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Quarterly Economic Bulletin

Julian Hodge Institute of Applied Macroeconomics

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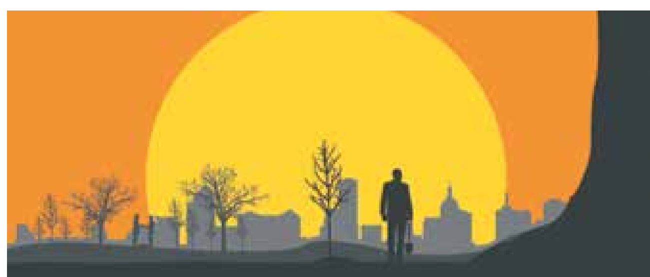
"The British public ... are scornfully disregarding the daily scare stories about 'No Deal' put about by the Remain lobbies. WTO rules prevail for other countries outside the EU and they do not cause queues at the border, or stop aircraft flying, or interrupt energy supplies (look at the Russian gas piped into Germany). WTO rules are in fact highly prescriptive: such things as border hold-ups and discrimination on standards are simply illegal, and the EU knows this which is why it does not try them on with third countries such as we will shortly become."



Commercial Lending

Commercial Deposits

Based in the heart of Cardiff, Hodge Bank continues to be one of Wales' leading success stories in the financial services market.

Hodge Bank specialises in providing key products and services to commercial clients. This includes the provision of funding facilities for property developers where the Bank caters for the specific requirements of a client through speed of response and flexibility of approach, rather than the adoption of a "one size fits all" strategy.

These projects are not restricted to the principality however, with clients located across the UK. The Bank has seen its business continue to grow and its client base expand during the last year. Demand for its products and services remains very high in what is still a competitive market place.

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With the Brexit negotiations still deadlocked the UK economy is growing steadily after a weak weather-related first quarter; there is very full employment, wage growth is finally picking up towards 3%, and with total hours flat productivity is growing more strongly too. The public finances are improving rapidly and the public debt ratio falling. The world economy is also growing well, at the top of the 3-4% range, led by an ebullient US and with large excess capacity still in commodities. Monetary policy is being tightened in the US and gradually also here, with the EU likely to follow soon. This is making waves for poorly managed emerging market economies; but generally they are weathering this re-entry into more normal monetary conditions.

The Chequers Proposals are Damaging: There are Better Alternatives 22

Patrick Minford

Mrs. May's government has finally come up with the 'Chequers' proposals for a trade deal with the EU (in areas other than trade deals are largely agreed). The Chequers proposals however are proving unacceptable to UK public opinion, especially that of Leavers, because they surrender control of most economic regulations to the EU; and also to the EU, because they do not propose free EU immigration into the UK or workable customs arrangements. A good alternative for both sides would be 'Canada+', a straightforward free trade deal. Otherwise if no trade deal can be agreed, trade relations governed by WTO rules would work well for the UK but lose the EU some vital revenues.

THE STRANGE IMPERTURBABILITY OF THE BRITISH ECONOMY

The political classes are in uproar, arguing over the various possible forms of Brexit, including one with no EU trade deal at all, exiting under WTO rules. Yet the economy sails on serenely, clocking up yet more record employment, with inflation coming down towards its target, interest rates finally rising, productivity recovering, the balance of payments improving and growth proceeding close to 2% (and on the latest ONS three month estimate May-July at a 2.6% annual rate). The pro-Remain media trumpet the 'uncertainties' and even the possible 'terrors' of no trade deal; and no one takes any notice apparently, outside the usual representatives of 'industry' such as the CBI.

What on earth is going on? We sometimes hear from pundits that ordinary people are ignorant of economic issues. Yet when we check the behaviour of their economies we typically find that their expectations are rational. This is not surprising since it is their interests that are at stake; and it is a stupid person indeed who ignores his or her very own interests.

The truth is that ordinary people have got this right: they realise that for all the posturing by politicians trade will continue largely undisturbed by Brexit but that Brexit will bring some longer term trend changes that they have by a substantial majority approved. The formal referendum majority was 4%. But it is well-known from previous polls that British opinion has been by a much larger majority 'euro-sceptic' for a very long time; when they joined the EEC they did not expect or want to be ruled by Brussels in the way things turned out and then have threatened to go further in the journey towards political union. Probably a fair percentage of the electorate was sufficiently scared by the doom-laden warnings of Project Fear into voting Remain. Those warnings proved the opposite of the truth. Now we know from the same polls that the vast majority of the electorate regard the issue of Brexit as settled and want the government just to 'get on with it'.

Nor are they worried that the government will somehow renege on 'full Brexit'. The British have enormous confidence in their democracy. They know full well that no government can survive by standing out against settled public opinion. The Conservatives are now reacting sharply to the unpopularity of this government's Chequers proposals which have greatly alienated the referendum majority and caused a swing away from the Conservatives that could be sufficient to let in a Corbyn government.

In an astonishing development, Mrs. May finally threw off all subterfuge and pushed through these Chequers proposals under which the UK effectively stays in the Single Market for goods. This volte-face from her Mansion House speech is described by her with her typical respect

Table 1: Summary of Forecast

	2016	2017	2018	2019	2020	2021	2022
GDP Growth[1]	1.9	1.8	1.5	1.9	2.0	2.1	2.3
Inflation CPI	1.1	2.6	2.5	2.2	2.0	2.0	2.0
Wage Growth	2.4	2.9	2.7	2.4	1.7	2.4	2.3
Unemployment (Mill.)[2]	0.8	0.8	0.8	0.8	0.7	0.7	0.6
Exchange Rate[3]	82.1	77.4	77.4	76.2	75.4	75.5	75.2
3 Month Interest Rate	0.5	0.4	0.6	1.1	2.4	3.1	3.1
5 Year Interest Rate	0.7	0.6	1.5	2.5	3.4	2.9	2.6
Current Balance (£bn)	-90.9	-66.3	-60.3	-49.5	-39.7	-31.0	-17.9
PSBR (£bn)	45.1	39.4	30.7	21.8	5.6	-6.7	-15.1

[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)

for the English language as an 'evolution'. These proposals cannot, even if agreed to by the EU in their present form, get through the House of Commons because of massive Brexiter opposition both in the Commons and in the country. Furthermore the EU will anyway insist on further 'evolution'. They may also be vetoed by the European Parliament.

The British public know this. They are scornfully disregarding the daily scare stories about 'No Deal' put about by the Remain lobbies. WTO rules prevail for other countries outside the EU and they do not cause queues at the border, or stop aircraft flying, or interrupt energy supplies (look at the Russian gas piped into Germany). WTO rules are in fact highly prescriptive: such things as border hold-ups and discrimination on standards are simply illegal, and the EU knows this which is why it does not try them on with third countries such as we will shortly become.

The irony therefore of the present negotiations between the EU and the UK government within the Chequers framework is that the discussions can easily be 'pivoted' into a Canada+ framework where essentially the same 'access' will be achieved, but without the paraphernalia of the Chequers-proposed 'EU rulebook'. The Chequers proposals simply cannot ultimately be agreed by either side: ours because it requires foreign rule, the EU's because it does not include the 'fourth freedom' of free migration. The sharpest irony is that it will be the EU in the end that is the keenest on this pivot to Canada+ to avoid the for-it disastrous effects of no trade deal; but Mrs. May will happily agree to pivot too, as it will save her from being crushed by a very unhappy Conservative Party.

Policy and the economy

The Bank of England has now reconciled itself broadly to Brexit. It is now eager to retake its role as regulator of the City in world markets. In its monetary policy judgements it is returning to normal analysis, arguing that whatever the trends in the economy due to non-monetary factors such as Brexit or productivity drivers it is simply its job to control

inflation, not to try and use monetary policy to offset such trends- which it is incapable of affecting anyway in anything other than the very short term.

The last policy shoe to fall is the Treasury. This remains unreconciled to Brexit. In this attitude it reminds one of HM Treasury in the very early years of Mrs. Thatcher, unreconciled then to her monetarist policies. Then as now it staged a mandarin rebellion. After a decent interval those mandarins had to go, having totally misjudged the democratic mood.

The Treasury is playing the game of announcing doom-laden forecasts still. Yet as Denis Healey memorably remarked 'when in a hole, stop digging'. The Treasury's predictions of doom were so badly wrong that they are entirely discredited as a forecasting organisation- even the new Brexit secretary has poked fun at them. Embarrassingly for the Treasury, in their home area of revenue, the money now keeps pouring in. The PSBR keeps on contracting, with the latest forecast for 2018-19 coming down to £30 billion, 1.5% of GDP, with the public debt/GDP ratio now having fallen steadily since 2015 (remembering to use the right debt definition, which must exclude all the Bank of England's market operations, as we explained in our last Bulletin).

It is high time the Treasury came round to accepting Brexit and making policy to optimise our economic prospects, building on the free trade and potential deregulation it will bring. For all the Remain efforts to defend our position within a protectionist EU, the truth has always been that free trade brings benefits in the form of lower prices and more competition. Furthermore this freedom does not need to come at the expense of barriers with the EU: even under WTO rules these barriers will consist solely of tariffs which are in general fairly low but under Canada+ they will be effectively non-existent. In any case once our markets are open to the world, any barriers with the EU will have an insignificant effect on our economy.

In the Economists for Free Trade 'Budget for Brexit' (see their webpage) the possibilities for imaginative Treasury policies on tax and public spending were carefully set out. For this Conservative government they suggested that at last the Treasury could get away from its position of endless austerity and create opportunities for greater growth.

The economic outlook at home and abroad

With plenty of excess capacity in world raw material markets the world outlook remains good for a long period ahead. The main challenge for the UK is to create growth from rising productivity now that the economy is hitting up against the limits of full employment. Some of this will occur naturally but after long years of austerity and a negative approach to growth-friendly policy the government now has a good chance to grasp the growth-creating opportunities from Brexit. Improved infrastructure, reformed funding of the NHS, and tax cuts can all usher in a new environment that will build on the extra productivity coming directly from Brexit itself.

The usual round of 'Brexit analyses' from City and other firms continues- 'showing' that growth has been lower than it would have been because of Brexit. The favourite method, used by several already including the Bank of England and now recycled by UBS in a recent offering, is to create a 'comparator group' of countries and to compare their growth and other behaviour with that of the UK. These countries can be a variety, such as euro-zone or North American. The problem with this method for judging business cycle behaviour is simple and damning: cyclical experience is highly individual if one is judging percent changes over very short periods. Consider for example the specific experience of the euro-zone compared with the UK's: it weathered the early financial crisis well, then the euro's own crisis hit, then there was a late burst of QE from the ECB, finally it is coping with difficult banking problems across the zone but especially in Italy. Or consider the US with its 'Trump effect'. The margin of error due to non-comparable features is simply too great to estimate differences in short term growth of a few percent. The method has reasonable validity when one looks at long periods of growth: for example if you compare the much faster growth of mainland Europe from 1945 to 1979 with the UK's you can reasonably treat this as evidence that we failed to achieve our potential during that period. In this case of a long period of history enough features of the two economies are similar to use the difference in long run growth to support good analysis based on economic modelling.

We have argued before that it is hard to ascribe any significant 'demand effect' to Brexit when the UK economy keeps on setting employment records in the region of full employment: could we have got 'more than full' employment without Brexit? On the supply side, any effect on investment would have only a miniscule effect on the capital stock (this being some 20 times the size of investment). As for productivity how could Brexit affect that, a longstanding 'puzzle' since the financial crisis hit? Brexit will have its long run effect on the supply side once it comes in. We will then be in a position to judge whether free trade has brought a productivity gain or whether a 'gravity effect' of distancing ourselves somewhat from the EU diminishes it at all, contrary to our research assessments.

Meanwhile the business of normalising monetary conditions needs to continue with due deliberate speed. As we have argued before, now that the economy is plainly not in the financial crisis situation any more, crisis monetary policy must be brought to an end. Interest rates need to go on rising and the Bank needs to sell off its government bonds.

The public finances tell the tale of the steadily improving economy

It is now ten years since the financial crisis struck, gaining ferocity in September 2008 with the collapse of Lehman. Recession began in 2008 with a fall in GDP of 0.5%, followed by a fall of 4.2% in 2009. It took three slow years to get GDP back to its pre-crisis 2007 level. By 2017 GDP had grown by an accumulated 11.2% above that level.

This recovery from the Great Recession has been accompanied by an 'austerity' programme conducted first by the Coalition government of 2010 and since the 2015 election by the Conservative government. Public debt as a percentage of GDP, excluding the Bank of England's monetary operations and also the various bank bailouts, peaked at 81% in 2015 and is now down to 75.2% at end July. Public Sector Borrowing fell in the 2017/18 financial year to £39.4 billion, or 1.9% of GDP. This borrowing rate if it persisted would lower the debt/GDP percentage by about 1 percentage point a year, as GDP growth would more than offset the effect of new borrowing. But on present minimalist Treasury policies the PSBR is also falling steadily as a percent of GDP. It follows that the UK is now moving, slowly but encouragingly, towards a target safe debt percentage of around 60%.

The latest PSBR figures up to end-July are more encouraging still. Compared with the same period last year borrowing over April-July was £8.5 billion lower, at £16.8 billion. This suggests that we are well on track to undershoot our previous full year forecast of £35 billion for 2018/19. This compares with the OBR Budget forecast of £39.5 billion. However, with employment still growing and inflation at around 2%, incomes will be growing steadily during this financial year and revenue has a strong response to such steady growth. Income tax and VAT both grow about 1.5-2 times as fast as money GDP. We have revised our forecast downwards to £30 billion. On unchanged policies our forecasts now suggest that the UK will reach the 60% public debt to GDP target within five years.

Other indicators suggest the economy is picking up steam again after the weak, weather-affected, first quarter. The ONS estimate of GDP growth for Q2 is 0.4%, while the Purchasing Manager Indices are pointing to 0.5% in Q3; the ONS' May-July estimate for GDP growth is 0.6%, as noted above a 2.6% annual rate. The latest PMIs in August are well above the neutral no-growth level of 50: manufacturing 52.8, services 54.3- and construction 52.9, maintaining its recovery from its weather-related drop to 47 in March.

Meanwhile retail sales in the three months to July surged by 2.1% on the previous quarter; they were up 3.4% on a year earlier, establishing that consumer spending is rising rather strongly again. Unemployment continued to fall, to 4.0% in May-July from 4.3% a year ago, and employment as a share of the labour force aged 16-64 to rise, to 75.5% from 75.3% a year ago, defying the labour market's increasing tightness. Total weekly hours were unchanged over the past year; this suggests that productivity (per hour) may at last be recouping some of its past sluggishness as the labour market tightens.

The economy is also rebalancing away from its excessive balance of payments deficits on current account. The quarterly deficit peaked at 6.7% of GDP in 2015 and averaged 5.9% of GDP in 2016. By Q1 2018 it had fallen to 3.4% of GDP. Most of this has been due to trade, with some coming from net foreign income. It is plainly due to the Brexit devaluation which has stimulated net exports at the expense of consumption demand.

For an economy so long in the tooth in its recovery from the shock of the Great Recession this is a good picture as we move into the age of applied AI and robotics, which supposedly threaten jobs but promise large gains in productivity. A strong labour market and a budget in good shape is a good background from which to cope with this promise and threat. Jobs can be relocated, without high unemployment, and demand can be supported by fiscal expansion. As we have explained before, the opening of the economy to free trade and better regulation via Brexit should boost productivity and further strengthen the budget.

This is also a time to move monetary policy away from its 'emergency loose' settings before they trigger more serious distortions in asset markets and the economy; savers and small firms must once again be treated normally by the markets for borrowing, and the government and large firms must stop having their privileged access to ultra-cheap money. Besides, if this is not done, we will have lost the monetary policy tools to sustain the economy when the going gets difficult again.

THE UK ECONOMY

Vo Phuong Mai Le

The economy's growth has picked up sharply from the weather-related weakness of the first quarter. Real GDP on the preliminary estimate rose 0.4% in Q2, up from 0.2% in Q1. While services (0.5%, up from 0.3% in Q1) and construction (0.9% after a collapse of -0.8% in Q1) sectors expanded strongly, manufacturing shrank unexpectedly (-0.9% in Q2, following -0.1% in Q1). The ONS has estimated growth of 0.6% in the three months May-July, suggesting that Q3 may show 0.5% growth or even more.

Recent data and surveys signal a continuous economic expansion in all sectors in Q3. Of the August PMIs, all well comfortably above the 50 zero-growth point. For the services sector the PMI rose to 54.3 in August from 53.5 in July; for manufacturing it dipped to 52.8 from 53.8 in July; and for construction it was 52.9.

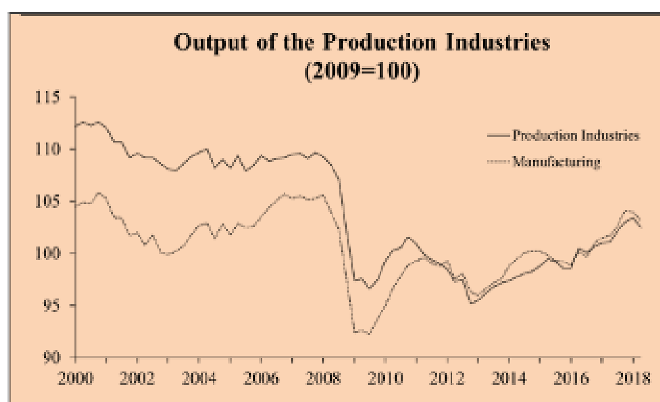
Labour market, costs and prices

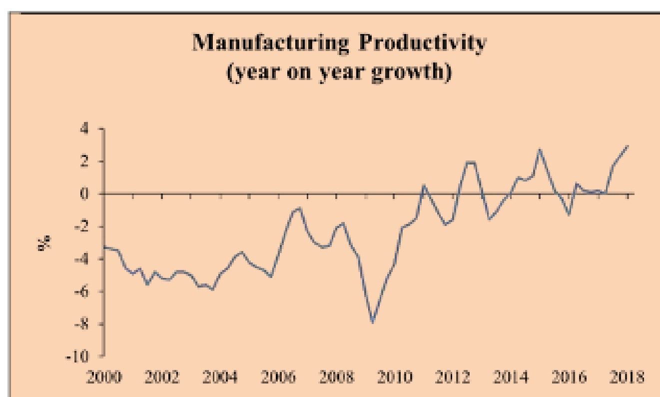
The labour market remained tight. The unemployment rate in Q2 remained at 4%. The employment rate for the three months to July was 75.5%, marginally down from 75.6% in February-April period. Working hours have remained flat. The tightened labour market has finally started translating into higher wage growth. Average earnings, excluding bonuses, increased by 2.9% in the three month of May-July compared with a year earlier, up from 2.7% in April-June. However, productivity is now also rising finally which is keeping unit labour costs below the inflation rate for now.

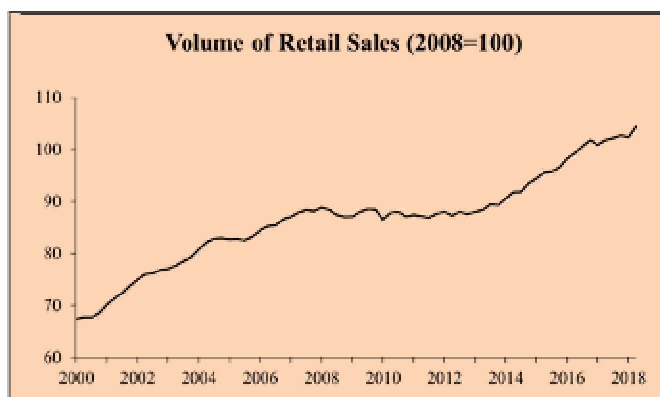
CPI year-to-year inflation was 2.5% in July, up from 2.4% in all three previous months. Part of this increase was a result of higher energy prices and the continued pass-through of the sterling depreciation. Input price annual inflation rose 10.9% in July, up from 10.3% in June. The Bank of England expected an increase in inflation in the short term due to higher import prices. It appears to believe that this import element will soon have passed through and that the path of wage growth will return inflation expectations to the Bank target of 2% in the medium term. Annual factory gate inflation for all manufactured products was 3.1% in July, down from 3.3% in June.

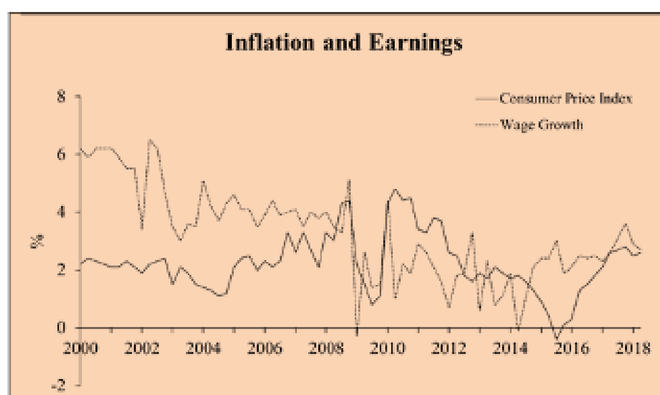
Fiscal and Monetary Developments

Given better economic growth and the inflation rate persisting above its target, the Bank of England raised the Bank rate by 0.25 percentage points to 0.75% in the August meeting. It left unchanged the current level of bond stocks purchased by printing money and central bank reserves (`Quantitative Easing'), at £435 billion in gilts and £10 billion in corporates.



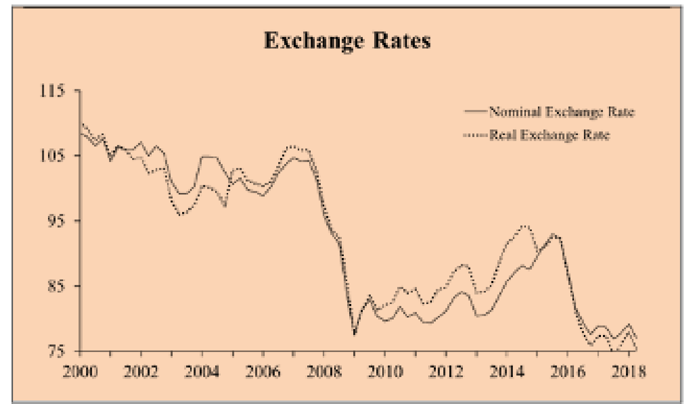


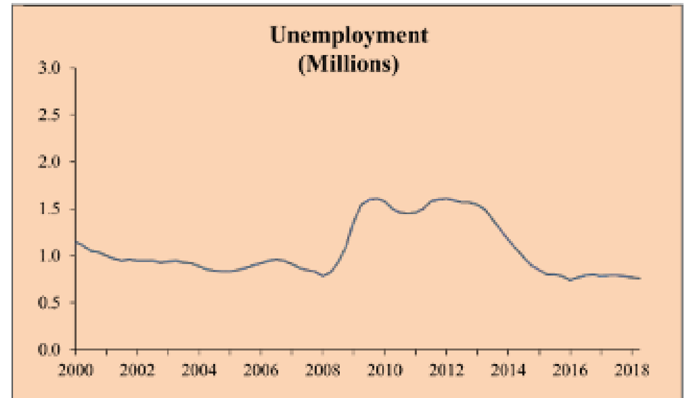


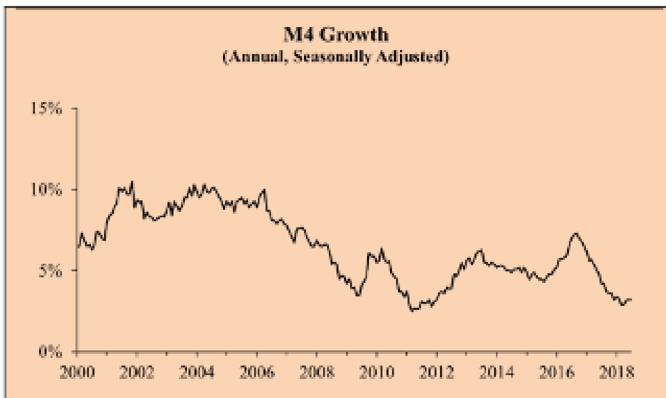


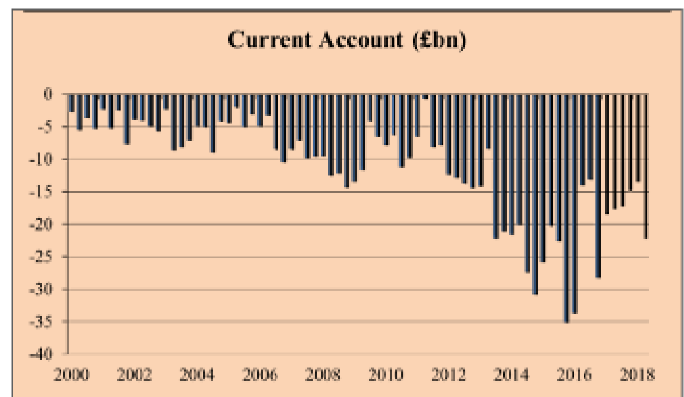
The growth rate of notes and coins in circulation was -0.3% in August on a year earlier. The year-on-year aggregate credit growth, M4 lending excluding intermediate OFCs, was 3.3% in July, up from 3.1% in June. This rate shows a significant slowdown in credit growth since 2016, and has contributed to a slowdown in money growth. The year-on-year growth rate of broad money-M4, excluding intermediate other financial corporations (OFCs), rose 3.4% in July, unchanged from the previous month. This represents a tightening of monetary policy, which could well slow the economy unless other action is taken. It would be as well if bank regulation was eased, as it has been in the US, in order to stimulate credit and money growth.

In July, the government's tax revenue exceeded its spending by £2 billion. It was the biggest surplus since July 2000. In the fiscal year 2018/2019 the total public net borrowing was £12.8 billion, down from £21.3 billion in the same period in 2017/2018. It is the lowest year-to-year borrowing for 16 years. The continuous reduction in net borrowing continues to facilitate a further reduction in net debt as a percentage of GDP. At the end of July 2008, public sector net debt (excluding both public sector banks and Bank of England) was £1584.6 billion or 75.2% of GDP. This compares with 78.9% of GDP in July 2017.









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]
2017	2.6	0.6	0.4	77.4	75.5	-1.6	3.8	-1.5
2018	2.5	1.5	0.6	77.4	75.8	-1.5	3.5	-0.5
2019	2.2	2.5	1.1	76.2	74.9	-1.0	2.9	0.5
2020	2.0	3.4	2.4	75.4	74.3	0.4	2.6	1.4
2021	2.0	2.9	3.1	75.5	74.9	1.0	2.5	0.9
2022	2.0	2.6	3.1	75.2	74.8	1.1	2.6	0.6
2017:1	2.2	0.6	0.3	76.8	75.0	-1.7	3.3	-1.5
2017:2	2.6	0.4	0.4	78.2	76.4	-1.5	3.8	-1.7
2017:3	2.7	0.6	0.3	76.7	74.5	-1.5	4.0	-1.5
2017:4	2.8	0.8	0.4	77.9	76.0	-1.7	4.1	-1.3
2018:1	2.5	1.0	0.5	79.2	78.0	-1.6	3.6	-1.0
2018:2	2.6	1.5	0.5	77.0	75.4	-1.7	3.6	-0.5
2018:3	2.5	1.8	0.8	77.1	75.4	-1.4	3.5	-0.2
2018:4	2.5	1.8	0.8	76.2	74.4	-1.4	3.4	-0.2
2019:1	2.2	2.5	0.8	76.6	75.4	-1.3	2.9	0.5
2019:2	2.2	2.5	1.0	76.5	75.4	-1.1	2.9	0.5
2019:3	2.2	2.5	1.0	75.9	74.4	-1.0	2.8	0.5
2019:4	2.2	2.5	1.5	75.7	74.3	-0.5	2.9	0.5
2020:1	2.1	3.0	2.1	75.5	74.3	0.1	2.7	1.0
2020:2	2.1	3.0	2.1	75.3	74.3	0.1	2.7	1.0
2020:3	2.0	3.8	2.0	75.6	74.4	0.0	2.5	1.8
2020:4	2.0	4.0	3.3	75.4	74.3	1.3	2.6	2.0
2021:1	1.9	3.0	3.2	75.2	74.4	1.2	2.4	1.0
2021:2	2.0	2.8	2.9	75.8	75.4	0.9	2.5	0.8
2021:3	2.0	2.8	3.0	76.0	75.3	0.9	2.5	0.8
2021:4	2.0	2.8	3.2	75.1	74.4	1.2	2.5	0.8
2022:1	1.9	2.7	3.2	75.7	75.3	1.1	2.4	0.7
2022:2	2.0	2.6	3.3	75.5	75.3	1.3	2.6	0.6
2022:3	2.0	2.5	2.9	74.9	74.3	0.9	2.6	0.5
2022:4	2.0	2.5	3.0	74.7	74.3	1.0	2.6	0.5

[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)
2017	259.1	2.9	2.2	0.8	141.7
2018	265.8	2.7	2.2	0.8	142.2
2019	272.3	2.4	2.1	0.8	142.5
2020	276.9	1.7	1.9	0.7	142.7
2021	283.4	2.4	1.9	0.7	142.3
2022	289.8	2.3	1.5	0.6	142.9
2017:1	258.1	2.3	0.8	142.2	190.2
2017:2	257.3	2.6	0.8	141.6	192.2
2017:3	260.2	3.1	0.8	142.7	194.0
2017:4	260.9	3.6	0.8	142.2	196.0
2018:1	264.6	2.9	0.8	142.8	196.1
2018:2	264.3	2.7	0.8	141.8	199.6
2018:3	267.0	2.6	0.8	142.9	201.3
2018:4	267.3	2.5	0.8	142.2	203.1
2019:1	269.7	2.0	0.7	142.3	203.0
2019:2	271.9	2.9	0.7	142.7	204.9
2019:3	272.8	2.2	0.7	142.9	206.7
2019:4	274.8	2.8	0.7	143.0	208.5
2020:1	275.3	2.1	0.7	142.3	208.4
2020:2	277.4	2.0	0.7	142.6	210.4
2020:3	277.1	1.6	0.7	142.3	212.2
2020:4	277.7	1.1	0.7	141.6	214.1
2021:1	282.5	2.6	0.7	143.3	214.0
2021:2	283.9	2.4	0.6	143.2	216.0
2021:3	283.6	2.4	0.6	142.8	217.9
2021:4	283.7	2.1	0.6	141.9	219.8
2022:1	288.1	2.0	0.5	143.3	219.7
2022:2	290.8	2.4	0.5	143.7	221.8
2022:3	289.7	2.2	0.5	143.0	223.7
2022:4	290.7	2.5	0.5	142.5	225.7

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
2017	162.3	777336.9	443745.6	302292.1	198857.7	-65371.5	102187.0
2018	164.7	788702.9	452535.4	300001.6	200246.3	-62820.3	101237.1
2019	167.8	803486.7	458033.7	303844.4	200602.7	-55631.9	103388.8
2020	171.1	819157.6	466811.5	305454.3	201938.2	-49424.8	105622.7
2021	174.6	836277.7	476328.1	309328.2	203070.4	-44408.2	108042.3
2022	178.6	855233.2	486139.0	312409.7	204308.6	-36921.2	110703.2
2017/16	1.8		0.6	0.8	0.4	-0.7	0.6
2018/17	1.5		2.0	-0.7	0.7	-0.8	2.0
2019/18	1.9		1.2	1.3	0.2	2.1	1.2
2020/19	2.0		1.9	0.5	0.7	2.2	1.9
2021/20	2.1		2.0	1.3	0.6	2.3	2.0
2022/21	2.3		2.1	1.0	0.6	2.5	2.1
2017:1	161.5	193340.7	110460.5	76110.0	50838.0	-16948.9	27118.9
2017:2	161.9	193817.5	111360.7	74039.4	48893.4	-16008.3	24467.6
2017:3	162.6	194710.8	110910.0	75858.8	49324.8	-15656.7	25726.1
2017:4	163.3	195468.0	111014.4	76284.0	49801.5	-16757.6	24874.3
2018:1	163.6	195906.9	110726.8	75395.5	51361.5	-16549.5	25007.4
2018:2	164.3	196658.4	113112.9	76462.4	49463.3	-17119.9	25257.6
2018:3	165.0	197581.8	114100.5	74023.6	49577.5	-14658.4	25458.2
2018:4	165.8	198555.8	114595.2	74120.1	49844.0	-14492.5	25513.8
2019:1	166.7	199543.9	113052.0	76413.1	50526.0	-14820.6	25636.7
2019:2	167.3	200322.9	114121.4	76582.8	50009.7	-14624.9	25773.7
2019:3	168.2	201324.8	115127.6	74790.6	50056.5	-12733.9	25925.3
2019:4	169.0	202295.1	115732.7	76058.0	50010.4	-13452.6	26053.1
2020:1	169.8	203298.7	115618.0	76877.1	50860.0	-13866.3	26192.1
2020:2	170.7	204318.6	116339.1	76180.8	50335.5	-12197.7	26338.8
2020:3	171.4	205259.6	117061.9	76323.5	50315.1	-11966.6	26474.2
2020:4	172.3	206280.7	117792.5	76072.8	50427.6	-11394.1	26617.5
2021:1	173.2	207302.5	118163.2	77790.4	51177.9	-13066.7	26763.1
2021:2	174.0	208319.9	118775.4	77524.6	50636.9	-11709.9	26907.2
2021:3	175.2	209811.5	119388.5	76993.4	50637.7	-10095.0	27112.6
2021:4	176.1	210843.8	120000.9	77019.8	50617.9	-9536.7	27259.3
2022:1	177.0	211888.0	120614.5	78065.4	51486.4	-10870.2	27407.3
2022:2	177.9	212936.6	121228.6	78213.5	50964.1	-9913.9	27556.1
2022:3	179.3	214686.5	121841.6	77992.8	50934.7	-8286.7	27796.2
2022:4	180.2	215722.2	122454.3	78138.1	50923.4	-7850.4	27943.7

[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)
2017	2.0	2047.3	39.4	79.9	-66.3
2018	1.4	2131.8	30.7	82.7	-60.3
2019	1.0	2219.8	21.8	87.5	-49.5
2020	0.2	2309.9	5.6	94.6	-39.7
2021	-0.3	2406.9	-6.7	98.0	-31.0
2022	-0.6	2513.2	-15.1	99.5	-17.9
2017:1	-2.9	507.9	-14.6	20.0	-15.7
2017:2	5.0	503.8	25.3	20.0	-20.5
2017:3	2.3	510.3	11.8	19.7	-15.3
2017:4	3.2	513.3	16.5	19.9	-14.8
2018:1	-2.7	520.0	-14.3	20.2	-13.4
2018:2	1.3	525.5	6.8	20.3	-22.2
2018:3	1.5	529.4	7.7	20.7	-13.5
2018:4	1.5	535.0	7.8	20.8	-11.3
2019:1	1.6	541.9	8.5	21.0	-10.8
2019:2	1.1	547.3	5.9	21.3	-18.4
2019:3	0.9	551.2	5.1	21.3	-10.6
2019:4	0.8	557.4	4.6	22.0	-9.6
2020:1	1.1	563.9	6.2	22.8	-9.4
2020:2	0.2	570.1	1.3	22.9	-14.7
2020:3	0.1	573.3	0.3	22.9	-9.4
2020:4	0.1	580.1	0.8	24.4	-6.2
2021:1	0.5	586.4	3.1	24.3	-8.1
2021:2	-0.1	592.9	-0.3	24.2	-13.9
2021:3	-0.3	598.0	-1.8	24.3	-6.1
2021:4	-0.4	604.8	-2.7	24.7	-2.9
2022:1	-0.3	611.1	-1.8	24.8	-4.1
2022:2	-0.2	618.7	-1.2	25.0	-10.9
2022:3	-0.6	624.5	-3.6	24.6	-3.0
2022:4	-0.9	631.7	-5.6	24.9	0.1

[1] GDP at market prices (Financial Year)

THE WORLD ECONOMY

US

The economy expanded at its fastest rate since 2014 Q3. Quarter-to-quarter real GDP rose over 1% in Q2, after growing 0.55% in Q1. All GDP expenditure components grew, but the main positive contribution came from an acceleration in private consumption (0.95% in Q2, after 0.125% in Q1) and net trade as exports surged (2.3% in Q2, after 0.9% in Q1) and imports decreased (-0.1% in Q2, after 0.75% in Q1). Net trade added 0.3 percentage points to quarterly GDP growth, after subtracting 0.005 percentage points in the previous quarter. Investment continued to expand, but at a significantly slower rate (0.1% in Q2, compared to 2.4% in Q1).

A strong pace of growth is also projected for Q3 by recent data and surveys. Consumer confidence was at an 18-year high of 133.4 in August, up from 127.9 in July. The Institute for Supply Management manufacturing index rose to 61.3 in August, up from 58.1 in July. This was its highest level since May 2004 and indicated that the sector has been expanding for 24 consecutive months.

The labour market continued to strengthen consistently with this economic growth performance. Job gains were strong. Nonfarm payrolls increased by 201,000 in August, after 147,000 jobs in July. It was the 95th consecutive month of job creation. The unemployment rate remained low at 3.9% in August, unchanged from the previous month. The tight labour market continued to push up wage growth and is now contributing to a higher inflation rate. Annual average hourly earnings rose by 2.9% in August, up from 2.7% in July. This is the highest growth since 2009. Annual inflation was 2.7% in August, down from 2.9% in July.

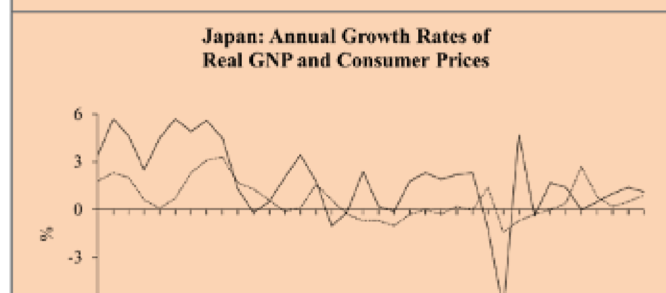
Given robust economic growth and rising inflation, the Federal Reserve continued a gradual tightening of monetary policy. In June it raised the target range for the federal funds rate to between 1.75% to 2%.

According to recent data and surveys the economic outlook for Q3 is not very bright. In July, industrial production contracted 0.1% month-on-month, after declining 1.8% in June. Consumer confidence fell to 43.3 in July from 43.7 in June, the lowest value recorded in a year.

US

	2013	2014	2015	2016	2017	2018
Real GDP Growth (% p.a.)	1.5	2.4	2.4	2.1	2.3	2.9
Inflation (% p.a.)	1.5	1.6	0.1	1.3	2.1	2.5
Real Short Int. Rate	–1.5	–0.1	–1.1	–1.4	–1.1	–0.2
Nominal Short Int. Rate	0.1	0.0	0.2	1.0	1.4	2.3
Real Long Int. Rate	1.6	0.7	0.3	0.3	0.3	0.6
Nominal Long Int. Rate	3.0	2.2	2.2	2.4	2.8	3.1
Real Ex. Rate (2000=100)[1]	82.1	83.9	93.0	94.0	94.5	94.8
Nominal Ex. Rate[2]	86.00	89.40	99.94	101.9	102.2	102.4

[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 of the real exchange rate.
[2] The series for the USA is a trade weighted index (1990=100)

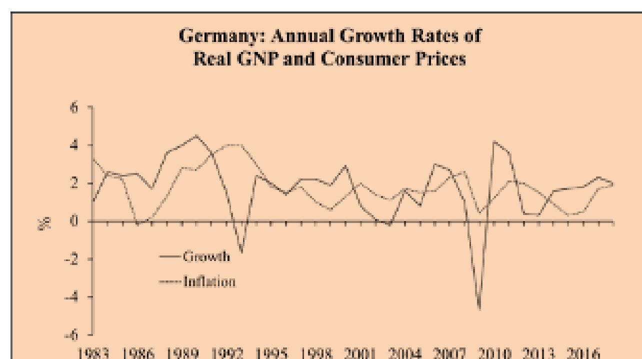


Germany

Growth picked up in Q2 with real GDP up 0.5%, following 0.4% in Q1. A positive contribution came from strong domestic demand with continuous expansion in consumption (0.3% after 0.5% in Q1) and investment (2.6% after 0.9% in Q1). On the other hand, net trade dragged economic growth lower as import growth (1.7%, after 0.2% in Q1) outpaced export growth (0.7%, after 0.3% in Q1).

The economic outlook for Q3 remains robust. The composite PMI was 55.7, up from 55.0 in July, implying that the private sector expanded at its fastest rate for six months. Business confidence in the private sector was 103.8 in August, up from 101.7 in July. It was the highest reading since February.

The labour market was robust. In July, seasonally adjusted harmonised unemployment rate remained at 3.4%, unchanged from June. Employment showed no growth, staying at 41.60 million.



German

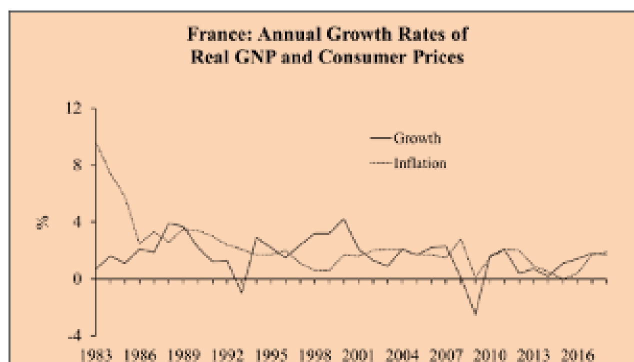
	2013	2014	2015	2016	2017	2018
Real GDP Growth (% p.a.)	0.3	1.6	1.7	1.8	2.3	2.0
Inflation (% p.a.)	1.5	0.9	0.3	0.5	1.7	1.9
Real Short Int. Rate	−0.6	−0.2	−0.6	−2.0	−2.0	−2.2
Nominal Short Int. Rate	0.3	0.1	−0.1	−0.2	−0.3	−0.3
Real Long Int. Rate	0.8	−0.8	−1.0	−1.6	−0.8	−1.3
Nominal Long Int. Rate	1.9	0.5	0.6	0.4	0.5	0.6
Real Ex. Rate (2000=100)[1]	99.0	99.9	94.7	95.0	94.1	94.9
Nominal Ex. Rate	0.75	0.76	0.90	0.95	0.83	0.85

[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 of the real exchange rate.

France

The economy has expanded steadily but weakly. Real GDP rose 0.2%, unchanged from its Q1 rate. The positive contribution came from investment (0.8%, up from 0.2% in Q1) and government consumption (0.3%, up from 0.1% in Q1). The negative contribution was due to a decrease in private consumption (-0.1% in Q2, after rising 0.2% in Q1) growth). Both exports and imports recovered in Q2, but the pace of imports growth (1.0%, after -0.4% in Q1) dominated that of exports (0.2%, after -0.4% in Q1)

The economic outlook for Q3 is uncertain. The household confidence index was 97 in August, unchanged from July. This is below the long term average of 100 for the 4th consecutive month. The business climate became less favourable with its composite index dropping from 114 in July to 111 in August.



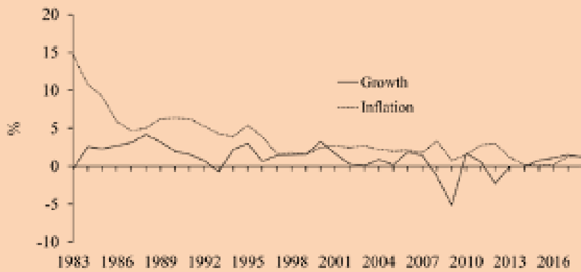
France

	2013	2014	2015	2016	2017	2018
Real GDP Growth (% p.a.)	0.7	0.2	1.1	1.4	1.8	1.7
Inflation (% p.a.)	0.9	0.5	0.0	0.4	1.0	1.9
Real Short Int. Rate	−0.2	0.1	−0.5	−1.5	−1.6	−2.2
Nominal Short Int. Rate	0.3	0.1	−0.1	−0.2	−0.3	−0.3
Real Long Int. Rate	1.1	−0.5	−0.8	−1.4	−0.4	-1.0
Nominal Long Int. Rate	1.9	0.5	0.6	0.4	0.9	0.9
Real Ex. Rate (2000=100)[1]	100.7	100.8	96.2	96.0	95.2	95.1
Nominal Ex. Rate[2]	0.75	0.76	0.90	0.95	0.83	0.85

[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 of the real exchange rate.

Italy

The economic recovery continued in Q2 but at a slower pace. Real GDP rose 0.2% in Q2, down from 0.3% in Q1. Domestic demand continued to contribute positively to quarterly growth. Consumption grew weakly (0.1%, after 0.4% in Q1) but there was a strong rebound in fixed investment (2.9% in Q2, after -1.4% in Q1). Net trade continued to drag the economy down. It subtracted 0.5 percentage points from Q2 GDP growth, after 0.4 percentage points in the previous quarter: exports declined in both quarters (0.2%, after 2.1% in Q1) and imports grew by 1.8%, after declining 0.9% in Q1. Recent surveys signal very weak growth for Q3. The manufacturing PMI declined from 51.5 in July to 50.1 in August, the lowest level for two years. The composite business confidence index dropped from 105.3 in July to 103.8 in August, the lowest level since January 2017.



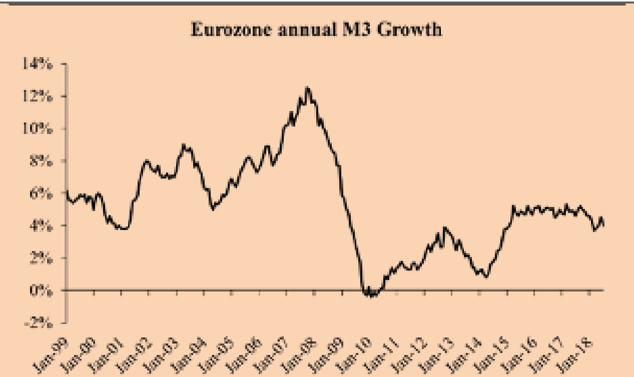
Italy

	2013	2014	2015	2016	2017	2018
Real GDP Growth (% p.a.)	–1.7	–0.3	0.8	1.1	1.5	1.2
Inflation (% p.a.)	1.2	0.2	0.1	0.2	1.3	1.3
Real Short Int. Rate	0.1	0.0	–0.3	–1.6	–1.4	–1.6
Nominal Short Int. Rate	0.3	0.1	–0.1	–0.2	–0.3	–0.3
Real Long Int. Rate	1.2	–0.5	–0.7	–1.3	1.2	1.8
Nominal Long Int. Rate	1.9	0.5	0.6	0.4	2.3	3.1
Real Ex. Rate (2000=100)[1]	106.9	107.5	102.1	102.0	101.1	101.0
Nominal Ex. Rate[2]	0.75	0.76	0.90	0.95	0.83	0.85

[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 of the real exchange rate.

Euro-zone monetary policy

The Harmonised Index of Consumer Prices inflation rate was 2.0% in August, down from 2.1% in July. The European Central Bank (ECB) kept its interest rates unchanged at its September meeting. It expects these rates to be kept at current levels at least through the summer 2019 to support the inflation target. It also reconfirmed its commitment to end asset purchases by the end of 2018. Until then the ECB will reduce the monthly pace of the net asset purchases to 15 billion euro until December.



WORLD FORECAST DETAIL

Growth Of Real GNP

	2013	2014	2015	2016	2017	2018
U.S.A.	1.5	2.4	2.4	2.1	2.3	2.9
U.K.	2.2	2.9	2.2	2.3	1.9	1.5
Japan	1.4	–0.1	0.5	1.0	1.4	1.1
Germany	0.3	1.6	1.7	1.8	2.3	2.0
France	0.7	0.2	1.1	1.4	1.8	1.7
Italy	–1.7	–0.3	0.8	1.1	1.5	1.2

Growth Of Consumer Prices

	2013	2014	2015	2016	2017	2018
U.S.A.	1.5	1.6	0.1	1.3	2.1	2.5
U.K.	2.3	1.7	0.2	1.2	2.6	2.5
Japan	0.4	2.7	0.8	0.2	0.5	0.9
Germany	1.5	0.9	0.3	0.5	1.7	1.9
France	0.9	0.5	0.0	0.4	1.0	1.9
Italy	1.2	0.2	0.1	0.2	1.3	1.3

Real Short-Term Interest Rates

	2013	2014	2015	2016	2017	2018
U.S.A.	–1.5	–0.1	–1.1	–1.1	–1.1	–0.2
U.K.	–0.8	–2.2	-0.5	–1.5	–2.2	–1.5
Japan	–2.5	–0.6	0.0	–0.7	–0.8	–0.8
Germany	–0.6	–0.2	–0.6	–2.0	–2.0	–2.2
France	–0.2	0.1	–0.5	–1.5	–1.6	–2.2
Italy	0.1	0.0	–0.3	–1.6	–1.4	–1.6

Nominal Short-Term Interest Rates

	2013	2014	2015	2016	2017	2018
U.S.A.	0.1	0.0	0.2	1.0	1.4	2.3
U.K.	0.6	0.6	0.6	0.4	0.4	0.6
Japan	0.2	0.2	0.2	0.0	0.1	0.1
Germany	0.3	0.1	–0.1	–0.2	–0.3	–0.3
France	0.3	0.1	–0.1	–0.2	–0.3	–0.3
Italy	0.3	0.1	–0.1	–0.2	–0.3	–0.3

Real Long-Term Interest Rates

	2013	2014	2015	2016	2017	2018
U.S.A.	1.6	0.7	0.3	0.3	0.3	0.6
U.K.	–0.8	–0.7	–1.0	–1.5	–1.7	–0.5
Japan	–0.8	–1.1	–1.3	–1.2	–0.8	–0.8
Germany	0.8	–0.8	–1.0	–1.6	–0.8	–1.3
France	1.1	–0.5	–0.8	–1.4	–0.4	-1.0
Italy	1.2	–0.5	–0.7	–1.3	1.2	1.8

Nominal Long-Term Interest Rates

	2013	2014	2015	2016	2017	2018
U.S.A.	3.0	2.2	2.2	2.4	2.8	3.1
U.K.	1.3	1.8	1.3	0.9	1.1	1.5
Japan	0.7	0.3	0.3	0.0	0.1	0.1
Germany	1.9	0.5	0.6	0.4	0.5	0.6
France	1.9	0.5	0.6	0.4	0.9	0.9
Italy	1.9	0.5	0.6	0.4	2.3	3.1

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

	2013	2014	2015	2016	2017	2018
U.S.A.	82.1	83.9	93.0	94.0	94.5	94.8
U.K.	86.5	93.1	91.6	80.4	75.5	75.8
Japan	63.5	59.8	56.0	58.4	58.3	58.1
Germany	99.0	99.9	94.7	95.0	94.3	94.9
France	100.7	100.8	96.2	96.0	95.3	95.1
Italy	106.9	107.5	102.1	102.0	101.1	101.0

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

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

	2013	2014	2015	2016	2017	2018
U.S.A.[1]	85.61	89.04	103.08	101.91	102.19	102.40
U.K.	1.55	1.65	1.53	1.35	1.28	1.32
Japan	98.20	120.60	120.50	118.40	112.70	109.90
Eurozone	0.75	0.76	0.90	0.95	0.83	0.85

[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

EMERGING MARKETS

Anupam Rastogi

India

India's economic growth rose to a nine-quarter high of 8.2% in the first quarter of 2018–19, compared to 7.7% growth in Q4FY18. The spurt in growth is the result of the favourable base effect which will wear off later in the year. However, the growth recovery will remain robust and we expect GDP growth to be 7.6% in this financial year as against 6.7% in 2017–18. If there is continuity in the regime, post-2019 general elections, we expect growth to be 8% plus in FY20 and FY21.

As India heads toward the elections, there is concern that India will breach its fiscal target and inflation. The economy is in for a rough ride, with rising oil prices and its already-weakened currency. Given the robust collection in direct and indirect taxes, we reckon, that government will be able to maintain its promises on both, fiscal and inflationary, fronts.

Consumer Price Index inflation remained slightly above the inflation target of 4% and the current account deficit below 2.5% of GDP. Almost normal monsoon and the implementation of the minimum support price hikes will balance each other out and would not weigh on inflation. The GST rate cuts on over 100 items will further help ease inflation. India's annual consumer inflation will be around 5%, staying above the RBI's medium-term 4% target for an eighth consecutive month. A significant fall in food inflation from 2.97% in June to 1.37% in July led to the cooling down of the overall inflation. Raw food items are exempted from the GST. Food and beverages have over 54% weight in Consumer Price Index (CPI).

The RBI is likely to gradually tighten policy further, in response to inflationary pressures emanating from the rise in crude prices and falling rupee. The Reserve Bank of India lifted its repurchase rate to 6.50% from 6.25%, its second rate increase of the year, on concern that rising oil and food prices are pushing inflation beyond its comfort zone. RBI is trying to ensure India's economic health remains as robust as possible as global trade tensions threaten to spiral. At a time when currencies of the countries with large external deficits are being punished by the markets, the monetary policy committee at its next review, scheduled for October 3–5 is expected to stay in pause mode for the rest of the FY19.

India is less exposed to trade frictions that hurt other countries. India's exports made up 18.9% of its gross domestic product in 2017 compared with 20.4% in Indonesia and 26% of Russia. India is trying to fill the void left by the US exporter. There are about a hundred items that India could supply to China. Indian exporters see the trade war between the US and China as a golden opportunity and is unlikely to give it up. India can gain competitiveness in some segments of the economy and compete with other countries who are looking at this unique opportunity to fill the gap and establish their presence in bilateral trade with both China and the USA.

India: BSE Sensitive

India's currency is under heavy pressure — the rupee is trading near record-lows against the dollar. It fell past 71 per dollar mark for the first time in early trade and recorded the biggest monthly drop in three years in the month of August. On a year-to-date basis the Indian rupee remains the worst performer — down 10.1% this year so far. As the "yield differential" with the US narrowed, one would expect capital outflows from India, but the reverse has happened. In the month of August there has been net inflow of dollars and reserves have crossed the US$ 400 billion mark once again. Contagion on the Indian currency will remain for some time as long as the global crude oil prices remain elevated.

The country's main stock index, the Sensex, is trading around all-time highs, having risen nearly 11% this year. Much of the buying has come from domestic fund managers. There is some interest from foreign investors as well. They turned buyers in July after three straight months of selloff in debt market, and inflows improved in August.

	16–17	17–18	18–19	19–20	20-21
GDP (%p.a.)	7.1	6.7	7.6	8.1	8.2
WPI (%p.a.)	4.5	3.5	5.0	4.7	4.2
Current A/c(US$ bill.)	-24.0	-26.0	-49.0	-44.0	-44.0
Rs./$(nom.)	68.2	65.0	69.5	71.5	73.5

China

China's relationship with the US is worsening and the US is all set to put tariffs on US$250 billion worth of imports from China by mid-September and China, in turn, is likely to put tariffs on imports on the US products worth US$120 billion. In the short run, this will shave off 1.3% of GDP of China and 1% of the US and the world will be poorer by 0.6% of world GDP. It is to be seen that how these two economic giants play their hands.

For the time being, China's economy maintained steady growth in the first half of this year with a robust growth of 6.8%. The GDP growth has stayed within the range of 6.7 to 6.9% for 12 straight quarters. We expect the impact of the tariff war to be felt in the second half of the year but China will manage to achieve a GDP growth rate of 6.5% in 2018.

The bad economic numbers have started trickling in. The manufacturing purchasing managers' index, a leading indicator, hit a five-month low in the last week of August and the yuan fell to a 13-month low against the U.S. dollar. Chinese stocks have lost one-fifth of their value since January and are near a two-year low. China's economy is cooling. Spending on factory machinery, public-works projects and other fixed-asset investments in China's nonrural areas grew at the slowest pace in nearly two decades. Retail sales also slowed, and unemployment increased. The slowdown in fixed-asset investment reflects Beijing's campaign to curb risky borrowing by local governments and companies. Pro-actively the government is trying to lean against the wind, once again. There are signs of policy support in increased lending. The central bank has already promised liquidity to banks to expand credit, and in the last week of August it offered $74 billion in medium-term financing. The authorities also encouraged companies to issue bonds and eased restrictions on borrowing by local governments for public works. Tax cuts are in the pipeline for corporations and individuals. Looser monetary policy has contributed to the yuan's weakness.

The consumer price index increased 2.1% in July from a year earlier, compared with a 1.9% gain in June, as consumers paid more for food and fuel.

Gasoline and diesel prices surged by more than 20% on year, adding about 0.42 percentage points to the headline index. The government aims to keep inflation under about 3% this year. The July inflation data is the first official reading on the impact on prices from China's retaliatory tariffs on $34 billion of U.S. goods that went into effect on July 6 and apply to a range of products from soybeans, to mixed nuts and whiskey.

Boosted by a strong appetite for commodities, China's imports were up 27.3% in July from a year earlier, accelerating from a 14.1% increase the previous month. Exports rose 12.2% from a year earlier following June's 11.3% increase. China reported a trade surplus of $28.05 billion in July, compared with a surplus of $41.61 billion a month earlier. China's service trade posted a deficit of $147.3 billion, up from $73.6 billion three months earlier. The spending on trips, transport, and intellectual property rights contributed to the bulk of the deficit. Amid the trade war with the US, China has reported a current account deficit of $28.3 billion in the first half of 2018 — a first in 20 years for China. It also recorded its first quarterly current account deficit in nearly 17 years this year, ending its dream run of accumulating trade surplus as top exporter for years.

China: SSE Composite Index

China guided the yuan 0.7% stronger against the dollar in the last week of August. The dollar is hovering around 6.82 yuan in the onshore market. This time, the yuan has slid more slowly. The move has been fuelled by market forces, not the central bank, based on the outlook for interest rates and trade. The slide of the yuan suggests that the yuan may weaken beyond 7 to the dollar by mid-2019, which it hasn't breached in a decade.

Chinese stocks suffered their biggest daily loss in more than eight years on August 24, 2015. The Shanghai Composite has fallen by roughly 25% from its January high and the yuan has tumbled 5.5% against the dollar this year. There is still a lack of confidence among investors, and pessimism about the economy's outlook. As a result, China's stock market may be stuck in bear country for a long, long time.

	16	17	18	19	20
GDP (%p.a.)	6.5	6.9	6.5	6.0	5.6
Inflation (%p.a.)	2.0	1.6	2.2	2.3	2.3
Trade Balance(US$ bill.)	510	400	300	300	300
Rmb/$(nom.)	6.7	6.6	6.8	7.0	7.1

South Korea

South Korea's GDP growth in 2018 will be around 2.6%. This is due to weaker export growth as a result of base effects and escalating global trade tensions, as well as the weak employment outlook in the country, which will weigh on private consumption. This is also lower than the 2.8% y-o-y figure in Q1 2018, which points to a further slowing

over the coming quarters. Our view is based on a decline in export growth due to high base effects in 2017 and ongoing trade tensions between US and China, as well as a weakening consumption outlook. South Korea's consumer confidence weakened for the third straight month in August.

We expect growth to be slightly better in 2019. In addition to a weak external picture, the consumption outlook for South Korea for the coming quarters is poor, with private consumption growth likely to be hampered by weak employment, a depreciation of the won and high levels of household debt, which stood at approximately 95% of GDP in 2017.

The South Korean economy is heavily reliant on trade as exports account for 42% of GDP, and a slowdown in the sector will weigh on growth over the coming quarters. To bolster the economy, President Moon Jae-in's government proposes to spend a record 471 trillion won ($420 billion) next year, aimed at speeding up the economy by creating jobs, raising the minimum wage and prodding innovative growth. The 2019 budget proposal calls for a spending increase of about 9.7% from last year's initial budget, the biggest jump since the aftermath of the global financial crisis in 2009. Spending to create jobs will rise to a record amount, while infrastructure spending will fall.

The BOK has held the benchmark interest rate at 1.5% since raising it from a record low in November. The slowing job growth and global trade battles raised concerns about the outlook for the export-dependent economy. The BOK Governor Lee Ju-yeol has cited financial imbalances and the need to create room for policy responses to an economic downturn as reasons for maintaining status quo. South Korea's producer price inflation accelerated for the fourth straight month in July. It climbed to 2.9% year-on-year in July, faster than June's 2.6% rise.

Export growth slowed to 4.0% y-o-y in Q2 2018, trending lower from 10.8% y-o-y in Q1 2018. This can be in large part explained by high base effects from 2017, and the growing uncertainty induced by the US-China trade conflict, with Chinese exports accounting for 25% of South Korea's total exports by value and intermediate goods accounting for 79% of South Korea's total exports to China.

Political developments are impacting near term economic prospects of the country. A deadlock in US-North Korea denuclearization talks is prompting South Korea's leader to re-evaluate the pace of his engagement with the North. Mr. Moon is still expected to continue with a planned inter-Korean summit to be hosted by North Korean leader Kim Jong Un in Pyongyang in September — though the agenda will likely change depending on the developments in the North's talks with Washington and Seoul. Mr. Moon and his advisers have described the use of economic incentives as a way of nudging Pyongyang toward giving up its nuclear weapons.

	16	17	18	19	20
GDP (%p.a.)	2.8	3.1	2.6	2.8	2.9
Inflation (%p.a.)	1.0	1.9	1.7	2.0	1.9
Current A/c(US$ bill.)	88.0	88.0	86.0	80.0	78.0
Won/$(nom.)	1160	1100	1100	1120	1050

Taiwan

In the first quarter the economy posted 3.04% growth but with external headwinds increasing, we expect the economy to slow down over the second half of the year and in 2019. We maintain growth rate of 2.6% in 2018 and 2019. The government forecast the economy to expand 2.69 percent in 2018 and 2.55 percent in 2019.

Taiwan's consumer price inflation accelerated at a faster-than-expected pace in July. The CPI climbed to 1.75% year-over-year in July, slower than the 1.4% rise in June. Costs for transportation and communication grew 4.36% annually in July and housing costs went up by 0.93%.

Exports are expected to have increased 5.35% from a year earlier, compared with 9.4% in June. Taiwan's export trends are a key gauge of global demand for hi-tech gadgets worldwide. In the second quarter, exports were buoyant, which might reflect stepped-up shipments ahead of the July 6 effective date of new United States tariffs on $34bn worth of imports from China, and Chinese countermeasures. The US-China trade war was already casting a shadow over the island's second half growth outlook. Orders for trade-

dependent Taiwan fell 0.1% from June 2017 to $40.31bn. In May, orders rose a robust 11.7% from a year earlier.

Taiwan is worried that it could become "a bargaining chip" in negotiations with Beijing, with US support for the island swapped for Chinese cooperation on North Korea or trade. The United States would seemingly have little to lose on trade by jettisoning Taipei.

Tsai's government has decided that it makes sense to stick close to Trump in the hope of greater diplomatic recognition and economic help. She unofficially visited the US. With her visits to the United States, Tsai is hoping to reinforce the long-term viability of her country. But Trump tends to think in the short term — and he seems to favour deals over democracy.

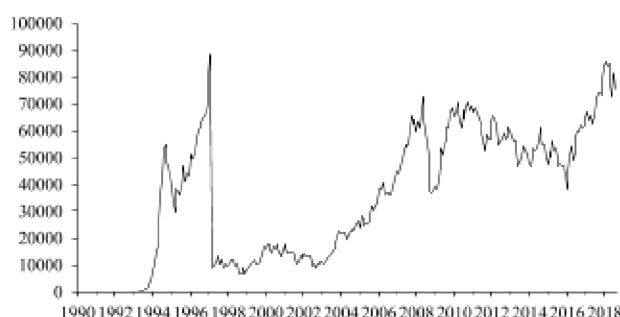
	16	17	18	19	20
GDP (%p.a.)	1.4	2.6	2.6	2.6	2.3
Inflation (%p.a.)	1.0	0.6	1.5	1.3	1.2
Current A/c(US$ bill.)	64.0	68.0	68.0	70.0	71.0
NT$/$(nom.)	32.5	31.0	29.8	31.0	31.0

Brazil

The Brazilian economy barely grew in the second quarter as a countrywide truckers' strike all but paralyzed key business sectors. GDP of Brazil expanded just 0.1% compared with the first three months of the year. This would mark the slowest growth rate since Brazil emerged, at the start of 2017, from the deepest recession in decades. There is a possibility that the economy may contract in the second half of 2018. For 2019 and 2020, the estimate for GDP growth remains at 2% and 2.5% respectively.

Inflation is expected to be higher than expected, but still within the government's target of 3% to 6%. Inflation cooled in mid-August to the slowest monthly pace since a nationwide truckers' strike in May drove widespread product shortages. Underlying pressures remain largely subdued due to insipid economic recovery, which took a further hit from the protests and has kept the unemployment rate stubbornly in double digits. Hence, the central bank has enough elbow room to hold interest rates at an all-time low even as the Brazilian real fell to its weakest in 2-1/2 years, leading to a sharp increase in import costs. We expect the country's benchmark interest rate (SELIC) should remain at 6.5 percentage points until the end of the year. Brazil's central bank will probably refrain from raising interest rates even though there are jitters ahead of the October 7 presidential election, as well as broad selling of emerging market currencies.

Brazil posted a wide deficit in its transactions with foreign nations in July, after four consecutive monthly surpluses, due mainly to interest payments. The central bank forecast the current-account deficit widening to $17.55 billion by the end of 2018. The challenges for Brazil remain sizable. The government struggles to tame a gaping budget shortfall equal to 7% of gross domestic product.



It is estimated that a 10% decline in the Brazilian currency would add around 50 basis points to inflation. The real is down nearly 17% so far this year. Brazil FX plunged 4.7% to 4.10/USD, the weakest nominal level since January 2016. Brazil's currency is sliding as investors are concerned about election.

The country is facing a high degree of uncertainty ahead of its presidential election, which is set to take place in October. A poll suggests that the jailed former President Luiz Inacio Lula da Silva is holding a double-digit lead against far-right Congressman Jair Bolsonaro. Lula is facing corruption charges and is expected to be barred from the race. Establishment politician Geraldo Alckmin, a former São Paulo governor who has the support of a wide coalition of parties, has established himself as the market's favourite but has consistently polled in the single digits. The race for the presidency remains all but clear.

Wealthy Brazilians are fleeing the country, terrified by spiralling gun violence and pessimistic about the nation's political and economic future. About 52% of the richest Brazilians — those with a monthly household income of more than $2,500 — want to emigrate, while 56% of college-educated Brazilians want to leave, according to a study published in June by Brazilian polling agency Datafolha. Overall, 43% of Brazilians would emigrate if they could.

	16	17	18	19	20
GDP (%p.a.)	-3.5	1.0	0.5	2.0	2.5
Inflation (%p.a.)	6.3	3.0	4.4	4.5	4.2
Current A/c(US$ bill.)	-28.0	-4.0	-20.0	-18.0	-18.5
Real/$(nom.)	3.5	3.2	3.8	4.0	4.0

Other Emerging Markets

Hong Kong: FT-Actuaries

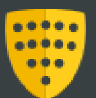
Indonesia: Jakarta Composite

Malaysia: FT-Actuaries (US$ Index)

Thailand: Composite Index

Singapore: Straits Times Index

Philippines: Manila Composite



THE CHEQUERS PROPOSALS ARE DAMAGING: THERE ARE BETTER ALTERNATIVES

Patrick Minford

Since the ill-fated Chequers Cabinet meeting on Friday July 6th much has been written about the faults of Theresa May's proposals that were agreed that day. In brief these are that they subject UK farming and manufacturing to EU Single Market regulations. We also agree to maintain social (including labour) and environmental regulations currently mandated by the EU, which govern much of the activity across the whole economy. This means that we cannot alter these EU standards, many of which discriminate against non-EU suppliers such as the US, when we enter into Free Trade Agreements, FTAs, with the rest of the world; we can reduce or eliminate tariffs but we cannot eliminate the protection created by EU standards. The New Customs Partnership Mark 2 now supposedly makes setting lower or zero tariffs on non-EU FTA partners feasible; however, doubts remain about the practicality of this proposal too. Finally, some formula about enhanced EU migration in the proposals implies that there will also be free migration in some degree from the EU.

Needless to say, these elements all damage the UK's economic interests. Our FTA strategy will be less beneficial as we can eliminate less protection and also get less return access from other non-EU countries. We will be unable to optimise regulations in major parts of our economy that will be subject to continued EU rule. Finally we will not gain control of our borders.

The situation is aggravated by the fact that these are just initial proposals to the EU and they may well lead to further concessions against the UK's national interests.

In this short piece I deal with two questions: first, for what reasons did Mrs. May take this route? Second, what better route could be taken and how would it deal with those reasons?

Why did Mrs. May choose this route?

There is a short answer to this question: UK farming and manufacturing, 'industry', wanted it. Whether it was the CBI and such titans as Airbus or JLR, or the Institute of Directors and Chambers of Commerce representing smaller businesses, or a host of individual trade associations, a more or less unanimous howl went up from them that they wanted existing regulations to continue uninterrupted by any new bureaucratic uncertainty. For them it was immaterial who set these regulations or how; they allowed industry to do what it now does and industry did not want them disturbed.

This view was supported across Whitehall, most strongly by the Industry Department (DEIS) and the Treasury, who leaked the notorious Cross-Whitehall Report claiming that there would be huge costs to trade and GDP in border barriers between the UK and the EU if we had a Canada+ trade agreement; and still larger barriers of course in the event of No Deal. Only if industry stayed within the Single Market in goods could the threat of new barriers be removed.

Whitehall and industry combined to make a formidable lobbying force, and dominated No 10's thinking. It also strongly influenced Tory rebels such as Dominic Grieve and Nicky Morgan. It was put about that the 'interests of the economy' dictated a 'soft Brexit' in which industry stayed in the Single Market.

What is interesting and a matter for relief is that this argument was not deployed in respect of services, at least in recent months. It has become understood that services are different, that the Single Market in services is of little importance, and the City requires UK regulation by the Bank of England, which has helped to emphasise this point. As services are 80% of the UK economy, the fact that they are not being involved in these proposals means that service regulation at least can be optimised by the UK government. However, even this will be hamstrung by commitments under the Chequers Proposals to keep social and environmental regulation unchanged.

What better route could be taken and could it deal with industry's concerns?

There is of course a far better route: Canada+. This would mean we would have zero tariffs between the UK and the EU, and also zero non-tariff barriers, together with freedom to see whatever standards were best for the UK home market. Standards on EU exports wold of course remain in place as those mandated by the EU; standards on UK imports would be free for us to determine as part of our domestic decisions on standards. If we liberalised these to permit goods from non-EU countries to be sold here, we would not discriminate against EU imports- they would be free to impose their own current EU standards, which would also meet our new liberalised standards which would be more embracing of variety from around the world.

What then of the threatened surge in barriers between us and the EU? The simple point is that there is no such threat. Any such surge would be completely illegal under WTO

industry, as they already are, then there can be no sudden withdrawal of trade permissions.

What has happened in our internal political debate is that extreme ignorance of how the WTO works has allowed a Project Fear to take hold among industrialists and the Civil Service interacting with them. They have assumed that the WTO world is a lawless world in which 'hostile governments' can 'make trouble'. Yet WTO law is plain- it mandates seamless border procedures and outlaws discrimination on standards. Furthermore no-one in their right mind would claim that either the UK or the EU would defy international law: both make a particular point of adhering to it, given the centrality of international law to the Treaties on which both take their stands.

How to get back on course?

The present Chequers proposals threaten the UK's economic interests. They will damage our regulation, undermine our FTAs with the rest of the world, and perpetuate uncontrolled and subsidised unskilled immigration from the EU. Furthermore they may lead to more compromises which worsen these aspects even more. We have not heard the response from the EU but it would be surprising if they did not demand such further compromises.

At some point these proposals as they shape-shift with increasing compromises will become impossible to get through the UK Parliament and will also raise huge concerns in the electorate. For the Conservative Party this could become a suicide mission. The outcome could well be a collapse into No Deal as Parliament refuses to ratify them. No Deal, discussed in the next section, would be a good outcome for the UK. But it could seriously damage the authority of this government and create political chaos, with unpredictable results.

However, industry, the Civil Service and Tory rebels need to understand that their fears about a plain Canada+ agreement with the EU are quite misplaced. Canada+ would give all the security over border treatment that would occur under the Chequers proposals. But it would also permit the UK to set its own regulations throughout the economy, sign FTAs with the rest of world in the knowledge that less discrimination on standards and so freer trade can be in the policy mix, and recover control of its borders.

Once the government had switched to the proposal of Canada+, the EU's reaction is known: indeed it offered this outcome some months ago. Why would it not do so? The UK will be a third country from end-March 2019; from a legal perspective, being outside all the EU's institutions, the only possible agreement for the UK is a trade agreement with the EU as a third country like Canada or Japan.

The problem all along with Mrs May's proclaimed desire for a 'deep and close relationship' with the EU has been that this contradicts third party status. It is 'half-in, half-out'. Yet the irony is that one does not need to have 'deep, close' relations in order to trade with the EU in a frictionless manner, most especially when you start from a situation where all your goods industries satisfy existing standards for exports, in both directions. If either we or the EU were to stop goods at the border on the Friday after Brexit on the grounds that they do not satisfy required standards, when on the Monday before Brexit the very same goods satisfied them, it would be a blatant breach of WTO rules, leading to an immediate WTO court case to outlaw it.

What if the EU refuses to enter into a Canada+ trade deal?

Should the EU refuse to enter into a Canada+ deal, then a plain WTO trade arrangement where we have no EU trade deal at all will work just as well for us. The reasons are the same: 'access' to the EU market for us and for the EU to ours is protected under WTO rules. The border must be seamless and as we each satisfy each other's export product standards there can be no denial of recognition of each other's standards without breaching the rules on non-discrimination.

The only impediment to our trade will be tariffs on goods each way. These are on average rather low, at around 4%. However they will have a negative effect: on the EU, not on us. To understand why think about how when we leave the EU we will sign FTAs with many countries around the world from which we will therefore buy at world prices with no tariffs imposed from our side. Apart from benefiting our consumers this creates strong competition between all producers, whether domestic or foreign. EU producers are no exception; they will have to meet these prices to sell anything much here at all. So any tariffs we impose they will have to absorb. As for our producers selling in the EU they too will sell at world prices since their competitors here would quickly undercut them if they charged more. Therefore any EU tariffs on them will be paid by EU importers, who can easily do so as EU prices are higher because of the tariffs on world producers.

What this all means is that if we leave the EU without a trade agreement, under WTO rules, and therefore with no transition (which is dependent on a trade deal), the EU carries the burden of paying about £13 billion a year tariff revenue to HM Treasury, it loses our £39 billion budget contribution for the transition period, and the world competition from our FTAs kicks in two years early. This can be costed in present value at around £500 billion. On the other hand we gain present value of £650 billion.

Much nonsense has recently been talked about 'no deal' halting air traffic, upsetting pensions, derailing N Ireland's electricity deal with Ireland and much else. However these

matters have nothing at all with 'no trade deal' which is the issue here. They are the basic meat and drink of any competent government to resolve as they deal with the necessary separation from the EU under Article 50, which indeed was created for this very purpose. For these negotiations about practical matters to fail one would need to assume that the EU and the UK were planning some sort of acrimonious divorce amounting to a level of implicit warfare. Since they are both allies in NATO, cooperating on security, and supposedly maintaining friendly diplomatic relations into the future, this would be a serious failure indeed. It would imply that one would kiss goodbye to good cross-Channel relations indefinitely. It would not stop Brexit however; it would merely reinforce in the British mind the picture of basic EU hostility and strengthen the urge to leave at any cost. For this reason it is reasonable to dismiss failure to agree these basic matters; indeed it has been said repeatedly by both sides that 80% of them are already agreed.

No trade deal is another matter: here agreement is held up by the 'theology' of the EU's Single market and Customs Union and their associated Four Freedoms, as well as by the failure of the UK side to understand the nature of the WTO rules-based world. It may well be that agreement cannot be reached on trade, at least in time for the UK's March 2019 departure from the EU. In this case the 'WTO-based option' is a desirable one from our viewpoint, less so from the EU's- as on top of the monetary loss above it would be technically bankrupt on its budget to 2020 without our budget contribution, given that it is not allowed to borrow. This should persuade the EU to agree to Canada+. But if not, it is their loss.

Conclusions

So bad is the mess into which the poorly thought-out Chequers proposals have plunged the UK and so much worse is it likely to get as negotiations with the EU proceed, that course alteration looks inevitable and certainly highly desirable, as soon as possible. Over the coming months it is essential that politicians start to get a grasp of the WTO world and its workings. Once they do so, the Plan B of Canada+ will come into focus as the superior way to go. However, if the EU refuses to cooperate even on that, we should simply go to WTO-rules based trade arrangements all round. This will bring us the full gains from Brexit and by bringing them faster with no burdensome transition period and tariff revenues from the EU, provide an additional fillip on top.

References:

More details of all these arguments can be found in:

https://www.economistsforfreetrade.com/wp-content/uploads/2018/06/Why-a-World-Trade-Deal-exit-from-the-EU-may-be-best-for-the-UK-Final-15.06.18.pdf

and

Patrick Minford 'The economics of Brexit: getting the best deal for the UK', downloadable from www.politeia.co.uk

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