Citi Research

Economics

22 January 2014 | 48 pages

Global

Global Economic Outlook and Strategy

January 2014

- We are pushing up our global growth forecasts this month, and now look for global GDP growth (at current exchange rates) to rise from 2.5% in 2013 to 3.3% in 2014 and 3.4% in 2015, up by 0.1pp for 2013, 0.2pp for 2014 and 0.1pp for 2015 from our previous forecast. This year will, we expect, mark a return to sustained above-average global growth rates, whereas global growth has been below average for three consecutive years (2011-13) and indeed in five of the last six years.

- Within that, there continues to be a marked divide between the trend to forecast upgrades among advanced economies (AEs) and downgrades among emerging markets (EMs). Among the advanced economies, we make further upgrades this month to forecasts for the US, Euro area, UK and Sweden. We expect a sizeable disparity between the US and UK (both likely to grow by about 3% YoY in 2014-15), versus Japan and the euro area (likely to grow by about 1-1½% YoY in 2014-15). By contrast, we have cut 1½% off our 2014 EM forecast and 1¼% off our EM 2015 forecast in total since mid-2011, with notable downgrades this month to Turkey, Brazil and Venezuela. The recovery in advanced economies is still not generating much revival in EM export growth — and this trend may well continue.

- The RBNZ may well hike rates soon, but we expect that the ECB and BoJ will probably loosen policy further this year — with the BoJ prompted by weaker growth and the ECB reacting to modest growth plus a continued inflation undershoot. By contrast, a range of emerging markets are likely to see rate hikes this year, even amidst disappointing growth. For the US and UK, we expect that the jobless rate will hit the central bank's guidance threshold by mid-14, although subdued inflation trends probably will lead the Fed and BoE to keep rates on hold for a while. We now expect the UK will start to hike rates late this year, while for 2015, we expect solid growth and rising capacity use to trigger a more widespread tightening cycle across advanced economies, including the Fed, BoE, BoC, RBA, Norges bank and Riksbank. Even then, tightening will probably remain distant for the ECB and BoJ.

Figure 1. Currency and Interest Rate Forecasts, as of 22 January 2014

	22 Jan 2014	1Q 14F	2Q 14F	3Q 14F	4Q 14F	1Q 15F	2Q 15F
United States: Federal Funds	0.25	0.25	0.25	0.25	0.25	0.25	0.25
10-Yr. Treasuries (Period Ave.)	2.84	2.85	2.95	3.15	3.25	3.40	3.50
Euro Area: US$/€	1.36	1.37	1.39	1.40	1.40	1.40	1.41
Euro Repo Rate	0.25	0.25	0.00	0.00	0.00	0.00	0.00
10-Yr. Bunds (Period Ave.)	1.75	1.75	1.70	1.70	1.80	1.90	1.90
Japan: Yen/US$	104	105	106	107	108	110	111
Call Money	0.10	0.10	0.10	0.10	0.10	0.10	0.10
10-Yr. JGB (Period Ave.)	0.67	0.65	0.55	0.70	0.85	0.95	1.05

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

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With thanks to Jan Maguire

Next issue 26 February 2014

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Figure 2. Forecast Highlights and Changes

■ Global	We are pushing up our global growth forecasts this month, and now look for global GDP growth (at current exchange rates) to rise from 2.5% in 2013 to 3.3% in 2014 and 3.4% in 2015, up by 0.1pp for 2013, 0.2pp for 2014 and 0.1pp for 2015 from our previous forecast.
■ United States	Accelerating growth in the second half of 2013 has boosted optimism that expansion may be on a modestly stronger track. Fiscal drag has faded and monetary policy remains focused on supporting highly accommodative financial conditions, with QE expected to continue until Q4 and no rate hikes until later next year.
■ Euro Area	We revise up our 2014 and 2015 GDP forecasts by 0.2pp to 1.1%, and 0.3pp to 1.3%, respectively. This meaningful upward adjustment stems from better dynamics in the periphery and some abating headwinds. The combination of negative private sector credit growth and extraordinarily subdued inflation illustrates the need for monetary policy to stay very accommodative. We continue to look for the ECB to cut the refi rate to 0% in June and the deposit rate to -0.1%.
■ China	Key factors shaping the economic outlook in 2014 are reform initiatives, he rising cost of capital and export growth. In order to achieve around 7.5% growth, Chinese authorities may put growth ahead of reform, acting to curb money market rates after the Chinese New Year, and facilitate two-way volatility in the RMB market.
■ Japan	We expect the BoJ to implement additional easing in the form of increased purchases of JGBs and risk assets this summer. The timing of the action will likely be somewhat later than the current consensus expects.
■ United Kingdom	We are edging up our 2014 growth forecast to 3.3% from 3.2%, far above consensus (around 2½%). The jobless rate is likely to hit the MPC's 7% threshold soon and the MPC will probably start to hike rates in late 2014 or early 2015.
■ Canada	We continue to anticipate fixed rates through mid-2015 and resumed tightening in 3Q 2015 reflecting protracted convergence of inflation to target. Brightening growth prospects suggest that rate cuts are unlikely, in our view.
■ Australia	The milk man is set to beat the iron man. Australia's economy will underperform its trans-Tasman neighbor this year, as New Zealand growth pushes above potential. The RBNZ will therefore need to begin the process of policy normalization in Q1 2014, whereas the RBA can wait another year before lifting official interest rates.
■ Emerging Asia (ex China)	EM Asia exports continue to get a moderate and uneven lift from improving demand in advanced economies. Current accounts are improving noticeably in Indonesia, Malaysia, Sri Lanka, while India's is stabilizing at lower levels. External stability has given space for central banks in India and Indonesia to pause, while damage from escalating political risks is pushing Thailand to cut.
■ CEEMEA	Judging from the performance of currency markets so far this year, the 'Fragile 5' has evolved into the 'Fragile 2', and both are in CEEMEA: while the Rupiah, Real and Rupee are the best three performing currencies in 2014, the Lira and Rand are the worst. External vulnerability in this time zone, therefore, remains a front-burner issue, and that vulnerability has the risk of spreading to countries that seemed less vulnerable in 2013, like Russia and Hungary, where smaller current account surpluses and lower rates could pose a threat to financial stability.
■ Lat Am	We expect growth to accelerate in Mexico in 2014, while we see softer growth in the case of Brazil. In both countries inflation probably will rise, albeit marginally. In Argentina and Venezuela, the imbalances continue growing. Thus, we expect growth to drop (and to turn negative in Venezuela) and inflation to accelerate in these countries.

Source: Citi Research

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

	2013F	2014F	2015F
World	2.2%	4.3%	3.9%
United States	2.6	4.3	4.3
Japan	-0.5	5.4	1.1
Euro Area	-0.7	2.3	2.0
United Kingdom	-0.1	1.4	0.8
Canada	0.9	1.8	1.8
China	9.7	9.2	8.6
India	1.5	4.4	5.8
Korea	0.0	2.8	4.2
Brazil	1.5	2.2	2.5

Source: Citi Research

Overview — Stronger Global Growth

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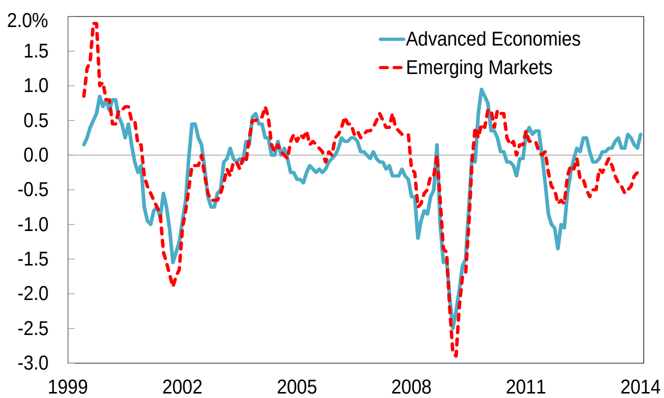
We are pushing up our global growth forecasts this month, and now look for global GDP growth (at current exchange rates) to rise from 2.5% in 2013 to 3.3% in 2014 and 3.4% in 2015, up by 0.1pp for 2013, 0.2pp for 2014 and 0.1pp for 2015 from our previous forecast[1].This year will, we expect, mark a return to sustained above-average global growth rates, whereas global growth has been below average for three consecutive years (2011-13) and indeed in five of the last six years.

We are raising our global forecasts this month, and expect above-average expansion in coming years

We continue to upgrade AE growth prospects, with downgrades to EMs

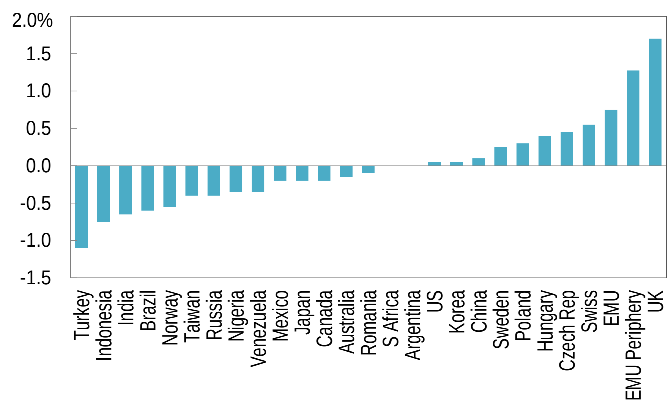
Within that, there continues to be a marked divide between the trend to forecast upgrades among advanced economies (AEs) and downgrades among emerging markets (EMs). We have cut 1½% off our 2014 EM forecast and 1¼% of our EM 2015 forecast in total since mid-2011, with notable downgrades this month to Turkey, Brazil and Venezuela. By contrast, as since early 2013, we continue to lift our forecasts for advanced economy growth, with further upgrades this month to forecasts for the US, Euro area, UK and Sweden.

Figure 4. Advanced Economies and Emerging Markets — Six-Month Sum of Revisions to GDP Growth Forecasts for Current and Next Year,



Source: Citi Research

Figure 5. Selected Countries — Revisions to Citi Forecasts for Real GDP Growth in 2014-15 Over Last Six Months



Note: EMU periphery defined here as the average for Italy, Spain, Greece, Portugal.
Source: Citi Research

We expect a modest further slowdown in China's growth this year…

In China, recent data point to a modest slowdown, with slightly lower GDP growth in Q4-13 (7.7% YoY versus 7.8% YoY in Q3) plus softer data for industrial production and fixed asset investment in the last month or two[2]. We expect GDP growth to edge down from 7.7% in 2013 to about 7.3% in 2014, the lowest since 1990. There seems to be a positive mood in Beijing over reform prospects and some reform momentum seems underway — one-child policy relaxation, liberalization in health care and anticipation of progress on price reforms, investment deregulation, and introduction of deposit insurance as a prelude to interest rate liberalization[3].

…but China's growth remains highly credit-dependent…

However, we continue to have major worries over China's medium-term growth outlook. There is still little sign that the economy is genuinely rebalancing away from the investment-intensive and credit-led growth of recent years. The growth of total social financing (17.9% YoY in Dec-13) remains roughly twice the growth of nominal GDP (10.0% YoY in Q4-13), while investment continues to account for roughly half

[1] See "*Prospects for Economies and Financial Markets in 2014 and Beyond*", Willem Buiter et al, 2 December 2013, Citi.

[2] See "*China Macro Flash - 2013 GDP: Flat Growth With Weaker Bias*", Minggao Shen and Shuang Ding, 20 January 2014, Citi.

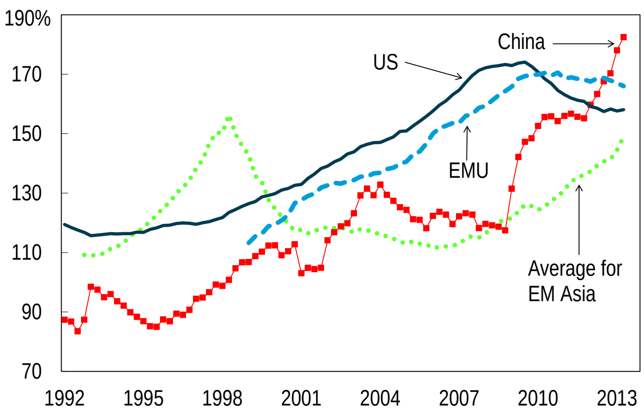
[3] See "*China Macro View - Beijing Trip Notes: Reform Hopes*", Johanna Chua and David Lubin, 16 January 2014, Citi.

the growth in GDP. As a result, the ratio of private debt/GDP (ie the combined gross unconsolidated debts of the household and non-financial corporate sectors) surged to 182.5% of annual GDP in Q2-13, having been just 119.1% five years earlier[4]. Far from becoming less credit-dependent, the rise in this ratio over the last four quarters (19.2pp) is far greater than in the prior four quarters (6.6pp). China's private debt/GDP ratio now comfortably exceeds recent peaks in the US and euro area (174% and 171% respectively), and is above current US and EMU levels (158% in the US, 168% for the euro area). The rise in China's private debt/GDP ratio over the last five years (63 percentage points) is about twice that in the US during 2003-08 (28pp) — and one of the greatest credit booms in any country over recent decades.

…and the authorities face a major dilemma between reform, rebalancing and their likely growth targets

China's credit boom is helping to sustain rapid GDP growth, at the rising cost of potential bad losses, credit excesses and resource misallocation. The authorities now seem to be seeking to deflate this credit boom, for example tolerating higher bond yields and seeking to rein in the shadow banking sector. However, in our view there is a fundamental tension between the reform agenda and the desire for growth of at least 7%. If, at some point, the authorities genuinely seek to rein in the credit boom, then the economy probably will face considerable further downside risks (especially if capital account liberalization cuts speculative housing demand). Moreover, China's medium-term growth prospects face the further challenge of worsening demographics: the population aged 15-59 years fell 1.9% YoY in 2013, the second consecutive decline — with the prospect of further drops to come.

Figure 6. Global — Private Debt (Non-Financial Sector) as Pct Four-Quarter Average for Nominal GDP, 1992-2013



Note: EM Asia average is average for Singapore, Thailand, HK, Indonesia, Korea, Malaysia. We show the sum of the unconsolidated gross debts of the household and non-financial corporate sectors. Sources: BIS, DataStream and Citi Research

Figure 7. Global — Advanced Economy GDP and World Trade Growth, QoQ Annualised, 1996-2013

Note: AE GDP proxied by the weighted average for GDP growth in the US, Euro Area, Japan and UK. Trade in Q4 based on data for Oct-Nov. Sources: CPB, DataStream and Citi Research

Other EM countries face nearterm growth downside…

Various other EM countries face a more immediate crunch between worsening growth, sticky inflation, worsening current account balances and, as advanced economy growth picks up, less benign global liquidity conditions. The recovery in advanced economies is still not generating much export boost for emerging markets. During 1996-07, GDP growth for the US, euro area, Japan and UK averaged 2½% QoQ annualized and, with high import intensity, this helped fuel average world trade gains of about 7% QoQ annualized. Moreover, EM export growth outpaced world trade growth, rising by an average of 9½% QoQ annualized. In Q2-Q4 of 2013, GDP growth for the US, euro area, Japan and UK roughly returned to that precrisis pace but — with less import-intensive growth — world trade growth averaged about 4½% QoQ annualized, well below precrisis norms.

[4] We use the BIS private debt data, which exclude debts of local authorities and central governments.

…as the hoped-for export boost from AE recovery disappoints

Moreover, EM exports are no longer outperforming world trade as much as previously, in part reflecting the erosion of cost-competiveness over recent years. As a result, EM export growth in Q2-Q4 of 2013 was about 5¾% QoQ annualized, a bit above the 2008-12 pace but still well below the precrisis norm. Resultant worries over prospects for growth and current account balances are prompting a rolling series of EM market strains and currency weakness (hence lifting inflation prospects). We expect a further series of EM rate hikes (see figure 17), some in response to currency-induced inflation worries and in some cases to limit currency weakness, thereby reinforcing downside growth risks.

The US and UK are heading for growth of 3%+ in 2014-15…

Among advanced economies, we expect a sizeable disparity between the US and UK (both likely to grow by about 3% YoY in 2014-15), versus Japan and the euro area (likely to grow by 1-1½% YoY in 2014-15). With higher US growth in H2-2013, supportive financial conditions and greatly reduced fiscal headwinds, we are lifting our 2014 US growth forecast to 3.1% from 2.7% in the late-13 forecast round[5]. We are also edging up our 2014 UK growth forecast to 3.3% from 3.2%. Details differ, but common themes for the US and UK are that monetary policy remains loose (ultra-low policy rates and large QE), while headwinds from deleveraging, poor credit availability and fiscal drag have receded markedly. For both the US and UK, we expect that the jobless rate will hit the central bank's guidance threshold by mid-14 and probably quite soon. We are advancing the first UK rate hike from H1-2015 to Q4-2014, although we still expect the Fed will be on hold until well into 2015.

…becoming the first major advanced economies to recover strongly from recent boom/bust cycles

The prospective turn in the US policy cycle probably has global implications. The US and UK are also of interest (as with Iceland) as evidence that advanced economies can recover from the recent major boom/bust credit cycles to solid growth (albeit after several years) as long as sufficient stimulus is in place, banks are recapitalized and background conditions (eg supply-side flexibility) are in place. To be sure, the level of real GDP in the US and UK will probably stay well below the rising pre-crisis trend. But, these countries' experience suggests that "secular stagnation" (ie persistent low growth of real and nominal GDP) is not an inevitable post-bubble feature[6]. It can be avoided through policy choices.

We expect modest growth in Japan and the euro area, with Japan underperforming consensus

For Japan, we expect growth to undershoot consensus because of sizable fiscal drag from the consumption tax hike (even with temporary offsets), with an insufficiently aggressive monetary response. We do expect the BoJ to loosen further through asset purchases, but only once adverse effects from the consumption tax hike become evident around midyear. For the euro area, we are again lifting our GDP growth forecasts, and now expect growth of 1.1% in 2014 and 1.3% in 2015 (up by 0.2pp and 0.3pp respectively), with marked upgrades among Spain, Portugal and Ireland (for 2014-15, plus Germany (for 2015). Fiscal policy will be roughly neutral this year, whereas periphery countries faced heavy fiscal drag in 2011-12. For Spain, Ireland and Portugal, recovery initially has been led by exports, feeding through to employment amidst unusual flexibility in labour costs. In Ireland, the domestic recovery is clearly underway: employment rose 3.2% YoY in Q3-13 while house prices bottomed about a year ago and in Nov-13 stood 5.6% up YoY. In Spain, domestic recovery is more tentative: house prices and turnover are still down YoY, although we expect upcoming data will show a modest rise in employment for Q4-13. In Portugal, the economy already has grown for two consecutive quarters, and surveys point to further (albeit modest) expansion in coming quarters.

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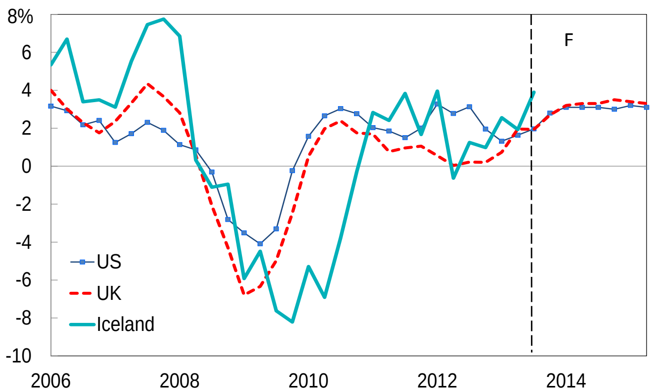
[5] See "*U.S. Economics Weekly: Market and Policy Comments - Forecast Update: Recovery Reaching Its Stride*", Robert DiClemente, 17 January 2014, Citi.

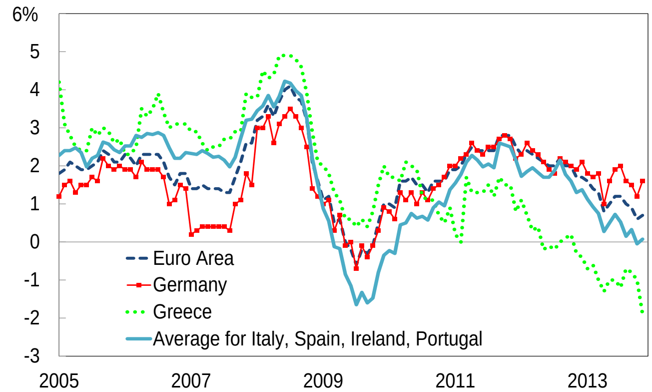
[6] See "*Global Economics View - Secular Stagnation: Only If We Really Ask For It*", Willem Buiter and Ebrahim Rahbari, 13 January 2014, Citi.

Figure 8. UK, US and Iceland — YoY Real GDP Growth, 2006-15F



Sources: DataStream and Citi Research

Figure 9. Euro Area — CPI Inflation (At Constant Tax Rates) in Selected Countries YoY, 2005-13



Sources: Eurostat and Citi Research

We expect the ECB will loosen a bit further, without doing enough to fully avert risks of a long inflation undershoot or to remove risks of mild deflation

Nevertheless, the euro area recovery is likely to remain modest, with persistently high unemployment and ample slack keeping inflation below 1% YoY in both 2014 and 2015. Even if inflation remains slightly above zero (which is our base case), such low inflation rates are a symptom of persistently depressed economy, with high costs in terms of incomes, profits and tax revenues foregone. We believe the ECB could justifiably loosen policy far more aggressively than it has done, even if outright deflation does not materialize. However, we expect that in practice the ECB will continue to act rather tentatively, cutting the refi rate target to (or very close to) zero and setting a slightly negative deposit rate — but probably not doing widespread asset purchases or seeking to directly weaken the euro unless sustained deflation does occur. As a result, we expect the economy to remain potentially one adverse shock away from deflation — akin perhaps to Japan's mid-90s position before the Asia crisis acted as the catalyst to tip the economy into sustained deflation.

We expect Portugal will seek a PCCL, but there is chance that – like Ireland – the country will initially seek a "clean" exit from its current programme

In the nearterm, we expect that periphery spreads will fall further, amidst low ECB rates and expansionary liquidity. Ireland has managed a "clean" exit from its programme, and has been "rewarded" with falling spreads and sovereign ratings upgrade. Our base case is for Portugal to seek a Precautionary Credit Line later this year to follow its current programme (which ends in June 2014). But there is a chance that Portugal also will initially seek a "clean" exit (ie with neither a PCCL or full programme), reflecting the government's desire to avoid externally-set conditionality, Germany's probable reluctance to undergo the parliamentary approval needed for a further programme and the assumption that a programme could be agreed quickly if market conditions dictate.

Unless there is further debt restructuring, the periphery will only get back to fiscal sustainability if nominal GDP growth accelerates sharply

Nevertheless, we remain worried about longer-term fiscal trends in periphery countries. Even with better real GDP growth, we expect mild deflation in Italy, Spain, Greece and Portugal in coming years. As far as we can tell, the ECB seems willing to tolerate mild periphery deflation, as a means to regain competitiveness while it keeps overall CPI inflation below 2%. However, unless deflation is accompanied by very rapid real GDP growth, nominal GDP growth for periphery countries is likely to stay low. Hence, we expect that general government gross debt/GDP ratios will keep rising in all periphery countries except Ireland in 2014-16, remaining well above 2013 levels even in 2018. Ireland is a possible exception, in that the very large export sector may ensure sufficient nominal GDP growth to bring the public debt/GDP ratio slightly lower even in 2014. But, even Ireland's fiscal path remains vulnerable to external shocks. Current policies are unlikely to restore fiscal sustainability in the other periphery countries in coming years.

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

	GDP Growth						CPI Inflation						Short-Term Interest Rates					
	2013F	2014F	2015F	2016F	2017F	2018F	2013F	2014F	2015F	2016F	2017F	2018F	2013	2014F	2015F	2016F	2017F	2018F
Global	2.5	3.3	3.4	3.6	3.5	3.4	2.6	3.0	3.1	3.4	3.5	3.5	2.22	2.31	2.58	3.04	3.54	3.82
Based on PPP weights	*3.0*	*3.7*	*3.8*	*4.1*	*4.1*	*3.9*	*3.1*	*3.5*	*3.6*	*3.9*	*4.0*	*4.0*	*2.79*	*2.93*	*3.28*	*3.71*	*4.15*	*4.28*
Industrial Countries	1.2	2.3	2.2	2.3	2.1	1.9	1.3	1.6	1.6	1.6	1.6	1.7	0.46	0.34	0.48	1.05	1.72	2.44
United States	1.9	3.1	3.1	3.2	2.7	2.2	1.1	1.5	1.7	2.2	2.3	2.2	0.25	0.25	0.40	1.50	2.70	3.80
Japan	1.7	1.6	1.0	1.2	1.2	1.0	0.3	2.6	1.6	1.6	0.7	1.0	0.10	0.10	0.10	0.10	0.10	0.50
Euro Area	-0.4	1.1	1.3	1.4	1.5	1.5	1.4	0.9	0.8	1.2	1.7	1.8	0.50	0.06	0.00	0.06	0.50	1.00
Canada	1.8	2.5	2.7	2.7	2.6	2.4	0.9	1.3	1.9	2.0	2.0	2.0	1.00	1.00	1.19	2.13	2.50	2.75
Australia	2.3	2.7	2.8	2.9	3.0	3.1	2.4	3.0	2.1	2.5	2.4	2.4	2.69	2.50	3.44	4.44	4.50	4.75
New Zealand	2.7	3.2	2.7	2.5	1.7	1.9	1.1	2.1	2.2	2.3	2.3	2.2	2.50	3.31	4.56	4.75	4.75	5.00
Germany	0.5	2.0	2.1	1.8	1.6	1.5	1.5	1.5	1.8	1.9	1.9	1.9						
France	0.2	0.9	1.1	1.4	1.7	1.8	1.0	1.2	1.3	1.5	1.3	1.5						
Italy	-1.8	0.3	0.3	0.4	0.5	0.6	1.3	0.5	-0.3	0.4	1.1	1.4						
Spain	-1.2	0.9	1.1	1.4	1.3	1.4	1.5	-0.2	-0.1	0.1	0.5	0.8						
Greece	-3.4	-1.9	-0.4	1.1	1.4	1.3	-0.9	-2.7	-2.4	-1.4	-0.4	0.8						
Ireland	0.0	2.1	2.2	3.5	3.9	4.0	0.7	0.3	0.9	1.0	1.0	1.0						
Portugal	-1.6	0.2	0.8	0.7	0.9	1.0	0.4	-0.4	-0.9	-0.2	0.6	1.0						
Netherlands	-1.0	0.5	0.9	1.2	1.6	1.9	2.5	1.2	1.3	1.4	1.5	1.8						
Belgium	0.2	1.2	1.3	1.4	1.9	2.1	1.1	1.0	1.0	1.1	1.6	2.0						
Denmark	0.4	1.2	1.5	1.8	1.7	1.9	0.8	1.5	1.7	1.8	1.9	2.0	0.20	0.13	0.25	0.47	0.78	1.00
Norway	1.8	2.0	2.4	2.6	2.9	2.7	2.1	2.0	2.1	2.1	2.3	2.5	1.50	1.50	1.71	2.08	2.74	3.33
Sweden	0.9	2.3	2.7	2.8	2.9	2.7	0.0	0.5	1.8	2.4	2.3	2.0	0.99	0.75	0.98	1.42	2.18	2.80
Switzerland	2.0	2.0	2.0	2.2	2.0	2.0	-0.2	-0.2	0.9	1.1	1.2	1.2	0.00	0.00	0.00	0.00	0.25	1.00
United Kingdom	1.9	3.3	3.2	2.7	2.2	2.2	2.6	1.8	1.9	2.2	2.1	2.1	0.50	0.54	1.58	2.00	2.21	2.71
Emerging Markets	4.6	4.8	5.0	5.4	5.5	5.3	4.7	5.1	5.4	5.1	5.1	5.0	4.99	5.29	5.71	5.98	6.15	5.74
China	7.7	7.3	7.0	7.5	7.3	7.0	2.6	3.3	3.7	3.8	4.0	3.8	3.00	3.03	3.63	3.88	4.25	4.50
Taiwan	2.0	3.2	3.8	4.2	4.5	4.5	0.8	1.7	2.3	1.8	1.8	1.8	1.88	1.88	2.19	2.63	3.13	3.63
India	4.8	5.6	6.7	7.3	7.4	7.5	10.0	8.3	7.5	7.5	7.5	7.5	7.75	8.00	8.00	8.00	8.00	8.00
Indonesia	5.7	5.3	5.5	5.7	5.9	5.7	7.0	6.4	5.7	5.4	5.3	5.5	4.65	6.00	6.44	6.25	6.00	6.00
Korea	2.9	3.7	4.0	4.1	3.7	3.8	1.3	2.1	3.1	3.1	3.0	2.9	2.56	2.50	3.13	3.75	4.13	4.25
Czech Republic	-1.4	1.9	2.4	2.4	2.7	3.1	1.4	1.2	2.3	1.6	2.0	2.0	0.05	0.05	0.05	0.55	1.54	2.54
Hungary	1.0	1.9	1.3	1.4	1.6	1.9	1.7	1.0	2.8	2.7	2.5	1.9	4.19	2.74	3.90	4.00	4.00	4.00
Poland	1.5	3.1	3.6	3.6	3.5	3.2	0.9	1.4	2.8	2.7	2.5	2.5	2.92	2.63	3.75	4.21	4.35	4.00
Romania	2.5	2.8	3.3	3.5	3.5	3.5	4.0	1.6	2.7	2.5	2.5	2.5	4.69	3.75	4.69	5.00	5.00	5.00
Russia	1.4	2.6	2.7	2.9	3.0	3.0	6.8	5.6	4.9	4.6	4.4	4.1	8.25	8.13	7.69	7.33	7.10	6.88
Turkey	4.0	2.5	3.5	3.8	4.0	4.0	7.5	7.3	7.6	7.0	6.1	5.8	6.16	8.88	9.75	9.06	8.63	8.25
Nigeria	6.5	6.6	6.4	6.4	7.0	6.2	8.5	8.8	10.6	10.8	9.9	9.2	11.75	11.75	12.50	11.25	9.00	9.00
South Africa	1.8	2.8	3.5	3.9	3.7	3.5	5.8	5.6	5.5	5.8	6.0	5.3	5.00	5.00	5.75	6.50	6.50	6.50
Argentina	5.3	3.0	2.0	-2.0	3.5	3.0	10.6	13.0	13.8	50.0	30.0	20.0	17.16	24.30	29.16	31.00	31.00	0.00
Brazil	2.3	1.8	2.0	2.5	3.0	3.0	6.2	6.0	5.7	5.5	5.5	5.5	8.44	10.73	11.90	11.50	11.00	11.00
Mexico	1.2	3.8	4.0	4.4	4.5	4.6	3.8	4.4	3.8	3.6	3.6	3.6	3.94	3.50	3.94	5.40	6.42	6.75
Venezuela	1.5	-1.0	1.9	1.9	1.9	1.9	38.7	67.3	79.5	60.0	60.0	60.0	14.50	14.50	14.50	14.80	14.80	14.80

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

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

	Current Balance (Pct of GDP)						Fiscal Balance (Pct of GDP)						Government Debt (Pct of GDP)					
	2013F	2014F	2015F	2016F	2017F	2018F	2013F	2014F	2015F	2016F	2017F	2018F	2013F	2014F	2015F	2016F	2017F	2018F
Global	0.7	0.7	0.6	0.3	0.1	0.1	-3.7	-3.1	-2.7	-2.5	-2.3	-2.2	89	87	87	86	85	84
Based on PPP weights	*0.4*	*0.4*	*0.3*	*0.1*	*-0.1*	*-0.1*	*-3.6*	*-3.2*	*-2.8*	*-2.6*	*-2.5*	*-2.4*	*81*	*81*	*80*	*79*	*78*	*77*
Industrial Countries	-0.2	0.1	0.2	0.1	0.1	0.2	-4.8	-3.8	-3.0	-2.8	-2.5	-2.3	116	115	115	115	114	114
United States	-2.3	-1.9	-1.6	-1.8	-1.7	-1.4	-5.8	-4.6	-3.9	-3.9	-3.8	-3.8	105	107	107	106	106	106
Japan	0.7	0.4	0.3	0.8	1.0	1.0	-9.8	-8.0	-6.2	-5.8	-5.4	-5.0	244	246	251	255	258	260
Euro Area	2.2	2.5	2.6	2.6	2.5	2.3	-2.9	-2.5	-2.0	-1.6	-1.4	-1.1	96	98	99	98	97	96
Canada	-3.5	-3.7	-3.2	-2.7	-2.5	-2.5	-0.9	-0.3	0.2	0.2	0.2	0.4	96	96	93	90	87	85
Australia	-3.2	-4.0	-4.1	-4.3	-4.6	-4.6	-1.2	-3.0	-2.1	-1.4	-1.0	-1.5	30	32	34	33	33	34
New Zealand	-3.7	-4.7	-4.8	-3.8	-3.6	-3.3	-2.0	-1.0	0.0	0.7	1.2	1.5	37	36	33	34	35	32
Germany	6.8	6.5	6.0	5.3	4.9	4.5	0.2	0.0	0.0	0.0	0.0	-0.2	78	76	74	71	69	67
France	-1.6	-0.8	-0.1	0.3	0.1	-0.2	-4.1	-3.6	-3.1	-2.7	-2.3	-1.8	94	96	97	98	97	95
Italy	0.9	1.3	1.6	1.9	2.2	2.4	-3.1	-2.8	-2.7	-2.5	-2.6	-2.3	133	137	140	142	143	142
Spain	1.0	1.0	1.4	1.5	1.7	1.8	-6.9	-5.8	-4.8	-4.0	-3.4	-2.9	94	100	104	106	107	107
Greece	0.7	1.9	2.4	2.9	3.3	3.2	-3.6	-3.5	-2.4	-2.1	-1.5	-1.3	176	191	201	203	203	200
Ireland	8.4	8.6	7.8	8.0	8.4	8.6	-7.0	-4.7	-3.0	-2.2	-2.2	-1.7	125	123	122	121	117	113
Portugal	0.4	2.2	2.5	2.6	2.7	2.7	-6.0	-4.6	-3.8	-3.1	-2.7	-2.7	129	138	142	145	146	146
Netherlands	10.2	10.4	9.4	8.9	8.4	7.9	-3.5	-2.6	-1.9	-1.2	-0.2	1.1	75	76	75	75	73	69
Belgium	-1.7	-0.1	0.6	0.8	0.6	0.4	-3.1	-2.6	-1.5	-1.0	-0.5	0.1	102	103	102	100	97	93
Denmark	6.3	5.8	5.0	4.7	5.0	4.9	-1.2	-1.8	-1.5	-1.0	-1.0	-0.9	46	47	47	46	46	45
Norway	11.9	12.2	12.5	12.8	13.0	13.2	11.3	11.8	11.0	10.0	10.0	9.0	NA	NA	NA	NA	NA	NA
Sweden	6.2	5.9	5.6	5.6	5.4	5.3	-1.4	-1.6	-1.0	-0.3	0.5	1.2	40	40	39	38	35	32
Switzerland	12.2	12.9	12.7	13.7	14.0	14.0	0.2	0.6	0.8	1.2	1.2	0.9	48	46	45	45	44	44
United Kingdom	-3.6	-2.9	-3.1	-3.0	-2.7	-2.4	-6.7	-5.3	-4.0	-2.4	-1.1	0.0	94	96	96	95	93	90
Emerging Markets	1.9	1.7	1.1	0.5	0.1	-0.1	-2.0	-2.1	-2.1	-2.0	-2.1	-2.1	45	45	45	44	43	42
China	2.2	2.0	1.5	0.8	0.5	0.5	-2.0	-2.0	-1.5	-1.5	-1.5	-1.5	54	54	52	51	49	48
Taiwan	10.9	9.8	9.5	8.0	8.0	8.0	-1.5	-1.4	-1.2	-1.0	-0.7	-0.5	42	41	42	43	44	44
India	-2.3	-2.3	-2.1	-1.9	-1.8	-1.6	-6.9	-6.7	-6.3	-6.1	-5.8	-5.8	69	68	65	64	62	60
Indonesia	-3.3	-2.8	-2.3	-2.1	-2.0	-2.0	-2.2	2.2	-1.7	-1.9	-2.0	-2.0	25	26	25	25	25	25
Korea	5.7	4.0	3.1	2.4	1.6	0.7	0.9	1.0	1.6	1.9	2.0	1.8	35	33	31	29	28	27
Czech Republic	-0.8	-0.3	-0.9	-0.1	-0.8	-1.4	-2.4	-2.9	-2.9	-2.8	-2.5	-2.0	48	49	50	51	51	51
Hungary	1.9	1.4	1.1	0.9	0.7	0.7	-2.7	-2.9	-2.9	-2.9	-3.0	-3.0	78	79	79	78	78	77
Poland	-1.8	-2.4	-3.4	-4.4	-4.6	-4.3	-4.2	5.6	-2.3	-2.2	-2.2	-2.2	55	47	46	45	44	44
Romania	-1.2	-2.5	-4.2	-4.5	-4.5	-4.5	-2.5	-2.3	-2.3	-2.3	-2.3	-2.3	41	40	40	39	39	39
Russia	1.6	1.1	0.8	-0.4	-1.3	-2.2	-2.0	-4.3	-4.9	-1.4	-1.4	-1.4	8	10	14	14	13	14
Turkey	-7.1	-5.9	-6.4	-5.9	-5.4	-4.9	-1.2	-2.8	-3.2	-3.3	-3.3	-3.3	37	37	37	36	35	33
Nigeria	5.0	3.2	2.2	2.1	2.0	1.2	-2.1	-2.9	-2.9	-2.7	-2.5	-2.4	NA	NA	NA	NA	NA	NA
South Africa	-5.9	-5.2	-4.9	-4.7	-4.6	-4.7	-4.4	-4.3	-4.4	-4.2	-4.0	-3.8	46	47	49	50	49	51
Argentina	-0.6	-0.4	-0.4	3.0	1.0	1.0	-2.3	-3.1	-2.3	0.0	-0.5	-1.0	40	44	50	48	46	45
Brazil	-3.5	-3.3	-3.0	-3.0	-3.0	-3.0	-3.6	-3.9	-2.7	-3.2	-3.2	-3.3	59	59	59	59	59	60
Mexico	-1.7	-2.0	-1.7	-1.3	-1.4	-1.5	-2.4	-3.5	-2.5	-2.0	-2.0	-2.0	38	38	38	37	37	37
Venezuela	3.2	3.8	3.6	3.0	3.0	3.0	-11.8	-11.0	-10.1	-11.9	-11.9	-11.3	41	40	40	41	41	42

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

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

	GDP Growth			CPI Inflation			Current Balance (Pct of GDP)			Fiscal Balance (Pct ofGDP)		
	2013F	2014F	2015F	2013F	2014F	2015F	2013F	2014F	2015F	2013F	2014F	2015F
Global	0.1	0.2	0.1			0.1					0.1	
Based on PPP weights	*0.1*	*0.1*			*0.1*	*0.1*				*0.1*		
Industrial Countries	0.1	0.3	0.1		-0.1			-0.1	-0.1			0.1
United States	0.2	0.4			-0.3	-0.3		0.1	0.1			
Japan	-0.1		0.1		0.3	0.2	-0.2	-1.2	-1.4			
Euro Area		0.2	0.3	0.1				-0.1		0.1	0.1	0.2
Canada	0.1	0.1		-0.1	-0.2		-0.3	0.5	1.0	0.1		
Australia	-0.2	-0.2	-0.2	-0.1	-0.1	-0.3	-0.7	-0.4	0.2		-0.4	-0.2
New Zealand	0.3	0.2		-0.1					0.1	0.7	0.8	0.7
Germany		0.1	0.4			0.2		-0.3	-0.2			0.1
France		0.1	0.2				-0.1					0.2
Italy		0.1			0.3		-0.2	-0.1	0.1			
Spain	0.1	0.7	0.3		0.2	0.1	-0.1	-1.1	-1.2		0.4	0.6
Greece	-0.1		0.1	-0.1	0.2		0.3	0.3	0.1	-0.7	-1.2	-0.6
Ireland	0.5	0.7	0.6	1.0	-0.2	-0.1	-0.2	-1.5	-2.6	0.1	0.9	1.0
Portugal		0.7	0.4			0.3	-0.3	-0.3	-0.3		0.4	0.6
Netherlands	0.1	0.1		-0.1	-0.1			0.4	0.8	0.1	0.3	0.3
Belgium	0.1	0.6	0.3	-0.1	-0.3	-0.1	2.2	4.0	4.5	-0.2	-0.3	
Denmark							0.2		0.3	0.4		
Norway		-0.1				-0.1	-0.9	-0.9	-0.9			
Sweden		0.2	0.2		-0.6	-0.1						-0.3
Switzerland					-0.1			-0.1	-0.1			
United Kingdom	0.4	0.1			-0.2		0.1	0.1		0.1	-0.4	-0.3
Emerging Markets					0.2	0.2		0.1			0.1	
China	0.1			-0.1								
Taiwan				-0.3								
India				0.8	0.8		0.4	0.1	0.3	-0.2	-0.3	-0.1
Indonesia				-0.1	-0.2		0.2			-0.1	4.0	
Korea			0.1	0.1	-0.2		0.1	-0.1	-0.1		-1.3	-0.7
Czech Republic	-0.1					0.4	-0.8	-1.6	-1.6			
Hungary			-0.2		-0.5	-0.5	0.4	0.5	0.3	0.2	0.1	
Poland	0.1			-0.1	-0.5		-0.3			0.4	0.4	0.3
Romania				-0.1	-0.3			0.6				
Russia				0.1	0.3							
Turkey	0.5	-1.0	-0.1			0.7	-0.1	0.4	-0.6			
Nigeria		0.1	0.1				0.6	1.2				
South Africa	-0.1						1.2	0.5	0.4			
Argentina	0.2			0.1	0.6		-0.1					
Brazil	-0.3	-0.2						0.1	0.1			
Mexico					0.4	0.1		-0.1				
Venezuela	-0.5	-1.0	-0.1	-0.1	8.3	15.7	-0.4		0.3	-0.1	0.8	1.8

Source: Citi Research

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

	10-Year Yields						Exchange Rates Versus U.S. Dollar*						Exchange Rate Versus Euro					
	2013	2014F	2015F	2016F	2017F	2018F	2013	2014F	2015F	2016F	2017F	2018F	2013	2014F	2015F	2016F	2017F	2018F
Industrial Countries																		
United States	2.35	3.05	3.55	3.85	4.15	4.35	NA	NA	NA	NA	NA	NA	1.32	1.39	1.41	1.41	1.41	1.41
Japan	0.71	0.69	0.98	1.25	1.50	1.50	98	107	112	115	115	115	130	148	158	162	162	162
Euro Area	1.60	1.74	1.90	2.15	2.40	2.65	1.32	1.39	1.41	1.41	1.41	1.41	NA	NA	NA	NA	NA	NA
Canada	2.26	2.93	3.45	3.70	3.95	4.00	1.04	1.12	1.12	1.12	1.11	1.10	1.37	1.55	1.58	1.57	1.56	1.56
Australia	3.65	4.45	4.86	5.50	5.50	5.80	0.95	0.86	0.85	0.85	0.85	0.85	1.39	1.62	1.65	1.66	1.66	1.66
New Zealand	3.98	5.25	6.15	6.40	6.40	6.70	0.82	0.86	0.86	0.83	0.80	0.76	1.62	1.63	1.64	1.70	1.77	1.84
Germany	1.60	1.74	1.90	2.15	2.40	2.65												
France	2.15	2.39	2.55	2.80	3.05	3.30												
Italy	4.25	3.41	3.40	3.65	3.90	4.15												
Spain	4.55	3.28	3.15	3.40	3.65	3.90												
Netherlands	1.95	2.09	2.25	2.50	2.75	3.00												
Belgium	2.40	2.39	2.55	2.80	3.05	3.30												
Denmark	1.73	1.84	2.00	2.30	2.65	2.90	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
Norway	2.57	2.86	2.75	2.90	3.15	3.40	6.01	5.81	5.55	5.37	5.20	5.03	7.94	8.07	7.80	7.57	7.33	7.10
Sweden	2.10	2.45	2.63	2.75	2.90	3.15	6.59	6.28	6.23	6.12	5.97	5.82	8.72	8.73	8.77	8.63	8.41	8.20
Switzerland	0.82	0.88	1.00	1.20	1.40	1.59	0.93	0.90	0.91	0.92	0.92	0.92	1.23	1.24	1.28	1.29	1.29	1.29
United Kingdom	2.34	3.33	3.75	3.90	4.00	4.20	1.58	1.73	1.77	1.79	1.79	1.79	0.84	0.80	0.79	0.79	0.79	0.79
Emerging Markets																		
China	3.68	4.68	5.11	5.49	5.86	6.11	6.15	6.01	6.00	6.01	6.03	6.05	8.17	8.36	8.44	8.48	8.50	8.53
Taiwan	1.52	1.76	2.14	1.70	2.00	2.50	29.68	29.65	29.17	28.85	28.58	28.32	39.43	41.22	41.03	40.68	40.30	39.92
India	8.25	8.50	8.50	8.50	8.50	8.50	58.57	61.76	59.73	57.20	55.80	54.40	77.80	85.85	84.01	80.65	78.68	76.71
Indonesia	NA	NA	NA	NA	NA	NA	10449	11950	11738	11201	10502	9802	13881	16610	16510	15793	14807	13821
Korea	3.00	3.52	4.03	4.30	4.55	4.75	1095	1035	1001	986	987	988	1454	1439	1407	1390	1391	1392
Czech Republic	2.10	2.27	2.39	2.61	2.97	3.20	19.6	19.4	18.7	18.2	17.8	17.4	26.0	27.0	26.3	25.7	25.1	24.5
Hungary	5.99	6.28	6.79	6.50	6.50	6.50	223	222	220	221	224	226	297	308	310	312	315	319
Poland	4.05	4.69	4.97	5.15	4.99	0.48	3.16	2.94	2.82	2.77	2.77	2.77	4.20	4.08	3.96	3.90	3.90	3.90
Romania	NA	NA	NA	NA	NA	NA	3.33	3.29	3.19	3.11	3.06	3.00	4.42	4.58	4.49	4.39	4.32	4.24
Russia	NA	NA	NA	NA	NA	NA	31.9	34.1	35.1	35.5	35.5	35.5	42.3	47.3	49.3	50.0	50.0	50.0
Turkey	NA	NA	NA	NA	NA	NA	1.91	2.24	2.23	2.20	2.12	2.04	2.53	3.11	3.14	3.11	2.99	2.87
Nigeria	NA	NA	NA	NA	NA	NA	159	163	166	171	175	180	212	226	234	241	247	254
South Africa	7.28	7.73	8.04	8.14	8.38	8.77	9.65	11.04	10.54	10.20	10.04	9.87	12.82	15.35	14.83	14.39	14.15	13.92
Argentina	NA	NA	NA	NA	NA	NA	5.45	7.85	11.00	17.65	24.71	26.71	7.24	10.91	15.47	24.89	34.84	37.66
Brazil	9.98	13.25	14.75	13.38	11.75	11.75	2.16	2.49	2.57	2.53	2.40	2.27	2.87	3.46	3.61	3.56	3.39	3.21
Mexico	5.60	6.56	7.12	7.46	7.95	8.00	12.8	12.8	12.4	12.3	12.3	12.3	17.0	17.8	17.4	17.3	17.3	17.3
Venezuela	11.11	15.50	17.47	15.50	15.50	15.50	5.99	10.58	19.80	31.28	49.43	78.10	7.96	14.70	27.85	44.11	69.69	110.12

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

Figure 14. Short Rates (End of Period), as of 22 January 2014 (Percent)

	Current	1Q 14	2Q 14	3Q 14	4Q 14	1Q 15	2Q 15
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	0.25	0.25	0.00	0.00	0.00	0.00	0.00
Canada	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Australia	2.50	2.50	2.50	2.50	2.50	2.75	3.25
New Zealand	2.50	2.75	3.25	3.50	3.75	4.25	4.50
Denmark	0.20	0.20	0.10	0.10	0.10	0.20	0.20
Norway	1.50	1.50	1.50	1.50	1.50	1.50	1.75
Sweden	0.75	0.75	0.75	0.75	0.75	0.75	1.00
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	0.75	1.25	1.50
China	3.00	3.00	3.00	3.00	3.25	3.50	3.75

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

Figure 15. 10-Year Yield Forecasts (Period Average), as of 22 January 2014 (Percent)

	Current	1Q 14	2Q 14	3Q 14	4Q 14	1Q 15	2Q 15
United States	2.84	2.85	2.95	3.15	3.25	3.40	3.50
Japan	0.67	0.65	0.55	0.70	0.85	0.95	1.05
Euro Area (Germany)	1.75	1.75	1.70	1.70	1.80	1.90	1.90
Canada	2.50	2.65	2.85	3.05	3.15	3.30	3.40
Australia	4.18	4.30	4.40	4.50	4.60	4.75	4.95
New Zealand	4.60	4.90	5.10	5.40	5.60	6.00	6.20
Denmark	1.83	1.85	1.80	1.80	1.90	2.00	2.00
Norway	2.85	2.90	2.82	2.80	2.90	2.80	2.75
Sweden	2.33	2.40	2.40	2.45	2.55	2.65	2.65
Switzerland	1.09	1.00	0.97	0.97	1.03	1.09	1.09
United Kingdom	2.89	3.05	3.25	3.40	3.60	3.70	3.80

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

Figure 16. 10-Year Yield Spreads (Period Average), as of 22 January 2014

	Spread vs. US$						Spread vs. Germany					
	Current	1Q 14	2Q 14	3Q 14	4Q 14	1Q 15	Current	1Q 14	2Q 14	3Q 14	4Q 14	1Q 15
United States	NA	NA	NA	NA	NA	NA	111	112	137	153	153	158
Japan	-221	-232	-237	-238	-238	-243	-110	-120	-100	-85	-85	-85
Euro Area	-111	-112	-137	-153	-153	-158	NA	NA	NA	NA	NA	NA
Canada	-34	-20	-20	-15	-15	-15	77	92	117	137	137	143
Australia	136	148	138	133	133	133	247	260	275	285	285	291
New Zealand	179	209	209	225	235	261	290	321	347	377	388	419
France	-43	-47	-72	-88	-88	-93	66	65	65	65	65	65
Italy	97	68	33	7	7	-8	206	180	170	160	160	150
Spain	88	63	23	-13	-13	-33	197	175	160	140	140	125
Netherlands	-79	-77	-102	-118	-118	-123	30	35	35	35	35	35
Belgium	-51	-52	-67	-88	-88	-93	58	60	70	65	65	65
Austria	-76	-77	-102	-118	-118	-123	33	35	35	35	35	35
Finland	-90	-92	-117	-133	-133	-138	19	20	20	20	20	20
Ireland	39	-2	-37	-53	-63	-73	148	110	100	100	90	85
Denmark	-101	-102	-127	-143	-143	-148	8	10	10	10	10	10
Norway	1	0	-27	-43	-63	-73	110	115	112	110	110	90
Sweden	-51	-42	-62	-78	-78	-83	58	65	70	75	75	75
Switzerland	-175	-187	-210	-226	-230	-239	-66	-75	-73	-73	-77	-81
United Kingdom	5	20	20	20	31	25	114	132	158	173	183	183

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

Figure 17. Emerging Market Countries — Short Rates Actual and Forecast of Additional Rate Moves (End of Period), as of 22 January 2014

Country	Current Rate (%)	Mar 14	Jun 14	Sep 14	Dec 14	Mar 15	Total Cumulative Rate Moves Expected
Turkey	7.14	61	100	50	50	0	261
Brazil	10.50	25	0	0	0	100	125
Poland	2.50	0	0	25	25	50	100
Hungary	2.85	-20	-5	0	60	60	95
Philippines	3.50	0	0	25	25	25	75
China	3.00	0	0	0	25	25	50
Malaysia	3.00	0	25	25	0	0	50
Indonesia	5.75	25	0	0	0	25	50
Israel	1.00	0	0	0	50	0	50
South Africa	5.00	0	0	0	0	50	50
India	7.75	25	0	0	0	0	25
Korea	2.50	0	0	0	0	25	25
Mexico	3.50	0	0	0	0	0	0
Thailand	2.25	-25	0	0	0	25	0
Russia	8.25	0	0	-25	0	-25	-50
Chile	4.50	-50	0	0	0	0	-50

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

Figure 18. Foreign Exchange Forecasts (End of Period), as of 22 January 2014

	vs. USD						vs. EUR					
	Current	Mar 14	Jun 14	Sep 14	Dec 14	Mar 15	Current	Mar 14	Jun 14	Sep 14	Dec 14	Mar 15
United States	NA	NA	NA	NA	NA	NA	1.36	1.37	1.39	1.40	1.40	1.40
Japan	104	105	106	107	108	110	141	145	147	149	152	154
Euro Area	1.36	1.37	1.39	1.40	1.40	1.40	NA	NA	NA	NA	NA	NA
Canada	1.10	1.11	1.12	1.12	1.12	1.12	1.48	1.53	1.55	1.56	1.57	1.57
Australia	0.88	0.87	0.86	0.85	0.85	0.85	1.54	1.59	1.61	1.64	1.65	1.65
New Zealand	0.82	0.84	0.85	0.87	0.87	0.86	1.65	1.64	1.63	1.61	1.62	1.63
Norway	6.17	5.97	5.85	5.74	5.67	5.62	8.36	8.21	8.12	8.02	7.95	7.89
Sweden	6.47	6.28	6.28	6.29	6.27	6.26	8.77	8.63	8.71	8.78	8.79	8.78
Switzerland	0.91	0.90	0.90	0.89	0.90	0.90	1.23	1.23	1.24	1.25	1.26	1.26
United Kingdom	1.64	1.70	1.72	1.75	1.76	1.76	0.82	0.81	0.80	0.80	0.80	0.80
China	6.05	6.03	6.02	6.00	6.00	6.00	8.2	8.3	8.3	8.4	8.4	8.4
India	61.6	60.5	61.6	62.8	62.2	61.2	83.4	83.2	85.4	87.7	87.2	85.9
Korea	1064	1047	1039	1032	1023	1014	1441	1439	1441	1442	1434	1423
Poland	3.07	2.98	2.95	2.92	2.89	2.86	4.17	4.10	4.09	4.08	4.05	4.02
Russia	33.7	33.6	33.9	34.2	34.5	34.7	45.7	46.2	47.0	47.9	48.4	48.7
South Africa	10.88	11.17	11.09	11.02	10.89	10.75	14.75	15.35	15.38	15.40	15.26	15.09
Turkey	2.24	2.28	2.25	2.21	2.21	2.22	3.04	3.14	3.11	3.09	3.09	3.11
Brazil	2.34	2.46	2.48	2.50	2.52	2.54	3.17	3.38	3.43	3.49	3.53	3.56
Mexico	13.3	13.2	12.9	12.7	12.6	12.5	18.0	18.1	17.9	17.7	17.6	17.5

Source: Citi Research

Figure 19. Foreign Exchange Forecasts (End of Period), as of 22 January 2014

	vs. JPY					
	Current	Mar 14	Jun 14	Sep 14	Dec 14	Mar 15
United States	104	105	106	107	108	110
Japan	NA	NA	NA	NA	NA	NA
Euro Area	141	145	147	149	152	154
Canada	95	95	95	95	97	98
Australia	92	91	91	91	92	93
New Zealand	85.7	88.1	90.3	92.6	93.8	94.8
Norway	16.9	17.6	18.1	18.6	19.1	19.5
Sweden	16.1	16.8	16.9	17.0	17.3	17.6
Switzerland	114	117	118	120	121	122
United Kingdom	171	179	183	186	190	194
China	17	17	18	18	18	18
India	1.69	1.74	1.72	1.70	1.74	1.79
Korea	10.21	9.94	9.80	9.66	9.45	9.23
Poland	33.9	35.3	36.0	36.6	37.5	38.4
Russia	3.1	3.1	3.1	3.1	3.1	3.2
South Africa	9.6	9.4	9.6	9.7	9.9	10.2
Turkey	46.4	46.1	47.2	48.4	49.0	49.5
Brazil	44.5	42.8	42.8	42.8	43.0	43.3
Mexico	7.8	8.0	8.2	8.4	8.6	8.8

Source: Citi Research

Country Commentary

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An apparent sharp acceleration in GDP in the second half of 2013 has upstaged debate over whether recovery can achieve above-trend growth in the coming year. Although some of that pickup reflected one-off gains, this period also featured notable fiscal drags that are fading to neutral now. The updated forecast continues to show a quarterly pattern of growth averaging 3% through 2015 with unemployment dropping below 6% and inflation staying low but edging above 1½%. Absent shocks, the economy has key supports from ample resource slack and a strong financial tailwind.

Monetary policy prospects remain unchanged in the wake of recovery's momentum and a belated start to tapering of QE. We expect the final tapering decision in September, followed by an end to reinvestment in early 2015 and limited rate hikes beginning later that summer. We see two-way risks here: Forward rate guidance has shifted the focus somewhat to the lack of inflation pressures, which could delay action beyond 2015. But a plausible case for faster recovery and encouraging wage gains could telescope initial tightening to the start of next year.

The outlook for inflation remains softer than policymakers' medium-term goal of 2%. Slower growth abroad has reduced pressures on domestic goods prices and still-modest wage gains have restrained labor costs despite slowing productivity. We expect a gradual move closer to the 2% target underpinned by domestic demand, gradually tightening job markets and an eventual pickup in global growth.

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

					2013		2014				2015	
		2013F	2014F	2015F	3Q	4QF	1QF	2QF	3QF	4QF	1QF	2QF
GDP	SAAR				4.1%	3.5%	2.4%	3.5%	3.2%	2.9%	3.2%	3.1%
	YoY	1.9	3.1	3.1	2.0	2.8	3.1	3.4	3.1	3.0	3.2	3.1
Domestic Demand	SAAR				2.3	2.5	2.9	3.3	3.3	3.3	3.4	3.3
	YoY	1.6	2.9	3.3	1.6	1.8	2.4	2.8	3.0	3.2	3.3	3.3
Consumption	SAAR				2.0	3.7	2.6	3.3	3.2	3.1	3.1	3.1
	YoY	2.0	2.9	3.1	1.9	2.4	2.5	2.9	3.2	3.0	3.2	3.1
Business Investment	SAAR				4.8	7.3	5.4	7.0	6.3	5.9	5.4	5.0
	YoY	2.8	6.1	5.5	3.5	2.9	5.5	6.1	6.5	6.1	6.1	5.6
Housing Investment	SAAR				10.3	2.7	11.0	10.6	14.8	15.9	18.2	16.5
	YoY	13.0	10.3	15.3	14.2	9.9	9.5	8.6	9.7	13.1	14.9	16.4
Government	SAAR				0.4	-4.4	1.0	-0.5	-0.2	-0.1	0.2	0.2
	YoY	-2.2	-0.7	0.0	-2.7	-2.2	-0.9	-0.9	-1.1	0.0	-0.1	0.0
Exports	SAAR				3.9	9.0	5.8	7.6	5.8	5.4	5.2	5.4
	YoY	2.7	6.6	5.7	2.9	4.8	6.7	6.6	7.1	6.2	6.0	5.4
Imports	SAAR				2.4	3.7	0.9	4.4	5.4	6.2	6.5	6.2
	YoY	1.6	3.5	6.0	1.6	3.4	3.5	2.9	3.6	4.2	5.6	6.1
PCE Deflator	YoY	1.1	1.5	1.7	1.1	0.9	1.1	1.6	1.6	1.7	1.7	1.7
Core PCE Deflator	YoY	1.2	1.5	1.8	1.2	1.1	1.2	1.5	1.6	1.7	1.8	1.8
Unemployment Rate	%	7.4	6.4	5.9	7.2	7.0	6.7	6.5	6.3	6.2	6.1	6.0
Federal Gov't Balance (Fiscal Year)	$Bn	-680	-550	-435								
	% of GDP	-4.1	-3.2	-2.4								
General Gov't Balance (Cal Year)	% of GDP	-5.8	-4.6	-3.9								
Federal Debt	% of GDP	72	73	73								
General Gov't Debt	% of GDP	105	107	107								
Current Account	US$bn	-390	-329	-296	-379	-373	-347	-332	-323	-315	-314	-305
	% of GDP	-2.3	-1.9	-1.6	-2.2	-2.2	-2.0	-1.9	-1.8	-1.8	-1.7	-1.7
S&P 500 Profits (US$ Per Share)	YoY	6.1	6.7	7.2	6.5	7.4	6.1	6.2	6.1	8.5	NA	NA

Notes: F Citi forecast. E Citi Estimate. YoY Year-to-year percent change. SAAR Seasonally adjusted annual rate. Domestic demand excludes inventories and net exports.
Sources: Bureau of Economic Analysis, Bureau of Labor Statistics, I/B/E/S, Treasury Department, *Wall Street Journal* and Citi Research forecasts

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We expect a bumpy ride for economic activity in quarters to come. The consumption tax hike from 5% currently to 8% in April likely will create significant distortions in the economy. The 3ppt hike in the tax rate in the context of modest growth in wages is expected to erode real purchasing power of household income, and this, along with a dropout of ongoing rush demand ahead of the tax hike, will likely weigh on household spending materially in early fiscal 2014 (starting April). Meanwhile, “policy offsets” designed to mitigate the negative impact of the tax hike will probably not be sufficient, in our view. Fiscal policy, the second arrow of *Abenomics*, will probably swing from the expansionary thrust in 2013 to a restrictive one in 2014.

Core inflation surprised to the upside in 2013, reflecting in particular significantly higher sensitivity of the core CPI to the yen/dollar rate. Japan’s dependence on imports (“import penetration”) has become substantially higher than before. The prolonged period of yen strength prompted domestic manufacturers to move production facilities overseas, leading to substantial growth in reverse imports. This effect, along with increasing shares of foreign manufacturers’ products in the domestic market, means that the boost to import prices from the weaker yen has been having a larger-than-expected impact on the CPI. Against this backdrop, we think Japan’s policymakers continue to have a strong incentive to seek further yen depreciation to stimulate profits, lift inflation, and entrench higher inflationary expectations. We expect the Bank of Japan (BoJ) to implement extra easing through purchases of JGBs and risk assets this year. However, the timing of the action will likely be somewhat later than the current consensus expects. The BoJ is quite optimistic about the economy after the consumption tax hike, and preemptive easing before confirming the impact from the tax hike appears to be inconsistent with the BoJ’s bullish outlook. We expect additional easing in June or July.

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

					2013		2014				2015	
		2013	2014F	2015F	3Q	4QF	1QF	2QF	3QF	4QF	1QF	2QF
Real GDP	YoY	1.7%	1.6%	1.0%	2.4%	3.1%	3.2%	1.1%	1.2%	0.7%	-0.2%	1.4%
	SAAR				1.1	3.5	4.7	-4.7	1.7	1.4	0.9	1.6
Domestic Demand	YoY	1.8	0.9	0.7	2.4	3.0	3.0	0.6	0.3	-0.2	-0.7	1.4
	SAAR				2.7	3.6	2.8	-6.3	1.4	1.4	0.7	2.0
Private Consumption	YoY	2.1	0.3	0.5	2.5	2.7	3.0	-0.5	-0.5	-0.9	-2.0	1.5
	SAAR				0.8	3.5	5.1	-10.6	0.8	1.8	0.5	2.9
Business Investment	YoY	-1.2	4.8	4.1	-0.7	1.9	4.8	4.3	5.6	4.6	3.9	4.4
	SAAR				0.0	8.4	7.1	1.9	5.0	4.6	4.1	3.9
Housing Investment	YoY	8.2	-4.0	1.8	8.5	7.8	3.3	-3.5	-7.3	-8.1	-3.3	5.3
Public Investment	YoY	10.0	1.6	-8.7	17.9	14.6	10.0	5.0	-1.5	-6.0	-6.5	-9.5
Exports	YoY	1.7	5.1	4.5	3.1	8.0	5.5	4.0	5.8	5.3	5.0	4.5
	SAAR				-2.4	6.5	6.3	6.0	4.3	4.5	5.2	4.0
Imports	YoY	3.0	1.6	2.9	3.2	7.7	4.9	2.0	0.4	-0.8	2.1	4.8
	SAAR				9.2	10.4	-6.4	-4.2	2.6	5.2	4.9	6.7
CPI	YoY	0.3	2.6	1.6	0.9	1.2	1.3	3.3	2.8	2.8	2.7	0.8
Core CPI	YoY	0.4	2.5	1.6	0.7	1.1	1.2	3.1	2.8	2.8	2.7	0.8
Nominal GDP	YoY	1.2	2.6	1.3	0.3	1.3	0.8	0.2	0.3	0.8	0.1	0.4
Current Account	¥ tn	3	2	2	1	0	0	1	1	0	0	0
	% of GDP	0.7	0.4	0.3	0.1	-0.1	0.0	0.1	0.1	0.1	0.1	0.0
Unemployment Rate	%	4.1	3.8	3.8	4.0	4.0	3.8	3.7	3.8	3.9	3.9	3.8
Industrial Production	YoY	-0.5	5.4	1.1	2.3	6.1	8.6	6.1	4.4	2.8	0.1	1.5
Corporate Profits (Fiscal Year)	YoY	45.0	10.0	12.5								
General Govt. Balance (Fiscal Year)	% of GDP	-9.8	-8.0	-6.2								
General Govt Debt	% of GDP	244	246	251								

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

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We are lifting our euro area GDP growth forecasts by 0.2pp for 2014 and by 0.3pp for 2015, to 1.1% and 1.3% respectively. Nevertheless, recovery is likely to stay subdued by historical norms hence – amidst very low inflation — prompting the ECB to loosen further. Sentiment surveys have recovered further in December and January, with headline readings now roughly back to long-term averages. Business cycle dynamics are improving a little, helped by better external demand, reduced fiscal drag and improving financial conditions. But private credit growth remains negative and employment is only just about stabilising. The strong euro is acting as a headwind, but many member states (especially the periphery, but perhaps likely to be joined by France) have shown significant progress in rebalancing, implementing ambitious strategies to cut labour costs and regain competitiveness. There are upside risks to 2014 GDP growth from investment, although this would likely require combined policy measures from the EC/EIB, supported by the ECB.

The inflation picture has not changed much since early December. We look for HICP inflation to average 0.8% YoY in 1Q-14 (unchanged from Q4-13), envisaging some modest increase to 1% in 2Q-14. Our base case is that the HICP will undershoot the ECB's quarterly forecasts of 0.95% and 1.15%, respectively, likely prompting further monetary easing. Note that our 0.9% 2014 core inflation forecast diverges significantly from the ECB's 1.3% projection. Several Executive Board members have noted recently that the door is firmly open to easing to address two contingencies: higher money market rates and the materialisation of downside risks to inflation. We think that it is only a matter of time before either the lower excess liquidity situation or the lower inflation path prompt action. The former would likely need additional liquidity (new fixed-rate LTRO, reduce or suspend reserve requirements), while the latter would likely call for a rate cut. Our base case is that the ECB will lower the refi rate to 0% in June, and take the deposit rate into negative territory at -0.1%, although we would not rule out an earlier (but smaller) move in March (15bp refi cut, but stable deposit rate).

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

					2013		2014				2015	
		2013F	2014F	2015F	3Q	4QF	1QF	2QF	3QF	4QF	1QF	2QF
Real GDP	YoY	-0.4%	1.1%	1.3%	-0.4%	0.5%	1.0%	1.0%	1.2%	1.2%	1.2%	1.2%
	SAAR				0.3	1.1	1.2	1.1	1.2	1.2	1.2	1.3
Final Domestic Demand	YoY	-0.8	0.8	1.1	-0.6	0.1	0.8	0.8	0.9	0.9	1.0	1.0
Private Consumption	YoY	-0.5	0.7	1.1	-0.5	0.2	0.5	0.6	0.8	0.9	1.0	1.1
Government Consumption	YoY	0.3	0.3	0.1	0.7	0.6	0.7	0.3	0.2	0.2	0.2	0.1
Fixed Investment	YoY	-3.0	1.8	2.0	-2.4	-0.7	1.8	1.9	1.8	1.9	1.9	2.0
Business Equipment	YoY	-2.3	1.3	3.2	-1.4	-0.6	0.9	0.8	1.1	2.3	3.3	3.2
Construction	YoY	-4.1	-0.5	2.0	-3.2	-2.8	-1.4	-0.7	-0.8	0.9	2.1	2.1
Stocks (Contrib. to Y/Y GDP Growth)		0.1	0.1	0.0	0.2	0.4	0.2	0.3	0.0	0.1	0.0	0.0
Exports	YoY	0.9	3.2	3.2	0.4	2.2	3.9	3.0	3.4	2.7	2.9	3.1
Imports	YoY	0.2	3.2	3.1	0.6	2.6	4.2	3.4	2.9	2.4	2.6	2.9
CPI	YoY	1.4	0.9	0.8	1.3	0.8	0.8	1.0	0.8	1.1	1.0	0.8
CPI Ex Unprocessed Food & Energy	YoY	1.3	0.9	0.6	1.3	1.0	0.9	1.0	0.8	0.8	0.7	0.5
Unemployment Rate	YoY	12.1	12.0	11.7	12.1	12.2	12.1	12.1	11.9	12.0	11.9	11.7
Current Account Balance	EUR bn	212.7	247.5	261.1								
	% of GDP	2.2	2.5	2.6								
General Government Balance	EUR bn	-275.9	-242.9	-193.5								
	% of GDP	-2.9	-2.5	-2.0								
Primary Balance	% of GDP	0.1	0.5	1.1								
General Government Debt	EUR bn	9,209.0	9,539.3	9,752.6								
	% of GDP	96.2	98.2	98.5								
Gross Operating Surplus	YoY	1.2	2.1	2.2								

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

Germany

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Germany is recovering and rebalancing. We expect German economic growth to pick up to an above-trend pace of 2.0% in 2014 and 2.1% in 2015, up from 0.5% in 2013. The 0.5% rise in 2013 GDP implies still-modest growth of 0-0.4%QQ in Q4, but we expect growth to pick up in coming quarters. The main drivers are gains in house prices and real disposable income, with reduced uncertainties. Exports are picking up, too, but as domestic demand strengthens, net exports are likely to deduct from GDP growth in 2014 and beyond. Inflation was 1.4% YY (national definition) in December and is likely to stay low. Politically, the new German government probably will continue with a cautious and reactive Eurozone policy, not least ahead of the European Parliament elections in May.

France

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We are lifting our French 2014 and 2015 GDP forecasts by 0.1pp and 0.2pp to 0.9% and 1.1%, reflecting the formal adoption of supply-side economics by French President François Hollande and a more ambitious reform agenda. Mr. Hollande explained what his 'Responsibility Pact' entailed and increased the amount of expenditure savings over 2015-17 from €48bn (2.2% of GDP) to €53bn (2.4% of GDP). This will require much greater efforts on making central and regional/ local government more efficient, while attempting to preserve the country's social model — albeit being stricter on health spending trends. Mr. Hollande defended his strategy, arguing that there are no alternatives to deliver structural budget equilibrium and lower taxes by 2017.

Italy

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Italy's economy has been underperforming the rest of the euro area, but we expect that GDP rose by 0.2% QoQ in Q4-13, the first positive quarter since Q2-11. We look for a modest pick-up in domestic demand, reflecting reduced fiscal austerity and falling inflation, as well as improved corporate liquidity due to the repayment of government debt arrears. However, credit conditions are likely to remain tight ahead of the ECB's AQR and EBA stress tests this year, while poor competitiveness will limit export gains. Inflation should continue to weaken and probably will turn negative in 2015, amidst ample slack and the strong euro. Political instability is likely to persist, with some material risks of early elections held in May. This will leave little scope for any progress on reforms beyond a new electoral law.

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

		Germany			France			Italy		
		2013F	2014F	2015F	2013F	2014F	2015F	2013F	2014F	2015F
Real GDP	YoY	0.5%	2.0%	2.1%	0.2%	0.9%	1.1%	-1.8%	0.3%	0.3%
Final Domestic Demand	YoY	0.6	2.2	2.4	0.2	0.4	0.7	-2.4	0.2	0.3
Private Consumption	YoY	1.0	1.7	2.3	0.4	0.6	0.8	-2.4	-0.1	0.3
Government Consumption	YoY	0.5	1.1	1.2	1.6	0.5	0.1	-0.1	0.1	-0.5
Fixed Investment	YoY	-0.4	5.1	4.2	-2.3	-0.4	1.2	-5.3	1.6	1.5
Exports	YoY	0.6	3.6	3.1	0.4	1.8	2.6	0.0	3.2	3.3
Imports	YoY	1.4	4.3	3.8	1.0	1.6	1.5	-2.6	2.9	3.8
CPI	YoY	1.5	1.5	1.8	1.0	1.2	1.3	1.3	0.5	-0.3
Unemployment Rate	%	5.3	5.2	5.0	10.5	10.6	10.3	12.2	12.7	12.6
Current Account	€bn	189.6	184.0	175.3	-31.9	-16.3	-3.1	13.6	21.0	25.6
	% of GDP	6.8	6.5	6.0	-1.6	-0.8	-0.1	0.9	1.3	1.6
General Govt. Balance	€bn	5.8	-0.5	-0.4	-83.8	-74.7	-65.8	-47.9	-43.7	-41.8
	% of GDP	0.2	0.0	0.0	-4.1	-3.6	-3.1	-3.1	-2.8	-2.7
Primary Balance	% of GDP	2.6	2.2	2.1	-1.5	-0.9	-0.4	2.4	2.6	2.8
General Govt. Debt	% of GDP	78.4	76.4	73.6	93.9	96.0	97.3	133.4	137.2	139.8
Gross Trading Profits	YoY	2.6	4.8	4.7	0.9	2.6	2.8	NA	NA	NA

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

Spain

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We lift our 2014 and 2015 GDP forecasts by 0.7pp and 0.3pp (to 0.9% and 1.1%) to reflect stronger exports, stronger corporate balance sheets and an improved labour market. Recent gains in business confidence reflect rising profits and falling labour costs which should allow for a stronger pickup in business investment, despite still tight credit conditions. Private consumption will likely lag behind on ongoing deleveraging pressures and a record-low saving rate. Inflation continues to subside, reflecting past labour and product market structural reforms.

Greece

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The contraction in GDP probably eased further in Q4, but recent surveys suggest that growth will remain negative in Q1 14. We expect the recession to continue, albeit at a slower pace, in 2014. Deflation is likely to persist over the next couple of years as part of the economic rebalancing process amid ample slack. The 2013 primary fiscal balance likely reached a surplus, but negotiations on further debt relief are stalled and they may soon raise political instability and risks of early elections in 2014. Only a haircut on official loans could restore fiscal sustainability, in our view, but this is unlikely to be agreed any time soon.

Ireland

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We are significantly lifting our growth forecasts in response to better data, upward revisions to earlier quarters, and buoyant business surveys. We expect real GDP growth of 2.1% for 2014 and 2.2% for 2015, up from 1.4% and 1.6% respectively, with higher growth in later years. The fiscal deficit is likely to fall quite rapidly in coming years, dropping from about 7% of GDP in 2013 to a little below 5% of GDP in 2014 and about 3% of GDP in 2015. Job growth surged to 3.2% YoY in Q3-2013 and, with weakness in labour costs encouraging a job-rich mix of growth, the jobless rate probably will continue to fall quite rapidly. The public debt/GDP ratio probably will begin to edge down this year after peaking a little above 125% of GDP in 2013.

Portugal

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We have raised our GDP growth forecasts for 2014 from -0.5% to 0.2% and from 0.4% to 0.8% in 2015, on stronger export performance, earlier-than-expected progress in labour market and an expected decline in the household saving rate. Fiscal tightening (2.3pp of GDP in 2014 Budget) will still limit private consumption. Further declines in inflation will likely keep nominal GDP growth subdued, preventing stabilisation in public debt-to-GDP any time soon. A precautionary credit line to be agreed in June remains our base case scenario.

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

		Spain			Greece			Ireland			Portugal		
		2013F	2014F	2015F	2013F	2014F	2015F	2013F	2014F	2015F	2013F	2014F	2015F
Real GDP	YoY	-1.2%	0.9%	1.1%	-3.4%	-1.9%	-0.4%	0.0%	2.1%	2.2%	-1.6%	0.2%	0.8%
Final Domestic Demand	YoY	-2.9	0.2	0.3	-7.0	-2.6	-1.9	-0.9	1.6	1.2	-2.8	-0.4	0.4
Private Consumption	YoY	-2.4	0.7	0.8	-6.5	-1.7	-1.3	-1.0	2.0	1.7	-1.8	0.5	0.6
Government Consumption	YoY	-1.0	-0.3	-0.9	-4.8	-3.7	-3.8	-1.0	-2.8	-2.5	-2.1	-2.9	-0.2
Fixed Investment	YoY	-5.9	-0.7	0.4	-12.1	-6.0	-2.2	-0.6	6.2	3.8	-7.5	-0.6	0.3
Exports	YoY	5.7	6.2	4.6	2.0	2.2	2.5	-0.1	5.1	4.9	6.1	4.6	3.8
Imports	YoY	0.8	5.0	2.9	-4.6	-0.7	-2.5	-0.3	4.9	4.8	2.5	3.0	2.8
CPI	YoY	1.5	-0.2	-0.1	-0.9	-2.7	-2.4	0.7	0.3	0.9	0.4	-0.4	-0.9
Unemployment Rate	%	26.4	25.6	24.6	27.6	28.2	27.8	13.1	11.1	10.1	16.3	15.0	14.2
Current Account	€bn	10.5	10.1	14.7	1.2	3.2	4.0	13.8	14.6	13.6	0.7	3.6	4.1
	% of GDP	1.0	1.0	1.4	0.7	1.9	2.4	8.4	8.6	7.8	0.4	2.2	2.5
General Govt. Balance	€bn	-70.6	-59.9	-50.5	-6.5	-6.0	-4.0	-11.5	-8.0	-5.3	-9.9	-7.6	-6.3
	% of GDP	-6.9	-5.8	-4.8	-3.6	-3.5	-2.4	-7.0	-4.7	-3.0	-6.0	-4.6	-3.8
Primary Balance	% of GDP	-3.4	-2.2	-1.1	0.6	0.6	1.0	-2.7	-0.3	1.4	-1.6	0.1	0.9
General Govt. Debt	% of GDP	93.9	99.7	103.5	176.3	190.9	200.6	125.0	122.9	122.5	129.4	138.2	142.0

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 2013 (€2.8bn). Sources: INE, Haver Analytics, Eurostat and Citi Research forecasts

Netherlands

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The Dutch economy is recovering very slowly, underperforming the neighbouring soft core countries such as Belgium and France. The continued modest improvement in business sentiment surveys is one of the drivers behind our decision to revise up our 2014 GDP forecast by 0.1pp to 0.5%. However, growth will continue to be capped by the fragility of consumer demand, fiscal drag and downward pressures on house prices. We forecast GDP to expand by 0.9% in 2015.

Belgium

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We lift our Belgian 2014 GDP growth forecast to 1.2% from 0.6% in Dec-13. Cheap financing costs, improving investment prospects and better sentiment make Belgium well positioned to gain from a pick-up in external demand. Headwinds from poor competitiveness, low employment growth and continued fiscal policy tightening are also diminishing. Looking ahead to the May parliamentary elections, we believe that coalition negotiations will be less protracted than in 2010. We expect that Flemish Separatists will be at the helm of a conservative government.

Slovakia

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We are slightly raising our GDP forecast by 0.1%pp to 0.8% in 2013, 1.9% in 2014 and 2.5% in 2015 owing to a better outlook for foreign demand, improved employment and reduced fiscal drag. The better-than-expected fiscal deficit in 2013, solid financing reserve and the pressure from the debt-brake rule should help cap bond yields. Nevertheless, some risks remain, notably large errors in the balance of payments data and renewed weakness in tax collection. The Presidential election could influence economic policy in the long-term if PM Fico loses the election.

Slovenia

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We keep our forecast of continued recession until mid-2014, although we still look for a modest recovery thereafter. The banking sector resolution plan (transfer of bad loans, recapitalisation) has been announced and partly implemented. However, the credit crunch is not over and restructuring of the over-indebted corporate sector remains incomplete. Business surveys point to negative GDP growth in 4Q13, although recent industrial production and construction output data generally have been somewhat supportive. We think the main risk lies in politics, in particular the privatisation programme. In addition, Government debt surged due to the transfer of bad loans, with upside risks if debt of other public entities is incorporated into the govemment sector.

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

		Netherlands			Belgium			Slovakia			Slovenia		
		2013F	2014F	2015F	2013F	2014F	2015F	2013F	2014F	2015F	2013F	2014F	2015F
Real GDP	YoY	-1.0%	0.5%	0.9%	0.2%	1.2%	1.3%	0.8%	1.9%	2.5%	-1.8%	-0.9%	0.8%
Final Domestic Demand	YoY	-2.8	-0.2	0.3	-0.1	0.6	1.0	-1.3	1.6	2.1	-3.6	-1.4	1.5
Private Consumption	YoY	-2.2	-0.6	0.4	0.5	0.5	0.7	-0.1	0.9	1.8	-3.4	-2.1	-0.1
Government Consumption	YoY	-1.0	-0.5	0.0	0.7	0.3	0.7	1.0	0.2	1.1	-2.9	-2.0	0.4
Investment (Ex Stocks)	YoY	-6.9	1.1	0.4	-2.6	1.1	2.2	-5.9	4.3	3.9	-3.5	-0.1	1.6
Exports	YoY	2.0	2.2	2.4	0.8	3.6	3.5	4.0	6.1	6.5	3.0	4.3	5.5
Imports	YoY	-0.2	2.0	2.0	-0.1	2.7	3.8	2.3	5.6	6.5	-0.4	2.7	5.1
CPI (Average)	YoY	2.5	1.2	1.3	1.1	1.0	1.0	1.4	0.8	1.6	1.8	1.6	1.5
Unemployment Rate	%	8.3	8.7	8.5	8.4	8.3	8.1	14.1	13.8	13.1	10.3	11.1	12.0
Current Account	% of GDP	10.2	10.4	9.4	-1.7	-0.1	0.6	4.2	4.4	3.7	4.1	4.6	4.4
General Govt Balance	% of GDP	-3.5	-2.6	-1.9	-3.1	-2.6	-1.5	-2.7	-3.3	-2.6	-4.9	-13.4	-4.4
Primary Balance	% of GDP	-1.5	-0.6	0.1	0.4	0.9	2.0	-1.2	-1.8	-1.2	-2.2	-10.5	-1.6
General Govt Debt	% of GDP	74.7	75.5	75.3	102.0	102.6	101.7	54.4	56.9	56.4	59.7	72.8	75.6

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

UK

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We continue to expect strong and above-consensus economic growth, with inflation below the 2% target and below consensus. We are edging up our 2014 growth forecast to 3.3% from 3.2% last month, to reflect the stronger Dec-13 retail sales data and (with slightly lower inflation) a slightly higher path for real wages and real incomes. By contrast, the consensus looks for both growth and inflation to be about 2½% YoY in 2014 and 2015. The economy already has grown at an annualised pace of about 3% since early 2013, and business surveys point to continued strength. Recovery initially is likely to be led by consumer spending and housebuilding, with modest recoveries in business investment and exports and only a limited drag from fiscal policy. Strong economic growth will ensure that the fiscal deficit falls quite rapidly, but the current account deficit is likely to remain sizeable — at about 3% of GDP in 2014-15.

With strong GDP growth and job-rich expansion (reflecting in part the decline in real wages), the jobless rate is likely to hit the MPC's 7% threshold soon, probably in the next couple of months — hence terminating the current forward guidance framework — and fall below 6½% by yearend. The MPC argued in mid-13 that the sustainable jobless rate is 6½% and seem reluctant to reset guidance with a lower jobless threshold. Rather, the January minutes show the MPC adopting Fed-style language that they see "*no immediate need*" to hike rates even once the jobless rate hits 7%, given the weak inflation path. Even so, with the rapid decline in the jobless rate, we are advancing our forecast for the first rate hike (25bp) from Q2-15 to Q4-14. We expect the MPC will get real rates back to zero (ie 2% policy rates) by late 2015, implying that policy will move to being fairly loose from very expansionary at present.

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

					2013		2014				2015	
		2013F	2014F	2015F	3Q	4QF	1QF	2QF	3QF	4QF	1QF	2QF
Real GDP	YoY	1.9%	3.3%	3.2%	2.0%	2.7%	3.2%	3.3%	3.3%	3.5%	3.4%	3.3%
	SAAR				3.1	2.7	3.6	3.6	3.4	3.4	3.3	3.0
Domestic Demand	YoY	1.8	2.8	3.5	2.9	2.3	2.8	3.2	2.1	3.1	3.5	3.5
(Incl. Inventories)	SAAR				7.9	-0.7	1.7	3.9	3.4	3.3	3.7	3.8
Private Consumption	YoY	2.2	3.1	3.1	2.5	2.3	2.5	3.2	3.2	3.3	3.0	3.0
	SAAR				3.2	2.1	3.9	3.7	3.0	2.8	2.4	3.9
Government Consumption	YoY	0.7	2.1	-0.3	1.4	2.4	3.5	2.6	2.0	0.5	0.1	-0.2
	SAAR				2.8	5.6	0.9	0.9	0.5	-0.4	-0.5	-0.5
Investment	YoY	-2.2	8.1	10.5	-0.7	5.6	7.1	7.3	8.3	9.4	10.7	11.1
	SAAR				6.0	6.4	8.9	8.0	9.9	10.9	14.0	9.7
Exports	YoY	0.9	4.7	5.2	-1.8	1.6	4.2	1.8	6.4	6.5	5.3	5.4
	SAAR				-11.3	6.3	9.9	3.6	5.9	6.7	5.0	3.9
Imports	YoY	0.9	3.7	5.9	1.2	1.4	4.1	2.7	3.3	4.9	5.6	6.0
	SAAR				2.9	-0.3	3.6	4.5	5.6	5.9	6.3	6.2
Unemployment Rate	%	7.6	6.7	5.6	7.6	7.1	7.0	6.9	6.7	6.4	6.1	5.8
CPI Inflation	YoY	2.6	1.8	1.9	2.7	2.1	1.9	1.9	1.7	1.8	1.8	1.8
Merch. Trade	£bn	-112.1	-105.7	-108.1								
	% of GDP	-6.9	-6.2	-6.0								
Current Account	£bn	-58.4	-49.3	-55.0								
	% of GDP	-3.6	-2.9	-3.1								
PSNB	£bn FY	-107.0	-87.3	-64.7								
	% of GDP	-6.5	-5.0	-3.6								
General Govt. Balance	% of GDP	-6.7	-5.3	-4.0								
Government Primary Balance		-3.5	-1.9	-0.2								
Public Debt	% of GDP	94.0	96.3	96.5								
Gross Nonoil Trading Profits	YoY	5.5	7.5	3.4								

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

Switzerland

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The Swiss economy continues to weather the elevated CHF surprisingly well. Real GDP grew 1.9% YoY in Q3-2013 and the Kof business survey index in December reached the highest since July-2011 (and well above its longrun average). We look for real GDP growth to stay around 2% YoY this year. The pace of deflation is easing, and core inflation has risen from -0.6% YoY at end-2012 to zero at end-13. We expect a few more months of negative inflation during 2014 but, with capacity use rising steadily, deflation probably will be over by yearend. The SNB is likely to keep policy loose for a while, but we factor in gradual tightening 2-3 years ahead.

Sweden

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Economic data finally suggest that recovery is starting, prompting us to lift our GDP growth forecasts by 0.2pp for both 2014 and 2015. Domestic demand is likely to benefit from strong real income growth (fuelled by low inflation and tax cuts), together with rising house prices, high household savings and improved balance sheets. Inflation probably will stay low and combined with low capacity use and low ECB rates, the repo rate is likely to stay low for a long period. Financial stability considerations remains an upside risk for rates, although the new macro-prudential framework means that it has become less likely that this will trigger a rate hike.

Denmark

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The Danish economy has been stagnant since mid-2010, and our forecast assumes only moderately accelerating growth ahead, driven by rising domestic demand plus a modest pickup in exports as the euro area recovers. Several years of crisis and nil growth implies that there currently is plenty of spare capacity in the economy. Economic activity is around 4% below normal, reflected in the relatively high jobless rate. The weak growth outlook for coming years will only just help turn the labour market around and slowly start closing the sizeable output gap.

Norway

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Norway's economy has outperformed the euro area in recent years, but is unlikely to accelerate much further in coming years. The business sector will probably be unable to lean on impulses from oil and housing to the same extent as previously, given that oil investment is likely to slow and house prices are very elevated. Also, the ongoing erosion in competitiveness suggests that Norway will be unable to benefit fully from global recovery. Meanwhile, loose fiscal policy and low policy rates should ensure a soft landing rather than an abrupt downturn.

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

		Switzerland			Sweden			Denmark			Norway		
		2013F	2014F	2015F	2013F	2014F	2015F	2013F	2014F	2015F	2013F	2014F	2015F
Real GDP	YoY	2.0%	2.0%	2.0%	0.9%	2.3%	2.7%	0.4%	1.2%	1.5%	1.8%	2.0%	2.4%
Final Domestic Demand	YoY	1.9	1.3	2.1	1.1	2.1	2.2	0.6	1.2	1.5	2.3	2.1	2.7
Private Consumption	YoY	2.1	1.2	1.7	1.8	2.3	2.5	0.3	1.1	1.7	2.2	1.9	2.8
Government Consumption	YoY	2.2	1.2	0.7	1.1	1.2	0.8	0.3	0.6	0.7	2.1	2.6	3.0
Investment (Ex Stocks)	YoY	1.1	1.7	4.2	-0.9	3.0	3.5	1.9	2.4	2.2	2.8	2.2	2.0
Exports	YoY	2.2	3.4	4.0	-1.5	2.4	4.6	1.1	2.7	3.1	0.1	1.1	2.1
Imports	YoY	0.4	2.3	5.0	-2.2	2.2	4.2	2.7	3.2	3.3	2.3	2.3	2.3
CPI (Average)	YoY	-0.2	-0.2	0.9	0.0	0.5	1.8	0.8	1.5	1.7	2.1	2.0	2.1
Unemployment Rate	%	3.1	2.7	2.3	8.0	7.8	7.5	7.0	6.9	6.7	3.5	3.8	3.9
Current Account	% of GDP	12.2	12.9	12.7	6.2	5.9	5.6	6.3	5.8	5.0	11.9	12.2	12.5
General Govt Balance	% of GDP	0.2	0.6	0.8	-1.4	-1.6	-1.0	-1.2	-1.8	-1.5	11.3	11.8	11.0
General Govt Debt	% of GDP	48.2	46.3	45.1	39.5	39.9	39.2	46.1	46.7	46.7	NA	NA	NA

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

Canada

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The Canadian economy continued to best expectations at the close of 2013 and prospects for 2014 are brightening. Key supports to the expansion ahead include diminished tail risks abroad, reduced fiscal drag in the US, the cheaper CAD, and North American energy infrastructure expansion. However, growth may be limited by the rotation of Canadian demand away from consumers and government, and towards business capex and exports. Commodity price volatility, competitiveness impediments, and softening EM growth likely will remain external headwinds.

Consumer inflation gauges continue to skirt the lower bound of the Bank of Canada's 1-3% inflation control zone. Subdued readings are likely to persist near term. Nonetheless, we continue to anticipate that both total and core inflation will converge on the BoC's 2% target by the end of 2015, when aggregate supply and demand return to balance. Assorted dampening pressures, like low mortgage interest costs and anemic wage inflation, are beginning to relent. The greatest depressants – slack and retail store competition – should ebb as output accelerates.

Risks to the inflation outlook are two-sided, but roughly balanced. Upside risks include stronger-than-anticipated Advanced Economy growth; greater momentum in domestic demand amid improving business confidence; and sustained domestic housing market strength that reinforces existing imbalances. Downside risks include setbacks in the Euro Area recovery; weaker-than-expected global demand that restrains Canadian exports; and domestic consumer retrenchment linked to household debt and/or disorderly unwind of housing market activity.

The BoC likely will maintain the overnight rate target at 1.00% through mid-2015 – accompanied by a neutral bias – and resume tightening in 3Q 2015. Policymakers remain vexed by low inflation, but appear unconvinced that additional stimulus would address the root causes of the phenomenon or spur business investment.

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

					2013F		2014F				2015F	
		2013F	2014F	2015F	3Q	4QF	1QF	2QF	3QF	4QF	1QF	2QF
Real GDP	YoY	1.8%	2.5%	2.7%	1.9%	2.4%	2.4%	2.7%	2.6%	2.4%	2.6%	2.7%
	SAAR				2.7	3.0	2.4	2.5	2.4	2.5	2.9	2.9
Final Domestic Demand	YoY	1.6	2.3	2.1	1.7	1.8	2.4	2.3	2.3	2.1	2.0	2.1
	SAAR				1.8	3.0	2.4	1.9	2.0	1.9	2.3	2.1
Private Consumption	YoY	2.3	2.5	2.4	2.3	2.5	2.8	2.5	2.5	2.2	2.2	2.4
	SAAR				2.2	3.2	2.4	2.0	2.4	2.0	2.5	2.5
Government Spending	YoY	0.7	0.6	0.4	0.7	0.5	0.8	0.7	0.5	0.4	0.3	0.4
	SAAR				0.8	1.2	0.7	0.3	0.0	0.5	0.5	0.5
Private Fixed Investment	YoY	0.9	3.6	3.4	1.1	1.6	3.0	3.8	4.1	3.7	3.5	3.4
	SAAR				2.3	4.9	4.3	3.8	3.2	3.4	3.8	3.2
Exports	YoY	1.0	1.9	5.1	1.7	1.0	0.4	0.7	2.4	4.2	4.8	5.1
	SAAR				-2.0	-2.1	2.6	4.6	4.7	4.6	5.2	5.8
Imports	YoY	0.8	1.6	3.2	-0.1	0.7	0.7	0.9	2.1	2.8	3.0	3.2
	SAAR				-1.4	0.2	2.5	2.5	3.3	3.0	3.3	3.3
CPI	YoY	0.9	1.3	1.9	1.1	0.9	0.9	1.3	1.4	1.7	1.8	1.8
Core CPI	YoY	1.2	1.5	1.9	1.3	1.2	1.1	1.2	1.5	1.9	1.9	1.9
Unemployment Rate	%	7.1	6.8	6.4	7.1	7.0	6.9	6.9	6.6	6.7	6.6	6.6
Current Account Balance	C$bn	-65.0	-71.8	-65.6	-61.9	-73.4	-68.5	-73.8	-70.4	-74.3	-67.6	-69.2
	% of GDP	-3.5	-3.7	-3.2	-3.3	-3.9	-3.6	-3.8	-3.6	-3.8	-3.4	-3.4
Net Exports (Pct. Contrib.)		0.1	0.1	0.5	-0.2	-0.7	0.0	0.6	0.3	0.4	0.5	0.6
Inventories (Pct. Contrib.)		0.2	0.1	0.1	1.2	0.3	0.0	0.0	0.0	0.1	0.1	0.1
Budget Balance (Fiscal Year)	% of GDP	-0.9	-0.3	0.2								
Federal Budget Debt	% of GDP	32.7	31.7	30.0								
General Govt. Debt	% of GDP	95.9	95.7	92.9								

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

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Australia

Economic activity will spend most of 2014 catching up to potential output, eliminating the gap by the end of the year. Until this occurs, financial conditions will need to remain accommodative towards non-mining activity, particularly household consumption and dwelling investment. We don't believe non-mining business investment will pick up before 2015 while a wider government budget deficit (from a mix of policy and parameter changes) suggests that fiscal policy could be slightly more contractionary. Thankfully, underlying inflation should remain anchored around the middle of the RBA's target band, allowing for a continuation of record low official interest rates throughout 2014. Further rate cuts are unlikely though. Some parts of the domestic economy, for example house prices, are responding to the previous rate cuts and the RBA Governor has stated his preference for a lower exchange rate rather than lower interest rates to support activity in the future. We expect the RBA to begin the interest rate hiking cycle in Q1 2015.

New Zealand

Economic growth in New Zealand is set to outpace Australian economic growth this year. A combination of strong migration flows, a pick-up in employment, reconstruction activity, confidence, house and dairy prices will drive above trend growth in 2014 and creates upside risk to our growth forecast for 2015. Stronger nominal GDP growth will strengthen the fiscal position allowing the budget position to return to surplus in FY15, three years ahead of when Australia's budget position is scheduled to return to surplus. This should improve the chances for a return to a triple-A sovereign rating. The RBNZ will not want to get behind the inflation curve so we expect Governor Wheeler to begin the monetary tightening cycle on January 30. Despite some evidence that the macro prudential tools are working, the stronger than expected Q3 GDP result (up 1.4%) and upswing in leading indicators brought forward our forecast for a March start to the tightening cycle. We expect that the RBNZ will have provided 125bps of tightening by the end of the year.

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

	Australia			New Zealand		
	2013F	2014F	2015F	2013F	2014F	2015F
Real GDP[a]	2.3%	2.7%	2.8%	2.7%	3.2%	2.7%
Real GDP (4Q versus 4Q)	2.3	2.9	2.8	3.0	3.1	2.1
Real Final Domestic Demand	0.9	2.1	2.2	4.2	4.4	3.3
Private Consumption	1.7	2.3	2.7	NA	NA	NA
Govt. Current & Capital Spending[b]	1.2	2.3	2.4	0.4	2.6	2.5
Housing Investment	1.5	5.9	5.4	19.3	14.0	11.5
Business Investment[c]	0.9	-2.0	-1.3	6.5	9.2	6.3
Exports of Goods & Services	6.7	7.1	7.4	-0.6	1.5	2.5
Imports of Goods & Services	-2.7	1.2	3.4	4.1	5.3	3.3
CPI	2.4	3.0	2.1	1.1	2.1	2.2
CPI (4Q versus 4Q)	2.7	2.7	2.1	1.6	2.0	2.3
Unemployment	5.8	6.1	6.1	6.1	5.6	5.4
Merch. Trade, BOP (Local Currency, bn)	0.7	-9.5	-11.7	0.8	-0.8	-1.6
Current Account, (Local Currency, bn)	-49.2	-64.5	-69.0	-8.0	-10.9	-11.7
Percent of GDP	-3.2	-4.0	-4.1	-3.7	-4.7	-4.8
Budget Balance[d] (Local Currency, bn)	-18.6	-48.2	-35.4	-4.4	-2.3	0.1
Percent of GDP	-1.2	-3.0	-2.1	-2.0	-1.0	0.0
General Govt. Debt (% of GDP)[e]	30.2	32.1	33.5	36.7	35.8	33.3
Gross Operating Surplus	1.3	3.7	5.9	NA	NA	NA

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

China

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The new reform path which is taking effect is likely to gradually reshape China's economic cycle. Supported by infrastructure and property investment, GDP growth achieved 7.7% in 2013, the same as in 2012 but well below the recent peak of 14.2% growth in 2007. The Chinese authorities seem unwilling to risk short-term pain or financial instability to rebalance the economy, but more likely prefer a measured transition. Beyond reform, China's GDP growth may be under pressure this year due to the surge in the cost of capital since 2H 2013, which is unlikely to be offset by better export growth. Recent developments suggest that there is more downside risk than upside risk to our forecast of 7.3% growth for 2014.

We are positive on the broad direction of the grand reform plan endorsed by the Chinese leadership, which could not only rebuild China's growth outlook but also change market expectations on sustainable growth. However, we expect that the authorities will put growth ahead of reform. The government does not seem to be ready to tolerate sub-7% growth, which may reduce the pace and priority for reforms. Any reforms that may prick market bubbles and result in systematic risk in the near-term probably will be postponed. For now, we expect that growth-supportive measures, e.g., one-child policy relaxation and new urbanization plans, will outweigh downside risks from de-leveraging.

The surging cost of capital is a symptom of financial excess and credit dislocation in the current growth model. Bankruptcy and default in the real economy and financial markets would, over time, help impose hard budget constraints on local government and state owned enterprises, and price risk premiums more appropriately. But this will likely be a gradual process. Indeed, money market rates could come off after the Chinese New Year to avoid damage to economic growth. The benign Dec-13 CPI makes accommodative monetary policy possible in the near term. Export growth could accelerate on better external demand, but unless the advanced economy recovery is import-led, we expect only single-digit export growth this year. The strong RMB and rising labor costs have eroded cost-competitiveness of manufacturing sectors. The recent rapid RMB appreciation was largely forced by speculative inflows driven by high onshore money market rates. The government is keen to increase two-way volatility of the CNYUSD by possibly relaxing the control over capital outflows and widening the daily trading band.

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

					2013F		2014F				2015F	
		2013	2014F	2015F	3Q	4QF	1QF	2QF	3QF	4QF	1QF	2QF
Real GDP	YoY	7.7%	7.3%	7.0%	7.8%	7.7%	7.6%	7.4%	7.0%	7.2%	7.3%	7.1%
Real Final Domestic Demand	YoY	8.3	7.3	7.1								
Consumption	YoY	7.8	7.1	7.6								
Fixed Capital Formation	YoY	8.9	7.4	6.6								
Industrial Production	YoY	9.7	9.2	8.6	10.1	10.0	9.8	9.4	8.6	9.0	9.2	8.8
Exports	YoY	7.9	5.5	6.7	3.9	7.5	-3.0	7.0	8.0	9.0	8.0	7.0
Imports	YoY	7.3	5.0	7.3	8.4	7.1	4.0	6.0	5.0	5.0	6.0	7.0
Merchandise Trade Balance	$bn	260	284	290	62	91	8	75	81	119	18	81
FX Reserves	$bn	3,821	4,005	4,205	3,663	3,821	3,799	3,850	3,906	4,005	3,994	4,049
Current Account	% of GDP	2.2	2.0	1.5								
Fiscal Balance	% of GDP	-2.0	-2.0	-1.5								
General Govt. Debt*	% of GDP	53.8	53.6	52.3								
Urban Unemployment Rate	%	4.1	4.2	4.3	4.0	4.1	4.2	4.2	4.2	4.3	4.3	4.3
CPI	YoY	2.6	3.3	3.7	2.8	2.9	3.0	3.3	3.1	3.9	3.7	3.6
Exchange Rate (end period)	CNY/$	6.05	6.00	6.00	6.12	6.05	6.03	6.02	6.00	6.00	6.00	6.00
1-Yr Deposit Rate (end period)	%	3.00	3.25	3.75	3.00	3.00	3.00	3.00	3.00	3.25	3.50	3.75

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

India

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2013 was a tough year for the Indian economy. GDP growth remained sub-5% in the last four quarters while inflation — after dipping temporarily to a near four-year low — surged in H2-13 thanks to a spike in vegetable prices. Fiscal consolidation remains clouded by smoke and mirrors (cuts in plan expenditure; subsidy rollovers), while the current account deficit saw a sharp compression – thanks to measures to contain imports of gold and non-essential items. All of the above, coupled with “taper tantrums”, took a toll on financial markets. The INR was among the worst performing currencies with the unit down 11% and the benchmark 10-year bond yield rising about 80bps in 2013.

As we head into 2014, the global story is a bit clearer - tapering has begun; the global growth outlook is improving and tail risks have diminished. Among domestic factors, we believe that the pillars of India’s problems will also become the legs for India’s recovery. As discussed in India Macroscope - ‘Four’ Sights for Fourteen (2014), we highlight four domestic factors which shape our outlook (1) Sustaining the trends in CAD compression (2) Lower inflation from vegetable price normalization (3) Investment pick up on institutional push to resolve execution bottlenecks and — the swing factor — (4) Political environment heading into general elections and after.

Overall, we maintain our estimates of a modest upturn in GDP growth from 4.8% in FY14 to 5.6% in FY15 and believe private sector investment will be key for the pickup in growth. We expect headline WPI and CPI inflation to moderate to 6% and 8.3% in FY15 thanks to lower vegetable prices and initiatives to remove perishables from the APMC act. Although inflation has slowed and the negative output gap persisted, the central bank is likely to continue its anti-inflationary stance, particularly in light of recommendations made by Dr.Urjit Patel committee to shift the monetary policy anchor to CPI (9.9% currently) from WPI (6.2%). On the external front, we expect the current account deficit to remain contained at 2–2½% of GDP in FY14 and FY15 as similar measures to those used to rein in gold imports in FY14 could be extended to iron ore exports and coal imports in FY15. On the fiscal front, while we expect fiscal consolidation to continue into FY15, the government’s borrowing program is likely to rise by close to 17% on higher redemptions.

Lastly, we believe that the political arithmetic on likely election outcomes has changed with the entry of a new political party AAP. While the markets’ priority will be a single party-led stable alliance after May elections, the rapidly evolving political dynamics suggest that such an outcome is far from certain at this point of time.

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

		FY 13/14F	FY 14/15F	FY 15/16F
Real GDP	YoY	4.8%	5.6%	6.7%
Final Domestic Demand	YoY	4.1	6.1	7.8
Private Consumption	YoY	4.5	6.5	8.0
Fixed Investment	YoY	2.5	5.5	8.0
Exports	YoY	5.2	11.0	9.0
Imports	YoY	5.0	9.5	9.3
Wholesale Price Index	YoY	6.5	6.0	5.0
Consumer Price Index	YoY	10.0	8.3	7.5
Current Account	US$ bn	-43	-47	-57
	% of GDP	-2.3	-2.3	-2.1
Consolidated Fiscal Balance	% of GDP	-6.9	-6.7	-6.3
Centre Fiscal Balance	% of GDP	-5.0	-4.5	-4.0
US Dollar Exchange Rate	Average	61.8	61.9	57.8

Sources: Haver Analytics and Citi Research forecasts

Korea

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The economy maintained a steady recovery in 4Q13 as production and investment continued to expand as expected. In particular, equipment investment showed a rapid recovery, growing 10.2%YoY in Oct-Nov, and export growth also rose to 4.7%YoY in 4Q13 from 2.7% in 3Q13. With resilient job growth (over 540K in 4Q13), the jobless rate at 3%, and about 4% nominal wage growth amid inflation around 1%, households' real income is likely be buoyant, hence supporting a recovery of consumer spending. The economy is likely to stay on the recovery path in 1Q14, growing at around 4% in both YoY and QoQ SAAR terms, due to further gains in private consumption, facilities investment, and exports. CPI inflation is likely to remain close to 1% until the recent increases of public service prices fully feed through. In this year, we expect a series of public service price hikes to consolidate the balance sheets of public corporations. The National Assembly passed the 2014 budget late last month and total government spending was increased just by 1.9%. With modest public spending growth and an expected shortfall of tax revenues (perhaps around KRW4.8trn), we think monetary policy needs to be accommodative with a stable policy rate this year.

Indonesia

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The economy appears to be on a "soft landing" trajectory, with non-oil and gas imports declining gradually. Uncertainties have been reduced substantially compared to two months ago. The current account deficit may have improved faster than expected in 4Q13, as trade data showed consecutive monthly surpluses in October-November, possibly followed by benign numbers in December (although part of the improvement was linked to recovery in coal and palm oil exports). There is clarity on the mineral export ban, which we expect may impact the CA deficit by 0.2-0.3% of GDP, a smaller effect than the government's previous guidance of 0.5-0.6% GDP. However we still expect another 25bps rate hike this year as not all the risks are out of the way. The oil trade deficit is still unrestrained and election campaign spending is intensifying (possibly propping up imports temporarily). Going forward, there is a possibility that the fiscal deficit target will be revised upward from currently 1.7% of GDP. The MoF may propose an early revision (possibly in Feb) as parliament and political parties will be busy with the general elections in April and July. We expect the budget deficit target to be raised towards 2–2.5% GDP.

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

		Korea			Indonesia		
		2013F	2014F	2015F	2013F	2014F	2015F
Real GDP	YoY	2.9%	3.7%	4.0%	5.7%	5.3%	5.5%
Final Domestic Demand	YoY	2.5	3.1	3.4	5.1	4.7	5.1
Private Consumption	YoY	1.9	2.9	3.4	5.0	4.6	4.3
Fixed Investment	YoY	3.5	4.6	4.1	5.4	4.8	6.0
Exports	YoY	4.5	6.1	8.0	3.5	5.5	10.0
Imports	YoY	3.5	5.4	7.7	0.8	4.0	9.0
Consumer Price Index	YoY	1.3	2.1	3.1	7.0	6.4	5.7
Unemployment Rate	%	3.1	3.1	3.1	6.3	6.5	6.3
Current Account	US$ bn	69.2	54.2	46.8	-29.4	-24.4	-23.1
	% of GDP	5.7	4.0	3.1	-3.3	-2.8	-2.3
Fiscal Balance	% of GDP	0.9	1.0	1.6	-2.2	2.2	-1.7
US Dollar Exchange Rate	Average	1095	1032	1003	10449	11795	11199

Sources: Haver Analytics and Citi Research forecasts

Hong Kong

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GDP growth probably remained solid in 4Q13 at about 3%YoY. With a gradual trade recovery, better consumption (driven by new tech products) and investment spending (construction), 1Q14 likely be a quarter of adjustment as US tapering kicks in. We have not seen large capital outflows so far, and during 2014 we will have to gauge if HK's liquidity situation will change as tapering effects kick in and whether China's prospects remain sound enough to retain liquidity in HK. Interest rates are likely to rise gradually amidst the gradual wind-down of the Fed's QE programme in 2014. Higher fiscal spending committed in the latest Policy Address to alleviate poverty and tackle social needs will likely leave the upcoming Budget Speech (26 Feb) with very few surprises. The political consultation on the election method for universal suffrage in 2017 may well lead to further heated debate.

Singapore

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With external demand yet to see a convincing pick-up amidst downward revisions in historical NODX data on technical errors, 4Q GDP could be revised downwards, setting a lower start-point for 2014. The labour market is straining at full employment, and supply-side constraints may also prove to be more binding even if demand improves. The pass-through of cost pressures could lift core inflation in 2014, although the 4Q13 QoQ decline in private property prices and Dec-13 plunge in home sales foreshadow lower rentals which should help keep headline inflation under control. With the growth environment still fragile, inflation within tolerance ranges, and given the need to redistribute and support the SME sector, the 2014 Budget could announce a mildly expansionary fiscal impulse via a smaller surplus.

Taiwan

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External momentum stayed weak for Taiwan in late-13, a worrisome sign given that 1Q is usually the soft patch of the tech export cycle. Non-tech exports are doing relatively better so far, and this is likely to persist in coming months. The stalling of ECFA (Economic Cooperation Framework Agreement) implementation for services due to political issues implies a delay in signing the ECFA for goods. But, in turn, these delays have produced a strong political push for other non-Chinese FTAs/TPP and to pilot a free economic zone. These issues will need to be tracked, as they could provide potential upside to the economy. Meanwhile, we believe the CBC will maintain accommodation for the economy and only hike rates in 2Q15. Long bond yields are expected to creep up along with global FI movements in coming quarters. The TWD has weakened along with the subdued economy, pressure from JPY and KRW; and we see it to stay at TWD30/USD in the near term.

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

		Hong Kong			Singapore			Taiwan		
		2013F	2014F	2015F	2013F	2014F	2015F	2013F	2014F	2015F
Real GDP	YoY	3.0%	3.4%	3.8%	3.7%	3.5%	3.5%	2.0%	3.2%	3.8%
Final Domestic Demand	YoY	3.3	2.1	2.4	2.8	2.9	1.7	1.5	1.9	2.5
Private Consumption	YoY	4.1	2.0	2.4	2.6	2.4	1.3	1.3	1.7	2.8
Fixed Investment	YoY	1.8	2.6	2.8	0.5	2.8	1.3	3.0	3.6	3.2
Exports	YoY	7.0	5.2	6.2	3.3	3.6	2.9	3.4	4.6	6.2
Imports	YoY	7.2	4.8	5.7	3.3	2.9	2.9	3.1	3.6	5.2
CPI	YoY	4.3	3.6	4.0	2.4	1.9	2.2	0.8	1.7	2.3
Unemployment Rate	%	3.2	3.2	3.1	1.9	1.8	1.8	4.2	4.0	3.9
Current Account	US$ bn	7.7	9.2	12.0	40.5	42.1	44.3	52.9	50.9	52.7
	% of GDP	2.8	3.1	3.9	14.0	13.5	13.0	10.9	9.8	9.5
Fiscal Balance	% of GDP	1.4	1.3	0.7	0.7	0.5	0.5	-1.5	-1.4	-1.2
US Dollar Exchange Rate	Average	7.76	7.76	7.75	1.25	1.24	1.20	29.68	29.24	29.04

Sources: Haver Analytics and Citi Research forecasts

Russia

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GDP growth has continued to disappoint. The final 3Q13 GDP estimate surprised on the downside, with growth eking out a meager 1.2%YoY, bringing year-to-date performance to only 1.3%. We see some scope for a mildly strengthening economic performance in 2014, but this is mainly related to expectations of stronger net exports to a slowly recovering Europe and a favorable base. However, investment spending will be constrained by the government's decision to freeze tariffs next year while consumer spending, while still robust, will moderate on decelerating retail lending, increased consumer indebtedness and more stringent regulatory oversight. As a result, we see 2014 growth gaining some momentum to 2.6%YoY from an estimated 1.4% in 2013. Medium-term growth prospects remain only slightly better due to adverse demographics and lack of incentives for enhancing capital accumulation and productivity growth. In a refreshing, if belated, recognition of these structural impediments, in November 2013 the Ministry of Economy downgraded its GDP forecasts for 2013-2030 to an average of 2.8% YoY from 4.3% previously. Structural challenges pose medium-term risks for the currency as the current account is likely to gradually transition from surplus to deficit in the next couple of years.

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Turkish assets got off to a rocky start to the New Year on the back of a sharp increase in political noise and the Fed's decision to begin tapering. The lira tumbled to a record low against the euro and the dollar, with the basket going above 2.60. The 2-year benchmark bond yield also rose to over 10% from 8.7% in November and 7.8% in October. At the January MPC meeting, the CBT delivered another convoluted tightening by announcing that interbank money market interest rates will materialize at 9.0% during additional monetary tightening days, instead of 7.75%. In our view, this decision increases discretion further and raises unpredictability of monetary policy — both of which will likely lead to an increase in interest rate volatility and introduce an additional source of uncertainty to the pricing of Turkish assets. All in all, we believe that the CBT's move will fall short of promoting FX stability and moving inflation closer to the target. We believe that the evolution of the lira and inflation will eventually lead the CBT to implement an outright rate hike through raising the upper band to 10.50% by the end of the year.

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

		Russia			Turkey		
		2013F	2014F	2015F	2013F	2014F	2015F
Real GDP	YoY	1.4%	2.6%	2.7%	4.0%	2.5%	3.5%
Final Domestic Demand	YoY	2.6	3.5	3.7	4.5	1.7	3.4
Private Consumption	YoY	4.4	4.2	4.1	4.6	1.7	3.2
Fixed Investment	YoY	0.1	3.8	4.5	4.4	0.1	4.0
Exports	YoY	1.5	2.0	2.1	1.9	4.5	4.4
Imports	YoY	5.5	4.5	7.2	8.1	1.5	4.0
CPI	YoY	6.8	5.6	4.9	7.5	7.3	7.6
Unemployment Rate	%	5.6	5.7	5.8	9.5	9.5	9.5
Current Account	US$ bn	34.0	24.0	18.6	-59.2	-45.6	-55.5
	% of GDP	1.6	1.1	0.8	-7.1	-5.9	-6.4
Fiscal Balance	% of GDP	-2.0	-4.3	-4.9	-1.2	-2.8	-3.2
US Dollar Exchange Rate	Average	31.9	34.1	35.1	1.91	2.24	2.23

Sources: Haver Analytics and Citi Research forecasts

Hungary

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Economic indicators for 4Q13 suggest growth has lost momentum, but it remains to be seen if this is due to seasonal factors or will have a lasting impact on growth. Participation in the second phase of the NBH's SME lending program has been disappointing so far, posing downside risks to our expectations of a revival in domestic demand. Parliamentary elections are unlikely to deliver sharp policy changes and the final decision on the FX mortgage aid scheme looks increasingly likely to be postponed beyond the elections. Inflation continues to ease further and may bottom out in January close to zero, while another round of retail gas and electricity price cuts may push headline CPI into negative territory in 1H14. Low underlying inflation and the supportive external environment increases the room for rate cuts. Therefore we have lowered our forecast on the bottom of the rate cutting cycle to 2.6% (from 2.8% previously), which we expect to be reached by April 2014. Rising external core yields and the prospect of inflation catching up to the 3% target by end-2014/early 2015 may force the NBH to reverse part of the rate cuts in 4Q14. Nevertheless, due to the probable improvement in Hungary's fiscal and external balances, rate hikes may remain gradual.

Poland

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Recent data suggest the Polish economy remains on a path towards faster growth. Even despite a somewhat weaker-than-expected manufacturing PMI in December, we have decided to lift our 4Q 2013 GDP growth forecast to 2.8% (from about 2.5% previously). The acceleration comes from domestic demand, with both private consumption and fixed investment gaining momentum. The MPC seems comfortable with the current level of interest rates and explicitly announced that rates would remain on hold at least until the end of June 2014. A new member of Monetary Policy Council — Jerzy Osiatyński — was appointed in December and we believe this should tilt the balance of powers within the MPC in a slightly more dovish direction. However, with our scenario of above-3%YoY growth in 2014 and likely further acceleration in 2015, the MPC will probably consider a first rate hike by the end of the year. The president signed the pension bill but also asked the Court to check the constitutionality of the law. This means the law will come into force, but the government might need to implement some changes at a later stage if the Court rules so. As a result of the pension system overhaul, 9% of GDP of pension assets managed by Open Pension Funds will be transferred on 3 February to the state pension system, thus cutting public debt towards 47% of GDP and turning the budget deficit into a temporary surplus for this year.

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

		Hungary			Poland		
		2013F	2014F	2015F	2013F	2014F	2015F
Real GDP	YoY	1.0%	1.9%	1.3%	1.5%	3.1%	3.6%
Final Domestic Demand	YoY	1.4	1.5	0.5	0.8	2.7	3.7
Private Consumption	YoY	-0.5	0.7	1.0	1.0	2.5	3.2
Fixed Investment	YoY	3.5	3.1	0.0	-0.1	3.9	6.0
Exports	YoY	4.5	4.4	4.0	3.6	5.9	6.5
Imports	YoY	4.8	4.1	3.6	0.6	6.7	7.5
CPI	YoY	1.7	1.0	2.8	0.9	1.4	2.8
Unemployment Rate	%	9.5	9.5	10.1	13.4	13.0	12.0
Current Account	US$ bn	2.5	1.9	1.6	-9.4	-13.9	-21.7
	% of GDP	1.9	1.4	1.1	-1.8	-2.4	-3.4
Fiscal Balance	% of GDP	-2.7	-2.9	-2.9	-4.2	5.6	-2.3
Euro Exchange Rate	Average	297	308	310	4.20	4.08	3.96

Sources: Haver Analytics and Citi Research forecasts

Czech Republic

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We are trimming 0.1pp from our growth forecasts for both 2013 and 2014, although the export-driven recovery, supported by improved foreign demand and a weaker koruna, should lead to growth accelerating to 1.9% YoY in 2014 from -1.4% in 2013. Looking at the strong industrial performance in 4Q13, we continue to expect a solid gain of GDP in that quarter, also lifted by front-loaded and tax-driven tobacco purchases. This is likely to have a negative base effect on GDP in 1Q14, although there may be an offset from the ongoing recovery in manufacturing and weather-related gains in construction. The December confidence indicator improved and suggests GDP growth at around 1.4% YoY, but this still implies downside risks to our 2014 GDP growth forecast. We are lifting our 2014-15 CPI forecasts although, with a weaker US dollar and lower VAT, our forecasts remain below the CNB's projection. Inflation is likely to ease significantly to around 0.3%YoY in 1Q14, in line with the CNB forecast. However, beyond this period, our forecast is for an acceleration of inflation to slightly above 2%YoY in 4Q14 and to 2.8% in 1Q15. The CNB's exit strategy is a premature question in our view, as the CNB will probably discuss its one-sided commitment to its FX intervention strategy first. However, this may be not necessary given our forecast of further ECB easing in coming months.

Romania

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The NBR started the New Year with a 25bp rate cut, bringing its policy rate to 3.75%. The Bank also cut the minimum reserve requirements ratio on leu-denominated liabilities of credit institutions to 12% from 15% and lowered the minimum reserve ratio on FX-denominated liabilities of credit institutions to 18% from 20%. According to the NBR, these changes will release €400 million and RON 4.0 billion to the market. Developments to date suggest to us that the NBR will continue to keep money market rates well below the policy rate on the grounds that the excess liquidity in the market will eventually lead banks to extend credit. We believe that the NBR's current strategy leaves the currency vulnerable. Looking ahead, we believe there is little room left for further easing this year. Nonetheless, our 2014 inflation forecast trajectory suggests that additional easing in 1Q cannot be entirely ruled out if the currency holds up. This view is confirmed by Governor Isarescu's recent comments, which suggest that while the NBR still has ammunition left, the Bank will closely monitor the effects of the January rate cut and react accordingly.

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

		Czech Republic			Romania		
		2013F	2014F	2015F	2013F	2014F	2015F
Real GDP	YoY	-1.4%	1.9%	2.4%	2.5%	2.8%	3.3%
Final Domestic Demand	YoY	-1.1	1.4	2.4	-0.4	2.3	3.3
Private Consumption	YoY	-0.5	0.9	0.9	0.3	2.1	3.5
Fixed Investment	YoY	-5.0	3.4	6.4	-3.0	3.2	3.5
Exports	YoY	-0.3	4.9	7.1	9.0	4.5	4.5
Imports	YoY	-0.1	6.0	7.2	0.5	3.0	4.0
CPI	YoY	1.4	1.2	2.3	4.0	1.6	2.7
Unemployment Rate	%	7.0	6.6	5.7	5.2	5.5	5.5
Current Account	US$ bn	-1.5	-0.7	-1.8	-2.3	-5.0	-9.1
	% of GDP	-0.8	-0.3	-0.9	-1.2	-2.5	-4.2
Fiscal Balance	% of GDP	-2.4	-2.9	-2.9	-2.5	-2.3	-2.3
EURCZK, USDRON	Average	26.0	27.0	26.3	3.33	3.29	3.19

Sources: Haver Analytics and Citi Research forecasts

Brazil

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We maintain our view that economic growth in 2014 will likely be even lower than in 2013 (1.8%, compared to our forecast of 2.3% for GDP growth in 2013). Regarding monetary policy, the higher-than-expected December CPI inflation has prompted the Central Bank to increase the Selic rate by an additional 50bps. We still expect a final 25bps hike in February, driving the policy rate to 10.75%. Furthermore, we continue to expect the Central Bank to resume the tightening cycle in 1Q15, and to raise the Selic rate by 125bps (to 12%). The tighter monetary policy stance is unlikely to entirely offset the weaker BRL and the short-term pressures on food prices. Thus, we are increasing our end-2014 CPI inflation forecast to 6.1% YoY, up from 5.9% before and above the CB mid-point target of 4.5%, although still inside the target band (which goes up to 6.5%). In terms of fiscal policy, we continue to see the primary surplus at around 1.5% of GDP this year, which is an insufficient leve to ensure a declining trend in the net public debt/GDP ratio. Regarding the external accounts, the weaker BRL and steady improvement in global growth support our view that the current account deficit will likely narrow in coming years. Finally, the President's popularity remains at a level which suggests that Dilma Rousseff's reelection is the most likely outcome in the October 2014 elections.

Mexico

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Recent economic releases suggest that activity was a bit more sluggish in 4Q13 than we expected. However, we remain confident on our 2014 GDP growth forecast of 3.8%. We are expecting a rebound in activity driven by better external demand and stronger public spending. Meanwhile, inflation ended 2013 barely within Banxico's target range at 3.97%, and will likely continue on an upward trend in early 2014 due to the effects of the fiscal reform. We now expect headline inflation at 4.4% for 2014 (from 4.2%, previously). In this context, Banxico's risk balance is now biased towards growth, but we think it is quite comfortable with its current policy stance. The minutes for its last meeting confirm that the central bank does not expect much change in policy this year. Thus, we remain convinced that Banxico will not raise the policy rate before 2Q15. Last year was characterized by significant progress on the structural reform agenda. If the implementation of reforms is as effective as the political negotiations that led to them being passed – in particular the energy and financial reforms — Mexico could see a noticeable improvement in economic performance in the next few years.

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

		Brazil			Mexico		
		2013F	2014F	2015F	2013F	2014F	2015F
Real GDP	YoY	2.3%	1.8%	2.0%	1.2%	3.8%	4.0%
Final Domestic Demand	YoY	3.0	1.7	1.6	1.3	3.9	4.3
Private Consumption	YoY	2.2	2.1	1.9	2.5	4.0	3.9
Fixed Investment	YoY	6.7	0.8	1.1	-2.0	5.0	6.9
Exports	YoY	1.3	5.5	6.8	0.9	8.0	47.6
Imports	YoY	8.9	3.7	4.4	2.8	8.5	8.4
CPI	YoY	6.2	6.0	5.7	3.8	4.4	3.8
Unemployment Rate	%	5.5	5.8	6.0	5.0	4.8	4.8
Current Account	US$ bn	-77.1	-71.0	-67.8	-21.2	-26.4	-25.1
	% of GDP	-3.5	-3.3	-3.0	-1.7	-2.0	-1.7
Fiscal Balance	% of GDP	-3.6	-3.9	-2.7	-2.4	-3.5	-2.5
US Dollar Exchange Rate	Average	2.16	2.42	2.49	12.76	12.83	12.40

Sources: Haver Analytics and Citi Research forecasts

Argentina

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The initial positive expectations around the newly appointed economic team have fizzled out. Investors, companies and individuals seem to have lost faith in hopes of a change in direction, as evidenced by the widening in the parallel FX market's premia and the behavior of the country's credit. We share market participants' concerns. The few initiatives undertaken by the new economic cabinet are both surprising and worrisome. The authorities have refrained from taking measures to improve the weak fiscal stance, which deteriorated further in 4Q13. The only policy change has been a significant increase in the pace of depreciation of the peso in the official market. However, this action is failing to close the gap with the parallel market, has not prevented further declines in BCRA reserves, and is fueling inflation. International reserves dropped an additional USD0.7bn in the first half of January to USD29.9bn. Additionally, inflation reached 4.1% MoM in December, according to the local consultancy firm MyS. As a result, annual inflation came at 28.8%, while annualized inflation stood at 36% during the second semester of last year — evidencing a clear upward trend. We now expect the official USDARS to increase by 40% in 2014 to 9.1 by yearend, and non-official inflation to accelerate to 35%. We continue to expect non-official growth to be only 0.5%, reflecting both structural and cyclical factors.

Venezuela

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Venezuela will continue to display a significant deterioration in its macroeconomic performance during 2014. In particular, we expect GDP growth to stand at -1.0% in 2014, while inflation should continue rising (up to 75%) during the year. The delays in economic data releases (namely inflation prints in November and December) and the announcements regarding the likelihood of methodological changes in CPI computations cast additional doubts on how to evaluate this variable going forward. Also, the surprising recent announcements made by President Maduro regarding the maintenance of the current exchange rate against the USD throughout the year, coupled with new price controls, FX regulations, and changes in the government's economic cabinet will definitely increase the size of the macroeconomic imbalances in the country.

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

		Argentina			Venezuela		
		2013F	2014F	2015F	2013F	2014F	2015F
Real GDP	YoY	5.3%	3.0%	2.0%	1.5%	-1.0%	1.9%
Final Domestic Demand	YoY	6.4	2.8	2.1	-0.2	-1.1	0.7
Private Consumption	YoY	6.5	3.3	2.3	3.8	0.1	0.3
Fixed Investment	YoY	6.2	1.2	0.1	-3.5	-3.5	0.9
Exports	YoY	-0.1	-1.6	-1.5	-3.8	1.3	4.2
Imports	YoY	8.6	-1.9	0.0	-4.6	-0.7	-1.0
CPI	YoY	10.6	13.0	13.8	38.7	67.3	79.5
Unemployment Rate	%	7.3	7.7	8.1	5.6	6.2	6.4
Current Account	US$ bn	-2.9	-1.9	-1.6	12.2	14.1	13.2
	% of GDP	-0.6	-0.4	-0.4	3.2	3.8	3.6
Fiscal Balance	% of GDP	-2.3	-3.1	-2.3	-11.8	-11.0	-10.1
US Dollar Exchange Rate	Average	5.45	7.85	11.00	5.99	10.58	19.80

Sources: Haver Analytics and Citi Research forecasts

Saudi Arabia

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Oil production declined in the final months of 2013, bringing the yearly average production to 9.5mbpd, in line with our forecasts. We expect production to decline slightly in 2014, and we are forecasting an average for 2014 of 9.2mbpd. The drop in production will reflect the slight softening in oil prices that we are forecasting going forward, along with increased production elsewhere in the region, most notably Iraq. The ongoing talks between the P5+1 and Iran may, in our opinion, result in an easing of some sanctions on oil exports. If this were to happen, it would represent a downside risk to Saudi production and our economic forecasts. The public finances and external balances are expected to remain robust in the near term: the current account surplus will remain in double digits in 2014, while the fiscal surplus will narrow from around 10% of GDP this year to a still healthy 5% or so in 2014. That said, we think rising expenditures and an expected leveling off in oil revenues present a challenge in the medium- to long-term. The fiscal breakeven oil price will rise to over $90 per barrel in 2014 and will continue to rise, resulting in forecast deficits as early as 2016. Although Saudi has ample resources to finance expected deficits from current cash reserves, the outlook does underscore the need for structural reform to set public finances on a long-term sustainable footing.

United Arab Emirates

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Dubai's award of Expo 2020 in late November capped another year of strong economic performance in the emirate, fuelling investor confidence and driving a steep recovery in asset prices. The Dubai Financial Market all-shares index gained over 80% in value in the course of 2013, and the real estate market continues to surge, with Cluttons data showing that the average selling price of mid-range villas rose 42% during 2013. Much of this rise occurred in the first six months of the year, with property values rising by a more modest 20% per year (annualized rate) in the second half. That said, we believe that the award of Expo may fuel further exuberance in the market, which has been accompanied by the announcement of a large number of new real estate projects. For now, construction activity remains contained to new developments in prime locations, such as on the Palm or in the Downtown area. Should we see a surge in construction activity in less-prime areas, accompanied by aggressive off-plan sales strategies, we believe the potential for further property-led volatility in the Dubai economy will become increasingly likely. Dubai Expo could, in our view, be a trigger for such activity.

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

		Saudi Arabia			United Arab Emirates		
		2013F	2014F	2015F	2013F	2014F	2015F
Real GDP	YoY	6.1%	5.8%	6.2%	3.7%	4.0%	4.0%
Final Domestic Demand	YoY	8.0	8.0	8.1	4.7	4.7	4.7
Private Consumption	YoY	5.0	5.0	5.0	5.0	5.0	5.0
Fixed Investment	YoY	10.0	10.0	10.0	5.0	5.0	5.0
Exports	YoY	-1.2	1.0	1.3	14.0	13.0	14.0
Imports	YoY	15.0	15.0	15.0	15.0	15.0	15.0
CPI	YoY	3.5	3.4	4.1	1.1	1.3	1.6
Current Account	US$ bn	134.5	106.4	75.8	114.8	102.5	90.1
	% of GDP	17.6	13.1	8.8	28.0	23.3	19.1
Fiscal Balance	% of GDP	10.0	5.0	0.4	NA	NA	NA
US Dollar Exchange Rate	Average	3.75	3.75	3.75	3.67	3.67	3.67

Sources: Haver Analytics and Citi Research forecasts

Nigeria

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Nigeria is to hold presidential and parliamentary elections in early 2015. Yet, even with political uncertainty set to rise steadily in 2014, we still expect growth to remain robust at over 6%. But the fiscal picture could deteriorate, notably in 2H 2014 if a supplementary budget (or more than one) is passed. We also forecast that inflation will rise back towards double digits in 2H 2014, meaning that whoever is appointed as the new central bank governor will be under less pressure to change the current tight monetary policy stance. This should help support the naira, but the pressure on the naira in Q3 2013 highlights that it is vulnerable to sentiment: both Nigeria specific, notably with rising political noise, and towards emerging markets in general. But while we expect greater naira volatility on a day-to-day basis in 2014, we still expect only limited overall naira depreciation, unless there was a major change to the oil price-production equation or reserves really came under pressure.

South Africa

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2013 GDP growth is likely to be confirmed at a disappointing 1.8%, with 2014 GDP looking only somewhat better. Politics, industrial action and the disappointing export performance in the face of ZAR weakness add downside risks to our forecast for 2.8% GDP this year. As a result, business confidence is likely to remain low, as reflected in the most recent PMI reading which fell below 50. Limited production and low private investment means job creation will struggle. High wage settlements, lower inflation and credit amnesty may help the consumer in the near-term, but further out a weakening currency adds upside risk to discretionary goods inflation which could 'cap' purchasing power in our view. There is some glimmer of hope for the consumer, in that some positive house price growth is likely this year as housing stock declines which would help improve consumer balance sheets. This probably will only likely be realized toward end-2014, but may provide enough nearterm insulation to the economy to justify rate hikes. We expect monetary policy to tighten from Q1-15 onwards but acknowledge that it may happen earlier if the current account fails to show signs of narrowing and the ZAR weakens further. Fiscal policy is likely to be crucial to the rating agencies in H1-14 and any signs that the Treasury has conceded to political pressure will likely result in another ratings downgrade. Adding to this risk is political uncertainty ahead of the national elections in April/May. The ANC looks likely to lose some voting support this year while the new opposition party, the EFF, looks to gain more than initially expected. No matter the outcomes, we believe that the elections will prove that local politics have reached a turning point.

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

		Egypt			Nigeria			South Africa		
		2013F	2014F	2015F	2013F	2014F	2015F	2013F	2014F	2015F
Real GDP	YoY	2.0%	2.9%	3.4%	6.5%	6.6%	6.4%	1.8%	2.8%	3.5%
Final Domestic Demand	YoY	3.1	4.2	6.1	NA	NA	NA	3.3	3.5	4.3
Private Consumption	YoY	2.7	3.5	5.1	NA	NA	NA	2.4	3.5	4.1
Fixed Investment	YoY	3.0	8.9	10.3	NA	NA	NA	5.1	3.8	5.0
Exports	YoY	2.9	2.0	6.0	NA	NA	NA	0.0	4.4	5.4
Imports	YoY	2.3	4.7	13.4	NA	NA	NA	5.1	6.6	7.5
CPI	YoY	9.5	7.3	6.9	8.5	8.8	10.6	5.8	5.6	5.5
Unemployment Rate	%	13.5	14.2	14.5	NA	NA	NA	25.5	25.0	24.6
Current Account	US$ bn	-4.2	-3.5	-6.2	16.0	11.7	9.1	-21.0	-18.9	-19.3
	% of GDP	-1.7	-1.3	-2.2	5.0	3.2	2.2	-5.9	-5.2	-4.9
Fiscal Balance	% of GDP	-12.7	-12.1	-10.0	-2.1	-2.9	-2.9	-4.4	-4.3	-4.4
US Dollar Exchange Rate	Average	6.87	7.15	7.54	159.2	162.58	166.10	9.65	10.36	10.29

Sources: Haver Analytics and Citi Research forecasts

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

	GDP Growth (%)			CPI Inflation (%)			Current Balance (% of GDP)			Fiscal Balance (% of GDP)		
	2013F	2014F	2015F	2013F	2014F	2015F	2013F	2014F	2015F	2013F	2014F	2015F
Asia	6.2	6.2	6.3	3.8	4.0	4.1	2.1	1.9	1.4	-2.4	-2.0	-1.8
China	7.7	7.3	7.0	2.6	3.3	3.7	2.2	2.0	1.5	-2.0	-2.0	-1.5
Hong Kong	3.0	3.4	3.8	4.3	3.6	4.0	2.8	3.1	3.9	1.4	1.3	0.7
India	4.8	5.6	6.7	10.0	8.3	7.5	-2.3	-2.3	-2.1	-6.9	-6.7	-6.3
Indonesia	5.7	5.3	5.5	7.0	6.4	5.7	-3.3	-2.9	-2.4	-2.2	2.2	-1.7
Korea	2.9	3.7	4.0	1.3	2.1	3.1	5.7	4.0	3.1	0.9	1.0	1.6
Malaysia	4.5	5.0	4.9	2.1	3.6	4.5	3.8	4.4	4.0	-4.2	-3.5	-3.0
Mongolia	12.0	11.0	8.0	10.5	13.6	12.0	-31.7	-20.5	-16.2	-8.0	-6.2	-2.9
Philippines	6.5	7.1	6.8	2.9	4.8	4.0	3.5	3.4	2.9	-1.7	-1.8	-1.6
Singapore	3.7	3.5	3.5	2.4	1.9	2.2	14.0	13.5	13.0	0.7	0.5	0.5
Sri Lanka	6.8	7.0	7.0	6.9	6.0	6.5	-4.0	-3.1	-3.1	-6.0	-5.8	-5.6
Taiwan	2.0	3.2	3.8	0.8	1.7	2.3	10.9	9.8	9.5	-1.5	-1.4	-1.2
Thailand	2.8	1.8	3.9	2.2	2.3	2.8	-0.9	2.2	-1.0	-1.8	-0.7	-1.8
Vietnam	5.4	5.7	5.9	6.6	6.9	7.2	4.9	3.7	2.5	-5.3	-4.5	-4.0
Latin America	2.4	2.6	3.0	7.4	9.4	10.0	-2.5	-2.5	-2.1	-3.3	-3.6	-2.8
Argentina	5.3	3.0	2.0	10.6	13.0	13.8	-0.6	-0.4	-0.4	-2.3	-3.1	-2.3
Brazil	2.3	1.8	2.0	6.2	6.1	5.7	-3.5	-3.3	-3.0	-3.6	-3.9	-2.7
Chile	4.0	4.0	4.5	1.8	3.2	3.1	-3.5	-3.8	-4.0	-0.3	-0.4	-0.4
Colombia	4.0	4.6	5.0	2.0	2.5	3.2	-3.1	-3.3	-3.6	-1.1	-0.7	-0.7
Costa Rica	3.5	4.0	4.5	5.3	3.1	4.1	-5.5	-5.1	-5.0	-6.0	-6.7	-7.0
Dominican Republic	3.0	4.0	4.5	5.1	5.1	4.6	-5.1	-5.3	-5.1	-4.2	-4.0	-4.2
Ecuador	4.0	4.0	4.5	2.7	2.9	3.1	-0.7	-0.9	-0.3	-2.4	-1.9	-1.5
El Salvador	1.8	2.2	2.5	0.9	1.2	1.8	-6.1	-6.3	-5.7	-4.2	-4.1	-3.7
Mexico	1.2	3.8	4.0	3.8	4.4	3.8	-1.7	-2.0	-1.7	-2.4	-3.5	-2.5
Panama	7.2	6.5	5.5	4.0	2.7	2.8	-14.3	-13.6	-9.2	-3.5	-3.0	-3.0
Peru	5.2	5.7	6.2	2.8	2.6	2.5	-5.5	-6.4	-1.5	0.8	0.0	0.0
Venezuela	1.5	-1.0	1.9	38.7	67.3	79.5	3.2	3.8	3.6	-11.8	-11.0	-10.1
Europe	1.9	2.7	3.1	5.3	4.8	4.9	-1.1	-1.1	-1.6	-2.2	-2.5	-3.6
Bulgaria	0.5	1.5	2.5	0.9	1.2	2.5	2.0	-0.8	-0.5	-2.0	-2.0	-1.2
Croatia	-1.0	1.2	2.0	2.2	1.6	2.8	0.6	-0.5	-1.0	-5.5	-5.7	-5.0
Czech Republic	-1.4	1.9	2.4	1.4	1.2	2.3	-0.8	-0.3	-0.9	-2.4	-2.9	-2.9
Hungary	1.0	1.9	1.3	1.7	1.0	2.8	1.9	1.4	1.1	-2.7	-2.9	-2.9
Kazakhstan	5.8	6.0	6.2	5.8	6.0	6.3	0.2	0.8	1.1	3.2	2.3	2.1
Poland	1.5	3.1	3.6	0.9	1.4	2.8	-1.8	-2.4	-3.4	-4.2	5.6	-2.3
Romania	2.5	2.8	3.3	4.0	1.6	2.7	-1.2	-2.5	-4.2	-2.5	-2.3	-2.3
Russia	1.4	2.6	2.7	6.8	5.6	4.9	1.6	1.1	0.8	-2.0	-4.3	-4.9
Serbia	2.7	1.5	2.2	7.9	5.9	5.8	-4.5	-4.0	-5.5	-5.0	-5.5	-5.0
Slovakia	0.8	1.9	2.5	1.4	0.8	1.6	4.2	4.4	3.7	-2.7	-3.3	-2.6
Turkey	4.0	2.5	3.5	7.5	7.3	7.6	-7.1	-5.9	-6.4	-1.2	-2.8	-3.2
Ukraine	-0.7	1.6	3.3	-0.3	4.2	4.8	-8.5	-7.2	-6.6	-6.3	-6.1	-4.3
Africa/Mideast	4.3	5.1	5.4	4.2	4.2	5.0	12.7	10.6	8.2	2.7	0.9	-0.4
Bahrain	4.3	4.0	4.1	3.3	2.3	2.0	5.3	2.4	-1.5	-2.2	-3.3	-5.5
Egypt	2.0	2.9	3.4	9.5	7.3	6.9	-1.7	-1.3	-2.2	-12.7	-12.1	-10.0
Ghana	7.4	6.8	6.5	11.4	10.3	7.1	-12.0	-12.0	-11.3	-9.2	-8.6	-7.4
Iraq	3.1	10.4	11.6	1.8	3.6	6.0	13.5	13.8	12.8	1.6	3.5	4.3
Israel	3.2	3.4	3.5	1.6	2.3	3.0	2.6	1.9	0.7	-3.6	-3.0	-2.5
Jordan	3.0	4.0	4.5	5.5	3.6	5.0	-15.2	-14.2	-11.9	-8.2	-10.1	-9.9
Kenya	5.1	5.5	6.1	5.7	6.5	7.3	-7.8	-7.6	-7.5	-7.0	-5.5	-4.5
Kuwait	4.2	3.8	3.9	2.6	3.3	5.0	51.0	49.5	47.8	36.8	32.1	29.5
Lebanon	1.4	2.0	2.4	2.0	3.4	5.0	-4.5	-5.3	-6.0	-10.0	-9.3	-8.7
Nigeria	6.5	6.6	6.4	8.5	8.8	10.6	5.0	3.2	2.2	-2.1	-2.9	-2.9
Oman	6.7	6.7	6.7	1.3	2.0	3.0	10.3	8.1	6.2	-0.2	-3.4	-5.4
Qatar	5.6	5.9	6.1	3.1	3.0	3.5	29.7	25.5	20.7	8.1	4.2	1.2
Saudi Arabia	6.1	5.8	6.2	3.5	3.4	4.1	17.6	13.1	8.8	10.0	5.0	0.4
South Africa	1.8	2.8	3.5	5.8	5.6	5.5	-5.9	-5.2	-4.9	-4.4	-4.3	-4.4
Tanzania	6.8	7.0	8.1	7.9	6.6	6.8	-10.2	-14.1	-12.4	-5.0	-5.2	-5.9
UAE	3.7	4.0	4.0	1.1	1.3	1.6	28.0	23.3	19.1	NA	NA	NA
Uganda	5.0	5.6	6.5	5.5	6.0	6.1	-12.0	-13.9	-14.9	-3.4	-3.3	-3.5
Zambia	6.0	6.4	6.3	7.0	7.0	7.3	-1.3	-1.0	-1.5	-8.5	-6.6	-5.5
Total	4.6	4.8	5.0	4.7	5.1	5.4	1.9	1.7	1.1	-2.0	-2.1	-2.1

Sources: National sources and Citi Research forecasts

Sovereign Ratings

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

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

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

	S&P Ratings				Moody's Ratings			
Country	Current Rating	Current Outlook	Citi Near-term (Up to 9 Months) Forecast Rating	Citi Longterm (Next 2-4 Years) Forecast Rating & Outlook	Current Rating	Current Outlook	Citi Near-term (Up to 9 Months) Forecast Rating	Citi Longterm (Next 2-4 Years) Forecast Rating & Outlook
US	AA+	Stable	AA+ (Stable)	AA+	Aaa	Stable	Aaa (Stable)	Aaa
Canada	AAA	Stable	AAA (Stable)	AAA	Aaa	Stable	Aaa (Stable)	Aaa
Japan	AA-	Neg	AA- (Neg)	A+ ↓	Aa3	Stable	Aa3 (Stable)	A1 ↓
Germany	AAA	Stable	AAA (Stable)	AAA	Aaa	Neg	Aaa (Neg)	Aaa
France	AA	Stable	AA (Stable)	AA	Aa1	Neg	Aa2 Stable ↓	Aa2 ↓
Italy	BBB	Neg	BBB- (Neg) ↓	BBB- ↓	Baa2	Neg	Baa2 (Neg)	Baa3 ↓
Spain	BBB-	Stable	BBB- (Stable)	BBB-	Baa3	Stable	Baa3 (Stable)	Baa3
Austria	AA+	Stable	AA+ (Stable)	AA+	Aaa	Neg	Aaa (Neg)	Aaa
Belgium	AA	Neg	AA (Neg)	AA	Aa3	Neg	Aa3 (Neg)	Aa3
Finland	AAA	Stable	AAA (Stabvle)	AAA	Aaa	Stable	Aaa (Stable)	Aaa
Greece	B-	Stable	B- (Stable)	B-	Caa3	Stable	Caa3 (Stable)	Caa3
Ireland	BBB+	Positive	A- (Stable) ↑	A- ↑	Baa3	Positive	Baa2 (Stable) ↑	A3 ↑↑↑
Netherlands	AA+	Stable	AA+ (Stable)	AA+	Aaa	Neg	Aaa (Neg W)	Aa1 ↓
Portugal	BB	Neg	BB (Neg)	BB	Ba3	Stable	Ba3 Stable	Ba3
UK	AAA	Neg	AAA (Stable)	AAA	Aa1	Stable	Aa1 (Stable)	Aa1
Switzerland	AAA	Stable	AAA (Stable)	AAA	Aaa	Stable	Aaa (Stable)	Aaa
Sweden	AAA	Stable	AAA (Stable)	AAA	Aaa	Stable	Aaa (Stable)	Aaa
Denmark	AAA	Stable	AAA (Stable)	AAA	Aaa	Stable	Aaa (Stable)	Aaa
Norway	AAA	Stable	AAA (Stable)	AAA	Aaa	Stable	Aaa (Stable)	Aaa
EU	AA+	Stable	AA+ (Stable)	AA+	Aaa	Neg	Aaa (Neg)	Aa1 ↓
EIB	AAA	Stable	AAA (Stable)	AAA	Aaa	Neg	Aaa (Stable)	Aaa
ESM	Not rated				Aa1	Neg	Aa1 (Neg)	Aa2 ↓
EFSF	AA	Stable	AA (Stable)	AA	Aa1	Neg	Aa1 (Neg)	Aa2 ↓

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

Expected Ratings Issues in 2014

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Overview: 2014 has started with the first euro area upgrade by Moody's (other than Greece's exit from default status) since 2002, with Ireland restored to Investment Grade Baa3 on 17th January. In their 2014 Outlook (25th November 2013), Moody's stated "*After several tumultuous years, global sovereign credit worthiness is likely to be comparatively stable in 2014*"[7]. The only EMU sovereigns at present where we see lingering downgrade risk later in 2014 are Italy and France, which still carry a negative outlook by at least one rating agency.

EMU calendar: In the new regulatory environment, the rating agencies have published a calendar indicating dates when potential rating actions can occur. Note that the agencies are under no obligation to publish when there is no change (as Moody's recently did not announce anything regarding Portugal on 17th Jan). Citi has combined S&P's and Moody's into one document here: *S&P and Moody's Sovereign Credit Ratings Calendar for 2014*. Key dates over the coming weeks are shown in Figure 43.

Figure 43. Upcoming Rating Calendar

Date	Sovereign	Rating Agency	Current Rating	Current Outlook
24-Jan-14	France	Moody's	Aa1	Neg
31-Jan-14	EFSF	Moody's	Aa1	Neg
07-Feb-14	Finland	Moody's	Aaa	Stable
14-Feb-14	Italy	Moody's	Baa2	Neg
21-Feb-14	Spain	Moody's	Baa3	Stable
28-Feb-14	Austria	Moody's	Aaa	Neg
28-Feb-14	Belgium	S&P	AA	Neg
28-Feb-14	Luxembourg	Moody's	Aaa	Neg
28-Feb-14	Germany	Moody's	Aaa	Neg

Source: Citi Research, Moody's, S&P, Bloomberg

Ireland: Moody's upgraded Ireland from Ba1 Stable (sub-IG) to Baa3 Pos (IG) on the evening of Friday 17th January. We expected Ireland to be upgraded in 2014 (*2014 Outlook*), but this rating action has come earlier than anticipated and was a positive market surprise. Ireland is now rated Investment Grade by all three rating agencies with a positive outlook by both Moody's and S&P. We expect another upgrade of Ireland by both agencies later this year (*Ireland UPGRADED*).

Portugal: S&P recently spared Portugal another downgrade despite having the sovereign on negative watch. Given that 2013 fiscal targets were probably met and Portugal's recent presence in capital markets, we had anticipated the "no change" decision (*QuickPost*) and believe such drivers will keep Portugal's rating at current levels for the time being.

Spain and Italy: European fixed income markets gave a sigh of relief when Moody's took its Baa3 rating for Spain off negative outlook in December last year. This was the last rating agency to do so for Spain (S&P having done so in November). Given on-going fundamental improvements, we expect Spain's rating to remain at current levels (BBB-, Baa3). However, economic and political risks remain for Italy which still has a negative outlook by both Moody's and S&P. This signifies the increased likelihood of further downgrade pressure over the medium term.

France: France's Aa1 rating by Moody's has carried a negative outlook since November 2012 (when France was moved from Aaa to Aa1). In their latest Credit Opinion (Dec 2013), Moody's indicated that a downgrade could occur in conjunction with an assessment of the government's progress in addressing its fiscal pressures. On balance, we think France's rating will be left unchanged later this week (see Figure 43) and that any potential action by Moody's might occur at the next calendar date (23 May). In any such scenario, this would normalize the rating to S&P's AA rating and the spread impact is likely to be muted in our view.

UK: Given the strong performance of the UK economy, we believe S&P will return its AAA rating of the UK back to stable in 2014. The next opportunity for this to occur is on 6th June when the UK features in S&P's calendar. We do not anticipate a further cut by Moody's which rates the UK Aa1 (stable outlook).

US: The US is rated AA+ Stable by S&P and Aaa Stable by Moody's and as such, we do not anticipate any change in the US rating over the long term, although the rating agencies are likely to follow any return of the debt ceiling debate in Q1.

[7] Moody's Investor Service "*2014 Outlook – Global Sovereigns*" 25 November 2013.

Yield and Spread Forecast Commentary

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US: We think that fundamental improvements in the economy in 2014 will be more significant than 2013, but that Treasury yields will rise much more modestly. Our rationale is that much of the rise in Treasury yields in 2013 was a 'normalization' of yields from levels which were well below fundamental fair value. We would credit technical factors, namely investors' positioned short duration, with the drop in Treasury yields since year-end. This is in contrast to 2013, when we felt that technical factors accelerated the rise in rates - including a fixed-income investor base that was long duration and a risk-asset investor base using duration as a hedge. These factors likely accelerated the May-June rise in Treasury yields, and the current set of technical will likely mute the rise in yields in 2014. We continue to forecast 3.30% for the 10yr Treasury at year-end.

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Core Europe: We do not expect much change in Bund yields from current levels in coming quarters. Inflation remains very low (0.8% YoY) and the euro area recovery is modest. We expect the front end of the EUR curve to decouple further from the US given Citi's forecast of further ECB easing. Together with somewhat enhanced forward-guidance, this should anchor the 0-5y sector, thus fuelling carry trades and further lowering Bobl's sensitivity to UST. Spreads to Bunds should stay around current levels with OAT-Bund spreads range-bound at 50bp-75bp.

EMU Periphery: EMU periphery markets continue to enjoy healthy supports, and we forecast Bono spreads to Bunds at 125bp and BTP spreads to Bunds at 150bp for Q4 2014. Citi's economists are lifting the 2014 Spain growth forecast from 0.2% to 0.9% this month, and this is one reason why we continue to expect Spain's government bonds to continue to outperform. By contrast, Italy's more muted economic prospects may limit BTP outperformance. Performance is likely to be even stronger for Ireland, especially in light of its IG status by Moody's (with prospects for further upgrades), improving growth outlook and the prospect that the public debt/ GDP ratio will edge down this year. We target a spread to Bunds of 85bp by Q4 2014 (from the current level of 118bp).

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UK: We are lifting our gilt forecasts this month, particularly in the front end. We have brought forward the first rate hike to Q4 2014 (previously Q2-15) and expect policy rates to move up to 2% by late-2015. This should mean bear-flattening in 2s10s (and 5s10s) for the first time since early 2008. The 10s30s curve is also likely to flatten; partly reflecting directionality and partly as the result of strong demand for the very long-end as pension funds de-risk. On a cross-market basis, our forecast changes suggest that the 10yr gilt-Treasury spread could widen to around +30bp in a year from now and make us even more bearish on 10yr gilts vs Bunds.

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Japan: Bond purchases by the BoJ in a large scale are expected to curb term premium of 5-10-year JGB yields. Furthermore, the BoJ is expected to employ extra accommodative measures around June or July this year, with a high chance that the size of JGB purchases will be increased. If the market environment with continued trends of Yen depreciation and equity gains on top of FRB's tapering are envisaged, an upward shift in expected growth and inflation rates will be a drag on the JGB market, in our view. A tug of war between these opposing forces will remain in place. We expect JGB yields to trend lower nearterm, as downside risks to growth will be under spotlight. But, if Japan's economy picks up gradually from summer onwards, then JGB yields are likely to test the upside at a moderate pace.

Figure 44. Interest Rate and Bond Market Forecasts as of 22 January 2014

	Quarterly Average						
	Current	1Q 14	2Q 14	3Q 14	4Q 14	1Q 15	2Q 15
US							
Policy Rate (Fed Funds) End Quarter	0.25	0.25	0.25	0.25	0.25	0.25	0.25
3-Month Libor	0.24	0.24	0.24	0.24	0.24	0.32	0.45
2 Year Treasury Yield	0.38	0.37	0.43	0.58	0.75	0.95	1.13
5 Year Treasury Yield	1.64	1.60	1.63	1.80	2.00	2.23	2.45
10 Year Treasury Yield	2.84	2.85	2.95	3.13	3.25	3.38	3.50
30 Year Treasury Yield	3.77	3.84	4.05	4.25	4.35	4.48	4.60
2-10 Year Treasury Curve	246	248	253	255	250	243	238
2 Year Swap Spread (Swap Less Govt), bp	12	16	20	20	20	20	20
10 Year Swap Spread (Swap Less Govt), bp	11	11	13	15	15	15	15
30 Year Swap Spread (Swap Less Govt), bp	-2	-4	-5	-5	-5	-5	-5
30 Year Mortgage Yield	4.45	4.45	4.55	4.73	4.9	5.08	5.23
10 Year Breakeven Inflation	224	232	240	238	235	238	238
Euro Area							
Policy Rate	0.25	0.25	0.00	0.00	0.00	0.00	0.00
Overnight Rate (EONIA)	0.36	0.20	0.00	0.00	0.00	0.00	0.00
3-Month (EURIBOR)	0.28	0.25	0.10	0.15	0.15	0.15	0.15
2 Year Schatz Yield	0.17	0.20	0.00	0.05	0.10	0.10	0.10
5 Year Bobl Yield	0.83	0.75	0.50	0.50	0.50	0.60	0.60
10 Year Bund Yield	1.75	1.75	1.70	1.70	1.80	1.90	1.90
30 Year Bund Yield	2.64	2.65	2.60	2.60	2.60	2.60	2.60
2-10 Year Bund Curve	158	155	170	165	170	180	180
10 Year BTP-Bund Spread	192	180	170	160	150	150	150
10 Year Bono-Bund Spread	195	175	160	140	140	125	125
2 Year BTP-Schatz Spread	84	85	75	75	50	50	50
2 Year Bono Schatz Spread	83	85	75	75	50	50	50
10 Year OAT-Bund Spread	66	65	65	65	65	65	65
10 Year Swap Spread (Swap Less Govt.), bp	22	25	25	25	25	20	20
10 Year Breakeven Inflation	153	145	145	150	150	150	150
Japan							
Policy Rate	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3-Month Libor	0.14	0.15	0.15	0.15	0.15	0.15	0.15
2 Year Treasury Yield	0.09	0.10	0.10	0.10	0.15	0.20	0.20
5 Year Treasury Yield	0.21	0.20	0.15	0.20	0.30	0.35	0.40
10 Year Treasury Yield	0.67	0.65	0.55	0.70	0.85	0.95	1.05
30 Year Treasury Yield	1.70	1.70	1.65	1.75	1.85	1.90	1.95
2-10 Year Treasury Curve	58	55	45	60	70	75	85
2 Year Swap Spread (Swap Less Govt.), bp	12	12	10	12	14	15	15
10 Year Swap Spread (Swap Less Govt.), bp	20	17	14	20	22	25	25
10 Year Breakeven Inflation	110	105	100	95	95	105	110
UK							
Policy Rate	0.50	0.50	0.50	0.50	0.67	1.08	1.42
3-Month Libor	0.52	0.55	0.60	0.70	1.00	1.45	1.70
2 Year Treasury Yield	0.56	0.70	1.10	1.50	1.70	1.85	1.95
5 Year Treasury Yield	1.80	2.00	2.35	2.65	2.80	2.95	3.05
10 Year Treasury Yield	2.89	3.05	3.25	3.40	3.60	3.70	3.80
30 Year Treasury Yield	3.61	3.70	3.80	3.90	4.00	4.05	4.10
2-10 Year Treasury Curve	232	235	215	190	190	185	185
10 Year Swap Spread (Swap Less Govt.), bp	3	5	10	15	15	20	20
10 Year Breakeven Inflation	309	310	320	325	330	335	335
Australia							
Policy Rate	2.50	2.50	2.50	2.50	2.50	2.75	3.25
3-Month Libor	2.64	2.60	2.60	2.60	2.65	2.95	3.45
2 Year Treasury Yield	2.69	2.80	2.90	2.90	3.20	3.50	3.80
5 Year Treasury Yield	3.47	3.50	3.60	3.75	3.90	4.20	4.45
10 Year Treasury Yield	4.27	4.30	4.40	4.50	4.60	4.75	4.95
2-10 Year Treasury Curve	158	150	150	160	140	125	115
10 Year Swap Spread (Swap Less Govt.), bp	29	30	30	35	40	45	45

Source: Citi Research

Commodities Market Outlook

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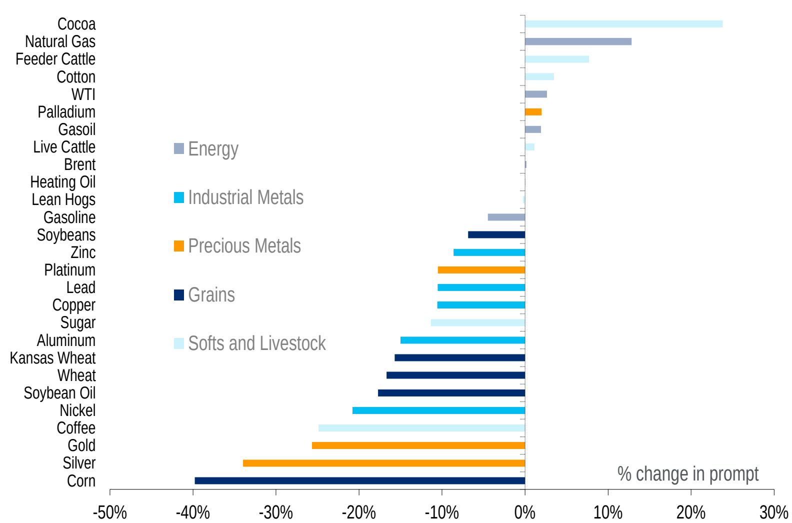
Commodity prices are broadly expected to remain tempered in 2014 after a difficult environment during most of 2013 whereby the average futures contract fell 5-10%. Macroeconomic headwinds, particularly across emerging markets, should continue to hinder demand growth this year just as a combination of rising output and swelling inventories are continuing to loosen fundamental balances in the petroleum, staple grains and industrial metals sectors.

Investor and fund flows are also expected to stay generally unsupportive across commodity indices and exchange traded funds (ETFs). Citi estimates that half of the record amount of institutional and retail net redemptions of c$50Bn last year were during 4Q 13 (totaling c$25Bn), reversing fully and then some, the 3Q'13 market rally net inflows driven by a Northern Hemisphere summer seasonal bounce; enhanced by heightened geopolitical risk where gold rebounded as a source of political insurance and oil market net long positioning hit all-time highs on the back of massive OPEC and non-OPEC supply disruptions as a potential US conflict with Syria neared. To be clear, precious metal ETFs were the primary driver at c55% of aggregate 2013 net outflows. Citi's forward outlook for 2014 also suggests ongoing weakness for net investor flows but for the size, scale and pace of retrenchment to be much less severe given the much lower baseline to begin the year.

With the unfolding of the super cycle sunset, individual and specific commodity underliers are likely to show a wider dispersion as market specific supply/demand factors and tail risks dictate varying price paths. This is most visible in energy and agriculture markets, but is also taking shape in base metals, whereby the preeminent sovereign consumer, China, rebalances its economy to one which is much less commodity intensive.

Figure 45. 2013 Nominal Commodity Price Returns



Sources: Bloomberg and Citi Research

The history of commodity cycles is that they are supply-side-based, with investors, following a herd mentality, oscillating between over-investment and too much supply and under-investment and too little supply. This pattern is unlikely changing. Beginning in 2012 but crystalizing in 2013, physical balances pointed to a cyclical trough for prices as the fruits of new supply were to be reaped over the next several years — in a fillip of the high price environment of the previous decade.

Agriculture and soft commodity cycles are the briefest with the shortest lead times and the ability for producers to adjust planting intentions on a 1-2 year basis. For benchmark grains, Citi expects the heightened price and spread volatility both in the US and globally, that was particularly exacerbated from 2010-1H'13 with the confluence of low inventories, growing biofuel demand and most notably the 2012 US drought coupled with other Northern hemisphere weather risks, to reduce dramatically. Cereal prices since 2H'13 have eased markedly as supplies are being replenished on bumper harvests and expectations of stock builds this year across the board for corn, wheat, soy; a trend likely to carry over into 2015/16. This is already feeding through in lower inflation components across EM and DM economies. Given the large global inventory surplus across the board this year, grain prices are likely to favor consumers as opposed to producers and trading levels are likely to remain compressed and low for the next several quarters.

The base metals cycle is somewhat stickier and can take a half-decade or more to incentivize new production capacity. Given the scale and complexity, it often takes years before a new mine comes online. Many of these markets — absent nickel — still suggest new sources of supply after substantial upstream investments were made in the past decade. This has already weighed on aluminum prices, which refuse to budge from a tight $1,800-$2,000/t range just above marginal producer costs. Short-term copper prices remain supported by the continued drawdown in LME inventories and rising levels of cancelled warrants, which has pushed the cash copper-3M spread into backwardation since mid-December despite a healthy 8% growth in mine supply in 2013. However, much of this is likely driven by collateralized financing demand (particularly given current credit tightness in China). A bearish tail risk to the market is that the Chinese government significantly cracked down on this shadow banking activity, allowing for significant volumes of copper to be dumped into the world market. Concerns over further price upside also reside with China. The country has recently announced a push on grid investments, pointing to higher demand, but it also has significant new smelter and refining capacity coming online, plus improving utilization rates at existing plants, which should buttress refined production growth. But the demand picture is still mixed. Although new budgets for energy infrastructure spending have looked positive, much of the cable requirement driven by planned first quart spending have already been fabricated through 4Q'13. In affinity to last year, we expect energy spending in China to be front-loaded this year with investment tailing off in 2H'14. Over the medium term, the industry is rapidly canceling projects potentially accelerating the time when the base metals markets tighten. Meanwhile, Indonesia's new ban on nickel ore exports — much against industry expectations — is tightening that market rapidly despite large inventories in China, the main importer.

Oil and gas historically took significantly longer to mobilize capital. But the unconventional revolution — harnessing shale resources plus deep water and oil sands — is different in two significant respects: it is occurring in OECD countries, with few market impediments compared to resource nationalistic EMs; and it is unleashing a new low-cost supply that is fairly ubiquitous globally, setting the stage potentially for a long period of relatively low cost resources. This is evidenced by official agencies as well as Citi forecasting muted demand growth of only 1-m b/d this year; well below non-OPEC supply growth projection. This should reduce the 'call-on-OPEC' to balance the market below its stated output targets of 30-m b/d. New infrastructure build-out across North America, where the US continues to ramp up production, should continue to push oil to the coasts and increasingly pressure policy makers to open up oil for direct exports. The US is already the world's largest petroleum product exporter and later this year will likely leapfrog Russia on a net basis as well. As commodity super cycles and correlations are typically led by the energy sector, the outlook for oil prices to average below $100/bbl this year has the additional benefit of reducing upstream costs for other energy-intensive commodity activity such as mining and farming. This places an additional weight on those markets until physical cycles begin tightening again later this decade.

Figure 46. Commodities Price Forecast*

		Point Prices																					
		0-3M	6-12M		Q3 2013	Q4 2013	Q1 2014E	Q2 2014E	Q3 2014E	Q4 2014E	Q1 2015E	Q2 2015E	Q3 2015E	Q4 2015E	2012	2013	2014	2015E	2016E	2017E	2018E
Energy				**5Y Cyclical**																			
NYMEX WTI	USD/bbl	97.0	92.5	81.0	108.0	97.6	97.0	89.0	97.0	88.0	91.0	83.0	90.0	81.0	94.1	98.0	92.8	86.3	83.0	78.0	80.0
ICE Brent	USD/bbl	100.0	97.5	85.0	112.0	109.3	100.0	95.0	100.0	95.0	95.0	90.0	95.0	90.0	111.7	108.7	97.5	92.5	90.0	85.0	85.0
Henry Hub Natural Gas	USD/MMBtu	3.70	3.80	N/A	3.55	3.85	3.70	3.60	3.70	3.90	4.20	4.50	4.50	4.80	2.75	3.73	3.70	4.50	4.90	4.90	5.50
Base Metals				**LT Price**																			
LME Aluminum	USD/MT	1,730	1,900	2,200	1,827	1,808	1,780	1,820	1,850	1,880	1,925	1,940	1,960	1,975	2,049	1,808	1,835	1,950	2,000	2,100	2,200
LME Copper	USD/MT	6,700	6,400	6,200	7,096	7,169	6,800	6,700	6,600	6,500	6,500	6,600	7,000	7,200	7,945	7,169	6,650	6,825	7,500	7,800	8,000
LME Lead	USD/MT	2,250	2,300	2,200	2,116	2,135	2,250	2,000	2,150	2,300	2,350	2,100	2,200	2,370	2,072	2,135	2,175	2,255	2,350	2,400	2,360
LME Nickel	USD/MT	17,500	18,000	20,000	13,996	13,968	17,000	16,500	17,000	17,500	18,000	18,500	19,000	20,500	17,592	13,968	17,000	19,000	23,000	24,000	24,000
LME Tin	USD/MT	22,500	23,500	20,000	21,284	22,917	22,000	21,500	22,000	24,000	25,000	24,000	23,000	24,000	21,108	22,917	22,375	24,000	25,000	24,000	23,000
LME Zinc	USD/MT	1,800	1,950	2,100	1,896	1,929	1,840	1,850	1,850	1,900	2,000	2,050	2,000	2,150	1,963	1,929	1,860	2,050	2,250	2,300	2,320
Precious Metals				**LT Price**																			
COMEX Gold	USD/T. oz	1,220	1,280	1,050	1,330	1,274	1,250	1,230	1,260	1,280	1,300	1,340	1,360	1,400	1,669	1,274	1,255	1,350	1,370	1,400	1,420
Silver	USD/T. oz	20.0	20.7	16.5	21.5	20.8	20.2	20.0	20.4	20.7	21.2	21.9	22.4	23.2	31.2	20.8	20.3	22.2	22.5	23.0	23.1
Platinum	USD/T. oz	1,500	1,525	1,763	1,456	1,398	1,500	1,525	1,550	1,575	1,625	1,640	1,660	1,675	1,552	1,398	1,538	1,650	1,700	1,750	1,850
Palladium	USD/T. oz	800	860	780	729	725	775	825	830	850	900	900	950	950	645	725	820	925	925	950	925
Bulk Commodities				**5Y Cyclical**																			
Hard Coking Coal (benchmark Asia)	USD/MT	150	160	200	145	152	155	160	160	165	170	170	170	170	211	159	160	170	180	190	200
Thermal Coal Asia (NEWC)	USD/MT	85	80	105	77	84	82	77	75	80	88	84	82	85	94	84	79	85	85	90	100
Iron Ore Spot (TSI)	USD/MT	135	115	81	133	135	130	120	115	115	115	100	95	90	128	135	120	100	90	90	90
Agriculture																							
CBOT Corn	USd/bu	420	390	N/A	512	430	440	450	430	380	420	450	505	505	695	578	425	470	515	N/A	N/A
CBOT Wheat	USd/bu	610	655	N/A	650	655	615	635	655	655	650	640	635	635	750	584	640	640	615	N/A	N/A
CBOT Soybeans	USd/bu	1,265	1,000	N/A	1,405	1,304	1,260	1,250	1,135	1,075	1,050	1,050	1,000	1,100	1,465	1,406	1,180	1,050	1,075	N/A	N/A
CBOT Rice	USD/cwt	15.5	15.3	N/A	15.6	15.5	15.4	15.3	15.4	15.0	14.4	14.2	14.1	14.1	14.9	15.5	15.3	14.2	N/A	N/A	N/A
NYB-ICE Cotton	USd/lb	79.0	77.8	N/A	85.6	80.3	79.0	78.0	80.5	75.0	75.0	75.0	75.0	75.0	80.0	83.3	78.0	75.0	N/A	N/A	N/A
Sugar#11	USd/lb	18.0	18.0	N/A	16.7	17.7	18.0	18.0	18.0	18.0	18.5	18.5	18.5	18.5	21.6	17.5	18.0	18.5	N/A	N/A	N/A
ICE Coffee	USd/lb	120	130	N/A	118	110	120	125	130	133	130	130	130	130	175	126	128	130	N/A	N/A	N/A
ICE Cocoa	USD/MT	2,600	2,700	N/A	2,420	2,706	2,550	2,550	2,700	2,600	2,600	2,600	2,600	2,600	2,348	2,405	2,600	2,600	N/A	N/A	N/A

Source: Citi Research, *subject to revision

Figure 47. Citi Global Economics Team For Informational Purposes Only

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Rohini Malkani was on a three months leave of absence for the period July 15 2013 until October 14 2013. During this period, she worked for the Ministry of Finance, India and she ceased all normal course business activity as an Economist at Citi.

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