25 June 2014 │ 52 pages

Global

Global Economic Outlook and Strategy

June 2014

- Our global growth forecasts are unchanged this month, at 3.0% for 2014 and 3.5% for 2015, a modest pick-up from last year's pace (2.5%). We highlight three key themes in the outlook.

- First, in contrast to the EM downgrades in 2013 and early 2014, our overall 2014-15 EM growth forecasts have now been stable for three months in a row. We do make downward revisions from last month to forecasts for Brazil, Chile, the Philippines, South Africa and Vietnam. But these are balanced by upward revisions to the Czech Republic, Hungary, and Turkey. Moreover, China's growth seems to be stabilizing in Q2. Nevertheless, there are still vulnerabilities to the EM growth outlook, given the sluggish trend in world trade growth plus medium-term worries over China's ability to maintain rapid economic growth in the next few years without exacerbating financial instability risks. We do forecast the RMB to appreciate slightly in coming months, but suspect that the major RMB appreciation trend of recent years — with the RMB/USD rate appreciating by 37% from mid-05 to end-13 — is probably over.

- Second, we believe that the weakness in US Q1 GDP growth is not representative of underlying growth or the current pace of growth. With very supportive financial conditions, we look for a strong rebound in activity in Q2 as the adverse weather effects fade, with growth in subsequent quarters staying at 3%+.

- Third, we expect that wide economic divergences among advanced economies will lead to substantial monetary policy divergence in the next few quarters. In the euro area, inflation probably will continue to undershoot ECB forecasts, hence prompting further easing — including a large-scale QE program around year-end. We also expect renewed QE from the BoJ in Q4 as soft data for Q2 and Q3 come through. Both the ECB and BoJ are likely to keep policy ultra-loose for a long period thereafter. By contrast, strong growth and falling unemployment are likely to prompt the UK MPC to hike rates late this year. In the US, we still forecast the first Fed hike to come in mid-15, and expect a gradual but extended tightening cycle that eventually carries the policy rate up to roughly 3% on average in 2017-18.

Willem Buiter
+1-212-816-2363
willem.buiter@citi.com

Guillermo Mondino
+1-212-816-6499
guillermo.mondino@citi.com

Michael Saunders
+44-20-7986-3299
michael.saunders@citi.com

Kiichi Murashima
+81-3-6270-4981
kiichi.murashima@citi.com

David Lubin
+44-20-7986-3302
david.p.lubin@citi.com

Johanna Chua
+852-2501-2357
johanna.chua@citi.com

With thanks to Jan Maguire

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Figure 1. Currency and Interest Rate Forecasts, as of 25 June 2014

	25 June 2014	3Q 14F	4Q 14F	1Q 15F	2Q 15F	3Q 15F	4Q 15F
United States: Federal Funds	0.25	0.25	0.25	0.25	0.25	0.75	1.00
10-Yr. Treasuries (Period Ave.)	2.59	2.70	2.90	3.00	3.05	3.15	3.20
Euro Area: US$/€	1.36	1.38	1.36	1.35	1.36	1.37	1.39
Euro Repo Rate	0.15	0.15	0.15	0.15	0.15	0.15	0.15
10-Yr. Bunds (Period Ave.)	1.33	1.45	1.50	1.50	1.55	1.55	1.60
Japan: Yen/US$	102	105	107	108	109	109	110
Call Money	0.10	0.10	0.10	0.10	0.10	0.10	0.10
10-Yr. JGB (Period Ave.)	0.58	0.60	0.55	0.70	0.80	0.85	0.75

F: Forecast. Note: All forecasts are for end of period, unless specified. Source: Citi Research

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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Figure 2. Forecast Highlights and Changes

Global	We are leaving our global growth forecasts (at current FX rates) unchanged this month, at 3.0% for 2014 and 3.5% for 2015. Our forecast still implies a pick-up from last year's pace (2.5%).
United States	The snap back to 3½% growth in Q2 and Q3 already has begun. We think the economy will continue to grow at an above-trend pace through 2015, as economic fundamentals have improved — fiscal drag is dissipating and financial conditions are providing a significant tailwind for growth. The Fed is in the process of revising its principles for exiting zero rates but, with inflation remaining below the 2% target, we do not expect the Fed to hike rates until mid-2015.
Euro Area	The ECB's series of announcements at the June meeting were a welcome development, reassuring investors of its strong commitment to defend its medium-term inflation target, and leaving the door open to additional support measures if and when necessary. Given the likely delay in the pass-through from the TLTRO to firms, we suspect that inflation dynamics will be key in determining the timing of QE, probably at the December 4 monetary policy meeting.
China	May data point to stabilization of the growth momentum, apart from the property sector. There has been a subtle change in policy tone in favour of easing. Improving external demand and measured monetary easing will likely offset the downside from a property market correction, and we see some upside risk to our 7.3% growth forecast for 2014.
Japan	We expect the BoJ will ease policy again in late October when policymakers update their economic outlook. We remain skeptical that the BoJ's bullish inflation forecasts will be met, given the subdued trend in wage growth and erosion in real purchasing power of household income.
United Kingdom	With strong economic growth and the rapid drop in unemployment, we continue to expect the MPC will start to hike rates in Q4 this year, with rates then rising further and faster than markets project.
Canada	CPI inflation is rising faster than expected, but the growth outlook remains roughly unchanged. While the BoC appears less concerned about low inflation, it is more worried about the potential for external shocks. Hence, we continue to anticipate the next rate hike in 3Q 2015.
Australia	We are revising up our 2014 GDP forecast to 3.4% (up 0.5ppts) on the back of stronger net exports. The forecast masks softer DFD growth of 1.5% that should help keep inflation contained within the RBA's 2.0% to 3.0% target band. We think the prospect of an RBA rate hike remains at least 12 months away.
Emerging Asia (ex China)	EM Asia's exports have been uneven, but we expect a modest pick-up as US demand recovers and China stabilizes. Oil price worries have raised perceived vulnerability in India and Indonesia, while stability post-coup is supporting sentiment in Thailand. The Philippines has started to hike rates on back of price/financial stability concerns, and Malaysia is likely very soon to follow, but the rest are on prolonged hold, and we push out our call on Korea's first hike to 2Q15 (vs. 1Q15).
CEEMEA	Relatively calm financial markets in the recent weeks have allowed easier monetary policy in CEEMEA. Examples include Turkey's rate cuts in May and June, and the failure of the South African Reserve Bank to hike rates last month. Meanwhile the market is now pricing in a rate cut in Poland, unthinkable until a few weeks ago. The market's ability to absorb easier-than-expected monetary policy remains emphatically dependent on a stable US Treasury market. Upward pressure on US 10-year yields would require tighter policy in CEEMEA.
Lat Am	We have reduced our growth forecasts for Brazil, and we see lower risks in respect of inflation. Thus, we believe monetary easing may take place if growth surprises on the downside. In Mexico, the data confirm an acceleration in growth during 2Q. We do not expect additional monetary easing. The outlook for Argentina remains challenging, particularly given the recent legal developments. We continue to expect GDP to shrink by 1% and inflation to escalate to 75% in Venezuela. We see risks of further economic deterioration.

Source: Citi Research

Figure 3. Selected Countries — Industrial Production Forecasts (Pct.), 2013-15F

	2013	2014F	2015F
World	2.3%	3.9%	4.4%
United States	2.9	3.6	4.0
Japan	-0.6	3.9	1.1
Euro Area	-0.7	2.2	4.5
United Kingdom	-0.3	2.2	2.0
Canada	1.9	2.1	2.3
China	9.7	8.7	8.5
India	0.4	3.9	5.9
Korea	0.3	3.4	5.9
Brazil	2.3	-0.5	1.0

Source: Citi Research

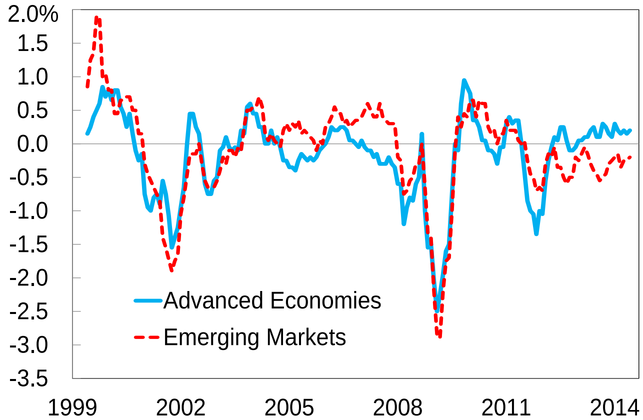
Overview: Steady Growth, With Divergence

Michael Saunders
+44-20-7986-3299
michael.saunders@citi.com

Our global growth forecasts are unchanged, with various revisions among individual countries

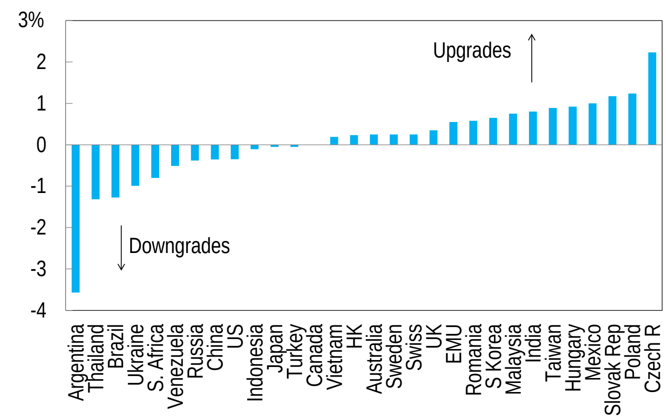
We are leaving our global growth forecasts (at current FX rates) unchanged this month, at 3.0% for 2014 and 3.5% for 2015. Our forecast still implies a pick-up from last year's pace (2.5%). Among the advanced economies (AEs), we make upward revisions this month for Australia, New Zealand and Spain. Among the emerging markets (EMs), we have downward revisions from last month for Brazil, Chile, the Philippines, South Africa and Vietnam among others, but upgrades include the Czech Republic, Hungary and Turkey. In all, our aggregate 2014 AE growth forecast is unchanged from six months ago (at 2.0%), while our 2015 AE forecast is up from 2.1% six months ago to 2.4% last month and 2.5% this month. By contrast, over the last six months, we have cut our aggregate 2014 EM growth forecast from 4.9% to 4.5%, while leaving our 2015 EM growth forecast at 5.0%.

Figure 4. Global — Six-Month Sum of Revisions to Citi GDP Growth Forecasts for Current Year and Next Year, 1999-2014



Source: Citi Research

Figure 5. Selected Countries — Revisions to Citi 2014-15 GDP Growth Forecasts Over Latest 6 Months



Source: Citi Research

World trade growth remains sluggish, and EM exports are no longer outperforming versus world trade growth…

We still have concerns at prospects for EM growth and imbalances, and this is likely to be reflected in a general trend of EM currency depreciation versus the USD over 6-12 months[1] plus easing measures in some specific countries. One set of downside risks comes from the ongoing weakness in world trade growth and reduced EM export outperformance — which may well limit scope for EM economies to transition back to export-led growth. In 1998-2007, world trade growth averaged 6.6% YoY, roughly twice global industrial production growth (3.3% YoY). Moreover, EM exports gained market share, rising 9.6% YoY on average — ie roughly three times the pace of global IP growth. By contrast, AE exports generally lost market share (ie grew less than world trade). During 2008-12, world trade growth was sluggish (averaging 2.6% YoY) against the backdrop of general weakness in global economic growth, especially in AEs. However, world trade growth has remained weak in 2013 and early 2014, even with the pick-up in global GDP and IP growth. Indeed, global IP growth in Jan-April (3.7% YoY) was a little above the pre-crisis average. CPB data show world trade growth (averaging export growth and import growth) at 2.7% YoY in 2013 and only 2.6% YoY in Jan-April 2014.

…with AE IP growth now — unusually — running above AE import growth

To be sure, the last few months' trade data may be distorted by the adverse US weather plus the unwinding of prior over-invoicing by China's exporters. But, even if we focus just on import data, global volume growth remains sluggish, at 3.1% YoY in Jan-April — roughly half the pre-crisis average. A key factor behind this is the reduction in the import intensity of AE economic growth. Moreover, EM exports are

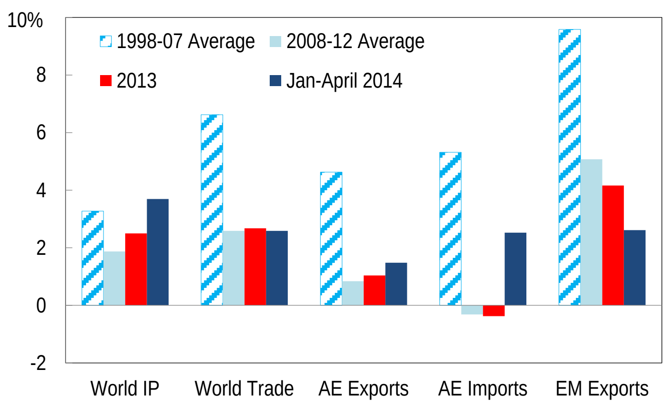
[1] See "Foreign Exchange Forecasts", Jeremy Hale et al, 20 June 2014, Citi.

no longer significantly outperforming world trade and AE exports. The overall result is that, even though global output growth is back to the pre-crisis norm, world trade growth remains roughly half the pre-crisis norm, and EM export growth (2.6% YoY in Jan-April this year) is roughly one third the pre-crisis norm. And there has been a striking crossover between AE IP growth and AE import growth, with — in marked contrast to pre-crisis period — IP growth running slightly ahead of import growth.

Continued weakness in world trade could pose downside risks to EM growth

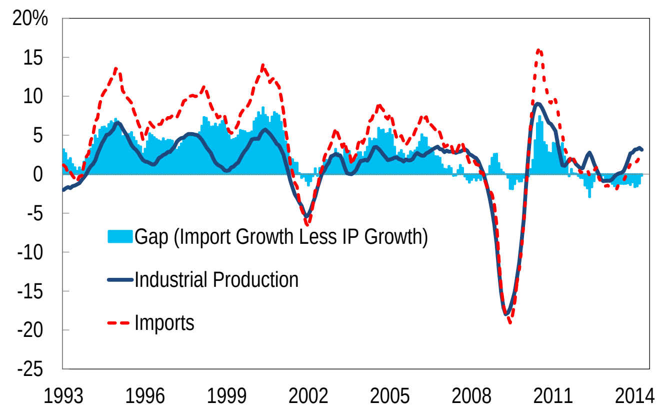
A range of factors probably lies behind these trends, including the shift to less-import intensive AE growth caused by sluggish growth in spending on consumer durables and investment[2], plus shifts in relative AE/EM cost competitiveness caused by the trend of EM real exchange appreciation in recent years and expansion of low-cost energy in the US. World trade growth may pick up a bit during this year, but we suspect that these factors will ensure that world trade growth remains modest — and EM export outperformance versus world trade also may be limited. All this poses downside risks to growth in export-oriented EMs.

Figure 6. Global — World Trade Growth and IP Growth, 1998-2014



Sources: CPB and Citi Research

Figure 7. Advanced Economies — YoY Growth of Industrial Production and Imports (3-Month Average), 1993-2014



Sources: CPB and Citi Research

Even though credit growth has slowed, China's private debt/GDP ratio is still rising rapidly…

A second set of worries — recently highlighted by the IMF[3] — concerns China's ability to achieve its stated aims of rapid economic growth (close to the authorities' 7.5% target for 2014) while scaling back the huge credit stimulus of recent years. Using the BIS data[4], China's private sector debt/GDP ratio (the sum of gross unconsolidated debts of the household and non-financial corporate sectors as a share of the four-quarter average of nominal GDP) surged to 186% in Q4-13 (latest data) from 170% a year earlier and 118% at end-2008. The level of private debt has roughly trebled over the last five years. China's private debt/GDP ratio exceeds recent peaks in the US (174.1% in Q3-2009) and euro area (172% in Q2-2010), both of which have since fallen. Moreover, with nominal GDP growth slowing, the private debt/GDP ratio rose by more in the last four quarters (16 percentage points) than in the prior four quarters (15 pp). Note that this measure excludes debts held in local governments and financial companies. Despite the authorities' stated aim of reducing China's credit dependence, credit growth remains high, with total social financing (TSF, a broad credit aggregate) rising 15-16% YoY in May — roughly

[2] See "*Global Economics View*: The Long-Run Decline in Advanced-Economy Investment", Willem Buiter et al, 11 June 2014, Citi.

[3] See Article IV Report on China, 5 June 2014.

[4] Data available at http://www.bis.org/statistics/credtopriv.htm

twice nominal GDP growth — hence implying that the private debt/GDP ratio is probably still rising rapidly.

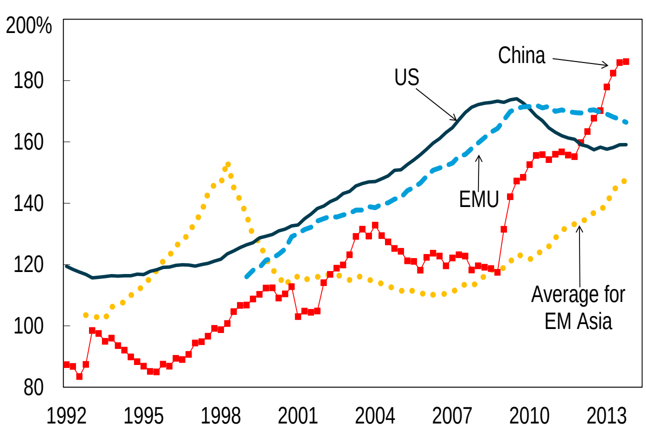
…and, with growth slowing, the authorities have recently introduced new credit easing and the trend of one-way FX appreciation may be over

With China's GDP growth likely to slow to about 7% YoY in Q2, the authorities have already implemented modest stimulus measures[5]. We expect further easing in coming months. In addition, we suspect that the relentless RMB appreciation trend of recent years — with the RMB/USD rate appreciating by 13% from end-09 to end-13 (and by 37% in total since end-04) — is probably over. It is notable that the authorities have engineered a drop in the exchange rate from RMB 6.04/$ in Mid-Jan to RMB 6.20-6.25/$ recently hence, in combination with other FX trends, causing the trade-weighted exchange rate to depreciate by 3-4%. We do forecast the RMB to appreciate slightly in coming months, but even so we expect the end-2014 level (RMB6.09/$) to show a slight depreciation from end-13 (RMB 6.05/$) — marking the first year since 2009 that the Chinese currency has not appreciated. Nor do we expect much change in the RMB/USD rate on average during 2015-18.

The authorities' dilemma between growth and financial stability is likely to intensify

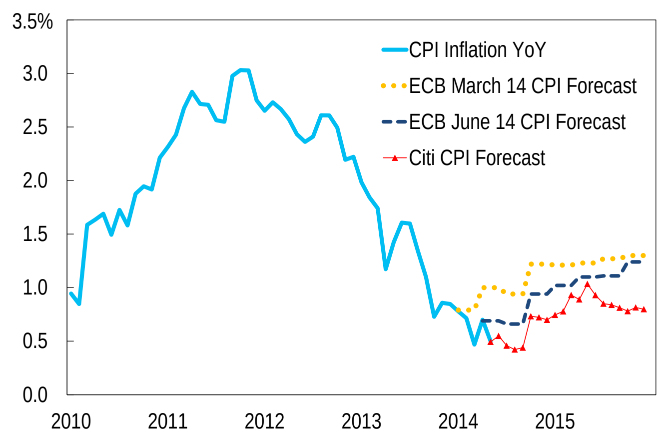
Even so, the dilemma between downside growth risks and medium-term financial stability risks will probably intensify. We expect GDP growth to slow below 7% YoY during 2015. And, if the authorities do respond by renewed credit easing — further inflating debt/GDP ratios — this would probably reinforce future downside risks to growth and credit quality. In turn, downside risks to China's growth would spill over into a range of other countries, including both AEs and EMs.

Figure 8. Selected Countries — Private Sector Debt/GDP Ratios, 1992-2013



Note: EM Asia average is the unweighted average for HK, Indonesia, Korea, Malaysia, Singapore and Thailand. Sources: BIS, DataStream and Citi Research

Figure 9. Euro Area — Inflation Outturns and Forecasts, 2010-16F



Sources: ECB, Eurostat and Citi Research

Even after the recent ECB easing, consensus forecasts for euro area inflation continue to fall…

In the Euro area, it is too early to see the full effects of the ECB's recent easing, especially the TLTRO. But, we suspect the measures will not be enough to lift the economy out of a sluggish growth trend and persistent inflation undershoot. There has been a modest loosening in financial conditions since the ECB meeting, with the Euro Stoxx index up roughly 1%, narrower intra-EMU sovereign spreads and the trade-weighted euro down roughly 1%. But recent business surveys remain lacklustre, while consensus inflation forecasts have continued to fall in June — and are now down by 0.4 percent for 2014 and 0.2 percent for 2015 since the start of this year (to 0.7% and 1.2%).

[5] See "*China Macro Flash*: Monetary Data Suggest Prudent Policy with an Easing Bias", Shuang Ding and Minggao Shen, 12 June 2014, Citi.

…and we continue to look for inflation to markedly undershoot compared to ECB and consensus forecasts

With modest economic growth, the large output gap, plus falling import prices, we continue to expect that inflation will markedly undershoot consensus and ECB forecasts. Indeed, even with the recent rise in oil prices, we are leaving our euro area inflation forecasts for 2014-15 unchanged, at 0.6% and 0.9% respectively. Within that, we expect CPI inflation to edge down from 0.5% YoY in May to 0.4% YoY in Q3. Our forecasts remain below the ECB's downwardly-revised outlook presented in early-June, which is for CPI inflation of 0.7% YoY in Q3-14, 1.1% in 2015 and 1.4% in 2016.

The persistent inflation undershoot is likely to prompt further ECB easing, with ABS purchases near term and — probably — QE around year-end

This outlook is very different to 2010-12, when inflation repeatedly overshot ECB forecasts, and those persistent inflation overshoots played a big role in the ECB's reluctance to loosen as aggressively as the Fed and BoE in that period (and indeed to tighten in 2011). Now, with inflation persistently undershooting its forecasts and the target, we continue to expect the ECB will ease further. Following Draghi's comment that the ECB "*decided to intensify preparatory work related to outright purchases in the ABS market to enhance the functioning of the monetary policy transmission mechanism*" we look for ABS purchases to start soon — most likely in Q3. Subsequently, we continue to expect the lower inflation outlook will prompt the ECB to implement large-scale QE (ie unsterilized asset purchases) around year-end, with an initial target of perhaps €1000bn spread over a year. We have tried to build possible effects of this into our economic forecasts. Our growth/inflation forecasts would face further downside risks if ECB action is not forthcoming, unless some other factor improves financial conditions markedly.

The UK remains our biggest above-consensus growth forecast…

The UK remains one of our major above-consensus growth forecasts. We continue to look for GDP growth of about 3½% YoY in both 2015 and 2016. By contrast, the consensus looks for YoY GDP growth (which already hit 3.1% YoY in Q1, a figure that is likely to be revised up in the upcoming June 27 release) of 3.0% YoY this year with a slowdown to 2.6% in 2015. Some aspects of the UK recovery story are similar to US, with marked improvements in private sector balance sheets and credit availability. In addition, the various headwinds that have capped US growth over the last few quarters (sequestration, rising fixed mortgage rates, adverse weather) are absent in the UK: fiscal policy has been roughly neutral since mid-2012 while key mortgage rates have fallen markedly since late-2012.

…and the BoE is likely to hike earlier, faster and further than markets price in

At the time of writing, the BoE's Financial Policy Committee decision (due on June 26) has not yet been released. We expect modest macro-prudential tightening measures aimed to averting a future credit boom — but not measures that will materially affect the near-term outlook for housing or economic growth. With strong economic growth and the jobless rate falling rapidly, the UK MPC is moving towards an early rate hike. We continue to look for the first hike to come in Q4 this year, with rates then rising faster and further than markets project in a benign response to the rapid upturn in growth and closing of the output gap.

Fed hiking, though still quite distant, also may eventually be greater than markets currently price in

In the US, we believe that the Q1 weakness is not representative of the economy's underlying momentum, and we expect a solid rebound in the economy in coming quarters. Moreover, inflation is likely to drift higher in coming months as the disinflationary effects of sequestration on health care costs and last year's weakness in commodity prices fade. Indeed, in contrast to the euro area, we are slightly lifting our US 2014-15 inflation forecasts this month. We still forecast the first Fed hike to come in mid-15 and — whereas market pricing implies that policy rates in 2015-16 will be below the median of FOMC members — we expect an extended tightening cycle that eventually carries rates up to roughly 3% on average in 2017-18. This implies a marked divergence with the long period of loose ECB policy that probably lies ahead.

Figure 10. Selected Countries — Economic Forecast Overview (Percent), 2013-2018F

	GDP Growth						CPI Inflation						Central Bank Policy Rates					
	2013	2014F	2015F	2016F	2017F	2018F	2013	2014F	2015F	2016F	2017F	2018F	2013	2014F	2015F	2016F	2017F	2018F
Global	2.5	3.0	3.5	3.7	3.6	3.4	2.6	2.9	3.1	3.4	3.4	3.4	2.14	2.35	2.47	2.82	3.22	3.45
Based on PPP weights	3.0	3.4	3.9	4.1	4.1	4.0	3.1	3.3	3.5	3.9	3.9	3.9	2.71	2.97	3.17	3.51	3.85	3.88
Industrial Countries	1.2	2.0	2.5	2.5	2.3	2.0	1.3	1.6	1.7	1.5	1.5	1.7	0.46	0.38	0.54	1.05	1.61	2.18
United States	1.9	2.2	3.2	3.2	2.7	2.2	1.1	1.6	1.9	2.2	2.3	2.2	0.25	0.25	0.48	1.46	2.48	3.25
Japan	1.5	1.5	0.9	1.2	1.2	1.0	0.4	2.8	1.7	1.6	0.7	1.0	0.10	0.10	0.10	0.10	0.10	0.30
Euro Area	-0.4	1.2	1.8	1.9	1.9	1.8	1.4	0.6	0.9	1.2	1.4	1.7	0.50	0.19	0.15	0.16	0.42	0.92
Canada	2.0	2.3	2.7	2.7	2.6	2.4	0.9	2.0	2.0	2.0	2.0	2.0	1.00	1.00	1.19	2.13	2.50	2.75
Australia	2.4	3.4	3.0	3.1	3.2	3.2	2.4	2.7	2.5	2.4	2.4	2.4	2.69	2.50	2.88	3.50	4.00	4.25
New Zealand	2.8	3.5	2.9	2.4	2.6	2.7	1.1	2.1	2.2	2.2	2.2	2.4	2.50	3.31	4.06	4.44	4.50	4.75
Germany	0.5	2.2	2.5	2.5	2.4	2.2	1.5	1.2	1.8	2.2	2.3	2.4						
France	0.4	0.7	1.3	1.7	2.0	1.9	1.0	0.7	1.2	1.4	1.4	1.5						
Italy	-1.8	0.2	1.1	1.1	0.9	0.7	1.3	0.3	-0.2	0.3	0.9	1.3						
Spain	-1.2	1.3	1.9	2.2	1.9	1.8	1.5	-0.2	0.0	0.5	0.6	0.8						
Greece	-3.9	-0.6	1.2	1.4	1.5	1.6	-0.9	-1.6	-1.6	-1.0	-0.3	0.9						
Ireland	-0.3	2.8	3.4	2.8	3.0	3.0	0.4	0.8	1.0	1.1	1.6	1.7						
Portugal	-1.4	1.2	2.0	1.9	1.9	2.0	0.4	-0.3	-0.7	-0.3	0.2	0.7						
Netherlands	-0.8	0.6	1.4	1.7	2.0	2.1	2.6	0.3	1.1	1.5	1.6	1.8						
Belgium	0.2	1.3	1.5	1.6	2.0	2.1	1.2	0.6	1.1	1.8	1.6	1.9						
Denmark	0.4	1.3	1.6	1.8	1.7	1.9	0.8	1.0	1.5	1.8	1.9	2.0	0.20	0.20	0.20	0.25	0.55	1.10
Norway	2.0	2.0	2.2	2.5	2.9	2.9	2.1	2.0	2.1	2.1	2.2	2.4	1.50	1.50	1.55	1.82	2.24	3.09
Sweden	1.6	2.4	2.7	2.8	2.9	2.7	0.0	-0.1	1.0	2.2	2.3	2.2	0.99	0.64	0.57	0.92	1.68	2.30
Switzerland	2.0	2.1	2.6	2.7	2.0	2.0	-0.2	-0.2	0.8	1.1	1.2	1.2	0.00	0.00	0.00	0.00	0.25	1.00
United Kingdom	1.7	3.5	3.6	2.8	2.2	2.4	2.6	1.6	1.9	2.1	2.0	2.0	0.50	0.54	1.67	2.50	2.71	3.21
Emerging Markets	4.5	4.5	5.0	5.4	5.5	5.4	4.7	4.9	5.2	5.1	5.1	4.9	4.78	5.30	5.36	5.47	5.57	5.27
China	7.7	7.3	7.0	7.5	7.3	7.0	2.6	2.6	3.2	3.8	4.0	3.8	3.00	3.00	3.00	3.13	3.50	3.75
Taiwan	2.1	3.2	3.7	4.2	4.5	4.5	0.8	1.2	2.0	1.8	1.8	1.8	1.88	1.88	2.19	2.63	3.13	3.63
India	4.7	5.6	6.5	7.0	7.1	7.1	9.5	8.0	6.5	6.5	6.5	6.5	7.75	8.00	8.00	7.50	7.00	7.00
Indonesia	5.8	5.3	5.5	5.6	5.8	5.7	6.4	6.5	6.7	6.0	5.3	4.8	4.65	5.81	6.00	6.00	6.00	6.00
Korea	3.0	3.9	4.0	4.4	3.6	3.8	1.3	1.9	2.9	3.1	3.0	2.9	2.56	2.50	2.88	3.63	4.13	4.25
Czech Republic	-0.9	2.4	2.7	3.0	3.1	3.2	1.4	0.7	2.0	1.6	2.0	2.0	0.05	0.05	0.08	0.75	1.54	2.54
Hungary	1.1	2.9	1.9	1.6	1.7	2.0	1.7	0.4	2.5	3.0	2.3	1.7	4.38	2.34	2.57	3.98	4.21	5.00
Poland	1.6	3.4	3.6	3.6	3.5	3.2	0.9	0.3	2.0	2.7	2.5	2.5	2.95	2.50	2.54	3.38	3.67	3.29
Romania	3.5	3.0	3.4	3.7	3.7	3.7	4.0	1.8	3.3	2.6	2.5	2.5	4.69	3.50	4.50	5.00	5.00	5.00
Russia	1.3	1.0	2.3	2.6	2.6	2.6	6.8	7.1	6.1	6.0	5.7	5.4	5.50	7.00	6.17	5.15	4.83	4.56
Turkey	4.0	3.5	3.5	3.8	4.0	4.0	7.5	8.6	7.9	7.3	7.1	6.7	6.16	9.88	10.75	9.88	9.50	9.00
Nigeria	6.8	6.5	6.4	7.0	6.2	6.8	8.5	8.7	10.6	9.2	9.9	9.2	12.00	12.00	11.75	11.00	9.00	9.00
South Africa	1.9	2.0	2.8	3.3	4.3	4.1	5.8	6.5	5.8	5.5	5.9	5.9	5.00	5.71	6.42	7.92	8.00	8.00
Argentina	3.0	0.0	1.0	-2.0	3.5	3.0	10.6	NA	31.8	42.5	40.0	25.0	17.16	26.37	34.16	37.00	37.00	0.00
Brazil	2.3	0.9	1.2	2.5	3.0	3.0	6.2	6.4	6.4	5.9	5.5	5.5	8.44	10.92	12.33	12.00	11.50	11.50
Mexico	1.1	3.0	4.0	4.4	4.5	4.6	3.8	4.0	3.6	3.6	3.6	3.6	3.94	3.50	3.75	4.90	5.17	6.21
Venezuela	1.3	-1.0	1.9	1.9	1.9	1.9	38.5	61.7	82.5	60.0	60.0	60.0	14.50	14.50	14.50	14.80	14.80	14.80

Note: For inflation, we use the PCE deflator in the US, GDP deflator in Ireland. For Indonesia we refer to the FasBI rate to reflect actual money market rates.
Source: Citi Research

Figure 11. Selected Countries — Economic Forecast Overview (Percent), 2013-2018F

	Current Balance (Pct of GDP)						Fiscal Balance (Pct of GDP)						Government Debt (Pct of GDP)					
	2013	2014F	2015F	2016F	2017F	2018F	2013	2014F	2015F	2016F	2017F	2018F	2013	2014F	2015F	2016F	2017F	2018F
Global	0.6	0.8	0.6	0.3	0.1	0.1	-4.1	-3.7	-3.2	-2.9	-2.7	-2.3	88	86	86	85	84	83
Based on PPP weights	0.4	0.5	0.4	0.0	-0.1	-0.1	-4.0	-3.7	-3.3	-3.0	-2.9	-2.4	80	80	80	79	78	77
Industrial Countries	-0.2	0.0	0.1	0.0	0.1	0.2	-5.5	-4.6	-3.8	-3.4	-3.0	-2.8	115	113	112	112	111	111
United States	-2.4	-2.1	-1.5	-1.8	-1.7	-1.4	-7.3	-6.4	-5.6	-5.6	-5.4	-5.4	105	106	106	106	106	106
Japan	0.7	-0.2	-0.3	0.0	0.2	0.2	-9.8	-8.0	-6.2	-5.8	-5.4	-5.0	241	243	247	248	251	254
Euro Area	2.4	2.8	2.8	2.8	2.6	2.5	-3.0	-2.6	-2.3	-1.7	-1.2	-0.9	95	97	97	96	94	92
Canada	-3.2	-2.8	-2.8	-2.5	-2.0	-1.9	-0.9	-0.1	0.3	0.4	0.4	0.4	94	92	90	89	87	84
Australia	-3.2	-1.9	-2.2	-2.4	-2.8	-2.8	-1.2	-3.1	-1.8	-1.0	-0.6	-0.2	30	32	34	33	33	34
New Zealand	-3.4	-4.2	-5.4	-5.0	-5.4	-6.6	-2.9	-1.6	-0.4	0.5	1.2	2.2	40	39	36	37	37	34
Germany	7.6	6.9	6.6	6.1	5.9	5.5	0.0	0.1	0.2	0.0	0.0	0.0	78	77	74	71	69	66
France	-1.4	-0.7	-0.1	0.4	0.1	-0.1	-4.3	-4.2	-3.6	-2.8	-1.9	-1.1	93	97	98	98	97	95
Italy	1.0	1.9	2.0	2.1	2.0	2.0	-2.8	-3.0	-2.8	-2.1	-1.6	-1.2	133	137	139	138	138	137
Spain	0.8	0.6	0.5	0.6	0.6	0.6	-7.1	-5.7	-4.9	-3.9	-3.2	-2.7	94	99	102	102	103	103
Greece	0.8	2.1	2.4	2.4	2.4	2.3	-12.7	-2.4	-2.7	-2.0	-1.6	-1.0	175	182	185	184	183	179
Ireland	6.6	9.6	10.3	9.4	8.7	7.8	-7.2	-5.1	-2.5	-1.8	-1.1	-0.3	124	120	119	115	111	106
Portugal	0.5	0.5	0.7	0.9	1.3	1.5	-5.0	-4.2	-3.0	-2.4	-2.0	-1.5	129	136	133	131	129	128
Netherlands	10.8	10.9	10.3	9.8	9.4	9.0	-2.4	-2.8	-2.2	-1.7	-1.3	-0.9	74	75	75	74	73	71
Belgium	-1.6	1.0	1.7	1.8	1.6	1.3	-2.7	-2.4	-1.9	-1.2	-0.4	0.5	101	102	101	99	96	92
Denmark	7.3	6.8	5.7	5.4	5.5	5.5	-1.0	-1.3	-2.7	-1.7	-1.0	-0.9	45	45	46	46	46	45
Norway	11.1	11.4	11.7	12.0	12.1	12.5	10.9	11.0	11.0	10.0	10.0	9.0	NA	NA	NA	NA	NA	NA
Sweden	6.4	6.3	6.0	6.1	6.0	6.0	-1.3	-1.6	-0.8	-0.3	0.5	1.2	39	40	39	38	35	32
Switzerland	12.0	11.1	10.2	9.9	10.5	10.5	0.2	0.7	1.1	1.7	1.7	0.9	48	46	45	44	42	44
United Kingdom	-4.4	-4.0	-4.0	-4.1	-3.8	-3.6	-7.1	-5.6	-3.7	-1.5	-0.7	0.3	94	97	96	94	92	88
Emerging Markets	1.8	1.9	1.3	0.6	0.1	-0.1	-2.1	-2.3	-2.4	-2.2	-2.3	-1.5	44	45	45	45	44	44
China	2.0	2.0	1.5	0.8	0.5	0.5	-1.9	-2.1	-2.0	-2.0	-2.0	-2.0	54	54	53	52	51	50
Taiwan	11.7	11.0	10.2	8.0	8.0	8.0	-1.4	-1.4	-0.8	-0.6	-0.6	-0.6	40	40	39	39	39	38
India	-1.7	-1.9	-2.0	-2.0	-2.0	-2.1	-6.9	-6.7	-6.5	-6.2	-5.9	-5.5	69	68	66	65	63	61
Indonesia	-3.3	-2.8	-2.4	-2.5	-2.2	-1.7	-2.2	-2.4	-2.2	-1.9	-2.0	-2.0	24	26	25	25	25	25
Korea	6.1	4.7	3.0	2.3	1.6	0.8	1.0	0.9	1.5	1.7	1.9	1.7	33	31	29	27	26	25
Czech Republic	-1.4	0.9	1.7	2.1	2.3	-0.3	-1.5	-2.0	-2.5	-2.4	-2.2	-2.0	46	45	45	46	46	45
Hungary	2.9	2.5	2.1	1.9	1.7	1.5	-2.2	-2.9	-2.9	-2.9	-3.0	-3.0	79	80	79	79	78	77
Poland	-1.3	-1.7	-2.7	-3.5	-3.6	-3.3	-4.3	5.2	-2.7	-2.6	-2.6	-2.6	54	48	47	46	46	45
Romania	-1.1	-2.5	-4.2	-4.5	-4.5	-4.5	-2.5	-2.3	-2.3	-2.3	-2.3	-2.3	42	42	41	40	39	39
Russia	1.5	2.7	1.9	0.6	-0.4	-1.4	-2.1	-4.4	-4.9	-1.4	-1.4	-1.4	7	9	13	13	12	13
Turkey	-7.9	-5.3	-5.4	-5.1	-5.0	-4.9	-1.2	-2.8	-3.2	-3.3	-3.3	-3.3	39	38	37	36	35	33
Nigeria	1.8	1.5	0.7	0.7	1.0	0.7	-1.6	-2.0	-1.8	-1.7	-1.6	-1.5	NA	NA	NA	NA	NA	NA
South Africa	-5.8	-4.9	-4.2	-3.4	-3.1	-2.7	-4.3	-4.2	-4.2	-3.7	-3.0	-2.0	46	47	48	49	49	49
Argentina	-0.7	-1.1	-1.2	3.0	1.0	1.0	-1.9	-2.4	-2.4	0.0	-0.5	-1.0	31	38	46	44	42	41
Brazil	-3.7	-3.8	-3.9	-4.0	-3.9	-3.9	-3.3	-3.9	-3.4	-3.4	-3.3	-3.3	57	57	58	58	58	58
Mexico	-1.8	-2.1	-1.8	-1.4	-1.5	-1.5	-2.4	-3.5	-2.5	-2.0	-2.0	-2.0	38	38	38	37	37	37
Venezuela	3.3	4.1	5.1	3.0	3.0	3.0	-11.9	-11.2	-10.3	-12.0	-12.1	-11.5	41	40	40	41	41	42

Note: Fiscal deficit and debt figures for all countries are general government debt and deficits. For Spain, fiscal deficits include the effect of financial support for banks. For Greece, we assume further reductions in the cost of official loans. Source: Citi Research

Figure 12. Selected Countries — Changes in Economic Forecasts (Percentage Points), 2013-2015F

	GDP Growth			CPI Inflation			Current Balance (Pct of GDP)			Fiscal Balance (Pct of GDP)		
	2013	2014F	2015F	2013	2014F	2015F	2013	2014F	2015F	2013	2014F	2015F
Global							-0.1				-0.1	
Based on PPP weights												
Industrial Countries			0.1		0.1			-0.1	-0.1			-0.1
United States		-0.1	0.1		0.1	0.1	-0.1	-0.1				
Japan	-0.1	0.1							-0.1			
Euro Area								-0.1	-0.1			-0.3
Canada		-0.1			0.2			-0.4	-0.8			
Australia		0.5	0.1				-0.3	0.6	0.2		-0.1	0.3
New Zealand	0.1	0.3	0.2									
Germany			0.1		-0.1		0.2	-0.2	-0.2			-0.1
France		-0.1	-0.1		-0.1			-0.1	-0.2		-0.1	-0.1
Italy		-0.1	-0.1					0.3	0.5			-0.1
Spain		0.3	0.3		-0.2	-0.2		-0.4	-0.4		0.1	-0.1
Greece		0.2				0.1		0.6	0.6		0.1	0.1
Ireland		0.7	0.1					1.0	1.6		0.3	0.3
Portugal	-0.1				0.1	-0.1		-1.0	-0.4		-0.2	-0.2
Netherlands					-0.4	-0.2	0.4	0.4	0.1			
Belgium												0.1
Denmark		0.3	0.1		-0.5	-0.2	-0.1		-0.1	0.2		-0.3
Norway							0.5	0.3	0.3	-0.5	-0.9	
Sweden	0.1	-0.2			-0.2	-0.2	0.2	0.4	0.4			
Switzerland		-0.1	0.3			-0.1		-1.1	-1.5			
United Kingdom					-0.1	-0.1		-0.4	-0.3			0.1
Emerging Markets					-0.1			0.1	0.1			
China												
Taiwan			-0.1									
India	-0.2						0.2	0.4	0.5			
Indonesia								-0.4	-0.3		-0.1	-0.5
Korea					-0.2	-0.2		0.8	0.1			
Czech Republic		0.5	0.1		-0.2	-0.1		0.7	0.9			
Hungary		0.4			-0.1	-0.1		-0.1	-0.1			
Poland					-0.5	-0.5		0.8	1.0			
Romania					-0.2	-0.1						
Russia					0.3	0.3						
Turkey		1.3						-0.1	-0.1			
Nigeria	0.2	0.1			-0.1		-2.0	-0.9	-0.7	-0.2	-0.3	-0.2
South Africa		-0.3	-0.1									
Argentina												
Brazil		-0.4	-0.6			0.1			-0.1			
Mexico												
Venezuela					-0.8	0.4						

Source: Citi Research

Figure 13. Selected Countries — Economic Forecast Overview and Exchange Rate Forecasts (Percent), 2013-2018F

	10-Year Yields						Exchange Rates Versus U.S. Dollar*						Exchange Rate Versus Euro					
	2013	2014F	2015F	2016F	2017F	2018F	2013	2014F	2015F	2016F	2017F	2018F	2013	2014F	2015F	2016F	2017F	2018F
Industrial Countries																		
United States	2.35	2.75	3.10	3.20	3.35	3.45	NA	NA	NA	NA	NA	NA	1.33	1.37	1.37	1.41	1.42	1.43
Japan	0.71	0.66	0.90	1.25	1.50	1.50	98	104	109	111	113	114	130	143	149	157	160	162
Euro Area	1.60	1.56	1.55	1.80	2.05	2.30	1.33	1.37	1.37	1.41	1.42	1.43	NA	NA	NA	NA	NA	NA
Canada	2.26	2.47	2.95	3.05	3.15	3.10	1.03	1.09	1.11	1.10	1.10	1.10	1.37	1.50	1.52	1.55	1.56	1.57
Australia	3.65	4.18	4.70	5.06	5.50	5.75	0.97	0.94	0.95	0.93	0.93	0.92	1.37	1.45	1.44	1.51	1.53	1.55
New Zealand	3.98	4.71	5.23	5.65	5.80	6.00	0.82	0.87	0.86	0.84	0.79	0.74	1.62	1.57	1.58	1.68	1.79	1.92
Germany	1.60	1.56	1.55	1.80	2.05	2.30												
France	2.12	2.04	1.95	2.20	2.45	2.70												
Italy	4.23	3.12	2.75	2.65	2.75	2.90												
Spain	4.48	3.06	2.75	2.85	2.95	3.10												
Greece	10.36	6.31	5.18	5.18	4.55	4.30												
Ireland	4.00	2.70	2.40	2.50	2.60	2.90												
Portugal	5.15	3.76	3.05	3.05	3.15	3.30												
Netherlands	1.89	1.81	1.80	2.05	2.30	2.55												
Belgium	2.33	2.13	2.05	2.30	2.55	2.80												
Denmark	1.73	1.63	1.68	1.95	2.30	2.55	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
Norway	2.57	2.76	2.46	2.65	2.90	3.15	5.88	6.04	5.85	5.48	5.26	5.06	7.81	8.28	7.99	7.71	7.46	7.21
Sweden	2.10	2.11	2.14	2.40	2.55	2.80	6.51	6.60	6.64	6.37	6.22	6.07	8.65	9.05	9.07	8.97	8.82	8.65
Switzerland	0.82	0.95	1.06	1.08	1.28	1.48	0.93	0.90	0.92	0.91	0.91	0.91	1.23	1.23	1.26	1.29	1.29	1.30
United Kingdom	2.34	2.85	3.20	3.35	3.45	3.50	1.56	1.73	1.77	1.77	1.78	1.80	0.85	0.79	0.77	0.80	0.80	0.79
Emerging Markets																		
China	3.68	4.41	4.33	4.45	4.83	5.08	6.15	6.16	6.03	6.01	6.02	6.04	8.17	8.45	8.24	8.46	8.54	8.62
Taiwan	1.46	1.60	1.89	2.19	2.49	2.79	29.68	30.13	29.94	29.70	29.18	28.65	39.43	41.29	40.90	41.83	41.40	40.85
India	8.25	8.50	8.50	8.00	7.50	7.50	58.57	60.49	62.32	62.31	59.46	56.39	77.80	82.90	85.16	87.78	84.35	80.41
Indonesia	6.97	8.34	8.75	8.75	8.75	8.75	10449	11724	12003	11653	10915	10149	13881	16068	16401	16415	15484	14471
Korea	3.00	3.15	3.59	4.15	4.55	4.75	1095	1034	1007	973	976	981	1454	1417	1376	1371	1384	1399
Czech Republic	2.09	1.87	2.27	2.61	2.97	3.20	19.6	20.1	20.0	18.7	18.1	17.5	26.0	27.5	27.3	26.4	25.7	24.9
Hungary	5.92	5.43	5.98	6.48	6.71	7.50	223	226	233	231	230	230	297	310	318	325	327	329
Poland	4.05	3.97	4.28	4.85	4.76	0.68	3.16	3.07	3.08	2.84	2.79	2.75	4.20	4.20	4.20	4.01	3.96	3.93
Romania	NA	NA	NA	NA	NA	NA	3.33	3.24	3.24	3.11	3.04	2.99	4.42	4.44	4.42	4.39	4.32	4.26
Russia	NA	NA	NA	NA	NA	NA	31.9	35.7	37.8	37.2	37.0	36.9	42.3	48.9	51.6	52.4	52.5	52.7
Turkey	NA	NA	NA	NA	NA	NA	1.91	2.16	2.26	2.39	2.38	2.36	2.53	2.96	3.09	3.36	3.38	3.37
Nigeria	NA	NA	NA	NA	NA	NA	159	164	169	171	175	180	212	225	231	241	248	257
South Africa	7.20	8.05	8.04	8.14	8.38	8.77	9.65	10.75	11.00	10.79	10.68	10.58	12.82	14.74	15.03	15.20	15.16	15.09
Argentina	NA	NA	NA	NA	NA	NA	5.45	8.75	11.81	18.23	25.82	30.98	7.24	12.00	16.14	25.67	36.62	44.18
Brazil	9.98	11.83	11.91	12.21	12.25	12.25	2.16	2.33	2.55	2.67	2.78	2.90	2.87	3.19	3.48	3.76	3.95	4.14
Mexico	5.67	6.54	7.47	7.58	7.65	7.65	12.8	13.0	13.0	12.7	12.5	12.4	17.0	17.9	17.7	17.9	17.8	17.7
Venezuela	10.81	14.01	14.95	15.50	15.50	15.50	5.99	9.15	19.80	31.28	49.43	78.10	7.96	12.54	27.06	44.07	70.12	111.36

*Per USD except Euro Area, Australia, New Zealand, United Kingdom. For China we use 5Y bond yields. Source: Citi Research

Figure 14. Short Rates (End of Period), as of 25 June 2014 (Percent)

	Current	3Q 14	4Q 14	1Q 15	2Q 15	3Q 15	4Q 15
United States	0.25	0.25	0.25	0.25	0.25	0.75	1.00
Japan	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Euro Area	0.15	0.15	0.15	0.15	0.15	0.15	0.15
Canada	1.00	1.00	1.00	1.00	1.00	1.25	1.50
Australia	2.50	2.50	2.50	2.50	2.75	3.00	3.25
New Zealand	3.25	3.50	3.75	3.75	4.00	4.25	4.25
Denmark	0.20	0.20	0.20	0.20	0.20	0.20	0.20
Norway	1.50	1.50	1.50	1.50	1.50	1.50	1.75
Sweden	0.75	0.50	0.50	0.50	0.50	0.50	0.75
Switzerland	0.00	0.00	0.00	0.00	0.00	0.00	0.00
United Kingdom	0.50	0.50	0.75	1.25	1.50	2.00	2.50
China	3.00	3.00	3.00	3.00	3.00	3.00	3.00

Note: The rates shown are overnight rates, except for Denmark, where it is the central bank's lending rate; Switzerland, where it is the SNB's three-month Libor target; and China, where it is the one-year deposit rate. Source: Citi Research

Figure 15. 10-Year Yield Forecasts (Period Average), as of 25 June 2014 (Percent)

	Current	3Q 14	4Q 14	1Q 15	2Q 15	3Q 15	4Q 15
United States	2.59	2.70	2.90	3.00	3.05	3.15	3.20
Japan	0.58	0.60	0.55	0.70	0.80	0.85	0.75
Euro Area (Germany)	1.33	1.45	1.50	1.50	1.55	1.55	1.60
Canada	2.28	2.40	2.65	2.80	2.90	3.00	3.10
Australia	3.74	4.15	4.25	4.40	4.60	4.80	5.00
New Zealand	4.45	4.70	4.90	5.00	5.10	5.30	5.50
Denmark	1.67	1.52	1.60	1.60	1.65	1.70	1.75
Norway	2.54	2.65	2.60	2.40	2.50	2.50	2.45
Sweden	1.91	2.00	2.10	2.10	2.10	2.10	2.25
Switzerland	0.69	0.95	0.95	1.02	1.02	1.10	1.10
United Kingdom	2.70	2.90	3.05	3.15	3.15	3.20	3.25

Note: Bond yields measured on local market basis (semi-annual for the United States, United Kingdom, Canada, Australia, and New Zealand; annual for the rest). The 10-year yield for the euro area is the Bund yield. Source: Citi Research

Figure 16. 10-Year Yield Spreads (Period Average), as of 25 June 2014

	Spread vs. US$						Spread vs. Germany					
	Current	3Q 14	4Q 14	1Q 15	2Q 15	3Q 15	Current	3Q 14	4Q 14	1Q 15	2Q 15	3Q 15
United States	NA	NA	NA	NA	NA	NA	128	127	142	152	152	162
Japan	-203	-212	-237	-232	-227	-232	-75	-85	-95	-80	-75	-70
Euro Area	-128	-127	-142	-152	-152	-162	NA	NA	NA	NA	NA	NA
Canada	-31	-30	-25	-20	-15	-15	96	96	117	132	137	147
Australia	117	147	137	143	158	168	244	274	280	295	310	331
New Zealand	189	204	204	204	209	220	317	331	346	356	362	382
France	-84	-77	-102	-112	-112	-122	42	50	40	40	40	40
Italy	30	13	-22	-32	-32	-42	156	140	120	120	120	120
Spain	7	13	-22	-32	-32	-42	133	140	120	120	120	120
Netherlands	-104	-102	-117	-127	-127	-137	22	25	25	25	25	25
Belgium	-82	-72	-92	-102	-102	-112	44	55	50	50	50	50
Austria	-97	-97	-117	-127	-127	-137	29	30	25	25	25	25
Finland	-107	-97	-117	-127	-127	-137	19	30	25	25	25	25
Ireland	-21	-17	-62	-72	-72	-82	105	110	80	80	80	80
Portugal	86	63	8	-2	-2	-12	212	190	150	150	150	150
Greece	322	303	258	223	223	188	448	430	400	375	375	350
Denmark	-92	-120	-132	-142	-142	-147	34	7	10	10	10	15
Norway	-5	-7	-32	-62	-57	-67	121	120	110	90	95	95
Sweden	-68	-72	-82	-92	-97	-107	58	55	60	60	55	55
Switzerland	-190	-177	-197	-200	-205	-207	-64	-50	-55	-48	-53	-45
United Kingdom	11	20	15	15	10	5	137	147	157	167	162	168

NA Not applicable. Note: Spreads calculated on annual basis (except those of the United Kingdom, Canada, Australia and New Zealand over the United States). Source: Citi Research

Figure 17. Emerging Market Countries — Short Rates Actual and Forecast of Additional Rate Moves (End of Period), as 25 June 2014

Country	Current Rate (%)	Sep 14	Dec 14	Mar 15	Jun 15	Sep 15	Total Cumulative Rate Moves Expected
Turkey	9.50	50	50	0	0	50	150
Brazil	11.00	0	0	100	50	0	150
South Africa	5.50	50	0	0	25	50	125
Colombia	4.00	50	0	25	0	25	100
Mexico	3.00	0	0	0	0	50	50
Malaysia	3.00	50	0	0	0	0	50
Philippines	3.50	0	25	25	0	0	50
Hungary	2.30	-20	0	0	30	40	50
Peru	4.00	-25	0	25	50	0	50
Indonesia	5.75	0	25	0	0	0	25
Israel	0.75	-25	75	-25	0	0	25
India	8.00	0	0	0	0	0	0
Thailand	2.00	0	0	0	0	0	0
China	3.00	0	0	0	0	0	0
Poland	2.50	0	0	0	0	0	0
Chile	4.00	0	-50	0	25	25	0
Russia	7.50	0	-50	-50	-50	-25	-175

Note: For Turkey we use the average funding rate of the CBT instead of the 1-week repo rate. Source: Citi Research

Figure 18. Foreign Exchange Forecasts (End of Period), as of 25 June 2014

	vs. USD							vs. EUR						
	Current	Sep 14	Dec 14	Mar 15	Jun 15	Sep 15	Dec 15	Current	Sep 14	Dec 14	Mar 15	Jun 15	Sep 15	Dec 15
United States	NA	NA	NA	NA	NA	NA	NA	1.36	1.38	1.36	1.35	1.36	1.37	1.39
Japan	102	105	107	108	109	109	110	139	145	145	146	148	150	152
Euro Area	1.36	1.38	1.36	1.35	1.36	1.37	1.39	NA	NA	NA	NA	NA	NA	NA
Canada	1.08	1.08	1.10	1.12	1.12	1.11	1.11	1.46	1.49	1.50	1.51	1.52	1.53	1.53
Australia	0.94	0.95	0.96	0.96	0.95	0.95	0.94	1.45	1.44	1.42	1.40	1.43	1.45	1.47
New Zealand	0.87	0.88	0.87	0.87	0.87	0.86	0.86	1.56	1.57	1.56	1.55	1.57	1.59	1.62
Norway	6.12	6.04	6.03	6.01	5.90	5.79	5.69	8.32	8.31	8.20	8.09	8.02	7.95	7.88
Sweden	6.71	6.59	6.68	6.75	6.68	6.60	6.52	9.13	9.07	9.09	9.10	9.08	9.06	9.04
Switzerland	0.90	0.90	0.91	0.93	0.93	0.92	0.92	1.22	1.24	1.24	1.25	1.26	1.27	1.28
United Kingdom	1.70	1.76	1.77	1.77	1.77	1.77	1.77	0.80	0.78	0.77	0.76	0.77	0.78	0.78
China	6.22	6.14	6.09	6.04	6.03	6.02	6.02	8.47	8.45	8.28	8.14	8.20	8.27	8.34
India	60.2	60.6	61.3	62.0	62.2	62.4	62.6	81.8	83.4	83.4	83.6	84.6	85.7	86.8
Korea	1021	1025	1025	1024	1013	1002	991	1389	1411	1394	1379	1377	1375	1373
Poland	3.06	3.06	3.13	3.19	3.11	3.04	2.97	4.17	4.22	4.26	4.29	4.23	4.17	4.11
Russia	34.5	35.8	37.0	38.1	37.9	37.7	37.5	46.9	49.3	50.4	51.3	51.5	51.7	52.0
South Africa	10.65	10.82	10.97	11.09	11.03	10.97	10.91	14.48	14.90	14.92	14.94	15.00	15.06	15.12
Turkey	2.14	2.16	2.18	2.20	2.24	2.28	2.32	2.91	2.98	2.97	2.97	3.05	3.14	3.22
Brazil	2.23	2.36	2.43	2.50	2.53	2.56	2.59	3.03	3.25	3.31	3.37	3.45	3.52	3.59
Mexico	13.0	13.0	13.1	13.1	13.0	12.9	12.9	17.7	17.9	17.8	17.6	17.7	17.8	17.8

Source: Citi Research

Figure 19. Foreign Exchange Forecasts (End of Period), as of 25 June 2014

	vs. JPY						
	Current	Sep 14	Dec 14	Mar 15	Jun 15	Sep 15	Dec 15
United States	102	105	107	108	109	109	110
Japan	NA	NA	NA	NA	NA	NA	NA
Euro Area	139	145	145	146	150	152	152
Canada	95	97	97	97	97	98	99
Australia	96	100	102	104	104	104	103
New Zealand	89	92	93	94	94	94	94
Norway	16.7	17.4	17.7	18.0	18.4	18.9	19.3
Sweden	15.2	16.0	16.0	16.0	16.3	16.6	16.8
Switzerland	114	117	117	116	117	118	119
United Kingdom	174	185	189	191	192	193	194
China	16	17	18	18	18	18	18
India	1.70	1.74	1.74	1.74	1.75	1.75	1.75
Korea	10.00	9.74	9.61	9.47	9.32	9.17	9.02
Poland	33.31	34.35	34.06	33.91	34.91	35.95	37.02
Russia	2.96	2.94	2.88	2.84	2.87	2.90	2.93
South Africa	9.59	9.72	9.73	9.74	9.85	9.96	10.07
Turkey	47.69	48.59	48.86	49.02	48.41	47.83	47.26
Brazil	45.78	44.58	43.82	43.17	42.89	42.62	42.36
Mexico	7.86	8.07	8.17	8.26	8.35	8.45	8.55

Source: Citi Research

Country Commentary

United States

Peter D'Antonio
+1-212-816-9889
peter.dantonio@citi.com

The extreme winter took a bigger bite out of Q1 activity than we had thought, with GDP falling by about 2% QoQ SAAR. But the economy is now rebounding sharply, setting up for solid growth of 3½% or better in Q2 and Q3. The rebound in growth, especially in private domestic demand, should continue to drive down the jobless rate to about 6% at year-end. Demand has important supports from healthy employment and income growth, ample slack and a strong financial tailwind. The Fed continues to shift policy accommodation away from quantitative easing and toward anchoring forward rates. New York Fed President Dudley reinforced the notion that short-term interest rates are the "*primary means for adjusting monetary policy*." The Fed has been cutting asset purchases by $10 billion per meeting, setting the bar extremely high for changing that pace of taper. Chair Yellen has indicated a desire to guide policy by feedback rules that are conditional on economic developments.

Policymakers appear to have begun the process of revising the principles for exiting zero policy rates, and we expect an announcement of a new plan in the next few meetings. We believe the Fed has two choices for exiting: (1) drain reserves and monitor the federal funds rate, or (2) leave the reserves and target the interest on excess reserves and the reverse repo rate. We think the Fed will do the latter, setting up a corridor system with the reverse repo rate defining the floor and the discount rate the ceiling. Wage inflation has been extremely mild during this expansion, and although there are signs that wage growth may pick up, we do not believe that it will pose an inflationary threat. Corporate profit margins have soared, reflecting cost cutting during the recession and a slow pace of labour cost increases since then. At this point, any wage cost increase will likely be absorbed by margins, rather than kindle inflation.

Figure 20. United States — Economic Forecasts, 2013-2015F

					2014				2015			
		2013	2014F	2015F	1QF	2QF	3QF	4QF	1QF	2QF	3QF	4QF
GDP	SAAR				-2.0%	3.5%	3.5%	3.2%	3.2%	3.0%	3.2%	3.1%
	YoY	1.9%	2.2%	3.2%	2.0	2.3	2.2	2.3	3.4	3.2	3.2	3.1
Domestic Demand	SAAR				1.1	2.7	3.6	3.2	3.2	3.3	3.0	3.1
	YoY	1.6	2.3	3.2	1.9	2.0	2.4	2.8	3.2	3.3	3.2	3.2
Consumption	SAAR				2.4	2.8	3.5	3.1	3.0	3.2	2.8	3.0
	YoY	2.0	2.9	3.1	2.5	2.8	3.2	3.1	3.1	3.2	3.0	3.0
Business Investment	SAAR				-1.5	4.3	6.6	6.7	6.1	5.9	5.8	5.9
	YoY	2.7	3.6	6.1	3.4	3.3	3.7	3.9	5.9	6.3	6.1	5.9
Housing Investment	SAAR				-4.3	7.2	9.6	11.7	13.6	11.6	10.3	9.5
	YoY	12.2	2.4	11.3	2.4	0.8	0.7	5.7	10.5	11.6	11.8	11.3
Government	SAAR				-0.7	0.8	0.7	-0.1	0.3	0.3	0.3	0.2
	YoY	-2.2	-1.0	0.3	-1.5	-1.2	-1.2	0.1	0.4	0.3	0.2	0.3
Exports	SAAR				-9.4	5.7	3.9	5.0	5.3	5.1	5.0	4.6
	YoY	2.7	3.0	5.0	3.7	3.1	3.1	2.0	5.0	4.9	5.1	5.0
Imports	SAAR				1.8	2.1	2.3	3.7	3.3	5.0	5.3	5.1
	YoY	1.4	2.1	3.9	2.9	1.7	1.7	2.2	2.8	3.6	4.3	4.7
PCE Deflator	YoY	1.1	1.6	1.9	1.1	1.7	1.7	1.9	2.0	1.9	1.8	1.8
Core PCE Deflator	YoY	1.2	1.5	1.9	1.1	1.5	1.6	1.8	2.0	1.9	1.8	1.8
Unemployment Rate	%	7.4	6.3	5.8	6.7	6.3	6.2	6.1	6.0	5.9	5.7	5.6
Federal Gov't Balance (Fiscal Year)	$Bn	-680	-475	-450								
	% of GDP	-4.1	-2.7	-2.5								
General Gov't Balance (Cal Year)	% of GDP	-7.3	-6.4	-5.6								
Federal Debt	% of GDP	72	73	73								
General Gov't Debt	% of GDP	105	106	106								
Current Account	US$bn	-400	-368	-280	-445	-354	-343	-330	-307	-288	-271	-254
	% of GDP	-2.4	-2.1	-1.5	-2.6	-2.0	-1.9	-1.9	-1.7	-1.6	-1.5	-1.4
S&P 500 Profits (US$ Per Share)	YoY	6.4	7.1	7.2	5.4	6.9	7.3	8.7	6.6	6.9	6.6	8.6

Notes: F Citi forecast. E Citi Estimate. YoY Year-to-year percent change. SAAR Seasonally adjusted annual rate. Domestic demand excludes inventories and net exports. The table shows our expectation for Q1-2014 data and is not updated for the figures published on 25 June. Sources: Bureau of Economic Analysis, Bureau of Labor Statistics, I/B/E/S, Treasury Department, *Wall Street Journal* and Citi Research forecasts

Japan

Kiichi Murashima
+81-3-6270 4980
kiichi.murashima@citi.com

Naoki Iizuka
+81-3-6270 4997
naoki.iizuka@citi.com

We expect real GDP to shrink by 5.5% QoQ annualised in the current quarter mostly thanks to a sharp payback from the frontloaded demand ahead of the consumption tax hike in April. The economy will likely return to an upward trend in the third quarter, largely driven by moderate growth in export and business fixed investment. However, the negative impact from erosion in real purchasing power of household nominal income — driven by the tax hike — may persist longer.

The BoJ continues to expect higher wages and improvement in the output gap, along with rising inflation expectations, to push up inflation ex-tax changes to around 2% sometime in fiscal 2015. However, we remain skeptical that this scenario will play out. Wage growth appears too low to push up inflation meaningfully in the near future, while the erosion in real purchasing power of household income is likely to limit pricing power for the corporate sector, in our view. If incoming data supports our view, the BoJ will likely eventually decide on additional easing. We expect the BoJ will act in late October when policymakers update their economic outlook.

The government finalized the updated version of its "Growth Strategy" — or structural reform programs — this month. The Administration promised to start cutting the corporate tax rate in fiscal 2015 and to reduce the tax rate to somewhere below 30% from 35.6% currently in coming years, while broadening the tax base. However, a reduction in the corporate tax rate alone is unlikely to change corporate behaviour much. Japanese companies already have a large pile of cash and the biggest reason why companies do not invest is a lack of growth expectations for domestic markets. In our view, bolder deregulation — including for labour markets — would be needed to improve growth expectations. However, so far the government's steps appear to be modest. Thus, we believe the updated growth strategy will have only a limited impact on the medium- to long-term growth potential of the economy.

Figure 21. Japan — Economic Forecasts, 2013-2015F

					2014				2015			
		2013	2014F	2015F	1QF	2QF	3QF	4QF	1QF	2QF	3QF	4QF
Real GDP	YoY	1.5%	1.5%	0.9%	2.8%	0.6%	1.0%	1.2%	-0.1%	1.6%	1.4%	0.6%
	SAAR				6.7	-5.5	2.8	1.1	1.6	1.0	1.9	-2.1
Domestic Demand	YoY	1.8	1.6	0.6	3.9	1.1	0.9	0.6	-0.9	1.6	1.5	0.2
	SAAR				7.9	-8.5	2.6	1.0	1.5	1.1	2.4	-4.1
Private Consumption	YoY	2.0	0.3	0.2	3.6	-1.1	-0.6	-0.7	-2.4	1.7	1.8	-0.1
	SAAR				9.2	-14.5	2.9	1.1	1.9	0.8	3.3	-6.2
Business Investment	YoY	-1.4	9.2	4.3	11.4	8.2	8.7	8.7	2.0	5.6	5.4	4.4
	SAAR				34.2	-7.7	5.4	6.7	4.4	5.8	4.6	2.8
Housing Investment	YoY	8.8	0.5	-2.2	12.0	2.7	-4.5	-7.4	-8.9	0.3	3.3	-2.8
Public Investment	YoY	11.5	3.2	-8.7	11.8	7.5	1.0	-6.0	-6.5	-9.5	-10.5	-8.4
Exports	YoY	1.6	8.6	4.0	8.9	7.0	9.0	9.5	4.2	4.0	4.0	4.0
	SAAR				26.3	4.6	4.9	3.7	3.6	3.8	4.9	3.7
Imports	YoY	3.4	8.6	2.4	14.9	8.7	7.2	4.2	-1.1	3.9	5.0	2.0
	SAAR				27.6	-13.9	4.0	3.2	3.7	4.8	8.3	-8.0
CPI	YoY	0.4	2.8	1.7	1.5	3.6	3.1	2.9	2.9	0.8	0.9	2.2
Core CPI	YoY	0.4	2.7	1.7	1.3	3.3	3.1	3.0	2.9	0.8	0.9	2.2
Nominal GDP	YoY	0.9	2.3	1.4	1.4	0.1	0.5	0.5	0.2	0.6	0.1	0.4
Current Account	¥ tn	3.3	-1.2	-1.4	-5.2	0.3	0.4	-0.2	-0.9	-1.6	-2.8	-0.4
	% of GDP	0.7	-0.2	-0.3	-1.1	0.1	0.1	0.0	-0.2	-0.3	-0.6	-0.1
Unemployment Rate	%	4.0	3.6	3.4	3.6	3.6	3.6	3.5	3.4	3.4	3.3	3.3
Industrial Production	YoY	-0.6	3.9	1.1	8.1	3.6	2.6	1.2	-1.2	2.2	2.8	0.7
Corporate Profits (Fiscal Year)	YoY	37.5	10.0	12.5								
General Govt. Balance (Fiscal Year)	% of GDP	-9.8	-8.0	-6.2								
General Govt Debt	% of GDP	241	243	247								

F Citigroup forecast. SAAR Seasonally adjusted annual rate. YoY Year-to-year percent change. Corporate profits are TSE-I nonfinancials consolidated recurring profits.
Source: Citi Research

Euro Area

Guillaume Menuet
+44-20-7986-1314
guillaume.menuet@citi.com

Giada Giani
+44-20-7986-3281
giada.giani@citi.com

Ebrahim Rahbari
+44-20-7986-6522
ebrahim.rahbari@citi.com

The euro area is continuing to recover, albeit very slowly, with the final estimate of Q1 GDP showing a modest gain of 0.2% QQ after 0.3% QQ in Q4-13. Our near-term outlook envisages a modest acceleration in economic activity, averaging around 0.4% QQ in the remainder of the year. Yet, the persistence of a large output gap, evidence of sizeable labour market slack and the strong euro are likely to keep headline inflation far below the ECB's target of '*less but close to 2%*'. Although unemployment is falling slightly, we doubt that the employment outlook will improve sufficiently rapidly for spare capacity to be absorbed and for wage pressures to emerge anytime soon. Hence, we expect that the ECB will take additional measures in late 2014, reacting to a likely further undershooting of HICP inflation compared to its baseline, and launch an unsterilised QE programme.

The ECB's series of announcements at the June meeting were a welcome development, reassuring investors of its strong commitment to defending its medium-term inflation target, and leaving the door open to additional support measures if and when necessary. We judge that the negative deposit rate and ambitious TLTRO programme will help keep sovereign bond spreads on a downward trajectory, while limiting the downside inflation and activity risks associated with banks' deleveraging strategies. Yet, we doubt these measures will be enough to prevent a sustained inflation undershoot, especially given the likely delay in the pass-through from the TLTRO to firms. We think that inflation dynamics will be important in determining the timing of QE, which we currently expect to be announced at the December 4 policy meeting. At the time of writing, European heads of states and governments have still not formally decided who to nominate as head of the next European Commission and are still debating the distribution of key portfolios. In parallel, suggestions of possible changes to the Stability Pact were quickly dismissed by German Chancellor Merkel and Deputy Chancellor and Economy Minister Gabriel, who argued that existing rules contain sufficient flexibility to overcome the current problems. We think that European governments will emphasise growth and employment as policy priorities, with fiscal policy roughly neutral — or perhaps even a marginal loosening — in 2015.

Figure 22. Euro Area — Economic Forecasts, 2013-2015F

					2014				2015			
		2013	2014F	2015F	1QF	2QF	3QF	4QF	1QF	2QF	3QF	4QF
Real GDP	YoY	-0.4%	1.2%	1.8%	0.9%	1.1%	1.4%	1.5%	1.8%	1.8%	1.8%	1.9%
	SAAR				0.7	2.0	1.7	1.7	2.0	1.9	1.7	2.1
Final Domestic Demand	YoY	-0.9	0.9	1.7	0.7	0.8	1.0	1.2	1.5	1.7	1.8	1.8
Private Consumption	YoY	-0.6	0.7	1.6	0.4	0.5	0.7	1.1	1.4	1.6	1.6	1.6
Government Consumption	YoY	0.1	0.1	0.6	0.2	0.1	-0.1	0.2	0.1	0.5	0.7	1.1
Fixed Investment	YoY	-2.8	2.6	3.5	1.9	2.6	2.9	3.0	3.6	3.6	3.5	3.2
Business Equipment	YoY	-1.5	3.9	5.0	3.5	3.7	4.4	4.2	4.8	5.1	5.2	4.9
Construction	YoY	-4.0	1.0	2.4	0.5	1.1	1.0	1.4	2.0	2.5	2.6	2.6
Stocks (Contrib. to Y/Y GDP Growth)		0.0	0.2	0.2	0.1	0.3	0.1	0.4	0.1	0.3	0.1	0.1
Exports	YoY	1.5	3.3	3.2	4.1	2.9	3.4	2.6	3.3	2.9	3.2	3.4
Imports	YoY	0.4	3.3	3.4	4.1	3.1	3.0	3.0	3.1	3.5	3.5	3.6
CPI	YoY	1.4	0.6	0.9	0.7	0.6	0.4	0.7	0.8	1.0	0.8	0.8
CPI Ex Unprocessed Food & Energy	YoY	1.3	0.9	0.8	1.0	0.9	0.9	0.9	0.8	0.8	0.7	0.7
Unemployment Rate	YoY	11.9	11.6	10.9	12.3	11.8	11.1	11.3	11.5	11.0	10.5	10.5
Current Account Balance	EUR bn	230.2	271.3	284.9								
	% of GDP	2.4	2.8	2.8								
General Government Balance	EUR bn	-290.3	-256.4	-226.1								
	% of GDP	-3.0	-2.6	-2.3								
Primary Balance	% of GDP	-0.1	0.3	0.7								
General Government Debt	EUR bn	9,121.3	9,475.6	9,681.6								
	% of GDP	95.0	96.9	96.7								
Gross Operating Surplus	YoY	1.4	2.9	2.5								

We publish further details of our European forecasts monthly in European Economic Forecast Highlights. Sources: Eurostat and Citi Research forecasts

Germany

Ebrahim Rahbari
+44-20-7986-6522
ebrahim.rahbari@citi.com

The second quarter has started slowly in Germany, with retail sales and industrial production on a weaker footing in April, partly as a payback to the strong increases seen in Q1 and perhaps also some adverse effect from tensions in Ukraine. We therefore marginally reduce our forecast for Q2 GDP to 0.4%QQ (from 0.5%). But we expect these drags to be temporary and leave our forecasts of robust growth in 2014 and beyond mostly unchanged. Inflation has surprised once more on the downside in May, leaving inflation at a mere 0.6% YoY for the HICP definition, but we still expect robust growth to modestly raise price pressures in H2.

France

Guillaume Menuet
+44-20-7986-1314
guillaume.menuet@citi.com

We lower our 2014-15 French forecasts by 0.1ppt to 0.7% and 1.3%, respectively. Disappointing hard data and sentiment surveys have introduced a downward bias in our forecast of a sizeable rebound in Q2-14 GDP. After another poor electoral result for the government — coming third in the EP elections behind the National Front (1st) and the centre-right (2nd) — Mr Hollande is struggling to mobilise voters to back his reform initiatives. The change of PM has not benefited the President's popularity ratings, while business and household surveys underscore the country's likely underperformance in terms of GDP growth compared with its peers. The latest Audit Court report warned that the strategy to lower public expenditure would need to be strengthened to meet the 2015 3% of GDP budget deficit target.

Italy

Giada Giani
+44-20-7986-3281
giada.giani@citi.com

GDP growth is projected to turn positive after the disappointing Q1 result (-0.1% QQ). Monthly data point to a pick-up in investment and positive, albeit modest, consumption growth. Domestic spending should be supported by the tax rebates recently introduced by the government (offsetting still-tight credit conditions). However, the slowdown in export growth continued in April, after a poor Q1, suggesting a weaker-than-expected underlying trend, and hence we are cutting our 2014-15 GDP growth forecasts by 0.1pp each year. The strong result at the EU elections for the ruling centre-left party PD reduced somewhat near-term political risks and raised hopes for more structural reforms to be agreed in coming months.

Figure 23. Germany, France and Italy — Economic Forecasts, 2013-15F

		Germany			France			Italy		
		2013	2014F	2015F	2013	2014F	2015F	2013	2014F	2015F
Real GDP	YoY	0.5%	2.2%	2.5%	0.4%	0.7%	1.3%	-1.8%	0.2%	1.1%
Final Domestic Demand	YoY	0.6	2.1	2.9	0.5	0.2	1.0	-2.6	0.1	1.1
Private Consumption	YoY	1.0	1.3	2.6	0.3	0.1	0.9	-2.6	0.0	0.8
Government Consumption	YoY	0.4	0.8	1.5	2.0	1.0	0.8	-0.8	0.4	-0.2
Fixed Investment	YoY	-0.7	6.2	5.6	-0.8	-0.4	1.7	-4.6	0.0	3.8
Exports	YoY	1.1	4.2	2.9	2.4	2.8	2.4	0.0	2.8	3.0
Imports	YoY	1.6	5.6	4.4	1.9	2.7	1.5	-2.9	1.5	3.1
CPI	YoY	1.5	1.2	1.8	1.0	0.7	1.2	1.3	0.3	-0.2
Unemployment Rate	%	5.3	5.1	4.7	9.9	9.7	9.4	12.2	12.7	12.4
Current Account	€bn	207.5	194.0	189.6	-28.4	-14.6	-1.4	15.5	29.4	31.4
	% of GDP	7.6	6.9	6.6	-1.4	-0.7	-0.1	1.0	1.9	2.0
General Govt. Balance	€bn	0.3	2.7	4.4	-88.2	-88.5	-77.5	-44.1	-47.1	-44.4
	% of GDP	0.0	0.1	0.2	-4.3	-4.2	-3.6	-2.8	-3.0	-2.8
Primary Balance	% of GDP	2.2	2.3	2.3	-2.0	-1.9	-1.3	2.2	1.9	2.0
General Govt. Debt	% of GDP	78.4	77.1	74.2	93.5	96.9	98.3	132.6	137.4	138.5
Gross Trading Profits	YoY	3.7	4.4	5.6	0.5	1.9	2.9	NA	NA	NA

F Citi forecast. YoY Year-to-year growth rate. Note: The German annual figures are derived from quarterly Bundesbank data and adjusted for working days. Forecasts for GDP and its components are calendar adjusted. Sources: Deutsche Bundesbank, Statistisches Bundesamt, INSEE, ISTAT and Citi Research forecasts

Spain

Giada Giani
+44-20-7986-3281
giada.giani@citi.com

Antonio Montilla
+44-20-7986-3282
antonio.montilla@citi.com

We are lifting our real growth forecasts by 0.3pp in 2014 and by 0.3pp and 0.2pp in 2015 and 2016, respectively. This reflects recent indications that the economic recovery is stronger than expected in Q2 as well as the impact of the announced fiscal reform and fiscal loosening — for 0.6pp of GDP over 2015-16, including personal and corporate tax cuts as well as reductions in social security contributions. We expect this looser fiscal stance is likely to add 0.3pp to real GDP growth over 2015-16, but it is also likely to lift somewhat the fiscal deficit trajectory.

Greece

Giada Giani
+44-20-7986-3281
giada.giani@citi.com

Monthly indicators suggest that the pace of contraction in GDP eased further in Q2, in line with our projections, but still not enough, in our view, to lift the annual average into positive territory for 2014. Exports of goods have weakened further recently from already low levels, and with poor corporate profitability and a negative household saving rate we think domestic demand is unlikely to recover significantly.

Ireland

Michael Saunders
+44-20-7986-3299
michael.saunders@citi.com

At the time of writing, Ireland's Q1 GDP data have not yet been released, but we expect them to show bumper growth of about 1% QoQ, after sharp swings in recent quarters (declines of more than 1% QoQ in Q1 and Q4 of 2013, gains of more than 1% QoQ in Q2 and Q3). Business surveys suggest that activity is expanding rapidly, while official data show strong growth in IP in Q1 (4% QoQ) and very strong readings in March-April. With higher nominal GDP growth, the public debt/GDP ratio is likely to fall slightly this year after seven consecutive annual increases.

Portugal

Giada Giani
+44-20-7986-3281
giada.giani@citi.com

We leave our GDP forecasts unchanged this month, on evidence confirming that weakness in Q1 GDP (-0.7% QQ) will be offset by a rebound in Q2. Industrial output and construction both rebounded in April, while exports were probably still affected by the temporary shutdown of a refinery plant. Both private consumption and investment should continue to expand along recent modest but steady trends. Despite the High Court negative ruling on some spending cuts, we still expect the budget deficit to decline close to the target (of 4% of GDP) in 2014.

Figure 24. Spain, Greece, Ireland and Portugal — Economic Forecasts, 2013-15F

		Spain			Greece			Ireland			Portugal		
		2013	2014F	2015F	2013	2014F	2015F	2013	2014F	2015F	2013	2014F	2015F
Real GDP	YoY	-1.2%	1.3%	1.9%	-3.9%	-0.6%	1.2%	-0.3%	2.8%	3.4%	-1.4%	1.2%	2.0%
Final Domestic Demand	YoY	-2.7	1.5	2.0	-6.4	0.1	0.5	-0.2	2.3	0.7	-2.4	0.9	1.2
Private Consumption	YoY	-2.0	2.0	2.3	-5.8	0.8	0.6	-1.1	1.3	1.0	-1.7	1.0	1.2
Government Consumption	YoY	-2.3	0.3	0.4	-3.9	-0.4	-0.1	-0.6	-2.8	-2.5	-1.8	-0.3	0.6
Fixed Investment	YoY	-5.0	1.2	2.8	-12.8	-3.3	0.6	4.9	14.3	3.5	-6.0	1.7	2.2
Exports	YoY	4.9	4.5	5.6	1.2	1.9	2.3	0.1	6.7	4.5	6.1	2.1	4.4
Imports	YoY	0.4	5.8	6.7	-5.3	-0.3	0.0	1.0	8.2	2.2	3.2	3.3	2.0
CPI	YoY	1.5	-0.2	0.0	-0.9	-1.6	-1.6	0.4	0.8	1.0	0.4	-0.3	-0.7
Unemployment Rate	%	26.1	24.7	23.2	27.5	27.1	26.3	13.1	12.1	12.3	16.2	14.8	13.1
Current Account	€bn	8.0	6.0	5.8	1.4	3.8	4.3	10.9	16.2	18.3	0.9	0.9	1.2
	% of GDP	0.8	0.6	0.5	0.8	2.1	2.4	6.6	9.6	10.3	0.5	0.5	0.7
General Govt. Balance	€bn	-72.4	-58.9	-51.9	-23.1	-4.3	-4.8	-11.8	-8.7	-4.5	-8.2	-7.1	-5.2
	% of GDP	-7.1	-5.7	-4.9	-12.7	-2.4	-2.7	-7.2	-5.1	-2.5	-5.0	-4.2	-3.0
Primary Balance	% of GDP	-3.7	-2.3	-1.6	-8.7	2.0	1.9	-2.8	-0.2	2.4	-0.6	0.2	1.6
General Govt. Debt	% of GDP	93.9	98.9	101.6	175.1	181.7	184.5	124.0	120.5	119.1	128.9	136.1	133.5

F Citi forecast. YoY Year-to-year growth rate. For Ireland we show the GDP deflator rather than the CPI. For Spain, Greece, and Portugal fiscal deficits include financial support in 2013 of €4.7bn (0.5% of GDP), €19.3bn (10.6%), and €0.7bn (0.4%), respectively. Sources: INE, Haver Analytics, Eurostat and Citi Research forecasts

Netherlands

Guillaume Menuet
+44-20-7986-1314
guillaume.menuet@citi.com

The Dutch economy is recovering gradually, as shown by better readings in business confidence and IP. Nevertheless, we expect GDP growth in the euro area's fifth-largest economy will remain relatively low in 2015 and 2016, partly because of weakness in natural gas production. We look for domestic demand to accelerate in 2015-16, supported by a likely delayed decline in unemployment and continued private sector deleveraging, but doubt that exports will recover strongly.

Belgium

Guillaume Menuet
+44-20-7986-1314
guillaume.menuet@citi.com

We leave our Belgium forecasts unchanged this month. News that Flemish nationalist party leader Bart De Wever has obtained of a third extension of the mandate to lead federal government negotiations was largely expected. The situation is complex as the Walloon centrists are seeking guarantees that there will be no further institutional reform. We believe that further extensions are likely to be granted when the 25 June deadline comes to pass, and anticipate that a federal government is unlikely to be formally operating much before year-end.

Slovakia

Jaromir Sindel
+42 0-233 061 485
jaromir.sindel@citi.com

We are lifting both our 2014 and 2015 GDP growth forecasts by 0.1%pt (to 2.2% and 2.7%), respectively, due to better domestic demand, although the manufacturing sector reports that foreign demand is likely to weaken in 2Q14. Hence, our forecast remains below the MinFin's outlook. Nevertheless, the recent rise in confidence surveys is supportive and the labour market improvement bodes well for private consumption. Fiscal policy is likely to continue to tighten slightly as the government faces a risk of another breach of the debt-brake trigger at 57% of GDP. However, the government should avoid this as it plans to sell the state telco company. Larger errors in the BoP data add to uncertainties over the GDP outlook.

Slovenia

Jaromir Sindel
+42 0-233 061 485
jaromir.sindel@citi.com

The economy is being supported by a recovery in construction from a low base plus export growth, which have helped to stabilize the labour market (we saw higher employment and real wage growth in April) and private consumption. Our momentum indicator suggests that QoQ GDP growth was positive in 2Q14 after a milder than expected fall of 0.3% in 1Q14. And as our outlook for foreign demand remains supportive (though accompanied with a downside risk due to Ukraine tensions), we lift our forecast to 1%YoY in 2014 from 0.4% before, with our 2015 forecast unchanged at 1.4% YoY, when we expect fiscal consolidation to return after milder progress this year.

Figure 25. Netherlands, Belgium, Slovakia and Slovenia — Economic Forecasts, 2013-15F

		Netherlands			Belgium			Slovakia			Slovenia		
		2013	2014F	2015F	2013	2014F	2015F	2013	2014F	2015F	2013	2014F	2015F
Real GDP	YoY	-0.8%	0.6%	1.4%	0.2%	1.3%	1.5%	0.9%	2.2%	2.7%	-0.9%	1.0%	1.4%
Final Domestic Demand	YoY	-2.0	1.2	0.9	0.3	1.0	1.2	-0.8	2.5	1.2	-2.2	0.1	0.5
Private Consumption	YoY	-2.1	-0.3	0.8	0.8	1.0	0.9	-0.1	2.1	1.4	-2.9	-0.2	-0.4
Government Consumption	YoY	-0.2	0.2	0.0	0.6	0.3	0.8	1.4	1.8	-1.4	-2.0	-0.9	-0.3
Investment (Ex Stocks)	YoY	-4.8	6.4	2.7	-1.4	2.1	2.4	-4.3	4.3	2.8	-0.2	1.2	1.0
Exports	YoY	1.4	1.5	2.4	1.9	3.1	3.6	4.5	7.6	7.8	2.7	4.5	6.7
Imports	YoY	-0.2	1.2	2.0	1.4	2.7	3.8	2.9	8.8	6.7	1.3	3.8	5.7
CPI (Average)	YoY	2.6	0.3	1.1	1.2	0.6	1.1	1.4	0.1	1.0	1.8	0.4	0.9
Unemployment Rate	%	8.3	8.7	8.5	8.4	8.5	8.3	14.1	13.0	12.4	10.1	10.1	10.5
Current Account	% of GDP	10.8	10.9	10.3	-1.6	1.0	1.7	2.1	1.6	2.7	6.3	3.3	3.5
General Govt Balance	% of GDP	-2.4	-2.8	-2.2	-2.7	-2.4	-1.9	-2.8	-3.0	-2.6	-14.7	-4.0	-3.5
Primary Balance	% of GDP	-0.7	-1.1	-0.5	0.6	0.8	1.2	-1.5	-1.7	-1.3	-12.1	-1.1	-0.7
General Govt Debt	% of GDP	73.5	75.2	75.0	101.2	102.0	101.4	55.4	56.3	55.7	71.7	81.3	82.7

F Citi forecast. YoY Year-on-year growth rate. Sources: National sources and Citi Research forecasts

United Kingdom

Michael Saunders
+44-20-7986-3299
michael.saunders@citi.com

Consensus growth forecasts continue to rise rapidly, with the consensus for 2014 growth now up to 3.0% from 1.6% a year ago. Even so, we suspect that the consensus remains far too low, and look for GDP growth of about 3½% YoY in both 2014 and 2015. Recent strength in data and business surveys suggest that growth picked up further in Q2, to about 1% QoQ, after 0.8% QoQ in Q1. Indeed, upcoming data (due on 27 June) may well show an upward revision to Q1 growth to 0.9% QoQ, given the upward revision to Q1 construction, although we have not allowed for this in our forecast. The boom is fuelled by cheap money, with ultra-low policy rates plus £375bn of QE, while the headwinds from private sector deleveraging, fiscal policy and the EMU crisis have receded markedly. The recovery is broad-based, with consumer spending, business investment and housebuilding all rising rapidly. The ONS data suggest that export growth remains sluggish, but surveys have shown a marked improvement in export orders, and the ONS often revise export growth up. Indeed, once revisions to recent GDP data are complete (and major revisions are due in September) we would not be surprised to find that GDP growth this year is really running at about 4% YoY.

With strong economic growth and the rapid drop in unemployment, the MPC are moving towards an early withdrawal of stimulus. We continue to expect the first rate hike to come in Q4 this year, although there is a chance it could even come in Q3. Subsequently, rates are likely to rise further and faster than markets project, in a benign response to strong economic growth and the closing output gap. We expect Bank Rate to be about 2.5% at end-2015, roughly 100bp higher than markets project.

Figure 26. United Kingdom — Economic Forecasts, 2013-2015F

					2014				2015			
		2013	2014F	2015F	1Q	2QF	3QF	4QF	1QF	2QF	3QF	4QF
Real GDP	YoY	1.7%	3.5%	3.6%	3.1%	3.3%	3.5%	3.9%	3.9%	3.8%	3.6%	3.2%
	SAAR				3.5	4.0	4.0	4.2	3.6	3.5	3.1	2.6
Domestic Demand	YoY	1.8	3.1	3.8	3.1	3.5	2.3	3.6	4.0	3.7	3.9	3.6
(Incl. Inventories)	SAAR				2.5	5.0	2.9	4.1	3.9	4.1	3.5	2.8
Private Consumption	YoY	2.2	3.0	3.5	2.1	3.1	3.1	3.6	3.7	3.6	3.5	3.3
	SAAR				3.1	4.3	3.4	3.6	3.4	3.9	3.2	2.5
Government Consumption	YoY	0.7	1.3	0.1	2.2	1.3	0.9	1.0	0.9	0.2	-0.2	-0.5
	SAAR				0.2	2.4	0.9	0.4	-0.1	-0.5	-0.5	-1.0
Investment	YoY	-0.6	9.9	12.7	8.5	8.9	10.3	11.6	14.7	12.9	12.1	11.1
	SAAR				2.2	18.3	13.3	13.2	14.0	11.2	10.1	9.2
Exports	YoY	1.0	2.2	5.5	2.2	-0.2	4.0	2.8	5.1	6.3	5.4	5.1
	SAAR				-4.0	0.0	9.1	6.5	4.9	4.7	5.6	5.4
Imports	YoY	0.5	1.9	6.6	2.3	1.1	1.1	3.2	6.0	6.6	6.9	6.8
	SAAR				-4.2	4.4	6.1	6.7	6.7	7.1	7.2	6.4
Unemployment Rate	%	7.6	6.5	5.0	6.8	6.7	6.4	6.1	5.7	5.3	4.8	4.4
CPI Inflation	YoY	2.6	1.6	1.9	1.7	1.6	1.4	1.5	1.6	1.8	2.1	2.1
Merch. Trade	£bn	-108.6	-101.9	-100.8								
	% of GDP	-6.7	-6.0	-5.6								
Current Account	£bn	-71.1	-67.9	-72.9								
	% of GDP	-4.4	-4.0	-4.0								
PSNB	£bn FY	-106.8	-87.7	-58.6								
	% of GDP	-6.5	-5.0	-3.2								
General Govt. Balance	% of GDP	-7.1	-5.6	-3.7								
Government Primary Balance		-3.5	-2.0	0.0								
Public Debt	% of GDP	94.4	96.8	96.0								
Gross Nonoil Trading Profits	YoY	2.6	10.5	5.8								

Note: Fiscal deficit shown excluding financial interventions, RM and APF transfers. F Citi forecast. YoY Year-to-year growth rate. Sources: ONS and Citi Research forecasts

Switzerland

Michael Saunders
+44-20-7986-3299
michael.saunders@citi.com

Recent data and surveys suggest the economy continues to grow solidly, and we look for Q2 GDP growth to be about 0.7% QoQ. At the same time, CPI inflation turned positive in June (0.2% YoY), the highest rate since late-2011 (although still well below the SNB's 2% target ceiling). Against this backdrop, the SNB will continue to cap the exchange rate at CHF1.20/€ by FXC intervention if necessary. However, the SNB decided not to follow the ECB with extra easing, and is unlikely to match the further ECB easing that we expect in coming months.

Sweden

Tina Mortensen
+44-20-7986-3284
tina.mortensen@citi.com

GDP corrected lower in 1Q following the strong 4Q-13 gain. The 0.1% Q/Q decline was driven by weak inventories and net exports, while private consumption (although weaker than expected) and fixed investments acted as offsets. Although we have revised our GDP forecast slightly lower, we continue to expect a solid pick-up in growth during this year. The recovery continues to face sizable headwinds given Sweden's relatively high EM export exposure and only modest growth recoveries in key euro area export markets. With inflation very low and undershooting the Riksbank's forecast, we expect the Central Bank to cut the repo rate by 25bp to 0.50% at the upcoming July meeting, and see an outside chance of additional monetary easing later this year.

Denmark

Tina Mortensen
+44-20-7986-3284
tina.mortensen@citi.com

GDP growth rebounded strongly in 1Q, but the economy's underlying performance is weaker than the headline figure (0.9% Q/Q) suggests. The DNB kept all of its policy rates unchanged in June even with ECB cutting rates, as EUR/DKK stayed above the central parity despite intervention again in May. This has reduced the negative carry on short EUR/DKK positions, supporting the exchange rate, thereby limiting the need for additional intervention or higher rates over the coming year.

Norway

Tina Mortensen
+44-20-7986-3284
tina.mortensen@citi.com

Growth in the mainland economy (ex. oil/gas and shipping) remains moderate. Both fiscal and monetary policy look set to remain expansive; fiscal stimulus will likely amount to 0.7pp of mainland trend GDP this year. Moreover, the Norges Bank postponed the timing of initial tightening by a year to mid-2016 at the June MPC meeting, and even opened the door for a near-term rate cut if economic activity deteriorates further. Given the Bank's unwillingness to deviate from monetary policy abroad, we now expect the first rate hike to commence late next year (2Q-15 before).

Figure 27. Switzerland, Sweden, Denmark and Norway — Economic Forecasts, 2013-2015F

		Switzerland			Sweden			Denmark			Norway		
		2013	2014F	2015F	2013	2014F	2015F	2013	2014F	2015F	2013	2014F	2015F
Real GDP	YoY	2.0%	2.1%	2.6%	1.6%	2.4%	2.7%	0.4%	1.3%	1.6%	2.0%	2.0%	2.2%
Final Domestic Demand	YoY	2.3	2.4	2.9	1.4	2.6	2.3	0.4	1.3	1.6	2.5	1.8	2.2
Private Consumption	YoY	2.3	1.7	1.9	2.1	2.3	2.6	0.0	1.3	1.7	2.2	2.1	2.5
Government Consumption	YoY	3.0	0.1	0.7	1.9	1.0	0.8	0.8	0.7	0.7	1.8	2.2	2.3
Investment (Ex Stocks)	YoY	1.8	5.4	6.7	-1.0	6.0	3.8	0.7	2.4	2.4	4.5	0.1	1.1
Exports	YoY	2.0	5.3	6.1	-0.3	3.1	4.6	1.2	3.1	3.4	0.8	1.2	2.8
Imports	YoY	1.8	3.3	6.7	-0.7	4.6	3.7	1.7	3.4	3.5	2.9	1.2	2.9
CPI (Average)	YoY	-0.2	-0.2	0.8	0.0	-0.1	1.0	0.8	1.0	1.5	2.1	2.0	2.1
Unemployment Rate	%	3.1	2.7	2.0	8.0	7.9	7.5	7.0	6.7	6.5	3.5	3.6	3.8
Current Account	% of GDP	12.0	11.1	10.2	6.4	6.3	6.0	7.3	6.8	5.7	11.1	11.4	11.7
General Govt Balance	% of GDP	0.2	0.7	1.1	-1.3	-1.6	-0.8	-1.0	-1.3	-2.7	10.9	11.0	11.0
General Govt Debt	% of GDP	48.2	46.3	44.8	39.0	39.8	39.1	44.5	44.7	46.0	NA	NA	NA

[a] For Norway, mainland GDP. F Citi forecast. YoY Year-on-year growth rate. Sources: National sources and Citi Research forecasts

Canada

Dana M. Peterson
+1-212-816-3549
dana.peterson@citi.com

Real activity slowed by more than expected during 1Q as the severe winter took its toll. But a second quarter rebound is underway, led by consumer spending on goods, services, and housing. Business investment is also likely to recover. The outlook for the second half of this year and beyond is roughly unchanged. Faster expansion should be supported by greater US demand momentum, the cheaper CAD, and stronger oil exports. The internal demand rotation will remain a headwind, but capex and exports should become greater contributors to growth. Elevated commodity prices and easy financial conditions continue to support the outlook.

Total CPI inflation is now above the BoC's 2% target, and core inflation is rising faster than expected. Transitory factors — like exchange rate pass-through and winter energy spikes — have lifted consumer prices. But services and non-energy goods costs are also levitating. It appears that retail prices are stabilizing after an extended period of heavy discounting and the degree of excess supply may be lessening. Total CPI inflation probably will remain near the bank's target over the medium term, and core inflation likely will converge on 2% by mid-2015 instead of in early 2016. Risks to the inflation outlook remain roughly balanced, in our view. Upside risks include (1) outperformance of the US economy; and (2) reinvigoration of the housing market that reinforces existing imbalances. Downside risks include (1) uncertainties related to China's growth and credit concerns, EA geopolitical risks, and US unconventional monetary policy unwind; (2) weaker-than-forecast global demand that hinders Canadian exports growth; and (3) domestic consumer retrenchment linked to household debt and/or a housing market hard landing.

While the BoC appears less concerned about low inflation, it is more worried about the potential for external shocks. Downside risks probably will remain "important" to the BoC for some time. Hence, we continue to anticipate the next rate hike in 3Q15.

Figure 28. Canada — Economic Forecast, 2013-2015F

					2014F				2015F			
		2013	2014F	2015F	1QF	2QF	3QF	4QF	1QF	2QF	3QF	4QF
Real GDP	YoY	2.0%	2.3%	2.7%	2.2%	2.5%	2.4%	2.3%	2.6%	2.6%	2.7%	2.8%
	SAAR				1.2	3.0	2.6	2.4	2.7	2.8	2.9	2.6
Final Domestic Demand	YoY	1.4	1.4	2.2	1.0	1.4	1.5	1.8	2.4	2.1	2.1	2.2
	SAAR				-0.3	3.4	2.1	1.9	2.3	2.1	2.1	2.1
Private Consumption	YoY	2.4	2.5	2.5	2.6	2.5	2.4	2.4	2.7	2.5	2.4	2.5
	SAAR				1.2	3.4	2.7	2.2	2.5	2.5	2.5	2.5
Government Spending	YoY	0.3	-0.7	0.3	-0.7	-0.9	-0.8	-0.5	-0.1	0.2	0.4	0.5
	SAAR				-1.1	-0.7	-0.2	0.1	0.5	0.5	0.5	0.5
Private Fixed Investment	YoY	0.2	1.3	3.6	-0.9	1.3	1.7	2.8	4.8	3.3	3.3	3.2
	SAAR				-3.7	8.9	3.2	3.3	3.7	3.1	3.1	3.0
Exports	YoY	2.2	2.2	4.9	1.7	1.6	2.7	2.9	4.6	4.8	5.0	5.1
	SAAR				-2.4	4.6	4.9	4.6	4.4	5.4	5.7	4.8
Imports	YoY	1.1	0.2	3.5	-1.1	-0.2	0.8	1.2	3.9	3.2	3.3	3.4
	SAAR				-7.2	6.0	3.3	3.0	3.3	3.3	3.5	3.3
CPI	YoY	0.9	2.0	2.0	1.4	2.1	2.2	2.2	2.1	1.9	1.8	2.0
Core CPI	YoY	1.2	1.6	1.9	1.3	1.6	1.7	1.8	1.9	1.9	2.0	2.0
Unemployment Rate	%	7.1	6.9	6.7	7.0	7.1	6.8	6.9	6.9	6.7	6.5	6.5
Current Account Balance	C$bn	-60.3	-56.5	-57.9	-49.5	-58.4	-58.6	-58.3	-60.7	-59.3	-56.2	-55.4
	% of GDP	-3.2	-2.8	-2.8	-2.6	-2.9	-2.9	-2.9	-3.0	-2.9	-2.7	-2.6
Net Exports (Pct. Contrib.)		0.3	0.6	0.4	1.6	-0.5	0.4	0.4	0.3	0.6	0.6	0.4
Inventories (Pct. Contrib.)		0.3	0.2	0.0	-0.1	-0.3	0.0	0.0	0.1	0.1	0.1	0.1
Budget Balance (Fiscal Year)	% of GDP	-0.9	-0.1	0.3								
Federal Budget Debt	% of GDP	32.4	30.7	29.1								
General Govt. Debt	% of GDP	93.5	91.8	90.3								

F Citi forecast. YoY Year-to-year percent change. SAAR Seasonally adjusted annual rate. Sources: Statistics Canada and Citi Research.

Paul Brennan
+61-2-8225-4899
paul.brennan@citi.com

Joshua Williamson
+61-2-8225-4904
josh.williamson@citi.com

Australia

We are lifting the 2014 GDP forecast to 3.4% (up 0.5 of a ppt from the previous forecast). The main drivers of the upgrade are stronger-than-expected growth in exports and lower imports. Domestically, we are lifting forecasts for housing investment and business investment in plant and equipment. But these are partly offset by downgrades to consumer spending and engineering construction. The change widens the gap between forecast GDP and DFD growth, with sub-trend growth in domestic demand (Citi's 2014 forecast is 1.5%) helping to keep underlying inflation within the RBA's 2.0%-3.0% target band. Our 2015 GDP forecast is marginally higher than the previous forecast at 3% (up 0.1 ppt), which is also well above forecast DFD growth of 1.7%. We continue to expect a gradual pick-up in consumer spending, reflecting low interest rates and further growth in housing construction. The drop in mining investment and continued currency strength argue against upside risks to our growth forecasts. The outlook remains consistent with no move in official interest rates until mid-2015 at the earliest.

New Zealand

Reconstruction activity drove Q1 GDP growth to a seven-and-a-half year high of 3.8% YoY. We are lifting our 2014 GDP forecast to 3.5% (up 0.3 ppt). For 2015, our forecast is 2.9% (up 0.2 ppt). With economic growth now forecast to be a full percentage point above potential over the course of this year, and with the RBNZ not changing its hawkish policy guidance that justified successive rate increases to date, we now call for a fourth successive 25 bp OCR hike next month. This is one OCR review earlier than we had previously expected. We then expect RBNZ Governor Wheeler to pause at the September 11 OCR review before committing to a further hike on December 11, taking the OCR to 3.75%. The decision to pause does not reflect the timing of the next general election to be held on September 20. We had always expected a pause following 100bps of tightening. Furthermore, the RBNZ is no stranger to hiking the OCR during the month of an election, having done so in July 2002 (up 25bps) and November 1999 (up 50 bps).

Figure 29. Australia and New Zealand — Economic Forecast, 2013-2015F

	Australia			New Zealand		
	2013	2014F	2015F	2013	2014F	2015F
Real GDP[a]	2.4%	3.4%	3.0%	2.8%	3.5%	2.9%
Real GDP (4Q versus 4Q)	0.4	2.7	3.2	3.3	3.0	2.9
Real Final Domestic Demand	0.9	1.5	1.7	4.4	5.3	4.0
Private Consumption	2.0	2.5	3.0	3.7	3.3	3.0
Govt. Current & Capital Spending[b]	1.1	1.9	2.0	1.3	3.0	3.0
Housing Investment	2.0	10.0	9.2	15.0	16.0	14.4
Business Investment[c]	0.4	-6.1	-6.5	9.3	13.0	7.0
Exports of Goods & Services	6.5	10.8	7.2	1.0	1.5	2.5
Imports of Goods & Services	-2.2	-1.1	4.7	8.7	7.6	4.7
CPI	2.4	2.7	2.5	1.1	2.1	2.2
CPI (4Q versus 4Q)	2.7	2.2	2.6	1.6	2.1	2.3
Unemployment	5.8	6.0	5.9	6.0	5.3	5.0
Merch. Trade, BOP (Local Currency, bn)	4.5	19.0	17.4	1.4	-0.1	-2.5
Current Account, (Local Currency, bn)	-50.2	-30.8	-37.1	-7.5	-9.6	-13.0
Percent of GDP	-3.2	-1.9	-2.2	-3.4	-4.2	-5.4
Budget Balance[d] (Local Currency, bn)	-18.7	-50.4	-30.8	-6.4	-3.8	-0.9
Percent of GDP	-1.2	-3.1	-1.8	-2.9	-1.6	-0.4
General Govt. Debt (% of GDP)[e]	30.2	32.1	33.5	39.8	39.0	36.3
Gross Operating Surplus	2.8	7.3	6.8	NA	NA	NA

BOP Balance of payments basis. CPI Consumer Price Index. F Citi forecast. NA Not available. [a]Averaged-based GDP in Australia and New Zealand. [b] In New Zealand excludes capital spending. [c] In New Zealand includes government capital spending. [d] Fiscal year ending June. Australia's underlying cash balance. [e] Australia and New Zealand Budget definition and forecasts. Sources: ABS, StatsNZ, NZIER and Citi Research forecasts

China

Minggao Shen
+852-2501-2485
minggao.shen@citi.com

Shuang Ding
+852-2501-2769
shuang.ding@citi.com

Data in May point to a broad stabilization of growth momentum with the exception of the property sector. Trade data normalized, pointing to recovery in the advanced economies and weakness in domestic investment. The widening trade surplus also led to some strengthening of the RMB. Better exports, stable retail sales and targeted policy stimulus for infrastructure investment seem to be supporting manufacturing activity, with the PMI and IP growth edging up. However, property investment growth slid further, and average home prices started to drop month-on-month. We expect a sizable correction of the property market, but see a market collapse as a tail risk.

There has been a subtle change in policy tone in favour of easing. The premier has recently emphasized the growth target of 7.5% and called for more action to support economic growth, although the government seems to favour targeted easing rather than comprehensive stimulus. Government spending grew by 25% YoY in May, while money and credit growth exceeded expectations. The PBOC also cut the RRR by 50bps for commercial banks with large exposures to agriculture and small and micro enterprises. With inflation staying below target, we expect monetary policy to remain prudent but with an easing bias to bring down the financing cost for the real economy. The government would probably only resort to broad-based loosening if there were signs of a sharp downturn.

Improving external demand and targeted policy easing will likely offset the downside from a property market correction. Exports may accelerate in the months ahead as the US bounces back from 1Q weather-related hiccup. As a result, the trade surplus may increase for the rest of the year, adding pressure from not only the US but also the G20 on currency issues. We expect the RMB to appreciate slightly in 2H along a volatile path. Meanwhile, more policy support is likely to be introduced to support the property sector, including PBOC re-lending to support social housing, higher loan quotas for mortgages, and relaxation of purchase restrictions at local levels. Data so far indicate that 2Q growth might be higher than our current forecast of 7.0%YoY, and our credit conditions index suggests growth may pick up in 2H. Barring a slump of the property market, we see some upside risk to our 7.3% growth forecast for 2014.

Figure 30. China — Economic Forecasts, 2013-2015F

					2014F				2015F			
		2013	2014F	2015F	1Q	2QF	3QF	4QF	1QF	2QF	3QF	4QF
Real GDP	YoY	7.7%	7.3%	7.0%	7.4%	7.0%	7.1%	7.4%	7.4%	7.2%	6.8%	6.7%
Real Final Domestic Demand	YoY	8.3	7.2	7.1								
Consumption	YoY	7.8	7.1	7.6								
Fixed Capital Formation	YoY	8.9	7.3	6.6								
Industrial Production	YoY	9.7	8.7	8.5	8.7	8.4	8.6	9.2	9.2	8.8	8.0	7.8
Exports	YoY	7.8	5.4	6.7	-3.4	7.0	8.0	9.0	8.0	7.0	6.0	6.0
Imports	YoY	7.3	4.5	7.3	1.7	6.0	5.0	5.0	6.0	7.0	8.0	8.0
Merchandise Trade Balance	$bn	259	291	298	17	76	81	118	27	81	75	115
FX Reserves	$bn	3,821	4,084	4,292	3,950	3,981	4,015	4,084	4,082	4,137	4,188	4,292
Current Account	% of GDP	2.0	2.0	1.5								
Fiscal Balance	% of GDP	-1.9	-2.1	-2.0								
General Govt. Debt*	% of GDP	53.7	54.0	53.4								
Urban Unemployment Rate	%	4.1	4.2	4.3	4.2	4.2	4.2	4.3	4.3	4.3	4.3	4.3
CPI	YoY	2.6	2.6	3.2	2.3	2.6	2.6	2.8	3.1	3.0	3.0	3.5
Exchange Rate (end period)	CNY/$	6.05	6.09	6.02	6.22	6.21	6.14	6.09	6.04	6.03	6.02	6.02
1-Yr Deposit Rate (end period)	%	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00

Note: F Citi forecast. E Citi estimate. YoY Year-to-year percent change. SAAR Seasonally adjusted annual rate. * General Govt. Debt includes the debt of central, local government and Ministry of Railway. Sources: Haver Analytics and Citi Research forecasts

India

Rohini Malkani
+91 22 6175 9876
rohini.malkani@citi.com

Anurag Jha
+91 22 6175 9877
anurag.jha@citi.com

India's new Prime Minister Mr Modi has got a sweeping 'change' mandate, and is already being compared with the world's successful economic statesmen. Markets have cheered, with Sensex trading at record high levels. While the mandate seems surpassed only by expectations, there are questions on how, what, and when?

As detailed in our latest India Macroscope, Mr Modi's 12-year track record as Gujarat's chief minister and his sharp early moves as PM suggest: a) A high level of centralization b) Bureaucratic empowerment c) On-boarding state governments and d) A 'the buck stops with me' attitude. While positive sentiment is a pre-requisite for growth to pick up and the new government has already delivered on that account, there is lot to be done (backlog apart). In that regard, the first budget of the Modi government in early July will be a key policy document — not only for the fiscal deficit roadmap, but also on major issues such as subsidies, GST timeline, disinvestment, public welfare programs, gold import controls etc.

In the real sector, the recent uptick in consumer and business sentiment bodes well, but the likelihood of a poor monsoon offsets this. So, while we maintain our FY15 GDP estimate of 5.6% growth (assuming sub-par agriculture growth), we expect a full-fledged capex-led upturn to be visible in FY16 with GDP growth picking up to 6.5%. As regards inflation, there is now strong political intent to rein in food inflation, which further complements the monetary policy stance. However, we expect CPI inflation to come off with a lag to an average of 8% in FY15 and 6.5% in FY16, given the near-term risks from the monsoon and recent oil spike. In the event that the BJP government takes definite measures to offload excess food grain stocks, calibrate MSP hikes, etc, space could open up for an easing of policy rates in 2015.

On the external front, we expect the current account deficit to rise marginally to US$39bn or 1.9% of GDP in FY15 after factoring in higher gold imports and a capex-led increase in non-oil/non-gold imports. Given supportive BoP trends and positive sentiment post-elections, we remain constructive on the INR, but near-term risks remain — notably from geo-politics/crude markets. We expect the INR to trade within a 59-62 range. As regards the fiscal account, we expect the government to uphold the trends of consolidation and restrict the fiscal deficit within 4.4% of GDP in the upcoming budget.

Figure 31. India — Economic Forecasts, FY2013/14-2015/16F

		FY 13/14F	FY 14/15F	FY 15/16F
Real GDP	YoY	4.7%	5.6%	6.5%
Final Domestic Demand	YoY	3.1	4.6	6.7
Private Consumption	YoY	4.8	5.5	7.0
Fixed Investment	YoY	-0.1	2.5	6.5
Exports	YoY	8.4	11.0	9.3
Imports	YoY	-2.5	9.5	9.0
Wholesale Price Index	YoY	5.9	5.5	5.0
Consumer Price Index	YoY	9.5	8.0	6.5
Current Account	US$ bn	-32	-39	-48
	% of GDP	-1.7	-1.9	-2.0
Consolidated Fiscal Balance	% of GDP	-6.9	-6.7	-6.5
Centre Fiscal Balance	% of GDP	-4.5	-4.1	-4.0
US Dollar Exchange Rate	Average	61.8	61.3	62.6

Sources: Haver Analytics and Citi Research forecasts

Korea

Jaechul Chang
+82 2 2077 4160
jaechul.chang@citi.com

The economic recovery in 2Q14 is likely to slow as domestic demand is affected by the aftermath of the ferry sinking incident in April as well as renewed sluggishness in the housing market. Disappointing readings on retail sales and some service sectors' data in April and May led the BoK to shift to a slightly dovish stance in June. The BoK Governor, Lee Juyeol, said after the June MPC meeting that the Bank sees downside risks to economic growth from the incident and might reflect them in its growth forecast revision in July. However, in our view, this dovish view is unlikely to lead the BoK to cut the policy rate, since it considers 2.5% accommodative enough to support economic recovery. We continue to expect the BoK will hold the rate until the end of this year and start a rate hike cycle in 1H15. However, we now expect the first rate hike to come in 2Q15, instead of 1Q15 previously, when the output gap will likely shift to positive and headline inflation should stay at 3%YoY.

Indonesia

Helmi Arman
+65-21-5290-8960
helmi.arman@citi.com

The race for the presidency has tightened, as a poll by LSI shows Jokowi's margin over Prabowo tightening to just 6 percentage points, from 13pps in May. Exports of commodities slid to a new low in April, following a drop in palm oil and coal shipments. Amid the prospect of continued weakness in commodity exports, we are raising our FY14 current account deficit forecast to around US$24bn or 2.8% of GDP, from 2.5% GDP previously. Meanwhile the 2Q14 CA deficit may reach 3.7% of GDP. Despite the worsening CA deficit prospects, we do not think policymakers will be in a hurry to tighten monetary policy or raise interest rates. Although BI has held its overnight policy rate steady for 7 months, upward pressure on bank deposit rates has persisted amid intense competition among banks to beef up funding. Credit growth also continues to slow (17.7% YoY in April, from a high of 24% in early-2013). We only expect another 25bps hike in the policy rate if our fuel price hike scenario in 4Q14 materializes. During the recent mid-year budget deliberations, parliament approved only half of the proposed increase in the fuel subsidy budget. We think this raises the possibility of a fuel price hike happening this year, although any move will likely have to be taken by the new government.

Figure 32. Korea and Indonesia — Economic Forecasts, 2013-2015F

		Korea			Indonesia		
		2013	2014F	2015F	2013	2014F	2015F
Real GDP	YoY	3.0%	3.9%	4.0%	5.8%	5.3%	5.5%
Final Domestic Demand	YoY	2.8	3.1	3.8	5.1	4.6	5.7
Private Consumption	YoY	2.0	2.6	3.3	5.3	5.1	4.4
Fixed Investment	YoY	4.2	4.2	4.9	4.7	4.5	10.3
Exports	YoY	4.3	5.6	6.9	5.3	1.1	5.7
Imports	YoY	1.6	5.4	6.6	1.2	-1.4	3.1
Consumer Price Index	YoY	1.3	1.9	2.9	6.4	6.5	6.7
Unemployment Rate	%	3.1	3.3	3.1	5.8	6.5	6.3
Current Account	US$ bn	79.9	69.4	48.9	-29.1	-24.0	-22.6
	% of GDP	6.1	4.7	3.0	-3.3	-2.8	-2.4
Fiscal Balance	% of GDP	1.0	0.9	1.5	-2.2	-2.4	-2.2
US Dollar Exchange Rate	Average	1095	1034	1007	10449	11724	12003

Sources: Haver Analytics and Citi Research forecasts

Hong Kong

Adrienne Lui
+852 2501 2753
adrienne.lui@citi.com

The unexpected relapse in April exports (-1.6% YoY) and sharp drop in April retail sales (-9.8% YoY) create a tough start for 2Q. We have nudged down our 2Q GDP forecast to 2.6% YoY to reflect the high base impacts of the tourist gold rush in Apr-May 13. Despite the 2Q downgrade, we maintain our full year forecast of 3.2% YoY, as we expect trade trends could gain better momentum in 2H as associated with tech product launches, stabilization in China's economy and a recovery in G3 demand. CPI disinflation is likely to continue, reflecting slower pass-through in private residential rentals and fierce completion amidst poor sales. Consumption is now facing a big wild card with potential visa policy changes by the Chinese government to reduce the number of Mainland tourists visiting HK. Political noise continues to escalate as HK debates its 2017 Chief Executive Election process.

Singapore

Kit Wei Zheng
+65 6657 50779
wei.zheng.kit@citi.com

The external demand tailwind appears to have stalled in April-May, and any boost to exports in 2H14 may be capped by diminishing sensitivity to a G3 recovery. Domestic headwinds have also strengthened. While home sales rebounded after developer price cuts in April-May, a supply overhang will remain a persistent drag even after property policies are eased, more likely in 2015. Consumer spending has slowed, partly on deleveraging. Meanwhile, restructuring is taking its toll — machinery investments are in recession, exports are underperforming and SME margins are being squeezed. While MAS retains a slight hawkish bias on the tight labour market, we would watch for knock-on effects of restructuring on the jobs market and core inflation as a signpost for any shift in the policy bias.

Taiwan

Adrienne Lui
+852 2501 2753
adrienne.lui@citi.com

Our call for a mild export recovery in 2014 still holds, although May data indicate that the recovery pace is still sluggish. We expect exports to gather pace in 2H on tech exports associated with smartphones/tablets, while — assuming China's economy stabilizes — non-tech exports also may recover. The CBC kept its policy rate unchanged for the 12th consecutive quarter, on the benign inflation outlook plus the uneven and slow macro recovery. We expect the TWD to be well supported after the recent appreciation to 30/USD, given strong FINI inflows, widening trade surplus (albeit on imports compression) and resumed RMB appreciation. The cross-strait agreements appear likely to be delayed. Subject to how much control KMT managed to secure in the year-end local elections, we see a narrow window between January-May 2015 for a potential swift passing of the oversight bill and the ECFA for Services pact. Our house view on TAIEX is raised to 10,000.

Figure 33. Hong Kong, Singapore and Taiwan — Economic Forecasts, 2013-2015F

		Hong Kong			Singapore			Taiwan		
		2013	2014F	2015F	2013	2014F	2015F	2013	2014F	2015F
Real GDP	YoY	2.9%	3.2%	3.6%	3.9%	3.5%	4.1%	2.1%	3.2%	3.7%
Final Domestic Demand	YoY	3.8	2.2	2.4	1.8	0.5	1.1	2.2	1.6	2.4
Private Consumption	YoY	4.2	2.1	2.4	2.6	2.5	0.8	1.8	1.7	2.8
Fixed Investment	YoY	3.3	2.7	2.8	-1.9	0.6	2.7	5.3	2.0	3.4
Exports	YoY	6.5	4.1	6.3	3.6	4.4	3.9	3.8	4.4	6.2
Imports	YoY	6.9	3.9	5.7	3.1	3.7	2.3	4.0	3.6	5.2
CPI	YoY	4.3	3.9	3.7	2.4	1.4	1.1	0.8	1.2	2.0
Unemployment Rate	%	3.4	3.1	3.1	1.9	1.8	1.8	4.2	4.0	3.9
Current Account	US$ bn	5.1	8.1	9.6	54.6	61.6	66.7	57.4	55.1	54.7
	% of GDP	1.9	2.8	3.2	18.3	18.0	18.0	11.7	11.0	10.2
Fiscal Balance	% of GDP	1.0	1.3	0.7	1.1	-0.3	0.2	-1.4	-1.4	-0.8
US Dollar Exchange Rate	Average	7.76	7.75	7.75	1.25	1.26	1.26	29.68	30.13	29.94

Sources: Haver Analytics and Citi Research forecasts

Russia

Ivan Tchakarov
+7 495 643 1507
ivan.tchakarov@citi.com

Lingering tensions in Ukraine make for a very challenging backdrop for the Russian economy, creating substantial downside risks to economic performance. The combination of more subdued investment and consumption spending related to heightened uncertainty, and tighter monetary policy, already led us to downgrade our 2014 GDP forecast from 2.6% to 1.0% (1.3% in 2013), but we see downside risks even to this forecast. Preliminary estimates for 1Q growth are at 0.9%YoY. Investment spending will be the key channel through which market volatility will affect growth performance and we have already seen investment contracting by almost 5.0% YoY in 1Q. On the other hand, consumer spending was resilient in 1Q as currency devaluation and rising inflation have caused households to bring spending forward. However, we expect this temporary factor to fade away over the course of the year and for consumer spending to also feel the pain. More broadly, while consumption has been the only bright spot in Russian macro over the last couple of years, it has been slowing recently, as fears the consumer boom might turn into a bubble have led to more restrictive regulatory behaviour. The CBR was right, in our view, to hike rates by 200bp to 7.50% to limit contagion, but this will also come at the cost of stronger headwinds to growth, including the recent S&P downgrade. More generally, Russia faces a tight fiscal-monetary policy mix, which creates an unfavourable background to the economy.

Turkey

Ilker Domac
+90 212 319 4623
ilker.domac@citi.com

Gultekin Isiklar
+90 212 319 4915
gultekin.isiklar@citi.com

At 4.3% YoY, GDP growth in the first quarter of 2014 came in somewhat stronger than the consensus (4.2%). Standing at 1.7% QoQ (SWDA), the 1Q GDP outturn also suggests that economic activity has gained momentum when compared with 4Q 2013 (0.9%) and 3Q 2013 (0.4%). According to the seasonally and working day adjusted official data, the Q1 gain in GDP was driven largely by agriculture (0.45pp), finance and insurance (0.43pp) and manufacturing (0.40pp). Developments to date, coupled with the increased likelihood of a more accommodative policy stance during the remainder of the year, lead us to lift our 2014 GDP growth forecast to 3.5% from 2.2%. In particular, we believe that, shrugging off the challenging inflation outlook, the CBT is likely to maintain its easing bias if the lira behaves. Following the 75bp rate cut at the June MPC meeting, we do not rule out additional easing as long as global markets permit. As a result, we remain concerned with the possibility of the CBT getting carried away with the easing cycle — particularly if growth indicators disappoint. The fact that external factors can easily become less benign — coupled with other domestic risk factors — leads us to believe that the CBT risks repeating past mistakes.

Figure 34. Russia and Turkey — Economic Forecast, 2013-2015F

		Russia			Turkey		
		2013	2014F	2015F	2013	2014F	2015F
Real GDP	YoY	1.3%	1.0%	2.3%	4.0%	3.5%	3.5%
Final Domestic Demand	YoY	2.7	1.3	2.5	4.7	0.5	3.4
Private Consumption	YoY	4.7	3.0	3.0	4.6	2.4	3.2
Fixed Investment	YoY	-0.1	-2.0	3.0	4.3	-8.1	4.0
Exports	YoY	4.2	2.0	2.1	0.1	9.8	4.4
Imports	YoY	3.7	4.5	5.0	8.5	-2.3	4.0
CPI	YoY	6.8	7.1	6.1	7.5	8.6	7.9
Unemployment Rate	%	5.5	5.7	5.8	9.8	9.5	9.5
Current Account	US$ bn	32.8	54.9	39.2	-65.1	-42.8	-46.9
	% of GDP	1.5	2.7	1.9	-7.9	-5.3	-5.4
Fiscal Balance	% of GDP	-2.1	-4.4	-4.9	-1.2	-2.8	-3.2
US Dollar Exchange Rate	Average	31.9	35.7	37.8	1.91	2.16	2.26

Sources: Haver Analytics and Citi Research forecasts

Hungary

Eszter Gargyan
+36 (1) 374-5559
eszter.gargyan@citi.com

MPC comments suggest that rate cuts may continue during the summer in minor, most likely 10bp steps. The environment for monetary loosening is favourable, given soft inflation surprises, strong demand for local bonds helped by new NBH instruments, plus the recent ECB easing. Economic growth shows strong momentum but the output gap remains negative. Growth is primarily driven by exports and EU-funded projects, which point towards a relatively benign inflation outlook. We expect that rate cuts will halt in September, with the base rate bottoming out at 2.10%, as tightening external conditions related to more hawkish Fed rhetoric and domestic noises around the finalization of the FX mortgage aid scheme may add to market volatility. The economy's momentum is likely to slow in 2H14 as EU fund absorption peaks and base effects slow manufacturing following the completion of car manufacturing capacity expansions from 2013. Given that the recovery in domestic demand is likely to remain subdued amidst continued deleveraging, we expect monetary conditions to remain loose as long as external factors remain supportive. We expect rate hikes to start only in 2Q15, when rising inflation is likely to turn real interest rates negative as inflation rises in the range of 2-2.5%. The erosion in the carry and noises related to the FX loan aid scheme may keep the HUF vulnerable to shifts in global risk sentiment but the external surplus may help to curb HUF depreciation.

Poland

Piotr Kalisz
+48 (22) 692 9633
piotr.kalisz@citi.com

Cezary Chrapek
+48 (22) 692 9421
cezary.chrapek@citi.com

Lower-than-expected inflation has made the Monetary Policy Council soften its rhetoric. At its June meeting, the MPC signaled that the most likely policy scenario is for stable interest rates in coming months, but also admitted that rate cuts or hikes cannot be completely ruled out depending on the growth and inflation outlook. This is a deviation from the prior communication strategy when the MPC dismissed suggestions of policy easing in Poland and only highlighted risks of rate increases. In reaction to these comments, the FRA market started to price in a high probability of policy easing around October. We do not share this view. In our base case, we project stable rates, as we believe the strong economic recovery and prospects of a gradual rebound in inflation will stop the MPC from cutting rates. We would see a possibility of additional cuts only in the event of a substantial economic slowdown or currency appreciation — a scenario to which we attach only approximately a 20% probability. As far as the fiscal situation is concerned, the deficit looks to be on its way to undershooting the annual plan by a wide margin. This puts the Finance Ministry in a very comfortable situation, allowing it to reduce bond issuances in 2H if such a need arises.

Figure 35. Hungary and Poland — Economic Forecasts, 2013-2015F

		Hungary			Poland		
		2013	2014F	2015F	2013	2014F	2015F
Real GDP	YoY	1.1%	2.9%	1.9%	1.6%	3.4%	3.6%
Final Domestic Demand	YoY	1.6	2.4	1.2	0.9	3.7	3.7
Private Consumption	YoY	0.2	1.8	1.9	0.8	2.8	3.2
Fixed Investment	YoY	5.9	4.5	0.0	-0.2	8.0	6.0
Exports	YoY	5.3	5.9	6.0	4.6	6.6	6.5
Imports	YoY	5.3	5.8	5.9	1.2	7.5	7.5
CPI	YoY	1.7	0.4	2.5	0.9	0.3	2.0
Unemployment Rate	%	9.1	8.6	8.5	13.4	12.4	11.7
Current Account	US$ bn	3.9	3.3	2.9	-6.6	-9.2	-15.9
	% of GDP	2.9	2.5	2.1	-1.3	-1.7	-2.7
Fiscal Balance	% of GDP	-2.2	-2.9	-2.9	-4.3	5.2	-2.7
Euro Exchange Rate	Average	297	310	318	4.20	4.20	4.20

Sources: Haver Analytics and Citi Research forecasts

Czech Republic

Jaromir Sindel
+42 0 233 061 485
jaromir.sindel@citi.com

We are raising our GDP growth forecast to 2.4% in 2014 and 2.7% in 2015 (from 1.9% and 2.6% respectively last month) as industrial production surprised positively in April and the recovery in domestic demand is likely to continue. GDP growth was revised upward to 2.5% YoY in 1Q14 from the 2% flash estimate, close to the CNB's forecast of 2.7% growth. Moreover, real wage growth picked up to 3.1% YoY in 1Q14, above the CNB's 2.5% forecast. Meanwhile, the government approved a 3.5% increase in public sector wages and the return to more generous pension valorization by full CPI inflation plus 1/3 of real wage growth in 2015. We expect the June CPI to show prices down 0.3% YoY, due to lower food prices. We forecast CPI inflation of 0.7% YoY this year, followed by 2% in 2015. Lower inflation could persuade the CNB to discuss a higher EURCZK floor, particularly if there is a stronger deceleration of retail sales later in 2Q14. However, we think that CNB will keep the EURCZK floor unchanged, despite the lower CPI trajectory unless we see an eventual drop in export competitiveness or in foreign demand. We do not rule out the possibility that the Board may start to think about a slightly negative policy rate if there is a pressure on the EURCZK floor after recent and prospective further ECB easing. We continue to expect a tilt back to tightening in late 2H15.

Romania

Ilker Domac
+90 212 319 4623
ilker.domac@citi.com

Gultekin Isiklar
+90 212 319 4915
gultekin.isiklar@citi.com

The recent pick-up in private consumption, which is in line with our expectations of growth drivers switching from net exports to domestic demand, is encouraging. However, we have become more cautious on the growth outlook for three reasons. First, the marked slowdown in the growth momentum warrants concern. Standing at 0.06%QoQ (SWA), the 1Q print represents a considerable slowdown when compared with the last two quarters of 2013 (1.4% in 4Q and 1.6% in 3Q). Second, preliminary data for 2Q this year — such as industrial production and retail trade turnover — do not suggest that economic activity is gaining traction after a soft patch in 1Q. Third, the outstanding issues on the IMF-EU program, if prolonged, could hurt investor sentiment, thereby thwarting the recovery process. Against this backdrop, we keep our 2014 GDP growth forecast at 3.0% but stand ready to make adjustments if needed. Turning to inflation, despite historically low food prices, stickiness in services prices and non-food prices leads us to remain cautious about the outlook. We expect a reversal in food prices in 2H, which suggests to us that year-end inflation is likely to be slightly above 3.5%. As a result, we believe that the NBR will keep rates steady at 3.5% during the remainder of the year.

Figure 36. Czech Republic and Romania — Economic Forecasts, 2013-2015F

		Czech Republic			Romania		
		2013	2014F	2015F	2013	2014F	2015F
Real GDP	YoY	-0.9%	2.4%	2.7%	3.5%	3.0%	3.4%
Final Domestic Demand	YoY	-0.5	2.1	2.3	0.0	1.8	3.3
Private Consumption	YoY	0.1	1.2	2.2	1.3	1.5	3.5
Fixed Investment	YoY	-3.5	4.3	3.5	-3.4	3.2	3.5
Exports	YoY	0.2	9.7	8.1	13.1	5.5	4.5
Imports	YoY	0.6	8.3	7.7	2.3	3.0	4.0
CPI	YoY	1.4	0.7	2.0	4.0	1.8	3.3
Unemployment Rate	%	7.0	6.8	6.5	5.3	5.5	5.5
Current Account	US$ bn	-2.9	1.8	3.7	-2.0	-5.1	-9.1
	% of GDP	-1.4	0.9	1.7	-1.1	-2.5	-4.2
Fiscal Balance	% of GDP	-1.5	-2.0	-2.5	-2.5	-2.3	-2.3
EURCZK, USDRON	Average	26.0	27.5	27.3	3.3	3.3	3.2

Sources: Haver Analytics and Citi Research forecasts

Brazil

Marcelo Kfoury
+55 11 4009 3470
marcelo.kfoury@citi.com

We recently revised down our growth forecasts for 2014 and 2015 to 0.9% and 1.2%, from 1.3% and 1.8% respectively, reflecting weak 1Q14 GDP growth and revision in historical series. We do not expect any quarterly drop in real GDP, though risks are increasing. In terms of monetary policy, we see the policy rate (Selic) flat at 11% until close to year-end. However, risks now look skewed to the downside, given the steady deceleration in labour and credit markets. The World Cup impact on inflation has been milder than expected so far and the shock to commodity prices is fading away. Yet, we still see year-end CPI inflation at 6.6% this year and 6.3% in 2015. Regarding the presidential race, the positive approval rate of President Dilma Rousseff is now below the threshold of 35% where re-election is difficult. Nonetheless, our base case scenario assumes she reacts and is able to turn this situation around. The recent downward trend in non-oil commodity prices leads us to slightly revise our USDBRL forecasts to 2.30 in the near term. We see the USDBLR at 2.43 and 2.59 by the end-2014 and end-2015, respectively.

Mexico

Sergio Luna Martinez
+52 55 2226 6799
sergio1.luna@banamex.com

The latest data suggest that economic activity rebounded in 2Q14. Industrial production grew by 0.6% MoM SA and by 2.5% YoY in April (the fastest annual increase in 19 months). Also, auto production and formal sector employment grew by 12.5% YoY and 3.2% YoY, respectively, in May. The figures point to a further acceleration in industrial production growth, while the labour market performed better than might be suggested by the slow pace of economic growth. We still see GDP growth at 3.0% GDP in 2014. Meanwhile, annual inflation continues to move as we expected, at 3.5%YoY in May and with the core rate at 3.0% YoY. We therefore reiterate our 3.8% headline inflation forecast for 2014 year-end. With inflation under reasonable control, and the absence of any kind of pressure, plus slow economic growth, Banxico surprised by lowering its policy rate by 50bps to 3.0% in June. The communiqué stated that further easing was not feasible. We agree, and thus we expect the policy rate to close 2014 at its current level (3.0%). In 2015, we expect Banxico to start raising its policy rate in the second half and to reach 4.0% by year-end. On the political front, we think secondary legislation on energy and telecommunications could be ready by the time of our next monthly review, or a few weeks after that.

Figure 37. Brazil and Mexico — Economic Forecasts, 2013-2015F

		Brazil			Mexico		
		2013	2014F	2015F	2013	2014F	2015F
Real GDP	YoY	2.3%	0.9%	1.2%	1.1%	3.0%	4.0%
Final Domestic Demand	YoY	2.9	1.1	1.3	1.4	3.1	4.4
Private Consumption	YoY	2.3	1.6	1.9	2.5	2.9	4.0
Fixed Investment	YoY	6.3	-3.2	1.1	-1.8	4.2	7.0
Exports	YoY	2.5	2.2	6.8	1.4	6.5	5.5
Imports	YoY	8.4	2.6	4.4	1.2	6.6	7.6
CPI	YoY	6.2	6.4	6.4	3.8	4.0	3.6
Unemployment Rate	%	5.5	5.8	5.9	5.0	4.8	4.5
Current Account	US$ bn	-81.4	-84.6	-86.2	-22.3	-27.4	-25.8
	% of GDP	-3.7	-3.8	-3.9	-1.8	-2.1	-1.8
Fiscal Balance	% of GDP	-3.3	-3.9	-3.4	-2.4	-3.5	-2.5
US Dollar Exchange Rate	Average	2.16	2.33	2.55	12.76	13.04	12.97

Sources: Haver Analytics and Citi Research forecasts

Argentina

Guillermo Mondino
+1 212 816 6499
guillermo.mondino@citi.com

The US Supreme Court denied a hearing to the Republic's appeal in the "pari passu" case. Following this development, the Second Circuit's Court of Appeals lifted the stay. In response to these judicial developments, the Argentine authorities and their legal representatives presented a long list of contradictory statements. The gist of the message is that Argentina will attempt to enter negotiations with the holdouts (though the government has said that it intends to do so under a court umbrella that, at the time of this writing, does not exist). It is unclear, at this point, whether Argentina will manage to obtain a stay from the courts before the due date of the June 30 coupon payments or whether the country will be negotiating during the 30-day grace period that follows. Therefore, the risk of an impending potential default looms large. The noise stemming from the pari passu case adds an extra layer of stress over the country's already-weak economic situation. The pressure on the FX market persists, forcing the authorities to keep very tight controls on imports and other financial flows. Also, the fiscal deficit, the main underlying imbalance, has not been tackled yet. We continue to expect non-official GDP to drop 1.5% this year. Downside risks to this forecast have increased. Also, we see the official USDARS at 10 by year-end, and non-official (i.e., true) inflation at 38%.

Venezuela

Munir Jalil
+57 1 639 4195
munir.jalil@citi.com

The first half of the year was marked by a reduction in economic activity and an acceleration of inflation. In addition, despite being produced, data are not being released on a timely basis. We believe the delay in releasing data may be related to negative outcomes, a situation that is not benefiting the government. This is the reason why, although we continue to expect a contraction of 1% in economic activity and inflation to reach 75% by year-end, we now believe there are risks of a deeper slide in economic activity and even higher inflation going forward.

Figure 38. Argentina and Venezuela — Economic Forecasts, 2013-2015F

		Argentina			Venezuela		
		2013	2014F	2015F	2013	2014F	2015F
Real GDP	YoY	3.0%	0.0%	1.0%	1.3%	-1.0%	1.9%
Final Domestic Demand	YoY	4.4	-0.2	1.2	-0.3	-1.1	0.7
Private Consumption	YoY	4.3	0.6	1.4	3.7	0.1	0.3
Fixed Investment	YoY	3.0	-4.2	-0.3	-3.5	-3.5	0.9
Exports	YoY	-5.3	-1.5	-1.5	-3.8	1.3	4.2
Imports	YoY	1.6	-2.0	0.0	-4.6	-0.7	-1.0
CPI	YoY	10.6	-	31.8	38.5	61.7	82.5
Unemployment Rate	%	7.1	7.7	8.1	5.6	4.8	4.0
Current Account	US$ bn	-4.3	-5.0	-5.3	12.2	14.9	18.2
	% of GDP	-0.7	-1.1	-1.2	3.3	4.1	5.1
Fiscal Balance	% of GDP	-1.9	-2.4	-2.4	-11.9	-11.2	-10.3
US Dollar Exchange Rate	Average	5.45	8.75	11.81	5.99	9.15	19.80

Sources: Haver Analytics and Citi Research forecasts

Saudi Arabia

Farouk Soussa
+44-20-7986-4356
farouk.soussa@citi.com

As the advance of ISIS in Iraq poses a theoretical (but small) risk of disruption in global oil supplies, the focus has turned on Saudi Arabia's ability to make up any potential shortfall in Iraqi exports. Saudi oil production has been in the 9.6mbpd-10mbpd range since mid-2013, while capacity remains at around 12.5 mbpd. The Kingdom has never pumped more than 10mbpd on a sustained basis, and the ease with which it can cover any Iraqi crude losses is thus uncertain. That said, heightened concerns about global supply risks suggest a firm underpinning to Saudi production, in our view, which we believe is likely to be sustained in the near term. We recently raised our expected average 2014 production for Saudi Arabia from 9.2mbpd to 9.5mbpd (on par with 2013) as a result. We expect public finances and external balances to remain robust in the near term, with a current account surplus of 14.8% of GDP this year, real GDP growth of 4.8%, and fiscal surplus of 6.2% of GDP. That said, we think that rising expenditures and an expected levelling off in oil revenues and production will present challenges in the medium to long-term. We forecast the fiscal breakeven oil price will rise to close to US$100 per barrel in 2015 and higher thereafter, resulting in forecast deficits as early as 2016. Although Saudi has ample resources to finance expected deficits from current cash reserves, the outlook does underscore the need for structural reform to set public finances on a long-term sustainable footing.

United Arab Emirates

Farouk Soussa
+44-20-7986-4356
farouk.soussa@citi.com

We continue to harbour concerns regarding the pace of asset price inflation in Dubai. Cluttons data available on Bloomberg suggests there has been a levelling off in residential prices in 2014, but data from Jones Lang Lasalle’s Q1 Dubai property market report suggests that prices continue their upward trajectory, albeit at a somewhat reduced pace. Either way, prices are up around a third on average across Dubai over the last year, with some areas seeing prices in excess of the 2008 peak. The number of announced projects and the sharp rise in land transactions over the past year and during the first quarter (value of transactions rose 57% YoY) suggest that momentum remains high, driven by strong investor confidence. We maintain our view that Dubai’s resilience to any potential property-led volatility is, at this point, much greater than it was in mid-2008, at the height of the previous property bubble. That said, Dubai’s economy is dynamic and fast-changing. We remain cautious — should we see a sharp rise in construction and/or leverage related to the housing market, we believe Dubai’s vulnerabilities will once again increase.

Figure 39. Saudi Arabia and United Arab Emirates — Economic Forecasts, 2013-2015F

		Saudi Arabia			United Arab Emirates		
		2013	2014F	2015F	2013	2014F	2015F
Real GDP	YoY	3.8%	4.8%	5.9%	3.7%	4.0%	4.0%
Final Domestic Demand	YoY	-0.4	8.0	8.1	4.7	4.7	4.7
Private Consumption	YoY	-1.3	5.0	5.0	5.0	5.0	5.0
Fixed Investment	YoY	-1.2	10.0	10.0	5.0	5.0	5.0
Exports	YoY	-9.2	1.5	-2.3	14.0	13.0	14.0
Imports	YoY	-2.6	15.0	15.0	15.0	15.0	15.0
CPI	YoY	3.5	3.5	4.1	1.1	2.0	2.4
Current Account	US$ bn	135.3	116.0	73.5	107.3	93.8	80.0
	% of GDP	18.2	14.8	8.9	26.2	21.4	17.0
Fiscal Balance	% of GDP	7.4	6.2	1.3	NA	NA	NA
US Dollar Exchange Rate	Average	3.75	3.75	3.75	3.67	3.67	3.67

Sources: Haver Analytics and Citi Research forecasts

Egypt

David Cowan
+44-20-7986-3285
david.cowan@citi.com

Following his May election victory, the new president Abdelfattah el Sisi will now focus his attention on three issues. The first, which draws mostly on his military background, will be to restore the security situation in the country. Second, to consolidate his power base prior to the parliamentary elections, which are likely to be held in September. And third, to put in place policies to kick-start the economy. Moreover, despite the vagueness of his policy pronouncements to date, the broad outlines of a new policy direction are now possible to discern — but a key element will remain the level of Gulf support available to part-fund a big push in capital spending. This could morph into a more coherent economic policy with a medium-term strategy to reduce the fiscal deficit and pave the way for an IMF programme. But while a surge in Gulf support has helped stabilize the exchange rate and eased, but not eliminated, foreign exchange shortages, the overall fragility of the economy is clear from the weakening of the EGP in April and May 2014.

South Africa

Gina Schoeman
+27-11-944 0813
gina.schoeman@citi.com

We are cutting our 2014 GDP forecast by 0.3pp to 2.0% but note that downside risks persist from the labour market and electricity supply. Q1 GDP fell due to mining strikes, which have remained ongoing for 21 weeks. This has impacted the up- and downstream of the supply chain, damaging manufacturing confidence and actual production in some cases. The overall effect is that Q2 GDP is likely to print only marginally positive, in our view. There are also negative spin-offs to external trade and the current account deficit. There have been sufficient platinum inventories since the strike began in January to keep exports generally unscathed to-date (as reflected in a relatively stable platinum price). However, this implies that the widening in the trade deficit in Q1 and so far in Q2 is due to a more generalized weakness in exports, which we believe comes down to manufacturing and its close links to the mining sector. Adding to the near-term risk for exports is a potential manufacturing strike in July that may impact 50% of total exports almost immediately, given the sector's low inventories. S&P's recent foreign currency ratings downgrade to BBB- (albeit with an upward shift in the outlook to stable), wider trade deficits, tight electricity conditions and persistent labour strikes are reasons for the weak ZAR. Add to this the rise in inflation (likely to peak at 6.9% in June, in our view) and we expect a 25bp rate hike in July. A weaker economy suggests that the hike is unlikely to be greater in magnitude. A final 25bp hike in September is a lower probability, in our view, but the ongoing expectation of a more hawkish Fed keeps the door open.

Figure 40. Egypt, Nigeria and South Africa — Economic Forecast, 2013-2015F

		Egypt			Nigeria			South Africa		
		2013	2014F	2015F	2013	2014F	2015F	2013	2014F	2015F
Real GDP	YoY	1.5%	2.4%	3.2%	6.8%	6.5%	6.4%	1.9%	2.0%	2.8%
Final Domestic Demand	YoY	2.5	3.0	3.5	NA	NA	NA	2.9	2.7	3.2
Private Consumption	YoY	3.7	2.0	2.6	NA	NA	NA	2.6	2.4	3.1
Fixed Investment	YoY	2.1	1.6	9.9	NA	NA	NA	4.7	3.8	4.1
Exports	YoY	-6.3	2.2	5.6	NA	NA	NA	4.2	6.6	5.5
Imports	YoY	-3.4	4.7	7.2	NA	NA	NA	4.7	4.0	6.8
CPI	YoY	9.5	7.9	6.5	8.5	8.7	10.6	5.8	6.5	5.8
Unemployment Rate	%	13.4	14.2	14.5	NA	NA	NA	24.7	25.0	24.6
Current Account	US$ bn	-3.3	-6.8	-6.4	9.2	8.4	4.5	-20.4	-16.9	-15.4
	% of GDP	-1.3	-2.5	-2.3	1.8	1.5	0.7	-5.8	-4.9	-4.2
Fiscal Balance	% of GDP	-13.7	-11.7	-9.0	-1.6	-2.0	-1.8	-4.3	-4.2	-4.2
US Dollar Exchange Rate	Average	6.87	7.12	7.52	159.2	164.18	168.83	9.65	10.75	11.00

Sources: Haver Analytics and Citi Research forecasts

Figure 41. Selected Emerging Market Countries — Economic Forecast Overview, 2013-2015F

	GDP Growth (%)			CPI Inflation (%)			Current Balance (% of GDP)			Fiscal Balance (% of GDP)		
	2013	2014F	2015F	2013	2014F	2015F	2013	2014F	2015F	2013	2014F	2015F
Asia	6.3	6.2	6.3	3.7	3.4	3.7	2.2	2.2	1.6	-2.3	-2.4	-2.2
China	7.7	7.3	7.0	2.6	2.6	3.2	2.0	2.0	1.5	-1.9	-2.1	-2.0
Hong Kong	2.9	3.2	3.6	4.3	3.9	3.7	1.9	2.8	3.2	1.0	1.3	0.7
India	4.7	5.6	6.5	9.5	8.0	6.5	-1.7	-1.9	-2.0	-6.9	-6.7	-6.5
Indonesia	5.8	5.3	5.5	6.4	6.5	6.7	-3.3	-2.8	-2.4	-2.2	-2.4	-2.2
Korea	3.0	3.9	4.0	1.3	1.9	2.9	6.1	4.7	3.0	1.0	0.9	1.5
Malaysia	4.7	5.4	5.6	2.1	3.2	4.0	4.0	4.4	4.0	-3.9	-3.5	-3.0
Mongolia	11.7	10.0	9.0	10.5	13.6	12.0	-30.9	-18.7	-20.0	-7.8	-7.5	-4.3
Philippines	7.2	6.7	7.2	2.9	4.4	4.0	3.5	3.5	3.1	-1.4	-1.8	-1.6
Singapore	3.9	3.5	4.1	2.4	1.4	1.1	18.3	18.0	18.0	1.1	-0.3	0.2
Sri Lanka	7.3	7.2	7.4	6.9	5.0	6.5	-3.9	-3.3	-3.1	-5.9	-5.6	-5.3
Taiwan	2.1	3.2	3.7	0.8	1.2	2.0	11.7	11.0	10.2	-1.4	-1.4	-0.8
Thailand	2.9	0.5	2.8	2.2	2.4	2.1	-0.7	2.3	-1.1	-1.8	-1.2	-1.8
Vietnam	5.4	5.4	5.7	6.6	5.0	6.8	6.0	4.9	3.9	-5.6	-6.4	-6.0
Latin America	2.5	1.8	2.6	7.3	9.2	10.1	-2.5	-2.7	-2.7	-3.2	-3.7	-3.2
Argentina	3.0	0.0	1.0	10.6		31.8	-0.7	-1.1	-1.2	-1.9	-2.4	-2.4
Brazil	2.3	0.9	1.2	6.2	6.4	6.4	-3.7	-3.8	-3.9	-3.3	-3.9	-3.4
Chile	4.1	3.0	4.0	1.9	4.0	3.0	-3.4	-2.6	-4.0	-0.3	-0.4	-0.4
Colombia	4.3	5.4	5.1	2.0	2.9	3.5	-3.4	-3.7	-3.6	-0.9	-1.6	-1.5
Costa Rica	3.5	3.1	2.2	5.2	4.4	4.6	-5.1	-7.4	-7.9	-6.5	-7.2	-7.7
Dominican Republic	4.1	5.0	4.5	4.8	3.4	4.2	-4.2	-4.5	-4.8	-4.1	-4.0	-4.2
Ecuador	4.5	4.5	4.5	2.7	3.5	2.5	-1.3	-1.1	-1.2	-5.9	-4.7	-3.7
El Salvador	1.7	2.2	2.5	0.8	1.0	1.7	-6.2	-6.4	-5.7	-4.2	-4.1	-3.7
Mexico	1.1	3.0	4.0	3.8	4.0	3.6	-1.8	-2.1	-1.8	-2.4	-3.5	-2.5
Panama	8.4	6.2	5.5	4.0	3.2	2.8	-11.3	-9.0	-8.5	-3.0	-3.0	-3.0
Peru	5.8	5.0	6.1	2.8	3.2	2.5	-4.8	-5.2	-4.8	0.8	0.0	0.0
Venezuela	1.3	-1.0	1.9	38.5	61.7	82.5	3.3	4.1	5.1	-11.9	-11.2	-10.3
Europe	2.0	1.9	2.9	5.3	5.7	5.4	-1.3	-0.1	-0.7	-2.2	-2.4	-3.6
Bulgaria	0.9	1.5	2.5	0.9	-0.8	2.5	1.9	-0.2	-0.5	-1.5	-2.0	-1.2
Croatia	-0.9	-0.6	1.2	2.2	0.3	2.7	1.3	0.5	-0.5	-4.9	-5.0	-3.5
Czech Republic	-0.9	2.4	2.7	1.4	0.7	2.0	-1.4	0.9	1.7	-1.5	-2.0	-2.5
Hungary	1.1	2.9	1.9	1.7	0.4	2.5	2.9	2.5	2.1	-2.2	-2.9	-2.9
Kazakhstan	5.9	5.0	6.0	5.7	6.5	5.9	-0.1	1.0	1.3	3.0	2.3	2.1
Poland	1.6	3.4	3.6	0.9	0.3	2.0	-1.3	-1.7	-2.7	-4.3	5.2	-2.7
Romania	3.5	3.0	3.4	4.0	1.8	3.3	-1.1	-2.5	-4.2	-2.5	-2.3	-2.3
Russia	1.3	1.0	2.3	6.8	7.1	6.1	1.5	2.7	1.9	-2.1	-4.4	-4.9
Serbia	2.5	1.2	2.0	7.9	2.9	6.2	-4.9	-5.0	-5.0	-5.7	-6.5	-6.5
Slovakia	0.9	2.2	2.7	1.4	0.1	1.0	2.1	1.6	2.7	-2.8	-3.0	-2.6
Turkey	4.0	3.5	3.5	7.5	8.6	7.9	-7.9	-5.3	-5.4	-1.2	-2.8	-3.2
Ukraine	0.0	-3.2	2.1	-0.3	7.2	7.3	-9.3	-4.7	-3.1	-6.7	-4.3	-3.4
Africa/Mideast	3.9	4.6	5.2	4.2	4.3	5.0	11.0	9.7	7.4	1.3	1.2	-0.4
Bahrain	5.3	4.0	4.0	3.3	2.5	2.0	6.8	5.5	1.3	-3.3	-4.5	-6.8
Egypt	1.5	2.4	3.2	9.5	7.9	6.5	-1.3	-2.5	-2.3	-13.7	-11.7	-9.0
Ghana	7.1	5.1	4.0	11.7	14.1	11.6	-12.7	-14.5	-14.3	-9.0	-8.7	-8.0
Iraq	3.1	10.4	11.6	1.9	2.5	5.0	13.3	13.6	12.6	-5.8	-2.3	-1.2
Israel	3.2	3.2	3.5	1.5	1.0	3.0	2.5	1.9	1.7	-2.7	-3.0	-2.5
Jordan	2.8	4.0	4.5	5.5	3.5	5.0	-11.3	-10.2	-7.9	-5.5	-9.6	-9.4
Kenya	4.7	5.5	6.1	5.4	7.5	6.6	-9.0	-7.6	-7.5	-7.8	-6.5	-6.0
Kuwait	5.7	3.8	3.9	2.6	3.0	4.0	37.9	40.4	38.3	28.8	32.2	26.5
Lebanon	1.4	2.0	2.4	2.1	3.5	5.0	-9.0	-9.8	-10.7	-9.3	-8.7	-8.0
Nigeria	6.8	6.5	6.4	8.5	8.7	10.6	1.8	1.5	0.7	-1.6	-2.0	-1.8
Oman	3.4	4.7	4.7	2.1	1.5	3.0	10.8	8.5	6.6	9.9	8.4	6.1
Qatar	6.5	5.9	6.2	3.1	3.0	3.5	30.9	29.4	25.1	8.2	4.2	1.2
Saudi Arabia	3.8	4.8	5.9	3.5	3.5	4.1	18.2	14.8	8.9	7.4	6.2	1.3
South Africa	1.9	2.0	2.8	5.8	6.5	5.8	-5.8	-4.9	-4.2	-4.3	-4.2	-4.2
Tanzania	7.0	7.1	7.2	7.9	6.6	6.1	-10.2	-14.1	-12.4	-6.0	-6.4	-6.5
UAE	3.7	4.0	4.0	1.1	2.0	2.4	26.2	21.4	17.0	NA	NA	NA
Uganda	6.0	6.1	6.5	5.5	5.3	7.4	-12.0	-13.9	-14.9	-3.7	-4.0	-4.5
Zambia	6.2	6.4	6.3	7.0	7.8	8.0	0.2	-1.0	-1.5	-6.5	-6.1	-5.5
Total	4.5	4.5	5.0	4.7	4.9	5.2	1.8	1.9	1.3	-2.1	-2.3	-2.4

Sources: National sources and Citi Research forecasts

Sovereign Ratings

Michael Saunders
+44-20-7986-3299
michael.saunders@citi.com

Peter Goves
+44-20-7986-3215
peter.goves@citi.com

The *Sovereign Ratings Outlook* is a joint product between the Citi economics and rate strategy teams, with input from various other research teams. We aim to forecast the direction and scale of sovereign debt ratings (local currency), as well as any changes in the ratings outlook, for a range of countries. These are our judgments over the ratings outlook, rather than model-determined recommendations. All economic and fiscal forecasts are consistent with those published in Citi's monthly "*Global Economic Outlook and Strategy*" or other research. We do not aim to make a judgment on the financial market implications of ratings changes, except in so far as we expect any such market implications to affect other sovereign ratings.

Given economic updates in this publication and based on rating agency criteria, we highlight our economists' and strategists' main expectations for sovereign ratings over the near (2-3 quarters) and longer (2-4 years) term.

Figure 42. Advanced Economies — Sovereign Long-Term Debt Ratings and Citi Ratings Forecasts

	S&P Ratings				Moody's Ratings			
Country	Current Rating	Current Outlook	Citi Near-term (Up to 9 Months) Forecast Rating	Citi Longterm (Next 2-4 Years) Forecast Rating & Outlook	Current Rating	Current Outlook	Citi Near-term (Up to 9 Months) Forecast Rating	Citi Longterm (Next 2-4 Years) Forecast Rating & Outlook
US	AA+	Stable	AA+ (Stable)	AA+	Aaa	Stable	Aaa (Stable)	Aaa
Canada	AAA	Stable	AAA (Stable)	AAA	Aaa	Stable	Aaa (Stable)	Aaa
Japan	AA-	Neg	AA- (Neg)	A+ ↓	Aa3	Stable	Aa3 (Stable)	A1 ↓
Germany	AAA	Stable	AAA (Stable)	AAA	Aaa	Stable	Aaa (Stable)	Aaa
France	AA	Stable	AA (Stable)	AA	Aa1	Neg	Aa1 (Neg)	Aa1
Italy	BBB	Neg	BBB (Stable)	BBB	Baa2	Stable	Baa2 (Stable)	Baa2
Spain	BBB	Stable	BBB (Stable)	BBB	Baa2	Pos	Baa1 (Stable) ↑	Baa1 ↑
Austria	AA+	Stable	AA+ (Stable)	AA+	Aaa	Stable	Aaa (Stable)	Aaa
Belgium	AA	Stable	AA (Stable)	AA	Aa3	Stable	Aa3 (Stable)	Aa3
Finland	AAA	Neg	AAA (Neg)	AAA	Aaa	Stable	Aaa (Stable)	Aaa
Greece	B-	Stable	B- (Stable)	B-	Caa3	Stable	Caa3 (Stable)	Caa3
Ireland	A-	Positive	A- (Positive)	A ↑	Baa1	Stable	Baa1 (Positive)	A3 ↑
Netherlands	AA+	Stable	AA+ (Stable)	AA+	Aaa	Stable	Aaa (Stable)	Aaa
Portugal	BB	Stable	BB (Pos)	BB+ ↑	Ba2	Pos W	Ba1 (Stable) ↑	Baa3 ↑↑
UK	AAA	Stable	AAA (Stable)	AAA	Aa1	Stable	Aa1 (Pos)	Aaa ↑
Switzerland	AAA	Stable	AAA (Stable)	AAA	Aaa	Stable	Aaa (Stable)	Aaa
Sweden	AAA	Stable	AAA (Stable)	AAA	Aaa	Stable	Aaa (Stable)	Aaa
Denmark	AAA	Stable	AAA (Stable)	AAA	Aaa	Stable	Aaa (Stable)	Aaa
Norway	AAA	Stable	AAA (Stable)	AAA	Aaa	Stable	Aaa (Stable)	Aaa
EU	AA+	Stable	AA+ (Stable)	AA+	Aaa	Stable	Aaa (Stable)	Aaa
ESM	Not rated				Aa1	Stable	Aa1 (Stable)	Aa1
EFSF	AA	Stable	AA (Stable)	AA	Aa1	Stable	Aa1 (Stable)	Aa1

Note: Arrows denote expected ratings changes from the current rating. (Neg) denotes negative outlook. (Neg W) denotes negative watch. SD means Selective Default. (P) means Provisional. The number of arrows denotes the expected change in ratings notches from the current level. We show a maximum of five arrows even for countries where we expect more than five notches of ratings change. NA Not available. Sources: Moody's, S&P and Citi Research

Michael Saunders
+44-20-7986-3299
michael.saunders@citi.com

Peter Goves
+44-20-7986-3215
peter.goves@citi.com

Expected Ratings Issues

Since we last published, the upward rating trend has continued with Spain now rated BBB by S&P and Ireland Baa1 by Moody's. S&P has also restored the UK's rating outlook from negative to stable. We detail our near-term outlook pertaining to the sovereign rating calendars over the coming weeks.

Figure 43. Upcoming Rating Calendar

Date	Sovereign	Rating Agency	Current Rating	Current Outlook
27-Jun-14	Austria	Moody's	Aaa	Stable
27-Jun-14	Germany	Moody's	Aaa	Stable
27-Jun-14	Luxembourg	Moody's	Aaa	Stable
27-Jun-14	Slovenia	S&P	A-	Stable
04-Jul-14	Belgium	Moody's	Aa3	Stable
04-Jul-14	Estonia	S&P	AA-	Stable
04-Jul-14	Netherlands	Moody's	Aaa	Stable
11-Jul-14	EU	Moody's	Aaa	Stable
11-Jul-14	Germany	S&P	AAA	Stable
11-Jul-14	Malta	S&P	BBB+	Stable
18-Jul-14	Cyprus	Moody's	Caa3	Pos

Sources: Citi Research, Moody's and S&P

Moody's on Germany: Moody's rates Germany Aaa with a stable outlook (having revised the outlook from negative on 28 February). Given the ongoing economic recovery and strong fundamental position of Germany, we do not expect any rating change by Moody's (or S&P) over the medium or longer term.

Moody's on Austria: Moody's also rates Austria Aaa stable (also having revised its outlook from negative on 28 February). We do not expect any change this week. In the context of the banking sector, Moody's indicated that there are "*reduced risks that Austria's government balance sheet will be affected by a further crystallisation of contingent liabilities from the Austrian banking system*", beyond what they expect in relation to the resolution of HAA.

Moody's on Belgium: On 2 June, the European Commission recommended ending Belgium's Excessive Deficit Procedure, based on the country's success in achieving a 2.6% fiscal deficit. Moody's noted that this was a credit positive "*because it demonstrates the government's commitment and capacity to implement fiscal consolidation and meet its fiscal targets, whilst ruling out a potential fine for failing to comply with the 3% rule".* While we expect Belgium to remain Aa3 stable, we acknowledge a higher probability of the outlook being revised to positive on 4 July.

Moody's on the Netherlands: Moody's revised the outlook on the Netherlands' Aaa rating from negative to stable in March as a function of improving systemic and idiosyncratic credit drivers. We do not expect any change over the medium term.

Moody's on the EU: Given the various improvements in EMU sovereign credit ratings, notably the upgrades of Ireland, Portugal and Spain seen already in 2014, we expect the supranational EU to maintain its Aaa stable rating. Over the longer term however, concerns surrounding political cohesiveness and the rise of 'New, Extreme or Alternative Political Parties' ('NEAPs') may undermine this rating. Relatedly, the general improvement in EMU credit quality and lower systemic risks drove the restoration of the EFSF's rating outlook from negative to stable by Moody's earlier in June: *Why the EFSF's credit quality is decoupling from France.*

S&P on Germany: As with Moody's, S&P assigns the highest rating to Germany of AAA stable and confirmed this on 10 January. In S&P's words (10^{th} January) "*the outlook on the long-term rating is stable, reflecting our view that Germany's public finances and strong external balance sheet will continue to withstand potential financial and economic shocks"*. As such, we expect no change in S&P's rating.

Ireland upgraded by S&P to A-: S&P upgraded Ireland from BBB- to A- on 6 June. Interestingly, the outlook remains positive, signifying the likelihood of a further upgrade over the medium term (specifically, a one in three chance over the next 2 years). This is our base case as we continue to see upside to Ireland's economic growth trajectory.

Moody's on Portugal — only sovereign on positive watch: In other developments, Portugal remains the only sovereign to be on positive watch (as opposed to positive outlook). This is the case for Moody's Ba2 rating and we continue to look for an upgrade to Ba1 over the near term.

Yield and Spread Forecast Commentary

Amitabh Arora
+1-212-723-6439
amitabh.arora@citi.com

US: After reassessing the current growth environment, we have revised our rate forecasts lower for 2014 and 2015. When comparing our expectations for growth at the start of the year with what has been realized so far (accounting for weather effects), the current rates environment does not appear to be as stimulative as we believed going into the year. The implication is that even as Fed policy begins to tighten, it may have to do so much more gently than in past cycles. Accordingly, we have lowered our 10y and 30y forecasts significantly for the rest of 2014 and 2015.

Alessandro Tentori
+44-20-7986-9224
alessandro.tentori@citi.com

Core Europe: The policy scenario continues to evolve in line with Citi's baseline. Following the package of measures announced in June, we expect the ECB to deliver some sort of asset purchase plan in Q4, which would validate current market valuations to some extent. Given the revisions to the UST yield projection, we have lowered our Bund yield estimates to 1.5% in Q4 2014 and 1.6% in Q4 2015. The forecast implies a sensitivity to UST yields of about 0.5 in a rising yields scenario. Our forecast is slightly above 2014 year-end forwards, while being about 10bp below forwards in 2015. As far as soft-core spreads are concerned, we have left our forecasts unchanged and expect OATs to trade around 40bp over Bunds for the rest of this year.

Peter Goves
+44-20-7986-3215
peter.goves@citi.com

EMU Periphery: The pace of the rally has certainly slowed with 10y BTP/Bono spreads to Bunds locked around the 150bp level at present. However, our base case remains for some form of QE in December predicated largely on a further downgrade to its CPI inflation forecast. We therefore continue to look for spreads to tighten to around 120bp in Q4 and for curves to flatten further. The primary market also continues to thaw with Cyprus now having issued €0.75bn in the 5yr sector. Greece is also expected to issue again this year — perhaps sometime over the summer months. Given the topicality, we have re-introduced Greece into our forecast table and look for 10yr spreads to Germany to average around 400bp in Q4.

Jamie Searle
+44-20 7986 9493
jamie.searle@citi.com

UK: The front-end of the UK curve is likely to be driven primarily by domestic policy while the long-end is likely to be heavily influenced by international factors. On the former, the more hawkish tone struck by MPC members recently supports our already bearish view on the front-end. On the latter, the downward revision to our US Treasury yield forecasts has been mirrored by lower 10yr gilt yield forecasts (while maintaining the bias for steadily rising yield levels). As a result, we now expect even more curve flattening than previously in 2s5s/2s10s (beyond the forwards). On a cross-market basis, we still expect gilts to underperform. However, having already moved a long way in a short space of time, the pace of underperformance is likely to moderate. For 10yr gilt-Bunds, we now target 155bp in Q4 (compared with 170bp previously).

Takeki Fukushima
+813-627-07256
takeki.fukushima@citi.com

Japan: The additional 4.9trn of cheap term funding by the BoJ, 4yr fixed rate at 10bp, during cash-rich June due to large redemption concurrent with pension payment is likely to strengthen the strong seasonal rally towards end of July. The GPIF is likely to announce the new asset allocation in August including reduction of domestic bonds from current 60% to possibly 45% or even lower. The negative impact on the JGB market, however, should be limited in our view because the reduction should be achievable without selling JGBs owing to the separated bond fund to deal with cash-out. In fact, we are lowering our forecasts on JGB yields on the back of change in our forecasts on UST. We now expect 10y JGB yields to test 50bp in 4Q 2014 — by which time it probably will be clear that the BoJ is too optimistic and additional easing will be implemented, in our view.

Figure 44. Interest Rate and Bond Market Forecasts as of 25 June 2014

		Quarterly Average (Unless Specified)					
	Current	3Q 14F	4Q 14F	1Q 15F	2Q 15F	3Q 15F	4Q 15F
US							
Policy Rate (Fed Funds) End Quarter	0.25	0.25	0.25	0.25	0.25	0.75	1.00
3-Month Libor	0.23	0.23	0.23	0.35	0.65	0.85	1.05
2 Year Treasury Yield	0.46	0.60	0.80	1.05	1.30	1.50	1.75
5 Year Treasury Yield	1.69	1.80	2.10	2.35	2.45	2.60	2.70
10 Year Treasury Yield	2.59	2.70	2.90	3.00	3.05	3.15	3.20
30 Year Treasury Yield	3.42	3.45	3.45	3.50	3.55	3.55	3.60
2-10 Year Treasury Curve	296	210	210	195	175	165	145
2 Year Swap Spread (Swap Less Govt), bp	15	13.5	12	12	12	12	12
10 Year Swap Spread (Swap Less Govt), bp	9	12	15	15	15	15	15
30 Year Swap Spread (Swap Less Govt), bp	-4	-4.5	-5	-5	-5	-5	-5
30 Year Mortgage Yield	4.17	4.30	4.60	4.80	4.90	5.05	5.15
10 Year Breakeven Inflation	226	230	230	235	235	235	235
Euro Area							
Policy Rate End Quarter	0.25	0.15	0.15	0.15	0.15	0.15	0.15
Overnight Rate (EONIA)	0.03	0.05	0.00	0.00	0.00	0.00	0.00
3-Month (EURIBOR)	0.18	0.15	0.15	0.15	0.15	0.15	0.15
2 Year Schatz Yield	0.08	0.07	0.05	0.05	0.05	0.05	0.05
5 Year Bobl Yield	0.39	0.50	0.50	0.50	0.50	0.60	0.60
10 Year Bund Yield	1.33	1.45	1.50	1.50	1.55	1.55	1.60
30 Year Bund Yield	2.30	2.35	2.35	2.45	2.45	2.55	2.55
2-10 Year Bund Curve	125	138	145	145	150	150	155
10 Year BTP-Bund Spread	149	140	120	120	120	120	120
10 Year Bono-Bund Spread	138	140	120	120	120	120	120
2 Year BTP-Schatz Spread	51	50	40	40	40	40	40
2 Year Bono Schatz Spread	52	50	45	45	45	45	45
10 Year OAT-Bund Spread	50	50	40	40	40	40	40
10 Year Swap Spread (Swap Less Govt.), bp	18	20	20	20	20	20	20
10 Year Breakeven Inflation	131	140	140	145	145	150	150
5y5y Implied Vol	72	73	73	72	72	71	70
Japan							
Policy Rate End Quarter	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3-Month Libor	0.13	0.15	0.15	0.15	0.15	0.15	0.15
2 Year Treasury Yield	0.09	0.10	0.10	0.10	0.10	0.10	0.10
5 Year Treasury Yield	0.18	0.20	0.20	0.25	0.25	0.30	0.25
10 Year Treasury Yield	0.58	0.60	0.55	0.70	0.80	0.85	0.75
30 Year Treasury Yield	1.71	1.70	1.65	1.75	1.80	1.80	1.75
2-10 Year Treasury Curve	49	50	45	60	70	75	65
2 Year Swap Spread (Swap Less Govt.), bp	8	8	8	8	11	12	10
10 Year Swap Spread (Swap Less Govt.), bp	16	13	11	15	15	18	15
10 Year Breakeven Inflation	135	110	100	105	110	110	105
UK							
Policy Rate End Quarter	0.50	0.50	0.75	1.25	1.50	2.00	2.50
3-Month Libor	0.55	0.55	1.00	1.55	1.70	2.10	2.55
2 Year Treasury Yield	0.85	1.30	1.60	1.85	2.10	2.40	2.60
5 Year Treasury Yield	2.05	2.30	2.45	2.60	2.70	2.85	2.90
10 Year Treasury Yield	2.70	2.90	3.05	3.15	3.15	3.20	3.25
30 Year Treasury Yield	3.44	3.50	3.55	3.60	3.60	3.60	3.60
2-10 Year Treasury Curve	185	160	145	130	105	80	65
10 Year Swap Spread (Swap Less Govt.), bp	9	10	15	20	20	25	25
10 Year Breakeven Inflation	303	315	325	335	335	340	340
Australia							
Policy Rate End Quarter	2.50	2.50	2.50	2.50	2.75	3.00	3.25
3-Month Libor	2.71	2.60	2.75	2.80	3.10	3.25	3.50
2 Year Treasury Yield	2.62	2.60	2.50	2.50	2.85	3.40	3.85
5 Year Treasury Yield	3.14	3.25	3.45	3.70	4.05	4.40	4.85
10 Year Treasury Yield	3.74	3.75	3.80	4.00	4.20	4.45	4.65
2-10 Year Treasury Curve	112	115	130	150	135	105	80
10 Year Swap Spread (Swap Less Govt.), bp	35	35	40	40	45	45	50

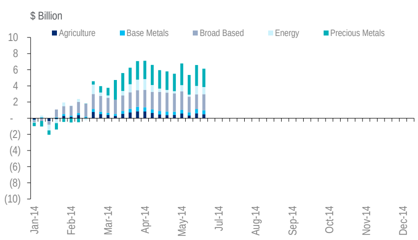
Source: Citi Research

Commodities Market Outlook

Aakash Doshi
+1-212-723-3872
aakash.doshi@citi.com

Edward L Morse
+1-212-723 3871
ed.morse@citi.com

Figure 45. 2014 Cumulative Commodity Investment by Major Sector



Source: Citi Research estimates

Commodities price weakness in May (-3%) has reversed in June (+2%) as geopolitics boosted the energy complex and global grain prices have begun to stabilize albeit in a much lower trading band just ahead of the Northern Hemisphere summer which can be a seasonally stronger period for energy and soft commodity markets. Gold prices also snapped back $75/t oz. this month as central banks continue to indicate loose monetary policy persisting and regional political tensions have escalated in Iraq. Year-to-date total returns for commodities at c9% continue to eclipse world equity index and Treasury returns of c5% and c3%, respectively. Cumulative net inflows into commodity investment vehicles are estimated north of c$6Bn this year and represent a 12% recovery after a record c$50Bn in net redemptions during 2013 (half of which were gold-linked) while assets under management have been boosted c$40Bn as of mid-2Q to c$400Bn after a 22% slide last year.

The second half of this year might see a further divergence among commodities with energy and industrial metals prices outperforming during a weaker grains price environment. Ongoing easy monetary policy could further boost stocks while inflation concerns may start weighing on bond markets — indirectly impacting macro commodity investment flows. For agriculture in particular there are expectations of record inventory builds for staple cereals (should US weather remain favourable) while tepid Chinese commodity consumption should pick up by year-end. This should keep supply/demand fundamentals balanced or in relative surplus later this year for a wide variety of commodities. The risk of El Niňo and weather volatility around the equator could also benefit soft commodities such as coffee, cocoa and sugar which have all outperformed this quarter amid tighter outlooks — further differentiating the grains view in 2H'14 versus other complexes.

The headlines out of Iraq have the oil market on edge for good reason as the world would struggle to replace the lost oil volumes if Iraq were to go the way of Libya. But the current turmoil could result in more rather than less oil coming out of Iraq in the near and medium term through accelerating exports from the Kurdish region and a continuation of robust Southern exports. Yet this may not translate into weakness in prices, with Brent currently trading at nine-month highs of ~$115/bbl. Entering 2014, geopolitical risks were already in the spotlight with ~3.5-m b/d of oil supply offline. The current Iraqi turmoil comes on top of the resurgence in Russia/Ukraine tensions and ongoing stand-off in Libya and the seemingly deteriorating situation in Nigeria. The "fear premium" has fed through into oil prices in three ways: (1) a counter-seasonal run-up in speculative length from investors using oil as a geopolitical hedge; (2) significant consumer hedging, especially airlines, serving to raise deferred parts of the oil curve; and (3) a stockpiling of crude by China and others as fear of a cut-off from key suppliers rises. Yet physical crude differentials have remained largely unaffected since the invasion of Mosul by ISIS and margins are still painfully weak. Moving into the third-quarter markets should tighten as refinery runs pick up and oil demand seasonally peaks, albeit Saudi production of over ~10-m b/d is expected. Iraq thus remains the big bull risk in the market right now, but Citi's base case view is for Baghdad to remain in government hands, with minimal disruptions to Southern oil flows which currently account for 100% of Federal Iraqi exports. Iran and the P5+1 failed to reach a deal in Vienna over their nuclear program and oil sanctions, and will resume on July 2. We expect prices to average ~$111/bbl in 3Q but see them significantly higher if turmoil spreads and erupts in Southern Iraq.

For natural gas markets — history repeats. High European gas inventories (now 67% full versus 41% at the same time last year) as a result of a mild winter continue to affect the market in a similar manner as what took place in 2012 in North America. To absorb the excess gas in North America, prices then declined from ~$4/MMBtu to the ~$2 range to boost coal-to-gas switching in power generation. In comparison, although absolute price levels are different, UK's NBP prices have fallen from the ~$10 range to as low as ~$6 before a modest ~10% rebound, where this move coincided with Russia's decision to cut gas supply to Ukraine. But this subdued NBP price recovery before a resumption of decline highlights how weak European gas demand is. Current European prices are able to induce some, but not a sizeable amount of coal-to-gas switching in Europe; winter gas supply risk is partly what's providing support to the forward curve further out.

More broadly, the increased interconnectedness of the global market is illustrated in how the LNG benchmark JKM (Japan-Korea Marker) has also fallen from a winter peak of ~$19 to ~$12; the lowest since Fukushima. Much lower Southern European LNG imports (81-Bcf in the last 30 days through mid-June versus 115-Bcf in the same 30-day span last year), low European prices and the perception that contracted LNG supply this summer in Asia should be sufficient is helping to drag down global LNG prices, despite stronger Middle East imports. Prices in UK's NBP and Asia's JKM are expected to remain low until late this summer possibly, when winter supply concerns reemerge. A strong price rebound would likely not happen unless gas supply from Russia to Europe via Ukraine was effectively cut for a prolonged period of time.

While the North American gas market remains separated from gas markets globally, the US government took steps that aim to boost LNG exports in the latter part of this decade. The US proposed to eliminate step one of the three-step approval process: The three-step process involves: (1) DOE's conditional approval to export to non-FTA countries, (2) FERC's approval of the siting, construction and operation of a liquefaction facility and (3) DOE's final exports approval. The proposed change would effectively allow project sponsors with financing backing and experience to accelerate the construction of terminals. The DOE also indicated that step (3) would likely be granted if step (2) is approved, given that spending as much as ~$100MM in step (2) demonstrates commitment. These developments are supportive of US gas exports and long-term prices. In the short term, the market awaits how the summer will unfold. Bal-2014 prices seem range-bound between ~$4.3 and ~$4.8, with the end-Oct'14 storage targeting a low ~3.4-Tcf.

The last month has been one of mixed blessings for base metals. Continued draws in LME aluminium and zinc inventory have lent a positive air towards both metals, with the latter trading up to $2,175/MT on June 20th, the highest price since February 2012, while aluminium has been trading up toward $1,900/MT. However, we believe the optimism over both metals is somewhat misplaced, with LME draws being read as consumption-driven, rather than what we believe to be trader-driven in order to support physical premiums. Aluminium production continues to grow, with May data released by the International Aluminium Institute showing a 2.7% y/y increase in global production at 4.331 million MT, the second-highest monthly volume on record, beaten by 4.405 Million MT in March. Year-to-date aluminium production is up 3% at 21.357 million MT, driven recently by restarting idled Chinese capacity plus newly commissioned capacity. In the case of zinc, a concentrate market in significant oversupply, combined with over 1 million tonnes of Chinese zinc smelter over capacity amid slowing Chinese construction activity, does not point to a bullish supply/demand picture for the galvanizing metal just yet.

Copper continues to labour under copper financing concerns in the port of Qingdao, with the ongoing Chinese authority investigation into the alleged multiple collateralization of metal prompting fears over the future of repo-based collateralized commodity financing. We believe such fears are overstated, with financing still apparently attractive in other more trusted port locations such as Shanghai. We see little prospect of large-scale deliveries into LME warehouses as a result of reduced demand for metal to collaterally finance. Indeed, both LME and Shanghai copper inventories have continued to draw over the last month, down a combined 42,883 MT since May 20th, and a combined 257,320 MT since the start of the year. Both markets remain firmly in backwardation in terms of forward curve price structure. Whilst the LME cash to 3-month backwardation structure has eased through June, somewhat prompted by the 19,450 MT of copper re-warranted on June 11th (which we believe was in relation to the ongoing Chinese financing concerns), we expect the market to continue to tighten physically, suggesting little significant downside possibilities for prices in the short term.

Nickel, the stand-out price performer over the first five months of the year, appears to have run out of steam for the time being, with prices now apparently stuck in an $18,000-19,000/MT range. The western world stainless steel consumer restocking drive that was instrumental in driving nickel prices to 26-month highs in mid-May appeared to have run its course by the end of the month, while Chinese stainless production also appears to be easing as we head into the summer season. However, the underlying story of forward tightness in the nickel market driven by the impact of the Indonesian ore export ban remains central to our positive nickel view. We expect renewed upside price movements into August, on the expectation of a post summer stainless steel restock, and also expect LME nickel inventory to begin to draw on a more consistent basis by September/October.

Our modestly constructive view on gold appeared to unfold in earnest this month, with COMEX bullion prices jumping to 13-week highs on Fed Chair Janet Yellen's outlook for US interest rates to remain low for the foreseeable future, weighing on the US dollar, boosting inflation expectations and with growing concerns over the escalating violence in Iraq. Despite our outlook of strong and persistent Chinese physical demand growth failing to materialize, with the China Gold Association now expecting 2014 China gold demand to be flat on 2013 levels, we continue to expect gold prices to trend above $1,300/oz. during 2H'14. We expect prices to find both physical market support from better Indian consumption helped by an expected relaxation of India's gold import duties in H2, and investor support from continued Middle Eastern geopolitical tensions on the one hand and US dollar weakness on the other.

In the PGM space, newsflow of settlements between the AMCU and South Africa's PGM miners has taken some of the gloss off the recent strike related price rally. However, both platinum and palladium prices remain well supported, with both markets facing a sizable deficit this year after more than five months of South African strikes, combined with strong auto sector demand for both metals. We expect prices to remain supported in 2H'14 as miners seek to rebuild and buffer stocks are depleted after such a lengthy production stoppage. We would not expect the South African mines to return to full production until September at the earliest — the timing of which could bolster price volatility next quarter.

In contrast to last month, where we highlighted the continued short-term downside risk to iron ore prices, we now believe prices are around the lowest they are likely to reach this year. We believe that $90 offers a strong support level from trader and mill purchasing and from further producer cutbacks — primarily in China, where roughly a quarter of capacity is now cash-negative, but sustained

prices below $90 would also likely see the first production curtailments outside China. We expect prices to remain more stable in H2 than they did in the first half due to two main factors: (1) Chinese steel demand should improve both fundamentally and seasonally from around September; (2) Australian supply growth was concentrated in Q2 this year but is not expected to see another significant increase in the second half.

Thermal coal prices have continued to grind lower, as expected. Prices remain challenged in the short term as the Chinese market remains oversupplied, India passes through the monsoon season, the gap between European dark and spark spreads contracts, and supply has resumed growing from first half disruptions in Colombia and South Africa. We do expect prices to increase moderately starting in August or September as Chinese demand improves and India resumes importing in size post-monsoon (particularly given how low power plant inventories are already). Coking coal spot prices have remained essentially flat over the past two months. This is expected to continue in July as production curtailments remain modest and Chinese mills are unlikely to restock given weak demand, though we forecast thermal prices to rise slightly from $120 in Q2 to $122 in Q3.

For agriculture markets, year-to-date 2014 price strength has already dissipated to price weakness for many staple crops save for perhaps a few 'equatorial/emerging market' softs such as cocoa and sugar, which could continue to benefit from the strong likelihood of a (mild) El Niňo this summer. Official weather agencies expect the extreme (D3/D4) US West Coast drought to linger. But this could be an isolated issue in the US affecting specialty vegetables/fruit crops or 'non-contract' agriculture markets. The bulk of US grains are grown across the US Midwest (IA, IL, IN, MN, NE), which is expected to see its minor drought situation today either dissipate completely or at least improve this summer according to the latest NOAA models. An El Niňo event could also prompt a cooler US farm-belt and heavier precipitation cycles in the Midwest, which could support the outlook for break-out corn and soybean yields although it is still early in the growing season and the next significant leg lower in new-crop prices (should weather remain favourable) might not be until July. Early season US corn and soybean crop conditions are both at the top of their trailing 10Y ranges. While it is premature and challenging to allocate final yield prospects to these crop ratings — should near-normal and favourable growing weather persist through the summer then it is possible that the 2014/15 crop could see upsized harvest potential with corn yields near 170-bu/acre and soybeans above 46-bu/acre. This would represent record row crop yields and lead to further downside risk for new-crop prices.

CBOT prices have already begun easing since May for the benchmark cereals and row crop trading levels still seem poised for another 15-20% correction if US and Chinese weather stays on an even course. Therefore, after significantly outperforming all other commodity sectors (and for that matter all other asset markets) during 1Q and early 2Q'14, the bearish row crop and grains outlook should see the sector diverge and underperform in 2H'14. Indeed, investors have massively unwound bullish trades in recent weeks across the major grains market as planting conditions progressed rapidly across the Northern Hemisphere and crop conditions appeared very favourable amid some stabilization of US export sales. The USDA, in our view, is still underestimating acreage for maize and beans in particular, which we expect could revise higher come June 30 (i.e. ~92-mn for corn and ~82-mn for soy); prevent-plantings were a major concern during April/early May but are much less an issue outside the NCB given the spring sowing recovery and the bias remains for prices to fall sharply by 4Q. This could be a boon for food consumers and EM importers in the coming months.

International food costs declined in May for a second straight month. The FAO Food Price Index eased 2.5 points m/m and 3.2% y/y to 207.8 — a high level by historical standards but representing ongoing relief for consumers following violent price spikes in 1Q for grains, dairy and related products. Milk and cheese prices have leveled as the North American supply outlook has improved for the balance of 2014. Prices for global grains fell 1.2% in May and should decline further in June and into harvest. World meat prices did tick higher but at a subdued 0.2% last month versus a 2% rate during March and April. The US barbecue season is in full-swing and should continue to buttress meat demand through the 4th of July Independence Day holiday. There is also historically a 1-3 month lag for upstream feed price impacts to filter through to livestock and poultry products downstream. As such, the bearish grains price outlook should filter down to lower meat prices in the coming quarters as well.

Figure 46. Commodity Price Forecast Table

		Point Prices																			
		0-3M	6-12M		Q3 2013	Q4 2013	Q1 2014	Q2 2014E	Q3 2014E	Q4 2014E	Q1 2015E	Q2 2015E	Q3 2015E	Q4 2015E	2012	2013	2014E	2015E	2016E	2017E
Energy				**5Y Cyclical**																	
NYMEX WTI	USD/bbl	103.0	103.0	81.0	108.0	97.6	99.0	103.0	107.0	99.0	101.0	96.0	104.0	97.0	94.1	98.0	102.0	100.0	83.0	78.0
ICE Brent	USD/bbl	110.0	110.0	85.0	112.0	109.3	107.8	110.0	111.0	108.0	106.0	103.0	108.0	103.0	111.7	108.7	109.0	105.0	90.0	85.0
Henry Hub Natural Gas	USD/MMBtu	4.70	4.85	5.50	3.55	3.85	5.20	4.63	4.80	4.90	4.50	4.40	4.50	4.60	2.75	3.73	4.90	4.50	4.90	4.90
Base Metals				**LT Price**																	
LME Aluminum	USD/MT	1,790	1,820	2,200	1,827	1,815	1,752	1,840	1,780	1,800	1,830	1,860	1,890	1,900	2,049	1,888	1,795	1,870	1,950	2,100
LME Copper	USD/MT	6,770	7,000	6,200	7,096	7,161	7,005	6,740	6,750	6,800	6,900	7,000	7,200	7,500	7,945	7,352	6,825	7,150	7,700	8,000
LME Lead	USD/MT	2,170	2,300	2,200	2,116	2,134	2,127	2,115	2,150	2,250	2,350	2,100	2,200	2,370	2,072	2,158	2,160	2,255	2,350	2,400
LME Nickel	USD/MT	19,000	22,000	21,000	13,996	13,980	14,693	18,530	18,700	19,400	22,000	23,000	24,000	26,500	17,592	15,105	17,830	23,875	26,500	26,000
LME Tin	USD/MT	23,000	24,500	20,000	21,284	22,951	22,622	23,135	23,500	24,000	25,000	24,000	23,000	25,000	21,108	22,340	23,315	24,250	25,000	24,000
LME Zinc	USD/MT	2,070	2,130	2,100	1,896	1,932	2,027	2,075	2,050	2,100	2,150	2,200	2,250	2,300	1,963	1,940	2,065	2,225	2,300	2,350
Precious Metals				**LT Price**																	
COMEX Gold	USD/T. oz	1,280	1,360	1,050	1,330	1,274	1,292	1,285	1,300	1,320	1,340	1,350	1,360	1,400	1,669	1,416	1,300	1,365	1,380	1,400
Silver	USD/T. oz	20.2	21.4	16.5	21.5	20.8	20.5	19.6	20.0	20.4	20.9	21.4	22.2	23.0	31.2	24.0	20.1	21.9	22.5	23.0
Platinum	USD/T. oz	1,480	1,525	1,763	1,456	1,397	1,429	1,445	1,500	1,525	1,525	1,565	1,640	1,675	1,552	1,490	1,475	1,600	1,710	1,800
Palladium	USD/T. oz	820	860	780	729	725	745	815	830	850	875	900	900	925	645	728	810	900	935	980
Bulk Commodities				**5Y Cyclical**																	
Hard Coking Coal (Spot)	USD/MT	120	130	200	143	142	122	113	120	135	145	150	155	160	191	148	122	153	180	190
Thermal Coal Asia (NEWC)	USD/MT	72	80	90	77	82	79	73	72	80	82	78	75	80	94	84	76	79	85	90
Iron Ore Spot (TSI)	USD/MT	95	100	81	133	135	120	102	95	100	98	92	85	85	128	135	104	90	80	83
Agriculture																					
CBOT Corn	USd/bu	440	380	N/A	512	430	450	480	440	380	420	450	505	505	695	578	440	470	515	N/A
CBOT Wheat	USd/bu	620	620	N/A	650	655	616	650	620	620	620	610	600	600	750	684	630	600	615	N/A
CBOT Soybeans	USd/bu	1,325	1,075	N/A	1,405	1,304	1,355	1,470	1,325	1,075	1,050	1,050	1,000	1,100	1,465	1,406	1,300	1,050	1,075	N/A
CBOT Rice	USD/cwt	14.3	14.3	N/A	15.6	15.5	15.5	15.1	14.3	14.3	13.7	13.5	13.4	13.4	14.9	15.5	14.8	13.5	N/A	N/A
NYB-ICE Cotton	USd/lb	85.0	75.0	N/A	85.6	80.3	88.0	90.0	85.0	75.0	75.0	75.0	75.0	75.0	80.0	83.3	85.0	75.0	N/A	N/A
Sugar#11	USd/lb	18.0	18.0	N/A	16.7	17.7	16.5	17.3	18.0	18.0	18.5	18.5	18.5	18.5	21.6	17.5	17.5	18.5	N/A	N/A
ICE Coffee	USd/lb	200	200	N/A	118	110	152	185	200	200	225	225	225	225	175	126	185	225	N/A	N/A
ICE Cocoa	USD/MT	3,100	3,075	N/A	2,420	2,706	2,880	3,000	3,100	3,075	3,400	3,400	3,500	3,300	2,348	2,405	3,000	3,400	N/A	N/A

Source: Citi Research, *subject to revision

Figure 47. Citi Global Economics Team *For Informational Purposes Only*

	Name	Office Number	Email Address	Responsibilities
NEW YORK	North America			
	Willem Buiter[3]	+1-212 816-2363	willem.buiter@citi.com	Chief Economist
	William Lee[3]	+1-212 816-2621	william.lee@citi.com	Global Economist, North America
	Peter D'Antonio[3]	+1-212 816-9889	peter.dantonio@citi.com	U.S. Forecast
	Dana Peterson[3]	+1-212 816-3549	dana.peterson@citi.com	U.S. Forecast and Canada
	Matt Dabrowski[3]	+1-212 816-9891	matt.dabrowski@citi.com	Global Political Analysis
	Benjamin Mandel[3]	+1-212 816-2735	benjamin.mandel@citi.com	Global Economics
	Joseph Seydl[3]	+1-212 816-2473	joseph.seydl@citi.com	Global Economics
	Malcolm Spittler[3]	+1-212 816-2461	malcolm.d.spittler@citi.com	U.S. Forecast
	Emerging Markets			
	Guillermo Mondino[3]	+1-212 816-6499	guillermo.mondino@citi.com	Head, EM Economics and Strategy Research
	Jorge Pastrana[2]	+1-212 816-5728	jorge.armando.pastranavillegas@citi.com	Chile, Caribbean and Central America
LONDON	Global			
	Tina Fordham[1]	+44-20 7986-9860	tina.fordham@citi.com	Global Political Analysis
	Western Europe			
	Michael Saunders[1]	+44-20 7986-3299	michael.saunders@citi.com	Head, Western Europe and U.K. Coverage
	Guillaume Menuet[1]	+44-20 7986-1314	guillaume.menuet@citi.com	Euro Area (France, Belgium, Netherlands) and ECB
	Giada Giani[1]	+44-20 7986-3281	giada.giani@citi.com	Euro Area (Italy,Spain, Greece, Portugal)
	Ebrahim Rahbari[1]	+44-20 7986-6522	ebrahim.rahbari@citi.com	Euro Area (Germany) and Global Economics
	Tina Mortensen[1]	+44-20 7986-3284	tina.mortensen@citi.com	Nordics
	Ann O'Kelly[1]	+44-20 7986-3297	ann.okelly@citi.com	Europe
	Antonio Montilla[1]	+44-20 7986-3282	antonio.montilla@citi.com	Global Economics and Europe
	Emerging Markets			
	David Lubin[1]	+44-20 7986-3302	david.p.lubin@citi.com	Head, Emerging Markets and CEEMEA
	David Cowan[1]	+44-20 7986-3285	david.cowan@citi.com	Africa
	Farouk Soussa[1]	+44-20 7986-4356	farouk.soussa@citi.com	Gulf, Middle East, Levant
	Alexander Demyanets[1]	+44-20 7986-4061	alexander.demyanets@citi.com	Emerging Markets Strategy
	Wilbur Maxino[1]	+44-20 7986-3303	wilbur.maxino@citi.com	Emerging Markets and CEEMEA
TOKYO	Kiichi Murashima[2]	+813 6270-4980	kiichi.murashima@citi.com	Head, Japan
	Naoki Iizuka[2]	+813 6270-4997	naoki.iizuka@citi.com	Japan
SYDNEY	Paul Brennan[15]	+612 8225-4899	paul.brennan@citi.com	Head, Australia, New Zealand
	Josh Williamson[15]	+612 8225-4904	josh.williamson@citi.com	Australia, New Zealand
BOGOTA	Munir Jalil[12]	+57 1 639-4195	munir.jalil@citi.com	Colombia, Peru and Venezuela
BUDAPEST	Eszter Gargyan[7]	+36 1 374-5559	eszter.gargyan@citi.com	Hungary
HONG KONG	Johanna Chua[4]	+852 2501-2357	johanna.chua@citi.com	Head, Emerging Asia, Sri Lanka, Vietnam
	Minggao Shen[4]	+852 2501-2485	minggao.shen@citi.com	China
	Shuang Ding[4]	+852 2501-2769	shuang.ding@citi.com	China
	Adrienne Lui[4]	+852 2501-2753	adrienne.lui@citi.com	Hong Kong, Mongolia, Taiwan
ISTANBUL	Ilker Domac[6]	+90 212 319-4623	ilker.domac@citi.com	Turkey, Romania, Balkans
	Gultekin Isiklar[6]	+90 212 319-4915	gultekin.isiklar@citi.com	Turkey, Romania, Balkans
JAKARTA	Helmi Arman[21]	+62-21-5290-8960	helmi.arman@citi.com	Indonesia
JOHANESBURG	Gina Schoeman[1]	+27 11 944 0813	gina.schoeman@citi.com	South Africa
MANILA	Jun Trinidad[17]	+63 2 894-7270	jun.trinidad@citi.com	Philippines, Thailand
MEXICO CITY	Sergio Luna Martinez[4]	+52 55 2226-6799	sergio1.luna@banamex.com	Mexico
MOSCOW	Ivan Tchakarov[18]	+7 495 643 1507	ivan.tchakarov@citi.com	Russia, Kazakhstan, Ukraine
MUMBAI	Rohini Malkani[8]	+91 22-6175-9876	rohini.malkani@citi.com	India
	Anurag Jha[8]	+91 22-6175-9877	anurag.jha@citi.com	India
PRAGUE	Jaromir Sindel[13]	+42 02 3306-1485	jaromir.sindel@citi.com	Czech Republic, Slovakia, Slovenia
SAO PAULO	Marcelo Kfoury[19]	+55 11 4009-3470	marcelo.kfoury@citi.com	Brazil
SEOUL	Jaechul Chang[16]	+82 2 2077-4160	jaechul.chang@citi.com	Korea
SINGAPORE	Kit Wei Zheng[20]	+65 6657-5079	wei.zheng.kit@citi.com	ASEAN, Singapore, Malaysia
	Adrian Thomas[20]	+65 6657-1931	adrian.thomas@citi.com	Global Emerging Markets, Asia and CEEMEA
WARSAW	Piotr Kalisz[7]	+48 22 692-9633	piotr.kalisz@citi.com	Head, CEE and Poland
	Cezary Chrapek[7]	+48 22 692-9421	cezary.chrapek@citi.com	Poland

1 Citigroup Global Markets Ltd; 2 Citigroup Global Markets Japan Inc.;3 Citigroup Global Markets Inc; 4 Citigroup Global Markets Asia; 5 Citigroup Global Markets (Pty) Ltd; 6 Citibank Anonim Sirketi; 7 Bank Handlowy w Warszawie; 8 Citigroup Global Markets India Private Limited; 9 Citigroup Global Markets India Private Limited; 10 Citibank (China) Co. Ltd; 11 Acciones y Valores Banamex, S.A. de C.V; 12 Citibank Taiwan Ltd; 13Banco Citibank S.A.; 14 Citibank Europe plc Czech Republic; 15 Citigroup Pty Limited; 16 Citigroup Global Markets Korea Securities Ltd; 17 Citibank N.A. Philippines; 18 ZAO Citibank; 19 Banco Citibank S.A.; 20 Citigroup Global Markets Singapore PTE LIMITED; 21 PT Citigroup Securities Indonesia

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Appendix A-1

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