

Global Economic Outlook and Strategy

May 2013



- Our global growth forecasts are little changed this month, at 2.6% for 2013 and 3.2% for 2014 (at current exchange rates), versus 2.6% and 3.1% respectively last month. Within that roughly stable aggregate picture, we are lifting our advanced economy growth forecasts — especially for Japan and the UK in 2013, and the euro area in 2014 — while again cutting growth forecasts for a range of emerging markets. Growth in investment spending is likely to outpace consumer spending in most regions next year.
- Even with improving financial conditions and modestly better growth prospects in some cases, we believe monetary policy is likely to loosen further in a range of advanced economies nearterm and to remain loose for an extended period. The Japanese authorities' words and actions have succeeded in lifting nearterm growth prospects and, to an extent, household inflation expectations. However, we doubt that Japan will achieve the 2% inflation target on a sustained basis unless contractual wages show consistent positive growth and the consumption tax hike scheduled for April 2014 is postponed or scrapped. In the US, the recovery seems to be broadening despite heavy fiscal drag. With highly supportive financial conditions, the Fed may be able to taper bond purchases later this year while continuing with MBS bond purchases into 2014.
- In the euro area, we no longer expect Grexit in 2014 in our base case, although we still believe there is a fairly high risk of Grexit at some stage in coming years because of economic weakness and the escalating government debt ratio. The ECB is likely to cut rates again later this year, but we doubt that this move — and some probable tentative credit easing — will be enough to lift the euro area out of persistent weakness. China's economy is transitioning to lower growth earlier than many observers expect, and our growth forecasts are below consensus for this year and 2014. The combination of lower Chinese growth and yen depreciation is capping growth prospects in many other emerging markets, reinforcing the bias to looser monetary policies.
- We expect that Moody's will restore Ireland's sovereign rating to investment grade later this year. Further ahead, we still believe widespread restructuring of government and/or bank liabilities is likely in a range of euro area countries over time, and this may involve restructuring of privately-held liabilities as well as official exposure in some cases.

Willem Buiter

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

Nathan Sheets

+1-212-816-9297
nathan.sheets@citi.com

Michael Saunders

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

Robert V DiClemente

+1-212-816-7942
robert.diclemente@citi.com

Kiichi Murashima

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

David Lubin

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

Johanna Chua

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

With thanks to Jan Maguire

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Figure 1. Currency and Interest Rate Forecasts, as of 22 May 2013

	22 May 2013	3Q 13F	4Q 13F	1Q 14F	2Q 14F	3Q 14F	4Q 14F
United States: Federal Funds	0.25	0.25	0.25	0.25	0.25	0.25	0.25
10-Yr. Treasuries (Period Ave.)	1.93	2.10	2.35	2.60	2.80	3.00	3.20
Euro Area: US\$/€	1.29	1.27	1.26	1.25	1.25	1.25	1.25
Euro Repo Rate	0.50	0.50	0.25	0.25	0.25	0.25	0.25
10-Yr. Bunds (Period Ave.)	1.43	1.40	1.40	1.40	1.40	1.50	1.60
Japan: Yen/US\$	102	108	109	110	110	110	110
Call Money	0.10	0.10	0.10	0.10	0.10	0.10	0.10
10-Yr. JGB (Period Ave.)	0.88	0.80	0.70	0.60	0.50	0.70	0.70

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 from Last Month

■ Global	Our global growth forecasts are little changed this month, with slight upgrades for the advanced economies (especially Japan, EMU and UK) but further downgrades for a range of emerging markets.
■ United States	Fiscal drag is limiting growth but stimulative monetary policy and underlying cyclical momentum are likely to provide substantial offsets. A gradual tapering of Fed QE is expected to begin later in the second half but purchases could extend into 2014. A rapidly improving near-term fiscal outlook is dulling appetites for needed structural reforms.
■ Euro Area	Although Grexit is no longer our baseline, economic activity is likely to contract further into the second half of 2013, likely prompting the ECB to cut its main refinancing rate again by 25bp to 0.25% as the scenario of a recovery continues to be pushed back. Positive financial market sentiment, if it were to persist, should help the economy stabilize during 2014.
■ China	The April data suggest GDP growth in 2Q is likely to be flattish. The easing bias of policies may stay for longer amid benign inflation. We maintain our growth forecast of 7.7% for 2013. The recent wave of interest rate cuts in both advanced and emerging economies has significantly reduced the chance of a rate hike in China. We now expect the authorities to keep the rate unchanged throughout the year.
■ Japan	The Abe administration's Growth Strategy (due to be published in June) is unlikely to be bold in our opinion, mostly because of concerns over a negative impact on the Upper House Election this summer. Meanwhile, discussions on whether or not to implement the consumption tax hike as planned will probably accelerate in coming months and this will be a key factor shaping the outlook, in our view.
■ United Kingdom	We are lifting our growth forecasts following better recent data, while also cutting our inflation forecasts in response to weaker trends in pay and commodities. The MPC is likely to adopt Fed-style forward guidance in H2 this year.
■ Canada	We continue to anticipate that the BoC will leave the policy rate target unchanged at 1.00% until 1Q 2015. Unless risks tilt downward, the Bank will probably retain its slight tightening bias.
■ Australia	The latest RBA rate cut should help with the task of economic rebalancing after the peak in mining investment this year. Further rate cuts are now less likely. The lower exchange rate should improve the prospects of import-competing and export-oriented firms.
■ Emerging Asia (ex China)	Slow growth and disinflation theme persists, and India, Korea, Philippines, Sri Lanka & Vietnam all cut policy rates this past month. In Thailand there is political pressure to cut rates further (although we believe easing is not warranted). The only exception is Indonesia — a much delayed subsidized fuel price hike is expected in the coming months, which we expect will put Bank Indonesia under pressure to hike FASBI rate by 75bp this year to contain inflation expectations.
■ CEEMEA	Central banks in Turkey, Israel, Poland and Serbia have all, in the past few weeks, cut rates by more than expected, earlier than expected, or completely out of the blue. This is a good reflection of the fall in inflationary pressures that have been induced by weak economic activity and subdued commodity prices. It is difficult to see where inflationary upside will come from, and although in some cases — Poland, for example — there is a reasonable amount of stimulus in the system to produce stronger data later this year, the general theme will remain: weak growth and dovish monetary policy.
■ Lat Am	We have recently cut our Brazil growth forecasts for 2013 and 2014, but still expect that COPOM will only make three 25bps hikes. We also downgrade our Mexico growth forecast, but do not expect additional monetary easing. The drop in central bank reserves in Argentina has led the authorities to raise interest rates and strengthen import controls. In Venezuela, USD scarcity will probably continue to affect inflation and growth.

Source: Citi Research

Figure 3. Selected Countries — Industrial Production Forecasts (Pct.), 2012-14F

	2012	2013F	2014F
World	1.8%	2.5%	3.8%
United States	3.6	3.1	4.3
Japan	-0.9	-0.1	3.2
Euro Area	-2.3	-0.9	0.5
United Kingdom	-2.4	-1.1	0.8
Canada	1.1	1.3	1.9
China	10.0	9.6	9.1
India	3.1	4.4	5.6
Korea	0.9	0.2	5.1
Brazil	-2.7	2.0	3.3

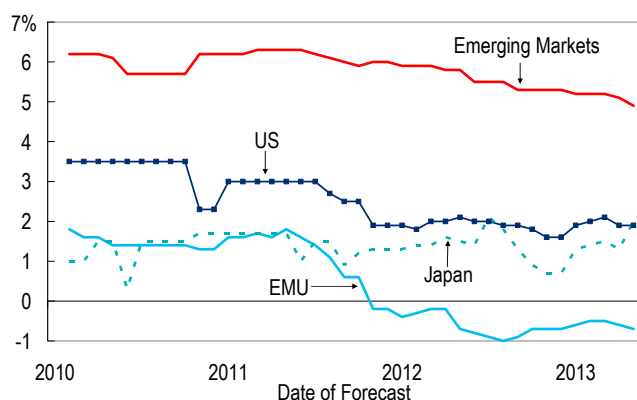
Source: Citi Research

Overview — Reduced Growth Divergences

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

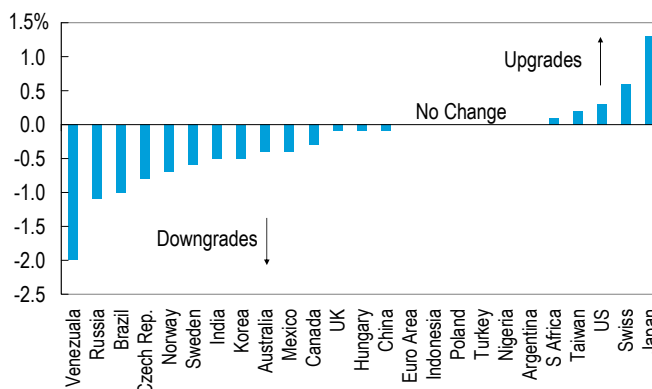
Our global growth forecasts are little changed this month, at 2.6% for 2013 and 3.2% for 2014 (at current exchange rates), versus 2.6% and 3.1% respectively last month. But, there are several important cross-currents within that roughly stable aggregate picture. In particular, we are lifting our advanced economy growth forecasts by 0.1% for both 2013 and 2014, with upgrades to our 2013 forecasts for Japan and the UK, and a higher euro area outlook for 2014. In a broad sense, these upward revisions to advanced economy growth forecasts reflect the greater traction from monetary policy loosening onto financial conditions, and more appropriate policies in areas of weakness — with aggressive monetary loosening in Japan and reduced early fiscal austerity in the euro area. Even with improving financial conditions and modestly better growth prospects in some cases, monetary policy is likely to loosen further in a range of advanced economies nearterm and to remain loose for an extended period in our view.

Figure 4. US, Euro Area, Japan and Emerging Markets — Citi Forecasts for 2013 GDP Growth, 2010-13



Source: Citi Research

Figure 5. Global — Change in Citi Growth Forecasts for 2013 Over Last Six Months



Source: Citi Research

Investment growth is likely to outpace consumer spending growth in all major regions next year...

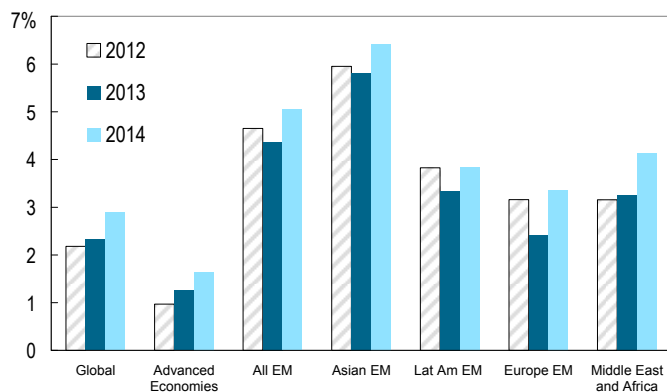
...with emerging market spending growth continuing to outpace advanced economies

Our forecast implies a modest pick up in global growth in the year ahead, from a little below average this year to a little above average in 2014. This acceleration will, we expect, be supported by slightly higher growth in consumer spending and investment across the advanced economies, a more marked acceleration in investment spending in many emerging markets outside Asia, and a widespread increase (including Asia) in consumer spending growth across emerging markets. The growth in investment is likely to slightly outpace growth in GDP and consumer spending in all major regions (albeit not in every country), reflecting the stronger state of corporate balance sheets as opposed to household balance sheets, some recovery in housing in advanced economies, the low starting point for investment in some advanced economies, plus a major impetus from government-supported infrastructure and construction programmes across many emerging markets.

Based on the countries covered in this report (which account for more than 90% of global GDP), we forecast that global consumer spending growth will pick up from 2.2% in 2012 to 2.4% in 2013 and 2.9% in 2014, with consumer spending growth of about 6% YoY in 2013-14 in Asian emerging markets, versus 1-1¼% in advanced economies. We project that global investment spending will rise by about 3.6% in 2013 and 5.0% in 2014, after growth of 3.8% in 2012. Within this, we look for investment growth in advanced economies to pick up from 1.0% in 2013 to about 2.9% in 2014, with EM investment growth rising from 6.2% in 2013 to 6.6% in 2014 despite a modest slowdown in investment in Asian EM. In nominal terms, consumer spending in Asian EM already has risen from USD\$3.0tn in 2006 to about

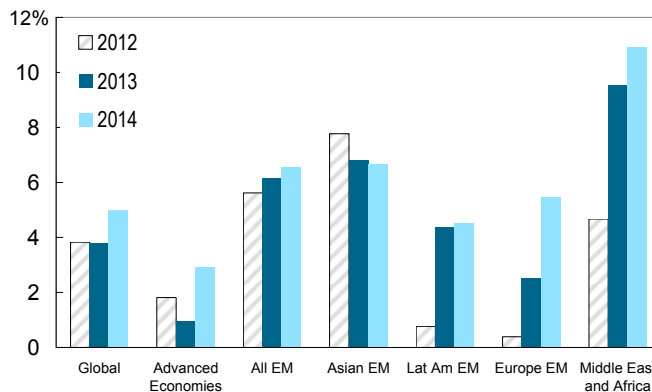
USD\$6.8tn this year (compound growth rate of 12.5% YoY), and is now close to the euro area level (USD\$7.1tn). Nominal consumer spending in Asian EM will probably exceed euro area spending next year, albeit remaining some way short of nominal consumer spending in the US (about \$10tn this year).

Figure 6. Global — Real Consumer Spending YoY, 2012-14F



F Forecast. Sources: DataStream and Citi Research

Figure 7. Global — Real Investment Spending YoY, 2012-14F



F Forecast. Sources: DataStream and Citi Research

We highlight four main themes and issues.

Japan: Recovering, But More Needed to Achieve 2% Inflation Target

We are lifting our 2013 Japan growth forecast...

We are lifting our 2013 growth forecast for Japan to 2.0% from 1.3% last month, edging up our 2014 forecast to 1.5% from 1.4%, reflecting the stronger Q1 GDP data plus the continued stimulus from yen depreciation and gains in domestic equities. In all, our 2013 Japan growth forecast has roughly trebled over the last six months, having been just 0.7% in late-2012 before the full scale of “Abenomics” stimulus became apparent. The BoJ’s words and actions have succeeded in lifting household inflation expectations to an extent. For example, the share of people (excluding single family households) that expect that consumer prices will rise in the coming year is up from 64% in Dec-12 to 86% in April, near the highs of recent years.

...but we still doubt the authorities have yet done enough to establish a path back to sustained 2% inflation...

However, we doubt that the authorities have yet done enough to lift Japan’s inflation to the 2% target on a sustained basis in coming years, after the long period of price deflation and wage stagnation. In particular, even with the recent monetary loosening, we doubt that the inflation target is achievable unless contractual wages show consistent positive growth and the consumption tax hike scheduled for April 2014 is postponed or scrapped¹.

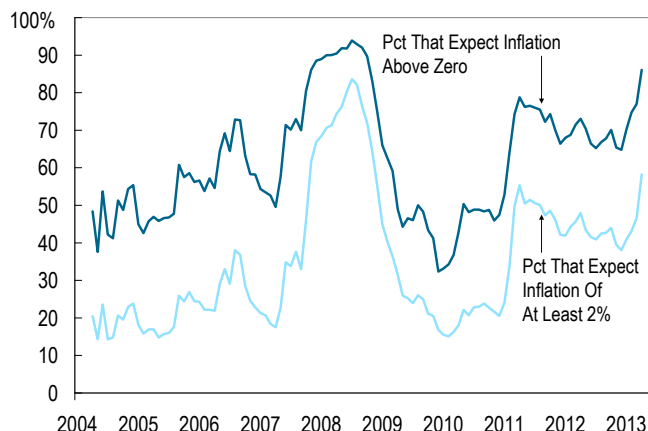
...unless wage growth picks up and/or the planned 2014 consumption tax hike is postponed

Neither condition is yet in place. Contractual wages fell 1.1% YoY in March, and the recent improvement in Japan’s growth prospects may have come too late to fully influence 2013 wage settlements, which largely take effect in April. The Keidanren reports that among 35 major companies, the average pay rise this year is similar to a year ago. Moreover, the 2014 wage round is likely to be clouded by uncertainties over growth if, as the government currently intends, the consumption tax is lifted from 5% to 8% in April 2014 (even if this is accompanied by temporary investment programmes). The government may decide later this year to postpone the

¹ See “Strong growth to continue in coming four quarters before cliff”, Japan Economics Weekly, Kaoki Iizuka and Kiichi Murashima, 10 May 2013, Citi.

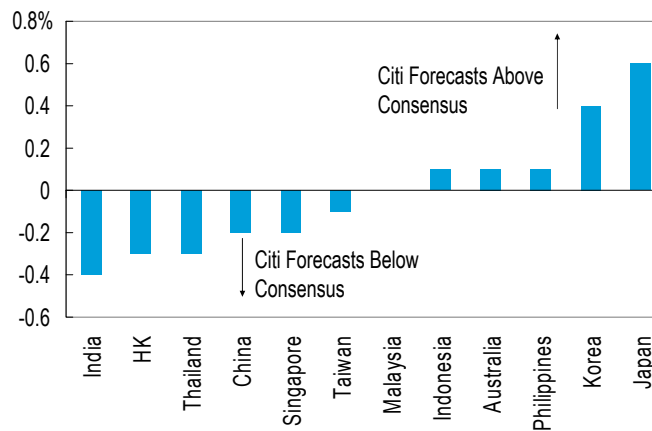
consumption tax hike. Postponement will become more likely, in our view, if the government does well in the July Upper House elections (and especially if the government calls, and achieves strong support in, Lower House elections at the same time). Even in this event, monetary policy is likely to remain biased to stimulus, and we expect the Japanese Yen will depreciate to about Y110/USD later this year.

Figure 8. Japan — Inflation Expectations For the Year Ahead Among the General Public, 2004-13



Note: The Survey excludes single person households.
Sources: Datastream and Citi Research

Figure 9. Asia — Citi Forecasts for 2013 Real GDP Growth Versus Consensus, May 2013



Sources: Consensus Economics and Citi Research

EM: Slower Growth and Increasing Imbalances

We are again cutting growth forecasts for many emerging markets...

We are again cutting growth forecasts in various EM countries, with downgrades this month to our 2013 numbers for Brazil, Korea, Mexico, Nigeria, Russia and Taiwan among others. In all, our 2013 EM growth forecast has fallen by 1% since early 2012. We do still expect that EM growth will outpace the advanced economies, but outperformance probably will be less than we expected previously and accompanied by more widespread concerns over current account deficits and escalating private debts. China's economy is transitioning to slower growth rather earlier than many outside observers expect, and we expect growth of about 7.7% this year, 7.3% in 2014 and 7.0% in 2015, whereas the consensus is for 7.9% growth in both 2013 and 2014 and the IMF expects growth of 8-8.5% YoY each year in 2013-15. Credit policy is likely to remain loose but we expect that — with the rapid rise in private debt over recent years — the authorities will view a modest growth slowdown as less disruptive than a further rapid expansion of bank credit aimed at keeping growth at 8%-plus.

...reflecting in particular spillovers from China's slowdown and Yen depreciation

In turn, China's slowdown is capping growth in other Asian EM economies, especially given reduced export competitiveness as Asian EM exchange rates appreciate versus the yen. We do expect that various Asian countries will cut interest rates further, but stimulus will be capped in some cases by worries over escalating private debts (eg Korea) and current account deficits (eg India). As demand for commodities weakens (and in some cases supply is increasing), the global commodities supercycle appears to be ending, feeding back to lower growth prospects in some major commodity exporters².

² See "From Commodities Supercycle to Unicycles: 2Q 2013 Commodities Market Update", Ed Morse and Heath Jansen, 12 April 2013, Citi.

Fiscal policy is tightening markedly in the US...

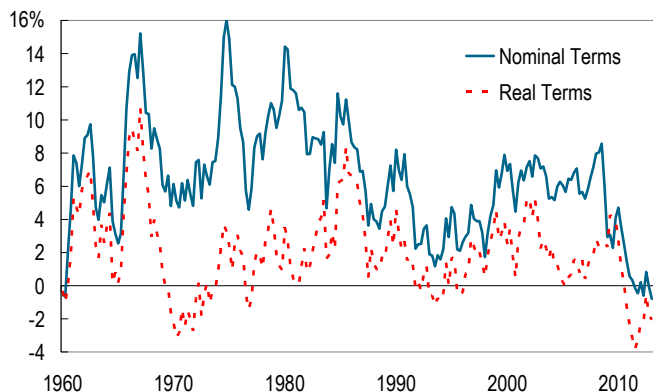
...but we expect that the expansion will not be derailed, supported by healthy financial conditions

US: Fiscal Drag Is Not Derailing the Recovery (and Will Not)

The IMF judges that the US fiscal stance (measured by the change in the primary structural balance) will tighten by about 1¾% of GDP this year, including sequester-related spending cuts, the biggest one-year US fiscal tightening for over 30 years and exceeding the likely fiscal drag in the euro area (1-1½% of GDP). Fiscal drag is evident in the Q1 GDP data, with the sum of government consumption and investment down 0.8% YoY in nominal terms, the sharpest YoY decline since the 1950s, and a decline of 2.1% YoY in real terms. We expect fiscal drag will cap US growth but, with improving financial conditions and private sector balance sheets, not derail it. Indeed, the drag from fiscal policy will probably be concentrated in the first half, with underlying cyclical forces and the Fed's own easing efforts overcoming or outlasting that restraint, lifting growth to an average of about 2¾% QoQ SAAR in H2 this year³.

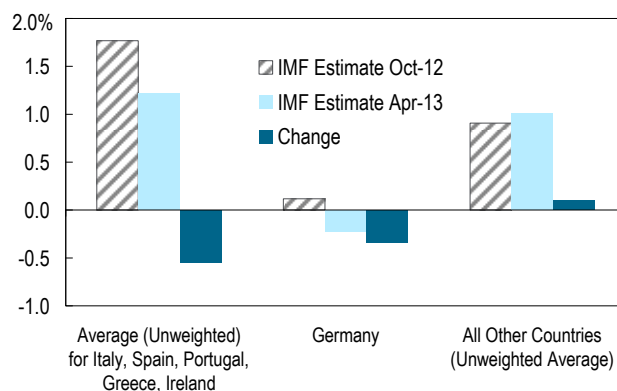
Our confidence in the US recovery's staying power is partly based on the assumption that monetary policy will remain supportive. Our base case is that the Fed will begin to taper bond purchases from the September meeting, with the program finally ending in Spring of 2014. But, with inflation low and slack remaining in the labour market, we are reasonably confident that the Fed would be willing to extend stimulus if the economy disappoints or financial conditions tighten enough to put the 2014 outlook in doubt. Moreover, the end of asset purchases simply stabilizes policy at a loose stance. An eventual move to the actual withdrawal of stimulus remains some way off.

Figure 10. US — Government Consumption and Investment YoY, Real and Nominal Terms, 1960-Q1 2013



Sources: Datastream and Citi Research

Figure 11. Euro Area — Structural Fiscal Tightening in 2013, Pct of GDP



Note: Fiscal tightening measured by change in structural primary balance as pct of GDP. Sources: IMF and Citi Research

We are lifting our 2014 euro area growth forecast...

Grexit Postponed, Euro Area Economy Still Weak

The euro area economy remains weak, and GDP has now fallen for six consecutive quarters. Growth prospects remain poor, and we expect that the euro area will continue to underperform versus official forecasts and the consensus in 2014 and 2015. Nevertheless, we have become a bit less gloomy on euro area growth for next year, and we are raising our 2014 growth forecast from minus 0.3% last month to 0.0% this month (while pulling our 2013 forecast down from minus 0.6% to minus 0.7%).

³ See "Outlook Update: From Tail Risks to Tailwinds", U.S. Economics Weekly, Robert V Diclemente, 17 May 2013, Citi.

**...reflecting less severe fiscal austerity
and postponed Grexit risks**

This upgrade reflects two main factors. First, with the drift to accepting deficit slippage amidst economic weakness and low government bond spreads, fiscal headwinds in the weak periphery economies should be less severe than seemed likely a few months ago. The IMF has scaled back its forecast for the average (unweighted) structural fiscal tightening in Italy, Spain, Portugal, Greece and Ireland in 2013 to 1.2% of GDP from 1.8% of GDP in its late-2012 forecast. Second, we are no longer including Grexit at the start of 2014 in our base case. We still believe that there is a fairly high risk of Grexit in coming years, but no longer put it in our base case at any particular date. This partly reflects a lower risk of Grexit, but also a sense that, with creditor nations taking a more relaxed line on fiscal targets and Greece's coalition government holding together, triggers for Grexit as early as 2014 have receded markedly. The chosen date was always somewhat arbitrary, but to construct a consistent forecast we pencilled in sizeable Grexit-related uncertainties and financial strains around that date, hitting the 2014 growth outlook⁴. That intensified headwind is now absent in our forecast.

**Nevertheless, the euro area outlook
remains weak and we believe the euro
crisis is not over...**

Even so, the euro area still faces major headwinds from fiscal drag, poor credit availability and high private debts in many periphery countries. Our forecast implies that real GDP will not regain the pre-recession-peak (Q1-08) until 2017, with GDP per head below its peak for even longer. The marked decline in sovereign bond spreads has not fed through to narrower lending spreads on SME loans in periphery countries, which remain around record highs. Moreover, ECB surveys show high refusal rates for SME loan applications in periphery countries, hinting at non-price restrictions on credit availability. As economic weakness in periphery economies feeds through to high and rising NPL rates, foreign banks have continued to cut exposure to periphery economies over the last year and domestic banks face continued pressure to lift capital ratios and deleverage further. As a result, credit growth in periphery economies remains deeply negative. The drag from poor bank credit availability is heightened by the major role in periphery economies played by small firms (who are more likely to be dependent on bank finance): more than 75% of employment in Italy, Spain, Portugal, and Cyprus is in firms with less than 250 employees, compared to 53% of employment in the UK.

**...with the ECB likely to cut the refi rate
again but unlikely to act decisively
enough to lift the euro area out of
extended weakness**

We expect that the ECB will cut the refi rate again later this year, but this will probably have little further effect given the low level of overnight rates. Nominal GDP growth is probably below 1% this year, and many periphery countries already have shrinking nominal GDP. However, we do not expect the ECB will implement more far-reaching monetary measures (eg negative deposit rate, QE) unless outright euro area deflation is imminent or the euro appreciates markedly. Various credit easing schemes are under discussion, perhaps involving the EIB. But we suspect actual policies will prove underwhelming. To be powerfully effective, a credit easing scheme would have to provide not just relatively cheap funding to the banks, but would also require a fiscal body to accept sizeable credit risk. The periphery countries themselves lack the fiscal capability to do this, and creditor nations are (understandably) unwilling to accept it or to allow European institutions to accept it on a large scale. Over time, the mix of persistent economic weakness and nearterm tolerance of deficit slippage implies that the periphery countries will continue to face escalating general government debt/GDP ratios. We continue to expect that financial market strains will oblige Italy and Spain to enter some form of ESM program and access the OMT facility at some point. Longer term, we believe there are sizeable risks of restructuring of government and/or bank liabilities in a range of euro area countries, and this may extend to privately-held liabilities as well as official exposures.

⁴ See, for example "Global Economic Outlook and Strategy", Willem Buiter et al, 23 May 2012, Citi

Figure 12. Citi Global Economics Team *For Informational Purposes Only*

	Name	Office Number	Email Address	Responsibilities
NEW YORK	North America			
	Willem Buiter ³	(1-212) 816-2363	willem.buiter@citi.com	Chief Economist
	Nathan Sheets ³	(1-212) 816-9297	nathan.sheets@citi.com	Global Head of International Economics
	Robert DiClemente ³	(1-212) 816-7942	robert.diclemente@citi.com	Head, North America
	Peter D'Antonio ³	(1-212) 816-9889	peter.dantonio@citi.com	U.S. Forecast
	Dana Peterson ³	(1-212) 816-3549	dana.peterson@citi.com	U.S. Forecast and Canada
	Matt Dabrowski ³	(1-212) 816-9891	matt.dabrowski@citi.com	Global Political Analysis
	Emerging Markets			
	Guillermo Mondino ³	(1-212) 816-6499	guillermo.mondino@citi.com	Head, EM Economics and Strategy Research
LONDON	Jorge Pastrana ²	(1-212) 816-5728	jorge.armando.pastranavillegas@citi.com	Caribbean and Central America
	Camilo González García ²	(1-212) 816-9901	camilo.gonzalezgarcia@citi.com	Argentina, Chile, Peru, Caribbean, Central America
	Global			
	Tina Fordham ¹	(44-20) 7986-9860	tina.fordham@citi.com	Global Political Analysis
	Ebrahim Rahbari ¹	(44-20) 7986-6522	ebrahim.rahbari@citi.com	Global Economics
	Deimante Kupciuniene ¹	(44-20) 7986-4061	deimante.kupciuniene@citi.com	Global Economics
	Antonio Montilla ¹	(44-20) 7986-3282	antonio.montilla@citi.com	Global Economics and Spain
	Western Europe			
	Michael Saunders ¹	(44-20) 7986-3299	michael.saunders@citi.com	Head, Western Europe and U.K. Coverage
TOKYO	Guillaume Menuet ¹	(44-20) 7986-1314	guillaume.menuet@citi.com	Euro Area (Germany, France, Belgium, Netherlands)
	Giada Giani ¹	(44-20) 7986-3281	giada.giani@citi.com	Euro Area (Italy, Spain, Greece, Portugal)
	Tina Mortensen ¹	(44-20) 7986-3284	tina.mortensen@citi.com	Nordics
	Ann O'Kelly ¹	(44-20) 7986-3297	ann.okelly@citi.com	Europe
	Emerging Markets			
	David Lubin ¹	(44-20) 7986-3302	david.p.lubin@citi.com	Head, Emerging Markets and CEEMEA
	David Cowan ¹	(44-20) 7986-3285	david.cowan@citi.com	Africa
	Gina Schoeman ¹			South Africa
	Global			
TOKYO	Kiichi Murashima ²	(813) 6270-4980	kiichi.murashima@citi.com	Head, Japan
	Naoki Iizuka ²	(813) 6270-4997	naoki.iizuka@citi.com	Japan
SYDNEY	Paul Brennan ¹⁵	(612) 8225-4899	paul.brennan@citi.com	Head, Australia, New Zealand
	Josh Williamson ¹⁵	(612) 8225-4904	josh.williamson@citi.com	Australia, New Zealand
BEIJING	Enjiang Cheng ¹⁰	(86) 10 5937-6038	enjiang.cheng@citi.com	China
BOGOTA	Munir Jalil ¹²	(57) (1) 639-4195	munir.jalil@citi.com	Colombia, Venezuela
BUDAPEST	Eszter Gargyan ⁷	(36) 1 374-5559	eszter.gargyan@citi.com	Hungary
DUBAI	Farouk Soussa ¹	(971) (4) 509-9750	farouk.soussa@citi.com	Gulf, Middle East, Levant
HONG KONG	Johanna Chua ⁴	(852) 2501-2357	johanna.chua@citi.com	Head, Emerging Asia, Sri Lanka, Vietnam
	Minggao Shen ⁴	(852) 2501-2485	minggao.shen@citi.com	China
	Shuang Ding ⁴	(852) 2501-2769	shuang.ding@citi.com	China
	Adrienne Lui ⁴	(852) 2501-2753	adrienne.lui@citi.com	Hong Kong, Mongolia, Taiwan
ISTANBUL	Ilker Domac ⁶	(90) 212 319-4623	ilker.domac@citi.com	Turkey, Romania, Balkans
	Gultekin Isiklar ⁶	(90) 212 319-4915	gultekin.isiklar@citi.com	Turkey, Romania, Balkans
JAKARTA	Helmi Arman ²¹	62-21-5290-8960	helmi.arman@citi.com	Indonesia
MANILA	Jun Trinidad ¹⁷	(63) (2) 894-7270	jun.trinidad@citi.com	Philippines, Thailand
MEXICO CITY	Sergio Luna Martinez ⁴	(52) (55) 2226-6799	sluna@banamex.com	Mexico
MUMBAI	Rohini Malkani ⁸	(91) 22-6631-9876	rohini.malkani@citi.com	India
PRAGUE	Jaromir Sindel ¹³	(42) (02) 3306-1485	jaromir.sindel@citi.com	Czech Republic, Slovakia, Slovenia
SAO PAULO	Marcelo Kfoury ¹⁹	(55) (11) 4009-3470	marcelo.kfoury@citi.com	Brazil
SEOUL	Jaechul Chang ¹⁶	(82) 2 2077-4160	jaechul.chang@citi.com	Korea
SINGAPORE	Kit Wei Zheng ²⁰	(65) 6657-5079	wei.zheng.kit@citi.com	ASEAN, Singapore, Malaysia
WARSAW	Piotr Kalisz ⁷	(48) (22) 692-9633	piotr.kalisz@citi.com	Head, CEE and Poland
	Cezary Chrapek ⁷	(48) (22) 692-9421	cezary.chrapek@citi.com	Poland

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

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Source: Citi Research.

Figure 13. Selected Countries — Economic Forecast Overview (Percent), 2012-2017F

	GDP Growth						CPI Inflation						Short-Term Interest Rates					
	2012	2013F	2014F	2015F	2016F	2017F	2012	2013F	2014F	2015F	2016F	2017F	2012	2013F	2014F	2015F	2016F	2017F
Global	2.5	2.6	3.2	3.6	3.8	4.0	2.9	2.7	3.0	3.2	3.2	3.2	2.35	2.17	2.27	2.56	2.95	3.35
<i>Based on PPP weights</i>	3.1	3.1	3.7	4.2	4.4	4.5	3.4	3.1	3.4	3.6	3.7	3.7	2.94	2.71	2.80	3.10	3.45	3.80
Industrial Countries	1.2	1.1	1.7	1.5	1.6	1.7	1.8	1.3	1.8	1.5	1.5	1.5	0.62	0.47	0.43	0.69	1.15	1.70
United States	2.2	1.9	2.9	3.2	3.2	3.0	1.8	1.3	2.1	2.1	2.1	2.1	0.25	0.25	0.25	0.75	1.65	2.50
Japan	2.0	2.0	1.5	1.5	1.2	1.2	0.0	0.0	2.0	0.7	0.5	0.7	0.10	0.10	0.10	0.10	0.10	0.10
Euro Area	-0.5	-0.7	0.0	0.8	1.2	1.5	2.5	1.5	1.3	1.4	1.4	1.4	0.88	0.50	0.25	0.25	0.31	0.75
Canada	1.8	1.8	2.6	3.0	3.0	2.8	1.5	1.0	1.7	2.0	2.0	2.0	1.00	1.00	1.00	1.63	2.44	3.00
Australia	3.6	2.7	3.1	3.5	3.6	3.2	1.8	2.8	2.5	2.8	2.5	2.3	3.50	2.80	3.25	4.00	4.75	4.75
New Zealand	2.2	2.6	2.8	2.0	1.9	1.8	1.1	1.2	2.3	2.4	2.3	2.1	2.50	2.50	3.20	4.75	5.00	5.00
Germany	0.9	0.3	1.3	2.0	1.9	2.0	2.0	1.4	2.2	2.1	2.0	1.8						
France	0.0	-0.3	0.4	0.9	1.4	1.9	2.0	1.0	1.6	1.3	1.6	1.4						
Italy	-2.4	-1.9	-0.6	0.2	0.5	0.7	3.3	1.6	1.3	0.8	0.3	0.5						
Spain	-1.4	-2.0	-1.2	0.1	1.0	1.9	2.4	1.6	0.7	0.6	0.5	0.6						
Greece	-6.4	-5.5	-4.5	-2.4	0.6	1.3	1.0	-0.6	-1.1	-0.7	0.2	0.3						
Ireland	0.9	0.6	2.0	2.5	2.8	2.8	1.9	1.3	1.4	1.6	1.6	1.6						
Portugal	-3.3	-3.1	-1.6	0.1	1.0	1.0	2.8	0.6	0.4	0.5	0.6	0.6						
Netherlands	-1.0	-1.0	0.1	0.9	1.2	1.6	2.8	2.6	1.7	1.6	1.8	1.8						
Belgium	-0.2	-0.3	0.2	1.0	1.5	1.7	2.8	1.2	2.0	2.0	2.0	2.1						
Denmark	-0.5	0.1	1.5	1.7	1.9	2.1	2.4	1.4	1.7	1.9	2.0	2.0	0.43	0.10	0.20	0.40	0.60	1.00
Norway	3.3	2.4	2.6	2.8	2.6	2.7	0.7	1.6	1.7	2.0	2.1	2.5	1.55	1.50	1.61	2.00	2.51	3.08
Sweden	1.2	1.0	2.0	2.5	2.5	2.9	0.9	0.1	1.0	1.8	2.2	2.3	1.45	0.89	0.75	1.07	1.73	2.29
Switzerland	1.0	1.5	1.3	1.8	2.0	1.5	-0.7	-0.5	-0.2	1.0	1.0	1.0	0.00	0.00	0.00	0.00	0.00	0.00
United Kingdom	0.3	0.7	0.8	1.5	1.5	1.8	2.8	2.7	2.3	2.2	2.4	2.4	0.50	0.50	0.50	0.50	0.50	1.04
Emerging Markets	4.7	4.9	5.3	5.5	5.6	5.7	4.6	4.8	4.7	4.7	4.6	4.6	5.21	4.84	4.97	5.24	5.43	5.55
China	7.8	7.7	7.3	7.0	7.5	7.3	2.6	2.9	3.1	3.5	3.8	4.0	3.25	3.00	3.13	3.25	3.38	3.75
Taiwan	1.3	3.2	4.0	4.0	4.5	4.5	1.9	1.7	1.9	1.8	1.8	1.8	1.88	1.88	1.97	2.38	2.88	3.38
India	5.0	5.7	6.4	7.2	7.3	7.4	7.3	5.5	5.0	5.0	5.0	5.0	7.80	6.75	6.75	6.75	6.75	6.75
Indonesia	6.2	6.1	6.3	6.5	6.5	6.7	4.3	6.9	5.4	5.7	5.4	5.3	3.90	4.38	4.75	4.63	5.13	5.30
Korea	2.0	2.9	3.7	3.9	4.2	3.7	2.2	1.9	2.8	3.2	3.1	3.0	3.06	2.56	2.50	3.00	3.88	4.38
Czech Republic	-1.2	-0.8	1.3	1.9	2.4	2.7	3.3	1.6	1.4	2.2	1.8	2.0	0.51	0.05	0.05	0.44	1.29	2.25
Hungary	-1.7	0.2	1.3	0.9	1.3	1.7	5.7	2.1	3.0	3.9	3.5	3.3	6.77	4.44	4.06	4.98	5.00	5.00
Poland	1.9	1.3	2.8	3.3	3.3	3.2	3.7	1.0	2.0	2.5	2.5	2.5	4.61	2.92	2.75	3.75	4.67	4.71
Romania	0.7	1.6	2.8	3.5	4.0	4.0	3.3	4.8	3.3	3.2	2.5	2.5	5.25	5.00	4.75	5.31	5.00	5.00
Russia	3.4	2.1	2.8	3.3	3.3	3.3	5.1	6.7	5.4	5.0	4.9	4.6	8.07	8.00	7.50	7.00	7.00	7.00
Turkey	2.2	4.0	4.3	4.2	4.4	4.4	8.9	7.4	7.3	6.9	6.4	5.8	5.69	4.50	4.88	7.25	7.50	7.50
Nigeria	7.4	6.5	6.9	6.8	7.1	7.0	12.2	8.9	10.0	12.2	10.8	9.9	12.00	11.00	11.50	12.50	11.25	9.00
South Africa	2.5	2.6	3.1	4.0	4.2	4.4	5.7	6.0	5.2	5.5	5.6	5.6	5.28	4.92	4.92	6.17	6.50	6.50
Argentina	1.9	3.0	3.0	2.0	-2.0	3.5	10.0	10.3	12.5	15.0	50.0	30.0	13.89	16.95	21.51	24.00	24.00	24.00
Brazil	0.9	2.9	3.8	3.5	3.5	3.7	5.4	6.4	5.7	5.3	4.8	4.5	8.46	7.83	8.25	8.88	9.25	8.75
Mexico	3.9	3.2	4.0	4.0	3.8	3.7	4.1	3.9	3.4	3.6	3.6	3.6	4.50	4.08	4.00	4.44	5.90	6.42
Venezuela	5.6	1.0	2.0	2.1	2.5	2.5	21.1	30.5	31.5	27.3	25.2	25.2	14.50	14.50	14.50	14.80	14.80	14.80

Note: For inflation, we use the PCE deflator in the US, wholesale price index in India, GDP deflator in Ireland. For Indonesia we refer to the FasB1 rate to reflect actual money market rates.

Source: Citi Research

Figure 14. Selected Countries — Economic Forecast Overview (Percent), 2012-2017F

	Current Balance (Pct of GDP)						Fiscal Balance (Pct of GDP)						Government Debt (Pct of GDP)					
	2012	2013F	2014F	2015F	2016F	2017F	2012	2013F	2014F	2015F	2016F	2017F	2012	2013F	2014F	2015F	2016F	2017F
Global	0.3	0.4	0.3	0.7	0.5	0.3	-4.5	-4.4	-3.6	-2.9	-2.7	-2.5	88	89	87	86	85	84
<i>Based on PPP weights</i>	<i>0.1</i>	<i>0.2</i>	<i>0.1</i>	<i>0.5</i>	<i>0.2</i>	<i>0.1</i>	<i>-4.3</i>	<i>-4.2</i>	<i>-3.6</i>	<i>-3.0</i>	<i>-2.8</i>	<i>-2.7</i>	<i>79</i>	<i>80</i>	<i>79</i>	<i>79</i>	<i>78</i>	<i>76</i>
Industrial Countries	-0.6	-0.1	-0.1	1.6	1.7	1.7	-6.1	-5.7	-4.2	-3.2	-2.9	-2.6	116	120	117	119	118	118
United States	-3.0	-2.5	-2.6	-3.0	-3.0	-3.0	-8.3	-6.0	-4.5	-4.0	-4.0	-4.0	106	109	111	112	112	112
Japan	1.1	0.6	1.7	1.5	1.5	1.3	-10.7	-9.8	-7.0	-6.2	-5.8	-5.4	237	244	245	250	254	257
Euro Area	1.2	2.5	2.3	2.3	2.3	2.3	-3.7	-2.9	-2.5	-2.1	-1.7	-1.0	91	96	97	98	97	95
Canada	-3.7	-3.0	-2.8	-2.0	-1.7	-1.4	-1.4	-1.0	-0.3	0.0	0.2	0.2	86	86	85	84	82	81
Australia	-3.7	-3.7	-4.7	-3.5	-3.2	-3.0	-3.0	-1.3	-1.1	-0.6	0.0	0.4	29	28	29	28	26	24
New Zealand	-5.0	-5.5	-6.8	-9.7	-12.6	-13.6	-4.4	-2.9	-0.9	0.0	0.3	1.00	38	37	39	35	35	37
Germany	7.0	6.8	5.5	5.3	5.2	5.3	0.2	-0.1	-0.3	0.3	0.5	1.8	82	82	79	76	73	69
France	-2.4	-1.7	-0.9	-0.2	0.2	0.0	-4.8	-3.8	-3.5	-3.4	-3.0	-2.4	90	94	96	97	98	97
Italy	-0.7	0.9	2.1	2.2	1.8	1.4	-3.0	-3.2	-2.7	-2.5	-2.3	-2.1	127	133	138	139	140	141
Spain	-1.1	1.7	2.7	4.0	4.6	4.8	-10.6	-6.3	-5.1	-5.1	-4.6	-4.0	84	95	104	108	111	112
Greece	-3.4	-1.9	-1.7	-1.2	1.3	2.5	-10.0	-5.1	-4.0	-2.5	-1.2	0.2	157	181	197	207	209	208
Ireland	4.4	4.5	5.2	5.8	6.6	7.0	-7.3	-7.4	-4.6	-2.4	-1.6	-1.2	117	122	121	118	114	111
Portugal	-3.5	0.0	2.0	2.9	3.2	3.5	-6.4	-5.6	-5.2	-3.8	-3.2	-3.1	124	136	145	148	149	150
Netherlands	9.9	9.3	8.8	9.4	9.4	9.6	-4.1	-3.6	-3.2	-2.7	-2.1	-1.2	71	74	76	76	76	75
Belgium	-1.4	-1.3	-1.1	-0.7	-0.1	0.5	-3.9	-3.3	-3.2	-2.4	-1.8	-1.6	100	103	104	103	102	99
Denmark	5.5	4.9	4.2	4.2	4.0	3.8	-4.1	-2.0	-1.2	-1.0	0.5	1.0	46	47	47	46	44	41
Norway	14.2	14.5	14.9	15.2	15.4	15.0	13.8	13.1	13.0	14.0	15.5	15.0	NA	NA	NA	NA	NA	NA
Sweden	7.2	7.3	7.2	6.9	7.1	7.0	-0.7	-1.4	-1.5	-0.4	0.7	1.5	39	39	40	39	36	33
Switzerland	12.8	13.2	12.6	12.8	14.2	14.0	0.5	0.6	0.7	0.7	0.7	-0.6	47	45	44	43	42	42
United Kingdom	-3.7	-2.5	-2.4	-2.2	-1.8	-1.4	-6.3	-7.5	-7.1	-6.7	-5.5	-4.7	90	94	100	104	107	109
Emerging Markets	1.7	1.1	0.7	0.1	-0.3	-0.5	-1.7	-2.4	-2.6	-2.5	-2.4	-2.4	42	42	42	41	40	40
China	2.3	2.2	2.0	1.5	0.8	0.5	-2.0	-2.0	-2.0	-1.5	-1.5	-1.5	45	45	45	44	43	42
Taiwan	10.5	8.4	8.0	8.0	8.0	8.0	-1.6	-1.2	-1.3	-1.0	-0.7	-0.5	39	40	42	43	44	44
India	-5.1	-4.1	-3.3	-3.4	-3.4	-3.5	-7.3	-7.0	-6.7	-6.4	-6.1	-5.8	68	67	66	65	64	63
Indonesia	-2.7	-2.3	-1.8	-1.2	-0.9	-0.8	-1.8	-2.1	-1.4	-1.0	-0.5	-0.4	24	23	23	21	20	20
Korea	3.8	2.8	1.7	0.7	0.2	-0.5	1.5	0.9	2.3	2.3	2.6	2.1	33	35	33	31	29	28
Czech Republic	-2.4	-2.8	-1.9	-1.6	-1.3	-0.8	-4.4	-2.9	-2.9	-2.9	-3.0	-2.5	46	49	50	51	51	51
Hungary	1.6	2.6	3.3	4.1	4.9	5.7	-1.9	-2.7	-2.9	-3.0	-2.8	-3.0	79	79	79	78	77	76
Poland	-3.5	-2.7	-3.6	-4.0	-4.3	-4.3	-3.9	-3.9	-3.5	-3.1	-3.0	-3.0	53	54	54	54	53	53
Romania	-3.8	-3.8	-4.5	-4.7	-5.0	-5.0	-2.2	-2.2	-2.5	-2.3	-2.0	-2.0	41	40	39	38	37	37
Russia	3.9	2.8	0.9	-1.7	-3.2	-4.2	-0.7	-2.0	-4.1	-4.6	-3.4	-3.4	8	7	10	13	15	16
Turkey	-6.0	-7.1	-7.0	-6.6	-6.0	-5.3	-2.0	-2.2	-2.7	-2.7	-3.0	-3.0	39	37	36	36	36	36
Nigeria	4.0	2.3	0.4	0.7	0.5	0.1	-2.8	-2.6	-2.8	-3.3	-2.7	-2.8	NA	NA	NA	NA	NA	NA
South Africa	-6.1	-6.0	-5.5	-4.6	-3.3	-3.1	-4.4	-4.6	-4.4	-4.0	-3.5	-3.3	41	42	43	43	43	42
Argentina	0.1	0.4	0.2	0.2	3.0	1.0	-2.6	-2.7	-2.9	-3.8	0.0	-0.5	39	40	43	45	43	41
Brazil	-2.4	-3.0	-3.1	-3.3	-3.3	-3.5	-2.5	-3.4	-3.2	-3.2	-3.2	-3.3	59	59	59	59	60	60
Mexico	-0.8	-1.6	-1.5	-2.5	-2.7	-2.7	-2.6	-2.1	-2.0	-2.0	-2.0	-2.0	40	38	38	38	37	37
Venezuela	2.9	5.5	4.5	5.5	4.6	5.0	-5.0	-4.0	-4.0	-4.8	-4.6	-4.5	41	43	36	37	38	38

Note: Fiscal deficit and debt figures for all countries are general government debt and deficits. We assume sovereign debt restructuring in Portugal, Italy and Spain in 2015 and Greece in 2017. For Spain, fiscal deficits include the effect of financial support for banks in 2011 (€5.4bn) and 2012 (€33.5bn). Source: Citi Research

Figure 15. Selected Countries — Changes in Economic Forecast from the Previous Month (Percentage Points), 2012-2014F

	GDP Growth			CPI Inflation			Current Balance (Pct of GDP)			Fiscal Balance (Pct of GDP)		
	2012	2013F	2014F	2012	2013F	2014F	2012	2013F	2014F	2012	2013F	2014F
Global			0.1							-0.1	-0.4	-0.4
<i>Based on PPP weights</i>		-0.1			-0.1		-0.1	-0.1		-0.1	-0.3	-0.3
Industrial Countries		0.1	0.1		-0.1		0.1	0.1	0.1	-0.1	-0.5	-0.5
United States			0.1					0.2	0.4	-0.2	-1.0	-1.1
Japan		0.7	0.1		-0.1	0.1	0.1		-0.2			
Euro Area		-0.1	0.3		-0.1					-0.2	-0.2	-0.1
Canada		0.3	0.1		-0.1							
Australia											-0.5	-1.1
New Zealand										0.9	-0.2	
Germany		-0.5	0.5			0.1		0.1		0.1	0.1	-0.1
France		-0.1	0.2			0.1					-0.2	-0.4
Italy		-0.3	0.6		-0.3	0.1	-0.1	1.2	2.3		0.3	0.8
Spain		0.2	0.9					-0.8	-1.1		0.1	0.8
Greece		0.5	6.7		-0.6	-18.4	0.9	1.4	-3.9	-2.7	0.5	-2.9
Ireland			-0.2					-0.1	-0.1			-0.1
Portugal	-0.1	0.6	1.2		0.3	-0.1		0.3	0.3		0.1	0.9
Netherlands			0.1		-0.2	-0.1		-0.2	-0.2	0.1	0.2	
Belgium		-0.2	-0.1		-0.1					-1.0	-0.8	-1.2
Denmark		-0.3	-0.2		-0.1		-0.1	-0.1	-0.1			
Norway		-0.2	-0.1							-0.1	-0.2	
Sweden			0.1		-0.2	-0.3			0.1	-0.2	-0.2	
Switzerland		0.4	0.2		-0.2	0.2		0.4	0.6		0.2	0.3
United Kingdom		0.3	0.1		-0.2	-0.4		0.1	0.5		0.3	0.2
Emerging Markets		-0.2	-0.1			0.0	-0.1	-0.2	-0.2		-0.2	-0.1
China						-0.4						
Taiwan		-0.3										
India					-1.0	-1.0	0.2	0.8	1.1			
Indonesia		-0.1			1.3	1.3	0.0	-0.2				
Korea		-0.3	-0.4		-0.4	-0.2		0.1	-0.3	0.1	0.1	0.9
Czech Republic	0.1	-0.6	0.4			-0.1	-0.1	-1.1	0.1		0.1	-0.2
Hungary					-0.3	-0.1			-0.1	0.2		
Poland	-0.1				-0.2	-0.4		0.1	0.1	-0.4	-0.4	-0.7
Romania		0.6	-0.1		-0.5	-0.3						
Russia		-1.0	-0.8		0.1		-0.1					
Turkey								-0.1	0.1			
Nigeria		-0.3	-0.2		-0.3	0.3	1.6	-1.4	-2.9			
South Africa					0.1		-0.1	-0.3				
Argentina												
Brazil		-0.2	-0.2		0.1		0.1	0.1	0.1	0.1	0.1	-0.1
Mexico		-0.4	0.2			-0.1	0.3	0.2	0.4			
Venezuela					5.9	7.5		-0.4	-0.6			

Source: Citi Research

Figure 16. Selected Countries — Economic Forecast Overview and Exchange Rate Forecasts (Percent), 2012-2017F

	10-Year Yields						Exchange Rates Versus U.S. Dollar*						Exchange Rate Versus Euro					
	2012	2013F	2014F	2015F	2016F	2017F	2012	2013F	2014F	2015F	2016F	2017F	2012	2013F	2014F	2015F	2016F	2017F
Industrial Countries																		
United States	1.80	2.20	2.90	3.25	3.50	3.75	NA	NA	NA	NA	NA	NA	1.28	1.27	1.25	1.25	1.27	1.29
Japan	0.85	0.75	0.65	1.00	1.25	1.50	81	105	110	110	110	110	104	133	138	138	140	142
Euro Area	1.57	1.39	1.48	1.80	2.00	2.50	1.28	1.27	1.25	1.25	1.27	1.29	NA	NA	NA	NA	NA	NA
Canada	1.87	2.04	2.85	3.50	3.50	3.65	1.00	1.03	1.01	0.97	0.96	0.96	1.28	1.30	1.26	1.22	1.22	1.23
Australia	3.28	3.25	4.10	5.00	5.50	5.20	1.02	0.98	0.96	0.95	0.93	0.92	1.24	1.29	1.31	1.33	1.36	1.40
New Zealand	3.61	3.40	4.30	5.20	5.80	5.50	0.82	0.81	0.80	0.80	0.78	0.76	1.57	1.57	1.56	1.58	1.63	1.69
Germany	1.57	1.39	1.48	1.80	2.00	2.50												
France	2.54	2.05	2.25	2.50	2.60	3.00												
Italy	5.49	4.15	3.60	5.30	5.00	5.00												
Spain	5.88	4.57	3.68	5.55	5.00	5.00												
Netherlands	1.95	1.75	1.88	2.20	2.30	2.80												
Belgium	2.43	2.25	2.40	2.60	2.80	3.20												
Denmark	1.51	1.55	1.60	1.95	2.25	2.75												
Norway	2.15	2.19	2.28	2.55	2.75	3.25	5.81	5.88	5.87	5.78	5.69	5.60	7.45	7.47	7.34	7.25	7.23	7.21
Sweden	1.59	1.77	1.83	2.10	2.25	2.75	6.73	6.71	6.82	6.77	6.65	6.54	8.63	8.53	8.53	8.49	8.46	8.42
Switzerland	0.64	0.65	0.60	0.83	0.98	1.33	0.94	0.98	1.02	1.04	1.02	1.01	1.20	1.25	1.27	1.30	1.30	1.30
United Kingdom	1.85	2.00	2.35	2.80	3.00	3.50	1.59	1.47	1.43	1.47	1.52	1.58	0.81	0.86	0.87	0.85	0.83	0.81
Emerging Markets																		
China	3.33	3.36	3.49	3.61	3.74	4.11	6.31	6.12	6.05	6.01	6.02	6.04	8.11	7.78	7.56	7.54	7.66	7.78
Taiwan	1.21	1.28	1.38	1.50	1.70	2.00	29.57	29.87	29.61	28.95	28.67	28.40	38.03	37.96	37.01	36.32	36.43	36.56
India	8.25	8.25	8.25	8.25	8.25	8.25	53.38	55.09	56.11	55.37	54.79	54.23	68.65	70.01	70.13	69.47	69.63	69.81
Indonesia	5.90	5.61	5.93	6.20	6.30	6.40	9361	9816	9805	9651	9593	9540	12038	12474	12257	12109	12191	12283
Korea	3.24	2.70	2.92	3.70	4.75	5.15	1127	1119	1077	998	992	990	1449	1422	1346	1252	1261	1274
Czech Republic	2.75	2.06	2.40	2.73	3.27	3.27	19.5	20.5	20.3	19.4	18.8	18.2	25.1	26.0	25.4	24.3	23.9	23.4
Hungary	7.91	5.46	5.67	6.00	6.00	6.00	225	236	238	232	231	231	289	300	298	291	294	297
Poland	5.05	3.72	4.25	4.68	5.16	5.01	3.25	3.31	3.29	3.11	3.04	2.97	4.18	4.21	4.11	3.90	3.86	3.83
Romania	NA	NA	NA	NA	NA	NA	3.46	3.40	3.46	3.43	3.31	2.97	4.45	4.32	4.32	4.30	4.21	3.82
Russia	NA	NA	NA	NA	NA	NA	31.1	32.6	34.0	33.7	33.4	33.2	40.0	41.4	42.5	42.2	42.5	42.8
Turkey	NA	NA	NA	NA	NA	NA	1.80	1.85	1.91	1.93	1.92	1.92	2.32	2.35	2.39	2.42	2.44	2.47
Nigeria	NA	NA	NA	NA	NA	NA	159	159	164	168	171	175	204	202	205	211	217	225
South Africa	7.15	6.81	8.00	9.15	9.20	9.25	8.21	9.47	9.64	9.72	9.80	9.89	10.56	12.03	12.05	12.20	12.46	12.73
Argentina	NA	NA	NA	NA	NA	NA	4.54	5.46	6.74	8.72	13.45	18.82	5.84	6.94	8.42	10.94	17.09	24.23
Brazil	9.31	8.48	10.25	10.88	10.00	9.50	1.95	2.00	2.06	2.09	2.14	2.18	2.51	2.55	2.58	2.63	2.72	2.81
Mexico	5.70	4.95	5.74	6.63	7.06	7.95	13.2	12.0	12.0	12.3	12.3	12.3	16.9	15.3	15.0	15.4	15.6	15.8
Venezuela	11.26	10.91	10.67	15.50	15.50	15.50	4.29	6.13	6.30	9.75	10.50	12.71	5.52	7.79	7.87	12.23	13.34	16.36

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

Figure 17. Short Rates (End of Period), as of 22 May 2013 (Percent)

	Current	3Q 13	4Q 13	1Q 14	2Q 14	3Q 14	4Q 14
United States	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Japan	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Euro Area	0.50	0.50	0.25	0.25	0.25	0.25	0.25
Canada	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Australia	2.75	2.75	2.75	2.75	3.00	3.50	3.75
New Zealand	2.50	2.50	2.50	2.75	3.00	3.25	3.75
Denmark	0.20	0.20	0.10	0.10	0.20	0.30	0.30
Norway	1.50	1.50	1.50	1.50	1.50	1.75	1.75
Sweden	1.00	0.75	0.75	0.75	0.75	0.75	0.75
Switzerland	0.00	0.00	0.00	0.00	0.00	0.00	0.00
United Kingdom	0.50	0.50	0.50	0.50	0.50	0.50	0.50
China	3.00	3.00	3.00	3.00	3.00	3.00	3.25

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

Figure 18. 10-Year Yield Forecasts (Period Average), as of 22 May 2013 (Percent)

	Current	3Q 13	4Q 13	1Q 14	2Q 14	3Q 14	4Q 14
United States	1.93	2.10	2.35	2.60	2.80	3.00	3.20
Japan	0.88	0.80	0.70	0.60	0.50	0.70	0.70
Euro area (Germany)	1.43	1.40	1.40	1.40	1.40	1.50	1.60
Canada	1.91	2.05	2.35	2.60	2.80	3.00	3.00
Australia	3.26	3.10	3.40	3.75	4.00	4.20	4.40
New Zealand	3.38	3.30	3.60	3.90	4.20	4.40	4.70
Denmark	1.47	1.55	1.60	1.55	1.50	1.60	1.70
Norway	2.16	2.15	2.15	2.20	2.15	2.25	2.45
Sweden	1.82	1.80	1.75	1.80	1.75	1.85	1.95
Switzerland	0.60	0.65	0.65	0.61	0.61	0.65	0.69
United Kingdom	1.91	2.05	2.10	2.20	2.30	2.40	2.50

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

Figure 19. 10-Year Yield Spreads (Period Average), as of 22 May 2013

	Spread vs. US\$						Spread vs. Germany					
	Current	3Q 13	4Q 13	1Q 14	2Q 14	3Q 14	Current	3Q 13	4Q 13	1Q 14	2Q 14	3Q 14
United States	NA	NA	NA	NA	NA	NA	51	71	96	122	142	162
Japan	-114	-141	-176	-212	-212	-232	-63	-70	-80	-90	-70	-80
Euro Area	-51	-71	-96	-122	-142	-152	NA	NA	NA	NA	NA	NA
Canada	-2	-5	0	0	0	0	49	66	96	122	142	152
Australia	135	101	107	117	122	122	186	172	203	239	264	274
New Zealand	147	122	127	132	142	143	198	193	223	254	284	295
France	-3	-11	-26	-52	-62	-72	47	60	70	70	80	80
Italy	197	179	154	103	83	48	247	250	250	225	225	200
Spain	222	209	184	118	98	48	272	280	280	240	240	200
Netherlands	-23	-36	-56	-82	-102	-112	27	35	40	40	40	40
Belgium	12	9	-6	-32	-42	-62	62	80	90	90	100	90
Austria	-19	-31	-51	-77	-102	-112	31	40	45	45	40	40
Finland	-33	-46	-66	-92	-112	-122	17	25	30	30	30	30
Ireland	151	129	104	78	58	48	201	200	200	200	200	200
Denmark	-46	-56	-76	-107	-132	-142	4	15	20	15	10	10
Norway	23	4	-21	-42	-67	-77	73	75	75	80	75	75
Sweden	-11	-31	-61	-82	-107	-117	39	40	35	40	35	35
Switzerland	-133	-146	-171	-201	-221	-237	-83	-75	-75	-79	-79	-85
United Kingdom	-2	-5	-25	-40	-51	-61	48	66	71	81	91	91

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

Source: Citi Research

Figure 20. Emerging Market Countries — Short Rates Actual and Forecast of Additional Rate Moves (End of Period), as of 22 May 2013

Country	Current Rate (%)	Jun 13	Sep 13	Dec 13	Mar 14	Jun 14	Total Cumulative Rate Moves Expected
Brazil	7.50	25	50	0	0	0	75
Indonesia	4.00	0	75	0	0	0	75
Philippines	3.50	0	0	0	25	50	75
Malaysia	3.00	0	0	0	25	25	50
Korea	2.50	0	0	0	0	0	0
China	3.00	0	0	0	0	0	0
Czech	0.05	0	0	0	0	0	0
Mexico	4.00	0	0	0	0	0	0
Turkey	4.50	0	-50	0	0	50	0
Israel	1.50	-25	-25	0	25	0	-25
South Africa	5.00	0	-25	0	0	0	-25
Thailand	2.75	-25	0	0	0	0	-25
Chile	5.00	0	-50	0	0	0	-50
India	7.25	0	-25	-25	0	0	-50
Poland	3.00	-25	-25	0	0	0	-50
Hungary	4.75	-50	-25	0	0	0	-75
Russia	8.25	0	-50	-25	0	0	-75

Source: Citi Research

Figure 21. Foreign Exchange Forecasts (End of Period), as of 22 May 2013

	vs. USD						vs. EUR					
	Current	Sep 13	Dec 13	Mar 14	Jun 14	Sep 14	Current	Sep 13	Dec 13	Mar 14	Jun 14	Sep 14
United States	NA	NA	NA	NA	NA	NA	1.29	1.27	1.26	1.25	1.25	1.25
Japan	102	108	109	110	110	110	132	137	137	138	138	138
Euro Area	1.29	1.27	1.26	1.25	1.25	1.25	NA	NA	NA	NA	NA	NA
Canada	1.02	1.03	1.03	1.02	1.01	1.00	1.32	1.31	1.29	1.28	1.27	1.25
Australia	0.98	0.97	0.96	0.96	0.96	0.96	1.32	1.31	1.31	1.30	1.31	1.31
New Zealand	0.81	0.80	0.80	0.80	0.80	0.80	1.59	1.58	1.57	1.56	1.56	1.56
Norway	5.86	5.89	5.91	5.91	5.88	5.86	7.53	7.46	7.42	7.39	7.36	7.33
Sweden	6.68	6.77	6.82	6.84	6.83	6.82	8.59	8.58	8.56	8.55	8.54	8.53
Switzerland	0.97	0.99	1.00	1.00	1.01	1.02	1.24	1.26	1.25	1.25	1.26	1.27
United Kingdom	1.53	1.46	1.43	1.42	1.43	1.44	0.84	0.87	0.88	0.88	0.87	0.87
China	6.14	6.09	6.08	6.07	6.06	6.04	7.9	7.7	7.6	7.6	7.6	7.6
India	54.9	55.4	56.1	56.4	56.2	56.0	70.6	70.1	70.5	70.5	70.3	70.0
Korea	1117	1121	1127	1118	1090	1063	1437	1421	1415	1397	1363	1329
Poland	3.25	3.33	3.38	3.37	3.32	3.26	4.18	4.22	4.24	4.22	4.15	4.08
Russia	31.4	33.1	33.8	34.1	34.0	33.9	40.4	41.9	42.4	42.6	42.5	42.4
South Africa	9.40	9.54	9.58	9.61	9.63	9.65	12.09	12.09	12.03	12.01	12.04	12.06
Turkey	1.84	1.87	1.89	1.90	1.91	1.91	2.37	2.36	2.37	2.38	2.39	2.39
Brazil	2.03	2.00	2.03	2.05	2.06	2.06	2.61	2.53	2.55	2.57	2.57	2.58
Mexico	12.3	11.9	11.8	11.8	11.9	12.0	15.8	15.1	14.8	14.8	14.9	15.0

Source: Citi Research

Figure 22. Foreign Exchange Forecasts (End of Period), as of 22 May 2013

	vs. JPY					
	Current	Sep 13	Dec 13	Mar 14	Jun 14	Sep 14
United States	102	108	109	110	110	110
Japan	NA	NA	NA	NA	NA	NA
Euro Area	132	137	137	138	138	138
Canada	100	105	106	107	109	110
Australia	100	105	105	105	105	105
New Zealand	83.0	86.6	87.5	88.0	88.0	88.0
Norway	17.5	18.4	18.5	18.6	18.7	18.8
Sweden	15.3	16.0	16.1	16.1	16.1	16.1
Switzerland	106	109	110	110	109	108
United Kingdom	156	158	157	157	157	158
China	17	18	18	18	18	18
India	1.87	1.96	1.95	1.95	1.96	1.96
Korea	10.91	10.36	10.30	10.16	9.91	9.66
Poland	31.5	32.5	32.4	32.6	33.2	33.7
Russia	3.3	3.3	3.2	3.2	3.2	3.2
South Africa	10.9	11.3	11.4	11.4	11.4	11.4
Turkey	55.7	58.0	57.9	57.8	57.6	57.4
Brazil	50.5	54.2	53.8	53.6	53.4	53.3
Mexico	8.3	9.1	9.3	9.3	9.2	9.1

Source: Citi Research

Country Commentary

United States

Robert V. DiClemente
(1-212) 816-7942
robert.diclemente@citi.com

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

Despite some very near-term softening in activity, we continue to expect economic growth this year near 2½% (4Q/4Q). Support for expansion has improved with sustained job growth, more effective monetary accommodation, and the spillover effects of reviving housing. The rebound from last year's drought and Hurricane Sandy offset significant tax hikes in Q1, but fiscal drag has increased more recently with new spending cuts weighing on Q2 growth. Nonetheless, the restraint on consumer spending from tax hikes appears to be fading a bit and the recovery's underlying momentum may buffer some of the effects of deficit reduction in the months ahead. The base case does not anticipate major budget reforms.

The Federal Reserve's aggressive forward guidance and open-ended bond-buying have contributed to extremely accommodative financial conditions. But a dip in Q2 growth and officials' high bar for a satisfactory jobs outlook will likely sustain QE at the current pace into the second half. We expect an initial tapering of QE by September but purchases could extend at a slower rate until next spring when unemployment is expected to drop below 7%. Low inflation suggests policymakers will be slow to signal a start to exit strategies through most or all of 2014.

The outlook for inflation remains benign with current trends softer than policymakers' goal of 2%. Slower growth abroad has reduced pressures on domestic goods prices and labor costs remain subdued. We expect inflation to stabilize closer to target over the forecast horizon as global growth firms and wage costs rise with continued improvement in the employment situation.

Figure 23. United States — Economic Forecasts, 2012-2014F

					2012	2013					2014		
		2012	2013F	2014F	4Q	1Q	2QF	3QF	4QF	1QF	2QF	3QF	
GDP	SAAR				0.4%	2.5%	1.5%	2.4%	3.1%	3.2%	3.1%	3.2%	
	YoY	2.2%	1.9%	2.9%	1.7	1.8	1.9	1.7	2.4	2.5	2.9	3.1	
Domestic Demand	SAAR				1.5	1.9	1.4	2.4	2.9	3.2	3.1	3.3	
	YoY	2.0	1.8	2.9	1.8	1.7	1.7	1.8	2.2	2.5	2.9	3.1	
Consumption	SAAR				1.8	3.2	1.7	2.8	3.0	3.2	3.2	3.3	
	YoY	1.9	2.3	3.0	1.8	2.0	2.1	2.4	2.7	2.7	3.1	3.2	
Business Investment	SAAR				13.2	2.1	3.8	4.6	5.8	5.4	5.3	5.5	
	YoY	8.0	4.5	5.3	5.5	4.1	4.2	5.8	4.1	4.9	5.3	5.5	
Housing Investment	SAAR				17.6	12.6	13.2	14.1	18.2	20.2	16.9	19.0	
	YoY	12.1	14.0	17.6	14.9	13.0	14.2	14.4	14.5	16.4	17.4	18.6	
Government	SAAR				-7.0	-4.1	-2.5	-2.2	-1.2	-0.9	-0.7	-0.6	
	YoY	-1.7	-2.8	-1.1	-1.8	-2.1	-2.5	-4.0	-2.5	-1.7	-1.3	-0.9	
Exports	SAAR				-2.8	2.9	2.7	4.5	7.2	7.6	7.4	7.3	
	YoY	3.4	2.2	6.8	2.1	1.8	1.1	1.8	4.3	5.5	6.7	7.4	
Imports	SAAR				-4.2	5.4	2.5	4.0	5.4	6.8	7.2	6.8	
	YoY	2.4	1.9	6.0	0.2	0.8	0.7	1.8	4.3	4.7	5.8	6.5	
PCE Deflator	YoY	1.8	1.2	2.0	1.6	1.2	1.0	1.2	1.3	1.6	2.2	2.2	
Core PCE Deflator	YoY	1.7	1.3	2.0	1.5	1.3	1.1	1.3	1.6	1.8	2.1	2.1	
Unemployment Rate	%	8.1	7.4	6.9	7.8	7.7	7.5	7.4	7.1	7.0	6.9	6.8	
Federal Gov't Balance (Fiscal Year)	\$Bn	-1087	-640	-545									
	% of GDP	-7.0	-4.0	-3.2									
General Gov't Balance (Cal Year)	% of GDP	-8.3	-6.0	-4.5									
Federal Debt	% of GDP	73	75	76									
General Gov't Debt	% of GDP	106	109	111									
Current Account	US\$b	-475	-412	-412	-442	-444	-399	-403	-401	-398	-409	-418	
	% of GDP	-3.0	-2.5	-2.4	-2.8	-2.8	-2.5	-2.5	-2.4	-2.4	-2.4	-2.5	
S&P 500 Profits (US\$ Per Share)	YoY	6.1	6.0	6.4	7.2	5.0	6.3	6.0	6.8	6.4	6.7	6.7	

Notes: F Citi forecast. E Citi Estimate. YoY Year-to-year percent change. SAAR Seasonally adjusted annual rate

Sources: Bureau of Economic Analysis, Bureau of Labor Statistics, I/B/E/S, Treasury Department, Wall Street Journal and Citi Research

Japan

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

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

Real GDP grew a solid 3.5% QoQ SAAR in the first quarter, driven by household demand and exports. We expect largely the same pace of growth to continue until the first quarter of 2014 before the consumption tax hike in April 2014 puts a strong brake on activity. First, exports likely will benefit from the sharp yen depreciation and a likely reacceleration in the U.S. economy. Second, household demand will probably maintain a solid pace reflecting reduced fears of unemployment, higher equity prices and frontloaded demand ahead of the consumption tax hike. Third, fiscal pump-priming included in the FY2012 supplementary budget now shows signs of feeding through to the economy. Lastly, a prospective strong rebound in corporate profits, along with new tax incentives and subsidies introduced by the Abe administration, are likely to boost business investment.

Meanwhile, underlying inflation seems unlikely to accelerate in a way that monetary policymakers expect. In our view, BoJ Governor Kuroda's strategy is to affect expectations among consumers, companies and market participants by bold easing measures in order to shift the Phillips curve and achieve 2% inflation in a relatively short timeframe. However, it is uncertain when and how far expectations will shift, given the unprecedented experiment of monetary policy. We remain sceptical that the measures taken so far are powerful enough to change stubborn deflationary expectations into inflationary expectations. Heavy fiscal drag from the consumption tax hike planned for April 2014 also may make it hard to change price expectations. From here, the new growth strategy that the administration plans to publish in mid-June and the administration's possible clarification of its stance on the consumption tax hike are the most important keys for the financial markets. The administration appears unlikely to announce bold structural reforms that will improve the growth potential, mostly because of concerns over a negative impact on the Upper House Election this summer. Meanwhile, discussions on whether or not to implement the consumption tax hike as planned may accelerate ahead of the Election, and this will be a key factor shaping the outlook for economic activity, prices and financial markets heading into 2014, in our view.

Figure 24. Japan — Economic Forecasts, 2012-14F

					2013				2014			
		2012	2013F	2014F	1Q	2QF	3QF	4QF	1QF	2QF	3QF	4QF
Real GDP	YoY	2.0%	2.0%	1.5%	0.0%	1.3%	3.2%	3.4%	3.6%	1.2%	0.6%	0.5%
	SAAR				3.5	4.2	3.9	2.1	4.1	-5.1	1.6	1.7
Domestic Demand	YoY	2.8	1.9	0.3	0.6	1.5	2.6	2.9	3.0	0.0	-0.8	-0.9
	SAAR				2.0	3.8	3.5	2.2	2.4	-7.6	0.2	1.5
Private Consumption	YoY	2.3	1.7	0.4	1.2	1.3	2.1	2.2	2.5	-0.1	-0.3	-0.5
	SAAR				3.7	1.2	1.7	2.0	5.2	-8.7	0.9	1.2
Business Investment	YoY	1.9	-1.4	4.3	-5.6	-4.4	0.8	3.8	6.3	4.9	3.3	2.6
	SAAR				-2.6	4.1	8.1	6.0	7.2	-1.6	2.0	3.2
Housing Investment	YoY	3.0	8.9	-7.1	9.6	9.3	10.3	6.6	2.6	-7.3	-11.4	-12.1
Public Investment	YoY	12.6	13.6	-11.6	13.9	15.0	14.0	11.5	2.5	-13.0	-17.5	-17.0
Exports	YoY	-0.1	2.1	5.6	-3.7	-1.8	4.8	10.0	7.3	6.5	5.0	3.8
	SAAR				16.1	8.1	8.3	7.7	5.1	4.9	2.3	2.6
Imports	YoY	5.5	1.8	-2.0	0.2	-0.2	1.4	6.0	3.4	-1.1	-4.1	-5.9
	SAAR				4.0	5.5	5.4	9.4	-6.0	-11.6	-7.1	1.5
CPI	YoY	0.0	0.0	2.0	-0.6	-0.2	0.3	0.4	0.5	2.6	2.5	2.3
Core CPI	YoY	-0.1	0.1	2.0	-0.3	0.0	0.3	0.5	0.5	2.6	2.5	2.3
Nominal GDP	YoY	1.1	0.9	2.2	-1.0	0.1	2.0	2.5	3.1	2.2	1.8	1.7
Current Account	¥ tn	5.2	3.0	8.6	2.9	3.0	3.6	2.5	4.8	8.4	10.4	10.6
	% of GDP	1.1	0.6	1.7	0.6	0.6	0.7	0.5	1.0	1.7	2.1	2.2
Unemployment Rate	%	4.4	4.1	3.9	4.2	4.1	4.1	3.9	3.8	3.8	4.0	4.1
Industrial Production	YoY	-0.9	-0.1	3.2	-7.7	-3.1	2.6	6.5	5.9	3.5	2.4	1.3
Corporate Profits (Fiscal Year)	YoY	5.0	40.0	-5.0								
General Govt. Balance (Fiscal Year)	% of GDP	-10.7	-9.8	-7.0								
General Govt Debt	% of GDP	237	244	245								

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

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

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

Euro Area

We cut our euro area 2013 GDP forecasts slightly to -0.7% YY from -0.6%, but raise our 2014 estimate to +0.0% from -0.3%. There are two main drivers behind these revisions. First, the 1Q GDP estimate disappointed slightly, particularly from Germany, together with evidence of continued underlying weakness in the soft core (FR, BE & NL). Second, we no longer expect Greece to leave the euro area in 2014, removing the downward bias in our baseline forecast around year-end.

To be sure, the lack of progress in various sentiment indicators since the start of 2Q continues to point to a very weak euro area outlook, likely extending the period of negative quarterly GDP readings into 2H 2013. Credit availability and cost are still causing problems for a large number of SMEs, even if the proportion of banks tightening lending standards fell to an aggregated net 8% in April (lowest for three quarters). Unemployment remains on a clear upward trajectory and businesses do not feel confident enough to alter their pessimistic mood about future staffing levels.

Yet market sentiment has improved significantly since the start of 2013, enabling periphery sovereigns to issue government debt at rapidly shrinking spreads, partly helped by the ECB's actions. The Governing Council's decision to cut its main refinancing rate by 25bp to a new record-low of 0.5% on 2 May, together with President Draghi not ruling out the possibility of another rate cut, and the enhanced commitment in the provision of unlimited liquidity, likely convinced investors that the ECB will keep monetary policy loose for an extended period, consistent with its medium-term objective of keeping inflation at "below but close to 2%".

We are leaving our inflation forecasts largely unchanged in May, lowering the 2013 average by 0.1ppt to 1.5% and maintaining the 2014 estimate at 1.3%. These compare to the ECB's 1.6% and 1.3% mid-points for 2013 and 2014, respectively. Given the likelihood of inflation undershooting compared to the ECB's target and the persistence of downside risks to economic activity, we still expect another 25bp refi rate cut to 0.25% in 2H-12, with a preference for 4Q. Recent ECB comments suggest that there is currently no consensus about negative deposit rates, a situation that we do not have as our central scenario.

Figure 25. Euro Area — Economic Forecasts, 2012-14F

		2012	2013F	2014F	2013				2014			
					1Q	2QF	3QF	4QF	1QF	2QF	3QF	4QF
Real GDP	YoY	-0.5%	-0.7%	0.0%	-1.0%	-0.9%	-0.8%	-0.3%	-0.1%	-0.1%	0.1%	0.3%
	SAAR	-	-	-	-0.9	0.1	-0.2	-0.3	0.1	0.0	0.4	0.6
Final Domestic Demand	YoY	-1.6	-1.2	-0.2	-1.7	-1.2	-1.1	-0.8	-0.5	-0.3	-0.2	0.0
Private Consumption	YoY	-1.3	-0.8	-0.2	-1.2	-0.9	-0.8	-0.4	-0.3	-0.2	-0.1	0.0
Government Consumption	YoY	-0.3	-0.3	-0.4	-0.3	-0.1	-0.2	-0.7	-0.6	-0.5	-0.5	-0.1
Fixed Investment	YoY	-3.9	-3.4	-0.1	-4.8	-3.6	-3.1	-2.0	-0.6	-0.1	-0.1	0.3
— Business Equipment	YoY	-3.3	-3.5	1.3	-5.0	-4.1	-3.1	-1.7	0.6	1.5	1.3	1.7
— Construction	YoY	-4.3	-2.9	-1.6	-4.1	-2.7	-2.7	-1.9	-2.0	-1.8	-1.4	-1.1
Stocks (Contrib. to Y/Y GDP Growth)		-0.3	-0.2	0.0	-0.2	-0.3	-0.1	0.0	0.0	0.0	0.0	0.0
Exports	YoY	2.9	1.2	2.4	1.8	0.9	0.5	1.7	2.2	2.1	2.4	2.9
Imports	YoY	-0.8	-0.7	1.6	-0.8	-1.2	-0.9	0.2	1.3	1.4	1.6	2.1
CPI	YoY	2.5	1.5	1.3	1.9	1.4	1.4	1.2	1.1	1.4	1.4	1.3
Core CPI	YoY	1.5	1.2	1.0	1.4	1.0	1.3	1.1	1.0	1.1	1.0	1.0
CPI Ex Energy and Food	YoY	1.8	1.3	1.1	1.5	1.2	1.3	1.2	0.9	1.3	1.2	1.1
Unemployment Rate	YoY	11.4	12.2	12.4	12.0	12.1	12.2	12.3	12.4	12.4	12.5	12.5
Current Account Balance	EUR bn	118.3	242.2	224.2								
	% of GDP	1.2	2.5	2.3								
General Government Balance	EUR bn	-352.7	-278.7	-244.5								
	% of GDP	-3.7	-2.9	-2.5								
Primary Balance	% of GDP	-0.4	0.3	0.6								
General Government Debt	EUR bn	8,596.9	9,197.8	9,491.2								
	% of GDP	90.6	95.9	97.5								
Gross Operating Surplus	YoY	-0.1	0.1	0.2								

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

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

Germany

We are lowering our 2013 forecast to 0.3% from 0.8% last month after the release of a disappointingly soft Q1 GDP figure, showing growth of 0.1% QQ (down 0.3% YY). We expect annualised growth of only about 1% in the first half of 2013, highlighting the still-cautious outlook for spending and investment. Although we doubt that German Chancellor Angela Merkel will heed the calls from her euro area partners for some loosening in the German fiscal policy stance ahead of the September elections, we believe any relaxation would ensure that German economic activity would outperform that of its peers both this year and next. On the political front, polls continue to suggest that Angela Merkel will be re-elected in September.

France

France fell back into recession in 1Q 2013, when INSEE confirmed that economic activity dropped by 0.2% QQ for the second successive quarter. With business surveys showing no signs of tangible improvement at the start of Q2, we are cutting our 2013 GDP forecast by 0.1ppt to -0.3%. While this is a blow to the French government's hope of modestly positive GDP outcome for 2013, the persistence of economic difficulties has led the European Commission to recommend giving Paris two extra years to bring its budget deficit below the 3%-of-GDP threshold, improving on the one-year delay that was in the Finance Ministry's sights. Despite the government's very low (and still falling) popularity highlighting some implementation risks, we continue to believe that more reforms aimed at reducing France's high share of public expenditure will have to be initiated in the coming quarters and years to reassure voters and investors.

Italy

Recent data suggest the recession is likely to persist, probably for the rest of this year and in 2014. Fiscal tightening remains severe, although less than in 2012, and credit conditions remain extremely tight due to banks' weak capital and asset quality deterioration. The government's decision to scrap some planned tax hikes is unlikely to give much boost to GDP, because fiscal room is limited and, if approved, these will have to be replaced by other deficit-reducing measures. The fiscal deficit is likely to again exceed the 3% limit this year, as pressure to loosen the fiscal stance within the government is mounting. The government debt/GDP ratio will likely get close to 140% in 2014. Some form of debt restructuring (in the form of maturity extension or interest rate reduction) may be likely in coming years.

Figure 26. Germany, France and Italy — Economic Forecasts, 2012-14F

		Germany			France			Italy		
		2012	2013F	2014F	2012	2013F	2014F	2012	2013F	2014F
Real GDP	YoY	0.9%	0.3%	1.3%	0.0%	-0.3%	0.4%	-2.4%	-1.9%	-0.6%
Final Domestic Demand	YoY	0.3	0.6	1.5	-0.1	-0.3	0.2	-4.7	-2.4	-1.1
Private Consumption	YoY	0.6	0.8	1.1	-0.3	-0.2	0.2	-4.3	-2.4	-0.8
Fixed Investment	YoY	-2.0	-1.0	3.4	-1.2	-2.3	-0.1	-8.0	-4.2	-1.9
Exports	YoY	4.3	1.3	3.3	2.5	0.0	1.8	2.2	0.9	1.0
Imports	YoY	2.2	1.4	3.7	-0.9	-0.6	1.0	-7.8	-3.0	-0.4
CPI	YoY	2.0	1.4	2.2	2.0	1.0	1.6	3.3	1.6	1.3
Unemployment Rate	%	5.5	5.3	5.3	9.9	10.9	11.1	10.6	11.9	12.1
Current Account	€bn	185.4	181.4	151.4	-49.3	-35.3	-19.7	-11.6	14.3	32.3
	% of GDP	7.0	6.8	5.5	-2.4	-1.7	-0.9	-0.7	0.9	2.1
General Govt. Balance	€bn	4.1	-2.9	-7.9	-98.8	-77.8	-73.0	-47.6	-49.6	-41.5
	% of GDP	0.2	-0.1	-0.3	-4.8	-3.8	-3.5	-3.0	-3.2	-2.7
Primary Balance	% of GDP	2.6	2.4	2.2	-2.3	-1.2	-0.9	2.5	2.2	2.5
General Govt. Debt	% of GDP	81.9	81.6	79.4	90.4	94.2	96.1	127.0	133.2	137.8
Gross Trading Profits	YoY	-1.9	-4.8	-1.0	-0.9	0.0	1.0	-2.4	-1.9	-0.6

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

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

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

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

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

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

Spain

We expect the recession will continue in 2013 and 2014, reflecting heavy fiscal drag, tight financing conditions, ongoing private deleveraging and housing adjustment. Export performance is improving but it is not enough, in our view, to offset the drop in domestic demand. The government has once again revised its deficit targets up, to 6.3% of GDP in 2013 (previous: 4.5%) and to 5.5% in 2014, and the pace of fiscal consolidation in 2013-14 is expected to slow relative to 2011-12. We still see risks that extra bank recap (given rising NPLs) will be needed after new steps towards cleaning up the banks' balance sheets. The debt ratio is expected to continue to rise rapidly and we think that some form of debt restructuring (maturity extensions/coupon reductions) may be likely eventually.

Greece

Although we still see risks of Greece leaving the euro in the next few years, we have removed "Grexit" from our central scenario in 2014. The governing coalition looks somewhat less fragile than we previously thought, even after pushing for more public sector job cuts last month, and social unrest remains contained overall so far. Growth is still likely to underperform targets this year and the next in our view, but improved achievements on bailout targets should make the Europeans more willing to grant additional OSI to Greece at the end of 2013 or in 2014.

Ireland

Recent data have been mixed, but overall suggest that GDP was roughly flat in Q1. Retail sales volumes fell 3.0% QoQ in Q1, while exports also fell, and broad money and credit continued to shrink. However, industrial production rebounded by 2.1% QoQ and the composite PMI held above 50. Our forecasts are little changed, with modest growth and a rising debt/GDP ratio this year but (provided external growth picks up and the euro does not rise ignorantly further) higher growth and a slight drop in the debt/GDP ratio next year. Nevertheless, Ireland's path back to fiscal sustainability will be extended and remains vulnerable to shocks.

Portugal

The recession is likely to remain severe this year and in 2014, due to fiscal austerity to rein in the still-high fiscal deficit (around 6% of GDP) and tight credit conditions. Additional spending cuts for 2014 have just been announced and ongoing austerity is likely to weaken the support for the bailout programme and the government. With about half of the debt in official hands, we think some combination of further OSI (after the recently-agreed 7-year maturity extension of bailout loans) and perhaps PSI (in the form of coupon-reduction/maturity extensions) may be eventually required to restore sustainability.

Figure 27. Spain, Greece, Ireland and Portugal — Economic Forecasts, 2012-14F

		Spain			Greece			Ireland			Portugal		
		2012	2013F	2014F	2012	2013F	2014F	2012	2013F	2014F	2012	2013F	2014F
Real GDP	YoY	-1.4%	-2.0%	-1.2%	-6.4%	-5.5%	-4.5%	0.9%	0.6%	2.0%	-3.3%	-3.1%	-1.6%
Final Domestic Demand	YoY	-4.0	-4.3	-2.3	-9.7	-6.8	-6.2	-1.2	0.2	-0.9	-6.9	-4.9	-2.9
Private Consumption	YoY	-2.2	-3.3	-1.4	-9.1	-7.2	-6.3	-0.9	1.4	-0.2	-5.6	-4.3	-2.1
Fixed Investment	YoY	-9.1	-7.8	-4.4	-19.0	-9.9	-7.0	1.1	-1.5	-3.6	-14.5	-8.8	-4.7
Exports	YoY	3.0	3.3	2.7	-2.0	-1.7	1.5	2.9	1.5	4.0	3.3	-1.1	1.0
Imports	YoY	-5.0	-4.4	-0.4	-13.7	-6.0	-5.0	0.3	1.0	1.9	-6.9	-6.0	-2.6
CPI	YoY	2.4	1.6	0.7	1.0	-0.6	-1.1	1.9	1.3	1.4	2.8	0.6	0.4
Unemployment Rate	%	25.0	27.2	28.9	24.1	28.2	31.5	14.7	13.9	13.8	15.7	18.1	19.6
Current Account	€bn	-11.3	17.8	27.9	-6.5	-3.3	-2.9	7.3	7.4	9.0	-5.8	0.0	3.2
	% of GDP	-1.1	1.7	2.7	-3.4	-1.9	-1.7	4.4	4.5	5.2	-3.5	0.0	2.0
General Govt. Balance	€bn	-111.6	-65.3	-52.3	-19.4	-8.7	-5.7	-12.0	-12.4	-8.0	-10.6	-9.0	-8.1
	% of GDP	-10.6	-6.3	-5.1	-10.0	-5.1	-4.0	-7.3	-7.4	-4.6	-6.4	-5.6	-5.2
Primary Balance	% of GDP	-7.7	-3.0	-1.5	-5.0	-0.3	0.5	-3.4	-1.9	0.5	-2.0	-1.1	-0.7
General Govt. Debt	% of GDP	84.2	94.6	104.1	156.9	180.6	196.7	117.4	122.4	121.0	123.6	136.1	145.2

F Citi forecast. YoY Year-to-year growth rate. For Ireland we show the GDP deflator rather than the CPI, for Spain fiscal deficits include the effect of financial support for banks in 2011 (€5.4bn) and 2012 (€11.6bn). Sources: INE, Haver Analytics, Eurostat and Citi Research

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

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

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

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

Netherlands

We leave our 2013 GDP forecast unchanged at -1.0%. Rising unemployment and purchasing power worries have been the mainstay of the Dutch households for some time. In our view, the situation will not change in the near term given the government's focus on fiscal consolidation efforts. The added worry for households who are exposed to residential real estate is the continued erosion in the price of residential real estate, 20% lower in April 2013 than the Aug-08 peak compared to a fall of 17% last December. We expect the contraction in domestic demand to continue until 1Q 2014 when we forecast GDP to finally break into positive territory.

Belgium

Belgium printed a modest 0.1% QQ gain in 1Q GDP, exceeding our 0.0% forecast. Although this was the first positive reading in four quarters, business confidence is struggling to recover meaningfully, suggesting in our view that the consensus of a modest recovery by year-end will be challenged. Indications from the Finance Ministry that a budgetary reserve would be created by freezing some credit relating to primary expenditure do not point to much relaxation in the budgetary consolidation effort. We keep our forecast of a tepid recovery in 2014, envisaging a 0.2% outcome, highlighting the large downside risks versus the 1.1% consensus.

Slovakia

1Q13 GDP outperformed, but domestic demand struggled. We slightly revise upwards our GDP growth forecast to 0.8%YoY in 2013 and to 2% in 2014 owing to the better outlook on exports, though some downside risks persist. While the government remains committed to the 3% of GDP fiscal deficit target, it is not supported by detailed fiscal plans.

Slovenia

The March data — decline in industrial and construction output, retail sales, accompanied with higher unemployment rate — were not supportive for GDP growth. The Government published a programme that envisages the transfer of troubled assets into the “Bad Bank” in Jun-Sep this year, and the start of privatisation processes in September. Low transfer price and privatisation revenues will probably help to stabilize the government debt above 70% of GDP in 2015 (with upside risk to 75% if the whole €4bn balance sheet of “Bad Bank” is exploited). However, some shortcomings remain in the plans for spending cuts, privatisation of the largest state-owned bank, and the fiscal golden rule. Moody's cut of the rating one notch below investment grade in April was followed by Fitch's cut to three notches above speculative grade (S&P is four notches).

Figure 28. Netherlands, Belgium, Slovakia and Slovenia — Economic Forecasts, 2012-2014F

		Netherlands			Belgium			Slovakia			Slovenia		
		2012	2013F	2014F	2012	2013F	2014F	2012	2013F	2014F	2012	2013F	2014F
Real GDP	YoY	-1.0%	-1.0%	0.1%	-0.2%	-0.3%	0.2%	2.0%	0.8%	2.0%	-2.2%	-1.9%	-0.2%
Final Domestic Demand	YoY	-1.6	-2.6	-0.4	-0.7	-0.6	-0.1	-1.4	-0.4	1.2	-3.8	-3.4	0.1
Public Consumption	YoY	0.0	-1.5	-0.7	0.1	0.0	0.3	-0.6	-1.4	-0.5	-1.6	-1.0	-0.6
Private Consumption	YoY	-1.4	-1.1	-0.3	-0.6	-0.1	-0.2	-0.6	0.1	0.6	-2.8	-3.7	-0.1
Investment (Ex Stocks)	YoY	-4.6	-8.4	0.1	-0.5	-2.5	-0.1	-3.7	-1.1	3.5	-9.1	-5.7	1.4
Exports	YoY	3.3	1.9	1.3	0.4	-0.2	2.2	8.6	3.3	3.3	1.3	0.4	2.1
Imports	YoY	3.1	-0.7	0.8	-0.1	-1.0	2.2	2.8	1.4	2.6	-4.3	-1.3	2.6
CPI (Average)	YoY	2.8	2.6	1.7	2.8	1.2	2.0	0.0	1.7	2.0	2.6	1.6	1.8
Unemployment Rate	%	6.4	7.9	8.3	7.6	8.4	8.7	13.6	14.5	14.7	8.9	9.7	10.5
Current Account	% of GDP	9.9	9.3	8.8	-1.4	-1.3	-1.1	2.2	3.3	3.2	2.3	2.4	3.1
General Govt Balance	% of GDP	-4.1	-3.6	-3.2	-3.9	-3.3	-3.2	-4.3	-3.4	-3.0	-4.0	-9.1	-6.0
Primary Balance	% of GDP	-2.2	-1.7	-1.3	-0.5	0.3	0.4	-2.9	-2.0	-1.5	-1.9	-6.9	-3.7
General Govt Debt	% of GDP	71.2	74.2	75.6	99.8	102.7	104.1	52.1	55.6	56.4	54.1	63.3	70.3

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

UK

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

We are lifting our 2013 growth forecast from 0.4% to 0.7%, and edging up the 2014 forecast to 0.8% from 0.7%. Recent data have been a bit better than expected, with Q1 GDP up 0.3% QoQ (we expected roughly zero). However, real GDP per head is roughly flat in YoY terms and about 6% below the pre-recession peak, and the outlook remains mixed, with gains in the PMI surveys but weakness in the European Commission's Economic Conditions Index. Powerful headwinds remain from private deleveraging and structural export weakness, while fiscal drag should intensify in 2013 and 2014. We are trimming our CPI inflation forecasts to 2.7% for 2013 and 2.3% for 2014 (versus 2.9% and 2.7% last month), reflecting recent weakness in wages and commodity prices plus the slight appreciation in sterling. We still expect that CPI inflation will not return to the 2% target in 2013 or 2014, but the overshoot is likely to be small — and more than accounted for by regulatory-driven gains in utility prices and university tuition fees. The economy does not have a general inflation problem: wage growth and the GDP deflator are very weak, while the IMF judges that the output gap will not be closed even in 2018.

BoE-Governor Designate Mark Carney's recent speech makes it clear that he strongly supports the use of forward guidance as a tool to loosen monetary policy. We expect the BoE will introduce guidance that goes beyond that used by the BoC in 2009 (a clear commitment to keep the policy stable, but only for the next five quarters). Most likely, the BoE will use Fed-style forward guidance with an intermediate threshold based on unemployment or nominal GDP growth and inflation knockout set above the 2% inflation target (eg at 2.5%), pointing to stable rates for at least 2 years. This would aim to compensate for the MPC's inability (and unwillingness) to cut rates significantly below zero by pre-committing to exit the zero bound later, hence generating higher expectations of future incomes and asset prices that feed back to higher spending now.

Figure 29. United Kingdom — Economic Forecasts, 2012-2014F

					2013				2014			
		2012	2013F	2014F	1Q	2QF	3QF	4QF	1QF	2QF	3QF	4QF
Real GDP	YoY	0.3%	0.7%	0.8%	0.6%	1.1%	0.3%	0.9%	0.6%	0.7%	0.9%	1.1%
	SAAR				1.6	0.4	0.7	0.8	0.3	0.9	1.5	1.8
Domestic Demand (Incl. Inventories)	YoY	1.4	0.5	0.7	1.1	0.4	0.0	0.3	0.2	0.7	0.9	1.0
	SAAR				0.9	-1.0	0.3	1.1	0.3	1.1	1.2	1.5
Consumption	YoY	1.2	1.4	1.2	1.7	1.6	1.4	1.0	0.7	0.9	1.3	1.9
	SAAR				2.0	1.4	0.6	0.2	0.6	2.1	2.5	2.4
Investment	YoY	1.5	-1.0	-0.3	1.0	-1.1	-2.1	-1.8	-1.5	-0.9	0.6	0.6
	SAAR				-0.1	-1.8	-5.6	0.4	1.3	0.4	0.2	0.6
Exports	YoY	-0.2	0.3	4.4	-2.0	0.7	-0.2	2.5	4.5	3.9	4.3	4.7
	SAAR				-3.7	6.3	3.7	4.2	4.0	3.8	5.3	5.7
Imports	YoY	2.7	-0.5	3.9	-0.4	-1.4	-1.2	1.1	3.1	3.9	4.3	4.2
	SAAR				-4.2	1.3	2.3	5.1	3.8	4.3	4.1	4.6
Unemployment Rate	%	7.9	8.1	8.1	7.9	8.0	8.2	8.1	8.1	8.1	8.1	8.0
CPI Inflation	YoY	2.8	2.7	2.3	2.8	2.8	2.7	2.6	2.4	2.4	2.2	2.2
Merch. Trade	£bn	-106.1	-98.0	-95.2								
	% of GDP	-6.9	-6.2	-5.8								
Current Account	£bn	-57.7	-40.4	-39.7								
	% of GDP	-3.7	-2.5	-2.4								
PSNB	£bn FY	-87.9	-110.0	-106.9								
	% of GDP	-5.7	-6.9	-6.5								
General Govt. Balance	% of GDP	-6.3	-7.5	-7.1								
Government Primary Balance		-2.6	-3.7	-3.3								
Public Debt	% of GDP	89.5	94.0	99.9								
Gross Nonoil Trading Profits	YoY	3.6	12.3	3.8								

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

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

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

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

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

Switzerland

We are edging up our growth forecasts to 1.5% for 2013 and 1.3% for 2014, versus 1.1% in both years last month, reflecting evidence in surveys and trade data of continued output growth and solid export gains so far this year. Nevertheless, CPI inflation remains firmly negative, and the SNB will continue to resist currency appreciation. Short term rates are likely to remain anchored close to zero for the foreseeable future in our view.

Sweden

Although the worst is behind us, economic recovery is likely to be weak in a historical perspective; exports will stay weak, household deleveraging risks are increasing and ongoing fiscal erosion limits the size of fiscal easing. With well-below trend GDP growth and rising unemployment, the government has announced total fiscal stimulus of around SEK 25bn (0.7% of GDP) this year. Combined with the outlook for monetary policy of a fairly long period of ultra-low rates, economic policies should continue to support economic growth ahead.

Denmark

Economic activity remains sluggish and given the substantial setback in 4Q 2012, the economy entered 2013 at a lower level than previously assumed. Coupled with weak export growth and stagnant domestic spending, we have cut our 2013 GDP forecast by 0.3pp, and now barely see any growth this year. Although implemented economic reforms have not had the intended effect in the short-term, they should bolster the fundamental structure of the economy, thus making it better positioned to benefit from economic recovery once the cycle in earnest turns. The DNB only partly shadowed ECB action in May, cutting its lending rate by 10bp to 0.20%, as the EUR/DKK had been reasonably stable and only trading marginally stronger than the central parity, at the same time as the lending rate was already close to zero prior to the rate announcement.

Norway

The cushion of high oil receipts and recovering private spending early this year should ensure continued Norwegian outperformance versus most of Europe. Momentum, though, has peaked and mainland GDP should settle at a slightly below-trend pace ahead in our view. The government's spring budget was seemingly more expansionary than what the original 2013 budget called for, but the stronger fiscal stimulus mostly reflected revisions to the 2012 outcome. Hence, the government refrained from pouring even more oil money into the economy to improve its chances for re-election in September. Monetary policy is likely to remain loose, with the key policy rate at 1.50% in the foreseeable future, absent any new lows in the I-44 NOK exchange rate.

Figure 30. Switzerland, Sweden, Denmark and Norway — Economic Forecasts, 2012-2014F

		Switzerland			Sweden			Denmark			Norway		
		2012	2013F	2014F	2012	2013F	2014F	2012	2013F	2014F	2012	2013F	2014F
Real GDP	YoY	1.0%	1.5%	1.3%	1.2%	1.0%	2.0%	-0.5%	0.1%	1.5%	3.3%	2.4%	2.6%
Final Domestic Demand	YoY	1.7	1.8	1.3	2.0	1.2	1.5	0.8	1.0	1.4	2.8	2.7	2.9
Public Consumption	YoY	0.7	2.5	1.4	1.2	0.9	0.8	0.2	1.1	0.6	1.6	2.1	2.0
Private Consumption	YoY	2.5	2.0	1.8	1.7	1.7	1.8	0.6	0.5	1.4	3.1	3.0	3.1
Investment (Ex Stocks)	YoY	0.1	0.8	-0.1	4.1	0.1	1.6	2.2	2.4	2.6	3.8	2.5	4.1
Exports	YoY	1.1	4.7	2.8	1.3	0.6	2.8	0.9	0.0	3.3	3.4	2.1	2.5
Imports	YoY	2.3	4.2	3.6	0.5	0.3	2.0	2.6	0.8	3.2	4.2	1.9	3.9
CPI (Average)	YoY	-0.7	-0.5	-0.2	0.9	0.1	1.0	2.4	1.4	1.7	0.7	1.6	1.7
Unemployment Rate	%	2.6	1.9	1.9	8.0	8.2	8.2	7.5	7.5	7.4	3.2	3.3	3.4
Current Account	% of GDP	12.8	13.2	12.6	7.2	7.3	7.2	5.5	4.9	4.2	14.2	14.5	14.9
General Govt Balance	% of GDP	0.5	0.6	0.7	-0.7	-1.4	-1.5	-4.1	-2.0	-1.2	13.8	13.1	13.0
General Govt Debt	% of GDP	46.7	45.4	43.6	38.5	39.5	39.9	45.8	47.1	46.8	NA	NA	NA

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

Canada

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

First half GDP is tracking above prior expectations, with output poised to grow by about 2% QoQ SAAR. Prospects for above-potential growth in the second half and beyond are becoming more probable in our view. Nonetheless, the expansion likely will remain underwhelming as the economy continues to be buffeted by moderate external demand, domestic slack and business caution. Consumer inflation gauges should remain subdued near-term and are unlikely, in our view, to converge to the BoC's 2% target until mid-2015 — coincident with closure of the output gap. We believe the central bank should keep rates unchanged until 1Q 2015, but retain the slight tightening bias.

Upside risks include (1) stronger US demand and/or positive spillover from foreign monetary policy stimulus; (2) faster Canadian export growth; and (3) resurgence of the Canadian housing market. Downside risks include (1) EA woes; (2) delay of the Canadian capex and exports revival; and (3) domestic consumer retrenchment linked to debt and/or disorderly unwind of housing activity. Risks remain balanced.

Canada continues to undergo a healthy rotation of demand away from household and government spending and towards business investment and external trade. Going forward, the importance of consumer spending should wane amid lackluster wage appreciation and as the housing correction caps household-related consumption. Residential construction should weigh as housing starts retreat to more sustainable levels. Government consolidation should persist near-term.

Meanwhile, business investment should reinvigorate as firms increase their global market share. Exports are rebounding from the late 2012-slump, owed to firming US demand despite significant fiscal drag. Elevated commodity prices and new North American energy infrastructure should further underpin Canadian exports. However, business skepticism about global recovery, as well as competitiveness pressures related to low productivity and CAD strength, may hinder progress on these fronts.

Figure 31. Canada — Economic Forecast, 2012-2014F

					2013				2014			
		2012	2013F	2014F	1Q	2QF	3QF	4QF	1QF	2QF	3QF	4QF
Real GDP	YoY	1.8%	1.8%	2.6%	1.4%	1.3%	1.8%	2.4%	2.5%	2.7%	2.7%	2.6%
	SAAR				2.5	1.5	2.6	3.0	2.7	2.5	2.5	2.6
Final Domestic Demand	YoY	1.9	1.7	2.4	1.4	1.4	1.9	1.9	2.4	2.5	2.3	2.2
	SAAR				0.5	1.7	2.7	2.8	2.3	2.1	2.2	2.3
Private Consumption	YoY	1.9	2.3	2.3	2.0	2.5	2.4	2.3	2.4	2.3	2.3	2.3
	SAAR				2.0	2.4	2.4	2.3	2.5	2.2	2.2	2.3
Government Spending	YoY	-0.6	0.4	1.0	0.4	0.1	0.7	0.4	1.0	1.0	1.0	1.0
	SAAR				-1.5	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Private Fixed Investment	YoY	5.3	1.5	4.2	1.2	0.2	1.8	2.8	4.1	4.8	4.2	3.5
	SAAR				-1.6	0.6	5.8	6.7	3.4	3.4	3.4	3.8
Exports	YoY	1.6	2.7	5.9	0.5	1.0	4.1	5.3	5.0	5.8	6.3	6.3
	SAAR				7.8	3.0	4.7	5.9	6.4	6.4	6.4	6.2
Imports	YoY	2.9	2.1	4.7	1.2	1.7	2.2	3.4	4.4	4.5	4.7	5.0
	SAAR				1.2	4.5	4.0	4.0	5.0	5.0	5.0	5.0
CPI	YoY	1.5	1.0	1.7	0.9	0.8	1.1	1.3	1.4	1.9	1.8	1.9
Core CPI	YoY	1.7	1.4	1.9	1.3	1.1	1.4	1.6	1.7	1.9	1.9	1.9
Unemployment Rate	%	7.3	7.2	6.7	7.1	7.2	7.3	7.0	6.7	6.8	6.8	6.6
Current Account Balance	C\$bn	-67.0	-56.9	-55.5	-59.9	-61.6	-53.4	-52.6	-57.0	-56.3	-53.7	-52.9
	% of GDP	-3.7	-3.0	-2.8	-3.2	-3.3	-2.8	-2.8	-3.0	-2.9	-2.8	-2.7
Net Exports (Pct. Contrib.)		-0.5	0.1	0.3	1.9	-0.6	0.1	0.5	0.3	0.3	0.3	0.3
Inventories (Pct. Contrib.)		0.2	-0.1	-0.1	0.4	0.3	-0.2	-0.3	0.0	0.0	0.0	0.0
Budget Balance (Fiscal Year)	% of GDP	-1.4	-1.0	-0.3								
Federal Budget Debt	% of GDP	33.3	33.2	32.4								
General Govt. Debt	% of GDP	86.0	85.9	85.2								

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

Australia

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

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

Having the cash rate target at a new low of 2.75% should help with the rebalancing of the Australian economy. While the RBA's easing bias remains, the recent drop in the exchange rate should make the RBA feel more secure that it will not have to cut interest rates further. If sustained, the decline should support non-mining activity and provide some breathing room for the tradeables sector. It should also help the fiscal position of the Federal Government. The 2013 Budget delayed the move back to a cash surplus by three years to FY16, partly from the impact of the high exchange rate on revenues. This delay means that the fiscal position is slightly less of a drag on the economy during the period when mining investment will peak and non-mining domestic demand is expected to strengthen. We don't believe the RBA will look to change its policy stance. Inflation is likely to remain well contained. Productivity is improving and credit growth remains well below average.

New Zealand

The RBNZ has started the process of enacting aspects of its new macro-prudential policy framework. This is a new development. We had expected the use of the framework to coincide with the start of the monetary hiking cycle in early 2014, not in the second half of 2013. The accelerated timetable shows the Bank's desire to move sooner on concern at house price developments in Auckland and Christchurch. It also illustrates the lack of traditional options to tackle this issue. An increase in monetary policy to lean against the housing cycle is highly unlikely in our view. This would place more upward pressure on the exchange rate which, according to the RBNZ, remains overvalued and is hindering economic rebalancing. With the RBNZ going so far as to say that if it were not for the housing market, the OCR could be lowered, the only responsible outcome is to leave the OCR at 2.50% for the remainder of 2013.

Figure 32. Australia and New Zealand — Economic Forecast, 2012-2014F

	Australia			New Zealand		
	2012	2013F	2014F	2012	2013F	2014F
Real GDP ^a	3.6%	2.7%	3.1%	2.2%	2.6%	2.8%
Real GDP (4Q versus 4Q)	3.1	2.8	3.1	1.6	3.5	2.2
Real Final Domestic Demand	4.6	2.0	3.0	2.4	3.9	3.2
Consumption	3.2	2.6	3.5	1.8	3.2	2.5
Govt. Current & Capital Spending ^b	2.4	-2.0	2.7	0.5	1.0	0.9
Housing Investment	-4.5	3.8	6.1	13.4	28.5	8.9
Business Investment ^c	16.1	4.9	0.7	4.4	4.2	6.1
Exports of Goods & Services	6.3	6.9	8.4	2.1	1.8	1.0
Imports of Goods & Services	6.8	5.7	7.5	2.6	3.7	4.4
CPI	1.8	2.8	2.5	1.1	1.2	2.3
CPI (4Q versus 4Q)	2.2	2.8	2.6	0.9	2.0	2.2
Unemployment	5.2	5.4	5.7	6.9	6.1	5.1
Merch. Trade, BOP (Local Currency, bn)	-15.9	-21.4	-35.2	1.1	1.5	-0.5
Current Account, (Local Currency, bn)	-54.4	-58.2	-76.4	-10.3	-11.9	-15.3
Percent of GDP	-3.7	-3.7	-4.7	-5.0	-5.5	-6.8
Budget Balance ^d (Local Currency, bn)	-43.7	-19.4	-18.0	-9.2	-6.3	-2.0
Percent of GDP	-3.0	-1.3	-1.1	-4.4	-2.9	-0.9
General Govt. Debt (% of GDP) ^e	29.0	28.4	28.7	38.2	36.8	38.5
Gross Trading Profits ^f	-4.6	2.0	5.7	NA	NA	NA

BOP Balance of payments basis. CPI Consumer Price Index. F Citi forecast. NA Not available. ^aAveraged-based GDP in Australia and New Zealand. ^bIn New Zealand excludes capital spending. ^cIn New Zealand includes government capital spending. ^dFiscal year ending June. Australia's underlying cash balance. ^eAustralia and New Zealand Budget definition and forecasts. ^fCompany gross operating surplus. Sources: ABS, StatsNZ, NZIER and Citi Research

China

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

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

Enjiang Cheng
(86) 10 5937 6038
enjiang.cheng@citi.com

GDP growth is flattish despite accommodative credit policies. Broad money growth powered on to reach 16.1%YoY in April, way above the annual target of 13%. Total social financing in the first four months was nearly 40% higher than the same period last year. However, real economic activity hardly improved during the month, with industrial production and retail sales marginally better but fixed asset investment slightly weaker than March.

The monetary easing bias may stay for longer amid benign inflation, and we no longer expect a rate hike this year. CPI inflation edged up from 2.1% YoY in March to 2.4% in April, mainly due to weather-related increases in vegetable prices. Vegetable prices have since retreated. Seasonally adjusted inflation is stable, and inflation should not pose a threat with continued PPI deflation. Inflation may trend up to 3% YoY in the middle of the year as a result of base effects, but we expect the annual average inflation rate to stay comfortably below the official target of 3.5%YoY. As the recovery is likely to remain weak, the shift of monetary policy stance from an easing bias to a neutral position is likely to be prolonged. The recent wave of interest rate cuts in both advanced and emerging economies has significantly reduced the chance of an early rate hike in China. Capital inflows remain strong, and we expect the authorities probably will keep rates unchanged throughout the year and temporarily tolerate a negative deposit rate in real terms.

Reform is more likely than stimulus in the absence of a sharp downturn in our view. We expect accommodative credit policies to support investment through 3Q, and maintain our forecast of 7.7% growth for 2013 as a whole. Stimulus is less likely under such a scenario. Premier Li Keqiang has pointed out recently that there is little room to promote growth through further government stimulus, and stressed that the investment potential of the private sector needs to be released instead. The state council has laid out a list of reforms for this year, including interest rate liberalization, exchange rate and capital account reform, as well as *hukou* reform. However, if growth decelerates toward 7% and unemployment pressure mounts, we believe more policy easing is likely, including rate cuts (possibly accompanied by rate liberalization measures such as allowing more upward floating for deposit rates).

Figure 33. China — Economic Forecasts, 2012-2014F

		2012	2013F	2014F	2013F				2014F			
					1Q	2QF	3QF	4QF	1QF	2QF	3QF	4QF
Real GDP	YoY	7.8%	7.7%	7.3%	7.7%	7.8%	7.9%	7.5%	7.5%	7.3%	7.1%	7.3%
Real Final Domestic Demand	YoY	8.3	7.4	7.5								
Consumption	YoY	8.2	7.3	7.8								
Fixed Capital Formation	YoY	8.4	7.6	7.1								
Industrial Production	YoY	10.0	9.6	9.1	9.5	9.7	9.9	9.4	9.3	9.1	8.9	9.1
Exports	YoY	7.9	9.7	5.9	18.4	6.0	7.0	9.0	2.0	5.0	7.0	9.0
Imports	YoY	4.3	9.6	7.2	8.4	10.0	12.0	8.0	8.0	7.0	6.0	8.0
Merchandise Trade Balance	\$bn	231	254	243	43	54	62	95	16	47	71	109
FX Reserves	\$bn	3,312	3,678	3,861	3,440	3,494	3,556	3,678	3,674	3,706	3,762	3,861
Current Account	% of GDP	2.3	2.2	2.0								
Fiscal Balance	% of GDP	-2.0	-2.0	-2.0								
General Govt. Debt*	% of GDP	45.0	45.2	45.2								
Urban Unemployment Rate	%	4.1	4.1	4.2	4.1	4.1	4.1	4.1	4.2	4.2	4.2	4.2
CPI	YoY	2.6	2.9	3.1	2.4	2.7	3.0	3.5	3.3	3.0	2.8	3.4
Exchange Rate (end period)	CNY/\$	6.23	6.08	6.02	6.21	6.10	6.09	6.08	6.07	6.06	6.04	6.02
1-Yr Deposit Rate (end period)	%	3.00	3.00	3.25	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.25

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 govt and Ministry of Railway. Sources: Haver Analytics and Citi Research

India

Rohini Malkani
+91 22 6631 9876
rohini.malkani@citi.com

The focus has been on headwinds for a while, but tailwinds are now on their way. India's biggest pressure point and vulnerability — its balance of payments (BOP) and its currency — have got a breather in terms of lower commodity prices. We believe this does not remove the fundamental challenges, but it should ease risks, raise expectations and gives a sense that global commodity prices and domestic policy efforts are beginning to work in India's favor. It's still early days, but the outlook is better. We maintain our view of a shallow recovery to 5.7% in FY13/14 vs 5.0% in FY12/13. This factors in: (1) The RBI easing rates by a further 50bps (2) A pick-up in consumption as FY14 is a pre-election year and lower rates could help consumer durables; (3) A marginal uptick in investment, which rests on continued government efforts — both policy change and execution. While stalled projects are high at US\$150bn, signs of light are evident with the Cabinet Committee on Investment clearing projects to the tune of US\$20bn. (See [Delhi-Mumbai Trip](#).)

As regards inflation, both the WPI and CPI have surprised positively with the latest reading at 4.89% YoY and 9.4% respectively. Going forward, we expect the WPI to rise by an average 5.5% YoY in FY14 after 7.4% in FY13, and for CPI inflation to average 7.5% YoY from 10.2% in FY13. This is due to (1) Demand slowdown impacting pricing power. (2) The interplay of commodities and currencies are dominant factors determining trends in the WPI as tradables account for about 57% of the WPI. (3) Recent positive developments pertaining to food output (Monsoons, FAO and USDA outlook) bode well for lower prices.

In its [annual policy](#) review barely a fortnight ago, the RBI highlighted that there was "little" room for easing given India's current account deficit and "upside risks to inflation still significant in the near term in view of sectoral demand supply imbalances, ongoing correction in administered prices ...". While admittedly the latest trade data was discomfiting and CPI is still at 9.4% YoY, the incremental delta change for both is clearly trending lower. This coupled with the socio/macro consequences of sub-par growth highlights the need for policy action at all levels to revive growth. We maintain our call of a further 50bps easing in FY14, but lower inflation does increase the window for positive surprises on the rate front.

On the external front, lower commodity prices are positive, but structural imports are likely to keep the CA deficit elevated at US\$85bn or 4.1% of GDP in FY14 v/s 5.1% of GDP in FY13. Consequently, we expect the INR to be range-bound at Rs54-56.

Figure 34. India — Economic Forecasts, FY2012/13-2014/15F

		FY 12/13F	FY 13/14F	FY 14/15F
Real GDP	YoY	5.0%	5.7%	6.4%
Final Domestic Demand	YoY	3.6	5.2	6.2
Private Consumption	YoY	4.1	5.5	6.7
Fixed Investment	YoY	2.5	4.0	5.5
Exports	YoY	5.1	10.0	11.0
Imports	YoY	5.7	12.0	9.5
Wholesale Price Index*	YoY	7.3	5.5	5.0
Consumer Price Index	YoY	10.2	7.7	7.5
Current Account	US\$ bn	-95	-85	-76
	% of GDP	-5.1	-4.1	-3.3
Consolidated Fiscal Balance	% of GDP	-7.3	-7.0	-6.7
Centre Fiscal Balance	% of GDP	-5.2	-4.8	-4.6
US Dollar Exchange Rate	Average	55.0	56.1	55.8

Note: * In India, policymakers look at the wholesale price index. Sources: Haver Analytics and Citi Research

Korea

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

Despite growth gains from the government's supplementary budget, we revised down our 2013 and 2014 economic growth forecasts by 0.3% and 0.4% to 2.9% and 3.7% respectively to reflect a reduced growth contribution of exports due to continued JPY weakness. We now expect the JPYKRW pair to fall below 10.3 in 6-month horizon and below 9.5 at end-2014. The BoK lowered the policy rate unexpectedly by 25bps at the May MPC meeting, following the ECB's and RBA's easing. Besides pressure from the government, the key backdrop for the rate cut was recent appreciation of KRW against JPY and USD. Going forward, the BoK's rate decision seems likely to turn from inflation issues towards the movement of the currency pair of JPY and KRW. Owing to the decline in prices of agricultural goods and oils, the CPI fell by 0.1% MoM in April, posting two consecutive months of monthly deflation and bringing YoY inflation further down to 1.2%. Moreover, recent currency swings have intensified the declines in import prices. As a result, we are cutting our inflation forecasts for 2013 and 2014 to 1.9% and 2.8% YoY respectively, from 2.3% and 3.0% previously.

Indonesia

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

The impending fuel price hike must still go through a political process and the final magnitude will depend on the approved amount of compensatory subsidies. However we think now the likelihood of a fuel price hike has grown higher than 50%. Thus we are incorporating it into our baseline forecasts. We think that a 33% fuel price hike may push yearend-2013 inflation towards 8.2% YoY, and expect that the FasBI rate may be raised by 3x25bps by 3Q. And we are revising down our GDP growth projection slightly to 6.1%, from 6.2% previously. In the draft revision of the government budget, the fiscal deficit may be increased by up to 2.5% if GDP, or an increment of up to Rp77tn. The government's bond issuance target this year will potentially increase Rp60.8tn, according to the MoF. However we think bond demand can improve if the government goes through with a 33% or even 44% price hike. We expect that reduced fuel import volumes may help the current account by around 0.2% GDP (annualized) and the price hike would also help to reduce the perceived risk of credit rating downgrades. Therefore our baseline expects a flattening of the yield curve, as short term rates rise but long term yields remain well anchored.

Figure 35. Korea and Indonesia — Economic Forecasts, 2012-2014F

		Korea			Indonesia		
		2012	2013F	2014F	2012	2013F	2014F
Real GDP	YoY	2.0%	2.9%	3.7%	6.2%	6.1%	6.3%
Final Domestic Demand	YoY	1.1	2.4	3.5	6.2	5.7	6.5
Private Consumption	YoY	1.7	2.0	3.3	5.3	5.1	4.9
Fixed Investment	YoY	-1.7	2.3	4.2	9.8	6.7	9.5
Exports	YoY	4.2	4.3	4.8	2.0	2.3	8.1
Imports	YoY	2.5	4.0	4.6	6.6	-0.2	8.7
Consumer Price Index	YoY	2.2	1.9	2.8	4.3	6.9	5.4
Unemployment Rate	%	3.2	3.2	3.2	6.1	5.9	5.8
Current Account	US\$ bn	43.1	33.6	22.8	-24.2	-22.3	-19.1
	% of GDP	3.8	2.8	1.7	-2.8	-2.3	-1.8
Fiscal Balance	% of GDP	1.5	0.9	2.3	-1.8	-2.1	-1.4
US Dollar Exchange Rate	Average	1127	1119	1077	9361	9816	9805

Sources: Haver Analytics and Citi Research

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

Hong Kong

1Q GDP came in better than expected at 2.8% YoY, with upside surprise seen in consumption, but downside a surprise in investment. The recent keen interest in non-monetary gold by tourists helped support exports in the GDP breakdown. The 1Q data confirms that economic recovery is in place, albeit at a mild pace. We expect the recovery will gather steam in 2H. In late April, the HKMA further relaxed its CNH-related measures, reflecting the increasing maturity of the CNH market. We see those moves as positive for CNH liquidity and its funding market. CPI inflation has been softer than expected thus far this year, although the minimum wage hike and the different timings of public rental waivers this year could cause headline inflation to rise in coming months. The HKD has moved away from the strong end of the trading band on USD strength despite new lows in CNY fixings.

Singapore

Incoming NODX and air/sea cargo traffic data point to a modest uptick in trade-related activities into 2Q, though we still expect only a muted recovery. While the recent one-off fall in COE premiums may keep headline inflation close to 3% for the rest of the year, core inflation could still rise to 2% by year end. The hurdle for changes in the MAS policy stance appear high — MAS seems willing to tolerate slightly higher than average core inflation of 2-2.5% YoY while downside surprises to its upwardly-biased inflation forecasts need not trigger an easing. Policymakers have hinted that there will be no further tightening related to the availability of foreign workers and the property market for now. With FDI commitments falling and company bankruptcies edging up, we would be mindful of disinflationary pressures intensifying, if the anticipated 2H13 recovery fails to materialize.

Taiwan

Economic recovery thus far has been weak. We cut our 2013 GDP forecast by 0.3ppt to 3.2% YoY, post the 1Q GDP preliminary release (which came in below expectations at 1.54% YoY). GDP growth was dragged by weak consumption and net exports. Imports and investment continue to be strong, which are conducive for Taiwan's economic recovery in the medium term. However, YoY export growth unexpectedly turned negative in April, hit by the sharp fall in European demand, alongside lacklustre demand from China and HK. These data confirm our view that any export recovery may need to wait until 2H when new tech products are launched, and external growth improves. The TWD is torn between opposing FX forces of weakness in JPY & KRW and the stronger USD/CNY.

Figure 36. Hong Kong, Singapore and Taiwan — Economic Forecasts, 2012-2014F

		Hong Kong			Singapore			Taiwan		
		2012	2013F	2014F	2012	2013F	2014F	2012	2013F	2014F
Real GDP	YoY	1.5%	3.0%	3.4%	1.3%	2.0%	4.0%	1.3%	3.2%	4.0%
Final Domestic Demand	YoY	4.8	2.8	2.0	2.9	2.2	3.3	0.1	2.5	3.3
Private Consumption	YoY	3.2	3.7	2.1	2.2	2.6	3.2	1.5	1.8	2.7
Fixed Investment	YoY	9.4	0.8	2.0	6.6	2.0	3.6	-4.4	6.4	6.8
Exports	YoY	1.8	3.5	4.3	0.3	2.3	3.3	0.1	4.5	4.3
Imports	YoY	2.8	3.7	3.7	3.2	2.5	2.9	-1.9	4.3	3.0
CPI	YoY	4.1	4.3	3.6	4.6	3.2	2.8	1.9	1.7	1.9
Unemployment Rate	%	3.3	3.3	3.2	2.0	1.9	1.8	4.2	4.1	4.0
Current Account	US\$ bn	2.9	15.9	18.7	51.5	41.0	43.3	49.6	41.1	42.1
	% of GDP	1.1	5.6	6.2	18.6	14.0	13.5	10.5	8.4	8.0
Fiscal Balance	% of GDP	3.3	1.8	1.0	1.1	0.7	0.5	-1.6	-1.2	-1.3
US Dollar Exchange Rate	Average	7.76	7.76	7.76	1.25	1.24	1.22	29.57	29.87	29.61

Sources: Haver Analytics and Citi Research

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

With thanks to
Adrian Thomas

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

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

Russia

GDP growth decelerated to 2.1% YoY in 4Q12 from 4.5% in 1H12. The growth of retail sales and industrial production remains below the average of recent years, and the data seem to be worsening: vehicle sales in April fell 8% YoY. As a result, we are cutting our growth forecasts quite substantially. For this year we now look for the economy to expand at 2.1% YoY and 2.8% in 2014 (from 3.1% and 3.6% last month respectively). Despite slowing growth, we do not expect the CBR to cut repo rates before 2H2013, since there are elements of stagflation in Russia's macro story: CPI inflation is currently at 7.2% YoY, far above the central bank's 4.5% proposal for an inflation target. Inflation will probably fall in H2, facilitating looser monetary policy, particularly since the weakness of domestic spending is supporting the trade surplus and helping to stabilise the exchange rate. Overall, we believe there are few reasons for optimism about the real economy: supply-side reforms are few, and the demand for credit is weakening as confidence declines.

Turkey

The much-awaited upgrade finally arrived with Moody's decision to raise Turkey to investment grade (Baa3) on May 16. Following this development, both Moody's and Fitch rate Turkey IG, while Standard & Poor's rating remains one notch below IG with a stable outlook. Against this backdrop, the focus turns to the reaction of Turkish assets to Moody's much anticipated upgrade. Our analysis suggests that the bond market continues to rally — both in absolute and relative terms — in the weeks after favorable rating actions. Our findings also demonstrate that, contrary to the prevailing consensus in the market, the yield curve (10s-2s) tends to steepen in the aftermath of rating actions. In light of our analysis, we believe that it would be unrealistic to expect the 10-year bond yield to decline as much as it did following Fitch's rating upgrade to IG in November 2012 since bond market valuations this year look considerably more stretched than they did in 2012. Our analysis suggests that, holding the global backdrop constant, the 10-year bond yield could rally by about 50bp in reaction to Moody's IG upgrade. In this regard, we believe that valuation concerns and the ongoing uncertainty regarding the unorthodox monetary policy emerge as risk factors that overshadow the bond market outlook.

Figure 37. Russia and Turkey — Economic Forecast, 2012-14F

		Russia			Turkey		
		2012	2013F	2014F	2012	2013F	2014F
Real GDP	YoY	3.4%	2.1%	2.8%	2.2%	4.0%	4.3%
Final Domestic Demand	YoY	5.2	3.4	3.9	-0.5	4.2	4.8
Private Consumption	YoY	6.7	3.5	3.6	-0.7	4.0	4.3
Fixed Investment	YoY	6.0	4.6	6.5	-2.5	5.3	6.7
Exports	YoY	1.4	0.5	1.7	17.2	3.5	4.2
Imports	YoY	9.5	4.5	4.5	0.0	4.5	6.1
CPI	YoY	5.1	6.7	5.4	8.9	7.4	7.3
Unemployment Rate	%	5.7	6.5	7.0	9.2	9.5	9.5
Current Account	US\$ bn	79.0	60.2	20.6	-46.9	-60.1	-64.5
	% of GDP	3.9	2.8	0.9	-6.0	-7.1	-7.0
Fiscal Balance	% of GDP	-0.7	-2.0	-4.1	-2.0	-2.2	-2.7
US Dollar Exchange Rate	Average	31.1	32.6	34.0	1.80	1.85	1.91

Sources: Haver Analytics and Citi Research

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

Hungary

The 1Q13 GDP flash estimate has surprised to the upside, reversing the sharp drop in industrial output from 4Q12. Despite the positive surprise, we remain cautious about the outlook and stick to our GDP growth forecast of 0.2% in 2013 and 1.3% in 2014. In particular, we note that further positive monthly readings for industrial output or a pick up in consumption in line with improved consumer confidence may be needed to lift the outlook. Signs of a recovery are unlikely to stop the MPC from cutting rates further, in 25bp steps, given domestic demand remains in contractionary territory and the inflation outlook is sliding further with the ongoing drop in fuel and easing food prices. We have lowered our fiscal deficit forecasts to 2.7% of GDP in 2013 and 2.9% in 2014, and expect that fiscal corrections announced in May improve the chances that Hungary may exit the EDP by June. In our view, the positive news flow and market positioning may continue to support the HUF near term. However, we expect a weaker HUF over the medium term, reflecting lower interest rates, likely fading growth momentum in 2H13 and increasing fiscal risks during the autumn months if strong EU control is removed.

Poland

Most recent monthly data surprised to the downside, while inflation continued to decline, moving away from the NBP target of 2.5% YoY +/- 1pp. This resulted in a 25bp interest rate cut by the MPC in May. As the Council emphasized, the next decisions on rates will be based mainly on prospects of CPI growth and risks of inflation returning to the target in the medium term. As we expect inflation to decline further in coming months, in our view the MPC will decide to ease monetary policy further. This view is supported by the weaker-than-expected flash 1Q GDP data and further decline of CPI growth in April. We expect the next 25bp rate cut to come in June and another most probably in July (probability marginally above 50%) unless (as is quite likely) the new NBP projection shows CPI inflation rising toward the NBP target next year. Weak economic activity is translating into poor results in the central budget, with the deficit in January-April already reaching about 90% of the planned full year total. Although the government cut its GDP growth forecast for this year, it still did not revise its deficit forecast. We expect the deficit forecast to be lifted by around PLN 10bn later this year. The government has already funded about 80% of its planned annual borrowing needs. We expect that economic growth will gradually recover from weakness in 1Q, and look for the economy to grow this year by 1.3% YoY as stronger private consumption outweighs continued weakness in investment.

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

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

Figure 38. Hungary and Poland — Economic Forecasts, 2012-2014F

		Hungary			Poland		
		2012	2013F	2014F	2012	2013F	2014F
Real GDP	YoY	-1.7%	0.2%	1.3%	2.0%	1.3%	2.8%
Final Domestic Demand	YoY	-2.1	-0.8	0.1	0.4	0.0	2.2
Private Consumption	YoY	-1.4	-0.5	0.5	0.5	1.0	2.2
Fixed Investment	YoY	-3.8	-2.0	-0.5	0.6	-3.1	2.6
Exports	YoY	2.0	2.2	3.8	1.6	3.1	4.0
Imports	YoY	0.1	1.3	2.8	-2.5	0.3	2.9
CPI	YoY	5.7	2.1	3.0	3.7	1.2	2.4
Unemployment Rate	%	10.9	10.6	10.2	13.3	14.2	13.4
Current Account	US\$ bn	2.1	3.4	4.4	-17.3	-14.0	-19.6
	% of GDP	1.6	2.6	3.3	-3.5	-2.8	-3.7
Fiscal Balance	% of GDP	-1.9	-2.7	-2.9	-3.9	-3.5	-2.8
Euro Exchange Rate	Average	289	300	298	4.18	4.21	4.11

Sources: Haver Analytics and Citi Research

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

Czech Republic

We revised downward our 2013 GDP forecast after the weak GDP flash estimate, which showed a drop of 1.9%YoY in 1Q13 after a decline of 1.7% YoY in Q4. The drop in GDP probably reflected the narrower trade surplus, better terms of trade and softer investment activity. Private consumption probably remained weak. The weaker GDP outturn is in line with April confidence indicators that pointed to a drop of about 2% YoY in 2Q13. We are cutting our 2013 growth forecast to minus 0.8% from minus 0.2% last month. Weaker GDP growth and weaker growth in Germany suggest the EURCZK will remain above 26 already in 2Q13 (whereas previously we expected this would happen in 2H13). The larger drop in GDP could persuade some Bank Board members to rethink whether the risk of actual deflation is really their trigger for further monetary easing. Anyway, we would expect the CNB to be unhappy with the EURCZK falling below 26, as its May forecast was based on EURCZK at 25.7 in 2Q13 and a 23bp cut in 3M PRIBOR. We would not rule out the CNB reopening the discussion on other monetary tools to keep the koruna weak. Economic weakness is likely to persuade the government to soften its planned fiscal tightening, in line with the government's proposal that it will seek to stabilize the fiscal at around -2.9% of GDP in 2014-16.

Romania

The Romanian bond market has experienced an impressive rally on the back of the improved political outlook following the December elections and the inclusion of the country's local debt in major emerging-market bond indices. The relative stability of the currency, owing in part to the NBR's active presence in the FX market, and the attractive carry have further increased the appetite for Romanian bonds: the share of non-residents in the bond market has risen to about 23% from around 12% in December 2012. Governor Mugur Isarescu's assertive comments in the aftermath of the May Board meeting revived expectations of a more aggressive easing than previously expected, which has provided further support to the bond market rally. Where do we go from here? The fact that money market rates have been hovering considerably below the policy rate since mid-February suggests that a substantial policy easing has already taken place. From this angle, we think that the impact of the likely cut in the policy rate on bond yields is likely to be fairly muted. Concurrently, we remain skeptical about the NBR's ability to deliver an aggressive easing without hurting the leu, as capital inflows still remain rather weak.

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

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

Figure 39. Czech Republic and Romania — Economic Forecasts, 2012-2014F

		Czech Republic			Romania		
		2012	2013F	2014F	2012	2013F	2014F
Real GDP	YoY	-1.2%	-0.8%	1.3%	0.7%	1.6%	2.8%
Final Domestic Demand	YoY	-2.4	-1.3	0.8	1.9	1.4	2.5
Private Consumption	YoY	-3.3	-0.7	0.4	1.0	1.0	2.4
Fixed Investment	YoY	-2.7	-1.9	2.3	5.0	3.0	3.5
Exports	YoY	4.0	3.5	2.1	-3.1	2.5	4.0
Imports	YoY	2.3	1.8	4.5	-0.8	2.1	3.0
CPI	YoY	3.3	1.5	1.5	3.3	4.8	3.3
Unemployment Rate	%	7.0	7.6	7.9	5.1	5.2	5.5
Current Account	US\$ bn	-4.7	-2.8	-3.6	-6.5	-7.0	-8.7
	% of GDP	-2.4	-1.4	-1.8	-3.8	-3.8	-4.5
Fiscal Balance	% of GDP	-4.4	-3.1	-2.7	-2.2	-2.2	-2.5
EURCZK, USDRON	Average	25.1	26.0	25.4	3.5	3.4	3.5

Sources: Haver Analytics and Citi Research

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

Brazil

The weaker performance of some activity indicators in March motivated a downward revision for our 1Q13 GDP growth forecast to 0.8% QoQ. As a result, we revised down our 2013 and 2014 real GDP growth forecasts to 2.9% and 3.8%, respectively, versus 3.1% and 4.0% last month. We are keeping our year end CPI inflation forecasts for this year and next at 5.8% and 5.7% YoY, in both cases above the CB's mid-point target of 4.5% but inside the target band (2.5%-6.5%). Regarding the Selic rate, the CB initiated a monetary policy normalization cycle in April with a 25bps hike. We expect three further hikes of 25bps each, driving the Selic to 8.25% at the end of the hiking cycle. In addition, we are keeping our slightly more pessimistic view about the current account deficit. However, we expect it to remain financed with capital inflows. Finally, due to the broadening of the tax exemptions, we now expect the 2013 and 2014 primary fiscal surpluses to stand at 1.5% and 1.7% of GDP, down from 1.8% and 2.0% previously. Given this worse fiscal outlook, we no longer expect the ratio of net public debt/GDP to continue declining, but to remain roughly flat around at 35% of GDP.

Mexico

Activity was weak in 1Q13, as GDP grew by only 0.8% YoY, leading us to revise down our 2013 and 2014 GDP growth forecast to 3.2% and 4%, from 3.6% and 3.8%, respectively. Note that in 1Q13 there was a disappointing under-execution in public spending, and programmable spending shrank 11% YoY. This, combined with a 4.1% YoY increase in non-oil tax revenues, led to a bigger-than-expected fiscal surplus. Annual headline inflation rose to 4.7% in April, up from 4.25% in March, driven by higher farm prices and Mexico City public transportation fares. We are confident that the inflation rebound is temporary, and reaffirm our view that inflation will reach a peak of 4.7% YoY in May. We are therefore holding our headline inflation forecasts at 3.6% for 2013 and 3.7% for 2014. Meanwhile, MXN's appreciation continues, supported by high liquidity in global markets. In this context, Banxico held the overnight rate unchanged at 4.0% in its last meeting. In its quarterly inflation report, Banxico confirmed a slight upward revision in its average inflation forecast for the coming quarters, and also reiterated the downside risk to economic activity. While Banxico is unlikely to give signs of a policy move, our scenario remains unchanged, with Banxico on hold for the rest of this year, although we recognize an increasing probability for further easing. On the political front, we see progress on reforms: the constitutional telecom reform is now in operation, and details of the financial reform will be worked out by Congress in few months.

Figure 40. Brazil and Mexico — Economic Forecasts, 2012-2014F

		Brazil			Mexico		
		2012	2013F	2014F	2012	2013F	2014F
Real GDP	YoY	0.9%	2.9%	3.8%	3.9%	3.2%	4.0%
Final Domestic Demand	YoY	1.7	3.9	4.5	3.7	3.2	3.8
Private Consumption	YoY	3.1	3.7	4.2	3.3	3.0	3.6
Fixed Investment	YoY	-4.0	5.7	6.8	5.9	5.1	6.0
Exports	YoY	0.5	3.6	4.6	4.6	3.4	8.6
Imports	YoY	0.2	8.8	7.8	4.1	2.9	5.4
CPI	YoY	5.4	6.4	5.7	4.1	3.9	3.4
Unemployment Rate	%	5.5	5.5	5.4	5.0	4.8	4.5
Current Account	US\$ bn	-54.2	-71.4	-81.4	-9.0	-21.6	-23.0
	% of GDP	-2.4	-3.0	-3.1	-0.8	-1.6	-1.5
Fiscal Balance	% of GDP	-2.5	-3.4	-3.2	-2.6	-2.1	-2.0
US Dollar Exchange Rate	Average	1.95	2.00	2.06	13.16	12.00	11.97

Sources: Haver Analytics and Citi Research

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

Argentina

Over the last few months, Argentina's economy has been driven by the vicissitudes of its balance of payments. The first half of the year has presented the central bank with unusual circumstances. Against the typical seasonal period when large FX reserve build ups materialize, so far this year, the central bank has only purchased USD0.3bn, compared to USD5.7bn in 2012. Moreover, the inability to accumulate reserves has continued during April and May despite the abundant FX supply by grain exporters (exporters sold FX for USD4.1bn, up from USD3.4bn in 2012). This trend is the result of large leaks in the system of FX controls and the large premia in the parallel market. We expect BCRA reserves to stand at USD37.5bn by year end, down from USD43.3bn a year ago. To mitigate the deterioration in the BoP, the BCRA has been pushing interest rates up, although real rates and devaluation expectation adjusted rates remain deeply negative. The authorities have also been tightening controls on imports, a course of action that if pursued further could negatively affect our 3% real GDP forecast for 2013. Despite the FX scarcity, we continue to expect the official USDARS rate to be at 6 by yearend, as we expect the government will seek to avoid a step devaluation.

Venezuela

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

Although we expect the opposition will continue to complain about the recent presidential election result, we consider that the political debate will shift to economic performance-related issues sooner rather than later. The latest data on inflation and shortages confirm an urgent situation in the overall availability of goods which, if it is not addressed, will likely translate into further drops in the government's popularity in our view. In order to tackle the stagflationary environment, we think that the authorities will likely take a more pragmatic approach, fighting inflation in the first place. In our view, solving the chronic USD shortage for imports, which is especially binding for small and medium size firms, is particularly important. The government has announced meetings with representatives from the private sector, while it has been saying that it is committed to normalize the flow of USD to producers in a short period of time. We will have to wait in order to know if these statements will translate into meaningful action. Nonetheless, we think that a lot of harm has already been done to the economy by the elimination of the SITME platform and the delay in the creation of an effective replacement for it. Hence, we expect inflation to reach 35% by yearend and GDP to expand 1% in 2013.

Figure 41. Argentina and Venezuela — Economic Forecasts, 2012-2014F

		Argentina			Venezuela		
		2012	2013F	2014F	2012	2013F	2014F
Real GDP	YoY	1.9%	3.0%	3.0%	5.6%	1.0%	2.0%
Final Domestic Demand	YoY	2.5	3.3	2.8	11.5	-0.2	0.7
Private Consumption	YoY	4.4	3.5	3.1	7.0	-0.8	0.0
Fixed Investment	YoY	-4.9	1.6	1.9	22.4	-0.9	1.1
Exports	YoY	-6.6	2.2	-1.9	1.6	2.6	4.8
Imports	YoY	-5.2	4.4	-2.3	22.2	-1.9	-1.0
CPI	YoY	10.0	10.3	12.5	21.1	30.5	31.5
Unemployment Rate	%	7.2	7.6	7.8	5.9	6.4	6.8
Current Account	US\$ bn	0.5	2.0	1.0	11.0	20.2	22.4
	% of GDP	0.1	0.4	0.2	2.9	5.5	4.5
Fiscal Balance	% of GDP	-2.6	-2.7	-2.9	-5.0	-4.0	-4.0
US Dollar Exchange Rate	Average	4.54	5.46	6.74	4.29	6.13	6.30

Sources: Haver Analytics and Citi Research

Farouk Soussa
+971 (4) 509 9750
farouk.soussa@citi.com

Saudi Arabia

Bloomberg data show a modest rise in oil production, from 9.0mbpd in March to 9.2mbpd in April. In our view, much of the added production will be going towards rising domestic demand as temperatures have started to creep up in the Gulf in recent weeks. Exports, therefore, are likely to have remained relatively flat. This is in line with recent comments made by the Kingdom's minister of oil, Ali Al Naimi, who asserted that in view of rising global production, not least in North America, Saudi Arabia would be '*lucky to go past*' current production levels by 2020 (Al Bawaba, May 13). Mr Al Naimi also clarified that Saudi would not be seeking to raise production capacity beyond 12.5mbpd after recent comments by HH Prince Turki al Faisal suggested plans were afoot to increase this to 15mbpd. Price stability remains the key policy goal of the Saudi oil ministry, in our view, and production is likely to react to price swings going forward. At current levels of production, however, we calculate that Saudi Arabia's fiscal break-even oil price has risen markedly, from US\$79 per barrel last year to an expected US\$93 per barrel in 2013. This is mostly down to a drop in production, though we are also expecting a rise in government expenditures of roughly 4% of GDP as well.

United Arab Emirates

Farouk Soussa
+971 (4) 509 9750
farouk.soussa@citi.com

Dubai's economic recovery continues in full swing, grounded in the Emirate's fundamental strengths in the tourism, travel and logistics sectors, as well as in its success in creating a commercial hub for the region. Based on data tracking the number of expatriate school children in Dubai's private schools, we estimate that the population has been growing at a steady rate of between 7% and 8% per year over the past two years. Dubai airport surpassed London Heathrow as the busiest international passenger airport in the world in January, handling 15% more passengers than in January 2012, while Emirates Airlines this month announced a 52% leap in profits for 2012. Occupancy rates in Dubai's hotels were at 90% in January, and average room rates were around US\$330 per night, both measures the highest in the region by some margin. In our view, there is no doubting the strength of the recovery in Dubai, but we are equally wary of signs of exuberance in asset prices, and the potential for bubbles to form. The yield on Dubai's external bonds have almost halved in the past 12 months, while the local Dubai Financial Market index has gained 40% in value since the start of the year. Property prices have also risen sharply, with Cluttons data showing a rise of 16% in average villa prices in the Emirate in the first four months of the year (a massive 44% rise on a YoY basis).

Figure 42. Saudi Arabia and United Arab Emirates — Economic Forecasts, 2012-2014F

		Saudi Arabia			United Arab Emirates		
		2012	2013F	2014F	2012	2013F	2014F
Real GDP	YoY	6.8%	5.1%	7.4%	2.3%	4.6%	4.9%
Final Domestic Demand	YoY	2.3	8.1	8.1	3.4	3.4	3.8
Private Consumption	YoY	1.6	5.0	5.0	2.0	2.0	3.0
Fixed Investment	YoY	1.1	10.0	10.0	5.0	5.0	5.0
Exports	YoY	-16.9	-12.7	2.1	13.0	13.0	13.0
Imports	YoY	5.2	15.0	15.0	15.0	15.0	15.0
CPI	YoY	4.0	6.0	8.0	0.7	0.8	1.0
Current Account	US\$ bn	176.2	96.0	70.8	0.7	8.1	16.9
	% of GDP	24.2	13.6	9.3	0.2	2.1	4.0
Fiscal Balance	% of GDP	13.7	1.9	-3.5	-	-	-
US Dollar Exchange Rate	Average	3.75	3.75	3.75	3.67	3.67	3.67

Sources: Haver Analytics and Citi Research

Egypt

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

Gina Schoeman
(On Leave)

With seemingly no end to the current political uncertainty in sight, we believe the government will probably continue to muddle through in terms of economic policy for much of 2013, relying on a constant drip of external financing from the Gulf states (especially Qatar). But with a steady weakening of the EGP on both the official and parallel markets, we think that there will be a sharp rise in inflation in 2H 2013, accompanied by rising foreign exchange shortages. There is also unlikely to be any reduction in the fiscal deficit, the financing of which will continue to constrain investment. Combined, these factors will all act as a significant brake on growth and rising economic difficulties could potentially spill over into widespread political unrest. Ultimately, the government is hoping that a deal with the IMF will crowd in both official and private sector finance. Coupled with the catalyst it would provide to the reform programme, this should provide a short-term kick to the economy which increasingly is in a state of stagflation. But this may only be possible after parliamentary elections are held, which remains highly uncertain.

South Africa

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

Ongoing problems in the mining sector in 2H 2012 dragged down growth for the year and are unlikely to be resolved quickly as the country enters its biannual wage negotiating round in May. The retail sector has also lost momentum as consumer balance sheets remain stretched and real incomes wane amidst rising inflation. Together with a pull-back in unsecured lending and attempts to contain the public sector wage bill, consumption growth will be limited in 2013. Low business confidence is constraining private investment intentions and growth is only likely to come from replacement/maintenance of current capex. While this limits capital imports, government infrastructure plans should keep public sector imports resilient, and therefore we expect the current account to narrow only slightly this year. Combined, all this will likely continue to lead to pressure on the rand. Rising food inflation should push CPI above the 6% target ceiling by mid 2013. However, if inflation was to ease in 4Q, coupled with ongoing weak growth a cut in the Repo rate at the September SARB MPC meeting is possible. The importance of monetary policy will remain given that the constraints on fiscal policy. Slow fiscal consolidation should be expected despite the 2014 elections, but, if the rating agencies see a bias toward rising 'social expenditure' rather than investment, a further sovereign ratings downgrade cannot be ruled out in our view.

Figure 43. Egypt, Nigeria and South Africa — Economic Forecast, 2012-2014F

		Egypt			Nigeria			South Africa		
		2012	2013F	2014F	2012	2013F	2014F	2012	2013F	2014F
Real GDP	YoY	2.1%	1.2%	3.5%	7.4%	6.5%	6.9%	2.5%	2.6%	3.1%
Final Domestic Demand	YoY	4.0	-0.3	2.8	NA	NA	NA	4.0	3.9	4.4
Private Consumption	YoY	2.8	-0.7	2.5	NA	NA	NA	3.5	2.6	3.4
Fixed Investment	YoY	3.8	1.8	4.7	NA	NA	NA	5.7	6.5	7.1
Exports	YoY	-1.1	1.7	6.1	NA	NA	NA	0.1	-0.5	3.1
Imports	YoY	2.7	-3.4	3.6	NA	NA	NA	6.3	5.6	6.6
CPI	YoY	7.2	13.8	12.9	12.2	8.9	10.0	5.7	6.0	5.2
Unemployment Rate	%	12.5	14.0	15.0	NA	NA	NA	125.5	26.5	27.0
Current Account	US\$ bn	-6.9	-6.7	-7.0	11.3	7.4	1.3	-23.6	-22.7	-21.9
	% of GDP	-2.8	-2.7	-2.7	4.0	2.3	0.4	-6.1	-6.0	-5.5
Fiscal Balance	% of GDP	-11.2	-12.7	-11.5	-2.8	-2.6	-2.8	-4.4	-4.6	-4.4
US Dollar Exchange Rate	Average	6.07	7.07	7.81	158.8	158.82	163.63	8.21	9.47	9.64

Sources: Haver Analytics and Citi Research

Figure 44. Selected Emerging Market Countries — Economic Forecast Overview, 2012-2014F

	GDP Growth			CPI Inflation			Current Balance (% of GDP)			Fiscal Balance (% of GDP)		
	2012	2013F	2014F	2012	2013F	2014F	2012	2013F	2014F	2012	2013F	2014F
Asia	6.2%	6.4%	6.5%	3.9%	3.7%	3.8%	1.8%	1.6%	1.5%	-2.4%	-2.4%	-2.2%
China	7.8	7.7	7.3	2.6	2.9	3.1	2.3	2.2	2.0	-2.0	-2.0	-2.0
Hong Kong	1.5	3.0	3.4	4.1	4.3	3.6	1.1	5.6	6.2	3.3	1.8	1.0
India*	5.0	5.7	6.4	7.3	5.5	5.0	-5.1	-4.1	-3.3	-7.3	-7.0	-6.7
Indonesia	6.2	6.1	6.3	4.3	6.9	5.4	-2.7	-2.3	-1.8	-1.8	-2.1	-1.4
Korea	2.0	2.9	3.7	2.2	1.9	2.8	3.8	2.8	1.7	1.5	0.9	2.3
Malaysia	5.6	5.2	6.0	1.6	2.0	2.8	6.1	5.0	4.0	-4.5	-4.0	-3.5
Mongolia	12.3	13.8	11.0	14.3	12.0	10.0	-31.3	-22.6	3.2	-8.3	-6.3	-5.2
Philippines	6.6	6.2	6.6	3.1	3.3	3.7	2.8	2.3	1.9	-2.3	-2.3	-2.0
Singapore	1.3	2.0	4.0	4.6	3.2	2.8	18.6	14.0	13.5	1.1	0.7	0.5
Sri Lanka	6.4	6.4	7.0	7.5	7.9	6.5	-6.7	-5.3	-4.0	-6.4	-6.2	-5.7
Taiwan	1.3	3.2	4.0	1.9	1.7	1.9	10.5	8.4	8.0	-1.6	-1.2	-1.3
Thailand	6.4	4.7	4.8	3.0	3.2	3.6	0.7	-0.2	-0.5	-2.1	-2.2	-2.1
Vietnam	5.0	5.2	5.5	9.3	7.1	7.4	5.8	5.1	4.1	-5.2	-4.8	-4.0
Latin America	2.4	3.1	3.8	5.8	6.9	6.4	-1.6	-1.8	-1.8	-2.2	-2.7	-2.6
Argentina	1.9	3.0	3.0	10.0	10.3	12.5	0.1	0.4	0.2	-2.6	-2.7	-2.9
Brazil	0.9	2.9	3.8	5.4	6.4	5.7	-2.4	-3.0	-3.1	-2.5	-3.4	-3.2
Chile	5.6	4.8	5.1	3.0	1.6	3.0	-3.6	-2.4	-2.5	0.6	-0.3	-0.4
Colombia	4.0	3.8	4.5	3.2	2.1	3.0	-3.1	-3.4	-3.2	-0.1	-1.1	-0.7
Mexico	3.9	3.2	4.0	4.1	3.9	3.4	-0.8	-1.6	-1.5	-2.6	-2.1	-2.0
Panama	10.7	9.0	8.0	5.7	4.6	4.4	-9.0	-8.5	-7.5	-2.1	-3.0	-3.0
Peru	6.3	6.2	6.4	3.7	2.6	2.6	-3.6	-3.2	-2.7	1.9	-0.6	-2.0
Venezuela	5.6	1.0	2.0	21.1	30.5	31.5	2.9	5.5	4.5	-5.0	-4.0	-4.0
Europe	2.4	2.2	3.0	5.3	5.5	5.1	0.0	-0.7	-1.6	-1.8	-2.2	-3.4
Bulgaria	0.8	1.0	2.0	3.0	2.2	3.6	-1.5	-1.7	-2.1	-0.5	-1.5	-0.7
Croatia	-2.0	0.0	1.2	3.4	2.9	3.0	0.1	-0.2	-0.5	-2.4	-4.5	-4.0
Czech Republic	-1.2	-0.8	1.3	3.3	1.6	1.4	-2.4	-2.8	-1.9	-4.4	-2.9	-2.9
Hungary	-1.7	0.2	1.3	5.7	2.1	3.0	1.6	2.6	3.3	-1.9	-2.7	-2.9
Kazakhstan	5.0	4.2	3.6	5.1	6.3	6.1	3.5	2.4	1.2	0.8	2.7	1.8
Poland	1.9	1.3	2.8	3.7	1.0	2.0	-3.5	-2.7	-3.6	-3.9	-3.9	-3.5
Romania	0.7	1.6	2.8	3.3	4.8	3.3	-3.8	-3.8	-4.5	-2.2	-2.2	-2.5
Russia	3.4	2.1	2.8	5.1	6.7	5.4	3.9	2.8	0.9	-0.7	-2.0	-4.1
Serbia	-1.7	2.3	2.6	7.8	9.3	6.8	-10.6	-8.2	-8.5	-5.7	-5.0	-5.0
Slovakia	2.0	0.8	2.0	0.0	1.7	2.0	2.2	3.3	3.2	-4.3	-3.4	-3.0
Turkey	2.2	4.0	4.3	8.9	7.4	7.3	-6.0	-7.1	-7.0	-2.0	-2.2	-2.7
Ukraine	0.2	-0.3	3.1	0.6	2.0	5.7	-8.4	-8.5	-5.5	-5.6	-4.5	-4.5
Africa/Mideast	5.1	4.7	5.7	4.9	5.7	6.2	9.7	6.0	4.2	3.0	-1.8	-3.6
Bahrain	3.5	3.6	4.4	2.8	4.0	2.5	6.9	-0.3	-3.8	-1.0	-2.1	-1.9
Egypt	2.1	1.2	3.5	7.2	13.8	12.9	-2.8	-2.7	-2.7	-11.2	-12.7	-11.5
Ghana	7.4	7.0	6.8	9.1	10.7	9.3	-12.2	-11.3	-10.8	-12.4	-9.2	-8.5
Iraq	11.0	7.9	9.8	6.1	6.0	6.0	13.5	8.7	6.7	6.6	-3.0	-3.5
Israel	3.0	3.2	3.0	1.7	2.0	2.8	-0.1	0.2	1.8	-3.7	-4.3	-2.5
Jordan	2.7	3.0	4.0	4.8	5.5	5.0	-18.2	-13.4	-11.5	-8.3	-8.2	-8.2
Kenya	4.7	5.5	6.1	9.6	6.3	7.8	-10.5	-10.1	-9.5	-5.3	-5.0	-4.7
Kuwait	7.0	3.6	3.7	2.9	5.0	5.0	49.1	47.0	43.9	24.0	13.0	6.5
Lebanon	1.5	2.0	4.5	6.4	5.0	5.0	-14.8	-15.9	-16.0	-8.8	-10.2	-10.5
Nigeria	7.4	6.5	6.9	12.2	8.9	10.0	4.0	2.3	0.4	-2.8	-2.6	-2.8
Oman	7.1	6.7	6.7	2.9	3.0	3.0	2.9	9.0	5.6	3.4	-2.4	-5.1
Qatar	6.0	8.3	7.2	3.0	3.0	3.0	28.5	17.9	9.4	5.5	2.4	0.5
Saudi Arabia	6.8	5.1	7.4	4.0	6.0	8.0	24.2	13.6	9.3	13.7	1.9	-3.5
South Africa	2.5	2.6	3.1	5.7	6.0	5.2	-6.1	-6.0	-5.5	-4.4	-4.6	-4.4
Tanzania	6.4	6.8	7.0	16.1	9.0	8.8	-11.9	-10.2	-11.5	-5.4	-5.0	-5.6
UAE	2.4	4.6	4.9	0.7	0.8	1.0	0.2	2.1	4.0	NA	NA	NA
Uganda	2.6	5.0	5.6	14.6	4.3	6.8	-11.0	-11.7	-11.5	-3.6	-3.4	-4.5
Zambia	6.5	6.9	7.5	6.6	7.1	7.3	-3.4	-0.5	2.9	-4.3	-3.5	-3.3
Total	4.7	4.9	5.3	4.6	4.8	4.7	1.7	1.1	0.7	-1.7	-2.4	-2.6

* Note: In India, policymakers look at the wholesale price index. Sources: National sources and Citi Research

Sovereign Ratings Outlook

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

Robert Crossley
(44-20) 7986-9255
robert.crossley@citi.com

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

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

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

Figure 45. 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 Months) Forecast Rating	Citi Longterm (Next 2-4 Years) Forecast Rating & Outlook	Current Rating	Current Outlook	Citi Near-term (Up to 9 Months) Forecast Rating	Citi Longterm (Next 2-4 Years) Forecast Rating & Outlook
US	AA+	Neg	AA+ (Neg)	AA ↓	Aaa	Neg	Aaa (Neg W)	Aa1 ↓
Canada	AAA	Stable	AAA	AAA	Aaa	Stable	Aaa	Aaa
Japan	AA-	Neg	AA- (Neg)	A+ ↓	Aa3	Stable	Aa3	A1 ↓
Germany	AAA	Stable	AAA	AAA	Aaa	Neg	Aaa (Neg)	Aaa
France	AA+	Neg	AA+ (Neg)	AA ↓	Aa1	Neg	Aa1 (Neg)	Aa2 ↓
Italy	BBB+	Neg	BBB+ (Neg)	SD* ↓↓↓↓	Baa2	Neg	Baa2 (Neg)	C* ↓↓↓↓
Spain	BBB-	Neg	BBB- (Neg)	SD* ↓↓↓↓	Baa3	Neg	Baa3 (Neg)	C* ↓↓↓↓
Austria	AA+	Stable	AA+	AA+	Aaa	Neg	Aaa (Neg)	Aaa
Belgium	AA	Neg	AA (Neg)	AA- ↓	Aa3	Neg	Aa3 (Neg)	A1 ↓
Finland	AAA	Stable	AAA	AAA	Aaa	Stable	Aaa	Aaa
Greece	B-	Stable	B-	SD* ↓↓↓↓	C		C	C*
Ireland	BBB+	Stable	BBB+	BBB+	Ba1	Neg	Baa3 ↑	Baa2 ↑↑
Netherlands	AAA	Neg	AAA (Neg W)	AA+ ↓	Aaa	Neg	Aaa (Neg W)	Aa1 ↓
UK	AAA	Neg	AAA	AA+ (Neg) ↓	Aa1	Stable	Aa1	Aa1 (Neg)
Switzerland	AAA	Stable	AAA	AAA	Aaa	Stable	Aaa	Aaa
Sweden	AAA	Stable	AAA	AAA	Aaa	Stable	Aaa	Aaa
Denmark	AAA	Stable	AAA	AAA	Aaa	Stable	Aaa	Aaa
Norway	AAA	Stable	AAA	AAA	Aaa	Stable	Aaa	Aaa

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

* Based Citi economists' longer term (2015-2017) view, Citi expects Greece and Portugal to remain sub-investment grade in coming years, and for Italy and Spain to fall to sub-investment grade ratings, and this may well include a period of "selective default" as determined by the rating agencies around the time of debt restructuring. Following the restructuring, we expect such sovereigns to attain a mid sub-IG rating.

Expected Ratings Issues

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

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

Market access is secure for now

Upgrade by Moody's still our base case
over coming quarters

We continue to expect S&P to follow
Moody's and ultimately downgrade the
UK by one notch in 1-2yr time

Moody's focus on US debt levels

Citi no longer expects a Grexit scenario – credit positive

Core EMU ratings: Many of our longer-term rating expectations were predicated on a stress scenario of EMU exit by Greece. We no longer view this as our base case for reasons provided on page 8. As such, we no longer expect downgrades in core countries over the next 2-5yrs (especially ones which currently have a Stable outlook). Specifically, we expect Germany, Austria and Finland to maintain their current ratings in both the near and long term. For idiosyncratic reasons, we do not rule out a downgrade of sovereigns such as France, Belgium and the Netherlands over the very long term - and such sovereigns have a Negative Outlook from both Moody's and S&P.

Likelihood of near-term ESM/OMT aid has reduced for Spain and Italy

Spain and Italy: In addition, our economists no longer expect Spain/Italy to enter sovereign support programmes this year (see page 8). Recent debt sales indicate a healthy degree of market access. This helps affirm our view (like last month's publication) that we do not expect downgrades of Spain or Italy in the immediate term. In a recent note, Moody's noted Spain and Italy's current ratings were due to the "scale of their economic and fiscal challenges"⁵. In the same note, Moody's comments "Spain has advanced further in correcting the loss in its external competitiveness" and "Italy's structurally strong public finances offer it more time to address the structural impediments to growth". However, as Citi details ([Euro Area: Sovereign Debt Crisis Update](#)), persistent lack of growth will likely raise again doubts of Italian public finance sustainability over the longer-term. As detailed in the Overview on page 8, over the very long term, some form of restructuring for both Italy and Spain remains the base case of our economists.

Other country specific rating views

Ireland: From Citi's point of view, Ireland's fiscal prospects now seem better than previously expected and our economists no longer expect debt structuring involving privately-held Irish government debt in the years ahead. Should Ireland continue to make steady progress towards independent and sustained private market access, then this is likely to be one factor in Moody's upgrading Ireland to Baa3 (investment grade) later this year in our view.

UK: We continue to expect S&P to downgrade the UK by one-notch to AA+ given rising debt and likely political tensions - probably in the next year or two rather than in coming quarters given that S&P recently affirmed the UK at AAA rating (5th April).

US: The most recent Moody's publication (Credit Opinion 15th May) noted "although government financial strength weakened as a result of interventions to support the financial system and the economy, the basic factors supporting the Aaa remain intact". We therefore do not expect downgrade pressure on the US rating in the immediate term. Over the longer-term however, the trajectory of debt levels and the US fiscal deficit will be key for Moody's which rates the US at Aaa Negative Outlook.

⁵ Moody's Investor Service "Spain and Italy: Italy's Stronger Budgetary Performance Still Justifies Higher Rating Than Spain". 17 May 2013

Rates Forecasts Commentary

Robert Crossley
(44-20) 7986-9255
robert.crossley@citi.com

With thanks to Brett Rose (US), Steven Mansell (APAC) and Jamie Searle (UK)

Sharp fall in US deficit and Treasury yields decoupling from Europe

Refi rate cut in Q4 but no negative deposit rate inside a year

Downward revision in peripheral spread forecasts

Grexit possible, but no longer our base case

The trough in GDP is finally behind us

OMT activation seems a distant prospect, and the ongoing supply of liquidity will continue to intensify the chase for yield

Various sources of downward pressure on JGB yields

We expect a modest flattening in JGBs

Gilt yields to remain anchored

US: Rising Treasury yields to outpace the forwards

We continue to expect US Treasury yields to significantly outpace the forwards by year-end, rising by 20-25bps/quarter. Recent economic data has been positive – but not overwhelmingly strong, putting 10yr yields slightly above the mid-point of the 6mo range. However, there are recent meaningful developments which support our expectation that these yields could soon move up out of their range. First, the significant drop in the US budget deficit, which also minimizes the likelihood of any further near-term fiscal policy tightening. Second, the correlation of Treasury yields has been rising versus US economic data and falling versus European risk factors. This suggests that US Treasury yields can separate from European sovereign yields if economic separation extends. Further, should US economic conditions continue at this pace we anticipate that the Fed will begin tapering the pace of QE in 2H13.

Europe: lower Grexit probability = lower peripheral spread forecasts

Our Bund forecast is unchanged at 1.40 through to 1Q14, before moving up to 1.60 by the end of 2014. OAT/Bund is forecast to drift up to 80 over the next year. Our economists' expectation of a final 25bp refi rate cut in 4Q13 is unchanged, but they do not expect a negative deposit rate inside 12 months.

The biggest change in our forecasts comes in peripheral spreads: 10yr BTP/Bund has been lowered to 250bps over 2H13, 225bps in 1H14 and 220 in 2H14. The dominant driver of changes in our European forecasts has been a further reduction in the probability of Grexit, making it no longer our base case (though still possible). This reduction is based on the ruling coalition being more stable than expected, the threat from the radical left wing opposition party, Syriza, in the polls receding, and Germany's stance towards Greece and OSI being more lenient than feared. The downgrading of Grexit pushes up our, still well below consensus, 2014 Euro Area growth forecast up to 0% (vs -0.7% for 2013, and +0.8% 2015).

OMT is highly unlikely in the absence of market pressure, and it is difficult to see the nearterm catalyst for that with self-interests aligned in favour of low yields. A positioning-led back-up in yields is possible, but it is likely to be seen as a buying opportunity with the need for yield still carrying all before it. It is difficult to see a nearterm sell-off of the magnitude required to force an OMT request. Our economists still expect some form of debt restructuring in both Italy and Spain, but not until 2015/2016.

Japan: yields to move back down into former trading ranges

While the JGB market remains extremely volatile, we believe that the BoJ will succeed in capping yields making it far more likely that yields will begin to retrace lower, respecting former established trading ranges. The long-end supply burden significantly reduces next month, with supportive cash flows also likely to help steady the market. Current JGB yield levels remain attractive to domestic investors in our opinion, while foreign bond alternatives are unlikely to be pursued aggressively at this stage. We expect the curve to flatten modestly, with JGBs exhibiting significant independence from global rate movements, notably the expected breakout in UST yields in Q3, as the BoJ absorbs 70% of gross issuance

UK: steepening curves and underperformance of gilts vs Bunds

In the UK, we continue to expect gilt yields to remain anchored at low levels by the weak economic outlook and further stimulus measures (probably including forward guidance and more QE). However, fiscal risks, high net issuance, and relatively elevated inflation rates are likely to lead to mild underperformance of gilts vs Bunds in the coming quarters. Forward guidance is likely to be bullish for the 2-5yr sector and lead to steeper curves and a richening of 5s versus the wings.

Figure 46. Interest Rate and Bond Market Forecasts as of 22 May 2013

		Quarterly Average					
	Current	3Q 13	4Q 13	1Q 14	2Q 14	3Q 14	4Q 14
US							
Policy Rate (Fed Funds) End Quarter	0.25	0.25	0.25	0.25	0.25	0.25	0.25
3-Month Libor	0.27	0.30	0.34	0.40	0.50	0.60	0.68
2 Year Treasury Yield	0.23	0.30	0.40	0.50	0.63	0.75	0.85
5 Year Treasury Yield	0.79	0.93	1.08	1.28	1.53	1.73	1.95
10 Year Treasury Yield	1.93	2.10	2.35	2.60	2.80	3.00	3.20
30 Year Treasury Yield	3.11	3.40	3.68	3.93	4.13	4.30	4.48
2-10 Year Treasury Curve	170	180	195	210	217	225	235
2 Year Swap Spread (Swap Less Govt), bp	14	16	19	20	20	20	20
10 Year Swap Spread (Swap Less Govt), bp	13	13	8	3	0	0	0
30 Year Swap Spread (Swap Less Govt), bp	-8	-10	-15	-18	-23	-28	-30
30 Year Mortgage Yield	3.60	3.73	3.88	4.10	4.33	4.45	4.60
10 Year Breakeven Inflation	225	238	240	245	248	243	240
Euro Area							
Policy Rate	0.50	0.50	0.25	0.25	0.25	0.25	0.25
Overnight Rate (EONIA)	0.07	0.05	0.03	0.03	0.03	0.03	0.03
3-Month (EURIBOR)	0.20	0.15	0.10	0.10	0.10	0.10	0.10
2 Year Schatz Yield	0.00	0.00	-0.05	-0.05	-0.05	0.00	0.00
5 Year Bobl Yield	0.40	0.40	0.35	0.35	0.35	0.40	0.40
10 Year Bund Yield	1.43	1.40	1.40	1.40	1.40	1.50	1.50
30 Year Bund Yield	2.31	2.25	2.25	2.25	2.25	2.35	2.35
2-10 Year Bund Curve	143	140	145	145	145	150	150
10 Year BTP-Bund Spread	255	250	250	225	225	200	200
10 Year Bono-Bund Spread	281	280	280	240	240	200	200
2 Year BTP-Schatz Spread	128	120	120	105	105	90	90
2 Year Bono Schatz Spread	167	160	160	130	130	100	100
10 Year OAT-Bund Spread	51	60	70	70	80	80	80
10 Year Swap Spread (Swap Less Govt.), bp	22	25	25	25	25	20	20
10 Year Breakeven Inflation	167	170	170	175	175	180	185
Japan							
Policy Rate	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3-Month Libor	0.16	0.15	0.15	0.15	0.15	0.15	0.15
2 Year Treasury Yield	0.13	0.15	0.15	0.10	0.10	0.15	0.15
5 Year Treasury Yield	0.39	0.35	0.30	0.25	0.20	0.30	0.30
10 Year Treasury Yield	0.88	0.80	0.70	0.60	0.50	0.70	0.70
30 Year Treasury Yield	1.79	1.80	1.70	1.65	1.60	1.70	1.70
2-10 Year Treasury Curve	75	65	55	50	40	55	55
2 Year Swap Spread (Swap Less Govt.), bp	15	15	15	13	13	15	15
10 Year Swap Spread (Swap Less Govt.), bp	15	17	15	13	10	15	15
UK							
Policy Rate	0.50	0.50	0.50	0.50	0.50	0.50	0.50
3-Month Libor	0.51	0.51	0.51	0.51	0.51	0.51	0.51
2 Year Treasury Yield	0.34	0.30	0.30	0.30	0.35	0.35	0.40
5 Year Treasury Yield	0.85	0.85	0.85	0.90	1.00	1.05	1.10
10 Year Treasury Yield	1.91	2.05	2.10	2.20	2.30	2.40	2.50
30 Year Treasury Yield	3.23	3.40	3.45	3.55	3.65	3.75	3.85
2-10 Year Treasury Curve	157	175	180	190	195	205	210
10 Year Swap Spread (Swap Less Govt.), bp	11	10	10	5	5	0	0
10 Year Breakeven Inflation	299	310	320	325	325	330	330
Australia							
Policy Rate	2.75	2.75	2.75	2.75	3.00	3.50	3.75
3-Month Libor	2.80	2.90	3.00	3.00	3.20	3.70	4.00
2 Year Treasury Yield	2.49	2.50	2.60	2.90	3.20	3.75	4.00
5 Year Treasury Yield	2.75	2.70	2.90	3.20	3.50	3.90	4.15
10 Year Treasury Yield	3.26	3.10	3.40	3.75	4.00	4.20	4.40
2-10 Year Treasury Curve	77	60	80	85	80	45	40
10 Year Swap Spread (Swap Less Govt.), bp	63	60	60	65	70	75	75

Source: Citi Research

Commodities Market Outlook

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

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

Commodity prices continue to trend lower and Citi's structurally bearish outlook — that was updated at length in April⁶ — remains firmly intact for now. Most bellwether commodities across the energy, metals and agriculture complex that declined 5-10% during 1Q'13 have retrenched an additional 5-10% this quarter with the precious metals group declining 15-20%. Those commodities that have shown signs of strength this year, such as US natural gas or soybeans, have done so for secular or uncorrelated (i.e. weather related) factors. Generally sluggish economic growth, the unfolding of looser supply/demand balances, persistent and surging US dollar strength and generally tepid Chinese consumption trends are likely to continue weighing on prices in 2H2013 and 2014. Citi's year-to-date estimates now point to \$2.8Bn in net inflows for index investments which contrasts with over \$8Bn in net inflows at this time in 2012. About \$14.6Bn in net redemptions through 30th April across listed commodity-linked exchange traded products which are dominated by physical gold funds also represents an all-time record withdrawal.

In general, oil market fundamentals remain soft. 1Q saw Dubai flirt with contango, then Brent slipped into full contango at the front of the curve and now, despite refinery turnarounds still on-going, products look weak and margins are so low that refiners are cutting runs. A wave of liquidation sent prices below \$100 for the first time since July 2012, though flat price has since recovered slightly with a seasonal pick up in crude demand and the force majeure on a key Nigerian export stream. Markets are playing out as Citi expected as weak global oil demand and a vulnerable economy is met with the US shale oil boom changing the landscape of global supply, continuing to back out crude imports from the US, particularly African light sweet grades. Demand continues to disappoint as slowing Chinese growth is causing a pullback for crude demand whilst European product markets are very weak, squeezing local margins. Physical market factors such as the BFOE price mechanism changes have been bearish for Brent; which earlier this month witnessed the first non-Forties cargo nominated under the changes, reflecting the increased liquidity the changes are designed to achieve. US supply growth continues apace, up 0.93-m b/d y/y. Elevated crude production from Iraq and Saudi Arabia as well as South Sudan's imminent return has added further downward pressure. Despite this bearish tone to the markets, Citi is neutral on prices at the current level as geopolitical risks seem undervalued in the market. Iraqi pipeline bombings, Iran's stand off with the west still ongoing, Nigerian oil theft and the Syrian conflict are all issues that the market will still have to contend with.

Among industrial metals, April saw LME copper prices slide from \$7,500-\$8,300/t to a new lower range of \$6,800-\$7,300/t into May, largely as a result of weaker than expected Chinese GDP data. However, on the downside prices are increasingly being supported by growing contango financing demand for the red metal, particularly since the copper forward went into full contango in March. On the upside, prices are constrained by rising levels of LME warehouse inventory. Indeed, warehouses are now paying cash premiums to traders and producers in order to attract physical copper into specific warehousing locations, namely Antwerp in Belgium, New Orleans in US, and Johor in Malaysia, with inventory levels up 95% since the beginning of the year. Large percentages of the metal inflow is then promptly cancelled for the purpose of building copper load out queues which in turn are driving up physical copper premiums in the US, Asia and Europe (in a similar vein to what has occurred in the aluminum and zinc markets over the last year). Indeed, the key copper price action is no longer the London Metals Exchange, but

⁶ See "[From Commodities Supercycle to Unicycles](#)", Edward Morse et al, 12 April 2013, Citi.

with physical premiums. As such there is little prospect of out of this newer range on the upside, particularly in the light of accelerating quarterly mine supply as prices more likely to drift lower within the current range over the remainder of the year.

With the recent price-related surge in retail gold buying from China and India seemingly having run its course, pressure has returned to the gold market; institutional investors continue to exit from the gold space. Physical ETF holdings are now down by over 400 tons compared to the start of the year, and the draws show no signs of slowing, symptomatic of the institutional buy-in to the US growth and equity market story. Indeed, the outperformance of US data, notably in the form of employment levels, continues to provide dollar support and weigh on precious prices. PGMS continue to get support from concerns over South African supply on the one hand, and positive auto sector demand (notably palladium on the other). China continues to move forward to tighter emissions controls on a city by city basis, while Euro 7 measures introduced from January 2014 are expect to increase platinum loading in European commercial vehicles.

We remain bearish the forward curves for deferred row-crop prices and continue to anticipate relative stability for wheat and rice trading levels both this year and next. On aggregate, staple cereal prices that rose from 2010 to 2011 to 2012 are expected to recede sharply in 2013 and further still in 2014. Lower prices should benefit consumers that have battled volatile markets amid inventory shortfalls, trade bans and weather disasters in recent campaigns. 13/14 corn and soybean balances are poised to loosen on a supply rebound across the Americas; notably the US, Brazil and Argentina. Wheat output should surge ex-US in producing blocs including the Black Sea and Europe. Meanwhile rice inventories and supply/demand fundamentals should remain stable in key Asian markets despite retrenchment in the US production profile. While adverse short-term weather issues must be monitored we view the likelihood of persistence (or repeat of the 2012 drought) as a tail risk. Additionally, we forecast a 'close-to-trend' normalized production rebound that would suggest a bias towards surplus balances materializing.

Figure 47. Commodities Price Outlook*

		Point Prices														
		0-3M	6-12M		Q1 2012	Q2 2012	Q3 2012	Q4 2012	2012	Q1 2013	Q2 2013E	Q3 2013E	Q4 2013E	2013E	2014E	
Energy				5Y Cyclical												
NYMEX WTI	USD/bbl	85.0	90.0	81.0	103.0	93.3	92.2	88.2	94.1	94.4	85.0	90.0	90.0	90.0	83.0	
ICE Brent	USD/bbl	100.0	103.0	85.0	118.4	108.8	109.4	110.1	111.7	112.6	100.0	105.0	100.0	104.0	93.0	
Henry Hub Natural Gas	USD/MMBtu	4.30	4.65	N/A	2.47	2.27	2.87	3.39	2.75	3.48	4.30	4.60	4.70	4.30	4.50	
Base Metals				LT Price												
LME Aluminum	USD/MT	1,900	2,100	2,200	2,216	2,019	1,944	2,017	2,049	2,042	1,935	1,940	1,985	1,975	1,930	
LME Copper	USD/MT	7,200	6,800	6,200	8,314	7,833	7,711	7,921	7,945	7,964	7,600	7,400	7,100	7,515	6,775	
LME Lead	USD/MT	2,100	2,300	2,200	2,118	1,987	1,984	2,200	2,072	2,314	2,150	2,100	2,200	2,190	2,200	
LME Nickel	USD/MT	18,200	21,000	20,000	19,721	17,228	16,383	17,036	17,592	17,387	17,000	18,500	19,250	18,035	20,900	
LME Tin	USD/MT	23,500	24,500	20,000	22,986	20,619	19,281	21,547	21,108	24,128	23,500	23,000	23,500	23,530	23,625	
LME Zinc	USD/MT	1,950	2,100	2,100	2,040	1,933	1,902	1,979	1,963	2,057	1,950	1,975	2,000	1,995	2,050	
Precious Metals				LT Price												
COMEX Gold	USD/T. oz	1,600	1,450	1,050	1,691	1,613	1,654	1,718	1669	1632	1580	1555	1455	1555	1435	
Silver	USD/T. oz	29	26	16.5	32.6	29.6	29.9	32.6	31.2	30.1	28.0	27.8	26.5	28.1	25.9	
Platinum	USD/T. oz	1,515	1,555	1,531	1,604	1,505	1,500	1,600	1552	1634	1515	1523	1530	1550	1625	
Palladium	USD/T. oz	790	900	680	683	630	613	653	645	741	790	825	875	810	950	
Bulk Commodities				5Y Cyclical												
Hard Coking Coal (benchmark Asia)	USD/MT	172	185	200	235	215	225	170	211	165	172	165	180	171	190	
Thermal Coal Asia (NEWC)	USD/MT	88	91	105	113	88	88	86	94	91	88	88	90	89	94	
Iron Ore Spot (TSI)	USD/MT	130	123	81	142	139	112	121	128	148	130	115	120	128	122	
Agriculture																
CBOT Corn	Usd/bu	630	500	N/A	641	618	783	737	695	715	630	600	515	615	500	
CBOT Wheat	Usd/bu	700	720	N/A	643	641	870	846	750	738	700	720	720	720	775	
CBOT Soybeans	Usd/bu	1,350	1,175	N/A	1,272	1,426	1,675	1,485	1,465	1,448	1,350	1,300	1,175	1,320	1150	
CBOT Rice	USD/cwt	15.4	15.3	N/A	14.3	14.8	15.3	15.1	14.9	15.3	15.4	15.4	15.2	15.3	15.0	
NYB-ICE Cotton	USD/lb	85	90	N/A	93	81	73	73	80	82	85	85	90	86	N/A	
Sugar#11	USD/lb	18.0	18.0	N/A	24.5	21.2	21.0	19.6	21.6	18.4	18.0	18.0	18.0	18.1	N/A	
ICE Coffree	USD/lb	145	155	N/A	205	171	172	152	175	144	150	150	155	150	N/A	
ICE Cocoa	USD/MT	2,200	2,400	N/A	2,308	2,221	2,440	2,420	2,348	2,176	2,200	2,425	2,475	2,320	N/A	

Source: Citi Research, *subject to revision

Notes

Appendix A-1

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