# Global Economic Outlook and Strategy

## September 2013

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- We have a slight tilt to forecast upgrades this month, and we look for growth of 2.5% in 2013 (up a tenth from last month) and 3.2% in 2014 (unchanged). We are again lifting growth forecasts for the UK and euro area. We are also edging our 2013 EM forecast up slightly, with upgrades to forecasts for China, Brazil, Argentina and Venezuela, balanced by downgrades for India, Indonesia, Nigeria, South Africa and Mexico. The upgrade to our overall EM growth forecast is small, but is the first upgrade since Feb-12. But, over the last six months as a whole, we have raised our 2014 growth forecast for advanced economies by 0.5%, while cutting our 2014 EM forecast by 0.5%. Our forecasts are below consensus in all four BRIC countries.

- A widespread recovery is under way across advanced economies. Some nearterm global downside risks have receded, with deferred Fed tapering plus signs that China's growth is stabilizing. Credit expansion in China is outstripping the 2012 pace, both in cash terms and as a share of GDP. However, downside risks across EM are sizeable, reflecting rising interest rates in some cases plus signs that, so far, recoveries in advanced economies are producing only a limited lift in EM exports. Some fiscal-related uncertainties also are rising with the US fiscal impasse and prospect of Japan's consumption tax hike in 2014. These uncertainties probably contributed to the Fed's decision to defer tapering, while both fiscal measures and BoJ loosening will probably help provide offsetting support in 2014. In the euro area, fiscal drag has diminished markedly in the last year and fiscal tightening is likely to remain modest in 2014.

- The recovery in advanced economies is unlikely to cause early tightening, given ample slack. Our base case is for the Fed to begin tapering before yearend, but either soft data or fiscal uncertainties could delay the first tapering step into 2014. We expect that the Fed and BoE will not hike rates until 2015, and that tightening will be gradual beyond that. Tightening is even more distant for the ECB and BoJ. By contrast, we expect many EM countries will hike rates in coming months amidst external vulnerabilities, market strains, and inflation worries.

Figure 1. Currency and Interest Rate Forecasts, as of 25 Sep 2013

| | 25 Sep 2013 | 4Q 13F | 1Q 14F | 2Q 14F | 3Q 14F | 4Q 14F | 1Q 15F |
|---|---|---|---|---|---|---|---|
| United States: Federal Funds | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 |
| 10-Yr. Treasuries (Period Ave.) | 2.72 | 2.70 | 2.78 | 2.98 | 3.15 | 3.25 | 3.40 |
| Euro Area: US$/€ | 1.35 | 1.37 | 1.36 | 1.36 | 1.37 | 1.38 | 1.38 |
| Euro Repo Rate | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 |
| 10-Yr. Bunds (Period Ave.) | 1.88 | 1.80 | 1.80 | 1.80 | 1.80 | 1.90 | 2.00 |
| Japan: Yen/US$ | 99 | 101 | 103 | 105 | 106 | 107 | 108 |
| Call Money | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 |
| 10-Yr. JGB (Period Ave.) | 0.68 | 0.65 | 0.60 | 0.50 | 0.60 | 0.70 | 0.80 |

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

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

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Figure 2. Forecast Highlights and Changes from Last Month

| | |
|---|---|
| ■ Global | We have a slight tilt to forecast upgrades this month, and we look for growth of 2.5% in 2013 (up a tenth from last month) and 3.2% in 2014 (unchanged). Upgrades are greatest among the advanced economies, but we also make our first (albeit slight) upgrade to EM growth forecasts since early 2012. |
| ■ United States | Recovery appears to be overcoming peak fiscal headwinds but lingering uncertainties and higher market interest rates have delayed a Fed decision on tapering QE until possibly December or later if budget negotiations are dragged out. Financial conditions remain looser than norms and, along with upticks in business surveys, suggest better underlying momentum. |
| ■ Euro Area | The euro area economy is growing again, albeit modestly. As the recovery remains fragile, the ECB will continue to keep monetary conditions accommodative, given the subdued inflation outlook. We expect the ECB to agree to the release of minutes and an extended forecast horizon in the coming months. |
| ■ China | Economic data released since the beginning of July have been generally positive. We now expect growth to rebound to 7.8% YoY in 3Q. Correspondingly, we upgrade 2013 growth from 7.4% to 7.6%, and 2014 growth from 7.1% to 7.2%. However, the growth downturn may resume toward the end of the year due to a less accommodative policy stance and the short-term negative impact of reform measures. |
| ■ Japan | PM Abe appears most likely to make a final decision to proceed with the consumption tax hike (in April 2014) in early October. While the administration has already accelerated its discussion about policy measures to mitigate a negative impact from the consumption tax hike, we are skeptical that these "policy offsets" can fully mitigate the negatives. |
| ■ United Kingdom | We have again raised our growth forecasts, and advanced the data of the first hike to 2015 from 2017 amidst signs that productivity may rebound a little more slowly than we previously assumed. |
| ■ Canada | The outlook for growth and inflation remains largely unchanged despite recent shocks. Hence, we maintain our expectation of a 1.00% policy rate target until 1Q 2015, accompanied by a slight tightening bias. |
| ■ Australia | Leading indicators of activity have given us more conviction in our above-consensus 2014 GDP forecast for Australia of 3.0%. We maintain our call for no further RBA interest rate cuts in the current cycle. |
| ■ Emerging Asia (ex China) | Asia remains on track for a mild export-led rebound in 3Q13. However, we continue to cut growth forecasts in taper-sensitive countries such as India, Indonesia and Malaysia. India's external deficit is narrowing significantly. Indonesia and Malaysia have not begun adjusting yet, but Malaysia's fiscal tightening plans and more hawkish central bank tone are likely to restore confidence faster than in Indonesia. The Fed's September "non-taper" surprise has bought EM countries some time, but policymakers should stay on course to address external and financial imbalances. |
| ■ CEEMEA | Central bankers in CEEMEA have expressed frustration with the FOMC's decision to delay tapering, judging it to be an extra source of volatility. And since there is still an uncertain outlook for a strong export-led recovery in EM, policymakers have reasons to be worried, particularly since a number of countries – Russia, South Africa, Turkey, for example – have uncomfortably high inflation. The brightest spot in CEEMEA continues to be Central Europe, where exchange rates are depreciated after years of deleveraging, and where the benefits of the Eurozone's stabilisation are felt most directly. |
| ■ Lat Am | In Brazil we continue to see growth decelerating in the coming quarters, despite the positive surprise in 2Q13. However, and on the back of increased inflationary pressures, we expect the Selic rate reach 9.75% by 2013 yearend. In Mexico, real GDP growth disappointed in 1H13 and stood at only 1% YoY. Sluggish activity growth and a benign inflation outlook should lead Banxico to cut the policy rate by 25bps in October, following the unexpected cut in September. In Venezuela and Argentina, the scarcity of foreign currency continues to be the main macroeconomic problem. |

Source: Citi Research

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

| | 2012 | 2013F | 2014F |
|---|---|---|---|
| World | 1.8% | 2.4% | 3.8% |
| United States | 3.6 | 2.7 | 4.7 |
| Japan | 0.2 | 0.2 | 3.2 |
| Euro Area | -2.3 | 0.0 | 0.9 |
| United Kingdom | -2.4 | -0.3 | 1.4 |
| Canada | 0.9 | 1.0 | 1.3 |
| China | 10.0 | 9.4 | 8.7 |
| India | 2.1 | 1.5 | 4.4 |
| Korea | 0.9 | -0.2 | 2.8 |
| Brazil | -2.7 | 2.0 | 2.5 |

Source: Citi Research

# Overview – AE Recovery, EM Worries

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**Our global growth forecasts are little changed, with a slight upgrade to our overall EM forecast**

We have a slight tilt to forecast upgrades this month, and we look for growth of 2.5% in 2013 (up a tenth from last month) and 3.2% in 2014 (unchanged). We continue to lift aggregate growth forecasts for advanced economies (AEs), with upgrades this month for the UK and euro area. This month, we are also edging our 2013 EM forecast up slightly, by a tenth, with upgrades to growth forecasts for China, Brazil, Argentina and Venezuela, balanced by downgrades for India, Indonesia, South Africa and Mexico. The upgrade to our aggregate EM growth forecast is small, but is the first upgrade since Feb-12. Over the last six months as a whole, we have raised our 2014 growth forecast for advanced economies by 0.5%, while cutting our 2014 EM forecast by 0.5%. Our forecasts are below consensus in many emerging markets, including all four BRIC countries, around consensus in the euro area and US, but above consensus in Japan, Australia, Korea and the UK.

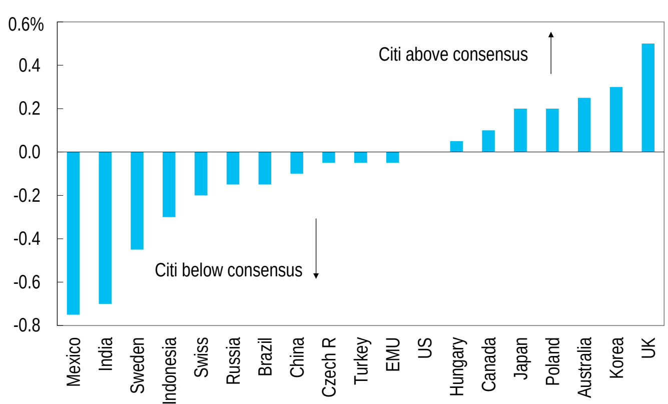
**Some nearterm downside risks over the growth outlook have receded**

Last month, we highlighted various nearterm uncertainties, including Fed tapering, Japan's consumption tax debate, the extent of China's slowdown, wider EM vulnerabilities and the need to resolve the next steps in the euro area programs for Greece, Portugal and Ireland[1]. Some immediate downside risks to growth have receded, with deferred Fed tapering plus signs that China's growth is stabilizing. By contrast, some fiscal-related uncertainties are rising.

- The Japanese government's apparent decision to proceed with the consumption tax hike in 2014 adds to uncertainties for 2014-15, although we suspect that – for the first year at least – there will be some offset from monetary easing and temporary fiscal measures.

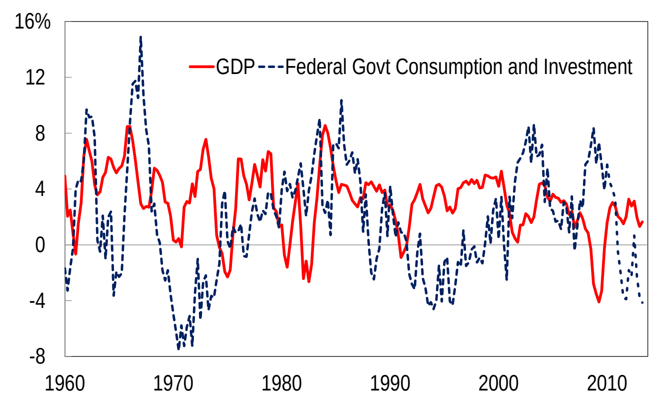
- Uncertainties are rising over US fiscal policy. Loose financial conditions have so far supported growth in the face of heavy fiscal tightening, with federal government consumption and investment down more than 4% YoY in Q2, the largest drop since the post-cold war "peace dividend" of the mid-90s. Our base case assumes some further fiscal tightening in 2014, but not enough to prevent GDP growth from running at 2½%-3% QoQ SAAR next year. However, the nearterm uncertainties over fiscal policy are clear, and fiscal indecision may have played some role in the Fed's decision to maintain QE. Provided fiscal hurdles are crossed without too much damage and delay, the Fed could begin tapering in December, with asset purchases done by Sep-14, but there is a chance that the fiscal debate could hamstring monetary policy decisions into next year.

Figure 4. Selected Countries – Citi GDP Growth Forecasts for 2013-14 Compared to Consensus, Sep 2013




Sources: Consensus Economics and Citi Research

Figure 5. US – Real GDP and Real Federal Government Consumption Plus Investment YoY, 1960-2013



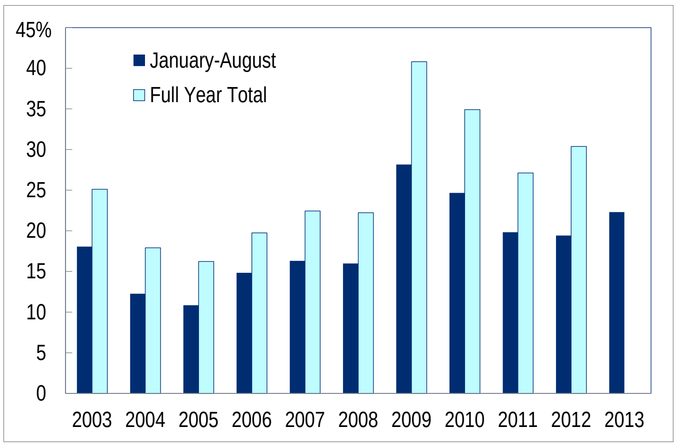

Sources: DataStream and Citi Research

[1] See "*Global Economic Outlook and Strategy*", Willem Buiter et al, August 2013, Citi.

**China's nearterm downside risks are diminishing, amidst signs that credit stimulus is ongoing…**

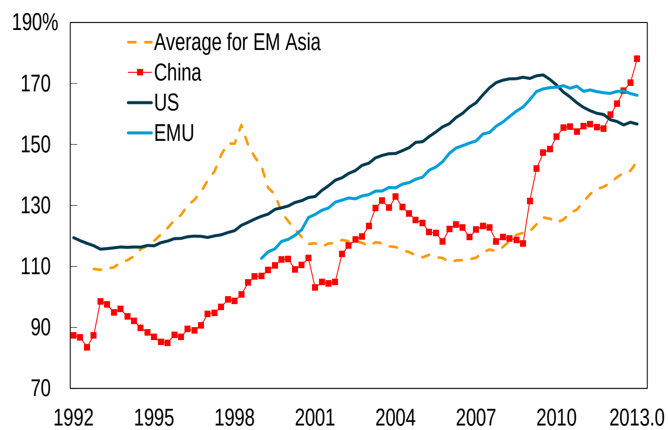
In China, we have edged up our GDP growth forecasts to 7.6% for 2013 and 7.2% for 2014, versus 7.4% and 7.1% respectively last month[2]. Recent data and surveys suggest that the economy is rebounding a bit, and we expect Q3 growth will rise to about 7.8% YoY from 7.5% in Q2. Moreover, total social financing (TSF) rebounded sharply in August, and we suspect that – despite declines in FX lending – the authorities will allow enough credit growth to achieve their 7.5% GDP growth target for 2013. TSF in Jan-Aug totaled RMB12.5tn, 24% up from last year and the highest Jan-Aug total on record (third highest as a share of annual GDP). If monthly TSF in Sep-Dec matches the Jan-Aug average, then the full year 2013 will reach about 33-34% of annual GDP, up from 30% of GDP in 2012 and 27% of GDP in 2011, albeit still below the 2009-10 levels (41% and 35% of annual GDP, respectively).

Figure 6. China – Total Social Financing as Pct of Annual GDP, 2003-13




Note: To calculate 2013 nominal GDP, we assume that YoY nominal GDP growth in H2-2013 matches the Q2-2013 pace. Sources: DataStream and Citi Research

Figure 7. Selected Countries – Ratio of Private Debt/GDP, 1992-2013




Note: We show the gross unconsolidated debts of the household and non-financial business sectors as a share of the four-quarter average of nominal GDP. EM Asia is the average for HK, Indonesia, Korea, Malaysia, Singapore and Thailand. Sources: BIS, DataStream and Citi Research

**…but we remain worried about the longrun sustainability of China's credit-driven growth model**

Nevertheless, we continue to be worried about China's ability to sustain this model of credit-driven stimulus over time. China's policymakers continue to rely on credit-driven investment spending to support growth, even though it seems to take ever-larger doses of credit stimulus. The ratio of private debt/GDP (measuring the gross unconsolidated debts of the household and non-financial corporate sectors against the four-quarter average of nominal GDP) has soared from 119% in Q1-2008 to 178% in Q1 this year, and now exceeds the pre-crisis peaks in the US and euro area. The rise in China's private debt/GDP ratio over the last five years (58-59 percentage points of GDP) is substantially greater than the pre-crisis rises for the US (up by 25-30pp from 2002-07) and UK (up by 40pp from 2004-09), although still a little below that seen in Spain (75pp of GDP from 2003-08) and Hungary (100% of GDP from 2004-09). With strong central government control of major companies and banks, China's policymakers may be able to maintain the credit boom for a while, even though potential costs (eg bank losses and economic inefficiencies) probably are growing. Nevertheless, in our view, the prospect that the credit boom will end at some point creates sizeable downside growth risks over time.

**In the pre-crisis period, advanced economy growth helped sustain EM export growth…**

In recent months, other EM countries have been caught between downside growth risks from China and financial stability-related risks from the prospect of early Fed tapering. These risks have diminished, although we still expect the Fed to begin tapering fairly soon. Nevertheless, many EM countries face fresh challenges from

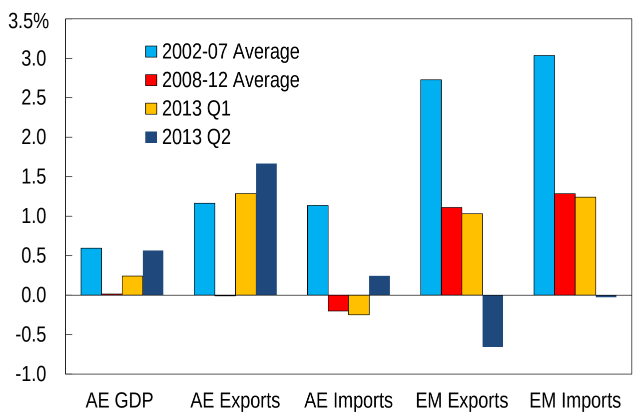
[2] See "*China Macro View: Is the Recent Rebound the Beginning of an Uptrend*", Shuang Ding, Minggao Shen and Enjiang Cheng, 10 September 2013, Citi.

market pressure for higher interest rates, external and fiscal imbalances, plus risks that the advanced economy rebound may not generate much recovery in EM exports. During 2002-07, GDP growth in the advanced economies (AEs, proxied by the weighted average for the US, Euro Area, Japan and UK) averaged 0.6% QoQ, AE import growth (goods only) averaged 1.1% QoQ (implying an import elasticity versus GDP growth of about 2), and EM export growth averaged 2.7% QoQ as EM countries gained market share. During 2008-12, the growth of AE GDP and imports were both around zero, and EM export growth slowed to an average of 1.1% QoQ.

**…but so far the current recovery among advanced economies is giving less benefit to EM exports**

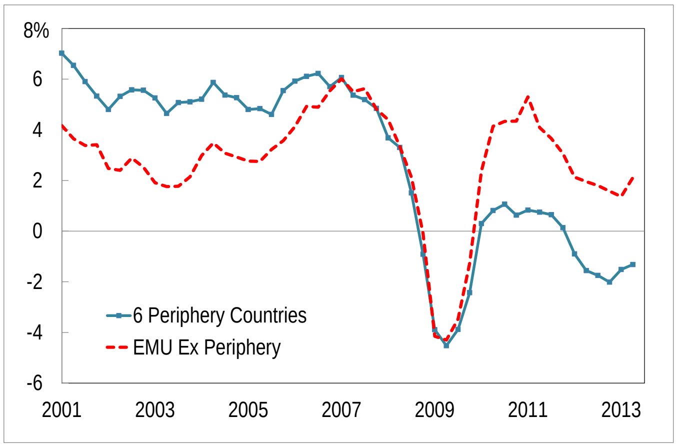
Some EM policymakers may have assumed that a recovery in AEs will again generate rapid EM export growth, and have regarded domestic stimulus as a bridge to that hoped-for export-led rebound. In practice, however, the recovery in advanced economies seems to be export-led and import-light so far. The weighted average of GDP growth in the US, euro area, Japan and the UK rebounded to 0.6% QoQ (the pre-crisis average) in Q2. However, in aggregate, the pickup in AE import growth has been negligible – with volumes falling 0.2% QoQ in Q1 and rising by just 0.2% in Q2 – hence limiting the boost to EM exports. Moreover, AE exports are gaining market share, with fairly strong gains in the last two quarters (1.3% and 1.7% QoQ respectively). EM export growth in H1 has been sluggish, with volumes falling quite sharply (0.7% QoQ) in Q2. We expect the overall QoQ gains in AE GDP will stay around the Q2 pace in coming quarters. The import content of AE growth may well expand a bit as recovery proceeds, but we suspect that the AE recovery will remain export-led, hence limiting the extent to which EMs derive a major export boost.

Figure 8. Global – QoQ Growth of GDP, Exports and Imports Among Advanced Economies and Emerging Markets, 2002-13




AE Advanced Economies. EM Emerging Markets. Note: AE GDP is proxied by the weighted average of the US, euro area, Japan and UK. Exports and imports are for goods only. Sources: CPB World Trade Monitor, DataStream and Citi Research

Figure 9. Euro Area – Nominal GDP YoY, 2001-13




Note: The six periphery countries are Italy, Spain, Portugal, Greece, Ireland and Cyprus. Sources: Eurostat and Citi Research

**The euro area has exited recession, helped by a quiet revolution in fiscal policy away from early austerity**

The euro area as a whole exited recession in Q2, and recent surveys point to further modest expansion in coming quarters. We are edging up our forecasts by 0.2% for 2013 and 0.1% for 2014 (to -0.3% and 0.7% respectively), reflecting a slight upward revision to earlier data, slightly less gloomy trends in some peripheral countries and reduced fiscal headwinds for 2014. There has been some improvement in financial conditions, with improving credit availability[3]. But the more important shift has been the quiet revolution in fiscal policy. As the euro crisis erupted, policymakers initially reacted with aggressive upfront fiscal tightening. The IMF judge that the euro area structural fiscal stance (cyclically adjusted primary balance excluding one-offs) tightened by 1-1½% of GDP in both 2011 and 2012,

[3] See "*Loan Dynamics: Renaissance by Year-End*", Guillaume Menuet, Euro Economics Weekly, 13 September 2013, Citi.

with even bigger tightening in periphery countries. Rather than calm markets (as policymakers hoped), the result was economic stagnation with high and volatile sovereign spreads. Since Draghi's "whatever it takes" comments (26 July 2012) established that the ECB would act as a backstop for markets, sovereign spreads have fallen markedly and policymakers have quietly taken the chance to greatly scale back the upfront fiscal tightening. Based on recent fiscal trends, we judge that the actual structural fiscal tightening across the euro area this year probably is just ¼%-½% of GDP, with a roughly neutral stance in Italy and Spain. This is far less than the drag in 2012, and much less than indicated in end-2012 national budgets. We assume a similar modest fiscal tightening in 2014.

**Government debt/GDP ratios are likely to continue to rise in a range of periphery countries…**

The upturn is unlikely to restore a range of fiscally-fragile countries to a sustainable fiscal path. Credit availability in periphery countries is still sub-par and credit growth remains deeply negative, with record declines in Spain, Ireland and Slovenia (down 8.1% YoY, 7.0% YoY and 5.7% YoY, respectively). Nominal GDP remains down in YoY terms for Greece, Portugal, Ireland, Italy, Spain and Slovenia, and – together with sticky fiscal deficits – general government debt/GDP ratios continue to climb. Most of these countries lack the ability to stabilise their debt/GDP ratios in coming years by fiscal policy alone: early fiscal tightening would undermine nominal GDP, while deferred fiscal tightening (as recently, to support growth) will probably keep deficits relatively high. Hence, further rises in public debt ratios lie ahead for most of these countries, with the possible exception of Ireland, where the debt ratio might edge down in 2014 or 2015 provided nominal GDP growth picks up as we expect.

**…and, while nearterm support is likely to be agreed, we continue to see risks of restructuring of public sector liabilities across a range of countries over time**

In the nearterm, we expect that further external support will be available for Greece, Portugal and Ireland. For Greece, we expect a third bailout in the next few quarters, with further maturity extensions and coupon reductions on official loans. Portugal will probably get a second bailout in 2014, with early restructuring of some public sector liabilities other than marketable central government debt (eg perhaps liabilities of public corporations or public-private partnerships, or non-marketable debt instruments). We expect that Ireland will agree a conditional ESM program to extend post-2013, aiming to fund itself fully but with the backstop of the OMT. Over time, we still see risks of varied forms of debt restructuring across a wider range of countries. For Italy and Spain, we have for a while penciled in some coupon reductions into our 2015 numbers, but are now shifting that to 2017. We expect that in coming quarters, low official rates, ample ECB liquidity, and the backstop of the OMT will keep EMU sovereign spreads around recent levels on average, and assume that the post-election German government will continue to tolerate modest fiscal slippage in periphery countries as long as EMU sovereign spreads are not alarming. But, we stress the medium-term risks that unsustainable fiscal trends in periphery countries eventually will have to be resolved.

**The main central banks in advanced economies are likely to keep policy loose for a while**

The modest improvement in advanced economy growth that is under way is unlikely to prompt early tightening, given ample slack in many countries. Nevertheless, markets are unlikely to be able to rely on central bank guidance to project unchanged rates much beyond the next 12-18 months or so. In the US and UK, the jobless rate probably will hit the central bank's thresholds in the next 12-18 months. We expect that both central banks will start to edge rates up in 2015, while keeping rates relatively low versus normal policy rules. The ECB is unlikely to cut rates again unless the economy weakens sharply, and we continue to expect that the refi rate will not rise until 2016 or so. The ECB also remains reluctant to convert its commitment to keep rates to hold for "extended period" into more formal time-based or state-contingent forward guidance. If market rate expectations rise in a way that damages the growth outlook a bit, the ECB's response is likely to be to restart the LTRO program along with enhanced communication (eg release of minutes and to an extended forecast horizon).

Figure 10. Selected Countries — Economic Forecast Overview (Percent), 2012-2017F

| | GDP Growth | | | | | | CPI Inflation | | | | | | Short-Term Interest Rates | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2012 | 2013F | 2014F | 2015F | 2016F | 2017F | 2012 | 2013F | 2014F | 2015F | 2016F | 2017F | 2012 | 2013F | 2014F | 2015F | 2016F | 2017F |
| Global | 2.6 | 2.5 | 3.2 | 3.4 | 3.7 | 3.7 | 2.9 | 2.6 | 3.0 | 3.2 | 3.2 | 3.2 | 2.32 | 2.58 | 2.76 | 3.12 | 3.65 | 4.12 |
| *Based on PPP weights* | *3.1* | *3.0* | *3.6* | *3.9* | *4.1* | *4.2* | *3.4* | *3.1* | *3.4* | *3.7* | *3.6* | *3.7* | *2.91* | *3.16* | *3.30* | *3.67* | *4.14* | *4.55* |
| Industrial Countries | 1.4 | 1.2 | 2.0 | 2.2 | 2.3 | 2.3 | 1.8 | 1.3 | 1.9 | 1.5 | 1.4 | 1.5 | 0.58 | 0.45 | 0.48 | 0.73 | 1.53 | 2.30 |
| United States | 2.8 | 1.7 | 2.7 | 3.2 | 3.2 | 3.0 | 1.8 | 1.2 | 1.9 | 2.1 | 2.1 | 2.1 | 0.25 | 0.25 | 0.25 | 0.50 | 1.60 | 2.70 |
| Japan | 2.0 | 2.0 | 1.8 | 1.0 | 1.2 | 1.2 | 0.0 | 0.0 | 2.1 | 0.7 | 0.5 | 0.7 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 |
| Euro Area | -0.6 | -0.3 | 0.7 | 1.0 | 1.3 | 1.5 | 2.5 | 1.5 | 1.5 | 1.4 | 1.4 | 1.4 | 0.88 | 0.56 | 0.50 | 0.50 | 0.56 | 0.81 |
| Canada | 1.7 | 1.7 | 2.5 | 3.0 | 3.0 | 2.8 | 1.5 | 1.1 | 1.8 | 1.9 | 2.0 | 2.0 | 1.00 | 1.00 | 1.00 | 1.63 | 2.44 | 3.00 |
| Australia | 3.7 | 2.5 | 3.0 | 3.0 | 3.0 | 3.2 | 1.8 | 2.2 | 2.9 | 2.5 | 2.3 | 2.5 | 3.56 | 2.69 | 2.69 | 3.63 | 4.75 | 4.75 |
| New Zealand | 2.7 | 2.6 | 3.0 | 2.0 | 1.9 | 1.8 | 1.1 | 0.9 | 1.9 | 2.4 | 2.3 | 2.1 | 2.50 | 2.54 | 3.25 | 4.74 | 5.00 | 5.00 |
| Germany | 0.9 | 0.6 | 1.8 | 1.8 | 1.7 | 1.5 | 2.0 | 1.6 | 2.0 | 1.8 | 2.0 | 1.9 | | | | | | |
| France | 0.0 | 0.2 | 0.8 | 0.9 | 1.4 | 1.9 | 2.2 | 1.1 | 1.7 | 1.4 | 1.7 | 1.2 | | | | | | |
| Italy | -2.4 | -1.7 | 0.1 | 0.0 | 0.2 | 0.6 | 3.3 | 1.6 | 1.3 | 0.6 | 0.2 | 0.4 | | | | | | |
| Spain | -1.6 | -1.3 | -0.2 | 0.4 | 1.1 | 1.6 | 2.4 | 1.8 | 0.9 | 0.7 | 0.6 | 0.7 | | | | | | |
| Greece | -6.4 | -3.8 | -2.9 | -1.4 | 0.9 | 1.3 | 1.0 | -0.5 | -1.1 | -0.7 | 0.1 | 0.2 | | | | | | |
| Ireland | 0.1 | -0.5 | 2.7 | 2.4 | 2.8 | 3.1 | 0.7 | -0.6 | 1.4 | 1.6 | 1.6 | 1.6 | | | | | | |
| Portugal | -3.2 | -1.9 | -0.8 | 0.1 | 1.0 | 1.1 | 2.8 | 0.5 | -0.1 | -0.2 | 0.4 | 0.7 | | | | | | |
| Netherlands | -1.3 | -1.3 | 0.3 | 0.9 | 1.2 | 1.6 | 2.8 | 2.9 | 1.7 | 1.5 | 1.8 | 1.6 | | | | | | |
| Belgium | -0.3 | 0.0 | 0.5 | 1.0 | 1.5 | 1.6 | 2.8 | 1.2 | 1.8 | 1.8 | 1.9 | 1.9 | | | | | | |
| Denmark | -0.4 | 0.2 | 0.9 | 1.4 | 1.5 | 1.5 | 2.4 | 0.7 | 1.5 | 1.7 | 1.8 | 1.9 | 0.43 | 0.21 | 0.25 | 0.40 | 0.60 | 1.00 |
| Norway | 3.3 | 1.9 | 2.4 | 2.6 | 2.7 | 2.7 | 0.7 | 2.1 | 1.6 | 2.0 | 1.9 | 2.3 | 1.55 | 1.50 | 1.64 | 2.00 | 2.51 | 3.08 |
| Sweden | 1.3 | 0.6 | 2.2 | 2.5 | 2.5 | 2.9 | 0.9 | 0.2 | 1.1 | 1.9 | 2.2 | 2.3 | 1.45 | 1.00 | 1.00 | 1.31 | 1.73 | 2.29 |
| Switzerland | 1.0 | 1.7 | 1.5 | 1.7 | 1.8 | 1.5 | -0.7 | -0.2 | 0.3 | 1.2 | 1.2 | 1.0 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| United Kingdom | 0.1 | 1.4 | 3.0 | 3.1 | 2.7 | 2.3 | 2.8 | 2.6 | 2.0 | 2.2 | 2.1 | 1.9 | 0.50 | 0.50 | 0.50 | 0.54 | 1.29 | 2.29 |
| Emerging Markets | 4.6 | 4.7 | 5.0 | 5.2 | 5.5 | 5.6 | 4.6 | 4.7 | 4.6 | 4.7 | 4.6 | 4.6 | 5.20 | 4.95 | 5.11 | 5.53 | 5.71 | 5.83 |
| China | 7.7 | 7.6 | 7.2 | 7.0 | 7.5 | 7.3 | 2.6 | 2.7 | 3.0 | 3.7 | 3.8 | 4.0 | 3.25 | 3.00 | 3.03 | 3.63 | 3.88 | 4.25 |
| Taiwan | 1.3 | 2.6 | 3.8 | 4.0 | 4.5 | 4.5 | 1.9 | 1.2 | 1.7 | 2.0 | 1.8 | 1.8 | 1.88 | 1.88 | 1.97 | 2.38 | 2.88 | 3.38 |
| India | 5.0 | 4.8 | 5.6 | 6.7 | 7.3 | 7.4 | 7.3 | 5.5 | 5.0 | 5.0 | 5.0 | 5.0 | 7.80 | 7.50 | 7.75 | 7.75 | 7.75 | 7.75 |
| Indonesia | 6.2 | 5.7 | 5.3 | 5.5 | 5.9 | 6.0 | 4.3 | 7.2 | 6.6 | 5.7 | 5.4 | 5.3 | 3.90 | 4.88 | 6.00 | 6.00 | 5.50 | 5.50 |
| Korea | 2.0 | 2.9 | 3.7 | 3.9 | 3.9 | 3.7 | 2.2 | 1.5 | 2.5 | 3.0 | 3.1 | 3.0 | 3.06 | 2.56 | 2.50 | 3.13 | 3.75 | 4.13 |
| Czech Republic | -1.2 | -1.1 | 1.6 | 2.3 | 2.4 | 2.7 | 3.3 | 1.5 | 1.3 | 1.9 | 1.6 | 2.0 | 0.51 | 0.05 | 0.05 | 0.44 | 1.29 | 2.08 |
| Hungary | -1.7 | 0.6 | 1.8 | 1.1 | 1.6 | 1.7 | 5.7 | 1.9 | 2.0 | 3.5 | 3.5 | 3.3 | 6.77 | 4.21 | 3.46 | 4.73 | 4.75 | 4.75 |
| Poland | 1.9 | 1.3 | 2.8 | 3.3 | 3.3 | 3.2 | 3.7 | 1.1 | 2.2 | 2.5 | 2.5 | 2.5 | 4.61 | 2.92 | 2.75 | 3.75 | 4.67 | 4.71 |
| Romania | 0.4 | 1.6 | 2.8 | 3.5 | 4.0 | 4.0 | 3.3 | 4.4 | 2.8 | 3.2 | 2.5 | 2.5 | 5.25 | 4.75 | 4.00 | 4.88 | 5.00 | 5.00 |
| Russia | 3.4 | 2.1 | 2.8 | 3.3 | 3.2 | 3.3 | 5.1 | 6.5 | 5.1 | 4.9 | 4.7 | 4.5 | 8.07 | 8.02 | 7.50 | 7.00 | 7.00 | 7.00 |
| Turkey | 2.2 | 3.5 | 4.0 | 4.2 | 4.2 | 4.2 | 8.9 | 7.3 | 7.3 | 6.9 | 6.4 | 5.8 | 5.69 | 4.75 | 5.00 | 7.25 | 7.50 | 7.50 |
| Nigeria | 7.4 | 6.5 | 6.5 | 6.3 | 6.8 | 7.0 | 12.2 | 8.2 | 8.4 | 12.2 | 10.8 | 9.9 | 12.00 | 11.75 | 11.75 | 12.50 | 11.25 | 9.00 |
| South Africa | 2.5 | 2.1 | 2.9 | 3.4 | 3.9 | 4.4 | 5.7 | 5.9 | 5.5 | 5.7 | 5.7 | 5.7 | 5.28 | 5.00 | 5.00 | 5.46 | 6.00 | 6.00 |
| Argentina | 1.9 | 5.3 | 3.0 | 2.0 | -2.0 | 3.5 | 10.0 | 10.4 | 12.6 | 13.8 | 50.0 | 30.0 | 13.89 | 16.95 | 21.43 | 25.16 | 28.00 | 28.00 |
| Brazil | 0.9 | 2.6 | 2.0 | 2.0 | 2.5 | 3.0 | 5.4 | 6.2 | 6.1 | 5.9 | 5.5 | 5.5 | 8.46 | 8.38 | 9.75 | 10.25 | 10.13 | 9.50 |
| Mexico | 3.8 | 1.2 | 3.8 | 4.0 | 3.8 | 3.7 | 4.1 | 3.7 | 3.4 | 3.6 | 3.6 | 3.6 | 4.50 | 3.94 | 3.50 | 3.94 | 5.40 | 6.42 |
| Venezuela | 5.6 | 2.3 | 2.8 | 2.0 | 2.4 | 2.5 | 21.1 | 35.9 | 35.6 | 26.5 | 24.4 | 24.4 | 14.50 | 14.50 | 14.50 | 14.80 | 14.80 | 14.80 |

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

Figure 11. Selected Countries — Economic Forecast Overview (Percent), 2012-2017F

| | Current Balance (Pct of GDP) | | | | | | Fiscal Balance (Pct of GDP) | | | | | | Government Debt (Pct of GDP) | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2012 | 2013F | 2014F | 2015F | 2016F | 2017F | 2012 | 2013F | 2014F | 2015F | 2016F | 2017F | 2012 | 2013F | 2014F | 2015F | 2016F | 2017F |
| Global | 0.5 | 0.7 | 0.6 | 0.3 | 0.1 | 0.0 | -4.4 | -3.5 | -3.0 | -2.6 | -2.4 | -2.3 | 86 | 88 | 86 | 85 | 84 | 83 |
| *Based on PPP weights* | *0.4* | *0.5* | *0.4* | *-10.5* | *-12.2* | *-14.0* | *-4.2* | *-3.5* | *-3.1* | *-2.8* | *-2.6* | *-2.4* | *78* | *79* | *79* | *79* | *78* | *76* |
| Industrial Countries | -0.6 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -6.0 | -4.4 | -3.6 | -2.9 | -2.6 | -2.4 | 112 | 116 | 114 | 115 | 115 | 115 |
| United States | -2.7 | -2.8 | -2.8 | -3.0 | -3.0 | -3.0 | -8.1 | -4.8 | -4.3 | -3.8 | -3.8 | -3.8 | 103 | 106 | 108 | 109 | 109 | 109 |
| Japan | 1.1 | 1.5 | 2.4 | 1.8 | 1.5 | 1.3 | -10.7 | -9.8 | -8.0 | -6.2 | -5.8 | -5.4 | 237 | 244 | 246 | 251 | 255 | 258 |
| Euro Area | 1.2 | 2.5 | 2.3 | 2.3 | 2.3 | 2.3 | -3.7 | -2.9 | -2.5 | -2.0 | -1.7 | -1.2 | 93 | 96 | 97 | 97 | 97 | 96 |
| Canada | -3.4 | -3.0 | -2.9 | -2.8 | -2.7 | -2.5 | -1.4 | -1.0 | -0.3 | 0.0 | 0.2 | 0.2 | 84 | 84 | 83 | 82 | 81 | 79 |
| Australia | -3.7 | -2.3 | -3.3 | -3.5 | -3.5 | -3.5 | -3.0 | -2.5 | -1.9 | -1.5 | -0.3 | 0.2 | 29 | 28 | 30 | 30 | 28 | 27 |
| New Zealand | -5.0 | -6.1 | -10.3 | -9.6 | -12.2 | -12.9 | -6.0 | -2.6 | -1.7 | -0.5 | -0.2 | 0.3 | 38 | 37 | 39 | 40 | 41 | 42 |
| Germany | 7.0 | 6.8 | 5.9 | 5.3 | 4.9 | 4.6 | 0.2 | 0.0 | 0.1 | 0.1 | 0.1 | 0.4 | 81 | 79 | 76 | 73 | 71 | 69 |
| France | -2.2 | -1.5 | -0.8 | -0.1 | 0.4 | 0.1 | -4.8 | -4.1 | -3.5 | -3.1 | -2.7 | -2.1 | 90 | 94 | 95 | 97 | 96 | 96 |
| Italy | -0.5 | 1.1 | 1.4 | 1.4 | 1.4 | 1.4 | -3.0 | -3.6 | -2.8 | -2.6 | -2.7 | -2.5 | 127 | 133 | 136 | 138 | 140 | 141 |
| Spain | -1.1 | 1.3 | 1.9 | 2.6 | 3.6 | 4.2 | -10.8 | -6.8 | -6.0 | -5.0 | -4.4 | -3.5 | 84 | 94 | 104 | 108 | 110 | 111 |
| Greece | -3.4 | -0.4 | 0.8 | 1.4 | 3.7 | 4.9 | -10.0 | -4.7 | -4.0 | -2.8 | -1.6 | -1.2 | 157 | 178 | 192 | 201 | 203 | 204 |
| Ireland | 4.4 | 8.8 | 11.2 | 11.8 | 12.5 | 13.3 | -7.6 | -8.6 | -5.6 | -3.6 | -2.9 | -2.6 | 119 | 126 | 123 | 121 | 118 | 115 |
| Portugal | -1.5 | 1.2 | 3.2 | 3.6 | 3.6 | 3.9 | -6.4 | -6.0 | -5.4 | -4.1 | -3.3 | -2.7 | 124 | 133 | 150 | 154 | 155 | 156 |
| Netherlands | 9.4 | 9.4 | 8.9 | 9.5 | 9.5 | 9.7 | -4.1 | -3.9 | -3.4 | -2.9 | -2.3 | -1.5 | 71 | 75 | 77 | 77 | 77 | 76 |
| Belgium | -1.6 | -2.0 | -1.6 | -1.0 | -0.2 | 0.5 | -3.9 | -3.0 | -2.6 | -1.8 | -1.2 | -1.0 | 100 | 102 | 103 | 102 | 99 | 97 |
| Denmark | 5.9 | 5.6 | 4.9 | 4.2 | 4.0 | 3.8 | -4.3 | -2.0 | -1.5 | -1.0 | 0.5 | 1.0 | 46 | 47 | 48 | 47 | 45 | 43 |
| Norway | 14.2 | 12.8 | 13.2 | 13.5 | 13.8 | 14.0 | 13.8 | 13.1 | 13.0 | 14.0 | 15.5 | 15.0 | NA | NA | NA | NA | NA | NA |
| Sweden | 6.0 | 5.9 | 5.6 | 5.3 | 5.3 | 5.0 | -0.6 | -1.4 | -1.5 | -0.4 | 0.7 | 1.5 | 38 | 39 | 40 | 38 | 36 | 33 |
| Switzerland | 12.8 | 12.9 | 13.0 | 12.9 | 14.0 | 14.0 | 0.5 | 0.7 | 0.9 | 0.8 | 0.8 | -0.6 | 47 | 45 | 43 | 42 | 42 | 42 |
| United Kingdom | -3.7 | -3.2 | -2.8 | -2.8 | -2.6 | -2.2 | -6.3 | -6.4 | -5.1 | -4.1 | -2.6 | -1.7 | 90 | 93 | 95 | 96 | 96 | 94 |
| Emerging Markets | 2.1 | 1.8 | 1.5 | 0.8 | 0.3 | 0.0 | -1.6 | -2.1 | -2.1 | -2.1 | -2.2 | -2.1 | 43 | 43 | 42 | 41 | 40 | 40 |
| China | 2.3 | 2.2 | 2.0 | 1.5 | 0.8 | 0.5 | -2.0 | -2.0 | -2.0 | -1.5 | -1.5 | -1.5 | 45 | 45 | 45 | 44 | 43 | 42 |
| Taiwan | 10.5 | 10.1 | 9.0 | 8.0 | 8.0 | 8.0 | -1.6 | -1.2 | -1.3 | -1.0 | -0.7 | -0.5 | 41 | 41 | 41 | 42 | 43 | 44 |
| India | -4.8 | -3.7 | -2.6 | -2.7 | -2.8 | -2.8 | -7.0 | -6.7 | -6.4 | -6.2 | -5.9 | -5.6 | 68 | 67 | 66 | 65 | 64 | 63 |
| Indonesia | -2.8 | -3.5 | -2.7 | -2.0 | -1.9 | -1.7 | -1.9 | -2.1 | -1.8 | -1.7 | -1.9 | 2.0 | 24 | 25 | 26 | 25 | 24 | 24 |
| Korea | 3.8 | 4.3 | 2.4 | 1.2 | 0.6 | -0.5 | 1.5 | 0.9 | 2.3 | 2.3 | 2.6 | 2.1 | 33 | 35 | 33 | 31 | 29 | 28 |
| Czech Republic | -2.4 | -1.0 | -1.6 | -2.3 | -2.2 | -2.3 | -4.4 | -2.8 | -2.9 | -2.9 | -3.0 | -2.5 | 46 | 48 | 49 | 50 | 51 | 51 |
| Hungary | 1.6 | 1.8 | 1.8 | 2.2 | 2.6 | 2.8 | -1.9 | -2.9 | -3.3 | -3.0 | -2.8 | -3.0 | 79 | 79 | 78 | 77 | 76 | 75 |
| Poland | -3.5 | -2.1 | -3.2 | -3.5 | -4.1 | -4.1 | -3.9 | -4.3 | 4.7 | -2.9 | -2.8 | -2.8 | 53 | 55 | 48 | 47 | 47 | 47 |
| Romania | -3.9 | -1.5 | -4.0 | -4.7 | -5.0 | -5.0 | -2.2 | -2.2 | -2.5 | -2.3 | -2.0 | -2.0 | 41 | 40 | 39 | 38 | 37 | 37 |
| Russia | 3.5 | 2.8 | 0.9 | -1.7 | -3.2 | -4.2 | -0.7 | -2.0 | -4.2 | -4.6 | -3.2 | -3.2 | 8 | 8 | 10 | 13 | 15 | 16 |
| Turkey | -5.8 | -6.9 | -6.7 | -6.3 | -5.6 | -4.8 | -2.0 | -1.8 | -2.7 | -2.7 | -3.0 | -3.0 | 39 | 38 | 37 | 36 | 36 | 36 |
| Nigeria | 4.0 | 2.3 | 0.4 | 0.7 | 0.5 | 0.1 | -2.8 | -2.6 | -2.9 | -3.3 | -2.8 | -2.9 | NA | NA | NA | NA | NA | NA |
| South Africa | -6.1 | -5.9 | -5.4 | -5.1 | -4.2 | -3.1 | -4.4 | -5.0 | -4.8 | -4.4 | -3.7 | -3.6 | 41 | 43 | 45 | 44 | 44 | 43 |
| Argentina | 0.0 | -0.5 | -0.6 | -0.5 | 3.0 | 1.0 | -2.6 | -2.1 | -2.8 | -2.0 | 0.0 | -0.5 | 38 | 39 | 42 | 47 | 45 | 43 |
| Brazil | -2.4 | -3.6 | -3.3 | -3.1 | -3.2 | -3.3 | -2.5 | -3.8 | -3.7 | -2.6 | -3.3 | -3.4 | 59 | 59 | 60 | 60 | 60 | 60 |
| Mexico | -0.9 | -1.5 | -1.4 | -4.1 | -3.3 | -3.1 | -2.6 | -2.1 | -2.0 | -2.0 | -2.0 | -2.0 | 40 | 38 | 38 | 38 | 37 | 37 |
| Venezuela | 3.1 | 3.7 | 8.3 | 6.1 | 5.3 | 5.8 | -5.0 | -4.0 | -4.0 | -4.8 | -4.6 | -4.5 | 43 | 44 | 45 | 46 | 47 | 47 |

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

Figure 12. Selected Countries — Changes in Economic Forecast from the Previous Month (Percentage Points), 2012-2014F

| | GDP Growth | | | CPI Inflation | | | Current Balance (Pct of GDP) | | | Fiscal Balance (Pct of GDP) | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2012 | 2013F | 2014F | 2012 | 2013F | 2014F | 2012 | 2013F | 2014F | 2012 | 2013F | 2014F |
| Global | | 0.1 | | | | | 0.2 | 0.3 | 0.4 | | 0.2 | 0.2 |
| *Based on PPP weights* | -0.1 | 0.1 | | | 0.1 | 0.1 | 0.2 | 0.3 | 0.4 | | 0.1 | 0.3 |
| Industrial Countries | | 0.2 | 0.1 | | | | -0.1 | | | | 0.1 | |
| United States | | 0.1 | | | -0.1 | -0.1 | | | | | | |
| Japan | | | -0.2 | | | | | | -0.1 | | | |
| Euro Area | -0.1 | 0.2 | 0.1 | | | 0.1 | | | | | | 0.1 |
| Canada | | -0.1 | | | -0.1 | | | 0.2 | 0.5 | | | |
| Australia | 0.1 | | -0.1 | | 0.1 | 0.1 | | 0.6 | 0.6 | | | |
| New Zealand | 0.5 | | 0.2 | | -0.3 | -0.4 | -0.1 | -0.6 | -3.5 | -0.7 | 0.5 | -0.8 |
| Germany | | | 0.1 | | -0.1 | 0.1 | | -0.1 | -0.1 | | 0.1 | -0.2 |
| France | | | | | | | | 0.1 | | | -0.3 | -0.3 |
| Italy | | -0.1 | 0.2 | | 0.1 | | | -0.3 | -0.7 | | -0.1 | 0.2 |
| Spain | -0.2 | 0.1 | | | | | | 0.1 | -0.1 | -0.2 | -0.3 | -0.1 |
| Greece | | 0.6 | 1.0 | | -0.1 | -0.2 | | | | | 0.6 | 0.9 |
| Ireland | | -0.7 | 0.2 | | -0.2 | | | 4.2 | 4.1 | | -0.4 | -0.2 |
| Portugal | | | 0.1 | | -0.1 | -0.2 | | | | | | 0.3 |
| Netherlands | | | | | -0.1 | -0.2 | -0.7 | | | | | |
| Belgium | | 0.2 | 0.1 | | -0.1 | -0.1 | | | | | 0.2 | 0.3 |
| Denmark | | 0.1 | 0.2 | | -0.2 | | -0.8 | 0.3 | 0.2 | | | |
| Norway | | -0.3 | -0.2 | | 0.4 | 0.1 | | -1.7 | -1.7 | | | |
| Sweden | 0.2 | -0.4 | | | 0.1 | 0.1 | -0.9 | -1.2 | -1.3 | | 0.1 | |
| Switzerland | | | | | | | | | | | | |
| United Kingdom | | 0.3 | 0.9 | | | | | 0.1 | 0.1 | | 0.5 | 0.7 |
| Emerging Markets | -0.1 | 0.1 | | | | 0.1 | 0.4 | 0.7 | 0.9 | 0.1 | 0.3 | 0.6 |
| China | -0.1 | 0.2 | 0.1 | | | | | | | | | |
| Taiwan | | | | | -0.3 | -0.2 | | 1.0 | 0.5 | | | |
| India | | -0.6 | -0.6 | | | | | 0.6 | 0.6 | | | |
| Indonesia | | -0.1 | -0.3 | | 0.1 | 1.1 | | -0.3 | -0.4 | -0.1 | | |
| Korea | | | | | | -0.1 | | | -0.1 | | | |
| Czech Republic | | -0.1 | | | -0.1 | | | 0.2 | -0.7 | | | |
| Hungary | | | 0.4 | | | -0.1 | | -0.4 | -0.8 | | -0.1 | -0.4 |
| Poland | | | | | | | | 0.1 | 0.2 | | | 8.6 |
| Romania | | | | | -0.1 | | | 1.5 | 0.5 | | | |
| Russia | | | | | | | -0.3 | | | | | |
| Turkey | | | | | | | | | 0.1 | | 0.4 | |
| Nigeria | | | -0.4 | | -0.4 | -2.0 | | | | | | -0.1 |
| South Africa | | -0.2 | | | 0.3 | -0.3 | | | 0.3 | | -0.1 | |
| Argentina | | 0.9 | | | | | -0.1 | -0.5 | -0.8 | | 0.6 | 0.8 |
| Brazil | | 0.5 | | | | 0.2 | | -0.1 | -0.2 | | -0.2 | -0.1 |
| Mexico | -0.1 | -0.8 | -0.4 | | -0.1 | | 0.7 | | 2.8 | | | |
| Venezuela | | 2.8 | 1.3 | | 1.2 | 3.1 | | -1.6 | 1.1 | | | |

Source: Citi Research

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

| | 10-Year Yields | | | | | | Exchange Rates Versus U.S. Dollar* | | | | | | Exchange Rate Versus Euro | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2012 | 2013F | 2014F | 2015F | 2016F | 2017F | 2012 | 2013F | 2014F | 2015F | 2016F | 2017F | 2012 | 2013F | 2014F | 2015F | 2016F | 2017F |
| Industrial Countries | | | | | | | | | | | | | | | | | | |
| United States | 1.80 | 2.35 | 3.05 | 3.50 | 3.75 | 4.00 | NA | NA | NA | NA | NA | NA | 1.28 | 1.33 | 1.37 | 1.39 | 1.40 | 1.40 |
| Japan | 0.85 | 0.72 | 0.60 | 0.90 | 1.25 | 1.50 | 81 | 98 | 105 | 109 | 110 | 110 | 104 | 131 | 144 | 152 | 154 | 154 |
| Euro Area | 1.57 | 1.62 | 1.83 | 2.00 | 2.25 | 2.50 | 1.28 | 1.33 | 1.37 | 1.39 | 1.40 | 1.40 | NA | NA | NA | NA | NA | NA |
| Canada | 1.87 | 2.28 | 3.03 | 3.74 | 3.75 | 3.90 | 1.00 | 1.03 | 1.05 | 1.05 | 1.05 | 1.05 | 1.28 | 1.36 | 1.44 | 1.47 | 1.47 | 1.47 |
| Australia | 3.28 | 3.65 | 4.25 | 4.75 | 5.50 | 5.50 | 1.02 | 0.96 | 0.89 | 0.88 | 0.89 | 0.91 | 1.24 | 1.38 | 1.54 | 1.58 | 1.57 | 1.54 |
| New Zealand | 3.61 | 3.98 | 5.25 | 6.15 | 6.40 | 6.40 | 0.82 | 0.82 | 0.80 | 0.79 | 0.78 | 0.76 | 1.57 | 1.61 | 1.72 | 1.77 | 1.80 | 1.83 |
| Germany | 1.57 | 1.62 | 1.83 | 2.00 | 2.25 | 2.50 | | | | | | | | | | | | |
| France | 2.54 | 2.20 | 2.60 | 2.70 | 2.85 | 3.00 | | | | | | | | | | | | |
| Italy | 5.49 | 4.33 | 4.45 | 5.50 | 5.25 | 5.00 | | | | | | | | | | | | |
| Spain | 5.88 | 4.62 | 4.39 | 5.75 | 5.25 | 5.00 | | | | | | | | | | | | |
| Netherlands | 1.95 | 1.98 | 2.24 | 2.40 | 2.55 | 2.80 | | | | | | | | | | | | |
| Belgium | 2.43 | 2.47 | 2.86 | 2.80 | 3.05 | 3.20 | | | | | | | | | | | | |
| Denmark | 1.51 | 1.76 | 1.93 | 2.15 | 2.50 | 2.75 | | | | | | | | | | | | |
| Norway | 2.15 | 2.58 | 2.95 | 2.90 | 3.00 | 3.25 | 5.81 | 5.84 | 5.61 | 5.39 | 5.25 | 5.13 | 7.45 | 7.75 | 7.67 | 7.51 | 7.35 | 7.18 |
| Sweden | 1.59 | 2.07 | 2.27 | 2.40 | 2.55 | 2.80 | 6.73 | 6.47 | 6.43 | 6.21 | 6.06 | 5.93 | 8.63 | 8.59 | 8.80 | 8.66 | 8.49 | 8.30 |
| Switzerland | 0.64 | 0.82 | 1.00 | 1.20 | 1.45 | 1.70 | 0.94 | 0.93 | 0.92 | 0.92 | 0.92 | 0.92 | 1.20 | 1.23 | 1.26 | 1.28 | 1.29 | 1.29 |
| United Kingdom | 1.85 | 2.34 | 3.08 | 3.60 | 3.80 | 4.00 | 1.59 | 1.58 | 1.67 | 1.74 | 1.75 | 1.75 | 0.81 | 0.84 | 0.82 | 0.80 | 0.80 | 0.80 |
| Emerging Markets | | | | | | | | | | | | | | | | | | |
| China | 3.33 | 3.32 | 3.45 | 3.82 | 4.20 | 4.57 | 6.31 | 6.15 | 6.14 | 6.03 | 6.02 | 6.04 | 8.11 | 8.16 | 8.40 | 8.40 | 8.43 | 8.45 |
| Taiwan | 1.21 | 1.51 | 1.97 | 1.50 | 1.70 | 2.00 | 29.57 | 29.64 | 29.54 | 29.08 | 28.76 | 28.49 | 38.03 | 39.34 | 40.40 | 40.55 | 40.26 | 39.89 |
| India | 8.25 | 8.20 | 8.25 | 8.25 | 8.25 | 8.25 | 53.38 | 59.27 | 62.74 | 58.72 | 56.73 | 55.33 | 68.65 | 78.66 | 85.80 | 81.88 | 79.42 | 77.46 |
| Indonesia | 5.90 | 7.43 | 8.13 | 8.25 | 8.50 | 8.50 | 9361 | 10471 | 11599 | 11072 | 10547 | 10047 | 12038 | 13897 | 15863 | 15439 | 14765 | 14066 |
| Korea | 3.24 | 3.09 | 3.59 | 4.03 | 4.30 | 4.55 | 1127 | 1091 | 1033 | 1001 | 993 | 991 | 1449 | 1448 | 1413 | 1396 | 1390 | 1387 |
| Czech Republic | 2.75 | 2.06 | 2.15 | 2.32 | 2.61 | 2.61 | 19.5 | 19.5 | 18.7 | 17.5 | 17.0 | 16.7 | 25.1 | 25.9 | 25.5 | 24.4 | 23.8 | 23.4 |
| Hungary | 7.91 | 6.01 | 6.28 | 6.60 | 6.60 | 6.60 | 225 | 226 | 223 | 222 | 223 | 224 | 289 | 300 | 305 | 309 | 312 | 313 |
| Poland | 5.05 | 4.03 | 4.64 | 4.68 | 5.16 | 5.01 | 3.25 | 3.18 | 3.07 | 2.89 | 2.84 | 2.81 | 4.18 | 4.22 | 4.20 | 4.03 | 3.97 | 3.94 |
| Romania | NA | NA | NA | NA | NA | NA | 3.46 | 3.38 | 3.31 | 3.12 | 3.05 | 2.97 | 4.45 | 4.48 | 4.53 | 4.34 | 4.28 | 4.16 |
| Russia | NA | NA | NA | NA | NA | NA | 31.1 | 31.9 | 32.9 | 32.7 | 32.6 | 32.6 | 40.0 | 42.4 | 45.0 | 45.6 | 45.7 | 45.7 |
| Turkey | NA | NA | NA | NA | NA | NA | 1.80 | 1.93 | 2.07 | 2.07 | 2.05 | 2.03 | 2.32 | 2.56 | 2.83 | 2.89 | 2.87 | 2.84 |
| Nigeria | NA | NA | NA | NA | NA | NA | 159 | 160 | 164 | 168 | 171 | 175 | 204 | 212 | 224 | 234 | 239 | 245 |
| South Africa | 7.23 | 7.36 | 8.00 | 9.00 | 9.20 | 9.25 | 8.21 | 9.65 | 10.06 | 10.44 | 10.56 | 10.63 | 10.56 | 12.81 | 13.76 | 14.55 | 14.78 | 14.88 |
| Argentina | NA | NA | NA | NA | NA | NA | 4.54 | 5.46 | 6.74 | 8.72 | 13.45 | 18.82 | 5.84 | 7.25 | 9.21 | 12.16 | 18.83 | 26.35 |
| Brazil | 9.31 | 9.23 | 11.75 | 12.25 | 10.88 | 10.25 | 1.95 | 2.18 | 2.39 | 2.44 | 2.38 | 2.30 | 2.51 | 2.89 | 3.27 | 3.40 | 3.33 | 3.23 |
| Mexico | 5.70 | 5.71 | 6.73 | 7.16 | 7.46 | 7.95 | 13.2 | 12.7 | 12.4 | 12.3 | 12.3 | 12.3 | 16.9 | 16.8 | 17.0 | 17.2 | 17.2 | 17.2 |
| Venezuela | 11.26 | 10.91 | 10.67 | 15.50 | 15.50 | 15.50 | 4.29 | 6.13 | 9.50 | 9.75 | 10.50 | 12.71 | 5.52 | 8.14 | 12.99 | 13.60 | 14.70 | 17.79 |

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

Figure 14. Short Rates (End of Period), as of 25 Sep 2013 (Percent)

| | Current | 4Q 13 | 1Q 14 | 2Q 14 | 3Q 14 | 4Q 14 | 1Q 15 |
|---|---|---|---|---|---|---|---|
| United States | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 |
| Japan | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 |
| Euro Area | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 |
| Canada | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 |
| Australia | 2.50 | 2.50 | 2.50 | 2.50 | 2.75 | 3.00 | 3.25 |
| New Zealand | 2.50 | 2.50 | 2.75 | 3.00 | 3.25 | 3.75 | 4.25 |
| Denmark | 0.20 | 0.20 | 0.20 | 0.20 | 0.30 | 0.30 | 0.30 |
| Norway | 1.50 | 1.50 | 1.50 | 1.50 | 1.75 | 1.75 | 2.00 |
| Sweden | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.25 |
| Switzerland | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| United Kingdom | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 |
| China | 3.00 | 3.00 | 3.00 | 3.00 | 3.00 | 3.25 | 3.50 |

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

Figure 15. 10-Year Yield Forecasts (Period Average), as of 25 Sep 2013 (Percent)

| | Current | 4Q 13 | 1Q 14 | 2Q 14 | 3Q 14 | 4Q 14 | 1Q 15 |
|---|---|---|---|---|---|---|---|
| United States | 2.72 | 2.70 | 2.78 | 2.98 | 3.15 | 3.25 | 3.40 |
| Japan | 0.68 | 0.65 | 0.60 | 0.50 | 0.60 | 0.70 | 0.80 |
| Euro Area (Germany) | 1.88 | 1.80 | 1.80 | 1.80 | 1.80 | 1.90 | 2.00 |
| Canada | 2.60 | 2.65 | 2.75 | 2.95 | 3.15 | 3.25 | 3.55 |
| Australia | 3.75 | 4.00 | 4.10 | 4.10 | 4.30 | 4.50 | 4.60 |
| New Zealand | 4.75 | 4.75 | 4.90 | 5.10 | 5.40 | 5.60 | 6.00 |
| Denmark | 2.01 | 1.95 | 1.90 | 1.90 | 1.90 | 2.00 | 2.10 |
| Norway | 2.95 | 2.89 | 2.89 | 2.99 | 2.90 | 3.00 | 2.95 |
| Sweden | 2.48 | 2.25 | 2.25 | 2.25 | 2.20 | 2.35 | 2.65 |
| Switzerland | 1.02 | 0.95 | 1.03 | 1.03 | 1.03 | 1.10 | 1.17 |
| United Kingdom | 2.87 | 2.80 | 2.85 | 3.05 | 3.15 | 3.25 | 3.40 |

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

Figure 16. 10-Year Yield Spreads (Period Average), as of 25 Sep 2013

| | Spread vs. US$ | | | | | | Spread vs. Germany | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Current | 4Q 13 | 1Q 14 | 2Q 14 | 3Q 14 | 4Q 14 | Current | 4Q 13 | 1Q 14 | 2Q 14 | 3Q 14 | 4Q 14 |
| United States | NA | NA | NA | NA | NA | NA | 86 | 92 | 100 | 120 | 137 | 138 |
| Japan | -209 | -212 | -230 | -240 | -247 | -248 | -123 | -120 | -130 | -120 | -110 | -110 |
| Euro Area | -86 | -92 | -100 | -120 | -137 | -138 | NA | NA | NA | NA | NA | NA |
| Canada | -12 | -5 | -3 | -3 | 0 | 0 | 74 | 87 | 97 | 117 | 137 | 138 |
| Australia | 105 | 132 | 134 | 114 | 117 | 127 | 191 | 224 | 234 | 234 | 255 | 265 |
| New Zealand | 207 | 209 | 216 | 216 | 230 | 240 | 293 | 301 | 316 | 337 | 367 | 378 |
| France | -35 | -32 | -30 | -40 | -57 | -58 | 49 | 60 | 70 | 80 | 80 | 80 |
| Italy | 151 | 158 | 175 | 155 | 113 | 112 | 235 | 250 | 275 | 275 | 250 | 250 |
| Spain | 154 | 158 | 175 | 130 | 113 | 112 | 238 | 250 | 275 | 250 | 250 | 250 |
| Netherlands | -50 | -47 | -55 | -80 | -97 | -98 | 34 | 45 | 45 | 40 | 40 | 40 |
| Belgium | -10 | 3 | 0 | -10 | -32 | -38 | 74 | 95 | 100 | 110 | 105 | 100 |
| Austria | -48 | -47 | -55 | -80 | -97 | -98 | 36 | 45 | 45 | 40 | 40 | 40 |
| Finland | -64 | -62 | -70 | -90 | -107 | -108 | 20 | 30 | 30 | 30 | 30 | 30 |
| Ireland | 115 | 108 | 75 | 55 | 38 | 37 | 199 | 200 | 175 | 175 | 175 | 175 |
| Denmark | -71 | -82 | -90 | -110 | -127 | -128 | 13 | 15 | 10 | 10 | 10 | 10 |
| Norway | 23 | 17 | 19 | -10 | -27 | -43 | 107 | 109 | 109 | 119 | 110 | 110 |
| Sweden | -24 | -47 | -55 | -80 | -92 | -73 | 60 | 45 | 45 | 45 | 40 | 45 |
| Switzerland | -170 | -177 | -177 | -197 | -214 | -218 | -86 | -85 | -77 | -77 | -77 | -80 |
| United Kingdom | 15 | 10 | 7 | 7 | 0 | 0 | 99 | 102 | 107 | 127 | 137 | 138 |

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

Figure 17. Emerging Market Countries — Short Rates Actual and Forecast of Additional Rate Moves (End of Period), as of 25 Sep 2013

| Country | Current Rate (%) | Dec 13 | Mar 14 | Jun 14 | Sep 14 | Dec 14 | Total Cumulative Rate Moves Expected |
|---|---|---|---|---|---|---|---|
| Turkey | 4.50 | 0 | 0 | 0 | 50 | 100 | 150 |
| Philippines | 3.50 | 0 | 25 | 50 | 25 | 0 | 100 |
| Brazil | 9.00 | 75 | 0 | 0 | 0 | 0 | 75 |
| Poland | 2.50 | 0 | 0 | 0 | 50 | 25 | 75 |
| Hungary | 3.60 | -35 | 0 | 0 | 25 | 75 | 65 |
| Indonesia | 5.50 | 25 | 25 | 0 | 0 | 0 | 50 |
| Thailand | 2.50 | 0 | 0 | 0 | 25 | 25 | 50 |
| Israel | 1.00 | 0 | 25 | 0 | 0 | 25 | 50 |
| India | 7.50 | 25 | 0 | 0 | 0 | 0 | 25 |
| Romania | 4.50 | 25 | 0 | 0 | 0 | 0 | 25 |
| China | 3.00 | 0 | 0 | 0 | 0 | 25 | 25 |
| Korea | 2.50 | 0 | 0 | 0 | 0 | 0 | 0 |
| South Africa | 5.00 | 0 | 0 | 0 | 0 | 0 | 0 |
| Mexico | 3.75 | -25 | 0 | 0 | 0 | 0 | -25 |
| Chile | 5.00 | 0 | -50 | 0 | 0 | 0 | -50 |
| Russia | 8.25 | -75 | 0 | 0 | 0 | 0 | -75 |

Source: Citi Research

Figure 18. Foreign Exchange Forecasts (End of Period), as of 25 Sep 2013

| | vs. USD | | | | | | vs. EUR | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Current | Dec 13 | Mar 14 | Jun 14 | Sep 14 | Dec 14 | Current | Dec 13 | Mar 14 | Jun 14 | Sep 14 | Dec 14 |
| United States | NA | NA | NA | NA | NA | NA | 1.35 | 1.37 | 1.36 | 1.36 | 1.37 | 1.38 |
| Japan | 99 | 101 | 103 | 105 | 106 | 107 | 134 | 138 | 140 | 143 | 145 | 148 |
| Euro Area | 1.35 | 1.37 | 1.36 | 1.36 | 1.37 | 1.38 | NA | NA | NA | NA | NA | NA |
| Canada | 1.02 | 1.02 | 1.04 | 1.06 | 1.06 | 1.06 | 1.38 | 1.39 | 1.42 | 1.44 | 1.45 | 1.45 |
| Australia | 0.94 | 0.94 | 0.91 | 0.88 | 0.88 | 0.88 | 1.43 | 1.46 | 1.50 | 1.55 | 1.56 | 1.56 |
| New Zealand | 0.84 | 0.84 | 0.81 | 0.79 | 0.79 | 0.79 | 1.62 | 1.63 | 1.68 | 1.72 | 1.73 | 1.74 |
| Norway | 5.82 | 5.68 | 5.67 | 5.65 | 5.59 | 5.53 | 7.88 | 7.77 | 7.73 | 7.70 | 7.65 | 7.61 |
| Sweden | 6.34 | 6.35 | 6.43 | 6.50 | 6.43 | 6.36 | 8.58 | 8.68 | 8.77 | 8.85 | 8.80 | 8.76 |
| Switzerland | 0.91 | 0.91 | 0.92 | 0.92 | 0.92 | 0.92 | 1.23 | 1.25 | 1.25 | 1.25 | 1.26 | 1.27 |
| United Kingdom | 1.60 | 1.65 | 1.66 | 1.66 | 1.68 | 1.70 | 0.84 | 0.83 | 0.82 | 0.82 | 0.82 | 0.81 |
| China | 6.12 | 6.12 | 6.15 | 6.18 | 6.14 | 6.10 | 8.3 | 8.4 | 8.4 | 8.4 | 8.4 | 8.4 |
| India | 61.8 | 61.9 | 63.0 | 63.9 | 62.6 | 61.4 | 83.6 | 84.6 | 85.9 | 86.9 | 85.8 | 84.6 |
| Korea | 1071 | 1047 | 1043 | 1039 | 1030 | 1021 | 1448 | 1431 | 1422 | 1414 | 1410 | 1406 |
| Poland | 3.11 | 3.06 | 3.09 | 3.12 | 3.06 | 3.01 | 4.20 | 4.18 | 4.22 | 4.24 | 4.19 | 4.14 |
| Russia | 31.7 | 32.1 | 32.7 | 33.1 | 33.0 | 32.9 | 42.8 | 43.9 | 44.5 | 45.1 | 45.2 | 45.3 |
| South Africa | 9.70 | 9.79 | 9.90 | 10.01 | 10.11 | 10.21 | 13.12 | 13.38 | 13.50 | 13.63 | 13.84 | 14.06 |
| Turkey | 1.96 | 2.01 | 2.05 | 2.08 | 2.08 | 2.08 | 2.66 | 2.75 | 2.79 | 2.83 | 2.84 | 2.86 |
| Brazil | 2.21 | 2.26 | 2.33 | 2.40 | 2.41 | 2.42 | 2.99 | 3.09 | 3.18 | 3.27 | 3.30 | 3.33 |
| Mexico | 12.7 | 12.7 | 12.5 | 12.4 | 12.4 | 12.4 | 17.2 | 17.3 | 17.1 | 16.9 | 16.9 | 17.0 |

Source: Citi Research

Figure 19. Foreign Exchange Forecasts (End of Period), as of 25 Sep 2013

| | vs. JPY | | | | | |
|---|---|---|---|---|---|---|
| | Current | Dec 13 | Mar 14 | Jun 14 | Sep 14 | Dec 14 |
| United States | 99 | 101 | 103 | 105 | 106 | 107 |
| Japan | NA | NA | NA | NA | NA | NA |
| Euro Area | 134 | 138 | 140 | 143 | 145 | 148 |
| Canada | 97 | 99 | 99 | 99 | 100 | 101 |
| Australia | 94 | 94 | 93 | 93 | 93 | 94 |
| New Zealand | 83.0 | 84.6 | 83.8 | 83.0 | 83.8 | 84.6 |
| Norway | 17.1 | 17.7 | 18.2 | 18.6 | 19.0 | 19.4 |
| Sweden | 15.7 | 15.9 | 16.0 | 16.2 | 16.5 | 16.8 |
| Switzerland | 109 | 110 | 112 | 114 | 115 | 116 |
| United Kingdom | 159 | 167 | 171 | 175 | 178 | 182 |
| China | 16 | 16 | 17 | 17 | 17 | 18 |
| India | 1.61 | 1.63 | 1.63 | 1.65 | 1.69 | 1.74 |
| Korea | 10.78 | 10.39 | 10.13 | 9.88 | 9.70 | 9.53 |
| Poland | 32.0 | 33.0 | 33.3 | 33.7 | 34.6 | 35.6 |
| Russia | 3.1 | 3.1 | 3.2 | 3.2 | 3.2 | 3.3 |
| South Africa | 10.2 | 10.3 | 10.4 | 10.5 | 10.5 | 10.5 |
| Turkey | 50.6 | 50.1 | 50.3 | 50.5 | 51.1 | 51.6 |
| Brazil | 45.0 | 44.6 | 44.1 | 43.8 | 44.0 | 44.2 |
| Mexico | 7.8 | 7.9 | 8.2 | 8.5 | 8.6 | 8.7 |

Source: Citi Research

# Country Commentary

## United States

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Recovery appears to have weathered the initial effects of fiscal tightening with growth estimated at a 1¾% annual rate in the first half and tilting higher in the second half. Higher interest rates have blunted some of the massive loosening in financial conditions but the Fed's decision to maintain peak accommodation should contain economic fallout. The housing rebound is intact, business hiring surveys show no faltering, and new lows in jobless claims do not point to sizable second-round fiscal drag. Fiscal deficits may drop below 3½% next year, and so the impetus for major budget reforms has waned.

We think improved fundamentals and still highly supportive financial conditions could resolve the start of Fed tapering by December, but there is a chance that the fiscal debate could hamstring monetary policy decisions into next year. The rate backup and fiscal indecision appear to have weakened Fed officials' confidence in their forecasts even though they have cited signs of underlying strength in recovery. Forward guidance on QE has been scuttled and we think rate hikes may be delayed until the jobless rate is closer to 6%.

The outlook for inflation remains softer than policymakers' medium-term goal of 2%. Slower growth abroad has reduced pressures on domestic goods prices and labor costs remain subdued. We expect a gradual move closer to the 2% target underpinned by domestic demand and an eventual pick-up in global growth. Labor costs should firm somewhat with continued gains in hiring demand.

Figure 20. United States — Economic Forecasts, 2012-2014F

| | | | | | 2013 | | | 2014 | | | | 2015 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | 2012 | 2013F | 2014F | 2QF | 3QF | 4QF | 1QF | 2QF | 3QF | 4QF | 1QF |
| GDP | SAAR | | | | 2.8% | 2.0% | 2.7% | 2.7% | 2.9% | 3.1% | 3.2% | 3.0% |
| | YoY | 2.8 | 1.7 | 2.7 | 1.7 | 1.5 | 2.2 | 2.5 | 2.6 | 2.8 | 3.0 | 3.0 |
| Domestic Demand | SAAR | | | | 2.1 | 1.8 | 2.6 | 3.0 | 3.2 | 3.4 | 3.5 | 3.2 |
| | YoY | 2.4 | 1.6 | 2.8 | 1.5 | 1.5 | 1.7 | 2.4 | 2.6 | 3.0 | 3.3 | 3.3 |
| Consumption | SAAR | | | | 1.9 | 2.0 | 2.9 | 3.1 | 3.1 | 3.3 | 3.5 | 3.2 |
| | YoY | 2.2 | 2.0 | 2.9 | 1.9 | 2.0 | 2.3 | 2.5 | 2.8 | 3.1 | 3.2 | 3.3 |
| Business Investment | SAAR | | | | 4.7 | 4.0 | 4.2 | 4.5 | 4.6 | 5.0 | 5.5 | 5.5 |
| | YoY | 7.3 | 2.5 | 4.5 | 2.4 | 3.3 | 2.0 | 4.3 | 4.3 | 4.6 | 4.9 | 5.1 |
| Housing Investment | SAAR | | | | 14.0 | 10.4 | 10.0 | 14.9 | 18.9 | 19.4 | 14.4 | 14.0 |
| | YoY | 12.9 | 13.4 | 14.7 | 15.1 | 14.1 | 11.7 | 12.3 | 13.5 | 15.7 | 16.9 | 16.6 |
| Government | SAAR | | | | -0.4 | -1.7 | -0.8 | -0.6 | -0.4 | 0.0 | 0.1 | 0.0 |
| | YoY | -1.0 | -2.2 | -0.6 | -2.0 | -3.2 | -1.8 | -0.9 | -0.9 | -0.5 | -0.2 | -0.1 |
| Exports | SAAR | | | | 8.0 | 4.8 | 5.8 | 5.5 | 5.5 | 4.7 | 5.3 | 5.1 |
| | YoY | 3.5 | 2.6 | 5.5 | 2.0 | 3.1 | 4.3 | 6.0 | 5.4 | 5.4 | 5.2 | 5.1 |
| Imports | SAAR | | | | 6.6 | 3.6 | 5.2 | 6.5 | 6.7 | 6.2 | 6.1 | 6.3 |
| | YoY | 2.2 | 1.8 | 5.9 | 1.1 | 1.9 | 4.0 | 5.5 | 5.5 | 6.1 | 6.4 | 6.3 |
| PCE Deflator | YoY | 1.8 | 1.2 | 1.9 | 1.1 | 1.2 | 1.2 | 1.5 | 2.0 | 2.1 | 2.1 | 2.1 |
| Core PCE Deflator | YoY | 1.8 | 1.3 | 1.9 | 1.2 | 1.3 | 1.4 | 1.5 | 1.9 | 2.0 | 2.1 | 2.1 |
| Unemployment Rate | % | 8.1 | 7.4 | 6.8 | 7.6 | 7.3 | 7.1 | 7.0 | 6.9 | 6.7 | 6.6 | 6.5 |
| Federal Gov't Balance (Fiscal Year) | $Bn | -1,098 | -625 | -530 | | | | | | | | |
| | % of GDP | -6.8 | -3.8 | -3.1 | | | | | | | | |
| General Gov't Balance (Cal Year) | % of GDP | -8.1 | -4.8 | -4.3 | | | | | | | | |
| Federal Debt | % of GDP | 70 | 72 | 72 | | | | | | | | |
| General Gov't Debt | % of GDP | 103 | 106 | 108 | | | | | | | | |
| Current Account | US$bn | -440 | -457 | -461 | -396 | -429 | -443 | -450 | -453 | -455 | -461 | -466 |
| | % of GDP | -2.7 | -2.8 | -2.8 | -2.4 | -2.6 | -2.7 | -2.7 | -2.7 | -2.7 | -2.7 | -2.7 |
| S&P 500 Profits (US$ Per Share) | YoY | 6.1 | 5.5 | 6.2 | 5.0 | 6.3 | 4.2 | 7.6 | 6.2 | 5.6 | 7.0 | 5.9 |

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

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## Japan

PM Abe appears most likely to make a final decision to go ahead with the consumption tax hike (slated in April 2014) in early October. Indeed, the administration has already accelerated its discussion about policy measures to mitigate negative impacts from the consumption tax hike. These "policy offsets" are reported to include yet another fiscal pump-priming, new tax incentives for business investment, modest reductions in the effective corporate tax rate, broadened tax incentives for higher wages, and direct subsidies for less-wealthy households (who are hardest hit by the consumption tax hike), with a combined total of 5 trillion yen.

However, we are quite skeptical that these measures can fully mitigate negative impacts in a meaningful manner. The consumption tax hike from 5% currently to 8% should erode real purchasing power of household nominal income very strongly by pushing up the CPI by 2%. Given that inflation is currently approaching 1% – mostly owing to higher energy prices – inflation will likely accelerate to nearly 3% next April. This will inevitably have a significant negative impact on household spending and business conditions at companies heavily dependent upon household demand. The aforementioned measures, largely centered on those for the corporate sector, are far from enough to mitigate these pains, in our view.

The administration is considering broadening tax incentives for companies to increase compensation. Under the current framework that started in this fiscal year, if companies increase total compensation by 5% or more, they can deduct 10% of increased compensation from tax burdens. However, the threshold of 5% is too high and as a result, the administration is considering cutting this threshold to 3% in order to provide more incentives to increase compensation. But it seems unlikely that companies will increase compensation – especially fixed salary – merely due to the tax incentives, especially when a large negative impact from the consumption tax hike is in the offing.

Figure 21. Japan — Economic Forecasts, 2012-14F

| | | | | | 2013 | | | 2014 | | | | 2015 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | 2012 | 2013F | 2014F | 2Q | 3QF | 4QF | 1QF | 2QF | 3QF | 4QF | 1QF |
| Real GDP | YoY | 2.0% | 2.0% | 1.8% | 1.3% | 2.8% | 3.5% | 3.6% | 1.5% | 1.5% | 0.7% | -0.2% |
| | SAAR | | | | 3.8 | 2.3 | 3.9 | 4.6 | -4.6 | 2.1 | 0.8 | 1.0 |
| Domestic Demand | YoY | 2.8 | 1.8 | 0.9 | 1.4 | 2.3 | 3.0 | 3.1 | 0.6 | 0.4 | -0.4 | -0.8 |
| | SAAR | | | | 3.0 | 2.4 | 4.2 | 2.8 | -6.7 | 1.7 | 1.0 | 1.0 |
| Private Consumption | YoY | 2.4 | 1.8 | 0.4 | 1.7 | 2.0 | 2.4 | 3.1 | -0.5 | -0.2 | -0.8 | -2.0 |
| | SAAR | | | | 3.0 | -0.4 | 3.6 | 6.3 | -10.7 | 0.8 | 1.2 | 1.4 |
| Business Investment | YoY | 1.8 | -0.8 | 4.9 | -3.2 | 1.0 | 4.2 | 6.0 | 4.7 | 5.1 | 4.0 | 3.2 |
| | SAAR | | | | 5.1 | 4.0 | 8.1 | 6.8 | 0.1 | 5.4 | 3.7 | 3.5 |
| Housing Investment | YoY | 3.0 | 8.1 | -6.0 | 7.0 | 8.6 | 7.3 | 3.3 | -5.3 | -9.9 | -11.8 | -9.0 |
| Public Investment | YoY | 12.5 | 12.9 | 0.7 | 11.6 | 14.5 | 12.0 | 5.0 | 3.4 | -0.8 | -4.2 | -2.2 |
| Exports | YoY | -0.1 | 2.7 | 6.5 | -0.5 | 5.4 | 9.9 | 7.6 | 6.3 | 6.5 | 5.5 | 4.5 |
| | SAAR | | | | 12.4 | 4.7 | 6.1 | 7.3 | 7.1 | 5.5 | 2.2 | 3.3 |
| Imports | YoY | 5.5 | 2.1 | 0.6 | 0.5 | 1.7 | 6.0 | 3.6 | 0.3 | -0.1 | -1.3 | 0.9 |
| | SAAR | | | | 6.2 | 4.9 | 8.7 | -4.8 | -6.8 | 3.3 | 3.5 | 4.1 |
| CPI | YoY | 0.0 | 0.1 | 2.2 | -0.3 | 0.6 | 0.8 | 0.8 | 2.9 | 2.7 | 2.5 | 2.5 |
| Core CPI | YoY | -0.1 | 0.3 | 2.3 | 0.0 | 0.7 | 0.9 | 0.9 | 2.9 | 2.7 | 2.5 | 2.5 |
| Nominal GDP | YoY | 1.1 | 1.4 | 2.8 | 0.7 | 2.4 | 3.3 | 3.8 | 2.8 | 2.7 | 1.9 | 0.3 |
| Current Account | ¥ tn | 5.2 | 7.1 | 12.0 | 8.2 | 8.6 | 8.3 | 10.3 | 12.5 | 12.8 | 12.5 | 3 |
| | % of GDP | 1.1 | 1.5 | 2.4 | 1.7 | 1.8 | 1.7 | 2.1 | 2.5 | 2.6 | 2.5 | 0.6 |
| Unemployment Rate | % | 4.4 | 4.0 | 3.7 | 4.0 | 3.8 | 3.8 | 3.7 | 3.6 | 3.7 | 3.8 | 3.8 |
| Industrial Production | YoY | 0.2 | -0.6 | 3.3 | -3.1 | 2.0 | 5.5 | 5.9 | 3.6 | 2.3 | 1.5 | 1.0 |
| Corporate Profits (Fiscal Year) | YoY | 5.0 | 40.0 | 5.0 | | | | | | | | |
| General Govt. Balance (Fiscal Year) | % of GDP | -10.7 | -9.8 | -8.0 | | | | | | | | |
| General Govt Debt | % of GDP | 237 | 244 | 246 | | | | | | | | |

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

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## Euro Area

The euro area economy is growing again, albeit modestly. Survey information for September has confirmed the slight upward bias in our 2013 and 2014 GDP forecasts of the last few months. However, the recovery remains fragile with domestic demand showing only tentative stabilisation while employment perspectives remain poor. This challenging backdrop requires the ECB to do all it can to keep monetary conditions accommodative, given the absence of any material upside risks to its medium-term price stability objective.

We are revising up 2013 and 2014 GDP growth forecasts by 0.2ppt and 0.1ppt to minus 0.3% and +0.7% respectively. While the 2013 upward revision is primarily explained by a higher euro GDP level in late 2012 and early 2013, we are revising up the 2014 GDP numbers in Greece, Italy, Belgium and Portugal. Our less pessimistic take on these countries' expected performance stems from a reduction in the amount of budgetary tightening that member states are delivering. Although the European Commission's (EC) focus remains on delivering lower structural deficits, the amount of fiscal tightening has declined. We expect confirmation of this trend through the adoption of a new methodology for structural budget deficit calculations in the next few months, if rubber-stamped by the Ecofin. The EC is expected to publish its Autumn Forecast using this new framework in November, showing smaller structural deficits – and hence reduced need for fiscal consolidation in both the nearterm and further ahead.

Banking union is the euro area's biggest challenge for the next 3-6 months, requiring that governments reach an agreement about the exact modalities of ESM bank recaps by year-end, ahead of the ECB's Asset Quality Review and stress tests in H1-2014. We continue to believe that official rates will be unchanged until late-2016, given the limited inflation risks. We do not believe that the ECB is about to adopt quantitative references or thresholds to beef up its forward guidance. Instead, we expect the ECB to agree to the release of minutes plus an extended forecast horizon. The ECB probably will offer another LTRO in the next quarter or two, most likely by yearend, and view this partly as a tool to help support periphery banks and partly as a tool to reinforce the "extended period" commitment on policy rates.

Figure 22. Euro Area — Economic Forecasts, 2012-14F

| | | | | | 2013 | | | 2014 | | | | 2015 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | 2012 | 2013F | 2014F | 2Q | 3QF | 4QF | 1QF | 2QF | 3QF | 4QF | 1QF |
| Real GDP | YoY | -0.6% | -0.3% | 0.7% | -0.5% | -0.2% | 0.5% | 0.8% | 0.7% | 0.7% | 0.7% | 0.8% |
| | SAAR | - | - | - | 1.2 | 0.6 | 0.9 | 0.7 | 0.6 | 0.8 | 0.7 | 1.1 |
| Final Domestic Demand | YoY | -1.7 | -0.9 | 0.4 | -0.9 | -0.7 | -0.2 | 0.5 | 0.3 | 0.4 | 0.4 | 0.5 |
| Private Consumption | YoY | -1.4 | -0.5 | 0.4 | -0.6 | -0.4 | 0.2 | 0.5 | 0.4 | 0.5 | 0.4 | 0.6 |
| Government Consumption | YoY | -0.6 | 0.1 | -0.2 | 0.3 | 0.4 | 0.2 | 0.1 | -0.4 | -0.4 | -0.3 | -0.2 |
| Fixed Investment | YoY | -3.7 | -3.5 | 0.9 | -3.5 | -3.1 | -1.7 | 0.8 | 0.7 | 0.9 | 1.0 | 1.0 |
| Stocks (Contrib. to Y/Y GDP Growth) | | -0.5 | 0.1 | 0.0 | -0.1 | 0.1 | 0.3 | 0.0 | 0.1 | 0.0 | 0.0 | 0.0 |
| Exports | YoY | 2.7 | 0.8 | 2.6 | 0.7 | 0.6 | 1.6 | 3.3 | 2.2 | 2.4 | 2.5 | 2.5 |
| Imports | YoY | -1.0 | -0.4 | 2.0 | -0.4 | -0.2 | 1.1 | 2.6 | 1.7 | 1.8 | 1.9 | 2.0 |
| CPI | YoY | 2.5 | 1.5 | 1.5 | 1.4 | 1.4 | 1.5 | 1.4 | 1.7 | 1.5 | 1.5 | 1.4 |
| CPI Ex Unprocessed Food and Energy | YoY | 1.8 | 1.4 | 1.3 | 1.3 | 1.3 | 1.4 | 1.3 | 1.4 | 1.3 | 1.3 | 1.3 |
| Unemployment Rate | YoY | 11.4 | 12.2 | 12.3 | 12.1 | 12.3 | 12.3 | 12.2 | 12.3 | 12.3 | 12.3 | 12.3 |
| Current Account Balance | EUR bn | 118.3 | 242.2 | 224.2 | | | | | | | | |
| | % of GDP | 1.2 | 2.5 | 2.3 | | | | | | | | |
| General Government Balance | EUR bn | -352.7 | -281.9 | -237.5 | | | | | | | | |
| | % of GDP | -3.7 | -2.9 | -2.4 | | | | | | | | |
| Primary Balance | % of GDP | -0.6 | 0.1 | 0.6 | | | | | | | | |
| General Government Debt | EUR bn | 8,794.6 | 9,220.7 | 9,546.7 | | | | | | | | |
| | % of GDP | 92.7 | 96.0 | 97.0 | | | | | | | | |
| Gross Operating Surplus | YoY | -0.4 | 1.7 | 1.0 | | | | | | | | |

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

## Germany

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Our forecasts are mostly unchanged this month and we still expect GDP growth to be 0.6% and 1.8% for 2013 and 2014. The limited data for Q3 so far (retail sales, orders and industrial production) have been weak. But PMIs and sentiment measures for both consumers and businesses remain strong and business investment rose for the first time in seven quarters in Q2, suggesting that the July data do not reflect the underlying positive trend. The German election is unlikely to affect the nearterm outlook much, with little prospect of major change in economic or Eurozone support policies. It could, however, take a few weeks for a new German government to be agreed, most likely a Grand Coalition of CDU/CSU and SPD, led by Chancellor Merkel.

## France

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We maintain our 2013 and 2014 GDP forecasts at 0.2% and 0.8%, respectively, expecting a very gradual recovery. FinMin Pierre Moscovici presented the key aspects of the 2014 Budget to be put before the cabinet on September 25. The baseline uses a 0.9% GDP growth forecast for 2014 (lowered from 1.2% in the spring), while the 2013 GDP estimate was confirmed at 0.1%. These more realistic assumptions could give the government some room for manoeuvre to undershoot the 4.1% and 3.6% budget deficit targets for 2013 and 20-14, respectively, in the event of a slightly higher growth trajectory. Targeted savings of €18bn or 0.9% of GDP in 2014, with an 80%-20% split between expenditure cuts and tax increases, are designed to limit the drag on activity.

## Italy

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Recent activity data for July point to still flat/slightly negative growth in Q3 GDP, despite further improvements in confidence indicators. We think a significantly less-tight fiscal stance and repayments of government arrears may lead to positive GDP growth in Q4, but this upturn is likely to be short-lived. We expect fiscal policy to turn a bit tighter in 2014 (after a deficit overshoot in 2013), leaving GDP roughly flat. Exports are not showing signs of gaining much strength. With the fiscal deficit re-widening and political instability still high, risks for further rating actions and renewed market tensions remain high. The political backdrop hinders scope for structural reforms and public spending cuts. We do not see the debt ratio stabilising in the next few years, therefore we suspect that some form of debt restructuring (maturity lengthening and/or coupon reductions) may be likely eventually.

Figure 23. Germany, France and Italy — Economic Forecasts, 2012-14F

| | | Germany | | | France | | | Italy | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | 2012 | 2013F | 2014F | 2012 | 2013F | 2014F | 2012 | 2013F | 2014F |
| Real GDP | YoY | 0.9% | 0.6% | 1.8% | 0.0% | 0.2% | 0.8% | -2.4% | -1.7% | 0.1% |
| Final Domestic Demand | YoY | 0.4 | 0.7 | 2.1 | -0.1 | 0.0 | 0.4 | -4.7 | -2.4 | -0.4 |
| Private Consumption | YoY | 0.7 | 1.1 | 1.9 | -0.3 | 0.3 | 0.5 | -4.3 | -2.5 | -0.7 |
| Government Consumption | YoY | 1.0 | 0.9 | 0.9 | 1.4 | 1.3 | 0.5 | -2.9 | -0.1 | -1.1 |
| Fixed Investment | YoY | -1.4 | -1.1 | 3.8 | -1.2 | -2.4 | -0.1 | -8.0 | -4.7 | 1.5 |
| Exports | YoY | 3.8 | 0.5 | 2.0 | 2.5 | 0.9 | 2.2 | 2.2 | 0.0 | 3.8 |
| Imports | YoY | 1.8 | 1.2 | 2.8 | -0.9 | 0.6 | 1.4 | -7.8 | -3.1 | 2.7 |
| CPI | YoY | 2.0 | 1.6 | 2.0 | 2.2 | 1.1 | 1.7 | 3.3 | 1.6 | 1.3 |
| Unemployment Rate | % | 5.5 | 5.6 | 5.5 | 9.8 | 10.6 | 10.7 | 10.7 | 12.2 | 12.4 |
| Current Account | €bn | 187.7 | 187.6 | 166.8 | -45.0 | -31.5 | -15.9 | -8.4 | 17.4 | 21.8 |
| | % of GDP | 7.0 | 6.8 | 5.9 | -2.2 | -1.5 | -0.8 | -0.5 | 1.1 | 1.4 |
| General Govt. Balance | €bn | 4.1 | -1.3 | 1.7 | -98.2 | -84.3 | -72.9 | -47.6 | -55.9 | -43.5 |
| | % of GDP | 0.2 | 0.0 | 0.1 | -4.8 | -4.1 | -3.5 | -3.0 | -3.6 | -2.8 |
| Primary Balance | % of GDP | 2.6 | 2.4 | 2.3 | -2.3 | -1.5 | -0.8 | 2.5 | 1.8 | 2.6 |
| General Govt. Debt | % of GDP | 81.2 | 79.5 | 76.0 | 90.2 | 93.9 | 95.5 | 127.0 | 133.0 | 136.4 |
| Gross Trading Profits | YoY | -1.4 | 3.0 | 4.5 | -1.5 | 0.0 | 2.5 | NA | NA | NA |

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

## Spain

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We are lifting our growth forecasts for 2013 by 0.1pp to -1.3%, reflecting reduced fiscal drag, lower inflation and better exports. The pace of fiscal tightening has slowed down significantly relative to 2012: real public consumption rose by 0.9% QQ in Q2 (largest rise since Q1-11) and YTD government deficit (ex. local governments) stood already at 5.3% of GDP in July (including 0.3% of GDP of financial sector support), posing some upside risks for the 2013 target (6.5%). Private deleveraging, the ongoing adjustment in the housing sector and still tight financial conditions will likely continue to cap economic growth until early 2015.

## Greece

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Recent data imply the recession is less deep than we expected, and hence we have again revised up our GDP forecasts in 2013 (by 0.6pp to -3.8) and in 2014 (by 1.0pp). Nevertheless, a financing gap is likely in 2014 due to poor tax collection and shortfalls in privatisation revenues, requiring further external help (either loans or debt relieving measures). Key discussions on further public debt restructuring are likely before year-end. A large debt relief from official lenders would probably be the only viable (but politically difficult) option to restore fiscal sustainability. We think risks of Greece leaving the euro remain, but this is not our base case.

## Ireland

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We are pulling our 2013 growth forecast lower again, to -0.5% from 0.2% last month, following the disappointingly mild Q2 GDP rebound (0.4% QoQ) and slippage in industrial production in July. The public debt profile also looks a bit worse, reflecting continued weakness in nominal GDP. We do still expect the debt/GDP ratio will start to edge down in 2014, but this relies on a much greater pick-up in nominal GDP growth than seen so far.

## Portugal

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Despite the strong Q2 GDP print (+1.1% QQ), we think the underlying growth trend remains negative. The reduced pace of fiscal tightening will likely cause some budget overshooting and a smaller likelihood of a smooth exit from the bailout programme in mid-14. More fiscal austerity will occur over the next couple of years, especially if (as we expect) a second bailout programme is agreed. With about half of the debt in official hands, we think some further OSI and perhaps PSI (in the form of coupon-reduction/maturity extensions) may eventually occur to restore debt sustainability.

Figure 24. Spain, Greece, Ireland and Portugal — Economic Forecasts, 2012-14F

| | | Spain | | | Greece | | | Ireland | | | Portugal | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | 2012 | 2013F | 2014F | 2012 | 2013F | 2014F | 2012 | 2013F | 2014F | 2012 | 2013F | 2014F |
| Real GDP | YoY | -1.6% | -1.3% | -0.2% | -6.4% | -3.8% | -2.9% | 0.1% | -0.5% | 2.7% | -3.2% | -1.9% | -0.8% |
| Final Domestic Demand | YoY | -4.2 | -3.3 | -1.1 | -9.7 | -6.6 | -4.2 | -1.1 | -2.6 | -0.3 | -6.8 | -3.1 | -1.8 |
| Private Consumption | YoY | -2.8 | -2.5 | -0.1 | -9.1 | -6.2 | -3.6 | -0.3 | -1.3 | 0.7 | -5.4 | -2.2 | -0.9 |
| Government Consumption | YoY | -4.8 | -1.9 | -2.2 | -4.0 | -5.2 | -4.6 | -3.8 | -1.9 | -1.6 | -4.8 | -1.7 | -2.3 |
| Fixed Investment | YoY | -7.0 | -7.0 | -2.7 | -19.0 | -10.9 | -6.3 | -0.7 | -9.9 | -3.2 | -14.3 | -8.6 | -5.2 |
| Exports | YoY | 2.1 | 5.2 | 4.5 | -2.0 | 1.8 | 2.3 | 1.6 | 0.9 | 7.4 | 3.2 | 4.8 | 2.6 |
| Imports | YoY | -5.7 | -0.8 | 2.0 | -9.3 | -8.5 | -4.0 | 0.0 | 0.9 | 4.9 | -6.5 | 1.9 | 0.3 |
| CPI | YoY | 2.4 | 1.8 | 0.9 | 1.0 | -0.5 | -1.1 | 0.7 | -0.6 | 1.4 | 2.8 | 0.5 | -0.1 |
| Unemployment Rate | % | 25.0 | 26.5 | 27.4 | 24.1 | 28.0 | 30.5 | 14.7 | 13.6 | 13.2 | 15.7 | 16.9 | 17.6 |
| Current Account | €bn | -11.5 | 13.3 | 19.2 | -6.5 | -0.7 | 1.3 | 7.3 | 14.2 | 19.0 | -2.6 | 1.9 | 5.1 |
| | % of GDP | -1.1 | 1.3 | 1.9 | -3.4 | -0.4 | 0.8 | 4.4 | 8.8 | 11.2 | -1.5 | 1.2 | 3.2 |
| General Govt. Balance | €bn | -111.6 | -69.7 | -61.5 | -19.4 | -8.5 | -6.9 | -12.5 | -13.9 | -9.5 | -10.6 | -9.8 | -8.7 |
| | % of GDP | -10.8 | -6.8 | -6.0 | -10.0 | -4.7 | -4.0 | -7.6 | -8.6 | -5.6 | -6.4 | -6.0 | -5.4 |
| Primary Balance | % of GDP | -7.8 | -3.4 | -2.2 | -5.0 | -0.5 | 0.1 | -3.9 | -3.5 | -0.5 | -2.0 | -1.6 | -1.1 |
| General Govt. Debt | % of GDP | 84.2 | 94.0 | 104.0 | 156.9 | 177.6 | 191.5 | 118.6 | 126.0 | 123.5 | 123.8 | 133.4 | 150.4 |

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

## Netherlands

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The Dutch economy is struggling, underperforming its closest neighbours and main trading partners. With business confidence rebounding to its long-term average in August, we expect that GDP growth will likely turn positive towards year-end. However, the significant amount of structural fiscal tightening (austerity measures of €6bn or 1% of GDP) to be delivered through the 2014 budget, together with rising joblessness, will likely constrain the recovery in the foreseeable future. Austerity fatigue suggests that there is a clear risk that the Senate will reject the budget as the government coalition does not have a majority.

## Belgium

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Belgium's 2Q GDP was revised up to 0.2% QQ (from an initial estimate of 0.1%) confirming that economic activity had expanded for the first time in five quarters. In light of more constructive business survey signals from Germany and France, we are revising up our 2013 and 2014 GDP forecasts by 0.2ppt and 0.1ppt to 0.0% and 0.5%, respectively. The government is focusing its attention on budget consolidation, aiming to end the Excessive Deficit Procedure in 2013. The arduous task of delivering on a tricky structural reform agenda will fall on the next administration (elections are due on 25 May, 2014).

## Slovakia

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Mild GDP growth is likely to continue during 2H13 as the sentiment indicator improved in August, but industry disappointed. A narrowing of the central government cash deficit eased concerns, but we still see risks that this measure will overshoot the government's target (4.2% of GDP) by about 0.3pp. The improvement particularly reflects a 9% YY drop in expenditure, as revenues fell by 2% due to lower inflows of EU funds. ARDAL returned to the market after a two-month pause and the auction was well received. The MinFin's financing needs for the full year are 90% covered and ARDAL will probably continue with buybacks.

## Slovenia

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We have cut our 2014 GDP forecast by 0.2%pt to -0.5% due to ongoing fiscal consolidation and the repeated delays in measures for banking sector resolution, where the risk is that it will be applied in early 2014 rather than by end-2013. Both factors are likely to negatively influence domestic activity. We remain constructive on export activity due to the recovery in foreign demand, and this is supported by recent local and foreign confidence surveys. Politics are likely to remain noisy in the month ahead, reflecting approval of the budget proposal, election of PS leader and of course banking sector resolution.

Figure 25. Netherlands, Belgium, Slovakia and Slovenia — Economic Forecasts, 2012-2014F

| | | Netherlands | | | Belgium | | | Slovakia | | | Slovenia | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | 2012 | 2013F | 2014F | 2012 | 2013F | 2014F | 2012 | 2013F | 2014F | 2012 | 2013F | 2014F |
| Real GDP | YoY | -1.3% | -1.3% | 0.3% | -0.3% | 0.0% | 0.5% | 2.0% | 0.8% | 1.8% | -2.2% | -2.2% | -0.5% |
| Final Domestic Demand | YoY | -1.8 | -2.9 | -0.2 | -0.5 | -0.4 | 0.2 | -1.4 | -1.4 | 1.3 | -3.8 | -2.7 | -0.2 |
| Private Consumption | YoY | -1.6 | -1.9 | -0.3 | -0.3 | 0.3 | 0.0 | -0.6 | 0.1 | 0.9 | -2.8 | -2.9 | -0.2 |
| Government Consumption | YoY | -0.7 | -0.9 | -0.6 | 0.4 | 0.3 | 0.3 | -0.6 | -0.1 | 0.1 | -1.6 | -2.4 | -1.4 |
| Investment (Ex Stocks) | YoY | -4.0 | -8.2 | 0.4 | -0.6 | -2.9 | 0.4 | -3.7 | -5.9 | 3.3 | -9.1 | -2.5 | 1.2 |
| Exports | YoY | 3.2 | 1.2 | 1.4 | 0.7 | -0.3 | 2.4 | 8.6 | 4.5 | 5.8 | 1.3 | 1.9 | 3.5 |
| Imports | YoY | 3.3 | -1.4 | 0.8 | 0.5 | -0.9 | 2.5 | 2.8 | 2.3 | 5.6 | -4.3 | 1.3 | 3.9 |
| CPI (Average) | YoY | 2.8 | 2.9 | 1.7 | 2.8 | 1.2 | 1.8 | 3.6 | 1.7 | 1.9 | 2.6 | 2.3 | 2.8 |
| Unemployment Rate | % | 6.4 | 8.4 | 9.0 | 7.6 | 8.8 | 9.5 | 13.6 | 14.3 | 14.3 | 8.9 | 10.5 | 11.4 |
| Current Account | % of GDP | 9.4 | 9.4 | 8.9 | -1.6 | -2.0 | -1.6 | 2.2 | 4.0 | 3.5 | 2.3 | 2.8 | 3.9 |
| General Govt Balance | % of GDP | -4.1 | -3.9 | -3.4 | -3.9 | -3.0 | -2.6 | -4.3 | -3.5 | -3.2 | -4.0 | -9.1 | -6.6 |
| Primary Balance | % of GDP | -2.2 | -2.0 | -1.4 | -0.5 | 0.5 | 1.0 | -2.9 | -2.1 | -1.7 | -1.9 | -6.4 | -3.7 |
| General Govt Debt | % of GDP | 71.3 | 75.1 | 76.6 | 99.8 | 102.0 | 102.6 | 52.1 | 56.8 | 57.4 | 54.1 | 63.4 | 68.8 |

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

## UK

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We are significantly changing our UK interest rate forecasts, advancing the first rate hike from 2017 to 2015. We expect that the tightening cycle will be relatively shallow, but now look for Bank Rate to be 0.75% at end-2015 and 1.75% at end-2016 (both 0.5% before), with the 2017 average revised up to 2¼% from 1.0% previously, and Bank Rate leveling off at about 3-3.5% in 2018.

These revisions reflect two main factors: First, with a broad-based upturn, we are again revising up our growth forecasts, and now expect growth of 1.4% this year, 3.0% in 2014 and 3.1% in 2015 (versus 1.1%, 2.1% and 2.7% respectively last month). In all, we have lifted our growth forecasts for this year and the next by 1.1-1.2% over the last three months, the sharpest 3-month upward revisions to Citi's UK growth forecasts of the last 15 years apart from the snap-back at the end of the 2008-09 recession. Our growth forecasts have swung from below consensus earlier this year to above consensus now, the first time since 2011 that our forecasts have been above consensus. Second, we now believe that productivity will rebound more slowly than we previously expected, partly because of continued declines in the cost of labour. With the higher GDP growth outlook, this implies a much faster decline in unemployment than our prior forecast, so that the jobless rate falls to the 7% threshold around end-2014 or early 2015 — hence ending the MPC's guidance framework. The MPC will almost certainly not return to a neutral stance as soon as the jobless rate hits 7%. But, we do expect that, provided the economy's momentum remains solid, they will nudge rates up in subsequent quarters, while keeping rates well below neutral for a while.

Figure 26. United Kingdom — Economic Forecasts, 2012-2014F

| | | | | | 2013 | | | 2014 | | | | 2015 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | 2012 | 2013F | 2014F | 2QF | 3QF | 4QF | 1QF | 2QF | 3QF | 4QF | 1QF |
| Real GDP | YoY | 0.1% | 1.4% | 3.0% | 1.6% | 1.5% | 2.4% | 3.0% | 3.0% | 3.0% | 3.0% | 3.0% |
| | SAAR | | | | 3.2 | 3.0 | 2.8 | 3.0 | 3.2 | 3.1 | 2.8 | 3.1 |
| Domestic Demand | YoY | 1.1 | 1.0 | 2.8 | 0.4 | 1.6 | 1.7 | 2.7 | 3.3 | 2.3 | 2.8 | 3.0 |
| (Incl. Inventories) | SAAR | | | | 1.3 | 6.6 | 0.6 | 2.5 | 3.8 | 2.6 | 2.3 | 3.2 |
| Private Consumption | YoY | 1.2 | 1.8 | 2.6 | 1.6 | 2.0 | 2.1 | 2.3 | 2.7 | 2.7 | 2.7 | 3.2 |
| | SAAR | | | | 1.5 | 3.1 | 2.6 | 2.0 | 3.2 | 2.9 | 2.8 | 3.9 |
| Government Consumption | YoY | 2.8 | 1.6 | -0.5 | 2.7 | 1.9 | 1.1 | 0.8 | -0.5 | -1.1 | -1.2 | -1.1 |
| | SAAR | | | | 3.7 | 0.5 | 0.0 | -0.9 | -1.4 | -1.9 | -0.5 | -0.5 |
| Investment | YoY | 0.5 | -2.9 | 9.5 | -4.8 | -2.9 | 5.0 | 7.5 | 9.5 | 11.3 | 9.5 | 8.7 |
| | SAAR | | | | 6.8 | 1.5 | 11.5 | 10.6 | 15.0 | 8.3 | 4.5 | 7.4 |
| Exports | YoY | 0.9 | 1.4 | 6.0 | 3.4 | -0.9 | 4.1 | 6.0 | 3.5 | 7.9 | 6.5 | 6.2 |
| | SAAR | | | | 15.2 | -8.8 | 12.3 | 7.1 | 4.6 | 7.6 | 6.9 | 5.8 |
| Imports | YoY | 2.8 | 0.3 | 5.4 | 0.1 | 0.0 | 2.1 | 5.6 | 4.6 | 5.6 | 5.7 | 5.9 |
| | SAAR | | | | 10.5 | 2.1 | 4.5 | 5.3 | 6.4 | 5.9 | 5.2 | 6.0 |
| Unemployment Rate | % | 7.9 | 7.8 | 7.3 | 7.8 | 7.7 | 7.7 | 7.6 | 7.5 | 7.3 | 7.0 | 6.9 |
| CPI Inflation | YoY | 2.8 | 2.6 | 2.0 | 2.7 | 2.7 | 2.3 | 2.0 | 2.0 | 2.0 | 2.1 | 2.2 |
| Merch. Trade | £bn | -104.1 | -103.1 | -95.3 | | | | | | | | |
| | % of GDP | -6.7 | -6.4 | -5.6 | | | | | | | | |
| Current Account | £bn | -57.7 | -51.5 | -47.6 | | | | | | | | |
| | % of GDP | -3.7 | -3.2 | -2.8 | | | | | | | | |
| PSNB | £bn FY | -89.4 | -95.6 | -78.3 | | | | | | | | |
| | % of GDP | -5.7 | -5.9 | -4.6 | | | | | | | | |
| General Govt. Balance | % of GDP | -6.3 | -6.4 | -5.1 | | | | | | | | |
| Government Primary Balance | | -2.7 | -2.8 | -1.5 | | | | | | | | |
| Public Debt | % of GDP | 89.5 | 93.1 | 95.3 | | | | | | | | |
| Gross Nonoil Trading Profits | YoY | 4.5 | 8.1 | 10.2 | | | | | | | | |

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

## Switzerland

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We are elaving our forecasts unchanged this month. The economy is growing at a modest pace, supported by loose domestic monetary conditions, but may face some headwinds if EM tensions hit exports. With inflation close to zero and subdued inflation prospects, the SNB is likely to keep policy on hold for some time.

## Sweden

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Revised GDP data suggest the Swedish economy has been markedly weaker than previously indicated in recent years, with stagnation over the past year. Given the downward revisions to 1H growth, we have cut our full-year 2013 GDP forecast by 0.4pp to 0.6% Y/Y. Meanwhile, there are clearer signs of impending recovery in lead indicators. The Riksbank remains concerned about household debt, but we reckon that once the new macro prudential measures become operational, this should leave room for the bank to keep rates low for longer, amidst weak growth and a larger output gap, to prevent a persistent undershoot of the inflation target.

## Denmark

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The Danish economy has on average been stagnant since the economic crisis took hold in late-2008, primarily reflecting flat private spending and waning exports. Given the substantial growth setback in late-2012, the economy entered 2013 at a very subdued level, indicating barely any growth this year. We see some green shoots in the economy (consumer confidence and Dankort debit card sales are rising), though, and our forecast assumes moderately accelerating growth ahead, driven by rising domestic demand. Economic reforms have not had the intended stimulus effect in the short term, but they should make the economy better positioned to benefit from external economic recovery once the cycle turns.

## Norway

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Momentum has slowed with mainland GDP running at a well below trend 1.7% Y/Y pace in 2Q and more widespread housing market weakness. In turn, we have cut our 2013-14 growth forecasts by 0.2-0.3pp. The spring downturn, though, should prove transitory; apart from near-stalling private consumption, other demand components were relatively healthy. In addition, a large fall in electricity prices dented growth by 0.6pp. Fundamentals also remain in place for a nearterm recovery in private consumption. With signs of accelerating inflation, Norges Bank did a U-turn at the September meeting, removing completely its nearterm easing bias and indicating an initial rate hike around summer next year (4Q-14 previously).

Figure 27. Switzerland, Sweden, Denmark and Norway — Economic Forecasts, 2012-2014F

| | | Switzerland | | | Sweden | | | Denmark | | | Norway | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | 2012 | 2013F | 2014F | 2012 | 2013F | 2014F | 2012 | 2013F | 2014F | 2012 | 2013F | 2014F |
| Real GDP | YoY | 1.0% | 1.7% | 1.5% | 1.3% | 0.6% | 2.2% | -0.4% | 0.2% | 0.9% | 3.3% | 1.9% | 2.4% |
| Final Domestic Demand | YoY | 1.7 | 1.7 | 1.2 | 1.9 | 0.5 | 2.0 | 0.4 | 0.2 | 0.9 | 2.8 | 2.5 | 2.7 |
| Private Consumption | YoY | 2.5 | 2.4 | 1.6 | 1.7 | 1.7 | 2.1 | 0.5 | 0.3 | 0.7 | 3.1 | 2.5 | 2.4 |
| Government Consumption | YoY | 0.5 | 1.0 | 1.4 | 1.1 | 1.0 | 1.2 | 0.7 | -0.1 | 0.6 | 1.7 | 2.3 | 2.5 |
| Investment (Ex Stocks) | YoY | -0.2 | 0.0 | -0.1 | 3.7 | -3.2 | 3.0 | -0.1 | 0.3 | 1.6 | 3.8 | 2.7 | 4.1 |
| Exports | YoY | 1.1 | 1.1 | 3.7 | 1.1 | -1.5 | 2.7 | 0.3 | 0.5 | 2.0 | 3.4 | 1.2 | 3.1 |
| Imports | YoY | 2.1 | -0.1 | 3.4 | 0.0 | -1.1 | 2.3 | 1.0 | 1.5 | 1.6 | 4.2 | 1.3 | 3.6 |
| CPI (Average) | YoY | -0.7 | -0.2 | 0.3 | 0.9 | 0.2 | 1.1 | 2.4 | 0.7 | 1.5 | 0.7 | 2.1 | 1.6 |
| Unemployment Rate | % | 2.6 | 1.8 | 1.7 | 8.0 | 8.0 | 7.9 | 7.5 | 7.1 | 6.9 | 3.2 | 3.6 | 3.7 |
| Current Account | % of GDP | 12.8 | 12.9 | 13.0 | 6.0 | 5.9 | 5.6 | 5.9 | 5.6 | 4.9 | 14.2 | 12.8 | 13.2 |
| General Govt Balance | % of GDP | 0.5 | 0.7 | 0.9 | -0.6 | -1.4 | -1.5 | -4.3 | -2.0 | -1.5 | 13.8 | 13.1 | 13.0 |
| General Govt Debt | % of GDP | 46.7 | 45.3 | 43.2 | 38.4 | 39.3 | 39.6 | 45.8 | 47.4 | 47.8 | NA | NA | NA |

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

## Canada

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The Canadian economy continues to weather a series of shocks that impacted the nation over the summer. Rotation of demand away from consumer and government spending and towards business investment and exports remains glacial and uneven. Excess supply abounds, and imbalances related to household debt and housing activity have reinvigorated. Nonetheless, stronger US and other advanced economy growth, and accommodative financial conditions continue to portend faster Canadian expansion ahead. Apparent growth stabilization among key emerging markets, further Canadian dollar depreciation, and an upgraded commodity price outlook should also lend support. Higher interest rates should reduce housing froth.

Total and core CPI inflation remain below the Bank of Canada's 2% objective, but are still poised to return to target by mid-2015, with closure of the output gap. Upside risks to the inflation projection include (1) stronger private US demand amid reduced fiscal drag and continued housing market revival; and (2) reinvigoration of the Canadian housing market. Downside risks include (1) EA woes; (2) weaker-than-expected Emerging Market growth that dampens commodity prices and subsequently exports; and (3) domestic consumer retrenchment linked to debt and/or disorderly unwind of housing activity. Risks are balanced, in our view.

The central bank continues to hold the overnight rate target at 1.00% and intends to keep interest rates low as long as slack persists, inflation expectations remain benign and there is gradual reduction of household imbalances. Higher mortgage rates prompted by US Fed taper discussions likely have also rendered a welcome degree of consumer restraint that allows for unchanged policy rates for longer. Nonetheless, the bank maintains a slight tightening bias in order to resist persistent household imbalances and in expectation of more robust growth ahead. We continue to anticipate fixed rates until 1Q 15 and retention of the tightening bias.

Figure 28. Canada — Economic Forecast, 2012-2014F

| | | | | | 2013F | | | 2014F | | | | 2015F |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | 2012 | 2013F | 2014F | 2Q | 3QF | 4QF | 1QF | 2QF | 3QF | 4QF | 1QF |
| Real GDP | YoY | 1.7% | 1.7% | 2.5% | 1.4% | 1.8% | 2.1% | 2.2% | 2.4% | 2.6% | 2.7% | 2.8% |
| | SAAR | | | | 1.7 | 2.2 | 2.4 | 2.5 | 2.6 | 2.8 | 2.9 | 3.1 |
| Final Domestic Demand | YoY | 2.3 | 1.7 | 2.3 | 1.7 | 1.9 | 1.9 | 2.3 | 2.3 | 2.3 | 2.3 | 2.4 |
| | SAAR | | | | 2.2 | 2.4 | 2.3 | 2.3 | 2.2 | 2.3 | 2.3 | 2.7 |
| Private Consumption | YoY | 1.9 | 2.2 | 2.2 | 2.5 | 2.3 | 2.2 | 2.5 | 2.0 | 2.2 | 2.3 | 2.3 |
| | SAAR | | | | 3.7 | 2.0 | 2.0 | 2.2 | 2.0 | 2.4 | 2.4 | 2.5 |
| Government Spending | YoY | 1.0 | 1.1 | 1.0 | 1.1 | 1.2 | 0.9 | 1.0 | 1.0 | 1.0 | 1.0 | 1.0 |
| | SAAR | | | | 1.1 | 0.8 | 1.0 | 1.0 | 1.0 | 1.0 | 1.0 | 1.0 |
| Private Fixed Investment | YoY | 5.2 | 1.2 | 4.3 | 0.1 | 1.7 | 2.3 | 3.7 | 5.0 | 4.4 | 4.0 | 4.3 |
| | SAAR | | | | -0.5 | 6.0 | 5.0 | 4.3 | 4.5 | 3.6 | 3.7 | 5.3 |
| Exports | YoY | 1.5 | 1.9 | 5.4 | 0.8 | 2.7 | 3.8 | 3.9 | 5.3 | 6.0 | 6.4 | 6.5 |
| | SAAR | | | | 0.9 | 3.8 | 5.4 | 5.7 | 6.3 | 6.7 | 6.8 | 6.2 |
| Imports | YoY | 3.1 | 1.5 | 4.4 | 1.2 | 1.0 | 2.8 | 3.5 | 4.4 | 4.7 | 5.0 | 5.0 |
| | SAAR | | | | 1.5 | 3.5 | 4.0 | 5.0 | 5.0 | 5.0 | 5.0 | 5.0 |
| CPI | YoY | 1.5 | 1.1 | 1.8 | 0.8 | 1.2 | 1.4 | 1.5 | 1.8 | 1.8 | 1.9 | 1.8 |
| Core CPI | YoY | 1.7 | 1.3 | 1.7 | 1.2 | 1.4 | 1.4 | 1.4 | 1.4 | 1.7 | 2.2 | 2.2 |
| Unemployment Rate | % | 7.3 | 7.1 | 6.7 | 7.1 | 7.2 | 7.0 | 6.8 | 6.8 | 6.8 | 6.6 | 6.3 |
| Current Account Balance | C$bn | -62.2 | -55.5 | -56.8 | -58.3 | -55.4 | -55.9 | -54.2 | -61.9 | -53.4 | -57.8 | -53.6 |
| | % of GDP | -3.4 | -3.0 | -2.9 | -3.1 | -2.9 | -3.0 | -2.8 | -3.2 | -2.7 | -2.9 | -2.7 |
| Net Exports (Pct. Contrib.) | | -0.6 | 0.1 | 0.2 | -0.2 | 0.0 | 0.3 | 0.1 | 0.3 | 0.4 | 0.4 | 0.2 |
| Inventories (Pct. Contrib.) | | 0.0 | -0.1 | -0.1 | -0.7 | -0.2 | -0.3 | 0.0 | 0.0 | 0.0 | 0.1 | 0.1 |
| Budget Balance (Fiscal Year) | % of GDP | -1.4 | -1.0 | -0.3 | | | | | | | | |
| Federal Budget Debt | % of GDP | 33.2 | 33.3 | 32.4 | | | | | | | | |
| General Govt. Debt | % of GDP | 83.9 | 84.0 | 83.1 | | | | | | | | |

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

## Australia

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There are early signs that the business cycle is starting to improve. Gains in consumer and business confidence alongside asset and commodity price rises and some resilience among Australia's major trading partners have given us greater conviction in our above consensus GDP growth forecast for 2014 of 3.0%. Furthermore, the risks to growth are arguably less to the downside than before with a strengthening housing market placing some slight upside risk to our household consumption growth forecasts. That said, a recovery in non-mining investment business investment remains unlikely before 2015 and the soft labour market limits the potential for domestic demand growth over at least the next six months. On balance we continue to expect no further interest rate cuts from the RBA in the current cycle. The RBA's scope to cut interest rates is limited by the strength of the property market. Equally, the Bank is unlikely to raise rates given it wants to see a lower exchange rate to assist with the task of economic rebalancing.

## New Zealand

We have lifted our GDP forecast for 2014 by 0.2 of a percentage point to 3.0%, the first time we have forecast growth at or above a trend rate for almost four years. We expect an increase in residential and other building investment as part of the Canterbury reconstruction efforts at the same time as consumer expenditure is forecast to accelerate. The 2014 forecast would have been even stronger except that net exports look set to detract from GDP growth. More reconstruction will involve an increase in imports that is likely to outweigh our forecast gain in exports. With domestic demand set to gain, inflation pressures should increase. However, we do not expect inflation to become a problem for the RBNZ, with the CPI set to reach to mid-point of the target band by the end of next year. By this time, we continue to expect the RBNZ to be well into its hiking cycle, with the OCR 125bps higher than the current level of 2.50%.

Figure 29. Australia and New Zealand — Economic Forecast, 2012-2014F

| | Australia | | | New Zealand | | |
|---|---|---|---|---|---|---|
| | 2012 | 2013F | 2014F | 2012 | 2013F | 2014F |
| Real GDP[a] | 3.7% | 2.5% | 3.0% | 2.7% | 2.6% | 3.0% |
| Real GDP (4Q versus 4Q) | 6.7 | 5.9 | 5.5 | 3.4 | 2.5 | 3.2 |
| Real Final Domestic Demand | 4.8 | 1.2 | 2.8 | 2.7 | 3.5 | 4.8 |
| Consumption | 3.2 | 2.0 | 2.9 | 2.4 | 3.4 | 3.5 |
| Govt. Current & Capital Spending[b] | 3.2 | 1.3 | 2.1 | 0.5 | 0.1 | 0.9 |
| Housing Investment | -3.8 | 3.1 | 5.6 | 12.0 | 30.0 | 21.1 |
| Business Investment[c] | 15.1 | 2.2 | -0.1 | 6.5 | 3.0 | 9.1 |
| Exports of Goods & Services | 5.8 | 6.6 | 8.1 | 2.6 | 0.0 | 2.5 |
| Imports of Goods & Services | 6.2 | -0.8 | 6.5 | 2.2 | 5.4 | 6.3 |
| CPI | 1.8 | 2.2 | 2.9 | 1.1 | 0.9 | 1.9 |
| CPI (4Q versus 4Q) | 2.2 | 2.1 | 2.8 | 0.9 | 1.4 | 2.1 |
| Unemployment | 5.3 | 6.1 | 5.9 | 6.9 | 6.5 | 6.1 |
| Merch. Trade, BOP (Local Currency, bn) | -5.0 | 13.5 | 3.8 | 1.1 | 0.4 | -3.1 |
| Current Account, (Local Currency, bn) | -54.9 | -36.1 | -54.1 | -10.5 | -13.1 | -23.1 |
| Percent of GDP | -3.7 | -2.3 | -3.3 | -5.0 | -6.1 | -10.3 |
| Budget Balance[d] (Local Currency, bn) | -44.6 | -37.8 | -30.7 | -12.5 | -5.5 | -3.7 |
| Percent of GDP | -3.0 | -2.5 | -1.9 | -6.0 | -2.6 | -1.7 |
| General Govt. Debt (% of GDP)[e] | 29.0 | 28.4 | 29.9 | 38.4 | 36.7 | 39.4 |
| Gross Operating Surplus | -4.5 | 2.0 | 5.3 | NA | NA | NA |

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

## China

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We have upgraded our growth forecast on better-than-expected real activity in 3Q. Economic data released since the beginning of July have been generally positive, with industrial production and fixed asset investment picking up speed on a YoY basis. If the positive momentum in the last two months is sustained in September, we may see the modest MoM pickups translate into a more significant improvement in YoY GDP growth this quarter, helped by base effects. We estimate that IP growth will reach about 10%YoY in 3Q. Based on the recent relationship between IP and GDP, we expect 3Q growth to be around 7.8% YoY, higher than our prior estimate of 7.4% YoY. Correspondingly, we upgrade 2013 growth from 7.4% to 7.6%, and 2014 growth from 7.1% to 7.2%.

The overall policy stance will likely be less accommodative in 2H. The current rebound has benefited from quite loose monetary and credit conditions in the first five months. Since June, credit conditions have been tightened, as evidenced in the monetary data and PBOC's 3Q survey of entrepreneurs and bankers. In this context, we see the total social financing rebound in August as a temporary deviation from a shift to a neutral policy stance. Recent remarks by the Premier and PBOC suggest little room for monetary loosening. In addition, the Minister of Finance has made it clear that the budget deficit for 2013 will not be increased. According to our estimate, fiscal policy will not be more expansionary than last year even if the budget is fully utilized. As a result, we think the current rebound is transitory, and growth may resume the downturn in 4Q.

Reform takes precedence over stimulating the economy. If growth can reach 7.8% YoY in 3Q, the government growth target of around 7.5% for 2013 is within reach. With growth in a reasonable range and downside risks reduced by an improving external environment, we expect the government to put more emphasis on reform, instead of re-leveraging the economy. In addition, the PMI employment index indicates the job market is normal, further reducing the incentive of policy stimulus. The recent steps taken by the government, including the launch of China (Shanghai) Free Trade Zone, suggest the government is laying groundwork for substantial reforms, and a comprehensive reform agenda is expected to be introduced during the Third Plenary Session of the Communist Party in November.

Figure 30. China — Economic Forecasts, 2012-2014F

| | | | | | 2013F | | | 2014F | | | | 2015F |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | 2012 | 2013F | 2014F | 2QF | 3QF | 4QF | 1QF | 2QF | 3QF | 4QF | 1QF |
| Real GDP | YoY | 7.7% | 7.6% | 7.2% | 7.5% | 7.8% | 7.4% | 7.2% | 7.0% | 7.1% | 7.5% | 7.2% |
| Real Final Domestic Demand | YoY | 8.2 | 7.2 | 7.2 | | | | | | | | |
| Consumption | YoY | 8.3 | 7.1 | 7.3 | | | | | | | | |
| Fixed Capital Formation | YoY | 8.1 | 7.4 | 7.0 | | | | | | | | |
| Industrial Production | YoY | 10.0 | 9.4 | 8.7 | 9.1 | 10.0 | 8.9 | 8.5 | 8.3 | 8.8 | 9.1 | 8.6 |
| Exports | YoY | 7.9 | 8.6 | 3.2 | 3.8 | 6.0 | 8.0 | -5.0 | 5.0 | 7.0 | 5.0 | 4.0 |
| Imports | YoY | 4.3 | 7.1 | 2.9 | 5.0 | 8.0 | 7.0 | -2.0 | 1.0 | 5.0 | 7.0 | 6.0 |
| Merchandise Trade Balance | $bn | 231 | 277 | 293 | 66 | 75 | 94 | 26 | 88 | 90 | 89 | 18 |
| FX Reserves | $bn | 3,312 | 3,693 | 3,925 | 3,497 | 3,571 | 3,693 | 3,699 | 3,772 | 3,847 | 3,925 | 3,924 |
| Current Account | % of GDP | 2.3 | 2.2 | 2.0 | | | | | | | | |
| Fiscal Balance | % of GDP | -2.0 | -2.0 | -2.0 | | | | | | | | |
| General Govt. Debt* | % of GDP | 45.0 | 45.1 | 45.3 | | | | | | | | |
| Urban Unemployment Rate | % | 4.1 | 4.1 | 4.2 | 4.1 | 4.1 | 4.1 | 4.2 | 4.2 | 4.2 | 4.3 | 4.3 |
| CPI | YoY | 2.6 | 2.7 | 3.0 | 2.4 | 2.7 | 3.1 | 2.8 | 2.9 | 2.7 | 3.4 | 3.6 |
| Exchange Rate (end period) | CNY/$ | 6.23 | 6.12 | 6.10 | 6.14 | 6.11 | 6.12 | 6.15 | 6.18 | 6.14 | 6.10 | 6.07 |
| 1-Yr Deposit Rate (end period) | % | 3.00 | 3.00 | 3.25 | 3.00 | 3.00 | 3.00 | 3.00 | 3.00 | 3.00 | 3.25 | 3.50 |

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

## India

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The capital outflows that began with taper talk exposed several of India's vulnerabilities, more importantly the twin deficits on current account and fiscal balances. The sharp Rupee depreciation and a consequent rise in headline inflation led to a swift reversal of the monetary easing cycle even though GDP growth dropped to a 4-year low of 4.4% in 1QFY14. The RBI raised repo rates by 25bps in its mid quarter policy, marking an end to the interest rate cutting cycle that started in April 2012.

Besides monetary tightening, policy makers took other administrative measures to mitigate heightened exchange rate volatility on both the current account and capital account fronts. The government clamped down on gold imports, while RBI offered swap concessions on NRI deposits and overseas borrowing. The delay in Fed tapering provided further relief to currency markets. Due to these developments, the INR has reversed more than a third of its depreciation since May 22. But it may still be too early to say that a corner has been turned as Fed tapering has only been postponed and structural impediments such as twin deficits remain a concern.

With neither monetary policy nor fiscal policy having enough space to stimulate demand in the near term, we have downgraded our GDP estimate to 4.8%YoY in FY14 (and 5.6% in FY15) compared to our earlier estimates of 5.4% and 6.2%, respectively. We expect a gradual improvement in activity levels on back of strong agriculture production and a pick-up in exports.

On monetary policy, there is a discernible change in the operating framework of the RBI under new governor Raghuram Rajan. The governor in his first monetary policy announcement highlighted high CPI inflation and entrenched inflation expectations as the key reasons behind his interest rate action, while traditionally the RBI has used WPI inflation as its nominal anchor for setting interest rates. Note that WPI inflation on average has been 2.9% lower than CPI inflation in the last 20 months. We now expect the RBI to hike repo rates by 25-50bps in 2HFY14, while simultaneously normalizing money market conditions by reducing marginal standing facility rates by 50-75bps.

Lastly, we now expect the current account deficit (CAD) to narrow to $68.4bn or 3.7% of GDP in FY14 vs $88.2bn in FY13 on account of some recovery in export demand as well as a substantial decline in gold imports. On the fiscal deficit, we estimate marginal slippage to 5% of GDP due to both a shortfall in revenue and an overshoot in subsidies and even after adjusting for cuts in planned expenditure.

Figure 31. India — Economic Forecasts, FY2012/13-2014/15F

| | | FY 12/13F | FY 13/14F | FY 14/15F |
|---|---|---|---|---|
| Real GDP | YoY | 5.0% | 4.8% | 5.6% |
| Final Domestic Demand | YoY | 3.2 | 4.9 | 6.1 |
| Private Consumption | YoY | 4.0 | 5.3 | 6.5 |
| Fixed Investment | YoY | 1.7 | 3.5 | 5.5 |
| Exports | YoY | 3.0 | 5.2 | 11.0 |
| Imports | YoY | 6.8 | 5.0 | 9.5 |
| Wholesale Price Index* | YoY | 7.3 | 5.5 | 5.0 |
| Consumer Price Index | YoY | 10.2 | 8.7 | 7.5 |
| Current Account | US$ bn | -88 | -68 | -60 |
| | % of GDP | -4.8 | -3.7 | -2.6 |
| Consolidated Fiscal Balance | % of GDP | -7.0 | -6.7 | -6.4 |
| Centre Fiscal Balance | % of GDP | -4.9 | -5.0 | -4.6 |
| US Dollar Exchange Rate | Average | 55.0 | 61.9 | 61.4 |

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

## Korea

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Ahead of the Fed's FOMC meeting in September, the KRW outperformed other EM currencies. KRW has gained against USD by around 4.5%, sliding down to 1,070 levels on 23 September from the previous peak of 1,123 on 22 August. We attribute the gain to the continued current account surplus, accruing to US$36.4bn in July, and foreigners' net-purchases of equities, which totalled US$7.5bn during Aug 23rd-Sep 23rd. With the KRW strengthening while the JPY remains weak, the BoK seems to be implementing active smoothing operation, especially when JPY/KRW falls below 10.8. On monetary policy, the BoK held the policy rate at 2.50% in September, expecting the economic recovery to continue with subdued inflation going forward. In line with our forecast, the BoK expects the economy to continue to grow by around 1%QoQ sa in 2H (2Q13: 1.1%QoQ sa), while inflation stays below the lower bound of its inflation target band (2.5-3.5%) for a while. Resilient job growth, averaging 387K YoY during the last three months, and steady nominal wage growth, around 5% YoY in 2Q13, seem likely to continue and probably will support a recovery of consumption in 2H. Thus, we maintain our view that the BoK will leave the policy rate at current level in the remainder of this year at the least.

## Indonesia

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Our GDP growth forecast is lowered to 5.3% in 2014, from previous 5.6%. FX volatility since August has further weakened the nearterm growth outlook. However, we think the sensitivity of growth to IDR/USD depreciation could be milder this time if compared to 2008. We still expect YoY inflation to rise towards 9.2% by YE13, before receding towards 4.9% in YE14. Imported inflation is rising, but the pass-through may be cushioned by benign global commodity prices and wider profit margins at the producer level. Although credit growth is already decelerating, we think the process of current account adjustment will occur gradually and risks that tighter monetary policy will cause a sharp slowdown are not alarmingly high. The case looks strong for policy tightening using multiple instruments, including further increase(s) in interest rates. Relying too much on exchange rate adjustment may be costlier in the long term, potentially stalling future growth recovery by weakening corporate balance sheets. In recent weeks, policy variables have taken a turn to the right direction with the FasBI and BI rate having been raised to 5.5% and 7.25%, respectively.  We see the possibility of a further 25bps interest rate hike in 4Q13 and another 25bps in early 2014 (bringing the total rate hike in the cycle to 200bps).

Figure 32. Korea and Indonesia — Economic Forecasts, 2012-2014F

| | | Korea | | | Indonesia | | |
|---|---|---|---|---|---|---|---|
| | | 2012 | 2013F | 2014F | 2012 | 2013F | 2014F |
| Real GDP | YoY | 2.0% | 2.9% | 3.7% | 6.2% | 5.7% | 5.3% |
| Final Domestic Demand | YoY | 1.1 | 2.3 | 3.0 | 6.2 | 4.6 | 4.6 |
| Private Consumption | YoY | 1.7 | 1.7 | 2.9 | 5.3 | 5.0 | 4.7 |
| Fixed Investment | YoY | -1.7 | 2.8 | 3.7 | 9.8 | 4.4 | 3.8 |
| Exports | YoY | 4.2 | 5.7 | 6.2 | 2.0 | 4.2 | 6.0 |
| Imports | YoY | 2.5 | 4.6 | 6.1 | 6.6 | 0.6 | 4.1 |
| Consumer Price Index | YoY | 2.2 | 1.5 | 2.5 | 4.3 | 7.2 | 6.6 |
| Unemployment Rate | % | 3.2 | 3.2 | 3.2 | 6.1 | 5.9 | 5.9 |
| Current Account | US$ bn | 43.1 | 51.9 | 32.7 | -24.4 | -31.3 | -24.6 |
| | % of GDP | 3.8 | 4.3 | 2.4 | -2.8 | -3.5 | -2.7 |
| Fiscal Balance | % of GDP | 1.5 | 0.9 | 2.3 | -1.9 | -2.1 | -1.8 |
| US Dollar Exchange Rate | Average | 1127 | 1091 | 1033 | 9361 | 10471 | 11599 |

Sources: Haver Analytics and Citi Research forecasts

## Hong Kong

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The economy is steadily recovering, and the July trade improvement is encouraging. We expect the trade recovery to be bumpy; for example, August data will face difficult base effects. Nevertheless, we expect that better overseas demand in developed countries, coinciding with year-end new product launches, could boost 4Q trade. Further cooperation between China and HK businesses has been established with the signing of annex 10 of the CEPA trade pact, allowing fund houses, law firms and film-making companies, etc. greater access into China. Policymakers remain vigilant on property price rises and reiterate their intention to retain existing cooling measures. EFN yields will probably continue to follow their UST counterparts closely, and have fallen since the Fed's surprise dovishness.

## Singapore

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The economy has been in a cyclical sweet spot, though the expansion path is likely to turn choppier in coming quarters. While a 3Q sequential GDP contraction is likely amidst external demand headwinds from the immediate region, this comes after a 15.5% QoQ SAAR surge in 2Q. Meanwhile inflation has surprised on the downside relative to MAS's April expectations. With official growth forecasts rising and inflation forecasts cut, we expect no change in MAS's policy stance in October. Core inflation could still rise near term, but medium-term deflationary forces may be rising from a likely fall in housing prices, household de-leveraging on tighter macroprudential regulations, and cost competitiveness strains from economic restructuring. For now, these will likely be addressed with non-monetary measures.

## Taiwan

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The economic recovery is likely pick up pace in 2H, with 4Q growth benefiting from a more meaningful trade recovery against the backdrop of China's economy stabilizing somewhat and the Fed's extended accommodation. Political turmoil could cause further delays in the implementation of ECFA for services, and other free economic zone initiatives, which in turn would limit a recovery in capex. Foreign demand for equities into the local stock market and the reversal in EM FX weakness are likely to provide nearterm support to the TWD. Ten-year government bond yields retreated at the latest auction and yields are likely to be capped by higher risk appetites after the delay in Fed tapering. After the August deflation print, we have cut our full year CPI forecast but still expect inflation to rise gradually near term given typhoon-related shocks, the electricity price hike and a slight better economy.

Figure 33. Hong Kong, Singapore and Taiwan — Economic Forecasts, 2012-2014F

| | | Hong Kong | | | Singapore | | | Taiwan | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | 2012 | 2013F | 2014F | 2012 | 2013F | 2014F | 2012 | 2013F | 2014F |
| Real GDP | YoY | 1.5% | 3.0% | 3.4% | 1.3% | 3.2% | 4.0% | 1.3% | 2.6% | 3.8% |
| Final Domestic Demand | YoY | 4.8 | 3.4 | 2.2 | 2.9 | 2.5 | 2.9 | 0.1 | 1.9 | 2.6 |
| Private Consumption | YoY | 3.2 | 4.1 | 2.2 | 2.2 | 1.8 | 1.9 | 1.5 | 1.7 | 2.7 |
| Fixed Investment | YoY | 9.4 | 2.0 | 2.4 | 6.6 | 0.0 | 3.4 | -4.4 | 3.9 | 3.6 |
| Exports | YoY | 1.8 | 6.8 | 5.3 | 0.3 | 1.5 | 3.8 | 0.1 | 5.2 | 4.8 |
| Imports | YoY | 2.8 | 7.1 | 4.9 | 3.2 | 1.7 | 2.9 | -1.9 | 4.9 | 3.8 |
| CPI | YoY | 4.1 | 4.3 | 3.6 | 4.6 | 2.4 | 2.3 | 1.9 | 1.2 | 1.7 |
| Unemployment Rate | % | 3.3 | 3.4 | 3.2 | 1.9 | 1.9 | 1.8 | 4.2 | 4.1 | 4.0 |
| Current Account | US$ bn | 2.9 | 6.3 | 11.2 | 51.5 | 40.6 | 42.6 | 49.9 | 49.6 | 46.8 |
| | % of GDP | 1.1 | 2.2 | 3.7 | 18.6 | 14.0 | 13.5 | 10.5 | 10.1 | 9.0 |
| Fiscal Balance | % of GDP | 3.3 | 1.8 | 1.0 | 1.1 | 0.7 | 0.5 | -1.6 | -1.2 | -1.3 |
| US Dollar Exchange Rate | Average | 7.76 | 7.76 | 7.76 | 1.25 | 1.25 | 1.23 | 29.57 | 29.64 | 29.54 |

Sources: Haver Analytics and Citi Research forecasts

## Russia

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With thanks to
Adrian Thomas

Economic activity continues to decelerate: GDP growth in Q2 fell to 1.2%YoY, from 1.6% in Q1. The authorities' response to the slowdown is aiming to rely more on monetary stimulus than fiscal: spending cuts have been announced to absorb the weakness in non-oil tax revenues, and, although monetary policy has not yet been loosened, the stage for monetary loosening has been set by the government's decision to freeze utility and railway tariffs next year, which should take pressure off the CPI and make room for rate cuts. Credit growth continues to decelerate, and since the CBR is concerned about rising NPLs – and is asking the banks for higher provisions – animal spirits in the credit market might stay weak next year. Overall, we see few reasons for optimism about the real economy: supply-side reforms are few, and while the real exchange rate is 5% cheaper than in Q1, it remains 45% more appreciated than it was on average between 2002 and 2005.

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Governor Basci's pledge to refrain from further rate hikes to defend the lira caught the markets off-guard. With the average funding rate hovering below 6.5% since early-September, we believe current monetary policy remains accommodative. The decline in the quality of Turkey's external financing, the marked deterioration in underlying inflation and the CBT's limited firepower raise further questions about the feasibility of the Governor's pledge to keep rates on hold. This backdrop suggests to us that the lira is likely to remain vulnerable. Turning to the growth outlook, despite the stronger-than-expected 2Q GDP reading, the composition of growth in 1H warrants concern for at least two reasons. First, standing at 2.6pp, the contribution of the public sector to GDP growth in 1H (3.7% YoY) is unusually high and cannot continue for long without raising concerns about the country's fiscal health. Second, private consumption, which grew by 4.2% YoY in 1H, is likely to weaken in 2H owing to higher interest rates and the lira depreciation. The available sentiment indicators lend support to this conjecture. Against this backdrop, we keep our 2013 GDP growth estimate at 3.5% and continue to monitor the key risk factors such as higher oil prices, further declines in capital inflows and geopolitical developments that could affect domestic sentiment.

Figure 34. Russia and Turkey — Economic Forecast, 2012-14F

| | | Russia | | | Turkey | | |
|---|---|---|---|---|---|---|---|
| | | 2012 | 2013F | 2014F | 2012 | 2013F | 2014F |
| Real GDP | YoY | 3.4% | 2.1% | 2.8% | 2.2% | 3.5% | 4.0% |
| Final Domestic Demand | YoY | 5.2 | 3.4 | 3.9 | -0.4 | 3.8 | 3.3 |
| Private Consumption | YoY | 6.7 | 3.5 | 3.6 | -0.6 | 3.8 | 3.8 |
| Fixed Investment | YoY | 6.0 | 4.6 | 6.5 | -2.7 | 2.5 | 0.9 |
| Exports | YoY | 1.4 | 0.5 | 1.7 | 16.7 | 1.5 | 4.3 |
| Imports | YoY | 9.5 | 4.5 | 4.5 | -0.3 | 4.1 | 1.6 |
| CPI | YoY | 5.1 | 6.5 | 5.1 | 8.9 | 7.3 | 7.3 |
| Unemployment Rate | % | 5.5 | 6.5 | 7.0 | 9.2 | 9.5 | 9.5 |
| Current Account | US$ bn | 71.4 | 60.2 | 20.6 | -45.4 | -56.3 | -56.9 |
| | % of GDP | 3.5 | 2.8 | 0.9 | -5.8 | -6.9 | -6.7 |
| Fiscal Balance | % of GDP | -0.7 | -2.0 | -4.2 | -2.0 | -1.8 | -2.7 |
| US Dollar Exchange Rate | Average | 31.1 | 31.9 | 32.9 | 1.80 | 1.93 | 2.07 |

Sources: Haver Analytics and Citi Research forecasts

## Hungary

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Based on the huge increase in the NBH's SME lending program and fiscal loosening, we are lifting our 2014 GDP forecast to 1.8%YoY from 1.4% previously. Inflation is likely to stay below the 3% target until 4Q14 as another round of household utility price cuts in November and potential cut to VAT on basic foods will probably reduce headline CPI inflation close to 1% by Jan-2014. The fiscal outlook has deteriorated with populist rhetoric ahead of parliamentary elections. Based on current plans, we expect the budget deficit to rise from 3.0% of GDP in 2013 to 3.3% in 2014 but risks of losing access to EU funds may prompt the government to take corrective steps after the spring 2014 elections. We do not expect a fast solution to bail out FX mortgage debtors without charging banks with upfront losses, and this may add to country-specific risks in coming months. Improved risk sentiment on easing Fed tapering concerns is likely to support local assets near term and allow the MPC to cut rates further in gradual steps. We project rate cuts to halt around 3.25% by year-end but the pace is likely to largely depend in external conditions. A rising inflation outlook and higher core yields probably will force the NBH to hike rates in 2H14 and we project the base rate at 4.25% by end-2014.

## Poland

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The government has announced details regarding planned changes in the pension system. The plan assumes more than half of the portfolio of non-equity assets managed by private pension funds (OFE) will be moved to the public sector, thus cutting public debt by around 7-8% of GDP. Additionally members of OFE will be given three months to decide whether to stay in the private pension system. Should they fail to do so, their future contributions will be flow to the public system. We estimate the whole change could improve the general government deficit permanently by at least 0.5% of GDP in the coming years. Furthermore, if the one-off capital transfer is counted as part of revenues, this would also allow Poland to record a large fiscal surplus (approx. 4% of GDP) in 2014. We believe this will give the government some fiscal space to support the economy. As a result, we stick to our above-consensus forecast of 2.8% of GDP growth in 2014. If changes in the pension system are followed by a cut in debt limits (as suggested by the Finance Minister), this should help lower concerns regarding medium-term fiscal trends. As far as monetary policy is concerned, we expect the central bank's base rate will remain on hold at least until mid-2014 and any rate hikes thereafter will be gradual.

Figure 35. Hungary and Poland — Economic Forecasts, 2012-2014F

| | | Hungary | | | Poland | | |
|---|---|---|---|---|---|---|---|
| | | 2012 | 2013F | 2014F | 2012 | 2013F | 2014F |
| Real GDP | YoY | -1.7% | 0.6% | 1.8% | 1.9% | 1.3% | 2.8% |
| Final Domestic Demand | YoY | -2.1 | 0.0 | 1.2 | 0.3 | 0.0 | 2.2 |
| Private Consumption | YoY | -1.4 | 0.4 | 1.0 | 0.8 | 1.0 | 2.2 |
| Fixed Investment | YoY | -3.8 | -0.3 | 3.1 | -0.8 | -3.2 | 2.6 |
| Exports | YoY | 2.0 | 2.4 | 3.5 | 2.8 | 3.1 | 4.0 |
| Imports | YoY | 0.1 | 2.1 | 3.1 | -1.8 | 0.3 | 2.9 |
| CPI | YoY | 5.7 | 1.9 | 2.0 | 3.7 | 1.1 | 2.2 |
| Unemployment Rate | % | 10.9 | 10.6 | 10.2 | 12.2 | 14.2 | 13.4 |
| Current Account | US$ bn | 2.1 | 2.4 | 2.4 | -17.3 | -10.9 | -17.9 |
| | % of GDP | 1.6 | 1.8 | 1.8 | -3.5 | -2.1 | -3.2 |
| Fiscal Balance | % of GDP | -1.9 | -2.9 | -3.3 | -3.9 | -4.3 | 4.7 |
| Euro Exchange Rate | Average | 289 | 300 | 305 | 4.18 | 4.22 | 4.20 |

Sources: Haver Analytics and Citi Research forecasts

## Czech Republic

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After slightly weaker data, we have slightly cut our GDP forecast to -1.1% YoY in 2013 (-1.0% previously) and kept our 2014 forecast at 1.6% with downside risks due to the political situation. Key things to watch are the CNB's policy and the early election on 25-26 October. Opinion polls indicate that we are probably heading toward the first left-centrist government since 2006, and the first pure left-wing government (ie without centrist support) since 1989. If the koruna strengthens below 25.6, we see a higher chance that some CNB board members will join the three members who probably already voted for FX intervention to ease monetary conditions. First, economic data are not promising. There was a mild gain in industrial production, while the July surge in construction was probably only temporary (due to post-flood reconstruction), improved (but by less than expected) July retail sales, soft real wage growth in 2Q13, and recent weakness in trade, the labour market and credit. Second, though GDP growth at 0.6% QoQ in 2Q13 was solid, final domestic demand was back in recession. Third, inflation is low, with another undershoot of the CNB's inflation forecast in August, and the policy-relevant CPI inflation gauge has been below the CNB's target for seven months in a row.

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Developments to date lead us to look for a 25bp rate cut at the September Board Meeting, bringing the policy rate to 4.25%. Specifically, the absence of a meaningful pick-up in economic activity and the fact that inflation is on track to be around 3%, which is in line with the NBR's most recent forecast, raise the likelihood of a 25bp easing on 30 September. Regarding the growth outlook, we remain concerned about the weak state of domestic demand, as net exports have so far been the main engine of GDP growth. The excessive reliance on exports, in turn, raises questions about the sustainability of the country's fragile recovery. This backdrop begs the following question: *Can the NBR carry out a more aggressive easing than we envision?* In our view, whether the NBR will opt for further easing at the last rate meeting of the year (November 5) will depend on the evolution of the leu. In this regard, if the leu holds up well following the likely easing at the September meeting, concerns over the strength of the recovery may lead the NBR to carry out another 25bp easing that would bring the policy rate to 4.0% by the end of 2013 instead of our base case of 4.25%.

Figure 36. Czech Republic and Romania — Economic Forecasts, 2012-2014F

| | | Czech Republic | | | Romania | | |
|---|---|---|---|---|---|---|---|
| | | 2012 | 2013F | 2014F | 2012 | 2013F | 2014F |
| Real GDP | YoY | -1.2% | -1.1% | 1.6% | 0.4% | 1.6% | 2.8% |
| Final Domestic Demand | YoY | -2.4 | -0.9 | 2.1 | 1.9 | 0.2 | 2.5 |
| Private Consumption | YoY | -3.3 | 0.3 | 1.4 | 1.0 | 0.5 | 2.4 |
| Fixed Investment | YoY | -2.7 | -3.9 | 3.4 | 5.2 | -1.0 | 3.5 |
| Exports | YoY | 4.0 | 1.0 | 5.4 | -3.1 | 4.2 | 4.0 |
| Imports | YoY | 2.3 | 0.6 | 7.3 | -0.8 | 1.2 | 3.0 |
| CPI | YoY | 3.3 | 1.5 | 1.3 | 3.3 | 4.4 | 2.8 |
| Unemployment Rate | % | 7.0 | 7.1 | 6.4 | 5.1 | 5.2 | 5.5 |
| Current Account | US$ bn | -4.7 | -1.9 | -3.3 | -6.6 | -2.8 | -8.1 |
| | % of GDP | -2.4 | -1.0 | -1.6 | -3.9 | -1.5 | -4.0 |
| Fiscal Balance | % of GDP | -4.4 | -2.8 | -2.9 | -2.2 | -2.2 | -2.5 |
| EURCZK, USDRON | Average | 25.1 | 25.9 | 25.5 | 3.5 | 3.3 | 3.3 |

Sources: Haver Analytics and Citi Research forecasts

## Brazil

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The stronger 2Q13 figure has motivated an upward revision in our 2013 annual GDP growth forecast to 2.6% (from 2.1%). Despite this increase, we continue to expect a sharp growth deceleration in coming quarters, and keep our 2014 GDP growth estimate at 2.0%. We are cutting our CPI inflation forecast to 5.9% at year-end (from 6.2%), reflecting the recent BRL appreciation. For 2014, we expect higher inflation pressures (6.2% at year-end) as that FX effect fades. Under these conditions, the central bank will likely hike the Selic rate to 9.75% before yearend, keeping rates at this level throughout 2014. Regarding fiscal policy, the release of 2014 Budget Law reinforced our conviction that government will not achieve the primary surplus fiscal target of 2.3% of GDP this year and in 2014, but rather a result of around 1.5% in both years. Moreover, the weaker BRL is already improving trade balance/current account results, supporting our forecasts that external accounts will likely show better figures in 2014 compared with this year's prints. Finally, and backed by the evidence of recent popularity polls, we continue to believe that Dilma will likely be reelected in next year's presidential election.

## Mexico

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GDP growth disappointed in 1H13 and stood at 1% YoY, and several indicators signal slow 3Q growth. While exports exhibited a healthy rebound, the soft US industrial production data suggest a weak recovery ahead. Compared to last month, we are cutting growth forecasts to 1.2% and 3.8% for 2013 and 2014, down by 0.8pp and 0.4pp, respectively. We think that the downside growth risks could be mitigated by the fiscal reform measures being discussed. Meanwhile, inflation stood at 3.5% YoY in August, and should remain stable for the next few months. Uncertainty about inflation pressures in 2013 has receded due to the solid performance of core inflation (2.5% YoY in August) and the recent drop in farm prices. We expect headline inflation to be 3.5% YoY by end-2013 and to be near 3.7% by end-2014. Banxico surprised by cutting the policy rate by 25bps in September on the back of the sharper-than-expected deceleration in activity. The central bank hinted at an eventual downward revision to its GDP growth and inflation forecasts. We expect another 25bps cut in October given weak economic data and a subdued low inflation trend. On the political front, we expect Congress to pass the fiscal, energy and financial reforms over the next few months.

Figure 37. Brazil and Mexico — Economic Forecasts, 2012-2014F

| | | Brazil | | | Mexico | | |
|---|---|---|---|---|---|---|---|
| | | 2012 | 2013F | 2014F | 2012 | 2013F | 2014F |
| Real GDP | YoY | 0.9% | 2.6% | 2.0% | 3.8% | 1.2% | 3.8% |
| Final Domestic Demand | YoY | 1.7 | 3.1 | 1.8 | 4.5 | 2.1 | 4.1 |
| Private Consumption | YoY | 3.1 | 1.9 | 1.9 | 4.6 | 2.5 | 4.0 |
| Fixed Investment | YoY | -4.0 | 7.6 | 0.3 | 5.5 | 1.7 | 5.8 |
| Exports | YoY | 0.5 | 1.9 | 6.3 | 4.2 | 2.6 | 8.0 |
| Imports | YoY | 0.2 | 8.0 | 3.9 | 6.0 | 3.0 | 8.5 |
| CPI | YoY | 5.4 | 6.2 | 6.1 | 4.1 | 3.7 | 3.4 |
| Unemployment Rate | % | 5.5 | 5.4 | 5.8 | 5.0 | 5.0 | 4.8 |
| Current Account | US$ bn | -54.2 | -78.5 | -71.4 | -11.1 | -19.7 | -19.3 |
| | % of GDP | -2.4 | -3.6 | -3.3 | -0.9 | -1.5 | -1.4 |
| Fiscal Balance | % of GDP | -2.5 | -3.8 | -3.7 | -2.6 | -2.1 | -2.0 |
| US Dollar Exchange Rate | Average | 1.95 | 2.18 | 2.39 | 13.16 | 12.68 | 12.42 |

Sources: Haver Analytics and Citi Research forecasts

## Argentina

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The FX outlook continues to get muddy. Foreign reserves have shrunk by USD8.3bn year-to-date to USD35bn, while BCRA's ability to purchase foreign currency remains limited. BCRA's foreign currency purchases stood at USD1.8bn during the last 12 months. We expect the government to tackle the drop in reserves and the lack of official foreign currency purchases as soon as the October midterm elections are past by tightening FX controls. Needless to say, this course of action will, in all likelihood, negatively affect economic activity. On the activity front, non-official (i.e., true) growth has decelerated faster than expected. We are thus cutting our forecast for non-official real GDP growth to 2.7% in 2013, down from 3% before. For 2014, we continue to expect non-official real GDP growth to stand at 0.5%.Regarding official real GDP, it continues to boom and the National Statistics Institute has recently announced it soared 8.3% YoY in 2Q13, a print which virtually ensured a GDP warrants payment in 2014 (unless major revisions to the already released figures take place). We have also increased our forecasts for the official USDARS to 6.15 and 8.15 for 2013 and 2014 yearends, respectively. Lastly, we continue to expect non-official inflation to be 26% and 30% in 2013 and 2014.

## Venezuela

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We are raising our growth forecasts substantially for 2013-14 after the higher-than-expected 2Q13 real GDP growth print. On the macroeconomic front, the main concerns continue to be the high level of annual inflation and scarcity of foreign currency faced by the private sector. That said, the government is currently studying the creation of an additional FX market for importers which will complement CADIVI and SICAD. Although President Maduro mentioned that this new market's characteristics will be announced after his visit to China, at the time of this writing no official information regarding this new mechanism has been released. In our view, the main feature of this mechanism is that it will include the direct participation of PDVSA as an USD supplier, something that it is not currently allowed. Thus, modification of the FX transaction and Capital Market laws is required. We believe that both laws should be easily approved by the National Assembly once the government presents the final bill. The announcement of this new FX mechanism, along with its sources of foreign currency supply (oil revenue and most likely debt issuances), should constitute the main economic development during the rest of the year. On the political front, we expect the government to intensify the confrontation with the opposition as the regional elections approach.

Figure 38. Argentina and Venezuela — Economic Forecasts, 2012-2014F

| | | Argentina | | | Venezuela | | |
|---|---|---|---|---|---|---|---|
| | | 2012 | 2013F | 2014F | 2012 | 2013F | 2014F |
| Real GDP | YoY | 1.9% | 5.3% | 3.0% | 5.6% | 2.3% | 2.8% |
| Final Domestic Demand | YoY | 2.5 | 6.3 | 2.7 | 12.3 | 1.6 | 2.1 |
| Private Consumption | YoY | 4.4 | 6.5 | 3.0 | 7.0 | 3.9 | 3.1 |
| Fixed Investment | YoY | -4.9 | 5.6 | 1.8 | 23.3 | 0.1 | 0.4 |
| Exports | YoY | -6.6 | 0.0 | -2.0 | 1.6 | 0.0 | 4.1 |
| Imports | YoY | -5.2 | 8.3 | -2.3 | 24.4 | -0.3 | 1.3 |
| CPI | YoY | 10.0 | 10.4 | 12.6 | 21.1 | 35.9 | 35.6 |
| Unemployment Rate | % | 7.2 | 7.6 | 7.8 | 5.9 | 5.9 | 6.1 |
| Current Account | US$ bn | -0.1 | -2.5 | -3.0 | 11.0 | 12.9 | 28.6 |
| | % of GDP | 0.0 | -0.5 | -0.6 | 3.1 | 3.7 | 8.3 |
| Fiscal Balance | % of GDP | -2.6 | -2.1 | -2.8 | -5.0 | -4.0 | -4.0 |
| US Dollar Exchange Rate | Average | 4.54 | 5.51 | 7.23 | 4.29 | 6.13 | 9.50 |

Sources: Haver Analytics and Citi Research forecasts

## Saudi Arabia

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Over the summer, Saudi Arabia has intervened aggressively in global oil markets to try to quell the steep rise in prices triggered by global supply pressures and concerns regarding a regional escalation in the Syrian conflict. Brent prices have risen to about US$110 per barrel, well in excess of the US$100 per barrel the Kingdom has in the recent past signaled it would consider the fair price. In response, Saudi has raised production in July and August to close to the 10 mbpd mark, the highest level of output since the Iranian revolution over 30 years ago. Part of the rise is in response to peak summer demand which we would expect to recede in the coming months, but we now revise our average production figure for Saudi to 9.5mbpd for 2013, from 9.0mbpd previously. Combined with a rise in our expected Brent price for 2013 from US$104 per barrel to US$109 per barrel, the effect on macro outturns this year is likely to be significant. We now see the budget surplus approaching 8% (from 1.1% previous forecast), economic growth rising to 6.1% (from 5.1%), and the breakeven oil price for 2013 falling to US$88/bbl (from US$94).

## United Arab Emirates

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Dubai's economic recovery continues in full swing, grounded in the Emirate's fundamental strengths in the tourism, travel and logistics sectors, as well as in its success in creating a commercial hub for the region. In our view, there is no doubting the strength of the recovery in Dubai, but we are equally wary of signs of exuberance in asset prices, and the potential for bubbles to form. The real estate market is a particular area of concern, in our view. Cluttons data show that the average selling price of mid-range villas in August has risen 34% since the start of the year, and 50% compared with the same period a year earlier. The announcement of new real estate projects capitalizing on the resurgence of the property market continues unabated. For now, construction activity remains contained to new developments in prime locations, such as on the Palm or in the Downtown area. Should we see a surge in construction activity in less prime areas, accompanied by aggressive off-plan sales strategies, we believe the potential for another cycle of property-led volatility in Dubai will become increasingly likely.

Figure 39. Saudi Arabia and United Arab Emirates — Economic Forecasts, 2012-2014F

| | | Saudi Arabia | | | United Arab Emirates | | |
|---|---|---|---|---|---|---|---|
| | | 2012 | 2013F | 2014F | 2012 | 2013F | 2014F |
| Real GDP | YoY | 5.1% | 6.1% | 6.6% | 4.4% | 4.6% | 4.9% |
| Final Domestic Demand | YoY | 3.3 | 8.0 | 8.1 | 8.7 | 3.3 | 3.7 |
| Private Consumption | YoY | 4.9 | 5.0 | 5.0 | 8.7 | 2.0 | 3.0 |
| Fixed Investment | YoY | -1.1 | 10.0 | 10.0 | 8.7 | 5.0 | 5.0 |
| Exports | YoY | -18.8 | -1.6 | 0.5 | 14.8 | 13.0 | 13.0 |
| Imports | YoY | 8.7 | 15.0 | 15.0 | 12.4 | 15.0 | 15.0 |
| CPI | YoY | 2.9 | 6.0 | 8.0 | 0.7 | 0.8 | 1.0 |
| Current Account | US$ bn | 165.7 | 133.0 | 102.9 | 115.5 | 140.6 | 167.3 |
| | % of GDP | 23.3 | 17.9 | 13.0 | 30.1 | 33.7 | 36.8 |
| Fiscal Balance | % of GDP | 14.0 | 7.7 | 2.3 | NA | NA | NA |
| US Dollar Exchange Rate | Average | 3.75 | 3.75 | 3.75 | 3.67 | 3.67 | 3.67 |

Sources: Haver Analytics and Citi Research forecasts

## Egypt

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Since June, the military's political roadmap towards holding parliamentary elections has slowly taken shape, with the next steps being to pass a new constitution and outline a detailed timetable for holding elections. Meanwhile, the military has cracked down heavily on the Muslim Brotherhood, which will probably now move back underground, potentially raising the possibility of a return to the low-level insurgency of the 1980s. Short-term external support from the Gulf will provide crucial financial support until a more coherent economic policy is in place. The inflows have already helped stabilize the exchange rate and eased, but not eliminated, foreign exchange shortages. It is not a long-term solution to stabilizing the currency and further weakness is possible. But assuming further progress towards political stability, a slow economic recovery may be possible in 2H 2014. Although we do not think the government will seek an agreement with the IMF, it is likely to adopt a 'home grown' reform plan, initially pushing extra infrastructure spending with a more cautious medium-term fiscal consolidation programme..

## South Africa

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ZAR weakness, higher inflation and lower confidence results in a downgrade to our 2013 GDP outlook. Specifically, less inventory accumulation is expected due to low production (mining and manufacturing mostly) as the struggle against labour unrest, high input costs and political uncertainty continues. This has resulted in another drop in Q3 business confidence, which suggests that investment spending remains uninspiring. Unfortunately the usual benefits of a weaker currency are not obvious as global demand remains subdued. The negative spin-off is a wide current account deficit which, together with local challenges, means the ZAR remains a key risk factor to the economy. Inflation has moved above the 6% target ceiling and with little employment creation, this means less real income growth and a more difficult time for private consumption. No surprise, consumer confidence remains low. The above factors reinforce the SARB's policy dilemma of low growth and high inflation. We maintain our view that rates will stay unchanged but acknowledge the upside risks. This makes the upcoming medium-term budget ever more tricky to navigate given the watchful eye of rating agencies and public spending needs (particularly ahead of the national elections). In our view, the path of fiscal consolidation will remain wide over coming years and more financing will be required. With the government debt ratio already at 40% (excluding contingent liabilities), this leaves South Africa more vulnerable than most other emerging market economies to external shocks.

Figure 40. Egypt, Nigeria and South Africa — Economic Forecast, 2012-2014F

| | | Egypt | | | Nigeria | | | South Africa | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | 2012 | 2013F | 2014F | 2012 | 2013F | 2014F | 2012 | 2013F | 2014F |
| Real GDP | YoY | 2.2% | 1.1% | 2.3% | 7.4% | 6.5% | 6.5% | 2.5% | 2.1% | 2.9% |
| Final Domestic Demand | YoY | 4.7 | -1.0 | 1.7 | NA | NA | NA | 4.0 | 2.9 | 3.2 |
| Private Consumption | YoY | 5.9 | -3.7 | 2.5 | NA | NA | NA | 3.5 | 2.6 | 3.4 |
| Fixed Investment | YoY | 0.7 | 4.9 | 4.7 | NA | NA | NA | 5.7 | 3.4 | 2.9 |
| Exports | YoY | -2.3 | 2.9 | 6.1 | NA | NA | NA | 0.1 | 4.0 | 4.9 |
| Imports | YoY | 10.8 | -10.5 | 3.6 | NA | NA | NA | 6.3 | 4.8 | 6.2 |
| CPI | YoY | 7.1 | 9.0 | 7.7 | 12.2 | 8.2 | 8.4 | 5.7 | 5.9 | 5.5 |
| Unemployment Rate | % | 12.7 | 13.5 | 14.2 | NA | NA | NA | 25.1 | 25.5 | 26.2 |
| Current Account | US$ bn | -7.6 | -5.7 | -6.1 | 11.3 | 7.4 | 1.3 | -23.6 | -20.9 | -19.9 |
| | % of GDP | -3.0 | -2.3 | -2.3 | 4.0 | 2.3 | 0.4 | -6.1 | -5.9 | -5.4 |
| Fiscal Balance | % of GDP | -10.9 | -12.9 | -12.3 | -2.8 | -2.6 | -2.9 | -4.4 | -5.0 | -4.8 |
| US Dollar Exchange Rate | Average | 6.07 | 6.89 | 7.16 | 158.8 | 159.83 | 163.54 | 8.21 | 9.65 | 10.06 |

Sources: Haver Analytics and Citi Research forecasts

Figure 41. Selected Emerging Market Countries — Economic Forecast Overview, 2012-2014F

| | GDP Growth | | | CPI Inflation | | | Current Balance (% of GDP) | | | Fiscal Balance (% of GDP) | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2012 | 2013F | 2014F | 2012 | 2013F | 2014F | 2012 | 2013F | 2014F | 2012 | 2013F | 2014F |
| Asia | 6.2 | 6.2 | 6.2 | 3.9 | 3.6 | 3.7 | 1.8 | 1.7 | 1.5 | -2.3 | -2.3 | -2.2 |
| China | 7.7 | 7.6 | 7.2 | 2.6 | 2.7 | 3.0 | 2.3 | 2.2 | 2.0 | -2.0 | -2.0 | -2.0 |
| Hong Kong | 1.5 | 3.0 | 3.4 | 4.1 | 4.3 | 3.6 | 1.1 | 2.2 | 3.7 | 3.3 | 1.8 | 1.0 |
| India* | 5.0 | 4.8 | 5.6 | 7.3 | 5.5 | 5.0 | -4.8 | -3.7 | -2.6 | -7.0 | -6.7 | -6.4 |
| Indonesia | 6.2 | 5.7 | 5.3 | 4.3 | 7.2 | 6.6 | -2.8 | -3.5 | -2.7 | -1.9 | -2.1 | -1.8 |
| Korea | 2.0 | 2.9 | 3.7 | 2.2 | 1.5 | 2.5 | 3.8 | 4.3 | 2.4 | 1.5 | 0.9 | 2.3 |
| Malaysia | 5.6 | 4.8 | 5.0 | 1.6 | 0.0 | 0.0 | 6.1 | 2.3 | 2.0 | -4.5 | -4.2 | -3.5 |
| Mongolia | 12.4 | 13.8 | 11.0 | 14.3 | 9.9 | 10.0 | -31.2 | -24.5 | -13.6 | -8.3 | -7.8 | -5.8 |
| Philippines | 6.8 | 7.3 | 6.9 | 3.2 | 2.7 | 3.2 | 2.8 | 3.6 | 3.3 | -2.3 | -2.3 | -2.0 |
| Singapore | 1.3 | 3.2 | 4.0 | 4.6 | 2.4 | 2.3 | 18.6 | 14.0 | 13.5 | 1.1 | 0.7 | 0.5 |
| Sri Lanka | 6.4 | 6.5 | 6.8 | 7.5 | 7.3 | 7.0 | -6.6 | -5.3 | -3.4 | -6.4 | -6.2 | -5.7 |
| Taiwan | 1.3 | 2.6 | 3.8 | 1.9 | 1.2 | 1.7 | 10.5 | 10.1 | 9.0 | -1.6 | -1.2 | -1.3 |
| Thailand | 6.5 | 4.0 | 4.4 | 3.0 | 2.4 | 2.3 | 0.0 | -0.8 | -1.0 | -2.1 | -2.6 | -2.3 |
| Vietnam | 5.3 | 5.1 | 5.4 | 9.3 | 6.6 | 7.1 | 6.3 | 4.2 | 3.0 | -5.2 | -4.8 | -4.0 |
| Latin America | 2.4 | 2.6 | 2.8 | 5.7 | 7.2 | 6.8 | -1.8 | -2.5 | -2.1 | -2.3 | -2.8 | -2.8 |
| Argentina | 1.9 | 5.3 | 3.0 | 10.0 | 10.4 | 12.6 | 0.0 | -0.5 | -0.6 | -2.6 | -2.1 | -2.8 |
| Brazil | 0.9 | 2.6 | 2.0 | 5.4 | 6.2 | 6.1 | -2.4 | -3.6 | -3.3 | -2.5 | -3.8 | -3.7 |
| Chile | 5.6 | 4.0 | 4.5 | 3.0 | 1.7 | 3.1 | -3.5 | -4.0 | -4.2 | 0.6 | -0.3 | -0.4 |
| Colombia | 4.2 | 3.8 | 4.5 | 3.2 | 2.2 | 3.0 | -3.2 | -3.2 | -3.2 | 0.3 | -1.1 | -0.7 |
| Mexico | 3.8 | 1.2 | 3.8 | 4.1 | 3.7 | 3.4 | -0.9 | -1.5 | -1.4 | -2.6 | -2.1 | -2.0 |
| Panama | 10.7 | 8.0 | 7.0 | 5.7 | 4.6 | 4.4 | -9.0 | -14.2 | -13.1 | -2.1 | -3.0 | -3.0 |
| Peru | 6.3 | 5.1 | 5.3 | 3.7 | 3.0 | 3.0 | -3.6 | -4.6 | -4.8 | 1.9 | -0.6 | -2.0 |
| Venezuela | 5.6 | 2.3 | 2.8 | 21.1 | 35.9 | 35.6 | 3.1 | 3.7 | 8.3 | -5.0 | -4.0 | -4.0 |
| Europe | 2.2 | 2.1 | 3.0 | 5.3 | 5.2 | 4.9 | -0.3 | -0.4 | -1.5 | -1.8 | -2.2 | -2.5 |
| Bulgaria | 0.8 | 0.5 | 2.0 | 3.0 | 1.6 | 3.9 | -1.5 | -1.2 | -2.1 | -0.5 | -1.5 | -0.7 |
| Croatia | -2.0 | -1.0 | 1.2 | 3.4 | 2.5 | 3.0 | 0.1 | -0.1 | -0.5 | -2.4 | -4.5 | -4.0 |
| Czech Republic | -1.2 | -1.1 | 1.6 | 3.3 | 1.5 | 1.3 | -2.4 | -1.0 | -1.6 | -4.4 | -2.8 | -2.9 |
| Hungary | -1.7 | 0.6 | 1.8 | 5.7 | 1.9 | 2.0 | 1.6 | 1.8 | 1.8 | -1.9 | -2.9 | -3.3 |
| Kazakhstan | 4.9 | 4.5 | 3.7 | 5.1 | 5.9 | 5.8 | 2.8 | 1.9 | 0.7 | 0.8 | 2.7 | 1.9 |
| Poland | 1.9 | 1.3 | 2.8 | 3.7 | 1.1 | 2.2 | -3.5 | -2.1 | -3.2 | -3.9 | -4.3 | 4.7 |
| Romania | 0.4 | 1.6 | 2.8 | 3.3 | 4.4 | 2.8 | -3.9 | -1.5 | -4.0 | -2.2 | -2.2 | -2.5 |
| Russia | 3.4 | 2.1 | 2.8 | 5.1 | 6.5 | 5.1 | 3.5 | 2.8 | 0.9 | -0.7 | -2.0 | -4.2 |
| Serbia | -1.7 | 2.3 | 2.0 | 7.8 | 8.8 | 7.2 | -10.6 | -6.5 | -8.0 | -5.7 | -5.0 | -5.0 |
| Slovakia | 2.0 | 0.8 | 1.8 | 3.6 | 1.7 | 1.9 | 2.2 | 4.0 | 3.5 | -4.3 | -3.5 | -3.2 |
| Turkey | 2.2 | 3.5 | 4.0 | 8.9 | 7.3 | 7.3 | -5.8 | -6.9 | -6.7 | -2.0 | -1.8 | -2.7 |
| Ukraine | 0.2 | 0.4 | 3.4 | 0.6 | 0.7 | 4.9 | -8.4 | -8.2 | -5.7 | -5.6 | -4.5 | -4.7 |
| Africa/Mideast | 4.9 | 4.9 | 5.4 | 4.6 | 5.2 | 5.6 | 13.8 | 12.5 | 11.2 | 3.4 | 1.1 | 0.2 |
| Bahrain | 3.4 | 3.6 | 4.4 | 2.8 | 4.0 | 2.5 | 6.4 | 3.8 | 1.9 | -2.0 | -1.1 | -0.3 |
| Egypt | 2.2 | 1.1 | 2.3 | 7.1 | 9.0 | 7.7 | -3.0 | -2.3 | -2.3 | -10.9 | -12.9 | -12.3 |
| Ghana | 7.9 | 6.7 | 6.8 | 9.2 | 10.7 | 9.3 | -12.1 | -11.2 | -11.5 | -12.4 | -10.1 | -8.5 |
| Iraq | 9.7 | 7.8 | 10.1 | 6.1 | 6.0 | 6.0 | 34.2 | 33.0 | 35.7 | 8.1 | 7.2 | 16.4 |
| Israel | 3.0 | 3.2 | 3.0 | 1.7 | 1.6 | 2.3 | -0.1 | 0.2 | 1.7 | -3.7 | -4.3 | -3.0 |
| Jordan | 2.7 | 3.0 | 4.0 | 4.8 | 5.5 | 5.0 | -18.2 | -13.4 | -11.5 | -8.3 | -8.2 | -8.2 |
| Kenya | 4.6 | 5.5 | 6.1 | 9.4 | 5.6 | 6.6 | -10.5 | -10.1 | -9.5 | -9.0 | -7.0 | -5.5 |
| Kuwait | 7.6 | 3.6 | 3.7 | 2.9 | 5.0 | 5.0 | 42.9 | 47.7 | 45.0 | 27.8 | 22.6 | 18.8 |
| Lebanon | 1.5 | 2.0 | 4.5 | 6.4 | 5.0 | 5.0 | -14.6 | -15.7 | -15.8 | -8.8 | -10.2 | -10.5 |
| Nigeria | 7.4 | 6.5 | 6.5 | 12.2 | 8.2 | 8.4 | 4.0 | 2.3 | 0.4 | -2.8 | -2.6 | -2.9 |
| Oman | 7.1 | 6.7 | 6.7 | 2.9 | 3.0 | 3.0 | 15.2 | 10.3 | 8.1 | 3.6 | 1.5 | 0.2 |
| Qatar | 6.0 | 8.3 | 7.2 | 1.9 | 3.0 | 3.0 | 31.0 | 20.4 | 12.0 | 5.5 | 2.4 | 0.5 |
| Saudi Arabia | 5.1 | 6.1 | 6.6 | 2.9 | 6.0 | 8.0 | 23.3 | 17.9 | 13.0 | 14.0 | 7.7 | 2.3 |
| South Africa | 2.5 | 2.1 | 2.9 | 5.7 | 5.9 | 5.5 | -6.1 | -5.9 | -5.4 | -4.4 | -5.0 | -4.8 |
| Tanzania | 6.9 | 6.8 | 7.0 | 16.0 | 7.7 | 5.1 | -11.9 | -10.2 | -13.3 | -5.4 | -5.0 | -5.6 |
| UAE | 4.4 | 4.6 | 4.9 | 0.7 | 0.8 | 1.0 | 30.1 | 33.7 | 36.8 | NA | NA | NA |
| Uganda | 2.6 | 5.0 | 5.6 | 14.0 | 5.9 | 8.7 | -9.7 | -12.9 | -14.8 | -3.6 | -3.4 | -3.3 |
| Zambia | 7.3 | 6.9 | 7.5 | 6.6 | 7.1 | 7.0 | -3.4 | -0.5 | 2.7 | -4.5 | -4.2 | -3.7 |
| Total | 4.6 | 4.7 | 5.0 | 4.6 | 4.7 | 4.6 | 2.1 | 1.8 | 1.5 | -1.6 | -2.1 | -2.1 |

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

# 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 (2-3 quarters) and longer (2-4 years) term.

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

| | S&P Ratings | | | | Moody's Ratings | | | |
|---|---|---|---|---|---|---|---|---|
| Country | Current Rating | Current Outlook | Citi Near-term (Up to 9 Months) Forecast Rating | Citi Longterm (Next 2-4 Years) Forecast Rating & Outlook | Current Rating | Current Outlook | Citi Near-term (Up to 9 Months) Forecast Rating | Citi Longterm (Next 2-4 Years) Forecast Rating & Outlook |
| US | AA+ | Stable | AA+ | AA+ | Aaa | Neg | Aaa (Neg W) | Aa1 ↓ |
| Canada | AAA | Stable | AAA | AAA | Aaa | Stable | Aaa | Aaa |
| Japan | AA- | Neg | AA- (Neg) | A+ ↓ | Aa3 | Stable | Aa3 | A1 ↓ |
| Germany | AAA | Stable | AAA | AAA | Aaa | Neg | Aaa (Neg) | Aaa |
| France | AA+ | Neg | AA+ (Neg) | AA ↓ | Aa1 | Neg | Aa1 (Neg) | Aa2 ↓ |
| Italy | BBB | Neg | BBB- (Neg) ↓ | SD* ↓↓↓↓↓ | Baa2 | Neg | Baa2 (Neg) | C* ↓↓↓↓↓ |
| Spain | BBB- | Neg | BBB- (Neg) | SD* ↓↓↓↓↓ | Baa3 | Neg | Baa3 (Neg) | C* ↓↓↓↓↓ |
| Austria | AA+ | Stable | AA+ | AA+ | Aaa | Neg | Aaa (Neg) | Aaa |
| Belgium | AA | Neg | AA (Neg) | AA- ↓ | Aa3 | Neg | Aa3 (Neg) | A1 ↓ |
| Finland | AAA | Stable | AAA | AAA | Aaa | Stable | Aaa | Aaa |
| Greece | B- | Stable | B- | SD* ↓↓↓↓↓ | C | | C | C* |
| Ireland | BBB+ | Positive | A- ↑ | A- ↑ | Ba1 | Stable | Baa3 ↑ | Baa2 ↑↑ |
| Netherlands | AAA | Neg | AAA (Neg W) | AA+ ↓ | Aaa | Neg | Aaa (Neg W) | Aa1 ↓ |
| Portugal | BB | Neg W | BB- ↓ | SD* ↓↓↓↓↓ | Ba3 | Neg | Ba3 (Neg) | C* ↓↓↓↓↓ |
| UK | AAA | Neg | AAA | AA+ (Neg) ↓ | Aa1 | Stable | Aa1 | Aa1 (Neg) |
| Switzerland | AAA | Stable | AAA | AAA | Aaa | Stable | Aaa | Aaa |
| Sweden | AAA | Stable | AAA | AAA | Aaa | Stable | Aaa | Aaa |
| Denmark | AAA | Stable | AAA | AAA | Aaa | Stable | Aaa | Aaa |
| Norway | AAA | Stable | AAA | AAA | Aaa | Stable | Aaa | Aaa |

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

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

# Expected Ratings Issues

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## Many EMU outlooks still negative

**Portugal – S&P outlook revised to "negative watch":** S&P placed its BB rating of Portugal on CreditWatch Negative on 18 September. Previously, S&P had Portugal on BB Outlook Negative (as of July). On balance, risks have therefore increased of a downgrade over the near-term. The drivers cited by S&P include potential shortfalls in meeting program targets and the extent of official creditors' willingness to increase exposure to Portugal. All this relates to assessing the sovereign's likely debt dynamics and credit quality. Such drivers (and criteria for a downgrade) are mostly idiosyncratic, pertaining to domestic politics and economic, rather than systemic, concerns. We therefore believe the wider market impact of this event is likely to be limited, but it does put the current Troika review much more in focus (*Euro Rates Strategy - Portugal Placed on Watch Negative by S&P - Implications*).

**Ireland – stable outlook by Moody's:** Ireland is the exception in having its S&P rating outlook as positive and its Moody's outlook now stable (as of 20 September). The recent action by Moody's reflects recent progress on its Troika program commitments and evidence of market access. Although this action by Moody's is likely to have limited impact for now, the greater significance probably lies further ahead. At Ba1, Ireland remains rated sub-IG by Moody's. A rating change from a "stable outlook" is statistically not very likely. However, it does alleviate near-term downgrade pressure and is perhaps a stepping stone for a "positive outlook" over the medium term. Note, S&P has already placed its BBB+ rating on "positive outlook" back in mid-July. Ultimately, a rating upgrade to Baa3 by Moody's or above would restore Ireland's IG status by both Moody's and S&P and hence restore certain investment opportunities (Ireland – The Road Back to Investment Grade?).

**Italy & Spain:** Although the periphery markets have rallied and spreads continue to tighten, downgrade risks remain a medium-term concern, largely because Spain (and Italy) remains on Negative Outlook by both Moody's and S&P. Spain was put on Negative Outlook almost a year ago in October 2012 by both rating agencies independently. We detail exactly what this means for Moody's and S&P (which have different criteria) in our *European Rates Weekly - EMU spread outlook and downgrade concerns.* A simultaneous move by both rating agencies downgrading the Spanish sovereign (and hence ejecting it from Citi's EGBI) is not our base case in the nearterm. For Italy, domestic politics remain a medium-term concern, but for now, immediate pressure on the rating from this factor has probably lessened given recent attempts to preserve coalition government.

**Moody's on the Netherlands:** In a recent Issuer Comment (23 September) entitled "*The Netherlands' 2014 Budget Is Unlikely To Help the Government Meet Its Deficit* Target", Moody's details the balancing act required by the Dutch government to maintain fiscal discipline versus nurturing economic growth. Note that this publication follows a document dated 15 August entitled "*Netherlands' Weak Consumer Confidence Undermines Growth and Fiscal Outlook*". In this comment, Moody's highlights how Netherland-specific factors (from housing to the pension system) have contributed to a weak outlook. The Netherlands remains Aaa/AAA (Negative Outlook) by both Moody's and S&P with downgrade pressure evidently lingering.

**Core ratings:** We make no changes to our views on core sovereign ratings. S&P has already commented that the German elections have no impact on Germany's rating. Separately, the US has a stable outlook by both Moody's and S&P. S&P also maintains a negative outlook on the UK, signifying the prospect of downward pressure on its AAA status over the medium term.

# Rates Forecasts Commentary

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Below we summarise the main factors driving our yield, spread and curve forecasts, highlight the main changes from last month, and outline the main risk scenarios. Broadly, we see Treasuries drifting higher over the forecast horizon, Bunds rangebound around 1.80, and JGB yields drifting towards their lows around 14Q2. Our main forecast change is in the UK where our economists now see the first hike in 2015. Cross-market we see the Treasury/Bund spread around flat for some time, but gilts underperforming Bunds by around 40bps from current levels. We expect peripheral spreads to rewiden modestly and peak in 14Q1 and JGBs to remain decoupled from Treasuries.

**US - We see 10yr yields moving up from an average of 2.85 in 14Q1 to 3.50 in 15Q1. Tapering to begin either before year end or shortly after**

**US:** We see 10yr yields moving up from an average of 2.85 in 14Q1 to 3.50 in 15Q1, but in the near term we maintain a bullish bias, especially in the 5yr sector. We see the softening in the Fed's stance and their guidance on Fed Funds as having a more significant and persistent influence on yields going forward than QE. Our central expectation is that the Fed will begin tapering QE purchases by year-end, but there is a reasonable chance that this could happen in early 2014 instead. We continue to think that it will require a meaningful strengthening of US economic data for 10yr yields to make new highs and move through 3% this year. Risks to our forecasts come in the form of a US growth shock (in either direction), and China and EM could be factors in this. Despite the media attention, they are unlikely to come from the fiscal situation, in our view.

**Europe – Bunds to rangetrade centred on 1.80. First refi rate hike in 16Q4. BTP and Bono spreads to widen again in 14Q1**

**Europe:** We have made no material changes to our Bund forecasts. We anticipate 10yrs to range trade around 1.80% in coming quarters with no change in the refi rate until 16Q4.The growth and inflation outlook remain subdued despite improvements in the data, and the German election is unlikely to herald any radical policy changes. We expect BTP and Bono spreads to rise again early next year. Spain could once again trade through Italy given the prospect of fresh Italian elections in 14H1 and their relative supply pipelines. Our main positive risk scenario is a new LTRO driving peripheral yields and spreads to Germany lower.

**Japan – consumption tax goes ahead as scheduled. Yields gradually drift lower until the middle of 2014**

**Japan:** We expect JGB yields to drift lower, bottoming out towards the middle of 2014, flattening the curve and tightening swap spreads. Our main assumption is that the consumption tax hike will be decided in October, and go ahead as scheduled in April. (The risk of its postponement or dilution has fallen significantly from last month, in our view). To mitigate the negative economic and political effects of the tax increase we anticipate a large-scale stimulus package in the autumn. Official buying coupled with unchanged JGB issuance will start to weigh more heavily on yields. JGBs will continue to be driven primarily by domestic rather than international factors.

**UK – Forecast changes driven by new policy rate trajectory. We anticipate substantial gilt underperformance vs Bunds, but Treasury/Bund to remain close to flat**

**UK:** The revisions to our yield forecasts this month have mainly been driven by the change in our economist's policy rate view. With the first rate hike now forecast for 2015, rather than 2017, we expect 2yr gilt yields to reach 1% by 1Q15 (vs 0.4% previously) and 10yr gilts to move 10-15bps higher per quarter next year. We expect bear steepening to eventually give way to bear flattening in late-2014. The rate outlook for the UK looks increasingly aligned with the US rather than Europe.

**Australia – rangebound yields with curve slope driven primarily by the US in the near term**

**Australia and New Zealand:** A deferred QE tapering schedule combined with steady policy rates from the RBA and RBNZ should keep yields largely rangebound for the remainder of 2013. The main driver of the ACGB curve will be the direction of UST yields. We expect the NZGB curve to bear flatten sooner than the ACBG curve with a RBNZ rate hike in 14Q1, and ACGB flattening only in 14Q2, anticipating RBA tightening in 14Q3. In terms of risk scenarios, a slowdown in Chinese growth and a renewal of US fiscal tensions could see Antipodean yields undershoot our forecasts.

Figure 43. Interest Rate and Bond Market Forecasts as of 25 September 2013

| | | Quarterly Average | | | | | |
|---|---|---|---|---|---|---|---|
| | Current | 4Q 13 | 1Q 14 | 2Q 14 | 3Q 14 | 4Q 14 | 1Q 15 |
| **US** | | | | | | | |
| Policy Rate (Fed Funds) End Quarter | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 |
| 3-Month Libor | 0.25 | 0.30 | 0.35 | 0.45 | 0.55 | 0.63 | 0.73 |
| 2 Year Treasury Yield | 0.33 | 0.40 | 0.48 | 0.63 | 0.78 | 0.93 | 1.08 |
| 5 Year Treasury Yield | 1.46 | 1.45 | 1.55 | 1.78 | 1.98 | 2.15 | 2.38 |
| 10 Year Treasury Yield | 2.72 | 2.70 | 2.78 | 2.98 | 3.15 | 3.25 | 3.40 |
| 30 Year Treasury Yield | 3.76 | 3.85 | 3.95 | 4.15 | 4.28 | 4.35 | 4.50 |
| 2-10 Year Treasury Curve | 239 | 230 | 230 | 235 | 238 | 233 | 233 |
| 2 Year Swap Spread (Swap Less Govt), bp | 16 | 20 | 20 | 20 | 20 | 20 | 20 |
| 10 Year Swap Spread (Swap Less Govt), bp | 15 | 10 | 8 | 5 | 5 | 5 | 5 |
| 30 Year Swap Spread (Swap Less Govt), bp | -2 | -12 | -14 | -18 | -23 | -25 | -25 |
| 30 Year Mortgage Yield | 4.37 | 4.40 | 4.50 | 4.68 | 4.83 | 4.98 | 5.15 |
| 10 Year Breakeven Inflation | 224 | 240 | 245 | 248 | 243 | 240 | 240 |
| **Euro Area** | | | | | | | |
| Policy Rate | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 |
| Overnight Rate (EONIA) | 0.08 | 0.10 | 1.15 | 0.20 | 0.20 | 0.25 | 0.40 |
| 3-Month (EURIBOR) | 0.16 | 0.25 | 0.25 | 0.30 | 0.30 | 0.35 | 0.35 |
| 2 Year Schatz Yield | 0.18 | 0.20 | 0.15 | 0.15 | 0.20 | 0.20 | 0.30 |
| 5 Year Bobl Yield | 0.86 | 0.80 | 0.80 | 0.80 | 0.80 | 0.80 | 0.90 |
| 10 Year Bund Yield | 1.88 | 1.80 | 1.80 | 1.80 | 1.80 | 1.90 | 2.00 |
| 30 Year Bund Yield | 2.70 | 2.60 | 2.50 | 2.50 | 2.50 | 2.60 | 2.70 |
| 2-10 Year Bund Curve | 170 | 160 | 165 | 165 | 160 | 170 | 170 |
| 10 Year BTP-Bund Spread | 235 | 250 | 275 | 275 | 250 | 250 | 250 |
| 10 Year Bono-Bund Spread | 236 | 250 | 275 | 250 | 250 | 250 | 250 |
| 2 Year BTP-Schatz Spread | 150 | 150 | 170 | 150 | 125 | 125 | 125 |
| 2 Year Bono Schatz Spread | 122 | 130 | 170 | 125 | 125 | 125 | 125 |
| 10 Year OAT-Bund Spread | 51 | 60 | 70 | 80 | 80 | 80 | 80 |
| 10 Year Swap Spread (Swap Less Govt.), bp | 33 | 35 | 35 | 30 | 30 | 25 | 25 |
| 10 Year Breakeven Inflation | 164 | 165 | 170 | 170 | 170 | 180 | 190 |
| **Japan** | | | | | | | |
| Policy Rate | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 |
| 3-Month Libor | 0.15 | 0.15 | 0.15 | 0.15 | 0.15 | 0.15 | 0.15 |
| 2 Year Treasury Yield | 0.11 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 |
| 5 Year Treasury Yield | 0.25 | 0.25 | 0.25 | 0.20 | 0.25 | 0.25 | 0.30 |
| 10 Year Treasury Yield | 0.68 | 0.65 | 0.60 | 0.50 | 0.60 | 0.70 | 0.80 |
| 30 Year Treasury Yield | 1.76 | 1.75 | 1.75 | 1.70 | 1.75 | 1.80 | 1.90 |
| 2-10 Year Treasury Curve | 57 | 55 | 50 | 40 | 50 | 60 | 70 |
| 2 Year Swap Spread (Swap Less Govt.), bp | 15 | 15 | 14 | 12 | 14 | 15 | 15 |
| 10 Year Swap Spread (Swap Less Govt.), bp | 19 | 18 | 15 | 13 | 15 | 18 | 22 |
| **UK** | | | | | | | |
| Policy Rate | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 |
| 3-Month Libor | 0.52 | 0.52 | 0.52 | 0.55 | 0.60 | 0.65 | 0.70 |
| 2 Year Treasury Yield | 0.45 | 0.45 | 0.50 | 0.55 | 0.65 | 0.80 | 1.00 |
| 5 Year Treasury Yield | 1.63 | 1.55 | 1.65 | 1.80 | 1.90 | 2.10 | 2.35 |
| 10 Year Treasury Yield | 2.87 | 2.80 | 2.85 | 3.05 | 3.15 | 3.25 | 3.40 |
| 30 Year Treasury Yield | 3.66 | 3.60 | 3.65 | 3.75 | 3.85 | 3.90 | 3.95 |
| 2-10 Year Treasury Curve | 242 | 235 | 235 | 250 | 250 | 245 | 240 |
| 10 Year Swap Spread (Swap Less Govt.), bp | -5 | 5 | 5 | 5 | 5 | 10 | 15 |
| 10 Year Breakeven Inflation | 287 | 290 | 295 | 310 | 315 | 330 | 350 |
| **Australia** | | | | | | | |
| Policy Rate | 2.50 | 2.50 | 2.50 | 2.50 | 2.75 | 3.00 | 3.25 |
| 3-Month Libor | 2.57 | 2.55 | 2.60 | 2.70 | 3.05 | 3.25 | 3.50 |
| 2 Year Treasury Yield | 2.66 | 2.50 | 2.55 | 2.65 | 2.90 | 3.30 | 3.60 |
| 5 Year Treasury Yield | 3.34 | 2.95 | 3.15 | 3.30 | 3.80 | 4.20 | 4.50 |
| 10 Year Treasury Yield | 3.75 | 4.00 | 4.10 | 4.10 | 4.30 | 4.50 | 4.60 |
| 2-10 Year Treasury Curve | 109 | 150 | 155 | 145 | 140 | 120 | 100 |
| 10 Year Swap Spread (Swap Less Govt.), bp | 49 | 60 | 60 | 65 | 65 | 70 | 75 |

Source: Citi Research

# Commodities Market Outlook

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## Commodities Super Cycle Sunset

Stronger macro data, adverse weather forecasts and geopolitical fodder during 3Q'13 buttressed a meaningful commodity price risk reversal during the northern hemisphere summer against expectations of only modest seasonal strength. To be sure, some gains were probably overdue given a precipitously weak 1H'13 for flat price—grains, base and precious metals depreciating 10-30 percent during those six-months—amid a record $30Bn of net investment redemptions across passive indices and commodity-linked exchange traded funds over the period.

But the uncertainty going forward rests more on whether higher commodity prices today can stay elevated for the balance of the year and in the medium-term, after a marked rise in investor net length in the past few months. While recent strength across the petroleum complex, gold and cocoa have prompted a modest increase in the Citi base-case price outlook for some commodities, on the whole, we maintain a bearish-to-neutral view on most complexes; noting longer-term structural headwinds that have reinforced the general thrust of a 'commodities super cycle' unwind.

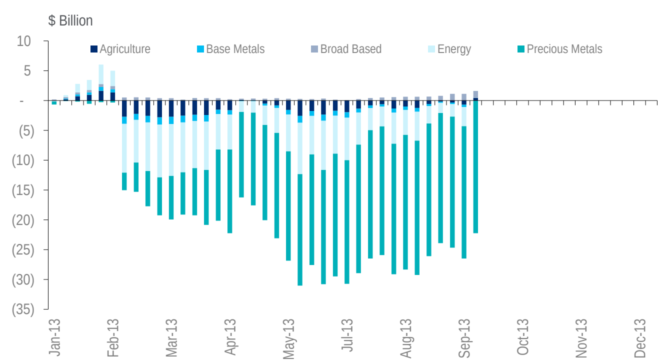
To simplify the point; more supply in most commodities amid tepid demand should continue to weigh on prices, especially heading into a seasonally softer period for both agriculture and petroleum. The easing of late-summer US weather risks has already reduced row crop levels back towards 3Q lows while oil prices are down 5-7% from their recent peaks. Hurricanes were mostly absent this year, so no loss of 500-k b/d of GC crude or 50-bcf of storage for US natural gas. Gold prices seem unable to sustain price gains even after the 'dovish' FOMC surprise. Improvement in Chinese economic indicators and trade data are likely a head fake for iron ore and local copper consumption looks weak despite a short-term surge in headline figures. Easing of Syrian tensions and a return of Libyan barrels whilst US crude output continues at 25-year highs can cap oil price cheer despite the extreme level of global supply disruptions this year. Inventory builds are expected for most staple grain markets worldwide in 2013/14, following the worst US drought in 75 years in 2012. The only major commodities where there could be more potential upside than downside risk in our view: nickel, palladium and cocoa, based on individual rather than structural supply/demand issues in those markets.

- *Crude oil:* the multitude of seasonally bearish factors for 4Q'13 (disappointing demand and surging US supply) were meant to drive prices lower in September yet MENA geopolitics supported prices. 'Hoarding' has been seen in paper and physical barrels amid ~3-m b/d of offline crude capacity, tightening balances. This likely places the oil market in an either/or bull/bear setting—in affinity to 2011. In a bearish scenario, the return of offline capacity could compound seasonal weakness. A bull scenario could see a worsening situation in Syria, Iranian dialogue as a head fake and Libyan barrels remaining offline.
- *Industrials:* continue to appear more bearish than bullish. Versus the August GEOS, the forecast this month suggests modest upward revisions to lead, tin, and silver although we remain bearish the complex as a whole. For bulk commodities, downgrades are seen in coal with only slight revisions to our bearish outlook for aluminum, copper and zinc. China is the key industrial commodity consumer and we feel local monetary policy tightening from 2Q will create headwinds for short-term demand with the recent rebound in PMI levels likely to be short-lived for demand growth. Chinese apparent copper demand is unlikely due to industrial activity but for collateralized financing.
- *Gold:* the postponement of Fed tapering is likely only a short-term reprieve for bullion. Indeed, prices after the announcement were unable to break $1,400/t oz.

and are already closer to $1,300/t oz. mark, with active producer hedging limiting short-term strength dominated by hedge fund short covering as opposed to new longs. With Syrian tension easing, the bid on gold as 'political insurance' has also waned in recent weeks and we expect prices to head towards $1,200/t oz. in 4Q. The rebound of spec positioning levels favors further liquidation, in our view.

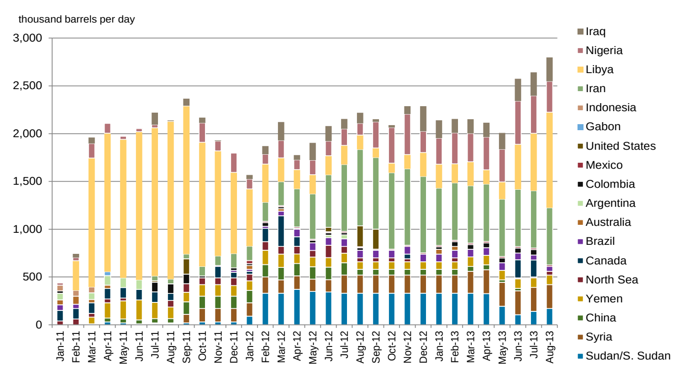
- *Agriculture:* the forward outlook for the balance of 2013/14 suggests at best modest relief for the sector in the medium-term with price action likely tempered in a compressed range. Expectations are for year/year gains in global corn, soy and rice inventories and for coffee and sugar markets to stay in surplus. Cotton appears likely to remain in its current trading band of USd80-90/lb absent a reserve purchase regime change in China. Wheat could outperform other grains on southern hemisphere production risks and should maintain a large premium to corn while cocoa looks like the one 'ag' market in large deficit.

Figure 44. Year-to-date Commodity Index Swap and ETF Net Flows*




Source: Citi Research estimates, *biased to US market activity

Figure 45. Global Supply Disruptions – k b/d (October 2011 – Present)*




Source: EIA, Citi Research, *if measuring disruptions to net exports, Iran sees in excess of 1-m b/d off of the world market

Figure 46. Commodities Price Outlook*

| | | Point Prices | | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | 0-3M | 6-12M | | 2012 | Q1 2013 | Q2 2013 | Q3 2013E | Q4 2013E | Q1 2014E | Q2 2014E | Q3 2014E | Q4 2014E | 2013E | 2014E | 2015E |
| **Energy** | | | | **5Y Cyclical** | | | | | | | | | | | | |
| NYMEX WTI | USD/bbl | 107.0 | 105.0 | 81.0 | 94.1 | 94.4 | 94.2 | 108.0 | 107.0 | 108.0 | 103.0 | 108.0 | 102.0 | 100.9 | 105.3 | 99.3 |
| ICE Brent | USD/bbl | 110.0 | 107.0 | 85.0 | 111.7 | 112.6 | 103.4 | 112.0 | 110.0 | 110.0 | 105.0 | 110.0 | 105.0 | 109.5 | 107.5 | 102.5 |
| Henry Hub Natural Gas | USD/MMBtu | 3.40 | 3.60 | N/A | 2.75 | 3.48 | 4.03 | 3.40 | 3.40 | 3.70 | 3.60 | 3.70 | 3.90 | 3.60 | 3.70 | 4.50 |
| **Base Metals** | | | | **LT Price** | | | | | | | | | | | | |
| LME Aluminum | USD/MT | 1,730 | 1,900 | 2,200 | 2,049 | 2,042 | 1,869 | 1,805 | 1,780 | 1,770 | 1,820 | 1,850 | 1,880 | 1,875 | 1,830 | 1,950 |
| LME Copper | USD/MT | 6,600 | 6,300 | 6,200 | 7,945 | 7,964 | 7,188 | 7,060 | 6,900 | 6,700 | 6,600 | 6,400 | 6,500 | 7,280 | 6,550 | 6,800 |
| LME Lead | USD/MT | 2,250 | 2,300 | 2,200 | 2,072 | 2,314 | 2,066 | 2,110 | 2,150 | 2,250 | 2,000 | 2,150 | 2,300 | 2,160 | 2,175 | 2,238 |
| LME Nickel | USD/MT | 14,500 | 17,500 | 20,000 | 17,592 | 17,387 | 15,057 | 14,047 | 14,400 | 15,000 | 16,000 | 17,000 | 17,500 | 15,222 | 16,375 | 19,000 |
| LME Tin | USD/MT | 22,500 | 23,500 | 20,000 | 21,108 | 24,128 | 20,995 | 20,895 | 22,200 | 22,000 | 21,500 | 22,000 | 24,000 | 22,055 | 22,375 | 24,000 |
| LME Zinc | USD/MT | 1,850 | 1,890 | 2,100 | 1,963 | 2,057 | 1,875 | 1,890 | 1,860 | 1,840 | 1,850 | 1,850 | 1,900 | 1,923 | 1,860 | 2,050 |
| **Precious Metals** | | | | **LT Price** | | | | | | | | | | | | |
| COMEX Gold | USD/T. oz | 1,200 | 1,280 | 1,050 | 1,669 | 1,632 | 1,429 | 1,315 | 1,250 | 1,220 | 1,230 | 1,260 | 1,280 | 1,405 | 1,250 | 1,350 |
| Silver | USD/T. oz | 20.0 | 20.7 | 16.5 | 31.2 | 30.1 | 23.5 | 21.5 | 20.2 | 19.6 | 20.0 | 20.4 | 20.7 | 23.8 | 20.2 | 22.2 |
| Platinum | USD/T. oz | 1,500 | 1,525 | 1,531 | 1,552 | 1,634 | 1,474 | 1,456 | 1,500 | 1,500 | 1,475 | 1,500 | 1,525 | 1,516 | 1,500 | 1,625 |
| Palladium | USD/T. oz | 750 | 840 | 680 | 645 | 741 | 716 | 729 | 750 | 750 | 800 | 800 | 850 | 734 | 800 | 925 |
| **Bulk Commodities** | | | | **5Y Cyclical** | | | | | | | | | | | | |
| Hard Coking Coal (benchmark Asia) | USD/MT | 150 | 160 | 200 | 211 | 165 | 172 | 145 | 155 | 160 | 160 | 160 | 165 | 159 | 161 | 170 |
| Thermal Coal Asia (NEWC) | USD/MT | 72 | 80 | 105 | 94 | 91 | 81 | 77 | 73 | 80 | 77 | 75 | 80 | 81 | 78 | 85 |
| Iron Ore Spot (TSI) | USD/MT | 115 | 115 | 81 | 128 | 148 | 126 | 126 | 121 | 120 | 110 | 115 | 115 | 130 | 115 | 115 |
| **Agriculture** | | | | | | | | | | | | | | | | |
| CBOT Corn | USd/bu | 450 | 480 | N/A | 695 | 715 | 661 | 525 | 475 | 485 | 500 | 520 | 520 | 595 | 505 | N/A |
| CBOT Wheat | USd/bu | 670 | 700 | N/A | 750 | 738 | 695 | 670 | 685 | 700 | 705 | 700 | 720 | 695 | 705 | N/A |
| CBOT Soybeans | USd/bu | 1,200 | 1,300 | N/A | 1,465 | 1,448 | 1,468 | 1,450 | 1,190 | 1,215 | 1,275 | 1,275 | 1,180 | 1,390 | 1,235 | N/A |
| CBOT Rice | USD/cwt | 15.5 | 15.3 | N/A | 14.9 | 15.3 | 15.5 | 15.5 | 15.2 | 15.3 | 15.3 | 15.5 | 15.0 | 15.4 | 15.3 | N/A |
| NYB-ICE Cotton | USd/lb | 85 | 84 | N/A | 80 | 82 | 85 | 85 | 86 | 84 | 83 | 85 | 80 | 85 | 83 | N/A |
| Sugar#11 | USd/lb | 17.0 | 18.0 | N/A | 21.6 | 18.4 | 17.1 | 17.0 | 17.0 | 17.5 | 18.0 | 18.0 | 18.0 | 17.4 | 17.9 | N/A |
| ICE Coffee | USd/lb | 115 | 123 | N/A | 175 | 144 | 131 | 115 | 120 | 120 | 125 | 130 | 135 | 128 | 128 | N/A |
| ICE Cocoa | USD/MT | 2,550 | 2,600 | N/A | 2,348 | 2,176 | 2,280 | 2,400 | 2,500 | 2,550 | 2,500 | 2,700 | 2,600 | 2,350 | 2,600 | N/A |

Source: Citi Research, *subject to revision

Figure 47. Citi Global Economics Team For Informational Purposes Only

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Source: Citi Research.

Notes

Notes

# Appendix A-1

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Rohini Malkani is on a three months leave of absence for the period July 15 2013 to October 14 2013. During this period, she will be working for the Ministry of Finance, India and she will cease all normal course business activity as an Economist at Citi.

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