LIVERPOOL INVESTMENT LETTER

May 2012

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

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 Bruce Webb and published on behalf of the group by Liverpool Macroeconomic Research Limited, which holds the copyright, and is available on subscription at £325 per annum.

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WEAK GROWTH AS THE UK STRUGGLES OFF THE BOTTOM

In this Letter we focus on the housing market which is an informative indicator of the state of the UK economy. We have just heard the first estimate by the ONS for first quarter growth, at –0.2%. This strikes us as a ridiculous estimate, at variance with indicators we have of current activity, whether from the Purchasing Managers' Indices, or the labour market, or as here the housing market. Summarising, these show signs of increasing life in the economy, even though plainly growth remains weak. The PMIs for all three sectors, manufacturing, services and construction, are all above the 50 point that indicates growth is occurring. Unemployment is flat or falling slightly.

As for the housing market it has drifted sideways for about a year whichever of the three main indices one looks at (Table 2). However it is clear from the steady rise in rentals that the demand for housing has continued to rise, even through the recession and weak recovery we are now experiencing. Also there are now signs of a rise in mortgage provision and the return of first time buyers — even though from a very low base.

Our forecast has for some time been for a slow recovery of house prices to a modest rate of growth that returns to track the basic trend — around 3% for real house prices over three and a half decades. According to the Nationwide index that we use as our measure for national and regional prices the two recent quarters have seen prices fall back by around 2% overall. But the other two indices we track, LSL and Halifax, show virtually no change over this period. Taking the picture across all the available evidence we are still therefore in a sideways movement.

Our previous forecasts were looking for gains over this period, reflecting what we saw as the general improvement in the economy. In fact we have had a stalling of growth; and the house market has reflected this. (Table 2) The causes of the stall lie in the eurozone crisis which became particularly threatening in the autumn. The uncertainty this created affected most developed economies, preventing firms from investing and consumers from spending. Productivity growth has been weak in the UK as well, creating an unpleasant mix of demand and supply weakness.

Looking ahead, we see a brightening outlook. The eurozone crisis has subsided to an 'always-with-us' simmering mess that UK businesses are being forced to diversify away from. There is no prospect of the crisis being resolved in any foreseeable future: the euro-elite that created this poor institution are in no mood to give way. The ECB has meanwhile produced a palliative for it in the form of huge liquidity injections (€1 trillion so far) into the euro banking system; this injection was aimed at ensuring bank liquidity (which dried up as worldwide banks feared for the safety of loans to euro banks) but it had the useful side-effect that the banks bought sovereign bonds of southern euro countries. We are therefore witnessing the prolonged battle between the political objectives of the euro-elite and the political objections of the suffering masses in these southern euro

Table 1: Summary of Forecast

		2010	2011	2012	2013	2014	2015	2016
GDP Growth[1]		1.8	1.0	1.4	2.0	2.5	2.8	2.5
Inflation	CPI	3.9	4.4	3.2	2.2	2.0	2.0	2.0
	RPIX	4.8	4.7	3.6	2.8	2.7	2.7	2.7
Unemployment (Mill.)								
	Ann. Avg.[2]	1.5	1.5	1.5	1.3	1.2	1.1	1.1
	4th Qtr.	1.5	1.6	1.4	1.2	1.1	1.1	1.0
Exchange Rate[3]		80.6	81.2	81.0	80.5	80.0	79.7	79.5
3 Month Interest Rate		0.6	1.0	2.3	2.5	2.5	2.5	2.5
5 Year Interest Rate		2.3	2.4	2.7	2.8	2.8	2.8	2.8
Current Balance (£bn)		–30.8	–5.8	–8.1	–7.4	–6.8	–6.2	–5.4
PSBR (£bn)		110.8	121.9	100.6	97.2	89.0	81.6	81.7

[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)

Table 2: Nominal UK House Price Indices (Index = 100 at highest level of series*.)

	Nationwide	LSL	Halifax
Aug-10	89.5	91.7	88.4
Sep-10	89.6	91.7	85.7
Oct-10	88.3	91.3	86.5
Nov-10	87.7	90.7	85.5
Dec-10	87.2	90.7	84.5
Jan-11	86.7	91.0	84.5
Feb-11	86.6	91.7	84.6
Mar-11	88.6	91.9	84.9
Apr-11	89.0	90.9	85.0
May-11	89.9	89.7	85.0
Jun-11	90.4	89.0	85.7
Jul-11	90.7	89.6	86.2
Aug-11	89.2	90.3	84.8
Sep-11	89.4	90.2	85.0
Oct-11	89.0	90.4	86.0
Nov-11	89.1	89.9	84.2
Dec-11	88.1	90.0	82.6
Jan-12	87.2	90.0	83.2
Feb-12	87.5	90.5	83.2
Mar-12	87.8	90.7	85.5

* Nationwide House Price Index peaked at 100 in October 2007, LSL Property Services/Acadametrics House Price Comparison Index at 100 in February 2008 and Halifax House Price Index 100 in August 2007

countries. It is anyone's guess which way this battle will go. But either way the eurozone will perform weakly to poorly in growth over the next few years.

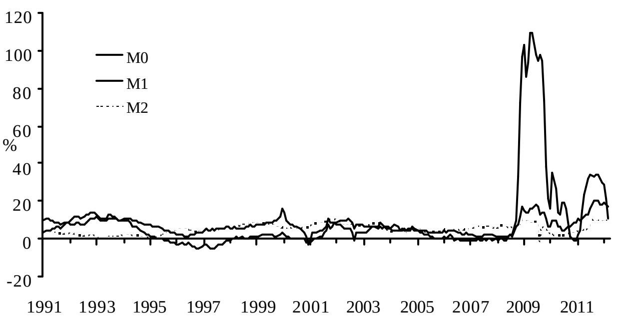
This weakness is now factored into our and others' forecasts. Growth in the world economy nevertheless remains solid, with emerging market countries growing fast still in reflection of their fast productivity growth. Also the US economy is looking a bit stronger, with housing dragging itself out of the doldrums and investment reviving on the back of strong profits growth. UK businesses are able to profit from these markets, given the strong traditional links the UK has across them all; a fundamental orientation of UK trade away from Europe towards these markets is overdue.

The implications for housing remain for a moderate growth along the previous trend. Effectively the recession has drained the froth from the market — at its peak in late 2007 this froth was on our calculations around 20%; furthermore the trend house price has come down with the collapse in GDP during the crisis. Overall real house prices have fallen about 30% from their peak as a result of these two things and are now close to their long run trend.

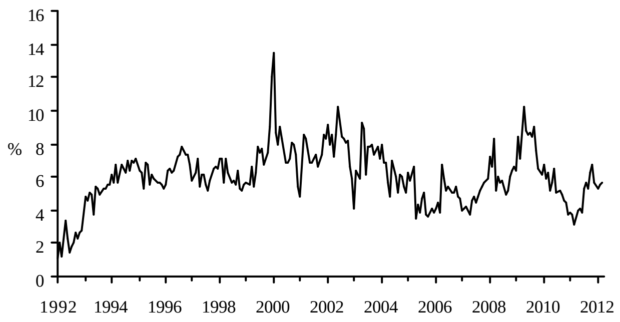
This adjustment now looks complete. Real house prices from now on should be rising slowly more or less along their long-run trend. They should rise hardly at all this year, and then rise faster, at around 4% in succeeding years. As usual the market is being led by London and the South east; and again as usual this southern growth spills over to the rest of the country with a lag.

Thus when one factors in the housing picture, one sees a UK economy which is trying to grow but still weak. For policymakers the urgent task is to find supply-side sources of growth. One does not have to look far; the labour market is still obstructed by regulation, the market in executives and entrepreneurs is beset by uncertainty over taxes and the government's attitudes to business, there is uncertainty over such basic infrastructure decisions as the Heathrow third runway, and worst of all the government is obsessed with the regulation of banks thus sandbagging credit growth. Growth will remain weak until the coalition finds its pro-business voice.

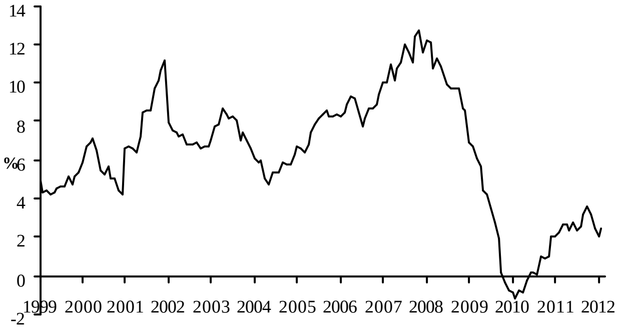
U.S.: Growth in Monetary Aggregates (Yr - on - Yr)



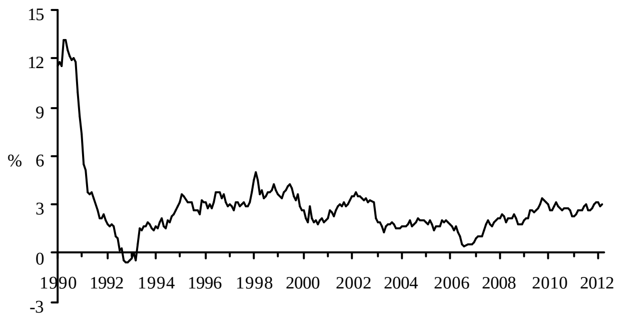
UK: Notes and Coins in Circulation Growth



Eurozone M3 Growth



Japan: Growth of M2+CD's



FOCUS ON JAPAN

Francesco Perugini

Japan's economy one year after the shock

Last month Japan marked the first anniversary of the terrible earthquake and tsunami; this killed nearly 16,000, with over 3000 unaccounted for, and set off a nuclear crisis that shattered public trust in atomic power and the nation's leaders. It was probably the most expensive disaster in human history. The government estimates that the direct damage amounted to ¥16.9 trillion or 3.5% of GDP, while the indirect effects, more difficult to calculate, were very substantial. They relate to loss of business and business opportunities because of the damage to infrastructure and production sites. Those caused by the nuclear accident include electricity shortages and rolling blackouts and the loss in exports caused by fear for radioactive contamination.

Reconstruction costs are also very high. According to official estimates they amount to ¥19 trillion (4% of GDP) over 5 years, the so-called "concentrated construction period", excluding those related to the nuclear disaster. In the past year, most of the discussion on the reconstruction of the Tohoku area has been concentrated on the funding. It was decided that the larger part of the programme will initially be financed by the issue of Reconstruction Bonds. These bonds will be reimbursed through temporary tax rises, both in corporation tax and in income tax. In the supplementary budgets in FY 2011, approximately ¥14.5 trillion has been set aside for the reconstruction. For FY2012, the reconstruction spending amounts to ¥3.8 trillion. However, the rebuilding of the area has had to be delayed because of radioactivity concerns, as compared to previous episodes such as the Kobe earthquake in 1995 and the Hokkaido earthquake in 1993.

How has the Japanese economy reacted one year on? There was a visible impact in the short term, as Japan's GDP contracted in Q1 and Q2 2011, driven by double-digit drops in exports (primarily transport components and electronics), and US auto sales dipped due to supply shortages. In addition, power shortages resulting from the crisis at Fukushima caused many Japanese manufacturers to halt domestic production. Flooding in Thailand further damaged Japanese firms' productivity while the sovereign debt crisis in Europe caused currency speculators to flock to the Japanese yen as a safe-haven currency, strengthening the yen and making Japanese exports less competitive overseas.

Nevertheless, economic prospects are brighter now than many hoped possible a year ago. The economy has made substantial steps forward in many areas with the help of the government who launched a big reconstruction programme. The nuclear crisis at the Fukushima power plant was brought under control pretty quickly, while the restoration of power, transport links and provision of aid to the affected areas, for the most part, happened more rapidly than many had expected, despite a faltering response from government officials on various occasions. Thanks to a significant collective effort to conserve energy, the disruption from electricity shortages -even through the peak summer season- were relatively minor.

Regarding economic activity, industrial production had increased by 15% from its March 2011 lows and the diffusion indices of current conditions for household-related businesses have recovered almost fully to the level before the disaster. In addition, it is expected that demand stemming from restoration and reconstruction will boost economic activity in the coming quarters — simulation results from JRI, the Japanese Research Institute, a private think-tank based in Tokyo, show a 1.2 percentage point on GDP increase this year from the reconstruction demand. However, construction activity in the disaster-hit areas is lagging behind, as shown in the fact that public investment on a GDP basis decreased over the previous quarter in the July-September period and the October-December period last year, two consecutive quarterly declines. It is pointed out that an insufficiency of workers for public works in these areas has been a bottleneck to the restoration and reconstruction — Onagawa, a tsunami-ravaged town, has lost 20% of its population since the earthquake. "After so many years of shrinking, we are having a hard time catching up with the orders flying in", says Hirohide Ito, secretary-general of the Miyagi General Construction Association, a local trade group. "The labour shortage is met in part by workers brought in from other parts of Japan, who have filled up the area's hotels and apartments".

A number of challenges still remain. First of all, business conditions have become more difficult. Before the disaster the corporate sector was already confronted with serious problems such as very high corporate taxes, a very ambitious climate change policy and rigid labour regulations. After the disaster, new problems have surfaced, such as intensified competition, the vulnerability of the supply chains and the lack of electric power. As a result of the disaster, enterprises, in particular in Tohoku, have lost clients, and forced by supply chain disruptions firms have started to look for alternative suppliers — according to a recent survey, of about 27,000 Japanese businesses in the region more than 20% have decided to go out of business permanently, while, in another survey conducted by the Japan External Trade Organization, a government trade and foreign-investment promotion bureau, about 30% of large companies said the earthquake made them consider setting up new facilities overseas or expanding existing ones.

Besides, the earthquake has left a number of legacies which will continue to represent challenges for Japan. For example, the disaster has caused a rethink of the efficacy of relying upon nuclear power for a significant proportion of electricity generation capacity. The bulk of that capacity has been shut down indefinitely as each plant went into its annual maintenance closure and was subsequently put through a stress-testing procedure — only a couple of Japan's 54 nuclear plants are currently operational.

MARKET DEVELOPMENTS

Equity markets have drifted lower this month and bond yields with them as the world has grappled with the ongoing eurozone crisis. This has settled down into a pattern of continuing bubbling unease. We do not see any end to this, as the euro elite cling relentlessly to the euro in all parts of the eurozone; thus Germany would no doubt be relieved if Greece decided to leave but Greece has no intention of doing so, a view shared widely by the Greek populace. For Greece read all the Southern countries; for them politically and economically they are terrified of a future outside the eurozone. Yet plainly there is ongoing uncertainty about whether they can pull it off. So the crisis will just carry on as now. This is not a good backdrop for equity markets. Nevertheless we still see returning growth, even if weakened by these uncertainties. Thus we remain committed to equities.

Table 1: Market Developments

	Market Levels		Prediction for Apr/May 2013	
	Mar 21	**Apr 25**	**April Letter**	**Current View**
Share Indices				
UK (FT 100)	5892	5719	7636	7675
US (S&P 500)	1403	1391	1564	1565
Germany (DAX 30)	7071	6705	8691	8521
Japan (Tokyo New)	859	809	1055	971
Bond Yields (government long-term)				
UK	2.36	2.15	3.40	3.40
US	2.29	1.99	4.00	4.00
Germany	1.97	1.73	4.00	4.00
Japan	1.03	0.93	1.50	1.50
UK Index Linked	-0.05	-0.09	1.40	1.40
Exchange Rates				
UK ($ per £)	1.59	1.61	1.58	1.58
UK (trade weighted)	81.7	83.0	80.7	80.2
US (trade weighted)	81.0	80.1	84.0	80.5
Euro per $	0.76	0.76	0.78	0.79
Euro per £	1.20	1.22	1.23	1.25
Japan (Yen per $)	83.6	81.4	87.0	81.0
Short Term Interest Rates (3-month deposits)				
UK	0.67	0.96	2.50	2.50
US	0.36	0.50	0.50	0.60
Euro	0.74	0.72	2.50	2.50
Japan	0.25	0.18	0.40	0.40

Table 2: Prospective Yields [1]

Equities: Contribution to £ yield of:

	Dividend Yield	Real Growth	Inflation	Changing Dividend Yield	Currency	Total
UK	3.60	2.0	2.2	30.00		37.80
US	2.00	2.5	2.0	8.00	1.92	16.42
Germany	3.50	1.5	1.7	24.00	−2.22	28.38
Japan	2.30	1.9	0.0	18.00	2.41	24.61
UK indexed[2]	−0.09		2.2	−9.00		−6.89
Hong Kong[3]	2.50	7.5	2.0	−3.00	1.92	10.92
Malaysia	3.10	5.2	2.0	39.00	1.92	51.22
Singapore	3.50	4.4	2.0	21.00	1.92	32.82
India	1.50	7.0	2.0	8.00	1.92	20.42
Korea	1.30	3.0	2.0	−24.00	1.92	−15.78
Indonesia	2.10	6.5	2.0	30.00	1.92	42.52
Taiwan	4.40	3.5	2.0	33.00	1.92	44.82
Thailand	3.00	4.4	2.0	25.00	1.92	36.32

Bonds: Contribution to £ yield of:

	Redemption Yield	Changing Nominal Rates	Currency	Total
UK	2.15	−12.50		−10.35
US	1.99	−20.10	1.92	−16.19
Germany	1.73	−22.70	−2.22	−23.19
Japan	0.93	−5.70	2.41	−2.36

Deposits: Contribution to £ yield of:

	Deposit Yield	Currency	Total
UK	0.96		0.96
US	0.50	1.92	2.42
Euro	0.72	−2.22	−1.50
Japan	0.18	2.41	2.59

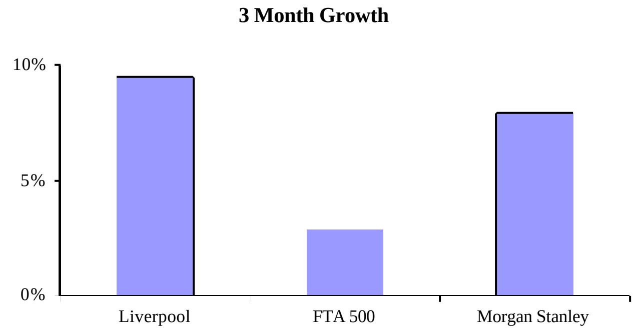
[1] Yields in terms of €s or $s can be computed by adjusting the £-based yields for the expected currency change.
[2] UK index linked bonds All Stocks
[3] Output based on China.

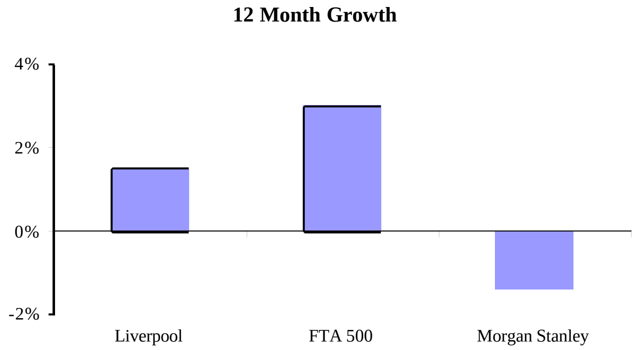
Table 3: Portfolio(%)

	Sterling Based Investor		Dollar Based Investor		Euro Based Investor	
	April Letter	Current View	April Letter	Current View	April Letter	Current View
UK Deposits (Cash)	10	10	10	10	1	1
US Deposits	-	-	-	-	-	-
Euro Deposits	-	-	-	-	-	-
Japanese Deposits	-	-	-	-	-	-
UK Bonds	-	-	-	-	-	-
US Bonds	-	-	-	-	-	-
German Bonds	-	-	-	-	-	-
Japanese Bonds	-	-	-	-	-	-
UK Shares	19	19	14	14	17	17
US Shares	14	14	19	19	16	16
German Shares	14	14	14	14	21	21
Japanese Shares	9	9	9	9	11	11
Hong Kong/Chinese Shares	4	4	4	4	4	4
Singaporean Shares	4	4	4	4	4	4
Indian Shares	4	4	4	4	4	4
Thai Shares	3	3	3	3	3	3
South Korean Shares	4	4	4	4	4	4
Taiwanese Shares	3	3	3	3	3	3
Brazilian Shares	3	3	3	3	3	3
Chilean Shares	3	3	3	3	3	3
Mexican Shares	3	3	3	3	3	3
Peruvian shares	3	3	3	3	3	3
Other:						
Index-linked bonds (UK)	-	-	-	-	-	-

PORTFOLIO PERFORMANCE

The charts below, and the Table opposite, measure the performance of the Liverpool Model Portfolio against the FTA Non-financials share index, and the Morgan Stanley World Capital International index, over the period from June 1992 to end-April 2011.





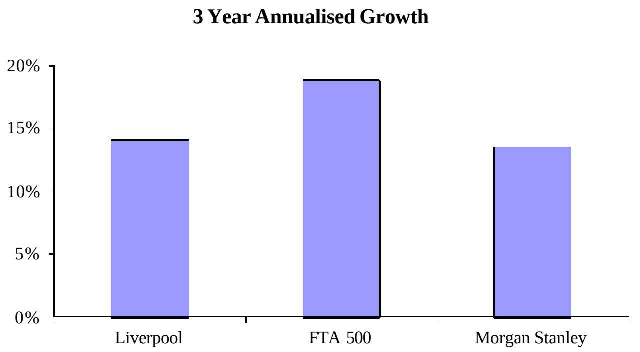


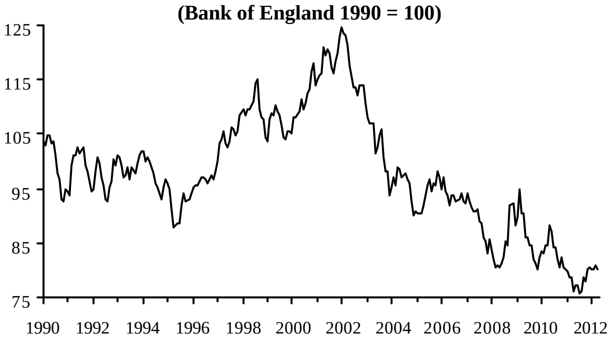
Table 4: Liverpool Portfolio Evaluation (End-June 1992 = 100)

Date	Index of Liverpool Portfolio	FTA Non Financials Index Total Return	Morgan Stanley World Capital International Index Total Return
2005			
1st Jan	243.20	252.89	297.05
Apr	249.35	264.15	298.79
Jul	261.84	278.70	316.89
Oct	284.62	304.68	343.82
2006			
1st Jan	297.46	313.59	365.50
Apr	315.78	334.87	386.04
Jul	302.95	332.52	360.85
Oct	313.66	340.59	371.76
2007			
1st Jan	331.94	361.22	382.93
Apr	343.65	376.53	389.99
Jul	364.54	403.07	403.44
Oct	378.18	401.46	405.04
2008			
1st Jan	394.93	411.25	403.19
Apr	387.93	367.01	365.34
Jul	386.86	381.90	355.90
Oct	399.43	324.99	335.11
2009			
1st Jan	437.80	314.73	323.33
Apr	423.18	294.99	283.79
Jul	440.33	315.62	295.72
Oct	506.73	375.37	355.96
2010			
1st Jan	525.13	408.79	365.52
Apr	562.49	436.43	399.80
Jul	530.11	382.77	351.60
Oct	570.59	435.61	378.02
2011			
1st Jan	618.84	476.51	413.02
Apr	619.56	481.43	420.69
Jul	629.42	494.36	418.86
Oct	546.47	437.69	358.02
2012			
1st Jan	574.29	482.11	384.40
Feb	605.19	488.07	397.36
Mar	628.12	504.02	410.83
Apr	628.86	495.88	414.96

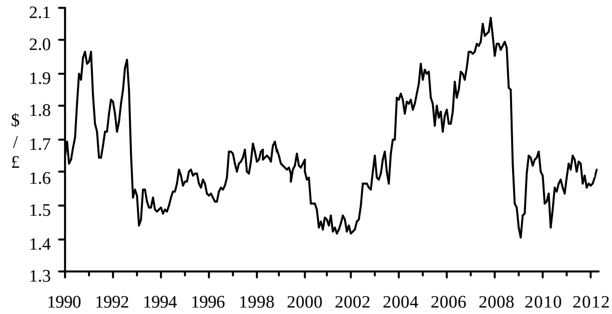
Source: Rensburg Sheppards Investment Management Limited, Liverpool Stock Exchange

INDICATORS AND MARKET ANALYSIS
FOREIGN EXCHANGE MARKETS[1]

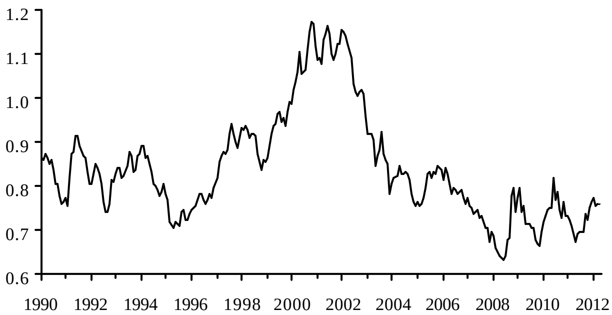
US : Trade Weighted Index
(Bank of England 1990 = 100)



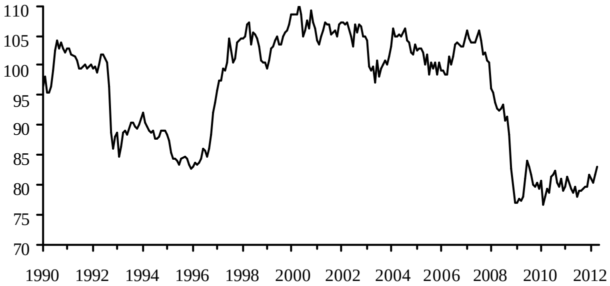
UK: Dollars Per Pound Sterling



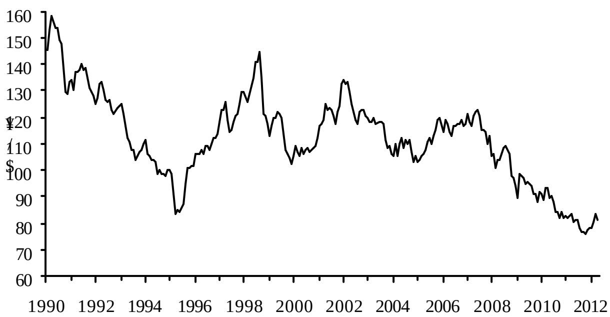
Euro per US dollar



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



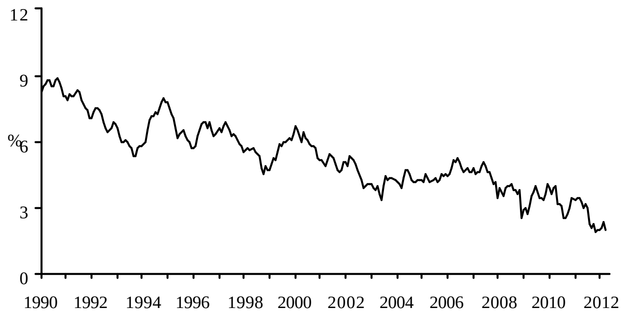
Japan : Yen Per U.S. Dollar



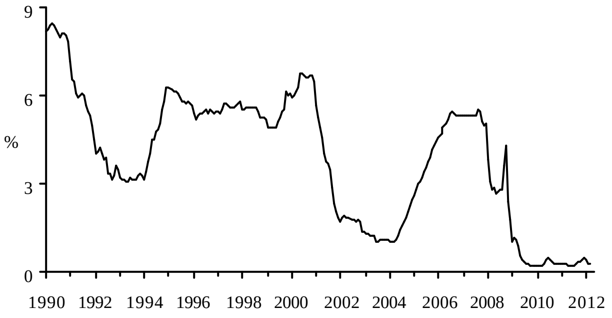
[1] John Wilmot, who has written these sections since this Letter began, is indisposed. We are issuing the charts without his commentary this month. We wish him a speedy recovery.

GOVERNMENT BOND MARKETS

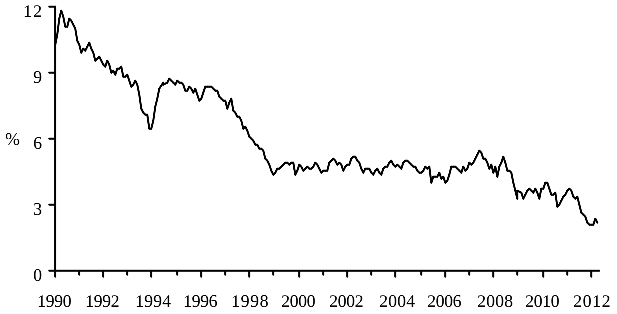
U.S.: Yield on Long-Term Government Bonds



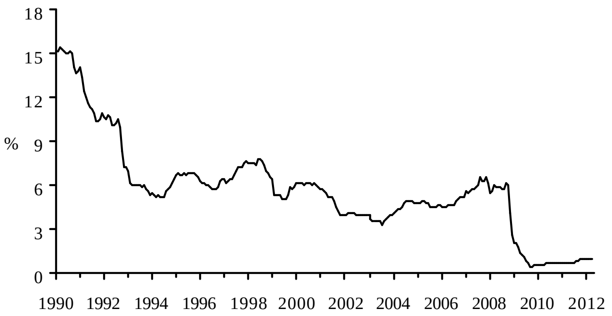
U.S. : 3-Month Certificate of Deposit



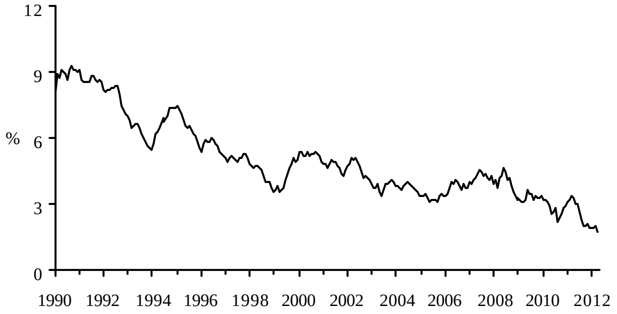
U.K. : Yield on Long-Term Government Bonds



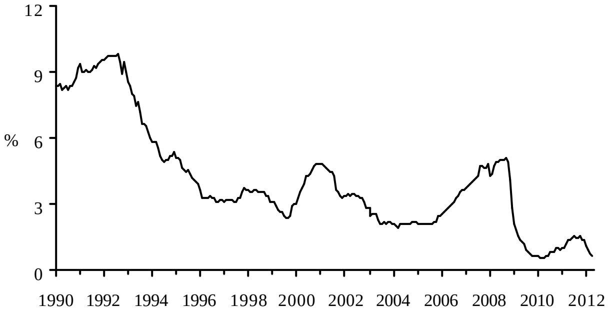
U.K. : 3-Month Interbank Rate



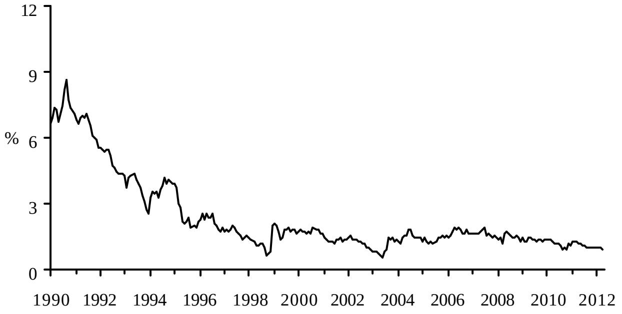
Germany: Yield on Public Authority Bonds



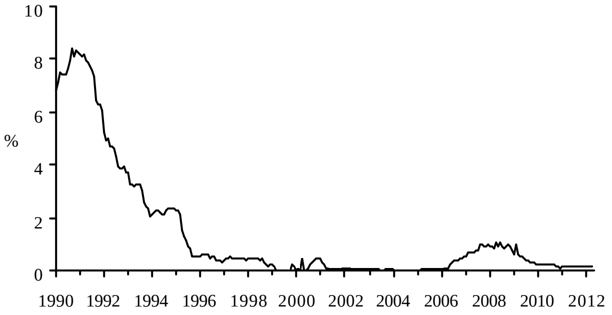
Germany : 3-Month Interbank Deposit Rate



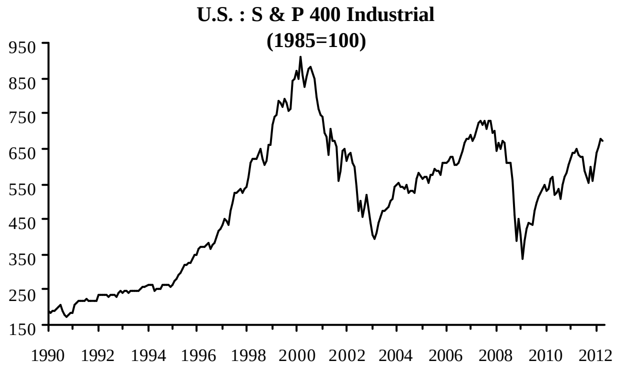
Japan: Yield on Long-Term Government Bonds

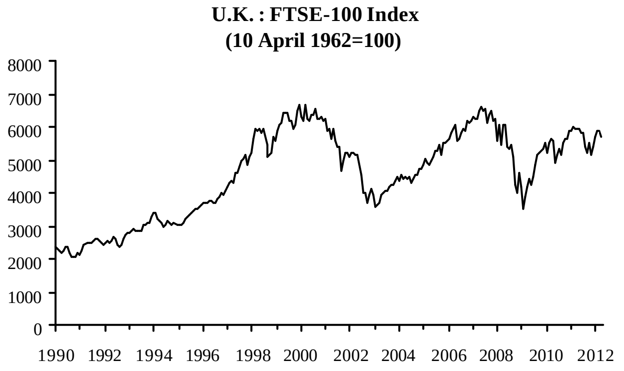


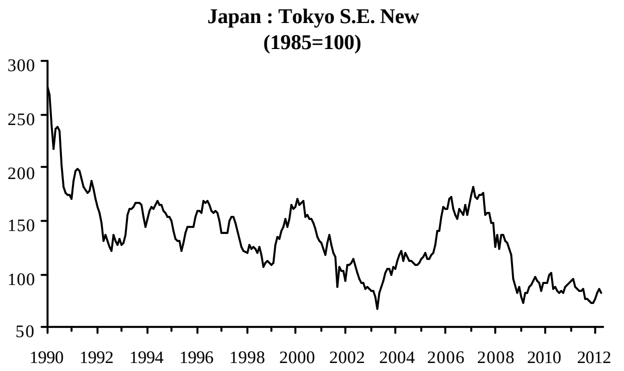
Japan : 3 Month Money Market Rate



MAJOR EQUITY MARKETS







EMERGING MARKETS

Anupam Rastogi

India

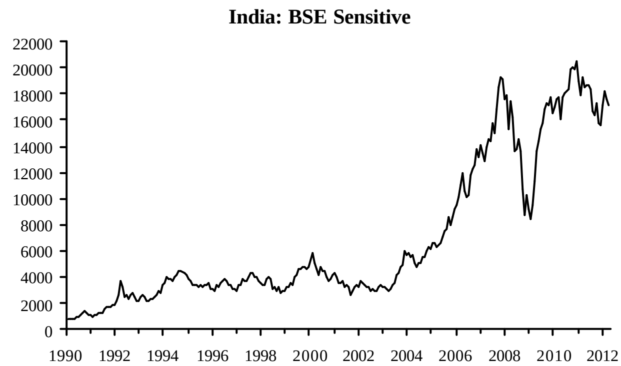
The dysfunctional government, with its arbitrariness and uncertainty in economic policies, has reached the stage where India's captains of industry are now dispirited. It seems that the leadership is out of step with the youthful entrepreneurial population. Uncertainty regarding tax policies is at a level unseen since India began liberalising in 1991, and investors are understandably angry. Moved by their own business lobbies, the US and the UK governments have sought assurances from the Finance Minister Pranab Mukherjee that retrograde tax policies will not be implemented that harm India's foreign investment environment. It is quite possible that the proposals will be watered down before they become law in May. Nevertheless, the damage to India's image has been done.

Mr Geithner, the US Treasury Secretary, has told/warned Mr Mukherjee that the US is "examining India's proposed tax provisions to determine their impact on the US–India bilateral income tax treaty". India's chief economic adviser, Kaushik Basu, is on record about the slow pace of India's economic reforms. He may have voiced his own exasperations, but this mirrors the dysfunctional nature of the government.

According to the central bank, GDP growth of 7.3% for the year that beginning April 1 is probably the maximum that India can achieve without reigniting inflationary pressures. The central bank has told the government — in sweet words — that the only institution that can remove the obstacles to higher growth is the government. This also indicates that the central bank has little room for future interest rate cuts, especially if high crude oil prices persist. The central bank surprised many by a 0.5 percentage point cut in the headline lending rate, to 8%.

Wholesale price inflation in March clocked in at 6.9% year-on-year. Core inflation, which excludes such nonessentials as food and fuel, is expected to hover around 5% for the foreseeable future.

Persistent concerns over inflation, and a high current account deficit, mean that the Indian rupee is unlikely to rally in a sustained fashion from current three-month lows of 51.61 to the U.S. dollar. The rupee shows the first signs of stress: It has fallen by more than 4% so far this month, hitting a 15-week low against the dollar. According to an advisor to the prime minister the trend won't reverse anytime soon. India wants to reduce its trade deficit from $185 billion in the fiscal year ended March 31 to about $150 billion for fiscal 2012–2013. The current account deficit, which was about 4% of gross domestic product in the last fiscal year, could narrow to 3.5% this year.



Among all this gloom and doom scenario, there is a bright spot. India will get sufficient monsoon rainfall this year, the third year in a row. The rains not only determine food supply and prices but also drive spending by rural consumers and are crucial to the broader economy.

Standard & Poor's Ratings Services has lowered its outlook on India's long-term rating to negative from stable and restated its rating of BBB–, just one notch above junk. The rating agency expects only modest progress in fiscal and public sector reforms ahead of general elections scheduled for 2014. The negative outlook signals a 33% chance that India's sovereign ratings would be downgraded within the next two years. Moody's Investors Service, however, doesn't see any immediate threat to the country's sovereign ratings which has already factored in these risks. Moody's has a Baa3 rating — its lowest investment-grade rating — with a "stable" outlook on India.

	09-10	10-11	11-12	12-13	13-14
GDP (%p.a.)	7.4	7.5	7.0	7.0	7.0
WPI (%p.a.)	9.5	9.0	7.5	7.5	7.0
Current A/c(US$ bill.)	-14.0	-31.0	-40.0	-35.0	-34.0
Rs./$(nom.)	48.0	49.0	49.5	50.0	50.5

China

China's gross domestic product growth slowed to 8.1% year-on-year in the first quarter of 2012, the country's lowest rate of economic growth since the first quarter of 2009. On a quarter-on-quarter basis the picture is even more tentative, with annualised growth dipping from 7.8% to 7.4%. This was a result of a slowdown in exports and real-estate investment. It is hoped that China will be able to guide its economy to a soft landing. Consumption contributed 76% of GDP growth in the first quarter, up sharply from 51.6% in 2011. The share from investment — including infrastructure, real estate and other big projects — fell from 54.2% to 33.4%.

The data for the China's labour markets published by the government shows that the market is tighter than ever.

There are structural forces at work as there is a deceleration in incremental working population.

China's consumer inflation gathered pace in March. The consumer price index for March was up 3.6% from a year earlier, quickening from February's 3.2% pace. However, there is little sign that the government will ease monetary policy.

The Chinese government's decision to widen the trading band around the yuan will bring it closer to "fair-value" and so will ease trade tensions and rob some U.S. politicians of a favourite whipping horse. In its first day of trading within the wider band the yuan fell 0.2%, which gave some credence to people who have been saying the currency is closer to fair value than critics contend. China's surplus fell to 2.8% of GDP in 2011, below the 4% target once mooted by U.S. Treasury Secretary Timothy Geithner, suggesting the degree of undervaluation of the yuan is drastically reduced.

What is keeping the analysts glued to their TV and other reports is Mr Bo Xilai's spectacular downfall. The abrupt change represents China's biggest political crisis since the 1989 Tiananmen Square massacre, as the country approaches the once-in-a-decade change in top leadership towards the end of this year. The potential outcome could be either instability and infighting among the elite leading, to paralysis within the system, or genuinely bold constitutional and political reforms as the party tries to repair its image as reformers take charge of the political system.

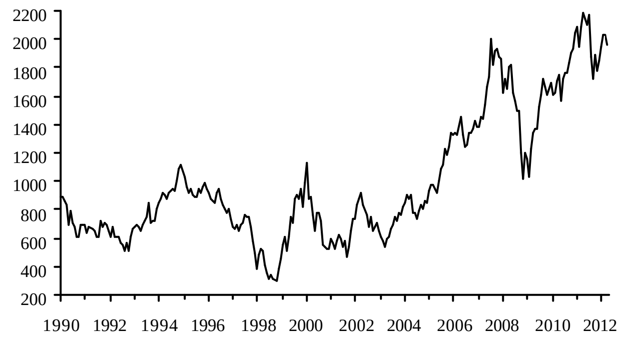
	09	10	11	12	13
GDP (%p.a.)	8.7	10.3	9.2	7.5	7.5
Inflation (%p.a.)	-0.8	5.9	4.3	3.1	3.0
Trade Balance(US$ bill.)	180	183	155	140	130
Rmb/$(nom.)	6.8	6.6	6.3	6.2	6.1

South Korea

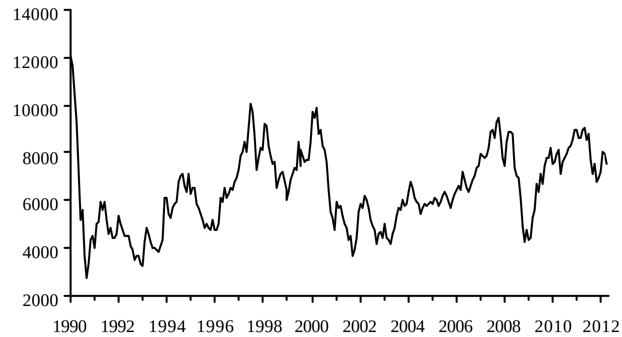
The South Korean economy is likely to expand by 3.3% in 2012, lower than the central bank's projection made in December of 3.7% growth. The BoK expects gross domestic product (GDP) growth to fall to 3% year-on-year for the first six months of the current calendar year, before picking up speed to 3.9% during the second half. GDP rose 3.6% last year, compared with 6.3% in 2010. The Bank of Korea has lowered its economic growth forecast for this year due to a slowdown in the global economy and Europe's sovereign debt crisis. Markets now expect that the central bank will maintain its accommodative monetary stance to underpin growth amid subdued inflation.

Inflation will ease from 4% in 2011 to 3.2% this year, comfortably staying within the BoK's target band of 2% to 4%. South Korean consumer inflation unexpectedly eased for a third straight month to a 20-month low in March, giving the central bank more flexibility on monetary policy this year. The consumer price index was up 2.6% from a year earlier in March, decelerating from February's 3.1%

Korea: Composite Index



Taiwan: Weighted TAIEX Price Index



gain and the slowest rise since July 2010, when the index rose by 2.5%.

Exports unexpectedly slipped 1.4% in March, weighed down by low shipments to China. However, exports to the US surged 28% on the back of a tariff-slicing trade deal which came into force last month. South Korea's trade balance posted a surplus of US$2.33 billion last month as reducing exports were offset by falling imports. Exports, which account for more than half of the economy, contracted 1.4% year-on-year to US$47.36 billion last month, while imports shrank 1.2% to US$45.03 billion dollars, thus posting a trade surplus of $2.33 billion in March, up from $1.5 billion in February. The won exchange rate has recently weakened to 1,138.55 per dollar.

The leader of South Korea's conservative political party, Park Geun-hye, thanked voters for keeping the party in control of the National Assembly and vowed to clean up some of its problems. At present, conservatives have retained control of the Parliament, giving party leader hope to launch a successful presidential bid later this year.

	09	10	11	12	13
GDP (%p.a.)	0.2	6.3	3.6	3.3	3.0
Inflation (%p.a.)	2.6	2.9	4.0	3.2	3.5
Current A/c(US$ bill.)	42.7	28.2	27.0	13.0	15.0
Won/$(nom.)	1200	1150	1100	1100	1100

Taiwan

Taiwan's GDP growth this year probably bottomed out in the first quarter, at approximately 3.1% for 2012. As the US economy starts looking up, Taiwan's economy will start growing as well. While that may be below last year's 4.04% and less than the current government forecast of 3.85% this year, it will be a rebound from the fourth quarter's recession.

Exports are the main driver of economic growth in Taiwan, and a pick-up in orders would confirm that trend. Taiwan's inflation will rise to an average of 2.4% between June and December, up from 1.2% in March, following the government's announcement of major increases in electric power rates. Uncertainty over China's economy is a worry because China is Taiwan's biggest trade partner. Export orders from China in March fell 2.5%.

The Taiwanese dollar is appreciating as the government vows to contain inflation. Taiwan's dollar is hovering at around NT$29.5 against its U.S. counterpart.

Taiwan's investors are wary amid signs that the government could introduce a capital gains tax on investments. This has impacted the Telex stock market index; since the issue hit newspaper headlines, the index has dropped 3.4%.

The race for chairman of Taiwan's opposition Democratic Progressive Party this year has turned into a battle between moderates versus hardliners in the party. The party continues to search for an appropriate China policy which can revive interest of voters in the wake of defeat in this year's presidential election.

	09	**10**	**11**	**12**	**13**
GDP (%p.a.)	-1.9	10.8	4.0	3.1	3.5
Inflation (%p.a.)	0.0	1.3	1.2	1.3	1.2
Current A/c(US$ bill.)	16.0	16.0	18.0	20.0	22.0
NT$/$(nom.)	32.0	31.0	30.0	29.0	29.0

Brazil

Brazil focused on loose monetary policy as the economic slowdown started biting. Brazil's central bank slashed its expected benchmark interest rate to 9% in mid-April, and left the door open for future rate cuts. So far the Brazilian Central Bank has cut interest rate six times since August, when it surprised financial markets by starting the easing cycle. The reason for easing monetary policy was the adverse impact of Europe's debt crisis and sluggish global economic growth on Brazil's economy. To ensure that the rate cuts have a desirable effect, the government has begun putting pressure on state and private banks to lower the interest rates they charge to help stimulate demand and ease the pressure on businesses.

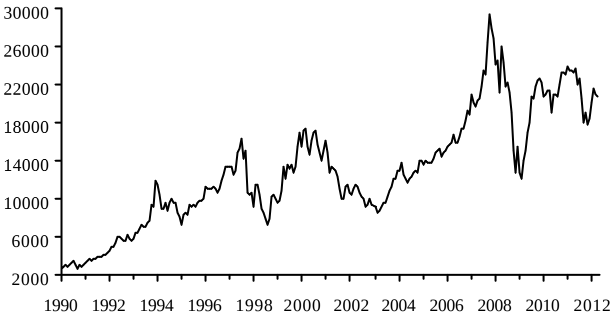
Another policy instrument which the Brazilian President Dilma Rousseff is using to spur growth is by weakening the currency. The stimulation to the economy is required as it has cooled down to 2.7% growth in 2011 after surging 7.5% in 2010. We expect gross domestic product to expand by 3%, and the Real to trade at an average of 1.78 in 2012. The government expects the real to trade at an average exchange rate of 1.84 per U.S. dollar, while the economy is to grow by 5.5% in 2013, according to the proposal the government presented to Congress. The Brazilian Real is inching towards 2 per dollar for the first time since 2009.

U.S. President Barack Obama met with Brazil's President Dilma Rousseff in Washington in the first week of April, and there are good chances for closer ties between Brazil and the US. The issues in their relationship reflect Brazil's growing economic reach. Brazil's biggest trade partner these days is China, not the U.S., and U.S. officials want Brazil as an ally in nudging China to let its currency rise.

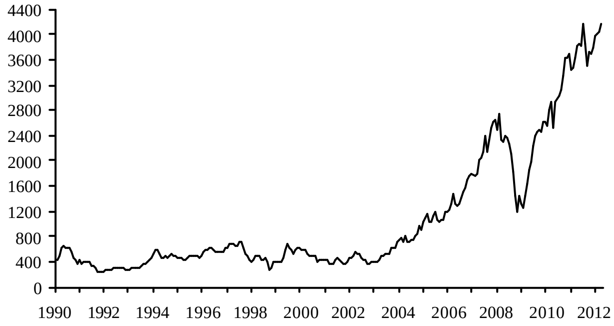
	09	**10**	**11**	**12**	**13**
GDP (%p.a.)	-0.2	7.5	2.7	3.0	3.5
Inflation (%p.a.)	4.1	5.9	6.5	5.6	5.0
Current A/c(US$ bill.)	-20.0	-47.3	-52.6	-60.0	-65.0
Real/$(nom.)	1.8	1.7	1.5	1.8	1.8

Other Emerging Markets

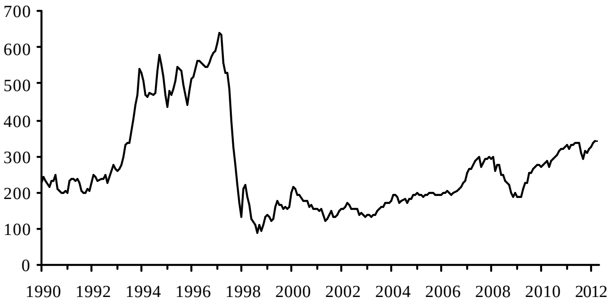
Hong Kong: FT-Actuaries



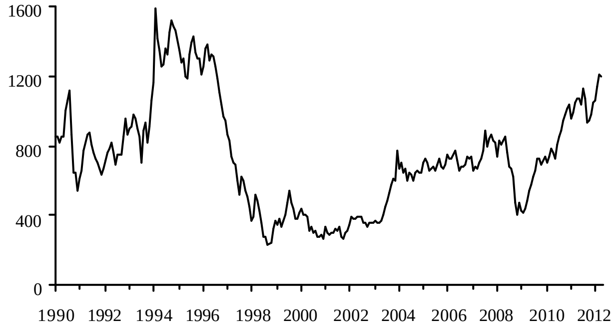
Indonesia: Jakarta Composite



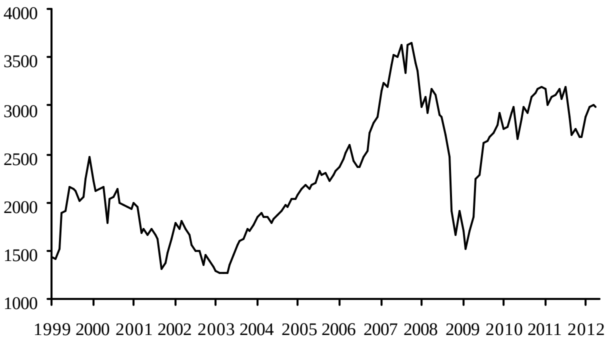
Malaysia: FT-Actuaries (US$ Index)



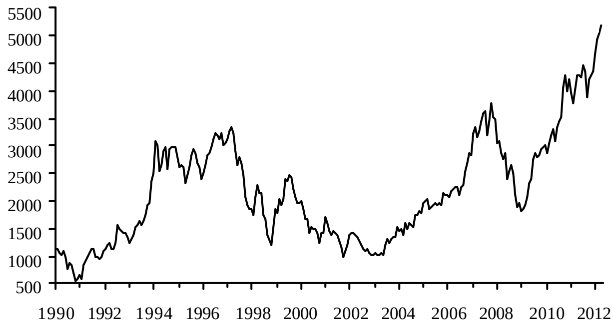
Thailand: Composite Index



Singapore: Straits Times Index

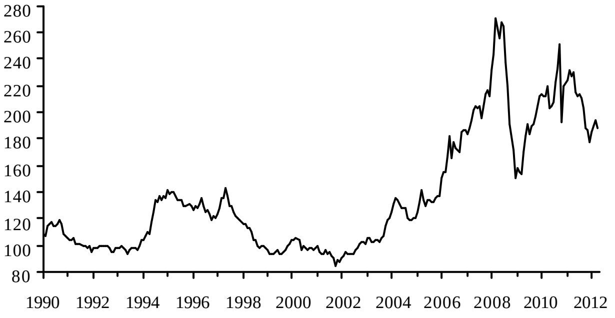


Philippines: Manila Composite

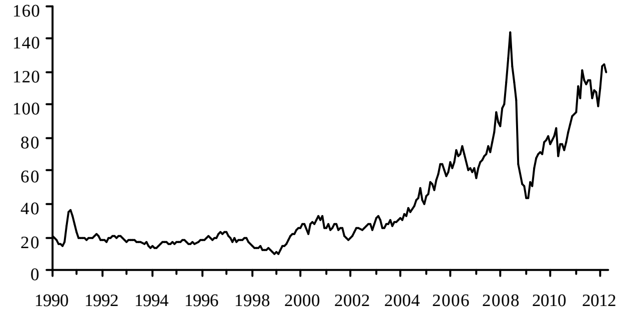


COMMODITY MARKETS

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

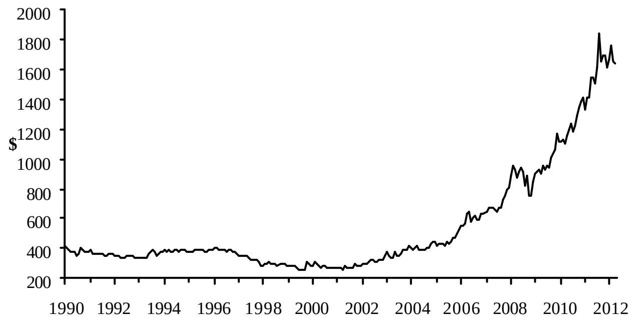


Oil Price: North Sea Brent (in Dollars)

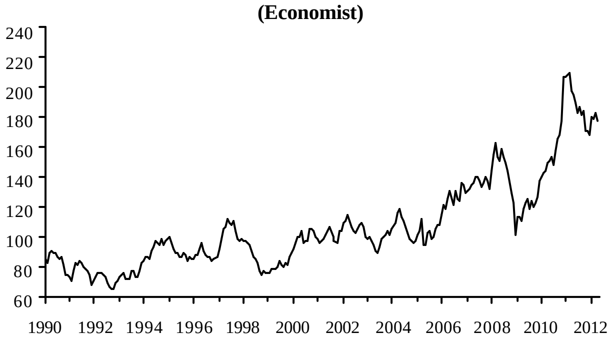


Commodity Price Index (Sterling)
(Economist, 2000=100)

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]
2008	3.3	4.0	5.1	91.2	100.3	3.7	4.3	1.0
2009	1.3	2.8	0.8	80.7	89.5	-3.1	2.0	-0.3
2010	3.9	2.3	0.6	80.6	91.2	-3.8	4.8	-0.5
2011	4.4	2.4	1.0	81.2	94.5	-2.2	4.7	0.1
2012	3.2	2.7	2.3	81.0	95.8	0.1	3.6	0.7
2013	2.2	2.8	2.5	80.5	95.7	0.5	2.8	0.8
2010:1	2.8	2.8	0.5	79.9	89.8	-4.3	4.5	-0.1
2010:2	4.1	2.2	0.7	80.2	90.3	-3.8	5.1	-0.6
2010:3	4.2	1.8	0.6	82.0	92.9	-3.6	4.7	-0.9
2010:4	4.4	2.3	0.7	80.5	91.6	-3.3	4.7	-0.3
2011:1	4.8	2.7	0.8	81.1	93.8	-2.8	5.3	0.2
2011:2	4.5	2.2	0.8	79.6	92.4	-2.5	5.0	-0.2
2011:3	4.2	2.4	1.1	82.2	95.8	-2.0	4.3	0.1
2011:4	4.0	2.5	1.6	82.0	95.9	-1.2	4.2	0.3
2012:1	3.6	2.6	2.0	80.7	95.4	-0.5	3.9	0.5
2012:2	3.3	2.6	2.2	81.3	96.1	0.0	3.7	0.6
2012:3	3.1	2.8	2.5	81.0	95.8	0.4	3.5	0.8
2012:4	2.8	2.8	2.5	80.9	95.7	0.5	3.3	1.4

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)
2008	220.4	3.5	2.8	0.91	138.9
2009	220.2	0.0	4.6	1.53	136.9
2010	225.2	2.4	4.6	1.50	134.8
2011	230.5	2.4	4.7	1.53	132.2
2012	239.9	4.1	4.4	1.47	133.4
2013	249.0	3.8	3.8	1.27	135.5
2010:1	224.2	4.4	4.8	1.57	136.3
2010:2	222.9	1.0	4.6	1.49	133.9
2010:3	225.3	2.2	4.5	1.47	134.3
2010:4	228.4	1.9	4.5	1.46	134.8
2011:1	229.8	2.6	4.4	1.45	133.2
2011:2	228.8	2.7	4.6	1.50	131.5
2011:3	229.9	2.0	4.8	1.58	131.5
2011:4	233.5	2.2	4.8	1.59	132.5
2012:1	237.3	3.3	4.6	1.54	132.8
2012:2	239.1	4.5	4.5	1.49	133.2
2012:3	240.5	4.6	4.3	1.44	133.5
2012:4	242.7	3.9	4.2	1.39	134.0

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
2008	147.3	705312.2	421176.1	253264.5	176727.6	-46562.6	99293.5
2009	140.8	674466.5	405440.7	218144.6	178391.0	-33226.3	94283.5
2010	143.3	686345.3	405565.3	241422.1	180777.4	-42021.1	99398.4
2011	144.8	693331.3	400381.9	236752.2	182398.0	-31348.2	94851.3
2012	146.8	703170.7	401572.0	247757.1	184603.4	-33345.2	97417.6
2013	149.8	717526.3	407987.9	255148.0	187436.1	-33320.4	99720.5
2008/07	-1.1		-1.5	-2.2	3.4		8.7
2009/08	-4.3		-3.7	-13.4	0.9		-5.0
2010/09	1.8		0.0	10.7	1.3		5.6
2011/10	1.0		-1.3	-1.7	0.9		-3.9
2012/11	1.4		0.3	4.7	1.2		2.8
2013/12	2.0		1.6	3.0	1.5		2.4
2010:1	141.9	169929.6	101035.9	54839.4	47326.4	-10076.3	23195.7
2010:2	143.4	171724.0	101994.9	57226.4	43888.6	-9819.2	21566.7
2010:3	144.3	172787.0	101409.9	65728.6	44640.8	-11710.3	27282.0
2010:4	143.6	171904.6	101124.6	63627.7	44921.5	-10415.2	27354.0
2011:1	144.2	172584.4	100688.1	55175.7	47489.5	-7019.6	23749.4
2011:2	144.3	172761.4	99684.3	58473.2	44536.4	-7695.8	22236.7
2011:3	145.6	174351.0	99891.2	61928.1	45087.9	-8312.5	24243.0
2011:4	145.0	173634.6	100118.2	61175.2	45284.1	-8320.4	24622.2
2012:1	145.7	174471.0	100187.7	58861.3	47967.7	-8338.6	24207.2
2012:2	146.2	174997.3	99883.8	62474.5	45027.4	-8332.2	24056.9
2012:3	147.8	176953.2	100387.2	63758.7	45681.0	-8335.7	24538.7
2012:4	147.6	176749.1	101113.3	62662.6	45927.2	-8338.7	24614.9

[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)
2008	5.8	1262.4	73.8	33.2	-22.0
2009	10.3	1244.4	127.8	32.4	-26.1
2010	8.3	1333.7	110.8	36.6	-30.8
2011	8.8	1391.3	121.9	43.1	-5.8
2012	6.9	1457.5	100.6	49.6	-8.1
2013	6.4	1519.8	97.2	52.7	-7.4
2010:1	8.1	317.8	25.9	8.4	-6.9
2010:2	10.2	321.7	32.7	8.8	-10.1
2010:3	7.8	335.7	26.2	8.9	-9.7
2010:4	11.3	337.6	38.3	9.2	-4.1
2011:1	4.0	338.7	13.6	9.7	-2.0
2011:2	8.5	339.2	28.9	10.1	-1.1
2011:3	4.7	347.4	16.3	10.4	-2.8
2011:4	12.2	349.5	42.5	11.0	0.1
2012:1	9.6	355.2	34.2	11.6	-4.0
2012:2	6.4	357.8	23.1	12.0	-1.6
2012:3	6.5	363.5	23.7	12.4	-2.8
2012:4	6.7	364.9	24.5	12.5	0.2

[1] GDP at market prices (Financial Year)

WORLD FORECAST DETAIL

Growth Of Real GNP

	2008	2009	2010	2011	2012	2013
U.S.A.	0.0	–2.6	2.6	1.7	2.5	2.6
U.K.	–1.1	–4.3	1.8	1.0	1.4	2.0
Japan	–1.2	–6.3	4.3	–0.7	2.1	1.6
Germany	1.0	–4.7	3.6	3.0	1.1	2.0
France	0.1	–2.5	1.5	1.7	1.0	1.2
Italy	–1.3	–5.1	0.9	0.5	0.1	0.3

Real Short-Term Interest Rates

	2008	2009	2010	2011	2012	2013
U.S.A.	1.8	–1.6	–1.8	–1.7	–1.5	–1.3
U.K.	3.7	–3.1	–3.8	–2.2	0.1	0.5
Japan	1.8	1.1	0.5	0.4	0.4	0.4
Germany	3.5	–0.4	–1.3	–0.3	0.8	0.5
France	3.8	–0.8	–1.4	–0.3	0.9	0.5
Italy	3.1	–0.8	–1.4	–0.3	–0.3	0.0

Real Long-Term Interest Rates

	2008	2009	2010	2011	2012	2013
U.S.A.	2.2	1.3	1.1	1.2	2.0	2.0
U.K.	1.0	–0.3	–0.5	0.1	0.7	0.8
Japan	2.0	1.4	1.1	1.1	1.3	1.5
Germany	3.0	2.3	1.9	1.8	2.0	2.0
France	3.0	2.2	1.9	1.8	2.0	2.0
Italy	2.8	2.2	1.9	1.8	2.0	2.2

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

	2008	2009	2010	2011	2012	2013
U.S.A.	80.1	88.7	81.7	81.8	82.0	82.1
U.K.	87.6	78.2	79.7	82.5	83.7	83.6
Japan	87.9	89.0	80.2	79.8	79.7	80.0
Germany	105.1	105.8	99.3	99.0	99.1	99.0
France	106.4	104.3	101.7	102.0	102.0	102.1
Italy	106.6	105.4	100.5	100.8	101.0	101.1

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

Growth Of Consumer Prices

	2008	2009	2010	2011	2012	2013
U.S.A.	3.8	–0.3	1.8	3.1	2.0	2.0
U.K.	3.3	1.3	3.9	4.4	3.2	2.2
Japan	1.4	–1.4	–1.0	–0.3	–0.2	0.0
Germany	2.6	0.4	1.1	2.3	1.8	1.7
France	2.8	0.1	1.5	2.1	1.6	1.6
Italy	3.4	0.8	1.5	2.8	2.7	2.8

Nominal Short-Term Interest Rates

	2008	2009	2010	2011	2012	2013
U.S.A.	1.5	0.2	0.1	0.3	0.5	0.7
U.K.	5.1	0.8	0.6	1.0	2.3	2.5
Japan	0.4	0.1	0.1	0.4	0.4	0.4
Germany	3.9	0.7	0.4	1.5	2.5	2.5
France	3.9	0.7	0.4	1.5	2.5	2.5
Italy	3.9	0.7	0.4	1.5	2.5	2.5

Nominal Long-Term Interest Rates

	2008	2009	2010	2011	2012	2013
U.S.A.	3.7	3.2	3.1	3.2	4.0	4.0
U.K.	4.0	2.8	2.3	2.4	2.7	2.8
Japan	1.5	1.3	1.1	1.2	1.5	1.5
Germany	4.4	4.0	3.8	3.8	4.0	4.0
France	4.4	4.0	3.8	3.8	4.0	4.0
Italy	4.4	4.0	3.8	3.8	4.0	4.0

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

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

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

* Forecasts based on the Liverpool World Model