LIVERPOOL INVESTMENT LETTER

September 2013

Cardiff Business School
Cardiff University

Julian Hodge Institute of Applied Macroeconomics

LIVERPOOL RESEARCH GROUP IN MACROECONOMICS

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

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

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

ISSN 0951-9262

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UK RECOVERY GAINING TRACTION

The second quarter second estimate of GDP growth has been raised to 0.7% and other data is coming in stronger. The PMIs are picking up, retail sales are rising, and the housing market is also strengthening, prompting the usual wails about ‘bubbles’ even though the market is still in recession! A further set of wails is heard about ‘unbalanced growth’, as if any growth is generally ‘balanced’ (except in the steady state).

It does now look as if the government’s desperate measures to get credit going are starting to have a little effect; so far only on mortgages but perhaps soon it will filter through to small businesses. The difficulty is that as fast as these ad hoc measures are brought in and start to have an effect, some regulatory arm of government introduces fresh regulatory shocks on the banks — the most recent case being the sudden imposition of a gross leverage ratio minimum, which caught both Barclays and nationwide on the hop. This seems to have been the parting gift of poison from the departing Governor. There seems to have been some subsequent compromises on timing with both institutions but the situation remains precarious, with regulation once again cutting across the functioning of the credit sector.

The difficulty of forecasting at present is bound up with these policy contradictions. On the one hand regulation is being lightened ad hoc by special measures such as the Funding for Lending schemes and Help to Buy. On the other the regulators continue gung ho with their programme, egged on by politicians who fail to understand the overall workings of the economy. Then we have monetary policy, attempting to undo the regulative tightness by monetary ease — the latest addition being the new Governor’s ‘forward guidance’. As we have argued before, this ease has little effect when credit is frozen, other than to bring down returns for savers and reduce the financial pressures on the government to bring down its deficit.

The biggest surprise in the second quarter outturn was the very strong pick-up in investment, by 1.7%. It had declined on average for much of the past two years, with a slight 0.2% pick-up in the first quarter. With large companies flush with cash and generally improving profits, it may well be that finally firms have decided to delay their investment plans no longer.

Table 1: Summary of Forecast

		2010	2011	2012	2013	2014	2015	2016
GDP Growth[1]		1.7	1.1	0.2	1.2	2.2	2.4	2.6
Inflation	CPI	3.3	4.5	2.7	2.7	2.5	2.2	2.0
	RPIX	4.8	5.3	3.2	2.5	3.1	2.8	2.7
Unemployment (Mill.)								
	Ann. Avg.[2]	1.5	1.5	1.6	1.5	1.4	1.3	1.2
	4th Qtr.	1.5	1.6	1.6	1.5	1.3	1.2	1.1
Exchange Rate[3]		80.4	80.0	83.1	82.6	83.0	82.3	82.5
3 Month Interest Rate		0.7	0.9	0.9	0.9	1.6	2.1	2.2
5 Year Interest Rate		2.4	2.0	0.9	1.3	1.8	2.1	2.4
Current Balance (£bn)		−40.0	−22.5	−59.2	−60.7	−62.9	−63.5	−62.0
PSBR (£bn)		112.6	91.0	68.4	119.7	106.0	94.6	74.5

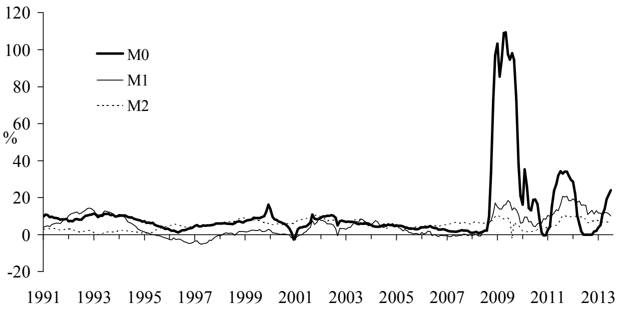
[1]Expenditure estimate at factor cost
[2]U.K. Wholly unemployed excluding school leavers (new basis)
[3]Sterling effective exchange rate, Bank of England Index (2005 = 100)

This good news on GDP is not yet feeding through into the government finances which seem stuck in deficit at around 7% of GDP. This is not sustainable. If clear improvement is not seen soon, further cuts will need to be made; for all the government’s plan A, the fact is that progress with deficit reduction has been very slow.

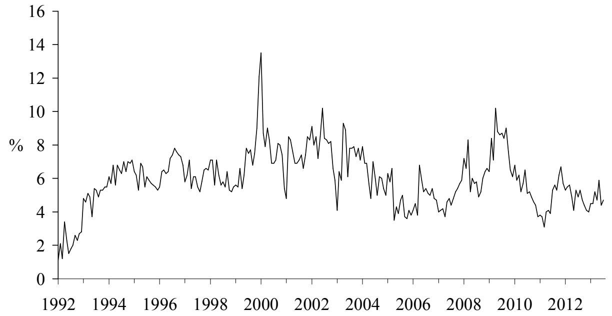
With so much uncertainty still around, it is premature to get alarmed about excessive monetary slackness. There is a huge overhand of printed money sitting in bank reserves but with the regulatory problems already discussed it is hard to see that being used to extend a lot of credit in the near future. Nevertheless the Bank ought now to be thinking about getting interest rates back to some normal level as the recovery gathers steam. It also should be thinking about how to get the money it has printed out of the system without too much disruption. Carney’s forward guidance has been an effort to persuade us that it will not do either of these painful things. But other members of the MPC may well think otherwise if the recovery does indeed stay strong.

Internationally we are seeing the US Fed become more cautious now and the result is rising interest rates on government longer term bonds. This has upset equity markets in emerging countries, especially India. The euro-zone is also picking up at last and the ECB will want to move to interest rate normality too.. China is having to tighten money in the face of a massive excess of credit extended during the reaction to the crisis. The world is moving to tighter money, if very slowly at present. The UK will have to do the same, if it is not to look out of line and risk a run on sterling that would destabilise the inflation figures.

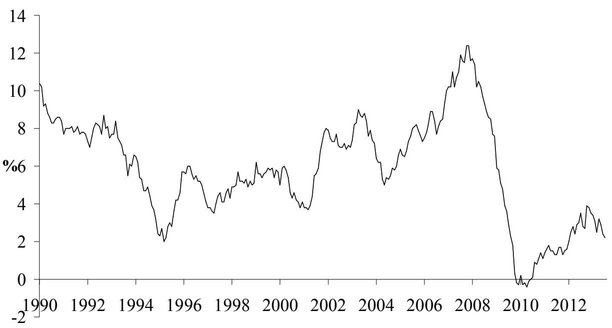
U.S.: Growth in Monetary Aggregates (Yr - on - Yr)



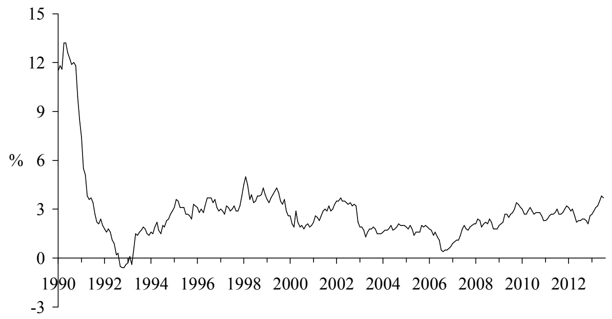
UK: Notes and Coins in Circulation Growth



Eurozone M3 Growth



Japan: Growth of M2+CD's



FOCUS ON JAPAN

Francesco Perugini

Japan growth slows in second quarter…

Japan's economy recorded three straight consecutive of growth up to June, but the increase was much smaller than expected. GDP grew by 0.6% versus expectations of 0.9% and compared to the 1% figure logged in the first quarter of the year helped by the Abe government's monetary and fiscal stimulus drive.

Looking at demand components, private consumption rose a better-than-expected 0.8% over the previous quarter, as a brightening mood in Japan pushed up spending on food, travel and luxury products, but private residential investment actually fell for the first time in five quarters (–0.2%), while corporate investment marked a sixth consecutive contraction (–0.1%) reflecting continued caution among Japanese corporations about the country's long-term prospects. "Corporations' cautious attitudes was the main factor limiting growth. Companies remained hesitant to increase capital expenditure and continued to cut inventory in light of the slow recovery of exports and uncertainty regarding the sustainability of the economic recovery", commented Harumi Taguchi, principal economist at the research firm IHS, in a note.

Public investment accelerated modestly (to +0.8%), but was nevertheless weaker than a Reuters poll of economists had anticipated, while exports of goods and services grew for the second consecutive quarters (+3.0%) as recovery gathered steam overseas especially in the US and Europe. A weaker yen has also assisted Japanese exports.

Other economic data, such as the industrial production or the PMI index, have been disappointing in recent months too. Hence the signs of slowing growth have strengthened the hand of critics of Abenomics, which has relied heavily on monetary stimulus and government spending to revive growth in Japan's long-deflationary economy. Abe has promised to follow up with market deregulation and the easing of trade barriers to raise the long-term growth potential. But so far there is little sign of such reforms, with as always huge opposition to them from powerful interest groups.

…adding to sales tax uncertainty

Weaker GDP growth could also derail Japan's plans to raise taxes and pare back soaring government debt, which reached ¥1,000 trillion, more than twice GDP. To start easing that debt burden, Abe's coalition parties and the previous government agreed last year to raise consumption tax in April 2014 to 8% from 5% and to 10% in October 2015. However, whether the government goes ahead with the plan will depend on how sustainable it deems economic growth to be. Abe has repeatedly flagged second-quarter GDP as a key factor, so a decision is expected to be made on September 9 following the release of revised second quarter GDP data.

On his side the Prime Minister said that he remained confident about Japan's economic prospects and that he would stay on course with his 'three arrows'. He has been noncommittal about consumption tax, however. "The economy has been steadily rising," he said at a news conference. "I'll continue to focus on the economy, implementing further growth strategies in the autumn." The GDP data drew mixed reaction from government officials. While the adviser to Prime Minister Shinzo Abe, Koichi Hamada, said the figures showed the government was in no hurry to raise the tax and could consider delaying the measure by one year, economy minister Akira Amari described the data as "good numbers" which are supportive of plan to raise the sales tax. The central bank's governor, Haruhiko Kuroda, also favours raising the tax, saying the pro-growth policies implemented by the Bank of Japan (BOJ) and the government would offset the tax's potential ill effect on consumer demand.

Last time Japan raised the consumption tax, in 1997, the results were catastrophic. A recession followed, government revenues ended up falling, making the debt problem worse, and the prime minister who approved the increase resigned. So economists warn that raising taxes too soon could derail Japan's nascent recovery. "A tightening in fiscal policy would almost certainly snuff out the current cyclical rebound," economists at UBS said in a note. "The desire for fiscal consolidation in the long run must not sacrifice the war on deflation in the short run," they added. "To hike or not to hike the consumption tax is the only policy which matters over the next four quarters."

However, it is becoming clearer that Abe will not make his final decision solely on the basis of economic factors. Politics is a bigger issue in Japan. Observers believe that since he wants to stay in power for a long period of time in order to accomplish historic tasks such as amending the Constitution, he would like to avoid a situation in which the tax hike leads to a lower rate of approval, which may in turn lead dissatisfied elements within his party to revolt against him. People close to LDP Secretary General Shigeru Ishiba, who aspires to succeed Abe, think that if Abe loses steam as a result of the tax hike, that would work to Ishiba's advantage. Raising the consumption tax rate as scheduled would create a situation advantageous to him.

So if the date for implementing the increase of the tax rate is put off not purely for economic considerations but rather because of a power struggle or lobbying by business groups that have vested interests, Japan could conceivably face unfavourable reactions from the international community and the market. It is back to the future.

MARKET DEVELOPMENTS

Emerging equity markets have had a shock from the Fed's 'tapering' of its money printing programme. But this must continue and yields on government bonds will go on rising. With rates of interest on cash so tiny and bond prospects so poor, it still remains the best strategy to be invested in a broad range of equities. With world growth continuing and western economies' growth strengthening they offer the best available returns.

Table 1: Market Developments

	Market Levels Jul 24	Market Levels Aug 29	Prediction for Aug/Aug 2014 Previous Letter	Prediction for Aug/Aug 2014 Current View
Share Indices				
UK (FT 100)	6620	6483	9845	9511
US (S&P 500)	1686	1638	2138	2094
Germany (DAX 30)	8379	8915	11521	11268
Japan (Tokyo New)	1220	1117	1705	1583
Bond Yields (government long-term)				
UK	2.40	2.77	1.70	1.70
US	2.59	2.75	2.10	2.10
Germany	1.66	1.86	1.50	1.50
Japan	0.78	0.71	0.70	0.70
UK Index Linked	–0.06	–0.07	–0.30	–0.30
Exchange Rates				
UK ($ per £)	1.54	1.55	1.56	1.56
UK (trade weighted)	80.4	81.6	83.1	83.1
US (trade weighted)	86.5	86.6	85.5	85.5
Euro per $	0.76	0.76	0.79	0.79
Euro per £	1.16	1.17	1.23	1.23
Japan (Yen per $)	100.0	98.4	98.0	98.0
Short Term Interest Rates (3-month deposits)				
UK	0.56	0.58	1.80	1.80
US	0.30	0.32	0.70	0.70
Euro	0.15	0.15	0.50	0.50
Japan	0.08	0.08	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	3.50	2.2	2.5	42.00		52.40
US	2.00	2.2	1.6	24.00	–0.71	27.14
Germany	3.10	0.8	1.7	35.00	–5.24	34.33
Japan	2.00	1.6	0.0	40.00	–0.30	42.07
UK indexed[2]	–0.07		2.5	–10.00		–7.56
Hong Kong[3]	2.60	7.4	1.6	16.00	–0.71	24.94
Malaysia	3.00	5.2	1.6	57.00	–0.71	63.04
Singapore	3.70	3.7	1.6	35.00	–0.71	39.14
India	1.70	6.1	1.6	20.00	–0.71	26.74
Korea	1.20	3.4	1.6	–2.00	–0.71	2.64
Indonesia	2.70	5.9	1.6	49.00	–0.71	54.34
Taiwan	2.80	3.0	1.6	31.00	–0.71	36.84
Thailand	3.50	4.7	1.6	52.00	–0.71	53.64

Bonds: Contribution to £ yield of:

	Redemption Yield	Changing Nominal Rates	Currency	Total
UK	2.40	7.00		9.40
US	2.59	4.90	–0.71	5.93
Germany	1.66	1.60	–5.24	–3.01
Japan	0.78	0.80	–0.30	2.05

Deposits: Contribution to £ yield of:

	Deposit Yield	Currency	Total
UK	0.56		0.56
US	0.30	–0.71	–1.26
Euro	0.15	–5.24	–6.12
Japan	0.08	–0.30	0.55

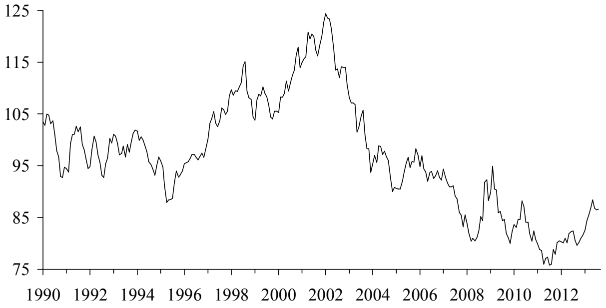
[1] Yields in terms of €s or $s can be computed by adjusting the £-based yields for the expected currency change.
[2] UK index linked bonds All Stocks
[3] Output based on China.

Table 3: Portfolio(%)

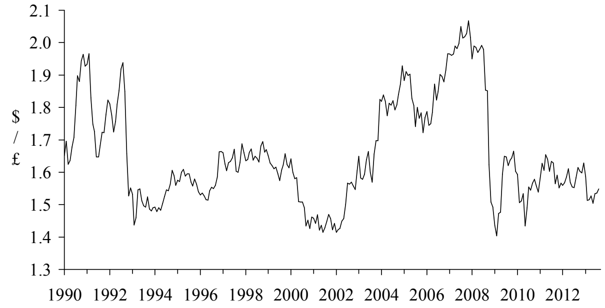
	Sterling Based Investor		Dollar Based Investor		Euro Based Investor	
	August Letter	Current View	August Letter	Current View	August Letter	Current View
UK Deposits (Cash)	5	5	5	5	1	1
US Deposits	-	-	-	-	-	-
Euro Deposits	-	-	-	-	-	-
Japanese Deposits	-	-	-	-	-	-
UK Bonds	-	-	-	-	-	-
US Bonds	-	-	-	-	-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

INDICATORS AND MARKET ANALYSIS
FOREIGN EXCHANGE MARKETS

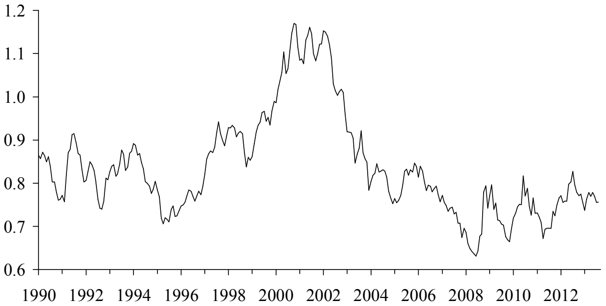
US : Trade Weighted Index
(Bank of England 1990 = 100)



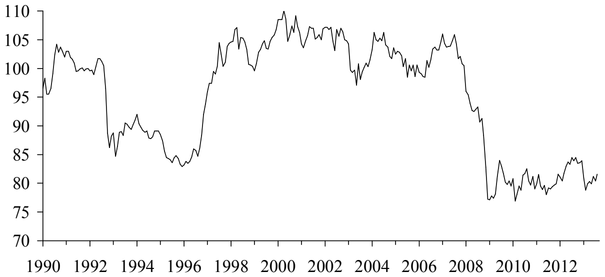
UK: Dollars Per Pound Sterling



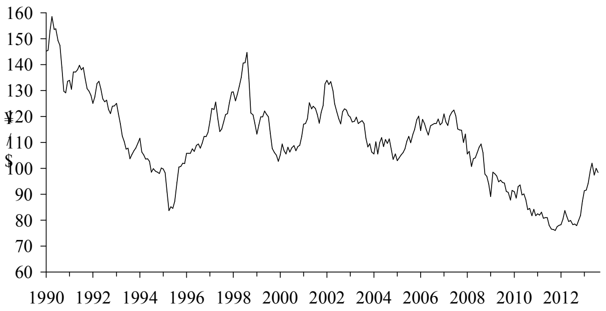
Euro per US dollar



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

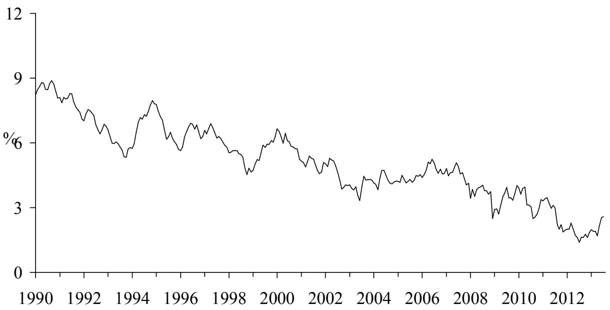


Japan : Yen Per U.S. Dollar

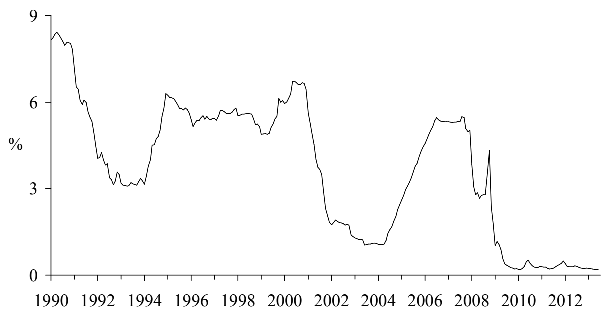


GOVERNMENT BOND MARKETS

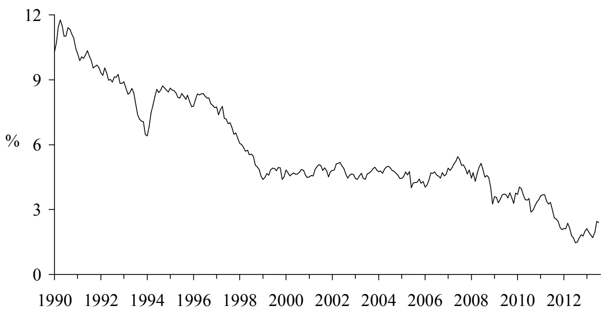
U.S.: Yield on Long-Term Government Bonds



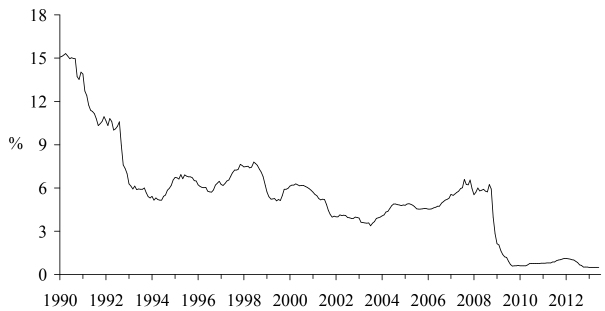
U.S. : 3-Month Certificate of Deposit



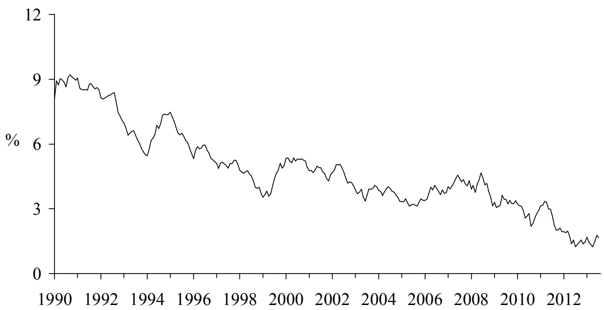
U.K. : Yield on Long-Term Government Bonds



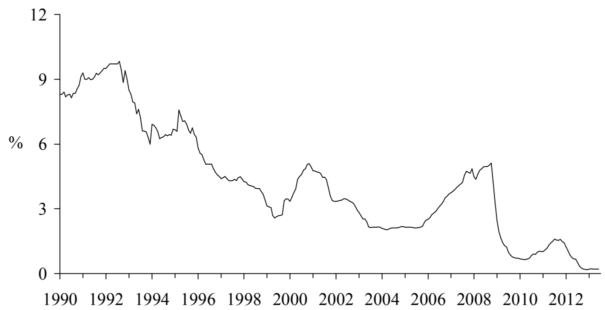
U.K. : 3-Month Interbank Rate



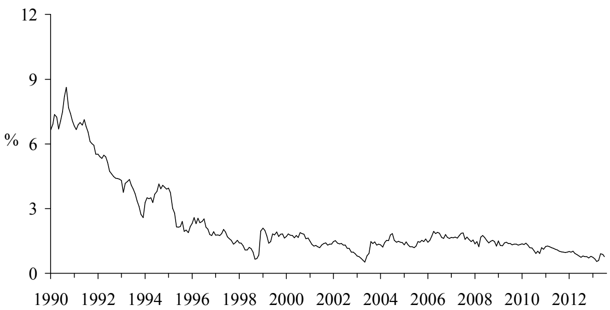
Germany: Yield on Public Authority Bonds



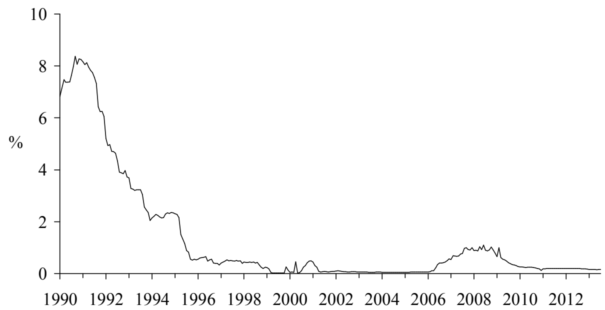
Germany : 3-Month Interbank Deposit Rate



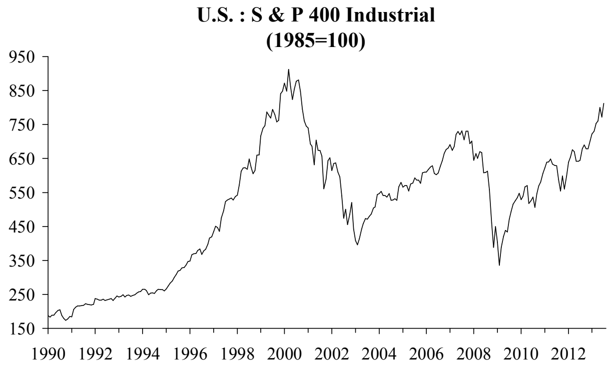
Japan: Yield on Long-Term Government Bonds

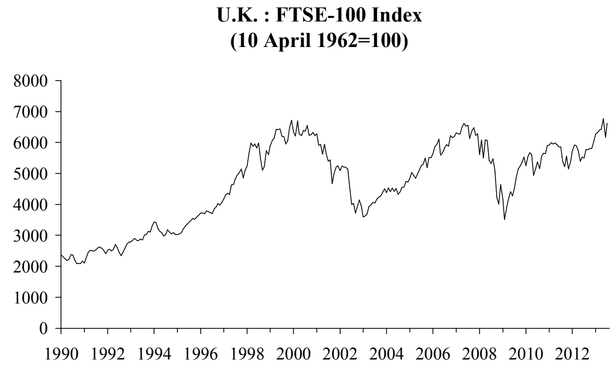


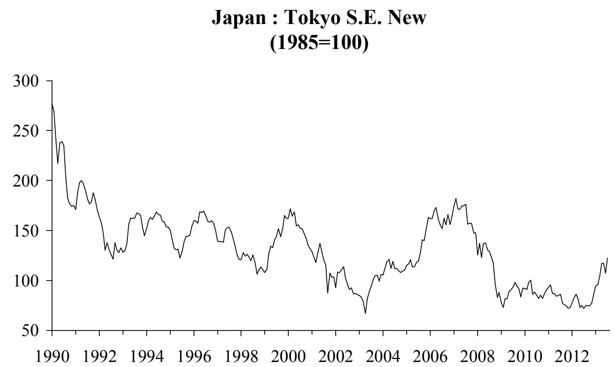
Japan : 3 Month Money Market Rate



MAJOR EQUITY MARKETS







EMERGING MARKETS

Anupam Rastogi

India

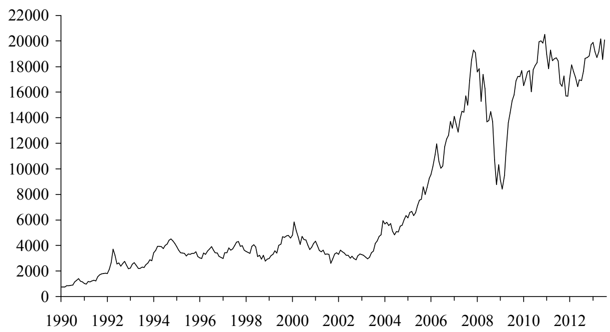
Talk of tapering has impacted all emerging markets. International money is flowing out of India, Brazil, South Africa, Turkey and Indonesia, and seeking safer returns in US bonds. India is the worst affected due to self-inflicted wounds by the government. The market has punished the Indian rupee because the Indian government, instead of keeping government spending under a tight leash, has unveiled a food subsidy programme which will cost approximately 1.25 trillion rupees. Besides this, fear of full scale conflict in Syria and therefore a rise in crude oil prices mean that the Finance Minister's promise that the current account deficit will be contained within $70 billion is most likely to be breached. In the last 10 days of August, the Indian rupee has depreciated by more than 10%, and 25% in 2013 — an unusual movement in the currency market during peace time.

At present the government is wooing voters, especially poor voters, by subsidizing everything from rice, fertilizer and cooking gas to housing and rural employment, while the country is waiting for elections due to be held before May 2014. The general mood in the country is that they need a change and we would not be surprised if the Indian public votes en mass for the opposition party, which is talking about development and small government. Only time will tell whether a new government is able to put the country's development on track or not, because the regressive economic policies of the present government have delayed India's development by at least 10 years. The irony is that the 'dream team' of the 1991 economic reforms of India is at the helm, and they participated in policy formulation and implementation which has driven out foreign capital and harmed the supply side of the economy. It may take well over 10 years to weaken welfare schemes and anti-industry legislations implemented under the garb of providing protection to poor and saving the environment from exploitation.

The economy grew 4.8% in the January–March quarter, and 4.4% in the April–June quarter. Overall India's growth could fall to 5% for the year ended March 31, 2014, versus expectations of 6.5% earlier this year. India's services sector output in July contracted for the first time since October 2011 as new orders declined amid weak economic conditions, fanning worries of a prolonged economic slowdown. India had better than a normal monsoon this year and that could sustain consumption to some extent.

India's inflation moved out of the central bank's comfort zone in July, as food prices rose and a weak local currency increased the cost of imports. The wholesale price index, India's main inflation gauge, rose 5.79% from a year earlier, compared with 4.86% in June and at its fastest pace since February. The consumer price index is just shy of 10% and, if talk of diesel prices being raised by 10% in the first week of September is correct, the ripple effect of that would keep inflation at an elevated level. In July India's central bank effectively pushed up interest rates in an effort to shore up the country's sinking currency. This didn't stop the slide. With monetary policy "hijacked by financial stability considerations" because of the rupee's weakness, the central bank is expected to keep interest rates steady this fiscal year through March.

India: BSE Sensitive



One question which is being asked is how much will the food security programme cost? Government estimates put the number at about 1.25 trillion rupees per year. But many believe these estimates are too optimistic; the Commission for Agricultural Costs and Prices (CACP) of the Ministry of Agriculture has pegged the expense at 2.41 trillion rupees for the first year and 6.82 trillion rupees for the first three years together. The government would have to resort to heavy borrowing or money printing. Therefore, in the long run the Food Security Bill is going to harm the Indian economy.

Another key concern revolves around the country's large current-account deficit. The withdrawal of foreign institutions, especially from India's debt market due to currency depreciation and narrowing yield differential, does not augur well. In order to calm the market the government took steps such as increasing tariffs on gold imports, reducing the amount of money which Indian individuals and companies can send overseas etc. These measures were interpreted as if the government is going to bring back capital controls. The government had to clarify that they don't plan to introduce capital controls, a fear that has hurt the Indian currency in the last month. The government was forced to reiterate that the country is not heading for a balance-of-payments crisis similar to the one experienced in 1991, because the country now has much larger foreign-exchange reserves to continue meeting its import obligations.

The government has sought new ways of financing the current account deficit: these include quasi-sovereign bonds issued by government corporations, more liberal corporate borrowings and a bond issue reserved for overseas Indians. But the real question is: can the deficit be cut? Otherwise, the rupee could keep sliding, and inflation keep rising.

As predicted in the last month's letter, Raghuram Rajan will be the next governor of the Reserve Bank of India. He has several crises to deal, starting with healing the rupee. Then he must consider the current account deficit, inflation, GDP growth and several other problems that are in the pipeline. His crisis prediction skills are proven, his crisis resolving skills need to be proved.

India's foreign exchange reserves have dropped by nearly $14 billion since the end of March and are set to dwindle further as international investors shun the rupee and other emerging market assets in favour of the US dollar. Palaniappan Chidambaram, the finance minister, has outlined a 10-point scheme to reduce the nation's current account deficit and restore economic growth.

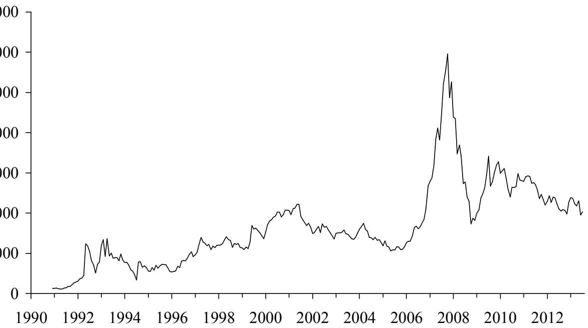
In short, fiscal concerns over the Food Security Bill and the Syria issue have brought the currency lower by 10% in the last 10 days. The sword of sovereign downgrade, to junk status, hangs mercilessly over India's economic fortune. Meanwhile, the government is not interested in paying any heed to the warnings of the RBI and other economists. India awaits a new government which may be in place in nine months' time.

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

China

In line with our expectations, The Chinese government has been able to keep the economy on even keel. The economy is showing signs of stabilisation backed by policy support and some improvement in global demand. Government debt is being brought under control and factory output seems to be recovering. More importantly, the government is keen on implementing some key reforms. The objective is to structurally change China's business model which was earlier dependent on debt fuelled construction and exports. These changes mean that China may not be able to record GDP growth of more than 7.5% in 2013. The economy expanded 7.5% on year in the second quarter, lower than the growth rate of 7.7% in the first quarter. If China posts a

China: SSE Composite Index



7.5% growth rate for the year, it will be the slowest growth since 1990.

The bank's flash purchasing managers' index jumped to 50.1 from 47.7 in July. In July, investment, construction, trade and factory production all ticked higher, suggesting that the economy is on a stable growth path. The better than expected manufacturing numbers were proof that China's "fine-tuning policies" are beginning to have their desired effect. Not surprisingly, People's Bank of China Governor Zhou Xiaochuan dismissed chances of a hard landing in China's economy.

Mr. Zhou said the central bank will broadly keep its monetary policy stance unchanged in the second half of the year. However, some fine-tuning measures may be required. China's consumer prices remain stable. The consumer-price index rose 2.7% in July from a year ago, unchanged compared with June.

The new Chinese leadership plans to unveil a package of economic reforms this year to stimulate domestic consumption as an alternative growth engine to the investment and exports that have powered the economy for the past 30 years. China's consumption estimates have remained a bone of contention. Official data severely understates household consumption according to People's Bank of China Deputy Governor Yi Gang. He cites numbers from the University of Pennsylvania showing that, measured in internationally comparable prices, China's consumption is higher and more stable than the official data suggest; that is because compared with other countries, China's consumer goods are cheap. The University of Pennsylvania numbers show that the share of household consumption in China's GDP was 43.8% in 2010, the latest year encompassed by their study.

Exports grew 5.1% year-over-year in July after a 3.1% fall in June. Imports were also strong, up 10.9% year-over-year compared with a fall of 0.7% in June. China ran a trade surplus — the difference between exports and imports — of $17.8 billion in July, down from $27.1 billion in June.

That lower figure could take some pressure off China's currency, the yuan, which has shown signs of returning to gains against the dollar in recent weeks. The dollar–yuan pair is trading within a range of 6.11–6.12. The yuan has risen 0.12% against the U.S. dollar in the month of July, gaining 1.9% so far this year. The currency is likely to strengthen further in coming months, partly due to expectations of higher interest rates in China. In the offshore yuan market in Hong Kong, where the Chinese currency floats freely, the dollar is trading at 6.10.

In the past couple of months, Mr. Xi has praised Maoist imagery, rhetoric and strategy; unlike his predecessors who emphasised collective leadership. We may see China returning to an authoritarian political model and Maoist revivalism. Mr. Xi's attitude toward political reform is a critical issue in China today because the country may be entering a prolonged period of slower economic growth and mounting public discontent over environmental problems, patchy public services and widespread corruption.

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

South Korea

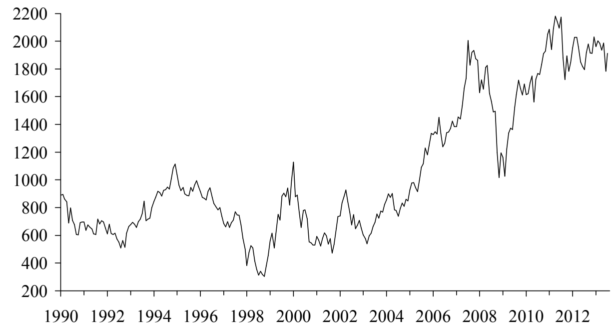
In Q2 of 2013, South Korean GDP growth beat market expectations as government stimulus measures boosted consumption and construction investment. Yet, this expansion may not hold much longer as the rise in consumer spending may not be enough to offset a still-weak industrial sector. In the second quarter of 2013 South Korea GDP increased 2.3% year-on-year, up from 1.5% growth in the previous quarter and beating market expectations. The expansion was boosted by a recovery in exports, consumption and construction. With China's economy stabilising, the South Korean economy would continue to grow a little as its competitiveness is being eroded by the depreciation of the yen.

The inflation rate in South Korea was recorded at 1.40% in July of 2013. The Monetary Policy Committee of the Bank of Korea decided on August 8th to leave the Base Rate unchanged at 2.50%. The Committee left its monetary policy unchanged for the 3rd straight meeting as its assessment on the economy points to recovery.

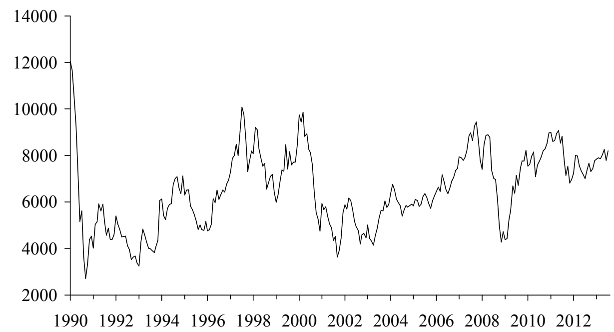
In July of 2013, South Korea's trade surplus slightly increased to 2.71 billion USD, from 2.69 billion USD a year earlier. While exports recovered on the back of higher Chinese and EU demand, imports grew in July for the first time in six months, and at a faster pace than exports.

In July, South Korea's seasonally adjusted unemployment rate remained unchanged at 3.2%. The number of unemployed persons increased by 33,000 to 828,000 people, or 4.1%, compared to July of 2012.

Korea: Composite Index



Taiwan: Weighted TAIEX Price Index



South Korea's President, Park Geun-hye, has pulled the plug on a proposed privatisation of Korea Development Bank and would like the institution to play a crucial role in stabilising the economy. The privatisation had been seen by the previous administration as a cornerstone project in the reform of the financial sector. The plan is to merge KDB, which has been a privatisation target for five years, with policy lender Korea Finance Corp.

	10	11	12	13	14
GDP (%p.a.)	6.3	3.6	2.0	2.0	2.8
Inflation (%p.a.)	2.9	4.0	2.2	1.1	1.6
Current A/c(US$ bill.)	28.2	27.0	44.0	28.0	28.0
Won/$(nom.)	1150	1100	1100	1120	1150

Taiwan

Taiwan's 2013 economic growth is likely to be 2.4% in 2013 despite better-than-expected growth in the second quarter. Taiwan's economy expanded 1.32% in 2012. If manufacturing momentum remains for the rest of the year, Taiwan's GDP in 2014 could grow 3%. GDP expanded 2.49% in the second quarter on the back of higher exports, better private consumption and smaller contraction in fixed investment.

Taiwan which was experiencing decline in industrial output in the last five months ended unexpectedly with a jump of 2.07% in July on the year after a 0.4% contraction in June. Manufacturing activity rose by 2% on the year, while the construction sector growth leapt 19% on the year. External demand seems to be more stable than previously thought, as export orders rose 0.5%. The gains were offset by a large 4.67% fall in mining and quarrying output.

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

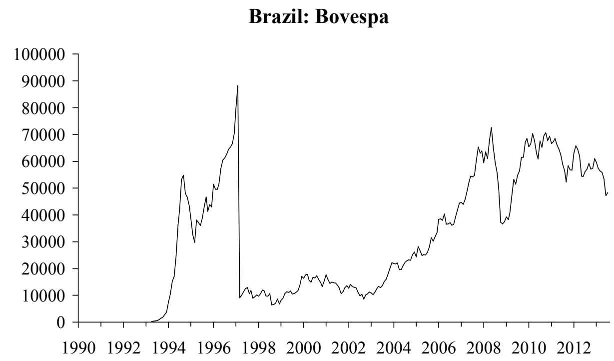
Brazil

Latin America's largest economy is grappling with sluggish growth and high inflation, a combination that has left policy makers in a bind and Brazilian assets, including its currency, under severe pressure. Domestic citizens have lost confidence in the ability of the government to navigate the country to growth.

Brazil's current-account deficit widened in July to $9.02 billion from $3.95 billion in June, due to increasing imports. The economy is expected to grow 2.2% in 2013, marginally better than 2012 growth rate but a far cry from the 7.5% growth in 2010. Annual inflation is running at 6.3% in July, near the top end of the government's target range. Brazil also swung to a $5 billion trade deficit through July, after a $9.9 billion surplus a year ago.

The pace of the real's slide is accelerating weekly, as the U.S. Federal Reserve prepares to wind down its bond-buying program later in the year. Brazil's central bank has tried to fight the outflows by raising interest rates three times this year, raising the yields on the country's debt. It also has stepped up market interventions, pumping $7.6 billion into the currency-futures market in the second week of August and $45.8 billion since May 31. The real is down more than 10% over that period.

The real is under same pressure as the Indian rupee is, but Brazil's response is different from India's. Brazilian policy makers have long argued that the real is overvalued against the dollar, and now the it has fallen about 15%. At the height of the emerging market economic boom, after the 2008–9 financial crisis, the real reached levels of near R$1.50 to the US currency. The real weakened to 2.41, trading above 2.4 for the first time since March 2009. The reversal of cheap dollars is creating problems and, although a depreciation in the longer term should help with competitiveness, the country must be careful about the



recent velocity of falls in the value of its currency, which could also have negative effects.

Brazil announced a plan in August to put the brakes on the real's recent slide, announcing that it will provide at least $60 billion more in dollar liquidity through the end of the year. The bank will offer $3 billion of dollar loans and swaps per week through Dec. 31, adding to the $45 billion it has sold in dollar swap contracts so far this year. And, since its interventions are in the futures market, Brazil isn't drawing on foreign-exchange reserves. The Brazilian real regained some lost ground. The dollar fell 2.8% against the real, trading at BRL2.37.

In order to defend the real the central bank's monetary policy committee raised Brazil's benchmark Selic rate by 50 basis points to 9%. The bank has increased the selic rate by 175 basis point since April. This may provide some relief to the falling real.

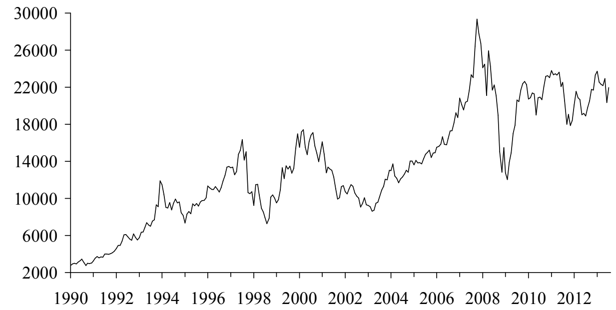
Brazil faces declining exports and a widening current account deficit. The current account deficit may touch $76 billion when July figures are released. The 12-month deficit was $72.6 billion in June. Declining exports are part of wider problems for Brazil, including 6.3% inflation. Brazil's credit rating is also under threat.

Foreign direct investment fell to $5.2 billion in July from $7.17 billion in June. At the same time, the current account deficit more than doubled on the year, to $9.1 billion compared with $3.7 billion last year, raising fears that — if FDI does not accelerate — the current account gap will not be covered, which would put downward pressure on the real.

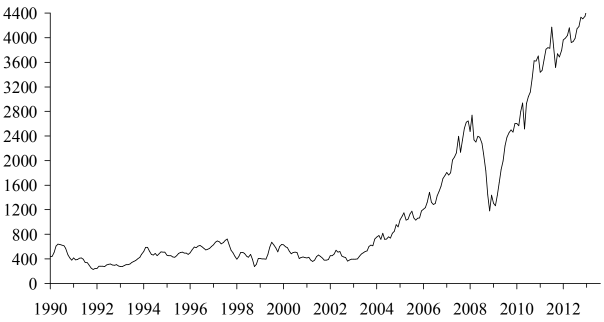
	10	11	12	13	14
GDP (%p.a.)	7.5	2.7	0.9	2.0	3.5
Inflation (%p.a.)	5.9	6.5	5.8	6.5	6.0
Current A/c(US$ bill.)	-47.3	-52.6	-60.0	-75.0	-70.0
Real/$(nom.)	1.7	1.5	2.0	2.3	2.4

Other Emerging Markets

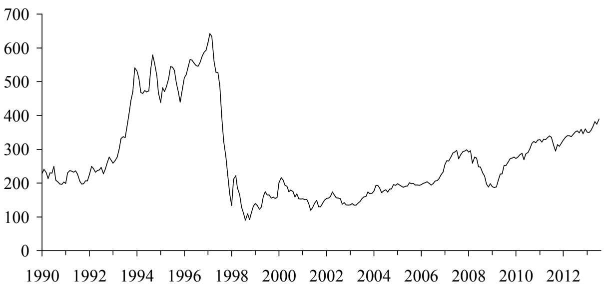
Hong Kong: FT-Actuaries



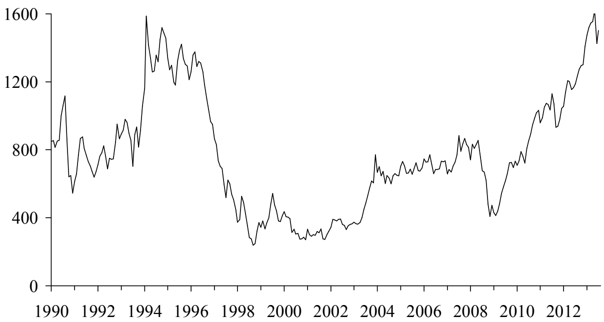
Indonesia: Jakarta Composite



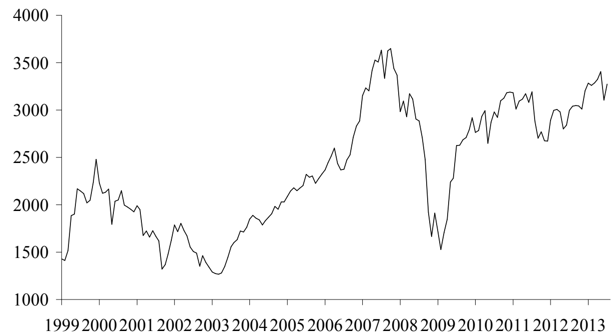
Malaysia: FT-Actuaries (US$ Index)



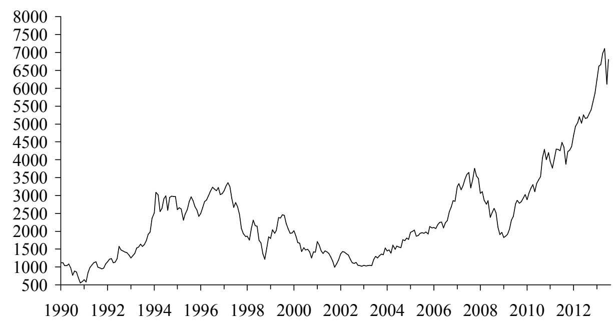
Thailand: Composite Index



Singapore: Straits Times Index

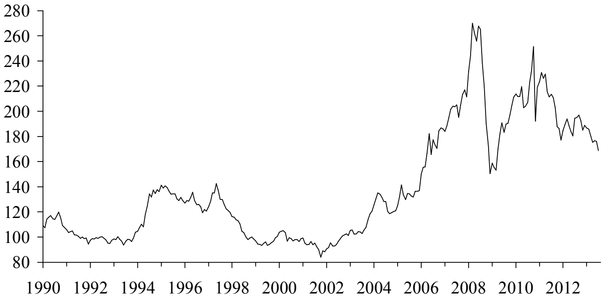


Philippines: Manila Composite

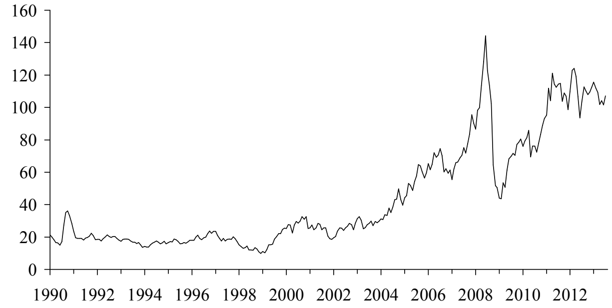


COMMODITY MARKETS

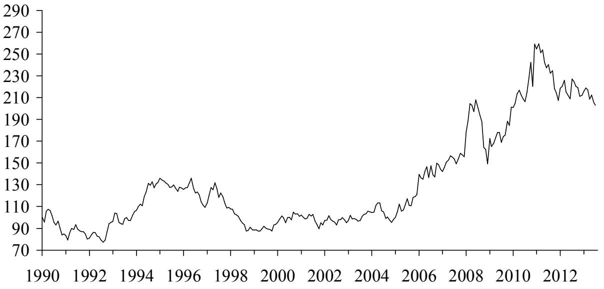
Commodity Price Index (Dollar)
(Economist, 2000=100)



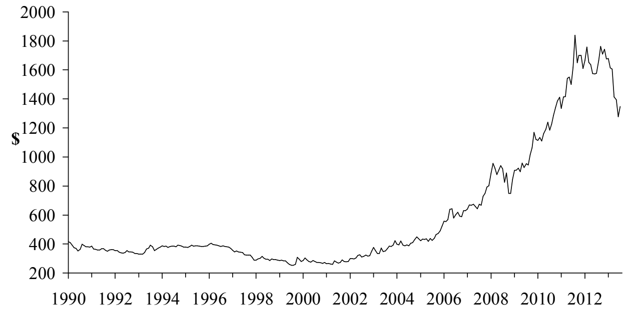
Oil Price: North Sea Brent (in Dollars)



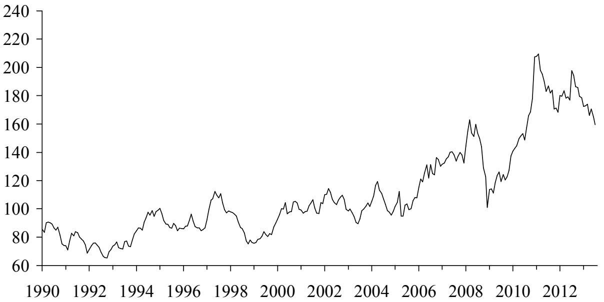
Commodity Price Index (Sterling)
(Economist, 2000=100)



Gold Price (in Dollars)



Commodity Price Index (Euro)
(Economist)



UK FORECAST DETAIL

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

	Inflation %[1] (CPI)	Short Dated (5 Year) Interest Rates	3 Month Int. Rates	Nominal Exchange Rate (2005=100)[2]	Real Exchange Rate[3]	Real 3 Month Int. Rates %[4]	Inflation (RPIX)	Real Short Dated Rate of Interest[5]
2010	3.3	2.4	0.7	80.4	88.6	−3.5	4.8	−0.2
2011	4.5	2.0	0.9	80.0	89.8	−2.8	5.3	−0.2
2012	2.7	0.9	0.9	83.1	94.0	−1.7	3.2	−1.5
2013	2.7	1.3	0.9	82.6	94.3	−1.6	2.5	−0.9
2014	2.5	1.8	1.6	83.0	95.7	−0.6	3.1	−0.3
2015	2.2	2.1	2.1	82.3	95.4	0.1	2.8	0.1
2012:1	2.7	1.1	1.1	81.2	91.6	−1.8	3.8	−1.3
2012:2	3.0	0.9	1.1	83.2	94.3	−1.4	3.2	−1.4
2012:3	2.5	0.7	0.8	84.1	95.2	−1.7	2.9	−1.6
2012:4	2.5	0.8	0.6	83.7	94.9	−2.0	3.0	−1.5
2013:1	2.6	1.0	0.6	80.5	91.1	−2.0	3.0	−1.3
2013:2	2.8	1.3	0.9	83.2	95.2	−1.6	3.3	−0.9
2013:3	2.8	1.5	0.9	83.5	95.5	−1.6	3.3	−0.7
2013:4	2.7	1.5	1.1	83.2	95.4	−1.3	3.2	−0.6
2014:1	2.6	1.8	1.3	83.6	96.0	−1.1	3.1	−0.3
2014:2	2.5	1.8	1.6	83.0	95.8	−0.6	3.1	−0.3
2014:3	2.5	1.7	1.8	83.1	95.8	−0.3	3.1	−0.4
2014:4	2.4	1.8	1.8	82.4	95.2	−0.3	3.0	−0.2

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

Labour Market and Supply Factors (Seasonally Adjusted)

	Average Earnings (1990=100)[1]	Wage Growth[2]	Unemployment (New Basis) Percent[3]	Millions	Real Wage Rate[4] (1990=100)
2010	227.1	2.4	4.6	1.50	135.6
2011	232.7	2.5	4.6	1.53	133.5
2012	237.1	1.9	4.7	1.59	132.5
2013	242.3	2.2	4.5	1.53	131.8
2014	248.5	2.6	4.2	1.43	131.9
2015	256.6	3.2	3.9	1.31	133.3
2012:1	234.7	0.7	4.8	1.61	132.4
2012:2	235.8	1.8	4.8	1.59	131.9
2012:3	237.4	1.9	4.7	1.57	132.5
2012:4	240.5	3.3	4.6	1.56	133.2
2013:1	241.8	3.0	4.6	1.54	133.0
2013:2	242.1	2.7	4.6	1.55	131.7
2013:3	242.0	2.0	4.5	1.54	131.4
2013:4	243.1	1.1	4.5	1.51	131.0
2014:1	245.1	1.3	4.4	1.48	131.4
2014:2	248.1	2.5	4.3	1.45	131.7
2014:3	249.4	3.0	4.2	1.42	132.1
2014:4	251.5	3.4	4.1	1.39	132.4

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

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

	Expenditure Index	£ Million '90 prices	Non-Durable Consumption[2]	Private Sector Gross Investment Expenditure[3]	Public Authority Expenditure[4]	Net Exports[5]	AFC
2010	143.2	685816.8	412464.1	222982.1	180596.2	−35977.3	94248.2
2011	144.8	693480.0	405707.9	232196.6	179249.7	−24641.9	99032.3
2012	145.1	694662.2	405184.0	235764.3	184689.2	−30801.2	100173.9
2013	146.8	702861.9	405176.8	223498.2	188405.4	−30067.7	84149.4
2014	150.0	718141.3	408306.9	241326.9	189177.7	−31205.7	89481.4
2015	153.6	735702.5	414580.1	250992.1	193479.8	−31157.8	92210.8
2010/09	1.7		0.3	11.0	0.1		8.3
2011/10	1.1		−1.6	3.8	−0.8		4.5
2012/11	0.2		−0.1	2.5	3.0		3.0
2013/12	1.2		0.0	−5.3	2.0		−16.0
2014/13	2.2		0.8	8.6	0.4		7.3
2015/14	2.4		1.5	4.0	2.3		3.1
2012:1	145.2	173777.2	101162.8	53040.9	48062.2	−6746.9	21741.9
2012:2	144.4	172906.5	101177.7	59892.9	44993.0	−8401.7	24755.4
2012:3	145.5	174189.9	101200.0	60648.4	45617.7	−7536.4	25739.8
2012:4	145.2	173788.7	101643.4	62182.0	46016.3	−8116.2	27936.9
2013:1	145.5	174253.1	101590.2	48881.4	48201.0	−6636.6	17782.9
2013:2	146.5	175446.1	101360.9	56536.5	45914.8	−7812.6	20545.8
2013:3	147.2	176195.9	101183.7	57185.3	48587.9	−7810.2	22948.1
2013:4	147.8	176966.8	101041.9	60894.9	45701.7	−7808.3	22872.6
2014:1	148.7	177984.2	101428.2	59849.8	46404.1	−7808.4	21893.9
2014:2	149.5	179011.0	101842.3	60408.6	46695.4	−7801.3	22139.1
2014:3	150.4	180074.6	102284.4	58779.4	49462.5	−7797.5	22657.5
2014:4	151.2	181071.5	102752.0	62289.0	46615.7	−7798.5	22791.0

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

Financial Forecast

	PSBR/GDP %[1]	GDP[1] (£bn)	PSBR (£bn) Financial Year	Debt Interest (£bn)	Current Account (£ bn)
2010	8.5	1319.8	112.6	36.6	−40.0
2011	6.5	1399.3	91.0	43.0	−22.5
2012	4.8	1425.0	68.4	46.9	−59.2
2013	8.1	1471.0	119.7	51.2	−60.7
2014	6.9	1541.7	106.0	56.6	−62.9
2015	5.9	1613.2	94.6	60.3	−63.5
2012:1	4.1	346.6	14.4	11.5	−12.5
2012:2	1.3	353.4	4.6	11.4	−17.8
2012:3	5.7	358.3	20.3	11.8	−15.3
2012:4	8.9	364.3	32.6	11.8	−13.6
2013:1	3.1	349.1	10.9	12.0	−14.5
2013:2	8.2	360.4	29.6	12.5	−17.1
2013:3	8.8	367.0	32.4	12.6	−15.9
2013:4	7.3	370.7	27.0	12.9	−13.2
2014:1	8.2	372.9	30.7	13.3	−16.3
2014:2	7.2	379.2	27.4	13.7	−17.3
2014:3	8.4	383.1	32.4	14.1	−16.0
2014:4	6.9	387.4	26.6	14.2	−13.3

1 GDP at market prices (Financial Year)

WORLD FORECAST DETAIL

Growth Of Real GNP

	2009	2010	2011	2012	2013	2014
U.S.A.	–2.6	2.4	1.8	2.2	2.2	2.8
U.K.	–3.9	1.7	1.1	0.2	1.2	2.2
Japan	–6.3	4.7	–0.5	1.9	1.8	1.6
Germany	–4.7	4.2	3.0	0.7	0.6	1.5
France	–2.5	1.6	2.0	0.0	–0.4	0.7
Italy	–5.1	1.7	0.5	–2.4	–1.8	0.4

Growth Of Consumer Prices

	2009	2010	2011	2012	2013	2014
U.S.A.	–0.3	1.6	3.1	2.1	1.6	2.0
U.K.	1.3	3.3	4.5	2.7	2.7	2.5
Japan	–1.4	–0.7	–0.3	0.0	0.0	2.0
Germany	0.4	1.2	2.0	2.0	1.7	2.0
France	0.1	1.5	2.1	2.0	1.6	1.5
Italy	0.8	1.5	2.8	3.0	2.8	1.6

Real Short-Term Interest Rates

	2009	2010	2011	2012	2013	2014
U.S.A.	–1.6	–3.0	–1.8	–1.9	–1.3	–1.2
U.K.	–0.3	–3.5	–2.8	–1.7	–1.6	–0.6
Japan	1.1	0.4	0.4	0.3	–1.6	–1.6
Germany	–0.4	–1.9	–0.5	–1.5	–1.5	–1.4
France	–0.8	–1.7	–0.5	–1.4	–1.5	–1.4
Italy	–0.8	–2.4	–1.5	–2.6	–2.0	–1.4

Nominal Short-Term Interest Rates

	2009	2010	2011	2012	2013	2014
U.S.A.	0.2	0.1	0.3	0.1	0.7	0.8
U.K.	1.1	0.7	0.9	0.9	0.9	1.6
Japan	0.1	0.1	0.4	0.3	0.4	0.4
Germany	0.7	0.4	1.5	0.2	0.5	0.6
France	0.7	0.4	1.5	0.2	0.5	0.6
Italy	0.7	0.4	1.5	0.2	0.5	0.6

Real Long-Term Interest Rates

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

Nominal Long-Term Interest Rates

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

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

	2009	2010	2011	2012	2013	2014
U.S.A.	88.7	87.4	85.7	90.4	97.3	99.1
U.K.	76.7	78.9	80.0	83.7	84.0	85.2
Japan	89.0	92.0	97.1	98.3	119.7	122.0
Germany	105.8	102.9	105.5	104.3	107.4	108.2
France	104.3	103.1	105.5	104.9	107.9	108.6
Italy	105.4	103.6	106.9	107.4	111.8	113.2

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

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

	2009	2010	2011	2012	2013	2014
U.S.A.[1]	85.98	83.73	78.08	80.90	85.50	85.40
U.K.	1.57	1.55	1.61	1.59	1.56	1.56
Japan	93.54	87.48	79.36	80.51	98.00	98.00
Eurozone	0.72	0.75	0.71	0.78	0.79	0.78

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

* Forecasts based on the Liverpool World Model