17 July 2013 | 48 pages

Global

Global Economic Outlook and Strategy

July 2013

- Global growth remains a little below its longrun average, with sluggish world trade, slowing EM prospects and lower investment growth by commodity producers. We are cutting 0.1% off our global growth forecasts for both 2013 and 2014, putting them at 2.5% and 3.1% respectively (at current exchange rates). As in recent months, we are again downgrading EM growth forecasts, and in total our 2013 EM growth forecasts have fallen by 0.5% in the last four months (with 2014 forecasts down by 0.4%). By contrast, our forecasts for advanced economy growth have been drifting up since late 2012. This month we have notable downgrades for China, Brazil, Indonesia, Peru and Turkey, with upgrades for the euro area and Argentina. Overall, our growth forecasts are generally below consensus, notably on the BRICs and euro area.

- In recent years, global growth and financial markets have received support from the Fed's massive LSAP programme and China's rampant credit boom. Now, again reflecting internal factors, the continuation of both these drivers is very much in doubt. With reduced US downside risks, the US Fed probably will begin tapering soon and, provided that labour market conditions improve, the Fed will probably end asset purchases around mid-2014. In China, the ratio of private debt/GDP now exceeds the levels in the US and euro area and has risen by more than 50 percentage points in just four years. In this context, China's authorities seem to believe that a modest further economic slowdown would be less destabilising than a major new credit stimulus aimed at restoring real GDP growth to 8%-plus. We expect China's growth will slow to about 7% YoY on average in 2014 and 2015, with a dip below 7%, capping growth in a range of other export-oriented and commodity-producing economies.

- Against this backdrop, the major central banks are likely to follow divergent policy paths. As noted above, the Fed's stimulus programme is probably coming to an end, while China's authorities probably will provide only limited stimulus as the economy slows. By contrast, the ECB and BoE are seeking to loosen further via forward guidance — the BoE probably will introduce Fed-style guidance at the August meeting — and the ECB remains likely to cut rates again.

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With thanks to Jan Maguire

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Figure 1. Currency and Interest Rate Forecasts, as of 17 July 2013

	17 July 2013	3Q 13F	4Q 13F	1Q 14F	2Q 14F	3Q 14F	4Q 14F
United States: Federal Funds	0.25	0.25	0.25	0.25	0.25	0.25	0.25
10-Yr. Treasuries (Period Ave.)	2.60	2.60	2.65	2.80	3.00	3.15	3.25
Euro Area: US$/€	1.30	1.30	1.29	1.28	1.29	1.31	1.32
Euro Repo Rate	0.50	0.50	0.25	0.25	0.25	0.25	0.25
10-Yr. Bunds (Period Ave.)	1.58	1.55	1.50	1.50	1.50	1.70	1.80
Japan: Yen/US$	99	100	105	109	110	110	110
Call Money	0.10	0.10	0.10	0.10	0.10	0.10	0.10
10-Yr. JGB (Period Ave.)	0.85	0.90	0.90	0.80	0.60	0.80	0.80

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

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Figure 2. Forecast Highlights and Changes from Last Month

■ Global	We are cutting 0.1% off our global growth forecasts for both 2013 and 2014 this month, putting them at 2.5% and 3.1% respectively (at current exchange rates). Global growth remains a little below its longrun average, with sluggish world trade, slowing EM prospects and lower investment growth by commodity producers.
■ United States	Despite resilient job growth, fiscal restraint has slowed 1H output. But financial conditions remain highly supportive and key areas of demand are regaining momentum at midyear. We expect an initial scaling back of Fed QE in September with tapering extending into next spring. The improved near-term fiscal position has quieted discussion of needed structural reforms.
■ Euro Area	We increase our 2013 euro area GDP forecast by 0.1ppt to -0.7% and the 2014 GDP forecast by 0.2ppt to 0.2%, essentially reflecting our expectations of a better 2Q outcome. We continue to expect a 25bp refi rate cut in 4Q-13.
■ China	GDP growth has declined steadily from 7.9% YoY in 4Q 12 to 7.5% in 2Q 13. Facing inflation uptrend and increasing financial risks, credit conditions may become less accommodative in 2H. Government emphasis on reforms may bring short-term pain before reaping long-term gain. We now expect 2013 and 2014 growth to be 7.4% and 7.1%, respectively.
■ Japan	The most important key to monitor in the coming months is PM Abe's final decision (likely in September or October 2013) regarding the consumption tax hike. We assume that PM Abe will decide to implement the tax hike as planned while introducing another large fiscal stimulus package with 3-4 trillion yen in public works spending later this year or early next year in order to mitigate a negative impact from the tax hike on economic activity.
■ United Kingdom	The MPC is likely to introduce Fed-style forward guidance at the August meeting, signalling several more years of ultra-low rates.
■ Canada	We continue to anticipate that the BoC will leave the policy rate target unchanged at 1.00% until 1Q 2015. Unless risks tilt downward, the Bank should retain its slight tightening bias, in our view.
■ Australia	With the unemployment rate firmly on an upward trend and inflation close to the bottom of the RBA's target range, we believe the path of least regret for the RBA is for a further 25bp rate cut at the August Board meeting.
■ Emerging Asia (ex China)	The Fed taper and China slowdown fears continue to be dominant themes. External imbalances have prompted Indonesia to hike rates more than expected, but other central banks are on hold with a neutral to dovish bias, and we have delayed our call for India's shallow easing cycle. There are signs that the export cycle has bottomed. but the rebound remains uncertain given downside risk from China's growth.
■ CEEMEA	We raised our GDP forecasts for Hungary by 0.2ppt in 2013 and 0.1ppt in 2014 on the improving consumer outlook, but still expect the MPC will continue to loosen monetary policy near term. In Poland we think we have seen the end of the current easing cycle even as the central bank cuts its projections for GDP growth and inflation. From Turkey we are seeing signs that the CBT acknowledges that stabilizing the lira only through selling FX is not a viable option.
■ Lat Am	In Brazil, we have cut our growth forecasts to 2.2% and 2.5% for 2013 and 2014, respectively but still expect the policy rate to rise to 9.25% by yearend. In Mexico, we are keeping our 2.7% real GDP growth forecast for 2013 despite soft 2Q13 data. We continue to see Banxico on hold for the foreseeable future. In Argentina, Central Bank reserves continue to drop, putting a downward bias on our activity forecasts. Lastly, in Venezuela the authorities have announced the reopening of SICAD, and this is likely be followed by foreign currency debt issuance later this year.

Source: Citi Research

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

	2012	2013F	2014F
World	**1.8%**	**2.4%**	**3.9%**
United States	3.6	2.7	5.1
Japan	0.2	0.2	3.2
Euro Area	-2.4	-0.4	0.6
United Kingdom	-2.4	-1.1	0.8
Canada	0.9	1.6	1.9
China	10.0	9.1	8.7
India	2.1	3.6	5.6
Korea	0.9	0.5	3.4
Brazil	-2.7	2.0	2.8

Source: Citi Research

Overview — Economies and Central Banks Diverging

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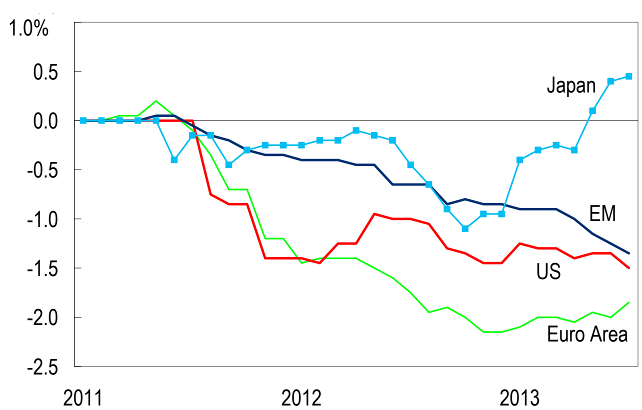
Global growth remains a little below its longrun average, with sluggish world trade, slowing EM prospects and lower investment growth by commodity producers. We are cutting 0.1% off our global growth forecasts for both 2013 and 2014 this month, putting them at 2.5% and 3.1% respectively (at current exchange rates). As in recent months, we are again downgrading EM growth forecasts. The changes this month in aggregate are relatively modest, with a 0.1% downgrade to our EM growth forecasts for 2013 and 2014. But, with a series of similar downgrades, in total our 2013 EM growth forecasts have fallen by 0.5% in the last four months and by 1.5% since late 2011 (with our 2014 forecasts down by 0.4% in the last four months and by 1.2% since mid-11). By contrast, our forecasts for aggregate advanced economy growth have been drifting up since late 2012.

We are trimming our growth forecasts, with downgrades again concentrated in emerging markets

This month we have notable forecast downgrades for China (by 0.2% for both 2013 and 2014), Brazil, Indonesia, Peru and Turkey, with upgrades for the euro area (by 0.1% for 2013 and 0.2% for 2014) and Argentina. Overall, the Citi growth forecasts are generally below consensus, notably on all four BRIC countries and the euro area. Moreover, we suspect that aggregate risks lie to the downside of our forecast, especially for 2014, stemming in particular from the possibility of a sharper China slowdown — and knock-on effects to a range of other economies, in particular through excess capacity in commodity-producing countries and resulting downward pressure on capex, as well as vulnerabilities in EM balance sheets and external accounts.

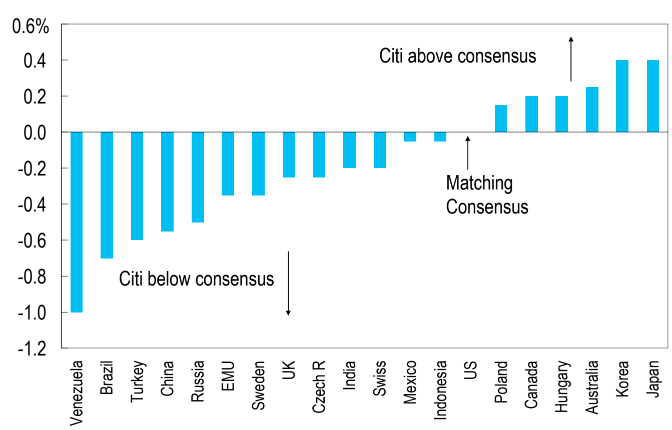
Our growth forecasts are generally below consensus, although not in all countries

Figure 4. Global — Cumulative Changes in Citi Forecasts for GDP Growth in 2013-14 Since January 2011, 2011-13



Source: Citi Research

Figure 5. Selected Countries — Citi Forecasts For GDP Growth in 2013-14 Versus Consensus



Sources: Consensus Economics and Citi Research

In recent years, global growth and financial markets have received support from the Fed's massive LSAP programme and China's rampant credit boom. These measures, undertaken for domestic stabilization reasons, had powerful external spillovers across a wide range of countries and asset markets.

China's private credit boom has helped support growth internally and externally

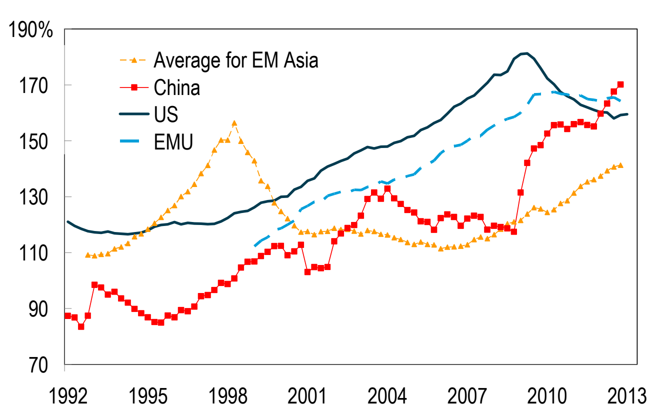
- In China, the authorities so far have relied on credit-fuelled investment in the traditional sectors and industries (local authority infrastructure, transportation and construction) to offset the headwinds from weakening external demand. As a result, the level of private debt (taking the sum of gross unconsolidated debt of the household and non-financial corporate sectors) has risen more than 500% over the last 10 years and the ratio of private debt/GDP (measured against the 4-quarter average of nominal GDP) has soared from 117% at end-2008 to 170% at

end-2012. The rise in this ratio, 53 percentage points over just four years, comfortably exceeds the rise in the private debt/GDP ratios for the US and euro area over the six-year period from 2002-08 (both about 30 percentage points). In turn, with the credit-fuelled domestic demand surge, China's imports of goods (nominal USD terms) have risen by more than 500% over the last 10 years, with even faster gains from some regions and countries (eg over 2002-12, China's imports from Australia rose more than 1200% in USD terms, with imports from Latin America up by more than 1400%, and imports from Africa up by more than 1900%). Between 2008 and 2012, China's imports[1] rose by USD528bn, far more than any other country (HK is second placed, with imports up by USD210bn, India is third, with imports up by USD122bn). Between 2008 and 2012, global investment spending rose by about USD2200bn (15%) in nominal terms: China directly accounted for about 80% of this expansion, with a higher impact if we include indirect spillovers to other countries.

Asset purchases by major central banks also have helped buoy asset markets and, indirectly, support growth

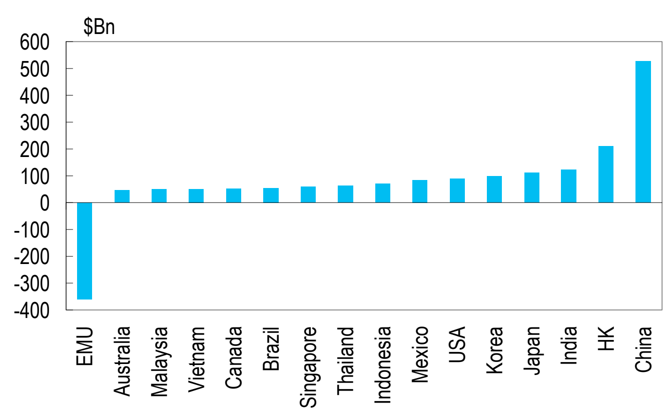
- The boosts to economic growth from central bank asset purchases are more indirect, but various studies suggest that they have helped boost asset prices and economies, especially when financial markets were disorderly and the assets purchased were illiquid and high-risk[2]. Of course, it may be hard to disentangle the effects of Fed actions from those of other central banks. But, we make the simple observation that, since late 2008, the Fed has been undertaking major asset purchases roughly 60% of the time, with no asset purchases for roughly 40% of the time. Over that whole period, global equity prices (using weekly data for the global MSCI index in local currency terms) have risen by about 60%. All of that gain in equity prices occurred in weeks when the Fed was making asset purchases, with a slight drop in equities on balance in the remaining weeks[3].

Figure 6. US, EMU, China and Asia EM — Private Sector Debt/GDP Ratio, 1992-2012



Note: We show the sum of the gross unconsolidated debts of the household and non-financial corporate sectors, measured against the four-quarter average of nominal GDP. Sources: BIS, IMF and Citi Research

Figure 7. Selected Countries — Change in Imports (Nominal USD Terms), During 2008-12



Note: We show the 15 countries with the biggest increases in imports, and the euro area for comparison. Data measured as the sum of other countries' exports to each country shown to avoid the effect of tariff changes. Sources: IMF and Citi Research

The Fed is likely to begin tapering asset purchases later this year…

Now, again reflecting internal factors, the continuation of both of these drivers (Fed LSAP and China's credit boom) is very much in doubt. US growth has been modest in H1, and data suggest that Q2 growth has been only about 0.5% QoQ SAAR, with

[1] Measured here as the sum of other countries' exports to China.

[2] See, for example, "Unconventional Monetary Policies – Recent Experience and Prospects", IMF, April 2013.

[3] The global MSCI rose by an average of 0.6% per week during the first wave of asset purchases (late 2008 to early 2010), by 0.1% per week in the second wave (late 2010 to mid-11) and by 0.4% per week since the third wave began in late 2012.

continued fiscal drag and a surprisingly sharp deterioration in net trade. However, recent months have seen solid gains in core capital goods orders, home sales and car sales. Provided that labour market conditions continue to improve, the Fed probably will judge in coming months that it can safely begin to slow asset purchases, before ending asset purchases around mid-2014. This would imply that stimulus (measured by the stock of asset purchases) will be expanding at a slower pace and then level off. We view the Fed's likely path as justified by reduced US downside risks, but the result is that global liquidity conditions may no longer be quite so super-easy (unless economic conditions elsewhere deteriorate so much that the BoJ, ECB and BoE loosen much more than recently).

…while China's authorities seem to believe that a modest further slowdown would be less destabilising than a major new credit stimulus

At the same time, China's authorities seem to believe that a modest further economic slowdown would be less destabilising than a major new credit stimulus aimed at restoring real GDP growth to 8%-plus. China's private debt/GDP ratio is extraordinarily high for a lowish income EM country[4] — and indeed above those in the US and euro area. A further large credit boost would have sizeable costs, for example further increasing inefficiencies in the allocation of capital, hindering the desired rebalancing away from over-investment, while also expanding potential losses and excesses in the official and shadow banking systems. Although the government is seeking to design reforms to boost consumer spending over the medium-term, the authorities have not yet developed alternatives (e.g. stimuli to private or public consumption funded through central government borrowing) to credit-led investment as a short-term demand management stimulus.

Consensus forecasts for China have fallen markedly but remain too high in our view

The IMF has recently cut its China growth forecasts to 7.8% for 2013 and 7.7% for 2014. Over the last three months, the consensus forecast for China growth has fallen by 0.7pp for 2013 and by 0.4pp for 2013 (to 7.5% and 7.6% respectively) — the sharpest three-month downgrade of the last 12 years, apart from late 2008/early 2009. Even so, we believe the consensus remains significantly too high. We suspect the authorities will tolerate a slowdown in real GDP growth to about 7% in 2014 and 2015, with perhaps a dip below 7%, with modest stimulus focused on urbanization and areas that may foster consumption over time (eg medical facilities, tourism, culture and entertainment industries)[5]. Slower Chinese growth is likely to ripple through to a wider slowdown and deterioration in trade balances across a range of other countries, especially those where exports to China and Asian EM are large (or have been rising sharply) as a share of GDP. Figure 8 shows exports of goods to Asian EM as a share of GDP for a range of countries in 2012, and the change in this export/GDP ratio since 2002, to give a sense of vulnerabilities.

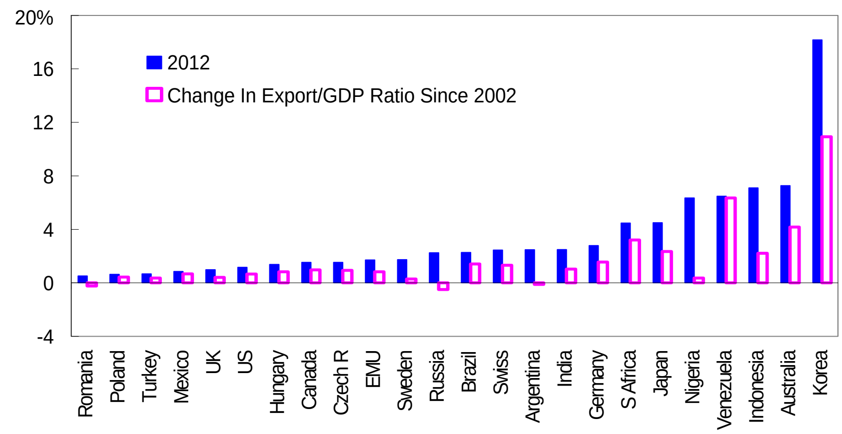
The euro area growth outlook is a little better, but still weak

Our euro area forecasts are a little higher this month. Our 2013 forecast (-0.7%) is little changed from the start of this year, but our 2014 forecast has crept up from -0.4% to +0.2% over that period. There are tentative signs in surveys that activity may be leveling off after six quarters of negative growth. Nevertheless, powerful headwinds remain from private deleveraging and tight fiscal policy, while exports will be capped by China's slowdown and the euro's appreciation (up 10% trade-weighted since Aug-12). Nominal GDP has been roughly flat over the last two quarters and has risen by just 0.4% YoY. Under these conditions, overall euro area inflation is likely to remain low for many years, with core inflation likely to be around 1% YoY in 2014-17. Inflation ex tax is already slightly negative for Greece, Spain and Cyprus and nominal GDP growth is negative in a range of periphery countries (roughly -1% YoY in Italy and Spain, -2% YoY in Ireland, -3½% YoY in Portugal and -8% YoY in Greece).

[4] See "*Global Economic Prospects*", World Bank, June 2013.

[5] See "China Macro View: Outlook for 2H: Tighter Credit to Extend the Downtrend", Minggao Shen, Shurang Ding, Enjiang Cheng, 7 July 2013, Citi.

Figure 8. Selected Countries — Exports to Asian Emerging Markets (Incl China) as Pct GDP



Sources: IMF and Citi Research

The periphery countries face extended economic weakness and deteriorating credit quality

We expect that time will not significantly improve the situation for the periphery countries which (with the possible exception of Ireland) are probably locked into a path of escalating public debt ratios and deteriorating private credit quality for this year and coming years, even with continued fiscal tightening. Political support for austerity is weakening and austerity fatigue is likely to become more widespread amidst continued economic depression and further rises in unemployment. Longer term, we suspect that further restructuring of public and private liabilities is likely in several periphery countries, and indeed restructuring of bank liabilities is likely to become more common throughout the euro area, core as well as periphery. The distribution of losses inevitably is uncertain but, as recently, the burden of restructuring may well continue to fall on some creditors of failed banks and official holders of sovereign debt, rather than on private holders of sovereign debt.

Central banks are likely to follow diverging paths, with tapering in the US, tolerance for slowdown in China, but a focus on renewed expansion via guidance in Europe

With this backdrop, central banks are likely to follow divergent policy paths, a very different picture to the concerted (albeit not really coordinated) stimulus of recent years. As noted above, we expect the Fed will begin to taper asset purchases later this year, with the first rate hike probably in H2-2015. For China, recent monetary data and PBOC comments indicate that, even with the economic slowdown, credit conditions may become less accommodating in 2H[6]. The ECB and UK MPC already have shown their desire to decouple European interest rate expectations from the rising US trend, with moves towards forward guidance. We expect that the UK MPC will introduce Fed-style forward guidance at the August meeting, with a jobless threshold of 6.5% or 7.0% and an inflation (in terms of the forecast) knockout set at 0.5% above the 2% longrun inflation aim. Such a framework will probably help cap policy rate expectations for an extended period, given the sluggish economy and ample labour market slack. The ECB probably will cut the refi rate further later this year in response to sluggish economic conditions and subdued inflation prospects. If market rate expectations ratchet higher, the ECB probably would strengthen its forward guidance. One possibility would be for the ECB to stretch its inflation forecast a year or two ahead in order to allow the current “extended period” language to be firmed up into an intention to not raise rates until the end of 2014 (ie guidance analogous to that used by the BoC in 2009). In practice, we expect that several years of ultra-low policy rates still lie ahead for the UK and euro area.

[6] See “China Macro Flash: Policy Support Needed to Defend 7.5% Growth”, Shuang Ding, Minggao Shen and Enjiang Cheng, 15 July 2013, Citi.

Figure 9. Selected Countries — Economic Forecast Overview (Percent), 2012-2017F

	GDP Growth						CPI Inflation						Short-Term Interest Rates					
	2012	2013F	2014F	2015F	2016F	2017F	2012	2013F	2014F	2015F	2016F	2017F	2012	2013F	2014F	2015F	2016F	2017F
Global	**2.5**	**2.5**	**3.1**	**3.4**	**3.6**	**3.7**	**2.9**	**3.0**	**3.2**	**3.1**	**3.2**	**3.2**	**2.35**	**2.19**	**2.29**	**2.60**	**2.98**	**3.37**
Based on PPP weights	3.1	3.0	3.6	3.9	4.1	4.2	3.4	3.4	3.6	3.6	3.6	3.7	2.93	2.73	2.83	3.13	3.47	3.81
Industrial Countries	**1.2**	**1.0**	**1.8**	**2.0**	**2.2**	**2.2**	**1.8**	**1.2**	**1.6**	**1.4**	**1.4**	**1.4**	**0.62**	**0.46**	**0.41**	**0.68**	**1.15**	**1.70**
United States	**2.2**	**1.6**	**2.9**	**3.2**	**3.2**	**3.0**	**1.8**	**1.1**	**1.9**	**2.1**	**2.1**	**2.1**	**0.25**	**0.25**	**0.25**	**0.75**	**1.65**	**2.50**
Japan	**1.9**	**2.2**	**2.0**	**1.0**	**1.2**	**1.2**	**0.0**	**0.0**	**1.9**	**0.7**	**0.5**	**0.7**	**0.10**	**0.10**	**0.10**	**0.10**	**0.10**	**0.10**
Euro Area	**-0.5**	**-0.7**	**0.2**	**0.7**	**1.2**	**1.5**	**2.5**	**1.5**	**1.3**	**1.2**	**1.3**	**1.3**	**0.88**	**0.50**	**0.25**	**0.25**	**0.31**	**0.75**
Canada	1.7	1.8	2.6	3.0	3.0	2.8	1.5	1.2	1.9	2.0	2.0	2.0	1.00	1.00	1.00	1.63	2.44	3.00
Australia	3.6	2.6	3.1	3.0	3.0	3.2	1.8	2.2	2.8	2.8	2.5	2.3	3.56	2.69	2.69	3.63	4.75	4.75
New Zealand	2.2	2.6	2.8	2.0	1.9	1.8	1.1	1.2	2.3	2.4	2.3	2.1	2.50	2.54	3.19	4.75	5.00	5.00
Germany	0.9	0.3	1.5	1.7	1.7	1.7	2.0	1.5	2.2	2.2	2.0	1.8						
France	0.0	-0.2	0.5	0.9	1.4	1.9	2.2	1.0	1.6	1.4	1.7	1.5						
Italy	-2.4	-2.0	-0.6	0.2	0.4	0.8	3.3	1.5	1.3	0.7	0.3	0.4						
Spain	-1.4	-1.7	-0.9	0.1	1.2	1.9	2.4	1.7	0.9	0.6	0.5	0.6						
Greece	-6.4	-5.0	-4.3	-2.3	0.6	1.3	1.0	-0.4	-0.9	-0.6	0.2	0.3						
Ireland	0.1	-0.2	2.2	2.4	2.7	2.7	0.7	-0.4	1.4	1.6	1.6	1.6						
Portugal	-3.2	-3.0	-1.4	0.1	1.1	1.1	2.8	0.8	0.3	-0.2	0.4	0.6						
Netherlands	-1.3	-1.2	0.2	0.9	1.2	1.6	2.8	2.8	1.7	1.5	1.8	1.6						
Belgium	-0.3	-0.2	0.4	1.0	1.4	1.6	2.8	1.2	1.9	1.8	1.9	1.9						
Denmark	-0.4	0.1	0.6	1.3	1.5	1.5	2.4	0.9	1.5	1.7	1.8	1.9	0.43	0.10	0.20	0.40	0.60	1.00
Norway	3.3	2.4	2.7	2.8	2.7	2.7	0.7	1.7	1.5	1.8	1.9	2.3	1.55	1.50	1.56	2.00	2.51	3.08
Sweden	1.1	1.2	2.0	2.5	2.5	2.9	0.9	0.1	1.0	1.8	2.2	2.3	1.45	1.00	1.00	1.32	1.73	2.29
Switzerland	1.0	1.5	1.2	1.7	1.8	1.5	-0.7	-0.3	-0.1	1.0	1.0	1.0	0.00	0.00	0.00	0.00	0.00	0.00
United Kingdom	0.1	0.9	1.3	1.8	1.7	1.7	2.8	2.6	2.2	2.4	2.2	2.2	0.50	0.50	0.50	0.50	0.50	1.04
Emerging Markets	**4.7**	**4.7**	**5.1**	**5.3**	**5.5**	**5.6**	**4.6**	**4.7**	**4.7**	**4.6**	**4.6**	**4.6**	**5.20**	**4.90**	**5.07**	**5.35**	**5.50**	**5.58**
China	**7.8**	**7.4**	**7.1**	**7.0**	**7.5**	**7.3**	**2.6**	**2.7**	**3.0**	**3.5**	**3.8**	**4.0**	**3.25**	**3.00**	**3.13**	**3.25**	**3.38**	**3.75**
Taiwan	1.3	2.9	3.8	4.0	4.5	4.5	1.9	1.5	1.9	1.8	1.8	1.8	1.88	1.88	1.97	2.38	2.88	3.38
India	5.0	5.7	6.4	7.2	7.3	7.5	7.3	5.5	5.0	5.0	5.0	5.0	7.80	6.75	6.75	6.75	6.75	6.75
Indonesia	6.2	6.0	6.1	6.2	6.3	6.3	4.3	7.0	5.4	5.7	5.4	5.3	3.90	4.56	5.00	5.25	5.25	5.25
Korea	2.0	2.9	3.7	3.9	4.2	3.7	2.2	1.6	2.6	3.2	3.1	3.0	3.06	2.56	2.50	3.00	3.75	4.00
Czech Republic	-1.2	-0.8	1.3	2.1	2.4	2.7	3.3	1.4	1.5	2.1	1.8	2.0	0.51	0.05	0.05	0.44	1.29	2.08
Hungary	-1.7	0.6	1.4	1.0	1.3	1.7	5.7	2.1	2.6	3.5	3.5	3.3	6.77	4.33	3.88	4.98	5.00	5.00
Poland	1.9	1.3	2.8	3.3	3.3	3.2	3.7	0.8	1.9	2.5	2.5	2.5	4.61	2.92	2.75	3.75	4.67	4.71
Romania	0.4	1.6	2.8	3.5	4.0	4.0	3.3	4.8	3.3	3.2	2.5	2.5	5.25	5.00	4.75	5.31	5.00	5.00
Russia	3.4	2.1	2.8	3.3	3.3	3.3	5.1	6.9	5.4	5.1	5.0	4.7	8.07	8.00	7.50	7.00	7.00	7.00
Turkey	2.2	3.5	4.0	4.2	4.2	4.2	8.9	7.3	7.3	6.9	6.4	5.8	5.69	4.75	5.00	7.25	7.50	7.50
Nigeria	7.4	6.5	6.9	6.8	7.1	7.0	12.2	8.9	10.0	12.2	10.8	9.9	12.00	11.75	11.75	12.50	11.25	9.00
South Africa	2.5	2.3	2.9	3.4	3.9	4.4	5.7	5.6	5.8	5.9	5.8	5.8	5.28	5.00	4.83	5.38	6.00	6.00
Argentina	1.9	4.4	3.0	2.0	-2.0	3.5	10.0	10.4	12.6	15.0	50.0	30.0	13.89	16.95	21.43	24.00	24.00	24.00
Brazil	0.9	2.2	2.5	2.5	3.0	3.0	5.4	6.4	6.1	5.7	5.5	5.5	8.46	8.29	9.25	10.00	10.13	9.50
Mexico	3.9	2.7	4.2	4.0	3.8	3.7	4.1	3.8	3.4	3.6	3.6	3.6	4.50	4.08	4.00	4.44	5.90	6.42
Venezuela	5.6	-0.5	1.5	2.1	2.5	2.6	21.1	34.7	32.5	24.8	22.9	22.9	14.50	14.50	14.50	14.80	14.80	14.80

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

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

	Current Balance (Pct of GDP)						Fiscal Balance (Pct of GDP)						Government Debt (Pct of GDP)					
	2012	2013F	2014F	2015F	2016F	2017F	2012	2013F	2014F	2015F	2016F	2017F	2012	2013F	2014F	2015F	2016F	2017F
Global	**0.3**	**0.4**	**0.2**	**-0.1**	**-0.3**	**-0.4**	**-4.4**	**-3.9**	**-3.3**	**-2.8**	**-2.6**	**-2.4**	**87**	**88**	**86**	**86**	**85**	**83**
Based on PPP weights	0.2	0.2	0.1	-0.3	-0.5	-0.6	-4.2	-3.8	-3.4	-2.9	-2.7	-2.6	78	79	80	79	78	76
Industrial Countries	**-0.6**	**-0.1**	**-0.1**	**-0.3**	**-0.2**	**-0.2**	**-6.1**	**-4.9**	**-3.7**	**-3.0**	**-2.7**	**-2.4**	**113**	**117**	**116**	**116**	**116**	**116**
United States	**-2.8**	**-2.8**	**-2.8**	**-3.0**	**-3.0**	**-3.0**	**-8.3**	**-6.0**	**-4.5**	**-4.0**	**-4.0**	**-4.0**	**106**	**109**	**111**	**112**	**112**	**112**
Japan	**1.1**	**1.4**	**2.7**	**1.8**	**1.5**	**1.3**	**-10.7**	**-9.8**	**-8.0**	**-6.2**	**-5.8**	**-5.4**	**237**	**244**	**246**	**251**	**255**	**258**
Euro Area	**1.2**	**2.5**	**2.3**	**2.3**	**2.3**	**2.3**	**-3.7**	**-3.0**	**-2.3**	**-1.7**	**-1.3**	**-0.5**	**93**	**96**	**97**	**97**	**96**	**94**
Canada	-3.4	-3.0	-3.1	-3.1	-2.6	-2.2	-1.4	-1.0	-0.3	0.0	0.2	0.2	84	84	83	82	80	79
Australia	-3.7	-2.8	-3.6	-3.5	-3.2	-3.0	-3.0	-1.3	-1.1	-0.6	0.0	0.4	29	28	29	28	26	24
New Zealand	-4.9	-5.5	-6.8	-9.6	-12.2	-12.9	-5.3	-3.1	-0.9	-0.5	-0.2	0.3	39	38	41	40	41	42
Germany	7.0	6.7	5.4	4.6	4.1	3.9	0.2	-0.5	0.1	0.4	0.4	1.3	82	81	78	75	72	69
France	-2.2	-1.6	-0.8	-0.2	0.3	0.0	-4.8	-3.9	-3.6	-3.5	-3.0	-2.5	90	94	96	98	98	97
Italy	-0.5	1.7	2.4	2.5	2.7	2.8	-3.0	-3.5	-3.2	-3.0	-2.8	-2.5	127	133	138	140	142	142
Spain	-1.1	1.0	1.8	3.1	3.8	4.0	-10.6	-6.5	-6.0	-4.9	-4.0	-3.2	84	94	104	108	110	110
Greece	-3.4	-0.7	0.4	1.1	3.6	4.7	-10.0	-5.5	-4.9	-3.7	-2.4	-1.0	157	181	199	212	216	217
Ireland	4.4	7.5	10.2	11.0	11.7	12.2	-7.6	-8.4	-5.7	-3.7	-3.0	-2.8	120	131	129	126	124	121
Portugal	-1.5	1.0	3.0	3.4	3.4	3.7	-6.4	-6.0	-5.7	-4.5	-3.9	-3.4	124	135	151	155	156	157
Netherlands	10.1	9.4	8.9	9.5	9.5	9.6	-4.1	-3.8	-3.4	-2.8	-2.3	-1.4	71	75	76	77	77	76
Belgium	-1.6	-2.0	-1.6	-1.0	-0.2	0.5	-3.9	-3.2	-2.9	-2.1	-1.5	-1.3	100	102	103	103	101	98
Denmark	6.2	5.3	4.7	4.2	4.0	3.8	-4.3	-2.0	-1.5	-1.0	0.5	1.0	46	47	48	47	45	43
Norway	14.2	14.5	14.9	15.2	15.4	15.0	13.8	13.1	13.0	14.0	15.5	15.0	NA	NA	NA	NA	NA	NA
Sweden	6.9	7.1	6.9	6.7	6.8	6.7	-0.6	-1.5	-1.5	-0.4	0.7	1.5	38	39	40	39	36	33
Switzerland	12.8	12.8	12.4	12.4	13.7	14.0	0.5	0.6	0.6	0.6	0.5	-0.6	47	45	44	43	43	43
United Kingdom	-3.7	-3.4	-3.3	-3.1	-3.0	-2.9	-6.3	-7.1	-6.3	-5.6	-4.2	-3.2	90	94	98	101	102	102
Emerging Markets	**1.7**	**1.1**	**0.7**	**0.1**	**-0.3**	**-0.6**	**-1.7**	**-2.4**	**-2.6**	**-2.5**	**-2.4**	**-2.4**	**43**	**42**	**42**	**41**	**40**	**39**
China	**2.3**	**2.2**	**2.0**	**1.5**	**0.8**	**0.5**	**-2.0**	**-2.0**	**-2.0**	**-1.5**	**-1.5**	**-1.5**	**45**	**45**	**45**	**44**	**43**	**42**
Taiwan	10.5	9.1	8.5	8.0	8.0	8.0	-1.6	-1.2	-1.3	-1.0	-0.7	-0.5	41	41	41	42	43	44
India	-4.8	-4.1	-3.2	-3.3	-3.3	-3.3	-7.0	-6.7	-6.4	-6.2	-5.9	-5.6	68	67	66	65	64	63
Indonesia	-2.7	-2.4	-2.2	-1.8	-1.6	-1.4	-1.8	-2.1	-1.4	-1.0	-0.5	-0.4	24	23	23	21	20	20
Korea	3.8	4.0	2.2	0.7	0.2	-0.5	1.5	0.9	2.3	2.3	2.6	2.1	33	35	33	31	29	28
Czech Republic	-2.4	-1.3	-2.0	-2.4	-2.5	-2.3	-4.4	-2.8	-2.9	-2.9	-3.0	-2.5	46	48	50	51	52	52
Hungary	1.6	2.8	3.8	5.0	6.0	7.3	-1.9	-2.8	-2.9	-3.0	-2.8	-3.0	79	79	78	77	76	75
Poland	-3.5	-2.7	-3.6	-3.8	-4.3	-4.3	-3.9	-3.9	-3.5	-3.1	-3.0	-3.0	53	55	55	54	53	53
Romania	-3.9	-3.0	-4.5	-4.7	-5.0	-5.0	-2.2	-2.2	-2.5	-2.3	-2.0	-2.0	41	40	39	38	37	37
Russia	3.9	2.8	0.9	-1.7	-3.1	-4.2	-0.7	-2.0	-4.1	-4.6	-3.5	-3.5	8	8	10	13	15	16
Turkey	-5.8	-6.9	-6.6	-6.2	-5.6	-4.7	-2.0	-2.2	-2.7	-2.7	-3.0	-3.0	39	38	37	36	36	36
Nigeria	4.0	2.3	0.4	0.7	0.5	0.1	-2.8	-2.6	-2.8	-3.3	-2.7	-2.8	NA	NA	NA	NA	NA	NA
South Africa	-6.1	-5.9	-5.7	-5.0	-4.1	-3.1	-4.4	-4.9	-4.8	-4.4	-3.7	-3.5	41	43	44	44	43	43
Argentina	0.1	0.0	0.2	0.2	3.0	1.0	-2.6	-2.7	-3.6	-3.8	0.0	-0.5	39	40	43	44	42	41
Brazil	-2.4	-3.3	-3.7	-4.0	-4.2	-4.4	-2.5	-3.6	-3.7	-2.7	-3.2	-3.2	59	59	59	59	59	60
Mexico	-0.9	-1.6	-1.5	-2.5	-2.7	-2.7	-2.6	-2.1	-2.0	-2.0	-2.0	-2.0	40	38	38	38	37	37
Venezuela	3.1	5.3	7.2	6.2	5.5	6.1	-5.0	-4.0	-4.0	-4.8	-4.6	-4.5	42	45	48	48	49	49

Note: Fiscal deficit and debt figures for all countries are general government debt and deficits. We assume sovereign debt restructuring in Portugal, Italy and Spain in 2015 and Greece in 2017. For Spain, fiscal deficits include the effect of financial support for banks in 2011 (€5.4bn) and 2012 (€33.5bn). Source: Citi Research

Figure 11. Selected Countries — Changes in Economic Forecast from the Previous Month (Percentage Points), 2012-2014F

	GDP Growth			CPI Inflation			Current Balance (Pct of GDP)			Fiscal Balance (Pct of GDP)		
	2012	2013F	2014F	2012	2013F	2014F	2012	2013F	2014F	2012	2013F	2014F
Global		**-0.1**	**-0.1**									
Based on PPP weights		-0.1	-0.1						0.1		0.1	
Industrial Countries		**-0.1**				**0.1**			**0.1**		**0.1**	**0.1**
United States		**-0.3**										
Japan			**0.1**			**-0.1**		**0.3**	**0.7**			
Euro Area		**0.1**	**0.2**		**0.1**	**0.1**					**0.1**	**0.3**
Canada					0.1	0.1		-0.2	-0.5			
Australia					-0.4	0.3		0.1	0.1			
New Zealand										0.9	0.2	
Germany												0.1
France		0.1	0.1				0.1	0.1	0.2		-0.1	
Italy						0.1		0.1	0.2		-0.3	-0.2
Spain		0.2	0.3		0.1	0.1		-0.1	-0.2			-0.1
Greece		0.5	0.2		0.1	0.1		-0.3	-0.3		-0.4	-0.8
Ireland	-0.8	-1.2	-0.1	-1.2	-1.7			2.6	4.3	-0.3	-1.1	-1.4
Portugal		0.1	0.2		-0.1	0.1					-0.4	-0.6
Netherlands	-0.3	-0.2	0.1		0.1	-0.1					-0.2	-0.2
Belgium		0.1	0.2		0.1	-0.1	-0.2	-0.7	-0.5		0.2	0.3
Denmark	0.1	-0.1	-0.5		-0.2		0.4		0.1	-0.2		-0.3
Norway						-0.2						
Sweden									-0.1	0.1	-0.1	
Switzerland					0.2	0.1						
United Kingdom	-0.2	-0.1	0.1		-0.1	-0.1		-0.6	-0.4		0.3	0.6
Emerging Markets		**-0.1**	**-0.1**					**0.1**	**0.1**			
China		**-0.2**	**-0.2**		**0.1**							
Taiwan												
India							0.4		0.1			
Indonesia		-0.1	-0.2		0.1				-0.4			
Korea					-0.2	-0.2		0.8	0.4			
Czech Republic					0.2	-0.1			-0.1			
Hungary		0.2	0.1		0.1	-0.5		0.6	0.7		-0.1	
Poland									-0.1			
Romania							-0.1	0.9				
Russia					0.2							
Turkey		-0.5	-0.3		-0.1				0.4			
Nigeria												
South Africa					-0.4	0.3						
Argentina		1.3			0.1	0.1						-0.7
Brazil		-0.3	-0.5		-0.1	0.1		-0.2	-0.1			
Mexico					-0.1		-0.2	0.1	0.1			
Venezuela					1.5	3.6		0.2	2.2			

Source: Citi Research

Figure 12. Selected Countries — Economic Forecast Overview and Exchange Rate Forecasts (Percent), 2012-2017F

	10-Year Yields						Exchange Rates Versus U.S. Dollar*						Exchange Rate Versus Euro					
	2012	2013F	2014F	2015F	2016F	2017F	2012	2013F	2014F	2015F	2016F	2017F	2012	2013F	2014F	2015F	2016F	2017F
Industrial Countries																		
United States	**1.80**	**2.30**	**3.15**	**3.25**	**3.50**	**3.75**	**NA**	**NA**	**NA**	**NA**	**NA**	**NA**	**1.28**	**1.29**	**1.30**	**1.35**	**1.35**	**1.35**
Japan	**0.85**	**0.80**	**0.75**	**1.00**	**1.25**	**1.50**	**81**	**100**	**110**	**110**	**110**	**110**	**104**	**129**	**143**	**148**	**149**	**149**
Euro Area	**1.57**	**1.51**	**1.63**	**1.80**	**2.00**	**2.50**	**1.28**	**1.29**	**1.30**	**1.35**	**1.35**	**1.35**	**NA**	**NA**	**NA**	**NA**	**NA**	**NA**
Canada	1.87	2.27	3.10	3.50	3.50	3.65	1.00	1.05	1.10	1.10	1.08	1.07	1.28	1.35	1.43	1.48	1.46	1.44
Australia	3.28	3.51	4.03	4.69	5.50	5.50	1.02	0.94	0.88	0.88	0.90	0.91	1.24	1.37	1.48	1.52	1.50	1.48
New Zealand	3.61	3.72	4.78	5.69	6.00	6.00	0.82	0.79	0.75	0.75	0.75	0.75	1.57	1.63	1.73	1.79	1.80	1.80
Germany	1.57	1.51	1.63	1.80	2.00	2.50												
France	2.54	2.12	2.40	2.50	2.60	3.00												
Italy	5.49	4.38	4.19	5.30	5.00	5.00												
Spain	5.88	4.76	4.38	5.55	5.00	5.00												
Netherlands	1.95	1.85	2.03	2.20	2.30	2.80												
Belgium	2.43	2.35	2.66	2.60	2.80	3.20												
Denmark	1.51	1.66	1.75	1.95	2.25	2.75	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
Norway	2.15	2.36	2.43	2.55	2.75	3.25	5.81	6.06	6.02	5.67	5.50	5.34	7.45	7.83	7.83	7.63	7.42	7.21
Sweden	1.59	1.91	2.03	2.10	2.30	2.80	6.73	6.74	6.77	6.42	6.28	6.16	8.63	8.71	8.79	8.63	8.47	8.31
Switzerland	0.64	0.80	0.86	0.89	1.04	1.30	0.94	0.96	0.97	0.96	0.96	0.95	1.20	1.24	1.26	1.30	1.29	1.29
United Kingdom	1.85	2.05	2.50	2.80	3.00	3.50	1.59	1.49	1.48	1.55	1.59	1.62	0.81	0.86	0.88	0.87	0.85	0.83
Emerging Markets																		
China	**3.33**	**3.32**	**3.45**	**3.57**	**3.70**	**4.07**	**6.31**	**6.17**	**6.13**	**6.01**	**6.02**	**6.04**	**8.11**	**7.97**	**7.97**	**8.09**	**8.13**	**8.16**
Taiwan	1.21	1.35	1.46	1.50	1.70	2.00	29.57	30.08	29.65	29.01	28.71	28.44	38.03	38.86	38.55	39.04	38.76	38.40
India	8.25	7.75	7.75	7.75	7.75	7.75	53.38	58.81	60.85	58.01	56.47	55.07	68.65	75.97	79.10	78.06	76.23	74.34
Indonesia	5.90	7.43	8.00	8.25	8.25	8.25	9361	10004	10114	9896	9754	9621	12038	12924	13148	13316	13168	12988
Korea	3.24	3.09	3.59	3.83	4.18	4.43	1127	1147	1107	1004	992	990	1449	1482	1439	1351	1340	1337
Czech Republic	2.75	1.97	1.96	2.32	2.61	2.61	19.5	20.1	19.6	18.1	17.6	17.3	25.1	25.9	25.5	24.3	23.8	23.4
Hungary	7.91	5.95	6.23	6.50	6.50	6.50	225	232	229	216	215	215	289	300	297	291	290	290
Poland	5.05	3.91	4.55	4.68	5.16	5.01	3.25	3.32	3.27	2.98	2.94	2.91	4.18	4.29	4.25	4.02	3.96	3.93
Romania	NA	NA	NA	NA	NA	NA	3.46	3.28	3.09	2.97	2.94	2.97	4.45	4.24	4.02	4.00	3.98	4.01
Russia	NA	NA	NA	NA	NA	NA	31.1	32.3	33.3	33.3	33.3	33.3	40.0	41.7	43.3	44.8	44.9	44.9
Turkey	NA	NA	NA	NA	NA	NA	1.80	1.94	2.03	2.06	2.01	1.96	2.32	2.50	2.64	2.77	2.72	2.64
Nigeria	NA	NA	NA	NA	NA	NA	159	159	164	168	171	175	204	206	213	226	231	236
South Africa	7.23	6.81	8.00	9.15	9.20	9.25	8.21	9.83	10.28	10.49	10.57	10.64	10.56	12.70	13.37	14.12	14.27	14.36
Argentina	NA	NA	NA	NA	NA	NA	4.54	5.46	6.74	8.72	13.45	18.82	5.84	7.06	8.76	11.73	18.15	25.41
Brazil	9.31	8.98	11.25	12.00	10.88	10.25	1.95	2.16	2.24	2.33	2.30	2.26	2.51	2.79	2.91	3.14	3.11	3.05
Mexico	5.70	5.43	6.52	7.16	7.46	7.95	13.2	12.6	12.4	12.3	12.3	12.3	16.9	16.3	16.1	16.6	16.6	16.6
Venezuela	11.26	10.91	10.67	15.50	15.50	15.50	4.29	6.13	9.50	9.75	10.50	12.71	5.52	7.92	12.35	13.12	14.18	17.15

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

Figure 13. Short Rates (End of Period), as of 17 July 2013 (Percent)

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

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

Figure 14. 10-Year Yield Forecasts (Period Average), as of 17 July 2013 (Percent)

	Current	3Q 13	4Q 13	1Q 14	2Q 14	3Q 14	4Q 14
United States	**2.60**	**2.60**	**2.65**	**2.80**	**3.00**	**3.15**	**3.25**
Japan	**0.85**	**0.90**	**0.90**	**0.80**	**0.60**	**0.80**	**0.80**
Euro Area (Germany)	**1.58**	**1.55**	**1.50**	**1.50**	**1.50**	**1.70**	**1.80**
Canada	2.40	2.55	2.65	2.85	3.05	3.20	3.30
Australia	3.76	3.55	3.70	3.80	3.90	4.10	4.30
New Zealand	4.18	4.00	4.20	4.35	4.55	4.90	5.30
Denmark	1.69	1.70	1.60	1.60	1.60	1.80	1.90
Norway	2.64	2.35	2.35	2.30	2.30	2.55	2.65
Sweden	2.08	2.00	1.90	1.85	1.90	2.15	2.25
Switzerland	1.01	0.90	0.80	0.77	0.77	0.91	0.98
United Kingdom	2.32	2.20	2.25	2.30	2.40	2.60	2.75

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

Figure 15. 10-Year Yield Spreads (Period Average), as of 17 July 2013

	Spread vs. US$						Spread vs. Germany					
	Current	3Q 13	4Q 13	1Q 14	2Q 14	3Q 14	Current	3Q 13	4Q 13	1Q 14	2Q 14	3Q 14
United States	**NA**	**NA**	**NA**	**NA**	**NA**	**NA**	**104**	**107**	**117**	**132**	**152**	**147**
Japan	**-172**	**-172**	**-187**	**-222**	**-222**	**-237**	**-68**	**-65**	**-70**	**-90**	**-70**	**-90**
Euro Area	**-104**	**-107**	**-117**	**-132**	**-152**	**-147**	**NA**	**NA**	**NA**	**NA**	**NA**	**NA**
Canada	-20	-5	0	5	5	5	83	102	117	137	157	153
Australia	118	96	107	102	92	97	222	203	223	234	244	244
New Zealand	161	142	158	158	158	179	264	249	274	290	310	326
France	-41	-47	-47	-62	-72	-67	61	60	70	70	80	80
Italy	186	173	183	143	98	103	288	280	300	275	250	250
Spain	207	203	213	173	128	118	309	310	330	305	280	265
Netherlands	-62	-72	-77	-92	-112	-107	40	35	40	40	40	40
Belgium	-8	-22	-22	-32	-42	-42	94	85	95	100	110	105
Austria	-58	-67	-72	-87	-112	-107	44	40	45	45	40	40
Finland	-75	-82	-87	-102	-122	-117	27	25	30	30	30	30
Ireland	122	93	83	68	48	53	224	200	200	200	200	200
Denmark	-91	-92	-107	-122	-142	-137	11	15	10	10	10	10
Norway	4	-27	-32	-52	-72	-62	106	80	85	80	80	85
Sweden	-52	-62	-77	-97	-112	-102	50	45	40	35	40	45
Switzerland	-159	-172	-187	-205	-225	-226	-57	-65	-70	-73	-73	-79
United Kingdom	-28	-40	-40	-51	-61	-56	74	66	76	81	91	92

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

Figure 16. Emerging Market Countries — Short Rates Actual and Forecast of Additional Rate Moves (End of Period), as of 17 July 2013

Country	Current Rate (%)	Sep 13	Dec 13	Mar 14	Jun 14	Sep 14	Total Cumulative Rate Moves Expected
Philippines	3.50	0	0	25	50	25	100
Brazil	8.50	50	25	0	0	0	75
Turkey	4.50	0	0	0	0	50	50
Poland	2.50	0	0	0	0	50	50
Indonesia	4.75	25	0	0	0	0	25
Thailand	2.50	0	0	0	0	25	25
Korea	2.50	0	0	0	0	0	0
Mexico	4.00	0	0	0	0	0	0
Czech	0.05	0	0	0	0	0	0
China	3.00	0	0	0	0	0	0
Israel	1.25	-25	0	25	0	0	0
Chile	5.00	-50	0	0	0	50	0
South Africa	5.00	0	0	-25	0	0	-25
Romania	5.00	-25	0	0	0	0	-25
India	7.25	0	-25	-25	0	0	-50
Hungary	4.25	-50	0	0	0	0	-50

Source: Citi Research

Figure 17. Foreign Exchange Forecasts (End of Period), as of 17 July 2013

	vs. USD						vs. EUR					
	Current	Sep 13	Dec 13	Mar 14	Jun 14	Sep 14	Current	Sep 13	Dec 13	Mar 14	Jun 14	Sep 14
United States	**NA**	**NA**	**NA**	**NA**	**NA**	**NA**	**1.30**	**1.30**	**1.29**	**1.28**	**1.29**	**1.31**
Japan	**99**	**100**	**105**	**109**	**110**	**110**	**130**	**130**	**135**	**140**	**142**	**144**
Euro Area	**1.30**	**1.30**	**1.29**	**1.28**	**1.29**	**1.31**	**NA**	**NA**	**NA**	**NA**	**NA**	**NA**
Canada	1.04	1.04	1.07	1.10	1.10	1.10	1.35	1.35	1.38	1.40	1.42	1.44
Australia	0.90	0.92	0.90	0.88	0.88	0.88	1.44	1.41	1.43	1.45	1.47	1.48
New Zealand	0.78	0.79	0.77	0.75	0.75	0.75	1.67	1.65	1.68	1.70	1.72	1.74
Norway	6.07	6.16	6.16	6.17	6.08	5.98	7.91	7.98	7.94	7.90	7.86	7.81
Sweden	6.68	6.86	6.89	6.91	6.82	6.72	8.70	8.89	8.87	8.85	8.82	8.78
Switzerland	0.95	0.96	0.97	0.98	0.97	0.97	1.24	1.25	1.25	1.25	1.26	1.27
United Kingdom	1.51	1.47	1.46	1.46	1.47	1.49	0.86	0.88	0.88	0.88	0.88	0.88
China	**6.14**	**6.16**	**6.17**	**6.18**	**6.15**	**6.11**	**8.0**	**8.0**	**7.9**	**7.9**	**7.9**	**8.0**
India	59.6	60.4	61.2	61.9	61.3	60.5	77.7	78.3	78.8	79.3	79.2	79.0
Korea	1124	1174	1163	1151	1123	1092	1466	1521	1498	1475	1451	1426
Poland	3.31	3.33	3.36	3.39	3.32	3.23	4.31	4.31	4.33	4.35	4.29	4.22
Russia	32.8	32.4	32.8	33.2	33.3	33.3	42.7	42.0	42.3	42.6	43.0	43.5
South Africa	10.03	10.08	10.14	10.19	10.25	10.31	13.07	13.06	13.06	13.06	13.25	13.47
Turkey	1.96	2.00	2.01	2.02	2.03	2.04	2.55	2.60	2.59	2.59	2.62	2.66
Brazil	2.27	2.20	2.20	2.20	2.23	2.26	2.96	2.85	2.83	2.82	2.88	2.95
Mexico	12.8	12.7	12.6	12.4	12.4	12.4	16.7	16.5	16.2	15.9	16.0	16.1

Source: Citi Research

Figure 18. Foreign Exchange Forecasts (End of Period), as of 17 July 2013

	vs. JPY					
	Current	Sep 13	Dec 13	Mar 14	Jun 14	Sep 14
United States	**99**	**100**	**105**	**109**	**110**	**110**
Japan	**NA**	**NA**	**NA**	**NA**	**NA**	**NA**
Euro Area	**130**	**130**	**135**	**140**	**142**	**144**
Canada	96	96	98	100	100	100
Australia	90	92	95	97	97	97
New Zealand	77.5	78.9	80.7	82.3	82.5	82.5
Norway	16.4	16.3	17.0	17.7	18.1	18.4
Sweden	14.9	14.6	15.2	15.8	16.1	16.4
Switzerland	105	104	108	112	113	113
United Kingdom	150	148	154	159	162	164
China	**16**	**16**	**17**	**18**	**18**	**18**
India	1.67	1.66	1.72	1.77	1.79	1.82
Korea	11.30	11.69	11.08	10.52	10.21	9.93
Poland	30.0	30.2	31.2	32.2	33.1	34.1
Russia	3.0	3.1	3.2	3.3	3.3	3.3
South Africa	9.9	10.0	10.4	10.7	10.7	10.7
Turkey	50.8	50.1	52.2	54.2	54.2	54.0
Brazil	43.9	45.6	47.7	49.7	49.4	48.8
Mexico	7.8	7.9	8.4	8.8	8.9	8.9

Source: Citi Research

Country Commentary

United States

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Growth in output has slowed more than expected based on GDP tracking data, but private demand has been resilient along with job growth at midyear. So we have cut our Q4/Q4 growth estimate to 2% tentatively ahead of more complete Q2 data and comprehensive multi-year GDP revisions at month-end. Housing, capex, car sales and employment all are on moderately strong trajectories with still very accommodating financial conditions despite a back up in interest rates. The sequester is at its most intense now, and it will be especially key to monitor near-term demand for any spillover, which so far has been scant. Fiscal deficits may drop below 4% next year, and so the impetus for major budget reforms has waned.

Fed officials continue to emphasize that a near-term start to scaling back QE still would leave policy on a highly accommodative path where no rate hikes are planned for a long time. The fiscal drag on Q2 growth and a high bar for a satisfactory jobs outlook will likely sustain the current pace of purchases until the September meeting. But tapering could extend QE until next spring when unemployment is forecast to drop below 7%. Low inflation suggests policymakers will be slow to signal a start to exit strategies through 2014.

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

Figure 19. United States — Economic Forecasts, 2012-2014F

					2013				2014			
		2012	2013F	2014F	1Q	2QF	3QF	4QF	1QF	2QF	3QF	4QF
GDP	SAAR				1.8%	0.5%	2.6%	2.9%	3.2%	3.1%	3.1%	3.2%
	YoY	2.2%	1.6%	2.9%	1.6	1.4	1.3	2.0	2.3	2.9	3.1	3.1
Domestic Demand	SAAR				1.3	1.0	2.5	3.0	3.1	3.3	3.4	3.4
	YoY	2.1	1.6	3.0	1.5	1.4	1.6	1.9	2.4	3.0	3.2	3.3
Consumption	SAAR				2.6	1.5	2.8	3.0	3.3	3.4	3.5	3.4
	YoY	1.9	2.1	3.1	1.9	1.9	2.2	2.5	2.6	3.1	3.3	3.4
Business Investment	SAAR				0.4	2.1	4.5	6.2	5.0	5.3	5.9	7.3
	YoY	8.0	3.9	5.2	3.7	3.3	4.9	3.3	4.4	5.2	5.6	5.8
Housing Investment	SAAR				14.0	7.2	15.6	20.7	18.9	18.5	16.6	11.4
	YoY	12.1	13.6	17.2	13.3	13.0	13.5	14.3	15.5	18.4	18.7	16.3
Government	SAAR				-4.8	-2.4	-1.5	-1.1	-0.9	-0.7	-0.6	-0.6
	YoY	-1.7	-2.8	-1.0	-2.2	-2.7	-3.9	-2.4	-1.5	-1.0	-0.8	-0.7
Exports	SAAR				-1.1	5.9	3.6	3.7	4.2	4.4	4.6	5.0
	YoY	3.4	1.5	4.3	0.8	0.9	1.3	3.0	4.3	4.0	4.2	4.6
Imports	SAAR				-0.4	9.3	4.1	4.3	5.2	5.7	5.6	5.5
	YoY	2.4	1.7	5.3	-0.6	0.9	2.1	4.3	5.7	4.8	5.2	5.5
PCE Deflator	YoY	1.8	1.1	1.9	1.2	1.0	1.2	1.3	1.6	2.2	2.1	2.1
Core PCE Deflator	YoY	1.7	1.2	1.9	1.3	1.0	1.2	1.4	1.5	1.9	2.0	2.1
Unemployment Rate	%	8.1	7.5	6.8	7.7	7.6	7.5	7.1	6.9	6.8	6.8	6.6
Federal Gov't Balance (Fiscal Year)	$Bn	-1,098	-647	-541								
	% of GDP	-7.0	-4.0	-3.2								
General Gov't Balance (Cal Year)	% of GDP	-8.3	-6.0	-4.5								
Federal Debt	% of GDP	73	75	75								
General Gov't Debt	% of GDP	106	109	111								
Current Account	US$bn	-440	-453	-473	-425	-419	-444	-458	-464	-482	-499	-517
	% of GDP	-2.8	-2.8	-2.8	-2.7	-2.6	-2.7	-2.8	-2.8	-2.9	-2.9	-3.0
S&P 500 Profits (US$ Per Share)	YoY	6.1	6.0	6.4	5.0	6.3	6.0	6.8	6.4	6.7	6.7	6.7

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

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We expect solid growth to continue until the first quarter of 2014 before the consumption tax hike in April 2014 puts a strong brake on activity. The BoJ's June Tankan revealed a broad-based improvement in business confidence and significant upward revisions to business investment plans. Corporate sentiment and behaviour are thawing thanks to the yen's depreciation since last autumn, a turnaround in exports and industrial production, and resilience in domestic demand. Moreover, the Tankan diffusion index regarding banks' willingness to lend, which captures borrowers' assessment of lenders' attitude, improved and we regard this as a tentative sign that banks are shifting business focus from securities (especially JGBs) investment to traditional lending.

The most important key to monitor in the coming months is PM Abe's final decision regarding the consumption tax hike after the upcoming Upper House Election (likely in September or October). We assume that PM Abe will decide to implement the tax hike as planned while introducing another large fiscal stimulus package later this year or early next year in order to mitigate the initial negative impact from the tax hike. But even in that case, real GDP is likely to shrink, albeit temporarily, in Q2-2014 and this would make it difficult to achieve the BoJ's stated aim of returning inflation to 2% in two years' time.

We expect the BoJ to take additional easing actions early next year (likely January). If as we anticipate, it becomes clear that the BoJ's core inflation forecasts for this fiscal year (+0.6%), a pointer for the BoJ's target of 2% inflation, are unlikely to be met, the BoJ should take additional actions in order to validate its medium-term inflation forecasts of around 2%. In that case, we expect additional actions will be centred on purchases of risk assets such as equities rather than JGBs, given that the BoJ's large JGB purchase operations caused the unintended consequence of lower market liquidity, rising volatility and the higher JGB yields.

Figure 20. Japan — Economic Forecasts, 2012-14F

					2013				2014			
		2012	**2013F**	**2014F**	**1Q**	**2QF**	**3QF**	**4QF**	**1QF**	**2QF**	**3QF**	**4QF**
Real GDP	YoY	1.9%	2.2%	2.0%	0.2%	1.5%	3.3%	3.7%	3.7%	1.8%	1.5%	1.1%
	SAAR				4.1	4.3	3.7	2.6	4.2	-2.9	2.2	1.2
Domestic Demand	YoY	2.8	2.0	1.0	0.8	1.5	2.7	3.0	3.1	0.8	0.2	-0.2
	SAAR				2.5	3.5	3.2	2.9	2.7	-5.4	1.0	1.1
Private Consumption	YoY	2.3	1.8	0.4	1.1	1.4	2.2	2.3	2.7	-0.2	-0.3	-0.5
	SAAR				3.6	2.0	1.5	2.2	5.0	-8.9	1.0	1.4
Business Investment	YoY	1.9	-1.1	4.6	-5.2	-4.0	0.9	4.4	6.5	4.8	4.1	2.8
	SAAR				-1.2	4.0	7.0	8.1	7.0	-2.5	4.2	2.9
Housing Investment	YoY	3.0	9.2	-6.2	9.5	9.2	10.7	7.6	3.8	-5.9	-10.4	-11.7
Public Investment	YoY	12.6	13.4	1.4	13.1	15.0	14.0	11.5	5.0	2.6	0.2	-1.9
Exports	YoY	-0.1	2.3	5.6	-3.7	-1.5	5.0	10.0	7.3	6.5	5.0	3.8
	SAAR				16.1	9.4	7.8	6.9	5.1	6.2	1.9	1.9
Imports	YoY	5.5	1.4	-1.4	0.2	-0.7	0.8	5.5	3.2	-0.3	-3.1	-5.1
	SAAR				4.0	3.4	5.0	9.7	-4.7	-10.1	-6.3	1.2
CPI	YoY	0.0	0.0	1.9	-0.6	-0.2	0.5	0.4	0.4	2.5	2.3	2.3
Core CPI	YoY	-0.1	0.1	1.9	-0.3	0.0	0.5	0.4	0.4	2.5	2.3	2.3
Nominal GDP	YoY	1.1	1.2	2.7	-0.6	0.3	2.2	2.8	3.2	2.8	2.6	2.2
Current Account	¥ tn	5.2	6.9	13.5	3.1	7.6	8.5	8.2	10.0	13.5	15.2	15.3
	% of GDP	1.1	1.4	2.7	0.7	1.6	1.8	1.7	2.0	2.7	3.1	3.1
Unemployment Rate	%	4.4	4.1	3.9	4.2	4.1	4.0	3.9	3.8	3.8	3.9	4.0
Industrial Production	YoY	0.2	0.2	3.2	-7.9	-2.4	3.3	7.0	7.3	3.9	1.4	0.5
Corporate Profits (Fiscal Year)	YoY	5.0	40.0	3.0								
General Govt. Balance (Fiscal Year)	% of GDP	-10.7	-9.8	-8.0								
General Govt Debt	% of GDP	237	244	246								

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

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Euro Area

We lift our 2013 euro area GDP forecast by 0.1ppt to -0.7% and the 2014 GDP forecast by 0.2ppt to 0.2%. This change mainly reflects the likelihood of a better 2Q outcome (0.2% QQ compared to our 0.0% June forecast). Indeed, sentiment readings as well as some hard data (IP, retail sales) have recovered a bit during the second quarter, despite expectations remaining well below historical averages. We argue that the 0.8% 2014 GDP consensus forecast will disappoint, given the persistence of private sector credit contraction. European officials are focusing their growth strategy on two main angles: first, by introducing measures against youth unemployment, and second by excluding non-recurring and growth-supportive public investment programmes from deficit calculations. While these initiatives — alongside some action to repay some government arrears to the private sector — could be of some help for growth, we doubt that they will make much of a dent in the large output gap. On banking union, it is also clear that there are ongoing fundamental disagreements about the degree of centralisation of the resolution authority and the resolution fund, illustrating the difficulties of coordination.

The ECB is continuing to do what it can to cement the euro area's fragile recovery prospects against a backdrop of muted inflation dynamics. At the July meeting, President Draghi announced a new 'forward guidance' framework, allowing "*the key interest rates to remain at present or lower levels for an extended period of time*". Yet, within a few days of the announcement, various Governing Council members suggested that the decision, aiming to bring market expectations of monetary policy into line with the ECB's expectations of inflation trends, amounted more to a change of communication than a commitment to a rate path. ECB Coeuré's remarks that forward guidance "*would need to be reassessed each month*" highlighted the limited value of the guidance, beyond the introduction of a clear bias on the policy stance. We continue to believe that a likely delay in the ECB's 2H recovery scenario and muted price developments leave the door open to another small 25bp rate cut later in the year, most likely in 4Q.

Figure 21. Euro Area — Economic Forecasts, 2012-14F

					2013				2014			
		2012	2013F	2014F	1Q	2QF	3QF	4QF	1QF	2QF	3QF	4QF
Real GDP	YoY	-0.5%	-0.7%	0.2%	-1.1%	-0.8%	-0.6%	0.0%	0.2%	0.1%	0.1%	0.2%
	SAAR				-1.1	0.7	0.3	0.0	-0.1	0.1	0.5	0.2
Final Domestic Demand	YoY	-1.7	-1.1	0.1	-2.0	-1.2	-0.9	-0.3	0.1	0.1	0.1	0.1
Private Consumption	YoY	-1.3	-0.5	0.1	-1.3	-0.6	-0.4	0.2	0.2	0.0	0.1	0.2
Government Consumption	YoY	-0.4	-0.2	-0.2	-0.5	-0.1	0.0	-0.2	0.0	-0.2	-0.3	-0.1
Fixed Investment	YoY	-4.2	-3.9	0.4	-5.9	-4.3	-3.5	-1.7	0.3	0.5	0.5	0.3
— Business Equipment	YoY	-3.5	-4.7	1.4	-6.4	-5.4	-4.5	-2.5	0.7	1.6	1.8	1.6
— Construction	YoY	-4.8	-4.0	-1.3	-5.5	-4.1	-3.8	-2.5	-1.6	-1.4	-1.1	-1.0
Stocks (Contrib. to Y/Y GDP Growth)		-0.3	0.0	-0.1	0.0	0.0	0.2	0.0	0.0	-0.1	-0.1	-0.1
Exports	YoY	2.9	0.5	2.7	0.5	0.0	-0.1	1.5	3.0	2.6	2.7	2.6
Imports	YoY	-0.7	-1.0	2.1	-1.9	-1.5	-1.1	0.4	2.3	2.1	2.0	2.1
CPI	YoY	2.5	1.5	1.3	1.9	1.4	1.3	1.3	1.3	1.4	1.3	1.2
CPI Ex Unprocessed Food and Energy	YoY	1.8	1.3	1.1	1.5	1.3	1.2	1.3	1.2	1.1	1.1	1.0
Unemployment Rate	YoY	11.4	12.4	12.7	12.1	12.4	12.6	12.6	12.6	12.7	12.7	12.7
Current Account Balance	EUR bn	118.3	242.2	224.2								
	% of GDP	1.2	2.5	2.3								
General Government Balance	EUR bn	-352.7	-287.3	-223.3								
	% of GDP	-3.7	-3.0	-2.3								
Primary Balance	% of GDP	-0.6	0.0	0.7								
General Government Debt	EUR bn	8,794.6	9,225.8	9,497.9								
	% of GDP	92.7	96.1	97.4								
Gross Operating Surplus	YoY	-0.3	-0.1	0.2								

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

Germany

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We forecast a 0.5% QQ gain in Q2, slightly less than last month on account of the weaker export and IP numbers in May. Weaker growth in China and continued weakness in Europe are likely to weigh on German exports for the remainder of 2013, and probably also the prospect of a recovery in business investment, while extensive flooding in late May and June is delaying a snap-back following weather-induced weakness in Q1. Prospects for private consumption are somewhat better, as wage deals are becoming more generous, and the probability of some relaxation of the fiscal stance after the German election — while not our base case — is rising. We still regard it as likely that the election itself will leave Merkel as Chancellor, but this time heading a Grand Coalition with the SPD.

France

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We leave our 2013-14 GDP forecasts unchanged, expecting a modest recovery in 2014. This is partly explained by the relative healthiness of its banking system, suggesting that credit availability will not be an obstacle to GDP growth. The key missing ingredients for a more positive outlook are confidence and greater visibility with respect to the government's policies, in our view. Note that a shift away from a continued focus on sizeable budget consolidation would also help. Although the French government has launched some reforms (labour market, competitiveness pact, pensions, etc…) in the year since President Hollande took office, more needs to be done for structural reforms to lift the economy's growth potential. We continue to worry that firms' weak profitability and persistent competitiveness issues will hinder the corporate sector's willingness to invest and hire. We doubt that France will meet its 3% 2015 budget deficit target without more efforts.

Italy

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Some improvements in sentiment surveys suggest the economy probably is still shrinking in Q2/Q3 but the decline is less than before. We still expect GDP to fall in H2 and most of 2014. Tight financing conditions act as a major drag on domestic demand, although fiscal drag is diminishing. While Italy exited the Excessive Deficit Procedure in June, recent data indicate a renewed widening of the fiscal deficit, and the deficit is likely to worsen in H2 due to the delays in tax hikes. This probably contributed to the recent S&P downgrade and may prompt more rating actions in the next few quarters. We see limited political willingness/ability to tackle public spending to allow for lower taxes. We do not see the debt ratio stabilising in the next few years, and we think some form of debt restructuring (maturity lengthening and/or coupon reductions) may be likely eventually.

Figure 22. Germany, France and Italy — Economic Forecasts, 2012-14F

		Germany			France			Italy		
		2012	2013F	2014F	2012	2013F	2014F	2012	2013F	2014F
Real GDP	YoY	0.9%	0.3%	1.5%	0.0%	-0.2%	0.5%	-2.4%	-2.0%	-0.6%
Final Domestic Demand	YoY	0.3	0.7	2.1	-0.1	-0.2	0.2	-4.7	-2.7	-1.1
Private Consumption	YoY	0.7	1.4	1.7	-0.3	-0.1	0.2	-4.3	-2.3	-0.8
Fixed Investment	YoY	-2.0	-1.7	4.1	-1.2	-2.3	-0.1	-8.0	-7.1	-2.3
Exports	YoY	4.5	-0.7	3.6	2.5	0.0	1.8	2.2	-0.5	1.4
Imports	YoY	2.6	0.1	4.9	-0.9	-0.6	1.0	-7.8	-4.1	-0.3
CPI	YoY	2.0	1.5	2.2	2.2	1.0	1.6	3.3	1.5	1.3
Unemployment Rate	%	5.5	5.6	5.5	9.8	10.8	10.9	10.7	12.4	12.8
Current Account	€bn	185.4	180.5	150.4	-44.4	-32.7	-17.1	-8.4	26.3	37.1
	% of GDP	7.0	6.7	5.4	-2.2	-1.6	-0.8	-0.5	1.7	2.4
General Govt. Balance	€bn	4.1	-14.5	2.0	-98.2	-80.4	-75.6	-47.6	-54.9	-50.6
	% of GDP	0.2	-0.5	0.1	-4.8	-3.9	-3.6	-3.0	-3.5	-3.2
Primary Balance	% of GDP	2.6	2.0	2.5	-2.3	-1.3	-1.0	2.5	1.9	2.1
General Govt. Debt	% of GDP	81.9	81.5	78.4	90.2	94.2	96.3	127.0	133.2	138.0
Gross Trading Profits	YoY	0.1	1.2	0.2	-0.9	0.0	1.0	NA	NA	NA

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

Spain

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We are revising up our growth forecasts for 2013 (by 0.2pp to -1.7pp) and 2014 (0.3pp to -0.9pp), reflecting signs of improvements in domestic demand and activity. Consumer confidence, retail sales and PMIs were getting slightly better in recent months, suggesting a better than expected Q2 and Q3 growth figures. We still think, however, that the ongoing internal adjustments (private deleveraging, housing, and fiscal) together with very tight financing conditions are likely to extend the recession at least until early 2015. We see the fiscal deficit narrowing only marginally to 6.5% of GDP in 2013, while extra bank recap needs may well also emerge. The debt ratio is expected to continue to rise rapidly and we think that some form of debt restructuring (maturity extensions/coupon reductions) may be likely eventually.

Greece

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Recent gains in confidence (albeit from extreme lows), better readings on inventories and the pickup in imports suggest that decline in domestic demand may be easing. Hence, we raise our 2013 GDP forecast to minus 5.0% from minus 5.5% last month. However, the government reshuffle and tense troika negotiations have reignited political risks. The bailout programme is probably off-track again, due to lack of privatization revenues, while the core fiscal numbers seem roughly in line with targets. Key discussions on further debt restructuring of official loans have been delayed until post-German elections. We think major debt relief from official lenders will be needed to restore fiscal sustainability and that risks remain quite high of Greece eventually exiting EMU (although this is no longer our base case).

Ireland

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We are cutting our 2013 growth forecast from 1.0% to minus 0.2% following the soft Q1 GDP data (down 0.6% QoQ) and downward revisions to recent quarters. Recent data suggest that the economy has exited recession in Q2, with growth of about 0.5% QoQ, but that would still leave Q2 GDP down 1.3% YoY. With this weaker outlook, we are revising up our estimate for the 2013 public debt/GDP ratio to 130-131% from 121.7% last month, but still expect this ratio will edge down in 2014.

Portugal

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The recent political turmoil mirrors mounting austerity fatigue and it likely implies more overshooting of budget targets and a reduced likelihood of a smooth exit from the bailout programme in mid-14. Private deleveraging remains a major headwind for the economy, especially for the most indebted corporate sector, adding to the fiscal drag. Fiscal tightening will likely remain severe in the next couple of years, especially if a second bailout programme is agreed. With about half of the debt in official hands, we think some further OSI and perhaps PSI (in the form of coupon-reduction/maturity extensions) may eventually occur to restore debt sustainability.

Figure 23. Spain, Greece, Ireland and Portugal — Economic Forecasts, 2012-14F

		Spain			Greece			Ireland			Portugal		
		2012	2013F	2014F	2012	2013F	2014F	2012	2013F	2014F	2012	2013F	2014F
Real GDP	YoY	-1.4%	-1.7%	-0.9%	-6.4%	-5.0%	-4.3%	0.1%	-0.2%	2.2%	-3.2%	-3.0%	-1.4%
Final Domestic Demand	YoY	-4.0	-3.7	-1.8	-9.7	-7.4	-5.9	0.2	2.0	-0.8	-6.9	-4.3	-3.1
Private Consumption	YoY	-2.2	-2.5	-0.7	-9.1	-7.7	-6.1	-0.3	-2.2	-0.1	-5.6	-3.6	-2.2
Fixed Investment	YoY	-9.1	-7.3	-3.7	-19.0	-11.3	-6.8	-0.7	-7.0	-3.3	-14.5	-10.8	-7.6
Exports	YoY	3.0	3.2	3.5	-2.0	1.3	1.5	1.6	-1.1	4.5	3.3	2.2	2.7
Imports	YoY	-5.0	-2.9	1.0	-9.3	-4.5	-4.2	0.0	-2.4	0.3	-6.6	-2.7	-1.7
CPI	YoY	2.4	1.7	0.9	1.0	-0.4	-0.9	0.7	-0.4	1.4	2.8	0.8	0.3
Unemployment Rate	%	25.0	27.0	28.5	24.1	28.5	31.7	14.7	13.5	13.4	15.7	18.0	19.4
Current Account	€bn	-11.5	10.4	19.0	-6.5	-1.3	0.7	7.3	12.2	17.2	-2.6	1.6	4.8
	% of GDP	-1.1	1.0	1.8	-3.4	-0.7	0.4	4.4	7.5	10.2	-1.5	1.0	3.0
General Govt. Balance	€bn	-111.6	-67.9	-62.4	-19.4	-9.9	-8.2	-12.5	-13.7	-9.6	-10.6	-9.6	-9.0
	% of GDP	-10.6	-6.5	-6.0	-10.0	-5.5	-4.9	-7.6	-8.4	-5.7	-6.4	-6.0	-5.7
Primary Balance	% of GDP	-7.7	-3.2	-2.3	-5.0	-1.4	-0.7	-3.9	-3.3	-0.6	-2.0	-1.4	-1.2
General Govt. Debt	% of GDP	84.2	93.9	104.2	156.9	181.5	199.3	120.0	130.7	128.6	123.8	135.1	151.0

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

Netherlands

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We cut our 2013 Dutch GDP forecast by 0.2ppt to -1.2% in July, mainly because of downward revisions to the 2011-12 GDP level. Looking ahead to 2014, the underlying growth picture remains weak due to the steady correction in house prices and additional fiscal tightening (ministers have earmarked 1% of GDP). In addition, there were news of further delays in pension system reform and the Dutch central bank called on domestic financial institutions to set aside a buffer of €6bn in high-quality capital to cover additional risks and expected losses. We expect the Dutch economy to underperform its 'soft core' peers throughout 2015.

Belgium

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We lift our 2013 and 2014 GDP forecasts by 0.2ppt and 0.1ppt to -0.2% and +0.4%, respectively, owing to the slightly better performance of Germany and France, together with tentative signs of improvement in the forward-looking components of the BNB business survey. Illustrating the continued focus on budgetary consolidation, the government announced a combined €3.5bn (1% of GDP) of budgetary savings for 2013-14, focusing on expenditure reduction rather than tax hikes to protect the GDP baseline. King Albert announced his abdication, passing the crown to his son, ahead of the 2014 May 25 legislative elections.

Slovakia

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We expect growth to slow to about 0.5% in 2013 from 2.0% in 2012 due to weaker trends in investment and exports. The downside risks from weaker order books are offset to an extent by better retail sales data, and we look for a recovery in GDP growth of 1.7% in 2014. Chances have risen that the government will meet its deficit goal of €3bn in 2013 (4.2% of GDP), but the seasonal pattern still suggests a risk of wider deficit at around 4.6% of GDP. The supply/demand factors at the bond market have remained supportive for bonds. Moreover, ARDAL cancelled the planned July auction as the MinFin´s borrowing needs for the full year are already 90% covered.

Slovenia

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All in all, we keep our forecast of 2.2% YoY contraction in GDP this year, followed by mild contraction of 0.3% in 2014, and a modest recovery (1.1%) in 2015. While the May real economy data worsened slightly compared to April, they still suggest some improvement in the economy. Moreover, the June business surveys and our slightly improved outlook on foreign demand provide supports to our forecast. Politics still represents the main downside risks, as the government continues to delay the necessary transfer of impaired banking assets to a consolidated "bad bank" structure and the privatisation process has not yet started.

Figure 24. Netherlands, Belgium, Slovakia and Slovenia — Economic Forecasts, 2012-2014F

		Netherlands			Belgium			Slovakia			Slovenia		
		2012	2013F	2014F	2012	2013F	2014F	2012	2013F	2014F	2012	2013F	2014F
Real GDP	YoY	-1.3%	-1.2%	0.2%	-0.3%	-0.2%	0.4%	2.0%	0.5%	1.7%	-2.2%	-2.2%	-0.3%
Final Domestic Demand	YoY	-1.8	-2.8	-0.3	-0.5	-0.6	0.0	-1.4	-1.5	1.6	-3.8	-2.9	0.1
Public Consumption	YoY	-0.7	-1.4	-0.7	0.4	0.2	0.3	-0.6	0.2	0.1	-1.6	-0.5	-0.6
Private Consumption	YoY	-1.6	-1.2	-0.3	-0.3	-0.2	-0.2	-0.6	-0.3	0.8	-2.8	-4.2	-0.1
Investment (Ex Stocks)	YoY	-4.0	-8.3	0.5	-0.6	-2.7	0.4	-3.7	-5.4	4.3	-9.1	-2.1	1.4
Exports	YoY	3.2	1.1	1.3	0.7	-0.9	2.2	8.6	1.5	2.7	1.3	2.9	2.1
Imports	YoY	3.3	-1.3	0.8	0.5	-1.4	2.2	2.8	-0.4	2.2	-4.3	2.6	2.6
CPI (Average)	YoY	2.8	2.8	1.7	2.8	1.2	1.9	3.6	1.7	1.9	2.6	2.7	2.9
Unemployment Rate	%	6.4	8.3	8.8	7.6	8.6	9.2	13.6	14.5	14.7	8.9	10.2	11.1
Current Account	% of GDP	10.1	9.4	8.9	-1.6	-2.0	-1.6	2.2	3.3	3.0	2.3	2.2	3.3
General Govt Balance	% of GDP	-4.1	-3.8	-3.4	-3.9	-3.2	-2.9	-4.3	-3.4	-3.2	-4.0	-9.1	-6.6
Primary Balance	% of GDP	-2.2	-1.9	-1.4	-0.5	0.4	0.7	-2.9	-2.0	-1.8	-1.9	-6.4	-3.7
General Govt Debt	% of GDP	71.3	74.8	76.3	99.8	102.4	103.4	52.1	55.6	56.5	54.1	63.7	69.1

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

UK

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Recent data and revisions contain both good news and bad news for the UK outlook. The economy is expanding, but has ample slack and continues to face major headwinds. Overall, our UK growth forecasts are little changed this month, with a marginal downgrade to our 2013 forecast to 0.9% from 1.0% last month but a slight upgrade to our 2014 forecast to 1.3% from 1.2% last month. We continue to look for growth of 1½%-2% YoY in later years. Among the components, we expect modest consumer spending growth (about 1½% YoY in both 2013 and 2014), with a small but positive boost from net trade. Investment was revised down markedly in the recent GDP data and probably will remain soft, while (in line with the government's fiscal plans) we expect declines in government consumption from 2014 onwards.

CPI inflation hit 2.9% YoY in the June data, but probably will now head lower. Medium-term, our forecast implies that headline inflation rate is likely to be close to 2% YoY on average in coming years, with persistent weakness in domestic costs offsetting the large upward effects (about 1% per year) from regulated prices and indirect taxes. But, this outlook will probably make only a modest dent in the economy's sizeable imbalances of high unemployment, large output gap, low investment, persistent current account deficit and weak fiscal position. We expect the MPC will implement Fed-style forward guidance soon, with an unemployment threshold of 6.5% or 7% and an inflation knockout (in terms of the MPC's inflation 2-year ahead forecast) set at 0.5% above the MPC's longterm inflation goal of 2%. This will probably come at the August meeting or — if not August — in September. At present, our forecasts assume little change in exchange rates but if sterling does fall substantially further then this could, over time, feed through to a notably stronger economic picture without, we suspect, creating a worrying level of underlying inflation pressures

Figure 25. United Kingdom — Economic Forecasts, 2012-2014F

					2013				2014			
		2012	2013F	2014F	1Q	2QF	3QF	4QF	1QF	2QF	3QF	4QF
Real GDP	YoY	0.1%	0.9%	1.3%	0.2%	1.3%	0.8%	1.4%	1.3%	1.1%	1.3%	1.4%
	SAAR				0.8	2.0	1.2	1.4	0.7	1.2	1.9	2.0
Domestic Demand	YoY	1.1	0.6	1.2	0.4	0.8	0.6	0.8	1.3	0.9	1.1	1.3
(Incl. Inventories)	SAAR				-1.4	2.8	0.8	1.1	0.6	1.3	1.6	1.6
Consumption	YoY	1.2	1.5	1.4	1.5	1.6	1.6	1.3	1.2	1.2	1.5	1.8
	SAAR				1.2	1.6	1.3	1.1	0.7	1.9	2.5	1.9
Investment	YoY	0.5	-6.2	1.4	-8.3	-7.7	-6.8	-1.6	-1.1	1.1	2.6	3.1
	SAAR				0.6	-5.5	-3.0	1.4	2.7	3.2	3.1	3.4
Exports	YoY	0.9	1.0	4.8	-0.8	1.2	0.0	3.5	4.7	4.3	5.0	5.1
	SAAR				-0.5	5.8	3.0	6.0	4.2	4.1	5.9	6.1
Imports	YoY	2.8	-0.1	4.2	-0.9	-0.5	-0.7	1.5	4.5	3.6	4.4	4.4
	SAAR				-7.7	8.2	1.5	4.7	3.7	4.4	4.7	4.6
Unemployment Rate	%	7.9	7.9	7.7	7.8	7.9	8.1	7.9	7.8	7.8	7.6	7.4
CPI Inflation	YoY	2.8	2.6	2.2	2.8	2.7	2.7	2.3	2.1	2.2	2.2	2.4
Merch. Trade	£bn	-104.1	-106.7	-104.6								
	% of GDP	-6.7	-6.6	-6.3								
Current Account	£bn	-57.7	-55.2	-54.8								
	% of GDP	-3.7	-3.4	-3.3								
PSNB	£bn FY	-89.4	-106.7	-97.2								
	% of GDP	-5.7	-6.6	-5.8								
General Govt. Balance	% of GDP	-6.3	-7.1	-6.3								
Government Primary Balance		-2.7	-3.5	-2.6								
Public Debt	% of GDP	89.5	93.9	98.4								
Gross Nonoil Trading Profits	YoY	4.5	9.9	6.1								

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

Switzerland

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Our Swiss economic forecasts are little changed from last month. Recent surveys suggest that the economy continued to expand in Q2, with growth probably at 0.3%-0.4% QoQ. The long period of negative inflation is coming to an end and inflation probably will rise to slightly above zero around end-13, although it will likely stay low for an extended period. Under these conditions, the SNB will continue to resist FX appreciation pressure for an extended period.

Sweden

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Lead indicators suggest the worst is behind us, but economic recovery is likely to be weak from a historical perspective: exports will stay weak, household deleveraging risks are increasing and ongoing fiscal erosion limits the size of fiscal easing. With very weak production-side data (industrial output down by 7.3% Y/Y in May combined with weak service sector momentum), we expect zero QQ GDP growth in 2Q and worry that it may be even worse. Although financial stability considerations top the Riksbank's agenda, a weak figure could put renewed pressure on the Bank to cut. Either way, the outlook for monetary policy is a long period of ultra-low rates.

Denmark

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The Danish economy appears to have very little momentum at present, and a near-term return to trend growth is not on the cards with house prices showing few signs of recovering, private spending being restrained by high private debts and sluggish euro area growth. Although the Danish economy likely will not contract in 2013, as it did in the past year, the overall rate of real GDP growth in Denmark probably will remain lacklustre for the next few years. Fiscal policy has been supportive in the downturn, but has failed to kick-start the economy, and the government has now largely exhausted its scope for additional counter-cyclical fiscal support. The key policy rate will be kept low for at least an extended period as the ECB.

Norway

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Although momentum has peaked, the Norwegian economy continues to be supported by vigorous activity in the petroleum sector and construction industry. Lead indicators suggest that mainland GDP should settle at a slightly below-trend pace ahead, but still continue to outperform most of Europe. Combined with below-target inflation, plus high lending margins, an interest rate cut has certainly moved closer (and the Norges bank's June rate path signalled a 50% probability of September cut). Financial stability concerns, though, weigh increasingly more in the interest rate decisions and, with the substantial NOK depreciation recently, we doubt Norges Bank will cut rates in the near term.

Figure 26. Switzerland, Sweden, Denmark and Norway — Economic Forecasts, 2012-2014F

		Switzerland			Sweden			Denmark			Norway		
		2012	2013F	2014F	2012	2013F	2014F	2012	2013F	2014F	2012	2013F	2014F
Real GDP	YoY	1.0%	1.5%	1.2%	1.1%	1.2%	2.0%	-0.4%	0.1%	0.6%	3.3%	2.4%	2.7%
Final Domestic Demand	YoY	1.7	1.6	1.3	1.9	0.4	1.7	0.4	-0.1	0.7	2.8	2.7	3.0
Public Consumption	YoY	0.5	1.0	1.4	1.1	0.8	0.7	0.7	-0.5	0.4	1.6	2.1	2.0
Private Consumption	YoY	2.5	2.4	1.6	1.6	2.0	2.0	0.5	0.5	0.7	3.1	3.0	3.1
Investment (Ex Stocks)	YoY	-0.2	0.0	0.4	3.9	-4.1	2.6	-0.1	-0.9	1.0	3.8	2.8	4.1
Exports	YoY	1.1	1.6	2.9	1.3	-1.5	2.5	0.2	-1.3	1.3	3.4	2.1	2.5
Imports	YoY	2.1	0.8	3.7	0.5	-2.6	1.9	1.0	1.2	1.4	4.2	1.9	3.9
CPI (Average)	YoY	-0.7	-0.3	-0.1	0.9	0.1	1.0	2.4	0.9	1.5	0.7	1.7	1.5
Unemployment Rate	%	2.6	1.9	2.0	8.0	8.3	8.2	7.5	7.5	7.4	3.2	3.6	3.6
Current Account	% of GDP	12.8	12.8	12.4	6.9	7.1	6.9	6.2	5.3	4.7	14.2	14.5	14.9
General Govt Balance	% of GDP	0.5	0.6	0.6	-0.6	-1.5	-1.5	-4.3	-2.0	-1.5	13.8	13.1	13.0
General Govt Debt	% of GDP	46.7	45.4	43.6	38.4	39.4	39.8	45.8	47.3	47.8	NA	NA	NA

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

Canada

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The rotation of demand is underway, but remains uneven. Consumer spending on goods and services is decelerating and settling into a healthier range consistent with income growth, and governments are consolidating. Residential investment is gradually shrinking as a share of GDP, and household imbalances are lessening — evident in two quarters of decline in the debt-to-income ratio and continued cooling in home prices. But recent housing starts and sales data suggest a resurgence of activity during the spring months. Meanwhile, business investment is lacklustre, and US fiscal constraint and slowing EM growth are weighing on exports. Fortunately, the depreciation of the Canadian dollar over the last six months and higher oil prices of late are helping to soften the blow to exports from external developments.

First half 2013 GDP continues to track at around 2% annualized, and financial conditions portend faster growth in the second half of this year. Nonetheless, the outlook for Canadian growth remains subdued relative to past expansions, as global demand is expected to be modest over the medium-term. Moreover, the rotation of Canadian demand away from consumers and government, and towards businesses and external trade will weigh on the economy until the adjustment is complete. Total CPI inflation has been tracking somewhat below expectations on past declines in commodity prices and discretionary items. But the deviations are not significant enough to alter its projected return to the BoC's 2% target by mid-2015.

Upside risks include (1) stronger US demand and/or positive spillover from foreign monetary policy stimulus; (2) faster Canadian exports growth; and (3) resurgence of the Canadian housing market. Downside risks include (1) EA woes; (2) delay of the Canadian capex and exports revival; and (3) domestic consumer retrenchment linked to debt and/or disorderly unwind of housing activity. While there has been some intensification of select risks, risks remain balanced, in our view. Thus, we continue to anticipate fixed rates until 1Q 15 and retention of the tightening bias.

Figure 27. Canada — Economic Forecast, 2012-2014F

					2013F				2014F			
		2012	2013F	2014F	1Q	2QF	3QF	4QF	1QF	2QF	3QF	4QF
Real GDP	YoY	1.7%	1.8%	2.6%	1.4%	1.5%	1.9%	2.4%	2.5%	2.7%	2.7%	2.6%
	SAAR				2.5	1.8	2.5	2.8	2.7	2.6	2.6	2.7
Final Domestic Demand	YoY	2.3	1.6	2.2	1.4	1.5	1.7	1.7	2.1	2.3	2.3	2.2
	SAAR				0.6	1.4	2.3	2.5	2.3	2.1	2.1	2.3
Private Consumption	YoY	1.9	1.8	2.3	1.7	1.9	1.9	1.8	2.3	2.3	2.3	2.3
	SAAR				0.8	2.0	2.4	2.3	2.5	2.2	2.2	2.3
Government Spending	YoY	1.0	1.2	1.0	1.3	1.2	1.3	1.0	0.9	1.0	1.0	1.0
	SAAR				1.3	0.7	1.0	1.0	1.0	1.0	1.0	1.0
Private Fixed Investment	YoY	5.2	1.2	3.6	0.6	0.5	1.6	2.2	3.3	4.0	3.9	3.5
	SAAR				-0.9	0.7	3.9	5.3	3.2	3.4	3.4	3.8
Exports	YoY	1.5	2.7	6.1	0.5	1.5	3.8	5.1	5.2	6.2	6.5	6.6
	SAAR				6.2	2.8	5.4	6.1	6.7	6.6	6.6	6.6
Imports	YoY	3.1	1.4	4.5	0.8	1.0	1.0	2.8	3.7	4.5	4.7	5.0
	SAAR				1.2	2.0	4.0	4.0	5.0	5.0	5.0	5.0
CPI	YoY	1.5	1.2	1.9	0.9	0.7	1.4	1.6	1.7	2.2	1.8	1.8
Core CPI	YoY	1.7	1.4	1.8	1.3	1.2	1.4	1.7	1.7	1.9	1.9	1.9
Unemployment Rate	%	7.3	7.1	6.7	7.1	7.1	7.2	7.0	6.7	6.7	6.8	6.5
Current Account Balance	C$bn	-62.2	-55.8	-61.2	-56.3	-55.0	-54.1	-57.5	-58.6	-65.0	-55.8	-65.2
	% of GDP	-3.4	-3.0	-3.1	-3.0	-2.9	-2.9	-3.0	-3.1	-3.4	-2.9	-3.3
Net Exports (Pct. Contrib.)		-0.6	0.4	0.4	1.4	0.2	0.3	0.5	0.4	0.4	0.4	0.4
Inventories (Pct. Contrib.)		0.0	-0.1	-0.1	0.5	0.0	-0.2	-0.3	0.0	0.0	0.0	0.0
Budget Balance (Fiscal Year)	% of GDP	-1.4	-1.0	-0.3								
Federal Budget Debt	% of GDP	33.2	33.1	32.3								
General Govt. Debt	% of GDP	83.9	83.8	83.0								

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

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Data released over the past month continue to show economic activity below trend. Consumers remain cautious in their spending habits, businesses are wary about investment and hiring decisions leading into the federal election, which are likely to be held a month or two later than originally planned. Most importantly, the unemployment rate is firmly in an upward trend. While sentiment among manufacturers has improved as the currency has weakened, we no longer believe the RBA can wait for the positive benefits of the lower currency to emerge before factoring this into the policy deliberations. Chinese activity is moderating and Citi has again lowered its growth forecasts for the Middle Kingdom. Combined with our outlook for Australian underlying inflation — that is now likely to go below the bottom of the RBA's target band in the second half of 2013 — we now expect the RBA to cut the official cash rate by 25bps at the August Board meeting.

New Zealand

Economic indicators continue to signal an ongoing recovery in activity, albeit one that is skewed towards Canterbury and Auckland. In these areas, stronger building and manufacturing activity have increased capacity utilisation and labour demand. In comparison, parts of the North Island have reduced activity from the drought, while provinces in the South Island report reduced activity. Our aggregate growth forecasts remain unchanged and we continue to expect the first OCR tightening in Q1 of 2014. The RBNZ has increased communication about the use of macroprudential tools instead of traditional monetary policy to contain the risks to financial stability from what it sees as strong housing market pressures in Canterbury and Auckland.

Figure 28. Australia and New Zealand — Economic Forecast, 2012-2014F

	Australia			New Zealand		
	2012	2013F	2014F	2012	2013F	2014F
Real GDP[a]	3.6%	2.6%	3.1%	2.2%	2.6%	2.8%
Real GDP (4Q versus 4Q)	3.3	2.6	3.0	1.6	3.5	2.2
Real Final Domestic Demand	4.7	1.4	2.8	2.4	3.9	3.2
Consumption	3.2	2.0	2.8	1.8	3.2	2.5
Govt. Current & Capital Spending[b]	3.1	0.8	2.1	0.5	1.0	0.9
Housing Investment	-3.8	3.9	5.7	13.4	28.5	8.9
Business Investment[c]	15.9	0.6	1.7	4.4	4.2	6.1
Exports of Goods & Services	6.0	8.5	8.4	2.1	1.8	1.0
Imports of Goods & Services	6.4	0.2	7.1	2.6	3.7	4.4
CPI	1.8	2.2	2.8	1.1	1.2	2.3
CPI (4Q versus 4Q)	2.2	2.1	2.8	0.9	2.0	2.2
Unemployment	5.3	5.9	5.7	6.9	6.1	5.1
Merch. Trade, BOP (Local Currency, bn)	-4.8	5.4	-2.7	114.9	147.5	-46.0
Current Account, (Local Currency, bn)	-55.0	-43.4	-58.5	-1034.9	-1187.6	-1531.4
Percent of GDP	-3.7	-2.8	-3.6	-4.9	-5.5	-6.8
Budget Balance[d] (Local Currency, bn)	-44.7	-20.0	-17.8	-1109.4	-663.6	-201.6
Percent of GDP	-3.0	-1.3	-1.1	-5.3	-3.1	-0.9
General Govt. Debt (% of GDP)[e]	0.3	0.3	0.3	38.8	38.1	41.3
Gross Operating Surplus	-4.5	0.8	5.5	NA	NA	NA

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

China

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The economy has been decelerating steadily. The growth rebound in late 2012 proved short-lived. Growth moderated from 7.9% YoY in 4Q/12 to 7.7% in 1Q/13, and to 7.5% in 2Q. Industrial production growth slowed from 9.5%YoY in 1Q/13 to 9.1% in 2Q. Year-to-date (YTD) FAI growth slowed consistently from 21.2%YoY at the beginning of the year to 20.1% in June. Retail sales have been improving since January, but 1H growth (12.7% YoY) paled relative to the annual expansion of 14.3% in 2012. The weak trade data in June point to weak external and domestic demand. Meanwhile, the gradual softening of the economy has not yet led to large-scale unemployment and job creation appears healthy, which allows the government to withhold stimulus and focus on restructuring the economy.

We have recently downgraded our 2013 growth forecast from 7.6% to 7.4%, and 2014 growth forecast from 7.3% to 7.1%, assuming no major stimulus. Government emphasis on reforms may bring short-term pain before reaping long-term gain. Growth in 3Q may stay at around 7.4% YoY, benefiting from the lagged effect of relatively loose monetary policy early this year and a low base last year. Tighter credit going forward may significantly affect investment, bringing growth down to 7.1% YoY in 4Q and 6.8% in 1Q/14 by our estimate. Credit conditions may become less accommodative in 2H. The uptick of inflation in June is not threatening, but the expected uptrend would preclude monetary loosening. The willingness of the PBOC to allow a liquidity crunch in June suggests the authorities are increasingly concerned about financial risks from rapid credit growth. We now see limited room for further RMB appreciation and expect the USDCNY spot rate to show two-way volatility, with periodic depreciation likely in time of capital outflows. M2 may grow by around 14% by year-end, and the chance of a RRR cut would increase if capital account outflows exceed current account surplus. The PBOC may cut the benchmark interest rate by 25bps, increase the upward floating range for deposit rates from 10% to 20%, and eliminate the floor for lending rates. This combination of measures would have a limited impact on the overall interest rate level. The recent liquidity crunch may contain off-balance-sheet credit by smaller banks, and we cut our annual forecast for total social financing to Rmb18tn.

Figure 29. China — Economic Forecasts, 2012-2014F

					2013F				2014F			
		2012	2013F	2014F	1Q	2QF	3QF	4QF	1QF	2QF	3QF	4QF
Real GDP	YoY	7.8%	7.4%	7.1%	7.7%	7.5%	7.4%	7.1%	6.8%	7.1%	7.1%	7.3%
Real Final Domestic Demand	YoY	8.3	7.2	7.0								
Consumption	YoY	8.3	7.5	7.5								
Fixed Capital Formation	YoY	8.3	6.8	6.4								
Industrial Production	YoY	10.0	9.1	8.7	9.5	9.1	9.1	8.5	9.0	8.2	8.5	9.1
Exports	YoY	7.9	7.2	3.7	18.4	3.8	4.0	5.0	-3.0	5.0	7.0	5.0
Imports	YoY	4.3	5.4	2.6	8.6	5.0	5.0	3.0	-4.0	2.0	5.0	7.0
Merchandise Trade Balance	$bn	231	282	313	42	66	78	96	46	83	93	91
FX Reserves	$bn	3,312	3,707	3,960	3,440	3,506	3,583	3,707	3,732	3,801	3,878	3,960
Current Account	% of GDP	2.3	2.2	2.0								
Fiscal Balance	% of GDP	-2.0	-2.0	-2.0								
General Govt. Debt*	% of GDP	45.0	45.1	45.2								
Urban Unemployment Rate	%	4.1	4.1	4.2	4.1	4.1	4.1	4.1	4.2	4.2	4.2	4.2
CPI	YoY	2.6	2.7	3.0	2.4	2.4	2.7	3.1	2.8	2.9	2.7	3.4
Exchange Rate (end period)	CNY/$	6.23	6.17	6.08	6.21	6.14	6.16	6.17	6.18	6.15	6.11	6.08
1-Yr Deposit Rate (end period)	%	3.00	3.00	3.25	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.25

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

India

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As has been highlighted in the past, India's problems over the last two years have largely been domestic (politics and policy paralysis). Its newer problems are now global. It's the tapering talk (See India Macroscope — Chattering on Tapering). Since then India has seen (1) Outflows to tune of US$9bn (debt ~US$8bn; equity <US$1bn); (2) The currency down 8% since May; (3) Yields higher by 38bps; and (4) Stocks down 4%. It is not only an India problem (many EM markets have been hit), and while some domestic concerns have since receded, it is hurting India. In this context, the China slowdown fear has some positive aspects for India, given its commodity user status and the relative flow of capital. While this is making India even harder to slot as a market, we view 'Tapering pains' dominating both 'China gains' and some domestic government action — and that is a risk, even from here.

India, as a global capital 'absorber', is vulnerable. It has a CAD of 4%+ of GDP, external debt is rising and its markets have gained on equity and debt inflows. The rupee has taken a hit, breaching Rs60/USD levels. While the fair value as per the REER lies in the Rs57-58 range. Thus, the currency continues to be the top concern for markets and policy makers. In response to heightened INR volatility, the RBI took some unprecedented measures to tighten money market conditions (See RBI's Three Arrows to Stem Rupee Volatility). As such, we see these moves as a tactical reaction to recent INR volatility and considering the high costs and risks of such measures for the real economy, we expect them to be time bound to the extent that the extraneous pressure on exchange rate front continues.

Implications for monetary policy: Given sub-par growth and easing core inflation, we maintain our view of a further 50bps of monetary easing in FY14. However, rupee volatility pushes our forecast for rate cuts to 2HFY14. We maintain our average WPI and CPI estimates of 5.5% and 7.5% as lower food prices on account of good monsoons could offset the inflationary impact of a weaker rupee. The weakness in the currency is likely to impact the subsidy bill, as every USD/INR change impacts fuel losses by Rs80bn. Added to this, is the proposed implementation of the food subsidy bill. But similar to FY13, the ratings constraint could keep the deficit in check at about 4.8% of GDP. Lastly on growth, we maintain our FY13/14 GDP estimate of 5.7%. While investment trends remain dismal and a delay in rate cuts could impact consumption, current monsoon trends are favourable and could offset industry weakness.

Figure 30. India — Economic Forecasts, FY2012/13-2014/15F

		FY 12/13F	FY 13/14F	FY 14/15F
Real GDP	YoY	5.0%	5.7%	6.4%
Final Domestic Demand	YoY	3.2	5.2	6.2
Private Consumption	YoY	4.0	5.5	6.7
Fixed Investment	YoY	1.7	4.0	5.5
Exports	YoY	3.0	10.0	11.0
Imports	YoY	6.8	12.0	9.5
Wholesale Price Index*	YoY	7.3	5.5	5.0
Consumer Price Index	YoY	10.2	7.5	7.5
Current Account	US$ bn	-88	-81	-74
	% of GDP	-4.8	-4.1	-3.2
Consolidated Fiscal Balance	% of GDP	-7.0	-6.7	-6.4
Centre Fiscal Balance	% of GDP	-4.9	-4.8	-4.6
US Dollar Exchange Rate	Average	55.0	61.2	59.7

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

Korea

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In 2Q13, exports showed a very weak recovery by growing 0.8% YoY from 0.4% in 1Q, resulting in 0.6% YoY growth in 1H13. Meanwhile, the contraction of raw material imports — mainly due to a decline in crude oil prices and slow domestic demand — caused imports in 1H13 to decrease by 2.8% from a year ago. With this, the trade surplus in 1H13 widened to US$20.0bn, and already has reached about 70% of the full-year trade surplus in 2012. We expect the trade surplus in 2H13 to shrink to around US$10bn as the expected recovery of exports (4.2% YoY) and domestic demand will generate a marked rebound of import growth (7.5% YoY). To avoid a sharp decline in housing transactions after the termination of the acquisition tax cut at end-June, the government reportedly is considering a permanent acquisition tax cut to 2%. However, the tax cut is likely to face strong opposition from political circles whose priority is on fiscal soundness and economic fairness. We think the housing market is likely to relapse into a slump despite some recovery signs in 2Q13, unless the government implements the tax cut promptly. On monetary policy, we maintain our call that the BoK will hold the policy rate in 2H13 amid economic growth expected at close to 4% and headline inflation near 2%.

Indonesia

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We downgrade our GDP growth forecasts to 6.0% and 6.1% in 2013 and 2014, respectively, from 6.1% and 6.3% previously, to account for increased external pressures. We also adjust our 2014 current account forecast to 2.2% of GDP from previously 1.8% amid a weaker outlook on commodity prices and continued China slowdown. Inflation has risen to 5.9% following the fuel price hikes in June and we expect it to reach about 8.2% by YE13. The BI has raised its policy rates by a total 75bps to 6.50% and signaled a pause, though we do not yet rule out another 25bps hike in August. The yield on the 10yr bond has risen by over 200bps towards 8%. Nonetheless supply concerns continue to weigh on market appetite, following relatively weak demand in recent auctions. We raise our 10-yr yield forecast to 8.5% by 3Q, from 6.5% previously. FX risk has been viewed uncomfortably following a steep drop in foreign reserves. However, the BI recently has allowed more flexibility and the IDR has depreciated above the 10,000/$ level. This is a move toward a more sustainable policy, in our view, which should dampen risk perceptions. We expect to see further IDR depreciation towards 10,100 in 0-3M and 10,200/$ in 6-12M.

Figure 31. Korea and Indonesia — Economic Forecasts, 2012-2014F

		Korea			Indonesia		
		2012	2013F	2014F	2012	2013F	2014F
Real GDP	YoY	2.0%	2.9%	3.7%	6.2%	6.0%	6.1%
Final Domestic Demand	YoY	1.1	2.4	3.4	6.2	5.6	6.3
Private Consumption	YoY	1.7	1.9	3.3	5.3	5.0	4.8
Fixed Investment	YoY	-1.7	2.8	4.0	9.8	6.6	9.5
Exports	YoY	4.2	4.2	4.8	2.0	2.3	8.1
Imports	YoY	2.5	3.9	4.5	6.6	-0.2	8.7
Consumer Price Index	YoY	2.2	1.6	2.6	4.3	7.0	5.4
Unemployment Rate	%	3.2	3.2	3.2	6.1	5.9	5.8
Current Account	US$ bn	43.1	45.6	27.3	-24.1	-22.3	-23.0
	% of GDP	3.8	4.0	2.2	-2.7	-2.4	-2.2
Fiscal Balance	% of GDP	1.5	0.9	2.3	-1.8	-2.1	-1.4
US Dollar Exchange Rate	Average	1127	1147	1107	9361	10004	10114

Sources: Haver Analytics and Citi Research forecasts

Hong Kong

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The HK economy and equity market both are restrained by economic slowdown in China. Exports unexpectedly fell in May, down 1% YoY. Retail sales also were softer than expected despite more tourist arrivals during the Golden Week holiday, likely due to the anti-graft program in China. The previous gold purchase hype also subsided with falling gold prices. Inflation is likely to remain steady in June, but we expect a one-off sharp statistical surge in July due to public rental waiver. As we approach Fed tapering, yields on HK EFNs will probably follow UST counterparts higher, given HKD peg linkages. The annual pro-democratic march on July 1 proceeded peacefully, but the march highlights that political noises will tend to escalate as HK discusses how to go about universal suffrage in 2017.

Singapore

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Following the 15.2% QoQ SAAR surge in 2Q GDP, we would not be surprised to see a temporary modest pullback in 3Q. With 1H13 growth already at 1.9% YoY, and more favourable base effects in 2H13, we are raising our GDP forecast to 3.2% (previous: 2.3%), though labour shortages, limited productivity improvements and REER appreciation may cap the expansion. Core inflation will probably head up to 2-2.5% as companies are pressured to pass on higher unit labour costs in a tightened labour market. With inflation likely to creep up and average 2-2.5% for the rest of the year, MAS is unlikely to ease policy, even if the official inflation forecast is cut to 2.5-3.5% on recent downside surprises from COE premiums.

Taiwan

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Nascent signs of recovery are evident in trade and investment. Consumption is stalled, awaiting nominal wage improvements, and weakened in May. Benign consumer inflation but rising property prices and concerns of capital inflow are reasons for CBC to remain in neutral monetary stance for 2H13. Recently, two milestones have been reached, (1) ECFA for services trade with China and (2) economic agreement with New Zealand removing passenger and cargo flights limits. Trade benefits from these will arise in the longer run, but these signs of progress in the international space, plus the dilution of capital gains tax, provide good talking points for equities in the near term. The TWD may be pressured near term by USD strength, but we expect a gradual appreciation as the macro picture brightens in 6-12M. Long end government bond yields are set to rise along with UST yields, although perhaps more gradually reflecting GDP growth differentials.

Figure 32. Hong Kong, Singapore and Taiwan — Economic Forecasts, 2012-2014F

		Hong Kong			Singapore			Taiwan		
		2012	2013F	2014F	2012	2013F	2014F	2012	2013F	2014F
Real GDP	YoY	1.5%	3.0%	3.4%	1.3%	3.2%	4.4%	1.3%	2.9%	3.8%
Final Domestic Demand	YoY	4.8	2.8	2.0	2.9	3.1	3.9	0.1	2.3	3.2
Private Consumption	YoY	3.2	3.7	2.1	2.2	2.0	2.8	1.5	1.8	2.7
Fixed Investment	YoY	9.4	0.8	2.0	6.6	2.0	4.9	-4.4	5.4	6.1
Exports	YoY	1.8	3.5	4.3	0.3	1.3	3.8	0.1	4.2	4.3
Imports	YoY	2.8	3.7	3.7	3.2	1.5	3.1	-1.9	4.3	3.0
CPI	YoY	4.1	4.3	3.6	4.6	2.5	2.8	1.9	1.5	1.9
Unemployment Rate	%	3.3	3.4	3.2	1.9	1.9	1.8	4.2	4.1	4.0
Current Account	US$ bn	2.9	6.3	11.2	51.5	40.8	43.2	49.9	44.7	44.5
	% of GDP	1.1	2.2	3.7	18.6	14.0	13.5	10.5	9.1	8.5
Fiscal Balance	% of GDP	3.3	1.8	1.0	1.1	0.7	0.5	-1.6	-1.2	-1.3
US Dollar Exchange Rate	Average	7.76	7.76	7.76	1.25	1.27	1.25	29.57	30.08	29.65

Sources: Haver Analytics and Citi Research forecasts

Russia

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With thanks to
Adrian Thomas

GDP growth continued to decelerate in 1Q13, easing to 1.6% YoY from 3.4% in 2012. The growth of retail sales and industrial production remains below the average of recent years, and data seem to be worsening: vehicle sales in May fell 12% YoY. We recently revised down our forecasts quite substantially and we still see downside risks to our forecasts. We look for the economy to expand at 2.1% YoY for this year, and 2.8% in 2014 (unchanged from last month). Despite slowing growth, we do not expect the CBR to cut repo rates before 2H2013, since there are elements of stagflation in Russia's macro story: CPI inflation is currently at 6.9% YoY, far above the central bank's 4.5% proposal for an inflation target. Inflation should fall in H2, though, facilitating looser monetary policy, particularly since the weakness of domestic spending is supporting the trade surplus and helping to stabilise the exchange rate. Overall, we see few reasons for optimism about the real economy: supply-side reforms are few, and the demand for credit is weakening as confidence declines.

Turkey

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On July 15, Governor Basci has issued a written statement underlining that a measured step to widen the interest rate corridor will be on the agenda at the next MPC meeting on July 23. In our view, this move demonstrates the CBT's acknowledgment that stabilising the lira only through selling FX is not a viable option. Under normal conditions, we would be inclined to read "measured tightening" as something like a 50bp hike in the CBT's lending rate, which is currently 6.5%. However, under current conditions, we believe that measured tightening means something like a 75bp-100bp or even higher, depending on the lira's performance at the time of the MPC meeting. We believe that additional rate hikes are likely after the July MPC meeting if the currency remains under pressure. Assuming that the CBT's reaction to the evolution of the REER will be the same as during the 2011 lira sell-off episode, we believe that the likelihood of an aggressive rate hike would increase substantially if the TRY basket goes above the 2.30-2.35 level. We recognize that since there are other factors at play, the noted TRY basket level that we underline is illustrative only.

Figure 33. Russia and Turkey — Economic Forecast, 2012-14F

		Russia			Turkey		
		2012	2013F	2014F	2012	2013F	2014F
Real GDP	YoY	3.4%	2.1%	2.8%	2.2%	3.5%	4.0%
Final Domestic Demand	YoY	5.2	3.4	3.9	-0.5	3.8	3.3
Private Consumption	YoY	6.7	3.5	3.6	-0.7	3.8	3.8
Fixed Investment	YoY	6.0	4.6	6.5	-2.5	2.5	0.9
Exports	YoY	1.4	0.5	1.7	17.2	1.5	4.3
Imports	YoY	9.5	4.5	4.5	0.0	4.1	1.6
CPI	YoY	5.1	6.9	5.4	8.9	7.3	7.3
Unemployment Rate	%	5.5	6.5	7.0	9.2	9.5	9.5
Current Account	US$ bn	78.0	60.2	20.6	-45.4	-55.9	-57.0
	% of GDP	3.9	2.8	0.9	-5.8	-6.9	-6.6
Fiscal Balance	% of GDP	-0.7	-2.0	-4.1	-2.0	-2.2	-2.7
US Dollar Exchange Rate	Average	31.1	32.3	33.3	1.80	1.94	2.03

Sources: Haver Analytics and Citi Research forecasts

Hungary

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We have further upped our GDP growth forecasts to 0.6% in 2013 and 1.4% in 2014, reflecting signs in April-May retail sales data that household consumption has already started to recover. The government has decided to implement additional regulated utility price cuts in 4Q13 and is considering public sector wage hikes in Sep-2013 and Jan-2014, which may further boost household consumption. Helped by the increased levy on the banking and the corporate sectors, the budget deficit is likely to stay below 3% this year and in 2014. The impact of regulated utility price cuts and the tobacco price hikes will likely offset each other in 2013 and keep inflation in a 1.6-1.9% range in 2H13. For 2014, we expect inflation to stay around 2.6% on average, below the 3% official target. Monetary policy has maintained its dovish bias despite the recent rise in global yields, reflecting moderating core inflation trends and the soft inflation outlook. This suggests that gradual rate cuts may continue in the coming months and the MPC is only expected to halt if market pressure rises sharply and local bonds suffer outflows.

Poland

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The MPC cut interest rates again in July by 25bp and strongly announced the end of the easing cycle with a total rate reduction of 225bp. The change in the MPC's bias to neutral occurred despite a further downward revision of the central bank's projections for GDP growth and inflation. However, in contrast to previous occasions, MPC members' comments suggested that this time the commitment to no more room for easing was unanimous. After a downward surprise in the CPI data for May, we expect inflation to bottom at 0.2% in June and slowly increase to about 1% at year-end. Moreover, in our view the bottom in the economic cycle is behind us and the economy should gradually recover in the coming quarters, with stronger gains in real disposable income and household loans supporting private consumption. We also expect a smaller decline of investment spending in 2H13. Despite an expected gradual recovery, the economy's performance will be weaker than assumed in this year's budget. Therefore we still expect the central budget deficit to be revised upwards by around PLN 10bn. According to the government, the amendment to the budget will be announced soon and will be preceded by changes in the public finance law. One of the biggest sources of uncertainty for capital markets in Poland is connected with changes in the pension system planned by the government, which are aimed at reducing public debt. The details of the final plan for the pension system will be presented by the end of August.

Figure 34. Hungary and Poland — Economic Forecasts, 2012-2014F

		Hungary			Poland		
		2012	2013F	2014F	2012	2013F	2014F
Real GDP	YoY	-1.7%	0.6%	1.4%	1.9%	1.3%	2.8%
Final Domestic Demand	YoY	-2.1	-0.9	0.2	0.3	0.0	2.2
Private Consumption	YoY	-1.4	0.3	0.8	0.8	1.0	2.2
Fixed Investment	YoY	-3.8	-3.6	-1.0	-0.8	-3.2	2.6
Exports	YoY	2.0	2.2	3.8	2.8	3.1	4.0
Imports	YoY	0.1	1.4	2.8	-1.8	0.3	2.9
CPI	YoY	5.7	2.1	2.6	3.7	0.8	1.9
Unemployment Rate	%	10.9	10.6	10.2	12.2	14.2	13.4
Current Account	US$ bn	2.1	3.5	5.2	-17.3	-13.5	-18.8
	% of GDP	1.6	2.8	3.8	-3.5	-2.7	-3.6
Fiscal Balance	% of GDP	-1.9	-2.8	-2.9	-3.9	-3.9	-3.5
Euro Exchange Rate	Average	289	300	297	4.18	4.29	4.25

Sources: Haver Analytics and Citi Research forecasts

Czech Republic

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We kept our forecast of 0.8%YoY fall in GDP in 2013, followed by 1.3% recovery in 2014. Industrial production increased by 0.8% MoM in May in line with our expectations, although this still left output down by 2.3% YoY. June data are likely to be slightly negatively influenced by floods and ongoing weakness in export orders. We expect some recovery in industrial activity in 2H13. The weakness in industrial activity was offset by a solid gain in retail sales in May, which reduces downside risks to our 2013 GDP forecast. We also kept our forecast for 2014 GDP growth unchanged at 1.3% YoY despite a better outlook on foreign demand, as currently-approved legislation does not point to fiscal easing and there is a risk that current political uncertainty will limit a pro-growth fiscal policy. Although the June CPI accelerated to 1.7% YoY from 1.6% in June, it was mainly driven by food prices and the adjusted core CPI excluding fuel continued falling by 0.7% YoY. This, together with ongoing deflation in core manufacturing prices (that disconnect from weaker koruna) and stronger deflation in construction and services prices, is likely to keep the CNB dovish. However, the higher-than-expected June CPI probably limit risks of immediate CNB intervention to weaken the koruna, because some of the CNB's Bank Board believes actual deflation risks would be needed to start intervention. Moreover, the rest of the Bank Board probably prefers a wait-and-see approach as the impact of FX intervention (via a weaker koruna) on the CPI is shorter (about 6 months) compared to the interest rate channel (12-18 months).

Romania

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Contrary to our expectations — but in line with the consensus — the NBR cut its policy rate at the July Board Meeting by 25bp to 5%. The NBR also decided to lower its lending facility (Lombard) and deposit facility to 8.0% (from 8.25%) and 2.0% (from 2.25%), respectively. In light of the recent leu depreciation, a marked increase in FX volatility and the absence of a meaningful pick up in capital inflows, we had expected the NBR to keep rates on hold and delay the rate cut to the next meeting in August. In our view, the NBR's decision at July Board Meeting reflects the Bank's rising concerns about economic recovery prospects. Looking ahead, we remain skeptical about the NBR's ability to deliver an aggressive easing without hurting the leu, as capital inflows still remain rather weak. In our view, the challenging inflation outlook and potential spillovers from the euro area crisis weaken the case for deeper interest rate cuts than we currently envision (another 25bp cut at the August meeting to 4.75%).

Figure 35. Czech Republic and Romania — Economic Forecasts, 2012-2014F

		Czech Republic			Romania		
		2012	2013F	2014F	2012	2013F	2014F
Real GDP	YoY	-1.2%	-0.8%	1.3%	0.4%	1.6%	2.8%
Final Domestic Demand	YoY	-2.4	-0.3	2.0	1.9	0.2	2.5
Private Consumption	YoY	-3.3	0.2	1.1	1.0	0.5	2.4
Fixed Investment	YoY	-2.7	-2.1	3.6	5.2	-1.0	3.5
Exports	YoY	4.0	1.5	5.6	-3.1	4.2	4.0
Imports	YoY	2.3	2.3	6.7	-0.8	1.2	3.0
CPI	YoY	3.3	1.6	1.4	3.3	4.8	3.3
Unemployment Rate	%	7.0	7.3	7.7	5.1	5.2	5.5
Current Account	US$ bn	-4.7	-2.4	-4.2	-6.6	-5.5	-9.1
	% of GDP	-2.4	-1.2	-2.1	-3.9	-3.0	-4.5
Fiscal Balance	% of GDP	-4.4	-2.8	-2.9	-2.2	-2.2	-2.5
EURCZK, USDRON	Average	25.1	25.9	25.5	3.5	3.4	3.3

Sources: Haver Analytics and Citi Research forecasts

Brazil

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We are cutting our GDP growth forecasts to 2.2% in 2013 and 2.5% in 2014 (from 2.5% and 3.0%, respectively). The recent social unrest will likely have negative implications in the near term (as demonstrations have been affecting sales and production since June) and in the medium term (through the effect of increased uncertainty on consumption and investment). On the inflation front, the demonstrations have produced a favourable one-off effect through the revoking of transportation fare hikes, which will likely offset the pass-through from the BRL depreciation. Thus, we keep our CPI inflation forecasts at 6.2% for end-2013 and at 5.9% for end-2014. Given this outlook, we continue to expect the central bank to increase the Selic rate to 9.25%, with a 50bps hike in August and a final 25bps hike in October. Another consequence of the social unrest was a significant drop in the president's popularity, which reduces the likelihood of fiscal tightening. Therefore, we believe the primary surplus is unlikely to reach 2.3% of GDP this year (the governement's target), unless fiscal manoeuvres are used. This should contribute to a slight depreciating trend for the BRL in the medium term.

Mexico

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Economic activity — as measured by the IGAE — grew 4.6% YoY in April. Recent data suggest that the slowdown in activity has come to an end. However, the signs of recovery are too dispersed to suggest that IGAE closed 2Q13 with a strong impulse, as we had originally forecasted. Therefore, we are downgrading our 2Q13 GDP growth forecast to 3.0% YoY (3.4% YoY before). We predict this difference will be recovered, however, in the second half of the year. Thus, we stick to our GDP growth forecasts for 2013 and 2014 of 2.7% and 4.2%. Headline inflation was lower than expected in June, slowing down to 4.1% YoY from 4.6% YoY in May, while core inflation consolidated below 3%YoY. Headline inflation will likely fall below 4% YoY starting from July. Thus, we keep our 3.6% forecast for year-end inflation, as well as our call for Banxico to hold its funding rate unchanged at 4.0% until mid 2015. On the political front, the results from the July 7 local elections in 14 states exhibited strong PRI support at the national level, while PAN managed to increase the population share under its rule and managed to keep the only governorship at stake, Baja California. We see these results are constructive for the spirit of political coordination between PRI and PAN in the Pact for Mexico. We expect the energy and fiscal reform bills to be submitted in September and passed before year-end.

Figure 36. Brazil and Mexico — Economic Forecasts, 2012-2014F

		Brazil			Mexico		
		2012	2013F	2014F	2012	2013F	2014F
Real GDP	YoY	0.9%	2.2%	2.5%	3.9%	2.7%	4.2%
Final Domestic Demand	YoY	1.7	3.6	3.2	3.7	3.1	4.1
Private Consumption	YoY	3.1	2.6	3.2	3.3	3.1	4.1
Fixed Investment	YoY	-4.0	6.8	3.3	5.9	4.3	5.5
Exports	YoY	0.5	-0.2	5.1	4.6	3.6	8.2
Imports	YoY	0.2	10.9	8.4	4.1	3.7	5.5
CPI	YoY	5.4	6.4	6.1	4.1	3.8	3.4
Unemployment Rate	%	5.5	5.5	5.4	5.0	5.0	4.8
Current Account	US$ bn	-54.2	-73.2	-83.3	-11.1	-20.4	-22.1
	% of GDP	-2.4	-3.3	-3.7	-0.9	-1.6	-1.5
Fiscal Balance	% of GDP	-2.5	-3.6	-3.7	-2.6	-2.1	-2.0
US Dollar Exchange Rate	Average	1.95	2.16	2.24	13.16	12.64	12.38

Sources: Haver Analytics and Citi Research forecasts

Argentina

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The Central Bank's reserves continue to decline and have already shrunk by USD6bn so far this year to USD37.3bn. Despite this trend being unsustainable, the government has not undertaken additional significant measures to reverse it. We are not surprised by this, as a tightening in the FX controls would, in all likelihood, negatively affect economic activity and, thus, the government's approval ratings. However, we expect announcements on this front once the October midterm elections are already behind us. We continue to expect non-official real GDP growth to stand at 3% this year and at 0.5% in 2014. As regards to official real GDP growth, we now expect a GDP warrants payment in December 2014, as the recent official activity prints almost ensure a growth rate for the year as a whole above 3.22% (our new forecast stands at 4.4%). We continue to expect official real GDP growth to be insufficient in 2014 to trigger a GDP warrants payments in 2015. Despite the recent depreciation in EM currencies, we continue to see the official USDARS at 6 by year-end, given the October midterm elections and the recent acceleration in inflation (following the end of the price controls launched on February). We expect non-official annual inflation to accelerate during 2H12 to 26%.

Venezuela

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We see two reasons why the reopening of SICAD will likely be the main economic policy development during 2H13. First, a viable replacement for the previous SITME system was needed in order to curb inflation and to limit the decline in overall economic activity. Second, we believe that it will imply a higher supply of Venezuelan USD denominated bonds, initially arising from the current holdings in the public sector and later from additional USD denominated debt issuance. If that scenario materialises and the external outlook permits, we think USD-denominated issuance is more likely to come from the sovereign first, in an amount between USD3-4 billion. We expect the total issuances to be between USD6-8 billion. We think that the re-opening of SICAD is a step in the right direction, but most of the harm has already been done in terms of 2013’s economic performance. In our view, while the recently announced measures signal that the Ministry of Finance is following a pragmatic approach, it also shows that it is taking longer than necessary for the government to fine-tune its FX policy. Nevertheless, we do not expect major surprises on the FX front this year, as the attention for the rest of 2013 will be focused on the implementation of the “enhanced” SICAD platform.

Figure 37. Argentina and Venezuela — Economic Forecasts, 2012-2014F

		Argentina			Venezuela		
		2012	2013F	2014F	2012	2013F	2014F
Real GDP	YoY	1.9%	4.4%	3.0%	5.6%	-0.5%	1.5%
Final Domestic Demand	YoY	2.5	5.0	2.8	12.3	-0.9	0.2
Private Consumption	YoY	4.4	5.8	3.0	7.0	-0.3	0.0
Fixed Investment	YoY	-4.9	2.0	1.9	23.3	0.5	0.6
Exports	YoY	-6.6	-0.8	-2.0	1.6	0.3	4.9
Imports	YoY	-5.2	4.9	-2.2	24.4	-1.3	-1.0
CPI	YoY	10.0	10.4	12.6	21.1	34.7	32.5
Unemployment Rate	%	7.2	7.7	7.8	5.9	6.4	6.8
Current Account	US$ bn	0.5	0.1	1.0	11.0	17.9	23.1
	% of GDP	0.1	0.0	0.2	3.1	5.3	7.2
Fiscal Balance	% of GDP	-2.6	-2.7	-3.6	-5.0	-4.0	-4.0
US Dollar Exchange Rate	Average	4.54	5.46	6.74	4.29	6.13	9.50

Sources: Haver Analytics and Citi Research forecasts

Saudi Arabia

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Bloomberg data showed a rise in oil production for the fourth month in a row, to 9.47mbpd in June, up from a low of 9.0mbpd in February. In our view, much of the added production will be going towards rising domestic demand as temperatures continue to increase in these summer months, although the magnitude of the rise over the past four months now is indicative of a rise in exports, in our view. We expect production rises to moderate in coming months, in line with recent comments made by the Kingdom's minister of oil, Ali Al Naimi, who asserted that in view of rising global production, not least in North America, Saudi Arabia would be 'lucky to go past' current production levels by 2020 (Al Bawaba, May 13). Mr Al Maimi also clarified that Saudi would not be seeking to raise production capacity beyond 12.5mbpd after recent comments by HH Prince Turki al Faisal suggested plans were afoot to increase this to 15mbpd. Price stability remains the key policy goal of the Saudi oil ministry, in our view, and production is likely to react to price swings going forward. At current levels of production, however, we calculate that Saudi Arabia's fiscal break-even oil price has risen markedly, from US$79 per barrel last year to an expected US$93 per barrel in 2013. This is mostly down to a drop in production, though we are also expecting a rise in government expenditures of roughly 4% of GDP as well.

United Arab Emirates

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Dubai's economic recovery continues in full swing, grounded in the Emirate's fundamental strengths in the tourism, travel and logistics sectors, as well as in its success in creating a commercial hub for the region. In our view, there is no doubting the strength of the recovery in Dubai, but we are equally wary of signs of exuberance in asset prices, and the potential for bubbles to form. The yield on Dubai's external bonds has almost halved in the past 12 months, while the local Dubai Financial Market index has gained over 40% in value since the start of the year. Property prices have also risen sharply, with Cluttons data showing a rise of 16% in average villa prices in the Emirate in the first four months of the year (a massive 44% rise on a YoY basis).

Figure 38. Saudi Arabia and United Arab Emirates — Economic Forecasts, 2012-2014F

		Saudi Arabia			United Arab Emirates		
		2012	2013F	2014F	2012	2013F	2014F
Real GDP	YoY	6.8%	5.1%	7.4%	2.4%	4.6%	4.9%
Final Domestic Demand	YoY	2.3	8.1	8.1	3.4	3.4	3.8
Private Consumption	YoY	1.6	5.0	5.0	2.0	2.0	3.0
Fixed Investment	YoY	1.1	10.0	10.0	5.0	5.0	5.0
Exports	YoY	-16.9	-12.7	2.1	13.0	13.0	13.0
Imports	YoY	5.2	15.0	15.0	15.0	15.0	15.0
CPI	YoY	4.0	6.0	8.0	0.7	0.8	1.0
Current Account	US$ bn	176.2	96.0	70.8	0.7	8.1	16.9
	% of GDP	24.2	13.6	9.3	0.2	2.1	4.0
Fiscal Balance	% of GDP	13.7	1.9	-3.5	NA	NA	NA
US Dollar Exchange Rate	Average	3.75	3.75	3.75	3.67	3.67	3.67

Sources: Haver Analytics and Citi Research forecasts

Egypt

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Political uncertainty looks set to remain high in the coming months, but following its intervention in politics in July, the military's roadmap does provide a possible route to holding parliamentary elections by early 2014. But securing buy-in from all parties will remain a challenge. In particular, the military will need to keep significant elements of the Islamist political community on board during the transition as without this it will lack wider political legitimacy. Policing street protests could also be difficult for the military, especially as the political transition is occurring against a deteriorating economic outlook. In particular, rising foreign exchange shortages will likely continue to negatively impact on growth and drive up inflation in 2H 2013. But the change in the political outlook means that broad policy continuity is now possible, supported by external assistance from the Gulf. But ultimately it seems the government is hoping that a deal with the IMF at some point in 2014 will crowd in both official and private sector finance. Coupled with the catalyst it would provide to the reform programme, this should provide a short-term kick to the economy which increasingly is in a state of stagflation.

South Africa

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Gina Schoeman
(On Leave)

The combination of a sharply weakening rand, poor growth data and resilient inflationary pressures in 1H 2013 all highlight that this year will be a difficult one for the South African economy. In fact there is unlikely to be a strong rebound in growth before the 2014 elections. Of these trends, the most pronounced has been the long anticipated rand crash which has seen the currency rapidly weaken to under the ZAR10:USD1 level since early May. This reflects both general concerns about the outlook for EM by investors but -- more crucially in the South Africa context -- domestic issues such as political uncertainty and labour unrest, against the background of poor economic data (not only growth and inflation, but also the wide current account and budget deficits). While concerns about the global outlook and weak GDP growth mean the SARB would like to cut interest rates, inflationary pressures and rand volatility will continue to ensure it acts cautiously. The focus on SARB and its policy options largely reflects the fact that fiscal policy is constrained by both recent ratings downgrades and pressing political needs. Lower growth projections have once again forced a widening in the path of fiscal consolidation over coming years, which requires more financing. With national government debt already pushing above 40% of GDP, investors and rating agencies are likely to remain wary of South Africa's fiscal sustainability, leaving the National Treasury little scope other than the reprioritization of policies.

Figure 39. Egypt, Nigeria and South Africa — Economic Forecast, 2012-2014F

		Egypt			Nigeria			South Africa		
		2012	2013F	2014F	2012	2013F	2014F	2012	2013F	2014F
Real GDP	YoY	2.2%	1.1%	2.3%	7.4%	6.5%	6.9%	2.5%	2.3%	2.9%
Final Domestic Demand	YoY	4.7	-1.0	1.7	NA	NA	NA	4.0	2.0	3.7
Private Consumption	YoY	5.9	-3.7	2.5	NA	NA	NA	3.5	1.5	3.4
Fixed Investment	YoY	0.7	4.9	4.7	NA	NA	NA	5.7	2.7	4.9
Exports	YoY	-2.3	2.9	6.1	NA	NA	NA	0.1	0.9	5.3
Imports	YoY	10.8	-10.5	3.6	NA	NA	NA	6.3	1.0	6.6
CPI	YoY	7.1	10.2	11.0	12.2	8.9	10.0	5.7	5.6	5.8
Unemployment Rate	%	12.5	14.0	15.0	NA	NA	NA	25.1	25.5	26.2
Current Account	US$ bn	-7.6	-5.7	-6.1	11.3	7.4	1.3	-23.6	-20.0	-19.9
	% of GDP	-3.0	-2.3	-2.5	4.0	2.3	0.4	-6.1	-5.9	-5.7
Fiscal Balance	% of GDP	-10.9	-12.7	-11.8	-2.8	-2.6	-2.8	-4.4	-4.9	-4.8
US Dollar Exchange Rate	Average	6.07	7.02	7.81	158.8	159.15	163.54	8.21	9.83	10.28

Sources: Haver Analytics and Citi Research forecasts

Figure 40. Selected Emerging Market Countries — Economic Forecast Overview, 2012-2014F

	GDP Growth			CPI Inflation			Current Balance (% of GDP)			Fiscal Balance (% of GDP)		
	2012	2013F	2014F	2012	2013F	2014F	2012	2013F	2014F	2012	2013F	2014F
Asia	**6.2**	**6.3**	**6.3**	**3.9**	**3.5**	**3.7**	**1.8**	**1.6**	**1.4**	**-2.3**	**-2.3**	**-2.1**
China	7.8	7.4	7.1	2.6	2.7	3.0	2.3	2.2	2.0	-2.0	-2.0	-2.0
Hong Kong	1.5	3.0	3.4	4.1	4.3	3.6	1.1	2.2	3.7	3.3	1.8	1.0
India*	5.0	5.7	6.4	7.3	5.5	5.0	-4.8	-4.1	-3.2	-7.0	-6.7	-6.4
Indonesia	6.2	6.0	6.1	4.3	7.0	5.4	-2.7	-2.4	-2.2	-1.8	-2.1	-1.4
Korea	2.0	2.9	3.7	2.2	1.6	2.6	3.8	4.0	2.2	1.5	0.9	2.3
Malaysia	5.6	5.2	5.8	1.6	2.0	2.5	6.1	2.3	2.0	-4.5	-4.0	-3.5
Mongolia	12.4	13.8	11.0	14.3	10.1	10.0	-31.3	-23.3	3.3	-8.3	-6.3	-5.3
Philippines	6.8	7.0	6.8	3.1	2.8	3.2	2.8	2.5	2.1	-2.3	-2.3	-2.0
Singapore	1.3	3.2	4.4	4.6	2.5	2.8	18.6	14.0	13.5	1.1	0.7	0.5
Sri Lanka	6.4	6.4	6.8	7.5	8.1	7.0	-6.6	-5.4	-4.0	-6.4	-6.2	-5.7
Taiwan	1.3	2.9	3.8	1.9	1.5	1.9	10.5	9.1	8.5	-1.6	-1.2	-1.3
Thailand	6.5	4.1	4.4	3.0	2.4	2.3	0.7	-0.1	-0.4	-2.1	-2.2	-2.1
Vietnam	5.3	5.1	5.4	9.3	6.6	7.1	5.8	3.3	1.5	-5.2	-4.8	-4.0
Latin America	**2.4**	**2.6**	**3.1**	**5.8**	**7.3**	**6.6**	**-1.7**	**-2.0**	**-2.0**	**-2.2**	**-2.8**	**-2.9**
Argentina	1.9	4.4	3.0	10.0	10.4	12.6	0.1	0.0	0.2	-2.6	-2.7	-3.6
Brazil	0.9	2.2	2.5	5.4	6.4	6.1	-2.4	-3.3	-3.7	-2.5	-3.6	-3.7
Chile	5.6	4.0	5.0	3.0	1.7	3.1	-3.5	-2.4	-2.5	0.6	-0.3	-0.4
Colombia	4.0	3.8	4.5	3.2	2.2	3.1	-3.2	-3.3	-3.2	-0.1	-1.1	-0.7
Mexico	3.9	2.7	4.2	4.1	3.8	3.4	-0.9	-1.6	-1.5	-2.6	-2.1	-2.0
Panama	10.7	9.0	8.0	5.7	4.6	4.4	-9.0	-10.2	-10.0	-2.1	-3.0	-3.0
Peru	6.3	5.5	6.0	3.7	2.6	2.6	-3.6	-4.0	-2.8	1.9	-0.6	-2.0
Venezuela	5.6	-0.5	1.5	21.1	34.7	32.5	3.1	5.3	7.2	-5.0	-4.0	-4.0
Europe	**2.3**	**2.0**	**2.9**	**5.1**	**5.5**	**5.1**	**-0.1**	**-0.5**	**-1.5**	**-1.8**	**-2.3**	**-3.4**
Bulgaria	0.8	1.0	2.0	0.0	2.2	3.6	-1.5	-1.7	-2.1	-0.5	-1.5	-0.7
Croatia	-2.0	-0.8	1.2	0.0	3.0	3.0	0.1	-0.2	-0.5	-2.4	-4.5	-4.0
Czech Republic	-1.2	-0.8	1.3	3.3	1.6	1.4	-2.4	-1.2	-2.1	-4.4	-2.8	-2.9
Hungary	-1.7	0.6	1.4	5.7	2.1	2.6	1.6	2.8	3.8	-1.9	-2.8	-2.9
Kazakhstan	5.0	4.2	3.6	5.1	6.3	6.1	3.5	2.4	1.2	0.8	2.7	1.8
Poland	1.9	1.3	2.8	3.7	0.8	1.9	-3.5	-2.7	-3.6	-3.9	-3.9	-3.5
Romania	0.4	1.6	2.8	3.3	4.8	3.3	-3.9	-3.0	-4.5	-2.2	-2.2	-2.5
Russia	3.4	2.1	2.8	5.1	6.9	5.4	3.9	2.8	0.9	-0.7	-2.0	-4.1
Serbia	-1.7	2.3	2.6	0.1	8.9	7.0	-10.6	-8.2	-8.5	-5.7	-5.0	-5.0
Slovakia	2.0	0.5	1.7	3.6	1.7	1.9	2.2	3.3	3.0	-4.3	-3.4	-3.2
Turkey	2.2	3.5	4.0	8.9	7.3	7.3	-5.8	-6.9	-6.6	-2.0	-2.2	-2.7
Ukraine	0.2	-0.1	3.1	0.6	2.0	5.7	-8.4	-8.7	-6.1	-5.6	-4.5	-4.6
Africa/Mideast	**5.1**	**4.7**	**5.6**	**4.9**	**5.3**	**6.0**	**9.7**	**6.1**	**4.3**	**3.0**	**-1.9**	**-3.8**
Bahrain	3.5	3.6	4.4	2.8	4.0	2.5	6.9	-0.3	-3.8	-2.1	-3.2	-3.0
Egypt	2.2	1.1	2.3	7.1	10.2	11.0	-3.0	-2.3	-2.5	-10.9	-12.7	-11.8
Ghana	7.0	6.7	6.8	9.1	10.7	9.3	-11.5	-10.8	-10.4	-12.4	-10.1	-8.5
Iraq	11.0	7.9	9.8	6.1	6.0	6.0	13.5	8.7	6.7	6.6	-3.0	-3.5
Israel	3.0	3.2	3.0	1.7	1.6	2.3	-0.1	0.2	1.8	-3.7	-4.3	-3.0
Jordan	2.7	3.0	4.0	4.8	5.5	5.0	-18.2	-13.4	-11.5	-8.3	-8.2	-8.2
Kenya	4.6	5.5	6.1	9.4	5.6	6.6	-10.5	-10.1	-9.5	-9.0	-7.0	-5.5
Kuwait	7.0	3.6	3.7	2.9	5.0	5.0	49.1	47.0	43.9	24.0	13.0	6.5
Lebanon	1.5	2.0	4.5	6.4	5.0	5.0	-14.8	-15.9	-16.0	-8.8	-10.2	-10.5
Nigeria	7.4	6.5	6.9	12.2	8.9	10.0	4.0	2.3	0.4	-2.8	-2.6	-2.8
Oman	7.1	6.7	6.7	2.9	3.0	3.0	4.1	8.3	5.1	3.3	-2.2	-4.7
Qatar	6.0	8.3	7.2	3.0	3.0	3.0	28.5	17.9	9.4	5.5	2.4	0.5
Saudi Arabia	6.8	5.1	7.4	4.0	6.0	8.0	24.2	13.6	9.3	13.7	1.9	-3.5
South Africa	2.5	2.3	2.9	5.7	5.6	5.8	-6.1	-5.9	-5.7	-4.4	-4.9	-4.8
Tanzania	6.9	6.8	7.0	16.0	8.0	4.8	-11.9	-10.2	-13.3	-5.4	-5.0	-5.6
UAE	2.4	4.6	4.9	0.7	0.8	1.0	0.2	2.1	4.0	NA	NA	NA
Uganda	2.6	5.0	5.6	14.0	4.4	6.8	-10.9	-12.9	-14.8	-3.6	-3.4	-3.3
Zambia	7.3	6.9	7.5	6.6	7.1	7.3	-3.4	-0.5	2.9	-4.5	-4.2	-3.7
Total	**4.7**	**4.7**	**5.1**	**4.6**	**4.7**	**4.7**	**1.7**	**1.1**	**0.7**	**-1.7**	**-2.4**	**-2.6**

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

Sovereign Ratings Outlook

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

Given economic updates in this publication and based on rating agency criteria, we highlight our economists' and strategists' main expectations for sovereign ratings over the near (2-3 quarters) and longer (2-4 years) term.

Figure 41. Advanced Economies — Sovereign Long-Term Debt Ratings and Citi Ratings Forecasts

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

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

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

Expected Ratings Issues

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Spain — BBB-/Baa3 Negative still: Both Moody's and S&P have detailed their Baa3/BBB- ratings of the Spanish sovereign recently. We see no causal link between S&P's downgrade of Italy and that of other sovereigns. The move on Italy pertained to domestic forces within the Italian economy, not wider system drivers (*European Rates Weekly - When Do Downgrades Matter?*). For Spain specifically, Moody's published on 11 July stating that "*Spain's economic developments are broadly in line with our expectations*". Moody's continues to expect Spain to return to growth next year, but acknowledges "*downside risks to the growth scenario are considerable*". Separately, S&P affirmed its BBB- rating on 14 June and then re-iterated (Supplementary Analysis 12 July) that this is supported by S&P's view of Spain's "*diversified and prosperous economy, and the government's ongoing implementation of a comprehensive financial, fiscal and structural reform agenda*". S&P notes that the rating is constrained by the sovereign's leverage and growth outlook and monitors domestic political developments. Taking these comments into account, although medium term risks remain considerable, an immediate downgrade of the Spanish sovereign is not our base case.

Given the recent comments by S&P, we believe downward ratings pressure is likely to persist for Italy

Italy — one notch downgrade: S&P downgraded Italy by one notch from BBB+ to BBB on 9th July citing the "*the effects of further weakening growth on Italy's economic structure and resilience, and its impaired monetary transmission mechanism*". S&P detailed Italy's growth remained constrained by "rigidities in Italy's labor and product markets". But the downgrade also drew attention again to Italy's fiscal woes, linking the next rating move to the ability to prevent further widening of the fiscal deficit. Given the strong pressures within the fragile coalition government for deficit-increasing measures and little room to compromise on spending cuts, we think the probability of further rating downgrades has increased. S&P, and ourselves, believe that Italy needs a 5% primary surplus (from 2.5% in 2012) to set the public debt on a mild downtrend from 2015.

Elevated political concerns weigh on the outlook for Portugal

Portugal — S&P outlook revised to negative: S&P stated (5 July) recent political developments "*complicate Portugal's already challenging policymaking environment and suggest even less room for manoeuvre than when we changed the rating outlook to stable in March 2013…We believe that growing political uncertainty could derail Portugal's forthcoming debt issuance and its hoped-for exit in 2014 from the Troika-sponsored support program*". Downward ratings pressure has clearly increased over the medium term and we agree with the wider implications regarding Portugal's current political situation (*Portugal — should markets be concerned*).

Fitch now rates France in line with both Moody's and S&P

France - one notch downgrade: Fitch downgraded France on 12 July from AAA to AA+ citing elevated government debt levels (expected to peak at 96% of GDP). This puts Fitch's rating in line with both Moody's (Aa1) and S&P (AA+). Based on Citi's fundamental views (see p17), our economists continue to expect further downward rating pressure over the longer-term (*Sovereign Debt Crisis Update*).

Ireland is the only sovereign covered in this publication to have a Positive Outlook

Ireland - S&P outlook revised to positive: Following S&P's decision on 12 July, Ireland is the only sovereign covered in our *Sovereign Ratings Outlook* to have a Positive Outlook. S&P upgraded its outlook for Ireland citing its debt burden was likely to fall more rapidly than previously expected. Fundamentally, Citi also agrees that prospects for Ireland have improved and we expect both Moody's and S&P to upgrade the Irish sovereign by one notch over coming quarters.

We continue to see downward pressure on the ratings of both the UK and the US over the longer term

Core rating views unchanged: We have not changed our views on core ratings since we last published. We continue to believe in further downward ratings pressure for both the UK and US over the longer-term as illustrated in Figure 41.

Rates Forecasts Commentary

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With thanks to Brett Rose (US), Steven Mansell (APAC) and Jamie Searle (UK)

US: rangebound 10yr yields but front end looks too high

The significant rise in longer maturity Treasury yields is consistent with a labour market that "has improved substantially" and the implications for the Federal Reserve's QE purchases. We expect the Fed will choose to begin tapering the level of purchase within a few months, barring a deterioration in labour market data. While this may cause longer maturity yields to move slightly higher, we think that this is now largely priced in. However, as economic data has been mixed recently, we don't see a near term catalyst for longer term yields to move higher from here. Instead we expect 10yr Treasury yields to stay in a modest range around current levels in the near term. We think the largely parallel rise in yields along the Treasury curve since early May is inappropriate: with data mixed we expect the Fed to continue emphasizing that it is likely to keep the Fed Funds rate near zero for a very long period of time - even if it starts tapering the level of QE purchases. We think shorter term yields should move lower to reflect this and we favour longs in 5yrs and curve steepening positions.

Europe: we still expect Bunds to range-trade, averaging 1.5%

10yr Bunds to average 1.5% in the coming quarters

With regards to the absolute level of Bund yields, we remain firmly of the view that rates will be lower for longer. We see 10yr Bund yields averaging 1.5% in the quarters ahead and this is based on the fundamental justification of the low growth and low inflation outlook. Furthermore, monetary policy is expected to remain loose — especially given the unprecedented move from the ECB to initiate forward guidance. Here, the ECB explicitly stated that key interest rates would remain at “present or lower levels for an extended period of time”. Citi also continues to expect a further cut in the refi rate by 25bp to 0.25% in Q4 this year.

Bund forecast slightly higher to maintain a stable UST/Bund spread, and peripheral spreads a little wider to reflect unpredictable political concerns

In terms of key changes in our forecasts since we last published, we have nudged our Bund yield expectations slightly higher later in 2014, essentially preserving the cross market Bund-UST spread given higher Treasury yields. We have also slightly widened our periphery EMU spreads to reflect growing political concerns, which as Portugal recently illustrated, remain somewhat unpredictable in nature.

Japan: impact of JGB purchases to increase in 2014

4 factors driving the JGB outlook: (i) portfolio damage, (ii) easing impact, (iii) exit strategy, and (iv) consumption tax, with the latter the most worrying for investors

We expect the consumption tax to rise to 8% on schedule in April 2014

We see four main factors impacting the JGB market outlook: (1) the extent of the damage to investor portfolios, (2) the impact of drastic monetary easing, (3) the consumption tax hike, and (4) the FRB exit strategy. Damage to investors’ portfolios is likely to persist through the end of the fiscal first half in September, or even through year-end. We expect the impact of big cumulative JGB purchases to increase next year. We think the risk of the postponement of the consumption tax hike is the most worrying factor for JGB market participants. Our main scenario is for the increase in the consumption tax from 5% to 8% to go ahead on schedule in April 2014. The likelihood of the BoJ achieving its 2% inflation target would rise if the tax hike is postponed, and nominal interest rates are likely to shift upwards.

UK: forward guidance positive for 2-5yr gilts and front end real yields

Forward guidance to richen 2-5yr nominals and front end real yields

Near term outperformance of long dated gilts; longer term, 10yr UST-gilt widening

The MPC has signaled an intention to cap policy rate expectations via forward guidance (probably from August). Guidance is likely to be stronger than the market currently anticipates, in our view, and should be supportive for the 2-5yr sector and front-end real yields. We also expect long-end gilt yields to perform relatively well in the near-term, both outright and vs Bunds. Over the longer-term, the MPC’s policy response is likely to drive a significant widening in the 10yr Treasury-gilt spread.

Figure 42. Interest Rate and Bond Market Forecasts as of 17 July 2013

		Quarterly Average					
	Current	3Q 13	4Q 13	1Q 14	2Q 14	3Q 14	4Q 14
US							
Policy Rate (Fed Funds) End Quarter	0.25	0.25	0.25	0.25	0.25	0.25	0.25
3-Month Libor	0.27	0.30	0.34	0.40	0.50	0.60	0.68
2 Year Treasury Yield	0.34	0.37	0.45	0.55	0.65	0.75	0.85
5 Year Treasury Yield	1.42	1.39	1.40	1.53	1.68	1.80	1.98
10 Year Treasury Yield	2.60	2.60	2.65	2.80	3.00	3.15	3.25
30 Year Treasury Yield	3.66	3.68	3.78	3.98	4.20	4.33	4.38
2-10 Year Treasury Curve	226	223	220	225	235	240	240
2 Year Swap Spread (Swap Less Govt), bp	18	18	19	20	20	20	20
10 Year Swap Spread (Swap Less Govt), bp	22	19	13	8	5	5	5
30 Year Swap Spread (Swap Less Govt), bp	-2	-5	-10	-14	-18	-23	-25
30 Year Mortgage Yield	4.48	4.49	4.53	4.60	4.70	4.80	4.93
10 Year Breakeven Inflation	205	218	235	245	248	243	240
Euro Area							
Policy Rate	0.50	0.50	0.25	0.25	0.25	0.25	0.25
Overnight Rate (EONIA)	0.08	0.00	0.10	0.15	0.20	0.20	0.25
3-Month (EURIBOR)	0.20	0.20	0.25	0.25	0.30	0.30	0.30
2 Year Schatz Yield	0.10	0.10	0.10	0.10	0.10	0.15	0.20
5 Year Bobl Yield	0.55	0.50	0.50	0.50	0.50	0.60	0.70
10 Year Bund Yield	1.58	1.55	1.50	1.50	1.50	1.70	1.80
30 Year Bund Yield	2.40	2.35	2.30	2.30	2.30	2.50	2.60
2-10 Year Bund Curve	148	145	140	140	140	155	160
10 Year BTP-Bund Spread	286	280	300	275	250	250	250
10 Year Bono-Bund Spread	318	310	330	305	280	265	250
2 Year BTP-Schatz Spread	156	154	162	142	110	122	122
2 Year Bono Schatz Spread	196	193	203	183	151	131	120
10 Year OAT-Bund Spread	60	60	70	70	80	80	80
10 Year Swap Spread (Swap Less Govt.), bp	30	35	35	30	30	30	30
10 Year Breakeven Inflation	158	165	165	170	170	180	180
Japan							
Policy Rate	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3-Month Libor	0.16	0.15	0.15	0.15	0.15	0.15	0.15
2 Year Treasury Yield	0.13	0.15	0.15	0.10	0.10	0.15	0.15
5 Year Treasury Yield	0.31	0.35	0.35	0.30	0.20	0.30	0.30
10 Year Treasury Yield	0.85	0.90	0.90	0.80	0.60	0.80	0.80
30 Year Treasury Yield	1.87	1.90	1.90	1.85	1.70	1.85	1.85
2-10 Year Treasury Curve	72	75	75	70	50	65	65
2 Year Swap Spread (Swap Less Govt.), bp	15	15	15	13	12	13	13
10 Year Swap Spread (Swap Less Govt.), bp	20	17	17	18	20	18	18
UK							
Policy Rate	0.50	0.50	0.50	0.50	0.50	0.50	0.50
3-Month Libor	0.51	0.51	0.51	0.51	0.51	0.51	0.51
2 Year Treasury Yield	0.35	0.30	0.30	0.30	0.35	0.40	0.45
5 Year Treasury Yield	1.29	1.15	1.20	1.20	1.30	1.45	1.55
10 Year Treasury Yield	2.32	2.20	2.25	2.30	2.40	2.60	2.75
30 Year Treasury Yield	3.49	3.40	3.45	3.50	3.55	3.70	3.80
2-10 Year Treasury Curve	197	190	195	200	205	220	230
10 Year Swap Spread (Swap Less Govt.), bp	12	10	10	5	5	0	0
10 Year Breakeven Inflation	296	305	310	315	315	320	320
Australia							
Policy Rate	2.75	2.50	2.50	2.50	2.50	2.75	3.00
3-Month Libor	2.78	2.55	2.55	2.60	2.70	3.05	3.25
2 Year Treasury Yield	2.50	2.30	2.35	2.40	2.60	2.90	3.20
5 Year Treasury Yield	3.03	2.80	2.85	2.95	3.10	3.35	3.60
10 Year Treasury Yield	3.76	3.55	3.70	3.80	3.90	4.10	4.30
2-10 Year Treasury Curve	1.26	1.25	1.35	1.40	1.30	1.20	1.10
10 Year Swap Spread (Swap Less Govt.), bp	57	55	60	65	65	70	70

Source: Citi Research

Commodities Market Outlook

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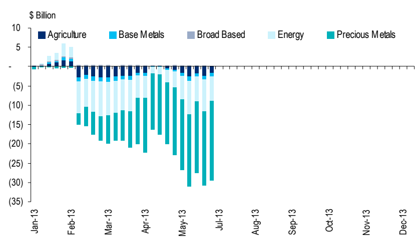
In the aftermath of the Q2 price retreat, if not collapse across commodities, there is a temptation to look for overshoots on the down side and new opportunities to enter the market. But the market retreat in Q2 was part of a more basic trend as the commodity supercycle wound down, and for most commodities, it's probably still not time for bottom-fishing. Commodities are being torn in two directions; one toward correlation with other asset classes in response to changes in macro risk sentiment, the other toward the logic of multiple commodity "unicycles." Citi expects overall trends to point to commodity prices responding in an increasingly differentiated way, to individual commodity fundamentals, but periodically moving together and with other asset markets. Recently, policy statements from China and the US prompted tighter correlations between commodities and equities in particular, but over time Citi expects renewed divergence, as was the case in Q1 and the beginning of Q2.

Figure 43. 1H 13 Cumulative Commodity Market Investment by Major Sector — negative across the board*



Source: Citi Research, *includes passive index benchmarks and US listed exchange traded funds

It may be tempting to hope for a renewed equilibrium across markets, but the bumpy and volatile macro environment of Q2 looks likely to re-assert itself in 2H '13, not just in commodities but in other asset classes as well. With decision-makers in the US and China trying to change long-held policies with massive implications across asset classes, the outlook is all the more uncertain and could be more volatile than might have been expected at the beginning of 2013. The macroeconomic setting along with policies from China and the US are likely above all else and in the absence of political or weather-related tail risk events to determine the volatility, direction and speed of this bumpy ride.

The outlook for global growth is weak but kaleidoscopic. Citi's economists have reduced growth forecasts for a number of large emerging economies, while raising those for advanced economies. For emerging markets, the period ahead appears to be one of growth downgrades, rising imbalances and worsening current accounts and risks to capital inflows. As commodity demand is a reflection of global growth, reduced economic activity and lower fixed asset investment, especially in China, point generally to a softer commodity price environment, especially given the huge recent capital expenditures for new supplies.

Policies in the US and China have suddenly moved to centre stage with impacts across sectors. In the US a more positive outlook is triggering changes in government credit policies, raising doubts about the economic outlook itself; in China, a worsening economic outlook is being tested by credit reforms that could have profound implications for future growth. Officials in both are torn between the short-term implications of longer term policies as they balance the long-term implications of short-term policies, dual balancing acts, with deep implications for commodities. In both cases officials are dealing with moving targets as short-term consequences of new policies emerge, making them likely to shift and exacerbating volatility. In this context of changing circumstances for the global economy, particularly the reduction in concerns over inflation and macro risks, and the two policy twists in the world's two largest economies (along with massive changes in the policies pursued in Japan), we have revised our commodities price outlook this month with notable highlights as follows:

- *Energy:* crude oil markets are expected to remain weak in 2013 but WTI (the US benchmark grade) is likely to keep outperforming Brent (the waterborne global benchmark) as new infrastructure bids US inland crude to world prices after several years of dislocation and congestion. Henry Hub natural gas prices are modestly revised lower for 2013 and cut 35-cents for calendar 2014 on stronger supply and weaker demand.

- *Industrial metals:* base metals prices are cut substantially for 2013 largely driven by marking-to-market 2Q prices which underperformed our very bearish outlook outlined in the 12 April Quarterly. 2014 London Metals Exchange prices are cut 5% for copper and aluminum which remain near marginal output costs and 10-20% for other metals.

- *Precious metals:* gold bullion and silver prices are expected to remain weak for the balance of 2013 absent fits and starts of short covering activity. The outlook for 2014 looks more daunting still with gold levels likely to average below $1200/oz and silver levels in the high-teens. The outlook for Platinum Group Metals appears less rosy than before but we remain bullish on palladium.

- *Bulk commodities:* are expected to perform neutral other than coal and will be largely dependent on China. We cut our old coal outlook 7% for 2013 and further still for 2014. The iron ore spot forecast is cut 2% this year and 6% next.

- *Agriculture:* prices were adjusted largely on a mark-to-market basis for 2Q with no changes larger than 1 or 2% from prior outlooks. Overall balances remain loose for most crops and the sector looks neutral to slightly bearish the curve. CBOT wheat is an exception which is downgraded 9% for 2014 to USd705/bu but is expected to outperform its row crop brethren.

Figure 44. 6-12mn Commodity Market Outlook

	Bullish	Neutral	Bearish
Energy		WTI	Brent
Base Metals	Nickel	Aluminium	Copper, Lead, Zinc
Precious Metals	Palladium	Platinum	Gold, Silver
Bulks		Met Coal, Thermal Coal	Iron Ore
Agriculture	Cocoa	Wheat, Cotton, Coffee	Corn, Soybeans

Source: Citi Research, *subject to revision. As published on 15 July 2013 'Curb Your Enthusiasm: 3Q 13 Commodities Market Update' Citigroup.

Figure 45. Commodities Price Forecasts*

		Point Prices																
		0-3M	6-12M		Q3 2012	Q4 2012	2012	Q1 2013	Q2 2013	Q3 2013E	Q4 2013E	Q1 2014E	Q2 2014E	Q3 2014E	Q4 2014E	2013E	2014E
Energy				**5Y Cyclical**													
NYMEX WTI	USD/bbl	100.0	92.5	81.0	92.2	88.2	94.1	94.4	94.2	99.0	96.0	95.0	90.0	95.0	87.0	95.9	91.8
ICE Brent	USD/bbl	105.0	97.5	85.0	109.4	110.1	111.7	112.6	103.4	105.0	100.0	100.0	95.0	100.0	95.0	105.3	97.5
Henry Hub Natural Gas	USD/MMBtu	4.30	4.10	N/A	2.87	3.39	2.75	3.48	4.03	4.25	4.40	4.15	4.05	4.15	4.30	4.05	4.15
Base Metals				**LT Price**													
LME Aluminum	USD/MT	1,750	1,900	2,200	1,944	2,017	2,049	2,042	1,874	1,790	1,770	1,800	1,830	1,850	1,880	1,870	1,840
LME Copper	USD/MT	6,600	6,300	6,200	7,711	7,921	7,945	7,964	7,204	6,900	6,750	6,700	6,600	6,300	6,400	7,205	6,500
LME Lead	USD/MT	1,900	2,300	2,200	1,984	2,200	2,072	2,314	2,066	1,980	2,000	2,050	1,900	1,950	2,000	2,090	1,975
LME Nickel	USD/MT	14,000	16,000	20,000	16,383	17,036	17,592	17,387	15,103	14,200	14,500	15,000	16,000	17,000	17,500	15,295	16,375
LME Tin	USD/MT	19,000	20,500	20,000	19,281	21,547	21,108	24,128	20,997	19,300	19,200	19,500	20,000	21,000	21,500	20,905	20,500
LME Zinc	USD/MT	1,750	1,850	2,100	1,902	1,979	1,963	2,057	1,876	1,820	1,800	1,820	1,850	1,850	1,870	1,890	1,850
Precious Metals				**LT Price**													
COMEX Gold	USD/T. oz	1,100	1,150	1,050	1,654	1,718	1,669	1,632	1,429	1,220	1,150	1,100	1,130	1,160	1,180	1,358	1,145
Silver	USD/T. oz	17.5	18.0	16.5	29.9	32.6	31.2	30.1	23.5	18.5	18.0	17.5	17.8	18.2	18.4	22.5	18.0
Platinum	USD/T. oz	1,400	1,500	1,531	1,500	1,600	1,552	1,634	1,474	1,365	1,425	1,425	1,450	1,500	1,525	1,474	1,475
Palladium	USD/T. oz	750	820	680	613	653	645	741	716	685	725	750	800	800	850	717	800
Bulk Commodities				**5Y Cyclical**													
Hard Coking Coal (benchmark Asia)	USD/MT	145	170	200	225	170	211	165	172	145	155	170	170	170	170	159	170
Thermal Coal Asia (NEWC)	USD/MT	79	88	105	88	86	94	91	81	79	82	88	88	88	88	83	88
Iron Ore Spot (TSI)	USD/MT	115	115	81	112	121	128	148	126	115	115	115	115	115	115	126	115
Agriculture																	
CBOT Corn	USd/bu	550	493	N/A	783	737	695	715	661	550	495	485	500	520	520	605	505
CBOT Wheat	USd/bu	670	703	N/A	870	846	750	738	695	670	685	700	705	700	720	695	705
CBOT Soybeans	USd/bu	1,300	1,160	N/A	1,675	1,485	1,465	1,448	1,468	1,300	1,175	1,150	1,170	1,170	1,140	1,350	1,160
CBOT Rice	USD/cwt	15.4	15.3	N/A	15.3	15.1	14.9	15.3	15.5	15.4	15.2	15.3	15.3	15.5	15.0	15.4	15.3
NYB-ICE Cotton	USd/lb	85	88	N/A	73	73	80	82	85	85	88	85	90	90	88	85	88
Sugar#11	USd/lb	17.0	18.0	N/A	21.0	19.6	21.6	18.4	17.1	17.0	17.0	17.5	18.0	18.0	18.0	17.4	17.9
ICE Coffee	USd/lb	125	130	N/A	172	152	175	144	131	125	130	130	130	135	135	133	133
ICE Cocoa	USD/MT	2,300	2,325	N/A	2,440	2,420	2,348	2,176	2,280	2,300	2,350	2,325	2,325	2,325	2,325	2,280	2,325

Source: Citi Research, *subject to revision

Figure 46. **Citi Global Economics Team For Informational Purposes Only**

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

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