

Economics

23 May 2012 | 80 pages

Global Economic Outlook and Strategy

May 2012

- We include three main changes in this month's forecasts. First, Q1 data for Japan and the euro area were stronger than expected. Second, China's economy is now slowing markedly and greater policy easing is likely. Third, we now believe the probability that Greece will leave EMU in the next year or two is 50-75%, and we attempt to include "Grexit" in our forecasts. Overall, we are edging up our 2012 global growth forecast to 2.7% versus 2.6% last month (revised up to 3.2% from 3.1% PPP-weighted). This is the fourth consecutive upgrade to the 2012 forecast. However, we are cutting our 2013 global growth forecast to 2.9% from 3.0% last month, with continued EMU recession.
- There are many uncertainties, but in our new forecasts we assume that Greece will leave EMU in early 2013, followed by sharp currency devaluation, with a large drop in economic activity in 2013 and a modest rebound further ahead. We believe that sizeable adverse economic and financial contagion to other euro area countries will be unavoidable and this is already happening to an extent. We expect that "Grexit" will be followed by far-reaching policy responses: we forecast the ECB will cut rates to 0.5% and resume its multi-year LTRO programme, a second package for both Portugal and Ireland, some kind of Troika programme for Spain, plus financial market support for Spain's and Italy's government bonds. We do not expect an early move to Eurobonds or full fiscal burden sharing. But, if deposit flight from periphery banks escalates, then EU policymakers may agree to a jointly-funded enhanced deposit guarantee scheme (DGS) — which aims to protect deposits against EMU exit and currency denomination as well as bank insolvency — plus a jointly-funded bank recapitalization scheme.
- We believe that, with such measures, Grexit can be contained in the sense that no other countries will be forced to exit EMU and the European banking system will continue to function. But, we believe that strained EMU sovereigns are likely to face high spreads plus poor credit availability, and the resultant economic weakness will cap revenues and lead to general fiscal deficit overshoots and rising debt ratios among many EMU countries. Grexit, if it happens, will not end the EMU crisis.

Figure 1. Currency and Interest Rate Forecasts (End of Period, Unless Specified), as of 23 May 2012

	23 May 2012	3Q 12	4Q 12	1Q 13	2Q 13	3Q 13	4Q 13
	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast
United States: Federal Funds	0.25	0.25	0.25	0.25	0.25	0.25	0.25
10-Yr. Treasuries (Period Ave.)	1.77	1.90	2.20	2.50	2.65	2.80	3.05
Euro Area: US\$/€	1.27	1.23	1.24	1.25	1.26	1.27	1.28
Euro Repo Rate	1.00	0.50	0.50	0.50	0.50	0.50	0.50
10-Yr. Bunds (Period Ave.)	1.46	1.40	1.25	1.25	1.35	1.75	2.15
Japan: Yen/US\$	79	80	80	80	81	82	83
Call Money	0.10	0.10	0.10	0.10	0.10	0.10	0.10
10-Yr. JGB (Period Ave.)	0.87	0.95	1.10	1.20	1.10	1.30	1.30

Source: Citi Investment Research and Analysis

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

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Figure 2. Forecast Highlights and Changes from Last Month

■ Global	Our forecasts reflect three major changes: better than expected Q1 growth in Japan and EMU; the China slowdown and Grexit. The overall effect is a slight upgrade to our 2012 global growth forecast, a downgrade to 2013, extended recession in the euro area and a range of policy measures aimed at supporting weak EMU governments and banks.
■ United States	Economic expansion remains on a modest track, although some payback from weather-induced gains has surfaced. Fed officials have focused accommodation efforts on rate guidance but additional asset purchases could be forthcoming if financial conditions deteriorate sharply or improvement in the job market stalls.
■ Euro Area	Grexit is now our base case. While we expect governments and the ECB (with extra LTRO and a rate cut to 0.5% in 3Q) to put in place measures to contain the contagion, Grexit will have negative repercussions in the euro area, which is likely to go back into recession in 2H 2012.
■ China	We have cut our Q2 growth forecast from 7.9% YoY to 7.5% YoY, reflecting weak data for trade, the real economy, money and credit in April. Downside risks are expected to trigger more policy easing. However, due to weakness in property investment as well as its spillover effect on consumption, we have cut our 2012 growth forecast from 8.4% to 8.1%.
■ Japan	We expect relatively stable growth of around 1.5-2% annualized in coming quarters, driven by reconstruction demand, resilience in consumer spending and a gradual pickup in exports. But the BoJ is likely to ease monetary policy further with inflation expected to undershoot the BoJ's official forecasts.
■ United Kingdom	With the economy back in recession and inflation slowing, the MPC are likely to resume QE soon. If the damage to the UK economy from the EMU crisis escalates markedly, other options include an even-lower policy rate and temporary fiscal stimulus.
■ Canada	The BoC adopted a hawkish tone, stating that some modest withdrawal of the present considerable degree of monetary policy stimulus may become appropriate. Nonetheless, we remain cautious about the outlook as key uncertainties are yet unresolved. Hence, we maintain our call for fixed rates through yearend.
■ Australia	We have downgraded the forecast for 2012 GDP growth from 3.4% to 2.8% and expect the RBA to cut monetary policy by 25 bps in Q3. We still expect economic activity to accelerate to a trend growth rate in 2013.
■ Emerging Asia (ex China)	April data show slowing exports, although domestic demand indicators (retail sales, UE rates) have been relatively resilient. Worries about China growth and EMU financial stress have significantly escalated, and we think central banks will likely sound more dovish than before, but they will probably stop short of doing pre-emptive easing.
■ CEEMEA	Our growth and inflation forecasts have been pushed down slightly in CEEMEA, but the big question now is how these countries respond to a deeper sense of crisis in the Eurozone. Since CEEMEA contains the countries which have EM's largest external financing requirements - Ukraine, Turkey, Poland, Romania, South Africa, for example - sustained risk aversion will leave these countries with more downside risks to growth and more asset price volatility.

Source: Citi Investment Research and Analysis

Figure 3. Global — Summary of Views of Citi's Market Strategists

	Equities	G10 Rates	Credit	Securitized Products	FX †	Commodities	Global Macro Strategy †
Overall View	Cheap valuations, reasonable EPS, easy monetary policy should limit downside	EMU crisis now dominates. Uncertainty remains high and risk-aversion is likely to continue to drive yields lower	Reducing exposure to neutral	Short, high-quality sectors optimise defensive positioning. Off-the-run sectors offer upside	USD higher	A more challenging 2Q 12 with potential for sharper rebound in 2H 12	Risk aversion rising until policy response
Most-Favoured Region/Sector	Japan, Asia Pac ex Japan/ IT, Industrials, Utilities	5yr EUR	Low-beta core non-fins	US CMBS senior tranches	USD	Precious Metals, Grains, Oilseeds	USD
Least-Favoured Region/Sector	US, Australia/ Healthcare, Telecoms, Cons. Disc	>10yr USD	Periphery sub-debt	Spanish and Irish RMBS	EUR, AUD, CHF	Bulk Commodities	Equities
Key Risks	Escalation of EMU crisis, hard landing in China	Rapid EMU contagion or a sudden EMU resolution	Sovereign crisis; bank runs; global slowdown	Regulation	QE3/Twist2	EMU contagion, oil shock double-dip, risk-off financial outflows China hard landing	EMU breakup, China growth, US fiscal, Central Bank stimulus

Source: Citi Investment Research and Analysis

† Summary view from our Global Macro Strategy Market Commentary team (see page 54 for definition of market commentary). The authors are not independent research analysts and may have knowledge of the Firm's positions and/or the Firm's interest in one or more of the securities referenced herein.

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We believe the probability that Greece will exit EMU is above 50%, and attempt to include Grexit in our forecasts

We assume Grexit occurs on 1 Jan 2013...

...with Greece staying in the EU and receiving external loan support...

...a sharp immediate drop in the new currency...

Overview: “Grexit” and China Slowdown

We are again edging up our 2012 global growth forecast, and now expect growth of 2.7% versus 2.6% last month (revised up to 3.2% from 3.1% PPP-weighted). This is the fourth consecutive month we have raised the 2012 forecast. However, we are cutting our 2013 global growth forecast to 2.9% from 3.0% last month, the first such downgrade this year. These latest changes reflect three major factors. First, we are raising our 2012 forecasts for Japan and EMU (to 2.6% and -0.6% respectively from 2.0% and -1.0% respectively last month) to reflect better-than-expected Q1 data. Second, we are cutting our 2012 forecast for China to 8.1% from 8.4% last month, to reflect the ongoing slowdown. Third, we now believe that Greece will probably leave EMU in the next year or two, and attempt to include this in our forecast.

We have repeatedly warned in recent months that the EMU crisis is likely to worsen and, after the first Greek election, raised our estimate of the probability that Greece will exit EMU over the next year or two to 50-75% (from “close to 50%” previously)¹. At the time of writing, it is not certain that Greece will leave EMU or, if it does, when. Moreover, there is huge uncertainty about the extent of post-Grexit contagion and policy responses. But in this publication we attempt to lay out forecasts on the assumption that Greece does leave EMU. We make the following assumptions:

- **Greece will leave EMU on 1 January 2013.** We believe the ECB will be willing to provide liquidity support for Greek banks (to replace lost deposits) until the June 17 election, either directly or via the expansion of Greece’s ELA. But, we assume that the election will not produce a viable government that can follow the Troika plan, leading to a stalemate between the Greek government and official creditors, and to the suspension of EFSF/IMF funding. The government’s cash reserves are limited, and probably will be exhausted well before year-end. Under these conditions, Greek EMU exit could be triggered by the government’s need to print money to cover its spending, or to fill the gap left by the outflow of deposits (if the ECB refuses to allow liquidity support directly or by vetoing the use of ELA). Of course, we acknowledge the possibility that the timetable could be stretched out considerably by, for example, the use of internal IOUs by the Greek government or the provision of “last chance” temporary funding from EU policymakers on a week-to-week basis.
- **Once EMU exit is decided on, the EU and IMF will cooperate to limit near-term economic damage to Greece** in order to mitigate risks of social unrest and collapse of civil society. Hence, we expect that Greece will remain in the EU (or leave and rejoin immediately), and will receive low-interest-rate loans from the IMF and EU (perhaps via the “Balance of Payments Facility”) to fund the remaining fiscal deficit (which is likely to be the primary deficit) and assist in bank recapitalisation. The government probably will implement some form of capital controls to stem the withdrawal of deposits.
- **Greece’s new currency will immediately fall 60% versus the euro and remain depreciated by 50-60% for the next five years.** This is similar to the average nominal currency depreciation (against the key base currency) in a range of countries after severe financial and sovereign debt crises².

¹ See “Hollande Takes Over; ‘Grexit’ More Likely”, Guillaume Menuet and Juergen Michels, 7 May 2012 and “Grexit’ Back In The Spotlight”, Global Economics View, Willem Buiter and Ebrahim Rahbari, 10 May 2012, Citi

² See “Rising Risks of Greek Euro Area Exit”, Willem Buiter and Ebrahim Rahbari, 6 February 2012, Citi.

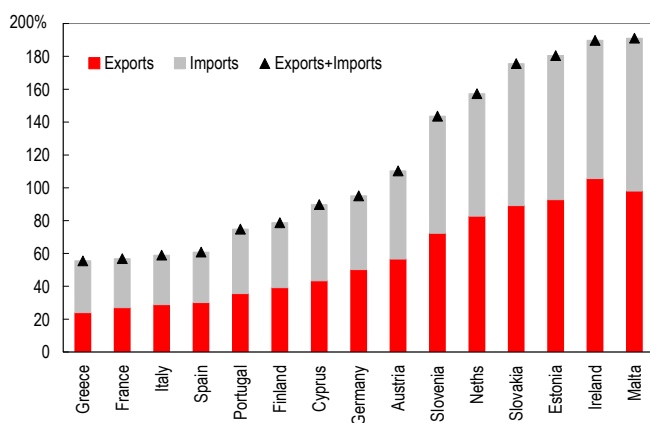
...immediate suspension of government debt interest payments and default on privately held debt

We expect that Greece's GDP initially will fall sharply, rebounding in subsequent years

■ **Greece will immediately suspend interest payments on all government debt.** But — in order to defer the recognition of losses among official creditors and as part of the package of EU/IMF cooperation post-Grexit — government debt will not be redenominated or written off immediately. With the new currency weakening and government debt largely in euros, the general government debt/GDP ratio will soar to about 400% in 2013. We pencil in eventual debt restructuring for 2015, aiming to cut the debt/GDP ratio to the EMU average (which at that stage will be about 95%) — and this will require large debt writedowns — probably covering both publicly held and privately held debt.

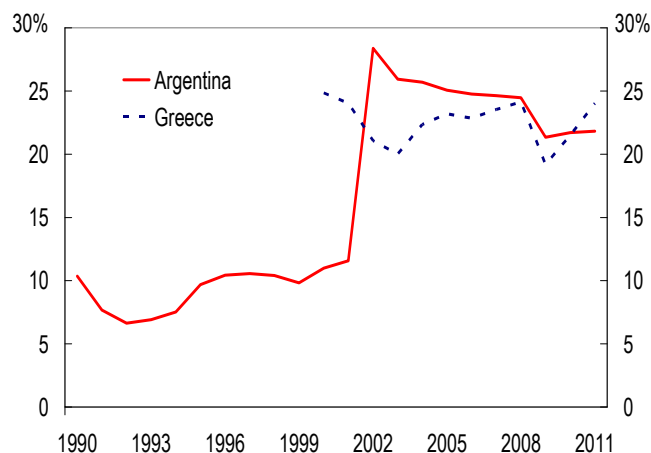
Under these assumptions, we expect that Greece's real GDP will fall by about 10% in 2013, with an eventual rebound of 4-5% YoY in 2015-16 as gains in cost competitiveness revive exports, especially tourism. To be sure, Greece is a relatively weak export country: exports of goods and services accounted for 24% of GDP in 2011, up from 19% in 2009, but the lowest among EMU countries. Exports and imports combined equal 55.5% of GDP, also the lowest among EMU countries, although not very different to France and Italy. But this low export share is in part the consequence of the recent loss of external competitiveness. Greece is a more open economy than Argentina was before the 2001-02 crisis: exports accounted for just 11.6% of Argentina's nominal GDP in 2001, but this rose to 28% in 2002 (amidst extreme weakness in domestic demand and surging export prices) and has since settled at about 22% in 2011. Of course, this ratio has been lifted by the surge in global commodity prices, and the export share is unlikely to rise so sharply in Greece. But some improvement is likely.

Figure 4. Selected EMU Countries — Exports (Goods and Services) as Pct of GDP, 2011



Sources: Eurostat and Citi Investment Research and Analysis

Figure 5. Argentina and Greece — Exports (Goods and Services) as Pct of GDP (Nominal Terms), 1990-2011



Sources: Datastream and Citi Investment Research and Analysis

We expect that inflation in Greece will surge, with the economy not regaining the pre-recession peak even in 2016

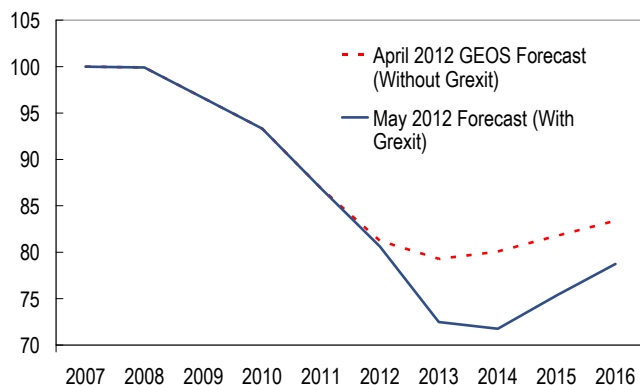
We expect that inflation in Greece will surge to about 20% YoY on average in 2013-14, but (given the very high jobless rate and hence probable low wage growth) we do not expect that competitiveness gains from the lower currency will be fully offset by inflation straight away. Overall, our forecast leaves Greece's GDP at end-2016 within a few percent of the level that we forecast last month (when we assumed the country would stay in EMU), and still about 20% below the 2007 level.

There are many uncertainties

We stress the many uncertainties here, over the big picture, the details and the timing. It is just about possible that the June 17 election in Greece will produce a parliamentary majority that credibly aims to implement the Troika plan. In that case, Troika funding would resume — although, with the likelihood that Greece's

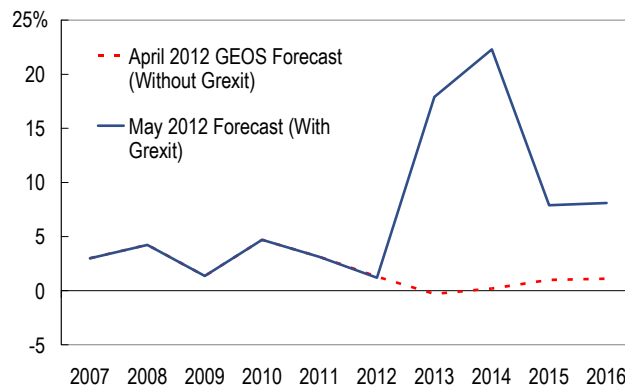
economy would continue to underperform, chances of an eventual collapse of the Troika programme would remain sizeable. It also is possible that other EU policymakers will be willing to markedly ease the terms for Greece to resume Troika funding after June 17 if, at that stage, financial market dislocation has become extreme enough to create a consensus that immediate Grexit must be avoided at all costs.

Figure 6. Greece — Level of Real GDP (Indexed to 2007=100), 2007-16F



F Citi forecast. Sources: Eurostat and Citi Investment Research and Analysis

Figure 7. Greece — YoY CPI Inflation, 2007-16F



F Citi forecast. Sources: Eurostat and Citi Investment Research and Analysis

There already are signs of a sizeable exodus of funds from periphery economies

If anything like our base case for Grexit occurs, we believe that sizeable adverse economic and financial contagion and spillovers to other euro area countries would be unavoidable. Of course, this is already happening to an extent, with a general exodus from periphery sovereign debt, portfolio assets, direct investment and bank deposits³. Indeed, "contagion" is not quite the correct phrase to describe the linkages, because it implies that other EMU peripheral countries have fundamentally sound economies and fiscal positions and are just being caught up in worries about Greece. In our view, this characterisation is not valid:

Greece is an extreme example of the general problem of excess debt and poor competitiveness among periphery economies ...

■ We regard Greece as a relatively extreme case of a general problem among periphery EMU economies of poor competitiveness (a mix of relatively high nominal wage growth and in some cases, low productivity), weak banking systems, weak fiscal positions, plus high public and/or private debt burdens. Greece is unusual in the degree of weakness in the economy, and the government's inability to fully comply with the Troika programme's targets for fiscal measures and other reforms. But, even in Ireland and Portugal, where governments have been fully compliant with Troika programmes, economic weakness leaves the countries on an unsustainable fiscal path, in our view⁴. Similarly, Spain and Italy's fiscal positions remain weak⁵. The high level of intra-EMU spreads for these governments is a reflection of their own problems, not just an irrational spillover from Greece. We regard Greece as more of a "canary in the coal mine" rather than a source of contagion that can be isolated.

³ See "Tracking the Flight from Peripherals", Matt King, 21 May 2012, Citi.

⁴ See "Ireland — Recession Casts Doubt On Fiscal Sustainability", Michael Saunders, Euro Economics Weekly, 18 May 2012, Citi.

⁵ See "Focus on Spain", Guillaume Menuet and Ebrahim Rahbari, 3 April 2012, Citi.

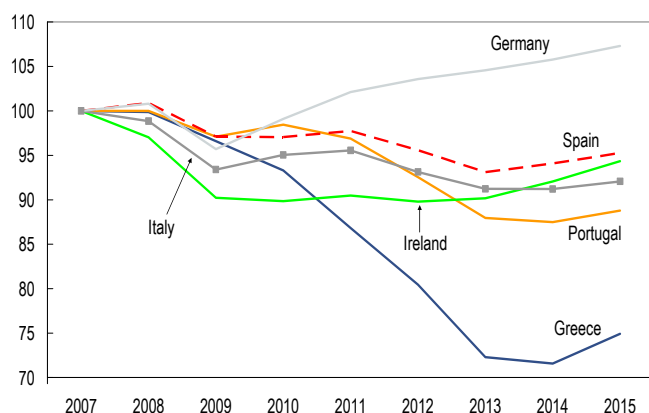
...and comments from senior EU and IMF policymakers have fundamentally changed the nature of EMU

■ Moreover, the past month has seen a range of key policymakers (EU, ECB, IMF) acknowledge that EMU exit is possible. These comments were meant as warnings to Greece, in order to pressure Greek voters to elect pro-austerity parties in the June 17 election. But, in our view, these comments have fundamentally and permanently altered EMU from a supposedly irrevocable system to one in which exit is no longer ruled out.

Financial strains in periphery economies are likely to stay high

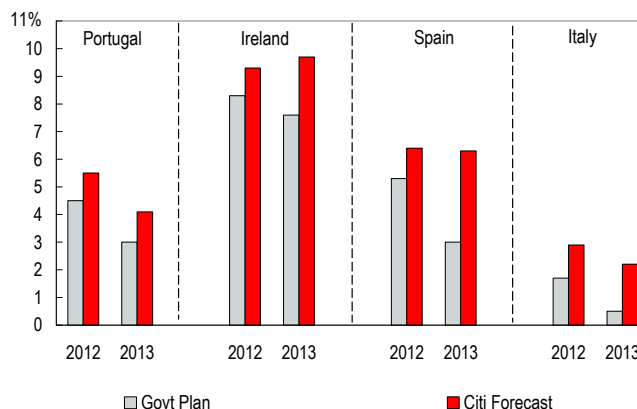
In these circumstances, it is not irrational for investors and companies to reduce exposure to periphery economies, in our view, even if EMU exit or widespread bank failures are a very remote possibility, because of the large potential scale of losses if such low-probability events do occur. These financial strains may well escalate quickly if Grexit occurs. But, given widespread recessions among the EMU periphery, intra-EMU strains are likely to persist even if Grexit does not occur in the next year or two.

Figure 8. Selected EMU Countries, Level of Real GDP Indexed to 2007 = 100, 2007-15F



Note: Citi forecasts for 2012-15.
Sources: Eurostat and Citi Investment Research and Analysis

Figure 9. Selected EMU Countries — Fiscal Deficits as Pct of GDP, 2012-13F



Sources: National governments and Citi Investment Research and Analysis

We expect a series of policy responses after Grexit aimed at limiting adverse spillovers...

As a result, we expect that Grexit will be followed by a series of policy responses aiming to prevent a domino-style collapse of the banking system and escalating economic disruption.

...including ECB easing and multi-year LTRO...

■ We expect the ECB will restart its multi-year LTRO programme and cut rates to 0.5%. Last month, we had penciled in the drop to 0.5% rates for 2013, but this month we are advancing it to Q3-2012.

...second programmes (initially without PSI) for Portugal and Ireland...

■ The Irish and Portuguese governments already are largely funded to end-2013 under the current Troika programmes. For both countries, we expect that a second 3-year package will be needed to cover the period beyond 2013, given the probable backdrop of weak economies and rising debt/GDP profiles. With the probable escalation of EMU tensions after Grexit, we suspect that Portugal and Ireland will get second programmes without PSI initially, to try to differentiate them from Greece. Nevertheless, we expect that PSI eventually may well be implemented for both Portugal and Ireland, perhaps in 2014 or 2015 if it becomes clear that a second programme will need to be followed by a third programme. We assume that any such PSI will be scaled to cut their debt/GDP ratios to match the EMU average of 90-95%.

...a Troika programme for Spain...

- As before, we expect some kind of Troika programme for Spain to be agreed late this year or in early 2013, mainly directed at funding bank recapitalization but including conditionality and possibly also some funding for the fiscal deficit.

...greater tolerance for adverse cyclical fiscal effects...

- We do not expect general fiscal loosening, even among core countries. But, we do expect greater tolerance among European policymakers for fiscal deficit overshoots that are largely caused by economic underperformance, with governments seeking to achieve deficit targets over longer periods. This will apply to Portugal and Ireland inside Troika programmes, but also (we expect) to a range of other countries facing recessions (eg Spain, Italy) or marked economic weakness (eg France, Belgium).

...and, possibly, more support for the Spanish and Italian government bond markets

- In addition, policymakers may implement extra support for Spanish and Italian government bonds, either through the EFSF/ESM in secondary or primary markets, or action by the ECB through the SMP or LTROs with pressure on periphery banks to purchase government debt.

An enhanced deposit guarantee scheme may come into place over time, aimed at protecting against redenomination risk as well as bank failure...

- If deposit flight from periphery banks escalates, then EU policymakers may agree on a jointly-funded enhanced deposit guarantee scheme (DGS) which aims to protect deposits against EMU exit and currency redenomination as well as bank insolvency. A traditional DGS probably would fail to stem deposit exodus, because such schemes protect against insolvency of an individual bank, and lack the larger funding needed to protect depositors against general redenomination risk. A DGS that protects against redenomination risk would imply a huge contingent fiscal liability for the creditor nations, whether funded directly or by guarantee from the ESM. Hence, we believe a joint DGS will only be introduced if the situation becomes dire. Even then, it would probably take time to fully implement and require agreement on a general bank resolution regime and shift of bank supervision from national authorities to an EMU-wide (or EU-wide) body. However, even an extended DGS would probably not fully stem deposit flight, because it would probably only cover personal deposits up to a certain size (€100,000 is typical for existing EU DGS) and hence exclude large personal deposits or corporate deposits⁶. But, the announcement that a DGS against redenomination risk will be implemented probably would encourage the ECB to greatly expand liquidity assistance to strained banks in the interim.

...as well as a jointly-funded bank recapitalization facility

- Another option that may come into play is to use the ESM to recapitalize banks, perhaps through an intermediary bank resolution fund, with the ECB perhaps accepting this fund as an eligible counterparty for repo operations.

But, we do not expect an early move to a transfer union or widespread fiscal burden sharing

There may be other measures, but we do not expect an early move to Eurobonds or full fiscal burden sharing, other than the limited acceptance of fiscal burden sharing and jointly-backed debts that is implicit in the EFSF, ESM, ECB and other EU institutions. We expect the EMU fiscal framework will largely remain one of national governments with separate public debts, rather than a genuine “United States of Europe” with a federal government, mostly common public debts, large systematic fiscal transfers and jointly funded lender of last resort facilities — at modest yields — for stressed national or local governments.

Even if spillovers from Grexit can be contained, sizeable economic and financial disruption is likely

With this backdrop, we believe that Grexit can be contained in the sense that no other countries will be forced to leave EMU and the European banking system will continue to function. Such an outcome would be a considerable achievement. But, we believe that strained EMU sovereigns are likely to face high spreads plus poor

⁶ The European Commission estimated in 2010 that a general EU-wide DGS up to €100,000 would cover about 40% of aggregate bank deposits. See “Impact Assessment on Deposit Guarantee Schemes”, Commission Staff Working Document, 2010.

We now expect another sizeable drop in euro area GDP in 2013

credit availability, and the resultant economic weakness will cap revenues and lead to general fiscal deficit overshoots and rising debt ratios among many EMU countries.

In total, we now expect that euro area GDP will fall by about 0.6% this year, and fall by about 0.7% in 2013, versus last month's forecasts of -1.0% and -0.2% respectively. The upgrade for the 2012 forecast reflects the better Q1 data, while the downgrade to 2013 reflects a broad-based deterioration in the outlook among EMU countries⁷. We expect that euro area real GDP will only regain the early-08 peak in 2016, significantly underperforming Japan's "lost decade" experience from 1992.

There also are sizeable economic and policy uncertainties in China and the US

This overview has focused on the EMU crisis, but there are other key issues and uncertainties. China's growth slowed markedly in Q1 and appears to be slowing further — to about 7½% YoY — in Q2. We assume that further easing of monetary and credit policies, as well as support from fiscal policy, will produce a rebound later this year. But, the necessary stimulus is not yet in place and so far the policy response has been quite slow. If further easing continues to be delayed, then the slowdown may prove more protracted, spilling over into other economies with high export dependence on China's boom. Moreover, uncertainties remain high over the US fiscal outlook for 2013 and beyond. Our base case assumes the US will avoid a fiscal calamity in 2013, but meaningful drag from the public sector (of about 1% of GDP for 2013) is still likely and risks around that are sizeable.

Major central banks are likely to keep policy loose for an extended period, and some will loosen further near term

Against this backdrop, we continue to expect that major central banks will keep monetary policy loose for an extended period and, in some cases, loosen further. As discussed, our base case is that the ECB will cut rates to 0.5% and restart the multi-year LTRO programme later this year or in 2013. We also expect the UK will restart QE soon, and continue to give a slight edge to further Fed accommodation in the outlook if serious risks to growth rise and inflation runs well within desired ranges. We pencil in the first Fed rate hike for 2014, with the first hike for the UK only in 2015 and for the ECB in 2016.

Figure 10. Selected Countries — Industrial Production Forecasts (Pct.), 2011-13F

	2011	2012F	2013F
World	3.9%	3.0%	3.3%
United States	4.1	4.1	3.0
Japan	-2.4	4.2	3.3
Euro Area	3.6	-2.0	-1.0
United Kingdom	-1.2	-1.0	1.3
Canada	3.5	0.0	0.7
China	13.9	11.5	12.3
India	3.9	5.0	6.1
Korea	6.9	5.2	7.0
Brazil	0.3	0.0	2.8

Source: Citi Investment Research and Analysis

⁷ Note that the 2012 EMU growth forecast compares aggregate GDP for the euro area including Greece in 2012 with aggregate GDP for the euro area including Greece in 2011. The 2013 EMU growth forecast compares aggregate GDP for the euro area excluding Greece in 2013 with aggregate GDP for the euro area excluding Greece in 2012.

Figure 11. Selected Countries — Economic Forecast Overview (Percent), 2011-2016F

	GDP Growth						CPI Inflation						Short-Term Interest Rates					
	2011	2012F	2013F	2014F	2015F	2016F	2011	2012F	2013F	2014F	2015F	2016F	2011	2012F	2013F	2014F	2015F	2016F
Global	3.0	2.7	2.9	3.6	3.8	4.0	3.7	3.0	2.9	2.9	3.0	2.9	2.52	2.41	2.45	2.65	2.98	3.40
<i>Based on PPP weights</i>	3.6	3.2	3.4	4.0	4.1	4.3	4.2	3.4	3.3	3.3	3.3	3.1						
Industrial Countries	1.3	1.2	1.1	2.2	2.4	2.6	2.3	1.9	1.5	1.5	1.5	1.6	0.76	0.60	0.55	0.67	1.02	1.60
United States	1.7	2.1	2.1	3.5	3.5	4.0	2.5	1.9	1.7	2.1	2.2	2.2	0.25	0.25	0.25	0.40	1.15	2.10
Japan	-0.7	2.6	1.5	1.5	1.5	1.2	-0.3	0.4	0.0	0.3	0.4	0.5	0.10	0.10	0.10	0.10	0.13	0.48
Euro Area	1.5	-0.6	-0.7	0.9	1.2	1.3	2.7	2.5	1.8	1.3	1.1	1.2	1.19	0.75	0.50	0.50	0.50	0.75
Canada	2.5	2.0	2.3	2.8	3.2	3.6	2.9	1.8	1.7	2.0	2.0	2.0	1.00	1.00	1.63	2.19	2.50	3.00
Australia	2.0	2.8	3.5	3.6	3.8	3.6	3.4	1.9	3.4	2.9	2.7	2.5	4.75	3.75	3.88	4.50	5.00	5.25
New Zealand	1.3	1.8	2.3	3.0	3.2	3.4	4.0	1.6	2.4	2.6	2.9	2.8	2.50	2.50	3.25	4.25	5.00	5.50
Germany	3.1	1.4	1.0	1.2	1.4	1.1	2.3	2.1	2.3	2.2	2.2	2.3						
France	1.7	-0.1	-0.1	1.3	1.5	2.1	2.3	2.3	1.0	1.4	1.9	1.6						
Italy	0.5	-2.5	-2.0	0.0	0.9	0.6	2.9	3.6	2.0	0.2	0.0	0.9						
Spain	0.7	-2.2	-2.6	1.1	1.3	1.7	3.1	2.2	2.3	1.0	0.8	1.2						
Greece	-6.9	-7.4	-10.1	-0.9	4.7	4.4	3.1	1.2	15.3	19.1	6.4	6.1						
Ireland	0.7	-0.8	0.4	2.1	2.5	3.1	-0.4	0.1	0.2	0.5	0.6	0.6						
Portugal	-1.6	-4.6	-5.2	-0.6	1.5	0.6	3.6	3.1	2.2	0.7	0.2	0.4						
Netherlands	1.3	-1.5	-0.6	1.1	1.5	1.9	2.3	2.8	2.6	1.6	1.9	1.8						
Belgium	2.0	0.0	0.1	1.8	2.1	1.8	3.5	2.9	1.7	1.9	2.3	2.3						
Denmark	1.0	0.6	1.2	1.4	1.6	1.8	2.7	2.2	1.7	1.5	1.6	1.8	1.30	0.35	0.30	0.55	0.60	1.00
Norway	2.5	3.0	2.9	2.7	2.7	2.9	1.3	1.3	1.8	2.0	2.3	2.3	2.10	1.95	2.00	2.30	2.60	2.90
Sweden	4.0	0.4	2.0	2.4	2.5	2.7	3.0	1.2	1.6	2.2	2.1	2.0	1.80	1.20	1.10	1.60	2.10	2.50
Switzerland	1.9	0.7	0.9	1.5	1.6	1.6	0.2	-1.1	-1.5	-0.9	0.5	0.7	0.22	0.00	0.00	0.00	0.00	0.00
United Kingdom	0.6	-0.2	0.5	1.3	2.2	3.1	4.5	2.9	1.8	1.6	1.4	1.5	0.50	0.50	0.50	0.50	1.04	2.04
Emerging Markets	6.0	5.2	5.8	5.8	5.9	5.9	6.1	4.9	5.0	5.0	5.0	4.7	5.69	5.42	5.47	5.61	5.77	5.85
China	9.2	8.1	8.5	7.7	7.6	7.5	5.4	3.5	3.5	4.5	5.0	4.5	3.22	3.50	3.63	4.13	4.75	5.00
Taiwan	4.0	3.3	4.2	4.5	4.5	4.5	1.4	1.9	2.1	1.8	1.8	1.8	0.70	0.87	1.08	1.25	1.50	1.75
India	6.9	7.0	7.5	8.2	8.3	8.5	9.0	7.0	6.5	6.0	6.0	6.0	8.20	7.80	7.50	7.50	7.50	7.50
Indonesia	6.5	6.2	6.5	6.7	6.9	6.7	5.4	4.4	4.7	5.3	5.8	5.4	5.43	3.75	4.20	4.50	4.63	5.13
Korea	3.6	3.4	4.2	3.8	4.0	4.2	4.0	3.0	3.2	3.1	3.0	3.2	3.19	3.25	3.81	4.25	4.50	4.50
Czech Republic	1.7	-0.6	1.3	2.6	3.6	3.7	1.9	3.3	2.7	2.5	2.0	1.6	0.75	0.56	0.29	1.00	1.58	2.25
Hungary	1.7	-0.5	0.9	2.1	2.0	1.8	3.9	5.6	3.9	3.5	3.1	3.3	6.04	6.79	5.75	5.75	5.69	5.25
Poland	4.3	2.7	2.4	3.1	3.4	3.4	4.3	3.8	2.6	2.5	2.5	2.5	4.22	4.67	4.33	4.42	4.75	4.75
Romania	2.5	1.3	3.0	4.2	4.3	4.3	5.8	2.8	2.7	2.5	2.5	2.5	6.19	5.25	5.00	5.00	5.00	5.00
Russia	4.3	3.5	4.0	4.1	4.0	4.2	8.4	5.1	6.9	5.8	5.5	5.0	8.12	8.00	7.08	6.00	5.96	5.42
Turkey	8.5	2.5	4.3	4.6	4.6	4.6	6.5	9.7	7.0	6.0	5.9	5.4	6.00	5.75	6.31	8.00	7.56	7.50
Nigeria	7.8	7.4	7.0	7.2	6.9	7.2	10.8	12.4	9.8	10.3	9.5	9.0	8.90	15.00	12.50	10.50	10.00	9.50
South Africa	3.1	2.9	3.8	4.4	4.4	4.5	5.0	6.1	5.4	5.2	5.4	5.5	5.50	5.50	6.13	6.50	6.50	6.50
Argentina	8.9	3.0	3.0	2.0	2.0	3.5	9.8	9.6	12.2	15.0	15.0	16.5	18.37	13.46	17.71	16.00	14.00	13.00
Brazil	2.7	3.3	4.5	4.5	4.5	4.5	6.6	5.4	5.6	4.5	4.0	4.0	11.71	8.63	8.67	9.63	9.00	8.25
Mexico	3.9	3.9	3.8	3.5	3.6	3.7	3.4	3.9	3.9	3.9	3.8	3.7	4.50	4.50	4.50	4.65	5.46	6.42
Venezuela	4.2	5.0	3.5	4.0	3.0	2.5	24.5	27.0	27.4	31.4	29.4	29.4	13.30	14.40	14.40	13.00	12.90	12.70

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

Figure 12. Selected Countries — Economic Forecast Overview (Percent), 2011-2016F

	Current Balance (Pct of GDP)						Fiscal Balance (Pct of GDP)						Government Debt (Pct of GDP)					
	2011	2012F	2013F	2014F	2015F	2016F	2011	2012F	2013F	2014F	2015F	2016F	2011	2012F	2013F	2014F	2015F	2016F
Global	0.3	0.2	0.2	0.1	0.1	0.2	-4.9	-4.1	-3.3	-2.8	-2.5	-2.3	80	82	82	81	80	78
<i>Based on PPP weights</i>	0.6	0.4	0.3	0.0	0.0	0.1	-4.3	-3.8	-3.1	-2.7	-2.5	-2.3						
Industrial Countries	-0.7	-0.8	-0.6	-0.5	-0.4	-0.3	-6.8	-5.6	-4.5	-3.8	-3.2	-2.8	105	111	113	114	115	114
United States	-3.1	-3.3	-3.1	-3.1	-3.2	-3.2	-9.4	-7.8	-5.9	-4.6	-4.0	-4.0	98	104	106	108	108	108
Japan	2.0	1.5	2.0	2.0	2.0	2.0	-10.7	-10.5	-8.1	-7.9	-7.5	-7.1	228	235	242	246	251	255
Euro Area	0.0	-0.1	0.1	0.2	0.4	0.5	-4.1	-3.1	-2.9	-2.4	-1.8	-1.2	87	96	96	96	95	94
Canada	-2.8	-1.6	-1.6	-1.9	-1.8	-1.5	-1.4	-1.2	-0.5	-0.1	0.2	0.4	85	85	84	83	81	79
Australia	-2.3	-4.0	-5.8	-4.9	-3.5	-3.2	-3.4	-3.0	0.1	0.1	0.3	0.4	6	10	9	9	8	7
New Zealand	-4.0	-5.2	-7.6	-6.9	-5.8	-5.5	-8.0	-5.9	-3.1	-0.9	0.2	0.9	21	27	30	30	30	29
Germany	5.8	5.4	4.5	4.6	4.5	4.4	-1.0	-0.5	-0.3	-0.2	0.1	0.4	81	83	82	81	78	76
France	-2.2	-1.9	-1.1	-0.3	0.3	0.4	-5.2	-4.4	-4.1	-3.8	-3.1	-2.1	86	93	99	101	101	99
Italy	-3.2	-2.3	-1.8	-1.4	-1.3	-1.1	-3.9	-2.9	-2.7	-2.8	-2.1	-1.6	121	129	135	137	138	138
Spain	-3.5	-2.1	-1.0	0.8	2.2	3.4	-8.9	-6.4	-6.3	-4.7	-3.8	-2.6	72	88	98	101	102	101
Greece	-9.6	-8.4	-4.4	-0.1	1.7	2.3	-9.1	-10.7	-5.8	-4.7	-3.0	-5.1	165	156	435	378	101	91
Ireland	0.1	3.2	3.6	6.1	7.9	10.1	-13.0	-9.3	-9.7	-7.4	-6.0	-4.8	108	121	129	132	135	134
Portugal	-8.1	-4.6	-2.5	-1.6	-1.5	-1.0	-4.2	-5.5	-4.1	-4.1	-2.4	-2.5	108	120	132	99	102	104
Netherlands	9.0	9.8	9.5	8.5	7.5	7.1	-4.7	-4.5	-3.5	-2.3	-1.5	-1.0	65	70	73	74	73	71
Belgium	-0.8	-0.2	0.3	1.0	2.0	2.4	-3.7	-3.2	-2.9	-1.9	-1.0	-0.4	98	112	119	117	113	109
Denmark	6.5	5.8	5.5	4.0	3.5	3.7	-1.9	-4.0	-2.4	-1.9	-1.7	0.5	44	47	48	49	49	47
Norway	14.0	14.3	14.9	15.2	15.8	16.5	13.8	13.6	14.0	15.0	17.0	18.5	NA	NA	NA	NA	NA	NA
Sweden	7.2	7.0	7.3	7.3	7.2	7.3	0.2	-0.4	-0.2	0.5	1.5	1.9	37	37	36	34	31	27
Switzerland	15.0	13.8	14.0	14.2	14.7	15.7	0.6	0.2	-0.2	0.0	-0.1	-0.2	53	52	51	51	51	51
United Kingdom	-1.9	-1.3	-0.5	0.2	0.8	1.2	-8.3	-6.3	-7.7	-7.1	-6.3	-5.0	83	88	95	100	104	105
Emerging Markets	2.2	2.0	1.6	0.9	0.8	0.8	-1.5	-1.6	-1.5	-1.4	-1.6	-1.5	34	34	33	32	31	30
China	2.8	2.0	1.5	1.0	1.0	1.0	-1.3	-2.4	-1.5	-1.0	-1.0	-1.0	15	16	16	15	14	14
Taiwan	8.8	8.7	8.4	8.0	8.0	8.0	-1.9	-1.6	-1.6	-1.3	-1.0	-0.7	39	39	40	42	43	44
India	-4.0	-4.1	-3.4	-2.8	-2.6	-2.0	-8.4	-8.0	-7.7	-7.0	-6.5	-5.0	69	69	68	66	64	63
Indonesia	0.2	-1.0	-0.9	-0.9	-0.9	-0.9	-1.2	-1.8	-0.7	-1.0	-0.5	-0.5	26	25	24	23	23	22
Korea	2.4	1.1	0.7	0.6	-0.3	-0.3	1.5	1.4	1.2	1.6	1.4	2.1	33	33	32	30	28	26
Czech Republic	-2.9	-2.6	-2.6	-2.9	-3.0	-2.3	-3.1	-3.1	-2.8	-2.3	-1.5	-0.5	41	44	45	45	43	40
Hungary	1.7	1.0	1.0	2.0	2.2	2.1	4.3	-2.8	-2.5	-3.0	-3.0	-3.0	81	79	77	77	76	76
Poland	-4.3	-3.9	-4.0	-5.2	-5.3	-4.9	-5.1	-3.1	-2.5	-1.8	-1.5	-1.5	54	52	50	48	47	45
Romania	-4.2	-4.5	-4.7	-5.0	-5.0	-5.0	-4.1	-2.4	-2.2	-2.5	-2.3	-2.0	39	39	39	39	38	37
Russia	5.2	5.3	2.1	-1.0	-1.0	-1.0	2.0	0.3	0.1	-0.1	-1.1	-1.1	8	9	8	8	8	8
Turkey	-10.0	-8.4	-8.0	-7.3	-6.8	-6.2	-1.3	-2.2	-2.5	-2.5	-2.7	-3.0	41	41	39	39	38	36
Nigeria	6.1	5.5	6.4	5.0	4.0	3.5	-3.1	-2.2	-2.1	-2.6	-3.0	-2.6	NA	NA	NA	NA	NA	NA
South Africa	-3.4	-4.7	-5.6	-6.6	-6.3	-5.8	-5.0	-4.8	-4.2	-3.6	-3.5	-3.5	38	41	42	43	43	42
Argentina	0.4	0.3	0.2	-0.6	-0.6	-0.5	-1.6	-3.0	-3.0	-1.3	-0.6	0.1	49	49	49	52	53	53
Brazil	-2.1	-2.1	-2.4	-2.7	-3.0	-3.3	-2.6	-1.9	-2.6	-2.4	-2.2	-2.5	63	63	63	64	64	65
Mexico	-0.8	-1.4	-2.0	-2.5	-2.4	-2.6	-2.5	-2.2	-2.0	-1.9	-1.9	-1.8	40	40	38	38	38	37
Venezuela	9.1	6.9	8.3	7.2	7.9	7.6	-5.0	-5.0	-4.0	-5.2	-5.0	-4.8	43	36	36	37	37	38

Note: Fiscal deficit and debt figures for all countries are general government debt and deficits. We assume sovereign debt restructuring in Portugal in 2014 and Greece in 2015. Source: Citi Investment Research and Analysis

Figure 13. Selected Countries — Changes in Economic Forecast from the Previous Month (Percentage Points), 2011-2013F

	GDP Growth			CPI Inflation			Current Balance (Pct of GDP)			Fiscal Balance (Pct of GDP)		
	2011	2012F	2013F	2011	2012F	2013F	2011	2012F	2013F	2011	2012F	2013F
Global		0.1	-0.1		-0.1	-0.1		0.1			0.1	
<i>Based on PPP weights</i>	<i>-0.1</i>	<i>0.1</i>	<i>-0.1</i>		<i>-0.1</i>	<i>-0.1</i>		<i>0.1</i>			<i>0.1</i>	
Industrial Countries		0.2	-0.2			-0.1	0.1		0.1	0.1	0.1	-0.1
United States			0.1		-0.2	-0.1			0.1			
Japan		0.6	-0.1		0.3	-0.2	-0.1	0.2	0.1		0.3	0.3
Euro Area		0.4	-0.5		-0.3	-0.1	0.3	0.2	0.4		0.2	-0.5
Canada					-0.3	-0.1		-0.1				
Australia		-0.6	-0.4		-0.7			-1.1	-0.8		-1.2	-0.1
New Zealand											0.1	-0.1
Germany		0.5	-0.6		-0.1			0.4	0.1		0.1	
France		-0.2	-0.6		-0.2	-0.6	0.1	0.1				-0.7
Italy	0.1	-0.3	-1.1					0.5	0.6		-0.3	-1.0
Spain		0.5	-1.3		0.2	0.6		0.7	1.2	-0.4	-0.1	-1.0
Greece		-0.9	-7.7		-0.1	15.6		0.1	3.1	0.2	-3.3	0.4
Ireland			0.1		-0.1	0.2		-1.0	-0.6	-3.2	0.3	
Portugal		0.8	-2.2			0.2		0.4	0.4	-0.2	0.3	-0.6
Netherlands			-1.0		0.2	0.8		-0.2				
Belgium	0.1		-1.0								-0.3	-1.2
Denmark	-0.1	-0.1			0.2	0.2		0.4	0.3	0.6	1.2	1.5
Norway	-0.2	0.5			-0.4	-0.2				1.8	1.1	0.5
Sweden		-0.3	0.1	0.1		-0.3		-0.5	-0.5	0.1		
Switzerland					0.1	-0.2						
United Kingdom		-0.4	-0.5		0.1	-0.2		0.3	-0.7		0.2	-0.3
Emerging Markets	-0.1	-0.1	-0.1	-0.1	-0.2	-0.1		0.1			-0.1	
China		-0.3	-0.1								-0.4	
Taiwan		-0.2	0.1									-0.3
India							-0.2	-0.2	0.4			
Indonesia					-1.4	-0.6		-0.4				
Korea		-0.3	-0.2		-0.1	-0.2	-0.1					
Czech Republic		-0.3	-0.3			-0.1		1.2	-0.1			
Hungary		-0.5	-0.5			0.5		-0.2	-0.4	0.1	0.4	0.5
Poland		-0.1			-0.1	-0.1	-0.2	-0.2	-0.1		0.1	0.1
Romania		-0.4	-0.1								-0.4	-0.2
Russia					-0.3	-0.1		0.1				
Turkey								0.1	0.3			
Nigeria					0.2	-0.2	0.2	0.3	0.4	-0.1	-0.1	-0.1
South Africa												
Argentina												
Brazil					0.1	0.2						
Mexico		0.4	0.1		-0.2	0.2		0.2	-0.1			
Venezuela		1.1	0.1	-2.6	0.9	-1.3		-0.1	-0.1			

Source: Citi Investment Research and Analysis

Figure 14. Selected Countries — Economic Forecast Overview and Exchange Rate Forecasts (Percent), 2011-2016F

	10-Year Yields						Exchange Rates Versus U.S. Dollar*						Exchange Rate Versus Euro					
	2011	2012F	2013F	2014F	2015F	2016F	2011	2012F	2013F	2014F	2015F	2016F	2011	2012F	2013F	2014F	2015F	2016F
Industrial Countries																		
United States	2.80	2.05	2.75	3.25	3.50	3.75	NA	NA	NA	NA	NA	NA	1.39	1.26	1.26	1.30	1.33	1.35
Japan	1.12	0.98	1.23	1.50	1.75	1.75	79	81	81	85	85	85	110	102	103	111	113	115
Euro Area	2.71	1.54	1.63	2.25	2.75	3.00	1.39	1.26	1.26	1.30	1.33	1.35	NA	NA	NA	NA	NA	NA
Canada	2.78	2.06	3.14	3.50	3.45	3.75	1.01	1.02	0.99	0.97	0.97	0.97	1.39	1.28	1.25	1.27	1.29	1.31
Australia	4.63	3.38	4.25	4.90	5.25	5.50	1.01	0.97	0.94	0.90	0.89	0.88	1.37	1.31	1.35	1.45	1.50	1.54
New Zealand	4.74	3.74	4.50	5.00	5.40	6.00	0.77	0.75	0.70	0.63	0.63	0.62	1.79	1.68	1.80	2.06	2.12	2.17
Germany	2.71	1.54	1.63	2.25	2.75	3.00												
France	3.31	2.99	2.88	3.25	3.55	3.60												
Italy	5.19	6.56	6.63	5.45	5.25	5.00												
Spain	5.43	7.00	6.25	5.35	5.05	4.80												
Netherlands	3.04	2.24	2.20	2.65	3.10	3.30												
Belgium	4.21	3.48	3.28	3.45	3.75	3.80												
Denmark	2.80	1.49	1.63	2.35	2.95	3.25	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
Norway	3.07	2.05	2.18	2.85	3.45	3.75	5.66	6.03	5.95	5.75	5.64	5.54	7.84	7.63	7.51	7.50	7.49	7.48
Sweden	2.66	1.58	1.68	2.30	2.85	3.25	6.60	7.14	6.92	6.63	6.50	6.38	9.14	9.02	8.74	8.65	8.63	8.62
Switzerland	1.53	0.66	0.70	1.10	1.75	2.10	0.90	0.95	0.97	0.96	0.97	0.98	1.25	1.20	1.22	1.26	1.29	1.32
United Kingdom	3.00	1.90	2.15	2.65	3.25	3.50	1.59	1.58	1.60	1.65	1.68	1.70	0.87	0.80	0.79	0.79	0.79	0.79
Emerging Markets																		
China	3.52	3.17	3.42	3.80	4.42	4.67	6.46	6.30	6.19	6.11	6.08	6.06	9.00	7.97	7.81	7.97	8.08	8.18
Taiwan	1.38	1.35	1.50	1.60	1.70	1.80	29.40	29.76	28.70	28.22	28.20	28.20	40.93	37.64	36.25	36.82	37.45	38.08
India	8.40	8.25	8.25	8.25	8.25	8.25	46.63	53.48	53.85	51.04	50.59	50.25	64.92	67.63	68.01	66.59	67.18	67.86
Indonesia	7.20	6.84	7.00	7.25	7.00	7.00	8763	9285	9382	9338	9288	9238	12201	11741	11849	12182	12334	12476
Korea	3.90	3.59	4.30	4.78	5.13	5.13	1108	1158	1095	990	987	989	1542	1465	1383	1292	1311	1335
Czech Republic	3.68	3.39	3.39	3.46	3.82	4.00	17.7	20.0	19.6	18.3	17.5	16.7	24.6	25.3	24.7	23.9	23.2	22.6
Hungary	7.63	8.43	8.08	7.99	7.77	7.48	201	232	227	221	215	209	279	294	287	289	286	283
Poland	5.99	5.63	5.38	5.55	5.57	5.40	2.96	3.46	3.30	3.00	2.94	2.89	4.12	4.38	4.17	3.91	3.90	3.90
Romania	NA	NA	NA	NA	NA	NA	3.04	3.50	3.42	3.23	3.13	3.06	4.23	4.42	4.32	4.21	4.16	4.13
Russia	NA	NA	NA	NA	NA	NA	29.4	30.9	32.1	32.0	31.3	30.6	41.0	39.1	40.5	41.7	41.6	41.4
Turkey	NA	NA	NA	NA	NA	NA	1.68	1.84	1.88	1.85	1.85	1.86	2.34	2.33	2.38	2.42	2.46	2.51
Nigeria	NA	NA	NA	NA	NA	NA	156	160	165	163	165	164	217	202	208	213	219	221
South Africa	8.24	8.21	8.90	9.15	9.20	9.20	7.26	8.25	8.57	8.85	9.25	9.65	10.11	10.44	10.82	11.55	12.28	13.03
Argentina	NA	NA	NA	NA	NA	NA	4.13	4.55	5.45	6.79	7.54	8.36	5.74	5.76	6.88	8.86	10.01	11.30
Brazil	11.45	10.71	10.77	9.88	8.75	8.25	1.67	1.96	1.90	1.85	1.83	1.81	2.33	2.48	2.40	2.41	2.43	2.45
Mexico	6.83	6.26	6.74	7.10	7.38	7.72	12.4	13.6	13.1	12.3	12.5	12.8	17.3	17.2	16.5	16.1	16.6	17.3
Venezuela	13.65	12.44	12.64	13.90	13.80	13.70	4.30	4.30	6.50	6.50	9.75	9.75	5.60	5.44	8.21	8.48	12.95	13.17

*Per USD except Euro Area, Australia, New Zealand, United Kingdom. Note: All foreign exchange forecasts are consistent with the rolling forecasts presented in Figure 81. Source: Citi Investment Research and Analysis

Figure 15. Short Rates (End of Period), as of 23 May 2012 (Percent)

	Current	3Q 12	4Q 12	1Q 13	2Q 13	3Q 13	4Q 13
United States	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Japan	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Euro Area	1.00	0.50	0.50	0.50	0.50	0.50	0.50
Canada	1.00	1.00	1.00	1.25	1.50	1.75	2.00
Australia	3.75	3.50	3.50	3.50	3.75	4.00	4.25
New Zealand	2.50	2.50	2.50	2.75	3.00	3.50	3.75
Denmark	0.70	0.10	0.10	0.10	0.10	0.10	0.10
Norway	1.50	1.50	1.50	1.75	1.75	2.00	2.00
Sweden	1.50	1.25	1.00	1.00	1.00	1.00	1.00
Switzerland	0.00	0.00	0.00	0.00	0.00	0.00	0.00
United Kingdom	0.50	0.50	0.50	0.50	0.50	0.50	0.50
China	3.50	3.50	3.50	3.75	3.75	3.75	3.75

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

Figure 16. 10-Year Yield Forecasts (Period Average), as of 23 May 2012 (Percent)

	Current	3Q 12	4Q 12	1Q 13	2Q 13	3Q 13	4Q 13
United States	1.77	1.90	2.20	2.50	2.65	2.80	3.05
Japan	0.87	0.95	1.10	1.20	1.10	1.30	1.30
Euro area (Germany)	1.46	1.40	1.25	1.25	1.35	1.75	2.15
Canada	1.91	1.95	2.25	2.80	3.05	3.20	3.45
Australia	3.17	3.15	3.40	3.70	4.10	4.50	4.70
New Zealand	3.52	3.60	3.80	4.00	4.40	4.75	4.90
Denmark	1.34	1.36	1.20	1.20	1.30	1.70	2.15
Norway	2.03	1.75	1.65	1.70	1.85	2.30	2.70
Sweden	1.53	1.40	1.25	1.25	1.40	1.80	2.20
Switzerland	0.67	0.61	0.56	0.56	0.60	0.75	0.90
United Kingdom	1.89	1.80	1.65	1.70	1.80	2.25	2.85

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

Figure 17. 10-Year Yield Spreads (Period Average), as of 23 May 2012

	Spread vs. US\$						Spread vs. Germany					
	Current	3Q 12	4Q 12	1Q 13	2Q 13	3Q 13	Current	3Q 12	4Q 12	1Q 13	2Q 13	3Q 13
United States	NA	NA	NA	NA	NA	NA	32	51	96	127	132	107
Japan	-91	-96	-111	-132	-157	-152	-59	-45	-15	-5	-25	-45
Euro Area	-32	-51	-96	-127	-132	-107	NA	NA	NA	NA	NA	NA
Canada	14	5	5	30	41	41	46	564	101	157	172	148
Australia	142	127	122	122	147	173	174	177	218	248	279	280
New Zealand	177	172	162	152	178	199	209	223	259	279	310	306
France	102	109	54	13	-2	13	133	160	150	140	130	120
Italy	399	499	504	423	418	393	430	550	600	550	550	500
Spain	436	549	504	423	368	343	467	600	600	550	500	450
Netherlands	16	29	-16	-57	-72	-57	47	80	80	70	60	50
Belgium	163	149	94	53	38	53	194	200	190	180	170	160
Denmark	-43	-55	-101	-132	-137	-112	-12	-4	-5	-5	-5	-5
Norway	25	-16	-56	-82	-82	-52	55	35	40	45	50	55
Sweden	-24	-51	-96	-127	-127	-102	7	0	0	0	5	5
Switzerland	-110	-130	-165	-196	-207	-207	-79	-79	-69	-69	-75	-100
United Kingdom	12	-11	-56	-82	-87	-57	43	40	40	45	45	50

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

Source: Citi Investment Research and Analysis

Figure 18. Emerging Market Countries — Short Rates Actual and Forecast of Additional Rate Moves (End of Period), as of 23 May 2012

Country	Current Rate (%)	Jun 12	Sep 12	Dec 12	Mar 13	Jun 13	Total Cumulative Rate Moves Expected
Thailand	3.00	0	0	0	25	25	50
South Africa	5.50	0	0	0	0	50	50
Philippines	4.00	0	0	0	25	25	50
Korea	3.25	0	0	0	25	25	50
Indonesia	3.75	0	0	0	25	25	50
China	3.50	0	0	0	25	0	25
Israel	2.50	0	0	0	0	0	0
Turkey	5.75	0	0	0	0	0	0
Mexico	4.50	0	0	0	0	0	0
Romania	5.25	0	0	0	-25	0	-25
Chile	5.00	0	0	-50	0	25	-25
Czech	0.75	-25	0	-25	0	0	-50
Poland	4.75	0	0	0	-25	-25	-50
India	8.00	0	-25	0	0	-50	-75
Brazil	9.00	-50	-75	0	0	50	-75
Russia	8.00	0	0	0	-50	-50	-100
Hungary	7.00	0	-25	-75	-25	0	-125

Source: Citi Investment Research and Analysis

Figure 19. Foreign Exchange Forecasts (End of Period), as of 23 May 2012

	vs. USD						vs. EUR					
	Current	Sep 12	Dec 12	Mar 13	Jun 13	Sep 13	Current	Sep 12	Dec 12	Mar 13	Jun 13	Sep 13
United States	NA	NA	NA	NA	NA	NA	1.27	1.23	1.24	1.25	1.26	1.27
Japan	79	80	80	80	81	82	101	99	99	100	101	104
Euro Area	1.27	1.23	1.24	1.25	1.26	1.27	NA	NA	NA	NA	NA	NA
Canada	1.02	1.03	1.02	1.01	1.00	0.99	1.29	1.26	1.26	1.25	1.25	1.25
Australia	0.98	0.93	0.94	0.95	0.94	0.93	1.29	1.32	1.32	1.32	1.33	1.36
New Zealand	0.76	0.72	0.72	0.73	0.72	0.69	1.68	1.71	1.71	1.71	1.75	1.83
Norway	5.98	6.22	6.13	6.05	5.97	5.91	7.60	7.67	7.60	7.54	7.50	7.50
Sweden	7.19	7.40	7.24	7.08	6.96	6.87	9.13	9.13	8.98	8.83	8.74	8.71
Switzerland	0.95	0.97	0.97	0.97	0.97	0.97	1.20	1.20	1.20	1.21	1.21	1.22
United Kingdom	1.58	1.58	1.58	1.58	1.59	1.61	0.80	0.78	0.78	0.79	0.79	0.79
China	6.33	6.31	6.27	6.23	6.20	6.17	8.00	7.80	7.80	7.80	7.80	7.80
India	54.7	54.2	54.5	54.8	54.5	53.5	69.4	66.8	67.6	68.3	68.5	67.9
Korea	1173	1170	1156	1142	1117	1080	1488	1442	1433	1424	1403	1369
Poland	3.44	3.65	3.55	3.45	3.35	3.25	4.36	4.50	4.40	4.30	4.21	4.12
Russia	31.3	31.4	31.7	32.0	32.1	32.1	39.8	38.7	39.3	39.9	40.4	40.8
South Africa	8.37	8.46	8.47	8.49	8.53	8.59	10.62	10.43	10.51	10.58	10.71	10.90
Turkey	1.84	1.87	1.88	1.89	1.89	1.88	2.33	2.30	2.33	2.36	2.38	2.39
Brazil	2.01	2.02	1.98	1.94	1.91	1.89	2.55	2.49	2.45	2.41	2.39	2.40
Mexico	13.8	14.0	13.7	13.5	13.2	12.9	17.6	17.2	17.0	16.8	16.6	16.4

Note: All foreign exchange forecasts are consistent with the rolling forecasts presented in Figure 80. Source: Citi Investment Research and Analysis

Figure 20. Foreign Exchange Forecasts (End of Period), as of 23 May 2012

	vs. JPY					
	Current	Sep 12	Dec 12	Mar 13	Jun 13	Sep 13
United States	79	80	80	80	81	82
Japan	NA	NA	NA	NA	NA	NA
Euro Area	101	99	99	100	101	104
Canada	78	78	79	80	81	83
Australia	78	75	75	76	76	76
New Zealand	60.1	57.7	58.0	58.3	57.9	56.7
Norway	13.2	12.9	13.0	13.2	13.5	13.8
Sweden	11.0	10.8	11.0	11.3	11.6	11.9
Switzerland	84	82	82	83	83	85
United Kingdom	125	126	126	127	128	131
China	13	13	13	13	13	13
India	1.45	1.48	1.47	1.46	1.48	1.53
Korea	14.79	14.62	14.45	14.28	13.86	13.19
Poland	23.1	21.9	22.5	23.2	24.0	25.2
Russia	2.5	2.5	2.5	2.5	2.5	2.5
South Africa	9.5	9.5	9.4	9.4	9.4	9.5
Turkey	43.2	42.9	42.6	42.3	42.5	43.5
Brazil	39.5	39.6	40.5	41.3	42.3	43.3
Mexico	5.7	5.7	5.8	5.9	6.1	6.3

Note: All foreign exchange forecasts are consistent with the rolling forecasts presented in Figure 80. Source: Citi Investment Research and Analysis

Country Commentary

United States

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Economic recovery is continuing to advance at a modest pace around 2%. Although some sectors are paying back temporary gains from a mild winter, demand has been a little stronger than expected at the start of Q2, while the apparent inventory overhang from Q1 may be revised away. Earlier concerns about rising gasoline prices have dissipated as pressures have eased and consumer spending has held up. Housing indicators also continue to transition from deeply depressed levels toward modest growth. Still, the upside to growth remains checked by financial headwinds and ongoing fiscal drag. Our base case assumes the US will avoid a fiscal calamity in 2013 but meaningful drag from the public sector is still likely.

We continue to give a slight edge to further Fed accommodation in the outlook but officials have not signaled that a move will follow immediately on the completion of Operation Twist next month. The readiness to act is contingent still on signs of serious risks to growth and, with inflation running well within desired ranges, the hurdles for additional QE measures are higher. With growth expected to remain below Fed projections and the threat of major fiscal tightening for 2013, this debate is likely to linger and the Fed is expected to anchor super-low rates for a long time.

Earlier worries about inflation have eased somewhat as gasoline prices have dropped contra-seasonally heading into peak driving season. An improving job market is just beginning to buoy wage growth and stable inflation expectations are acting as a steadying force in the outlook that should allow policy flexibility.

Figure 21. United States — Economic Forecasts, 2011E-2013F

					2012				2013			
		2011	2012F	2013F	1QE	2QF	3QF	4QF	1QF	2QF	3QF	4QF
GDP	SAAR				1.8%	2.0%	2.2%	2.3%	1.3%	1.9%	2.9%	3.3%
	YoY	1.7%	2.1%	2.1%	2.0	2.1	2.2	2.1	1.9	1.9	2.1	2.3
Domestic Demand	SAAR				1.7	2.0	1.8	2.0	1.9	1.8	1.9	3.2
	YoY	1.9	1.9	2.0	1.5	2.4	2.1	2.0	1.1	1.9	2.7	2.2
Consumption	SAAR				2.9	2.7	2.1	2.1	1.0	1.7	2.6	3.1
	YoY	2.2	2.3	1.9	1.8	2.3	2.4	2.4	2.0	1.7	1.8	2.1
Business Investment	SAAR				-1.1	5.6	6.2	4.9	5.2	5.6	5.7	6.3
	YoY	8.8	5.3	5.5	7.3	6.2	3.9	3.9	5.5	5.5	5.3	5.7
Housing Investment	SAAR				19.0	7.6	10.4	17.8	18.5	18.8	19.8	21.8
	YoY	-1.3	11.1	17.1	8.8	9.7	12.1	13.6	13.5	16.3	18.7	19.7
Government	SAAR				-3.9	-1.1	-1.4	-2.1	-3.1	-1.9	-1.3	-1.2
	YoY	-2.1	-2.4	-2.0	-2.3	-2.3	-2.7	-2.1	-1.9	-2.1	-2.1	-1.9
Exports	SAAR				7.9	7.4	5.9	7.8	7.1	6.6	7.0	7.7
	YoY	6.7	5.9	7.0	4.7	5.7	6.0	7.2	7.0	6.8	7.1	7.1
Imports	SAAR				6.2	5.7	3.6	4.4	4.3	4.1	5.3	6.0
	YoY	4.9	4.3	4.5	3.1	4.2	4.8	5.0	4.5	4.1	4.5	4.9
PCE Deflator	YoY	2.5	1.9	1.7	2.3	1.8	1.7	1.7	1.6	1.7	1.7	1.9
Core PCE Deflator	YoY	1.4	1.8	1.6	1.9	1.9	1.8	1.8	1.7	1.6	1.6	1.7
Unemployment Rate	%	9.0	8.0	7.8	8.3	8.1	8.0	7.8	7.8	7.8	7.8	7.7
Federal Gov't Balance (Fiscal Year)	\$Bn	-1297	-1175	-875								
	% of GDP	-8.7	-7.6	-5.5								
General Gov't Balance (Cal Year)	% of GDP	-9.4	-7.8	-5.9								
Federal Debt	% of GDP	68	74	78								
General Gov't Debt	% of GDP	98	104	106								
Current Account	US\$b	-473	-513	-504	-540	-513	-503	-498	-484	-505	-497	-528
	% of GDP	-3.1	-3.3	-3.1	-3.5	-3.3	-3.2	-3.1	-3.0	-3.1	3.1	-3.2
S&P 500 Profits (US\$ Per Share)	YoY	14.4	5.5	4.6	8.9	6.5	1.4	5.7	2.7	5.3	4.2	6.2

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

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

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Japan

We expect relatively stable growth of around 1.5-2% annualized in coming quarters. In the first quarter, contributions of net export to growth were minimal, but reconstruction demand from the earthquake and resilience in consumer spending, in part helped by policy effects (i.e. the government's subsidies for eco-car purchases) drove solid growth. This pattern likely will largely be sustained until the third quarter. However, exports will also probably recover gradually if as we anticipate, the Chinese economy accelerates in the second half of this year amid further support measures, and this will probably support activity when reconstruction demand and policy effects start to taper off (probably in Q4 and beyond).

The BoJ expanded the asset purchase program again in late April and we expect the BoJ to take more measures going forward. First, upward pressures on the yen likely will persist given global risk aversion. Second, inflation is likely to undershoot the BoJ's forecast (which is that core inflation will reach the price stability goal of 1% in the not-too-distant future). Lastly, under the current asset purchase program, monthly JGB purchases are set to roughly halve beginning in next January. But the BoJ likely will eventually decide to maintain the same pace of purchases by extending the program. Debates about the consumption tax hike are a key policy issue. However, it appears quite unlikely that the consumption tax hike bill (calling for a tax rate hike to 8% in April 2014 from 5% currently and to 10% in October 2015) will be smoothly approved by the Parliaments. There is no consensus on the tax hike within the DPJ (Democratic Party of Japan), although it is possible that the LDP (Liberal Democratic Party) will cooperate with the DPJ in approving the bill if PM Noda promises to hold general elections soon. While there remain uncertainties, we expect the bill will be approved eventually this year.

Figure 22. Japan — Economic Forecasts, 2011-13F

					2012				2013F			
		2011	2012F	2013F	1Q	2QF	3QF	4QF	1Q	2Q	3Q	4Q
Real GDP	YoY	-0.7%	2.6%	1.5%	2.6%	3.4%	1.9%	2.3%	1.8%	1.6%	1.4%	1.2%
	SAAR				4.1	2.0	1.5	1.5	2.2	1.4	0.5	0.9
Domestic Demand	YoY	0.2	2.9	1.4	3.4	3.3	2.6	2.1	1.7	1.5	1.2	1.1
	SAAR				3.3	2.3	1.7	1.2	1.7	1.4	0.5	0.6
Private Consumption	YoY	0.1	2.7	1.0	3.4	3.3	2.5	1.8	1.0	0.9	0.9	1.2
	SAAR				4.4	1.6	1.2	-0.2	1.3	1.2	1.2	1.0
Business Investment	YoY	1.0	0.5	3.0	0.4	1.4	2.3	-2.2	2.7	2.9	3.1	3.3
	SAAR				-14.8	2.4	2.6	2.3	3.7	3.2	3.1	3.2
Housing Investment	YoY	5.4	3.1	6.0	0.0	5.2	1.8	5.4	9.9	8.0	5.7	0.6
Public Investment	YoY	-2.9	9.9	-3.0	11.9	8.0	9.5	10.5	4.5	-1.0	-6.0	-9.0
Exports	YoY	-0.2	3.5	3.9	0.9	8.0	0.1	5.3	3.5	4.0	4.0	4.0
	SAAR				12.3	1.1	3.0	5.0	5.0	3.0	3.0	5.0
Imports	YoY	5.9	5.8	3.3	6.7	7.3	4.8	4.7	3.2	3.4	3.1	3.3
	SAAR				8.0	3.2	4.4	3.2	2.1	3.8	3.5	3.8
CPI	YoY	-0.3	0.4	0.0	0.3	0.5	0.4	0.4	-0.2	-0.1	0.0	0.1
Core CPI	YoY	-0.3	0.1	0.0	0.1	0.1	0.1	0.1	-0.2	-0.1	0.0	0.1
Nominal GDP	YoY	-2.8	2.0	1.4	1.4	2.8	1.6	2.2	1.8	1.6	1.3	1.1
Current Account	¥ tn	9.6	7.2	9.5	7.1	6.7	7.1	7.9	8.9	9.2	9.6	10.3
	% of GDP	2.0	1.5	2.0	1.5	1.4	1.5	1.6	1.8	1.9	2.0	2.1
Unemployment Rate	%	4.6	4.5	4.3	4.5	4.5	4.4	4.4	4.3	4.3	4.3	4.3
Industrial Production	YoY	-2.4	4.2	3.3	4.8	7.8	3.0	3.6	3.2	3.7	3.6	2.8
Corporate Profits (Fiscal Year)	YoY	-12.5	22.5	15.0								
General Govt. Balance (Fiscal Year)	% of GDP	-10.7	-10.5	-8.1								
General Govt Debt	% of GDP	228	235	242								

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 Investment Research and Analysis

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Euro Area

With the probability of Grexit seen at between 50% to 75%, our base scenario is now that Greece will leave the euro area. Therefore our euro area forecasts from 2013 onwards exclude Greece. Depending on the outcome of the Greek elections on June 17, the decision on Grexit will take some time, during which heightened uncertainty will undermine economic activity. Taking this into account, we have revised down our 2013 GDP forecasts for all euro area countries compared to last month and we expect the euro area to contract by 0.7% next year. Although we have revised up our 2012 GDP forecast by 0.4 points to -0.6% to reflect the better-than-expected Q1 data, we expect the region to move into recession in 2H.

In order to contain the contagion from Greece to the rest of the euro area, we expect governments and the ECB to take further action. As we have learned during the crisis several times, the timing and the size of the measures depends on market pressure and probably also on the behaviour of deposit holders at periphery country banks. We expect that the governments will use the EFSF and — if put in place in July — the ESM to support euro area sovereigns and banks. With increasing pressure, we expect that there will be more integration in the financial sector including a euro area wide special resolution regime for banks and a resolution fund to back large cross-border financial institutions. While Germany is likely to continue to block the issuance of common euro area bonds, it probably will eventually agree to participate in a euro area wide deposit guarantee scheme.

As most measures by governments will not be immediately available, the ECB is likely to act quicker in a situation of severe stress caused by Grexit. We expect that the ECB will provide additional multi-year LTROs and will expand the eligible collateral pool substantially (probably on a country-by-country basis). We now also expect the ECB to cut rates by 50bp to 0.5% in 3Q. In addition to the financial stress, historically high unemployment rates and the outlook of below-2% inflation in the medium term supports the reduction of the main refi rate below the previous low of 1.0%. We expect the deposit rate to decline from currently 0.25% to 0.1%.

We publish further details of our European forecasts monthly in European Economic Forecast Highlights

Figure 23. Euro Area — Economic Forecasts, 2011-13F

		2011	2012F	2013F	2012F				2013F			
					1QF	2QF	3QF	4QF	1QF	2QF	3QF	4QF
Real GDP	YoY	1.5%	-0.6%	-0.7%	0.0%	-0.4%	-1.0%	-1.1%	-1.2%	-1.0%	-0.5%	0.0%
	SAAR				0.1	-1.0	-2.0	-1.3	-0.3	-0.4	0.1	0.7
Final Domestic Demand	YoY	0.4	-1.6	-1.2	-0.9	-1.3	-2.1	-2.1	-2.0	-1.5	-0.8	-0.3
Private Consumption	YoY	0.2	-1.0	-0.8	-0.7	-0.6	-1.4	-1.3	-1.4	-1.1	-0.6	-0.1
Government Consumption	YoY	0.0	-1.3	-1.3	-0.4	-1.2	-1.8	-2.0	-2.1	-1.5	-0.8	-0.6
Fixed Investment	YoY	1.5	-3.5	-2.3	-2.1	-3.2	-4.2	-4.5	-3.8	-2.7	-1.7	-0.8
— Business Equipment	YoY	3.5	-3.4	-2.6	-0.9	-2.9	-4.8	-4.9	-4.7	-3.1	-1.8	-0.7
— Construction	YoY	-0.8	-3.0	-1.1	-2.9	-3.0	-2.8	-3.2	-2.5	-1.8	-0.7	0.5
Stocks (Contrib. to Y/Y GDP Growth)		0.1	-0.2	-0.1	-0.3	-0.4	-0.2	0.0	0.0	-0.1	-0.1	-0.1
Exports	YoY	6.3	2.0	2.0	3.1	2.2	1.1	1.6	1.4	1.6	2.1	2.9
Imports	YoY	3.9	-0.7	0.7	0.1	-0.8	-1.6	-0.4	-0.5	0.3	1.1	1.8
CPI	YoY	2.7	2.5	1.8	2.7	2.5	2.5	2.2	1.8	1.8	1.8	1.8
Core CPI	YoY	1.4	1.5	1.5	1.5	1.4	1.4	1.5	1.4	1.6	1.6	1.3
CPI Ex Energy and Food	YoY	1.7	1.6	1.5	1.9	1.7	1.4	1.5	1.3	1.7	1.7	1.4
Unemployment Rate	YoY	10.2	11.0	11.3	10.8	11.0	11.1	11.2	11.3	11.3	11.3	11.3
Current Account Balance	EUR bn	-4.2	-8.1	8.2								
	% of GDP	0.0	-0.1	0.1								
General Government Balance	EUR bn	-387.6	-292.6	-273.5								
	% of GDP	-4.1	-3.1	-2.9								
General Government Debt	EUR bn	8215.3	9034.5	9179.6								
	% of GDP	87.2	95.5	96.4								
Gross Operating Surplus	YoY	2.7	-0.5	0.3								

Sources: Eurostat and Citi Investment Research and Analysis

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Germany

We have revised up our GDP forecast for 2012 from 0.9% to 1.4%, mainly reflecting the unexpected gain in GDP in 1Q. However, with the recent escalation of the euro area crisis, which is likely to cap German exports, we have cut our forecast for 2H 2012 and for 2013. We now expect GDP growth of only 1.0% next year versus 1.6% last month although, with somewhat higher-than-expected recent wage agreements and further drop in financing costs, we expect domestic demand to be a bit stronger than last month's forecast. German inflation will probably remain elevated, but we do not expect a significant increase in inflation in coming years. After the defeat in the NRW election, Angela Merkel's coalition remains under pressure and will need support from opposition parties in the Bundesrat upper house to pass legislation.

France

European issues will loom large in François Hollande's diary. Reaching an agreement with Angela Merkel about adding a growth supplement to the fiscal compact will require France to give explicit guarantees about meeting its 3.0% of GDP budget deficit target in 2013. On the domestic stage, we expect the Socialist Party, together with its Communist and Green allies, to win the legislative elections on 10 & 17 June. With no GDP growth in Q1, and negative momentum in Q2, the newly appointed government led by Prime Minister Jean-Marc Ayrault will present an updated budget relying on tax increases to bring the 2012 deficit to 4.5% of GDP during an extraordinary parliamentary session in July. With Grexit our baseline, we lower our H2 GDP forecast to reflect its impact on the economy, given the still high level of French claims (€29bn) on Greek banks. We cut our 2012 and 2013 GDP forecasts by 0.2ppt to -0.1% and by 0.6ppt to -0.1%, respectively.

Italy

We revised our forecasts for Italy's GDP growth from -2.2% to -2.5% for 2012 and from -0.9% to -2.0% for 2013 partly reflecting the negative impact of Grexit on Italian financing conditions and consumer and business sentiment. Based on the deficit numbers to date, we expect that the Government's planned fiscal adjustment of 2.9% of GDP in 2012 will not be enough to reduce the deficit to 1.6% of GDP by year-end. As a reaction to this the Government might put in place additional cuts in public consumption. Over the medium term, we believe Italy's growth potential will stay weak because the adoption of new (and the implementation of) structural reforms is likely to slow markedly as we approach the April 2013 elections.

Figure 24. Germany, France and Italy — Economic Forecasts, 2011-13F

		Germany			France			Italy		
		2011	2012F	2013F	2011	2012F	2013F	2011	2012F	2013F
Real GDP	YoY	3.1%	1.4%	1.0%	1.7%	-0.1%	-0.1%	0.5%	-2.5%	-2.0%
Final Domestic Demand	YoY	2.4	1.2	1.6	0.9	0.1	0.2	-0.3	-3.9	-3.4
Private Consumption	YoY	1.4	1.1	1.5	0.3	0.2	0.2	0.2	-2.7	-2.4
Fixed Investment	YoY	6.6	1.7	3.5	3.6	-0.9	-0.5	-1.2	-8.5	-8.2
Exports	YoY	8.4	3.4	2.7	5.5	2.8	4.0	6.4	0.4	-0.5
Imports	YoY	7.5	2.9	4.3	5.2	0.3	3.4	1.3	-6.9	-5.3
CPI	YoY	2.3	2.1	2.3	2.3	2.3	1.0	2.9	3.6	2.0
Unemployment Rate	%	6.0	5.4	5.3	9.3	9.5	9.3	8.4	9.8	11.0
Current Account	€bn	147.7	141.2	119.6	-43.4	-38.3	-21.7	-50.5	-36.5	-27.3
	% of GDP	5.8	5.4	4.5	-2.2	-1.9	-1.1	-3.2	-2.3	-1.8
General Govt. Balance	€bn	-26.7	-12.8	-8.7	-103.1	-90.2	-85.0	-62.4	-44.6	-40.9
	% of GDP	-1.0	-0.5	-0.3	-5.2	-4.4	-4.1	-3.9	-2.9	-2.7
General Govt. Debt	% of GDP	81.2	82.9	82.4	86.0	93.3	99.0	120.6	129.3	134.7
Gross Trading Profits	YoY	1.5	-0.2	0.6	3.0	0.0	1.0	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, and Citi Investment Research and Analysis

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Spain

This month we have revised up our GDP growth forecasts for 2012 from -2.7% to -2.2% based on a better-than-expected outturn for Q1 GDP and an increase in net exports due to a larger compression of imports. We continue to expect the recession to deepen over the course of 2012, and we have downgraded our GDP growth forecast for 2013 from -1.3% to -2.6% due to adverse base effects and the negative impact of Grexit on Spanish exports and domestic investment. Weaker 2013 growth also implies a larger 2013 budget deficit, and we now expect Spanish gross general government debt to peak at 102% of GDP in 2015/16.

Greece

Grexit is our base case and in our forecasts we assume that Greece returns to the Drachma in 2013. GDP is likely to fall sharply in 2012 (-7.4%) and 2013 (-10.1%). We expect domestic demand to plummet in 2H this year and in 2013. A currency depreciation by about 60% is likely to lead to a significant improvement in net exports in the course of 2013 and will probably help to limit the GDP contraction to 0.9% in 2014. The weak currency and accommodative monetary policy is likely to lead to double digit inflation in 2013/14. Even with a moratorium on interest payments, we think the weakening currency will lead to a massive rise in the public debt-to-GDP ratio, and we assume sizeable debt restructuring further ahead.

Ireland

Ireland's fiscal deficit fell below target in 2011, but the outlook remains fragile, with the high structural fiscal deficit, renewed recession and rapid rise in the government debt/GDP ratio. Weakness in real and nominal GDP is likely to cap government revenues and push the public debt/GDP ratio above 130% of GDP in 2014 or 2015. As a result, we continue to expect that — regardless of the referendum outcome over the Fiscal Compact — Ireland will need (and get) a second bailout beyond 2013. Eventually, Ireland may need extensive public and private debt restructuring.

Portugal

We are raising our GDP forecast for 2012 up by 0.9ppt in light of the smaller-than-anticipated contraction of 0.1% of GDP in Q1. But, we expect the Greek crisis will hit Portugal's very depressed economy. We assume that Portugal will get a second Troika programme this autumn to cover its funding needs through to 2015, with no debt restructuring initially. However, some time in 2014 it will probably become apparent that fiscal position remains unsustainable. We expect that a third Troika programme will then be granted together with a substantial debt write-off.

Figure 25. Spain, Greece, Ireland and Portugal — Economic Forecasts, 2011-13F

		Spain			Greece			Ireland			Portugal		
		2011	2012F	2013F	2011	2012F	2013F	2011	2012F	2013F	2011	2012F	2013F
Real GDP	YoY	0.7%	-2.2%	-2.6%	-6.9%	-7.4%	-10.1%	0.7%	-0.8%	0.4%	-1.6%	-4.6%	-5.2%
Final Domestic Demand	YoY	-1.7	-5.7	-6.1	-9.6	-9.1	-12.5	-3.0	-4.8	-2.4	-5.3	-7.9	-5.3
Private Consumption	YoY	-0.1	-2.6	-4.2	-7.1	-8.4	-12.0	-2.7	-1.7	-2.3	-3.9	-5.9	-4.1
Fixed Investment	YoY	-5.1	-10.7	-9.8	-20.6	-15.7	-18.6	-10.6	-21.4	-17.9	-11.5	-15.8	-10.5
Exports	YoY	9.1	-2.2	-1.8	-0.8	0.9	0.3	4.1	2.9	4.0	7.4	1.3	0.3
Imports	YoY	-0.1	-13.5	-14.4	-8.0	-12.9	-8.6	-0.6	0.4	2.5	-5.4	-7.3	-1.2
CPI	YoY	3.1	2.2	2.3	3.1	1.2	15.3	-0.4	0.1	0.2	3.6	3.1	2.2
Unemployment Rate	%	21.6	24.5	25.9	17.3	21.9	27.8	14.4	15.1	16.6	12.7	16.0	18.5
Current Account	€bn	-37.8	-22.0	-10.4	-21.1	-17.3	-7.8	0.1	5.0	5.6	-13.9	-7.5	-4.0
	% of GDP	-3.5	-2.1	-1.0	-9.6	-8.4	-4.4	0.1	3.2	3.6	-8.1	-4.6	-2.5
General Govt. Balance	€bn	-95.3	-67.8	-66.8	-19.6	-21.6	-4.7	-20.4	-14.4	-15.2	-7.3	-3.9	-6.4
	% of GDP	-8.9	-6.4	-6.3	-9.1	-10.7	-5.8	-13.0	-9.3	-9.7	-4.2	-5.5	-4.1
General Govt. Debt	% of GDP	72.3	88.1	97.9	165.3	155.7	434.8	108.2	121.0	128.8	107.8	119.8	132.5

F Citi forecast. YoY Year-to-year growth rate. For Ireland we show the GDP deflator rather than the CPI. Sources: ISTAT, INE, Haver Analytics, Eurostat, and CIRA

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Netherlands

The Netherlands are heading for early elections in September, but the incumbent minority government managed to get parliamentary approval for a €16bn austerity package targeted to reduce the general government deficit-to-GDP ratio to 3% in 2013. With the extra austerity measures, including a planned VAT rate hike in October, we left our GDP forecast for 2012 unchanged, despite a smaller contraction in 1Q GDP, and expect a contraction in 2013 also. We do not expect that the government will meet the 3% deficit target in 2013.

Belgium

Although GDP growth surprised to the upside in Q1 (+0.3% QoQ, 0.5% YoY), we argue that Grexit will be damaging for confidence and that financial market volatility will be detrimental to economic activity. As a result, we lowered our 2013 GDP forecast by 1.0ppt to 0.1%. The Belgian finance ministry's latest budget plans envisage a slightly smoother path to budget balance in 2015, showing that the debate about growth has emboldened the government to do a little less in terms of fiscal austerity. Their forecasts of a 2.1% (Citi 2.9%) deficit in 2013, compared to a 2.8% (Citi 3.2%) target for 2012, look optimistic in our view.

Slovakia

We keep our recently upgraded forecast of GDP growth of 2.2% YoY in 2012 after it surged by 0.8% QoQ in 1Q12, boosted by the car sector. GDP details will be released on 6 June, but we do not believe that domestic demand recovered strongly given the limited improvement of employment. The "Grexit" scenario could put Slovak assets under pressure, particularly if the new left-wing government starts to flirt with pro-growth measures at the expense of the consolidation effort. However, 88% of the government borrowing requirements have been covered in May.

Slovenia

Pre-election polls suggest weaker support for the coalition parties after the recent approval of austerity measures. Moreover, consumer confidence fell in April and recent readings suggest that GDP in early 2012 is down by more than 2%YoY (it was -1.5%YoY in 4Q11). The austerity measures probably will cut the general government deficit to about 4% of GDP in 2012 from 6.4% last year. The government has planned to implement the fiscal "golden rule" of a balanced budget, but it failed to gain the necessary 2/3 majority in Parliament. However, political leaders seem to agree on changes that could curb the use of referendums in the future, as the current system seems to represent a block to reforms.

Figure 26. Netherlands, Belgium, Slovakia and Slovenia — Economic Forecasts, 2011-2013F

		Netherlands			Belgium			Slovakia			Slovenia		
		2011	2012F	2013F	2011	2012F	2013F	2011	2012F	2013F	2011	2012F	2013F
Real GDP	YoY	1.3%	-1.5%	-0.6%	2.0%	0.0%	0.1%	3.3%	2.2%	1.8%	0.2%	-1.3%	1.0%
Final Domestic Demand	YoY	0.7	-1.6	-1.0	2.5	-0.3	0.3	0.6	1.0	1.1	-2.6	-2.6	0.1
Public Consumption	YoY	0.2	-0.5	-0.6	0.6	0.1	0.0	-3.5	-0.6	-1.2	-0.9	-2.3	-0.4
Private Consumption	YoY	-1.1	-1.5	-1.2	0.9	-0.1	0.2	-0.4	-0.4	0.6	-0.1	-0.9	0.8
Investment (Ex Stocks)	YoY	5.8	-3.6	-1.0	5.2	-0.3	0.7	5.7	4.9	3.5	-10.2	-5.2	-1.5
Exports	YoY	3.8	3.4	1.7	4.4	0.7	2.5	10.8	6.4	4.5	7.8	-2.1	1.8
Imports	YoY	3.5	3.2	1.5	5.1	0.4	2.0	4.5	5.1	4.2	4.7	-2.9	1.6
CPI (Average)	YoY	2.3	2.8	2.6	3.5	2.9	1.7	3.9	3.7	3.1	1.8	2.7	3
Unemployment Rate	%	5.3	6.2	6.4	7.2	7.6	8.0	13.2	13.6	13.5	8.2	9.3	10.3
Current Account	% of GDP	9.0	9.8	9.5	-0.8	-0.2	0.3	0.2	1.3	0.8	-1.5	-0.8	0.3
General Govt Balance	% of GDP	-4.7	-4.5	-3.5	-3.7	-3.2	-2.9	-4.8	-4.7	-3.2	-6.4	-4.0	-3.2
General Govt Debt	% of GDP	65.2	69.9	73.0	98.1	112.2	118.8	43.4	45.7	47.3	47.6	51.5	53.3

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

UK

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We are cutting our UK forecasts, and now expect GDP to fall by 0.2% this year and rise by 0.5% in 2013, versus forecasts for growth of 0.2% and 1.0% respectively last month. The downgrades partly reflect greater than expected weakness in Q1 GDP, which fell 0.2% QoQ (we had expected roughly unchanged GDP). In addition, the EMU crisis is capping growth prospects, with the recent appreciation of sterling, prospects for a longer period of EMU economic weakness, and heightened uncertainties. Real GDP is still about 4% below the pre-recession peak after 16 quarters: markedly underperforming versus the major recession/recovery cycles of the 1930s, 1970s, 1980s and 1990s. We expect the economy to remain sluggish even beyond 2013 given the headwinds from high household debt and fiscal drag.

Inflation has remained sticky in recent months, and may well remain sticky in the immediate near term, reflecting gains in food and energy prices, indirect tax increases plus some lagged effects from the plunge in sterling during 2007-09. However, whereas we have repeatedly warned in the last few years that inflation would overshoot consensus and BoE forecasts, we now believe medium-term inflation risks are tilted to the downside and (unless oil and commodity prices surge) inflation probably will fall below target in 2013. The fiscal deficit will fall sharply, to 6-7% of GDP in 2012E/13E, because of the absorption of the pension fund of the state-owned postal service. But the medium-term trend is of a gently falling deficit, with the general government gross debt/GDP ratio likely to reach about 100% in 2014 or 2015. The MPC kept policy on hold in May, but probably will have to restart QE in coming months if, as we expect, the escalating EMU crisis threatens to prolong the UK's economic weakness.

Figure 27. United Kingdom — Economic Forecasts, 2011-2013F

					2012				2013			
		2011	2012F	2013F	1QF	2QF	3QF	4QF	1QF	2QF	3QF	4QF
Real GDP	YoY	0.6%	-0.2%	0.5%	0.0%	0.0%	-0.5%	-0.2%	0.2%	0.6%	0.7%	0.6%
	SAAR				-0.8	-0.2	0.2	0.0	0.9	1.3	0.6	-0.2
Domestic Demand (Incl. Inventories)	YoY	-0.8	-0.5	-0.5	0.4	-0.2	-1.1	-1.1	-1.2	-0.7	-0.2	-0.1
	SAAR				0.5	-1.2	-1.6	-2.2	0.2	0.9	0.2	-1.5
Consumption	YoY	-1.2	0.7	0.7	0.1	0.8	1.1	0.8	0.5	0.6	0.8	1.0
	SAAR				1.6	0.8	0.4	0.3	0.4	1.4	0.9	1.3
Investment	YoY	-1.2	-3.9	-8.1	0.7	-1.7	-4.9	-9.8	-10.8	-8.6	-6.9	-5.8
	SAAR				3.2	-9.9	-10.2	-20.6	-1.5	-0.4	-3.5	-16.9
Exports	YoY	4.6	2.7	5.7	-0.6	2.5	4.2	4.7	6.0	6.2	5.7	4.9
	SAAR				0.5	3.6	6.5	8.4	5.5	4.5	4.3	5.5
Imports	YoY	1.2	1.0	2.2	0.7	1.4	1.3	0.7	1.3	2.1	2.7	2.8
	SAAR				0.9	0.3	0.4	1.1	3.4	3.4	2.9	1.4
Unemployment Rate	%	8.1	8.7	9.5	8.2	8.5	9.0	9.2	9.4	9.5	9.5	9.5
CPI Inflation	YoY	4.5	2.9	1.8	3.5	3.1	2.8	2.3	2.0	1.9	1.8	1.7
Merch. Trade	£bn	-99.7	-82.0	-67.5								
	% of GDP	-6.6	-5.3	-4.3								
Current Account	£bn	-29.0	-20.0	-7.6								
	% of GDP	-1.9	-1.3	-0.5								
PSNB	£bn FY	-126.0	-100.3	-123.5								
	% of GDP	-8.3	-6.5	-7.8								
General Govt. Balance	% of GDP	-8.3	-6.3	-7.7								
Public Debt	% of GDP	82.9	87.5	94.7								
Gross Nonoil Trading Profits	YoY	3.5	-1.2	5.0								

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

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Switzerland

We continue to expect modest growth coupled with persistent deflation this year and in 2013. The Q1 GDP data (released end-May) will probably show growth of about 0.1% QoQ, the same as Q4. April survey readings were mixed, with a pick up in the Kof but weaker PMI and at this stage we expect that Q2 growth again will be slightly positive. With steady deflation (CPI inflation was minus 1.0% YoY in March and April), the SNB will continue to firmly resist CHF appreciation. We expect that the policy rate will stay at zero to the end of the forecast horizon (end-2016).

Sweden

Economic activity in Sweden is set to slow markedly this year, and we have cut our 2012 GDP growth forecast by 0.3pp to 0.4%, on an expectation of a larger negative contribution from stock building. The slowdown will primarily be driven by weaker exports (about 70% of exports stay within Europe and Sweden is heavily dependent on cyclically sensitive investment and intermediate goods), but private consumption will also moderate substantially, reflecting a weaker housing market and only limited support from economic policies. The Riksbank is expected to continue to cut rates to 1% this year due to rising unemployment and low inflation.

Denmark

Denmark was in a technical recession in the second half of 2011, with government consumption being the largest negative factor. Denmark is set for a long period of sluggish economic activity. The EMU crisis will probably hit exports. Moreover, although the reimbursement of contributions to the voluntary early retirement pension scheme is likely to support consumers, the weak housing market, stagnating labour market and continued balance sheet deleveraging will likely continue to weigh on spending. Investment is expected again this year to be driven largely by public initiatives as part of the government's "kick-start" stimulus package.

Norway

Norway's economy has so far been largely unaffected by the global slowdown, thanks to high activity in the oil sector and a pickup in private consumption. Fiscal policy is also supportive (0.75% of mainland trend-GDP). Norges Bank cut interest rates by 25bp to 1.5% in March, reflecting euro area strains, low domestic inflation, a strong krone and continued financial market unrest. Unless the NOK appreciates strongly, the sight deposit rate should remain stable for the remainder of the year. Domestic conditions do not warrant a lower policy rate and low rates could fuel a housing bubble.

Figure 28. Switzerland, Sweden, Denmark and Norway — Economic Forecasts, 2011-2013F

		Switzerland			Sweden			Denmark			Norway		
		2011	2012F	2013F	2011	2012F	2013F	2011	2012F	2013F	2011	2012F	2013F
Real GDP	YoY	1.9%	0.7%	0.9%	4.0%	0.4%	2.0%	1.0%	0.6%	1.2%	2.5%	3.0%	2.9%
Final Domestic Demand	YoY	1.8	1.7	0.1	2.8	0.6	1.8	-0.5	1.1	1.1	3.2	2.7	3.3
Public Consumption	YoY	1.7	1.2	0.9	1.8	0.5	0.8	-1.0	0.7	0.1	1.6	1.9	2.2
Private Consumption	YoY	1.0	1.1	0.3	2.1	0.8	1.9	-0.5	0.6	1.3	2.4	2.9	2.9
Investment (Ex Stocks)	YoY	3.9	3.7	-0.9	6.3	0.4	2.9	0.4	2.8	2.1	8.1	3.5	6.4
Exports	YoY	3.4	0.4	2.5	7.0	0.3	3.4	6.8	1.1	2.7	1.0	2.5	4.9
Imports	YoY	1.9	0.0	1.2	6.3	-1.0	3.3	5.3	0.9	2.7	2.9	2.5	4.3
CPI (Average)	YoY	0.2	-1.1	-1.5	3.0	1.2	1.6	2.7	2.2	1.7	1.3	1.3	1.8
Unemployment Rate	%	3.1	3.3	3.8	7.5	7.8	8.0	7.6	7.7	7.8	3.3	3.4	3.4
Current Account	% of GDP	15.0	13.8	14.0	7.2	7.0	7.3	6.5	5.8	5.5	14.0	14.3	14.9
General Govt Balance	% of GDP	0.6	0.2	-0.2	0.2	-0.4	-0.2	-1.9	-4.0	-2.4	13.8	13.6	14.0
General Govt Debt	% of GDP	52.6	51.7	51.3	36.9	36.7	35.6	44.0	46.8	47.9	NA	NA	NA

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

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Canada

In April, the Bank of Canada posted a revised base-case that is largely more optimistic than our own. Moreover, the Bank adopted a slightly hawkish stance — stating that some extraordinary monetary policy stimulus may need to be removed. The change reflected the bank's belief that certain downside risks were less acute and that uncertainties were reduced. We posit that the change in rhetoric was also a signal to markets that the BoC will continue to operate independently of other central banks in order to achieve its 2% inflation target, as well as a message to domestic lenders and borrowers that interest rates likely will rise sooner than later.

Financial market activity and economic developments since have been mixed. Externally, US domestic demand strengthened and the surge in global energy prices, from which Canada did not benefit, is reversing. However, concerns about re-intensification of the EA sovereign debt and banking crisis are heightened, with the threat of a possible Greek exit from the euro. The risks around the US 2013 fiscal cliff loom large, and concerns that the Chinese economy may moderate more sharply than expected are weighing on markets and commodity prices.

Domestically, Canadian employment data have been spectacular, and wage income is becoming more supportive of debt-free spending and possible consumer deleveraging. Housing excess remains apparent in selected markets, boosting its contribution to growth. However, it appears that the Canadian economy may not expand as rapidly in the first half of this year as policymakers anticipated amid subdued exports, reduced North American demand for Canadian energy products, and unplanned production shutdowns in the natural resources sector.

Moderate growth, inflation gauges near the 2% target and balanced risks all suggest that the bank will bide its time until key uncertainties are resolved. Hence, we maintain our longstanding call of fixed rates through yearend and a 1Q 13 hike.

Figure 29. Canada — Economic Forecast, 2011-2013F

		2011	2012F	2013F	2012F				2013F			
					1QF	2QF	3QF	4QF	1QF	2QF	3QF	4QF
Real GDP	YoY	2.5%	2.0%	2.3%	1.8%	2.4%	1.9%	2.0%	2.1%	2.3%	2.4%	2.6%
	SAAR				2.0	1.8	2.0	2.4	2.1	2.5	2.6	3.1
Final Domestic Demand	YoY	3.0	1.8	2.6	2.0	1.6	1.7	1.9	2.2	2.6	2.8	2.9
	SAAR				1.7	1.1	2.0	2.7	2.9	2.9	2.8	2.9
Private Consumption	YoY	2.2	1.7	2.3	1.8	1.6	1.7	1.6	2.0	2.3	2.4	2.4
	SAAR				0.5	1.1	2.1	2.5	2.4	2.4	2.4	2.4
Government Spending	YoY	0.5	-2.2	0.6	-2.4	-2.6	-2.3	-1.3	0.1	0.7	0.9	0.9
	SAAR				-4.8	-1.5	0.1	1.0	0.9	0.9	0.9	0.9
Private Fixed Investment	YoY	9.3	6.5	5.9	7.6	6.4	6.1	5.8	5.1	5.7	6.2	6.6
	SAAR				10.1	4.1	4.0	5.3	6.9	6.6	6.1	7.0
Exports	YoY	4.4	6.2	3.6	5.8	8.4	5.5	5.3	3.3	3.2	3.6	4.2
	SAAR				9.9	3.7	3.8	3.9	2.0	3.3	5.4	6.2
Imports	YoY	6.5	3.3	4.5	4.6	1.8	3.2	3.8	3.7	4.4	4.7	5.0
	SAAR				4.6	2.0	4.0	4.5	4.5	4.5	5.5	5.5
CPI	YoY	2.9	1.8	1.7	2.3	1.8	1.6	1.5	1.5	1.3	1.8	2.3
Core CPI	YoY	1.7	2.1	2.2	2.1	2.1	2.0	2.0	2.2	2.2	2.3	2.1
Unemployment Rate	%	7.5	7.2	6.8	7.4	7.2	6.9	7.2	7.1	6.9	6.5	6.8
Current Account Balance	C\$b	-48.3	-29.1	-30.4	-25.1	-26.7	-31.4	-33.3	-28.1	-31.9	-32.6	-28.9
	% of GDP	-2.8	-1.6	-1.6	-1.4	-1.5	-1.7	-1.8	-1.5	-1.7	-1.7	-1.5
Net Exports (Pct. Contrib.)		-1.3	0.6	-0.7	1.3	0.4	-0.4	-0.6	-1.3	-0.9	-0.6	-0.3
Inventories (Pct. Contrib.)		0.2	-0.2	0.2	0.5	0.2	0.2	0.1	0.3	0.3	0.2	0.2
Budget Balance (Fiscal Year)	% of GDP	-1.4	-1.2	-0.5								
Federal Budget Debt	% of GDP	33.5	33.4	32.4								
General Govt. Debt	% of GDP	85.0	84.9	83.9								

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

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Australia

Uncertainty from Europe's debt crisis has slightly outweighed the positive effect of the RBA's 50bp interest rate cut to weaken expectations about economic activity. Households have become more cautious in their attitudes to spending, which has not been helped by the impending introduction of the new carbon tax that starts on July 1 or reports of job losses from some major companies and at least one State government. We have reflected these developments through a downgrade to our 2012 growth forecast (from 3.4% to 2.8%). Slower non-mining expenditure growth is likely to keep inflation at the bottom end of the RBA's 2-3 percent target band. Combined with a further slight deceleration in Chinese GDP growth in Q2, we expect the RBA to take out some insurance shortly afterwards with a 25 bp easing of monetary policy in Q3. This would take the cash rate target to 3.50%, which is mildly expansionary and helps lays the foundation for an acceleration in economic activity in 2013.

New Zealand

Recent economic data continues to suggest that the New Zealand economy will grow at a sub-trend pace. Employment improved in Q1, but intentions towards hiring and household wealth (via lower house prices) retreated at the start of Q2, arguing against any near-term improvement in business activity and consumer expenditure. Events from overseas have not helped, with renewed European concerns driving global commodity prices lower, which are likely to be felt through lower prices for dairy exports, an important commodity for the New Zealand economy. Any moderation in exports while the domestic sector remains well below trend continues the argument for low and stable monetary policy. If not for the recent fall in the exchange rate, the RBNZ may consider easing monetary policy further in coming months.

Figure 30. Australia and New Zealand — Economic Forecast, 2011-2013F

	Australia			New Zealand		
	2011	2012F	2013F	2011F	2012F	2013F
Real GDP ^a	2.0%	2.8%	3.5%	1.3%	1.8%	2.3%
Real GDP (4Q versus 4Q)	2.3	3.0	3.3	1.8	2.5	2.0
Real Final Domestic Demand	4.1	3.7	3.7	2.3	1.7	2.8
Consumption	3.4	3.1	3.2	2.5	2.3	2.1
Govt. Current & Capital Spending ^b	-0.6	-0.2	0.6	1.8	1.3	1.3
Housing Investment	1.1	-2.4	4.8	-12.0	7.4	12.6
Business Investment ^c	16.9	13.2	9.0	6.9	0.1	5.0
Exports of Goods & Services	-1.6	2.5	8.0	2.4	4.0	1.6
Imports of Goods & Services	11.6	6.2	8.0	6.0	2.7	3.7
CPI	3.4	1.9	3.4	4.0	1.6	2.4
CPI (4Q versus 4Q)	3.1	2.7	3.1	1.8	2.2	2.4
Unemployment	5.1	5.4	5.0	6.5	6.4	5.6
Merch. Trade, BOP (Local Currency, bn)	18.1	-10.9	-32.1	3.3	2.4	-0.4
Current Account, (Local Currency, bn)	-32.6	-60.0	-92.5	-8.3	-10.8	-16.3
Percent of GDP	-2.3	-4.0	-5.8	-4.0	-5.2	-7.6
Budget Balance ^d (Local Currency, bn)	-47.7	-44.4	1.5	-15.9	-12.1	-6.5
Percent of GDP	-3.4	-3.0	0.1	-8.0	-5.9	-3.1
General Govt. Debt (% of GDP) ^e	5.9	9.6	9.2	20.9	26.8	30.0
Gross Trading Profits ^f	6.2	3.9	7.3	NA	NA	NA

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

China

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Data for April were weak across the board, prompting the recent RRR cut. Imports stagnated, confirming weak domestic demand. Industrial value added grew 9.3% YoY, the lowest since May 2009. Property investment growth plummeted from 19.6% YoY in Mar to 9.2% in Apr, and data on new residential starts and land acquisition predicts further slowdown in the months ahead. Retail sales growth slowed to 14.1% YoY. M2 growth fell from 13.4% YoY in Mar to 12.8% in Apr (relative to the PBOC forecast of 14% growth for 2012), and monthly RMB lending fell from 1,011bn to 682bn. Fiscal revenue growth fell to 6.9% YoY (tax revenue 2.6% YoY), from 18.7% in Mar and 25% in 2011. In response, the PBOC cut the RRR by 50bps effective on May 18, unlocking about Rmb400bn of deposits.

We expect the downside risks to trigger further policy easing. The political economics in a year of leadership transition suggest that the authorities would not like to see a continued economic slowdown into Q3, right before the National Party Congress. We see the latest RRR cut as the beginning of more resolute policy easing. Further policy easing may include: (i) two additional RRR cuts this year to bring M2 growth to 14%; (ii) fiscal deficit close to the budgeted level (effectively 2.4% of GDP); (iii) extension of property policy easing from first home purchase to second home purchase, accompanied by adequate funding of social housing programs; (iv) launch of new infrastructure projects under the 12th Five-Year Plan.

Above-8% growth is still achievable with sustained policy easing. Based on the recent data and assumption on continued policy easing, we have cut our 2012 growth forecast from 8.4% to 8.1%. In particular, total FAI growth is revised down from 18-19% to 16-17%. The slowing investment is expected to have a spillover effect on consumption. We keep the contribution of net export to growth at -0.7ppt, assuming weakening exports (especially due to possible escalation of the European sovereign crisis) are to be offset by slowing domestic demand and imports. We also downgrade Q2 growth from 7.9% to 7.5% YoY. The risk of below-8% growth becomes clear if policy easing continues to lag behind the economy's needs.

Figure 31. China — Economic Forecasts, 2011-2013F

					2012F				2013F			
		2011	2012F	2013F	1QF	2QF	3QF	4QF	1QF	2QF	3QF	4QF
Real GDP	YoY	9.2%	8.1%	8.5%	8.1%	7.5%	8.3%	8.4%	8.6%	8.8%	8.7%	8.1%
Real Final Domestic Demand	YoY	10.4	9.2	9.1								
Consumption	YoY	10.0	9.6	9.4								
Fixed Capital Formation	YoY	10.8	8.8	8.7								
Industrial Production	YoY	13.9	11.5	12.3	11.6	10.1	11.8	12.5	12.6	12.3	12.1	12.0
Exports	YoY	20.3	6.5	13.1	7.6	4.2	5.5	8.8	11.0	12.0	14.0	15.0
Imports	YoY	24.9	9.1	15.1	6.9	6.1	9.6	13.3	13.0	14.0	16.0	17.0
Merchandise Trade Balance	\$bn	155	120	98	1	40	47	32	-8	36	44	26
FX Reserves	\$bn	3,181	3,413	3,530	3,305	3,370	3,408	3,413	3,405	3,441	3,500	3,530
Current Account	% of GDP	2.8	2.0	1.5								
Fiscal Balance	% of GDP	-1.3	-2.4	-1.5								
General Govt. Debt	% of GDP	15.3	16.1	15.8								
Urban Unemployment Rate	%	4.1	4.2	4.1	4.1	4.2	4.2	4.2	4.1	4.1	4.1	4.1
CPI	YoY	5.4	3.5	3.5	3.8	3.6	3.0	3.7	3.8	3.3	3.0	3.8
Exchange Rate (end period)	CNY/\$	6.29	6.27	6.15	6.30	6.33	6.31	6.27	6.23	6.20	6.17	6.15
1-Yr Deposit Rate (end period)	%	3.50	3.50	3.75	3.50	3.50	3.50	3.50	3.75	3.75	3.75	3.75

Note: F Citi forecast. E Citi estimate. YoY Year-to-year percent change. SAAR Seasonally adjusted annual rate. *Based on official data. The ratio was roughly 50% in 2010 if the debt of Ministry of Railway and local government debt as audited by the National Auditing Office are included. Sources: Haver Analytics and Citi Investment Research and Analysis

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India

There is now near-consensus that the India story has de-rated, with growth at best likely in the 6.5% to 7% range during FY13. The unfortunate part is that the problems appear self-inflicted with, in our view, India now seen to be specializing in scoring 'own goals' — e.g. (a) inordinate delays in project approvals and fuel supply issues (b) controversies surrounding foreign investment. Added to this is the issue of the 'quadruplet' deficits (see [India Macroscope - Deficits – Not Twins, But Quadruplets](#)) — (1) current a/c at ~4% of GDP, (2) fiscal (government profligacy), (3) governance (self-inflicted) and (4) liquidity (cyclical, with strains of structural). All of this is reflected in S&P's recent sovereign outlook downgrade of India from Stable to Negative, coupled with its statement that *"there is a one-in-three likelihood of a downgrade over the next 24 months* (current rating is at BBB-).".

There is no simple fix: the vicious deficit mix is feeding on and across itself. The solution lies in, first, an aggressive thrust on fiscal consolidation, policy and execution reform; and second, India needs a bit of luck on lower oil prices, weaker inflation and stronger capital flows. It needs a mix of both to regain its luster — and at least one of the two to maintain its current momentum.

A point to note is that our macro forecasts have incorporated crude at US\$125/bbl. A drop of about 10\$bbl in oil prices would (a) reduce the CAD by 10% and consequently external financing requirements by 10% (b) lower the subsidy bill and (c) temper inflation and thus provide the RBI more leeway on the rate front. (Our base case is for 25bps easing in 2012.)

On the external front, given global macro issues coupled with India's rising financing requirements, there is a near-consensus worry on financing the current account deficit, which is roughly 4% of GDP (ie US\$77bn). Thus, despite forex reserves at US\$265bn and the likelihood of the RBI taking more measures to attract dollar inflows, declining confidence has taken a toll on the currency with the unit down 20% YTD with investor consensus expectations of the unit touching Rs60/\$. Our 6-12-month view is of the INR at Rs55.

Figure 32. India — Economic Forecasts, FY2012/13-2014/5F

		FY 12/13F	FY 13/14F	FY 14/15F
Real GDP	YoY	7.0%	7.5%	8.2%
Final Domestic Demand	YoY	6.3	7.1	7.8
Private Consumption	YoY	6.5	6.7	7.0
Fixed Investment	YoY	6.5	8.0	10.0
Exports	YoY	13.5	15.0	11.0
Imports	YoY	8.3	10.8	9.3
Wholesale Price Index*	YoY	7.4	6.5	6.0
Consumer Price Index	YoY	7.0	6.5	6.0
Current Account	US\$ bn	-77	-76	-74
	% of GDP	-4.1	-3.4	-2.7
Consolidated Fiscal Balance	% of GDP	-8.0	-7.7	-7.0
Centre Fiscal Balance	% of GDP	-5.5	-5.0	-4.5
US Dollar Exchange Rate	Average	54.5	52.5	50.8

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

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Korea

We are cutting our 2012 growth forecast to 3.4% from 3.7% previously, and cutting our 2013 forecast to 4.2% from 4.4%, given recent developments in the global economy as well as the EMU sovereign debt crisis. Weaker-than-expected economic growth in China and the soft European economy with political uncertainty are expected to hit external demand for Korea exports and also cap domestic demand further as well. Facilities investment rebounded rapidly in 1Q12 on expectations that the global economy will recover in 2H12, but now probably will be restrained. We cut our forecast for 2012 CPI inflation by 0.1ppt to 3.0%, reflecting government measures such as free child care and the cut in college tuition fees. Despite these government policies and the decline in oil prices, KRW weakness in a "risk-off" environment is likely to remain as the main source of inflationary pressure, along with public service tariff hikes. We think that the authorities are highly likely to intervene in FX markets to prevent excessive weakening of KRW and to reduce inflationary pressures from imported goods. Since the economy is expected to expand, albeit slower than expected, and inflation concern seems set to persist throughout this year, the BoK will likely leave the policy rate unchanged in 2012.

Indonesia

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Stagnant exports have led to a slow-down in GDP growth to 6.3% in 1Q-12, from 6.5% in 4Q-11. However, consumption growth was relatively resilient. With oil prices falling, the likelihood of fuel prices being raised anytime soon is diminishing. In this regard, we expect end-2012 inflation would be close to 4.8% YoY without a fuel price hike. Yet despite the apparently more benign inflation outlook, the BI may not turn dovish very easily. The current account has deteriorated fast, registering an annualized deficit equivalent to 1.3% GDP in 1Q12 (from 0.8% in 4Q12). The widening of the CA deficit outpaced the growth of FDI, both on net and gross bases. We don't think the coast is clear yet; although lower oil prices will help prevent further swelling of the oil trade deficit, non-oil commodities (e.g. coal) are also sliding. We revise our FY12 CA deficit forecast to 1.0% of GDP from 0.7% previously and see continued pressure on the IDR. To support the balance of payments, BI has hinted at scaling down its bond buying operations, in order to let yields rise and recover market demand. We still expect the O/N rate to stay on hold this year but now do not rule out an increase next year, given the structural CA deficit.

Figure 33. Korea and Indonesia — Economic Forecasts, 2011-2013F

		Korea			Indonesia		
		2011	2012F	2013F	2011	2012F	2013F
Real GDP	YoY	3.6%	3.4%	4.2%	6.5%	6.2%	6.5%
Final Domestic Demand	YoY	1.3	2.6	4.3	5.7	7.3	6.8
Private Consumption	YoY	2.3	1.7	3.6	4.7	4.8	5.0
Fixed Investment	YoY	-1.1	4.1	6.6	8.8	11.4	11.4
Exports	YoY	9.5	4.3	7.6	13.6	4.6	12.0
Imports	YoY	6.5	3.5	7.4	13.3	6.7	15.4
Consumer Price Index	YoY	4.0	3.0	3.2	5.4	4.4	4.7
Unemployment Rate	%	3.4	3.3	3.2	6.6	6.1	5.9
Current Account	US\$ bn	26.5	12.0	8.7	2.1	-9.6	-9.1
	% of GDP	2.4	1.1	0.7	0.2	-1.0	-0.9
Fiscal Balance	% of GDP	1.5	1.4	1.2	-1.2	-1.8	-0.7
US Dollar Exchange Rate	Average	1108	1158	1095	8763	9285	9382

Sources: Haver Analytics and Citi Investment Research and Analysis

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Hong Kong

We cut our 2012 GDP forecast to 2.6% YoY (from 3% last month) to reflect lower-than-expected 1Q GDP (0.4% for both YoY and QoQ SA growth), China's slowdown, and the ongoing Euro sovereign crisis. Net exports will likely still be the main drag in 2Q, despite some cushioning from local consumption and exports of services (especially tourism). Inflation is falling as pass-through from home rentals has peaked and food prices retreat. Although we still expect the 2012 average inflation rate will be around 4% YoY, the year end rate may come below 3% YoY. Risk-off sentiments have dominated the equity markets and, with fund outflows, the HKD is likely to be around the middle of the trading band. Barring any unexpected counterparty risk that freezes banking funds, we expect only a very gradual rise in the HIBOR rates.

Singapore

Final estimates for 1Q GDP were similar to the Advance Estimate at 10% QoQ SAAR, 1.6% YoY. The surprisingly large jump in Apr NODX and 3%QoQ rise in the Composite Leading Indicator suggests positive growth momentum likely continued into early 2Q, but renewed global growth concerns suggest GDP momentum may moderate in 2H12. Inflation remains a pressing policy concern, with MAS tightening in April likely to be followed by non-monetary measures on the supply side. We suspect policymakers may be biased towards further tightening in October if growth surprises positively, and the hurdle for easing is high. The Hougang by-election on May 26th will be a barometer of public sentiment a year after the watershed General Elections, and could influence the pace of restructuring.

Taiwan

Downside growth risks prevail again and we are lowering our 2012 GDP forecast to 3.3% YoY from 3.5% last month. We expect less contribution from two key drivers. Exports remained lackluster in April, driven by slowing China demand, and will likely face headwinds from weaker global demand. Private consumption slows on flat wages and rising CPI inflation. The government decided to raise utility prices in three steps instead of one full adjustment to moderate the impact on CPI inflation, which we believe should be capped below 2% this year. The proposed capital gain tax has been sent for legislative approval that is likely to be passed in the next session. The CBC will likely keep policy rates unchanged for an extended period, with price stability concerns slightly dominating downside growth risks.

Figure 34. Hong Kong, Singapore and Taiwan — Economic Forecasts, 2011-2013F

		Hong Kong			Singapore			Taiwan		
		2011	2012F	2013F	2011	2012F	2013F	2011	2012F	2013F
Real GDP	YoY	5.0%	2.6%	4.2%	4.9%	3.6%	5.0%	4.0%	3.3%	4.2%
Final Domestic Demand	YoY	7.5	4.2	1.9	3.4	4.6	3.8	1.3	0.9	3.1
Private Consumption	YoY	8.4	3.8	2.0	4.1	3.8	4.8	3.0	2.2	3.3
Fixed Investment	YoY	7.3	6.0	2.0	3.3	9.0	2.7	-3.8	-2.4	4.9
Exports	YoY	4.2	0.6	7.0	2.6	3.8	5.9	4.5	2.6	6.2
Imports	YoY	4.6	1.1	6.1	2.4	5.2	6.6	-0.6	-0.6	5.1
CPI	YoY	5.3	4.0	3.0	5.2	4.4	3.3	1.4	1.9	2.1
Unemployment Rate	%	3.4	3.6	3.7	2.0	2.3	2.0	4.4	4.3	4.2
Current Account	US\$ bn	12.4	24.3	28.3	57.1	41.7	41.2	41.3	42.6	45.2
	% of GDP	5.1	9.4	10.2	21.9	15.0	13.0	8.8	8.7	8.4
Fiscal Balance	% of GDP	3.9	0.8	0.7	1.5	1.0	1.0	-1.9	-1.6	-1.6
US Dollar Exchange Rate	Average	7.78	7.76	7.76	1.26	1.26	1.22	29.40	29.76	28.70

Sources: Haver Analytics and Citi Investment Research and Analysis

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Russia

The current account surplus reached a record high of US\$43bn in 1Q due to oil prices trading above US\$120/bbl, but capital outflows of US\$38bn drained most of it and capital outflows continued at a similar pace in April. In the meantime, growth remained exceptionally strong in the first 4 months of 2012, owing to the high pre-election spending. In 2H2012, we expect growth to slow, but inflation to accelerate owing to the tariff increase, higher domestic demand, and base effects. With the increase in global risk aversion, the ruble is likely to suffer along with other high beta currencies even if oil prices remain stable, and is likely to trade in the 34-36 range against the basket. Furthermore we estimate the ruble is more sensitive to oil price declines, while rising prices bring little change to the exchange rate. The central bank's operational floating band is now in the 32.15-38.15 range; we expect the CBR to continue letting the ruble move with market pressure, while aiming to keep overnight rates close to 5-6%.

Turkey

It appears the CBT has started to pay more attention to inflation — a stance further reinforced by the higher-than-expected April inflation. Why is this so? In our view, the CBT is satisfied with the re-balancing process and developments on the growth front, which have, in turn, enabled it to refocus on inflation. Concerning the former, while the recent data provide encouraging signs, we think the external adjustment is likely to lose steam in 2H 2012, as economic activity picks up. Regarding the latter, the latest growth indicators seem to be in line with our “soft-patch” view. Where do we go from here? Given the sizeable discretion in the conduct of monetary policy, it remains to be seen whether the Bank will maintain its current stance. What is clear, however, is that, unlike the CBT's prediction, capital flows have not been particularly strong. In the absence of a pick-up in capital inflows, we believe the CBT will continue to worry about both the lira and inflation, which should make it harder for it to relax monetary policy without hurting market sentiment. All in all, the low likelihood of a tighter policy stance, the wide current account deficit, elevated inflation and uncertainties associated with monetary policy lead us to believe Turkish assets are likely to remain at the mercy of global risk appetite.

Figure 35. Russia and Turkey — Economic Forecast, 2009F-11F

		Russia			Turkey		
		2009F	2010F	2011F	2009F	2010F	2011F
Real GDP	YoY	4.3%	3.5%	4.0%	8.5%	2.5%	4.3%
Final Domestic Demand	YoY	1.7	1.5	2.0	9.8	1.6	4.5
Private Consumption	YoY	6.3	5.9	5.3	7.7	1.0	4.5
Fixed Investment	YoY	8.0	6.7	9.0	18.3	2.3	4.9
Exports	YoY	0.4	1.0	2.7	6.5	1.8	5.5
Imports	YoY	20.3	4.3	5.8	10.6	-1.4	6.2
CPI	YoY	8.4	5.1	6.9	6.5	9.7	7.0
Unemployment Rate	%	6.6	7.5	7.5	9.8	9.8	10.0
Current Account	US\$ bn	98.8	102.6	44.8	-77.2	-66.4	-68.7
	% of GDP	5.2	5.3	2.1	-10.0	-8.4	-8.0
Fiscal Balance	% of GDP	2.0	0.3	0.1	-1.3	-2.2	-2.5
US Dollar Exchange Rate	Average	29.4	30.9	32.1	1.68	1.84	1.88

Source: Citi Investment Research and Analysis

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Hungary

The EC's unexpectedly positive decision to approve the start of official loan talks delivered a huge rally in local assets last month. Although this is clearly positive progress, significant risks to the potential start of the talks remain, depending on whether the government will deliver changes to the Central Bank Bill required by the IMF for loan talks to start. We expect it will take 3-6 more months before the deal concludes, as the government will likely continue its slow strategy to soften up conditions but, given the rising funding pressures by year-end, we expect the deal to be finalized in 4Q12. New fiscal austerity measures presented in April will likely be sufficient to lift the suspension of EU Cohesion Funds from 2013, but may not be supported by the EU and IMF due to the negative impacts of the announced tax hikes on Hungary's weak growth prospects. Based on the fiscal measures and deteriorating external growth outlook, we have lowered our GDP forecasts for both 2012 and 2013 to -0.5% and 0.9%, respectively. Weak growth will likely provide arguments for the MPC doves to start gradual rate cuts as soon as any progress in official loan negotiations delivers further correction in risk premiums. Therefore we have lowered our year-end base rate forecast from 6.75% previously to 6.00%.

Poland

The Monetary Policy Council (MPC) surprised markets by raising the reference rate by 25bps to 4.75% and then issued a relatively neutral statement saying future decisions will be data dependent. The tone of the communiqué and interviews of several MPC members suggest the Council believes one rate hike might be sufficient and the central bank is now likely to have a "wait and see" approach. We believe the prospect of weaker growth in coming quarters and deteriorating labour market conditions do not justify more rate hikes, and recent comments from the IMF staff suggest they share this view. We expect after that, a temporary rise above 4% YoY related to the Euro 2012 championships, consumer price inflation will fall by year-end, returning to the 2.5% target in early 2013. Demand-side price pressures remain weak and, despite high inflation expectations of households, we do not see material risks of second-round effects. A potential source of upward pressure on CPI could come from currency depreciation. But, since FX pass through is usually weaker in periods of economic slowdown and increased FX volatility, we believe the risk for core inflation is relatively contained. Having said this, we expect the central bank to keep rates on hold in the coming months.

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Figure 36. Hungary and Poland — Economic Forecasts, 2011-2013F

		Hungary			Poland		
		2011	2012F	2013F	2011	2012F	2013F
Real GDP	YoY	1.7%	-0.5%	0.9%	4.3%	2.7%	2.4%
Final Domestic Demand	YoY	-1.2	-2.1	-0.9	3.6	2.8	2.0
Private Consumption	YoY	0.0	-1.8	-0.8	3.1	2.3	2.5
Fixed Investment	YoY	-5.4	-2.3	0.2	8.7	5.6	1.0
Exports	YoY	8.4	4.2	6.2	5.9	4.5	4.5
Imports	YoY	6.3	3.3	5.2	4.8	2.9	2.3
CPI	YoY	3.9	5.6	3.9	4.3	3.8	2.6
Unemployment Rate	%	11.6	11.8	11.0	12.5	12.9	11.7
Current Account	US\$ bn	2.0	1.3	1.4	-22.2	-18.3	-20.8
	% of GDP	1.7	1.0	1.0	-4.3	-3.9	-4.0
Fiscal Balance	% of GDP	4.3	-2.8	-2.5	-5.1	-3.1	-2.5
Euro Exchange Rate	Average	279	294	287	4.12	4.38	4.17

Sources: Haver Analytics and Citi Investment Research and Analysis

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Czech Republic

After the larger-than-expected drop in GDP of 1% QoQ in 1Q12, we now expect it to fall by 0.6% in 2012 and expand 1.3% in 2013 (previously -0.4% and 1.6%). We have not fully included the adverse impact of the 1Q data (it would otherwise imply a 1.3%YoY fall this year) as we expect part of the 1Q fall to be offset in 2Q12 or even to be revised on 9 June, when the details are published. Falling food prices reduced CPI growth to 3.5%YoY in April — 0.4% pts below the CNB forecast. However, the CNB expects less disinflation in May/June. Nevertheless, the combination of weaker GDP and CPI growth made the CNB more dovish, with 3 of the 7 members talking about a cut after Governor Singer and Vicegovernor Tomsik voted for a cut already in May. While the market started to price-in a cut in the policy rate, we expect it in 4Q12 as there are risks on both sides, but skewed to the downside. Main upsides are weaker koruna, domestic political uncertainty, stronger German growth, better labour market compared to GDP outturn and elevated household price expectations; while downsides are our outlook for EURIBOR and full implementation of fiscal austerity (we expect it slightly milder). While we expect koruna to weaken in short term owing to "Grexit" concerns, the sound current balance should return it later to its appreciation trend.

Romania

Romania's 3-month-old centre-right government collapsed on 27 April after losing a no confidence vote in Parliament. This was followed by the nomination of Mr. Victor Ponta, leader of the Social Democratic Party, who became the country's new PM after the approval of his cabinet line-up by Parliament on 7 May. Developments to date lead us to believe the government led by Mr. Ponta is likely to be in charge until elections in November. Although predicting the composition of the next government in the aftermath of the November elections is difficult at this stage, it is not very likely to deviate from the main tenets of the current EU-IMF supported economic program. These political developments and rising tensions in the euro zone, which have driven the leu weaker, have led the NBR to become more cautious. In our view, the May Inflation Report also confirms this reversal in monetary policy, as it acknowledges the balance of risks surrounding the current projection of the inflation rate is more visibly tilted to the upside than anticipated in the February 2012 Inflation Report. Against this backdrop, we expect the NBR to keep rates on hold at 5.25% for the remainder of the year and pursue a tighter liquidity policy to contain depreciation pressures on the leu if needed.

Figure 37. Czech Republic and Romania — Economic Forecasts, 2011-2013F

		Czech Republic			Romania		
		2011	2012F	2013F	2011	2012F	2013F
Real GDP	YoY	1.7%	-0.6%	1.3%	2.5%	1.3%	3.0%
Final Domestic Demand	YoY	-1.0	-1.1	0.9	1.9	0.9	2.7
Private Consumption	YoY	-0.7	-0.8	0.5	1.3	0.9	2.7
Fixed Investment	YoY	-1.5	-1.0	2.2	6.2	1.2	3.5
Exports	YoY	11.1	2.0	3.3	10.5	5.5	4.2
Imports	YoY	7.4	-1.5	5.0	11.5	3.9	3.2
CPI	YoY	1.9	3.3	2.7	5.8	2.8	2.7
Unemployment Rate	%	8.5	8.8	8.9	5.4	5.2	5.2
Current Account	US\$ bn	-6.3	-4.9	-5.3	-7.9	-7.7	-8.8
	% of GDP	-2.9	-2.6	-2.6	-4.2	-4.5	-4.7
Fiscal Balance	% of GDP	-3.1	-3.1	-2.8	-4.1	-2.4	-2.2
EURCZK, USDRON	Average	24.6	25.3	24.7	3.0	3.5	3.4

Sources: Haver Analytics and Citi Investment Research and Analysis

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Brazil

We keep our 2012 and 2013 GDP growth forecasts at 3.3% and 4.5%, given the signs of domestic demand growth acceleration on the back of fiscal and monetary stimuli. However, the intensification of global turmoil and its consequent impact through trade, credit and confidence, among others, suggests setting downward biases in those estimates. Regarding monetary policy, the dovish message in the last Copom minutes as well as developments related to savings accounts scheme leads us to expect the Selic rate will fall further, reaching 7.75% in August. This points to upward revisions in our USD/BRL estimates now at 1.91 and at 1.85 in 2012 and 2013 year-ends. On the inflation front, currency depreciation will likely have a limited impact on inflation, given the simultaneous drop in commodity prices. We keep our 2012 and 2013 year end CPI inflation forecasts at 5.3% and at 5.6%. However, the dovish stance of monetary policy and potential exchange rate pass-through on prices still suggests upside risks to our inflation estimates. Finally, the government will likely accomplish the primary fiscal target of 3.1% of GDP, although the worsening global scenario tends to incentivise more expansionary fiscal policy.

Mexico

GDP rebounded in 1Q12, growing 4.6% y/y versus 3.9% in 4Q11 and above the 4.1% rate we had anticipated. We expect this to continue firmly in 2Q12. Indeed, auto production grew solidly in April: 31% y/y versus an average of 12% in 1Q12. Thus, we are revising up our GDP growth forecasts for 2012 and 2013 to 3.9% and 3.8%, respectively, from 3.5% and 3.6% previously. Meanwhile headline annual inflation has performed well, declining to 3.4% in April from 3.7% in March. However, we expect it to temporarily rise in the following months with a peak at 4.1% in 3Q12, before falling to 3.7% at year-end, which we revised from 3.6% before. We see limited risks to this forecast, but the recent depreciation of the peso will be a new test of pass-through effects, especially when our year-end USD/MXN forecast has increased to 13.7 versus the previous 12.8. At its last meeting, contrary to our forecast of a 50 bps cut, Banxico's Board stayed put at 4.5%. It considered that financial market instability advised waiting, and now we think it will do so, clinging to 4.5% until year-end 2013. On the political front, the voting intention surveys for the July 1st presidential election have been significantly stable, with the PRI's Enrique Peña Nieto maintaining a solid lead. As a result, political analysts are now considering the possibility that the PRI will achieve a legislative majority in both Chambers, something not seen since 1997.

Figure 38. Brazil and Mexico — Economic Forecasts, 2011-2013F

		Brazil			Mexico		
		2011	2012F	2013F	2011	2012F	2013F
Real GDP	YoY	2.7%	3.3%	4.5%	3.9%	3.9%	3.8%
Final Domestic Demand	YoY	3.8	3.9	4.8	5.0	4.6	4.5
Private Consumption	YoY	4.1	4.2	4.8	4.6	4.2	4.0
Fixed Investment	YoY	4.7	3.7	6.5	8.7	7.1	7.4
Exports	YoY	4.5	5.8	6.2	6.7	4.4	6.2
Imports	YoY	9.7	8.4	7.0	6.8	7.3	7.0
CPI	YoY	6.6	5.4	5.6	3.4	3.9	3.9
Unemployment Rate	%	6.1	6.3	6.5	5.3	5.2	5.3
Current Account	US\$ bn	-48.6	-51.4	-65.4	-8.7	-15.6	-26.2
	% of GDP	-2.1	-2.1	-2.4	-0.8	-1.4	-2.0
Fiscal Balance	% of GDP	-2.6	-1.9	-2.6	-2.5	-2.2	-2.0
US Dollar Exchange Rate	Average	1.67	1.96	1.90	12.44	13.63	13.08

Sources: Haver Analytics and Citi Investment Research and Analysis

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Argentina

The tight controls on capital outflows, profit remittances and imports introduced by the government since October 2011 have, so far, been sufficiently effective for the central bank to stop selling foreign currency in the FX market and indeed to resume purchases. After selling \$3.4 billion in reserves in the six months to October 2011, the central bank purchased \$7.9 billion during the following six months. Yet, the controls have led to an increase in the gap between the parallel exchange rate (i.e. the blue chip swap) and the official one of around 30%, and real GDP growth has shrunk markedly. According to our in-house real GDP estimator, 1Q12 growth stood at 2.6% y/y, down from 3.8% y/y in 4Q11. We do not expect growth to rebound any time soon, due to a combination of supply side constraints, which are likely to remain binding, and weak aggregate demand. We expect 2012 non-official real GDP growth to stand at 1%, down from 5.7% in 2011. We also expect non-official annual inflation and the USDARS to stand at 25% and 4.8 by year-end, respectively.

Venezuela

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Uncertainty regarding the health of president Chávez continues, as his absences from the public arena have intensified. We still believe that at some point before October it will be necessary for Mr. Chávez to announce a political heir and the most popular name for that job is Foreign Relations Minister Nicolás Maduro. In our view, Mr. Chávez will remain as the most important politician in Venezuela, but in order to guarantee continuity of his policies, it is more efficient that he plays the role of backing up a candidate. The possibility that President Chávez will provide political support for the candidate he chooses is something that we believe has not yet been incorporated in opinion polls, as the comparisons have always been done between the set of likely candidates vs. Henrique Capriles. Our view is that results would not be as favorable for Mr. Capriles as they have shown so far, once the presence of President Chávez is added. We expect that due to the treatment for his illness, Mr. Chávez would have to dedicate a good portion of his time to that endeavor, but he would still be able to show support and occasionally appear in campaign events. In terms of this credit, most of the recent price action associated with Venezuelan debt has had to do with news associated with President Chávez's health and we believe this should continue to be the main factor behind market dynamics going forward.

Figure 39. Argentina and Venezuela — Economic Forecasts, 2011-2013F

		Argentina			Venezuela		
		2011	2012F	2013F	2011	2012F	2013F
Real GDP	YoY	8.9%	3.0%	3.0%	4.2%	5.0%	3.5%
Final Domestic Demand	YoY	12.0	3.3	3.8	7.6	6.0	1.8
Private Consumption	YoY	10.7	2.8	2.8	4.0	6.4	0.7
Fixed Investment	YoY	-	-	-	4.4	2.6	2.2
Exports	YoY	4.3	1.9	2.1	4.7	6.8	5.2
Imports	YoY	17.8	5.2	6.5	15.4	8.5	-0.9
CPI	YoY	9.8	9.6	12.2	24.5	27.0	27.4
Unemployment Rate	%	8.1	7.8	8.2	6.5	6.4	6.6
Current Account	US\$ bn	1.8	1.5	1.1	27.2	25.7	30.6
	% of GDP	0.4	0.3	0.2	9.1	6.9	8.3
Fiscal Balance	% of GDP	-1.6	-3.0	-3.0	-5.0	-5.0	-4.0
US Dollar Exchange Rate	Average	4.13	4.55	5.45	4.30	4.30	6.50

Sources: Haver Analytics and Citi Investment Research and Analysis

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Saudi Arabia

April figures show an uptick in Saudi production to 9.8 mbpd, supporting our view that Saudi will pursue a lower oil price through greater production. That said, we note that the uptick does not necessarily indicate higher crude exports considering that domestic demand is on the rise as we enter the summer months. Moreover, Brent oil prices have come off around 10% since early May, mainly on the back of concerns over a re-escalation in the European sovereign debt crisis, which spells downside risks to our oil production forecast of around 9.5mbpd for the year on average. For the time being, we maintain our GDP growth forecast of 7.1% in 2012, and project record fiscal revenues. Expenditures will probably once again overshoot the budget plans in our view (although remaining below 2011 levels due to the one-off nature of many such expenditures), but the net result will be a budget surplus of around 20.5% of GDP in 2012E, up from just under 14% in 2011. We believe growth in the non-oil economy will remain strong, around 8.5%, on the back of continued high government expenditure and increased domestic demand. We continue to expect progress on passing of the mortgage law in 2012, which we believe will create a significant boost to the local housing sector and domestic demand. Meantime, inflation remains sticky, flat at 5.4% in March, but we continue to expect demand-side pressure to pose a significant threat to price stability in coming months.

United Arab Emirates

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Lead indicators point to a continued recovery in Dubai's economy, with DP World announcing a 9% increase in volumes at Jebel Ali Port and DHCOC, which owns the Jumeirah Hotel group, announcing strong revenue growth. In a recent Knight Frank report, Dubai premium property prices are showing a strong recovery as well, up 4% in the first quarter of 2012, higher than for any of the 22 other global cities surveyed in the report. That said, supply continues to come on line, meaning that prices are likely to remain soft outside the mature premium areas of Dubai. Dubai's debt restructuring efforts continue to progress. Dubai Drydocks has applied for insolvency protection under Dubai Decree 57, having lost a lawsuit the previous month to one of its minority creditors, Monarch Capital. This will be the first test of the insolvency regime since its establishment in 2009. DIC, a private equity arm of Dubai Holding Group, finally reached an agreement with creditors on restructuring of US\$2.5bn in debt. However, on May 16, the IMF expressed caution over what it said was US\$30bn of GRE debt falling due in 2012, and more in 2014-2015.

Figure 40. Saudi Arabia and United Arab Emirates — Economic Forecasts, 2011-2013F

		Saudi Arabia			United Arab Emirates		
		2011	2012F	2013F	2011	2012F	2013F
Real GDP	YoY	6.8%	7.1%	6.5%	5.3%	0.5%	3.4%
Final Domestic Demand	YoY	7.7	7.8	7.9	3.0	3.4	3.4
Private Consumption	YoY	3.9	5.0	5.0	1.0	2.0	2.0
Fixed Investment	YoY	13.5	10.0	10.0	5.0	5.0	5.0
Exports	YoY	10.7	15.0	1.5	13.0	13.0	13.0
Imports	YoY	1.4	15.0	15.0	15.0	15.0	15.0
CPI	YoY	5.0	7.0	8.0	0.9	1.1	1.3
Current Account	US\$ bn	154.3	183.1	160.9	48.7	11.9	20.7
	% of GDP	26.8	29.2	24.5	15.0	3.5	5.7
Fiscal Balance	% of GDP	13.7	20.5	12.2	-	-	-
US Dollar Exchange Rate	Average	3.75	3.75	3.75	3.67	3.67	3.67

Sources: Haver Analytics and Citi Investment Research and Analysis

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Egypt

The political focus is now firmly on the first round of the presidential elections which is to be held on May 23/24 and the run-off, if required, scheduled for June 16/17. The slightly odd aspect of this election is that, without a new constitution, the exact role of the new president remains unclear, although we still expect the country's first post-Mubarak president to be a key player in the political scene in 2H 2012 and into 2013, most crucially as an important force for political reconciliation. Although the drastic fall in foreign exchange reserves witnessed in 2011 has slowed so far in 2012, we still think they will remain under pressure unless there is a significant commitment from foreign donors. At present we do not think this is possible until an agreement with the IMF is signed, and this is unlikely until well into 2H 2012. Until this point we expect the government will continue to muddle through as long as possible in terms of economic policy, seeking to maintain exchange rate stability, contain inflation and make no significant fiscal adjustment.

South Africa

The February 22 budget highlighted the unfavourable external environment facing the country and that growth, which is now officially forecast at only 2.7% in 2012, will remain subpar and only start to really recover into 2013. Although the Treasury remains committed to budget deficit reduction and debt stabilisation — focusing more on micro policy steps to foster stronger growth — weak revenue growth and pressure from the public wage bill mean that a significant reduction in the deficit is only likely in 2014/15. In the meantime, even with weak housing sector growth and rising inflation eroding household purchasing power, the ongoing monetary stimulus is supporting resilient consumer spending, while corporate finances are healthy and there are signs of an upturn in private investment. We expect no immediate change in the monetary policy stance, with a rate hike unlikely before early 2013 and only gradual normalisation afterwards, although inflation will probably hover around the top end of the 3%-6% target range in the next 15 months. However, we think it is unlikely to make a sustained breach of the upper limit, even if rand fragility and wage stickiness pose upside risk. Poor export performance and the high import content of capital spending suggest that the current account deficit will gradually widen, after being kept low by favourable terms of trade.

Figure 41. Egypt, Nigeria and South Africa — Economic Forecast, 2011-2013F

		Egypt			Nigeria			South Africa		
		2011	2012F	2013F	2011	2012F	2013F	2011	2012F	2013F
Real GDP	YoY	1.8%	3.0%	3.9%	7.8%	7.4%	7.0%	3.1%	2.9%	3.8%
Final Domestic Demand	YoY	2.9	3.7	3.8	NA	NA	NA	4.6	3.3	4.0
Private Consumption	YoY	5.0	0.2	1.5	NA	NA	NA	4.9	2.8	3.3
Fixed Investment	YoY	-5.6	9.9	3.4	NA	NA	NA	4.3	4.4	5.7
Exports	YoY	3.7	-3.8	6.3	NA	NA	NA	5.9	5.3	6.2
Imports	YoY	8.1	-2.3	5.5	NA	NA	NA	9.1	6.7	7.0
CPI	YoY	10.2	10.0	11.2	10.8	12.4	9.8	5.0	6.1	5.4
Unemployment Rate	%	12.1	13.0	14.5	NA	NA	NA	26.0	25.7	25.2
Current Account	US\$ bn	-5.4	-6.8	-8.8	15.9	16.5	21.9	-13.6	-18.3	-22.4
	% of GDP	-2.3	-2.7	-3.3	6.1	5.5	6.4	-3.4	-4.7	-5.6
Fiscal Balance	% of GDP	-10.1	-9.1	-7.4	-3.1	-2.2	-2.1	-5.0	-4.8	-4.2
US Dollar Exchange Rate	Average	5.94	6.07	6.63	155.9	159.92	164.58	7.26	8.25	8.57

Source: Citi Investment Research and Analysis

Figure 42. Selected Emerging Market Countries — Economic Forecast Overview, 2011-2013F

	GDP Growth			CPI Inflation			Current Balance (% of GDP)			Fiscal Balance (% of GDP)		
	2011	2012F	2013F	2011	2012F	2013F	2011	2012F	2013F	2011	2012F	2013F
Asia	7.2%	6.8%	7.3%	5.7%	4.1%	4.0%	2.3%	1.5%	1.2%	-2.2%	-2.8%	-2.1%
China	9.2	8.1	8.5	5.4	3.5	3.5	2.8	2.0	1.5	-1.3	-2.4	-1.5
Hong Kong	5.0	2.6	4.2	5.3	4.0	3.0	5.1	9.4	10.2	3.9	0.8	0.7
India*	6.9	7.0	7.5	9.0	7.0	6.5	-4.0	-4.1	-3.4	-8.4	-8.0	-7.7
Indonesia	6.5	6.2	6.5	5.4	4.4	4.7	0.2	-1.0	-0.9	-1.2	-1.8	-0.7
Korea	3.6	3.4	4.2	4.0	3.0	3.2	2.4	1.1	0.7	1.5	1.4	1.2
Malaysia	5.1	5.0	5.3	3.2	2.3	3.1	11.5	10.5	9.0	-5.0	-5.0	-4.7
Pakistan	2.8	3.1	4.2	10.5	11.0	11.0	-2.8	-3.6	-3.8	-6.5	-6.2	-5.5
Philippines	3.7	4.6	5.0	4.8	3.5	4.0	3.1	3.1	2.4	-2.0	-2.8	-2.0
Singapore	4.9	3.6	5.0	5.2	4.4	3.3	21.9	15.0	13.0	1.5	1.0	1.0
Sri Lanka	8.3	7.4	7.6	6.8	7.5	7.7	-7.9	-7.3	-6.1	-7.0	-6.2	-5.5
Taiwan	4.0	3.3	4.2	1.4	1.9	2.1	8.8	8.7	8.4	-1.9	-1.6	-1.6
Thailand	0.1	4.7	5.0	3.8	2.9	3.3	3.4	-1.3	-0.5	-1.5	-3.8	-2.7
Vietnam	5.9	5.0	5.6	18.6	10.0	7.9	-1.1	-1.2	-3.7	-3.5	-4.5	-4.3
Latin America	3.9	3.6	4.1	6.8	6.0	6.3	-1.0	-1.2	-1.5	-2.3	-2.1	-2.3
Argentina	8.9	3.0	3.0	9.8	9.6	12.2	0.4	0.3	0.2	-1.6	-3.0	-3.0
Brazil	2.7	3.3	4.5	6.6	5.4	5.6	-2.1	-2.1	-2.4	-2.6	-1.9	-2.6
Chile	6.0	4.5	5.0	3.3	3.7	3.2	-1.3	-1.8	-1.9	1.6	0.7	0.6
Colombia	5.9	5.0	4.5	3.4	3.5	3.8	-3.0	-3.1	-2.9	-2.9	-3.0	-2.5
Mexico	3.9	3.9	3.8	3.4	3.9	3.9	-0.8	-1.4	-2.0	-2.5	-2.2	-2.0
Panama	10.6	7.0	7.0	5.9	5.6	3.2	-12.7	-11.8	-10.2	-2.3	-2.7	-1.5
Peru	6.9	5.7	6.5	3.4	3.8	2.9	-1.3	-2.4	-2.8	1.7	1.2	-0.3
Venezuela	4.2	5.0	3.5	24.5	27.0	27.4	9.1	6.9	8.3	-5.0	-5.0	-4.0
Europe	5.0	2.8	3.7	6.7	5.5	5.8	-0.2	0.0	-1.3	-0.3	-1.2	-1.1
Czech Republic	1.7	-0.6	1.3	1.9	3.3	2.7	-2.9	-2.6	-2.6	-3.1	-3.1	-2.8
Hungary	1.7	-0.5	0.9	3.9	5.6	3.9	1.7	1.0	1.0	4.3	-2.8	-2.5
Kazakhstan	7.5	6.2	6.4	8.3	5.2	6.5	7.6	1.9	2.3	5.9	1.7	3.0
Poland	4.3	2.7	2.4	4.3	3.8	2.6	-4.3	-3.9	-4.0	-5.1	-3.1	-2.5
Romania	2.5	1.3	3.0	5.8	2.8	2.7	-4.2	-4.5	-4.7	-4.1	-2.4	-2.2
Russia	4.3	3.5	4.0	8.4	5.1	6.9	5.2	5.3	2.1	2.0	0.3	0.1
Slovakia	3.3	2.2	1.8	3.9	3.7	3.1	0.2	1.3	0.8	-4.8	-4.7	-3.2
Turkey	8.5	2.5	4.3	6.5	9.7	7.0	-10.0	-8.4	-8.0	-1.3	-2.2	-2.5
Ukraine	5.1	3.0	4.5	8.0	3.4	7.3	-5.2	-6.6	-4.3	-3.8	-3.4	-3.5
Africa/Mideast	6.0	4.3	5.2	5.6	6.0	6.0	11.5	12.5	13.2	2.3	4.8	3.4
Bahrain	3.2	3.0	3.9	-0.4	3.0	3.5	11.6	29.2	21.4	-1.2	4.8	5.1
Egypt	1.8	3.0	3.9	10.2	10.0	11.2	-2.3	-2.7	-3.3	-10.1	-9.1	-7.4
Ghana	14.4	7.5	6.5	8.7	10.2	11.6	-8.2	-7.2	-4.5	-5.4	-5.6	-4.7
Iraq	9.4	9.3	11.5	5.6	5.0	6.0	-5.1	32.7	66.7	15.8	16.5	25.2
Israel	4.9	2.7	3.0	3.4	2.6	2.7	0.1	-1.5	-1.0	-2.7	-3.2	-2.7
Jordan	2.6	2.5	3.0	4.4	5.0	5.0	-10.6	-12.4	-11.7	-3.9	-8.0	-9.5
Kenya	4.5	5.0	5.8	14.0	11.9	8.2	-8.2	-7.5	-6.5	-5.5	-5.0	-4.9
Kuwait	4.3	0.2	2.5	4.7	5.0	5.0	47.5	45.6	46.8	17.1	17.1	13.9
Lebanon	6.0	3.5	4.3	5.1	6.0	5.0	-21.3	-22.6	-23.5	-6.8	-8.0	-9.1
Nigeria	7.8	7.4	7.0	10.8	12.4	9.8	6.1	5.5	6.4	-3.1	-2.2	-2.1
Oman	4.9	3.0	4.5	4.0	3.0	3.0	3.4	2.6	21.3	5.4	4.4	3.9
Qatar	18.1	6.0	8.3	3.0	3.0	3.0	38.7	38.2	30.3	8.1	7.1	3.3
Saudi Arabia	6.8	7.1	6.5	5.0	7.0	8.0	26.8	29.2	24.5	13.7	20.5	12.2
South Africa	3.1	2.9	3.8	5.0	6.1	5.4	-3.4	-4.7	-5.6	-5.0	-4.8	-4.2
Tanzania	6.3	6.2	6.8	12.7	15.7	7.4	-8.5	-7.8	-11.2	-7.8	-6.2	-5.8
UAE	5.3	0.5	3.4	0.9	1.1	1.3	15.0	3.5	5.7	NA	NA	NA
Uganda	5.7	4.5	5.5	18.6	16.4	6.0	-11.1	-12.5	-10.7	-7.2	-5.5	-5.2
Zambia	6.6	6.5	6.9	8.7	7.5	8.0	4.2	1.2	-2.5	-3.2	-4.2	-5.2
Total	6.0	5.2	5.8	6.1	4.9	5.0	2.2	2.0	1.6	-1.5	-1.6	-1.5

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

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Source: Citi Investment Research and Analysis.

Figure 44. (Continued) Citi Global Strategy and Macro Team For Informational Purposes Only

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	Michael Hampden-Turner ¹	(44-20) 7986-3445	michael.hampdenturner@citi.com	Structured Credit
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	Ratul Roy ³	(1-212) 723-6043	ratul.roy@citi.com	Structured Credit
	Jason Shoup ³	(1-212) 723-6147	jason.b.shoup@citi.com	US HG Flow Credit
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Securitized Products Strategy Research				
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	Stav Gaon ³	(1-212) 816-3233	stav.gaon@citi.com	CMBS
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London	Gordon Kerr ¹	(44-20) 7986-1998	gordon.kerr@citi.com	European RMBS/ABS

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Sovereign Ratings Outlook

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

Given economic updates in this publication and based on rating agency criteria, we highlight our economists' and strategists' main expectations for sovereign ratings over the near term. We are keeping the majority of our views unchanged since we last published (April 2012), but we do see scope for additional downgrades of Spain and Ireland in the near term and for Greece to move to "default" upon an EMU exit.

Figure 45. Advanced Economies — Sovereign Long-Term Debt Ratings and Citi Ratings Forecasts

Country	S&P Ratings				Moody's Ratings			
	Current Rating	Current Outlook	Citi Nearterm (Up to 9 Months) Forecast Rating	Citi Longterm (Next 2-3 Years) Forecast Rating & Outlook	Current Rating	Current Outlook	Citi Nearterm (Up to 9 Months) Forecast Rating	Citi Longterm (Next 2-3 Years) Forecast Rating & Outlook
US	AA+	Neg	AA+ (Neg)	AA ↓	Aaa	Neg	Aaa (Neg)	Aa1 ↓
Canada	AAA	Stable	AAA	AAA	Aaa	Stable	Aaa	Aaa
Japan	AA-	Neg	AA- (Neg)	A+ ↓	Aa3	Stable	Aa3	A1 ↓
Germany	AAA	Stable	AAA (Neg W)	AAA (Neg)	Aaa	Stable	Aaa (Neg W)	Aaa (Neg)
France	AA+	Neg	AA+ (Neg W)	AA ↓	Aaa	Neg	Aaa (Neg W)	Aa1 ↓
Italy	BBB+	Neg	BBB ↓	BBB- ↓↓	A3	Neg	Baa1 ↓	Baa3 ↓↓↓
Spain	BBB+	Neg	BBB ↓	BBB- ↓↓	A3	Neg	Baa1 ↓	Baa2 ↓↓
Austria	AA+	Neg	AA+ (Neg W)	AA ↓	Aaa	Neg	Aaa (Neg W)	Aa1 ↓
Belgium	AA	Neg	AA (Neg W)	AA- ↓	Aa3	Neg	Aa3 (Neg W)	Aa3
Finland	AAA	Neg	AAA (Neg W)	AA+ ↓	Aaa	Stable	Aaa (Neg W)	Aaa (Neg)
Greece	CCC	Stable	D ↓↓↓↓	CCC ↑↑↑↑	C		C	Caa2 ↑↑↑↑
Ireland	BBB+	Neg	BBB- ↓↓	BB ↓↓↓↓	Ba1	Neg	Ba2 ↓	Ba3 ↓↓
Netherlands	AAA	Neg	AAA (Neg W)	AA+ ↓	Aaa	Stable	Aaa (Neg W)	Aaa (Neg)
Portugal	BB	Neg	B+ ↓↓	CCC ↓↓↓↓	Ba3	Neg	B1 ↓	Caa2 ↓↓↓↓
UK	AAA	Stable	AAA	AAA (Neg)	Aaa	Neg	Aaa (Neg)	Aaa (Neg)
Switzerland	AAA	Stable	AAA	AAA	Aaa	Stable	Aaa	Aaa
Sweden	AAA	Stable	AAA	AAA	Aaa	Stable	Aaa	Aaa
Denmark	AAA	Stable	AAA	AAA	Aaa	Stable	Aaa	Aaa
Norway	AAA	Stable	AAA	AAA	Aaa	Stable	Aaa	Aaa

Note: Arrows denote expected ratings changes from the current rating. (Neg) denotes negative outlook. (Neg W) denotes negative watch. SD means Selective Default. (P) means Provisional. The number of arrows denotes the expected change in ratings notches from the current level. We show a maximum of five arrows even for countries where we expect more than five notches of ratings change. In the outlook we have not included an extension of the actual EFSF lending beyond the now targeted €440bn maximum capacity. In the event that a substantial extension of the EFSF takes place and is likely to incur sizeable fiscal costs, various Euro Area countries may be at risk of downgrade. NA Not available. Sources: Moody's, S&P and Citi Investment Research and Analysis

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Should Greece leave the euro, we expect both agencies soon to assign a “default” rating status

Programme countries are probably most vulnerable to downward rating pressure in the near-term should the EMU crisis intensify

Spain and Italy remain susceptible to further downgrades this year depending on how the EMU crisis unfolds

Core countries are not immune from ratings pressure

Key Expected Ratings Issues

Citi continues to expect further downgrades in the near and long term (Figure 45). This is due to many factors from the rising probability of Greece's exit from the euro zone, a weak economic backdrop, broad-based fiscal slippage and stresses in the financial sector. Furthermore, it is entirely possible that following a Greek exit, both agencies undertake a “blanket” re-appraisal of generic European credit-worthiness as they did in late-2011 / early-2012. Our views also reflect the fact that Moody's and S&P already have many countries that are covered below on Negative Outlook.

Greece: Given Citi's view that Greece will likely exit EMU at some point (see p4) and will be unable to meet (privately held) euro-denominated claims, we expect agencies to view the Greek sovereign as “in default” upon leaving the euro. We expect the agencies to score Greece in the mid CCC range post EMU exit.

Ireland: Although Ireland remains compliant with Troika reforms and has achieved notable progress, we think weak growth (as with many EMU sovereigns) is likely to undermine debt metrics going forward (*Ireland — Recession Casts Doubt On Fiscal Sustainability* and p20). A Greek exit would also likely exacerbate the already weak macro environment. We think ratings for Ireland could move downwards by two notches by S&P (from BBB+ to BBB-) and by one-notch by Moody's (from Ba1 to Ba2). Moody's have recently stated that “A further deterioration in the country's economic outlook would ... exert downward pressure on the rating, as would a rejection of the EU fiscal compact in the forthcoming referendum or a further market disruption resulting from an event like a disorderly Greek re-default” (11th May).

Portugal: We continue to believe that a deepening EMU crisis will also likely put downward pressure on Portugal's rating in the near term. Both agencies allude, inter alia, to fiscal sustainability issues that could arise should the EMU crisis escalate. We continue to expect a two-notch downgrade by S&P (from BB to B+) and a one-notch downgrade by Moody's (from Ba3 to B1) later this year. Over the longer term, we expect ratings to reflect our view of likely PSI as detailed on p20.

Spain: In line with Citi expectations, since we last published, S&P downgraded Spain by two-notches to BBB+. Both Moody's and S&P allude to more downward rating pressure should debt metrics deteriorate further as a result of rising tensions in the banking sector and/or from fiscal weaknesses (and Spain has just revised up its 2011 deficit estimate to 8.9% due to regional fiscal slippage). We think there is scope for another downgrade by S&P later in the year to BBB and downward pressure is also likely from Moody's, in our view. Over the longer term, we think Spain's ratings will settle at the lower end of the BBB range.

Italy: Moody's also cites that potential “shocks from the euro area crisis” will likely weigh on Italy's rating (13th Feb). We thus continue to believe rating agencies will downgrade Italy by one-notch in the near term as a result of escalating EMU tensions. Over the longer term (and like Spain), we expect Italy's ratings will probably migrate to the lower end of the BBB range.

AAAs/AAs: Both agencies generally highlight headwinds emanating from peripheral Europe and factors such as “ongoing uncertainty over the prospects for institutional reform in the euro area” (eg in Moody's piece on Austria dated 21st May) which weigh on core ratings. Based on an intensification of the crisis and/or a Greek exit, we would expect both Moody's and S&P to undergo a “blanket” re-appraisal of European credit-worthiness as they did in late 2011 / early 2012. Core countries would not be immune in our view. At the very least, we would expect many — if not all - to be put on Credit Watch Negative as they were in late 2011.

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Rates Strategy

The past month has seen a significant deterioration of sentiment in EMU markets and a coincident flight-to-quality trade in all the perceived “safe-haven” assets, notably US Treasuries, German Bunds and UK Gilts. The market-implied probability of an EMU break-up calculated from our Fiscal Risk Index has risen from about 10% in March to almost 20% at the time of writing, and this is leading to higher peripheral yields, lower Bund yields and flatter yield curves.

While the probability of a Greek exit from EMU appears increasingly likely, a total EMU break-up is not our base-case scenario. This does not mean, however, that markets cannot price in an increasingly elevated probability of such an event. Given that in times of stress investors may well be prepared to accept a zero “risk-free” rate of return, a higher probability of a break-up could well see nominal bond yields turn negative in Germany. This is due to the expectation that a new Deutschemark would likely appreciate by something like 15-20% against the rest of the Euro basket. Indeed, this month we are revising down our forecasts for German Bund yields and these now reflect an expectation that 2yr – 3yr yields will turn negative.

We do, however, think that the EMU related flight-to-quality trade is getting overdone in US Treasuries. As we have previously noted, the slope of the US money-market curve looks far too flat, even relative to the fairly benign Fed guidance. We continue to expect US Treasuries to decouple from Bunds and think that the 10yr spread will eventually move out towards 100bp.

Trading EMU peripheral markets has become increasingly problematic, with tremendous volatility and hugely negative carry on short positions. With correlations between the various sovereign credit tiers having almost totally broken down we see little appeal in trading spreads. Given that further widening from current levels would likely be a result of either more default risk or more currency risk being priced in, we would expect such moves to lead to significantly flatter yield curves and we think that these trades have a much better risk/reward profile than inter-country spreads.

The outlook for UK Gilts remains somewhat clouded, in our view. We continue to expect further QE, which should be supportive for Gilt yields; however the flight-to-quality flows from the EMU crisis have seen 10yr Gilt yields fall 60bp since mid-March. Ongoing tensions in Europe and the prospect of QE are likely to keep gilts well supported in the near term but we think that higher US Treasury yields and the medium-term effects of QE might weigh on Gilts going forward.

APAC markets still remain highly correlated with global rate moves. With heightened political and growth risks in Europe, we expect markets to track any further moves lower in core market yields. The prospects of further RBA easing and continued inflows for the AUD are also underpinning market sentiment.

Figure 46. Interest Rate and Bond Market Forecasts (End of Period), as of 23 May 2012

		Forecast End Period					
	Current	3Q 12	4Q 12	1Q 13	2Q 13	3Q 13	4Q 13
US							
Policy Rate (Fed Funds) End Quarter	0.25	0.25	0.25	0.25	0.25	0.25	0.25
3-Month Libor	0.47	0.50	0.55	0.65	0.75	0.90	1.00
2 Year Treasury Yield	0.29	0.35	0.45	0.60	0.75	0.90	1.00
5 Year Treasury Yield	0.74	1.00	1.35	1.50	1.65	1.85	2.00
10 Year Treasury Yield	1.77	2.00	2.45	2.60	2.75	3.00	3.20
30 Year Treasury Yield	2.81	3.20	3.65	3.80	4.00	4.25	4.40
2-10 Year Treasury Curve	148	165	200	200	200	210	220
2 Year Swap Spread (Swap Less Govt.), bp	36	40	35	35	35	35	35
10 Year Swap Spread (Swap Less Govt.), bp	12	20	22	24	25	25	25
30 Year Swap Spread (Swap Less Govt.), bp	-31	-40	-50	-50	-50	-50	-50
30 Year Mortgage Yield	3.80	4.00	4.30	4.45	4.65	4.85	4.85
10 Year Breakeven Inflation	215	235	235	235	240	240	240
Euro Area							
Policy Rate	1.00	0.50	0.50	0.50	0.50	0.50	0.50
Overnight Rate (EONIA)	0.35	0.20	0.15	0.15	0.15	0.15	0.15
3-Month Libor	0.61	0.50	0.30	0.30	0.30	0.30	0.30
2 Year Treasury Yield	0.08	0.00	-0.15	-0.15	-0.15	0.00	0.05
5 Year Treasury Yield	0.55	0.45	0.20	0.20	0.30	0.60	0.90
10 Year Treasury Yield	1.46	1.40	1.25	1.25	1.35	1.75	2.15
30 Year Treasury Yield	2.16	2.20	2.00	2.00	2.10	2.50	2.75
2-10 Year Treasury Curve	138	140	140	140	150	175	210
10 Year BTP-Bund Spread	428	550	600	550	550	500	400
10 Year Swap Spread (Swap Less Govt.), bp	49	50	45	40	35	30	30
10 Year Breakeven Inflation	150	170	160	160	170	190	200
Japan							
Policy Rate	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3-Month Libor	0.20	0.20	0.20	0.20	0.20	0.20	0.20
2 Year Treasury Yield	0.10	0.10	0.10	0.15	0.10	0.15	0.15
5 Year Treasury Yield	0.23	0.30	0.40	0.45	0.40	0.55	0.55
10 Year Treasury Yield	0.87	0.95	1.10	1.20	1.10	1.30	1.30
30 Year Treasury Yield	1.81	1.90	2.00	2.05	2.00	2.15	2.15
2-10 Year Treasury Curve	77	85	100	105	100	115	115
2 Year Swap Spread (Swap Less Govt.), bp	25	25	26	27	26	28	28
10 Year Swap Spread (Swap Less Govt.), bp	4	5	7	10	7	12	12
10 Year Breakeven Inflation	NA	NA	NA	NA	NA	NA	NA
UK							
Policy Rate	0.50	0.50	0.50	0.50	0.50	0.50	0.50
3-Month Libor	1.01	0.90	0.85	0.85	0.90	1.00	1.00
2 Year Treasury Yield	0.37	0.35	0.40	0.40	0.50	0.60	0.60
5 Year Treasury Yield	0.88	0.90	0.85	0.85	0.95	1.25	1.60
10 Year Treasury Yield	1.89	1.80	1.65	1.70	1.80	2.25	2.85
30 Year Treasury Yield	3.18	3.00	2.90	3.00	3.15	3.35	3.65
2-10 Year Treasury Curve	152	145	125	130	130	165	225
10 Year Swap Spread (Swap Less Govt.), bp	37	35	35	40	40	40	40
10 Year Breakeven Inflation	267	275	265	270	280	300	300
Australia							
Policy Rate	3.75	3.50	3.50	3.50	3.75	4.00	4.25
3-Month Libor	3.73	3.60	3.60	3.70	3.90	4.10	4.40
2 Year Treasury Yield	2.64	2.60	2.70	2.90	3.30	3.80	4.00
5 Year Treasury Yield	2.70	2.60	2.80	3.00	3.30	3.90	4.20
10 Year Treasury Yield	3.17	3.15	3.40	3.70	4.10	4.50	4.70
2-10 Year Treasury Curve	53	55	70	80	80	70	70
10 Year Swap Spread (Swap Less Govt.), bp	83	75	70	65	60	60	55

Source: Citi Investment Research and Analysis

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Credit Outlook

A host of measures have been flashing (and continue to flash) risk-off, and the credit markets have responded accordingly. For example, the S&P 500 dropped another 4.3% last week, which brings the decline since late March to 8.6%. Oil is off 15% since then, and curves in the rates markets have flattened sharply as well. The 2s10s Treasury curve, for example, is hovering around 145bp, its lowest level in 3 years. And of course credit spreads have been under significant pressure as well (ex: CDX.HY -7 pts, iTraxx Xover -6 pts since late March; Figure 48).

Developments in the Eurozone are obviously the key driver of the price action at this point; specifically, fear of deposit flight in not only Greece but the periphery in general is the latest source of investor angst. Recently the Greek president warned politicians that the country's banks had seen roughly €700mm of withdrawals after the most recent round of elections (bankers subsequently revised this to more than €1.2bn), and press reports in Spain noted that €1bn had been withdrawn from Bankia after its partial-nationalization.

When viewed as isolated events evidence of deposit leakage may not yet be indicative of a potential systemic problem, but in combination it's a different story. Who can truly know how distant a confidence crisis really is in this environment? We encourage readers to refer to "[Tracking the Flight from Peripherals](#)", dated May 21, 2012 for a detailed analysis of capital flows.

Figure 47. Spread performance of new deals in the US high-grade and high-yield markets

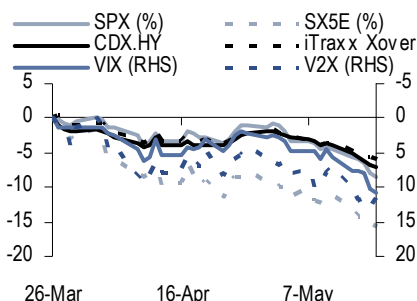
Issue	Z-Spread (bp)		
	Issued	Current	Change
F 2.75s of '15	198	206	+8
K 3.125s of '22	125	140	+15
PGN 2.8s of '22	91	95	+3
TLMCN 5.5s of '42	311	325	+14
FTR 9.25s of '21	753	752	-1

Note: As of May 21, 2012; issued 5/10 (F), 5/14 (K), 5/15 (PGN, TLMCN),
Sources: CIRA and Bloomberg

And it is not just European headlines that have weighed on valuations, as technical factors have also softened over the past few weeks. For example, Lipper reported a \$655 bn outflow last week in the US high-yield market, which was only the second outflow of the year. And while primary market activity has slowed from the torrid pace in Q1 (weekly average of \$47.7bn in Q1 vs. \$23.5 in Q2), performance of new deals in secondary trading has been decidedly mixed (Figure 47).

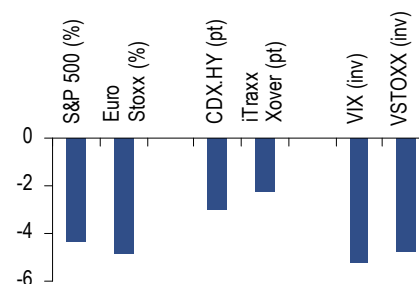
One aspect of the recent price action that we find particularly noteworthy is how closely various assets in the US and Europe have been tracking (in fact, some US markets have been under even more pressure than their European counterparts). For example, Figure 49 shows that the equity markets in the US and Europe have fallen by essentially the same amount since May 11th — S&P 500 declined by 4.1% and Euro Stoxx by 4.3%. Implied equity vol in the US edged a bit higher (VIX up 5.2 pt vs. VSTOXX up 4.7 pt), and the CDX.HY index is off 3 pts relative to 2 pts for the iTraxx since May 11th. The reason why we find this interesting is because while valuations are closely tracking the fundamental outlook for the two markets appear to be diverging.

Figure 48. Changes in valuations in the U.S. and European markets since March 26th



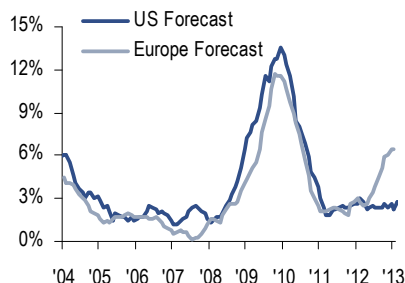
Note: As of May 18, 2012
Sources: CIRA and Bloomberg

Figure 49. Assets in the U.S. and Europe have been tracking closely since May 11th



Note: As of May 18, 2012
Sources: CIRA and Bloomberg

Figure 50. Default rate forecasts for the US and European speculative-grade markets



Note: Refer to [“Default Rates to Climb Rapidly in Q3 and Q4”](#) for calculation methodologies
Source: CIRA

For example, our base case expectation is that the default rate in the US will continue to hover around 2.5% this year, and in fact will remain low the following year as well (Figure 50). None of the key indicators in our default model are pointing to an increase in US default rates anytime soon. Lending surveys are again favorable, for example, and our economists' forecasts are for growth to continue.

In effect, over the next few years we expect that, by and large, US defaults will be idiosyncratic. In this regard two factors that we will be watching are the legacy LBO balance sheets from the prior cycle and the depressed natural gas market. Distressed LBOs are likely to be okay until early next year (at least), and most of the large companies negatively affected by low natural gas prices have sufficient near-term liquidity.

Conversely, our base case scenario in Europe is that the 12m trailing Speculative Grade Default Rate, which is currently at 2.35%, is set to rise steadily to 6% by December 2012. This forecast rise is mostly a result of the drop in GDP growth since second half of 2011, and our expectation that this drop will continue until Q4 '12. Another factor affecting this quick rise in default rates is Spread per unit of Leverage (SPL), which has risen sharply in the past six months as spreads continue to widen while corporates continue to deleverage. We encourage readers to refer to the article titled [“Default Rates to Climb Rapidly in Q3 and Q4”](#), dated May 16, 2012 for more detail on default rise.

The bottom line is that credit spreads in the US have been widening in sympathy with those in Europe, and, while we expect this trend to continue in the near term we also view this disconnect (spreads vs. fundamentals) as increasingly noteworthy.

Global Equity Strategy

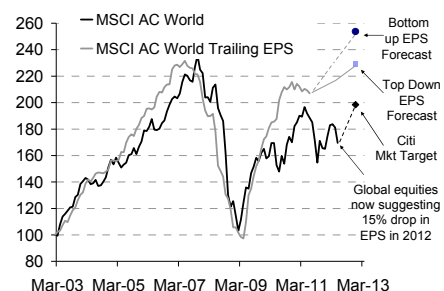
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Global equities have given up almost all the gains made YTD. The recent pullback in the global stock market triggered by European woes might continue during the summer. Attractive valuations, healthy corporate performance and the belief that world economy is not heading into a double dip mean that and we would be buyers into weakness. For end-2012, we target 360 on the MSCI ACWI benchmark, implying 19% upside from current levels. The main risk to our outlook is a disorderly Greek exit from EMU and contagion in other periphery sovereigns, with potential secondary consequences for global growth.

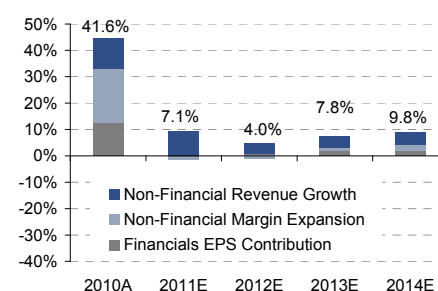
The close lead/lag relationship between global share prices and trailing EPS suggests that the market has recently moved to price in global EPS contracting by 15% in 2012 (see Figure 51). We think this is unlikely to happen. We expect 4% EPS growth this year and 8% in 2013 (Figure 52). The bottom-up consensus is suggesting global EPS will grow by 11% in 2012 and 13% in 2013. So we are more cautious than the analyst consensus but not as bearish as what the market is suggesting now. Our earnings revision index recently turned slightly negative, but we believe it is too early to say a new downgrade cycle has started. It rather seems like analysts are looking for direction as the revision index has been hovering between +/- 10% for the last 3 months.

Figure 51. MSCI AC World Price vs EPS (9m Lagged)



Sources: MSCI, CIRA

Figure 52. Top-down Global EPS Growth Forecasts



Sources: CIRA, Factset

While we think there is more upside from here until year-end, investors shouldn't be anticipating the gains we had during the 2009 rally. Back then, there was both a re-rating of stock markets and a recovery in global EPS, both from depressed levels. Currently, valuations are low, but global profits are not depressed like they were in 2009. So, our expected gain for the stock market is more likely to be similar to the one we had in 2010-11.

The Eurozone crisis remains a concern and investors are closely watching the policy response. Our economists think the ECB (and other central banks) has the firepower to act when they see it necessary. Another positive is that there appears to be a lot of bad news already priced in. Global equities look cheap, especially against artificially low core government bond yields. Cheap valuations should limit the downside when pullbacks occur. Global equities are trading at 16x CAPE while the long-term average is 24x.

Peaking global margins have been causing concerns for investors. While Western margins are close to their all time peaks, capex has been lagging and is not competing away these super-normal profits. Companies are returning cash through dividends and buybacks instead of investing in new capacity. While this may be worrying for longer-term profitability and is certainly unhelpful for job creation, it

helps to sustain profits in the shorter run. As a result, while we admit profit margins remain susceptible to cyclical downturns, we think margins are more sustainable at these levels than many think. This is another reason why we remain positive on markets.

Our key regional and global sector recommendations are summarised in Figure 54. We have downgraded Emerging Markets to Neutral as we no longer expect significant outperformance from EM equities. EM companies have struggled to turn premium GDP growth into premium EPS growth and we don't see this changing soon. We are Neutral on the UK. While it stands out as one of the cheapest markets in the world, the UK is suffering weakening EPS and GDP trends in the short term. We are Overweight Japan. In the medium term, we believe earnings growth in Japan will remain robust. We are Neutral on Europe ex UK equities. While sovereign concerns will continue to weigh on the region, liquidity provisions by the central bank should help support equity markets. We are Underweight the US. While solid earnings should support US equities, we believe regions offering cheaper valuations will outperform. Joining the US amongst our Underweights is Australia.

In line with our view of slower gains in markets, we had tempered our global sector allocation at end-1Q12. We are Neutral on Financials. Deleveraging and weak demand in Europe are likely to keep a lid on performance. We are Overweight Industrials as we prefer operational leverage to financial leverage. Industrial companies have successfully de-leveraged and aggregate cash balances are at record levels. They also benefit from solid earnings trends. We are Overweight Utilities. The sector has been a serial underperformer, but now seems to be enjoying stabilising earnings momentum along with cheap valuations. Our analysts note that political risks remain in Europe, while the US sector, which is a much larger component of the global benchmark, looks to be an attractive contrarian allocation for investors. The sector has a dividend yield of 4.8%. We are Neutral on Consumer Staples. The earnings outlook for Consumer Staples remains sound and is supported by considerable barriers to entry and growing EM exposure. But it stands out as being amongst the most expensive across the world. Still, amongst the consumer sectors we prefer Staples to Discretionary (which includes Autos, Media and Retailers). Consumer Discretionary remains our least favoured cyclical, in part because valuations are high and earnings revisions could be weakening.

Figure 53. Strategists' Forecasts

Region	Index	Current Level (17 May 12)	End 2012 Target	Exp Gain (%)
US	S&P 500	1305	1425	9%
Pan Euro	DJ Stoxx600	242	285	18%
UK	FTSE 100	5338	6200	16%
Japan	Topix	747	960	28%
Asia xJpn	MSCI Asia x JP	476	585	23%
Australia	S&P/ASX 200	4157	4750	14%
GEMs	MSCI EM	921	1100	19%
LATAM	MSCI Latam	3395	4900	44%
CEEMEA	MSCI EM EMEA	301	350	16%
Global	MSCI ACWI	302	360	19%

Sources: MSCI, CIRA

Figure 54. Regional And Global Sector Recommendations

Overweight	Neutral	Underweight
Asia Pac ex-Japan	UK	US
Japan	Europe ex-UK	Australia
	Global Emerging Markets ↓	
Overweight	Neutral	Underweight
Industrials	Consumer Staples	Consumer Disc
IT	Energy	Health Care
Utilities	Financials	Telecoms
	Materials	

Source: CIRA

Securitized Products Strategy

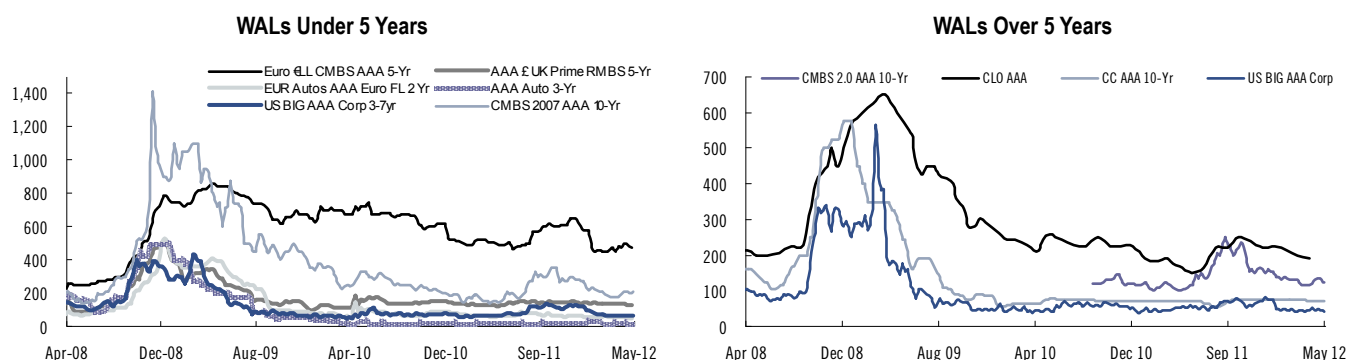
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As the market appears biased toward higher yields post FOMC, investing in short and high quality securitized products remains an attractive strategy. Agency MBS, retail auto loan ABS, seasoned CMBS dupers and seasoned prime residential mortgages are attractive sectors for assembling a balanced portfolio. Global macro investors will find European ABS and RMBS cheap to US counterparts — UK prime residential RMBS earn roughly LIBOR + 125bp, and seasoned US CMBS dupers earn swaps + 75–205bp, while US auto loan ABS are much lower yielding at swaps + 12–20bp. Higher spread, off-the-run sectors present a good balance to the short-term, high quality securitized products. Some of our top calls this month are subordinate auto (swaps + 100–175bp), 2005 CMBS AJs, 2007 CMBS AMs and 2006 & 2007 CMBS dupers — we think these sectors are oversold. In Europe, UK buy-to-let and Italian RMBS are interesting.

Figure 55. Selected Securitized Products Sectors — Spread Performance, Apr 08-May 12



Source: Citi Investment Research and Analysis

Strong Demand Amid Persistent Concerns

The successful ML III liquidations afforded the market a chance to demonstrate that risk appetite remains robust, owing to the proliferation of cash needing to be put to work. Higher-yielding products, such as non-agency, and CMBS AJs cleared the market and set new benchmark levels. Yet the market demonstrates equally strong demand for high-quality short-term products, such as senior autos, credit cards and duper CMBS. These contrasting trends serve as a reminder that caution and bond selection remain at work in securitized markets, especially amid renewed macro uncertainty.

Recovery Looks Sustainable — Good for Credit Investing

Our economists project that any near-term softening will be temporary, and this view is constructive for credit investments. Evidence is building that housing is transitioning from wide-spread weakness to small-scale gains. Although first quarter GDP rose less than expected, private sector demand is continuing on track and financial conditions and policy are providing underlying support. The Fed's latest assessment of the outlook suggests that policymakers continue to gain confidence in recovery's sustainability.

On the employment front, our economists reason that the softer employment gains in April were unsurprising and in line with the "payback scenario" from exaggerated winter gains. The economists still expect average increases this year in a 175,000

range.⁸ Continued sizable upward revisions to headcounts are not consistent with a faltering job market and diffusion measures are posting cyclical highs along with an elevated workweek.

Selected Securitized Products Recommendations

- **Go long in Agency MBS.** Overweight lower coupons (3.5s) vs Swaps to get long the mortgage basis. MBS valuations look fair to us and positive carry on lower coupons indicate there is fair compensation for taking MBS duration and convexity risk.
- **FFELP student loan bonds are cheap.** FFELP student loan spreads remain wide to long-term means, and are cheap to Agency notes. Off-the-run FFELP student loans offer the most value, recently tightening by 30bp, and have more compression potential, in our view. The 5–6YR FFELP floaters earn roughly LIBOR + 80–100bp.
- **Auto subs remain top pick.** Auto ABS subordinates remain our top pick. Auto subordinate spread pickups to the long-term price target tightened by about 25–40bp during April, yet remain more compelling than the pickups for subordinate credit cards. At swaps + 75–135bp, 3YR single-A and triple-B auto ABS remain attractive.
- **Underweight Dutch subordinates.** We move to underweight Dutch RMBS subordinates because of the newly enacted Dutch mortgage market changes, which take effect in January 2013. The risk of long extensions has elevated, and there is heavy reliance upon originator support. Dutch housing market conditions and a deteriorating economic outlook also concern us.
- **Euro Off-the-Run diversification.** We like first-pay short WAL UK nonconforming RMBS at LIBOR +330bp, as well as UK BTL RMBS (LIBOR +238bp), select CMBS (EURIBOR +475) and senior Italian (EURIBOR +345bp) and Portuguese RMBS (EURIBOR +1025).
- **Non-agency better quality, fixed rate paper.** We continue to prefer better quality, fixed rate paper because of high carry and a strong investor base. In the lower credit sectors, we see limited upside at current yield levels unless there is a significant improvement in fundamentals.

Sector Relative Value and Allocation Recommendations

Our securitized products strategists have mixed views on the market, ranging from bullish to neutral, and Figure 56 shows Citi strategists' recommendations for major structured products sectors on a scale of -3 (maximally bearish) to +3 (maximally bullish). The table also incorporates our strategists' most current thinking about value and presents one or two trade ideas.

Figure 56. Sector Relative Value and Asset Allocation Recommendations — Selected Sectors, May 2012

Sector	Strategist Recommendation	Spreads Relative to Long-Term Averages	Comments
CABS	0	Fair	Remain market weighted. Subordinate auto ABS is our top pick. We also like senior auto lease ABS.
CMBS	0	Fair	2005 AJs, 2007 AMs, 3.0 junior triple-As, and 2005 and 2006 dupers are the most attractive at the moment. These sectors have widened the most relative to their recent tights.
Agency MBS	+1	Fair	We recommend overweighting lower coupons (30yr 3.5s) vs swaps to get long the mortgage basis. Supply/demand technicals look favorable going forward.
European Securitized Products	0	Cheap to Fair	Remain market weighted. We prefer a barbell strategy with stable, short sectors, combined with select off-the-run opportunities. Recent Dutch mortgage regulation changes concern us and move to underweight subordinate Dutch RMBS.

Source: Citi Investment Research and Analysis

⁸ See "Comments on Credit – Payback Scenario Unfolding," Citi, May 4, 2012.

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Commodity Outlook and Forecast

Commodities have sold-off sharply during May — just as they did in May 2011 and just as they did in May 2010. After an impressive first quarter for spot commodity markets that gained 2.55%, prices have dropped 5% month-to-date and are in negative territory on the year. The breaching of technical support levels across benchmark petroleum, precious metals and agriculture contracts earlier this month has further accentuated the move lower, which has been largely affected by deteriorating economic conditions in China and Europe and the accompanying adverse currency moves. To be sure, perhaps the most meaningful technical headwind for near-term US dollar denominated commodity prices is the recent surge in the nominal value of the greenback, which has appreciated 3.3% this month. Ongoing concerns about the stability of the European Monetary Union and the region's fragile banking system has prompted Citi's FX strategy team to forecast limited short-term upside for the EURUSD cross which could weaken this summer to 1.23, before settling around 1.25 by the end of 2012E. EMU concerns have led to vols getting bid across asset markets, serving as an additional headwind to risk sentiment. After \$5Bn of net inflows for commodity exchange traded funds during January and February, the market has since seen \$1.3Bn in net redemptions through April—in affinity to the moves in the larger commodity index swap market and a negative trend likely to hold through May.

Figure 57. Citi Commodity Price Forecasts*

		Recent Spot	0-3M	6-12M	5Y Cyclical	2012E	2013E
Energy							
NYMEX WTI	USD/bbl	91.5	105.0	110.0	81.0	106.0	113.0
ICE Brent	USD/bbl	107.1	125.0	127.5	85.0	125.0	120.0
Henry Hub Natural Gas	USD/MMBtu	2.7	2.4	2.5	N/A	2.5	3.6
Base Metals							
LME Aluminum	USD/MT	2,068	2,250	2,325	2,500	2,279	2,388
LME Copper	USD/MT	7,653	8,500	8,575	7,500	8,491	8,375
LME Lead	USD/MT	1,967	2,100	2,213	2,300	2,161	2,275
LME Nickel	USD/MT	16,827	18,500	19,750	22,000	19,430	22,819
LME Tin	USD/MT	19,645	22,500	23,250	24,500	22,997	25,625
LME Zinc	USD/MT	1,895	2,050	2,195	2,300	2,121	2,301
Precious Metals							
Gold	USD/T. oz	1,592	1,680	1,750	1,050	1720.0	1835
Silver	USD/T. oz	28.7	31.0	29.3	15	30.6	27.1
Platinum	USD/T. oz	1,459	1,675	1,725	1,500	1682.0	1725.0
Palladium	USD/T. oz	604	750	885	600	801.0	925.0
Bulk Commodities							
Hard Coking Coal (benchmark Asia)	USD/MT	285	215	240	220	233	231
Thermal Coal Asia (NEWC)	USD/MT	99	114	123	105	119	136
Iron Ore Spot (TSI)	USD/MT	131	160	148	100	149	138
Agriculture							
Corn	USd/bu	636	610	630	N/A	628	600
Wheat	USd/bu	695	650	630	N/A	638	675
Soybeans	USd/bu	1,405	1,475	1,390	N/A	1,369	1,303
Rice	USD/cwt	15.18	15.15	15.08	N/A	14.90	15.15
Cotton	USd/lb	78	90	90	N/A	91	90
Sugar	USd/lb	20.5	24.0	24.5	N/A	24.4	24.0
Coffee	USd/lb	178	185	183	N/A	189	200
Cocoa	USD/MT	2,273	2,275	2,308	N/A	2,300	2,400

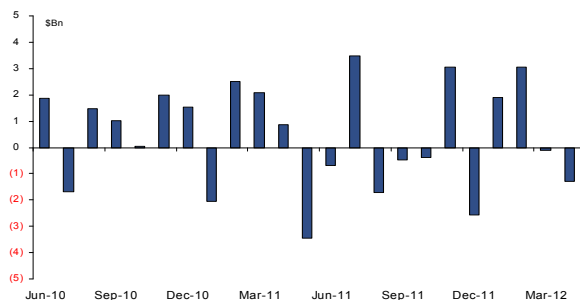
Source: Citi Investment Research and Analysis, *updated 16 April, 2012 – subject to revision

Fundamentally, commodities appear to be in an either/or market whereby policy responses — or lack there-of — could drive the next move higher or lower, in conjunction with any meaningful shift in the macro environment. While Citi's base case commodity price forecasts remain intact this month, it is clear that some of the

bullish fundamental and geopolitical catalysts of 1Q'12 have softened the market since April. After record energy, bulk, base metal and agriculture product net imports throughout 1Q'12, April trade data for the world's most important commodity consumer, China, point to signs of slowdown in industrial commodity demand, strong coal imports notwithstanding. For the last ten days of April, CISA estimates that steel production averaged 2.035t/d. But it is the forward looking data that continue to be worrisome; in particular increasingly bearish Chinese housing statistics and declines in power generation. April figures show that growth in new loans continues to fall, as does floor space under construction (down from 35% in February to 25%). More disconcerting for iron ore and steel demand in 3Q'12 is that overall starts dropped 4.2% in March, with housing starts down 9.8%. However, a reversal of the bearish tinge might also be on the horizon as stronger seasonal demand patterns, the potential for further stimulus in the US and China to support growth and ongoing supply tail risks in energy and agriculture markets could stabilize if not lead to stronger prices in 2H'12 — particularly for crude oil and 'ags.'

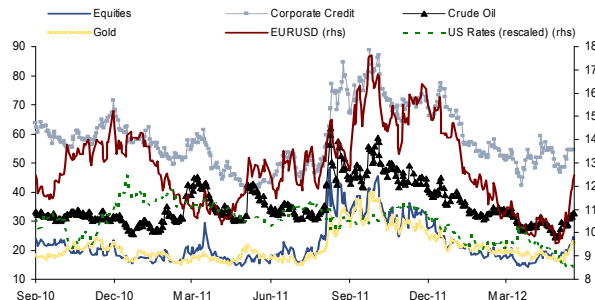
Seasonal factors and stronger front-to-back spreads in the backwardated ICE Brent market point to higher prices in the third quarter as refinery runs uptick 2-m b/d (or higher) and product demand globally surges as much as 4-m b/d. Certainly policy responses from the Saudis and continued (even if fading) prospects of a coordinated strategic petroleum reserve release remain bearish. Easing geopolitical concerns in advance of today's P5+1 meeting with Iran have also weakened bullish sentiment. But outside of Iran, a myriad of supply tail risks are still prevalent across OPEC; Iraq, Venezuela and Libya in particular. Prompt month Brent contracts have fallen below the \$110/bbl support level this month, and below Citi's \$110-\$130/bbl range. Global inventories have been building as heightened Saudi (10-m b/d) and OPEC production (31.8-m b/d) outweigh lost Iranian barrels (up to 700-k b/d or more come July 1) and other global supply disruptions, filling commercial (and strategic, in the case of China) stockpiles around the world. As such a seasonal price increase is likely to be less robust than the \$130/bbl 3Q average we forecast. We still believe corn, wheat and soybean markets have room to stay firm and better 'weather' macroeconomic headwinds into the new crop year and are particularly bullish soybeans. In contrast to industrial commodities, Chinese buying and US export sales continue to be supportive for CBOT grain and oilseed prices. The world's largest consumer imported 4.84-mt of soy in April — up 26% year-on-year and above the record 1Q'12 net import average of 4.75-mt. Asian stockpiling is expected to continue this summer. Despite record total acreage and strong crop yield prospects in the US, disappointing production outlooks from South America are likely to continue pressuring US export markets and keep prices bid.

Figure 58. Listed Commodity Exchange Traded Fund Flows (Net)



Source: Citi Investment Research and Analysis estimates

Figure 59. Market Implied Volatility: Equities, Credit, Oil, Gold, FX, Rates



Source: CBOE, ICAP, Citi Investment Research and Analysis

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† This author is not an independent research analyst and may have knowledge of the Firm's positions and/or the Firm's interest in one or more of the securities referenced herein.

Citi Foreign Exchange Forecasts

Market Commentary

This market commentary has been prepared by a member of the Institutional Clients Group of Citi. The information in this communication is not intended to constitute "research" as that term is defined by applicable regulations.

** For specific trade ideas associated with this sector review, please contact the contributors listed at the end of this piece.

- USD strength continues to be our central forecast, as EMU tensions and China growth worries contribute to higher global risk aversion
- Cyclical factors and rising EMU tensions should drive ongoing weakness in EUR
- Further AUD weakness is expected; CAD to be most resilient in the G10 dollar bloc given its normal low beta nature
- In Europe, Sterling may lose some ground vs. USD, but a falling EUR will pull EUR/GBP lower still
- In light of higher risk aversion, SEK and NOK should sell off vs. EUR, but depreciation is probably limited given sharp moves already at least in the case of SEK
- Growth concerns around China likely mean a flat-lining CNY, which in turn could constrain upside potential in many EM Asian currencies vs. the USD

These forecasts are a joint venture between Citi's foreign exchange, global macro and technical strategy groups and our developed and emerging markets economists. Under normal circumstances, we expect to present Forecasts on a monthly schedule although we may offer intra month updates if circumstances dictate.

While these forecasts should be considered the best guide to Citi's short to medium term views on the outlook for the exchange rates covered, individual analysts within various strategy teams may offer separate trade ideas in spot, forward, options or futures when this seems appropriate for technical, tactical or strategic reasons.

Figure 60. Citi Foreign Exchange Forecasts

		Market data			Forecasts			Returns**	
		spot	3m Fwd	12m Fwd	0-3 mos	6-12 mos	long-term	3 mos rtn	12 mos rtn
G10									
Euro	EURUSD	1.27	1.27	1.28	1.23	1.25	1.30	-3.1%	-2.1%
Japanese yen	USDJPY	79	79	79	80	80	85	1.0%	1.7%
British Pound	GBPUSD	1.58	1.58	1.58	1.58	1.58	1.65	-0.1%	0.4%
Swiss Franc	USDCHF	0.95	0.95	0.94	0.98	0.97	0.96	3.2%	3.2%
Australian Dollar	AUDUSD	0.98	0.98	0.96	0.93	0.95	0.90	-4.8%	-0.9%
New Zealand Dollar	NZDUSD	0.76	0.75	0.74	0.72	0.73	0.63	-4.4%	-1.8%
Canadian Dollar	USDCAD	1.02	1.02	1.03	1.03	1.00	0.97	0.9%	-2.6%
Dollar Index*	DXY	81.53	81.50	81.22	83.41	82.13	80.17	2.3%	1.1%
G10 Crosses									
Japanese yen	EURJPY	101	101	100	98	100	111	-2.2%	-0.5%
Swiss Franc	EURCHF	1.20	1.20	1.20	1.20	1.21	1.25	0.0%	1.0%
British Pound	EURGBP	0.80	0.80	0.81	0.78	0.79	0.79	-3.0%	-2.5%
Swedish Krona	EURSEK	9.13	9.17	9.28	9.20	8.75	8.65	0.3%	-5.7%
Norwegian Krone	EURNOK	7.60	7.64	7.75	7.70	7.50	7.50	0.8%	-3.2%
Norwegian Krone	NOKSEK	1.20	1.20	1.20	1.19	1.17	1.15	-0.6%	-2.6%
Australian Dollar	AUDNZD	1.30	1.30	1.29	1.29	1.30	1.43	-0.4%	0.9%
Australian Dollar	AUDJPY	78	77	75	74	76	77	-3.9%	0.7%
Asia									
Chinese Renminbi	USDCNY	6.33	6.35	6.39	6.33	6.21	6.11	-0.3%	-2.9%
Hong Kong Dollar	USDHKD	7.77	7.77	7.76	7.75	7.76	7.75	-0.2%	-0.1%
Indonesian Rupiah	USDIDR	9351	9569	10008	9300	9400	9350	-2.8%	-6.1%
Indian Rupee	USDINR	54.7	55.9	58.0	54.0	55.0	51.0	-3.4%	-5.2%
Korean Won	USDKRW	1173	1177	1186	1176	1135	985	-0.1%	-4.3%
Malaysian Ringgit	USDMYR	3.13	3.15	3.17	3.14	3.01	2.95	-0.3%	-5.2%
Philippine Peso	USDPHP	43.2	43.6	44.1	43.0	42.0	41.5	-1.4%	-4.7%
Singapore Dollar	USDSGD	1.27	1.27	1.27	1.27	1.23	1.19	-0.3%	-3.2%
Thai Baht	USDTHB	31.4	31.6	32.0	32.0	30.2	30.0	1.4%	-5.7%
Taiwan Dollar	USDTWD	29.6	29.6	29.3	30.3	28.8	28.2	2.5%	-1.7%
EMEA									
Czech Koruna	EURCZK	25.4	25.5	25.5	25.6	25.0	24.0	0.5%	-1.9%
Hungarian Forint	EURHUF	298	303	312	295	285	290	-2.5%	-8.6%
Polish Zloty	EURPLN	4.36	4.41	4.54	4.55	4.25	3.90	3.1%	-6.4%
Israeli Shekel	USDILS	3.84	3.86	3.89	3.90	3.95	3.90	1.1%	1.6%
Russian Ruble	USDRUB	31.3	31.9	33.4	31.3	32.1	32.2	-1.9%	-3.7%
Russian Ruble Basket		35.1	35.8	37.5	34.5	35.8	36.5	-3.5%	-4.7%
Turkish Lira	USDTRY	1.84	1.88	1.99	1.86	1.90	1.85	-0.9%	-4.3%
South African Rand	USDZAR	8.37	8.49	8.80	8.45	8.50	8.75	-0.4%	-3.4%
LATAM									
Brazilian Real	USDBRL	2.01	2.04	2.12	2.04	1.91	1.85	-0.3%	-9.7%
Chilean Peso	USDCLP	505	511	524	516	492	490	1.0%	-6.0%
Mexican Peso	USDMXN	13.8	14.0	14.3	14.1	13.4	12.2	0.9%	-6.5%
Colombian Peso	USDCOP	1806	1835	1892	1815	1811	1850	-1.1%	-4.3%

* The DXY forecasts are implied from the forecasts of the constituent crosses.

** Returns are relative to forwards

Source: Citi Investment Research and Analysis

Overview

Trend appreciation in the USD across the board continued and accelerated in May. In addition to cyclical outperformance of the US economy and related concerns about growth in both EMU and China/ Asia, rising risk aversion since mid March has added to downward pressures on non-USD currencies relative to the dollar.

The move has been led by G10 currencies with EUR and CHF notably weak but EM currencies have also suffered. Notably the laggard has been Asia thus far despite

evidence of sharper than expected economic slowdown in China and a flat lining CNY.

Citi forecasts anticipate further USD gains relative to G10 majors with EUR/USD falling towards 1.20 and AUD below 95c. In EM space, most of the recent USD gains are retained, at least over the 0-3m horizon, so the USD on a global basis is expected to rise over this horizon. Heightened risk aversion, related financial market volatility, falling commodity prices and weakening growth expectations form the near term background to these projections.

Over 6-12m, our base case is that risk appetite recovers, probably supported by additional Central Bank liquidity injections. This probably then takes some of the steam out of the USD rally though our forecasts still show the USD flat on an all world basis compared with current spot over this time horizon. Risk return still seems to favour hedging non-USD exposure at this juncture.

G10 Exchange Rates

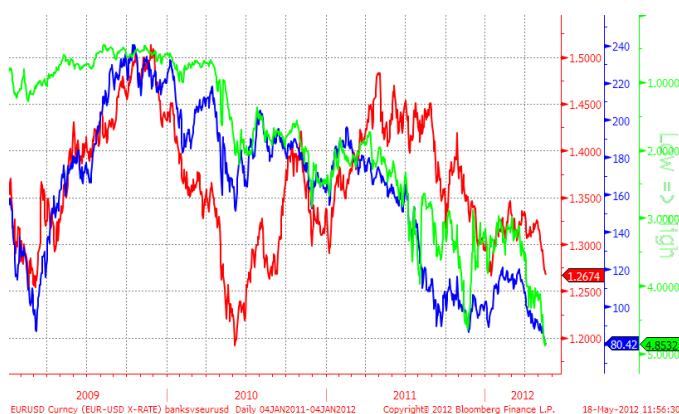
EUR/USD — Downward Pressures Remain

EUR/USD broke downwards through 1.30 in early May and is testing support at 1.26. Citi forecasts assume more downside over the medium term with 1.20-1.25 perhaps the new trading range though lower rates still are not to be ruled out given the ongoing EMU crisis and Citi's related expectation that, eventually, further ECB easing will be forthcoming.

Until recently, key drivers have had opposite pulls on the cross. On one side, a move towards relatively easier monetary policy by the ECB compared to the Fed has exerted downwards pressure. By contrast, the general improvement in risk appetite helped to ease risk premiums around the EMU periphery and support a higher EUR. This helps explain range trading in the first four months of this year and investor frustration that the EUR did not fall more.

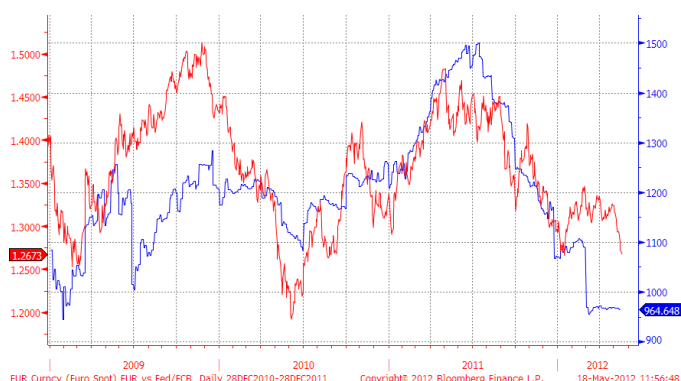
However, recent elections in France and Greece, and the earlier government change in Spain have again raised risk premia as electoral fatigue with austerity programmes has been evident. With the ECB apparently reluctant to ride to the rescue with new SMP purchases, bank equity prices have again been under downwards pressure in the EA and sovereign bond spreads have widened once more (Figure 61).

Figure 61. EUR/USD (Red) vs. EA Bank Stocks (Blue) and Spain-Germany 10y Bond Spread (Green)



Source: Bloomberg

Figure 62. EUR/USD (Red) vs. Relative Balance Sheet of Fed/ECB (Blue)



Source: Bloomberg

Although the ECB has temporarily stepped aside in the provision of new liquidity and rate cuts, over time this will not be the case, in our view. As risk aversion rises, we think EMU pressures will rise and, maybe after a Greek EMU exit and Spain entering a Troika programme, further substantial ease will be forthcoming from the ECB. As a result, both relative front end rates and relative base money/ Central Bank balance sheet expansion should continue to favour USD over EUR (Figure 62).

For now, with prospective risk premia and relative monetary supports to the EUR dubious, we continue to forecast the single currency lower vs. other G10 majors like USD and GBP. Risks here are probably twofold. First, positioning is mainly short EUR. Second, should the Fed lose its nerve first, and respond to a tightening of financial conditions emanating from Europe by easing/ entering QE3, then this might generate unexpected EUR strength.

USD/JPY — Sideways

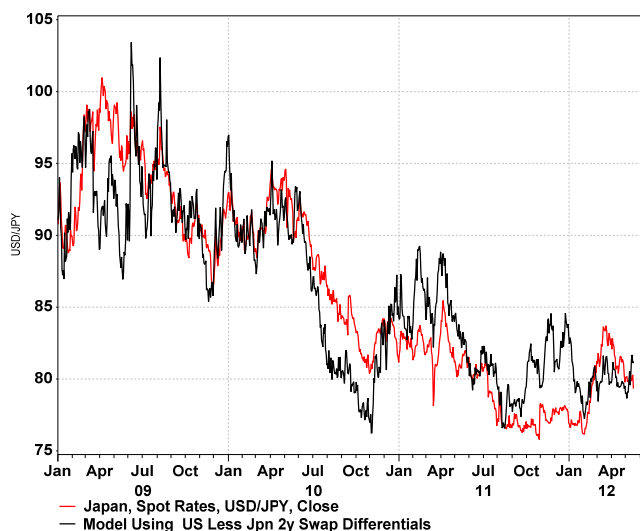
Rising risk aversion starting in mid-March saw USD/JPY re-trace about half of the move higher in the cross observed earlier this year. Since the beginning of May, however, the pair has basically traded sideways around the 80 mark, something we expect to continue for the next several months.

As the yen typically benefits in risk-off periods, our central scenario of weaker risk appetite globally could lead to more downwards pressure on USD/JPY. For instance, the yen rallied around the time of the two major risk-off episodes in early 2010 and mid 2011, reaching a low of 76.24 in the latter case. One factor to consider is that the Fed has typically been more aggressive than the BoJ in responding to a deterioration in financial conditions. However, a decline in the cross to much below 80 at the current juncture could prompt greater political pressure on the BoJ to add further stimulus/ intervention (as it did earlier in the year). By itself, anticipation of such a policy response by the Japanese authorities could limit the amount of downside in the cross.

On the flipside, more sluggish export growth and import flows related to tight domestic energy markets could be negatives for the yen. But USD/JPY is unlikely to move much higher until short-term interest rates in the US rise materially. In fact, a simple model based on 2y swap rate differentials suggests that the cross should be about 80-81 (Figure 63). Similar levels are predicted by a broader model which also takes into account economic, risk appetite and investor positioning indicators

(Figure 64). Citi forecasts show some widening in US-Japan rate differentials over the course of this year, which could push USD/JPY a few figures higher. However, it is only when the Fed is closer to hiking rates that we expect USD/JPY to make a more decisive shift towards 85 or beyond.

Figure 63. USD/JPY: Regressed on US-Japan Rate Differentials



Source: Reuters EcoWin and Citi

Figure 64. Model of USD/JPY Based on Market, Economic and Investor Positioning Indicators



Source: Reuters EcoWin and Citi

Dollar Bloc — AUD & NZD Under Pressure

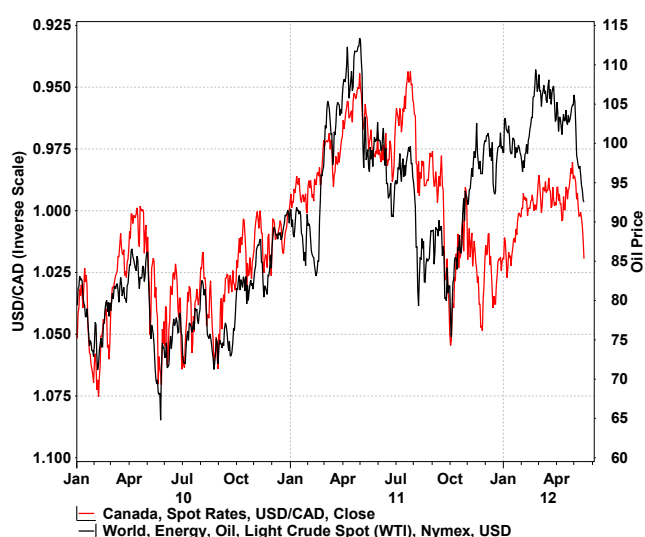
AUD/USD has continued to trend downwards since our last forecast round, with the latest spell of risk aversion pushing the cross below parity for the first time since last December. We expect the sell off to continue and forecast 93c in 0-3 months. Growing concerns about the severity of the slowdown in China combined with higher global risk aversion are key drivers of a weaker AUD. Valuations don't help, either, as AUD continues to look expensive relative to several indicators. Currently, our markets-based model estimates fair value on AUD/USD at 93c. Inputs to our model include terms of trade, Asian FX, Citi's GRAMI measure of risk aversion and volatility-adjusted carry variables. If global financial conditions worsen as expected, then the likely deterioration in the model's inputs will predict an even lower value for the cross. A narrowing rate spread vs. the US, for instance, will only serve to keep downwards pressure on AUD.

Figure 65. Citi's Economic Surprise Indices: G10 (Black), Australia (Blue), Canada (Red) and New Zealand (Green)



Source: Bloomberg and Citi

Figure 66. USD/CAD (inverted) vs. Oil Prices



Source: Reuters EcoWin and Citi

On the domestic side, the economic data in Australia has been somewhat mixed recently. Citi's ESI appears to have reached a bottom in March, although the index remains in negative territory and below the one for G10 as a whole (Figure 65). But if the data in China continues to get worse — see the sharp drop in the Asia ESI led by China in Figure 13 — continued improvements in the Australian employment data are unlikely and other vulnerabilities, such as the housing market, may come to the fore.

Some improvement in risk appetite later this year should help generate some rebound in risk asset prices and could benefit the AUD as well. However, valuations are likely to limit upside in AUD/USD in the medium term and we thus forecast 95c at 6-12 months. Longer term the trend is still down, in our opinion: AUD remains rich to long-term fair value based on Citi's WERM estimate of 87c and some PPP estimates put long-term equilibrium even lower.

The darkening global outlook has also weighed against NZD, which, like AUD, is still very rich relative to longer term fundamentals. In fact, the sell-off in NZD/USD since the start of May can also be seen as a slightly belated response to narrowing interest rate differentials between New Zealand and the US, with current rate spreads still pointing to further downside in the cross. Even though the RBNZ has kept rates on hold since early last year, weaker global growth suggests that the risks of a rate cut in the next few months have been growing.

Our forecasts put NZD/USD at 72c in 0-3 months and 73c in 6-12 months. Together with our forecasts for AUD/USD, AUD/NZD is expected to move mainly sideways around the 1.29-1.30 level over the next year.

CAD should outperform both AUD and NZD though it could weaken slightly vs. USD in the near term. This is in line with the normal low beta nature of CAD of course. Continuation of the recent sharp fall in crude oil prices would likely be a negative for the Canadian dollar. However, as Figure 66 illustrates, the currency failed to continue strengthening as the rally in oil extended to late February. Thus, on the downside, the sensitivity of CAD to a drop in oil prices may be more muted than in the past.

Furthermore, unlike its \$ Bloc counterparts, CAD is actually a bit cheap to long-term fair value, which Citi estimates put at 0.97 on USD/CAD. Similarly, a simple regression model on rate differentials indicates that the cross should be around parity. On the domestic front, the recent data has actually been a bit better relative to expectations compared to other G10 countries, especially Australia and New Zealand (see Figure 5) and Citi economists do not expect the Bank of Canada to cut rates despite stronger global headwinds.

Overall, we expect USD/CAD to trade around parity, a bit higher near term and lower in the long run.

European Crosses

GBP — Rally to Slow But More Upside vs. EUR To Come

After being extraordinarily stable versus a 50:50 basket of EUR and USD since 2010, Sterling rallied strongly since our last *Forecasts*, breaking the recent range to the upside. With the Euro losing ground against the USD, Sterling strength has been particularly evident against the single currency: EUR/GBP has traded at lows not seen since 2008 and GBP gained nearly 4% vs. the EUR since the beginning of April.

The main driver of Sterling strength has been a less dovish MPC, causing the market to price out QE expectations. Nonetheless, given expectations for GDP growth of only 0.2% in 2012, Citi economists think extra stimulus is forthcoming and continue to expect that QE will be expanded further in the UK. Together with heightened risk aversion, our base case sees Cable continuing to trade near 1.58 in the short to medium term.

However, the source of this risk aversion is likely to come from within EMU, and as such we expect EUR/USD to fall faster than Cable, pushing EUR/GBP lower still in the short term. Indeed, as we have pointed out in previous forecasts, EUR/GBP is heavily driven by moves in EUR/USD. With EUR/USD expected to be 1.23 in the short run, our forecast of EUR/GBP is 0.78 in 0-3 months.

Scandis — Depreciation In Risk-Off But Limited Given Recent Moves

In light of the recent increase in risk aversion, EUR/SEK has broken its 8.75-8.95 range established earlier this year to hit a 2012 high above 9.15. This is perhaps not too surprising given that, historically, weaker risk asset prices have coincided with SEK sell-offs. Strikingly, however, EUR/SEK has somewhat overshot relative to its relationship with VIX (Figure 67). As our base case sees risk aversion increasing in the short term, we do not expect this overshoot to be corrected, but rather think VIX will rise further.

In the meantime, local fundamentals are not constructive either. Recent data has been weaker, with the latest industrial production print missing expectations again. Citi economists expect Swedish GDP growth to slow to 0.7% in 2012 from 4.0% a year earlier, with weaker exports to the depressed EA countries a major drag. The Riksbank will thus likely continue to ease policy. Citi continues to expect 50bp of cuts to the repo rate in the remainder of this year, and with only around half of that priced into rate markets, this reduction in carry could also weigh on SEK.

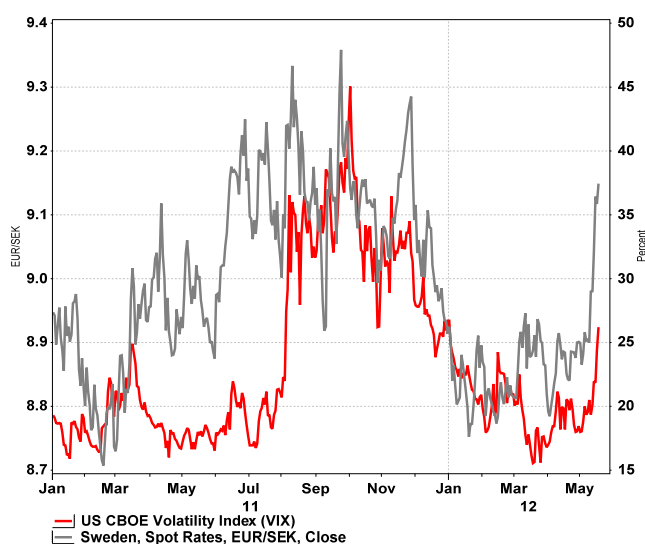
As a result, further EUR/SEK rallies are possible, albeit probably somewhat limited given its recent “overshoot” to risky assets. Our forecast puts EUR/SEK at 9.20 in 0-3 months. In the medium term, a recovery in risk appetite will see EUR/SEK starting

to move back towards long term fair value (e.g. 8.61 on our WERM model) and our forecasts show 8.75 in 6-12 months.

Turning to Norway, after rallying quite sharply following the 25bp rate cut in mid-March, EUR/NOK has held a trading range at higher levels for now. As with the Swedish Krona, NOK will also not be immune to heightened risk aversion, especially given sharply falling oil prices. The last time WTI traded below \$95/bbl, EUR/NOK was at 7.90, although we have seen divergences in the NOK-oil relationship previously (Figure 68). Given the above, we forecast marginal EUR/NOK upside to 7.70 in 0-3 months.

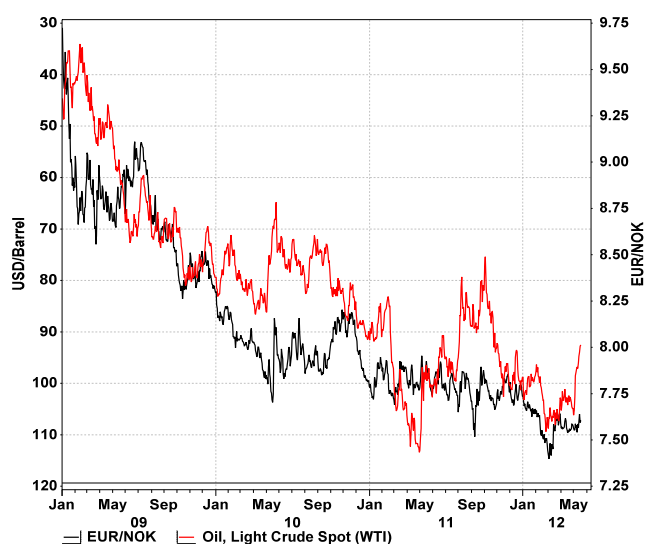
Over the medium term, ECB rate cuts will likely weaken the EUR again, and with the Norges Bank expected to be on hold for the foreseeable future, EUR/NOK is seen edging back towards fair value (just below 7.50 on our WERM estimate).

Figure 67. EUR/SEK vs. VIX



Source: Reuters EcoWin

Figure 68. EUR/NOK and Oil Prices



Source: Reuters EcoWin

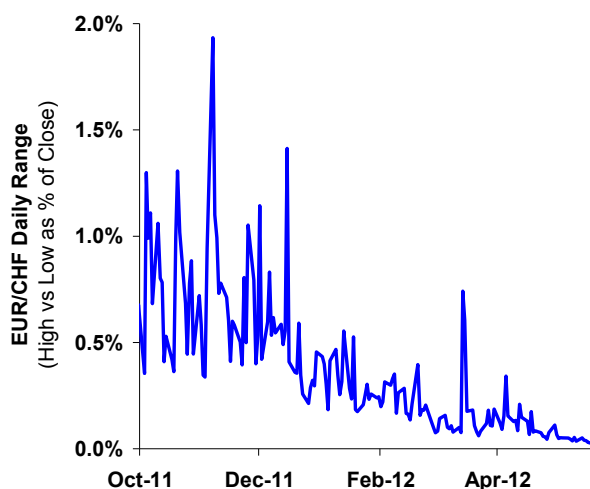
CHF — 1.20 Peg Holds

The Swiss Franc continues to trade in close proximity to its 1.20 peg vs. the EUR. Since our last *Forecasts* in mid-April, realised volatility has also continued to be extraordinarily low. In fact, the daily trading range of EUR/CHF has gradually drifted lower ever since the peg was introduced and has recently become virtually zero (Figure 69).

Meanwhile, CHF remains highly overvalued according to many metrics (e.g. our EUR/CHF WERM estimate puts long term fair value at 1.34). Furthermore, with deflation risks still very evident (Figure 70), it is unlikely that the SNB will baulk anytime soon at the explosive base money growth that has been needed to defend the peg. As a result, we expect continued defence of the existing 1.20 floor.

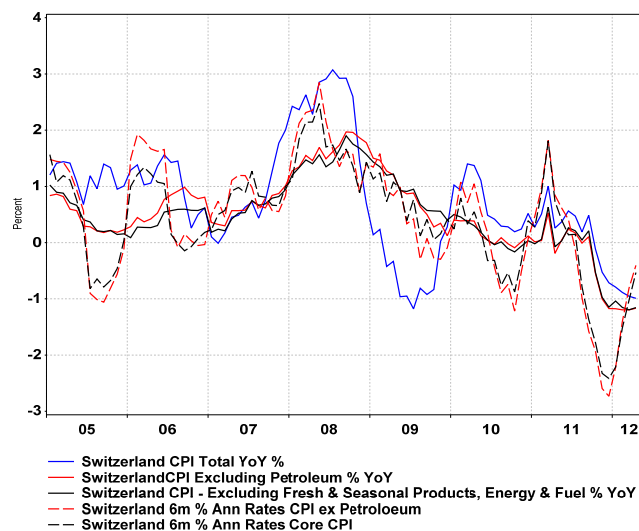
Our forecasts remain unchanged as a result and we continue to see EUR/CHF hovering in a tight 1.20-1.21 range in the short to medium term.

Figure 69. EUR/CHF Realised Volatility Virtually Zero



Source: Citi and Bloomberg

Figure 70. Swiss Inflation Negative

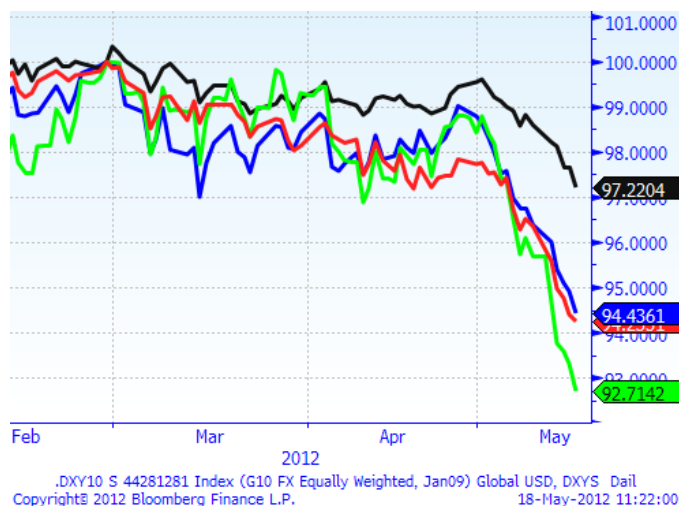


Source: Reuters EcoWin

EM Exchange Rates

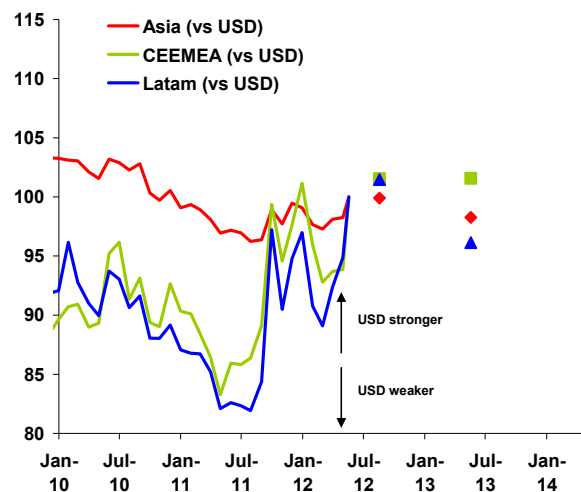
EM FX has continued to sell off, in line with other risky assets. In general our forecasts are for this to continue in the near term, as global risk appetite deteriorates further and growth expectations continue to be revised lower, notably in China. Global risk-off tends to be positive for the USD and negative for EM FX. For the EM exporters, of which there are many, weaker currencies are also desirable to preserve competitiveness. In general Asian FX continues to be more resilient than one might expect, given a flat-lining CNY and falling global trade volumes. Since the end of February when broad USD strength vs. EM became more apparent, CEEMEA has weakened the most and Asia the least (Figure 71). Our forecasts this month reflect a shift in this pecking order between Asia and Latam over 6-12m, while CEEMEA remains a laggard (Figure 72).

Figure 71. Asia (Black) Falls the Least, vs. Latam (Red), CEEMEA (Green) Normalised To Feb 28 (Equally-Weighted Baskets, Lower = Stronger USD)



Source: Citi and Bloomberg

Figure 72. GDP Weighted FX Forecast Paths



Source: Citi and Bloomberg

EM Asia — A Flat CNY

A basket of equally weighted Asian FX has been the strongest in EM since the generalised USD rally began at the end of February (see Figure 71). Yet a number of factors could put pressure on a number of EM Asian currencies. For instance: on balance emerging Asia is the most export-reliant region, with intimate links to a sharply weakening China; data are already weakening ahead of expectations *and* ahead of other EM regions (Figure 73); and, with a couple of exceptions (like India), Asia has less room to cut interest rates than either CEEMEA or Latam, so may seek stimulus via weaker exchange rates.

Our forecasts for Asia this month split into two distinct camps. The first is comprised of China, Hong Kong, India and Indonesia, which are either forecast to stay around current spot (CNY and HKD) or to correct recent overshoots (INR and IDR). The second mainly export led camp (Korea, Taiwan and Thailand), which is also heavily linked to China, is expected to have generally weaker currencies in the near term.

Our forecasts have USD/CNY around current spot at 6.33 in the next three months — i.e., maintaining the flat-lining trend since December. Risks are tilted towards a weaker and more volatile CNY in the very near term in a risk off, strong USD setting. This is especially the case as China's own twin growth engines — exports and property investment — are choking in tandem, and Economic Surprise Indices are plummeting. Citi economists have again lowered their growth forecasts for the second half of 2012. With required reserve ratios at best a blunt policy tool, negative real deposit rates and a reluctance of the PBoC to repeat a distortive, 2009-10 type credit stimulus — a flat or weaker exchange rate is probably the best way to stabilise the economy.

INR and IDR have depreciated ahead of our forecasts, and are expected to recover some lost ground after sell-offs that seem overdone. They are also the two domestic demand led economies in an otherwise export-frenzied region, so should suffer relatively less from falling global trade volumes. INR, which hit a record low against the dollar, has come under pressure for the "right" reasons. These include a higher current account deficit, profligate government (and commensurate wide fiscal

deficit), and a nasty mix of high interest rates with rising inflation but rapidly slowing growth. But at current levels these risks look priced, and our forecasts have USD/INR at 54-55 in the next year.

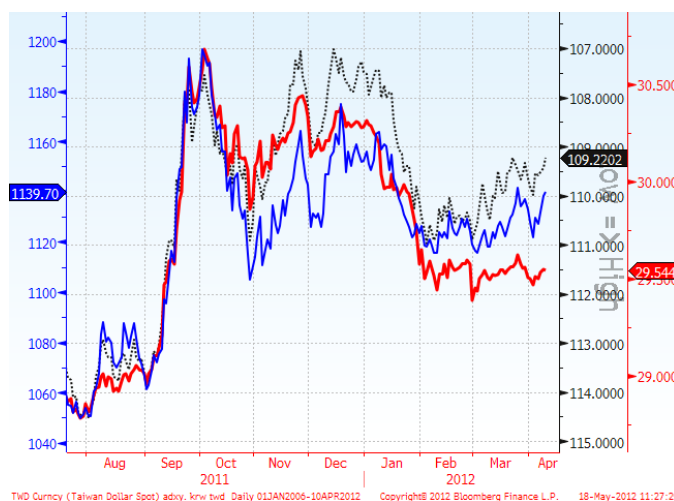
IDR, meanwhile, continues to trade poorly. With heavy foreign bond ownership, sticky inflation and a deteriorating current account, this is as expected. But we doubt it will weaken further given the sell-off so far, and forecast it to strengthen modestly to 9300 in the next three months, ahead of forwards.

Figure 73. ESIs: Asia (Red) vs. CEEMEA (Green) vs. Latam (Blue)



Source: Citi and Bloomberg

Figure 74. TWD (Red) Lags Equally Weighted Asia (Black) and KRW (Blue)



Source: Citi and Bloomberg

At the other end of the Asian spectrum is TWD, which has significantly lagged moves in the rest of the region (Figure 74). In a more acute risk off setting, TWD is forecast to catch up, leaving it the worst performing Asian currency in the next three months. Long (and surprisingly sticky) investor positioning and central bank intervention explain TWD's disconnect with other Asian FX in recent months. But with risk off sentiment mounting just as local macro data and inflation have started to weaken sharply, we expect the recent move higher in USD/TWD to be sustained. Taiwan is also of course more exposed to a weakening China/ flat-lining CNY as the most open economy in Asia (Figure 80). Our forecasts have USD/TWD at 30.3 in the next three months.

High beta KRW could also weaken further in the next three months. The need for stimulus is clear, with increasingly weak domestic data and a central bank that on balance seems to prefer easing via the exchange rate rather than via interest rates. Reversing equity portfolio flows and falling bond inflows should add to downward pressure.

MYR is forecast to stay around current spot in the next three months. Risks around this forecast include: Malaysia's greater commodity focus; intensely export reliant economy; and heavy foreign ownership of local bonds. MYR is also overvalued in real effective terms, which is unusual in EM Asia.

THB, meanwhile, is expected to underperform. USD/THB has been in a tight upward sloping channel since May 1st, and if it stays in this channel, should rise to 32 by end-May/early-June, which is also our three month forecast. An additional

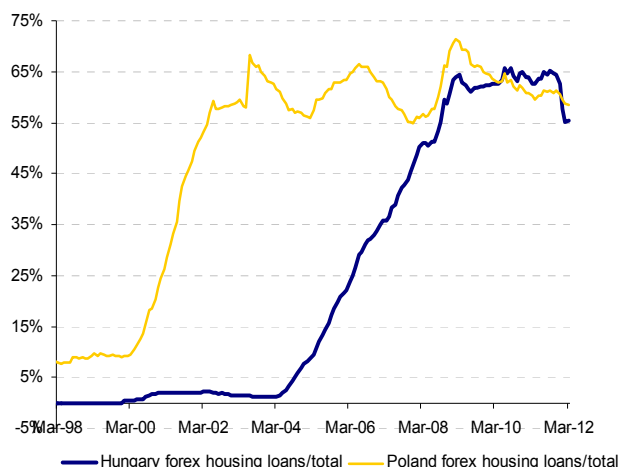
source of pressure could stem from its current account deficit, which stands out in the region.

PHP and SGD are both forecast to hover around current spot. The relative strength of the PHP noted last month has since reversed, and we forecast PHP to stay generally weak at around 43 in the next three months. We have also adjusted our USD/SGD forecasts higher, to 1.27 in the 0-3 month window. Deeper weakness in data could pare expectations of another tightening from the MAS, dampening the currency.

CEEMEA — Contagion

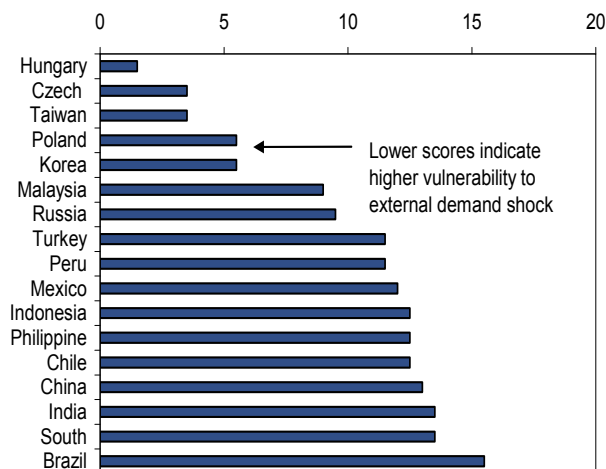
Emerging Europe is of course in the eye of the “Grexit” storm, and currencies across the region have come under intense pressure in recent weeks as uncertainty around the EMU crisis has mounted. Indeed most of the worst performing EM currencies since May 1st are clustered in CEEMEA. The Polish zloty has suffered the most, and is down by around 8% against the USD. Our forecasts this month show near-term pressure on CEEMEA FX being sustained, with PLN forecast to fall another 7% or so, vs. the USD in the next 3m.

Figure 75. Poland Still Has Heavy FX Borrowing



Source: Reuters EcoWin and Citi

Figure 76. Citi's External Vulnerability Rankings*



*Each score averages the export share of GDP and net exports' contribution to GDP growth in 2012. Source: CIRA

Perhaps ironically, the move sharply higher in EUR/PLN coincided with a surprise interest rate hike from the National Bank of Poland. Although Poland is better protected than some of its peers — in the 2008-9 crisis it stood out as the only country in Europe to escape recession — it is certainly not insulated, with a tight correlation between Polish and German industrial production growth, for example. With twin deficits on the current and fiscal accounts, growing reliance on portfolio flows, substantial external ownership of the local bond market and a hefty chunk of private domestic mortgages that are still denominated in foreign exchange (Figure 75), we expect continued pressure on PLN. Our forecasts have EUR/PLN at 4.55 in the next three months, making it the worst performing EM currency relative to spot.

The Czech koruna and Hungarian forint are forecast to fare a bit better, notwithstanding the large downside surprises in recent economic data in each, particularly Q1 GDP, and more dovish sounding central banks. The Czech

Republic is the second most sensitive economy in EM to shifting external tides (Figure 76) — but also has a healthy trade surplus, forecast to be around 2.5% this year, by far the best fiscal dynamics, and importantly, low foreign penetration in the bond market which makes it less sensitive to shifts in global sentiment. Our forecasts have EUR/CZK around current spot in the next three months.

Hungary meanwhile combines sharply weakening current activity with huge falls in PMIs (the April PMI collapsed from 57.7 to 46.9) and fresh fiscal austerity measures. Credible fiscal commitments are certainly needed: Citi economists forecast a 4.2% fiscal surplus in 2011 turning to a 3.2% deficit this year, a 7 percentage point swing, while debt to GDP stays around 80%, the highest in EM. In Hungary's case we expect interest rate cuts to be somewhat supportive of HUF in the medium term, as they could provide a necessary boost to a depressed real economy. That said, continued uncertainty around the IMF deal does pose a risk to the HUF stability, especially in a less risk-friendly market setting. The significant widening of HUF basis in cross currency swaps, for example, hints at this threat. We forecast EUR/HUF to oscillate around 290 over the next twelve months, with risks tilted to the upside.

The risk-off environment that we anticipate in the short term also paints a challenging picture for the Turkish lira, even though the central bank is keen to keep the currency relatively strong to dampen inflation pressures. Monetary policy remains as an important source of uncertainty: The CBT recently provided liquidity in its one-week repo at 5.75% despite the recent depreciation pressures, once again surprising the markets. It has also allowed TRY to “break through” the informal “band” of 1.75-1.80. Moreover, the quality of external financing continues to deteriorate and, contrary to the CBT's prediction, there has not been a pick up in capital inflows. Our forecasts show USD/TRY at 1.86 in 0-3 months, more or less in line with 3m forwards.

ILS has done better than most in its region since the start of the year, and is up some 6.7% vs. the HUF or PLN for example over this period. Our forecasts show ILS weakening, to 3.90 in 0-3 months and 3.95 further out. FRAs suggest 50% chance of a rate cut in the coming months — and, although we don't believe that the case for cuts is clear, weak fiscal policy implementation and gloomy trade data are likely to weigh against the currency.

USD/ZAR has been moving in a steep upward sloping channel since the beginning of May, and our projections show this continuing to 8.45 in 0-3 months and 8.50 over the medium term. Factors underpinning our bearishness include: terms of trade that remain under pressure; continued relative richness of ZAR on a real effective basis; and a weak macro backdrop.

Finally, the ruble, where our forecasts reflect two opposing forces. On the one hand, Citi's forecasts point to some upside in Brent by year-end, which would be supportive for the currency. On average, the RUB basket appreciates/depreciates by 1% for every 15% change in the oil price. We find that sensitivity to analysts' oil forecasts can be even higher. But on the other hand, RUB is also highly sensitive to global risk appetite. For instance, a 0.3 point change in our Global Macro Risk Aversion Index could move the basket by 1%. Balancing these out, our forecasts have the basket at 34.5 in the next three months and 35.8 in the medium term.

Latam — Weaker, Then Stronger

BRL has led the sell off in EM FX that has occurred since our last *Forecast* round. The chief drivers of moves in individual crosses have been strikingly different, however — intervention in the case of BRL, for example, and investor positioning

and global risk off for high-beta MXN. In the near term, this trend is expected to continue, and we have all four crosses weakening vs. the USD in spot. Further out, however, they outperform, with BRL the best performing global currency relative to 12 month forwards.

Figure 77. CLP, AUD and Copper



Blue — USD/CLP inverted; Red — AUD; Black — Copper spot
Source: Bloomberg

Figure 78. MXN is High Beta



Orange — USD/MXN; Black — GRAMI With 30 day Lead
Source: Citi and Bloomberg

We forecast continued underperformance for MXN and expect USD/MXN at 14.1 in three months' time. Two reasons underpin our bearishness. The first is the fact that MXN is high beta to global risk appetite (Figure 78), and so would be expected to continue to suffer more than others (and continue to overshoot) if risk aversion continues to rise as we expect. Second, and importantly, USD/MXN has been something of a consensus short. So the wider forecast USD rally in a less risk-friendly setting has been exacerbated in the case of MXN. At the current juncture, these outweigh structural positives for MXN, including close ties to a strong US and limited China vulnerability (unlike BRL or CLP) and firm local data.

For Brazil, meanwhile, it is difficult to forecast a near-term bounce even if it is justified by the very sharp sell-off this year or indeed positioning data that show investors are already quite long USD/BRL. The reason is straightforward: the sheer will of policy-makers, both in government and at the central bank, to keep the currency weak. That the central bank "let" USD/BRL push past the 2.0 mark could be telling — late last year, they intervened in the opposite direction at 1.95. Rising expectations for further monetary easing are an added negative for BRL, which is also of course sensitive to commodity prices and developments in China, its main trading partner. In the medium term, BRL is forecast to outperform as risk appetite improves. Our forecasts have USD/BRL at 2.04 in 0-3 months and 1.91 further out.

CLP is expected to fare worst in Latam in the next three months, both relative to current spot and forwards. The Chilean currency and economy are intimately linked to copper prices, where downward pressure should intensify in risk off, and CLP has lagged weakening in other commodity currencies, e.g. AUD (Figure 77). Furthermore, since the largest source of copper demand is China, where Citi has once again cut growth forecasts, downside for copper could be greater than for

other commodity complexes. We expect USD/CLP at around 516 in the next three months.

COP, meanwhile, continues to outperform its cohort — despite a central bank that has a strong preference for a weaker exchange rate. As in 2009, central bank intervention has been calibrated as it still has very limited sterilization capabilities — and, as was the case then, will take some time to meaningfully weaken COP and forward points. With FX inflows from oil sector companies continuing apace, some of COP's beta to global risk measures should stay dampened — particularly given that carry remains attractive too. Our forecasts have USD/COP at 1815 in the next three months, and 1811 in the medium term.

Contributors

**** Citi Foreign Exchange: Forecasts** is a joint venture between Citi's foreign exchange, global macro and technical strategy groups and our developed and emerging markets economists. The analysts listed below have contributed to these forecasts in one form or another.

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Figure 80. Citi Quarterly Interpolated Forecasts

Quarterly Interpolated Forecasts

	Currency	Spot	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14
G10-US Dollar											
Euro	EURUSD	1.27	1.25	1.23	1.24	1.25	1.26	1.27	1.28	1.29	1.30
Japanese yen	USDJPY	79	80	80	80	80	81	82	83	84	85
British Pound	GBPUSD	1.58	1.58	1.58	1.58	1.58	1.59	1.61	1.62	1.64	1.65
Swiss Franc	USDCHF	0.95	0.96	0.97	0.97	0.97	0.97	0.97	0.96	0.96	0.96
Australian Dollar	AUDUSD	0.98	0.96	0.93	0.94	0.95	0.94	0.93	0.92	0.91	0.90
New Zealand Dollar	NZDUSD	0.76	0.74	0.72	0.72	0.73	0.72	0.69	0.67	0.64	0.63
Canadian Dollar	USDCAD	1.02	1.02	1.03	1.02	1.01	1.00	0.99	0.98	0.97	0.97
Dollar Index*	DXY	81.56	82.40	83.20	82.77	82.35	81.89	81.39	80.90	80.42	80.05
G10 Crosses											
Japanese yen	EURJPY	101	100	99	99	100	101	104	107	109	111
Swiss Franc	EURCHF	1.20	1.20	1.20	1.20	1.21	1.21	1.22	1.23	1.24	1.25
British Pound	EURGBP	0.80	0.79	0.78	0.78	0.79	0.79	0.79	0.79	0.79	0.79
Swedish Krona	EURSEK	9.14	9.17	9.13	8.98	8.83	8.74	8.71	8.69	8.66	8.65
Norwegian Krone	EURNOK	7.60	7.65	7.67	7.60	7.54	7.50	7.50	7.50	7.50	7.50
Norwegian Krone	NOKSEK	1.20	1.20	1.19	1.18	1.17	1.17	1.16	1.16	1.16	1.15
Australian Dollar	AUDNZD	1.30	1.30	1.29	1.30	1.30	1.32	1.35	1.38	1.41	1.43
Australian Dollar	AUDJPY	78.1	76.4	74.7	75.2	75.7	76.1	76.2	76.3	76.4	76.4
EM Asia											
Chinese Renminbi	USDCNY	6.33	6.33	6.31	6.27	6.23	6.20	6.17	6.15	6.12	6.11
Hong Kong Dollar	USDHKD	7.77	7.76	7.75	7.75	7.76	7.76	7.76	7.75	7.75	7.75
Indonesian Rupiah	USDIDR	9350	9327	9316	9349	9382	9394	9382	9369	9357	9344
Indian Rupee	USDINR	54.7	54.4	54.2	54.5	54.8	54.5	53.5	52.5	51.5	51.0
Korean Won	USDKRW	1173	1174	1170	1156	1142	1117	1080	1042	1005	985
Malaysian Ringgit	USDMYR	3.13	3.14	3.12	3.08	3.03	3.00	2.99	2.97	2.96	2.95
Philippine Peso	USDPHP	43.3	43.1	42.8	42.5	42.2	41.9	41.8	41.7	41.6	41.5
Singapore Dollar	USDSGD	1.27	1.27	1.26	1.25	1.24	1.23	1.22	1.21	1.20	1.19
Thai Baht	USDTHB	31.4	31.7	31.7	31.1	30.5	30.2	30.1	30.0	30.0	30.0
Taiwan Dollar	USDTWD	29.6	29.9	30.1	29.6	29.1	28.7	28.6	28.4	28.3	28.2
EM Europe											
Czech Koruna	EURCZK	25.41	25.50	25.51	25.30	25.11	24.88	24.63	24.38	24.13	23.93
Hungarian Forint	EURHUF	299	297	293	290	287	286	287	288	289	290
Polish Zloty	EURPLN	4.36	4.45	4.50	4.40	4.30	4.21	4.12	4.03	3.95	3.90
Israeli Shekel	USDILS	3.84	3.87	3.91	3.92	3.94	3.94	3.93	3.92	3.91	3.88
Russian Ruble	USDRUB	31.4	31.3	31.4	31.7	32.0	32.1	32.1	32.1	32.2	32.1
Russian Ruble Basket	RUB	35.1	34.8	34.7	35.1	35.5	35.8	36.0	36.2	36.4	36.5
Turkish Lira	USDTRY	1.84	1.85	1.87	1.88	1.89	1.89	1.88	1.87	1.86	1.85
South African Rand	USDZAR	8.38	8.41	8.46	8.47	8.49	8.53	8.59	8.66	8.72	8.80
EM Latam											
Brazilian Real	USDBRL	2.01	2.02	2.02	1.98	1.94	1.91	1.89	1.87	1.86	1.85
Chilean Peso	USDCLP	505	510	512	504	496	492	491	491	490	490
Mexican Peso	USDMXN	13.8	14.0	14.0	13.7	13.5	13.2	12.9	12.6	12.4	12.2
Colombian Peso	USDCOP	1806	1810	1814	1813	1811	1815	1825	1835	1845	1854

* The DXY forecasts are implied from the forecasts of the constituent crosses.

Source: Citi Investment Research and Analysis

Figure 81. Citi Annual Forecasts

Annual Forecasts

	Currency	Spot	2012*	2013*	2014*	2015*	2016*
G10-US Dollar							
Euro	EURUSD	1.27	1.26	1.26	1.30	1.33	1.35
Japanese yen	USDJPY	79	81	81	85	85	85
British Pound	GBPUSD	1.58	1.58	1.60	1.65	1.68	1.70
Swiss Franc	USDCHF	0.95	0.95	0.97	0.96	0.97	0.98
Australian Dollar	AUDUSD	0.98	0.97	0.94	0.90	0.89	0.88
New Zealand Dollar	NZDUSD	0.76	0.75	0.70	0.63	0.63	0.62
Canadian Dollar	USDCAD	1.02	1.02	0.99	0.97	0.97	0.97
Dollar Index**	DXY	81.56	81.80	81.63	79.95	78.95	78.00
G10 Crosses							
Japanese yen	EURJPY	101	102	103	111	113	115
Swiss Franc	EURCHF	1.20	1.20	1.22	1.26	1.29	1.32
British Pound	EURGBP	0.80	0.80	0.79	0.79	0.79	0.79
Swedish Krona	EURSEK	9.14	9.02	8.74	8.65	8.63	8.62
Norwegian Krone	EURNOK	7.60	7.63	7.51	7.50	7.49	7.48
Norwegian Krone	NOKSEK	1.20	1.18	1.16	1.15	1.15	1.15
Australian Dollar	AUDNZD	1.30	1.29	1.34	1.42	1.42	1.41
Australian Dollar	AUDJPY	78.1	78.0	76.1	76.2	75.4	74.4
EM Asia							
Chinese Renminbi	USDCNY	6.33	6.30	6.19	6.11	6.08	6.06
Hong Kong Dollar	USDHKD	7.77	7.76	7.76	7.75	7.75	7.75
Indonesian Rupiah	USDIDR	9350	9284	9382	9338	9288	9238
Indian Rupee	USDINR	54.7	53.5	53.8	51.0	50.6	50.3
Korean Won	USDKRW	1173	1158	1095	990	987	989
Malaysian Ringgit	USDMYR	3.13	3.10	3.00	2.95	2.95	2.96
Philippine Peso	USDPHP	43.3	42.8	41.9	41.5	41.6	41.7
Singapore Dollar	USDSGD	1.27	1.26	1.22	1.19	1.19	1.19
Thai Baht	USDTHB	31.4	31.3	30.2	30.0	30.0	30.0
Taiwan Dollar	USDTWD	29.6	29.8	28.7	28.2	28.2	28.2
EM Europe							
Czech Koruna	EURCZK	25.41	25.28	24.75	23.86	23.21	22.58
Hungarian Forint	EURHUF	299	294	287	289	286	283
Polish Zloty	EURPLN	4.36	4.38	4.17	3.91	3.90	3.90
Israeli Shekel	USDILS	3.84	3.85	3.93	3.86	3.69	3.53
Russian Ruble	USDRUB	31.4	30.9	32.1	32.0	31.3	30.6
Russian Ruble Basket	RUB	35.1	34.6	35.9	36.5	36.7	36.9
Turkish Lira	USDTRY	1.84	1.84	1.88	1.85	1.85	1.86
South African Rand	USDZAR	8.38	8.25	8.57	8.85	9.25	9.65
EM Latam							
Brazilian Real	USDBRL	2.01	1.96	1.90	1.85	1.83	1.81
Chilean Peso	USDCLP	505	504	493	490	490	490
Mexican Peso	USDMXN	13.8	13.6	13.1	12.3	12.5	12.8
Colombian Peso	USDCOP	1806	1807	1822	1858	1891	1925

*Averages of end-quarter data shown in quarterly interpolation table.

** The DXY forecasts are implied from the forecasts of the constituent crosses.

Source: Citi Investment Research and Analysis

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Appendix A-1

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Data current as of 31 Mar 2012

	12 Month Rating			Relative Rating		
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