Citi Research
Economics

25 January 2013 | 75 pages

Asia Pacific

Asia Macro and Strategy Outlook

Currency Wars? More Like Currency Skirmishes*

- Monthly
- Economic Trends

- **Currency tensions stay elevated in near-term** — With expected yen weakness, the rising role of financial vs. trade flows in the region, manageable inflation risks, and lingering growth concerns, will make some Asian countries more defensive about seeing outsized FX gains.
- **KR will likely feel most "heat" from the yen, followed by TW & SG given export structure** — JP's ODI in those countries could fall as similar cost structure makes them more prone to JP companies' production substitution.
- **While ASEAN (ex SG) & South Asia are less vulnerable** — Only TH seems to have a similar export structure to JP, but this is likely distorted by its own production chain with JP. We don't expect JP's ODI to developing S./S.E. Asia to be impacted much given both the region's domestic-led growth prospects and cost differentials.
- **The Philippines "currency war" is a bit different from the rest** — Goods & services trade competitiveness is a factor, but we think a bigger concern is the importance of remittances, especially more important for lower income households.
- **We expect escalating CB FX intervention among some "surplus" countries** — Potential for sustained capital inflows amid still muted inflation risks and lingering growth uncertainties may make PBOC, BoK, CBC and BSP more defensive on their currency. BSP may have received more ammunition via its recent government capital injection. BoT may be less aggressive in intervening given strong growth vs. inflation/financial stability concerns. BNM and MAS may not be sufficiently tested near-term due to election related concerns in the former, and structural growth/competitiveness issues plus use of SGD as funding currency in the latter.
- **Another "weapon" is to keep rates low for as long as possible** — We expect BoK can cut by at least 25bps and BSP has trimmed SDA yields by 50bps. Improved growth vs. inflation/financial stability risks will keep most on hold in 2013, although less dovish rhetoric means BoT is likely to hike earlier on domestic demand growth upside, rising inflation & financial stability concerns, and negative real yields.
- **KR, PH, TH & TW may be at risk of announcing more but not so punitive capital-flow related regulations** — Such moves could be more politically supported in KR if yen weakness escalates beyond expectations or becomes more pressing for countries if inflation/financial stability become a growing risk, and thus there may be a need to regain more monetary autonomy.
- **Market Implications** — We are biased towards INR given domestic policy catalysts & attractive carry plus RBI is unlikely to join the "war". We like THB near-term given the increasingly hawkish BoT. Further expansion of Asian CB balance sheets from FX intervention this year should provide a favorable backdrop for some risk assets (i.e. Asian equities and higher yielding bonds).
- **This version corrects GDP & CPI 2014E "Previous" column data in Figs. 1 & 2.*

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

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Citi Key Economic Forecasts

Figure 1. GDP Forecasts (growth rate in percent)

	2012 GDP Forecasts	2013 GDP Forecasts			2014 GDP Forecasts		
	Current	Current	Previous	Consensus	Current	Previous	Consensus
Asia-Pacific	6.2	6.6	6.6	6.8	6.6	6.6	—
Asian NIEs*	1.6	3.0	3.1	3.2	4.0	3.9	—
SEAN-4**	5.7	5.7	5.5	5.6	5.9	5.9	—
China	7.8	7.8	7.8	8.1	7.3	7.3	8.0
Hong Kong	1.4	2.8	2.8	3.4	3.5	3.5	4.1
India***	5.4	6.2	6.2	6.5	6.9	6.9	—
Indonesia	6.2	6.1	6.1	6.2	6.3	6.3	6.3
Malaysia	5.5	5.5	5.2	4.9	6.0	6.0	5.2
Mongolia	12.3	13.8	13.8	—	11.0	11.0	—
Philippines	6.3	6.1	5.3	5.7	6.4	5.8	5.7
Singapore	1.2	2.0	2.0	2.7	4.0	4.0	3.8
South Korea	2.0	3.2	3.4	3.2	4.1	4.0	3.7
Sri Lanka	6.4	7.1	7.3	6.6	7.5	7.5	6.9
Taiwan	1.1	3.0	3.0	3.3	3.8	3.8	3.9
Thailand	4.4	4.5	4.5	4.6	4.8	4.8	4.7
Vietnam	5.0	5.4	5.4	5.5	5.8	6.0	6.0

Figure 2. CPI Forecasts (growth rate in percent)

	2012 CPI	2013 CPI Forecasts			2014 CPI Forecasts		
	Current	Current	Previous	Consensus	Current	Previous	Consensus
Asia-Pacific	3.4	3.5	3.5	3.9	3.9	3.9	—
Asian NIEs*	2.7	2.8	2.8	2.7	2.9	2.8	—
SEAN-4**	3.4	3.7	3.8	4.2	4.1	4.1	—
China	2.6	2.8	2.8	3.2	3.6	3.6	3.4
Hong Kong	4.1	4.0	3.5	4.0	3.7	3.7	3.8
India***	7.5	7.0	7.0	7.6	6.0	6.0	—
Indonesia	4.3	4.7	4.7	5.3	4.7	4.7	5.2
Malaysia	1.6	1.7	2.1	2.3	2.4	2.6	2.9
Mongolia	14.3	12.0	12.0	—	10.0	10.0	—
Philippines	3.1	3.5	3.5	3.6	3.8	3.8	4.0
Singapore	4.6	4.0	3.8	3.8	3.4	3.4	3.3
South Korea	2.2	2.6	2.7	2.6	3.0	3.1	2.9
Sri Lanka	7.5	7.1	6.7	7.3	6.5	6.5	6.9
Taiwan	1.9	2.0	2.0	1.8	1.8	1.1	1.9
Thailand	3.0	3.3	3.3	3.3	4.0	4.3	3.4
Vietnam	9.3	7.2	8.2	8.5	7.0	7.5	8.2

Figure 3. Current Account Forecasts (percent of GDP)

	2012 CAB Forecasts	2013 CAB Forecasts			2014 CAB Forecasts		
	Current	Current	Previous	Consensus	Current	Previous	Consensus
Asia-Pacific	1.9	1.5	1.2	0.8	1.2	1.2	—
Asian NIEs*	6.6	5.0	5.1	1.4	5.1	4.6	—
SEAN-4**	0.0	-0.1	-0.3	-0.1	-0.2	0.1	—
China	2.5	2.0	1.5	2.4	1.5	1.5	1.9
Hong Kong	5.0	5.6	5.5	2.4	6.2	6.2	2.3
India***	-4.0	-3.5	-2.1	-3.4	-3.0	-2.5	—
Indonesia	-2.6	-2.0	-1.7	-1.4	-1.5	-1.5	-0.9
Malaysia	5.0	4.0	4.0	5.4	3.3	3.3	5.5
Mongolia	-35.1	-22.1	-10.5	—	3.1	3.0	—
Philippines	2.8	2.2	2.4	2.8	1.1	1.1	2.6
Singapore	16.3	13.9	14.1	16.0	13.3	13.3	15.9
South Korea	3.7	1.4	1.5	2.4	1.8	1.0	2.2
Sri Lanka	-5.5	-4.7	-3.8	-4.7	-4.0	-3.6	-3.8
Taiwan	8.7	8.4	8.4	8.2	8.0	8.0	7.7
Thailand	0.1	-0.4	-2.2	0.8	-0.7	0.9	1.0
Vietnam	3.2	2.4	-0.6	0.0	0.7	-0.9	0.0

Note: * Asian NIEs are Hong Kong, Korea, Singapore, and Taiwan. ** SEAN-4 includes Indonesia, Malaysia, the Philippines and Thailand. Asia-Pacific is Asian NIEs + SEAN-4 + China + India + Mongolia + Sri Lanka + Vietnam, GDP-weighted. *** India Fiscal year runs from April-March and inflation forecasts are Wholesale Price Index.
Source: CEIC Data Company Limited, Consensus Economics (January 14, 2013) and Citi Research Estimates.

Macro Overview

Currency Wars? More Like Currency Skirmishes

The stage is set for rising tensions

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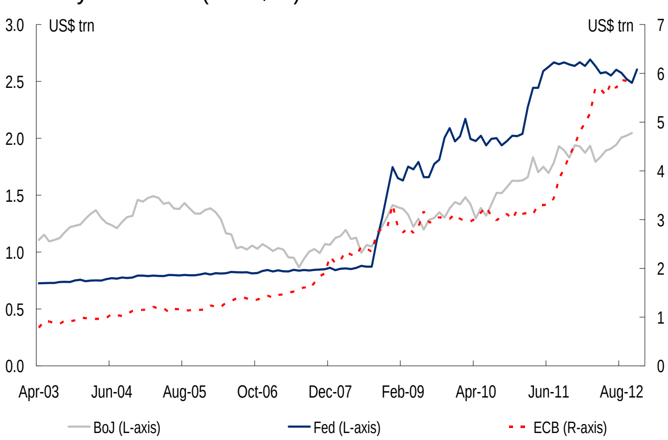
Central banks in advanced economies (AE) are making concerted efforts to boost their economies through increasingly loose monetary policies. Key policy actions taken by the Fed and ECB earlier in September (see *Asia Macro and Strategy Outlook - How Will "QE3" Impact Asia's Policy Stance?*) and by the BoJ more recently (*Post-election Reactions and Opportunities - A Multi-Asset Investment Perspective*) – whether actual or verbal – are meant to safeguard economic growth, partly via the debasement of their fiat currencies relative to those where money is not as easy – EM including Asia. Some countries' sizeable current account financing needs and/or high inflationary pressures would clearly welcome the benefits of AE liquidity injection and capital inflows (e.g. India), but in some external-demand driven economies in Asia, the initial benefits in boosting demand and risk assets could eventually be outweighed by the costs in terms of managing capital flows, financial stability and the potential loss of external competitiveness if there is excessive pressure on real effective exchange rate (REER) appreciation. We loosely define "currency war" as concerted efforts by policymakers to suppress the value of their currency versus another – either via direct intervention or via financial & capital flow regulations.

The shifting drivers of Asia FX appreciation from the lagged impact of central bank intervention in advanced economies, may also be shifting policy response

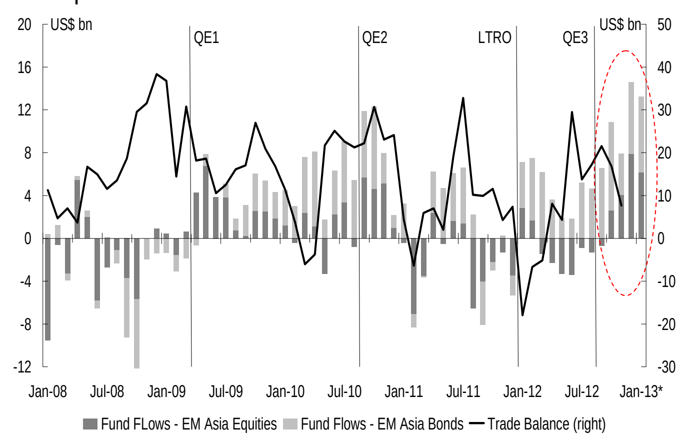
We believe the *rising role of financial* vs. trade flows in driving recent FX pressures will likely shift attitudes towards tolerating FX adjustment. In the initial risk rally in late September to October, Asia FX intervention was surprisingly minimal – even among the historically interventionist central banks – e.g. PBOC, BoK or CBC, which we think is a function of the dominance of trade flows in driving that appreciation.[1] However, this has changed in recent months: For example, EPFR shows 19 consecutive weeks of equity inflows into Asia (as of 16 January), the longest streak since 2006, compounding the already strong bond flows into the region.

Figure 4. Size of Balance Sheet of the Fed, BoJ and the Euro Area Monetary Authorities (in US$bn)



Source: Haver, CEIC, and Citi Research

Figure 5. Relative size of external flows have shifted with the increasing role of portfolio vs. trade flows



Source: EPFR, CEIC, and Citi Research
Note: *We interpolate Jan 2013 by averaging the first three weeks of fund flows into four weeks

[1] See *Asia Macro View - FX Policy: To Intervene or Not to Intervene?* (19 Nov 2012)

Increasing acceptance of participating in "currency war" as more people are doing it

Another factor that could set the stage for a currency war is the declining "stigma" associated with both currency "manipulation" and capital flow management. Rethinking the conventional approach to macro policies (including inflation targeting frameworks and moving towards liberalized capital account) has been widely debated since the global financial crisis. We think a recent IMF report clarifying its institutional view towards using macro-prudential and capital flow management policies (i.e. "capital controls") highlights shifting attitudes about capital flow management as a useful tool in safeguarding against risks associated with volatile capital flows.[2] With central banks in advanced economies themselves pursuing unconventional monetary policies that appear to deliberately weaken their domestic currency, who is in a position of moral authority to mediate currency tensions?

However, we think currency tensions won't be too serious -- more like a skirmish than a war. While there will be efforts to curb outsized FX gains, we think ASEAN countries won't resort to punitive capital flow measures and will let the currency eventually bear some of the adjustment as latent risks to seeping inflation and financial stability concerns make excessive FX intervention increasingly costly. For the current account deficit countries of Indonesia and South Asia, they should be more accommodating to capital flows to meet external financing needs. The more cyclical newly industrialized economies (NIEs) of Korea, Singapore and Taiwan may be more sensitive to yen movements and the risks to external competitiveness, but in Singapore's case, financial stability/property risks are serious enough concerns to make the MAS unlikely to loosen monetary policy via weakening the SGD band. Korea and Taiwan could take some comfort if we see better US-led global growth prospects in 2H 2013 alongside gradual CNY appreciation, which might lead them to take their foot slightly off the pedal and let their currencies adjust as well. We eventually see more room for Won outperformance.

"Abenomics" may be a watershed event

We expect yen to weaken to ¥90- ¥95 against the dollar even amidst our lingering view of Asia FX (sans IDR) going the opposite direction.

Currency debasement is especially sensitive in Asia when it hits closer to home…i.e. when Japan is now the leading advocate! The landslide victory of LDP – securing more than two-thirds of the Lower House along with its coalition partner New Komeito – has dramatically increased the credibility of Prime Minister Shinzo Abe's pro-growth economic policies (dubbed "Abenomics"). Subsequent action by the BoJ and further policy announcements on monetary and fiscal front has dramatically re-set our (and market) expectations about the yen. ***We now expect the yen to weaken to ¥90- ¥95 against the dollar*** (after depreciating more than 11% vs. USD since November) and even PM Abe's top economic advisor, Prof. Koichi Hamada, signaled ¥95- ¥100 as "nothing to worry about". This yen view comes amidst our lingering view of Asia FX appreciation vis-à-vis USD (sans IDR) will persist, driving a dramatic divergence in the JPY-Asia FX crosses.

We believe Korea more distantly followed by Taiwan and Singapore are likely to feel the competitive threat of a weaker yen than others given a more similar export structure to Japan

Exports from Korea, followed by Singapore and Taiwan, are likely to feel the most competitive heat from a significant underperformance of the yen vis-à-vis their currency. To measure which country in Asia faces the most competitive pressure, we estimate their degree of export product overlap with Japan (which we infer will also result in import substitution) by calculating a "*Modified Export Similarity index*", which takes on a value between 0 to 100 – a higher reading indicating a greater export similarity.[3] The modified version uses net (instead of

[2] For details, see http://www.imf.org/external/np/pp/eng/2012/111412.pdf

[3] We first used this index when looking at Asia's export similarity with China --*Asia Macro and Strategy Outlook - Asia Gradually "Normalizing", When Does The RMB?* (26 Mar 2010, see p. 7)

gross) export similarity as earlier studies have shown that highly integrated production chains will likely exaggerate export similarity of countries as there will be an increasingly similar structure of both exports and imports.[4] By measuring export similarity on a *net* basis, only measuring similarity when exports provide positive domestic value added, we reduce this distortion.

Our updated results in Figure 6 show that **Korea**, not surprisingly, has the most similar export structure to Japan, with important overlaps in three major items: road vehicles, transport equipment and electronics, though Korea's recent rising overlap with Japan appears to be driven by growing importance of "iron and steel" and "chemicals". Korea is followed more distantly, by **Singapore** and **Taiwan**, whose export overlap with Japan seems to be concentrated in electronics.

Figure 6. Modified Finger-Kreinin Export Similarity Index* with Japan -- Korea is the most similar followed by SG & TW (we would be cautious in interpreting the Thailand index – see next paragraph)

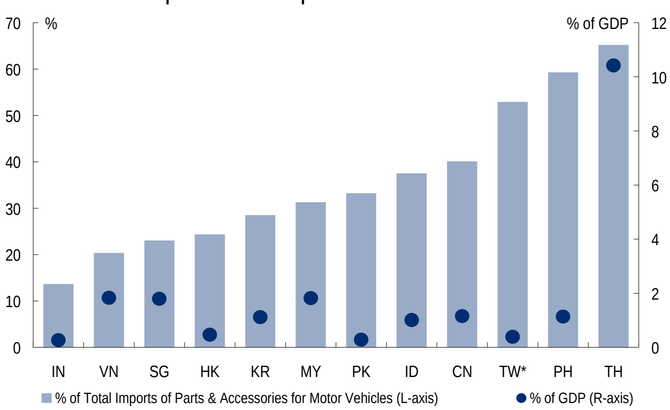
Index	CN	HK	IN	ID	MY	PK	PH	KR	SG	SL	TH	TW	VN
2009	9.0	10.9	9.6	4.3	9.4	0.9	18.9	42.9	27.3	5.2	27.5	26.4	2.2
2010	12.9	11.9	17.5	1.6	2.3	0.0	13.3	54.6	26.0	3.3	28.2	23.6	1.2
2011	17.9	0.6	22.2	2.3	12.2	1.2	18.7	65.3	29.0	2.5	24.3	24.7	—

Source: CEIC, UN Comtrade, and Citi Research
Note: *See J.M. Finger and M.E. Kreinin. "A Measure of Export Similarity and its Possible Uses" The Economic Journal (1979) and revised version used by Australia's Dept of Foreign Affairs & Trade. China's Industrial Rise: East Asia's Challenge (2003) and YW Cheung & XW Qian. Southeast Asia: Similarity in Trade Structures (May 2009). The revised Finger-Kreinin index looks at net export rather than just exports – as noted in the Australia study, when production chains are integrated, exports and imports of the same products could grow together. In this exercise, we go down 2-digit codes for SITC code 6 and 7.

Thailand's high export similarity reading with Japan is largely attributed to autos – but we think this exaggerates competition risks between the two as we believe Thailand is a significant production hub for Japanese automakers in the region -- they are production compliments not competitors.

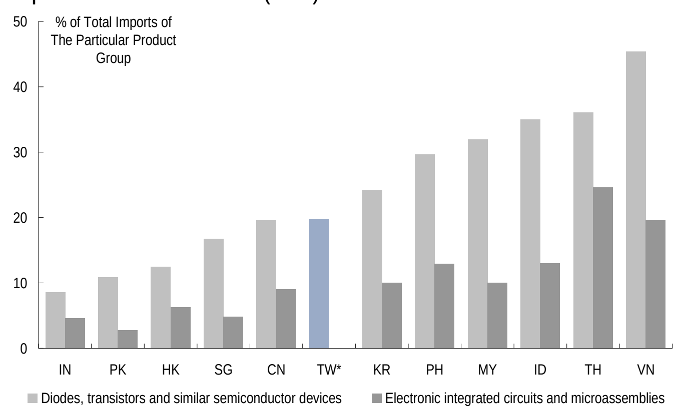
We would be cautious over interpreting Thailand's relatively high export similarity with Japan – we believe this is highly distorted by its own production chain with Japan. Upon closer inspection, the *dominant* item explaining the high export similarity between Japan and Thailand is in road vehicles (commodity code SITC 78). However, we believe this is still highly distorted by vertical integration – Thailand is a significant production hub for Japanese automakers, and this production linkage can be easily seen by the extent to which Thailand relies on Japan for key inputs – in fact, Japan accounts for more than 60% of Thailand's imports of auto parts (see Figure 7).

Figure 7 Imports of Parts & Accessories for Motor Vehicles from Japan, as a % of Total Imports of these products and as a % of GDP



Source: CEIC, UN Comtrade, and Citi Research
Note: *Because UN Comtrade data does not include Taiwan, we supplement our chart with Taiwan's motor vehicle component imports

Figure 8. Imports of Electronic Components from Japan, as a % of Total Imports of These Products (2011)



Source: CEIC, UN Comtrade, and Citi Research
Note: *Because UN Comtrade data does not include Taiwan, we supplement our chart with Taiwan's trade data, under the classification "Electrical Machinery, Equipment and Parts Thereof", which is a broader category than what we used in other countries.

[4] For a sample study, see Australia's Department of Foreign Affairs & Trade. *China's Industrial Rise: East Asia's Challenge* (2003).

In fact, if Japan manages to boost the competitiveness of its products via a weaker yen, this could have positive spillover on countries like Thailand (and possibly Vietnam) who can import cheaper parts from Japan for key exports, and where major overlapping export items are more likely to be complimentary rather than competitors.

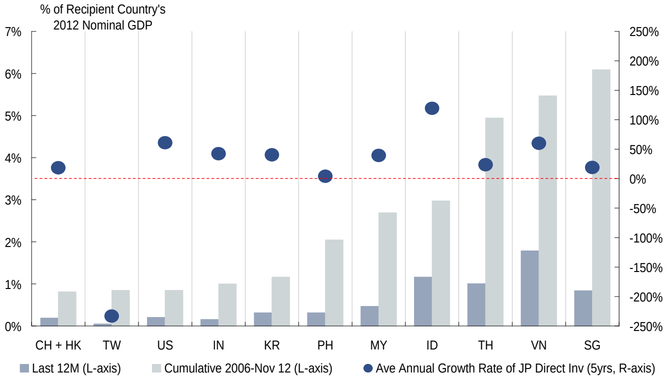
We don't see yen weakness to have significant impact on Japan's ODI into ASEAN (ex SG) or India…

Japan is also a significant source of FDI into Asia – would a weaker JPY-Asia FX cross hinder flows? Answer: Not quite. According to the latest IMF *Coordinated Direct Investment Survey* (CDIS), the inward FDI *stock* of EM Asia coming from Japan accounts for about 15% of total stock of total FDI inflows.[5] Relative to the country's GDP, FDI flows from Japan are more economically meaningful in ASEAN countries – cumulatively highest in Singapore relative to GDP (though that may be distorted by the use of Singapore as a regional hub of Japanese investment eventually be destined to other countries in South and Southeast Asia) and growing fastest in Indonesia (see Figure 9). Between 2005 to June 2012, about 43% of Japan's cumulative outward FDI was in the manufacturing sector and we suspect in EM Asia's case, the ratio is even higher. We don't think yen weakness will significantly dampen JP's ODI into ASEAN (ex SG) or India – well, for one thing, INR and IDR have also been under their own pressure, plus not only are domestic growth prospects strong (in fact, Japan's exports to ASEAN is one of the bright spots of Japan's export story), but there is a still a wide gap in manufacturing production/labor costs which will likely make the lower income Asian countries a complimentary (rather than competing) production hub for Japanese manufacturers.

…but FDI into NIEs look more vulnerable – maybe China at the margin – Singapore's economy may be hurt more, Korea to a lesser extent -- JP's ODI to Taiwan is already falling

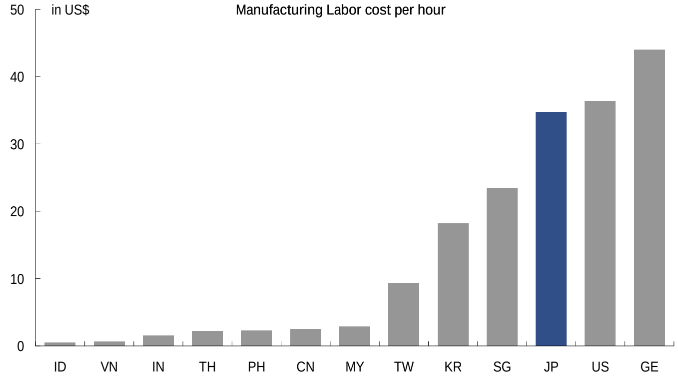
At the margin, we think the Asia NIEs – Singapore, Korea & Taiwan – could see an increasing downward pressure on Japan's ODI, but this is likely only relatively significant economically in Singapore and to a lesser extent, Korea. Outside of ASEAN, Japan's annual ODI into Korea and China (+HK) has surged and that trend could now slow (the share of JP ODI going to HK has risen dramatically vis-à-vis CN in 2012). Meanwhile, Japan's ODI into Taiwan, and more recently Singapore, has already been on the decline – that process could be accelerated by the relative underperformance of yen, not to mention that Singapore's domestic costs pressures over the years have escalated, making it increasingly less competitive in real terms.

Figure 9. Japan's Outward Direct Investment–Cumulative (2006-Nov 12) and Recent Flows relative to GDP



Source: EIU, and Citi Research

Figure 10. Comparing Manufacturing Labor Cost per Hour (2012E, in US$)



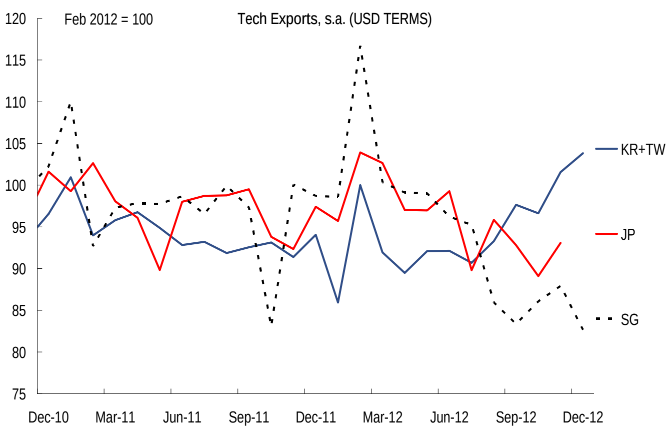
Source: EIU, and Citi Research

[5] We include China and Hong Kong (5% of Total FDI), India (6%), Indonesia (7%), Korea (26%), Malaysia (13%), Philippines (24%), Singapore (8%) and Thailand (31%). Note: Sri Lanka, Taiwan and Vietnam are not included in the IMF CDIS Survey. When we include Bangladesh (7% of Total FDI) and Pakistan (3%), the ratio drops to 13%.

At the margin, Korea probably has the most to lose to yen weakness, followed by Singapore and Taiwan, although currency is not the only competitive tool – we think Singapore already has a head start in losing competitiveness

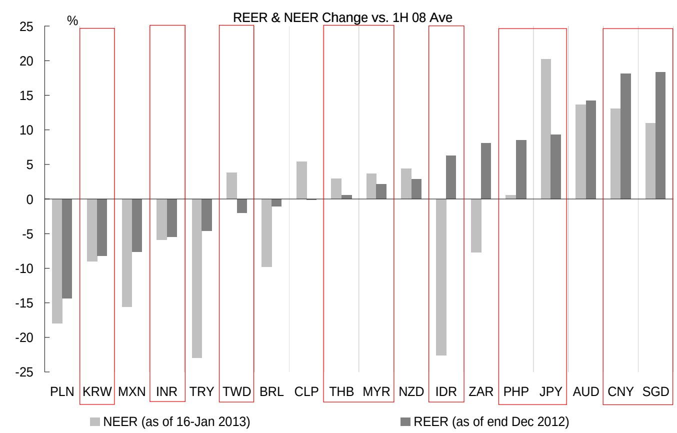
In a nutshell, the highly open Newly Industrialized Economies (NIEs) in Asia – primarily **Korea, Singapore and Taiwan**, likely have the most to lose on a sustained underperformance of the JPY relative to their currency. The main ramification comes from the increased production competition with Japan that could impact exports (more important for NIEs) and direct investment flows**.** While Korea is likely the most exposed given what we believe to be a greater product overlap with Japan, relative currency movements is only one factor among a host of others (domestic factor costs and productivity differentials) that drive market share of key products. So far, we believe at least in electronics, Japan may have a bit more catch-up to do with Korea and Taiwan. On the other hand, there is increasing signs that Singapore is already losing competitiveness in electronics, partly on product segment displacement (e.g. the shift to smartphones) and we also believe domestic cost and supply constraints will increase as Singapore's economy restructures.

Figure 11. Singapore already seems to be losing competitiveness in electronics exports versus competing countries



Source: CEIC, and Citi Research

Figure 12. Comparing REER and NEER Change since Pre-Global Financial Crisis (1H 2008), percent change



Source: BIS, Bloomberg, and Citi Research

Philippines' own currency war: a Special Case

Philippines' concern about FX outperformance differs from the other countries – while competitiveness of goods & services exports is a concern…

Philippines' concern toward PHP outperformance is a special case that deserves a separate discussion. For most of Asia, the worry about FX outperformance is centered on potential impact on export competitiveness and growth. On the other hand, the Philippines has been enjoying a very strong domestic-driven growth momentum, and external growth sensitivity metrics are low vis-à-vis the region, yet BSP has been one of the most vocal in raising worries about capital flows and peso appreciation, and like Korea, has recently been at the forefront of imposing macro-prudential policies to mitigate capital inflows.

… a bigger differentiating factor is the importance of remittances, especially to the most vulnerable segments of society

While goods (and services) competitiveness concerns play some role, we think strong peso concern is also driven by the Philippines somewhat unique structural problems. For a low middle income country, the Philippines level of poverty incidence is high, with a significant proportion of the population mired in unemployment and underemployment, we think partly due to its very weak industrial base and low productivity in the agricultural sector. Among the remittance intensive countries in Asia (Sri Lanka, Philippines, Bangladesh, Vietnam and, to a lesser extent, India), the Philippines is the *only* one where the currency regime is flexible (as opposed to VND) and has a very strong external balance sheet with elevated recurring CA surpluses and net external creditor stator (as opposed to BG, IN, PK and LK) which is partly a function of its structural under-investment. Thus, unlike the

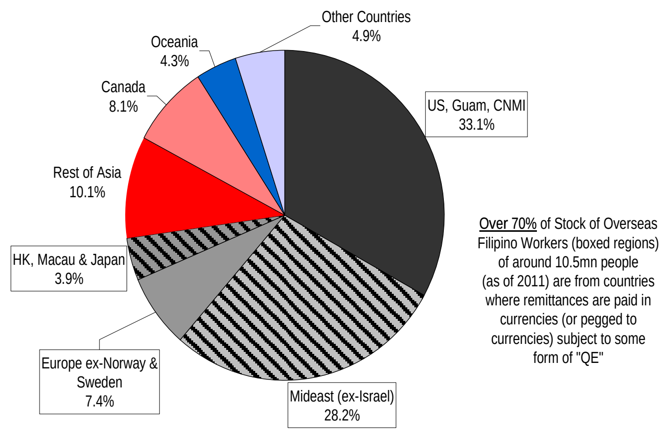
others, it has been facing chronic FX appreciation pressures, for the most part, since 2009. With JPY now joining the ranks of USD, GBP, EUR and CHF where there is concerted effort to suppress the value of their domestic currencies, we estimate that remittances from more than 70% of the stock of Overseas Filipino Workers (~10.5mm people) would be subject to income losses in peso terms if the PHP were to outperform, assuming wages are rigid. Not only would this undermine growth (private consumption accounts for 74% of the economy), but it would also have important income re-distributional consequences, i.e. lower income households will get hit harder. Until there is sufficient domestic job creation, partly via a re-rating of public/private investment leading to enhanced productivity and competitiveness in the economy, we believe concerns about PHP outperformance will remain a lingering concern.

Figure 13. Comparing the Importance of Remittance Flows

	2012E			2007			2001		
Net Remittances	Annual US$bn	Per Capita (US$)	% of GDP	Annual US$bn	Per Capita (US$)	% of GDP	Annual US$bn	Per Capita (US$)	% of GDP
Bangladesh	13.7	91.5	11.6%	6.6	46.1	8.9%	2.1	16.1	4.5%
China	62.7	46.3	0.8%	33.8	25.6	1.0%	5.5	4.3	0.4%
India	65.9	54.0	3.5%	35.2	30.9	2.8%	13.5	13.0	2.7%
Indonesia	4.0	16.4	0.5%	4.5	20.0	1.0%	1.0	5.0	0.7%
Korea	-0.3	-5.0	0.0%	-3.4	-69.8	-0.3%	0.3	7.1	0.1%
Malaysia	-0.6	-20.7	-0.2%	-4.8	-177.7	-2.5%	-0.3	-11.1	-0.3%
Pakistan	13.9	77.7	6.0%	6.0	37.9	4.2%	1.5	10.4	2.0%
Philippines	24.2	247.9	9.6%	16.3	183.4	10.8%	8.7	111.3	11.5%
Sri Lanka	5.7	270.7	9.9%	2.2	110.4	6.8%	1.0	52.9	6.1%
Thailand*	1.7	26.4	0.5%	1.6	24.9	0.6%	1.3	19.9	1.1%
Vietnam	8.5	94.4	6.1%	6.2	72.8	8.7%	1.1	14.0	3.4%

Source: CEIC, World Bank, and Citi Research
Note: In the absence of data, we assume 2012 remittance outflows is the same as in 2011.

Figure 14. Philippines – Geographical Breakdown of the Estimated Stock of Overseas Filipino Workers (as of 2011)



Source: CEIC, and Citi Research

Choosing the "Weapons"

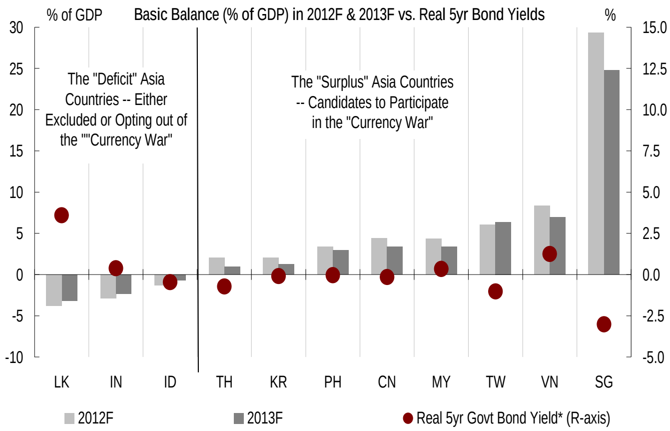
Not all countries will be part of this currency war – some basic balance deficit could face FX depreciation bias, such as IDR, and occasionally, INR & LKR. The latter two are likely to opt out of the war and tolerate more appreciation given their significant previous FX underperformance plus desire for disinflation

As mentioned, we define a "currency war" as concerted efforts by policymakers to suppress the value of their domestic currency versus another. However, **not all countries are facing appreciation pressures**. Some current account and basic balance deficit countries in Asia (from hereon, we dub as the "deficit" countries) can be susceptible to the opposite depreciation bias, especially if domestic policies do not inspire confidence, and end up impeding capital flows. For example, we think the policy paralysis regarding fuel subsidies, BI purchases suppressing domestic bond yields, and concerns about BI's credibility in adjusting both interest rate policy or smoothing dollar shortages, will likely lead to a gradual weakening bias of IDR vis-à-vis other currencies in the region for the most part of this year.[6] Notwithstanding recent FX gains, we also think both INR and LKR could see some occasional reversals given external vulnerabilities. Moreover, with significant FX underperformance since 2011 and high degree of external indebtedness in Sri Lanka's case, they would likely be more accommodating to FX appreciation, especially if it also further enhances disinflationary efforts.

[6] See *Indonesia Macro Flash - Same Trade Deficit, Different Origin: Some Potential Consequences* (8 Jan 2013).

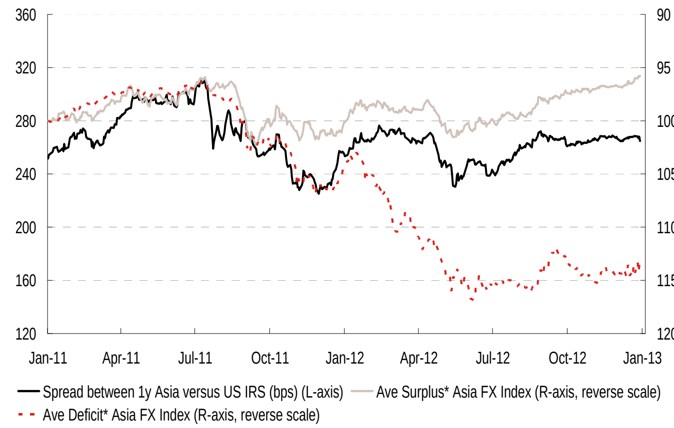
Managing capital flows, with a bias towards inflows, will likely be an increasing challenge to the current account surplus countries in Asia (from hereon, we dub them "surplus" countries). We believe Asia's strong domestic fundamentals alongside positive yield differentials (though may not rise much this year), global liquidity expansion, and improving risk sentiment, will lead to renewed capital inflows into the region in the coming months. We assess their likely policy options:

Figure 15. We need to distinguish between the basic balance deficit and basic balance surplus countries to assess who is more likely to be part of the "currency war"



Source: CEIC, Consensus Economics, and Citi Research
Note: *We discount 5yr bond yields as of 18 January 2013 with consensus average inflation forecast for 2013F

Figure 16. Asia FX Index* versus the Spread between 1yr Asia and 1yr US Interest Rate Swaps (IRS)



Source: Bloomberg, and Citi Research
Note: *We take the average non-pegged spot Asia FX indexed at 100 in Jan 2011- The surplus currencies are the average of CNY, IDR, KRW, MYR, PHP, SGD, THB, TWD, and the deficit currencies is the average of INR, IDR and LKR.

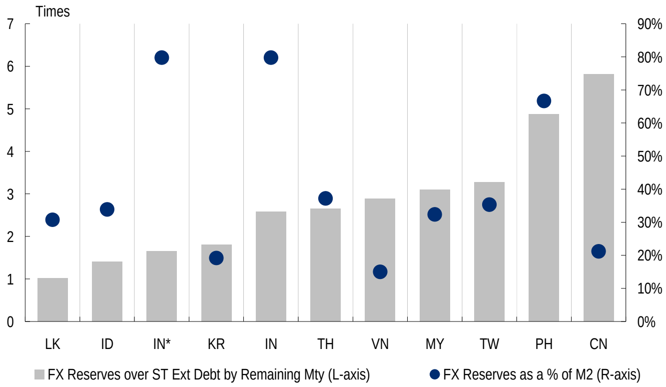
Central banks are already intervening in the FX market – and we believe Korea's incentive to do so remains high – maybe higher than others – and despite high cost to intervention, BSP just got a capital injection from the government and may have more ammunition in the coming months

Weapon #1: Central Bank FX Intervention – expect escalating usage. In recent months, we've seen stepped up Asia FX intervention amid renewed capital flows – especially by the usual suspects – PBOC, BoK, CBC, and BSP (while SGD has been increasingly used as a funding currency – MAS hasn't been tested on our estimates of the SGD NEER band since early January this year). We think still manageable inflation concerns at this juncture (plus targeted use of macro-prudential policies to address financial stability concerns) give them a bit more flexibility to lean on stepped up FX intervention in the coming months.

This weapon is most useful when precautionary reserves motives are still relatively high. Among the Asian "surplus" countries, Vietnam is one of them – despite high reserve coverage relative to short-term external liabilities, a historically fragile banking system would likely warrant increased reserve backing vis-à-vis M2. At the margin, Korea is another – in fact BoK's net forward book had begun expanding in Nov, and together with spot reserves, climbed ~US$16bn from Sep-Dec. Next to HKMA, BoK's international reserves (incl. forward book) rose at the fastest pace (in percentage terms) during this period. However, precautionary motives among other "surplus" countries are very low – reserves are already excessive and increasingly costly in some (PH, MY, TH) more than others (SG, TW) – Philippines has the highest sterilization costs (largely via SDAs) among the surplus "Asian" counties (Figure 18). We think BSP and BoT, at the margin, may be more predisposed to worry about its balance sheet more than PBOC, BoK or BNM. However, BSP has received more "ammunition" lately – the government recently made another P20bn in capital injection to BSP in Dec, helping buffer its escalating losses[7] – and thus, we think this could potentially give BSP increased flexibility to intervene more, especially if perceived to be driven by short-term portfolio flows.

[7] *Philippines Macro Flash - No Liquidity Shock from BSP's Financial Losses Thus Far* (18 Jan 2013)

Figure 17. Gross Official Reserves relative to Short-Term External Debt and as a percent of M2 (as of 2012)



Source: CEIC, and Citi Research
*Note: India including NRI deposits > 1Yr as part of ST external debt. Relative to other countries in EM, this is a particularly significant amount in India that, while classified as long-term external debt, could become a short-term liability of banking sector in times of significant stress.

Figure 18. Estimated average carrying costs of sterilized intervention

	2006	2007	2008	2009	2010	2011	2012
China	-3.2	-1.9	0.7	-0.2	0.7	2.4	2.1
India	7.0	3.7	6.9	6.4	5.6	5.8	4.1
Indonesia	11.9	8.4	9.2	7.5	6.4	6.2	4.4
Korea	-0.3	0.8	2.8	1.4	1.8	2.8	2.8
Malaysia	-1.2	-0.9	1.0	0.9	1.7	2.3	2.7
Philippines	3.0	2.6	3.3	3.4	3.3	4.0	3.8
Singapore	-1.5	-1.7	-1.1	-0.6	-0.5	-0.3	0.0
Taiwan	-3.2	-2.5	-0.4	-0.6	-0.3	0.2	0.5
Thailand	0.1	-0.4	0.9	0.1	0.3	2.1	2.5

Source: Bloomberg, and Citi Research
Note: *Measured as the spread between the main sterilization instrument (CN: 3M PBOC Bills, IN: 1yr MSS, ID: series is a combo of SBI bills and more recent use of TD rates; KR: 3M-12M MSBs, MY: 3M BNM notes, PH: 1M SDA rate, SG: 3M FX Swap & MAS 1yr bill; TW: 3M NCD rate and TH: 3M FX Swap & 1yr Bills) and the average of the US 2- and 3-y Treasury yields

Manageable inflation for most should give many "surplus" countries leeway to stay on hold this year – Korea is the standout case for further rate easing among "surplus" countries

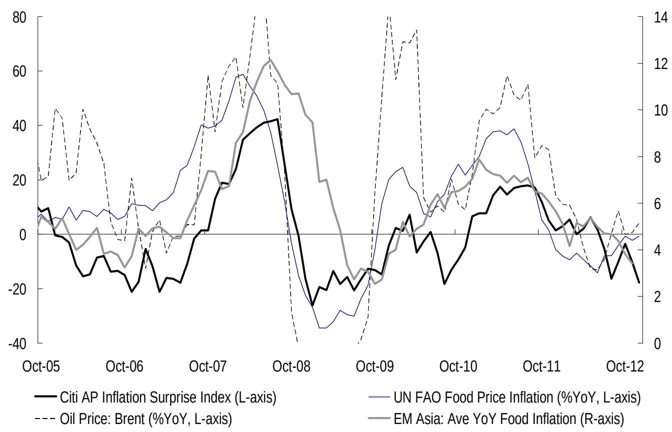
Weapon #2: Keep rates on hold for as long as possible – and cut if you can – the latter is likely only a palatable option in Korea (& Vietnam) among the "surplus" countries.[8] Unlike in the run up to QE2 which came amidst Asia being in the middle of a rate hiking cycle amid rising inflation momentum, we think conditions this time around are far more benign. Recent inflation momentum across the board has been muted, especially when we look at our core metrics – and countries where we saw recent inflation surprising to the upside – China and Thailand – appear to be driven more by some one-off weather related factors. Benign inflation in the region owes much to the lack of sustained pressure from commodity prices like food and oil – usually the major culprit to significant inflation surprises (see Figure 19).

We think Korea could cut 1-2x, but market is only pricing in less than 1 cut

We think the market may be under-estimating rate cut prospects in Korea, at less than one cut. We believe the BoK's move to ease rates have been disrupted in the last few months owing to the December elections. However, the monetary tightening via KRW outperformance amid a weak domestic economy with prolonged negative output gaps should warrant some policy easing bias via lower rates and/or fiscal easing. Inflation should be a secondary concern – BoK already lowered its 2013 inflation forecast to the low end of its target band of 2.5% (Citi: 2.6%), and so far, inflation readings have been at or below consensus for 11 out of the last 12 months. We also think Japan has somewhat changed the game for Korea, and will be another motivating factor to cut another 25bps – either in February or March, and may keep the option open for one more.

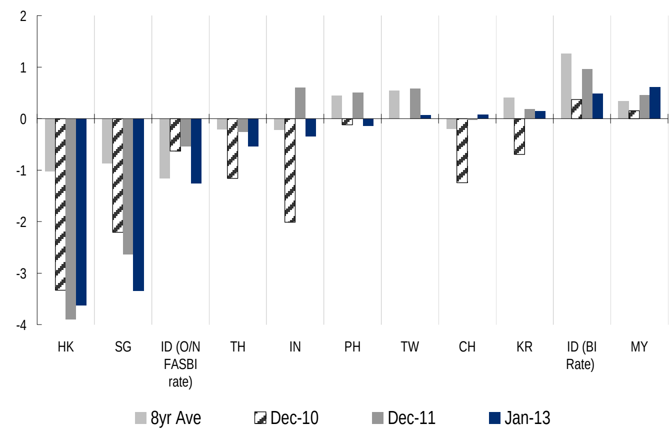
[8] We also expect rate cuts among the "deficit" countries – India and Sri Lanka – but we believe this is unrelated to currency objectives (they want capital inflows) and more motivated by growth concerns.

Figure 19. Headline inflation momentum in the region still remains relatively benign



Source: Bloomberg, and Citi Research

Figure 20. Comparing short-term real interest rate discounted by 12month forward consensus inflation forecast



Source: Bloomberg, Consensus Economics, and Citi Research

Others in "surplus" Asia may likely opt to keep rates low for longer with the exception of Thailand which may have to hike earlier

Others will likely keep rates low for longer, although Thailand (and Indonesia among the "deficit" countries) may not be able to do it for too long. BSP has already tacitly eased by recently cutting 50bps on SDA yield to 3% - a policy move clearly used to reduce sterilization costs and curb peso appeal. Financial stability concerns in Malaysia and structural inflation drivers in China and Singapore are likely going to be significant deterrents to monetary easing. We believe other "surplus" countries outside of Korea will keep rates on hold for longer, partly due to concerns that earlier tightening might exacerbate capital inflows. However, with Thailand's stronger than expected domestic demand growth amid notably negative real rates and an increasingly hawkish central bank, we think BoT may not be able to stay on hold for as long as the others this year.

Weapon # 3: More active use of capital flow measures, sometimes used in the guise of macro-prudential/financial stability objectives. Korea and the Philippines have recently been the most proactive in introducing new "macroprudential" measures that are meant to reduce speculative bids on their currency, mainly via tightening forward position limit for the banks. However, we don't see these as sufficiently deterring either KRW or PHP appreciation amid structural surpluses in their external accounts. We think Korean officials may have the greater proclivity to announce more measures to curb capital inflows. Aside from tightening existing measures, the transition team of President-elect Park is reportedly studying the option of a "Tobin tax" on portfolio-related FX transactions. It's not clear how far this will go (as it may be in violation of OECD capital account rules) but is a sign of growing worries about the won. In the Philippines' case, we think they have more room to liberalize on the outflows which we believe are unnecessarily restrictive given the dramatic shift in its external accounts. In general, we expect Korea, Philippines, Thailand and Taiwan could be candidates for announcing tighter capital-flow related regulations, and such moves could be more pressing for Korea if yen weakness escalates beyond expectations or more pressing for countries in general inflation becomes a growing risk, and thus the need to regain more monetary autonomy.

Figure 21. Recent Regulations on Capital Flows and Potential Future Measures in the Pipeline

	Recent Measures Targeted at Capital Flows	Potential New Measures
	On the Defense	
Korea	(Nov 2012)Announced tighter ceiling on FX forward positions for local banks to 30% from previous 40%, and that for foreign bank branches to 150% from 200%, effective as of Jan 1, 2013.	Could expand on existing measures further: 1) lowering again the general level of ceils on banks' FX forward position; 2) or change the criteria for the ceilings, for example moving from the current the average of the position during past 6 month to the level of which a business day ago or put more weights to the NDF position; 3) raising the bank levy levels (current bank levies are 0.2% for less than 1yr on non-deposit foreign currency liabilities, 0.1% for 1-3yr, 0.05% for 3-5yr, and 0.02% for longer than 5yr or transfer taxes.
Philippines	(Jul 2012) Restriction of non-resident access to accounts linked to the Special Deposit Accounts (SDAs), (Jul-Aug 2012) Tighter monitoring of bank NDF positions, (Dec 2012) Imposed maximum bank limits on NDF transactions with 2 months to comply: 20% of capital for local banks and 100% of capital for foreign banks.	Relaxing regulations pertaining to capital outflows, for example easing the restrictions on selling dollars to offshore entities. BSP may also extend the BSRD (Bangko Sentral Registration Document) requirement not only for 90-day Time Deposit but also for portfolio investments for all types of fixed income instruments.
Taiwan	(Nov 2012) Tighten regulation on reporting FX transactions greater than $1mn -- banks now have to report the transactions to CBC (central bank) before dealing.	Liberalize regulations for overseas investment of Taiwan institutions, especially insurance companies, to encourage capital outflow.
Thailand	(Oct 2012) Announced the "Capital Account Liberalization Master Plan" to encourage overseas investment; remove limits to ODI by Thai individuals, widen institutional investor base and raise limits for outward portfolio investment; remove limit on FCY deposit account, etc.	Lower taxes or grant tax exemption to dividends/profits repatriated from abroad to encourage more capital outflows, could tighten foreign exemptions from paying the 15% WHT.
	Targeting Capital Flows Related to Property	
Hong Kong	(Oct 2012) Announced a new Buyer's Stamp Duty (BSD) on property purchases by any non-HK permanent resident or corporate.	We think that the government could lower the mortgage Loan-to-Value ratio for foreign buyers and corporate/multiple property investors.
Singapore	(Dec 2011) Introduced Additional Buyers Stamp Duty (ABSD) discriminating based on residency status of the buyer (Jan 2013) Raising ABSD unevenly applied to Singaporeans (doesn't impact first property) and permanent residents (covers second property).	Could raise the Additional Buyer Stamp Duty (ABSD) for foreign buyers if the last round of property measures doesn't do the trick.
	The Passive Ones (Potentially May Look at Macro-Prudential Rather Than Capital Flow-Related)	
Malaysia	None.	None.
	General Capital Account Liberalization (Two-Way Flows)	
China	(April 2012) The authorities expanded its renminbi Qualified Foreign Institutional Investors (RQFII) pilot program by increasing the investment quota by 50 billion yuan from the previous 20 billion yuan and also raised the investment quota of Qualified Foreign Institutional Investors (QFII) by $50 billion to $80 billion; (Nov 2012) The authorities further expanded RQFII quota from 70bn yuan to 270bn yuan.	CSRC head has recently said they may increase QFII quota by 9 times. Speed up QFII approvals and facilitate the operation of the QFII program to attract more long-term overseas investment; loosen restrictions to allow more institutions to apply for exchange-traded-fund (ETF) products under a pilot scheme; encourage more two way flows At the same time, we expect to see two way. PBoC m program to allow qualified individual investors to invest offshore (QDII2) could be launched in 2013.
	Welcoming Capital Inflows	
Indonesia	None really.	None (would welcome capital Inflows).
India	(Sep-Oct 2012) FDI reforms on some multibrand retail and pension/insurance (subject to parliamentary approval) and WHT reduction to encourage capital inflows including lower WHT on interest payments on overseas borrowings.	Further widening of the scope of the External commercial borrowing window, Further increasing the FII limits on govt and corporate debt, issuance of dollar bonds targeted to NRIs.
Sri Lanka	(Jul 2012) Liberalized fund transfer rules between Non-resident foreign currency and resident foreign currency accounts; (Sep 2012) increased flexibility of the 12.5% foreign quota rule on T-bills/bonds by allowing this quota to be applied to the combined amount (rather than separately) (Jan 2013) Allowed foreigners to front-load their quota on bonds for the year.	Raise the quota for foreign holdings of Treasury bonds/bills further; take further steps to enhance the attractiveness of foreign investment in corporate bonds.

Source: Factiva, and Citi Research

There are pacifying factors, but are they strong enough?

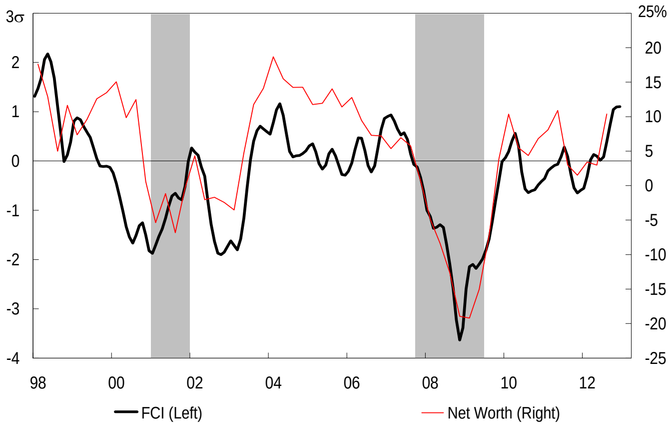
Global economy is undergoing a mild cyclical rebound that is buoying Asia's exports. Prospects for performance in coming quarters have improved as we upgrade our global growth forecasts, led by the US and Japan

First, the global economy is undergoing a mild cyclical recovery with improving prospects. We nudged our 2014F global growth forecast higher at 3.2% (prev. 3.1%). Despite fiscal cliff concerns, US final demand and income gains in 4Q 2012 surprised to the upside, buoyed by supportive financial conditions, and we have subsequently upgraded our 1H 2013 US real GDP growth from 1¼% to 1¾% (full year growth upgraded to 1.9% from 1.6%). We also upgraded our JP growth outlook in 2013 (with upside centered on Q2 13 & Q3 13) to 1.3% (prev. 0.7%), reflecting the impact of the new economic stimulus package – mostly increased public works spending and the stimulative impact of the sharp yen depreciation.[9]

[9] See *U.S. Economics Weekly: Market and Policy Comments - Raising First Half Growth Estimates (11 Jan 2013)* and *Japan Economics Weekly - Economic outlook for 2013: PM Abe to benefit from the cyclical recovery?* (11 Jan 2013)

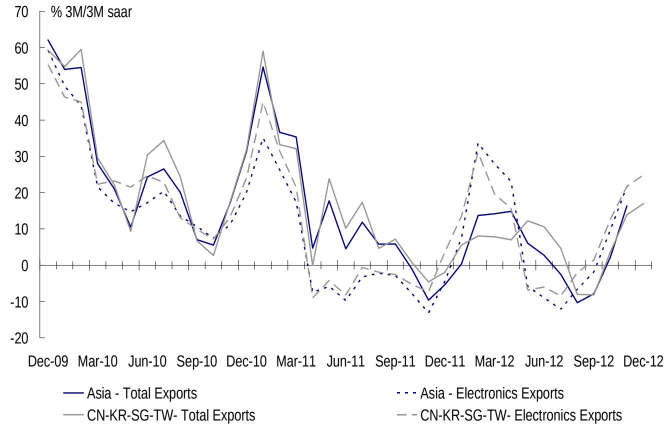
Stronger global growth should be particularly welcome among the more cyclical economies in the region – Singapore, Taiwan, Korea, Malaysia, and Thailand – but among these countries there are already signs that Singapore has been a significant laggard in the manufacturing/export upturn – and there are some concerns that the strength of the recent tech-led export momentum could soften amidst some softening of tech leading indicators and unsustainable outsized gains made in shipping exports to Europe, whose economy is still mired in recession.[10]

Figure 22. US - Final Private Domestic Demand (Year-to-Year Percent) and Citi Financial Conditions Index (Three-Month Average), 1998-4Q 12E



Source: Bureau of Economic Analysis, and Citi Research

Figure 23. Asia's Export Momentum has bounced led by Tech Exports which rebounded as early as August



Source: CEIC, and Citi Research

Our expected modest CNY appreciation should give some offsetting relief to others – especially in Taiwan, Malaysia, Korea and Thailand – but the relief is unlikely to be so significant given the relative bigger projected moves in JPY than CNY

Second, we also think China is going to let CNY gradually appreciate vis-à-vis USD throughout the year – another 2% in 6-12M – which should ease some pressure for the others and help offset some the impact of the yen. We don't think China wants to pursue aggressive FX intervention as this only delays much needed domestic rebalancing (China's trade surplus in 2012 ironically grew 47% YoY to its highest level since 2008, partly also due to the decline in commodity prices) and could create inflation and asset price risks – the latter being an acute concern, warranting greater financial market reforms. With inflation expected to gradually rebound in the 3-3.5% range in 2H 2013, approaching the 3.5% comfort threshold, we expect they will likely tolerate some CNY appreciation to aid in monetary tightening. Such a move should provide a buffer for other countries sensitive to CNY– especially in Taiwan and Korea where intra-China trade almost twice the size of intra-Japan trade share and, especially in Taiwan's case, where the export similarity with China seems much higher (though like in the Thailand-Japan case, could be distorted by production linkages). We also think Malaysia may see a greater offsetting relief as its export overlap with China is higher, not to mention that in Malaysia's case, intra-China trade is more than 3.5x the size of its intra-Japan trade links. However, we note that the expected magnitude of the relative moves may not be much consolation. The yen is forecast to potentially *depreciate* by 18.5% starting in November (assuming it gets to ¥96 in 6-12M) versus the yuan appreciating 2.2% in the same period.

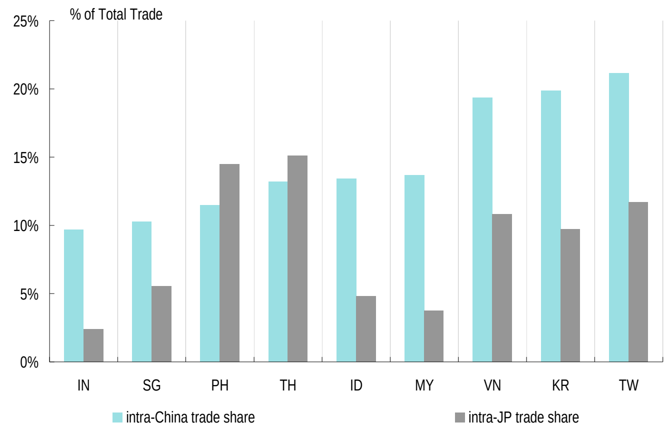
[10] See *Asia Macro Flash - Dissecting Asia's Export Trends* (17 Jan 2013).

Figure 24. Modified Finger-Kreinin Export Similarity Index* with China

Index	2009	2010	2011
HK	58.8	57.5	60.3
IN	62.4	60.6	79.3
ID	23.5	19.5	22.9
MY	56.8	60.8	58.7
PH	53.0	42.0	29.1
KR	46.8	40.1	41.6
SG	23.3	20.2	21.3
SL	48.4	46.1	58.0
TH	57.5	55.9	53.8
TW	52.8	67.9	73.8
VN	47.1	46.8	—

Source: CEIC, UN Comtrade, and Citi Research
Note: See footnote on Figure 6 for more details

Figure 25. Intra China Trade Shares (as a % of Total Trade) are far Higher than Intra-Japan Trade Shares for Most of Asia ex- PH & TH



Source: CEIC, IMF Direction of Trade Statistics, and Citi Research
Note: We look at trade data in 2011 and 1H 2012 and define country *i's* intra-trade share with country *j* as IT Share $i=(X_{ij}+M_{ij})/(X_i+M_i)$ where X_{ij} is exports from region *i* to region *j*, M_{ij} is imports from region *i* to region *j*, X_i is the total exports of region *i* and M_i is total imports from region *i*.

Market Implications

We prefer INR given domestic policy catalysts and attractive carry, plus RBI is unlikely to join the "currency war"

On Asia FX, in the short-term we favor currencies that can be well supported by domestic fundamentals and are unlikely to join the currency war, such as INR. We think India's positive reform momentum – the most recent event being the latest round of diesel price reforms (see *India Macro View - Fuel Reforms – Positive Signal, Bodes Well for Ratings; Implementation Could Lower Subsidy Bill by 0.5% of GDP in FY14*) – will persist in the coming months as the government prepares to announce the widely anticipated FY2014 budget and officials remain determined to restore confidence of the rating agencies. In addition, INR still provides an attractive carry (see Figure 26) and we don't see RBI trying to fight appreciation (though importers may). The pending rate cut is priced-in, but further capital account liberalization and signs of a gradual growth rebound can provide some FX support.

We remain generally constructive towards the rest of the Asian currencies of "surplus" countries – we have a bias towards THB near-term, and KRW, PHP and TWD over the medium-term

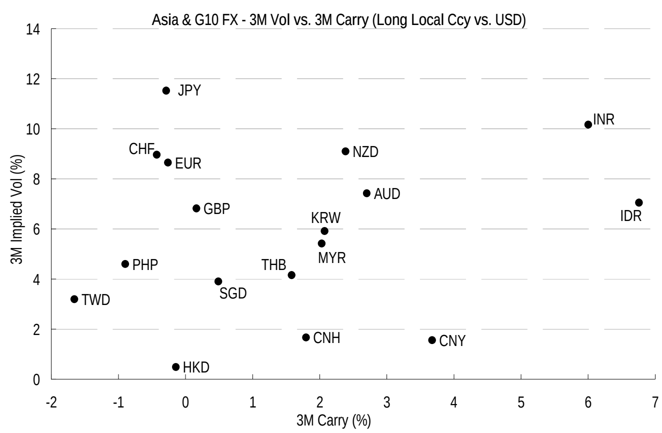
We remain generally constructive towards the rest of the Asian currencies of "surplus" countries – we have a bias towards THB near-term, and KRW, PHP and TWD over the medium-term. Despite growing currency tensions, we think the natural bias of most Asia currencies (ex the "deficit" countries like IDR and eventually INR) is to appreciate vs. USD amid both structural basic balance inflows and improved risk appetite buoying capital inflows. This should also get a further lift from our expected managed appreciation of CNY by about 2% in 6-12M. However, with inflation still contained for many, the strength of sustained export rebound unclear, and yen weakness persisting, we sense we will see growing defensiveness among a few central banks about their currency, particularly BoK, CBC and BSP (plus PBOC may only allow very slow movement in the fix while inflation will likely average below 2.5% in 1Q 2013). However, we think BoT may have less willingness to intervene – not only has growth consistently surprised to the upside but so has headline inflation. While core inflation is still benign and within their target, the risks of second round impact from the minimum wage hike and already very negative real rates cannot be discounted. With BoT increasingly hawkish, they may need to lean more on baht appreciation – as they have already done so recently – to tighten monetary conditions before paving the way for an earlier move to rate normalization this year. Moreover, as mentioned earlier, yen weakness may not be a major issue

for Thailand, and could actually have positive spillovers given high production linkages of Thai's exports to Japanese companies. A weaker yen could end up improving margins of Thai companies with significant reliance on Japanese imported inputs. Over the medium-term, we expect KRW, TWD and PHP will catch up – we believe the former two are still very competitive and should benefit from global growth upside (we are in particular more bullish KRW), while sustained growth resilience and some eventual financial stability/inflation concerns could also improve BSP's tolerance to further adjustment, testing a sub-40 handle on USDPHP

IRS curves in China and Korea could maintain a steepening bias; still biased toward higher yielding bonds like INR bonds, and some frontier markets like LKR and VND bonds

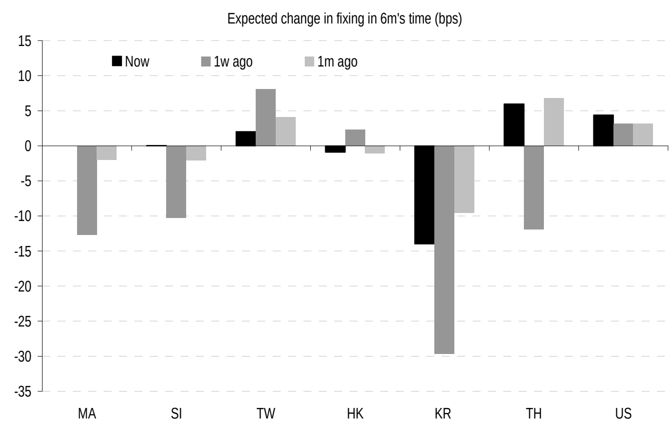
IRS curves in China and Korea could maintain a steepening bias; still biased toward higher yielding bonds like INR bonds and some frontier markets like LKR and VND bonds. Potential for near-term currency appreciation could keep liquidity flush amid some currency intervention (plus some residual room for further BoK easing), while long end rates could underperform amid improving cyclical growth recovery. Meanwhile, flush global liquidity amid concerted "currency intervention" by advanced economies should reaffirm our view favoring high yielding local bonds such as longer duration INR government bonds (also benefiting from expected RBI easing and reform breakthroughs) and also LKR Treasury and VND government bonds.

Figure 26. Asia & G10 FX – 3-Month Vol vs. 3 Month Carry



Source: Bloomberg, and Citi Research

Figure 27. Market Implied Change in IRS Fixing in 6-month's Time*



Source: Bloomberg, and Citi Research
*Note: We calculate the expected change in fixings by a simple linear interpolation between 1y IRS and the fixing – this is not exactly the same as change in policy rate.

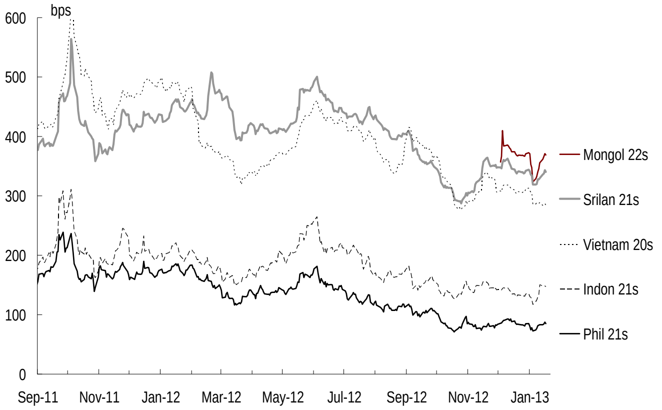
Higher yielding Asia sovereign credits have not fared as well, but may remain weighed in the near-term by sovereign/sovereign-related supply

Higher yielding Asia sovereign credits haven't fared as well – but may remain weighed in the near-term by sovereign/sovereign-related supply. Despite some renewed risk appetite, Mongolia, Sri Lanka and Indonesia have underperformed Vietnam and Philippines (see Figure 28) since the start of the year. We think a very heavy front-loaded supply pipeline out of Asia and expectation of supply from basic balance/current account deficit countries has been a factor (and thus Vietnam is insulated), alongside some domestic concerns (e.g. rupiah volatility). We think these issues may continue to weigh in the near-term, but as the supply pipeline eases we expect them to recover and see some room for spread catch-up.

Our Asian equity strategist notes that valuation multiples are correlated with Asian Central Bank balance sheets

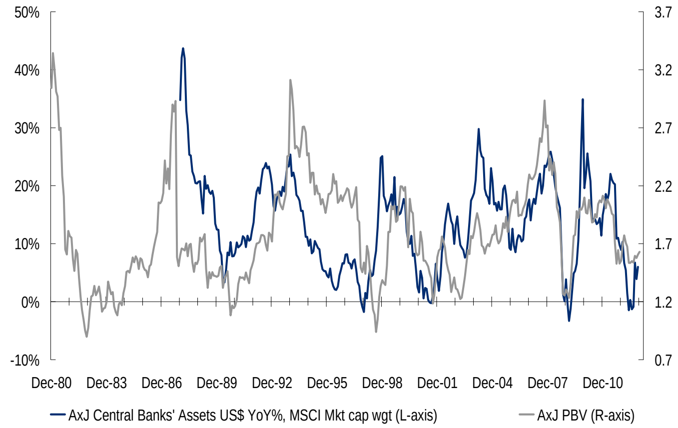
Our Asian equity strategist Markus Rosgen notes that valuation multiples are correlated with Asian central bank balance sheets[11] (which tend to expand on imperfectly sterilized currency intervention). As we are still in the early phase of this cycle, we still see more upside to the Asian equities, and we continue to favor cyclicals (including financials) relative to defensives.

Figure 28. Comparing historical Z-spreads – Yield grab doesn't seem to be translating to the higher yielding sovereigns compression just yet – new supply could provide entry points



Source: Bloomberg, and Citi Research

Figure 29. Asian central bank balance sheets are highly correlated to Asia equity valuation multiples



Source: Haver, MSCI, and Citi Research

[11] See Markus Rosgen *The Asia Investigator - Risk Trade Neither Over-Owned Nor Expensive: It Has Further to Run* (14-Jan-2013).

Asian Currencies & Interest Rate Forecasts

Figure 30. Currency Forecasts and Forwards

	Mkt Data			Forecasts								
vs. USD	24-Jan	3M Fwd	12M Fwd	0-3 Mos	6-12 Mos	Long-term	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14
Euro	1.33	1.33	1.34	1.36	1.32	1.30	1.35	1.34	1.32	1.32	1.31	1.31
Japanese Yen	90	90	89	93	96	90	94	95	96	95	94	93
Chinese Renminbi	6.22	6.28	6.29	6.18	6.10	6.05	6.17	6.14	6.11	6.09	6.08	6.07
Hong Kong Dollar	7.75	7.75	7.75	7.75	7.76	7.75	7.75	7.76	7.76	7.76	7.76	7.75
Indonesian Rupiah	9625	9725	10060	9950	9800	9660	9925	9868	9811	9777	9750	9722
Indian Rupee	53.7	54.7	57.1	53.0	54.0	54.5	53.2	53.5	53.9	54.1	54.2	54.3
Korean Won	1068	1075	1087	1050	1030	995	1047	1039	1031	1024	1017	1010
Malaysian Ringgit	3.04	3.06	3.11	2.99	3.04	3.05	3.00	3.02	3.04	3.04	3.04	3.05
Philippine Peso	40.6	40.6	40.4	40.2	39.9	40.8	40.1	40.0	39.9	40.0	40.2	40.4
Singapore Dollar	1.23	1.23	1.23	1.22	1.20	1.19	1.22	1.21	1.20	1.20	1.20	1.19
Sri Lanka Rupee	127.2	130.0	NA	130.0	130.0	125.0	130.0	130.0	130.0	130.0	130.0	130.0
Thai Baht	29.8	29.9	30.3	29.6	30.5	29.9	29.8	30.1	30.4	30.4	30.3	30.2
Taiwan Dollar	29.1	29.1	29.0	28.8	28.5	28.2	28.7	28.6	28.5	28.5	28.4	28.3
Vietnam Dong	20845	21211	22816	20850	20850	21000	20850	20850	20850	20850	20850	20850

*Forecast as of Citi Foreign Exchange: Forecasts (January 18, 2013)
Source: Bloomberg, CEIC Data Company Limited, Reuters, and Citi Research Estimates

Figure 31. Interest Rate Forecasts (% period end)

		24-Jan	In 3M	In 6M	In 12M	1Q13	2Q13	3Q13	4Q13	1Q14	2Q14
US*	Fed Fund Target Rate	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
	10-Year Treasuries	1.81	NA	NA	NA	1.80	1.95	2.20	2.50	2.65	2.90
EU*	Repo Rate	0.75	0.50	0.25	0.25	0.75	0.50	0.25	0.25	0.25	0.25
	10-Year Bunds	1.52	NA	NA	NA	1.55	1.55	1.75	1.50	1.25	1.50
JP*	Call Money	0.09	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
	10-Year JGBs	0.73	NA	NA	NA	0.80	0.95	0.85	1.05	1.05	0.95
CN	1-Year Deposit rate	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.25	3.50	3.50
	1-Month Shibor	3.86	4.90	4.90	5.22	4.90	4.90	4.90	5.15	5.40	5.40
	Government bond yield (5 -Year)	3.33	3.33	3.33	3.65	3.33	3.33	3.33	3.58	3.83	3.83
HK	3-Month Interbank Rate	0.39	0.40	0.50	0.70	0.37	0.47	0.57	0.67	0.77	0.87
	5-Year Exchange Fund Note	0.41	0.45	0.64	1.08	0.40	0.60	0.75	1.00	1.30	1.50
IN	Overnight Repo Rate	8.00	7.50	7.25	7.25	7.50	7.25	7.25	7.25	7.25	7.25
	Overnight Reverse Repo Rate	7.00	6.50	6.25	6.25	6.50	6.25	6.25	6.25	6.25	6.25
	91-Day T Bill	7.98	7.50	7.50	7.50	7.50	7.50	7.50	7.50	7.50	7.50
	10-Year Gilt	7.89	8.25	8.25	8.25	8.25	8.25	8.25	8.25	8.25	8.25
ID	BI Policy Rate	5.75	5.75	5.75	5.75	5.75	5.75	5.75	5.75	5.75	5.75
	FasBI Rate	4.00	4.00	4.00	4.25	4.00	4.00	4.25	4.50	4.50	4.50
	O/N Interbank Rate	0.00	4.20	4.28	4.66	4.20	4.20	4.50	4.65	4.70	4.70
	10-Year Government Bond	5.20	5.65	5.55	6.07	5.70	5.50	5.70	6.00	6.25	6.00
MY	Overnight Policy Rate	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.25	3.50
	3-Month Interbank Rate	3.21	3.21	3.21	3.26	3.21	3.21	3.21	3.21	3.40	3.60
	5-year MGS	3.21	3.21	3.25	3.33	3.20	3.25	3.25	3.30	3.40	3.50
PH	O/N Rate	3.50	3.50	3.50	3.50	3.50	3.50	3.50	3.50	3.50	3.75
	1-Month Reference Rate	0.21	1.14	1.63	2.64	1.00	1.50	2.00	2.50	3.00	3.50
	5-Year T Bond	3.68	3.78	3.85	3.85	3.75	3.85	3.85	3.85	3.85	4.00
SG	3-Month Interbank Rate	0.38	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30
	10-Year SGS	1.38	1.33	1.45	1.78	1.30	1.40	1.60	1.70	2.00	2.10
KR	BOK Policy Rate	2.75	2.50	2.50	2.75	2.50	2.50	2.50	2.75	3.00	3.25
	91-Day CD	2.84	2.70	2.70	3.07	2.70	2.70	2.70	3.00	3.25	3.45
	5-Year Treasury	2.83	2.78	2.86	3.14	2.75	2.85	2.90	3.05	3.38	3.65
SL	Repo Rate	7.50	7.50	7.25	7.25	7.50	7.25	7.25	7.25	7.25	7.50
	1-Month T-Bills	12.37	12.36	11.87	10.50	12.50	12.00	11.50	10.50	10.50	10.50
	364-Day T-bill	11.25	11.23	10.50	10.00	11.50	10.50	10.50	10.00	10.00	10.00
TW	Overnight Rate	0.39	0.44	0.47	0.53	0.43	0.46	0.49	0.52	0.55	0.58
	Re-discount Rate	1.88	1.88	1.88	1.88	1.88	1.88	1.88	1.88	1.88	1.88
	10-Year Government Bond	1.17	1.20	1.23	1.29	1.20	1.23	1.26	1.29	1.32	1.35
TH	Overnight Repo Rate	2.75	2.75	3.25	3.75	2.75	3.00	3.50	3.75	3.75	3.75
	1-Month interbank Rate	2.79	2.57	2.88	3.50	2.50	2.75	3.25	3.50	3.50	3.50
	10-Year Government Bond	3.72	3.78	3.89	4.18	3.75	3.85	4.00	4.25	4.00	4.00
VN	Refinance Rate	9.00	8.00	8.00	8.00	8.00	8.00	8.00	8.00	8.00	8.00
	1-Month interbank Rate	4.75	7.18	7.00	8.00	7.25	7.00	7.00	8.00	8.00	8.00
	5-Year Treasury	9.75	9.50	9.57	10.00	9.50	9.50	9.75	10.00	10.00	10.00

Note: *Forecast as of Global Economic Outlook and Strategy (January 23, 2013)
Source: Bloomberg, CEIC Data Company Limited, Reuters, and Citi Research Estimates

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- **Summary view** – Recent data in China confirm a mild economic rebound which should continue into 2013 1H in our view. China has entered an era of lower growth initiated by lower manufacturing growth in 2012. Shadow banking and non-performing loans may present risks in 2013.
- **Things to watch** – The road map for urbanisation, the major driving force for China's growth, has not been worked out yet. The government may start up with fiscal reforms to address business burdens and income gaps and the financial reforms toward interest rate liberalisation in 2013.
- **Strategy** – We continue to favour cyclical sectors in 1H this year, including consumer discretionary, airlines, materials, capital goods, insurance and securities. Our top stock picks are chosen based on two key criteria: 1) large earnings upside potential and 2) more room for re-rating.

A mild economic rebound confirmed

GDP growth in Q4 confirms a mild economic rebound — China's GDP grew at 7.9% in Q4, which makes the annual GDP growth at 7.8%. The economic rebound since Q3 is supported by other major economic indicators. December industrial production growth accelerated to 10.3% yoy, the highest since March 2012. Retail sales growth accelerated from 14.9% in November to 15.2% in December, also the highest growth rate since March. China's exports and imports went up by 14.1% and 6% yoy respectively in December 2012, the highest since June. It appears that the economy has bottomed and a hard landing has been avoided.

Slower growth in the manufacturing sector — Production and investment in the manufacturing industries, especially over-capacity industries, have experienced slower growth. Production growth in ferrous metals dropped significantly from 23.2% in August to 19.1% in November, and further down to 12.2% in December, a fall of 7 ppt in a month. Growth in cement production, another over capacity industry, dropped from 9.4% in November to 5.4% in December, down by 4 ppt. China's ytd FAI declined slightly from 20.7% in November to 20.6% in December yoy. By industry, the secondary industry FAI went down from 27.3% in 2011 to 20.2% in 2012, a drop of 7.1 ppt.

Growth slowdown and structural changes in the Chinese economy

A lower growth rate and structural changes marks the beginning of the re-balancing process — China's GDP grew at 7.8% in 2012, the lowest growth rate since 1999. With contribution to GDP growth (7.8%), consumption in 2012 accounted for 4.04%, surpassed investment (3.93%) as the largest contributor to GDP growth. By industry, structural adjustment so far has been marked by decelerated growth in the secondary industry whose growth declined from 10.3% in 2011 to 8.1% in 2012, a drop of 2.1 ppt. While total FAI grew at 20.6%, FAI growth with the secondary industry fell from 27.3% in 2011 to 20.2% in 2012, a drop of 7 ppt. Following a drop in the share of the working age population in 2011, the number of the working age population fell by 3.5 million in 2012. The trend puts downward pressure on China's growth potential.

China's trade growth normalised to single-digit growth in 2012 – Net export contribution to GDP in 2012 recorded a negative 0.17%. The higher-than-expected growth in China's December exports does not change the fact that China's trade growth is returning to normality. On a year-by-year basis, China's export growth declined from 18.7% in 2010 to 14.2% in 2011, and further down to 7.9% in 2012. China's total trade grew by 6.2% in 2012, short of a 10% target set by the government.

Growth of non-bank financing overshadowed loan growth – Chinese banks increased RMB loans by only Rmb454bn in December, bringing the annual total to Rmb8.2tn, much lower than expectations. In 2012, the share of RMB loan in total social financing declined to a historically low level of 52%, while that for trust loans and bond financing rose to 8% and 14%, respectively. For shadow banking, maturity transformation creates risks but Ponzi scheme is an overstatement, as shadow banking has similar underlying assets as those related to bank credits.

Inflation has been under control – December consumer prices rose 0.8%MoM and 2.5%YoY, broadly in line with our estimate. The 0.5 ppt jump in YoY CPI inflation relative to November was mainly caused by food inflation that was related to the coldest December in seven years. PPI fell 0.1% MoM and YoY deflation shrank from -2.2% in November to -1.9% in December. PPI deflation is likely to ease further, as PMI input price index rose from 50.1 in November to 53.3 in December.

Challenges, likely policies and strategy

Deceleration in manufacturing growth is expected to continue in 2013 – Slower manufacturing growth in 2013 and 2014 will likely be driven by de-capacity, an uncertain external demand and rising labour and environmental costs. De-capacity is expected to reduce business earnings, give rise to job losses and lower family consumption.

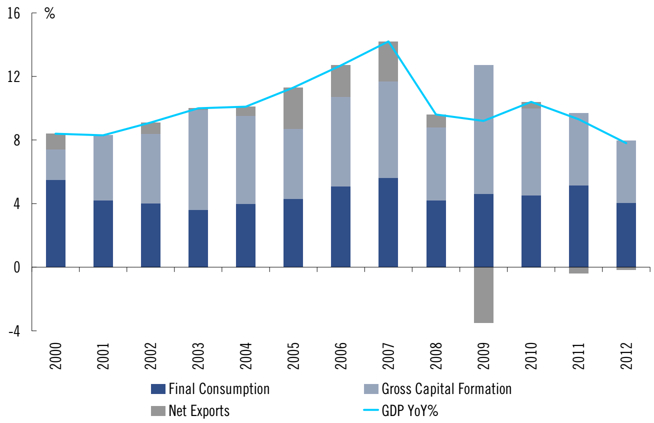
A proactive fiscal policy to reduce business burdens and income gaps – The pilot reform in Shanghai on converting sales tax to VAT has been replicated to more Chinese cities to reduce the tax burdens for the firms in the service as well as manufacturing industries. It is widely expected that government spending on the low income population and on social welfare will be increased this year.

Monetary policies may gradually return to a neutral position – The near-term price outlook remains benign, although we anticipate CPI inflation to rise above 3% in 2H. Given the expansion of shadow banking, we expect the PBOC to be more cautious about credit growth in the banking system. Monetary policy may gradually return to a neutral stance from an easing bias in 2012, and more regulation may be introduced to contain risks in the shadow banking system. The PBOC may set the M2 growth target at 13% this year.

Market outlook – For MSCI China, HSCEI and the A-share index, we estimate the upside is about 15% considering both re-rating and earnings upside, implying 75, 13550 and 2780, respectively. For CS300, we estimate the upside would be about 20%, implying the index level of 2960.

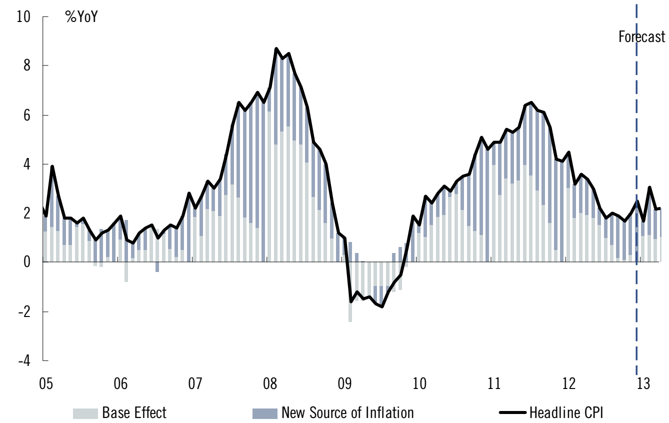
Top picks – We continue to favour cyclical sectors in 1H this year, including consumer discretionary, airlines, materials, capital goods, insurance and securities. Our top stock picks are chosen based on two key criteria: 1) large earnings upside potential, and 2) more room for re-rating.

Figure 32. GDP contributions by expenditure



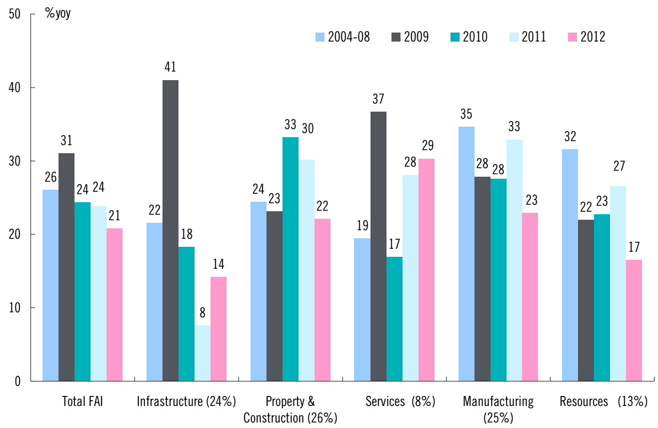
Source: CEIC and Citi Research

Figure 33. . CPI inflation will likely remain below 2.5% in 1Q on average



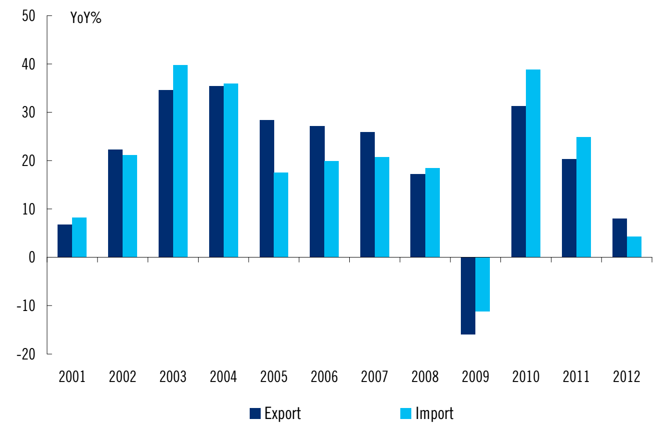
Source: CEIC and Citi Research

Figure 34. FAI by indsutry



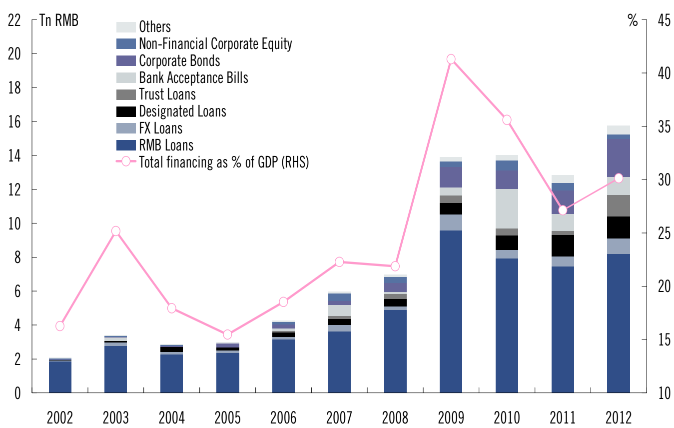
Source: CEIC and Citi Research

Figure 35. Trade growth returns to single digit growth



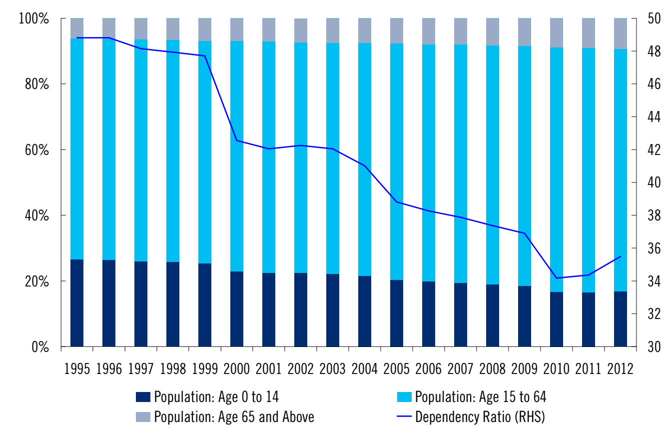
Source: CEIC and Citi Research

Figure 36. Total social financing reached record high



Source: CEIC and Citi Research

Figure 37. Share of working age population dropped first time in 2012



Source: CEIC and Citi Research

Figure 38. China Economic Indicators

	2006	2007	2008	2009	2010	2011	2012F	2013F	2014F
Summary Data									
Nominal GDP, US$ bn	2,787.2	3,494.5	4,544.0	5,070.5	5,932.5	7,319.0	8,244.5	9,255.3	10,348.4
Nominal GDP, local currency bn	22,224	26,583	31,490	34,632	40,151	47,310	51,932	57,048	62,931
GDP per capita, US$	2,120	2,645	3,422	3,800	4,424	5,432	6,089	6,808	7,582
Population, mn	1,314.5	1,321.3	1,328.0	1,334.5	1,340.9	1,347.4	1,354.0	1,359.5	1,364.9
Unemployment, % of labour force	4.1	4.0	4.2	4.3	4.1	4.1	4.1	4.1	4.2
Economic Activity									
Real GDP, % yoy	12.7	14.2	9.6	9.2	10.4	9.3	7.8	7.8	7.3
Real investment growth % yoy	13.6	14.7	11.0	19.2	11.9	9.7	8.4	8.2	7.3
Real consumption growth % yoy	9.8	11.0	8.5	9.4	9.2	10.7	8.2	8.5	8.1
private consumption growth % yoy	11.3	11.1	9.2	10.3	8.5	17.1	8.4	8.7	8.3
Prices, Money & Credit									
CPI, % yoy	2.8	6.5	1.2	1.9	4.6	4.1	2.5	3.5	4.0
CPI, % avg	1.5	4.8	5.9	-0.7	3.3	5.4	2.6	2.8	3.6
Nominal wages, % yoy	14.6	18.5	16.9	11.6	13.3	17.8	9.8	9.9	10.3
Credit extension to private sector, % yoy	14.3	19.3	14.0	33.2	20.3	15.1	14.8	13.6	13.4
Policy interest rate, % eop	2.52	4.14	2.25	2.25	2.75	3.50	3.00	3.25	3.75
1 month inter-bank rate, % eop	2.58	3.61	1.23	1.79	6.17	6.00	4.90	5.15	5.65
Long term yield, % eop	2.62	4.19	1.80	3.06	3.61	3.27	3.33	3.58	4.08
lc/US$, eop	7.81	7.30	6.82	6.83	6.59	6.29	6.23	6.09	6.05
lc/US$, avg	7.97	7.61	6.95	6.83	6.77	6.46	6.31	6.13	6.07
Balance of Payments, US$ bn									
Current account	231.8	353.2	420.6	243.3	237.8	201.7	206.1	185.1	155.2
% of GDP	8.3	10.1	9.3	4.8	4.0	2.8	2.5	2.0	1.5
Trade balance	177.5	264.3	298.1	195.7	181.5	154.9	231.1	205.0	190.2
Exports	969.0	1,220.5	1,430.7	1,201.6	1,577.8	1,898.4	2,048.9	2,205.5	2,452.8
Imports	791.5	956.1	1,132.6	1,005.9	1,396.2	1,743.5	1,817.8	2,000.5	2,262.6
Service balance	-8.8	-7.9	-11.8	-29.4	-31.2	-55.2	-60.8	-66.8	-73.5
Income balance	-5.1	8.0	28.6	-8.5	-25.9	-11.9	-2.0	-0.6	-1.9
FDI, net	102.9	143.1	121.7	87.2	185.7	170.4	157.0	125.6	94.3
International reserves	1,066.3	1,528.2	1,946.0	2,399.2	2,847.3	3,181.1	3,311.6	3,522.2	3,646.7
Total Amortisations	22.1	25.0	30.0	35.0	34.4	38.3	42.1	46.3	50.9
Public Finances, % of GDP									
Consolidated government balance	-1.0	0.6	-0.4	-2.2	-2.2	-1.3	-2.4	-2.0	-2.0
Consolidated gov primary balance	-0.5	1.0	0.1	-1.8	-1.7	-0.9	-2.0	-1.6	-1.6
Public debt	18.6	39.0	37.4	47.8	49.2	44.3	43.7	42.6	40.9
of which Domestic	17.4	38.0	36.6	47.0	48.6	43.7	43.2	42.1	40.5
Foreign Assets & Liabilities, US$ bn									
External debt	338.6	389.2	390.2	428.6	548.9	695.0	764.5	840.9	925.0
Private	304.2	354.3	356.9	391.8	510.1	657.6	723.4	795.7	875.3
Public	34.4	34.9	33.3	36.9	38.8	37.4	41.1	45.2	49.7
External debt / GDP	12.1	11.1	8.6	8.5	9.3	9.5	9.3	9.1	8.9
External debt / XGS	31.9	29.0	24.7	32.2	31.5	33.4	33.9	34.7	34.3
Short-term debt	199.2	235.7	226.3	259.3	375.7	475.7	523.2	575.5	633.1
Short-term debt/International Reserves (%)	18.7	15.4	11.6	10.8	13.2	15.0	15.8	16.3	17.4

Quarterly Economic Indicators

	2012 Q2	2012 Q3	2012 Q4	2013 Q1F	2013 Q2F	2013 Q3F	2013 Q4F	2014 Q1F	2014 Q2F
GDP, % yoy	7.6	7.4	7.9	8.0	8.2	7.7	7.5	7.1	7.2
CPI, % yoy	2.2	1.9	2.5	2.2	2.7	3.1	3.5	3.5	3.3
Policy interest rate, % eop	3.25	3.00	3.00	3.00	3.00	3.00	3.25	3.50	3.50
1 month inter-bank rate, % eop	4.48	3.99	4.90	4.90	4.90	4.90	5.15	5.40	5.40
Long term yield, % eop	2.92	3.24	3.33	3.33	3.33	3.33	3.58	3.83	3.83
lc vs USD, eop	6.35	6.28	6.23	6.17	6.14	6.11	6.09	6.08	6.07

Source: CEIC Data Company Ltd, Fitch, IFS, Moody's and Citi Research estimates
*Note: Public debt is based on official data, not including the local government debt as audited by the National Auditing Office in summer 2011. External debt is based on the residency of the holder of the debt (not by currency denomination).

Hong Kong

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- **Summary view** – Recovery likely firmed up further in 4Q12E given encouraging retail sales and trade performance in Nov. Recent uptick in stock market sentiment and capital inflows, if sustained, could further boost real activities in 1Q13E. We expect 4Q GDP to be at 2.4%yoy and 2.8%yoy in 2013E.

- **Things to watch** – Although no demand side property market curbs were announced in the Policy Address, vigilant policymakers likely will keep property prices stable this year. Inflation likely will bottom out in Jan13 and we expect further inflation relieving measures to be announced in the Budget Speech.

- **Strategy** – HKMA issued more EF bills post it's many rounds of HKD injections to defend the HK peg, more issuances and interventions can be expected. Interest rates likely to remain low given flush liquidity. Our equity strategist target for the HSI Index in FY13 is 22,700.

Positive signs mounting at the turn of the year

Economic recovery appears to be firming up at the turn of the year. Leading indicator, PMI, continues to indicate HK has returned to an expansion mode for the third month, with both output and new orders increasing in December. The equity market has finally seen benefits of capital inflows, post QE3, the US fiscal resolution and market affirming signs of Chinese economy recovery. If these are sustained in the first quarter, both business and consumer sentiments could significantly benefit. Indeed HKD loan growth has started to pick up since November 2012, and anecdotal evidences indicate that this trend turns more apparent in the new year.

Consumer retrenchment appears to have paused entering the festive season. Thanks to tourist spending, luxury items such as watches and jewellery saw solid gains and new tech products were also popular for Christmas. Consumption appears to have started to pick up earlier than we expected; December retail sales will likely suffer from a high base. The large amount of tourist arrivals during the holiday seasons will likely help favour low to middle-end retail goods. Local consumers remain selective, although the unemployment rate surprisingly edged down in December and year-end promotions (including autos) should provide some cushioning. We think the local consumer recovery will still lag, but more meaningful wealth effects from the equity market, and better sentiments associated with China's recovery could become a factor for upside surprise to our 1Q13E GDP estimate of 1.7%yoy.

External demand also saw some light, with broad based recovery. November saw a narrowing of trade balance due to strong export recovery, and we expect December exports could also be upbeat on easier comparison base, last-minute-flown-over tech product exports and continued recovery in Chinese demand. The smaller net export drag on 4Q GDP would be welcomed, but we continue to believe that the expected trade recovery in 2013 is unlikely to come in a straight line.

Inflation likely bottomed out in Jan13. We expect headline CPI could fall in January on high base effects (in particularly food and rent), but the inflation trend could start to pick up in Feb on higher prices during festive celebrations. We also see several other inflation drivers for 2013: 1) higher pass-through from rental increases (reflecting delayed impacts since rents started to pick up in 2013); 2) the increase in minimum wage from HK$28/hour to HK$30/hour in May; and 3) recent liquidity inflows if sustained could add to loans and real demand.

Next 5 years' policy blueprint

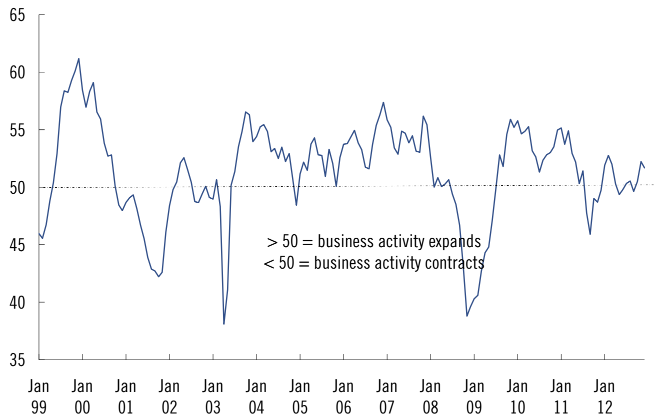
Policy Address (PA) indicates a pro-growth government via innovative measures. The government set economic development and availing affordable housing as the key agenda for the next five years, while tackling issues related to poverty, ageing and environment. Policymakers believe sustaining economic growth is the way to deal with the mentioned issues, and several important facilitation non-official committees were launched. Namely, a new *Economic Development Commission* is being set up to oversee/coordinate HK's long-term development, to act as a policy advisor on how to best take advantage of expanding business opportunities with the mainland. Specific working groups are installed to promote four identified key sectors: 1) Transportation, 2) Convention & Exhibition Industries and Tourism, 3) Manufacturing/ Innovative Technology and Cultural & Creative Industries, and 4) Professional Services. The new *Financial Services Development Council*, which taps on private sector talents, will be responsible to expand offshore RMB business, act as the communicator with regulatory and trade bodies in China and overseas, and explore financial industry developments to promote HK as an international financial centre. Also to maximise existing benefits in the hinterland, a *CEPA Joint Working Group* between Mainland/HK officials will be established to help cut red-taps for the businesses that are liberalized under CEPA framework. The discussion of a 15-year free education system will also be long term positive to productivity and easing of parents' burden.

Adding land supply for building homes. The PA focused on the increase of land for building housing over the medium/long term. A reorganised S*teering Committee on Land Supply* will be responsible to seek for buildable land. In sum, a total of 159K units of housing supply could be launched in the next 5 years, of which 67K for new private developments, 75K for Public Rental Housing (PRH) and 17K for new Home Ownership System (HOS) units. The annual PRH supply target stays at 15K for the next 5 years, but the target will be raised to 20K starting 2018. Officials also mentioned other technical possibilities of faster/earlier pre-sale of private residential developments and launching a vacancy tax on unsold new flats.

Policymakers are still vigilant on home prices. Some market participants read the lack of demand curbs in the PA as a relaxation of/an inability for the government to cool the property market. We, however, think that policymakers are cognisant that home prices in HK remain elevated (despite lower turnovers), continued capital inflows could further worsen asset inflation, Asian-peers (like Singapore) are also on proactive policy mode to cool their property market. Specifically the Chief Executive in the PA and the Financial Secretary subsequently have repeated that they are ready to act if the property market activities turn robust again. We view the current policy thinking as that during times of housing demand/supply imbalance, property purchases by foreign investors, speculators or local multiple property investors will have to pay an additional premium, but will try to minimise the policy impact on genuine end users.

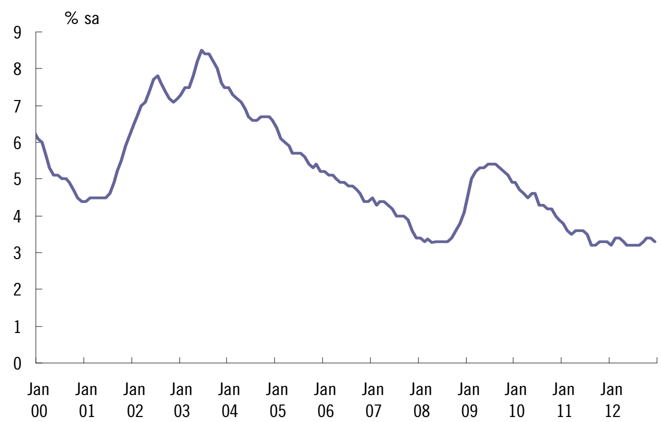
More inflation relief measures likely in Budget Speech on 27 February. The government has committed itself to additional healthcare and disability facilities and several large-scale subsidies for the elderly and phasing out of the old diesel commercial cars. The Financial Secretary will have to allocate additional recurrent expenditure for these in the upcoming budget. In addition, we expect the Financial Secretary to announce more tax benefits to help the lower and middle income class, although direct cash handouts have been ruled out. The existing $2 transport fare concession scheme could also be expanded.

Figure 39. PMI indicates further expansion



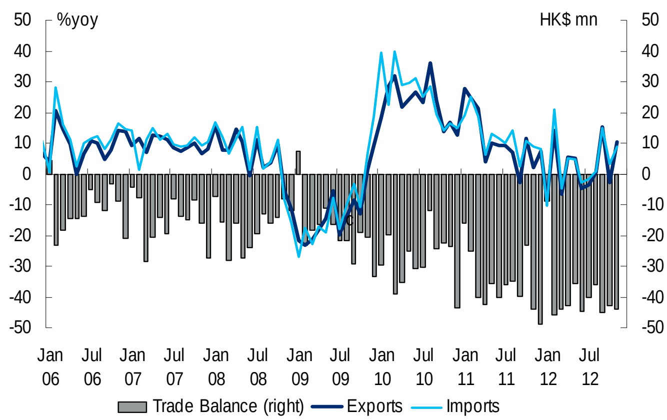
Source: Markit, Haver, and Citi Research

Figure 40. Jobless rate unexpectedly improved



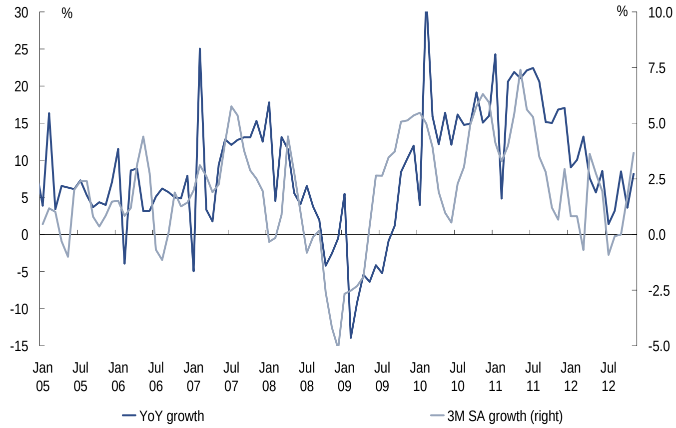
Source: CEIC, and Citi Research

Figure 41. Trade recovery started, but may not be in a straight line



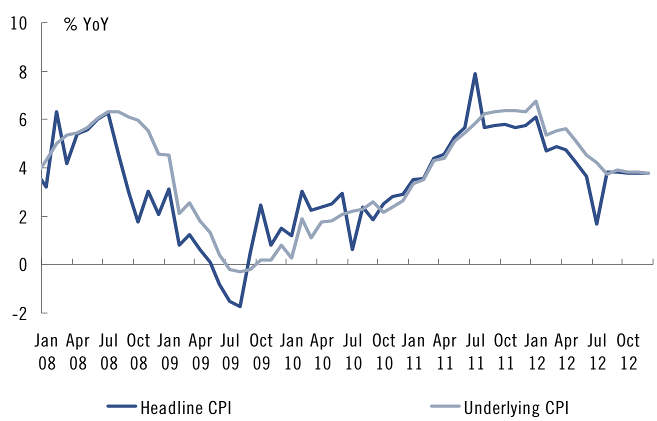
Source: CEIC, and Citi Research

Figure 42. Consumption also warming up earlier than we expected



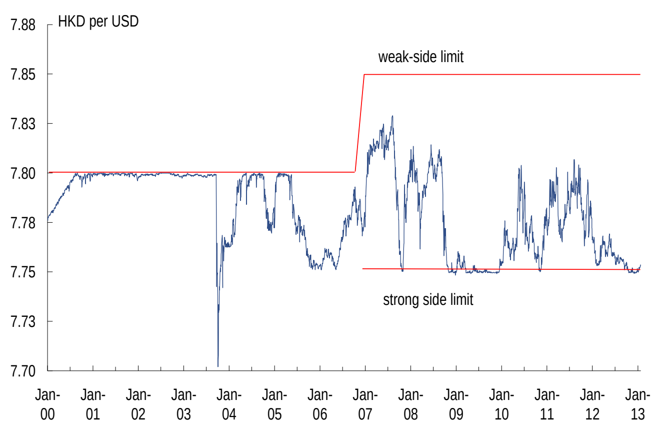
Source: CEIC, and Citi Research

Figure 43. Further disinflation likely in Jan13E on base effects



Source: CEIC, and Citi Research

Figure 44. HKD peg strength likely maintained near term



Source: Reuters, and Citi Research

Figure 45. Hong Kong Economic Indicators

	2006	2007	2008	2009	2010	2011	2012F	2013F	2014F
Summary Data									
Nominal GDP, US$ bn	193.5	211.6	219.3	214.0	228.8	248.6	263.1	281.1	301.7
Nominal GDP, local currency bn	1,503	1,651	1,707	1,659	1,778	1,935	2,041	2,181	2,339
GDP per capita, US$	28,010	30,434	31,375	30,432	32,375	35,157	36,932	39,142	41,673
Population, mn	6.9	7.0	7.0	7.0	7.1	7.1	7.1	7.2	7.2
Unemployment, % of labour force	4.8	4.1	3.4	5.2	4.4	3.4	3.3	3.4	3.3
Economic Activity									
Real GDP, % yoy	7.0	6.5	2.1	-2.5	6.8	4.9	1.4	2.8	3.5
Real investment growth % yoy	8.4	7.8	-0.3	0.9	10.1	1.9	2.6	5.0	2.3
Real consumption growth % yoy	5.4	7.9	1.9	1.0	6.0	7.5	3.7	2.0	2.0
private consumption growth % yoy	6.1	8.6	1.9	0.8	6.3	8.2	3.8	1.9	2.1
Real export growth, % yoy	9.4	8.3	2.5	-10.2	16.8	4.1	1.0	1.8	4.3
Real import growth, % yoy	9.1	9.1	2.2	-9.0	17.4	4.6	1.9	1.7	3.7
Prices, Money & Credit									
CPI, % yoy	2.3	3.8	2.1	1.5	2.9	5.7	3.8	4.0	3.5
CPI, % avg	2.0	2.0	4.3	0.6	2.3	5.3	4.1	4.0	3.7
Nominal wages, % yoy	2.1	2.4	4.0	-1.9	2.4	9.9	5.0	3.5	4.5
Credit extension to private sector, % yoy	2.3	15.2	11.0	-2.1	20.9	12.8	6.0	7.0	8.0
1 month inter-bank rate, % eop	3.84	3.31	0.89	0.13	0.33	0.33	0.50	0.75	1.15
Long term yield, % eop	3.69	3.10	1.19	1.93	1.76	0.96	0.32	1.00	2.10
lc/US$, eop	7.78	7.80	7.75	7.75	7.77	7.77	7.75	7.76	7.75
lc/US$, avg	7.77	7.80	7.79	7.75	7.77	7.78	7.76	7.76	7.75
Balance of Payments, US$ bn									
Current account	24.6	27.6	32.9	20.3	15.0	16.2	13.2	15.8	18.7
% of GDP	12.7	13.0	15.0	9.5	6.6	6.5	5.0	5.6	6.2
Trade balance	-17.9	-23.5	-25.9	-28.9	-43.1	-54.8	-61.3	-52.2	-53.0
Exports	316.8	344.7	363.0	318.7	390.4	429.2	441.2	477.7	522.3
Imports	334.7	368.2	388.9	347.6	433.5	484.0	502.5	529.8	575.4
Service balance	-9.3	-4.3	-2.7	3.4	10.1	19.0	18.0	18.2	18.4
Income balance	4.6	6.8	12.9	6.4	4.8	8.8	7.1	7.1	7.2
FDI, net	-15.5	-19.0	-8.9	-6.4	-10.5	-6.9	-9.8	-11.0	-12.0
International reserves	133.2	152.6	182.5	255.8	268.7	285.4	317.3	340.0	365.0
Public Finances, % of GDP									
Consolidated government balance	3.8	7.3	0.1	1.5	4.1	3.8	0.8	1.1	1.1
Consolidated gov primary balance	3.9	7.4	0.1	1.6	4.2	3.8	0.8	1.1	1.1
Public debt	1.4	1.2	1.0	0.7	0.6	0.6	0.5	1.0	1.3
of which Domestic	0.6	0.4	0.2	0.1	0.0	0.0	0.1	0.2	0.3

Quarterly Economic Indicators	2012 Q2	2012 Q3	2012 Q4F	2013 Q1F	2013 Q2F	2013 Q3F	2013 Q4F	2014 Q1F	2014 Q2F
GDP, % yoy	1.2	1.3	2.4	1.7	2.2	3.4	3.7	3.6	4.9
CPI, % yoy	3.7	3.8	3.8	3.4	4.1	4.0	4.0	4.1	3.6
Policy interest rate, % eop	--	--	--	--	--	--	--	--	--
1 month inter-bank rate, % eop	0.33	0.33	0.35	0.37	0.47	0.57	0.67	0.77	0.87
Long term yield, % eop	0.38	0.32	0.33	0.40	0.60	0.75	1.00	1.30	1.50
lc vs USD, eop	7.76	7.75	7.75	7.75	7.76	7.76	7.76	7.76	7.75

Source: CEIC Data Company Ltd, Fitch, IFS, Moody's and Citi Research estimates
*Note: Public debt is general government debt.

India

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- **Summary view** – The incremental reform momentum is positive with the possibility of further reform on fuel pricing in our view. However, key to note that crucial bills on GST, the land bill and FDI in insurance/pensions are pending. We maintain our FY13 GDP and FY14 GDP estimates of 5.4% and 6.2%, respectively.

- **Things to watch** – (1) The dilemma of the RBI responding to industry demands of lowering rates to boost growth; and (2) measures likely to rein in the fiscal deficit and a credible fiscal consolidation path.

- **Strategy** – Despite WPI moderating and growth now at a 10-year low, we believe elevated CPI levels and the continued shift to physical savings is likely to result in modest monetary easing. As regards to FX, India's high CAD is a major headwind and likely to result in the INR trading in the Rs54-56 range over the next 12 months in our view.

GDP – maintain estimates of 5.4% for FY13; 6.2% for FY14

Looking at GDP by activity, while agriculture is dependent on the vagaries of the monsoons, monthly data in industrial activity has been volatile with the latest factory output reading at -0.1%. However, most high frequency data including 3mma trends in industrial activity clearly indicate a bottoming out, with growth at 2.5% vs near zero readings earlier this fiscal. This is in line with the PMI data which has stabilised over the last four months. We are thus maintaining our FY13 and FY14 GDP estimates of 5.4% and 6.2% respectively.

On the investment side, while the reforms including the setting up of the Cabinet Committee on Investments are positive, the CCI needs to be operationalised. Moreover, key to note is that, with the general election due in FY14, things could slow down a bit a few months prior to the polls. **As regards consumption**, with eight states going to the polls and all eyes on the next general election in 2014, one could expect a continued focus on government welfare schemes. In addition to wage growth, the introduction of direct cash transfers would support consumption

RBI – the dilemma continues; expect moderate easing

WPI Moderates; CPI Remains Sticky: India's headline WPI continued to surprise positively with the December reading at 7.2%. More importantly, manufactured non-food product inflation – the RBI's proxy to core edged closer to the RBI's comfort zone of 4% with the latest reading at 4.2% as compared to 8% readings a year ago. However, CPI remains sticky at ~9%+ due to the high weighting of food and structural factors driving food prices. Given the outlook for commodity prices and that ~57% of India's WPI basket is tradable, lower commodity prices bode well for headline WPI. We expect headline WPI to come in at 6.5%-7% in FY14 vs the 7%-8% readings in FY13. (Total decontrol of diesel could increase WPI by 1%).

Easing Limited to 75bps in 2013: Despite lower WPI, elevated levels of CPI and consequently higher inflation expectations bring to the fore the RBI's dilemma of reducing rates despite growth slowing to a 10-year low. Lower rates could lead to a further diversion of financial savings into physical savings which has resulted in deposit growth at historic lows. We maintain our view that easing will be limited to 75bps in 2013 and expect a 25bps cut in its policy on 29 January.

Fiscal – govt committee to meet its 5.3% target

FY13 Deficit – Government is Committed to a 5.3% Number: On the fiscal deficit, the current run rate for the period April-November indicates the deficit at being 80% of budget estimates. Accounting for expenditure and revenue slippages, we maintain our view of the FY13 deficit coming in at 5.9% of GDP vs. the government's "revised" target of 5.3%. However, the government appears committed to meeting its 5.3% deficit number. Possible ways to achieve it would be (1) a successful re-auction in the telecom space, (2) a deferment of fuel subsidies, and (3) the possibility of compressing plan expenditure. While the current fiscal situation is worrying, the government is taking measures towards fiscal consolidation.

Kelkar Committee and Divestments: While there is ongoing discussion regarding the fuel subsidy, i.e. a monthly or one-off hike, on divestments, the government is considering instruments such as Offer For sale, Call Option Model, Exchange Traded Fund to enable it to meet its divestment targets. The Kelkar Committee has proposes the dissolution of SUUTI (Specialised Undertaking of UTI) which would entail the government selling its shares in key blue-chips. Another proposal is the "use it or lose it" policy for cash-rich PSUs which should be asked to either invest their excess cash, or pay it as dividends to the government.

Cash Transfers: The Aadhaar-enabled system of direct cash transfer of subsidies and welfare payments is scheduled to roll out in 43 districts on 1 January 2013 and is expected to cover 18 states by end-FY13 and remaining 16 states by April 2014. The system would consist of transferring cash to a beneficiary's bank account linked to Aadhaar – a unique biometric ID issued by the government. The Direct Cash Transfer system will play an important rule in reducing inefficiency due to corruption, duplication, and high transaction costs in the transfer of payments to beneficiaries

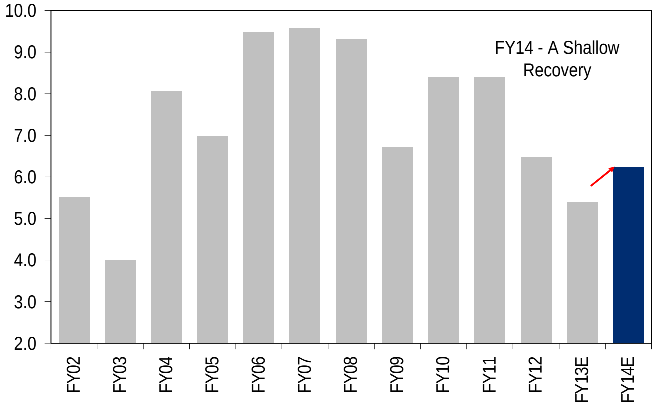
External – high deficits remain a headwind for the INR

Trade Deficit – To Remain Elevated: On the trade account, in line with both market and Citi expectations, the global slowdown is taking its toll on exports (both merchandise and software). As mentioned earlier, given the changing composition of India's exports, exports are more sensitive to global demand rather than the INR. As regards imports, despite the economy being on a lower growth trajectory, India's inelastic oil demand and rising gold prices have resulted in the trade deficit remaining elevated. A quick re-cap: oil accounts for ~30% of India's import bill while gold currently accounts for ~10% of the bill.

Invisibles – Begin to Moderate: While India's trade deficit – led by oil and gold – was key to the deterioration in the CAD to 4.2% in FY12, the moderation in invisible earnings in FY13 is an unpleasant surprise. Historically, invisibles, led by remittances and software exports, have partly cushioned the impact of a rising CAD. However, in addition to the slowdown in software services – a result of global developments, given the rise in external private sector debt – investment income outflows, primarily interest payments, have more than doubled in the last few years

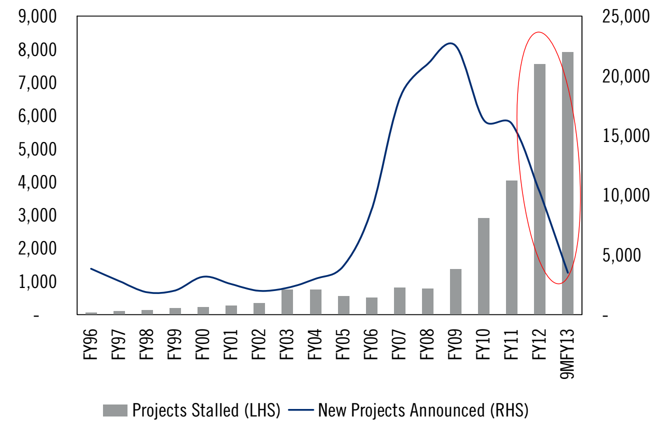
Elevated CAD to remain Headwind for the INR: The high trade deficit and moderation in invisibles is likely to result in headline levels of the CAD remaining over US$75bn in FY14 in our view, though rising nominal GDP is likely to rein it in at 3.5% of GDP. The high CAD is likely to limit any reserve build-up and consequently, we expect the INR to trade in the Rs54-Rs56 range over the next 12 months

Figure 46. GDP – expect a shallow recovery (%)



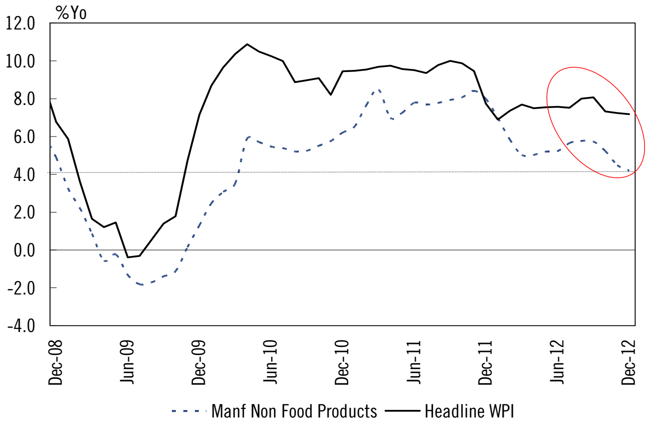
Source: CSO, and Citi Research

Figure 47. As projects cancelled and announced stay high (Rs bn)



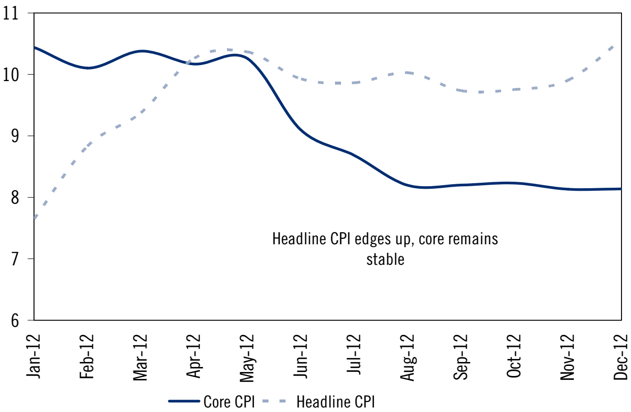
Source: CMIE

Figure 48. WPI – headline and core surprise positively (%)



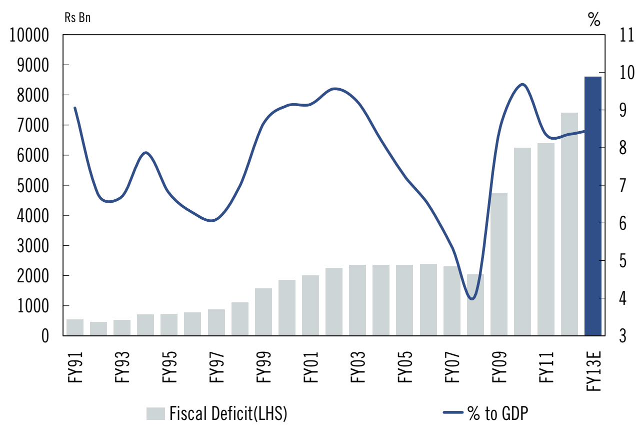
Source: Office of the Economic Advisor

Figure 49. But elevated CPI to limit easing to 75bps in 2013



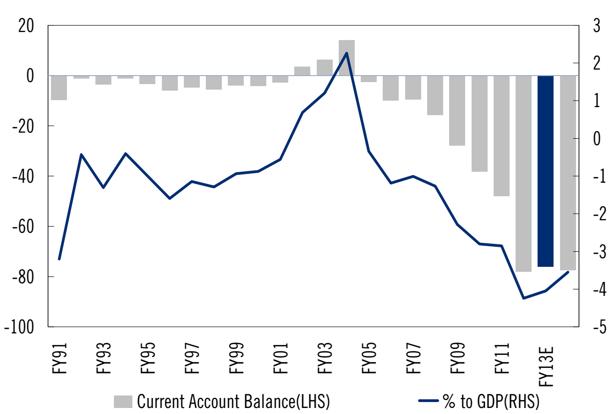
Source: Bloomberg

Figure 50. Fiscal Consolidation – Key for Ratings (Rs bn, %)



Source: Budget Documents, and Citi Research

Figure 51. Elevated CAD – Headwind for the INR



Source: RBI, and Citi Research

Figure 52. India Economic Indicators

	FY07	FY08	FY09	FY10	FY11	FY12F	FY13F	FY14F	FY15F
Summary Data									
Nominal GDP, US$ bn	950.2	1,240.6	1,223.9	1,362.3	1,683.7	1,841.1	1,877.8	2,179.6	2,508.2
Nominal GDP, local currency bn	42,947	49,871	56,301	64,574	76,741	88,558	101,399	116,609	132,934
GDP per capita, US$	847	1,090	1,061	1,164	1,420	1,532	1,539	1,760	1,996
Population, mn	1,122.0	1,138.0	1,154.0	1,170.0	1,186.0	1,202.0	1,220.0	1,238.3	1,256.9
Economic Activity									
Real GDP, % yoy	9.6	9.3	6.7	8.4	8.4	6.5	5.4	6.2	6.9
Real investment growth % yoy	13.4	18.1	-5.2	15.6	11.1	5.3	4.6	5.1	7.4
Real consumption growth % yoy	7.9	9.3	7.6	8.1	8.1	5.4	5.0	5.7	6.6
private consumption growth % yoy	8.7	9.2	7.1	7.0	8.1	5.5	5.0	5.5	6.7
Real export growth, % yoy	19.9	5.9	14.4	-4.1	22.7	15.3	8.0	15.0	11.0
Real import growth, % yoy	21.3	10.2	22.7	-2.0	15.6	18.5	6.0	10.8	9.5
Prices, Money & Credit									
WPI, % yoy	6.8	7.7	1.5	10.6	9.7	7.7	7.5	7.0	6.0
WPI, % avg	6.5	4.8	8.1	3.8	9.6	8.9	7.5	7.0	6.0
Credit extension to private sector, % yoy	28.5	23.0	19.0	16.0	17.0	17.5	17.5	17.5	17.5
Policy interest rate, % eop	7.50	7.75	5.00	5.00	6.75	8.50	7.75	7.50	7.50
1 month inter-bank rate, % eop	9.43	8.00	5.68	4.49	7.25	6.50	6.50	6.50	6.50
Long term yield, % eop	7.98	7.96	7.01	7.83	7.99	8.25	8.25	8.25	8.25
lc/US$, eop	44.12	39.41	48.62	46.41	44.71	53.02	55.00	54.08	54.48
lc/US$, avg	45.19	41.18	43.42	48.30	45.68	46.63	53.38	53.68	54.33
Balance of Payments, US$ bn									
Current account	-9.6	-15.7	-27.9	-38.2	-48.1	-78.2	-76.0	-77.3	-74.7
% of GDP	-1.0	-1.3	-2.3	-2.8	-2.9	-4.2	-4.0	-3.5	-3.0
Trade balance	-61.8	-91.5	-119.5	-118.2	-127.3	-189.8	-188.4	-193.8	-208.1
Exports	128.9	166.2	189.0	182.4	256.2	309.8	291.2	314.5	345.9
Imports	190.7	257.6	308.5	300.6	383.5	499.5	479.6	508.3	554.1
Service balance	29.5	38.9	53.9	35.8	44.1	64.1	62.0	64.1	73.1
Income balance	-7.3	-5.1	-7.1	-8.0	-18.0	-16.0	-17.0	-17.0	-11.0
FDI, net	7.7	15.9	19.8	18.0	11.8	22.1	22.0	27.0	29.0
International reserves	191.9	299.1	241.6	252.8	273.7	260.9	262.5	264.7	269.7
Total Amortisations	11.4	14.9	15.6	19.1	18.7	22.8	23.0	18.7	19.9
Public Finances, % of GDP									
Consolidated government balance	-5.4	-4.1	-8.4	-9.7	-8.3	-8.4	-8.5	-8.0	-7.5
Consolidated gov primary balance	0.0	-1.1	3.4	4.7	2.7	2.3	--	--	--
Public debt	79.9	76.1	76.8	75.8	70.7	69.9	67.6	66.8	66.2
of which Domestic	74.7	71.4	72.2	70.8	66.0	65.9	63.2	63.0	62.8
Foreign Assets & Liabilities, US$ bn									
External debt	172.4	224.4	224.5	260.9	305.9	345.4	360.4	375.4	390.4
Private	123.0	166.3	168.6	193.9	227.9	263.5	278.4	291.4	304.4
Public	49.4	58.1	55.9	67.1	78.1	81.9	82.0	84.0	86.0
External debt / GDP	18.1	18.1	18.3	19.2	18.2	18.8	19.2	17.2	15.6
External debt / XGS	86.1	88.5	77.7	95.1	79.8	76.1	--	--	--
Short-term debt	28.1	45.7	43.3	52.3	65.0	78.2	83.2	88.2	93.2
Short-term debt/International Reserves (%)	14.7	15.3	17.9	20.7	23.7	30.0	31.7	33.3	34.6

Quarterly Economic Indicators

	2012 Q2	2012 Q3	2012 Q4F	2013 Q1F	2013 Q2F	2013 Q3F	2013 Q4F	2014 Q1F	2014 Q2F
GDP, % yoy	5.5	5.3	5.3	6.1	6.1	6.0	6.3	6.4	6.4
WPI, % yoy	7.6	8.1	7.2	7.0	7.0	6.8	6.5	7.0	7.0
Policy interest rate, % eop	8.00	8.00	8.00	7.50	7.25	7.25	7.25	7.25	7.25
1 month inter-bank rate, % eop	8.50	8.50	8.50	8.00	8.00	8.00	8.00	8.00	8.00
Long term yield, % eop	8.25	8.25	8.25	8.25	8.25	8.25	8.25	8.25	8.25
lc vs USD, eop	55.51	52.86	55.00	53.17	53.55	53.93	54.08	54.18	54.28

Source: CEIC Data Company Ltd, Fitch, IFS, Moody's and Citi Research estimates
*Note: Public debt is general government debt and external debt is based on the residency of the holder of the debt (not by currency denomination).

Indonesia

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- **Summary view** – We maintain our growth forecast of 6.1% in 2013 but raise our headline inflation forecast to 5.5%, from 5% previously, on increasing cost pressures.
- **Things to watch** – Excluding oil and gas, the trade balance has improved in recent months. However the overall trade deficit has been increasingly pushed by the worsening deficit in the oil and gas trade. Perceived policy paralysis on both the government and central bank can negatively affect portfolio flows.
- **Strategy** – Over a 6-12m horizon, exports should gradually recover further, providing some slack on the trade balance. However in the near term, we expect to see continued pressure on the IDR (0-3M forecast 9,950/$). Our call on rates remains for 2 x 25bps hike in 2H13, with risk of it coming sooner.

Inaction on fuel subsidies adding pressure on IDR

Non oil and gas trade balance has seen improvements. In recent months, net exports of non-oil and gas commodities have stopped deteriorating and even slightly recovered. This is amid modest improvements in the prices of export commodities e.g. coal and iron ore. Furthermore CPO prices have also rebounded from late December. On the import side, the contribution to growth of capital goods imports to overall import growth has also been subsiding. Although domestic-oriented capital goods imports, e.g. aircraft, remains visible, imports of mining-related heavy equipment and trucks have weakened considerably.

Current account deficit still expected to improve this year, but no sharp turnaround. Overall we still expect commodity exports to see a moderate rebound this year amid a recovery in prices and demand. Meanwhile the risk of surging non-oil import growth seems increasingly capped. Following a string of anti-dumping safeguard tariffs, e.g. on metals, ceramics, etc. last year, the trade ministry has introduced regulations to manage imports on mobile phones, electronics, textiles and toys early this year. However, the pace of narrowing of the CA deficit may not be as quick as we had initially projected. We now forecast the CA deficit at 1.9% of GDP this year (from our previous forecast of 1.7%).

Conservative forecast stems from risk of worsening oil and gas trade deficit. The oil trade deficit worsened to a record high $1.4bn in November 2012. Last year, national oil lifting dropped 3% from the previous year to around 861kbpd. However, consumption of subsidised fuel continued growing strongly by 8% YoY, amid the government's insistence to maintain subsidised fuel prices at Rp4,500/l (or nearly half its economical price). Separately the net volume of gas exports has also been declining amid high inventories in destination countries, growing industrial usage domestically, as well as lack of investment in needed infrastructure.

Assertive policies needed to curb fuel consumption but remain far-fetched. The government has been reluctant to cap subsidies on apparent political considerations. Yet the need to reduce profligacy of transportation fuel consumption, i.e. through significant rationing or price hikes, has become more imperative from both the trade balance and fiscal perspectives, in our view. In 2012 energy subsidies hit Rp306tn and are now equal to 87% of non-tax revenue, up from around 54% in 2007. The status quo looks unsustainable in our view; the energy needs of industry are likely to grow further as consequence of industrial revitalisation.

Risk of perceived policy paralysis in the near term

Perceived risk of policy paralysis could spread to both government and BI. With the trade deficit recently being exacerbated by the energy accounts, monetary policy also risks being reactive instead of pre-emptive. BI has so far let the IDR weaken gradually, but tolerance may run thinner as the IDR drifts closer towards 10,000/$ (a key psychological level). Meanwhile in regard to interest rates, BI may view the external imbalance increasingly as a result of imprudent energy policies hence see no need to respond with a tighter policy stance. After all, following new macroprudential policies last year, YoY credit growth has slowed to the low 20% region as of end-2012. Investment credit growth also remains faster vs consumption credit, as BI desires.

FX view positive 6-12m, but cautious near term. While our 6-12m view on the IDR (Rp9,800/US$) is relatively benign, we see risk of the IDR weakening further in the near term (0-3m forecast: Rp9,950/US$). The status quo or policy inaction could raise the tail risks on the BOP and exert continued pressure on IDR. This is by potentially exacerbating portfolio investment outflows in any reversal of sentiment, which could be triggered by unfavourable trade and current account data points.

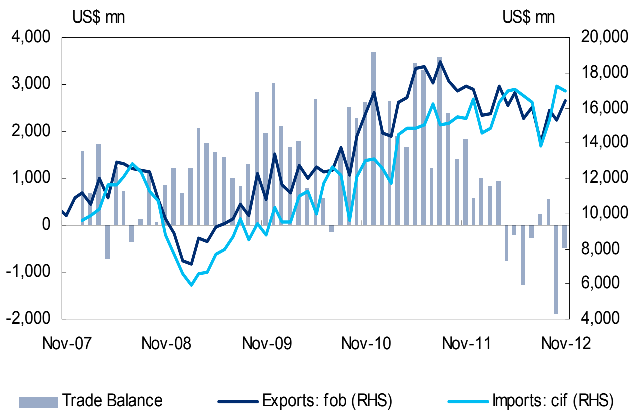
A positive surprise if the government suddenly decides to act on fuel prices. A fuel price hike would have a negative impact on inflation but may reduce concerns over the trade balance and currency risk, depending on the magnitude. A fuel price hike of significant magnitude (e.g. 30%), however, is unlikely to come without warning, in our view. It would likely be preceded by discussions with parliament to form a compensatory social safety net programme, as in previous instances. An exception would be if the fuel price hike proposal is mild (e.g. 10%). However, we caution that a too mild fuel price hike may not yield the desired results in terms of curbing fuel import growth.

Inflation subject to increasing cost pressures

Raising our forecast of headline inflation to 5.5%, from 5% previously. This is to account for rising cost pressures next year; e.g. from minimum wage increases. In case fuel prices are raised e.g. by 30% (contrary to our baseline of no hike), we think headline inflation could rise further towards 7.5%-8.0% depending on the timing. However judging from past experiences, we do not think the impact to economic growth would be dramatic (seeing only a mild drop to our 6.1% baseline FY13 GDP growth forecast), especially if financial sector stability can be maintained. See *Indonesia Macro View - That Was Then, This is Now: Lessons from 2008 Fuel Price Hikes*, 19 March 2012.

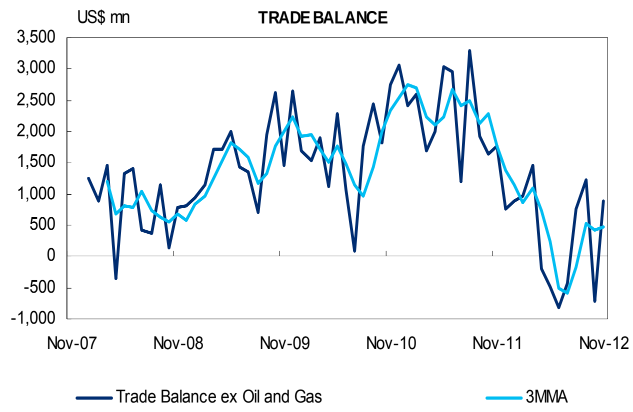
Baseline expecting 2 x 25bps hike in rates in 2H13, but forthcoming data releases could spark earlier move. BI has been hesitant to raise rates in response to the external imbalance, as the capital account surplus has so far been able to offset the current account deficit. However while the FDI outlook is still positive, we caution that portfolio inflows are affected by sentiment which could worsen if perceptions of policy paralysis heighten and trade data outcomes remain unfavourable. The 4Q12 current account data, which is expected to show a deterioration from 3Q towards 3% of GDP, will be released in early-mid February and should be watched as a potential trigger for an earlier than expected hike in the FasBI rate.

Figure 53. Trade balance dipped back to deficit in Oct and Nov...



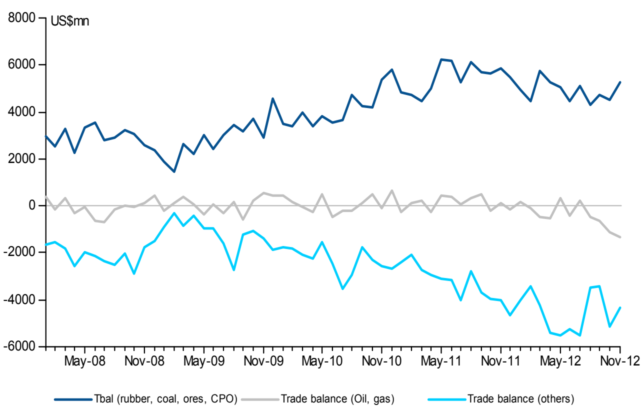
Source: CEIC, and Citi Research

Figure 54. ...but deterioration of trade balance ex O&G has subsided



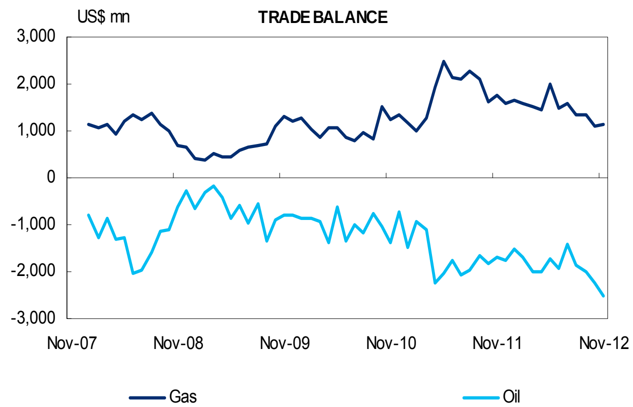
Source: CEIC, and Citi Research

Figure 55. Deterioration in non-O&G commodity t.balance subsiding



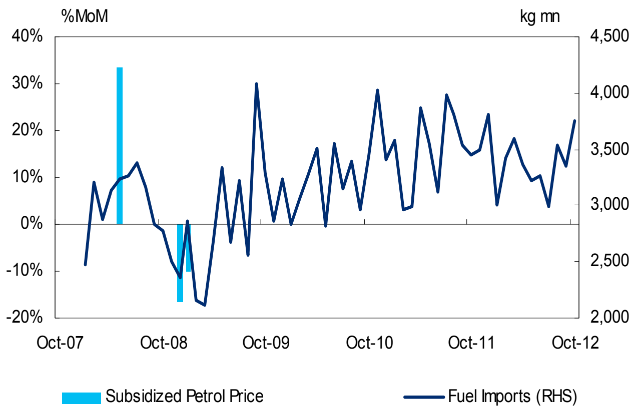
Source: CEIC, and Citi Research

Figure 56. Both the oil and gas trade balances have worsened



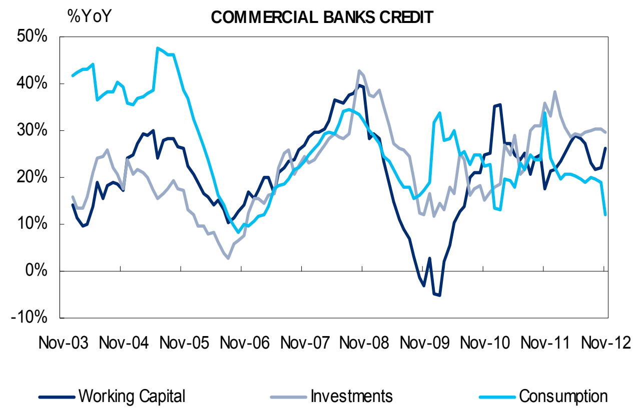
Source: CEIC, and Citi Research

Figure 57. Fuel imports dropped by around 25% after 2008 price hike



Source: CEIC, and Citi Research

Figure 58. Investment credit growth exceeds consumption credit



Source: CEIC, and Citi Research

Figure 59. Indonesia Economic Indicators

	2006	2007	2008	2009	2010	2011	2012F	2013F	2014F
Summary Data									
Nominal GDP, US$ bn	364.4	432.2	510.7	538.6	708.7	846.3	886.4	969.5	1,106.8
Nominal GDP, local currency bn	3,339,217	3,950,893	4,948,688	5,606,203	6,436,271	7,427,086	8,318,564	9,545,103	10,744,505
GDP per capita, US$	1,636	1,915	2,235	2,328	2,982	3,488	3,630	3,933	4,438
Population, mn	222.8	225.6	228.5	231.4	237.6	242.6	244.2	246.5	249.4
Unemployment, % of labour force	10.3	9.1	8.4	7.9	7.1	6.6	6.1	5.9	5.8
Economic Activity									
Real GDP, % yoy	5.5	6.3	6.0	4.6	6.2	6.5	6.2	6.1	6.3
Real investment growth % yoy	1.3	1.9	12.4	2.4	11.1	10.6	12.7	12.1	10.6
Real consumption growth % yoy	3.9	4.9	5.9	6.2	4.1	4.5	4.3	4.9	6.0
private consumption growth % yoy	3.2	5.0	5.3	4.9	4.7	4.7	5.1	4.4	5.0
Real export growth, % yoy	9.4	8.5	9.5	-9.7	15.3	13.6	1.3	5.5	10.2
Real import growth, % yoy	8.6	9.1	10.0	-15.0	17.3	13.3	4.3	7.7	11.9
Prices, Money & Credit									
CPI, % yoy	6.6	5.8	11.1	2.8	7.0	3.8	4.3	5.5	4.3
CPI, % avg	13.1	6.3	9.9	4.8	5.1	5.4	4.3	4.7	4.7
Nominal wages, % yoy	6.3	4.2	7.6	5.3	12.2	4.6	12.0	28.0	15.0
Credit extension to private sector, % yoy	12.1	22.4	30.7	18.0	20.6	25.9	22.0	18.0	20.0
Policy interest rate, % eop	4.75	3.00	8.75	6.00	5.50	4.50	4.00	4.50	4.50
1 month inter-bank rate, % eop	5.75	3.35	9.44	6.39	5.66	4.57	4.24	4.65	4.70
Long term yield, % eop	10.18	10.02	11.92	10.07	7.83	6.05	5.39	6.00	6.20
lc/US$, eop	8994	9393	10900	9425	9010	9068	9638	9777	9666
lc/US$, avg	9171	9140	9673	10376	9078	8763	9361	9845	9708
Balance of Payments, US$ bn									
Current account	10.9	10.5	0.1	10.6	5.1	1.7	-22.8	-19.8	-16.7
% of GDP	3.0	2.4	0.0	2.0	0.7	0.2	-2.6	-2.0	-1.5
Trade balance	29.7	32.8	22.9	30.9	30.6	34.8	10.0	14.3	18.3
Exports	103.5	118.0	139.6	119.6	158.1	200.8	190.1	211.2	259.0
Imports	73.9	85.3	116.7	88.7	127.4	166.0	180.1	196.9	240.7
Service balance	-9.9	-11.8	-13.0	-9.7	-9.3	-10.6	-10.2	-11.0	-11.2
Income balance	-13.8	-15.5	-15.2	-15.1	-20.8	-26.7	-26.4	-26.5	-28.0
FDI, net	2.2	2.3	3.4	2.6	11.1	11.5	11.5	13.0	14.5
International reserves	42.6	56.9	51.6	66.1	96.2	110.1	112.8	111.8	114.9
Total Amortisations	16.4	18.8	16.7	20.4	24.0	25.1	40.3	41.0	42.0
Public Finances, % of GDP									
Consolidated government balance	-0.9	-1.3	-0.1	-1.6	-0.7	-1.1	-1.8	-1.5	-1.4
Consolidated gov primary balance	1.5	0.8	1.7	0.1	0.6	0.1	-0.8	-0.4	-0.2
Public debt	39.6	34.1	29.3	31.4	26.3	23.5	23.6	21.9	20.9
of which Domestic	22.6	19.7	16.2	19.3	16.7	15.5	16.1	15.6	15.6
Foreign Assets & Liabilities, US$ bn									
External debt	132.6	141.2	155.1	172.9	202.4	225.4	250.0	285.0	310.0
Private	56.8	60.6	68.5	73.6	83.8	106.7	116.5	146.5	168.0
Public	75.8	80.6	86.6	99.3	118.6	118.6	133.5	138.5	142.0
External debt / GDP	36.4	32.7	30.4	32.1	28.6	26.6	28.2	29.4	28.0
External debt / XGS	115.3	108.2	100.1	130.2	115.8	101.8	117.4	121.2	109.2
Short-term debt	12.2	18.7	20.5	24.0	31.6	36.6	39.0	42.0	45.0
Short-term debt/International Reserves (%)	28.7	32.8	39.7	36.4	32.8	33.2	34.6	37.6	39.2

Quarterly Economic Indicators

	2012 Q2	2012 Q3	2012 Q4F	2013 Q1F	2013 Q2F	2013 Q3F	2013 Q4F	2014 Q1F	2014 Q2F
GDP, % yoy	6.4	6.2	6.1	6.0	6.0	6.1	6.2	6.0	6.2
CPI, % yoy	4.5	4.3	4.3	4.3	5.2	4.6	5.5	5.1	4.3
Policy interest rate, % eop	3.75	4.00	4.00	4.00	4.00	4.25	4.50	4.50	4.50
1 month inter-bank rate, % eop	3.98	4.11	4.24	4.20	4.20	4.50	4.65	4.70	4.70
Long term yield, % eop	6.28	5.98	5.39	5.70	5.50	5.70	6.00	6.25	6.00
lc vs USD, eop	9393	9570	9638	9925	9868	9811	9777	9750	9722

Source: CEIC Data Company Ltd, Fitch, IFS, Moody's and Citi Research estimates
*Note: Public debt is central government debt and external debt is based on the residency of the holder of the debt (not by currency denomination).

Malaysia

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- **Summary view** – We raise our 2012 and 2013 GDP forecasts to 5.5%. Stronger growth virtually eliminates the possibility of rate cuts, though still-low inflation suggests there is no urgency to hike rates immediately in our view. Media reports suggest that PM Najib may dissolve Parliament in March.
- **Things to watch** – (1) Newsflow on election timing; (2) Export performance, especially E&E, and spillovers on employment; (3) Implementation of fiscal spending and ETP projects.
- **Strategy** – Notwithstanding the recent catch-up in MYR on cyclical strength, we believe a narrowing current account, heavy foreign positioning in bonds and overseas purchases by domestic institutional investors will weigh on the MYR's relative performance in the medium term.

Raising 2012 and 2013 GDP forecasts to 5.5%

A rebound in IP in Oct-Nov, led by mining and manufacturing, suggests a broad-based acceleration in 4Q12 GDP looks likely. October-November seasonally-adjusted headline IP levels are 6.0% above the 3Q average, hinting at a strong sequential lift to 4Q GDP. Oct-Nov exports levels are also 3% above 3Q, offsetting still resilient imports and suggesting a smaller net exports drag and perhaps an improvement in the current account balance.

Despite some slowdown, consumption and investment indicators remain resilient. Imports of consumption goods slowed in Oct-Nov but seasonally-adjusted Oct-Nov levels remain 1.7% above the 3Q average – into December, consumption will likely be further boosted by the half-month civil servant bonus announced in the Budget. Meanwhile the Nov surge in capital good imports offset much of the plunge in October, bringing Oct-Nov seasonally-adjusted levels to 4.1% below 3Q, though YoY growth still remains elevated in excess of 10%. The long implementation pipeline of projects suggests investments could rise further still in 2013.

Overall, we now expect 5.5% GDP growth for both 2012 and 2013 (prev: 5.2%). Assuming conservative growth profiles for manufacturing and services, available sectoral monthly data for Oct-Nov points to the possibility of 4Q12 GDP growth accelerating to near 6%YoY, significantly higher than our previous estimate of 5% YoY, and maintaining a similar pace of sequential growth as in 3Q at near 4%QoQ SAAR. Together with likely upward revisions of 1Q-3Q12 GDP from the next rounds of civil servant bonuses, full year growth could hit 5.5%. Into 2013, assuming a somewhat faster pace of QoQ growth momentum given continued implementation of investment projects and a 2H13 export recovery, full year growth could remain broadly similar at 5.5%.

We remain cautious on the export outlook. We continue to see ample reasons to remain cautious in 1H13 given signs of continued weakness in manufacturing and North Asian exports in December. The continued fall in intermediate good imports suggests exporters are not sufficiently confident over the demand outlook to restock inventories of components. Moreover Malaysia is less exposed to “star” product segments like tablets and smartphones that have lifted North Asian tech exports – though the smaller exposure could limit the impact from weak iPhone 5 shipments on exports and production.

Rate outlook remains stable, though risks to upside

Dec inflation came in at 1.2%YoY (Nov: 1.3%), bringing the full year figure to 1.6% (2011: 3.2%). We expect inflation to average 1.7% in 2013, picking up to 1.5-2.5% in 2H13. Our inflation forecasts incorporate two RON95 fuel price cuts of 10 sen in June and December after elections and some spillovers from stronger domestic demand, a narrowing output gap, and possibly minimum wages.

Overall, our base case remains for a stable rate outlook through 2013, though risks are to the upside. Stronger-than-expected growth has virtually eliminated the possibility of rate cuts. BNM has also reiterated that rates are assessed to be slightly neutral and "sufficiently accommodative" – which suggests risks to rates are more likely to the upside. But with inflation likely to remain below the BNM's 3% comfort threshold in 2013, we do not see any urgency to hike rates either. Macroprudential measures on household lending seem to have successfully slowed household loan growth, giving few reasons to hike on household debt concerns either.

That said, the risk of a more hawkish MPC would rise as we head towards 2H13 when the growth recovery becomes more entrenched and inflation likely breaches 2% levels. Should there be concern about over-investments in non-productive sectors, policymakers will likely opt for macroprudential and non-monetary tightening as a first policy choice. Interest rates will likely be used if there are clearer signs of domestic demand overheating, which can be seen in inflation or broader credit/leverage indicators. Key to watch will be inflation risks from the minimum wage and demand pull pressures.

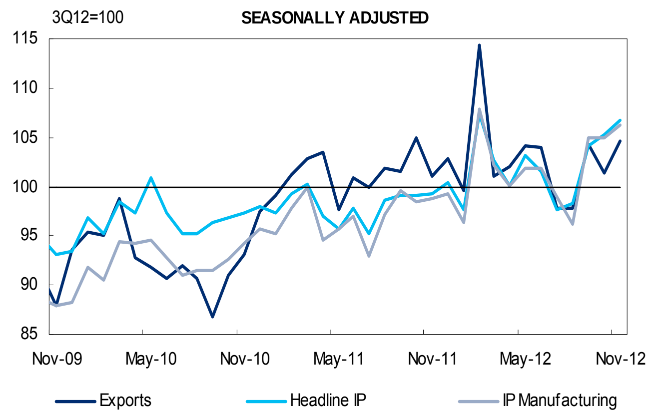
So far the minimum wage implemented on 1 January has had some impact on inflation and employment. Hardest hit has been cheap foreign labour, which SMEs rely heavily on. Some estimates suggest the cost of hiring foreign workers will rise about 70% annually, which has led petrol stations for example to allow the employment contracts of 50,000 foreign workers to expire, even as the prices of food and drinks sold at these kiosks are set to rise. On the flip side, recent decisions by rubber glove companies to invest in new machinery also suggest the minimum wage is successfully forcing some employers to raise productivity.

Last leg of the race to elections

PM Najib will have to call elections by April 2013. The timing of the monsoons suggests elections will likely be held only after February. Media reports suggest PM Najib is unlikely to allow the Johor state assembly term to expire on 21 March before parliament is dissolved. Elections need not be held immediately – only within 60 days of the dissolution of parliament – but the timing of various festivals suggests they could be held by mid-May. Elections are also unlikely to be held too long after the last of the next handouts in March in our view.

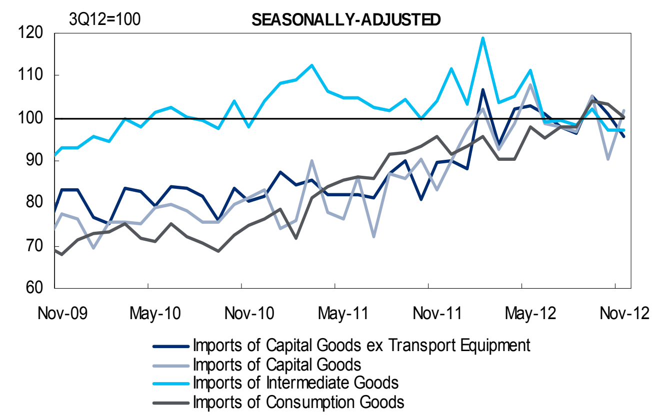
Latest polls and developments continue to suggest a tight race. The Merdeka Centre's latest poll shows PM Najib's approval ratings continued to trend down to 63% from 65% in October. Meanwhile a Royal Commission of Inquiry has produced damaging testimonies supporting allegations that the ruling Barisan Nasional had handed out citizenships to Muslim immigrants in Sabah in exchange for votes. Yet the opposition has also been plagued by its own share of poor newsflow – an aide to one of the two deputy chief ministers in the opposition-run Penang state government was arrested on charges of corruption, while the DAP was forced to reveal that it had miscalculated the results of its internal party elections.

Figure 60. IP rebound suggests broad-based acceleration in 4Q12 GDP



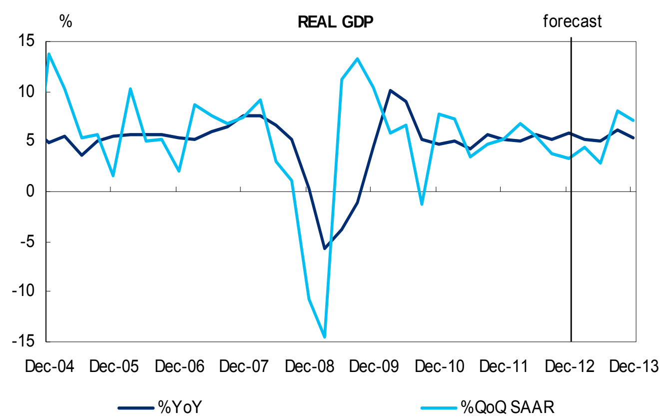
Source: CEIC, Citi Research

Figure 61. Consumption and investment good imports remain resilient



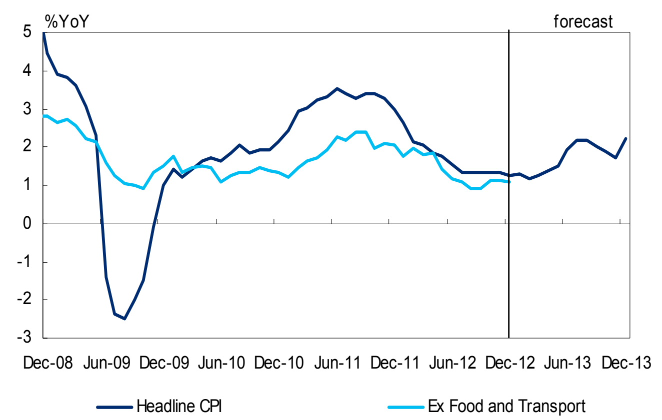
Source: CEIC, Citi Research

Figure 62. We now expect 5.5% GDP growth for both 2012 and 2013



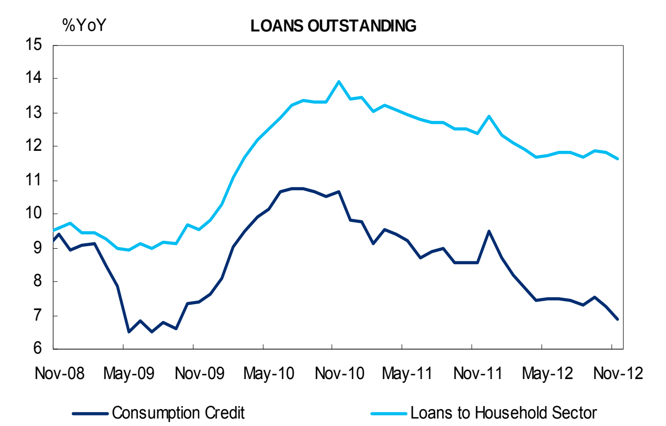
Source: Haver, Citi Research

Figure 63. We expect inflation to average 1.7% in 2013



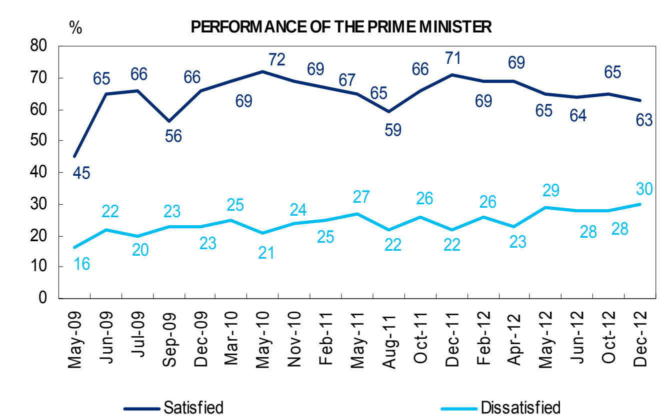
Source: Haver, Citi Research

Figure 64. Household loan growth has slowed



Source: CEIC, and Citi Research

Figure 65. PM Najib's approval ratings continued to trend down



Source: Merdeka Centre

Figure 66. Malaysia Economic Indicators

	2006	2007	2008	2009	2010	2011	2012F	2013F	2014F
Summary Data									
Nominal GDP, US$ bn	162.8	193.7	231.1	202.4	247.0	288.2	306.1	335.5	360.6
Nominal GDP, local currency bn	597	665	770	713	795	881	944	1,013	1,100
GDP per capita, US$	6,067	7,123	8,393	7,255	8,639	9,949	10,433	11,222	11,823
Population, mn	26.8	27.2	27.5	27.9	28.6	29.0	29.3	29.9	30.5
Unemployment, % of labour force	3.3	3.2	3.3	3.7	3.2	3.1	3.0	2.9	2.9
Economic Activity									
Real GDP, % yoy	5.6	6.3	4.8	-1.5	7.2	5.1	5.5	5.5	6.0
Real investment growth % yoy	8.6	9.1	1.8	-9.4	23.8	3.2	22.8	14.1	8.3
Real consumption growth % yoy	6.4	9.7	8.4	1.4	5.8	8.9	7.5	5.7	5.8
private consumption growth % yoy	6.6	10.4	8.7	0.6	6.6	7.1	8.1	6.5	6.4
Real export growth, % yoy	6.7	3.8	1.6	-10.9	11.3	4.2	0.3	3.1	4.4
Real import growth, % yoy	8.2	5.9	2.3	-12.7	15.6	6.2	5.7	5.8	5.8
Prices, Money & Credit									
CPI, % yoy	3.1	2.3	4.5	1.0	2.1	3.0	1.2	2.2	2.6
CPI, % avg	3.6	2.0	5.4	0.6	1.7	3.2	1.6	1.7	2.4
Nominal wages, % yoy	2.1	4.3	4.5	2.5	8.2	3.8	6.0	5.0	5.0
Credit extension to private sector, % yoy	6.8	9.2	10.2	6.8	10.6	12.3	12.0	11.0	11.0
Policy interest rate, % eop	3.50	3.50	3.25	2.00	2.75	3.00	3.00	3.00	3.50
1 month inter-bank rate, % eop	3.71	3.61	3.37	2.17	2.98	3.22	3.21	3.21	3.70
Long term yield, % eop	3.70	3.78	3.00	3.79	3.39	3.23	3.20	3.30	3.70
lc/US$, eop	3.53	3.31	3.45	3.42	3.08	3.17	3.06	3.04	3.05
lc/US$, avg	3.67	3.44	3.33	3.52	3.22	3.06	3.09	3.02	3.05
Balance of Payments, US$ bn									
Current account	26.2	29.7	39.5	31.4	27.4	31.8	15.3	13.3	12.0
% of GDP	16.1	15.4	17.1	15.5	11.1	11.0	5.0	4.0	3.3
Trade balance	37.4	37.7	51.6	40.0	41.9	48.4	32.9	26.2	27.0
Exports	160.9	176.1	199.3	157.1	198.8	227.8	227.9	236.2	242.0
Imports	123.5	138.5	147.7	117.1	157.0	179.4	195.0	210.0	215.0
Service balance	-2.0	0.8	0.0	1.1	0.5	-2.6	-6.6	-1.0	-3.0
Income balance	-4.7	-4.1	-6.9	-4.0	-8.2	-7.2	-11.0	-12.0	-12.0
FDI, net	0.0	-2.7	-7.8	-6.3	-4.2	-3.3	-2.0	-2.0	-1.0
International reserves	82.5	101.3	91.5	96.7	106.5	133.6	139.7	151.0	157.0
Total Amortisations	5.3	7.8	6.3	9.8	11.3	9.0	9.3	10.0	10.0
Public Finances, % of GDP									
Consolidated government balance	-3.2	-3.1	-4.6	-6.7	-5.4	-4.8	-4.5	-4.0	-3.5
Consolidated gov primary balance	-1.1	-1.2	-3.0	-4.7	-3.5	-2.8	-2.3	-1.8	-1.3
Public debt	40.6	40.1	39.8	50.8	51.2	51.8	53.7	53.7	53.0
of which Domestic	36.4	37.1	37.2	48.9	49.1	49.7	51.8	52.0	51.5
Foreign Assets & Liabilities, US$ bn									
External debt	52.0	56.2	66.6	68.3	72.6	81.5	87.6	94.7	98.5
Private	30.8	37.8	41.5	41.9	44.7	53.7	82.0	89.0	93.0
Public	21.2	18.4	25.2	26.3	27.9	27.8	5.6	5.7	5.5
External debt / GDP	32.0	29.0	28.8	33.7	29.4	28.3	28.6	28.2	27.5
External debt / XGS	28.5	27.4	29.0	36.9	31.3	30.9	33.1	33.9	34.3
Short-term debt	12.1	16.3	22.5	22.7	25.4	32.9	35.0	40.0	42.0
Short-term debt/International Reserves (%)	14.6	16.1	24.6	23.5	23.8	24.6	25.1	26.5	26.8

Quarterly Economic Indicators

	2012 Q2	2012 Q3	2012 Q4F	2013 Q1F	2013 Q2F	2013 Q3F	2013 Q4F	2014 Q1F	2014 Q2F
GDP, % yoy	5.6	5.2	5.8	5.1	5.1	6.2	5.4	5.9	6.5
CPI, % yoy	1.6	1.3	1.2	1.3	1.9	2.0	2.2	2.3	2.5
Policy interest rate, % eop	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.25	3.50
1 month inter-bank rate, % eop	3.19	3.20	3.21	3.21	3.21	3.21	3.21	3.40	3.60
Long term yield, % eop	3.21	3.31	3.20	3.20	3.25	3.25	3.30	3.40	3.50
lc vs USD, eop	3.17	3.06	3.06	3.00	3.02	3.04	3.04	3.04	3.05

Source: CEIC Data Company Ltd, Fitch, IFS, Moody's and Citi Research estimates
*Note: Public debt is general government debt and external debt is based on the residency of the holder of the debt (not by currency denomination).

Philippines

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- **Summary view** – Election spending should boost 1Q consumption but we don't think it will be sufficient to ease the impact of the election ban on new public projects. We continue to expect GDP growth of 6.1% this year although the growth distribution should be uneven with more than 6%YoY gains in post-elections 2H13.
- **Things to watch** – Whether the 2013 budget can be jump started soon and lift to revenues from new excise tax reforms. Auction of more PPP projects in 1H13. Inflation starting to edge up in 1Q13 as BSP accommodates a stronger peso. Additional macro prudential tools deployed by BSP to ease peso appreciation.
- **Strategy** – Negative offshore NDF peso rates due to QE3 flows and BSP's financial losses that bloat SDA weigh down on the policy rate stance. Peso likely correlated with the strong equity gains. Strong liquidity, unchanged policy rate stance and subdued fiscal deficit risk bode well for flatter long bond yields.

Expect slower pace of 1H13 GDP but 2H acceleration likely

Election spending ban starting March and election focus could weigh on 1H13 GDP. We continue to see 2013F GDP growth at 6.1%, with uneven growth of 6.4%YoY in 2H13 post-elections. Real government consumption expenditure (RGCE) has been upbeat since 1Q12 with growth of 5.6%QoQ SA easing to 2.3%QoQ SA in 3Q12. Its share to GDP stood at 11% as of end-Sep (vs 9.7% share in FY11). While the FY13 budget had already been approved and ready for implementation, mid-term political cycle elections will remain a distraction.

Campaign spending among those vying for over 18,000 electoral seats (local governments and Congress) **can boost household consumption prior to the May 2013 elections.** On the supply side, this demand uplifts the services sector with a bias for telecoms, land transport, media services, retail and other private services that tend to enjoy a one-off rise from election-related activities. In the last presidential elections (May 2010) that included elections for local government and Congressional positions, household consumption posted a seasonally adjusted gain of 0.9%QoQ SA in 1Q10 followed by 0.7%QoQ SA in 2Q10. That's not as upbeat as in 2Q12 and 3Q12, which posted gains in excess of 1%QoQ SA.

Aside from the one-off election related spending boost to consumption prospects, we believe: 1) resilient remittances, 2) non-tech export gains, 3) upbeat private investment cycle, and 4) accommodative financial setting, remain in place to support growth of 5.4%YoY in 1H13. Non-tech exports of manufacturers that presently account for ~50% of exports continue to post double-digit gains, in line with strong regional car demand and improving external demand. We believe the dry season, residential private demand, projects carried over from the FY12 budget and affordable mortgage rates will drive faster private and public construction. We see faster rollout of PPP projects this year with six big-ticket projects led by the LRT I expansion and modernisation project, in various stages of 'due diligence' and close to being auctioned off. The earlier timetable for PPP rollout enhances 2H construction prospects.

We expect the strong peso disincentive faced by remittance providers will make them think twice about saving in foreign currency and thus remit more money either for savings or real estate investments. We expect domestic demand (ex-inv) to expand by 5.8%YoY in 1H13.

Fiscal deficit ratio likely to narrow in 2013

2013F tax to GDP ratio likely to come at 13.4%, supports a fiscal deficit of 2.1% (of GDP). Our tax to GDP ratio assumption includes the boost of Php15bn or slightly less than half of the estimated cash flows from the new 'sin' tax measures effective at the start of the year. Primary expenditure gains of 10% are anticipated with faster growth likely in 2H13. Tax revenues likely to rise by 14.1% with upside risks if new 'sin' taxes outperform our assumption. Since tax revenue gains are likely to exceed primary expenditures (hindered by the election ban), the fiscal deficit for the third straight year may fall short of the 2013 programme deficit target of Php241bn.

Government financing will also be biased towards onshore funding. While the government targets a 75/25 mix in favour of LCY funding, this early, fiscal borrowings through the onshore FCDU may again be tapped just like late 2012 to ease the structural imbalance skewed to net inflows. In the 2013 cash borrowing programme, we noted Php130.5bn of foreign bonds and other inflows that account for 17% of total gross borrowings. However, the foreign bond funding if it pushes through would still fall short of the public sector external debt service of US$7bn-US$8bn annually.

Overnight rate stance hampered by strong liquidity

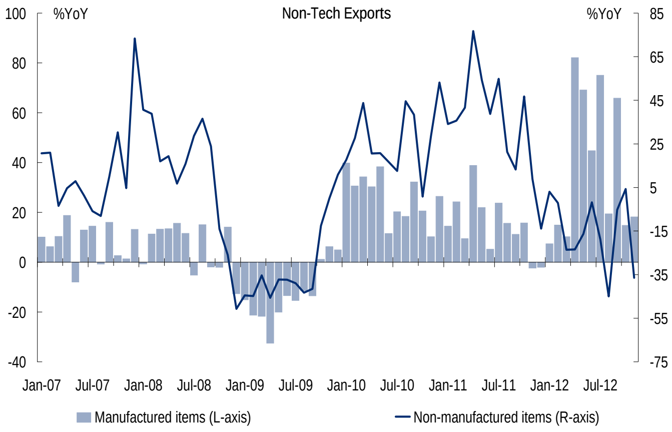
Portfolio flows triggered by cheap funding from persistently negative offshore peso NDF rates and BSP's financial losses from higher interest expense support the unchanged policy rate outlook. But even prior to portfolio investments crowding the t-bill auctions that compressed t-bill rates to ~zero and uplifted the local equity market, BSP has accommodated a strong peso down to 40.56 in mid-Jan from 41 at the start of the 2013 to signal a step towards 'tightening' amid upbeat prospects. Under a QE3 environment, the strong peso outlook would be highly correlated with the stock market. As such, we expect BSP will be wary of hiking interest rates in the near-term and for much of the year so as not to provide an incentive for QE3-driven offshore flows to take a strong peso position in view of negative offshore peso NDF rates.

BSP's financial losses, driven by FX losses and interest losses attributed mainly to servicing SDA that hit a high in early October, will also compel the regulator to be cautious in jacking up its policy rate in our view. We believe the liquidity arising from BSP's losses particularly the net interest payments were absorbed by SDA whose yield is fixed to BSP's O/N rate. In short, so as not to aggravate its interest expense in servicing SDA, BSP will not want to entice more local liquidity into SDA by hiking its O/N rate. BSP has signalled the use of macro prudential tools as well, e.g. tighten bank lending exposure to the real estate sector and mortgage lending and banks' NDF limit exposures, to plug loopholes and other issues that can aggravate liquidity and the strong peso.

Strong peso below 40 by end-year

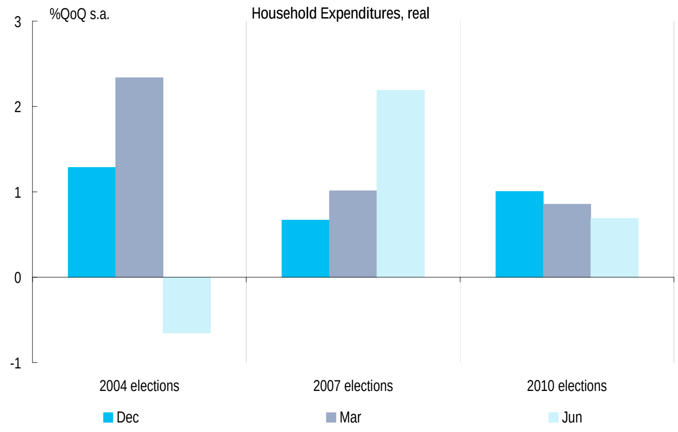
A structural imbalance in the foreign exchange demand-supply persists, likely aggravated by QE3 portfolio flows that further skewed the imbalance to the supply side and thus accelerated the strong peso. QE3 and structural imbalance effects may weigh on the policy rate, but BSP still has non-interest rate tools in its macro prudential tool kit that could be deployed for open market operations to its policy objectives. Peso is likely to be correlated with strong equity market gains. Abundant liquidity alongside an unchanged overnight rate stance and subdued fiscal deficit risk bode well for flatter long bonds. Bottom for the 10yr yield will be 50bp-75bp of the SDA yield.

Figure 67. Non-tech mfg exports likely to close 2012 still upbeat



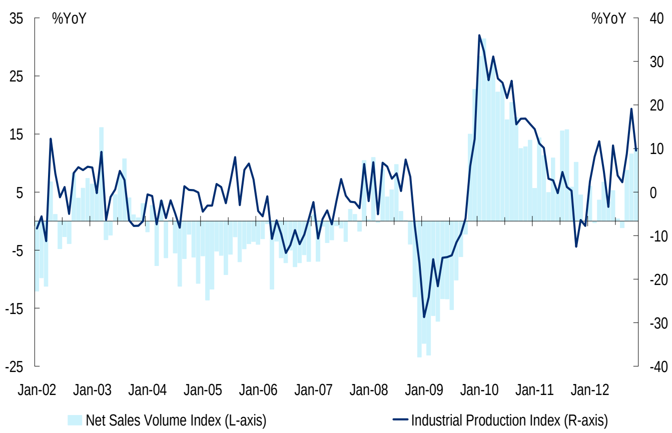
Source: CEIC, and Citi Research

Figure 68. Election lift to 1Q consumption not assured except in 1Q04



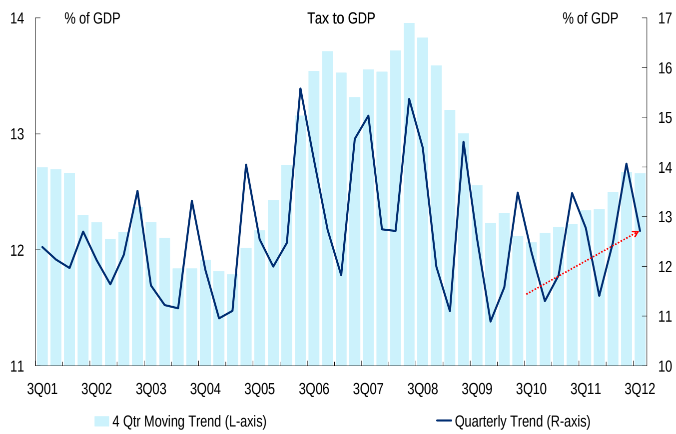
Source: CEIC, and Citi Research

Figure 69. Mfg output eases to 9.6%YoY in Nov from 19%YoY in Oct



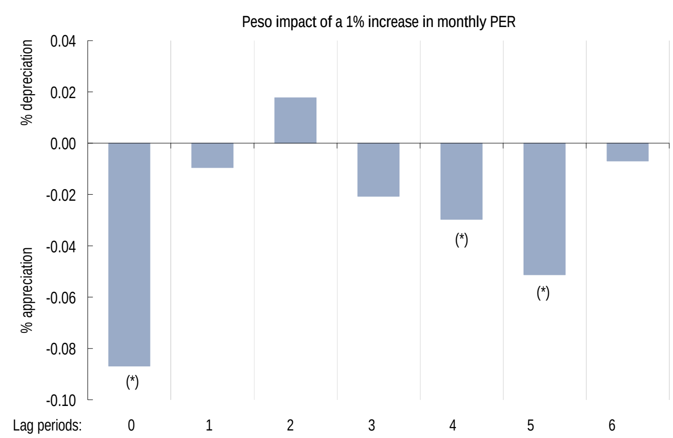
Source: CEIC, and Citi Research

Figure 70. Trend of rising tax to GDP ratio



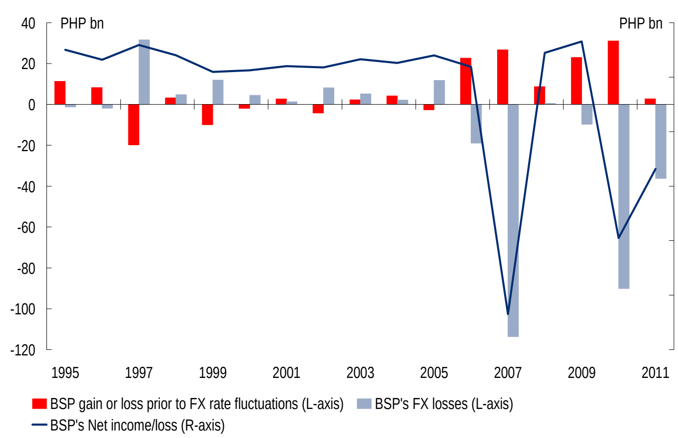
Source: CEIC, and Citi Research

Figure 71. PHP likely correlated with equity gains in a QE3 environment



Source: CEIC, and Citi Research
Note: * - statistically significant at the 5% level

Figure 72. BSP's financial losses bloat SDA weigh on the policy rate



Source: CEIC, and Citi Research

Figure 73. Philippines Economic Indicators

	2006	2007	2008	2009	2010	2011	2012	2013F	2014F
Summary Data									
Nominal GDP, US$ bn	122.4	150.2	173.4	168.6	200.0	224.7	252.6	292.8	319.4
Nominal GDP, local currency bn	6,271	6,893	7,721	8,026	9,003	9,736	10,668	11,710	12,934
GDP per capita, US$	1,408	1,693	1,916	1,829	2,127	2,344	2,583	2,933	3,168
Population, mn	87.0	88.7	90.5	92.2	94.0	95.9	97.8	99.8	100.8
Unemployment, % of labour force	8.0	7.3	7.4	7.5	7.3	7.0	7.0	6.5	6.0
Economic Activity									
Real GDP, % yoy	5.2	6.6	4.2	1.1	7.6	3.9	6.3	6.1	6.4
Real investment growth % yoy	-15.1	-0.5	23.4	-8.7	31.6	8.1	0.4	8.0	15.5
Real consumption growth % yoy	4.9	4.9	3.3	3.3	3.4	5.6	6.6	6.1	6.1
private consumption growth % yoy	4.2	4.6	3.7	2.3	3.4	6.3	5.9	5.8	6.0
Real export growth, % yoy	12.6	6.7	-2.7	-7.8	21.0	-4.2	6.7	5.3	7.9
Real import growth, % yoy	3.5	1.7	1.6	-8.1	22.5	0.2	4.4	6.2	11.8
Prices, Money & Credit									
CPI, % yoy	4.3	3.9	8.0	4.3	3.6	4.2	2.9	3.6	4.0
CPI, % avg	6.3	2.8	9.3	3.2	4.1	4.7	3.1	3.5	3.8
Nominal wages, % yoy	7.7	3.4	5.5	0.0	5.8	5.4	5.0	6.5	7.5
Credit extension to private sector, % yoy	9.0	10.6	12.8	4.3	13.8	16.2	13.5	11.3	15.0
Policy interest rate, % eop	7.50	5.25	5.50	4.00	4.00	4.50	3.50	3.50	4.50
1 month Philippine Reference rate, % eop	6.35	6.03	5.20	4.11	0.75	1.68	-1.38	2.50	4.50
Long term yield, % eop	5.99	5.70	6.55	6.25	4.78	4.21	3.70	3.85	5.00
lc/US$, eop	49.05	41.23	47.47	46.50	43.65	43.84	41.06	40.00	40.76
lc/US$, avg	51.28	46.05	44.48	47.56	45.06	43.29	42.22	40.01	40.48
Balance of Payments, US$ bn									
Current account	5.3	7.1	3.6	9.4	8.9	7.1	7.0	6.3	3.4
% of GDP	4.4	4.7	2.1	5.5	4.5	3.1	2.8	2.2	1.1
Trade balance	-6.7	-8.4	-12.9	-8.8	-11.0	-15.5	-14.9	-16.9	-19.3
Exports	46.5	49.5	48.3	37.6	50.7	47.2	49.9	53.4	59.7
Imports	53.3	57.9	61.1	46.5	61.7	62.7	64.8	70.3	79.0
Service balance	0.1	2.2	1.2	2.1	2.7	3.6	1.8	1.7	1.9
Income balance	-1.3	-0.9	0.1	-0.2	0.5	1.3	0.1	1.0	0.8
FDI, net	2.8	-0.6	1.3	1.6	0.7	1.3	1.5	2.0	3.0
International reserves (ex-gold)	23.0	33.8	37.6	44.2	62.4	75.3	84.2	82.1	86.8
Total Amortisations	9.4	6.3	8.2	6.4	9.5	7.3	8.5	9.3	9.7
Public Finances, % of GDP									
Consolidated government balance	-1.0	-0.2	-0.9	-3.7	-3.5	-2.0	-2.3	-2.1	-1.6
Consolidated gov primary balance	3.9	3.7	2.6	-0.2	-0.2	0.8	0.6	0.9	1.4
Public debt	70.5	60.9	61.7	62.4	58.5	56.7	49.1	48.5	48.0
of which Domestic	39.0	35.5	32.9	32.2	31.8	31.3	30.0	31.0	32.0
Foreign Assets & Liabilities, US$ bn									
External debt	53.9	55.5	54.3	54.9	60.0	61.7	63.5	65.0	68.7
Private	16.5	17.5	13.7	11.6	13.9	14.1	15.2	17.0	21.2
Public	37.4	38.0	40.6	43.2	46.2	47.6	48.3	48.0	47.5
External debt / GDP	44.0	36.9	31.3	32.5	30.0	27.5	25.1	22.2	21.5
External debt / XGS	101.8	93.6	93.7	112.8	92.6	98.5	101.1	96.7	91.4
Short-term debt	5.0	7.1	7.0	4.0	6.3	7.0	8.0	10.5	11.8
Short-term debt/International Reserves (%)	21.8	21.0	18.6	9.0	10.1	9.3	9.5	12.8	13.6

Quarterly Economic Indicators

	2012 Q2	2012 Q3	2012 Q4	2013 Q1F	2013 Q2F	2013 Q3F	2013 Q4F	2014 Q1F	2014 Q2F
GDP, % yoy	6.0	7.1	5.7	5.2	5.5	6.0	7.4	6.8	6.5
CPI, % yoy	2.8	3.6	2.9	3.3	3.4	3.5	3.6	3.7	3.9
Policy interest rate, % eop	4.00	3.75	3.50	3.50	3.50	3.50	3.50	3.75	4.25
1 month Philippine Reference rate, % eop	2.61	0.85	-1.38	1.00	1.50	2.00	2.50	3.50	4.00
Long term yield, % eop	4.70	4.35	3.70	3.75	3.85	3.85	3.85	4.00	4.50
lc vs USD, eop	41.93	41.68	41.06	40.14	40.01	39.88	40.00	40.19	40.38

Source: CEIC Data Company Ltd, Fitch, IFS, Moody's and Citi Research estimates
*Note: Public debt is central government debt and external debt is based on the residency of the holder of the debt (not by currency denomination).

Singapore

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- **Summary view** – We believe external demand will stay challenging in 1H13 even as supply constraints become increasingly binding. Despite a temporary retreat in core inflation, elevated headline gives MAS little room to ease in April. The latest round of property cooling measures may cause home prices to soften around 5%.

- **Things to watch** – (1) Signs of bottom in exports, especially electronics, (2) announcements on population and foreign worker policy, (3) Budget 2013, to be announced on 25 February, (4) Hints of further property measures.

- **Strategy** – The recent retreat of the SGD NEER is likely temporary in our view, as signs of a bottom in growth momentum would dispel lingering expectations of MAS easing in Apr. Any dip to below the upper quartile of the band may provide good opportunities to long the SGD NEER.

Demand and supply constraints weigh on 1H13 growth

While our base case forecasts anticipate that growth momentum has bottomed, external conditions could remain challenging in 1H13. While the Advance Estimates showed another narrow escape from technical recession in 4Q, revisions to the 4Q GDP figures (both to the upside and downside) are very possible. Our 2013 GDP forecast of 2% is predicated on a continued mild sequential expansion in 1H13 before picking up in 2H13. With sub-2% US growth persisting into 1H13 and Singapore's tech sector comparatively less exposed to fast growing smartphone segments, external demand could remain challenging near-term. REER appreciation may also erode cost competitiveness of tradables sectors. Indeed, these factors may explain the recent underperformance of Singapore's PMI and exports vs North Asian peers.

Mounting complaints of labour shortages amongst SMEs are indications that supply continues to lag demand amidst a tighter foreign worker policy. The SME Business and Budget 2013 Sentiments survey reports that 88.4% of SMEs expect manpower to be their greatest worry and main cause of cost increases for year 2013. Despite these complaints, we doubt that the foreign worker policy will be relaxed in the upcoming Budget on 25 February. We also do not expect offsets via cost cutting measures on other fronts – administrative fees for applying and renewing work passes will in fact be tripled from April onwards, further adding to costs.

SMEs are responding to these shortages in a number of ways. For example, there are hopes that the Budget will provide more incentives for firms to recruit local staff. Others have also asked for the Productivity Innovation Credit (PIC) Scheme to be extended beyond 2015, the cash payout component increased to 80% from the current 60%, and qualifying expenditure raised to S$200,000 from the current S$100,000. Finally, the ASME survey indicated that 65.8% of SMEs are looking to expand or relocate to South-East Asian countries with Malaysia being the most popular choice. ASME plans to set-up a One-Stop Centre in Iskandar Malaysia to assist local SMEs seeking to relocate or expand there. Indeed other surveys indicate that cost and supply constraints may be eroding Singapore's attractiveness even to MNCs. According to the 2013 Asia Business Outlook Survey, Singapore has also lost some popularity as a priority market for investment growth, slipping from being fifth most important Asian market in 2012 to seventh this year, behind China, the Indian sub-continent, Indonesia, Malaysia, Thailand and Vietnam – even though more than a third of the MNCs polled plan to raise their level of investment here.

Temporary retreat in core no excuse for MAS to ease

With few signs of labour demand easing, wage pressures should continue to drive inflation in services. According to a recent poll by placement firm Achieve Group, 54% of 500 companies polled intend to recruit workers in 1H13, a sharp increase from the previous poll six months earlier showing only 32%. Firms have also indicated that they are ready to raise the pay of workers (though by <5%). With the unemployment rate possibly facing further downward pressure and MAS studies showing wages have become more sensitive to changes in the unemployment rate, the modest cyclical recovery in 2H13 could cause wages to rise faster than the historical average of 3%, while contribution to headline CPI from services could rise.

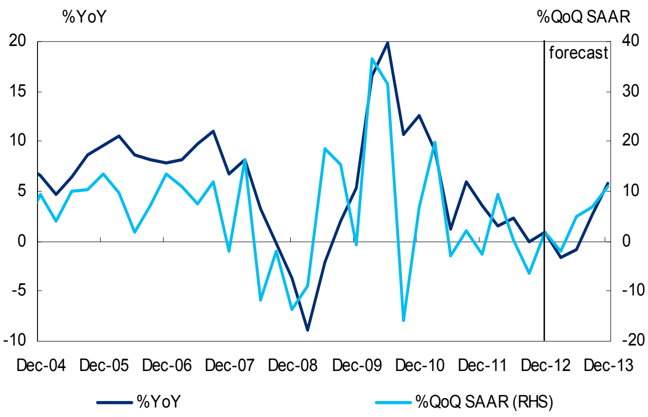
Wage pressures should reinforce the lift from private road transport as COEs hit a new record high, with the latest January auction showing COE for small cars jumping 9.4% from December levels to a record S$92.1K. Given that COEs now account for a higher proportion of the overall cost of a car, the impact on headline CPI could well exceed 0.2-0.3% in our view. This would come on top of continued rental pressures in the HDB market pushing up housing accommodation costs.

As a result, while base effects could temporarily push core inflation below 2% in early 2013, we believe continued elevated headline at near 4% will give MAS little room to ease in April. Core inflation peaked in 1Q12 at 3-3.5% and the cyclical slowdown and narrowing of the positive output gap through 2012 has had some effect on slowing core inflation momentum. As a result, YoY core inflation may dip to 1.5-2% in 1Q13 before the lagged impact of wage and other demand side pressures from the bottoming of the economy kicks in from 2H13. But given the pressures from COEs and rents, we believe headline will likely remain near 4% in 1Q13 and for the full year – well above tolerance thresholds. Thus, while the dip in core inflation could stoke speculation of policy easing, barring a sharp downside growth surprise below the government's 1-3% forecast, we doubt MAS will have room to ease in April for fear of stoking inflation expectations amidst an elevated headline figure. In any case, the recent softening of the SGD NEER in response to first, a stronger USD and second, property cooling measures has already achieved some measure of de-facto easing.

Property cooling measures may trigger mild correction

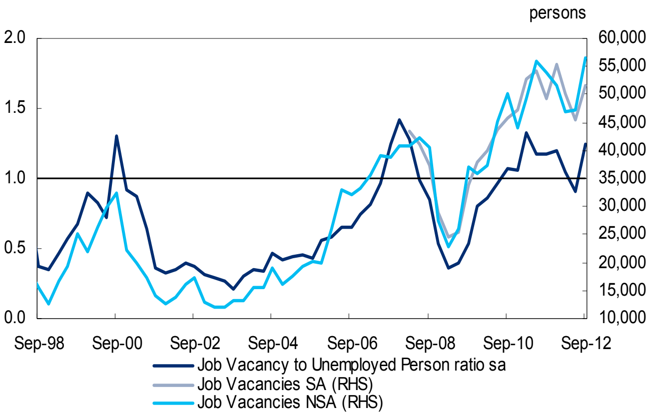
The latest round of measures came just three months after the previous set of measures in October, triggered by continued acceleration in private and HDB prices in 4Q. Previous measures such as higher and broader-ranging Additional Buyer Stamp Duties and lowering of LTV ratios were extended. The measures aimed to curb investment demand, including from both locals and foreigners, tilting the balance in favour of genuine first time home buyers. Raising of the ABSD to 15% for foreigners brings this in line with Hong Kong, further discouraging foreign inflows which would otherwise be diverted to Singapore – though the proportion of foreign buying had already collapsed in the wake of the initial imposition of ABSD in 2011. As expected, measures to discourage speculation in industrial properties via the imposition of sellers stamp duty were also implemented. With the new measures the most comprehensive to date, and with the authorities hinting for the first time that some degree of price correction would be a measure of policy effectiveness, property analyst Adrian Chua expects primary sales volumes to drop and private residential prices to fall by 5% in 2013 (from +2% previously). However, a persistent demand/supply shortage for owner occupation should limit the downside for prices.

Figure 74. Another narrow escape from technical recession in 4Q



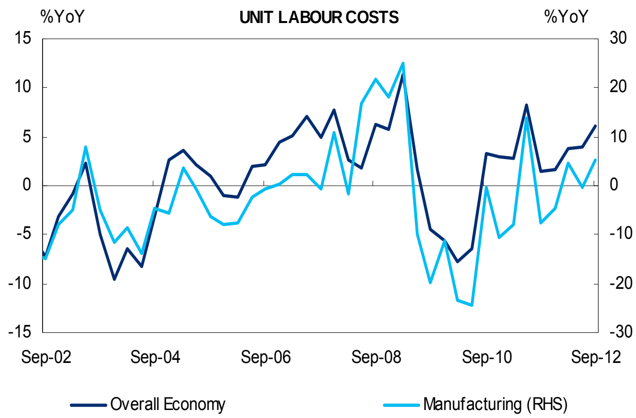
Source: CEIC, MTI, and Citi Research

Figure 75. Labour supply continues to lag demand



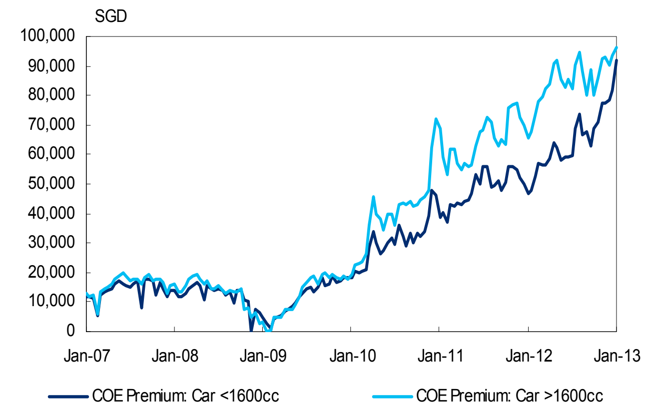
Source: Haver, MoM, and Citi Research

Figure 76. Wage pressures will continue to drive inflation



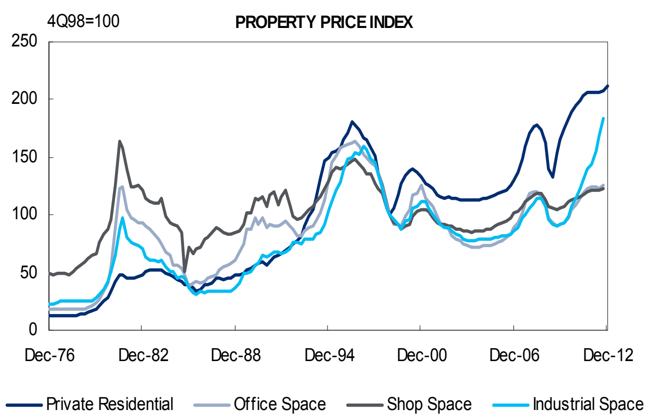
Source: CEIC, and Citi Research

Figure 77. COEs hit a new record high



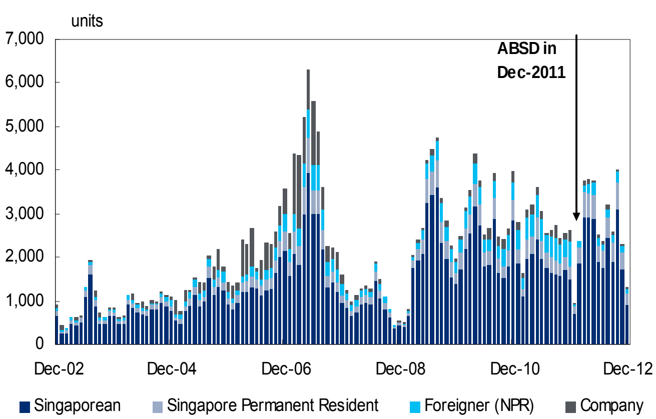
Source: CEIC, and Citi Research

Figure 78. Continued acceleration in property prices in 4Q



Source: CEIC, and Citi Research

Figure 79. Proportion of foreign buying had already collapsed



Source: URA Realis, and Citi Research

Figure 80. Singapore Economic Indicators

	2006	2007	2008	2009	2010	2011	2012F	2013F	2014F
Summary Data									
Nominal GDP, US$ bn	145.9	177.9	190.2	186.2	227.9	260.0	276.9	303.3	331.8
Nominal GDP, local currency mn	232	268	269	270	310	327	346	367	395
GDP per capita, US$	33,155	38,764	39,305	37,329	44,889	50,157	52,133	56,139	60,326
Population, mn	4.4	4.6	4.8	5.0	5.1	5.2	5.3	5.4	5.5
Unemployment, % of labour force	2.7	2.1	2.3	3.0	2.2	2.0	2.2	1.9	1.8
Economic Activity									
Real GDP, % yoy	8.8	8.9	1.7	-1.0	14.8	4.9	1.2	2.0	4.0
Real investment growth % yoy	17.4	16.5	27.4	-20.1	5.8	9.7	12.3	2.1	6.7
Real consumption growth % yoy	5.0	5.9	3.9	0.9	7.4	3.4	0.6	2.8	3.3
private consumption growth % yoy	5.0	6.8	3.3	0.1	6.5	4.1	1.4	2.8	3.3
Real export growth, % yoy	10.9	9.0	4.7	-7.8	19.1	2.6	0.2	2.1	2.8
Real import growth, % yoy	11.3	8.1	9.5	-11.1	16.2	2.4	1.4	3.0	2.7
Prices, Money & Credit									
CPI, % yoy	0.8	3.7	5.5	-0.5	4.6	5.5	4.3	3.6	3.5
CPI, % avg	1.0	2.1	6.6	0.6	2.8	5.2	4.6	4.0	3.4
Nominal wages, % yoy	3.2	6.2	5.4	-2.6	5.6	6.0	4.0	5.0	5.5
Credit extension to private sector, % yoy	4.9	16.9	23.2	3.5	4.5	18.6	14.0	12.0	11.0
3 month inter-bank rate, % eop	3.44	2.38	1.00	0.69	0.44	0.38	0.38	0.30	0.40
Long term yield, % eop	3.05	2.68	2.05	2.66	2.71	1.63	1.30	1.70	2.40
lc/US$, eop	1.53	1.44	1.43	1.41	1.28	1.30	1.22	1.20	1.19
lc/US$, avg	1.59	1.51	1.41	1.45	1.36	1.26	1.25	1.21	1.19
Balance of Payments, US$ bn									
Current account	35.7	45.9	26.3	30.1	55.5	57.0	45.2	42.3	44.1
% of GDP	24.4	25.8	13.8	16.2	24.4	21.9	16.3	13.9	13.3
Trade balance	50.2	57.1	41.7	47.3	63.1	67.5	58.1	59.8	66.0
Exports	281.3	312.8	354.8	288.5	371.3	429.6	431.0	443.9	456.0
Imports	231.2	255.8	313.2	241.2	308.1	362.1	372.9	384.1	390.0
Service balance	-7.3	-2.5	-2.7	-3.2	1.5	1.8	2.5	1.4	2.0
Income balance	-7.2	-8.7	-12.6	-13.9	-9.1	-12.3	-15.4	-18.7	-24.0
FDI, net	18.1	10.0	5.0	6.7	27.4	38.8	36.0	33.0	32.0
International reserves	136.3	163.0	174.2	187.8	225.8	237.7	254.0	260.0	270.0
Public Finances, % of GDP									
Consolidated government balance	0.0	2.8	0.1	-0.3	0.3	1.2	1.3	1.0	1.0
Consolidated gov primary balance	0.6	2.7	1.1	-0.8	0.2	1.4	2.0	1.0	1.0

Quarterly Economic Indicators

	2012 Q2	2012 Q3	2012 Q4	2013 Q1F	2013 Q2F	2013 Q3F	2013 Q4F	2014 Q1F	2014 Q2F
GDP, % yoy	2.3	0.0	1.0	-1.1	-0.4	3.3	6.2	5.1	4.6
CPI, % yoy	5.3	4.7	4.3	4.0	3.9	3.4	3.6	3.4	3.4
1 month inter-bank rate, % eop	0.38	0.38	0.38	0.30	0.30	0.30	0.30	0.30	0.30
Long term yield, % eop	1.61	1.47	1.30	1.30	1.40	1.60	1.70	2.00	2.10
lc vs USD, eop	1.27	1.23	1.22	1.22	1.21	1.20	1.20	1.20	1.19

Source: CEIC Data Company Ltd, Fitch, IFS, Moody's and Citi Research estimates
*Note: Public debt is general government debt.

South Korea

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- **Summary view** – Despite a rebound in November industrial production, the continued slump in investment and weaker-than-expected exports weighed on growth momentum in 4Q12 and is likely to in the coming months. In reflection of this, we recently lowered our 2013 growth forecast by 0.2%p to 3.2%.
- **Things to watch** – As KRW continues to strengthen, measures to curb sharp appreciation are being considered. Introduction of a Tobin tax has been raised, but the implementation by the next government is not clear. Before that, the incoming government may tighten existing macro-prudential measures first.
- **Strategy** – Low inflation amid negative output gap will likely lead the BoK to cut the rate by 25bps in 1Q13 to alleviate the household debt burden and support a recovery of domestic demand in our view. Yet, we believe the BoK will prepare rate normalisation at end 2H13 as CPI inflation rises to 3% due to economic recovery and a low base effect.

Bottoming out but weaker than expected

IP surprised positively with continued boost from IT products. November industrial production (IP) expanded on a seasonally adjusted MoM basis for the third month, bringing YoY growth to snap back to 2.9% from -0.8% in October. Propelled by exports of smartphones and LCD, manufacturing of semiconductors & parts continued solid growth, and production of video, sound & communications equipment shifted back to increase sequentially. Inventory accumulation of these key IT products along with improvement in exports, was confirmed.

Service activity and retail sales improved from weak readings in October. Service activity growth improved to 2.0%YoY in November, lifted by solid growth in financial & insurance and social work, and rebounds in information & communications and wholesale & retail. Meanwhile, retail sales growth rose to 3.9%YoY. Sales of semi-durables and non-durables both moved into positive terrain as sales of winter clothes and fuel increased due to the early cold spell. Durables sales continued their steady growth as auto sales maintained double-digit growth. Despite November improvements, service activity growth and retail sales growth during Oct-Nov were just half of those in 3Q12 on both MoM and YoY basis due to sluggishness in October.

Investment slump remained as a main drag on growth. Decline in equipment investment continued, registering -9.3%YoY in November. Construction completed increased over the month, but fell short of a year ago level by 2.2%. Domestic machinery orders and construction orders plunged by double digits do not hint at a recovery in near-term. The BoK's monthly business survey index (BSI) for facilities investments also has not showed a clear positive turnaround and still indicate that majority of manufacturers are reluctant to investment. Falling facilities investment continued to weigh on GDP growth in 4Q12.

Tepid macro readings are expected to continue in 1H13. Though latest trend in IP data is encouraging, other macro indicators suggest us not to be hasty about the economic rebound. We expect January exports to revert to a positive YoY growth from December's sharp contraction which was mainly due to fewer working days and high base effect. Daily average exports which excludes the effect of difference in the number of working days, are likely to rather fall on seasonal effect in January. We believe fiscal challenges unresolved in the US and eurozone will remain as major hurdles for the recovery of exports and investments in 1H13.

We cut our 2013 growth outlook to 3.2%. Slower-than-expected growth in 4Q12 as a result of weak exports and investment slump, hints at reduced recovery momentum in the upcoming periods. Seeing more downside risks to facilities investment and construction in 1H13 from deteriorated economic sentiment and market prospects, we lower our 2013 growth forecast to 3.2% from 3.4%. We still forecast economic growth at 3% level for this year, expecting a bit faster recovery in exports and facilities investment in 2H along with a pickup in the global economy. The BoK also revised down its economic outlook for 2012 and 2013 each by 0.4ppt to 2.0% and 2.8% respectively from previous forecasts made in Oct 2012.

Last rate cut likely amid low inflation pressure

CPI inflation stays low with upside in agricultural products price. Dec CPI shifted to rise on MoM basis in three months but YoY inflation further eased to 1.4% due to high base effect. While industrial products inflation came down, prices of agricultural products – particularly vegetables used as ingredients of Kimchi -- surged as the supply was hit by a cold wave. We see some upside in agricultural product prices from the exceptionally cold winter. Meanwhile, house rent -- both Cheonse and monthly rent – continued to rise.

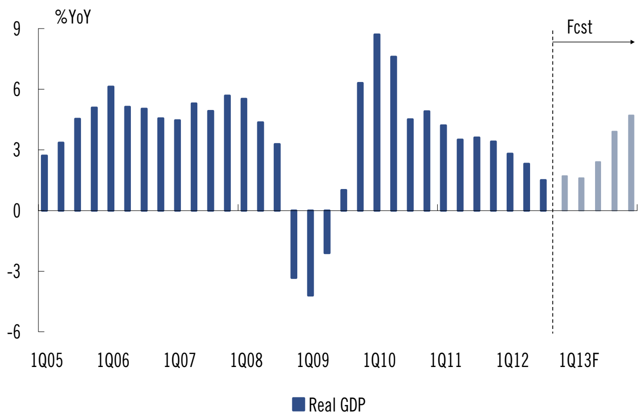
BoK's last 25bps rate cut likely in 1Q before rate normalisation. Following a 25bps cut in October 2012, the BoK has held the policy rate at 2.75% for the third month at the January MPC meeting, despite concerns about weak economic growth and rapid appreciation of KRW. We continue to expect a 25bps rate cut in February at the earliest, amid low inflation pressure. With big cuts made to our growth forecast for 1H13 (2.6%p to 2.0%), an increase in estimated negative gap and thus less demand-side inflation pressure reinforce our view of low inflation in 1H. CPI inflation will likely stay below the lower threshold of BoK's new inflation target band (2.5±3.5%) in 1H. However, it will likely approach the upper limit of the band in 2H on expected service price hikes and low base of a year ago, possibly giving grounds to a rate hike at the end of the year to contain inflation expectations preemptively.

Moves to curb KRW appreciation

KRW strengthens further despite intervention concern. As of 18 January, USD/KRW has fallen about 7.5% from its previous peak in 5 September 2012. As KRW strengthened against USD towards 1,050, the BoK has intervened in the market to slow the appreciation. Contrary to the general view but in line with our forecast, the president-elect Park's transition committee is considering measures to prevent abrupt falls in USD/KRW and the inflow of speculative foreign funds, including introduction of Korea's unique style of Tobin tax on FX transactions. For now, it is unclear whether such Tobin- tax will be adopted by the new government.

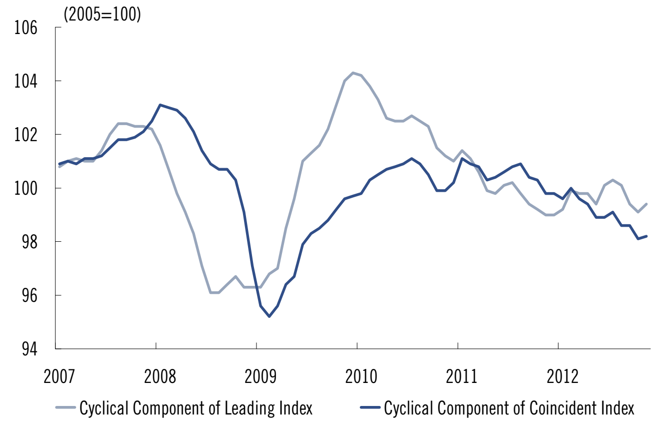
Leaving the door open to additional measures. While the MoSF continues to view that the existing three major macro-prudential measures (ceilings on banks' FX forward positions, bank levies, and withholding tax on KTBs) will be enough to stabilise the market but is not excluding the possibility of additional measures. If FX regulators are to consider reinforcing measures, the most possible ones would be: 1) further lowering the general level of ceilings on banks' FX forward positions (current: 150% for local banks and 40% for foreign bank branches); and 2) changing the calculation of the ceiling levels (current: average position during the past six months), e.g. to the level of previous business day, or increasing the weighting of NDF positions.

Figure 81. We cut our 2013 growth outlook by 0.2%p to 3.2%



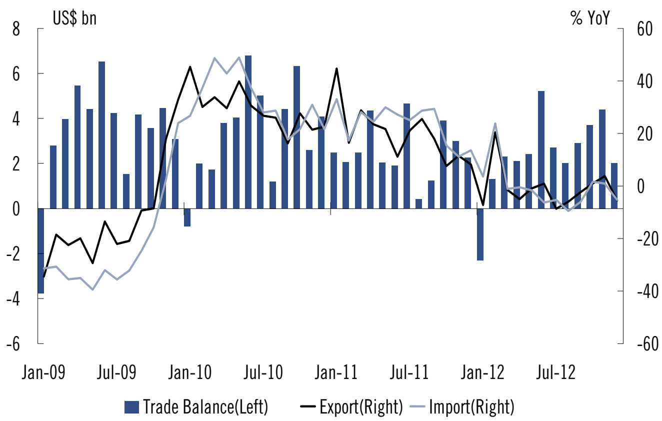
Source: Bank of Korea, and Citi Research Estimates

Figure 82. Cyclical component of leading/coincident index reversed up



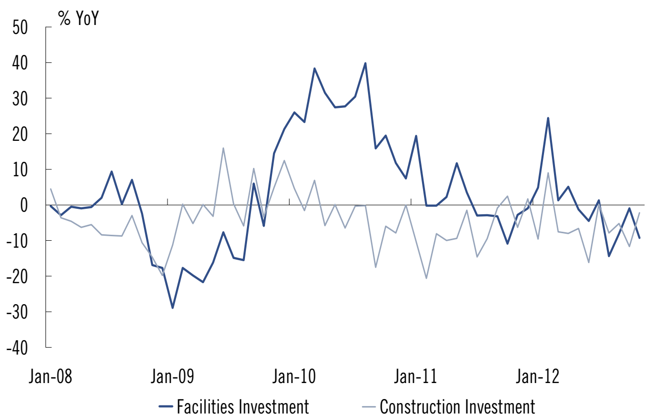
Source: Statistics Korea

Figure 83. Exports remained weak, despite boost from IT products



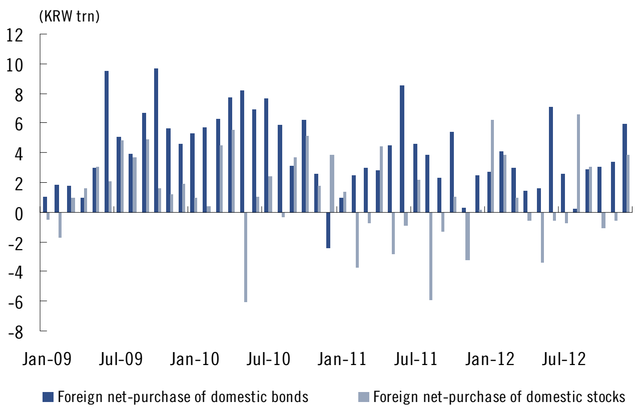
Source: Korea International Trade Association

Figure 84. Investment likely continued to weigh on GDP growth in 4Q



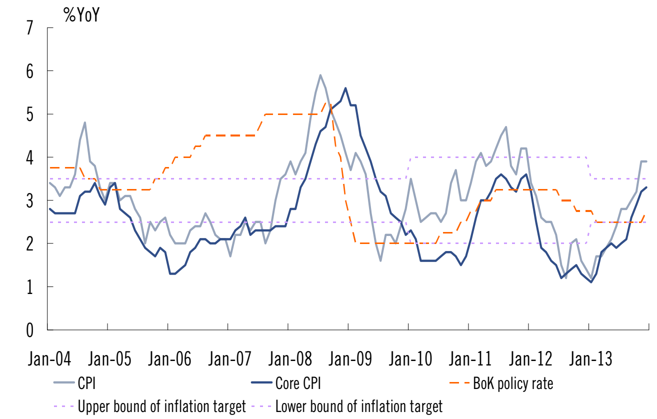
Source: Statistics Korea

Figure 85. Foreigners' net-purchase of domestic securities increased



Source: Financial Supervisory Service

Figure 86. We expect last 25bps rate cut in 1Q amid low inflation



Source: Bank of Korea, Statistics Korea, and Citi Research Estimates

Figure 87. Korea Economic Indicators

	2006	2007	2008	2009	2010	2011	2012	2013F	2014F
Summary Data									
Nominal GDP, US$ bn	954.0	1,048.0	929.1	834.7	1,014.9	1,116.6	1,142.6	1,314.2	1,448.4
Nominal GDP, local currency bn	908,744	975,013	1,026,452	1,065,037	1,173,275	1,237,128	1,287,406	1,360,483	1,457,825
GDP per capita, US$	19,722	21,565	18,981	16,972	20,540	22,431	22,850	26,169	28,724
Population, mn	48.4	48.6	48.9	49.2	49.4	49.8	50.0	50.2	50.4
Unemployment, % of labour force	3.5	3.2	3.2	3.6	3.7	3.4	3.2	3.2	3.2
Economic Activity									
Real GDP, % yoy	5.2	5.1	2.3	0.3	6.3	3.6	2.0	3.2	4.1
Real investment growth % yoy	4.4	3.5	0.0	-13.5	15.8	1.5	-1.5	1.3	3.5
Real consumption growth % yoy	5.1	5.1	2.0	1.2	4.1	2.2	2.2	2.9	3.3
private consumption growth % yoy	4.7	5.1	1.3	0.0	4.4	2.3	1.8	2.4	3.4
Real export growth, % yoy	11.4	12.6	6.6	-1.2	14.7	9.5	3.7	4.8	9.5
Real import growth, % yoy	11.3	11.7	4.4	-8.0	17.3	6.5	2.3	4.3	9.3
Prices, Money & Credit									
CPI, % yoy	2.1	3.6	4.1	2.8	3.0	4.2	1.4	3.9	2.7
CPI, % avg	2.2	2.5	4.7	2.8	3.0	4.0	2.2	2.6	3.0
Nominal wages, % yoy	5.7	0.7	3.1	2.6	6.8	1.0	4.2	5.6	6.2
Credit extension to private sector, % yoy	14.7	12.4	15.0	2.3	3.6	5.1	7.6	12.6	10.1
Policy interest rate, % eop	4.50	5.00	3.00	2.00	2.50	3.25	2.75	2.75	3.50
91-Day CD Rate, % eop	4.76	5.73	4.68	2.82	2.80	3.55	2.89	3.00	3.70
Long term yield, % eop	5.00	5.78	3.77	4.92	4.08	3.46	2.97	3.05	4.05
lc/US$, eop	930	936	1263	1166	1121	1159	1064	1024	996
lc/US$, avg	955	929	1102	1275	1156	1108	1127	1035	1007
Balance of Payments, US$ bn									
Current account	14.1	21.8	3.2	32.8	29.4	26.5	42.1	28.6	26.5
% of GDP	1.5	2.1	0.3	3.9	2.9	2.4	3.7	2.2	1.8
Trade balance	16.1	14.6	-13.3	40.4	41.2	30.8	28.5	24.1	21.8
Exports	325.5	371.5	422.0	363.5	466.4	555.2	548.1	574.2	633.2
Imports	309.4	356.8	435.3	323.1	425.2	524.4	519.6	550.1	611.4
Service balance	-13.3	-12.0	-5.7	-6.6	-8.6	-4.4	2.8	2.1	0.3
Income balance	-4.0	-3.4	3.8	1.6	-2.1	0.3	2.1	0.2	-0.7
FDI, net	-7.6	-17.9	-16.9	-14.9	-22.2	-16.4	-18.5	-12.5	-8.6
International reserves	239.0	262.0	201.0	270.0	291.0	304.0	323.0	326.0	350.0
Total Amortisations	17.7	43.8	42.9	43.6	40.0	42.0	43.0	42.0	40.0
Public Finances, % of GDP									
Consolidated government balance	0.4	3.5	1.2	-1.7	1.4	1.5	1.4	1.1	1.4
Consolidated gov primary balance	1.7	4.9	2.6	-0.2	2.8	2.9	2.7	2.4	2.7
Public debt	30.1	29.7	29.0	32.5	31.9	32.6	34.0	33.0	31.0
of which Domestic	28.9	28.6	28.1	31.4	31.0	31.7	33.3	32.4	30.1
Foreign Assets & Liabilities, US$ bn									
External debt	225.2	333.4	317.4	345.7	359.4	398.4	413.2	426.0	441.8
Private	205.3	279.8	265.0	278.3	314.7	358.0	373.0	384.8	399.6
Public	19.9	53.6	52.4	67.4	44.7	40.4	40.2	41.2	42.2
External debt / GDP	23.6	31.8	34.2	41.4	35.4	35.7	36.2	32.4	30.5
External debt / XGS	58.9	75.0	61.9	79.1	64.9	61.3	62.9	61.9	57.9
Short-term debt	113.8	160.3	149.9	149.2	139.8	136.1	136.9	140.3	150.5
Short-term debt/International Reserves (%)	47.6	61.2	74.6	55.3	48.0	44.8	42.4	43.0	43.0

Quarterly Economic Indicators

	2012 Q2	2012 Q3	2012 Q4F	2013 Q1F	2013 Q2F	2013 Q3F	2013 Q4F	2014 Q1F	2014 Q2F
GDP, % yoy	2.3	1.5	1.5	1.4	2.7	3.9	4.7	3.9	3.9
CPI, % yoy	2.2	2.0	1.4	1.7	2.4	3.0	3.9	3.3	2.8
Policy interest rate, % eop	3.25	3.00	2.75	2.50	2.50	2.50	2.75	3.00	3.25
91-Day CD Rate, % eop	3.54	3.09	2.89	2.70	2.70	2.70	3.00	3.25	3.45
Long term yield, % eop	3.42	2.87	2.97	2.75	2.85	2.90	3.05	3.38	3.65
lc vs USD, eop	1141	1114	1064	1047	1039	1031	1024	1017	1010

Source: CEIC Data Company Ltd, Fitch, IFS, Moody's and Citi Research estimates
*Note: Public debt is central government debt and external debt is based on the residency of the holder of the debt (not by currency denomination).

Sri Lanka

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- **Summary view** – Growth has slowed sharply in 3Q but as the worst of the drought effect wanes and policy has moved towards easing, we expect growth will rebound from 6.4% in 2012 to 7.1% in 2013F. Inflation looks manageable but external and fiscal accounts remain a source of vulnerability.

- **Things to watch** – Front-loaded foreign borrowings could be bullish short term, but may introduce more volatility later on. The trade deficit may stay wide if pro-growth policies boost imports. IMF Mission in February could pave the way for an extended program, which we believe the market would like.

- **Strategy** – We think the LKR T-bonds have room for further short-term rally amid near-term monetary easing and a relaxation of policies allowing for front-loaded foreign purchases of T-bonds/bills. The 5Y T-bond could decline to the 10% range. However, we would start paring down positions once front-loaded foreign quotas are close to being exhausted, as sustaining low yields will be difficult amid high external and fiscal risks and less prudent policy stance.

A quick end to the tightening cycle has some risks

The central bank surprised the market in December by ending what it regards as its "*shortest tightening cycle since 2001*". While growth has clearly slowed more sharply than expected, with real GDP growth decelerating to only 4.8% in 3Q – the lowest growth rate in three years (we consequently downgrade our growth forecasts for 2012 and 2013F to 6.4% (from 6.7%) and 7.1% (from 7.3%), respectively) – CBSL's very dovish rhetoric, rate cut and removal of credit ceilings entails some risks. First, it somewhat undermines inflation credibility given that the end to the tightening cycle comes even amidst inflation remaining high (even surprising positively) and should stay sticky in the near term given the latest round of fuel price adjustments. Second, despite slower growth, the trade deficit has remained stubbornly wide in recent months, such that the current account deficit for 2012 is likely to narrow only modestly with the help of remittances and services receipts. Ending the credit ceilings and signaling a more pro-growth stance puts lingering pressure on the external accounts.

With a more pro-growth bias, expect further monetary easing as inflation recedes in 2Q – bond market gets excited. The turn in the monetary cycle has prompted a faster than expected rally in LKR Treasury bonds. We expect CBSL will cut the repo rate by 25bps by 2Q 2013 (to 7.25%), but we think they could cut the reverse repo rate by 75bps to 8.75% to narrow the policy rate corridor back to pre-April spread of 150bps. Sri Lanka plan to transition from the current "monetary targeting" towards "inflation targeting" framework, and thus, will increasingly focus on short term interest rates as a policy tool. We expect them to more tightly manage short-term interest rates via a narrower policy rate corridor, alongside regular term auctions to address short term liquidity.

Expect some easing inflation…

We believe easing beyond our base case will be constrained by inflation as CBSL plans to maintain a positive real interest rate to mobilise domestic savings. Inflation is likely to ease with the help of the base effect and easing food supply issues – to 7.1% on average in 2013F versus 7.5% in 2012 – but we don't see a dramatic and sustained deceleration, especially in core.

Nonetheless, there will be two dramatic period of base effects disinflation kicking in: in March (when the big price hikes kicked in last year) and in June (when we had huge spikes in food prices). We also still expect further adjustments to fuel and electricity hikes this year to contain sizeable fiscal drains from loss-making Ceylon Petroleum Corp (CPC) and Ceylon Electricity Board (CEB), the magnitude of the adjustment may also not be as large as last year's. Moreover, with the government's pro-growth policy bias and resurgence of looser liquidity and credit conditions could also see a gradual shift from what was a more cost-pus./supply driven inflation last year to a reemergence of more demand-push inflation this year.

… but external vulnerability remains high

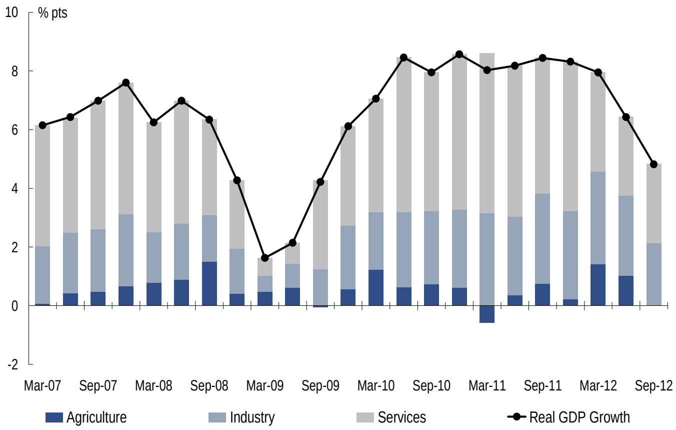
CBSL is still forecasting a current account (CA) deficit of 4.7% of GDP in 2013F from 5.5% in 2012 -- we expect only a third of this is being covered by FDI, which so far has proven to be a disappointment. Sri Lanka has been largely able to boost external accounts via attracting more debt related capital inflows, which we think will continue this year as we expect further liberalisation of foreign holdings on Treasury bills/bonds and continued global bond issuance by Sri Lankan issuers, with a larger role likely played by non-sovereign issuers such as banks. Such dependency of capital flows on external inflows comes in the backdrop of already low reserve coverage. Despite FX reserves rising in December to $6.8bn from $6.49bn in November, which is just about enough to cover short-term external debt by remaining maturity – low by Asian and EM standards Given significant FCY component of Sri Lanka's debt, volatile external accounts have a negative feedback loop on debt dynamics, as we already saw last year.

IMF support would be market a positive – next IMF mission in February. One potentially positive development is the re-emergence of discussion of another two-year IMF programme of around $1bn, after our earlier concern that the government seemed more reluctant to do so or would tap a smaller amount. Treasury Secretary Jayasundera announced they are seeking extended "budget support" programme from the IMF of about $1bn for development projects (we are a bit puzzled with the "budget support" headline as IMF lending does not fund budgets – it's lending is generally for financial stability/balance of payment support purposes). While details and timing are unclear, we expect a new IMF facility would be market positive – it would help strengthen credibility of policy discipline alongside providing much needed reserve insurance.

…and public finances deteriorated last year

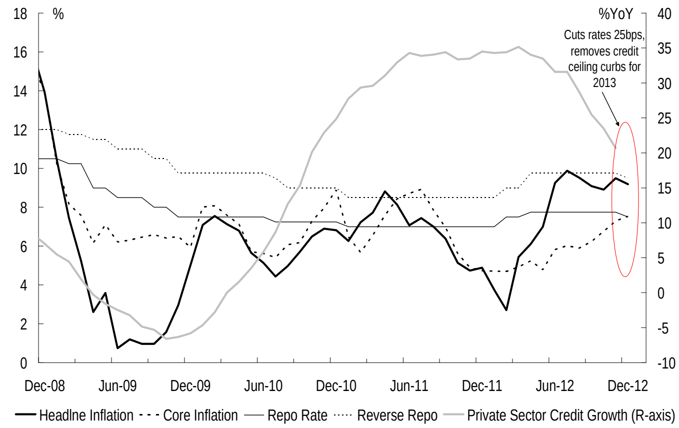
Another factor that would constrain a significant bond rally is the country's weak fiscal position. Sri Lanka's public debt ratio last year deteriorated – we are forecasting it rose from 78.5% of GDP in 2011 to about 83% of GDP in 2012E – hurt largely by the sharp depreciation of the rupee with foreign debt comprising about 48% of total public debt. The fiscal deficit last year likely breached the full year target on the back of disappointing revenues amid sustained public investment spending and high interest burden, and we expect a similar trend may happen this year, capping the ability of the government to improve its fiscal accounts. Its "targeted" net domestic bond issuance this year is 90% higher than last year as it seeks to curb foreign currency borrowings. Absorbing such a sharp increase in bond will be costly unless the government further liberalises the foreign quota this year – something we expect it will pursue – or alternatively, change their borrowing mix and shift some of this supply to global bonds (both of which we expect).

Figure 88. GDP growth slows down sharply in 3Q 2012



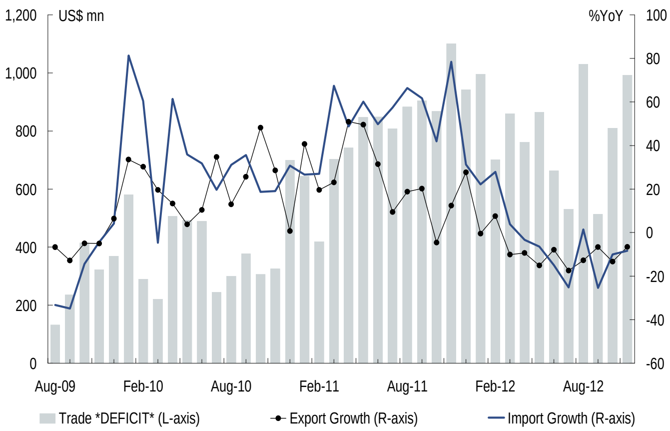
Source: CEIC, and Citi Research

Figure 89. Earlier than expected end to the monetary tightening cycle...



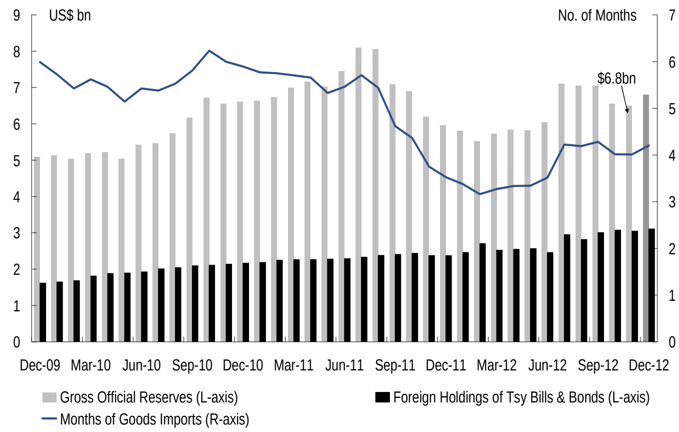
Source: CBSL, CEIC, and Citi Research

Figure 90. ...even as trade deficit remains persistently wide...



Source: CEIC, and Citi Research

Figure 91. ..and FX reserves coverage stays low, partly by ST flows



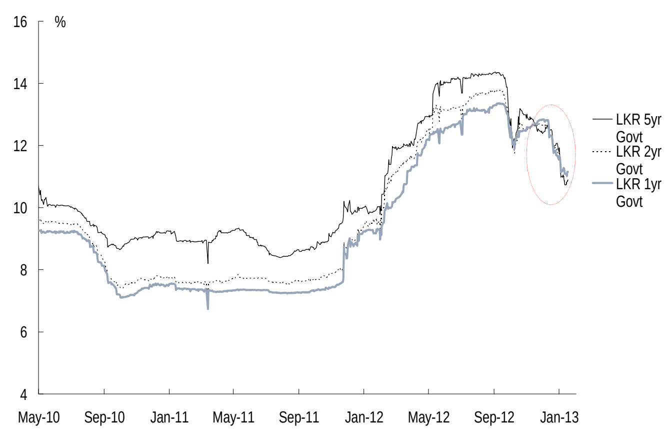
Source: CEIC, and Citi Research

Figure 92. Sustained public invest' amidst weak revenues and higher interest is a recipe for fiscal slippage

	Jan-Sep 2011		2011		2012 Budget*		Jan-Sep 2012	
	LKR bn	%YoY	LKR bn	% YoY	LKR bn	%YoY	LKR bn	%YoY
Total Revenues & Grants	671	14.7%	950	13.9%	1,126	18.5%	726	8.2%
Total Revenues	661	13.6%	935	14.4%	1,106	18.3%	711	7.6%
Tax	591	15.5%	813	12.1%	1,001	23.1%	630	6.6%
Non Tax	70	-0.2%	122	32.0%	106	-13.6%	82	16.2%
Grants	10	222.4%	15	-10.5%	20	32.1%	14	48.5%
Total Exp	1,052	14.8%	1400	9.4%	1,595	13.9%	1,209	14.9%
Recurrent Exp	781	9.9%	1007	7.4%	1,108	10.1%	852	9.1%
Capital & Net Lending	271	31.8%	393	14.7%	487	23.8%	357	31.8%
Overall Budget Balance	-381		-450		-469		-483	

Source: CEIC, and Citi Research

Figure 93. LKR T-bond bullishness likely sustained short term on the turn in monetary policy and front-loaded foreign bond purchases



Source: Bloomberg, and Citi Research

Figure 94. Sri Lanka Economic Indicators

	2006	2007	2008	2009	2010	2011	2012F	2013F	2014F
Sri Lanka									
Nominal GDP, US$ bn	28.3	32.4	40.7	42.1	49.6	59.2	57.4	65.4	74.6
Nominal GDP, local currency bn	2,939	3,579	4,410	4,835	5,604	6,543	7,452	8,505	9,696
GDP per capita, US$	1,422	1,615	2,014	2,058	2,400	2,836	2,721	3,067	3,459
Population, mn	19.9	20.0	20.2	20.5	20.7	20.9	21.1	21.3	21.6
Economic Activity									
Real GDP, % yoy	7.7	6.8	5.9	3.5	8.0	8.3	6.4	7.1	7.5
Prices, Money & Credit									
CPI, % yoy	13.5	18.8	13.9	5.0	6.8	4.9	9.2	6.2	6.5
CPI, % avg	10.0	15.8	22.5	3.6	6.2	6.8	7.5	7.1	6.5
Credit extension to private sector, % yoy	28.8	19.3	7.0	-5.8	24.9	34.5	20.0	18.0	15.0
Policy interest rate, % eop	10.00	10.50	10.50	7.50	7.25	7.00	7.50	7.25	7.50
1 month inter-bank rate, % eop	15.29	19.46	17.88	9.52	8.37	9.46	12.50	10.50	10.50
Long term yield, % eop	12.98	19.96	19.12	9.33	7.55	8.99	11.69	10.00	10.50
lc/US$, eop	107.5	108.7	113.0	114.4	110.9	113.9	127.7	130.0	130.0
lc/US$, avg	103.9	110.6	108.3	114.9	113.0	110.5	127.2	130.0	130.0
Balance of Payments, US$ bn									
Current account	-1.5	-1.4	-3.9	-0.2	-1.1	-4.6	-3.2	-3.1	-3.0
% of GDP	-5.3	-4.3	-9.5	-0.5	-2.2	-7.8	-5.5	-4.7	-4.0
Trade balance	-3.4	-3.7	-6.0	-3.1	-4.8	-9.7	-9.3	-10.6	-11.4
Exports	6.9	7.6	8.1	7.1	8.6	10.6	9.7	10.5	11.9
Imports	10.3	11.3	14.1	10.2	13.5	20.3	19.0	21.1	23.2
Service balance	0.3	0.3	0.4	0.4	0.7	1.1	1.2	1.7	1.8
Income balance	-0.4	-0.4	-1.0	-0.5	-0.6	-0.6	-0.5	-0.4	-0.5
FDI, net	0.5	0.5	0.7	0.4	0.4	0.9	1.0	1.0	1.0
International reserves	2.5	3.1	1.8	5.1	6.6	6.0	6.8	8.3	9.1
Total Amortisations	0.8	0.8	1.1	1.4	1.1	1.0	1.8	1.9	2.2
Public Finances, % of GDP									
Consolidated government balance*	-7.0	-6.9	-7.0	-9.9	-8.0	-6.9	-6.7	-6.2	-5.5
Consolidated gov primary balance*	-1.9	-1.8	-2.2	-3.4	-1.7	-1.4	-1.7	-1.2	-0.5
Public debt	87.9	85.0	81.4	86.1	81.9	78.5	83.0	80.0	78.0
of which Domestic	50.3	47.9	48.5	49.8	45.8	42.9	43.1	42.0	37.4
Foreign Assets & Liabilities, US$ bn									
External debt	14.0	16.5	17.8	20.9	24.8	28.9	32.0	37.0	44.0
Private	14.0	4.3	5.0	5.5	6.6	8.0	8.8	10.4	13.4
Public	0.0	12.2	12.8	15.4	18.2	20.9	23.2	26.6	30.6
External debt / GDP	49.4	50.9	43.6	49.7	50.1	48.8	55.7	56.6	59.0
Short-term debt	2.6	2.5	2.7	3.1	2.6	4.4	4.8	5.6	6.6
Short-term debt/International Reserves (%)	104.0	81.3	152.1	60.7	39.3	73.1	70.6	66.7	72.8

Quarterly Economic Indicators

	2012 Q2	2012 Q3	2012 Q4F	2013 Q1F	2013 Q2F	2013 Q3F	2013 Q4F	2014 Q1F	2014 Q2F
GDP, % yoy	6.4	4.8	6.4	6.7	6.8	7.7	7.1	7.3	7.5
CPI, % yoy	9.3	9.1	9.2	7.9	5.0	6.5	6.2	6.8	7.6
Policy interest rate, % eop	7.75	7.75	7.50	7.50	7.25	7.25	7.25	7.25	7.50
1 month inter-bank rate, % eop	11.48	12.28	12.50	12.50	12.00	11.50	10.50	10.50	10.50
Long term yield, % eop	12.67	13.30	11.69	11.50	10.50	10.50	10.00	10.00	10.00
lc vs USD, eop	133.3	129.4	127.7	130.0	130.0	130.0	130.0	130.0	130.0

Source: CEIC Data Company Limited, Central Bank of Sri Lanka, Moody's and Citi Research estimates
*Note: Public debt is general government debt and external debt is based on the residency of the holder of the debt (not by currency denomination).

Taiwan

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- **Summary view** – Economic recovery looking more evident at the end of 2012. Further strength in real activities, except consumption, was noted. Trade recovery likely to continue in a zig-zag manner. We don't see signs of JPY weakness significantly eroding the competitiveness of Taiwanese' exports yet.
- **Things to watch** – Offshore RMB banking will likely be launched after the Chinese New Year and other RMB-denominated products (e.g. bonds and loans) could be next on the list. ECFA for services and FTA negotiations are also on the table. CBC likely to step up on FX intervention to alleviate TWD strength.
- **Strategy** – Mild NTD appreciation, along with regional trends, likely to continue in 2013E. CBC kept its policy rate on hold at its December meeting; we expect a neutral stance to prevail in 2013E. Other market rates are likely to stay low for an extended period. Our strategist has set 8,200 as TAIEX year-end 2013 target.

Trade recovery in the making and the weaker yen impact

Key real activities data continued to confirm recovery. Stronger exports, positive export orders growth and industrial production were noted in December. These more upbeat data at the turn of the year should contribute to better-than-earlier-expected 4Q GDP growth (Citi F: 3%yoy, to be released on 31 January). Specifically, exports recovery was broad based as witnessed in both the tech and non-tech space. Sources of demand growth were also diversified, even European demand surprised on the upside. We expect exports to post further recovery in 2013, but not necessarily to be in a straight line, as performance is distorted by holiday patterns and various tech product launches. Also recent strength witnessed in European demand is unlikely to be sustainable given the heightening of financial deleveraging and austerity there.

The impact of a weakening Yen on Taiwanese exports… The Yen has recently depreciated ~10% post LDP government was elected. Citi expects USDJPY to reach 93 in 0-3 months and 96 in 6-12 months. Trade data wise, it is still early to tell the magnitude of impacts (as November exports to Japan are still on a recovery path). Analytically, our study on export similarity index between Japanese and Taiwanese net exports shows that about 25% of Taiwanese net exports are similar with Japan (and index similarity can be exaggerating the competition risks). The biggest overlapping net trade segment (according to SITC breakdown of UN Commtrade data) is "Machinery and Transport Equipment"; of which higher overlapping export structure were seen in the following sub-categories: 1) "Electrical machinery, apparatus and appliances, and electrical parts" (~12% similar), which includes circuits, panels, semiconductors; 2) "Road vehicles" (~4-5% similar); and 3) "Metal working machinery" (~3-5% similar).

Importers from Japan or Yen denominated imports are beneficiaries. Taiwan actually is a net importer from Japan and incurred a trade deficit with Japan of NT$853bn in 2012. Exports to Japan accounted for 6.3% of Taiwan's total exports or 3.9% of GDP in 2012; products ranging from electronics, machinery, chemicals, plastics/rubber/iron/steel articles, precision/optical instruments, info/communication products and transport equipment. Meanwhile imports from Japan accounted for 17.6% of Taiwan's total imports or 9.7% of GDP; popular imported products include: electronics, machineries, chemicals (especially organic ones), plastics/iron/steel articles, precision/optical instruments and transport equipment. Note some product categories are two-way traded and/or used in a production process.

Japanese divestments plans into Taiwan could slow, at the margin. Japanese FDI into Taiwan has not been large historically – only 0.05% of Taiwan's 2012E GDP was accumulated over the last 12 months, or 0.85% accumulated since 2006. There were previous discussions that Japanese firms would investigate the option of relocating their plants from the mainland to Taiwan. Similarly Japanese investments into Taiwanese banks were also mentioned previously. With a likely structural weakening to the yen, these investment plans may now be on hold.

Instead talks Japanese outsourcing to Taiwan still make sense from a relative labor cost perspective. Taiwanese manufacturing labor cost is around US$9.3/hour, still much cheaper than Japanese wage of US$34.7/hour.

… And lastly on FX – A weaker JPY could likely increase CBC interventions to defend the TWD appreciation to mitigate the relative currency strength impacts on Taiwanese exports. However, strength in RMB and KRW appreciation in the near future could still push the TWD near to 28.8 in 0-3m and 28.5 in 6-12m.

Upside risks to 2013E GDP depends on consumers

Weak consumption trends becoming the main drag on growth, at least in 1QE. With sustained trade drag moving behind us, we are now most worry about the lack of consumption drivers. Consumer confidence as of Dec continues to decline, although liquidity inflows continue, the domestic equity market (TWSE) moved up about 10% post government attempts to talk up the market, the unemployment rate continue to improve in December 2012 (to 4.22%sa). However, real wages continue to fall (-0.59%yoy in Jan-Nov12) and this is probably the main culprit that is handicapping purchasing power of local consumers. We think we will need to see real wages back into positive before we will see material improvements in private consumption.

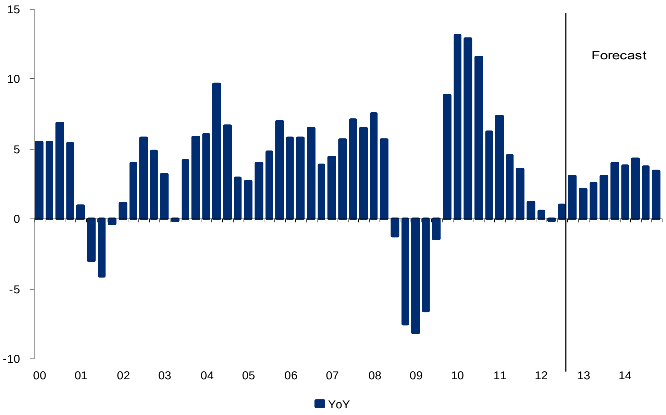
Other foreword indicators confirm recovery case for the rest of 2013. For instance, HSBC/Markit PMI for Taiwan turned into expansion mode of 50.6 in December. The official leading indicator as of November (+0.8pt mom) indicates that the economy is improving, albeit very gradually. With recent upgrades in Citi's US and China GDP growth for 2013E, there is upside risk to Taiwanese exports recovery in 2013E. Anecdotal evidence suggests that tech products pipeline for 1Q13E will remain mix and visibility beyond 1Q will depend on Win 8/PC performance. Therefore, we prefer to wait for further confirmation in the actual data before making adjustments.

CPI inflation likely to rise near term, on impacts of festive activities and comparison base. 2012 full-year average is at 1.9%yoy, higher than 2011's 1.4%yoy, and we expect CPI in 2013E to average at similar level (2%yoy). With relatively stable inflation trend and a moderate economic recovery in the marking, we expect the CBC to stay neutral in 2013E, keeping policy rate at 1.875%p.a.

CNT banking business likely to kick off post-CNY

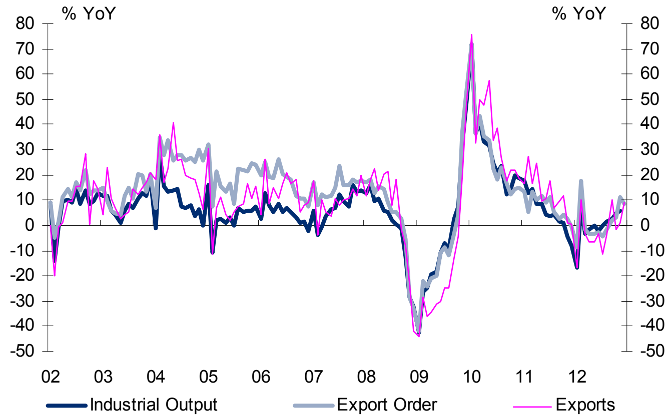
Progress update. The clearing banks for RMB transactions in Shanghai and Taiwan have finally been designated, to Bank of Taipei and Bank of China's Taipei branch, respectively. Newswires suggest that CNT clearing businesses could start after Chinese New Year. This will likely kick off a round of banks competition for RMB retail deposits via term deposit promotions. Aside for capturing market share, the participating banks will have to look into RMB (trade settlement) loans to generate returns from the accumulated RMB deposit. The launching of RMB bond market will be next, but could take more time, subject to regulatory progress.

Figure 95. Gradual recovery expected in 2013E



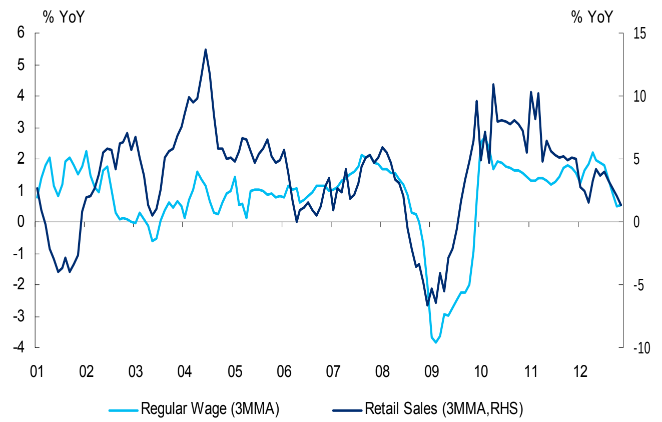
Source: CEIC, and Citi Research estimate

Figure 96. IP and exports recovering but in a zig-zag path



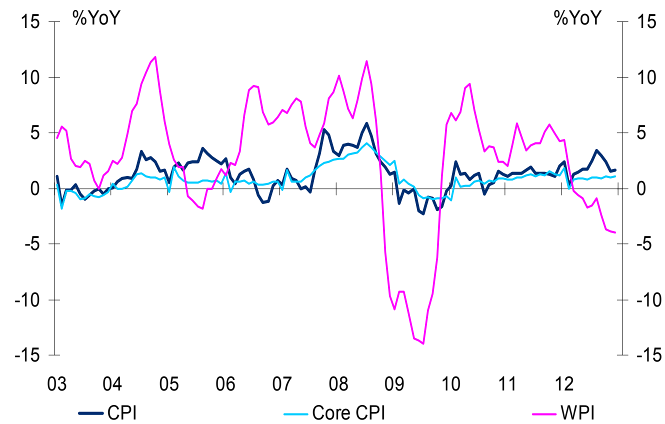
Source: CEIC, and Citi Research

Figure 97. Consumption recovery likely to lag



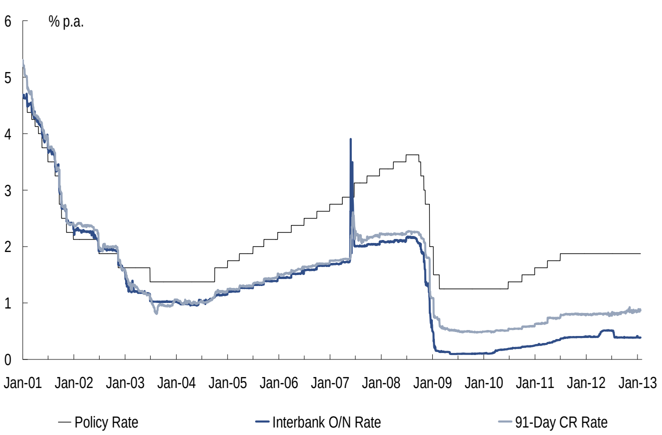
Source: MOEA, and Citi Research estimate

Figure 98. Benign inflation expected in 2013E



Source: CEIC, and Citi Research

Figure 99. CBC likely to sustain its neutral stance in 2013E



Source: Bloomberg

Figure 100. NT$ appreciation likely with regional FX trends/risk-on mode

Source: CEIC, and Citi Research

Figure 101. Taiwan Economic Indicators

	2006	2007	2008	2009	2010	2011	2012F	2013F	2014F
Summary Data									
Nominal GDP, US$ bn	376.3	393.1	400.2	377.6	430.2	466.8	488.8	538.9	573.3
Nominal GDP, local currency bn	12,243	12,911	12,620	12,481	13,614	13,757	14,475	15,344	16,208
GDP per capita, US$	16,513	17,191	17,444	16,404	18,659	20,200	21,076	23,192	24,623
Population, mn	22.8	22.9	22.9	23.0	23.1	23.1	23.2	23.2	23.3
Unemployment, % of labour force	3.9	3.9	4.1	5.8	5.2	4.4	4.2	4.2	4.0
Economic Activity									
Real GDP, % yoy	5.4	6.0	0.7	-1.8	10.7	4.0	1.1	3.0	3.8
Real investment growth % yoy	0.5	-0.7	-7.9	-21.2	39.5	-7.6	-2.7	3.0	5.3
Real consumption growth % yoy	1.1	2.1	-0.6	1.3	3.1	2.8	1.1	1.6	2.3
private consumption growth % yoy	1.5	2.1	-0.9	0.8	3.7	3.0	1.2	1.9	2.7
Real export growth, % yoy	11.4	9.6	0.9	-8.7	25.6	4.5	-0.4	3.9	4.3
Real import growth, % yoy	4.6	3.0	-3.7	-13.1	28.2	-0.6	-2.1	2.6	3.0
Prices, Money & Credit									
CPI, % yoy	0.7	3.3	1.3	-0.2	1.2	2.0	1.6	2.5	2.0
CPI, % avg	0.6	1.8	3.5	-0.9	1.0	1.4	1.9	2.0	1.8
Nominal wages, % yoy	0.8	2.1	0.0	-5.1	5.5	2.7	0.0	1.5	3.0
Credit extension to private sector, % yoy	4.7	3.9	2.7	-0.8	6.7	5.7	3.0	5.0	7.0
Policy interest rate, % eop	2.75	3.38	2.00	1.25	1.63	1.88	1.88	1.88	2.13
1 month inter-bank rate, % eop	1.69	2.04	1.02	0.57	0.74	0.87	0.87	0.93	1.05
Long term yield, % eop	1.99	2.53	1.44	1.47	1.47	1.27	1.17	1.29	1.41
lc/US$, eop	32.59	32.43	32.78	32.23	29.17	30.29	29.06	28.45	28.21
lc/US$, avg	32.52	32.85	31.58	33.04	31.50	29.40	29.57	28.59	28.30
Balance of Payments, US$ bn									
Current account	26.3	35.2	27.5	42.9	39.9	41.3	42.4	45.4	45.9
% of GDP	7.0	8.9	6.9	11.4	9.3	8.8	8.7	8.4	8.0
Trade balance	11.6	16.8	4.4	20.3	11.0	11.3	14.4	23.5	37.0
Exports	213.2	235.1	243.8	193.8	261.6	291.9	284.2	303.5	333.0
Imports	201.6	218.2	239.5	173.5	250.5	280.6	269.8	280.0	296.0
Service balance	-3.5	-1.6	1.9	2.0	2.5	4.3	4.4	23.3	17.3
Income balance	9.6	10.1	10.0	12.5	13.6	13.2	16.8	17.5	19.0
FDI, net	0.0	-3.3	-4.9	-3.1	-9.1	-14.7	-13.0	-11.0	-9.0
International reserves	266.1	270.3	291.7	348.2	382.0	385.5	403.2	425.0	450.0
Total Amortisations	5.8	3.8	8.8	2.5	3.2	6.8	3.0	3.3	4.5
Public Finances, % of GDP									
Consolidated government balance	0.1	0.3	-0.5	-3.5	-2.3	-1.9	-1.6	-1.2	-1.3
Consolidated gov primary balance	1.2	1.4	0.5	-2.5	-1.4	-0.9	-0.6	-0.3	-0.6
Public debt	29.6	28.8	29.9	33.1	33.3	34.7	39.2	39.5	42.0
of which Domestic	19.0	25.3	28.4	27.2	25.3	30.1	32.4	32.6	36.6
Foreign Assets & Liabilities, US$ bn									
External debt	85.8	94.5	90.4	82.0	101.6	122.5	124.0	125.5	127.0
Private	75.2	91.1	88.9	76.0	93.5	118.0	119.0	120.5	121.9
Public	10.6	3.5	1.5	5.9	8.0	4.5	5.0	5.0	5.1
External debt / GDP	22.8	24.0	22.6	21.7	23.6	26.2	25.4	23.3	22.2
External debt / XGS	38.4	38.3	35.4	40.3	37.1	39.9	33.7	31.0	29.4
Short-term debt	74.2	83.3	78.8	68.2	83.7	107.8	120.0	115.0	110.0
Short-term debt/International Reserves (%)	27.9	30.8	27.0	19.6	21.9	28.0	29.8	27.1	24.4

Quarterly Economic Indicators

	2012 Q2	2012 Q3	2012 Q4F	2013 Q1F	2013 Q2F	2013 Q3F	2013 Q4F	2014 Q1F	2014 Q2F
GDP, % yoy	-0.1	1.0	3.0	2.1	2.6	3.1	4.0	3.8	4.3
CPI, % yoy	1.8	3.0	1.6	2.8	1.9	1.1	2.5	2.5	1.1
Policy interest rate, % eop	1.88	1.88	1.88	1.88	1.88	1.88	1.88	1.88	1.88
1 month inter-bank rate, % eop	0.87	0.87	1.17	1.20	1.23	1.23	1.26	1.32	1.35
Long term yield, % eop	1.24	1.19	1.17	1.20	1.23	1.26	1.29	1.32	0.99
lc vs USD, eop	29.79	29.32	29.06	28.75	28.64	28.52	28.45	28.39	28.33

Source: CEIC Data Company Ltd, Fitch, IFS, Moody's and Citi Research estimates
*Note: Public debt is central government debt and external debt is based on the residency of the holder of the debt (not by currency denomination).

Thailand

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- **Summary view** – We upgrade 2012 GDP growth to 4.4% while retaining our growth expectations of 4.5% in 2013 and 4.8% in 2014. We are excited over the prospects of investment-driven growth as flood-induced spending tapers off. Share of real investments ex-inventories to GDP may rise to 24%-25%.

- **Things to watch** – More MPC tightening signals with investment-driven growth shaping up. Core inflation likely to bottom out in 2Q13. Parliamentary approval of the government's medium-term public investment programme of Bt1.95tr. Application of macroprudential tools to ensure financial market stability.

- **Strategy** – We now expect rate tightening to start late 2Q13 for a cumulative hike of 75bp-100bp leading to an overnight rate peak of 3.75%. Pay 2yr interest rate swaps amid likelihood of rate tightening. As bear flatteners emerge, extend duration for those expressing their strong Baht view in government securities.

Higher likelihood of investment-driven growth in 2013-14

We upgraded our 4Q12 GDP growth forecast to 10.3%YoY from ~ 8%YoY, rounding off the FY GDP forecast to 4.4%. Upside export surprise in Oct-Nov likely to extend for the whole 4Q may result 18%YoY growth. Most of manufacturing capacity has normalised to exploit improving external demand with focus on techs and contributions to smartphone producers. Real investments would lead domestic demand with growth of 17% during 4Q. 4Q consumption growth of 8.5%YoY – again led by demand for cars and other durable goods will follow upbeat real investments. Base effect however may dampen consumption since the annualised growth rate was 9.1% in 3Q12. Domestic demand (ex-inventories) probably rose by 10.4%YoY to account for much of upbeat GDP growth during the quarter.

Normalising growth prospects and base effects lead to a growth trajectory of 5%YoY in 1Q13, and 4%YoY in 4Q13 (4.5% annual growth). Growth triggers should be: 1) fiscal spending; 2) 2H export recovery; 3) strong consumer/business sentiment; 4) accommodative financial setting likely to boost durables demand; and 5) new high for FDI approvals in 2012 that will support 2013 private investments.

We see strong investment-driven growth in 2013-14 despite GDP prospects staying within potential of 4%-5%. Estimated contribution of real investments (ex-inventories) to real GDP may fall in the range of 24%-25% in 2013-14 after a high of 23% in 2012 (high of more than 23% share in 2005-06). Last year's record high FDI approvals (Bt548bn) will provide a lift to private investments. For every 1% increase in real FDI approvals during the current quarter, real investments (ex-inventories) rises by 0.029%QoQ SA. Past two quarters of real FDI approvals also showed statistically significant effects on real investments in the range of 0.02%QoQ SA and 0.037%QoQ SA. Last year's FDI approvals were concentrated in metal products & machinery (35% share), electronics and electrical parts (22.3%) and services (18.5%). Ten straight quarters of QoQ growth for real investments starting 2003 supported an investment-driven growth cycle back then.

Strong public investments will also contribute to enhancing the potential for investment driven growth. The government plans to have the Bt1.95tr MT public investment programme (2013-2020) approved in parliament this quarter with the bulk consisting of rail transport investments of Bt1.28tr. The key assumption is that political risk will not derail approval/implementation of the public investment agenda.

Elevated our overnight rate outlook

We now see MPC to start policy rate hikes in May that will culminate in a rate tightening cycle of 75bp-100bp to less than 4% in 2H13 — The following reasons support our view: 1) 'Tightening' has begun with BoT's accommodation of a strong Baht. 2) Investment driven growth likely to replace missing robust exports, will not require sustained monetary stimulus or accommodation. Our 2013/14 GDP forecasts assume real investments (ex-inv) will lead domestic demand and GDP momentum. Last year's new high for FDI approvals of Bt528bn should translate into stronger real investments. In BoT's Monetary Policy report for Jan that highlighted GDP forecast upgrades, policymakers cited these factors behind the strong private investment outlook: a) business capacity expansion to accommodate growing domestic demand; b) inclination towards greater capital intensity in production; and c) export preparation particularly when ASEAN tariff rates fall further in 2015; and d) 'crowding-in effect of public investment projects. Policymakers may wait for strong evidence that private investments as flagged by the record high FDI approvals will indeed lead the economy to shift to investment-driven growth. 3) If fiscal policy bias and catalysts underpinning the re-balancing theory (reduce economy's dependence on global markets) were to persist, the consumption outlook will not require sustained policy rate accommodation. Once the macro and micro profiles confirm the shift to investment-driven growth in succeeding months amid a strengthening Baht, gradual policy rate tightening will be the next prudent step in our view.

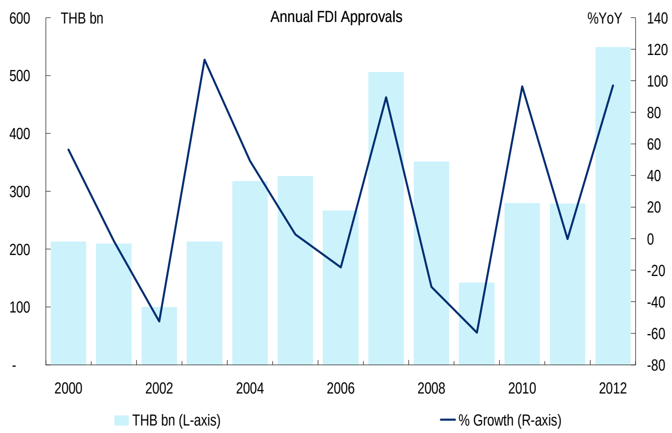
Marginal current account deficit outlook

We estimate investment-driven growth coupled with a sustained fiscal deficit position will result in faster import growth (relative to modest export recovery) that will mute the trade surplus outlook and likely result in a current account deficit of 0.4% of GDP in 2013 and 0.7% of GDP in 2014. Investment-driven growth that includes the emphasis on public investments should sustain 2-digit gains for imports of capital goods and intermediate inputs. Expecting export gains of 11.7% in 2013 and 13% in 2014 won't be sufficient to overcome faster import growth and persistent net outflows in the services, incomes and transfer accounts. FDI, portfolio and debt flows would probably be more than sufficient to fund the marginal current account deficit outlook although foreign exchange outflows reflected by Thai investments overseas and those flows accruing to banks, public sector and BoT can always give a mixed picture of the capital and financial accounts. We still expect capital account flows to be in a stronger position to drive FX reserve accumulation this year.

Extend duration for those with strong Baht view

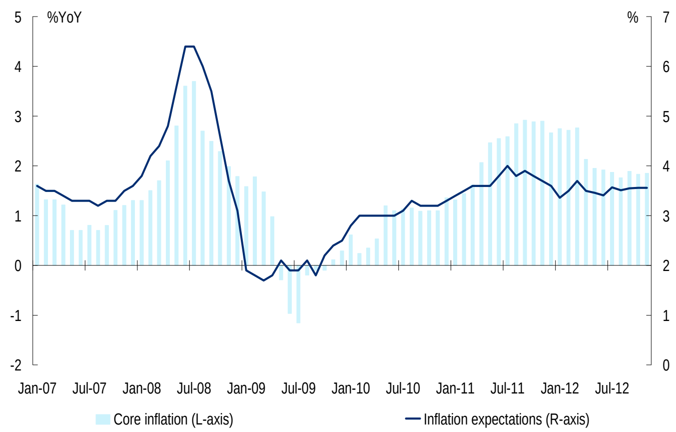
While markets may have priced in the risk of a rising government debt to GDP ratio, we think its only recently after the first MPC meeting (9 January) that Thailand may soon face a higher interest rate environment. Pay 2-yr interest rate swaps would be appropriate in an elevated interest rate setting. While those with a strong Baht view invested in government securities should extend duration as bear flatteners materialise in a rate tightening cycle. Timing for inception of the rate tightening cycle would be crucial for guarding against local currency spillover. Close to mid-year, we will know whether US recovery prospects may be in place that increases likelihood of QE3 phaseout and rate differentials conducive to USD. These conditions that de-link policy rate adjustments from the Baht facilitate rate tightening. Moderation of investment activities following last year's strong capex activities and government's infra budget execution risk are risks to our rate hike call.

Figure 102. Record high FDI approvals in 2012 bode well for investments



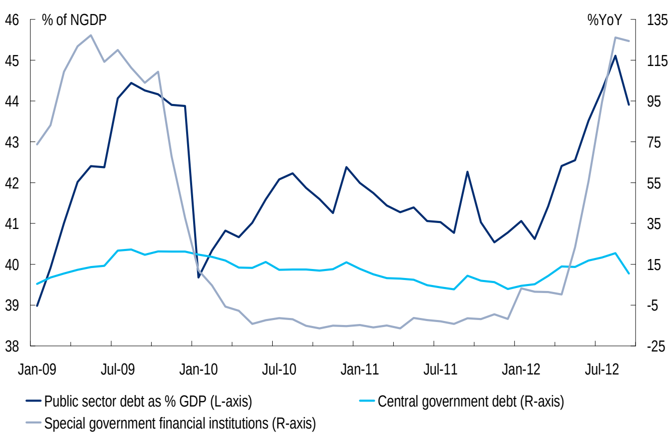
Source: CEIC, and Citi Research

Figure 103. Steady inflation outlooks despite core disinflation in 2H12



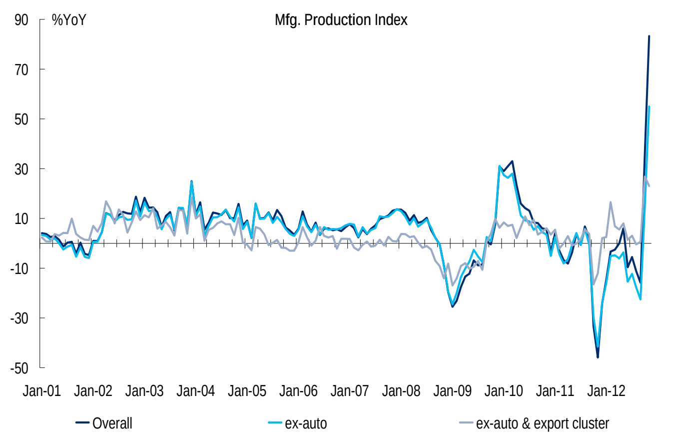
Source: CEIC, and Citi Research

Figure 104. FY12 Off budget stimulus via SFI balance sheet expansion



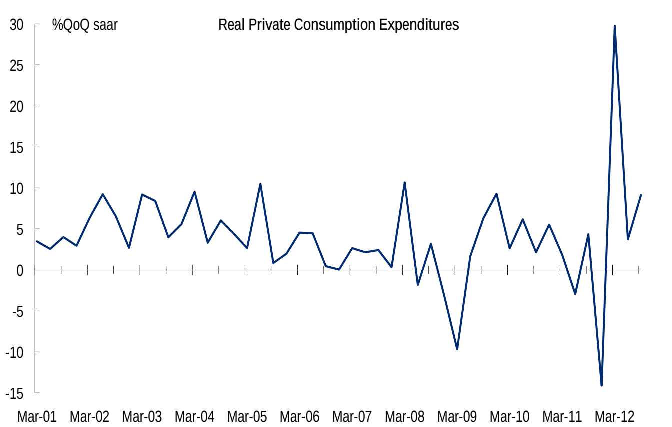
Source: CEIC, and Citi Research

Figure 105. Ex-autos, ex-exports, manufacturing remains upbeat in 4Q12



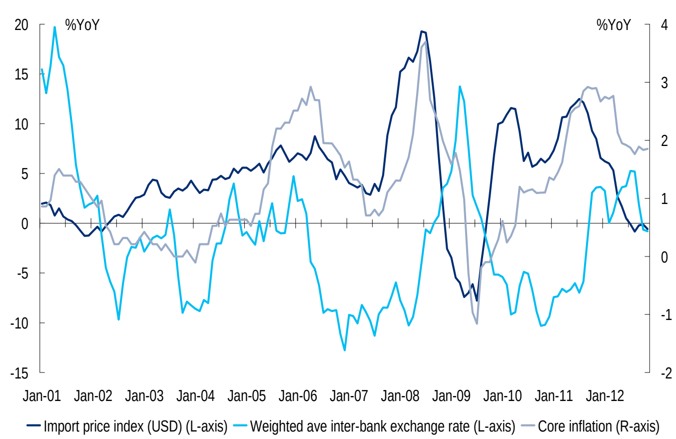
Source: CEIC, and Citi Research

Figure 106. Robust private consumption outlook in 3Q12



Source: CEIC, and Citi Research

Figure 107. Tightening has begun with BoT receptive to a strong Baht



Source: CEIC, and Citi Research

Figure 108. Thailand Economic Indicators

	2006	2007	2008	2009	2010	2011	2012	2013F	2014F
Summary Data									
Nominal GDP, US$ bn	207.4	265.2	276.1	263.8	319.3	346.1	359.7	395.7	428.5
Nominal GDP, local currency bn	7,845	8,525	9,080	9,042	10,105	10,540	11,169	11,949	12,899
GDP per capita, US$	3,177	4,034	4,163	3,945	4,745	5,121	5,564	6,084	6,489
Population, mn	65.3	65.7	66.3	66.9	67.3	67.6	64.6	65.0	66.0
Unemployment, % of labour force	1.5	1.4	1.4	1.5	1.0	0.7	1.1	0.8	1.0
Economic Activity									
Real GDP, % yoy	5.1	5.0	2.5	-2.3	7.8	0.1	4.4	4.5	4.8
Real investment growth % yoy	-3.6	1.0	8.1	-25.2	28.7	0.1	14.7	9.1	7.5
Real consumption growth % yoy	3.0	2.9	2.9	0.1	5.1	1.3	5.7	3.8	3.2
private consumption growth % yoy	3.2	1.8	2.9	-1.1	4.8	1.3	5.7	3.7	3.1
Real export growth, % yoy	9.1	7.8	5.1	-12.5	14.7	9.5	2.6	9.9	10.6
Real import growth, % yoy	3.3	4.4	8.9	-21.5	21.5	13.7	7.3	12.2	11.1
Prices, Money & Credit									
CPI, % yoy	3.6	3.1	0.4	3.5	3.0	3.5	3.6	3.3	4.3
CPI, % avg	4.7	2.2	5.4	-0.9	3.3	3.8	3.0	3.3	4.0
Nominal wages, % yoy	6.2	3.0	10.2	-2.5	6.5	7.2	40.0	0.0	2.5
Credit extension to private sector, % yoy	4.5	29.3	6.3	2.5	18.9	18.0	16.0	13.5	11.5
Policy interest rate, % eop	5.00	3.25	2.75	1.25	2.00	3.25	2.75	3.75	3.75
1 month inter-bank rate, % eop	5.22	3.74	3.07	1.28	2.03	3.26	2.79	3.50	3.50
Long term yield, % eop	5.04	5.13	2.84	4.37	3.74	3.28	3.55	4.25	4.00
lc/US$, eop	35.45	30.05	34.79	33.36	30.07	31.57	30.60	30.40	29.92
lc/US$, avg	37.93	32.33	33.03	34.33	31.71	30.48	31.08	30.17	30.10
Balance of Payments, US$ bn									
Current account	2.3	15.7	2.2	21.9	10.0	5.9	0.4	-1.8	-2.8
% of GDP	1.1	5.9	0.8	8.3	3.1	1.7	0.1	-0.4	-0.7
Trade balance	13.7	26.6	17.3	32.6	29.8	17.0	7.6	3.6	3.1
Exports	127.9	151.3	175.2	150.8	191.6	219.1	220.2	246.0	278.2
Imports	114.3	124.6	157.9	118.2	161.9	202.1	212.6	242.4	275.1
Net service and Transfer accounts	-8.0	-8.0	-12.9	-6.4	-10.7	-10.6	-23.8	-25.7	-28.0
Income balance	-3.4	-3.0	-2.3	-4.4	-9.0	-0.5	--	--	--
FDI, net	8.5	8.3	4.4	0.7	4.5	-0.4	7.0	5.5	6.5
International reserves	67.0	87.5	111.0	138.4	172.1	175.1	180.0	195.0	200.8
Total Amortisations	12.8	20.5	15.0	10.7	9.4	8.9	17.3	18.0	19.0
Public Finances, % of GDP									
Consolidated government balance	-0.7	-1.6	-1.0	-5.7	0.0	-1.0	-2.1	-2.2	-2.1
Consolidated gov primary balance	0.9	-0.3	0.2	-4.5	1.2	0.2	-0.8	-0.9	-0.7
Public debt	24.9	24.1	23.5	28.6	29.7	29.3	31.6	32.9	36.1
of which Domestic	22.9	23.0	22.7	28.0	29.7	28.9	33.8	34.7	35.3
Foreign Assets & Liabilities, US$ bn									
External debt	70.0	74.4	76.1	75.3	100.6	104.6	100.1	102.5	103.5
Private	64.7	71.6	72.7	69.4	87.9	88.4	75.1	76.9	76.9
Public	5.2	2.8	3.4	5.9	12.7	16.2	25.0	25.6	26.6
External debt / GDP	33.7	28.1	27.6	28.5	31.5	30.2	27.8	25.9	24.2
External debt / XGS	45.9	41.0	36.5	41.6	44.5	40.1	45.4	41.7	37.2
Short-term debt	27.2	34.0	33.6	33.1	50.7	47.3	49.8	51.1	52.1
Short-term debt/International Reserves (%)	40.7	38.9	30.3	23.9	29.4	27.0	27.7	26.2	25.9

Quarterly Economic Indicators

	2012 Q2F	2012 Q3F	2012 Q4F	2013 Q1F	2013 Q2F	2013 Q3F	2013 Q4F	2014 Q1F	2014 Q2F
GDP, % yoy	4.4	3.0	10.3	5.0	4.7	4.3	4.0	4.5	4.8
CPI, % yoy	2.6	3.4	3.6	3.5	3.7	3.6	3.3	3.5	3.7
Policy interest rate, % eop	3.00	3.00	2.75	2.75	3.00	3.50	3.75	3.75	3.75
1 month inter-bank rate, % eop	3.05	3.05	2.79	2.50	2.75	3.25	3.50	3.50	3.50
Long term yield, % eop	3.62	3.62	3.55	3.75	3.85	4.00	4.25	4.00	4.00
lc vs USD, eop	31.57	30.83	30.60	29.75	30.09	30.43	30.40	30.28	30.17

Source: CEIC Data Company Ltd, Fitch, IFS, Moody's and Citi Research estimates
*Note: Public debt is central government debt and external debt is based on the residency of the holder of the debt (not by currency denomination).

Frontier Asia

Mongolia

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2012 Real GDP came in higher than expected; likely to pick up in 2013E. Preliminary GDP estimates indicated that the economy grew a tad faster than expected at 12.3%YoY (vs. our expectation of 12%). 2012 GDP was sponsored by final consumption (64.2% of GDP), gross capital formation (60.6%), offsetting the net export drag of -24.7%; and strong consumption growth was the driver. Agri still has the fastest growth in 2012 (+2.3%YoY), while mining & quarrying grew by 8.9%YoY. We expect the contribution to GDP from mining will rise in 2013E. Oyu Tolgoi (OT) copper mine appears on schedule to begin commercial production by Jun13 and has already secured sales contracts for 75% of its production and committed the remaining 25% to Inner Mongolia. However, the selection of mining companies of the nation's biggest coal field Tavan Tolgo (TT) has been delayed to mid-2103, ramp up of TT's phase I has also been slow, this may lessen the expected coal contribution to exports and GDP in 2013E.

Inflation began to taper off a little at the end of the year. The MNT posted a small appreciation in December 2012; we expect depreciation trends to persist in 1Q13E but the pace likely to slow before turning back to appreciation starting in 2Q13E. Due to the high imported content, the nation returning to appreciation stance would help lower inflation. We see inflation to average around 12%YoY in 2013E, from 2012's peak at 14.3%YoY. However, rising wages, fast money growth (Dec12 M2: 18.8%YoY), and gov't handouts (pre-election) should continue to spur consumption. Mongolia likely will receive more overheating warnings from supranationals in 2013.

Can Mongolia really satisfy its Fiscal Stability Law (FSL), or just technically? The latest Budget expects 2013 fiscal deficit will comply to the FSL and come in below 2%. Although our fiscal deficit forecast remain as -2.4% of GDP in 2013E, we reiterate that the usage of the Development Bank of Mongolia as the off-budget financing vehicle is only a technical reduction of the fiscal deficit as liability incurred by the DBM are after-all explicitly guaranteed by the government. We also expect the Mongolia government will further tap international markets in 2013, as last year's issuance has only used up $1.5bn of its sovereign bond mandate.

More politics to come in the run-up to the Presidential election. Last year-end the internal political episode of MPRP threatening to resign from the cabinet in a protest against the corruption charges against its leader caused a knee-jerk market reaction in its recent sovereign bond. The event, in the end, did not cause much actual disturbance in the parliament, as the ruling coalition was able to maintain majority in the parliament. However, with the Presidential election coming up in June 2013, we expect more strong resource nationalism voices and populism policies to be tabled again. Recent proposed changes to the mining law (final draft to be submitted to parliament in Apr13) are negative for FDI prospects.

Vietnam

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We expect 2013F growth recover ~5.4%, vs 5.0 % in 2012. Recovery should be aided by some external demand rebound, continued structural support for FDI inflows into manufacturing, and lagged impact of further monetary/fiscal easing that started in 2012. We expect another 100bp cut in 2013, after 600bps of cuts in 2012. We don't see this as too destabilising for macro stability given the difficulty in intermediating looser liquidity and lower rates into stronger credit growth amid a glacial pace of bank restructuring. We are also somewhat encouraged by the government's willingness to tolerate slower growth to safeguard macro stability.

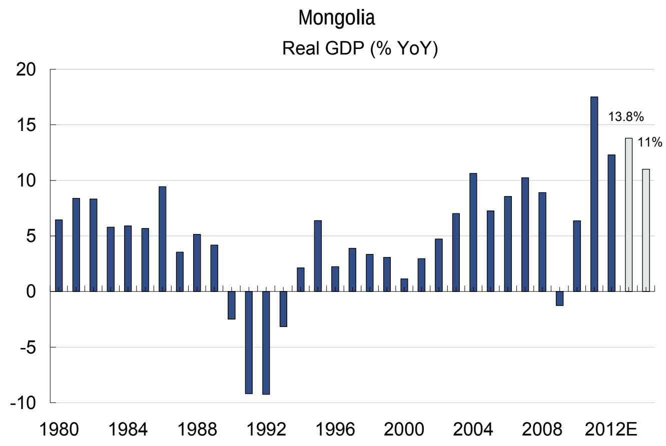
We've raised our current account (CA) forecast in 2012-14F – expecting a persistent surplus. We believe the 2012 CA hit $4.4bn (3.2% of GDP) amid a higher than expected trade surplus (hit $1.3bn surplus), which complimented with resilient remittances, bode well for the full year CA balance. We think the surplus can remain until 2014F but will narrow over time as domestic economy recovers, as domestic recovery will be capped by the ongoing delay in bank sector restructuring.

There are two important drivers to the shift in the current account: First, with unresolved banking sector issues, the pressure for Vietnamese banks to de-lever remain strong, impairing credit intermediation. The transmission of low rates and loose liquidity to inducing credit-fueled demand/overheating risk is not happening, which is a departure from the past. Second, a dynamic and dramatically changing export sector. Vietnam's exports, up 20% YoY in 2012, have been the best performing in the region. A big driver of this has been dramatic changes due to FDI-driven production relocation diversification, creating Vietnam's high tech production base. Computers and phone-related tech exports – the latter especially due to Samsung – saw an explosive 87% YoY and 98% YoY growth, respectively, in 2012. High-tech exports now account for the largest component of Vietnam's exports, eclipsing textile and garments for the first time in history. It's also worth noting that Vietnam's other non-tech exports have fared reasonably well vis-à-vis peers, indicating lingering competitiveness in the manufacturing sector.

We expect dong will remain stable in our forecast period – we recommend exposure via VND bonds. On top of the shift in the current account**,** access to long term capital flows, be it via net FDI (though commitments have come down substantially, disbursals have remained sticky) and official loans (consultative donor group pledged another $6.5bn for 2013), has remained resilient adding to structural external surpluses. We estimate that SBV has increased its official FX reserve holding by around 70% in 2012 to almost $24bn, which should help bolster confidence in SBV's ability to defend the dong. We don't see much upside to the dong versus USD as we think SBV's reserve accumulation tack will persist – while reserve coverage over short-term external liabilities has improved significantly to high levels, FX reserves over M2 is still very low – only about 15% of M2 (up from 11% in end of 2011). Given the risk to domestic confidence in the local financial system, we believe SBV will want to target a higher FX reserves/M2 ratio.

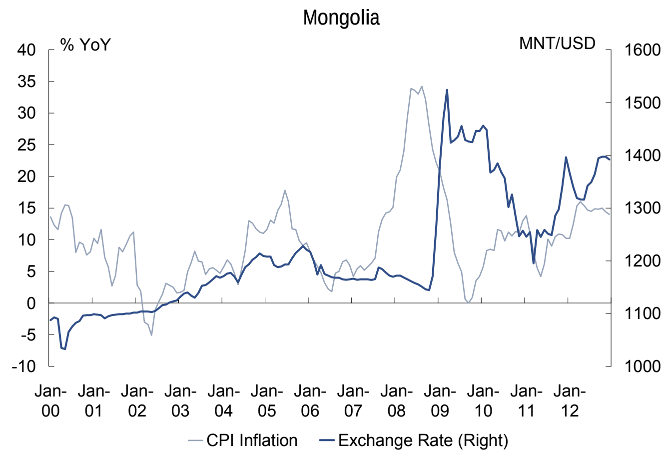
Expect a very slow pace of bank restructuring going into 2013F. We could see attempts to raise capital by increasing bank foreign ownership limits, more forceful efforts to address/restructure/close the weak banks (i.e. "Group 4") which are unnecessarily driving up cost of funding across the banking system and more clarity in assessing state of the financial sector via participation of the WB-IMF Financial Sector Assistance Program (FSAP). However, we don't think we will see significant resolution of the bank sector problems yet: First, information quality on the extent of the NPL problem is still lacking. Second, legal/regulatory framework for disposing of bad assets, and the governance structure and capital to support the government run DATC (Debt Asset Trading Company) is inadequate. Third, decisive leadership driving tough decisions on reforms (e.g. how much government funds to use for recapitalisation) look unclear. Lastly, the lack of market pressure (e.g. no external funding issue, rising domestic deposit funding base, resilient growth in other parts of the economy) has allowed the government to take its time with reforms.

Figure 109. Mongolia – GDP growth could climb again in 2013E



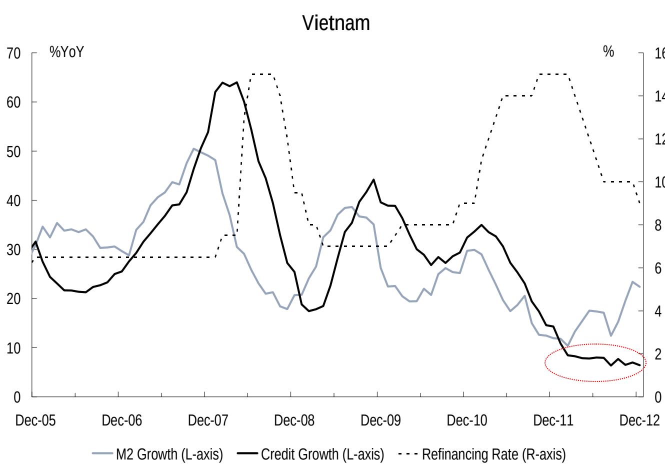
Source: IMF, Haver and Citi Research estimates

Figure 110. Inflation tapered and MNT appreciated a little at year end



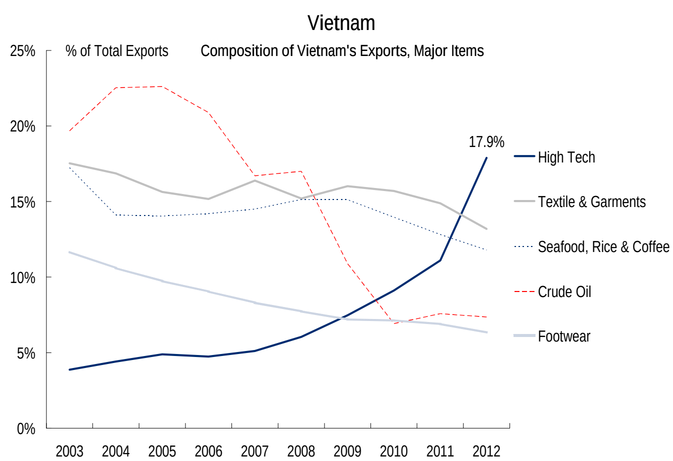
Source: BoM, NSO and Citi Research

Figure 111. Vietnam – Bank intermediation remains weak



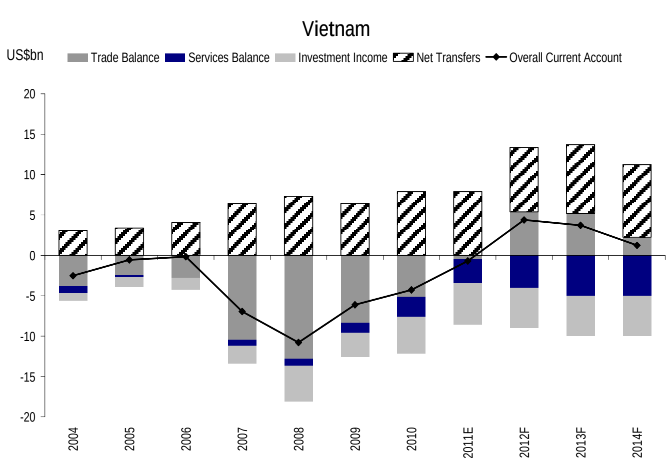
Source: CEIC,IMF, and Citi Research

Figure 112. Change in Vietnam exports structure drive buoyant growth



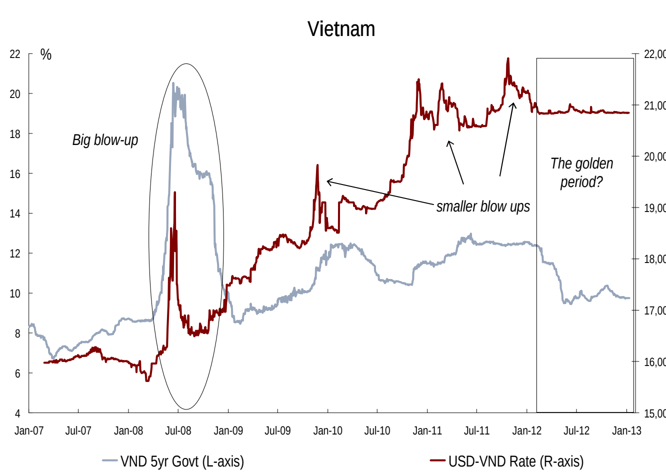
Source: CEIC, and Citi Research

Figure 113. The C/A surplus in 2012F expect to stay intact in 2013-14F



Source: Factiva, VCBS, and Citi Research

Figure 114. We like shorter end up (upto 3Yr) of VND bonds for carry



Source: IMF, and Citi Research

Figure 115. Asia Frontier Economic Indicators

	2006	2007	2008	2009	2010	2011	2012F	2013F	2014F
Mongolia									
Nominal GDP, US$ bn	3.4	4.2	5.6	4.6	6.2	8.7	10.3	12.7	16.4
GDP per capita, US$	1326	1616	2100	1688	2262	3110	3607	4376	5529
Population, mn	2.6	2.6	2.7	2.7	2.8	2.8	2.8	2.9	3.0
Real GDP, % yoy	8.6	10.2	8.9	-1.3	6.4	17.3	12.3	13.8	11.0
CPI, % yoy	6.0	15.1	22.1	4.2	13.0	10.2	14.0	10.2	10.0
CPI, % avg	4.5	9.0	28.0	8.0	10.1	9.2	14.3	12.0	10.0
Policy interest rate, % eop	6.42	9.85	14.78	10.82	10.99	14.25	13.25	14.25	14.75
Long term yield, % eop	26.93	21.83	20.58	21.67	20.07	16.61	19.20	20.40	21.60
lc/US$, eop	1164	1172	1275	1433	1233	1378	1378	1343	1277
lc/US$, avg	1181	1171	1167	1434	1349	1256	1353	1382	1297
Current account (US$ bn)	0.2	0.3	-0.7	-0.4	-0.9	-2.8	-3.6	-2.8	0.5
% of GDP	6.5	6.3	-12.9	-9.0	-14.9	-31.7	-35.1	-22.1	3.1
Trade balance (US$ bn)	0.1	-0.2	-1.1	-0.2	-0.4	-1.7	-2.4	-1.9	-1.8
Exports (US$ bn)	1.5	1.9	2.5	1.9	2.9	4.8	4.3	5.7	6.9
Imports (US$ bn)	1.5	2.1	3.6	2.1	3.3	6.5	6.7	7.7	8.7
International reserves (US$ bn)	0.6	0.8	0.6	1.3	2.2	2.3	2.4	2.9	3.4
Consolidated government balance (% of GDP)	7.6	2.6	-4.5	-5.2	0.5	-4.8	-8.3	-2.4	-2.0
Public debt (% of GDP)	40.3	37.7	32.0	43.2	38.3	46.1	62.8	55.9	60.0
Vietnam									
Nominal GDP, US$ bn	60.9	71.2	90.0	91.9	102.4	121.6	139.0	156.6	175.4
GDP per capita, US$	724	836	1044	1054	1163	1366	1544	1722	1910
Population, mn	84.1	85.2	86.2	87.2	88.1	89.0	90.0	90.9	91.8
Real GDP, % yoy	8.2	8.5	6.3	5.3	6.8	5.9	5.0	5.4	5.8
CPI, % yoy	6.6	12.6	19.9	6.5	11.7	18.1	6.8	7.5	6.5
CPI, % avg	7.5	8.5	23.2	7.0	9.2	18.6	9.3	7.2	7.0
Policy interest rate, % eop	6.50	6.50	9.50	8.00	9.00	15.00	9.00	8.00	8.00
Long term yield, % eop	8.29	8.73	10.00	11.68	11.50	12.55	9.75	10.00	10.00
lc/US$, eop	16056	16028	17483	18474	19498	21034	20840	20850	21000
lc/US$, avg	15990	16081	16445	17806	19123	20648	20875	20850	21000
Current account (US$ bn)	-0.2	-7.0	-10.7	-7.2	-4.3	-0.7	4.4	3.7	1.2
% of GDP	-0.3	-9.8	-11.9	-7.8	-4.2	-0.6	3.2	2.4	0.7
Trade balance (US$ bn)	-2.8	-10.4	-12.8	-8.3	-5.1	-0.5	5.4	5.2	2.2
Exports (US$ bn)	39.8	48.6	62.7	57.1	72.2	96.9	114.5	133.9	150.3
Imports (US$ bn)	42.6	58.9	75.5	65.4	77.3	97.4	109.1	128.7	148.0
International reserves (US$ bn)	13.4	23.5	23.9	16.4	12.5	13.8	23.6	33.7	36.2
Consolidated government balance (% of GDP)	-1.1	-5.3	-1.2	-7.2	-3.1	-3.2	-5.2	-3.8	-4.0
Public debt (% of GDP)	37.5	39.0	34.9	40.0	45.5	45.9	44.2	43.8	44.3

Source: CEIC Data Company Limited, IFS, IMF, Haver, Moody's and Citi Research estimates

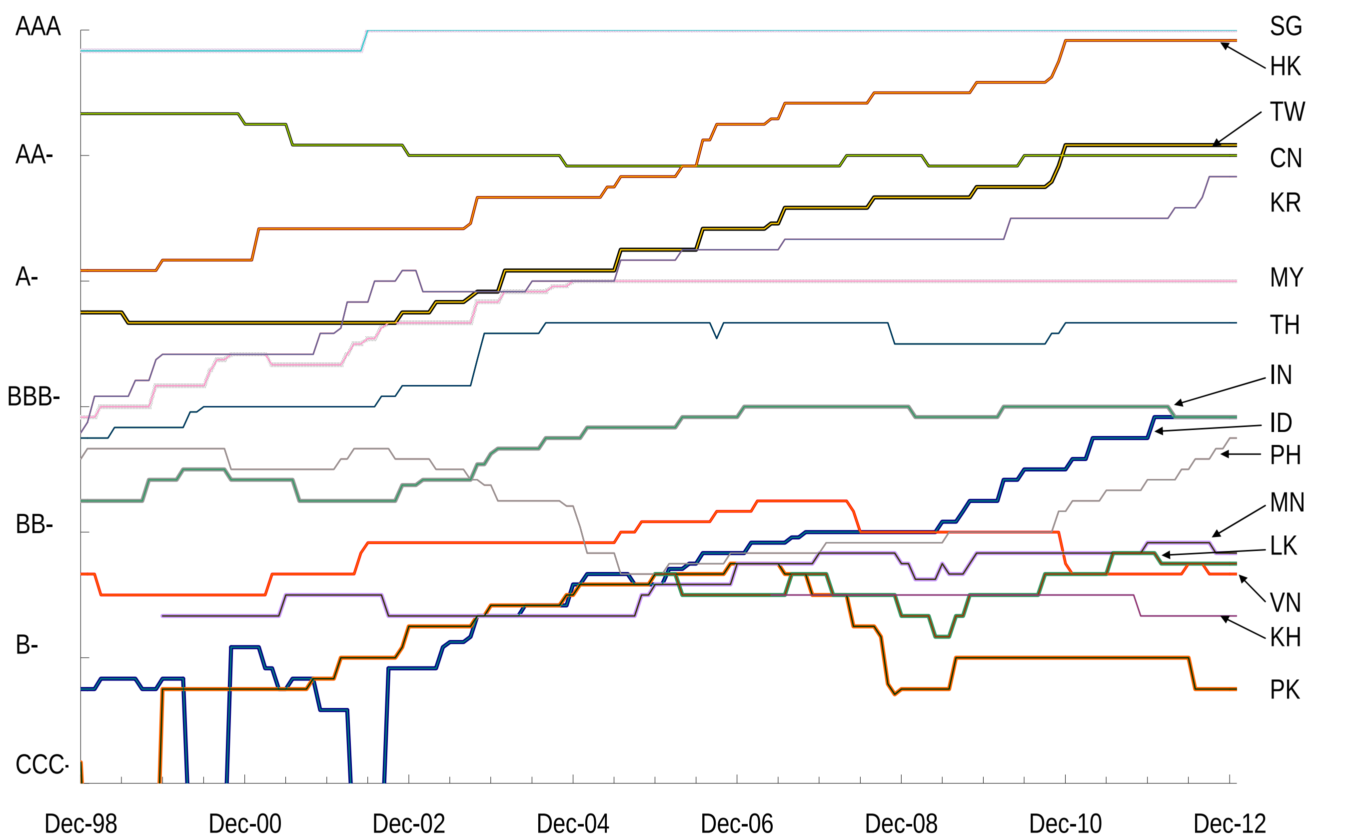
Summary

Figure 116. Long-Term Foreign Currency Ratings

	S&P	Moody's	Fitch
AAA/Aaa	Hong Kong (stable) Singapore (stable)	Singapore (stable)	Singapore (stable)
AA+/Aa1	—	Hong Kong (positive)	Hong Kong (stable)
AA/Aa2	—	—	—
AA-/Aa3	China (stable) Taiwan (stable)	China (positive) Korea (stable) Taiwan (stable)	Korea (stable)
A+/A1	Korea (stable)	—	China (stable) Taiwan (stable)
A/A2	—	—	—
A-/A3	Malaysia (stable)	Malaysia (stable)	Malaysia (stable)
BBB+/Baa1	Thailand (stable)	Thailand (stable)	—
BBB/Baa2	—	—	Thailand (stable)
BBB-/Baa3	India (negative)	India (stable) Indonesia (stable)	India (negative) Indonesia (stable)
BB+/Ba1	Indonesia (positive) Philippines (positive)	Philippines (stable)	Philippines (stable)
BB/Ba2	—	—	—
BB-/Ba3	Mongolia (stable) Vietnam (stable)	—	Sri Lanka (stable)
B+/B1	Sri Lanka (stable)	Fiji (negative) Mongolia (stable) Sri Lanka (positive)	Mongolia (stable) Vietnam (stable)
B/B2	Cambodia (stable) Fiji (stable)	Cambodia (stable) Vietnam (stable)	—
B-/B3	Pakistan (stable)	—	—
CCC+/Caa1	—	Pakistan (negative)	—
CCC/Caa2	—	—	—
CC+/Ca1 & Below	—	—	—

Source: S&P, Moody's, Fitch, Bloomberg

Figure 117. Ratings History (Average of S&P and Moody's Ratings), December 1998-January 2013



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

Global Assumptions

	2012 Q3	2012 Q4F	2013 Q1F	2013 Q2F	2013 Q3F	2013 Q4F	2014 Q1F	2014 Q2F	2012F	2013F	2014F	2015F	2016F	2017F
Global Indicators														
GDP Growth (y/y %)	—	—	—	—	—	—	—	—	2.5	2.6	3.2	3.6	3.8	3.7
CPI Inflation (average, y/y %)	—	—	—	—	—	—	—	—	2.8	2.8	3.0	2.9	2.9	2.9
Current Account (% of GDP)	—	—	—	—	—	—	—	—	0.3	0.3	0.1	0.0	-0.2	-0.3
Fiscal Balance (% of GDP)	—	—	—	—	—	—	—	—	-4.4	-4.0	-3.2	-2.7	-2.4	-2.3
Industrial Countries*														
GDP Growth (y/y %)	—	—	—	—	—	—	—	—	1.2	1.0	1.6	2.2	2.5	2.1
CPI Inflation (average, y/y %)	—	—	—	—	—	—	—	—	1.9	1.6	1.9	1.7	1.7	1.7
Current Account (% of GDP)	—	—	—	—	—	—	—	—	-0.8	-0.4	-0.3	-0.2	-0.2	-0.2
Fiscal Balance (% of GDP)	—	—	—	—	—	—	—	—	-5.9	-5.3	-3.9	-3.0	-2.7	-2.5
United States														
GDP Growth (SAAR %)	3.1	0.7	1.6	1.9	2.9	3.1	3.0	3.1	—	—	—	—	—	—
GDP Growth (y/y %)	2.6	1.8	1.7	1.8	1.8	2.4	2.7	3.0	2.2	1.9	3.1	3.5	4.0	3.0
CPI Inflation (average, y/y %)	1.5	1.5	1.2	1.5	1.6	1.7	2.0	2.1	1.7	1.5	2.1	2.1	2.1	2.1
Current Account (% of GDP)	-2.7	-2.8	-2.7	-2.7	-2.7	-2.7	-2.6	-2.6	-3.0	-2.7	-2.6	-2.7	-2.8	-2.8
Fiscal Balance (% of GDP)	—	—	—	—	—	—	—	—	-8.3	-7.2	-5.0	-4.0	-4.0	-4.0
S&P 500 EPS (y/y %)	1.4	5.7	5.0	6.3	6.0	8.2	5.7	5.2	5.7	6.4	5.0	—	—	—
Business Investment (y/y %)	4.6	2.7	1.4	1.5	3.4	4.5	5.5	6.0	7.2	2.7	6.0	—	—	—
Imports (y/y %)	2.5	0.9	1.0	1.2	2.6	4.2	4.6	4.9	2.6	2.3	4.8	—	—	—
Japan														
GDP Growth (SAAR %)	-3.5	-0.5	1.5	3.9	4.0	3.1	1.7	-4.5	—	—	—	—	—	—
GDP Growth (y/y %)	0.5	0.3	-0.7	0.3	2.2	3.1	3.2	1.0	2.0	1.3	1.2	1.5	1.2	1.2
CPI Inflation (y/y %)	-0.3	-0.2	-0.8	-0.5	-0.1	0.1	0.2	2.5	0.0	-0.3	1.9	0.5	0.2	0.5
Current Account (% of GDP)	0.8	0.6	0.4	0.2	0.5	0.7	1.0	1.6	1.0	0.4	1.6	1.5	1.5	1.5
Fiscal Balance (% of GDP)	—	—	—	—	—	—	—	—	-10.7	-9.8	-7.0	-6.2	-5.8	-5.4
Euro Area														
GDP Growth (SAAR %)	-0.2	-1.9	-0.7	0.0	-0.2	-0.2	-1.3	-0.4	—	—	—	—	—	—
GDP Growth (y/y %)	-0.6	-0.7	-0.9	-0.7	-0.7	-0.3	-0.4	-0.5	-0.5	-0.6	-0.4	0.7	1.0	1.1
CPI Inflation (y/y %)	2.5	2.3	1.9	1.8	1.8	1.6	1.5	1.5	2.5	1.8	1.5	1.5	1.4	1.3
Current Account (% of GDP)	—	—	—	—	—	—	—	—	1.0	2.4	2.1	2.1	2.1	2.1
Fiscal Balance (% of GDP)	—	—	—	—	—	—	—	—	-3.2	-2.8	-2.4	-1.4	-1.0	-0.5
Exchange Rates														
US$ vs. Euro (eop)	1.32	1.35	1.34	1.32	1.32	1.31	1.31	1.30	1.28	1.33	1.31	1.32	1.35	1.38
US$ vs. JPY (eop)	87	94	95	96	95	94	93	91	81	95	92	88	86	83
JPY vs. Euro (eop)	114	127	127	127	125	123	121	119	104	126	120	117	116	115
Short Interest Rates (eop)**														
United States	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	1.10	2.10	2.90
Japan	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.07	0.07	0.13	0.10	0.10	0.10
Euro Area	0.75	0.75	0.75	0.50	0.25	0.25	0.25	0.25	0.88	0.44	0.25	0.25	0.31	0.75
10-Yr Yield Forecasts (Period Avg.)														
United States	1.60	1.76	1.80	1.95	2.20	2.50	2.65	2.90	1.80	2.10	2.80	3.25	3.50	3.75
Japan	0.78	0.79	0.80	0.95	0.85	1.05	1.05	0.95	0.85	0.91	1.00	1.38	1.50	1.63
Euro Area***	1.44	1.32	1.55	1.55	1.75	1.50	1.25	1.50	1.57	1.59	1.44	1.50	2.00	2.50
Emerging Markets														
GDP Growth (y/y %)	—	—	—	—	—	—	—	—	4.7	5.2	5.5	5.5	5.6	5.7
CPI Inflation (eop, y/y %)	—	—	—	—	—	—	—	—	4.4	4.6	4.7	4.7	4.6	4.5
Current Account (% of GDP)	—	—	—	—	—	—	—	—	2.0	1.2	0.7	0.2	-0.1	-0.3
Fiscal Balance (% of GDP)	—	—	—	—	—	—	—	—	-1.9	-2.0	-2.2	-2.2	-2.0	-2.0
Commodities														
WTI Oil price (US$/bbl)	92.2	88.2	85.0	85.0	85.0	85.0	—	—	94.1	85.0	83.0	—	—	—
Copper (Average, USD/MT)	7711	7921	8160	8000	7800	7900	—	—	7945	7965	7775	—	—	—
Gold (Average, US$/oz)	1654	1718	1705	1685	1665	1650	—	—	1669	1675	1655	—	—	—

Note: *It includes: US, Japan, Germany, France, Italy, Spain, Netherlands, Belgium, Finland, Denmark, Norway, Sweden, Switzerland, United Kingdom, Canada, Australia, and New Zealand. **Average from 2008 on. ***Ten-year Bond yield.
Sources: National Authorities and Citi Research Estimates.

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Country/Region	Topic	Aurthor	Date
Thailand	BoT GDP Upgrades Bode Well For Shift to Rate Tightening	Jun Trinidad	22-Jan-13
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Asia-Pacific Economics and Market Analysis

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