

# Global Economic Outlook and Strategy

## Global Economic Outlook and Strategy — August 2014



- We continue to have a slight bias to growth forecast downgrades, and are trimming our global growth forecasts for both 2014 and 2015 by 0.1 percent from last month, to 2.8% and 3.4% respectively (at current exchange rates). Among individual countries, we make modest growth forecast downgrades this month for Japan, the euro area, Australia, Brazil, South Africa and Sweden. Indeed, this month sees the biggest one-month downgrade to our euro area growth forecast since Jan-2012.
- We believe that early easing by both the BoJ and ECB is more likely than the consensus view. We look for both central banks to downgrade their economic forecasts and to launch major QE programs in Q4-14 or perhaps Q1-15. In the euro area, inflation is close to zero, inflation expectations are falling sharply, while weakness in Q2 GDP and recent business surveys suggest that growth is unlikely to be strong enough to prevent a sustained inflation undershoot. In Japan, recent comments suggest that the BoJ is now becoming more worried about growth prospects, in light of weak data after the tax hike. We regard the BoJ's semi-annual forecast update in late-October as a likely trigger for further easing, especially given the prospect that the government will proceed with the second consumption tax hike in 2015. By contrast, the UK remains likely to tighten in the next six months or so, with the Fed likely to start to hike rates about a year from now.
- Some aspects of globalisation seem to have slowed or stalled: world trade growth is sluggish, cross-border bank exposure is shrinking and global FDI flows remain well below the pre-crisis norms relative to global GDP. To be sure, the prior boost to globalization from trade deregulation and rapid expansion of cross-border bank lending has diminished. However, some of these "de-globalisation" trends mainly reflect the modest pace of advanced economy growth — notably Europe — rather than a reversal of globalization itself. Indeed, with big inflows of foreign workers, labour markets in many advanced economies have become more globalized.

### 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

Next issue 24 September 2014

Figure 1. Currency and Interest Rate Forecasts, as of 20 August 2014

	Current	4Q 14F	1Q 15F	2Q 15F	3Q 15F	4Q 15F	1Q 16F
United States: Federal Funds	0.25	0.25	0.25	0.25	0.75	1.00	1.25
10-Yr. Treasuries (Period Ave.)	2.40	2.70	2.90	3.05	3.15	3.20	3.25
Euro Area: US\$/€	1.34	1.34	1.33	1.33	1.34	1.36	1.38
Euro Repo Rate	0.15	0.15	0.15	0.15	0.15	0.15	0.15
10-Yr. Bunds (Period Ave.)	1.00	0.75	1.00	1.25	1.50	1.50	1.75
Japan: Yen/US\$	102	105	107	108	109	109	109
Call Money	0.10	0.10	0.10	0.10	0.10	0.10	0.10
10-Yr. JGB (Period Ave.)	0.51	0.50	0.70	0.80	0.85	0.75	0.85

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

<b>Global</b>	We have cut our 2014 global growth forecast (at current exchange rates) to 2.8% from 2.9% last month and 3.3% at the start of the year, and are also trimming 0.1 percent off our 2015 forecast to 3.4% from 3.5% last month.
<b>United States</b>	We expect the economy to grow at an above-trend pace through 2015. Economic fundamentals have improved, fiscal drag is dissipating, and financial conditions are providing a significant tailwind to growth. Inflation is likely to remain quiet, despite some higher readings earlier this year. The Fed is in the process of revising its exit principles, but we do not expect the Fed to hike rates until the third quarter of 2015.
<b>Euro Area</b>	We lower our GDP forecasts for 2014 and 2015 by 0.3pp and 0.2pp to 0.8% and 1.5%, respectively. This is the largest cut in our numbers since January 2012 and the third downward adjustment in four months. At the same time, inflation continues to weaken, hitting 0.4% YY in July from 0.5% YY in June, suggesting that the Q3 average will again undershoot the ECB's baseline. We continue to expect the ECB to deliver additional policy stimulus in either late 2014 or early 2015.
<b>China</b>	July data point to strong external demand and weak domestic demand. With the benign inflation outlook, the PBOC will likely keep its easing bias for monetary policy and aim to lower overall financing costs across the economy. Meanwhile, we expect the government to take steps to support property demand. We keep our 2014 growth forecast at 7.5%.
<b>Japan</b>	The BoJ's view on the economy has turned somewhat more nuanced. Policymakers have revised down their assessment regarding exports and also tweaked the section regarding consumer spending in the Monthly Report. In this environment, we are sticking to our view that the BoJ will act in late October when it updates its semi-annual outlook report.
<b>United Kingdom</b>	We recently pushed our forecast for the first UK rate hike from Q4-14 to Q1-15, reflecting the MPC's decision to lower their estimate for the medium-term equilibrium unemployment rate from about 6% to 5.5% (and falling). We continue to expect that rapid economic growth will prompt the MPC to hike further than markets price in over the next 2-3 years.
<b>Canada</b>	The BoC is unlikely to raise interest rates until there is sustained improvement in capex and export growth, and/or a notable pick up in inflation expectations. Hence, we keep our long-standing expectation for rate hikes to resume in 3Q15.
<b>Australia</b>	Markets continue to price around a 50% probability of a further rate cut, but with interest rates already unusually low by Australian standards, the RBA appears content to wait for confirmation of its view that the improvement in business confidence will be reflected in higher spending.
<b>Emerging Asia (ex China)</b>	Asia's growth is on a multi-speed recovery path. Malaysia and Philippines are expected to hike again in September while others will be on hold. Inflation remains benign except food-driven inflation in Philippines and India, the latter dashing hopes for imminent easing by RBI. Indonesia's current account deficit remains an issue, and thus, market awaits for clarity on fuel subsidy policies in the coming months.
<b>CEEMEA</b>	CEEMEA is increasingly split between countries that have high-inflation problems (South Africa, Turkey, Russia) and countries with low-inflation problems (Israel, Czech, Poland, Hungary). To some extent, Russia's suspension of food imports from countries that have implemented sanctions will reinforce these trends: inflation probably will go up in Russia and Turkey, and down in Poland.
<b>Lat Am</b>	In Brazil, despite the recent developments, we continue to expect President Rousseff will be re-elected. We have also downgraded our growth forecasts for Brazil and Mexico. Additionally, we expect the CBs in these countries to remain on hold for some time. Argentina failed to make an interest payment and is now in default. We believe that this situation, if not remedied in the short-term, will add a thick extra layer of pressure on its already-weak economic fundamentals. The situation in Venezuela remains unsustainable and, thus, we expect economic announcements in the next few months.

Source: Citi Research

Figure 3. Selected Countries — Industrial Production Forecasts (Pct.), 2013-2015F

	2013	2014F	2015F
World	2.3	3.6	4.0
United States	2.9	3.9	3.4
Japan	-0.6	2.6	1.1
Euro Area	-0.7	1.0	3.3
United Kingdom	-0.4	2.1	2.0
Canada	1.9	3.0	2.5
China	9.7	9.1	8.5
India	0.4	3.9	5.9
Korea	0.3	3.1	5.6
Brazil	2.3	-2.2	1.0

Source: Citi Research

[Michael Saunders](#)

## Overview: Prospects for ECB/BoJ Easing, and Is Globalisation Reversing?

We are cutting our 2014 global growth forecast (at current exchange rates) to 2.8% from 2.9% last month and 3.3% at the start of the year, and are also trimming 0.1 percent off our 2015 forecast (to 3.4% from 3.5% last month). Within the global totals, we are cutting 0.1 percent off our advanced economy (AE) GDP growth forecasts for 2014 and 2015 (to 1.8% and 2.4% respectively), while also cutting 0.1 percent off our forecast for 2014 emerging market growth. Among individual countries, we are cutting our growth forecasts this month in Japan, the euro area, Australia, Brazil, South Africa and Sweden. We highlight two themes in the outlook: the prospect of ECB/BOJ easing; and whether globalization is reversing.

### ECB and BoJ Easing Comes Into Focus

We continue to expect the ECB and BoJ will ease further via major QE programs in the next couple of quarters. Moreover, while there are uncertainties, for both the ECB and BoJ we believe the probability of policy action soon is higher than the consensus view (reflecting both a higher probability of action and a higher chance that action will come relatively early).

At the early-August press conference, ECB President Draghi repeated the ECB's willingness to loosen further — via unconventional policies — if its inflation forecasts and inflation expectations trends indicate that a sustained undershoot of its inflation target is likely: *"the Governing Council is unanimous in its commitment to also using unconventional instruments within its mandate, should it become necessary to further address risks of too prolonged a period of low inflation. We are strongly determined to safeguard the firm anchoring of inflation expectations over the medium to long term."*

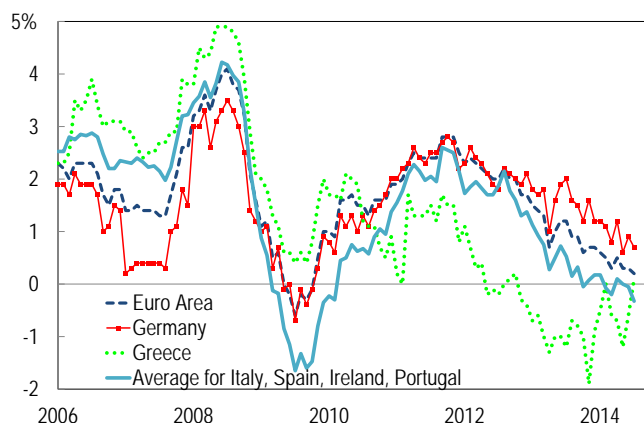
We believe these conditions for easing are falling into place, and that further downgrades to the ECB's inflation forecasts are likely to trigger a major QE program, most likely at the December meeting but perhaps in early 2015. Headline inflation (at just 0.4% YoY) continues to undershoot ECB forecasts, and CPI inflation ex tax changes is down to only 0.2% YoY from 1.2% a year ago. YoY CPI inflation ex tax is positive in only one of the euro area's five biggest economies (Germany): it is negative in Italy and Spain, and zero in France and the Netherlands. Moreover, in contrast to the ECB's prior forecast of a sustained recovery that would narrow the output gap, Q2 GDP was flat, trends in money and credit remain lackluster, and business surveys have turned down. Spillovers from strains in Russia/Ukraine add to downside risks. In turn, the EC survey indicates that household inflation expectations have weakened markedly, while financial market breakeven inflation rates for the next 5-10 years have fallen sharply in recent weeks.

In our view, the ECB cannot credibly blame the current weakness in GDP growth and inflation just on supply-side problems or on a price-level adjustment in ex-program countries. Economic growth is weak even in core countries, France and Italy are very soft, and YoY CPI inflation is below 2% YoY in every single euro area country. By contrast, a year ago, inflation weakness was concentrated in some periphery countries and inflation ex tax was close to 2% YoY in Germany, Austria and Finland. The case for monetary easing is correspondingly stronger now.

To be sure, a decision to launch QE would probably prompt intense criticism of the ECB from some quarters. But we suspect that the consequence of policy inaction would over time be far more damaging to the economy and the ECB's reputation. Even if the euro area does not tip into deflation, a persistent inflation undershoot amidst high unemployment implies a major economic and social cost of wasted resources. In addition, a persistent inflation undershoot creates risks of future

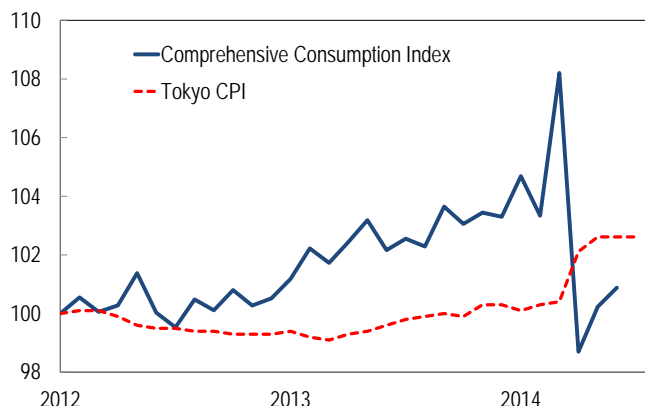
economic and market instability. This is because such low inflation rates are likely to be reflected in persistently weak nominal GDP growth that would make it even harder for periphery countries to regain fiscal sustainability, while also probably undermining private sector credit quality. Even with shrinking fiscal deficits, the euro area general government debt/GDP ratios continues to rise: the Q1 figure (96.4%) rose by 1.6 points from a year earlier (94.8%) — with YoY rises in this ratio of 13.5 points for Greece, 6.8 points for Spain, 5.5 points for Portugal, and 5.4 points for Italy. For all these four countries, the government debt/GDP ratio hit a record high in Q1 this year. Such trends create ongoing risks that EMU strains might reignite.

Figure 4. Euro Area — CPI Inflation At Constant Tax Rates YoY, 2006-14



Sources: Eurostat and Citi Research

Figure 5. Japan — Consumption and CPI, Jan-2012 = 100, 2012-14



Sources: DataStream and Citi Research

In Japan, the BoJ has succeeded in lifting household inflation expectations, and roughly two thirds of households expect prices to rise by at least 2% over the year ahead. However, the rise in inflation expectations may partly reflect fears of a further hike in indirect taxes, and is not translating into underlying economic recovery. Rather, recent data suggest that the consumption tax hike has cast a lasting shadow on Japan's growth prospects, reflecting not just the temporary unwind of advance purchases before the tax hike but also a more persistent erosion of household real incomes<sup>1</sup>. The split of Q2 GDP shows weakness in spending on non-durable consumer goods and services — neither of which had grown strongly in Q1. Moreover, the Cabinet Office's comprehensive consumption index in June remained around 2% below the H2-13 average (before the rush demand surge in Q1). In turn, the price level (using the Tokyo CPI) has been roughly stable since May, casting doubt on the BoJ's forecast that underlying inflation is picking up.

We expect that real GDP growth in 2014-15 will undershoot the BoJ's forecasts of April-14 (1.5% growth in FY15), especially if (as seems likely) the government goes ahead with the next consumption tax hike planned for Oct-15. Indeed, there are hints that the BoJ is becoming more concerned over growth prospects, and we expect the BoJ's next forecast round (in late October) to show significant forecast downgrades — prompting policy easing straight away or soon after.

By contrast, we continue to expect that, amidst strong economic growth and shrinking labour market slack in the UK and US, the BoE and Fed are both likely to start their exit strategies in the next 2-3 quarters. We have recently pushed back our forecast for the first UK rate hike and scaled down our forecast for the initial pace of

<sup>1</sup> See "The BoJ's view turns more nuanced", Kiichi Murashima and Naoki Iizuka, *Japan Economics Weekly*, 15 August 2014, Citi.

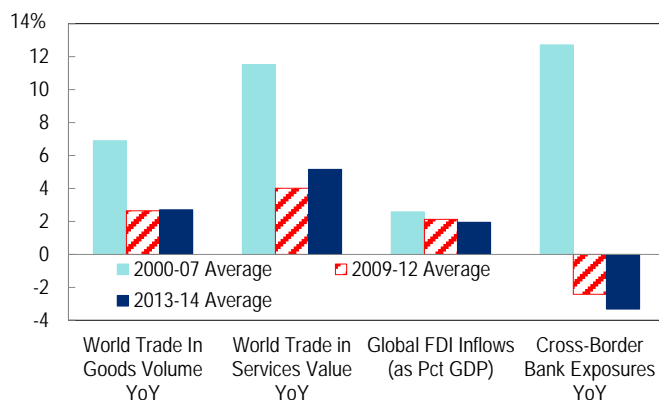
MPC tightening<sup>2</sup>. Nevertheless, we pencil in the first MPC hike in Q1-2015, while we expect the Fed will look to close part of the spread between the reverse repo rate, the fed funds rate and interest on excess reserves in the next 2-3 quarters and to hike rates around mid-2015<sup>3</sup>.

### Is Globalisation Unwinding?

We have recently highlighted the continued weakness of world trade growth, which (for goods) is still running at 2-3% YoY, versus the precrisis average of 6-7% YoY<sup>4</sup>. World trade growth is currently roughly matching the growth of global GDP and industrial production, in contrast to pre-crisis trends in which world trade grew about twice as fast as global GDP and industrial production growth. There are also some other aspects of globalization (ie increased flows of goods, services, ideas, capital and people across developed and developing countries) which have at least stalled.

- The growth of world trade in commercial services has also slowed markedly, growing by just 4.1% YoY on average in 2009-13, versus an average of 11.6% YoY in 2000-07.
- Cross-border banking exposures continue to shrink, dropping 2.0% YoY in Q1 (adjusted for exchange rate changes) and have fallen by a total of 16% since Q1-08 (average drop of 2.8% YoY). By contrast, cross-border banking exposure rose by an average of 11.4% YoY in the 10 years ended Q1-08.
- Global FDI flows have fallen to an average of 2.1% of global GDP per year in 2009-13 (and 1.9% of GDP in 2013 alone) from an average of 2.6% of GDP per year in 2000-07.

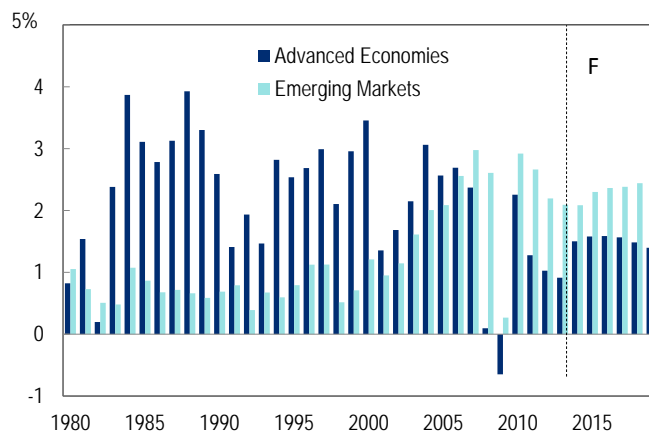
Figure 6. Global —World Trade Growth, FDI Flows, and Cross-Border Bank Exposure YoY, 2000-14



Note: Latest FDI and services trade data are for 2013, data for trade in goods and bank exposures include early 2014.

Sources: CPB, United Nations, BIS and Citi Research

Figure 7. Global — IMF Projections of Contributions to Global GDP Growth, 1980-2019F



Sources: IMF and Citi Research

These trends raise the question of whether we are seeing a reversal of the broader globalisation trends of recent decades. To be sure, there is, at the very least, sand in the wheels of globalization. Amidst high unemployment and sluggish growth in

<sup>2</sup> See "Change in Rate View", Michael Saunders, *UK Economics Weekly*, 15 August 2014, Citi.

<sup>3</sup> See "Our Fed Call: Fed Poised For On-Time Or Early Liftoff?", *US Economics Weekly*, Willem Buiter and William Lee, 15 August 2014, Citi.

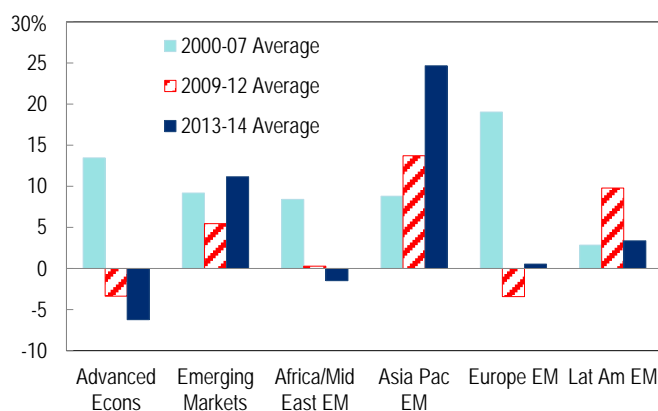
<sup>4</sup> See, for example, "Global Economic Outlook and Strategy", Willem Buiter et al, 30 July 2014, Citi.

advanced economies, policymakers are focused more on reviving their own economies rather than opening up further to external competition. For example, after sharp reductions in the 1990s, the average effective tariff on imports of manufactured goods to the US, EU and Japan has been roughly stable over the last 10 years. The Doha trade round on further trade liberalization was launched 13 years ago, but talks have been largely stalled since 2008. The WTO report a notable rise in non-tariff restrictions on trade since 2009, with such measures often introduced on technical or safety grounds. Moreover, some regulator measures (for example via changes in capital and liquidity policies) are pressuring banks to focus more on domestic lending rather than external expansion.

But, in part, the slowdowns in world trade, cross-border bank exposure and FDI flows are simply a direct result of the modest pace of advanced economy growth (especially in Europe), and other economic trends, rather than a retreat from globalisation as such.

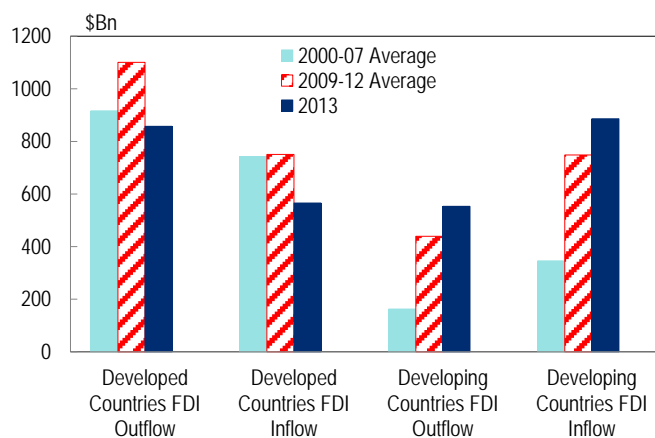
For example, FDI inflows to advanced economies have fallen from an average of 2.4% of GDP per year in 2000-07 to 1.5% of GDP in 2009-13 (and only about 1¼% of GDP in 2012-13). Cross-border banking liabilities of advanced economies have fallen by an average of 4.2% YoY over the six years since Q1-08 (and a drop also of 5.1% YoY in Q1-14) compared to average YoY growth of 12.6% YoY in the 10 years prior to Q1-08). And this decline also has been greatest in Europe, with cross-border liabilities of European countries down by 7.7% YoY in Q1 — whereas cross-border liabilities of advanced economies outside Europe rose 0.6% YoY. Likewise, AE import growth has been persistently weak in recent years, reflecting various factors including lower growth in consumer spending and business investment, plus the shift of IT spending away from imported hardware and towards software (which, even if partly developed overseas, may not show up in trade data)<sup>5</sup>.

Figure 8. Global — YoY Growth of Cross-Border Bank Liabilities, By Region, 2000-14



Sources: BIS and Citi Research

Figure 9. Global — FDI Inflows and Outflows, Annual, \$bn, 2000-13



Sources: United Nations and Citi Research

By contrast, aggregate FDI inflows to developing countries have remained strong, at 3.0% of GDP in 2009-13 (and a similar pace in 2013), close to the 2000-07 average (3.2% of GDP). FDI inflows to developing countries ex China in 2009-13 have been a little above the 2000-07 pace as a share of GDP. In USD terms, FDI inflows to developing and transition economies overtook FDI inflows to advanced economies

<sup>5</sup> See "Why is World Trade Growth So Weak?", *Global Economic Outlook and Strategy*, Willem Buiter et al, 2 December 2013, Citi.

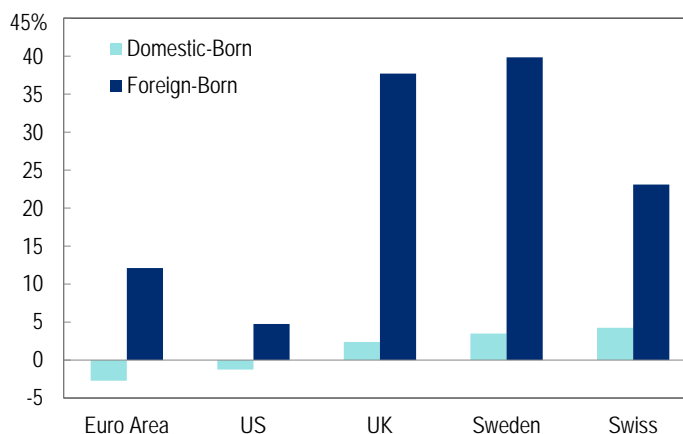


in 2010 (and in 2013 were 57% bigger than FDI inflows to developed countries) — a marked contrast to the pre-crisis norm (in which the majority of FDI inflows went to advanced economies). Moreover, FDI *outflows* from developing and transition economies also have increased markedly, and in 2013 accounted for roughly 40% of global FDI flows, up from only 15% on average in 2000-07<sup>6</sup>. Likewise, the growth of cross-border bank liabilities among developing countries over the last six years (6.3% YoY on average) is close to the pre-crisis average — and indeed their growth rate rose to 10.1% YoY in Q1-14. In turn, this has been reflected in sharp rises in private debt/GDP ratios across a wide range of emerging market countries. The close link between many EM asset markets and changes in US 10-year yields over the last year suggests that at least some financial aspects of globalisation remain intense.

In all, the share of world trade that involves EM countries (as either importer or exporter) has stabilized at 61-62% over the last year, up from about 55% five years ago and 45% 10 years ago. Likewise, EM GDP growth continues to outpace AE GDP growth, and their weight in global GDP continues to rise. The growth of trade and investment flows has slowed, but the mix of these flows has if anything become more, not less, global.

Indeed, in terms of labour markets, globalization has continued to expand, with continued sizeable inflows of foreign workers to advanced economies (and also outflows of domestic workers from AEs). From Q1-07 (ie the pre-crisis level) to Q1 this year, the numbers of foreign-born people in work rose by roughly 5% in the US, 12% in euro area countries (including people from other euro area countries), 23% in Switzerland, 38% in the UK and 40% in Sweden — in each case, rising more rapidly than the numbers of domestic-born people in work. Indeed, since 2007, the numbers of foreign-born workers has grown more rapidly (in percentage terms) than the number of domestic-born workers in almost all EU countries (the exceptions being Estonia, Spain, Hungary and Portugal). In turn, the resultant increase in labour supply quantity and flexibility in many advanced economies has probably capped pay growth and allowed companies to achieve some of the cost savings and profit gains that previously prompted a shift to low-cost emerging markets.

Figure 10. Europe and US — Change in Numbers of People in Work By Place of Birth, 2007-14



Note: data measured in Q1 2007 and Q1 2014. Source: Citi Research

<sup>6</sup> See "Global Investment Trends Monitor", April 2014, UN.



Figure 11. Citi Global Economics Team (For Informational Purposes Only)

	Name	Office Number	Responsibilities
NEW YORK	North America		
	Willem Buiter <sup>3</sup>	+1-212 816-2363	Chief Economist
	William Lee <sup>3</sup>	+1-212 816-2621	Global Economist, North America
	Peter D'Antonio <sup>3</sup>	+1-212 816-9889	U.S. Forecast
	Dana Peterson <sup>3</sup>	+1-212 816-3549	U.S. Forecast and Canada
	Benjamin Mandel <sup>3</sup>	+1-212 816-2735	Global Economics
	Joseph Seydl <sup>3</sup>	+1-212 816-2473	Global Economics
	Malcolm Spittler <sup>3</sup>	+1-212 816-2461	U.S. Forecast
	Emerging Markets		
	Guillermo Mondino <sup>3</sup>	+1-212 816-6499	Head, EM Economics and Strategy Research
LONDON	Jorge Pastrana <sup>2</sup>	+1-212 816-5728	Chile, Caribbean and Central America
	Global		
	Tina Fordham <sup>1</sup>	+44-20 7986-9860	Global Political Analysis
	Western Europe		
	Michael Saunders <sup>1</sup>	+44-20 7986-3299	Head, Western Europe and U.K. Coverage
	Guillaume Mennet <sup>1</sup>	+44-20 7986-1314	Euro Area (France, Belgium, Netherlands), ECB
	Giada Giani <sup>1</sup>	+44-20 7986-3281	Euro Area (Italy, Spain, Greece, Portugal)
	Ebrahim Rahbari <sup>1</sup>	+44-20 7986-6522	Euro Area (Germany) and Global Economics
	Tina Mortensen <sup>1</sup>	+44-20 7986-3284	Nordics
	Ann O'Kelly <sup>1</sup>	+44-20 7986-3297	Europe
	Antonio Montilla <sup>1</sup>	+44-20 7986-3282	Global Economics and Europe
	Emerging Markets		
	David Lubin <sup>1</sup>	+44-20 7986-3302	Head, Emerging Markets and CEEMEA
	David Cowan <sup>1</sup>	+44-20 7986-3285	Africa
	Farouk Soussa <sup>1</sup>	+44-20 7986-4356	Gulf, Middle East, Levant
	Alexander Demyanets <sup>1</sup>	+44-20 7986-4061	Emerging Markets Strategy
	Wilbur Maxino <sup>1</sup>	+44-20 7986-3303	Emerging Markets and CEEMEA
TOKYO	Kiichi Murashima <sup>2</sup>	+813 6270-4980	Head, Japan
	Naoki Iizuka <sup>2</sup>	+813 6270-4997	Japan
SYDNEY	Paul Brennan <sup>15</sup>	+612 8225-4899	Head, Australia, New Zealand
	Josh Williamson <sup>15</sup>	+612 8225-4904	Australia, New Zealand
BOGOTA	Munir Jali <sup>12</sup>	+57 1 639-4195	Colombia, Peru and Venezuela
BUDAPEST	Eszter Gargyan <sup>7</sup>	+36 1 374-5559	Hungary
HONG KONG	Johanna Chua <sup>4</sup>	+852 2501-2357	Head, Emerging Asia, Sri Lanka, Vietnam
	Minggao Shen <sup>4</sup>	+852 2501-2485	China
	Shuang Ding	+852 2501-2769	China
ISTANBUL	Adrienne Lui <sup>4</sup>	+852 2501-2753	Hong Kong, Mongolia, Taiwan
	Ilker Domac <sup>6</sup>	+90 212 319-4623	Turkey, Romania, Balkans
	Gultekin Isiklar <sup>6</sup>	+90 212 319-4915	Turkey, Romania, Balkans
JAKARTA	Helmi Arman <sup>21</sup>	+62-21-5290-8960	Indonesia
JOHANNESBURG	Gina Schoeman <sup>1</sup>	+27 11 944 0813	South Africa
MANILA	Jun Trinidad <sup>17</sup>	+63 2 894-7270	Philippines, Thailand
MEXICO CITY	Sergio Luna Martinez <sup>4</sup>	+52 55 2226-6799	Mexico
MOSCOW	Ivan Tchakarov <sup>18</sup>	+7 495 643 1507	Russia, Kazakhstan, Ukraine
MUMBAI	Rohini Malkani <sup>8</sup>	+91 22-6175-9876	India
	Anurag Jha <sup>8</sup>	+91 22-6175-9877	India
PRAGUE	Jaromir Sindel <sup>13</sup>	+42 02 3306-1485	Czech Republic, Slovakia, Slovenia
SAO PAULO	Marcelo Kfoury <sup>19</sup>	+55 11 4009-3470	Brazil
SEOUL	Jaechul Chang <sup>16</sup>	+82 2 2077-4160	Korea
SINGAPORE	Kit Wei Zheng <sup>20</sup>	+65 6657-5079	ASEAN, Singapore, Malaysia
	Adrian Thomas <sup>20</sup>	+65 6657-1931	Global Emerging Markets, Asia and CEEMEA
WARSAW	Piotr Kalisz <sup>7</sup>	+48 22 692-9633	Head, CEE and Poland
	Cezary Chrapek <sup>7</sup>	+48 22 692-9421	Poland

Source: Citi Research

Figure 12. 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
<b>Global</b>	2.6	2.8	3.4	3.6	3.6	3.4	2.6	2.9	3.0	3.2	3.2	3.3	2.14	2.35	2.38	2.75	3.10	3.45
<i>Based on PPP weights</i>	3.0	3.3	3.9	4.0	4.1	3.9	3.1	3.3	3.4	3.6	3.7	3.7	2.71	2.98	3.09	3.47	3.72	3.98
<b>Industrial Countries</b>	1.3	1.8	2.4	2.5	2.3	2.0	1.3	1.6	1.7	1.5	1.5	1.7	0.46	0.37	0.50	1.05	1.64	2.19
<b>United States</b>	2.2	2.1	3.2	3.2	2.7	2.2	1.2	1.6	1.9	2.2	2.3	2.2	0.25	0.25	0.48	1.46	2.48	3.25
<b>Japan</b>	1.5	1.2	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
<b>Euro Area</b>	-0.4	0.8	1.5	1.9	1.9	1.8	1.4	0.5	0.9	1.2	1.5	1.7	0.50	0.19	0.15	0.16	0.42	0.92
Canada	2.0	2.7	2.7	2.7	2.6	2.4	0.9	2.0	2.0	2.1	2.0	2.0	1.00	1.00	1.19	2.13	2.50	2.75
Australia	2.4	3.2	3.0	3.0	3.3	3.3	2.4	2.6	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	0.2	1.6	2.0	2.3	2.3	2.1	1.5	1.0	1.7	2.1	2.3	2.5						
France	0.4	0.4	0.9	1.7	2.0	1.9	1.0	0.7	1.2	1.4	1.5	1.6						
Italy	-1.8	-0.1	0.8	1.1	0.9	0.7	1.3	0.1	-0.2	0.3	0.9	1.2						
Spain	-1.2	1.4	2.0	2.2	1.9	1.8	1.5	0.0	0.3	0.5	0.6	0.8						
Greece	-3.9	0.1	1.5	1.4	1.5	1.6	-0.9	-1.1	-1.0	-1.0	0.0	1.1						
Ireland	0.2	5.8	3.6	3.8	3.9	4.0	1.0	0.3	1.0	1.1	1.6	1.7						
Portugal	-1.4	1.1	2.1	2.1	2.1	2.2	0.4	-0.3	-0.4	-0.2	0.3	0.8						
Netherlands	-0.7	0.7	1.3	1.6	2.0	2.1	2.6	0.7	1.5	1.5	1.7	1.8						
Belgium	0.2	1.1	1.3	1.8	2.1	2.2	1.2	0.8	1.2	1.8	1.6	1.9						
Denmark	0.4	1.4	1.7	2.0	1.9	2.0	0.8	0.7	1.2	1.6	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	1.50	1.77	2.24	2.85
Sweden	1.6	2.0	2.6	2.7	2.6	2.6	0.0	-0.1	1.1	2.4	2.3	2.2	0.99	0.52	0.25	0.61	1.18	1.80
Switzerland	2.0	2.0	2.6	2.7	2.7	2.7	-0.2	0.1	1.1	1.1	0.9	1.0	0.00	0.00	0.00	0.00	0.38	1.25
United Kingdom	1.7	3.4	3.7	3.1	2.4	2.2	2.6	1.6	1.7	1.9	1.8	2.0	0.50	0.50	1.08	2.46	3.21	3.50
<b>Emerging Markets</b>	4.6	4.4	5.0	5.1	5.4	5.3	4.7	4.9	5.0	4.6	4.8	4.7	4.78	5.30	5.21	5.30	5.24	5.24
<b>China</b>	7.7	7.5	7.1	6.7	7.1	6.8	2.6	2.3	2.6	2.7	3.3	3.3	3.00	3.00	2.84	2.75	3.00	3.25
Taiwan	2.1	3.6	4.0	4.2	4.5	4.5	0.8	1.5	2.0	1.8	1.8	1.8	1.88	1.88	1.97	2.38	2.88	3.38
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	5.1	5.2	5.5	5.5	5.7	6.4	6.5	6.7	6.0	5.3	4.8	4.65	5.81	6.00	6.00	6.00	5.75
Korea	3.0	3.9	4.0	4.2	3.6	3.8	1.3	1.9	2.9	3.1	3.0	2.9	2.56	2.38	2.44	3.25	3.88	4.00
Czech	-0.9	2.4	2.5	3.2	3.1	3.2	1.4	0.4	1.4	1.9	2.0	2.0	0.05	0.05	0.05	0.37	1.40	2.15
Hungary	1.1	2.9	1.9	1.6	1.7	2.0	1.7	0.2	2.1	2.9	2.2	1.7	4.38	2.33	2.31	3.49	3.71	4.50
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	3.96	3.29
Romania	3.5	3.0	3.4	3.7	3.7	3.7	4.0	1.5	3.2	2.6	2.5	2.5	4.69	3.50	4.50	5.00	5.00	5.00
Russia	1.3	0.7	2.3	2.6	2.6	2.6	6.8	7.0	5.6	5.1	4.7	4.5	5.50	7.38	6.67	5.56	4.83	4.56
Turkey	4.0	3.5	3.5	3.8	4.0	4.0	7.5	8.8	7.4	7.0	6.8	6.5	6.16	9.34	10.75	9.88	9.50	9.00
Nigeria	5.5	6.0	6.4	7.0	6.2	6.8	8.5	8.7	10.7	9.2	9.9	9.2	12.00	12.00	11.75	11.00	9.00	9.00
South Africa	1.9	1.7	2.8	3.7	3.6	4.1	5.8	6.3	5.7	5.4	5.8	5.8	5.00	5.63	6.17	7.67	8.00	8.00
Argentina	2.9	0.0	1.0	-2.0	3.5	3.0	10.6	NA	29.8	35.0	32.5	25.0	17.16	25.86	34.16	46.13	38.00	30.00
Brazil	2.5	0.5	1.0	2.5	3.0	3.0	6.2	6.3	6.4	6.0	5.5	5.5	8.44	10.92	11.00	10.50	10.00	10.00
Mexico	1.1	2.6	3.9	4.4	4.5	4.6	3.8	3.9	3.4	3.6	3.6	3.6	3.94	3.21	3.25	4.19	4.67	5.71
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 13. 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	0.7	0.9	0.6	0.4	0.1	0.1	-4.1	-3.7	-3.3	-3.0	-2.8	-2.3	88	86	86	86	85	84
Based on PPP weights	0.4	0.6	0.4	0.2	-0.1	-0.1	-4.0	-3.8	-3.4	-3.1	-2.9	-2.5	80	80	80	79	78	77
Industrial Countries	-0.2	0.2	-0.1	0.1	0.0	0.1	-5.5	-4.7	-3.8	-3.4	-3.1	-2.9	115	113	113	113	111	111
United States	-2.4	-1.9	-2.3	-1.8	-1.7	-1.4	-7.4	-6.4	-5.6	-5.6	-5.4	-5.4	105	107	107	107	106	106
Japan	0.7	0.4	0.7	0.8	0.7	0.7	-9.8	-8.0	-6.2	-5.8	-5.4	-5.0	241	243	247	248	251	254
Euro Area	2.4	2.9	2.8	2.8	2.6	2.5	-3.0	-2.8	-2.4	-1.9	-1.5	-1.1	95	97	97	97	95	94
Canada	-3.2	-2.4	-2.2	-1.9	-1.6	-1.5	-0.9	-0.1	0.3	0.4	0.4	0.4	94	92	90	89	87	84
Australia	-3.2	-2.5	-2.8	-3.0	-3.4	-3.5	-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	7.1	7.0	6.3	5.8	5.6	5.3	0.0	0.1	0.2	0.0	0.0	-0.1	78	77	73	70	68	66
France	-1.4	-0.7	-0.1	0.4	0.1	-0.1	-4.3	-4.5	-4.3	-3.5	-2.6	-1.8	93	97	100	100	100	98
Italy	1.0	1.6	1.7	1.8	1.8	1.8	-2.8	-2.9	-2.8	-2.1	-1.6	-1.2	133	138	139	139	139	138
Spain	0.8	0.6	0.5	0.7	0.7	0.9	-7.1	-5.6	-4.6	-3.6	-2.9	-2.3	94	99	101	101	101	101
Greece	0.8	1.2	1.1	1.1	1.1	1.1	-12.7	-2.2	-2.2	-1.5	-1.0	-0.5	175	180	180	180	177	173
Ireland	4.4	4.1	4.7	4.6	4.7	4.7	-6.7	-1.9	0.6	1.7	2.7	3.8	123	115	109	103	95	86
Portugal	0.5	0.5	0.7	0.9	1.3	1.5	-5.0	-4.2	-3.1	-2.4	-1.9	-1.3	129	136	134	131	129	126
Netherlands	10.9	11.4	9.8	9.3	8.8	8.2	-2.4	-2.7	-2.2	-1.7	-1.3	-1.0	74	75	74	74	73	71
Belgium	-1.9	0.1	0.7	0.9	0.8	0.5	-2.7	-2.7	-2.5	-1.7	-0.8	0.1	101	102	102	100	98	94
Denmark	7.1	6.6	5.6	5.3	5.4	5.4	-0.9	-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	-1.2	-1.9	-0.9	-0.3	0.5	1.2	39	40	39	38	35	33
Switzerland	16.0	13.5	12.8	12.3	10.5	10.5	0.0	-0.2	0.5	1.1	1.5	1.9	49	48	47	45	43	40
United Kingdom	-4.5	-4.1	-4.5	-4.9	-4.8	-4.5	-7.1	-5.6	-3.6	-1.3	-0.5	0.4	94	96	95	92	90	87
Emerging Markets	1.8	1.9	1.5	0.8	0.3	0.1	-2.1	-2.4	-2.5	-2.3	-2.3	-1.5	45	45	45	45	45	45
China	2.0	2.0	2.0	1.5	1.0	1.0	-1.9	-2.1	-2.0	-2.0	-2.0	-2.0	54	54	54	54	53	53
Taiwan	11.8	11.0	10.2	8.0	8.0	8.0	-1.3	-1.4	-0.8	-0.6	-0.6	-0.6	40	39	39	39	38	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	-3.0	-2.6	-2.7	-2.4	-2.0	-2.2	-2.4	-2.2	-1.9	-2.0	-1.5	24	26	25	25	25	25
Korea	6.1	4.9	3.1	2.3	1.6	0.8	1.0	0.9	1.5	1.7	1.9	1.7	32	31	29	27	26	25
Czech	-1.4	1.3	1.5	3.1	3.7	1.5	-1.5	-2.0	-2.4	-2.3	-2.2	-2.0	46	45	45	45	44	44
Hungary	3.0	3.6	3.1	2.9	2.7	2.5	-2.2	-2.9	-2.9	-2.9	-3.0	-3.0	79	80	79	79	78	77
Poland	-1.3	-1.7	-2.8	-3.5	-3.6	-3.3	-4.3	5.2	-2.7	-2.6	-2.6	-2.6	54	48	47	46	45	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	-1.1	-1.1	-1.1	7	10	13	13	12	12
Turkey	-7.9	-5.4	-5.8	-5.5	-5.3	-5.2	-1.2	-2.8	-3.2	-3.3	-3.3	-3.3	39	38	37	36	35	33
Nigeria	3.9	1.0	1.3	0.7	0.6	0.1	-1.6	-2.0	-1.8	-1.8	-1.6	-1.5	NA	NA	NA	NA	NA	NA
South Africa	-5.8	-5.3	-5.0	-4.1	-3.2	-2.7	-4.1	-4.1	-4.1	-3.5	-2.8	-1.8	46	48	49	48	50	50
Argentina	-0.7	-1.0	-1.1	2.5	1.0	1.0	-1.9	-2.4	-2.6	0.0	-0.5	-1.0	31	37	43	52	51	50
Brazil	-3.7	-3.7	-3.8	-3.9	-3.9	-3.9	-3.3	-4.4	-3.5	-3.5	-3.4	-3.4	57	57	58	58	58	58
Mexico	-2.0	-1.7	-1.7	-2.0	-2.4	-2.6	-2.3	-3.5	-3.0	-2.2	-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 14. 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
<b>Global</b>		-0.1	-0.1					0.2	0.1			
<i>Based on PPP weights</i>							-0.1	0.1	0.1		-0.1	
<b>Industrial Countries</b>		-0.1	-0.1					0.3			-0.1	
United States						0.1		0.6				
Japan		-0.2						0.5	0.7			
Euro Area		-0.3	-0.2						-0.2		-0.1	
Canada		0.4			0.1	0.1		0.3	0.3			
Australia		-0.3						-0.7	-0.8			
New Zealand												
Germany	-0.3	-0.4	-0.4		-0.2	-0.3	-0.5		-0.6		-0.1	
France		-0.3	-0.4								-0.3	-0.7
Italy		-0.2	-0.3		-0.1			-0.1	-0.1		0.1	0.1
Spain		0.1	0.1			0.1					0.1	0.3
Greece		-0.2	0.2		0.4	0.5		-0.9	-1.3		-0.2	
Ireland		-0.3	-0.3					-0.2	-0.5		-0.1	-0.2
Portugal			0.1			0.2						0.1
Netherlands		0.1	-0.1		0.3	0.3	0.1	0.8	-0.3		0.1	0.1
Belgium		-0.2	-0.2		0.1	0.1		0.4	0.3		-0.2	-0.5
Denmark							-0.1	-0.1		0.1		
Norway												
Sweden		-0.2	-0.2							0.1	-0.3	-0.1
Switzerland		-0.1			0.1	0.2	4.0	2.4	2.6	-0.2	-0.9	-0.6
United Kingdom	-0.1				-0.1	-0.3		-0.3	-0.4		-0.3	-0.2
<b>Emerging Markets</b>		-0.1					-0.1		0.1			
<b>China</b>												
Taiwan		0.4	0.3				0.1			0.1		
India												
Indonesia									-0.1			
Korea												
Czech			-0.2		-0.1	-0.4		-0.1				0.1
Hungary					-0.1	-0.2						
Poland												
Romania					-0.2	-0.2						
Russia												
Turkey									0.3			
Nigeria												
South Africa		-0.3			-0.2	-0.1		-0.4	-0.8		-0.1	-0.1
Argentina									0.1			-0.2
Brazil	0.2	-0.4	-0.2		-0.1				0.1		-0.5	-0.1
Mexico		-0.1										
Venezuela												

Note: For Ireland we use the GDP deflator rather than the CPI. Source: Citi Research

Figure 15. Selected Countries — Economic Forecast Overview (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
<b>Industrial Countries</b>																		
United States	2.35	2.65	3.11	3.25	3.35	3.45	NA	NA	NA	NA	NA	NA	1.33	1.36	1.34	1.39	1.41	1.42
Japan	0.71	0.57	0.78	1.25	1.50	1.50	98	103	108	109	107	103	130	140	145	152	151	147
Euro Area	1.60	1.28	1.31	1.56	1.81	2.06	1.33	1.36	1.34	1.39	1.41	1.42	NA	NA	NA	NA	NA	NA
Canada	2.26	2.34	2.93	3.10	3.15	3.10	1.03	1.09	1.11	1.10	1.10	1.10	1.37	1.48	1.48	1.53	1.55	1.56
Australia	3.65	3.93	4.33	5.03	5.50	5.75	0.97	0.94	0.94	0.93	0.93	0.92	1.37	1.45	1.43	1.50	1.52	1.54
New Zealand	3.98	4.51	4.83	5.58	5.80	6.00	0.82	0.86	0.83	0.81	0.77	0.74	1.62	1.57	1.61	1.72	1.82	1.93
Germany	1.60	1.28	1.31	1.56	1.81	2.06												
France	2.12	1.71	1.56	1.81	2.06	2.31												
Italy	4.23	2.81	2.31	2.61	2.71	2.86												
Spain	4.48	2.65	1.96	2.41	2.51	2.66												
Greece	10.36	6.14	4.69	4.69	4.31	4.06												
Ireland	4.00	2.37	1.86	2.26	2.36	2.61												
Portugal	5.15	3.67	2.81	2.81	2.91	3.06												
Netherlands	1.89	1.50	1.36	1.61	1.86	2.11												
Belgium	2.33	1.77	1.56	1.81	2.06	2.31												
Denmark	1.73	1.34	1.44	1.71	2.06	2.31	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
Norway	2.57	2.48	2.29	2.51	2.66	2.91	5.88	6.05	5.94	5.56	5.32	5.10	7.81	8.22	7.95	7.75	7.50	7.25
Sweden	2.10	1.83	1.89	2.16	2.31	2.56	6.51	6.69	6.78	6.46	6.27	6.10	8.65	9.09	9.08	8.99	8.84	8.68
Switzerland	0.82	0.68	0.70	0.72	0.91	1.10	0.93	0.90	0.92	0.90	0.90	0.90	1.23	1.22	1.23	1.25	1.27	1.28
United Kingdom	2.34	2.64	3.06	3.15	3.25	3.50	1.56	1.68	1.69	1.76	1.78	1.80	0.85	0.81	0.79	0.79	0.79	0.79
<b>Emerging Markets</b>																		
China	3.68	4.11	3.97	4.26	4.57	4.82	6.15	6.16	6.04	6.01	6.02	6.04	8.17	8.36	8.08	8.37	8.49	8.58
Taiwan	1.46	1.60	1.89	2.19	2.49	2.79	29.68	30.07	29.77	29.56	29.14	28.67	39.43	40.83	39.86	41.18	41.10	40.75
India	8.25	8.50	8.50	8.00	7.50	7.50	58.57	60.64	62.17	62.52	59.96	56.89	77.80	82.34	83.26	87.10	84.58	80.86
Indonesia	6.97	8.14	8.75	8.75	8.60	8.25	10449	11707	12014	11737	11039	10272	13881	15897	16089	16351	15572	14601
Korea	3.00	2.86	3.11	3.68	4.30	4.63	1095	1034	1017	977	975	980	1454	1404	1362	1361	1375	1393
Czech	2.09	1.74	1.91	2.25	2.41	2.66	19.6	20.3	20.5	19.1	18.3	17.6	26.0	27.6	27.5	26.5	25.8	25.0
Hungary	5.92	4.92	4.80	5.14	5.22	5.50	223	229	240	233	232	231	297	312	321	325	327	328
Poland	4.05	3.78	4.26	4.73	4.70	4.12	3.16	3.08	3.16	2.89	2.81	2.77	4.20	4.19	4.23	4.03	3.97	3.93
Romania	NA	NA	NA	NA	NA	NA	3.33	3.31	3.29	3.12	3.02	2.95	4.42	4.49	4.40	4.35	4.27	4.19
Russia	NA	NA	NA	NA	NA	NA	31.9	35.5	38.1	37.4	37.1	37.0	42.3	48.2	51.0	52.1	52.4	52.6
Turkey	NA	NA	NA	NA	NA	NA	1.91	2.16	2.32	2.39	2.38	2.37	2.53	2.94	3.10	3.33	3.36	3.36
Nigeria	NA	NA	NA	NA	NA	NA	159	163	167	171	175	180	212	222	224	238	247	256
South Africa	7.20	8.08	8.04	8.14	8.38	8.77	9.65	10.68	11.01	10.82	10.70	10.60	12.82	14.51	14.75	15.07	15.09	15.07
Argentina	NA	NA	NA	NA	NA	NA	5.45	8.38	11.15	19.49	24.86	29.84	7.24	11.38	14.93	27.15	35.07	42.41
Brazil	9.98	11.75	11.75	12.25	11.62	10.75	2.16	2.29	2.52	2.65	2.77	2.88	2.87	3.11	3.38	3.69	3.90	4.10
Mexico	5.67	6.08	6.73	7.28	7.65	7.65	12.8	13.0	13.0	12.7	12.6	12.4	17.0	17.7	17.4	17.7	17.7	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	12.43	26.52	43.58	69.73	111.01

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

Figure 16. Short Rates (End of Period), as of 20 August 2014 (Percent)

	Current	4Q 14	1Q 15	2Q 15	3Q 15	4Q 15	1Q 16
United States	0.25	0.25	0.25	0.25	0.75	1.00	1.25
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	1.25	1.50	1.75
Australia	2.50	2.50	2.50	2.75	3.00	3.25	3.25
New Zealand	3.50	3.75	3.75	4.00	4.25	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	0.25	0.25	0.25	0.25	0.25	0.25	0.50
Switzerland	0.00	0.00	0.00	0.00	0.00	0.00	0.00
United Kingdom	0.50	0.50	0.75	1.00	1.25	1.75	2.00
China	3.00	3.00	3.00	2.75	2.75	2.75	2.75

Source: Citi Research

Figure 17. 10-Year Yield Forecasts (Period Average), as of 20 August 2014 (Percent)

	Current	4Q 14	1Q 15	2Q 15	3Q 15	4Q 15	1Q 16
United States	2.40	2.70	2.90	3.05	3.15	3.20	3.25
Japan	0.51	0.50	0.70	0.80	0.85	0.75	0.85
Euro Area (Germany)	1.00	0.75	1.00	1.25	1.50	1.50	1.75
Canada	2.07	2.40	2.70	2.90	3.00	3.10	3.10
Australia	3.43	3.80	4.00	4.25	4.40	4.55	4.65
New Zealand	4.20	4.50	4.60	4.70	4.90	5.10	5.30
Denmark	1.37	0.85	1.10	1.35	1.65	1.65	1.90
Norway	2.33	1.85	2.00	2.25	2.45	2.45	2.75
Sweden	1.57	1.35	1.60	1.80	2.05	2.10	2.35
Switzerland	0.47	0.31	0.49	0.66	0.83	0.83	1.01
United Kingdom	2.40	2.50	2.80	3.00	3.20	3.25	3.30

Source: Citi Research

Figure 18. 10-Year Yield Spreads (Period Average), as of 20 August 2014

	Spread vs. US\$						Spread vs. Germany					
	Current	4Q 14	1Q 15	2Q 15	3Q 15	4Q 15	Current	4Q 14	1Q 15	2Q 15	3Q 15	4Q 15
United States	NA	NA	NA	NA	NA	NA	140	197	192	182	167	173
Japan	-189	-222	-222	-227	-232	-248	-49	-25	-30	-45	-65	-75
Euro Area	-140	-197	-192	-182	-167	-173	NA	NA	NA	NA	NA	NA
Canada	-33	-30	-20	-15	-15	-10	107	166	172	167	152	162
Australia	102	112	112	122	127	138	243	309	304	305	295	310
New Zealand	180	183	173	168	179	194	320	380	365	351	346	367
France	-101	-167	-167	-157	-142	-148	39	30	25	25	25	25
Italy	18	-87	-92	-82	-67	-73	159	110	100	100	100	100
Spain	1	-122	-127	-117	-102	-108	141	75	65	65	65	65
Netherlands	-122	-187	-187	-177	-162	-168	19	10	5	5	5	5
Belgium	-103	-167	-167	-157	-142	-148	38	30	25	25	25	25
Austria	-114	-182	-182	-172	-157	-163	26	15	10	10	10	10
Finland	-122	-177	-177	-167	-152	-158	18	20	15	15	15	15
Ireland	-48	-137	-137	-127	-112	-118	93	60	55	55	55	55
Portugal	99	-22	-42	-32	-17	-23	239	175	150	150	150	150
Greece	340	203	183	168	158	127	480	400	375	350	325	300
Denmark	-103	-187	-182	-172	-152	-158	37	10	10	10	15	15
Norway	-7	-87	-92	-82	-72	-78	133	110	100	100	95	95
Sweden	-83	-137	-132	-127	-112	-113	57	60	60	55	55	60
Switzerland	-193	-241	-243	-241	-234	-240	-53	-44	-51	-59	-67	-67
United Kingdom	0	-20	-10	-5	5	5	140	177	182	177	173	178

Source: Citi Research

Figure 19. Emerging Market Countries — Short Rates Actual and Forecast of Additional Rate Moves (End of Period), as 20 August 2014

	Current Rate	Sep 14	Dec 14	Mar 15	Jun 15	Sep 15	Total Cumulative Rate Moves Expected
Turkey	8.29	-54	275	0	0	50	271
Romania	3.25	25	0	75	25	25	150
South Africa	5.75	0	0	0	25	50	75
Mexico	3.00	0	0	0	25	25	50
Thailand	2.00	0	0	0	0	50	50
Malaysia	3.25	25	0	0	0	0	25
Philippines	3.75	25	0	0	0	0	25
Indonesia	5.75	0	25	0	0	0	25
Israel	0.50	0	75	-75	25	0	25
Hungary	2.10	0	0	0	0	25	25
Brazil	11.00	0	0	0	0	0	0
India	8.00	0	0	0	0	0	0
Poland	2.50	0	0	0	0	0	0
China	3.00	0	0	0	-25	0	-25
Russia	8.00	0	0	-50	-100	-50	-200
Ukraine	12.50	200	0	-250	0	-200	-250

Source: Citi Research

Figure 20. Foreign Exchange Forecasts (End of Period), as of 20 August 2014

	vs. USD							vs. EUR						
	Current	Dec 14	Mar 15	Jun 15	Sep 15	Dec 15	Mar 16	Current	Dec 14	Mar 15	Jun 15	Sep 15	Dec 15	Mar 16
United States	NA	NA	NA	NA	NA	NA	NA	1.34	1.34	1.33	1.33	1.34	1.36	1.38
Japan	102	105	107	108	109	109	109	137	140	142	144	146	148	150
Euro Area	1.34	1.34	1.33	1.33	1.34	1.36	1.38	NA	NA	NA	NA	NA	NA	NA
Canada	1.09	1.10	1.11	1.11	1.11	1.11	1.10	1.46	1.47	1.47	1.47	1.49	1.50	1.52
Australia	0.93	0.94	0.94	0.94	0.94	0.94	0.93	1.44	1.42	1.41	1.41	1.43	1.45	1.47
New Zealand	0.85	0.85	0.84	0.84	0.83	0.83	0.82	1.58	1.57	1.57	1.59	1.62	1.65	1.68
Norway	6.14	6.05	6.06	6.01	5.90	5.79	5.69	8.23	8.09	8.03	7.98	7.93	7.88	7.83
Sweden	6.85	6.83	6.87	6.85	6.75	6.66	6.57	9.17	9.13	9.11	9.09	9.07	9.05	9.03
Switzerland	0.90	0.91	0.92	0.93	0.92	0.91	0.90	1.21	1.22	1.23	1.23	1.24	1.24	1.24
United Kingdom	1.67	1.67	1.67	1.68	1.70	1.72	1.74	0.80	0.80	0.79	0.79	0.79	0.79	0.79
China	6.14	6.09	6.06	6.04	6.03	6.02	6.01	8.2	8.1	8.0	8.0	8.1	8.2	8.3
India	60.8	61.4	61.8	62.1	62.3	62.5	62.7	81.4	82.1	81.9	82.4	83.7	85.0	86.2
Korea	1018	1030	1030	1024	1012	1000	988	1363	1377	1366	1360	1360	1360	1360
Poland	3.13	3.16	3.23	3.22	3.13	3.05	2.97	4.19	4.23	4.28	4.27	4.21	4.15	4.09
Russia	36.0	36.9	37.9	38.4	38.1	37.9	37.6	48.2	49.3	50.3	50.9	51.2	51.5	51.8
South Africa	10.59	10.87	11.02	11.07	11.01	10.95	10.89	14.18	14.54	14.61	14.70	14.79	14.89	14.98
Turkey	2.17	2.23	2.27	2.31	2.33	2.35	2.37	2.90	2.98	3.02	3.07	3.13	3.19	3.26
Brazil	2.26	2.37	2.46	2.51	2.54	2.57	2.60	3.03	3.18	3.26	3.34	3.42	3.50	3.58
Mexico	13.1	13.0	13.1	13.1	13.0	12.9	12.8	17.5	17.4	17.3	17.3	17.4	17.5	17.6

Source: Citi Research

Figure 21. Foreign Exchange Forecasts (End of Period), as of 20 August 2014

	Vs. JPY						
	Current	Dec 14	Mar 15	Jun 15	Sep 15	Dec 15	Mar 16
United States	102	105	107	108	109	109	109
Japan	NA	NA	NA	NA	NA	NA	NA
Euro Area	137	140	142	144	146	148	150
Canada	94	95	97	98	98	99	99
Australia	95	98	100	102	102	102	102
New Zealand	86.9	89.0	90.1	90.6	90.3	89.9	89.6
Norway	16.7	17.3	17.6	18.0	18.4	18.8	19.2
Sweden	15.0	15.3	15.5	15.8	16.1	16.4	16.7
Switzerland	113	115	115	117	118	119	121
United Kingdom	171	174	178	182	185	188	190
China	17	17	18	18	18	18	18
India	1.69	1.70	1.73	1.74	1.74	1.74	1.74
Korea	9.94	9.85	9.64	9.47	9.32	9.18	9.04
Poland	32.7	33.0	33.1	33.6	34.6	35.7	36.8
Russia	2.8	2.8	2.8	2.8	2.8	2.9	2.9
South Africa	9.7	9.6	9.7	9.8	9.9	10.0	10.0
Turkey	47.2	47.0	47.0	46.8	46.6	46.4	46.2
Brazil	45.3	44.0	43.5	43.0	42.7	42.3	42.0
Mexico	7.8	8.0	8.2	8.3	8.4	8.4	8.5

Source: Citi Research



## Country Commentary

### United States

[Peter D'Antonio](#)

The economy bounced back forcefully in Q2, reversing much of the disappointing weather-related decline in Q1. Improving consumer fundamentals, especially healthy employment and income growth, are pointing to solid growth of 3 percent or better in the next few quarters. The bounce-back in growth, especially in private domestic demand, will probably drive the unemployment rate below 6 percent later this year. The Fed continues to maintain an accommodative stance along with its tapering its use of quantitative easing. The Fed has been cutting asset purchases by \$10 billion per meeting and should complete the program by October. Fed Chair Yellen has indicated a desire to allow the trajectory of the recovery and economic developments to guide policy. Moreover, she has made it clear that monetary policy should be focused on the real economy — the dual mandate. Macroprudential policies that make financial institutions and infrastructure more resilient will be the primary means for addressing financial stability concerns. We expect more information about how the Fed will revise its principles for exiting zero policy rates later this fall. Wage inflation has been extremely mild during this expansion, and although there are signs that wage growth may pick up late this year or next, 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 labor cost increases since then. At this point, wage cost increase will likely be absorbed by the elevated margins. However, we cannot rule out that continued rising profit shares, amid disappointing productivity growth, could translate into higher price markups.

Figure 22. United States — Economic Forecasts, 2013-2016F

		2013	2014F	2015F	2014			2015				2016
					2QF	3QF	4QF	1QF	2QF	3QF	4QF	1QF
GDP	SAAR				4.0	3.2	3.2	3.2	3.0	2.9	3.3	3.0
	YoY	2.2	2.1	3.2	2.4	2.1	2.0	3.4	3.2	3.1	3.1	3.1
Domestic Demand	SAAR				2.8	3.2	3.2	3.2	3.2	3.1	3.3	3.1
	YoY	1.9	2.2	3.2	2.1	2.3	2.5	3.1	3.2	3.2	3.2	3.2
Consumption	SAAR				2.5	2.7	2.9	3.1	3.1	2.9	3.1	2.9
	YoY	2.4	2.3	2.9	2.3	2.5	2.3	2.8	2.9	3.0	3.0	3.0
Business Investment	SAAR				5.5	6.7	6.6	6.8	6.8	6.6	7.3	7.1
	YoY	3.0	5.4	6.7	5.7	6.0	5.1	6.4	6.7	6.7	6.9	6.9
Housing Investment	SAAR				7.5	7.3	9.0	7.5	6.9	8.1	8.8	8.2
	YoY	11.9	2.2	7.8	0.9	0.0	4.5	7.8	7.7	7.9	7.8	8.0
Government	SAAR				1.6	0.1	-0.4	0.3	0.3	0.3	0.2	0.3
	YoY	-2.0	-0.6	0.2	-0.7	-0.7	0.1	0.4	0.1	0.1	0.3	0.3
Exports	SAAR				9.5	3.8	3.7	6.1	6.0	6.0	5.8	5.0
	YoY	3.0	2.8	5.5	3.5	3.2	1.7	5.7	4.9	5.5	6.0	5.7
Imports	SAAR				11.7	2.0	2.1	3.6	5.0	5.2	5.0	4.8
	YoY	1.1	3.9	4.1	3.9	4.2	4.4	4.8	3.1	3.9	4.7	5.0
PCE Deflator	YoY	1.2	1.6	1.9	1.6	1.7	1.9	2.0	1.9	1.8	1.8	1.9
Core PCE Deflator	YoY	1.3	1.5	1.9	1.5	1.6	1.7	1.9	1.9	1.8	1.8	1.9
Unemployment Rate	%	7.4	6.2	5.7	6.2	6.1	5.9	5.9	5.7	5.6	5.5	5.4
Federal Gov't Balance (Fiscal Year)	\$Bn	-680	-475	-450								
	% of GDP	-4.1	-2.8	-2.5								
General Gov't Balance (Cal Year)	% of GDP	-7.4	-6.4	-5.6								
Federal Debt	% of GDP	72	74	74								
General Gov't Debt	% of GDP	105	107	107								
Current Account	US\$b	-400	-333	-426	0	-441	-446	-438	-434	-421	-410	-410
	% of GDP	-2.4	-1.9	-2.3	0.0	-2.5	-2.5	-2.4	-2.4	-2.3	-2.2	-2.2
S&P 500 Profits (US\$ Per Share)	YoY	6.4	7.1	7.2	6.9	7.3	8.7	6.6	6.9	6.6	8.6	NA

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. 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](#)

[Naoki Iizuka](#)

Real GDP in Q2 fell by 6.8% QoQ annualized after a 6.1% gain in Q1. Most notably, consumer spending plunged 5.0% QoQ (non-annualized) after a 2.0% gain. The plunge in spending away from durable goods (which are most vulnerable to payback to frontloaded demand before the tax hike) suggests that the large drop in real incomes hit spending. While we expect a rebound in real GDP in Q3, the Q2 weakness will likely have a second-round effect by way of a likely slowdown in profits and income generation in quarters to come. The BoJ's view on the economy has turned somewhat more nuanced. Policymakers revised down assessment regarding exports in their latest policy statement and also tweaked the section regarding consumer spending in the Monthly Report. Moreover, there were a number of times at the latest press briefing when Governor Kuroda did not answer questions directly or struggled to answer in a succinct manner. This suggests to us that gaps may be appearing in the BoJ's bullish scenario.

The dominant view in recent months in the markets has been that the BoJ is unlikely to take a further easing action. Given the developments above, however, the probability of additional easing appears to have increased somewhat. We are sticking to our view that the BoJ will act in late October when it updates its semi-annual outlook report. The Abe Administration will officially decide on whether or not to implement the next consumption tax hike slated in October 2015 after having scrutinized the Q3 GDP report (due on November 17). Based on our expectations of 4.2% growth annualized in the quarter, PM Abe is likely to go ahead with the tax hike. In that case, the negative impact on households' real income will probably be meaningful again, leading to a continued bumpy ride in consumer spending. Moreover, political discussions regarding stimulus measures to offset the negative impact from the tax hike are also likely to emerge this autumn and winter.

Figure 23. Japan — Economic Forecasts, 2013-2016F

					2014			2015				2016
		2013	2014F	2015F	2QF	3QF	4QF	1QF	2QF	3QF	4QF	1QF
Real GDP	YoY	1.5	1.2	0.9	0.0	0.7	1.1	-0.1	1.8	1.9	0.1	0.9
	SAAR				-6.8	4.2	1.2	1.4	0.5	4.5	-5.7	4.7
Domestic Demand	YoY	1.8	0.9	0.4	0.1	0.1	-0.2	-1.6	1.5	2.0	-0.3	0.3
	SAAR				-10.8	2.9	1.1	1.1	0.9	4.9	-7.7	3.7
Private Consumption	YoY	2.0	-0.6	0.1	-2.6	-1.6	-1.6	-3.2	2.2	2.5	-1.0	-0.1
	SAAR				-18.7	4.8	1.3	1.5	1.2	6.1	-11.9	5.3
Business Investment	YoY	-1.4	8.6	4.1	7.1	7.8	8.0	1.2	5.4	5.3	4.4	4.7
	SAAR				-9.7	5.3	6.3	3.8	6.2	4.7	3.0	4.7
Housing Investment	YoY	8.8	-3.6	-3.8	-1.9	-11.0	-12.1	-12.5	-1.1	3.0	-3.3	-5.6
Public Investment	YoY	11.5	3.8	-8.7	5.3	4.0	-5.0	-6.5	-9.5	-10.5	-8.4	-8.0
Exports	YoY	1.5	8.0	4.4	5.6	8.0	9.2	4.2	5.0	4.5	4.0	4.0
	SAAR				-1.8	6.4	5.7	6.6	1.3	4.4	3.7	6.6
Imports	YoY	3.3	6.3	1.7	6.0	3.7	1.3	-3.5	3.3	5.5	1.8	0.7
	SAAR				-20.5	-1.9	5.6	5.4	4.2	6.9	-8.4	0.7
CPI	YoY	0.4	2.8	1.7	3.6	3.2	2.8	2.9	0.9	0.9	2.3	2.1
Core CPI	YoY	0.4	2.7	1.7	3.3	3.2	3.0	3.0	0.9	0.9	2.3	2.1
Nominal GDP	YoY	0.9	2.4	1.6	-0.1	0.7	0.5	0.3	0.4	0.7	-0.4	1.1
Current Account	¥ tn	3.3	1.9	3.4	4.3	4.5	4.1	3.7	3.1	2.2	4.5	5.6
	% of GDP	0.7	0.4	0.7	0.9	0.9	0.8	0.7	0.6	0.4	0.9	1.1
Unemployment Rate	%	4.0	3.6	3.4	3.6	3.6	3.5	3.4	3.4	3.3	3.3	3.3
Industrial Production	YoY	-0.6	2.6	1.1	2.7	0.4	-0.5	-2.7	1.9	4.3	1.0	1.3
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](#)

[Giada Giani](#)

[Ebrahim Rahbari](#)

We are cutting our GDP forecasts for 2014 and 2015 by 0.3pp and 0.2pp to 0.8% and 1.5%, respectively. This marks the largest cut in our numbers since Jan-2012 and the third downward adjustment in four months, despite the [better-than-expected performance in the euro area periphery excluding Italy](#). This change reflects the disappointing Q2 GDP data, risks that sentiment surveys will weaken further in coming weeks ([Is the Euro Area Recovery at Risk of Faltering?](#)) and rising geopolitical risks (including [developments in Russia](#)).

At the same time, inflation continues to slow, hitting 0.4% YY in July from 0.5% YY in June, suggesting that the Q3 average will again undershoot the ECB's baseline that we estimate to be around 0.65% YY. Our forecasts envisage that the flash HICP August reading could fall to a new cycle low of 0.3% YY, with a risk of a 0.2% YY print if oil prices continue to weaken. Note that last week the Q3-14 Survey of Professional Forecasters (SPF) revealed a further downward drift in the 2014-15 average inflation forecasts to 0.7% and 1.2%, but also had shown that the cumulative proportion of respondents expecting inflation to be between 0.0% and 1.4% in 2019 (34.1%) exceeds those expecting inflation between 1.5% and 1.9% (32.7%) for the fourth successive survey. These findings suggest a widespread sense that risks of a persistent inflation undershoot now are greater than at any time in the survey's 15-year history. We continue to believe that the Governing Council remains in wait-and-see mode nearer term and that no action will be forthcoming in September, except perhaps on ABS purchases. Generally, the hurdle for additional policy action remains elevated in the short-term following the June announcements (lower key rates and TLTROs). However, we maintain our baseline that the risks of a prolonged period of very low inflation and the vulnerability of the recovery will prompt the Governing Council to launch a large scale asset purchase programme in late 2014 or early 2015, despite the reservations of some Council members.

Figure 24. Euro Area — Economic Forecasts, 2013-2016F

					2014			2015				2016
		2013	2014F	2015F	2QF	3QF	4QF	1QF	2QF	3QF	4QF	1QF
Real GDP	YoY	-0.4	0.8	1.5	0.7	0.9	0.9	1.1	1.5	1.6	1.8	1.9
	SAAR				0.2	1.3	1.2	1.7	1.7	1.9	1.9	2.2
Final Domestic Demand	YoY	-0.8	0.8	1.4	0.7	0.7	0.9	1.0	1.4	1.6	1.7	1.7
Private Consumption	YoY	-0.6	0.8	1.5	0.7	0.8	1.1	1.3	1.4	1.5	1.6	1.7
Government Consumption	YoY	0.2	0.6	0.6	0.6	0.4	0.7	0.2	0.5	0.7	1.1	0.9
Fixed Investment	YoY	-2.8	1.0	2.2	1.0	0.8	0.5	1.1	2.3	2.6	2.7	2.8
Business Equipment	YoY	-1.8	2.0	2.3	2.0	1.9	0.9	0.5	2.2	3.0	3.5	3.6
Construction	YoY	-3.8	0.9	2.3	0.8	0.5	1.0	1.2	2.4	2.6	2.8	2.8
Stocks (Contrib. to Y/Y GDP Growth)		0.0	0.0	0.0	0.1	-0.1	0.1	-0.1	0.0	0.0	0.0	0.1
Exports	YoY	1.5	3.1	3.4	2.7	3.2	2.6	3.4	3.2	3.5	3.6	3.7
Imports	YoY	0.4	3.3	3.4	3.4	2.9	2.9	3.1	3.2	3.6	3.7	3.5
CPI	YoY	1.4	0.5	0.9	0.6	0.3	0.6	0.7	0.9	1.0	1.0	1.1
CPI Ex Unprocessed Food & Energy	YoY	1.3	0.9	0.9	0.9	0.8	0.9	0.9	0.9	0.9	0.8	0.9
Unemployment Rate	YoY	11.9	11.5	10.8	11.5	11.0	11.1	11.4	10.9	10.5	10.6	10.8
Current Account Balance	€bn	230.7	279.5	280.4								
	% of GDP	2.4	2.9	2.8								
General Government Balance	€bn	-290.3	-275.5	-243.5								
	% of GDP	-3.0	-2.8	-2.4								
Primary Balance	% of GDP	-0.1	0.1	0.6								
General Government Debt	€bn	9,121.3	9,494.4	9,718.0								
	% of GDP	95.0	97.2	97.4								
Gross Operating Surplus	YoY	1.4	2.1	2.1								

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

## Germany

[Ebrahim Rahbari](#)

German GDP fell by 0.2% QQ in Q2, its first contraction since Q1-2013. Even though temporary factors (including payback from the strong Q1 and calendar effects) may have exaggerated the weakness in Q2, lead guides suggest that momentum in H2 will also be weaker than we expected previously. We therefore cut our growth forecasts for 2014 and 2015 down to 1.6% and 2.0%, respectively (from 2.0% and 2.4%), reflecting weaker export prospects and the spillover to investment. But even with these influences, we expect a strong labour market and very supportive financial conditions to keep German growth above trend in 2014 overall (and beyond) unless the external environment worsens further.

## France

[Guillaume Menuet](#)

For the second time in three months, we cut our 2014-15 GDP forecasts after the disappointing Q2 outcome, when the economy flat-lined for the second successive quarter. The lack of confidence in the government's ability to engineer a rebound is having negative consequences on industrialists' ability to make investment plans, with a noticeable deterioration in hiring intentions in the July surveys. Against this backdrop, any further escalation in sanctions related to the Ukraine crisis will likely detract from the already-weak export performance. Although France's reform efforts have gone largely unnoticed in recent years, we doubt that the euro area's second largest economy can recover meaningfully [unless the government is able to deliver a confidence shock in the short-term](#). We expect tax cuts in 2016 to help a little.

## Italy

[Giada Giani](#)

With Q2 GDP data showing that Italy slipped back into recession in H1 14, we are again cutting our 2014 growth forecast (from +0.1% to -0.1%). We still expect the tax rebates and ample corporate liquidity to support domestic demand in the next couple of quarters, returning GDP growth into positive territory (in line with survey-based indicators). But growth is likely to be weak amid tight financing conditions and poor competitiveness, and below 1% also in 2015. The fiscal deficit may remain just within the 3%-of-GDP threshold this year, but above the government's 2014 target of 2.6%, while the public debt ratio to GDP is likely to keep rising in 2014 and 2015.

Figure 25. Germany, France and Italy — Economic Forecasts, 2013-15F

		Germany			France			Italy		
		2013	2014F	2015F	2013	2014F	2015F	2013	2014F	2015F
Real GDP	YoY	0.2	1.6	2.0	0.4	0.4	0.9	-1.8	-0.1	0.8
Final Domestic Demand	YoY	0.6	1.8	2.5	0.5	0.0	0.7	-2.6	0.0	0.7
Private Consumption	YoY	1.0	1.2	2.4	0.3	0.2	1.0	-2.6	0.1	0.6
Government Consumption	YoY	0.4	0.9	1.5	2.0	1.5	0.9	-0.8	0.4	-0.2
Fixed Investment	YoY	-0.7	4.7	4.2	-0.8	-2.3	-0.2	-4.6	-0.9	2.1
Exports	YoY	1.1	3.7	3.2	2.4	2.4	2.3	0.0	3.1	3.4
Imports	YoY	1.6	5.3	4.2	1.9	2.4	1.6	-2.9	2.6	3.1
CPI	YoY	1.5	1.0	1.7	1.0	0.7	1.2	1.3	0.1	-0.2
Unemployment Rate	%	5.3	5.0	4.9	9.9	9.9	9.8	12.2	12.6	12.3
Current Account	€bn	193.5	194.3	186.1	-28.4	-14.6	-1.4	15.5	25.6	27.6
	% of GDP	7.1	7.0	6.3	-1.4	-0.7	-0.1	1.0	1.6	1.7
General Govt. Balance	€bn	0.3	2.0	5.7	-88.2	-94.6	-91.4	-44.1	-45.7	-44.3
	% of GDP	0.0	0.1	0.2	-4.3	-4.5	-4.3	-2.8	-2.9	-2.8
Primary Balance	% of GDP	2.2	2.1	2.1	-2.0	-2.3	-2.1	2.2	1.9	1.9
General Govt. Debt	% of GDP	78.4	77.2	72.8	93.5	97.5	99.8	132.6	137.8	139.3
Gross Trading Profits	YoY	2.7	1.3	3.7	-0.2	3.1	3.7	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

## Spain

[Giada Giani](#)

[Antonio Montilla](#)

With strong Q2 data (real GDP up by 0.6% QQ), we are raising our growth forecast to 1.4% (vs. 1.3% previously) for this year and to 2% (vs. 1.9%) for 2015. The recovery continues to be driven by private consumption and business investment, supported by a strong corporate financial position leading to job creation, by reduced fiscal tightening, and improving financial conditions. The 2014 budget deficit is likely to be broadly in line with the government target (of 5.5% of GDP).

## Greece

[Giada Giani](#)

The rebound in Q2 GDP (by 1.0% QQ, based on our estimate of SA data) was probably driven by the strong tourism season. The fall in YY GDP growth eased to minus 0.2% in Q2, the least negative reading since 2008. However, with June IP and retail sales data looking quite weak, we are lowering slightly our 2014 average growth forecast to 0.1% (from 0.3% last month, against the government forecast of 0.6%). Growth is likely to accelerate to around 1½ in 2015 amid reduced fiscal tightening and further export competitiveness gains.

## Ireland

[Michael Saunders](#)

Recent data suggest that Q2 GDP growth was very strong, but cast doubt on whether that expansion will be sustained. Industrial production surged by 11.9% QoQ in Q2, the biggest rise since data began in 1980. However, after strong April-May figures, IP fell 16% MoM in June, dropping a little below the Q1 average level. Hence while we forecast a 2% QoQ rise in Q2 GDP, we pencil in a much slower figure for Q3 GDP. Behind these swings, the underlying trend in the economy seems to be pretty strong, judging from the PMIs.

## Portugal

[Giada Giani](#)

Q2 GDP rebounded by 0.6% QQ, broadly in line with our forecasts and confirming that Q1 weakness (-0.6% QQ) was temporary. We therefore leave our 2014 GDP forecast unchanged. Export growth is feeding through to employment, which rose 2% QQ in Q2, adding to the recovery's sustainability. Despite the negative rulings by the High Court on some budget measures, we think the fiscal deficit is likely to fall near the government target of 4% of GDP this year and fall further in 2015 (while still overshooting the government's forecast of 2.5% of GDP).

Figure 26. 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	1.4	2.0	-3.9	0.1	1.5	0.2	5.8	3.6	-1.4	1.1	2.1
Final Domestic Demand	YoY	-2.7	1.5	1.9	-6.4	0.3	0.6	-0.6	0.7	1.5	-2.4	0.7	1.3
Private Consumption	YoY	-2.0	2.0	2.1	-5.8	1.1	0.7	-0.8	0.8	1.6	-1.7	1.1	1.4
Government Consumption	YoY	-2.3	0.3	0.4	-3.9	-0.4	-0.1	1.3	-1.5	-2.5	-1.8	-0.3	0.2
Fixed Investment	YoY	-5.0	1.2	2.9	-12.8	-2.7	1.1	-1.8	2.9	5.3	-6.0	0.1	2.4
Exports	YoY	4.9	4.6	5.7	1.2	6.4	3.4	1.1	7.1	5.3	6.1	1.9	4.8
Imports	YoY	0.4	5.7	6.4	-5.3	1.7	0.1	0.6	4.0	3.7	3.2	3.6	2.3
CPI	YoY	1.5	0.0	0.3	-0.9	-1.1	-1.0	1.0	0.3	1.0	0.4	-0.3	-0.4
Unemployment Rate	%	26.1	24.5	23.1	27.5	27.0	25.8	13.1	11.6	10.5	16.2	13.7	11.5
Current Account	€bn	8.0	6.3	5.4	1.4	2.2	2.0	7.6	7.6	9.2	0.9	0.9	1.2
	% of GDP	0.8	0.6	0.5	0.8	1.2	1.1	4.4	4.1	4.7	0.5	0.5	0.7
General Govt. Balance	€bn	-72.4	-57.8	-49.4	-23.1	-3.8	-4.0	-11.8	-3.5	1.2	-8.2	-7.0	-5.3
	% of GDP	-7.1	-5.6	-4.6	-12.7	-2.2	-2.2	-6.7	-1.9	0.6	-5.0	-4.2	-3.1
Primary Balance	% of GDP	-3.7	-2.2	-1.5	-8.7	2.3	2.3	-2.6	2.8	5.3	-0.6	0.3	1.5
General Govt. Debt	% of GDP	93.9	98.7	100.8	175.1	179.7	180.3	123.3	114.6	109.1	128.9	136.1	133.5

Source: Citi Research

## Netherlands

[Guillaume Menuet](#)

Q2 GDP recorded a 0.5% QQ gain, more than offsetting the upwardly revised 0.4% QQ drop (-0.6% prev.) in Q1. But domestic demand contracted again, falling by 0.6% QQ in Q2-14 after a 0.4% drop in Q1-14, highlighting some underlying weakness. The contribution from net trade was strong (1.2pp) thanks to a seventh successive gain in exports (+0.6% QQ, 2.9% YY) while imports fell by 1.1% QQ (1.6% YY), which highlights the recovery's vulnerability to adverse external shocks.

## Belgium

[Guillaume Menuet](#)

We are cutting our 2014-15 GDP growth forecasts by 0.2pp each to 1.1% and 1.3% respectively. Although the flash estimate of Q2 GDP showed a fifth successive gain, the pace of economic activity slowed to 0.1% QQ and 1.1% YY, mirroring the trend of declining business and consumer confidence in Q2-14. Indications of a further deterioration in July surveys are part of the reason behind our decision to cut our forecasts. On the political front, parties are continuing to negotiate to form a government coalition, a situation that should help limit fiscal uncertainty.

## Slovakia

[Jaromir Sindel](#)

Though the outlook on foreign demand worsened, we slightly increase our 2014 GDP (to 2.3% from 2.2% last month) due to better developments in domestic demand. Both factors have influenced our 2015 forecast, but in different directions. Thus our 2015 GDP forecast remains unchanged at 2.7% YoY assuming average GDP quarterly growth of 0.8% during 2015. A key risk for both our economic and fiscal forecast remains the ESA2010 revision of GDP and the government debt/GDP ratio — which could potentially trigger another debt-brake rule, although MinFin plans to reduce its cash buffer to avoid this.

## Slovenia

[Jaromir Sindel](#)

The Centrist SMC, lead by PM-designated Miro Cerar, is likely to establish a centre-left wing government with pensioners DeSUS, the left-wing ZaAB and socialist SD groups. In our view, the likelihood that the NSi will not join the coalition suggests a slower path for privatization and structural reforms, which will be driven mainly by EC pressure. The EC approved the resolution plan for the third largest (state-owned) bank. We keep our 2014-15 GDP forecasts unchanged as our momentum indicator points to an upside risk but this is offset by downside external risks.

Figure 27. 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	-0.7	0.7	1.3	0.2	1.1	1.3	0.9	2.3	2.7	-0.9	1.0	1.4
Final Domestic Demand	YoY	-1.7	0.0	0.4	0.3	1.1	1.1	-0.8	2.7	1.5	-2.2	0.1	0.5
Private Consumption	YoY	-1.6	-0.3	0.5	0.8	1.0	0.8	-0.1	2.3	1.9	-2.8	-0.2	-0.4
Government Consumption	YoY	-0.2	0.2	-0.1	0.6	0.2	0.7	1.4	1.9	-0.2	-2.0	-0.9	-0.3
Investment (Ex Stocks)	YoY	-3.9	0.3	0.8	-1.4	2.4	2.1	-4.3	4.3	2.1	-0.3	1.2	1.0
Exports	YoY	2.2	2.6	2.5	1.9	3.7	4.2	4.5	7.6	7.2	2.7	4.5	6.7
Imports	YoY	1.0	1.8	1.6	1.4	3.1	4.3	2.9	8.9	6.5	1.3	3.8	5.7
CPI (Average)	YoY	2.6	0.7	1.5	1.2	0.8	1.2	1.4	0.0	1.0	1.8	0.4	0.9
Unemployment Rate	%	8.3	8.6	8.4	8.4	8.5	8.3	14.1	12.9	12.3	10.1	10.1	10.5
Current Account	% of GDP	10.9	11.4	9.8	-1.9	0.1	0.7	2.1	1.4	2.2	6.0	3.3	3.5
General Govt Balance	% of GDP	-2.4	-2.7	-2.2	-2.7	-2.7	-2.5	-2.8	-3.0	-2.8	-14.7	-4.0	-3.5
Primary Balance	% of GDP	-0.7	-1.0	-0.5	0.6	0.5	0.7	-1.5	-1.7	-1.5	-12.1	-1.1	-0.7
General Govt Debt	% of GDP	73.5	74.7	74.4	101.2	102.3	102.3	55.4	55.6	55.8	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](#)

We expect that UK GDP growth will continue to outpace the consensus, with growth of about 3.4% in 2014 and 3.7% in 2015 (consensus 3.0% and 2.6% respectively). Q2 GDP rose 3.2% YoY, and business surveys give no sign that a slowdown is likely, with a wide range of surveys indicating that GDP will continue to grow at an above-average pace. The expansion is led by consumer spending and, especially, investment, with little effect either way from net trade. Inflation is likely to remain close to target. Although exports to Russia are falling, these account for a low share of total UK exports (1-2% of the total) and weakness in UK-Russia trade is unlikely to impact the overall UK economy significantly. Major GDP revisions are due in September, and we expect these will probably upgrade recent growth data.

The MPC made a more radical re-think than we had expected in the August Inflation Report, with greater optimism over the supply-side as well as economic growth forecasts. As expected, the MPC lifted their growth forecasts and cut their jobless forecasts. But, in addition, the MPC also cut their estimate for the medium-term equilibrium unemployment rate to 5.5% from about 6% previously (we had not expected this), and hence concluded that (with the jobless rate at 6.4%) the labour market still has significant slack. We had expected that the MPC would start to hike rates in Q4 this year, prompted by the jobless rate hitting (or getting very close to) 6.0%, the MPC's estimate of the medium-term equilibrium jobless rate. With their lower estimate for the equilibrium jobless rate, that trigger for tightening probably will not be present in Q4 and hence we have pushed back our forecast for the first hike from Q4-14 to Q1-15. The MPC's likely bias to a "low for longer" stance reinforces our view that the economy will continue to grow rapidly.

Figure 28. United Kingdom — Economic Forecasts, 2013-2016F

		2013	2014F	2015F	2014			2015				2016
					2QF	3QF	4QF	1QF	2QF	3QF	4QF	1QF
Real GDP	YoY	1.7	3.4	3.7	3.2	3.4	3.9	3.9	4.0	3.7	3.3	3.4
	SAAR				3.5	4.4	4.4	3.5	3.7	3.2	2.8	3.7
Domestic Demand (Incl. Inventories)	YoY	1.8	3.0	4.4	3.5	2.1	3.3	4.1	4.2	4.8	4.5	4.3
	SAAR				4.3	2.2	4.9	4.9	5.0	4.2	3.9	4.2
Private Consumption	YoY	2.2	2.9	3.4	3.1	2.9	3.3	3.2	3.2	3.5	3.5	3.5
	SAAR				4.1	2.7	2.9	3.3	4.1	3.6	2.9	3.3
Government Consumption	YoY	0.7	0.4	-0.1	0.1	-0.3	-0.1	0.0	0.2	-0.2	-0.5	-0.8
	SAAR				-1.3	0.9	0.4	-0.1	-0.5	-0.5	-1.0	-1.0
Investment	YoY	-0.8	12.7	16.9	11.6	12.9	16.2	18.6	17.1	16.7	15.4	14.0
	SAAR				22.0	14.9	18.6	19.1	16.0	13.0	13.7	13.5
Exports	YoY	0.5	1.2	4.6	-2.8	3.5	3.8	4.5	6.6	3.8	3.5	4.6
	SAAR				-4.1	15.8	4.9	2.4	3.9	4.0	3.7	7.0
Imports	YoY	0.2	0.4	7.2	-1.2	-0.5	2.5	5.7	7.7	7.7	7.8	8.0
	SAAR				0.6	7.7	6.9	7.7	8.4	7.7	7.5	8.4
Unemployment Rate	%	7.6	6.3	5.1	6.4	6.2	5.9	5.6	5.3	5.0	4.6	4.6
CPI Inflation	YoY	2.6	1.6	1.7	1.7	1.4	1.5	1.5	1.6	1.9	1.9	2.0
Merch. Trade	£bn	-109.7	-99.4	-103.5								
	% of GDP	-6.8	-5.8	-5.7								
Current Account	£bn	-72.8	-69.2	-81.2								
	% of GDP	-4.5	-4.1	-4.5								
PSNB	£bn FY	-106.8	-88.0	-57.6								
	% of GDP	-6.5	-5.1	-3.1								
General Govt. Balance	% of GDP	-7.1	-5.6	-3.6								
Government Primary Balance		-3.5	-2.0	0.1								
Public Debt	% of GDP	94.5	95.7	94.7								
Gross Nonoil Trading Profits	YoY	4.6	14.2	6.1								

Source: Citi Research



## Switzerland

[Michael Saunders](#)

With fairly buoyant business surveys, we expect the Q2 GDP data (due in early September) to show real GDP growth of about 0.6% QoQ. The Swiss economy continues to perform well compared to most other advanced economies, with the budget deficit and inflation both close to zero, the jobless rate around 3%, a current account surplus of 16% of GDP in 2013 and a general government debt ratio of below 50% and falling. We expect the SNB to keep rates at zero for a while with rates eventually rising modestly as the economy continues to do well.

## Sweden

[Tina Mortensen](#)

The Swedish economy returned to growth in 2Q, but GDP was up by a weaker-than-expected 0.2% Q/Q. With the 0.1% Q/Q drop in 1Q, the economy nearly stagnated in 1H. Meanwhile, the 2Q flash estimate likely underestimates the economy's strength and probably be revised up at a later stage. Still, with sentiment guides flattish or weaker, our forecast of a pickup in GDP growth going into 2015 is in doubt. Core inflation has been in line with or above consensus expectations for four consecutive months, suggesting that Sweden is past the period of ultra-low inflation figures. Nevertheless, with inflation likely to stay well below target also in 2015, rates are likely to stay very low for an extended period.

## Denmark

[Tina Mortensen](#)

Economic activity is rising again in Denmark, and lead indicators support our forecast of a moderate pickup in growth ahead, driven by improving domestic demand and exports. Public finances look robust this year, but the outlook for 2015 is weaker: with the lapse of the temporary tax receipts, the public budget deficit could come close to the budget act limits and this will coincide with a general election that must be held in autumn-2015 at the latest.

## Norway

[Tina Mortensen](#)

Economic activity will likely continue to grow at a below-trend rate pace in coming years; while private spending and non-oil exports should continue to add to growth, slowing oil investment trends and ongoing erosion in competitiveness will act as offsets. Both fiscal and monetary policy will remain expansive, to support economic recovery. With core inflation in excess of expectations and the 2.5% target in July, this points to an upward revision of Norges Bank's CPI and interest rate forecasts in the Sep MPR. Combined with firm economic activity indicators since the latest policy meeting in June, a rate cut probably is now off the agenda.

Figure 29. 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	2.0	2.6	1.6	2.0	2.6	0.4	1.4	1.7	2.0	2.0	2.2
Final Domestic Demand	YoY	2.3	2.1	2.7	1.4	2.6	2.2	0.4	1.3	1.8	2.5	1.7	2.2
Private Consumption	YoY	2.3	1.7	1.9	2.1	2.6	2.4	0.1	1.3	2.0	2.2	2.1	2.5
Government Consumption	YoY	3.0	0.1	0.7	1.9	1.1	0.9	0.7	0.8	0.9	1.8	2.2	2.3
Investment (Ex Stocks)	YoY	1.8	4.4	6.1	-1.0	5.0	3.4	0.5	2.3	2.4	4.5	0.1	1.1
Exports	YoY	2.0	5.3	6.1	-0.3	2.7	4.3	1.0	4.1	3.3	0.8	1.2	2.8
Imports	YoY	1.8	2.7	6.4	-0.7	4.3	3.6	1.4	4.6	3.6	2.9	1.2	2.9
CPI (Average)	YoY	-0.2	0.1	1.1	0.0	-0.1	1.1	0.8	0.7	1.2	2.1	2.0	2.1
Unemployment Rate	%	3.2	3.3	3.1	8.0	8.0	7.6	7.0	6.7	6.5	3.5	3.6	3.8
Current Account	% of GDP	16.0	13.5	12.8	6.4	6.3	6.0	7.1	6.6	5.6	11.1	11.4	11.7
General Govt Balance	% of GDP	0.0	-0.2	0.5	-1.2	-1.9	-0.9	-0.9	-1.3	-2.7	10.9	11.0	11.0
General Govt Debt	% of GDP	49.4	48.2	47.2	38.9	40.0	39.4	44.5	44.9	46.3	NA	NA	NA

Source: Citi Research

## Canada

[Dana M. Peterson](#)

The Canadian economy likely rebounded sharply in 2Q, reflecting revivals in housing, consumption and business investment. Exports also spiked by the most since 2011, when global supply chains normalized after the Japanese earthquake. Hiring is lackluster, but symptomatic of tepid business sentiment. Increasing US growth momentum and the surge in 2Q Canadian exports should encourage Canadian firms to become more engaged in the expansion. The outlook for the second half of this year and beyond is unchanged. Faster output should be fueled by burgeoning US demand, the cheaper CAD, and domestic energy infrastructure build-out. The internal demand rotation probably will remain a headwind. Total CPI inflation persists above the BoC's 2% target, and core inflation continues to rise at a brisk pace. Transitory factors like exchange rate pass-through and winter energy spikes lifted prices. But services costs are also levitating. We posit that inflation is stabilizing after an extended period of competitive discounting, and that the degree of excess supply may be lessening. Overall CPI inflation probably will remain near the BoC's target over the medium term, and core inflation will probably converge on 2% by mid-2015 — one year ahead of the BoC's projection.

Risks to the inflation outlook remain roughly balanced, in our view. Upside risks include (1) stronger global growth; (2) higher commodity prices induced by geopolitical events; and (3) reinvigoration of the housing market that reinforces existing imbalances. Downside risks include (1) weaker global growth; (2) failure of the domestic demand rotation to occur due to insufficient exports and capex growth; (3) anemic Emerging Market growth; and (4) domestic household imbalances. The BoC is unlikely to raise interest rates until there is sustained improvement in capex and export growth, and/or a notable lift in inflation expectations. Hence, we continue to maintain our long-standing expectation for rate hikes to resume in 3Q15.

Figure 30. Canada — Economic Forecast, 2013-2016F

					2014			2015				2016
		2013	2014F	2015F	2QF	3QF	4QF	1QF	2QF	3QF	4QF	1QF
Real GDP	YoY	2.0	2.7	2.7	3.0	2.8	2.7	3.1	2.6	2.6	2.7	2.7
	SAAR				5.0	2.4	2.4	2.6	2.8	2.7	2.6	2.6
Final Domestic Demand	YoY	1.4	1.5	2.2	1.5	1.6	1.8	2.5	2.1	2.1	2.1	2.1
	SAAR				3.7	2.1	1.9	2.2	2.1	2.1	2.0	2.2
Private Consumption	YoY	2.4	2.5	2.5	2.6	2.4	2.4	2.7	2.4	2.4	2.4	2.3
	SAAR				4.0	2.3	2.2	2.5	2.5	2.5	2.3	2.0
Government Spending	YoY	0.3	-0.7	0.3	-0.9	-0.8	-0.5	-0.1	0.2	0.4	0.5	0.6
	SAAR				-0.7	-0.2	0.1	0.5	0.5	0.5	0.5	1.0
Private Fixed Investment	YoY	0.2	1.4	3.8	1.3	2.0	3.1	5.0	3.6	3.3	3.2	3.3
	SAAR				8.9	4.3	3.3	3.7	3.1	3.0	3.1	4.0
Exports	YoY	2.2	4.5	5.4	4.8	5.7	5.9	7.7	4.6	4.7	4.8	4.9
	SAAR				18.0	4.4	4.5	4.4	5.1	5.0	4.9	4.8
Imports	YoY	1.1	1.0	3.6	0.9	2.0	2.3	5.0	3.1	3.0	3.1	3.2
	SAAR				11.0	3.3	3.0	3.0	3.1	3.0	3.3	3.3
CPI	YoY	0.9	2.0	2.0	2.2	2.1	2.1	2.1	1.9	2.0	2.2	2.2
Core CPI	YoY	1.2	1.7	2.0	1.7	1.9	1.9	2.0	1.9	1.9	2.0	2.0
Unemployment Rate	%	7.1	6.9	6.6	7.0	6.8	6.9	6.9	6.6	6.5	6.5	6.4
Current Account Balance	C\$bn	-60.3	-47.3	-45.5	-47.1	-48.6	-44.9	-48.6	-47.9	-43.9	-41.4	-42.7
	% of GDP	-3.2	-2.4	-2.2	-2.4	-2.4	-2.2	-2.4	-2.3	-2.1	-2.0	-2.0
Net Exports (Pct. Contrib.)		0.3	1.0	0.5	1.7	0.3	0.4	0.4	0.6	0.6	0.5	0.4
Inventories (Pct. Contrib.)		0.3	0.1	0.0	-0.9	0.0	0.0	0.0	0.1	0.0	0.1	0.0
Budget Balance (Fiscal Year)	% of GDP	-0.9	-0.1	0.3								
Federal Budget Debt	% of GDP	32.4	30.9	29.3								
General Govt. Debt	% of GDP	93.5	92.0	90.3								

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

## Australia

[Paul Brennan](#)

[Joshua Williamson](#)

We are cutting our economic growth forecasts for this year and now expect an increase of 3.2%, down from 3.5% last month. The downgrade reflects weaker export volumes rather than lower domestic demand. That said, recent readings on the labour market and wages have been disappointing and pose some downside risk to consumer spending. Q2 GDP could be particularly soft, reversing the strong start to the year. More positively, forward indicators such as business confidence and share prices are encouraging so we have not changed our 3% growth forecast for next year. That 2015 forecast masks a strengthening in non-mining activity which is broadly offset by a greater decline in mining investment as large projects are progressively completed. Markets continue to price around a 50% probability of a further rate cut, but with interest rates already unusually low by Australian standards the RBA appears content to wait for confirmation of its view that the improvement in business confidence will be reflected in higher spending.

## New Zealand

[Paul Brennan](#)

[Joshua Williamson](#)

The RBNZ is set to step back from the frontier of advanced economy rate hikes and pause to assess the current level of the OCR on activity and prices. With evidence that the economy was already responding to earlier hikes and with macroprudential tools still in place, the RBNZ is ahead of the curve on inflation risks. There is little evidence of troublesome inflation pressures outside of reconstruction-based product and labour demand. But the current pause should not be extrapolated into an argument for abandoning the move back to neutral monetary policy. Labour market slack is diminishing, domestic demand is growing and inflation pressures are likely to spread into other parts of the economy in coming quarters. The timing of the next rate rise will partly depend on the FOMC because of the risk that more domestic tightening might further boost the NZD (Governor Wheeler already described the currency's level as "unjustified and unsustainable" in July). We continue to expect the hiking cycle to recommence on December 11, but the risk is that it is pushed out into early 2015.

Figure 31. Australia and New Zealand — Economic Forecast, 2013-2015F

	Australia			New Zealand		
	2013	2014F	2015F	2013	2014F	2015F
Real GDP <sup>a</sup>	2.4	3.2	3.0	2.8	3.5	2.9
Real GDP (4Q versus 4Q)	2.7	3.0	3.1	3.3	3.0	2.9
Real Final Domestic Demand	0.9	1.6	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 <sup>b</sup>	1.1	1.9	2.0	1.3	3.0	3.0
Housing Investment	2.0	11.1	9.5	15.0	16.0	14.4
Business Investment <sup>c</sup>	0.4	-6.1	-6.5	9.3	13.0	7.0
Exports of Goods & Services	6.5	8.7	7.1	1.0	1.5	2.5
Imports of Goods & Services	-2.2	-0.4	4.6	8.7	7.6	4.7
CPI	2.4	2.6	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	5.8	6.0	5.3	5.0
Merch. Trade, BOP (Local Currency, bn)	4.5	9.9	6.1	1.4	-0.1	-2.5
Current Account, (Local Currency, bn)	-50.2	-39.8	-48.5	-7.5	-9.6	-13.0
Percent of GDP	-3.2	-2.5	-2.8	-3.4	-4.2	-5.4
Budget Balanced (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) <sup>e</sup>	30.2	32.1	33.5	39.8	39.0	36.3
Gross Operating Surplus	2.8	7.4	6.7	NA	NA	NA

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

## China

[Mingqiao Shen](#)

[Shuang Ding](#)

Strong exports have been offset by weak investment. In July, exports surprised significantly on the upside, while imports disappointed. Industrial production, fixed asset investment and retail sales all missed expectations. The data pointed to better external demand and weak domestic demand. In particular, the growth of property, infrastructure and manufacturing investment slowed from June to July, mainly due to the ongoing property market correction and overcapacity. On the positive side, growth of planned investment under newly-started projects continued to improve, likely reflecting better sentiment following recent targeted policy easing. Retail sales growth has moved in a tight range, suggesting stable consumption growth in the context of steady growth of employment and wage.

We expect the PBOC to maintain its easing bias. Money and credit data missed expectations by a large margin in July. We see the weak data as a correction following the surge of monetary and credit indicators in June, with M2 and TSF growth getting back to the May pace. As suggested by PBOC, we think the monetary policy stance remains unchanged. With M2 growth above the annual target (13%) and 4-5ppts higher than nominal GDP growth, monetary conditions are still accommodative. The 2Q monetary policy report indicates that the central bank is less concerned about inflation, and more worried about the financial risks associated with the rising private debt-to-GDP ratio. The PBOC will likely target M2 growth at 13-14% range, with its focus shifting from liquidity and credit expansion to lowering the financing cost of the real economy (qualitative easing).

Better exports and accommodative credit conditions should offset the impact from the property market correction this year. The PMI export orders index continues to improve. Export growth is likely to remain strong, with the US economy expected to grow by more than 3% in 2H, adding RMB appreciation pressure. The PBOC may continue to guide lending rates down through open market operations and lending to commercial banks. Meanwhile, we expect the government to take targeted measures to support property demand and contain downside risks, including relaxation of purchase and lending restrictions, buyback of commodity houses to meet the social housing target, and hukou reform. We continue to expect a mild growth rebound in 2H, and keep annual forecast at 7.5%.

Figure 32. China — Economic Forecasts, 2013-2016F

					2014			2015				2016
		2013	2014F	2015F	2QF	3QF	4QF	1QF	2QF	3QF	4QF	1QF
Real GDP	YoY	7.7	7.5	7.1	7.5	7.5	7.7	7.5	7.2	6.8	7.0	6.3
Real Final Domestic Demand	YoY	8.5	7.3	7.0								
Consumption	YoY	7.9	7.3	7.2								
Fixed Capital Formation	YoY	9.1	7.2	6.8								
Industrial Production	YoY	9.7	9.1	8.5	8.9	9.2	9.6	9.2	8.6	7.8	8.2	7.0
Exports	YoY	7.8	5.1	7.0	5.0	8.0	10.0	7.0	7.0	7.0	7.0	5.5
Imports	YoY	7.3	4.4	6.0	1.5	6.0	8.0	6.0	6.0	6.0	6.0	6.5
Merchandise Trade Balance	\$bn	259	287	328	86	76	109	23	97	86	122	19
FX Reserves	\$bn	3,821	4,079	4,285	3,990	4,020	4,079	4,061	4,123	4,174	4,285	4,263
Current Account	% of GDP	2.0	2.0	2.0								
Fiscal Balance	% of GDP	-1.9	-2.1	-2.0								
General Govt. Debt*	% of GDP	53.7	54.0	53.6								
Urban Unemployment Rate	%	4.1	4.2	4.3	4.2	4.2	4.3	4.3	4.3	4.3	4.3	4.4
CPI	YoY	2.6	2.3	2.6	2.2	2.3	2.4	2.6	2.7	2.5	2.7	2.7
Exchange Rate (end period)	CNY/\$	6.05	6.09	6.02	6.20	6.13	6.09	6.06	6.04	6.03	6.02	6.01
1-Yr Deposit Rate (end period)	%	3.00	3.00	2.75	3.00	3.00	3.00	3.00	2.75	2.75	2.75	2.75

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](#)

[Anurag Jha](#)

As discussed in our latest [Macroscope Beyond Swings, The New Dynamic](#), the Indian economy stands at the cusp of a recovery. We believe that GDP growth bottomed out at 4.5% in FY13 and we expect growth to come in at 5.6% in the current fiscal year. The good news begins, but does not end, with improving output. Inflation has come off too, from roughly 10% in FY13 and FY14 to an estimated level of 8% in FY15 and is likely to decline further towards 6.5% in FY16.

In addition to the improving growth/inflation balance, there has been meaningful progress on the twin deficit front. From levels above 4% of GDP in FY12 and FY13, the current account deficit has declined to 1.7% of GDP in FY14 and is likely to remain at sub-2% levels in FY15 / FY16. As regards the fiscal accounts, while the quality of consolidation could be debated, on a two-year basis, headline trends in the deficit have seen a 160bps decline.

While there is some improvement on the macro front, the process has just begun and there is still a long way to go for the economy. Growth remains below potential, inflation is above comfort levels; risk on capital flows and the exchange rate remains present; and lastly S&P continues to maintain India's credit rating on negative watch.

Nonetheless, while the challenges remain formidable, the regime change in Delhi and Mumbai inspire confidence. PM Modi's focus is to boost growth through investment revival and fast tracking execution/clearances. The RBI governor Rajan continues to focus on financial services expansion while simultaneously devising a monetary policy framework that could help achieve low and stable inflation. One can pin it to personalities, but this mix is steadily changing India's dynamics.

In the last year, India has been prone to mood swings between global developments and domestic economics/politics. Risk on/off matters; India is not immune and there is no room for complacency, but dynamics are changing: (1) vulnerability is lower and there is better preparedness; and (2) macro stabilization is underway - growth-inflation balance, twin deficits improving. While there can be plenty of debate on pace and timing, India is on its way back to 7% growth and 6% inflation in our view.

Figure 33. India — Economic Forecasts, FY2013/14-2015/16F

		FY13/14F	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	-4.6	-4.1	-4.0
US Dollar Exchange Rate	Average	61.8	61.4	62.5

Sources: Haver Analytics and Citi Research forecasts

## Korea

[Jaechul Chang](#)

The government announced activity-boosting measures on 24 July, including extra spending of KRW40.7trn (c0.3% of GDP) and easing DTI and LTV rules, etc. The government also introduced several tax incentives to bolster household income, investment and employment. In particular, it introduced three new tax schemes: 1) tax credit for any company which raises wages more than the three-year average wage growth, 2) reduction of withholding tax rate on dividend income, and 3) tax on cash reserves in excess of wage and dividend payouts and investment. On top of that, the government also plans to increase the 2015 budget to sustain economic recovery at the similar magnitude of the forecast revenue growth (6.2%). Following its expansion of the Bank Intermediate Lending Support Facility (mostly for SMEs) by KRW3trn to KRW15trn in July, the BoK cut the policy rate by 25bps to 2.25% after the revision of its 2014-15 growth forecasts by 0.2%p in July (to 3.8% and 4.0% respectively). We reiterate that the BoK will keep the policy rate at 2.25% until it begins rate hikes in 2H15, when the output gap is likely to turn positive amidst high expected inflation and the Fed starts to raise the US policy rate.

## Indonesia

[Helmi Arman](#)

Indonesia's current account deficit improvement stalled in 2Q, reaching roughly 4.3% of GDP from 4.5% GDP in the same period last year. This was amid weaker performance of primary commodity exports, particularly coal and palm oil. Merchandise imports (customs basis) were still about 4% weaker YoY. The latest investment indicators such as industrial land sales, commercial vehicles sales and cement sales have not shown a strong resurgence. And although consumption growth in the second quarter was relatively resilient, we expect retail sales growth to lose some steam in 3Q as the period of heightened political campaigns ends. With the backdrop of slowing GDP growth and significant external imbalances, we expect the BI to continue to hold rates steady for at least the next two months. However we expect a 25bps rate hike by December if our fuel price hike scenario materializes in November. A hike in fuel prices this year would relieve short term pressure on the IDR in our view, although we still expect the IDR to weaken over a 6-12M horizon (given our strong dollar scenario).

Figure 34. 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	5.1	5.2
Final Domestic Demand	YoY	2.8	2.7	4.1	5.1	5.0	5.2
Private Consumption	YoY	2.0	2.1	3.5	5.3	5.0	4.3
Fixed Investment	YoY	4.2	3.8	5.2	4.7	5.5	7.0
Exports	YoY	4.3	5.1	7.0	5.3	-1.8	3.4
Imports	YoY	1.6	4.0	6.7	1.2	-4.2	2.4
Consumer Price Index	YoY	1.3	1.9	2.9	6.4	6.5	6.7
Unemployment Rate	%	3.1	3.5	3.1	5.8	6.5	6.3
Current Account	US\$ bn	79.9	72.3	48.9	-29.1	-26.5	-24.5
	% of GDP	6.1	4.9	3.1	-3.3	-3.0	-2.6
Fiscal Balance	% of GDP	1.0	0.9	1.5	-2.2	-2.4	-2.2
US Dollar Exchange Rate	Average	1095	1034	1017	10449	11707	12014

Source: Haver Analytics and Citi Research forecasts

## Hong Kong

[Adrienne Lui](#)

We are cutting our 2014 GDP forecast to 2.6% YoY (-0.6ppt) on the surprise downfall in 2Q tourism and investment spending. A possible revision to Chinese tourists' multiple entry visa scheme in 4Q will likely deal another blow to retail sales later in the year and next year. The changing behavior of Chinese tourist spending habits will inevitably alter shop sales expectations, hiring and store rentals. Demonstrations of support for both 'Occupy Central' and 'anti-Occupy Central' campaigns continue to escalate over the summer, while waiting for China's State Council to give further guidance on HK's election reform. Capital inflows and strong HKD demand prompted more HKMA liquidity injections in August, keeping the system buffered with liquidity. Preparatory drills for the Shanghai-HK Stock Connect launch in October are underway. When the program is launched, it will provide a higher yield investment route for CNH to be remitted onshore.

## Singapore

[Kit Wei Zheng](#)

Despite the slight upward revision in 2Q GDP to a marginal 0.1% QoQ SAAR expansion, the details reveal that both external and domestic demand remain soft with weakness in both fixed investment and private consumption. The MTI's updated 2014 GDP forecast of 2.5-3.5% anticipates a 2H export recovery, but leading indicators remain mixed. We expect MAS to stand pat in October — the narrower positive output gap limits upside risks to core inflation despite higher labour costs, while easing is unlikely as core inflation expectations exceed the 2.5% target. Falling deposits are pushing up deposit rates and tighten monetary conditions independent of the Fed.

## Taiwan

[Adrienne Lui](#)

The strong 2Q GDP figure (3.8% YoY) has led us to upgrade our full year forecast to 3.6%yoy (+0.4ppt). We anticipate a further recovery in 2H, reflecting AE recovery, new tech product launches and a stabilized China economy (which should benefit Taiwan's non-tech exports). We think the TWD likely stay around 30 against the USD near term, as we believe the merchandise trade surplus was previously enlarged by imports compression and this likely will be replaced by export improvements and normalization of imports trend in 2H. Foreign inflows have recently calmed down and our equity strategist expects that the recent correction in the TAIEX is needed for further rallying by year end. However, foreign investors may watch the December super 7-in-1 local elections more closely than usual, to see if there are any changes in the blue-green parties power distribution — which could have profound implications for 2016 President Election and cross-strait policies.

Figure 35. 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	2.6	3.3	3.9	3.1	3.2	2.1	3.6	4.0
Final Domestic Demand	YoY	3.8	1.6	2.4	1.8	0.4	1.6	2.2	2.0	2.6
Private Consumption	YoY	4.2	1.9	2.4	2.6	1.8	0.7	2.0	2.2	3.0
Fixed Investment	YoY	3.3	0.6	2.8	-1.9	-0.1	2.6	4.7	2.2	3.4
Exports	YoY	6.5	2.8	6.3	3.6	3.9	3.8	3.8	4.7	6.3
Imports	YoY	6.9	2.7	5.7	3.1	3.2	2.3	3.9	3.7	5.2
CPI	YoY	4.3	3.8	3.5	2.4	1.2	1.0	0.8	1.5	2.0
Unemployment Rate	%	3.4	3.1	3.1	1.9	2.0	2.1	4.2	4.0	3.9
Current Account	US\$ bn	5.1	8.0	9.5	54.6	61.6	66.5	57.7	55.9	55.2
	% of GDP	1.9	2.8	3.2	18.3	18.0	18.0	11.8	11.0	10.2
Fiscal Balance	% of GDP	1.0	1.3	0.7	1.1	-0.3	0.2	-1.3	-1.4	-0.8
US Dollar Exchange Rate	Average	7.76	7.75	7.75	1.25	1.25	1.27	29.68	30.07	29.77

Source: Citi Research



[Ivan Tchakarov](#)

## Russia

The newly-imposed sanctions by the US and EU will make for a more challenging backdrop to the Russian economy, creating additional downside growth risks and uncertainties that are likely to hit spending. The combination of these risks and tighter monetary policy led us to downgrade our 2014 GDP forecast from 1.0% to 0.7% last month. Nevertheless, we still maintain a more positive view on macroeconomic performance than the consensus and Russian government, which see GDP growth at 0.5%. Preliminary estimates from Rosstat point to economic growth slowing marginally to 0.8% YoY in 2Q14, down from the 0.9% YoY expansion posted in 1Q14. While on a downtrend, GDP grew better than the consensus estimate of 0.7% YoY. We estimate that after the 1.1% SA QoQ contraction in 1Q14, the economy expanded by 0.3% on a seasonally-adjusted QoQ basis in 2Q14. Such a pace of quarterly expansion is very modest, yet it would be just enough to avoid a technical recession. After the very large Q1 contraction in fixed investment (-4.9% YoY) – probably hit by geopolitical tension — incoming data have shown significant moderation in the pace of decline: fixed investment fell by 1.6% YoY in 2Q and actually rose 0.5% YoY in June (first positive YoY figure this year). Risks are higher for H2 as we suspect that investment spending will again fall YoY while consumer spending may continue to slow on higher inflation.

## Turkey

[Ilker Domac](#)

As was widely expected, Mr Erdogan won the presidential election in the first round, receiving about 52% of the vote. Following the AKP's decision to call an extraordinary convention to elect the new party leader on August 27, one day before Mr Gul's term expires, all eyes are on the succession process. Notwithstanding his remarks suggesting that he plans to return to the party, this development rules out the possibility of Mr Gul leading the AKP once his term expires. In particular, the markets are anxious to see whether there will be major changes regarding positions in charge of the economy. Turning to the economic outlook, we believe that Turkey's relatively attractive cyclical story in 1H, which was underpinned by the resilient economy and relatively strong external adjustment, will become considerably less favorable going forward. Growth indicators are already softening and signs of subdued economic activity will probably become more visible. By and large, this is also the case for the current account adjustment, which is largely driven by the sharp reversal in net gold exports. In the case of inflation, we believe that a secular deterioration is probably underway. Despite this difficult backdrop, we do not rule out additional easing if the lira and global markets permit.

Figure 36. Russia and Turkey — Economic Forecast, 2013-2015F

		Russia			Turkey		
		2013	2014F	2015F	2013	2014F	2015F
Real GDP	YoY	1.3	0.7	2.3	4.0	3.5	3.5
Final Domestic Demand	YoY	2.7	1.0	2.5	4.7	0.5	3.4
Private Consumption	YoY	4.7	2.8	3.0	4.6	2.4	3.2
Fixed Investment	YoY	-0.1	-2.7	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	7.0	5.6	7.5	8.8	7.4
Unemployment Rate	%	5.5	5.7	5.8	9.1	9.5	9.5
Current Account	US\$ bn	32.8	54.9	39.2	-65.1	-44.1	-50.3
	% of GDP	1.5	2.7	1.9	-7.9	-5.4	-5.8
Fiscal Balance	% of GDP	-2.1	-4.4	-4.9	-1.2	-2.8	-3.2
US Dollar Exchange Rate	Average	31.9	35.5	38.1	1.91	2.16	2.32

Sources: Haver Analytics and Citi Research forecasts

## Hungary

[Eszter Gargyan](#)

Retail and construction growth slowed in 2Q14, but there are no signs of weakening in industrial output. The Russian import ban on agriculture products should not have a meaningful impact on growth, as it may only impact about 0.3% of total Hungarian exports. There are no signs of weakness in industrial orders yet, but we expect export momentum to slow in H2 this year, in line with the decline in European business surveys. This suggests downside risks to our 2.9% GDP growth forecast for this year. The NBH has ended its rate-cut cycle in July and signaled its intentions to keep the base rate unchanged until late-2015. The July CPI surprised to the upside, but the pickup mainly reflected the reversal of weakness in food prices from the prior months, and probably does not change the CPI outlook in our view. We expect CPI inflation to stay close to zero in the coming months, rising to about 1.5%YoY by year-end and to around 2.4%YoY by mid-2015 on base effects as the impact of utility price cuts fall out of the index. This outlook leaves room for the NBH to tolerate some more FX weakness. We expect the currency to remain stable in the coming months and see prospects for further HUF weakening in 1H15 related to household debt conversion amidst eroding real interest rates as headline CPI rises. Our base case is that the NBH will start gradual rate hikes in 3Q15 as US monetary policy turns and we project the base rate at 3.10% by end-2015.

## Poland

[Piotr Kalisz](#)

[Cezary Chrapek](#)

GDP growth slowed only slightly in 2Q to 3.2%YoY from 3.4%YoY in 1Q, but the manufacturing PMI for July surprised to the downside again and fell to 49.4 pts. Although there are still no signs of reversal of positive trends in the labour market, the falling PMI, weaker euro zone growth and Russian embargo versus Poland and the EU are negative factors for 3Q GDP growth (we expect a slowdown to 3%YoY) and for our annual GDP growth forecast at 3.4%YoY. Meanwhile, inflation fell below zero in July for the first time in history, reaching -0.2%YoY and will likely stay negative till the year-end — pushed down by the impact of the Russian embargo on food prices. Unless monthly data from the real economy for 3Q surprise significantly to the upside the MPC may not be able to withstand rising pressure to cut rates and will likely lower them by 50 bp in October/November. On the fiscal front, the central budget performance is quite positive with still strong growth in VAT revenues. Moreover, the FinMin has already nearly covered this year's borrowing needs and will lower bond issuance in 2H in refinancing for 2015.

Figure 37. Hungary and Poland — Economic Forecasts, 2013-15F

		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	0.3	1.8	1.9	0.8	2.8	3.2
Fixed Investment	YoY	5.8	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	0.2	2.1	0.9	0.3	2.0
Unemployment Rate	%	9.1	8.6	8.1	13.4	12.4	11.7
Current Account	US\$ bn	4.0	4.6	4.3	-6.6	-9.2	-15.9
	% of GDP	3.0	3.6	3.1	-1.3	-1.7	-2.8
Fiscal Balance	% of GDP	-2.2	-2.9	-2.9	-4.3	5.2	-2.7
Euro Exchange Rate	Average	297	312	321	4.20	4.19	4.23

Source: Citi Research

## Czech Republic

[Jaromir Sindel](#)

We are cutting both our GDP and CPI forecasts, shifting to a later forecast for CNB tightening. While we keep our 2014 GDP growth forecast unchanged at 2.4% YoY, but slightly cut our 2015 outlook by 0.2%pt to 2.5% owing to external risks. There is a downside risk if we see an escalation of the Ukraine/Russian crisis that could trigger another round of foreign trade sanctions. Why do we keep our 2014 outlook unchanged? First, while GDP was flat QoQ in 2Q, the details were actually slightly better than our forecast and imply positive growth in value added. We forecast average 0.3% QoQ growth in 2H14, which is below the pace of growth suggested by the economic sentiment indicator. There is actually an upside risk as foreign trade data suggest faster export growth than shown by Czech data. Nevertheless, weakness in imported costs leads us to lower our CPI outlook by 0.4%pt to 1.4% in 2015, below CNB's 1.8% forecast. While we do not assume a hike in the FX floor, we return back to our interest rate forecast from early this year — with the first policy rate hike in 1H16.

## Romania

[Ilker Domac](#)

[Gultekin Isiklar](#)

The NBR surprised markets by cutting its policy rate by 25bp at the August Board meeting to 3.25% — a move which was largely motivated by the marked revision of the NBR's year-end inflation forecast to 2.2% from 3.3%. Nonetheless, we continue to work with a more pessimistic year-end inflation forecast (3.0%) when compared with the NBR. In our view, the pace of disinflation in non-food and food components is unsustainable. Moreover, the close link between the actual inflation outturn and forward-looking expectations emerges as an additional factor complicating inflation dynamics. This backdrop, coupled with unimpressive capital inflows, the uncertainty surrounding the EU-IMF supported program and the possibility of a higher level of political noise ahead of the upcoming presidential elections — leads us to believe that there is not much room for further easing. With the policy rate at 3.25%, the NBR's 2015 inflation forecast of 3% corroborates our view that those who wait for aggressive rate cuts during the remainder of the year may be disappointed. Nonetheless, given the Governor's relatively dovish comments, we do not rule out a 25bp rate cut at the September Board meeting, particularly if the leu holds up well and our expectation of a reversal in food prices does not materialize in August.

Figure 38. Czech Republic and Romania — Economic Forecasts, 2013-2015F

		Czech Republic			Romania		
		2013	2014F	2015F	2013	2014F	2015F
Real GDP	YoY	-0.9	2.4	2.5	3.5	3.0	3.4
Final Domestic Demand	YoY	-0.5	2.7	2.2	0.0	1.8	3.3
Private Consumption	YoY	0.1	1.9	2.1	1.3	1.5	3.5
Fixed Investment	YoY	-3.5	5.2	3.5	-3.4	3.2	3.5
Exports	YoY	0.2	9.9	7.5	13.1	5.5	4.5
Imports	YoY	0.6	9.5	7.7	2.3	3.0	4.0
CPI	YoY	1.4	0.4	1.4	4.0	1.5	3.2
Unemployment Rate	%	6.9	6.3	6.0	5.3	5.5	5.5
Current Account	US\$ bn	-2.9	2.8	3.0	-2.0	-5.0	-9.0
	% of GDP	-1.4	1.3	1.5	-1.1	-2.5	-4.2
Fiscal Balance	% of GDP	-1.5	-2.0	-2.4	-2.5	-2.3	-2.3
EURCZK, USDRON	Average	26.0	27.6	27.5	3.3	3.3	3.3

Sources: Haver Analytics and Citi Research forecasts

## Brazil

[Marcelo Kfoury](#)

The unfortunate death of Eduardo Campos significantly raises the uncertainty around the presidential election result. Despite that, our base case scenario continues to assume President Rousseff's reelection. Under this crucial assumption, we now expect a more marked deterioration in economic fundamentals. In addition, the weakness in Q2 GDP hurts our annual GDP growth forecasts. We now forecast GDP to rise 0.5% in 2014 and 1.0% in 2015 (down from 0.9% and 1.2%, respectively). On the inflation front, the recent lower-than-expected readings prompt us to cut our 2014 yearend CPI inflation forecast to 6.4% YoY (from 6.6%). With this lower growth and inflation outlook, we expect the CB to stay on hold for some time, keeping the Selic rate at 11% until end-2015. Regarding the fiscal accounts, there is increasing evidence pointing towards an even lower primary surplus, which we now expect to stand at 1.0% of GDP by end-2014, compared to the official 1.9% of GDP target. Finally, we continue to see the current account deficit stabilizing at a level slightly lower than 4% of GDP, and the domestic currency depreciating ahead.

## Mexico

[Sergio Luna Martinez](#)

Activity picked up in 2Q14, mostly driven by stronger external demand. However, the acceleration in growth was slower than originally expected: we now estimate 2Q14 GDP growth at 1.5% YoY versus 1.8% before. Although we are holding our 2H14 GDP growth forecast at 3.5% YoY, based mainly on a US economic recovery and the encouraging signs in two key sectors (autos and construction), the slower growth in 1H14 has led us to slightly downgrade our GDP growth forecast for 2014 as a whole to 2.6%, from 2.7% before. Meanwhile, annual headline inflation rose to 4.07% in July from 3.75% in June, in line with its expected trajectory. We think this increase is transitory and expect annual inflation to close 2014 at 3.7%, falling to around 3% in early 2015, once the effects of the rise in taxes this year vanish. Thus, we reiterate our call for Banxico to remain on hold, keeping its reference rate at 3.0%, until mid-2015. President Peña Nieto signed the bylaws of the energy reform and implementation began in earnest, with earlier announcements of result for round zero (i.e., the field Pemex will keep) and the fields to be considered for round one. We now expect the allocation of fields to private companies to begin in May 2015. While implementation of this ground-breaking reform is going to involve challenges, we think it can have a transformational effect on the economy and our mid-term outlook has now a clear positive bias.

Figure 39. Brazil and Mexico — Economic Forecasts, 2013-2015F

		Brazil			Mexico		
		2013	2014F	2015F	2013	2014F	2015F
Real GDP	YoY	2.5	0.5	1.0	1.1	2.6	3.9
Final Domestic Demand	YoY	2.9	0.8	1.4	1.4	2.5	4.2
Private Consumption	YoY	2.6	1.4	1.9	2.5	2.4	3.7
Fixed Investment	YoY	5.2	-4.2	1.1	-1.8	2.7	6.9
Exports	YoY	2.5	1.5	6.8	1.2	6.9	8.1
Imports	YoY	8.3	2.6	4.4	1.5	5.1	7.6
CPI	YoY	6.2	6.3	6.4	3.8	3.9	3.4
Unemployment Rate	%	5.5	5.8	5.9	5.0	4.8	4.5
Current Account	US\$ bn	-81.1	-81.9	-84.4	-25.7	-22.8	-24.8
	% of GDP	-3.7	-3.7	-3.8	-2.0	-1.7	-1.7
Fiscal Balance	% of GDP	-3.3	-4.4	-3.5	-2.3	-3.5	-3.0
US Dollar Exchange Rate	Average	2.16	2.29	2.52	12.76	13.02	13.01

Source: Citi Research

## Argentina

[Guillermo Mondino](#)

The grace period came and went and Argentina entered default. We believe that the initial consequences of a default should be relatively mild; that, in economic terms, the missed payment will not be a “discrete” event (or shock) but, rather, a process that builds gradually. If the default is cured quickly, the consequences should be relatively limited. However, a default longer than just a few weeks is likely to have growing consequences on Argentina's fragile macroeconomic variables. Despite the fact that the bonds in question may be mostly held by foreign investors and the relative robustness of the local financial sector's exposure to the sovereign, fragile macroeconomic fundamentals provide conditions where deteriorating expectations could add pressure to the FX, balance of payment, inflation and activity side of the economy. In particular, the large public debt payments in 2015 and deteriorating fiscal accounts make fresh external financing necessary to prevent macroeconomic variables from deteriorating further. In the absence of additional financing, the authorities will need to increase the pace of crawl of the ARS in the official FX market, tighten FX controls further and eventually (although they seem reluctant to) increase interest rates.

## Venezuela

[Munir Jalil](#)

The Venezuelan economy continues to suffer from low levels of production and imports, which translate into low availability of goods and high inflation. Unfortunately data on activity and inflation is not being published despite the fact it is still being produced, which can only be interpreted as a sign that the numbers are poor. The implementation of the alternative FX market (known as SICAD II) has not provided the relief the government expected. Therefore, we will likely hear about further changes to the FX system in the following months. Although there is a lot of speculation regarding what the new FX system will look like, our view is that the country will switch from a three-tier system to a two-tier one, which means that the 6.3 exchange rate will disappear and that the SICAD I and SICAD II rates will remain. In addition, we believe before this change is implemented the government will announce increases in gasoline prices as well as utilities, and will also implement the unification of all available USD funds in the central bank's international reserves. The latter will help to provide an answer to the old question of how much of the assets available in the special funds are liquid.

Figure 40. Argentina and Venezuela — Economic Forecasts, 2013-2015F

		Argentina			Venezuela		
		2013	2014F	2015F	2013	2014F	2015F
Real GDP	YoY	2.9	0.0	1.0	1.3	-1.0	1.9
Final Domestic Demand	YoY	4.2	-0.2	1.2	-0.3	-1.1	0.7
Private Consumption	YoY	4.3	0.1	1.4	3.7	0.1	0.3
Fixed Investment	YoY	3.0	-2.5	-0.3	-3.5	-3.5	0.9
Exports	YoY	-3.8	-2.0	-1.5	-3.8	1.3	4.2
Imports	YoY	1.9	-2.5	0.0	-4.6	-0.7	-1.0
CPI	YoY	10.6	-	29.8	38.5	61.7	82.5
Unemployment Rate	%	7.1	7.7	8.2	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	-1.0	-1.1	3.3	4.1	5.1
Fiscal Balance	% of GDP	-1.9	-2.4	-2.6	-11.9	-11.2	-10.3
US Dollar Exchange Rate	Average	5.45	8.38	11.15	5.99	9.15	19.80

Sources: Haver Analytics and Citi Research forecasts

## Saudi Arabia

[Farouk Soussa](#)

As the advance of ISIS in Iraq poses a theoretical (but small) risk of disruption in global oil supplies, the focus has turned to 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 14-15% 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](#)

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

		Saudi Arabia			United Arab Emirates		
		2013	2014F	2015F	2013	2014F	2015F
Real GDP	YoY	4.0	4.8	5.9	5.2	4.0	4.0
Final Domestic Demand	YoY	0.9	8.0	8.1	9.7	4.7	4.7
Private Consumption	YoY	-0.8	5.0	5.0	11.7	5.0	5.0
Fixed Investment	YoY	-1.0	10.0	10.0	7.3	5.0	5.0
Exports	YoY	-9.3	1.4	-2.4	5.7	13.0	14.0
Imports	YoY	-0.4	15.0	15.0	10.5	15.0	15.0
CPI	YoY	3.5	3.5	4.1	1.1	2.0	2.4
Current Account	US\$ bn	133.6	113.9	70.9	114.1	102.2	88.3
	% of GDP	17.9	14.4	8.5	28.4	23.7	19.1
Fiscal Balance	% of GDP	8.7	4.7	-0.1	NA	NA	N
US Dollar Exchange Rate	Average	3.75	3.75	3.75	3.67	3.67	3.67

Source: Citi Research

## Egypt

[David Cowan](#)

Following his May election victory, the new president Abdelfattah el Sisi will now focus his attention on three issues: improving the security situation; consolidating his power base prior to the parliamentary elections; and putting 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: ongoing Gulf support helping to part-fund a big push in capital spending, 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. The recent decisions to reduce subsidies is likely to significantly boost inflation in July and it is likely to remain in double digits until well into 2015, despite the pre-emptive 100 basis point hike by the Central Bank of Egypt of the overnight lending and deposit rates. These hikes highlight the difficult policy choices facing the country

## South Africa

[Gina Schoeman](#)

We downgrade our 2014 GDP forecast to 1.7% from a previous expectation of 2.0%, reflecting the July manufacturing strike and weaker consumption activity. Although the manufacturing strike (and the H1 platinum strike) has now ended, production through the various supply chains has deteriorated more than expected, which has also hit exports. This means the near-term current account deficit is also at risk. Following the negative Q1 GDP print of -0.6% QoQ SAAR — which sparked concern of a technical recession — high-frequency data suggests that Q2 GDP will settle at a shallow growth rate of 0.8% QoQ SAAR. Poor economic growth prospects, coupled with above-6% inflation makes for tricky monetary policy decisions however, with CPI peaking in June, we now expect no further rate hikes in 2014. This would mean a total 2014 rate hike cycle of 75bp. We continue to believe that the SARB is intent on policy rate normalization however, which is why we still look for the rate hiking cycle to recommence in mid-2015 alongside Fed hiking. With October's Medium-Term Budget looming, we expect some hints of measures to lift tax revenues, with indication that the VAT rate could rise.

Figure 42. 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	5.5	6.0	6.4	1.9	1.7	2.8
Final Domestic Demand	YoY	2.5	3.0	3.5	NA	NA	NA	2.9	2.4	3.0
Private Consumption	YoY	3.7	2.0	2.6	NA	NA	NA	2.6	2.1	3.0
Fixed Investment	YoY	2.1	1.6	9.9	NA	NA	NA	4.7	3.7	3.9
Exports	YoY	-6.3	2.2	5.6	NA	NA	NA	4.2	5.1	6.2
Imports	YoY	-3.4	4.7	7.2	NA	NA	NA	4.7	4.1	6.9
CPI	YoY	9.5	10.6	10.4	8.5	8.7	10.7	5.8	6.3	5.7
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	20.1	5.6	8.2	-20.4	-18.0	-18.4
	% of GDP	-1.3	-2.4	-2.1	3.9	1.0	1.3	-5.8	-5.3	-5.0
Fiscal Balance	% of GDP	-13.7	-11.7	-9.6	-1.6	-2.0	-1.8	-4.1	-4.1	-4.1
US Dollar Exchange Rate	Average	6.87	7.09	7.32	159.2	163.32	167.42	9.65	10.68	11.01

Source: Citi Research



Figure 43. 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
<b>Asia</b>	<b>6.3</b>	<b>6.3</b>	<b>6.3</b>	<b>3.7</b>	<b>3.3</b>	<b>3.4</b>	<b>2.2</b>	<b>2.2</b>	<b>2.0</b>	<b>-2.3</b>	<b>-2.4</b>	<b>-2.2</b>
China	7.7	7.5	7.1	2.6	2.3	2.6	2.0	2.0	2.0	-1.9	-2.1	-2.0
Hong Kong	2.9	2.6	3.3	4.3	3.8	3.5	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	5.1	5.2	6.4	6.5	6.7	-3.3	-3.0	-2.6	-2.2	-2.4	-2.2
Korea	3.0	3.9	4.0	1.3	1.9	2.9	6.1	4.9	3.1	1.0	0.9	1.5
Malaysia	4.7	5.7	5.6	2.1	3.1	4.0	4.0		5.8	-3.9	-3.5	-3.0
Mongolia	11.7	10.0	9.0	10.5	13.8	12.0	-30.9	-14.1	-18.6	-7.8	-7.6	-4.5
Philippines	7.2	5.5	7.2	2.9	4.4	4.0	3.5	3.6	3.4	-1.4	-1.8	-1.6
Singapore	3.9	3.1	3.2	2.4	1.2	1.0	18.3	18.0	18.0	1.1	-0.3	0.2
Sri Lanka	7.3	7.4	7.4	6.9	4.5	6.2	-3.9	-3.3	-3.1	-5.9	-5.6	-5.3
Taiwan	2.1	3.6	4.0	0.8	1.5	2.0	11.8	11.0	10.2	-1.3	-1.4	-0.8
Thailand	2.9	1.1	4.0	2.2	2.2	2.1	-0.6	5.3	4.1	-1.8	-1.2	-1.8
Vietnam	5.4	5.4	5.7	6.6	4.9	6.0	5.6	5.1	4.1	-5.6	-6.4	-6.0
<b>Latin America</b>	<b>2.6</b>	<b>1.5</b>	<b>2.5</b>	<b>7.3</b>	<b>9.1</b>	<b>10.1</b>	<b>-2.6</b>	<b>-2.6</b>	<b>-2.6</b>	<b>-3.2</b>	<b>-3.9</b>	<b>-3.4</b>
Argentina	2.9	0.0	1.0	10.6	NA	29.8	-0.7	-1.0	-1.1	-1.9	-2.4	-2.6
Brazil	2.5	0.5	1.0	6.2	6.3	6.4	-3.7	-3.7	-3.8	-3.3	-4.4	-3.5
Chile	4.1	3.0	4.0	1.9	4.0	3.0	-3.4	-2.6	-4.0	-0.3	-0.4	-0.3
Colombia	4.7	5.0	5.5	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	2.6	3.9	3.8	3.9	3.4	-2.0	-1.7	-1.7	-2.3	-3.5	-3.0
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	4.0	5.3	2.8	3.2	2.5	-4.4	-6.2	-3.9	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
<b>Europe</b>	<b>2.0</b>	<b>1.7</b>	<b>2.9</b>	<b>5.3</b>	<b>5.7</b>	<b>5.0</b>	<b>-1.3</b>	<b>0.0</b>	<b>-0.6</b>	<b>-2.2</b>	<b>-2.4</b>	<b>-3.6</b>
Bulgaria	0.9	1.3	2.5	0.9	-0.8	2.2	1.9	-0.2	-1.0	-1.5	-2.5	-1.2
Croatia	-0.9	-0.5	1.2	2.2	0.1	2.7	0.9	0.5	-0.5	-4.9	-5.0	-3.5
Czech Republic	-0.9	2.4	2.5	1.4	0.4	1.4	-1.4	1.3	1.5	-1.5	-2.0	-2.4
Hungary	1.1	2.9	1.9	1.7	0.2	2.1	3.0	3.6	3.1	-2.2	-2.9	-2.9
Kazakhstan	5.9	5.0	6.0	5.7	6.5	6.0	-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	-2.8	-4.3	5.2	-2.7
Romania	3.5	3.0	3.4	4.0	1.5	3.2	-1.1	-2.5	-4.2	-2.5	-2.3	-2.3
Russia	1.3	0.7	2.3	6.8	7.0	5.6	1.5	2.7	1.9	-2.1	-4.4	-4.9
Serbia	2.5	-0.5	2.3	7.9	2.8	6.2	-4.9	-5.3	-5.5	-5.7	-6.5	-6.5
Slovakia	0.9	2.3	2.7	1.4	0.0	1.0	2.1	1.4	2.2	-2.8	-3.0	-2.8
Turkey	4.0	3.5	3.5	7.5	8.8	7.4	-7.9	-5.4	-5.5	-1.2	-2.8	-3.2
Ukraine	0.0	-5.5	2.1	-0.3	9.9	9.5	-9.3	-4.9	-3.2	-6.7	-4.3	-3.4
<b>Africa/Mideast</b>	<b>3.9</b>	<b>4.5</b>	<b>5.1</b>	<b>4.2</b>	<b>4.5</b>	<b>5.1</b>	<b>11.3</b>	<b>9.7</b>	<b>7.5</b>	<b>1.5</b>	<b>0.7</b>	<b>-1.0</b>
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	10.6	10.4	-1.3	-2.4	-2.1	-13.7	-11.7	-9.6
Ghana	7.1	5.1	4.0	11.7	15.3	11.1	-11.5	-13.6	-15.5	-9.0	-8.7	-8.0
Iraq	2.4	10.3	11.5	1.9	2.5	5.0	13.9	14.2	13.2	-5.8	-2.3	-1.2
Israel	3.2	2.9	3.0	1.5	0.8	0.8	2.0	1.9	1.7	-2.7	-3.0	-2.5
Jordan	2.8	4.0	4.5	5.5	3.5	5.0	-10.0	-8.9	-6.7	-5.5	-9.6	-9.4
Kenya	4.7	5.3	5.8	5.7	7.1	6.9	-9.0	-7.6	-7.5	-7.8	-6.5	-6.7
Kuwait	5.7	3.8	3.9	2.6	3.0	4.0	39.0	41.4	39.2	30.3	33.8	27.8
Lebanon	1.4	1.1	1.5	2.1	3.5	5.0	-15.8	-15.8	-15.7	-9.3	-9.9	-10.4
Nigeria	5.5	6.0	6.4	8.5	8.7	10.7	3.9	1.0	1.3	-1.6	-2.0	-1.8
Oman	3.4	4.7	4.7	2.1	1.5	3.0	6.1	8.4	6.5	0.8	-0.5	-2.8
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	4.0	4.8	5.9	3.5	3.5	4.1	17.9	14.4	8.5	8.7	4.7	-0.1
South Africa	1.9	1.7	2.8	5.8	6.3	5.7	-5.8	-5.3	-5.0	-4.1	-4.1	-4.1
Tanzania	7.0	7.1	7.2	7.9	6.6	6.1	-10.2	-13.9	-12.9	-6.0	-6.4	-6.5
UAE	5.2	4.0	4.0	1.1	2.0	2.4	28.4	23.7	19.1	NA	NA	NA
Uganda	5.8	6.1	6.5	5.5	4.5	5.0	-8.2	-9.5	-10.1	-4.5	-5.5	-6.0
Zambia	6.2	6.2	6.3	7.0	7.8	8.0	0.2	-1.0	-1.5	-6.5	-5.8	-5.5
<b>Total</b>	<b>4.6</b>	<b>4.4</b>	<b>5.0</b>	<b>4.7</b>	<b>4.9</b>	<b>5.0</b>	<b>1.8</b>	<b>1.9</b>	<b>1.5</b>	<b>-2.1</b>	<b>-2.4</b>	<b>-2.5</b>

Source: Citi Research

## Sovereign Ratings

[Michael Saunders](#)

[Peter Goves](#)

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

Country	S&P Ratings				Moody's Ratings			
	Current Rating	Current Outlook	Citi Near Term (Up to 9 Mths) Forecast Rating	Citi Long Term (Next 2-4 Years) Forecast Rating & Outlook	Current Rating	Current Outlook	Citi Near Term (Up to 9 Mths) Forecast Rating	Citi Long Term (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 (Stable)	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-	Caa1	Stable	Caa1 (Stable)	Caa1
Ireland	A-	Pos	A- (Pos)	A+ ↑↑	Baa1	Stable	Baa1 (Pos)	A2 ↑↑
Netherlands	AA+	Stable	AA+ (Stable)	AA+	Aaa	Stable	Aaa (Stable)	Aaa
Portugal	BB	Stable	BB (Pos)	BB+ ↑	Ba1	Stable	Ba1 (Stable)	Baa3 ↑
UK	AAA	Stable	AAA (Stable)	AAA	Aa1	Stable	Aaa (Stable) ↑	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

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](#)

[Peter Goves](#)

## Expected Ratings Issues

Since we last published, there has been one further upgrade within the EMU periphery. Moody's upgraded Greece by two notches on 1 August from Caa3 to Caa1 ([Euro Rates Strategy - Greece upgraded by Moody's by two notches to Caa1](#)). This upgrade was based on three key drivers: Greece's fiscal performance, improvements in Greece's economic outlook and structural changes in the sovereign's debt profile. This continues the rather positive rating trend by Moody's seen already in 2014, given the upgrades of Spain (Baa2), Ireland (Baa1) and Portugal (Ba1).

Figure 45. Upcoming Rating Calendar

Date	Sovereign	Rating Agency	Current Rating	Current Outlook
5-Sep	Portugal	Moody's	Ba1	Stable
12-Sep	Greece	S&P	B-	Stable
12-Sep	Ireland	Moody's	Baa1	Stable
19-Sep	France	Moody's	Aa1	Neg
26-Sep	Austria	S&P	AA+	Stable
26-Sep	EFSF	Moody's	Aa1	Stable
26-Sep	Lux	S&P	AAA	Stable

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

**Moody's on Portugal:** Moody's upgraded Portugal by one-notch from Ba2 to Ba1 stable in July citing an improved fiscal condition, its exit from the external support programme, its return to public debt markets and its comfortable liquidity position. Note that this was an "unscheduled" move in the sense that this rating action was not listed on its formal sovereign ratings calendar but was rather necessitated by the conclusion of its "review for upgrade" initiated on 9 May (Portugal was on "positive watch by Moody's". Of recent interest, also note that Moody's had already stated that problems at Banco Espírito Santo are *"unlikely to jeopardize Portugal's improving fundamentals"* (Moody's Announcement 11 July). We expect Portugal to remain Ba1 stable by Moody's over the medium term.

**S&P on Greece:** S&P affirmed its B- stable rating of Greece earlier in March. We expect no change on 12 September when it next features in S&P's calendar.

**Moody's on Ireland:** Moody's last comment on Ireland was to note that *"recovery gains traction, but high non-performing loan levels, muted credit availability and high levels of indebtedness will temper growth"*. Having made several upgrades of Ireland this year (from Ba1 in January), we expect further upgrades from both Moody's and S&P in the longer term, especially in light of the better growth outlook.

**Moody's on France — how might Moody's alter its outlook?** On 8th November 2013, S&P assigned a stable outlook to France's AA rating, leaving Moody's as the last of the main rating agencies to have France with a negative outlook (assigned on 19 November 2012). Since we last published, the French economy failed to grow in Q2 and Moody's has stated that it expects France to miss its 2014 budget target of 3.8% of GDP (a credit negative). Specifically, Moody's noted that the contraction in investment spending was *"a particularly negative development for France's future growth potential"*. Although risks have increased to the contrary, on balance we continue to believe Moody's will keep France at Aa1 and restore the outlook back to stable ([France: More Reforms to Jump Start Confidence?](#)).

**S&P on Austria:** We expect no change in Moody's assessment of Austria later in September which has rated the sovereign Aaa with a stable outlook since February.

**S&P on Luxembourg:** We expect no change in S&P's stable AAA rating of Luxembourg.

## Yield and Spread Forecast Commentary

### [Amitabh Arora](#)

**US:** Treasury yields started August on their highs after the strong 2Q GDP figure (4.0% QoQ), and fell gradually over the month. The rally was further fuelled by the uptick in the jobless rate, the authorization of US airstrikes in Iraq and the recent escalation of tensions in Ukraine. These rallies are part of a general lowering in yields and flattening of the curve over the course of the year, which we believe is partly due to the ongoing monetary easing in Europe. We are lowering our 5, 10, and 30y forecasts through 1Q 2015 to reflect the strong possibility of further easing by the ECB.

### [Alessandro Tentori](#)

**Core Europe:** A further, unanticipated deterioration of Eurozone fundamentals has significantly increased the probability of the ECB having to ease through QE by yearend. Given the current level and trend in CPI inflation, we think it will not take too long before the market puts Mr Draghi under pressure on the concept of “price stability”, thus questioning (again) whether the Eurozone is really so different from Japan as the ECB thinks. Our view on “Japanisation” has always been that eventually this is where the Eurozone was heading. There still is some uncertainty with regards to the timing of this scenario, though. Taking into account both the intensification of geo-political risks as well as Mr Carney’s reduced conviction about an “early hike”, we have lowered the year end Bund forecast to an unprecedented 0.75%, followed by a rebound to 1% in Q1-15, which is a reaction we have observed in other episodes of QE. From there, we expect Bunds to reach 1.50% by Q3-15, a more justified fundamental yield level in our mind.

### [Peter Goves](#)

**EMU Periphery:** We forecast ongoing spread compression for the periphery markets of Greece, Portugal, Italy and Spain compared to Germany, largely as a function of QE forecast. Moreover, we see scope for Spain to outperform further. Spain is benefiting from an improved growth environment which should enhance fundamental credit metrics — and we believe there are rising prospects for Spain to be rated higher than Italy over the medium term. Together with recent market behaviour (whereby Spain has been outperforming in both sell offs and rallies), we look for 10yr Bono spreads to Bunds to average 75bp in Q4 and would not fade the rally vs Italy. We target a 10yr Bono-BTP spread of -35bp in Q4.

### [Jamie Searle](#)

**UK:** Citi now expects the first rate hike in February 2015, rather than November 2014 previously, following the BoE’s reassessment of the supply-side of the economy. The hiking cycle is also now more likely to be back-loaded than front-loaded. This has prompted us to revise down our front-end yield forecasts. However, we have also revised down our long-end yield forecasts. This is more a reflection of our lower Bund yield forecasts to reflect a higher probability of full-blown QE. The net result is that we still expect gilt curves (2s5s, 2s10s, 10s-30s) to flatten sharply. We expect the 10yr gilt-Bund spread will widen to 175bp by year-end. A rally in Bunds below 1% is also likely to have a greater impact on gilts than Treasuries. The 10yr gilt-UST spread may spend some time in negative territory.

### [Takeki Fukushima](#)

**Japan:** 10y JGB yield easily broke the resistance at 50bp and it is likely to hover around that level until it becomes clear whether CPI will rebound in Q4 or turns out to have already peaked in April. The weak Q2 GDP figure and its details suggest a diverging from the BoJ’s bullish scenario and markets may price in capitulation by the BoJ before checking the likely rebound in Q3. On the other hand, JGB yields are likely to somehow catch up with US yields through arbitrage. Given that volatility is likely to remain compressed by the BoJ operation (including 10bp 4year fixed rate funding) as well as due to gamma supply for yield enhancement, it will be difficult for domestic factors to lift the 10y JGB yield above 1%.

Figure 46. Interest Rate and Bond Market Forecasts as of 20 August 2014

		Quarterly Average (Unless Specified)					
	Current	4Q 14	1Q 15F	2Q 15F	3Q 15F	4Q 15F	1Q 16F
US							
Policy Rate (Fed Funds) End Quarter	0.25	0.25	0.25	0.25	0.75	1.00	1.25
3-Month Libor	0.23	0.23	0.35	0.65	0.85	1.05	1.30
2 Year Treasury Yield	0.42	0.85	1.10	1.30	1.55	1.75	1.95
5 Year Treasury Yield	1.56	2.00	2.25	2.45	2.60	2.70	2.80
10 Year Treasury Yield	2.40	2.70	2.90	3.05	3.15	3.20	3.25
30 Year Treasury Yield	3.15	3.30	3.40	3.50	3.60	3.60	3.65
2-10 Year Treasury Curve	198	185	180	175	160	145	130
2 Year Swap Spread (Swap Less Govt), bp	23	16.5	15	15	15	15	15
10 Year Swap Spread (Swap Less Govt), bp	15	15	15	15	15	15	15
30 Year Swap Spread (Swap Less Govt), bp	-3	-5	-5	-5	-5	-5	-5
30 Year Mortgage Yield	4.12	4.60	4.8	4.9	5.05	5.15	5.25
10 Year Breakeven Inflation	223	230	235	235	235	235	235
Euro Area							
Policy Rate End Quarter	0.15	0.15	0.15	0.15	0.15	0.15	0.15
Overnight Rate (EONIA)	0.01	0.05	0.00	0.00	0.00	0.00	0.00
3-Month (EURIBOR)	0.15	0.15	0.15	0.15	0.15	0.15	0.15
2 Year Schatz Yield	-0.01	0.05	0.05	0.05	0.05	0.05	0.05
5 Year Bobl Yield	0.22	0.15	0.20	0.35	0.50	0.50	0.60
10 Year Bund Yield	1.00	0.75	1.00	1.25	1.50	1.50	1.75
30 Year Bund Yield	1.87	1.60	1.90	2.15	2.40	2.40	2.65
2-10 Year Bund Curve	99	70	95	120	145	145	170
10 Year BTP-Bund Spread	150	110	100	100	100	100	100
10 Year Bono-Bund Spread	132	75	65	65	65	65	65
2 Year BTP-Schatz Spread	32	25	25	25	25	25	25
2 Year Bono Schatz Spread	22	15	15	15	15	15	15
10 Year OAT-Bund Spread	38	30	30	30	30	30	30
10 Year Swap Spread (Swap Less Govt.), bp	23	25	20	20	20	20	20
10 Year Breakeven Inflation	118	135	140	140	145	145	145
5y5y Implied Vol	72	72	70	70	70	70	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	0.08	0.10	0.10	0.10	0.10	0.10	0.10
5 Year Treasury Yield	0.15	0.15	0.20	0.20	0.25	0.20	0.25
10 Year Treasury Yield	0.51	0.50	0.70	0.80	0.85	0.75	0.85
30 Year Treasury Yield	1.66	1.65	1.75	1.80	1.80	1.75	1.80
2-10 Year Treasury Curve	43	40	60	70	75	65	75
2 Year Swap Spread (Swap Less Govt.), bp	10	8	8	11	12	10	12
10 Year Swap Spread (Swap Less Govt.), bp	13	10	15	15	18	15	18
10 Year Breakeven Inflation	123	95	105	110	110	105	105
UK							
Policy Rate End Quarter	0.50	0.50	0.75	1.00	1.25	1.75	2.00
3-Month Libor	0.56	0.55	1.00	1.25	1.55	1.80	2.05
2 Year Treasury Yield	0.72	1.15	1.60	1.90	2.20	2.40	2.45
5 Year Treasury Yield	1.83	2.00	2.30	2.50	2.75	2.85	2.90
10 Year Treasury Yield	2.40	2.50	2.80	3.00	3.20	3.25	3.30
30 Year Treasury Yield	3.11	3.10	3.25	3.40	3.55	3.55	3.60
2-10 Year Treasury Curve	168	135	120	110	100	85	85
10 Year Swap Spread (Swap Less Govt.), bp	13	12	15	20	20	25	25
10 Year Breakeven Inflation	296	305	310	315	325	330	340
Australia							
Policy Rate End Quarter	2.50	2.50	2.50	2.75	3.00	3.25	3.25
3-Month Libor	2.65	2.75	2.80	3.10	3.25	3.50	3.50
2 Year Treasury Yield	2.57	2.55	2.90	3.30	3.60	4.05	4.20
5 Year Treasury Yield	2.98	3.40	3.70	4.05	4.30	4.70	4.85
10 Year Treasury Yield	3.43	3.80	4.00	4.25	4.40	4.55	4.65
2-10 Year Treasury Curve	86	125	110	95	80	50	45
10 Year Swap Spread (Swap Less Govt.), bp	39	40	40	45	45	50	50

Source: Citi Research

## Commodities Market Outlook

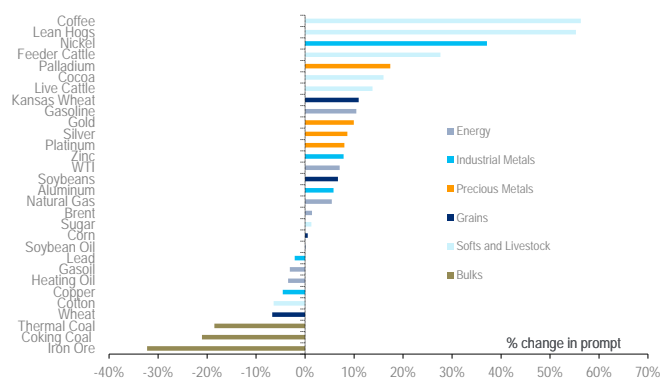
[Edward L Morse](#)

[Aakash Doshi](#)

With few exceptions, commodities have given up year-to-date gains midway through Q3. Most of the bearish turn-of-events has stemmed from weakening fundamentals, predictable across the grains and unpredictable across the energy spectrum, where ample supplies are meeting lower growth-induced weak demand and larger inventories. Market weakness seems also to have been exaggerated by flows out of commodities, especially the flushing out of speculative length in highly liquid crude oil as geopolitical risks seemed to have been overwhelmed by unexpectedly bearish fundamentals.

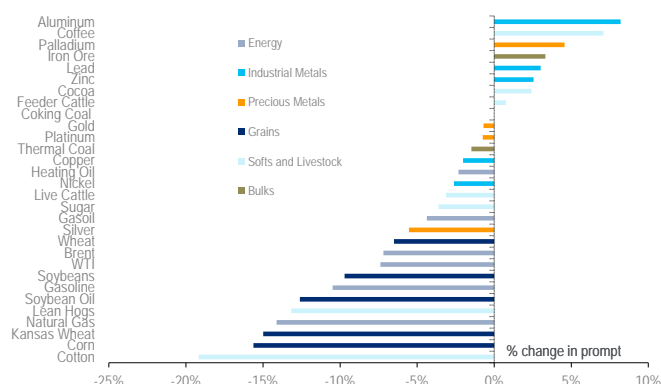
Citi's short-term outlook into the end of Q3 is bearish. But looser credit in China and winter weather should point to tighter metals and energy markets come winter, just as end of monsoon season should see robust imports of thermal coal into India. As is always the case, on their own or working together, geopolitics and a very cold winter would induce higher prices, given the way commodities tend to react to tail risk events.

Figure 47. Nominal Commodity Price Change — 1H 2014



Source: Bloomberg, Citi Research

Figure 48. Nominal Commodity Price Change — 3Q 2014-to-date\*



Source: Bloomberg, Citi Research, \*through mid-August

## Energy

### Petroleum

Citi had forecast Brent to average \$111 in 3Q, slightly higher than the average \$110 price in Q1'11. So far Brent has averaged around \$107 and looks likely to weaken further into September and October, with the tapering of summer transportation fuel demand and the start of fall refinery maintenance.

The tight market that many expected in Q3 has failed to materialize as a well-supplied Atlantic Basin crude market, rising European crude stocks and a shedding of financial speculative length have pushed Brent to a YTD low of ~\$103/bbl. Refinery demand has been particularly weak and with Libyan exports picking up from their Q2 lows and Iraq's Basrah exports remaining robust amidst rising domestic tensions, the Atlantic Basin is suffering from an overhang of crude. This has seen barrels head into storage in Europe as July crude stocks rose 14-m bbls m/m to 380-m bbls and are 15-m bbls higher on a y/y basis. It has also cleared out a lot of speculative length in the market that had been long timespreads in 2H'14, with managed money net length down 60% since June while open interest is down 17%. The weakness has been contained to the front however, with the back

remaining supported by consumer hedging activity and increased uncertainty of long-term Iraqi and Russian oil production growth prospects.

The market remains cautious and rightly so, and will likely need strong signals to get long again. There are some green shoots potentially developing with a narrow Brent-Dubai, Urals in the Med at a premium and refinery margins firming as gasoil cracks strengthen. Prices can grind higher in Q3 as a result, with Asian runs needed to clear-up the Atlantic Basin crude market but the underlying theme of sub-par oil demand and continuing North American supply growth are starting to overbear the long list of supply outages. The current weakness in the prompt is coming with geopolitical tensions running high in Iraq, Ukraine, Libya, Iran, Syria and Gaza suggesting the balance is shifting from supportive geopolitics to soft fundamentals.

Meanwhile, WTI crude prices remain discounted to Brent, as fast-growing US oil production bumps up against restrictive US crude oil export policy. The adjustments to this new supply have rippled through North America, incentivizing high refinery utilization to produce petroleum products that have been exported, new pipelines and rail capacity to carry production from inland areas to the coastal regions, and the backing out of similar-quality imports from West Africa.

With most of the light sweet crude imports backed out of the US (by US shale oil, which is light sweet in quality), other crude imports are harder to push out. These are from base load suppliers like Saudi Arabia, Mexico, and Venezuela, who export heavier, sourer crudes. Since US Gulf Coast refineries prefer to run such crudes, which tend to be cheaper, US light sweet crude prices need to fall even further versus heavy crude prices in order to incentivize refinery switching to use lighter crudes, even at the expense of deteriorating crude run rates and product yields. And even as this happens, Canadian heavy crudes are increasingly making their way down to the Gulf Coast on new pipelines and growing crude-by-rail capacity in 4Q'14, meaning direct heavy-on-heavy crude oil competition with such suppliers. As has already begun to some extent, these oil exporting countries should continue to divert volumes away from the Gulf Coast to other parts of the US, or other regions globally, and/or face steeper and steeper price discounts.

Without fast-enough growth in crude oil export outlets, this is the bearish direction that WTI crude prices are headed in. While the few summer weeks remaining could yet see some support for WTI (in terms of forward curve structure, which is in steep backwardation due to low inventories at Cushing, Oklahoma, which have drawn down with the introduction of new pipelines to the Gulf Coast), the autumn sees seasonal refinery maintenance kick-in — with some 1-m b/d offline on the US Gulf Coast in October — which should mean Texas and Louisiana crude oil inventories again rise substantially as they did in the spring. This surplus weight can extend into 2015, even as crude exports rise towards 1-m b/d, as is Citi's view (see ["Mind the Gulf"](#)), pushing barrels back up into Cushing and the US midcontinent from an increasingly glutted Gulf Coast region. Thus, WTI looks to remain well discounted to Brent going forward, unless crude export legislation is more widely eased.

## Natural Gas

Is the market now showing sharp growing pains, ushering in the Golden Age of Gas? The industry looks to be demonstrating how prolific gas production in North America could be by continuing to raise production despite very low regional prices — often nearly a half or less vs. the benchmark US Henry Hub. Such strong production and mild weather have driven US prices lower. Looking ahead, stronger weather-normalized demand could be sustained as coal burn falls, either due to the



end of seasonal operation or outright retirement; some regulated utilities also plan to shift to more gas-fired generation away from coal. But the continued strength of Marcellus/Utica gas production in the US Northeast, now reaching 16-Bcf/d, and a return of mild weather are headwinds to this price stabilization.

Meanwhile, European gas prices have not been able to edge higher despite the tension in Ukraine, as gas inventories remain high. Hot weather in Asia has helped raise LNG (JKM) prices from the low-\$10 to nearly \$11, but this is still far from the \$15 range seen in the past couple of years. But LNG prices should rise later in the year as demand in Asia, which lacks storage facilities, increases in winter. If the Ukrainian tension lingers and Russia's gas supply to Europe is disrupted, the call for LNG in Europe would climb, pushing LNG prices even higher than now.

## Industrials

### Base metals

The rally that began in June for many of the base metals ran into significant macro-economic turbulence in mid-August, as weak European growth most notably in Germany, plus a sharp contraction in Chinese lending in July, prompted a surge in profit-taking on long positions built over the preceding month and a half. While we have to be careful in reading too much into weaker data over the summer months, we believe the mid-August corrections are taking some over the CTA-driven froth from pricing levels.

Accelerating Chinese aluminium primary and product output in July, the latter up 24% y/y, points to further strong pickups in aluminium product exports in the coming months. Indeed, it is notable that Chinese unwrought aluminium and aluminium product exports for July jumped by 22.6% y/y to the third highest level on record, and we expect similar y/y export growth levels over much of the remainder of the year. Chinese product exports we believe will continue to counter Western world aluminium market tightness. Rising zinc inventory in LME sheds in New Orleans, up over 80,000 MT since the end of July, plus strong growth in Chinese refined zinc production in July, up 13.5% y/y, are effectively countering market beliefs that the zinc market is in deficit this year. Citi continues to project modest surpluses in the global zinc market this year, on weak Chinese demand growth due to the sharp deceleration in construction activity seen in the year-to-date, combined with our expectation of a continuation in the pick-up in Chinese refined production, pointing to further downside price moves over the remainder of this month.

Nickel prices continue to hold above the key \$18,500/MT level despite LME inventory continuing to tick upwards, now at over 320,000 MT. Firm commitments to the ore export ban by the incoming Indonesian Vice President, and the current Chief Economics Minister, have clearly provided support to the market during August. However, we expect prices to remain relatively range-bound until September, with strong upside moves not likely until into Q4; we expect a pick-up in the LME warrant cancellations to be the precursor to such moves.

### Precious metals

Gold has found support from continued geopolitical tensions in Ukraine and the Middle East, whilst macro sentiment towards gold received a boost from weaker than expected US employment data for the week ending August 9<sup>th</sup> and saw the prospect of sooner rather than later interest rate hikes diminish. Indeed, the gold market appears to have largely ignored the 16% y/y drop in Q2 physical gold demand due to a continued lack of appetite for physical purchases in the key

Chinese and Indian markets. In Q3-to-date, Comex spot gold prices have averaged \$1,309/oz., but we continue to forecast that prices during the quarter as a whole will average \$1,300/oz., on the expectation that levels will gently drift lower as geopolitical tension support slowly wanes.

### **Bulk commodities**

Bulk prices are expected to improve across the board in September. The most pronounced rally is expected for thermal coal as Indian exports are expected to rise significantly and Chinese imports should recover. In India, inventories are the lowest for this time of year since at least 2008 and power plants with less than 7 days of inventory are near historic peak levels. Moreover, monsoon rainfall as of writing was down -17.5% compared to normal levels, which is expected to reduce hydro generation and increase demand for agricultural pumps. In China, Shenhua's announcement of planned 50 Mt production and 60 Mt sales cuts, along with smaller indications from other miners has improved sentiment. More significantly, improving industrial activity should lead to a demand recovery.

The European market has moved earlier over fears that geopolitical tensions will impact supply, but we think it unlikely there will be a material impact in the near term. Met coal prices are also expected to rise on improved Chinese steel demand and growing production curtailments in China, Australia, and North America (including recent announcements from Peabody and Alpha Natural Resources). Iron ore prices may take somewhat longer to edge higher, and even then we expect the upside to be limited, maintaining our \$100 price target for Q4.

### **Agriculture**

Staple grain prices have collapsed another 10-15% this quarter and might head lower still during the Northern Hemisphere harvest in 4Q'14 due to lack of storage capacity and relatively stable demand trends. The question is no longer about whether key producers are likely to reap a bumper crop but rather how heavy inventories could build during the 2014/15 season. The United States is the preeminent global farmer and is poised to harvest a record corn crop of 365.8-mn tons (+3.5% y/y) and an all-time high for soybeans at 104.5-mn tons (+17% y/y). China—the second largest worldwide producer and user of corn—is also forecast to harvest its own record maize crop of 220-mn tons just as it has pushed out US imports since December 2013 due to GMO-related trade issues. The world wheat outlook also appears rosier and further emphasizes the outlook of a surplus supply environment. Benchmark US prices for these crops could therefore continue trading down and drift towards multi-year lows in the short-term; corn to \$3-3.25/bushel, soybeans below \$10/bushel and wheat down to \$5/bu.

Lower cereal prices underpin the outlook for declining food price inflation since feed grains represent a primary input cost into processed/packaged foods, livestock and meat products. World meat prices did tick higher for the fifth consecutive month in July, but at a more subdued rate of 1.8% versus more than 3% in June. Given how tight livestock and hog inventories are, meat prices can stay elevated for the next few quarters but new supply should start coming online, encouraged by strong feeder margins and abundant feed grain supplies. With corn, soybean and wheat prices likely to remain in a generally low and compressed range for the next several quarters (possibly hitting a nadir this November), this could be a boon to emerging market consumers that had already started to build up stocks during 2013/14.

In contrast, 'luxury crops' such as coffee and cocoa have rallied in recent weeks and are likely to remain elevated per the Citi Research outlook. This is despite the receding prospects of a strong El Nino event in 2H'14. Arabica coffee markets are digesting the level of retrenchment to the total Brazilian crop which the CNC pegged at 40-mn bags this year and looks to be at greater risk in 2015. The cocoa curve has shifted to backwardation in recent weeks as North American and Asian demand trends for chocolate and powders continue to outpace supply growth—which is constrained to West Africa and requires greater lead time than grains to respond. This price divergence of stronger 'soft' commodities and weaker 'grain' commodities is likely to continue for the rest of this year.

Figure 49. Commodities Price Outlook\*

		Point Prices																			
		0-3M	6-12M		Q3 2013	Q4 2013	Q1 2014	Q2 2014	Q3 2014E	Q4 2014E	Q1 2015E	Q2 2015E	Q3 2015E	Q4 2015E	2012	2013	2014E	2015E	2016E	2017E	2018E
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	99.5	86.0	82.0	85.0
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	95.0	90.0	90.0
Henry Hub Natural Gas	USD/MMBtu	4.55	4.53	5.50	3.55	3.85	5.06	4.58	4.55	4.55	4.50	4.40	4.50	4.60	2.75	3.73	4.70	4.50	4.90	4.90	5.50
Base Metals				LT Price																	
LME Aluminum	USD/MT	1,885	1,900	2,200	1,827	1,815	1,752	1,836	1,870	1,900	1,900	1,920	1,950	1,970	2,049	1,888	1,840	1,935	2,000	2,100	2,200
LME Copper	USD/MT	7,000	7,150	6,200	7,096	7,161	7,005	6,758	6,950	7,050	7,150	7,100	7,200	7,500	7,945	7,352	6,940	7,240	7,800	8,200	8,400
LME Lead	USD/MT	2,260	2,350	2,200	2,116	2,134	2,127	2,120	2,200	2,320	2,350	2,100	2,300	2,450	2,072	2,158	2,190	2,300	2,400	2,450	2,360
LME Nickel	USD/MT	22,000	24,000	21,000	13,996	13,980	14,693	18,512	19,500	21,500	22,500	24,000	24,000	26,000	17,592	15,105	18,550	24,125	26,500	26,000	25,000
LME Tin	USD/MT	23,750	24,500	20,000	21,284	22,951	22,622	23,125	23,500	24,000	25,000	24,000	23,000	25,000	21,108	22,340	23,310	24,250	25,000	24,000	23,000
LME Zinc	USD/MT	2,125	2,200	2,100	1,896	1,932	2,027	2,079	2,100	2,150	2,200	2,225	2,250	2,300	1,963	1,940	2,090	2,245	2,300	2,400	2,320
Precious Metals				LT Price																	
COMEX Gold	USD/T. oz	1,310	1,360	1,050	1,330	1,274	1,292	1,290	1,300	1,320	1,340	1,350	1,360	1,400	1,669	1,416	1,300	1,365	1,380	1,400	1,420
Silver	USD/T. oz	20.6	21.0	16.5	21.5	20.8	20.5	19.7	20.5	20.7	20.9	21.0	21.3	21.5	31.2	24.0	20.3	21.2	22.0	23.0	23.1
Platinum	USD/T. oz	1,520	1,560	1,763	1,456	1,397	1,429	1,448	1,500	1,525	1,525	1,565	1,640	1,675	1,552	1,490	1,475	1,600	1,710	1,800	1,960
Palladium	USD/T. oz	890	920	780	729	725	745	816	875	900	910	920	930	940	645	728	835	925	935	980	980
Bulk Commodities				5Y Cyclical																	
Hard Coking Coal (Spot)	USD/MT	120	130	180	143	142	122	113	115	130	138	135	140	145	191	148	120	140	150	160	180
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	100
Iron Ore Spot (TSI)	USD/MT	95	100	81	133	135	120	103	97	100	98	92	85	85	128	135	105	90	80	83	85
Agriculture																					
CBOT Corn	USD/bu	350	390	N/A	512	430	450	480	400	370	420	450	505	505	695	578	425	470	515	N/A	N/A
CBOT Wheat	USD/bu	550	500	N/A	650	655	616	652	550	510	575	600	600	600	750	684	580	595	615	N/A	N/A
CBOT Soybeans	USD/bu	1,350	1,000	N/A	1,405	1,304	1,355	1,470	1,325	1,050	1,050	1,050	1,000	1,100	1,465	1,406	1,300	1,050	1,075	N/A	N/A
CBOT Rice	USD/cwt	14.5	14.0	N/A	15.6	15.5	15.5	15.1	14.3	14.0	14.0	14.0	14.0	14.0	14.9	15.5	14.7	14.0	N/A	N/A	N/A
NYB-ICE Cotton	USD/lb	70.0	65.0	N/A	85.6	80.3	88.0	89.0	75.0	68.0	70.0	70.0	70.0	70.0	80.0	83.3	80.0	70.0	N/A	N/A	N/A
Sugar#11	USD/lb	18.0	19.0	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	N/A
ICE Coffee	USD/lb	180	200	N/A	118	110	152	185	200	200	225	225	225	225	175	126	185	225	N/A	N/A	N/A
ICE Cocoa	USD/MT	3,000	3,200	N/A	2,420	2,706	2,880	3,005	3,200	3,200	3,300	3,300	3,400	3,400	2,348	2,405	3,100	3,350	N/A	N/A	N/A

Source: Citi Research, \*subject to revision; unchanged from [3Q'14 commodities quarterly](#) published on 14 July 2014.



## Appendix A-1

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