve its target.

The budget cements Modi and his Government's reputation as being someone who wants to take the reforms and investments route in order to grow India's economy. There were no big-bang announcements on the social spending front.

Now, the most important part is execution. Therefore, it would be interesting to see what kind of steps the minister takes in order to achieve the target.

The consumer-price index rose 7.31% from a year earlier. The rise was the lowest since the series was started in January 2012. The wholesale price index, another closely



watched inflation gauge, climbed 5.43% from a year earlier, a slower increase than the 6.01% year-over-year rise recorded in May. Notwithstanding moderation in the inflation rate, the Reserve Bank of India is likely to leave its key interest rate unchanged on August 5 and won't ease policy until early next year.

India's merchandise exports grew by more than 10% in June. June exports increased 10.2% from the year-earlier month to $26.48 billion, after climbing 12.4% in May and 5.3% in April. Imports rose 8.3% to $38.24 billion, following the 11.4% decline in May The trade deficit stood at $11.76 billion in June, compared with $11.23 billion in May and $11.28 billion in June 2013.

The Indian equity markets are clearly in a state of high optimism right now. In fact, one might even be tempted to call it euphoria. The run up which began well before the elections has resulted in huge short term gains across stocks and sectors. The 30-company Sensex index has gained 25% so far in 2014 and has been hovering around the 26000-level since the July 10 budget in which investors had expected to see more deregulation. Foreign investors — the crucial swing investors who often decide whether the Indian market rises or falls — have poured about $25 billion in the markets so far. They were net buyers of $20 billion a year over the last two years.

Deal-making activity in India is off to its best start in the last three years, as companies and investors become optimistic about the country's prospects.

India is on the verge of vetoing the Trade Facilitation Agreement of WTO, and at issue yet again are the country's massive government programs to help both, the farmers and the millions of poor households who buy the food they grow. However, the US and other developed countries say the financial support that India, China and some other developing countries are providing to agriculture violates their commitments to the WTO, which sets a cap on food production subsidies.

	11-12	12-13	13-14	14-15	15-16
GDP (%p.a.)	6.2	4.5	4.7	6.0	7.0
WPI (%p.a.)	9.0	7.5	7.0	6.5	6.0
Current A/c(US$ bill.)	-40.0	-88.0	-50.0	-50.0	-50.0
Rs./$(nom.)	49.5	54.5	60.0	61.0	62.0

China

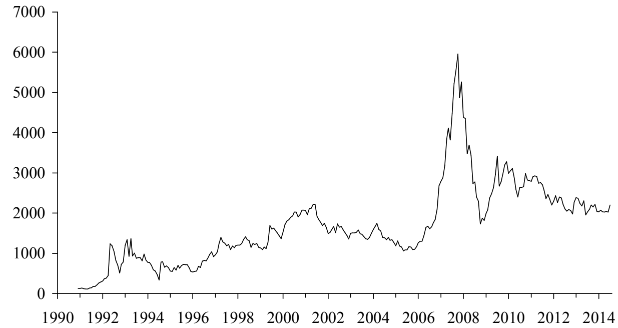
The economy grew 7.5% in the second quarter compared with 7.4% growth in the first quarter, which was the slowest pace in 18 months. However, the priority of Premier Li Keqiang is to keep unemployment in check so long as income is growing. After a sluggish start to the year, China's economy appears to be picking up speed, with July's HSBC Preliminary Purchasing Managers' Index hitting an 18-month high of 52.0 from 50.7 at the end of June. The "Keqiang index", named after premier Li Keqiang has electricity use and rail freight increasing by 8% and 5% respectively. This offers indisputable evidence that China is emerging from its economic slowdown and that the government's selective stimulus efforts are bearing fruit. Beijing is trying to walk a fine line between stimulating small businesses with tax breaks and by steering bank lending to that sector while keeping a grip on the expansion of bigger, debt-laden state-owned businesses and property developers.

GDP generated by services outstripped secondary industry (manufacturing and construction) for the first time last year, and continued to grow in the first half of 2014. Consumption also contributed more than half of all GDP growth in the first half of this year. By contrast in 2013, investment generated more than half of GDP growth. This indicates that China is progressing well in rebalancing its economy — from an export oriented economy to a consumption led economy taking shape. China is focusing on the service sector economy as well even though service-oriented economies tend to grow slowly, but more consistently than those reliant on manufacturing and construction. They are also more labour-intensive, so slower rates of growth can still generate plenty of jobs.

China's consumer-price index rose 2.3% in June from a year earlier compared with a 2.5% year-over-year rise in May, according to the National Bureau of Statistic. Inflation remains below Beijing's annual target of 3.5% year for 2014.

Chinese exports grew in June on the back of strengthening U.S. consumer demand, in a positive sign for China's factory sector and for the global economic outlook. Chinese exports expanded by 7.2% year-over-year in June, compared with the 7% year-over-year increase in May. China's trade surplus was $31.6 billion in June, well below May's $35.92 billion surplus. Imports grew by 6% year-over-year in June compared with a 1.6% decline in May.

China: SSE Composite Index



The Chinese currency has depreciated by 2.4% against the dollar this year and is currently trading at around 6.19 yuan to the dollar, up from a 3% depreciation earlier this year. U.S. Treasury Secretary, Jacob Lew, pressed China for more currency appreciation amid U.S. accusations that Beijing is continuing to suppress the value of the yuan. Beijing argues that the market now determines the currency's value, an assessment the U.S. challenges but stopped short of calling the country a "currency manipulator."

Argentina and China signed multibillion-dollar infrastructure-financing and currency-swap deals during a visit by Chinese President Xi Jinping, a sign of the Asian country's growing influence in Latin America and keeping up with its objective of internationalization of the yuan. The two governments approved 20 agreements, including 70 billion yuan currency swap between central banks, equivalent to about $11 billion.

The central banks of China and Switzerland also signed a bilateral currency swap agreement. Switzerland hopes to become a trading hub for the Chinese currency. Under the terms of the deal, renminbi and Swiss francs can be purchased and repurchased between the two central banks, up to a limit of Rmb150bn or SFr21bn. The deal comes amid fierce competition among western financial centres for renminbi business. Earlier this year, the PBoC struck deals with the Bundesbank in Frankfurt and the Bank of England in London, which will make it easier for business to be settled in the Chinese currency in both centres.

	11	12	13	14	15
GDP (%p.a.)	9.2	7.7	7.7	7.5	7.0
Inflation (%p.a.)	4.3	2.6	3.5	2.5	2.5
Trade Balance(US$ bill.)	210	214	220	220	200
Rmb/$(nom.)	6.3	6.3	6.2	6.3	6.3

South Korea

The economy grew a seasonally adjusted 0.6% in the second quarter. This is the weakest quarter-on-quarter growth. The government reduced its 2014 growth forecast to 3.7% from 3.9%. The government announced a $40 billion stimulus package to boost domestic demand that will increase household debt. They included a relaxation of limits on mortgage loans—a move to try to jump-start the stagnant property market. This may prop up a weakening economy, but the measures risk worsening already-high debt levels of the household sector.

South Korean manufacturers are facing tough export market due to a stronger won. The electronics leader Samsung has lost market share for its smartphones to Apple's iPhone and to cheaper competitors such as China's Huawei. But with Taiwan reporting a substantial bounce in industrial production last week, mostly because of revived semiconductor orders, there's hope yet that June could show the beginnings of a turnaround for South Korean industry.

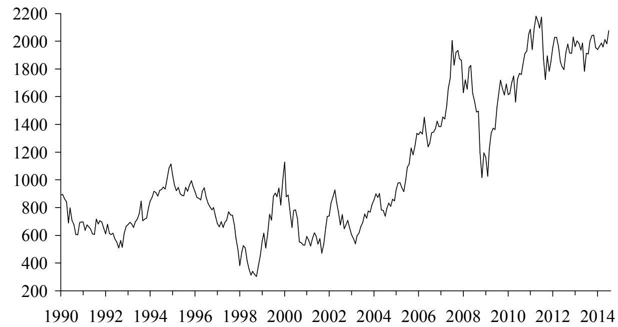
With a weaker-than-expected recovery and tamed increase in consumer prices, the BOK has some elbow room to cut interest rates. The BOK kept its policy rate on hold at 2.5% for 14th straight month in mid-July. The nation's new finance minister, Choi Kyung-hwan, also made the case for a rate cut in Parliament. A cut of 0.25 percentage point at its next policy board meeting on August 14 is expected to boost growth.

Korea's trade deficit with the E.U. widened to $7.4 billion in the ten months through May, two months before the third anniversary of the implementation of their free-trade agreement. Korea posted a deficit of $4.6 billion in the second year after the deal, following a surplus of $1.8 billion in the first. South Korea has completed 12 FTAs—including nine already in effect and three awaiting ratification—since the first deal with Chile became effective in 2004. The trade ministry is negotiating or studying another 13 more deals.

South Korean authorities frequently warn of an overvalued currency. To ride over the volatility in the currency market, they have added to forex reserves and built up long positions in foreign currency forwards against the won – a form of intervention that does not show up in headline reserves data.

South Korea's financial authorities issued a rare warning last month about the surging Korean currency as the won hit a six-year high against the dollar, which threatens to erode the nation's export competitiveness. The won has risen about 10% in the past year and was the best-performing Asian currency of 2014. The Korean currency strengthened to as far as 1,009 per dollar, its strongest level since July 2008. For now, financial authorities are still allowing the won to appreciate, but if the exchange rate approaches the important 1,000 level, it will take action aggressively.

Korea: Composite Index



	11	12	13	14	15
GDP (%p.a.)	3.6	2.0	2.8	3.7	4.0
Inflation (%p.a.)	4.0	2.2	1.3	2.0	2.5
Current A/c(US$ bill.)	27.0	44.0	71.0	80.0	80.0
Won/$(nom.)	1100	1100	1100	1020	1000

Taiwan

Taiwan's industrial production rose 8.63% year-over-year in June for the fifth straight month, as demand for semiconductors and other electronic components for hand-held devices remained strong. The economic growth of the country this year would be around 3% compared to 2.1% recorded last year. The economy is still operating below its full potential, due to uneven demand from developed economies and Taiwan's loss of global market share in personal computers, smartphones and television panels.

The consumer-price index rose 1.64% in June from a year earlier, suggesting the central bank may not be able to keep policy interest rates low enough to promote economic growth. Inflation could exceed 2% in the third quarter. CPI growth remained below the central bank's target of 2%. Higher import prices of food and fuel and a buoyant local stock market drove prices 1.62% higher in March and inflation has hovered there since then.

Taiwan's export orders grew at their fastest pace in 17 months in June, a sign that a recovering global economy is boosting demand for Asia's electronics and other manufactured goods. Taiwan's exports expanded 3% in the second quarter, up from just 1% in the first quarter.

	11	12	13	14	15
GDP (%p.a.)	4.0	1.3	2.1	3.0	3.0
Inflation (%p.a.)	1.2	1.9	1.2	1.5	1.5
Current A/c(US$ bill.)	18.0	41.7	50.6	57.4	60.0
NT$/$(nom.)	30.0	29.5	30.0	30.5	30.5

Brazil

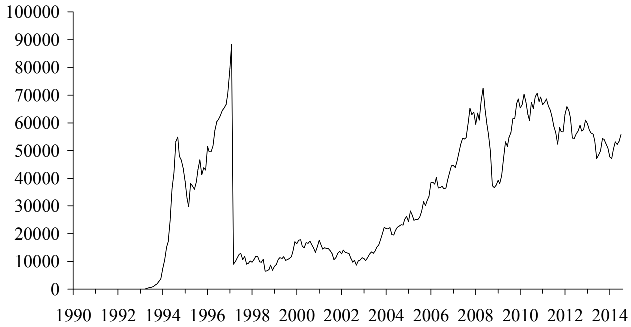
Brazil is on the brink of a mild recession. The government cut its economic growth forecast for 2014 to 1.8% in 2014 from the 2.5% projected earlier this year. The government also raised its forecast for inflation for the year, to 6.2% from 5.6%. The country is directionless and in the midst of the presidential election the government cannot take hard decisions to revive the economy with long term prospects. A package of economic measures announced by Brazil's government, at the beginning of July, is met with skepticism. The package includes incentives for investors to buy corporate bonds and stocks issued to finance infrastructure projects, tax breaks and a back-tax payoff program for companies. These are ad hoc measures instead of long-term reforms required to revive the industry. Unfortunately, the government spends too much money in cash-assistance welfare programs which have stoked inflation by increasing the purchasing power of millions of consumers. A high-employment policy has increased labour costs, which has fuelled prices further.

Brazil's annual inflation rate rose to 6.52% in June compared to 6.37% in May. The CPI has been well above the central point of the target range, or 4.5%, for over a year, and was at 5.9% at the end of 2013.

The central bank has sent a strong signal to the market that the Selic rate will remain unchanged at 11% for the rest of the year. It fits with its inflation strategy as well as it will keep the monetary authority out of the country's politics ahead of the presidential election in October. The government has left its forecast for the exchange rate at the end of the year unchanged at 2.29 reais to the dollar.

Brazil's presidential election is set for October 5, with a second round if needed, scheduled for October 26. President Dilma Rousseff, who faces re-election, has been losing ground with potential voters and raised the odds that she will face a runoff in October's presidential election.

Brazil: Bovespa



Though Ms. Rousseff is still favored to win against Aecio Neves of the Brazilian Social Democracy Party and Eduardo Campos of the Brazilian Socialist Party, a survey published by the newspaper Folha de S. Paulo showed the President reducing her advantage over the main contender.

According to Moody's macroeconomic conditions will not improve in the rest of the year, even after uncertainty surrounding the coming October general election fades away. The country's sovereign rating will likely be affected by any policy changes made by the winner of the presidential election. Moody's has an investment-grade Baa2 rating for Brazil, with a stable outlook, meaning that the agency isn't planning to change the country's grade for the time being. But with slowing growth and persistent inflation, the scenario is getting more challenging for Brazilian policy makers.

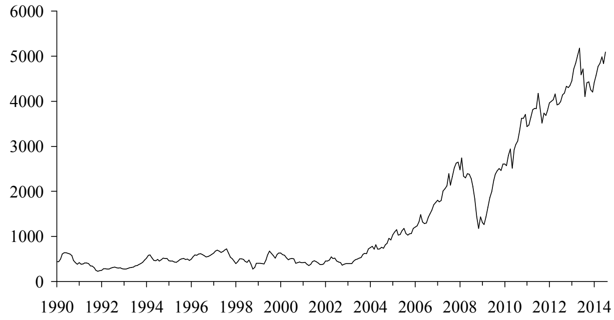
But as Brazil's economy slows, China is hoping to play a larger role in funding critical infrastructure in South America's largest country.

	11	12	13	14	15
GDP (%p.a.)	2.7	0.9	2.5	0.4	1.5
Inflation (%p.a.)	6.5	5.8	5.9	6.5	6.0
Current A/c(US$ bill.)	-52.6	-60.0	-75.0	-70.0	-70.0
Real/$(nom.)	1.5	2.0	2.3	2.30	2.40

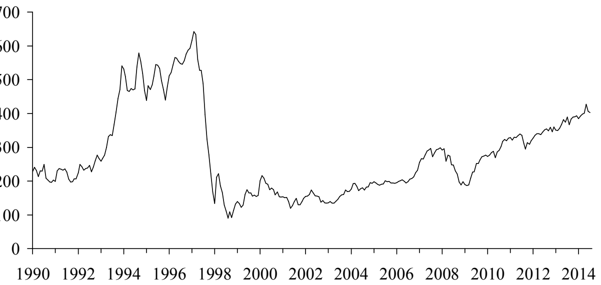
Other Emerging Markets

Hong Kong: FT-Actuaries

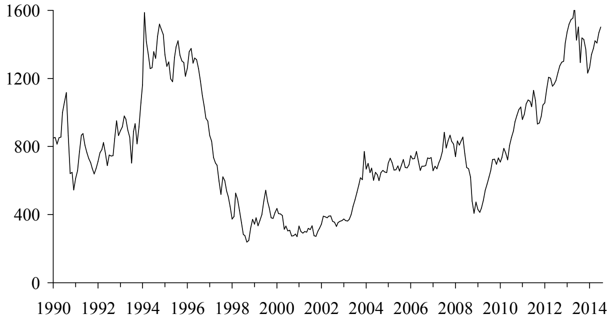
Indonesia: Jakarta Composite



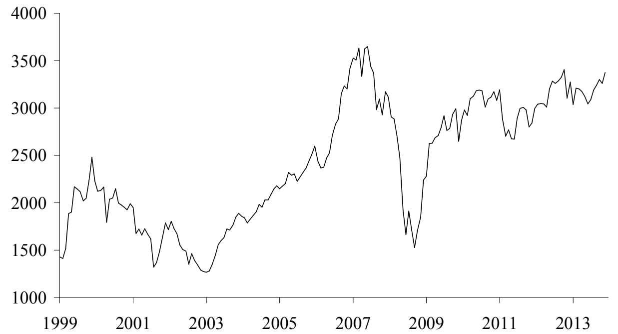
Malaysia: FT-Actuaries
(US$ Index)



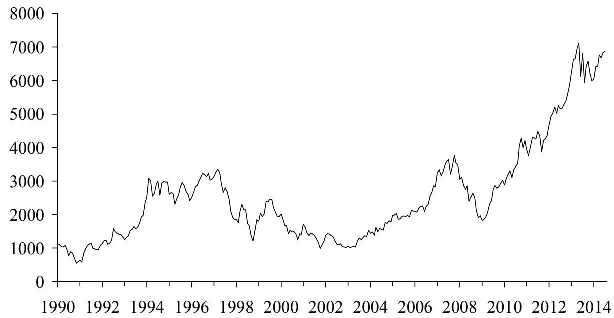
Thailand: Composite Index



Singapore: Straits Times Index

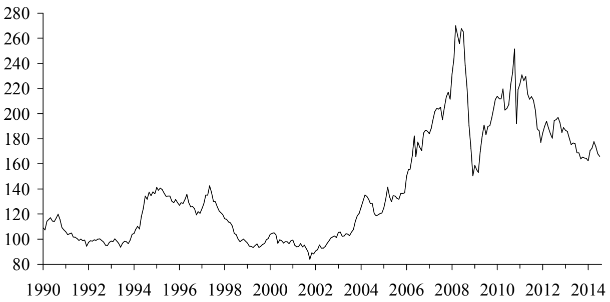


Philippines: Manila Composite

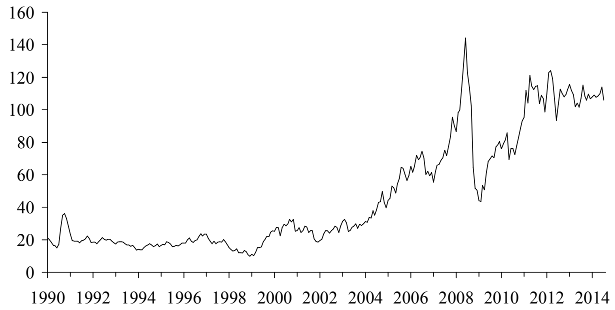


COMMODITY MARKETS

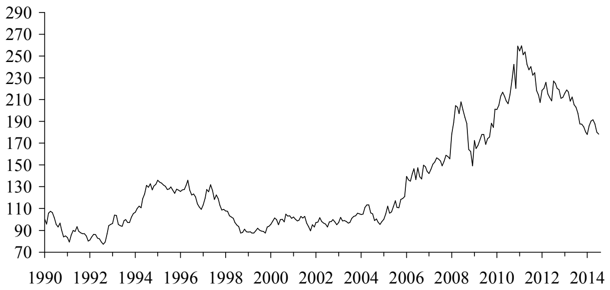
Commodity Price Index (Dollar)
(Economist, 2000=100)



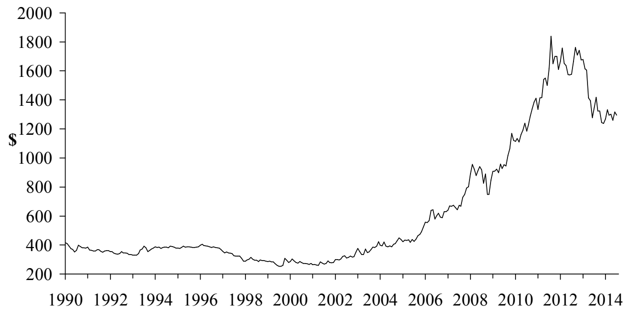
Oil Price: North Sea Brent (in Dollars)



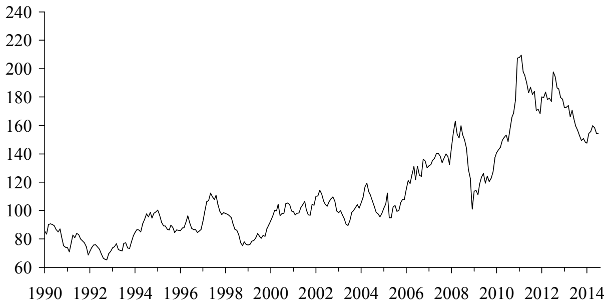
Commodity Price Index (Sterling)
(Economist, 2000=100)



Gold Price (in Dollars)



Commodity Price Index (Euro)
(Economist)



UK FORECAST DETAIL

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

	Inflation %[1] (CPI)	Short Dated (5 Year) Interest Rates	3 Month Int. Rates	Nominal Exchange Rate (2005=100)[2]	Real Exchange Rate[3]	Real 3 Month Int. Rates %[4]	Inflation (RPIX)	Real Short Dated Rate of Interest[5]
2010	3.3	2.4	0.7	80.4	88.6	−3.5	4.8	−0.2
2011	4.5	2.0	0.9	80.0	89.8	−2.8	5.3	−0.2
2012	2.7	0.9	0.9	83.1	93.9	−1.8	3.2	−1.4
2013	2.4	1.2	0.6	81.4	92.5	−1.7	3.2	−1.0
2014	2.0	1.6	1.8	83.0	94.1	−1.1	2.5	−0.4
2015	2.2	2.0	2.1	82.3	95.4	0.1	2.8	0.1
2012:1	2.7	1.1	1.1	81.2	91.6	−1.9	3.8	−1.3
2012:2	3.1	0.9	1.1	83.1	94.2	−1.4	3.2	−1.4
2012:3	2.5	0.7	0.8	84.1	95.2	−1.8	2.9	−1.6
2012:4	2.5	0.8	0.6	83.6	94.8	−2.0	3.0	−1.5
2013:1	2.6	1.0	0.6	80.3	90.9	−1.7	3.3	−1.3
2013:2	2.3	1.0	0.6	80.6	92.6	−1.9	3.1	−1.3
2013:3	2.4	1.5	0.5	81.2	93.2	−1.5	3.2	−0.7
2013:4	2.5	1.5	0.7	83.5	93.2	−1.9	3.2	−0.7
2014:1	1.8	1.6	1.2	82.9	93.7	−0.9	2.5	−0.5
2014:2	2.0	1.6	1.6	82.8	94.0	−1.1	2.5	−0.4
2014:3	2.0	1.7	1.9	82.9	94.0	−1.2	2.5	−0.4
2014:4	2.1	1.7	2.2	83.4	94.6	−1.2	2.6	−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)
2010	227.1	2.4	4.6	1.50	135.6
2011	232.7	2.5	4.6	1.53	133.5
2012	237.0	1.9	4.7	1.59	132.4
2013	240.2	1.4	4.3	1.45	131.0
2014	246.3	1.6	3.9	1.33	131.1
2015	251.0	2.2	3.9	1.31	133.3
2012:1	236.6	0.7	4.8	1.61	132.6
2012:2	238.1	1.8	4.8	1.59	132.2
2012:3	238.1	1.9	4.7	1.57	132.9
2012:4	236.6	3.3	4.6	1.56	131.8
2013:1	238.2	0.6	4.5	1.54	130.1
2013:2	239.5	2.4	4.4	1.50	132.3
2013:3	240.6	0.8	4.1	1.39	130.8
2013:4	242.5	1.7	4.0	1.37	130.8
2014:1	243.6	3.1	4.0	1.36	130.7
2014:2	245.5	1.6	3.9	1.34	131.1
2014:3	247.4	2.7	3.8	1.31	131.1
2014:4	248.6	2.8	3.8	1.30	131.2

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

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

	Expenditure Index	£ Million '90 prices	Non-Durable Consumption[2]	Private Sector Gross Investment Expenditure[3]	Public Authority Expenditure[4]	Net Exports[5]	AFC
2010	143.2	685816.8	412464.1	222982.1	180596.2	–35977.3	94248.2
2011	144.8	693480.0	405707.9	232196.6	179249.7	–24641.9	99032.3
2012	145.0	694345.6	405044.8	241788.1	182996.5	–31204.8	104279.0
2013	147.5	706149.6	409500.3	244931.3	182264.4	-32815.0	102184.0
2014	151.6	725921.8	416052.3	266975.2	176432.0	-38621.8	95765.3
2015	155.3	743343.9	422293.1	285663.4	180489.9	-31157.8	98734.0
2010/09	1.7		0.3	11.0	0.1		8.3
2011/10	1.1		–1.6	3.8	–0.8		4.5
2012/11	0.2		–0.1	2.5	3.0		3.0
2013/12	1.7		1.1	1.3	-0.4		-2.0
2014/13	2.8		1.6	9.0	-3.2		-6.3
2015/14	2.4		1.5	7.0	2.3		3.1
2012:1	145.2	173789.2	101182.0	58927.4	47960.2	–6985.4	27295.1
2012:2	144.5	172990.1	101166.9	58367.1	44720.2	–8453.9	22810.2
2012:3	145.4	174050.5	100983.7	61663.0	45063.8	–7626.9	26033.1
2012:4	145.0	173515.9	101712.2	62830.6	45252.2	–8138.6	28140.5
2013:1	147.7	176743.6	102295.0	59693.5	47768.4	-7067.3	27132.5
2013:2	147.0	175930.9	102279.7	59125.9	44541.3	-7180.1	24182.3
2013:3	147.9	177009.4	102094.5	62464.6	44883.5	-9285.0	25475.0
2013:4	147.5	176465.7	102831.0	63647.4	45071.2	-9282.6	25394.2
2014:1	151.8	181692.4	103931.7	65065.9	46239.8	-9664.1	23431.4
2014:2	151.1	180857.0	103916.2	64447.2	43116.0	-9655.3	23693.8
2014:3	152.0	181965.6	103728.0	68086.4	43447.3	-9650.6	24248.6
2014:4	151.6	181406.7	104476.3	69375.7	43628.9	-9651.8	24391.5

1 GDP at factor cost. Expenditure measure; seasonally adjusted
2 Consumers expenditure less expenditure on durables and housing
3 Private gross domestic capital formation plus household expenditure on durables and clothing plus private sector stock building
4 General government current and capital expenditure including stock building
5 Exports of goods and services less imports of goods and services

Financial Forecast

	PSBR/GDP %[1]	GDP[1] (£bn)	PSBR (£bn) Financial Year	Debt Interest (£bn)	Current Account (£ bn)
2010	10.5	1319.8	139.6	36.6	–40.0
2011	8.4	1399.3	118.5	43.0	–22.5
2012	8.0	1429.6	115.0	46.4	–59.2
2013	7.6	1482.5	112.3	48.0	–60.7
2014	7.1	1549.3	109.4	52.8	–62.9
2015	5.9	1613.2	94.6	60.3	–63.5
2012:1	5.9	356.4	21.0	11.5	–12.5
2012:2	10.5	350.3	36.7	11.4	–17.3
2012:3	7.2	358.6	25.7	11.8	–14.8
2012:4	10.6	364.3	38.6	11.8	–13.1
2013:1	3.8	364.3	14.0	12.0	–14.0
2013:2	9.3	363.3	33.7	11.6	–16.7
2013:3	6.2	369.4	23.1	12.0	–15.5
2013:4	7.6	374.6	28.3	12.3	–12.8
2014:1	7.2	375.2	27.3	12.7	–15.9
2014:2	6.9	379.8	26.2	13.1	–17.3
2014:3	7.1	384.4	27.3	13.5	–16.0
2014:4	7.1	390.1	27.9	13.6	–13.3

1 GDP at market prices (Financial Year)

WORLD FORECAST DETAIL

Growth Of Real GNP

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

Growth Of Consumer Prices

	2009	2010	2011	2012	2013	2014
U.S.A.	–0.3	1.6	3.1	2.1	1.6	2.0
U.K.	1.3	3.3	4.5	2.7	2.4	2.0
Japan	–1.4	–0.7	–0.3	0.0	0.0	2.0
Germany	0.4	1.2	2.0	2.0	1.7	2.0
France	0.1	1.5	2.1	2.0	1.1	1.5
Italy	0.8	1.5	2.8	3.0	1.4	1.6

Real Short-Term Interest Rates

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

Nominal Short-Term Interest Rates

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

Real Long-Term Interest Rates

	2009	2010	2011	2012	2013	2014
U.S.A.	1.3	1.0	0.9	–0.2	0.1	0.6
U.K.	–0.3	–0.2	–0.2	–1.4	–1.0	–0.5
Japan	1.2	0.4	–0.2	–0.8	–1.3	–1.1
Germany	2.2	1.8	–0.1	–0.4	–0.5	–0.1
France	2.2	1.9	–0.1	–0.4	–0.5	–0.1
Italy	1.5	1.2	–0.7	–0.8	–0.6	–0.1

Nominal Long-Term Interest Rates

	2009	2010	2011	2012	2013	2014
U.S.A.	3.2	3.1	1.9	1.8	2.1	2.6
U.K.	2.8	2.4	2.0	0.9	1.2	1.6
Japan	1.3	1.1	1.0	0.8	0.7	0.9
Germany	4.0	3.8	1.8	1.5	1.5	1.9
France	4.0	3.8	1.8	1.5	1.5	1.9
Italy	4.0	3.8	1.8	1.5	1.5	1.9

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

	2009	2010	2011	2012	2013	2014
U.S.A.	88.7	87.4	85.7	90.4	97.3	99.1
U.K.	76.7	88.6	89.8	93.9	92.5	94.1
Japan	89.0	92.0	97.1	98.3	119.7	122.0
Germany	105.8	102.9	105.5	104.3	107.4	108.2
France	104.3	103.1	105.5	104.9	107.9	108.6
Italy	105.4	103.6	106.9	107.4	111.8	113.2

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

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

	2009	2010	2011	2012	2013	2014
U.S.A.[1]	85.98	83.73	78.08	80.90	85.50	85.40
U.K.	1.57	1.58	1.61	1.59	1.55	1.55
Japan	93.54	87.48	79.36	80.51	98.00	98.00
Eurozone	0.72	0.75	0.71	0.78	0.79	0.78

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

* Forecasts based on the Liverpool World Model