LIVERPOOL INVESTMENT LETTER

November 2013

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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COMMON SENSE ON THE CITY BREAKS OUT IN THREADNEEDLE STREET

A joyful sound was heard recently in the City. It was the reaction to a recently rare outbreak of common sense from the Old Lady of Threadneedle Street. Mark Carney, the new Governor, has announced that he and the government welcome the growth of the City in numerous international financial markets, whether in renminbi bonds or sukuks or anything in between. If 'this requires bank assets to GDP to rise to nine times GDP by 2030' so be it, the governor declared; he would welcome it, provided it was backed by soundness and prudence.

With credit at last starting to flow again, so far it is true mainly to mortgages supported by Help to Buy but perhaps also with signs of a trickle into business lending, and the economy also starting to grow confidently mainly because of this renewed credit flow, the politics of growth is beginning to reassert itself. The new governor of the Bank is a pragmatic realist — and this is what we need in that important post. No one really knows how the new banking era is going to be regulated and generally kept safe. Our view is that it requires much more competition and a jaundiced competition eye on the massive beasts of prey that used to prowl Wall Street and the City. We want nimble efficient institutions that need to compete in the marketplace on the basis of reputation for soundness combined with profitability; the old set-up where massive risks were taken on the basis of heavy borrowing where somehow the lenders felt impregnable to risk will go in this new environment where banks are small and will be allowed to fail individually even while the system is guaranteed collectively. This was always the vision of practical economists like Bagehot more than a century ago and it can ride again, reinvented for the modern more complex era.

With such an environment the emphasis can return to self-regulation with the Bank keeping a weather eye, as it used to before the ill-fated tripartite system set up by Gordon Brown. Each bank ought to know itself how much capital it needs to reassure its depositors and bondholders. In all this deposit insurance for the 'little guy' is basically an irrelevance, since the bulk of funds and certainly of marginal funds will be unprotected. Thus we will just have political insurance for small depositors; banks will still have to think about the safety of their main funders. In conditions of competition that we must now hope will be actively encouraged, banks will have to have quite wide differences in capital back-up. We can leave it to the market, much as we leave airline safety to the market beyond specifying some minimum safety benchmarks. No airline can afford an accident due to negligence; and no bank should be able to afford to risk its reputation for safety either and so will provide necessary capital back-up, just as an airline pays for the best maintenance.

Table 1: Summary of Forecast

		2010	2011	2012	2013	2014	2015	2016
GDP Growth[1]		1.7	1.1	0.2	1.2	2.2	2.4	2.6
Inflation	CPI	3.3	4.5	2.7	2.7	2.5	2.2	2.0
	RPIX	4.8	5.3	3.2	2.5	3.1	2.8	2.7
Unemployment (Mill.)								
	Ann. Avg.[2]	1.5	1.5	1.6	1.5	1.4	1.3	1.2
	4th Qtr.	1.5	1.6	1.6	1.5	1.3	1.2	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	0.9	1.6	2.1	2.2
5 Year Interest Rate		2.4	2.0	0.9	1.3	1.8	2.1	2.4
Current Balance (£bn)		−40.0	−22.5	−59.2	−60.7	−62.9	−63.5	−62.0
PSBR (£bn)		112.6	91.0	68.4	119.7	106.0	94.6	74.5

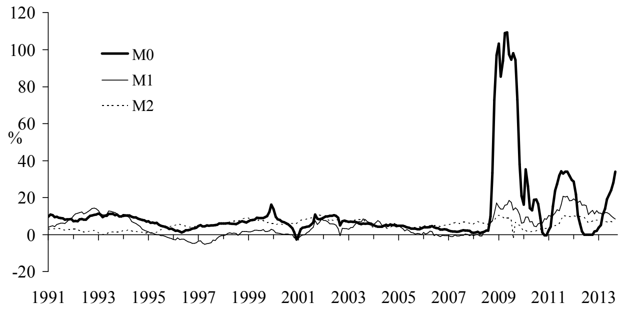
[1]Expenditure estimate at factor cost
[2]U.K. Wholly unemployed excluding school leavers (new basis)
[3]Sterling effective exchange rate, Bank of England Index (2005 = 100)

A further ray of light coming from the Bank was the new arrangements for liquidity provision; these will now at last mimic those of the Fed and the ECB and stand behind banks, ready to exchange against liquidity any asset that can reasonably be valued by the market.

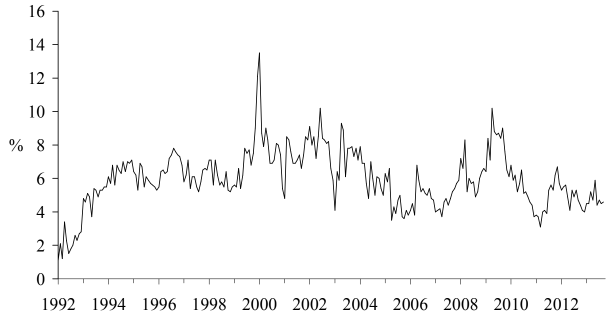
The sum total of these new arrangements, taken with the robust approach to Help to Buy and the Funding for Lending Schemes, is enormously encouraging. It implies that finally the penny has dropped with our main policymakers that the economy desperately needs a banking system ready and able to lend if it is to grow and that regulation must accommodate itself to this reality. The 'Taliban tendency' has been put to flight within the Bank.

Looking at the outlook against this background it is at last possible to be reasonably optimistic. We may now start to see credit flowing to business and SMEs in particular, as the banks respond to the greater certainty in the environment. Large businesses are flush with cash and should now start to look at investment plans for the growth ahead. Small firms may do their necessary cheeky work of snatching victory from in front of their lethargic paws. Entrepreneurial Britain may be waking up again. With world commodity prices falling and oil prices steady under the impact of shale oil and gas, reflecting the slowing of the emerging countries as well as new technology and discovery, the background for some growth in real disposable income is there too. It has been growing slowly; it should gather speed, as real wages start to pick up with a tightening labour market. The stage is also set for some tightening of monetary policy once credit growth picks up; interest rates should rise and QE start to be reversed.

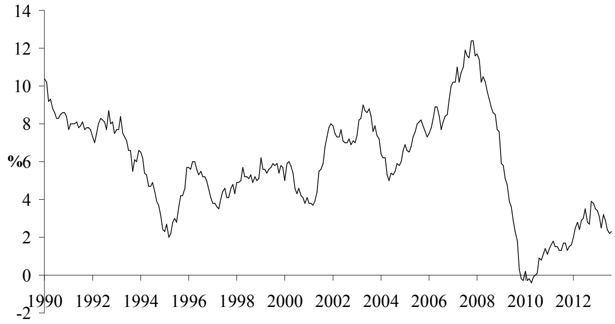
U.S.: Growth in Monetary Aggregates (Yr - on - Yr)



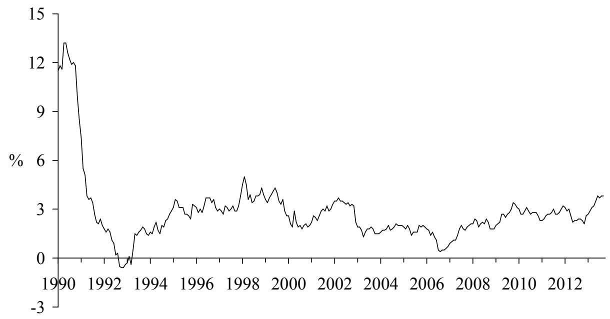
UK: Notes and Coins in Circulation Growth



Eurozone M3 Growth



Japan: Growth of M2+CD's



FOCUS ON JAPAN

Francesco Perugini

The third arrow of Abenomics
Special economic zones head for approval

Japanese prime minister, Shinzo Abe, has called the autumn session of the Parliament, which was convened on October 15 and is expected to run until early December, the "Growth Strategy Implementation Diet". This is a significant message from the government: it is aiming to pass several important pieces of legislation, including some designed to strengthen Japan's industrial competitiveness which it sees as essential to the success of the "Abenomics" program. The final part of "Abenomics", named "Japan Revitalization Strategy (Japan is Back)", was launched last June. Designed to be the "third arrow" — the first two arrows focused on loosening monetary policy and boosting public spending — the strategy aims at increasing potential growth by reforming the supply side of the economy and promoting regulatory reforms. "Now is the time for Japan to be an engine for world economic recovery", Abe said at the press conference right after the program was announced.

The Revitalization Strategy plan has several key components with target dates and key performance indicators to track and quantify performance. Among them are previously taboo subjects, such as enabling mergers and acquisitions, controversial labour reforms, the reduction or elimination of zombie industries and companies and efforts to improve the low corporate profitability that has long hampered progress in the economy (see box for more details). The plan also includes the creation of National Strategic Special Zones, special areas that are easy to live and work in for foreigners and are free from opportunity-narrowing regulations. The aims of the special zones are to make Japan the third easiest OECD country to do business in by 2020, up from 15th at present, and to double foreign direct investment into the country to ¥35 trillion by the same year. To foster an international business environment, Abe wants to promote deregulation, introduce tax incentives for corporate investment, and make a series of reforms which will let private firms operate public schools, expand the scope of treatment that can be administered by non-Japanese doctors and nurses, facilitate the use of foreign drugs and increase the number of hospital beds. "We'll create an international business environment comparable to cities such as London and New York", Abe said.

However the package of steps does not include bold reforms in areas such as labour mobility which are seen as essential to lure more foreign capital. "Japan should make it easier for companies to lay off workers, otherwise foreign companies, which are no longer able to offer good compensation packages after the financial crisis, will hesitate to make large-scale investments in Japan", said Atsushi Nishiguchi, a consultant at UBS. On the contrary, the government panel recently did not approve a plan to relax the rules for firing workers and decided to extend contract lengths for part-time and contract workers nationwide to increase their job security. Abe had hoped for more sweeping regulatory reforms but bureaucratic opposition to changing long-standing labour regulations proved too powerful to surmount. In particular, a so-called white-collar exemption to allow work schedules exceeding an eight-hour workday and a 40-hour week had been viewed as a signature move that could showcase Japan's commitment to flexible employment options. The plan quickly ran into opposition from the Labour Ministry, which was dead set against creating such a precedent in the special zones. "Such a move could lead to discrepancies in labour protection guaranteed under the Constitution", the ministry warned. "Looking worldwide, there are no examples of core labour rules being relaxed only in economic zones", asserted Labour Minister Norihisa Tamura.

The government aims to submit the bills needed to create the special zones to Parliament in early November, and decide on their exact locations by early next year — details are sketchy at this stage, other than that Tokyo, Osaka and Nagoya could be chosen as bases. Observers believe that at the end the deregulatory blueprint will be far from the sweeping initiative Abe had envisioned. So far there has been no consensus within the government on whether the special zones should allow such radical reforms. The debate is vigorous, confirms Robert Feldman, an economist at Morgan Stanley, who recently presented ideas for the zones to an official working group. "Those who want radical deregulation are pitted against others who prefer to use them in more old-fashioned ways, such as helping particular local industries and attracting foreign investment", he said.

Observers also believe that special zones, which have resulted in boomtowns like Shenzhen, Xiamen and Zhuhai in China, will be a hard sell in Japan. Japan has in the past tried special zones, which allow political and economic experiments not permitted elsewhere in the country, but they did not go anywhere. "There was a lack of co-ordination between the central government and the localities. Abe would need to co-opt bureaucrats, who wield enormous power", says Izumi Devalier, economist at HSBC.

Furthermore, in order to give tangible results the special economic zone has to stand out in contrast with other parts of a country that are not special. The country is already littered with special economic zones. The first group, almost a thousand, was chosen by the government of Junichiro Koizumi, Japan's reforming prime minister between 2001 and 2006. Most failed, chiefly because central-government bureaucrats rejected many ideas for deregulation for fear of offending vested interests. "Unlike China, which initiated its first special economic zone three decades ago when the economy was closed, it is more difficult for Japan to offer something really special at this stage of its development, as the economy was already market-oriented", said Lok-sang Ho, professor of economics and director of the Centre for Public Policy Studies in China.

More importantly tax breaks, which Abe said were the backbone of special economic zones, would have to differ significantly from the rest of the country for these zones to matter. Japan's top corporate tax rate is 35.64%, excluding a temporary surcharge for earthquake reconstruction, the second-highest among leading industrialized nations after the US. The Tokyo Metropolitan Government offers a special corporate tax rate of 26.9% for foreign companies coming into their own special economic zone called the Tokyo Business Special Zone for Asian Headquarters. But critics say the rules to qualify are too complicated and note that the figure is still much higher than Singapore's 17.0% and Hong Kong's 16.5%. "You're still going to be paying a lot more tax than if you are in Singapore or Hong Kong", said Kenneth Lebrun, chairman of the FDI committee at the American Chamber of Commerce in Japan. "Potential business opportunities are the main factors for companies when deciding whether to come to Japan", he added.

Box — Highlights of the Government's New Growth Strategy (Japan Revitalization Strategy)*

Growth Strategy: Aims and Targets	Three main "arrows" make up the government's plan to revitalize the Japanese economy: (1) bold monetary relaxation, (2) flexible application of fiscal stimulus, and (3) a growth strategy for arousing private investment. Together, these policies aim to bring the economy out of its long deflationary spiral. The government is targeting average nominal GDP growth of approximately 3% for the next 10 years, and an average of 2% growth in real GDP. The aim is for an increase of at least ¥1.5 million in per capita gross national income in ten years' time.
Area	**Main growth targets included in the Japan Revitalization Strategy**
Private sector revitalization	• Maximize the potential of the private sector by reducing the burden on corporations through cuts to investment taxes. • Capital investment: Back to ¥70 trillion in three years' time. • Make it easier for entrepreneurs to start new companies, and for unsuccessful businesses to fail. Increase business startup/closure rate to around 10%, on par with USA and UK. • Increase number of SMEs in the black, from 700,000 to 1.4 million (2020) • 10,000 new companies to expand overseas in the next five years
Business environment	• Establish national strategic special zones to bring in international investment • Lift Japan's ranking from 15th to 3rd place among industrialized countries on the Ease of Doing Business Index • Review systems to allow foreign doctors to practice in Japan • Energize financial and capital markets: Develop the No. 1 market in Asia
Commerce and globalization	• Increase FTA ratio from current 19% to 70% (by 2018) • Infrastructure spending: Combined total for public and private sectors from approx. ¥10 trillion at present to ¥30 trillion (2020) • Export value of SMEs to double from 2010 values by 2020 • Cool Japan: Threefold increase in value of overseas sales of broadcast content from ¥6.3 billion at present (2018) • Number of foreign tourists visiting Japan: From 10 million in 2013 to 30 million by 2030
Agriculture, forestry, and fisheries	• Exports of agricultural, forestry, fisheries products, and foods: from ¥450 billion at present to ¥1 trillion (2020) • Value of "sixth-order" industries: Tenfold increase to ¥10 trillion (2020) • Double total income of agriculture and farming villages over the next ten years

Employment, women's issues, training	• Reduce the number of people unemployed for 6 months or more by 20% in the next five years • Percentage of women in work (ages 25–44): Increase from 68% at present to 73% (2020) • World university rankings: At least ten universities in the Top 100 within the next ten years • Internationally competitive human resources: Double the number of Japanese studying abroad by 2020 (from 60,000 to 120,000)
Energy	• Developing the energy industry: Market to be worth ¥26 trillion by 2020 • Reform electricity supply systems: Create ¥16 trillion worth of new industry, new employment • Introduction of renewable energy: New regulations and reforms of current systems • Commercial development of the marine resources that will provide the energy of the future
Healthcare and medicine	• Expand the health and preventative medicine market: From ¥4 trillion at present to ¥10 trillion in 2020 • Scale of medical market: From ¥12 trillion at present to ¥16 trillion (2020) • Establish a national institute of health to exercise central control over medical research and development • Lift prohibition on online sales of conventional medical products

* Based on the Japan Revitalization Strategy decided at a cabinet meeting on June 14
http://www.kantei.go.jp/jp/singi/keizaisaisei/pdf/en_saikou_jpn_hon.pdf

MARKET DEVELOPMENTS

With a new Fed Chairman committed to supporting markets and the new Bank governor showing pragmatism, equity markets are in good heart and the prospects are turning out along the lines of moderate growth and controlled inflation. This as for some time favours equities. Emerging markets are currently under a cloud; but in the long term they remain good value in aggregate.

Table 1: Market Developments

	Market Levels		Prediction for Oct/Nov 2014	
	Sep 25	**Nov 1**	**Previous Letter**	**Current View**
Share Indices				
UK (FT 100)	6552	6735	9546	9745
US (S&P 500)	1693	1717	2163	2177
Germany (DAX 30)	8666	9008	111829	12206
Japan (Tokyo New)	1211	1183	1693	1666
Bond Yields (government long-term)				
UK	2.75	2.66	1.70	1.70
US	2.62	2.62	2.10	2.10
Germany	1.82	1.69	1.50	1.50
Japan	0.68	0.60	0.70	0.70
UK Index Linked	0.03	–0.10	–0.30	–0.30
Exchange Rates				
UK ($ per £)	1.61	1.59	1.56	1.56
UK (trade weighted)	83.1	82.4	83.1	83.1
US (trade weighted)	85.2	85.7	85.5	85.5
Euro per $	0.74	0.74	0.79	0.79
Euro per £	1.19	1.18	1.23	1.23
Japan (Yen per $)	98.7	98.8	98.0	98.0
Short Term Interest Rates (3-month deposits)				
UK	0.50	0.51	1.80	1.80
US	0.24	0.24	0.70	0.70
Euro	0.19	0.26	0.50	0.50
Japan	0.15	0.07	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	3.30	2.2	2.5	40.00		48.00
US	1.90	2.2	1.6	23.00	2.01	30.71
Germany	2.90	0.8	1.7	33.00	–4.47	32.98
Japan	1.90	1.6	0.0	39.00	2.80	45.50
UK indexed[2]	–0.10		2.5	–10.00		–7.60
Hong Kong[3]	2.50	7.4	1.6	15.00	2.01	28.51
Malaysia	2.90	5.2	1.6	56.00	2.01	67.71
Singapore	3.40	3.7	1.6	32.00	2.01	42.71
India	1.50	6.1	1.6	18.00	2.01	29.21
Korea	1.10	3.4	1.6	–3.00	2.01	5.11
Indonesia	2.50	5.9	1.6	47.00	2.01	59.01
Taiwan	2.70	3.0	1.6	30.00	2.01	39.31
Thailand	3.20	4.7	1.6	49.00	2.01	60.51

Bonds: Contribution to £ yield of:

	Redemption Yield	Changing Nominal Rates	Currency	Total
UK	2.66	9.60		12.26
US	2.62	5.20	2.01	9.83
Germany	1.69	1.90	–4.47	–0.88
Japan	0.60	–1.00	2.80	2.40

Deposits: Contribution to £ yield of:

	Deposit Yield	Currency	Total
UK	0.51		0.51
US	0.24	2.01	2.25
Euro	0.26	–4.47	–4.21
Japan	0.07	2.80	2.87

[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

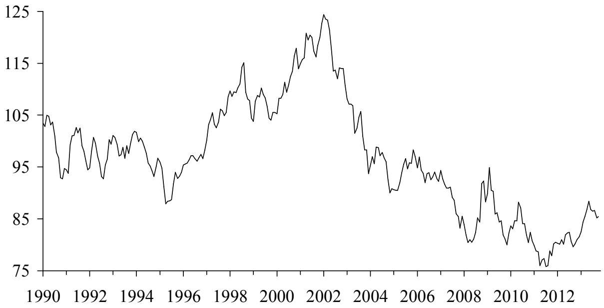
[3] Output based on China.

Table 3: Portfolio(%)

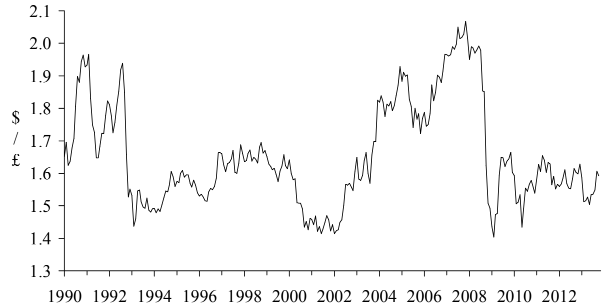
	Sterling Based Investor		Dollar Based Investor		Euro Based Investor	
	October Letter	Current View	October Letter	Current View	October Letter	Current View
UK Deposits (Cash)	5	5	5	5	1	1
US Deposits	-	-	-	-	-	-
Euro Deposits	-	-	-	-	-	-
Japanese Deposits	-	-	-	-	-	-
UK Bonds	-	-	-	-	-	-
US Bonds	-	-	-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

INDICATORS AND MARKET ANALYSIS
FOREIGN EXCHANGE MARKETS

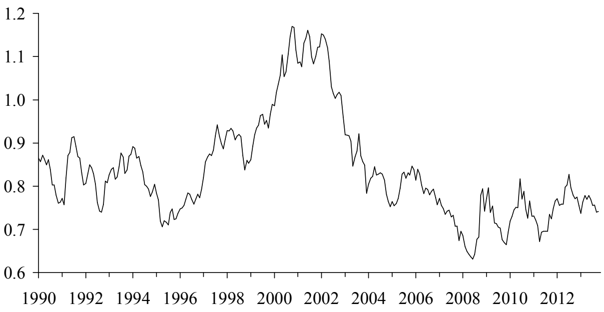
US : Trade Weighted Index
(Bank of England 1990 = 100)



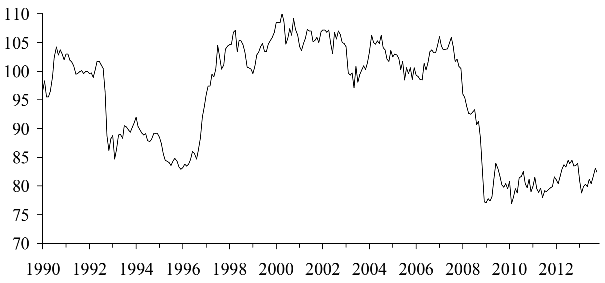
UK: Dollars Per Pound Sterling



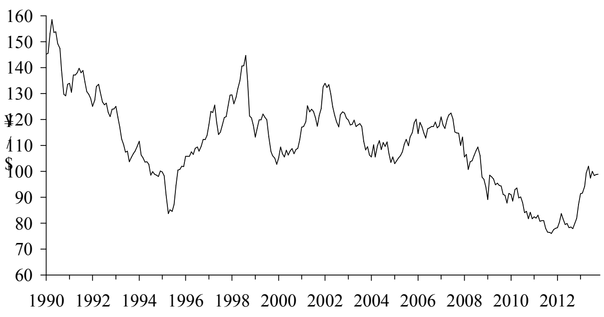
Euro per US dollar



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

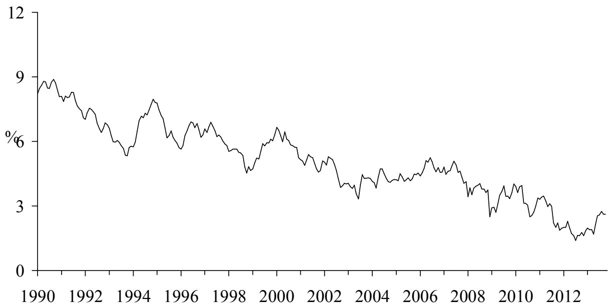


Japan : Yen Per U.S. Dollar

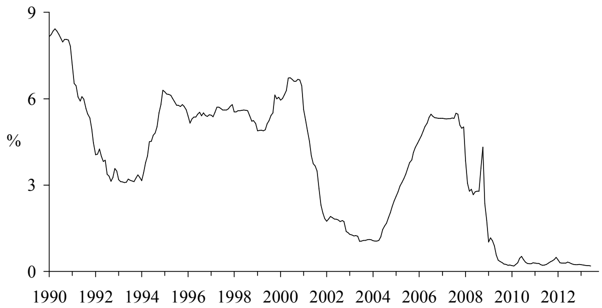


GOVERNMENT BOND MARKETS

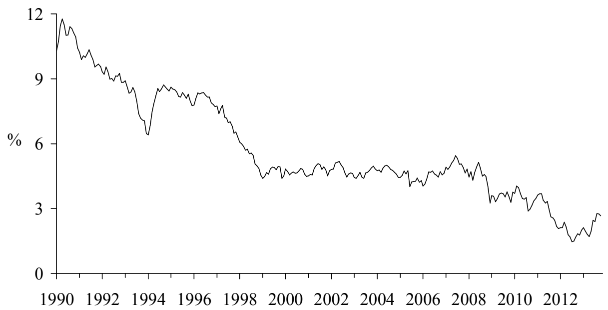
U.S.: Yield on Long-Term Government Bonds



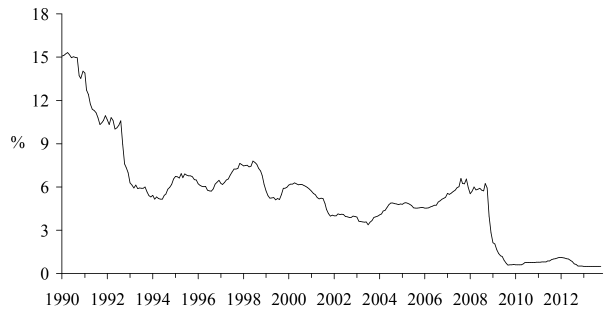
U.S. : 3-Month Certificate of Deposit



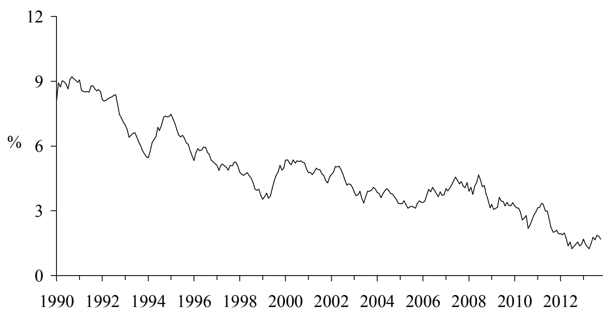
U.K. : Yield on Long-Term Government Bonds



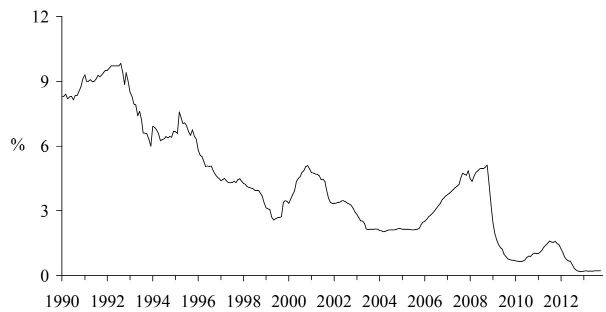
U.K. : 3-Month Interbank Rate



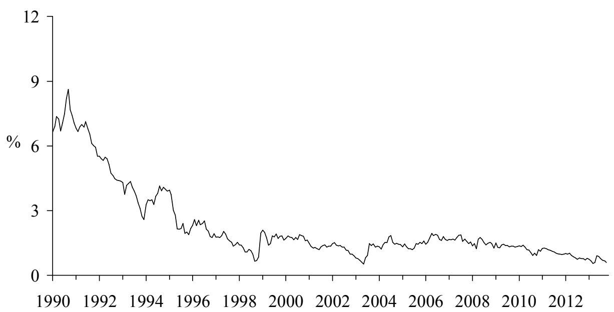
Germany: Yield on Public Authority Bonds



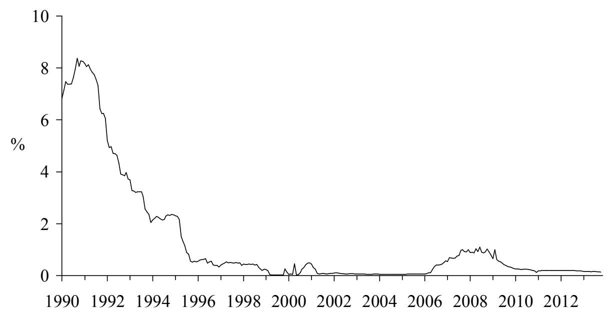
Germany : 3-Month Interbank Deposit Rate



Japan: Yield on Long-Term Government Bonds

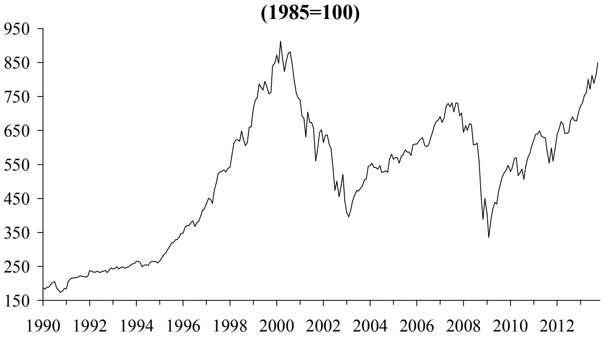


Japan : 3 Month Money Market Rate

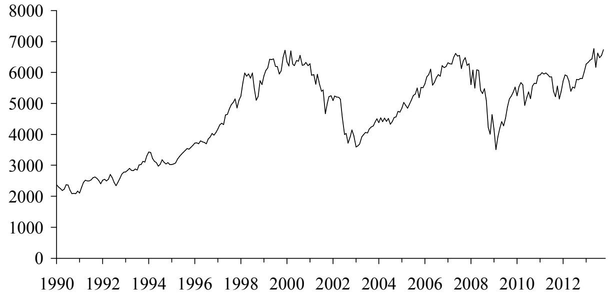


MAJOR EQUITY MARKETS

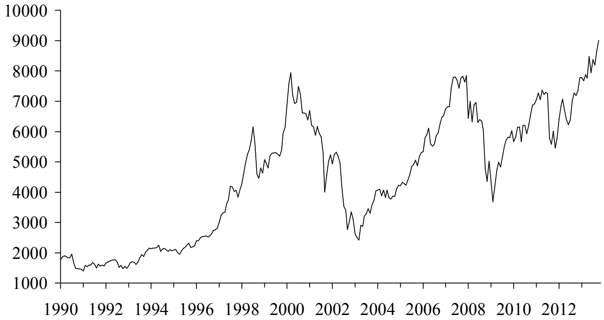
U.S. : S & P 400 Industrial
(1985=100)



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



Germany : DAX 30



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

EMERGING MARKETS

Anupam Rastogi

India

Gross domestic product increased just 4.4% in the April–June quarter, the weakest in more than four years, after decade-low annual growth of 5.0% in the fiscal year ended March 31. India's economy is currently growing at it its slowest pace in more than 10 years, but there are signs that suggest that the economy will be able to grow by more than 5% in the year ending in March 2014. The PMI remained at 49.6 in October, indicating that the country's manufacturing sector is still contracting, but also that the contraction is not accelerating. The index of industrial production, to be declared next week, is likely to be higher for October as electricity generation grew by more than 10% in October.

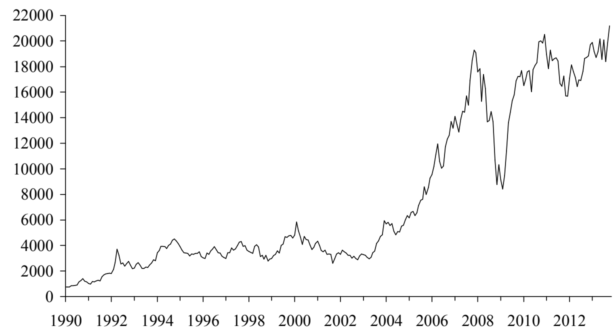
Central bank governor Raghuram Rajan said that the global growth outlook had improved, and that India's full-year GDP growth could rise to 5% due to improving exports, a pick-up in services and an expected pick-up in agriculture following a strong monsoon.

The government is confident that the fiscal-deficit target of 4.8% of GDP for the current fiscal year will be achieved. However, the country's consumer inflation measured by its consumer-price index is stuck at more than 9%. In its last policy meeting on September 29th, the central bank raised its policy lending rate by a quarter percentage point, to 7.75%, for the second time as part of its efforts to tame inflation. It, however, also lowered the interest rate by a quarter percentage point charged under an emergency lending facility for banks as it rolled back measures, implemented in July, to prop up the rupee.

Wholesale inflation — the main gauge of prices in India — reached a seven-month high of 6.46% in September, remaining above the central bank's comfort level of 5.0% for the fourth consecutive month. The country's consumer-price inflation remained more than 9% in September.

India's finance minister said that India's current-account deficit will be much smaller than $70 billion — the target announced in July to arrest runaway rupee depreciation. The current account deficit is likely to be contained at $60 billion this fiscal year. The current account got a boost from rising exports, investment flows and import controls initiated by the government. Lower oil and gold imports have helped reduce overall imports also, which were down 18.1% on the year at $34.4 billion and exports were up 11.15% from a year earlier at $27.68 billion in September. India is likely to meet its exports target of $325 billion for the current fiscal year. The Federation of Indian Export Organizations expects exports to exceed the target and may even touch $350 billion.

India: BSE Sensitive



The International Finance Corp. will raise $1 billion by selling rupee-linked bonds outside India and invest the proceeds in Indian companies engaged in agricultural and infrastructure development. Though bond settlements would be in U.S. dollars for the convenience of international investors, the coupon and valuation of these bonds would be linked to the rupee and its exchange rate as well as interest rates in India.

India's benchmark stock index reached a record high on Diwali Day — the festival of lights — as foreign investors returned to the market. This is unusual considering that GDP growth has been at its lowest levels for the last 10 years. The investors are confident that the country's biggest companies will continue to rise even as its economy struggles with a slowdown. Part of this investment is coming from the easy liquidity as the US Federal Reserve has decided to postpone its tapering programme. Liquidity apart, hopes of a BJP victory in next year's general elections has also been a key driver of the recent rally. Investors hope that a decisive outcome in India's forthcoming national election, which is due to be held before May, will end the nation's period of slowing growth and indecisive policy making.

The benchmark Sensex is now up 9.1% this year. Nearly all of those gains have started coming since early October. The rupee has also rebounded since then. It is now trading at around 10% stronger than its record low of 68.80 to the U.S. dollar which it reached in August 2013.

	10-11	**11-12**	**12-13**	**13-14**	**14-15**
GDP (%p.a.)	7.5	6.2	5.0	5.0	6.5
WPI (%p.a.)	9.0	7.5	7.0	6.5	6.0
Current A/c(US$ bill.)	-31.0	-40.0	-80.0	-70.0	-60.0
Rs./$(nom.)	49.0	49.5	54.5	62.0	64.0

China

China's gross domestic product growth rebounded to 7.8% in the third quarter, from 7.5% in the second, on the back of a modest recovery in demand for China's exports.

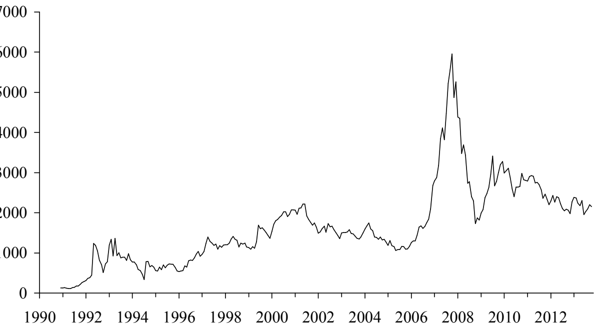
China's manufacturing sector accelerated in October to its strongest level in 18 months, suggesting continued expansion in the world's most important manufacturing sector. The official PMI came in at 51.4 in October, compared with 51.1 in September. A reading above 50 indicates expansion in the manufacturing sector. The closely watched index has been positive for more than a year, although it has flirted with contraction on a few occasions.

China's consumer inflation expanded marginally in September, but it is not going to be a nuisance for policy makers who are trying to steer the world's No. 2 economy toward stronger growth based on expanding domestic consumption. China's consumer-price index rose 3.1% on year in September compared to a 2.6% rise in August, topped expectations and clocked its fastest pace in seven months, was due mainly to higher food prices, reflecting typhoon damage as well as seasonal factors.

China's exports unexpectedly shrank by 0.3% in September, sharply down from August's 7.2% growth and far below economists' median forecast of a 5.5% expansion. Compared with a year earlier, China's exports to Hong Kong slipped 4.1%, while exports to Taiwan decreased 8.6% and exports to the European Union fell by 1.1%. However, exports to the U.S. rose 4.2% and Japan rose 1.3%.

China has been consistently working towards internationalising the yuan. The financial and tax reforms, are likely to be approved in the meeting of the Central Committee of the Communist Party to be held on November 9 in Beijing. Chinese President Xi Jinping plans to shift the economy away from a growth-at-any-cost strategy to a domestically led economy. The changes are expected to include greater access to the economy for private and foreign investors, further economic deregulation and move to allow increased mobility of the population. Reforms call for a free market for land and more market competition. Many of those initiatives, however, have been opposed by more conservative officials and state-owned enterprises, who have argued that these changes could destabilize the economy.

China: SSE Composite Index



Mr. Xi has already hinted that China would lower its growth target for 2014 to 7% from this year's 7.5%. Mr Xi addressing a meeting of regional leaders told that the lower growth rate is sufficient to double per-capita income between 2010 and 2020, a long-stated goal.

Beijing has intervened aggressively in the currency market to blunt a rise in the yuan's value as part of its cautious policy in liberalising its foreign-exchange policy. According to the data, China's foreign-exchange reserves reached \$3.66 trillion at the end of the third quarter, up from \$3.50 trillion at the end of the second quarter — a \$160 billion rise which is one of the largest increases on record.

As the largest lender to the US, the US president and policy makers were told, in no uncertain terms, that China expects Washington to live up to its global responsibilities. China is worried that a protracted stalemate in Washington would send the US economy back into recession and throw markets into a tailspin. China would not escape lightly from a US default and there would be serious repercussions on Chinese growth. Beijing is also concerned that the continued weakness of the dollar is devaluing China's huge stock of US debt. China is also worried that a US policy to move from acting as the guarantor of broadly based multilateral rules to a preference for small coalitions with its friends would impact China's continued prosperity in the years to come. Already adverse news of China's growth rattles commodities market significantly.

	10	**11**	**12**	**13**	**14**
GDP (%p.a.)	10.3	9.2	7.8	7.5	7.0
Inflation (%p.a.)	5.9	4.3	2.6	3.5	3.0
Trade Balance(US$ bill.)	183	210	214	220	220
Rmb/$(nom.)	6.6	6.3	6.3	6.2	6.1

South Korea

South Korea's economy maintained a robust pace of growth in the third quarter as private consumption and investment compensated for a fall in exports. Gross domestic product rose a seasonally adjusted 1.1% from the second quarter. Growth was the strongest since 1.3% in the first quarter of 2011. The economy expanded 3.3% in the third quarter on year-on-year basis. The Bank of Korea maintained its growth forecast for this year at 2.8% but cut its growth outlook for 2014 to 3.8% from 4.0%. Good news for South Korea is that South Korean manufacturing conditions in October, according to the PMI calculated by the HSBC, reached 50.2.

October consumer price inflation was low at 0.7% year-on-year — but core inflation, stripping out food and energy, was 1.6%, while consumer price expectations for the next year stand at 2.9%. We expect the central bank to keep rates on hold at 2.5% in the near future, before rising in the second half of 2014 if the economic recovery accelerates and the GDP growth is above the target level.

Exports fell 1.3% last year, the first decline in three years, as growth weakened in China, the country's largest export destination, and as the European debt crisis undercut the global economy. The slide in exports in the third quarter, however, is a concern to policy makers. Shipments overseas fell 0.9% over one quarter in the third quarter, a turnaround from a 1.8% gain in the second quarter. South Korean exports rose 2.9% from a year earlier in the first 20 days of October, suggesting that the third quarter contraction in exports was due to a large number of public holidays. Improved demand for smartphones and automotives helped drive exports to a record high in October, in spite of government concerns about the impact of recent currency appreciation. The country's monthly exports reached $50.5 billion, 7.3% higher than in the same month a year before. This reflected resurgent demand in the US and the EU, to which exports rose 23.2% and 16% respectively, while sales to China rose 5.5%.

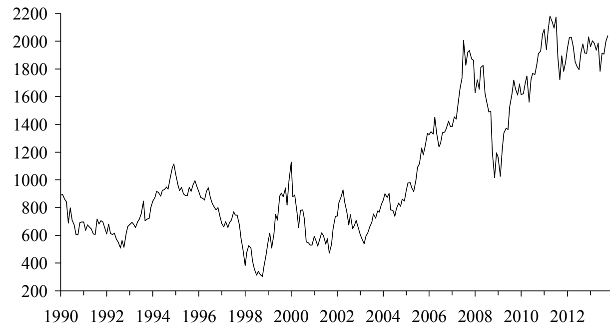
South Korea and Indonesia have agreed to sign a three-year currency swap deal worth up to $10 billion, bolstering their defence against financial-market turbulence, according to the central bank and the Finance Ministry in Seoul.

	10	11	12	13	14
GDP (%p.a.)	6.3	3.6	2.0	2.4	3.2
Inflation (%p.a.)	2.9	4.0	2.2	1.6	2.6
Current A/c(US$ bill.)	28.2	27.0	44.0	55.0	50.0
Won/$(nom.)	1150	1100	1100	1100	1080

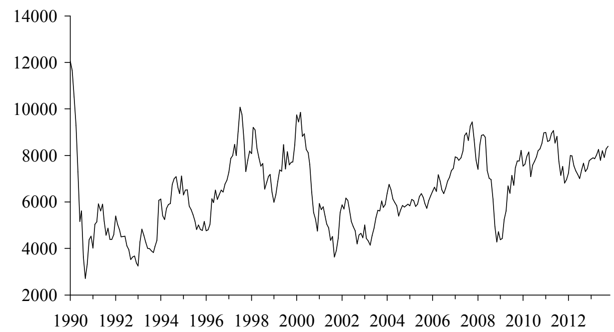
Taiwan

Taiwan's economy grew far more slowly than expected in the third quarter, as slowing exports dragged down GDP growth. Growth clocked in 1.58% year on year, against a government forecast of 2.47%. The government has cut its full-year growth forecast to 2.3% from 3.6%. The latest HSBC Taiwan Purchasing Managers' Index showed an expansion in manufacturing activity — the first in six months — with both output and new orders growing.

Korea: Composite Index



Taiwan: Weighted TAIEX Price Index



Inflation remained subdued and is likely to remain below 1% for 2013.

Good news for Taiwan is that its major export partners are growing faster. Taiwan's export orders rose 2% on the year in September, as they were buoyed by demand from the U.S. and Europe for new electronic gadgets. That marked the third consecutive month of gains. Orders from the U.S. rose 7%, while orders from Europe jumped 15.6%.

Exports in the third quarter grew just 1.68% year on year. That was a sharp deceleration from the second quarter, when exports grew 5.16% and the overall economy grew 2.49%. Private consumption also slipped slightly in the third quarter.

Taiwan's imports in September came to US$22.9 billion, down 0.7% from a year earlier, compared with the 2.40% drop forecast by the surveyed economists. It was also improved from August's 1.20% drop. Taiwan had a trade surplus of US$2.35 billion in September, smaller than August's US$3.36 billion.

	10	11	12	13	14
GDP (%p.a.)	10.8	4.0	1.3	2.4	2.5
Inflation (%p.a.)	1.3	1.2	1.9	0.6	1.0
Current A/c(US$ bill.)	16.0	18.0	20.0	22.0	23.0
NT$/$(nom.)	31.0	30.0	29.5	30.0	29.5

Brazil

The Brazilian economy is showing green shoots of expansion and, with that, the fortunes of its President Ms Dilma Rousoff are also improving. The country's economy is improving over the 2012 and early-2013 performance that initiated and fanned the June street demonstrations. Growth of only 0.9% in 2012 was near recession levels, but the economy is on track to expand 2.5% this year and 3.0% to 3.5% in 2014. Industrial production rose 0.7%, seasonally adjusted in September, according to the government statistics agency IBGE.

Inflation is still running high at 5.9%, but has fallen from its peak of 6.7%. Brazil's central bank raised its benchmark interest rate for the fifth time in a row in mid-October, bringing it close to double digits and raising questions about how much longer the tightening cycle likely to run. The bank increased the Selic rate by 50 basis points to 9.5% amid debate about whether it plans to continue the cycle at the next meeting in six weeks' time. We expect that the bank would tighten by another 50 basis points in November 27 meeting. The reason being that the government's fiscal deficits remain a big concern. Fiscal deficit in September was at R$10.4 billion. The reversal of the trend is unlikely as general elections are due next October. The central bank is in a dilemma now as the real is appreciating and itt wants to keep the real at the current rate. A weaker currency can add to inflationary pressures, but too strong a currency can harm the nation's exports.

Brazil's government issued $3.2 billion in new bonds due 2025, as investors set aside some of their pessimism on emerging markets and Brazil in particular.

Moody's Investors Service, however, has sounded a negative note on Brazil. Moody's lowered its outlook on Brazil's credit rating to stable, from positive. The rating itself was maintained at Baa 2, still two notches into investment grade, and the same as at the other two major credit ratings firms, Standard & Poor's Ratings Services and Fitch Ratings.

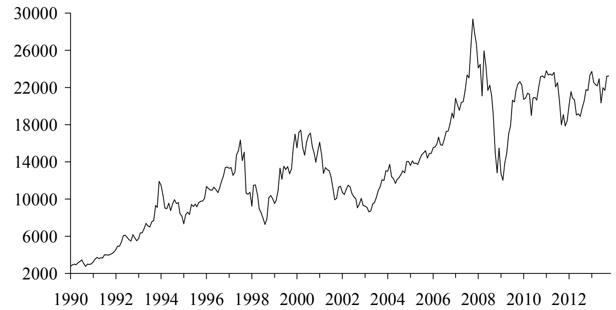
It's the second time this year that Brazil has had bad news on the credit ratings front. In June, Standard & Poor's cut its outlook on Brazil to negative from stable, raising the possibility of an outright downgrade.

Dilma Rousseff commands a strong lead over her rivals one year before Brazilians vote in the country's next presidential election, according to a new opinion poll. The results show that the president may garner 41% of the vote, against only 14% for Senator Aécio Neves, likely candidate of the centrist, pro-business Social Democratic Party, and 10% for Governor Eduardo Campos of the socialist PSB party. Presidential elections in Brazil are based on a two-tier system. If no candidate gets an absolute majority in the first round, a run-off follows between the two top vote-getters. Ms. Rousseff's left-leaning Workers' Party has won three straight presidential elections.

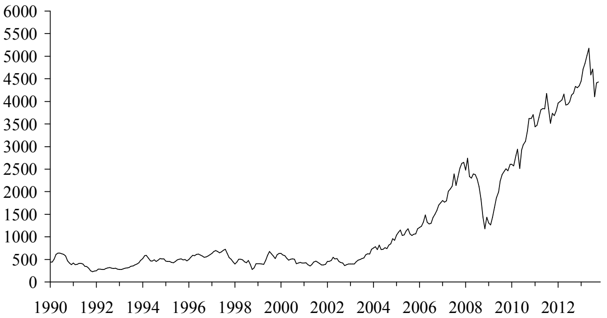
	10	11	12	13	14
GDP (%p.a.)	7.5	2.7	0.9	2.5	3.5
Inflation (%p.a.)	5.9	6.5	5.8	6.5	6.0
Current A/c(US$ bill.)	-47.3	-52.6	-60.0	-75.0	-70.0
Real/$(nom.)	1.7	1.5	2.0	2.3	2.4

Other Emerging Markets

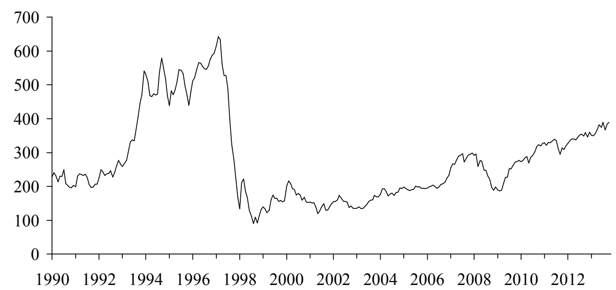
Hong Kong: FT-Actuaries



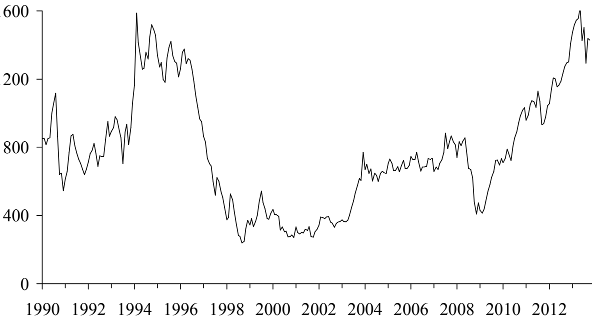
Indonesia: Jakarta Composite



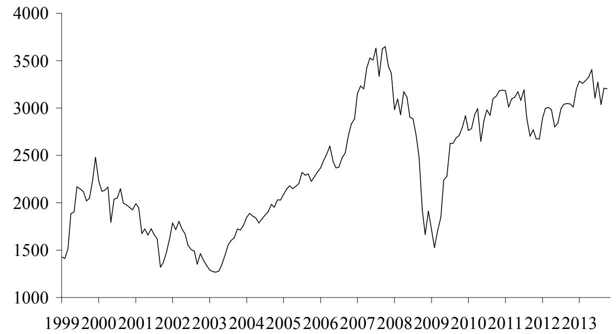
Malaysia: FT-Actuaries
(US$ Index)



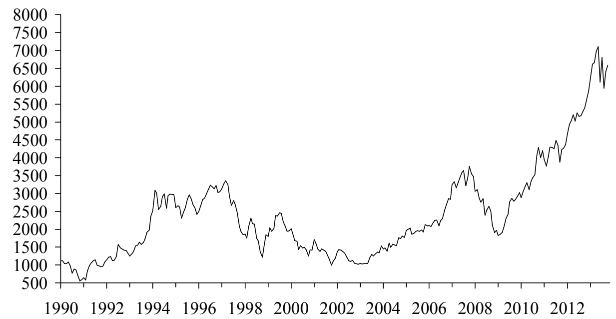
Thailand: Composite Index



Singapore: Straits Times Index

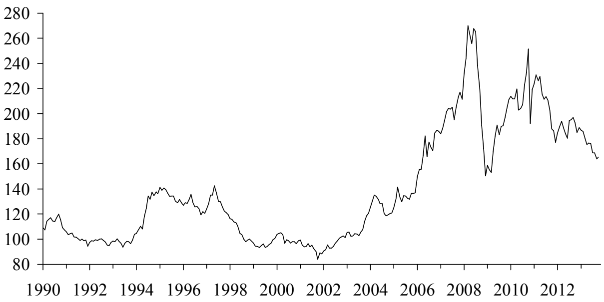


Philippines: Manila Composite

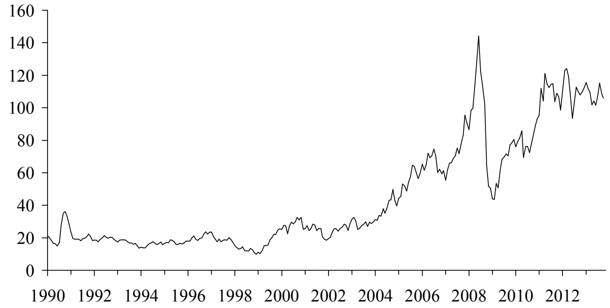


COMMODITY MARKETS

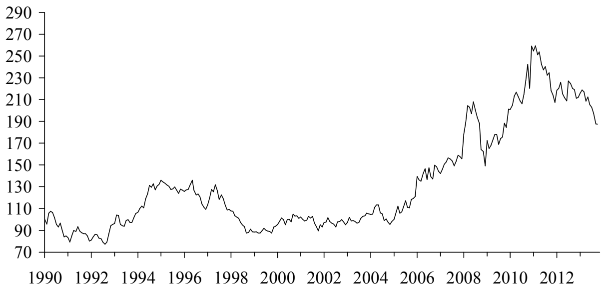
Commodity Price Index (Dollar)
(Economist, 2000=100)



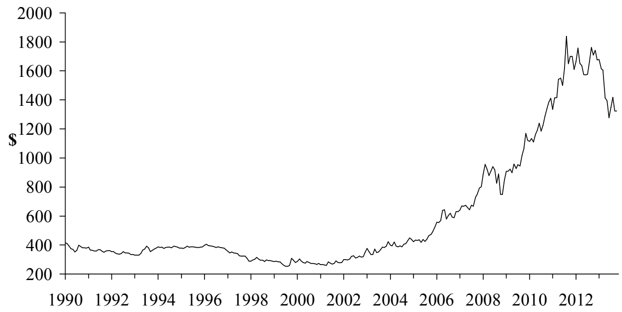
Oil Price: North Sea Brent (in Dollars)



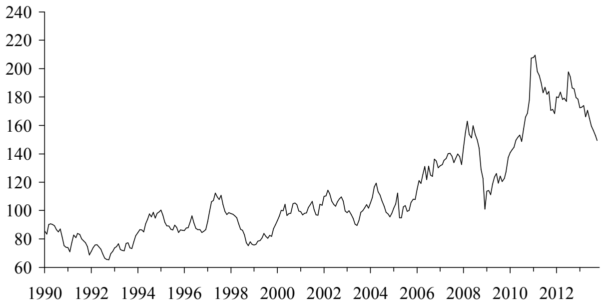
Commodity Price Index (Sterling)
(Economist, 2000=100)



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	94.0	−1.7	3.2	−1.5
2013	2.7	1.3	0.9	82.6	94.3	−1.6	2.5	−0.9
2014	2.5	1.8	1.6	83.0	95.7	−0.6	3.1	−0.3
2015	2.2	2.1	2.1	82.3	95.4	0.1	2.8	0.1
2012:1	2.7	1.1	1.1	81.2	91.6	−1.8	3.8	−1.3
2012:2	3.0	0.9	1.1	83.2	94.3	−1.4	3.2	−1.4
2012:3	2.5	0.7	0.8	84.1	95.2	−1.7	2.9	−1.6
2012:4	2.5	0.8	0.6	83.7	94.9	−2.0	3.0	−1.5
2013:1	2.6	1.0	0.6	80.5	91.1	−2.0	3.0	−1.3
2013:2	2.8	1.3	0.9	83.2	95.2	−1.6	3.3	−0.9
2013:3	2.8	1.5	0.9	83.5	95.5	−1.6	3.3	−0.7
2013:4	2.7	1.5	1.1	83.2	95.4	−1.3	3.2	−0.6
2014:1	2.6	1.8	1.3	83.6	96.0	−1.1	3.1	−0.3
2014:2	2.5	1.8	1.6	83.0	95.8	−0.6	3.1	−0.3
2014:3	2.5	1.7	1.8	83.1	95.8	−0.3	3.1	−0.4
2014:4	2.4	1.8	1.8	82.4	95.2	−0.3	3.0	−0.2

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	237.1	1.9	4.7	1.59	132.5
2013	242.3	2.2	4.5	1.53	131.8
2014	248.5	2.6	4.2	1.43	131.9
2015	256.6	3.2	3.9	1.31	133.3
2012:1	234.7	0.7	4.8	1.61	132.4
2012:2	235.8	1.8	4.8	1.59	131.9
2012:3	237.4	1.9	4.7	1.57	132.5
2012:4	240.5	3.3	4.6	1.56	133.2
2013:1	241.8	3.0	4.6	1.54	133.0
2013:2	242.1	2.7	4.6	1.55	131.7
2013:3	242.0	2.0	4.5	1.54	131.4
2013:4	243.1	1.1	4.5	1.51	131.0
2014:1	245.1	1.3	4.4	1.48	131.4
2014:2	248.1	2.5	4.3	1.45	131.7
2014:3	249.4	3.0	4.2	1.42	132.1
2014:4	251.5	3.4	4.1	1.39	132.4

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	145.1	694662.2	405184.0	235764.3	184689.2	−30801.2	100173.9
2013	146.8	702861.9	405176.8	223498.2	188405.4	−30067.7	84149.4
2014	150.0	718141.3	408306.9	241326.9	189177.7	−31205.7	89481.4
2015	153.6	735702.5	414580.1	250992.1	193479.8	−31157.8	92210.8
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	1.2		0.0	−5.3	2.0		−16.0
2014/13	2.2		0.8	8.6	0.4		7.3
2015/14	2.4		1.5	4.0	2.3		3.1
2012:1	145.2	173777.2	101162.8	53040.9	48062.2	−6746.9	21741.9
2012:2	144.4	172906.5	101177.7	59892.9	44993.0	−8401.7	24755.4
2012:3	145.5	174189.9	101200.0	60648.4	45617.7	−7536.4	25739.8
2012:4	145.2	173788.7	101643.4	62182.0	46016.3	−8116.2	27936.9
2013:1	145.5	174253.1	101590.2	48881.4	48201.0	−6636.6	17782.9
2013:2	146.5	175446.1	101360.9	56536.5	45914.8	−7812.6	20545.8
2013:3	147.2	176195.9	101183.7	57185.3	48587.9	−7810.2	22948.1
2013:4	147.8	176966.8	101041.9	60894.9	45701.7	−7808.3	22872.6
2014:1	148.7	177984.2	101428.2	59849.8	46404.1	−7808.4	21893.9
2014:2	149.5	179011.0	101842.3	60408.6	46695.4	−7801.3	22139.1
2014:3	150.4	180074.6	102284.4	58779.4	49462.5	−7797.5	22657.5
2014:4	151.2	181071.5	102752.0	62289.0	46615.7	−7798.5	22791.0

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	8.5	1319.8	112.6	36.6	−40.0
2011	6.5	1399.3	91.0	43.0	−22.5
2012	4.8	1425.0	68.4	46.9	−59.2
2013	8.1	1471.0	119.7	51.2	−60.7
2014	6.9	1541.7	106.0	56.6	−62.9
2015	5.9	1613.2	94.6	60.3	−63.5
2012:1	4.1	346.6	14.4	11.5	−12.5
2012:2	1.3	353.4	4.6	11.4	−17.8
2012:3	5.7	358.3	20.3	11.8	−15.3
2012:4	8.9	364.3	32.6	11.8	−13.6
2013:1	3.1	349.1	10.9	12.0	−14.5
2013:2	8.2	360.4	29.6	12.5	−17.1
2013:3	8.8	367.0	32.4	12.6	−15.9
2013:4	7.3	370.7	27.0	12.9	−13.2
2014:1	8.2	372.9	30.7	13.3	−16.3
2014:2	7.2	379.2	27.4	13.7	−17.3
2014:3	8.4	383.1	32.4	14.1	−16.0
2014:4	6.9	387.4	26.6	14.2	−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	1.2	2.2
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	–0.4	0.7
Italy	–5.1	1.7	0.5	–2.4	–1.8	0.4

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	–1.7	–1.6	–0.6
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

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	–1.5	–0.9	–0.3
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

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	78.9	80.0	83.7	84.0	85.2
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.

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	2.7	2.5
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	1.6	1.5
Italy	0.8	1.5	2.8	3.0	2.8	1.6

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	0.9	1.6
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

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	1.3	1.8
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

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	1.55	1.61	1.59	1.56	1.56
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