FINANCIAL MARKET ANALYSIS

Volume 14, Issue 8 **February 24, 2014**

Mixed economic data

Highlights

- Economic data are mixed with the US and Japan raising concern that the acceleration seen in 2H of 2013 has lost steam. Despite the losses to output from weather delays and soft housing market data that may dampen growth in 1Q this year, Citi analysts believe the US economy may bounce back supported by continued highly accommodative financial conditions and ample resource availability.
- In Japan, GDP grew only 1.0% QoQ annualized, much weaker than expected. While expecting high volatility in upcoming data, Citi analysts expect further easing steps after the tax hikes to boost the economy.
- Meanwhile, China's PBOC governor indicated 7 to 8% GDP growth is appropriate, market positive, a proxy pledge by PBOC to limit downside growth risk concern.
- Despite mixed data, Citi analysts have made minor changes in its views and asset allocations and remained overweight in equity and selective North Asian markets.

Performance

- After the V-shaped down-and-ups for weeks, equity markets now seem to have relatively stabilised. Stock markets ended the week slightly higher with the MSCI world gaining 0.55%. The S&P 500 lost 0.13%. But Europe and Japan continued to grind higher with the Stoxx Europe 600 rising 0.83% and the Topix gaining 3.25% over the week. The MSCI Asia ex Japan too rose 0.8% led by Indonesia (JCI +3.06%), Philippines (PSE +3.18%), Singapore (STI +2.01%) and Hong Kong (HSI +1.21%).

The Week Ahead

- The US will see durable goods orders, new home sales, Q4 GDP, and the conference Board consumer confidence coming out this week.
- In Europe, HICP inflation, M3 numbers and the German Ifo data will attract attention.
- In Japan, the data flow is heavy with the major monthly economic data for January due out this week including Industrial production, core CPI, unemployment rate, real household consumption.
- In China, the NBS PMI for February will be in focus. Elsewhere in emerging Asia, India Q4 GDP and industrial production numbers from Taiwan, Korea, Singapore and Thailand will be released.

	Feb 21 Close	Last week's return	YTD Return	YTD return (USD)
S&P 500:	1836.25	-0.13%	-0.66%	-0.66%
Stoxx Europe:	336.09	+0.83%	+2.39%	+1.98%
Topix:	1222.31	+3.25%	-6.14%	-3.91%
MSCI Asia ex Japan:	534.44	+0.80%	-3.08%	-3.08%

Citigold

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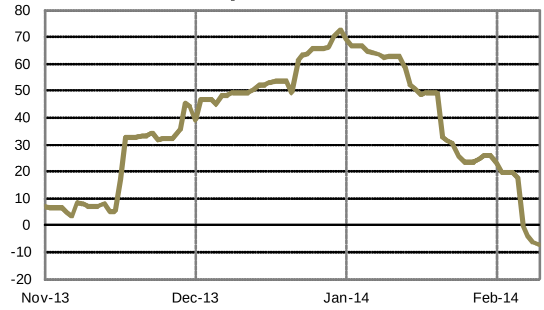
US/NORTH AMERICA

Citi Economic Surprise Index - US



Source: Bloomberg

Economic Outlook

Room to Grow

Despite a weakening start to the year, Citi analysts have made only minor changes to the outlook with growth still expected to improve slightly on last year's upside surprise. Much of the losses to output from weather delays and disruptions can be made up quickly but some may not be recoverable. Greater, more costly energy consumption has drained an estimated $20 billion from consumers' discretionary budgets in Q1.

The outlook derives key support from continued highly accommodative financial conditions and ample resource availability. With an output gap very conservatively estimated between 2% and 4%, there is scope for at least a year or two of above-average gains in GDP, with unemployment expected to decline to near 6% later this year. Housing has proved especially vulnerable to weather extremes, but only moderate gains are expected in residential investment this year.

With forecasts not dissimilar from the Fed's, Citi analysts still expect an end to QE by fall, with pre-tightening operations beginning toward mid-2015. Initial rate hikes could prove too slow, but it is far too soon to judge how this risk would play out, either as sharper rate hikes later, rising price pressures or other imbalances that could eventually undermine expansion.

S&P 500 (21/11/2013 to 21/2/2014)

Source: Bloomberg

	Last week's close	Last week's return	YTD return
S&P 500	1836.25	-0.13%	-0.66%
DJIA	16103.30	-0.32%	-2.86%
Nasdaq	4263.41	+0.46%	+2.08%

- **End-2014 S&P500 Index Target: 1975**

Equities

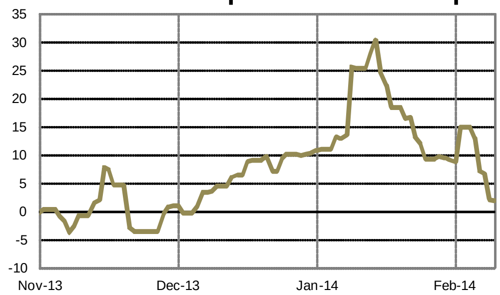
Fall in Consumer stocks do not equate to weak consumer segment

With equities off slightly, investors have been hit hard in the Consumer Discretionary sector, despite signs of greater household wealth, employment growth (albeit recently disrupted seemingly by weather) and respectable consumer spending trends. However, given valuation issues and lead indicators, plus earnings estimate revision momentum, the underperformance is not surprising and is expected to continue.

While there is a tendency to connect stock price shifts to some fundamental driver, it must be understood that share prices might discount other dynamics as well, such that the underlying health of the US consumer is not being questioned.

Indeed, there are many positive signs regarding US consumers including higher home prices, rising hiring intentions, lower debt service as well as pent-up demand. Hence, the consumer side of the economy may be in better shape than even consumer sentiment data implies.

Citi Economic Surprise Index - Europe



Source: Bloomberg

Economic Outlook

German Inflation: Lower For a Little Longer

German inflation has been subdued recently, falling to 1.3% YoY in January after 1.5% in 2013 and 1.6% pa in the 2000-2012 average. The weakness in German inflation has had two main drivers: First, 'imported' inflation has been very weak, deducting up to 1pp from CPI inflation over the last year. Second, domestic price pressures have remained low, as a sluggish economy held down wage pressures.

Citi analysts expect domestic price pressures to increase in the course of this year and beyond, as a strengthening economy and the prospect of a national minimum wage raise wage growth. Continued disinflationary pressure from the strong euro and low energy and import prices should still keep inflation quite low in 2014 (we expect 1.5%), but stronger domestic price pressure may push up inflation in 2015 to 1.9%.

German consumer prices and unit labour costs are outgrowing the Eurozone periphery by 1pp and 2-3pp per year, respectively. That is enough to help those countries generate current account surpluses, but too low to lift the Eurozone out of the deflation 'danger zone' or to help the periphery address their debt sustainability challenges. Importantly, it is probably too high for the ECB to adopt QE.

STOXX (21/11/2013 to 21/2/2014)

Source: Bloomberg

	Last week's close	Last week's return	YTD return
STOXX	336.09	+0.83%	+2.39%
FTSE 100	6838.06	+2.62%	+1.32%
DAX	9656.95	-0.06%	+1.10%

Equities

European Equities Remain Relatively Resilient

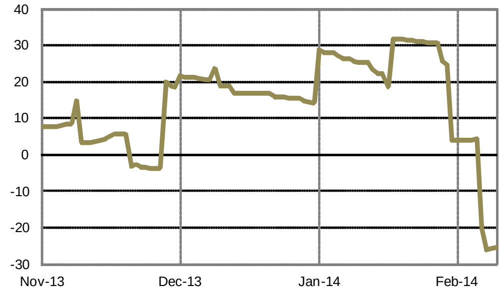
UK and European equities have returned 120-30% since the 2009 lows, with much higher returns from small- and mid-caps. Last year, UK and European equities returned over 20%, mostly achieved through re-rating rather than earnings.

Shares have largely moved higher in the last couple of years because the "bad stuff", ie Euro Area break-up and US stall speed, has not happened. Now, with valuations in fair value territory, as opposed to being cheap, further progress will likely be dependent on the "good stuff" happening, ie earnings growth.

Citi analysts expect earnings to grow 10% in 2014, which supports their bullish view. However, higher equity valuations also raise markets' vulnerability to risk and uncertainty. While both have fallen in Europe and the US in the past few quarters, EM risks have flared up in the past couple of weeks. This has driven the third 5%+ pullback in European equities since start-2012. Despite the pull-back, European equities have been more resilient than US, EM and Japanese equities year-to-date.

- **End-2014 Stoxx Index Target: 370**

Citi Economic Surprise Index - Japan



Source: Bloomberg

Economic Outlook

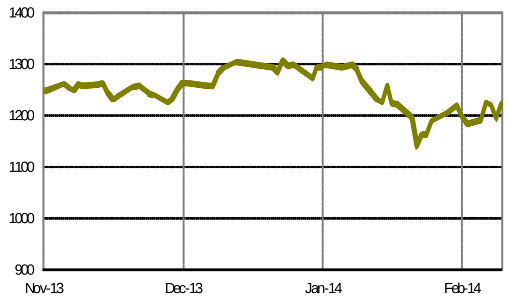
Real exports continue to lack momentum

Real exports (the seasonally-adjusted export value divided by the seasonally-adjusted export price index) dropped 3.2% MoM in January. In Citi analysts' view, the large fall was partly caused by slower exports associated with the Chinese New Year and thus does not signal a turnaround to a decreasing trend. Meanwhile, real imports (the seasonally-adjusted import value divided by the seasonally-adjusted import price index) increased significantly by 5.2% MoM in January. Rush demand ahead of the tax hike has prompted increased imports of durable goods since the fourth quarter of 2013, in addition to ongoing strong imports of mineral fuels including LNG.

In the customs-clearance data, the trade deficit logged a new record of ¥1.8188trn after seasonal adjustment in January (-¥2.79trn before adjustment). That said, the latest trade gap was exaggerated by transient factors including: 1) an export decline to the greater China region due to the Lunar New Year holiday; and 2) rush demand–driven import growth ahead of the consumption tax hike in Japan.

Citi analysts believe real exports have continued to seesaw since the third quarter of 2013 with the trend of the trade balance remaining in deeply negative territory. While Citi analysts expect the balance to start improving in the second quarter after the tax hike, it looks unlikely to grow out of the red figure.

Topix (21/11/2013 to 21/2/2014)



Source: Bloomberg

	Last week's close	Last week's return	YTD return
Nikkei	14865.67	+3.86%	-8.75%
Topix	1222.31	+3.25%	-6.14%

- **End-2014 Topix Index Target: 1520**

Equities

Gap between share prices and fundamentals likely to shrink

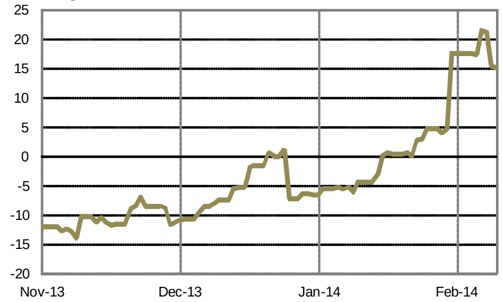
Japanese equities have pulled back sharply since late January and have underperformed the equity indexes of other major regions. However, Citi analysts do not see any justification for the underperformance on fundamentals.

The Japan fundamentals are not turning inferior to those of other countries. October–December results, announced from late January, were ahead of prior forecasts, with publicly traded firms reporting cumulative October–December recurring profits (RP) growth of 43.3% YoY. Japan's revision index is the only one that is in positive territory among developed markets. Also the 2014 forecast EPS growth rate is higher than those for other countries and the PER is low, alongside that of Europe, for a developed market region

In addition, Citi analysts have highlighted moves to boost shareholder returns via dividend hikes and noted the possibility that total dividends could overtake the peak reached before the global financial crisis in FY3/14.

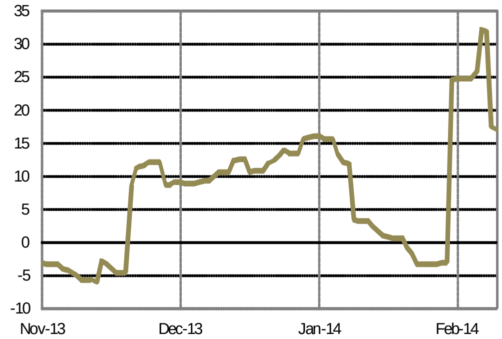
The BoJ boosted lending support measures last week triggering a strong rebound as a result of the shrinkage of the gap between share prices and fundamentals. Citi analysts think the gap between Japanese share prices and fundamentals may close further, despite the country-specific lack of visibility on the consumption tax hike.

Citi Economic Surprise Index – Asia Pac Ex Japan



Source: Bloomberg

Citi Economic Surprise Index – China



Source: Bloomberg

MSCI AC Asia ex Japan (21/11/2013 to 21/2/2014)

Source: Bloomberg

	Last week's close	Last week's return	YTD return
MSCI AC Asia ex Japan	534.44	+0.80%	-3.08%

- **End-2014 MSCI AC Asia ex Japan Index Target: 660**

Economic Outlook

Thoughts On Recent USDCNY Movements

PBOC continues to set the USDCNY for weakening in the fifth consecutive session. Citi analysts think this mainly reflects PBOC's intention to introduce two-way volatility in the exchange rate, paving way for the widening of the trading band.

Current account surplus was 2.1% of GDP in 2013. Citi's economic forecast envisages pickup of growth in advanced economies and slowdown in China in 2014-15, suggesting the surplus may stay or be even larger. As long as the current account remains in surplus, there is likely to be economic arguments and international political pressure for appreciation.

Meanwhile, with the Fed tapering on track which may reduce capital inflows or cause periodic capital outflows (in light of the degree of liability dollarization of the corporate sector), Citi analysts expect appreciation pressures to ease over time. Citi analysts therefore forecast limited appreciation of the currency in the next 12 months with USDCNY spot reaching around 6.0.

Equities

Taiwan: Implications of Cross-Strait Relations

The year 2014 could prove to be an important turning point from the standpoint of cross-strait relations. The recent meeting between Mainland Affairs Council Chairman WANG Yu-chi and ZHANG Zhijun, head of China's Taiwan Affairs Office, marked the first government to- government interface since between the two sides ever. Next month, Taiwan's Legislative Yuan will bring to a vote the ratification of the Cross-Strait Agreement on Trade in Services signed back in June of last year. Its passage is likely to pave the way for the more important Cross-Strait Agreement on Trade in Goods which could be signed as early as late this year.

One likely development facilitated by the Wang-Zhang meeting is the progress on the issue of double taxation. Currently, Taiwanese companies are unable to repatriate their China-derived accumulated income back without incurring a second tax income tax bill. Discussions are currently in place to eliminate that double taxation although whether it applies retroactively is still uncertain. If so, the implication for cross-border capital flows, which have turned quite negative over the past 3 years, could improve.

In addition, the agreement allows for PRC banks to take up to a 15% stake in Taiwanese financial holding companies or 20% of individual banks. It allows for Taiwan brokers to own 51% of a Chinese broker. It also provides a framework by which Taiwanese banks expand more aggressively in China. Already the agreement is having a meaningful impact on the Taiwan financial sector.

Developed Markets

24 February (Monday)

- **Europe** — Inflation should be confirmed at 0.7% YoY in the final January print, as incoming information from member states' Harmonized Indices of Consumer Prices (HICPs) has been consistent with a decline in the headline rate at the euro area level.

25 February (Tuesday)

- **US** — Citi analysts look for very little change in consumer confidence in February (80.5), mirroring other measures of sentiment.
- **Europe** — Citi analysts expect the first reading for German 4Q GDP to be confirmed at 0.4% QoQ.

26 February (Wednesday)

- **US** — Citi analysts look for another decline in new home sales in January to 380K, reflecting the severe winter weather.
- **Europe** — Surveys suggest that UK service sector output is expanding quite strongly, and hence Citi analysts expect another solid gain in December (0.3% MoM, 3.1% YoY).

27 February (Thursday)

- **US** — Initial jobless claims for the week ending February 22 probably edged lower to 330K.
- **US** — Citi analysts look for another large decline in durable goods orders in January (-3.5%).
- **Europe** — Citi analysts expect a small bounce back in Feb business climate in Italy, after an unexpected drop in January (98.0).
- **Europe** — Citi analysts expect the final 4Q GDP reading (+0.3% QoQ, highest quarterly rate since 1Q08) to confirm the end of recession in the Spanish economy in 2H 2013, after two years of QoQ contractions.

28 February (Friday)

- **US** — Data since the advance GDP release indicated that the economy grew much more slowly at 2.2% in the fourth quarter than first reported.
- **US** — Citi analysts anticipate a substantial drop-off in the Chicago business barometer in February to 55.0.
- **Europe** — French Consumer spending is forecast to decline for the second successive month in January (-0.6% MoM, 1.0% YoY).
- **Europe** — Judging from the monthly data during 4Q, Swedish GDP looks set to undershoot the Riksbank's 0.7% QoQ forecast at 0.4%.
- **Japan —** The nationwide core CPI (the CPI excluding fresh food) likely rose 1.2% YoY in January (+1.3% in December).
- **Japan —** January real spending of all households likely increased 1.2% YoY and 2.7% MoM due to rush demand before the consumption tax hike in April as well as stronger demand for seasonal goods.
- **Japan —** Citi analysts expect the unemployment rate to be 3.7% in January with the effective job-offers-to-seekers ratio coming to 1.04.
- **Japan —** January industrial production likely increased 3.0% MoM (+0.9% MoM in December). The official projection points to a 6.1% MoM gain.
- **Japan —** Retail sales probably increased 3.7% YoY in January.
- **Japan —** January housing starts may stand at 1,013k (+15.3% YoY) on a seasonally adjusted annualized basis.

Asia ex-Japan

During the week

- **Thailand —** Base effects and high manufacturing inventory ratios probably led January import growth to remain negative (-20.6% YoY).

24 February (Monday)

- **Singapore —** CPI inflation is expected to ease to 1% YoY in January on lower COE premiums.
- **Taiwan —** January IP likely to fall by 1.9% YoY with less working days during the Lunar New Year period.

25 February (Tuesday)

- **Hong Kong —** Trade growth is likely to be in the red in January (exports: -4.4% YoY; imports: -1.1% YoY) due to the Lunar New Year base effects.
- **Philippines —** Imports may fall by 4.6% YoY in December due to the typhoon disasters alongside weak Peso and base effects.

26 February (Wednesday)

- **Hong Kong —** Citi analysts expects a strong expansionary bias in the Budget Speech due to higher recurrent expenditure committed in the Policy Address, with upward adjustments in a variety of government charges to secure more fiscal revenue.
- **Hong Kong —** The economy likely continues to recover in 4Q as GDP growth inched higher to 3% YoY.
- **Singapore —** In January, IP growth likely slowed to 3.9% YoY partly due to the Lunar New Year base effects.

28 February (Friday)

- **India —** 3Q FY14 GDP growth likely rose to 5.2% YoY, led by the agriculture sector.
- **Korea —** January IP likely fell by 1.4% YoY partly due to the Lunar New Year base effects.
- **Thailand —** Negative growths on manufacturing output (-4.8% YoY) likely persisted in January due to base effects and elevated manufacturing inventory ratios.

1 March (Saturday)

- **China —** The official manufacturing PMI may come lower at 50.1 in February on slower demand and output.
- **Korea —** February export growth likely returned to positive (1.6% YoY) as tech & shipbuilding sectors continued to pick up.

WORLD MARKETS AT A GLANCE

	Previous Week's Close	52-Week High	52-Week Low	Weekly Return	YTD Return	YTD Return (USD)
UNITED STATES						
Dow Jones Industrial Average	16103.30	16588.25	13784.01	-0.32%	-2.86%	-2.86%
S&P 500	1836.25	1850.84	1485.01	-0.13%	-0.66%	-0.66%
Nasdaq	4263.41	4284.85	3105.37	+0.46%	+2.08%	+2.08%
EUROPE						
DJ Euro STOXX	336.09	337.65	274.97	+0.83%	+2.39%	+1.98%
FTSE 100	6838.06	6875.62	6023.44	+2.62%	+1.32%	+1.77%
DAX	9656.95	9794.05	7418.36	-0.06%	+1.10%	+0.62%
JAPAN						
Nikkei 225	14865.67	16320.22	11175.67	+3.86%	-8.75%	-6.58%
TOPIX	1222.31	1308.08	948.58	+3.25%	-6.14%	-3.91%
ASIA						
MSCI Asia ex Japan	534.44	566.88	475.70	+0.80%	-3.08%	-3.08%
Hong Kong Hang Seng	22568.24	24111.55	19426.36	+1.21%	-3.17%	-3.20%
Shanghai Composite Index	2113.69	2369.65	1849.65	-0.10%	-0.11%	-0.74%
Taiwan Weighted Index	8601.86	8668.95	7663.23	+1.04%	-0.11%	-1.77%
Korea KOSPI	1957.83	2063.28	1770.53	+0.90%	-2.66%	-4.32%
Mumbai Sensex	20700.75	21483.74	17448.71	+1.64%	-2.22%	-2.68%
Singapore Straits Times Index	3099.93	3464.79	2953.01	+2.01%	-2.13%	-2.52%
Kuala Lumpur Composite	1830.74	1882.20	1611.70	+0.62%	-1.94%	-2.39%
Thai Stock Exchange	1304.21	1649.77	1205.44	-0.58%	+0.42%	+1.43%
Jakarta Composite Index	4646.15	5251.30	3837.74	+3.06%	+8.70%	+13.19%
Philippines Stock Exchange Index	6308.36	7403.65	5562.13	+3.18%	+7.11%	+6.69%
Australia All Ordinaries	5449.43	5466.00	4610.60	+1.54%	+1.80%	+2.24%
EMEA						
Russia MICEX Index	1487.64	1538.74	1271.48	-0.57%	-1.09%	-8.14%
South Africa JSE All Shares Index	47452.24	47616.85	37717.78	+1.77%	+2.59%	-1.27%
Turkey ISE National 100 Index	63885.62	93398.33	60753.53	-1.54%	-5.78%	-6.89%
LATIN AMERICA						
Mexico Bolsa Index	39724.58	44466.74	37034.30	-2.42%	-7.03%	-8.21%
Brazil Bovespa Index	47380.24	59472.49	44107.06	-1.70%	-8.01%	-7.66%
COMMODITIES						
Gold	1324.28	1620.37	1180.50	+0.42%	+9.84%	+9.84%
Oil	102.20	112.24	85.61	+1.89%	+3.84%	+3.84%
FIXED INCOME						
Citi Treasury Index	1360.19	1392.61	1331.45	+0.04%	+1.23%	+1.23%
Citi World Big Index	197.69	198.49	190.96	+0.07%	+1.60%	+1.60%
Citi World Govt Index	647.67	650.43	627.83	+0.05%	+1.59%	+1.59%
Citi High Yield	835.79	835.79	767.09	+0.53%	+2.06%	+2.06%
Citi Global Emerging Mkt Sovereigns	644.90	688.93	612.40	+0.42%	+0.86%	+0.86%
Citi GEM Sovereign Asia	564.64	607.61	509.39	+1.15%	+2.48%	+2.48%

Source: Bloomberg (As at February 21, 2014)

CURRENCY FORECASTS

Currency		24-Feb-14	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16
G10											
Euro	EURUSD	1.37	1.37	1.38	1.39	1.40	1.40	1.4	1.41	1.41	1.41
Japanese yen	USDJPY	102	105	106	107	108	109	111	112	114	115
British Pound	GBPUSD	1.66	1.71	1.74	1.76	1.77	1.76	1.76	1.75	1.74	1.74
Swiss Franc	USDCHF	0.89	0.90	0.90	0.89	0.89	0.90	0.90	0.91	0.91	0.91
Australian Dollar	AUDUSD	0.90	0.90	0.90	0.91	0.91	0.91	0.91	0.92	0.92	0.92
New Zealand	NZDUSD	0.83	0.83	0.84	0.85	0.85	0.85	0.85	0.85	0.85	0.85
Canadian Dollar	USDCAD	1.11	1.13	1.14	1.15	1.15	1.15	1.15	1.15	1.15	1.15
Swedish Krona	USDSEK	6.53	6.56	6.45	6.34	6.28	6.26	6.25	6.23	6.21	6.19
Norwegian Krone	USDNOK	6.07	6.04	5.91	5.79	5.69	5.64	5.59	5.54	5.49	5.44
EM Asia											
Chinese Renminbi	USDCNY	6.09	6.04	6.02	6.01	6.00	6.00	6.00	6.00	6.00	6.00
Hong Kong	USDHKD	7.76	7.75	7.75	7.76	7.76	7.76	7.76	7.75	7.75	7.75
Indonesian Rupiah	USDIDR	11688	12008	12082	12158	12182	12143	12103	12063	12023	11911
Indian Rupee	USDINR	62.1	61.60	62.60	63.70	64.10	63.90	63.70	63.40	63.10	62.70
Korean Won	USDKRW	1076	1061	1068	1076	1077	1071	1065	1059	1053	1048
Malaysian Ringgit	USDMYR	3.30	3.33	3.36	3.39	3.40	3.39	3.39	3.38	3.37	3.36
Philippine Peso	USDPHP	44.6	45.00	45.30	45.60	45.50	44.90	44.40	43.90	43.30	42.90
Singapore Dollar	USDSGD	1.27	1.27	1.28	1.29	1.30	1.29	1.28	1.27	1.26	1.26
Thai Baht	USDTHB	32.6	33.50	33.90	34.30	34.40	34.10	33.80	33.50	33.20	32.90
Taiwan Dollar	USDTWD	30.3	30.30	30.40	30.50	30.40	30.20	30.10	29.90	29.70	29.60
EM Europe											
Czech Koruna	USDCZK	19.93	19.85	19.83	19.8	19.7	19.5	19.3	19.11	18.91	18.74
Hungarian Forint	USDHUF	225	230	234	237	239	238	237	236	235	234
Polish Zloty	EURPLN	3.02	3	3.04	3.08	3.09	3.05	3.01	2.97	2.93	2.9
Israeli Shekel	USDILS	3.50	3.5	3.54	3.58	3.62	3.67	3.72	3.77	3.82	3.83
Russian Ruble	USDRUB	35.5	36.5	37.1	37.8	38.1	38.1	38.1	38	38	38
Turkish Lira	USDTRY	2.18	2.3	2.34	2.38	2.41	2.43	2.45	2.47	2.49	2.48
South African Rand	USDZAR	10.96	11.22	11.41	11.59	11.68	11.64	11.6	11.56	11.52	11.44
EM Latam											
Brazilian Real	USDBRL	2.35	2.46	2.55	2.65	2.71	2.74	2.77	2.80	2.83	2.83
Chilean Peso	USDCLP	555	556	569	583	590	590	590	590	590	586
Mexican Peso	USDMXN	13.3	13.30	13.20	13.20	13.10	13.00	12.90	12.80	12.70	12.70
Colombian Peso	USDCOP	2044	2064	2097	2131	2150	2150	2150	2150	2150	2138

Source: CR, Bloomberg (As of February 24, 2014; Forecasts as of February 21, 2014)

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