24 September 2014 │ 52 pages

Global

Global Economic Outlook and Strategy

September 2014

- Our global growth forecasts continue to drift down, and we are cutting 0.1 percent off our 2015 forecast this month, and now look for global GDP growth of 2.8% this year and 3.3% for 2015 (at current exchange rates). This is the second consecutive monthly downgrade to our 2015 growth forecast, while in total we have cut our 2014 forecast by 0.5 percent (from 3.3% to 2.8%) since January. We make notable downgrades this month to 2014-15 growth forecasts for Argentina, Brazil, China, Denmark, Japan, Romania, Russia, South Africa and Switzerland, partly balanced by a slight upgrade to our 2014 US growth forecast.

- Sizeable economic divergence among advanced economies is likely to be reflected in major monetary policy divergence in the next few quarters. The Fed's asset purchases are near their end, and both the BoE and Fed are likely to hike rates in the next 12 months. By contrast, we still expect both the ECB and BoJ will ease further in the next couple of quarters, although we are shifting our base case for BoJ asset purchases to Q1-2015 from Q4-2014. Having cut rates again, the ECB has now made balance-sheet expansion its main focus for further stimulus. However, its measures (TLTRO and ABS purchases) are unlikely to be enough -- both in terms of substantially reversing the shrinkage in its balance sheet and in terms of lifting the economy out of persistent "low-flation". Hence, we expect the ECB will soon launch a major fully-fledged asset purchase program, including government bonds. We forecast both the euro and yen to weaken markedly further against the US dollar and sterling in coming months.

- We highlight three other themes. First, we continue to have worries over China's medium-term growth outlook, given the rapid rise in the private debt/GDP ratio and signs that even a modest withdrawal of credit stimulus has caused the economy to slow markedly. Second, world trade growth is likely to remain sluggish. Third, even after the Scottish "No" vote, political independence movements remain a potential trigger for broader economic and political uncertainties in a range of countries: the upcoming Catalonia referendum (November 9) is a key near-term focus.

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With thanks to Jan Maguire

Next issue 29 October 2014

Figure 1. Currency and Interest Rate Forecasts, as of 24 September 2014

	Current	4Q 14F	1Q 15F	2Q 15F	3Q 15F	4Q 15F	1Q 16F
United States: Federal Funds	0.25	0.25	0.25	0.25	0.75	1.00	1.25
10-Yr. Treasuries (Period Ave.)	2.53	2.70	2.95	3.05	3.15	3.20	3.25
Euro Area: US$/€	1.28	1.21	1.18	1.15	1.16	1.17	1.18
Euro Repo Rate	0.05	0.05	0.05	0.05	0.05	0.05	0.05
10-Yr. Bunds (Period Ave.)	1.00	0.75	1.00	1.25	1.50	1.50	1.75
Japan: Yen/US$	109	111	113	115	114	113	112
Call Money	0.10	0.10	0.10	0.10	0.10	0.10	0.10
10-Yr. JGB (Period Ave.)	0.52	0.50	0.70	0.80	0.85	0.75	0.85

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

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

Contents

Figure 2. Forecast Highlights and Changes

Global	We are trimming 0.1 percent off our 2015 global growth forecast this month, with a range of downgrades — especially to some key emerging markets. Looking ahead, we expect sizeable monetary policy divergence between advanced economies in coming quarters.
United States	We expect the economy to grow at an above-trend pace through 2015. Economic fundamentals have improved, fiscal drag is dissipating, and financial conditions are providing a tailwind to growth. Inflation is likely to remain tame. We believe the economic outlook is consistent with a first rate hike in the third quarter of 2015.
Euro Area	We shave 0.1pp from each of our 2015-17 GDP forecasts to 1.4%, 1.8% and 1.8%, respectively. We are lifting our inflation profile by 0.2pp to 1.1% in 2015 and by 0.1pp in both 2016-17 to 1.3% and 1.6%, respectively, on a significantly weaker euro forecast. We still expect the ECB to launch a QE programme including public sector assets soon.
China	The August data suggest that the property drag is spreading to other sectors, and we think the impact will not be offset by strong exports and targeted policy easing. We recently cut our GDP growth forecasts to 7.3% for 2014 (from 7.5%) and 6.9% for 2015 (from 7.1%) to reflect delays in policy response, and now expect three policy rate cuts from now to mid-2015.
Japan	We expect the Bank of Japan will implement additional easing measures (probably in January 2015) after PM Abe has made an official decision to go ahead with another consumption tax hike (slated for October 2015) in December after the Q3 GDP report. The BoJ will likely focus more on increases in ETFs purchases rather than JGBs.
United Kingdom	We continue to expect strong economic growth and a rapid drop in unemployment in the UK. Even after the Scottish “No” vote, sizeable political uncertainties remain, with the approach of the general election in May 2015 and a possible EU referendum in 2017 or so.
Canada	The BoC is unlikely to raise interest rates until there is sustained improvement in capex and exports growth, and/or a notable rise in inflation expectations. Hence, we maintain our long-standing expectation for rate hikes to resume in 3Q 15.
Australia	The recent fall in the AUD is a positive for the rebalancing of the economy as mining investment declines. Even so, the RBA will need to keep interest rates steady at current levels until at least mid next year.
Emerging Asia (ex China)	Growth is diverging, but inflation is benign almost across the board. We no longer expect a rate hike in Indonesia. The Malaysia central bank paused but we see this as delaying, not derailing, prospects for another hike. The Philippines has hiked rates, but may now pause as inflation comes off. Korea's fiscal stimulus plans and modest growth rebound could keep the BoK on hold for now, while India's hawkish rhetoric is keeping its FX and bonds well supported.
CEEMEA	Some of the circumstances of last year’s ‘taper tantrum’ have returned: EM is caught between rising US yields and slower-growing China. One big difference between last year’s taper-tantrum and this year’s version is that it is commodity-exporting EM which are suffering the most: global demand for manufactured goods seems stronger than global commodities demand. In this time zone, that means that South Africa is most at risk: the rand has been CEEMEA’s worst-performing currency since early September.
Lat Am	In Brazil, we now expect Marina Silva to defeat incumbent President Rousseff in the second round of the presidential election. We have also downgraded our growth forecast for this year to 0.1%. For Mexico, we continue to believe activity will accelerate moving forward, while we see Banxico on hold for the rest of the year. The situation continues to get more complicated for Argentina and Venezuela, and we expect the two economies to shrink in both 2014 and 2015.

Source: Citi Research

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

	2013	2014F	2015F
World	2.3	3.5	3.9
United States	2.9	3.9	3.4
Japan	-0.6	2.4	0.9
Euro Area	-0.7	1.2	3.3
United Kingdom	-0.4	2.1	2.0
Canada	1.8	3.1	2.6
China	9.7	8.5	7.8
India	0.4	3.9	5.9
Korea	0.3	3.2	5.5
Brazil	2.3	-2.7	1.0

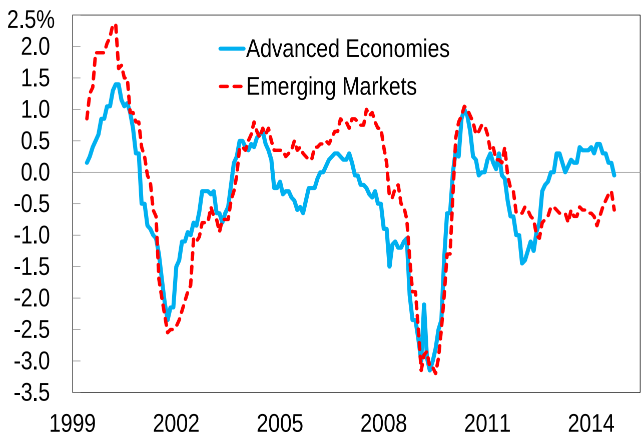
Source: Citi Research

Overview: Divergence and Fragilities

Michael Saunders

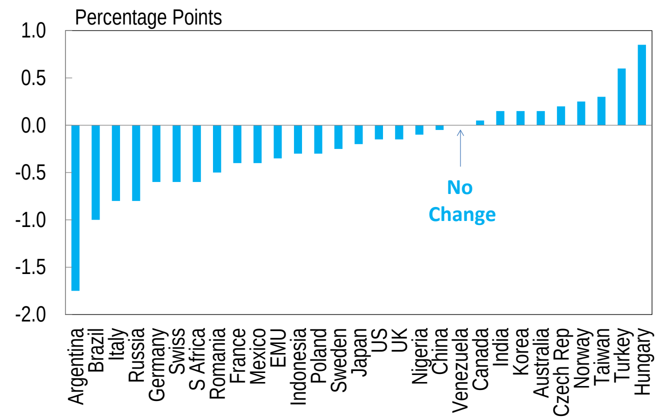
Our global growth forecasts continue to drift down, and we are cutting 0.1 percent off our 2015 forecast this month, and now look for global GDP growth of 2.8% this year and 3.3% for 2015 (at current exchange rates). This is the second consecutive monthly downgrade to our 2015 growth forecast, and in addition we have cut our 2014 forecast by 0.5 percent (from 3.3% to 2.8%) since January. We make notable downgrades this month to 2014-15 growth forecasts for Argentina, Brazil, China, Denmark, Japan, Romania, Russia, South Africa and Switzerland, partly balanced by a 0.2 percent upgrade to our 2014 US growth forecast (to 2.3% from 2.1% last month). In all, we are cutting our EM growth forecast by 0.2 percent for 2014 and by 0.3 percent for 2015 — and this is the biggest monthly downgrade to our overall forecast for EM GDP growth in the current year and next year since mid-2011.

Figure 4. Global — 12-Month Sum of Revisions to Citi Forecasts for Real GDP Growth in Current Year and Next Year, 1999-2014



Source: Citi Research

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



Source: Citi Research

We highlight four main themes this month:

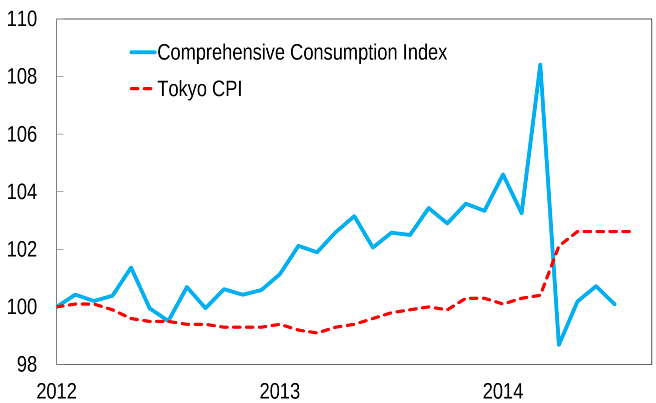
AE economic and monetary policy divergence

Persistent economic divergence is likely to be reflected in sizeable monetary policy divergence among AEs in coming quarters. The Fed is set to end asset purchases in October, while we expect that the BoE probably will start to hike rates in the next six months, with the Fed tightening around Q3-2015. By contrast, we expect further easing via asset purchases in Japan and the euro area in coming months. In turn, we project marked further weakness in the EUR and JPY versus the USD and GBP.

In Japan, recent data suggest only a muted rebound in Q3 GDP growth, after the sharp drop in Q2, leaving GDP only marginally up from a year earlier. Policymakers had hoped that the combination of asset purchases, the weaker yen and temporary fiscal support would offset the drag from the consumption tax hike. But, in practice, export volumes remain stalled, while the sluggish trends in retail sales, consumer confidence and the Cabinet Office consumption indicator suggest that the erosion of real incomes from the consumption tax hike is having a lasting effect on spending. In our view, the economy is unlikely to grow fast enough to close the output gap and prevent a persistent undershoot of the inflation target in coming years. Indeed, the price level has been roughly flat since the consumption tax hike in April. The current monetary and fiscal policy path would, we believe, also fail to achieve the government's stated aim of a lower general government debt/GDP ratio in coming years, because of persistent weakness in nominal GDP growth.

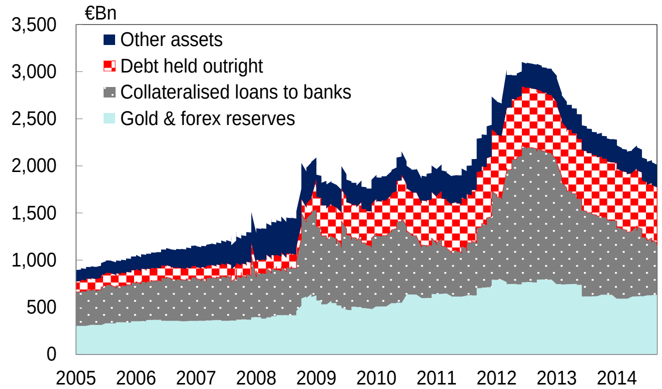
The government has said that it will officially decide in December whether to proceed with the second consumption tax hike planned for October 2015. In our view, recent data imply that the government *should* postpone that hike. However, we believe that the government is reluctant to change course, and expect the government *will* officially confirm that next year's consumption tax hike is going to take place as planned, with some further (probably inadequate) fiscal offsets. Under these circumstances, the BoJ probably will ease further through asset purchases in coming months. Recent sharp yen depreciation, along with the resultant rally in equity markets, has probably reduced the possibility of early easing (ie late October). We believe that fresh easing in January 2015 — after the Q3 GDP data and after PM Abe's official decision to implement the tax hike — is most likely now.

Figure 6. Japan — Consumption Indicator and Tokyo CPI, Indexed to Jan-2012 = 100, 2012-14



Sources: DataStream and Citi Research

Figure 7. Euro Area — Eurosystem Assets, Euros in Billions, 2005-14



Sources: ECB and Citi Research

In the euro area, the H1 weakness in real GDP growth may have been partly erratic, but there is no sign that the expansion will be strong enough to close the large output gap in the next few years. Indeed, recent business surveys and data suggest the economy's momentum is weakening, with notable weakness in France and Italy plus some softer signs in Germany. CPI inflation has markedly undershot the ECB's forecasts in recent quarters, and indeed, CPI inflation at constant tax rates is just 0.1% YoY — the lowest since late-2009 — with negative inflation in Spain, Italy, Portugal, and Greece. Various measures suggest that inflation expectations have fallen markedly in recent months.

Such low inflation rates represent a clear policy failure for the ECB, implying that the economy is running with far higher unemployment and weaker economic growth than needed to hit its inflation target of "*below but close to 2%*". Moreover, persistent "low-flation" is risky for the euro area, because of the adverse effect on public and private debt dynamics in a range of countries. In turn, the ECB in recent months has clearly signaled that it will aim to lift the economy out of persistent "low-flation". As well as cutting rates, the ECB has put the renewed expansion of its balance sheet at centre stage, with Draghi's comments that the TLTROs and ABS purchases aim to "*steer, significantly steer, the size of our balance sheet towards the dimensions it used to have at the beginning of 2012*." Some key aspects of the ECB's intentions remain unclear: eg the scale of balance sheet expansion sought by the ECB, the timeframe, and the exact range of private sector asset purchases. But, as a point of reference we note that the aggregate balance sheet of the eurosystem of central banks has now fallen below €2000bn for the first time since mid-2011, and has shrunk by €910bn compared to the H1-2012 average and by €1110 compared to the June-2012 peak level.

However, we doubt that the ECB's recent easing measures (rate cuts, TLTROs and ABS purchases) will be effective enough — both in terms of achieving its balance sheet aims and in terms of achieving its inflation target. Initial take-up of the TLTRO has been modest, with bids of just €82.6bn in the first round. This is consistent with the experience of the UK FLS, for which the amounts borrowed have been quite low. Moreover, the scale of purchases of private sector assets is likely to be constrained by the ECB's reluctance to accept significant credit risk, EMU governments' reluctance to provide guarantees on ABS mezzanine tranches, and the limited amount of eligible assets meeting the ECB's "simple and transparent" criteria. In addition, the maturing of previous LTROs and SMP purchases will tend to shrink the ECB's balance sheet by roughly €400bn-€500bn over the next two years.

More broadly, our euro area financial conditions index is merely around neutral, rather than the very stimulative stance warranted by current conditions. In particular, even after its recent depreciation, the trade-weighted euro is still 2-3% *above* its longrun average (ie since 1999) in nominal terms. As a result, we expect merely modest growth and, with ample spare capacity, forecast inflation of about 1% YoY in 2015-16. In turn, we expect that persistently low inflation, and the ECB's new-found emphasis on balance sheet expansion, will pave the way for a full-blown QE programme (including government bonds) in the next couple of quarters.

China's downside risks

In China, the authorities' desire to rein in some of the worst excesses of the credit boom is now being reflected in a marked wider slowdown of the economy. The recent credit boom has lifted China's private debt/GDP ratio (the sum of the gross unconsolidated debts of the household and nonfinancial private corporate sectors as a share of the four-quarter average of nominal GDP, using BIS data) from 117% at end-2008 to 192% in Q1 this year. This ratio comfortably exceeds the pre-crisis peaks in the US and euro area (both 170-175% of GDP). Indeed, the rise in China's private debt/GDP ratio over the last six years — more than 70 percentage points — is similar to that in some of the most spectacular boom-bust cycles of recent years (eg Spain in 2002-08, Hungary in 2003-09). Moreover, the overall scale of the rise in debt in China may be even bigger than shown by the BIS data, given the accumulation of debts among local governments and financial companies.

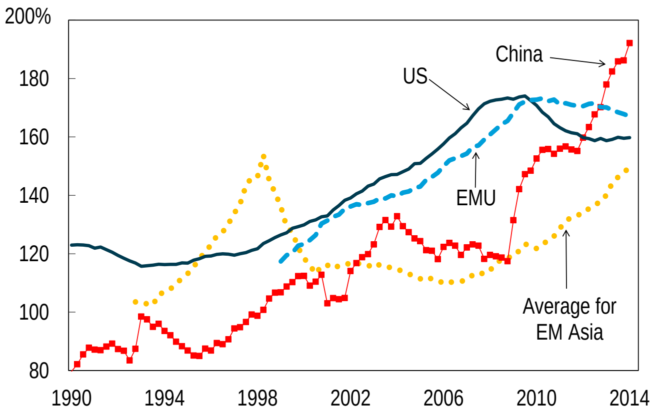
In turn, with worries over the misallocation of capital, plus the likely accumulation of banking sector losses, China's authorities are seeking to deflate the credit bubble. The growth of total social financing (TSF, a broad credit aggregate) has slowed sharply in the last couple of months, with the YoY rate down to 15% YoY in August (lowest since 2005) from 20% a year earlier. Even so, TSF growth is still well above nominal GDP growth (9.0% YoY in Q2) — implying that the private debt/GDP ratio continues to rise rapidly. However, even with this modest reduction of credit stimulus, recent data show a sharp slowdown in the economy. In response, we expect the authorities to loosen reserve requirements and cut the key policy rate by 75bp by mid-2015. Even so, both credit growth and economic growth are likely to slow further. And, with the private debt/GDP ratio likely to go on rising near-term, risks remain of a sharper slowdown in the economy over time if the authorities do actually seek to slow credit growth close to nominal GDP growth.

World trade growth remains sluggish

The CPB data show a slight rise in world trade volume growth to 3.2% YoY in Q2 from 2.7% in Q1, but this remains well below the pre-crisis norm (6.6% YoY over 1998-07). There was a notable pick up in Asian EM exports and US imports in Q2 after soft Q1 data. But, this was balanced by weakness in exports from LatAm,

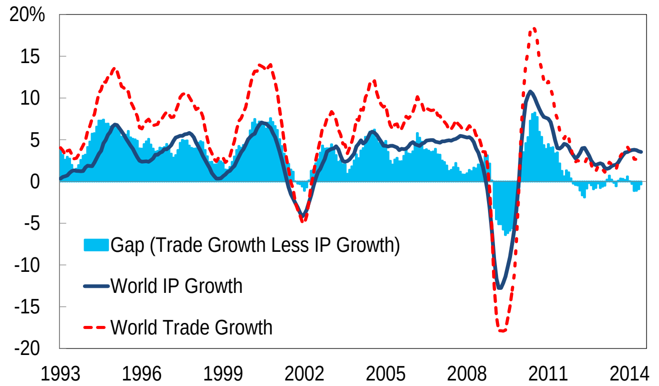
Central and Eastern Europe and Africa, while Japan's imports also fell sharply after the consumption tax hike. World trade growth remains slightly below global industrial production growth (3.5% YoY), a sharp contrast to the pre-crisis trend whereby world trade growth was usually about twice the pace of global IP growth. Various factors probably are behind the sluggish trend in world trade growth and we expect that world trade growth will stay well below pre-crisis norms.

Figure 8. Selected Countries — Private Sector Debt/GDP Ratios, 1990-2014



Note: We compare private debts with the four-quarter average of nominal GDP.
Sources: IMF, BIS and Citi Research

Figure 9. Global — World Trade and Industrial Production YoY, 3-Month Averages, 1993-2014



Sources: CPB and Citi Research

The modest pace of world trade growth will not, we expect, derail the strong domestic-driven expansions in the US and UK, but probably will make for a more uneven global expansion. In particular, it is less likely that countries with subdued domestic demand (eg Japan, euro area) or high private debt burdens (eg various EM countries) will be bailed out by export-driven growth.

Independence Movements and Nation States

The Scottish independence referendum — which ended in a 55%:45% win for the "No" (anti-independence) side — has brought independence movements to center stage. Many countries have independence movements of some kind, often based on old national borders, although in some cases there are also issues of religious or ethnic identity. Strictly speaking, such movements can be classed as separatist (seeking greater autonomy within an established country), secessionist (seeking independence), or irredentist (seeking to join or rejoin a different country). There was a surge of independence movements during the post-WW2 process of decolonization, and again after the Soviet Union's collapse. More recently, the expansion of supranational organisations that offer defence guarantees (eg NATO) and free trade zones (EU) may cut perceived risks of independence for some regions — provided the newly-independent region becomes a member.

In some cases, independence movements may seem to be part of a country's cultural fabric. But, such movements may be a trigger for political "wild card" events, for example constraining fiscal policy within a fractured political system, or (if independence seems likely) creating market volatility as investors start to grapple with post-independence economic and political uncertainties – in particular, over who is responsible for servicing sovereign debt. The Catalonia independence referendum (November 9) is a key upcoming wild card in this respect: the Spanish Constitutional Court has declared the referendum "unconstitutional and null" but if turnout and support for independence are high then the issue is likely to rumble on.

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

	GDP Growth						CPI Inflation						Central Bank Policy Rates					
	2013	2014F	2015F	2016F	2017F	2018F	2013	2014F	2015F	2016F	2017F	2018F	2013	2014F	2015F	2016F	2017F	2018F
Global	2.6	2.8	3.3	3.6	3.5	3.4	2.6	2.8	3.0	3.2	3.3	3.3	2.14	2.33	2.31	2.66	3.05	3.39
Based on PPP weights	*3.1*	*3.2*	*3.7*	*4.0*	*4.0*	*3.9*	*3.1*	*3.3*	*3.4*	*3.6*	*3.7*	*3.8*	*2.71*	*2.94*	*2.99*	*3.35*	*3.65*	*3.92*
Industrial Countries	1.3	1.8	2.3	2.5	2.2	2.0	1.3	1.5	1.6	1.6	1.5	1.7	0.46	0.36	0.47	1.02	1.63	2.17
United States	2.2	2.3	3.3	3.2	2.7	2.2	1.2	1.4	1.6	2.2	2.3	2.2	0.25	0.25	0.48	1.46	2.48	3.25
Japan	1.5	0.9	0.6	1.2	1.2	1.0	0.4	2.8	1.7	1.6	0.7	1.0	0.07	0.13	0.10	0.10	0.10	0.30
Euro Area	-0.4	0.8	1.4	1.8	1.8	1.8	1.4	0.6	1.1	1.3	1.6	1.7	0.50	0.16	0.05	0.07	0.42	0.92
Canada	2.0	2.4	2.7	2.7	2.6	2.4	0.9	2.0	2.0	2.2	2.1	2.0	1.00	1.00	1.19	2.13	2.50	2.75
Australia	2.3	3.2	3.0	3.2	3.6	3.5	2.4	2.5	2.5	2.3	2.4	2.4	2.69	2.50	2.88	3.50	4.00	4.25
New Zealand	2.8	3.5	2.9	2.4	2.6	2.7	1.1	2.1	2.2	2.2	2.2	2.4	2.50	3.25	4.06	4.44	4.50	4.75
Germany	0.2	1.5	1.8	2.1	1.9	1.8	1.5	1.0	1.7	2.1	2.4	2.4						
France	0.4	0.4	1.0	1.8	1.9	2.0	1.0	0.8	1.3	1.5	1.6	1.7						
Italy	-1.8	-0.4	0.3	0.8	0.8	0.9	1.3	0.2	0.1	0.4	0.9	1.1						
Spain	-1.2	1.3	2.0	2.2	1.9	1.7	1.5	0.0	0.5	0.6	0.7	0.9						
Greece	-3.9	0.1	1.3	1.6	1.7	1.8	-0.9	-1.1	-0.6	-0.6	0.0	0.8						
Ireland	0.2	5.5	4.2	4.8	4.5	4.1	1.0	0.4	1.0	1.1	1.6	1.7						
Portugal	-1.4	1.0	1.8	2.1	1.7	1.8	0.4	-0.1	0.3	0.1	0.7	1.0						
Netherlands	-0.7	0.7	1.5	1.8	2.0	2.1	2.6	0.6	1.6	1.6	1.8	1.9						
Belgium	0.2	1.1	1.5	1.9	1.8	2.0	1.2	0.6	1.3	1.7	1.8	1.9						
Denmark	0.4	0.6	1.3	1.7	1.9	2.0	0.8	0.7	1.2	1.6	1.9	2.0	0.20	0.20	0.20	0.30	0.60	1.10
Norway	2.0	2.3	2.2	2.6	2.8	2.6	2.1	2.0	2.1	2.1	2.2	2.4	1.50	1.50	1.50	1.64	1.83	2.38
Sweden	1.5	2.2	2.6	2.7	2.7	2.5	0.0	0.0	1.1	2.4	2.3	2.2	0.99	0.52	0.25	0.46	0.96	1.55
Switzerland	1.9	1.1	1.3	1.7	1.7	1.7	-0.2	0.1	1.1	1.1	0.9	1.0	0.00	0.00	0.00	0.00	0.13	0.63
United Kingdom	1.7	3.3	3.5	2.9	2.0	2.0	2.6	1.6	1.8	2.0	1.9	2.0	0.50	0.50	1.08	2.46	3.21	3.50
Emerging Markets	4.6	4.2	4.7	5.2	5.4	5.3	4.7	4.8	5.0	4.6	4.8	4.7	4.78	5.25	5.07	5.13	5.13	5.13
China	7.7	7.3	6.9	6.7	7.1	6.8	2.6	2.3	2.6	2.7	3.3	3.3	3.00	2.97	2.38	2.25	2.50	2.88
Taiwan	2.1	3.6	4.0	4.2	4.5	4.5	0.8	1.5	2.0	1.8	1.8	1.8	1.88	1.88	1.97	2.38	2.88	3.38
India	4.7	5.6	6.5	7.0	7.1	7.1	9.5	8.0	6.5	6.5	6.5	6.5	7.75	8.00	8.00	7.50	7.00	7.00
Indonesia	5.8	5.1	5.1	5.5	5.5	5.7	6.4	6.2	6.7	6.0	5.3	4.8	4.65	5.75	5.75	5.75	5.75	5.75
Korea	3.0	3.9	4.0	4.2	3.6	3.8	1.3	1.6	2.6	3.1	3.0	2.9	2.56	2.38	2.44	3.25	3.88	4.00
Czech	-0.9	2.4	2.4	3.3	3.1	3.2	1.4	0.4	1.6	1.9	2.0	2.0	0.05	0.05	0.05	0.18	1.23	2.15
Hungary	1.1	3.1	2.2	1.5	1.7	2.0	1.7	0.2	2.1	2.9	2.1	1.6	4.38	2.33	2.31	3.49	3.71	4.50
Poland	1.6	3.0	3.4	3.5	3.5	3.2	0.9	0.1	1.3	2.7	2.5	2.5	2.95	2.40	2.00	2.85	3.92	3.29
Romania	3.5	2.0	3.4	3.6	3.6	3.6	4.0	1.4	2.9	2.6	2.5	2.5	4.69	3.25	3.56	4.25	5.00	5.00
Russia	1.3	0.7	1.0	2.4	2.5	2.6	6.8	7.3	6.7	5.7	5.4	5.1	5.50	7.38	7.73	6.83	6.00	5.17
Turkey	4.1	3.5	3.5	3.7	4.0	3.9	7.5	9.0	6.7	7.0	6.8	6.3	6.16	9.46	9.75	10.00	9.50	9.00
Nigeria	5.5	6.4	6.4	6.8	6.2	6.7	8.5	8.2	9.5	8.9	9.9	9.2	12.00	12.00	11.75	11.00	9.00	9.00
South Africa	1.9	1.4	2.6	3.4	3.7	4.3	5.8	6.2	5.7	5.3	5.7	5.7	5.00	5.63	6.17	7.67	8.00	8.00
Argentina	2.9	0.0	-1.0	1.0	2.5	3.0	10.6	NA	29.0	37.0	32.5	25.0	17.16	23.62	31.55	42.74	38.00	30.00
Brazil	2.5	0.1	1.0	2.8	3.0	3.0	6.2	6.3	6.6	6.1	5.5	5.5	8.44	10.92	11.67	10.50	10.00	10.00
Mexico	1.1	2.6	3.9	4.4	4.5	4.6	3.8	4.0	3.5	3.6	3.6	3.6	3.94	3.21	3.25	4.19	4.67	5.71
Venezuela	1.3	-1.0	1.9	1.9	1.9	1.9	38.5	61.7	82.5	60.0	60.0	60.0	14.50	14.50	14.50	14.80	14.80	14.80

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

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

	Current Balance (Pct of GDP)						Fiscal Balance (Pct of GDP)						Government Debt (Pct of GDP)					
	2013	2014F	2015F	2016F	2017F	2018F	2013	2014F	2015F	2016F	2017F	2018F	2013	2014F	2015F	2016F	2017F	2018F
Global	0.7	0.8	0.6	0.4	0.3	0.2	-4.1	-3.8	-3.3	-2.9	-2.7	-2.5	88	86	86	85	85	84
Based on PPP weights	*0.6*	*0.7*	*0.6*	*0.3*	*0.1*	*0.1*	*-4.0*	*-3.9*	*-3.4*	*-3.0*	*-2.8*	*-2.7*	*80*	*80*	*80*	*79*	*78*	*77*
Industrial Countries	-0.2	-0.2	-0.3	-0.1	0.0	0.1	-5.5	-4.7	-3.9	-3.4	-3.0	-2.7	115	113	112	112	111	111
United States	-2.4	-2.4	-2.2	-1.8	-1.7	-1.4	-7.4	-6.6	-5.7	-5.4	-5.1	-5.1	105	105	105	105	105	105
Japan	0.7	0.1	0.4	0.8	0.7	0.7	-9.8	-8.0	-6.2	-5.8	-5.4	-5.0	241	243	247	248	251	254
Euro Area	2.4	2.8	3.0	3.0	2.9	2.8	-3.0	-2.7	-2.3	-1.7	-1.3	-0.9	95	97	97	96	95	93
Canada	-3.2	-2.0	-1.6	-1.3	-1.0	-0.9	-0.9	-0.1	0.3	0.4	0.4	0.4	94	92	90	89	87	84
Australia	-3.3	-3.4	-3.6	-3.7	-3.4	-2.6	-1.2	-3.1	-1.8	-1.0	-0.6	-0.2	30	32	34	33	33	34
New Zealand	-3.4	-4.2	-5.4	-5.0	-5.4	-6.6	-2.9	-1.6	-0.4	0.5	1.2	2.2	40	39	36	37	37	34
Germany	7.1	7.3	7.4	6.9	6.7	6.5	0.0	0.2	0.2	0.1	0.2	0.0	78	76	73	70	67	65
France	-1.4	-0.7	-0.1	0.4	0.1	-0.1	-4.3	-4.5	-4.2	-3.3	-2.4	-1.6	93	97	99	100	99	97
Italy	1.0	1.6	1.7	1.7	1.6	1.6	-2.8	-3.0	-2.8	-2.1	-1.6	-1.1	128	131	133	133	133	131
Spain	0.8	0.4	0.4	0.4	0.6	0.9	-7.1	-5.6	-4.7	-3.6	-2.9	-2.4	94	99	101	102	102	101
Greece	0.8	1.6	2.0	1.9	1.9	1.9	-12.7	-2.2	-2.5	-1.9	-1.7	-1.3	175	180	181	181	179	176
Ireland	4.4	3.9	3.9	4.6	5.1	5.2	-6.7	-2.0	0.7	2.2	3.3	4.5	123	115	109	101	92	82
Portugal	0.5	0.5	0.7	0.9	1.4	1.6	-5.0	-4.2	-3.3	-2.6	-2.2	-1.9	129	136	134	132	130	129
Netherlands	10.9	11.4	9.9	9.5	8.9	8.4	-2.4	-2.7	-2.1	-1.4	-1.0	-0.6	74	75	74	73	71	69
Belgium	-1.9	0.1	0.7	0.9	0.8	0.5	-2.7	-2.6	-2.3	-1.6	-1.0	-0.4	101	102	102	100	97	94
Denmark	7.2	6.7	5.7	5.4	5.6	5.5	-0.9	-1.0	-2.3	-1.7	-1.0	-0.9	45	45	46	46	45	45
Norway	11.1	11.0	11.7	12.2	12.5	12.4	10.9	11.0	11.0	10.0	10.0	9.0	NA	NA	NA	NA	NA	NA
Sweden	6.7	6.2	6.0	5.8	5.9	5.9	-1.2	-2.1	-1.2	-0.3	0.5	1.2	38	39	39	37	35	32
Switzerland	16.0	13.1	11.9	11.3	10.8	10.0	0.0	-0.6	-0.4	-0.2	-0.1	-0.2	49	49	48	48	47	46
United Kingdom	-4.5	-4.8	-5.7	-6.0	-5.7	-5.4	-7.1	-5.9	-4.1	-1.9	-1.2	-0.4	94	96	96	95	93	91
Emerging Markets	2.0	2.2	1.8	1.0	0.6	0.3	-1.9	-2.5	-2.5	-2.3	-2.2	-2.1	45	45	45	45	45	45
China	2.0	2.3	2.3	2.0	1.5	1.0	-1.9	-2.1	-2.0	-2.0	-2.0	-2.0	54	54	53	53	53	52
Taiwan	11.7	11.0	10.2	8.0	8.0	8.0	-1.3	-1.4	-0.8	-0.6	-0.6	-0.6	40	39	39	39	38	38
India	-1.7	-1.9	-2.0	-2.0	-2.0	-2.1	-6.9	-6.7	-6.5	-6.2	-5.9	-5.5	69	68	66	65	63	61
Indonesia	-3.3	-3.2	-2.8	-2.7	-2.4	-2.0	-2.2	-2.4	-1.9	-1.9	-2.0	-1.5	24	26	25	25	25	25
Korea	6.1	5.1	3.1	2.3	1.6	0.8	1.0	0.9	1.4	1.7	1.9	1.7	32	31	29	27	26	25
Czech	-1.4	0.1	-0.5	0.6	0.0	1.8	-1.5	-2.0	-2.5	-2.3	-2.2	-2.0	46	44	43	41	41	41
Hungary	3.0	3.8	2.9	2.6	2.1	2.2	-2.2	-2.9	-3.0	-2.9	-3.0	-3.0	79	79	78	77	76	75
Poland	-1.3	-1.7	-3.0	-4.5	-4.5	-4.5	-4.3	-3.3	-2.9	-2.7	-2.7	-2.7	54	48	47	46	46	46
Romania	-1.1	-1.7	-3.0	-4.5	-4.5	-4.5	-2.5	-2.3	-2.3	-2.3	-2.3	-2.3	42	42	41	40	39	39
Russia	1.6	2.9	2.9	1.4	0.4	-0.7	-2.1	-4.4	-4.9	-0.9	-0.9	-0.9	7	10	13	12	12	12
Turkey	-7.9	-5.3	-5.5	-5.5	-5.3	-5.3	-1.2	-2.8	-3.2	-3.3	-3.3	-3.3	39	38	37	36	35	33
Nigeria	4.0	2.3	1.8	1.0	0.7	0.5	-1.6	-2.0	-1.9	-1.8	-1.6	-1.6	NA	NA	NA	NA	NA	NA
South Africa	-5.6	-5.3	-4.7	-4.1	-3.2	-2.7	-4.1	-4.1	-4.1	-3.5	-2.8	-1.8	46	50	51	51	50	47
Argentina	-0.7	-1.2	-1.2	-1.3	1.0	1.0	-1.9	-3.7	-4.7	-3.7	-0.5	-1.0	31	37	46	55	53	52
Brazil	-3.7	-3.7	-3.8	-3.9	-3.9	-3.9	-3.3	-4.4	-3.6	-3.5	-3.4	-3.4	57	57	58	58	58	58
Mexico	-2.1	-1.9	-1.9	-2.0	-2.4	-2.6	-2.3	-3.6	-3.5	-3.0	-2.5	-2.0	38	38	38	37	37	37
Venezuela	3.3	4.1	5.1	3.0	3.0	3.0	-11.9	-11.2	-10.3	-12.0	-12.1	-11.5	41	40	40	41	41	42

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

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

	GDP Growth			CPI Inflation			Current Balance (Pct of GDP)			Fiscal Balance (Pct of GDP)		
	2013	2014F	2015F	2013	2014F	2015F	2013	2014F	2015F	2013	2014F	2015F
Global			-0.1		-0.1				0.1		-0.1	
Based on PPP weights	*0.1*	*-0.1*	*-0.2*				*0.2*	*0.2*	*0.1*		*-0.1*	
Industrial Countries			-0.1		-0.1	-0.1		-0.1	-0.1			
United States		0.2	0.1		-0.2	-0.2		0.1	0.1		-0.2	-0.1
Japan		-0.3	-0.3					-0.3	-0.3			
Euro Area			-0.1		0.1	0.2		-0.1	0.2		0.1	0.1
Canada		-0.3						0.4	0.6			
Australia	-0.1				-0.1		-0.1	-0.9	-0.8			
New Zealand												
Germany		-0.1	-0.2					0.3	1.1		0.1	
France			0.1		0.1	0.1						0.1
Italy		-0.3	-0.5		0.1	0.3					-0.1	
Spain		-0.1				0.2		-0.2	-0.1			-0.1
Greece			-0.2			0.4		0.4	0.9			-0.3
Ireland		-0.3	0.6		0.1			-0.2	-0.8		-0.1	0.1
Portugal		-0.1	-0.3		0.2	0.7						-0.2
Netherlands			0.2		-0.1	0.1			0.1			0.1
Belgium			0.2		-0.2	0.1					0.1	0.2
Denmark		-0.8	-0.4				0.1	0.1	0.1		0.3	0.4
Norway		0.3						-0.4				
Sweden	-0.1	0.2			0.1		0.3	-0.1			-0.2	-0.3
Switzerland	-0.1	-0.9	-1.3					-0.4	-0.9		-0.4	-0.9
United Kingdom		-0.1	-0.2			0.1		-0.7	-1.2		-0.3	-0.5
Emerging Markets		-0.2	-0.3				0.2	0.3	0.3	0.2	-0.1	
China		-0.2	-0.2					0.3	0.3			
Taiwan							-0.1					
India												
Indonesia			-0.1		-0.3			-0.2	-0.2			0.3
Korea					-0.3	-0.3		0.2				-0.1
Czech		-0.1	0.1			0.2		-1.2	-2.0			-0.1
Hungary		0.2	0.3					0.2	-0.2			-0.1
Poland		0.4	0.2		-02	-0.7		0.9	0.8		-8.5	-0.2
Romania		-1.0			-0.1	-0.3		0.8	1.2			
Russia			-1.3		0.3	1.1	0.1	0.2	1.0			
Turkey	0.1				0.2	-0.7		0.1				
Nigeria		0.4			-0.5	-1.2	0.1	1.3	0.5			-0.1
South Africa		-0.3	-0.2				0.2		0.3			
Argentina			-2.0			-0.8		-0.2	-0.1		-1.3	-2.1
Brazil		-0.4				0.2						-0.1
Mexico					0.1	0.1	-0.1	-0.2	-0.2		-0.1	-0.5
Venezuela												

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

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

	10-Year Yields						Exchange Rates Versus U.S Dollar						Exchange Rate Versus Euro					
	2013	2014F	2015F	2016F	2017F	2018F	2013	2014F	2015F	2016F	2017F	2018F	2013	2014F	2015F	2016F	2017F	2018F
Industrial Countries																		
United States	2.35	2.65	3.11	3.25	3.35	3.45	NA	NA	NA	NA	NA	NA	1.33	1.30	1.17	1.20	1.23	1.26
Japan	0.71	0.57	0.78	1.25	1.50	1.50	98	106	114	110	107	104	130	138	132	132	132	131
Euro Area	1.69	1.28	1.31	1.56	1.81	2.06	1.33	1.30	1.17	1.20	1.23	1.26	NA	NA	NA	NA	NA	NA
Canada	2.26	2.34	2.94	3.10	3.15	3.10	1.03	1.10	1.15	1.15	1.13	1.12	1.37	1.44	1.34	1.37	1.40	1.41
Australia	3.65	3.90	4.30	4.94	5.50	5.75	0.97	0.91	0.83	0.81	0.84	0.88	1.37	1.44	1.41	1.48	1.47	1.44
New Zealand	3.98	4.51	4.83	5.58	5.80	6.00	0.82	0.83	0.70	0.69	0.69	0.70	1.62	1.58	1.65	1.73	1.78	1.82
Germany	1.60	1.28	1.31	1.56	1.81	2.06												
France	2.12	1.71	1.56	1.81	2.06	2.31												
Italy	4.23	2.82	2.31	2.61	2.71	2.86												
Spain	4.48	2.68	1.96	2.41	2.51	2.66												
Greece	10.36	6.14	4.69	4.69	4.31	4.06												
Ireland	4.00	2.37	1.86	2.26	2.36	2.61												
Portugal	5.15	3.67	2.81	2.81	2.91	3.06												
Netherlands	1.89	1.50	1.36	1.61	1.86	2.11												
Belgium	2.33	1.77	1.56	1.81	2.06	2.31												
Denmark	1.73	1.44	1.47	1.71	2.06	2.31	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
Norway	2.57	2.51	2.31	2.51	2.66	2.91	5.88	6.33	7.04	6.53	6.12	5.76	7.81	8.26	8.20	7.81	7.52	7.27
Sweden	2.10	1.82	1.89	2.16	2.31	2.56	6.51	7.02	8.07	7.58	7.20	6.88	8.65	9.16	9.40	9.06	8.86	8.69
Switzerland	0.82	0.68	0.70	0.72	0.91	1.10	0.93	0.93	1.04	1.04	1.03	1.02	1.23	1.22	1.22	1.25	1.27	1.28
United Kingdom	2.34	2.64	3.06	3.15	3.25	3.50	1.56	1.65	1.58	1.60	1.61	1.62	0.85	0.79	0.74	0.75	0.76	0.78
Emerging Markets																		
China	3.68	4.11	3.97	4.26	4.57	4.95	6.15	6.17	6.04	6.01	6.02	6.04	8.17	8.04	7.04	7.18	7.40	7.63
Taiwan	1.46	1.66	1.92	2.15	2.45	2.75	29.68	30.22	30.03	29.63	29.18	28.71	39.43	39.42	34.99	35.43	35.89	36.28
India	8.25	8.50	8.50	8.00	7.50	7.50	58.57	60.70	62.42	62.68	60.23	57.16	77.80	79.19	72.72	74.94	74.09	72.22
Indonesia	6.97	8.23	8.75	8.75	8.60	8.25	10449	11873	12133	11795	11106	10340	13881	15488	14135	14104	13663	13064
Korea	3.00	2.86	3.11	3.68	4.30	4.63	1095	1043	1029	980	975	980	1454	1360	1199	1172	1199	1238
Czech	2.09	1.59	1.49	2.12	2.41	2.66	19.6	21.1	23.9	22.5	21.2	20.0	26.0	27.5	27.8	26.9	26.0	25.2
Hungary	5.92	5.02	5.08	5.39	5.43	5.50	223	239	278	272	265	260	297	312	324	325	327	328
Poland	4.05	3.70	3.81	4.42	4.46	4.12	3.16	3.22	3.67	3.38	3.23	3.12	4.20	4.20	4.28	4.04	3.97	3.94
Romania	NA	NA	NA	NA	NA	NA	3.33	3.41	3.81	3.67	3.49	3.33	4.42	4.44	4.44	4.39	4.29	4.21
Russia	NA	NA	NA	NA	NA	NA	31.9	37.0	41.1	40.5	39.9	39.4	42.3	48.2	47.8	48.4	49.1	49.7
Turkey	NA	NA	NA	NA	NA	NA	1.91	2.20	2.46	2.57	2.52	2.44	2.53	2.87	2.86	3.08	3.11	3.08
Nigeria	NA	NA	NA	NA	NA	NA	159	163	167	171	175	180	212	213	195	205	215	227
South Africa	7.20	8.11	8.04	8.14	8.38	8.77	9.65	10.88	11.41	11.14	10.92	10.72	12.82	14.19	13.29	13.32	13.43	13.54
Argentina	NA	NA	NA	NA	NA	NA	5.45	8.38	11.15	19.49	24.86	29.84	7.24	10.93	12.99	23.30	30.58	37.70
Brazil	9.98	11.75	11.75	12.25	11.62	10.75	2.16	2.30	2.53	2.64	2.76	2.87	2.87	3.00	2.94	3.16	3.39	3.63
Mexico	5.67	6.03	6.52	7.29	7.65	7.65	12.8	13.1	13.1	12.8	12.6	12.4	17.0	17.1	15.3	15.3	15.5	15.7
Venezuela	10.81	14.01	14.95	15.50	15.50	15.50	5.99	9.15	19.80	31.28	49.43	78.10	7.96	11.94	23.07	37.41	60.81	98.68

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

Figure 14. Short Rates (End of Period), as of 24 September 2014 (Percent)

	Current	4Q 14	1Q 15	2Q 15	3Q 15	4Q 15	1Q 16
United States	0.25	0.25	0.25	0.25	0.75	1.00	1.25
Japan	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Euro Area	0.05	0.05	0.05	0.05	0.05	0.05	0.05
Canada	1.00	1.00	1.00	1.00	1.25	1.50	1.75
Australia	2.50	2.50	2.50	2.75	3.00	3.25	3.25
New Zealand	3.50	3.50	3.75	4.00	4.25	4.25	4.25
Denmark	0.20	0.20	0.20	0.20	0.20	0.20	0.20
Norway	1.50	1.50	1.50	1.50	1.50	1.50	1.50
Sweden	0.25	0.25	0.25	0.25	0.25	0.25	0.50
Switzerland	0.00	0.00	0.00	0.00	0.00	0.00	0.00
United Kingdom	0.50	0.50	0.75	1.00	1.25	1.75	2.00
China	2.75	2.50	2.25	2.25	2.25	2.25	2.75

Source: Citi Research

Figure 15. 10-Year Yield Forecasts (Period Average), as of 24 September 2014 (Percent)

	Current	4Q 14	1Q 15	2Q 15	3Q 15	4Q 15	1Q 16
United States	2.53	2.70	2.95	3.05	3.15	3.20	3.25
Japan	0.52	0.50	0.70	0.80	0.85	0.75	0.85
Euro Area (Germany)	1.00	0.75	1.00	1.25	1.50	1.50	1.75
Canada	2.17	2.40	2.75	2.90	3.00	3.10	3.10
Australia	3.61	3.80	4.00	4.25	4.40	4.55	4.65
New Zealand	4.19	4.50	4.60	4.70	4.90	5.10	5.30
Denmark	1.25	0.95	1.20	1.40	1.65	1.65	1.90
Norway	2.37	1.95	2.10	2.25	2.45	2.45	2.75
Sweden	1.52	1.30	1.60	1.85	2.05	2.05	2.35
Switzerland	0.46	0.31	0.49	0.66	0.83	0.83	1.01
United Kingdom	2.47	2.50	2.80	3.00	3.20	3.25	3.30

Source: Citi Research

Figure 16. 10-Year Yield Spreads (Period Average), as of 24 September 2014

	Spread vs. US$						**Spread vs. Germany**					
	Current	4Q 14	1Q 15	2Q 15	3Q 15	4Q 15	Current	4Q 14	1Q 15	2Q 15	3Q 15	4Q 15
United States	NA	NA	NA	NA	NA	NA	154	197	197	182	167	173
Japan	-201	-222	-227	-227	-232	-248	-47	-25	-30	-45	-65	-75
Euro Area	-154	-197	-197	-182	-167	-173	NA	NA	NA	NA	NA	NA
Canada	-37	-30	-20	-15	-15	-10	117	166	177	167	152	162
Australia	107	112	107	122	127	138	261	309	304	305	295	310
New Zealand	165	183	168	168	179	194	319	380	365	351	346	367
France	-120	-167	-172	-157	-142	-148	34	30	25	25	25	25
Italy	-13	-82	-97	-82	-67	-73	141	115	100	100	100	100
Spain	-33	-112	-132	-117	-102	-108	120	85	65	65	65	65
Netherlands	-140	-187	-192	-177	-162	-168	14	10	5	5	5	5
Belgium	-127	-167	-172	-157	-142	-148	27	30	25	25	25	25
Austria	-134	-182	-187	-172	-157	-163	20	15	10	10	10	10
Finland	-143	-177	-182	-167	-152	-158	11	20	15	15	15	15
Ireland	-79	-137	-142	-127	-112	-118	75	60	55	55	55	55
Portugal	65	-22	-47	-32	-17	-23	219	175	150	150	150	150
Greece	361	203	178	168	158	127	514	400	375	350	325	300
Denmark	-128	-177	-177	-167	-152	-158	26	20	20	15	15	15
Norway	-17	-77	-87	-82	-72	-78	137	120	110	100	95	95
Sweden	-101	-142	-137	-122	-112	-118	53	55	60	60	55	55
Switzerland	-207	-241	-248	-241	-234	-240	-54	-44	-51	-59	-67	-67
United Kingdom	-7	-20	-15	-5	5	5	147	177	182	177	173	178

Source: Citi Research

Figure 17. Emerging Market Countries — Short Rates Actual and Forecast of Additional Rate Moves (End of Period), as of 24 September 2014

	Current Rate	Dec 14	Mar 15	Jun 15	Sep 15	Dec 15	Total Cumulative Rate Moves Expected
Turkey	8.29	221	-25	-125	25	125	221
Thailand	2.00	0	0	0	50	50	100
South Africa	5.75	0	0	25	50	25	100
Hungary	2.10	0	0	0	25	75	100
Mexico	3.00	0	0	25	25	25	75
Korea	2.25	0	0	0	25	25	50
Brazil	11.00	0	100	0	-50	-50	0
India	8.00	0	0	0	0	0	0
Indonesia	5.75	0	0	0	0	0	0
Philippines	4.00	0	0	0	0	0	0
Israel	0.25	-25	0	0	0	25	0
Chile	3.25	-25	0	0	0	0	-25
Russia	8.00	0	0	-25	-25	0	-50
Ukraine	12.50	0	0	0	0	-50	-50
Poland	2.50	-50	0	0	0	0	-50
China	3.00	-25	-25	-25	0	0	-75

Source: Citi Research

Figure 18. Foreign Exchange Forecasts (End of Period), as of 24 September 2014

	vs. USD							vs. EUR						
	Current	Dec 14	Mar 15	Jun 15	Sep 15	Dec 15	Mar 16	Current	Dec 14	Mar 15	Jun 15	Sep 15	Dec 15	Mar 16
United States	NA	NA	NA	NA	NA	NA	NA	1.28	1.21	1.18	1.15	1.16	1.17	1.18
Japan	109	111	113	115	114	113	112	140	134	133	132	132	132	132
Euro Area	1.28	1.21	1.18	1.15	1.16	1.17	1.18	NA	NA	NA	NA	NA	NA	NA
Canada	1.10	1.13	1.14	1.15	1.15	1.15	1.15	1.41	1.36	1.34	1.32	1.34	1.35	1.36
Australia	0.89	0.86	0.85	0.83	0.82	0.82	0.81	1.44	1.39	1.39	1.39	1.41	1.43	1.46
New Zealand	0.81	0.76	0.73	0.70	0.70	0.70	0.69	1.58	1.60	1.62	1.65	1.66	1.68	1.70
Norway	6.35	6.82	7.03	7.20	7.04	6.89	6.74	8.15	8.23	8.27	8.29	8.18	8.07	7.96
Sweden	7.15	7.76	8.02	8.24	8.09	7.93	7.78	9.18	9.36	9.43	9.49	9.39	9.29	9.19
Switzerland	0.94	1.00	1.03	1.05	1.05	1.05	1.05	1.21	1.21	1.21	1.21	1.22	1.23	1.24
United Kingdom	1.63	1.59	1.58	1.58	1.58	1.59	1.59	0.79	0.76	0.74	0.73	0.73	0.74	0.74
China	6.14	6.10	6.07	6.04	6.03	6.02	6.02	7.88	7.36	7.14	6.95	7.00	7.05	7.11
India	60.9	61.7	62.1	62.4	62.5	62.7	62.8	78.1	74.4	73.0	71.9	72.6	73.4	74.2
Korea	1044	1047	1044	1039	1024	1010	996	1340	1263	1228	1196	1190	1183	1177
Poland	3.26	3.54	3.66	3.77	3.67	3.58	3.50	4.18	4.27	4.31	4.33	4.27	4.20	4.13
Russia	38.4	40.0	40.7	41.4	41.2	41.0	40.8	49.3	48.2	47.9	47.6	47.8	48.0	48.1
South Africa	11.08	11.30	11.40	11.49	11.41	11.33	11.25	14.21	13.62	13.42	13.23	13.25	13.27	13.29
Turkey	2.23	2.31	2.38	2.45	2.48	2.51	2.54	2.87	2.79	2.80	2.82	2.88	2.94	3.00
Brazil	2.37	2.37	2.45	2.53	2.55	2.58	2.60	3.04	2.86	2.88	2.91	2.96	3.02	3.07
Mexico	13.2	13.3	13.3	13.2	13.1	13.0	12.9	16.9	16.0	15.6	15.2	15.2	15.2	15.2

Source: Citi Research

Figure 19. Foreign Exchange Forecasts (End of Period), as of 24 September 2014

	Vs. JPY						
	Current	Dec 14	Mar 15	Jun 15	Sep 15	Dec 15	Mar 16
United States	109	111	113	115	114	113	112
Japan	NA	NA	NA	NA	NA	NA	NA
Euro Area	140	134	133	132	132	132	132
Canada	99	98	99	100	99	98	97
Australia	97	96	96	95	94	92	91
New Zealand	89	84	82	80	79	79	78
Norway	17.2	16.2	16.1	16.0	16.2	16.4	16.6
Sweden	15.2	14.3	14.1	13.9	14.1	14.2	14.4
Switzerland	116	110	110	109	108	108	107
United Kingdom	178	176	179	181	180	179	178
China	18	18	19	19	19	19	19
India	1.79	1.80	1.82	1.84	1.82	1.80	1.78
Korea	9.58	9.45	9.23	9.04	9.00	8.95	8.91
Poland	33.45	31.29	30.85	30.51	31.00	31.50	32.01
Russia	2.84	2.77	2.77	2.78	2.77	2.76	2.75
South Africa	9.84	9.81	9.91	10.00	9.98	9.96	9.94
Turkey	48.80	47.96	47.41	46.82	45.85	44.90	43.98
Brazil	46.05	46.76	46.10	45.44	44.60	43.78	42.98
Mexico	8.25	8.33	8.52	8.69	8.69	8.68	8.67

Source: Citi Research

Country Commentary

United States

Peter D'Antonio

Improving consumer and business fundamentals, along with supportive financial conditions (including a massive rise in wealth) are pointing to a solid 3 percent (or better) growth in the next few quarters. The rebound in growth, especially in private domestic demand, should help drive the unemployment rate below 6 percent later this year.

Meanwhile, inflation remains muted. Wage inflation has been extremely mild during this expansion, and although there are signs that wage growth may pick up late this year or next, we do not believe that it will pose an inflationary threat. Corporate profit margins have soared, reflecting cost-cutting during the recession and a slow pace of labor cost increases since then. At this point, wage cost increases will likely be absorbed by the elevated margins. However, we cannot rule out that a secular rise in profit shares, amid disappointing productivity growth, could translate into higher price mark-ups.

The Fed continued its gradual normalization of policy this month by cutting asset purchases by another $10 billion and indicating that the program will end in October. Fed Chair Yellen stressed that the trajectory of the recovery and economic developments will guide policy. In addition the Fed revised its principles for exiting zero policy rates, with the funds rate as the primary policy tool. We continue to expect that the first rate hike will take place in the summer of 2015.

Figure 20. United States — Economic Forecasts, 2013-2016F

					2014			2015				2016
		2013	2014F	2015F	2QF	3QF	4QF	1QF	2QF	3QF	4QF	1QF
GDP	SAAR				4.8	3.4	3.2	3.2	3.0	2.9	3.3	3.0
	YoY	2.2	2.3	3.3	2.6	2.4	2.3	3.7	3.2	3.1	3.1	3.1
Domestic Demand	SAAR				3.8	3.2	3.1	3.2	3.2	3.1	3.3	3.1
	YoY	1.9	2.4	3.2	2.4	2.6	2.7	3.3	3.1	3.1	3.2	3.2
Consumption	SAAR				3.2	2.7	2.9	3.1	3.1	2.9	3.1	2.9
	YoY	2.4	2.5	3.0	2.5	2.7	2.5	3.0	2.9	3.0	3.0	3.0
Business Investment	SAAR				9.1	7.8	6.3	6.8	6.8	6.6	7.3	7.1
	YoY	3.0	6.2	7.0	6.6	7.2	6.2	7.5	6.9	6.6	6.9	6.9
Housing Investment	SAAR				8.6	10.3	9.0	7.5	6.9	8.1	8.8	8.2
	YoY	11.9	2.7	8.2	1.1	0.9	5.5	8.8	8.4	7.9	7.8	8.0
Government	SAAR				1.7	1.1	0.3	0.3	0.3	0.3	0.2	0.3
	YoY	-2.0	-0.4	0.5	-0.7	-0.5	0.6	0.9	0.5	0.3	0.3	0.3
Exports	SAAR				10.8	4.8	3.7	6.1	6.0	6.0	5.8	5.0
	YoY	3.0	3.1	5.7	3.8	3.8	2.2	6.3	5.1	5.5	6.0	5.7
Imports	SAAR				11.4	1.3	2.1	3.6	5.0	5.2	5.0	4.8
	YoY	1.1	3.8	4.0	3.8	4.0	4.2	4.5	3.0	3.9	4.7	5.0
PCE Deflator	YoY	1.2	1.4	1.6	1.6	1.4	1.5	1.6	1.4	1.6	1.8	1.9
Core PCE Deflator	YoY	1.3	1.4	1.7	1.5	1.4	1.4	1.6	1.6	1.7	1.8	1.9
Unemployment Rate	%	7.4	6.2	5.7	6.2	6.1	5.9	5.9	5.7	5.6	5.5	5.4
Federal Gov't Balance (Fiscal Year)	$Bn	-680	-515	-490								
	% of GDP	-4.1	-3.0	-2.7								
General Gov't Balance (Cal Year)	% of GDP	-7.4	-6.6	-5.7								
Federal Debt	% of GDP	72	72	72								
General Gov't Debt	% of GDP	105	105	105								
Current Account	US$bn	-400	-412	-406	-394	-421	-426	-418	-414	-401	-390	-390
	% of GDP	-2.4	-2.4	-2.2	-2.3	-2.4	-2.4	-2.3	-2.3	-2.2	-2.1	-2.1
S&P 500 Profits (US$ Per Share)	YoY	6.4	8.0	6.9	9.8	8.1	8.7	6.8	5.6	6.0	9.2	NA

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

Japan

Kiichi Murashima

Naoki Iizuka

Economic activity has generally remained lacklustre this summer following a sharp fall in Q2 driven by the consumption tax hike. The Bank of Japan (BoJ) attributes recent sluggishness in consumer spending largely to payback from frontloaded demand ahead of the tax hike and the unseasonal weather in this summer. As a result, policymakers expect consumer spending will soon recover amid ongoing moderate rises in wages as these negative factors disappear. However, we believe that the decline in real income is playing a more important role in weighing on consumer spending than policymakers assume. If our assessment is correct, any pickup in consumer spending will likely be limited in the months to come.

Despite a sharp slowdown in the economy, we expect PM Abe will officially confirm in early December that the government will implement the additional consumption tax hike planned for Oct-2015. The political hurdle for him to postpone the tax hike is high, in our view. In particular, if PM Abe postpones the tax hike, his decision to implement the tax hike last April will likely be perceived as a policy mistake. But if the tax hike does proceed, there probably will again be a meaningful negative impact on households' real income, dampening consumer spending.

We expect the BoJ will implement additional easing measures during the period between late October and January 2015. Recent sharp yen depreciation, along with the resultant rally in equity markets, has probably reduced the possibility of early easing (say, in late October). We believe that fresh easing in January 2015 — after PM Abe's official decision to implement the tax hike — is most likely now. We are sceptical that policymakers will prioritise significant further yen depreciation from the current level by expanding the BoJ's balance sheet as aggressively as last year. Instead, the BoJ will likely focus more on increased purchases of risk assets (ETFs).

Figure 21. Japan — Economic Forecasts, 2013-2016F

					2014			2015				2016
		2013	2014F	2015F	2QF	3QF	4QF	1QF	2QF	3QF	4QF	1QF
Real GDP	YoY	1.5	0.9	0.6	0.0	0.2	0.5	-0.6	1.4	1.7	0.1	0.4
	SAAR				-7.1	2.9	0.6	1.4	0.7	4.1	-5.4	2.5
Domestic Demand	YoY	1.8	0.6	0.1	0.0	-0.4	-0.7	-2.1	1.1	1.8	-0.3	-0.2
	SAAR				-11.2	1.9	0.3	1.1	1.1	4.5	-7.5	1.5
Private Consumption	YoY	2.0	-0.7	0.0	-2.6	-1.9	-1.8	-3.4	2.1	2.5	-1.0	-1.0
	SAAR				-19.0	4.1	1.7	1.5	1.1	5.7	-11.5	1.5
Business Investment	YoY	-1.4	6.6	3.7	3.8	5.7	5.8	-0.8	6.3	4.7	4.5	4.6
	SAAR				-18.8	9.7	4.4	4.3	6.8	3.5	3.5	4.6
Housing Investment	YoY	8.8	-4.2	-4.6	-2.0	-12.0	-13.2	-13.7	-2.3	2.6	-3.6	-5.8
Public Investment	YoY	11.5	3.8	-8.7	5.3	4.0	-5.0	-6.5	-9.5	-10.5	-8.4	-8.0
Exports	YoY	1.5	7.9	4.4	5.5	7.9	9.2	4.2	5.0	4.5	4.0	4.0
	SAAR				-2.0	6.4	6.1	6.6	1.0	4.4	4.1	6.6
Imports	YoY	3.3	6.6	1.9	6.0	4.2	1.7	-3.2	3.6	5.4	1.9	0.8
	SAAR				-20.6	0.1	5.2	5.2	4.1	7.3	-8.2	0.7
CPI	YoY	0.4	2.8	1.7	3.6	3.2	2.8	2.9	0.9	0.9	2.3	2.1
Core CPI	YoY	0.4	2.7	1.7	3.3	3.2	3.0	3.0	0.9	0.9	2.3	2.1
Nominal GDP	YoY	0.9	2.1	1.3	-0.2	0.3	0.3	0.4	0.4	0.6	-0.3	0.6
Current Account	¥ tn	3.3	0.7	2.0	2.6	2.9	2.9	2.5	1.6	0.6	3.2	4.3
	% of GDP	0.7	0.1	0.4	0.5	0.6	0.6	0.5	0.3	0.1	0.6	0.9
Unemployment Rate	%	4.0	3.6	3.5	3.6	3.7	3.6	3.5	3.5	3.4	3.5	3.5
Industrial Production	YoY	-0.6	2.4	0.9	2.7	-0.1	-0.9	-3.1	1.4	4.2	1.1	1.1
Corporate Profits (Fiscal Year)	YoY	37.5	10.0	12.5								
General Govt. Balance (Fiscal Year)	% of GDP	-9.8	-8.0	-6.2								
General Govt Debt	% of GDP	241	243	247								

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

Euro Area

Guillaume Menuet

Giada Giani

Ebrahim Rahbari

We are shaving 0.1pp from each of our 2015-17 GDP forecasts to 1.4% in 2015, and to 1.8% in 2016 and 2017. The weak Q2 GDP figure and weakening business surveys are partly to blame for this near-term adjustment. But early evidence of slow activity in Q3 also suggests that various downside risks are materialising. Our biggest downgrades this month come from Italy (domestic demand) and Germany (where prospects for exports and export-sensitive investment have deteriorated). With these two economies accounting for 45% of the euro area's nominal GDP and France (21% of EA-18 GDP) essentially flat-lining, prospects for faster growth will be limited despite better growth in the periphery.

Inflation in August was revised up slightly to 0.37% YY (0.34% flash estimate), leaving the YY rate broadly stable relative to July (0.38% YY). While core inflation ticked up to 0.9% YY in August from 0.8% in July, we believe that most of this increase was driven by calendar effects from summer sales of clothing prices that are likely to be reversed in Sep/Oct. The ECB surprised in September, cutting all its key interest rates by 10bp, lowering the refi rate to 0.05%. In our view, the Governing Council's (GC) decision to include a third programme of covered bonds purchases in parallel to an ABS purchase programme highlighted growing concerns about excessive euro strength needing to be addressed through expansion of the Eurosystem's balance sheet. Despite many GC members arguing that time is needed to assess the impact of recent monetary policy decisions, we argue that the removal of the "*broadly balanced*" reference to risks to the outlook for price developments is very significant. We still expect the ECB to launch a QE programme including public sector assets soon. We are lifting our 2015-17 inflation profile by 0.2pp to 1.1% in 2015 and by 0.1pp in both 2016-17 to 1.3% and 1.6%, respectively, on our forecast of a significantly weaker euro. But even with further euro weakness and QE, our Q4-17 estimate of 1.7% YY is very much at the low end of the ECB's inflation target ("below but close to 2%") three years out.

Figure 22. Euro Area — Economic Forecasts, 2013-2016F

					2014			2015				2016
		2013	2014F	2015F	2QF	3QF	4QF	1QF	2QF	3QF	4QF	1QF
Real GDP	YoY	-0.4	0.8	1.4	0.7	0.8	0.8	1.0	1.3	1.5	1.7	1.8
	SAAR				0.1	1.0	1.1	1.7	1.5	1.7	1.9	2.0
Final Domestic Demand	YoY	-0.9	0.8	1.2	0.8	0.8	0.8	0.9	1.2	1.3	1.5	1.5
Private Consumption	YoY	-0.6	0.8	1.3	0.7	0.8	1.0	1.2	1.3	1.3	1.4	1.5
Government Consumption	YoY	0.2	0.6	0.6	0.8	0.3	0.5	0.1	0.3	0.7	1.2	0.9
Fixed Investment	YoY	-2.8	1.2	1.8	1.3	1.2	0.6	1.0	1.9	2.1	2.3	2.3
Business Equipment	YoY	-1.6	2.9	1.8	3.7	3.6	1.6	2.3	0.8	1.6	2.5	2.8
Construction	YoY	-3.8	-0.3	0.5	-0.8	0.0	-1.7	-1.5	1.0	0.1	2.3	2.3
Stocks (Contrib. to Y/Y GDP Growth)		0.0	0.0	-0.1	0.1	-0.2	0.0	-0.2	0.0	0.0	0.0	0.0
Exports	YoY	1.5	2.6	3.4	2.0	2.6	1.9	2.8	3.3	3.6	3.9	4.0
Imports	YoY	0.4	2.8	3.2	2.8	2.2	2.2	2.4	3.1	3.5	3.6	3.5
CPI	YoY	1.4	0.6	1.1	0.6	0.4	0.7	0.9	1.1	1.2	1.2	1.2
CPI Ex Unprocessed Food & Energy	YoY	1.3	0.9	0.9	0.9	0.9	0.9	0.8	0.9	0.8	0.9	1.0
Unemployment Rate	YoY	11.9	11.4	10.9	11.4	11.0	11.2	11.6	10.9	10.5	10.5	10.9
Current Account Balance	€bn	230.7	276.1	302.0								
	% of GDP	2.4	2.8	3.0								
General Government Balance	€bn	-290.3	-261.3	-225.6								
	% of GDP	-3.0	-2.7	-2.3								
Primary Balance	% of GDP	-0.1	0.3	0.7								
General Government Debt	€bn	9,121.3	9,480.2	9,685.9								
	% of GDP	95.0	97.2	97.3								
Gross Operating Surplus	YoY	1.4	1.5	1.7								

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

Germany

Ebrahim Rahbari

This month we cut our growth forecasts again, to 1.5% for 2014 and 1.8% for 2015 (from 1.6% and 2.0% in August). German sentiment indicators have continued to weaken and consumer confidence is now also weakening (from a very high level) in response to a string of weak data and external risks. We currently expect 0.5% QQ Q3 growth, but acknowledge that the strong rebounds in industrial production and exports in July point to the possibility of a higher figure.

France

Guillaume Menuet

President Hollande's popularity fell to a record low in September, with only 15.5% of people having a positive opinion of him. News of more tax cuts for low-income households in 2015-16, and our forecast of a lower euro add 0.1pp to our GDP growth forecast in both 2015 and 2016. A confidence motion on PM Valls' second government with a renewed focus on supply-side reforms was approved by parliament, albeit by a small majority. The new Economy minister Emmanuel Macron noted that France is "paying the price of a lost decade" and vowed to continue his predecessor's efforts on trimming regulation and reforming closed professions. Moody's maintained France's Aa1 rating with a negative outlook, suggesting that a reassessment would take place within 12 months.

Italy

Giada Giani

After surprisingly weak Q2 GDP data (-0.2% QQ), preliminary Q3 data suggest GDP growth may have remained negative, against our prior expectations of a small rebound. Hence, we are cutting our 2014 growth forecast to -0.4% YY (from -0.1% last month). Poor business competitiveness is at the roots of Italy's growth underperformance relative to peers, while recent fiscal stimulus measures have failed to lift domestic demand. Despite the weaker euro, we expect tight credit conditions and poor export growth to continue weighing on recovery prospects, unless rapid implementation of reforms surprisingly gives a major confidence boost to domestic demand. Hence, we are also cutting our 2015 growth expectations, to +0.3% YY (from +0.8% YY previously). The weaker outlook for real and nominal GDP growth has increased risks of rating downgrades, in our view.

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

		Germany			France			Italy		
		2013	2014F	2015F	2013	2014F	2015F	2013	2014F	2015F
Real GDP	YoY	0.2	1.5	1.8	0.4	0.4	1.0	-1.8	-0.4	0.3
Final Domestic Demand	YoY	0.6	1.5	1.9	0.5	0.0	0.7	-2.6	-0.3	0.2
Private Consumption	YoY	1.0	1.1	1.9	0.3	0.2	1.0	-2.6	0.1	0.4
Government Consumption	YoY	0.7	0.9	1.4	2.0	1.5	0.9	-0.8	0.2	-0.5
Fixed Investment	YoY	-0.6	3.6	2.5	-0.8	-2.3	-0.2	-4.6	-2.0	0.5
Exports	YoY	1.7	3.5	3.6	2.4	2.5	2.4	0.0	1.2	2.1
Imports	YoY	3.2	4.1	4.3	1.9	2.4	1.5	-2.9	1.0	2.2
CPI	YoY	1.5	1.0	1.7	1.0	0.8	1.3	1.3	0.2	0.1
Unemployment Rate	%	5.3	5.0	5.1	9.9	9.8	9.7	12.2	12.5	12.4
Current Account	€bn	193.5	206.3	215.4	-28.4	-14.6	-1.4	15.5	25.6	27.6
	% of GDP	7.1	7.3	7.4	-1.4	-0.7	-0.1	1.0	1.6	1.7
General Govt. Balance	€bn	0.3	5.5	6.6	-88.2	-94.4	-89.8	-45.4	-49.5	-45.5
	% of GDP	0.0	0.2	0.2	-4.3	-4.5	-4.2	-2.8	-3.0	-2.8
Primary Balance	% of GDP	2.2	2.2	2.1	-2.0	-2.3	-2.0	2.1	1.6	1.6
General Govt. Debt	% of GDP	78.4	75.7	73.5	93.5	97.4	99.5	127.9	130.8	132.8
Gross Trading Profits	YoY	-0.6	2.4	3.6	-0.2	3.1	3.7	NA	NA	NA

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

Spain

Giada Giani

Antonio Montilla

We are trimming our 2014 real GDP growth by 0.1pp to 1.3%, based on indications that growth slowed in Q3. Industrial production remained feeble in July, while Jul-Aug data on registered unemployment point to a slower pace of job creation. However, survey data remain buoyant, export growth is picking up, and the slump in housing seems to ending. We expect more supportive financial conditions and reduced fiscal drag to further support domestic demand in coming quarters. The 2014 budget deficit is likely to be close to the government target (of 5.5% of GDP).

Greece

Giada Giani

The strong tourism season has been the main driver behind the pick-up in GDP growth in Q2 and probably in Q3 – we estimate YY growth turned positive in Q3 for the first time since Q2-08. Nevertheless, 2014 growth will probably be around 0.1%, somewhat below the official forecast (+0.6%). We expect the 2015 recovery also to be shallower, although supported by reduced fiscal tightening and further export competitiveness gains.

Ireland

Michael Saunders

Consensus forecasts for Ireland's real GDP growth in 2014 have risen sharply in recent months, reaching 3.2% YY in September, but in our view remain far too low. We continue to expect real GDP growth of 5-6% YoY in 2014, and our bullish growth outlook has been reinforced by the strong Q2 GDP growth data (1.5% QQ). The Q2 surge in GDP (and IP) was probably partly erratic, and recent data suggest that Q3 GDP growth is around zero. Even so, the economy's momentum remains strong, and GDP growth will probably stay far above the euro area average in 2015.

Portugal

Giada Giani

We are slightly cutting our GDP growth forecasts for 2014 (by 0.1pp) and 2015 (by 0.3pp) amid signs of weaker external demand and some softening in Q3 data. Nevertheless, we think the recovery will remain supported by strong gains in competitiveness and faster-than-expected job creation. The pace of reduction in the budget deficit is likely to be smaller than the government's official targets, but with the debt-to-GDP ratio probably peaking in 2014, this should not create too many concerns among investors and European official creditors.

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

		Spain			Greece			Ireland			Portugal		
		2013	2014F	2015F	2013	2014F	2015F	2013	2014F	2015F	2013	2014F	2015F
Real GDP	YoY	-1.2	1.3	2.0	-3.9	0.1	1.3	0.2	5.5	4.2	-1.4	1.0	1.8
Final Domestic Demand	YoY	-2.7	1.6	2.0	-6.4	0.0	0.5	-0.6	2.5	1.8	-2.3	1.3	1.2
Private Consumption	YoY	-2.0	2.2	2.2	-5.8	0.4	0.6	-0.8	1.1	1.5	-1.4	1.6	1.1
Government Consumption	YoY	-2.3	0.5	0.4	-3.9	-1.6	-0.5	1.3	1.3	-2.5	-2.0	-0.1	-0.4
Fixed Investment	YoY	-5.0	1.0	3.1	-12.8	0.7	1.8	-1.8	8.4	6.9	-6.1	1.6	3.2
Exports	YoY	4.9	4.1	6.2	1.3	6.3	4.0	1.1	10.0	5.4	6.4	2.4	4.7
Imports	YoY	0.4	5.7	7.1	-5.3	2.6	1.1	0.6	8.1	3.8	3.7	5.1	2.5
CPI	YoY	1.5	0.0	0.5	-0.9	-1.1	-0.6	1.0	0.4	1.0	0.4	-0.1	0.3
Unemployment Rate	%	26.1	24.4	22.9	27.5	26.7	25.5	13.1	11.4	10.2	16.2	13.8	12.0
Current Account	€bn	8.0	3.7	4.0	1.4	2.9	3.5	7.6	7.3	7.6	0.9	0.9	1.3
	% of GDP	0.8	0.4	0.4	0.8	1.6	2.0	4.4	3.9	3.9	0.5	0.5	0.7
General Govt. Balance	€bn	-72.4	-57.9	-49.5	-23.1	-3.9	-4.4	-11.8	-3.7	1.4	-8.2	-7.0	-5.6
	% of GDP	-7.1	-5.6	-4.7	-12.7	-2.2	-2.5	-6.7	-2.0	0.7	-5.0	-4.2	-3.3
Primary Balance	% of GDP	-3.7	-2.3	-1.5	-8.7	2.3	2.1	-2.6	2.7	5.4	-0.6	0.3	1.4
General Govt. Debt	% of GDP	93.9	99.1	101.5	175.1	180.1	181.1	123.3	114.9	108.6	128.9	135.5	133.7

Source: Citi Research

Netherlands

Guillaume Menuet

With the prospect of further euro weakness, we are adding 0.2pp to our GDP forecasts for both 2015 and 2016. In all, we now look for GDP growth to roughly double, from about 0.7% in 2014 to 1.5% in 2015 and 1.8% in 2016. With exports plus imports at about 150% of GDP, external developments remain the key risk to our baseline. The government's focus on budgetary consolidation, aiming for a 0.7pp fall in the 2015 deficit to 2.2% of GDP will still act as a headwind to growth.

Belgium

Guillaume Menuet

We add a few decimal points to our 2015-16 GDP forecasts to 1.5% and 1.9%, respectively, to reflect the lower projected path of the euro in coming quarters. Although business confidence has been treading water in Q3, we estimate that export prospects will improve in 2015-16, alongside expected gains in business investment (driven by cuts in employers' social security contributions as part of the federal government coalition negotiations). The government's budget deficit reduction targets in 2015-16 are likely to be broadly met.

Slovakia

Jaromir Sindel

We are keeping our 2014 GDP growth forecast unchanged at 2.3%, and marginally cutting that for 2015 to 2.6% (from 2.7%), and the structure of growth is likely to shift more in favour of domestic demand. These changes reflect the mix of weaker foreign demand, softer currency and robust domestic demand. We think that risks to our forecast are balanced and our forecast is close to MinFin's forecast (which for 2015 was recently downgraded from 3% to 2.6%). The activation of the trigger in the debt-brake rule is likely to force the MinFin to use more cash from its treasury account to help to lower the debt-to-GDP ratio.

Slovenia

Jaromir Sindel

Both economic and political developments remain supportive for Slovenian economy. We expect a mild QQ fall in 3Q14 GDP, after growth of 1% QQ in 2Q. However, trends in surveys, industrial production, retail sales and labour market data suggest the economy's underlying momentum is solid. Hence, we are raising our GDP growth forecast to 1.9% in 2014 from 1%. We expect the new centre-leftwing government can survive its four-year term, but that the way to fiscal consolidation and privatization - though both are likely to continue to be bumpy.

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

		Netherlands			Belgium			Slovakia			Slovenia		
		2013	2014F	2015F	2013	2014F	2015F	2013	2014F	2015F	2013	2014F	2015F
Real GDP	YoY	-0.7	0.7	1.5	0.2	1.1	1.5	0.9	2.3	2.6	-0.9	1.9	1.6
Final Domestic Demand	YoY	-1.7	0.0	0.4	0.3	1.4	1.2	-0.8	4.3	2.5	-2.2	0.1	0.5
Private Consumption	YoY	-1.6	-0.3	0.5	0.8	1.1	0.9	-0.1	2.9	2.0	-2.8	-0.2	-0.4
Government Consumption	YoY	-0.2	0.2	-0.1	0.6	0.1	0.7	1.4	3.8	2.1	-2.0	-0.9	-0.3
Investment (Ex Stocks)	YoY	-3.9	0.3	0.8	-1.4	3.8	2.5	-4.3	8.0	4.1	-0.3	1.2	1.0
Exports	YoY	2.2	2.6	2.7	1.9	3.5	4.6	4.5	5.7	6.5	2.7	4.5	6.7
Imports	YoY	1.0	1.8	1.6	1.4	3.2	4.6	2.9	7.8	7.3	1.3	3.8	5.7
CPI (Average)	YoY	2.6	0.6	1.6	1.2	0.6	1.3	1.4	-0.1	1.2	1.8	0.4	0.9
Unemployment Rate	%	8.3	8.5	8.1	8.4	8.5	8.3	14.1	12.9	12.3	10.1	10.0	10.2
Current Account	% of GDP	10.9	11.4	9.9	-1.9	0.1	0.7	2.1	0.3	-0.3	6.0	3.4	4.0
General Govt Balance	% of GDP	-2.4	-2.7	-2.1	-2.7	-2.6	-2.3	-2.8	-3.0	-2.8	-14.7	-4.5	-2.1
Primary Balance	% of GDP	-0.7	-1.0	-0.4	0.6	0.6	0.8	-1.5	-1.7	-1.5	-12.1	-1.6	0.7
General Govt Debt	% of GDP	73.5	74.8	74.1	101.2	102.4	101.8	55.4	55.5	55.6	71.7	81.2	81.1

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

United Kingdom

Michael Saunders

Uncertainties over the possible implications of Scottish independence are likely to recede given the fairly clearcut 55:45% win for the "No" vote (against independence) in the Scottish referendum. There will now be a period of negotiations between the UK and Scottish governments over plans for "Devo-max", with the transfer of further powers to the Scottish government. It is conceivable that there will be another Scottish independence referendum in the future, but we doubt it would occur in the next five years at least.

We continue to look for real GDP growth of about 3½% in both 2014 and 2015, led by strong gains in consumer spending and investment. There may be some referendum-related weakness in September activity. But, based on surveys and a limited amount of data, we believe that Q3 real GDP rose by about 1% QoQ, implying a YoY gain of 3.3-3.4% YoY after 3.2% YoY in Q2. However, major revisions to the national accounts data are due on September 30, well before the Q3 GDP data are published in late October, and these revisions may well alter our forecast. The ONS has already said that the YoY gain in real GDP over 2008-12 will be revised up by an average of 0.5 percent per year. We expect that the recent GDP growth rates (for 2013-14) will also be revised up significantly: indeed, given the strength in recent business surveys and jobs data, we would not be surprised if revisions eventually show that real GDP growth currently is around 4% YoY. Many other data series are likely to be revised markedly as well. The jobless rate is likely to continue to fall rapidly, dropping below 6% by the end of this year and below 5% by the end of 2015. Although pay growth is subdued, other guides (eg vacancies, surveys of labour shortages) suggest that labour market slack is shrinking fast. As a result, we continue to expect the MPC will hike rates soon, either in Q4-14 or Q1-15, as an early step away from the current ultra-loose policy stance.

Figure 26. United Kingdom — Economic Forecasts, 2013-2016F

					2014			2015				2016
		2013	2014F	2015F	2QF	3QF	4QF	1QF	2QF	3QF	4QF	1QF
Real GDP	YoY	1.7	3.3	3.5	3.2	3.4	3.7	3.8	3.8	3.5	3.1	3.1
	SAAR				3.5	4.1	4.2	3.4	3.3	3.1	2.5	3.2
Domestic Demand	YoY	1.8	3.2	4.2	3.5	2.6	3.6	4.3	4.4	4.2	4.1	3.7
(Incl. Inventories)	SAAR				4.3	4.5	3.6	4.9	4.5	3.8	3.3	3.3
Private Consumption	YoY	2.2	2.9	3.2	3.1	3.0	3.3	3.2	3.2	3.3	3.2	3.2
	SAAR				4.1	3.2	2.7	3.0	3.9	3.4	2.5	3.1
Government Consumption	YoY	0.7	0.4	-0.1	0.1	-0.3	-0.1	0.0	0.2	-0.2	-0.5	-0.8
	SAAR				-1.3	0.9	0.4	-0.1	-0.5	-0.5	-1.0	-1.0
Investment	YoY	-0.8	12.3	14.8	11.6	12.6	15.0	16.8	14.8	14.2	13.5	12.2
	SAAR				22.0	13.6	14.8	17.2	13.9	11.0	12.0	12.1
Exports	YoY	0.5	0.5	4.2	-2.8	1.4	2.9	3.4	5.4	4.8	3.4	4.7
	SAAR				-4.1	7.0	9.5	1.8	3.3	4.8	3.7	7.1
Imports	YoY	0.2	0.5	7.0	-1.2	-0.4	2.9	5.9	7.7	7.4	7.1	7.1
	SAAR				0.6	8.2	7.8	7.2	7.4	7.2	6.5	7.4
Unemployment Rate	%	7.6	6.3	5.2	6.4	6.1	5.8	5.6	5.3	5.0	4.7	4.7
CPI Inflation	YoY	2.6	1.6	1.8	1.7	1.5	1.5	1.6	1.7	1.9	2.0	2.0
Merch. Trade	£bn	-109.7	-111.8	-125.1								
	% of GDP	-6.8	-6.6	-7.0								
Current Account	£bn	-72.8	-81.3	-101.9								
	% of GDP	-4.5	-4.8	-5.7								
PSNB	£bn FY	-106.8	-92.9	-66.0								
	% of GDP	-6.5	-5.4	-3.6								
General Govt. Balance	% of GDP	-7.1	-5.9	-4.1								
Government Primary Balance		-3.5	-2.3	-0.4								
Public Debt	% of GDP	94.5	96.5	96.5								
Gross Nonoil Trading Profits	YoY	4.6	12.2	4.5								

Source: Citi Research

Switzerland

Michael Saunders

With the sharp loss of momentum in Q2 GDP and recent business surveys, we are cutting our 2014 GDP growth forecast to 1.1% from 2.0% last month, and cutting our 2015 forecast to 1.3% from 2.6%. Export volumes have stalled in recent months, the manufacturing PMI has dived by 5 points in the last two months, while the Kof activity guide in July-August was at its weakest since mid-2012. With inflation still close to zero, the SNB is likely to keep rates on hold for an extended period. If needed, we believe the SNB would be prepared to resume major FX intervention to prevent CHF appreciation.

Sweden

Tina Mortensen

Reflecting the substantial upward revision to 1H GDP, we raise our full-year 2014 forecast by 0.2pp. The Riksbank unanimously left the key policy rate unchanged at 0.25% in Sep and with ongoing inflation concerns confirmed its 3bp short-term easing bias (first rate hike still seen in 4Q-15). The general election ended without a majority for either side. The SocDem-led bloc is trying to form a government that can pass a budget this autumn. With the nationalist SD holding the balance of power, this will likely prove a complex task, requiring cross-block cooperation. Hence, the SocDem-led coalition probably will have to make major concessions.

Denmark

Tina Mortensen

The Danish economy returned to negative growth in 2Q, and with rising geopolitical unrest and weaker momentum in a majority of Denmark's key trading partners, the near-term outlook does not look too bright. In turn, we have more than halved our 2014 GDP forecast. Mirroring the ECB's action, the DNB cut the CD-rate by 10bp to -0.05% in Sep (but refrained from changing the ceiling for current account deposits). The DNB may well be forced to cut the CD-rate deeper into negative territory to keep pace with ECB's extraordinary measures to defend its currency peg.

Norway

Tina Mortensen

Mainland GDP rebounded by a strong 0.9% Q/Q in 2Q, suggesting that the economy, so far, has weathered the sharp slowdown in investment growth in the petroleum sector. Next year, declining oil-related investment and the ongoing erosion in competitiveness will probably keep mainland GDP growth at a below-trend rate pace. At the September MPC meeting, Norges Bank removed its near-term easing bias and lowered its forecast for the medium-term rate outlook by roughly 10bp, delaying its forecast for initial tightening to late-16 from mid-2016.

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

		Switzerland			Sweden			Denmark			Norway		
		2013	2014F	2015F	2013	2014F	2015F	2013	2014F	2015F	2013	2014F	2015F
Real GDP	YoY	1.9	1.1	1.3	1.5	2.2	2.6	0.4	0.6	1.3	2.0	2.3	2.2
Final Domestic Demand	YoY	2.2	1.5	2.5	1.4	2.4	2.2	0.4	1.3	1.6	2.5	1.9	2.3
Private Consumption	YoY	2.3	1.3	2.1	2.1	2.7	2.7	0.1	1.2	1.7	2.2	2.2	2.5
Government Consumption	YoY	2.4	0.0	0.6	1.9	1.1	0.9	0.7	1.0	1.0	1.9	2.1	2.3
Investment (Ex Stocks)	YoY	1.8	2.8	4.4	-1.0	3.5	3.1	0.5	2.2	2.3	4.5	0.7	1.8
Exports	YoY	1.9	4.2	2.6	-0.3	2.5	4.2	1.0	2.4	3.3	0.8	2.4	3.3
Imports	YoY	1.8	3.1	3.9	-0.7	4.1	3.9	1.4	5.1	4.2	2.9	1.4	2.3
CPI (Average)	YoY	-0.2	0.1	1.1	0.0	0.0	1.1	0.8	0.7	1.2	2.1	2.0	2.1
Unemployment Rate	%	3.2	3.5	4.1	8.0	8.0	7.5	7.0	6.6	6.5	3.5	3.4	3.6
Current Account	% of GDP	16.0	13.1	11.9	6.7	6.2	6.0	7.2	6.7	5.7	11.1	11.0	11.7
General Govt Balance	% of GDP	0.0	-0.6	-0.4	-1.2	-2.1	-1.2	-0.9	-1.0	-2.3	10.9	11.0	11.0
General Govt Debt	% of GDP	49.4	48.5	48.5	37.5	38.8	38.6	44.5	44.9	46.1	NA	NA	NA

Source: Citi Research

Canada

Dana M. Peterson

The economy expanded at an above-trend rate in the second quarter, and the positive momentum in export growth, home buying and consumer spending has extended into the third quarter. More robust US demand, elevated Canadian consumer confidence and extraordinarily accommodative financial conditions are all supporting output. However, labor market indicators suggest that economic slack persists, and business investment remains lackluster. Broader trade should lead to increased business engagement in the expansion. Stronger US performance, the weaker CAD and energy infrastructure build-out should propel the economy ahead.

CPI inflation continues to track above the BoC's forecasts. Importantly, a surprise pop in core inflation above the bank's 2 percent target in August appeared to reflect fundamental as well as temporary elements, in our view. Services costs, which are largely immune to exchange rate pass-through, continue to rise, along with goods excluding food and energy. We posit that retail prices are stabilizing after an extended period of competitive discounting and the degree of excess supply is lessening. Both total and core CPI inflation probably will remain near target over the medium term.

Risks to the inflation outlook remain roughly balanced, in our view. Upside risks include (1) stronger global growth; (2) higher commodity prices induced by geopolitical events; and (3) reinvigoration of the housing market that reinforces existing imbalances. Downside risks include (1) weaker global growth; (2) failure of the domestic demand rotation to occur due to insufficient exports and capex growth; (3) anemic Emerging Market activity; and (4) domestic household imbalances. The BoC is unlikely to raise interest rates until there is sustained improvement in capex and exports growth, and/or a notable rise in inflation expectations. Hence, we maintain our long-standing expectation for rate hikes to resume in 3Q 15.

Figure 28. Canada — Economic Forecast, 2013-2016F

					2014			2015				2016
		2013	2014F	2015F	2QF	3QF	4QF	1QF	2QF	3QF	4QF	1QF
Real GDP	YoY	2.0	2.4	2.7	2.5	2.6	2.5	2.9	2.8	2.6	2.6	2.6
	SAAR				3.1	3.5	2.4	2.6	2.8	2.7	2.5	2.5
Final Domestic Demand	YoY	1.4	1.4	2.1	1.3	1.4	1.7	2.3	2.1	2.0	2.0	2.0
	SAAR				3.0	2.2	2.0	2.1	2.0	2.0	1.9	2.1
Private Consumption	YoY	2.4	2.6	2.5	2.7	2.5	2.6	2.8	2.5	2.5	2.4	2.3
	SAAR				3.6	2.5	2.5	2.5	2.5	2.5	2.3	2.0
Government Spending	YoY	0.3	-0.3	0.4	-0.3	-0.3	0.1	0.4	0.2	0.4	0.5	0.6
	SAAR				1.1	-0.2	0.1	0.5	0.5	0.5	0.5	1.0
Private Fixed Investment	YoY	0.2	0.1	2.9	-0.3	0.4	1.4	3.4	3.1	2.7	2.6	2.8
	SAAR				3.4	4.2	2.8	3.1	2.5	2.4	2.3	3.9
Exports	YoY	2.2	5.9	6.3	5.1	8.0	8.2	9.6	6.5	4.7	4.8	4.9
	SAAR				17.8	12.2	4.4	4.4	5.1	5.0	4.9	4.5
Imports	YoY	1.1	1.1	3.2	1.4	1.7	2.0	4.3	2.3	3.0	3.1	3.2
	SAAR				11.1	0.3	3.0	3.0	3.1	3.0	3.3	3.3
CPI	YoY	0.9	2.0	2.0	2.2	2.1	2.2	2.0	1.9	2.0	2.2	2.2
Core CPI	YoY	1.2	1.8	2.0	1.7	2.0	2.1	2.1	2.0	1.9	1.9	2.0
Unemployment Rate	%	7.1	7.0	6.7	7.0	7.0	6.9	6.8	6.6	6.6	6.6	6.5
Current Account Balance	C$bn	-60.3	-40.1	-32.8	-47.5	-34.4	-31.2	-35.7	-35.5	-31.3	-28.6	-30.3
	% of GDP	-3.2	-2.0	-1.6	-2.4	-1.7	-1.6	-1.8	-1.7	-1.5	-1.4	-1.4
Net Exports (Pct. Contrib.)		0.3	1.4	1.0	1.7	3.6	0.4	0.4	0.6	0.6	0.5	0.4
Inventories (Pct. Contrib.)		0.3	-0.5	-0.4	-1.8	-2.5	0.0	0.0	0.1	0.0	0.1	0.0
Budget Balance (Fiscal Year)	% of GDP	-0.9	-0.1	0.3								
Federal Budget Debt	% of GDP	32.4	31.1	29.3								
General Govt. Debt	% of GDP	93.5	92.0	90.3								

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

Australia

Paul Brennan

Joshua Williamson

While the slowdown in China is lowering commodity prices, the impact of lower commodity prices on mining investment is only gradually impacting Australia's real GDP growth. And in the meantime, the common financial cycles between the US and Australia are driving a pick-up in interest-rate sensitive sectors. As a result, Australia's economic growth has held up reasonably well at close to trend. Our economic forecasts are unchanged this month with 3.2% growth this year and 3.0% next year. At the same time, the higher USD is helping to lower the AUD from levels that have been a handbrake on many companies. That said, the AUD probably needs to fall further before non-mining companies will look to step up hiring and investment in new capacity. In the meantime, the RBA will need to keep interest rates steady at current levels until at least mid-2015. Concerns about rising house prices most likely will be managed through jawboning and APRA surveillance of lending practices.

New Zealand

Paul Brennan

Joshua Williamson

Economic growth is moderating from the rapid pace of H2 last year and earlier this year, but it still retains solid momentum. The headline 0.7% QoQ rise in Q2 GDP was a slowdown from the previous three quarters, which averaged 1.0%, but growth in the past 12 months was still strong at 3.9% YoY. The slowdown is consistent with other indications that the recent rapid monetary policy tightening is working. Additionally, the decline in the terms of trade is eroding nominal GDP growth. More timely reads on the economy suggest continued moderate growth in Q3. Both business and consumer confidence have eased from their highs but they still remain relatively high and consumer confidence rose slightly in September. Job ads and net migration both increased in August. Less positively, dairy prices have continued to decline, weighing on income growth. The decisive re-election of the National government for a third term provides an opportunity to pursue further economic reforms.

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

	Australia			New Zealand		
	2013	2014F	2015F	2013	2014F	2015F
Real GDP[a]	2.3	3.2	3.0	2.8	3.5	2.9
Real GDP (4Q versus 4Q)	2.6	2.9	3.3	3.3	3.0	2.9
Real Final Domestic Demand	0.9	1.5	1.8	4.4	5.3	4.0
Private Consumption	2.0	2.5	3.1	3.7	3.3	3.0
Govt. Current & Capital Spending [b]	1.1	1.5	2.0	1.3	3.0	3.0
Housing Investment	1.8	9.1	8.6	15.0	16.0	14.4
Business Investment [c]	0.3	-5.3	-5.7	9.3	13.0	7.0
Exports of Goods & Services	6.6	7.4	6.9	1.0	1.5	2.5
Imports of Goods & Services	-2.0	0.9	2.1	8.7	7.6	4.7
CPI	2.4	2.5	2.5	1.1	2.1	2.2
CPI (4Q versus 4Q)	2.7	1.8	2.7	1.6	2.1	2.3
Unemployment	5.8	6.1	6.0	6.0	5.3	5.0
Merch. Trade, BOP (Local Currency, bn)	4.5	-1.2	-10.7	1.4	-0.1	-2.5
Current Account, (Local Currency, bn)	-51.5	-54.9	-60.7	-7.5	-9.6	-13.0
Percent of GDP	-3.3	-3.4	-3.6	-3.4	-4.2	-5.4
Budget Balance [d] (Local Currency, bn)	-18.7	-50.2	-30.4	-6.4	-3.8	-0.9
Percent of GDP	-1.2	-3.1	-1.8	-2.9	-1.6	-0.4
General Govt. Debt (% of GDP) [e]	30.2	32.1	33.5	39.8	39.0	36.3
Gross Operating Surplus	2.8	5.2	5.3	NA	NA	NA

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

China

Minggao Shen

Shuang Ding

The property sector slowdown is spilling over to a larger part of the economy. With housing sales registering negative growth since the beginning of the year, real estate investment growth moderated to 13.2%YoY in Jan-Aug from nearly 20% in 2013. In addition, infrastructure investment growth decelerated from 25%YoY in Jan-Jul to 23.5%YoY in Jan-Aug, likely reflecting funding constraints faced by local governments as land sales became stagnant. Upstream industries also suffered from the housing market correction: compared with Jan-Jul, production growth of steel, cement and plain glass fell by 1.3ppts, 0.5ppt and 5.6ppts, respectively in August. The retail sales of home appliances, furniture and construction materials all saw slower growth. More strikingly, industrial production growth plummeted to 6.9%YoY, the third-lowest monthly growth since 1995, suggesting strong exports and targeted policy easing are not sufficient to offset the property-related drag.

We have revised our 2014 growth forecast down to 7.3% from 7.5% to reflect delays in the policy response. RMB credit and total social financing data for Jul-Aug suggest relatively weak demand for credit amid the property market correction, partly because the cost of borrowing has been elevated in real terms. The government accelerated fiscal spending earlier this year, but with the total budget unchanged, fiscal spending will have to grow less rapidly for the rest of year. This would be a drag on growth in 4Q and early next year. Stagnating land sales revenue would weigh on investment late this year and early next year. We therefore also downgrade the 2014 growth forecast, and trim our 2015 growth forecast from 7.1% to 6.9%.

We expect targeted easing to be followed by broad-based easing. Home purchase restrictions will likely be abolished in most cities. Local governments may turn low-end residential property into social housing. The mortgage loan rate for first-home buyers may be cut to support demand. We think these measures may turn out to be insufficient, and broad-based rate cuts also will be needed to mitigate the downside risk of the property sector. We now expect three policy rate cuts, 25bps each, from now on to mid-2015. This would bring the benchmark deposit rate to 2.25%, with real interest rates around zero.

Figure 30. China — Economic Forecasts, 2013-2016F

					2014			2015				2016
		2013	2014F	2015F	2Q	3QF	4QF	1QF	2QF	3QF	4QF	1QF
Real GDP	YoY	7.7	7.3	6.9	7.5	7.2	7.1	6.9	6.7	7.0	7.1	6.6
Real Final Domestic Demand	YoY	8.5	7.0	6.8								
Consumption	YoY	7.9	7.2	7.1								
Fixed Capital Formation	YoY	9.1	6.8	6.5								
Industrial Production	YoY	9.7	8.5	7.8	8.9	8.2	8.0	7.7	7.4	8.0	8.2	7.2
Exports	YoY	7.8	5.1	6.7	5.0	10.0	8.0	7.0	7.0	6.0	7.0	6.0
Imports	YoY	7.3	2.1	5.0	1.5	0.0	5.0	5.0	5.0	5.0	5.0	5.0
Merchandise Trade Balance	$bn	259	332	389	86	117	112	27	102	129	131	34
FX Reserves	$bn	3,821	4,120	4,386	3,990	4,037	4,120	4,107	4,173	4,267	4,386	4,380
Current Account	% of GDP	2.0	2.3	2.3								
Fiscal Balance	% of GDP	-1.9	-2.1	-2.0								
General Govt. Debt*	% of GDP	53.7	53.8	53.4								
Urban Unemployment Rate	%	4.1	4.2	4.2	4.1	4.2	4.3	4.3	4.3	4.3	4.3	4.4
CPI	YoY	2.6	2.3	2.6	2.2	2.3	2.4	2.6	2.7	2.5	2.7	2.7
Exchange Rate (end period)	CNY/$	6.05	6.10	6.02	6.20	6.14	6.10	6.07	6.04	6.03	6.02	6.02
1-Yr Deposit Rate (end period)	%	3.00	2.75	2.25	3.00	3.00	2.75	2.50	2.25	2.25	2.25	2.25

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

India

Rohini Malkani

Anurag Jha

The quarterly GDP data released earlier this month reinforces our view that the Indian economy may indeed be turning a corner. GDP growth accelerated to 5.7%YoY in 1QFY15 compared to 4.6% in 4QFY14, with encouraging trends seen across supply-side and demand-side components. Incorporating the 1Q data, we maintain our view of FY15 GDP growth at 5.6% with risks balanced on both sides: upside risks from a faster-than-expected pick-up in investment and pent-up consumption demand being offset by a likely compression in government spending.

While the process of macro stabilization has begun, there is still a long way to go. In our latest Macro trip for investors, we observed that the pro-business Modi government has not only boosted sentiment and revived confidence, but is focused on execution and policy implementation. The immediate focus for the policymakers are (1) unlocking investment through PMG clearances, (2) implementing fiscal reforms e.g. GST, DTC, expenditure commission, (3) financial inclusion scheme using UIDAI, (4) cutting red tape through online environment/forests clearance, (5) measures to contain food price inflation, and (6) delivering infrastructure and easier financing. As discussed in the Macroscope, India is largely a 'self-help' story, aided by the new political will plus active central bank. There is plenty of debate on pace and timing, but we believe India is on its way back to 7% growth by FY17.

The headline CPI inflation rate has come off, but still remains elevated at 7.8%YoY in August. Despite favorable base effects, food price inflation has remained high on higher vegetable prices. Encouragingly the core CPI inflation rate has softened to 6.9% YoY, a 3-year low. While the RBI highlighted an upside risk to its glide-path target of 6% YoY by Jan-16, we believe that the late pick-up in the monsoon, lower core inflation, the stable INR and lower crude prices could likely mitigate such upside risks. Thus, we expect the rate easing window to open in 2015, the timing of which could depend on (1) budget, (2) Fed rate actions and (3) geo-politics/commodity prices. On the external sector, despite a moderation in exports and pick-up in non-oil non-gold imports, the trade deficit has remained in check on softer oil prices and lower gold imports. As a result, we continue to expect the current account deficit to be contained at about US$39bn or 1.9% of GDP with the balance of payment at a surplus of US$33bn. The improved macro and RBI's strengthened reserves is likely to prevent the Rupee from depreciating sustainably beyond a 59-62 range in the event of a renewed bout of EM risk aversion.

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

		FY13/14F	FY 14/15F	FY 15/16F
Real GDP	YoY	4.7	5.6	6.5
Final Domestic Demand	YoY	3.1	4.6	6.7
Private Consumption	YoY	4.8	5.5	7.0
Fixed Investment	YoY	-0.1	2.5	6.5
Exports	YoY	8.4	11.0	9.3
Imports	YoY	-2.5	9.5	9.0
Wholesale Price Index	YoY	5.9	5.5	5.0
Consumer Price Index	YoY	9.5	8.0	6.5
Current Account	US$ bn	-32	-39	-48
	% of GDP	-1.7	-1.9	-2.0
Consolidated Fiscal Balance	% of GDP	-6.9	-6.7	-6.5
Centre Fiscal Balance	% of GDP	-4.6	-4.1	-4.0
US Dollar Exchange Rate	Average	61.8	61.7	62.7

Sources: Haver Analytics and Citi Research forecasts

Korea

Jaechul Chang

The government is seeking to bolster the economic recovery further in 2015 by increasing its spending by KRW7.6bn, following its implementation of extra spending in 2H14 and 2015 by KRW40.7trn in August. With this, we expect real GDP growth in 2014-15 to inch up by about 0.2%p on average. After the downward revision of its 2Q14 growth amid concerns over sluggish economic sentiments, the BoK cut the policy rate by 25bps to 2.25% in August. The government's pressure on the BoK to ease monetary policy stance further — and risks that JPY weakness will hit Korea's exports – have increased speculation about another policy rate cut in the remainder of this year. We expect the BoK will keep rates on hold, given the BoK governor's view that a rate cut is not a desirable tool to support the KRW and also because of worries over the elevated level of household debt. However, the likelihood of a rate cut could rise if the government's pressure on the BoK becomes harsher, and the readings on IP in August and exports in September are weak enough to lead a meaningful downgrade of prospective 3Q GDP growth. We regard such economic downside as unlikely since the government's fiscal measures and consumption recovery from the slump after the ferry incident in April seem to be bolstering economic growth.

Indonesia

Helmi Arman

We are trimming our GDP growth forecast for 2015 to 5.1% (from 5.2%), matching our forecast for 2014. Oil prices have subsided and copper exports partially resumed in Aug-Sep this year after licensing issues were resolved. However exports of coal and palm oil, which contribute the bigger chunk of the commodity trade surplus, have weakened. Accordingly, we have also become less sanguine about the current account deficit outlook. Meanwhile, the politics have not yet seen significant progress, especially in Jokowi's attempt to widen his coalition. As Golkar probably will remain in opposition, hope now rests on inviting in two smaller parties (e.g. PPP and PAN / Demokrat). However rhetoric on fuel prices from the Jokowi camp remains hawkish. As a result, we think our November fuel price hike forecast is still likely to be valid, possibly even by a larger magnitude than our baseline 33% figure. Meanwhile, loan growth has slowed to the lower end of BI's expectation range (July: 15% YoY). We now think that policymakers will hold the policy rate at 7.50% despite any one-off inflation surge to 7-8% that may follow a fuel price hike. Rate cuts are unlikely anytime soon given the uncomfortably-high current account deficit.

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

		Korea			Indonesia		
		2013	2014F	2015F	2013	2014F	2015F
Real GDP	YoY	3.0	3.9	4.0	5.8	5.1	5.1
Final Domestic Demand	YoY	2.8	2.8	4.1	5.1	4.6	4.7
Private Consumption	YoY	2.0	2.0	3.4	5.3	5.1	4.1
Fixed Investment	YoY	4.2	4.0	5.3	4.7	5.0	6.2
Exports	YoY	4.3	5.2	7.1	5.3	-1.4	4.8
Imports	YoY	1.6	4.2	6.6	1.2	-4.4	3.5
Consumer Price Index	YoY	1.3	1.6	2.6	6.4	6.2	6.7
Unemployment Rate	%	3.1	3.5	3.1	5.8	6.5	6.3
Current Account	US$ bn	79.9	75.6	48.9	-29.1	-28.1	-26.7
	% of GDP	6.1	5.1	3.1	-3.3	-3.2	-2.8
Fiscal Balance	% of GDP	1.0	0.9	1.4	-2.2	-2.4	-1.9
US Dollar Exchange Rate	Average	1095	1043	1029	10449	11873	12133

Source: Haver Analytics and Citi Research forecasts

Hong Kong

Adrienne Lui

Retail sales have fallen in YoY terms for six consecutive months, with lower tourist-related spending hitting consumption and export of services. We believe downward adjustments to shop sales expectations, hiring and store rentals are in progress. The jobless rate is edging up. Democrats considered Beijing's decision on HK's electoral reform as a closing of dialogue and we expect waves of protests to follow. The likely official Occupy Central event on a public holiday will probably cause minimum business disruption, but police clearance and arrests appear unavoidable. The Shanghai-HK Stock Connect scheme, due to start either October 13 or (more likely) 20 October, is likely to be a game changer for the accumulated CNH funds in HK by providing a higher-yielding investment route back onshore. The HKMA is preparing a new reverse repo system to provide intraday RMB liquidity to facilitate the program and HK's personal RMB conversion quota likely be lifted soon.

Singapore

Kit Wei Zheng

After the disappointing 1H 14, July-August data point to better growth in 2H 14 on the back of improving external demand. For example, Jul-Aug non-oil domestic exports rose 3.5% above 2Q levels in real terms, while a pickup in non-oil retained imports suggests manufacturers are confident enough of the demand outlook to re-stock parts and components. Although falling car prices, housing rents and base effects should push headline inflation to below 1% from August 2014, we expect the MAS to stand pat in October. Easing is unlikely as core inflation expectations exceed the 2.5% target.

Taiwan

Adrienne Lui

The August PMI (56.1) was the highest rate since January 11 and much stronger than regional peers. We continue to expect 2H GDP to pick up to 3.7% YoY from 3.5% YoY in 1H. Although macro-economic data related to technology exports and production are likely to improve in coming months, renewed signs of weakness of China's economy and the strengthening USD are likely offsetting factors and we now see TWD at 30.3 in 0-3M. Given the uncertain external environment and worries over the export boost from ongoing hi-tech product launches, we think the CBC will keep rates unchanged until 2H 15. Foreign investors may watch the December local elections more closely than usual to see if there is any dilution in the government's control.

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

		Hong Kong			Singapore			Taiwan		
		2013	2014F	2015F	2013	2014F	2015F	2013	2014F	2015F
Real GDP	YoY	2.9	2.6	3.3	3.9	3.1	3.2	2.1	3.6	4.0
Final Domestic Demand	YoY	3.8	1.6	2.4	1.8	0.3	1.1	2.2	2.0	2.6
Private Consumption	YoY	4.2	1.9	2.4	2.6	1.5	0.8	2.0	2.2	3.0
Fixed Investment	YoY	3.3	0.6	2.8	-1.9	-0.1	1.0	4.7	2.2	3.4
Exports	YoY	6.5	2.8	6.3	3.6	4.0	3.7	3.8	4.7	6.3
Imports	YoY	6.9	2.7	5.7	3.1	3.2	2.3	3.9	3.7	5.2
CPI	YoY	4.3	4.0	3.6	2.4	1.2	0.9	0.8	1.5	2.0
Unemployment Rate	%	3.4	3.2	3.1	1.9	2.0	2.1	4.2	4.0	3.9
Current Account	US$ bn	5.1	8.1	9.5	54.6	58.8	64.8	57.3	56.0	55.6
	% of GDP	1.9	2.8	3.2	18.3	18.0	18.0	11.7	11.0	10.2
Fiscal Balance	% of GDP	1.0	1.3	0.7	1.1	-0.3	0.2	-1.3	-1.4	-0.8
US Dollar Exchange Rate	Average	7.76	7.75	7.75	1.25	1.26	1.27	29.68	30.22	30.03

Source: Citi Research

Russia

Ivan Tchakarov

We are cutting our 2015 GDP growth forecast from 2.3% to 1.0% on the back of the further increase in Western sanctions. The combination of more-subdued investment and consumption spending, and tighter monetary policy, will probably provide significant headwinds to growth for longer than we previously anticipated. At the same time, economic performance so far in the year has exceeded expectations. Preliminary estimates from Rosstat suggest that Q2 growth slowed marginally to 0.8%YoY, from 0.9% growth in Q1, a little above the consensus forecast of 0.7%YoY. We estimate that after the 1.1% seasonally-adjusted QoQ contraction in 1Q, the economy expanded by 0.3% QoQ SA in 2Q. The quarterly expansion is very modest, yet it is just enough to avoid a technical recession. However, monetary headwinds are rising. The Central Bank of Russia raised the one-week repo rate by 150bp to 7% on 3 March and by a further 50bp to 8% on both 25 April and 25 July, respectively. The CBR argued the recent decisions were driven by a desire to ensure financial stability and ward off the build-up of inflationary expectations against the backdrop of heightened market volatility. More broadly, the CBR's task to bring inflation down to its medium-term target of 4% will be complicated by the recently-imposed food import ban.

Turkey

Ilker Domac

Gultekin Isiklar

The release of the 2Q GDP print confirmed downside risks to growth. After a somewhat surprisingly resilient 1Q, the economy has slowed quite sharply in Q2 and contracted by 0.5% QoQ. A closer look points to broad-based domestic demand weakness, with foreign demand contributing 2.9pp to overall growth. In our view, recent developments suggest that it probably will be very painful — but also unsustainable — to rebalance the economy through a squeeze on domestic demand. In this respect, nearterm focus probably will be whether the new Medium-term Program (to be released in early October) will contain credible targets and signs of structural reforms focusing on the supply-side. In light of rising growth concerns, we expect pressure for further relaxation in monetary policy to intensify ahead of the 2015 general elections. It is, however, difficult to justify additional easing given that year-end inflation is on track to be around 9% YoY, with the risks tilted higher. Subdued capital inflows cast further doubt on the CBT's policy stance, particularly when the short-end of the US yield curve is under pressure. Despite the challenging external and domestic backdrop, we believe that the CBT will look for opportunities to ease if the lira and global conditions permit, which leads us to believe that the CBT risks repeating past mistakes.

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

		Russia			Turkey		
		2013	2014F	2015F	2013	2014F	2015F
Real GDP	YoY	1.3	0.7	1.0	4.1	3.5	3.5
Final Domestic Demand	YoY	2.7	0.5	0.9	5.0	0.9	3.4
Private Consumption	YoY	4.7	1.9	1.0	5.1	0.5	3.2
Fixed Investment	YoY	-0.1	-2.7	1.5	4.2	-1.3	4.0
Exports	YoY	4.2	2.0	2.0	-0.3	8.1	4.4
Imports	YoY	3.7	2.5	2.0	9.0	-0.6	4.0
CPI	YoY	6.8	7.3	6.7	7.5	9.0	6.7
Unemployment Rate	%	5.5	5.7	5.8	9.1	9.5	9.5
Current Account	US$ bn	34.1	56.5	54.8	-65.1	-42.3	-44.0
	% of GDP	1.6	2.9	2.9	-7.9	-5.3	-5.5
Fiscal Balance	% of GDP	-2.1	-4.4	-4.9	-1.2	-2.8	-3.2
US Dollar Exchange Rate	Average	31.9	37.0	41.1	1.91	2.20	2.46

Sources: Haver Analytics and Citi Research forecasts

Hungary

Eszter Gargyan

We are lifting our GDP forecasts for both 2014 and 2015, to 3.1% YoY and 2.2% YoY, respectively from 2.9% and 1.9% respectively last month. Our 2014 GDP upgrades reflect the positive surprise in industrial output data and the prospect that accelerated EU fund absorption will lift infrastructure investment. Our 2015 upgrade reflects a better outlook for consumer spending, supported by an average reduction of 25-30% in FX debt burdens. This relates to legislation that declared FX margins and changes in loan conditions to be unfair, forcing banks to deduct these unfair charges from outstanding loan principal. The outlook for fixed investment in 2015 has also improved as the NBH has doubled the available size of its SME lending program and the absorption of EU funds may slightly increase further next year, before falling back in 2016. The CPI outlook has not changed much: We expect headline CPI inflation to remain close to zero until October as new, smaller rounds of utility price cuts compress prices. However, base effects from previous (larger) utility price cuts is likely to lift CPI inflation to around 1.4% YoY by year-end and to 2-2.3% by mid-2015. In our view, the NBH is unlikely to cut interest rates further and will keep rates on hold until 3Q15. Nevertheless, the beginning of a gradual rate hike cycle may largely depend on external factors. FX loan conversion may be delayed to 2H15 and as the NBH is likely to provide hard currency from its FX reserves for the conversion, risks for a sharp FX weakening seem to be lower now.

Poland

Piotr Kalisz

Cezary Chrapek

Data released over the last month showed weaker activity in Poland with economic growth likely to have slowed towards 2.6% in 3Q vs 3.3% in 2Q. Although some of the deceleration in year-on-year terms is a reflection of statistical factors, the quarter on quarter growth slowed as well. Taking into account currency weakness, continued growth in lending activity and relatively favourable situation in the labour market, we expect the economy to accelerate again in coming quarters. Growth should also benefit from looser fiscal policy as the government signaled in September that there will be more generous pension indexation and additional tax benefits for families with children. These measures could add around 0.3% point to next year's GDP growth. The CPI fell 0.3% YoY in August, with particular weakness in food and energy prices but also a subdued (albeit positive) trend in core inflation. With this in mind, the Polish central bank has turned more dovish and we expect it may cut rates by 50bps in October.

Figure 35. Hungary and Poland — Economic Forecasts, 2013-15F

		Hungary			Poland		
		2013	2014F	2015F	2013	2014F	2015F
Real GDP	YoY	1.1	3.1	2.2	1.6	3.0	3.4
Final Domestic Demand	YoY	1.6	3.4	2.0	0.9	3.5	3.3
Private Consumption	YoY	0.3	1.8	2.0	0.8	2.5	2.8
Fixed Investment	YoY	5.8	11.0	3.5	-0.2	8.1	6.0
Exports	YoY	5.3	6.8	6.0	4.6	3.5	4.9
Imports	YoY	5.3	7.2	6.2	1.2	5.3	4.8
CPI	YoY	1.7	0.2	2.1	0.9	0.1	1.3
Unemployment Rate	%	9.1	8.6	8.1	13.4	12.1	11.3
Current Account	US$ bn	4.0	4.4	3.4	-6.6	-4.1	-9.6
	% of GDP	3.0	3.8	2.9	-1.3	-0.8	-2.0
Fiscal Balance	% of GDP	-2.2	-2.9	-3.0	-4.3	-3.3	-2.9
Euro Exchange Rate	Average	297	312	324	4.20	4.20	4.28

Source: Citi Research

Czech Republic

Jaromir Sindel

We are cutting our 2015 GDP growth forecast by 0.1 percent while lifting our 2015 inflation forecast by 0.2 per cent. Various factors are at work. There are mixed data coming into our GDP forecast. Domestic demand was supportive in 2Q, while July industrial production data and the August PMI point to further growth in 3Q14. However, industrial capacity use fell slightly in July and the outlook on foreign demand seems to be weaker than before. Hence, we are slightly cutting our outlook for investment and exports in 2015, though the investment outlook may be supported by government investment while exports will probably still outperform foreign demand due to the weaker currency. While our lower GDP forecast is disinflationary, our new FX forecast is the opposite, and with a weaker EURUSD outlook we are slightly increasing our 2015 CPI forecast. On the other side, electricity power prices have fallen further. The central bank has said it will "*continue using the exchange rate as a monetary policy instrument at least until 2016*". The inflation outlook is unlikely to be so high as to force an earlier abandonment of this policy. The CNB would probably only step away from the currency if it sees a larger weakening of EURCZK above our forecast of 28 over the next 12 months. By contrast, if there is a weaker outlook on both domestic and foreign growth, coupled with looser ECB monetary policy and resilience in EURCZK, then the CNB's "exit" could be deferred to mid-2016.

Romania

Ilker Domac

Gultekin Isiklar

After a closer look at the details of the 2Q GDP data, we decided to cut our 2014 growth forecast to 2% from 3%. This revision is underpinned by the absence of a pick-up in investment spending, the anemic recovery in private consumption and the deterioration in the Eurozone growth outlook. The ongoing weakness in investment spending is particularly discouraging if one considers the improvement in the absorption of EU funds and the accommodative monetary policy stance, among other things. In our view, the disappointing 2Q GDP growth, along with the Governor's relatively dovish remarks and the August inflation print, pave the way for a 25bp cut at the September Board Meeting. Nonetheless, with the policy rate standing at 3.25%, the NBR's 2015 inflation forecast of 3% corroborates our view that those who wait for aggressive rate cuts during the remainder of the year may be disappointed. Our more cautious inflation forecast trajectory, unimpressive capital inflows, the uncertainty surrounding the EU-IMF supported program and the possibility of a higher level of political noise ahead of the upcoming presidential elections also lend support to this view.

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

		Czech Republic			Romania		
		2013	2014F	2015F	2013	2014F	2015F
Real GDP	YoY	-0.9	2.4	2.4	3.5	2.0	3.4
Final Domestic Demand	YoY	-0.5	2.8	2.2	0.0	1.2	3.3
Private Consumption	YoY	0.1	2.1	2.0	1.3	4.0	3.5
Fixed Investment	YoY	-3.5	5.5	3.5	-3.4	-8.0	3.5
Exports	YoY	0.2	10.1	7.0	13.1	9.5	4.5
Imports	YoY	0.6	11.0	7.5	2.3	7.5	4.0
CPI	YoY	1.4	0.4	1.6	4.0	1.4	2.9
Unemployment Rate	%	6.9	6.2	5.9	5.3	5.5	5.5
Current Account	US$ bn	-2.9	0.2	-0.9	-2.0	-3.2	-5.4
	% of GDP	-1.4	0.1	-0.5	-1.1	-1.7	-3.0
Fiscal Balance	% of GDP	-1.5	-2.0	-2.5	-2.5	-2.3	-2.3
EURCZK, USDRON	Average	26.0	27.5	27.8	3.3	3.4	3.8

Sources: Haver Analytics and Citi Research forecasts

Brazil

Marcelo Kfoury

Recent polls have confirmed the higher popularity of Marina Silva compared to Eduardo Campos. Because of that, we now expect Silva to beat Dilma Rousseff in the second-round (on October 26), becoming the new Brazilian president in 2015. Silva's already-published platform suggests such a new government would implement more market-friendly economic policies to restore the "macroeconomic tripod": floating exchange rate, credible inflation targets and primary surplus. Provided this backdrop, and given the deeper contraction seen in 2Q14, we now expect GDP growth to reach 0.1% this year (from 0.5%), accelerating next year to 1.0%. On the inflation front, we see CPI increasing 6.4% by 2014 year-end, rising to 6.8% at end-2015 due to sharper offloads of pent-up monitored prices. In light of this challenging inflation outlook, we see Copom hiking the policy rate by 100bps in the first two meetings of 2015, creating scope to reduce it (back to 11%) during 2H15. On the fiscal front, we maintain our view that the primary surplus will reach 1.0% of GDP at 2014 year end (the Budget Law still targets 1.9% of GDP), increasing next year to 2.0% of GDP. Finally, we continue to envisage that the current account deficit will stabilize at a level slightly below 4% of GDP, with the domestic currency depreciating in the medium/long term.

Mexico

Sergio Luna Martinez

GDP grew by 1.6% YoY in 2Q14, with quarterly growth accelerating to 4.2% SAAR from 1.8% SAAR in 1Q14. External demand is still the main driver, although the domestic market is gradually gaining strength. The available data point to continued recovery in 3Q. We reiterate our 2.6% GDP growth forecast for 2014 and 3.9% for 2015. Headline inflation was 4.1% YoY in August and we forecast that it will stay around this level until November, slowing to 3.9% by year end (compared our previous forecast of 3.8%). For 2015, we continue to expect consumer inflation to end the year at 3.3% YoY. Banxico did not change its funding rate in September but modified its tone, expressing more concern about inflation and more optimism regarding activity. The communiqué noted that economic slack prevails, while the inflationary rebound is likely to prove temporary. We still think Banxico will stay on hold in 2014. In his second State of the Union Address, President Peña noted that it is now time to move from reforms to large-scale actions — he announced the construction of a new airport for Mexico City, an USD13bn project. He also submitted to Congress his 2015 budget proposal, with public income and expenditure up modestly, by 1.0%YoY and 0.9% YoY, respectively, and the broad fiscal deficit down to 4.0% of GDP in 2015 from 4.2% in 2014.

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

		Brazil			Mexico		
		2013	2014F	2015F	2013	2014F	2015F
Real GDP	YoY	2.5	0.1	1.0	1.1	2.6	3.9
Final Domestic Demand	YoY	2.9	-0.1	1.1	1.4	2.4	4.1
Private Consumption	YoY	2.6	1.2	1.3	2.5	2.3	3.6
Fixed Investment	YoY	5.2	-7.0	2.4	-1.8	2.8	6.9
Exports	YoY	2.5	2.3	2.4	1.2	6.9	6.7
Imports	YoY	8.3	0.2	2.8	1.5	5.5	8.3
CPI	YoY	6.2	6.3	6.6	3.8	4.0	3.5
Unemployment Rate	%	5.5	5.8	5.9	5.0	4.8	4.5
Current Account	US$ bn	-81.1	-81.9	-84.4	-26.5	-25.2	-27.4
	% of GDP	-3.7	-3.7	-3.8	-2.1	-1.9	-1.9
Fiscal Balance	% of GDP	-3.3	-4.4	-3.6	-2.3	-3.6	-3.5
US Dollar Exchange Rate	Average	2.16	2.30	2.53	12.76	13.14	13.15

Source: Citi Research

Argentina

Guillermo Mondino

The scarcity of foreign currency continues to worsen and the next few months will probably be even more challenging. Meanwhile, the likelihood of a prolonged default has increased, despite the need for external financing, exacerbating the pressures on FX markets. Furthermore, agricultural prices have continued to trend down and exports remain depressed. Unsurprisingly, despite severe FX rationing, international reserves are decreasing. They have dropped to USD28.2bn, USD1.5bn lower than in July 24, when they reached a 6-month high. In this context, we have changed our main forecasts for next year. If the default continues, as the authorities suggest in their presentations, we expect GDP (our measure of) to contract 2% in 2015, after shrinking 1.5% this year. We also now expect the official USDARS to increase to 14 by the end of next year, up from 9.2 at the end of 2014. As a consequence of the higher devaluation in the official FX market and the rationing in place, we see (non-official) inflation accelerating to 45% in 2015, up from 38% this year.

Venezuela

Munir Jalil

The Venezuelan economy continues to exhibit negative growth and high inflation. The latest inflation data released by the central bank show YoY inflation standing close to 64% in August and, although GDP growth data have not been provided throughout the year, at this point it is clear the economy is in a recession. The low availability of US dollars continues, affecting operations in the country. In this context, the government has not made announcements aimed at boosting economic activity or reducing inflation but, instead, decided to rebalance its cabinet. The most important adjustment consisted on changing Rafael Ramirez from Minister of Oil and Energy to Minister of Foreign Relations. Indicators of external liquidity continue to weaken, with international reserves and balances at the special funds both trending down, with an important debt amortization (USD4.8 billion) from both the sovereign and PDVSA due as soon as in early October. The growing macroeconomic imbalances amid an environment of low external liquidity, and the fact the government is not acting in order to improve economic conditions, signal a situation where the country will continue trending down in terms of activity and up in terms of inflation. This is why we are now expecting the economy to post -1% YoY GDP growth this year and 1.9% YoY next year with inflation reaching 62% and 83% respectively.

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

		Argentina			Venezuela		
		2013	2014F	2015F	2013	2014F	2015F
Real GDP	YoY	2.9	0.0	-1.0	1.3	-1.0	1.9
Final Domestic Demand	YoY	4.2	-0.3	-1.3	-0.3	-1.1	0.7
Private Consumption	YoY	4.3	-0.3	-0.8	3.7	0.1	0.3
Fixed Investment	YoY	3.0	-2.4	-5.5	-3.5	-3.5	0.9
Exports	YoY	-3.8	-4.8	-2.5	-3.8	1.3	4.2
Imports	YoY	1.9	-5.1	-3.5	-4.6	-0.7	-1.0
CPI	YoY	10.6	-	29.0	38.5	61.7	82.5
Unemployment Rate	%	7.1	7.6	8.9	5.6	4.8	4.0
Current Account	US$ bn	-4.3	-6.2	-5.3	12.2	14.9	18.2
	% of GDP	-0.7	-1.2	-1.2	3.3	4.1	5.1
Fiscal Balance	% of GDP	-1.9	-3.7	-4.7	-11.9	-11.2	-10.3
US Dollar Exchange Rate	Average	5.45	8.38	11.63	5.99	9.15	19.80

Sources: Haver Analytics and Citi Research forecasts

Saudi Arabia

Farouk Soussa

The sharp fall in oil prices in recent weeks is potentially bad news for all oil producers, but for Saudi Arabia — the global swing supplier of crude oil — it raises particular challenges. Brent oil tested the $96 per barrel lows of last year, below the $100 'fair price' that Saudi has indicated in the past. Bearish sentiment has been fed by stronger-than-expected global supply, with continued weakness in global demand. This is in direct contrast to the past decade, where supply disruptions and strong demand bolstered oil markets. Just as Saudi Arabia intervened by raising supply in the past decade (by almost 2mbpd), so it is likely to intervene by reducing supply in the current circumstances. Indeed, Saudi cuts appear to have begun, with our loading indicator suggesting a fall in Saudi crude exports by as much as 10% in recent weeks. While overall production remains high, however, at almost 10mbpd, this seems to be reflecting rising domestic consumption and expansion in local refining capacity. The bottom line is, however, a rise in downside risks to government revenues, as prices and exports decline in tandem. That said, we maintain our forecasts as they already incorporated a fall in prices and volumes in line with current levels, but further deterioration could spell downside risks to our forecasts.

United Arab Emirates

Farouk Soussa

The UAE economy continues to perform strongly, driven by high oil prices and strong, wide-based growth in Dubai's non-oil economy. Asset values reflect this positive dynamic (as well as wider EM trends), but in the case of Dubai we believe they should also reflect three key risks that continue to mar the Emirate's credit profile (relative to many of its GCC peers). These are (i) high leverage, with ongoing rumbles of restructuring in Dubai's GRE sector, (ii) a highly cyclical real estate market with associated construction and financial sector risks, and (iii) high vulnerability to global financial and economic conditions. Balanced against these risks, however, is a relatively low direct dependence on oil markets, significant potential upside from any potential rolling back of Iranian sanctions, and solid local liquidity that we believe will continue to support asset prices in the near to medium term (particularly short-term assets).

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

		Saudi Arabia			United Arab Emirates		
		2013	2014F	2015F	2013	2014F	2015F
Real GDP	YoY	4.0	4.8	4.2	5.2	4.0	4.0
Final Domestic Demand	YoY	4.2	8.0	8.1	9.7	4.7	4.7
Private Consumption	YoY	2.5	5.0	5.0	11.7	5.0	5.0
Fixed Investment	YoY	2.3	10.0	10.0	7.3	5.0	5.0
Exports	YoY	-6.3	-0.6	-6.5	5.7	13.0	14.0
Imports	YoY	2.9	10.0	10.0	10.5	15.0	15.0
CPI	YoY	3.5	2.9	3.0	1.1	2.0	2.4
Current Account	US$ bn	133.6	112.8	70.0	114.1	102.2	88.3
	% of GDP	17.9	14.8	9.2	28.4	23.7	19.1
Fiscal Balance	% of GDP	8.7	6.0	0.9	NA	NA	NA
US Dollar Exchange Rate	Average	3.75	3.75	3.75	3.67	3.67	3.67

Source: Citi Research

Nigeria

David Cowan

Although political uncertainty is set to rise towards the February 2015 elections, we still expect growth to remain robust. The recent GDP rebasing exercise has made Nigeria Africa's largest economy. But, it does seem to have led to a downward revision to growth rates in 2011-12, although growth picked up pace in 2H 2013 and we expect growth of around 6% YoY in 2014-15. While the finance minister, Ngozi Okonjo-Iweala, will probably seek to maintain fiscal discipline for the rest of this year, this could be problematic, and progress with structural reform is already stalled. It is also likely that with increased spending, rising inflation, and maybe even a weaker oil price, the naira could come under a new bout of pressure in the coming months. Having kept the monetary policy rate on hold after his first MPC meeting in July, all eyes will then be on the new CBN governor, Godwin Emefiele, and his potential policy response. Having said that, we also think that with only a modest tightening of monetary policy, coupled with a potential increase in oil production, naira weakness will be limited, allowing more substantive policy questions about the currency to be put off until after the polls, or to mid-2015

South Africa

Gina Schoeman

We downgrade our 2014 GDP forecast to 1.4% from a previous expectation of 1.7%. Having flagged downside risk from the mining strike in H1 13, the manufacturing strike in Q3 14 and weaker consumption activity, these realities underpin our adjustment. Production growth has stalled and has negatively impacted investment, exports and business confidence. This means continued risk for the current account deficit, with a narrowing below 5.0% of GDP unlikely this year — leaving the ZAR vulnerable in a world of potential Fed hiking. The consumer remains overly indebted and faces weak job growth, still-high inflation, tighter monetary policy and relatively tight credit standards. While weak GDP and a slow downward inflation trajectory allows the SARB justification for unchanged policy rates at 5.75% in the near-term, by Q2 15 the potential currency risk from Fed hiking — coupled with rising electricity tariffs — will likely see the SARB restart its process of policy rate normalization. For fiscal policy, the revenue outlook is clouded by weak GDP growth. As a result, the upcoming October Medium-Term Budget is likely to provide more colour to potential tax changes in the economy. Though it is too early in our view for a full announcement on VAT, we do expect the current 14% rate to rise over the next 18 months.

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

		Egypt			Nigeria			South Africa		
		2013	2014F	2015F	2013	2014F	2015F	2013	2014F	2015F
Real GDP	YoY	1.5	2.4	3.2	5.5	6.4	6.4	1.9	1.4	2.6
Final Domestic Demand	YoY	2.5	3.0	3.5	NA	NA	NA	2.9	2.4	2.8
Private Consumption	YoY	3.7	2.0	2.6	NA	NA	NA	2.6	2.2	2.7
Fixed Investment	YoY	2.1	1.6	9.9	NA	NA	NA	4.7	3.4	3.6
Exports	YoY	-6.3	2.2	5.6	NA	NA	NA	4.2	3.7	5.5
Imports	YoY	-3.4	4.7	7.2	NA	NA	NA	4.7	1.7	6.3
CPI	YoY	9.5	10.4	11.1	8.5	8.2	9.5	5.8	6.2	5.7
Unemployment Rate	%	13.2	14.2	14.5	NA	NA	NA	24.7	25.0	24.6
Current Account	US$ bn	-3.3	-6.8	-6.4	20.6	12.8	11.7	-19.6	-17.7	-16.5
	% of GDP	-1.3	-2.4	-2.1	4.0	2.3	1.8	-5.6	-5.3	-4.7
Fiscal Balance	% of GDP	-13.7	-11.7	-9.5	-1.6	-2.0	-1.9	-4.1	-4.1	-4.1
US Dollar Exchange Rate	Average	6.87	7.09	7.32	159.2	163.01	167.42	9.65	10.88	11.41

Source: Citi Research

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

	GDP Growth			CPI Inflation			Current Balance (% of GDP)			Fiscal Balance (% of GDP)		
	2013	2014F	2015F	2013	2014F	2015F	2013	2014F	2015F	2013	2014F	2015F
Asia	6.3	6.2	6.2	3.7	3.2	3.4	2.2	2.5	2.2	-2.3	-2.4	-2.2
China	7.7	7.3	6.9	2.6	2.3	2.6	2.0	2.3	2.3	-1.9	-2.1	-2.0
Hong Kong	2.9	2.6	3.3	4.3	4.0	3.6	1.9	2.8	3.2	1.0	1.3	0.7
India	4.7	5.6	6.5	9.5	8.0	6.5	-1.7	-1.9	-2.0	-6.9	-6.7	-6.5
Indonesia	5.8	5.1	5.1	6.4	6.2	6.7	-3.3	-3.2	-2.8	-2.2	-2.4	-1.9
Korea	3.0	3.9	4.0	1.3	1.6	2.6	6.1	5.1	3.1	1.0	0.9	1.4
Malaysia	4.7	5.7	5.6	2.1	3.0	3.9	4.0	5.5	5.7	-3.9	-3.5	-3.0
Mongolia	11.7	10.0	9.0	10.5	13.8	12.0	-30.9	-10.3	-11.1	-7.8	-7.6	-4.4
Philippines	7.2	6.3	6.5	2.9	4.3	3.5	3.5	3.6	3.4	-1.4	-1.8	-1.6
Singapore	3.9	3.1	3.2	2.4	1.2	0.9	18.3	18.0	18.0	1.1	-0.3	0.2
Sri Lanka	7.3	7.7	7.5	6.9	3.3	5.6	-3.9	-3.3	-3.1	-5.9	-5.6	-5.3
Taiwan	2.1	3.6	4.0	0.8	1.5	2.0	11.7	11.0	10.2	-1.3	-1.4	-0.8
Thailand	2.9	1.2	3.9	2.2	2.2	2.1	-0.6	5.2	4.1	-1.8	-1.2	-1.8
Vietnam	5.4	5.4	5.7	6.6	4.5	5.8	5.6	5.1	4.1	-5.6	-6.4	-6.0
Latin America	2.6	1.2	2.2	7.3	9.2	10.2	-1.7	-1.7	-1.7	-2.8	-3.8	-3.3
Argentina	2.9	0.0	-1.0	10.6	NA	29.0	-0.7	-1.2	-1.2	-1.9	-3.7	-4.7
Brazil	2.5	0.1	1.0	6.2	6.3	6.6	-3.7	-3.7	-3.8	-3.3	-4.4	-3.6
Chile	4.1	1.8	3.0	1.9	4.2	3.2	-3.4	-2.0	-2.8	-0.6	-2.0	-1.6
Colombia	4.7	4.8	5.2	2.0	2.8	3.2	-3.4	-3.7	-3.7	-0.9	-1.6	-1.5
Costa Rica	3.5	3.1	2.2	5.2	4.4	4.6	-5.1	-7.4	-7.9	-6.5	-7.2	-7.7
Dominican Republic	4.6	6.0	4.5	4.8	3.3	3.8	-4.0	-3.7	-3.8	-4.1	-4.0	-4.0
Ecuador	4.6	4.6	4.6	2.7	3.4	2.5	53.5	49.7	46.2	-5.8	-4.6	-3.6
El Salvador	1.7	2.2	2.5	0.8	1.0	1.7	-6.2	-6.4	-5.7	-4.2	-4.1	-3.7
Mexico	1.1	2.6	3.9	3.8	4.0	3.5	-2.1	-1.9	-1.9	-2.3	-3.6	-3.5
Panama	8.4	6.2	5.5	4.0	3.2	2.8	-11.3	-9.0	-8.5	-3.0	-3.0	-3.0
Peru	5.8	3.5	4.9	2.8	3.2	2.5	-4.4	-5.7	-5.2	12.5	9.0	9.0
Venezuela	1.3	-1.0	1.9	38.5	61.7	82.5	3.3	4.1	5.1	-11.9	-11.2	-10.3
Europe	2.0	1.6	2.3	5.3	5.9	5.3	-1.2	0.2	-0.1	-2.2	-3.5	-3.7
Bulgaria	0.9	1.5	2.5	0.9	-1.0	2.2	2.1	0.5	-1.0	-1.5	-2.5	-1.2
Croatia	-0.9	-0.7	1.2	2.2	-0.1	2.5	0.9	1.0	-0.5	-4.9	-5.0	-4.0
Czech Republic	-0.9	2.4	2.4	1.4	0.4	1.6	-1.4	0.1	-0.5	-1.5	-2.0	-2.5
Hungary	1.1	3.1	2.2	1.7	0.2	2.1	3.0	3.8	2.9	-2.2	-2.9	-3.0
Kazakhstan	5.9	5.0	6.0	5.8	6.6	6.2	-0.1	1.0	1.3	3.0	2.3	2.1
Poland	1.6	3.0	3.4	0.9	0.1	1.3	-1.3	-0.8	-2.0	-4.3	-3.3	-2.9
Romania	3.5	2.0	3.4	4.0	1.4	2.9	-1.1	-1.7	-3.0	-2.5	-2.3	-2.3
Russia	1.3	0.7	1.0	6.8	7.3	6.7	1.6	2.9	2.9	-2.1	-4.4	-4.9
Serbia	2.5	-0.5	2.3	7.9	2.7	5.8	-4.9	-5.3	-5.8	-5.7	-6.5	-6.5
Slovakia	0.9	2.3	2.6	1.4	-0.1	1.2	2.1	0.3	-0.3	-2.8	-3.0	-2.8
Turkey	4.1	3.5	3.5	7.5	9.0	6.7	-7.9	-5.3	-5.5	-1.2	-2.8	-3.2
Ukraine	0.0	-5.5	1.5	-0.3	11.0	12.6	-9.0	-3.7	-2.1	-6.5	-6.1	-4.1
Africa/Mideast	4.2	3.7	4.5	4.2	4.2	4.6	11.3	9.4	6.9	2.1	0.9	-1.2
Bahrain	5.5	4.8	4.4	3.3	4.2	4.6	6.8	6.6	2.2	-3.3	-3.7	-5.4
Egypt	1.5	2.4	3.2	9.5	10.4	11.1	-1.3	-2.4	-2.1	-13.7	-11.7	-9.5
Ghana	7.1	5.1	4.0	11.7	15.2	12.5	-11.5	-10.8	-11.6	-9.0	-8.7	-7.0
Iraq	6.8	0.1	8.9	1.9	2.5	5.0	14.1	10.7	9.5	-5.9	-5.9	-4.3
Israel	3.2	2.3	2.2	1.5	0.5	0.4	2.0	1.9	1.8	-2.7	-3.0	-3.3
Jordan	2.8	3.6	3.8	5.5	2.8	3.1	-10.0	-11.7	-12.9	-5.5	-4.9	-4.2
Kenya	4.7	5.3	5.8	5.7	7.5	7.2	-9.0	-7.6	-7.5	-7.8	-6.5	-6.7
Kuwait	5.7	3.8	3.9	2.6	3.0	3.5	40.7	38.4	35.0	31.6	26.7	15.1
Lebanon	0.7	0.4	2.5	2.1	1.9	2.6	-16.4	-15.0	-14.0	-9.6	-9.8	-9.8
Nigeria	5.5	6.4	6.4	8.5	8.2	9.5	4.0	2.3	1.8	-1.6	-2.0	-1.9
Oman	3.4	4.7	4.7	2.1	1.0	0.9	6.1	7.7	4.9	0.8	-1.4	-4.5
Qatar	6.5	5.5	6.9	3.1	3.0	3.5	30.9	28.8	23.7	15.6	13.0	9.5
Saudi Arabia	4.0	4.8	4.2	3.5	2.9	3.0	17.9	14.8	9.2	8.7	6.0	0.9
South Africa	1.9	1.4	2.6	5.8	6.2	5.7	-5.6	-5.3	-4.7	-4.1	-4.1	-4.1
Tanzania	7.0	7.1	7.2	7.9	6.4	6.3	-10.2	-13.9	-12.9	-6.0	-6.4	-6.5
UAE	5.2	4.0	4.0	1.1	2.0	2.4	28.4	23.7	19.1	NA	NA	NA
Uganda	5.8	6.1	6.5	5.5	4.6	4.9	-8.2	-9.5	-10.1	-4.5	-5.3	-5.6
Zambia	6.2	6.2	6.3	7.0	7.9	6.5	0.2	-1.0	-1.5	-6.5	-5.3	-4.6
Total	4.6	4.2	4.7	4.7	4.8	5.0	2.0	2.2	1.8	-1.9	-2.5	-2.5

Source: Citi Research

Sovereign Ratings

Michael Saunders

Peter Goves

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

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

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

	S&P Ratings				Moody's Ratings			
Country	Current Rating	Current Outlook	Citi Near Term (Up to 9 Mths) Forecast Rating	Citi Long Term (Next 2-4 Years) Forecast Rating & Outlook	Current Rating	Current Outlook	Citi Near Term (Up to 9 Mths) Forecast Rating	Citi Long Term (Next 2-4 Years) Forecast Rating & Outlook
US	AA+	Stable	AA+ (Stable)	AA+	Aaa	Stable	Aaa (Stable	Aaa
Canada	AAA	Stable	AAA (Stable)	AAA	Aaa	Stable	Aaa (Stable)	Aaa
Japan	AA-	Neg	AA- (Neg)	A+ ↓	Aa3	Stable	Aa3 (Stable)	A1 ↓
Germany	AAA	Stable	AAA (Stable)	AAA	Aaa	Stable	Aaa (Stable)	Aaa
France	AA	Stable	AA (Stable)	AA	Aa1	Neg	Aa1 (Neg)	Aa1
Italy	BBB	Neg	BBB (Neg)	BBB	Baa2	Stable	Baa2 (Neg)	Baa2
Spain	BBB	Stable	BBB (Stable)	BBB	Baa2	Pos	Baa1 (Stable) ↑	Baa1 ↑
Austria	AA+	Stable	AA+ (Stable)	AA+	Aaa	Stable	Aaa (Stable	Aaa
Belgium	AA	Stable	AA (Stable)	AA	Aa3	Stable	Aa3 (Stable)	Aa3
Finland	AAA	Neg	AAA (Neg)	AAA	Aaa	Stable	Aaa (Stable)	Aaa
Greece	B	Stable	B (Stable)	B	Caa1	Stable	Caa1 (Stable)	Caa1
Ireland	A-	Pos	A- (Pos)	A+ ↑↑	Baa1	Stable	Baa1 (Pos)	A2 ↑↑
Netherlands	AA+	Stable	AA+ (Stable)	AA+	Aaa	Stable	Aaa (Stable)	Aaa
Portugal	BB	Stable	BB (Pos)	BB+ ↑	Ba1	Stable	Ba1 (Stable)	Baa3 ↑
UK	AAA	Stable	AAA (Stable)	AAA	Aa1	Stable	Aaa (Stable) ↑	Aaa ↑
Switzerland	AAA	Stable	AAA (Stable)	AAA	Aaa	Stable	Aaa (Stable)	Aaa
Sweden	AAA	Stable	AAA (Stable)	AAA	Aaa	Stable	Aaa (Stable)	Aaa
Denmark	AAA	Stable	AAA (Stable)	AAA	Aaa	Stable	Aaa (Stable)	Aaa
Norway	AAA	Stable	AAA (Stable)	AAA	Aaa	Stable	Aaa (Stable)	Aaa
EU	AA+	Stable	AA+ (Stable)	AA+	Aaa	Stable	Aaa (Stable	Aaa
ESM	Not rated				Aa1	Stable	Aa1 (Stable)	Aa1

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

Expected Ratings Issues

Michael Saunders

Peter Goves

Ratings wrap-up: Since we last published, there has been one further upgrade within the EMU periphery: S&P upgraded Greece by one notch from B- to B on 12 September. Furthermore, it is also instructive to note what the agencies have *not* done over recent weeks. First, Moody's did not downgrade France on 19 September nor did it revise its outlook on France from negative to stable (*Euro Rates Strategy - France: Moody's maintains Aa1 negative outlook – time to buy*). Ultimately, we believe France will retain its Aa1 rating despite ongoing credit challenges and persistent downgrade concerns. Second, Moody's did not revise its outlook on the UK to positive on 19 September. As stated in their recent Credit Opinion (19 September), the "*continued improvement in these forecasts is credit positive, but does not materially change our view on the UK's sovereign rating given that the debt legacy of the crisis remains substantial*".

Figure 43. Upcoming Rating Calendar

Date	Sovereign	Rating Agency	Current Rating	Current Outlook
26 Sep	Austria	S&P	AA+	Stable
26 Sep	EFSF	Moody's	Aa1	Stable
26 Sep	Lux	S&P	AAA	Stable
3 Oct	Finland	Moody's	Aaa	Stable
10 Oct	Italy	Moody's	Baa2	Stable
10 Oct	EFSF	S&P	AA	Stable
10 Oct	Finland	S&P	AAA	Neg
10 Oct	France	S&P	AA	Stable
10 Oct	Lux	Moody's	Aaa	Stable
17 Oct	Spain	Moody's	Baa2	Pos
24 Oct	Cyprus	S&P	B	Pos
24 Oct	Austria	Moody's	Aaa	Stable
24 Oct	Germany	Moody's	Aaa	Stable

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

S&P on Austria: We expect no change in S&P's AA+ stable rating of Austria this Friday. According to S&P, "*the ratings reflect Austria's stable governance and predictable economic policies supporting growth. The ratings benefit from the second highest GDP per capita in the EU (according to Eurostat) and Austria's competitive economy*."

Moody's on Italy: Italy features on Moody's calendar on 10 October and is rated Baa2 with a stable outlook. Since Moody's last published on Italy in late June, we have had confirmation that the sovereign is now back in recession given the -0.2% GDP growth in Q2. Moody's subsequently published a note entitled "*Italy's recession adds headwinds to country's fiscal and structural reform*" and lowered its own growth forecasts to 0.1% in 2014 and 0.5% in 2015. This month, Citi's own economists have again lowered growth estimates and now expect -0.4% growth in 2014 and 0.3% in 2015. Separately, last week S&P also lowered their estimates to -0.3% in 2014 and 0.5% in 2015. At the same time, there is a strong commitment to reform with many structural changes on Renzi's agenda. With this in mind, we do not anticipate any rating change in October, but see growing risks that the rating is put on negative outlook (in line with S&P).

S&P on France: France is rated AA stable by S&P (note, this is one notch lower than Moody's Aa1 rating which was maintained on a negative outlook last week). This rating was affirmed at the last calendar entry date on 25 April. In general, S&P notes the shift by the French government towards policies to reduce labour costs and corporate taxation. In recent developments, there have been various official revisions to the economic outlook. The French government now expects 2014 growth of 0.5% YoY (previously 1%), and a fiscal deficit of 4.4% of GDP in 2014 and 4.3% in 2015. S&P had noted its expectations for the French government deficit to gradually decrease to less than 3% in 2017 and so any changes in their own growth/deficit forecasts will be noteworthy. However, overall, given the stable rating, we are not expecting any change in S&P's AA assessment of France over the medium term.

Moody's on Spain - upgrade potential: Moody's rates Spain Baa2 with a positive outlook (unlikely S&P which rates Spain BBB stable). We have pencilled in an upgrade of Spain – whose Q2 data were relatively healthy — and note that the sovereign features on Moody's calendar on 17 October. Spain was last upgraded by Moody's in February from Baa3 to Baa2. The positive outlook indicates that Moody's expects positive trends to continue. Specifically, Moody's said they would consider an upgrade if the public debt-to-GDP were to fall more quickly than currently anticipated and/or if nominal GDP were to exceed their base case. We believe Moody's will soon upgrade Spain either in October or early next year.

Yield and Spread Forecast Commentary

Amitabh Arora

US: Rates have sold off through September as this summer's geopolitical tensions have eased. A truce in Ukraine at the start of the month was the impetus for a selloff in rates, which has continued throughout the month, and was compounded by the FOMC meeting last Thursday. The Fed's new economic projections paint a much more hawkish picture of the committee's expectations for rate hikes. Accordingly, we are raising our year-end forecasts for 2y, 5y, and 10y rates to reflect heightened expectations of a March rate hike.

Alessandro Tentori

Core Europe: Demand at the 1st TLTRO was below market expectations. Only 255 counterparties submitted bids for a total of EUR 82.6bn. We continue to look for a total amount of around €250bn to be allocated across both the September and December TLTROs. Of course, a lower than expected TLTRO demand together with significant uncertainties about the modalities of the ABS/CBPP3 are a real threat to the success of this stimulus package. Our view on "Japanisation" has always been that eventually this is where the Eurozone was heading. In our baseline scenario we continue to expect additional stimulus by the ECB, eventually in form of QE via EGBs. We therefore maintain our Bund forecast of 0.75% in Q4, followed by a rebound to 1% in Q1-15, which is a reaction we've observed in other episodes of QE. From there, we expect Bunds to reach 1.50% by Q3-15, a more justified fundamental yield level in our mind.

Peter Goves

EMU Periphery: Our economists have again lowered GDP forecasts for Italy. Citi now expects -0.4% in real GDP growth in 2014 (from -0.1% last month) and just 0.3% in 2015 (from 0.8% last month). In contrast, there is no change in expectations for 2015 Spanish growth at 2% and only a slight modification in 2014 growth forecast from1.4% to 1.3%. Ongoing economic divergence to this extent helps justify further outperformance of Spain vs Italy in our view. We continue to expect 10yr Bonos to trade at a spread of -35bp to 10yr BTPs over coming months (currently around -19bp). We also expect ECB QE to stimulate further broad-based spread tightening across EGBs overall.

Jamie Searle

UK: With the clear cut "No" vote, the immediate uncertainties of possible implications of Scottish independence are likely to recede further and the market to return its full focus back to prospects of a BoE rate hike next year. Citi expects the first rate hike in Q1 2015. The hiking cycle is also now more likely to be back-loaded than front-loaded. Our forecasts also reflect our low yield forecasts for Bunds which reflect Citi's base case for full-blown ECB QE later in Q4. The net result remains that we still expect gilt curves (2s5s, 2s10s, 10s30s) to flatten sharply. The forecasts further imply that the 10yr gilt-Bund spread will widen to 175bp by year-end. A rally in Bunds below 1% is also likely to have a greater impact on gilts than Treasuries. The 10yr gilt-UST spread may spend some time in negative territory. .

Takeki Fukushima

Japan: We are keeping our forecasts unchanged this month. The recent yen depreciation and NKY rally have reduced the demand for carry in JGBs and 10y yields rebounded from sub-50bp to over-55bp. We believe, however, the demand for carry should pick up once the quarter-end passes and the 10-year yield is likely to go back to a sub-55bp range. JGB yields are likely to be range-bound due to a tug of war between the possible second bazooka by GPIF (whose direct impact on supply/demand of JGB should be minimum but indirect impacts through yen depreciation and NKY rally could be large enough to push up yields) and possible earlier-than-expected additional easing by the BoJ (including an increase in JGB purchase which could push down the 10yr yield below 40bp). We continue to expect that the 10y yield will test 50bp as volatility declines.

.Figure 44. Interest Rate and Bond Market Forecasts as of 24 September 2014

		Quarterly Average (Unless Specified)					
	Current	4Q 14	1Q 15F	2Q 15F	3Q 15F	4Q 15F	1Q 16F
US							
Policy Rate (Fed Funds) End Quarter	0.25	0.25	0.25	0.25	0.75	1.00	1.25
3-Month Libor	0.23	0.23	0.35	0.65	0.85	1.05	1.30
2 Year Treasury Yield	0.58	0.80	1.15	1.35	1.55	1.75	1.95
5 Year Treasury Yield	1.77	2.00	2.30	2.45	2.60	2.70	2.80
10 Year Treasury Yield	2.53	2.70	2.95	3.05	3.15	3.20	3.25
30 Year Treasury Yield	3.25	3.30	3.40	3.50	3.60	3.60	3.65
2-10 Year Treasury Curve, bp	195	191	180	170	160	145	130
2 Year Swap Spread (Swap Less Govt), bp	21	22	20	20	20	20	20
10 Year Swap Spread (Swap Less Govt), bp	13	14	15	15	15	15	15
30 Year Swap Spread (Swap Less Govt), bp	-2	-3	-5	-5	-5	-5	-5
30 Year Mortgage Yield	4.23	4.45	4.80	4.90	4.05	5.15	5.25
10 Year Breakeven Inflation, bp	203	209	218	220	220	220	223
Euro Area							
Policy Rate End Quarter	0.05	0.05	0.05	0.05	0.05	0.05	0.05
Overnight Rate (EONIA)	0.01	0.00	0.00	0.00	0.00	0.00	0.00
3-Month (EURIBOR)	0.05	0.05	0.05	0.05	0.05	0.05	0.05
2 Year Schatz Yield	-0.05	-0.05	0.00	0.05	0.05	0.05	0.05
5 Year Bobl Yield	0.20	0.15	0.20	0.35	0.50	0.50	0.60
10 Year Bund Yield	1.00	0.75	1.00	1.25	1.50	1.50	1.75
30 Year Bund Yield	1.91	1.60	1.90	2.15	2.40	2.40	2.65
2-10 Year Bund Curve, bp	105	70	95	120	145	145	170
10 Year BTP-Bund Spread, bp	135	115	100	100	100	100	100
10 Year Bono-Bund Spread, bp	114	80	65	65	65	65	65
2 Year BTP-Schatz Spread, bp	38	25	25	25	25	25	25
2 Year Bono Schatz Spread, bp	39	15	15	15	15	15	15
10 Year OAT-Bund Spread, bp	39	30	25	25	25	25	25
10 Year Swap Spread (Swap Less Govt.), bp	17	25	20	20	20	20	20
10 Year Breakeven Inflation, bp	121	135	140	140	145	145	145
5y5y Implied Vol, bp	72	69	69	65	65	65	65
Japan							
Policy Rate End Quarter	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3-Month Libor	0.12	0.15	0.15	0.15	0.15	0.15	0.15
2 Year Treasury Yield	0.07	0.10	0.10	0.10	0.10	0.10	0.10
5 Year Treasury Yield	0.17	0.15	0.20	0.20	0.25	0.20	0.25
10 Year Treasury Yield	0.52	0.50	0.70	0.80	0.85	0.75	0.85
30 Year Treasury Yield	1.68	1.65	1.75	1.80	1.80	1.75	1.80
2-10 Year Treasury Curve, bp	45	40	60	70	75	65	75
2 Year Swap Spread (Swap Less Govt.), bp	10	8	8	11	12	10	12
10 Year Swap Spread (Swap Less Govt.), bp	11	10	15	15	18	15	18
10 Year Breakeven Inflation, bp	117	95	105	110	110	105	105
UK							
Policy Rate End Quarter	0.50	0.50	0.75	1.00	1.25	1.75	2.00
3-Month Libor	0.56	0.55	1.00	1.25	1.55	1.80	2.05
2 Year Treasury Yield	0.85	1.15	1.60	1.90	2.20	2.40	2.45
5 Year Treasury Yield	1.83	2.00	2.30	2.50	2.75	2.85	2.90
10 Year Treasury Yield	2.47	2.50	2.80	3.00	3.20	3.25	3.30
30 Year Treasury Yield	3.07	3.10	3.25	3.40	3.55	3.55	3.60
2-10 Year Treasury Curve, bp	162	135	120	110	100	85	85
10 Year Swap Spread (Swap Less Govt.), bp	8	12	15	20	20	25	25
10 Year Breakeven Inflation, bp	296	305	310	315	325	330	340
Australia							
Policy Rate End Quarter	2.50	2.50	2.50	2.75	3.00	3.25	3.25
3-Month Libor	2.69	2.75	2.80	3.10	3.25	3.50	3.50
2 Year Treasury Yield	2.66	2.55	2.90	3.30	3.60	4.05	4.20
5 Year Treasury Yield	3.09	3.40	3.70	4.05	4.30	4.70	4.85
10 Year Treasury Yield	3.61	3.80	4.00	4.25	4.40	4.55	4.65
2-10 Year Treasury Curve, bp	95	125	110	95	80	50	45
10 Year Swap Spread (Swap Less Govt.), bp	31	40	40	45	45	50	50

Source: Citi Research

Commodities Market Outlook

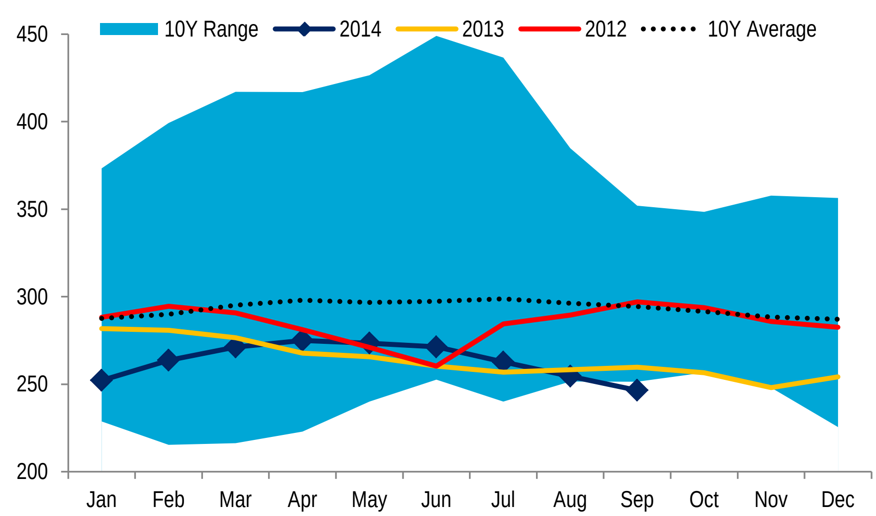
Edward L Morse

Aakash Doshi

The commodities story in 2014 has been a case of two extremes. During 1H 14, on the back of severe weather and geopolitical tail risks that boosted energy and agriculture markets in particular, commodities broadly outperformed all other global asset markets for their strongest start to a year since 2008. During the past quarter, commodities have broadly underperformed every other asset market. The commodities sell-off started in early July and has only accelerated in September. Citi Research expects such price weakness to persist short-term as a record Northern Hemisphere row crop harvest still looms large, crude oil markets need to muddle through refinery turnaround and as the US dollar is poised to keep rallying and remain a headwind for the complex as a whole — particularly gold. Indeed, passive index and commodity ETF trading data suggest investor outflows have jumped during 3Q 14, likely exacerbating downward price pressure on commodities; the benchmark BCOM commodity index now hovering at trailing 10Y seasonal lows. To be certain, passive investment redemptions during mid-September showed net outflows of c$3Bn — the largest weekly commodities unwind since December 2013.

Weaker data out of China have led to increasingly bearish sentiment on its growth prospects. Reflecting concerns about a property market slowdown, Citi revised its 2014 and 2015 China GDP forecast down this month. Crucial to watch going forward is how aggressively officials pursue monetary easing to defend GDP targets. July and August data indicated relatively weak demand for credit as property markets correct. Further rate cuts could help boost credit demand going forward and cushion an investment slowdown. Citi's China economists expect three broad based rates cuts by 1H 2015 of 25bps each, and our outlook for China's property sector calls for a soft landing over the next few years. Any monetary easing is expected to take about six months to show effects in the real economy. Thus, looking at Chinese commodity demand in 4Q, we expect a milder than previously expected pickup in consumption, with a more negative outlook for winter. Improved 4Q demand is based on the lagging impact of credit easing seen in Q2, moderate fiscal stimulus, and improving manufacturing exports. But the weak credit expansion during July and August might make the outlook for December-February appear a bit more challenging.

Figure 45. Bloomberg Commodity Total Return Index Level



Sources: Bloomberg and Citi Research

Energy

Oil prices this summer finally caved into the bearish pressures that Citi has been describing for the last two years. The market had been expecting a much tighter 2H 14 and geopolitical risks and supply disruptions from Iraq/Libya/Russia led investors to counter seasonally increase length in ICE Brent in 2Q'14. Yet inventories ended-up building, demand was stuttering and US crude production continued to grow at over 1-m b/d.

This led to an oversupplied Atlantic Basin despite global crude runs peaking in August. When ~0.5-m b/d of Libyan crude returned to market, crude prices began to buckle. This weakness was exacerbated by the shedding of financial length by money managers as fears over Iraq receded, which helped to push Brent into deep contango after spending the past three years with a firmly backwardated curve.

With oil inventories high and fall refinery maintenance approaching, there are calls for OPEC (mainly Saudi Arabia) to cut production below 30-m b/d to help clear the overhang of crude. Atlantic Basin crudes have weakened given current output levels. In particular, Nigerian barrels continue to struggle to clear, and differentials are at multi-year lows.

Yet this is all occurring amidst a backdrop of elevated geopolitical risk, with the US military on the brink of returning to Iraq and Russia-Ukraine tensions showing no signs of de-escalating. But the onslaught of crude from North America is helping to negate the aforementioned risks and the link between geopolitics and oil appears to be fading with speculative length close to all-time lows. A Saudi pullback, winter heating demand, the pick-up in runs into year-end, stronger distillate cracks and further supply disruptions can all help crude prices in Q4 but the case for oil prices to be much higher than $100/bbl is tough to make. Citi has revised down its Q4 Brent price to $100/bbl and expects prices to average $98/bbl in 2015.

The Atlantic Basin crude deficit is being reduced as North American crude production growth continues at a fast pace, and ongoing improvements in infrastructure bring inland production to the coastal regions, where trade flows and associated pricing need to adjust fitfully.

A major bottleneck that drives fluctuations of the Brent-WTI price differential is the policy constraint on the rise of US crude exports. While the policy is restrictive, US crude exports have surged to almost 400-k b/d in June 2014, up from ~50-k b/d levels in early-2013; going forward, Citi sees robust growth of exports, but will it keep up with the fast pace of US shale production growth? US crude export policy remains a wildcard, but Citi is quite optimistic on prospects for significant liberalization being discussed in the months ahead; ultimately, free flow of US crude exports could reconnect WTI to ~$4 below Brent, but timing on this remains uncertain. US crude price WTI has gone down with Brent, but its discount to Brent has fluctuated between $3-9/bbl over 3Q'14. Going forward, the outlook for the price spread depends on many moving parts, and their impact on crude oil inventories in the Gulf Coast region, and in Cushing, where WTI is priced.

Crude production in the US looks to continue on its roaring growth path, keeping up a 1-m b/d y/y growth, driven by high rig counts and ongoing productivity gains in the big three shale plays of the Bakken, Eagle Ford, and Permian Basin, as well as emerging smaller plays in Colorado and Oklahoma and elsewhere; some minor

hiccups may be seen in 1Q'15 with weather disruptions to shale drilling as in past years. This light sweet crude is joined by greater availability of medium and heavy crudes in the Gulf Coast region due to new pipelines in the Midwest down to Texas, as well as resumed growth in deepwater Gulf of Mexico production. The crude import market in the US is a shrinking one as a result; light sweet crude imports have all but disappeared, meaning West African suppliers have turned their eyes eastward to Asia.

Baseload medium and heavy crude suppliers Saudi Arabia, Mexico, Venezuela have stubbornly clung on, but are shifting too. In particular, Saudi Arabia has indicated with its Official Selling Prices into the US that it is looking to shift volumes to other markets. Crude export licenses have been applied for and approved at a fast pace, and shipments from the Gulf and East Coasts have risen to eastern Canada, Europe, and Asia. Some of these are US-origin crude oil, including condensates produced in Texas shale plays; others are re-exports of Canadian crude. These can continue to rise, perhaps to as much as 1-m b/d by early-2015. But these adjustments may not be enough, especially during seasonal periods of refinery maintenance, when temporarily lower crude demand can lead to bloating of stockpiles. Citi sees US Gulf Coast inventories to be ample in 4Q'14 and into 2015, increasing in pressure through to 2H'15, keeping WTI discounted to Brent; Citi has revised its 4Q'14 WTI price to $91 ($9 below Brent) and sees 2015 prices averaging $90 ($8 below Brent).

For natural gas, the US Northeast production glut continues to overwhelm the market, though several mitigating factors on the demand side could eventually help tighten the supply-demand balance. So far this year, a mild summer and robust Northeast production, despite very low regional prices, sharply raised gas inventories. Hence, Citi expects 2014 US Henry Hub cash prices to average $4.40/MMBtu, $3.90 in 2015 due to the supply overhang, and $4.40 in 2016 as the supply overhang should be worked off by then. Amid this production overhang, several factors could collectively mitigate this surplus: (1) winter demand may be colder than normal, as some meteorologists are suggesting; (2) lower gas imports from Canada due to low inventories and compressed regional price spreads; (3) higher gas exports to Mexico due to pipeline startups; and (4) stronger gas demand for power generation primarily due to coal-fired generation retirements and robust industrial demand growth. Until the production overhang is completely cleared, Citi expects any demand/export-driven Henry Hub price increase to be delayed.

Globally, prices have recovered somewhat as preparation for winter begins. Europe's NBP has experienced a modest recovery, from as low as $6 to the mid-$7, even though gas inventories are still very high. European prices remain torn between the underlying bearish fundamentals of the market and the rising risk of a curtailment of Russian winter gas flows to Europe. Polish gas operator PGNiG reported a 20% drop in flows from Russia recently and stated that they are receiving less gas than they ordered from Russian supplier Gazprom. Data indicate that flows remain around September average levels on a net basis to Europe. Reverse flow was halted from Poland to Ukraine last week, as Gazprom is unlikely to be happy with European's essentially rerouting Russian gas to Ukraine, and the size of winter flows remains highly uncertain.

A cold winter remains the big risk to European gas supplies, especially if Gazprom is unwilling to send additional supply and this likely warrants some risk premia in winter gas prices despite the bearish backdrop. LNG, Norwegian and indigenous supplies remain at levels seen over the previous few years while total

EU storage is ~90% full. The deep contango in the NBP curve is expected to remain in place therefore, as fundamentals depress the prompt and uncertainty supports the further out contracts.

The current spot Asian LNG marker, JKM, has begun to strengthen in line with seasonality and it now sits just under $15/MMBtu. Europe's need for LNG could be high this winter, if Russian flows are limited during a cold winter, but aside from that, global gas markets aren't expected to be as tight as the winter of 2013, given new Australian and PNG supply, and the likely return of some Japanese nuclear reactors.

Metals

Within the last month, investor sentiment towards the base metals has become increasingly fragile. On the one hand, a slew of weak Chinese macro-economic data ranging from housing starts to Industrial production have reignited concerns over the short term outlook for the World's largest metal consumer, while on the other growing expectancy of a sooner than later interest rate hike in the US has further dampened investor appetite for metals exposure. The rapid CTA driven aluminium price rally, which started towards the end of June appears to have stalled after reaching YTD highs of $2,119/MT on September 2nd, and subsequently retraced by over $130/MT at the time of writing as CTAs and funds begun scaling back long positions. For a sustained downside move in Aluminium, the market would need to see CTA s and funds starting to add to short positions, a situation was not apparent in LME COT data in the week ending Sept 12th.

We see little reason for prices not to retrench further through Q4, with continued strong Chinese refined aluminium production growth, plus strong aluminium semi's exports, plus ongoing macro-concerns/USD strength undermining support for the light metal. In contrast, over the last month copper has been remarkably stable, ignoring China macro-concerns and dollar strength. Low and falling levels of exchange copper inventories, and a backwardated forward pricing structure, have not presented the fund community with an attractive shorting proposition, while at the same time China concerns have presented little in the way of upside optimism. As a result, investor positioning in copper has essentially been relatively light compared to the other base metals over the last month. However, we believe the physical market is looking more positive, in particular with China energy grid spending accelerating by 17% y/y in August, after spending was held up by a fraud related audit, sparking strong growth in power cable manufacturing rates, which in turn appears to have boosted copper demand. Indeed, physical copper premiums often a good barometer of underlying demand, have indeed begun to pick up since August. We continue to hold our previous Q4 copper price expectations, with levels forecast to average $7,050/MT.

Gold prices have now been in a clear down trend since the second week of August. The growing expectation of 2015 US interest rate increases has reduced investor interest in holding gold, while its risk related source of support has been diminished as the vestiges of geopolitical support that had pushed prices to $1,345/oz. in mid-July have been slowly pared back. Ukraine and Russia agreed an outline peace deal on September 3rd, while a ratcheting up of the US/European air campaign against IS (Islamic State) in Iraq appears to have contained the regional threat for the time being. From a fundamental perspective, continued weak Chinese gold imports, plus a muted start to the run up to the Indian wedding season, do not bode well for gold in the face of waning investor interest. As a result we have

downgraded our gold price expectations, with levels expected to average $1,220/oz. through Q4.

Bulks

Iron ore prices have fallen sharply over the past month. However, unlike the decline in the first half of the year, the fall in prices has not been driven by increasing supply. Rather, it has been a reflection of weak domestic demand and deleveraging, most notably among traders, but also mills running down iron ore stocks. Steel inventories at traders are at historic lows and iron ore traders are scaling back activity with increasing numbers exiting the industry. While Chinese steel net exports remain high, they are hard pressed to increase further (already at 90% of US steel production). Increased domestic demand is needed to pull the market higher and we do expect some improvement in the infrastructure and machinery sectors (35% of demand) over the coming months. However, the outlook has worsened, particularly for the winter months due to tight credit conditions.

New Chinese coal regulations have grabbed the market's attention and caused a sell-off in thermal coal prices. However, we believe the final regulations — due to take effect January 1 – are bullish for thermal coal prices, as well as for exporters to China. The key remaining uncertainty is whether the tighter 16% ash and 1% sulfur limits for the three largest economic regions apply only to small boilers or to broader categories of consumers. Regardless, the impact on exporters is likely to be limited, while domestic supply will fall, particularly from 30% ash limits on coal travelling over 600km (the majority of coal supplying Southern China travels farther than that). On the other hand, recent developments in India have been moderately less bullish, including greater rainfall and better domestic production.

Agriculture

The outlook for record US corn and soybean harvests over the next few months totaling c18.2-bn bushels has been an increasingly bearish headwind for row crop flat-price and term structure—both of which might weaken further still during the 4Q 14 Northern Hemisphere peak grain-inventory season. Active corn and soybean contracts posted fresh lows this month below $3.35/bu and $9.60/bu, respectively, and could hit their nadir this winter before gradually rising into 2015/16. The longstanding bearish grains view held by Citi Research since 2H 13 has materialized and should benefit domestic and international consumers; allowing further inventory builds across corn, soybean and wheat markets in the coming months. This contrasts with a somewhat tighter outlook for 'luxury' soft commodities such as cocoa and coffee which seem poised to continue trading in a higher range over the next year; above $3,100/MT for cocoa and north of $2/lb for Arabica coffee.

Overall, international food costs declined in August for a fifth straight month. The FAO Food Price Index collapsed 7.3 points m/m and 3.9% y/y to 196.6 — its lowest level since September 2010 and showing ongoing relief for consumers following violent price spikes in 1Q and early 2Q for grains, dairy and related products. World food prices are likely to ease further into year-end as the world reaps a record grain crop next quarter, milk and cheese prices have come off sharply from their YTD peaks on improving supplies and as vegetable oil prices continue weakening as output ramps-up on abundant and cheaper feedstock. The 30-40% drop in cereal prices has had a meaningful impact in lowering headline food

prices, however, since staple grains are inputs for processed/packaged foods as well as feed for consumed animal units.

To be sure, the downward grains price move contrasts with higher red meat prices which are likely to persist over the next year, as well as production risks that have elevated prices of 'equatorial-grown' soft commodities such as premium coffee and cocoa. Official agency data show global staple grain costs declined 3.6% in August but at the same time world meat prices ticked higher for the sixth straight month. However, given positive feeder margins (induced by low grain costs), livestock producers are incentivized to build out cattle-herds over the next several months. It will just take some time.

The 2014 US West Coast and Brazilian drought, combined with the feedback loop of high grain costs during 2010-2013, have led to the lowest US cattle-head count in forty years and a diminished annual hog slaughter on the back-of pig-virus. This has been exacerbated by resilient demand, particularly in North America, even though beef and pork costs have jumped some 5-6% this year. Although the availabilities of poultry appear a bit better, the ill-supplied livestock situation is likely to keep supporting meat prices for the next few quarters. The similar phenomenon is occurring in luxury markets such as cocoa and coffee, where market deficits appear to be looming, production responses are slow, and unforeseen weather or disease tail-risks have tightened markets and meaningfully boosted prices this year; elevated levels we think will hold over the coming quarters.

Figure 46. Commodities Price Outlook*

		Point Prices																	
		0-3M	6-12M		Q3 2013	Q4 2013	Q1 2014	Q2 2014	Q3 2014E	Q4 2014E	Q1 2015E	Q2 2015E	Q3 2015E	Q4 2015E	2012	2013	2014E	2015E	2016E
Energy				**5Y Cyclical**															
NYMEX WTI	USD/bbl	91.0	90.0	81.0	108.0	97.6	99.0	103.0	96.0	91.0	92.0	88.0	93.0	85.0	94.1	98.0	97.3	89.5	85.0
ICE Brent	USD/bbl	100.0	98.0	85.0	112.0	109.3	108.0	110.0	102.0	100.0	100.0	96.0	99.0	95.0	111.7	108.7	105.0	97.5	95.0
Henry Hub Natural Gas	USD/MMBtu	3.90	3.80	5.50	3.55	3.85	5.06	4.58	3.90	3.90	3.90	3.80	3.90	4.00	2.75	3.73	4.40	3.90	4.40
Base Metals				**LT Price**															
LME Aluminum	USD/MT	1,940	1,970	2,200	1,827	1,815	1,752	1,836	2,010	1,950	1,950	1,980	2,000	2,050	2,049	1,888	1,885	1,995	2,100
LME Copper	USD/MT	7,050	7,200	6,200	7,096	7,161	7,005	6,758	7,005	7,050	7,040	7,100	7,200	7,400	7,945	7,352	6,955	7,185	7,800
LME Lead	USD/MT	2,250	2,300	2,200	2,116	2,134	2,127	2,120	2,195	2,250	2,250	2,100	2,250	2,350	2,072	2,158	2,175	2,240	2,400
LME Nickel	USD/MT	22,000	24,000	21,000	13,996	13,980	14,693	18,512	18,785	20,500	22,000	23,500	24,000	26,000	17,592	15,105	18,125	23,875	26,500
LME Tin	USD/MT	22,250	23,500	20,000	21,284	22,951	22,622	23,125	21,980	22,000	22,600	23,000	24,000	24,500	21,108	22,340	22,430	23,525	25,000
LME Zinc	USD/MT	2,300	2,350	2,100	1,896	1,932	2,027	2,079	2,310	2,290	2,300	2,295	2,300	2,350	1,963	1,940	2,175	2,310	2,350
Precious Metals				**LT Price**															
COMEX Gold	USD/T. oz	1,200	1,240	1,050	1,330	1,274	1,292	1,290	1,290	1,220	1,200	1,220	1,230	1,250	1,669	1,416	1,275	1,225	1,300
Silver	USD/T. oz	18.3	18.7	16.5	21.5	20.8	20.5	19.7	20.0	18.4	18.2	18.5	18.7	19.2	31.2	24.0	19.6	18.7	20.0
Platinum	USD/T. oz	1,400	1,500	1,763	1,456	1,397	1,429	1,448	1,450	1,360	1,425	1,475	1,525	1,575	1,552	1,490	1,422	1,500	1,675
Palladium	USD/T. oz	890	920	780	729	725	745	816	871	860	910	920	930	940	645	728	824	925	935
Bulk Commodities				**5Y Cyclical**															
Hard Coking Coal (Spot)	USD/MT	125	140	180	143	142	122	113	113	125	135	140	145	150	191	148	118	143	152
Thermal Coal Asia (NEWC)	USD/MT	74	75	90	77	82	79	73	69	74	78	73	73	76	94	84	74	75	82
Iron Ore Spot (TSI)	USD/MT	87	80	81	133	135	120	103	91	87	82	80	78	78	128	135	100	80	78
Agriculture																			
CBOT Corn	USd/bu	310	390	N/A	512	430	450	480	360	325	360	375	400	400	695	578	405	385	475
CBOT Wheat	USd/bu	475	500	N/A	650	655	616	652	535	495	500	530	550	545	750	684	575	530	550
CBOT Soybeans	USd/bu	900	1,000	N/A	1,405	1,304	1,355	1,470	1,175	950	1,000	1,010	1,030	1,015	1,465	1,406	1,240	1,015	1,075
CBOT Rice	USD/cwt	13.0	14.0	N/A	15.6	15.5	15.5	15.1	13.1	13.0	13.0	13.0	13.0	13.0	14.9	15.5	14.2	13.0	N/A
NYB-ICE Cotton	USd/lb	58.0	60.0	N/A	85.6	80.3	88.0	89.0	67.0	60.0	55.0	60.0	60.0	62.0	80.0	84.0	77.0	59.0	N/A
Sugar#11	USd/lb	16.0	18.0	N/A	16.7	17.7	16.5	17.3	16.0	16.0	17.5	17.5	18.0	18.0	21.6	17.5	16.5	17.8	N/A
ICE Coffee	USd/lb	190	225	N/A	118	110	152	185	175	190	225	225	225	225	175	125	175	225	N/A
ICE Cocoa	USD/MT	3,200	3,200	N/A	2,420	2,706	2,880	3,005	3,175	3,200	3,250	3,300	3,350	3,350	2,348	2,400	3,065	3,315	N/A

Source: Citi Research, *subject to revision

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Appendix A-1

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