25 July 2012 │ 76 pages

Global

Global Economic Outlook and Strategy

July 2012

- We make only modest changes to our growth forecasts this month, and expect global growth of 2.5% in 2012 and 2.8% in 2013 at current exchange rates (versus 2.6% and 2.7% respectively last month). Our forecast remains well below those of the consensus and IMF, reflecting in particular a much weaker outlook for the euro area and a modestly weaker outlook for many emerging markets.
- Within this subpar global outlook, we remain gloomy on the euro crisis. Our base case is for prolonged economic weakness and financial market strains in periphery countries, spilling over into renewed recession for the euro area as a whole this year and the next. We now believe the probability that Greece will leave EMU in the next 12-18 months is about 90%, up from our previous 50-75% estimate, and believe the most likely date is in the next 2-3 quarters. As before, for the sake of argument, we assume that “Grexit” occurs on 1 January 2013, but we stress this is an assumption rather than a forecast of the precise date. Even with the Spanish bank bailout, we continue to expect that both Spain and Italy are likely to enter some form of Troika bailout for the sovereign by the end of 2012. Over the next few years, the EA end-game is likely to be a mix of EMU exit (Greece), a significant amount of sovereign debt and bank debt restructuring (Portugal, Ireland and, eventually, perhaps Italy, Spain and Cyprus) with only limited fiscal burden-sharing.
- Major central banks are likely to keep policy loose or ease further, with the ECB likely to cut the refi rate to 0.25% (and to cut the deposit rate below zero) in the next 2-3 quarters. Predicated on economic weakness in the periphery plus “Grexit”, we expect a wide series of ratings downgrades among EMU countries in the next 2-3 quarters, with at least a one-notch downgrade by at least one major agency for Austria, Belgium, France, Germany, Greece, Ireland, Italy, the Netherlands, Portugal and Spain. We continue to expect a one-notch downgrade for both the US and Japan over the next 2-3 years. In addition, with economic weakness and fiscal slippage, we believe the UK also may lose its AAA sovereign rating over the next 2-3 years.

Figure 1. Currency and Interest Rate Forecasts (End of Period, Unless Specified), as of 25 Jul 2012

	25 Jul 2012	3Q 12 Forecast	4Q 12 Forecast	1Q 13 Forecast	2Q 13 Forecast	3Q 13 Forecast	4Q 13 Forecast
United States: Federal Funds	0.25	0.25	0.25	0.25	0.25	0.25	0.25
10-Yr. Treasuries (Period Ave.)	1.41	1.45	1.65	1.80	2.10	2.35	2.60
Euro Area: US$/€	1.22	1.22	1.20	1.18	1.16	1.18	1.22
Euro Repo Rate	0.75	0.50	0.25	0.25	0.25	0.25	0.25
10-Yr. Bunds (Period Ave.)	1.26	1.15	1.00	1.15	1.25	1.50	2.00
Japan: Yen/US$	79	78	79	80	82	82	83
Call Money	0.10	0.10	0.10	0.10	0.10	0.10	0.10
10-Yr. JGB (Period Ave.)	0.73	0.80	0.95	1.10	1.20	1.10	1.30

Source: Citi Research

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With thanks to Jan Maguire

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Figure 2. Forecast Highlights and Changes from Last Month

■ Global	We make only modest changes to our growth forecasts this month, and look for global growth of 2.5% this year and 2.8% in 2013 at current exchange rates (respectively down by 0.1% and up by 0.1% from last month). Within this subpar global outlook, we remain gloomy on the euro crisis.
■ United States	Economic growth remains disappointing amid hints that fiscal uncertainty may be restraining business activity. The dual threats of European financial headwinds and large-scale fiscal drag in 2013 will likely keep the Fed focused on easing in coming months.
■ Euro Area	We are increasing our probability of Greece leaving the euro area over the next 12 to 18 months to about 90%. We also expect that Italy and Span will request assistance from the EFSF/ESM. We continue to expect an ongoing recession in the euro area and expect the ECB to cut the refi rate to 0.25% and the deposit rate to -0.5% by the end of 2012.
■ China	The economy slowed further in 2Q, but beat our expectation. The June data reveal early signs of a demand-driven growth upturn. We have revised up 2012 and 2013 growth forecasts by 0.1ppt to 7.9% and 8.0%, respectively. Average CPI inflation is revised down from 2.9% to 2.7% reflecting faster-than-expected disinflation.
■ Japan	We revised up growth forecasts for 2013 to 2.1% from 1.4% reflecting likely frontloading in spending before the April 2014 consumption tax hike. However, 2014 GDP growth will inevitably slow sharply due to a payback to frontloaded spending, which in turn would make the second tax hike slated for October 2015 difficult.
■ United Kingdom	We are cutting our growth forecasts slightly, and – with inflation heading below the 2% target – we continue expect the MPC will expand QE markedly further over time.
■ Canada	Domestic strength and balanced risks continue to influence the BoC's slightly hawkish policy stance, despite rising external woes and lingering uncertainties. Hence, we maintain our call for fixed rates this year and modest withdrawal of stimulus in early 2013.
■ Australia	The RBA is likely to leave the cash rate unchanged in the near term as it assesses the impact of earlier rate cuts and developments in Europe.
■ Emerging Asia (ex China)	The theme of slower growth continues to dominate, though the source of growth worries is shifting from China to the US. After rate cuts by China and Korea, we think risks are now tilted towards Philippines, Singapore and Thailand to ease monetary policy. Others are likely to remain on prolonged hold.
■ CEEMEA	Our forecast changes this month are generally to the downside: our growth forecasts for Czech, Slovakia, Ukraine and Kazakhstan have all been taken down slightly for 2012/13, reflecting weak European demand and retrenchment by European banks. The next big test will be whether Hungary can issue a bond before IMF/EU negotiations are complete.
■ Lat Am	Stability is still the name of the game when it comes to monetary policy (except in Brazil). Resilient growth has kept most central banks in "wait-and-see" mode but we continue to expect easing later in the year. The recent spike in commodity prices creates uncertainties, but at the moment we expect its effect to be relatively muted.

Source: Citi Research

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

	Equities	G10 Rates	Credit	Securitized Products	FX †	Commodities	Global Macro Strategy †
Overall View	Cheap valuations, reasonable EPS, easy monetary policy should provide moderate upside	EMU crisis now dominates. Uncertainty remains high and risk-aversion is likely to continue to drive yields lower	Impressive technical support risks being overwhelmed by escalating sovereign crisis	Short, high-quality sectors optimise defensive positioning. Off-the-run sectors offer upside	USD higher	Bearish most industrial commodities although see some short-term seasonal strength in crude and agriculture	Easy money balances negative macro
Most-Favoured Region/Sector	Japan, Asia Pac ex Japan, Australia / IT, Energy, Health Care	5yr EUR	Low-beta core non-fins	US CMBS senior tranches	USD, CAD	Precious Metals, Grains and Oilseeds (due to weather risks)	Gold, Bunds
Least-Favoured Region/Sector	Europe ex UK/ Cons. Disc, Industrials, Utilities	>10yr USD	Periphery sub-debt	Spanish and Irish RMBS	EUR, AUD	Copper, Zinc, Coffee	EUR, Oil
Key Risks	Deeper downturn in Continental Europe earnings, profits begin to collapse in the US	Rapid EMU contagion or a sudden EMU resolution	Sovereign crisis; bank runs; global slowdown	Regulation	QE3, US fiscal cliff	EMU contagion, oil shock double-dip, risk-off financial outflows China hard landing	EMU breakup, China growth, US fiscal, Central Bank stimulus

Source: Citi Research

† Summary view from our Global Macro Strategy Market Commentary team (see page 52 for definition of market commentary). The authors are not independent research analysts and may have knowledge of the Firm's positions and/or the Firm's interest in one or more of the securities referenced herein.

Overview — Modest Global Growth and Worsening EMU Crisis

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We make little change to our growth forecasts, but remain well below consensus

We make only modest changes to our growth forecasts this month, and continue to look for global growth of 2.5% this year and 2.8% in 2013 at current exchange rates (versus 2.6% and 2.7% respectively last month). Our forecast remains well below those of the consensus and IMF, reflecting in particular a much weaker outlook for the euro area and a modestly weaker outlook for many emerging markets. Within that aggregate, since last month's GEOS we have a slight downgrade to our 2012 US forecast (to 1.9% this month from 2.1% last month), with a 0.1% upgrade to our 2012 euro area forecast and a 0.1% downgrade to the 2013 outlook. In addition, with the assumption of the Japanese consumption tax hike in 2014, we revise up the 2013 Japan growth forecast to 2.1% from 1.4% last month, balanced by a downgrade to the 2014 outlook to 0.3% from 1.5% last month[1].

We continue to expect the EMU crisis will intensify further

Within this subpar global outlook, we remain gloomy on the euro crisis. Our base case is for prolonged economic weakness and financial market strains in periphery countries, with "Grexit" increasingly likely in the next 2-3 quarters, spilling over into renewed recession for the euro area as a whole this year and the next. We do not believe the recent developments (Eurogroup agreement on moves towards a banking union[2], bailout for Spanish banks, heightened fiscal austerity in Spain) will ease the EMU crisis, let alone solve it.

The "banking union" proposals lack an adequate DGS…

First, the banking union proposals do not include an EMU-wide deposit guarantee scheme (DGS) that could protect against redenomination risk, and hence will probably do little to stem the deposit flow out of periphery country banks.

…and there does not seem to be agreement as to exactly what conditions would need to be met to allow direct ESM recapitalization of strained banks

Second, it is not certain that the key issue of shifting the costs of Spain's bank recapitalizations from weak periphery sovereigns to the ESM will be achieved anytime soon. The reference in the Eurogroup statement of 29 June to "*appropriate conditionality*" for direct ESM bank recapitalization masked a lack of agreement as to exactly what the conditions should be. We expect that Germany and other creditor nations will insist on tough conditions, in addition to the already-mentioned single bank supervisor, probably at a minimum including the following: ECB to have direct responsibility for major euro area banks and indirect responsibility for other banks; acceptance that all ESM-recapitalised banks gravitate to direct ECB bank supervision, bail-ins for bond and equity investors of ESM-recapitalised banks; the early creation of a pan-euro bank resolution regime. Banks are not exactly the political "flavour of the month", and the German government's room for manoeuvre over help for banks will probably be greatly constrained in the runup to next year's national elections[3]. We do expect that such conditions will be accepted eventually, but we suspect that the earliest date at which the Spanish bank recapitalization costs will be removed from the Spanish general government debt is mid-2013, and it is not definite even for then.

Even without bank recapitalization costs, Italy and Spain probably have unsustainable fiscal trends

Third, other than Ireland, the fiscal burden of bank recapitalizations probably is not the critical factor in determining whether any periphery sovereign can fund itself at a tolerable yield. Other than Ireland, the surge in public debt/GDP ratios are mainly driven by economic weakness and resultant revenue shortfalls (plus long-lasting inefficiencies in public spending programmes) rather than direct bank recapitalization costs. And economic prospects in periphery economies remain poor, reflecting a mix of weak external competitiveness, high private debts, heavy fiscal drag, poor credit availability, relatively low export exposure to high-growth emerging markets and a vicious circle as many of these factors exacerbate each other.

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[1] See Japan Economics Weekly - Reflecting the consumption tax hike into our economic outlook, Kiichi Murashima, 12 July 2012, Citi.

[2] On 28/29 June 2012.

[3] See Euro Economics Weekly - Assessing Germany's Resilience, Jürgen Michels, 13 July 2012, Citi.

Surveys and banking data point to further weakness in the periphery economies

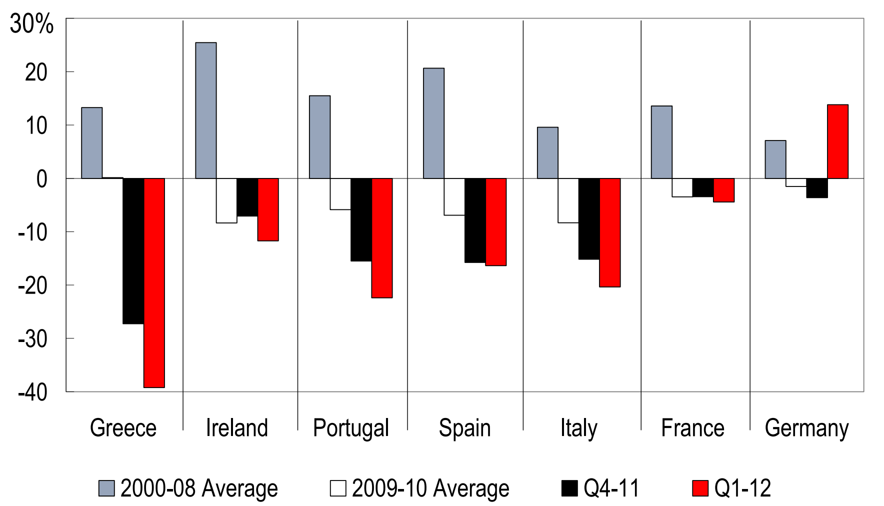
Recent business and consumer surveys show widespread weakness in periphery economies, while the BIS report that foreign banks are cutting exposure to periphery economies at an accelerating pace. In Q1 this year, exposure of foreign banks to Greece (public and private sectors) fell 39% YoY (including the PSI), with YoY declines of 12% to Ireland, 16% to Spain, 20% to Italy and 22% to Portugal. From their recent peaks, the exposure of foreign banks to Greece (public and private sectors) has fallen by 60%, with declines of 40%-50% in exposure to Ireland, Portugal, Italy and Spain. Indeed, agreement on the use of "bail-ins" for bank bond and equity investors – which probably is necessary to persuade creditor nations approve direct ESM recapitalization of banks and to lead to a consolidation in the European banking sector — may well increase funding strains for periphery banks because of the extra risk premium on bank liabilities, hence further hitting credit availability in those countries.

Figure 4. Selected Countries — Industrial Production Forecasts (Pct.), 2011-13F

	2011	2012F	2013F
World	3.9%	2.5%	3.1%
United States	4.1	4.0	2.8
Japan	-2.4	3.0	3.9
Euro Area	3.6	-2.3	-1.2
United Kingdom	-0.7	-1.3	1.3
Canada	3.5	0.3	0.5
China	13.9	10.8	11.3
India	3.4	4.1	4.5
Korea	6.9	4.0	5.1
Brazil	0.3	-1.8	3.0

Source: Citi Research

Figure 5. EMU — Exposure of Foreign Banks to Selected Countries, YoY Pct Change, 2000-12



Sources: BIS and Citi Research

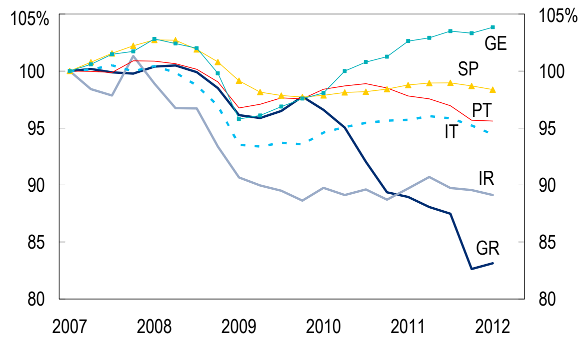
We do not expect the current approach of austerity and supply side reform will return any periphery country to a sustainable fiscal path

As a result, we still believe that, for all periphery countries, the current mix of fiscal austerity and supply-side reform will fail to achieve a return to a sustainable fiscal path, and expect that public debt/GDP ratios will continue to rise in coming years. We continue to expect that both Spain and Italy are likely to enter some form of Troika bailout for the sovereign by the end of 2012. We stress that we believe this is likely even with the probable eventual exclusion of bank recapitalization costs from the Spanish general government's debt.

It is unclear if moves towards banking union will be consistent with sufficient financial repression to finance the Italian and Spanish sovereigns

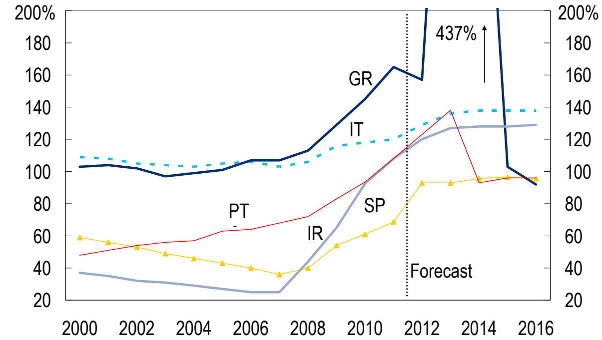
Fourth, given the limited resources available to the EFSF/ESM, it is likely that any bailout for Spain and Italy will cover only part of their financing needs. However, with the assumption that the EFSF and ESM will in practice be granted senior status in any future debt restructuring, it is unlikely that there will be significant private sector appetite for remaining issuance at a yield tolerable for the governments without marked financial repression of banks. And it is unclear whether the moves to banking union will be consistent with the scale of financial repression that will probably be needed to finance the Spanish and Italian sovereigns even for a period at tolerable yields.

Figure 6. Selected EMU Countries — Real GDP Indexed to Q1-2007 = 100, 2007-12



Sources: Datastream and Citi Research

Figure 7. Selected EMU Countries — General Government Gross Debt/GDP Ratios, 2000-16F



Sources: Eurostat and Citi Research

A crucial part of the bank-sovereign nexus is the high exposure of periphery banks to weak periphery sovereigns and creditor nations may be unwilling to bear the costs of recapitalizing periphery banks unless those banks improve their liquid asset portfolios

The Eurogroup statement asserted that "*it is imperative to break the vicious circle between banks and sovereigns*". In our view, a crucial part of that vicious circle has been the rapid accumulation by periphery country banks of the debt of their own strained sovereign. Between Nov-11 and May-12, holdings of domestic government debt rose by 31% for Portuguese banks, 32% among Italian banks and 51% for Spanish banks[4]. These bond purchases gave temporary liquidity assistance to periphery governments, but left a hangover of weakened bank balance sheets and increased the concentration of periphery risks in weak hands. The IMF recently noted: "*the long-term refinancing operations of the ECB and the US$ swap lines stabilized funding markets. They also contributed to temporarily reducing sovereign stress. However, the stabilization of bond yields was achieved by increasing the sovereign exposures of Spanish and Italian banks, setting the stage for stronger adverse loops between weak sovereigns and domestic banks…After the first LTRO, Spanish and Italian banks with larger exposures to their sovereign underperformed their peers*".[5] The BIS recently made the same point.[6] Creditor nations may quite reasonably be unwilling to share recapitalization costs if periphery banks continue to be used as "piggy banks" for fiscally-weak governments, and will instead insist that Spanish and Italian banks over time shift their liquid assets to genuinely high quality government debt. However, with few other private buyers for Spanish and Italian government debt, limits to financial repression would probably leave the Spanish and Italian governments facing serious financing difficulties.

We are raising our probability of "Grexit" over the next 12-18 months to 90% from 50-75% previously

Fifth, we believe it is increasingly likely that Greece will leave the EMU ("Grexit") in the next 2-3 quarters. We previously argued that the probability of Grexit over the next 12-18 months is 50-75%. However, we are now raising this probability (Grexit over the next 12-18 months) to about 90%, and believe the most likely date is in the next 2-3 quarters, possibly following the September Troika assessment. This reflects two main factors. First, earlier this year, before the Greek election, the Troika members were willing to be patient while Greece slipped off-programme in expectation that the election might produce a government that was able and willing to get the programme back on track. It is now fairly clear that these hopes have not been fulfilled. There still looks to be a considerable, and probably unbridgeable, gap between the reform measures and fiscal improvements insisted upon by the creditors and those that are politically and economically achievable in Greece.

[4] Including loans, the total exposure of Spanish banks to the Spanish general government sector is now close to 10% of assets.

[5] Source: IMF Article IV Report on the Euro Area, July 2012.

[6] Source: BIS Annual Report June 2012.

Second, with possible bailouts for Spain and Italy looming, comments from the Troika and various european politicians suggest they are becoming less patient with Greece, because of the need to reassure creditor nations that countries which persistently miss their programmes will not be financed.

We continue to expect that any "Grexit" will intensify financial and economic strains in other periphery countries

The exact details of the end-game for Greece are unclear. For example, there may be a final "last-chance" grace period, possibly via further expansion of Greece's ELA programme, to ensure that ESM ratification is complete and to see if there is some way to bridge the gap between Greece and external creditors. For the sake of argument, we assume (as the last two months) that Greece will exit EMU on 1 January 2013, but stress this is an assumption rather than a forecast. As before, our base case assumes that the new currency would quickly weaken by about 60%, leading to a surge in inflation, with the economy initially contracting sharply and then recovering somewhat, followed by a large further debt restructuring at some stage. The damage could be limited (but not avoided) by ensuring that Greece remains an EU member even after EA exit. We stress the uncertainties: it remains possible that Greece will not leave EMU in the next 12-18 months, and also possible that "Grexit" may come even earlier or later within that 12-18 month period. If "Grexit" does occur we believe it would intensify capital flight out of other periphery markets.

The end-game is likely to be a mix of fiscal burden-sharing, debt restructuring and EMU exit

Over the next few years, the EA end-game is likely to be a mix of EMU exit (Greece?), a significant amount of sovereign debt and bank debt restructuring (Portugal, Ireland and, eventually, perhaps Italy, Spain and Cyprus) with only limited fiscal burden-sharing. We regard moves to a banking union as creating a framework that makes debt restructuring for banks and sovereigns more likely. As discussed earlier, acceptance of "bail-ins" for bank debt and equity is likely to be a precondition for creditors to accept burden-sharing on bank recapitalization costs. Moreover, banking union would increase the extent to which periphery countries can cut their public debt/GDP ratios via sovereign debt restructuring, because the resultant need to recapitalize domestic banks (which have high exposure to domestic sovereign debt) would be borne by the ESM rather than the domestic government. We do not expect a full EMU breakup, but nor do we expect a sufficient move to fiscal burden-sharing to resolve the fiscal problems of periphery countries.

Both Portugal and Ireland are likely to need some form of debt restructuring in coming years, although it is unclear whether for Ireland this will include PSI

We continue to believe Portugal and Ireland will probably both need, and get, a second bailout. But, with both countries likely to face persistent economic weakness and government debt/GDP ratios above 125% in 2013 or 2014, eventual debt restructuring is likely, perhaps during 2013-15[7]. In Ireland's case, we doubt that restructuring of the promissory notes (by coupon reductions and maturity extension) would be enough to return Ireland to a sustainable fiscal path. But, if other EMU partners agree, it may be possible to achieve the necessary restructuring by shifting part or all the existing bank recapitalization costs into a direct ESM obligation rather than via PSI.

Major central banks are likely to keep policy loose or loosen further

Against this backdrop, we continue to expect that major central banks will loosen further, or maintain an easing bias, in coming months. We now forecast the ECB will cut the refi rate to 0.25% by end-2012, versus our prior 0.5% forecast, and this will probably take the deposit rate to minus 50bp. We also expect the ECB will implement other non-standard measures, with a renewed multi-year LTRO programme and wider pool of accepted collateral. Denmark also is likely to cut rates further into negative territory. The UK BoE has resumed its QE programme, and is likely to expand it markedly further in coming quarters. We expect the PBOC will cut both rates and reserve requirements further, while U.S Fed officials are weighing a new lending effort or asset purchases as well as enhanced communications.

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[7] See "Euro Economics Weekly - Ireland — Recession Casts Doubt On Fiscal Sustainability, Jürgen Michels et al, 18 May 2012, Citi.

Figure 8. Selected Countries — Economic Forecast Overview (Percent), 2011-2016F

	GDP Growth						CPI Inflation						Short-Term Interest Rates					
	2011	2012F	2013F	2014F	2015F	2016F	2011	2012F	2013F	2014F	2015F	2016F	2011	2012F	2013F	2014F	2015F	2016F
Global	3.0	2.5	2.8	3.4	3.7	3.9	3.6	2.7	2.7	3.0	2.8	2.8	2.48	2.30	2.22	2.48	2.77	3.16
Based on PPP weights	*3.6*	*3.0*	*3.3*	*3.8*	*4.0*	*4.2*	*4.2*	*3.1*	*3.0*	*3.3*	*3.1*	*3.1*						
Industrial Countries	1.3	1.1	1.1	1.9	2.3	2.6	2.3	1.7	1.5	1.9	1.5	1.6	0.76	0.56	0.46	0.60	0.95	1.55
United States	1.7	1.9	2.0	3.5	3.5	4.0	2.5	1.7	1.6	2.1	2.2	2.2	0.25	0.25	0.25	0.40	1.15	2.10
Japan	-0.7	2.7	2.1	0.3	1.5	1.2	-0.3	0.2	-0.1	2.7	0.3	0.5	0.10	0.10	0.10	0.10	0.10	0.27
Euro Area	1.5	-0.6	-0.9	0.6	1.0	1.4	2.7	2.3	1.8	1.2	0.9	1.0	1.19	0.69	0.25	0.25	0.31	0.75
Canada	2.4	2.0	2.2	2.7	3.2	3.5	2.9	1.7	1.8	2.0	2.0	2.0	1.00	1.00	1.63	2.19	2.50	3.00
Australia	2.1	3.7	3.4	3.8	3.8	3.6	3.4	1.8	3.2	2.9	2.7	2.5	4.75	3.56	3.44	4.50	5.00	5.25
New Zealand	1.3	2.3	2.8	3.0	3.2	3.4	4.0	1.5	2.2	2.6	2.9	2.8	2.50	2.50	2.94	4.00	5.00	5.50
Germany	3.1	1.2	0.8	0.8	1.3	1.5	2.3	2.0	2.2	2.5	2.2	2.2						
France	1.7	-0.2	-0.2	0.9	1.2	1.8	2.1	2.0	1.3	1.3	1.7	1.5						
Italy	0.5	-2.5	-2.2	0.0	0.7	0.7	2.9	3.0	1.8	0.1	-0.1	0.8						
Spain	0.7	-1.8	-3.3	0.2	1.3	1.9	3.1	1.8	2.1	0.8	0.8	1.3						
Greece	-6.9	-7.5	-10.1	-1.1	4.5	4.3	3.1	1.0	15.1	19.0	6.3	6.0						
Ireland	1.4	-0.7	0.6	2.6	2.3	2.4	0.2	0.8	0.2	0.5	0.6	0.7						
Portugal	-1.6	-4.6	-5.6	-0.8	1.4	2.1	3.6	2.5	1.5	0.6	0.0	0.1						
Netherlands	1.1	-1.4	-0.6	0.7	1.1	1.4	2.3	2.8	2.5	1.6	1.9	1.8						
Belgium	2.0	0.2	-0.2	0.8	1.5	1.9	3.5	2.5	1.3	1.9	2.2	2.2						
Denmark	1.0	0.7	1.3	1.6	1.7	1.8	2.8	2.5	1.7	1.5	1.6	1.8	1.30	0.16	-0.30	0.00	0.41	1.00
Norway	2.5	3.0	2.9	2.7	2.7	2.9	1.3	0.9	1.7	2.0	2.4	2.5	2.10	1.50	1.90	2.30	2.90	3.30
Sweden	4.0	0.4	1.9	2.4	2.5	2.7	3.0	1.2	1.6	2.2	2.1	2.0	1.80	1.20	1.10	1.60	2.10	2.50
Switzerland	2.1	1.4	0.8	1.1	1.1	1.1	0.2	-0.9	-1.4	-0.9	0.4	0.7	0.22	0.00	0.00	0.00	0.00	0.00
United Kingdom	0.7	-0.5	0.3	0.9	1.5	2.3	4.5	2.5	1.8	1.8	1.5	1.5	0.50	0.50	0.50	0.50	0.50	1.04
Emerging Markets	6.0	4.9	5.5	5.7	5.7	5.7	6.0	4.5	4.6	4.7	4.7	4.6	5.6	5.2	5.0	5.3	5.4	5.4
China	9.2	7.9	8.0	7.6	7.3	7.0	5.4	2.7	2.9	3.8	4.0	4.0	3.2	3.5	3.0	3.6	4.0	4.0
Taiwan	4.0	2.4	3.6	4.5	4.5	4.5	1.4	1.9	2.1	1.8	1.8	1.8	0.8	0.9	0.9	1.0	1.2	1.4
India	6.5	6.4	6.9	7.1	7.3	7.4	8.9	7.4	6.5	6.0	6.0	6.0	8.2	7.8	7.5	7.5	7.5	7.5
Indonesia	6.5	6.1	6.3	6.7	6.5	6.7	5.4	4.4	4.7	5.3	5.8	5.4	5.4	3.8	4.2	4.5	4.6	5.1
Korea	3.6	2.8	3.6	3.8	4.0	4.2	4.0	2.8	3.0	3.1	3.0	3.2	3.2	3.1	2.6	3.3	4.0	4.4
Czech Republic	1.7	-1.1	0.6	2.0	2.2	2.8	1.9	3.5	2.6	1.4	1.7	1.6	0.8	0.6	0.3	1.0	1.6	2.3
Hungary	1.7	-0.9	0.8	2.0	2.0	1.8	3.9	5.6	3.9	3.5	3.1	3.3	6.0	6.9	5.8	5.5	5.4	5.0
Poland	4.3	2.7	2.4	3.1	3.4	3.4	4.3	3.9	2.6	2.5	2.5	2.5	4.2	4.7	4.3	4.4	4.8	4.8
Romania	2.5	1.3	3.0	4.2	4.3	4.3	5.8	2.8	2.7	2.5	2.5	2.5	6.2	5.3	5.0	5.0	5.0	5.0
Russia	4.3	3.5	4.0	4.1	4.0	4.2	8.4	5.1	6.9	5.8	5.5	5.0	8.1	8.0	7.1	6.0	6.0	5.4
Turkey	8.5	2.5	4.3	4.6	4.6	4.6	6.5	9.1	7.0	6.0	5.9	5.4	6.0	5.8	6.3	8.0	7.6	7.5
Nigeria	7.8	7.4	6.8	7.2	6.9	7.2	10.8	12.4	9.8	10.3	9.5	9.0	8.9	15.0	12.5	10.5	10.0	9.5
South Africa	3.1	2.7	3.6	4.2	4.4	4.2	5.0	5.8	5.0	5.2	5.3	5.3	5.5	5.3	5.0	5.3	5.5	5.5
Argentina	8.9	1.5	3.0	2.0	2.0	3.5	9.8	9.8	11.8	15.0	15.0	18.0	13.5	13.3	17.7	22.0	25.0	25.0
Brazil	2.7	1.8	4.5	4.5	4.5	4.5	6.6	5.1	5.2	4.5	4.0	4.0	11.7	8.5	7.9	9.4	9.0	8.3
Mexico	3.9	3.9	3.8	3.5	3.6	3.7	3.4	4.0	3.9	3.9	3.8	3.7	4.5	4.5	4.5	4.6	5.5	6.4
Venezuela	4.2	5.0	3.5	4.0	3.0	2.5	27.1	23.3	27.8	31.9	29.9	29.9	13.3	14.4	14.4	13.0	12.9	12.7

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

Figure 9. Selected Countries — Economic Forecast Overview (Percent), 2011-2016F

	Current Balance (Pct of GDP)						Fiscal Balance (Pct of GDP)						Government Debt (Pct of GDP)					
	2011	2012F	2013F	2014F	2015F	2016F	2011	2012F	2013F	2014F	2015F	2016F	2011	2012F	2013F	2014F	2015F	2016F
Global	0.3	0.1	-0.1	-0.2	-0.1	-0.1	-4.9	-4.3	-3.4	-2.9	-2.6	-2.3	81	82	82	82	81	79
Based on PPP weights	*0.5*	*0.2*	*0.0*	*-0.2*	*-0.2*	*-0.1*	*-4.3*	*-4.0*	*-3.3*	*-2.8*	*-2.5*	*-2.3*						
Industrial Countries	-0.7	-0.9	-0.9	-0.7	-0.6	-0.5	-6.9	-5.9	-4.5	-3.7	-3.1	-2.8	107	112	115	115	116	116
United States	-3.1	-3.2	-3.2	-3.1	-3.2	-3.2	-9.6	-8.1	-5.9	-4.9	-4.0	-4.0	103	107	110	112	112	112
Japan	2.0	1.0	1.2	1.7	1.7	1.7	-10.7	-10.5	-7.9	-6.6	-6.2	-5.8	228	235	240	241	246	250
Euro Area	0.0	0.2	0.2	0.3	0.4	0.6	-4.1	-3.3	-2.8	-2.4	-1.8	-1.3	87	96	96	95	95	93
Canada	-2.8	-2.7	-2.2	-1.7	-1.1	-0.5	-1.4	-1.2	-0.5	-0.1	0.2	0.4	85	85	84	83	81	79
Australia	-2.3	-4.1	-5.3	-4.9	-3.5	-3.2	-3.4	-3.0	0.1	0.1	0.3	0.4	6	10	9	9	8	7
New Zealand	-4.2	-5.0	-7.0	-6.4	-5.8	-5.5	-9.2	-4.1	-3.6	-0.9	0.1	0.9	22	27	31	34	35	36
Germany	5.7	5.2	3.7	3.6	3.4	3.2	-1.0	-0.3	-0.2	-0.4	-0.2	0.0	81	83	82	81	79	77
France	-2.2	-1.9	-1.1	-0.3	0.3	0.4	-5.2	-4.4	-3.8	-3.5	-2.6	-1.8	86	93	99	101	100	99
Italy	-3.2	-2.3	-1.8	-1.5	-1.3	-1.2	-3.9	-2.9	-2.9	-2.5	-2.0	-1.6	120	129	136	138	138	138
Spain	-3.5	-2.9	-2.3	-1.9	-1.7	-1.4	-8.9	-6.5	-5.9	-4.5	-3.6	-2.3	69	93	93	96	97	96
Greece	-9.8	-7.7	-3.4	0.7	2.4	3.0	-9.1	-11.0	-5.2	-2.2	-0.6	-3.7	165	157	437	382	103	92
Ireland	1.1	0.1	2.5	5.2	6.9	8.4	-12.8	-8.3	-8.6	-6.0	-4.9	-5.0	108	120	127	128	128	129
Portugal	-8.1	-4.5	-2.5	-1.5	-1.4	-1.0	-4.2	-5.0	-5.8	-5.8	-3.4	-2.3	108	123	138	93	96	96
Netherlands	8.5	9.7	9.6	8.6	7.6	7.2	-4.7	-4.6	-3.7	-3.7	-2.9	-2.3	65	73	76	79	79	79
Belgium	-1.0	-1.3	-0.8	0.0	0.9	1.4	-3.7	-2.8	-2.6	-2.3	-1.5	-1.1	98	112	119	118	115	112
Denmark	6.6	5.5	5.4	4.0	3.5	3.7	-1.9	-3.5	-2.0	-1.9	-1.7	0.5	47	49	49	50	50	48
Norway	14.0	14.3	14.9	15.2	15.8	16.5	13.8	13.6	14.0	15.0	17.0	18.5	NA	NA	NA	NA	NA	NA
Sweden	7.0	7.0	7.2	7.3	7.2	7.3	0.1	-0.1	-0.2	0.6	1.2	1.5	37	37	36	33	31	28
Switzerland	14.8	12.4	11.1	10.4	10.4	10.5	0.7	0.5	0.1	0.2	-0.1	-0.4	52	51	50	50	50	50
United Kingdom	-1.9	-2.6	-1.4	-0.4	0.4	0.9	-8.4	-6.9	-8.2	-7.7	-7.3	-6.3	83	88	96	102	107	110
Emerging Markets	2.1	1.7	1.1	0.5	0.5	0.4	-1.4	-1.8	-1.8	-1.7	-1.8	-1.7	33	32	32	31	30	29
China	2.8	2.0	1.5	1.0	1.0	1.0	-1.3	-2.4	-1.5	-1.0	-1.0	-1.0	15	16	16	16	15	15
Taiwan	8.8	8.7	8.4	8.0	8.0	8.0	-1.9	-1.6	-1.6	-1.3	-1.0	-0.7	39	39	40	42	43	44
India	-4.0	-3.5	-2.6	-2.2	-1.7	-1.1	-8.4	-8.0	-7.7	-7.0	-6.5	-5.0	69	69	68	66	64	63
Indonesia	0.2	-1.9	-1.2	-0.9	-1.0	-0.9	-1.2	-1.8	-0.7	-1.0	-0.5	-0.5	26	25	24	23	23	22
Korea	2.4	1.8	1.9	1.2	0.2	-0.7	1.5	1.2	1.5	1.6	1.5	2.2	33	33	32	31	29	27
Czech Republic	-3.0	-2.9	-1.9	-2.6	-1.9	-1.4	-3.1	-3.2	-3.1	-2.3	-1.5	-0.5	41	45	47	47	46	45
Hungary	1.7	1.9	2.7	2.5	2.2	2.0	4.3	-3.1	-3.7	-3.0	-3.0	-3.0	81	78	79	78	78	78
Poland	-4.3	-3.8	-4.5	-5.2	-5.3	-4.9	-5.1	-3.1	-2.5	-1.8	-1.5	-1.5	54	52	50	48	47	45
Romania	-4.4	-4.5	-4.7	-5.0	-5.0	-5.0	-4.1	-2.4	-2.2	-2.5	-2.3	-2.0	39	39	39	39	38	37
Russia	5.3	5.7	2.4	-1.0	-1.0	-1.0	2.0	0.3	0.1	-0.1	-1.1	-1.1	8	9	8	8	8	8
Turkey	-10.0	-7.5	-7.0	-6.5	-6.0	-5.6	-1.3	-2.2	-2.5	-2.5	-2.7	-3.0	41	41	39	39	38	36
Nigeria	3.4	2.3	3.5	3.0	1.9	1.3	-3.1	-2.2	-2.1	-2.6	-3.0	-2.6	NA	NA	NA	NA	NA	NA
South Africa	-3.4	-4.7	-5.6	-6.6	-6.3	-5.8	-5.0	-4.8	-4.2	-3.6	-3.5	-3.5	38	41	42	43	43	42
Argentina	0.0	0.3	-0.8	-1.0	-1.0	-1.0	-1.7	-2.8	-3.0	-3.0	-3.0	-3.0	40	38	40	41	42	43
Brazil	-2.3	-2.3	-2.7	-2.9	-3.2	-3.5	-2.6	-1.9	-2.7	-2.5	-2.3	-2.6	54	54	55	55	56	56
Mexico	-0.8	-1.0	-1.4	-2.5	-2.4	-2.6	-2.5	-2.2	-2.0	-1.9	-1.9	-1.8	40	40	38	38	38	37
Venezuela	9.1	7.2	4.1	6.3	6.7	6.1	-5.0	-5.0	-4.0	-5.2	-5.0	-4.8	43	34	35	36	36	37

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

Figure 10. Selected Countries — Changes in Economic Forecast from the Previous Month (Percentage Points), 2011-2013F

	GDP Growth			CPI Inflation			Current Balance (Pct of GDP)			Fiscal Balance (Pct of GDP)		
	2011	2012F	2013F	2011	2012F	2013F	2011	2012F	2013F	2011	2012F	2013F
Global		**-0.1**	**0.1**	**-0.1**	**-0.1**		**-0.2**	**-0.2**	**-0.4**			
Based on PPP weights			*0.1*		*-0.1*	*-0.1*	*-0.2*	*-0.3*	*-0.3*		*-0.1*	*-0.1*
Industrial Countries		**-0.1**	**0.1**			**0.2**	**-0.2**	**-0.3**	**-0.5**	**-0.1**	**-0.2**	
United States		-0.2				0.1			-0.2	-0.2	-0.3	
Japan			0.7					-0.5	-0.5			0.2
Euro Area		**0.1**	**-0.1**			**0.2**		**0.2**	**0.1**			**-0.1**
Canada					0.1	0.2		-0.1	0.2			
Australia	0.1											
New Zealand					-0.1	-0.2						
Germany			-0.1		0.1	0.1	-0.1		-0.1		0.3	0.2
France		-0.1		-0.2	-0.1	0.5					0.1	0.2
Italy		0.1	-0.2		-0.1	0.8						
Spain		0.3	-0.2		0.3	1.8		-0.4	-0.6		-0.3	0.1
Greece					0.1	0.1	-0.2	-0.1	0.1		-0.2	0.6
Ireland	0.7	0.3	0.2	0.6	0.7		1.0	-3.7	-1.5	0.2	1.1	1.2
Portugal			-0.1		-0.1						0.5	-1.6
Netherlands	-0.2	0.1					0.1	0.1	0.1		-0.1	-0.2
Belgium		0.2	0.1		-0.4	-0.4	-0.2	-1.1	-1.1			
Denmark												
Norway					-0.4	-0.1						
Sweden												
Switzerland												
United Kingdom	0.1	-0.1	-0.3		-0.1			-0.9	-0.7	-0.1	-0.2	-0.3
Emerging Markets				**-0.1**	**-0.2**	**-0.2**	**-0.1**	**-0.2**	**-0.3**	**0.1**		**-0.1**
China		**0.1**	**0.1**		**-0.2**	**-0.2**						
Taiwan		-0.4	-0.6									
India				0.1								
Indonesia												
Korea												
Czech Republic		-0.1	-0.4		0.3	0.2		-0.7	0.3			-0.2
Hungary					0.4	0.4		0.7	0.8		-0.3	-1.2
Poland												
Romania												
Russia								-0.1				
Turkey					-0.3				-0.1			
Nigeria							-2.7	-3.4	-2.9			
South Africa					-0.3	-0.4						
Argentina		-1.5			0.2	0.4		0.2	-0.5	-0.1	0.2	-1.0
Brazil		-0.5				-0.1	-0.2	-0.2	-0.2			
Mexico								0.4	0.6			
Venezuela					-0.3	0.3		2.3	0.4			

Source: Citi Research

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

	10-Year Yields						Exchange Rates Versus U.S. Dollar*						Exchange Rate Versus Euro					
	2011	2012F	2013F	2014F	2015F	2016F	2011	2012F	2013F	2014F	2015F	2016F	2011	2012F	2013F	2014F	2015F	2016F
Industrial Countries																		
United States	2.80	1.75	2.20	3.00	3.40	3.75	NA	NA	NA	NA	NA	NA	1.39	1.26	1.18	1.29	1.33	1.35
Japan	1.12	0.90	1.18	1.25	1.75	1.75	79	80	82	84	84	84	110	100	97	108	112	114
Euro Area	2.71	1.39	1.48	2.30	2.50	3.00	1.39	1.26	1.18	1.29	1.33	1.35	NA	NA	NA	NA	NA	NA
Canada	2.78	1.79	2.59	3.40	3.50	3.75	1.01	1.01	1.00	0.97	0.96	0.96	1.39	1.27	1.18	1.25	1.28	1.30
Australia	4.63	3.25	3.83	4.90	5.25	5.50	1.01	1.03	0.97	0.91	0.90	0.90	1.37	1.22	1.21	1.42	1.48	1.51
New Zealand	4.74	3.58	4.21	4.75	5.25	5.75	0.77	0.80	0.73	0.66	0.65	0.65	1.79	1.56	1.63	1.96	2.05	2.09
Germany	2.71	1.39	1.48	2.30	2.50	3.00												
France	3.31	2.52	2.49	3.20	3.30	3.60												
Italy	5.19	6.64	7.98	7.30	7.00	6.50												
Spain	5.43	6.76	7.98	7.10	6.70	6.20												
Netherlands	3.04	1.93	2.09	2.70	2.85	3.30												
Belgium	4.21	3.06	2.89	3.40	3.50	3.80												
Denmark	2.80	1.16	1.25	2.35	2.65	3.25												
Norway	3.07	1.95	2.06	2.90	3.20	3.75	5.66	5.99	6.25	5.66	5.51	5.41	7.84	7.52	7.40	7.31	7.30	7.31
Sweden	2.66	1.40	1.52	2.35	2.60	3.25	6.60	6.88	7.11	6.51	6.36	6.26	9.14	8.64	8.41	8.40	8.43	8.46
Switzerland	1.53	0.65	0.70	1.10	1.50	2.10	0.90	0.96	1.01	0.93	0.93	0.94	1.25	1.20	1.20	1.21	1.24	1.27
United Kingdom	3.00	1.65	1.75	2.00	2.50	3.00	1.59	1.57	1.53	1.64	1.68	1.71	0.87	0.80	0.77	0.79	0.79	0.79
Emerging Markets																		
China	3.52	2.72	2.61	3.30	3.67	3.67	6.46	6.35	6.31	6.16	6.12	6.09	9.00	7.97	7.47	7.95	8.12	8.23
Taiwan	1.38	1.35	1.50	1.60	1.70	1.80	29.40	29.99	30.15	28.66	28.39	28.29	40.93	37.66	35.66	36.99	37.66	38.23
India	8.40	8.25	8.25	8.25	8.25	8.25	46.63	53.79	54.66	52.45	51.48	50.71	64.92	67.54	64.64	67.68	68.29	68.53
Indonesia	7.20	6.06	6.45	7.00	7.00	7.00	8763	9383	9625	9641	9596	9546	12201	11782	11383	12442	12729	12900
Korea	3.90	3.21	2.86	3.75	4.63	5.00	1108	1143	1163	1085	1049	1020	1542	1435	1375	1400	1391	1378
Czech Republic	3.68	3.39	3.39	3.46	3.82	4.00	17.7	20.1	21.7	19.1	17.9	16.9	24.6	25.3	25.7	24.6	23.7	22.9
Hungary	7.63	8.07	6.63	6.41	6.19	5.90	201	232	243	224	216	209	279	291	287	289	286	283
Poland	5.99	5.63	5.38	5.55	5.57	5.40	2.96	3.35	3.63	3.06	2.94	2.89	4.12	4.21	4.30	3.94	3.90	3.90
Romania	NA	NA	NA	NA	NA	NA	3.04	3.50	3.63	3.23	3.06	2.93	4.23	4.40	4.30	4.17	4.07	3.96
Russia	NA	NA	NA	NA	NA	NA	29.4	32.2	34.8	33.1	32.0	31.0	41.0	40.4	41.1	42.7	42.4	41.9
Turkey	NA	NA	NA	NA	NA	NA	1.68	1.80	1.86	1.86	1.88	1.91	2.34	2.25	2.20	2.40	2.50	2.58
Nigeria	NA	NA	NA	NA	NA	NA	156	161	165	163	165	164	217	202	195	210	219	222
South Africa	8.24	8.21	8.90	9.15	9.20	9.20	7.26	8.11	8.65	8.78	9.16	9.57	10.11	10.19	10.23	11.34	12.15	12.93
Argentina	NA	NA	NA	NA	NA	NA	4.13	4.55	5.45	6.75	8.34	9.99	5.74	5.72	6.45	8.71	11.07	13.50
Brazil	11.45	10.07	9.48	9.24	8.75	8.25	1.67	1.96	2.03	1.95	1.90	1.85	2.33	2.46	2.40	2.52	2.52	2.50
Mexico	6.83	5.87	6.27	6.75	6.99	7.29	12.4	13.2	13.4	12.4	12.5	12.8	17.3	16.5	15.8	16.0	16.6	17.2
Venezuela	13.65	12.44	12.64	13.90	13.80	13.70	4.29	4.30	6.50	6.50	9.75	9.75	5.98	5.40	7.69	8.39	12.93	13.18

*Per USD except Euro Area, Australia, New Zealand, United Kingdom. Note: All foreign exchange forecasts are consistent with the rolling forecasts presented in Figure 80. Source: Citi Research

Figure 12. Short Rates (End of Period), as of 25 Jul 2012 (Percent)

	Current	3Q 12	4Q 12	1Q 13	2Q 13	3Q 13	4Q 13
United States	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Japan	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Euro Area	0.75	0.50	0.25	0.25	0.25	0.25	0.25
Canada	1.00	1.00	1.00	1.25	1.50	1.75	2.00
Australia	3.50	3.25	3.25	3.25	3.25	3.50	3.75
New Zealand	2.50	2.50	2.50	2.50	2.75	3.00	3.50
Denmark	0.20	-0.10	-0.45	-0.45	-0.35	-0.25	-0.25
Norway	1.50	1.50	1.50	1.75	1.75	2.00	2.00
Sweden	1.50	1.25	1.00	1.00	1.00	1.00	1.00
Switzerland	0.00	0.00	0.00	0.00	0.00	0.00	0.00
United Kingdom	0.50	0.50	0.50	0.50	0.50	0.50	0.50
China	3.25	2.75	2.75	2.75	2.75	3.00	3.25

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

Figure 13. 10-Year Yield Forecasts (Period Average), as of 25 Jul 2012 (Percent)

	Current	3Q 12	4Q 12	1Q 13	2Q 13	3Q 13	4Q 13
United States	1.41	1.45	1.65	1.80	2.10	2.35	2.60
Japan	0.73	0.80	0.95	1.10	1.20	1.10	1.30
Euro area (Germany)	1.26	1.15	1.00	1.15	1.25	1.50	2.00
Canada	1.59	1.50	1.70	2.10	2.50	2.75	3.00
Australia	2.73	2.90	3.10	3.30	3.70	4.00	4.30
New Zealand	3.24	3.30	3.50	3.70	4.00	4.40	4.75
Denmark	1.05	0.85	0.50	0.65	1.05	1.40	1.90
Norway	1.71	1.75	1.60	1.75	1.85	2.05	2.55
Sweden	1.24	1.15	1.00	1.15	1.30	1.55	2.05
Switzerland	0.50	0.50	0.44	0.50	0.54	0.64	0.84
United Kingdom	1.46	1.40	1.25	1.40	1.50	1.75	2.25

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

Figure 14. 10-Year Yield Spreads (Period Average), as of 25 Jul 2012

	Spread vs. US$						Spread vs. Germany					
	Current	3Q 12	4Q 12	1Q 13	2Q 13	3Q 13	Current	3Q 12	4Q 12	1Q 13	2Q 13	3Q 13
United States	NA	NA	NA	NA	NA	NA	15	31	66	66	86	86
Japan	-68	-66	-71	-71	-91	-126	-53	-35	-5	-5	-5	-40
Euro Area	-15	-31	-66	-66	-86	-86	NA	NA	NA	NA	NA	NA
Canada	18	5	5	30	40	41	34	36	71	96	127	127
Australia	133	147	147	152	162	168	149	177	212	218	248	254
New Zealand	185	187	187	193	193	208	201	218	253	258	279	295
France	87	69	44	44	19	14	102	100	110	110	105	100
Italy	511	569	634	634	564	564	526	600	700	700	650	650
Spain	624	619	634	634	564	564	639	650	700	700	650	650
Netherlands	35	19	4	4	-21	-26	50	50	70	70	65	60
Belgium	141	109	84	84	59	54	156	140	150	150	145	140
Denmark	-36	-61	-116	-116	-106	-96	-21	-30	-50	-50	-20	-10
Norway	30	29	-6	-6	-26	-31	45	60	60	60	60	55
Sweden	-17	-31	-66	-66	-81	-81	-2	0	0	0	5	5
Switzerland	-91	-96	-122	-131	-157	-172	-76	-65	-56	-65	-71	-86
United Kingdom	5	-6	-41	-41	-61	-61	20	25	25	25	25	25

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

Figure 15. Emerging Market Countries — Short Rates Actual and Forecast of Additional Rate Moves (End of Period), as of 25 Jul 2012

Country	Current Rate (%)	Sep 12	Dec 12	Mar 13	Jun 13	Sep 13	Total Cumulative Rate Moves Expected
Turkey	5.75	0	0	0	0	75	75
Indonesia	3.75	0	0	25	25	0	50
Brazil	8.00	-50	-25	0	0	100	25
Thailand	3.00	0	0	0	0	25	25
Mexico	4.50	0	0	0	0	0	0
South Africa	5.00	0	0	0	0	0	0
China	3.00	-25	0	0	0	0	-25
Colombia	5.25	0	-50	0	0	25	-25
Czech	0.50	0	-25	0	0	0	-25
Israel	2.25	-25	0	0	0	0	-25
Chile	5.00	0	-50	0	0	0	-50
Korea	3.00	0	-25	-25	0	0	-50
Philippines	4.00	-25	-25	0	0	0	-50
Poland	4.75	0	0	-25	-25	0	-50
India	8.00	0	-50	-25	0	0	-75
Hungary	7.00	0	-50	-50	-25	-25	-150
Russia	8.00	0	0	-50	-50	-50	-150

Source: Citi Research

Figure 16. Foreign Exchange Forecasts (End of Period), as of 25 Jul 2012

	vs. USD						vs. EUR					
	Current	Sep 12	Dec 12	Mar 13	Jun 13	Sep 13	Current	Sep 12	Dec 12	Mar 13	Jun 13	Sep 13
United States	NA	NA	NA	NA	NA	NA	1.22	1.22	1.20	1.18	1.16	1.18
Japan	79	78	79	80	82	82	96	95	95	95	94	97
Euro Area	1.22	1.22	1.20	1.18	1.16	1.18	NA	NA	NA	NA	NA	NA
Canada	1.01	1.01	1.01	1.00	1.00	0.99	1.23	1.23	1.21	1.18	1.16	1.17
Australia	1.04	1.04	1.02	1.00	0.98	0.96	1.17	1.17	1.17	1.17	1.17	1.22
New Zealand	0.80	0.80	0.79	0.76	0.74	0.71	1.52	1.52	1.53	1.55	1.57	1.65
Norway	6.08	6.13	6.22	6.31	6.41	6.26	7.42	7.48	7.47	7.44	7.41	7.38
Sweden	6.92	6.96	7.05	7.16	7.28	7.12	8.45	8.49	8.47	8.44	8.41	8.40
Switzerland	0.98	0.98	1.00	1.02	1.04	1.02	1.20	1.20	1.20	1.20	1.20	1.20
United Kingdom	1.57	1.56	1.55	1.53	1.51	1.53	0.78	0.78	0.78	0.77	0.77	0.77
China	6.37	6.38	6.37	6.36	6.34	6.30	7.8	7.8	7.7	7.5	7.3	7.4
India	55.3	54.3	54.3	54.8	55.2	54.7	67.5	66.2	65.3	64.5	63.8	64.5
Korea	1141	1140	1152	1167	1182	1164	1392	1391	1384	1375	1365	1373
Poland	3.41	3.44	3.55	3.67	3.80	3.65	4.16	4.20	4.26	4.32	4.39	4.30
Russia	32.0	33.0	33.9	34.6	35.3	34.9	39.0	40.3	40.7	40.7	40.7	41.2
South Africa	8.26	8.25	8.37	8.52	8.67	8.70	10.08	10.07	10.06	10.04	10.01	10.27
Turkey	1.81	1.79	1.81	1.84	1.87	1.87	2.20	2.18	2.17	2.17	2.16	2.21
Brazil	2.01	1.99	2.00	2.03	2.05	2.04	2.46	2.42	2.40	2.39	2.37	2.40
Mexico	13.3	13.2	13.3	13.5	13.7	13.4	16.2	16.1	16.0	15.9	15.8	15.8

Note: All foreign exchange forecasts are consistent with the rolling forecasts presented in Figure 79. Source: Citi Research

Figure 17. Foreign Exchange Forecasts (End of Period), as of 25 Jul 2012

	vs. JPY					
	Current	Sep 12	Dec 12	Mar 13	Jun 13	Sep 13
United States	79	78	79	80	82	82
Japan	NA	NA	NA	NA	NA	NA
Euro Area	96	95	95	95	94	97
Canada	78	77	78	80	82	83
Australia	82	81	81	81	80	79
New Zealand	63.0	62.8	62.1	61.1	60.1	58.8
Norway	12.9	12.7	12.7	12.7	12.7	13.2
Sweden	11.4	11.2	11.2	11.2	11.2	11.6
Switzerland	80	79	79	79	79	81
United Kingdom	123	122	122	123	123	126
China	12	12	12	13	13	13
India	1.42	1.44	1.45	1.47	1.48	1.51
Korea	14.52	14.60	14.57	14.52	14.46	14.13
Poland	23.1	22.7	22.3	21.9	21.5	22.6
Russia	2.5	2.4	2.3	2.3	2.3	2.4
South Africa	9.5	9.5	9.4	9.4	9.4	9.5
Turkey	43.5	43.7	43.8	43.7	43.6	44.0
Brazil	39.0	39.3	39.5	39.6	39.8	40.4
Mexico	5.9	5.9	5.9	6.0	6.0	6.1

Note: All foreign exchange forecasts are consistent with the rolling forecasts presented in Figure 79. Source: Citi Research

Country Commentary

United States

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Expansion's pace appears to have slowed to a meager 1½% or less in the second quarter. Although some softening reflects payback from temporary factors, the pullback in hiring and retail sales has raised doubts about the second half. The Fed has indicated a readiness to buoy financial conditions if hiring does not improve. Consumer finances have benefited from slowing inflation and easier credit, while numerous housing indicators are pointing higher. But the upside appears checked for now by economic policy uncertainty and ongoing fiscal drag. Our base case assumes the U.S. will avoid massive fiscal tightening in 2013 but meaningful restraint from the public sector is still likely next year and beyond.

Worries about financial headwinds from Europe and the threatened 4% U.S. fiscal cliff amid already subpar growth have pushed the Fed closer to another major easing step. Although Operation Twist has been extended, officials are weighing a new lending effort or asset purchases as well as enhanced communications. We would not rule out an early August move but September seems the more likely timeframe. There are higher perceived costs to growing the balance sheet, but it's doubtful the policy status quo can survive another downgrade to the outlook and the easing vigil is likely to extend well into 2013.

Despite the threat from prospective food crop shortfalls, we do not anticipate a change in relatively muted underlying inflation patterns. Wage growth has bottomed but labor costs remain contained along with longer-term inflation expectations, providing an element of monetary policy flexibility.

Figure 18. United States — Economic Forecasts, 2011-2013F

					2012				2013			
		2011	2012F	2013F	1QE	2QF	3QF	4QF	1QF	2QF	3QF	4QF
GDP	SAAR				1.9%	1.3%	1.7%	2.0%	1.3%	2.0%	3.2%	3.5%
	YoY	1.7%	1.9%	2.0%	2.0	2.0	1.9	1.7	1.6	1.7	2.1	2.5
Domestic Demand	SAAR				1.6	1.1	1.7	1.9	1.4	2.2	3.1	3.5
	YoY	1.8	1.6	2.0	1.7	1.7	1.5	1.6	1.5	1.8	2.2	2.6
Consumption	SAAR				2.5	1.2	1.8	2.1	1.3	2.1	3.0	3.5
	YoY	2.2	1.8	2.0	1.7	1.9	1.9	1.9	1.6	1.8	2.1	2.5
Business Investment	SAAR				3.1	2.4	3.3	4.8	6.4	5.7	7.5	7.2
	YoY	8.8	5.4	5.5	8.5	6.5	3.5	3.4	4.2	5.0	6.1	6.7
Housing Investment	SAAR				20.0	11.0	12.3	14.9	16.7	21.8	18.4	22.3
	YoY	-1.3	12.0	17.0	9.0	10.8	13.7	14.5	13.7	16.4	17.9	19.8
Government	SAAR				-4.0	-0.8	-0.8	-1.8	-2.8	-1.7	-1.1	-1.1
	YoY	-2.1	-2.2	-1.7	-2.3	-2.3	-2.5	-1.9	-1.6	-1.8	-1.9	-1.7
Exports	SAAR				4.2	3.0	4.6	5.3	5.5	5.6	6.0	6.7
	YoY	6.7	3.8	5.4	3.8	3.6	3.6	4.3	4.6	5.3	5.6	6.0
Imports	SAAR				2.7	2.9	3.7	3.6	5.0	5.5	5.6	5.9
	YoY	4.9	2.8	4.7	2.2	2.6	3.2	3.2	3.8	4.5	4.9	5.5
PCE Deflator	YoY	2.5	1.7	1.6	2.3	1.7	1.3	1.4	1.2	1.5	1.8	1.9
Core PCE Deflator	YoY	1.4	1.9	1.6	2.0	1.9	1.8	1.8	1.7	1.6	1.6	1.7
Unemployment Rate	%	9.0	8.1	8.0	8.3	8.2	8.1	8.1	8.0	8.0	8.0	7.9
Federal Gov't Balance (Fiscal Year)	$Bn	-1297	-1175	-875								
	% of GDP	-8.7	-7.6	-5.5								
General Gov't Balance (Cal Year)	% of GDP	-9.6	-8.1	-5.9								
Federal Debt	% of GDP	68	74	78								
General Gov't Debt	% of GDP	103	107	110								
Current Account	US$bn	-466	-498	-511	-549	-492	-476	-477	-477	-510	-511	-547
	% of GDP	-3.1	-3.2	-3.2	-3.6	-3.2	-3.1	-3.0	-3.0	-3.2	3.2	-3.4
S&P 500 Profits (US$ Per Share)	YoY	14.4	5.5	4.6	8.9	6.5	1.4	5.7	2.7	5.3	4.2	6.2

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

Japan

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This month we have reflected the planned consumption tax hike in April 2014 into our forecasts given that the tax hike bill, calling for the tax rate to rise to 8% in April 2014 from 5% currently and to 10% in October 2015, is likely to pass the Parliament in August. As a result, we revised up our 2013 GDP growth forecast from 1.4% last month to 2.1% reflecting the likely frontloading in spending ahead of the tax hike. Economic growth in this year and next will probably be pushed up to an above-2% pace by reconstruction demand from the earthquake and frontloaded spending, respectively, when external environment is likely to remain challenging.

However, GDP growth in 2014 will inevitably slow sharply due to a payback to frontloaded spending and erosion in real household disposable income driven by tax hikes. We expect a sharp contraction in GDP right after the tax hike in April 2014, which in turn would make the second tax hike slated for October 2015 less likely to occur. Our base-case is that the second rate hike will not be implemented. There is a relatively benign general perception about Japan's sovereign at present, supported in part by the assumption that there is ample room for future consumption tax hikes. This, however, means that if the government's inability to implement planned hikes becomes clear, the perception about fiscal sustainability could be severely undermined.

We expect additional BoJ easing in late October. But the most likely measure is to increase the ceiling for short-term and longer-term JGB purchases under the asset purchase program. In our view, a reduction in the interest rate on excess reserve (currently 0.10%) is unlikely given the Governor's stance and the hurdle for extending the maturity of JGBs that the BoJ purchases also appears high. Devising measures with real accommodative effects is becoming increasingly difficult under the current framework, in our view. The BoJ's gradualism without meaningful positive effects on financial conditions and the real economy would probably just keep long-term interest rates low.

Figure 19. Japan — Economic Forecasts, 2011-13F

					2012				2013			
		2011	2012F	2013F	1Q	2QF	3QF	4QF	1QF	2QF	3QF	4QF
Real GDP	YoY	-0.7%	2.7%	2.1%	2.7%	3.7%	2.1%	2.3%	1.7%	1.7%	2.2%	2.7%
	SAAR				4.7	2.3	1.2	1.1	2.2	2.4	3.0	3.0
Domestic Demand	YoY	0.1	3.0	2.1	3.5	3.6	2.8	2.3	1.8	1.7	2.1	2.7
	SAAR				4.1	2.7	1.5	0.9	2.2	2.3	3.1	3.0
Private Consumption	YoY	0.1	2.9	1.4	3.6	3.5	2.6	1.8	0.9	0.9	1.4	2.5
	SAAR				4.9	1.8	0.8	-0.5	1.4	1.8	2.9	4.1
Business Investment	YoY	1.0	2.5	3.2	2.8	3.7	4.2	-0.4	2.5	2.8	3.4	4.1
	SAAR				-8.2	2.5	2.4	2.2	2.9	3.9	4.8	5.0
Housing Investment	YoY	5.4	3.1	15.1	0.0	5.2	1.8	5.5	12.4	14.9	17.7	15.4
Public Investment	YoY	-3.0	8.1	-1.1	9.4	5.7	8.0	9.5	4.8	0.0	-3.0	-6.0
Exports	YoY	-0.2	4.2	3.7	1.0	9.1	1.0	6.0	3.8	3.5	3.8	3.8
	SAAR				12.4	5.2	2.5	4.2	3.1	4.2	3.5	4.2
Imports	YoY	5.9	6.9	4.1	6.6	8.6	6.3	6.2	5.0	3.8	3.7	4.0
	SAAR				7.9	8.4	5.1	3.3	3.3	3.6	4.5	4.5
CPI	YoY	-0.3	0.2	-0.1	0.3	0.4	0.1	0.1	-0.3	-0.2	0.0	0.1
Core CPI	YoY	-0.3	0.0	-0.1	0.1	0.0	-0.2	-0.2	-0.3	-0.2	0.0	0.1
Nominal GDP	YoY	-2.8	2.0	1.9	1.4	3.0	1.6	2.1	1.5	1.5	2.0	2.5
Current Account	¥ tn	9.6	5.0	5.9	5.9	4.4	4.5	5.1	5.6	5.9	5.9	6.4
	% of GDP	2.0	1.0	1.2	1.2	0.9	0.9	1.1	1.2	1.2	1.2	1.3
Unemployment Rate	%	4.6	4.5	4.3	4.5	4.5	4.4	4.4	4.3	4.3	4.3	4.3
Industrial Production	YoY	-2.4	3.0	3.9	4.8	5.7	1.6	2.0	1.6	4.5	4.7	4.8
Corporate Profits (Fiscal Year)	YoY	-16.3	22.5	20.0								
General Govt. Balance (Fiscal Year)	% of GDP	-10.7	-10.5	-7.9								
General Govt Debt	% of GDP	228	235	240								

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

Euro Area

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The sovereign crisis continues to escalate. While market pressure is rising rapidly — especially on Spain — Moody's decision to put Germany, the Netherlands and Luxembourg Aaa ratings on Negative Outlook makes it clear that the core and soft-core countries also will be increasingly affected by the crisis. Taking into account the increasing reluctance in core countries to provide extra support to Greece and the problems of the Greek government to implement the existing programme, we increase our probability of Grexit in the next 12 to 18 months to about 90% from 50%-75% previously, and believe the most likely date is in the next 2-3 quarters, possibly following the September assessment. Note that in our economic forecasts, we continue to model an assumption that Greece leaves the euro area on January 1 2013.

Compared to last month, we are revising our GDP forecasts slightly, lifting the 2012 forecast by 0.1point to -0.6% and cutting the 2013 forecast by 0.1 points to -0.9%. In addition to indications of a somewhat smaller contraction of GDP in 2Q, the forecast changes mainly reflect the delay in the VAT rate hike in Italy. Growth will be hit by substantial fiscal tightening, ongoing deleveraging in the private sector and tight lending conditions by banks. Contagion from any Grexit would also have a negative impact on economic activity, particularly in periphery countries. With more negative news on the economy, suggesting that inflation will undershoot the ECB's target of "below, but close to 2%", we expect the ECB to cut the refi rate to 0.5% in 3Q, probably in September. Assuming that the ECB Governing Council were to maintain the current 75bp spread, this would likely push the deposit rate into negative territory to -0.25% from 0%. During 4Q we expect a further 25bp reduction in both rates, taking the refi rate to 0.25% and the deposit rate to -0.5%. Regarding non-standard measures, we expect that Spain and Italy will request support from the ESFS/ESM, and that the ECB would then provide more multi-year LTROs and also extend the eligible collateral pool. We do not expect that the ECB will re-activate the SMP any time soon.

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

Figure 20. Euro Area — Economic Forecasts, 2011-13F

					2012F				2013F			
		2011	2012F	2013F	1QF	2QF	3QF	4QF	1QF	2QF	3QF	4QF
Real GDP	YoY	1.5%	-0.6%	-0.9%	0.0%	-0.5%	-1.1%	-1.1%	-1.3%	-1.1%	-0.7%	-0.3%
	SAAR	-	-	-	0.1	-1.2	-1.8	-1.4	-0.7	-0.4	-0.5	0.2
Final Domestic Demand	YoY	0.3	-1.4	-1.4	-0.9	-1.0	-1.8	-1.8	-1.9	-1.6	-1.3	-0.9
Private Consumption	YoY	0.2	-1.0	-1.1	-0.7	-0.5	-1.5	-1.3	-1.4	-1.3	-1.0	-0.6
Government Consumption	YoY	-0.3	-0.3	-1.3	0.0	-0.1	-0.6	-0.5	-1.3	-1.4	-1.4	-1.2
Fixed Investment	YoY	1.6	-3.8	-2.7	-2.6	-3.6	-4.3	-4.7	-4.0	-3.0	-2.2	-1.5
— Business Equipment	YoY	3.7	-5.1	-3.5	-2.5	-4.5	-6.4	-6.8	-5.8	-4.0	-2.7	-1.6
— Construction	YoY	-0.8	-2.8	-2.0	-3.1	-2.7	-2.5	-3.0	-2.4	-2.4	-1.9	-1.5
Stocks (Contrib. to Y/Y GDP Growth)		0.2	-0.6	-0.1	-0.5	-0.9	-0.5	-0.3	-0.1	-0.1	-0.1	-0.1
Exports	YoY	6.3	1.9	1.6	3.0	1.9	0.9	1.8	1.2	1.5	1.7	1.9
Imports	YoY	4.1	-1.1	0.2	-0.7	-1.3	-2.1	0.0	0.0	0.2	0.2	0.4
CPI	YoY	2.7	2.3	1.8	2.7	2.5	2.2	2.0	1.7	1.6	2.0	1.7
Core CPI	YoY	1.4	1.5	1.3	1.5	1.6	1.6	1.4	1.4	1.2	1.5	1.2
CPI Ex Energy and Food	YoY	1.7	1.7	1.4	1.9	1.8	1.5	1.5	1.3	1.3	1.6	1.3
Unemployment Rate	YoY	10.2	11.1	11.4	10.9	11.1	11.2	11.3	11.4	11.4	11.4	11.4
Current Account Balance	EUR bn	-3.2	21.4	14.8								
	% of GDP	0.0	0.2	0.2								
General Government Balance	EUR bn	-387.6	-313.5	-263.9								
	% of GDP	-4.1	-3.3	-2.8								
Primary Balance	% of GDP	-1.1	0.0	0.6								
General Government Debt	EUR bn	8,215.3	9,066.1	9,111.9								
	% of GDP	87.2	95.8	95.9								
Gross Operating Surplus	YoY	2.5	-0.5	0.3								

Sources: Eurostat and Citi Research

Germany

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We keep our GDP forecast for 2012 unchanged, but – with business expectations worsening — we are cutting our 2013 forecast by 0.1 point to 0.8%. German exporters should increasingly suffer from the lack of demand from the rest of the euro area, although the weaker euro will probably allow modest gains in exports this year and in 2013. Next year will be a key election year, with state elections starting in January and the general election in the autumn. As those elections approach, a political stalemate is likely pretty soon. With the opposition parties demanding additional conditions before agreeing to give the ESM the ability to lend directly (e.g. bail-in system of equity and bond holders of banks), it will become increasingly difficult to obtain German parliamentary approval for more rescue measures.

France

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We are leaving our GDP baseline unchanged this month, expecting a small recession to begin in Q2 2012 and to continue for another two quarters. Our forecast is for GDP to fall by about 0.2% in both 2012 and 2013. The new government's supplementary budget will probably be enough to hit this year's deficit target of 4.5% of GDP. But for 2013, we believe that supplementary efforts (mainly spending cuts) will be needed to hit the 3% budget deficit target. Ratification of the fiscal compact treaty in the autumn will be the next big event for parliament after the holidays. With unemployment rising, the government faces a real test of its resolve and credibility, given that Mr Hollande pledged during the Presidential campaign to reverse industrial decline and protect manufacturing jobs.

Italy

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With thanks to Carla Clifton

We are revising our forecast for Italy's GDP growth in 2012 up by 0.1 points to -2.5% but are cutting the 2013 outlook by 0.2 points to -2.2%. This mainly reflects the delay of the 2-point VAT rate increase from October 2012 to July 2013. Moreover, uncertainty over Italy's ability to stick to its structural reform and deficit reduction plans in the lead up to the spring 2013 election, coupled with possible contagion if Grexit occurs, and the crisis escalation in Spain will, in our view, affect the economy negatively and keep funding costs at an unsustainable high level. In order to reduce its funding costs we expect Italy to request external assistance from the EFSF/ESM by end-2012.

Figure 21. Germany, France and Italy — Economic Forecasts, 2011-13F

		Germany			France			Italy		
		2011	2012F	2013F	2011	2012F	2013F	2011	2012F	2013F
Real GDP	YoY	3.1%	1.2%	0.8%	1.7%	-0.2%	-0.2%	0.5%	-2.5%	-2.2%
Final Domestic Demand	YoY	2.3	1.3	1.7	0.9	0.0	0.1	-0.3	-4.0	-3.5
Private Consumption	YoY	1.4	1.3	1.5	0.3	0.0	0.2	0.2	-2.7	-2.8
Fixed Investment	YoY	6.6	1.6	4.0	3.6	-0.9	-0.8	-1.2	-10.6	-8.7
Exports	YoY	8.4	2.9	1.8	5.5	2.7	1.9	6.4	0.2	-0.5
Imports	YoY	7.9	2.3	3.7	5.2	0.4	1.5	1.3	-8.2	-5.4
CPI	YoY	2.3	2.0	2.2	2.1	2.0	1.3	2.9	3.0	1.8
Unemployment Rate	%	6.0	5.5	5.5	9.2	9.6	9.4	8.5	10.6	11.9
Current Account	€bn	147.7	135.6	98.9	-43.4	-38.3	-21.7	-50.5	-36.5	-27.3
	% of GDP	5.7	5.2	3.7	-2.2	-1.9	-1.1	-3.2	-2.3	-1.8
General Govt. Balance	€bn	-26.7	-7.3	-6.4	-103.1	-89.2	-78.7	-62.4	-45.6	-44.7
	% of GDP	-1.0	-0.3	-0.2	-5.2	-4.4	-3.8	-3.9	-2.9	-2.9
Primary Balance	% of GDP	1.6	2.1	1.9	-2.6	-2.3	-1.5	1.0	2.6	3.1
General Govt. Debt	% of GDP	81.2	82.8	82.3	86.0	93.5	99.1	120.1	129.4	135.6
Gross Trading Profits	YoY	2.7	4.6	0.0	3.0	0.0	1.0	NA	NA	NA

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

Spain

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With thanks to Deimante Kupciuniene

In effect, the Spanish government is now part-way into a Troika programme, with a programme in place for the banks plus extra fiscal tightening to meet required conditions. We expect the government to request and obtain external assistance for its own financing needs soon, by end-2012, and this will probably not require extra conditionality to that which already has been announced. We revise our 2012 GDP growth forecast up by 0.3ppts and the 2013 forecast down by 0.2ppts to -1.8% and -3.3%, respectively, as the latest macro data are less bad than expected, but more fiscal cuts were announced for 2012-14. The 2012 fiscal deficit will probably overshoot modestly versus the new deficit target of 6.3% of GDP, with larger overshoots — of 1% of GDP on average — likely in 2013 and 2014.

Greece

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With thanks to Carla Clifton

We continue to expect Greece to endure a very deep recession this year and next – making 2013 the 5th year of sharp GDP contractions. We have increased our probability of the country leaving the euro from a range of 50% to 75% previously to about 90%, and believe the most likely date is in the next 2-3 quarters, possibly following the September assessment. Creditor countries remain unwilling to ease the terms of the rescue package, while the Greek programme remains clearly off track in many areas, notably deficit targets and supply-side reforms.

Ireland

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Real GDP fell sharply in Q1, down 1.1% QoQ, but there were notable offsetting positives: 2011 GDP growth was revised up from 0.7% YoY to 1.4% with solid nominal GDP growth in Q1-2012 (up 0.5% QoQ, up 4.3% YoY). As a result, recent revenue gains look more durable than we judged previously. Hence we have cut our forecast for the 2016 debt/GDP ratio from 137% last month to 129% — although this remains well above official and IMF forecasts, which peak at 120-121% in 2013.

Portugal

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With thanks to Carla Clifton

We keep our GDP forecast for 2012 unchanged at -4.6%, but cut the 2013 forecast by 0.1pp to -5.6%. We expect that Portugal, as part of the conditions of a second Troika programme, will have to implement extra fiscal tightening, likely on spending. Growth also will be hit by the escalation of the crisis in Spain, Portugal's main trading partner. We expect that with such a deep and prolonged recession, Portugal will continue stay on an unsustainable fiscal path and that debt restructuring will take place sometime in 2013-15.

Figure 22. Spain, Greece, Ireland and Portugal — Economic Forecasts, 2011-13F

		Spain			Greece			Ireland			Portugal		
		2011	2012F	2013F	2011	2012F	2013F	2011	2012F	2013F	2011	2012F	2013F
Real GDP	YoY	0.7%	-1.8%	-3.3%	-6.9%	-7.5%	-10.1%	1.4%	-0.7%	0.6%	-1.6%	-4.6%	-5.6%
Final Domestic Demand	YoY	-1.7	-4.9	-7.3	-9.6	-11.4	-12.6	-3.8	-2.6	-4.4	-5.3	-7.3	-6.0
Private Consumption	YoY	-0.1	-2.2	-4.2	-7.1	-10.2	-12.1	-2.4	-2.6	-2.9	-4.0	-7.1	-4.6
Fixed Investment	YoY	-5.1	-11.3	-12.9	-20.6	-21.6	-19.1	-12.8	-4.6	-19.0	-11.4	-11.5	-11.9
Exports	YoY	9.1	0.7	2.0	-0.8	-3.1	-1.2	5.0	5.3	4.2	7.6	2.1	-0.1
Imports	YoY	-0.1	-8.6	-11.3	-8.0	-17.9	-10.4	-0.3	4.2	1.0	-5.2	-4.7	-1.6
CPI	YoY	3.1	1.8	2.1	3.1	1.0	15.1	0.2	0.8	0.2	3.6	2.5	1.5
Unemployment Rate	%	21.7	24.7	26.1	17.3	23.6	29.0	14.4	15.6	17.6	12.7	16.2	18.7
Current Account	€bn	-37.5	-30.6	-24.3	-21.1	-15.6	-6.1	1.8	0.2	4.1	-13.9	-7.5	-3.9
	% of GDP	-3.5	-2.9	-2.3	-9.8	-7.7	-3.4	1.1	0.1	2.5	-8.1	-4.5	-2.5
General Govt. Balance	€bn	-95.3	-69.0	-61.9	-19.6	-22.0	-4.2	-20.4	-13.2	-13.8	-7.3	-8.3	-9.6
	% of GDP	-8.9	-6.5	-5.9	-9.1	-11.0	-5.2	-12.8	-8.3	-8.6	-4.2	-5.0	-5.8
Primary Balance	% of GDP	-6.5	-3.5	-1.1	-2.2	-3.2	-5.1	-5.4	-4.2	-2.8	-0.4	-1.0	-1.6
General Govt. Debt	% of GDP	68.6	92.9	92.9	165.3	156.5	436.6	108.2	119.6	127.0	107.8	122.8	138.0

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

Netherlands

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The recently revised GDP data show that the recession in the Netherlands ended in 1Q 2012. However, the ongoing deterioration of the economic sentiment readings suggest that the economy will fall back into recession in the remainder of the year and we have revised up our forecast by only 0.1 points to -1.4%. With the ongoing housing market correction, we leave our GDP forecast for 2013 unchanged at -0.6%. Recent polls suggest an inconclusive outcome at the September 12 early elections. This suggests that it will be difficult to form a government, and the implementation of the earlier agreed fiscal package looks uncertain.

Belgium

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Belgium is one of the few countries benefiting from a slight upward revision to its GDP baseline. An unexpected gain in net-trade in Q1 proved sufficient to generate a 0.3% QQ increase after a period of flat economic activity in H2-11. We now forecast GDP growth of 0.2% this year, but a return of negative growth of 0.2% in 2013. Hence, with business confidence having fallen below its long-term average in March 2012 and a fourth successive drop in the composite sentiment indicator, we believe that the government will need to announce additional fiscal tightening measures of around €3bn in order to meet its 2013 budget deficit target.

Slovakia

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While we retain our GDP forecast of 2.2%YoY in 2012, we cut it to 1.6% in 2013 given external risks to this small export oriented economy that has been recently driven by foreign trade. The central government deficit continued to worsen in June, and if there is no policy correction we expect the full year deficit will exceed the government's target by about 1% of GDP. We estimate the borrowing requirement to be 96% funded by July. However, there is a risk that funding needs will be lifted by about €500m because of the fiscal deficit overrun and the delivery of two capital injections to the ESM. The Fiscal Compact is likely to be ratified later in 2H12.

Slovenia

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We cut 2013's GDP forecast reflecting a recent worsening of the confidence indicators, weakness in the construction sector and a likely larger fiscal consolidation in 2013, given a slightly wider current fiscal deficit, which we estimate around 5% of GDP in May. However, the government remained committed towards the fiscal consolidation, but the bank recapitalization could involve government aid.

Figure 23. Netherlands, Belgium, Slovakia and Slovenia — Economic Forecasts, 2011-2013F

		Netherlands			Belgium			Slovakia			Slovenia		
		2011	2012F	2013F	2011	2012F	2013F	2011	2012F	2013F	2011	2012F	2013F
Real GDP	YoY	1.1%	-1.4%	-0.6%	2.0%	0.2%	-0.2%	3.3%	2.2%	1.6%	0.2%	-0.9%	0.1%
Final Domestic Demand	YoY	0.6	-1.3	-1.0	2.5	0.0	0.3	0.6	0.5	1.0	-2.6	-1.5	-0.7
Public Consumption	YoY	0.1	0.5	-0.4	0.6	0.3	0.0	-3.5	1.5	-1.3	-0.9	0.8	-0.9
Private Consumption	YoY	-1.0	-1.5	-1.3	0.9	0.1	0.2	-0.4	-0.4	0.6	-0.1	0.1	0.0
Investment (Ex Stocks)	YoY	5.7	-3.6	-1.3	5.2	0.6	0.7	5.7	1.5	3.2	-10.2	-7.8	-2.3
Exports	YoY	3.9	2.0	1.6	4.4	0.1	2.0	10.8	3.7	3.5	7.8	-1.7	0.5
Imports	YoY	3.6	1.6	1.2	5.1	-0.1	2.0	4.5	2.9	3.7	4.7	-2.4	-0.5
CPI (Average)	YoY	2.3	2.8	2.5	3.5	2.5	1.3	3.9	3.6	2.8	1.8	2.5	2.6
Unemployment Rate	%	5.3	6.3	6.4	7.2	7.4	7.8	13.2	13.4	13.6	8.2	9.0	10.2
Current Account	% of GDP	8.5	9.7	9.6	-1.0	-1.3	-0.8	0.1	0.5	-0.5	-1.5	-0.9	-0.2
General Govt Balance	% of GDP	-4.7	-4.6	-3.7	-3.7	-2.5	-2.0	-4.8	-4.8	-3.2	-6.4	-4.2	-3.3
Primary Balance	% of GDP	-2.6	-2.8	-2.1	-0.4	0.5	1.1	-3.5	-3.4	-1.8	-4.5	-2.1	-1.1
General Govt Debt	% of GDP	65.2	72.5	76.2	98.1	111.4	117.4	43.4	46.6	48.4	47.6	51.3	53.3

Note: Our forecasts for the Netherlands do not take account of the revised GDP data published on 26 June 2012.
F Citi forecast. YoY Year-on-year growth rate. Sources: National sources and Citi Research

UK

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We are again cutting our UK growth forecasts, and now expect GDP to fall by 0.5% this year and rise by 0.3% in 2013, versus last month's forecasts of minus 0.4% and plus 0.5% Note that our forecast predates the release of the Q2 GDP data, which showed GDP down by 0.7% QoQ: we had expected a drop of 0.3% QoQ, and hence the data imply downside risks even compared to our weak forecast. There are major and persistent headwinds from high household debt, poor credit availability, fiscal drag and the EMU crisis. Real GDP is still about 4% below the pre-recession peak after 16 quarters: markedly underperforming versus the major recession/recovery cycles of the 1930s, 1970s, 1980s and 1990s. We expect that GDP will not regain the pre-recession peak (Q1-08) until 2016. It is unclear what the net effect of the Olympic Games will be on Q3 GDP: tourist inflows will increase (which is a positive) but some people may take extra time off work (which could be a negative). Experience from previous Olympic Games does not point to a major growth boost in the quarter of the Games.

Inflation has already dropped from 5.2% last September to 2.4% YoY in June – and it is likely to fall below the 2% target in September or October this year. The inflation boost from the low pound is now fading, while other inflation pressures are being crushed by weak pay growth and the stagnant economy. Unless external costs rise, inflation is likely to stay below target on average next year and subsequently. The fiscal deficit will fall to 6-7% of GDP in 2012/13, because of the absorption of the pension fund of the state-owned postal service. But the underlying deficit should rise slightly this year because of economic weakness, with little change likely in 2013. The general government gross debt/GDP ratio is likely to reach about 100% in 2014 or 2015. The MPC is likely to expand QE markedly further in coming quarters, and if the euro area crisis worsens markedly, then the MPC may also cut the Bank Rate and the government may implement emergency fiscal loosening late this year.

Figure 24. United Kingdom — Economic Forecasts, 2011-2013F

					2012				2013			
		2011	2012F	2013F	1QF	2QF	3QF	4QF	1QF	2QF	3QF	4QF
Real GDP	YoY	0.7%	-0.5%	0.3%	-0.2%	-0.4%	-0.7%	-0.5%	0.2%	0.4%	0.3%	0.5%
	SAAR				-1.6	-1.2	0.9	-0.3	1.3	-0.3	0.5	0.3
Domestic Demand	YoY	-0.5	-0.2	-0.6	0.3	0.1	-0.8	-0.4	-0.2	-1.1	-0.6	-0.4
(Incl. Inventories)	SAAR				0.3	1.6	-1.8	-1.6	1.1	-2.0	0.0	-0.5
Consumption	YoY	-1.1	0.1	0.9	-0.9	0.1	0.8	0.4	0.8	0.8	0.9	0.9
	SAAR				-0.4	1.6	0.4	0.2	1.1	1.7	0.5	0.4
Investment	YoY	-1.4	-2.3	-8.0	1.9	-0.4	-4.3	-6.4	-7.1	-10.2	-7.9	-6.8
	SAAR				7.9	-9.2	-12.5	-10.6	4.9	-20.7	-3.3	-6.4
Exports	YoY	4.4	0.8	5.5	-1.0	0.1	2.9	1.2	4.1	7.6	5.2	5.2
	SAAR				-6.6	-7.4	14.8	5.8	4.3	6.0	4.8	5.9
Imports	YoY	0.5	1.7	2.5	0.7	1.8	2.8	1.5	2.7	2.5	2.1	2.6
	SAAR				-1.3	1.2	4.8	1.3	3.6	0.5	3.2	3.1
Unemployment Rate	%	8.1	8.4	9.0	8.2	8.2	8.6	8.8	8.9	9.0	9.1	9.1
CPI Inflation	YoY	4.5	2.5	1.8	3.5	2.7	2.1	1.6	1.4	1.7	2.0	1.9
Merch. Trade	£bn	-95.8	-97.3	-82.9								
	% of GDP	-6.3	-6.3	-5.3								
Current Account	£bn	-29.0	-40.5	-21.7								
	% of GDP	-1.9	-2.6	-1.4								
PSNB	£bn FY	-127.6	-106.1	-128.4								
	% of GDP	-8.4	-6.9	-8.2								
General Govt. Balance	% of GDP	-8.2	-6.6	-7.9								
Public Debt	% of GDP	82.5	87.9	95.5								
Gross Nonoil Trading Profits	YoY	6.3	0.0	3.9								

Note: Forecast does not include the GDP data released on 25 July. Fiscal deficit shown excluding financial interventions. F Citi forecast. YoY Year-to-year growth rate. Sources: ONS and Citi Research

Switzerland

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We are leaving our 2012 and 2013 growth forecasts at 1.4% and 0.8% respectively. Exports are being hit by the super-strong CHF, but consumer spending is solid, fuelled by low interest rates, gains in housing activity and solid job growth (1.4% YoY in Q1-2012). The SNB is likely to continue to defend the CHF1.20/€ level.

Sweden

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Most activity indicators confirm our view of a marked growth slowdown in Sweden this year. Supportive economic policies, however, suggest that a recession should be avoided; the government plans to present a stimulus package in the autumn budget and the Riksbank lowered its conditional interest rate path by 10-20bp in July, signalling a 30% probability of a 25bp rate cut at the upcoming Sep 6 meeting (had no bias for rate cuts before). This supports our view of a 1% trough in the repo rate by yearend.

Denmark

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Economic activity indicators continue to point to a prolonged period of limited economic expansion in Denmark, with below-trend GDP growth in coming years. In early-July, the DNB entered uncharted territory by cutting the CD-rate below zero. However, the ceiling for current account deposits was also raised, limiting the extent to which the negative CD rate (applies to deposits above DKK 70bn) bites. Given sustained stress in the euro area, demand for DKK is likely to stay strong near-term, adding to pressures for more policy action. We expect the lending rate to be cut to zero (currently 0.2%) and then probably also into negative territory by year-end.

Norway

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Momentum in the Norwegian economy remains relatively strong and lead indicators point to only a marginal slowdown in economic activity in the near term. Growth is supported by a recovery in private consumption (fuelled by strong labour market and income growth) and high activity in the oil sector. The 16-day long labour conflict and associated output losses in the oil sector, though, will weigh on overall industrial production in June and even more so in July, and should also affect GDP. Given strong domestic fundamentals, Norges Bank now signals a 25bp rate hike in 2Q ’13 with 50/50 probability of even earlier tightening.

Figure 25. Switzerland, Sweden, Denmark and Norway — Economic Forecasts, 2011-2013F

		Switzerland			Sweden			Denmark			Norway		
		2011	2012F	2013F	2011	2012F	2013F	2011	2012F	2013F	2011	2012F	2013F
Real GDP	YoY	2.1%	1.4%	0.8%	4.0%	0.4%	1.9%	1.0%	0.7%	1.3%	2.5%	3.0%	2.9%
Final Domestic Demand	YoY	1.8	2.1	1.6	2.8	1.2	1.7	-0.5	1.4	1.3	3.2	2.7	3.3
Public Consumption	YoY	2.6	3.3	1.8	1.9	0.5	0.8	-1.0	0.6	0.6	1.6	1.9	2.2
Private Consumption	YoY	0.9	1.8	0.8	2.1	1.2	1.9	-0.5	1.1	1.1	2.4	2.9	2.9
Investment (Ex Stocks)	YoY	3.9	2.1	3.3	7.1	2.3	3.0	0.4	3.6	2.9	8.1	3.5	6.4
Exports	YoY	3.6	0.4	2.1	7.4	0.2	3.3	6.8	1.1	2.8	1.0	2.5	4.9
Imports	YoY	2.1	3.9	3.8	6.5	-0.7	3.3	5.3	2.4	2.8	2.9	2.5	4.3
CPI (Average)	YoY	0.2	-0.9	-1.4	3.0	1.2	1.6	2.8	2.5	1.7	1.3	0.9	1.7
Unemployment Rate	%	3.1	3.2	3.6	7.5	7.8	8.0	7.6	7.7	7.6	3.3	3.1	2.9
Current Account	% of GDP	14.8	12.4	11.1	7.0	7.0	7.2	6.6	5.5	5.4	14.0	14.3	14.9
General Govt Balance	% of GDP	0.7	0.5	0.1	0.1	-0.1	-0.2	-1.9	-3.5	-2.0	13.8	13.6	14
General Govt Debt	% of GDP	52.0	51.0	50.0	37.0	36.5	35.5	46.5	48.6	49.1	NA	NA	NA

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

Canada

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The Canadian expansion persists. Business and consumer sentiment is largely optimistic, and domestic financial conditions are accommodative. The composition of growth is nonetheless lopsided, as the economy continues to be supported by consumers and businesses, while governments consolidate and exports flag. We anticipate moderate activity this year and next, and a modest pick-up in 2014.

Risks to the inflation outlook remain two-sided, but roughly in balance. Upside risks include greater global inflationary pressures; stronger Canadian exports as competitiveness constraints are removed; and unrelenting domestic housing exuberance. Downside risks include failure to contain the European crisis; weaker Canadian exports absent US fiscal cliff smoothing or soft landings among EM nations; and domestic consumer retrenchment amid outsized debt obligations.

The BoC conceded to lower growth rates for the global and Canadian economies in its most recent base-case projection update. Nonetheless, the central bank remains resolute in maintaining its slightly hawkish policy stance. Conditional on the persistence of the Canadian expansion and the absorption of excess supply, policymakers continue to believe that some modest withdrawal of the considerable degree of monetary policy stimulus currently in place may become appropriate.

Still, given externally focused downside risks and lingering uncertainties, the BoC will probably remain on the sidelines through early 2013. Ballooning Canadian household debt burdens, diminishing slack, firmer underlying inflation, a sound financial system, healthy economic fundamentals, and roughly balanced risks defy easing, despite market pricing for a rate cut over the next twelve months.

Figure 26. Canada — Economic Forecast, 2011-2013F

					2012F				2013F			
		2011	2012F	2013F	1Q	2QF	3QF	4QF	1QF	2QF	3QF	4QF
Real GDP	YoY	2.4%	2.0%	2.2%	1.8%	2.4%	1.7%	1.8%	2.0%	2.1%	2.3%	2.5%
	SAAR				1.9	1.5	1.7	2.2	2.1	2.4	2.6	3.0
Final Domestic Demand	YoY	3.0	1.7	2.5	1.7	1.5	1.6	1.8	2.1	2.4	2.6	2.7
	SAAR				1.3	1.4	2.0	2.5	2.7	2.5	2.6	2.8
Private Consumption	YoY	2.4	1.9	2.3	1.9	1.7	1.9	1.8	2.2	2.4	2.4	2.4
	SAAR				0.9	1.3	2.7	2.4	2.3	2.4	2.4	2.5
Government Spending	YoY	0.1	-1.8	0.6	-2.3	-2.2	-1.8	-0.8	0.0	0.7	0.9	0.8
	SAAR				-2.3	-1.9	0.1	1.0	0.8	0.8	0.8	0.8
Private Fixed Investment	YoY	8.9	6.1	5.1	6.5	6.4	5.6	5.7	5.3	4.3	5.2	5.6
	SAAR				7.6	9.0	1.9	4.4	6.1	4.9	5.4	6.0
Exports	YoY	4.6	3.8	3.7	4.8	5.8	2.8	2.0	2.0	3.4	4.2	5.0
	SAAR				2.5	-1.4	3.2	3.6	2.7	4.1	6.4	7.0
Imports	YoY	7.0	2.9	4.4	4.1	1.0	3.0	3.5	3.6	4.4	4.7	5.0
	SAAR				4.4	1.2	4.0	4.5	4.5	4.5	5.5	5.5
CPI	YoY	2.9	1.7	1.8	2.3	1.6	1.5	1.5	1.6	1.4	1.9	2.3
Core CPI	YoY	1.7	1.9	2.1	2.1	2.0	1.7	1.8	2.0	2.1	2.3	2.1
Unemployment Rate	%	7.5	7.2	6.9	7.4	7.3	7.0	7.3	7.2	7.0	6.7	6.9
Current Account Balance	C$bn	-48.4	-48.1	-41.1	-41.1	-49.4	-44.8	-56.5	-46.2	-42.9	-38.2	-37.0
	% of GDP	-2.8	-2.7	-2.2	-2.3	-2.8	-2.5	-3.1	-2.5	-2.3	-2.0	-2.0
Net Exports (Pct. Contrib.)		-1.5	0.0	-0.7	-0.6	-1.0	-0.7	-0.8	-1.1	-0.6	-0.3	-0.1
Inventories (Pct. Contrib.)		0.3	0.0	0.2	1.0	1.0	0.2	0.3	0.2	0.2	0.0	0.0
Budget Balance (Fiscal Year)	% of GDP	-1.4	-1.2	-0.5								
Federal Budget Debt	% of GDP	33.4	33.5	32.5								
General Govt. Debt	% of GDP	84.9	83.9	82.7								

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

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Australia

Having cut interest rates in May and June by a total of 75bp, the RBA has recalibrated monetary policy to where it needs to be given the weaker global backdrop and low domestic inflation. Consequently, we expect rates to be left unchanged at the August Board meeting. That said, some of the loosening in financial conditions has been eroded by the rebound in the AUD, which looks excessive when judged against a range of risk appetite and fundamental metrics. Since the last Board meeting, employment surprised on the downside but the unemployment rate remained low at 5.2%. The outlook for mining and energy projects remains strong despite lower commodity prices and the recent rate cuts should support housing construction and the consumer. Concerns over a hard landing in China and the potential impact on Australia have been moderated by the recent signs of stabilisation in China. Nevertheless, we still see the balance of economic and financial risks tilted towards a further slight easing of policy by the RBA later in the year.

New Zealand

Given the lower-than-expected Q2 CPI and the continuing uncertain global outlook, we have pushed back our forecast of the timing of the first tightening by the RBNZ until mid-2013 (previously end Q1). We expect inflation to pick up moderately to just shy of the mid-point of the RBNZ's 1%-3% target by end year. This is slightly lower than we had previously forecast and the risk is probably to the downside. Our forecast of a pick up in inflation assumes that domestic demand gradually gains momentum. Inflation expectations have risen slightly, yet remain low and the planned increase in the carbon price has been deferred. The high NZD also will keep downward pressure on inflation and hinder the competitiveness of exporters.

Figure 27. Australia and New Zealand — Economic Forecast, 2011-2013F

	Australia			New Zealand		
	2011	2012F	2013F	2011F	2012F	2013F
Real GDP[a]	2.1%	3.7%	3.4%	1.3%	2.3%	2.8%
Real GDP (4Q versus 4Q)	2.5	3.5	3.6	1.9	2.6	3.0
Real Final Domestic Demand	4.0	3.8	3.6	2.3	1.7	2.8
Consumption	3.3	3.7	3.2	2.5	2.3	2.1
Govt. Current & Capital Spending[b]	-0.8	-0.1	0.6	1.8	1.3	1.3
Housing Investment	1.1	-5.0	3.0	-12.0	7.4	12.6
Business Investment[c]	16.9	12.8	8.5	6.9	2.0	5.0
Exports of Goods & Services	-1.3	6.0	8.2	2.4	4.0	3.0
Imports of Goods & Services	11.4	7.3	7.9	6.0	2.7	3.7
CPI	3.4	1.8	3.2	4.0	1.5	2.2
CPI (4Q versus 4Q)	3.1	2.5	2.9	1.8	1.8	2.3
Unemployment	5.1	5.3	5.1	6.5	6.4	5.6
Merch. Trade, BOP (Local Currency, bn)	17.9	-14.2	-31.3	3.3	2.4	-0.4
Current Account, (Local Currency, bn)	-33.2	-61.4	-84.1	-8.3	-10.8	-16.3
Percent of GDP	-2.3	-4.1	-5.3	-4.2	-5.0	-7.0
Budget Balance[d] (Local Currency, bn)	-47.7	-44.4	1.5	-15.9	-12.1	-6.5
Percent of GDP	-3.4	-3.0	0.1	-9.2	-4.1	-3.6
General Govt. Debt (% of GDP)[e]	5.9	9.6	9.2	21.8	27.1	30.9
Gross Trading Profits[f]	6.2	-1.4	6.1	NA	NA	NA

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

China

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The economy has slowed further on weaker investment and external headwinds. Growth decelerated from 8.1% YoY in 1Q to 7.6% YoY in 2Q, but seasonally adjusted annualized growth accelerated from 6.6% to 7.4%. Investment was the main drag while consumption played a stabilizing role. Industrial production growth remained sluggish at around 9.5% YoY in 2Q, but agriculture and service industries — which are less energy-intensive — helped mitigate the growth downturn. The economic slowdown appears to have been felt in the labor market, although employment indicators were still much better than late 2008 and early 2009.

Data for June reveal early signs of a demand-driven rebound. Despite weakening manufacturing activity, FAI and retail sales accelerated in real terms in both May and Jun. In particular, infrastructure investment turned from contraction in 1Q to growth in 1H, although property investment growth continued to fall. Destocking still has some way to go, but if demand growth is sustained, a production catch-up should follow, based on recent experience.

We continue to expect a 2H rebound with sustained policy easing. Recent government statements do not imply great urgency to introduce a large-scale stimulus. Instead, with inflation expected to remain subdued, we think the government will fully utilize the policy space within the pre-set policy mix (expansionary fiscal policy and effectively accommodative monetary policy) to consolidate growth momentum, with special emphasis on infrastructure investment. Two more RRR cuts and one more rate cut are likely, but risks of a home price rebound will probably rule out further loosening of property policies. We have revised up 2012 and 2013 growth forecast by 0.1ppt to 7.9% and 8.0%, implying a mild rebound in 2H of 2012 and early 2013. We are cutting our 2012 CPI inflation forecast to 2.7% from 2.9% last month, reflecting faster-than-expected disinflation and risks posed by recent rally of soft commodity prices.

Figure 28. China — Economic Forecasts, 2011-2013F

					2012F				2013F			
		2011	2012F	2013F	1QF	2QF	3QF	4QF	1QF	2QF	3QF	4QF
Real GDP	YoY	9.2%	7.9%	8.0%	8.1%	7.6%	7.8%	8.1%	8.3%	8.1%	7.9%	7.8%
Real Final Domestic Demand	YoY	10.2	9.1	8.8								
Consumption	YoY	9.7	9.4	9.2								
Fixed Capital Formation	YoY	10.7	8.7	8.5								
Industrial Production	YoY	13.9	10.8	11.3	11.6	9.5	10.5	11.5	12.0	11.5	11.0	10.5
Exports	YoY	20.3	8.1	9.2	7.6	10.6	8.7	5.5	6.0	8.0	10.0	12.0
Imports	YoY	24.9	8.1	11.4	6.9	6.5	7.8	11.0	9.0	10.0	12.0	14.0
Merchandise Trade Balance	$bn	155	167	141	1	69	72	26	-12	65	70	19
FX Reserves	$bn	3,181	3,301	3,461	3,305	3,240	3,302	3,301	3,289	3,355	3,439	3,461
Current Account	% of GDP	2.8	2.0	1.5								
Fiscal Balance	% of GDP	-1.3	-2.4	-1.5								
General Govt. Debt	% of GDP	15.3	16.2	16.1								
Urban Unemployment Rate	%	4.1	4.2	4.1	4.1	4.2	4.2	4.2	4.1	4.1	4.1	4.1
CPI	YoY	5.4	2.7	2.9	3.8	2.9	1.8	2.3	2.4	2.6	3.1	3.4
Exchange Rate (end period)	CNY/$	6.29	6.37	6.25	6.30	6.35	6.38	6.37	6.36	6.34	6.30	6.25
1-Yr Deposit Rate (end period)	%	3.50	2.75	3.25	3.50	3.25	2.75	2.75	2.75	2.75	3.00	3.25

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

India

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Following the nine year low GDP print of 6.5% in FY12, we expect growth in FY13 to edge lower, with monsoons and global woes posing downside risks to our 6.4%YoY GDP forecast. While monsoons have recovered a bit (rainfall deficiency as of July 19 is 23% vs 31% earlier), the next two weeks are crucial. (see *Monsoon Watch — Clear Skies, Cloudy Outlook*). This, coupled with global worries which could impact exports, could shave 40-80bps from our 6.4% GDP estimate for FY13.

On the policy front, with the previous FM standing for presidential elections, markets are hoping that the change in guard at the finance ministry could kickstart reforms. We expect greater action, but not as much as the market may be inferring. Structurally, not much has changed: the dual leadership model in the government remains intact and consequently non-populist reforms may not be implemented. Nonetheless, small fuel price hikes, coupled with measures that are largely execution in nature, could make the environment conducive for investment.

Headline inflation has moderated, with the WPI and CPI at 7.3% and 10% YoY respectively. Going forward, given the high weight of food/primary products (Food weights: CPI 49.7%; WPI 20.1%), inflation could remain above the RBI's comfort zone of 4%-5% for awhile. Factors on the domestic front include the hike in MSP's and the missing monsoon season, while on the global front the issue is of deteriorating crop conditions. However, with growth well below the RBI's non-inflationary rate of growth of 7%; and the decline in commodity prices likely to offset INR depreciation, we are holding on to our 50-75bps rate cut call for the 2HFY13. Trends in the fiscal situation remain bleak with the April-May deficit coming in at 28% of budget targets. This is in line with our views of a fiscal slippage to the tune of 40-50bps which could put pressure on India's sovereign ratings.

India's monthly trade balances have begun to narrow thanks to lower oil prices and moderating gold demand which have offset the contraction in exports. Thus, while we expect an improvement in India's CAD, we stress that the overall BoP is still likely to be in the red due to lower FDI and external borrowings. This coupled with trends in REER, supports our global FX teams' view of the INR remaining weak in the near-term at 54-56 levels, but a return to a steady appreciation path in the medium term.

Figure 29. India — Economic Forecasts, FY2012/13-2014/5F

		FY 12/13F	FY 13/14F	FY 14/15F
Real GDP	YoY	6.4%	6.9%	7.1%
Final Domestic Demand	YoY	5.7	7.1	7.5
Private Consumption	YoY	6.0	6.7	7.0
Fixed Investment	YoY	5.5	8.0	9.0
Exports	YoY	13.5	15.0	11.0
Imports	YoY	8.3	10.8	9.3
Wholesale Price Index*	YoY	7.4	6.5	6.0
Consumer Price Index	YoY	7.0	6.5	6.0
Current Account	US$ bn	-65	-57	-58
	% of GDP	-3.5	-2.6	-2.2
Consolidated Fiscal Balance	% of GDP	-8.0	-7.7	-7.0
Centre Fiscal Balance	% of GDP	-5.5	-5.0	-4.5
US Dollar Exchange Rate	Average	54.3	54.0	52.0

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

Korea

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The BoK cut its growth forecasts for 2012 by 0.5%p to 3.0% and for 2013 by 0.4%p to 3.8%. We expected a downward revision when the BoK cut the policy rate unexpectedly by 25bps at July MPC meeting on the previous day. The BoK attributed the downgrade to the external slowdown plus sluggish domestic demand. We also expect overseas and domestic demand to remain weak in 2H12, leading 2H economic growth to post 2.9%YoY and full year growth at about 2.8%. Private consumption and construction investment are likely to grow at meagre rates of 1.5%YoY and 1.1% respectively, capped by the high household debt burden and weak real estate market. Recession in the Eurozone and China's slowdown will probably cap exports growth to a low single digit pace, although import growth also will be limited by the weakness in exports and domestic demand, as well as the recent decline in oil prices. We expect the trade surplus to be about US$12.8bn this year. CPI inflation is expected to stay at about 2.8% YoY in 2H12, below the mid-point (3%) of the BoK's inflation target. Based on the moderation of inflation and sub-par growth in 2012 and 2013, we expect two more 25bp policy rate cuts in the coming quarters, one in late 2012 and the other early next year.

Indonesia

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Coincident indicators of the economy show a mixed picture, but domestic demand seems relatively strong amid benign inflation. As of June, the consumer confidence index still increased to 114.4 and car sales saw a record high (101K units), with no significant disruption from the implementation of down-payment regulations. However, the trade balance saw a second month of deficit in May amid strong import growth. Bond inflows have rebounded this month and accordingly the IDR has stabilized. Nevertheless, FX market pressure was still strong, with anecdotal evidence that corporate net demand for FX remains solid and the decline in FX reserves to $106.5bn in June from $111.5bn in May. The significant drop in reserves apparently reflects BI's reluctance to allow the IDR to adjust too quickly to the changing balance of payments dynamics, but we still expect the IDR to weaken under a 6-12M horizon. Meanwhile, actual O/N interbank rates have recently seen upward pressure amid BI's continued FX intervention and recent policy of steepening the money market yield curve. However, BI kept the policy rate unchanged in July for the fifth consecutive month. Despite BI's added caution on growth, we expect the policy rates to be left unchanged throughout the year.

Figure 30. Korea and Indonesia — Economic Forecasts, 2011-2013F

		Korea			Indonesia		
		2011	2012F	2013F	2011	2012F	2013F
Real GDP	YoY	3.6%	2.8%	3.6%	6.5%	6.1%	6.3%
Final Domestic Demand	YoY	1.3	2.4	3.2	5.7	6.5	7.0
Private Consumption	YoY	2.3	1.5	2.0	4.7	4.4	4.5
Fixed Investment	YoY	-1.1	3.4	4.9	8.8	11.4	12.1
Exports	YoY	9.5	2.0	3.3	13.6	4.3	11.7
Imports	YoY	6.5	1.6	2.0	13.3	6.4	15.1
Consumer Price Index	YoY	4.0	2.8	3.0	5.4	4.4	4.7
Unemployment Rate	%	3.4	3.3	3.3	6.6	6.1	5.9
Current Account	US$ bn	26.5	19.9	22.4	1.7	-17.2	-11.4
	% of GDP	2.4	1.8	1.9	0.2	-1.9	-1.2
Fiscal Balance	% of GDP	1.5	1.2	1.5	-1.2	-1.8	-0.7
US Dollar Exchange Rate	Average	1108	1143	1163	8763	9383	9625

Sources: Haver Analytics and Citi Research

Hong Kong

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We expect a slight recovery in 2Q GDP growth from 0.4% YoY in 1Q to 1.9% in 2Q, reflecting favourable base effects and improving trade flows, although consumption appears to have slowed (including lower tourism receipts). HK's labor market remains tight and this should prevent a sharp fall in wages or consumption in the near term. Inflation however is moderating more visibly given the economic slowdown and base effects. The new CEPA9 will likely foster cross-boarder developments in financial/designated sectors, thus encouraging labor mobility within the Pearl River Delta region. The HKD will probably remain near the strong end of the trading band but remain vulnerable to the EMU debt crisis and China slowdown. Domestic interest rates are likely to stay low given global monetary accommodation.

Singapore

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We are cutting our 2012 and 2013 GDP forecasts to 2.6% and 3.5% (from 3.6% and 5.0% respectively last month) on 2Q's GDP contraction. The official GDP forecast (1%-3%) will probably be narrowed to 2%-3% in the Prime Minister's National Day message (Aug 8). A further tightening in immigration policies was announced, but this could worsen supply constraints in labour and perhaps housing, exacerbating pressure from tighter COE supply. Hence, we do not expect inflation to moderate much below 4% in 2H12. However, the Oct 2011 episode suggests that 4% inflation need not be an obstacle for monetary easing, if weaker than expected growth sets the stage for future disinflation. While we assign a calibrated MAS slope reduction as our base case, this is a very close call. With supply constraints keeping inflation elevated, officials continue to see a high bar for fiscal easing to stimulate demand.

Taiwan

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We are cutting our 2012 and 2013 GDP forecast to 2.4% and 3.6% respectively (from 2.8% and 4.2% last month) to reflect rising global uncertainty and a more conservative view on the outlook for hi-tech industries. This is the fourth time this year that we have cut our growth forecast. We still expect GDP growth to increase to 4.1% YoY in 2H12 from about 0.7% YoY in 1H12. Inflation concerns have eased slightly but food prices remain an upside risk. With lower interest rates globally, the CBC led interbank overnight rates much lower to 0.42% in July. However, we believe the CBC will likely keep policy rates unchanged for a long period and rely on open market operation and a weaker NT$ to help the economy. The increasing cross-strait links with Mainland China remain an important support for the economy.

Figure 31. Hong Kong, Singapore and Taiwan — Economic Forecasts, 2011-2013F

		Hong Kong			Singapore			Taiwan		
		2011	2012F	2013F	2011	2012F	2013F	2011	2012F	2013F
Real GDP	YoY	5.0%	2.5%	3.8%	4.9%	2.6%	3.5%	4.0%	2.4%	3.6%
Final Domestic Demand	YoY	7.5	4.2	1.9	3.4	4.1	2.9	1.3	0.7	2.8
Private Consumption	YoY	8.4	3.8	2.0	4.1	3.6	3.4	3.0	1.9	2.7
Fixed Investment	YoY	7.3	6.0	2.0	3.3	8.1	2.7	-3.8	-2.6	5.2
Exports	YoY	4.2	0.5	6.0	2.6	2.6	3.8	4.5	1.7	5.3
Imports	YoY	4.6	1.0	5.1	2.4	4.1	4.7	-0.6	-0.7	4.8
CPI	YoY	5.3	4.0	3.0	5.2	4.4	3.3	1.4	1.9	2.1
Unemployment Rate	%	3.4	3.5	3.7	2.0	2.2	2.1	4.4	4.3	4.2
Current Account	US$ bn	12.4	20.0	16.7	57.1	41.7	41.2	41.3	42.0	44.8
	% of GDP	5.1	7.7	6.0	21.9	15.0	13.9	8.8	8.7	8.4
Fiscal Balance	% of GDP	3.9	0.8	1.1	1.5	1.0	1.0	-1.9	-1.6	-1.6
US Dollar Exchange Rate	Average	7.78	7.76	7.76	1.26	1.26	1.27	29.40	29.99	30.15

Sources: Haver Analytics and Citi Research

Russia

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Growth is slowing, but domestic demand remains upbeat – although excess inventories and high interest rates are weighing on business activity. We keep our 3-3.5% GDP growth forecast for 2012 (which assumes oil at US$100-105/bbl in 2H), but risks are probably skewed to the downside. After the electricity and gas tariff hikes, inflation has hit 5%YoY. With droughts plus the recent ruble depreciation, CPI inflation may rise even higher. We believe the CBR will remain focused on inflation and will try to keep money market rates in the 5-6% range. The regulator is also likely to continue adjusting the list of collateral and non-key rates. The MoF has adopted the new budget rule that will limit the use of oil proceeds, while excess oil revenues and borrowings above the deficit financing needs will be directed into the Reserve Fund. The 2Q12 current account fell to US$19bn, in line with our expectations. Private capital flight in Q2 was near zero due to increased borrowings that followed the sovereign bond placement. We expect that in H2, capital outflows will absorb most of the current account surplus given high debt repayments and liquidity infusions from the budget. We believe global growth uncertainty, weaker oil prices and looser liquidity will bring the ruble to 37.5 versus the basket by 4Q.

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Recent indicators suggest that, after falling by 0.4%QoQ (SWA) in Q1, GDP has expanded modestly in 2Q and is likely to show further modest expansion thereafter. The sluggish outlook, plus softer oil prices and lower-than-expected inflation, has raised expectations of monetary policy easing. The fixed income market has benefited from this backdrop, with the 2-year benchmark bond yield dropping as low as 7.72% from 8.47% in June and 9.45% in May. Nevertheless, although there are some encouraging developments regarding rebalancing, we believe there are at least three reasons for not getting carried away. First, one should not ignore the importance of strong base effects in the rebalancing process, and seasonally adjusted data show less recent progress. Second, the recent decline in inflation is largely driven by food and cyclical factors. There is no evidence suggesting that a permanent improvement in Turkey's inflation dynamics is underway. Third, we believe that the data for identified inflows in relation to the current account deficit level during the first five months of the year do not paint a comforting picture about the CBT's ability to ease. Against this backdrop, we believe that a sustained drop in money market rates to below 8% is not very likely unless capital inflows pick up.

Figure 32. Russia and Turkey — Economic Forecast, 2011-13F

		Russia			Turkey		
		2011	2012F	2013F	2011	2012F	2013F
Real GDP	YoY	4.3%	3.5%	4.0%	8.5%	2.5%	4.3%
Final Domestic Demand	YoY	1.7	1.5	2.0	9.8	1.6	4.5
Private Consumption	YoY	6.3	5.9	5.3	7.7	1.0	4.5
Fixed Investment	YoY	8.0	6.7	9.0	18.3	2.3	4.9
Exports	YoY	0.4	1.0	2.7	6.5	1.8	5.5
Imports	YoY	20.3	4.3	5.8	10.6	-1.4	6.2
CPI	YoY	8.4	5.1	6.9	6.5	9.1	7.0
Unemployment Rate	%	6.6	7.5	7.5	9.8	9.4	9.7
Current Account	US$ bn	98.8	107.1	46.6	-77.2	-60.2	-60.8
	% of GDP	5.3	5.7	2.4	-10.0	-7.5	-7.0
Fiscal Balance	% of GDP	2.0	0.3	0.1	-1.3	-2.2	-2.5
US Dollar Exchange Rate	Average	29.4	32.2	34.8	1.68	1.80	1.86

Sources: Haver Analytics and Citi Research

Hungary

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We expect that the recently announced tax and social contribution cuts will raise the 2013 budget deficit to 3.7% of GDP against the 2.2% official target, even with the offset from charging central bank operations with the financial transaction tax. The drop in labour costs for low wage earners is a step in the right direction to improve competitiveness. But, in the absence of fiscal offsetting measures, it may complicate the loan agreement with the IMF and the EU. Moreover, the government rejects the idea of imposing a more progressive personal tax system or higher wealth taxes to improve the fiscal balance. Hence, we expect that protracted loan negotiations lie ahead, likely not concluding before late-2012 when funding pressures may rise. Given our expectations of slow progress in the loan talks we expect rate cuts to only materialize in 4Q12, although recent comments from external MPC members increase the risk of earlier rate cuts. Such a move could increase the vulnerability of the HUF if negotiations do not deliver fast progress.

Poland

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In July, the MPC left interest rates on hold and maintained its informal tightening bias but the tone of the NBP Governor's comments suggests the Council is not planning hikes anytime soon. MPC members have admitted they are now more worried by signs of economic slowdown than in May (when they voted to increase interest rates). Some policymakers even suggested a possibility of a rate cut this year. The market reacted to these dovish comments by starting to price in the first rate cut in December. We do not share this view. As argued in previous months, we think weak growth prospects and slow wage growth indeed justify a strategy of quick policy easing. However, in our opinion MPC members will probably move from tightening to a neutral bias very slowly, probably only around September or October, and it will probably take another few more months before the MPC starts to cut rates. Having said this, we expect the easing cycle to begin early next year when inflation falls towards the target and in our view the base rate will fall by 75bps by the end of 2013. The Finance Ministry remains committed to fiscal deficit reduction. However, slower GDP growth is already affecting tax revenues and, taking this into account, we expect the decline in general government deficit will be smaller than initially expected. The bond market should be however protected by the fact the Finance Ministry has already met more than 80% of its full-year borrowing needs.

Figure 33. Hungary and Poland — Economic Forecasts, 2011-2013F

		Hungary			Poland		
		2011	2012F	2013F	2011	2012F	2013F
Real GDP	YoY	1.7%	-0.9%	0.8%	4.3%	2.7%	2.4%
Final Domestic Demand	YoY	-1.2	-1.9	-1.1	3.5	2.3	2.0
Private Consumption	YoY	0.0	-1.1	-0.8	3.1	2.2	2.5
Fixed Investment	YoY	-5.4	-5.6	-2.0	8.3	4.1	1.0
Exports	YoY	8.4	2.1	5.3	7.5	4.4	4.5
Imports	YoY	6.3	1.0	4.0	5.8	2.8	2.3
CPI	YoY	3.9	5.6	3.9	4.3	3.9	2.6
Unemployment Rate	%	11.6	11.8	11.0	12.5	12.9	11.7
Current Account	US$ bn	2.0	2.3	3.5	-22.2	-18.3	-20.8
	% of GDP	1.7	1.9	2.7	-4.3	-3.8	-4.5
Fiscal Balance	% of GDP	4.3	-3.1	-3.7	-5.1	-3.1	-2.5
Euro Exchange Rate	Average	279	291	287	4.12	4.21	4.30

Sources: Haver Analytics and Citi Research

Czech Republic

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The drop in the July confidence index and likely larger woes in the euro area lead us to cut our GDP forecast to -1.1%YoY in 2012 and 0.6% in 2013 (from -1.0% and 1.0% respectively previously). CPI inflation is likely to decelerate in 2013 due to weaker growth and the lower impact of higher VAT in 2013 compared to 2012, although the recent commodity price surge will lift food price growth. Politics remains noisy despite the government's survival of the no-confidence vote. Nevertheless, although the left-wing dominated Upper House is likely to reject recently approved laws, we expect them to be re-approved later this year. The financing requirement is covered this year unless the risk of a wider deficit materialises. While the government is ready to possibly lower spending this year, it is likely to allow the deficit to widen due to the weaker economy. Hence, the Medium Term Objective of a balanced fiscal budget in 2016 is unlikely to be met and we estimate general government debt could reach 47% of GDP in 2014-15 - above Moody's forecast of 45% (who just reaffirmed A1 foreign rating in July). With our negative outlook on the real economy we keep our forecast of another 25bp cut in the CNB policy rate to 0.25% in September though we still expect the koruna around 26 against the euro on one year horizon.

Romania

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The political temperature has increased markedly, as the country gets ready for a referendum on the impeachment of President Basescu on July 29. Although the presence of a minimum turnout threshold on referendums (at least 50% of the electorate plus one voter) increases the chances that suspended President Traian Basescu will survive the impeachment, it is likely to be a close call in our view. In light of the recent developments, the IMF has decided to postpone its upcoming review with a view to disassociating itself from the highly charged political process. Not surprisingly, the deterioration in political stability has intensified depreciation pressures, driving the EUR/RON above 4.60. This, coupled with the weakness in identified inflows compared with the current account deficit level so far, paints a more challenging picture for the NBR. In our view, the NBR is not very likely to sell FX as aggressively as it did during the April-June period. Specifically, we believe that the Bank would be reluctant to bring the level of its international reserves significantly below €32bn. This, in turn, suggests to us that upward pressures on interest rates are likely to intensify in the near-term.

Figure 34. Czech Republic and Romania — Economic Forecasts, 2011-2013F

		Czech Republic			Romania		
		2011	2012F	2013F	2011	2012F	2013F
Real GDP	YoY	1.7%	-1.1%	0.6%	2.5%	1.3%	3.0%
Final Domestic Demand	YoY	-0.9	-1.4	0.6	1.9	0.9	2.7
Private Consumption	YoY	-0.6	-2.2	0.3	1.3	0.9	2.7
Fixed Investment	YoY	-0.9	-1.4	1.5	6.2	1.2	3.5
Exports	YoY	11.0	4.1	0.0	10.5	5.5	4.2
Imports	YoY	7.5	-0.1	-1.2	11.5	3.9	3.2
CPI	YoY	1.9	3.5	2.6	5.8	2.8	2.7
Unemployment Rate	%	8.5	8.6	8.7	5.4	5.2	5.2
Current Account	US$ bn	-6.3	-5.4	-3.4	-8.3	-7.2	-9.0
	% of GDP	-3.0	-2.9	-1.9	-4.4	-4.5	-4.7
Fiscal Balance	% of GDP	-3.1	-3.2	-3.1	-4.1	-2.4	-2.2
EURCZK, USDRON	Average	24.6	25.3	25.7	3.0	3.7	3.3

Sources: Haver Analytics and Citi Research

Brazil

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The disappointing performances of activity indicators in May led us to downgrade again our 2012 GDP growth forecast to 1.8% (from 2.3%). Despite the worsening outlook, we continue to expect economic growth to accelerate markedly in 2H12, narrowing the output gap. The softer than expected GDP expansion and tax exemptions keep supporting a benign inflation outlook, offsetting the upward pressures coming from some soft commodity prices. Therefore, we maintain our 2012 CPI inflation estimate at 4.9% as well as our Selic rate call for 2012 year end at 7.25%. For 2013, the base effect continues to favor our GDP growth estimate of 4.5%, contributing to an increase in CPI inflation to 5.6%. Under this scenario, we maintain our view that Copom will likely hike interest rates next year by 200bp, starting in July. Regarding external accounts, the trade balance's frustrating performance in June motivated a downward revision in our 2012 year end estimate, although the impact on the current account should be limited. Finally, the government will likely accomplish the primary fiscal target of 3.1% of GDP, unless the expected GDP recovery fails, motivating the government to ease the fiscal policy further.

Mexico

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The economic activity figures for 2Q12 continue to show growth, although with signs of slowdown. Manufacturing exports are gradually weakening, while other indicators — retail sales, family remittances, investment, formal sector employment and wages — still point in the direction of a progressive recovery in domestic demand. Nevertheless, we are sticking to our estimate of an economic slowdown in 2Q12, with quarterly annualized GDP growth of 3.8% versus 5.3% for the previous quarter. We reiterate our growth expectation for the whole of this year at 3.9%. Headline inflation grew by 4.3% YY in June, above the upper limit of Banxico's variability range (3.0% +/- 1%), due to an increase in non-core inflation, in particular farm prices. We estimate that while these pressures will continue for the coming months, they will be short-lived. We see limited inflation risk as the rise is essentially being driven by volatile farm prices, while core inflation remains well behaved, at 3.5% YY. Accordingly, Banxico's neutral policy stance should remain basically unchanged: we see the policy rate closing this year at its current 4.5% level.

Figure 35. Brazil and Mexico — Economic Forecasts, 2011-2013F

		Brazil			Mexico		
		2011	2012F	2013F	2011	2012F	2013F
Real GDP	YoY	2.7%	1.8%	4.5%	3.9%	3.9%	3.8%
Final Domestic Demand	YoY	3.8	2.6	5.2	5.0	4.7	4.5
Private Consumption	YoY	4.1	3.4	4.7	4.5	4.2	4.0
Fixed Investment	YoY	4.7	0.4	8.2	8.9	7.9	7.5
Exports	YoY	4.5	4.6	21.9	6.7	8.6	7.8
Imports	YoY	9.7	7.1	21.3	6.7	8.8	6.1
CPI	YoY	6.6	5.1	5.2	3.4	4.0	3.9
Unemployment Rate	%	6.1	6.3	6.5	5.3	5.2	5.3
Current Account	US$ bn	-52.5	-54.0	-71.6	-9.0	-11.5	-17.8
	% of GDP	-2.3	-2.3	-2.7	-0.8	-1.0	-1.4
Fiscal Balance	% of GDP	-2.6	-1.9	-2.7	-2.5	-2.2	-2.0
US Dollar Exchange Rate	Average	1.67	1.96	2.03	12.44	13.16	13.39

Sources: Haver Analytics and Citi Research

Argentina

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We have been arguing for a relatively long time that, in the medium term, stagflation is the name of the game in Argentina. This seems to have come to pass. The widening gap between the official and the parallel market exchange rates, rampant fiscal dominance of monetary policy, potential financial repression due to the reform to the central bank (BCRA)'s charter, heavy import restrictions, are all features similar to those during Argentina's worst economic decades. Additionally, non-official real GDP growth in 2Q12 was about -1.3% YoY. We have, therefore, revised our forecast for non-official real GDP growth for 2012 as a whole to -1.7%. For 2013, we expect a rebound in real GDP growth to about 2.0% on the back of a better harvest, stronger external demand (helped by Brazil), a more expansive fiscal policy and lower public debt service. We expect official real GDP growth to be 1.5% in 2012, and 3% in 2013. Naturally, the gloomy outlook for activity implies that an increase in the depreciation rate of the peso is likely in our view. Our forecasts for the USDARS are 4.9 and 6.0 for 2012 and 2013 year-ends, respectively. Last but not least, we expect non-official inflation to be 25% in 2012, and 30% in 2013, well above the official CPI data (expected to be 9.8% YoY in 2012 and 11.8% YoY in 2013)..

Venezuela

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The presidential campaign is heating up, with both candidates increasing their visibility and attacks against each other. Mr. Capriles has centered his attacks toward President Chávez based on the low achievements after 13 years in power and increased insecurity. On the other hand, President Chávez has been selling the idea that Mr. Capriles represents the old way of doing politics in Venezuela and that with Capriles in power, social spending will be reduced. Most pollsters are showing President Chávez ahead of Mr. Capriles in voting intentions, with just one poll showing them really close. Nevertheless, there is still a high percentage of undecided voters, and the way this percentage evolves in the next couple of months will be crucial in determining the final election outcome. In addition, we continue to believe that any setback in President Chávez's health condition also would have a significant effect on the election. On the economic front, activity has continued to rebound while inflation remains at bay, as part of a strategy in which fiscal spending and direct imports of basic goods by the government are having a positive effect.

Figure 36. Argentina and Venezuela — Economic Forecasts, 2011-2013F

		Argentina			Venezuela		
		2011	2012F	2013F	2011	2012F	2013F
Real GDP	YoY	8.9%	1.5%	3.0%	4.2%	5.0%	3.5%
Final Domestic Demand	YoY	12.0	1.7	3.2	7.6	6.0	1.8
Private Consumption	YoY	10.7	3.1	3.4	4.0	6.4	0.7
Fixed Investment	YoY	-	-	-	4.4	2.6	2.2
Exports	YoY	4.3	-2.8	3.6	4.7	6.8	5.2
Imports	YoY	17.8	-3.3	5.0	15.4	8.5	-0.9
CPI	YoY	9.8	9.8	11.8	27.1	23.3	27.8
Unemployment Rate	%	7.2	7.5	8.3	6.5	6.0	6.3
Current Account	US$ bn	0.0	1.6	-3.9	27.2	17.7	13.4
	% of GDP	0.0	0.3	-0.8	9.1	4.9	3.7
Fiscal Balance	% of GDP	-1.7	-2.8	-3.0	-5.0	-5.0	-4.0
US Dollar Exchange Rate	Average	4.13	4.58	5.46	4.29	4.30	6.50

Sources: Haver Analytics and Citi Research

Saudi Arabia

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We expect Brent oil prices for 2012 to average US$113 per barrel (similar to last month) while the 2013 forecast of US$99/bbl was left unchanged. Although June data shows sustained oil production at just below the 10mbpd mark, meaning an average oil production of 9.75mbpd so far this year, we see average Saudi production at around 9.6mbpd for the full year, because over-supply risks for the rest of the year will likely lead to production cuts. The base effect of stronger-than-expected 2011 GDP growth of 7.1% has led us to revise down our 2012 forecast to 6.1% from 6.8% previously, and concurrently raise the 2013 number to 6.1% from 6.0% previously. With no change to our expenditure forecast, we expect the government's budget surplus will come in at around 15.4% of GDP in 2012, slightly below our prior forecast (16.9% of GDP). We still expect that growth in the non-oil economy will remain strong, at around 8.5% this year, reflecting high government expenditure and increasing domestic demand. At the beginning of July, the Saudi Council of Ministers finally approved the long-awaited mortgage law and we believe it transforms the stagnant mortgage market, though some caution is merited given the likely challenges if housing demand surges. June inflation eased to 4.9%YoY on the back of weaker food prices, though over the medium-term we believe the drive to hire Saudis in place of cheap foreign labour and rising demand for housing, given chronic supply shortages, are likely to add to inflationary pressure.

United Arab Emirates

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We think the recent repayment of Dubai International Financial Centre Investments US$1.25bn sukuk is likely to reinforce investor confidence in Dubai's ability to manage its public sector debt overhang. This said, Reuters reported Dubai Group sold its rights to the Bank Muscat share offering at an almost 50 per cent discount. We believe the macro story remains positive. Lead indicators point to a continued recovery in Dubai's economy, with DP World announcing a 9% increase in volumes at Jebel Ali Port and DHCOG, which owns the Jumeirah Hotel group, announcing strong revenue growth. Hotel capacity is likely to rise rapidly this year according to a recent Jones Lang Lasalle report which expected an additional 4.5k hotel rooms to be completed, and another 11k through to 2014. In a Knight Frank report, Dubai premium property prices are showing a strong recovery as well in 1Q 12, higher than any of the 22 other global cities surveyed. That said, supply continues to come on line, meaning prices are likely to remain soft outside the mature premium areas of Dubai. We still see downside risks to growth in the coming 18 months, including uncertainty over global economic growth and regional geo-political risks.

Figure 37. Saudi Arabia and United Arab Emirates — Economic Forecasts, 2011-2013F

		Saudi Arabia			United Arab Emirates		
		2011	2012F	2013F	2011	2012F	2013F
Real GDP	YoY	7.1%	6.1%	6.1%	5.3%	0.5%	3.4%
Final Domestic Demand	YoY	6.8	7.8	7.9	3.0	3.4	3.4
Private Consumption	YoY	4.7	5.0	5.0	1.0	2.0	2.0
Fixed Investment	YoY	10.1	10.0	10.0	5.0	5.0	5.0
Exports	YoY	18.7	5.2	-5.6	13.0	13.0	13.0
Imports	YoY	13.7	15.0	15.0	15.0	15.0	15.0
CPI	YoY	5.0	7.0	8.0	0.9	1.1	1.3
Current Account	US$ bn	142.7	136.2	87.7	48.7	11.9	20.7
	% of GDP	23.9	21.4	14.0	15.0	3.5	5.7
Fiscal Balance	% of GDP	15.3	15.4	3.8	-	-	-
US Dollar Exchange Rate	Average	3.75	3.75	3.75	3.67	3.67	3.67

Sources: Haver Analytics and Citi Research

Egypt

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For much of 2012 it was believed that the recent presidential election would mark the end of the political transition underway since early 2011. However, recent events now mean that the election of the new president Mohammed Mursi is arguably just a new start, with the political outlook now more uncertain for 2H 2012 than at any time since early 2011: the country has a relatively weak president facing tough political decisions as he tries to oversee the drafting of a new constitution and balance the competing political demands of the military with those of political parties and activists for more fundamental political reform. But, even assuming political compromises can be cobbled together, more worrying is that the prospects for economic reform are limited for the rest of this year. Instead, we believe Government economic policy will continue to preserve the status quo in 2012, notably a stable exchange rate. But falling foreign exchange reserves continue to highlight that this policy option may well have run its course and harder choices have to be made in 2013 as the current policy comes under increasing strain.

South Africa

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Despite residual concerns about domestic policy in the run up to the ANC's elective conference in Mangaung in December, in the short term the Q1 2012 growth data continue to highlight the unfavourable external environment facing the country. We expect that growth will remain subpar in 2012, at only about 2.7%, and only start to recover into 2013. The Treasury remains committed to budget deficit reduction and debt stabilisation, focusing on micro policy steps to foster stronger growth. Nevertheless, weak revenue growth and pressure from the public wage bill mean that a significant reduction in the deficit is unlikely until 2014/15. In the meantime, even with robust inflationary pressures eroding household purchasing power, the ongoing monetary stimulus is just about supporting resilient consumer spending. Moreover, corporate finances are healthy and there are signs of an upturn in private investment. Inflation will probably hover around the top end of the 3%-6% target range into early 2013. Nevertheless, we think it is unlikely to make a sustained breach of the upper limit, even if rand fragility and wage stickiness pose upside risks. We expect no early change in the monetary policy stance, with a gradual normalisation of policy into 2013 as inflationary pressures ease. Poor export performance and the high import content of capital spending suggest that the current account deficit will gradually widen, after being kept low by favourable terms of trade.

Figure 38. Egypt, Nigeria and South Africa — Economic Forecast, 2011-2013F

		Egypt			Nigeria			South Africa		
		2011	2012F	2013F	2011	2012F	2013F	2011	2012F	2013F
Real GDP	YoY	1.8%	2.0%	2.7%	7.8%	7.4%	6.8%	3.1%	2.7%	3.6%
Final Domestic Demand	YoY	2.9	2.7	2.6	NA	NA	NA	4.6	3.1	3.7
Private Consumption	YoY	5.0	0.9	0.8	NA	NA	NA	4.9	2.5	2.9
Fixed Investment	YoY	-5.6	3.7	6.5	NA	NA	NA	4.3	4.4	5.7
Exports	YoY	3.7	-3.8	6.3	NA	NA	NA	5.9	5.3	6.2
Imports	YoY	8.1	-2.3	5.5	NA	NA	NA	9.1	6.7	7.0
CPI	YoY	10.2	7.5	10.8	10.8	12.4	9.8	5.0	5.8	5.0
Unemployment Rate	%	12.1	13.0	14.5	NA	NA	NA	26.0	25.7	25.2
Current Account	US$ bn	-5.4	-7.2	-9.0	8.8	6.9	11.9	-13.6	-17.8	-21.9
	% of GDP	-2.3	-2.9	-3.5	3.4	2.3	3.5	-3.4	-4.7	-5.6
Fiscal Balance	% of GDP	-10.1	-9.3	-7.7	-3.1	-2.2	-2.1	-5.0	-4.8	-4.2
US Dollar Exchange Rate	Average	5.94	6.08	6.63	155.9	160.79	165.17	7.26	8.11	8.65

Sources: Haver Analytics and Citi Research

Figure 39. Selected Emerging Market Countries — Economic Forecast Overview, 2011-2013F

	GDP Growth			CPI Inflation			Current Balance (% of GDP)			Fiscal Balance (% of GDP)		
	2011	2012F	2013F	2011	2012F	2013F	2011	2012F	2013F	2011	2012F	2013F
Asia	7.3%	6.5%	6.9%	5.7%	3.5%	3.5%	2.4%	1.6%	1.4%	-2.1%	-2.8%	-2.1%
China	9.2	7.9	8.0	5.4	2.7	2.9	2.8	2.0	1.5	-1.3	-2.4	-1.5
Hong Kong	5.0	2.5	3.8	5.3	4.0	3.0	5.1	7.7	6.0	3.9	0.8	1.1
India*	6.5	6.4	6.9	8.9	7.4	6.5	-4.0	-3.5	-2.6	-8.4	-8.0	-7.7
Indonesia	6.5	6.1	6.3	5.4	4.4	4.7	0.2	-1.9	-1.2	-1.2	-1.8	-0.7
Korea	3.6	2.8	3.6	4.0	2.8	3.0	2.4	1.8	1.9	1.5	1.2	1.5
Malaysia	5.1	5.0	5.3	3.2	2.0	2.6	11.0	7.0	6.7	-5.0	-5.0	-4.7
Mongolia	17.3	16.0	17.5	9.6	13.5	14.5	-32.4	-25.4	-10.3	-3.6	-7.3	-0.9
Philippines	3.9	4.9	5.3	4.8	3.1	3.5	3.1	3.1	2.5	-2.0	-2.4	-2.1
Singapore	4.9	2.6	3.5	5.2	4.4	3.3	21.9	15.0	13.9	1.5	1.0	1.0
Sri Lanka	8.3	6.9	7.4	6.8	7.0	6.8	-7.8	-5.5	-4.9	-6.9	-6.5	-6.0
Taiwan	4.0	2.4	3.6	1.4	1.9	2.1	8.8	8.7	8.4	-1.9	-1.6	-1.6
Thailand	0.1	4.7	4.6	3.8	2.7	2.9	3.4	1.1	0.2	-1.5	-4.7	-3.9
Vietnam	5.9	5.2	5.6	18.6	9.1	7.3	-0.6	-0.7	-0.6	-2.9	-4.5	-4.3
Latin America	3.9	2.9	4.0	6.8	5.8	6.1	-1.1	-1.2	-1.8	-2.3	-2.0	-2.2
Argentina	8.9	1.5	3.0	9.8	9.8	11.8	0.0	0.3	-0.8	-1.7	-2.8	-3.0
Brazil	2.7	1.8	4.5	6.6	5.1	5.2	-2.3	-2.3	-2.7	-2.6	-1.9	-2.7
Chile	6.0	4.9	4.5	3.3	3.1	3.1	-1.3	-1.8	-1.9	1.4	0.7	0.6
Colombia	5.9	4.0	4.5	3.4	3.2	3.2	-3.0	-2.9	-3.0	-2.9	-1.8	-1.6
Mexico	3.9	3.9	3.8	3.4	4.0	3.9	-0.8	-1.0	-1.4	-2.5	-2.2	-2.0
Panama	10.6	9.2	7.0	5.9	5.6	3.2	-12.7	-11.6	-10.0	-2.3	-3.0	-3.0
Peru	6.9	5.7	6.5	3.4	3.7	2.8	-1.9	-2.4	-2.8	1.7	1.2	-0.3
Venezuela	4.2	5.0	3.5	27.1	23.3	27.8	9.1	7.2	4.1	-5.0	-5.0	-4.0
Europe	5.0	2.7	3.6	6.7	5.3	5.8	-0.2	0.3	-1.1	-0.3	-1.2	-1.1
Czech Republic	1.7	-1.1	0.6	1.9	3.5	2.6	-3.0	-2.9	-1.9	-3.1	-3.2	-3.1
Hungary	1.7	-0.9	0.8	3.9	5.6	3.9	1.7	1.9	2.7	4.3	-3.1	-3.7
Kazakhstan	7.5	5.5	6.0	8.3	5.1	5.7	7.6	1.9	2.4	5.9	1.7	3.0
Poland	4.3	2.7	2.4	4.3	3.9	2.6	-4.3	-3.8	-4.5	-5.1	-3.1	-2.5
Romania	2.5	1.3	3.0	5.8	2.8	2.7	-4.4	-4.5	-4.7	-4.1	-2.4	-2.2
Russia	4.3	3.5	4.0	8.4	5.1	6.9	5.3	5.7	2.4	2.0	0.3	0.1
Slovakia	3.3	2.2	1.6	3.9	3.6	2.8	0.1	0.5	-0.5	-4.8	-4.8	-3.2
Turkey	8.5	2.5	4.3	6.5	9.1	7.0	-10.0	-7.5	-7.0	-1.3	-2.2	-2.5
Ukraine	5.1	2.8	4.5	8.0	1.7	7.1	-5.2	-6.6	-4.3	-3.8	-3.5	-2.9
Africa/Mideast	6.0	4.0	5.0	5.5	5.7	5.8	10.2	9.5	8.3	2.6	3.0	-0.1
Bahrain	3.2	3.0	3.9	-0.4	3.0	3.5	11.6	24.8	11.3	-1.2	2.6	0.2
Egypt	1.8	2.0	2.7	10.2	7.5	10.8	-2.3	-2.9	-3.5	-10.1	-9.3	-7.7
Ghana	14.4	7.5	6.5	8.7	11.4	9.9	-8.2	-7.3	-4.8	-5.4	-6.8	-6.2
Iraq	9.4	9.3	11.5	5.6	5.0	6.0	-5.1	28.1	50.7	15.8	11.8	14.3
Israel	4.9	2.7	3.0	3.4	2.0	2.2	0.1	-1.5	-1.1	-2.7	-3.7	-3.2
Jordan	2.6	2.5	3.0	4.4	5.0	5.0	-10.6	-12.4	-11.7	-3.9	-8.0	-9.5
Kenya	4.5	5.0	5.8	14.0	10.5	6.6	-11.8	-10.5	-9.5	-5.5	-5.0	-4.9
Kuwait	4.0	0.9	2.8	4.7	5.0	5.0	44.1	43.9	41.1	17.1	13.4	4.4
Lebanon	6.0	3.5	4.3	5.1	6.0	5.0	-22.9	-24.2	-25.1	-5.7	-6.9	-8.1
Nigeria	7.8	7.4	6.8	10.8	12.4	9.8	3.4	2.3	3.5	-3.1	-2.2	-2.1
Oman	3.5	3.0	4.4	4.0	3.0	3.0	16.4	2.7	8.3	5.6	6.0	3.0
Qatar	18.1	6.0	8.3	3.0	3.0	3.0	31.6	31.0	24.2	8.1	7.1	3.3
Saudi Arabia	7.1	6.1	6.1	5.0	7.0	8.0	23.9	21.4	14.0	15.3	15.4	3.8
South Africa	3.1	2.7	3.6	5.0	5.8	5.0	-3.4	-4.7	-5.6	-5.0	-4.8	-4.2
Tanzania	6.3	6.2	6.8	12.7	15.7	7.4	-20.1	-11.9	0.0	-7.8	-6.2	-5.8
UAE	5.3	0.5	3.4	0.9	1.1	1.3	15.0	3.5	5.7	NA	NA	NA
Uganda	5.7	4.5	5.5	18.7	15.2	7.9	-13.2	-12.5	-10.7	-7.2	-5.5	-5.2
Zambia	6.6	6.5	6.9	6.4	6.8	6.9	0.4	2.6	2.4	-3.2	-3.5	-3.7
Total	6.0	4.9	5.5	6.0	4.5	4.6	2.1	1.7	1.1	-1.4	-1.8	-1.8

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

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Source: Citi Research.

Figure 41. Citi Global Strategy and Macro Team *For Informational Purposes Only*

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

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Sovereign Ratings Outlook

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

Given economic updates in this publication and based on rating agency criteria, we highlight our economists' and strategists' main expectations for sovereign ratings over the near (2-3 quarters) and longer (2-3 years) term. Citi economists and strategists continue to expect further downgrades over the near-term in the euro area, and a broader range of downgrades over the longer term.

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

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

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

Key Expected Ratings Issues

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We expect the ratings of many core EMU sovereigns to be downgraded in the next 2-3 quarters, including Germany. These moves reflect our higher probability (90%) of Greece's possible exit from the euro zone over the next 12-18 months and the increased likelihood that this could happen relatively soon (next 2-3 quarters), the weak economic backdrop, broad-based fiscal slippage and bank stresses, plus recent comments by Moody's. Our views also reflect the fact that Moody's and S&P already have many EMU countries on Negative Outlook.

On 23 July, Moody's placed Germany and the Netherlands on Negative Outlook (at Aaa Negative Outlook, these sovereign are now rated the same as France and Austria by Moody's). Moody's cited[8] two core reasons for the change in outlook:

- Increased susceptibility to event risk due to the rising probability of a Greek exit.
- Increased likelihood that greater collective support for other euro area sovereigns, most notably Spain and Italy, will be required. Moody's placed on Negative Outlook those Aaa euro area sovereigns whose balance sheets are expected to bear the main financial burden of support.

A Greek exit would exert downward ratings pressure on core EMU sovereigns

Furthermore, in terms of what could put Aaa ratings under downgrade pressure, Moody's specifically cites the following: "*Germany's Aaa rating could potentially be downgraded if Moody's were to observe a prolonged deterioration in the government's fiscal position and/or the economy's long term strength that would take debt metrics outside scores that are commensurate with a Aaa rating. This could happen if…any country were to exit the European monetary union, as such an event is expected to set off a chain of financial sector shocks and associated liquidity pressures for sovereigns that would entail very high cost for wealthy countries…*".

A pan-European review of all EMU sovereigns is likely in a Greek exit scenario

Citi has increased the probability that Greece will leave the EMU in the next 12-18 months to 90%, and believe the most likely date is in the next 2-3 quarters. In the near term (next 2-3 quarters) therefore, we expect at least one major agency to downgrade the core EMU countries by one notch following a Credit Negative Watch review period. Both major agencies also stress that a Greek exit would constitute a "defining" moment in the euro project and effectively breaks the assumption of irreversibility. In addition, given Citi's base case that Spain and Italy are likely to enter some form of Troika programme by end-2012 regardless of whether Greece leaves EMU, we expect at least a one notch downgrade by one major rating agency of Italy and Spain. Over the longer term, we expect that persistent economic weakness and adverse fiscal trends will prompt further downgrades among EMU periphery countries.

Globally, Citi continues to expect downwards rating pressure in the US and Japan over the longer-term

Over the longer-term, the pool of solid AAAs is likely to shrink further, with only Canada, the Australasian countries, Switzerland and the Scandis likely to remain AAA Stable over the near-term and longer-term. The UK will probably be placed on "Negative Outlook" by S&P in coming quarters as weak economic data increasingly impacts fiscal data, and over the longer term the UK may well lose its AAA status if growth remains elusive and fiscal consolidation is partly delayed. The US is currently on Negative Outlook by both Moody's and S&P and we continue to expect a one-notch downgrade over the next 2-3 years. We also envisage downwards ratings pressure for Japan over the next 2-3 years, predicated on longer-term debt sustainability trends.

[8] Moody's Announcement: "*Moody's changes the outlook to negative on Germany, the Netherlands, Luxembourg and affirms Finland's Aaa stable rating*". 23 July 2012.

Rates Strategy

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The past month has seen a significant worsening in the EMU crisis. The Spanish 10yr spread to Germany has broken out of its 5-5.5% range and is currently trading at 6.15%. 10yr Spanish yields have touched 7.5%, 10yr BTP yields have broken above 6.25% and yield curves are flattening dramatically suggesting that investors are beginning to raise their perceived probability of an eventual restructuring of peripheral debt or of a possible EMU break-up.

Core EMU markets, US Treasuries, Gilts and JGBs have all seen yields fall to new lows and equity markets are looking increasingly vulnerable. This suggests that the market is focussing on more than just peripheral markets debt woes. Disappointing data out of the US and the UK as well as Europe and further concerns over slowdown in China have also contributed to what is currently a very nervous environment.

Despite the recent moves we have not significantly changed our rates forecasts this month. We continue to look for short-end German yields to trade well into negative territory and for negative yields to be seen out as far as 3-4yr maturities. 5yr paper will, we think, trade very close to zero which means that the reach for yield will continue to be felt in flattening of the 5 to 10yr sector of the curve, further narrowing in core EMU spreads and outperformance of any high-grade spread product, notably the SSA sector.

All that said, we note that weaker commodity prices and concomitantly lower breakeven inflation rates have also been a feature of the drop in nominal bond yields, notably in the US and the UK. With oil prices seemingly finding some support this may reduce the momentum of the rally over the next few weeks. We therefore look for 10yr yields to stabilise around current levels, forming trading ranges for the near-term, before heading lower again in Europe as the economic data continues to deteriorate.

In the US, much of the focus will now shift to the impending fiscal cliff as markets weigh up the various risks of significant fiscal tightening, increased taxes or a surge in government spending to replace existing measures. The first two of these would likely support lower US Treasury yields, but a significant roll-over of fiscal stimulus would probably be very unsettling for the markets. To a great extent, we think that the risk of fiscal tightening adding to the headwinds to economic growth has been a factor in the recent rally and that anything other than a disorderly and abrupt end to the current policy measures is likely to be viewed as a slight uptick for growth prospects. We therefore see scope for US Treasury yields to rise modestly later in the year.

A small rise in US Treasury yields and our expectation of lower core EMU yields suggests spread widening although as we have previously noted, this will to some extent be constrained by the forward short rate differential between the two markets. We do, however, expect the ECB to cut the deposit rate to -0.5% and this should allow the 5yr yield spread between US Treasuries and Bobls to move 25-30bp wider and the 10yr spread to widen 10-15bp.

Our main strategies, then, are to continue buying duration on dips in Bunds and Gilts. However we think current levels are a little too expensive and look for some correction; we would target 1.4% in 10yr Bunds. Equally we look to enter long Bund against US Treasury trades in the 5yr sector if the spread gets back to about -10bp. We continue to look for significant flattening of yield curves in peripheral markets.

Figure 43. Interest Rate and Bond Market Forecasts as of 25 Jul 2012

		Forecast End Period					
	Current	3Q 12	4Q 12	1Q 13	2Q 13	3Q 13	4Q 13
US							
Policy Rate (Fed Funds) End Quarter	0.25	0.25	0.25	0.25	0.25	0.25	0.25
3-Month Libor	0.45	0.45	0.42	0.44	0.55	0.65	0.75
2 Year Treasury Yield	0.21	0.25	0.25	0.35	0.55	0.70	0.85
5 Year Treasury Yield	0.58	0.60	0.75	0.85	1.10	1.25	1.40
10 Year Treasury Yield	1.41	1.45	1.65	1.80	2.10	2.35	2.60
30 Year Treasury Yield	2.54	2.50	2.70	2.90	3.20	3.50	3.80
2-10 Year Treasury Curve	120	120	140	145	155	165	175
2 Year Swap Spread (Swap Less Govt.), bp	24	25	30	30	30	35	35
10 Year Swap Spread (Swap Less Govt.), bp	24	25	24	22	25	25	25
30 Year Swap Spread (Swap Less Govt.), bp	-23	-25	-35	-45	-50	-50	-50
30 Year Mortgage Yield	3.62	3.60	3.65	3.80	4.05	4.25	4.45
10 Year Breakeven Inflation	206	210	215	220	230	235	240
Euro Area							
Policy Rate	0.75	0.50	0.25	0.25	0.25	0.25	0.25
Overnight Rate (EONIA)	0.10	-0.10	-0.30	-0.40	-0.40	-0.40	-0.40
3-Month Libor	0.32	0.10	-0.20	-0.30	-0.30	-0.30	-0.30
2 Year Treasury Yield	-0.07	-0.15	-0.20	-0.15	-0.15	0.00	0.05
5 Year Treasury Yield	0.25	0.25	0.15	0.20	0.30	0.60	0.90
10 Year Treasury Yield	1.26	1.15	1.00	1.15	1.25	1.50	2.00
30 Year Treasury Yield	2.05	2.20	2.00	2.00	2.10	2.25	2.50
2-10 Year Treasury Curve	133	130	120	130	140	150	195
10 Year BTP-Bund Spread	524	600	700	700	650	650	600
10 Year Swap Spread (Swap Less Govt.), bp	54	50	45	40	35	30	30
10 Year Breakeven Inflation	159	150	140	150	160	175	200
Japan							
Policy Rate	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3-Month Libor	0.20	0.20	0.20	0.20	0.20	0.20	0.20
2 Year Treasury Yield	0.10	0.10	0.10	0.10	0.15	0.10	0.15
5 Year Treasury Yield	0.18	0.20	0.25	0.35	0.40	0.35	0.50
10 Year Treasury Yield	0.73	0.80	0.95	1.10	1.20	1.10	1.30
30 Year Treasury Yield	1.79	1.85	1.95	2.05	2.15	2.05	2.20
2-10 Year Treasury Curve	63	70	85	100	105	100	115
2 Year Swap Spread (Swap Less Govt.), bp	20	20	21	23	25	23	27
10 Year Swap Spread (Swap Less Govt.), bp	1	2	4	6	8	6	10
10 Year Breakeven Inflation	NA	NA	NA	NA	NA	NA	NA
UK							
Policy Rate	0.50	0.50	0.50	0.50	0.50	0.50	0.50
3-Month Libor	0.78	0.75	0.75	0.75	0.85	1.00	1.00
2 Year Treasury Yield	0.70	0.10	0.10	0.10	0.25	0.50	0.75
5 Year Treasury Yield	0.43	0.45	0.40	0.50	0.65	0.90	1.30
10 Year Treasury Yield	1.46	1.40	1.25	1.40	1.50	1.75	2.25
30 Year Treasury Yield	2.88	2.80	2.50	2.65	2.75	2.90	3.00
2-10 Year Treasury Curve	139	130	115	130	125	125	150
10 Year Swap Spread (Swap Less Govt.), bp	42	35	35	40	40	40	40
10 Year Breakeven Inflation	234	225	215	235	250	265	275
Australia							
Policy Rate	3.50	3.25	3.25	3.25	3.25	3.50	3.75
3-Month Libor	3.52	3.40	3.40	3.40	3.60	3.80	4.10
2 Year Treasury Yield	2.42	2.40	2.50	2.60	2.70	2.90	3.25
5 Year Treasury Yield	2.43	2.45	2.55	2.70	2.85	3.10	3.50
10 Year Treasury Yield	2.73	2.90	3.10	3.30	3.70	4.00	4.30
2-10 Year Treasury Curve	31	50	60	70	100	110	105
10 Year Swap Spread (Swap Less Govt.), bp	85	80	75	70	65	60	55

Source: Citi Research

Credit Outlook — Forced Buying is Not Stable Buying

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It is hard not to be impressed by the strength of the credit market. Both macro and corporate negatives have in the vast majority of cases been shrugged off, sending spreads in $, €, and especially £ to close to their tightest levels of the year. And yet with so many concerns unaddressed and in what still for us is the trading of a very broad range, the tighter spreads go, the less inclined we are to chase them.

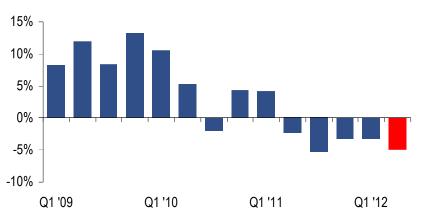
The commonly cited explanation for the rally is technicals. Low interest rates are causing investors to reach for yield wherever they can find it. Funds which used to invest only in government bonds now buy investment grade. Those which bought investment grade are being forced into high yield. Corporates whose balance sheets seem "safe" can issue at lower yields than ever before. The reduction in the ECB's deposit rate to zero has only increased the pressure on the market.

Against such a backdrop, a variety of negatives seem simply to have been shrugged off. Ratings downgrades of Spain and Italy, and the announcement of the likely use of bail-in for Spanish bank bondholders, did little to dent the broader market. A steady stream of negative surprises on macroeconomic data, and the failure by Bernanke to give any real indication of QE being around the corner, likewise had little impact.

Look more closely, though, and the old concerns have not gone away. CDS — in some ways a 'purer' measure of people's risk appetite, has rallied far less than cash, leaving the average basis close to record wides. It is not that investors want to buy; it is that they are being forced to.

Likewise, our heatmaps show that while the majority of the cash market has rallied hard over the past month, telltale red spots show that a few corporates have actually widened quite sharply. In corporates, this is typically in response to worse than expected earnings: Supervalu, Peugeot, JCPenney. In financials, it is the likes of BBVA, Santander and Monte Paschi which have sold off, or Barclays. Investors seem to like the *idea* of buying corporates, just so long as they aren't confronted by the gritty reality.

Figure 44. US earnings surprise relative to beginning-of-quarter consensus (%)



Source: Citi Research

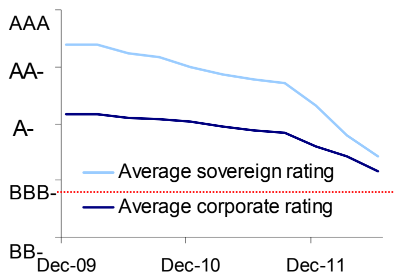
Yet the assumption clearly at work here — that the problems in the outlook can be confined to just a few names — seems to us to be tenuous at best, and in time is likely to be reversed. Take earnings, for example. Although 72% of the 110 companies in the S&P 500 which have reported earnings have beaten expectations, they have done so largely because of downward revisions to previous guidance. If we look at earnings surprises relative to expectations at the start of the quarter, this looks set to be the fifth consecutive quarter of negative surprises, and the second worst since 4Q2008 (see Figure 44).

Something similar could be said about the tendency for companies to beat on cost cutting rather than on top-line growth. For individual companies, this produces the high earnings and record margins we see today. But when every corporate adopts the same measures, it risks raising unemployment to the point where the economy is driven back into recession.

In Europe, the systemic risks are even more apparent. Admittedly, they may not be especially imminent, in part thanks to the collective decision to reduce government bond auctions and go on holiday in August. Bail-in of Spanish bank bondholders, for example, seems unlikely before the bottom-up stress tests are completed in September.

But the steady continued capital flight from Spain and Italy, visible in their TARGET2 liabilities, coupled with the deterioration in their economic outlooks, risks driving the sovereigns into more formal support programmes over the next twelve months, potentially resulting in downgrades to junk, at least from Moody's.

Figure 45. Periphery sovereign and corporate ratings converging



Source: Citi Research

Although it would take downgrades from the other rating agencies to force ejection from most bond indices, investors are already fretting about the magnitude of the potential impact, both indirectly in terms of increased risk aversion, and directly, given the likelihood of knock-on downgrades and potential forced selling in corporates. Although corporates can in principle be rated through their sovereigns, as sovereign rating downgrades have accelerated and levels have converged on average corporate ratings this year, the momentum in corporate rating downgrades has clearly accelerated (Figure 45). As in the rates markets, the size of the associated forced selling does not really bear contemplating: Spanish and Italian corporate debt represents some 65% and 125% of existing € HY market outstandings.

Although such unpleasant outcomes could still be prevented, the pattern to date strongly suggests that the sort of drastic policy action required to do so is likely only *following* much greater — and more broad-based — pressure from markets, not in its absence. That makes rallies such as the past month's ultimately self-defeating.

We would therefore be inclined to use any further rally to set shorts, with the following biases:

- Short financials to non-financials — whether with respect to the growing likelihood of widespread bail-in in Europe, or regulatory uncertainties, we are surprised at the extent to which the market reaction has thus far been idiosyncratic. It is true that, unlike last year, there is no liquidity crisis in the banking system currently, and until now there has been willingness to recapitalise banks without sacrificing bondholders. However, financials are more exposed to systemic risk than other sectors — due to their interconnectedness, their leverage, their regular refinancing needs and their mark-to-market sensitivity. The risks surrounding Spain and Italy are highly systemic.

- Long US versus European banks — The widening in Spanish and Italian spreads was barely reflected in spreads on European banks in the core. However, given the large exposures — both direct and indirect — we believe the increase in systemic risk should be reflected much more in their spreads than for US counterparts.

- Long covered/ABS and hybrid debt selectively versus underweight senior — The effective subordination of unsecured bank debt makes investment in bank bonds a more binary proposition. That speaks for barbelling between bonds with security or hybrid capital, where the subordination risk is already priced in.

- Overweight IG to HY — While high yield has benefited from the low-interest rate environment, a deteriorating economic outlook, coupled with the negative effects of potential benchmark changes, to our minds favours investment grade, especially in Europe.

- Use rally to underweight periphery corporates further — our credit survey clearly illustrates that there is a large consensus underweight on € periphery credit. This creates a risk of a near-term short squeeze. However, medium-term we think the bigger issue is likely to be the growing number of fallen angels in these countries — with or without the sovereigns. That is likely to cause renewed pressure on spreads.

Global Equity Strategy

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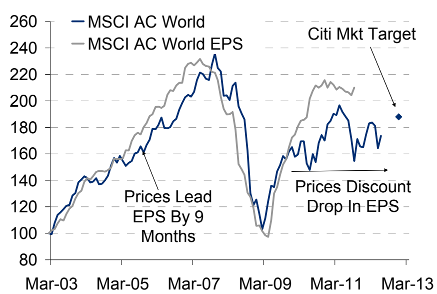
Global equities are up 2% YTD and 5% from the lows reached in early June. Policy easing from major central banks and small yet positive steps at the EU Summit seem to have helped the global stock market. We forecast a further 11% gain for global equities by year-end which would imply the MSCI AC World index ending the year at 340. This represents a healthy gain for the entire year, if below our previous 360 target.

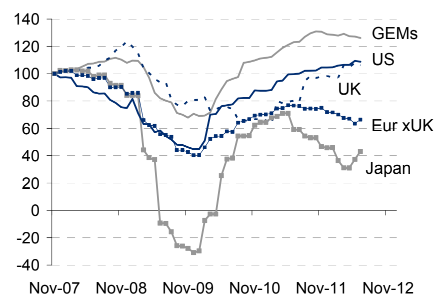
Figure 46 shows the relationship between global share prices and the trailing EPS index lagged by 9 months. Between 2003 and 2010, prices led EPS. Since then, this relationship suggests that prices have started to discount a contraction in global EPS. An aggregation of Citi strategists' top-down forecasts suggests 6% EPS growth in 2012 followed by 6% in 2013. This is now well below the bottom-up analysts consensus forecasts of 8% in 2012 and 13% in 2013. So Citi strategists are not forecasting a contraction in global profits, but they are less optimistic than analysts.

Figure 46. MSCI AC World Price vs EPS (9m Lagged)



Source: MSCI, Citi Research

Figure 47. Trailing EPS Since November 2007



Source: Citi Research, Factset

A slowing global economy is reflected in slowing global EPS. Figure 47 shows trailing EPS since the global peak in November 2007. Only the US and EM have regained their previous highs. The scope for further EPS growth in the US is limited by already-high margins and a slowing economy, in our view. UK EPS have been surprisingly strong given the weakness of the domestic economy, but we think the UK is vulnerable to lower commodity prices with its heavy weightings in the Energy and Materials sectors. The Eurozone crisis has dragged Europe ex UK EPS back down to 30% below highs and EMU recession is likely to prove a continued drag on Europe ex UK EPS. Overall, we suspect that the risks to global EPS have been rising. However, there appears to be a lot of bad news already priced in. Global equities look cheap, especially against artificially low core government bond yields. Cheap valuations help limit the downside when pullbacks occur. Global equities are trading at 17x Cyclically Adjusted PE (CAPE) while the long-term average is 25x.

Our key regional and sector recommendations are summarised in Figure 49. Lower global GDP forecasts mean that those areas generating some growth should be valued more highly. In line with this view, we are increasing our exposure to those regions with solid EPS and GDP trends, while at the same time lowering the importance of valuation in our allocation. We therefore upgrade the US from Underweight to Neutral. US GDP growth, while not stellar, has remained stable over the last 18 months while other regions have fallen back into recession. Although US equity valuations are amongst the most expensive in the world, they are not extreme enough to offset the positives of superior EPS and GDP, in our view. Within the US, our strategists like IT as earnings remain solid and Telecoms as valuations are appealing.

By comparison, the Eurozone economy is only part way through a contraction, which continues to be a considerable drag on corporate profits. Although Continental European equities trade on relatively low valuations, we downgrade the region to Underweight from Neutral given the uninspiring EPS outlook. Within Europe, our strategists are most cautious on some of the domestic-focused sectors like Construction and Utilities. They are buyers of Pharmaceuticals where the patent concerns seem discounted and balance sheets are healthy.

We are Neutral on the UK. The UK economy is also contracting but 70-80% of FTSE 100 sales come from outside of the UK, much of this directly from Emerging Markets. Large international exposure means that UK profits are very sensitive to moves in a currency which is now being depressed by unconventional monetary policy. We are also Neutral on Emerging Markets as we no longer expect significant outperformance from EM equities. EM companies have struggled to turn premium GDP growth into premium EPS growth and we don't see this changing soon.

Our preferred equity markets right now are all in Asia. This includes Japan, Asia Pac ex Japan and Australia where we are Overweight. Unlike Europe, Asia is not suffering a recession. By contrast, Japan is experiencing a rebound in GDP and EPS following the earthquake last year. Within Japan, our strategists prefer Autos and Financials. Japanese Financials trade close to European Bank valuations but without the intertwined sovereign risks. Within Asia Pac ex Japan, our strategists like Energy, which trades on depressed valuations and IT, which benefits from solid EPS momentum. We upgraded Australia to Overweight. Australia benefits from easy monetary policy and attractive valuations. The dividend yield is the highest in the world at more than 5%. Within Australia, our strategists are buyers of the Energy sector.

Figure 48. Strategists' forecasts

Region	Index	Current Level (23 Jul 12)	End 2012 Target	Exp Gain (%)
US	S&P 500	1351	1425	6%
Pan Euro	DJ Stoxx600	252	275	9%
UK	FTSE 100	5534	6000	8%
Japan	Topix	721	960	33%
Asia xJpn	MSCI Asia x JP	470	585	25%
Australia	S&P/ASX 200	4129	4450	8%
GEMs	MSCI EM	912	1100	21%
LATAM	MSCI Latam	3475	4300	24%
CEEMEA	MSCI EM EMEA	305	350	15%
Global	MSCI ACWI	306	340	11%

Sources: MSCI, Citi Research

Figure 49. Regional And Global Sector Recommendations (Arrows show latest changes)

Global Regions		
Overweight	Neutral	Underweight
Asia Pac ex Japan	Global Emerging Markets	Europe ex UK ↓
Australia ↑	UK	
Japan	US ↑	

Global Sectors		
Overweight	Neutral	Underweight
Energy ↑	Consumer Staples	Consumer Discretionary
Health Care ↑	Financials	Industrials ↓
IT	Materials	Utilities ↓
	Telecoms ↑	

Sectors	
Overweight	Underweight
Japan - Autos	US - Capital Goods
Australia - Energy	Europe - Construction
CEEMEA - Energy	GEMs - Consumer Staples
Asia ex Japan - Energy	US - Materials
GEMs - Financials	Europe - Media
Japan - Financials	US - Retailing
US - Telecoms	Europe - Telecoms
Asia ex Japan - IT	GEMs - Telecoms
US - IT	Europe - Utilities
Europe - Pharmaceuticals	Japan - Utilities

Source: Citi Research

Securitized Products Strategy

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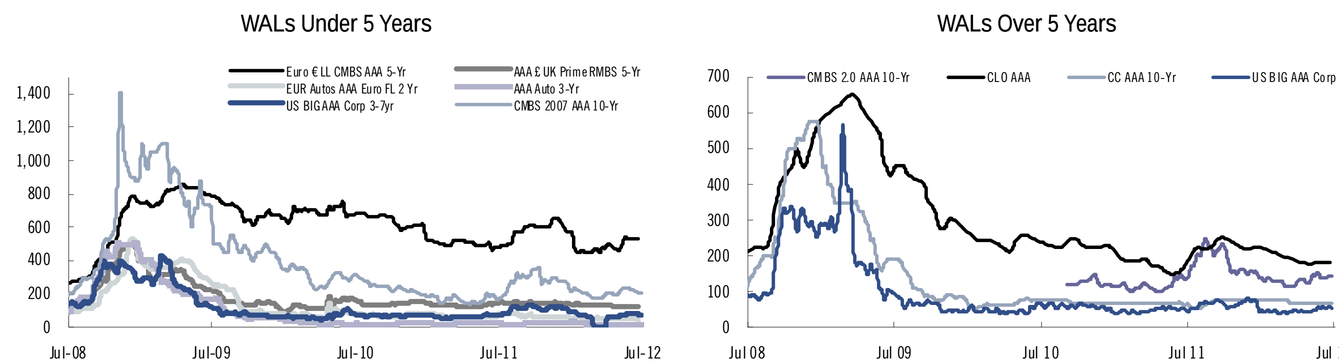
Remaining defensive is a practical strategy for securitized products portfolios during the potentially volatile second half of 2012. The ongoing European debt crisis and the not-as-yet well appreciated US "fiscal cliff" will likely motivate the market to stay cautious and short. Our strategists emphasize a defensive stance in their current recommendations. In US CABS, short WAL ABS investments uniquely suit a defensive approach. In Europe, we prefer to allocate the majority of the portfolio to core country collateral. In non-agency, we prefer current yielding assets with stable cash flows, better servicer and geographic profile. In CMBS, we recommend to stay at the top of the capital structure.

Figure 50. Selected Securitized Products Sectors — Spread Performance, Jul 08-Jul 12



Source: Citi Research

Good Second Half Prognosis, with Some Downside Risks

Despite the continued volatility we expect to see in second half, the overall economic prognosis is good. Halfway through 2012, economic growth is near 2%, and the economy demonstrates slow improvement in unemployment with low inflation. Housing markets are beginning to resuscitate and falling energy prices offer consumers a windfall. Our economists estimate that declining fuel prices will add about $75 billion to discretionary income.[9]

Still, the downside risks are tangible as US policymakers flirt with fiscal disaster and Europe's financial crisis deepens. Moreover, politically motivated gridlock creates a slippery slope standing in the way of accelerating growth next year and may already be weighing on current economic decisions. Deeper threats originate from Europe where our economists warn that the headwinds are likely to intensify.[10]

Robust Gross Supply, But Net Supply Provides Supportive Technicals

While gross Y-o-Y supply remains robust, net supply barely moves the needle for portfolio managers looking to grow their securitized products portfolios. In CABS, for example, we project $183 billion of total ABS gross supply for 2012, but the net supply should be slightly positive because of runoff. This increases our original full year gross estimate by about 50%. In CMBS, we maintain our base case projection of $25 billion of conduit issuance for 2012. Our overall 2012 base case CMBS issuance projection, including Agency multifamily deals, is $80 billion.

[9] See U.S. Economics Weekly: "Market and Policy Comments - Midyear Outlook: Against the Wind", Robert V. DiClemente et al, 29 June 2012, Citi

[10] See Global Economic Outlook and Strategy - June 2012, Willem Buiter et al, 27 June, 2012, Citi

The flat to negative net supply should generally support spreads for the remainder of the year. Of course, in more macro-sensitive sectors other factors will also influence spread direction. For example, macro concerns could drive higher the VIX, which showed relatively high correlation with CMBS spreads.

Selected Securitized Products Recommendations

- **Auto subs remain top pick.** Our top pick remains auto ABS subordinates, which are cheaper than credit card subs from a historical valuation perspective. At swaps + 100–175bp, single-A and triple-B auto ABS are attractive and pick up 35–65bp to comparable credit card subordinates. The auto ABS subordinate pickups to the 10YR adjusted mean range from 37–51bp.
- **Euro Core Focus.** We prefer a focus on core country collateral in the current market environment. We recommend a credit barbell strategy containing a core country focus with selective high-yield opportunities. We like UK prime RMBS (122bp), autos (49bp), and credit cards (135bp) with select opportunities in UK BTL (245bp), UK NCRMBS (325bp), and CMBS (530bp).
- **Non-agency current recommendation.** Because continued macro uncertainties can lead to price volatility, we prefer current yielding assets with stable cash flows, better servicer and geographic profile.
- **CMBS 2007-vintage duper pickup.** We continue to recommend the 2007-vintage dupers versus the earlier-vintage dupers.

"Alternatives to Ratings" Regulatory Focus Shifts to Delinquencies from Losses

On the regulatory front, the Dodd-Frank Act implementation continues. The final U.S. market risk capital rules released in early June will focus on delinquencies rather than cumulative losses in determining risk-based capital charges. Going forward, the market will naturally have an even greater focus on delinquency projections and trends. We also expect to see an ongoing interest in the market in comparing the capital charges resulting from the final "delinquencies-based" approach to those mandated in the Basel's ratings-based approach. The final market risk capital charges rules become effective January 1, 2013.[11]

Sector Relative Value and Allocation Recommendations

Figure 51. Sector Relative Value and Asset Allocation Recommendations — Selected Sectors, July 2012

Sector	Strategist Recommendation	Spreads Relative to Long-Term Averages	Comments
CABS	0	Fair	Remain market weighted. Subordinate auto ABS is our top pick. We also like senior auto lease, private label credit card and dealer floorplan ABS.
CMBS	0	Fair	2007 dupers now pick up 115bp to those from 2005. While we continue to recommend this spread pickup, investors must be comfortable with the higher mark-to-market risk that accompanies it.
Agency MBS	0	Fair	Valuations are fair, outlook for declined volatility and likelihood of balance sheet action by Fed boost the valuations.
European Securitized Products	0	Cheap to Fair	We prefer a defensive bias in our barbell strategy with stable, short sectors, combined with select off-the-run opportunities. We prefer core country yield opportunities in UK BTL, UK NCRMBS and select CMBS.

Source: Citi Research

[11] For more details on the final rules, please see "Alternatives to Ratings" Focus Shifts to Delinquencies from Losses, Citi, June 22, 2012.

Commodity Outlook and Forecast

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This month Citi updated its commodity price deck (3Q'12 Commodity Update: 'Tis the Seasonality), outlining opportunities and challenges facing the commodity complex in 2H'12 to 2013 and beyond. Within the various sectors, the short-term conviction calls were for oil, palladium, nickel, gold, corn, wheat and soybeans on the bullish side with copper, zinc, US natural gas, cotton and coffee appearing more bearish 0-3m forward. The first half of 2012 challenged many of the commodity axioms of the last decade; certainly over the last six months going long has not proven to be a winning strategy, and Q2'12 brought negative returns to virtually all classes of commodities, with the biggest exception being US natural gas and the major grains and oilseeds, which significantly outperformed other sectors. The lackluster performance of commodities should not be surprising, given that GDP growth has been decelerating across the global economy, with negative growth deepening in core Europe, US growth faltering and emerging market growth slowing down faster than virtually anyone had forecast. At the heart of the declining rate of commodity consumption growth has been China, the major demand driver for industrial, agricultural and energy commodities over the last decade.

Figure 52. Citi Commodity Price Forecasts*

		Point Prices												
		0-3M	6-12M	5Y Cyclical	Q1 2012	Q2 2012E	Q3 2012E	Q4 2012E	2012E	Q1 2013E	Q2 2013E	Q3 2013E	Q4 2013E	2013E
Energy														
NYMEX WTI	USD/bbl	90.0	80.0	81.0	103.0	93.3	100.0	80.0	94.0	85.0	85.0	85.0	85.0	85.0
ICE Brent	USD/bbl	105.0	100.0	85.0	118.4	108.8	120.0	105.0	113.0	105.0	95.0	100.0	95.0	99.0
Henry Hub Natural Gas	USD/MMBtu	2.5	2.7	N/A	2.5	2.4	2.5	2.3	2.4	3.1	3.5	3.8	3.7	3.6
Base Metals														
LME Aluminum	USD/MT	1,900	2,065	2,300	2,216	2,019	1,900	2,000	2,035	2,050	2,080	2,120	2,200	2,115
LME Copper	USD/MT	7,550	8,180	7,300	8,314	7,833	7,550	7,900	7,900	8,100	8,260	8,240	8,200	8,200
LME Lead	USD/MT	1,850	2,075	2,300	2,118	1,987	1,850	1,950	1,975	2,100	2,050	2,000	2,150	2,075
LME Nickel	USD/MT	16,800	22,513	22,000	19,721	17,228	16,800	20,500	18,560	22,550	22,475	23,000	23,250	22,820
LME Tin	USD/MT	18,700	22,500	24,500	22,986	20,619	18,700	21,500	20,950	22,000	23,000	23,500	22,000	22,625
LME Zinc	USD/MT	1,830	1,988	2,300	2,040	1,933	1,830	1,900	1,925	1,975	2,000	2,080	2,100	2,040
Precious Metals														
COMEX Gold	USD/T. oz	1,610	1,680	1,350	1,691	1,613	1,610	1,660	1645.0	1670	1690	1700	1720	1695
Silver	USD/T. oz	29	30	21	32.6	29.6	28.6	29.5	30.0	29.7	29.8	30.0	30.0	29.9
Platinum	USD/T. oz	1,475	1,565	1,750	1,604	1,505	1,475	1,550	1535.0	1565.0	1565.0	1565.0	1565.0	1565.0
Palladium	USD/T. oz	650	700	775	683	630	650	675	660.0	700.0	700.0	700.0	700.0	700.0
Bulk Commodities														
Hard Coking Coal (benchmark Asia)	USD/MT	215	220	200	235	215	225	220	224	225	230	225	225	226
Thermal Coal Asia (NEWC)	USD/MT	90	115	105	113	88	94	98	98	110	115	115	120	115
Iron Ore Spot (TSI)	USD/MT	130	135	100	142	139	135	140	139	140	138	130	130	135
Agriculture														
CBOT Corn	USd/bu	850	693	N/A	641	618	730	710	675	675	660	635	610	645
CBOT Wheat	USd/bu	925	750	N/A	643	641	765	750	700	750	725	730	715	730
CBOT Soybeans	USd/bu	1,875	1,488	N/A	1,272	1,426	1,550	1,525	1,443	1450	1375	1375	1300	1,375
CBOT Rice	USD/cwt	15.0	15.1	N/A	14.31	14.82	15.00	15.10	14.81	15.15	15.20	15.25	15.00	15.15
NYB-ICE Cotton	USd/lb	83	83	N/A	93	81	83	83	85	N/A	N/A	N/A	N/A	85
Sugar#11	USd/lb	23	24	N/A	24.5	21.2	23.5	23.5	23.2	N/A	N/A	N/A	N/A	23.0
ICE Coffee	USd/lb	180	185	N/A	205	171	185	180	186	N/A	N/A	N/A	N/A	190
ICE Cocoa	USD/MT	2,315	2,315	N/A	2,308	2,221	2,315	2,300	2,290	N/A	N/A	N/A	N/A	2,400

Source: Citi Research, *subject to revision. Published 16th July 2012, 'ag' prices published 11th July 2012 – point prices can update more frequently than quarterly averages

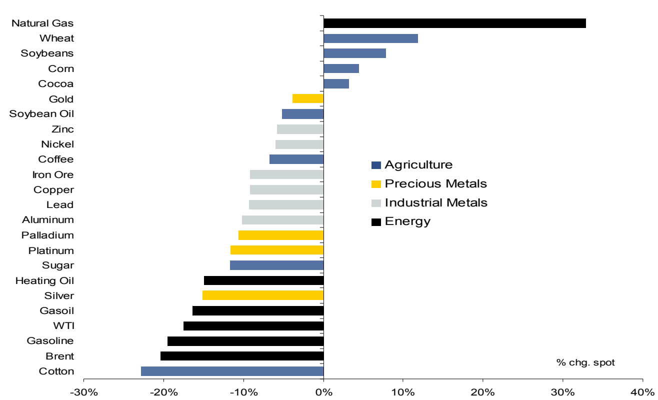
The deteriorating macroeconomic outlook has resulted in unusually coordinated activism among the world's central banks. Notably, the European Central Bank has cut interest rates by 25bps to 0.75%. The Bank of England has announced a £50bn expansion of its balance sheet. And finally, the People's Bank of China has cut its own lending rate by 31bps to 6%. This was alongside rate cuts by smaller central banks such as by South Africa, Denmark, South Korea, and Taiwan.

Notably, the US Federal Reserve has remained on hold, announcing only an extension of its balance-sheet neutral Operation Twist program by $267bn. However, recent poor employment and retail sales data and a downturn in manufacturing activity has raised expectations of more activist Fed policy at the upcoming September meeting, which has capped dollar strength and may provide nominal price support, particularly to the precious metals.

The demand outlook for the industrial commodity complex is expected to weaken through 3Q'12 as the physical markets reflect the uncertainty currently present in financial markets. On the supply side, expectations are mounting for increased output into the second half of 2012. These factors coupled with the EU crisis and EM slowdown is likely to result in the complex moving lower in the short-term. In the medium-term, Citi expects to see the transition to later cycle commodities, which should benefit the base and precious metals over bulk commodities. For oil, Citi reiterated its short-term bullish call made in June and Brent flat price and structure has strengthened in suit on the seasonal returns of refiners globally and the non-seasonal bullish factors of Iran, Syria and potential Libyan field maintenance. Prices are expected to weaken into 4Q'12 and 2013 on weaker consumption, non-OPEC supply growth and continued Saudi overproduction. Given the seasonal return of refiners, it should drive a convergence of high global crude stocks and low product stocks, meaning the recent weakness in crude should migrate to products. This suggests that the key seasonal trade is to sell refining margins, as well as buying Brent structure (with WAF differentials as a key indicator to see strengthening).

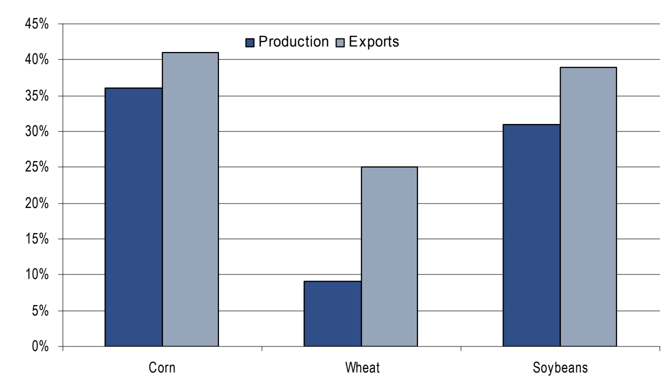
Agriculture markets led by coarse grains, wheat and oilseeds are poised to continue outperforming other commodity sectors this quarter and for the balance of 2012. The worst drought in a half-century across the American farm-belt has sharply eroded supply prospects for the world's swing producer; tightening crop balances in the US as well as internationally, boosting bullish spec positioning to record levels for wheat, beans and corn contracts. What were expectations of a record US corn crop of 370-mt in April have long been forgotten with the USDA forecast of 329.5-mt (versus Citi 324.1-mt) likely to be revised down to show zero-growth or negative year-on-year production growth (below 314-mt) later this summer. US oilseed output also is at risk and although the US wheat crop has been resilient, a global shortfall is tightening carryout estimates. Weather risks are not just isolated to the US although it remains the primary focal point as the world's largest grower of corn and soybeans and largest exporter of wheat. The Black Sea producing bloc has been impacted by lack of precipitation that has curtailed its 12/13 grain export capacity, particularly for Russian wheat. Reports also indicate that a weaker and slowly drifting Indian monsoon may hinder its coarse grain, oilseed and sugar output at a critical juncture when South Asian crops will be needed to satisfy global demand. Corn, wheat and soybean prices are likely to trade higher still.

Figure 53. Commodity Performance in Q2 2012



Source: Bloomberg, Citi Research

Figure 54. US: Swing Grains and Beans Supplier Globally (% of World)*



Source: USDA, Citi Research, *Citi estimates might slightly differ from USDA statistics

Citi Foreign Exchange Forecasts

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

Market Commentary

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

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

- USD strength in the face of better risk appetite and position unwinds suggests underlying fundamental strength. We forecast further USD upside medium term
- EUR should be weak across the board medium term assuming Grexit, volatile and wide bond yield spreads between core and periphery, weak EMU growth, further ECB rate cuts and additional LTROs. But near term, we may see some stability given the sharp move lower recently
- In Europe, GBP, SEK and NOK may give back some of their recent gains, as the single currency stabilises in the short term. But longer term these EUR crosses should move lower again
- The EUR/CHF peg should hold so long as inflation in Switzerland is contained and EMU pressures remain manageable
- Within EM, growth weakness in Asia relative to expectations is marked. This is on the back of developments in China. Export intensive Asian FX may now underperform

Figure 55. Citi Forecasts

		Market data			Forecasts			Returns**	
		spot	3m Fwd	12m Fwd	0-3 mos	6-12 mos	long-term	3 mos rtn	12 mos rtn
G10									
Euro	EURUSD	1.22	1.22	1.23	1.22	1.15	1.30	-0.3%	-6.4%
Japanese yen	USDJPY	79	78	78	78	82	84	-0.6%	4.9%
British Pound	GBPUSD	1.57	1.57	1.57	1.56	1.50	1.65	-0.3%	-4.1%
Swiss Franc	USDCHF	0.98	0.98	0.97	0.98	1.04	0.92	0.3%	7.3%
Australian Dollar	AUDUSD	1.04	1.03	1.01	1.04	0.98	0.90	0.8%	-3.0%
New Zealand Dollar	NZDUSD	0.80	0.80	0.78	0.81	0.73	0.65	1.1%	-6.7%
Canadian Dollar	USDCAD	1.01	1.01	1.02	1.01	1.00	0.97	-0.1%	-1.7%
Dollar Index*	DXY	83.08	83.13	82.92	83.22	87.38	79.82	0.1%	5.4%
G10 Crosses									
Japanese yen	EURJPY	96	96	96	95	94	109	-0.9%	-1.8%
Swiss Franc	EURCHF	1.20	1.20	1.19	1.20	1.20	1.20	0.0%	0.4%
British Pound	EURGBP	0.78	0.78	0.78	0.78	0.77	0.79	0.0%	-2.4%
Swedish Krona	EURSEK	8.45	8.50	8.60	8.50	8.40	8.40	0.0%	-2.3%
Norwegian Krone	EURNOK	7.42	7.46	7.55	7.50	7.40	7.30	0.6%	-2.0%
Norwegian Krone	NOKSEK	1.14	1.14	1.14	1.13	1.14	1.15	-0.6%	-0.3%
Australian Dollar	AUDNZD	1.30	1.30	1.29	1.29	1.34	1.38	-0.3%	4.0%
Australian Dollar	AUDJPY	82	81	79	81	80	76	0.2%	1.7%
Asia									
Chinese Renminbi	USDCNY	6.37	6.35	6.42	6.38	6.34	6.15	0.5%	-1.2%
Hong Kong Dollar	USDHKD	7.76	7.76	7.75	7.75	7.76	7.75	-0.1%	0.1%
Indonesian Rupiah	USDIDR	9458	9561	9927	9450	9649	9649	-1.2%	-2.8%
Indian Rupee	USDINR	55.3	56.3	58.6	54.0	55.3	52.3	-4.0%	-5.7%
Korean Won	USDKRW	1141	1148	1158	1140	1185	1080	-0.7%	2.3%
Malaysian Ringgit	USDMYR	3.15	3.17	3.20	3.15	3.23	3.11	-0.6%	1.0%
Philippine Peso	USDPHP	41.9	42.1	42.4	42.5	43.0	40.8	0.9%	1.4%
Singapore Dollar	USDSGD	1.26	1.26	1.25	1.25	1.28	1.23	-0.4%	2.2%
Thai Baht	USDTHB	31.7	31.9	32.3	31.5	32.0	29.9	-1.2%	-0.9%
Taiwan Dollar	USDTWD	30.0	29.9	29.6	30.3	30.5	28.5	1.2%	2.9%
EMEA									
Czech Koruna	EURCZK	25.6	25.6	25.7	25.3	26.0	24.6	-1.1%	1.3%
Hungarian Forint	EURHUF	286	290	300	295	285	290	1.9%	-4.9%
Polish Zloty	EURPLN	4.16	4.21	4.34	4.21	4.40	3.90	0.0%	1.5%
Israeli Shekel	USDILS	4.00	4.01	4.04	4.20	4.20	4.00	4.7%	3.9%
Russian Ruble	USDRUB	32.0	32.5	34.0	33.3	35.4	33.0	2.4%	4.2%
Russian Ruble Basket		35.2	35.8	37.5	36.6	37.8	37.5	2.3%	0.8%
Turkish Lira	USDTRY	1.81	1.84	1.92	1.78	1.88	1.85	-3.0%	-2.0%
South African Rand	USDZAR	8.26	8.37	8.66	8.25	8.70	8.72	-1.4%	0.5%
LATAM									
Brazilian Real	USDBRL	2.01	2.04	2.11	1.98	2.06	1.95	-3.1%	-2.4%
Chilean Peso	USDCLP	485	492	506	488	508	490	-0.8%	0.4%
Mexican Peso	USDMXN	13.3	13.4	13.7	13.2	13.7	12.2	-1.9%	-0.1%
Colombian Peso	USDCOP	1780	1809	1861	1763	1860	1800	-2.6%	0.0%

* The DXY forecasts are implied from the forecasts of the constituent crosses.
** Returns are relative to forwards

Source: Citi Research

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

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

Overview

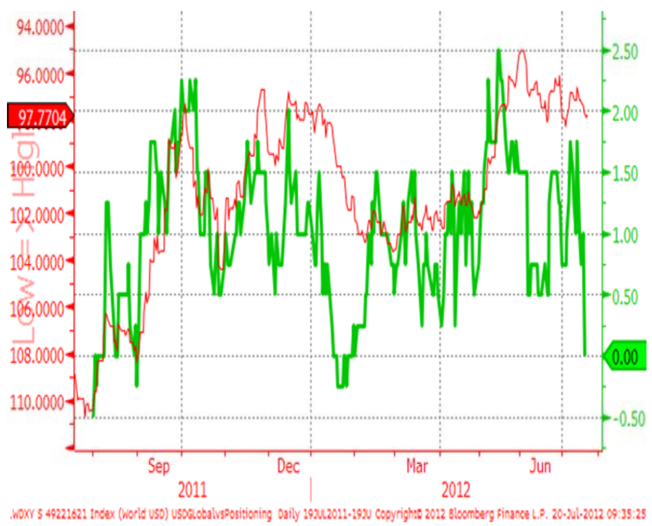
Trend USD appreciation has paused since early June with LATAM currencies so far regaining a little more ground on a beta adjusted basis than other regional currencies. A couple of factors have probably contributed to this USD consolidation. First, risk appetite, as proxied by (the inverse of) our GRAMI indicator, has recovered somewhat helped by rate cuts in several centres, and various other announcements detailing or hinting at Central Bank monetary ease. In addition, the early July EMU summit outlining plans for a future banking union helped to stabilise sentiment in Europe. Second, CFTC data point to a partial unwind of extreme long USD positioning while Citi platform based positioning data also suggest USD longs were reduced after mid May (Figure 56).

Nonetheless, we remain medium term USD bulls. We think the USD rally this year has been about more than simply risk aversion. This is perhaps highlighted by the divergent movements in the GRAMI and our world USD index (Figure 57) where improving risk appetite since early June has generated much less of a USD sell off than would have been expected before. The same observation holds in Figure 56 too.

This is turn reflects likely US cyclical outperformance. FX investors believe that the US economy may be sub-par but is still likely to outperform other regions. Equity outperformance, and bond market underperformance on trend suggest similar expectations are in other asset markets. These factors are likely to drive USD appreciation over the medium term, absent US policy disasters.

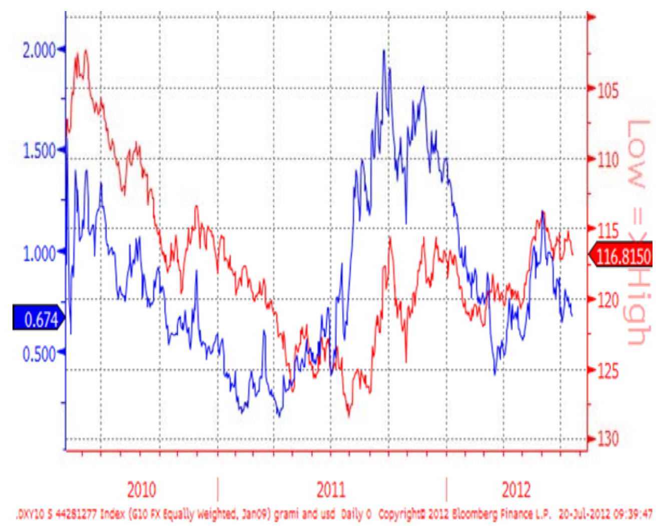
All in all, Citi forecasts anticipate further USD gains medium term, especially relative to G10 majors with EUR/USD falling towards 1.15. Overall, gains of around 5% over 6-12m are likely vs. G10 currencies and about 4% on a global GDP weighted basis.

Figure 56. USD vs. Global Currencies (Red), Citi USD ex EM Positioning Indicator (Green)



Sources: Citi Research and Bloomberg

Figure 57. GRAMI (Blue) vs. World USD Index (Red) — Higher = Greater Risk Aversion and Stronger USD Respectively



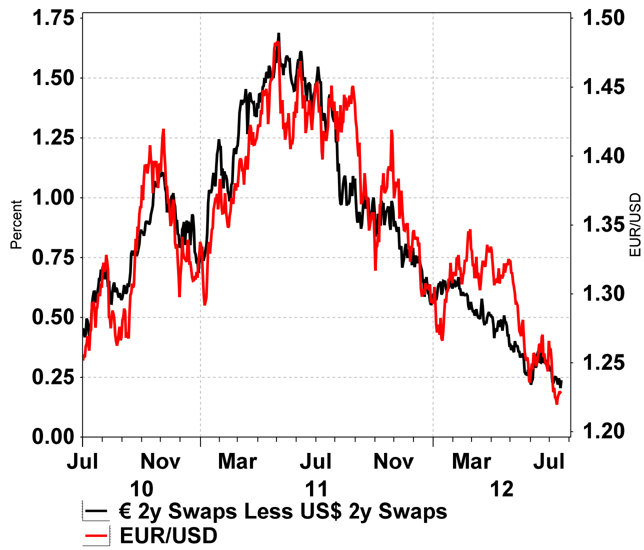
Source: Citi Research and Bloomberg

G10 Exchange Rates

EUR/USD — Downward Pressures Remain

EUR/USD continues to trend lower, breaking through June lows around 1.229 in early July before finding support for now just below 1.22. The rate may consolidate for a while now given that, on several measures, it seems to have overshot to the downside. For example, comparing EUR/USD to rate differentials (Figure 58) or to relative CDS movements (Figure 59) the current exchange rate looks a bit too low. That said, a trend of falling highs and lows has been in place since May 2011 and shows no obvious signs of reversal.

Figure 58. EUR/USD (Red) Has Slightly Overshot 2y Rate Differentials (Black)



Source: Reuters EcoWin

Figure 59. EUR/USD (Red) vs. GDP Weighted EMU Less US 5y CDS (Black)

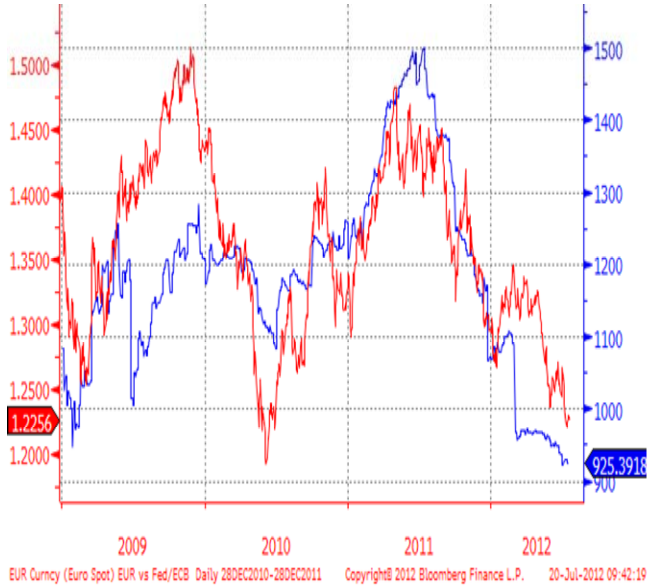
Source: Bloomberg

Medium term, fundamentals seem to remain against the EUR. Over this time horizon, Citi sees an increased possibility of Grexit, volatile and wide bond yield spreads between core and periphery, weak EMU growth, further ECB rate cuts and additional LTROs. The latter are likely to prolong a trend rise in the size of the ECB balance sheet relative to that of the Fed, another factor undermining the single currency (Figure 60).

Another factor that may be relevant but which is less in the spotlight is the re-balancing in large EM economies, especially China. China's current account surplus was 10% of GDP as recently as 2007 but will be around 1.5% of GDP next year. This has contributed to a much slower FX reserve build up as downwards pressures on USD/CNY have waned. As Figure 61 shows, this may in turn lead to less pressure to buy EUR as diversification out of USD and therefore a reduced support for the single currency in times when fundamentals are unhelpful. Perhaps this is why the EUR/USD rate has been trading below levels indicated by other market variables (Figure 58 and Figure 59).

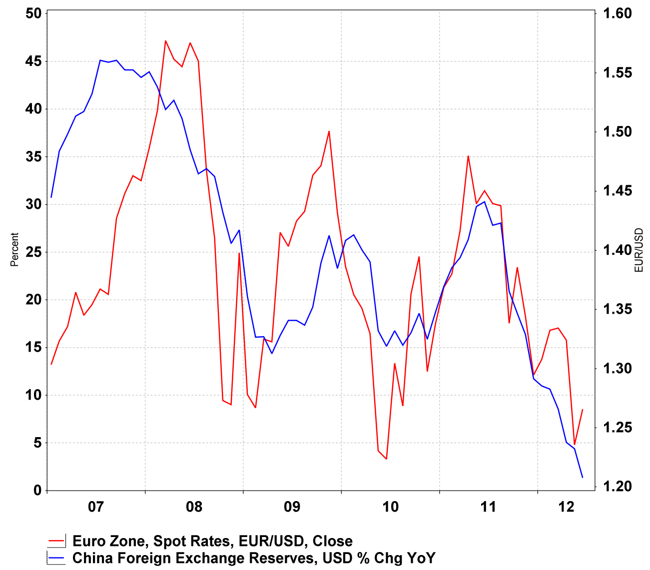
Our forecasts show EUR/USD heading to 1.15 over 6-12 months though some near term consolidation is possible.

Figure 60. EUR/USD (Red) vs. Relative Balance Sheet of Fed/ECB (Blue)



Source: Bloomberg

Figure 61. Chinese FX Reserves Growth (Blue) vs EUR/USD (Red)



Source: Reuters EcoWin

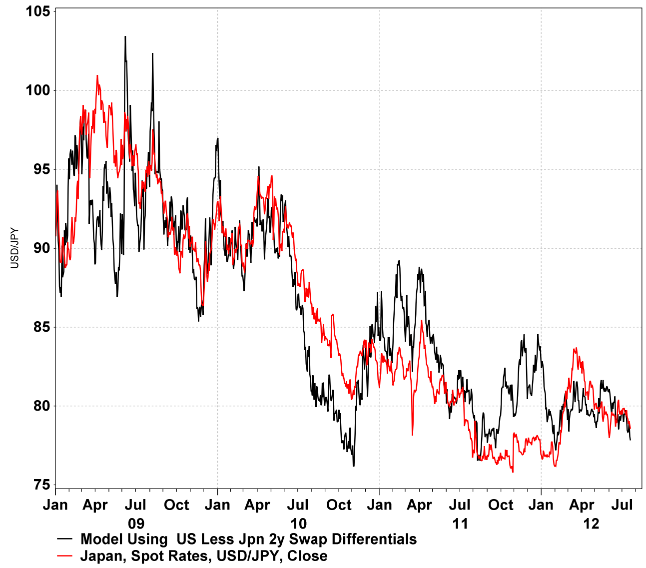
USD/JPY — Sideways

USD/JPY continues to trade mainly sideways, broadly within a range bounded by 75-85. Our forecasts essentially see this continuing. Flows from trade hedging are likely to be relatively light and retail investors are showing signs of returning to local equities, where dividend yields look attractive, rather than to entering new carry trade in high yield currencies. As such, neither group is likely to move JPY very much.

Should the Fed move towards QE3 (more likely from September than August if at all) this too may temporarily push USD/JPY lower along with other USD crosses. This may be behind very recent moves lower. A successful reflationary policy, such as QE1, and to a lesser degree QE2, also tends to raise UST yields eventually and with this USD/JPY usually moves higher at least for a period. In the current environment of disappointing economic data everywhere (including the US) core bond yields are unlikely to move up much and USD/JPY may drift a bit lower over 0-3 months in line with rate differentials (Figure 62). However, intervention from BoJ/ MoF is likely at least to attempt to slow the downside from 76 onwards.

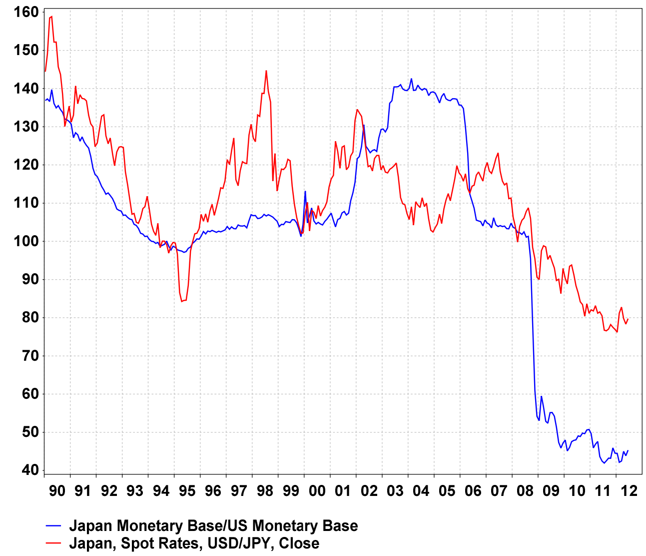
One of the factors that, over time, has supported JPY strength is the stance of the BoJ. Typically, the BoJ is much less aggressive with monetary easing than the Fed has been (Figure 63). This may be changing slightly at the edges with the BoJ finally adopting an inflation target but significant additional QE, for example, still seems lacking. As such, upside in USD/JPY is limited by this conservative stance despite a gradual deterioration in other fundamentals such as the trade balance. Our 6-12m forecast is USD/JPY 82 well within the range since mid-2010.

Figure 62. USD/JPY vs. A Model Based on 2y Swap Rate Differentials



Sources: Reuters EcoWin and Citi Research

Figure 63. USD/JPY vs. Relative Monetary Base



Sources: Reuters EcoWin and Citi Research

Dollar Bloc — CAD Outperforms Longer Term

Our forecasts for the $-bloc currencies are for range trading/ moderate appreciation near term but with some tendency to weaken against a strong USD over the medium term. However: (i) all $ bloc currencies outperform the EUR medium term; and (ii) within the bloc, we believe that CAD may be the outperformer longer term reflecting better valuation and less exposure to a weakening economy in China.

AUD is slightly stronger than at the time of our last forecast, mainly reflecting better risk appetite since carry adjusted for volatility is reduced, Asian currencies have been mixed but generally not strong enough to support AUD at recent levels and the terms of trade have not improved recently for Australia.

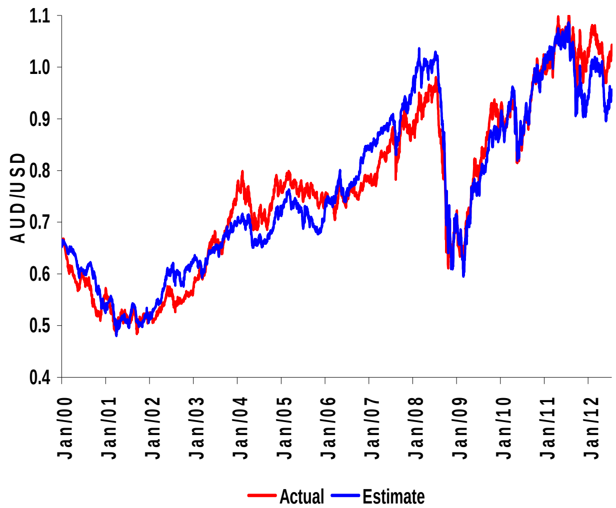
We can't rule out the possibility that the AUD continues to hold up near term, since it is also possible that Reserve Managers have bought AUD given concerns about over-exposure to the USD and a reluctance to buy EUR.

That said, our short and long term valuation models continue to suggest that it should be trading more like 90-94c (Figure 64) and our forecasts have spot moving this way over the medium to long term. With AUD likely to come down again, albeit not until the fourth quarter, and with key commodity prices also likely to be weaker, we expect a move back below parity in AUD/USD over 6-12m in the context of generalised USD strength and a stable USD/CNY rate.

Medium term, we expect AUD to continue to outperform NZD. Carry is slightly better on AUD, growth is more robust and unemployment lower in Australia, the NZ current account deficit is bigger and widening faster and the first RBNZ rate hike keeps getting pushed further into the future by very favourable (low) inflation readings. All this will likely see AUD/NZD push higher towards our WERM fair value estimate at 1.39 over the longer term.

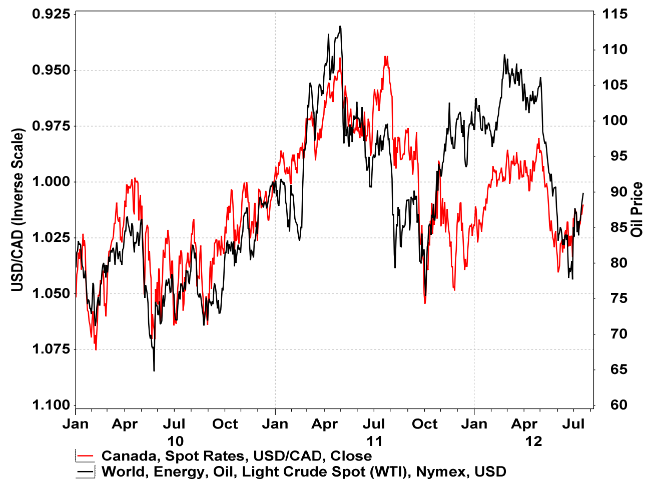
Near term, however, rising food related commodity prices likely benefit NZ more than Australia and the latter's exposure to China becomes at least a short term negative. As a result, over 0-3m we see NZD outperforming, rising to NZD/USD 0.81 before falling back further out to 0.73 over 6-12m.

Figure 64. AUD/USD vs. Model Based on Terms of Trade, GRAMI, Carry and ADXY



Sourced: Bloomberg and Citi Research

Figure 65. USD/CAD (Inverted) vs. Oil Prices



Source: Reuters EcoWin and Citi Research

CAD remains relatively low beta but is supported in our view by valuation and fundamentals relative to AUD and NZD over the medium term. One of the key factors is the monetary policy stance of the BoC. Here policymakers are keen to normalise rates as soon as possible and continue to view current monetary settings as highly accommodative. Citi forecasts show rates rising in March 2013, clearly very early in the cycle compared with other major Central Banks. Short term, low inflation will provide nothing for officials to hang an earlier rate move on, while it would take a considerable downside shock to the global economy for any further easing to be considered.

Stable policy settings, somewhat lopsided growth (consumer/ businesses strong and exports/ government weak) and mixed news on commodity prices (Figure 65) will likely keep CAD in a range for now but our medium and long term forecast is for a drift down towards WERM fair value at 95c.

European Crosses

GBP — Sterling To Give Back Some of Its Gains Short Term

After a pause in its rally last month, Sterling appreciated against both the euro and the greenback since our last *Forecasts*. In fact, GBP has broken out of its range versus a 50:50 basket of EUR and USD, and now seems to be trading in an upwards sloping channel (Figure 66).

Since our last *Forecasts*, the BoE expanded its QE program by a further £75bn. This was expected by Citi economist, and, judging by the market reaction (i.e. GBP rallying and not selling off), consensus was probably also already expecting more QE.

In the meantime, data continues to be weak, with Citi's UK ESI remaining near nine month lows. Citi economists have further downgraded their growth outlook, now expecting a real GDP contraction of 0.4% in 2012. With inflation both falling and likely to undershoot the MPCs target, even more QE is also likely. Citi's forecasts

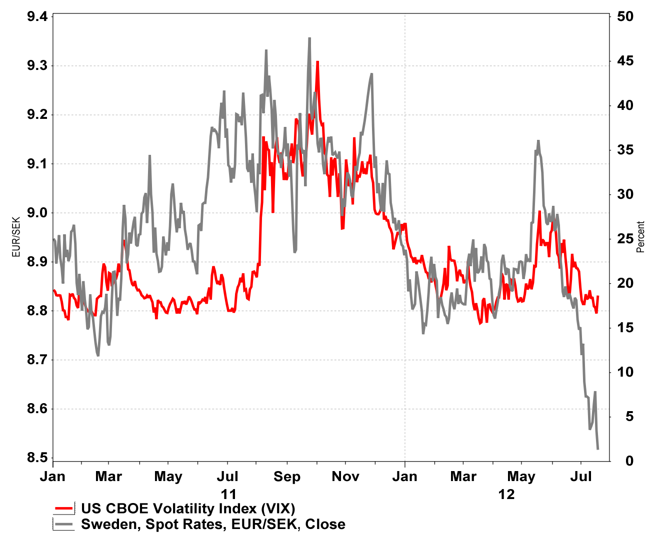
see the total QE program expanding to £500bn, alongside liquidity and credit easing. All else equal, this is a sterling negative vs. USD, but we have the feeling this is probably already priced to some extent and there is obviously also the QE3 risk for the USD itself.

As a result, we see expect GBP/USD to maintain its recent 1.54-1.58 range short term. Given our expectations for EUR/USD to stabilise for a while, sterling may consolidate versus the euro. More medium term, with the single currency losing ground again, we see EUR/GBP pushing modestly lower and GBP/USD falling to around 1.50.

Figure 66. GBP vs. Average of USD and EUR (Higher = Stronger GBP)

Source: Reuters EcoWin and Citi Research

Figure 67. EUR/SEK vs. VIX — Relationship Decoupled



Source: Bloomberg and Citi Research

Scandis — Likely To Trade Broadly Sideways After Recent Gains

Since our last *Forecasts*, the Swedish Krona appreciated strongly vs. the EUR, decisively breaking the 8.75-8.95 range it held for most of the previous seven months. In fact, having traded near 9.20 just two months ago, EUR/SEK has fallen to an intraday low below 8.50 in recent days, and is now coinciding with our WERM long term fair value model.

After such sharp moves, the cross seems short term oversold on a number of metrics. Having traded in-line with implied equity volatility for example (i.e. SEK appreciated in risk-on when VIX declined), the relationship has broken down completely — current EUR/SEK spot is historically consistent with VIX at 2%, a level it has never traded at before (Figure 67).

While recent macro data has been more positive — after missing expectations for three months running, the latest industrial production print surprised strongly to the upside for example — and Citi's ESI is back in positive territory, Citi economists still forecast weakness in growth. Swedish GDP growth is expected to be only 0.4% in 2012, down from 4.0% a year earlier — weaker exports to the depressed EA countries continues to be a major drag. Furthermore, the Riksbank will likely continue to ease policy and Citi continues to expect 50bp of cuts to the repo rate in the remainder of this year. With only around half of that priced into rate markets, this reduction in carry could weigh on SEK.

Interestingly, recent EUR/SEK moves have been mainly driven by the euro's decline — USD/SEK has been fairly stable, hovering around the 7.0 level. Given our forecasts of some stabilisation of EUR/USD in 0-3 months, we expect SEK to consolidate recent gains vs. EUR in the short term rather than continue stronger.

As a result, our forecast puts EUR/SEK at 8.50 in 0-3 months. In the medium term, strong fiscal and external balances will help EUR/SEK appreciate again, and our forecasts show 8.40 in 6-12 months.

Unlike its Swedish counterpart, EUR/NOK remains somewhat above recent lows, but nonetheless, has started drifting lower since our last *Forecasts* — current spot trades around the levels seen before the March policy rate cut. NOK/SEK has been under heavy downwards pressures as a result.

In terms of growth, Norway is set markedly to outperform most other European economies this and next year, in part due to the stabilizing effect of the petroleum industry. Citi economists thus see the Norges Bank to be on hold for the remainder of this year, and even expect a 25bp hike in 1Q 2013. Given further ECB rate cuts, this increase in carry should lend support to the Norwegian Krone.

With a possible consolidation near term in EUR/USD, we may see NOK losing some ground versus the single currency in the short term. More medium term, EUR/NOK should push back towards fair value (7.31 on our WERM model). We forecast 7.40 in 6-12 months and 7.30 further out.

CHF — EMU Crisis Poses Risk To Peg

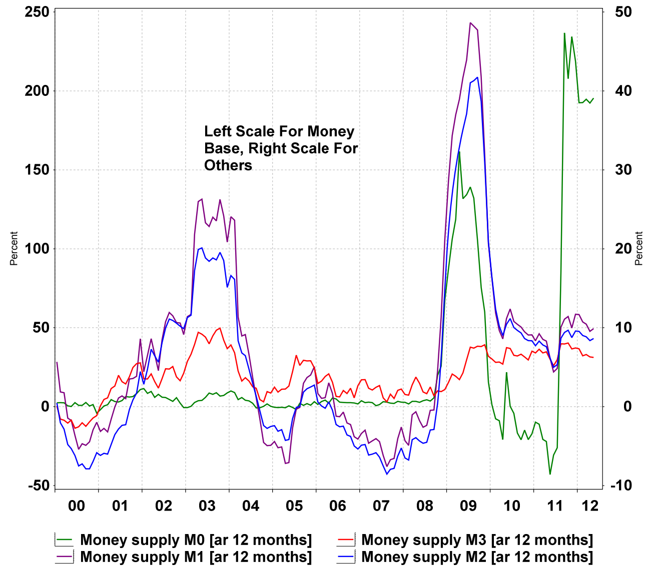
The Swiss Franc peg continues to hold and EUR/CHF remains in close proximity to the 1.20 level, while exhibiting hardly any realised volatility. In fact, the daily trading range of EUR/CHF has gradually drifter lower ever since the peg was introduced, and is virtually zero at the current juncture. We doubt this pattern will be disturbed in the near term.

Citi economists continue to forecast economic weakness and expect inflation pressures to remain weak. While this is the case, market participants are unlikely to question the peg and as such, the SNB will likely continue to print as many CHF as it takes to absorb market sales of EUR. We therefore forecast the 1.20 peg to hold in the short to medium term.

Further out, the peg faces two risks. Firstly, inflation — effectively making the money supply endogenous to the FX market has already resulted in explosive base money growth (Figure 68). This rapid growth in local liquidity risks asset price, and eventually, CPI inflation. Headline inflation rates already appear to be bottoming out and annualised rates have crept back into positive territory (Figure 69) while Swiss house prices have also started to pick up. The second risk stems from the euro zone crisis. EMU pressures building strongly could cause CHF safe haven inflows to overwhelm the SNB and as a result the downside in EUR/CHF may well be tested in the long term.

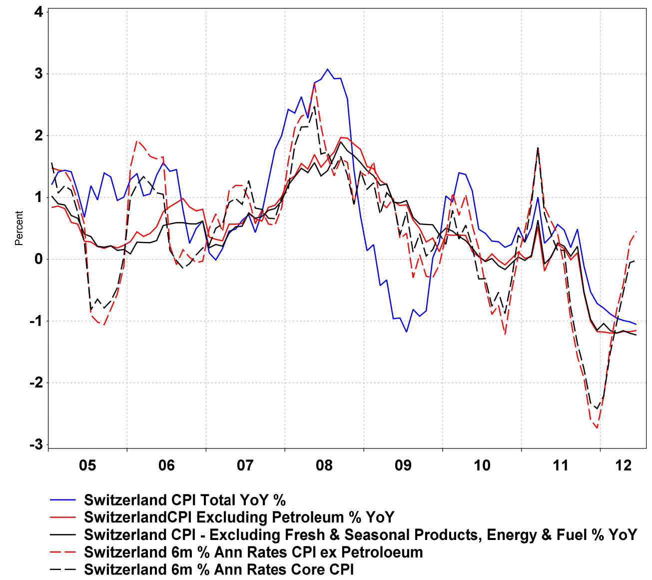
Our point forecasts remain unchanged at 1.20 but we note the above risks to the downside further out.

Figure 68. Swiss Base Money Growth is Rapid



Source: Reuters EcoWin

Figure 69. Swiss Inflation Bottoming Out?



Source: Reuters EcoWin

EM Exchange Rates

The USD continues gently to correct lower and the forecasts presented here are for consolidation of these moves, in the near term. In beta adjusted terms since early June, LATAM currencies have outperformed and CEEMEA FX has underperformed, broadly in line with our expectations.

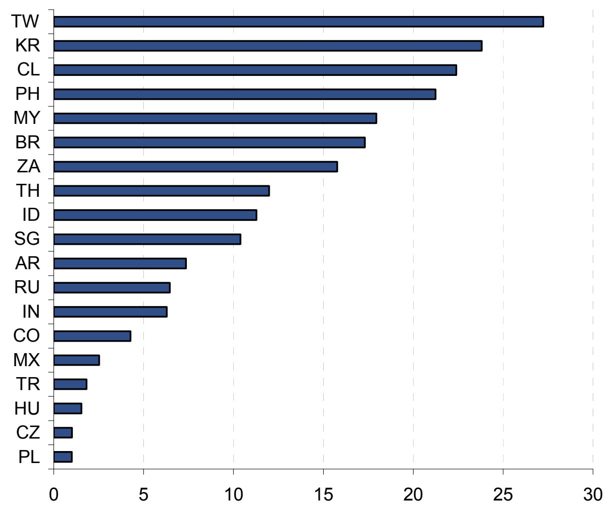
This pecking order is expected to persist over our forecast horizon, with Latam FX holding up better than CEEMEA. Asia in aggregate runs a middling course, lifted by crosses like INR that is expected to reverse its sharp recent sell off.

Growing evidence of weakness in China and surrounding Asian exporters leads us to expect a flat to slightly weaker CNY and weakness in CNY-sensitive Asian FX (Figure 70). In a softer-growth setting, Asian central banks may “manage” exchange rates lower as they did the last time CNY was held steady. Moreover, the fact that the time lag for changes in interest rates to feed through the real economy is typically 18 months means that FX depreciation could be the sharper way to stimulate growth anyway.

For EM in general, higher food prices are a clear inflation risk (Figure 71), and to some extent, if they persist, may present a risk to these forecasts too. There are important differences between various economies/individual commodity prices, however. So, for example, the rise in ags so far has been concentrated in grains, with relatively tame rises in rice prices. This potentially leaves Asia relatively less vulnerable and Latam more at risk.

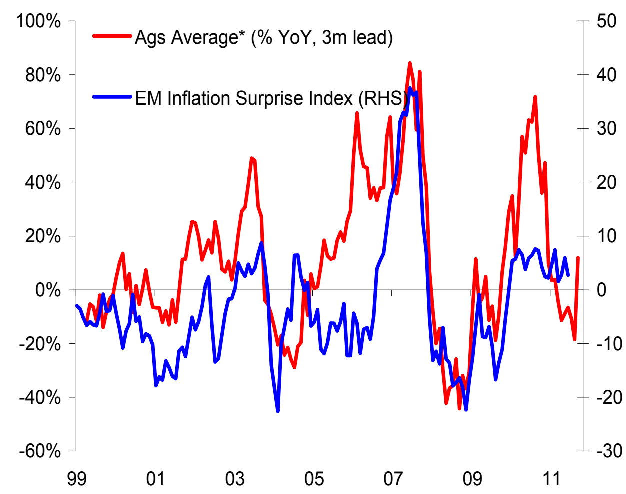
Based on our July forecasts, the best three month return is achieved in India, and the worst in ILS.

Figure 70. China Sensitivity — Share of Exports to China



Source: Citi Research

Figure 71. Food Prices and EM Inflation Surprises



Sources: Citi Research and Bloomberg
*Average of Wheat, Corn and Rice Prices (all rebased 100=1999)

EM Asia — FX as Part of Overall Easing

Two chief factors guide our Asian FX forecasts this month. The first is mounting evidence of Chinese economic weakness and a flat-lining/slightly depreciated yuan. Asian exporters have kept their currencies broadly steady against both the USD and CNY so far (Figure 72), but we doubt that this is sustained if domestic data continue to weaken and the dollar strengthens as we expect over the medium term. The second factor is growing recognition within the ranks of other Asian economies that weaker FX could be desirable as part of broader monetary easing — as indeed was the case in 2008, when USD/CNY last flat-lined.

Since early May, USD/CNY has drifted higher — in onshore spot, offshore spot and NDFs — and the spread between spot and fixings has continued to widen. We forecast USD/CNY at 6.38 over the next three months, slightly higher than current spot. There is little doubt that China needs to preserve export-competitiveness. The latest real GDP growth print was a three year low of 7.6%, and indicators like M1 growth, for example, that have tended to give a pretty good lead (of about six months) on GDP, point to further downside risks.

A flat to slightly weaker yuan has important implications for China-sensitive Asian FX. On balance, Korea, Taiwan and the Philippines are probably most exposed: they are very open economies, with large shares of exports to China (see Figure 70) and are high beta to China's own exports. KRW, TWD and PHP are expected to face the largest downside risks.

We expect USD/KRW to hover around current spot in the next three months but to then weaken to 1185 in the 6-12 month window. Both the Bank of Korea and Citi economists have pared growth forecasts, and the *Minutes* of the last central bank meeting (where the central bank surprised markets with a rate cut) makes explicit reference to won strength. Both the BoK's historical sensitivity to currency strength, and the relationship between swaps and USD/KRW (Figure 73), point to a considerably softer won in the medium term.

Malaysia, meanwhile, is exposed not just to China, but also to commodity prices. Heavy foreign ownership of its bond market, of around 40% on the latest data, is an added vulnerability, as it makes Malaysia much more sensitive to shifts in global sentiment. USD/MYR has found support at around current spot since late May/early June, and we see no reason for it to break lower now. Our 0-3 month forecasts are thus centred on 3.15, with weakness growing more pronounced in 6-12 months' time when we expect USD/MYR at 3.23.

Figure 72. CNY and Asian FX

Sources: Citi Research and Bloomberg
Red – Equally weighted Asia vs. CNY; Black – USD/CNY spot; Green – 12m CNY NDFs.

Figure 73. USD/KRW (Blue, Inverted) and 2y Swaps Spreads (Red)

Sources: Citi Research and Bloomberg

The Taiwanese dollar remains our least favoured currency in Asia. We forecast USD/TWD at 30.3 and 30.5 in 0-3 and 6-12 months respectively, i.e., weakening throughout the next twelve months, and by more than indicated by respective forwards. It seems odd that moves in USD/TWD have continued to lag other Asian crosses, especially given that Taiwan is the most open Asian economy around and with the greatest direct exposure to China (Figure 70). Our forecasts are for USD/TWD to rise to 30.5 in 6-12 months.

While it is true that the Philippines is slightly lower beta to Chinese data than Taiwan, it has also been by far the strongest Asian currency vs. the US dollar in the last couple of months. With the BSP clearly turning more dovish and increasingly sensitive about PHP, and with low inflation to boot, Citi economists expect easing to come soon. Our forecasts have USD/PHP broadly back in the trading range of early months of the year, at between 42.5 and 43.0.

At the other end of the spectrum are INR, and to a lesser extent IDR, both of which are forecast to strengthen against the US dollar throughout the forecast horizon. USD/INR is forecast at 54 and 55.3 in 0-3 and 6-12 months respectively; USD/IDR is expected at 9450 and 9649 in each of these periods.

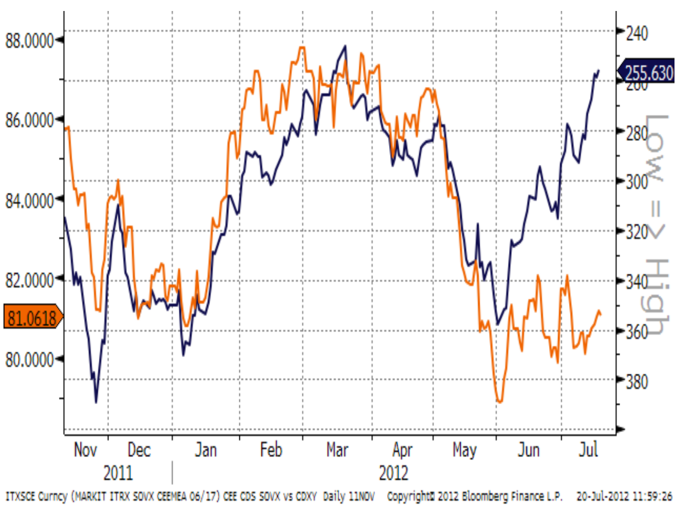
In both cases, this is not a story of fundamental strength/improvement. For example, each runs twin deficits on the current and fiscal accounts, which is rarely a positive in FX and particularly in Asia where most countries run current account surpluses. Moreover, growth has slowed already in both and Citi economists have further downgraded growth expectations, both for this year and next. Quite simply, our forecasts reflect an expectation for oversold markets to move back into more normal trading ranges.

CEEMEA — Idiosyncrasies Persist

In aggregate terms, CEEMEA FX continues to look weak relative to CEEMEA sovereign credit spreads (Figure 74). The CEEMEA region is also fraught with local idiosyncrasies, and in toto remains very sensitive to the euro area crisis. As such, while we expect some currencies, like CZK and TRY, to regain some lost ground, others, particularly HUF, ILS, and RUB — and to a lesser extent, PLN — are forecast to remain under pressure.

TRY remains our favoured regional currency, and we expect USD/TRY to retrace back to 1.78 in the next 3 months, i.e., back to the mid-June daily lows (Figure 75). The tight downward sloping channel shown in Figure 20 suggests that this could be reached quite soon. Our near term forecast is to a large extent a policy call: the central bank is strongly committed to keeping TRY firm as a way to fight high inflation. In the medium term, we expect TRY to give back some of these gains. Our 6-12 month forecasts have USD/TRY back at early the June highs of 1.88-1.90.

Figure 74. CEEMEA FX and SoVX CEEMEA



Blue – SovX CEEMEA; Orange – Equally Weighted CEEMEA FX
Sources: Bloomberg and Citi Research

Figure 75. USD/TRY in Candles

Source: Bloomberg

Despite weaker numbers from real economy and a cut in policy rates to 0.5% (the lowest in generally high yielding CEEMEA), the Czech koruna has held its own, helped by better global risk sentiment. Looking ahead, our expectation of near term consolidation in EUR/USD means CZK consolidates too: EUR/USD and CZK/EUR are tightly correlated (around 70% on 60 day changes). We forecast EUR/CZK at 25.3 in the next three months, rising to 26 in 6-12 months' time as the EUR comes under fresh pressure.

Our 4.21 short term call for EUR/PLN, meanwhile, balances two conflicting forces. Arguing for weakness is that EUR/PLN has once again bounced of a critical support line and relatively extreme longs in PLN are coming off according to Citi's platform based indicators and points to PLN lower. On the other hand, Poland has continued to enjoy solid foreign inflows, especially in bonds, and the economy still has fairly good growth prospects. Further out, PLN should weaken to around 4.40 vs. EUR. Twin deficits, on the current and fiscal accounts, are forecast to stay relatively high and are rarely supportive of FX in the medium term. Moreover, the recent change in laws surrounding the fiscal debt ceiling — to using an average, rather than year end PLN — means that authorities are unlikely to be as sensitive to EUR/PLN as in the past.

ILS, meanwhile, looks very weak, and we see USD/ILS approaching 2009 highs of 4.20 in the next three months. Recent price action has taken out both the 2012 and 2010 supports, and, as the macro setting continues to deteriorate USD/ILS continues to march higher. The cross appears to be still responding to the big re-pricing of front end rates following the end-June rate cut — 1y1y forward rates, for example, having fallen some 40bps in the last fortnight to an all time low, are heading lower still.

We have also cut sharply our optimism for the HUF, which we now see at 295 vs. the euro in the next three months from 275 last month. Fresh noise around IMF/EU negotiations is likely to weigh against HUF, which had been boosted by hoped for progress on an agreement. Citi economists no longer expect the loan negotiations to be concluded in a 3 month horizon, and as such we see EURHUF reversing the recent trend and moving higher.

The Russian ruble has appreciated very recently, supported by risk appetite, seasonal gains in oil prices and expectations of tighter RUB liquidity. We doubt this lasts, however, as our economists point to mounting local growth concerns and lower oil prices as key risks. The ruble basket closely tracks oil prices — and, should crude fall back to, say 80, the basket should trade at between 36.5-37, which is around our 3 month forecast. Further out, the ruble is expected to trade closer to 38.

For the other commodity backed CEEMEA currency, the South African rand, we forecast only modest weakness in the near term. USD/ZAR is expected at 8.25 in the next three months. This is supported first, by substantial foreign inflows into local bond markets, and second, by improving local data that should be boosted by the long-awaited rate cut, announced on July 19th. Our 6-12m view is adjusted sharply higher, however. Historical relationships suggest that EUR/USD at 1.15 would push very high beta USD/ZAR to 8.80-8.85 at least, roughly in the middle of its post 2009 crisis range.

Latam FX — Samba Continues in the Near-term

The medium term vulnerabilities that we have highlighted previously for Latam FX remain broadly in place. All four currencies are commodity-backed to some degree, with Chile and Brazil also intimately linked to China where activity is slowing. Mexico and Chile are directly vulnerable to the European banks that have extended some 30% of total credit in each, and both MXN and BRL are amongst the “higher beta” EM currencies and are much more sensitive to shifting global tides than say Asian FX for example. But, as we pointed out last month, a lot of this is in the price, at least over the next three months.

Since early June Latam FX has outperformed other regions in beta-adjusted terms, with MXN, CLP and COP doing most of the heavy lifting. BRL has lagged so far, but our forecasts are for some near term catch up.

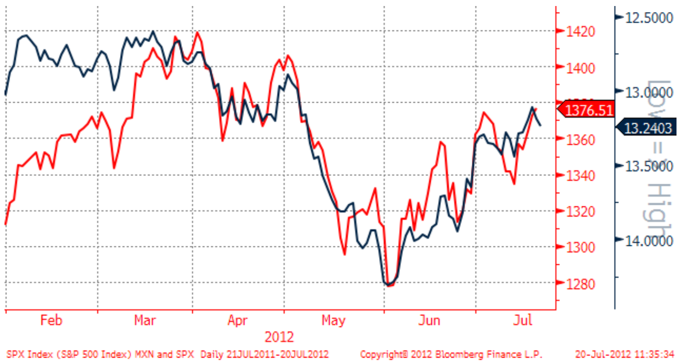
We forecast USD/BRL at 1.98 in the next three months — i.e., back to the early July levels — making it the best performer in Latam by some distance. Two forces combine to give us this bullish view. First is that USD/BRL has overshot most fundamentals, like terms of trade for example, and also looks too high vis-à-vis other assets like CDS spreads. Second is the strong policy commitment to lower nominal interest rates, which is complicated by a strong USD/BRL that feeds powerfully into inflation expectations (Figure 76). Further out, we expect the USD/BRL to rise to 2.06, with risks skewed to the upside still.

The Mexican peso has been the best performing currency in EM since early June, up by nearly 10%. This was driven by better global risk appetite, to which MXN is high beta (Figure 77), and also by favourable positioning. The relatively good outlook for Mexico's economy also provides support: Mexico's ESIs have held up far better than Latam and the "spread" between the two is approaching early 2010 levels — as might be expected given Mexico's proximity to the US and distance from China. Our forecasts have MXN around current spot in the next three months, and weakening to 13.7 6-12 months out as the USD strengthens more broadly.

Figure 76. USD/BRL and Expected Inflation

Blue – USD/BRL; Red – 1 year ahead inflation expectations
Sources: Citi Research and Bloomberg

Figure 77. MXN and Risk Assets



Blue – USD/MXN; Red – S&P 500
Source: Citi Research and Bloomberg

CLP is one of the few currencies in Latam against which USD is forecast to strengthen both 0-3 months and 6-12 months ahead. Like MXN, CLP has rallied strongly in the last couple of months — but unlike MXN, the rally does not look well-supported. CLP it is intimately linked to a weakening China and copper prices, and the central bank has turned more dovish recently. Copper prices at present point to USD/CLP at around 508, which is our medium term forecast. In the next three months, we expect CLP slightly weaker than current spot, at around 488-490.

The COP continues to be one of the strongest in Latam, despite the central bank's efforts to stem appreciation. We continue to look for some pull-back: USD/COP is again approaching the critical 1750 support level, where Citi economists expect Banrep to step up minimum USD daily purchases. Reflecting this our forecasts have USD/COP above 1750 in the next three months, at around 1763, and at 1860 further out.

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

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Figure 79. Citi Quarterly Interpolated Forecasts

Quarterly Interpolated Forecasts

	Currency	Spot	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14
G10-US Dollar											
Euro	EURUSD	1.22	1.22	1.20	1.18	1.16	1.18	1.22	1.25	1.29	1.30
Japanese yen	USDJPY	79	78	79	80	82	82	83	83	84	84
British Pound	GBPUSD	1.57	1.56	1.55	1.53	1.51	1.53	1.57	1.60	1.64	1.65
Swiss Franc	USDCHF	0.98	0.98	1.00	1.02	1.04	1.02	0.99	0.96	0.93	0.92
Australian Dollar	AUDUSD	1.04	1.04	1.02	1.00	0.98	0.96	0.94	0.92	0.90	0.90
New Zealand Dollar	NZDUSD	0.80	0.80	0.79	0.76	0.74	0.71	0.69	0.67	0.65	0.65
Canadian Dollar	USDCAD	1.01	1.01	1.01	1.00	1.00	0.99	0.99	0.98	0.97	0.97
Dollar Index*	DXY	83.07	83.22	84.28	85.64	87.06	85.77	83.80	81.97	80.20	79.61
G10 Crosses											
Japanese yen	EURJPY	96	95	95	95	94	97	101	105	108	110
Swiss Franc	EURCHF	1.20	1.20	1.20	1.20	1.20	1.20	1.20	1.20	1.20	1.21
British Pound	EURGBP	0.78	0.78	0.78	0.77	0.77	0.77	0.78	0.78	0.79	0.79
Swedish Krona	EURSEK	8.45	8.49	8.47	8.44	8.41	8.40	8.40	8.40	8.40	8.41
Norwegian Krone	EURNOK	7.42	7.48	7.47	7.44	7.41	7.38	7.36	7.33	7.31	7.30
Norwegian Krone	NOKSEK	1.14	1.13	1.13	1.13	1.14	1.14	1.14	1.15	1.15	1.15
Australian Dollar	AUDNZD	1.30	1.29	1.31	1.32	1.34	1.35	1.36	1.37	1.38	1.39
Australian Dollar	AUDJPY	81.7	81.2	80.9	80.7	80.4	79.4	78.2	77.0	75.9	75.6
EM Asia											
Chinese Renminbi	USDCNY	6.37	6.38	6.37	6.36	6.34	6.30	6.25	6.21	6.16	6.14
Hong Kong Dollar	USDHKD	7.76	7.75	7.75	7.76	7.76	7.76	7.76	7.75	7.75	7.75
Indonesian Rupiah	USDIDR	9458	9452	9502	9568	9634	9649	9649	9649	9649	9639
Indian Rupee	USDINR	55.3	54.3	54.3	54.8	55.2	54.7	54.0	53.2	52.5	52.1
Korean Won	USDKRW	1141	1140	1152	1167	1182	1164	1138	1112	1086	1074
Malaysian Ringgit	USDMYR	3.15	3.15	3.17	3.20	3.22	3.21	3.18	3.15	3.12	3.10
Philippine Peso	USDPHP	41.9	42.4	42.6	42.8	43.0	42.6	42.0	41.5	40.9	40.7
Singapore Dollar	USDSGD	1.26	1.25	1.26	1.27	1.28	1.27	1.26	1.25	1.23	1.23
Thai Baht	USDTHB	31.7	31.5	31.6	31.8	32.0	31.6	31.1	30.5	30.0	29.8
Taiwan Dollar	USDTWD	30.0	30.2	30.4	30.4	30.5	30.1	29.6	29.1	28.6	28.5
EM Europe											
Czech Koruna	EURCZK	25.57	25.36	25.48	25.72	25.95	25.72	25.37	25.03	24.68	24.44
Hungarian Forint	EURHUF	286	293	292	289	286	286	287	288	290	289
Polish Zloty	EURPLN	4.16	4.20	4.26	4.32	4.39	4.30	4.18	4.05	3.93	3.90
Israeli Shekel	USDILS	4.00	4.16	4.20	4.20	4.20	4.16	4.11	4.06	4.01	3.96
Russian Ruble	USDRUB	32.0	33.0	33.9	34.6	35.3	34.9	34.3	33.8	33.2	32.8
Russian Ruble Basket	RUB	35.2	36.3	36.9	37.3	37.7	37.7	37.7	37.6	37.5	37.5
Turkish Lira	USDTRY	1.81	1.79	1.81	1.84	1.87	1.87	1.87	1.86	1.85	1.86
South African Rand	USDZAR	8.26	8.25	8.37	8.52	8.67	8.70	8.71	8.71	8.72	8.80
EM Latam											
Brazilian Real	USDBRL	2.01	1.99	2.00	2.03	2.05	2.04	2.01	1.98	1.96	1.94
Chilean Peso	USDCLP	485	487	493	500	507	504	500	495	491	490
Mexican Peso	USDMXN	13.3	13.2	13.3	13.5	13.7	13.4	13.0	12.7	12.3	12.3
Colombian Peso	USDCOP	1780	1766	1788	1820	1853	1848	1833	1818	1803	1810

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

Source: Citi Research

Figure 80. Citi Annual Forecasts

Annual Forecasts

	Currency	Spot	2012*	2013*	2014*	2015*	2016*
G10-US Dollar							
Euro	EURUSD	1.22	1.26	1.18	1.29	1.33	1.35
Japanese yen	USDJPY	79	80	82	84	84	84
British Pound	GBPUSD	1.57	1.57	1.53	1.64	1.68	1.71
Swiss Franc	USDCHF	0.98	0.96	1.02	0.94	0.93	0.94
Australian Dollar	AUDUSD	1.04	1.03	0.97	0.91	0.90	0.90
New Zealand Dollar	NZDUSD	0.80	0.80	0.73	0.66	0.65	0.65
Canadian Dollar	USDCAD	1.01	1.01	1.00	0.97	0.96	0.96
Dollar Index**	DXY	83.07	81.95	85.55	80.26	78.67	77.63
G10 Crosses							
Japanese yen	EURJPY	96	100	97	108	112	114
Swiss Franc	EURCHF	1.20	1.20	1.20	1.21	1.24	1.27
British Pound	EURGBP	0.78	0.80	0.77	0.79	0.79	0.79
Swedish Krona	EURSEK	8.45	8.64	8.41	8.40	8.43	8.46
Norwegian Krone	EURNOK	7.42	7.52	7.40	7.31	7.30	7.31
Norwegian Krone	NOKSEK	1.14	1.15	1.14	1.15	1.15	1.16
Australian Dollar	AUDNZD	1.30	1.28	1.34	1.38	1.39	1.39
Australian Dollar	AUDJPY	81.7	82.4	79.7	76.0	75.6	75.7
EM Asia							
Chinese Renminbi	USDCNY	6.37	6.35	6.31	6.16	6.12	6.09
Hong Kong Dollar	USDHKD	7.76	7.76	7.76	7.75	7.75	7.75
Indonesian Rupiah	USDIDR	9458	9383	9625	9641	9596	9546
Indian Rupee	USDINR	55.3	53.8	54.7	52.4	51.5	50.7
Korean Won	USDKRW	1141	1143	1163	1085	1049	1020
Malaysian Ringgit	USDMYR	3.15	3.14	3.20	3.11	3.06	3.01
Philippine Peso	USDPHP	41.9	42.5	42.6	41.0	40.5	40.2
Singapore Dollar	USDSGD	1.26	1.26	1.27	1.23	1.22	1.20
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EM Europe							
Czech Koruna	EURCZK	25.57	25.29	25.69	24.59	23.71	22.87
Hungarian Forint	EURHUF	286	291	287	289	286	283
Polish Zloty	EURPLN	4.16	4.21	4.30	3.94	3.90	3.90
Israeli Shekel	USDILS	4.00	3.99	4.17	3.99	3.79	3.59
Russian Ruble	USDRUB	32.0	32.2	34.8	33.1	32.0	31.0
Russian Ruble Baske	RUB	35.2	35.8	37.6	37.5	37.3	37.2
Turkish Lira	USDTRY	1.81	1.80	1.86	1.86	1.88	1.91
South African Rand	USDZAR	8.26	8.11	8.65	8.78	9.16	9.57
EM Latam							
Brazilian Real	USDBRL	2.01	1.96	2.03	1.95	1.90	1.85
Chilean Peso	USDCLP	485	493	503	492	490	490
Mexican Peso	USDMXN	13.3	13.2	13.4	12.4	12.5	12.8
Colombian Peso	USDCOP	1780	1782	1839	1813	1854	1904

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

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

Source: Citi Research

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