

Economics

23 March 2011 | 80 pages

Global Economic Outlook and Strategy

March 2011

- The outlook has been clouded by two major shocks in recent months: the high level of oil prices plus the earthquake and tsunami in Japan. Our conclusion is that these shocks do not greatly alter global growth prospects for 2011 and 2012, and that global growth will remain strong in the year ahead. Over the last three months, we have made more GDP forecast upgrades than downgrades, but this month there is a slight bias to forecast downgrades. This month, we have cut our 2011-12 forecasts for Brazil, Australia and the UK, while raising our growth forecasts for Saudi Arabia, Russia, Venezuela and Switzerland.
- High oil prices redistribute incomes from oil consumers to oil producers within countries and between countries. But the cross-country effects are likely to be more complex than a simple "winners and losers" analysis based on oil consumption and production. Quite a few emerging market countries (but almost no industrial countries) are likely to use fiscal policy to cushion the impact of high fuel prices on the economy, limiting the adverse effects on growth and real incomes at the expense of weaker fiscal balances. Moreover, some countries will gain from the recycling of petrodollars into spending, especially countries with high export exposure to oil producers.
- We have slightly delayed forecast tightening in Australia and Canada. We continue to expect the US Fed to stay on hold through this year, but have moved forward the forecast start of Fed exit strategies by a few months to early 2012. The ECB has signalled that a rate hike is likely in April and we have raised our rate forecasts for Sweden and Norway. The UK MPC also remains likely to hike in coming months in response to high inflation, elevated inflation expectations and signs that pay deals are picking up. We continue to expect widespread monetary tightening across emerging markets in response to strong growth and inflation worries.

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Next issue 20 April 2011

Figure 1. Currency and Interest Rate Forecasts (End of Period, Unless Specified), as of 23 Mar 2011

	23 Mar 2011	2Q 11	3Q 11	4Q 11	1Q 12	2Q 12	3Q 12
	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast
United States: Federal Funds	0.25	0.25	0.25	0.25	0.50	0.75	1.00
10-Yr. Treasuries (Period Ave.)	3.30	3.40	3.50	3.60	3.70	3.85	4.00
Euro Area: US\$/€	1.42	1.40	1.42	1.44	1.45	1.43	1.41
Euro Repo Rate	1.00	1.25	1.50	1.50	1.75	2.00	2.25
10-Yr. Bunds (Period Average)	3.24	3.40	3.50	3.70	3.80	3.90	4.00
Japan: Yen/US\$	81	78	81	84	87	87	87
Call Money	0.10	0.10	0.10	0.10	0.10	0.10	0.10
10-Yr. JGB (Period Average)	1.22	1.40	1.40	1.40	1.60	1.80	1.80

Source: Citi Investment Research and Analysis

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

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Figure 2. Forecast Highlights and Changes from Last Month

■ Global	The outlook has been clouded by two major shocks in recent months: the high level of oil prices plus the earthquake and tsunami in Japan. Our conclusion is that these shocks do not greatly alter global growth prospects for 2011 and 2012, and we continue to expect that global growth will remain strong in the year ahead.
■ United States	We have moved up the start of Fed exit strategies by a few months reflecting policymakers' confidence in expansion and more balanced inflation risks. Accelerating final demand late in 2010 now appears to be strengthening hiring trends after a severe winter. While higher energy costs are lifting inflation, a backdrop of lingering financial headwinds and ample slack does not point to persistent price pressures.
■ Euro Area	The sovereign debt crisis is likely to continue, despite recent policy decisions on the rescue package. Taking into account an earlier ECB rate hike, we have slightly revised down our GDP growth forecast for 2012. We expect the ECB to increase rates by 25bp in April. We expect a further rate hike in 3Q and after a pause in 4Q the ECB is likely to go ahead with four rate increases of 25bp each in 2012.
■ China	Significant liquidity tightening has reduced the odds for persistent high inflation. We believe that liquidity tightening is near an end, though further rate hikes remain necessary. We continue to see growth moderation with inflation peaking in 2Q. The National People's Congress laid out numerous targets for the next five years to transform the economy, likely reducing growth rates and raising input costs.
■ Japan	In the wake of the 11 March earthquake, disruptions to the supply chain and reduction in power supply likely will constrain economic activity in coming months. Reconstruction demand is expected to materialise later this year, but we expect the net impact on GDP growth in 2011 to be negative. The government likely will introduce a series of supplementary budgets, which should gradually exert upward pressures on JGB yields.
■ United Kingdom	We continue to expect the MPC to hike rates quite soon, once evidence accumulates that Q1 inflation is overshooting the MPC's forecast and that the economy is not sliding into extreme weakness.
■ Canada	Persistent disinflationary pressures on underlying consumer prices suggest that the BoC will resume accommodative monetary policy removal in July instead of April. Geopolitical uncertainties impacting key commodities markets and Canada's top trading partners may also factor into the bank's decision to remain on hold near term. Nonetheless, we maintain our expectation for 200bp of tightening by the end of 2012.
■ Australia	A moderate reduction in forecasts for economic growth and inflation for 2011 should allow the RBA to keep official interest rates on hold for a little longer than previously expected. But further rises in commodity prices and stronger investment spending will require a further tightening in monetary policy from late Q3 2011.
■ Emerging Asia (ex China)	Inflation concerns have been supplanted for now by worries about the growth implications of Japan's earthquake, given Japan's significant role as a global supplier of key components (tech and autos) has raised some concerns. Nonetheless, we think inflation remains an overriding issue, with food price moderation being replaced by rises in non-food components. Central banks in the region will likely maintain a tightening bias in the face of resilient growth (our base case) and longer-term supply-driven inflation shocks.
■ Latin America	Casual empiricism suggests that external shocks to EM account for a larger percentage of short-run macroeconomic fluctuations than domestic variables. In Latam, this is particularly true for real growth, the real exchange rate and the current account, which are critically affected by global growth, the terms of trade and financial conditions. Inflation, on the other hand, is more exclusively determined by idiosyncratic factors, including monetary and fiscal policy.
■ CEEMEA	Higher-than-expected CPI on the back of the persistent rise in oil and food prices has led us to raise our end-year policy rate forecasts for Israel and Romania by 50bps. In the case of Israel, we have adjusted the pace of hikes to increments of 25bps each, starting 28 March. Given Citi's expectation that oil prices are now likely to average US\$105/barrel in 2011, we sharply raise our Saudi fiscal surplus expectations to 8.5% of GDP, and 2011 GDP growth to 7.5% from our previous forecast of 4.8%, on the assumption that Saudi will pump more crude oil to compensate for the loss of Libyan production.

Source: Citi Investment Research and Analysis

Overview — Twin Shocks: Oil and Earthquake

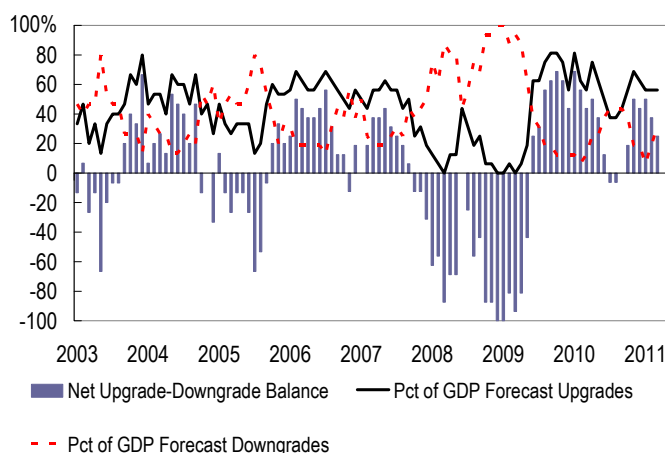
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The outlook has been clouded by two major shocks in recent months: the high level of oil prices plus the earthquake and tsunami in Japan. The Japan section (see page 19) argues that the economy is likely to weaken in Q2, mainly reflecting damage and disruption to economic activity, with a rebound in Q3 — extending into Q4 — because of reconstruction activity. This note aims to discuss the implications of the oil price surge for the economic outlook and economic policies.

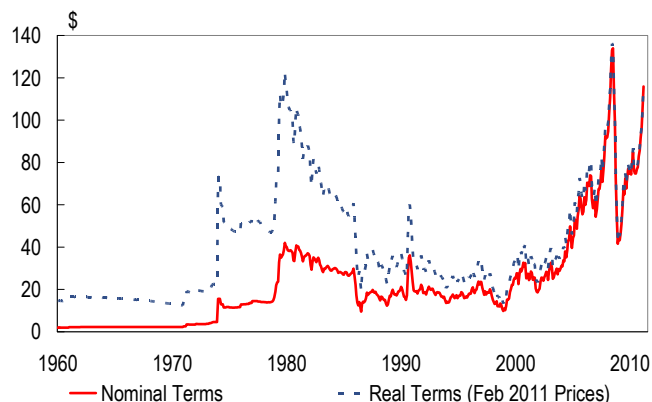
Our conclusion is that these shocks do not greatly alter global growth prospects for 2011 and 2012, and we continue to expect that global growth will remain strong in the year ahead. Over the last three months, we have made more GDP forecast upgrades than downgrades, but this month there is a slight bias to forecast downgrades. This month, for example, we have cut our 2011-12 forecasts for Brazil, Australia and the UK, while raising our growth forecasts for Saudi Arabia, Russia and Venezuela.

Figure 3. Global — Pct. of Citi Growth Forecast Upgrades and Downgrades, 3-Month Total, 2003-11



Note: We compare revisions to our growth forecasts for the current and next year in the US, Euro, Japan, UK, Australia, Brazil, Canada, China, India, Korea, Norway, Poland, Russia, Sweden, South Africa, Switzerland.
Source: Citi Investment Research and Analysis.

Figure 4. Global — Nominal and Real Crude Oil Price (in USD) 1970 to 21 Mar 11



Note: Prices are monthly, converted to real terms using the US CPI.
Sources: BP Statistical Review of World Energy 2010, Bloomberg and Citi Investment Research and Analysis

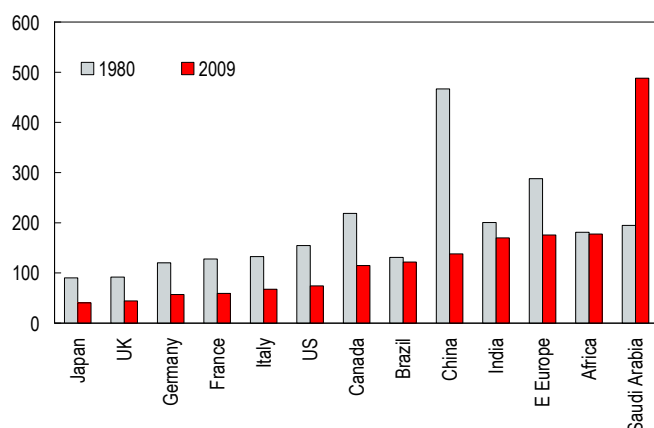
The increase in oil prices has indeed been large. From a low in December 2008 — the nadir of the global downturn — of \$37/barrel, the price of Brent crude oil has risen more than 200% in nominal USD terms to a high of about \$116/barrel now. Recent prices are still substantially below the (nominal) peaks of almost \$150/barrel in mid-2008, but are high versus historical averages, both in nominal and real terms. The 1970s oil shock was followed by a major global economic slowdown and inflation spike. However, in our view, the effect of the current level of oil prices on world GDP growth will be modest for four reasons.

First, the increase in oil prices so far appears to be mainly the result of rising demand for oil, driven by robust GDP growth, particularly in relatively energy-intensive and oil-intensive sectors in emerging economies. Brent oil prices on 17 December 2010 — the earliest possible date to time the start of Middle East unrest — already stood at \$92/barrel. Hence, a rough estimate would attribute around 70% of the oil price surge since the end-2008 lows to the recovery in demand. Prices of other commodities also rose strongly over the same period. The causation has thus mainly run from (high) demand driven by (high) GDP

growth to high oil prices, rather than actual or feared possible restrictions in future oil supply. Of course, downside risks to global growth would grow if actual or feared supply restrictions were to send oil prices spiking higher near term, or if worries over nuclear fuel safety were to send long-term price expectations sharply higher.

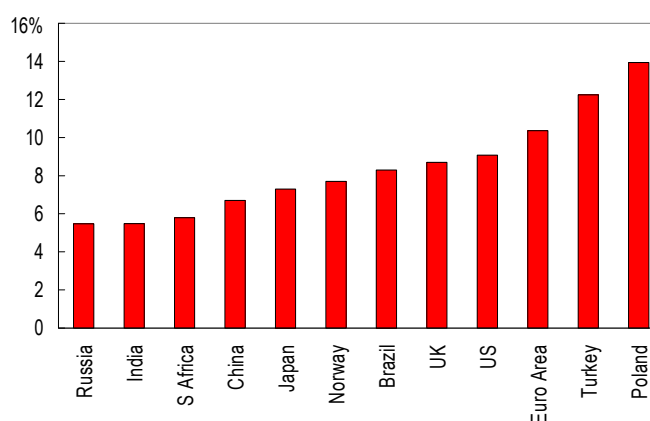
Second, a rise in oil prices does not destroy aggregate spending power, but mainly redistributes wealth and spending power from oil consumers to oil producers. In judging the outlook for global growth, we need to allow for the positive effects on incomes in oil-producing countries as well as income losses among oil consumers. Third, as discussed below, in some countries fiscal measures will be used to offset the erosion of real incomes from high oil prices. Fourth, although a sustained rise in oil prices is a permanent adverse shock to potential growth — because oil-intensive production processes may need to be reconfigured in light of the higher oil price — this effect appears to be quite slow-working¹.

Figure 5. Global — Oil intensity of GDP (Tons of Oil Consumed per Million US Dollars of GDP at Market Exchange Rates), 1980-09



Sources: BP, World Bank and Citi Investment Research and Analysis

Figure 6. Global — Energy Weights in the CPI, 2010



Sources: OECD, BLS, Eurostat and Citi Investment Research and Analysis

Despite the limited effect of high oil prices on overall global growth, we expect substantial cross-country variation in the effects on economies and policy.

First, the adverse effects of higher oil prices on economic activity and potential growth appear to be greater in major emerging markets than the G7, because EM economies in general are more energy intensive and oil intensive. The weights of energy in CPIs vary quite markedly, depending in part on the extent to which household energy prices are taxed or subsidised. However, including energy use in production processes, China's energy intensity (energy

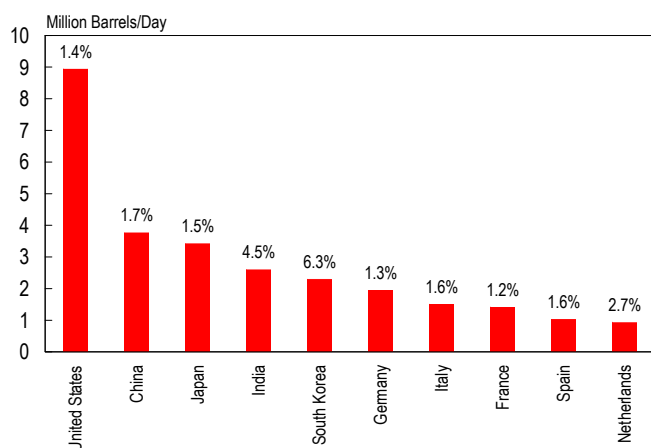
¹ See, for example, Robert B. Barsky & Lutz Kilian, 2004. "Oil and the Macroeconomy since the 1970s", Journal of Economic Perspectives, American Economic Association, vol. 18(4), pages 115-134. They argue "The magnitude of the effect of an oil price shock on gross output must be small. A 1 percent reduction in oil usage reduces gross output - to a first order approximation - by a percentage amount corresponding to the cost share of oil. This share of oil in output is thought to be no larger than 4 percent and may be much smaller. With a unit elasticity of substitution between oil and value added, a 10 percent increase in oil prices will result in less than a 0.5 percent reduction in gross output. Empirically, increases in oil prices appear to raise the share of oil in output. This implies that the elasticity of substitution must be less than unity, suggesting that the actual drop in gross output is even smaller." These papers then go on to discuss that the effect of oil prices on value added, including GDP, rather than gross output is unlikely to be large (and theoretically could be zero).

consumption per \$ of GDP at market exchange rates) is more than three times that of the US. Even allowing for the fact that oil accounts for only 19% of energy consumption in China and 30% for India, versus 37% for Germany and 38% in the US, China's oil intensity (oil use per \$ of GDP) is 75% higher than the US and more than double that in Germany. Oil accounts for a greater share of total energy consumption in India and Brazil, and hence their oil intensity also is well above that in the US and other G7 countries. Of course, if the high level of oil prices also lifts demand for other energy sources, then other energy prices may rise, which could make it more relevant to focus on the total energy intensity of different economies rather than just oil intensity.

Second, an increase in oil prices redistributes income between countries (from net oil importers to net oil exporters) and within countries (from oil consumers to oil producers and from those short oil to those long oil). The US is the world's largest net importer of crude oil and studies tend to find that oil price shocks have their most pronounced effects on the US economy through their effects on demand, in particular for consumer durables and residential investment.² Relative to GDP, net imports of crude oil are much larger than in the US in India and South Korea, but are slightly higher in China.

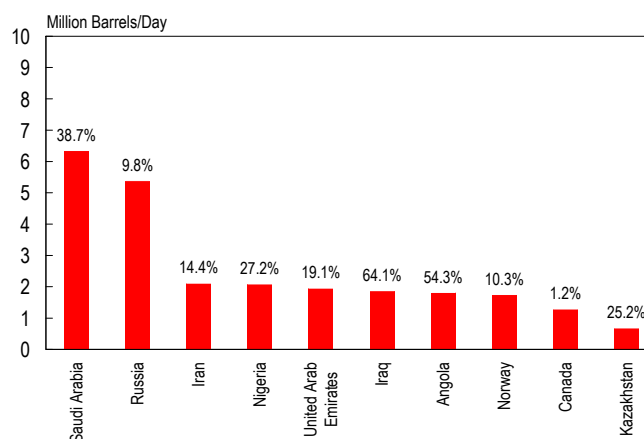
Oil production is concentrated in relatively few countries. The world's major oil net exporters in 2009 were Saudi Arabia, Russia, Iran, Nigeria and the UAE. But it is important to recognise that income is also redistributed between producers and consumers of oil within a country. This holds true for the largest net oil exporters listed above, but it is also true for the US which, despite being the world's largest net oil importer, remains one of the largest oil producers in the world.

Figure 7. Global — Largest Crude Net Oil Importers (Million Barrels/Day and Pct. of GDP), 2009



Note: Percentage of 2009 GDP above bars, computed as net exports times average Brent price in 2009. Sources: IEA and Citi Investment Research and Analysis

Figure 8. Global — Largest Crude Oil Net Exporters (Million Barrels/Day and Pct. of GDP), 2009



Note: Percentage of 2009 GDP above bars, computed as net exports times average Brent price in 2009. Sources: IEA and Citi Investment Research and Analysis

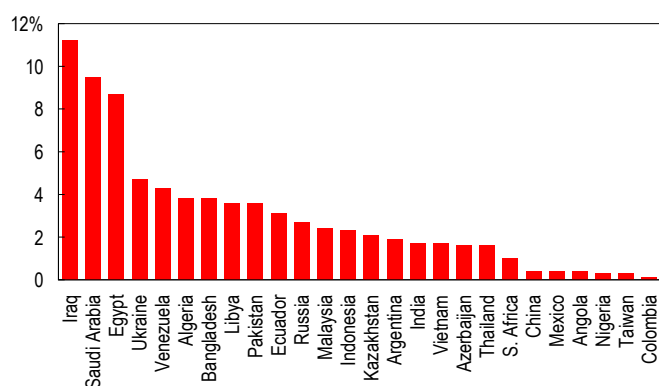
Third, high oil prices may induce an endogenous fiscal policy response to cushion the pain for consumers and/or producers. In previous research³, we have made the point that higher energy costs affect food prices in two ways: by raising the cost of producing food and by increasing the world's demand for

² See e.g. Lutz Kilian, 2008. "The Economic Effects of Energy Price Shocks," Journal of Economic Literature, American Economic Association, vol. 46(4), pages 871-909, December.

³ See "Food Prices Revisited, Emerging Markets Macro View", January 2011, David Lubin et al, Citi.

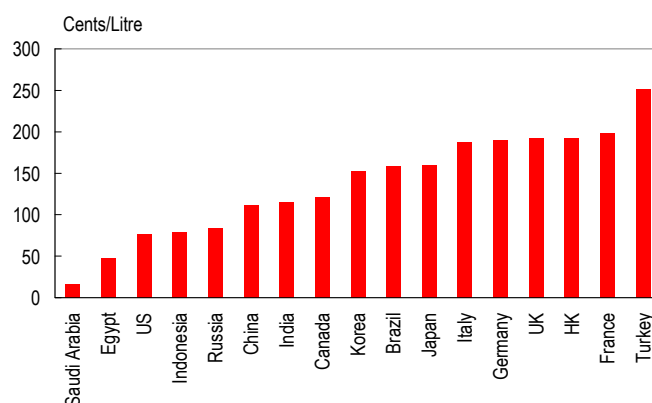
biofuels⁴. Both fuel and food are subsidised in many countries, particularly in the emerging world, and higher oil prices may increase the pressure for increases in both types of subsidies, particularly given that food prices are already high. Most major advanced industrial countries have weak fiscal positions, and hence have little fiscal space to respond. The few industrial countries with enough fiscal space to consider acting (such as Norway or Switzerland) show no signs of wanting to do so. We therefore do not expect action to cap consumers' fuel or food prices in most advanced industrial countries, with minor exceptions (e.g. the UK is likely to limit the planned hike of petrol duties).

Figure 9. Selected Countries — Fuel Subsidies (Pct. of GDP), 2009



Note: Fossil-fuel consumption subsidy rates as pct of GDP. Sources: International Energy Agency and Citi Investment Research and Analysis

Figure 10. Selected Countries — Retail Prices for Gasoline, US Cents/Litre, November 2010



Sources: DIZ and Citi Investment Research and Analysis

Figure 11. Selected Countries — Industrial Production Data and Forecasts (Pct.), 2010-12F

	2010	2011F	2012F
World	9.4%	5.0%	5.4%
United States	5.7	4.4	4.4
Japan	16.0	-0.5	5.5
Euro Area	7.2	4.8	3.1
United Kingdom	2.0	2.0	1.6
Canada	4.7	0.8	1.6
China	15.5	13.6	12.5
India	8.1	7.7	8.7
Korea	16.2	10.6	9.0
Brazil	10.5	3.5	4.5

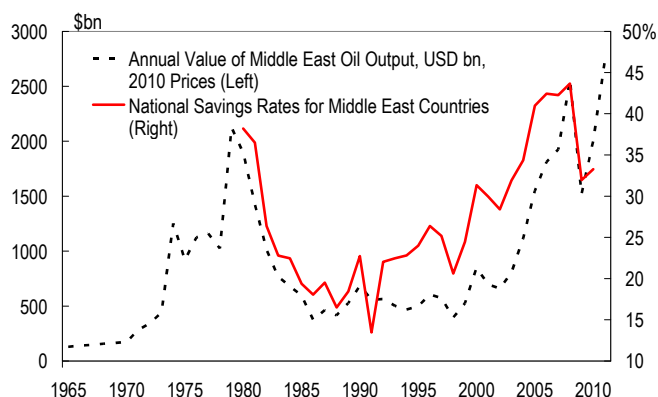
Source: Citi Investment Research and Analysis

Among emerging market economies, the degree of fiscal space varies quite widely. The willingness to respond varies also, but can on average be expected to be higher than in mature economies given the higher share of fuel and food in household consumption and the wider current use of subsidies. Another factor is the wave of unrest that is currently sweeping through many countries, in particular in the Middle East and North Africa. These developments have complex, often country-specific origins, but perceptions of excessive inequality, plus erosions of living standards through high and rising food and commodity prices and high unemployment are often implicated. Authorities in a number of countries, including to date in Algeria, Bahrain, Kazakhstan, Libya, Russia and Saudi Arabia, have attempted to calm the tensions by providing handouts to households.

Net oil exporters can finance such handouts from increased oil revenues simply by saving less of them, with a corresponding rise in domestic demand. Net oil importers with strong fiscal positions, such as China or parts of (non-oil exporting) Latin America, can also easily muster the fiscal resources for some discretionary fiscal relief which would limit the dampening effect of higher oil prices on domestic demand. But the likes of Jordan, India and Pakistan – net oil importers with relatively heavy fiscal burdens – find themselves in an uncomfortable position and may have to choose between a bigger shock to demand and a potentially elevated risk of instability and a worsening fiscal position.

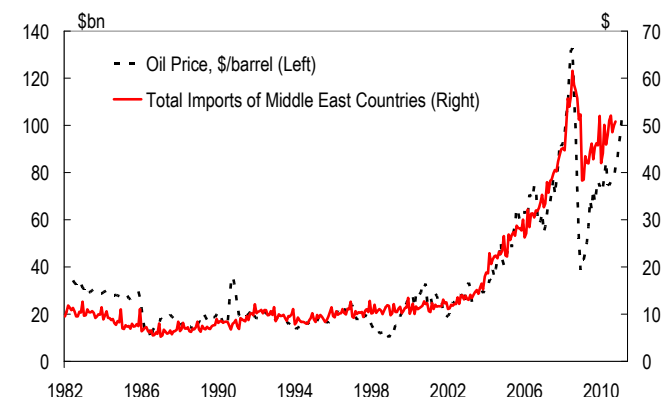
⁴ Although biofuels currently uses only three main feedstocks – corn, soyabeans and sugar – an arbitrage process tends to put upward pressure on other commodities when the prices of these rise.

Figure 12. Middle East — Revenues from Oil Production and National Savings Rates, 1965-2011



Note: Revenues from oil production approximated using oil output and oil prices. Deflated to 2010 prices using the US CPI.
Sources: IMF, BP, and Citi Investment Research and Analysis

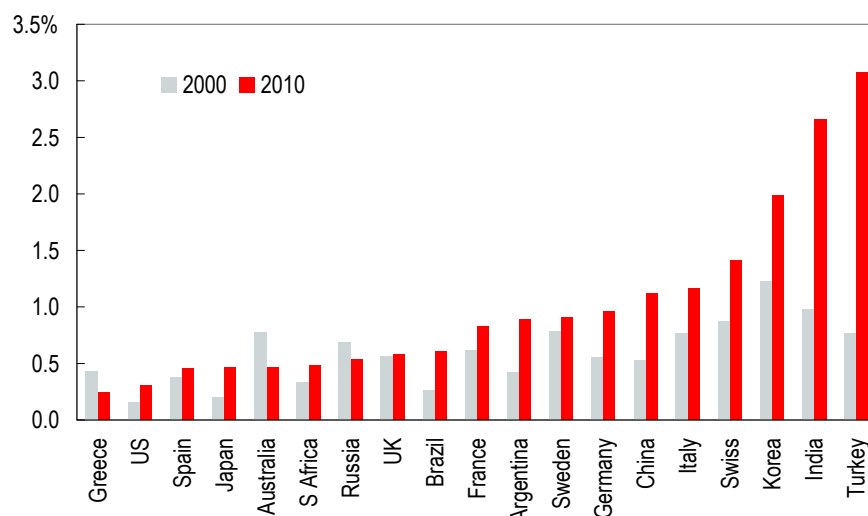
Figure 13. Global — Oil Prices and Imports of Middle East Countries, 1982-2011



Note: We use the IMF definition of Middle East countries.
Sources: IMF, Datastream and Citi Investment Research and Analysis

Fourth, countries and regions will benefit to differing extents from the recycling of petrodollars into Middle East imports of goods and services, plus capital outflows into portfolio assets. Both channels are powerful. There is a close relation between oil prices and national savings rates of Middle East countries, and also a close relation between oil prices and imports of Middle East countries. These links imply that sizeable — but not full — recycling of petrodollars into spending occurs quickly. The rapid rise and high oil prices over recent years have seen imports of the Middle East countries (using the IMF definition) surge to \$483bn in Jan-Oct 2010, nearly 300% higher than the same months in 2002 (\$124bn).

Figure 14. Selected Countries — Exports to the Middle East as Pct. of GDP, 2000-10



Note: Estimate for 2010 uses data for January-October, annualised.
Sources: IMF and Citi Investment Research and Analysis

Within that overall surge, there has been a marked and accelerating shift towards imports from emerging market countries. Since 2002, imports to the Middle East from emerging markets have risen 490%, while imports from developed countries have risen by 175%. As a result, in January-October 2010, imports to Middle East countries from emerging markets (excluding imports from other Middle East countries) slightly exceeded imports from developed countries. By contrast, in 2002, imports from developed countries were double imports from emerging markets. In 1992, imports from developed countries were nearly four times the level of imports from emerging markets.

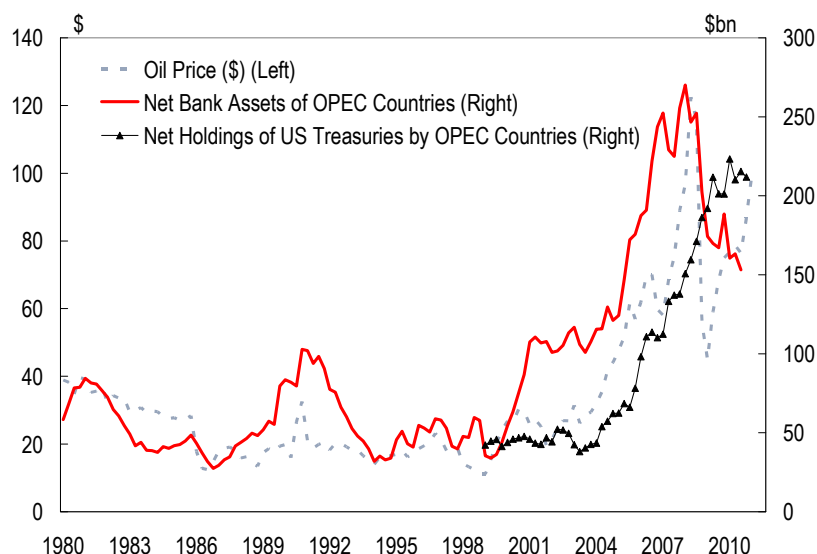
In particular, exports to the Middle East countries have risen extremely strongly in recent years from Brazil, Argentina, Germany, Italy, China, Switzerland, Korea, India and Turkey. For Korea, India and Turkey, exports to the Middle East are 2% of GDP or higher⁵, and these economies could receive additional indirect gains, for example in higher remittances to India and involvement of Korean construction companies in the Middle East. In addition, the stock of FDI in GCC (Gulf Cooperation Countries) countries has ballooned from \$33bn (9% of GCC GDP) in 2002 to \$278bn in 2009 (31% of GCC GDP). In countries with high trade and FDI exposure to oil exporters, the recycling of petrodollars could go a long way to offsetting the adverse effects on real incomes of the rise in oil prices – and many of these countries, such as India, Turkey and Korea, are also among the largest net oil importers.

It is far harder to trace recycling of petrodollars into portfolio flows and investments, because of data limitations. The traditional route, evident in the 1970s, was that high oil prices were recycled via higher deposits at major banks. Hence, there used to be a general link between changes in oil prices and the net assets at BIS-reporting banks of GCC residents and governments. However, this link appears to have weakened in recent years, perhaps because of flows into a wider range of assets or because of difficulties in correctly identifying the ownership of deposits. Holdings of US Treasury securities by residents and institutions of OPEC countries have risen sharply in recent years, and the resultant downward pressure on low-risk yields could help encourage other yield-seeking flows into a wide range of assets. However, these holdings have not risen since Q209, despite continued high oil prices, suggesting a rising preference for other assets.

Anecdotal evidence strongly suggests that oil funds themselves now buy a wide range of financial assets and currencies, with perhaps some element of regional “home bias” — in other words, a preference for assets in other GCC, Middle East or nearby countries. If so, to the extent that many of these economies (e.g. Turkey) also have high export exposure to the Middle East, rising capital inflows will provide additional balance-of-payments support.

⁵ India's exports to the Middle East include a high share of pearls and precious stones. These account for more than half of India's exports to the UAE, the top export market for India in the Middle East.

Figure 15. OPEC Countries — Oil Prices and Holdings of Selected Financial Assets By OPEC Countries, 1980-2011



Note: Net bank assets are measured at BIS-reporting banks.

Sources: US Treasury, BIS and Citi Investment Research and Analysis

Given these diverging influences and other factors, the monetary policy response to high oil prices will probably vary considerably across countries. In general, the consensus for the response of monetary policy to supply shocks is to accommodate the initial shock to the price level (which would manifest itself as a temporary increase in inflation), but to tighten in response to second-round effects of the initial price level increase on inflation expectations and to tighten if a rising oil price expands aggregate demand relative to potential output, allowing for both the aggregate demand effects of the oil price rise (which depends on the net import position) and the aggregate supply effect.

Currently, we expect the ECB to focus more on the upside effects on inflation and inflation expectations, rather than adverse effects on growth — perhaps because many European economies, mostly in the core, are substantial beneficiaries of the recycling of petrodollars into imports from other countries. We expect the ECB to hike at the April meeting unless some major downside shock emerges in the next week or two. Since the last forecast round, we also have revised up our interest rate forecasts in Sweden and Norway. The UK MPC currently also may feel pressured by the elevated level of inflation and inflation expectations, and probably will hike in the next few months. By contrast, we have delayed our forecasts for tightening in Canada and Australia over the last month. The US Fed probably will be more sensitive to risks that high oil prices could undermine financial conditions and remains likely to keep rates on hold through this year.

Inflation is already high in many emerging market economies. With fiscal slippage used to limit the adverse effects of oil on real incomes in many oil-importing countries, we continue to expect a continuation of the widespread trend towards higher interest rates and other forms of monetary tightening among emerging market countries. With rising interest rates, strong growth, plus the recycling of petrodollars into exports to Middle East economies and capital inflows, many oil-importing emerging markets probably will not see their

currencies come under pressure. Indeed, nominal exchange rate appreciation for many EMs might remain a useable tool against growing inflationary risks. For that reason, we remain relatively optimistic about EMFX, even in a higher oil-price environment.

Against this backdrop, Citi strategists have mixed views. Citi rate strategists believe the recent bond rally offers an opportunity to reduce duration, and that rates must eventually rise as economies recover. Citi credit strategists are also wary of chasing credit, seeing more downside risks from valuations and positioning. Citi equity strategists believe valuations are more supportive, and expect that stock prices will continue to grind higher from here even with no re-rating of global equities. Citi strategists are bullish commodities medium term but also expect medium-term USD weakness. Many Citi strategists highlight vulnerabilities of European periphery assets.

Figure 16. Global — Summary of Views of Citi Market Strategists

	Equities	G10 Rates	Credit	Securitized Products	FX	Commodities	Global Macro Strategy
Overall View	Constructive, 10% upside to the end of 2011	Cautious while geopolitical risks remain elevated. Still looking for higher yields medium term	Cautious on euro credit, more bullish on US	Market weight	Bearish \$	Bullish medium term on EM growth outperformance	Cautious risk assets short term, weaker USD in medium term
Most-Favoured Region/Sector	EM, UK, Japan/ Cons. Discr., Materials, Industrials	5yr JGB	Core BB and BBBs	US CMBS senior tranches	AUD,GBP,EM	Base metals, gold and Ags	EM vs.DM in equity and FX
Least-Favoured Region/Sector	Eur x UK/ Financials, Utilities, Energy	5yr GBP	Undiversified periphery corporates	Spanish & Irish RMBS	USD, JPY, CHF	Silver	European financials
Key Risks	Sharp rise in bond yields, global profits recovery is a false dawn	MENA tensions, Japan slowdown, EMU default	Sovereign contagion, early corporate releveraging	Regulation	Early Fed hikes, early ECB hikes, periphery crisis Ongoing MENA crisis HIA and positioning	Chinese business cycle	Overstretched positioning in risk assets, rising EM inflation, political instability

Source: Citi Investment Research and Analysis

Figure 17. Selected Countries — Economic Forecast Overview (Percent) 2010-2015F

	GDP Growth						CPI Inflation						Short-Term Interest Rates					
	2010	2011	2012	2013	2014	2015	2010	2011	2012	2013	2014	2015	2010	2011	2012	2013	2014	2015
Global	4.0	3.6	3.9	3.9	4.3	4.1	2.7	3.7	3.2	3.1	3.0	3.0	2.07	2.67	3.30	3.82	4.20	4.40
<i>Based on PPP weights</i>	4.9	4.3	4.6	4.6	4.9	4.7	3.4	4.3	3.7	3.6	3.5	3.5						
Industrial Countries	2.5	2.2	2.5	2.4	3.0	2.8	1.4	2.4	1.8	1.8	1.9	1.9	0.65	0.83	1.41	2.25	2.95	3.39
United States	2.9	2.9	3.3	3.0	4.5	4.0	1.6	2.6	1.8	2.0	2.0	2.2	0.25	0.25	0.75	2.00	3.00	3.50
Japan	3.9	1.1	2.6	1.7	1.6	1.5	-0.7	0.6	0.5	0.5	0.7	1.0	0.10	0.10	0.10	0.13	0.48	0.83
Euro Area	1.6	1.7	1.3	1.7	1.6	1.5	1.6	2.7	2.2	1.9	2.2	1.8	1.00	1.25	2.00	2.75	3.25	3.75
Canada	3.1	2.9	3.0	3.2	3.5	3.7	1.8	2.2	2.0	2.0	2.0	2.0	0.69	1.38	2.63	3.00	3.50	3.50
Australia	2.7	2.5	4.3	4.3	4.4	3.8	2.8	2.6	2.8	3.2	3.0	2.8	4.44	5.00	5.40	6.00	6.25	6.25
New Zealand	0.7	1.1	2.9	2.5	2.8	3.0	2.3	4.3	2.9	2.5	2.4	2.6	2.81	2.50	3.30	5.00	5.50	6.00
Germany	3.5	3.0	2.0	2.2	2.0	1.7	1.1	2.6	2.1	1.9	1.9	2.1	NA	NA	NA	NA	NA	NA
France	1.5	1.6	1.5	1.5	1.6	1.5	1.7	2.2	2.0	2.4	1.7	1.6	NA	NA	NA	NA	NA	NA
Italy	1.1	1.0	1.0	0.9	0.9	0.9	1.6	2.9	2.5	1.9	1.9	1.9	NA	NA	NA	NA	NA	NA
Spain	-0.1	0.1	0.2	0.9	1.2	1.3	2.0	3.2	1.8	1.5	1.7	1.7	NA	NA	NA	NA	NA	NA
Greece	-4.5	-3.2	-1.1	0.5	1.0	1.5	4.7	3.3	1.8	1.3	1.4	1.5	NA	NA	NA	NA	NA	NA
Portugal	1.4	-1.6	-1.5	0.1	0.9	1.0	1.4	3.5	0.8	0.5	1.0	0.8	NA	NA	NA	NA	NA	NA
Netherlands	1.7	2.5	2.0	1.8	1.7	1.8	1.3	2.0	1.7	1.9	1.8	2.0	NA	NA	NA	NA	NA	NA
Denmark	2.1	2.1	2.0	2.2	2.5	2.4	2.3	2.4	2.1	2.1	2.2	2.0	1.05	1.30	2.15	3.00	3.50	4.00
Norway	2.2	3.2	3.3	3.0	2.8	2.8	2.4	1.7	2.2	2.3	2.5	2.5	1.90	2.29	3.44	4.50	4.80	4.80
Sweden	5.3	5.0	3.5	3.3	2.6	2.5	1.2	2.6	2.2	2.3	2.4	2.1	0.50	1.92	3.15	3.96	4.00	4.00
Switzerland	2.6	3.1	2.3	2.2	2.4	2.8	0.7	0.7	1.0	0.7	0.6	0.8	0.22	0.44	1.31	1.88	2.38	2.25
United Kingdom	1.3	1.9	2.2	2.8	3.0	2.8	3.3	4.7	3.1	2.5	2.4	2.5	0.50	0.81	1.79	2.79	4.06	4.98
Emerging Markets	7.2	6.2	6.2	6.3	6.2	6.1	5.3	6.2	5.6	5.2	4.9	4.8	5.07	6.11	6.62	6.45	6.19	5.92
China	10.3	9.2	9.0	8.8	8.5	8.0	3.3	4.6	4.0	3.8	3.5	3.5	2.30	3.38	3.75	3.75	3.75	3.75
Hong Kong	6.8	4.5	5.2	4.0	4.0	4.0	2.4	4.5	3.0	3.0	3.5	3.5	0.25	0.29	0.69	3.00	3.80	4.50
India	8.6	8.4	8.7	8.8	8.8	9.0	8.6	7.0	6.0	6.0	6.0	6.0	6.50	7.50	7.50	7.50	7.50	7.50
Indonesia	6.1	6.5	6.6	6.7	6.9	7.0	5.1	6.7	6.8	6.8	7.0	7.0	6.50	7.06	7.50	7.50	7.75	7.75
Korea	6.1	4.3	4.6	4.4	5.0	4.2	3.0	4.0	3.4	2.8	3.2	3.0	2.68	3.68	4.60	4.75	5.00	5.15
Singapore	14.5	5.5	6.0	7.1	7.1	7.1	2.8	4.2	2.8	2.0	2.0	2.0	0.56	0.40	0.75	2.30	2.80	3.20
Czech Republic	2.3	1.9	3.0	4.3	4.0	3.8	1.5	1.9	2.6	1.5	2.4	2.0	0.83	1.02	1.85	2.56	3.33	3.50
Hungary	1.2	2.7	3.5	3.1	2.7	2.9	4.7	3.7	3.4	3.1	3.0	3.1	5.48	6.00	6.50	6.60	6.02	6.00
Poland	3.8	4.2	4.5	4.1	3.4	3.4	2.7	3.7	2.8	2.6	2.5	2.5	3.50	4.15	4.88	5.00	5.00	4.63
Romania	-1.3	2.0	4.2	4.7	4.8	4.8	6.1	6.1	3.5	3.0	3.0	3.0	6.67	6.13	5.13	5.00	5.00	5.00
Russia	4.0	4.3	4.1	4.0	4.3	4.3	6.9	8.8	7.3	5.9	5.5	5.5	7.75	8.00	7.50	6.00	6.00	5.50
Turkey	8.2	4.5	5.0	5.0	5.0	5.0	8.6	5.8	6.4	5.8	5.3	5.0	6.50	7.75	9.00	8.00	7.50	7.50
Nigeria	7.2	6.8	6.5	6.5	6.9	7.2	13.7	11.1	10.1	10.5	10.3	9.5	6.08	7.08	7.83	10.00	10.50	10.00
South Africa	2.8	3.6	3.8	3.9	4.0	4.1	4.1	4.8	5.6	6.0	5.7	5.5	6.41	5.75	7.25	8.50	8.75	8.50
Argentina	9.2	6.5	4.0	3.0	3.0	3.0	18.4	26.0	32.5	32.5	30.0	30.0	10.19	11.70	13.68	13.39	11.00	9.00
Brazil	7.5	4.0	4.5	4.5	4.5	4.5	5.0	6.4	5.2	4.5	4.0	4.0	9.80	11.75	12.75	11.88	10.25	9.00
Mexico	5.5	4.8	3.8	3.4	3.2	3.2	4.2	3.9	3.8	4.0	3.9	3.8	4.40	4.58	6.13	7.00	7.00	7.00
Venezuela	-1.4	1.0	1.6	2.3	2.5	2.4	29.1	28.4	27.0	28.0	26.0	29.0	14.60	19.40	20.40	21.00	21.00	21.00

Source: Citi Investment Research and Analysis

Figure 18. Selected Countries — Economic Forecast Overview (Percent) 2010-2015F

	Current Balance (Pct of GDP)						Fiscal Balance (Pct of GDP)						Government Debt (Pct of GDP)					
	2010	2011	2012	2013	2014	2015	2010	2011	2012	2013	2014	2015	2010	2011	2012	2013	2014	2015
Global	0.2	0.3	0.2	0.1	0.2	0.3	-3.3	-3.4	-2.9	-2.4	-2.0	-1.8	70	71	72	69	68	67
<i>Based on PPP weights</i>	<i>0.6</i>	<i>0.3</i>	<i>0.1</i>	<i>0.0</i>	<i>0.0</i>	<i>0.0</i>	<i>-3.4</i>	<i>-3.4</i>	<i>-2.9</i>	<i>-2.4</i>	<i>-2.1</i>	<i>-2.0</i>						
Industrial Countries	-0.8	-0.5	-0.4	-0.5	-0.3	-0.1	-3.4	-3.7	-3.1	-2.5	-2.0	-1.9	89	93	96	97	97	97
United States	-3.2	-3.4	-3.3	-3.3	-3.2	-3.0	-8.9	-9.2	-7.0	-5.4	-4.3	-4.3	62	70	73	76	76	76
Japan	3.5	2.9	3.0	3.5	3.5	3.5	-9.8	-9.2	-9.2	-8.5	-8.2	-7.7	225	233	237	242	246	250
Euro Area	-0.6	-0.3	0.0	0.1	0.1	0.2	-5.8	-4.3	-3.2	-2.5	-2.0	-1.7	86	88	88	89	88	87
Canada	-3.1	-1.2	-0.3	0.0	1.0	2.0	-2.5	-1.7	-1.1	-0.5	0.0	0.2	34	34	33	32	30	29
Australia	-2.6	-2.0	-3.4	-5.5	-6.9	-5.5	-4.4	-3.0	-0.8	0.2	0.2	0.5	4	6	6	6	6	4
New Zealand	-2.6	-1.0	-4.2	-5.0	-5.5	-5.7	-4.4	-5.1	-3.2	-4.5	-3.0	-1.5	15	19	22	26	24	22
Germany	5.7	5.7	5.9	6.0	6.1	6.3	-3.3	-2.4	-1.2	-0.1	0.4	0.6	88	88	87	84	82	89
France	-2.1	-0.9	-0.8	-0.8	-0.7	-0.7	-7.2	-6.0	-4.5	-3.5	-3.0	-2.5	83	87	88	89	89	89
Italy	-3.5	-4.0	-4.2	-2.7	-2.9	-3.1	-4.6	-4.4	-3.9	-3.9	-3.8	-3.8	119	121	122	121	122	122
Spain	-4.5	-3.3	-2.1	-2.2	-1.9	-1.8	-9.3	-6.9	-5.2	-4.6	-4.3	-4.1	60	69	74	81	84	86
Greece	-10.4	-7.9	-5.2	-2.5	-3.3	-9.7	-9.7	-8.0	-7.4	-6.4	-6.3	-6.2	141	155	164	169	173	175
Portugal	-10.5	-8.4	-6.7	-5.3	-4.1	-2.9	-7.2	-5.8	-5.0	-4.7	-4.5	-4.3	82	89	94	98	100	102
Netherlands	6.4	6.4	6.4	6.4	6.4	6.4	-5.4	-3.4	-2.7	-2.0	-1.2	0.0	64	65	65	65	64	62
Denmark	5.2	4.0	3.5	3.1	2.8	2.6	-4.0	-4.3	-3.6	-2.5	-1.3	0.0	43	46	46	46	45	43
Norway	12.9	14.5	16.0	16.5	16.0	16.0	10.0	10.0	12.0	13.0	15.0	19.0	NA	NA	NA	NA	NA	NA
Sweden	6.3	6.4	6.5	6.6	6.7	6.9	-0.8	0.0	1.1	1.8	1.7	2.2	40	37	33	31	30	29
Switzerland	14.3	12.2	11.2	10.3	10.7	10.7	1.1	1.3	1.5	1.7	2.0	2.0	42	39	37	34	31	31
United Kingdom	-2.5	-1.9	-1.3	-0.5	0.4	1.4	-9.6	-6.6	-4.7	-2.9	-1.4	-0.3	76	80	82	82	80	78
Emerging Markets	2.5	1.7	1.2	1.2	1.0	0.8	-2.7	-2.3	-2.2	-2.1	-1.9	-1.8	29	30	29	29	29	28
China	5.2	4.6	3.8	3.1	2.6	2.0	-1.6	-2.0	-2.0	-2.0	-2.0	-2.0	21	20	21	21	21	21
Hong Kong	6.6	9.1	10.0	10.0	10.0	10.0	4.1	2.2	3.0	2.5	2.0	2.0	1	1	2	2	3	3
India	-2.3	-3.0	-2.5	-2.1	-1.6	-1.0	-5.1	-5.3	-4.5	-4.0	-3.0	-3.0	67	66	64	68	66	63
Indonesia	0.9	0.3	-0.2	-0.5	-0.7	-0.7	-0.6	-1.8	-1.6	-1.5	-1.3	-1.0	26	26	25	24	23	23
Korea	2.8	1.0	1.1	0.4	-0.4	-0.3	-0.3	0.8	1.0	1.4	1.6	1.4	35	35	34	33	31	30
Singapore	22.2	16.5	15.0	13.0	13.0	12.0	0.5	0.0	2.0	2.0	1.0	1.0	107	110	115	118	120	120
Czech Republic	-3.7	-3.6	-4.2	-1.9	-2.5	-1.9	-5.3	-4.9	-3.8	-3.5	-2.3	-1.5	39	42	44	45	45	44
Hungary	1.1	0.1	-0.6	-1.0	-2.7	-3.8	-3.8	5.5	-3.3	-3.8	-4.1	-3.9	78	68	66	66	66	66
Poland	-3.3	-4.1	-4.9	-4.5	-4.2	-3.8	-8.1	-6.4	-5.2	-4.2	-3.1	-2.6	53	53	53	53	53	52
Romania	-4.2	-5.1	-5.4	-5.5	-5.5	-5.0	-6.7	-4.5	-3.0	-2.5	-2.0	-1.5	32	35	35	35	34	32
Russia	5.1	4.8	1.7	-0.6	-2.1	-2.9	-4.2	-2.2	-2.2	-2.0	-0.6	-0.6	8	9	9	10	10	9
Turkey	-6.5	-7.5	-7.9	-5.5	-5.0	-4.5	-3.5	-3.2	-3.2	-3.0	-3.0	-3.0	42	41	40	38	38	37
Nigeria	6.1	7.6	7.1	5.2	4.3	3.8	-4.7	-1.9	-1.2	-1.4	-1.7	-2.4	NA	NA	NA	NA	NA	NA
South Africa	-2.7	-2.8	-5.6	-6.1	-6.7	-6.4	-5.2	-5.2	-4.8	-4.0	-3.8	-3.5	35	38	42	39	36	34
Argentina	1.0	-0.1	0.8	0.3	-0.1	-0.1	-0.8	-0.6	1.0	1.5	2.1	2.3	49	49	49	50	52	53
Brazil	-2.3	-2.7	-2.8	-2.5	-2.2	-2.0	-2.6	-2.6	-2.8	-1.8	-1.2	-0.8	69	69	69	70	70	71
Mexico	-0.5	-2.0	-2.4	-2.6	-2.7	-2.7	-2.7	-2.5	-2.0	-1.9	-1.9	-1.9	42	41	41	41	41	40
Venezuela	6.5	5.4	3.9	5.0	4.9	4.7	-6.0	-5.0	-5.0	-5.5	-5.9	-5.8	38	38	34	39	41	40

Note: US debt and deficit figures are for the Federal government only. All other countries are general government debt and deficits. Source: Citi Investment Research and Analysis

Figure 19. Selected Countries — Changes in Economic Forecast from the Previous Month (Percent) 2011-2013F

	GDP Growth			CPI Inflation			Current Balance (Pct of GDP)			Fiscal Balance (Pct of GDP)		
	2011	2012	2013	2011	2012	2013	2011	2012	2013	2011	2012	2013
Global	-0.1	0.1	0.1	0.2	0.1							
<i>Based on PPP weights</i>	-0.1	0.1		0.1			-0.1	-0.1			-0.1	0.1
Industrial Countries	-0.2	0.1		0.2								
United States	-0.2			0.4	0.1				0.2	0.2		
Japan	-0.6	0.7		0.4	0.3	0.2	-1.0	-0.9	-0.3	-1.1	-0.5	-0.1
Euro Area		-0.1	0.1	0.2	0.1	-0.1	-0.1	-0.1	-0.1	0.1		
Canada	0.1		0.1	0.1	-0.1		-1.8	-1.9	-2.2		0.1	0.1
Australia	-0.8	0.3	0.3	-0.2	-0.2	0.2	-0.1	0.7	0.2			
New Zealand	-0.5	-0.6					5.3	1.3				
Germany			0.2	0.3	0.1	-0.2	0.6	0.6	0.4		0.1	0.1
France	0.1			-0.1	0.2	-0.3	-0.1	-0.1	-0.1			
Italy	-0.1			0.2	0.4		-0.8	-1.0		0.1		
Spain				0.2	0.2		0.1			0.2	0.1	
Greece	-0.1	-0.1		0.6	0.4			0.1	0.1	0.6	0.6	
Portugal	-0.2	-0.8	-0.5	0.4	-0.1	-0.5		0.5	1.1	0.3	1.3	2.1
Netherlands												
Denmark	0.1			0.5	0.1							
Norway							-2.0	-1.5	-1.0			
Sweden			0.3	0.3			0.1	0.1	0.1			
Switzerland	0.3		0.1				-0.5	1.7	2.8	0.1	0.2	0.2
United Kingdom	-0.4		-0.2	-0.1	-0.1	-0.1			0.2	-0.6	-0.6	-0.9
Emerging Markets	0.1		0.1	0.1	0.2	0.1		-0.1	0.1	0.4	0.2	0.2
China												0.5
Hong Kong												
India				0.5			0.3	0.3	0.2	2.5	3.0	3.0
Indonesia					0.3	0.5				-0.6	-0.4	-0.5
Korea				0.3	0.2		-0.7	0.8	0.7			
Singapore												
Czech Republic				-0.5	-0.9		-1.6	-1.6				
Hungary				-0.1			-0.1					
Poland	0.2	-0.3		-0.2			-0.4	-0.1		0.2	0.3	0.1
Romania				0.5								
Russia	0.3	0.1		0.1	0.4		0.7	-0.9	0.4	1.4	0.9	0.8
Turkey								0.2				
Nigeria	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
South Africa	0.1	0.1		0.2			0.4	0.1	0.1	-0.8	-0.9	-0.6
Argentina		2.0		-1.5	7.5	2.5	-0.1	-0.1	0.1			
Brazil	-0.8			0.4	0.5	0.5		-0.2		0.2	-1.0	-0.6
Mexico				-0.1								
Venezuela												

Source: Citi Investment Research and Analysis

Figure 20. Selected Countries — Economic Forecast Overview and Exchange Rate Forecasts(Percent) 2010-2015F

	10-Year Yields						Exchange Rates Versus U.S. Dollar*						Exchange Rate Versus Euro					
	2010	2011	2012	2013	2014	2015	2010	2011	2012	2013	2014	2015	2010	2011	2012	2013	2014	2015
Industrial Countries																		
United States	3.21	3.50	3.90	4.35	5.10	5.50	NA	NA	NA	NA	NA	NA	1.32	1.42	1.42	1.38	1.37	1.36
Japan	1.18	1.35	1.75	1.80	1.80	2.00	87	81	87	87	87	87	114	115	124	120	119	118
Euro Area	2.78	3.60	4.00	4.10	4.15	4.20	1.32	1.42	1.42	1.38	1.37	1.36	NA	NA	NA	NA	NA	NA
Canada	3.24	3.79	4.56	4.79	5.35	5.50	1.03	0.98	0.95	0.96	0.97	0.99	1.35	1.38	1.35	1.32	1.33	1.35
Australia	5.55	6.00	6.30	6.80	7.20	6.60	0.94	1.00	0.98	0.86	0.85	0.84	1.41	1.41	1.45	1.61	1.62	1.63
New Zealand	5.87	5.80	6.30	6.70	7.00	6.80	0.73	0.73	0.69	0.63	0.62	0.61	1.81	1.95	2.06	2.20	2.21	2.22
Germany	2.78	3.60	4.00	4.10	4.15	4.20	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
France	3.12	4.01	4.41	4.40	4.45	4.50	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
Italy	4.03	5.25	4.05	5.05	5.05	5.10	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
Spain	4.27	5.94	5.65	5.55	5.35	5.40	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
Greece	9.20	12.22	12.88	13.05	12.55	11.10	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
Portugal	5.38	8.96	8.88	9.55	8.85	8.20	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
Netherlands	3.00	3.79	4.20	4.30	4.35	4.40	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
Denmark	2.90	3.73	4.20	4.35	4.40	4.45	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
Norway	3.48	4.27	4.73	4.80	4.85	4.85	6.02	5.50	5.42	5.60	5.64	5.68	7.95	7.79	7.70	7.71	7.73	7.75
Sweden	3.00	3.85	4.37	4.50	4.55	4.65	7.09	6.25	6.12	6.33	6.38	6.44	9.36	8.86	8.70	8.71	8.75	8.78
Switzerland	1.57	1.75	2.25	2.35	2.65	2.75	1.01	0.92	0.97	1.02	1.03	1.03	1.33	1.30	1.38	1.40	1.41	1.41
United Kingdom	3.58	4.01	4.61	4.71	4.76	4.81	1.54	1.64	1.73	1.74	1.74	1.73	0.86	0.86	0.82	0.79	0.79	0.79
Emerging Markets																		
China	2.91	4.15	4.25	4.50	4.40	4.50	6.77	6.36	6.08	5.95	5.80	5.60	8.94	9.01	8.65	8.20	7.95	7.64
Hong Kong	1.54	2.00	2.53	3.25	3.50	4.00	7.77	7.76	7.75	7.75	7.75	7.75	10.3	11.0	11.0	10.7	10.6	10.6
India	7.75	7.75	7.75	7.75	7.75	7.75	45.7	46.1	44.8	44.0	42.0	40.5	60.3	65.4	63.6	60.6	57.6	55.2
Indonesia	8.49	8.69	8.25	8.25	8.50	8.50	9092	8800	8663	8600	8600	8500	12000	12472	12316	11845	11788	11594
Korea	4.08	4.85	5.33	5.35	5.45	5.60	1156	1065	1008	1000	975	970	1526	1509	1433	1377	1336	1323
Singapore	2.41	2.79	3.11	2.80	3.20	3.60	1.36	1.25	1.20	1.20	1.14	1.10	1.80	1.77	1.71	1.65	1.56	1.50
Czech Republic	3.71	3.97	3.95	4.20	4.20	4.20	19.1	17.1	16.5	16.8	16.7	16.5	25.2	24.2	23.5	23.2	22.8	22.5
Hungary	NA	NA	NA	NA	NA	NA	195	191	193	200	197	193	276	271	275	276	270	264
Poland	NA	NA	NA	NA	NA	NA	2.81	2.84	2.68	2.60	2.59	2.58	3.98	4.02	3.81	3.59	3.55	3.52
Romania	NA	NA	NA	NA	NA	NA	3.19	3.16	2.89	2.91	2.86	2.81	4.21	4.17	4.10	4.01	3.92	3.83
Russia	7.27	7.06	7.57	7.59	7.60	7.60	30.4	28.2	29.3	30.3	30.2	30.2	40.1	39.9	41.7	41.7	41.4	41.1
Turkey	NA	NA	NA	NA	NA	NA	1.50	1.60	1.62	1.65	1.64	1.62	1.98	2.27	2.31	2.28	2.24	2.21
Nigeria	NA	NA	NA	NA	NA	NA	151	154	153	150	148	150	199	218	218	207	203	205
South Africa	8.38	8.80	9.15	9.50	9.25	9.20	7.32	7.23	7.90	8.69	9.18	9.66	9.7	10.2	11.2	12.0	12.6	13.2
Argentina	16.96	13.92	15.68	16.58	15.19	13.00	3.90	4.11	4.68	6.27	6.77	7.27	5.14	5.83	6.66	8.64	9.28	9.92
Brazil	12.05	12.27	11.78	10.77	9.64	8.75	1.76	1.67	1.69	1.70	1.75	1.79	2.32	2.37	2.41	2.34	2.40	2.44
Mexico	6.93	7.27	7.73	7.50	8.10	8.00	12.6	12.0	12.0	12.2	12.7	13.0	16.7	17.0	17.1	16.8	17.4	17.7
Venezuela	13.78	13.00	14.00	15.00	15.00	15.00	3.80	4.35	4.40	4.80	4.80	5.30	5.02	6.16	6.26	6.61	6.58	7.23

*Per USD except Euro Area, Australia, New Zealand, United Kingdom. Source: Citi Investment Research and Analysis

Figure 21. Short Rates (End of Period), as of 23 Mar 2011 (Percent)

	Current	2Q 11	3Q 11	4Q 11	1Q 12	2Q 12	3Q 12
United States	0.25	0.25	0.25	0.25	0.50	0.75	1.00
Japan	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Euro Area	1.00	1.25	1.50	1.50	1.75	2.00	2.25
Canada	1.00	1.00	1.50	2.00	2.00	2.50	3.00
Australia	4.75	4.75	5.00	5.25	5.25	5.25	5.50
New Zealand	2.50	2.50	2.50	2.50	2.50	3.00	3.00
Denmark	1.05	1.30	1.55	1.60	1.85	2.15	2.40
Norway	2.00	2.25	2.50	2.75	3.00	3.50	3.75
Sweden	1.50	1.75	2.25	2.50	2.75	3.00	3.25
Switzerland	0.25	0.25	0.50	0.75	1.00	1.25	1.50
United Kingdom	0.50	0.75	1.00	1.25	1.50	1.75	2.00
China	3.00	3.50	3.75	3.75	3.75	3.75	3.75

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

Figure 22. 10-Year Yield Forecasts (Period Average), as of 23 Mar 2011 (Percent)

	Current	2Q 11	3Q 11	4Q 11	1Q 12	2Q 12	3Q 12
United States	3.30	3.40	3.50	3.60	3.70	3.85	4.00
Japan	1.22	1.40	1.40	1.40	1.60	1.80	1.80
Euro Area (Germany)	3.24	3.40	3.50	3.70	3.80	3.90	4.00
Canada	3.17	3.60	4.00	4.20	4.25	4.45	4.75
Australia	5.43	5.85	6.00	6.10	6.10	6.30	6.40
New Zealand	5.63	5.70	5.80	6.00	6.20	6.20	6.40
Denmark	3.31	3.52	3.62	3.85	3.95	4.10	4.20
Norway	3.85	4.05	4.19	4.40	4.50	4.65	4.75
Sweden	3.33	3.65	3.75	4.05	4.20	4.30	4.40
Switzerland	1.84	2.15	2.25	2.50	2.65	2.80	2.90
United Kingdom	3.63	3.75	3.95	4.10	4.25	4.35	4.50

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

Figure 23. 10-Year Yield Spreads (Period Average), as of 23 Mar 2011

	Spread vs. US\$						Spread vs. Germany					
	Current	2Q 11	3Q 11	4Q 11	1Q 12	2Q 12	Current	2Q 11	3Q 11	4Q 11	1Q 12	2Q 12
United States	NA	NA	NA	NA	NA	NA	9	3	3	-7	-7	-1
Japan	-211	-203	-213	-223	-213	-209	-202	-200	-210	-230	-220	-210
Euro Area	-9	-3	-3	7	7	1	NA	NA	NA	NA	NA	NA
Canada	-13	20	51	61	56	61	-4	23	54	54	50	60
Australia	218	251	256	256	246	251	226	254	259	249	239	250
New Zealand	238	235	235	246	256	241	247	238	238	239	250	240
France	30	32	32	37	32	26	36	35	35	30	25	25
Italy	148	177	157	147	117	101	154	180	160	140	110	100
Spain	189	227	217	207	177	151	195	230	220	200	170	150
Netherlands	26	27	27	32	27	21	32	30	30	25	20	20
Belgium	91	92	92	97	87	71	97	95	95	90	80	70
Denmark	1	19	32	32	37	31	7	12	12	15	15	20
Norway	55	62	66	77	77	76	61	65	69	70	70	75
Sweden	3	22	22	42	47	41	9	25	25	35	40	40
Switzerland	-146	-128	-128	-113	-108	-109	-140	-125	-125	-120	-115	-110
United Kingdom	33	36	46	51	56	51	39	39	49	44	50	50

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

Source: Citi Investment Research and Analysis

Figure 24. Emerging Market Countries — Short Rates Actual and Forecast of Additional Rate Moves (End of Period), as of 23 Mar 2011

	Current Rate (%)	by Jun 11	Sep 11	Dec 11	Mar 12	Total Cumulative Rate Moves Expected
Turkey	6.25	0	50	100	100	250
Chile	4.00	75	25	75	25	200
Israel	2.50	100	50	0	50	200
South Africa	5.50	0	50	50	50	150
Philippines	4.00	100	0	0	25	125
Thailand	2.50	50	50	0	25	125
Brazil	11.75	100	0	0	0	100
Czech	0.75	25	25	0	50	100
Korea	3.00	25	25	25	25	100
Mexico	4.50	0	0	50	50	100
Poland	3.75	50	0	25	25	100
China	3.00	50	25	0	0	75
India	6.75	25	25	0	25	75
Indonesia	6.75	25	25	25	0	75
Hungary	6.00	0	0	0	25	25
Russia	8.00	0	0	0	-25	-25
Romania	6.25	0	-25	0	-50	-75

Source: Citi Investment Research and Analysis

Figure 25. Foreign Exchange Forecasts (End of Period), as of 23 Mar 2011

	vs USD						vs EUR					
	Current	Jun 11	Sep 11	Dec 11	Mar 12	Jun 12	Current	Jun 11	Sep 11	Dec 11	Mar 12	Jun 12
United States	NA	NA	NA	NA	NA	NA	1.42	1.40	1.42	1.44	1.45	1.43
Japan	81	78	81	84	87	87	115	110	115	121	126	124
Euro Area	1.42	1.40	1.42	1.44	1.45	1.43	NA	NA	NA	NA	NA	NA
Canada	0.98	0.99	0.98	0.96	0.95	0.95	1.39	1.39	1.38	1.38	1.38	1.36
Australia	1.00	0.97	1.00	1.03	1.05	1.00	1.41	1.44	1.41	1.39	1.37	1.42
New Zealand	0.73	0.72	0.72	0.73	0.73	0.70	1.93	1.95	1.96	1.97	1.99	2.04
Norway	5.57	5.56	5.47	5.39	5.32	5.38	7.88	7.80	7.76	7.73	7.70	7.70
Sweden	6.27	6.38	6.24	6.11	6.01	6.08	8.87	8.94	8.86	8.77	8.70	8.70
Switzerland	0.91	0.91	0.92	0.93	0.94	0.96	1.28	1.27	1.30	1.33	1.36	1.37
United Kingdom	1.62	1.61	1.65	1.69	1.73	1.73	0.87	0.87	0.86	0.85	0.84	0.83
China	6.56	6.37	6.30	6.25	6.18	6.10	9.3	8.9	8.9	9.0	8.9	8.7
India	45.1	46.3	46.0	45.8	45.5	45.0	63.8	64.8	65.2	65.7	65.9	64.4
Korea	1125	1110	1090	1070	1050	1040	1592	1556	1546	1536	1520	1488
Poland	2.86	2.89	2.83	2.77	2.72	2.69	4.05	4.05	4.01	3.98	3.94	3.85
Russia	28.3	27.8	28.1	28.4	28.7	29.1	40.1	39.0	39.9	40.8	41.6	41.7
South Africa	6.97	7.21	7.31	7.41	7.53	7.78	9.86	10.11	10.37	10.64	10.90	11.13
Turkey	1.58	1.62	1.61	1.61	1.60	1.62	2.23	2.27	2.29	2.30	2.32	2.31
Brazil	1.67	1.67	1.67	1.67	1.67	1.70	2.36	2.34	2.37	2.40	2.42	2.43
Mexico	12.0	12.1	11.9	11.8	11.8	12.0	17.0	17.0	16.9	16.9	17.1	17.2

Note: All foreign exchange forecasts are consistent with the rolling forecasts presented in Figure 94. Source: Citi Investment Research and Analysis

Figure 26. Foreign Exchange Forecasts (End of Period), as of 23 Mar 2011

	vs JPY					
	Current	Jun 11	Sep 11	Dec 11	Mar 12	Jun 12
United States	81	78	81	84	87	87
Japan	NA	NA	NA	NA	NA	NA
Euro Area	115	110	115	121	126	124
Canada	83	79	83	88	92	92
Australia	81	76	82	87	92	87
New Zealand	59.6	56.4	58.8	61.3	63.3	61.1
Norway	14.6	14.1	14.9	15.7	16.4	16.2
Sweden	13.0	12.3	13.0	13.8	14.5	14.3
Switzerland	90	86	89	91	93	91
United Kingdom	132	126	134	143	150	151
China	12	12	13	13	14	14
India	1.80	1.69	1.77	1.84	1.91	1.93
Korea	13.85	14.18	13.40	12.69	12.07	11.95
Poland	28.4	27.1	28.7	30.4	32.0	32.3
Russia	2.9	2.8	2.9	3.0	3.0	3.0
South Africa	11.7	10.9	11.1	11.4	11.6	11.2
Turkey	51.5	48.4	50.4	52.5	54.3	53.8
Brazil	48.8	46.9	48.7	50.5	52.1	51.2
Mexico	6.8	6.5	6.8	7.1	7.4	7.3

Note: All foreign exchange forecasts are consistent with the rolling forecasts presented in Figure 94. Source: Citi Investment Research and Analysis

Country Commentary

United States

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We anticipate growth averaging near 3¼% over the forecast horizon with unemployment declining to about 8¼%. The outlook reflects competing influences of stronger initial conditions and potential new drags: The spillover from surging final demand late in 2010 to output and employment is colliding with uncertainties stemming from events in Japan and the Middle East, which have raised energy costs and unsettled risk appetites.

Monetary policy is expected to keep overnight rates unchanged through 2011, but signs of strengthening labour markets and diminishing deflation threats could speed the timetable for exit strategies relative to previous forecasts. Following an anticipated end to the asset purchase programme at mid-year, policymakers could begin a gradual sequence of measures to prepare for an initial rate hike in January-March 2012. Officials retain high hurdles for unwinding accommodation and the latest setbacks in financial markets are cautioning. But the FOMC's more upbeat March statement recognised that risks are becoming more two-sided and the new policy tack may reflect a desire for greater flexibility.

We raised our forecasts for inflation to include higher near-term energy costs and related transportation fees. However, the backdrop of high unemployment, unused capacity and wide profit margins, combined with lingering financial headwinds, does not support a forecast of rising inflation. This setting is expected to moderate cyclical pressures on bond yields despite background concerns about fiscal sustainability.

Figure 27. United States — Economic Forecast, 2010-12F

		2010	2011F	2012F	2010 4Q	2011				2012		
						1QF	2QF	3QF	4QF	1QF	2QF	3QF
GDP	SAAR				3.3%	2.4%	3.1%	3.7%	3.8%	2.7%	3.3%	3.3%
	YoY	2.9%	2.9%	3.3%	2.8	2.5	2.8	3.1	3.3	3.3	3.4	3.3
Consumption	SAAR				4.1	2.2	3.2	3.4	3.4	1.9	3.1	3.1
	YoY	1.8	3.0	2.9	2.6	2.7	3.0	3.2	3.0	3.0	2.9	2.8
Business Investment	SAAR				6.2	6.6	10.2	11.5	11.4	9.5	9.4	9.8
	YoY	5.6	9.2	10.1	10.2	9.9	8.2	8.6	9.9	10.6	10.4	10.0
Housing Investment	SAAR				2.7	4.2	15.6	13.5	10.2	8.2	10.7	12.9
	YoY	-3.0	4.0	10.9	-4.7	-0.5	-2.6	8.9	10.8	11.8	10.6	10.5
Government	SAAR				-1.6	0.4	-2.9	-1.4	-1.1	-1.4	-1.5	-1.5
	YoY	1.0	-0.3	-1.5	1.2	1.7	-0.1	-1.4	-1.3	-1.7	-1.4	-1.4
Exports	SAAR				10.1	6.0	6.7	6.8	6.9	7.1	7.1	7.2
	YoY	11.8	7.2	7.0	9.2	7.9	7.2	7.3	6.6	6.9	7.0	7.1
Imports	SAAR				-12.2	13.9	3.9	3.7	3.5	2.9	4.3	5.5
	YoY	12.7	6.0	3.9	11.0	11.7	4.9	1.8	6.2	3.5	3.6	4.0
CPI	YoY	1.6	2.6	1.8	1.2	2.1	2.7	2.9	2.6	1.9	1.8	1.7
Core CPI	YoY	1.0	1.3	1.4	0.6	1.1	1.3	1.4	1.5	1.4	1.4	1.5
Unemployment Rate	%	9.6	8.8	8.4	9.6	9.0	8.9	8.7	8.7	8.5	8.4	8.4
Gov't Balance (Fiscal Year)	% of GDP	-8.9	-9.2	-7.0								
Assumed WTI Spot Price	US\$	79.4	101.3	103.6	85.0	92.6	103.1	104.6	105.0	104.9	104.0	103.1
Current Account	US\$bn	-473	-527	-522	-455	-487	-529	-545	-546	-533	-525	-520
	% of GDP	-3.2	-3.4	-3.3	-3.1	-3.2	-3.5	-3.5	-3.5	-3.4	-3.3	-3.2
S&P 500 Profits (US\$ Per Share)	YoY	38.4	12.4	7.3	36.4	17.7	12.0	10.8	9.8	9.1	7.3	7.3

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

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

Japan

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The earthquake and the subsequent Tsunami that struck the northeastern region have significantly changed Japan's economic outlook. Even activity in the areas not directly hit is being severely affected by disruption in supply chain and reduction in power supply caused in part by the nuclear power plant shut-offs. At least in coming months and probably longer, the power supply reduction likely will constrain economic activity meaningfully. However, reconstruction demand is likely to start to push up the economy later this year.

We now expect GDP to contract in the second quarter mainly reflecting the severe damage to supply capacity of the economy. By demand component, consumer spending and exports will probably fall, while public spending is expected to rise in the beleaguered regions. In the third quarter, reconstruction demand will probably start to materialise thanks to the new supplementary budget, but there is a risk that the implementation of public works spending is delayed because of the serious risk related to the nuclear power plants. We expect the net impact of the earthquake on GDP in 2011 to be negative, but growth in 2012 will likely be pushed up by normalisation in power supply and increasing reconstruction demand. Given that supply capacity of the economy was severely damaged by the earthquake, the output gap probably narrowed in a *discrete* manner and as a result we expect deflationary pressures will moderate somewhat more quickly than we previously thought.

The outlook for economic policies has also shifted. The government likely will introduce a supplementary budget, probably amounting to ¥5 trillion or so (1% of GDP), in April followed by another later this year in order to secure the earthquake-related budgets. Meanwhile, the Administration will probably give up some of its policy proposals (such as an increase in the child allowance) to save money. Moreover, the Bank of Japan doubled its asset purchase programme last week while injecting unusually large liquidity. Thus, the earthquake seems to be a catalyst for changes in the basic thrust of economic policies.

Figure 28. Japan — Economic Forecast, 2010-12F

					2010	2011					2012		
		2010	2011F	2012F	4Q	1QF	2QF	3QF	4QF	1QF	2QF	3QF	
Real GDP	YoY	3.9%	1.1%	2.6%	2.5%	1.4%	0.5%	0.7%	1.8%	2.3%	3.3%	2.6%	
	SAAR				-1.3	1.3	-1.5	4.3	3.2	3.3	2.5	1.3	
Domestic Demand	YoY	2.2	1.8	2.3	2.1	1.6	1.6	1.6	2.4	2.6	3.0	2.1	
	SAAR				-0.8	2.1	1.0	4.2	2.4	3.0	2.5	0.5	
Private Consumption	YoY	1.9	-0.2	1.4	0.6	0.5	-0.6	-0.8	0.4	0.4	2.0	1.5	
	SAAR				-3.2	1.8	-4.5	2.8	1.5	2.2	1.5	0.8	
Business Investment	YoY	2.4	4.6	5.9	5.5	5.8	3.5	4.0	5.2	5.7	6.7	6.0	
	SAAR				2.0	3.8	2.5	7.9	6.5	5.9	6.5	5.0	
Housing Investment	YoY	-6.5	8.3	13.9	6.1	6.8	8.3	8.3	9.5	10.8	14.3	17.1	
Public Investment	YoY	-3.3	2.7	4.8	-12.5	-8.5	-2.0	6.0	17.0	17.5	14.0	0.0	
Exports	YoY	24.2	0.4	5.3	13.1	5.5	-2.3	-2.0	0.8	2.5	5.5	6.0	
	SAAR				-3.0	-2.2	-9.6	7.6	8.3	4.8	1.4	9.6	
Imports	YoY	9.8	5.7	3.9	10.1	7.5	5.4	4.4	5.5	5.4	3.7	3.1	
	SAAR				-0.5	2.5	8.1	7.7	3.9	2.2	1.2	5.3	
CPI	YoY	-0.7	0.6	0.5	0.1	0.1	0.8	0.9	0.7	0.7	0.5	0.5	
Core CPI	YoY	-1.0	0.5	0.5	-0.5	-0.3	0.6	0.9	0.7	0.7	0.5	0.5	
Nominal GDP	YoY	1.8	0.3	2.5	0.6	-0.5	-0.3	0.3	1.7	2.3	3.2	2.4	
Current Account	¥ tn	17.0	13.9	14.6	16.7	16.0	13.1	12.9	13.5	13.9	14.0	14.7	
	% of GDP	3.5	2.9	3.0	3.5	3.3	2.7	2.7	2.8	2.8	2.8	3.0	
Unemployment Rate	%	5.1	4.8	4.4	5.0	4.9	4.8	4.7	4.6	4.5	4.5	4.4	
Industrial Production	YoY	16.0	-0.5	5.5	4.9	0.2	-4.7	-0.4	2.9	2.4	7.9	6.3	
Corporate Profits (Fiscal Year)	YoY	57.5	-15.0	50.0									
General Govt. Balance (Fiscal Year)	% of GDP	-9.8	-9.2	-9.2									

F Citi forecast. SAAR Seasonally adjusted annual rate. YoY Year-to-year percent change. Corporate profits are TSE-I non-financials consolidated recurring profits. Source: Citi Investment Research and Analysis

Euro Area

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Available sentiment indicators for 1Q suggest that the euro area started 2011 with GDP growth of around 0.6% QQ. Although sentiment indicators of the fiscally-strained periphery countries improved in recent months, the large divergence between core and periphery countries is likely to stay high. We keep our 2011 GDP forecast unchanged at 1.7%, but have slightly revised down our forecast for 2012 from 1.4% to 1.3%, mainly reflecting the earlier and larger than previously expected increase in interest rates. With additional pressure from higher import prices, we have increased our inflation forecast from 2.5% to 2.6% in 2011, with inflation peaking around 3% in June/July.

At the Council meeting on 24/25 March, the EU Heads of State and Government are likely to agree on the details of the permanent rescue mechanism (ESM), an increase of the lending facility of the EFSF and the right of both facilities to buy bonds in the primary market as an exception. There will be probably also a reduction of the interest rates for Greece and Ireland. Portugal, which is likely to tap the facilities soon, is likely to benefit from lower rates as well. However, in our view, the agreement, which also includes a competitiveness pact, does not solve the sources of the crisis, particularly because the problems of euro area banks are not sufficiently addressed.

The ECB has signalled an intent to increase interest rates in April. We expect a hike in the main refinancing rate by 25bp to 1.25%. But, as the ECB is likely to widen the difference between the deposit and the main refi rate back to 100bp, the deposit rate is likely to stay unchanged at 0.25%, suggesting that EONIA rates will increase less than 25bp in April. As the ECB prefers a symmetric band for the rates for the standing facilities, the rate for the marginal lending facility is likely to increase by 50bp to 2.25%. We expect a further refi rate hike in 3Q. Following a small pause in 4Q, we expect four rate hikes of 25bp in 2012.

Figure 29. Euro Area — Economic Forecast, 2010-12F

		2010	2011F	2012F	2010	2011				2012		
					4Q	1QF	2QF	3QF	4QF	1QF	2QF	3QF
Real GDP	YoY	1.6%	1.7%	1.3%	2.0%	2.2%	1.5%	1.4%	1.4%	1.2%	1.2%	1.4%
	SAAR				1.1	2.3	1.2	1.0	1.3	1.3	1.4	1.7
Final Domestic Demand	YoY	0.4	1.1	0.8	1.0	1.3	1.0	1.0	1.0	0.7	0.8	0.9
Private Consumption	YoY	0.7	1.1	0.9	1.1	1.1	1.1	1.2	1.0	0.9	0.9	0.9
Government Consumption	YoY	0.7	-0.2	-0.7	0.7	0.6	0.1	-0.5	-0.9	-0.9	-0.8	-0.6
Fixed Investment	YoY	-0.8	2.3	2.3	1.2	2.9	1.3	2.0	2.9	1.8	2.0	2.4
— Business Equipment	YoY	2.8	4.4	3.7	5.6	5.3	4.0	4.4	3.8	3.6	3.3	3.7
— Construction	YoY	-4.2	0.5	1.6	-3.3	0.4	-1.2	-0.1	2.9	1.0	1.5	1.7
Stocks (Contrib. to Y/Y GDP Growth)		0.4	0.1	0.1	0.3	0.0	-0.1	0.1	0.2	0.2	0.1	0.0
Exports	YoY	10.6	7.4	4.5	11.7	10.8	7.3	6.2	5.7	4.7	4.6	4.5
Imports	YoY	8.7	5.9	3.5	10.4	8.6	5.4	5.0	4.8	3.9	3.6	3.3
CPI	YoY	1.6	2.7	2.2	2.0	2.4	2.7	2.8	2.7	2.5	2.2	2.2
Core CPI	YoY	1.0	1.3	1.6	1.1	1.0	1.4	1.5	1.5	1.7	1.6	1.5
CPI Ex Energy and Food	YoY	1.0	1.7	1.8	1.1	1.2	1.8	1.8	1.8	1.9	1.8	1.8
Unemployment Rate	YoY	10.0	9.8	9.6	10.0	9.9	9.9	9.8	9.7	9.7	9.6	9.6
Current Account Balance	EUR bn	-56.4	-26.4	-1.1								
	% of GDP	-0.6	-0.3	0.0								
General Government Balance	EUR bn	-531.6	-409.5	-310.3								
	% of GDP	-5.8	-4.3	-3.2								
General Government Debt	EUR bn	7904.0	8333.5	8663.8								
	% of GDP	86.2	87.9	88.4								
Gross Operating Surplus	YoY	3.6	3.5	3.2								

Sources: Eurostat and Citi Investment Research and Analysis

Germany

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We keep our GDP forecasts for 2011 and 2012 unchanged. Record high readings in some business sentiment indicators and an already reported strong rebound in construction activity in January — reversing the sharp snow-related fall in December — signal decent growth (around 1.0% QQ) in 1Q. With ongoing strong demand from Asia and oil-exporting countries, we expect that export growth will remain high, albeit less dynamic than in 2010. With above-average capacity use and probably more investment in renewable energy production, we expect ongoing strong capital expenditure. Higher energy prices are likely to have some dampening impact on consumption but, with substantial employment gains and increasing wage growth, we still expect decent gains in consumption in 2011 and 2012. With ongoing pressure from higher import prices, we have increased our inflation forecast for 2011 from 2.3% to 2.6%. Despite the good economic performance, the centre-right government coalition has lost support in recent months and Germany is in political stalemate. If the current coalition loses in the state election in Baden-Württemberg at the end of March, Angela Merkel's coalition will come under severe pressure.

France

Available sentiment indicators suggest that the increase in 1Q GDP is probably somewhat larger than previously expected. We now forecast an increase of 0.6% QQ leading to a small upward revision of our 2011 GDP forecast from 1.5% to 1.6%. However, with ongoing repair in private and public sector balance sheets, and a relatively low share of exports (around 1% of GDP) to emerging Asia — the booming part of the world economy — we expect only modest GDP growth of around 0.3% QQ in the remainder of 2011. Despite the further gain in commodity prices, we revise down slightly our 2011 inflation forecast from 2.3% to 2.2% reflecting lower-than-expected inflation in the first two months of the year. With some austerity measures put in place, we expect a reduction of the general government deficit to GDP ratio to around 6% in 2011 — in line with the government forecast. However, without substantial additional fiscal tightening — which might be enacted after the Presidential and General elections in spring 2012 — a reduction of the deficit to 3% in 2013 (the government's target) is unlikely.

Figure 30. Germany and France — Economic Forecast, 2010-12F

		Germany			France		
		2010	2011F	2012F	2010	2011F	2012F
Real GDP	YoY	3.5%	3.0%	2.0%	1.5%	1.6%	1.5%
Final Domestic Demand	YoY	1.9	2.5	1.5	1.0	1.7	1.3
Private Consumption	YoY	0.4	1.9	1.4	1.6	1.8	1.3
Fixed Investment	YoY	6.2	6.6	3.4	-1.6	2.9	2.7
Exports	YoY	13.8	10.4	6.4	9.9	5.4	5.1
Imports	YoY	12.4	8.9	5.9	7.7	4.9	3.9
CPI	YoY	1.1	2.6	2.1	1.7	2.2	2.0
Unemployment Rate	%	6.9	6.2	5.8	9.3	9.0	8.8
Current Account	€bn	141.4	148.6	157.3	-40.7	-18.3	-17.5
	% of GDP	5.7	5.7	5.9	-2.1	-0.9	-0.8
General Govt. Balance	€bn	-82.5	-62.0	-31.8	-142.5	-122.6	-94.7
	% of GDP	-3.3	-2.4	-1.2	-7.2	-6.0	-4.5
General Govt. Debt	% of GDP	87.7	87.9	86.8	83.1	86.5	88.3
Gross Trading Profits	YoY	13.4	6.0	4.9	1.5	3.5	4.0

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

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Italy

Growth was weak in Q410, +0.1% QQ, but survey indicators suggest the current trend growth rate is probably around 0.3% QQ. Exports remain buoyant while the end of the re-stocking cycle should reduce import growth. However, higher energy costs will dampen domestic demand more than we previously expected, so we have revised down our outlook for private consumption and investment. While fiscal variables in 2010 were slightly better than expected, the new debt parameter in the Stability and Growth Pact will likely add pressure on Italy to tighten fiscal policy more than we had previously envisaged, creating an additional drag on demand. Political tensions may lead to early elections sometime in 2011, but we think the recent cautious management of fiscal policy is unlikely to be reversed.

Spain

GDP growth surprised slightly on the upside in Q410, with a gain of 0.2% QQ, but we think it is likely to decelerate again in H111 on the back of tighter fiscal policy, still falling house prices and tighter credit conditions. Net exports will likely continue to be the only source of GDP growth. Private consumption should slow again in 2011, after a temporary expansion in 2010, while business and construction investment growth should stay negative. This will likely cause some slippage in fiscal variables relative to targets. Political resolve towards structural reforms has been stronger than we had expected, with important changes being agreed on the pension system, banks and labour market. However, the impact on GDP growth will probably be limited in the short term.

Greece

Substantial fiscal tightening in 2010 and additional measures planned for 2011 will continue to depress economic activity in 2011 and 2012, probably deeper and for longer than the EU/IMF programme projects. Exports are recovering, but more slowly than in other European countries, and they are still too small to provide a boost for the rest of the economy. Higher inflation will create an additional drag for private consumption. Therefore, fiscal slippage will likely persist, although we do not expect a credit event before 2013.

Figure 31. Italy, Spain and Greece — Economic Forecast, 2010-12F

		Italy			Spain			Greece		
		2010	2011F	2012F	2010	2011F	2012F	2010F	2011F	2012F
Real GDP	YoY	1.1%	1.0%	1.0%	-0.1%	0.1%	0.2%	-4.5%	-3.2%	-1.1%
Final Domestic Demand	YoY	0.9	0.4	0.7	-1.2	-1.7	-1.0	-7.6	-6.5	-2.5
Private Consumption	YoY	1.0	0.6	0.4	1.3	-0.8	-1.4	-4.4	-5.3	-1.2
Fixed Investment	YoY	2.4	0.3	2.6	-7.5	-3.6	0.9	-20.9	-12.6	-3.5
Exports	YOY	8.9	7.7	2.7	10.3	4.3	2.1	1.1	4.9	2.3
Imports	YOY	10.3	8.2	1.6	5.5	-2.0	-1.7	-13.8	-12.9	-3.9
CPI	YOY	1.6	2.9	2.5	2.0	3.2	1.8	4.7	3.3	1.8
Unemployment Rate	%	8.4	8.7	8.5	20.1	20.8	20.6	12.3	15.1	16.4
Current Account	€bn	-54.3	-63.6	-68.7	-47.7	-35.8	-23.2	-23.8	-17.8	-11.8
	% of GDP	-3.5	-4.0	-4.2	-4.5	-3.3	-2.1	-10.4	-7.9	-5.2
General Govt. Balance	€bn	-71.2	-70.2	-63.9	-98.6	-74.4	-56.3	-22.5	-18.3	-17.0
	% of GDP	-4.6	-4.4	-3.9	-9.3	-6.9	-5.2	-9.7	-8.0	-7.4
General Govt. Debt	€bn	1844	1916	1983	638	745	801	321	347	367
	% of GDP	119.0	121.2	122.0	60.0	69.0	73.6	140.9	154.7	164.3

F Citi forecast. YoY Year-to-year growth rate. Sources: ISTAT, INE, Haver Analytics, Eurostat, and Citi Investment Research and Analysis

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UK

We have again trimmed our 2011 GDP growth forecast, and now expect 1.9% growth this year (down from 2.3% in the February forecast and 2.5% in the January forecast), because of the downgrade to the ONS Q4 reading and – with strong cost pressures — high inflation. Nevertheless, we expect a sharp rebound in Q1 GDP of about 1% QoQ and the general picture remains of steady and well-balanced growth led by exports and business investment but with sluggish consumer spending. Our 2011 inflation forecast is little changed at 4.7% (4.8% last month, 4.1% two months ago) and remains well above consensus (3.9%). Inflation is being lifted by the lagged effects of the weak pound plus strong global cost increases, while the recession appears to have created less disinflationary slack than expected because of adverse supply-side trends and the sharp cuts to business investment in the recession. Surveys suggest that capacity use among manufacturing and service sector firms is close to its long-run average, in contrast to output gap estimates which imply ample slack.

The Budget confirmed that the fiscal deficit is slightly undershooting the OBR's previous forecast, but left the pre-planned fiscal squeeze intact. On monetary policy, the MPC are edging towards a rate hike and seem likely to hike in the next three months. They want to keep rates low and would prefer a low pound in order to support growth in the face of fiscal consolidation and high private debts. However, the cost of that stimulus is a prolonged and sizeable inflation overshoot which is now feeding through to a sharp rise in long-run inflation expectations. Moreover, the MPC's credibility is being undermined by their inability to produce credible inflation forecasts. If early hikes succeed in capping inflation expectations, then rates will not need to rise quickly. But, rates are still likely to rise quite a long way over time. And rates could rise quite sharply if pay deals pick up significantly.

Figure 32. United Kingdom — Economic Forecast, 2010-2012F

		2010			2010	2011				2012		
		2010	2011F	2012F	4Q	1QF	2QF	3QF	4QF	1QF	2QF	3QF
Real GDP	YoY	1.3%	1.9%	2.2%	1.4%	2.2%	1.5%	1.5%	2.6%	2.0%	2.2%	2.3%
	SAAR				-2.4	4.3	1.4	2.6	2.0	2.0	2.2	2.9
Domestic Demand (Incl. Inventories)	YoY	2.5	1.5	1.9	2.7	1.7	1.3	1.1	1.8	1.8	1.8	1.9
	SAAR				-1.1	1.6	1.6	2.4	1.7	1.4	1.7	2.7
Consumption	YoY	0.9	1.6	1.1	0.4	1.6	1.2	1.7	2.2	1.0	1.2	1.0
	SAAR				-0.4	4.5	0.3	2.3	1.6	-0.1	1.0	1.7
Investment	YoY	3.1	0.9	6.5	5.6	0.8	1.0	-0.9	2.8	6.9	6.3	6.3
	SAAR				-9.5	-5.7	5.6	7.0	4.7	10.2	3.6	7.0
Exports	YoY	5.8	6.5	7.0	6.4	8.6	5.9	6.1	5.4	6.0	7.2	7.2
	SAAR				9.4	5.0	2.5	7.6	6.7	7.1	7.2	7.8
Imports	YoY	8.5	4.2	5.3	9.0	5.6	4.4	4.3	2.6	4.8	5.4	5.4
	SAAR				12.3	-3.7	3.0	6.5	5.1	4.6	5.2	6.7
Unemployment Rate	%	7.7	7.9	8.0	7.5	7.7	7.8	8.0	8.0	8.0	8.0	7.9
CPI Inflation	YoY	3.3	4.7	3.1	3.4	4.3	4.7	5.0	4.7	3.6	3.1	2.9
Merch. Trade	£bn	-97.6	-94.4	-88.0								
	% of GDP	-6.7	-6.1	-5.5								
Current Account	£bn	-35.7	-29.1	-20.7								
	% of GDP	-2.5	-1.9	-1.3								
PSNB	£bn FY	-142	-102	-77								
	% of GDP	-9.6	-6.6	-4.7								
General Govt. Balance	% of GDP	-11.1	-7.9	-5.8								
Public Debt	% of GDP	76.4	80.2	82.3								
Gross Nonoil Trading Profits	YoY	2.1	10.2	6.5								

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

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With thanks to Frida Sellberg

Switzerland

The Swiss economy continues to grow strongly, with GDP up 3.2% YoY in Q410 and strong trends in recent business surveys for Q1. Exports have slowed a bit, but investment is strong (up 6.2% YoY in Q4) and consumer spending continues to grow steadily. The SNB indicated in its March statement that it is increasingly confident that deflation risks have receded, and we expect them to start to move away from the current emergency level of rates in Q2 or Q3, provided the CHF does not soar further.

Sweden

Growth outperformed consensus again in 4Q10 (as in all quarters of last year), and we expect the same this year, keeping our forecast of 5.0% growth. With strong signals of an earlier-than-expected ECB rate hike and a clearly hawkish tone in the Riksbank's February minutes, we see some upside risks to our rate forecast of four more 25bp hikes this year. We expect the policy rate to be 3.5% at end-2012 before heading towards 4.0% in early 2013.

Denmark

With rising food and energy prices, we revise up our forecast for headline CPI to 2.4% for this year (1.9% previously). Inflation should fall back in late 2H to stay around its 10-year average of 2.1% in 2012. On monetary policy, our view is still that Nationalbanken will follow the ECB this year. Hence, we now expect two hikes, leaving the lending rate at 1.55% at year-end. For 2012, the Bank is more likely to start widening the spreads against the ECB, back to more normal levels around 20-30bp.

Norway

All surveys continue to point in the direction of a pick-up in growth this year supporting our forecast of 3.2% rise in GDP. Even with rising inflation expectations, inflation is expected to stay subdued this year. Still, because of higher global rate expectations, we have revised up our rate forecast since last month, adding one more 25bp hike, now expecting rates at 2.75% at year-end and reaching 4.0% in late 2012, in line with Norges Bank's rate path published mid-March.

Figure 33. Switzerland, Sweden, Denmark and Norway — Economic Forecast, 2010-2012F

		Switzerland			Sweden			Denmark			Norway		
		2010	2011F	2012F	2010	2011F	2012F	2010	2011F	2012F	2010	2011F	2012F
Real GDP ^a	YoY	2.6%	3.1%	2.3%	5.3%	5.0%	3.5%	2.1%	2.1%	2.0%	2.2%	3.2%	3.3%
Final Domestic Demand	YoY	0.8	4.7	2.6	3.6	3.9	3.2	0.8	1.5	1.3	0.2	3.6	3.6
Public Consumption	YoY	-1.6	1.0	0.9	2.3	1.6	0.8	1.7	0.1	0.4	2.3	2.0	1.9
Private Consumption	YoY	1.7	1.6	1.9	3.5	3.0	3.0	2.1	2.1	2.1	3.5	3.0	3.2
Investment (Ex Stocks)	YoY	4.6	4.9	5.5	6.0	9.7	7.0	-3.7	1.8	0.6	-4.4	8.5	5.0
Exports	YoY	10.1	7.2	7.8	10.4	9.6	5.7	2.5	5.0	3.7	3.3	6.8	5.2
Imports	YoY	6.7	11.1	9.5	12.1	8.4	4.9	2.0	3.6	2.6	7.4	6.5	3.8
CPI (Average)	YoY	0.7	0.7	1.0	1.2	2.6	2.2	2.3	2.4	2.1	2.4	1.7	2.2
Unemployment Rate	%	3.9	2.9	2.2	8.4	7.3	6.9	4.2	4.1	3.8	3.6	3.5	3.2
Current Account	% of GDP	14.3	12.2	11.2	6.3	6.4	6.5	5.2	4.0	3.5	12.9	14.5	16.0
General Govt Balance	% of GDP	1.1	1.3	1.5	-0.8	0.0	1.1	-4.0	-4.3	-3.6	10.0	10.0	12.0
General Govt Debt	% of GDP	42	39	37	40	37	33	43	46	46	NA	NA	NA

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

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Canada

The Canadian recovery is gaining momentum. Domestic demand is being supported by favourable financial conditions, consumer spending and business investment. Rising commodity prices and improving terms of trade are bolstering exports, corporate profits and business sentiment. Employment gains remain substantial among private and full-time workers, underpinning earned income growth, consumer confidence and discretionary spending. Housing risks remain benign and consumer debt levels have shown signs of abatement.

Higher food and energy costs, as well as the residual effects of last year's HST implementations, probably will keep headline inflation above the 2% target over much of the forecast horizon. However, economic slack should continue to dampen core inflation, which is now expected to return to target in early 2013, as opposed to the end of 2012. Upside risks to the inflation outlook include higher commodity prices, a stronger-than-anticipated US recovery and robust Canadian household activity. Downside risks include impediments to global growth – including new uncertainties related to developments in MENA and Japan – threats to Canadian competitiveness stemming from poor productivity performance and persistent strength of the CAD, and consumer retrenchment.

Given persistent disinflationary pressures on underlying Canadian consumer prices, we now anticipate that the central bank will resume extraordinarily accommodative monetary policy removal in July instead of April. Geopolitical uncertainties impacting key commodities markets and Canada's top trading partners may also factor into the central bank's decision to remain on hold near term. Nonetheless, we maintain our expectation that rates will rise by 200bp by end-2012. We continue to forecast a policy target of 2.00% by December this year and 3.00% by the close of 2012.

Figure 34. Canada — Economic Forecast, 2010-2012F

		2010	2011F	2012F	2010	2011				2012		
					4Q	1QF	2QF	3QF	4QF	1QF	2QF	3QF
Real GDP	YoY	3.1%	2.9%	3.0%	3.2%	2.7%	2.8%	3.1%	3.0%	2.8%	3.0%	3.1%
	SAAR				3.3	3.5	2.5	3.0	3.0	2.7	3.2	3.5
Final Domestic Demand	YoY	4.4	3.5	2.4	4.4	4.1	3.7	3.3	2.7	2.1	2.3	2.4
	SAAR				4.7	4.4	1.9	2.3	2.0	2.3	2.6	2.8
Private Consumption	YoY	3.4	3.2	3.2	3.4	3.2	3.4	3.4	2.9	2.9	3.1	3.2
	SAAR				4.9	3.5	2.5	3.0	2.5	3.5	3.5	3.5
Government Spending	YoY	5.0	0.8	-1.8	3.0	2.9	1.5	0.2	-1.4	-2.2	-2.2	-1.6
	SAAR				3.5	1.3	-0.9	-2.8	-3.0	-2.1	-0.8	-0.7
Private Fixed Investment	YoY	7.1	7.2	5.1	10.0	8.4	7.1	6.6	6.9	5.5	5.5	5.0
	SAAR				6.1	9.2	3.8	7.2	7.2	3.7	4.0	4.9
Exports	YoY	6.4	8.9	5.8	7.2	8.7	8.3	10.5	8.0	5.8	5.9	5.8
	SAAR				17.1	13.1	5.6	6.6	6.7	4.4	5.9	6.3
Imports	YoY	13.4	9.5	4.2	10.1	12.6	8.8	8.0	8.9	4.1	4.1	4.1
	SAAR				0.5	24.0	4.5	4.5	4.0	3.5	4.5	4.5
CPI	YoY	1.8	2.2	2.0	2.3	2.4	2.4	2.2	2.0	1.8	2.0	2.0
Core CPI	YoY	1.7	1.4	1.9	1.6	1.2	1.3	1.5	1.7	1.9	1.8	1.9
Unemployment Rate	%	8.0	7.5	7.0	7.7	7.8	7.7	7.6	7.1	7.3	7.2	7.1
Current Account Balance	C\$bn	-50.0	-21.5	-4.7	-44.2	-34.7	-35.1	-13.8	-2.2	-0.5	-8.6	-6.0
	% of GDP	-3.1	-1.2	-0.3	-2.7	-2.1	-2.1	-0.8	-0.1	0.0	-0.5	-0.3
Net Exports (Pct. Contrib.)		-3.1	-1.1	0.2	4.6	-5.3	-0.1	0.3	0.5	0.0	0.1	0.2
Inventories (Pct. Contrib.)		0.9	0.3	0.3	-5.9	5.0	0.4	0.2	0.2	0.3	0.3	0.2
Budget Balance (Fiscal Year)	% of GDP	-2.5	-1.7	-1.1								
Federal Budget Debt	% of GDP	33.9	33.5	33.0								

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

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We expect the current soft patch to persist through the first half of this year. Severe floods have seriously disrupted coal exports and the recovery in mine production is taking longer than had been hoped. We expect real GDP to, at best, post a slight rise in the March quarter. And the rebuild of housing and infrastructure damaged by the floods will be long tailed. At the same time, more of the boost to national income from record commodity prices has gone into saving rather than spending. As a result, we have lowered our forecasts this year for both economic growth and inflation. But we expect spending to pick up with capex plans in mining and energy pointing to a surge in investment. In the wake of the earthquake in Japan, markets have priced the risk of a rate cut, but in our view this is an over-reaction as fundamentals such as commodity prices have not changed, nor is there evidence of financial system stress.

New Zealand

The RBNZ reduced the OCR by 50bps to its previous low of 2.50% at the March MPS as an 'insurance' measure against the potential fallout on the economy following the second earthquake in Christchurch on 22 Feb. We are not currently forecasting a 'double-dip' recession, and further easing by RBNZ would require a significant deterioration in the economic outlook. The government deficit is set to rise markedly on financing the cost of rebuilding, but some of the funding will be diverted from other spending priorities. A new savings policy scheme is also set to be announced at the 2011 Federal Budget in a few months. Overall, we see little prospect of the RBNZ raising the OCR until mid-2012.

Figure 35. Australia and New Zealand — Economic Forecast, 2010-2012F

	Australia			New Zealand		
	2010	2011F	2012F	2010F	2011F	2012F
Real GDP ^a	2.7%	2.5%	4.3%	0.7%	1.1%	2.9%
Real GDP (4Q versus 4Q)	2.7	3.4	4.1	0.6	2.9	3.8
Real Final Domestic Demand	3.6	2.8	4.3	2.2	2.3	2.8
Consumption	2.7	2.9	3.1	1.9	1.1	1.9
Govt. Current & Capital Spending	9.1	-0.8	1.4	-2.1	0.3	-1.0
Housing Investment	4.8	4.6	5.0	4.4	3.5	8.8
Business Investment	-0.9	8.1	12.4	0.1	6.8	6.4
Exports of Goods & Services	5.3	0.8	9.1	2.7	1.3	4.2
Imports of Goods & Services	13.2	6.6	9.4	7.9	5.9	3.7
CPI	2.8	2.6	2.8	2.3	4.3	2.9
CPI (4Q versus 4Q)	2.7	2.5	2.8	4.0	3.1	2.6
Unemployment	5.2	4.8	4.2	6.8	6.8	5.8
Merch. Trade, BOP (Local Currency, bn)	16.7	34.1	20.5	-0.61	-1.07	-0.86
Current Account, (Local Currency, bn)	-34.5	-28.4	-52.2	-4.5	-1.3	-11.2
Percent of GDP	-2.6	-2.0	-3.4	-2.6	-1.0	-4.2
Budget Balance ^b (Local Currency, bn)	-57.1	-41.5	-12.3	-8.4	-10.4	-7.0
Percent of GDP	-4.4	-3.0	-0.8	-4.4	-5.1	-3.2
General Govt. Debt (% of GDP) ^c	3.7	5.7	6.4	-14.9	-18.6	-21.7
Gross Trading Profits ^d	12.5	9.1	8.6	NA	NA	NA

BOP Balance of payments basis. CPI Consumer Price Index. F Citigroup forecast. NA Not available. ^aAveraged-based GDP in Australia; Production in New Zealand. ^bFiscal year ending June. Australia's underlying cash balance. ^cAustralia and New Zealand Budget definition and forecasts — debt equals an asset. ^dCompany gross operating surplus. Source: Citi Investment Research and Analysis

China

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Liquidity tightening since last year was more effective than expected, and thus is likely to be reaching an end. Successive increases in required reserves have shrunk banks' excess cash, causing a small liquidity crunch ahead of the Spring Festival and a spike in money market rates. Since then, liquidity has returned to more normal conditions, but actual borrowing costs have risen much more than benchmark rates.

Due to tighter liquidity and other factors, inflation is not out of control. To be clear, we do expect rising CPI through 2Q due to food, input costs and base effects. But food supply should be secure, with comfortable levels of reserves and output in grain and pork. Warmer weather also makes speculation more difficult. Even the impact of high oil prices likely will be limited, as the government may subsidise and cap prices if crude prices exceed \$130/bbl. The Japan earthquake and MENA unrest add to inflation risks, but the expected slowdown in growth will help tame prices. Property tightening has already curbed loan demand and reduced retail growth in related products, which we expect to continue if property policies are not relaxed. Strong investment growth in Jan-Feb may face constraints from commodity prices and credit. The decline in the PMI may also imply slower growth ahead. China's trade appears near to balance in 1Q, reducing our expected annual surplus. But the trade balance may rebound subsequently due to developed market demand, especially Japan.

Against this backdrop, we expect more rate hikes than RRR changes. To offset maturing central bank paper, the PBOC will increasingly go to the open market, with RRR hikes as a back-up. We saw the first relaxation of RRR recently for banks that were previously penalised for over-lending. Rate hikes are still likely and necessary, as real deposit rates remain very negative. The National People's Congress approved the 12th Five-Year Plan, consistent with last October's draft, but more detailed. The ultimate objective is to improve household living standards, focusing on new domestic sources of growth, resource efficiency, industrial upgrading and regional rebalancing. The reform measures, if implemented, would improve the quality of growth, but at lower growth rates and higher input costs.

Figure 36. China — Economic Forecast, 2010-2012F

					2010	2011				2012		
		2010	2011F	2012F	4Q	1QF	2QF	3QF	4QF	1QF	2QF	3QF
Real GDP	YoY	10.3%	9.2%	9.0%	9.8%	9.5%	9.4%	9.2%	9.0%	9.2%	9.0%	9.0%
Real Final Domestic Demand	YoY	10.4	10.3	9.9								
Consumption	YoY	8.2	9.4	9.8								
Fixed Capital Formation	YoY	12.8	11.2	10.0								
Industrial Production	YoY	15.5	13.6	12.5	13.2	13.8	14.0	13.5	13.0	13.3	12.7	12.5
Exports	YoY	31.3	18.3	13.4	24.9	23.2	18.5	17.0	16.0	15.0	15.0	13.0
Imports	YoY	38.9	22.5	15.9	29.5	29.0	22.3	21.0	19.0	15.6	16.8	16.3
Merchandise Trade Balance	\$bn	184.5	160.0	142.8	63.1	0.3	35.7	62.2	61.8	-2.0	33.4	55.7
FX Reserves	\$bn	2,847	3,130	3,400	2,847	2,881	2,950	3,051	3,130	3,150	3,220	3,300
Current Account	% of GDP	5.2	4.6	3.8								
Fiscal Balance (trailing 4-qtr sum)	% of GDP	-1.6	-2.0	-2.0	-1.6	-1.7	-1.7	-1.5	-2.0	-1.7	-1.5	-1.5
General Govt. Debt	% of GDP	20.5	20.4	20.6								
Urban Unemployment Rate	%	4.1	4.0	4.0	4.1	4.0	4.0	4.0	4.0	4.0	4.0	4.0
CPI	YoY	3.3	4.6	4.0	4.7	5.1	5.3	4.5	3.6	3.4	3.9	4.1
Exchange Rate (end period)	CNY/\$	6.77	6.36	6.08	6.60	6.50	6.37	6.30	6.25	6.18	6.10	6.05
1-Yr Deposit Rate (end period)	%	2.75	3.75	3.75	2.75	3.00	3.50	3.75	3.75	3.75	3.75	3.75

Note: F Citi forecast. E Citi estimate. YoY Year-to-year percent change. SAAR Seasonally adjusted annual rate. Sources: Haver Analytics and Citi Investment Research and Analysis

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India

The tensions in MENA and revisions to our 2011 global oil price forecast will undoubtedly take their toll on the macro economy. But mitigating factors, including a US\$300bn FX reserve cushion, declining energy intensity and new gas discoveries, could make the impact less severe than in the past. This, coupled with fuel price regulation, prompts us to maintain our FY11/12 GDP estimate at 8.4%. On the domestic front, environmental clearances and land acquisition issues have been bottlenecks over the last year. However, we think the worst could be behind us: (1) order timelines for investment projects are being shifted to 4QFY11 - 1QFY12; (2) with FY12 the last year of the 11th Plan, infra spending is expected to pick up; (3) FDI is likely to recover; and (4) strong exports and rural/urban wage revisions will support consumption.

Inflation for February came in higher than expected at 8.3%, with manufactured products reversing the moderation posted in the previous month. At its recent policy meeting, the RBI has also highlighted upside risks to inflation and raised its March 2011 WPI estimate from 7% to 8%. The combination of emerging demand pressures, higher oil and structurally high food prices will likely result in an upward bias to our FY12 inflation estimate of 7.0-7.5%. We expect rates to be tightened by 75bps by early 2012. But upside risks to inflation could result in front-loading and perhaps an extension of the rate hike cycle.

Set against a backdrop of low expectations, the Union Budget for FY12 surprised positively on most counts, but disappointed on the arithmetic. This is based on nominal GDP growth of 14%, tax revenues rising 18.5% and expenditure rising 3.4%. While revenue and growth assumptions appear realistic, the expenditure numbers look optimistic. The key item which stands out is subsidies, where the budget projects a 12.5% YoY decline, with both fuel and food subsidies under-stated. Depending on the implementation of the food subsidy bill and diesel de-regulation, we expect an overshoot of Rs500-700bn, which would take the headline deficit number to 5.3% vs. the target of 4.6%. On the external front, the export recovery should offset the increase in oil imports due to rising prices. This would likely result in the current account deficit coming in at US\$59.5bn or 3% of GDP (vs. 3.2% of GDP earlier expected). Moreover, budgetary measures coupled with the RIL-BP deal should support overall capital flows. This would result in the overall accretion to reserves at US\$9.6bn (from US\$2.2bn earlier), albeit lower than the US\$22.7bn estimated for FY11.

Figure 37. India — Economic Forecast, FY2010/11-2012/13F

		FY 10/11F	FY 11/12F	FY 12/13F
Real GDP	YoY	8.6%	8.4%	8.7%
Final Domestic Demand	YoY	7.6	7.5	9.1
Private Consumption	YoY	8.2	7.0	7.0
Fixed Investment	YoY	8.4	8.4	14.0
Exports	YoY	14.0	10.8	9.8
Imports	YoY	11.8	7.7	8.3
Wholesale Price Index*	YoY	8.6	7.0	6.0
Consumer Price Index	YoY	9.5	6.5	6.0
Unemployment Rate	%	NA	NA	NA
Current Account	US\$ bn	-39.4	-59.5	-57.6
	% of GDP	-2.3	-3.0	-2.5
Consolidated Fiscal Balance	% of GDP	-8.1	-7.9	-7.6
Centre Fiscal Balance	% of GDP	-5.1	-5.3	-4.5
US Dollar Exchange Rate	Average	45.7	45.9	44.4

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

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Korea

Industrial production continued double-digit growth on the back of upswings in exports. Jan IP growth posted 13.7% YoY and 4.6% MoM, following 10.6% YoY and 3.1% MoM in Dec 2010. Exports in Jan registered a monthly record of US\$44.6bn, growing by 45.1% YoY, but slowed to US\$38.6bn (16.9% YoY) in the following month due to Lunar New Year Holidays. The steady recovery of the economy, especially the manufacturing sector, produced solid job growth of 469K YoY and 233K MoM in Feb. However, the seasonally-adjusted jobless rate rose to 4.0%, as workforce participation rose and foot-and-mouth disease eroded jobs in the agricultural sector. Headline CPI inflation in Feb inched up further to 4.5% from 4.1% in Jan, leading the BoK to raise the policy rate by 25bps to 3.0%. Two consecutive months with headline inflation above the inflation target (2~4%) and crude oil prices above US\$100/bbl have prompted the BoK and the government to shift the policy priority to fighting inflation. We revise up our inflation forecast for 2011 and 2012 to 4.0% and 3.4%, 0.3%p and 0.2%p higher than our previous forecasts, but maintain our call of additional 75bps policy rate hikes this year, taking the policy rate to 3.75% at year-end.

Indonesia

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Indonesia's growth remains resilient. Bank Indonesia expects growth will reach 6.6% in 1Q11 (Citi at 6.7%), and domestic demand indicators remain buoyant despite some slowdown in exports, largely due to oil production setbacks. Inflation momentum will likely recede over the near term as food prices record seasonal declines during harvest time alongside some rupiah strengthening. But, with still-elevated inflation expectation, strong growth and risks to global energy prices, we continue to expect headline inflation to remain persistently high and well above BI's "target". Bank Indonesia paused earlier this month after initiating its first hike in this cycle in February, but we expect this pause will be temporary. We anticipate three more hikes this year, though the risk of delays to the hikes has risen. Plans for the phased ban of fuel subsidies have been delayed or altered, which will limit near-term inflationary pressures but have adverse fiscal implications. This change may raise the deficit by about 0.2-0.3% of GDP depending on how high oil prices go, raising longer-term sustainability concerns that may lead to future price adjustments. We have underestimated BI's tolerance for rupiah appreciation and we thus revise our FX forecasts towards a stronger path.

Figure 38. Korea and Indonesia — Economic Forecast, 2010-12F

		Korea			Indonesia		
		2010	2011F	2012F	2010	2011F	2012F
Real GDP	YoY	6.1%	4.3%	4.6%	6.1%	6.5%	6.6%
Final Domestic Demand	YoY	4.6	3.8	4.2	5.2	7.2	7.2
Private Consumption	YoY	4.1	3.9	4.5	4.6	5.4	5.4
Fixed Investment	YoY	6.2	4.6	4.1	8.5	10.7	11.0
Exports	YoY	14.1	8.1	11.5	14.9	11.1	7.3
Imports	YoY	17.2	11.8	13.1	17.3	13.5	9.5
Consumer Price Index	YoY	3.0	4.0	3.4	5.1	6.7	6.8
Unemployment Rate	%	3.7	3.4	3.2	7.1	6.8	6.5
Current Account	US\$ bn	28.2	12.0	14.3	6.3	2.1	-1.5
	% of GDP	2.8	1.0	1.1	0.9	0.3	-0.2
Fiscal Balance	% of GDP	-0.3	0.8	1.0	-0.6	-1.8	-1.6
US Dollar Exchange Rate	Average	1156	1065	1008	9092	8800	8663

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

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Hong Kong

Although 2010 set a high base for further recovery this year, both external and domestic data so far suggest strong economic momentum in the first two months of the year, hence supporting our 4.2% YoY growth forecast for 1Q11. However, recent external shocks will likely be visible from March onwards. Financial linkages with Japan likely will be impacted, given HK's role as an international financial centre, and fund outflows will be inevitable in the general "risk-off" sentiment. As a result, the HKD has retreated beyond the middle of its trading band. But, with MENA and Japan risks likely to subside over time, we expect the HKD to strengthen again in 2H10. Business and consumer confidence are likely to fall temporarily, given the wait-and-see mentality. Exports to Japan are about 4% of HK's total exports and about 7% of GDP. Lesser numbers of Japanese tourist arrivals are also likely in the next six months, but in 2010, Japanese tourists accounted for only about 4% of total tourist arrivals. Inflation remains the policy focus, given further price pressures from rising energy and food prices globally, coupled with the local trend of rising rentals. The government recently decided to redistribute part of its high fiscal surplus to the public via cash handouts and tax rebates.

Singapore

Against a backdrop of increased risk aversion in the past month, we maintain that the balance of risks remains tilted towards inflation for 2011. Despite the decline in ex-pharma NODX in Feb, barring a sharp sequential decline in Feb IP, we continue to see upside risks to our 2011 GDP growth forecast of 5.5%, possibly to the 6.5-7.0% range. While some disruption to Japan-bound NODX is likely in 2Q, the downside risks to growth should not be exaggerated. Risks to future core inflation pressures continue to rise, as commodity prices are likely to stay high, while the step-up level shift in 1Q GDP has likely widened the positive output gap and exacerbated wage inflation pressures, further compounded by policy measures to raise the price of foreign labour. 4Q jobs growth was stronger than expected at 33.6K (previously 30.6K) and surveys indicate continued buoyant demand for labour amidst tightening of foreign worker inflows. The extensive use of non-monetary measures to tame inflation are no substitute for monetary tightening, in our view, and we maintain that the step-up level shifts in GDP and CPI justify a band re-centring, and a possible concurrent band narrowing. As such, the recent correction of the SGD NEER from the strong side of the band may provide attractive entry levels to position for MAS tightening.

Figure 39. Hong Kong and Singapore — Economic Forecast, 2010-12F

		Hong Kong			Singapore		
		2010	2011F	2012F	2010	2011F	2012F
Real GDP	YoY	6.8%	4.5%	5.2%	14.5%	5.5%	6.0%
Final Domestic Demand	YoY	6.0	4.0	4.2	5.5	6.1	6.2
Private Consumption	YoY	5.8	3.9	4.0	4.2	4.2	5.3
Fixed Investment	YoY	8.1	4.7	5.3	5.1	9.7	8.2
Exports	YoY	16.8	5.7	6.2	19.2	6.8	8.4
Imports	YoY	17.3	5.4	5.6	16.6	8.1	8.0
CPI	YoY	2.4	4.5	3.0	2.8	4.2	2.8
Unemployment Rate	%	4.4	3.7	3.5	2.2	2.0	2.0
Current Account	US\$ bn	14.8	22.0	26.1	49.5	44.0	45.3
	% of GDP	6.6	9.1	10.0	22.2	16.5	15.0
Fiscal Balance	% of GDP	4.1	2.2	3.0	0.5	0.0	2.0
US Dollar Exchange Rate	Average	7.77	7.76	7.75	1.36	1.25	1.20

Sources: Haver Analytics and Citi Investment Research and Analysis

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Russia

Given the stronger oil prices, we have upgraded our forecast for GDP growth this year to 4.3%. This reflects our expectations of higher budget spending and private consumption, which we assume will be compensated by faster growth in imports. We expect close to double-digit investment growth this year on the back of state companies' investment programmes and a recovery in FDI inflows. The forthcoming elections will shape major policy decisions this year, in our view. We expect the fiscal plans to be revised up in the middle of the year and believe they are likely to include an additional indexation of public wages. At the same time, high oil revenues could reduce budget borrowing needs, and we think this year domestic borrowings will stay below the planned US\$50bn. CPI inflation will likely stay in a 9-10% range in 1H11, supported by rising non-food inflation. Given this, we forecast further monetary tightening, including rate hikes (up to 50bp increase in interest rates on CBR deposits in March-May) and a further increase in reserve requirements. Expectations of further tightening in monetary policy and high oil prices both suggest a strong ruble, at least in the short run. However, we think the basket could start weakening in the second half of 2011 on the back of a declining current account surplus, uncertainty related to elections, plus higher budget spending.

Turkey

High-frequency growth indicators do not display any signs of a slowdown. In parallel, the marked widening in the current account gap continues unabated, with the 12-month rolling deficit in January reaching an all-time high of USD51.4 billion. More importantly, capital account developments show no signs of improvement, as unidentified inflows (such as the errors and omissions) play an important role in financing the large current account deficit. With the current account gap set to reach 7.5% of GDP this year, the emerging picture on the external financing front warrants concerns. In our view, the macro backdrop is further complicated by rising inflation risks. Despite the strong case for a tighter policy stance to restrain domestic demand and rein in the current account deficit, the prospects for corrective actions ahead of the June elections look bleak. In particular, the CBT remains reluctant to hike rates and there doesn't seem to be any appetite for fiscal tightening. Against this backdrop, we believe that Turkish assets are vulnerable to sudden stops in capital flows, as investors will need to pay more attention to the challenging external financing outlook.

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Figure 40. Russia and Turkey — Economic Forecast, 2010-12F

		Russia			Turkey		
		2010F	2011F	2012F	2010F	2011F	2012F
Real GDP	YoY	4.0%	4.3%	4.1%	8.2%	4.5%	5.0%
Final Domestic Demand	YoY	2.6	6.1	6.4	10.5	4.9	6.7
Private Consumption	YoY	2.7	5.1	5.3	7.6	4.3	6.3
Fixed Investment	YoY	3.5	10.8	12.0	26.8	6.5	9.5
Exports	YoY	11.1	3.5	3.1	3.6	7.8	7.5
Imports	YoY	25.4	20.0	10.0	20.6	9.0	13.2
CPI	YoY	6.9	8.8	7.3	8.6	5.8	6.4
Unemployment Rate	%	8.0	8.0	7.5	#N/A	11.0	10.8
Current Account	US\$ bn	72.6	84.6	32.9	-48.6	-58.2	-67.7
	% of GDP	5.1	4.8	1.7	-6.5	-7.5	-7.9
Fiscal Balance	% of GDP	-4.2	-2.2	-2.2	-3.5	-3.2	-3.2
US Dollar Exchange Rate	Average	30.4	28.2	29.3	1.50	1.60	1.62

Sources: Haver Analytics and Citi Investment Research and Analysis

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Hungary

4Q GDP growth was revised down to 1.9% YoY and data showed economic growth in late 2010 resulted mainly from net exports, while the domestic demand recovery relied on re-stocking. In our view, the contribution of net exports to GDP should stay slightly positive in 2011, but the pick-up in economic growth probably will mainly result from domestic demand improvement. Although inflation is still elevated at about 4.0% YoY, we expect a slow decline in CPI inflation in 2H11 and we see a threat of second-round effects from rising commodity prices as quite distant because the output gap is likely to remain negative in coming quarters. The MPC left interest rates unchanged at 6% at the February meeting and we expect rates will stay unchanged until year-end. In March, the Hungarian parliament's Economic Committee appointed two new MPC members and we believe these appointments should be neutral for the markets. However, overall fundamentals, large external debt redemptions in coming quarters and high external debt make Hungary particularly vulnerable to changes in market sentiment.

Poland

GDP growth accelerated in 4Q to 4.4%YoY and the expansion was driven by domestic demand (5.6%) with high private consumption growth (4.1%) and gradual recovery in investment (0.9%). We think private consumption growth will decelerate in 1Q as consumers decided to speed up their purchases at the end of 2010. Nevertheless, industrial output growth in the first months of 2011 should be still supported by high economic growth in Germany. We see some downward risk to our forecast of a significant recovery in investment in 1Q as construction production data disappointed in January. Despite the downside CPI surprise in February, we think the MPC will increase interest rates to 4% in April and continue monetary policy tightening by 50bp later in 2011 and another 50bp in 2012 due to elevated inflation and strong economic growth. The government wants parliament to approve changes in the pensions system that would take effect most probably in May and would help to keep public debt below the 55% of GDP threshold in 2011 and 2012.

Figure 41. Hungary and Poland — Economic Forecast, 2010-12F

		Hungary			Poland		
		2010	2011F	2012F	2010F	2011F	2012F
Real GDP	YoY	1.2%	2.7%	3.5%	3.8%	4.2%	4.5%
Final Domestic Demand	YoY	-1.1	1.5	3.1	2.1	4.2	5.3
Private Consumption	YoY	-1.6	2.3	3.3	3.2	3.4	4.0
Fixed Investment	YoY	-3.0	2.5	5.2	-2.0	9.5	9.9
Exports	YoY	13.7	7.9	7.5	10.2	7.0	8.0
Imports	YoY	12.3	8.4	7.7	10.7	8.0	10.5
CPI	YoY	4.7	3.7	3.4	2.7	3.7	2.8
Unemployment Rate	%	11.2	10.0	9.5	12.1	11.1	10.0
Current Account	US\$ bn	1.4	0.2	-0.9	-15.4	-22.0	-30.0
	% of GDP	1.1	0.1	-0.6	-3.3	-4.1	-4.9
Fiscal Balance	% of GDP	-3.8	5.5	-3.3	-8.1	-6.4	-5.2
US Dollar Exchange Rate	Average	208	191	193	3.0	2.8	2.7

Sources: Haver Analytics and Citi Investment Research and Analysis

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Czech Republic

Given 4Q10 GDP was roughly in line with our forecast, we continue to expect 2011 growth to be 1.9% after 2.2% in 2010, followed by a stronger recovery in 2012. As before, the export-driven recovery is supportive for industry, while fiscal consolidation represents a headwind for consumption which has already taken effect in 2H10. We expect a rebound in inventories in 1Q11 but this is unlikely to persist for the rest of 2011. Fixed investment is likely to improve given better prospects and a surge in capacity use. The government prepared the principles of the 2013 pension reform, but it does not look to be strongly backed as some amendments were made. For example, the VAT rates unification has changed significantly. Thus we have cut our CPI forecast. But fiscal consolidation remains on track and positive for the bond market. Nevertheless, it is likely to suffer from latent fiscal woes in the euro area periphery and likely hikes in the CNB policy rate. We expect 50bp this year, starting probably in 2Q. The koruna is likely to be lacklustre in the short term (larger negative spread versus the ECB and adverse revisions to trade figures) and resume its appreciation trend around mid-year.

Romania

High-frequency indicators suggest the recovery is gaining momentum. In addition to the improvement in sentiment indicators, industrial production (which is now above its pre-crisis level) and retail sales confirm that GDP growth is likely to turn positive this year after two consecutive years of contraction. Concurrently, exports remain robust, which should keep the current account deficit this year around 5% of GDP — close to its long-term estimated norm. The favourable macroeconomic backdrop, however, is overshadowed by rising inflation risks. Specifically, higher-than-expected food prices, along with the likely administrative price adjustments, led us to revise our year-end inflation projection to 4.5% from about 4.0%. We expect inflation to drop drastically to about 5% YoY in July once the first-round effect of the VAT rate hike fades away entirely and then move towards 4.5% YoY by the end of 2011. A more challenging inflation outlook, coupled with the widely-expected rate hike by the ECB in April, will not allow the NBR to cut as much as we had initially pencilled in (75bp). Instead, we think the Bank is more likely to carry out a 25bp cut in 3Q (probably in September).

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Figure 42. Czech Republic and Romania — Economic Forecast, 2010-12F

		Czech Republic			Romania		
		2010	2011F	2012F	2010	2011F	2012F
Real GDP	YoY	2.3%	1.9%	3.0%	-1.3%	2.0%	4.2%
Final Domestic Demand	YoY	-1.0	2.9	3.1	-4.3	3.3	5.4
Private Consumption	YoY	0.4	3.6	4.2	-1.5	2.6	5.5
Fixed Investment	YoY	-4.6	5.4	5.5	-13.1	6.1	6.3
Exports	YoY	18.0	8.6	8.0	14.3	7.0	5.1
Imports	YoY	18.0	9.2	8.3	12.4	2.3	6.6
CPI	YoY	1.5	1.9	2.6	6.1	6.1	3.5
Unemployment Rate	%	9.0	8.9	8.4	6.9	7.1	6.8
Current Account	US\$ bn	-7.2	-7.9	-10.1	-6.8	-9.6	-11.2
	% of GDP	-3.7	-3.6	-4.2	-4.2	-5.1	-5.4
Fiscal Balance	% of GDP	-5.3	-4.9	-3.8	-6.7	-4.5	-3.0
US Dollar Exchange Rate	Average	19.1	17.1	16.5	3.2	2.9	2.9

Sources: Haver Analytics and Citi Investment Research and Analysis

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Brazil

The central bank has raised the Selic rate by 50bp to 11.75%, but indicated that the end of the tightening cycle is close given the convergence of its inflation forecasts to the mid-point target in 2012. In spite of this, we continue to expect two additional Selic rate hikes of 50bp each, based on our assessment that the inflation outlook remains challenging. With this in mind, we increased our 2011 and 2012 CPI inflation forecasts to 6.4% (from 5.6%) and 5.2% (from 4.5%) respectively, highlighting our scepticism regarding the convergence of inflation to the mid-point of the target (4.5%) next year, even though our new estimates remain inside the target band (from 2.5% to 6.5%). On the activity front, we downgrade our 2011 GDP growth forecast to 4.0% (from 4.8%) because of the weaker-than-expected 4Q10 GDP growth figure, together with evidence that the already-implemented macro prudential measures will hurt 1Q11 GDP more intensively. Regarding the exchange rate, the increase in government intervention has been containing BRL appreciation, allowing a gradual improvement in the external account outlook due to higher commodity prices. Finally, we reaffirm our 2011 public sector primary surplus estimate of 2.7% of GDP, slightly below the government's target of 2.9% of GDP.

Mexico

The latest IP figure was encouraging, up 6.6% YoY in January, and surprised on the upside. We expected 6.2% YoY and the consensus stood at 5.5%. We think the difference relative to our forecast should offset the likely adverse impact on agricultural GDP of the recent frost in northwestern Mexico. Thus, we expect that GDP will grow by 4.9% YoY in 1Q. Our 4.8% GDP growth forecast for this year remains unchanged. Meanwhile, inflation is still declining, with headline inflation at 3.57% YoY in February, down from 3.78% a month earlier, and we estimate that it should reach a trough of 3.3% in March. Nevertheless, we think market concerns about inflation will gradually rise because of higher commodity prices and because the output gap is likely to shift into positive territory in the early 2H. We still see headline and core inflation at 3.9% and 3.8% in 2011 as a whole. That said, we are sceptical about Banxico's ability to reach its 3% inflation target: accordingly, we call for rate hikes before the end of 2011. We therefore reiterate our call for the first 25bp rate hike to take place in October this year. Finally, we are constructive about MXN prospects and we still see the USD/MXN at 11.80 by the end of this year.

Figure 43. Brazil and Mexico — Economic Forecast, 2010-12F

		Brazil			Mexico		
		2010F	2011F	2012F	2010F	2011F	2012F
Real GDP	YoY	7.5%	4.0%	4.5%	5.5%	4.8%	3.8%
Final Domestic Demand	YoY	8.3	5.5	5.1	4.4	5.2	4.4
Private Consumption	YoY	7.0	5.5	4.1	5.3	4.7	3.9
Fixed Investment	YoY	21.9	7.3	5.7	2.4	8.7	7.7
Exports	YoY	11.5	9.3	6.4	22.7	15.1	11.1
Imports	YoY	36.2	17.1	9.4	23.1	15.3	11.7
CPI	YoY	5.0	6.4	5.2	4.2	3.9	3.8
Unemployment Rate	%	6.7	6.7	7.2	5.4	4.6	4.8
Current Account	US\$ bn	-47.5	-61.0	-68.0	-5.2	-24.2	-30.2
	% of GDP	-2.3	-2.7	-2.8	-0.5	-2.0	-2.4
Fiscal Balance	% of GDP	-2.6	-2.6	-2.8	-2.7	-2.5	-2.0
US Dollar Exchange Rate	Average	1.76	1.67	1.69	12.6	12.0	12.0

Sources: Haver Analytics and Citi Investment Research and Analysis

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Argentina

Wage negotiations are heating up, with workers demanding adjustments that exceed 30%. We expect wage negotiations to be a source of social unrest in the next months, and to fuel inflation of around 30% this year. On the political front, recent local elections in Catamarca province marked the beginning of a busy electoral calendar that will culminate with the 23 October presidential and legislative elections. The victory of the official candidate — from the Frente Para la Victoria party — in Catamarca was considered evidence of support for President Cristina Fernandez. In this vein, provincial elections will draw increased scrutiny in the months ahead, as they are indicative of the support gathered by contending political parties in main urban centres ahead of the presidential elections.

Venezuela

Although presidential elections should take place on 2 December 2012, the race to occupy Palacio de Miraflores has begun. President Chávez is already positioning and campaigning in an effort to boost his polling numbers. The opposition has also begun discussions about when to schedule primaries in order to elect its presidential candidate. This person would have the big responsibility of keeping unity within its movement, while running against the most important politician that Venezuela has had over the last decade based on favourability surveys: current President Hugo Chávez. In our view, President Chávez and PSUV's election strategy has prompted announcements of additional spending by the government regarding housing and infrastructure projects. These facts led us to increase our GDP forecasts for 2011 and 2012 for which we expect annual prints of 1.0% and 1.6%, respectively. We consider that current oil prices should provide the government with additional funding sources to take control of its finances without having to step on the gas pedal in terms of external debt issuance. Nevertheless, external debt issuance by the government and its oil companies is still expected. We continue to wait for at least US\$5 billion of additional debt issuance this year. US dollar scarcity in the private sector continues in Venezuela, not because of a trade balance issue, as the amount of exports should come in this year higher than imports (we expect a trade surplus of US\$24 billion) but rather due to capital outflows which have been generally increasing over the years.

Figure 44. Argentina and Venezuela — Economic Forecast, 2010-12F

		Argentina			Venezuela		
		2010F	2011F	2012F	2010F	2011F	2012F
Real GDP	YoY	9.2%	6.5%	4.0%	-1.4%	1.0%	1.6%
Final Domestic Demand	YoY	11.6	8.1	4.5	-0.9	0.9	1.5
Private Consumption	YoY	9.0	7.5	4.6	-2.3	2.0	2.5
Fixed Investment	YoY	21.2	8.5	3.6	-4.4	-3.0	-2.0
Exports	YoY	14.6	8.0	5.0	-12.4	3.0	3.5
Imports	YoY	34.0	20.0	8.0	-4.6	1.5	2.1
CPI	YoY	18.4	26.0	32.5	29.1	28.4	27.0
Unemployment Rate	%	9.3	8.1	7.8	6.5	8.8	6.7
Current Account	US\$ bn	3.6	-0.6	3.8	14.4	12.9	12.0
	% of GDP	1.0	-0.1	0.8	6.5	5.4	3.9
Fiscal Balance	% of GDP	-0.8	-0.6	1.0	-6.0	-5.0	-5.0
US Dollar Exchange Rate	Average	3.9	4.1	4.7	3.8	4.4	4.4

Sources: Haver Analytics and Citi Investment Research and Analysis

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Saudi Arabia

The escalation in violence in neighbouring Bahrain, where Saudi troops have been deployed to support the government, is raising concerns in markets that the unrest could spill over into Saudi Arabia, particularly in the eastern provinces where oil production is concentrated. We maintain our view that the risk of widespread unrest in Saudi Arabia, and in the eastern provinces, remains low, and that oil production will be unaffected under most reasonable scenarios. Oil facilities in Saudi Arabia are well guarded and dispersed over an area almost twice the size of the UK. In addition, Saudi maintains a high level of spare capacity, allowing it to divert production should one or two facilities become affected under extreme scenarios. The economic impact on Saudi Arabia from the crisis has been benign, in our view. With our view that oil prices are now likely to average US\$105 in 2011, we have sharply revised upwards our fiscal surplus expectations to 8.5% of GDP. This takes into account an anticipated rise in current expenditure of over 50%, reflecting the measures taken by King Abdullah in the past few weeks and a 10% rise in oil production as Saudi pumps more crude to compensate for the loss of Libyan production. This rise in oil output raises our GDP growth expectations for 2011 to 7.5%, up around 3% from our previous estimate, reflecting the share of oil production in GDP. While comfortably accommodated in the near term, the rise in expenditure raises the fiscal breakeven oil price for Saudi Arabia to over US\$80 per barrel, potentially leaving public finances exposed to any future fall in the oil price.

United Arab Emirates

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The UAE may be a net beneficiary of the political turmoil experienced in other parts of the Middle East. Due to its relative political stability, we believe there is a possibility of diversion of commercial, investor and tourist activity from less stable parts of the region. The external sector is expected to be the main driver of the recovery, with gains in export growth and a reduction in imports. Dubai's economy, in particular, is showing signs of a strong external-led recovery as sectors such as tourism, trade, logistics and transportation respond strongly to the rebound in the global economy. Political instability in regional competitors may give an extra boost. We expect that economic growth in Dubai in 2011 will be almost 5%, rising to over 6% in 2012. In Abu Dhabi, government spending and ongoing megaprojects continue to drive economic activity, although the real estate sector will be a drag on growth for the next 2-3 years, in our view, due to contagion and the substitution effect from Dubai.

Figure 45. Saudi Arabia and United Arab Emirates — Economic Forecast, 2010-12F

		Saudi Arabia			United Arab Emirates		
		2010F	2011F	2012F	2010F	2011F	2012F
Real GDP	YoY	3.8%	7.5%	6.3%	3.6%	3.9%	4.2%
Final Domestic Demand	YoY	-0.8	6.4	7.8	1.5	2.5	3.1
Private Consumption	YoY	2.3	5.0	5.0	1.0	1.0	2.0
Fixed Investment	YoY	-5.6	10.0	10.0	5.0	5.0	5.0
Exports	YoY	5.0	13.0	8.0	10.0	13.0	13.0
Imports	YoY	-8.0	10.0	12.0	10.0	15.0	15.0
CPI	YoY	5.4	8.0	6.0	1.5	2.0	2.4
Current Account	US\$ bn	45.3	45.1	46.1	21.6	9.5	8.4
	% of GDP	11.2	10.2	7.5	7.8	3.2	2.6
Fiscal Balance	% of GDP	6.7	8.5	8.2	0.0	0.0	0.0
US Dollar Exchange Rate	Average	3.8	3.8	3.8	3.7	3.7	3.7

Sources: Haver Analytics and Citi Investment Research and Analysis

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Nigeria

Growth remained strong in Nigeria in 2010, and even if it slows in 1H11 due to rising political tensions, we still expect it to remain robust at 6.8% in 2011. Inflation, however, has also remained firmly in double digits and is likely to remain in double digits for much of 2011, although the high oil price should allow the central bank to maintain naira stability. There already signs that the post-election macroeconomic policy will see a return to more orthodox policies: notably reducing the fiscal deficit while monetary policy becomes more focused on the problem of inflation, rather than the health of the banking system. The elections, meanwhile, are moving closer, with the crucial presidential poll set to be held on 9 April 2011. While the incumbent president, Goodluck Jonathan, of the ruling People's Democratic Party (PDP) is the front runner to win, the main uncertainty is whether he is able to avoid a run-off which would be required if he failed to secure either 50% plus one vote and one-quarter of votes in two-thirds of Nigeria's 36 states.

South Africa

Evidence of a more steady economic recovery has continued to emerge over the past month, and consequently, we retain our forecast for real GDP growth of 3.6-3.75% in 2011-12. Retail sales remained dynamic early in the year, benefitting from ongoing monetary stimulus, while improving business confidence suggests greater corporate willingness to re-stock and boost fixed investment than in 2011. Still, businesses are likely to remain cautious — especially with respect to hiring — and the erosion of real income growth through higher inflation and (eventually) interest rate hikes places limits on a consumer boom. In addition, housing remains in the doldrums, while the strong rand weighs on export competitiveness. Price pressures are gradually building up as food and oil price rises filter through and the impact of rand strengthening gradually wanes. We see CPI up by 5%-plus in late 2011 and nearly 6% by the end of 2012. Commodity price gains should keep the current account deficit moderate in 2011, but it should widen again next year as capital spending recovers and net dividend outflows resume their trend rise. We expect the SARB to start normalising policy rates upwards in late 3Q11, but the pace of tightening afterwards should be relatively gradual. Delayed fiscal consolidation, with the budget deficit unlikely to fall in 2011/12, is another reason for monetary normalisation.

Figure 46. Nigeria and South Africa — Economic Forecast, 2010-12F

		Nigeria			South Africa		
		2010F	2011F	2012F	2010F	2011F	2012F
Real GDP	YoY	7.2%	6.8%	6.5%	2.8%	3.6%	3.8%
Final Domestic Demand	YoY	NA	NA	NA	2.8	3.9	4.2
Private Consumption	YoY	NA	NA	NA	4.4	4.2	3.9
Fixed Investment	YoY	NA	NA	NA	-3.7	2.7	5.3
Exports	YoY	NA	NA	NA	4.7	9.1	7.6
Imports	YoY	NA	NA	NA	9.6	10.2	9.1
CPI	YoY	13.7	11.1	10.1	4.1	4.8	5.6
Unemployment Rate	%	NA	NA	NA	25.5	25.7	25.3
Current Account	US\$ bn	14.2	20.8	22.9	-10.0	-11.3	-22.5
	% of GDP	6.1	7.6	7.1	-2.7	-2.8	-5.6
Fiscal Balance	% of GDP	-4.7	-1.9	-1.2	-5.2	-5.2	-4.8
US Dollar Exchange Rate	Average	151	154	153	7.32	7.23	7.90

Sources: Haver Analytics and Citi Investment Research and Analysis

Figure 47. Selected Emerging Market Countries — Economic Forecast Overview, 2010-12F

	GDP Growth			CPI Inflation			Current Balance (% of GDP)			Fiscal Balance (% of GDP)		
	2010	2011F	2012F	2010	2011F	2012F	2010	2011F	2012F	2010	2011F	2012F
Asia	9.0%	7.7%	7.8%	4.2%	5.1%	4.5%	4.0%	3.1%	2.6%	-2.5%	-2.6%	-2.4%
Bangladesh	6.2	6.7	7.0	7.0	6.0	6.0	1.7	1.1	-0.4	-5.0	-4.7	-4.4
China	10.3	9.2	9.0	3.3	4.6	4.0	5.2	4.6	3.8	-1.6	-2.0	-2.0
Hong Kong	6.8	4.5	5.2	2.4	4.5	3.0	6.6	9.1	10.0	4.1	2.2	3.0
India*	8.6	8.4	8.7	8.6	7.0	6.0	-2.3	-3.0	-2.5	-8.1	-7.9	-7.6
Indonesia	6.1	6.5	6.6	5.1	6.7	6.8	0.9	0.3	-0.2	-0.6	-1.8	-1.6
Korea	6.1	4.3	4.6	3.0	4.0	3.4	2.8	1.0	1.1	-0.3	0.8	1.0
Malaysia	7.2	5.7	6.1	1.7	3.0	3.3	11.8	10.5	9.0	-5.6	-5.5	-5.3
Pakistan	2.5	3.5	5.0	14.7	13.5	12.0	-3.1	-4.7	-4.5	-6.4	-6.1	-5.9
Philippines	7.3	5.5	5.3	3.8	5.0	5.7	6.6	4.6	3.6	-3.7	-3.3	-2.7
Singapore	14.5	5.5	6.0	2.8	4.2	2.8	22.2	16.5	15.0	0.5	0.0	2.0
Sri Lanka	7.5	7.2	7.3	6.0	6.0	5.0	-2.7	-3.6	-3.9	-8.0	-6.8	-5.2
Taiwan	10.8	4.5	5.0	0.9	1.8	2.0	9.4	7.5	8.0	-3.2	-2.0	-1.0
Thailand	7.8	4.2	5.2	3.3	3.5	4.6	4.6	2.8	0.1	-2.0	-2.9	-2.0
Vietnam	6.8	6.7	7.4	9.2	12.9	10.4	-6.8	-6.4	-5.1	-5.9	-5.0	-4.5
Latin America	6.0%	4.4%	4.3%	7.6%	8.4%	7.5%	-1.0%	-1.8%	-1.9%	-2.7%	-2.4%	-2.2%
Argentina	9.2	6.5	4.0	18.4	26.0	32.5	1.0	-0.1	0.8	-0.8	-0.6	1.0
Brazil	7.5	4.0	4.5	5.0	6.4	5.2	-2.3	-2.7	-2.8	-2.6	-2.6	-2.8
Chile	5.2	5.9	5.3	1.4	3.5	3.5	2.0	0.6	-0.4	-0.4	0.5	1.0
Colombia	4.0	4.4	4.7	2.3	3.5	4.0	-2.8	-2.2	-2.1	-3.6	-3.5	-3.2
Ecuador	2.0	3.5	3.5	3.4	2.8	3.0	-4.7	-3.2	0.0	-3.5	-3.2	-3.3
Mexico	5.5	4.8	3.8	4.2	3.9	3.8	-0.5	-2.0	-2.4	-2.7	-2.5	-2.0
Panama	7.5	8.0	7.0	3.5	5.3	5.7	-11.0	-13.0	-11.5	-1.9	-3.0	-2.0
Peru	8.9	7.1	6.5	1.5	2.7	2.9	-1.5	-2.7	-3.3	-0.8	-0.5	-0.6
Uruguay	7.8	5.8	4.7	6.7	7.4	6.6	1.0	0.4	-1.9	-1.2	-1.1	-1.0
Venezuela	-1.4	1.0	1.6	29.1	28.4	27.0	6.5	5.4	3.9	-6.0	-5.0	-5.0
Europe	4.4%	4.1%	4.3%	6.1%	6.7%	6.0%	-0.1%	-0.3%	-2.1%	-4.9%	-3.0%	-3.1%
Czech Republic	2.3	1.9	3.0	1.5	1.9	2.6	-3.7	-3.6	-4.2	-5.3	-4.9	-3.8
Hungary	1.2	2.7	3.5	4.7	3.7	3.4	1.1	0.1	-0.6	-3.8	5.5	-3.3
Kazakhstan	7.0	6.5	5.2	7.1	8.7	6.9	3.4	4.2	1.6	-2.6	-1.9	-2.1
Poland	3.8	4.2	4.5	2.7	3.7	2.8	-3.3	-4.1	-4.9	-8.1	-6.4	-5.2
Romania	-1.3	2.0	4.2	6.1	6.1	3.5	-4.2	-5.1	-5.4	-6.7	-4.5	-3.0
Russia	4.0	4.3	4.1	6.9	8.8	7.3	5.1	4.8	1.7	-4.2	-2.2	-2.2
Slovakia	4.0	3.4	4.3	1.0	3.3	2.7	-3.2	-4.2	-3.5	-7.5	-5.6	-4.5
Turkey	8.2	4.5	5.0	8.6	5.8	6.4	-6.5	-7.5	-7.9	-3.5	-3.2	-3.2
Ukraine	4.2	5.4	4.3	9.4	8.6	9.0	-1.9	-2.2	-4.0	-7.0	-3.3	-4.5
Africa/Mideast	4.8%	5.4%	5.4%	5.3%	6.4%	6.1%	6.1%	5.1%	4.3%	0.4%	0.7%	0.9%
Bahrain	4.0	1.0	6.0	1.5	2.0	3.0	6.3	6.2	6.4	-1.5	-4.2	-5.0
Egypt	5.1	1.4	3.6	11.1	11.9	12.5	-1.7	-5.4	-3.2	-8.5	-11.3	-9.4
Ghana	6.6	11.9	6.9	10.8	8.1	8.7	-11.6	-5.9	-4.5	-6.9	-5.2	-5.6
Israel	4.6	3.7	5.0	2.7	4.1	3.2	3.1	1.7	1.4	-3.0	-2.2	-1.2
Kenya	5.3	6.0	6.5	3.9	8.4	9.0	-6.7	-7.4	-7.3	-6.5	-6.4	-5.9
Kuwait	6.2	4.4	4.7	4.4	4.2	5.0	38.1	38.8	39.1	21.7	18.4	14.1
Lebanon	6.0	4.0	4.3	5.0	3.4	4.0	-8.6	-8.6	-8.4	-9.7	-10.7	-10.4
Nigeria	7.2	6.8	6.5	13.7	11.1	10.1	6.1	7.6	7.1	-4.7	-1.9	-1.2
Oman	4.9	4.4	4.1	3.5	3.5	3.0	2.6	3.4	3.0	-1.6	-1.1	-1.0
Qatar	8.7	13.9	10.0	-2.0	3.0	3.0	17.3	16.5	12.9	15.2	14.9	14.4
Saudi Arabia	3.8	7.5	6.3	5.4	8.0	6.0	11.2	10.2	7.5	6.7	8.5	8.2
South Africa	2.8	3.5	3.7	4.1	4.8	5.6	-2.8	-3.2	-5.5	-5.3	-5.3	-4.9
Tanzania	6.9	7.2	7.6	6.2	8.1	9.3	-8.8	-8.8	-9.1	-6.4	-5.5	-5.0
UAE	3.6	3.9	4.2	1.5	2.0	2.4	7.8	3.2	2.6	0.0	0.0	0.0
Uganda	6.9	7.2	7.6	4.1	9.2	9.5	-6.4	-9.2	-9.7	-4.5	-5.1	-3.9
Zambia	6.7	6.6	6.7	8.5	9.9	9.6	-1.6	5.2	3.0	-3.3	-3.9	-3.5
Total	7.2%	6.2%	6.2%	5.3%	6.2%	5.5%	2.5%	1.7%	1.2%	-2.7%	-2.3%	-2.2%

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

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Source: Citi Investment Research and Analysis.

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Rates Strategy — Bearish View Intact

The events of the past fortnight have shaken the world. The tensions in the Middle East are, in our view, potentially more disruptive now than they have been at any time in the last month or so. This has, however, been overshadowed by the earthquake in Japan. We do not, however, see these events as likely to reverse what we believe to be a now established bear market in bonds. The rally may persist awhile as investors look to reduce risk but we see this as an opportunity to reduce duration. The path to higher yields is unlikely to be a smooth one, particularly while the timing of the reversal of policy cycles is still unclear, but rates must eventually rise as economies recover and the longer they remain depressed in the face of geopolitical upsets, the higher they may eventually have to go.

In our opinion, what we are currently witnessing is a flight-to-quality bid and a re-pricing of an oversold market; our global rate indicator suggested that the bond markets were approximately 35bp oversold at their peak in mid-February. As that has reversed, we have seen key technical levels being broken in a number of markets, which could lead to further falls in yield, but this does not necessarily imply a re-pricing of long-term growth and inflation expectations.

Our fair value indicator for the global rate environment has turned a little lower of late but the divergence between the market and the model is less convincing than it was when we became bearish at the end of last year. At that time, the fundamental drivers of the model were leading the way, now the drop in the fair value rate is almost entirely explained by its sentiment-driven indicators rather than the fundamental macroeconomic variables. It remains to be seen if the actual data follow the sentiment lower; our expectation is that this will not be the case, given the nature of the recent shocks and the underlying policy environment. We therefore think that bond yields could resume their bear trajectory quite quickly, once the immediate concern has subsided.

The second rationale behind our bearish outlook is that, in the case of the UK and the Eurozone at least, we still believe that rate hikes are imminent. Even the Fed seems increasingly hawkish, albeit coming from an extremely dovish starting point. As we have previously observed, it does not require an actual rate hike to significantly steepen the money-market curve and put upwards pressure on the rest of the term structure. This was very much the case in 2003-04 when the money-market curve steepened dramatically as much as a year before the first rate hikes. Simply by holding firm the timing of the first tightening move and shortening the anticipated period of policy rate normalisation, we could see two-year yields rise up to 100bp from current levels over the remainder of the year.

We therefore remain bearish on the US, Euro and UK bond markets and are looking to use this latest flight-to-quality rally to initiate new duration shorts. We accept that there is great uncertainty in the markets right now and that the latest moves to lower yields have turned the short-term technical picture quite bullish, but we do not believe that the multiple years of negative real yields priced into the US and UK curves is sustainable against the backdrop of a steadily improving global economy.

Figure 50. Interest Rate and Bond Market Forecasts (End of Period), as of 23 March 2011

		Forecast End Period					
	Current	2Q 11	3Q 11	4Q 11	1Q 12	2Q 12	3Q 12
US							
Policy Rate (Fed Funds) End Quarter	0.25	0.25	0.25	0.25	0.50	0.75	1.00
3-Month Libor	0.31	0.31	0.35	0.40	0.80	1.10	1.35
2 Year Treasury Yield	0.63	0.70	0.80	1.00	1.50	1.65	1.80
10 Year Treasury Yield	3.30	3.40	3.50	3.60	3.70	3.85	4.00
30 Year Treasury Yield	4.40	4.50	4.60	4.65	4.70	4.75	4.85
2-10 Year Treasury Curve	267	270	270	260	220	220	220
2 Year Swap Spread (Swap Less Govt.), bp	20	20	25	30	35	40	40
10 Year Swap Spread (Swap Less Govt.), bp	11	12	14	16	18	20	20
30 Year Swap Spread (Swap Less Govt.), bp	-23	-24	-30	-35	-40	-45	-50
30 Year Mortgage Yield	4.81	4.80	4.90	5.00	5.15	5.35	5.55
10 Year Breakeven Inflation	240	245	250	245	240	240	240
Euro Area							
Policy Rate	1.00	1.25	1.50	1.50	1.75	2.00	2.25
3-Month Libor	1.17	1.20	1.55	1.65	1.85	2.15	2.35
2 Year Treasury Yield	1.67	1.70	2.00	2.05	2.20	2.45	2.65
10 Year Treasury Yield	3.24	3.40	3.50	3.70	3.80	3.90	4.00
30 Year Treasury Yield	3.69	3.80	3.90	4.00	4.07	4.15	4.25
2-10 Year Treasury Curve	157	170	150	165	160	145	135
10 Year BTP-Bund Spread	147	160	140	125	100	90	85
2 Year Swap Spread (Swap Less Govt.), bp	58	55	50	50	45	45	40
10 Year Swap Spread (Swap Less Govt.), bp	29	30	32	35	37	40	40
30 Year Swap Spread (Swap Less Govt.), bp	7	9	12	15	20	20	20
10 Year Breakeven Inflation	212	225	230	225	225	220	220
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	0.22	0.25	0.25	0.25	0.30	0.35	0.40
10 Year Treasury Yield	1.22	1.40	1.40	1.40	1.60	1.80	1.80
30 Year Treasury Yield	2.18	2.35	2.35	2.35	2.50	2.70	2.70
2-10 Year Treasury Curve	100	115	115	115	130	145	140
2 Year Swap Spread (Swap Less Govt.), bp	16	20	20	20	22	25	25
10 Year Swap Spread (Swap Less Govt.), bp	3	7	7	7	10	12	12
30 Year Swap Spread (Swap Less Govt.), bp	-14	-5	-5	-5	-2	0	0
10 Year Breakeven Inflation	NA	NA	NA	NA	NA	NA	NA
UK							
Policy Rate	0.50	0.75	1.00	1.25	1.50	1.75	2.00
3-Month Libor	0.81	1.00	1.50	1.75	2.00	2.25	2.50
2 Year Treasury Yield	1.23	1.50	1.95	2.15	2.35	2.55	2.75
10 Year Treasury Yield	3.63	3.75	3.95	4.10	4.25	4.35	4.50
30 Year Treasury Yield	4.30	4.45	4.50	4.55	4.57	4.60	4.62
2-10 Year Treasury Curve	240	225	200	195	190	180	175
2 Year Swap Spread (Swap Less Govt.), bp	51	49	46	44	42	39	37
10 Year Swap Spread (Swap Less Govt.), bp	12	17	20	25	27	30	35
30 Year Swap Spread (Swap Less Govt.), bp	-21	-12	-5	0	5	10	15
10 Year Breakeven Inflation	317	330	345	360	365	370	370
Australia							
Policy Rate	4.75	4.75	5.00	5.25	5.25	5.25	5.50
3-Month Libor	4.81	5.00	5.25	5.50	5.60	5.70	5.90
2 Year Treasury Yield	4.79	5.20	5.40	5.60	5.65	5.75	5.90
10 Year Treasury Yield	5.43	5.85	6.00	6.10	6.10	6.30	6.40
2-10 Year Treasury Curve	0.64	0.65	0.60	0.50	0.45	0.55	0.50
10 Year Swap Spread (Swap Less Govt.), bp	52	45	50	50	55	45	50

Source: Citi Investment Research and Analysis

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Credit Outlook — Resilient or Complacent?

In the face of a multitude of negative headlines, credit markets were remarkably resilient for quite some time. Investment grade CDS indices are now well off their tights, but still comfortably within the tighter half of nine-month ranges. Traded bonds have widened as well, but many of the more illiquid bonds have yet to be marked meaningfully wider.

Even now, it's striking how credit *wants* to go tighter — spreads tighten in the absence of news. However, we'd be wary of chasing credit here. Adding up the main factors driving spreads — valuations, positions and our views on fundamentals and news relative to consensus — we continue to see more downside risks than upside supports (see Figure 51)⁶.

Figure 51. The investment matrix

Our views vs consensus - more bearish: -2 to
more bullish: +2

	Fundamental	Technical
Short-term	News -1	Positions -1
Long-term	Leverage 0	Valuation 0

Source: CIRA

Quite simply, we find it hard to see how things can keep getting better from here. The wave of liquidity, which markets have been riding on, is still being administered by the Fed. And much of the economic data, at least coming out of the US, is positive. But that should already be in the price — it's not about where things are; it's about where they're going.

To us there are simply too many negative headlines at the moment to turn bullish: a potentially expensive rethink of energy policies in the wake of the Japan earthquake, an oil price shock, geopolitical risk, signs of corporate releveraging, European sovereign issues, EM inflation and hawkish central banks. The widening in spreads we've now had does make us a little less negative, but taken together, all of the above does not suggest things are improving from the current consensus.

It's not that we are super bearish, but in a range-trading year, our role is to harp on about the risks when spreads are too tight — and about the opportunities when spreads are too wide.

Precariously positioned

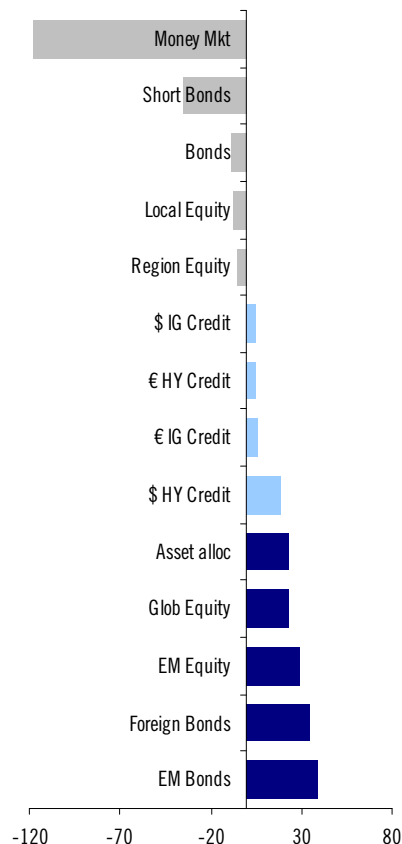
It wouldn't matter so much if we felt the credit market was already conservatively positioned. A couple of months ago, the market was. Not only were periphery positions in Europe very short, but bank sub debt exposure had been cut aggressively and a lot of protection had been bought in the indices. Real money cash levels had accumulated through inflows, redemptions, coupon payments and in Europe through limited supply. With hindsight, the prerequisites for a contrarian rally were in place.

But the rally in January and February has taken out most of those shorts. Our credit survey indicates that real money investors remain very long to history, while inflows into high-grade credit are near their lowest levels in two years (see Figure 52 and Figure 53). As such, we reckon technical support is less well founded than many people commonly perceive — a few weeks of decent supply or a desire to reduce risk among real money investors and things would look quite different.

It's important to put this into the bigger context too. Zero interest rates even two years into the recovery and the lowest yields in decades (recently) have left investors scrambling for returns wherever they can find them.

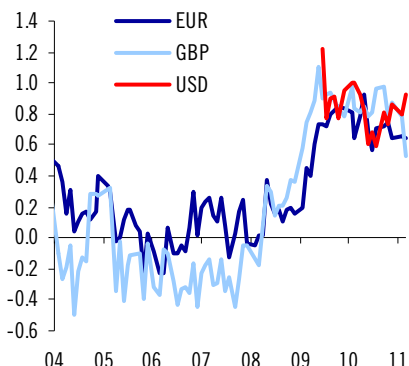
⁶ The figures in the matrix aren't our assessment of whether it is 'good or bad' or 'rich or cheap', but where we stand relative to consensus, so 'better or worse' or 'richer or cheaper'.

Figure 54. European fund net inflows for top- & bottom-5 & selected credit fund types, €bn



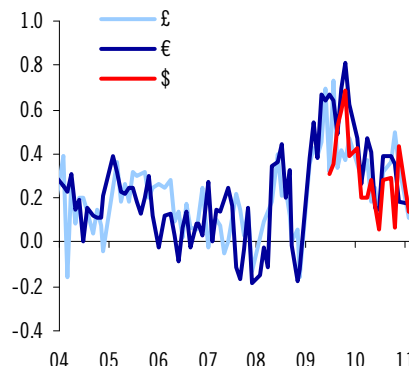
Source: Lipper, CIRA

Figure 52. Positions in credit



Source: Citi Credit Survey. +2: Very long, -2: Very short

Figure 53. Real money inflows into credit



Source: Citi Credit Survey. +2: Large inflows, -2: Large outflows

No wonder investors were selling cash (and money market) assets to buy almost anything else in 2010 (see Figure 54). Although not to the same extent as in 2009, credit was also a big beneficiary — especially in HY. As yields move higher and the upside in credit is reduced, those net inflows are unlikely to be repeated in 2011.

Conclusion

Whether you think this resilience in spreads is benign, and demonstrates that the market will continue to be well supported, or whether you think investors remain complacent says a lot about your world view. We continue to be much closer to the complacency argument.

Of course, there has been plenty of good news too, with the end of another solid earnings season, US employment finally showing signs of improvement and nearly every indicator suggesting the German expansion still has strong momentum.

Yes, we can see the underlying bid in credit remains solid. And granted, it is understandable that people are reluctant to go short/reduce exposure, having been burned several times in the subsequent retracements over the last 12 months.

But to outperform in 2011, we reckon you have to trade the ranges. And we really struggle to see the outlook improving relative to what the market is already assuming in pricing. There are just too many tail risks.

We suspect it will be hard for the market to ignore the challenging backdrop with so many existing longs and would look for better entry points over the coming weeks.

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The earthquake in Japan has been the most recent addition to the list of investor concerns which also include Middle East tensions and the EU sovereign crisis. These concerns have helped global stock markets sell off more recently. However, global equities had risen 24% from last summer's lows and were due a pull-back, in our view. We remain constructive on equity markets and believe stock prices will continue to grind higher from here (see Figure 55). We target 360 for end-2011 on the MSCI AC World (currently at 330). This is in line with our EPS growth projections of 10-15% for 2011 and 2012, following 35-40% in 2010. Our forecasts conservatively assume no re-rating of global equities, so the risks to our targets probably remain on the upside. We would buy into further weakness.

The significance of Japan in the global equity market is less meaningful now than around the Kobe earthquake in January 1995. Japan now accounts for 9% of global GDP, down from 18% around 1995. Meanwhile, Japanese equities make up just 8% of the global benchmark. This compares to 50% in 1989 and 30% around the Kobe earthquake. The closed nature of the Japanese economy means that it is not a big source of direct profits for companies listed elsewhere in the world. We estimate for non-Japanese listed companies, only 2% of total EPS comes from Japan. Clearly the significance of Japan for the global equity investor has faded. This is why we are more inclined to view the current pull-back as more of a buying opportunity.

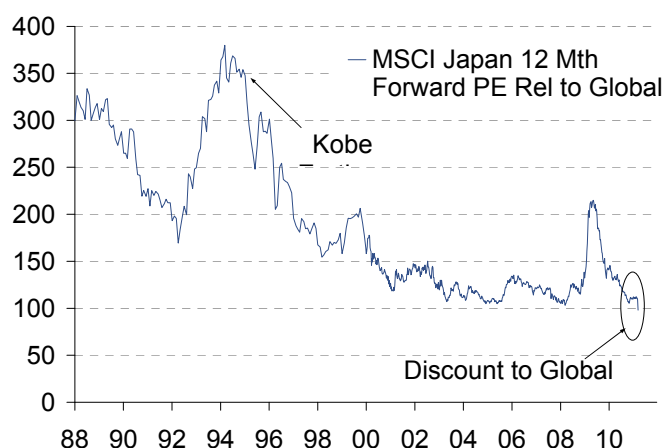
During previous "grind higher" phases, we have seen rallies average 18% and subsequent corrections of about 9%. This time round, global equities rallied 24% from the summer lows. The pullback has been around 7%. But still consistent with the "two steps forward, one step back" markets that we tend to see at this point in the cycle.

Figure 55. MSCI AC World (US\$)



Source: Citi Investment Research and Analysis

Figure 56. Japan 12 Mth Fwd PE Rel to Global PE



Sources: MSCI AC World Index (US\$), CIRA

So we remain constructive on global equities from here. Within the global equity benchmark, we continue to stay Overweight Japanese equities. Japanese stock prices are already down 12% since the earthquake and have underperformed global equities by 10%. Investors have rushed for the exits. It took the Japanese market more than four weeks to underperform by this amount after the Kobe earthquake in January 1995. It has taken four days now. The Kobe

earthquake was followed by material underperformance by the Japanese equity market. In the five months that followed, the MSCI Japan index fell by more than 20% in absolute terms and underperformed the global ex Japan benchmark by 28%.

However, there is a key difference between the situation now versus 1995. Back then, the biggest driver of weak Japanese performance was valuation. Japanese equities were really just starting their 20-year de-rating. At the start of 1995, they were trading on 55x 12-month forward PEs, a 250% premium to the Global benchmark. We acknowledge current PE valuations are pre any EPS downgrades, but the region now trades at a small discount. It is the first 12-month forward discount we have data for (Figure 56).

We think that the immediate reaction of the Japanese equity market is overdone. Low valuations and the prospect for future recovery means that we stay Overweight Japanese equities, which remain our preferred cyclical play. Our key regional and global sector recommendations are summarised in Figure 57.

Emerging Markets remain our preferred structural growth play. With EM prices recently underperforming, but earnings expectations remaining stable, there has been a sizable de-rating. Valuation is less likely to be a headwind for EM stock prices from here as it was 3-6 months ago.

Decent earnings and reasonable valuations mean that we are also Overweight the UK. We are Neutral the US market. Earnings momentum is improving, although we believe valuations here are high. Europe ex-UK is our key Underweight due to its worsening EPS outlook. We would be reluctant to chase the rally here. Developed Asia remains Underweight given higher valuations and less competitive earnings growth prospects.

Our belief in the ongoing global EPS recovery means that our sector strategy still has a cyclical tilt. We think it is too early to give up on the recovery trade. Our Overweights (Consumer Disc, Materials, Industrials) should benefit from a continued, if muted, recovery in the global economy. Our Underweights now look more mixed. We are Underweight Financials given lacklustre earnings momentum and ongoing, dilutive equitisation. Energy earnings momentum is disappointing. The sector is also overweight mega-caps. Utilities remains our least preferred classic defensive.

Figure 57. Regional And Global Sector Recommendations

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

Source: CIRA

Securitized Products Strategy

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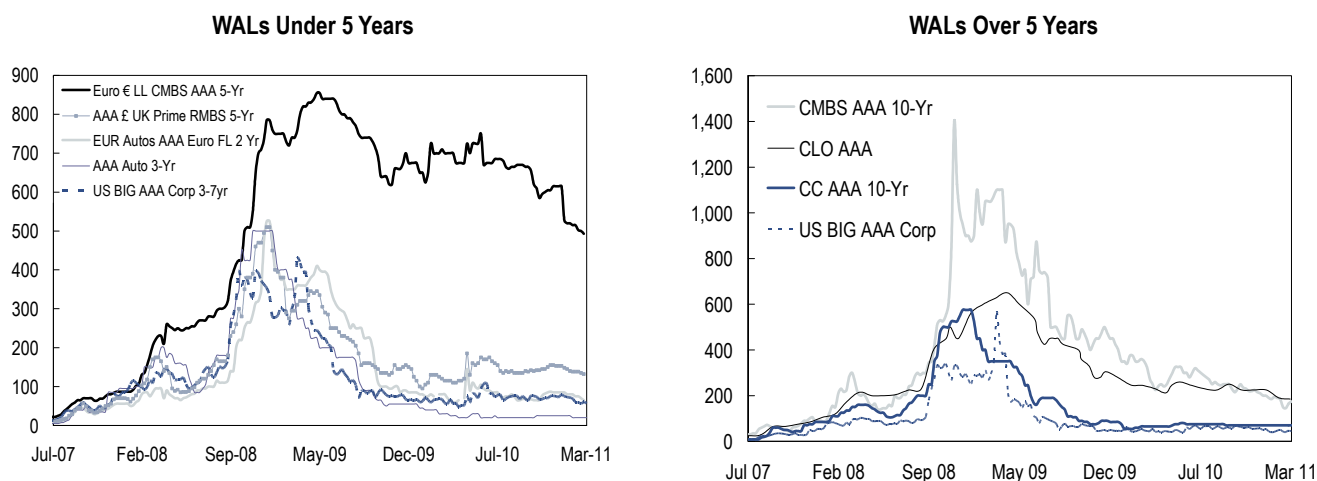
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Holding ground in volatile market periods and profiting from selective spread tightening potential are the ingredients to outperforming in securitized products in the coming months, in our view. Geopolitical volatility certainly took its toll on spread performance over the past few weeks. CMBS duper spreads, for example, widened 25bp over the past three weeks. Similarly, CMBS new issuance priced to wider spreads compared to both initial guidance and new deals priced earlier in the year. Still, some sectors, such as US CABS, are actually, impressively, largely shrugging off the recent market tremors.

Despite the volatility, our fundamental stance remains unchanged. We continue to expect securitized markets to sustain their good performance in the medium term. With that, we would view periods of geopolitical-induced volatility as an opportunity to selectively add exposure.

Figure 58. Selected Securitized Products Sectors — Spread Performance, July 07-Mar 11



Source: Citi Investment Research and Analysis

Geopolitical Volatility Counteracted With Brightening US Economic Outlook

A brightening US economic outlook overshadowed the impact of the Middle East turmoil and the recurring worries about oil supplies. Our economists opine that the snapback in February employment validates earlier judgments that bad weather disrupted economic activity in January.⁷ Another strong household employment gain, broad-based industry job gains and accelerating declines in layoffs suggest a more fundamental strengthening in labor markets. The prospect of further employment strengthening bodes well for securitized markets credit performance and spread outlook.

In a similarly positive vein, the slowing in consumer spending at the start of the year probably reflected a pause after a strong year end as well as the effects of higher energy costs. Surprising strength in vehicle sales in February, along with an apparent pick-up in retailing, is more consistent with the medium-term outlook. Revivals in leasing activity and strong auto ABS

⁷ See "Comments on Credit – Grounds for Optimism," CIRA, 4 March 2011

markets have also helped vehicle sales to increase. Overall, our economists conclude that the full sweep of better data and the growing perception that downside risks may be receding, especially on inflation, ought to be acknowledged as an important checkpoint in the outlook.

High-Quality Short Positions and Attractive Risk-Adjusted Returns on Longer Duration — Strategic Sector Top Picks

Against this economic backdrop, and as the market's search for yield continues, securitized products should continue to offer both reasonable pick-ups for short-duration high-quality benchmarks (US CABS in particular) and attractive risk-adjusted returns on riskier sectors (credit CMBS and non-agency RMBS, for example). Our consumer ABS strategists reiterate their market weight consumer ABS index recommendation. They also recommend overweighting selective off-the-run triple-A and generic subordinate ABS sectors. In CMBS, our strategists maintain their constructive view on later-vintage dupers, seasoned-vintage AMs and CMBS 2.0. In Europe, the team's top picks are CMBS, UK BTL, UK prime RMBS, credit cards and autos.

Geopolitics Sidelines Regulation, Likely not for Long

Risk retention rules are likely to emerge soon but may miss the 17 April deadline

Regulatory changes affecting securitized markets are likely again to grab headlines in the coming weeks. Indeed, with the focus on the shaking ground in the Middle East, the impact of the humming rulemaking process in Washington recently took a somewhat backseat. But there are growing indications that regulators are getting closer to releasing the much-anticipated risk retention regulations. This should refocus the market attention on regulatory issues. It appears, however, that regulators are unlikely to meet the 17 April deadline for actually adopting the final risk retention regulations.

The effort to implement covered bond legislation in the US has also gained renewed momentum. The US Covered Bond Act of 2011 was introduced in the House of Representatives on 8 March. A hearing on covered bonds was held on 11 March in the House Committee on Financial Services.

Sector Relative Value and Allocation Recommendations

Our securitized products strategists have mixed views on the market, ranging from bullish to neutral, and Figure 59 shows Citi's strategists' recommendations for major structured products sectors on a scale of -3 (maximally bearish) to +3 (maximally bullish). The table also incorporates the strategists' most current thinking about value and presents one or two trade ideas.

Figure 59. Sector Relative Value and Asset Allocation Recommendations — Selected Sectors, March 2011

Sector	Strategist Recommendation	Spreads Relative to Long-Term Averages	Comments
CABS	0	Fair	Remain market weighted. To outperform, we suggest buying subordinate credit cards and autos. We also like certain off-the-run senior sectors, including dealer floorplan, private label credit card, equipment, auto lease and first cash flow private student loans.
CMBS	+1	Cheap	Favourable supply technicals should persist through at least the first half of 2011. Generic dupers should tighten 30–50bp from the year-end level of 200bp. The AM/duper and AJ/AM differentials, which remain very wide to comparable corporate differentials, should compress further in 2011.
CLO	+1	Cheap	Despite the significant tightening seen in 2010, there is still room for CLOs to rally more. Many new buyers have entered the market accompanied by upgrades from both ratings agency.
Agency MBS	0	Fair	We remain neutral on the MBS basis. Policy risk remains our major concern for MBS, and we continue to favour intra-sector trades. We recommend long Ginnie IIs over Ginnie IIs in 4.5s and 5.0s and long 30-YR MBS versus 15-YR, DV01 neutral, 2s10s curve hedge.

Source: Citi Investment Research and Analysis

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

Citi Commodities Outlook and Price Forecasts

Market Commentary

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

** For specific trade ideas associated with this sector review, please contact the contributors listed at the back of this section

This section is a summary of the March issue of our Citi Commodity Price Forecasts (published on 15 March). These monthly forecasts are a joint venture between different groups at Citi, including commodities, equities, global macro strategy and futures research.

- Tension in MENA, the EMU periphery crisis and concerns about the impact of the Japan earthquake are likely to lead to a further leg up in risk aversion and, hence, a correction in most commodity prices in the near term. However, we are still constructive about the medium-term outlook as we think the global economy, especially the emerging world, should be able to weather the negative impact of these shocks.
- Crude oil prices are likely to ease from recent highs, but to remain elevated given the potential for more supply disruption even if OPEC uses its 5.2mbd spare capacity to mitigate price pressures. We see WTI prices at \$100/bl and \$95/bl and Brent prices at \$110/bl and \$100/bl in 0-3m and 6-12m, respectively. Note that large deviations from these levels are likely as uncertainty from MENA has increased.
- Our US natural gas forecast is for a gradual increase in prices over the forecast horizon, as we expect the declines in the US onshore natural gas rig count to continue, eventually causing output to top out late this year and to begin a downward trend thereafter.
- The near-term pull-back in base metals that we anticipated last month has materialised. However, we see base metals trading water in the short term, as high oil prices, the earthquake in Japan, and tighter monetary policy in China and Western Europe take some heat out of the market. The recent record highs could be revisited in H2 provided oil prices move back below \$100/bl and the Chinese do not tighten excessively.
- Gold prices are likely to reach \$1450/oz in 0-3m and \$1550/oz in 6-12m, supported by ongoing macro risks, mainly MENA social unrest and the EMU sovereign crisis. A weaker USD should also support prices medium term. We see less upside for silver as the gold/silver ratio is historically low.
- We retain our bullish outlook for the bulk commodities. We have increased our forecast of the iron ore 0-3m spot price to \$190/t. In coking coal, we remain confident that 2Q11 contract prices will be settled around \$325/t. We maintain our forecast of the thermal coal price for JFY 2011-12 at \$130/t FOB.
- Tight US corn inventories should drive prices higher over the next few months to about \$7.0, unchanged from our previous forecast. Wheat prices failed to recover from mid-February losses, but are slated to rebound back to \$8.25 in 0-3m on unfavourable US weather.

- Soybean prices are expected to trade sideways near term, but we expect higher prices in 6-12m as strong Chinese demand and lower US soybean acreage will encourage markets to add a relatively large weather risk premium. For soybean oil prices, we are constructive medium term due to robust demand for biodiesel and rapidly falling US soybean oil stocks.

These forecasts are a joint venture between Citi's commodities, equities, global macro strategy and futures research groups. 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 prices of the commodities covered, individual analysts within various teams may offer separate trade ideas in spot, options or futures when this seems appropriate for technical, tactical or strategic reasons. These groups may also offer in depth demand and supply analyses periodically.

Figure 60. Citi Commodity Price Forecasts

		Market data			Forecasts			Returns vs Fwd*	
		spot	3m Fwd	12m Fwd	0-3 mos	6-12 mos	5 years	3 mos rtn	12 mos rtn
Energy									
WTI Crude	USD/bl	101.2	101.3	102.0	100.0	95.0	90.0	-1.3%	-6.8%
Brent Crude	USD/bl	113.6	112.3	111.6	110.0	100.0	90.0	-2.0%	-10.4%
NYMEX Natural Gas**	USD/mmBtu	3.89	4.01	4.64	4.10	4.50	5.50	2.2%	-2.9%
Base Metals									
LME Aluminium	USD/mt	2525	2545	2622	2550	2650	2500	0.2%	1.1%
LME Copper	USD/mt	9173	9110	9205	9000	10000	6600	-1.2%	8.6%
LME Lead	USD/mt	2534	2505	2479	2500	2600	1850	-0.2%	4.9%
LME Nickel	USD/mt	25800	25675	25300	26000	30000	16250	1.3%	18.6%
LME Tin	USD/mt	29863	29680	29815	29000	32000	17000	-2.3%	7.3%
LME Zinc	USD/mt	2302	2315	2377	2300	2500	2000	-0.6%	5.2%
Precious Metals									
Gold	USD/oz	1416	1417	1436	1450	1550	900	2.3%	7.9%
Silver	USD/oz	35.3	35.2	35.8	34.0	35.0	16.0	-3.5%	-2.1%
Bulk Commodities									
Contract prices***:									
Hard Coking Coal (benchmark Asia)	USD/t	225**	n/a	n/a	325	300	200	n/a	n/a
Thermal Coal (benchmark Asia, FOB)	USD/t	95**	n/a	n/a	130	130	90	n/a	n/a
Iron Ore Fines (Brockman, FOB)	USD/t	137**	n/a	n/a	182	172	68	n/a	n/a
Iron Ore Spot (TSI)	USD/t	166	147	142	190	180	80	29.6%	27.2%
Agriculture									
CME Corn****	USDC/bu	666	672	585	700	625	500	4.2%	6.9%
CME Wheat****	USDC/bu	720	753	830	825	850	600	9.6%	2.4%
CME Soybeans****	USDC/bu	1341	1349	1289	1400	1500	1350	3.8%	16.4%
CME Soybean Oil****	USDC/lb	55.6	56.2	56.0	60.0	62.0	60.0	6.8%	10.7%
Freight									
Baltic Dry Index		1559	n/a	n/a	1950	1850	1900	n/a	n/a
Capesize Rates	USD/day	10845	15161	17075	16000	18500	21000	5.5%	8.3%
Panamax Rates	USD/day	17070	16841	14269	18000	15000	15000	6.9%	5.1%

* Returns are relative to forwards

** Natural Gas: to avoid seasonality, the 3m fwd shown is the average of NG1 to NG3 and the 12m fwd shown is the average of NG7 to NG12

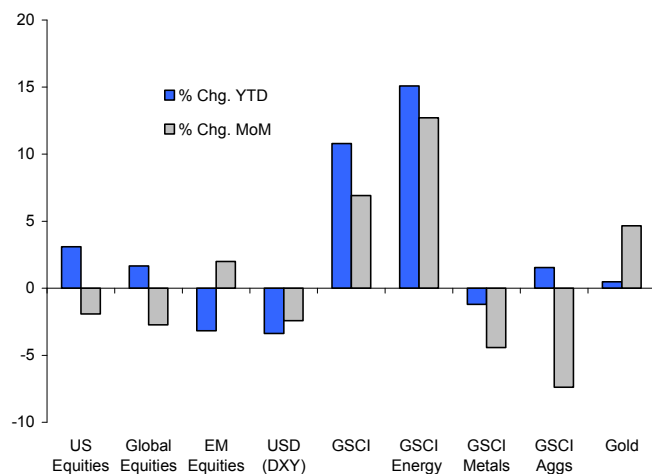
***Iron ore and coking coal are quarterly contracts. Thermal coal is an annual contract based on the Japanese financial year.

****We use front contract prices for the agricultural commodities, instead of spot (cash) prices. Forecasts refer to those front contracts

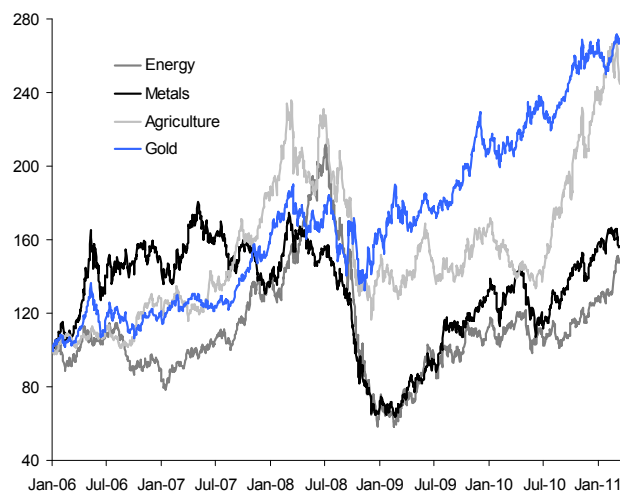
Source: Citi Investment Research and Analysis

Commodity prices rose 8% over the last month (and are up 12% YTD), having rallied by 20% in 2010, according to the S&P GSCI Spot (Figure 61 and Figure 62). Movements in commodity prices are mainly driven by current and expected supply and demand balances, financial flows into different commodity complexes and the global macroeconomic outlook. In the text that follows we discuss the likely influence of these factors on the future path of commodity prices over the short term (0-3 months), the medium term (6-12 months) and the long term (5 years out). We start the discussion with the macroeconomic outlook.

Figure 61. Market Movements: Equity Prices, Commodity Prices and the USD **Figure 62. GSCI Commodity Indices and Gold Prices**



Source: Citi and Bloomberg

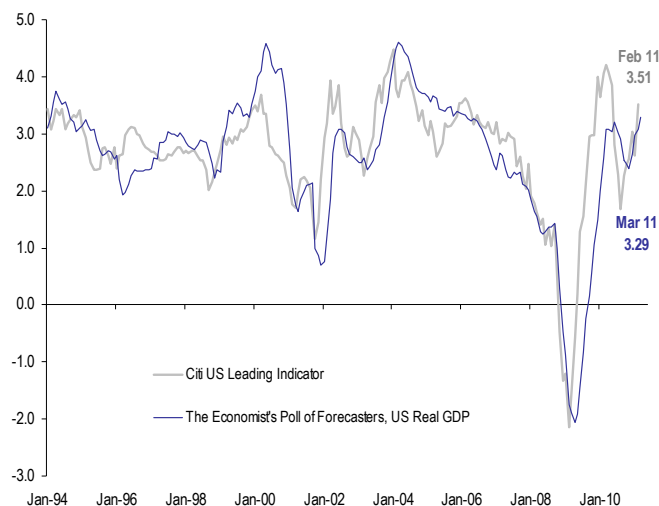


Source: Citi Investment Research and Analysis

The global economy is facing two large macroeconomic shocks: (i) higher oil prices as a result of social unrest in the MENA region; and (ii) the ongoing EMU periphery sovereign crisis. More recently, the earthquake in Japan is adding to negative market sentiment. Risk assets are showing further signs of weakness, with many starting to fall following earlier consolidation patterns. However, the strong performance of many risky asset markets, including commodities, YTD is still at odds with the potential negative impact of these macro shocks.

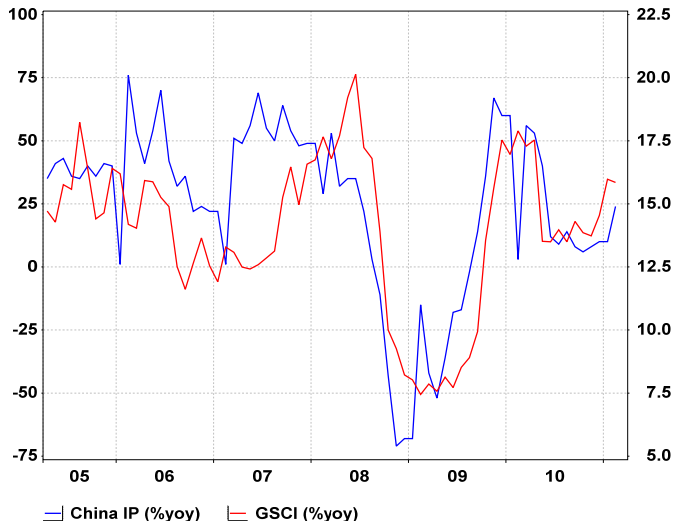
If the shocks from MENA and the European periphery are likely to linger, why have markets been so resilient? We think a key factor supporting the latest risk rally is the string of positive data in the US. This is evidenced by our US leading indicator of consensus growth forecasts which has risen to 3.5% in February, compared with 1.8% in Europe (Figure 63). Other indicators, such as Citi's economic surprise index for the US (at its highest for almost 10 years), confirm the cyclical momentum of the US economy.

Figure 63. US Leading Indicator of Consensus Growth Forecasts (%)



Source: Citi and Bloomberg

Figure 64. Chinese Industrial Production and Commodity Prices (%yoy)



Source: Reuters Ecowin

So far the key balancing act continues to be the level of oil prices. The surge in oil prices has occurred against a backdrop where inflationary pressures were already rising in the EM world due to the sharp rise in food prices. Chinese inflation data for February, for example, remained at 4.9% (yoy) and industrial production growth picked up to almost 15% (Figure 64).⁸ So investors are concerned about monetary tightening and its potential impact on EM growth. The oil shock also has the potential to slow the recovery in DM, and therefore (partially) reverse rising growth expectations which helped spur the risk rally since December.

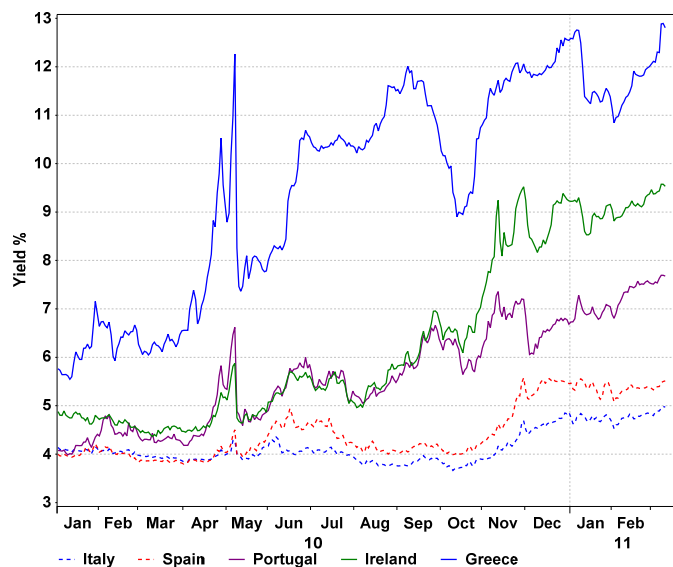
Overall, markets are just starting to wake up to the latent macro risks mentioned above following several weeks of complacency. Event risk is high around both the MENA and periphery crises. EMU periphery yields continue to drift higher, but markets are waiting for key meetings of European leaders for decisive direction (Figure 65). And the MENA crisis is likely to last for long even though we might see periods of relative calm. The news of an earthquake hitting Japan, possibly the biggest in a century, only adds fuel to the fire. Yet implied volatilities have been very low across a range of asset classes even if they have started to move higher in some cases.

Our bias is for oil prices to remain elevated (Figure 66), but to ease from the early March highs going forward, especially if there is a pause in the social tension in MENA or if OPEC (mainly Saudi) ramps up oil production. But the jury is still out there for oil prices, meaning that uncertainty around our forecasts is very high this month. Oil price uncertainty, together with the EMU periphery crisis and concerns about the impact of the Japan earthquake, are likely to lead to a further leg up in risk aversion. In this context, our bias is for a short-term correction in most commodity prices. However, we are still constructive about the medium-term outlook for commodities as we think the global recovery, especially in EM, should be able to weather the negative impact of these shocks.

⁸ Retail sales growth (yoy) fell to 11.6% from 19% in January, to some extent reflecting policy tightening and higher inflation. But the series does have occasional blips, so we would not interpret the size of the move as pure cyclical weakness.

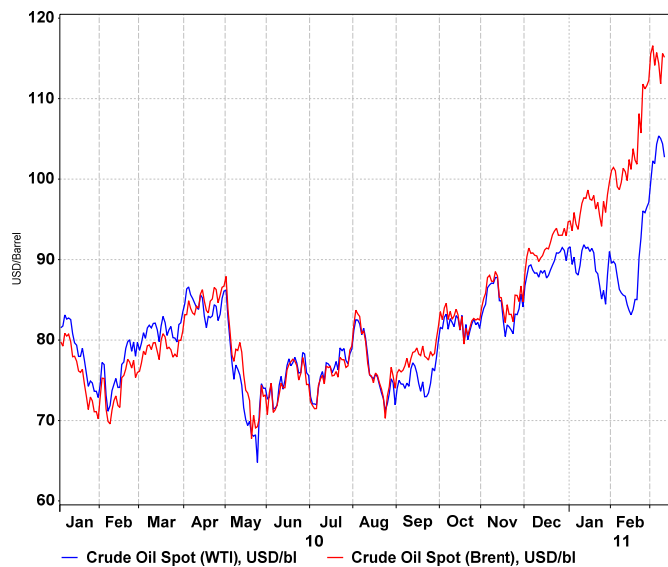
A weak USD over the medium term, given a high current account deficit in the US, diversification of USD holdings by central banks and renewed outflows into EM, also bode well for the medium-term outlook for commodities. However, the near-term outlook for the USD is less clear. The USD has typically weakened when oil prices soar. But in the current environment, we cannot rule out short-term USD strength, especially if higher risk aversion leads to a flight to USD liquidity.

Figure 65. EMU Periphery Yields (%)



Source: Reuters Ecowin

Figure 66. Crude Oil Prices



Source: Reuters Ecowin

Base metals are likely to experience near-term pull-backs, given worries about global growth and waning risk appetite. However, we continue to expect medium-term upside for most base metals given strong EM physical demand and buoyant investor demand. Precious metals should be the beneficiaries in the current environment as safe haven demand is likely to be a short- and medium-term support.

Finally, we expect further upside for grains prices over the short term. Corn prices should be supported by tight US corn inventories, while wheat prices should strengthen due to unfavourable US weather. We are still constructive on the outlook for the bulk commodities, with thermal and coking coal prices still supported by the lingering effect of the floods in Eastern Australia. Finally, the iron ore market is likely to benefit from strong Chinese demand which comes at a time when supply-side disruptions continue to hit the market.

Contributors

**** Citi Commodity Price Forecasts** is a joint venture between Citi's commodities, equities, global macro strategy and futures research groups. The analysts listed below have contributed to these forecasts in one form or another.

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Source: Citi Investment Research and Analysis

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Citi Foreign Exchange Forecasts

Market Commentary

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

** For specific trade ideas associated with this sector review, please contact the contribute

- Short-term USD gains are possible on position unwinds and medium-term ones if a new HIA emerges. Otherwise, USD rallies will likely be short-lived.
- High beta currencies could be further set back over the next month or so as adverse shocks impact risk appetite but we still see AUD as the G10's best performer over 12 months. GBP should also do well on economic re-balancing and higher rates.
- A more hawkish ECB may continue to offset ongoing periphery sovereign concerns allowing EUR/USD to rise to over 1.45 over 6-12 months.
- In the emerging world, we expect limited gains versus forwards in the near term as risk aversion mitigates fundamental appreciation pressures. But we continue to expect broad appreciation vs. forwards in 6-12m given high carry, strong macro fundamentals and, for some, high commodity prices
- In EM Asia, CNY appreciation in the near term may be less aggressive than previously anticipated, but still necessary to help contain rising inflation. This should support currency appreciation in EM Asia over the medium term.
- In CEEMEA and Latam, we expect a mixed performance versus forwards near term. Over the medium term, we like PLN and TRY, and in Latam we favour BRL relative to forwards.

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

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

Figure 68. Citi Foreign Exchange Forecasts

		Market data			Forecasts			Returns**	
		spot	3m Fwd	12m Fwd	0-3 mos	6-12 mos	long-term	3 mos rtn	12 mos
G10									
Euro	EURUSD	1.42	1.41	1.40	1.40	1.45	1.38	-0.9%	3.
Japanese yen	USDJPY	81	81	81	78	87	87	-3.9%	7.
British Pound	GBPUSD	1.62	1.62	1.61	1.61	1.73	1.75	-0.8%	7.
Swiss Franc	USDCHF	0.91	0.91	0.90	0.91	0.94	1.01	0.1%	3.
Australian Dollar	AUDUSD	1.00	0.99	0.96	0.97	1.06	0.86	-2.2%	10.
New Zealand Dollar	NZDUSD	0.73	0.73	0.72	0.72	0.73	0.63	-1.2%	1.
Canadian Dollar	USDCAD	0.98	0.98	0.99	0.99	0.95	0.95	0.9%	-4.
Dollar Index*	DXY	75.69	75.79	76.24	75.98	74.56	76.98	0.2%	-2.
G10 Crosses									
Japanese yen	EURJPY	115	115	113	109	126	120	-4.8%	11.
Swiss Franc	EURCHF	1.28	1.28	1.27	1.27	1.36	1.40	-0.8%	7.
British Pound	EURGBP	0.87	0.87	0.87	0.87	0.84	0.79	-0.1%	-3.
Swedish Krona	EURSEK	8.87	8.90	9.00	8.95	8.70	8.70	0.5%	-3.
Norwegian Krone	EURNOK	7.88	7.91	7.99	7.80	7.70	7.70	-1.4%	-3.
Norwegian Krone	NOKSEK	1.13	1.13	1.13	1.15	1.13	1.13	1.9%	0.
Australian Dollar	AUDNZD	1.37	1.36	1.34	1.35	1.45	1.37	-1.0%	8.
Australian Dollar	AUDJPY	81	81	78	76	92	75	-6.0%	19.
Asia									
Chinese Renminbi	USDCNY	6.56	6.53	6.44	6.43	6.20	5.95	-1.6%	-3.
Hong Kong Dollar	USDHKD	7.80	7.79	7.78	7.76	7.75	7.75	-0.4%	-0.
Indonesian Rupiah	USDIDR	8733	8815	9222	8850	8700	8600	0.4%	-5.
Indian Rupee	USDINR	45.1	45.9	48.0	46.3	45.5	44.0	0.7%	-5.
Korean Won	USDKRW	1125	1131	1148	1130	1050	1000	-0.1%	-8.
Malaysian Ringgit	USDMYR	3.04	3.06	3.11	3.05	2.90	2.85	-0.4%	-6.
Philippine Peso	USDPHP	43.5	43.7	43.9	44.0	42.8	41.8	0.8%	-2.
Singapore Dollar	USDSGD	1.27	1.27	1.27	1.28	1.21	1.20	0.9%	-4.
Thai Baht	USDTHB	30.3	30.4	30.7	30.3	29.9	29.5	-0.4%	-2.
Taiwan Dollar	USDTWD	29.6	29.3	28.7	29.5	28.5	28.8	0.7%	-0.
EMEA									
Czech Koruna	EURCZK	24.4	24.4	24.4	24.5	23.6	23.3	0.4%	-3.
Hungarian Forint	EURHUF	271	274	282	270	273	278	-1.5%	-3.
Polish Zloty	EURPLN	4.05	4.07	4.13	4.05	3.95	3.60	-0.6%	-4.
Israeli Shekel	USDILS	3.53	3.55	3.58	3.50	3.50	3.40	-1.3%	-2.
Russian Ruble	USDRUB	28.3	28.6	29.4	27.8	28.7	30.3	-2.7%	-2.
Russian Ruble Basket		33.6	33.9	34.8	32.8	34.5	35.5	-3.2%	-0.
Turkish Lira	USDTRY	1.58	1.60	1.69	1.62	1.60	1.66	1.1%	-5.
South African Rand	USDZAR	6.97	7.06	7.37	7.20	7.50	8.50	1.9%	1.
LATAM									
Brazilian Real	USDBRL	1.67	1.70	1.82	1.67	1.67	1.70	-1.9%	-8.
Chilean Peso	USDCLP	481	486	499	490	480	485	0.9%	-3.
Mexican Peso	USDMXN	12.0	12.1	12.5	12.1	11.8	12.2	-0.2%	-5.
Colombian Peso	USDCOP	1874	1870	1885	1850	1850	1900	-1.1%	-1.

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

** Returns are relative to forwards

Source: Citi Investment Research and Analysis

Overview

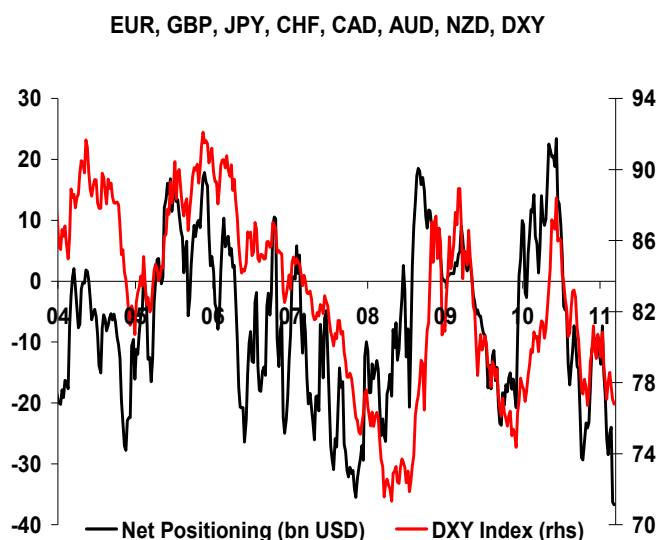
The bear market in the USD seems intact, notwithstanding some wobbles in the USD/JPY rate with first the Japan earthquake and then intervention. Also, high beta currencies in general have been set back a bit as a series of adverse shocks have been coursing through the markets. These include political turmoil in MENA countries, higher food and oil prices and, of course, the Japan earthquake.

We think risk appetite may remain impaired for a while given these, and other, adverse developments and this may result in temporary further weakness in high beta currencies and underlying strength in JPY. However, over the long term, we expect USD weakness and strength in AUD and GBP in the G10 arena. In EM, relative to forwards, we forecast most upside in BRL and KRW with MYR close behind.

The main drivers for this expected USD trend are: (i) a widening/still large current account deficit; (ii) a resumption of the structural outflow of risk capital to other, especially EM, asset markets; and (iii) continued diversification of reserve flows by central banks who are overweight USD (Figure 70).

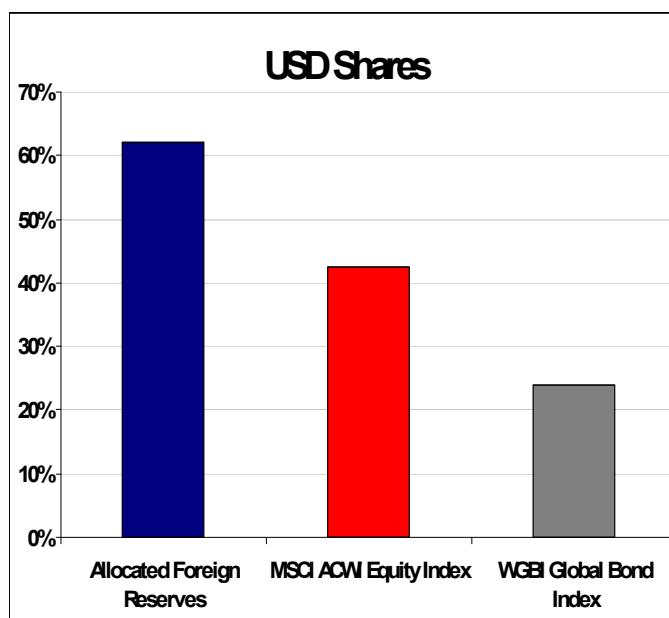
Short-term USD rallies are always possible given how short speculative positioning is (Figure 69). A more serious medium-term risk is a new Homeland Investment Act to allow repatriation of profits to the US at favourable tax rates. Absent something like this, however, our bias is for longer-term investors to sell into rallies in the current environment.

Figure 69. CFTC Data Suggest Short-Term Investors Are Very Short USD...



Sources: CFTC and Bloomberg

Figure 70.But Medium-Term Reserve Managers Remain Long USD...



Source: Bloomberg

G10 Exchange Rates

EUR/USD — Upside risks unless core economies slow

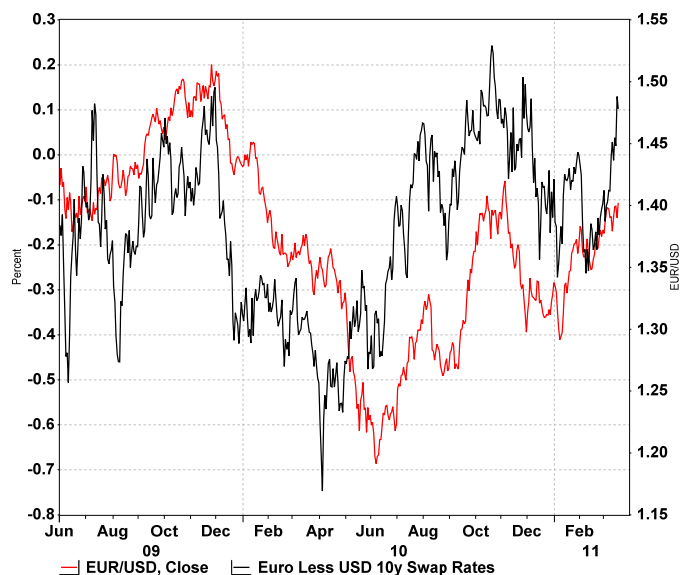
EUR/USD has appreciated relatively sharply recently, to almost 1.42, despite ongoing EMU strains and the underperformance of European stocks in a general risk sell-off. Over the past couple of years, investors have got used to an inverse relationship between risk and the USD. Risk sell-offs would often produce USD rallies. This has recently not been the case. We think this is because an older trend is at work. This is that when oil prices rise, the USD falls. In recent times, easy money has tended to be the common driver of higher equities, higher commodities and a weaker USD/ stronger EUR. Now, however, higher oil prices are arguably leading to lower stocks and the USD has revealed something of a preference to fall, at least vs. EUR. Figure 71 shows that oil prices have been correlated positively with EUR/USD. Two reasons are likely. First, oil producers diversify reserves to EUR from USD as revenues rise. Second, the ECB tends to become more hawkish earlier than the Fed when oil prices rise. Indeed Figure 72 shows term yield differentials are also playing a role in driving EUR/USD higher.

Figure 71. EUR/USD vs. Crude Oil Spot Prices



Source: Reuters Ecowin

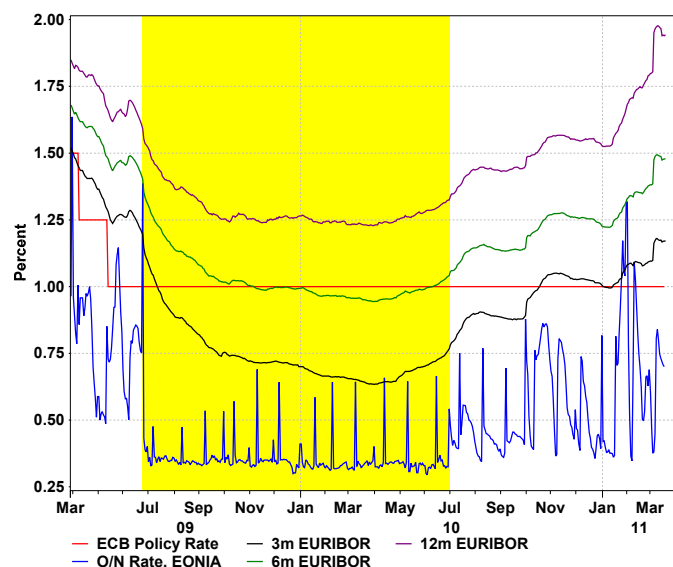
Figure 72. EUR/USD vs. EUR Less US 10y swap Rate Spreads



Source: Citi and Bloomberg

Speculation that the ECB would reverse its pre-announced rate hike for April in the face of recent events was quashed by the hawkish comments of President Trichet on 18 March. Thus it seems that a rate hike is coming and Citi expects a further two hikes over a one-year period, broadly in line with market pricing. The key to the impact this all has on the EUR will be the performance of the economies of core countries. Higher rates will likely hit indebted periphery countries harder (Spain and Ireland have a high proportion of variable rate mortgages) but it will be core performance that matters. If Germany and co. hold up, the rate hikes should stick and EUR strength be maintained. This is our core view for now and we forecast 1.45 over 6-12 months.

Figure 73. EUR Money Market Rates



Source: Reuters EcoWin

Figure 74. EUR/USD vs. EUR Less US 2y Swap Rate Differentials



Source: Reuters EcoWin

Yen — USD/JPY lower near term absent intervention

JPY is clearly in the market spotlight. The consensus view is to expect JPY weakness over the medium term, perhaps over 6-12 months, driven by easy BoJ policy, fiscal concerns made worse by the disaster and, possibly, accelerated corporate FDI outflows. Broadly speaking, we concur with this outlook.

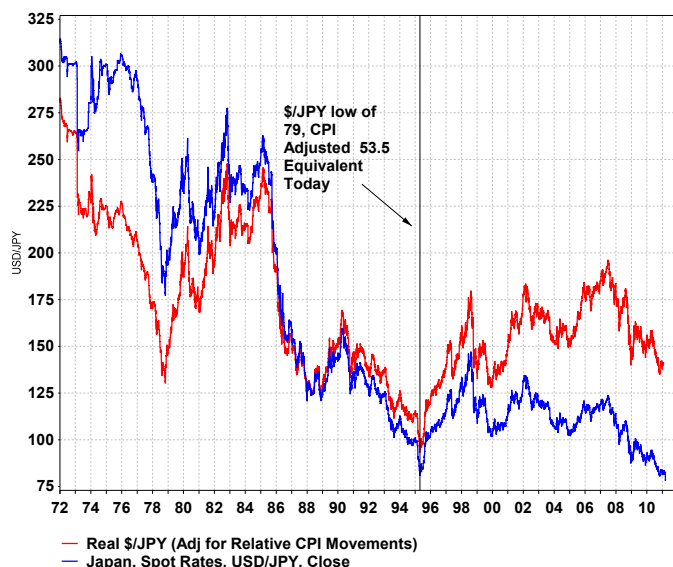
For JPY bulls, it is the likely repatriation of foreign assets (and anticipation of the same) that could still yet drive the JPY higher. Japan's post disaster reconstruction will take funding but fiscal accounts are already stretched with the fiscal deficit at 7.5% of GDP and net government debt at 120% of GDP. This suggests that using foreign assets may make sense where possible. It is not clear to us why selling local assets is more patriotic for Japanese institutions than selling overseas assets at this point. In addition, the recent (absolute and relative) fall in Japanese stocks will have automatically raised the share of foreign assets in Japanese institutional portfolios. To keep these proportions stable, Japanese investors need to sell some foreign holdings. Maybe the recent official FX intervention helps facilitate this.

One caveat is that, in the past, we have pointed out that the steep US yield curve, and low USD LIBOR rate, makes hedged bond investments attractive for Japanese investors. We have seen this as something that has explained previous JPY strength. Now, however, it may limit JPY strength as UST sales and USD short hedges are unwound at the same time.

On the issue of official intervention. We are not sure why other policymakers are selling JPY here apart from in sympathy for Japan and possibly as a way to stabilise risk sentiment. Absent such intervention, we think the short-term outlook would be for USD/JPY to move lower as in 1995, after the Kobe quake. After all, policy rates cannot be cut now (though extra QE has been announced), JGB yields cannot fall 200bp like last time and, crucially, the real USD/JPY exchange rate is about 20% higher now than before Kobe (Figure 75).

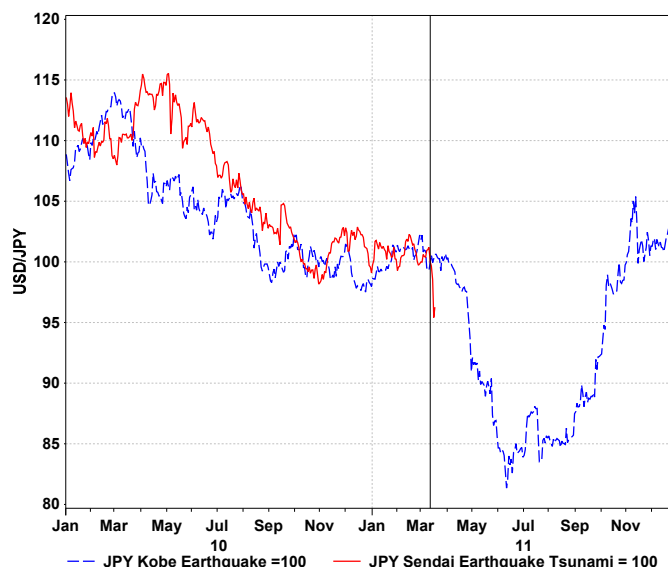
We think intervention will ultimately fail to prevent some downside over 0-3 months in USD/JPY in the context of a generally softer USD and weaker risk appetite. We forecast 78 over 0-3 months but 87 over 6-12 months.

Figure 75. USD/JPY, in Real Terms Much Higher Than in 1995



Source: Reuters EcoWin and Citi

Figure 76. 1995 All Over Again If Not For Intervention?



Source: Reuters EcoWin and Citi

Dollar Bloc — CAD looks the best near-term risk return

AUD/USD peaked at 1.0256 on 31 December but has essentially been trading a range of about 0.965-1.025 since October. We think the rate will trade in the lower end of the range first but will eventually break through the top end of this pattern over 6-12 months.

Near-term constraints for AUD include the general correction in risk appetite, market expectations that the RBA could even cut rates (we do not expect this), setbacks recently for non-oil commodities and stretched valuations both relative to our WERM models and compared with these underlying drivers. Figure 77, for example, reports the results of a regression by Citi FX strategists linking AUD to commodity prices, equity levels and volatility, and 10y rate differentials. Right now the model suggests further downside to 0.97. Given that Australian growth has hit a soft patch, and that Citi has recently downgraded GDP and CPI forecasts, we expect 0.97 over 0-3 months.

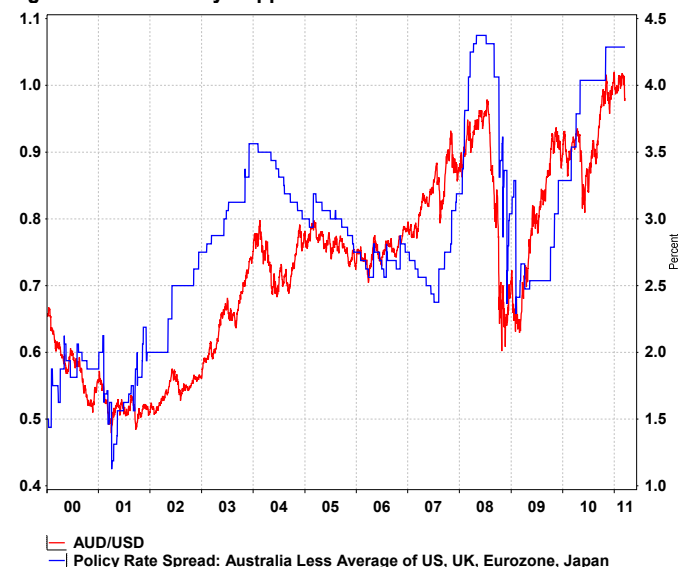
More medium term, Citi expects a re-acceleration of Australian GDP growth over the rest of the year with major mining and energy investment spending on the way. Our economists now expect two rate rises in 2011 H2 rather than three previously, but this is still well ahead of market expectations which now show less than one hike over 12 months. As the commodity cycle will likely remain robust over this time horizon, we expect eventual further appreciation to around 1.06 over 12 months.

Figure 77. Citi FX Strategy: AUD Model



Source: Reuters EcoWin and Citi

Figure 78. RBA Policy Supports AUD Medium Term



Source: Reuters EcoWin

USD/CAD has been trending steadily lower since May and, so far, the spike in risk aversion does not seem to have interrupted this trend. Steadily higher oil prices (Figure 79), expected rate hikes and association with the recovering US economy have all been supportive for CAD.

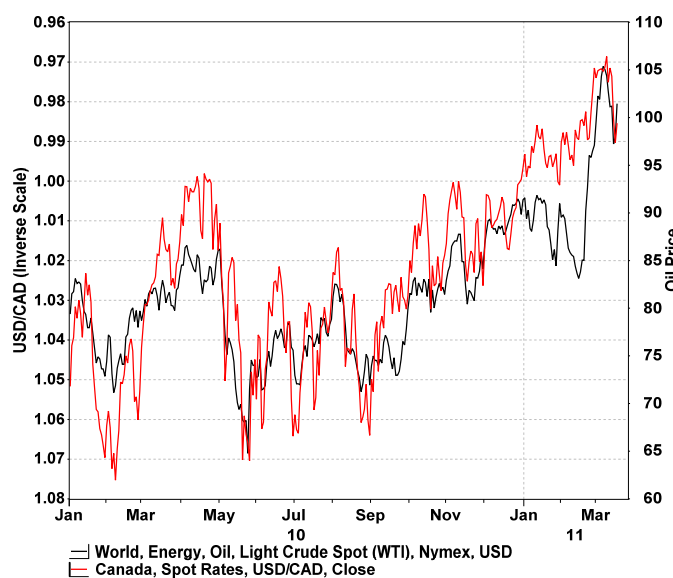
On growth, the recovery is regaining traction after the third-quarter 2010 slump. Real output in the final quarter of last year rose by an above-trend 3.3%, with considerable strength in both consumer spending and external trade. Easy financial conditions and terms of trade gains are bolstering profits and sentiment while rising employment supports earned income growth, consumer confidence and discretionary spending.

Core inflation, though, remains low even as headline is elevated by energy prices and sales tax harmonisation effects. According to the 1 March Bank of Canada meeting, upside and downside risks are nearly evenly balanced on inflation, but we do not expect core inflation to return to the 2% target until early 2013. We now think rates will not rise again until July but will still be hiked 200bp over the period to end-2012. This is much faster than market forwards, which should be CAD supportive.

Over 0-3 months, we may see some upside in USD/CAD as risk aversion remains elevated but we expect CAD sell-offs to be more limited than in the case of AUD (Figure 80). Over 6-12 months, we look for USD/CAD 0.95.

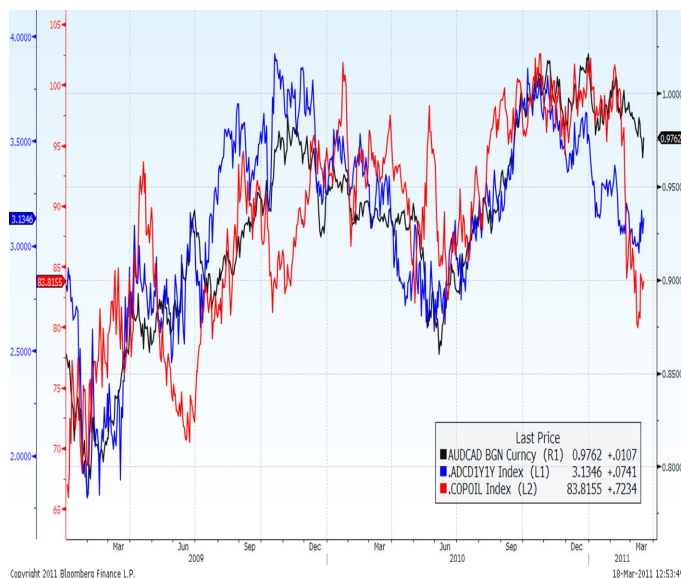
Finally, in New Zealand, recent growth data have been disappointing and Citi has downgraded forecasts for 2011 to 1.5% from 2.5% previously. 2012 is also expected to show slower growth than previously expected, though 2013 may see some payback. As a result, we now expect no RBNZ rate hikes through to mid-2012 leaving the policy rate at 2.5% after the cut of 50bp on 10 March. 1-2 rate hikes are currently priced in the forwards, probably implying some NZD underperformance. Commodity price strength helps NZD but probably less than the case in either CAD (oil) or AUD (metals and ores). Over 6-12 months, we see NZD/USD spot as likely to be roughly flat, implying significant upside for AUD/NZD. But near term, positioning considerations suggest that, in a correction, NZD would likely outperform vs. AUD a bit.

Figure 79. Oil Prices vs. CAD



Source: Reuters EcoWin

Figure 80. AUD/ CAD vs. 1y1y Rate Differentials and Copper/ Oil Ratio



Source: Bloomberg

European Crosses

GBP — We are GBP bulls

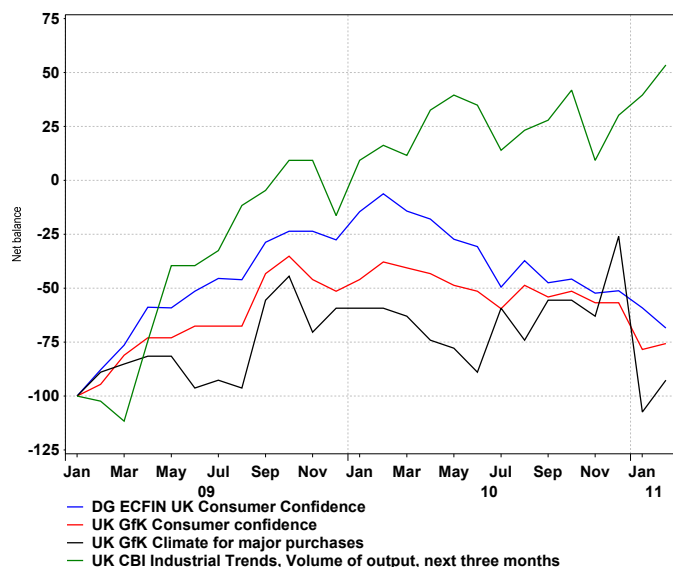
We still expect broad GBP appreciation over the medium term helped by lower perceived fiscal risks (due to the coalition government's deficit reduction programme) and tighter money assuming BoE rate hikes beginning at least by May. We expect around 100bp of tightening over the next 12 months vs. closer to 70bp priced in as we write this. Since this bearish view on policy rates is more pronounced for the BoE than either the ECB or Fed, we expect GBP to appreciate against both EUR and USD over the medium term.

In addition, re-balancing of the economy is already evident in rising indicators for exports/ production and weak ones for consumer confidence (Figure 81). This is helpful for the currency longer term as the UK external deficit will shrink. Lags between changes in the fiscal / current account deficit and the exchange rate are occasionally long and variable but big swings, such as we expect in the UK over the next couple of years, are usually GBP positive (Figure 82).

Investors are divided over GBP prospects. Many see the fiscal stance as a big negative, expecting severe economic slowdown. We don't. Others think that despite the coalition efforts, the UK could still get dragged into the sovereign risk crisis. The deciding moment is likely to come when the MPC does begin to raise rates and investors can then gauge how well the economy holds up in the face of this.

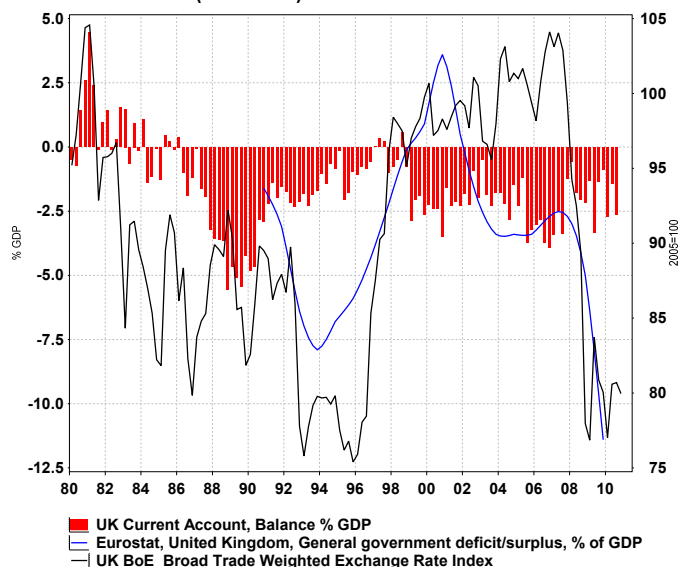
Sterling is trading roughly 6-10% weak to our WERM estimates of EUR/GBP 0.79 and GBP/USD of 1.73. As UK rates rise this year, we see this undervaluation gradually eroding. Over the 6-12 month horizon, we see cable above 1.70 and EUR/GBP at about 0.84.

Figure 81. UK is Re-Balancing Away From Consumption



Source: Reuters EcoWin

Figure 82. Sterling Broad Trade Weighted, Fiscal and Current Account Balances (% of GDP)



Source: Reuters EcoWin and Citi

Scandis — Fundamentals still good but now more fully priced

EUR/SEK continues to trend lower within a broad channel and the latest risk aversion spike does not look like it has interrupted this downtrend. SEK is supported by a fundamental background of a strong economy, rising policy rates, a current account surplus of around 6.5% of GDP and a relatively strong fiscal position. However, EUR/SEK is also heavily correlated with risk appetite, e.g. with implied equity market volatility (Figure 83).

Strong fundamentals seem likely to persist but may be more baked into prices than before. For example, Citi forecasts 5% GDP growth in 2011 but, with 4Q 2010 GDP numbers higher than consensus expectations for the fifth consecutive quarter, that consensus now seems to be moving closer to our forecast. Most domestic banks have revised up their forecasts, while the Swedish government now expects 4.8% growth this year.

Similarly with rates. We expect four more rate hikes this year (in line with what the Riksbank's own rate path suggests), and see upside risks to our forecast after the hawkish Riksbank minutes from the February meeting. Still, we are actually slightly on the dovish side of expectations over 12 months (where 150bp are priced in) and roughly neutral over long time horizons, expecting a 3.5/3.75% rate at end-2012 reaching 4.0% in mid-2013.

Hence, while fundamentals remain bullish SEK, much is effectively priced in. Meanwhile, with spot close to our long-term WERM value at 8.80, there is less to go for from a valuation perspective too. Our forecasts still show EUR/SEK trending lower but more slowly, reaching 8.70 on the 6-12 months horizon.

In Norway, EUR/NOK has trended much less than EUR/SEK recently but rather has been volatile in a 7.70-8.20 range. We see longer-term fair value towards the low end of this range which means that spot may eventually shift to a new lower range centred around 7.70 over the next 12 months.

We expect a fair pick-up in Norwegian growth this year (3.2% compared to 1.9% estimated in 2010). Indicators remain mixed but overall suggest both households and firms are confident about the future. At the same time, underlying inflation has been low, undershooting Norges Bank expectations. We still expect headline inflation to rise to 1.9% in 2011 and 2.0% in 2012, but this remains well under the Norges Bank 2.5% target.

We have revised up our rate forecast for 2011 adding one more 25bp rate hike (we now expect in total three). We now forecast rates to be at 2.75% at the end of this year. At the latest policy meeting on 16 March, Norges Bank revised up their rate path forecast and they now have the same expectations as we do for the coming years. Whether the next hike will be in May or June this year is still uncertain and probably will depend on global developments and domestic data. Fiscal data have been better than expected as oil prices have risen. This windfall largely is automatically saved in the SWF but, over time, is also a NOK positive (Figure 84).

Figure 83. EUR/SEK vs. VIX



Source: Reuters EcoWin and Citi

Figure 84. EUR/NOK Tracking Oil



Source: Reuters EcoWin

CHF — Overvalued but global risks still present

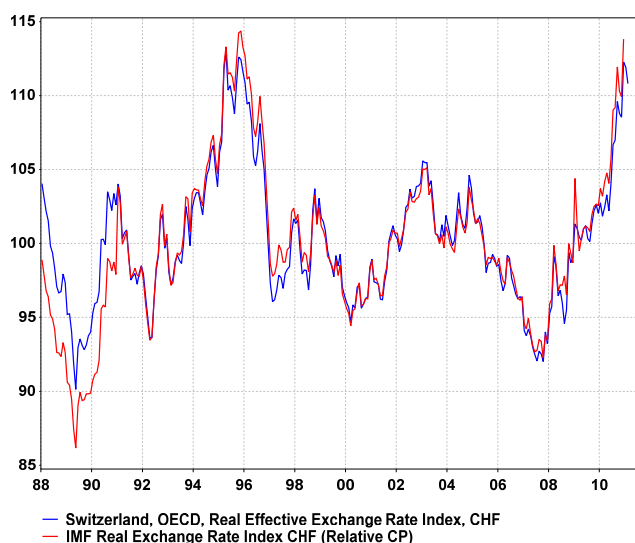
Lower lows and lower highs in the EUR/CHF cross have been evident for well over a year now, albeit the Central Bank has been trying to resist CHF strength all the way. Also against the USD, CHF has reached new all-time highs recently.

In the short term, we think this CHF strength can be maintained. As highlighted above, several global risks are still lurking (EMU, MENA, etc) and as a result the safe haven bid for CHF will likely remain. In addition, our economists expect three rate rises by 1Q12, ahead of market expectations which show just one over the next 12 months. This should support the franc as well. We forecast EUR/CHF 1.27 in 0-3 months.

Longer term, we continue to see the Swiss franc as one of the most overvalued G10 currencies as the EUR/CHF cross is trading nearly 10% below our WERM fair value estimate of 1.41. On an effective basis too, CHF is at multi-year

high. Such spikes have happened before (Figure 85) but tend not to last for too long. Furthermore, rate differentials often can explain movements in EUR/CHF in absence of periods of major risk aversion. Based on a simple regression on 2y swap rate differentials (Figure 86), EUR/CHF should be trading at around 1.55 levels, even above our WERM estimate. In the medium and long term, we expect safe haven dynamics slowly to dissipate and fundamentals to come back into play. We forecast 1.36 and 1.40 respectively.

Figure 85. Real Effective CHF at Multi-Year Highs



Source: Reuters EcoWin

Figure 86. EUR/CHF (Red) vs. Regression on 2y Swap Rate Differentials



Source: Reuters EcoWin and Citi

EM Exchange Rates

Emerging Asia — Stuck between tightening pressures and risk aversion

We continue to expect most EM Asian currencies to strengthen vs. USD over the medium term, given strong regional growth and tighter monetary policy / high carry. We maintain a neutral view on EM Asian currencies over the next 0-3m. On the one hand, rising inflation and tightening pressures support currency appreciation. On the other hand, the ongoing macro shocks to the global economy and the resulting risk aversion will likely induce near-term currency weakness in the region. The recent appreciation trend has taken a pause according to the ADXY index, which is consistent with these conflicting forces (Figure 87).

In China, CNY appreciation vs. USD has paused over the past month. This reflects increased uncertainty in financial markets and the global economy, but possibly is also due to a few weaker economic indicators, such as the sudden shift to a trade deficit and the slowdown in retail sales growth (from 19% to 11.6% yoy) in February. Nonetheless, there are still factors in favour of CNY appreciation over the short term. The key one is inflation concerns. Inflation remains elevated, with CPI inflation coming in at 4.9% in February. Both the food and non-food components are still on an upward trend (Figure 88) and higher oil prices are shifting risks to the upside. Tightening efforts continue, with

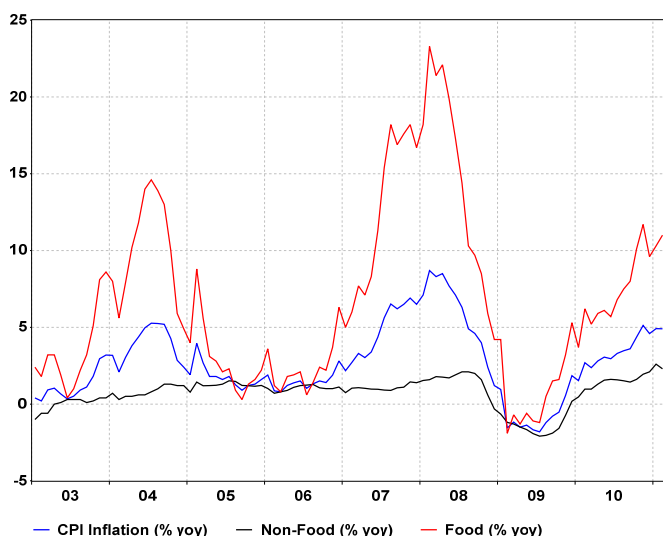
the PBoC hiking reserve requirement ratios for the third time this year. In addition, the USD continues to weaken and that should give some comfort to the authorities to allow some CNY strength. We still expect CNY to appreciate by around 5-6% in 6-12m but have tempered our expectation for short-term strength vs. the USD.

Figure 87. ADXY Index (Weighted Average of 8 EM Asian Currencies vs. USD)



Source: Citi and Bloomberg

Figure 88. China: CPI Inflation (yoy)



Source: Reuters EcoWin

In Indonesia, we underestimated the Bank Indonesia's (BI) tolerance for rupiah appreciation to mitigate inflation. It is likely that the BI has reached a new "comfort" threshold for USD/IDR at the 8,500-9,000 range as they seem less concerned about the REER appreciation given terms of trade gains from higher commodity prices. 43% of exports comprise oil & gas, coal, palm oil, copper and other mining products. The stability of IDR has provided offshore real money investors some level of comfort. But we are concerned that: (i) Indo bonds may sell off if risk aversion persists; and (ii) higher oil prices may delay fuel subsidy rationalisation which could lead to higher inflation longer term. While risks of short-term IDR weakness persist, strong fundamentals still support longer-term capital inflows and a stronger rupiah further out.

The Korean won, a typical risk currency, is likely to continue facing the weight of higher risk aversion. In addition, the upside risks to crude oil prices and the expected decrease in Japanese tourists should narrow the current account surplus. However, Korea competes with Japan in third markets, so exports and the KRW could benefit from the disruptions to Japanese exporters in the aftermath of the earthquake. Overall, we expect appreciation of the won to pause near term, but we expect it to resume further out supported by renewed risk appetite and a normalisation of foreign portfolio inflows.

In India, we still expect some short-term weakness given over-reliance on portfolio inflows and the negative impact of higher oil prices on India's trade balance. However, over the medium term, a recovery in Indian exports should help offset higher oil imports, with the likely result of the FY12 current account deficit coming in marginally lower, at around USD60bn or 3% of GDP (vs. 3.2% of GDP earlier expected). Moreover, budgetary measures coupled with the RIL-BP deal should support overall capital flows further out.

In Thailand, we expect relative baht stability against the USD in the near term, following a period of strength since early February. The key risk to the appreciation path is that supply disruption from Japan could curtail imports of key intermediate inputs and capital goods, which in turn could hamper the supply of final goods exports. Ongoing macro risks may contribute to a temporary pause in the tightening cycle, but rate normalisation should support the baht over the medium term.

In the Philippines, higher risk aversion in financial markets is also likely to hurt PHP. But over the medium term, several factors still favour peso appreciation: persistently strong external accounts, the reform environment (fiscal and legislative) and the likely shift to investment-driven growth. Higher oil prices and lower remittances from abroad are the key risks to medium-term appreciation.

In Singapore, we expect a pause in the recent fast pace of appreciation of the SGD over the short term. But we expect this to continue further out supported by strong economic activity and likely MAS tightening over the medium term given rising inflation concerns. In Malaysia, we expect relative stability of MYR vs. spot in the near term. But we expect higher crude palm oil prices and policy rate hikes by Bank Negara to lead to a stronger MYR over the medium term.

CEEMEA – Mixed currency performance in the near term

We expect currency performance in CEEMEA to be mixed over the next 0-3m, but look for a resumption in the appreciation trends further out supported by a clearer outlook for the EMU and MENA crises, tighter monetary policy in the region and, in some cases (e.g. ZAR and RUB), robust commodity prices.

The Czech koruna is likely to continue experiencing moderate short-term weakness vs. the euro, given ongoing risk aversion and narrower interest rate differentials vs. the Eurozone. Further out, however, we anticipate renewed strength based on relatively strong export-intensive growth, a robust fiscal stance and the prospect of 50bp of monetary tightening in 2011.

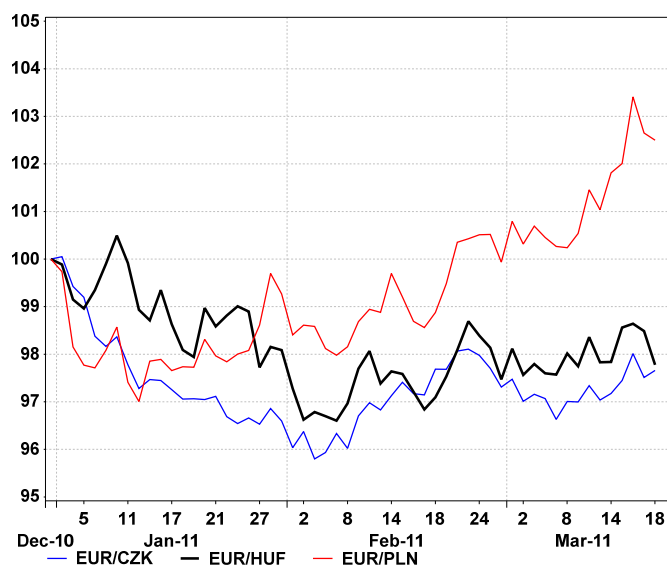
In Hungary, HUF remains resilient amid higher risk aversion mainly due to: (i) the improvement in the government's short-term funding position as a result of funds available from the conversion of the private pension fund into a public one; (ii) the new fiscal package which seeks to reduce the budget deficit to 1.9% of GDP by 2014 and public debt to 50% of GDP by 2018; and (iii) a large trade surplus. All of these factors are short-term supports going forward. However, the medium- and longer-term outlooks remain challenging since we have doubts about the government's ability and willingness to implement the proposed fiscal package and the chance that Hungary's growth potential has been eroded by the government's failure to improve the investment climate.

The Polish zloty has underperformed its peers over the past month (Figure 89), and is unlikely to strengthen much vs. the euro in the near term mainly due to: (i) opinion polls showing falling support for the ruling party ahead of the October 2011 elections; (ii) a worsening of the current account; and (iii) rate hikes being priced out following lower-than-expected inflation in February. Further out, the zloty should be supported by wider interest rate differentials versus the Eurozone, relatively strong GDP growth, inflows from the privatisation process and likely sales of foreign currency by the Ministry of Finance to manage the debt/GDP ratio.

In Israel, inflationary pressures have become more evident recently and inflation expectations across the linkers' curve have shifted well above the ceiling of the inflation target range. Meanwhile, GDP growth has been strong (7.8% Q4). This puts pressure on the Bank of Israel to accelerate rate hikes (possibly like the Central Bank of Chile in switching to +50bp hikes), and we think there might be greater tolerance of nominal appreciation for the sake of inflation control.

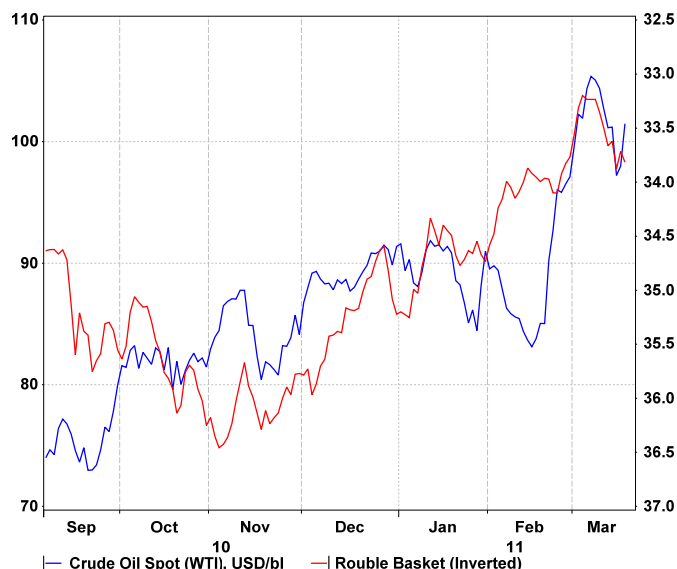
In Russia, we believe the rouble basket has potential for further appreciation in the short run given higher oil prices (Figure 90) and seasonal factors (such as quarterly and annual tax payments in April). However, we expect gradual weakening in H2 due to: (i) a narrowing current account surplus due to rising imports; (ii) seasonal capital outflows in 3Q; and (iii) uncertainty related to parliamentary elections in December. But we expect rouble downside to be limited by central bank intervention especially as we get close to the elections.

Figure 89. PLN Underperforming Its Peers Since February



Source: Reuters EcoWin

Figure 90. RUB Supported By Higher Oil Prices



Source: Reuters EcoWin

In South Africa, we expect the rand to weaken slightly in the short term. On one hand, it faces the potential for further capital outflows if risk aversion persists. On the other hand, exporters are still fairly long USD and it is benefiting from elevated gold, coal and iron ore prices. Further out ZAR weakness should continue given: (i) economic underperformance vs. other EM; (ii) increased SARB intervention; and (iii) a general overvaluation of the currency.

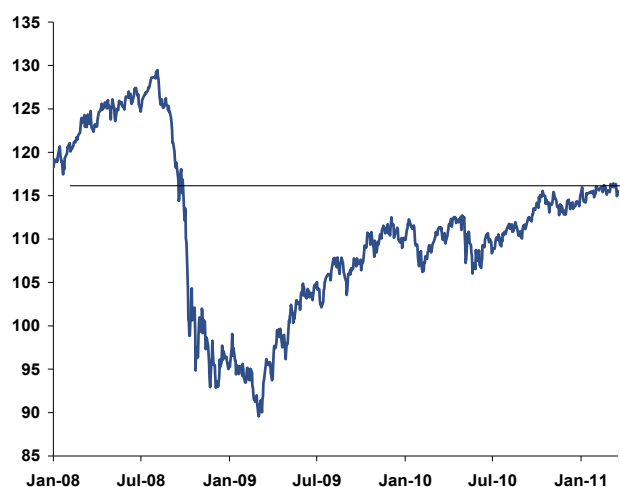
Finally, in Turkey, the lira depreciation since the inception of the CBT's unconventional monetary policy has alleviated our overvaluation concerns. But we remain concerned about the widening current account deficit, especially as Turkey is a big oil importer. We expect some lira strength (vs. forwards anyway) over 6-12m, as the central bank starts hiking policy rates.

Latin America – Appreciation Momentum Eases Amid Macro Uncertainty

The recent appreciation trend of most Latam currencies vs. USD has taken a pause (Figure 91). This owes mainly to the cross currents of risk aversion, central bank intervention and in some cases support from higher oil prices. We anticipate these cross currents to persist in the near term and therefore expect limited gains vs. forwards near term.

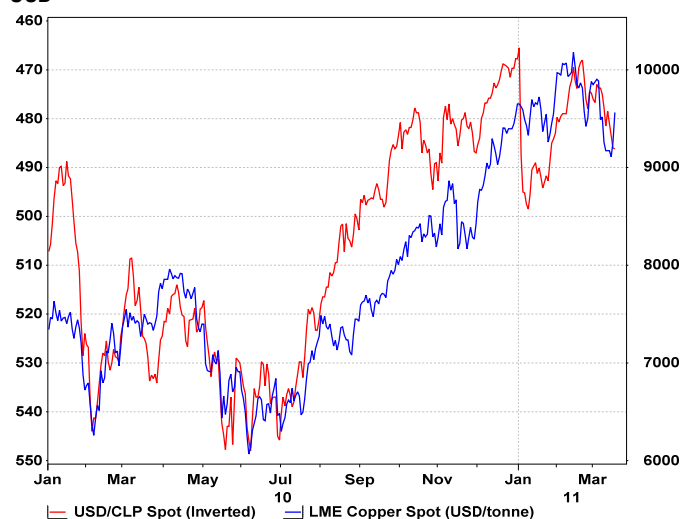
Strong commodity prices have been pressuring BRL towards further appreciation. But at the same time, the government has extended its instruments (e.g. in spot and futures markets, as well as via regulation) to weaken the Brazilian real. Overall, the government is having some success in limiting the appreciating trend of BRL, although more recently higher risk aversion is working in the central bank's favour. We expect BRL to stay around current levels over the next few months. Nonetheless, our forecasts remain bullish versus forwards, especially in the medium term.

Figure 91. Latam Currencies Index (Weighted Average of 6 Latam Currencies vs. USD)



Source: Citi and Bloomberg

Figure 92. Chile: Lower Copper Prices Led to Peso Weakness vs. USD



Source: Reuters Ecowin

Against a backdrop of exacerbated risk aversion abroad, the relative stability shown by the Mexican peso recently has been remarkable. We expect MXN to hover around current levels in the near term, but it has further appreciation potential versus the USD once risk aversion dissipates. The key peso positives in the medium term are that: (i) Mexico is a direct beneficiary of the recent improvement in the US growth outlook; (ii) intervention in the fx market by Banxico is limited; and (iii) fiscal fundamentals are robust, with strong oil prices an additional source of support.

We expect the recent weakening trend in the CLP to continue in the short term, driven by an increase in global risk aversion and the ensuing deterioration of copper prices. Over the medium term, we see USD/CLP at 480 as risk appetite returns and the Chilean economy outperforms industrialised ones.

For the Colombian peso, we expect a small appreciation in the short term given the recent upgrade of the nation's sovereign credit rating by S&P. In the medium term, we expect the cross to fall gradually as the central bank stops its daily purchases of USD on 17 June. Strong portfolio and FDI inflows should support the peso at around 1850 over the rest of 2011.

Contributors

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

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Source: Citi Investment Research and Analysis

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Figure 94. Citi Quarterly Interpolated Forecasts

Quarterly Interpolated Forecasts

	Currency	Spot	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar
G10-US Dollar											
Euro	EURUSD	1.42	1.41	1.40	1.42	1.44	1.45	1.43	1.41	1.40	1
Japanese yen	USDJPY	81	81	78	81	84	87	87	87	87	
British Pound	GBPUSD	1.62	1.62	1.61	1.65	1.69	1.73	1.73	1.74	1.74	1
Swiss Franc	USDCHF	0.91	0.91	0.91	0.92	0.93	0.94	0.96	0.98	1.00	1
Australian Dollar	AUDUSD	1.00	1.00	0.97	1.00	1.03	1.05	1.00	0.95	0.90	0
New Zealand Dollar	NZDUSD	0.73	0.73	0.72	0.72	0.73	0.73	0.70	0.68	0.65	0
Canadian Dollar	USDCAD	0.98	0.98	0.99	0.98	0.96	0.95	0.95	0.95	0.95	0
Dollar Index*	DXY	75.69	75.73	75.93	75.46	74.98	74.62	75.21	75.82	76.43	76
G10 Crosses											
Japanese yen	EURJPY	115	114	110	115	121	126	124	123	121	
Swiss Franc	EURCHF	1.28	1.28	1.27	1.30	1.33	1.36	1.37	1.38	1.39	1
British Pound	EURGBP	0.87	0.87	0.87	0.86	0.85	0.84	0.83	0.81	0.80	0
Swedish Krona	EURSEK	8.87	8.88	8.94	8.86	8.77	8.70	8.70	8.70	8.70	8
Norwegian Krone	EURNOK	7.88	7.87	7.80	7.76	7.73	7.70	7.70	7.70	7.70	7
Norwegian Krone	NOKSEK	1.13	1.13	1.15	1.14	1.14	1.13	1.13	1.13	1.13	1
Australian Dollar	AUDNZD	1.37	1.37	1.35	1.39	1.42	1.45	1.43	1.41	1.38	1
Australian Dollar	AUDJPY	81.5	80.9	76.2	81.8	87.3	91.7	87.4	83.0	78.6	7
EM Asia											
Chinese Renminbi	USDCNY	6.56	6.50	6.37	6.30	6.25	6.18	6.10	6.05	6.00	5
Hong Kong Dollar	USDHKD	7.80	7.78	7.76	7.75	7.75	7.75	7.75	7.75	7.75	7
Indonesian Rupiah	USDIDR	8733	8800	8850	8800	8750	8700	8700	8650	8600	80
Indian Rupee	USDINR	45.1	46.5	46.3	46.0	45.8	45.5	45.0	44.5	44.0	4
Korean Won	USDKRW	1125	1130	1110	1090	1070	1050	1040	1020	1010	10
Malaysian Ringgit	USDMYR	3.04	3.05	3.00	2.97	2.93	2.90	2.88	2.85	2.85	2
Philippine Peso	USDPHP	43.5	44.0	43.5	43.3	42.9	42.8	42.5	42.0	41.9	4
Singapore Dollar	USDSGD	1.27	1.28	1.26	1.24	1.22	1.21	1.20	1.19	1.20	1
Thai Baht	USDTHB	30.3	30.8	30.3	30.0	29.9	29.9	29.8	29.7	29.5	2
Taiwan Dollar	USDTWD	29.6	29.5	29.3	29.0	28.8	28.5	28.5	28.8	28.8	2
EM Europe											
Czech Koruna	EURCZK	24.40	24.41	24.47	24.17	23.87	23.59	23.52	23.44	23.37	23
Hungarian Forint	EURHUF	271	271	270	271	272	273	274	276	277	1
Polish Zloty	EURPLN	4.05	4.05	4.05	4.01	3.98	3.94	3.85	3.76	3.68	3
Israeli Shekel	USDILS	3.53	3.53	3.50	3.50	3.50	3.50	3.47	3.45	3.42	3
Russian Ruble	USDRUB	28.3	28.3	27.8	28.1	28.4	28.7	29.1	29.5	30.0	3
Russian Ruble Basket	RUB	33.6	33.6	32.9	33.4	34.0	34.5	34.8	35.0	35.3	3
Turkish Lira	USDTRY	1.58	1.58	1.62	1.61	1.61	1.60	1.62	1.63	1.65	1
South African Rand	USDZAR	6.97	6.99	7.21	7.31	7.41	7.53	7.78	8.03	8.28	8
EM Latam											
Brazilian Real	USDBRL	1.67	1.67	1.67	1.67	1.67	1.67	1.70	1.70	1.70	1
Chilean Peso	USDCLP	481	486	490	484	478	480	482	483	485	1
Mexican Peso	USDMXN	12.0	12.1	12.1	11.9	11.8	11.8	12.0	12.1	12.2	1
Colombian Peso	USDCOP	1874	1875	1850	1839	1844	1850	1872	1887	1900	19

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

Source: Citi Investment Research and Analysis

Figure 95. Citi Annual Forecasts

Annual Forecasts

	Currency	Spot	2010*	2011*	2012*	2013*	2014*	2015*
G10-US Dollar								
Euro	EURUSD	1.42	1.32	1.42	1.42	1.38	1.37	1.36
Japanese yen	USDJPY	81	87	81	87	87	87	87
British Pound	GBPUSD	1.62	1.54	1.64	1.73	1.74	1.74	1.73
Swiss Franc	USDCHF	0.91	1.01	0.92	0.97	1.02	1.03	1.03
Australian Dollar	AUDUSD	1.00	0.94	1.00	0.98	0.86	0.85	0.84
New Zealand Dollar	NZDUSD	0.73	0.73	0.73	0.69	0.63	0.62	0.61
Canadian Dollar	USDCAD	0.98	1.03	0.98	0.95	0.96	0.97	0.99
Dollar Index**	DXY	75.70	81.10	75.52	75.51	77.14	77.55	77.97
G10 Crosses								
Japanese yen	EURJPY	115	114	115	124	120	119	118
Swiss Franc	EURCHF	1.28	1.33	1.30	1.38	1.40	1.41	1.41
British Pound	EURGBP	0.87	0.86	0.86	0.82	0.79	0.79	0.79
Swedish Krona	EURSEK	8.87	9.36	8.86	8.70	8.71	8.75	8.78
Norwegian Krone	EURNOK	7.88	7.95	7.79	7.70	7.71	7.73	7.75
Norwegian Krone	NOKSEK	1.13	1.18	1.14	1.13	1.13	1.13	1.13
Australian Dollar	AUDNZD	1.37	1.29	1.38	1.42	1.36	1.36	1.36
Australian Dollar	AUDJPY	81.5	81.1	81.5	85.2	74.4	73.5	72.6
EM Asia								
Chinese Renminbi	USDCNY	6.56	6.73	6.36	6.08	5.95	5.80	5.60
Hong Kong Dollar	USDHKD	7.80	7.77	7.76	7.75	7.75	7.75	7.75
Indonesian Rupiah	USDIDR	8733	9020	8800	8663	8600	8600	8500
Indian Rupee	USDINR	45.1	45.3	46.1	44.8	44.0	42.0	40.5
Korean Won	USDKRW	1125	1155	1100	1030	1000	975	970
Malaysian Ringgit	USDMYR	3.04	3.16	2.99	2.87	2.85	2.74	2.64
Philippine Peso	USDPHP	43.5	44.8	43.4	42.3	41.8	41.3	41.8
Singapore Dollar	USDSGD	1.27	1.35	1.25	1.20	1.20	1.14	1.10
Thai Baht	USDTHB	30.3	31.3	30.2	29.7	29.5	29.3	29.7
Taiwan Dollar	USDTWD	29.6	31.1	29.2	28.7	28.8	29.0	29.0
EM Europe								
Czech Koruna	EURCZK	24.40	25.17	24.23	23.48	23.17	22.83	22.50
Hungarian Forint	EURHUF	271	276	271	275	276	270	264
Polish Zloty	EURPLN	4.05	3.98	4.02	3.81	3.59	3.55	3.52
Israeli Shekel	USDILS	3.53	3.69	3.51	3.46	3.40	3.40	3.40
Russian Ruble	USDRUB	28.3	30.4	28.2	29.3	30.3	30.2	30.2
Russian Ruble Basket	RUB	33.6	34.8	33.5	34.9	35.4	35.3	35.1
Turkish Lira	USDTRY	1.58	1.52	1.60	1.62	1.65	1.64	1.62
South African Rand	USDZAR	6.97	7.13	7.23	7.90	8.69	9.18	9.66
EM Latam								
Brazilian Real	USDBRL	1.67	1.73	1.67	1.69	1.70	1.75	1.79
Chilean Peso	USDCLP	481	505	484	482	485	481	479
Mexican Peso	USDMXN	12.0	12.5	12.0	12.0	12.2	12.7	13.0
Colombian Peso	USDCOP	1874	1883	1852	1877	1900	1860	1835

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

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

Source: Citi Investment Research and Analysis

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Notes

Notes

Appendix A-1

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