LIVERPOOL INVESTMENT LETTER

November 2014

Cardiff Business School
Cardiff University

Julian Hodge Institute of Applied Macroeconomics

LIVERPOOL RESEARCH GROUP IN MACROECONOMICS

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

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

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

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In spite of recent market turbulence prospects remain good for the world economy. The Long Wave upturn is only just getting into its stride. Monetary policy is in disarray but as luck would have it the excessive regulation on banks produced by officialdom since the banking crisis has been more than offset by the massive QE programmes which have worked by boosting equity prices.	
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HOW DURABLE IS FUTURE GROWTH?

In the past month we have seen the equity market drop on fears — about what? The end of Quantitative Easing by the US Fed; Ukraine's fallout on the euro-zone, especially Germany; China's excessive indebtedness and overcapacity; 'secular stagnation' suggestions and more besides. Equity prices are now recovering again, as the sky did not fall in when the Fed announced the immediate end of QE and then the Bank of Japan suddenly decided to have another large tranche of its QE. So it goes on from day to day, with news buffeting what has actually been a steadily rising stock market.

For some market-watchers it is only loose monetary policy that is keeping equities going and price-earnings ratios have risen too high. For others we are on a growth and recovery path so that equities are discounting better future prospects.

We have been doing work on the world economy over the last 150 years and there are two key factors we find one should look at: money and commodities. As we said in our August Letter the big underlying picture is of the commodities Long Wave, whereby the commodities cycle of investment in capital and technology lags behind the main cycle of world spending and production; periodically world production overtakes commodity capacity and there is a crisis, and then after a recessionary pause commodity capacity, boosted by the period of commodity scarcity and high prices, overtakes world production again and there is another long world boom as production benefits from low commodity prices. The cycle is then repeated; but it is a long one, of roughly 30 years from trough to trough.

We are now some five years from the last trough (2009) which implies that a run of 25 good years lies ahead. That then brings us to the second factor which, if handled well, can stop the Long Wave becoming unstable — money. There are two bad monetary episodes that stand out as 'Lessons in what not to do with money': the 1930s and the 1970s. In the 1930s the world's central banks, mainly the Fed, allowed the money supply to contract sharply with huge numbers of bank failures. The result was prolonged world slump, lasting throughout the 1930s. In the 1970s world central banks responded to surging commodity prices by printing money rapidly (growth rates went into double digits) in order to keep down unemployment: the result was a sharp rise in inflation, and this prolonged the slump of the mid-1970s into the early 1980s.

What then is the current monetary outlook? The answer is that it is a varying mixture of partially offsetting factors depending on exactly which parts of the world you look. Poorly thought-out regulation is clobbering banks in the developed world, especially the euro-zone where the euro crisis has worsened the banks' already weak balance sheets. But in some developed countries the credit-killing effects of this bank-clobbering have been mostly offset by massive QE programmes — again the exception is the euro-zone where QE has not yet occurred because in its usual form (ECB buying government bonds) it is actually illegal. QE has bypassed the banks and fed straight into the equity market: central banks have bought government and private bonds, driving down their interest rates, and the sellers have bought equities, driving up their prices, as the yield on bonds became less attractive. While this has not led to more credit to firms, because the banks have barely expanded it, it has made firms attractive to private investors through the peer-to-peer (P2P) lending channel (via the internet). This last credit channel seems to be expanding very fast though statistics on its total are hard to come by.

Table 1: Summary of Forecast

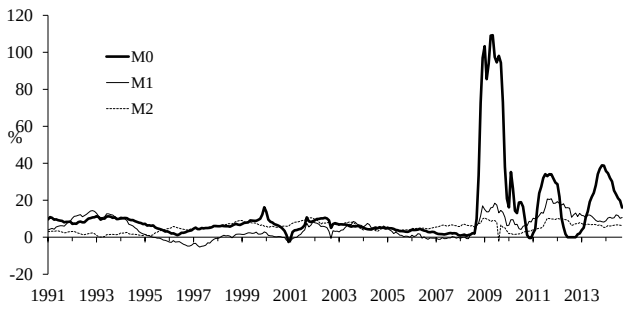
	2010	2011	2012	2013	2014	2015	2016
GDP Growth[1]	1.7	1.1	0.2	1.7	2.8	2.4	2.4
Inflation CPI	3.3	4.5	2.7	2.4	2.0	2.2	2.0
RPIX	4.8	5.3	3.2	3.2	2.5	2.8	2.7
Unemployment (Mill.)							
Ann. Avg.[2]	1.5	1.5	1.6	1.5	1.3	1.3	1.2
4th Qtr.	1.5	1.6	1.6	1.4	1.3	1.3	1.1
Exchange Rate[3]	80.4	80.0	83.1	82.6	83.0	82.3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

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

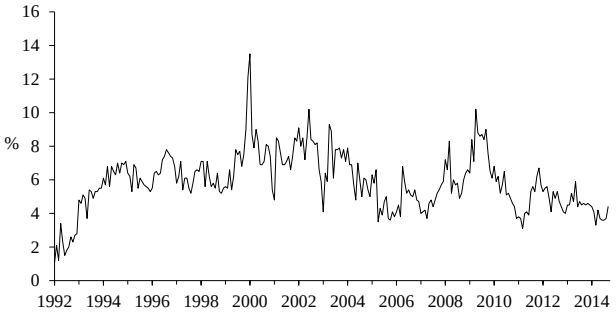
Hence on balance in the developed world money is supportive, unlike the 1930s, but because of the unintended effects of bank regulation it is also not strongly expansionary, unlike the 1970s. On balance money is in a tolerable middle zone — even if this is more the result of luck than good management. As for the developing world it is also a mixture of situations; some countries in disarray (Russia), others doing well (Singapore), and then the big ones, China and India, somewhere in the middle, with problems that do not prevent continuing moderate growth.

We therefore currently have world growth in the 3–4% range which is a good range to be in. The prospects longer term look good and there is no madcap boom as recovery proceeds. Some Keynesians, like Olivier Blanchard the chief economist of the IMF, constantly fret when growth is not at some maximum speed. But this perspective is a bad one: growth needs to proceed at manageable rates that do not threaten to get out of hand and threaten a bigger crisis when the pause has to happen. The challenge for the developed countries who dominate the worlds' money and banking is to move towards an environment where bank lending resumes under a market-friendly regulative system and where money growth is controlled to prevent the type of credit/money boom of the mid-2000s.

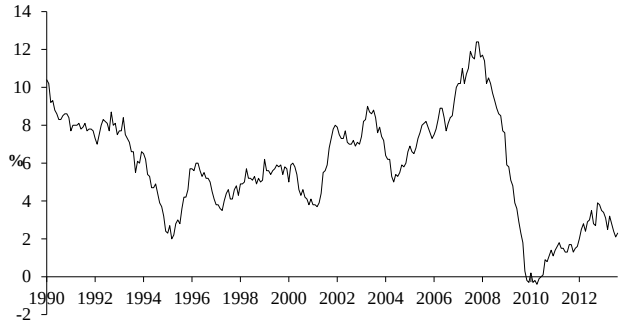
U.S.: Growth in Monetary Aggregates (Yr - on - Yr)



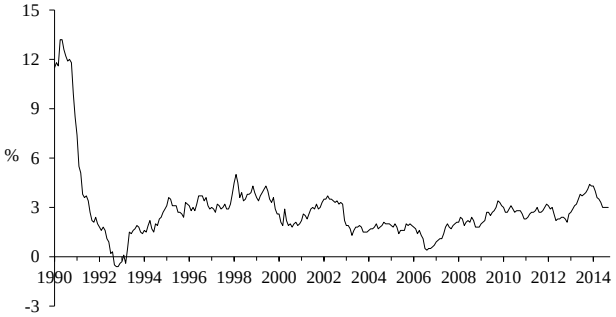
UK: Notes and Coins in Circulation Growth



Eurozone M3 Growth



Japan: Growth of M2+CD's



FOCUS ON JAPAN

Francesco Perugini

Inflationary pressures were fading before the latest QE injection

The Bank of Japan has just announced a substantial new injection of QE, raising the monthly injection by a quarter to about $700 billion per year, 1.4% of GDP per month. This comes just after the Fed has stopped its QE programme; and with the ECB considering a start with QE.

The reasoning behind this new injection is plain to see in recent events. On April 2013 the Bank of Japan (BOJ) said that it would achieve the price stability target of 2% "at the earliest possible time, with a time horizon of about two years". Since then the core consumer price index (CPI) hit a six-year high in April this year after a year of rapid gains fuelling expectations that the target could be achieved.

However, over the last few months inflationary pressures have ebbed. "So far most of the inflation can be attributed to the weaker yen and higher imported commodity prices — especially energy products and food items — not stronger domestic demand. This means that after adjustment for the consumption tax, a weaker yen and imported food or energy prices, the 2% inflation target is looking unattainable" says John Greenwood, chief economist at Invesco.

Adjusted for an increase in the sales tax that took effect in April, the nationwide CPI, which excludes volatile fresh food prices but includes oil products, rose 1.1%from a year earlier in August. That marks a slip back from the 1.3% rate recorded in July and is the lowest reading since the 0.9% rate recorded last October. Data also showed inflation in the central Tokyo area, a leading indicator for the national trend, came to an estimated 2.6% in September from a year earlier, while prices slipped 0.1% from August, the first dip in eight months. The latest BOJ survey also showed that Japanese firms expect the rise in CPI will be only 1.5% in a year, well below the BOJ's 2% target.

Eighty-seven percent of economists do not expect inflation to reach the 2% target in the year starting next April, according to a Bloomberg News survey conducted last month, because they expect the rise in gasoline prices to slow, and consumer spending to stay weak in the light of the April consumption tax rise, which is likely to curb price rises in the coming months.

The figures on the CPI are the latest in a series of economic indicators suggesting that Prime Minister Shinzo Abe's economic revival plan has hit a major stumbling block as the higher sales tax took much of the steam out of a recovery driven mainly by consumption.

The weakening momentum in growth and prices could make it more difficult for the BOJ to raise inflation expectations, a crucial part of BOJ Governor Haruhiko Kuroda's plan to push the inflation rate up. If such scepticism dampens inflation expectations, that could be troubling to the BOJ. In a sign that weak demand (probably due to the sales tax increase) is forcing some companies to cut prices to attract consumers, a separate price index of everyday goods at supermarkets has been falling since early May.

Kuroda has repeatedly said that the core CPI rate will resume its upward march from as early as this autumn, with a tightening labour market helping to drive prices higher. Even so, analysts said the latest reading — weaker than the expected 1.2% — casts doubt on that scenario. "With the economy having lost its momentum, there is now a possibility that languishing growth will begin to ricochet against employment, which typically reacts to changes in the overall economy with a lag", said Toshihiro Nagahama, chief economist at Dai-ichi Life Insurance Research Institute.

As a result last week the government cut its assessment of the economy for the first time in five months, noting a "pause" in private consumption in the wake of the tax increase. Retail spending has been subdued since April, while real household incomes — adjusted for inflation — have been falling for almost a year.

Although Kuroda had, until the latest announcement, rejected the need for immediate action, pressure was plainly building on the BOJ to add to its large-scale easing program launched a year and a half ago. "The BOJ's price outlook is evidently unreasonable", said Yasunari Ueno, chief market economist at Mizuho Securities. "Even with the recent sharp drop in the yen, which should lift prices for imported fuels and minerals, momentum towards the 2% target could be difficult to claw back, echoed Yuichiro Nagai, economist at Barclays.

Economists expected the BOJ to increase its easing by the end of the year because efforts to restore Japan's fiscal health, the worst among all advanced economies, required offsetting monetary action. Abe is to make the final decision on the second stage of the tax rise by the end of the year. If he gives the green light, it will hit 10% in October 2015. The damage to the economy from the April tax rise is evident. Japan's GDP shrank by an annualized real 7.1% in the April–June quarter, marking the biggest drop since the global financial crisis unfolded in 2008. But even if Abe were to put off the tax rise, the current weakness in demand provides evidence of the need for monetary action: economic conditions under "Abenomics" remain quite fragile.

In the event the BOJ has acted strongly. There has been a sharp fall in the yen and another fillip for the stock market. QE may have stopped in the US; but in Japan it is alive and well. It could lead to retaliatory monetary easing in the rest of Asia where the yen's fall has had dramatic effects on currency relationships. But it comes at a difficult time in China and South Korea where the recent credit boom has generated an overhang of bad debts and excess capacity. These will put practical limits on the monetary response.

MARKET DEVELOPMENTS

Equity prices have been buoyed up by QE and now the Fed's QE is stopping. But QE elsewhere is continuing: the Bank of Japan has just announced a bigger programme and it is expected that somehow or other the ECB will have to do something similar soon. Meanwhile the Long Wave recovery is also supporting the equity market; profit growth should be strong as commodity prices continue to slump. This slump strengthens consumer incomes and lowers firms' costs; profits will be strengthened both by higher sales and by higher margins. So the investment climate continues to point to equities as the best investment vehicle. With QE continuing worldwide bond prices will also stay high but yields are low and their situation looks exposed.

Table 1: Market Developments

	Market Levels		Prediction for Oct/Nov 2015	
	Sep 26	Oct 31	Previous Letter	Current View
Share Indices				
UK (FT 100)	6649	6546	9615	9466
US (S&P 500)	1983	2018	2554	2599
Germany (DAX 30)	9491	9327	13429	13198
Japan (Tokyo New)	1312	1334	1831	1862
Bond Yields (government				
UK	2.47	2.24	2.00	2.00
US	2.53	2.33	2.10	2.10
Germany	0.97	0.84	1.50	1.50
Japan	0.53	0.46	0.70	0.70
UK Index Linked	–0.33	–0.44	0.10	0.10
Exchange Rates				
UK ($ per £)	1.62	1.60	1.56	1.56
UK (trade weighted)	88.2	87.8	82.3	82.3
US (trade weighted)	91.6	93.2	85.5	85.5
Euro per $	0.79	0.80	0.79	0.79
Euro per £	1.28	1.28	1.23	1.23
Japan (Yen per $)	109.0	112.0	98.0	98.0
Short Term Interest Rates (3-month deposits)				
UK	0.61	0.60	2.10	2.10
US	0.38	0.27	0.70	0.70
Euro	0.04	0.04	0.50	0.50
Japan	–0.03	0.00	0.70	0.70

Table 2: Prospective Yields [1]

Equities: Contribution to £ yield of:

	Dividend Yield	Real Growth	Inflation	Changing Dividend Yield	Currency	Total
UK	3.40	2.5	2.1	40.00		48.00
US	1.90	2.8	2.0	24.00	2.50	33.20
Germany	2.70	1.5	2.0	38.00	3.48	47.68
Japan	1.80	1.6	2.0	36.00	14.69	56.09
UK indexed[2]	–0.44		2.4	–5.00		–3.34
Hong Kong[3]	2.50	7.0	2.0	6.00	2.50	20.00
Malaysia	3.00	5.2	2.0	55.00	2.50	68.00
Singapore	3.70	4.5	2.0	38.00	2.50	50.70
India	1.40	7.0	2.0	21.00	2.50	33.90
Korea	1.10	4.2	2.0	0.00	2.50	9.80
Indonesia	2.30	6.1	2.0	42.00	2.50	54.90
Taiwan	2.90	3.0	2.0	27.00	2.50	37.40
Thailand	3.00	4.1	2.0	36.00	2.50	47.60

Bonds: Contribution to £ yield of:

	Redemption Yield	Changing Nominal Rates	Currency	Total
UK	2.24	2.40		4.64
US	2.33	2.30	2.50	7.13
Germany	0.84	–6.60	3.48	–2.28
Japan	0.46	–2.40	14.69	12.75

Deposits: Contribution to £ yield of:

	Deposit Yield	Currency	Total
UK	0.60		0.60
US	0.27	2.50	2.77
Euro	0.04	3.48	3.52
Japan	0.00	14.69	14.69

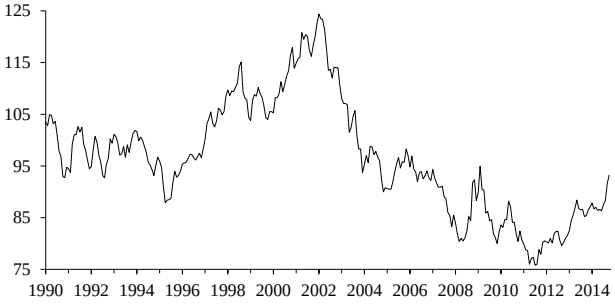
[1] Yields in terms of €s or $s can be computed by adjusting the £-based yields for the expected currency change.
[2] UK index linked bonds All Stocks
[3] Output based on China.

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)	-	-	-	-	-	-

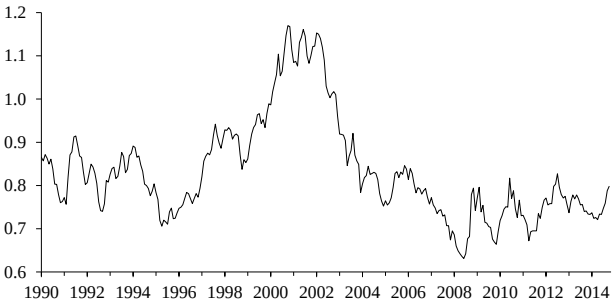
INDICATORS AND MARKET ANALYSIS
FOREIGN EXCHANGE MARKETS

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

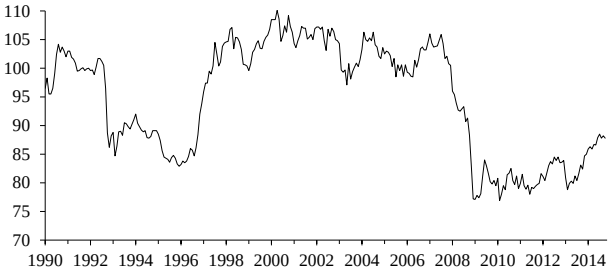


UK: Dollars Per Pound Sterling

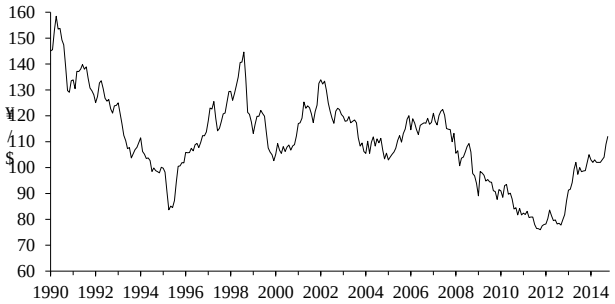
Euro per US dollar



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



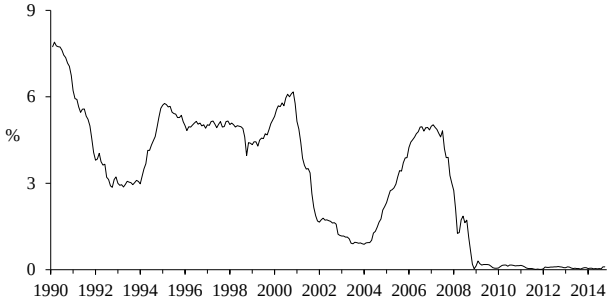
Japan : Yen Per U.S. Dollar



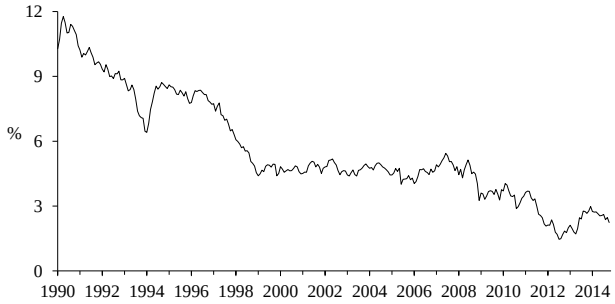
GOVERNMENT BOND MARKETS

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

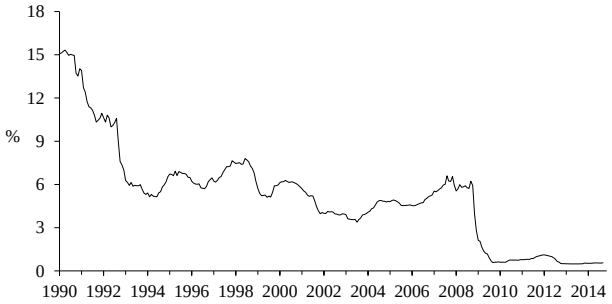
U.S. : 3-Month Treasury Bill



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

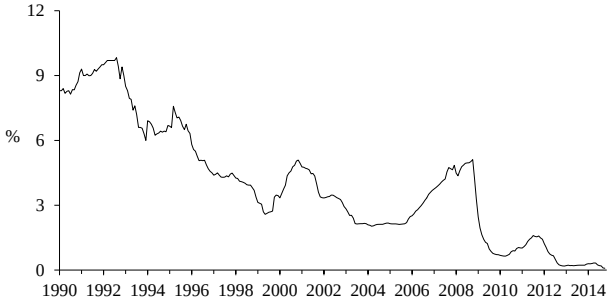


U.K. : 3-Month Interbank Rate



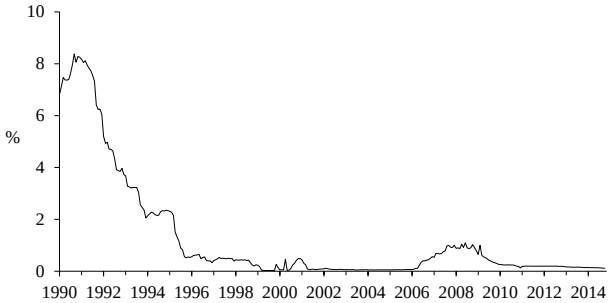
Germany: Yield on Public Authority Bonds

Germany : 3-Month Interbank Deposit Rate



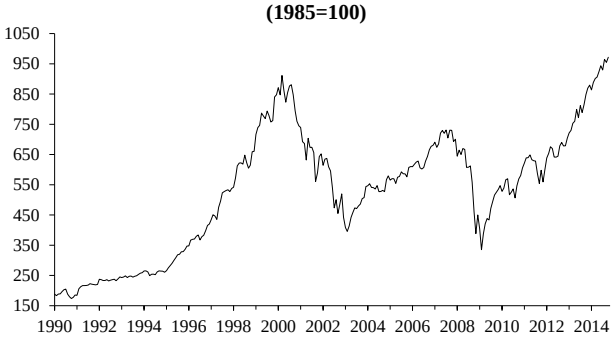
Japan: Yield on Long-Term Government Bonds

Japan : 3 Month Money Market Rate

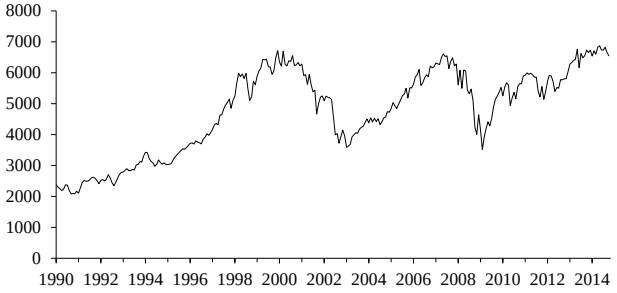


MAJOR EQUITY MARKETS

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



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



Germany : DAX 30

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

EMERGING MARKETS

Anupam Rastogi

India

Economic growth has rebounded moderately. GDP is likely to grow 6% in the current fiscal year and steadily grow 7% in the fiscal year 2015–16. Falling commodity prices is a boon to India's newly elected government. The falling prices have tamed both the fiscal deficit as well as current account deficit. The government's fiscal deficit target of 4.1% of GDP this fiscal is achievable now.

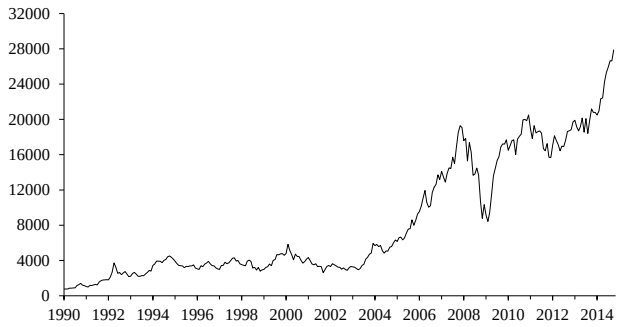
India's wholesale inflation hit a five-year low in September and the consumer inflation has cooled-off more than expected. Consumer inflation fell to 6.46% in September, the lowest level in nearly three years and below the Reserve Bank of India's 8% target for January, 2015.

The government is all set to make India business-friendly. However, instead of using a big bang approach, the government is gradually removing cobwebs within the administration. Within 6 months of coming to power the government has unfolded a series of reforms. This suggests that the government's intent is that the reforms are not for namesake. In fact, areas like land acquisition, labour laws, coal allocation, fuel deregulation had been untouchable areas for the previous government. However, most of these are now being tackled head on.

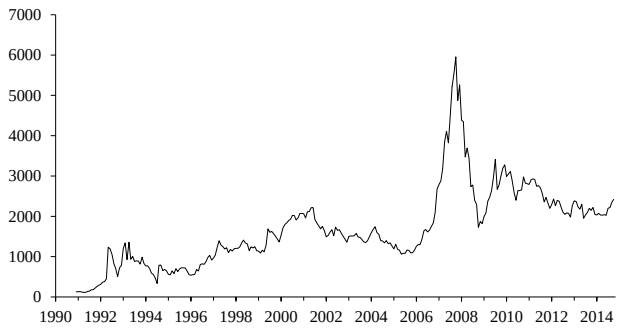
The recent decision to de-regulate diesel, increase natural gas price and auction the de-allocated coal blocks reflects that the new government is ready to bite the bullet. It also shows the government is intent in aligning the fiscal imbalance. Divestment in PSUs, overhauling tax laws and dealing with politically sensitive issue of fertilizer subsidies is next on the radar. After years of policy paralysis and lack of reforms, the initiatives by the new government have been noteworthy. Among some reforms that the government announced recently, labour reforms is a key area. For a long time, India has been grappling with the issues of antiquated labour laws. And this has been severely hampering the country's growth, particularly in the manufacturing sector. The diesel deregulation has given more confidence to credit rating agencies like Moody's about India's fiscal health. But more importantly, it will also attract private investments in India's energy sector.

Narendra Modi, the Indian prime minister, has accelerated his economic reform drive a day after his party won two state elections. The victories in regions that aren't traditional BJP strongholds dealt a blow to the Congress party, which has been reeling since its defeat by the BJP in national elections in May after a decade in power. The election results could give Mr. Modi's government an opportunity to push for more far-reaching economic liberalization before the annual budget, due in February.

India: BSE Sensitive



China: SSE Composite Index



The market is scaling new highs. In the current year the market has gained more than 25%. A similar outcome is expected next year as well as there are signs that corporate profits are going to rise next year.

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

China

In China, the deceleration of growth continues amid growing concerns about the stability of credit markets. China's housing prices fell for the fifth consecutive month in September as oversupply and falling sales continued to undermine the sector that has driven growth in the country for much of the past decade.

China reported that its third-quarter GDP rose 7.3% compared to the year earlier. Although that was the slowest growth in more than five years, the results were better than market expectations. In 2014, we expect China to hit its economic growth target of 7.5%. Next year, China's growth will be slightly less than 7%; the International Monetary Fund is lobbying Beijing to choose a range between 6.5% and 7%. A stable slowdown is good for

China as well as for the world economy. The government has been keen to focus on structural reforms rather than short-term stimulus, but it recently decided to loosen monetary policy in order to stem the slowdown in economic activity. So far the government has used a range of measures to give the economy a helping hand. It has reduced taxes and fees and tried to cut red tape. It has also tried to encourage home buying, allowing local authorities to dismantle many of the controls on new home purchases and obtaining financing. Meanwhile, it has stepped up spending on key sectors such as infrastructure.

China's official Manufacturing Purchasing Managers' Index dropped to 50.8 in October from 51.1 in September. The index remained above the key 50 level, which indicates an expansion albeit slower than the previous month.

China's central bank is planning to inject 200 billion yuan ($32.6 billion) into the banking system, as recent credit-easing measures have failed to push the world's second-largest economy back to stronger growth rates amid deepening worries about a global slowdown. The People's Bank of China will offer funds to about 20 large national and regional banks, in addition to providing 500 billion yuan into the country's five major state-owned banks.

China's consumer prices last month rose at their slowest pace in more than four years, its lowest level since the 1.5% recorded in January 2010 and slower than the 2% year-on-year rise in August of this year. This is far below the governments' goal to keep consumer inflation below 3.5%. Chronic overcapacity, particularly in industries that supply the real estate sector such as steel and cement, has led to China's longest period of producer price deflation on record.

China's exports and imports rose faster than expected in September. Imports in September rose 7% from a year earlier, following a 2.4% decline in August. The stronger-than-expected import figure suggests that the domestic economy is decelerating gradually. Exports rose 15.3% in September compared to Augusts' 9.4% growth. China's exports have been rising since April as the U.S. economy started to pick up, along with demand from parts of Asia and Europe. While China's imports and exports grew faster than expected last month, the country's overall trade surplus narrowed to $31 billion from $49.8 billion in August.

China's yuan hit a seven-month high in October, despite a slowdown in the country and a downward pressure on the currency. The central parity rate was fixed at the strongest level against the U.S. dollar in more than a month at 6.1408. The People's Bank of China sets the exchange rate and then allows the yuan to trade 2% above or below it. Despite downward pressure on the yuan from the increased flow of U.S. dollars into the economy, the currency has appreciated 2.2% since its weakest on April 30 but remains 1.2% weaker for the year.

China's outbound direct investment is for the first time set to exceed investment into the country, highlighting the ongoing shift of global economic influence to the east. Outbound direct investment rose 21.6% in the first nine months compared with last year to $75bn and on the basis of current trends it would probably exceed inbound investment by the end of the year. China is a capital exporting country and it is now poised to become a net exporter of capital.

Chinese equities have outperformed every leading market in the world for the past three months. The CSI 300, an index of large companies listed in Shanghai and Shenzhen, is up 13% in the last three months. The index hit a near 20-month high this month before retreating slightly. Even after recent gains, the index remains nearly 60% below its 2007 peak.

China's legal system and economic growth were in focus at China's fourth plenum, held in the third week of October. China's leaders are attempting to bring the country's relationship with law into balance. The Chinese Communist party will remain supremely powerful, but the Chinese people are to have the right to seek redress through the courts. The "socialist rule of law", as the party calls it, is a strange animal. The party elite gave its blessing to a comprehensive overhaul of the legal system. The idea is to give a new sheen of legitimacy to a system tarnished by corruption and government dysfunction. The "socialist rule of law" is an incoherent ambition. It is a sign of a party that clings to Chinese characteristics even when it is embracing western ideas.

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

South Korea

The central bank expects the economy to grow a moderate 3.5% amid declining exports. For 2015, it has trimmed its projection to 3.9% from 4.0%. South Korea's economy expanded 3% in 2013, following 2.3% growth in 2012. South Korea's economic growth picked up some pace in the third quarter, as a rebound in domestic demand supported by stimulus measures offset weak exports.

Gross domestic product rose a seasonally adjusted 0.9% in the July-September period from the previous quarter, after growing 0.5% in April–June. Private consumption in July–September rose 1.1% from the previous quarter after a 0.3% decline in April–June. Government expenditure and construction investments increased in the third quarter, when authorities took a series of steps to spur anemic economic growth.

President Park Geun-hye's government is trying to boost local demand to reduce reliance on exports. In July, the government had announced a $40 billion stimulus package to encourage spending and jump-start the stagnant property market. The central bank cut interest rates in October to a record low of 2%.

The central bank has cut its benchmark interest rate by a quarter percentage point to 2%, matching a record low set in the aftermath of the global financial crisis. The central bank is most likely to cut rates further because domestic demand has yet to pick up. Japan's unexpected quantitative easing may help the Korean economy marginally.

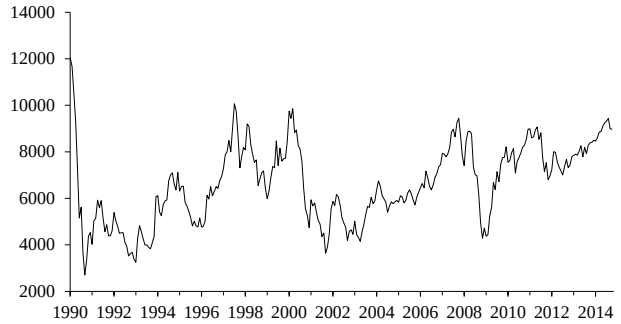
South Korea's exports grew 2.5% from a year earlier to $51.76 billion, following a revised 6.9% gain in September. Imports fell 3% from a year earlier to $44.26 billion in October, compared with an 8% increase in September. Trade surplus widened to $7.5 billion in October from the previous month's revised $3.43 billion.

The Korea Institute for Industrial Economics and Trade has predicted that by 2018, Chinese manufacturers will likely catch up with or overtake their South Korean competitors in most of the industries in which Korea currently leads the world. According to the institute's report, over the next few years, South Korea will gradually lose out to China in the former's flagship export items such as mobile phones, displays, ships, machinery, petrochemicals, steel and textiles. The shift is reminiscent of how South Korea overtook Japan in several export industries late last century following a government-directed move in the 1960's to pour capital into key manufacturing sectors.

Sluggish exports, coupled with foreign selling of South Korean equities, have eroded recent strength in the South Korean won. The currency strengthened against the US dollar by 11% in the year to July 1 but has since retreated by nearly 5%.

Korea: Composite Index

Taiwan: Weighted TAIEX Price Index



The weakening Korean won will improve the price competitiveness of underperforming exporters, while global demand should strengthen [next year] on the back of faster US growth and a moderate growth in China. China and South Korea hope to conclude a free-trade pact by the end of 2014, a sign both sides see their role in Asia's supply chain for electronics and other products as complementary.

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

Taiwan

Taiwan's GDP is most likely to outstrip the government's target of 3.41%, mainly due to rising income from tourism. In the three months ended September 30, Taiwan's gross domestic product rose 3.78% from the same period a year earlier.

Capital formation, which includes government and private-sector investment in fixed assets and changes in inventories, gained 7.89% in the third quarter, after rising

6.9% in the second quarter. An improving job market has lifted private consumption by 2.43% in the third quarter.

Taiwan's exports are also doing much better, growing 3.6% on year in the first nine months of 2014. One reason could be that Taiwan uses China as a production base to export to the U.S. and elsewhere.

The Hong Kong protest has brought Taiwan into focus, especially its political relationship with China. Taiwan President Ma Ying-jeou said China should move toward constitutional democracy and that process could start in Hong Kong, where protesters are demanding a greater say in local elections. He has suggested that China should carry out a pragmatic experiment that its leaders did when the country initiated economic reforms. "Thirty years ago, when Deng Xiaoping was pushing for reform and opening up in the mainland, he famously proposed letting some people get rich first. So why couldn't they do the same thing in Hong Kong, and let some people go democratic first?" Mr. Ma said that as a reaction to the HK protest. Alas, nobody is there to hear him!

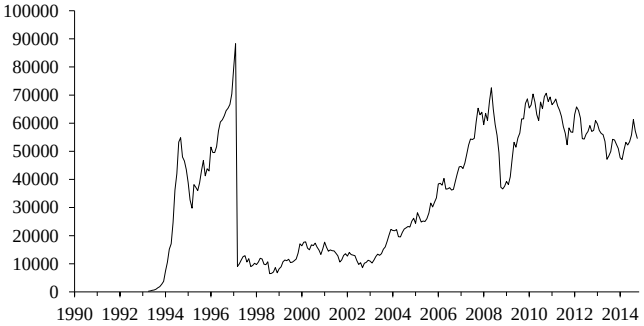
	11	**12**	**13**	**14**	**15**
GDP (%p.a.)	4.0	1.3	2.1	3.8	3.6
Inflation (%p.a.)	1.2	1.9	1.2	1.5	1.5
Current A/c(US$ bill.)	18.0	41.7	50.6	57.4	60.0
NT$/$(nom.)	30.0	29.5	30.0	30.5	30.5

Brazil

Investors took Brazilian President Dilma Rousseff's narrow win for re-election as a big loss. The currency had its worst day in a decade, the country's stock market fell 3% to a six-month low, and the state-owned energy giant lost more than a tenth of its value, reflecting the challenges Ms. Rousseff now faces over Brazil's stagnant economy. In her victory speech in Brasília on November 2, Ms. Rousseff pledged to combat inflation and take measures to boost industrial output.

Ms. Rousseff is under pressure to maintain Brazil's investment-grade credit rating, following a March downgrade by Standard & Poor's. One of her first big tests will be to name a new finance minister to replace outgoing Guido Mantega Ratings. Brazil's government has admitted that it won't be able to hit a key fiscal target for 2014. The target for the primary surplus, of 1.9% of gross domestic product for 2014, is unlikely to be achieved because of slower-than-expected economic growth in Brazil and around the world. The government will announce the new target in November. In the first nine months of 2014, central government revenue grew 7.2% from a year earlier, while spending increased 13.2%.

Brazil: Bovespa



Gross domestic product will expand less than 0.3% in the full year and only 1% in 2015, with the inflation rate falling only to 6.3%. Rate hikes are the usual remedy for slowing consumer-price increases, but they also curb economic activity.

Citing a less favourable outlook for inflation, Brazil's central bank unexpectedly raised its benchmark interest rate amid slow economic growth and concern about the country's weakening currency. The bank increased the Selic short-term lending rate to 11.25% from 11%, where it had been since April. The rate increase extends a tightening cycle started in April 2013 from a historic low of 7.25%.

The central bank has a mandate to keep annual inflation at 4.5%, but the IPCA price index rose in September to 6.75%, outside the bank's tolerance range of 2.5% to 6.5%. The bank is likely to raise the Selic more in coming months to slow price increases and manage market expectations about inflation.

Brazil's currency, the real, fell almost 2% and was trading at about 2.52 against the dollar in the last week of October, close to its lowest point in a decade. Brazilian markets rallied after a surprising interest-rate increase showed the central bank's resolve to tame inflation.

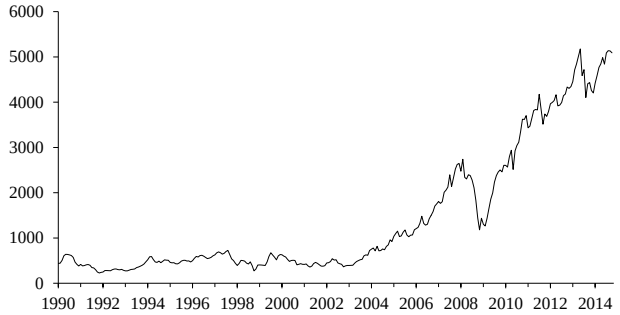
The European Union has escalated a dispute with Brazil over the country's local content programmes in the auto and other industries by asking the World Trade Organization to set up a panel to rule on the matter. The move by the EU comes soon after incumbent president Dilma Rousseff, whose centre-left Workers' party government introduced some of the measures, won a second term in elections.

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

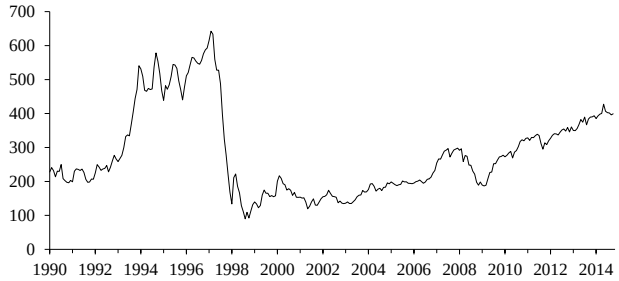
Other Emerging Markets

Hong Kong: FT-Actuaries

Indonesia: Jakarta Composite

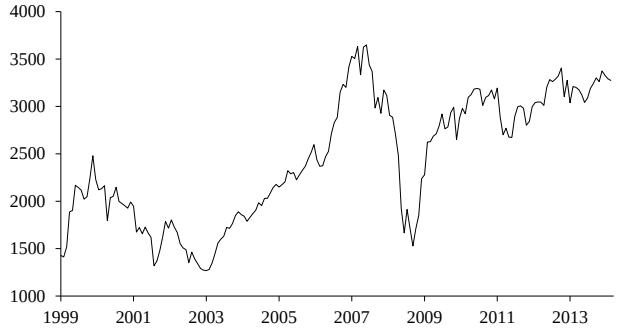


Malaysia: FT-Actuaries (US$ Index)

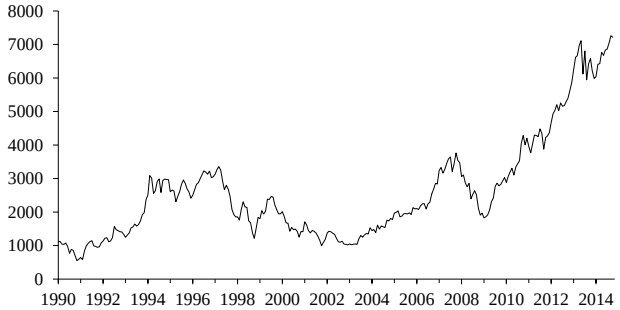


Thailand: Composite Index

Singapore: Straits Times Index



Philippines: Manila Composite



COMMODITY MARKETS

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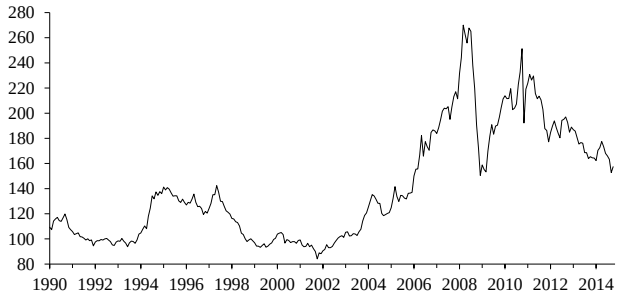
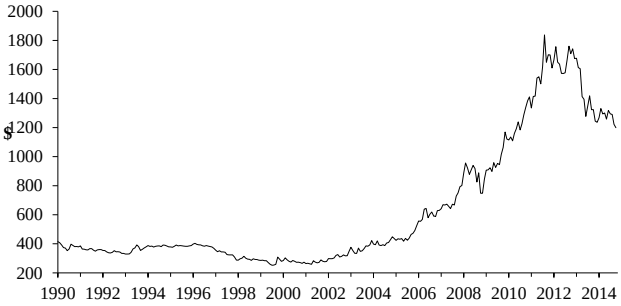
Commodity Price Index (Dollar)
(Economist, 2000=100)



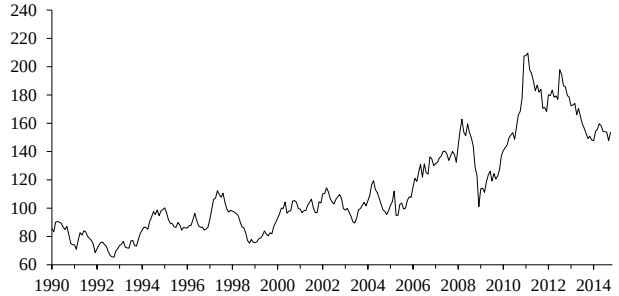
Oil Price: North Sea Brent (in Dollars)

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

Gold Price (in Dollars)



Commodity Price Index (Euro)
(Economist)



UK FORECAST DETAIL

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

	Inflation %[1] (CPI)	Short Dated (5 Year) Interest Rates	3 Month Int. Rates	Nominal Exchange Rate (2005=100)[2]	Real Exchange Rate[3]	Real 3 Month Int. Rates %[4]	Inflation (RPIX)	Real Short Dated Rate of Interest[5]
2010	3.3	2.4	0.7	80.4	88.6	–3.5	4.8	–0.2
2011	4.5	2.0	0.9	80.0	89.8	–2.8	5.3	–0.2
2012	2.7	0.9	0.9	83.1	93.9	–1.8	3.2	–1.4
2013	2.4	1.2	0.6	81.4	92.5	–1.7	3.2	–1.0
2014	2.0	1.6	1.8	83.0	94.1	–1.1	2.5	–0.4
2015	2.2	2.0	2.1	82.3	95.4	0.1	2.8	0.1
2012:1	2.7	1.1	1.1	81.2	91.6	–1.9	3.8	–1.3
2012:2	3.1	0.9	1.1	83.1	94.2	–1.4	3.2	–1.4
2012:3	2.5	0.7	0.8	84.1	95.2	–1.8	2.9	–1.6
2012:4	2.5	0.8	0.6	83.6	94.8	–2.0	3.0	–1.5
2013:1	2.6	1.0	0.6	80.3	90.9	–1.7	3.3	–1.3
2013:2	2.3	1.0	0.6	80.6	92.6	–1.9	3.1	–1.3
2013:3	2.4	1.5	0.5	81.2	93.2	–1.5	3.2	–0.7
2013:4	2.5	1.5	0.7	83.5	93.2	–1.9	3.2	–0.7
2014:1	1.8	1.6	1.2	82.9	93.7	–0.9	2.5	–0.5
2014:2	2.0	1.6	1.6	82.8	94.0	–1.1	2.5	–0.4
2014:3	2.0	1.7	1.9	82.9	94.0	–1.2	2.5	–0.4
2014:4	2.1	1.7	2.2	83.4	94.6	–1.2	2.6	–0.3

1 Consumer's Expenditure Deflator
2 Sterling Effective Exchange Rate Bank of England
3 Ratio of UK to other OECD consumer prices adjusted for nominal exchange rate
4 Treasury Bill Rate less one year forecast of inflation
5 Short Dated 5 Year Interest Rate less average of predicted 5 year ahead inflation rate

Labour Market and Supply Factors (Seasonally Adjusted)

	Average Earnings (1990=100)[1]	Wage Growth[2]	Unemployment (New Basis) Percent[3]	Millions	Real Wage Rate[4] (1990=100)
2010	227.1	2.4	4.6	1.50	135.6
2011	232.7	2.5	4.6	1.53	133.5
2012	237.0	1.9	4.7	1.59	132.4
2013	240.2	1.4	4.3	1.45	131.0
2014	246.3	1.6	3.9	1.33	131.1
2015	251.0	2.2	3.9	1.31	133.3
2012:1	236.6	0.7	4.8	1.61	132.6
2012:2	238.1	1.8	4.8	1.59	132.2
2012:3	238.1	1.9	4.7	1.57	132.9
2012:4	236.6	3.3	4.6	1.56	131.8
2013:1	238.2	0.6	4.5	1.54	130.1
2013:2	239.5	2.4	4.4	1.50	132.3
2013:3	240.6	0.8	4.1	1.39	130.8
2013:4	242.5	1.7	4.0	1.37	130.8
2014:1	243.6	3.1	4.0	1.36	130.7
2014:2	245.5	1.6	3.9	1.34	131.1
2014:3	247.4	2.7	3.8	1.31	131.1
2014:4	248.6	2.8	3.8	1.30	131.2

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

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

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

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

Financial Forecast

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

1 GDP at market prices (Financial Year)

WORLD FORECAST DETAIL

Growth Of Real GNP

	2010	2011	2012	2013	2014	2015
U.S.A.	2.4	1.8	2.2	2.2	2.1	3.1
U.K.	1.7	1.1	0.2	1.7	2.8	2.4
Japan	4.7	–0.5	1.9	1.8	1.2	1.3
Germany	4.2	3.0	0.7	0.6	1.7	1.8
France	1.6	2.0	0.0	0.2	0.5	1.1
Italy	1.7	0.5	–2.4	–1.8	-0.1	0.9

Growth Of Consumer Prices

	2010	2011	2012	2013	2014	2015
U.S.A.	1.6	3.1	2.1	1.6	1.9	2.0
U.K.	3.3	4.5	2.7	2.4	2.0	2.2
Japan	–0.7	–0.3	0.0	0.0	2.8	1.8
Germany	1.2	2.0	2.0	1.7	1.1	1.7
France	1.5	2.1	2.0	1.1	0.7	1.0
Italy	1.5	2.8	3.0	1.4	0.3	0.7

Real Short-Term Interest Rates

	2010	2011	2012	2013	2014	2015
U.S.A.	–3.0	–1.8	–1.9	–1.3	–1.9	–1.4
U.K.	–3.5	–2.8	–1.8	–1.7	–1.1	0.1
Japan	0.4	0.4	0.3	–1.6	–1.6	–1.8
Germany	–1.9	–0.5	–1.5	–1.5	–1.6	–1.9
France	–1.7	–0.5	–1.4	–1.5	–0.9	–0.9
Italy	–2.4	–1.5	–2.6	–2.0	–0.6	–0.7

Nominal Short-Term Interest Rates

	2010	2011	2012	2013	2014	2015
U.S.A.	0.1	0.3	0.1	0.7	0.1	0.6
U.K.	0.7	0.9	0.9	0.6	1.8	2.1
Japan	0.1	0.4	0.3	0.4	0.2	0.2
Germany	0.4	1.5	0.2	0.5	0.1	0.1
France	0.4	1.5	0.2	0.5	0.1	0.1
Italy	0.4	1.5	0.2	0.5	0.1	0.1

Real Long-Term Interest Rates

	2010	2011	2012	2013	2014	2015
U.S.A.	1.0	0.9	–0.2	0.1	0.8	1.4
U.K.	–0.2	–0.2	–1.4	–1.0	–0.4	0.0
Japan	0.4	–0.2	–0.8	–1.3	–1.4	–1.2
Germany	1.8	–0.1	–0.4	–0.5	–0.8	–0.4
France	1.9	–0.1	–0.4	–0.5	–0.8	–0.4
Italy	1.2	–0.7	–0.8	–0.6	–0.8	–0.4

Nominal Long-Term Interest Rates

	2010	2011	2012	2013	2014	2015
U.S.A.	3.1	1.9	1.8	2.1	2.8	3.4
U.K.	2.4	2.0	0.9	1.2	1.6	2.0
Japan	1.1	1.0	0.8	0.7	0.6	0.8
Germany	3.8	1.8	1.5	1.5	1.2	1.6
France	3.8	1.8	1.5	1.5	1.2	1.6
Italy	3.8	1.8	1.5	1.5	1.2	1.6

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

	2010	2011	2012	2013	2014	2015
U.S.A.	84.0	79.8	81.6	82.1	83.0	83.2
U.K.	88.6	89.8	93.9	92.5	94.1	95.4
Japan	79.5	80.6	79.6	63.5	61.1	60.7
Germany	101.3	100.1	96.7	99.0	100.5	100.2
France	103.5	102.9	99.5	100.7	101.7	101.4
Italy	107.4	107.2	105.2	106.9	107.8	107.0

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

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

	2010	2011	2012	2013	2014	2015
U.S.A.[1]	83.73	78.08	80.90	85.50	88.60	89.00
U.K.	1.58	1.61	1.59	1.55	1.67	1.67
Japan	87.48	79.36	80.51	98.00	104.50	104.00
Eurozone	0.75	0.71	0.78	0.79	0.74	0.75

[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