19 June 2013 │ 48 pages

Global

Global Economic Outlook and Strategy

June 2013*

- Our global growth forecasts are little changed this month, at 2.6% for 2013, 3.2% for 2014 and 3.4% for 2015 (versus 2.6%, 3.2% and 3.6%, respectively, last month). We are once again cutting our growth forecasts for various emerging markets (notably China, Taiwan, Brazil, Mexico and Venezuela) and lifting growth forecasts overall for advanced economies (notably Japan and the UK). Overall, our growth forecasts remain a little below consensus, especially for Brazil, Russia, India, China and the euro area.
- The multi-year period of increasing emerging market outperformance and resilient balance sheets is now giving way to growth downgrades with worsening current accounts and rising private debt/GDP ratios. We believe that China's policymakers now regard a further modest economic slowdown to 7%-7½% real GDP growth as less disruptive than a large new credit stimulus aimed at restoring growth to 8%+. China's private debt/GDP ratio (households and non-financial companies) already has soared by about 50 percentage points in the last four years, a markedly bigger rise than in other major EMs and also even bigger than those in the US and euro area over the six-year period of 2002-08. Many other EM countries now face the long-absent challenge of having to attract capital with worsening fundamentals when (with the prospect of Fed tapering) global liquidity conditions may not be easing significantly further.
- In Japan, we now assume that the government will deliver another large fiscal stimulus package to mitigate initial negative impacts from the consumption tax hike slated for April 2014. As a result, we are lifting our growth forecasts to 2.2% this year and 1.9% in 2014, up by 0.2% and 0.4%, respectively, from last month. Nevertheless, we still doubt that the BoJ stimulus announced so far will lift Japan's inflation to 2% on a sustained basis. Hence, we expect that markets will anticipate further BoJ stimulus, leading to renewed yen depreciation beyond Y100/USD. The ECB is likely to cut the refi rate again, but we doubt that this will provide much stimulus. The ECB's subsequent step if the economy remains weak might be forward guidance on interest rates. We doubt the ECB will implement wider unconventional policies (eg negative deposit rate or large-scale asset purchases) unless deflation is occurring or imminent, or the euro appreciates sharply. The Fed is likely to signal that tapering will be gradual and data-dependent, and that any move to tightening is both distant and data-dependent.

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With thanks to Jan Maguire

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Figure 1. Currency and Interest Rate Forecasts, as of 19 June 2013

	19 June 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.)	2.14	2.25	2.50	2.70	2.90	3.10	3.20
Euro Area: US$/€	1.33	1.37	1.36	1.36	1.37	1.38	1.39
Euro Repo Rate	0.50	0.50	0.25	0.25	0.25	0.25	0.25
10-Yr. Bunds (Period Ave.)	1.57	1.50	1.50	1.50	1.50	1.50	1.60
Japan: Yen/US$	95	102	106	110	110	110	110
Call Money	0.10	0.10	0.10	0.10	0.10	0.10	0.10
10-Yr. JGB (Period Ave.)	0.87	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

*CORRECTION: We have corrected our quarterly forecasts for the US PCE deflator, Core PCE deflator and current account in Fig 20.

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

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Figure 2. Forecast Highlights and Changes from Last Month

■ Global	Our global growth forecasts are little changed this month, but with a continued trend of downgrades to emerging markets and upgrades overall to advanced economies.
■ United States	Fiscal headwinds have slowed 1H growth but stimulative monetary policy and more visible cyclical momentum are likely to provide substantial offsets ahead. We see an initial scaling back of QE in September with continued purchases until next spring. A rapidly improving near-term fiscal outlook is dulling appetites for needed structural budget reforms.
■ Euro Area	We leave our euro area GDP forecasts largely unchanged in June, activity is expected to be marginally negative or flat for the next four quarters. 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.
■ China	Key macro indicators in May were generally weaker than expected. But slow policy reaction signals that policy-makers prefer a more real albeit slower growth. We downgrade our GDP growth forecast in 2Q from previously 7.8% YoY to 7.5% YoY, which implies 7.6% annual growth. Our annual CPI forecast is also adjusted down from 2.9% to 2.6%. Policy should remain accommodative with possible two-way movement of CNYUSD.
■ Japan	We raise our growth forecasts to 2.2% for 2013 and 1.9% for 2014 from previous forecasts of 2.0% and 1.5%, respectively, as of May. At this forecast round, we assume that the administration will introduce another large fiscal stimulus package with public works spending of around ¥3trn later this year in order to mitigate a negative impact from the consumption tax hike slated for April 2014.
■ United Kingdom	The economy is gradually improving but still has ample slack and is underperforming versus prior recovery cycles. We expect that the MPC will adopt Fed-style forward guidance once Carney takes over as BoE Governor from midyear.
■ Canada	Canadian prospects are brightening. Nonetheless, 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 probably will retain its slight tightening bias.
■ Australia	Market pricing anticipates more rate cuts to achieve the rebalancing of the economy, but with the AUD becoming less of a headwind to the outlook we believe the RBA would prefer not to cut further.
■ Emerging Asia (ex China)	Slow growth and disinflation is still the theme. Indonesia hiked earlier than expected, will need to hike more amid high inflation and need to stabilize FX, but all the others are likely to stay neutral/dovish with a few who can cut more. Most countries have significant "space' to absorb inflationary impact of weaker FX. In fact, many will welcome weaker exchange rates to loosen monetary conditions.
■ CEEMEA	As in other emerging economies, yield curves in CEEMEA are being pulled in two directions: a dovish environment at the short end, and long-end steepening due to the rise in UST yields. Although recent days have seen stabilisation - due partly to some (we think unwarranted) expectation of monetary tightening in countries such as SA, Turkey and Israel - we think financial volatility is likely to continue.
■ Lat Am	We are cutting growth forecasts for Brazil, Mexico and Venezuela, while for Argentina, we have reduced our forecast for 2014 non-official real GDP growth to 0.5%, reflecting tighter FX controls and monetary and fiscal policies after the midterm elections.

Source: Citi Research

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

	2012	2013F	2014F
World	**1.7%**	**2.6%**	**3.9%**
United States	3.6	3.3	4.9
Japan	-0.9	-0.1	3.2
Euro Area	-2.4	-0.4	0.6
United Kingdom	-2.4	-0.6	1.0
Canada	0.9	1.6	1.9
China	10.0	9.4	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 — Growth Gap Between EMs and AEs Narrows

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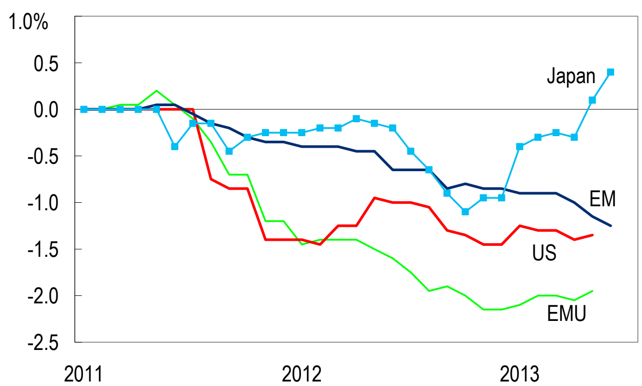
Our global growth forecasts are little changed, but with a continued bias to downgrades among EMs and upgrades in AEs

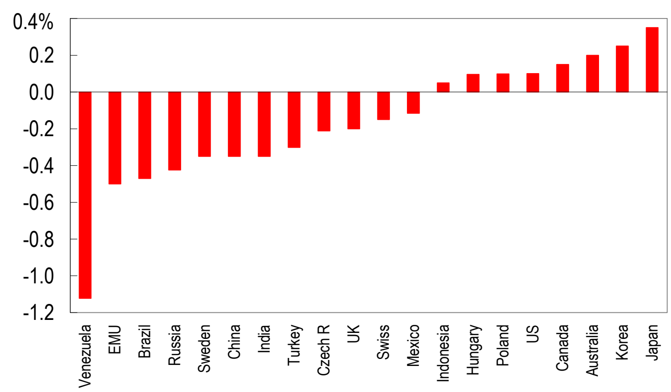
Our global growth forecasts are little changed this month, at 2.6% for 2013, 3.2% for 2014 and 3.4% for 2015 (versus 2.6%, 3.2% and 3.6%, respectively, last month). World trade growth remains sluggish, the euro area remains in recession and growth is weakening in a range of emerging markets. As in recent months, we are once again cutting our growth forecasts for a range of emerging market countries (notably China, Taiwan, Brazil, Mexico, Venezuela) and lifting growth forecasts overall for advanced economies (notably Japan and the UK). Overall, our growth forecasts remain a little below consensus, notably for the BRICs and euro area.

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



Note: We show the average for forecasts in 2013-14. Source: Citi Research

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



Note: We show the average for forecasts in 2013-14. A positive figure implies the Citi forecast is above consensus. Sources: Consensus Economics and Citi Research

Our EM growth forecasts have been falling for a while

The multi-year period of growing emerging market outperformance and resilient balance sheets is now giving way to repeated growth forecast downgrades with rising imbalances — more widespread and significant current account deficits, plus rising private debt/GDP ratios. We have cut our 2013 EM growth forecast by 0.5% (from 5.3% to 4.8%) since end-2012 and by a total of 1.5% (from 6.3% to 4.8%) since mid-2011. We expect this underperformance will be sustained, with our 2014 EM growth forecasts also down by 1% (from 6.2% to 5.2%) since mid-11.

China's policymakers appear willing to tolerate a further modest slowdown rather than risk exacerbating imbalances through major new credit stimulus…

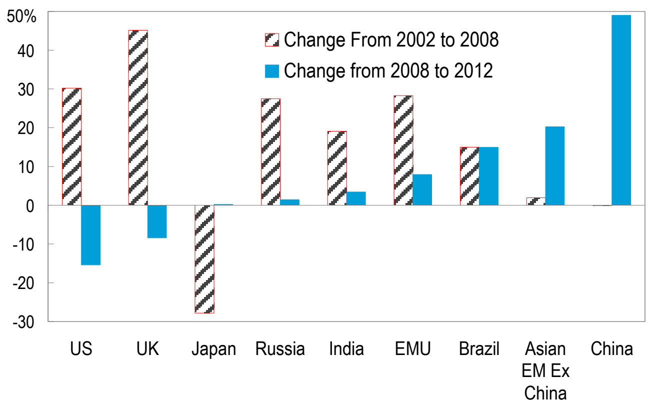
Several factors are at work. First, China's transition to the new normal of 7%-7½% real GDP growth rates in the near future (and perhaps even lower medium term) is already here. China's exports have been capped by sluggish growth in advanced economy imports for several years and, in addition, the large Yen depreciation since mid-12. In recent years, the diminished boost to growth from net trade has been broadly offset by a credit-driven investment surge. However, we believe that China's policymakers now regard a further modest economic slowdown as less disruptive than a large new credit stimulus aimed at restoring growth to 8%+. China's private gross debt/GDP ratio (using BIS data for households and non-financial companies and measured against the four-quarter average of nominal GDP) has soared by about 50 percentage points in the last four years, from 119% in Q3-08 to 168% in Q3-12. The rise in debt is particularly marked in the corporate sector. The counterpart has been a massive expansion of bank lending and the shadow banking system. The rise in China's private debt/GDP ratio over the last four years has been substantially greater than in other major EM countries and indeed is even bigger than that in the US and euro area over the six year period of 2002-08 (both about 30 percentage points of GDP). The rise in China's private debt/GDP ratio over the last four years is similar in scale to that in Japan in 1986-90 (rise of 45% of

GDP) and Finland during 1988-92 (rise of 51%). Such large rises in a country's private debt/GDP ratio often have been followed by marked economic weakness and balance sheet vulnerabilities among banks and other lenders.

…given the sharp rise in China's private debt/GDP ratio and concern over probable inefficiencies in the allocation of capital

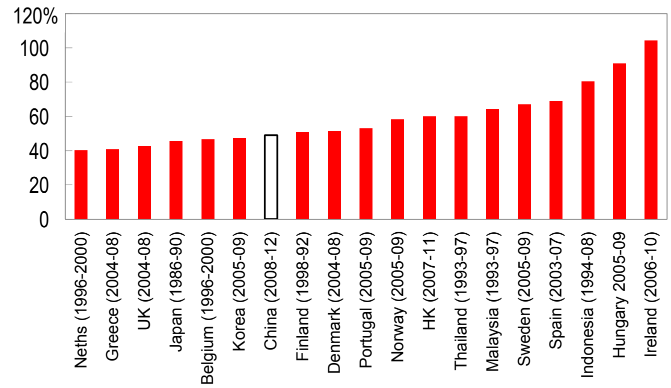
To be sure, China's economic institutions (state-owned banks and a central government with fairly robust fiscal-financial prospects) can probably absorb potential costs of banking losses and possible recapitalization needs in a relatively non-disruptive fashion. However, China's (physical) capital-output and credit-output ratios have been rising in a way that implies it would take ever-larger doses of credit stimulus — and probably greater inefficiencies in the allocation of capital — to sustain growth at the pace of recent years, even if labour supply constraints were not becoming increasingly binding. As a result, the scale of near-term credit stimulus, and hence the pace of economic growth, probably will be limited by the desire to avoid exacerbating risks of future potential losses and instability.

Figure 6. Selected Countries — Changes in Private Debt/GDP Ratios, 2002-12



Note: Data measured in Q3 each year. Note: For Asian EM we show the unweighted average for HK, Indonesia, Korea, Malaysia, Singapore and Thailand. Sources: BIS, Datastream and Citi Research

Figure 7. Selected Countries — Large Four-Year Changes in Private Debt/GDP Ratios, 1970-2012



Note: We show all cases in which the private debt/GDP ratio rose by at least 40% over a four-year period. Sources: BIS, DataStream and Citi Research

A range of other EMs are being squeezed by China's slowdown, yen depreciation and sluggish import growth in AEs

Other emerging markets face similar external headwinds as China, reinforced by China's slowdown. Hence, slowing EM growth is being accompanied by rising EM imbalances. Excluding China and the Middle East, the remaining EM countries will have an aggregate current account deficit of 1½%-2% of GDP this year, the highest since the late 1990s (albeit well below historical peaks). Moreover, the average (unweighted) private debt/GDP ratio (households and non-financial companies) across HK, Indonesia, Korea, Malaysia, Singapore and Thailand has risen by 25 percentage points over the last four years. In Korea and HK, the private debt/GDP ratio is well above late 1990s' peaks, and similar to levels in Spain and the UK (around 200% of annual GDP). These imbalances may not yet have hit peaks of unsustainability. But, at the very least, many EM countries now face the long-absent challenge of rising capital needs with worsening fundamentals at a time when (with the prospect of Fed tapering) global liquidity conditions may not be easing further.

We are again lifting our near-term Japan growth forecasts…

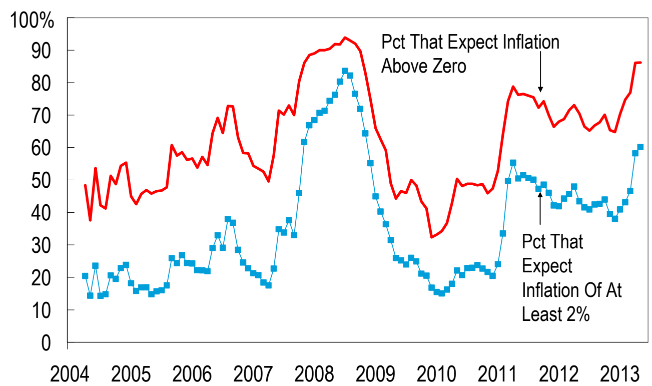
In Japan, we are again lifting our near-term growth forecasts, and now expect growth of 2.2% this year and 1.9% in 2014, up by 0.2% and 0.4%, respectively, from last month. In all, since end-2012, we have lifted our growth forecasts by 1.5% for 2013 and by 1.2% for 2014. This month's upward revision reflects signs of strength in recent data and surveys (especially on business investment), plus the assumption that the government will deliver another large fiscal stimulus package with public works spending of around ¥3trn later this year in order to mitigate initial negative

impacts from the first stage (3 percentage points) of the consumption tax hike slated for April 2014. We doubt that recent structural reform measures will alter the outlook.

…but, with fiscal drag looming in coming years, we doubt the economy is yet on the way to sustained 2% inflation

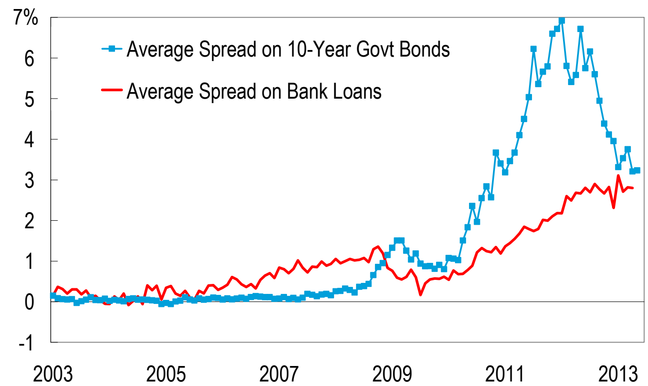
We do not expect that the BoJ balance sheet expansion announced so far will be enough to achieve 2% inflation on a sustained basis. To be sure, household inflation expectations and pay growth have picked up a bit, but consumer spending will be capped by the probable consumption tax hike. Moreover, the near-term public works program will, most likely, be just a temporary patch for one year, leaving a large fiscal tightening in 2015 as public works spending falls back and the planned second stage of the consumption tax hike (2pp) kicks in. As a result, we are cutting our 2015 growth forecast to 1.0% from 1.5% last month. Hence, in keeping with the BoJ's "whatever it takes" attitude, we expect that markets will anticipate further BoJ stimulus, leading to renewed yen depreciation beyond Y100/USD.

Figure 8. Japan — Household Inflation Expectations for Year Ahead (Net Balances), 2004-13



Sources: Cabinet Office Survey, DataStream and Citi Research

Figure 9. Euro Area — Average Interest Rate Spreads Over Germany for Italy, Spain, Portugal, Ireland, 2003-13



Note: We show the average spreads on bank loans for new business loans up to €1 million. Sources: ECB, DataStream and Citi Research

We expect continued weakness in real and nominal GDP growth in the euro area…

For the euro area, we still expect prolonged economic weakness and very low inflation, with marked underperformance in periphery countries[1]. Nominal GDP growth for the euro area as a whole is extremely weak, and has been below 1% YoY for four consecutive quarters. Indeed, the level of nominal GDP in Q1-13 was virtually unchanged from two quarters earlier. Although interest rates are low, the trade-weighted euro is up by about 6½% since mid-2012. Financial conditions in a broad sense are not really supportive, as evident in the weakness of money and credit.[2] The pace of fiscal tightening is declining, but (defined in terms of the change in the structural primary balance) will still amount to about ¾% of GDP this year.

…with marked underperformance and rising debt ratios in the periphery countries

Moreover, many euro area countries still face extra headwinds from private deleveraging and, especially in periphery countries, from poor availability and high cost of credit. The backstop of the OMT facility has helped to markedly narrow spreads on periphery sovereign bonds since mid-2012. However, with worries over credit quality of banks and the ultimate borrowers in periphery countries, spreads between bank lending rates in the periphery countries and lending rates in Germany remain extremely high. Credit growth in periphery countries is deeply negative. To fix this would probably require the ECB or ESM to underwrite banks against credit

[1] See "*Global Economics View: The Euro Area Crises Are by No Means Over*", Willem Buiter and Ebrahim Rahbari, 11 June 2013, Citi.

[2] See "*Financial Conditions Neutral, At Best, on Growth*", Giada Giani, European Economics Weekly, 7 June 2013, Citi.

risk in periphery countries, or to implement a major bank recapitalization of periphery banks (and perhaps repression to encourage lending at lower spreads). The continuing debate over banking union is unlikely to provide either of these anytime soon. As a result, we expect that nominal GDP will continue to shrink in 2013 and 2014 in Italy, Portugal, Greece and Spain, further inflating public and private debt burdens. The unweighted average ratio of public plus non-financial gross private debt to GDP in six periphery countries (Ireland, Greece, Spain, Italy, Cyprus and Portugal) has surged from 196% in 2000 (similar to Germany) to 333% in 2012 and probably will climb further in coming years.

The ECB has further options for stimulus, but is unlikely to act aggressively enough to lift the economy back to normal growth…

We doubt if the response from the ECB and other policymakers will be aggressive enough to lift the euro area out of general economic weakness and restore periphery countries to a sustainable fiscal path. We do expect a further 25bp ECB rate cut later this year, and expect the ECB will continue to offer long-term liquidity at variable rates. But, we doubt that such measures will have much effect given that money market rates already are well below the refi rate. Beyond that, we suspect that the ECB appears to believe there are sizeable potential risks associated with both major balance sheet expansion and negative interest rates. Hence, if further easing is required beyond a lower refi rate and variable rate liquidity, we believe the next step probably would be forward guidance on interest rates. The ECB's Governing Council has already said that "*monetary policy will remain accommodative for as long as necessary*"[3]. This language could, for example, be sharpened to conditional time-limited guidance (eg "if events unfold broadly as expected, the ECB does not expect it will need to hike rates for at least a year"). Or, the ECB could set a specified economic threshold to exit from ultra-low rates accompanied by outline forecasts of when the threshold might be met. Given the ECB's price stability mandate, any such threshold would have to be couched in terms of inflation prospects rather than the jobless rate.

…and unconventional policies are only likely to come into play if outright deflation is occurring in prices and expectations

Beyond that, subsequent easing (if needed) probably would be via a negative deposit rate and/or long term fixed-rate liquidity, with large-scale asset purchases as a final (but unlikely) tool. But, we stress that the ECB probably will only go down this list of unconventional policy tools if euro area deflation is actually evident or in prospect (for example if the euro appreciates sharply). And it would probably take more than a mere month or two of negative CPI inflation to prompt such action. Draghi's definition of deflation – a "*generalised protracted fall in prices, with self-fulfilling expectations… explosive downward dynamics*" – probably would be hard to fulfill if strictly applied. Indeed, it is questionable in our view as to whether even Japan in recent years – which has seen persistent but modest deflation — would truly meet Draghi's definition that deflation implies "*explosive downward dynamics* " in prices and expectations. Longer term, we expect that further restructuring of public and private debt burdens is likely in several periphery countries. As recently, the burden of restructuring may well fall on some creditors of failing banks and official holders of sovereign debt, rather than on private holders of sovereign debt.

We expect a long period of loose or loosening monetary policy across advanced economies and a range of emerging markets

Against this background, we expect that the Fed is likely to start to taper QE later this year, but tapering probably will be gradual and data-dependent. We expect that tightening via a higher Fed Funds rate will not start until 2015. For the ECB, tightening is likely to be even more distant, perhaps not until 2016 or 2017. In the UK, the emphasis is likely to shift from balance sheet expansion (QE, credit easing) to forward guidance once Carney takes over as Governor from midyear. Rate prospects among emerging markets are more mixed, with the probability of further near-term tightening in response to FX weakness in some (eg Brazil and Indonesia) but slowdown-induced easing in others (eg Hungary, India, Russia).

[3] See, for example, speech by ECB President Draghi on 18 June 2013.

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

	GDP Growth						CPI Inflation						Short-Term Interest Rates					
	2012	2013F	2014F	2015F	2016F	2017F	2012	2013F	2014F	2015F	2016F	2017F	2012	2013F	2014F	2015F	2016F	2017F
Global	**2.5**	**2.6**	**3.2**	**3.4**	**3.6**	**3.7**	**2.9**	**3.0**	**3.2**	**3.1**	**3.2**	**3.3**	**2.34**	**2.56**	**2.76**	**3.10**	**3.53**	**3.89**
Based on PPP weights	*3.1*	*3.1*	*3.7*	*3.9*	*4.1*	*4.2*	*3.4*	*3.4*	*3.6*	*3.6*	*3.6*	*3.7*	*2.93*	*3.11*	*3.27*	*3.60*	*3.97*	*4.29*
Industrial Countries	**1.2**	**1.1**	**1.8**	**2.1**	**2.2**	**2.2**	**1.8**	**1.2**	**1.5**	**1.4**	**1.4**	**1.5**	**0.62**	**0.45**	**0.50**	**0.88**	**1.50**	**2.08**
United States	**2.2**	**1.9**	**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**	**1.9**	**1.0**	**1.2**	**1.2**	**0.0**	**0.0**	**2.0**	**0.7**	**0.5**	**0.7**	**0.10**	**0.10**	**0.10**	**0.10**	**0.10**	**0.10**
Euro Area	**-0.5**	**-0.8**	**0.0**	**0.7**	**1.1**	**1.4**	**2.5**	**1.4**	**1.2**	**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	1.1	1.8	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	3.5	3.6	3.2	1.8	2.6	2.5	2.8	2.5	2.3	3.56	2.81	3.25	4.00	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	2.0	1.9	2.0	2.0	1.5	2.2	2.1	2.0	1.8						
France	0.0	-0.3	0.4	0.9	1.4	1.9	2.0	1.0	1.6	1.3	1.6	1.4						
Italy	-2.4	-2.0	-0.6	0.2	0.5	0.8	3.3	1.5	1.2	0.8	0.3	0.4						
Spain	-1.4	-1.9	-1.2	0.0	1.2	1.3	2.4	1.6	0.8	0.6	0.5	0.5						
Greece	-6.4	-5.5	-4.5	-2.3	0.6	1.3	1.0	-0.5	-1.0	-0.6	0.2	0.3						
Ireland	0.9	1.0	2.3	2.6	2.8	2.8	1.9	1.3	1.4	1.6	1.6	1.6						
Portugal	-3.2	-3.1	-1.6	0.1	1.0	1.0	2.8	0.9	0.2	0.3	0.5	0.6						
Netherlands	-1.0	-1.0	0.1	0.9	1.2	1.6	2.8	2.7	1.8	1.6	1.8	1.8						
Belgium	-0.3	-0.3	0.2	1.0	1.5	1.6	2.8	1.1	2.0	2.0	2.0	2.1						
Denmark	-0.5	0.2	1.1	1.6	1.6	1.7	2.4	1.1	1.5	1.9	2.0	1.9	0.43	0.10	0.20	0.40	0.60	1.00
Norway	3.3	2.4	2.7	2.9	2.7	2.7	0.7	1.7	1.7	2.0	2.1	2.5	1.55	1.50	1.61	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	0.89	0.75	1.07	1.73	2.29
Switzerland	1.0	1.5	1.2	1.7	1.8	1.5	-0.7	-0.5	-0.2	1.0	1.0	1.0	0.00	0.00	0.00	0.00	0.00	0.00
United Kingdom	0.3	1.0	1.2	1.8	1.7	1.8	2.8	2.7	2.3	2.2	2.3	2.3	0.50	0.50	0.50	0.50	0.50	1.04
Emerging Markets	**4.7**	**4.8**	**5.2**	**5.4**	**5.5**	**5.6**	**4.6**	**4.7**	**4.7**	**4.6**	**4.6**	**4.6**	**5.20**	**4.89**	**5.07**	**5.35**	**5.51**	**5.60**
China	**7.8**	**7.6**	**7.3**	**7.0**	**7.5**	**7.3**	**2.6**	**2.6**	**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	6.1	6.3	6.5	6.5	6.7	4.3	6.9	5.4	5.7	5.4	5.3	3.90	4.44	5.13	5.25	5.25	5.25
Korea	2.0	2.9	3.7	3.9	4.2	3.7	2.2	1.8	2.8	3.2	3.1	3.0	3.06	2.56	2.50	3.00	3.88	4.38
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	0.4	1.3	1.0	1.3	1.7	5.7	2.0	3.1	3.9	3.5	3.3	6.77	4.44	4.06	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	6.7	5.4	5.0	4.9	4.6	8.07	8.00	7.50	7.00	7.00	7.00
Turkey	2.2	4.0	4.3	4.2	4.4	4.4	8.9	7.4	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	6.0	5.5	5.9	5.8	5.8	5.28	5.00	4.83	5.38	6.00	6.00
Argentina	1.9	3.0	3.0	2.0	-2.0	3.5	10.0	10.3	12.5	15.0	50.0	30.0	13.89	16.95	21.51	24.00	24.00	24.00
Brazil	0.9	2.5	3.0	2.5	3.0	3.0	5.4	6.5	6.0	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	3.9	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	33.2	28.9	25.1	23.1	23.1	14.50	14.50	14.50	14.80	14.80	14.80

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

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

	Current Balance (Pct of GDP)						Fiscal Balance (Pct of GDP)						Government Debt (Pct of GDP)					
	2012	2013F	2014F	2015F	2016F	2017F	2012	2013F	2014F	2015F	2016F	2017F	2012	2013F	2014F	2015F	2016F	2017F
Global	**0.3**	**0.4**	**0.2**	**0.7**	**0.5**	**0.3**	**-4.4**	**-3.9**	**-3.3**	**-2.9**	**-2.6**	**-2.5**	**87**	**88**	**87**	**86**	**85**	**84**
Based on PPP weights	0.2	0.2	0.0	0.4	0.2	0.0	-4.2	-3.9	-3.4	-3.0	-2.8	-2.6	78	79	80	79	78	77
Industrial Countries	**-0.6**	**-0.1**	**-0.1**	**1.6**	**1.7**	**1.7**	**-6.1**	**-5.0**	**-3.8**	**-3.1**	**-2.8**	**-2.5**	**113**	**117**	**116**	**117**	**117**	**117**
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**	**1.1**	**2.0**	**1.5**	**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**	**-3.1**	**-2.6**	**-2.0**	**-1.6**	**-0.8**	**91**	**96**	**98**	**98**	**97**	**95**
Canada	-3.4	-2.8	-2.6	-1.7	-1.4	-1.1	-1.4	-1.0	-0.3	0.0	0.2	0.2	86	86	85	84	82	81
Australia	-3.7	-2.9	-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	5.3	5.2	5.2	0.2	-0.5	0.0	0.8	1.0	2.2	82	81	79	75	71	67
France	-2.3	-1.7	-1.0	-0.3	0.2	-0.1	-4.8	-3.8	-3.6	-3.5	-3.1	-2.5	90	94	96	98	98	97
Italy	-0.5	1.6	2.2	2.2	2.3	2.3	-3.0	-3.2	-3.0	-2.9	-2.7	-2.4	127	133	138	140	141	141
Spain	-1.1	1.1	2.0	3.4	4.1	3.9	-10.6	-6.5	-5.9	-5.4	-4.8	-4.5	84	94	105	109	112	114
Greece	-3.4	-0.4	0.7	1.4	3.9	5.1	-10.0	-5.1	-4.1	-2.6	-1.3	0.2	157	181	199	210	213	213
Ireland	4.4	4.9	5.9	6.5	7.2	7.6	-7.3	-7.3	-4.3	-2.1	-1.3	-0.8	117	122	120	116	112	109
Portugal	-1.5	1.0	3.0	3.4	3.4	3.7	-6.4	-5.6	-5.1	-3.8	-3.1	-3.1	124	135	144	147	148	149
Netherlands	10.1	9.4	8.9	9.4	9.5	9.6	-4.1	-3.6	-3.2	-2.7	-2.1	-1.2	71	74	76	76	76	75
Belgium	-1.4	-1.3	-1.1	-0.7	-0.1	0.5	-3.9	-3.4	-3.2	-2.4	-1.8	-1.7	100	103	104	104	102	100
Denmark	5.8	5.3	4.6	4.2	4.0	3.8	-4.1	-2.0	-1.2	-1.0	0.5	1.0	46	47	47	47	44	42
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	7.0	6.7	6.8	6.7	-0.7	-1.4	-1.5	-0.4	0.7	1.5	39	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	-2.8	-2.9	-2.7	-2.6	-2.5	-6.3	-7.4	-6.9	-6.5	-5.3	-4.6	90	94	99	103	106	108
Emerging Markets	**1.7**	**1.0**	**0.6**	**0.0**	**-0.4**	**-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	-5.1	-4.1	-3.3	-3.4	-3.4	-3.5	-7.0	-6.7	-6.4	-6.2	-5.9	-5.6	68	67	66	65	64	63
Indonesia	-2.7	-2.4	-1.8	-1.6	-1.4	-1.2	-1.8	-2.1	-1.4	-1.0	-0.5	-0.4	24	23	23	21	20	20
Korea	3.8	3.2	1.8	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	-1.2	-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	2.2	3.1	4.2	5.0	6.1	-1.9	-2.7	-2.9	-3.0	-2.8	-3.0	79	79	78	78	77	76
Poland	-3.5	-2.7	-3.5	-3.9	-4.3	-4.3	-3.9	-3.9	-3.5	-3.1	-3.0	-3.0	53	55	55	54	53	53
Romania	-3.8	-3.9	-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	-1.6	-3.0	-4.0	-0.7	-2.0	-4.1	-4.6	-3.4	-3.4	8	7	10	13	15	16
Turkey	-5.8	-6.9	-7.0	-6.6	-6.0	-5.3	-2.0	-2.2	-2.7	-2.7	-3.0	-3.0	39	37	36	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	42	43	43	43	42
Argentina	0.1	0.4	0.2	0.2	3.0	1.0	-2.6	-2.7	-2.9	-3.8	0.0	-0.5	39	40	43	45	43	41
Brazil	-2.4	-3.1	-3.6	-3.7	-3.9	-4.1	-2.5	-3.6	-3.7	-2.7	-3.2	-3.2	59	59	59	59	59	60
Mexico	-0.8	-1.7	-1.6	-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	5.1	5.0	5.6	4.7	5.1	-5.0	-4.0	-4.0	-4.8	-4.6	-4.5	42	44	38	38	39	39

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

	GDP Growth			CPI Inflation			Current Balance (Pct of GDP)			Fiscal Balance (Pct of GDP)		
	2012	2013F	2014F	2012	2013F	2014F	2012	2013F	2014F	2012	2013F	2014F
Global					**0.3**	**0.2**			**-0.1**	**0.1**	**0.5**	**0.3**
Based on PPP weights					*0.3*	*0.2*	*0.1*		*-0.1*	*0.1*	*0.3*	*0.2*
Industrial Countries			**0.1**		**-0.1**	**-0.3**		**-0.1**	**-0.1**		**0.7**	**0.4**
United States					**-0.2**	**-0.2**	**0.2**	**-0.3**	**-0.2**	**0.2**	**2.0**	**1.5**
Japan	**-0.1**	**0.2**	**0.4**					**0.5**	**0.3**			**-1.0**
Euro Area		**-0.1**			**-0.1**	**-0.1**					**-0.2**	**-0.1**
Canada	-0.1				0.1	0.1	0.3	0.2	0.2			
Australia		-0.1						0.7	0.9			
New Zealand												
Germany			0.2		0.1			-0.1	-0.1		-0.4	0.3
France							0.1		-0.1			-0.1
Italy		-0.1			-0.1	-0.1	0.2	0.7	0.1			-0.3
Spain		0.1				0.1		-0.6	-0.7		-0.2	-0.8
Greece					0.1	0.1		1.5	2.4			-0.1
Ireland		0.4	0.3					0.4	0.7		0.1	0.3
Portugal	0.1				0.3	-0.2	2.0	1.0	1.0			0.1
Netherlands					0.1	0.1	0.2	0.1	0.1			
Belgium	-0.1				-0.1						-0.1	
Denmark		0.1	-0.4		-0.3	-0.2	0.3	0.4	0.4			
Norway			0.1		0.1							
Sweden	-0.1	0.2					-0.3	-0.2	-0.2			
Switzerland			-0.1					-0.4	-0.2			-0.1
United Kingdom		0.3	0.4					-0.3	-0.5		0.1	0.2
Emerging Markets		**-0.1**	**-0.1**		**-0.1**			**-0.1**	**-0.1**			
China		**-0.1**			**-0.3**	**-0.1**						
Taiwan		-0.3	-0.2		-0.2			0.7	0.5			
India										0.3	0.3	0.3
Indonesia								-0.1				
Korea					-0.1			0.4	0.1			
Czech Republic					-0.2	0.1		1.6	-0.1		0.1	
Hungary		0.2			-0.1	0.1		-0.4	-0.2			
Poland					-0.2	-0.1			0.1			
Romania	-0.3							-0.1				
Russia												
Turkey							0.2	0.2				
Nigeria												
South Africa		-0.3	-0.2			0.3		0.1	-0.2		-0.3	-0.4
Argentina												
Brazil		-0.4	-0.8		0.1	0.3		-0.1	-0.5		-0.2	-0.5
Mexico		-0.5	0.2					-0.1	-0.1			
Venezuela		-1.5	-0.5		2.7	-2.6	0.1	-0.4	0.5			

Source: Citi Research

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

	10-Year Yields						Exchange Rates Versus U.S. Dollar*						Exchange Rate Versus Euro					
	2012	2013F	2014F	2015F	2016F	2017F	2012	2013F	2014F	2015F	2016F	2017F	2012	2013F	2014F	2015F	2016F	2017F
Industrial Countries																		
United States	**1.80**	**2.20**	**3.00**	**3.25**	**3.50**	**3.75**	**NA**	**NA**	**NA**	**NA**	**NA**	**NA**	**1.28**	**1.34**	**1.37**	**1.40**	**1.40**	**1.40**
Japan	**0.85**	**0.80**	**0.75**	**1.00**	**1.25**	**1.50**	**81**	**100**	**110**	**110**	**110**	**110**	**104**	**134**	**151**	**154**	**154**	**154**
Euro Area	**1.57**	**1.47**	**1.53**	**1.80**	**2.00**	**2.50**	**1.28**	**1.34**	**1.37**	**1.40**	**1.40**	**1.40**	**NA**	**NA**	**NA**	**NA**	**NA**	**NA**
Canada	1.87	2.15	2.98	3.50	3.50	3.65	1.00	1.02	1.01	0.97	0.96	0.95	1.28	1.36	1.39	1.36	1.34	1.33
Australia	3.28	3.48	4.10	5.00	5.50	5.20	1.02	0.98	0.95	0.93	0.93	0.93	1.24	1.36	1.45	1.50	1.51	1.51
New Zealand	3.61	3.40	4.30	5.20	5.80	5.50	0.82	0.81	0.80	0.80	0.78	0.76	1.57	1.65	1.72	1.76	1.79	1.83
Germany	1.57	1.47	1.53	1.80	2.00	2.50												
France	2.54	2.13	2.30	2.50	2.60	3.00												
Italy	5.49	4.36	3.90	5.30	5.00	5.00												
Spain	5.88	4.75	4.06	5.55	5.00	5.00												
Netherlands	1.95	1.83	1.93	2.20	2.30	2.80												
Belgium	2.43	2.33	2.45	2.60	2.80	3.20												
Denmark	1.51	1.62	1.65	1.95	2.25	2.75	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
Norway	2.15	2.27	2.33	2.55	2.75	3.25	5.81	5.76	5.52	5.25	5.16	5.08	7.45	7.72	7.58	7.34	7.22	7.11
Sweden	1.59	1.85	1.88	2.10	2.25	2.75	6.73	6.48	6.33	6.13	6.02	5.92	8.63	8.69	8.70	8.57	8.43	8.29
Switzerland	0.64	0.75	0.64	0.85	1.00	1.30	0.94	0.91	0.92	0.93	0.92	0.92	1.20	1.22	1.27	1.30	1.29	1.29
United Kingdom	1.85	2.00	2.35	2.80	3.00	3.50	1.59	1.58	1.60	1.63	1.66	1.69	0.81	0.85	0.86	0.86	0.84	0.83
Emerging Markets																		
China	**3.33**	**3.36**	**3.49**	**3.61**	**3.74**	**4.11**	**6.31**	**6.13**	**6.05**	**6.01**	**6.02**	**6.04**	**8.11**	**8.21**	**8.31**	**8.40**	**8.43**	**8.46**
Taiwan	1.21	1.35	1.46	1.50	1.70	2.00	29.57	29.99	29.60	28.98	28.69	28.42	38.03	40.21	40.65	40.52	40.16	39.79
India	8.25	7.75	7.75	7.75	7.75	7.75	53.38	56.76	56.66	55.88	55.14	54.41	68.65	76.11	77.83	78.14	77.20	76.17
Indonesia	5.90	6.03	6.65	6.20	6.30	6.40	9361	9976	9966	9875	9744	9610	12038	13377	13689	13808	13641	13455
Korea	3.24	2.97	3.20	3.83	4.75	5.15	1127	1132	1084	1000	992	990	1449	1519	1489	1398	1389	1386
Czech Republic	2.75	1.97	1.96	2.32	2.61	2.61	19.5	19.3	18.5	17.4	17.0	16.7	25.1	25.9	25.4	24.3	23.8	23.4
Hungary	7.91	6.04	6.06	6.20	6.20	6.20	225	227	218	214	211	209	289	304	300	299	296	293
Poland	5.05	3.69	4.20	4.68	5.16	5.01	3.25	3.21	3.17	3.02	2.91	2.80	4.18	4.31	4.35	4.22	4.07	3.92
Romania	NA	NA	NA	NA	NA	NA	3.46	3.28	3.09	2.97	2.95	2.97	4.45	4.40	4.24	4.16	4.13	4.16
Russia	NA	NA	NA	NA	NA	NA	31.1	32.1	32.7	31.8	31.8	31.8	40.0	43.0	44.9	44.5	44.5	44.5
Turkey	NA	NA	NA	NA	NA	NA	1.80	1.86	1.91	1.93	1.92	1.92	2.32	2.50	2.62	2.70	2.69	2.68
Nigeria	NA	NA	NA	NA	NA	NA	159	159	164	168	171	175	204	213	225	235	239	245
South Africa	7.23	6.81	8.00	9.15	9.20	9.25	8.21	10.12	10.67	10.53	10.58	10.64	10.56	13.57	14.65	14.72	14.81	14.90
Argentina	NA	NA	NA	NA	NA	NA	4.54	5.46	6.74	8.72	13.45	18.82	5.84	7.33	9.25	12.19	18.83	26.35
Brazil	9.31	8.98	11.25	12.00	10.88	10.25	1.95	2.13	2.20	2.20	2.21	2.21	2.51	2.85	3.02	3.08	3.09	3.10
Mexico	5.70	5.14	5.74	6.63	7.06	7.95	13.2	12.6	12.2	12.3	12.3	12.3	16.9	16.8	16.8	17.2	17.2	17.2
Venezuela	11.26	10.91	10.67	15.50	15.50	15.50	4.29	6.13	6.30	9.75	10.50	12.71	5.52	8.22	8.65	13.63	14.70	17.79

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

Figure 14. Short Rates (End of Period), as of 19 June 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	2.75	2.75	2.75	3.00	3.50	3.50
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	1.75	1.75
Sweden	1.00	0.75	0.75	0.75	0.75	0.75	0.75
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 15. 10-Year Yield Forecasts (Period Average), as of 19 June 2013 (Percent)

	Current	3Q 13	4Q 13	1Q 14	2Q 14	3Q 14	4Q 14
United States	**2.14**	**2.25**	**2.50**	**2.70**	**2.90**	**3.10**	**3.20**
Japan	**0.87**	**0.90**	**0.90**	**0.80**	**0.60**	**0.80**	**0.80**
Euro Area (Germany)	**1.57**	**1.50**	**1.50**	**1.50**	**1.50**	**1.50**	**1.60**
Canada	2.16	2.25	2.50	2.70	2.90	3.10	3.20
Australia	3.39	3.55	3.65	3.85	4.15	4.35	4.40
New Zealand	3.77	3.50	3.75	3.90	4.20	4.40	4.70
Denmark	1.65	1.65	1.65	1.65	1.60	1.60	1.70
Norway	2.35	2.30	2.25	2.30	2.25	2.30	2.45
Sweden	1.95	1.90	1.85	1.90	1.85	1.85	1.95
Switzerland	0.76	0.75	0.75	0.60	0.60	0.65	0.70
United Kingdom	2.16	2.10	2.15	2.25	2.35	2.40	2.50

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

Figure 16. 10-Year Yield Spreads (Period Average), as of 19 June 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**	**58**	**78**	**102**	**122**	**142**	**160**
Japan	**-125**	**-136**	**-172**	**-212**	**-212**	**-232**	**-67**	**-60**	**-70**	**-90**	**-70**	**-70**
Euro Area	**-58**	**-76**	**-102**	**-122**	**-142**	**-162**	**NA**	**NA**	**NA**	**NA**	**NA**	**NA**
Canada	2	0	0	0	0	0	60	76	102	122	142	162
Australia	127	132	117	117	127	127	185	208	218	239	269	290
New Zealand	165	127	127	122	132	132	224	203	229	244	274	295
France	-2	-16	-32	-52	-62	-82	55	60	70	70	80	80
Italy	214	199	173	128	108	63	271	275	275	250	250	225
Spain	239	224	198	153	123	88	296	300	300	275	265	250
Netherlands	-22	-41	-62	-82	-102	-122	35	35	40	40	40	40
Belgium	21	4	-12	-32	-42	-72	78	80	90	90	100	90
Austria	-19	-36	-57	-77	-102	-122	38	40	45	45	40	40
Finland	-34	-51	-72	-92	-112	-132	23	25	30	30	30	30
Ireland	170	124	98	78	58	38	227	200	200	200	200	200
Denmark	-49	-61	-87	-107	-132	-152	8	15	15	15	10	10
Norway	21	4	-27	-42	-67	-82	78	80	75	80	75	80
Sweden	-19	-36	-67	-82	-107	-127	38	40	35	40	35	35
Switzerland	-138	-151	-177	-212	-232	-247	-81	-75	-75	-90	-90	-85
United Kingdom	2	-15	-35	-46	-56	-71	59	61	66	76	86	91

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

Figure 17. Emerging Market Countries — Short Rates Actual and Forecast of Additional Rate Moves (End of Period), as of 19 June 2013

Country	Current Rate (%)	Sep 13	Dec 13	Mar 14	Jun 14	Sep 14	Total Cumulative Rate Moves Expected
Brazil	8.00	100	25	0	0	0	125
Indonesia	4.25	50	0	25	0	25	100
Philippines	3.50	0	0	25	50	25	100
Malaysia	3.00	0	0	25	25	0	50
Turkey	4.50	0	0	0	0	50	50
Poland	2.75	-25	0	0	0	50	25
Thailand	2.50	0	0	0	0	25	25
Chile	5.00	-50	0	0	0	50	0
China	3.00	0	0	0	0	0	0
Czech	0.05	0	0	0	0	0	0
Israel	1.25	-25	0	25	0	0	0
Korea	2.50	0	0	0	0	0	0
Mexico	4.00	0	0	0	0	0	0
South Africa	5.00	0	0	-25	0	0	-25
Hungary	4.50	-50	0	0	0	0	-50
India	7.25	-25	-25	0	0	0	-50
Russia	8.25	-50	-25	0	0	0	-75

Source: Citi Research

Figure 18. Foreign Exchange Forecasts (End of Period), as of 19 June 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**	**1.33**	**1.37**	**1.36**	**1.36**	**1.37**	**1.38**
Japan	**95**	**102**	**106**	**110**	**110**	**110**	**126**	**139**	**145**	**150**	**151**	**152**
Euro Area	**1.33**	**1.37**	**1.36**	**1.36**	**1.37**	**1.38**	**NA**	**NA**	**NA**	**NA**	**NA**	**NA**
Canada	1.02	1.02	1.02	1.03	1.02	1.00	1.35	1.39	1.40	1.40	1.39	1.38
Australia	0.96	0.97	0.96	0.96	0.95	0.95	1.38	1.41	1.42	1.42	1.44	1.45
New Zealand	0.81	0.80	0.80	0.80	0.80	0.80	1.65	1.71	1.70	1.70	1.71	1.72
Norway	5.74	5.73	5.69	5.65	5.56	5.48	7.64	7.84	7.76	7.69	7.62	7.55
Sweden	6.47	6.48	6.45	6.42	6.36	6.30	8.61	8.85	8.80	8.74	8.71	8.68
Switzerland	0.93	0.89	0.91	0.92	0.92	0.92	1.23	1.22	1.24	1.25	1.26	1.27
United Kingdom	1.56	1.60	1.59	1.58	1.59	1.60	0.85	0.85	0.86	0.86	0.86	0.86
China	**6.13**	**6.09**	**6.09**	**6.08**	**6.06**	**6.04**	**8.2**	**8.3**	**8.3**	**8.3**	**8.3**	**8.3**
India	57.5	57.7	57.3	57.0	56.8	56.6	76.6	78.8	78.1	77.6	77.7	77.9
Korea	1126	1144	1136	1125	1098	1071	1499	1563	1548	1532	1504	1475
Poland	3.17	3.19	3.22	3.23	3.19	3.15	4.22	4.37	4.38	4.39	4.36	4.33
Russia	31.8	32.5	32.8	33.1	32.8	32.5	42.3	44.4	44.8	45.0	44.9	44.8
South Africa	9.89	10.48	10.63	10.74	10.69	10.64	13.17	14.32	14.49	14.62	14.64	14.66
Turkey	1.85	1.88	1.89	1.90	1.91	1.91	2.47	2.57	2.58	2.59	2.61	2.64
Brazil	2.12	2.17	2.18	2.20	2.20	2.20	2.82	2.96	2.98	3.00	3.01	3.03
Mexico	12.7	12.7	12.4	12.2	12.2	12.2	16.9	17.3	16.9	16.6	16.7	16.9

Source: Citi Research

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

	vs. JPY					
	Current	Sep 13	Dec 13	Mar 14	Jun 14	Sep 14
United States	**95**	**102**	**106**	**110**	**110**	**110**
Japan	**NA**	**NA**	**NA**	**NA**	**NA**	**NA**
Euro Area	**126**	**139**	**145**	**150**	**151**	**152**
Canada	93	100	104	107	108	110
Australia	91	98	102	105	105	104
New Zealand	76.8	81.5	85.1	88.0	88.0	88.0
Norway	16.5	17.8	18.7	19.5	19.8	20.1
Sweden	14.7	15.7	16.5	17.1	17.3	17.4
Switzerland	103	114	117	120	119	119
United Kingdom	148	163	169	174	175	176
China	**15**	**17**	**17**	**18**	**18**	**18**
India	1.65	1.77	1.86	1.93	1.94	1.94
Korea	11.87	11.23	10.68	10.23	9.98	9.74
Poland	29.9	31.9	33.1	34.1	34.5	35.0
Russia	3.0	3.1	3.2	3.3	3.4	3.4
South Africa	9.6	9.7	10.0	10.2	10.3	10.3
Turkey	51.2	54.2	56.3	57.9	57.7	57.5
Brazil	44.7	47.0	48.7	50.0	50.0	50.0
Mexico	7.5	8.0	8.6	9.0	9.0	9.0

Source: Citi Research

Country Commentary

United States

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Despite a subpar second quarter, we continue to expect economic growth this year near 2½% (4Q/4Q). Support for expansion has improved with moderate job growth, super-accommodative monetary policy, and the spillover effects of reviving housing. The rebound from last year's drought and Hurricane Sandy offset significant tax hikes in Q1, but fiscal drag has increased more recently and slowing abroad has trimmed exports. Nonetheless, the restraint on consumer spending from tax hikes may be fading now and the recovery's underlying momentum may begin to overtake the effects of deficit reduction in the months ahead. With federal deficits heading below 4% next year, the impetus for major budget reforms has waned.

The Federal Reserve's aggressive forward guidance and open-ended bond-buying have contributed to extremely accommodative financial conditions. The apparent dip in Q2 growth and officials' high bar for a satisfactory jobs outlook will likely sustain QE at the current pace at least a few more months. We expect an initial tapering of QE by September but purchases could extend at a slowing rate until next spring when unemployment is expected 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 labor costs remain subdued. We expect a gradual move closer to the 2% target underpinned by domestic demand and an eventual pick-up in global growth. Labor costs should firm somewhat with continued gains in hiring demand.

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

					2013				2014			
		2012	2013F	2014F	1Q	2QF	3QF	4QF	1QF	2QF	3QF	4QF
GDP	SAAR				2.4%	1.5%	2.7%	3.1%	3.2%	2.9%	3.1%	3.0%
	YoY	2.2%	1.9%	2.9%	1.8	1.8	1.7	2.4	2.6	3.0	3.0	3.0
Domestic Demand	SAAR				1.9	1.8	2.6	3.2	3.2	3.1	3.3	3.2
	YoY	2.1	2.0	3.0	1.7	1.8	2.0	2.4	2.7	3.0	3.2	3.2
Consumption	SAAR				3.4	2.0	2.8	3.1	3.2	3.2	3.4	3.2
	YoY	1.9	2.4	3.1	2.1	2.2	2.5	2.8	2.8	3.1	3.2	3.2
Business Investment	SAAR				2.2	2.8	4.9	6.7	5.4	5.0	5.3	6.5
	YoY	8.0	4.5	5.4	4.1	4.0	5.7	4.2	5.0	5.5	5.6	5.6
Housing Investment	SAAR				12.0	13.6	18.6	21.7	23.0	17.6	17.3	13.6
	YoY	12.1	14.8	19.2	12.8	14.2	15.4	16.4	19.2	20.2	19.9	17.8
Government	SAAR				-4.9	-1.2	-1.5	-1.1	-0.9	-0.7	-0.6	-0.6
	YoY	-1.7	-2.6	-0.9	-2.3	-2.4	-3.7	-2.2	-1.2	-1.0	-0.8	-0.7
Exports	SAAR				0.8	0.4	1.6	3.3	3.9	4.1	4.4	4.9
	YoY	3.4	0.7	3.4	1.2	0.1	0.0	1.5	2.3	3.2	3.9	4.3
Imports	SAAR				1.9	1.7	3.3	4.3	5.0	5.2	5.0	4.8
	YoY	2.4	0.8	4.5	-0.1	-0.3	0.6	2.8	3.6	4.4	4.9	5.0
PCE Deflator	YoY	1.8	1.1	1.9	1.2	1.0	1.1	1.2	1.4	2.0	2.1	2.1
Core PCE Deflator	YoY	1.7	1.2	1.9	1.3	1.1	1.2	1.4	1.6	1.9	2.0	2.1
Unemployment Rate	%	8.1	7.5	6.8	7.7	7.6	7.5	7.1	7.0	6.9	6.8	6.6
Federal Gov't Balance (Fiscal Year)	$Bn	-1,098	-649	-543								
	% of GDP	-7.0	-4.0	-3.2								
General Gov't Balance (Cal Year)	% of GDP	-8.3	-6.0	-4.5								
Federal Debt	% of GDP	73	75	75								
General Gov't Debt	% of GDP	106	109	111								
Current Account	US$bn	-440	-450	-479	-425	-428	-444	-455	-458	-473	-487	-498
	% of GDP	-2.8	-2.8	-2.8	-2.7	-2.7	-2.7	-2.8	-2.7	-2.8	-2.9	-2.9
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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The final proposal of PM Abe's Growth Strategy fell short of convincing investors and ourselves that his economic policies can improve the medium- to long-term growth potential of the economy in a meaningful manner. In particular, corporate tax cuts and a bold labor market reform were dropped from the proposal. However, if PM Abe wins the Upper House election in July, he would have a mandate to propose and implement more controversial policies as there will be no nationwide elections in the following three years. On the economic front, he is likely to start a second stage of structural reform programs and he may decide on bolder reforms. At the same time, we cannot rule out the possibility that PM Abe's policy focus will shift away from the economy.

We raise our growth forecasts to 2.2% for 2013 and 1.9% for 2014 from previous forecasts of 2.0% and 1.5%, respectively, as of May. At this forecast round, we assume that the administration will introduce another large fiscal stimulus package with public works spending of around ¥3trn later this year in order to mitigate a negative impact from the consumption tax hike slated for April 2014. Meanwhile, recent data indicate that private capex is starting to pick up as the corporate profit outlook brightened thanks to the yen depreciation and the government's policy supports for investment kicked in April. We expect private capex to increase in quarters to come after a fifth consecutive quarterly decline.

The JGB markets have been volatile since the BoJ decided to expand JGB purchases significantly in early April. While there remains speculation that the BoJ will take additional action to stabilize the markets, we don't expect BoJ action unless JGB yields rise sharply again. Meanwhile, in our view, the BoJ is likely to take additional easing action (probably centered on purchases of risk assets such as equity) late this year or early next year with actual inflation expected to undershoot the BoJ's bullish forecasts for fiscal 2013.

Figure 21. 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%	1.9%	0.2%	1.4%	3.4%	3.6%	3.5%	1.9%	1.2%	1.1%
	SAAR				4.1	4.3	4.0	2.0	3.8	-2.2	1.3	1.6
Domestic Demand	YoY	2.8	2.0	0.9	0.8	1.5	2.7	2.9	2.8	0.8	0.0	-0.2
	SAAR				2.5	3.3	3.5	2.3	2.3	-4.5	0.2	1.4
Private Consumption	YoY	2.3	1.7	0.4	1.1	1.3	2.1	2.2	2.5	-0.1	-0.3	-0.5
	SAAR				3.6	1.4	1.7	2.0	5.0	-8.5	0.9	1.2
Business Investment	YoY	1.9	-0.6	4.6	-5.2	-3.6	1.6	4.9	7.1	5.1	3.7	2.7
	SAAR				-1.2	5.9	8.2	7.2	7.2	-1.7	2.3	3.1
Housing Investment	YoY	3.0	8.8	-7.1	9.5	9.2	10.2	6.5	2.5	-7.3	-11.4	-12.0
Public Investment	YoY	12.6	13.4	0.2	13.1	15.0	14.0	11.5	2.5	2.6	-2.3	-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	1.3	-1.2	0.2	-0.9	0.5	5.4	3.1	-0.1	-2.7	-4.8
	SAAR				4.0	2.7	4.7	10.3	-4.8	-9.3	-5.9	1.2
CPI	YoY	0.0	0.0	2.0	-0.6	-0.2	0.3	0.4	0.5	2.6	2.5	2.3
Core CPI	YoY	-0.1	0.1	2.0	-0.3	0.0	0.3	0.5	0.5	2.6	2.5	2.3
Nominal GDP	YoY	1.1	1.2	2.6	-0.6	0.3	2.2	2.7	3.0	2.9	2.4	2.2
Current Account	¥ tn	5.2	5.1	9.7	2.9	6.1	7.0	4.6	6.5	9.7	11.3	11.4
	% of GDP	1.1	1.1	2.0	0.6	1.3	1.5	0.9	1.3	2.0	2.3	2.3
Unemployment Rate	%	4.4	4.1	3.9	4.2	4.1	4.1	3.9	3.8	3.8	4.0	4.1
Industrial Production	YoY	-0.9	-0.2	3.4	-7.7	-3.2	2.5	6.3	5.6	3.8	2.7	1.6
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 leave our euro area GDP forecasts largely unchanged in June, with a marginal downward revision of our 2013 estimate to -0.8% from -0.7% in May. Activity is expected to be marginally negative or flat for the next four quarters. Despite some suggestions of relaxation in fiscal consolidation, member states are still required to show sizeable structural budget deficit-reduction efforts against a backdrop of well-below-average confidence and rising jobless rates. We doubt that more supportive inflation dynamics will lead to much recovery in consumer spending.

The euro area crisis is by no means over: deleveraging will dominate the landscape for some time to come, and regaining competitiveness will require some additional and lasting efforts by the majority of member states, dampening domestic demand. Banking union is therefore the euro area's major policy initiative to deepen the monetary union and to reduce the link between weak sovereigns and their banks, even if any mutualisation of legacy problems remains off the agenda. The main focal point for investors will be the ECB's Asset Quality Review, with a more rigorous assessment of banks' balance sheets to be unveiled by mid-2014 as the ECB endorses its role of single supervisor.

Although ESM direct bank recapitalisation is expected to be finally approved at the June EU Council meeting, recently published documents stipulate that both bondholders and national governments would contribute to shoring up a failing bank before ESM finance becomes available. Aid would be offered only to systemically important banks and aggregate ESM bank recaps would be capped at €50-70bn. Since ESM direct bank recap rules will not be finalised until EU institutions, including the EU Parliament, agree on guaranteeing bank deposits and a Single Resolution Mechanism (SRM), full banking union is unlikely to be on the table much before mid-2015, in our view. In the meantime, the ECB argues that there are no reasons to adjust its monetary policy stance further, indicating that it will remain "*accommodative for as long as necessary*". 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 22. Euro Area — Economic Forecasts, 2012-14F

					2013				2014			
		2012	2013F	2014F	1Q	2QF	3QF	4QF	1QF	2QF	3QF	4QF
Real GDP	YoY	-0.5%	-0.8%	0.0%	-1.1%	-0.9%	-0.7%	-0.2%	-0.1%	-0.1%	0.0%	0.2%
	SAAR				-0.8	0.1	0.1	-0.3	-0.1	0.0	0.3	0.5
Final Domestic Demand	YoY	-1.7	-1.2	-0.1	-1.9	-1.3	-1.0	-0.5	-0.2	-0.1	-0.1	0.1
Private Consumption	YoY	-1.3	-0.7	-0.2	-1.2	-0.8	-0.7	-0.2	-0.4	-0.3	-0.2	0.0
Government Consumption	YoY	-0.4	-0.4	-0.3	-0.6	-0.3	-0.1	-0.5	-0.4	-0.4	-0.4	-0.1
Fixed Investment	YoY	-4.2	-3.6	0.6	-5.5	-4.0	-3.1	-1.5	0.4	0.8	0.6	0.6
— Business Equipment	YoY	-3.4	-3.9	2.1	-5.6	-4.6	-3.6	-1.8	1.2	2.4	2.3	2.4
— Construction	YoY	-4.8	-3.8	-1.4	-5.5	-3.9	-3.6	-2.4	-1.7	-1.5	-1.3	-1.0
Stocks (Contrib. to Y/Y GDP Growth)		-0.3	0.0	0.0	0.0	-0.1	0.1	0.0	0.0	0.0	-0.1	-0.1
Exports	YoY	2.9	0.7	2.5	0.7	0.4	0.2	1.5	2.8	2.1	2.4	2.8
Imports	YoY	-0.7	-0.9	1.7	-1.6	-1.2	-1.0	0.3	1.7	1.5	1.6	2.0
CPI	YoY	2.5	1.4	1.2	1.9	1.4	1.4	1.1	1.0	1.3	1.2	1.2
Core CPI	YoY	1.5	1.2	0.9	1.4	1.1	1.3	1.0	0.9	1.0	0.9	0.9
CPI Ex Energy and Food	YoY	1.8	1.3	1.0	1.5	1.3	1.3	1.1	0.9	1.1	1.1	1.0
Unemployment Rate	YoY	11.4	12.2	12.4	12.0	12.1	12.2	12.3	12.4	12.4	12.5	12.5
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	-296.0	-253.7								
	% of GDP	-3.7	-3.1	-2.6								
Primary Balance	% of GDP	-0.4	0.3	0.6								
General Government Debt	EUR bn	8,598.0	9,209.6	9,531.9								
	% of GDP	90.6	96.1	97.9								
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 0.6% QQ gain in 2Q GDP after a disappointing weather-related soft 1Q figure (0.1% QQ). We are confident in the ability of the German economy to outperform its peers in the foreseeable future, given the small amount of budget stimulus pencilled in for 2013, together with 3%-equivalent pay hike for 20 months secured by the industrial metal workers' union in late May. From a euro area standpoint, this will be music to the ears of many periphery member states which have been calling on Germany to do more to support its domestic demand to help struggling member states in rebalancing their economy towards exports. Despite the unpopularity of bailouts, German Vox Populi risk appears limited: we expect Chancellor Merkel to be re-elected.

France

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Our French 2013 GDP forecast is unchanged, showing a likely fall in economic activity of 0.3%. The tentative improvement in surveys since the start of the second quarter argues in favour of some stabilisation in GDP during the second half compared to an average annualised contraction of 0.7% in 4Q-12 and 1Q-13. While the government is still pushing its modest reform agenda, opinion polls suggest that households would be willing to accept more radical changes, particularly with respect to their pensions and various entitlements but also labour market laws, in exchange for greater clarity with respect to the overall level of taxation. Key risks going forward are the persistence of subdued profitability dynamics, together with negative business investment as firms struggle with weak domestic demand. We expect that the challenging growth picture will mean the government will only meet its revised 3% of GDP budget deficit target in 2016, rather than in 2015.

Italy

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Data revisions have suggested that GDP fell more sharply at the turn of the year. Due to this and to lack of yet clear signs of the recession easing, we have revised down by 0.1pp our 2013 GDP growth. Although fiscal tightening is less severe than in 2012, credit conditions remain extremely tight in our view due to banks’ weak capital and asset quality deterioration. Calls for some additional relaxation of the fiscal stance are mounting, but fiscal room is limited and we think the deficit target for 2013 (2.9%) is already likely to be missed. This, together with falling GDP, will likely drive the debt ratio close to 140% in 2014. Some form of debt restructuring (in the form of maturity extension or interest rate reduction) may be likely in coming years.

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

		Germany			France			Italy		
		2012	2013F	2014F	2012	2013F	2014F	2012	2013F	2014F
Real GDP	YoY	0.9%	0.3%	1.5%	0.0%	-0.3%	0.4%	-2.4%	-2.0%	-0.6%
Final Domestic Demand	YoY	0.3	0.4	1.7	-0.1	-0.3	0.2	-4.7	-2.8	-1.2
Private Consumption	YoY	0.7	0.9	0.9	-0.3	-0.2	0.2	-4.3	-2.5	-0.9
Fixed Investment	YoY	-2.0	-1.5	5.3	-1.2	-2.3	-0.1	-8.0	-6.7	-2.2
Exports	YoY	4.5	-0.2	3.4	2.5	0.0	1.8	2.2	-0.4	1.0
Imports	YoY	2.6	0.0	3.9	-0.9	-0.6	1.0	-7.8	-4.1	-0.6
CPI	YoY	2.0	1.5	2.2	2.0	1.0	1.6	3.3	1.5	1.2
Unemployment Rate	%	5.5	5.5	5.5	9.9	10.7	10.9	10.7	12.4	12.8
Current Account	€bn	185.4	181.4	151.4	-46.7	-35.6	-20.0	-8.4	24.6	33.7
	% of GDP	7.0	6.7	5.4	-2.3	-1.7	-1.0	-0.5	1.6	2.2
General Govt. Balance	€bn	4.1	-14.5	0.7	-98.2	-78.5	-74.2	-47.6	-50.0	-47.3
	% of GDP	0.2	-0.5	0.0	-4.8	-3.8	-3.6	-3.0	-3.2	-3.0
Primary Balance	% of GDP	2.6	2.0	2.5	-2.3	-1.2	-0.9	2.5	2.2	2.2
General Govt. Debt	% of GDP	81.9	81.5	78.5	90.2	94.1	96.1	127.0	132.9	137.6
Gross Trading Profits	YoY	0.1	-0.1	-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 still expect the recession to continue in 2013 and 2014, reflecting a still large fiscal drag, tight financing conditions, ongoing private deleveraging and housing adjustment. Recent slightly less negative developments of some indicators (e.g. PMIs and retail sales) do not suggest positive economic growth any time soon. Domestic demand is likely to remain weak and continue to offset a fairly positive export performance. We see the fiscal deficit narrowing only marginally to 6.5% of GDP in 2013, while extra bank recap needs (given rising NPLs and shortfalls in loan loss provisions) may emerge after the upcoming asset quality review. 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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We don't think the recession is going to end any time soon, contrary to official forecasts. But the fiscal dynamics have improved slightly recently and this should result in another small reduction in the fiscal deficit in 2013. However, the debt ratio keeps rising and we think a major debt relief from official lenders (which hold 80% of public debt) will eventually occur if sustainability is to be restored. Although we still consider risks of "Grexit" as quite high, we no longer have it in our baseline scenario. However, the ongoing political turmoil around the closure of the public broadcaster shows the still-elevated fragility of the governing coalition.

Ireland

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We are raising our 2013 growth forecast to 1.0% from 0.6% last month. Available data suggest that Q1 GDP was roughly flat or perhaps up only marginally. Early signs suggest that Q2 GDP is up by about 0.8% QoQ, although this estimate may well be revised as more details for Q2 become available. The public debt/GDP ratio probably will go on rising this year but, provided the economy does not weaken sharply, may begin to edge down in 2014. We still expect further restructuring of the public debt in official hands to improve Ireland's fiscal sustainability.

Portugal

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GDP is likely to keep falling this year and in 2014, despite improving export growth, as domestic demand is likely to remain a major drag. Fiscal austerity will remain quite large also post-2014. Return to full market funding after the bailout expires in mid-2014 is unlikely, in our view, and some precautionary credit line and/or OMT activation are likely in the post-bailout period. 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 be eventually required to restore sustainability.

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

		Spain			Greece			Ireland			Portugal		
		2012	2013F	2014F	2012	2013F	2014F	2012	2013F	2014F	2012	2013F	2014F
Real GDP	YoY	-1.4%	-1.9%	-1.2%	-6.4%	-5.5%	-4.5%	0.9%	1.0%	2.3%	-3.2%	-3.1%	-1.6%
Final Domestic Demand	YoY	-4.0	-4.1	-2.4	-9.7	-7.5	-5.9	-1.2	0.2	-0.8	-6.9	-4.6	-2.7
Private Consumption	YoY	-2.2	-3.0	-1.4	-9.1	-7.7	-6.1	-0.9	1.4	-0.1	-5.6	-3.9	-2.0
Fixed Investment	YoY	-9.1	-7.7	-4.8	-19.0	-12.3	-7.1	1.1	-1.5	-3.7	-14.5	-10.0	-4.7
Exports	YoY	3.0	2.6	3.4	-2.0	0.5	1.3	2.9	2.2	4.5	3.3	1.2	0.9
Imports	YoY	-5.0	-4.1	-0.1	-9.3	-4.2	-4.1	0.3	1.5	2.2	-6.6	-4.1	-2.1
CPI	YoY	2.4	1.6	0.8	1.0	-0.5	-1.0	1.9	1.3	1.4	2.8	0.9	0.2
Unemployment Rate	%	25.0	27.1	28.8	24.1	28.7	32.0	14.7	13.9	13.7	15.7	18.1	19.6
Current Account	€bn	-11.3	11.3	21.1	-6.5	-0.8	1.2	7.3	8.1	10.2	-2.6	1.6	4.7
	% of GDP	-1.1	1.1	2.0	-3.4	-0.4	0.7	4.4	4.9	5.9	-1.5	1.0	3.0
General Govt. Balance	€bn	-111.6	-67.1	-61.0	-19.4	-9.1	-6.7	-12.0	-12.2	-7.5	-10.6	-9.0	-8.1
	% of GDP	-10.6	-6.5	-5.9	-10.0	-5.1	-4.1	-7.3	-7.3	-4.3	-6.4	-5.6	-5.1
Primary Balance	% of GDP	-7.7	-3.1	-2.3	-5.0	-0.3	0.4	-3.4	-1.7	0.7	-2.0	-1.1	-0.7
General Govt. Debt	% of GDP	84.2	94.1	104.5	156.9	181.5	198.6	117.4	121.7	119.7	123.6	134.7	144.0

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 made no changes to our Dutch 2013 GDP forecast this month, expecting a contraction of 1% for the second successive year and a very modest 0.1% gain in 2014. We expect the recession to last until the start of next year as the fiscal tightening effort remains substantial (the government announced additional civil servant reductions in May), with the residential market correction also likely to continue over the next four to six quarters. Yet, with household confidence recovering for the last three successive months, we remain hopeful of some stabilisation in private sector expenditure toward the end of 2013.

Belgium

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Revised data suggest that the economy flat-lined in 1Q 2013 compared to a preliminary estimate of a 0.1% QQ gain, marking the fourth quarter of contraction or stagnation since 1Q 2012. Nevertheless, we leave our 2013 GDP forecast of a 0.3% contraction unchanged. Belgium is being watched very carefully by the European Commission, having been required to submit new budget plans by October, including its reform measures, to comply with a minimum amount of structural budget deficit reduction to meet its EU requirements or risk a fine. More efforts will have to be delivered in a delicate period politically, ahead of the legislative elections scheduled for the spring of 2014.

Slovakia

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Our decision to cut our 2013 growth forecast to 0.5%YoY from 0.7% initially reflects weaker GDP in 1Q13, accompanied by a larger drop in investment, and another big drop in industrial production. Downside risks are limited to an extent by better order-books and higher capacity use, which are likely to support investment. We expect a milder recovery at 1.7% in 2014 compared to MinFin´s 2.2% forecast, due to soft foreign demand and likely fiscal tightening. The central government deficit narrowed to 4.5% of GDP in May, which is the lowest ratio since end-2009.

Slovenia

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Ongoing weakness in domestic demand in 1Q13 was limited by improved fixed investment and stronger exports, but short-term indicators suggest a milder recession ahead. We do not change our forecasts much and expect GDP to fall by 2.2% YoY in 2013 (-1.9% previously) after -2.2% in 2012, followed by ongoing mild contraction of 0.3% YoY in 2014 (previously -0.5%) before the economy starts to recover by 1.1% in 2015. We think recapitalization in state-owned banks is likely to exceed the initial estimate of the Slovenian central bank, while the mix of realized transfer of bad loans into a bad bank and banks' privatization will be key in this issue.

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

		Netherlands			Belgium			Slovakia			Slovenia		
		2012	2013F	2014F	2012	2013F	2014F	2012	2013F	2014F	2012	2013F	2014F
Real GDP	YoY	-1.0%	-1.0%	0.1%	-0.3%	-0.3%	0.2%	2.0%	0.5%	1.7%	-2.2%	-2.2%	-0.3%
Final Domestic Demand	YoY	-1.6	-2.6	-0.4	-0.5	-0.7	0.0	-1.4	-1.5	1.6	-3.8	-2.9	0.1
Public Consumption	YoY	0.0	-1.5	-0.7	0.4	0.2	0.3	-0.6	0.2	0.1	-1.6	-0.5	-0.6
Private Consumption	YoY	-1.4	-1.1	-0.3	-0.3	-0.2	-0.2	-0.6	-0.3	0.8	-2.8	-4.2	-0.1
Investment (Ex Stocks)	YoY	-4.6	-8.4	0.1	-0.6	-2.8	0.1	-3.7	-5.4	4.3	-9.1	-2.1	1.4
Exports	YoY	3.3	1.9	1.3	0.7	-0.9	2.2	8.6	1.5	2.7	1.3	2.9	2.1
Imports	YoY	3.1	-0.7	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	2.7	1.8	2.8	1.1	2.0	3.6	1.7	2.0	2.6	1.5	1.7
Unemployment Rate	%	6.4	8.2	8.8	7.6	8.4	8.7	13.6	14.5	14.7	8.9	10.1	11.1
Current Account	% of GDP	10.1	9.4	8.9	-1.4	-1.3	-1.1	2.2	3.3	3.0	2.3	2.2	3.4
General Govt Balance	% of GDP	-4.1	-3.6	-3.2	-3.9	-3.4	-3.2	-4.3	-3.4	-3.2	-4.0	-9.1	-6.0
Primary Balance	% of GDP	-2.2	-1.7	-1.3	-0.5	0.2	0.4	-2.9	-2.0	-1.8	-1.9	-6.9	-3.7
General Govt Debt	% of GDP	71.2	74.4	75.8	99.8	102.9	104.3	52.1	55.6	56.5	54.1	63.6	70.5

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

UK

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We are again lifting our growth forecasts and now expect growth of 1.0% in 2013 and 1.2% in 2014, versus 0.7% and 0.8% respectively last month (and 0.4% and 0.7%, respectively, two months ago). Recent data have been a bit better than expected, with gains in industrial production and housing, while surveys suggest that Q2 GDP growth is about 0.5% QoQ (non-annualised). Note that upcoming GDP revisions (end-June) may alter the overall growth rate – and the split of growth – in recent years. Nevertheless, the economy remains some way short of a proper recovery. The level of real GDP per head is about 6% below the pre-recession peak, and probably will not regain that peak even by the decade's end. The jobless rate is relatively high (close to 8%) and the IMF estimate that the economy has an output gap of about 4% of potential GDP, the highest for over 30 years. Although CPI inflation remains a little above target, the overshoot is likely to be small – and more than accounted for by regulatory-driven gains in utility prices and university tuition fees. The economy does not have a general inflation problem, with extreme weakness in wage growth.

BoE-Governor Designate Mark Carney's comments have made it clear that he strongly supports the use of forward guidance. We expect the BoE in the next few months will introduce Fed-style guidance – committing to not tighten via Bank Rate or QE at least until a specified threshold has been hit (most likely a jobless rate of 6.5%-7% or 4%-6% nominal GDP growth), subject to an inflation knockout set above the 2% inflation target (eg at 2.5%) and a general caveat over not allowing inflation expectations to become unanchored. This would aim to compensate for the MPC's inability (and unwillingness) to cut rates significantly below zero by pre-committing to exit the zero bound later, hence generating higher expectations of future incomes and asset prices that feeds back to higher near-term spending. Such a framework would set the stage for a further long period (several more years) of ultra-low interest rates.

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

					2013				2014			
		2012	2013F	2014F	1Q	2QF	3QF	4QF	1QF	2QF	3QF	4QF
Real GDP	YoY	0.3%	1.0%	1.2%	0.6%	1.5%	0.6%	1.3%	1.1%	0.9%	1.2%	1.5%
	SAAR				1.6	1.9	0.6	1.0	0.9	1.1	1.8	2.1
Domestic Demand	YoY	1.4	0.9	1.1	1.3	0.9	0.5	0.9	0.9	1.0	1.3	1.3
(Incl. Inventories)	SAAR				1.5	0.4	0.4	1.4	1.2	1.0	1.4	1.7
Consumption	YoY	1.2	1.3	1.9	1.3	1.2	1.4	1.4	1.7	1.8	1.9	2.2
	SAAR				0.5	1.2	2.3	1.6	1.9	1.6	2.6	2.6
Investment	YoY	1.5	-1.4	0.6	0.2	-1.6	-2.4	-2.0	-0.8	-0.1	1.6	1.7
	SAAR				-3.0	-0.6	-5.1	1.1	1.6	2.4	1.5	1.3
Exports	YoY	-0.2	0.3	4.8	-1.8	0.2	-0.1	2.8	4.6	4.8	4.8	5.1
	SAAR				-3.1	3.7	5.8	4.9	4.1	4.5	5.7	6.1
Imports	YoY	2.7	0.0	4.4	0.1	-1.4	-0.6	1.8	3.5	4.9	4.7	4.5
	SAAR				-2.0	-1.2	4.9	5.9	4.7	4.2	4.2	4.8
Unemployment Rate	%	7.9	7.9	7.8	7.8	7.9	8.1	7.9	7.9	7.9	7.7	7.5
CPI Inflation	YoY	2.8	2.7	2.3	2.8	2.6	2.7	2.5	2.3	2.3	2.2	2.2
Merch. Trade	£bn	-106.1	-103.2	-103.2								
	% of GDP	-6.9	-6.5	-6.3								
Current Account	£bn	-57.7	-44.7	-47.3								
	% of GDP	-3.7	-2.8	-2.9								
PSNB	£bn FY	-88.3	-109.2	-104.6								
	% of GDP	-5.7	-6.8	-6.3								
General Govt. Balance	% of GDP	-6.3	-7.4	-6.9								
Government Primary Balance		-2.6	-3.6	-3.1								
Public Debt	% of GDP	89.5	93.5	99.1								
Gross Nonoil Trading Profits	YoY	3.6	10.5	5.6								

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

Switzerland

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We expect the SNB to keep policy stable for some time, with the Libor target band at 0-0.25% and (as since late-2011) capping the currency at CHF1.20/€. The economy is a little stronger than the SNB had expected, while CPI inflation is a little weaker. But, at the same time, there is no evidence that the Swiss economy is sinking into a deflationary trap. We suspect the SNB will remain reluctant to fine-tune the FX cap, on the grounds that frequent changes could fuel destabilising capital flows in anticipation of further changes. Hence, the FX cap is only likely to be changed if there is a solid case to move it substantially (or scrap it).

Sweden

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After stagnating in Q4-2012, growth recovered in early 2013, although 1Q GDP showed signs of weakness (rising inventories). Economic recovery is likely to be weak in a historical perspective; exports will stay weak, household deleveraging risks are increasing and ongoing fiscal erosion limits the size of fiscal easing. With GDP growth well below trend and rising unemployment, the government announced total fiscal stimulus of around SEK 25bn (0.7% of GDP) this year. With a general election scheduled for 2014, we look for similar fiscal easing next year. Combined with the outlook for monetary policy of a fairly long period of ultra-low rates, economic policies should continue to support economic growth ahead.

Denmark

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The Danish economy has balanced on the edge of recession since mid-2010, and GDP fell by 0.5% Y/Y last year, the weakest outcome since 2009. Economic activity remains sluggish, and, given the 0.9% drop in GDP in 4Q-12, the economy entered 2013 at a lower level than previously assumed. Our forecast assumes moderately accelerating growth ahead, driven by domestic demand. Although economic reforms have not had the intended effect in the short term, they should make it better positioned to benefit from economic recovery once the cycle turns.

Norway

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High oil receipts and rebounding private spending should ensure the economy continues to outperform versus the euro area. Momentum, though, has peaked and mainland GDP probably will settle at a slightly below-trend pace ahead. With below-target inflation in the foreseeable future, this outlook could justify additional monetary policy easing. However, worries over a renewed pick-up in house prices and household indebtedness are likely to keep rates steady at 1.50%, absent any new lows in I-44. Hence, key rates will be used to keep monetary policy *"robust"*, one of Norges Bank's three criteria for *"an appropriate interest rate path"*.

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

		Switzerland			Sweden			Denmark			Norway		
		2012	2013F	2014F	2012	2013F	2014F	2012	2013F	2014F	2012	2013F	2014F
Real GDP	YoY	1.0%	1.5%	1.2%	1.1%	1.2%	2.0%	-0.5%	0.2%	1.1%	3.3%	2.4%	2.7%
Final Domestic Demand	YoY	1.7	1.6	1.3	1.9	0.4	1.7	0.3	0.5	1.3	2.8	2.7	3.0
Public Consumption	YoY	0.5	1.0	1.4	1.1	0.8	0.7	0.2	0.2	0.6	1.6	2.1	2.0
Private Consumption	YoY	2.5	2.4	1.6	1.6	2.0	2.0	0.6	0.4	1.2	3.1	3.0	3.1
Investment (Ex Stocks)	YoY	-0.2	0.0	0.4	3.9	-4.1	2.6	0.0	1.1	2.6	3.8	2.8	4.1
Exports	YoY	1.1	1.6	2.9	1.3	-1.5	2.5	0.9	-1.4	2.3	3.4	2.1	2.5
Imports	YoY	2.1	0.8	3.7	0.5	-2.6	1.9	1.8	2.0	2.7	4.2	1.9	3.9
CPI (Average)	YoY	-0.7	-0.5	-0.2	0.9	0.1	1.0	2.4	1.1	1.5	0.7	1.7	1.7
Unemployment Rate	%	2.6	1.9	2.0	8.0	8.3	8.2	7.5	7.5	7.4	3.2	3.4	3.4
Current Account	% of GDP	12.8	12.8	12.4	6.9	7.1	7.0	5.8	5.3	4.6	14.2	14.5	14.9
General Govt Balance	% of GDP	0.5	0.6	0.6	-0.7	-1.4	-1.5	-4.1	-2.0	-1.2	13.8	13.1	13.0
General Govt Debt	% of GDP	46.7	45.4	43.6	38.5	39.5	39.9	45.8	47.2	47.2	NA	NA-	NA

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

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Canada

Incoming data continue to signal 1H 2013 GDP growth of about 2% annualized. Jobs, housing and imports data suggest an uptick in 2Q domestic demand and April exports exceeded our expectations. Prospects for above-potential growth in 2H 2013 and beyond are becoming more probable. Nonetheless, the expansion likely will remain underwhelming as the economy continues to be buffeted by moderate external demand, domestic slack and business caution. Consumer inflation gauges are forecast to remain subdued near term and not converge to the BoC's 2% target until mid-2015 — coincident with closure of the output gap. The central bank probably will keep rates fixed until 1Q 2015, but retain its slight tightening bias.

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. Risks remain balanced.

Canada continues to undergo a healthy rotation of demand away from household and government spending and towards business investment and external trade. Going forward, the importance of consumer spending should wane amid lackluster wage appreciation and as the housing correction caps household-related consumption. Residential construction will weigh as housing starts retreat to more sustainable levels. Government consolidation should persist near term.

Meanwhile, business investment should reinvigorate as firms increase their global market share. Exports are rebounding from the late 2012 slump, owed to firming US demand despite significant fiscal drag. Elevated commodity prices and new North American energy infrastructure should further underpin Canadian exports. However, business skepticism about global recovery, as well as competitiveness pressures related to low productivity and CAD strength, may hinder progress on these fronts.

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

					2013				2014			
		2012	2013F	2014F	1Q	2QF	3QF	4QF	1QF	2QF	3QF	4QF
Real GDP	YoY	1.7%	1.8%	2.6%	1.4%	1.4%	1.9%	2.4%	2.5%	2.7%	2.7%	2.6%
	SAAR				2.5	1.5	2.6	3.0	2.7	2.4	2.5	2.6
Final Domestic Demand	YoY	2.3	1.6	2.2	1.4	1.5	1.7	1.7	2.2	2.3	2.3	2.2
	SAAR				0.6	1.5	2.3	2.5	2.3	2.1	2.1	2.3
Private Consumption	YoY	1.9	1.8	2.3	1.7	1.8	1.8	1.8	2.2	2.3	2.3	2.3
	SAAR				0.8	1.7	2.4	2.3	2.5	2.2	2.2	2.3
Government Spending	YoY	1.0	1.3	1.0	1.3	1.3	1.4	1.1	1.0	1.0	1.0	1.0
	SAAR				1.3	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Private Fixed Investment	YoY	5.2	1.4	3.7	0.6	0.7	1.8	2.4	3.5	4.0	3.9	3.5
	SAAR				-0.9	1.5	3.9	5.4	3.2	3.4	3.4	3.8
Exports	YoY	1.5	2.9	6.2	0.5	1.6	4.1	5.5	5.6	6.3	6.5	6.4
	SAAR				6.2	3.4	5.9	6.5	6.7	6.2	6.4	6.2
Imports	YoY	3.1	1.9	4.7	0.8	1.6	1.6	3.4	4.4	4.5	4.7	5.0
	SAAR				1.2	4.5	4.0	4.0	5.0	5.0	5.0	5.0
CPI	YoY	1.5	1.1	1.8	0.9	0.8	1.3	1.4	1.5	2.0	1.8	1.8
Core CPI	YoY	1.7	1.3	1.8	1.3	1.1	1.4	1.6	1.6	1.9	1.9	1.9
Unemployment Rate	%	7.3	7.1	6.7	7.1	7.2	7.2	7.0	6.7	6.8	6.7	6.5
Current Account Balance	C$bn	-62.2	-52.6	-50.4	-56.3	-58.2	-49.5	-47.7	-52.5	-52.0	-48.7	-48.4
	% of GDP	-3.4	-2.8	-2.6	-3.0	-3.1	-2.6	-2.5	-2.7	-2.7	-2.5	-2.5
Net Exports (Pct. Contrib.)		-0.6	0.3	0.4	1.4	-0.4	0.5	0.6	0.4	0.3	0.3	0.3
Inventories (Pct. Contrib.)		0.0	0.0	-0.1	0.5	0.3	-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	86.0	85.8	85.0								

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

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Australia

We have slightly shaved our 2013 economic growth forecast to 2.6% (from 2.7% previously) but left our 2014 forecast unchanged at 3.1%. Both forecasts are a little above consensus. Growth this year is expected to be moderately below trend, resulting in a gradual rise in the unemployment rate to a touch below 6%. The slowdown mainly reflects a weaker outlook for investment as the lower terms of trade wind down the contribution to growth from mining capex. Next year we expect economic growth to return to around trend as the rebalancing of the economy starts to take shape, led by housing investment and consumer spending. Market pricing anticipates more rate cuts to achieve this rebalancing, but with the AUD becoming less of a headwind to the outlook we believe the RBA would prefer not to cut further. That said, if inflation continues to surprise to the downside or the global outlook weakens again, another rate cut would be more likely.

New Zealand

Economic growth likely slowed in the first half of this year after the outsized rise of 1.5% in Q4 last year. Drought earlier in the year is expected to subtract 0.5% points from GDP in 1H2013, according to RBNZ estimates. Nevertheless, most lead indicators point to sustained above-trend growth later this year and into 2014. In particular, the Canterbury rebuild will inject over $NZ40bn into the economy over the next few years. Even with the economy growing above trend, inflation is likely to rise only gradually to the mid point of the RBNZ's 1%-3% target because there is still ample capacity of over 1% of GDP according to the OECD. In contrast, rapid house price inflation and accompanying credit growth pose a significant risk to financial stability. At this stage the RBNZ prefers the use of macro-prudential policies to deal with these risks. But should the NZD decline from currently overvalued levels it is possible that the RBNZ could raise the OCR earlier than our forecast of Q1 2014.

Figure 29. 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	2.7	3.0	1.6	3.5	2.2
Real Final Domestic Demand	4.7	1.5	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	1.8	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	0.4	7.4	2.6	3.7	4.4
CPI	1.8	2.6	2.5	1.1	1.2	2.3
CPI (4Q versus 4Q)	2.2	2.6	2.6	0.9	2.0	2.2
Unemployment	5.3	5.8	5.7	6.9	6.1	5.1
Merch. Trade, BOP (Local Currency, bn)	-4.8	4.7	-2.1	1.1	1.5	-0.5
Current Account, (Local Currency, bn)	-55.0	-44.3	-57.7	-10.3	-11.8	-15.3
Percent of GDP	-3.7	-2.9	-3.6	-4.9	-5.5	-6.8
Budget Balance[d] (Local Currency, bn)	-44.7	-20.0	-17.8	-11.9	-6.6	-2.0
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	1.1	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

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The Chinese economy will likely record another year of slow growth. Key macro indicators in May were generally weaker than expected, with exports up only 1% YoY. We suspect the May export data reflect the underlying reality better after the government started to take measures to address export over-invoicing and FX borrowing for faked imports to bring in FX in anticipation of currency appreciation. Industrial production rose 9.2% YoY in May vs. 9.3% YoY in April, but fell short of the Q1 pace (9.5% YoY). The slow policy reaction signals that policy-makers prefer more sustainable but slower growth. We downgrade our GDP growth forecast in 2Q from previously 7.8% YoY to 7.5% YoY. A slight rebound in 3Q is possible owing to the recent launch of investment projects, but there is a chance that 4Q growth could further break down to below 7.5% YoY due partly to a high base from last year. We are inching down our annual 2013 GDP growth estimate from 7.7% to 7.6%.

It remains a challenge how the Chinese leaders will be able to address the downward pressure of the economy due to both cyclical and structural drags. The over-capacity problem has intensified, particularly in the upstream industries, dragging the PPI back to -2.9% YoY in May from -2.6% YoY in April. Stronger monetary data failed to lift the economy as more credit is allocated to highly-leveraged sectors of the economy, e.g., local governments, large state-owned enterprises and non-coastal areas. This only exacerbated inefficiencies in credit allocation and structural distortion, the opposite to the desired direction of economic rebalancing. Economic growth for the rest of 2013 will rely on investment (in infrastructure and property) and retail sales, which all showed signs of stabilization in May. The policy direction remains unclear after the leadership transition since March this year. Because of weaker-than-expected economic activity, we have cut our CPI inflation forecast from 2.9% previously for 2013 to 2.6%. This has created some room for further policy accommodation. Rate cuts are possible though constrained by the fear of boosting property prices. The pace of RMB appreciation will probably be contained by weak export data, and two-way volatility of the CNYUSD is likely in 2H. We still expect the spot rate to end this year at 6.09. Structural reforms are possible before October this year and critical to improve market sentiment and economic outlook going forward. But it remains to be seen how the authorities address debt problems among local governments, improve investment efficiency and invent new growth drivers.

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

					2013F				2014F			
		2012	2013F	2014F	1Q	2QF	3QF	4QF	1QF	2QF	3QF	4QF
Real GDP	YoY	7.8%	7.6%	7.3%	7.7%	7.5%	7.9%	7.4%	7.4%	7.0%	7.2%	7.5%
Real Final Domestic Demand	YoY	8.3	7.3	7.5								
Consumption	YoY	8.2	7.8	7.8								
Fixed Capital Formation	YoY	8.4	6.9	7.1								
Industrial Production	YoY	10.0	9.4	8.7	9.5	9.2	9.9	9.0	9.0	8.2	8.5	9.1
Exports	YoY	7.9	9.7	5.9	18.4	6.0	7.0	9.0	2.0	5.0	7.0	9.0
Imports	YoY	4.3	9.6	7.2	8.4	10.0	12.0	8.0	8.0	7.0	6.0	8.0
Merchandise Trade Balance	$bn	231	254	243	43	54	62	95	16	47	71	109
FX Reserves	$bn	3,312	3,678	3,861	3,440	3,494	3,556	3,678	3,674	3,706	3,762	3,861
Current Account	% of GDP	2.3	2.2	2.0								
Fiscal Balance	% of GDP	-2.0	-2.0	-2.0								
General Govt. Debt*	% of GDP	45.0	45.3	45.4								
Urban Unemployment Rate	%	4.1	4.1	4.2	4.1	4.1	4.1	4.1	4.2	4.2	4.2	4.2
CPI	YoY	2.6	2.6	3.0	2.4	2.3	2.5	3.0	2.8	3.0	2.9	3.4
Exchange Rate (end period)	CNY/$	6.23	6.09	6.03	6.21	6.11	6.09	6.09	6.08	6.06	6.04	6.03
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 discussed last month, commodity tailwinds have worked well for India. Inflation is down, there is some cushion on the current account, and some fiscal adjustment challenges have eased. (See BOP: A Welcome POP). This is, top down, a somewhat sweet spot for India – and the markets are appreciating India's commodity 'user' status amongst EMs.

However, there are now capital headwinds. There is chatter that the US Fed could slow down its pace of monetary expansion. As a global capital 'absorber' India will be vulnerable. It's got a 4%+ CAD, external debt is rising and its markets have been supported by equity and debt inflows. (See Chattering on Tapering). The Fed's tapering is now more of a timing issue; but while India is vulnerable, there are offsets – i.e. (1) continued expansionary policy by other Central Banks, (2) further declines in commodity prices and (3) pro-active measures by domestic policy makers.

On the external front, the rupee has seen volatility, with the INR down~7% over the last month and currently trading at ~Rs58/US$ levels. This is a combination of (1) chattering on tapering (2) differential between US Treasuries and Indian G-Secs narrowing thus resulting in limited returns if one takes into account hedging costs and (3) unwinding of long dollar positions.

As regards monetary policy, given sub-par growth and easing core inflation, we maintain our view of a further 50bps of monetary easing in FY14. However, apart from current rupee volatility, given elevated CPI and the possibility of another weak trade deficit print in May, we expect the RBI to cut rates only in its July 30 meeting.

Lastly on growth, we maintain our view of a shallow recovery to 5.7% in FY14. Key factors include (1) a normal monsoon, (2) a pick-up in consumption as FY14 is a pre-election year and lower rates could help consumer durables, (3) a marginal uptick in investment, which rests on continued government efforts – both policy change and execution. The Cabinet Committee on Investments and Freight Corridor are rays of light.

Figure 31. 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	7.7	7.5
Current Account	US$ bn	-95	-85	-76
	% of GDP	-5.1	-4.1	-3.3
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	57.3	56.4

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

Korea

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Macro indicators released recently hint that recovery of the economy in 2Q13 might be better than expected. Industrial production in April and exports in May all grew faster than market expectations, and the housing slump eased with an increase in transactions and fewer unsold apartments. However, sluggishness of retail sales and facilities investment continued to weigh on the recovery pace. Headline CPI inflation moderated further to 1.0% YoY in May, from 1.2% YoY in April, as prices of agricultural products and oils stayed on downward trends on both a MoM and YoY basis. Meanwhile, core inflation rose to 1.6% YoY and 0.4% MoM, both up by 0.4pp from a month ago, due mostly to price increases of industrial products and services. We expect CPI inflation to pick up in June – as agricultural prices will likely rise along with the start of the monsoon and service prices head higher – but to remain below the lower bound of the BoK's inflation target (2.5%) for a while. The BoK is likely to hold its policy rate after the 25bp cut in May, as the economy will likely stay on the recovery path and inflation rises gradually. Yet we still do not rule out another cut if any downside risks to economic growth materializes.

Indonesia

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For Indonesia, the next few months will be about delivering policies that could restore credibility. Despite weaker 1Q growth readings, we see further tightening of monetary policy going forward. After BI's surprise 25bps FasBI/BI rate hikes in June, we expect at least two more 25bps hikes to follow in July and August. This may also be accompanied by macroprudential policies e.g. to further curb speculative property purchases. Finally, the implementation of the planned fuel price hike is also just a mater of time now after recent approval of the revised 2013 budget. The policy package addresses fundamental issues and hence can eventually help improve sentiment; after the global asset reallocation flows subside. Nonetheless the global landscape is probably seeing a structural change, with higher US Treasury yields. With global conditions becoming less loose, we think the IDR could see further weakening to 10,000/US$ in 6-12M, after overshooting to 10,150/US$ in 0-3M. We also see additional 2x25bps rate hikes in 2014 and revise our YE13 10-yr yield forecast upward to 6.3%, from previously 5.6%.

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

		Korea			Indonesia		
		2012	2013F	2014F	2012	2013F	2014F
Real GDP	YoY	2.0%	2.9%	3.7%	6.2%	6.1%	6.3%
Final Domestic Demand	YoY	1.1	2.4	3.4	6.2	5.7	6.5
Private Consumption	YoY	1.7	1.9	3.3	5.3	5.1	4.9
Fixed Investment	YoY	-1.7	2.8	4.0	9.8	6.7	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	1.8	2.8	4.3	6.9	5.4
Unemployment Rate	%	3.2	3.2	3.2	6.1	5.9	5.8
Current Account	US$ bn	43.1	37.5	22.8	-24.1	-22.3	-19.1
	% of GDP	3.8	3.2	1.8	-2.7	-2.4	-1.8
Fiscal Balance	% of GDP	1.5	0.9	2.3	-1.8	-2.1	-1.4
US Dollar Exchange Rate	Average	1127	1132	1084	9361	9976	9966

Sources: Haver Analytics and Citi Research forecasts

Hong Kong

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The recent April data indicate that the export recovery remains mild, and we continue to see uneven demand recovery in the region with lacklustre demand from developed countries. Owing to gold purchases by tourists, retail sales strength continues, providing much-needed support to the economy. CPI inflation appears on a faster climb as we come into the summer months with higher vegetable prices, minimum wage hike and the different timings of public rental waiver this year. Capital outflows associated with the large stock market correction continue to keep the HKD further away from the strong end of the trading band, despite new lows in CNY fixings. Regulators remain vigilant over property prices amid recent warming-up of market activities, especially in the secondary market. Worries of Fed tapering are taking 5Y EFNs higher along with its US counterparts.

Singapore

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Recent Apr-May data suggest that exports are bottoming, though our 2.3% full year forecast assumes QoQ SAAR growth rates averaging about 5% for the remaining three quarters of 2013 vs 12% at similar stages in past recovery cycles, reflecting supply constraints and competitiveness erosion. Inflation is likely to edge upwards after the April decline to a 38-month low of 1.5% YoY, given upward pressure on COE premiums as vehicle population growth slows amid margin pressures from surging unit labour costs. MAS's strategy of "under-promising" but over-delivering on inflation outcomes suggests downside surprises to upwardly-biased forecasts need not necessarily trigger a policy easing. Policymakers may become more wary of deflationary risks as a consequence of restructuring pains – no further tightening in foreign worker and property policies seems necessary for now.

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Investment growth is likely to lead the economy in 2H, followed by a gradual net export recovery, but consumption will likely lag given still-falling wages. TWD depreciation could step up a little beyond the 30/USD threshold given the latest round of EM FX weakness, although the new lows in CNY fixing and the recent retreat in JPY depreciation should limit depreciation near term. The expected signing of the Economic Cooperation Framework Agreement for trade of services and the further dilution of Capital Gains Tax in the near term will likely be positive for equity and FX markets. Both consumer inflation and wholesale inflation has been trending down, on anaemic economic recovery thus far and lower global commodity prices. Despite benign inflation outlook, the CBC is likely to keep its policy rate on hold again given worries of capital inflows and still-rising home prices.

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

		Hong Kong			Singapore			Taiwan		
		2012	2013F	2014F	2012	2013F	2014F	2012	2013F	2014F
Real GDP	YoY	1.5%	3.0%	3.4%	1.3%	2.3%	4.4%	1.3%	2.9%	3.8%
Final Domestic Demand	YoY	4.8	2.8	2.0	2.9	2.6	3.8	0.1	2.3	3.2
Private Consumption	YoY	3.2	3.7	2.1	2.2	1.9	2.8	1.5	1.8	2.7
Fixed Investment	YoY	9.4	0.8	2.0	6.6	0.9	4.8	-4.4	5.4	6.1
Exports	YoY	1.8	3.5	4.3	0.3	1.1	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	2.6	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	40.4	42.6	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	1.25	1.23	29.57	29.99	29.60

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 remain below the average of recent years, and the 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. For this year, we look for the economy to expand at 2.1% YoY and 2.8% in 2014 (from 3.1% and 3.6% last month respectively). 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 7.2% 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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During the recent EM sell-off, Turkish assets have underperformed, due in part to domestic developments. To the extent that the recent events may lead investors to re-price the country’s political risks, we think any resulting extra risk premium is likely to aggravate pressures on Turkish assets. Against this backdrop, the CBT has opted for additional short-term tightening, which will be carried out through open market operations. To this end, the CBT underlined that liquidity provided to the market at the policy rate (4.5%) is reduced temporarily below the lower bound announced for normal days. Moreover, the CBT has also started opening FX sales auctions. According to the CBT, the duration of its additional tightening will depend on FX volatility. With the interbank o/n rate and the CBT’s o/n lending rate standing at 6% and 6.5% (or 6% for primary dealers), respectively, we are not sure that liquidity tightening alone will be sufficient to stabilize markets unless the CBT raises the upper band or domestic and external conditions improve considerably. Looking ahead, we believe that the CBT is likely to resist raising the upper band as long as possible and would prefer to rely on the ROM by reducing reserve option coefficients.

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

		Russia			Turkey		
		2012	2013F	2014F	2012	2013F	2014F
Real GDP	YoY	3.4%	2.1%	2.8%	2.2%	4.0%	4.3%
Final Domestic Demand	YoY	5.2	3.4	3.9	-0.5	4.2	4.8
Private Consumption	YoY	6.7	3.5	3.6	-0.7	4.0	4.3
Fixed Investment	YoY	6.0	4.6	6.5	-2.5	5.3	6.7
Exports	YoY	1.4	0.5	1.7	17.2	3.5	4.2
Imports	YoY	9.5	4.5	4.5	0.0	4.5	6.1
CPI	YoY	5.1	6.7	5.4	8.9	7.4	7.3
Unemployment Rate	%	5.7	6.5	7.0	9.2	9.5	9.5
Current Account	US$ bn	79.0	60.2	20.6	-45.4	-58.8	-64.7
	% of GDP	3.9	2.8	0.9	-5.8	-6.9	-7.0
Fiscal Balance	% of GDP	-0.7	-2.0	-4.1	-2.0	-2.2	-2.7
US Dollar Exchange Rate	Average	31.1	32.1	32.7	1.80	1.86	1.91

Sources: Haver Analytics and Citi Research forecasts

Hungary

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We are lifting our 2013 GDP forecast from 0.2% to 0.4% on the back of the strong April retail sales and industrial output data. But, we are leaving our 2014 GDP forecast unchanged at 1.3% reflecting the absence of any positive trend in fixed investment that would help to improve long-term growth prospects. Inflation continues to surprise to the downside. Therefore we have further reduced our CPI forecasts to 2.0% in 2013 and 3.1% in 2014 (both down 0.1% from last month) with further risks to the downside if additional household utility price cuts materialize. While the prospect of weak growth and soft inflation points towards further gradual rate cuts, the intensified EM sell-off limits scope for further monetary easing. External factors may be the key determinant of the end of the rate-cutting cycle. Our base case is that the NBH will not give up its dovish bias quickly and will deliver one or two more 25bp rate cuts with a cautious tone. This may intensify the pressure on the currency in the short term, in line with the continued global EM FX sell-off. But, we do not expect rates to decline below 4.00%, given that the NBH will likely focus on financial stability risks and would react to political sensitivity in the event of excess HUF weakening in the run-up to the spring 2014 general elections.

Poland

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After an interest rate cut in June, the MPC signaled that the easing cycle is near the end and that it will give clear signals on rates prospects in July. We expect a 25bp rate cut in July to mark the end of the easing cycle, even though inflation remains subdued. We expect CPI growth to edge up to 1.2% at year-end and to about 2% in 2014. Moreover, we expect that GDP growth bottomed in 1Q at 0.5% YoY, amid a continued drop in fixed investment and stagnation in private consumption. We look for the economy to accelerate to 2% YoY in 4Q. Our scenario will be supported by easing of lending criteria by FSA and stabilization in the labour market, which should support credit growth and consumption. Weak economic data so far have negatively affected budget revenues and the government has finally admitted that a budget revision is likely this year – in line with our long-held view. The government also approved assumptions for 2014 with GDP growth at 2.5% YoY and CPI at 2.4% YoY, which seem quite realistic, in our view. According to PM Tusk, the government will also take decisions regarding changes in the pension system, although their liquidation does not appear to be an option. The NBP has intervened in the market to limit zloty volatility (and thereby strengthened the zloty). However, in our view, the NBP has only limited scope to limit adverse FX market flows, especially given global market trends.

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

		Hungary			Poland		
		2012	2013F	2014F	2012	2013F	2014F
Real GDP	YoY	-1.7%	0.4%	1.3%	1.9%	1.3%	2.8%
Final Domestic Demand	YoY	-2.1	-1.2	0.1	0.3	0.0	2.2
Private Consumption	YoY	-1.4	0.0	0.5	0.8	1.0	2.2
Fixed Investment	YoY	-3.8	-4.0	-0.5	-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	2.0	3.1	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	2.9	4.4	-17.3	-13.5	-18.8
	% of GDP	1.6	2.2	3.1	-3.5	-2.7	-3.5
Fiscal Balance	% of GDP	-1.9	-2.7	-2.9	-3.9	-3.9	-3.5
Euro Exchange Rate	Average	289	304	300	4.18	4.31	4.35

Sources: Haver Analytics and Citi Research forecasts

Czech Republic

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Our GDP forecasts are unchanged at -0.8% YoY in 2013 and +1.3% in 2014. We believe looser fiscal policy, plus recoveries in exports and fixed investment, will have a positive impact on headline GDP In coming quarters. Private consumption is likely to act as a drag, given recent weak confidence indicators. Official worries over inflation likely were calmed by the May inflation data (3-year low) and we are cutting our 2013 CPI inflation forecast to 1.4% from 1.5% previously — below the CNB's 1.7% forecast. Central bankers Janacek and Governor Singer have recently sounded rather neutral and dovish, respectively, contrasting with market expectations. Hence, we continue to expect the CNB policy to remain accommodative, though maybe less than last month. Therefore, we continue to see EURCZK at around 26 both on a 3- and 9 month horizon, before the koruna starts to resume a mild appreciation trend to 24.3 over the 2-year horizon. The risk of an early election has increased substantially with the PM's resignation after his closest aide was charged with corruption and abuse of power. The coalition is likely to try to find another PM candidate from ODS with majority support, otherwise an early election will take place around end of August. Polls suggest that voters' preferences are for left-wing parties, while right-wing parties would only be able to make up a grand coalition.

Romania

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A quick glance at the data suggests the recent EM sell-off has had a greater impact on Romanian assets, the currency in particular, compared with regional peers. We think this will make it harder for the NBR to carry out aggressive easing in the near term. To recap, Governor Isarescu provided strong signals of the NBR's intention to ease in the aftermath of the May Board meeting, which had led us to expect a 50bp rate cut in 3Q. Thus, we think the recent leu depreciation is likely to weaken the NBR's hand to ease. In fact, the upward trend in money market rates since the beginning of May corroborates this conjecture. Turning to the growth outlook, standing at 2.6% YoY, 1Q GDP has revived recovery hopes. On a seasonally adjusted QoQ basis, the data suggest the strong pick-up in exports was the key driver, as domestic demand, private consumption in particular, continues to remain soft. Against this backdrop, we keep our 2013 GDP forecast at 1.6%. In our base case, we continue to include another EU-IMF arrangement once the current one expires in June and assume an increase in the absorption of EU funds. Deviations from these assumptions would lead us to revisit our growth forecasts. Risks to the outlook are mostly on the downside, owing to the country's exposure to the euro area crisis and the absence of robust signs of a sustained pick-up in domestic demand.

Figure 36. 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	1.4	2.5
Private Consumption	YoY	-3.3	0.2	1.1	1.0	1.0	2.4
Fixed Investment	YoY	-2.7	-2.1	3.6	5.2	3.0	3.5
Exports	YoY	4.0	1.5	5.6	-3.1	2.5	4.0
Imports	YoY	2.3	2.3	6.7	-0.8	2.1	3.0
CPI	YoY	3.3	1.4	1.5	3.3	4.8	3.3
Unemployment Rate	%	7.0	7.6	7.7	5.1	5.2	5.5
Current Account	US$ bn	-4.7	-2.5	-4.1	-6.5	-7.4	-9.7
	% of GDP	-2.4	-1.2	-2.0	-3.8	-3.9	-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	25.4	3.5	3.3	3.1

Sources: Haver Analytics and Citi Research forecasts

Brazil

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Weaker 1Q13 GDP growth and stronger monetary policy reaction motivated reductions in our 2013 and 2014 GDP growth forecasts to 2.5% and 3.0%, respectively. Regarding prices, we raised our 2013 and 2014 year-end CPI inflation estimates to 6.2% and 5.9%, up from 5.8% and 5.7%, respectively. In terms of monetary policy, after the acceleration in the pace of monetary tightening to 50bp in May's Copom meeting, we now expect the Selic rate to be raised up to 9.25% by year-end, and to remain at this level throughout 2014. On the fiscal front, despite believing that the decision from S&P to put the sovereign outlook in negative perspective (from stable) will likely limit the decline in the primary surplus, it should be insufficient to improve the outlook for the fiscal accounts substantially. Overall, we expect the primary surplus to reach 1.5% of GDP this year and next, contributing to a slight depreciating trend for the BRL in the medium term. Regarding the external accounts, we keep the view that current account deficit will continue to widen to levels around 3.0% of GDP, likely financed by capital inflows.

Mexico

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A gap has opened between cyclical and secular activity trends. Prospects for the latter are constructive, as Mexico is benefiting from the 'manufacturing renaissance' in North America. On the cyclical front, the soft patch we were anticipating for the first half of this year has proved deeper than expected. Several of the factors behind this result will likely revert (such as government spending falling behind expectations), but not quickly enough to keep our year-end GDP growth projection unaffected. Therefore, we revise our GDP growth forecasts for 2013 and 2014 to 2.7% and 4.2%, respectively, from 3.2% and 4.0% before. Softer activity will help cap core inflation, in spite of the weaker exchange rate. Thus, we continue to expect headline and core inflation to close this year at 3.6% and 3.0%, respectively. Meanwhile, the fact that local financial variables have reacted as elsewhere in the emerging world to the signals of potential normalization by the Fed has, in our view, reduced the dovish bias of Banxico's board — a weaker FX, for example, implies looser monetary conditions. Thus, we reaffirm our call for the policy rate to close this year at 4%, its current level. On the political front, market participants will follow the results of local elections on July 7 to assess whether the opposition parties could adopt a more conflictive stance within the 'Pact of Mexico' regarding support for structural reforms. Notwithstanding the political challenges, we think that meaningful energy and fiscal reforms will take place in 2H13.

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

		Brazil			Mexico		
		2012	2013F	2014F	2012	2013F	2014F
Real GDP	YoY	0.9%	2.5%	3.0%	3.9%	2.7%	4.2%
Final Domestic Demand	YoY	1.7	3.8	3.9	3.7	3.1	3.8
Private Consumption	YoY	3.1	3.0	3.8	3.3	3.0	3.6
Fixed Investment	YoY	-4.0	7.1	5.1	5.9	4.6	5.9
Exports	YoY	0.5	-0.3	5.1	4.6	3.4	8.6
Imports	YoY	0.2	10.6	10.0	4.1	2.4	5.0
CPI	YoY	5.4	6.5	6.0	4.1	3.9	3.4
Unemployment Rate	%	5.5	5.5	5.4	5.0	4.8	4.5
Current Account	US$ bn	-54.2	-73.3	-83.4	-9.0	-21.6	-23.0
	% of GDP	-2.4	-3.1	-3.6	-0.8	-1.7	-1.6
Fiscal Balance	% of GDP	-2.5	-3.6	-3.7	-2.6	-2.1	-2.0
US Dollar Exchange Rate	Average	1.95	2.13	2.20	13.16	12.55	12.23

Sources: Haver Analytics and Citi Research forecasts

Argentina

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Our preliminary estimates put real GDP growth at 0.3% YoY and 0.9% QoQ, seasonally-adjusted, during 1Q13. These figures are marginally weaker than our initial expectations. Despite this, we maintain our 3% real GDP growth forecast for 2013 as a whole on the official GDP data, though with a downward bias. Conversely, we have significantly revised our non-official real GDP growth forecast for 2014 to 0.5%, down from 2% before. We think that, after the October midterm elections, the government will tighten further FX controls and (marginally) monetary and fiscal policy. This course of action should negatively affect activity. During the first five months of 2013, BCRA's net foreign currency purchases stood at only USD0.7bn, down from USD6.6bn during the same period last year. As a result, international reserves have shrunk from USD43.3bn in the beginning of the year to USD38.6bn at the end of May. The trend of FX management, increasingly tight FX restrictions and reserve losses is clearly unsustainable. However, we do not expect the authorities will fight the drop in BCRA reserves with orthodox instruments such as openly restrictive monetary and fiscal policies. Rather, tighter capital controls, import restrictions (probably on non-fuel imports and tourism) and other limitations to FX access are likely to be used. A step devaluation in the official USDARS is unlikely too. We thus continue to see the USDARS at 6 by end of 2013 and at 7.5 by the end of 2014.

Venezuela

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The country's macroeconomic fundamentals continue to deteriorate. GDP growth stood at 0.7% YoY in 1Q13, while May's monthly inflation stood at 6.1% with the scarcity index reaching 20.5% (meaning that at least a fifth of the basic basket is unavailable). Unfortunately, we do not expect this situation to reverse any time soon and we maintain our call for a significant deceleration in growth this year. The extremely low availability of USD for the private sector is causing shortages of necessary raw materials and intermediate goods, and putting pressure on domestic supply. That being said, we are cutting our GDP growth forecast for 2013 to -0.5%, down from 1% before. In addition, while we expect year-end annual inflation to stand at 35%, it should increase to close to 40% during 2H13 due to a low comparison base. On the political front, we expect the government to intensify the confrontation with the opposition as a strategy to divert attention from the weak economic performance.

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

		Argentina			Venezuela		
		2012	2013F	2014F	2012	2013F	2014F
Real GDP	YoY	1.9%	3.0%	3.0%	5.6%	-0.5%	1.5%
Final Domestic Demand	YoY	2.5	3.3	2.8	12.3	-0.9	0.2
Private Consumption	YoY	4.4	3.5	3.1	7.0	-0.3	0.0
Fixed Investment	YoY	-4.9	1.6	1.9	23.3	0.5	0.6
Exports	YoY	-6.6	2.2	-1.9	1.6	0.3	4.9
Imports	YoY	-5.2	4.4	-2.3	24.4	-1.3	-1.0
CPI	YoY	10.0	10.3	12.5	21.1	33.2	28.9
Unemployment Rate	%	7.2	7.6	7.8	5.9	6.4	6.8
Current Account	US$ bn	0.5	2.0	1.0	11.0	17.9	23.1
	% of GDP	0.1	0.4	0.2	3.1	5.1	5.0
Fiscal Balance	% of GDP	-2.6	-2.7	-2.9	-5.0	-4.0	-4.0
US Dollar Exchange Rate	Average	4.54	5.46	6.74	4.29	6.13	6.30

Sources: Haver Analytics and Citi Research forecasts

Saudi Arabia

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Bloomberg data showed a continued rise in oil production, to 9.35mbpd in May, up from a low of 9.0mbpd in March. In our view, much of the added production will be going towards rising domestic demand as temperatures continue to increase in these summer months. Exports, therefore, are likely to remain relatively flat. This is 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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The UAE, along with Qatar, has been upgraded to the MSCI emerging markets index, from their previous denomination as a frontier market. The upgrade had been in consideration for a number of years, pending certain reforms which have now been implemented. While we do not expect volumes and prices to rise exponentially on the back of the upgrade, we do believe it will help sustain the increase in volumes we have seen over the past six months or so. Valuations may come under upward pressure in the near term, despite having risen over 40% so far this year already. More generally, 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 39. Saudi Arabia and United Arab Emirates — Economic Forecasts, 2012-2014F

		Saudi Arabia			United Arab Emirates		
		2012	2013F	2014F	2012	2013F	2014F
Real GDP	YoY	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

Nigeria

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Since mid-2012 the Central Bank of Nigeria (CBN) has been able to maintain a stable naira, based on factors reflecting its tight monetary policy and oil prices over US$100/barrel, among other things. Moreover, a tight monetary policy has been justified by high inflation and levels of government spending. But the policy will likely become more complicated in 2H 2013 and into 1H 2014. This reflects both the impending departure of the current CBN governor in early June 2014 and our view that inflation will become firmly fixed in single digits – making a strong case for a potential cut in the Monetary Policy Rate (MPR). But, while a cut is possible, if it happens it is likely to be only modest. This reflects the fact that the CBN does not only consider inflationary trends when setting the MPR, but also considers wider factors – including its commitment to broad naira stability. While other factors could also be naira supportive, the task of building savings in the Sovereign Wealth Fund or making more payments into the Excess Crude Account (which would allow an even faster reserve buildup) is proving problematic. Therefore, with only limited progress with structural reform, reasonable growth and modest fiscal consolidation, the focus will remain on monetary policy.

South Africa

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Gina Schoeman
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A combination of a sharply weakening rand and poor Q1 2013 growth data highlight that 2013 will be a difficult year for the South African economy. In fact, with our forecast indicating that inflation may even breach the top of the South African Reserve Bank (SARB) target range of 3-6%, 2H 2013 could potentially be described as a period of stagflation for the economy. Moreover, despite a weaker rand, we think that ongoing economic woes in Europe and slowing Chinese demand for key SA commodities will limit any quick rebound in exports. With import growth still reasonably strong, we expect the current account deficit to fall only marginally below 6% of GDP in 2013-14. While concerns about weak GDP growth mean the SARB would like to cut interest rates, inflationary pressures and rand volatility will probably continue to ensure it acts cautiously. Therefore, we think a cut in the repo rate from its current level of 5% seems possible only in 2014 as inflation starts to ease. The focus on SARB and its policy options largely reflects the fact that growth projections have once again forced a slower path of fiscal consolidation over coming years. Moreover, slower fiscal consolidation implies more financing needs and, with national government debt already pushing above 40% of GDP in the outer years, investors and rating agencies are likely to remain wary of South Africa's fiscal sustainability.

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

		Egypt			Nigeria			South Africa		
		2012	2013F	2014F	2012	2013F	2014F	2012	2013F	2014F
Real GDP	YoY	2.1%	1.2%	3.5%	7.4%	6.5%	6.9%	2.5%	2.3%	2.9%
Final Domestic Demand	YoY	4.0	-0.3	2.8	NA	NA	NA	4.0	2.0	3.7
Private Consumption	YoY	2.8	-0.7	2.5	NA	NA	NA	3.5	1.5	3.4
Fixed Investment	YoY	3.8	1.8	4.7	NA	NA	NA	5.7	2.7	4.9
Exports	YoY	-1.1	1.7	6.1	NA	NA	NA	0.1	0.9	5.3
Imports	YoY	2.7	-3.4	3.6	NA	NA	NA	6.3	1.0	6.6
CPI	YoY	7.1	9.4	10.4	12.2	8.9	10.0	5.7	6.0	5.5
Unemployment Rate	%	12.5	14.0	15.0	NA	NA	NA	125.5	26.5	27.0
Current Account	US$ bn	-6.9	-6.7	-7.0	11.3	7.4	1.3	-23.6	-20.0	-19.9
	% of GDP	-2.8	-2.9	-2.9	4.0	2.3	0.4	-6.1	-5.9	-5.7
Fiscal Balance	% of GDP	-11.2	-13.2	-12.2	-2.8	-2.6	-2.8	-4.4	-4.9	-4.8
US Dollar Exchange Rate	Average	6.07	7.07	7.81	158.8	158.90	163.63	8.21	10.12	10.67

Sources: Haver Analytics and Citi Research forecasts

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

	GDP Growth			CPI Inflation			Current Balance (% of GDP)			Fiscal Balance (% of GDP)		
	2012	2013F	2014F	2012	2013F	2014F	2012	2013F	2014F	2012	2013F	2014F
Asia	**6.2**	**6.4**	**6.5**	**3.9**	**3.5**	**3.7**	**1.8**	**1.5**	**1.4**	**-2.3**	**-2.3**	**-2.1**
China	7.8	7.6	7.3	2.6	2.6	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	-5.1	-4.1	-3.3	-7.0	-6.7	-6.4
Indonesia	6.2	6.1	6.3	4.3	6.9	5.4	-2.7	-2.4	-1.8	-1.8	-2.1	-1.4
Korea	2.0	2.9	3.7	2.2	1.8	2.8	3.8	3.2	1.8	1.5	0.9	2.3
Malaysia	5.6	5.2	6.0	1.6	2.0	2.8	6.1	2.5	2.0	-4.5	-4.0	-3.5
Mongolia	12.3	13.8	11.0	14.3	12.0	10.0	-31.3	-22.9	3.2	-8.3	-6.3	-5.2
Philippines	6.8	7.0	6.8	3.1	2.8	3.2	2.8	2.4	2.0	-2.3	-2.3	-2.0
Singapore	1.3	2.3	4.4	4.6	2.5	2.6	18.6	14.0	13.5	1.1	0.7	0.5
Sri Lanka	6.4	6.4	7.0	7.5	7.7	6.5	-6.6	-5.3	-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	4.7	4.8	3.0	2.4	2.3	0.7	-0.3	-1.6	-2.1	-2.2	-2.1
Vietnam	5.0	5.2	5.5	9.3	6.9	7.4	5.8	3.3	1.5	-5.2	-4.8	-4.0
Latin America	**2.4**	**2.7**	**3.5**	**5.8**	**7.2**	**6.3**	**-1.6**	**-1.9**	**-2.0**	**-2.2**	**-2.8**	**-2.8**
Argentina	1.9	3.0	3.0	10.0	10.3	12.5	0.1	0.4	0.2	-2.6	-2.7	-2.9
Brazil	0.9	2.5	3.0	5.4	6.5	6.0	-2.4	-3.1	-3.6	-2.5	-3.6	-3.7
Chile	5.6	4.0	5.0	3.0	1.6	3.0	-3.5	-2.4	-2.5	0.6	-0.3	-0.4
Colombia	4.0	3.8	4.5	3.2	2.1	3.0	-3.1	-3.4	-3.2	-0.1	-1.1	-0.7
Mexico	3.9	2.7	4.2	4.1	3.9	3.4	-0.8	-1.7	-1.6	-2.6	-2.1	-2.0
Panama	10.7	9.0	8.0	5.7	4.6	4.4	-9.0	-8.5	-7.5	-2.1	-3.0	-3.0
Peru	6.3	6.2	6.4	3.7	2.6	2.6	-3.6	-3.2	-2.7	1.9	-0.6	-2.0
Venezuela	5.6	-0.5	1.5	21.1	33.2	28.9	3.1	5.1	5.0	-5.0	-4.0	-4.0
Europe	**2.3**	**2.1**	**3.0**	**5.3**	**5.4**	**5.0**	**-0.1**	**-0.6**	**-1.7**	**-1.8**	**-2.3**	**-3.4**
Bulgaria	0.8	1.0	2.0	3.0	2.2	3.6	-1.5	-1.7	-2.1	-0.5	-1.5	-0.7
Croatia	-2.0	-0.8	1.2	3.4	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	1.4	1.5	-2.4	-1.2	-2.0	-4.4	-2.8	-2.9
Hungary	-1.7	0.4	1.3	5.7	2.0	3.1	1.6	2.2	3.1	-1.9	-2.7	-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	-3.5	-3.9	-3.9	-3.5
Romania	0.4	1.6	2.8	3.3	4.8	3.3	-3.8	-3.9	-4.5	-2.2	-2.2	-2.5
Russia	3.4	2.1	2.8	5.1	6.7	5.4	3.9	2.8	0.9	-0.7	-2.0	-4.1
Serbia	-1.7	2.3	2.6	7.8	8.6	6.9	-10.6	-8.2	-8.5	-5.7	-5.0	-5.0
Slovakia	2.0	0.5	1.7	3.6	1.7	2.0	2.2	3.3	3.0	-4.3	-3.4	-3.2
Turkey	2.2	4.0	4.3	8.9	7.4	7.3	-5.8	-6.9	-7.0	-2.0	-2.2	-2.7
Ukraine	0.2	-0.3	3.1	0.6	2.0	5.7	-8.4	-8.9	-6.1	-5.6	-4.5	-4.5
Africa/Mideast	**5.1**	**4.7**	**5.7**	**4.9**	**5.3**	**6.0**	**9.7**	**6.1**	**4.3**	**3.0**	**-2.0**	**-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	2.1	1.2	3.5	7.1	9.4	10.4	-2.8	-2.9	-2.9	-11.2	-13.2	-12.2
Ghana	7.9	7.0	6.8	9.1	10.7	9.3	-11.5	-10.8	-10.3	-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	6.2	7.8	-10.5	-10.1	-9.5	-5.3	-5.0	-4.7
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	2.9	9.0	5.6	3.4	-2.4	-5.1
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	6.0	5.5	-6.1	-5.9	-5.7	-4.4	-4.9	-4.8
Tanzania	6.4	6.8	7.0	16.0	9.0	8.8	-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	4.3	6.8	-10.9	-12.9	-14.8	-3.6	-3.4	-3.3
Zambia	6.5	6.9	7.5	6.6	7.1	7.3	-3.4	-0.5	2.9	-4.3	-3.5	-3.3
Total	**4.7**	**4.8**	**5.2**	**4.6**	**4.7**	**4.7**	**1.7**	**1.0**	**0.6**	**-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 42. Advanced Economies — Sovereign Long-Term Debt Ratings and Citi Ratings Forecasts

	S&P Ratings				Moody's Ratings			
Country	Current Rating	Current Outlook	Citi Near-term (Up to 9 Months) Forecast Rating	Citi Longterm (Next 2-4 Years) Forecast Rating & Outlook	Current Rating	Current Outlook	Citi Near-term (Up to 9 Months) Forecast Rating	Citi Longterm (Next 2-4 Years) Forecast Rating & Outlook
US	AA+	Stable	AA+	AA +	Aaa	Neg	Aaa (Neg W)	Aa1 ↓
Canada	AAA	Stable	AAA	AAA	Aaa	Stable	Aaa	Aaa
Japan	AA-	Neg	AA- (Neg)	A+ ↓	Aa3	Stable	Aa3	A1 ↓
Germany	AAA	Stable	AAA	AAA	Aaa	Neg	Aaa (Neg)	Aaa
France	AA+	Neg	AA+ (Neg)	AA ↓	Aa1	Neg	Aa1 (Neg)	Aa2 ↓
Italy	BBB+	Neg	BBB+ (Neg)	SD* ↓↓↓↓↓	Baa2	Neg	Baa2 (Neg)	C* ↓↓↓↓↓
Spain	BBB-	Neg	BBB- (Neg)	SD* ↓↓↓↓↓	Baa3	Neg	Baa3 (Neg)	C* ↓↓↓↓↓
Austria	AA+	Stable	AA+	AA+	Aaa	Neg	Aaa (Neg)	Aaa
Belgium	AA	Neg	AA (Neg)	AA- ↓	Aa3	Neg	Aa3 (Neg)	A1 ↓
Finland	AAA	Stable	AAA	AAA	Aaa	Stable	Aaa	Aaa
Greece	B-	Stable	B-	SD* ↓↓↓↓↓	C		C	C*
Ireland	BBB+	Stable	BBB+	BBB+	Ba1	Neg	Baa3 ↑	Baa2 ↑↑
Netherlands	AAA	Neg	AAA (Neg W)	AA+ ↓	Aaa	Neg	Aaa (Neg W)	Aa1 ↓
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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Citi no longer expects a Grexit scenario — credit positive

Core EMU ratings: Many of our longer-term rating expectations were predicated on a stress scenario of EMU exit by Greece. We removed that from our base case a month ago. As such, we no longer expect downgrades in core countries over the next 2-5yrs (especially ones which currently have a Stable outlook). Specifically, we expect Germany, Austria and Finland to maintain their current ratings in both the near and long term. For country-specific reasons, we do not rule out a downgrade of sovereigns such as France, Belgium and the Netherlands over the very long term – and such sovereigns have a Negative Outlook from both Moody's and S&P.

Likelihood of near-term ESM/OMT aid has reduced for Spain and Italy

Market access is secure for now

Spain and Italy: We remain worried about long-term fiscal trends, but do not see a trigger for Spain/Italy to enter sovereign support programmes this year. Recent debt sales indicate a healthy degree of market access. This helps affirm our view that we do not expect downgrades of Spain or Italy in the immediate term. In a recent note, Moody's noted Spain and Italy's current ratings were due to the "*scale of their economic and fiscal challenges*"[4]. In the same note, Moody's comments that *"Spain has advanced further in correcting the loss in its external competitiveness"* and that "*Italy's structurally strong public finances offer it more time to address the structural impediments to growth*". However, as Citi details (*Euro Area: Sovereign Debt Crisis Update*), persistent lack of growth will likely raise again doubts of Italian public finance sustainability over the longer term. Over the very long term, some form of restructuring for both Italy and Spain remains the base case of our economists.

Other country-specific rating views

Upgrade by Moody's still our base case over coming quarters

Ireland: From Citi's point of view, Ireland's fiscal prospects now seem better than previously expected and our economists no longer expect debt structuring involving privately held Irish government debt in the years ahead. Should Ireland continue to make steady progress towards independent and sustained private market access, then this is likely to be one factor in Moody's upgrading Ireland to Baa3 (investment grade) later this year, in our view.

We continue to expect S&P to follow Moody's and ultimately downgrade the UK by one notch in 1-2yr time

UK: We continue to expect S&P to downgrade the UK by one-notch to AA+ given rising debt and likely political tensions probably in the next year or two rather than in coming quarters, given that S&P recently affirmed the UK at AAA rating (5 April).

Moody's focus on US debt levels

US: The recent Moody's publication (Credit Opinion 15 May) noted "*although government financial strength weakened as a result of interventions to support the financial system and the economy, the basic factors supporting the Aaa remain intact*". We therefore do not expect downgrade pressure on the US rating in the immediate term. With the marked improvement in the fiscal position, we no longer expect a further downgrade by S&P in coming years, although we still judge there to be a risk that the marked rise in the public debt ratio over recent years will prompt Moody's (which rates the US at Aaa Negative Outlook) to move the US rating down one notch at some stage.

[4] Moody's Investor Service "*Spain and Italy: Italy's Stronger Budgetary Performance Still Justifies Higher Rating Than Spain*". 17 May 2013

Rates Forecasts Commentary

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

US: longer-dated Treasury yields to outpace the forwards

We continue to expect longer maturity US Treasury yields to rise significantly more than the forwards by year-end. While recent economic performance in the US has been good rather than great, the large drop in the budget deficit shows that growth has been able to remain on its moderate upward path despite the fiscal headwinds. The drop in the deficit also minimizes the likelihood of any further near-term fiscal policy tightening.

We expect the Federal Reserve to confirm market expectations of QE tapering within the next several months, but they may also guide expectations of the first Fed Funds hike further into the future. Offsetting forces should keep the front end relatively unchanged, while longer-term yields rise by more than the forwards. The rising correlation of Treasury yields to US economic data and falling correlation to European risk factors suggests that Treasuries can diverge further from European sovereign yields if the economic separation extends.

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

The recent sell-off in Europe reflects positioning and doesn't herald the beginning of a bear market, in our view

The flushing out of crowded longs has driven many EMU yields and swap rates higher, but this is unlikely to be the beginning of a structural bear market, in our view. We continue to expect Bunds to range trade and target an average of 1.5% in the coming quarters. Growth is likely to remain weak (Citi expects -0.8% in 2013 and 0% in 2014) and inflation low (Citi expects 1.4% in 2013 and 1.2% in 2014) and we still subscribe to the 'rates lower for longer' view fundamentally.

We expect another refi cut in Q4 but the probability of negative deposit rates has fallen

Although Draghi was perhaps less dovish at the last ECB meeting, the door remains open to further loosening and we continue to expect a 25bp cut in the main refi rate later in 13Q4. However, we have raised our low EONIA trajectory slightly to reflect the reduced probability of negative deposit rates, the reduction in excess liquidity and LTRO repayments. We continue to expect relatively low EONIA levels but rising to around 10bp on average later in Q4.

Japan: yields will eventually bow to BOJ pressure

We expect JGB yields to hover at the top of their range for the rest of this year before moving lower early in 2014

BOJ buying will provide a buffer against US Treasury yields drifting higher

We expect JGB yields to hover at the top of their range for the rest of this year before moving lower early in 2014. The sharp rise in yields and volatility in response to the unprecedented BOJ easing resulted in severe damage to bond portfolios of banks and other major domestic investors and the JGB market may remain vulnerable to external shocks near term. Abe is likely to present a large-scale stimulus package in autumn to retain cabinet support and to enable a consumption tax hike on schedule in April 2014. Although Treasury yields trending higher would be a drag on JGBs, the cumulative impact of the BoJ's aggressive JGB purchases should insulate JGBs from external markets. BOJ buying, along with a consumption tax hike in Spring, will likely put downward pressure on JGB yields.

UK: yields to be capped by forward guidance

The recent sell-off in gilts isn't the start of a bear market, in our view

Long-end yields to consolidate

Forward guidance to richen 2-5yr sector, 5yr vs wings, and steepen curves

In the UK, we have revised our 10yr yield forecasts slightly higher (+5bp), but we do not believe that the recent sell-off is the precursor to a sustained bear market. Our forecasts reflect our view that long-end yields will consolidate close to current levels in the next couple of quarters before drifting higher in 2014. In particular, we believe that yields will be capped by the introduction of forward guidance. Recent data have shown signs of economic improvement, but the economy is far from achieving 'escape velocity' and further monetary loosening is likely to be required. Forward guidance is likely to be bullish for the 2-5yr sector in particular and lead to steeper curves and a richening of 5s vs the wings.

Figure 43. Interest Rate and Bond Market Forecasts as of 19 June 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	0.26	0.33	0.45	0.55	0.65	0.75	0.85
5 Year Treasury Yield	1.02	1.14	1.30	1.43	1.60	1.75	1.95
10 Year Treasury Yield	2.14	2.27	2.50	2.70	2.90	3.08	3.20
30 Year Treasury Yield	3.32	3.46	3.73	3.95	4.15	4.30	4.40
2-10 Year Treasury Curve	188	194	205	215	225	233	235
2 Year Swap Spread (Swap Less Govt), bp	16	17	19	20	20	20	20
10 Year Swap Spread (Swap Less Govt), bp	17	16	13	8	5	5	5
30 Year Swap Spread (Swap Less Govt), bp	-11	-12	-14	-18	-23	-28	-30
30 Year Mortgage Yield	3.94	3.97	4.05	4.18	4.33	4.45	4.6
10 Year Breakeven Inflation	206	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	0.17	0.10	0.10	0.10	0.10	0.15	0.15
5 Year Bobl Yield	0.59	0.50	0.50	0.50	0.50	0.50	0.60
10 Year Bund Yield	1.57	1.50	1.50	1.50	1.50	1.50	1.60
30 Year Bund Yield	2.38	2.30	2.30	2.30	2.30	2.40	2.40
2-10 Year Bund Curve	140	140	140	140	140	135	145
10 Year BTP-Bund Spread	283	275	275	250	250	225	225
10 Year Bono-Bund Spread	312	300	300	275	265	250	225
2 Year BTP-Schatz Spread	157	150	140	120	110	100	100
2 Year Bono Schatz Spread	198	185	180	160	140	120	120
10 Year OAT-Bund Spread	62	60	70	70	80	80	80
10 Year Swap Spread (Swap Less Govt.), bp	28	35	35	30	30	30	30
10 Year Breakeven Inflation	150	165	165	170	170	175	175
Japan							
Policy Rate	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3-Month Libor	0.15	0.15	0.15	0.15	0.15	0.15	0.15
2 Year Treasury Yield	0.13	0.15	0.15	0.10	0.10	0.15	0.15
5 Year Treasury Yield	0.33	0.35	0.35	0.30	0.20	0.30	0.30
10 Year Treasury Yield	0.87	0.90	0.90	0.80	0.60	0.80	0.80
30 Year Treasury Yield	1.82	1.85	1.85	1.80	1.65	1.80	1.80
2-10 Year Treasury Curve	74	75	75	70	50	65	65
2 Year Swap Spread (Swap Less Govt.), bp	14	15	15	13	12	13	13
10 Year Swap Spread (Swap Less Govt.), bp	16	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	0.44	0.35	0.35	0.35	0.40	0.40	0.45
5 Year Treasury Yield	1.25	1.05	1.05	1.10	1.20	1.25	1.30
10 Year Treasury Yield	2.16	2.10	2.15	2.25	2.35	2.40	2.50
30 Year Treasury Yield	3.40	3.40	3.45	3.55	3.65	3.70	3.80
2-10 Year Treasury Curve	171	175	180	190	195	200	205
10 Year Swap Spread (Swap Less Govt.), bp	13	10	10	5	5	0	0
10 Year Breakeven Inflation	278	300	310	315	315	320	320
Australia							
Policy Rate	2.75	2.75	2.75	2.75	3.00	3.50	3.50
3-Month Libor	2.96	2.98	3.10	3.30	3.55	3.72	3.75
2 Year Treasury Yield	2.48	2.70	2.83	3.05	3.38	3.60	3.65
5 Year Treasury Yield	2.80	3.10	3.25	3.45	3.80	4.05	4.10
10 Year Treasury Yield	3.39	3.55	3.65	3.85	4.15	4.35	4.40
2-10 Year Treasury Curve	92	85	83	80	78	75	75
10 Year Swap Spread (Swap Less Govt.), bp	60	48	53	60	68	71	72

Source: Citi Research

Commodities Market Outlook

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Commodity markets continue to struggle and, for now, we remain bearish for the short and medium term. Most major commodities that declined 5-10% during the first quarter have fallen a further 5-10% this quarter and the price outlook for 2H'13 remains generally weak. Tepid macro data, weakening Chinese economic growth, the unfolding of looser balances for a diverse basket of underliers (i.e. crude oil, copper, grains) and the return of heightened asset market volatility should continue to weigh on sentiment.

To be sure, 2013 has already been a year of record net withdrawals across the commodity universe, particularly exchange traded funds (ETFs). ETF net redemptions continued for a fifth consecutive month in May and affirm the measurable dislocation between diversified commodity indices vis-à-vis an exchange traded commodity product group dominated by precious metal funds. May data imply net ETF withdrawals north of $3.8Bn inclusive of more than $3.1Bn exiting physical gold fund tickers GLD and IAU; the two largest commodity ETFs globally. A silver lining – if any – is that the May's net outflows fell short of April's record GLD and IAU net redemptions of $7.3Bn and the prior monthly record of $4.1Bn during February albeit the sector sell-off has been ongoing in June. Year-to-date passive index net outflows are also estimated at $10Bn amid an environment whereby investment flows have been unable to gain much positive momentum.

Petroleum markets seem fundamentally soft yet supportive geopolitics and a low North Sea June loading schedule has kept Brent prices in the $100-$105 range. Oil demand continues to stutter; Chinese growth rates are slowing somewhat amidst the weak macro backdrop, European demand continues to fall y/y from a flat base and the US driving season has failed to bring the seasonal lift for gasoline demand. Global stocks are very healthy as US supply growth continues its ≈1-m b/d growth and OPEC agreed to maintain its production target of 30-m b/d despite the call on OPEC crude being below this and realized production above 31-m b/d in May. Supply disruptions in Iraq, Iran, Nigeria and Libya have been supportive. Situations in Syria and Iran continue to worsen as oil markets have started to take note.

Base metals prices have remained relatively range bound in recent weeks. LME Copper levels have been oscillating between $6,800-$7,500/t in recent months and within our range for both fundamental and macroeconomic reasons. Mine supply losses are being matched by growth at new projects. Chinese demand growth, though still positive, appears insufficient to keep the market tight enough to drive prices higher, while positive US demand growth is essentially being countered by generally weaker demand in Europe. Downside moves have been muted by the growing impact of financing demand for metal, consumer buying interest at lower levels, plus the emergence Chinese arbitrage opportunities. In addition, contrary to conventional cost analysis, we believe that recent lows have actually eaten into the cost curve, providing a strong price floor at around $6,700-$6,800/t. Given that we expect the copper market to be in only moderate surplus this year, such cost levels do suggest a degree of price support around the recent lows, further suggesting that copper looks to be fairly priced in its current pattern.

Aluminum remains relatively range-bound as well, trading in a $1,850-$1,950/t band for much of the period since March. Oversupply remains a key characteristic despite recent production announcements; however, downside moves remain limited by contango financing demand for physical metal. Nickel prices have been under extreme pressure, trading down to $14,052/t on June 14th, the lowest levels since June 2009. At current levels, approximately 40% of nickel operations are not making positive margins on a cash price versus cash cost basis, suggesting that prices are close to finding a floor.

For gold, it has now been more than two months since bullion markets crashed through $1,500/oz, and there is little to suggest a bounce-back will occur any time soon. Longer-term investors continue to exit the gold space, highlighted by the continued liquidation of physical ETF holdings, now down over 513 tons or 25% since the beginning of the year. The forthcoming launch of two new RMB-denominated gold ETFs in China could help stem the general ETF outflow trend, given Asian bias to owning the metal, but we suspect this will simply cannibalize existing physical investment demand regionally, providing little in the way of a positive price impact. A further bearish factor for gold is that prices have even failed to react to the softer USD seen since late May. Over the third quarter we expect prices to trend lower within $1,350-$1,420/oz range established since mid-May.

We remain bearish the forward curves for deferred row-crop prices and continue to anticipate relative stability for wheat and rice trading levels both this year and next. On aggregate, staple cereal prices that rose from 2010 to 2011 to 2012 are expected to recede sharply in 2013 and further still in 2014. Lower prices should benefit consumers that have battled volatile markets amid inventory shortfalls, trade bans and weather disasters in recent campaigns. 13/14 corn and soybean balances are poised to loosen on a supply rebound across the Americas; notably the US, Brazil and Argentina. Wheat output should surge ex-US in producing blocs including the Black Sea and Europe. Meanwhile rice inventories and supply/demand fundamentals should remain stable in key Asian markets despite retrenchment in the US production profile. While adverse short-term weather issues must be monitored we view the likelihood of persistence (or repeat of the 2012 drought) as a tail risk. Additionally, we forecast a 'close-to-trend' normalized production rebound that would suggest a bias towards surplus balances materializing.

Figure 44. Commodities Price Forecasts*

		Point Prices													
		0-3M	6-12M		Q1 2012	Q2 2012	Q3 2012	Q4 2012	2012	Q1 2013	Q2 2013E	Q3 2013E	Q4 2013E	2013E	2014E
Energy				**5Y Cyclical**											
NYMEX WTI	USD/bbl	85.0	90.0	81.0	103.0	93.3	92.2	88.2	94.1	94.4	85.0	90.0	90.0	90.0	83.0
ICE Brent	USD/bbl	100.0	103.0	85.0	118.4	108.8	109.4	110.1	111.7	112.6	100.0	105.0	100.0	104.0	93.0
Henry Hub Natural Gas	USD/MMBtu	4.30	4.65	N/A	2.47	2.27	2.87	3.39	2.75	3.48	4.30	4.60	4.70	4.30	4.50
Base Metals				**LT Price**											
LME Aluminum	USD/MT	1,900	2,100	2,200	2,216	2,019	1,944	2,017	2,049	2,042	1,935	1,940	1,985	1,975	1,930
LME Copper	USD/MT	7,200	6,800	6,200	8,314	7,833	7,711	7,921	7,945	7,964	7,600	7,400	7,100	7,515	6,775
LME Lead	USD/MT	2,100	2,300	2,200	2,118	1,987	1,984	2,200	2,072	2,314	2,150	2,100	2,200	2,190	2,200
LME Nickel	USD/MT	18,200	21,000	20,000	19,721	17,228	16,383	17,036	17,592	17,387	17,000	18,500	19,250	18,035	20,900
LME Tin	USD/MT	23,500	24,500	20,000	22,986	20,619	19,281	21,547	21,108	24,128	23,500	23,000	23,500	23,530	23,625
LME Zinc	USD/MT	1,950	2,100	2,100	2,040	1,933	1,902	1,979	1,963	2,057	1,950	1,975	2,000	1,995	2,050
Precious Metals				**LT Price**											
COMEX Gold	USD/T. oz	1,600	1,450	1,050	1,691	1,613	1,654	1,718	1669	1632	1580	1555	1455	1555	1435
Silver	USD/T. oz	29	26	16.5	32.6	29.6	29.9	32.6	31.2	30.1	28.0	27.8	26.5	28.1	25.9
Platinum	USD/T. oz	1,515	1,555	1,531	1,604	1,505	1,500	1,600	1552	1634	1515	1523	1530	1550	1625
Palladium	USD/T. oz	790	900	680	683	630	613	653	645	741	790	825	875	810	950
Bulk Commodities				**5Y Cyclical**											
Hard Coking Coal (benchmark Asia)	USD/MT	172	185	200	235	215	225	170	211	165	172	165	180	171	190
Thermal Coal Asia (NEWC)	USD/MT				113	88	88	86	94	91	88	88	90	89	94
Iron Ore Spot (TSI)	USD/MT	130	123	81	142	139	112	121	128	148	130	115	120	128	122
Agriculture															
CBOT Corn	USd/bu	630	500	N/A	641	618	783	737	695	715	630	600	515	615	500
CBOT Wheat	USd/bu	700	720	N/A	643	641	870	846	750	738	700	720	720	720	775
CBOT Soybeans	USd/bu	1,450	1,175	N/A	1,272	1,426	1,675	1,485	1,465	1,448	1,435	1,300	1,175	1,340	1150
CBOT Rice	USD/cwt	15.4	15.3	N/A	14.3	14.8	15.3	15.1	14.9	15.3	15.4	15.4	15.2	15.3	15.0
NYB-ICE Cotton	USd/lb	85	90	N/A	93	81	73	73	80	82	85	85	90	86	N/A
Sugar#11	USd/lb	18.0	18.0	N/A	24.5	21.2	21.0	19.6	21.6	18.4	18.0	18.0	18.0	18.1	N/A
ICE Coffee	USd/lb	133	138	N/A	205	171	172	152	175	144	130	136	140	138	N/A
ICE Cocoa	USD/MT	2,400	2,430	N/A	2,308	2,221	2,440	2,420	2,348	2,176	2,275	2,425	2,450	2,330	N/A

Source: Citi Research, *subject to revision

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Appendix A-1

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