

Asia Macro and Strategy Outlook

'Goldilocks' Returns, But the Bears Still Linger

- **Exports moderately strengthening, divergent domestic demand dynamics** — Financial conditions appear tight in CN, IN and ID but still growth supportive in others, and optimism for structural reforms post-election has risen in both IN and ID.
- **Inflation looks benign for most...** — Core inflation/inflation expectations muted for most which supports our view that CN has space to ease. We believe the three countries worth watching are ID, PH and MY. Indo inflation is above target and we see greater odds of a subsidized fuel price hike before year-end (which would be credit positive). PH has the most positive output gap in Asia plus weather-related price risks and overly accommodative monetary setting may warrant the start of rate hikes in 3Q14. MY is already signaling the start of rate hiking cycle in Jul driven more by financial stability concerns as persistently negative real rates and resilient growth could spur excessive risk taking.
- **Financial Stability concerns could weigh more heavily on policy decisions** — Our expectation of a very gradual pace of Fed Funds adjustment (only 2% rate by end of 2016) alongside ECB now expected to launch QE in 2H14 should still be risk-supportive, but also raises risks that EM Asia's financial cycle gets extended further, which could exacerbate financial imbalances and output volatility later on. This likely factors into CN's reluctance for broad-based easing and raises lingering questions on how to time the reversal of macroprudential tightening when the financial cycle turns.
- **"Goldilocks scenario" remains conducive to extended carry trades** — We see three viable triggers for a sharp disruption: 1) bigger positive US data surprises with inflation building that could prompt a sharp re-pricing of expectations on Fed Funds rates – we don't see material inflation building just yet – thus, a low inflation recovery in US would still be carry-friendly; 2) policy miscalculation by CN that could spark a big enough shock to financial stability and risk appetite – but we think there are still policy levers that can be used to contain these risks (though this is a worry); 3) big political shocks, e.g. risk for serious post-election disappointments from IN or ID. Our base case is a market positive outcome on both elections and policies – in the event we are wrong on the latter, we think there's still some time before the markets face a serious enough risk of disappointment.
- **Market Outlook** — Still in carry-friendly mode, we add MYR & KRW to our favored overweights within EM Asia (on top of INR & IDR). We move THB to neutral (from earlier underweight) on crowded shorts and risk for post coup interim stability; neutral PHP, underweight low carry TWD, SGD. We remain biased towards higher yielding local bonds (INR, IDR and LKR gov't bonds), but we take profit on our tactical long position on MN external debt following spread outperformance since Feb and risk of legislating a higher gov't debt ceiling.

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

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Contents

Citi Key Economic Forecasts	3
Macro Overview	4
Asian Currencies & Interest Rate Forecasts	14
Country Section	15
China	16
Hong Kong	20
India	24
Indonesia	28
Malaysia	32
Philippines	36
Singapore	40
South Korea	44
Taiwan	48
Thailand	52
Frontier Asia	56
Appendix: Sovereign Risk Ratings Summary	60
Global Assumptions	61
Recent Publications	62
Asia-Pacific Economics and Market Analysis	63
Appendix A-1	67

Citi Key Economic Forecasts

Figure 1. GDP forecasts (growth rate in percent)

	2013F GDP	2014 GDP Forecasts			2015 GDP Forecasts		
		Current	Previous	Consensus	Current	Previous	Consensus
Asia-Pacific	6.3	6.2	6.2	6.2	6.3	6.3	6.3
Asian NIEs*	2.9	3.6	3.7	3.6	3.9	3.9	3.7
SEAN-4**	5.2	4.5	4.8	4.8	5.3	5.4	5.4
China	7.7	7.3	7.3	7.3	7.0	7.0	7.2
Hong Kong	2.9	3.2	3.4	3.4	3.6	3.8	3.5
India***	4.9	5.6	5.6	5.4	6.5	6.2	6.0
Indonesia	5.8	5.3	5.3	5.3	5.5	5.5	5.8
Malaysia	4.7	5.4	5.0	5.1	5.6	5.0	5.0
Mongolia	11.7	10.0	10.0	—	9.0	9.0	—
Philippines	7.2	6.9	6.9	6.4	7.3	7.3	6.3
Singapore	3.9	3.5	3.5	3.8	4.0	4.0	4.0
South Korea	3.0	3.9	3.9	3.6	4.0	4.0	3.7
Sri Lanka	7.3	7.2	7.2	7.3	7.4	7.4	7.2
Taiwan	2.1	3.2	3.2	3.2	3.8	3.8	3.6
Thailand	2.9	0.5	1.8	2.3	2.8	4.1	4.2
Vietnam	5.4	5.7	5.7	5.7	5.9	5.9	5.9

Figure 2. CPI forecasts (growth rate in percent)

	2013 CPI	2014 CPI Forecasts			2015 CPI Forecasts		
		Current	Previous	Consensus	Current	Previous	Consensus
Asia-Pacific	3.7	3.5	3.5	3.4	3.8	3.9	3.7
Asian NIEs*	1.7	2.1	2.1	2.1	2.7	2.7	2.6
SEAN-4**	4.3	4.8	4.7	4.7	4.9	5.3	4.4
China	2.6	2.6	2.6	2.5	3.2	3.2	3.0
Hong Kong	4.3	3.9	3.9	3.8	3.7	3.7	3.6
India***	9.5	8.0	8.0	7.7	6.5	7.5	7.0
Indonesia	6.4	6.5	6.4	6.3	6.7	7.2	5.7
Malaysia	2.1	3.5	3.5	3.3	4.5	4.5	3.6
Mongolia	10.5	13.1	13.3	—	12.0	12.0	—
Philippines	2.9	4.1	4.1	4.1	4.0	4.0	3.9
Singapore	2.4	1.8	1.8	2.4	1.3	1.4	2.7
South Korea	1.3	2.1	2.1	1.9	3.1	3.0	2.6
Sri Lanka	6.9	5.7	5.7	5.9	6.5	6.5	6.7
Taiwan	0.8	1.2	1.2	1.2	2.0	2.0	1.8
Thailand	2.2	2.4	2.3	2.5	2.1	2.7	2.8
Vietnam	6.6	5.4	5.4	5.8	6.8	6.8	6.9

Figure 3. Current account forecasts (percent of GDP)

	2013F CAB	2014 CAB Forecasts			2015 CAB Forecasts		
		Current	Previous	Consensus	Current	Previous	Consensus
Asia-Pacific	2.2	2.1	2.1	0.7	1.5	1.5	0.7
Asian NIEs*	8.3	7.0	6.9	2.2	6.3	6.4	1.9
SEAN-4**	-0.5	0.6	0.6	-0.3	0.0	0.0	-0.2
China	2.0	2.0	2.0	2.0	1.5	1.5	1.9
Hong Kong	2.1	2.8	3.1	1.6	3.2	3.9	1.6
India***	-2.0	-2.3	-2.3	-2.0	-2.5	-2.5	-2.0
Indonesia	-3.3	-2.4	-2.4	-2.4	-2.1	-2.1	-1.9
Malaysia	4.0	4.4	4.4	3.9	4.0	4.0	4.1
Mongolia	-30.9	-17.9	-13.8	—	-19.7	-16.1	—
Philippines	3.5	3.4	3.5	3.1	2.9	2.9	2.7
Singapore	18.3	18.0	18.0	17.1	18.0	18.0	16.7
South Korea	6.1	3.9	3.8	4.9	2.9	3.0	3.9
Sri Lanka	-3.9	-3.3	-3.3	-3.7	-3.0	-3.0	-3.5
Taiwan	11.7	11.0	11.0	11.0	10.2	10.2	10.5
Thailand	-0.7	2.2	2.2	1.3	-1.1	-1.1	1.1
Vietnam	5.3	4.1	4.1	0.0	2.9	2.9	0.0

Note: * Asian NIEs are Hong Kong, Korea, Singapore, and Taiwan. ** SEAN-4 includes Indonesia, Malaysia, the Philippines and Thailand. Asia-Pacific is Asian NIEs + SEAN-4 + China + India + Mongolia + Sri Lanka + Vietnam, GDP-weighted. *** India Fiscal year runs from April-March.

Source: CEIC Data Company Limited, Consensus Economics (May 12, 2014) and Citi Research estimates.

Macro Overview

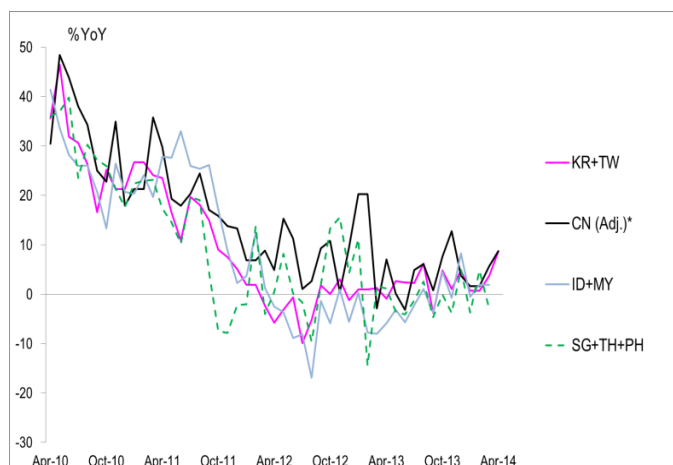
‘Goldilocks’ Returns, but the Bears Still Linger

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While exports are looking better, domestic demand dynamics varies

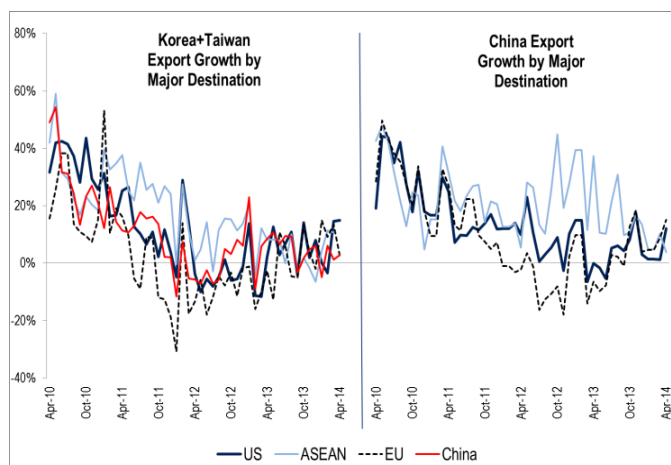
More signs of life in EM Asia’s exports, but nothing to write home about. If March was a mixed bag for exports, April has so far been decisively more positive, though the growth momentum among the North Asian exports still looks relatively subdued by historical standards (Figure 4) and while US data continues to gradually improve, China and other parts of EM continue to face growth headwinds. The multi-speed global growth backdrop can be seen in the divergence in performance of export markets – both China, Korea and Taiwan all show a more pronounced pick-up in growth of exports to the US, but they diverge on growth momentum for both exports to EU and ASEAN, plus NIEs are showing more subdued export growth to China even after Chinese New Year (Figure 5). On a sectoral level, tech exports in North Asia seem to be doing particularly well (especially in Korea) – the expected launch of iPhone 6 in July/Aug could provide a bit of boost for Taiwan tech exports by mid-year, but ASEAN tech exports lost momentum (again) highlighting the still volatile nature of this industry and, perhaps, the lack of follow thru business investment pick up in the US so far.

Figure 4. Asia’s Export Growth (%YoY) – Moderate improvements underway....



Source: CEIC, Citi Research; Note: *We adjust the China export series for the export over-invoicing via HK; We also smooth out for the lunar new year effect.

Figure 5. ... but one can clearly see the impact of the multi-speed world as % YoY export growth diverges by geography



Source: CEIC, Citi Research

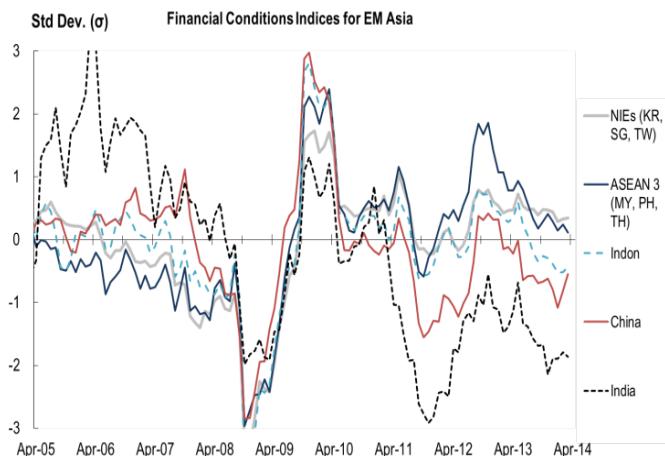
CN, IN & ID are seeing tight financial conditions, but others are still mildly supportive; HH leverage will likely drag private consumption growth in TH, MY and SG, but look more secularly challenging in SG, and politically-debilitated in TH

Ability of financial conditions to support domestic demand growth varies substantially across the region. Our Citi Financial Conditions Indices (FCI) for China, India and Indonesia are all acting as constraints to economic activity, with the latter two exacerbated by the impact of need to curb the CA deficit (Figure 6). However, financial conditions in most others have been marginally supportive so far. GDP data in 1Q14 point to a mixed picture – we think China’s GDP growth is much weaker than what was officially reported and still points to further slowdown,¹ while Indonesia’s 1Q14 data also surprised to the downside, alongside Thailand, Singapore and Hong Kong. However, Malaysia’s and, to a lesser extent, Korea’s economic activity both surprised to the upside. Cyclical and structural factors point to varied growth vulnerabilities in domestic demand – Korea and Taiwan seem to be seeing some domestic demand rebound alongside net exports after years of subdued performance, while China and Indonesia’s domestic demand slowdown look more concentrated on investments than consumption. We argued in the previous monthly that we think private consumption growth in Thailand, Malaysia

¹ See [China Macro View - A Reality Check on GDP Deflator and Job Creation](#) (9-May-2014).

and Singapore are more vulnerable to high levels of household debt.² However, a more pronounced secular weakness in private consumption seem more visible in Singapore, given that consumption has been crimped further by macro-prudential curbs like TDSR caps, slowing labor productivity growth, and real wage growth. Thai consumption weakness is a combination of debt overhang and idiosyncratic political shocks while Malaysia's private consumption has defied expectations and proved resilient so far in 1Q14, but should inevitably slow.

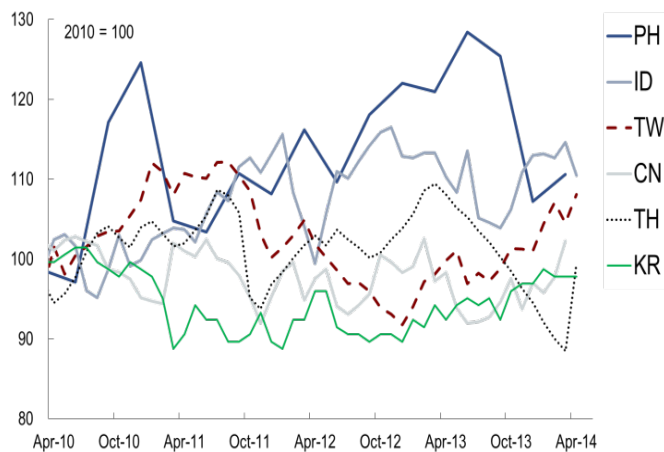
Figure 6. Financial Conditions are tight in China, India & Indonesia vs. history, but still slightly growth supportive in others



Source: Citi Research estimates

Note: For details on methodology, see [Asia Macro View - Financial Conditions Present a Mixed Picture for EM Asia](#).

Figure 7. Select Asia – Consumer Confidence Indicators (2010=100)



Source: CEIC, Citi Research

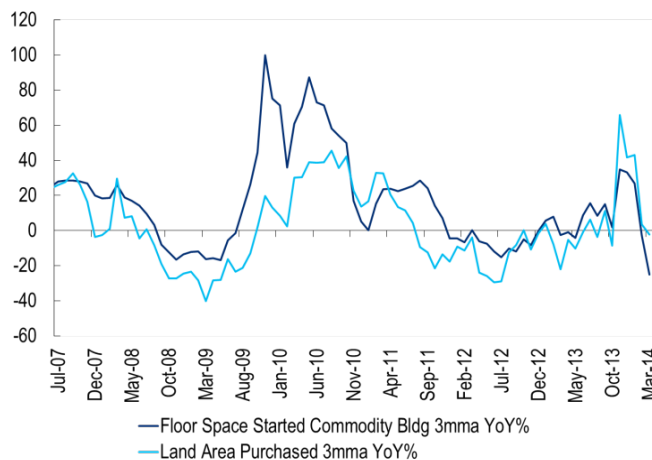
Outlook for investment growth is varied – China looks challenging while biggest hopes for an investment upswing likely hinges on India.

The outlook for investments will vary depending on both demand factors influenced by varying financial conditions, but also more structural/supply-side issues related to debt overhang and diminishing potential returns among the more industrialized Asian countries. Our biggest worry continues to be China, especially given the unprecedented credit-fueled investment growth in the post-GFC years and now the deteriorating conditions in the property sector that could feed into broader based investment slowdown (Figure 8)³. Vietnam's investment has already been going through more than three years of massive bank deleveraging that may further be weighed down by the FDI vulnerabilities following recently damaging serious anti-China riots. However, even though financial conditions still look supportive among other countries – Korea & Taiwan seem to be on a modest upswing, growth in domestic investment may still be constrained by constraints to potential growth in the higher income countries of Korea, Singapore and Taiwan. With decent dose of structural reforms and stable macro environment, we think investment prospects are most promising in South and Southeast Asia (Figure 9). Recent landslide win by India's BJP led coalition bodes well for a rebound in India's investment given the high priority by the new leadership, as highlighted in the BJP manifesto, and we already anticipate a reversal of declining investment to GDP ratio as soon as this FY 2015.

² See [Asia Macro and Strategy Outlook - Dissecting 3Ds: Debt, Demographics & \(Income\) Disparity](#) (2-May-2014).

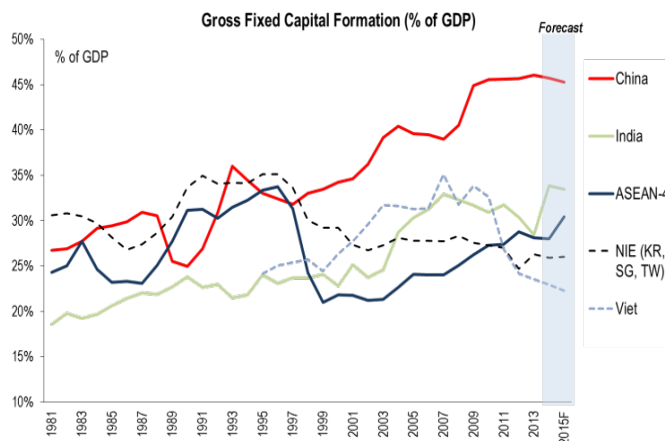
³ For more details on deterioration in property sector, please see [China Macro View - Risk of a Property Market Slump: The Tail Is Getting Fatter](#) (19-May-2014).

Figure 8. China – Indicators for property investment signal a sharp downturn — Floor Space Starts and Land Purchase, 3mma YoY%



Source: CEIC, Citi Research

Figure 9. Historical and Forecast path for Gross Fixed Capital Formation, as a % of GDP



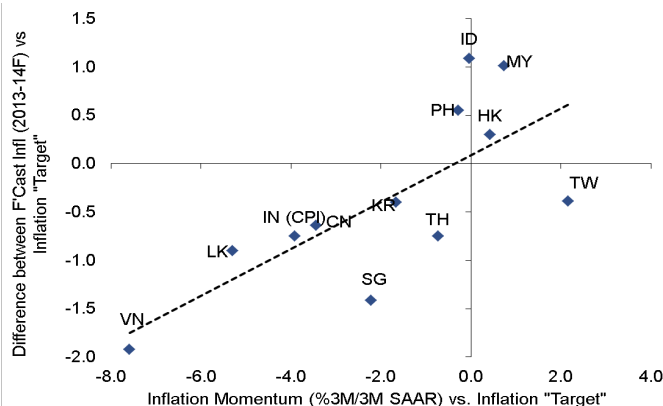
Source: CEIC, Haver, Citi Research

Inflation looks manageable for most, but there are exceptions

Inflation looks manageable in most countries in EM Asia, and well below the central bank inflation thresholds with core being muted.

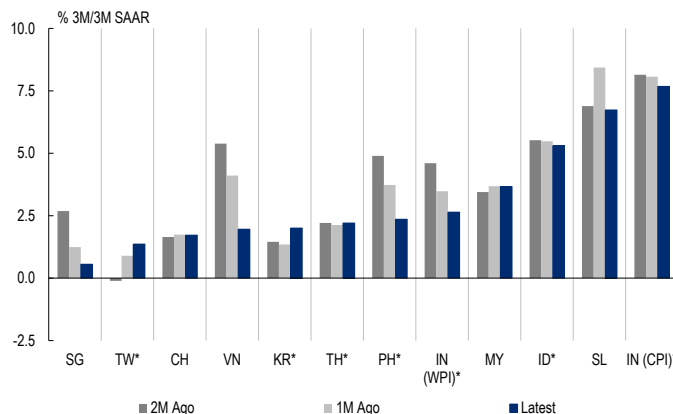
Inflation pressures remain fairly benign for most... Unlike the gradual build-up of inflation in the early post GFC years in early 2010 from very depressed levels, sparking much talk about normalizing policy rates in the region, overall inflation momentum has been largely muted, and has been particularly benign in the case of China, thus warranting our view that PBoC has policy space to ease. We expect they could relax M2 growth targets, ease macro-prudential policies on property and, eventually, cut RRR rates (though the hurdle for a broad-based easing as opposed to targeted easing seems high). A big drive of recent modest positive inflation surprises in a few places, namely India, Taiwan and Thailand – have largely been driven by food inflation, but we see limited second round effects so far. Core inflation across the board has been generally benign (Figure 11) and we estimate most economies are operating on narrowing but still negative output gap (Figure 12).

Figure 10. Inflation forecast minus CB inflation threshold (Y axis) vs. Latest Inflation Momentum minus CB inflation threshold (X-axis)



Source: CEIC, Haver, Citi Research

Figure 11. EM Asia - Core Inflation remains manageable in most places, measured in %3M/3M SAAR



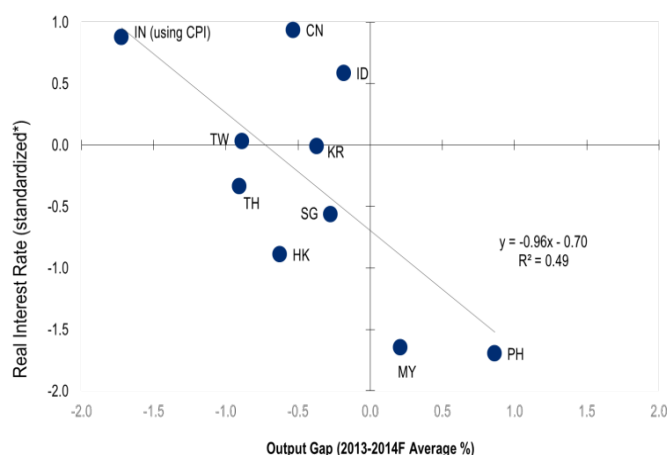
Source: CEIC, Haver, Citi Research

*Note: official core inflation for IN, ID, KR, PH, TH, and TW

However, Indonesia, Philippines and Malaysia's are worth watching given elevated inflation and positive output gaps in the latter two. Indonesia has already done the bulk of its hikes, It seems only Malaysia is incorporating financial stability concerns in its monetary policy decision, while prolonged risk-friendly environment could slow the pace of tightening in some, especially the Philippines.

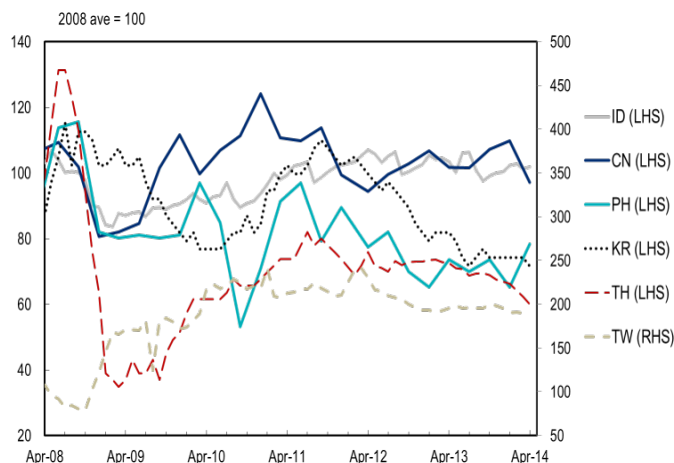
We think there are three worth watching – Indonesia, Philippines and Malaysia. Indonesia's inflation is expected to persist well above the official target (4.5%-5.5% in 2014F, 4% in 2015F), and the odds of pending subsidized fuel price hike forecast by year-end has risen significantly as we expect presidential elections will conclude by July, leading us to raise our end-2014 inflation forecast to 7.3% (vs. 5.3%). As the economy has been slowing, we don't expect much second round inflationary impact but we wouldn't rule out further rate hikes starting 4Q14. Philippines is facing the "quadruple risks" of strong growth driving positive output gap, very low real rates, abundant liquidity and scorching hot weather driving up food prices, all of which make a recipe for potentially unhinging inflation expectations (Figure 13). BSP is likely to tighten further beyond the benign 200bps RRR hikes since March, we think by hiking by ~100bps in the next 12 months starting in 3Q14. However, if USD strength remains muted for longer, the risk that BSP adjusts more slowly will rise. Similarly, though we think Malaysia is a less severe case of demand-driven inflation risk given dissipating effect of administered price adjustments, we think BNM will start hiking rates in July (another 25bps in Sep and possible more thereafter) for financial stability reasons, as persistently negative real rates and resilient growth could spur excessive risk taking.

Figure 12. Expected Real Interest Rate vs. Output Gap



Source: Bloomberg, Consensus Economics, Citi Research
Note: Real interest rate is the short-term (policy) rate discounted by the forward looking 12M consensus inflation forecasts normalized over 10yr history

Figure 13. Inflation expectations seem very well anchored (except Philippines needs monitoring)



Source: CEIC, Citi Research; Note: Korea, Philippines and Thailand survey inflation expectations in the next 12months while China, Indonesia and Taiwan survey future price expectations (in 6M for ID & TW);

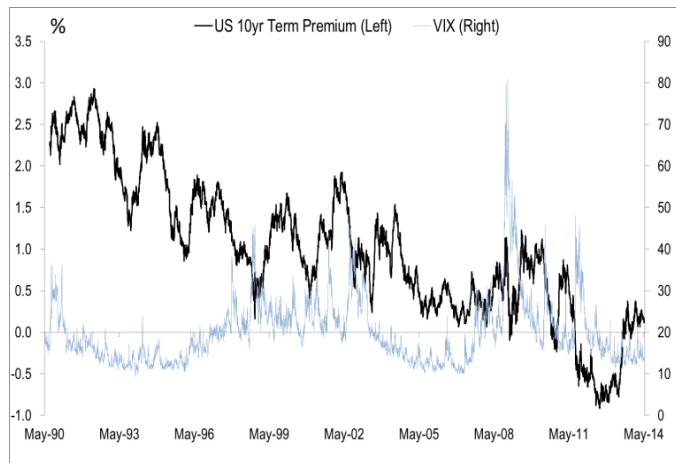
Should financial stability weigh more heavily on monetary policy decisions?

Expectations of a more gradual approach by the Fed to exit its accommodative monetary stance, with ECB going the opposite direction, raises the risk that the expansionary financial cycle in Asia is lengthened further, and could be a source of future imbalances/volatility.

The likely action facing BNM in July of needing to curb financial vulnerability from excessive risk-taking raises an **important question on the extent to which Asian CBs should lean more heavily against the wind of the region's financial cycle.** While we expect the Fed's ongoing withdrawal of QE and pending rate hike is partly due to the need to unwind risks to credit overheating/asset bubbles (alongside improving growth), it is likely that Fed hiking cycle will continue to be a gradual adjustment and that the longer term equilibrium for the Fed Funds rate will still be lower than where it was historically (projected to be only ~2% by end-2016, or 175bps in 2.5years, as opposed to the 425bps Fed Funds hikes in 2 years (from mid-2004 to mid-2006). Expectation of such extended and gradual approach to withdrawing of Fed's accommodative monetary policies alongside ECB now expected to move in the opposite direction this year has helped keep barometers of

risk appetite such as US 10yr term premium and the VIX supportive, but also raises concerns about the disconnect that arises between asset prices and fundamentals as well as worries that the financial cycle in Emerging Asia will be lengthened further, going into 6th or 7th year (Figure 15). This could exacerbate financial imbalances and create greater risk of output volatility later on once the Fed starts hiking.⁴

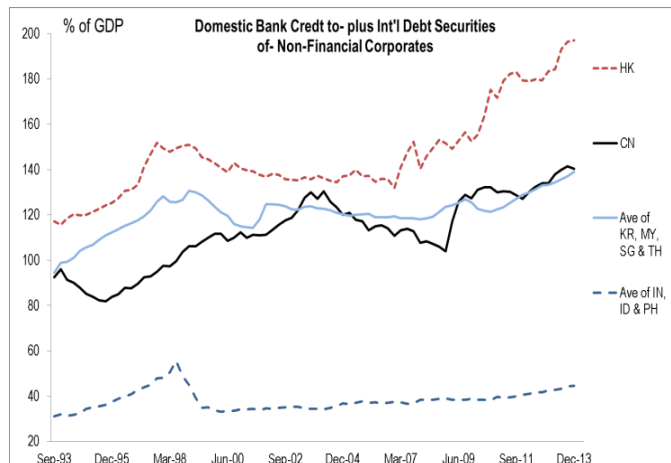
Figure 14. Recent trends in US 10yr Term Premium vs S&P500 Volatility Index (VIX) continue to point to a constructive outlook for risk-taking



Source: FRBNY (Kim & Wright), Bloomberg, Citi Research

Note: The K&W series hasn't been updated beyond Mar 2014, we extrapolate its Apr to May values using its historical relationship with other term risk premium estimates.

Figure 15. History of domestic bank credit + international debt securities by Nationals (% of Country GDP)



Source: Haver, BIS, IMF, CEIC, Citi Research

Note: The international debt securities data are based on the nationality and not residency of the issuer. We didn't add cross border bank claims as there will be double-counting with the IMF IFS data on domestic bank claims.

We really think the bigger worry for Asia is about subpar recovery in those that levered too much – not a financial crisis.

There are many ways one can define a credit boom – but either way, China (&HK), SG, MY and TH are clear candidates.

It is always complex to diagnose an unsustainable credit boom versus a healthy dose of financial deepening needed for economic development. While empirical studies show that a banking crisis is always preceded by a credit boom, the other way around is more often than not untrue – i.e. in majority of the cases, credit booms don't lead to a banking crisis. However, findings from Dell'Ariccia et al (2012) show that, among 170 countries they analyze from 1960s to 2010 citing 175 episodes of "credit booms", 60% of those cases are followed by subpar economic recoveries.⁵ In the absence of clear systemic fragilities in the banking system in Asia (to be discussed in the next section), it is the subpar nature of recovery amid an already subdued but improving global growth backdrop that lingering worries are centered on.

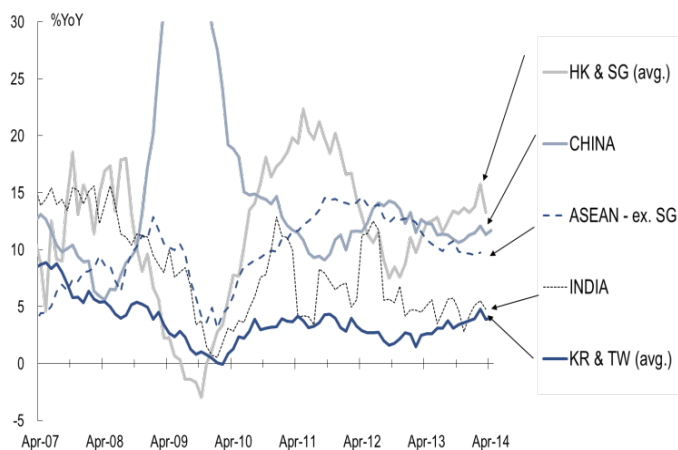
Credit booms can be defined in varying ways – one can look at the rate of growth of credit in real terms, as in Figure 16, which suggest that real credit growth via the banking system was particularly strong among offshore financial centers (HK and Singapore) and China (and the latter will likely be even higher if we include shadow banking sources of financing). Another approach is to de-trend credit data using HP filter and establish a threshold beyond which a deviation from trend is identified as a credit boom. A simpler benchmark, but one that must be interpreted with caution, is to look at the rate in which credit has expanded vis-a-vis GDP – we shade a rather arbitrary threshold of 5ppts, based on a benchmark used for a

⁴ This is a recurring issue we've discussed in the past. For example, see [Asia Macro and Strategy Outlook - Time to Lean \(a Little More\) Against the Wind](#) (21-Apr-2011) and [Asia Macro and Strategy Outlook - On the Lookout for Excessive Leverage](#) (1-Mar-2013).

⁵ G. Dell'Ariccia, D. Igan, L. Laeven, H. Tong, B. Bakker & J. Vandeussche. "Policies for Macroeconomic Stability: How to Deal with Credit Booms." *IMF Staff Discussion Note* (June 2012).

broader definition of credit boom in an IMF (2011) event study.⁶ Based on this metric, and discounting episodes where the increase in credit to GDP was driven by a negative shock to the denominator (post GFC quarters or the floods that hit Thai GDP on a rolling 4qtr basis from 4Q2011 to 1H 2012), it is clear that where the bank credit boom seems particularly long and pronounced is in Singapore, China (especially if we include HK) and Malaysia, though if we add credit via off balance sheets of the banks and non-bank financial corporations, the situation in China is the bigger issue, alongside Thailand and Malaysia (relating to households). Thus, the threat of subpar recovery on the domestic demand side could loom larger here, but with global liquidity conditions still somewhat supportive, and Fed Governor Janet Yellen signaling only a gradual rise in policy rates, plus no obvious signs of fragility in the banking system, this raises the odds that this financial cycle could be lengthened further in some countries.

Figure 16. Credit Growth in Real Terms (%YoY)



Source: Haver, CEIC, Citi Research

Figure 17. Annual Change in Bank Credit to GDP Ratio (shaded areas are where annual change in bank credit to GDP ratio exceeds 5ppts)

	CN	HK*	IN	ID	KR	MY	PH	SG	TW	TH	VN
Mar-09	8.6	2.9	0.5	-0.1	10.5	0.8	0.6	10.7	6.5	2.9	-9.0
Jun-09	18.7	2.8	0.7	-1.5	2.6	6.7	0.9	8.3	8.2	3.7	3.3
Sep-09	23.1	3.0	0.4	-1.9	-5.7	13.1	0.2	5.0	5.7	4.1	17.1
Dec-09	23.5	1.1	0.4	-1.4	-15.1	14.8	0.1	-0.5	2.7	2.8	22.1
Mar-10	14.1	6.0	0.6	-1.2	-17.0	10.2	0.6	-4.0	0.1	0.0	20.7
Jun-10	6.4	10.8	1.0	0.4	-13.0	5.2	-0.5	-5.6	-2.6	-1.7	14.9
Sep-10	3.2	18.5	-0.1	0.7	-11.7	-0.9	0.3	-4.5	-4.7	-2.9	11.3
Dec-10	2.7	19.3	2.7	1.0	-8.6	-1.2	0.4	-1.4	-2.5	0.5	12.3
Mar-11	-0.8	23.2	1.1	1.8	-6.1	0.7	1.2	2.4	2.5	5.1	12.3
Jun-11	-2.2	17.2	0.8	1.8	-4.9	1.6	2.4	7.7	4.6	7.2	3.9
Sep-11	-3.6	6.1	2.4	2.2	0.3	1.8	2.0	8.6	8.2	8.7	-5.1
Dec-11	-3.0	5.5	-0.5	2.4	2.2	1.4	2.3	10.6	6.4	11.8	-13.4
Mar-12	-0.3	-1.7	0.6	2.9	0.9	1.6	2.3	12.1	6.2	12.3	-19.5
Jun-12	2.2	-3.4	2.0	3.1	1.4	3.0	1.6	8.9	3.4	13.1	-15.5
Sep-12	5.4	-4.2	1.2	3.0	-1.7	5.1	1.0	9.7	1.3	14.1	-11.6
Dec-12	6.7	2.8	1.4	2.9	-1.4	5.9	1.5	9.1	0.9	6.7	-7.3
Mar-13	7.7	3.2	1.2	2.6	-0.9	7.8	1.6	10.1	-0.7	4.2	-5.3
Jun-13	7.5	10.0	-0.1	2.7	-0.6	8.2	1.9	12.1	-0.7	3.4	-5.0
Sep-13	7.4	13.8	1.9	3.1	-1.5	7.3	2.7	11.3	0.0	2.0	-7.0
Dec-13	6.3	10.6	0.0	2.7	-0.5	8.1	2.5	12.7	0.0	5.5	-18.4
Mar-14	5.9	19.1	#N/A	2.1	0.1	2.9	#N/A	7.1	1.0	5.1	-15.6

Source: IMF, Haver, CEIC & Citi Research; Note: *Loans for domestic use.

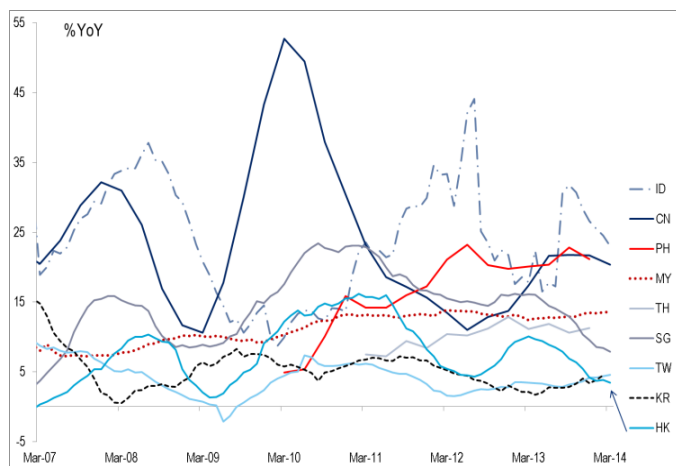
Macprudential policies are supposed to lean against the wind – Asia is a heavy user, especially as it relates to property, but prolonged low real rates is still a risk – the jury is still out on when and how orderly Asia needs to reverse some MPP tightening to avert abrupt de-leveraging.

This is where macro-prudential policies (MPPs) are supposed to come in to lean against the wind, to mollify the amplitude of the financial cycle in order to reduce the vulnerabilities later on. IMF finds that Asia is already the most proactive region globally in using MPPs in recent years, especially when it relates to housing market, with loan to value caps being the most popular.⁷ So far, along with a host of other housing related measures (including stamp duties), residential mortgage-related lending seems to have slowed much more dramatically in the heavy MPP-users with the most negative real interest rates – HK and Singapore (Figure 18), but seems elevated everywhere else except KR & TW (rising from the lows), highlighting the need to be vigilant. Financial disintermediation of savings and regulatory arbitrage (e.g. the rise of China's shadow banking) is still a risk when real rates stay too low for too long, and we welcome BNM's signal to act. The lingering question will be how to time the reversal of MPP tightening when the financial cycle turns in order to prevent excessive and destabilizing de-leveraging. We think this is an issue China may need to confront earlier on, but others like Singapore and HK would need to also address once the Fed starts hiking interest rates next year. The jury is still out on how orderly this process will be.

⁶ International Monetary Fund. "Toward Operationalizing Macprudential Policies: When to Act?". Chapter 3, *Global Financial Stability Report* (Sep 2011)

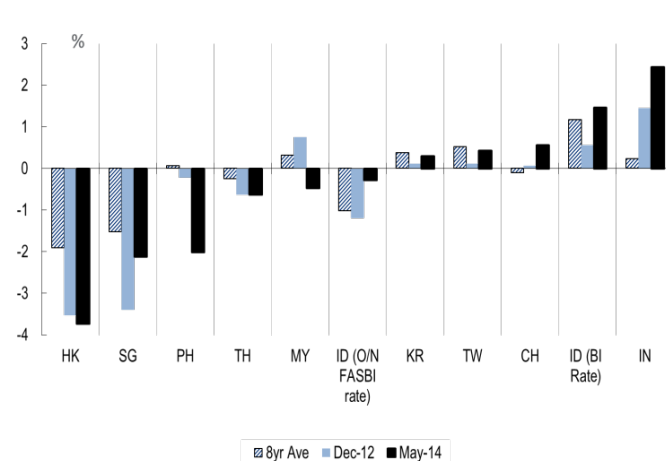
⁷ See Chapter 4. Of IMF's Regional Economic Outlook – Asia Pacific (April 2014).

Figure 18. Residential Mortgages to Households (%YoY, in local currency)



Source: CEIC, Citi Research; Note: We look at the data on real estate lending under households/consumer loans category, or explicitly when mentioned as residential mortgages, to distinguish this from lending to property developers.

Figure 19. Real Interest Rates, discounted by 12M forward looking CPI Inflation forecast

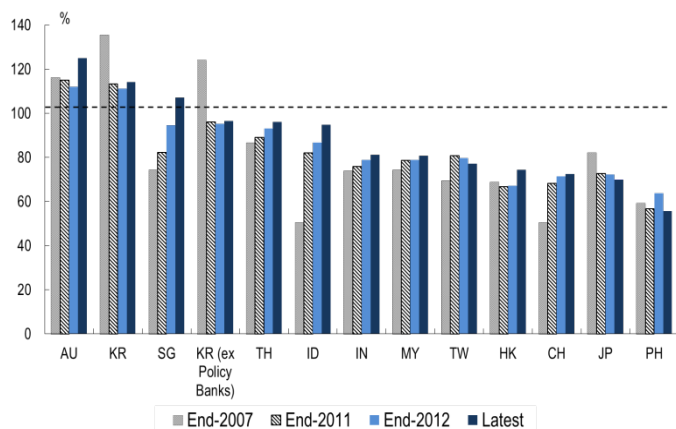


Source: Bloomberg, Consensus Economics, Citi Research;

The countries where leverage is the biggest concern also seem to be the countries where capital ratios seem to have broadly improved since 2007, but it's hard to know whether this capital buffer is sufficient to absorb losses as the credit cycle turns.

Banks of more levered countries seem to have decent capital buffers, but the system is not really being tested yet. We have seen bank liquidity (via LTDs) tighten across most countries varying degrees in recent years except the Philippines, where deposit growth far outstripped loan growth (Figure 20). Financial cycle has already been correcting in Indonesia, but we believe leverage is not a systemic issue. Moreover, most banks in EM Asia have decent capital buffers, and at least for the more levered countries people tend to worry about the most – China, Singapore, Thailand and Malaysia – capital ratios seem to have broadly improved since 2007. Nonetheless, it's far from clear what the eventual losses will be when the credit cycle turns, especially if we also get a sharp correction in property-related collateral values, and thus, the need for supervisory authorities to remain vigilant.

Figure 20. Asian banks – Loan to Deposit Ratios (%), 2007, 2011, 2012, latest



Source: CEIC, Citi Research

Figure 21. Asian Banking Sector* – Tier 1 Capital and overall Capital Adequacy Ratios, 2005, 2007, 2013 and 2014F

	Tier 1 Capital Ratio				Capital Adequacy Ratio			
	2005	2007	2013	2014F	2005	2007	2013	2014F
CN	8.5	10.5	10.0	10.9	10.9	12.9	12.5	13.0
HK	12.3	9.9	11.7	11.0	14.6	12.3	14.5	15.8
IN	8.9	10.4	11.8	11.3	12.2	14.2	16.2	15.4
ID	16.0	16.1	14.4	14.3	18.7	18.5	15.5	15.0
MY	11.1	10.1	11.7	11.7	15.5	13.5	14.7	14.7
PH	16.8	11.7	14.1	15.4	19.2	14.9	16.3	17.5
SG	10.8	9.4	13.5	13.5	15.4	13.9	16.4	16.3
TW	10.1	9.7	9.3	9.4	10.7	10.0	12.5	12.6
TH	10.3	11.0	11.9	12.5	14.0	14.1	15.5	15.8

Source: Company Reports & Citi Research

*Only covers the listed banks covered by our Asia equity banking team;
Note: Values for India are for FY ending March. Country averages represent weighted cap averages of stocks under Citi coverage

The probability and timing of key risks that could spark pain on these carry trades don't seem too high and imminent to us.

Risk of India and Indonesia disappointing post-elections may not be properly priced in until later on.

Within EM Asia FX, we are adding MYR & KRW to our persistently carry-friendly bias longs in EM Asia FX (INR, IDR) – even though INR and IDR spot moves may be limited now, the carry and post-election optimism should still provide support. We remain neutral PHP and also move THB to neutral (from underweight) as heavy short positioning and potential binary outcome on politics keep us sidelined now – remain underweight TWD, SGD.

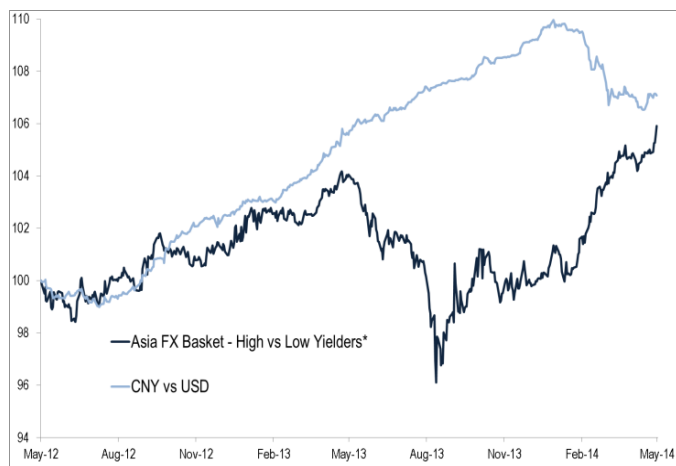
What could spark a serious end to this period of calm for risk assets? We see three potential viable triggers, none seems imminent to us: First, US data surprising to an even greater degree than expected, especially with signs of inflation building that could prompt a sharp recalibration of expectation in Fed rates. There could already be a few hiccups later on this year as we expect US data will continue to improve, and the exaggerated moves on US treasuries correct itself (we forecast 10yr Treasury yield at 3.2% by year-end); Second, policy errors/miscalculation by Chinese authorities on the extent of slowdown (with rising defaults) that could spark a big enough shock to financial stability and overall risk appetite; and Third, some unforeseen geopolitical shock that seriously threatens growth prospects globally/in the region and inflicts sufficient damage to risk appetite. In the last few years, we've seen the election of more right-biased nationalist leaders in the region -- Shinzo Abe in Japan, Geun-Hye Park in South Korea, and more recently, a landslide victory for Narendra Modi in India. We think single-party political systems such as those run by both the Communist parties in China and Vietnam intrinsically lean on nationalism. Adding territorial disputes to the mix doesn't help. Others worry that a correction to the frothier valuations in US equity markets could be the trigger, but with US data surprising to the upside now, we don't see a correction to be meaningfully large enough to prompt a sustained broad-based risk sell-off.

There is also the risk that election-related optimism in market-favored India and Indonesia lead to disappointments later on, but we don't see that as an imminent shock in the next 2 months (even much longer in Indonesia since new government doesn't take office until Oct) – “honeymoon period” where there is some benefit of the doubt will likely lingering around the first 100 days in office. A key event to watch in India is the new government budget out in early July.

Market Outlook

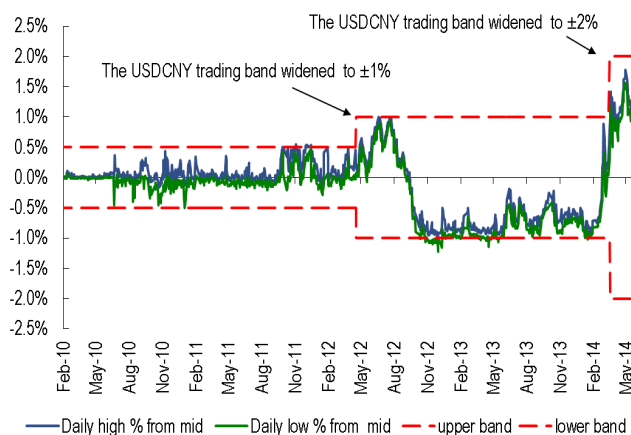
Asia FX: Still in carry-friendly mode – adding MYR & KRW to our favored overweights within EM Asia (on top of INR & IDR) and now cut our THB underweight. We have been overweight the “high carry” currencies of INR and IDR *within EM Asia FX* for a while, and though price action this month has been stellar following election optimism, we see no obvious reason why we should change our view – even if spot FX may retrace back a bit, especially amid CB intervention, with rates still at 8% and 6-7%% respectively, flows are likely to limit the downside moves in spot vs. USD. We add KRW and MYR to our favored longs – while KRW has already significantly outperformed EM last month, low volatility, reserve diversification support (which will likely get amplified if ECB eases further) and hawkish stance of BoK (which is unlikely to change if growth momentum continues to improve) remains supportive. We also think the drive to weaken CNY much further from here is somewhat running out of momentum if May trade data improves significantly, which could dissuade very aggressive BoK intervention. We also are increasingly constructive MYR – we think there is a more healthy economic rebalancing with manageable growth payoff – BNM stands out in Asia as a central bank that seriously incorporates financial stability objectives in their monetary policy – we now think BNM could hike more than 50bps starting in July, anchoring the currency. We remain neutral PHP – we worry that a more carry friendly environment could slow the pace of BSP tightening, and carry is unappealing. Underweighting THB has worked for us awhile, but with positioning now very skewed on the short side, and a more binary risk that the recent military coup could bring some stability and negotiated solution, we cut our underweight (though we are still medium-to-longer term believers of THB underperformance). We still remain underweight low carry TWD and SGD.

Figure 22. Asia's Reversal of Fortune in FX Return performance - FX Carry Basket (High vs. Low Yields)* & CNY vs USD



Source: Bloomberg and Citi Research; Note: Our Asia FX carry basket is comprised of equally weighted long position on INR, IDR, KRW and MYR vs. short TWD, SGD, PHP & USD (we exclude THB which are driven by idiosyncratic factors)

Figure 23. Could USDCNY now be hitting a turning point?



Source: Bloomberg, Citi Research

No major change from last month's view, except we are now more cautious THB bonds following strong rally & rising political risk premium - we stay bias towards higher yielding markets (including frontier: LKR & VND) for carry assuming range bound US yields.

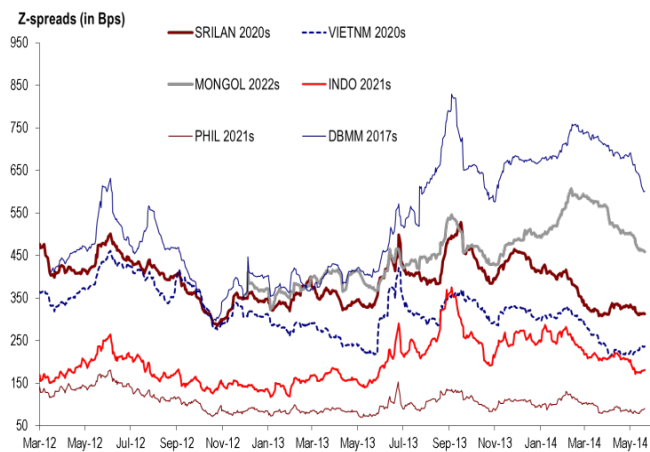
We take profit on our long position on Mongolia for now; quasi-sovereign issuance could stall Indonesia bonds but medium-to-longer term sovereign prospects look positive to us.

Asia Rates: We persistently remain biased towards high yielding local

markets for carry, though we acknowledge much of the rally has likely already happened and further downside for US long end yields look very limited now that US data is expected to continually improve. We still like duration in LKR bonds, pare back a bit on IDR government bonds partly as we could see substantial increase bond supply after the mid-year budget revision, and remain neutral duration on INR bonds. With yields having already rallied substantially, we think risk-reward argues for slightly more caution now on THB bonds given rising political risk premium, and we remain underweight/cautious on both MGS and PHP bonds as rate hiking cycles appear imminent and bond look increasingly rich to swaps in the case of Malaysia. We are more neutral KTBs, counterbalancing both improving economic growth momentum that argue for steeper curves vs. safe haven flows that could get further support as we believe fully priced-in Fed taper is now offset by not-so-fully priced in expectation of ECB QE by year-end.

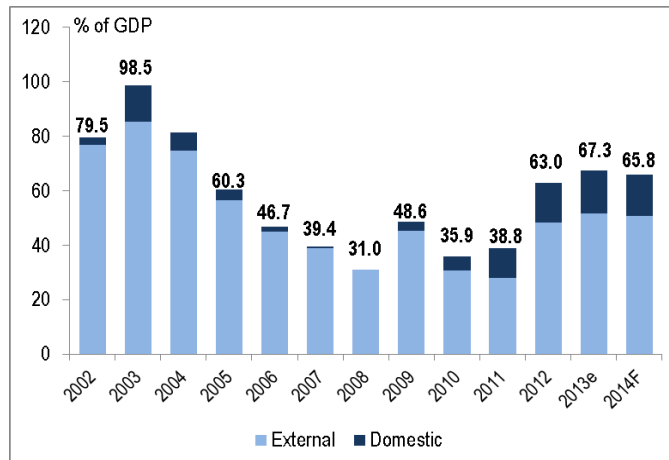
External Debt: We take profit on our tactical long position on Mongolia following spread outperformance since Feb as BoP worries receded – Mongolia bonds have already outperformed other high yield sovereign names in and outside of our region, with the 2022s rallying about 120+bps, despite being helped by carry-seeing environment. However, we think the risk of credit negative news looming is rising given the proposal in parliament to raise the government debt ceiling from 40% of GDP in NPV terms including government guaranteed debt to 70% of GDP in non-NPV terms excluding guaranteed debt + an extra 20% of GDP in government guaranteed debt, which will likely be credit negative given the lack of fiscal credibility historically and risk of government guaranteed debt supply. We are now neutral Mongolia and see more relative value in the quasi-sov DBMMN at the margin. Vietnam underperformed on the back of the escalating Sino-Vietnam tensions – while we expect the longer term damage (especially on FDI) can be relatively contained, and could see some marginal belated catch up later on.

Figure 24. Comparing Historical Z-spread performance



Source: Bloomberg, Citi Research

Figure 25. Mongolia – Public & Publicly Guaranteed Debt (% of GDP)



Source: IMF

Asian Currencies & Interest Rate Forecasts

Figure 26. Currency Forecasts and Forwards

	Mkt Data			Forecasts								
vs USD	22-May	3M Fwd	12M Fwd	0-3 Mos	6-12 Mos	Long-term	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15
Euro	1.37	1.37	1.37	1.40	1.35	1.41	1.38	1.36	1.35	1.36	1.38	1.39
Japanese Yen	102	102	101	100	105	111	102	104	106	107	108	109
Chinese Renminbi	6.23	6.20	6.24	6.30	6.08	6.00	6.20	6.12	6.07	6.06	6.04	6.02
Hong Kong Dollar	7.75	7.75	7.75	7.76	7.76	7.75	7.76	7.76	7.76	7.76	7.76	7.75
Indonesian Rupiah	11,524	11,716	12,314	11,400	12,100	11,800	11,703	11,966	12,072	12,012	11,951	11,890
Indian Rupee	58.6	59.8	63.1	59.0	62.0	63.0	60.3	61.4	62.1	62.3	62.5	62.7
Korean Won	1,025	1,030	1,042	1,030	1,040	980	1,034	1,038	1,034	1,022	1,010	998
Malaysian Ringgit	3.21	3.23	3.29	3.30	3.40	3.37	3.34	3.38	3.40	3.39	3.39	3.38
Philippine Peso	43.7	43.7	43.9	44.0	45.0	43.0	44.4	44.8	44.8	44.4	44.0	43.6
Singapore Dollar	1.25	1.25	1.25	1.26	1.26	1.26	1.26	1.26	1.26	1.26	1.26	1.26
Sri Lanka Rupee	130.4	131.8	NA	130.8	131.3	129.0	131.5	131.0	130.5	130.0	130.0	129.0
Thai Baht	32.4	32.5	32.9	32.5	33.0	33.0	32.7	32.9	33.0	33.0	33.0	33.0
Taiwan Dollar	30.1	30.1	29.8	30.5	30.2	29.8	30.4	30.3	30.2	30.1	30.0	29.9
Vietnam Dong	21,150	21,575	22,425	21,093	21,036	21,000	21,036	21,036	21,036	21,036	21,036	21,036

*Forecast as of Citi's [Foreign Exchange Forecasts](#) (May 16, 2014)

Source: Bloomberg, CEIC Data Company Limited, Reuters, and Citi Research estimates

Figure 27. Interest rate forecasts (% period end)

	22-May	In 3M	In 6M	In 12M	3Q14	4Q14	1Q15	2Q15	3Q15	4Q15
US* Fed Fund Target Rate	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.75	1.00
10-Year Treasuries	2.56	NA	NA	NA	2.95	3.20	3.40	3.45	3.50	3.55
EU* Repo Rate	0.25	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
10-Year Bunds	1.42	NA	NA	NA	1.60	1.60	1.70	1.70	1.80	1.80
JP* Call Money	0.09	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
10-Year JGBs	0.60	NA	NA	NA	0.65	0.70	0.85	0.95	0.95	0.85
CN 1-Year Deposit rate	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00
1-Month Shibor	4.20	4.89	5.06	5.38	4.96	5.13	5.29	5.45	5.61	5.91
Government bond yield (5 -Year)	4.15	4.27	4.31	4.39	4.29	4.33	4.37	4.41	4.45	4.49
HK 3-Month Interbank Rate	0.37	0.43	0.48	0.71	0.45	0.50	0.60	0.80	1.00	1.20
5-Year Exchange Fund Note	1.16	1.52	1.83	2.31	1.60	2.00	2.20	2.40	2.60	2.90
IN Overnight Repo Rate	8.00	8.00	8.00	8.00	8.00	8.00	8.00	8.00	8.00	8.00
91-Day T Bill	8.65	8.25	8.16	8.10	8.25	8.10	8.10	8.10	8.10	8.10
10-Year Gilt	8.76	8.61	8.50	8.50	8.50	8.50	8.50	8.50	8.50	8.50
ID BI Policy Rate	7.50	7.50	7.50	7.75	7.50	7.75	7.75	7.75	7.75	7.75
FasBI Rate	5.75	5.75	5.75	6.00	5.75	6.00	6.00	6.00	6.00	6.00
O/N Interbank Rate	5.86	6.10	6.16	6.20	6.10	6.20	6.20	6.20	6.20	6.20
10-Year Government Bond	8.03	8.34	8.46	8.66	8.40	8.50	8.60	8.70	8.70	8.70
MY Overnight Policy Rate	3.00	3.00	3.50	3.50	3.50	3.50	3.50	3.50	3.50	3.50
3-Month Interbank Rate	3.43	3.59	3.80	3.80	3.80	3.80	3.80	3.80	3.80	3.80
5-year MGS	3.72	3.86	3.96	4.10	3.90	4.00	4.10	4.10	4.00	4.00
PH O/N Rate	3.50	3.50	3.75	4.25	3.75	4.00	4.25	4.50	4.50	4.50
1-Month Reference Rate	0.94	1.79	2.14	2.64	2.00	2.25	2.50	2.75	3.00	3.25
5-Year T Bond	3.40	3.89	4.00	4.39	4.00	4.00	4.25	4.50	4.75	4.50
SG 3-Month Interbank Rate	0.40	0.40	0.40	0.48	0.40	0.40	0.45	0.50	0.60	0.80
10-Year SGS	2.29	2.84	2.96	3.06	2.90	3.00	3.00	3.10	3.20	3.20
KR BOK Policy Rate	2.50	2.50	2.50	2.75	2.50	2.50	2.75	3.00	3.25	3.50
91-Day CD	2.65	2.68	2.72	3.01	2.68	2.75	2.90	3.10	3.35	3.60
5-Year Treasury	3.08	3.52	3.61	3.86	3.55	3.65	3.75	3.95	4.15	4.25
SL Standing Lending Facility Rate	8.00	8.00	8.00	8.00	8.00	8.00	8.00	8.00	8.00	8.00
1-Month T-Bills	7.73	7.77	7.60	8.10	7.60	7.60	8.10	8.10	8.10	8.10
5-Year Government Bond	9.05	9.14	9.39	9.11	9.25	9.50	9.25	9.00	9.00	9.00
TW Overnight Rate	0.39	0.39	0.41	0.46	0.40	0.42	0.45	0.48	0.51	0.54
Re-discount Rate	1.88	1.88	1.88	2.00	1.88	1.88	2.00	2.13	2.25	2.38
10-Year Government Bond	1.47	1.60	1.64	1.80	1.61	1.66	1.74	1.84	1.94	2.04
TH Overnight Repo Rate	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00
1-Month interbank Rate	2.08	2.09	2.06	2.09	2.08	2.05	2.08	2.10	2.10	2.10
10-Year Government Bond	3.66	3.60	3.63	3.73	3.60	3.65	3.70	3.75	3.80	3.85
VN Refinance Rate	6.50	6.50	6.00	6.00	6.00	6.00	6.00	6.00	6.00	6.00
1-Month interbank Rate	4.38	5.36	6.00	6.00	6.00	6.00	6.00	6.00	6.00	6.00
5-Year Treasury	7.25	7.39	7.50	7.89	7.50	7.50	7.75	8.00	8.25	8.50

Note: *Forecast as of [Global Economic Outlook and Strategy](#) (May 21, 2014).

Source: Bloomberg, CEIC Data Company Limited, Reuters, and Citi Research estimates

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China

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- **Summary view** – Mild easing did not reverse the investment-led growth downturn in April. President Xi Jinping called for accepting the “new normal”, hinting more tolerance of slower growth. We keep 2014 growth forecast at 7.3%, assuming better export performance and targeted policy accommodation.
- **Things to watch** – Macro policy fine-tuning continued to gain momentum amid concerns over property price correction and growth slowdown. We expect PBOC to maintain adequate liquidity to lower the borrowing cost, and government to take more measures to support demand and prevent a property market crash.
- **Strategy** – Headline exports growth may improve substantially from May, leading to higher trade surplus. This would result in mounting political pressures from not only the US but also G20 on currency issues. We expect RMB appreciation to resume ahead of the China-US Strategy and Economic Dialogue in early July.

Policy fine-tuning amid growth woes

Apr data show no sign of economic recovery. Growth in fixed asset investment, industrial production and retail sales was all weaker than market expectations. Investment has been the key drag on growth this year due to tightened credit in the real economy. On the fiscal side, value-added tax growth dropped from 10.5%YoY in Mar to 4.9%YoY in Apr. In particular, property-related business tax and income tax registered negative growth. The property price will likely correct nationwide this year, and the risk of a property price bubble bust is rising starting in lower tier cities. The long-awaited regulation on inter-bank business should further restrain off-balance sheet activities and increase the market-based cost of capital. Growth for the rest of the year will largely depend on better export growth and/or further policy accommodation.

President Xi Jinping called for China to adapt to the “new normal”. This hints that the Chinese policy-makers may tolerate somewhat slower growth as long as the labor market remains largely intact. Our analysis suggests that 1Q GDP growth could be much weaker than the officially reported number. After augmenting the GDP deflator, the GDP growth in year-on-year terms might have fallen into the range of 6-7%. (See [China Macro View - A Reality Check on GDP Deflator and Job Creation](#), 9-May) Citi Li Keqiang index in April also ticked down a bit as power consumption growth slowed from 7.2%YoY in Mar to 4.6%YoY in Apr, and railway cargo growth remained in the red at -3.2%YoY. Due to the mild easing, the rebound of the Li Keqiang Index this time will be much weaker than those in the past two years.

Policy initiatives have revealed government preference for targeted easing. Over the past month, the State Council published a follow-up document on supporting trade. PBOC cut RRR for selected rural banks, and urged commercial banks to extend more mortgage loans at lower rates to reduce the risk of a sharp slowdown in the property sector. Some local governments relaxed home purchase restrictions to secure real housing demand. Meanwhile, the upward adjustment of the railway projects and plans to allow local governments to issue municipal debt to finance infrastructure is likely to provide a buffer for investment. We expect PBOC to maintain adequate liquidity to lower the borrowing cost, and the government to take more measures (including loosening housing purchase restrictions) to prevent a property market crash.

Risk of a property market slump

A property market slump remains a tail risk, but the tail is getting fatter. From a medium-term perspective, the current inventory and incoming supply can be mostly digested by rising demand amid ongoing urbanization and upgrading of living conditions. But in the near term, China's housing market suffers from demand over-drafting and supply mislocation, and there are signs that a correction is around the corner. We expect government policies to be geared toward supporting demand while avoiding another construction boom that could disrupt the medium-term supply/demand balance.

Property investment slowdown would put downward pressure on growth. Since property investment accounted for roughly one-fourth of total FAI and FAI made up nearly half of China's GDP, property investment directly contributes about 12% to GDP. We now estimate that total property investment may decelerate to about 14% this year, a main factor that would slow GDP growth to an estimated 7.3% in 2014. If residential new starts drop by 25% this year in the absence of policy support, GDP growth may fall below 7%.

We expect the government to take targeted policies to support house demand. Policies could include: (i) increasing land supply in 1st tier cities; (ii) relaxing home purchase restrictions; (iii) linking hukou with house purchase; (iv) making mortgages more available and less costly; (v) government purchase of commodity houses to meet social housing targets.

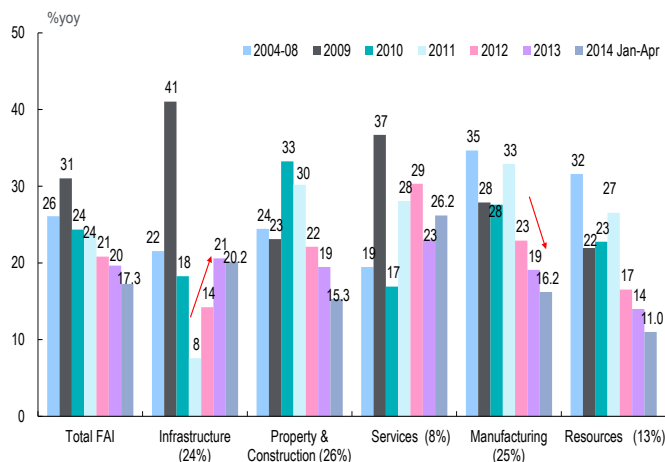
Apart from policy support, price cuts may be necessary to stabilize demand. The NBS data on the 70 large- and medium-sized cities show new house price rose only by 0.1%MoM in Apr, and YoY price increase has slowed since Jan 2014. As market expectation starts to shift, sales could remain sluggish in the months ahead, forcing more developers to cut prices. We expect 70-city average house prices to decline MoM as early as in May, and see price cuts necessary to improve affordability and unleash potential demand.

For details, please see [China Macro View - Risk of a Property Market Slump: The Tail Is Getting Fatter](#) (19-May)

RMB to resume appreciation along a volatile path in 2H

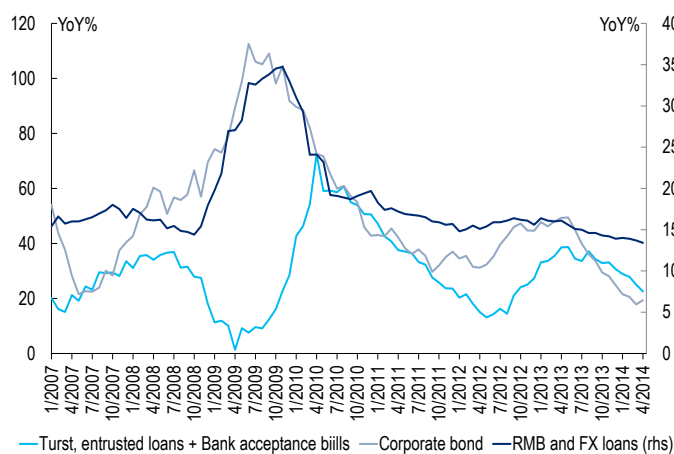
RMB depreciation is likely to be reversed as early as June. The widening of the USDCNY trading band and increased volatility of the RMB has started to dampen speculation on the currency. The RMB has depreciated against the US dollar by about 3% year to date. The FX position data suggest a small-scale non-FDI capital outflow in Apr, the first monthly outflow since last Oct. Going forward, with inflated base fading out and recovery in advanced economies, the headline exports growth may improve substantially from May, leading to a higher trade surplus. This would result in mounting political pressures from not only the US but also G20 on currency issues. We expect RMB appreciation to resume ahead of the China-US Strategy and Economic Dialogue scheduled for early Jul and USDCNY spot rate to fall back to 6.12 by the year-end.

Figure 28. Investment has been the key drag on growth this year



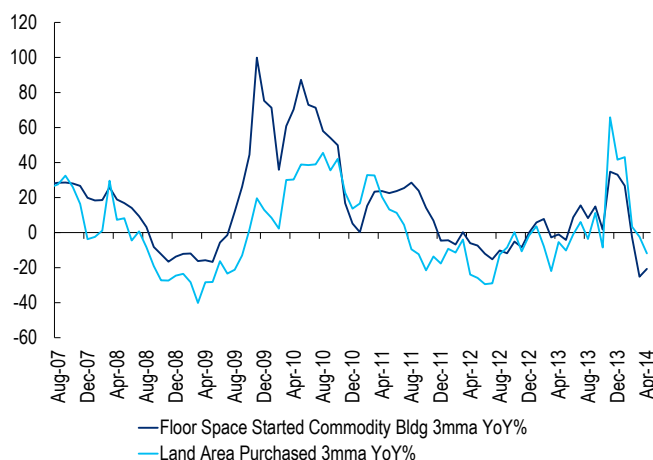
Source: CEIC and Citi Research

Figure 29. Off-balance sheet activities slowed since 2H 2013



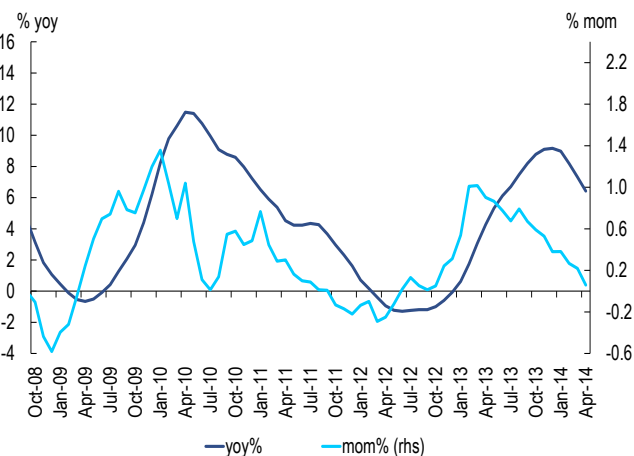
Source: CEIC and Citi Research

Figure 30. Weak demand in the property sector



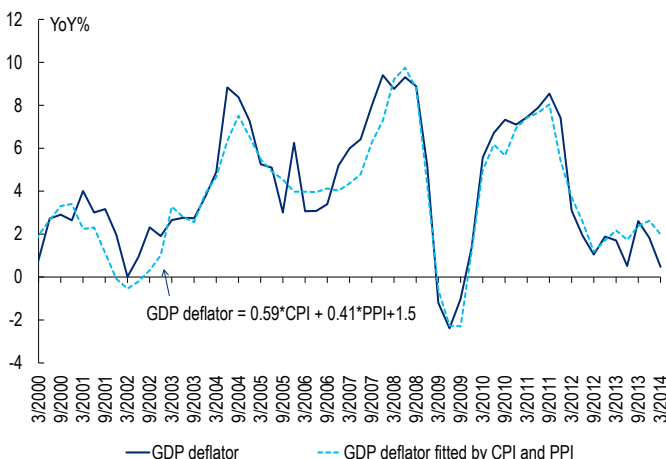
Source: CEIC and Citi Research

Figure 31. 70-city YoY property price increase has slowed since Jan 2014



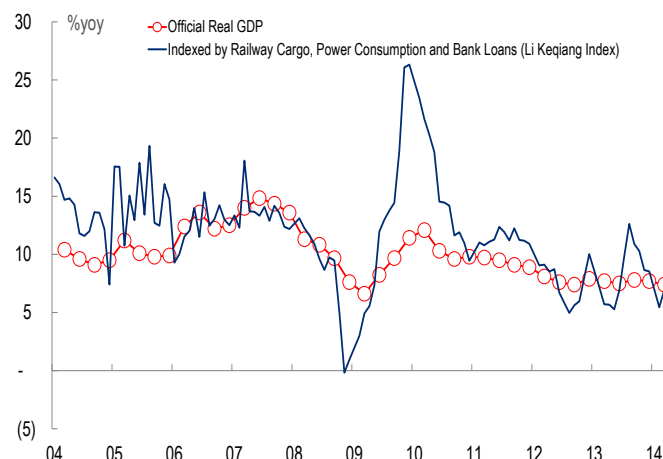
Source: CEIC and Citi Research

Figure 32. GDP deflator could have been understated in 1Q 2014



Source: CEIC and Citi Research

Figure 33. Citi Li Keqiang index ticked down in Apr



Source: CEIC and Citi Research

Figure 34. China Economic Indicators

	2007	2008	2009	2010	2011	2012	2013F	2014F	2015F
Summary Data									
Nominal GDP, US\$ bn	3,494.5	4,544.0	5,070.5	5,932.5	7,319.0	8,238.5	9,244.8	10,063.1	11,256.4
Nominal GDP, local currency bn	26,583	31,490	34,632	40,151	47,310	51,894	56,881	62,138	67,988
GDP per capita, US\$	2,645	3,422	3,800	4,424	5,432	6,084	6,794	7,366	8,218
Population, mn	1,321.3	1,328.0	1,334.5	1,340.9	1,347.4	1,354.0	1,360.7	1,366.2	1,369.7
Unemployment, % of labour force	4.0	4.2	4.3	4.1	4.1	4.1	4.1	4.2	4.3
Economic Activity									
Real GDP, % yoy	14.2	9.6	9.2	10.4	9.3	7.7	7.7	7.3	7.0
Real investment growth % yoy	14.4	11.0	19.2	11.9	9.4	8.1	8.9	7.3	6.6
Real consumption growth % yoy	11.0	8.5	9.4	9.2	10.9	8.3	7.8	7.1	7.6
private consumption growth % yoy	11.1	9.2	10.3	8.5	18.2	8.5	8.0	7.3	7.8
Prices, Money & Credit									
CPI, % yoy	6.5	1.2	1.9	4.6	4.1	2.5	2.5	3.2	3.5
CPI, % avg	4.8	5.9	-0.7	3.3	5.4	2.6	2.6	2.6	3.2
Nominal wages, % yoy	18.5	16.9	11.6	13.3	14.4	11.9	9.6	9.2	9.4
Credit extension to private sector, % eop	19.3	14.0	33.2	20.3	15.1	15.6	14.1	13.5	13.1
Policy interest rate, % eop	4.14	2.25	2.25	2.75	3.50	3.00	3.00	3.00	3.00
Short-term market rate, % eop	3.61	1.23	1.79	6.17	6.00	4.90	5.91	5.13	5.13
Long term yield, % eop	4.19	1.80	3.06	3.61	3.27	3.33	4.49	4.33	4.33
lc/US\$, eop	7.30	6.82	6.83	6.59	6.29	6.23	6.05	6.12	6.02
lc/US\$, avg	7.61	6.95	6.83	6.77	6.46	6.31	6.15	6.21	6.05
Balance of Payments, US\$ bn									
Current account	353.2	420.6	243.3	237.8	136.1	215.4	182.8	201.3	168.8
% of GDP	10.1	9.3	4.8	4.0	1.9	2.6	2.0	2.0	1.5
Trade balance	264.3	298.1	195.7	181.5	154.9	230.3	259.2	291.4	298.4
Exports	1,220.5	1,430.7	1,201.6	1,577.8	1,898.4	2,048.7	2,209.5	2,328.7	2,484.1
Imports	956.1	1,132.6	1,005.9	1,396.2	1,743.5	1,818.4	1,950.3	2,037.3	2,185.7
Service balance	-7.9	-11.8	-29.4	-31.2	-61.6	-89.7	-124.5	-137.0	-150.7
Income balance	8.0	28.6	-8.5	-25.9	-70.3	-19.9	-43.8	-13.6	-19.2
FDI, net	139.1	114.8	87.2	185.7	231.7	176.3	185.0	170.3	118.1
International reserves	1,528.2	1,946.0	2,399.2	2,847.3	3,181.1	3,311.6	3,821.3	4,084.1	4,292.5
Total Amortisations	20.3	23.3	34.2	27.2	33.2	33.0	39.2	41.2	45.3
Public Finances, % of GDP									
Consolidated government balance	0.6	-0.4	-2.2	-2.2	-1.3	-2.0	-1.9	-2.1	-2.0
Consolidated gov primary balance	1.0	0.1	-1.8	-1.7	-0.9	-1.5	-1.4	-1.6	-1.5
Public debt	39.0	37.4	47.8	49.2	44.3	53.5	53.7	54.0	53.4
of which Domestic	38.0	36.6	47.0	48.6	43.7	53.1	53.3	53.6	53.0
Foreign Assets & Liabilities, US\$ bn									
External debt	389.2	390.2	428.6	548.9	695.0	737.0	863.2	949.5	1,044.4
Private	354.3	356.9	391.8	510.1	657.6	700.4	828.8	911.7	1,002.9
Public	34.9	33.3	36.9	38.8	37.4	36.6	34.3	37.8	41.5
External debt / GDP	11.1	8.6	8.5	9.3	9.5	8.9	9.3	9.4	9.3
External debt / XGS	29.0	24.7	32.2	31.5	33.4	32.8	35.6	37.1	38.3
Short-term debt	235.7	226.3	259.3	375.7	500.9	540.9	676.6	744.3	818.7
Short-term debt/International Reserves (%)	15.4	11.6	10.8	13.2	15.7	16.3	17.7	18.2	19.1

Quarterly Economic Indicators

	2013 Q4	2014 Q1	2014 Q2F	2014 Q3F	2014 Q4F	2015 Q1F	2015 Q2F	2015 Q3F	2015 Q4F
GDP, % yoy	7.7	7.4	7.0	7.1	7.4	7.4	7.2	6.8	6.7
CPI, % yoy	2.5	2.4	2.6	2.5	3.2	3.2	2.9	3.0	3.5
Policy interest rate, % eop	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00
Short-term market rate, % eop	5.91	4.62	4.80	4.96	5.13	5.29	5.45	5.61	5.91
Long term yield, % eop	4.49	4.21	4.25	4.29	4.33	4.37	4.41	4.45	4.49
lc vs USD, eop	6.05	6.22	6.29	6.20	6.12	6.07	6.06	6.04	6.02

Source: CEIC Data Company Ltd, Fitch, IFS, Moody's and Citi Research estimates

*Note: Public debt includes the debt of central, local govt and Ministry of Railway. Long term yield refers to 5Y Sovereign Bond yield. External debt is based on the residency of the holder of the debt (not by currency denomination).

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Hong Kong

- **Summary view** – We think 2Q GDP could still see some headwinds, but is likely to turn better in 2H14E. Recent minor housing regulation adjustments do not change overall property tightening policy stance. Mild disinflation likely forming a trend, despite food prices. Political debate on election process took a new turn.
- **Things to watch** – 1) Lingering liquidity concerns on taper and China's credit tightening; 2) Sustainability of trade recovery; 3) Property market adjustment; 4) Tourist shopping trends (volume vs. value/pax); 5) Political debate on electoral reforms; 6) Measures to enhance cooperation with Qianhai and Shanghai FTZ.
- **Strategy** – EFN yields are likely to continue to trend up with US yields as the Fed normalizes policies. Our equity strategist's HSI target for 2014 year-end is 25,000, as few catalysts for a re-rating are visible. Citi's house view is that home prices will drop 10% in 2014E.

Lingering macro uncertainties in 2Q

We lowered our 2014 GDP forecast to 3.2%YoY on disappointing 1Q real GDP. HK only grew 2.5%YoY in 1Q on slower-than-expected private consumption and weak trade contribution. On a seasonally adjusted basis, 1Q grew only 0.2% qoq, from 4Q's 0.9% qoq. As a result of this unexpected dip in 1Q, we nudge down our full-year forecast by 0.2ppt to 3.2%YoY.

We expect economic momentum in 2Q, albeit in recovery mode, but pace could still see some headwinds externally and domestically; our new forecast is at 2.9%YoY. Although overall exports improved in March to 3.4%YoY from Jan-Feb's average of -0.8%YoY; the impacts of the China slowdown was clearly observed as exports to China fell 2.3%YoY, while developed markets appear to be rebounding at double-digit growth. We therefore expect another small drag in net exports contribution in 2Q, as ongoing China slowdown worries likely will offset in part recovery expected in the US/Europe/Japan.

Domestic demand is also indirectly affected by China slowdown. We think consumption trends will remain unexciting in 2Q, given China and geopolitical news will dominate headlines, which in turn will make financial market volatility inevitable in the near term and thus affecting wealth effect. Moreover, recent slowing in retail sales could become a trend (Mar retail sales unexpectedly declined 1.3%YoY (value) and 2.3% (volume)). We think the tourist spending trend may be turning away from high-end purchases, as affected by the slowing China economy and anti-corruption drive, but more toward middle-to-low end spending, given that many tourists nowadays do not stay overnight and are affected by the ongoing anti-corruption campaign in China. We are also less hopeful of significant improvements in April or China's golden week holiday in May. This trend deserves monitoring as it would have implications on the labor market and rent price (especially for the numerous high-end retail stores on the street, although many of these luxury chain stores remain cash rich), which in turn will affect local spending.

Investment plans also will be affected by China headline risks. The support from ongoing large-scale public infrastructure projects to GFCF is expected to continue, but China reform/deleveraging risks likely weighed and will continue to prompt businesses to defer machinery and equipment acquisitions beyond 2Q. Understandably, a bigger swing factor could be how China risks will take a toll on HK's property prices. If China risks significantly deteriorate investor sentiment in the physical asset market, then private housing developments would also be delayed.

Recent property policy adjustments are only technical. On 13th May, the government (1) relaxed the six-month timeline of the Double Stamp Duty (DSD) refund, which a HK permanent resident can now effectively benefit from an extra 30-45 days with the bill adjusted to commence from the conveyance on sale instead of the agreement for sale and purchase of the newly acquired property; (2) exempted stamp duty of purchasing one car parking space that is together acquired with the residential property. We consider these minor policy adjustments are driven by practicality rather than a change of policy stance. Our property analyst, Ken Yeung, believes that these relaxations will help attract home upgraders to primary launches and further stabilize prices (see [Hong Kong Property: Developers the Beneficiaries of DSD Relaxation](#)). We think overall demand controls (except these technical adjustments) will remain largely in place as overall property prices of the mass market only softened by 4.1%YoY since its latest peak seen in Feb13. The ultimate goal for policymakers is to create more supply ASAP via building both public and private housing.

Leading indicators appear to indicate near-term pressure points too: April Markit PMI dipped into contraction zone of 49.7, and in particular new orders from Mainland China were particularly weak. Business tendency survey for 2Q showed mixed profiles among industries, with trade, logistics, retail, accommodation and food services deteriorating or still in contraction mode, but expectations for financial and insurance sector, and information/communications doing slightly better.

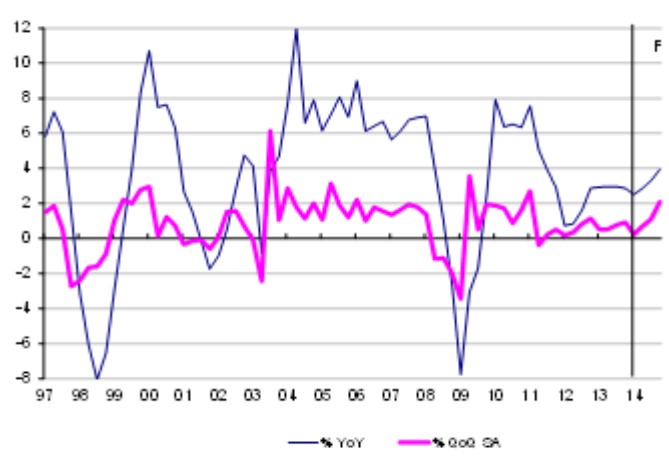
Potential lifting of daily RMB conversion cap soon

Personal RMB convertible quota need to be raised or removed to facilitate retail participation in the Shanghai-HK Stock Connect program. HKMA Chief Norman Chan was quoted in the news that HKMA on 6 May is seeking PBOC's approval to remove daily conversion quota before the pilot Shanghai-HK Stock Connect becomes effective in Oct14. The pilot scheme requires cross-exchange securities purchase to be settled in RMB only, as northbound investors (i.e., HK/overseas investors trading Shanghai Stock Exchange's securities) will need to first obtain sufficient RMB prior to transaction. Retail clients currently are subjected to a maximum RMB20,000 per daily conversion limit, while institution clients can access the accumulated CNH deposit pool in HK (which size is RMB944.9bn as of Mar14). Therefore an enlargement or removal of the personal conversion quota would make it easier for retail participants to access the pilot program.

Election reform update

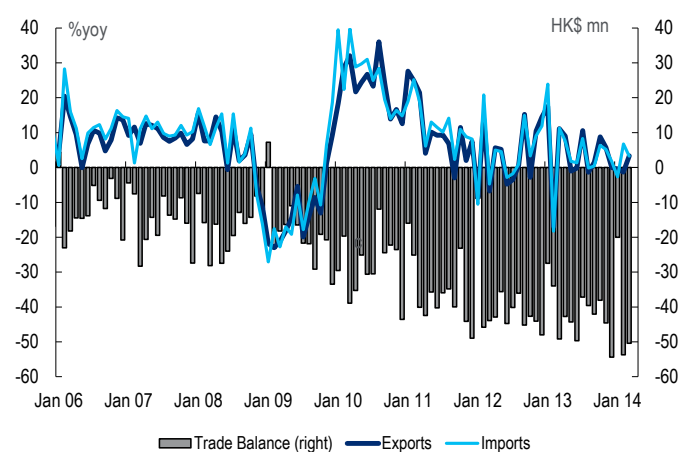
Political noise will further escalate. According to the Chief Executive, the government has received over 130,000 submissions of diverse views during phase I of the constitutional reform consultation. A comprehensive report will be compiled and submitted to the central government and a phase II consultation will be launched in 4Q. However, shortly after the end of phase I consultation, the government has indicated that civil or party nomination mechanism for the 2017 Chief Executive will likely be excluded from future political consultation. Activist group Occupy Central will be hosting a public referendum on June 22 on three pre-elected electoral procedures for the 2017 elections, all of which included the element of civic nomination. Although there are criticisms raised against the legitimacy of this vote, the voting turnout and actual results will be closely watched as the referendum is supposed to legitimize the act of occupying the streets of Central, despite high profile warnings by China and HKSAR governments that the act is illegal.

Figure 35. 1Q14 GDP dips, expect gradual recovery in 2Q



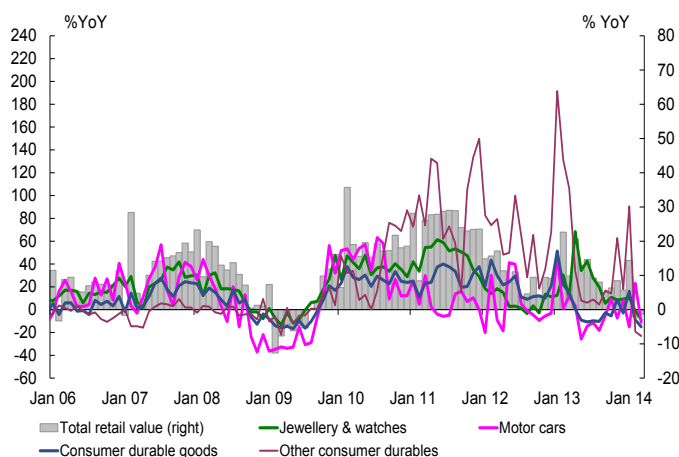
Source: CEIC, Citi Research

Figure 36. Trade recovery still rather weak



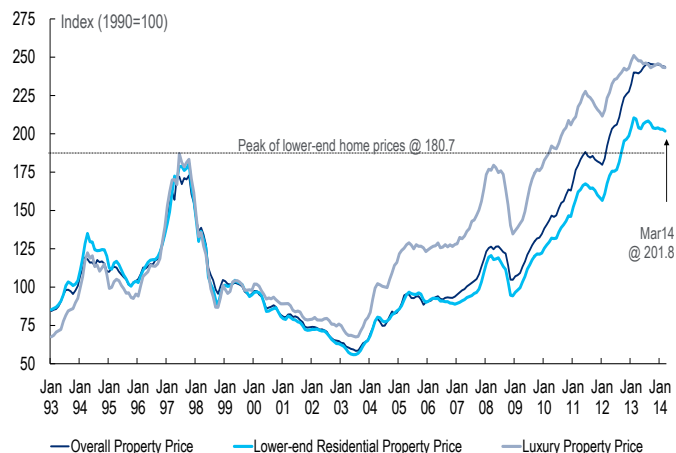
Source: CEIC, Citi Research

Figure 37. Retail sales slowdown may become trend



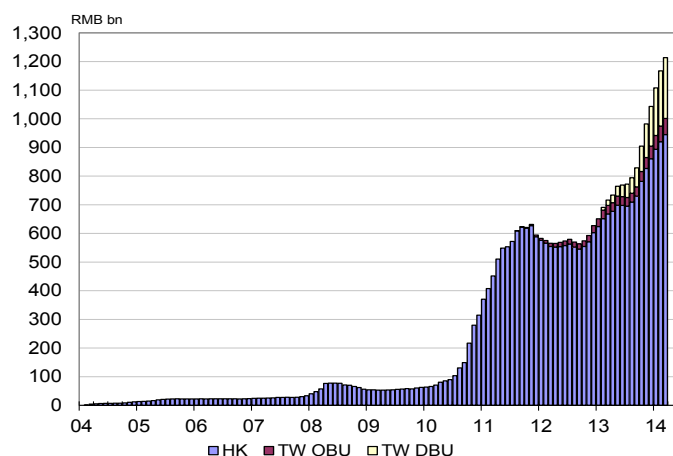
Source: CEIC, Citi Research

Figure 38. Price softening insufficient for bold property policy easing



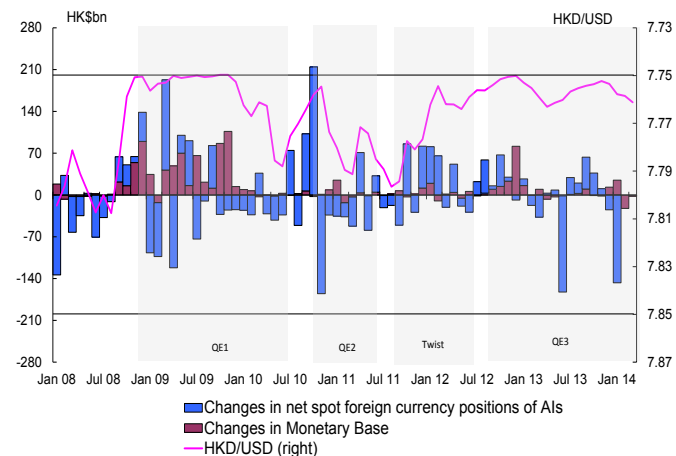
Source: CEIC, Citi Research

Figure 39. Offshore RMB Deposits in HK+TW to stay abundant



Source: CEIC, Citi Research

Figure 40. Net outflows recorded in Jan14; HKD easing from strong end



Source: CEIC, Citi Research

Note: Net FC positions data not available for Feb-Mar14 yet

Figure 41. Hong Kong Economic Indicators

	2007	2008	2009	2010	2011	2012	2013F	2014F	2015F
Summary Data									
Nominal GDP, US\$ bn	211.6	219.3	214.1	228.7	248.5	262.6	274.0	285.2	301.4
Nominal GDP, local currency bn	1,651	1,707	1,659	1,776	1,934	2,037	2,125	2,213	2,338
GDP per capita, US\$	30,495	31,491	30,595	32,424	34,941	36,587	37,953	39,390	41,503
Population, mn	6.9	7.0	7.0	7.1	7.1	7.2	7.2	7.2	7.3
Unemployment, % of labour force	4.0	3.5	5.3	4.3	3.4	3.3	3.4	3.1	3.1
Economic Activity									
Real GDP, % yoy	6.5	2.1	-2.5	6.8	4.8	1.5	2.9	3.2	3.6
Real investment growth % yoy	7.9	-0.3	1.0	11.1	2.3	3.5	3.7	4.6	2.7
Real consumption growth % yoy	7.9	1.9	0.5	5.8	7.6	4.0	4.0	2.0	2.3
private consumption growth % yoy	8.6	1.9	0.2	6.1	8.4	4.1	4.2	2.1	2.4
Real export growth, % yoy	8.3	2.5	-10.0	16.8	3.9	1.9	6.5	4.1	6.3
Real import growth, % yoy	9.1	2.2	-9.0	17.4	4.6	2.9	6.9	3.9	5.7
Prices, Money & Credit									
CPI, % yoy	3.8	2.1	1.5	2.9	5.7	3.8	4.3	3.4	3.4
CPI, % avg	2.0	4.3	0.6	2.3	5.3	4.1	4.3	3.9	3.7
Nominal wages, % yoy	2.4	4.0	-1.9	2.4	9.9	4.7	4.9	4.5	4.5
Credit extension to private sector, % yoy	15.2	11.0	-2.1	20.9	12.5	7.0	10.6	11.0	8.0
Short-term market rate, % eop	3.45	0.95	0.14	0.28	0.38	0.40	0.38	0.55	1.30
Long term yield, % eop	3.10	1.19	1.93	1.76	0.96	0.32	1.40	2.10	2.90
lc/US\$, eop	7.80	7.75	7.75	7.77	7.77	7.75	7.75	7.76	7.75
lc/US\$, avg	7.80	7.79	7.75	7.77	7.78	7.76	7.76	7.76	7.76
Balance of Payments, US\$ bn									
Current account	27.6	32.9	21.2	16.0	13.8	4.1	5.6	8.1	9.6
% of GDP	13.0	15.0	9.9	7.0	5.6	1.6	2.1	2.8	3.2
Trade balance	-23.1	-25.8	-28.8	-43.0	-54.9	-61.6	-64.6	-65.0	-66.7
Exports	344.5	362.7	318.5	390.2	428.7	442.8	458.9	483.7	515.7
Imports	367.6	388.6	347.3	433.1	483.6	504.3	523.5	548.7	582.4
Service balance	-4.3	-2.7	3.6	10.1	17.0	21.9	29.1	29.7	30.3
Income balance	6.8	12.9	6.4	4.8	6.8	3.8	5.4	7.0	7.0
FDI, net	-19.0	-8.9	-6.4	-10.5	-8.7	-11.2	-10.9	-11.0	-12.0
International reserves	152.6	182.5	255.7	268.6	285.3	317.2	311.1	335.0	360.0
Public Finances, % of GDP									
Consolidated government balance	7.3	0.0	1.5	4.1	3.8	3.1	1.0	1.3	0.7
Consolidated gov primary balance	7.4	0.0	1.6	4.2	3.8	3.2	1.1	1.3	0.8
Public debt	1.2	1.0	0.7	0.6	0.6	0.5	0.6	1.0	1.4
of which Domestic	0.4	0.2	0.1	0.0	0.0	0.0	0.1	0.1	0.1
Quarterly Economic Indicators									
	2013 Q4	2014 Q1	2014 Q2F	2014 Q3F	2014 Q4F	2015 Q1F	2015 Q2F	2015 Q3F	2015 Q4F
GDP, % yoy	2.9	2.5	2.9	3.3	3.9	3.1	3.6	3.9	3.8
CPI, % yoy	4.3	3.9	3.8	6.1	3.4	4.0	3.5	3.4	3.4
Short-term market rate, % eop	0.38	0.38	0.40	0.45	0.50	0.60	0.80	1.00	1.20
Long term yield, % eop	1.39	1.45	1.40	1.60	2.00	2.20	2.40	2.60	2.90
lc vs USD, eop	7.75	7.76	7.76	7.76	7.76	7.76	7.76	7.76	7.75

Source: CEIC Data Company Ltd, Fitch, IFS, Moody's and Citi Research estimates

*Note: Public debt is general government debt.

India

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- **Summary view** – India's election result is unanimously seen as positive ([Big Win, Big Possibilities](#)). The BJP's clear majority implies a stable/decisive govt that now needs to deliver. We believe the economy's revival will be investment-led but gradual with GDP at 5.6% in FY15 and picking up to 6.5% in FY16.
- **Things to watch** – The new government's pace of policy implementation and effectiveness in removing supply-side bottlenecks will be under scrutiny. The upcoming ministerial appointments are also crucial, particularly that of Finance Minister. We also await the new government's budget, expected in early July.
- **Strategy** – Given BJP's focus on manufacturing, but supportive capital flows, we expect INR to trade close to its equilibrium value in the Rs59-62 band. A positive INR bias, political will to contain food inflation and a focused monetary policy, could see 10-year bond yields trending toward 8.5% in the next 3 to 6 months.

Election results: big win with big possibilities

BJP Sweeps General Election: The BJP beat expectations by gaining "absolute majority" (282 seats of a total of 543) in the 2014 general elections. This is the largest majority for a single party in 30 years, giving the government significant legislative firepower and no excuses. The mandate is both clear and complete. This suggests the government will need to deliver, and deliver fast

The New Government can deliver, but there are some risks: The change in government is significant, and we believe it can deliver given its emphasis on the economy and decisive governing structure. While this could bode well for the macro, there are some risks: (1) El Nino, (2) Global risk environment, (3) high inflation environment, tight monetary/ fiscal policy and (4) political factors like ministerial appointments and minority status in the upper house.

Real economy: gradual, investment-led recovery in FY16

Maintain 5.6% GDP growth in FY15, FY16 GDP revised up to 6.5%: While the new political formation is likely to set the wheel in motion immediately, effects on the economy will be lagged and a full-fledged recovery will be realized only in FY16/17E as (1) governance and institutional reforms will start reflecting in the numbers with a lag, (2) high inflation and interest rates could impede growth in the short term. Consequently, whilst retaining our FY15 GDP estimate of 5.6%, we revise up our FY16 GDP growth estimate to 6.5% on an accelerated pick-up in investments

'Unlocking' Investments is the key to Higher Growth: A sustainable recovery would only be possible by addressing issues on the investment and infrastructure front. Given the overwhelming mandate, there is now more than ever a need to bring project execution/implementation back in focus. The pick-up in growth will be a function of (1) pace of policy de-bottlenecking, (2) investment appetite of the corporate sector and (3) extent of the government's own role in capital formation. Furthermore, in order to ensure that a pick-up in investments is financed largely by domestic savings, the next step should be to revive domestic financial savings that offer competitive real return.

Inflation edges up: govt. to focus on structural issues

CPI Inflation to come off with a lag – Headline CPI inflation edged higher to 8.6% in April while core CPI inflation remained unchanged at 7.8%. “Price rise” has been identified as one of the foremost agenda topics in BJP’s manifesto. Accordingly, we expect the government to take appropriate measures such as offloading excess food stocks, calibrating MSP with market prices, reducing suppressed inflation in administered fuel, etc., to achieve stable price dynamics. Overall, we maintain our view of CPI averaging 8% in FY15 vs. 9.5% in FY14, but we revise down our FY16 inflation estimate to 6.5% on the renewed political will of the government.

Maintain view of Extended Pause: As regards monetary policy, we maintain our view of an extended pause on rates through 2014 as CPI inflation roughly meets RBI’s target of 8% by Jan’15 and 6% by Jan’16. In the event that the new government takes definite measures to reduce food inflation, the space could open up for an easing of policy rates in 2015. **In the near term**, however, risks on inflation are balanced including an upside that could come from occurrence of El Nino. Note that the central bank can achieve a higher effective operating rate by keeping liquidity tight, e.g., overnight rates have been close to 50bps higher than repo since Nov 2013.

Fiscal indicators: Watch out for quality of deficit

Consolidation to Continue, Quality will be Key. India’s fiscal deficit seems to be going in the right direction with the outgoing government achieving more than 1% reduction in fiscal deficit in the last two years. The new government is expected to maintain the trends of fiscal consolidation and simultaneously aim to improve the quality of fiscal spending. While the BJP manifesto is silent on subsidies, the broad expectation is of rationalization of subsidies and directing the expenditure toward social infrastructure and other productive sectors.

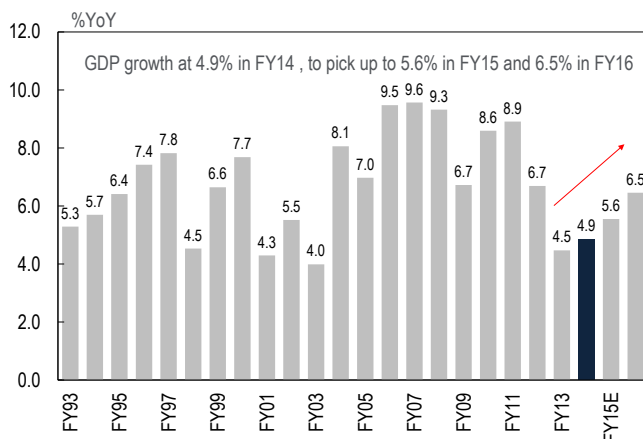
Sovereign rating downgrade risk to recede: Political stability at the center and a gradual revival will provide necessary fillip to the credit profile of the sovereign (S&P ratings: BBB-, negative outlook). In contrast, as the economy gathers momentum, the rating agencies may consider revising the outlook to stable from negative.

External front: INR range bound, CAD under control

Gold Import restrictions could be relaxed: Thanks to measures taken to contain imports, primarily gold, the current account deficit is expected to be within US\$36bn or 2% of GDP in FY14 from US\$88bn last year. As stability returns to external sector, we expect the new government to gradually relax gold import restrictions but not withdraw them completely. However, we expect higher gold imports to be largely offset by resumption of iron-ore exports as well as easing supply bottlenecks in coal production. Thus, we expect the CAD to be contained at 2.3% of GDP in FY15.

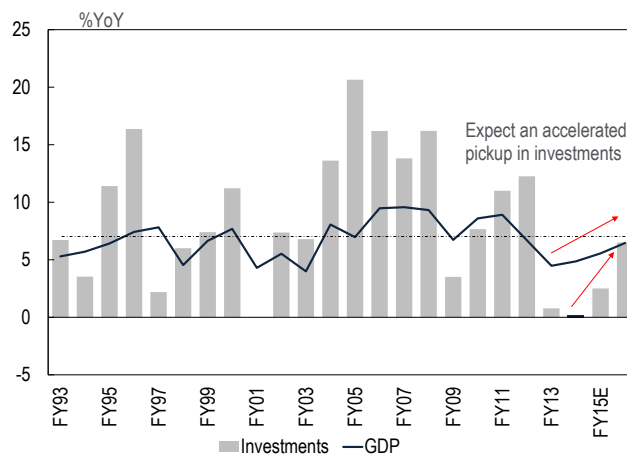
Rupee to trade with a positive bias: On back of an improved political environment and a supportive balance of payments environment, the Rupee is likely to trade with a positive bias. While the central bank has proactively intervened to prevent the Rupee from appreciating much below 60/US\$ ahead of election results, the decisive election outcome could see the Rupee stabilizing in a Rs59-62 range over the next 12 months. Key to note is the need to rebuild reserves given (1) The US\$ 31bn short forward position – largely a result of the FCNR deposit scheme; (2) Rise in external debt to US\$426bn and (3) Volatile global risk environment.

Figure 42. Trends in annual GDP growth (%YoY)



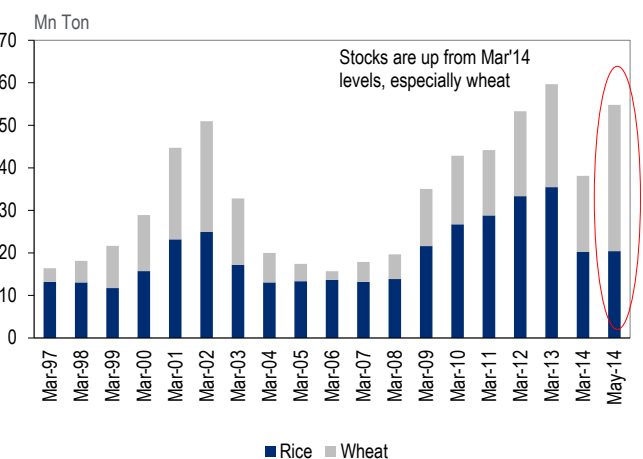
Source: CSO, Citi Research

Figure 43. Trends in investments (%YoY)



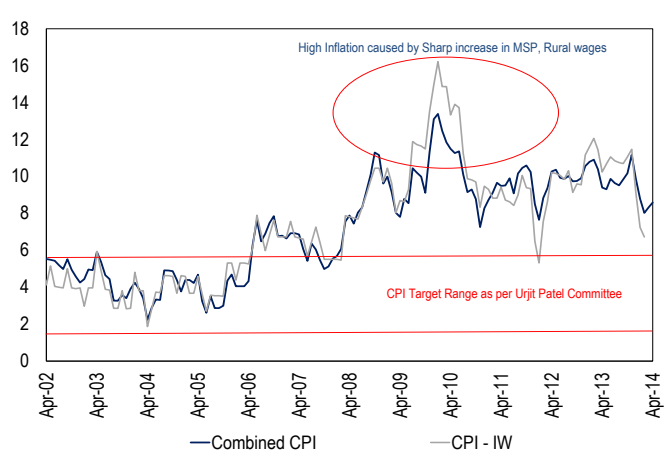
Source: CSO, Citi Research

Figure 44. Trends in foodgrain stocks (Mn T)



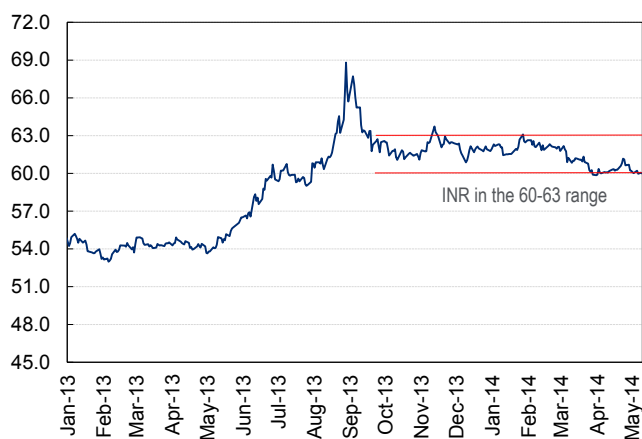
Source: FCI

Figure 45. Trends in CPI-combined and CPI-IW (%YoY)



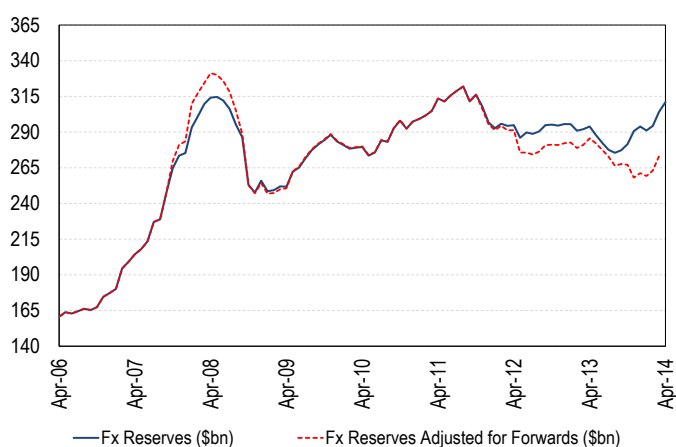
Source: RBI, CSO

Figure 46. Trends in INR / US\$



Source: Bloomberg

Figure 47. FX reserves and forwards-adjusted reserves (US\$bn)



Source: RBI, Citi Research

Figure 48. India Economic Indicators

	FY08	FY09	FY10	FY11	FY12	FY13	FY14F	FY15F	FY16F
Summary Data									
Nominal GDP, US\$ bn	1,240.6	1,223.9	1,366.6	1,707.8	1,873.1	1,872.8	1,874.2	2,063.2	2,352.1
Nominal GDP, local currency bn	49,871	56,301	64,778	77,841	90,097	101,133	113,205	127,921	145,830
GDP per capita, US\$	1,090	1,061	1,168	1,440	1,558	1,539	1,517	1,646	1,848
Population, mn	1,138.0	1,154.0	1,170.0	1,186.0	1,202.0	1,217.0	1,235.3	1,253.8	1,272.6
Economic Activity									
Real GDP, % yoy	9.3	6.7	8.6	8.9	6.7	4.5	4.9	5.6	6.5
Real investment growth % yoy	18.1	-5.2	17.3	14.1	3.9	4.9	0.0	3.4	5.6
Real consumption growth % yoy	9.4	7.7	8.4	8.2	8.9	5.2	4.4	5.6	6.8
private consumption growth % yoy	9.4	7.2	7.4	8.7	9.3	5.0	4.1	5.5	7.0
Real export growth, % yoy	5.9	14.6	-4.7	19.6	15.6	5.0	8.0	11.0	9.3
Real import growth, % yoy	10.2	22.7	-2.1	15.6	21.1	6.6	-1.6	9.5	9.0
Prices, Money & Credit									
CPI, % yoy	7.9	8.0	14.9	8.8	9.0	10.4	8.3	8.0	6.5
CPI, % avg	6.2	9.1	12.4	10.4	8.4	10.2	9.5	8.0	6.5
Credit extension to private sector, % eop	23.0	19.0	16.0	17.0	17.5	17.5	17.5	17.5	17.5
Policy interest rate, % eop	7.75	5.00	5.00	6.75	8.50	7.50	8.00	8.00	8.00
Short-term market rate, % eop	8.00	5.68	4.49	9.54	10.90	8.50	8.50	8.50	8.50
Long term yield, % eop	7.96	7.01	7.83	7.99	8.56	8.00	8.50	8.50	8.50
lc/US\$, eop	39.41	48.62	46.41	44.71	53.02	55.00	61.81	61.42	62.70
lc/US\$, avg	41.18	43.42	48.30	45.68	46.63	53.38	58.57	60.20	62.40
Balance of Payments, US\$ bn									
Current account	-15.7	-27.9	-38.2	-45.9	-78.2	-88.2	-36.8	-46.7	-58.1
% of GDP	-1.3	-2.3	-2.8	-2.7	-4.2	-4.7	-2.0	-2.3	-2.5
Trade balance	-91.5	-119.5	-118.2	-130.6	-189.8	-195.7	-148.7	-165.3	-181.8
Exports	166.2	189.0	182.4	250.5	309.8	306.6	323.4	349.3	384.3
Imports	257.6	308.5	300.6	381.1	499.5	502.2	472.1	514.6	566.1
Service balance	38.9	53.9	36.0	48.8	64.1	64.9	72.1	77.8	84.0
Income balance	-5.1	-7.1	-8.0	-17.3	-16.0	-21.5	-24.0	-24.0	-26.0
FDI, net	15.9	22.4	18.0	9.4	22.1	19.8	20.0	18.0	23.0
International reserves	299.1	241.6	252.8	273.7	260.9	264.7	278.0	294.8	314.2
Total Amortisations	14.9	15.6	19.1	18.7	22.8	23.0	18.7	19.9	21.0
Public Finances, % of GDP									
Consolidated government balance	-4.0	-8.3	-9.3	-6.9	-8.1	-7.2	-6.9	-6.7	-6.5
Consolidated gov primary balance	-1.2	3.3	4.5	2.4	3.6	--	--	--	--
Public debt	76.1	76.8	75.5	70.2	69.7	69.8	69.5	68.1	66.3
of which Domestic	71.4	72.2	70.6	65.6	65.9	65.4	65.6	64.6	63.2
Foreign Assets & Liabilities, US\$ bn									
External debt	224.4	224.5	260.9	317.9	360.8	404.9	426.0	441.0	456.0
Private	166.3	168.6	193.9	239.8	278.9	323.2	349.5	362.5	375.5
Public	58.1	55.9	67.1	78.1	81.9	81.7	76.4	78.4	80.4
External debt / GDP	18.1	18.3	19.1	18.6	19.3	21.6	22.7	21.4	19.4
External debt / XGS	88.5	77.7	95.2	84.7	80.7	90.1	92.3	84.4	73.6
Short-term debt	45.7	43.3	52.3	65.0	78.2	96.7	92.7	97.7	102.7
Short-term debt/International Reserves (%)	15.3	17.9	20.7	23.7	30.0	36.5	33.4	33.1	32.7

Quarterly Economic Indicators

	2013 Q4	2014 Q1F	2014 Q2F	2014 Q3F	2014 Q4F	2015 Q1F	2015 Q2F	2015 Q3F	2015 Q4F
GDP, % yoy	4.7	5.0	5.2	5.6	5.8	5.8	6.5	6.6	6.0
CPI, % yoy	10.4	8.4	8.5	7.5	7.0	8.5	7.9	7.0	6.4
Policy interest rate, % eop	7.75	8.00	8.00	8.00	8.00	8.00	8.00	8.00	8.00
Short-term market rate, % eop	9.00	8.36	8.25	8.25	8.10	8.10	8.10	8.10	8.10
Long term yield, % eop	8.80	8.78	8.75	8.50	8.50	8.50	8.50	8.50	8.50
lc vs USD, eop	61.81	60.02	59.17	60.30	61.42	62.09	62.29	62.50	62.70

Source: CEIC Data Company Ltd, Fitch, IFS, Moody's and Citi Research estimates

*Note: Public debt is general government debt and external debt is based on the residency of the holder of the debt (not by currency denomination).

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Indonesia

- **Summary view** – We expect the elections to be finished in one round or July. A quick conclusion would raise the chance of a fuel price hike happening in 2H14 instead of 1Q15. This is positive, though must be weighed against the possibility of a rise in the fiscal debt issuance of up to Rp65tn (eq. US\$5.7bn).
- **Things to watch** – Short term CA deficit concerns have eased as the momentum on import compression has been persistent. We think attention will start to focus on the medium term current account sustainability, which we don't think is in the bag yet. Regulatory reforms in the financial sector are also needed.
- **Strategy** – Policy rate should remain paused although we don't rule out a 25bps increase in 4Q amid a fuel price hike. IDR may see appreciation pressure in the near term (0-3M) which should also be driven by inflows from carry trade, although we remain relatively cautious on a 6-12M horizon.

The reality of slowing growth kicks-in

Policymakers revising down their FY14 GDP growth forecasts. As GDP growth slowed to 5.2% YoY in 1Q14 from 5.7% in the previous quarter, policymakers have toned down their expectations for the full year. Bank Indonesia has lowered its FY14 mid-point growth forecast to 5.3% (at par with Citi's baseline forecast) from 5.7% previously. Meanwhile the government may also revise down its proposed growth assumption in the 2014 budget to 5.5%, from 6% previously.

The 2014 fiscal budget will be discussed with parliament in May. Officials have signaled that the deficit could reach the high end of our 2 – 2.5% GDP forecast range. This is due to bloating fuel subsidies and lower realization of oil revenues. MoF officials indicate that the increase in the debt issuance may reach up to Rp65tn (from the existing Rp357tn gross issuance target), which by our calculation could increase the targeted bond issuance in the bi-weekly auctions by up to 50% from currently around Rp8tn per auction.

Although near term CA deficit concerns have subsided, policymakers still appear cautious. The current account deficit in 1Q14 shrank further to 2.06% GDP from 2.12% in the previous quarter. However the quarterly deficit may see a hump-shaped trajectory. We expect it to rise towards 2.8% GDP in 2Q amid seasonally high imports in the run up to the Ramadan fasting month and travel season. There are also seasonal dividend repatriations peaking in May and June. We sense BI is still in a cautious mood and do not expect them to turn dovish anytime soon.

Fuel price hike possible in 2H14 instead of 1Q15

We have moved our baseline forecast for the next fuel price hike to 2H14 from previously 1Q15. Presidential candidate Joko Widodo has said that he plans to abolish the fuel subsidies in 4 years if he were elected president. The complementing programs that usually accompany a fuel price hike (e.g. compensatory social spending) are also being proposed in the forthcoming 2014 budget revision. This should pave the way for any new government to move quickly on the subsidies in order to ease the burden on the budget. Furthermore with the elections looking likely to finish in one round (Jul) instead of two (Sep), the incoming president should have time to prepare and hit the ground running after the 20-Oct inauguration.

Raising our YE14 inflation forecast to 7.3% from 5.3% previously. For a given magnitude fuel price hike, we think the inflation impact will not be as high as in 2013. Under the 2012 CPI base year, the weights on fuel and food are lower vs. in the previous CPI (base 2007). As the fuel price hike may improve the medium term sustainability of the current account, higher short term inflation should not be taken too negatively by the bond markets, Market participants also have seen that the inflation impact of the price hike in Jun-13 was one off and did subside after several months.

We do not think that a fuel price hike warrants further tightening, but do not rule out a 25bps rate hike to anchor inflation expectations. On the IDR, Citi believes that the IDR may see appreciation pressure in the near term (0-3M). We believe the catalyst would be inflows from carry trade and also a quick win in the elections. However we remain relatively cautious on a 6-12M horizon given expectations of rising UST yields and also medium term questions on Indonesia's current account outlook.

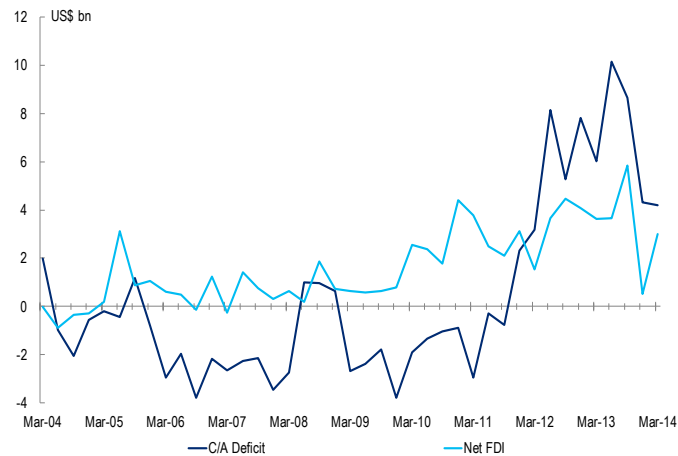
Medium-term outlook in the spotlight

Although we think the CA deficit may have reached sustainable levels in the short term, its medium term sustainability still needs to be chased after. Our concerns relate to the factors driving the narrowing of the CA deficit (the savings – investment gap). Indonesia's savings-investment gap has indeed narrowed, but this was due to a collapse in the investment ratio as opposed to a rise in the savings ratio. The CA deficit improvement would have been of better quality had it been driven by a rising savings rate (i.e. due to consumption growth slowing). With the current account deficit still at 2% of GDP at a time when investment growth is suppressed, we think there is risk that it may resurge towards elevated levels when the investment cycle peaks again towards 2016, if not 2015.

The era of excess liquidity also appears to be reaching the end of the road. Apart from the structural current account deficit, we also think that the depletion of excess liquidity in the banking system would be a key determinant of the medium term macro and policy outlook. The balance of liquidity absorbed through BI's open market operations has come down towards pre-1998 levels, while average bank loan to deposit ratios (LDR) crawl towards 95%. With the current account in structural deficit, money supply growth may no longer see a strong push from rising foreign assets. We think the average rate of loans growth in Indonesia will head south towards a new normal.

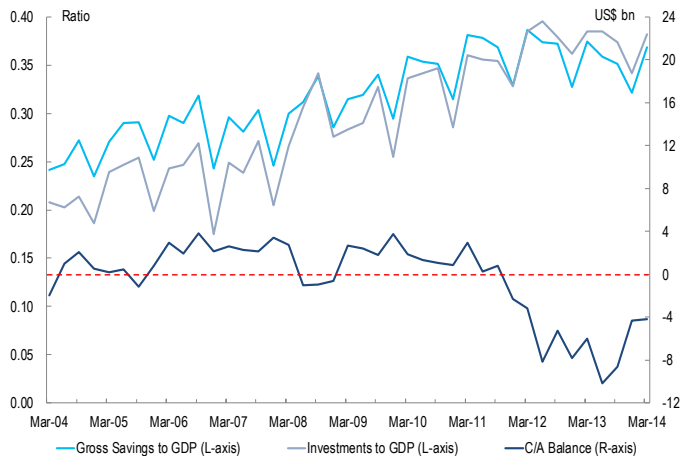
Business as usual, not an option. Under the backdrop of structural CA deficit and no longer abundant with liquidity in the banking sector, we believe Indonesia undoubtedly needs to fine-tune its growth model towards a more outward-looking one in order to avoid a downgrade in its medium-term growth prospects. The financial sector too must be adapted to the new realities. We think that a review of regulatory regimes is forthcoming, especially those related to 1) restrictions on non-resident deposit holdings; 2) regulatory thresholds on bank LDRs; and 3) hedging of currency risk. With bank margins being compressed and lower tier banks seeing a tougher operating environment, we also think that policymakers may become more accommodative towards banking sector consolidation. Monetary policy may also see a change in paradigm as BI may have to play a more central role in extending liquidity and expanding base money; e.g. through its repo facility.

Figure 49. CA deficit more sustainable? Basic balance narrows



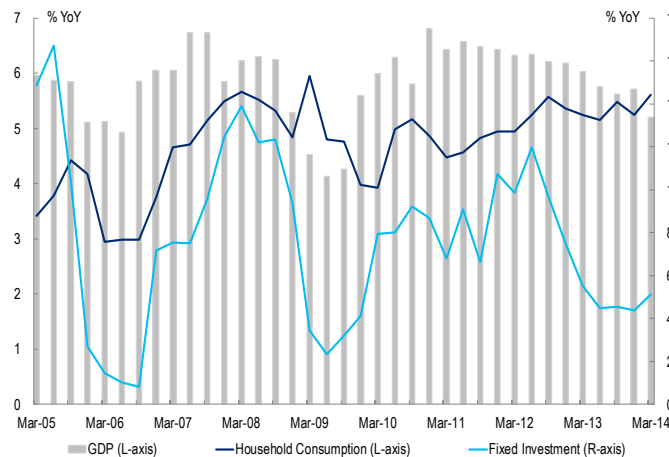
Source: CEIC, Citi Research

Figure 50. But CA deficit improvement not due to rising savings rate



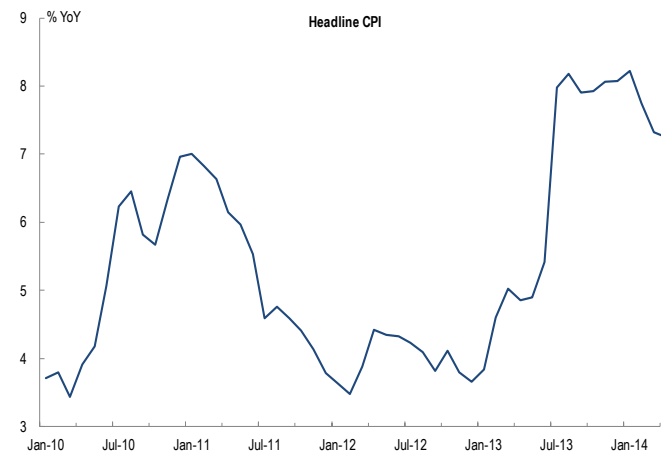
Source: CEIC, Citi Research

Figure 51. Reality of slower growth kicking in



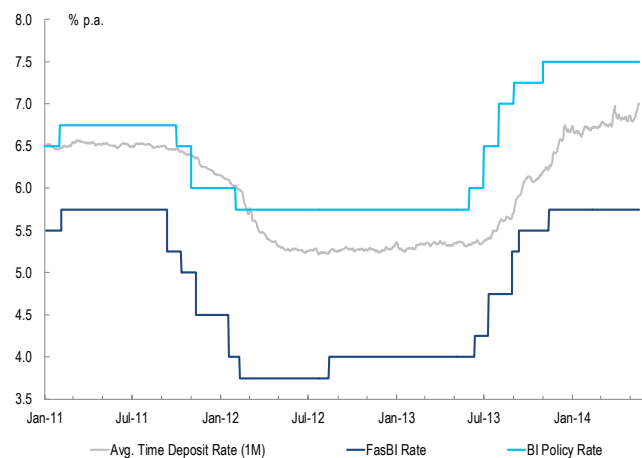
Source: CEIC, Citi Research

Figure 52. YE14 CPI inflation may stick at 7% figure if fuel prices hiked



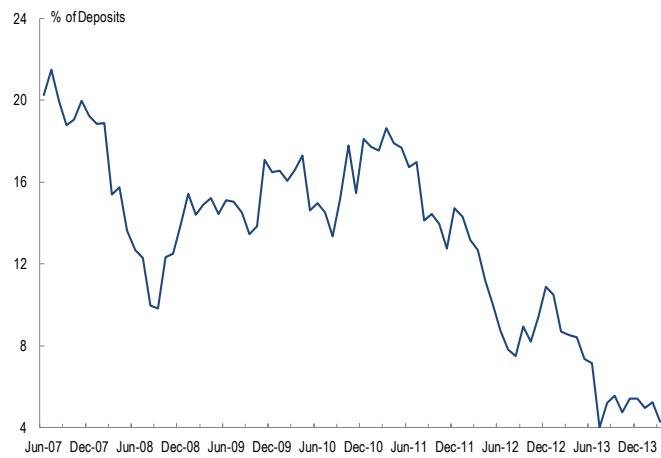
Source: CEIC, Citi Research

Figure 53. TD rates still see upward push though policy rate unmoved



Source: CEIC, Citi Research

Figure 54. The excess liquidity era reaching the end of the road



Source: CEIC, Citi Research

Figure 55. Indonesia Economic Indicators

	2007	2008	2009	2010	2011	2012	2013	2014F	2015F
Summary Data									
Nominal GDP, US\$ bn	432.2	510.7	538.6	709.5	845.4	876.9	868.5	863.8	932.6
Nominal GDP, local currency bn	3,950,893	4,948,688	5,606,203	6,446,852	7,419,187	8,229,439	9,083,972	10,035,224	11,173,188
GDP per capita, US\$	1,915	2,235	2,328	2,986	3,484	3,591	3,510	3,464	3,695
Population, mn	225.6	228.5	231.4	237.6	242.6	244.2	247.4	249.4	252.4
Unemployment, % of labour force	9.1	8.4	7.9	7.1	6.6	5.8	5.8	6.5	6.3
Economic Activity									
Real GDP, % yoy	6.3	6.0	4.6	6.2	6.5	6.3	5.8	5.3	5.5
Real investment growth % yoy	1.9	12.4	2.4	8.8	10.1	16.3	4.9	4.7	6.0
Real consumption growth % yoy	4.9	5.9	6.2	4.1	4.5	4.8	5.2	4.7	3.9
private consumption growth % yoy	5.0	5.3	4.9	4.7	4.7	5.3	5.3	5.1	4.4
Real export growth, % yoy	8.5	9.5	-9.7	15.3	13.6	2.0	5.3	1.1	5.7
Real import growth, % yoy	9.1	10.0	-15.0	17.3	13.3	6.7	1.2	-1.4	3.1
Prices, Money & Credit									
CPI, % yoy	5.8	11.1	2.8	7.0	3.8	3.7	8.1	7.3	4.3
CPI, % avg	6.3	9.9	4.8	5.1	5.3	4.0	6.4	6.5	6.7
Nominal wages, % yoy	4.9	7.6	5.3	12.2	3.4	20.4	11.5	17.1	15.0
Credit extension to private sector, % yoy	22.4	30.7	18.0	20.6	25.9	22.1	18.0	16.0	17.0
Policy interest rate, % eop	3.00	8.75	6.00	5.50	4.50	4.00	5.75	6.00	6.00
Short-term market rate, % eop	3.35	9.44	6.39	5.66	4.57	4.24	6.01	6.00	6.90
Long term yield, % eop	10.02	11.92	10.07	7.83	6.05	5.39	8.60	8.50	8.70
lc/US\$, eop	9,393	10,900	9,425	9,010	9,068	9,638	12,170	11,966	11,890
lc/US\$, avg	9,140	9,673	10,376	9,078	8,763	9,361	10,449	11,617	11,981
Balance of Payments, US\$ bn									
Current account	10.5	0.1	10.6	5.1	1.7	-24.4	-28.5	-20.9	-19.3
% of GDP	2.4	0.0	2.0	0.7	0.2	-2.8	-3.3	-2.4	-2.1
Trade balance	32.8	22.9	30.9	30.6	34.8	8.6	6.2	11.0	13.3
Exports	118.0	139.6	119.6	158.1	200.8	188.5	183.5	190.6	201.9
Imports	85.3	116.7	88.7	127.4	166.0	179.9	177.4	179.6	188.6
Service balance	-11.8	-13.0	-9.7	-9.3	-10.6	-10.3	-11.4	-10.7	-11.1
Income balance	-15.5	-15.2	-15.1	-20.8	-26.7	-26.8	-27.2	-25.4	-26.0
FDI, net	2.3	3.4	2.6	11.1	11.5	13.7	14.8	14.0	14.5
International reserves	56.9	51.6	66.1	96.2	110.1	112.8	99.4	107.9	113.6
Total Amortisations	18.8	16.7	20.4	24.0	25.2	29.4	41.0	42.0	42.0
Public Finances, % of GDP									
Consolidated government balance	-1.3	-0.1	-1.6	-0.7	-1.1	-1.9	-2.2	-2.3	-1.7
Consolidated gov primary balance	0.8	1.7	0.1	0.6	0.1	-0.6	-0.9	-1.0	-0.5
Public debt	34.1	29.3	31.4	26.4	23.6	23.3	23.5	26.0	25.0
of which Domestic	19.7	16.2	19.3	16.7	15.5	16.1	16.2	15.6	16.0
Foreign Assets & Liabilities, US\$ bn									
External debt	141.2	155.1	172.9	202.4	225.4	252.4	264.1	280.0	302.4
Private	60.6	68.5	73.6	83.8	106.7	126.2	140.5	150.5	166.9
Public	80.6	86.6	99.3	118.6	118.6	126.1	123.5	129.5	135.5
External debt / GDP	32.7	30.4	32.1	28.5	26.7	28.8	30.4	32.4	32.4
External debt / XGS	108.2	100.1	130.2	115.8	101.8	119.3	128.1	129.9	132.7
Short-term debt	18.7	20.5	24.0	31.6	36.6	43.4	46.6	46.0	49.0
Short-term debt/International Reserves (%)	32.8	39.7	36.4	32.8	33.2	38.4	46.9	42.6	43.1
Quarterly Economic Indicators									
	2013 Q4	2014 Q1	2014 Q2F	2014 Q3F	2014 Q4F	2015 Q1F	2015 Q2F	2015 Q3F	2015 Q4F
GDP, % yoy	5.7	5.2	5.2	5.3	5.3	5.4	5.3	5.6	5.6
CPI, % yoy	8.1	7.3	6.9	4.8	7.3	7.0	7.2	7.0	4.3
Policy interest rate, % eop	5.75	5.75	5.75	5.75	6.00	6.00	6.00	6.00	6.00
Short-term market rate, % eop	6.01	5.86	5.90	6.00	6.00	6.00	6.00	6.00	6.00
Long term yield, % eop	8.60	8.21	8.25	8.40	8.50	8.60	8.70	8.70	8.70
lc vs USD, eop	12,170	11,360	11,440	11,703	11,966	12,072	12,012	11,951	11,890

Source: CEIC Data Company Ltd, Fitch, IFS, Moody's and Citi Research estimates

*Note: Public debt is central government debt and external debt is based on the residency of the holder of the debt (not by currency denomination). We refer to the FasBI rate to better reflect actual money market rates for Indonesia's policy rate.

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Malaysia

- **Summary view** – The upside surprise in 1Q GDP, including private consumption coming in above the 7% threshold, leaves little room to further delay rate hikes – more to address financial imbalances than inflation, though negative real rates after GST implementation may necessitate more hikes.
- **Things to watch** – [1] Private consumption growth; [2] improvements in external demand; [3] fuel price hikes and impact on inflation; [4] pervasiveness of inflation; [5] inflation expectations and wage growth; [6] progress on fiscal consolidation; [7] household credit growth; [8] guidance from Gov Zeti on monetary policy.
- **Strategy** – While a strong USD backdrop and heavy foreign positioning in bonds remain a headwind for MYR, this could be offset by an improving CA surplus and tightening bias in monetary policy, which may impute a bear flattening bias to the MGS curve near term.

Upside surprise in 1Q GDP growth...

1Q GDP growth surprised on the upside with acceleration to 6.2%YoY (4Q: 5.1%). Official seasonally adjusted data show 0.8%QoQ SA growth (4Q: 1.9%), or 3.3%QoQ SAAR (4Q: 7.6%). The acceleration in gross exports helped net export contribution turn positive even as the drag from inventories widened. Meanwhile domestic demand surprisingly accelerated, boosted by public consumption which surged 23.2%QoQ SAAR (4Q: -3.4%) due to supplies and services. Private consumption growth notably remained above 7%YoY (1Q: 7.1%, 4Q: 7.4%) – against BNM's previous expectations of a moderation toward its long-term average of 6.6% – with a 6.8%QoQ SAAR increase (4Q: -0.8%). Fixed investments also surged 12.4%QoQ SAAR (4Q: -7%) – our estimates suggest more due to public than private investments. By sector, the sequential pick-up was led by construction (1Q: 53.5%QoQ SAAR, 4Q: 12.1%) and agriculture (1Q: 9.6%, 4Q: 5.4%).

Positive net exports were mirrored in a wider 1Q CA surplus of RM19.8bn, 7.7% of GDP (4Q: RM14.8bn, 5.6%). The improvement was led by a narrowing of the services deficit (1Q: -RM2.7bn, 4Q: -RM4.1bn) as well as the primary income deficit (1Q: -RM6.4bn, 4Q: -RM10.0bn), even as the goods surplus widened marginally to RM33.6bn (4Q: 33.3bn). Meanwhile, direct investments saw net outflows (1Q: -RM14.6bn, 4Q: RM4.0bn), reflecting a tripling of ODI while inward FDI halved. The basic balance (CA+net DI) thus saw its surplus narrow to RM5.2bn or 2% of GDP (4Q: RM18.8bn, 7.1%). Net portfolio outflows accelerated to RM13.4bn (4Q: RM769mn), though partly offset by slower net outflows in other investments – the financial account deficit thus widened to RM37.6bn (4Q: RM9.7bn).

However the external debt reclassification leaves reserve coverage less favorable vs ASEAN. The new definition includes non-resident holdings of MYR-denominated debt securities, non-resident deposits, trade credits provided by foreign trade counterparts, and other debt liabilities in line with international standards. This would result in external debt coming in at 65.2% of GDP vs 30.5% previously. BNM's calculation of reserve coverage, i.e. reserve to ST external debt ratio, comes in at just 1.3 (previous definition: 3.3), which we estimate does not fare so well on a relative basis against the rest of the ASEAN-5, though this measure does not take into account Malaysia's current account surplus. Nonetheless this is not new information – we have highlighted this in [previous reports](#).

...leaves little room to further delay rate hikes

We raised our 2014 and 2015 GDP growth forecasts to 5.4% and 5.6% respectively (prev: 5%, 5%). While the Composite Leading Indicator hints at some moderation in domestic demand in subsequent quarters, some front-loading of consumer spending in late 2014/early 2015 is likely ahead of GST implementation, as the experience of Japan and Singapore suggest. Meanwhile exports could be further supported as the US shakes off the worst of the 1Q14 winter chill, even if the sensitivity of Malaysia's exports to US domestic demand has fallen, possibly reflecting the failure of tech capex to pick up thus far. Healthy G3 demand should also help support Malaysia's exports of intermediate goods to China meant ultimately to the G3 and provide a cushion against the slowdown in China.

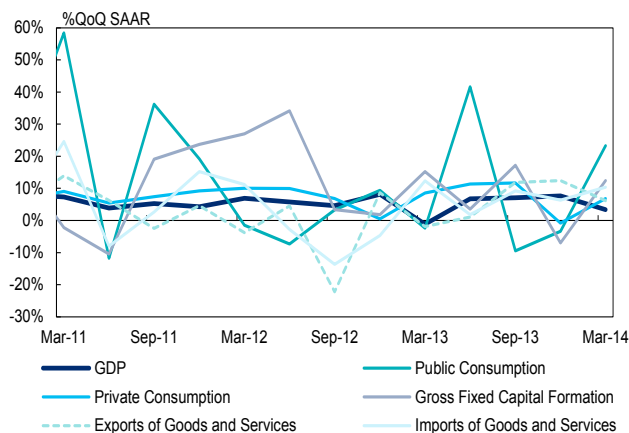
1Q intermediate good imports point to improving manufacturing output.

Despite two straight months of sequential decline, we estimate average 1Q14 seasonally-adjusted imports of intermediate goods were still 1.2% above 4Q13 levels, likely reflecting restocking by exporters catching up with improving external demand which could foreshadow further strength in exports, as was the case in 1H13. We note that the surge in manufacturing sales growth continued to outstrip IP growth into Mar, suggesting production still has not caught up with demand, with inventories consequently drawn down, reflected in the inventory drag to 1Q GDP.

With private consumption growth exceeding the 7% threshold, there is little room to further delay rate hikes. We had previously argued that with [inflation still manageable for now](#), financial imbalances may be the larger consideration for the interest rate outlook – our conversations with policymakers suggest that while targeted macroprudential measures have tackled pockets of imbalances, an improving growth outlook could spur excessive risk taking amidst negative real interest rates – which could prompt a re-assessment of the policy rate outlook. The latest MPC statement now confirms that “there are signs of the continued build-up of financial imbalances” and that “current monetary and financial conditions could lead to a broader build up in economic and financial imbalances”. With the MPC thus concluding that “the degree of monetary accommodation may need to be adjusted”, we confirm our call for an initial 25bps hike in July, which could possibly follow a 20sen/litre fuel price hike, with a second 25bps hike in Sep, but do not rule out further hikes thereafter. We note that prior to the last OPR hike in May 2011, the MPC likewise signaled in the Mar-11 meeting that “the degree of monetary accommodation may be reviewed”.

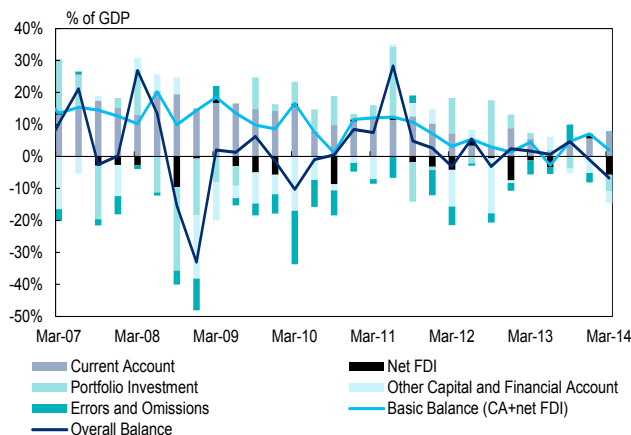
Inflation less of a concern for now – but may keep real rates in negative territory after GST. Headline inflation remained stable into Mar at 3.5%YoY, though excluding food, alcoholic beverages and tobacco, transport, and electricity, our estimate of core inflation edged up to 2.1%YoY (Feb: 2.0%). Nonetheless there are signs that inflation became less pervasive – our inflation diffusion index suggests that the share of the CPI basket seeing MoM price increases declined into Mar, while our proxy for BNM's inflation pervasiveness index indicates that a slightly smaller (unweighted) proportion of the CPI basket is now seeing above-2% inflation. But with inflation possibly climbing to 4.5% in 2015 on GST implementation and fuel price hikes amidst strong growth, the extent to which further hikes may be required to arrest the slide in real interest rates into negative territory remains to be seen.

Figure 56. Domestic demand surprisingly accelerated in 1Q14



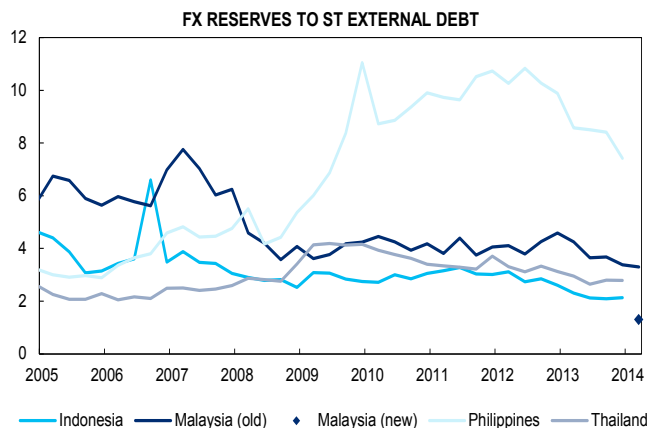
Source: CEIC, Citi Research

Figure 57. Positive net exports were mirrored in a wider 1Q CA surplus



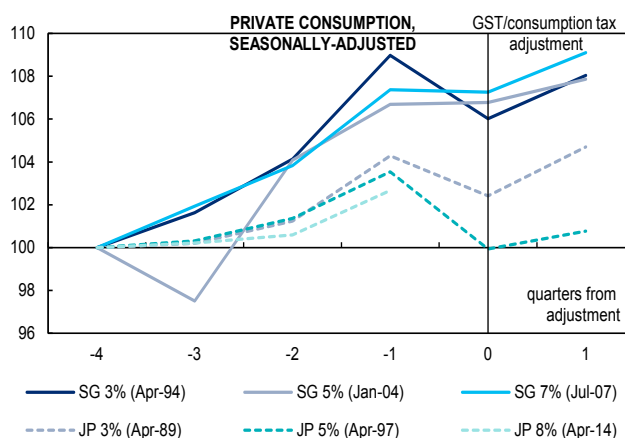
Source: CEIC, Citi Research

Figure 58. The new reserve to ST external debt ratio comes in at just 1.3



Source: CEIC, Citi Research

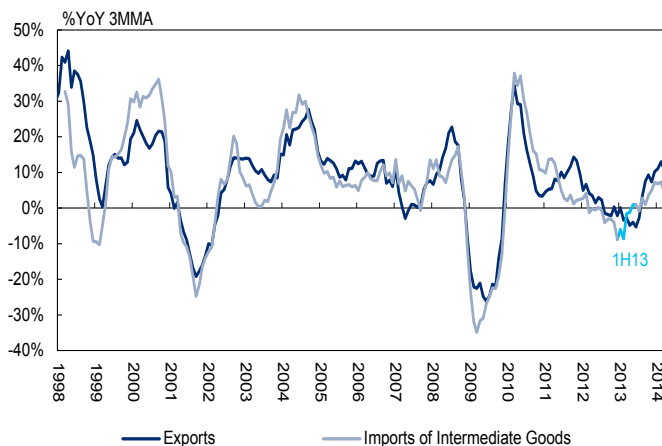
Figure 59. GST implementation could spur front-loaded consumption



Note: We show seasonally-adj. private consumption levels indexed to 4Q before the implementation/hiking of GST (in SG) and consumption tax (JP).

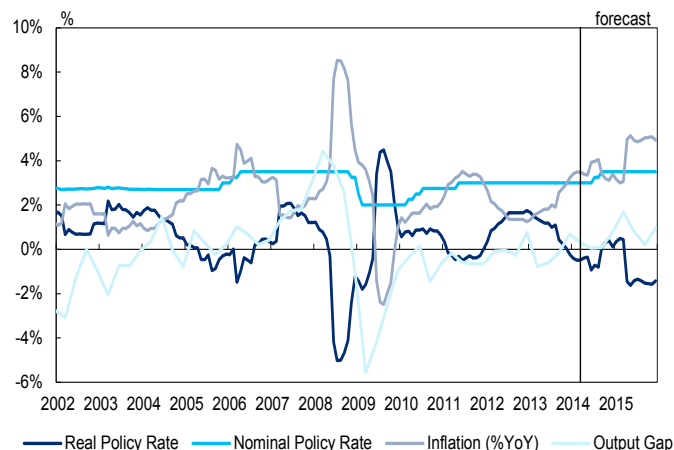
Source: CEIC, Citi Research

Figure 60. Intermediate good imports point to improving mfg output



Source: CEIC, Citi Research

Figure 61. Real interest rates may turn more negative after GST



Note: Prior to April 2004, BNM used the Intervention Rate to affect the Base Lending Rate; however since Apr 2004 it has used the O/N Policy Rate.

Source: CEIC, Citi Research

Figure 62. Malaysia Economic Indicators

	2007	2008	2009	2010	2011	2012	2013	2014F	2015F
Summary Data									
Nominal GDP, US\$ bn	193.7	231.1	202.4	247.7	289.5	305.3	313.3	320.1	333.6
Nominal GDP, local currency bn	665	770	713	797	885	942	987	1,063	1,131
GDP per capita, US\$	7,123	8,393	7,255	8,664	9,997	10,405	10,544	10,495	10,763
Population, mn	27.2	27.5	27.9	28.6	29.0	29.3	29.7	30.5	31.0
Unemployment, % of labour force	3.2	3.3	3.7	3.4	3.1	3.0	3.1	2.9	2.9
Economic Activity									
Real GDP, % yoy	6.3	4.8	-1.5	7.4	5.2	5.6	4.7	5.4	5.6
Real investment growth % yoy	9.1	1.8	-9.4	25.3	2.3	22.3	7.2	-0.9	2.7
Real consumption growth % yoy	9.7	8.4	1.4	6.2	8.6	7.1	7.3	6.4	5.6
private consumption growth % yoy	10.4	8.7	0.6	6.9	6.8	7.7	7.6	6.9	6.3
Real export growth, % yoy	3.8	1.6	-10.9	11.1	4.6	-0.1	-0.3	6.0	7.1
Real import growth, % yoy	5.9	2.3	-12.7	15.6	6.1	4.7	1.9	4.5	6.3
Prices, Money & Credit									
CPI, % yoy	2.3	4.5	1.0	2.1	3.0	1.2	3.2	3.4	4.9
CPI, % avg	2.0	5.4	0.6	1.7	3.2	1.6	2.1	3.5	4.5
Nominal wages, % yoy	4.3	4.5	2.5	8.2	3.8	6.4	7.8	5.0	5.0
Credit extension to private sector, % yoy	9.2	10.2	6.8	10.6	12.5	12.1	11.0	11.0	11.0
Policy interest rate, % eop	3.50	3.25	2.00	2.75	3.00	3.00	3.00	3.50	3.50
Short-term market rate, % eop	3.61	3.37	2.17	2.98	3.22	3.21	3.32	3.80	3.80
Long term yield, % eop	3.78	3.00	3.79	3.39	3.23	3.24	3.66	4.00	4.00
lc/US\$, eop	3.31	3.45	3.42	3.08	3.17	3.06	3.28	3.38	3.38
lc/US\$, avg	3.44	3.33	3.52	3.22	3.06	3.09	3.15	3.32	3.39
Balance of Payments, US\$ bn									
Current account	29.7	39.4	31.4	27.1	33.5	17.6	12.7	14.1	13.3
% of GDP	15.4	17.1	15.5	10.9	11.6	5.8	4.0	4.4	4.0
Trade balance	38.1	51.1	39.8	42.5	49.6	40.6	34.4	34.0	35.0
Exports	176.5	198.9	157.0	199.2	228.8	222.3	215.6	257.4	265.0
Imports	138.5	147.7	117.1	156.7	179.2	181.8	181.3	223.4	230.0
Service balance	0.4	0.5	1.2	-0.4	-2.1	-5.3	-5.3	-3.8	-3.0
Income balance	-8.7	-12.2	-9.6	-15.0	-14.0	-17.7	-16.4	-16.1	-18.7
FDI, net	-2.7	-7.8	-6.3	-4.3	-3.1	-7.9	-1.7	-3.0	-1.0
International reserves	101.3	91.5	96.7	106.5	133.6	139.7	134.9	135.0	140.0
Total Amortisations	7.8	6.3	9.8	11.3	9.0	7.4	10.0	11.0	12.0
Public Finances, % of GDP									
Consolidated government balance	-3.1	-4.6	-6.7	-5.4	-4.8	-4.5	-3.9	-3.5	-3.0
Consolidated gov primary balance	-1.2	-3.0	-4.7	-3.5	-2.8	-2.4	-1.8	-1.3	-0.9
Public debt	40.1	39.8	50.8	51.1	51.5	53.3	54.7	55.0	55.0
of which Domestic	37.1	37.2	48.9	49.0	49.5	51.5	53.0	53.5	53.5
Foreign Assets & Liabilities, US\$ bn									
External debt	56.2	66.6	68.3	72.6	81.5	82.8	97.9	97.0	96.0
Private	37.8	41.5	41.9	44.7	53.7	55.6	69.2	67.0	67.0
Public	18.4	25.2	26.3	27.9	27.8	27.1	28.7	30.0	29.0
External debt / GDP	29.0	28.8	33.7	29.3	28.1	27.1	31.2	30.3	28.8
External debt / XGS	27.4	29.0	36.9	31.4	30.7	31.8	38.3	32.7	31.4
Short-term debt	16.3	22.5	22.7	25.4	32.8	30.4	39.4	42.0	42.0
Short-term debt/International Reserves (%)	16.1	24.6	23.5	23.8	24.6	21.8	29.2	31.1	30.0
Quarterly Economic Indicators									
	2013 Q4	2014 Q1	2014 Q2F	2014 Q3F	2014 Q4F	2015 Q1F	2015 Q2F	2015 Q3F	2015 Q4F
GDP, % yoy	5.1	6.2	5.3	5.7	4.5	6.4	5.8	5.1	5.2
CPI, % yoy	3.2	3.5	3.9	3.4	3.4	3.1	4.9	5.0	4.9
Policy interest rate, % eop	3.00	3.00	3.00	3.50	3.50	3.50	3.50	3.50	3.50
Short-term market rate, % eop	3.32	3.33	3.31	3.80	3.80	3.80	3.80	3.80	3.80
Long term yield, % eop	3.53	3.65	3.80	3.90	4.00	4.10	4.10	4.00	4.00
lc vs USD, eop	3.28	3.26	3.31	3.34	3.38	3.40	3.39	3.39	3.38

Source: CEIC Data Company Ltd, Fitch, IFS, Moody's and Citi Research estimates

*Note: Wage is based on Citi Research estimates of average manufacturing sector wage. Public debt is general government debt and external debt is based on the residency of the holder of the debt (not by currency denomination).

Philippines

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- **Summary view** – We maintain our 1Q14 GDP growth forecast of 6.8%YoY although risk to growth and inflation for duration of 2014 had been elevated by scorching weather that may preview El Niño. Non-farm output expected to drive much of growth. Upbeat credit ratings outlook enhances investment prospects.
- **Things to watch** – Moody's rating action (or inaction) in 3Q. End to bank reserve hike on the back of slower broad money gains. Whether El Niño risk is certain. Fiscal mitigation measures to address supply constraints that include rice imports and its deficit impact. When CPI would peak given rice supply constraints.
- **Strategy** – BSP's intervention down to sub-44 given an upbeat ratings cycle alongside recovery of portfolio flows. Upside food CPI risk also support BSP's preference for a firmer PHP. End of bank reserve hikes bode well for long duration. Prefer the curve's belly with the ratings upgrade and firmer PHP.

Upbeat 1Q GDP but with persistent El Niño downside risk

First quarter economic indicators support our view of 6.8%YoY GDP growth in 1Q14. OFW remittances logged US\$6.1bn in 1Q for growth of 6.6%YoY. We estimate that the corresponding real peso value of these remittances grew 12.3%YoY. With this strong income capacity of remittance households to support basic and discretionary spending, first quarter consumption probably resumed its pace of 6%YoY. Car sales soaring by ~23%YoY in 1Q14 mirrored upbeat consumption and consumer sentiment as well. Meanwhile 1Q exports grew 6.5%YoY following a material correction of 2-digit export gain in Feb. Cash budget rose 12%YoY in 1Q14 with primary expenditures up 14%YoY. Upswing in 1Q fiscal spending left in its wake a strong contribution to 1Q growth. Pace of fiscal expenditures exceeded revenues (9%YoY) despite 1Q Customs revenues up 26%YoY. Between domestic demand and net trade, the former probably underpinned 1Q growth driven by onshore private and public spending.

Fiscal spending slippage in 1Q implies foregone growth opportunities.

Bloomberg reported a 1Q budget deficit short of the program deficit target of Php145.8bn by Php61.7bn. 1Q revenues of Php398bn were 7% below target. Despite upbeat expenditure gains, 1Q disbursements were 16% short of the goal for a Php77bn shortfall that translates to 2.6% of our nominal 1Q GDP forecast. Whether absorptive capacity constraints are in play, underspending implies foregone growth and, as such, 1Q growth of 7% or more from fiscal lift would be difficult to realize.

Risks to growth and inflation in 2014 had been elevated by scorching weather that may be a prelude to El Niño.

Water elevation in a major dam that supplies water to Metro Manila fell to less than critical level due to soaring temperatures forcing water cutoff to irrigation for 27,000 hectares of surrounding rice farm lands. Facing potential El Niño episode this year, growth should be concentrated in non-farm output driven mainly by strong internal demand and favorable exports. Infra spending, up by nearly 50% in Jan-Feb, resilient remittances, strong imports, upbeat durable goods demand, and double-digit bank loan growth are among the indicators supporting and reflecting robust domestic demand. On the back of non-farm output, our 2014 forecast of 6.9% stays. Farm output is vulnerable to weather shocks, suggesting growth in excess of 7% may be tough to beat. During the El Niño episode in 2010, water-dependent key crops, led by rice (-3%), corn (-9.6%), sugar (-21.8%), and pineapples (-1.8%) posted declines that resulted in a 2.6% drop in crop output (50% of total farm output).

Upside food price risk likely to persist

Another El Niño episode would sustain an elevated food inflation risk led by CPI rice (8.9% CPI weight). 2-digits rice inflation remained for the 4th straight month (Apr: 12.1%YoY) as lingering effects of supply constraints due to typhoons in 4Q13 and reduced rice inventory has led to material food price pressures. Our extrapolation of rice inflation easing to a high 1-digit in Sep-Oct would be at risk if El Niño, that may come in 2H14, lowers the average rainfall and cuts local food output. In 2Q10, stable CPI rice running at an average of 1.3%YoY soared to a high of more than 5%YoY in 4Q10 largely due to the El Niño impact. With prevailing CPI rice posting 2-digits, an El Niño episode in 2H14 could extend upside risk of CPI food. Not to mention the risk of supply cutback faced by other cash crops — mainly fruits & vegetables, particularly in the smaller farms heavily dependent on rains.

Rice imports would be key to stabilizing rice CPI while social spending may focus on sagging farmers' incomes. Rice imports buoyed up the national inventory up 22% to 2.18mn mtons (64-days consumption). Current rice inventory and more rice imports would be better poised to either mitigate or offset the price threat of El Nino on farm output. We believe timely rice importation of the National Food Authority (NFA) — a fiscal intervention measure that could contribute more to easing rice inflation than a strong PHP. NFA's cheap rice policy (selling imported rice below market prices) is unlikely to get a lift from a strong PHP.

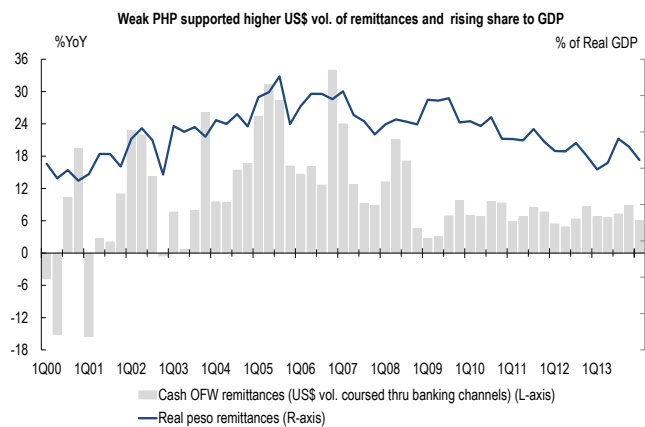
Hawkish bias still in place amid an upbeat rating cycle

No shift in the policy bias appears imminent since the focus is still on excess liquidity although strong PHP implications of an upbeat credit rating cycle may result in benign view of rate actions. The unexpected S&P ratings upgrade (BBB from BBB-) with Moody's on a positive rating outlook, would result in new country weighting adjustments in an investor's portfolio that could unleash offshore inflows into the local markets and give PHP a boost. Prior to the S&P upgrade, portfolio investments turned to net inflows of US\$323mn to reverse net outflows of US\$2.3bn in 1Q14. Upbeat ratings cycle and its PHP impact, the 200bp hike in bank reserves as well as the missing global episode of a strong USD conspire to favor a benign view of policy rate adjustments in 2H14. With CPI's upside risk coming from food supply shocks that may still impact inflation expectations and consumer sentiment as well as willingness to spend, the hawkish bias may not require immediate rate action. Our rate hike call of 50bp in 2H14 or 25bp hike distributed over the last two quarters would still qualify as benign adjustments although timing of the first hike seems a lot more fluid now. Another possible scenario would be to start with the SDA rate to narrow the gap with the policy rate of 3.5% later in the year while delaying policy rate adjustments to 1Q15.

Upbeat ratings cycle, duration risk and rate hike timing

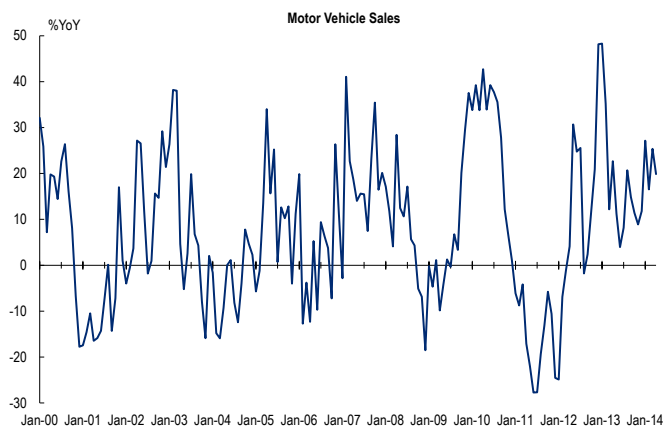
BSP's intervention in the spot market should retreat to sub-44 given an upbeat ratings cycle alongside recovery of portfolio flows positioning for strong macro readings starting with buoyant 1Q GDP. Food inflation risk could extend the run of inflation past 4% and support BSP's willingness to allow a firmer PHP without massively diluting remittance income. End of bank reserve hikes in addressing excess liquidity rather than strong PHP bode well for long duration risk exposure. We prefer the curve's belly with the ratings upgrade and firmer PHP in the near-term while a hawkish bias remains that eventually could lead to rate tightening. With the tightening bias intact, timing of the rate adjustments might be blurred by strong PHP and upside food CPI risk.

Figure 63. 2-digit gains in 1Q for real peso value of remittances



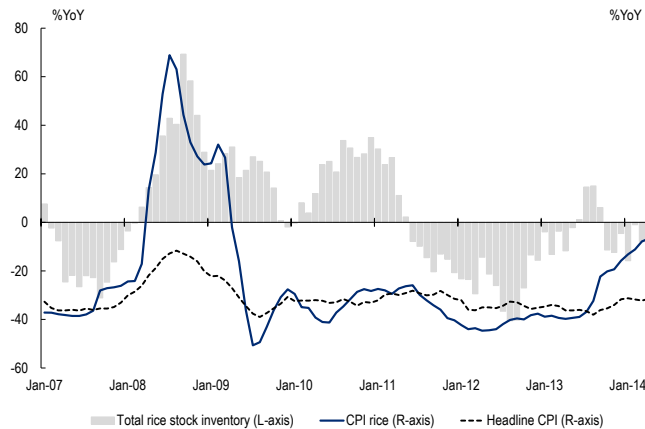
Source: CEIC, Citi Research

Figure 64. Upbeat discretionary spending boosts consumption as well



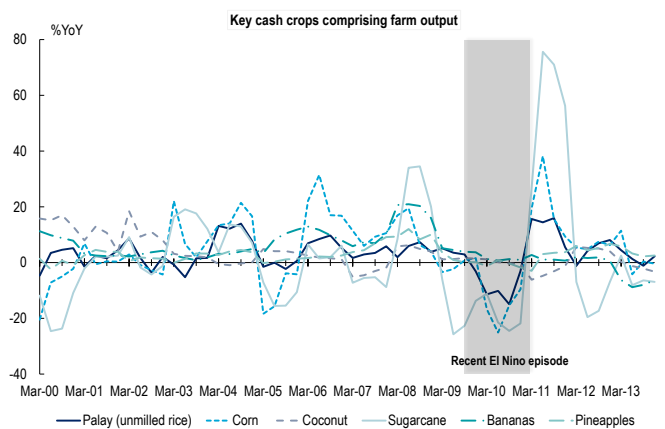
Source: CEIC, Citi Research

Figure 65. Higher rice inventory bode well for stabilizing CPI rice



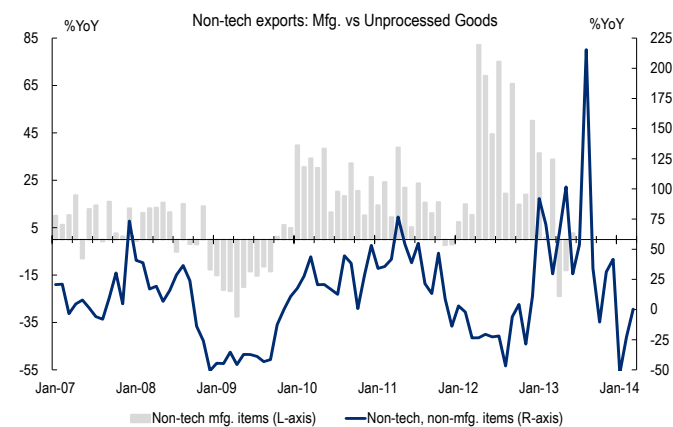
Source: CEIC, Citi Research

Figure 66. Scorching weather may be a prelude to El Niño



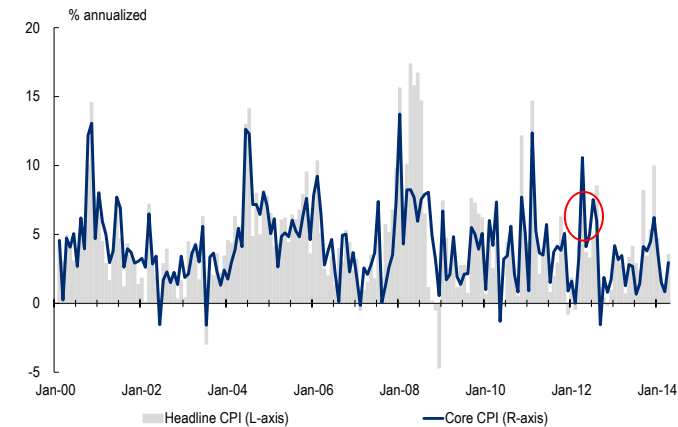
Source: CEIC, Citi Research

Figure 67. Exports of non-tech manufactures did not disappoint in Mar



Source: CEIC, Citi Research

Figure 68. Faster annualized rate of headline and core CPI in Apr



Source: CEIC, Citi Research

Figure 69. Philippines Economic Indicators

	2007	2008	2009	2010	2011	2012	2013	2014F	2015F
Summary Data									
Nominal GDP, US\$ bn	150.2	173.4	168.6	200.0	224.1	250.5	271.9	287.0	348.5
Nominal GDP, local currency bn	6,893	7,721	8,026	9,003	9,706	10,565	11,546	12,849	14,205
GDP per capita, US\$	1,693	1,917	1,829	2,127	2,339	2,567	2,735	2,835	3,380
Population, mn	88.7	90.5	92.2	94.0	95.8	97.6	99.4	101.2	103.1
Unemployment, % of labour force	7.3	7.4	7.5	7.3	7.0	7.0	7.1	6.8	6.5
Economic Activity									
Real GDP, % yoy	6.6	4.2	1.1	7.6	3.6	6.8	7.2	6.9	7.3
Real investment growth % yoy	-0.5	23.4	-8.7	31.6	2.0	-3.2	18.2	10.6	15.0
Real consumption growth % yoy	4.9	3.3	3.3	3.4	5.2	7.3	6.0	6.3	6.2
private consumption growth % yoy	4.6	3.7	2.3	3.4	5.7	6.6	5.6	6.0	6.2
Real export growth, % yoy	6.7	-2.7	-7.8	21.0	-2.8	8.9	0.8	5.3	3.9
Real import growth, % yoy	1.7	1.6	-8.1	22.5	-1.0	5.3	4.3	5.6	4.9
Prices, Money & Credit									
CPI, % yoy	3.9	8.0	4.3	3.6	4.2	3.0	4.1	4.2	3.8
CPI, % avg	2.8	9.3	3.2	4.1	4.7	3.2	2.9	4.1	4.0
Nominal wages, % yoy	3.4	5.5	0.0	5.8	5.4	7.0	2.2	5.0	5.0
Credit extension to private sector, % yoy	10.6	12.8	4.3	13.8	16.2	14.1	10.0	13.5	15.0
Policy interest rate, % eop	5.25	5.50	4.00	4.00	4.50	3.50	3.50	4.00	4.50
Short-term market rate, % eop	6.03	5.20	4.11	0.75	1.68	-1.38	-0.15	2.25	3.25
Long term yield, % eop	5.70	6.55	6.25	4.78	4.21	3.70	2.91	4.00	4.50
lc/US\$, eop	41.23	47.47	46.50	43.65	43.84	41.06	44.39	44.81	43.60
lc/US\$, avg	46.05	44.48	47.56	45.06	43.29	42.22	42.46	44.53	44.21
Balance of Payments, US\$ bn									
Current account	8.1	0.1	8.4	7.2	5.6	7.0	9.4	9.8	10.0
% of GDP	5.4	0.1	5.0	3.6	2.5	2.8	3.5	3.4	2.9
Trade balance	-14.0	-18.6	-13.9	-16.9	-20.4	-18.9	-18.5	-14.4	-15.1
Exports	32.8	34.7	29.1	36.8	38.3	46.4	44.7	51.7	55.5
Imports	46.8	53.3	43.0	53.6	58.7	65.3	63.3	66.0	70.5
Service balance	6.0	2.0	4.9	5.8	6.6	6.2	6.8	3.3	3.4
Income balance	16.1	16.8	17.4	18.3	19.5	19.7	21.1	20.8	21.7
FDI, net	2.5	0.6	-0.2	1.6	0.3	1.0	-0.2	3.0	3.0
International reserves (ex-gold)	33.8	37.6	44.2	62.4	75.3	83.8	83.2	83.5	90.0
Total Amortisations	4.7	7.0	5.7	8.3	6.3	2.7	9.3	9.7	10.0
Public Finances, % of GDP									
Consolidated government balance	-0.2	-0.9	-3.7	-3.5	-2.0	-2.3	-1.4	-1.8	-1.6
Consolidated gov primary balance	3.7	2.6	-0.2	-0.2	0.8	0.7	1.4	1.1	1.1
Public debt	53.9	54.7	54.8	52.4	51.0	51.5	49.2	46.0	45.0
of which Domestic	31.9	31.3	30.8	30.2	29.6	32.8	32.3	30.0	29.5
Foreign Assets & Liabilities, US\$ bn									
External debt	55.5	54.3	54.9	60.0	60.4	60.3	58.5	61.0	63.5
Private	17.5	13.7	11.6	13.9	14.1	15.2	18.0	18.0	18.5
Public	38.0	40.6	43.2	46.2	46.4	45.2	40.5	43.0	45.0
External debt / GDP	36.9	31.3	32.5	30.0	27.0	24.1	21.5	21.3	18.2
External debt / XGS	119.8	113.8	126.9	110.1	105.7	90.3	87.9	84.6	82.6
Short-term debt	7.1	7.0	4.0	6.3	7.0	8.5	11.2	11.1	12.0
Short-term debt/International Reserves (%)	21.0	18.6	9.0	10.1	9.3	10.1	13.5	13.3	13.3
Quarterly Economic Indicators									
	2013 Q4	2014 Q1F	2014 Q2F	2014 Q3F	2014 Q4F	2015 Q1F	2015 Q2F	2015 Q3F	2015 Q4F
GDP, % yoy	6.5	6.8	7.1	6.8	7.0	6.8	7.3	7.5	7.6
CPI, % yoy	4.1	3.9	4.2	4.2	4.2	4.1	4.0	3.9	3.8
Policy interest rate, % eop	3.50	3.50	3.50	3.75	4.00	4.25	4.50	4.50	4.50
Short-term market rate, % eop	-0.15	0.94	1.50	2.00	2.25	2.50	2.75	3.00	3.25
Long term yield, % eop	2.91	3.38	3.75	4.00	4.00	4.25	4.50	4.75	4.50
lc vs USD, eop	44.39	44.76	44.06	44.43	44.81	44.81	44.41	44.01	43.60

Source: CEIC Data Company Ltd, Fitch, IFS, Moody's and Citi Research estimates

*Note: Public debt is central government debt excludes contingent liabilities, and external debt is based on the residency of the holder of the debt (not by currency denomination).

Singapore

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- **Summary view** – 1Q GDP was revised after a rebasing to 2010 prices, but leaves no strong reason to change monetary policy stance for the time being. The revival in Apr primary home sales in response to developer price discounts renders any relaxation of property policies less likely for now.
- **Things to watch** – [1] Near-term export and production momentum; [2] house prices, which could trigger property policy easing; [3] household debt; [4] labour market and core inflation trends; [5] signs of financial stress in the SME sector.
- **Strategy** – MAS intervention could provide some support for the SGD near term, but further out SGD NEER movements should be driven more by broad DXY movements and expected disinflation trends. We remain alert for upward pressures on SOR on tighter banking liquidity and eventual Fed hikes.

1Q GDP reflects the realities of restructuring

1Q GDP was revised to +4.9%YoY, +2.3%QoQ SAAR after the GDP data was rebased to 2010 prices (prev: 2005p) vs Advance Estimates +5.1%YoY, +0.1%QoQ SAAR (4Q: 4.9%YoY, +6.9%QoQ SAAR). Ex biomed, we estimate 1Q GDP was revised to 4.5%YoY, 0%QoQ SAAR (4Q: 5.1%YoY, 6.2%QoQ SAAR). The 1Q sequential expansion appears to be narrowly-based in manufacturing and trade-related activities – and even in the case of manufacturing, our estimates suggest this was more due to biomedical rather than more cyclical segments like electronics which are probably weighed by the stronger REER and labour shortages. The more domestically- and regionally-oriented sectors like construction and restaurants and accommodation also performed more poorly likely due to labour shortages as well as demand weakness – which likely drove greater pessimism amongst firms in the Business Times-UniSIM Business Climate Survey over their business prospects for the next six months – with the exception being the Integrated Resorts, which are reflected in the Other Services. By expenditure, external demand contributed +4.8%pts YoY (4Q: +4.3%pts) while final domestic demand contribution posed a small drag (1Q: -0.2%pt, 4Q: +0.2%pt).

The realities of restructuring are manifesting in NODX underperformance vs regional peers. Labour constraints and a strong SGD have caused manufacturing exports to underperform regional peers even as an improvement in re-exports suggests tradeable services are benefitting from improving regional trade. Upside surprise notwithstanding, exuberance over the 9%MoM SA jump in Apr NODX (which should now be clear of Chinese New Year distortions) has to be tempered by the fact that this was a rebound after the unexpected 8.9% drop in Mar. While there were other bright spots – non-oil retained imports of intermediate goods (NORI) surged 11.3%MoM SA (Mar: -1.2%) bringing Apr seasonally-adjusted levels 6.2% above 1Q14 levels – NODX appears to have yet to break out of the choppy profile that has characterized the last 2-3 years, with seasonally-adjusted levels seesawing between expansion and decline each month since 4Q13. Despite the improvement in external demand reflected in the pick-up in NORX since Dec, the choppy and at best flattish NODX continues to suggest that the domestic manufacturing sector is underperforming regional peers, especially in tech. While the NODX data is unlikely to sway monetary policy decisions in the near term, it indicates the toll that economic restructuring and possibly the strong SGD has taken on the manufacturing demand thus far.

Going forward, recent data is consistent with a moderate if somewhat patchy expansion. [1] The Composite Leading indicator – which leads GDP by one quarter – fell into sequential decline (1Q: -2%QoQ, 4Q: +0.6%); [2] EDB's Survey of Business Expectations for Biomedicals Output shows a sequential increase in 2Q with a net 28% of manufacturers expecting to raise output; [3] the rise in Apr domestic PMI new orders to inventories ratio suggests possible production increases for re-stocking; [4] Apr seasonally-adjusted NODX and NORX levels are 4.7% and 2.6% above average 1Q14 levels respectively.

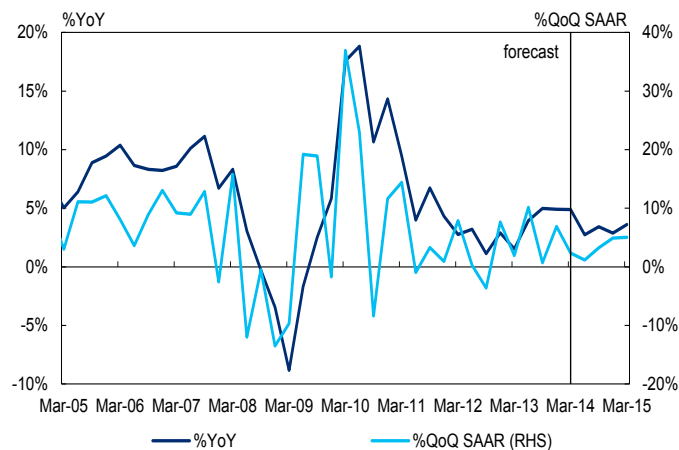
Any relaxation of property policies is less likely for now after private home sales surged to 745 units in Apr (Mar: 480) – the highest since Nov – in response to developer price discounts, revealing still present underlying demand. Singapore Real Estate Exchange flash estimates showed Apr resale prices of non-landed private homes falling 1.7% to a 16-month low while HDB flat resale prices edged down just 0.2% but saw a 4.4% increase in volumes to the highest since Jul. Applications for the Special CPF Housing Grant for the purchase of HDB flats have also surged after it was extended to middle-income households in Aug, with 2320 households receiving the grant in 1Q14 vs 1243 in 2013. Nonetheless even if property policies are relaxed in 2015, the impending spike in completions till 2016 rules out any sustained rebound.

High hurdle to changes in MAS policy

MAS sees a risk that core inflation breaches the 2-2.5% implicit tolerance threshold, given the still tight labour market. With growth likely to fall in the upper half of the official forecast range, we see the positive output gap persisting. The labour market remains tight, with the 1Q14 unemployment rate still low despite rising to 2.1% s.a. (4Q13: 1.8%), especially with the ratio of job vacancies to unemployed persons (a measure of demand-supply balance in the labour market) at 1.44 as of 4Q (3Q: 1.41) – an all-time high since 1997. 1Q ULC growth edged down to 1.4% YoY (4Q: 1.5%), helped by a marginal increase in labour productivity growth (1Q: 0.9%, 4Q: 0.8%), which could hint at continued but slowing cost pressures. Indications are that the labour market will remain consistently tight given relatively stable hiring intentions indicated in the recent Manpower Inc. survey (2Q14 net employment outlook: +18%, 1Q: +16%) and the tightening in foreign worker supply forcing firms to further draw down the resident labour force.

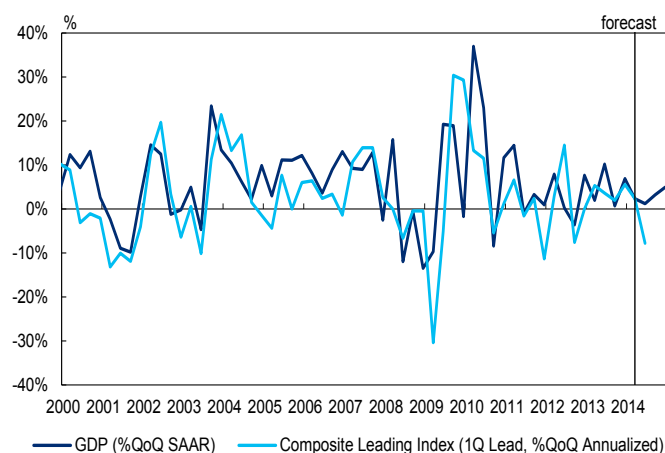
We see the MAS core, rather than headline, inflation forecast as an indication of policy bias. Should inflation data and pipeline pressures suggest a risk that MAS' implicit 2-2.5% core inflation tolerance threshold is breached, we would not rule out a slope steepening to the "new normal" slope of 3% at some stage, though this is not our base case for now – MAS views the current policy stance as "appropriate" for ensuring medium-term price stability as the basis for sustainable growth. Headline disinflationary forces on the other hand will likely be welcomed after the recent years of high inflation – we maintain our 2014 headline inflation forecast of 1.8% as the correcting housing market and caps in car price increases from higher COE supply gather steam, on top of disinflationary forces from lower industrial and commercial rentals as well as the strong SGD and household deleveraging curbing demand-pull pressures.

Figure 70. 1Q GDP was revised to +4.9%YoY, +2.3%QoQ SAAR



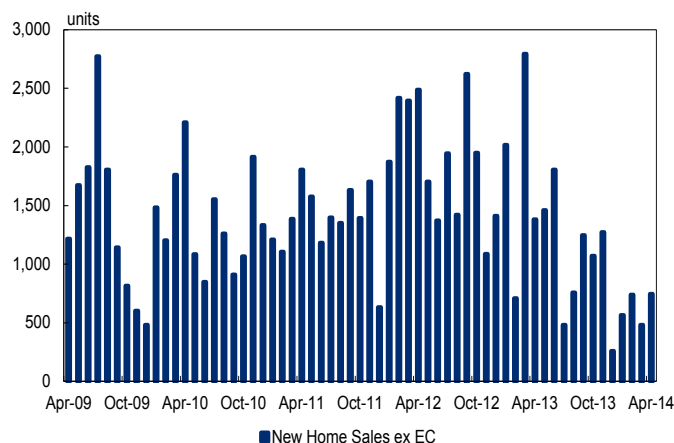
Source: CEIC, Citi Research

Figure 72. CLI fell into sequential decline



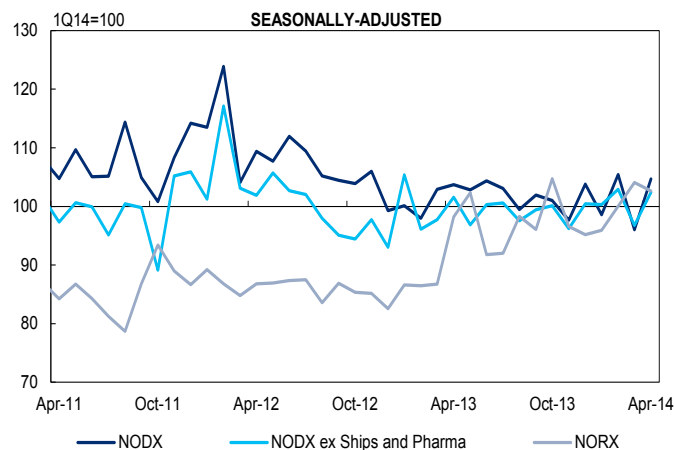
Source: CEIC, Citi Research

Figure 74. Private home sales surged to 745 units in Apr



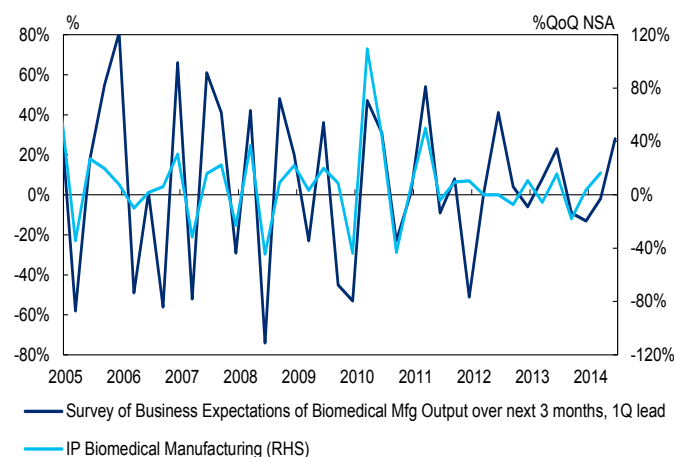
Source: URA, Business Times, Citi Research

Figure 71. NODX appears to have yet to break out of the choppy profile



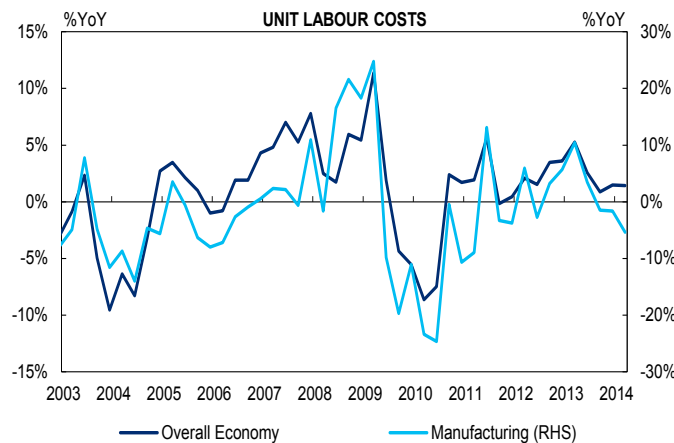
Source: IE Singapore, CEIC, Citi Research

Figure 73. EDB survey shows a sequential increase in 2Q biomedical



Source: CEIC, Citi Research

Figure 75. 1Q ULC growth edged down to 1.4%YoY



Source: CEIC, Citi Research

Figure 76. Singapore Economic Indicators

	2007	2008	2009	2010	2011	2012	2013	2014F	2015F
Summary Data									
Nominal GDP, US\$ bn	180.3	192.5	193.0	236.9	274.3	287.2	298.0	343.1	371.2
Nominal GDP, local currency mn	271	272	280	322	345	359	373	432	468
GDP per capita, US\$	39,287	39,772	38,694	46,671	52,908	54,058	55,199	62,386	66,283
Population, mn	4.6	4.8	5.0	5.1	5.2	5.3	5.4	5.5	5.6
Unemployment, % of labour force	2.1	2.3	3.0	2.2	2.0	1.9	1.9	1.8	1.8
Economic Activity									
Real GDP, % yoy	9.1	1.8	-0.6	15.2	6.1	2.5	3.9	3.5	4.0
Real investment growth % yoy	12.1	29.6	-11.3	24.4	4.3	14.9	-2.2	3.9	1.5
Real consumption growth % yoy	5.4	4.0	0.0	6.9	3.1	3.1	4.1	-0.1	-1.0
private consumption growth % yoy	6.1	3.5	-1.1	5.9	4.3	3.9	2.6	1.6	-0.8
Real export growth, % yoy	8.6	4.6	-7.5	17.4	4.6	1.5	3.6	4.4	4.0
Real import growth, % yoy	7.4	10.0	-10.4	16.2	3.2	3.1	3.1	3.8	2.4
Prices, Money & Credit									
CPI, % yoy	3.7	5.5	-0.5	4.6	5.5	4.3	1.5	1.4	1.4
CPI, % avg	2.1	6.6	0.6	2.8	5.2	4.6	2.4	1.8	1.3
Nominal wages, % yoy	6.2	5.4	-2.7	5.6	6.0	2.3	4.3	5.0	5.0
Credit extension to private sector, % yoy	16.6	14.8	3.1	13.6	19.9	13.9	12.0	10.0	8.0
Short-term market rate, % eop	2.38	1.00	0.69	0.44	0.38	0.38	0.40	0.40	0.80
Long term yield, % eop	2.68	2.05	2.66	2.71	1.63	1.30	2.56	3.00	3.20
lc/US\$, eop	1.44	1.43	1.41	1.28	1.30	1.22	1.26	1.26	1.26
lc/US\$, avg	1.51	1.41	1.45	1.36	1.26	1.25	1.25	1.26	1.26
Balance of Payments, US\$ bn									
Current account	46.8	27.7	32.4	56.0	62.6	50.2	54.6	61.8	66.8
% of GDP	25.9	14.4	16.8	23.6	22.8	17.5	18.3	18.0	18.0
Trade balance	57.8	41.6	47.6	62.9	69.6	63.5	67.8	65.0	65.0
Exports	312.4	352.9	287.4	370.5	432.0	434.5	437.7	455.0	462.0
Imports	254.6	311.3	239.8	307.6	362.5	371.0	369.9	390.0	397.0
Service balance	-2.3	-1.5	-2.3	-0.4	2.8	0.9	0.8	1.0	2.0
Income balance	-8.7	-12.4	-12.9	-6.5	-9.8	-14.2	-14.0	-4.2	-0.2
FDI, net	10.8	5.4	-2.4	21.7	26.9	47.7	36.8	32.0	32.0
International reserves	163.0	174.2	187.8	225.8	237.7	259.3	273.1	280.0	290.0
Public Finances, % of GDP									
Consolidated government balance	2.8	0.1	-0.3	0.3	1.2	1.7	1.1	-0.3	0.2
Consolidated gov primary balance	2.7	1.1	-0.8	0.2	1.3	2.0	1.3	0.7	0.5
Public debt	86.3	93.9	104.2	99.6	102.7	107.4	104.7	110.0	110.0
of which Domestic	86.3	93.9	104.2	99.6	102.7	107.4	104.7	110.0	110.0
Quarterly Economic Indicators									
	2013 Q4	2014 Q1	2014 Q2F	2014 Q3F	2014 Q4F	2015 Q1F	2015 Q2F	2015 Q3F	2015 Q4F
GDP, % yoy	4.9	4.9	2.7	3.4	2.9	3.6	3.6	4.6	4.1
CPI, % yoy	1.5	1.2	2.6	1.7	1.4	1.4	1.0	1.3	1.5
Short-term market rate, % eop	0.40	0.41	0.40	0.40	0.40	0.45	0.50	0.60	0.80
Long term yield, % eop	2.56	2.49	2.75	2.90	3.00	3.00	3.10	3.20	3.20
lc vs USD, eop	1.26	1.26	1.26	1.26	1.26	1.26	1.26	1.26	1.26

Source: CEIC Data Company Ltd, Fitch, IFS, Moody's and Citi Research estimates

*Note: Public debt is general government debt.

South Korea

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- **Summary view** – Despite recent favorable production and export data, the Sewol ferry sinking incident and slower housing transactions and prices led concerns over a setback in economic recovery. However, the government's preemptive measures seem to offset the impact and thus we maintain our growth forecasts.
- **Things to watch** – KRW has recently appreciated against USD by c6% from its previous peak in the middle of Feb or by c13.6% from the level in the middle of last year. Given recent outperformance and the FX authorities' strong intention to support KRW, we think there is not much room for KRW to strengthen further.
- **Strategy** – With negative output gap likely to maintain this year amidst downside risks to headline inflation, we expect the BoK's monetary stance to stay accommodative, with no change in the policy rate until early next year.

Concerns over a setback in economic recovery grow

Mar IP improved and continued export rebound bodes well. Industrial production (IP) in Mar shifted to expand on sequential terms by 0.9% after two consecutive months of fall, maintaining positive YoY growth at 2.7%. Export rebound continued in Apr at a stronger than expected 9.0%YoY points to a pickup in IP growth in coming months. Export gains in Apr were broad-based across key products, particularly shipbuilding, semiconductors, and autos. By destination, exports to the US, ASEAN, and Japan grew sharply by double digits. However, exports to China grew at a slower pace than in Mar, with continued sluggishness of LCD and petroleum products due to increased domestic supply in China and decline in unit export price. While exports will likely continue to improve, we think the resiliency of export rebound in Apr may be somewhat exaggerated given the rush before the long holiday weekend in early May, and thus expect export growth to be softer in May.

Domestic demand recovery may be delayed. Retail sales and service activities also turned to grow sequentially in Mar, both posting higher YoY growth of 2.1%. While retail sales growth in 1Q14 accelerated to 2.5%YoY from 1.2% in the 4Q13, the risk of delayed recovery has increased with the Sewol ferry sinking tragedy (Apr 16th) as it has discouraged consumer spending and suppressed marketing. Flash numbers of credit card use after the incident showed slowdowns in leisure, restaurant, transportation, and lodging businesses. Moreover, housing market transactions and prices rose at a slower pace after the government announced its plan to collect taxes on lease income, which acted as a disincentive to house buying.

In response, government puts in measures preemptively. In light of slowdown in consumption and service activities after the ferry incident, the government decided to advance its spending in 2Q14 by KRW7.8trn, executing 57% of the annual budget in 1H (vs. the originally planned 55%). The extra spending should support the affected retailers, travel & transportation & lodging businesses, and SMEs, resulting in upside potential to 2Q14 real GDP growth by 0.2%p on a quarter-on-quarter basis. Moreover, fiscal, financial, and taxation measures were announced to be arranged for the affected industries, fishermen, and small-scale businessmen. For example, low interest loans, extensions on loans, special low cost guarantees, and tax payment deferrals will be allowed. In our view, these measures could offset the setback, leaving the impact as temporary, and we maintain economic growth for this year at 3.9%.

BoK remains accommodative but rate cut unlikely

Policy rate unchanged but BoK governor's rhetoric turns hawkish. The BoK governor assessed external risks have eased over the month but domestic risks from the Sewol ferry tragedy have emerged as it could hamper economic recovery. Nevertheless, the policy rate was kept on hold at 2.50% at the May MPC meeting based on the BoK's unchanged view of a continued economic recovery and narrowing negative output gap. To counter negative impact from the ferry incident, the BoK plans an early execution of the unused portion of KRW2.9trn of its Bank Intermediate Lending Support Facility. The governor still sees the current policy rate as accommodative to support economic recovery and believes the chances of a rate hike are greater than a cut when assuming economic growth exceeding potential growth. Despite his hawkish rhetoric and higher inflation likely in 2H14, we expect the BoK to leave the policy rate unchanged this year as inflationary pressures from the demand side are unlikely to materialize amid continued negative output gap. We think the rate hike will begin early next year.

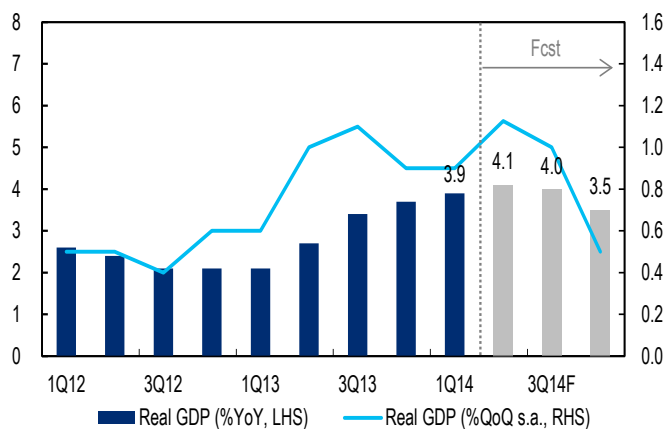
Uptrend in CPI inflation confirmed but downside risk to our forecast. CPI inflation further rose in Apr to 1.5%YoY (Mar: 1.3%) mainly due to the low base of industrial product prices last year and an increase in personal service prices. With deflation of agricultural goods and oils, core CPI inflation rose to 2.3%YoY (Mar: 2.1%). We expect headline inflation to rise to 2.7% in 2H14, led by further increases in service prices and a low base of a year ago. However, we see some downside risks from: 1) expanded free school meals and delayed public tariff hikes, 2) imported manufacturing products given the likelihood of further weakening of raw material demand due to EM growth risks, 3) industries at risk of sluggish domestic demand likely to refrain from price hikes in the near term, and 4) stronger than previously expected KRW against USD lowering import prices.

Strong KRW makes it difficult for exporters to stay competitive

Continued current account surplus amid weak USD led KRW strength. Exporters' rush of USD selling since late Apr before the long holiday weekend in early May had led KRW to appreciate against USD to 1,030 levels. In addition to continued current account surplus and weak USD, foreigners' selling of export stocks on worries about the falling USDKRW drove down the currency further to 1,022.5 on May 7th, the lowest since Aug 7th, 2008 (1,016.5). Though foreigners reversed back to net purchase in the local stock market recently, the currency rate testing 1,020 levels led to verbal intervention by the FX authorities on May 9th, followed by an assumed smoothing operation on the 14th.

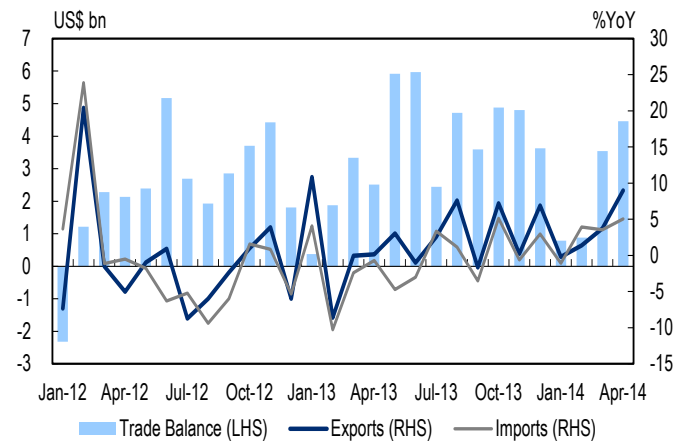
Price competitiveness and profitability of exporters deteriorated. Sharp appreciation of KRW against USD has aggravated the concerns over exporters' price competitiveness and profitability, especially given that the USD is the most favored currency for export settlement (85% of total in 1Q14). The BoK's latest business survey in Apr already showed that manufacturing firms' concerns over the FX rate increased notably amid KRW appreciation. Moreover, according to a survey held during May 8-12 by Korea International Trade Association (KITA), the break-even USDKRW is estimated at 1,045. If the currency rate maintains its recent level near 1,020, 87.1% of the firms cited their exports will fall short of their plans. The FX authorities appeared to defend the 1,020 level actively with verbal or direct intervention. We expect USDKRW at 1,030 over the 0-3 month horizon and, with the end of Fed tapering, at 1,040 for the 6-12 month period.

Figure 77. Recovery likely to continue despite worries over a setback



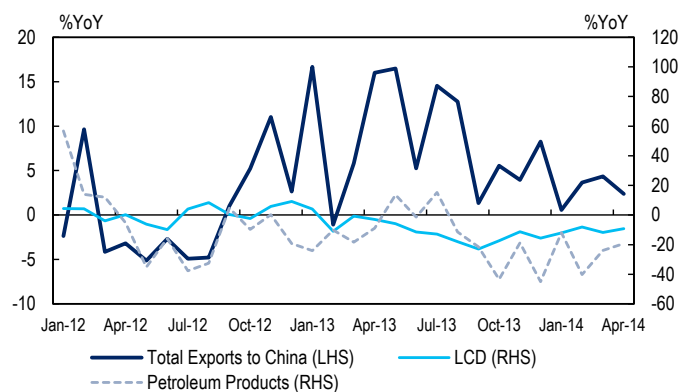
Source: Bank of Korea, Citi Research

Figure 78. Rebound of exports looks favorable to economic recovery



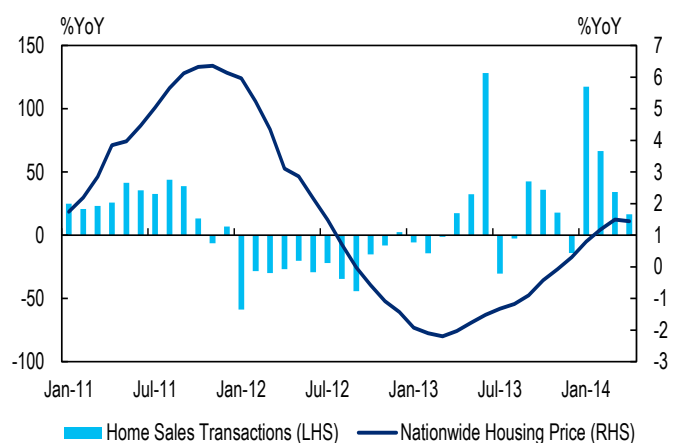
Source: Korea International Trade Association

Figure 79. Export growth to China waned



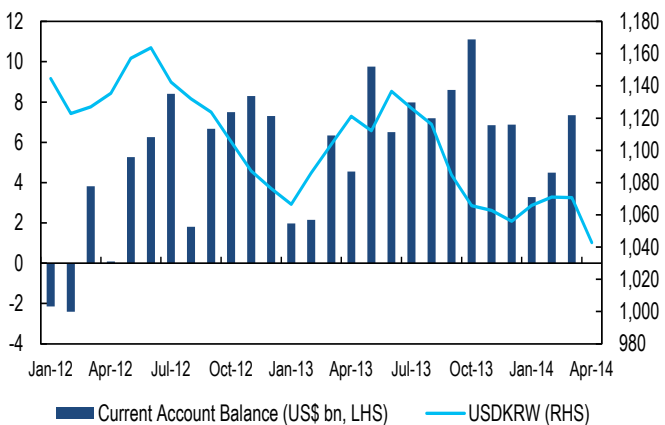
Source: Korea International Trade Association

Figure 80. Growth of housing transactions and price slowed recently



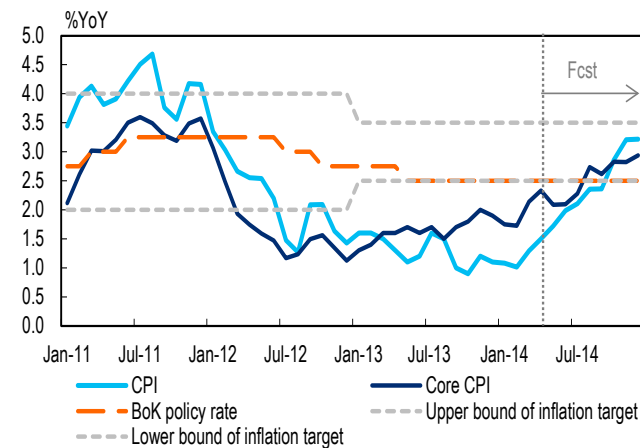
Source: Ministry of Land, Infrastructure and Transport, Korea Appraisal Board

Figure 81. Current account surplus amid USD led KRW appreciation



Source: Bank of Korea

Figure 82. Inflation to rise but policy rate likely to stay accommodative



Source: Bank of Korea, Statistics Korea, Citi Research

Figure 83. Korea Economic Indicators

	2007	2008	2009	2010	2011	2012	2013F	2014F	2015F
Summary Data									
Nominal GDP, US\$ bn	1,121.3	999.7	902.6	1,094.6	1,203.0	1,222.0	1,304.0	1,456.0	1,594.0
Nominal GDP, local currency bn	1,043,258	1,104,492	1,151,708	1,265,308	1,332,681	1,377,457	1,428,295	1,516,883	1,619,556
GDP per capita, US\$	23,073	20,423	18,352	22,153	24,167	24,438	25,966	28,875	31,491
Population, mn	48.6	48.9	49.2	49.4	49.8	50.0	50.2	50.4	50.6
Unemployment, % of labour force	3.2	3.2	3.6	3.7	3.4	3.2	3.1	3.3	3.1
Economic Activity									
Real GDP, % yoy	5.5	2.8	0.7	6.5	3.7	2.3	3.0	3.9	4.0
Real investment growth % yoy	4.5	-1.0	-10.1	17.8	3.5	-2.3	0.0	6.0	5.7
Real consumption growth % yoy	5.3	2.2	1.3	4.3	2.7	2.2	2.2	2.5	3.2
private consumption growth % yoy	5.1	1.4	0.2	4.4	2.9	1.9	2.0	2.7	3.3
Real export growth, % yoy	12.7	7.5	-0.3	12.7	15.1	5.1	4.3	5.9	6.9
Real import growth, % yoy	11.6	3.2	-6.8	17.3	14.3	2.4	1.6	6.3	6.7
Prices, Money & Credit									
CPI, % yoy	3.6	4.1	2.7	3.1	4.2	1.4	1.1	3.2	2.9
CPI, % avg	2.5	4.7	2.8	3.0	4.0	2.2	1.3	2.1	3.1
Nominal wages, % yoy	5.6	-4.1	2.6	6.8	1.0	5.3	3.9	4.8	5.1
Credit extension to private sector, % yoy	12.5	14.9	5.0	4.0	6.5	3.2	4.7	5.7	7.9
Policy interest rate, % eop	5.00	3.00	2.00	2.50	3.25	2.75	2.50	2.50	3.50
Short-term market rate, % eop	5.73	4.68	2.82	2.80	3.55	2.89	2.66	2.75	3.60
Long term yield, % eop	5.78	3.77	4.92	4.08	3.46	2.97	3.23	3.65	4.25
lc/US\$, eop	936	1,263	1,166	1,121	1,159	1,064	1,051	1,038	998
lc/US\$, avg	929	1,102	1,275	1,156	1,108	1,127	1,095	1,042	1,016
Balance of Payments, US\$ bn									
Current account	11.8	3.2	33.6	28.9	18.7	50.8	79.9	56.5	46.7
% of GDP	1.1	0.3	3.7	2.6	1.6	4.2	6.1	3.9	2.9
Trade balance	14.6	-13.3	40.4	41.2	30.8	28.3	44.0	38.7	35.6
Exports	371.5	422.0	363.5	466.4	555.2	547.9	559.6	590.9	642.1
Imports	356.8	435.3	323.1	425.2	524.4	519.6	515.6	552.2	606.5
Service balance	-12.0	-5.7	-6.6	-8.6	-5.8	-5.2	-1.4	-0.8	-1.2
Income balance	-3.4	3.7	1.6	-2.1	0.3	6.6	7.2	0.5	-1.0
FDI, net	-17.9	-16.9	-14.9	-22.2	-16.4	-18.9	-13.1	-8.6	-4.3
International reserves	262.2	201.1	270.0	291.5	304.2	323.2	341.7	377.5	391.5
Total Amortisations	24.5	31.0	30.2	35.7	42.7	43.5	44.3	45.1	46.0
Public Finances, % of GDP									
Consolidated government balance	3.2	1.1	-1.5	1.3	1.4	1.3	1.0	0.9	1.5
Consolidated gov primary balance	4.5	2.4	-0.2	2.6	2.7	2.5	2.3	2.2	2.7
Public debt	27.7	27.0	30.1	29.5	30.2	30.9	32.5	30.7	28.9
of which Domestic	26.7	26.1	29.1	28.7	29.4	30.1	31.7	29.9	28.2
Foreign Assets & Liabilities, US\$ bn									
External debt	333.4	317.4	345.7	359.8	398.7	409.4	416.6	420.5	428.5
Private	279.8	264.9	277.9	280.1	314.7	311.2	312.3	314.6	319.8
Public	53.6	52.5	67.8	79.7	84.0	98.2	104.3	105.9	108.7
External debt / GDP	29.7	31.7	38.3	32.9	33.1	33.5	31.9	28.9	26.9
External debt / XGS	75.0	61.9	79.1	65.0	61.3	62.1	61.8	58.9	55.1
Short-term debt	160.3	149.9	149.2	139.8	137.4	127.2	112.8	104.0	108.0
Short-term debt/International Reserves (%)	61.1	74.5	55.3	48.0	45.2	39.4	33.0	27.5	27.6
Quarterly Economic Indicators									
	2013 Q4	2014 Q1	2014 Q2F	2014 Q3F	2014 Q4F	2015 Q1F	2015 Q2F	2015 Q3F	2015 Q4F
GDP, % yoy	3.7	3.9	4.1	4.0	3.5	3.5	3.5	4.1	5.0
CPI, % yoy	1.1	1.3	2.0	2.4	3.2	3.1	3.3	3.1	2.9
Policy interest rate, % eop	2.50	2.50	2.50	2.50	2.50	2.75	3.00	3.25	3.50
Short-term market rate, % eop	2.66	2.65	2.67	2.68	2.75	2.90	3.10	3.35	3.60
Long term yield, % eop	3.23	3.16	3.49	3.55	3.65	3.75	3.95	4.15	4.25
lc vs USD, eop	1,051	1,065	1,031	1,034	1,038	1,034	1,022	1,010	998

Source: CEIC Data Company Ltd, Fitch, IFS, Moody's and Citi Research estimates

*Note: Public debt is central government debt and external debt is based on the residency of the holder of the debt (not by currency denomination).

Taiwan

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- **Summary view** – April exports and orders data kick start recovery in 2Q, likely leading to manufacturing improvements too. Taiwanese businesses operating in Vietnam suffered severe damages in recent anti-China protests. Fund inflows have supported the equity market and helped ease depreciation.
- **Things to watch** – 1) Cross-strait momentum: Banks M&A, RMB swap line, ECFA for services and goods; 2) Pension reform; 3) 2014's local elections; 4) Liberalization efforts in FEZ; 5) Efforts to kickstart TPP and RECP talks mid-year; 6) 4th nuclear plant referendum; 7) China impacts via exports, financials, RMB and geopolitics.
- **Strategy** – Policy rate likely stable till 2015; 10Y government bond yields likely on a gradual uptrend despite recent jump in global yields. TWD likely to see spurts of depreciation along with the CNH in the near term, but could appreciate mildly over time on macro recovery. Citi's TAIEX 2014 year-end target at 9,300.

April trade related data turning slightly more promising

1Q real GDP (advanced estimates) met expectations at 3.04%yoy, with pretty even improvements noted in both external and domestic demand, contributing 1.47%pt and 1.57%pt, respectively, to GDP. However, overall recovery momentum remains mild, with QoQ SA momentum at 0.27% or 1.07% when annualized.

April exports (+6.2%yoy) and export orders (+8.9%yoy) kick started the recovery trend that we expected in 2Q, as more new tech products are being launched and better demand seen from advanced economies. The diffusion indices (from surveys to manufactures about their export orders outlook for May) rose to 56.7 by value (50 is the expansion threshold), giving some hope for further momentum building in May.

The lingering market concern is whether a managed slowdown in China would derail Taiwan's export recovery for the rest of the year? We are of the view that a China domestic slowdown will take a toll on Taiwan's exports, but it will likely be manageable, as only ~30% of what Taiwan exports to China is being used in China, the remaining ~70% is used for re-exports (by our estimations). Specifically, we think China's domestic slowdown will be more reflected in Taiwan's non-tech exports like commodities, rubber/plastics, chemicals and basic metals, which could be affected by China's commodities glut and investment slowdown. Using April's export orders data by product type and destination breakdown as a reference of China domestic impacts on individual non-tech categories, China orders most of Taiwan's commodities export (44.5%), and similarly for rubber/plastics (35.5%), machineries (28.8%) and basic metals (18.5%). Taiwan also exports other non-tech goods like electric appliances, finished products of textile, prepared foodstuff/beverages and perishable goods to China, but demand for these types of goods are likely more resilient.

Somewhat better macro data and FINI inflows support the TWD, but RMB and therefore TWD depreciation risks still lingering in 0-3M period. USD/TWD drifted higher in the latter half of April, though it has retraced lower since the start of the month, in line with CNY. China's data for April show further macro weakness and reforms could potentially generate negative headline risks, thus we are maintaining our 0-3M USD/CNY call of 6.30. This in turn would subject TWD to another spurt of currency weakness, despite continued inflows in Taiwan's equity market (especially for the tech names) have well supported the currency. In 6-12M time, we expect better Taiwan macro outlook and sizable current account surplus (1Q at US\$15.3bn) should support USD/TWD at around 30.2.

Affected by China-Vietnam territorial conflict

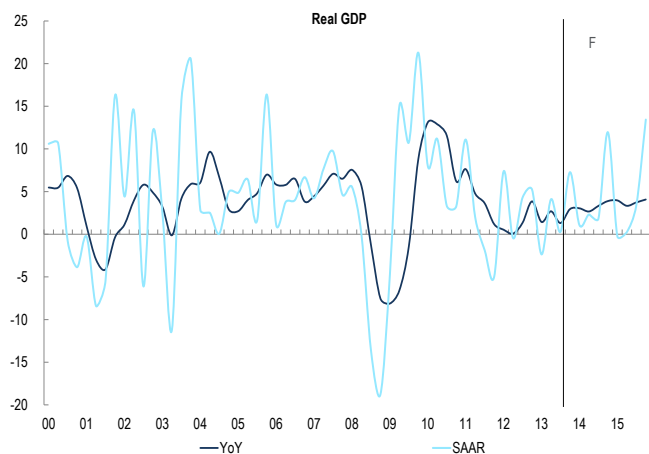
Taiwanese businesses operating in Vietnam suffered severe damages in recent anti-China protests. Placement of a China state-owned gigantic oil rig in disputed waters with Vietnam sparked tensions. Anti-China protests erupted on 13th May, it started outside of the China embassy in Hanoi but spilled over to disruptions in industrial parks where many Taiwanese factories are located and 11 Taiwanese factories were set ablaze. The political standoff doesn't involve Taiwan. According to Ministry Of Economic Affairs, 224 companies were damaged in Vietnam protests and 400 Taiwanese factories suspended operations for safety reasons.

Taiwan cumulated FDI in Vietnam is the fifth largest, at US\$15.6bn since 2001, after Japan, South Korea, Singapore and Malaysia, according to available Vietnam FDI data. Vietnam has been an attractive destination in the eyes of Taiwanese investors since 1991 (before Asian Financial Crisis), with two more waves of Taiwanese investments destined for Vietnam in 2008 and 2013. Looking at Taiwan's approved outward investment statistics, 2012-13 were years where Taiwanese investments may have deliberately been diversified from China to Vietnam (on average ODI to Vietnam grew 95%yoy but to China dropped 19%yoy), likely due to China's more stringent environmental and labor standards in recent years. Large listed and smaller private Taiwanese businesses of various types of non-tech manufacturing have ventured into Vietnam, ranging from food, paper & printing, plastics, textile, garment & apparels, furniture, chemicals, steel, bicycles to home appliances, etc. The entrenched production chains that Taiwanese now have operating in various parts of Vietnam are likely due to Vietnam's low cost of manufacturing, a growing domestic market as well as access to economic blocs (ASEAN, APEC) and countries it has bilateral trade agreements (with Japan, New Zealand, potentially EU by 2015) -- thereby allowing Taiwanese exporters operating in Vietnam to potentially enjoy preferential tariff treatment.

Taiwan will likely have to go through a prolonged process to seek for compensation from Vietnam. The total cost of damage is still being tallied. Vietnam government is stepping up efforts to ensure the safety of foreign investors in the country, as well as mulling over options of reducing or removing land or business taxes, and possibly offering the affected businesses concessional loans or debt relief on overdue loans. Taiwan Government in the meantime is providing emergency loan lines and facilitating loans renegotiation with banks; and for longer term operation purposes, the Government is seeking to expand an investment protection agreement with Vietnam.

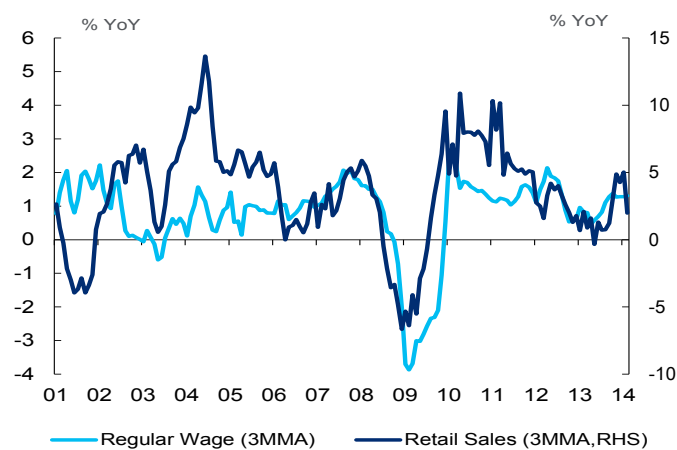
Although some factories are restarting operations despite the geopolitical situation, Taiwanese manufacturers are re-thinking their FDI strategies for the longer run. It does appear to us that there are limited options of nearby countries that can offer such low production costs, hard & soft infrastructure and market access. Other things being equal, on a cost comparison of manufacturing wages across Asia, in 2013, hourly cost in Vietnam is US\$1.52 only, making relocating to China (cost is at US\$3.52) expensive and most likely many manufacturers would have explored this option already. Perhaps selected garment/textile manufacturing could consider Sri Lanka where hourly wages is lower at US\$0.63, but this may not be suitable for all industry types. Some have argued that Taiwan manufacturers in Vietnam should reconsider moving their production chain back to Taiwan, but hourly manufacturing cost of Taiwan (US\$9.23) would make it almost impossible for these non-tech production lines (even if the government were to provide tax incentives and to help locate land). Moreover, if comparing productivity (using output per employed person as proxy for available country data), Vietnam ranks third in the region after China and India.

Figure 84. GDP recovered mildly in 1Q, but could dampen in 2Q



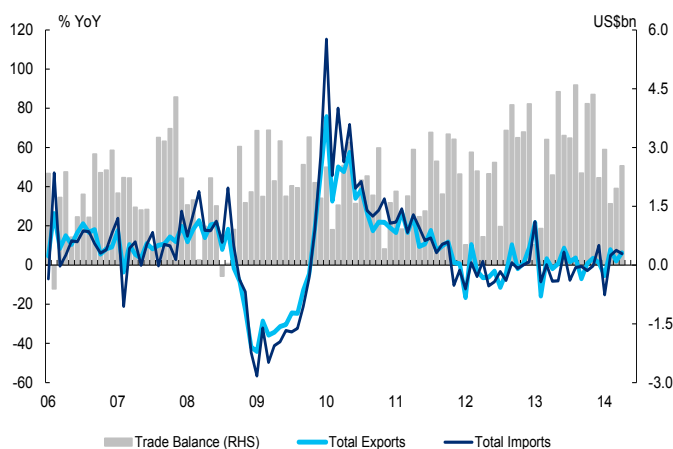
Source: CEIC, Citi Research

Figure 85. Consumption (ex-CNY effects) on a general recovery path



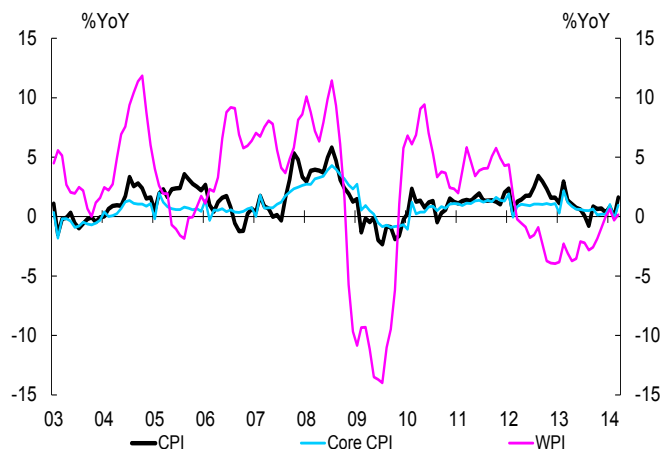
Source: CEIC, Citi Research

Figure 86. Gradual trade recovery likely to step up pace in 2H



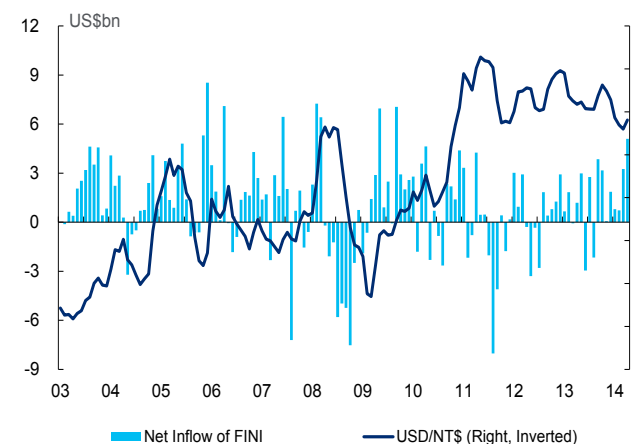
Source: CEIC, Citi Research

Figure 87. Benign inflation gives room for CBC's accommodation



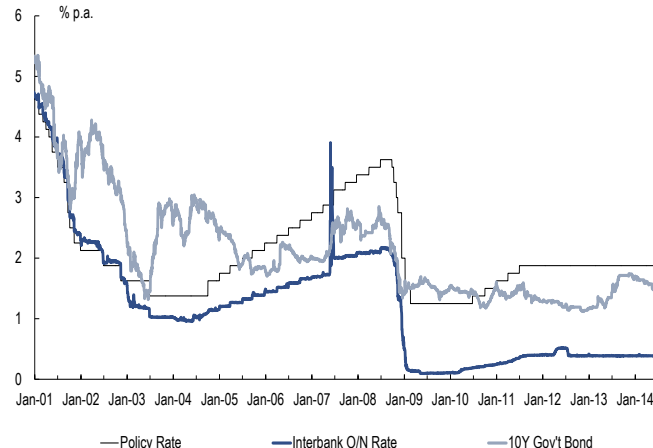
Source: CEIC, Citi Research

Figure 88. FINI inflows continued, pacifying TWD depreciation



Source: CEIC, Citi Research

Figure 89. 10Y gov't bonds could rise again with US tapering



Source: CEIC, Citi Research

Figure 90. Taiwan Economic Indicators

	2007	2008	2009	2010	2011	2012	2013	2014F	2015F
Summary Data									
Nominal GDP, US\$ bn	393.0	400.2	378.0	430.3	466.5	476.3	490.8	500.9	536.6
Nominal GDP, local currency bn	12,911	12,620	12,481	13,552	13,709	14,077	14,564	15,214	16,094
GDP per capita, US\$	17,118	17,370	16,348	18,579	20,084	20,429	20,996	21,388	22,866
Population, mn	23.0	23.0	23.1	23.2	23.2	23.3	23.4	23.4	23.5
Unemployment, % of labour force	3.9	4.1	5.8	5.2	4.4	4.2	4.2	4.0	3.9
Economic Activity									
Real GDP, % yoy	6.0	0.7	-1.8	10.8	4.2	1.5	2.1	3.2	3.8
Real investment growth % yoy	-0.7	-7.9	-21.2	36.8	-6.8	-4.6	3.5	5.0	3.6
Real consumption growth % yoy	2.1	-0.6	1.3	3.3	2.9	1.5	1.4	1.6	2.1
private consumption growth % yoy	2.1	-0.9	0.8	4.0	3.1	1.6	1.8	1.8	2.7
Real export growth, % yoy	9.6	0.9	-8.7	25.6	4.5	0.1	3.8	4.6	6.2
Real import growth, % yoy	3.0	-3.7	-13.1	27.7	-0.5	-2.2	4.0	3.7	5.2
Prices, Money & Credit									
CPI, % yoy	3.3	1.3	-0.2	1.2	2.0	1.6	0.3	2.5	2.8
CPI, % avg	1.8	3.5	-0.9	1.0	1.4	1.9	0.8	1.2	2.0
Nominal wages, % yoy	2.1	-0.1	-5.0	5.3	2.6	0.1	0.2	1.5	3.0
Credit extension to private sector, % yoy	3.9	2.7	-0.8	6.7	5.6	4.1	5.3	7.0	8.5
Policy interest rate, % eop	3.38	2.00	1.25	1.63	1.88	1.88	1.88	1.88	2.38
Short-term market rate, % eop	2.04	1.02	0.57	0.74	0.87	0.87	0.87	0.93	1.17
Long term yield, % eop	2.53	1.44	1.47	1.47	1.27	1.15	1.69	1.66	2.04
lc/US\$, eop	32.43	32.78	32.23	29.17	30.29	29.06	29.83	30.26	29.92
lc/US\$, avg	32.85	31.58	33.04	31.50	29.40	29.57	29.68	30.40	30.04
Balance of Payments, US\$ bn									
Current account	35.2	27.5	42.9	39.9	41.7	50.7	57.4	55.1	54.7
% of GDP	8.9	6.9	11.4	9.3	8.9	10.6	11.7	11.0	10.2
Trade balance	27.4	15.2	29.3	23.4	26.8	30.7	35.5	38.7	51.0
Exports	246.7	255.6	203.7	274.6	308.3	301.2	305.4	320.9	352.0
Imports	219.3	240.4	174.4	251.2	281.4	270.5	269.9	282.2	301.1
Service balance	-1.6	1.8	2.0	2.5	3.9	6.3	10.4	11.6	7.4
Income balance	10.1	10.0	12.5	13.6	13.2	15.3	14.1	17.0	19.0
FDI, net	-3.3	-4.9	-3.1	-9.1	-14.7	-9.9	-10.3	-10.0	-9.0
International reserves	270.3	291.7	348.2	382.0	385.5	403.2	416.8	440.0	460.0
Total Amortisations	3.8	8.8	2.5	3.2	6.8	3.4	2.9	3.0	3.0
Public Finances, % of GDP									
Consolidated government balance	0.9	0.9	-2.2	-1.2	-0.5	-1.4	-1.4	-1.4	-0.8
Consolidated gov primary balance	1.9	1.9	-1.2	-0.3	0.4	-0.5	-0.5	-0.6	-0.5
Public debt	33.3	34.7	38.0	38.3	40.0	40.9	39.9	39.6	39.3
of which Domestic	33.3	34.7	38.0	38.2	40.0	40.8	39.9	39.6	39.3
Foreign Assets & Liabilities, US\$ bn									
External debt	94.5	90.4	82.0	101.6	122.5	130.8	150.0	160.0	150.0
Private	91.1	88.9	76.0	93.5	118.0	127.5	146.3	156.0	146.0
Public	3.5	1.5	5.9	8.0	4.5	3.3	3.7	4.0	4.0
External debt / GDP	24.1	22.6	21.7	23.6	26.3	27.5	30.6	31.9	28.0
External debt / XGS	33.4	30.9	34.7	32.0	34.6	37.4	41.9	43.2	37.0
Short-term debt	83.3	78.8	68.2	83.7	107.8	116.5	125.0	130.0	120.0
Short-term debt/International Reserves (%)	30.8	27.0	19.6	21.9	28.0	28.9	30.0	29.5	26.1
Quarterly Economic Indicators									
	2013 Q4	2014 Q1	2014 Q2F	2014 Q3F	2014 Q4F	2015 Q1F	2015 Q2F	2015 Q3F	2015 Q4F
GDP, % yoy	2.9	3.0	2.7	3.3	3.9	4.0	3.3	3.7	4.1
CPI, % yoy	0.3	1.6	0.6	0.7	2.5	0.9	1.7	2.3	2.8
Policy interest rate, % eop	1.88	1.88	1.88	1.88	1.88	2.00	2.13	2.25	2.38
Short-term market rate, % eop	0.87	0.87	0.87	0.87	0.93	0.99	1.05	1.11	1.17
Long term yield, % eop	1.68	1.56	1.58	1.61	1.66	1.74	1.84	1.94	2.04
lc vs USD, eop	29.83	30.45	30.48	30.37	30.26	30.16	30.08	30.00	29.92

Source: CEIC Data Company Ltd, Fitch, IFS, Moody's and Citi Research estimates

*Note: Public debt is central government debt and external debt is based on the residency of the holder of the debt (not by currency denomination).

Thailand

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- **Summary view** – Amid signs of domestic demand ‘recession’ in 1Q14, we revised our 2014 GDP growth to 0.5%YoY (1.8% previously) and 2015 growth to 2.8% (4.1% previously). Domestic demand fell 1.7%QoQ SA for the 3rd straight quarter underpinned by a streak of at least 3 quarterly declines in private spending.
- **Things to watch** – Military-backed initiative to cobble together an interim, ‘reconciliation’ gov’t. NACC’s findings on the role of ex-PM Yingluck and other cabinet ministers in the rice pledging scheme. Agreement on the new election date. New GDP trajectory and any shift in MPC’s rate bias.
- **Strategy** – MPC dovish bias strengthened by 1Q GDP although missing disinflation risk may not necessarily prompt rate cut signals. Dovish MPC, downside GDP risk and expectations of tighter US monetary conditions would sustain our medium-term forecast for USD/THB at 33.

Signs of 1Q14 domestic demand already in recession

1Q14 GDP fell 0.6%YoY for lower than expected weakness (-2.1%QoQ s.a.). Domestic demand (ex-inv) fell 4.2%YoY in 1Q14 for the 3rd straight quarterly drop. Consumption posted another decline of 3%YoY (Citi: -2%YoY) to record the 3rd straight quarterly decline. Durable goods consumption largely driven by falling demand for transport equipment plunged by 29%YoY, to sustain the drag on private consumption. We believe this resulted from severe savings propensity in response to political uncertainty. Gross domestic savings to GDP soared to a new high of 42.7% in 1Q14 despite lack of significant deterioration in the jobless rate. Ex-durable goods, private consumption grew 3.1%YoY during the period providing the silver lining to the private spending collapse. Real investments (ex-inv) fell 9.8%YoY for a 3rd straight quarterly drop driven by broadening slack and contraction in public investments owing to the protracted crisis. Machinery & equipment investments as well as construction for the 7.3%YoY decline in private investment while public investments fell 19.3%YoY. Government consumption grew 2.9%YoY to buck the private spending downtrend. Net exports expanded by 28.8%YoY in 1Q14 to cushion domestic demand impact. Commodity exports eked out growth of 0.8%YoY but the 12%YoY contraction in real imports facilitated strong net exports roughly contributing >20% of 1Q GDP.

We believe domestic demand is already in recession. This domestic spending measure fell 1.7%QoQ SA for its 3rd straight quarterly decline, giving the impression bulk of GDP is already in a recession. Private consumption declined 0.5%QoQ SA for the 5th straight quarterly drop. Real investments (ex-inv) reported a 1Q decline of 2.8%QoQ SA for the 3rd straight quarterly drop. Severe savings propensity and broadening slack contributed to sustained drag to private spending.

Farm output managed 0.8%YoY gain while non-farm GDP dipped 0.7%YoY in 1Q14. Manufacturing (-2.7%YoY), construction (-12.4%YoY) and utilities (-3.1%YoY) underpinned stagnant non-farm output. Falling tourist arrivals contributed to the 3.1%YoY drop in hotels & restaurant services as this segment posted the heaviest drop in the services sector. On a quarterly basis, farm output fell 1%QoQ SA while non-farm GDP declined by 2.2%QoQ SA in 1Q14. Manufacturing GDP fell by 3.2%QoQ SA to weigh down on 1Q industrial GDP. Capital-intensive mfg industries including automotive posted a hefty drop (-6.1%YoY) in output mainly in response to weak domestic demand. Both private and public construction conspired to lower construction output by 4%QoQ SA. Subdued fiscal disbursements, higher raw material costs, lack of skilled labor, extended crisis and poor investment climate weighed on 1Q construction.

2014 GDP forecast revised lower to 0.5% (1.8% previously)

Extended crisis, absence of a functioning government that could pursue fiscal initiatives as well as public investments, and lackluster export recovery led us to downgrade our forecasts to 0.5% growth in 2014 and 2.8% gain in 2015. Below potential GDP would be the 2yr outlook with 2H15 upside risk to growth likely assuming elections are held late 2014 or early 2015. Government declared martial law recently, creating additional uncertainty although one possibility is that military intervention could cut short the process of cobbling together an 'interim' government as 'back-channeling' may take time while averting potential clash between rallying red shirt and PDRC groups. Whether the military backed government would inspire confidence and reconciliation would depend on the 1) cabinet appointments and 2) political/ economic agenda. Lacking strong exports, assuming tech recovery remains moderate to uncertain, and with durable goods onshore demand unlikely to go through a v-shaped recovery, 2014 growth already looks compromised while in 2015, below potential growth remains a possibility.

Unlikely v-shaped recovery this time

Imminent tech recession risk is not a key issue as far as we are concerned, since we believe domestic demand is already in a 'recession'. A 'reconciliation' government that bodes well for the political outlook may not be able to restore the ability of the fiscal authority to facilitate or contribute to a 'v-shaped' recovery that has been a hallmark of previous economic recoveries. In the past, despite hefty GDP drops owing to external (e.g. 2009 global recession)/internal (e.g. 4Q11 flooding event) shocks, recovery materialized after 1-3 quarters based on GDP's quarterly gains (adj.) and enabled the domestic economy to resume its potential growth pace. This strong capacity to bounce back after strong income shocks offers a testament to Thai economic resilience. While v-shaped recoveries were driven essentially by the private sector, we worry this time around that consumer and business sentiment may take a long while to recover from the current crisis alongside FDI diversion risk. We estimate a share of real investment to GDP of 19.4%, slightly higher than 4Q13 (18.8%). We highlighted earlier that this pattern of sluggish contribution of real investment (ex-inv) to GDP may persist with the protracted crisis and breach downside of 20% which we believe would be the start of a mediocre to bleak investment setting. A falling investment ratio could reflect near-term production slack but also the start of structural investment decay. On a 4-quarter rolling sum, the real investment share to GDP stood at slightly above 21% in 1Q14. The investment ratio hit a high of 23.1% in 2006.

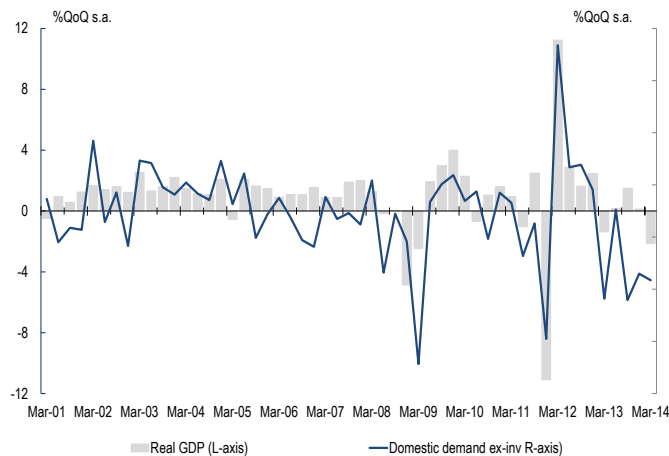
Needing a hefty export upside to drive away recession

To soak up mfg slack and approximate potential growth of 3% or more this year, a major export rebound is required in our view. In our sensitivity test, external demand has to generate commodity export gains (forget tourism for now) of close to 10% in 2Q14 rising to 15% in 4Q14. Even if we incorporate an export lift to import volume, net export contribution could elevate to 19%-21% of GDP in 2H14. This modest 2-digit export gain has been attained in the past but recent regional demand (Asian exJ) doesn't signal any upbeat export recovery soon.

Awaiting MPC signals amid THB expected at 33

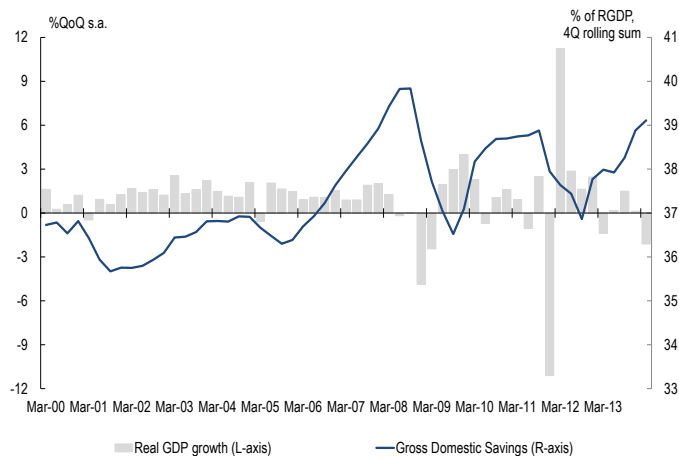
Despite signs of demand recession, disinflation remains missing. Core CPI peaking and BoT's GDP forecast downgrade may signal likely shifts in the policy rate bias currently stuck at 2%. GDP deflator consistent with headline CPI rose to 1.8%YoY in 1Q14. Dovish MPC, downside GDP risk and expectations of tighter US monetary conditions sustain our medium-term forecast for USD/THB at 33.

Figure 91. Domestic demand already likely in recession in 1Q14



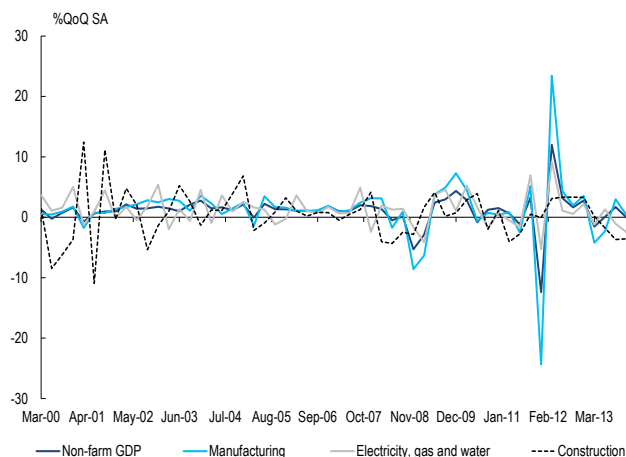
Source: CEIC, Citi Research

Figure 92. Savings ratio soars to 42.7% amid significant job losses



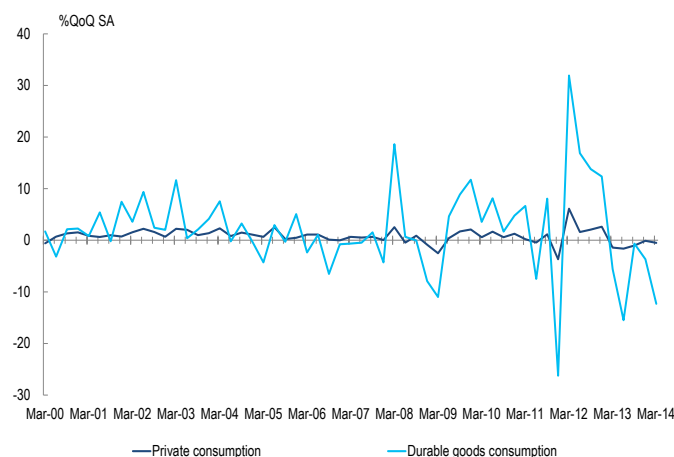
Source: CEIC, Citi Research

Figure 93. Bearish industrial GDP due to mfg and construction decline



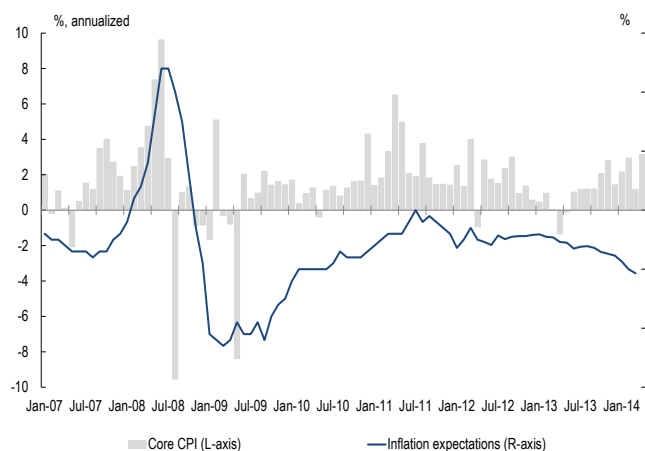
Source: CEIC, Citi Research

Figure 94. Flipside of higher savings is cut in durable goods demand



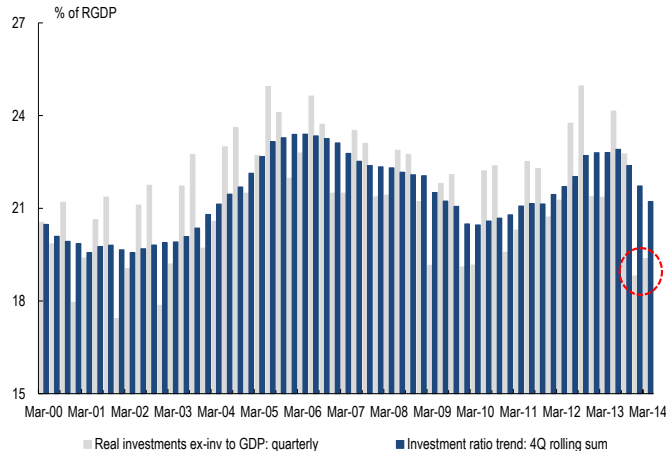
Source: CEIC, Citi Research

Figure 95. Soaring core in Apr against slower inflation expectations



Source: CEIC, Citi Research

Figure 96. Higher likelihood of <20% ratio of investments to real GDP



Source: CEIC, Citi Research

Figure 97. Thailand Economic Indicators

	2007	2008	2009	2010	2011	2012	2013	2014F	2015F
Summary Data									
Nominal GDP, US\$ bn	265.2	276.1	263.8	319.3	346.1	366.4	387.8	371.9	386.4
Nominal GDP, local currency bn	8,525	9,080	9,042	10,105	10,540	11,375	11,899	12,309	12,916
GDP per capita, US\$	4,207	4,355	4,153	4,998	5,401	5,685	5,987	5,713	5,906
Population, mn	63.0	63.4	63.5	63.9	64.1	64.5	64.8	65.1	65.4
Unemployment, % of labour force	1.4	1.4	1.5	1.0	0.7	0.7	0.7	0.8	0.8
Economic Activity									
Real GDP, % yoy	5.0	2.5	-2.3	7.8	0.1	6.5	2.9	0.5	2.8
Real investment growth % yoy	1.0	8.1	-25.2	28.7	0.1	16.8	2.2	-2.2	0.0
Real consumption growth % yoy	2.9	2.9	0.1	5.1	1.3	6.8	1.1	-0.3	2.5
private consumption growth % yoy	1.8	2.9	-1.1	4.8	1.3	6.7	0.3	-1.0	2.2
Real export growth, % yoy	7.8	5.1	-12.5	14.7	9.5	3.1	4.2	1.0	3.4
Real import growth, % yoy	4.4	8.9	-21.5	21.5	13.7	6.2	2.3	-0.7	2.0
Prices, Money & Credit									
CPI, % yoy	3.1	0.4	3.5	3.1	3.5	3.6	1.7	2.3	2.3
CPI, % avg	2.2	5.5	-0.9	3.3	3.8	3.0	2.2	2.4	2.1
Nominal wages, % yoy	3.0	10.5	-1.9	5.8	7.2	11.9	7.9	4.0	3.5
Credit extension to private sector, % yoy	29.3	6.3	2.5	18.8	18.3	14.0	10.5	8.5	10.0
Policy interest rate, % eop	3.25	2.75	1.25	2.00	3.25	2.75	2.25	2.00	2.00
Short-term market rate, % eop	3.74	3.07	1.28	2.03	3.26	2.79	2.31	2.05	2.10
Long term yield, % eop	5.13	2.84	4.37	3.74	3.28	3.55	4.07	3.65	3.85
lc/US\$, eop	30.05	34.79	33.36	30.07	31.57	30.60	32.70	32.90	33.00
lc/US\$, avg	32.33	33.03	34.33	31.71	30.48	31.08	30.72	32.64	33.00
Balance of Payments, US\$ bn									
Current account	15.7	2.2	21.9	10.0	8.9	-1.5	-2.8	8.3	-4.3
% of GDP	5.9	0.8	8.3	3.1	2.6	-0.4	-0.7	2.2	-1.1
Trade balance	26.6	17.3	32.6	29.8	17.0	6.0	6.4	16.2	2.5
Exports	151.3	175.2	150.8	191.6	219.1	225.9	225.4	233.7	246.5
Imports	124.6	157.9	118.2	161.9	202.1	219.9	219.0	217.4	244.1
Net service and Transfer accounts	-8.0	-12.9	-6.4	-10.7	-10.6	-3.4	3.7	-0.6	-0.8
Income balance	-3.0	-2.3	-4.4	-9.0	2.5	-4.0	-12.8	-7.3	-6.0
FDI, net	8.3	4.4	0.7	4.5	-2.8	-2.2	6.4	1.2	1.0
International reserves	87.5	111.0	138.4	172.1	175.1	181.6	167.2	170.0	180.0
Total Amortisations	20.3	15.4	11.3	9.4	8.8	9.5	18.0	19.0	20.0
Public Finances, % of GDP									
Consolidated government balance	-1.6	-1.0	-5.7	0.0	-1.0	-2.1	-1.8	-1.2	-1.8
Consolidated gov primary balance	-0.3	0.2	-4.5	1.1	-1.5	-1.6	-1.2	-0.3	-0.7
Public debt	38.3	37.3	45.2	42.6	41.7	45.4	45.9	47.2	48.1
of which Domestic	33.4	33.0	40.9	39.0	38.4	42.3	42.7	43.0	43.3
Foreign Assets & Liabilities, US\$ bn									
External debt	74.4	76.1	75.3	100.6	104.3	130.7	139.9	135.0	140.0
Private	71.6	72.7	69.4	87.9	88.1	104.5	114.7	108.4	112.9
Public	2.8	3.4	5.9	12.7	16.2	26.2	25.2	26.6	27.1
External debt / GDP	28.1	27.6	28.5	31.5	30.1	35.7	36.1	36.3	36.2
External debt / XGS	41.0	36.5	41.6	44.5	40.0	47.5	49.2	45.5	44.6
Short-term debt	33.7	32.5	33.3	50.7	47.3	58.2	59.9	59.8	61.0
Short-term debt/International Reserves (%)	38.6	29.3	24.0	29.4	27.0	32.0	35.8	35.2	33.9
Quarterly Economic Indicators									
	2013 Q4	2014 Q1	2014 Q2F	2014 Q3F	2014 Q4F	2015 Q1F	2015 Q2F	2015 Q3F	2015 Q4F
GDP, % yoy	0.6	-0.6	0.0	0.7	1.8	2.3	3.0	2.8	3.0
CPI, % yoy	1.7	2.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Policy interest rate, % eop	2.25	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00
Short-term market rate, % eop	2.32	2.08	2.10	2.08	2.05	2.08	2.10	2.10	2.10
Long term yield, % eop	4.07	3.80	3.60	3.60	3.65	3.70	3.75	3.80	3.85
lc vs USD, eop	32.70	32.43	32.53	32.72	32.90	33.00	33.00	33.00	33.00

Source: CEIC Data Company Ltd, Fitch, IFS, Moody's and Citi Research estimates

*Note: Public debt is central government debt and external debt is based on the residency of the holder of the debt (not by currency denomination).

Frontier Asia

Mongolia

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We see supply risk 4Q14/early 2015 with new Debt Management Law. In our view, the likely amendment of the public debt law paves the way for more concessional loans as well as potential debt issuance by quasi sovereigns that comes with gov't guarantee. The new Debt Management Law will lift the public debt ceiling from the existing 40% of GDP to 70%, plus another limit of 20% of sov. guaranteed debt and will exclude SOE debt and guarantees from the calculation; but the debt will no longer be calculated in Net Present Value terms and will be more transparently calculated in nominal terms. The criteria amendments would provide the Gov't with more room to raise funds domestically and abroad and yet comply with the Fiscal Stability Law. The supply risk, depending on the quasi-sov. entity issued and whether issued in the int'l market, may be credit negative, but the additional needed funds would likely enable the gov't to engage in key infrastructure investments that would lift MN's potential growth. We will have to monitor how the extra ammunition will be spent, but for the time being we exit from our previous tactical long position on the Mongolia sovereign, and see more relative value in the quasi-sov. DBMMN (given its recent underperformance, sovereign guarantee and potential benefit from an OT deal by Sep14).

Total improvements from net FDI and current account were reduced in March.

We continue to expect exports to improve in April, mainly due to OT copper/gold exports, but imports pick up could weigh on trade improvements in the near term. FDI in March rose by US\$155mn, smaller than the Jan-Feb average (US\$194mn /month), but still not a bad figure. We expect more incremental FDI improvements in the near future, but the real jump may have to wait for Rio/Gov't to strike a deal on Phase II of Oyu Tolgoi. Recent updates from both parties regarding the negotiation continues to be constructive, including confirmation that 14 out of 15 of the banks consortium has agreed to extend financing agreement to Sep14.

We believe international reserves continue to fall, especially with the continued MNT depreciation. The Turgrik reached 1818/USD on 15 May, indicating locals' lack of confidence in the MNT (BoM representative attributed part of the currency weakness is caused by some mineral exports having experienced delayed receipt of payment). With the likely intervention of the exchange rate amidst an expired but under negotiation RMB swap line, plus continued draw down of the Chinggis bond proceeds, we think the reserves have fallen further from Jan's (published) US\$2.4bn to somewhere slightly below US\$2bn in recent months .

Sri Lanka

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Inflation pressures mildly up on the back of food prices, CBSL likely on prolonged hold. April inflation rose to 4.9%YoY largely due to an uptick on food prices which may already be symptomatic of some spillover impact from the drought. While headline inflation may recede in May on favorable base effect, we see the trend as bottoming and should rise in subsequent months, with risk of another electricity price hike looming as Ceylon Electricity Board's losses rise. Nonetheless, trends in broad money and credit look fairly benign, and with external imbalances being relatively well contained, we think CBSL will keep policy on hold for awhile. We *remove* our further expectation of another 50bps cut this year. CBSL's latest monetary policy statement was more hawkish, citing that the economy is "poised for stronger performance with the recovery observed in the external sector, sustained momentum in construction and manufacturing sectors", and the language on inflation was not as dovish as before. We do think growth will disappoint vis-à-vis their expectations, but the bottoming of inflation and the need to support savings would raise the hurdle for them to ease further.

External position bolstered by external borrowings. Despite some disappointments last year (vis-à-vis what we had hoped), recent external trends still look favorable with the Feb goods trade deficit being contained on the back of muted import growth, especially imports of investment goods which may be a reflection of government's nearing its completion phase, and modest export recovery. Gross tourism flows continue to grow very healthily, likely benefiting from some tourism diversion flows due to the Thai political crisis. We still believe the CA deficit will narrow gradually this year to about 3.3% of GDP. FX reserves rose to a new historical high at US\$8.3bn in Feb with the help of the US\$1bn bond issuance in Jan, and should be further bolstered by US\$500mn issuance in April.

We continue to like longer duration LKR Treasury bonds. Given carry friendly environment trends, we expect the rupee should be stable with a medium term appreciation bias amid improving external accounts and more prudent policies (vis-à-vis history). However, lack of revenue improvements will likely remain a drag on the rating, and government's resolve to contain SOE losses will be tested this year with how losses from CEB are contained. We remain constructive LK Tsy bonds and we recommend investors shift to longer duration bonds (up to 5yrs). Dollar bonds have already rallied significantly, but with sovereign supply out of the way, there is no clear trigger for a sell off, it may grind a bit tighter, though we see more residual value in the National Savings Bank (NSBLK) which lagged the sovereign slightly.

Vietnam

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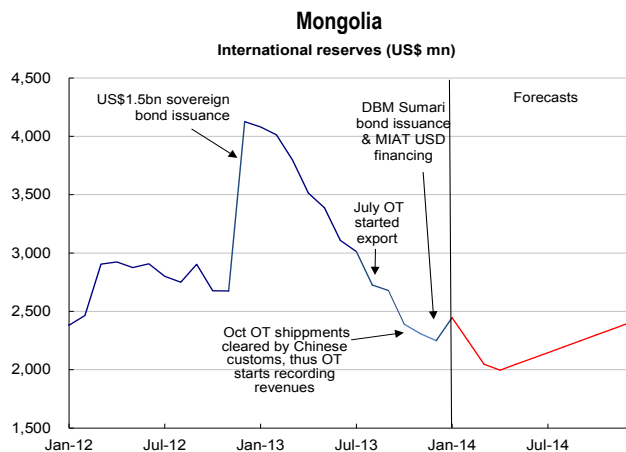
China-Vietnam political tensions rise on Chinese oil rig in disputed waters. Geopolitical concerns have risen over the last month after China's CNOOC placed a gigantic deepwater oil rig in disputed waters about 130 nautical miles off the coast of Vietnam, sparking confrontations between Chinese and Vietnamese vessels, verbal complaints by the Prime Minister at the ASEAN summit, as well as relatively rare public protests being held outside of the Chinese embassy. While we expect cooler heads will prevail, these escalating tensions could put pressure on the gov't to step up defense spending at a time when debt is on the rise.

While in terms of trade, Vietnam has more to lose if the situation worsen due to the high reliance on exports to CCN (10.2% of VN total exports, after 18.2% to US, and 10.4% to JP) [EU is 18% of VN's exports]. And on the other hand, CN's exports to VN only consists 2.3% of total exports, hence, China is clearly more significant to Vietnam as a trading partner than the other way around.

As well, damaged FDI sentiment following the riots may pose downside risk on VN's growth via exports. Despite the weak domestic demand led by a sharp slowdown in investment in the last three years, an important driver to VN's growth has been export and strong FDI flows in recent years, now dominated by mfg.-related FDI (exports rose by 14.6%YoY in the first four month of 2014, of which 10.3%pt were contributed by FIE). However, protests and riots targeting Chinese firms in Vietnam caused damages on 400 foreign factories, and forced 1,100 others to shut down (including KR, JP, SG, TW), this could deteriorate foreign investors' sentiments amid the unstable investment environment.

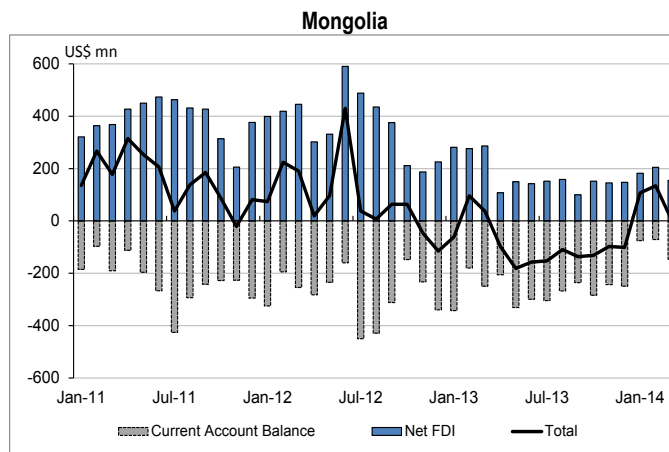
We expect Vietnamese dong to remain stable, and still provide a decent carry via LCY bonds despite yields already having rallied. There is a risk given CNY weakness and benign inflation, that Vietnamese authorities may try to artificially push the dong weaker, but we don't see more than a 1-2% move a year, still giving us good risk-reward for the carry. Vietnam CDS/dollar bonds have lagged the other strong sovereign performers recently and could marginally catch up if, as we expect, geopolitical risks recede.

Figure 98. Mongolia – More reserves likely drained with MNT weakness



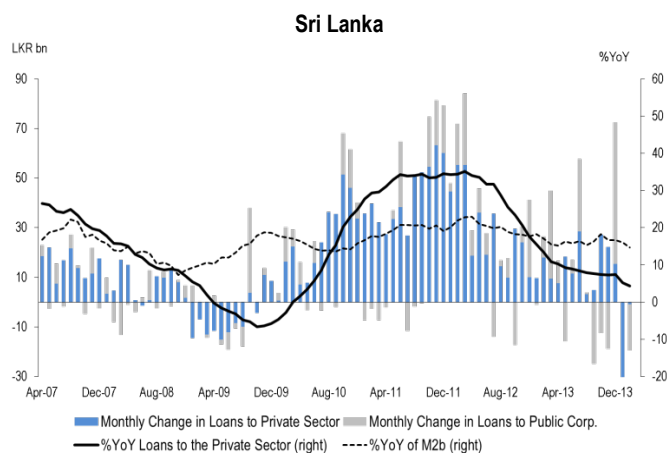
Source: BoM, CEIC and Citi Research

Figure 99. Net FDI and trade improvements shrank in March



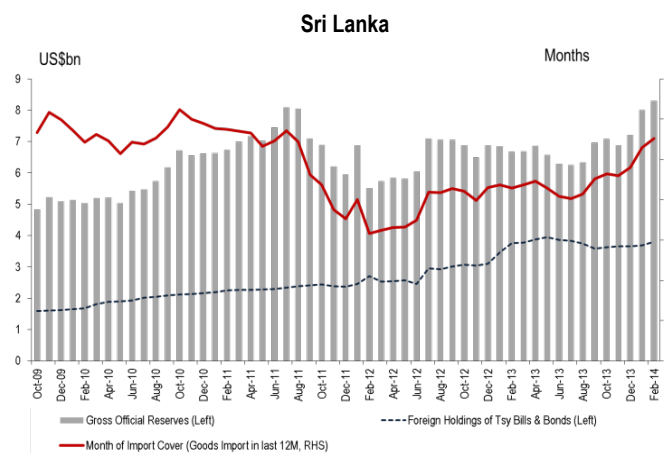
Source: BoM, CEIC and Citi Research

Figure 100. Sri Lanka – Credit and Monetary aggregates show very subdued growth



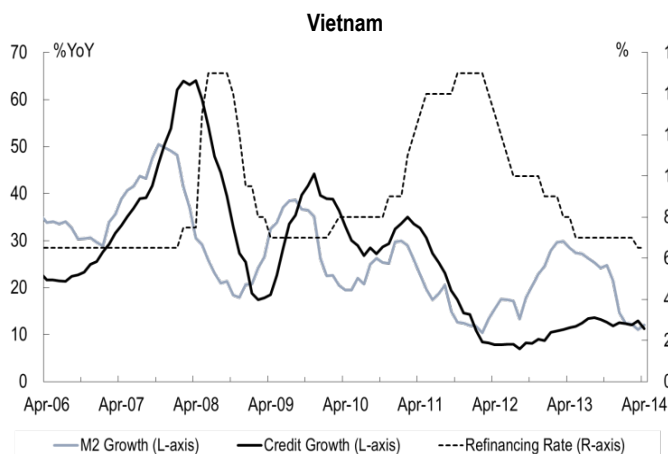
Source: CBSL, CEIC and Citi Research

Figure 101. FX Reserves rise with the help of foreign borrowings



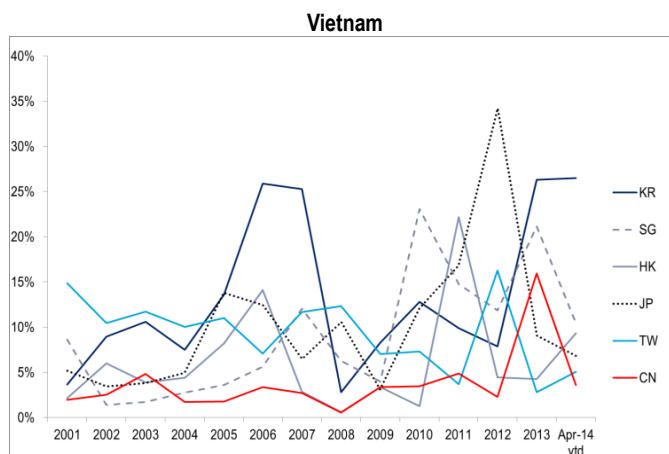
Source: CBSL, CEIC, and Citi Research

Figure 102. Vietnam – Credit and M2 growth still looks very anemic



Source: CEIC, Citi Research

Figure 103. FDI flows by registered capital, by country of origin, as a % of total FDI by registered capital



Source: CEIC, Citi Research

Figure 104. Asia Frontier Economic Indicators

	2007	2008	2009	2010	2011	2012	2013F	2014F	2015F
Mongolia									
Nominal GDP, US\$ bn	4.2	5.6	4.6	6.2	8.8	10.3	10.3	11.9	15.0
GDP per capita, US\$	1,629	2,138	1,717	2,287	3,186	3,595	3,525	4,005	4,967
Population, mn	2.6	2.6	2.7	2.7	2.8	2.9	2.9	3.0	3.0
Real GDP, % yoy	10.2	8.9	-1.3	6.4	17.5	12.4	11.7	10.0	9.0
CPI, % yoy	15.1	22.1	4.2	13.0	10.2	14.0	12.5	14.0	11.5
CPI, % avg	--	28.0	8.0	10.1	9.2	14.3	10.5	13.1	12.0
Policy interest rate, % eop	8.40	9.75	10.00	11.00	12.25	13.25	10.50	11.00	11.50
Long term yield, % eop	21.83	20.58	21.67	20.07	16.61	18.11	18.48	19.68	21.08
lc/US\$, eop	1,172	1,275	1,433	1,233	1,378	1,378	1,660	1,787	1,717
lc/US\$, avg	1,171	1,167	1,434	1,349	1,256	1,353	1,505	1,813	1,743
Current account (US\$ bn)	0.3	-0.7	-0.4	-0.9	-3.4	-3.2	-3.2	-2.1	-2.9
% of GDP	6.3	-12.8	-8.9	-15.0	-38.4	-31.1	-30.9	-17.9	-19.7
Trade balance (US\$ bn)	-0.2	-0.7	-0.3	-0.3	-1.8	-2.4	-2.1	-0.6	-1.1
Exports (US\$ bn)	1.9	2.5	1.9	2.9	4.8	4.4	4.3	5.6	6.7
Imports (US\$ bn)	2.2	3.2	2.1	3.2	6.6	6.7	6.4	6.1	7.8
FDI, net (US\$ bn)	0.4	0.8	0.6	1.6	4.6	3.9	-2.1	2.4	3.4
International reserves (US\$ bn)	0.8	0.6	1.3	2.2	2.3	3.9	2.2	2.4	3.5
Consolidated government balance (% of GDP)	2.6	-4.5	-5.2	0.5	-6.9	-9.9	-7.8	-7.5	-4.3
Public debt (% of GDP)	36.0	30.6	44.2	28.7	28.9	42.1	67.3	73.5	74.6
Sri Lanka									
Nominal GDP, US\$ bn	32.4	40.7	42.1	49.6	59.2	59.4	67.2	74.8	85.9
GDP per capita, US\$	1,617	2,014	2,057	2,400	2,836	2,923	3,281	3,621	4,128
Population, mn	20.0	20.2	20.5	20.7	20.9	20.3	20.5	20.6	20.8
Real GDP, % yoy	6.8	5.9	3.5	8.0	8.2	6.3	7.3	7.2	7.4
CPI, % yoy	18.8	13.9	5.0	6.8	4.9	9.2	4.7	8.1	6.0
CPI, % avg	15.8	22.5	3.6	6.2	6.8	7.5	6.9	5.7	6.5
Policy interest rate, % eop	12.00	12.00	9.75	9.00	8.50	9.50	8.50	8.00	8.00
Long term yield, % eop	19.96	19.20	11.50	9.24	10.00	11.81	9.91	9.50	9.00
lc/US\$, eop	108.7	113.0	114.4	110.9	113.9	127.7	130.8	131.0	129.0
lc/US\$, avg	110.6	108.3	114.9	113.0	110.5	127.2	129.1	131.1	129.9
Current account (US\$ bn)	-1.4	-3.9	-0.2	-1.1	-4.6	-4.0	-2.6	-2.5	-2.6
% of GDP	-4.3	-9.5	-0.5	-2.2	-7.8	-6.7	-3.9	-3.3	-3.0
Trade balance (US\$ bn)	-3.7	-6.0	-3.1	-4.8	-9.7	-9.4	-7.6	-7.8	-8.3
Exports (US\$ bn)	7.6	8.1	7.1	8.6	10.6	9.8	10.4	11.2	12.0
Imports (US\$ bn)	11.3	14.1	10.2	13.5	20.3	19.2	18.0	19.0	20.3
FDI, net (US\$ bn)	0.5	0.7	0.4	0.4	0.9	0.9	0.9	0.9	1.0
International reserves (US\$ bn)	3.1	1.8	5.1	6.6	6.0	6.9	7.2	7.3	7.9
Consolidated government balance (% of GDP)	-6.9	-7.0	-9.9	-8.0	-6.9	-6.4	-5.9	-5.6	-5.3
Public debt (% of GDP)	85.0	81.4	86.1	81.9	78.5	79.2	78.3	77.0	76.0
Vietnam									
Nominal GDP, US\$ bn	77.5	98.3	101.6	112.8	133.4	155.7	169.8	174.3	196.7
GDP per capita, US\$	920	1,154	1,181	1,297	1,518	1,754	1,893	1,926	2,154
Population, mn	84.2	85.1	86.0	86.9	87.8	88.8	89.7	90.5	91.3
Real GDP, % yoy	7.1	5.7	5.4	6.4	6.2	5.2	5.4	5.7	5.9
CPI, % yoy	12.6	19.9	6.5	11.8	18.1	6.8	6.0	6.4	7.0
CPI, % avg	8.3	23.1	7.0	9.2	18.6	9.3	6.6	5.4	6.8
Policy interest rate, % eop	6.50	9.50	8.00	9.00	15.00	9.00	7.00	6.00	6.00
Long term yield, % eop	8.73	10.00	11.68	11.49	12.55	9.75	9.29	7.50	8.50
lc/US\$, eop	16,028	17,483	18,474	19,498	21,034	20,840	21,095	21,036	21,036
lc/US\$, avg	16,081	16,445	17,806	19,123	20,648	20,875	21,028	21,063	21,036
Current account (US\$ bn)	-7.1	-10.8	-6.6	-4.3	0.2	9.1	8.9	7.1	5.6
% of GDP	-9.1	-11.0	-6.5	-3.8	0.2	5.8	5.3	4.1	2.9
Trade balance (US\$ bn)	-10.4	-12.8	-7.6	-5.1	-0.5	9.9	9.4	8.6	6.9
Exports (US\$ bn)	48.6	62.7	57.1	72.2	96.9	114.6	133.3	157.3	180.9
Imports (US\$ bn)	59.0	75.5	64.7	77.4	97.4	104.7	123.9	148.7	174.0
FDI, net (US\$ bn)	6.5	9.3	6.9	7.1	6.6	7.2	7.3	7.6	7.7
International reserves (US\$ bn)	23.5	23.9	16.0	12.1	13.5	25.6	33.3	35.8	40.8
Consolidated government balance (% of GDP)	-5.3	-1.2	-7.2	-3.1	-3.2	-5.2	-5.3	-5.3	-4.5
Public debt (% of GDP)	40.9	39.4	46.9	44.6	43.2	46.6	45.7	41.3	45.0

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

*Note: Consolidated government balance for Mongolia include off budget spending.

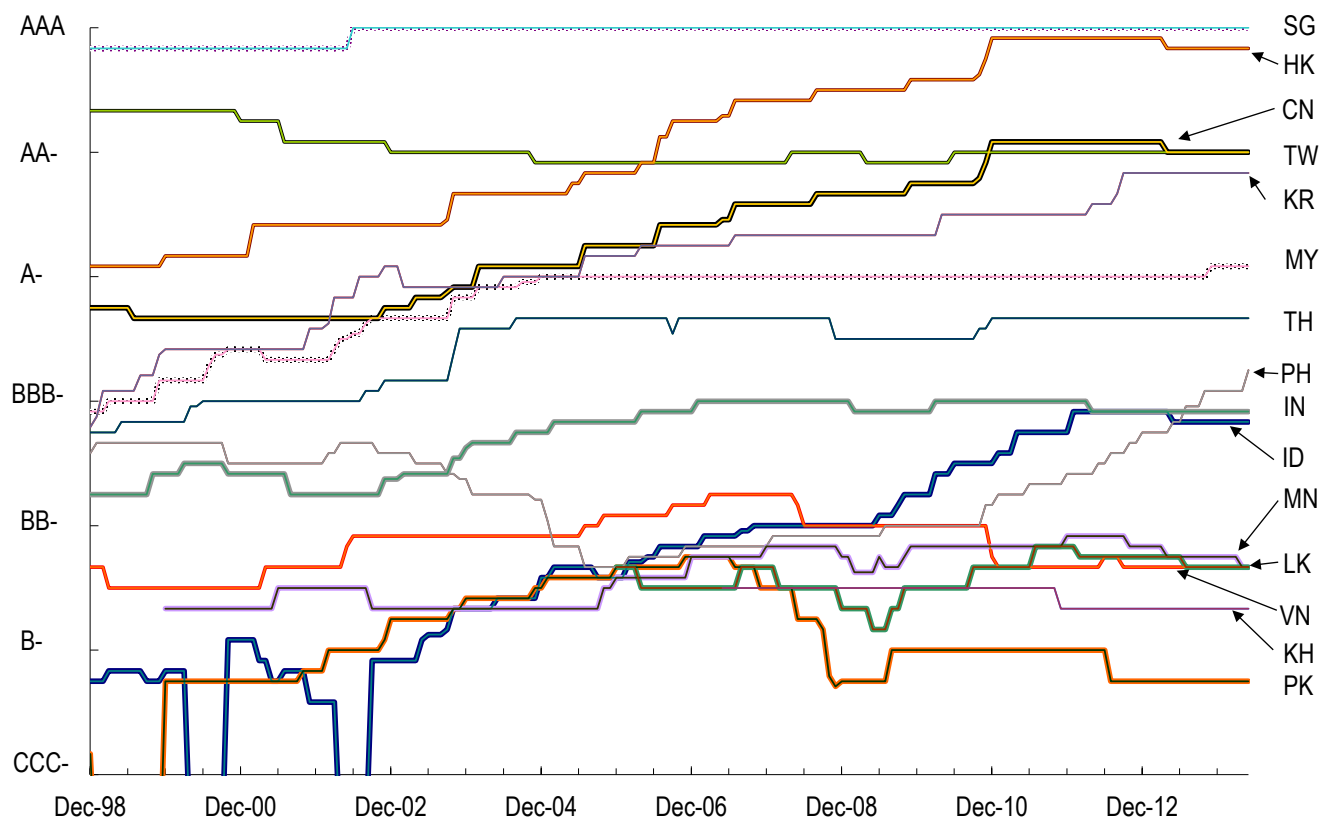
Appendix: Sovereign Risk Ratings Summary

Figure 105. Long-Term Foreign Currency Ratings

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

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

Figure 106. Ratings History (Average of S&P and Moody's Ratings), December 1998-May 2014



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

Global Assumptions

	2014 Q1F	2014 Q2F	2014 Q3F	2014 Q4F	2015 Q1F	2015 Q2F	2015 Q3F	2015 Q4F	2013	2014F	2015F	2016F	2017F	2018F
Global Indicators														
GDP Growth (y/y %)	—	—	—	—	—	—	—	—	2.5	3.0	3.5	3.7	3.6	3.4
CPI Inflation (average, y/y %)	—	—	—	—	—	—	—	—	2.6	2.9	3.1	3.4	3.4	3.5
Current Account (% of GDP)	—	—	—	—	—	—	—	—	0.7	0.8	0.7	0.3	0.1	0.0
Fiscal Balance (% of GDP)	—	—	—	—	—	—	—	—	-4.1	-3.6	-3.2	-2.9	-2.7	-2.2
Industrial Countries*														
GDP Growth (y/y %)	—	—	—	—	—	—	—	—	1.2	2.0	2.4	2.5	2.3	2.0
CPI Inflation (average, y/y %)	—	—	—	—	—	—	—	—	1.3	1.5	1.7	1.6	1.5	1.7
Current Account (% of GDP)	—	—	—	—	—	—	—	—	-0.2	0.1	0.2	0.1	0.1	0.2
Fiscal Balance (% of GDP)	—	—	—	—	—	—	—	—	-5.5	-4.6	-3.7	-3.3	-3.0	-2.8
United States														
GDP Growth (SAAR %)	-0.4	3.5	3.5	3.1	3.2	2.8	3.2	3.1	—	—	—	—	—	—
GDP Growth (y/y %)	2.2	2.4	2.3	2.4	3.3	3.1	3.1	3.1	1.9	2.3	3.1	3.2	2.7	2.2
CPI Inflation (average, y/y %)	1.1	1.6	1.6	1.8	1.9	1.8	1.8	1.8	1.1	1.5	1.8	2.2	2.3	2.2
Current Account (% of GDP)	-2.0	-2.0	-1.9	-1.9	-1.7	-1.6	-1.5	-1.4	-2.3	-2.0	-1.5	-1.8	-1.7	-1.4
Fiscal Balance (% of GDP)	—	—	—	—	—	—	—	—	-7.3	-6.4	-5.6	-5.6	-5.4	-5.4
S&P 500 EPS (y/y %)	3.8	7.4	6.7	8.7	7.8	6.2	6.0	8.0	6.4	6.7	7.0	—	—	—
Business Investment (y/y %)	2.9	3.4	3.6	3.6	5.7	5.1	4.8	4.5	2.7	3.4	5.0	—	—	—
Imports (y/y %)	2.7	2.2	2.5	3.2	4.5	4.7	5.1	5.1	1.4	2.7	4.8	—	—	—
Japan														
GDP Growth (SAAR %)	5.9	-5.2	3.0	1.3	1.0	0.7	3.2	-2.1	—	—	—	—	—	—
GDP Growth (y/y %)	2.7	0.5	1.0	1.2	0.0	1.5	1.6	0.7	1.6	1.4	0.9	1.2	1.2	1.0
CPI Inflation (y/y %)	1.5	3.6	3.2	3.0	2.9	0.8	0.8	2.1	0.4	2.8	1.7	1.6	0.7	1.0
Current Account (% of GDP)	-1.1	0.0	0.1	0.0	-0.1	-0.3	-0.5	0.0	0.7	-0.2	-0.2	0.0	0.2	0.2
Fiscal Balance (% of GDP)	—	—	—	—	—	—	—	—	-9.8	-8.0	-6.2	-5.8	-5.4	-5.0
Euro Area														
GDP Growth (SAAR %)	0.8	1.9	1.5	1.6	1.7	1.9	1.9	2.0	—	—	—	—	—	—
GDP Growth (y/y %)	0.9	1.0	1.3	1.4	1.7	1.7	1.8	1.9	-0.4	1.2	1.8	1.9	1.9	1.8
CPI Inflation (y/y %)	0.7	0.6	0.4	0.7	0.8	0.9	0.9	0.8	1.4	0.6	0.9	1.2	1.3	1.8
Current Account (% of GDP)	—	—	—	—	—	—	—	—	2.4	2.9	2.9	2.8	2.6	2.4
Fiscal Balance (% of GDP)	—	—	—	—	—	—	—	—	-3.0	-2.6	-2.0	-1.5	-1.1	-0.7
Exchange Rates														
US\$ vs. Euro (eop)	1.38	1.40	1.38	1.36	1.35	1.36	1.38	1.39	1.33	1.38	1.37	1.41	1.41	1.41
US\$ vs. JPY (eop)	103	100	102	104	106	107	108	109	98	102	107	111	113	114
JPY vs. Euro (eop)	142	140	141	141	143	146	149	152	130	141	147	157	159	160
Short Interest Rates (eop)**														
United States	0.25	0.25	0.25	0.25	0.25	0.25	0.75	1.00	0.25	0.25	0.50	1.65	3.00	3.75
Japan	0.09	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.30
Euro Area	0.25	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.50	0.16	0.10	0.11	0.42	0.92
10-Yr Yield Forecasts (Period Avg.)														
United States	2.72	2.85	2.95	3.20	3.40	3.45	3.50	3.55	2.35	3.00	3.50	3.75	4.10	4.25
Japan	0.64	0.55	0.65	0.70	0.85	0.95	0.95	0.85	0.71	0.65	0.90	1.25	1.50	1.50
Euro Area***	1.57	1.60	1.60	1.60	1.70	1.70	1.80	1.80	1.60	1.63	1.75	2.00	2.25	2.50
Emerging Markets														
GDP Growth (y/y %)	—	—	—	—	—	—	—	—	4.5	4.5	5.0	5.4	5.5	5.4
CPI Inflation (eop, y/y %)	—	—	—	—	—	—	—	—	4.7	5.0	5.2	5.1	5.1	4.9
Current Account (% of GDP)	—	—	—	—	—	—	—	—	1.8	1.9	1.2	0.6	0.1	-0.1
Fiscal Balance (% of GDP)	—	—	—	—	—	—	—	—	-2.0	-2.2	-2.4	-2.2	-2.3	-1.5
Commodities														
WTI Oil price (US\$/bbl)	99.0	103.0	107.0	99.0	101.0	96.0	104.0	97.0	98.0	102.0	100.0	83.0	78.0	80.0
Copper (Average, USD/MT)	7,005	6,650	6,700	6,800	6,800	7,000	7,200	7,500	7,352	6,785	7,125	7,700	8,000	8,200
Gold (Average, US\$/oz)	1,297	1,310	1,330	1,340	1,340	1,350	1,360	1,400	1,416	1,320	1,365	1,380	1,400	1,420

Note: *It includes: US, Japan, Germany, France, Italy, Spain, Greece, Ireland, Portugal, Netherlands, Belgium, Denmark, Norway, Sweden, Switzerland, United Kingdom, Canada, Australia, and New Zealand. **Average for annual data and forecasts. ***Ten-year Bond yield. Sources: National authorities and Citi Research.

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Asia-Pacific Economics and Market Analysis

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