FINANCIAL MARKET ANALYSIS

Volume 12, Issue 04 **February 6, 2012**

Equity markets extend winning streak on positive economic data

Global stock markets continued their weekly advance as reports showing improvements in manufacturing in the US, China, India and Europe, and better-than-expected US employment data overshadowed a stalemate over Greek debt negotiations. The S&P 500 index registered a weekly gain of 2.2% to close at 1,344.90, the Stoxx Europe rose 3.40% to 247.71 and the MSCI Asia ex Japan climbed 1.65% to 439.94. Negotiations around the Greek private sector involvement (PSI) deal remain the main focus this week as uncertainty continues over whether Athens can finalize its second bailout before the major debt redemption on March 20. Eurogroup chairman Juncker's announcement on Friday that the Eurozone finance minister meeting scheduled on February 6 will not go ahead raises concerns that the PSI deal is further away than otherwise expected. The European Central Bank board meeting follows on Thursday and on the data front we get German factory orders (Monday) and German IP (Tuesday). In the UK, the Bank of England meets on Thursday; data to watch includes IP and trade balance (Thursday) with PPI on Friday. US data is less heavy, with trade balance and University of Michigan confidence (Friday) being the main events. In Asia Pacific, policy meetings and Chinese data (CPI, WPI, trade data, money growth and new Yuan loans) are likely to be the market focus this week. The Reserve Bank of Australia meets on Tuesday followed by Bank Indonesia and Bank of Korea on Thursday.

	Feb 3 Close	Last week's return	YTD Return	YTD return (USD)
S&P 500:	1344.90	+2.17%	+6.94%	+6.94%
Stoxx Europe:	247.71	+3.40%	+9.71%	+11.23%
Nikkei 225:	8831.93	-0.11%	+4.45%	+5.04%
MSCI Asia ex Japan:	439.94	+1.65%	+12.01%	+12.01%

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- *Asia Pacific ex Japan economy: China: Threefold policy easing expected to counter a soft patch*

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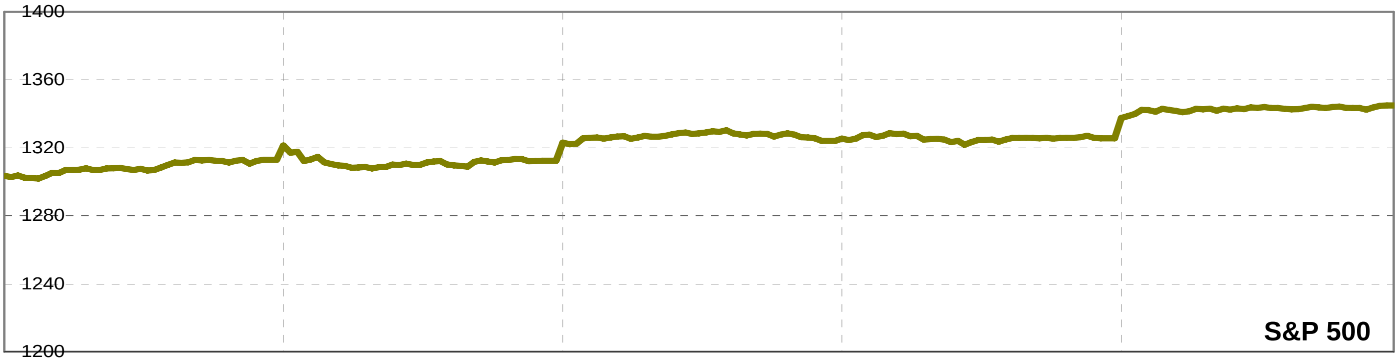
TAKING STOCK



Monday Jan 30

S&P:	-0.25%
STOXX:	-1.42%
Nikkei:	-0.54%
MSCI Asia ex Japan:	-1.13%

US: Personal income rose 0.5% in Dec, reflecting not only the 200K rise in payrolls in the month, but also the uptick in the workweek and the rise in average hourly earnings. Spending was flat in nominal terms and down a tenth in real terms.

US: The Dallas Fed Manufacturing index was 15.3 in Jan vs. -0.3 in Dec. The output index was 5.8 in Jan vs. 0.2 in Dec.

EU: The Jan EU Commission survey on the Eurozone revealed an improvement in general economic sentiment, with the headline economic sentiment indicator rising to 93.4 in Jan from 92.8 in Dec. This was however below market expectations of 93.8.

EU: Preliminary data showed German CPI falling -0.4% MoM in Jan, causing the annual rate to dip back to 2.0% from 2.1% YoY in Dec.

EU: Preliminary 4Q11 GDP in Spain fell -0.3% QoQ to turn in a 0.3% yoY growth rate. This is a deterioration from 0.0% QoQ (0.8% YoY) in 3Q11.

AP: Taiwan's unemployment rate fell to 4.22% s.a. in Dec from 4.32% s.a. in Nov.

Tuesday Jan 31

S&P:	-0.05%
STOXX:	+0.69%
Nikkei:	+0.11%
MSCI Asia ex Japan:	+1.13%

US: The employment cost index increased 0.4% in 4Q11, vs. +0.3% in 3Q11.

US: The Jan Chicago headline PMI fell to 60.2, from 62.2 in Dec and below market expectations of 63.0.

US: The Conference Board Jan consumer confidence estimate fell to 61.1, from a revised 64.8 in Dec (prev. 64.5), contributing to an increase in the 3-month average of 60.4 (from 53.6).

US: The Nov S&P/Case-Shiller composite home price index fell -3.67% YoY, vs. Oct -3.42% YoY, and consensus expectations of -3.30% YoY.

EU: The Eurozone unemployment rate was unchanged at 10.4% in Dec.

EU: German ILO-based seasonally adjusted employment rose 47.0K in Dec, vs. +70K in Nov and +37.0K in Dec '10.

EU: German Jan seasonally adjusted unemployment fell 34K. The unemployment rate fell to 6.7% from 6.8% in Dec.

JP: Industrial production rose 4.0% MoM (-4.1% YoY) in Dec after -2.7% MoM (-4.2% YoY) in Nov, vs. market expectations of +3.0% MoM.

JP: Real consumer spending in the Household Survey rose 0.5% YoY in Dec, the first rise since last Feb.

AP: Singapore's 4Q11 unemployment rate was unchanged vs. 3Q11 at 2.0% s.a.

Wednesday Feb 1

S&P:	+0.89%
STOXX:	+2.29%
Nikkei:	+0.08%
MSCI Asia ex Japan:	+0.00%

US: The Jan ADP employment estimate increased +170K, vs. +292K in Dec, just below market expectations for +182.

US: The ISM manufacturing index rose to 54.1 in Jan, from 53.1 in Dec and vs. market expectations of 54.5.

US: Construction spending rose 1.5% in Dec. vs. market expectations of 0.6% and 0.4% in Nov. In Dec, private construction spending rose 2.1%, while public rose 0.5%.

EU: The preliminary estimate of Eurozone Jan HICP inflation was 2.7% YoY, the same as the previous figure.

EU: Belgian 4Q11 GDP was -0.2% QoQ, down from -0.1% QoQ in 3Q11.

EU: Switzerland's Jan PMI fell to 47.3 from 49.1 in Dec, (Consensus 51.2).

EU: Sweden's Jan PMI rose to 51.4 from 48.9, outpacing expectations of 49.5 and taking the manufacturing index to notably above the neutral mark for the first time since last Jul.

EU: Norway's Jan PMI jumped to 54.9 from 46.6, taking the manufacturing index to expansionary territory for the first time since Sep.

EU: The UK manufacturing PMI for Jan rose to 52.1, well above market expectations of 50 after 49.6 in Dec.

EU: UK Jan Nationwide house prices fell -0.2% MoM, vs. -0.2% MoM in Dec.

AP: Singapore Jan headline PMI was more contractionary than expected at 48.7 (Dec 49.5, Consensus 49.4).

Thursday Feb 2

S&P:	+0.11%
STOXX:	+0.37%
Nikkei:	+0.76%
MSCI Asia ex Japan:	+1.53%

US: Initial jobless claims for the week ending 28 Jan decreased -12K to 367K, vs. 379K in the week prior, below market expectations for 371K. The 4-week average was reported at 375.8K, down from 377.8K in the week prior.

US: The preliminary 4Q11 Labor Department productivity report revealed an overall increase of 0.7%, vs. the +1.9% reading in 3Q11, in line with market expectations for 0.8%. Unit labour costs increased 1.2% in 4Q11, vs. -2.1% in 3Q11, above market expectations for +0.8%.

EU: Eurozone Dec PPI declines -0.2% MoM to register a 4.3% YoY rate, down from 5.3% YoY in Nov.

EU: The 51.4 print on the UK Jan construction sector PMI disappoints, against market expectations of a 52.6 outturn, following a 53.2 print in Dec, and represents the slowest rate of expansion since Sep '11.

AP: Hong Kong retail sales value rose 23.4% YoY in Dec (Nov 23.4% YoY), while retail sales volume rose 17.1% YoY vs. 16.9% YoY in Nov.

Friday Feb 3

S&P:	+1.46%
STOXX:	+1.46%
Nikkei:	-0.51%
MSCI Asia ex Japan:	+0.13%

US: Non-farm payrolls rose +243K in Jan vs. +203K in Dec and market expectations of +140K. The unemployment rate fell to 8.3% from 8.5%, the lowest rate since Feb '09.

US: The Jan ISM non-manufacturing index rose to 56.8 vs. 53.0 in Dec and market expectations of 53.2.

US: Dec factory orders rose 1.1% vs. 2.2% in Nov and market expectations of 1.5%.

EU: A Greek bailout deal is reportedly held up by Greek employers/unions rejecting private-sector wage cuts as demanded by the troika.

EU: Final Jan German services PMI was revised down to 53.7 (flash 54.5, Dec 52.4). This causes the final Eurozone services print to be revised down slightly to 50.4 (flash 50.5, Dec 48.8). The final estimate of the Eurozone composite PMI was left unchanged at 50.4 (Dec 48.3).

EU: UK services sector PMI rose to 56.0 in Jan from 54.0 in Dec (Consensus 53.5).

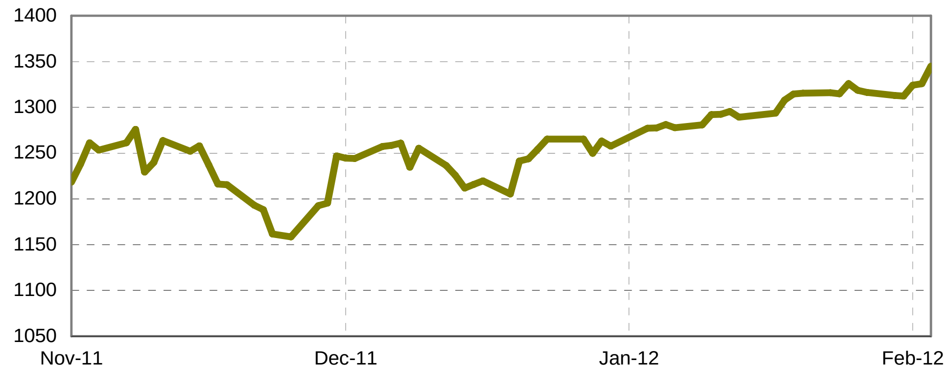
Over the Weekend Feb 4 and Feb 5

Others: --

Please note: Citi analysts' comments are in italics. Source: Bloomberg, Reuters, Associated Press, CIRA

US/NORTH AMERICA

S&P 500 (1/11/2011 to 3/2/2012)



Source: Bloomberg

Economic Outlook

Some drags on recovery may be diminishing

Data and market developments since the start of the year have bolstered impressions that the economic recovery may be on a more durable if only modest track. The first round effects of recent monetary policy actions in the US and Europe have provided a visible lift to financial conditions key to sustaining moderate demand growth.

Indeed, the January jobs report was considerably stronger than expected on several counts with recent payroll growth easily in a range that can potentially sustain declines in unemployment. The broadening base of hiring gains is especially encouraging for recovery's staying power as the drags from intense job losses in some areas appear to be diminishing.

Although the better jobs picture suggests some upside to near-term growth estimates, Citi analysts believe we may first need to see strength in consumer demand along with a sustained backdrop of improved financial conditions. The jump in January car sales suggests the rise in the December savings rate was not the beginning of a new retrenchment. Rather, it reflected the windfall effects of lower energy prices and a mild winter.

The Week Ahead

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- **Initial jobless claims** for the week ending February 3 probably were little changed from the prior week at 365K.

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- Citi analysts look for little change in the December **trade balance** (-US$48.0 billion), but the report likely featured a rebound in exports and a similar petroleum-led rise in imports.
- Citi analysts look for another increase in **consumer sentiment** in early February (76.5).

Equities

Near term could see some pullback

	Last week's close	Last week's return	YTD return
S&P 500	1344.90	+2.17%	+6.94%
DJIA	12862.23	+1.59%	+5.28%
Nasdaq	2905.66	+3.16%	+11.54%

Investors have become more worried about corporate earnings again, since the proportion of S&P 500 companies that have beaten 4Q11 earnings estimates thus far has dipped to 60% after being the 70%+ range for the past several quarters. But considering that only a third of the S&P has reported, investors may be jumping to conclusions prematurely. However, such reactions reflect the underlying sense of unease prevalent in today's markets.

Admittedly, Citi analysts are concerned that some pullback is likely after the 20% upward move and believe there are several triggers that could generate a moderate retrenchment ranging from the payroll tax deferment ending in about a month's time through to developing corporate margin pressures and likely pullbacks from extreme positive levels in the Citi US Economic Surprise Index.

Bonds

Preference for high-grade corporates and emerging market debt

	Feb 3 2011	Jan 27 2011	Jan 20 2011
2-yr Try:	0.230%	0.211%	0.240%
5-yr Try:	0.768%	0.749%	0.886%
10-yr Try:	1.922%	1.891%	2.025%

Treasuries: Slow growth and fading inflation pressures could keep rates low. In Citi's view, curves are likely to bull-flatten further but gains appear poised to be less robust.

High-grade corporates: Citi analysts favour non-financial issuers in the US, where fundamentals are solid, balance sheets are strong and liquidity is robust.

High-yield corporates: Despite relatively decent valuations, high yield bonds are likely to remain volatile as long as risk appetite remains depressed.

EMD: Spreads are still attractive as improving fundamentals and credit quality of EM debt provides investors with a way to diversify their sovereign holdings from developed markets.

Currencies

USD: Broad based USD strength to resume

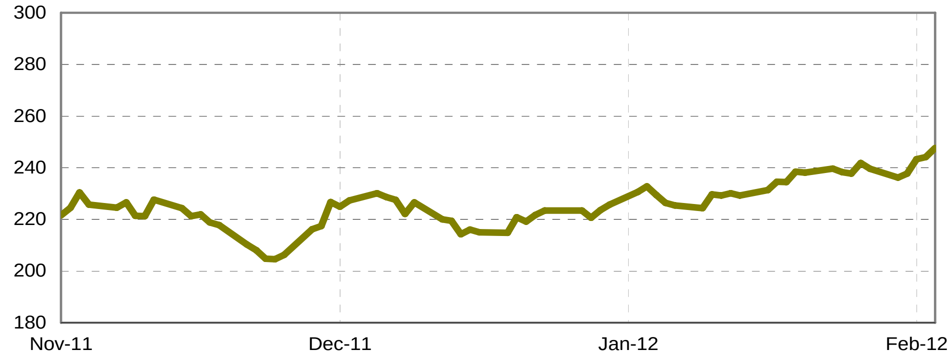
March 2012 forecasts		
EURUSD	**USDJPY**	**USDCAD**
1.25	77	1.03

The European Central Bank's actions in cutting policy rates and providing liquidity via 3-Year long-term refinancing operations (LTROs) have probably helped to boost risk appetite and weaken the EUR. Citi analysts think the latter effect is likely to last longer than the former. If so, and with Chinese economic slowdown an underestimated risk for some LATAM currencies and the AUD, they expect broad based USD strength to resume unless the Federal Reserve's new operating transparency is perceived to be hugely dovish.

They believe EUR/USD could likely decline into a 1.20-1.25 range and see potential for further USD gains versus the commodity backed G10 currencies as commodity prices ease, with NZD likely the worst performing. In their view, only JPY appears likely to be strong enough to resist the USD advance.

Source: CIRA

STOXX (1/11/2011 to 3/2/2012)



Source: Bloomberg

The Week Ahead

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- **Sweden:** Citi analysts expect a slight pickup in December **service production** (0.3% MoM, 3.8% YoY).

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- **Norway:** Citi analysts expect weak **manufacturing production** in December (-4.8% MoM).

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- **Germany:** Following an increase in the seasonally adjusted trade surplus in November, Citi analysts expect a narrowing **trade surplus** in December to €13.8 billion.

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- **France:** Citi analysts look for a small contraction of -1% in the January **survey of industrial invesments**.

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- **Switzerland:** Citi analysts expect that the pace of deflation likely intensified further, with the **CPI** falling about 1% YoY in January.

Economic Outlook

ECB likely to leave policy rates unchanged

Citi analysts expect the European Central Bank (ECB) to leave interest rates unchanged in February, with the main refinancing rate at 1.0%. With further gains seen in sentiment indicators and inflation still above the ECB's target, the ECB is likely to maintain its outlook of a modest economic recovery in the course of the year and a decline in inflation. However, with the recent sharp fall in loans and the further tightening in lending conditions, the ECB President is likely to continue to highlight downside risks to growth.

With the main admitted aim of easing lending standards, and welcoming the "side effects" of sovereign bond purchases in the troubled countries, which reduces the need of securities markets programme (SMP) purchases, the ECB will provide a second 3-Year longer-term refinancing operations (LTRO) on February 29. In Citi's view, the take-up of this facility is mainly dependent on the expansion of the eligible collateral pool regarding credit claims. Citi's earlier estimate of a take-up in the second 3-Year LTRO of €200bn to €300bn seems to be too conservative, but unless the collateral rules are much more generous than we reckon, Citi analysts expect the take-up to likely be in a range between €400bn and €500bn.

Equities

Synchronized liquidity driving the markets

	Last week's close	Last week's return	YTD Return
STOXX	247.71	+3.40%	+9.71%
FTSE 100	5901.07	+2.92%	+5.90%
DAX	6766.67	+3.91%	+14.72%

Liquidity appears to be the driving force behind improving confidence across financial markets in Citi's view. Unlike in 2011, we now have synchronized liquidity from policymakers in Europe, the US and emerging markets. Citi analysts see increased liquidity and stabilizing global growth expectations mixing with light investor positioning and attractive equity valuations to potentially drive 15-20% returns for European equities this year.

In particular, they see two key beneficiaries of synchronized liquidity – liquidity junkies and free riders. Liquidity junkies are mainly Financials and capital-poor banks. As there has been a sharp move in many peripheral banks, the preference remains for Insurance, stronger banks and selective banks which can see improving capital positions. Overall, Citi analysts prefer to back the free riders. These tend to have medium-term fundamental support as well as exposure to near-term liquidity trends. In this space, emerging markets, commodities and strong corporates appear to be the key beneficiaries.

Bonds

Favour long-dated UK gilts

	Feb 3 2011	Jan 27 2011	Jan 20 2011
2-yr Try:	0.204%	0.191%	0.207%
5-yr Try:	0.874%	0.813%	0.891%
10-yr Try:	1.933%	1.858%	1.929%

The UK is not immune to the periphery problems in continental Europe. However, gilts are benefiting from the Bank of England's decision on October 6 to boost its bond purchase program from £200 billion to £275 billion. Gilts also benefit from the government's renewed commitment to its austerity plan on November 30, which solidifies the UK's AAA rating. Long-dated UK gilts, which generated the most impressive bond returns of 2011, remain Citi's preference.

Currencies

EUR: Further downside anticipated medium-term
GBP: Up vs. EUR, down vs. USD

March 2012 forecasts

GBPUSD	USDCHF	EURGBP
1.52	0.97	0.82

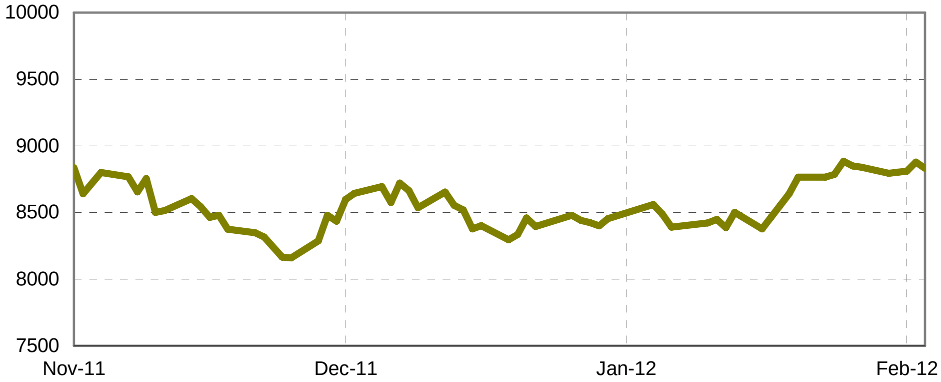
Uncertainties remain, including the Greek March package, related private sector involvement (PSI) and the risks of failed bond auctions elsewhere as supply picks up and banks show signs of hording long-term refinancing operation (LTRO) cash than reinvesting. But on the US side of the equation, we may need to account for the impact of more Fed transparency on the policy front. Citi analysts forecast EURUSD to decline into a 1.20-1.25 range.

GBP is being pulled in different directions by valuation (cheap) and economic and monetary conditions (not helpful). The outlook for the UK economy continues to look poor and could lead a further expansion of the Bank of England's quantitative easing (QE2) program. This mix of easy money and tight fiscal policy is likely to weaken GBP against USD. Policymakers though are likely to accept further downside in EUR/GBP (GBP strength) against the backdrop of deepening euro stresses.

Source: CIRA

JAPAN

Nikkei 225 (1/11/2011 to 3/2/2012)



Source: Bloomberg

The Week Ahead

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- The December **Coincident Composite Index** (CI) likely rose 2.7 points MoM (-1.1 points in November), while the December **Leading CI** probably dropped 0.6 point MoM (-1.2 points in November).

8/2

- Citi analysts expect the **current account** to generate a ¥197.7bn surplus before seasonal adjustment (-83.5% YoY) and a ¥625.3bn surplus after the adjustment (+30.2% MoM) in December.
- **Private machinery orders ex ships and power plants** (private core orders) probably decreased 6.4% MoM (+7.1% YoY) in December after +14.8% MoM in November.
- Citi analysts expect the **domestic corporate goods price index** to rise 0.1% MoM (+0.8% YoY) in January, the same pace as in December (0.1% MoM, 1.3% YoY).

Economic Outlook

Trade deficits likely to persist well into 2013

Japan posted a trade deficit of ¥2.5tn in 2011, the first deficit since 1980. Some cite Japanese firms' weakening competitive edge and production shifts abroad as important factors in the loss. In reality, Citi analysts note that the overwhelmingly major factors were on the import side, namely higher import prices (energy price spikes) and real import growth. However, this does not mean that the trade balance is likely to be back in surplus in the near future.

Exports are expected to help improve the balance in the second half of 2012 amid a gradual economic recovery abroad. But in the past, global commodity prices (Japan's import prices) have tended to rise when the world economy recovered. Therefore, the positive contribution from exports was often offset by the negative from import prices. This suggests that the trade balance is unlikely to return to the black in the second half of 2012. Mainly due to a decline in exports, Japan's GDP is estimated to have contracted -0.3% QoQ and -1.4% QoQ annualized in the fourth quarter of 2011 (compared to +1.4% QoQ and +5.6% QoQ annualized in 3Q11). The expected result would confirm that economic activity has stalled.

Equities

Japanese equities remain undervalued

	Last week's Close	Last week's return	YTD return
Nikkei	8831.93	-0.11%	+4.45%
Topix	760.69	-0.06%	+4.40%

At end-January the TOPIX cyclically adjusted price-to-earnings ratio (CAPE) stood at 7.6x, a slight increase from the end-December 2011 figure of 7.4x. The TOPIX CAPE remains lower than in past TOPIX bottoms except for March 2009, and Japanese stocks remain significantly undervalued on CAPE. Even on the conservative assumption that the valuations of Japanese equities are on a long-term downtrend, Japanese equities look undervalued. A return to the trendline suggests potential upside of 33.9%. From August 1992 to March 2009, Japanese equities have experienced four bull markets and four bear markets, with each lasting 25 months on average. Estimating the annual rate of rise/decline for the coming 25 months from historical patterns, Citi analysts see potential for an annual gain of 17.4%. This suggests that TOPIX could rise above the trendline within the next two years. But performance since the Lehman Brothers bankruptcy has undershot Citi analysts' 25-month estimates due to factors like yen strength and structural problems in the Eurozone, and performance over the near term could undershoot their estimates too.

Bonds

Modest rise in long-term rates expected

	Feb 3 2011	Jan 27 2011	Jan 20 2011
2-yr Try:	0.135%	0.131%	0.131%
5-yr Try:	0.325%	0.334%	0.346%
10-yr Try:	0.949%	0.970%	0.987%

Fiscal austerity in the industrialized nations and slowing growth continues to disproportionately put the onus on central banks to jumpstart economic recoveries. Citi analysts expect quantitative easing measures from the Bank of Japan to support market conditions via purchases of government debt. Indeed, Japan's central bank announced on October 27 that it had boosted its bond purchase program by ¥5 trillion. Citi analysts believe that this could precipitate a modest rise in long-term rates.

Currencies

JPY: USD/JPY flat to slightly lower

March 2012 forecast		
USDJPY	**EURJPY**	**AUDJPY**
77	96	78.0

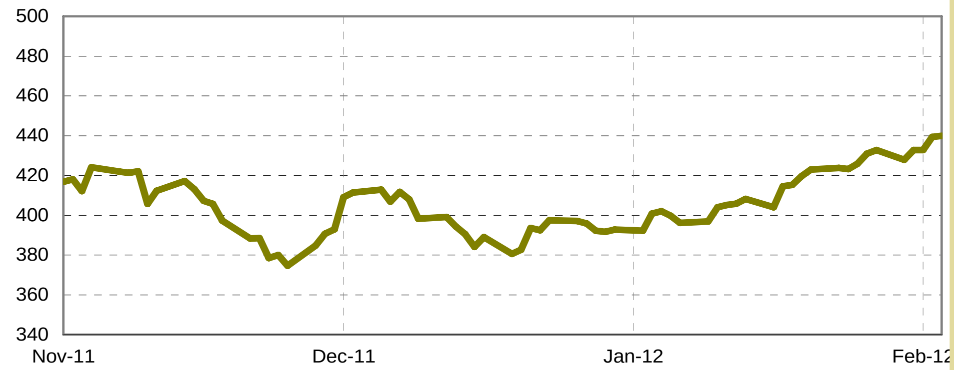
Japanese fundamentals are mixed. The current account surplus of around 2.5-3.0% of GDP remains positive and unemployment is low by international standards. On the other hand, economic growth remains fragile and supported by a large, and probably unsustainable, fiscal deficit. The Noda Administration wants to raise the sales tax and this is likely to require as accommodative a monetary stance (rates, QE and FX) as possible.

That said, Japanese policy is rarely proactive, and Citi analysts doubt that further Bank of Japan actions are likely to cause a major impact on JPY. Overall, they forecast broad stability, or a slight decline, in USD/JPY in the face of USD strength elsewhere.

Source: CIRA

ASIA PACIFIC EX JAPAN

MSCI Asia ex Japan (1/11/2011 to 3/2/2012)



Source: Bloomberg

Economic Outlook

China: Threefold policy easing expected to counter a soft patch

Citi analysts expect China's economy to decelerate further and hit a soft patch in 1Q12. But with inflation contained, monetary, fiscal and property policy easing could help engender a mild rebound in 2H12. Monetary, fiscal, and property policies were all tight in 2011, and with growth risk rising and inflation becoming less of a concern, Citi analysts think policy easing may be introduced in a measured and sequenced way, reducing the chance of a hard landing in 2012.

1) Monetary policy is expected to remain prudent with an easing bias. Monetary policy has already been eased. Citi analysts expect M2 growth at or below 14% which requires four reserve requirement ratio (RRR) cuts in their baseline. They believe new RMB lending may reach 8tn; benchmark interest rates could remain stable; and RMB appreciation may slow to 1.5%. 2) The budget deficit is likely to be set at 2.5% of GDP. If fully implemented, this would be a sizable stimulus compared with 2011 (actual fiscal deficit was 1.1% of GDP). Fiscal policy may become more proactive after the budget is approved in March, featuring structural tax cut and social and infrastructure spending. 3) Property policy is likely to be loosened following adequate market correction. Citi analysts expect policies to be loosened if the sector's slowdown threatens growth stability, starting with less stringent mortgages and followed by loosening of the purchase restriction. The tipping point may come by the middle of the year, in their view.

The Week Ahead

6/2

- **Indonesia: 4Q11 GDP** likely slowed to 6.38% YoY (3Q11 6.54%).
- **Taiwan: CPI** inflation probably came higher at 2.6% YoY in Jan due to the Chinese New Year. **WPI** likely rose to 4.8% YoY.

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- **Philippines: CPI** inflation may fall to 3.8% YoY in Jan on the back of fading food price pressures (Dec 4.2% YoY).

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- **China: CPI** may have risen 4.0% YoY in Jan on holiday effects, while **PPI** probably declined by -0.2% MoM (+0.6% YoY) in Jan.
- **Indonesia:** Bank Indonesia is likely to keep the **policy rate** on hold at 6.00%.
- **Korea:** Bank of Korea is likely to keep the **policy rate** unchanged at 3.25%.

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- **China: Export growth** likely dropped to 1.9% YoY in Jan while **import growth** probably almost stalled (0.5% YoY). The **trade surplus** likely narrowed to US$8.3bn from US$16.5b in Dec.
- **India:** Following a 5.9% rise in November, Citi analysts expect **industrial production** to moderate to 3.6%YoY in December.

Equities

The question of corporate earnings

	Last week's close	Last week's return	YTD Return
MSCI Asia ex Japan	439.94	+1.65%	+12.01%

The near-constant refrain from investors is that corporate earnings expectations are just too high and need to come down. Citi analysts have looked at the question of Asian earnings from the perspective of how far they are above their 10-year trend earnings and have found that Asian earnings are only 4% above their post 2000 trend.

While they acknowledge that Asian earnings are above their prior peak of 2008, they note that unlike back then, valuations of current earnings are 1 standard deviation below the mean versus +1 standard deviation above in 2008. With the exception of the consumer sector, all sectors appear cheaper today ahead of the results season than they have been on average since 2002 (many sectors are 20-30% cheaper than on average). Citi analysts also highlight that January saw the first upward revision in earnings estimates after 28 months of cuts. The upward revisions were widespread, and only Australia, Hong Kong and Singapore saw some weakness. By sector, the consumer sector fared worst.

Bonds

Asia local bond curves likely to steepen in India, Indonesia, Thailand and Malaysia

While inflation pressures dissipate, and central banks will likely either be on hold or with a bias to ease, rate cuts in the region are likely to be limited and, if anything, temporary, given the risky nature of exacerbating inflation expectations and financial stability risks amid already low real interest rates (domestically and globally) and DM central bank balance sheets biased towards expansion. Thus, the likely onus of policy support will lean on the fiscal side. Both of these factors should eventually be supportive of steeper curves, especially in Thailand, where THB bonds look overvalued and fiscal pressures will emerge, and in India, where fiscal slippage of about 1% of GDP should keep long-end yields elevated, while liquidity easing measures including RBI's OMO purchases and eventual rate cuts could anchor the short end.

Citi analysts think Indonesian long-end bond yields also look artificially too low, not taking into account the additional risk premium from BI's aggressive policy easing gamble, BI bond purchases that will prove unsustainable and still heavy offshore positioning on long duration bonds. The latter also applies to Malaysia.

Currencies

AUD: Bias still lower
EM Asia: Mixed performance

March 2012 forecasts		
AUDUSD	**NZDUSD**	**USDSGD**
1.01	0.78	1.30

Citi analysts believe AUD remains overvalued in the context of commodity prices/ terms of trade, carry and rate differentials, risk appetite globally etc. Economic data surprises in Australia have also been on a downtrend while US data has surprised to the upside. But more importantly, Citi analysts are concerned that the Chinese property bubble poses a huge threat to AUD, and forecast AUD downside over the medium term.

The outlook for EM Asia currencies appear mixed over the near term, with Chinese developments staying key. Citi analysts expect more near-term downside for EM Asia currencies that have intimate China ties and where domestic data have also softened. With mounting Chinese macro risks in a generally firm USD environment, Citi analysts have pared back their expectations for meaningful USDCNY depreciation over the next 12 months.

Source: CIRA

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	12862.23	12876.00	10404.49	+1.59%	+5.28%	+5.28%
S&P 500	1344.90	1370.58	1074.77	+2.17%	+6.94%	+6.94%
Nasdaq	2905.66	2908.13	2298.89	+3.16%	+11.54%	+11.54%
EUROPE						
DJ Euro STOXX	247.71	297.73	194.63	+3.40%	+9.71%	+11.23%
FTSE 100	5901.07	6105.77	4791.01	+2.92%	+5.90%	+7.98%
DAX	6766.67	7600.41	4965.80	+3.91%	+14.72%	+16.31%
JAPAN						
Nikkei 225	8831.93	10891.60	8135.79	-0.11%	+4.45%	+5.04%
TOPIX	760.69	976.28	703.88	-0.06%	+4.40%	+4.99%
ASIA						
MSCI Asia ex Japan	439.94	512.12	353.80	+1.65%	+12.01%	+12.01%
Hong Kong Hang Seng	20756.98	24468.64	16170.35	+1.25%	+12.60%	+12.78%
Shanghai Composite Index	2330.41	3067.46	2132.63	+0.49%	+5.96%	+5.85%
Taiwan Weighted Index	7741.24	9207.33	6609.11	+7.02%	+9.46%	+11.31%
Korea KOSPI	1972.34	2231.47	1644.11	+0.38%	+8.03%	+12.00%
Mumbai Sensex	17604.96	19811.14	15135.86	+2.15%	+13.91%	+23.90%
Singapore Straits Times Index	2917.95	3232.99	2521.95	+0.06%	+10.26%	+15.09%
Kuala Lumpur Composite	1538.77	1597.08	1310.53	+1.17%	+0.53%	+5.92%
Thai Stock Exchange	1098.95	1148.28	843.69	+2.11%	+7.18%	+9.61%
Jakarta Composite Index	4015.95	4195.72	3217.95	+0.74%	+5.07%	+7.46%
Philippines Stock Exchange Index	4758.57	4855.00	3705.18	+1.68%	+8.84%	+12.45%
Australia All Ordinaries	4320.12	5069.50	3829.40	-0.65%	+5.09%	+10.51%
EMEA						
Russia MICEX Index	1564.82	1865.25	1242.75	+3.77%	+11.60%	+18.84%
South Africa JSE All Shares Index	34386.97	34460.57	28305.41	+1.45%	+7.51%	+14.89%
Turkey ISE National 100 Index	60147.96	70335.62	48600.16	+4.87%	+17.32%	+26.17%
LATIN AMERICA						
Mexico Bolsa Index	38092.81	38229.90	31561.51	+2.44%	+2.74%	+12.72%
Brazil Bovespa Index	65217.37	70107.71	47793.49	+3.68%	+14.91%	+24.92%
COMMODITIES						
Gold	1726.25	1921.15	1343.72	-0.74%	+10.40%	+10.40%
Oil	97.84	114.83	74.95	-1.73%	-1.00%	-1.00%
FIXED INCOME						
Citigroup World Government Bond Index	612.17	613.79	568.55	+0.05%	+0.48%	+0.48%

Source: Bloomberg (As at February 3, 2012)

CURRENCY FORECASTS

Currency		6-Feb-12	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Jan-14
G10-US Dollar											
Euro	EURUSD	1.31	1.25	1.24	1.22	1.20	1.22	1.25	1.27	1.3	1.3
Japanese yen	USDJPY	77	77	77	76	76	76	77	77	78	79
British Pound	GBPUSD	1.58	1.52	1.52	1.51	1.50	1.53	1.57	1.60	1.64	1.65
Swiss Franc	USDCHF	0.92	0.97	0.98	1.00	1.01	1.01	0.99	0.98	0.96	0.96
Australian Dollar	AUDUSD	1.07	1.01	0.99	0.96	0.93	0.92	0.92	0.91	0.90	0.90
New Zealand	NZDUSD	0.83	0.78	0.76	0.73	0.70	0.69	0.67	0.65	0.63	0.63
Canadian Dollar	USDCAD	1.00	1.03	1.04	1.05	1.07	1.04	1.01	0.98	0.95	0.95
Dollar Index	DXY	79.37	82.23	83.07	83.93	84.82	83.66	82.18	80.73	79.32	79.02
G10 Crosses											
Japanese yen	EURJPY	100	96	95	93	91	93	96	98	101	102
Swiss Franc	EURCHF	1.21	1.21	1.21	1.22	1.22	1.23	1.23	1.24	1.25	1.26
British Pound	EURGBP	0.83	0.82	0.81	0.81	0.80	0.80	0.80	0.79	0.79	0.79
Swedish Krona	EURSEK	8.79	8.90	8.93	8.96	9.00	8.95	8.88	8.82	8.76	8.75
Norwegian Krone	EURNOK	7.62	7.79	7.80	7.80	7.80	7.76	7.71	7.66	7.61	7.60
Norwegian Krone	NOKSEK	1.15	1.14	1.14	1.15	1.15	1.15	1.15	1.15	1.15	1.15
Australian Dollar	AUDNZD	1.29	1.30	1.30	1.32	1.33	1.35	1.37	1.40	1.43	1.43
Australian Dollar	AUDJPY	82.1	78.0	75.8	73.4	71.0	70.6	70.5	70.3	70.2	70.5
EM Asia											
Chinese Renminbi	USDCNY	6.31	6.30	6.27	6.24	6.20	6.15	6.10	6.05	6.01	6.01
Hong Kong Dollar	USDHKD	7.76	7.78	7.77	7.77	7.76	7.76	7.75	7.75	7.75	7.75
Indonesian Rupiah	USDIDR	8988	9000	9300	9200	9100	9050	9000	8950	8900	8900
Indian Rupee	USDINR	48.7	52.0	52.0	51.5	51.0	50.0	49.5	49.0	49.0	49.0
Korean Won	USDKRW	1121	1150	1145	1120	1100	1080	1070	1040	1020	1020
Malaysian Ringgit	USDMYR	3.01	3.18	3.12	3.11	3.08	3.04	3.01	2.96	2.94	2.94
Philippine Peso	USDPHP	42.6	44.5	43.8	43.3	43.0	42.9	42.7	42.5	42.3	42.3
Singapore Dollar	USDSGD	1.25	1.30	1.28	1.27	1.25	1.23	1.22	1.20	1.19	1.19
Thai Baht	USDTHB	30.9	31.8	31.6	31.4	31.2	31.0	30.8	30.5	30.3	30.3
Taiwan Dollar	USDTWD	29.6	30.2	30.5	30.2	29.8	29.8	29.5	29.5	29.2	29.2
EM Europe											
Czech Koruna	EURCZK	25.00	26.11	25.86	25.46	25.06	24.79	24.54	24.29	24.04	23.87
Hungarian Forint	EURHUF	292	310	306	301	296	293	290	288	285	285
Polish Zloty	EURPLN	4.18	4.53	4.48	4.40	4.31	4.22	4.12	4.02	3.91	3.90
Israeli Shekel	USDILS	3.72	3.89	3.93	3.96	4.00	3.98	3.95	3.93	3.90	3.86
Russian Ruble	USDRUB	30.2	32.3	32.8	33.3	33.9	33.6	33.1	32.7	32.2	32.0
Russian Ruble	Basket	34.4	36.0	36.3	36.6	37.0	36.9	36.8	36.6	36.5	36.5
Turkish Lira	USDTRY	1.76	1.85	1.88	1.91	1.95	1.92	1.88	1.84	1.81	1.79
South African Rand	USDZAR	7.58	8.36	8.50	8.62	8.73	8.76	8.77	8.79	8.80	8.88
EM Latam											
Brazilian Real	USDBRL	1.72	1.80	1.80	1.80	1.80	1.79	1.78	1.76	1.75	1.75
Chilean Peso	USDCLP	479	506	510	515	519	514	506	499	491	494
Mexican Peso	USDMXN	12.7	13.6	13.5	13.5	13.4	13.1	12.8	12.5	12.2	12.3
Colombian Peso	USDCOP	1785	1849	1850	1850	1850	1850	1850	1850	1850	1857

Source: CIRA, Bloomberg (As February 6, 2012; Forecasts as of January 19, 2012)

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