

LIVERPOOL INVESTMENT LETTER

November 2015



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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THE ECONOMY AND HOUSING

The UK economy has continued to grow well, at between 2.5 and 3%, with the latest figures for growth coming in closer to the bottom of this range. Third quarter house price growth also came in a bit weaker than we expected last quarter — Table 2. We can attribute this also partly to the ‘macro-prudential’ controls exerted on housing via the guidance to the banks on mortgages etc.

Looking ahead, we find that much commentary stresses the uncertainties of the world environment, and especially of China. Yet the most dramatic world developments are in commodity prices and these are encouraging for the continuation of the world’s general, if so far slow, recovery from the recent crisis. Commodity prices have collapsed, as frequently happens at this stage of the world cycle. They are fuelling ‘deflation’, but this is ‘virtuous’ because it represents a huge tax cut from producers for consumers. The way this works is that producing countries can do little except borrow their way through their cash collapse, while consuming countries find profits and real incomes rising, stimulating investment, consumption and innovation.

In spite of its grim overhang from the investment splurge of 2009–10 China is also participating in this tax-cut environment. Consumption and services investment are growing strongly even as manufacturing investment is being cut to reduce excess capacity. The US is growing well if not in the traditional V-shaped recovery. Even the euro-zone is now recovering; its recession was recently dated by the euro business cycle group as having ended in early 2013. Also, as one looks around the emerging market economies most are growing respectably if not joyously. So China is slowing; but the world is not going into recession. The UK’s recovery has support in the rest of the world — and the strengthening of the euro-zone is particularly welcome.

Turning to our housing forecast, it remains positive, with house prices set to rise around 7% a year until the end of the decade. This can be thought of as the process of real house prices (i.e. prices corrected for general inflation) returning to their long run trend, which shows growth of around 3% a year. Being somewhat below trend, prices need to catch up by growing a bit faster than this for a time.

Across the different regions the main thing to notice is the difference in trends in real house prices. Some regions such as the North, Scotland, Wales and Northern Ireland simply have slower growing house prices because there is less ongoing pressure of demand on the available supply. There also continues to be some catching-up of other regions, such as the Midlands and the non-London south, on London whose real house prices from now on are forecast to grow slightly below the national average.

Table 1: Summary of Forecast

	2012	2013	2014	2015	2016	2017	2018
GDP Growth ¹	0.7	1.7	2.8	3.0	2.5	2.4	2.4
Inflation	2.1	1.9	1.6	0.6	1.6	1.7	2.0
RPIX	3.2	3.1	2.4	1.6	2.4	2.5	2.7
Unemployment (Mill.)							
Ann. Avg. ²	1.6	1.4	1.0	0.8	0.7	0.7	0.6
4th Qtr.	1.6	1.3	0.9	0.7	0.7	0.7	0.6
Exchange Rate ³	83.0	81.6	87.1	90.7	90.8	90.7	90.3
3 Month Interest Rate	0.9	0.6	0.6	0.6	1.0	1.6	2.1
5 Year Interest Rate	0.9	1.3	1.8	1.8	2.2	2.5	2.5
Current Balance (£bn)	-53.2	-65.9	-84.2	-77.8	-78.2	-78.8	-79.5
PSBR (£bn)	110.6	92.5	88.6	84.0	79.6	58.7	39.1

¹Expenditure estimate at factor cost

²U.K. Wholly unemployed excluding school leavers (new basis)

³Sterling effective exchange rate, Bank of England Index (2005 = 100)

Table 2: Forecast and out-turns for Nominal House prices 2015Q2–2015Q3

	Forecast	Actual
UK	2.52%	0.76%
North	1.75%	-0.67%
Yorks & Hside	2.62%	-1.16%
North West	1.94%	-0.74%
East Mids	2.53%	0.03%
West Mids	2.17%	0.79%
East Anglia	2.80%	0.26%
Outer S East	2.97%	2.56%
London	2.83%	3.19%
South West	2.91%	2.05%
Wales	2.48%	1.49%
Scotland	1.00%	-0.08%
N Ireland	2.10%	0.82%

Figure 1: Nominal UK House Prices, Actual and Forecast

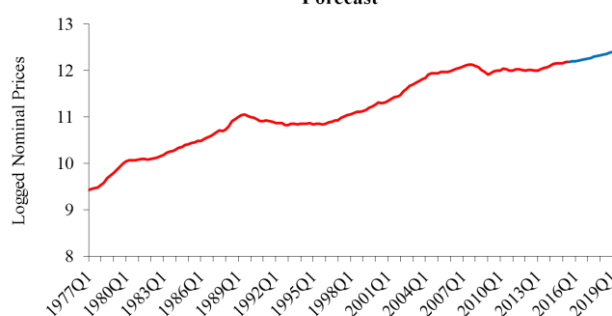


Figure 2: UK Real House Prices, Forecast and Underlying

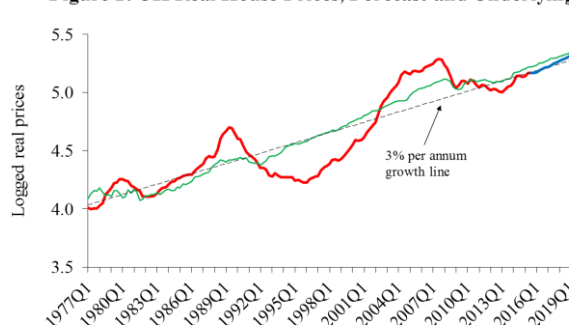


Table 3: Nominal house prices, national and by region

	UK	NORTH	YORKS & HSIDE	NORTH WEST	EAST MIDS	WEST MIDS	EAST ANGLIA
2000	13.00%	4.82%	5.81%	6.41%	11.04%	10.70%	15.56%
2001	10.49%	8.36%	9.46%	10.46%	11.68%	11.05%	14.21%
2002	19.83%	19.30%	22.82%	18.74%	23.92%	21.55%	23.14%
2003	19.58%	32.42%	27.45%	23.96%	25.28%	22.56%	17.82%
2004	16.59%	29.49%	25.51%	26.98%	18.37%	16.79%	14.32%
2005	5.37%	5.31%	8.17%	7.75%	4.05%	4.62%	3.79%
2006	6.49%	2.66%	6.03%	4.68%	3.31%	3.34%	5.31%
2007	8.95%	5.46%	5.07%	4.73%	5.09%	4.93%	7.27%
2008	-6.83%	-5.28%	-7.40%	-7.33%	-7.40%	-7.06%	-7.94%
2009	-7.37%	-9.15%	-7.19%	-7.68%	-8.25%	-7.66%	-7.70%
2010	5.73%	2.43%	2.93%	2.98%	6.43%	5.11%	7.07%
2011	-0.21%	-1.02%	-0.28%	-0.99%	-0.37%	-1.15%	0.22%
2012	-0.91%	-0.71%	-2.35%	-2.50%	-0.49%	-0.27%	-0.24%
2013	3.24%	0.32%	2.05%	1.66%	3.25%	2.67%	4.39%
2014	9.88%	5.67%	5.05%	5.94%	7.29%	7.60%	9.95%
2015	4.54%	2.36%	2.06%	0.96%	4.05%	3.22%	4.77%
2016	4.39%	0.76%	3.22%	2.81%	4.08%	4.95%	3.96%
2017	6.72%	3.84%	5.68%	6.18%	7.42%	7.57%	6.34%
2018	7.04%	4.16%	5.96%	6.54%	7.75%	7.91%	6.64%
2019	6.99%	4.06%	5.87%	6.49%	7.71%	7.85%	6.62%
	OUTER S EAST	LONDON	SOUTH WEST	WALES	SCOTLAND	N IRELAND	
2000	18.95%	20.15%	16.61%	8.32%	4.58%	12.52%	
2001	10.79%	11.25%	11.94%	9.00%	3.03%	8.00%	
2002	19.86%	18.00%	24.53%	18.92%	12.96%	9.20%	
2003	16.46%	12.89%	18.61%	26.19%	14.80%	11.28%	
2004	10.22%	8.93%	15.39%	31.50%	22.51%	15.12%	
2005	2.26%	2.84%	3.87%	5.95%	10.42%	12.77%	
2006	5.16%	7.15%	5.25%	5.31%	12.96%	30.50%	
2007	9.64%	14.81%	8.36%	5.79%	12.98%	43.06%	
2008	-6.56%	-5.53%	-7.36%	-7.04%	-2.23%	-21.98%	
2009	-6.94%	-6.31%	-6.86%	-7.30%	-5.88%	-18.69%	
2010	8.58%	9.91%	7.37%	3.94%	2.43%	-7.26%	
2011	0.71%	2.71%	-0.70%	-0.47%	-1.79%	-8.31%	
2012	0.44%	1.58%	-0.09%	-3.92%	-2.49%	-9.21%	
2013	3.99%	8.72%	2.80%	3.38%	-0.07%	1.16%	
2014	12.82%	20.69%	8.63%	5.18%	5.60%	8.03%	
2015	8.16%	10.12%	5.04%	1.35%	-0.76%	6.55%	
2016	6.59%	5.64%	6.91%	4.15%	0.84%	2.71%	
2017	8.39%	5.90%	9.50%	5.27%	4.59%	4.25%	
2018	8.70%	6.22%	9.80%	5.58%	4.89%	4.54%	
2019	8.68%	6.22%	9.76%	5.52%	4.75%	4.43%	

A Variant Forecast — Monetary Policy Remains Extremely Loose

Given that there is still much debate about whether interest rates should be raised and repeatedly expectations of their raising have been deferred, we have looked at a variant scenario where interest rates simply stay down where they are and money, with credit, starts to grow far more vigorously. In this scenario (see Table 4) GDP growth picks up strongly to well over 3% and inflation also increases; however it does not increase so much that it stops the policy, given the inflation target background. So the scenario mirrors what one might call a credit boom in which the inflation target manages to remain credible and so keep a lid on wage and price increases. How long this could continue is clearly quite uncertain; but we had some such developments in the decade of the 2000s until the crisis. So it is something of a repeat of recent history.

In this scenario real house prices grow much faster, roughly 4% faster per year (see Table 5). In effect we get another house price boom, with prices rising over 10% a year, well above inflation still around the 2% mark — hence real house price growth over the 8% mark.

This scenario should be something of a warning to policymakers that it is only too easy, after a period of recession, to allow policy to react by being excessively loose, through fear of ‘stopping the recovery’.

What we may be finding here once again is how UK monetary policy shows up most clearly in the housing market.

Table 4: Summary of Variant Forecast

	2012	2013	2014	2015	2016	2017	2018
GDP Growth ¹	0.7	1.7	2.8	3.8	4.8	3.7	2.5
Inflation							
CPI	2.1	1.9	1.6	0.2	1.4	1.5	2.9
RPIX	3.2	3.1	2.4	1.4	2.2	2.3	3.4
Unemployment (Mill.)							
Ann. Avg. ²	1.6	1.4	1.0	0.8	0.7	0.7	0.6
4th Qtr.	1.6	1.3	0.9	0.7	0.7	0.7	0.6
Exchange Rate ³	83.0	81.6	87.1	91.0	91.4	91.5	90.4
3 Month Interest Rate	0.9	0.6	0.6	0.5	0.5	0.5	0.5
5 Year Interest Rate	0.9	1.3	1.8	1.3	0.5	0.5	0.5
Current Balance (£bn)	-53.2	-65.9	-84.2	-77.5	-77.7	-78.1	-79.6
PSBR (£bn)	110.6	92.5	88.6	76.7	57.1	25.7	2.9

¹Expenditure estimate at factor cost

²U.K. Wholly unemployed excluding school leavers (new basis)

³Sterling effective exchange rate, Bank of England Index (2005 = 100)

Table 5: Nominal Annual House Price Growth, Base and Variant Scenarios

	Base	Variant
2014	9.88%	9.88%
2015	4.54%	4.65%
2016	4.39%	6.93%
2017	6.72%	11.46%
2018	7.04%	11.47%
2019	6.99%	10.45%
2020	6.90%	9.10%

Figure 3: Nominal UK House Prices, Actual and Forecast, Variant Forecast in black

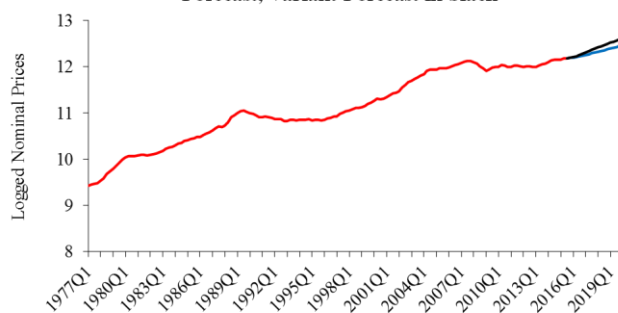
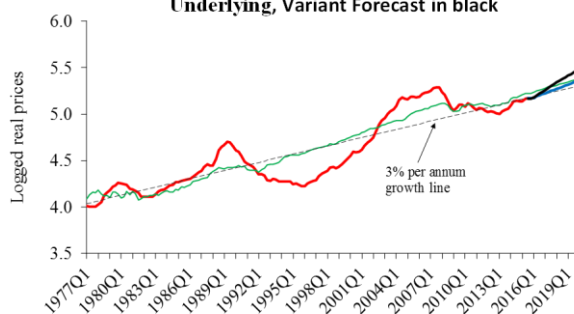
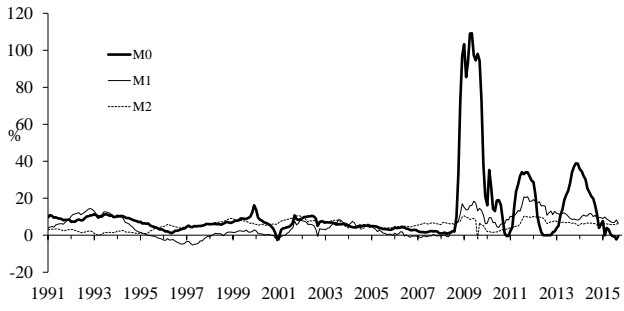


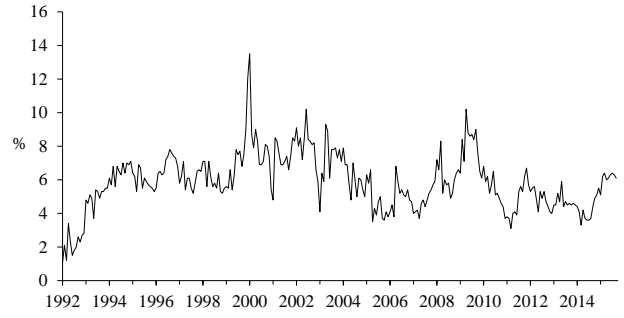
Figure 4: UK Real House Prices, Forecast and Underlying, Variant Forecast in black



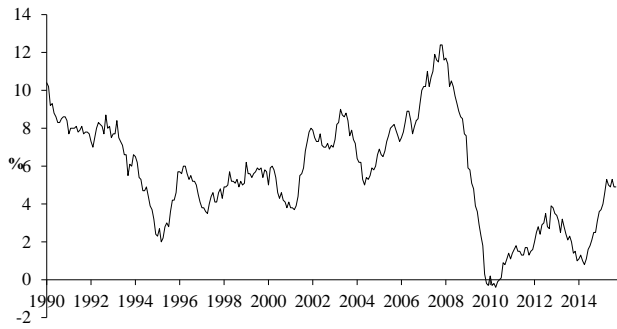
U.S.: Growth in Monetary Aggregates (Yr - on - Yr)



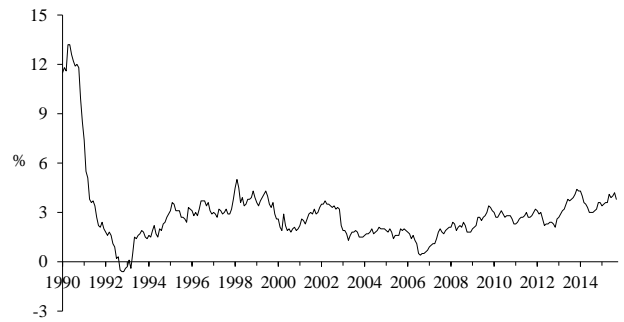
UK: Notes and Coins in Circulation Growth



Eurozone M3 Growth



Japan: Growth of M2+CD's



FOCUS ON JAPAN

Francesco Perugini

Abe unveils 3 new arrows: a sense of déjà vu

Earlier this month, Japanese Prime Minister Shinzo Abe reshuffled his ministry to create his third cabinet since coming to office in December 2012. He kept nine cabinet members, including Finance Minister Taro Aso and Akira Amari, minister of economic and fiscal policy. He also appointed 10 new members, including Katsunobu Kato, who was appointed to a newly created post tasked with achieving Abe's goal of creating a society in which "all 100 million people in the nation can play active roles."

After forcing through widely unpopular legislation to allow the military to take part in US-led wars of aggression abroad, Abe is now seeking to address his failure to reverse the country's ongoing economic stagnation. "The economy would be the new Cabinet's top policy priority," Abe said during a news conference later in the day. Indeed, the new cabinet has been installed to push through Abe's newly launched economic agenda, consisting of a new set of three arrows: a promise to lift nominal GDP by 22% to ¥600 trillion, provide a child care support that fosters family dreams, and establish a social security system that leads to a stronger sense of reassurance.

Abe has said the new arrows aim to tackle structural problems left unaddressed for years, such as the labour shortage that is set to worsen as the population ages rapidly. However, observers believe that this is another case of over-promising and under-delivering. They say that the new set of three arrows are targets to be achieved rather than policy measures to implement which were the focus of the original set of three arrows in the first stage — massive monetary stimulus, increased government spending and pro-business economic reforms. "These measures are not even weak substitutes for the more fundamental reforms that Mr Abe had previously proposed, such as reducing the entrenched privileges of doctors, pharmacists and farmers, which he has not had the courage or political strength to implement", said John Greenwood, chief economist at Invesco.

Lawmakers familiar with the new "Abenomics" say the last two arrows are aimed at justifying more spending on child-care support, such as offering free early-child education, and building more nursing homes for the elderly. "The new arrows focus on redistribution of wealth mainly through child-care support and social welfare, because they are areas the public can relate to," said Etsuro Honda, one of Abe's key economic advisers. "I won't even call these

arrows economic policy, it has the smell of election campaigning".

Business lobbies and academics are critics too. They say the GDP target is unrealistic, and the new arrows lack the clear messaging that made the original arrows effective. The growth target is based on a government estimate that Japan's GDP will reach 600 trillion yen around 2020 if it grows a nominal 3% each year, a pace never experienced in the past two decades.

The new arrows also shed light on an emerging conflict of interest between Abe and his hand-picked BOJ governor Haruhiko Kuroda. Kuroda's massive stimulus is based on the "reflationist" idea that by printing money aggressively, the BOJ can generate inflation and nudge companies into boosting spending. But inflation has ground to a halt on slumping oil prices, while rising import costs from a weak yen have hurt consumption. Wary of the rising cost and diminishing returns of Kuroda's stimulus program, Abe is starting to distance himself from the BOJ's reflationist approach, politicians close to him say.

The new arrows make no mention of monetary policy. While Finance Minister Taro Aso and Kuroda say it has been "condensed" into the new GDP target, the BOJ's fading prominence underscores Abe's changing priorities, politicians say. "It's clear the administration's priority has shifted away from monetary policy," said a policymaker close to Abe. The premier told an audience in New York on Tuesday that Japan has wiped out its "deflationary mindset," a day after Kuroda warned in a speech that it was taking time for companies to shift from their deflationary way of thinking. The contrast underscores the gap between the views of Abe — who feels that inflation need not accelerate further — and Kuroda, who persists in trying to hit 2% inflation, sources say. "The premier is probably saying the BOJ doesn't need to rush in achieving its 2% price target," said one government official with knowledge of the deliberations.

Overall, Abe's new policy framework is no game-changer. It seems that the new arrows are substitutes for much sharper ones that Abe has promised to use, but left in the quiver — most notably, an assault on privileged groups, including farmers, doctors and pharmacists, that collectively stifle the economy. "Abenomics now risks veering away from its original ambition into populism and misguided policy", says Takatoshi Ito of Columbia University, a former adviser to the prime minister.

MARKET DEVELOPMENTS

In spite of the recent panic over China and all things emerging, it seems that balance has returned to the markets and the reality of the ongoing recovery has begun to sink in. The environment remains one favouring equities. Monetary tightening should start around the new year and this will refocus market sentiment on the prospect of falling bond prices and rising yields. There will be plenty of voices

urging ‘do not raise rates because of uncertainty’. But finally these will have to be ignored if we are ever to get away from the distortions of a world of zero rates for privileged borrowers like governments and big corporates, while the rest of us languish with dreadful saving returns and big rates of interest on ‘risky’ SME borrowing.

Table 1: Market Developments

	Market Levels		Prediction for Oct/Nov 2016	
	Oct 5	Oct 29	Previous Letter View	Current View
Share Indices				
UK (FT 100)	6326	6438	8989	9148
US (S&P 500)	1983	2090	2589	2730
Germany (DAX 30)	9903	10832	13755	15046
Japan (Tokyo New)	1476	1547	2013	2110
Bond Yields (government)				
UK	1.70	1.80	2.20	2.20
US	2.04	2.06	2.10	2.10
Germany	0.60	0.44	1.50	1.50
Japan	0.33	0.29	0.70	0.70
UK Index Linked	-0.86	-0.81	0.10	0.10
Exchange Rates				
UK (\$ per £)	1.51	1.53	1.50	1.50
UK (trade weighted)	90.9	92.4	90.6	90.6
US (trade weighted)	103.3	104.0	100.0	100.0
Euro per \$	0.89	0.90	0.91	0.91
Euro per £	1.35	1.38	1.37	1.37
Japan (Yen per \$)	120.5	120.6	120.5	120.5
Short Term Interest Rates (3-month deposits)				
UK	0.58	0.60	1.30	1.30
US	0.32	0.30	1.10	1.10
Euro	-0.04	-0.13	0.10	0.10
Japan	0.08	-0.10	0.20	0.20

Table 2: Prospective Yields¹

Equities: Contribution to £ yield of:						
	Dividend Yield	Real Growth	Inflation	Changing Dividend Yield	Currency	Total
UK	3.40	2.5	1.6	38.00		45.50
US	1.90	3.0	1.6	26.00	2.08	34.58
Germany	2.60	1.4	1.5	36.00	1.39	42.89
Japan	1.70	1.4	2.0	33.00	2.12	40.22
UK indexed ²	-0.81		1.6	1.00		1.79
Hong Kong ³	2.60	6.8	1.6	2.00	2.08	15.08
Malaysia	3.30	5.5	1.6	58.00	2.08	70.48
Singapore	3.50	4.5	1.6	36.00	2.08	47.68
India	1.40	8.0	1.6	31.00	2.08	44.08
Korea	1.10	3.0	1.6	-12.00	2.08	-4.22
Indonesia	2.20	6.1	1.6	41.00	2.08	52.98
Taiwan	2.80	3.4	1.6	29.00	2.08	38.88
Thailand	3.20	4.1	1.6	38.00	2.08	48.98
Bonds: Contribution to £ yield of:						
	Redemption Yield	Changing Nominal Rates	Currency	Total		
UK	1.80	-4.00				-2.20
US	2.06	-0.40	2.08			3.74
Germany	0.44	-10.60	1.39			-8.77
Japan	0.29	-4.10	2.12			-1.69
Deposits: Contribution to £ yield of:						
	Deposit Yield	Currency	Total			
UK	0.60		0.60			
US	0.30	2.08	2.38			
Euro	-0.13	1.39	1.26			
Japan	-0.10	2.12	2.02			

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.

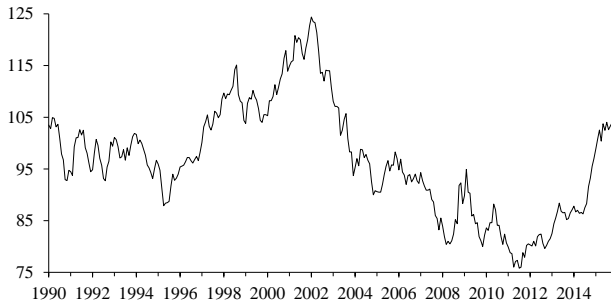
Table 3: Portfolio(%)

	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

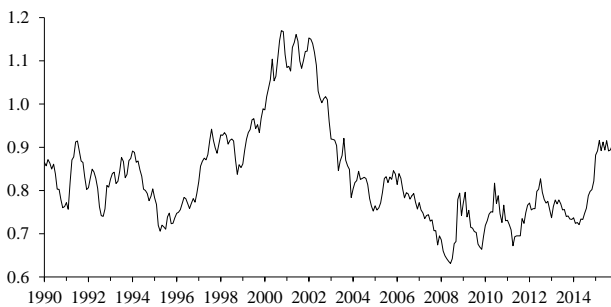
**US : Trade Weighted Index
(Bank of England 1990 = 100)**



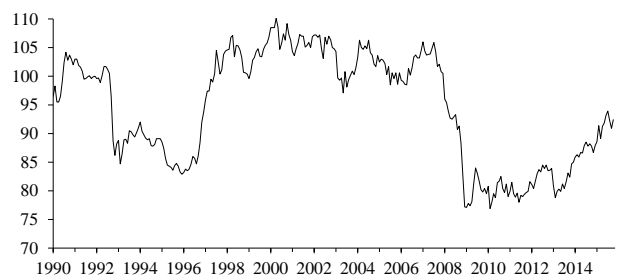
UK: Dollars Per Pound Sterling



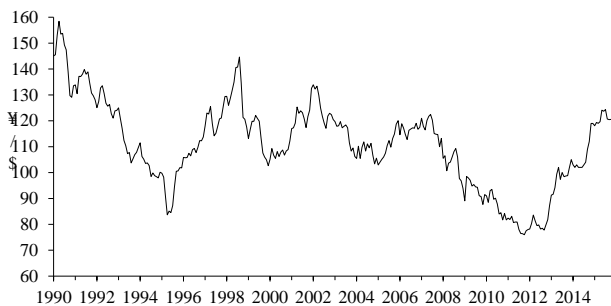
Euro per US dollar



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



Japan : Yen Per U.S. Dollar

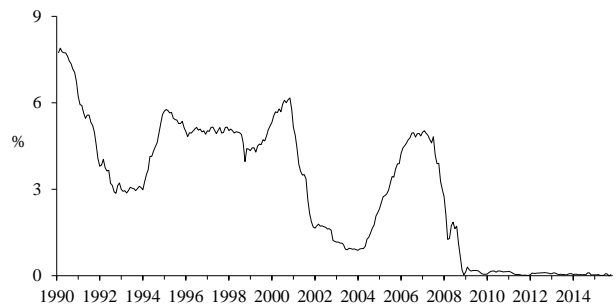


GOVERNMENT BOND MARKETS

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



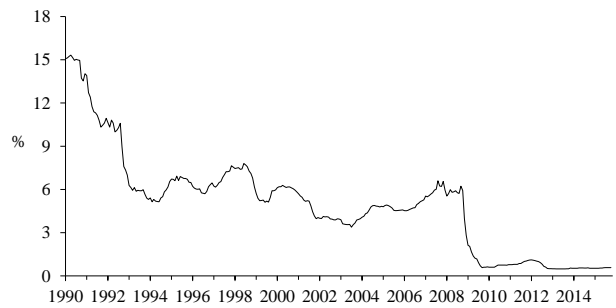
U.S. : 3-Month Treasury Bill



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



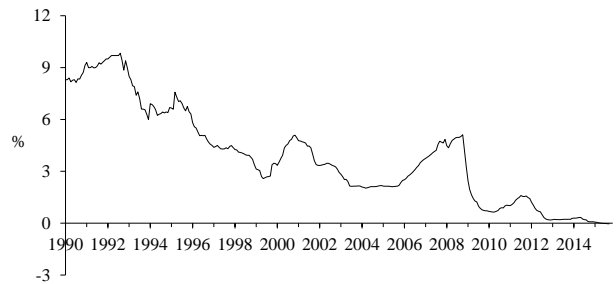
U.K. : 3-Month Interbank Rate



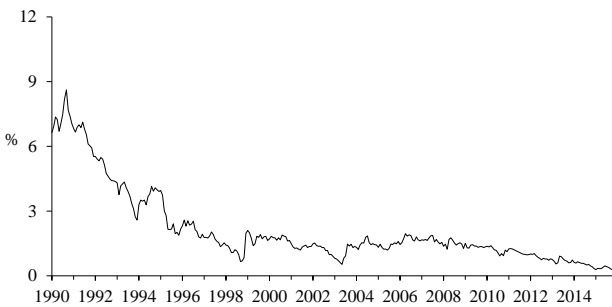
Germany: Yield on Public Authority Bonds



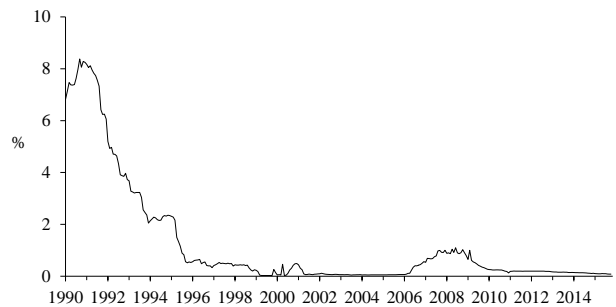
Germany : 3-Month Interbank Deposit Rate



Japan: Yield on Long-Term Government Bonds

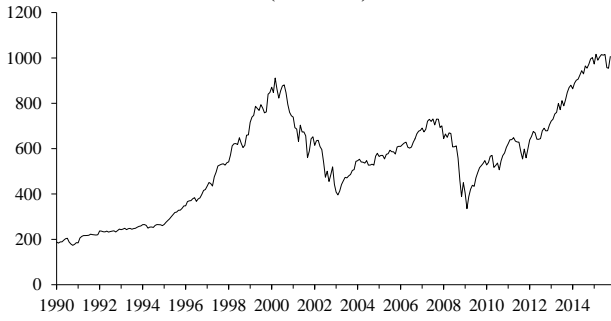


Japan : 3 Month Money Market Rate

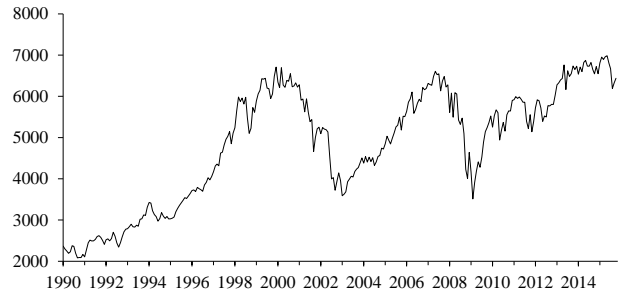


MAJOR EQUITY MARKETS

**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

Government is targeting a growth rate of 8% in the current fiscal year 2015–16 ending in March 2016. It hopes that consumer demand and growth in investment after easing of monetary policy in the last nine months would give a boost to the economy. S&P forecasts that India would expand 7.4% in 2015 and just under 8% on average between 2015 and 2018. According to the International Monetary Fund forecast, the country is on track to remain the world's fastest-growing large economy and the GDP would expand by 7.3% in the current fiscal year.

India's industrial output rose 6.4% from a year earlier in August, faster than the 4.1% rise in July. The country's domestic demand is projected to remain strong and inflation looks set to fall in 2015, reacting to a fall in global oil and agricultural commodity prices.

There is no doubt that India has achieved good macroeconomic stability and is likely to benefit from the decline in commodity prices. But all is not as rosy as it appears from outside. The private sector is watching the government carefully as its legislative agenda is stuck in the upper house of the parliament. Earlier, it was expected that the government will cut a deal with the opposition but, now, it looks that the ruling party's strategy is to win state elections over the next two years and achieve near majority in two years in the upper house. Total capital expenditure has "nosedived" so far this year, according to rating agency Fitch. Laden with debt, corporates are shying away from new spending. The government has kick-started investment in the infrastructure sector. The private sector will loosen its purse strings when the impact of accommodative monetary and fiscal policies are felt on the ground.

Mr. Modi's government insists it will push on with reforms. Private sector and FIIs are waiting for the results of the state elections in Bihar. The results would tell if Mr. Modi's development agenda still resonates with the electorate or not. Opposition parties are in no mood to let Mr Modi have his say.

Remittances from Indians working abroad would touch a record high of \$72 billion this year. Compared to trade

India: BSE Sensitive



balance, remittances are holding well. In the first eight months of the year, Indian merchandise exports were down 16% from a year earlier. The biggest export category, machinery and auto parts, is getting hit as companies world-wide cut capital spending. Another key category, refined petroleum products, is also falling in value terms — frittering away some of the gains India enjoys from importing cheaper crude oil.

Mr. Modi pledged to provide Africa with \$10bn in soft loans over the next five years, and \$600m in grant aid. The offer comes at a time when African growth has slowed as a result of China's slowdown. This was announced by Mr. Modi at the formal opening of the India-Africa Forum Summit in New Delhi. Mr Modi also urged African leaders to push alongside India for reform of the UN Security Council, one of India's top foreign policy priorities. India is looking to oil-rich Africa as part of its long-term energy security plan, as a potential source of raw materials, and as a market for its wares, given the region's rising middle class. If India's 'Make-in-India' campaign has to work, India needs markets to sell made-in India products. Besides this, India hopes to win African goodwill with support in niche areas where India has comparative advantages such as higher education, telemedicine, and agriculture. India would offer 50,000 scholarships to African students over the next five years. A shared history of colonialism gives an edge to India in services sector and trade.

	13-14	14-15	15-16	16-17	17-18
GDP (%p.a.)	6.9	7.3	7.4	8.0	8.5
WPI (%p.a.)	7.0	6.0	5.2	4.2	4.0
Current A/c(US\$ bill.)	-50.0	-34.0	-24.0	-28.0	-32.0
Rs./\$(nom.)	60.0	62.0	65.5	66.0	67.0

China

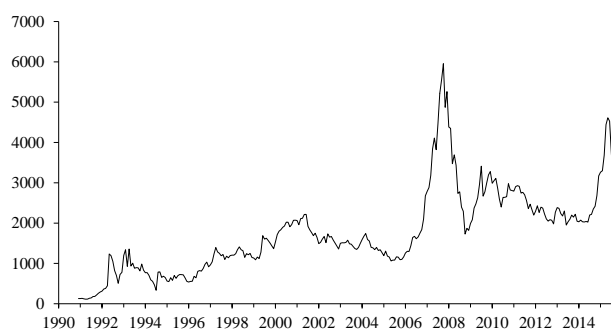
China posted third-quarter growth of 6.9% and signalled that the full-year growth target of about 7% will not be achieved. The IMF expects China to hit its 6.8% forecast in 2015 and 6.3% in 2016. We maintain that there are enough signs to suggest that the Chinese economy is smoothly transforming itself to a consumption-led economy. Chinese movements in the currency market and its monetary policy is to achieve its aim of making the yuan a reserve currency. The resilient growth in the services sector has helped the economy.

Services and consumption accounted for more than half of China's GDP in the third quarter at 51.4%, up from 41.4% a decade ago. This rebalancing of the economy gives us comfort and suggests that macro deceleration will be gradual as we have been saying from the last two quarters. Though consumption is not fully immune from the overall deceleration trend, with real retail sales up 10.5% over the first three quarters of this year, down from 10.7% during the same period last year. Consumption grew 11.4% and 11.6% in 2013 and 2012 respectively. On the other hand, industrial production grew only 5.9% compared to 6.3% in the second quarter. The fixed-asset investment also slowed marginally. Producer prices have been in decline for 43 consecutive months and fell by 5.9% in September. But, financial services expanded 16.1% in the third quarter compared to the 17.4% growth in the first half of the year.

The PBoC cut policy rates by 25 basis points, lowering the one-year benchmark deposit rate to 1.5% and the one-year lending rate to 4.35% in the last week of October. Both are all-time lows, but neither is binding for banks anymore. The central bank also cut the share of customer deposits banks must hold in reserve, injecting Rmb560bn (\$90bn) of cash into the banking system to counteract the cash drain from capital outflows in recent months. The required reserve ratio was lowered by 0.5 percentage points to 17.5%. This implies that China's savers earn a negative real return on their deposits as the average rate of inflation over the past three months was 1.7%. This was not done to spur spending and investment but to fully liberalize deposit rates — which is one of the conditions of the IMF to consider yuan as a reserve currency. We expect China to lower interest rates in the coming years as its economy slows further and the PBoC to allow gradual adjustment towards the fair value (weaker) over 2016, which means more depreciation of yuan against the US dollar.

China's exports and imports fell in September as global demand remained weak. Chinese exports fell 3.7% in

China: SSE Composite Index



September from a year earlier in U.S. dollar terms following a 5.5% drop in August. Imports in September fell 20.4% from a year earlier, compared with a 13.8% decrease in August, according to the customs agency data. The country's trade surplus increased to \$60.3 billion in September from \$60.2 billion in August.

To make the yuan a global reserve currency, China has opened up its sovereign bond market. China's central bank has attracted orders of more than Rmb30bn (\$4.7bn) for its debut sale of debt on London's markets in a deal timed to coincide with the first day of President Xi Jinping's state visit to the UK.

China's President Xi Jinping's visit to the UK was more than a success as the UK accommodated Beijing more than what Beijing expected. The visit was a demonstration to the domestic audience that China is a developed nation.

One of the far reaching policy decisions announced after the Fifth Plenum was that the one child policy rule is to be abolished and families can have two children now. The 35-year-old policy has led to myriad social and economic ills in China and Chinese society as a whole will continue to bear the consequences for decades to come because the fertility rate has collapsed in urban, rural and poor areas. The price of raising a child is too high vis-à-vis long term benefits a family can get from an extra child. The policy was relaxed in the last two years and many couples could have two children but results do not show any increase in birth rate.

	13	14	15	16	17
GDP (%p.a.)	7.7	7.4	6.3	6.0	6.0
Inflation (%p.a.)	3.5	2.0	1.3	1.5	2.0
Trade Balance(US\$ bill.)	260	382	550	420	400
Rmb/\$ (nom.)	6.2	6.2	6.4	6.5	6.6

South Korea

South Korea's GDP increased 1.2% in the third quarter from the previous three months, aided by a stimulus-driven rebound in domestic demand that overshadowed, for the time being, the negative effect on exports of slowing Chinese and global demand. In the second quarter the economy grew 0.3% only. The Bank of Korea expects the economy to grow 2.7% for this year. The Bank of Korea, in June, had cut its policy rate for a second time this year to a record-low of 1.50% which may have blunted the impact of the MERS outbreak which had threatened South Korea's economic vitality.

Exports plunged 8.3% in September, the ninth straight monthly decline. Stagnant job and wage growth and surging living costs on top of the highest household debt among emerging-market economies — 84% of gross domestic product (the average is about 30%) in 2014 — has forced consumers to be circumspect. Consumption is sliding.

The dwindling economy may force President Park to accelerate economic reforms. Park may encourage a startup boom. Faster growth offers her a cushion to rein in the handful of family-run conglomerates that dominates the economy.

Long-stalled summit talks between East Asia's three main powers — Japan, South Korea and China resumed. The meeting focused on regional co-operation in economic and social fields. The deal on the Trans-Pacific Partnership has caused some nervousness in South Korea, which missed the chance to become a founding member and is now worrying over the boost the trade pact will give to rival exporters in Japan. Though the direct impact of membership would have been relatively limited for South Korea, which already has bilateral trade deals with 10 of the TPP's 12 members over the past 11 years.

	13	14	15	16	17
GDP (%p.a.)	3.0	3.3	1.9	2.5	2.5
Inflation (%p.a.)	1.3	2.0	0.7	1.8	2.0
Current A/c(US\$ bill.)	71.0	80.0	90.0	88.0	88.0
Won/\$ (nom.)	1100	1080	1180	1200	1220

Taiwan

The disappointing export performance of Taiwan will keep GDP growth for 2015 around 1% and the central bank may lower its key interest rates again by the end of this year. Taiwanese exporters are feeling the pinch of the weak global market.

Korea: Composite Index



Taiwan: Weighted TAIEX Price Index



In the third quarter GDP contracted 2.11% from a year earlier after the country's exports in merchandise exports fell 13.8% year-on-year and merchandise imports dropped 19.6% in U.S. dollar terms. In the fourth quarter, the economy is expected to stage a rebound and grow about 1% or so.

In a surprising move, Taiwan's governing party Kuomintang or Nationalist party has called a special congress to consider the drastic step of dropping its unpopular presidential candidate, Hung Hsiu-chu, a straight-talking legislator from the ruling party, just three months before an election that will set the tone for all-important relations with Beijing. In a recent opinion poll, Ms Hung Hsiu-chu popularity has fallen more than 20 percentage points behind the frontrunner, opposition politician Tsai Ing-wen.

	13	14	15	16	17
GDP (%p.a.)	2.1	3.7	1.0	1.6	2.0
Inflation (%p.a.)	1.2	1.5	0.0	1.0	1.0
Current A/c(US\$ bill.)	50.6	57.4	60.0	64.0	68.0
NTS/\$ (nom.)	30.0	31.0	32.8	33.0	32.0

Brazil

Political instability and continuing weak commodity prices for another 12–18 months are going to be painful for the Brazilian economy. It is forecast to contract about 2.7% this year and about 3% in 2016, as investment and consumer spending have declined. The government’s growing budget deficit, and rising debt levels, leave no room for any economic levers to be applied now. According to the rating agency Fitch there is no “swift or meaningful” turnaround for the country. Would Brazil be able to maintain its remaining investment-grade credit ratings with Moody’s and Fitch, after Standard & Poor’s downgraded the country’s debt to junk status in September, remains a moot question.

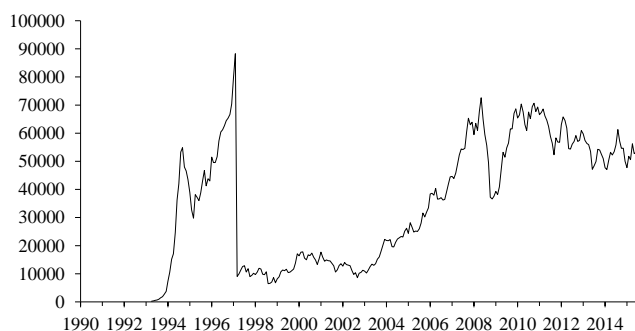
A combination of weak economic growth, high inflation and rising interest rates is hurting consumer confidence, especially toward discretionary items. New-vehicles sales and production in Brazil declined in September. The national auto makers’ association has reduced its sales and production forecast for this year.

The central bank announced that the current-account deficit shrank to \$3.1 billion in September, from \$7.9 billion a year earlier. The bank estimates 2015 will end with a \$65 billion deficit, a 37% drop from last year’s \$103.6 billion deficit. The improvement stems from the sharp depreciation in the country’s currency this year, combined with a deep recession. The Brazilian real has lost about a third of its value in 2015. This has forced Brazilians to buy less imported products and they have substituted the products with the local products.

Even though the Brazilian real has lost about 30% of its value against the dollar so far this year, Brazil’s central bank has not used its foreign reserves of approximately \$350 billion dollars to prop up the real. Propping up of the currency would lead to downgrading of its credit rating.

Brazil plans to auction contracts to operate hydroelectric power plants on November 6, with no restrictions on foreign bidders, according to the government. The auction will kick off one of the country’s efforts to spark an economic recovery by selling concessions for large infrastructure projects with more market-friendly rules. The

Brazil: Bovespa



government hopes to auction contracts to operate 29 existing power plants to private operators. Brazil’s recession has also attracted distressed asset hunters due to a rise in bankruptcy filings and the disposal by banks of their non-performing loan portfolios.

Ousting Brazil’s President Dilma Rousseff would be a messy affair and is likely to linger on for months and has no guarantee of succeeding. The streak of bad news, however, has increased doubts about the president’s ability to build enough political support to hang on to her job and fix a crumbling economy. In a rear guard action, president Rousseff shook up her cabinet in a bid to save her job and break a political logjam that is paralyzing the economy. The changes give more clout to Brazil’s largest political party, the PMDB. Its leaders are seen as key to blocking a possible impeachment process against Ms. Rousseff and helping her pass the much-needed fiscal reforms.

Ms. Rousseff has a small consolation because the government’s chief opponent in the house, Mr Cunha, who was implicated by Brazilian authorities in a big corruption scandal afflicting Petrobras, is transferred to Brazil by Swiss authorities. He is to be “further investigated and judged by the Brazilian judicial authorities” according to the Swiss Attorney General.

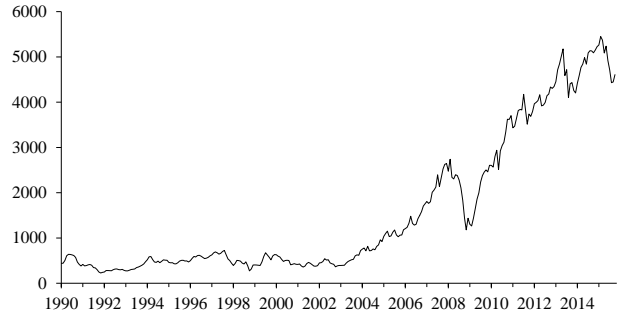
	13	14	15	16	17
GDP (%p.a.)	2.5	0.1	-2.7	-3.0	1.2
Inflation (%p.a.)	5.9	6.5	8.2	6.2	6.0
Current A/c(US\$ bill.)	-75.0	-104.0	-90.0	-60.0	-50.0
Real/\$(nom.)	2.3	2.4	3.9	4.0	4.0

Other Emerging Markets

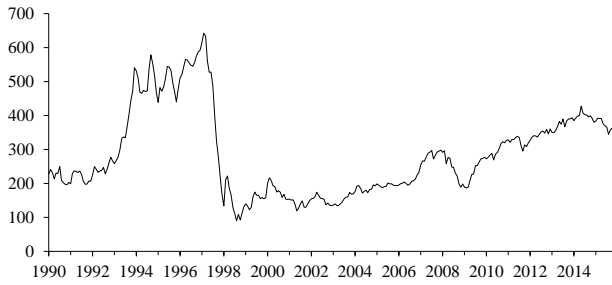
Hong Kong: FT-Actuaries



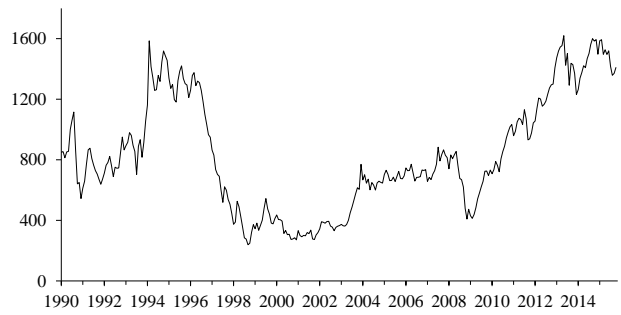
Indonesia: Jakarta Composite



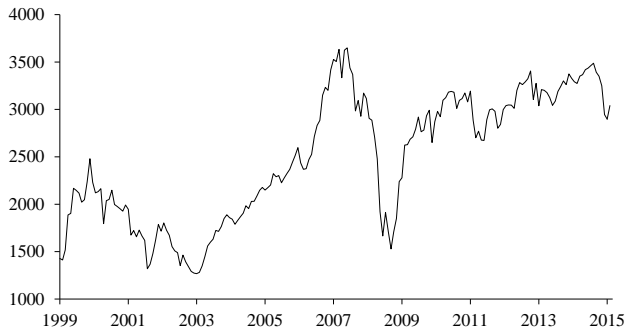
**Malaysia: FT-Actuaries
(US\$ Index)**



Thailand: Composite Index



Singapore: Straits Times Index

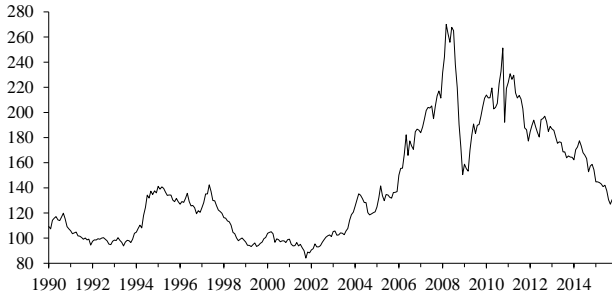


Philippines: Manila Composite

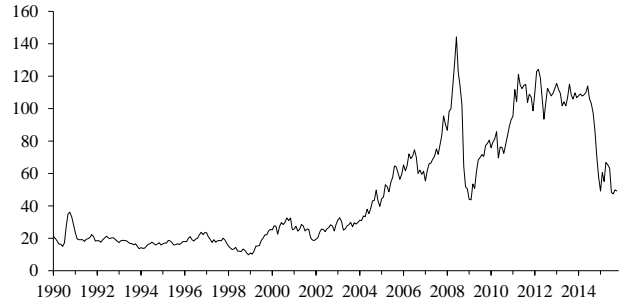


COMMODITY MARKETS

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



Oil Price: North Sea Brent (in Dollars)



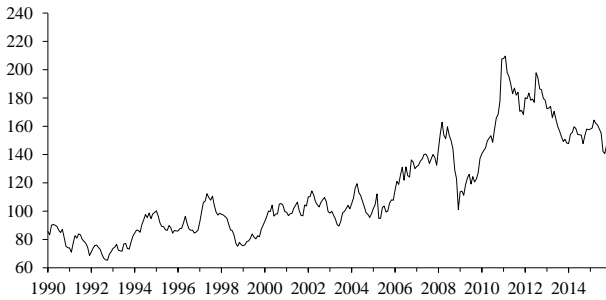
Commodity Price Index (Sterling)
(Economist, 2000=100)



Gold Price (in Dollars)



Commodity Price Index (Euro)
(Economist)



UK FORECAST DETAIL

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

	Inflation % ¹ (CPI)	Short Dated (5 Year) Interest Rates	3 Month Int. Rates	Nominal Exchange Rate (2005=100) ²	Real Exchange Rate ³	Real 3 Month Int. Rates % ⁴	Inflation (RPIX)	Real Short Dated Rate of Interest ⁵
2013	1.9	1.3	0.6	81.6	85.6	-1.3	3.1	-0.2
2014	1.6	1.8	0.6	87.1	92.0	-1.0	2.4	0.2
2015	0.6	1.8	0.6	90.7	95.6	-1.0	1.6	-0.1
2016	1.6	2.2	1.0	90.8	95.8	-0.7	2.4	0.3
2017	1.7	2.5	1.6	90.7	95.8	-0.4	2.5	0.4
2018	2.0	2.5	2.1	90.3	95.8	0.0	2.7	0.2
2013:1	1.9	1.0	0.6	80.5	84.1	-1.1	3.3	-0.8
2013:2	1.7	0.9	0.5	80.7	84.2	-1.5	3.1	-0.9
2013:3	2.1	1.5	0.5	81.4	85.3	-1.4	3.2	-0.2
2013:4	1.9	1.7	0.5	83.7	88.7	-1.1	2.7	0.4
2014:1	1.7	1.8	0.6	85.7	90.6	-1.2	2.7	0.7
2014:2	1.8	1.9	0.6	87.1	91.6	-1.0	2.6	1.0
2014:3	1.6	1.9	0.6	88.2	93.0	-0.7	2.5	1.2
2014:4	1.3	1.4	0.5	87.5	92.9	-1.0	2.0	0.6
2015:1	0.1	1.8	0.5	91.0	95.4	-1.1	1.3	0.7
2015:2	0.5	1.6	0.6	90.6	95.4	-1.1	1.6	0.3
2015:3	0.8	1.8	0.7	90.8	96.0	-0.9	1.8	0.3
2015:4	1.0	2.0	0.8	90.5	95.7	-0.9	1.9	0.3

¹ Consumer's Expenditure Deflator

² Sterling Effective Exchange Rate Bank of England

³ Ratio of UK to other OECD consumer prices adjusted for nominal exchange rate

⁴ Treasury Bill Rate less one year forecast of inflation

⁵ Short Dated 5 Year Interest Rate less average of predicted 5 year ahead inflation rate

Labour Market and Supply Factors (Seasonally Adjusted)

	Average Earnings (1990=100) ¹	Wage Growth ²	Unemployment (New Basis) Percent ³	Millions	Real Wage Rate ⁴ (1990=100)
2013	238.6	1.1	4.2	1.4	132.1
2014	241.6	1.3	3.0	1.0	131.6
2015	247.5	2.4	2.2	0.8	134.1
2016	255.3	3.2	2.0	0.7	136.1
2017	262.9	3.0	1.9	0.7	137.8
2018	270.9	3.0	1.7	0.6	139.2
2013:1	236.8	0.6	4.6	1.5	131.6
2013:2	240.7	2.3	4.4	1.5	133.3
2013:3	239.0	0.8	4.1	1.4	134.0
2013:4	238.0	1.1	3.7	1.3	134.7
2014:1	241.4	1.9	3.4	1.2	132.4
2014:2	240.4	-0.1	3.1	1.1	131.2
2014:3	241.5	1.0	2.8	1.0	131.3
2014:4	243.0	2.1	2.6	0.9	131.6
2015:1	245.7	1.8	2.3	0.8	134.6
2015:2	245.9	2.3	2.2	0.8	133.5
2015:3	247.6	2.5	2.2	0.8	133.6
2015:4	250.8	3.2	2.1	0.7	134.5

¹ Whole Economy

² Average Earnings

³ Wholly unemployed excluding school leavers as percentage of employed and unemployed, self employed and HM Forces

⁴ Wage rate deflated by CPI

Estimates and Projections of the Gross Domestic Product¹ (£ Million 1990 Prices)

	Expenditure Index	£ Million '90 prices	Non-Durable Consumption ²	Private Sector Gross Investment Expenditure ³	Public Authority Expenditure ⁴	Net Exports ⁵	AFC
2013	149.7	716792.3	422942.6	280112.3	186839.5	-43986.8	129115.4
2014	153.9	737015.5	427963.1	304158.8	190713.6	-49433.4	136386.5
2015	158.6	759444.4	437481.6	315661.6	193150.9	-45651.0	141194.8
2016	162.6	778752.4	447600.9	324004.5	197878.0	-45648.1	145082.7
2017	166.5	797118.0	458510.3	331200.7	201835.6	-45657.5	148775.7
2018	170.4	815975.2	469801.9	338544.2	205872.3	-45677.8	152572.1
2013/12	1.7		0.8	6.9	-0.8		6.5
2014/13	2.8		1.2	9.2	2.1		6.0
2015/14	3.0		2.2	3.8	1.3		3.6
2016/15	2.5		2.3	2.6	2.4		2.8
2017/16	2.4		2.4	2.2	2.0		2.5
2018/17	2.4		2.5	2.2	2.0		2.6
2013:1	148.3	177519.5	105980.9	63263.4	48156.3	-9136.5	30744.6
2013:2	149.2	178660.4	105506.8	65944.1	45724.2	-8941.9	29572.8
2013:3	150.3	179940.8	105672.5	73909.9	46393.6	-13073.1	32962.1
2013:4	150.9	180671.6	105782.4	76994.9	46565.5	-12835.3	35835.9
2014:1	152.2	182265.5	106436.3	74892.1	48266.6	-12641.4	34688.1
2014:2	153.5	183784.4	106421.7	75257.3	46811.9	-12072.8	32633.8
2014:3	154.5	184921.4	106888.2	77659.4	47749.3	-13346.2	34029.3
2014:4	155.4	186044.2	108216.9	76350.0	47885.7	-11373.0	35035.4
2015:1	157.1	188027.6	108559.6	76022.9	49960.4	-11418.3	35097.0
2015:2	158.9	190219.7	109098.3	80639.9	47084.9	-11415.5	35185.9
2015:3	159.0	190337.9	109639.8	79590.1	47855.5	-11410.3	35336.8
2015:4	159.4	190859.2	110183.9	79408.7	48250.2	-11407.0	35575.2

¹ GDP at factor cost. Expenditure measure; seasonally adjusted

² Consumers expenditure less expenditure on durables and housing

³ Private gross domestic capital formation plus household expenditure on durables and clothing plus private sector stock building

⁴ General government current and capital expenditure including stock building

⁵ Exports of goods and services less imports of goods and services

Financial Forecast

	PSBR/GDP % ¹	GDP ¹ (£bn)	PSBR (£bn)	Debt Interest (£bn)	Current Account (£ bn)
			Financial Year		
2013	6.0	1550.9	92.5	47.1	-65.9
2014	5.5	1615.2	88.6	51.8	-84.2
2015	5.0	1679.3	84.0	53.9	-77.8
2016	4.6	1752.9	79.6	57.6	-78.2
2017	3.2	1827.4	58.7	62.4	-78.8
2018	2.1	1909.0	39.1	65.4	-79.5
2013:1	3.5	373.6	13.3	11.9	-14.1
2013:2	8.0	374.9	30.0	11.2	-8.4
2013:3	5.0	385.5	19.3	11.5	-22.2
2013:4	8.3	394.8	32.7	11.9	-21.1
2014:1	2.7	395.7	10.6	12.4	-17.7
2014:2	7.8	396.7	31.0	12.8	-21.0
2014:3	4.9	402.8	19.6	13.0	-23.8
2014:4	7.1	408.3	29.2	13.1	-21.8
2015:1	2.1	407.4	8.7	12.9	-16.0
2015:2	8.6	415.2	35.8	13.2	-19.9
2015:3	4.3	418.5	17.8	13.4	-20.2
2015:4	8.0	422.4	33.7	13.7	-21.7

¹ GDP at market prices (Financial Year)

WORLD FORECAST DETAIL

Growth Of Real GNP

	2011	2012	2013	2014	2015	2016
U.S.A.	1.6	2.3	2.2	2.3	3.0	3.0
U.K.	1.6	0.7	1.7	2.8	3.0	2.5
Japan	-0.4	1.7	1.6	0.3	1.2	1.7
Germany	3.6	0.4	0.1	1.4	1.7	1.8
France	2.1	0.4	0.4	0.4	0.8	1.3
Italy	0.6	-2.3	-1.9	-0.3	0.4	1.0

Growth Of Consumer Prices

	2011	2012	2013	2014	2015	2016
U.S.A.	3.1	2.1	1.5	1.7	0.5	2.0
U.K.	3.5	2.1	1.9	1.6	0.6	1.6
Japan	-0.3	0.0	0.4	2.8	1.0	1.4
Germany	2.1	2.0	1.5	1.0	0.5	1.7
France	2.1	2.0	0.9	0.6	0.2	0.1
Italy	2.8	3.0	1.2	0.2	0.2	0.6

Real Short-Term Interest Rates

	2011	2012	2013	2014	2015	2016
U.S.A.	-1.5	-1.5	-1.5	-1.6	-1.4	-0.5
U.K.	-2.4	-1.1	-1.3	-1.0	-1.0	-0.7
Japan	-0.9	-1.3	-1.6	-1.6	-1.7	-1.8
Germany	0.1	-0.7	-1.2	-1.4	-1.4	-1.8
France	0.6	0.0	-0.6	-0.9	-1.3	-1.7
Italy	0.4	0.0	-0.6	-1.0	-1.4	-1.7

Nominal Short-Term Interest Rates

	2011	2012	2013	2014	2015	2016
U.S.A.	0.1	0.1	0.1	0.1	0.6	1.5
U.K.	0.9	0.9	0.6	0.6	0.6	1.0
Japan	0.2	0.2	0.2	0.1	0.2	0.2
Germany	1.4	0.6	0.2	0.2	0.1	0.1
France	1.4	0.6	0.2	0.2	0.1	0.1
Italy	1.4	0.6	0.2	0.2	0.1	0.1

Real Long-Term Interest Rates

	2011	2012	2013	2014	2015	2016
U.S.A.	0.0	-0.1	1.1	0.3	0.2	0.8
U.K.	0.2	-0.8	-0.2	0.2	-0.1	0.2
Japan	-0.8	-1.1	-1.3	-1.6	-1.6	-1.5
Germany	0.0	-0.3	-0.9	-1.4	-1.7	-1.4
France	0.2	-0.1	-0.7	-1.3	-1.6	-1.4
Italy	0.1	-0.2	-0.7	-1.3	-1.6	-1.4

Nominal Long-Term Interest Rates

	2011	2012	2013	2014	2015	2016
U.S.A.	1.9	1.8	3.0	2.2	2.2	2.8
U.K.	2.0	0.9	1.3	1.8	1.8	2.2
Japan	1.0	0.8	0.7	0.3	0.4	0.5
Germany	1.8	1.5	1.0	0.5	0.3	0.6
France	1.8	1.5	1.0	0.5	0.3	0.6
Italy	1.8	1.5	1.0	0.5	0.3	0.6

Index Of Real Exchange Rate(2000=100)¹

	2011	2012	2013	2014	2015	2016
U.S.A.	79.8	81.6	82.1	83.0	83.2	83.0
U.K.	88.7	92.4	81.6	87.1	90.7	90.8
Japan	80.6	79.6	63.5	61.1	60.7	60.4
Germany	100.1	96.7	99.0	100.5	100.2	100.5
France	102.9	99.5	100.7	101.7	101.4	101.7
Italy	107.2	105.2	106.9	107.8	107.0	107.3

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

Nominal Exchange Rate

(Number of Units of Local Currency To \$1)

	2011	2012	2013	2014	2015	2016
U.S.A. ¹	78.08	80.90	86.00	89.40	100.50	100.00
U.K.	1.61	1.59	1.55	1.65	1.50	1.50
Japan	79.36	80.51	98.20	106.70	120.00	120.50
Eurozone	0.71	0.78	0.75	0.76	0.90	0.91

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

* Forecasts based on the Liverpool World Model