FINANCIAL MARKET ANALYSIS

Volume 12, Issue 30 **August 6, 2012**

Equity markets edge higher on better-than-expected US jobs data

Market action was mixed last week with equity markets initially selling off after the Federal Reserve and the European Central Bank failed to announce additional stimulus to bolster growth. Better-than-expected US jobs data however gave markets a boost late in the week, with ADP private employment rising 163K versus consensus expectations of 120K and Non-farm payrolls rising 163K versus an anticipated 100K gain. The S&P 500 index ended the week up 0.4% to close at 1,390.99 while the Dow Jones Industrial Average climbed to its highest level since May 3 (+0.2% to 13,096.17). This week is very quiet in terms of data releases in the US and Europe. A number of them will come from China (CPI, PPI, Industrial Production, Retail Sales and FAI are due out on Thursday and Trade Balance on Friday). Elsewhere we have the Bank of England quarterly inflation report (Wednesday) and central bank meetings from the Reserve Bank of Australia (Tuesday), Bank of Japan, Bank of Korea and Bank Indonesia (Thursday). In the US, we have the Trade Balance on Thursday, and Ben Bernanke speaks on economic measurement at a research based conference on Monday and on financial education to a US teachers group on Tuesday. European data is thin, with Italian GDP on Tuesday and German Industrial Production and a bund auction on Wednesday while in the UK, Industrial Production is out on Tuesday and PPI on Friday. In Japan, Current Account is on Wednesday, Machine Tool Orders on Thursday, and Industrial Production on Friday.

	Aug 3 Close	Last week's return	YTD Return	YTD return (USD)
S&P 500:	1390.99	+0.36%	+10.61%	+10.61%
Stoxx Europe:	236.03	+2.41%	+4.54%	-0.21%
Nikkei 225:	8555.11	-0.13%	+1.18%	-0.91%
MSCI Asia ex Japan:	417.11	+1.57%	+6.19%	+6.19%

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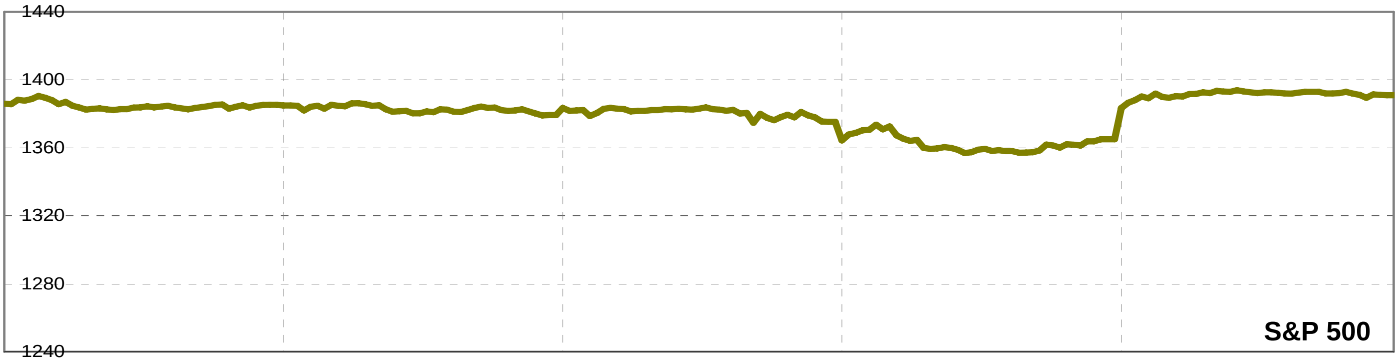
TAKING STOCK



Monday Jul 30

S&P:	-0.05%
STOXX:	+1.51%
Nikkei:	+0.80%
MSCI Asia ex Japan:	+1.22%

US: The Dallas Fed Texas manufacturing index fell to 12 in Jul vs. 15.5 in Jun. The index of general business activity fell to -13.2 vs. 5.8 in Jun.

EU: The tone of the Jul EU Commission Eurozone survey was a lot weaker than expected, with the headline economic sentiment gauge dropping 2 points to 87.9 from 89.9 in Jun, vs. market expectations of 88.7. The industry sentiment sub-index also dropped further to -15 from -12.8 in Jul, vs. consensus of -14.0.

EU: Spain 2Q12 GDP declined -0.4% QoQ (in line with expectations), vs. -0.3% QoQ in 1Q12.

EU: UK BoE Jun data showed mortgage approvals volumes fell to 44.2K from 50.5K in May, vs. consensus of 49.0K. Net repayment on mortgages was -£0.4bn vs. £0.3bn lending in May. Net consumer credit eased to £0.6bn from £0.8bn in May, vs. expectations of £0.4bn. Broad M4 money supply growth fell sharply by -1.6% MoM vs. -0.1% MoM in May, causing the YoY rate to plunge deeper into negative territory, -5.2% YoY vs. -4.1% YoY in May.

JP: Industrial production dipped -0.1% MoM (-2.0% YoY) in Jun after -3.4% MoM (+6.0% YoY) in May, below market expectations of +1.6% MoM. On a quarterly basis, IP fell -2.2% QoQ in 2Q12 (1Q12 +1.3% QoQ), the first negative growth since 2Q11.

Tuesday Jul 31

S&P:	-0.43%
STOXX:	-0.68%
Nikkei:	+0.69%
MSCI Asia ex Japan:	+1.36%

US: Personal income rose 0.5% in Jun vs. consensus of 0.4% and 0.3% in May. Personal spending was flat vs. 0.1% expected and -0.1% in May. The savings rate rose to 4.4% vs. 4.0% in May.

US: The employment cost index rose 0.5% in 2Q12 vs. 0.4% in 1Q12.

US: The Jul Chicago PMI was 53.7, vs. 52.9 in Jun and consensus of 52.5.

US: The Jul Conference Board Consumer Confidence Index jumped to 65.9 from 62.7 in Jun, exceeding the consensus estimate for 61.5.

EU: Eurozone unemployment rate was revised to a record 11.2% in May (Prev. 11.1%) and held at that level in Jun.

EU: Jun German retail sales fell -0.1 MoM vs. market expectations of a +0.5% MoM rebound, after a -0.3% MoM drop in May. Despite the Jun decline, real retail sales climbed 0.3% QoQ in 2Q12 (1Q12 -0.7% QoQ).

JP: The unemployment rate dropped to 4.3% in Jun, the lowest level since Sep '11 (4.2%), from 4.4% in May.

AP: The Reserve Bank of India left the O/N Repo rate unchanged at 8%, O/N Reverse Repo rate at 7% and the Cash Reserve Ratio at 4.75%. The RBI surprised markets with a 100 bps cut to the Statutory Liquidity Ratio.

AP: Singapore's 2Q12 unemployment rate fell to 2.0% from 2.1% in 1Q12.

AP: Taiwan 2Q12 GDP fell -0.16% YoY vs. +0.4% YoY in 1Q12, the first negative YoY growth since 4Q09.

Wednesday Aug 1

S&P:	-0.30%
STOXX:	+0.25%
Nikkei:	-0.61%
MSCI Asia ex Japan:	+0.07%

US: The FOMC left policy on hold; initiated no new easing actions and maintained guidance for near zero rates until late 2014. Although they acknowledged deceleration in economic activity over 1H12, they failed to offer the strong hints of a Sep action that many expected. But, the policy course remains wide open, depending on the evolving outlook.

US: Jul ADP employment was 163K vs. 172K in Jun.

US: Jul ISM manufacturing index rose to 49.8 from 49.7 in Jun (Consensus 50.2).

US: Construction spending rose 0.4% MoM in Jun.

EU: The final Eurozone aggregate manufacturing PMI was revised lower, to 44.0 from the flash print of 44.1 (Jun 45.1).

EU: UK Jul manufacturing PMI fell by 3pts to 45.4 from 48.4 in Jun, in contrast to the market expectations of 48.5. The headline figure is now at its lowest since May '09 when the UK was still in recession.

EU: UK Nationwide house prices declined -0.7% MoM in Jul after -0.6% MoM in Jun.

AP: Australia's official ABS house price index rose 0.5% in 2Q12, vs. -0.1% in 1Q12.

AP: China's Jul official manufacturing PMI (CFLP) inched down 0.1ppt to 50.1 vs. consensus of 50.5. The HSBC measure rose to 49.3 from 48.2 in Jun.

AP: Korea Jul headline CPI inflation fell to 1.5% YoY (Jun. 2.2% YoY), lowest since Jun '00. MoM deflation continued for the second month, -0.2% in Jul. Core CPI edged down to 1.2% YoY (Jun 1.5% YoY).

Thursday Aug 2

S&P:	-0.74%
STOXX:	-2.65%
Nikkei:	+0.13%
MSCI Asia ex Japan:	-0.61%

US: Initial jobless rose to 365K in the week of Jul 28, vs. 357K in the prior week. Continuing claims fell to 3272K in the week of Jul 21, vs. 3291K in the prior week.

US: Jun factory orders fell -0.5%, vs. +0.5% in May and consensus of +0.5%. Ex-transportation, orders declined -1.8%; ex-defense -1.5%. Shipments fell -1.1%. The inventory/shipment ratio rose to 1.29 (May 1.27).

EU: The ECB left the refi rate at 0.75%, the marginal lending rate at 1.5% and the deposit rate at 0.0%.

EU: S&P affirmed Germany's AAA rating while keeping the outlook unchanged, due mainly to its ability to absorb large economic and financial shocks. Adds Germany could lose its rating if net debt ratio reaches 100%.

EU: S&P lowered Cyprus' l-t rating to 'BB,' puts on a negative watch. Says even with official assistance the government will remain in a weak fiscal position.

EU: The Aug BoE MPC meeting culminated in the decision to maintain the official Bank Rate at 0.5% and the programme of asset purchases at £375bn.

EU: UK Jul construction PMI rebounded to expansion territory, to 50.9 (Jun 48.2).

AP: Australia Jun retail sales rose 1.0% vs. 0.8% in May. Real retail sales rose 1.4% in 1Q12 (1Q12 1.4%).

AP: In value terms, Hong Kong retail sales rebounded to double digits in Jun, 11% YoY after 8.7% YoY in May; by volume, growth was 8.5% YoY (May 5.7% YoY).

Friday Aug 3

S&P:	+1.90%
STOXX:	+4.10%
Nikkei:	-1.13%
MSCI Asia ex Japan:	-0.47%

US: Non-farm payrolls showed 163K job gains in Jul, better than market expectations of 100K. The unemployment rate rose to 8.3% from 8.2%.

US: ISM non-manufacturing index was 52.6 in Jul, vs. 52.1 in Jun and consensus of 52.1. The new orders subindex rose to 54.3 from 53.3 in Jun. The employment subindex fell to 49.3 from 52.3 in Jun, the lowest since Sep '11.

EU: Final Jul aggregate Eurozone services sector PMI was revised up to 47.9 from a flash print of 47.6, and combined with the slight downward revision to the manufacturing PMI to 44.0 from a flash print of 44.1, enabled the final composite Eurozone PMI to be revised up to 46.5, from a flash print of 46.4, and vs. 46.4 in Jun.

EU: S&P cuts ratings of 32 Italian banks.

EU: UK services sector PMI fell to 51.0 in Jul from 51.3 in Jun, confounding market expectations of a rise to 51.5.

AP: China's official non-manufacturing PMI (CFLP) in Jul softened to 55.6 from 56.7 in Jun. The HSBC measure rose to 53.1 from 52.3 in Jun.

AP: Hong Kong PMI (HSBC) improved slightly again in Jul, reverting to the "expansion" zone at 50.3 after dipping below 50 for two months.

Others: Global all industry PMI was 51.7 in Jul vs. 50.3 in Jun, according to JP Morgan. The global services PMI was 52.7 vs. 50.6 in Jun.

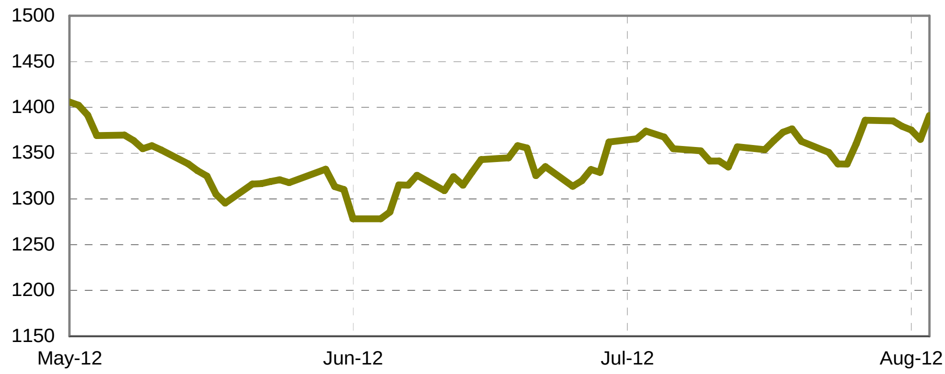
Over the Weekend Aug 4 and Aug 5

Others: --

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

US/NORTH AMERICA

S&P 500 (1/5/2012 to 3/8/2012)



Source: Bloomberg

Economic Outlook

FOMC Policy Statement: Still buying time

The Federal Open Market Committee (FOMC) signalled last week that they are moving closer to additional easing steps unless recovery shows signs of strengthening. But the statement leaves unresolved whether the next step would be in the form of communications or expanding the balance sheet. At the very least, the FOMC is unlikely to wait past September if sluggish job growth persists or if eroding financial conditions aggravate risks to the downside.

The Committee chose to retain the current interest rate guidance. That may have reflected a view that they are still anticipating a pickup in the second half or that such guidance is lacking financial punch so far out on the horizon. However, Citi analysts do not rule out that officials could use extended guidance as an interim step to balance sheet expansion, even now, effectively adding another hurdle to QE3.

Nonetheless, the introduction of so-called "close monitoring" language is a warning that there may be only a few key data points or market events needed to resolve the forecast and risks following the first half slowdown. The decision to add upcoming financial developments to this guidance is likely a nod to the risks that conditions in Europe may yet weigh heavily on US markets again, particularly if near-term policy efforts fail to bolster investor confidence.

The Week Ahead

8/8
- **Non-farm productivity** likely increased at a moderate rate of 1.0% in 2Q12.

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- **Initial jobless claims** for the week ending August 4 likely edged up by 5K to 370K.
- Citi analysts look for another narrowing of the **trade balance** in June (-US$46.5 billion), largely reflecting a pullback in petroleum imports.

10/8
- Rising petroleum prices likely boosted **import prices** in July (1.0%), after three months of decline.

Equities

Lower earnings estimates not unexpected

	Last week's close	Last week's return	YTD return
S&P 500	1390.99	+0.36%	+10.61%
DJIA	13096.17	+0.16%	+7.19%
Nasdaq	2967.90	+0.33%	+13.92%

While many investors have been focused on disappointing top-line trends (with roughly 60% of reporting S&P 500 constituents thus far missing revenue estimates), more than 70% of companies are beating on the bottom line.

Several cyclical groups, including Autos & Components, Materials as well as Capital Goods have substantial European sales exposure along with translation risks to earnings. In contrast, more stable defensive groups such as Household Products, Pharmaceuticals and Food, Beverage & Tobacco that have meaningful sales within Europe seem to be more affected by just their generally modest FX restraints.

In general, Citi analysts believe that one should be less worried about 2012 earnings, as half the year is behind us and earnings estimate revision momentum already indicates that estimates are being trimmed back for 2H12 which is expected by the investment community.

Bonds

Preference for high-grade corporates and emerging market debt

	Aug 3 2012	Jul 27 2012	Jul 20 2012
2-yr Try:	0.238%	0.239%	0.202%
5-yr Try:	0.664%	0.651%	0.575%
10-yr Try:	1.563%	1.546%	1.457%

Treasuries: Citi analysts expect yield curves to flatten, and for gains to be potentially generated in the intermediate- to longer-dated maturity range.

High-grade corporates: A strengthening technical backdrop, large cash balances, low default rates, decreasing net issuance, and a smaller universe of safe haven assets continue to remain supportive.

High-yield corporates: Although valuations have become more attractive, Citi analysts remain cautious due to festering concerns in Europe and expectation that global growth will continue to slow. As such, they selectively favour high quality, double-B rated issuers and select single-B rated issuers with strong fundamentals.

EMD: Increased corporate bond issuance in emerging markets may present opportunities to pick up yield while benefiting from stronger domestic growth.

Currencies

USD: USD strength likely to remain medium-term

September 2012 forecasts		
EURUSD	**USDJPY**	**USDCAD**
1.22	78	1.01

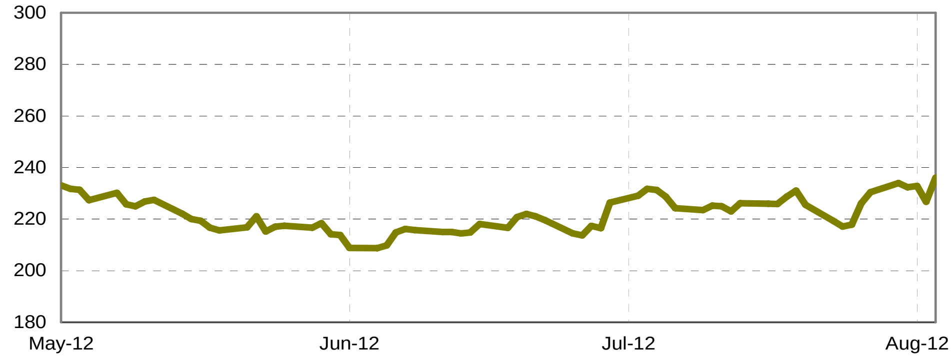
USD strength in the face of better risk appetite and position unwinds suggests underlying fundamental strength. It appears that FX investors believe that while the US economy may be sub-par, it is still likely to outperform other developed regions. Equity outperformance and bond market underperformance on trend also suggest similar expectations are in other asset classes. These factors are likely to drive USD appreciation over the medium term, absent US policy mis-steps.

All in all, Citi analysts forecast further USD upside over the medium term, especially relative to G10 majors with EUR/USD potentially falling towards 1.15. Overall, gains of around 5% over 6-12 months appear likely versus G10 currencies.

Source: CR

EUROPE

STOXX (1/5/2012 to 3/8/2012)



Source: Bloomberg

Economic Outlook

ECB ready, waiting for Spain and Germany

The European Central Bank's (ECB) decision to go ahead with a new government bond purchase facility leaves lots of open questions. However, with the new programme, the ECB might help to stretch the European Financial Stability Facility/European Stability Mechanism capacity to cover a bond purchase programme for Italy and Spain for up to two years.

However, in order to activate the ECB's new facility, Spain and Italy have to ask the EFSF for assistance, and the Eurogroup (backed by the German parliament) has to approve the request. In Citi's view, even with increasing market pressure, such decisions are unlikely to take place before September 12, when the German Constitutional Court decides on Germany's ESM participation and the Dutch general election takes place.

Indeed, more far reaching decisions on the ESM and/or debt mutualisation are outstanding, which could lead to a break-up of the German government coalition. If this occurs, Citi analysts believe an interim grand coalition in Germany may be more likely to agree on a leveraged ESM with access to ECB funding than on a debt redemption fund.

The Week Ahead

6/8
- **Sweden:** Citi analysts expect **service production** to continue its declining trend in June (-0.8% MoM SA, +0.7% YoY NSA).

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- **Italy:** Citi analysts expect **2Q12 GDP** to contract by -0.9% QoQ after a QoQ contraction of -0.8% in 1Q12.

8/8
- **Spain:** Citi analysts expect that **industrial production** likely continued to experience large YoY falls in June (-7.5% YoY NSA), based on a very weak PMI reading.

9/8
- **UK:** The June **trade balance** may show a fairly sharp drop in exports, because of disruptions around the Queen's Jubilee (-£4.0 billion).

10/8
- **Germany:** Citi analysts expect a confirmation of the July **national CPI** flash estimate, showing an increase of 0.4% MoM, which is mainly led by seasonal factors.

Equities

Favour dividend paying stocks with exposure to Emerging Markets

	Last week's close	Last week's return	YTD Return
STOXX	236.03	+2.41%	+4.54%
FTSE 100	5787.28	+2.84%	+3.86%
DAX	6865.66	+2.63%	+16.40%

Rate cuts have taken policy rates in Europe, the UK and the US down towards zero. But, interest rates are also heading Beyond Zero (BeZe).

In such an environment, Citi analysts prefer stocks (Big Guns) that are big dividend payers and also have at least 30% sales exposure to Emerging Markets. Not only do these stocks have higher dividend cover and strong balance sheets, but their exposure to Emerging Markets could provide better protection of their dividend than the rest of the market.

For example, the yield gap between the UK Big Guns and UK gilts area is at a record level. To not buy equities, even following the post-May rally, suggests a very gloomy macro backdrop which would undermine the dividend paying capacity of the market. Indeed, Citi analysts believe this is highly unlikely and continue to see potential upside in the equity market.

Bonds

Favour UK Gilts vs German Bunds

	Aug 3 2012	Jul 27 2012	Jul 20 2012
2-yr Try:	-0.022%	-0.029%	-0.074%
5-yr Try:	0.427%	0.418%	0.240%
10-yr Try:	1.424%	1.398%	1.167%

Citi analysts remain positive on the long end of the German yield curve, which has bull-flattened around 25 basis points. Indeed, the yield difference between 10 year and 30 year German Bunds now stands at around 50 basis points, a six-month low.

As global growth slows further and heightened uncertainties persist, high quality government bonds in safe haven markets, particularly UK Gilts are likely to be well-supported.

Currencies

EUR: Downward pressures remain
GBP: Likely to give back some of its gains in the short term

September 2012 forecasts		
GBPUSD	**USDCHF**	**EURGBP**
1.56	0.98	0.78

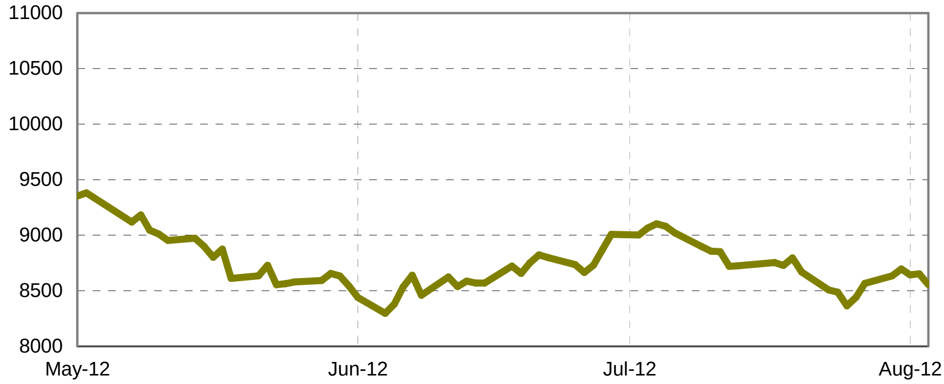
EUR is likely to be weak medium-term assuming Greece exits the EMU, volatile and wide bond yield spreads between core and periphery, weak EMU growth, further European Central Bank rate cuts and additional long-term refinancing operations (LTROs). Citi forecast EUR/USD heading to 1.15 over 6-12 months, though there may be some stability near-term given the recent sharp move lower.

Citi analysts expect the quantitative easing (QE) program to be expanded to a total of £500bn, alongside liquidity and credit easing. This is GBP negative vs. USD, but may already be priced in to some extent. Moreover, there is still the risk of QE3 for the USD itself. As a result, GBP/USD is expected to maintain its recent 1.54-1.58 range short-term. Given expectations for EUR/USD to stabilise for awhile, GBP may consolidate vs. EUR. More medium term, with EUR losing ground again, EUR/GBP may push modestly lower and GBP/USD could fall to around 1.50.

Source: CR

JAPAN

Nikkei 225 (1/5/2012 to 3/8/2012)



Source: Bloomberg

Economic Outlook

Japanese economy likely to proceed along an idiosyncratic path

Citi analysts expect the Japanese economy to proceed along an idiosyncratic path in years to come with reconstruction demand from the earthquake and frontloading of household spending ahead of the consumption tax hike (and subsequent decline after) expected to distort economic activity. They forecast GDP growth above 2% in 2012 and 2013 but virtually zero growth in 2014.

Real GDP growth may to slow to a 1%+ annualized pace in 3Q12 and 4Q12, reflecting policy-driven deceleration in consumer spending, weakening positive impact of reconstruction demand, and continued tepid growth in exports. However, growth could pick up next year as unwinding of the policy effects runs its course and household spending is brought forward ahead of the consumption tax hike. Growth may accelerate toward the end of fiscal 2013. But in fiscal 2014, GDP could contract in an outright manner early on amid negative impacts from the tax hike.

The Week Ahead

6/8

- The June **coincident composite index** likely fell -1.8 points MoM (May -1.2 points), a third consecutive fall.

8/8

- Citi expects the **current account** to generate a ¥430.9bn surplus before seasonal adjustment (-20.0% YoY) and a ¥633.8bn surplus after the adjustment (¥282.2bn in May) in June.

9/8

- Private machinery orders ex ships and power plants (**private core orders**) probably increased 11.0% MoM in June (-5.6% YoY) after a -14.8% MoM plunge in May (+1.0% YoY).

10/8

- The **domestic corporate goods price index** likely rose 0.1% MoM in July (-1.5% YoY) after a -0.6% MoM fall in June (-1.3% YoY). Excluding about a 0.4ppt boost from a summer power surcharge, however, Citi estimates that the index probably dropped -0.3% MoM in the month.

Equities

Upside likely hard to come by in August

	Last week's Close	Last week's return	YTD return
Nikkei	8555.11	-0.13%	+1.18%
Topix	723.94	-0.34%	-0.64%

TOPIX fell sharply in July as EU debt concerns reignited. However, Citi analysts believe a further decline for TOPIX is unlikely in August as they anticipate support from expectations for policy measures by Euro Area authorities as well as from low valuations.

At the same time, a significant increase also seems unlikely given the possibility of a global economic slowdown and weak April-June corporate earnings results.

Citi analysts have downgraded their stance on the Consumer Discretionary sector to neutral as it looks increasingly as if the global economy is slowing, and they are now underweight the IT sector. However, as they expect factors positive for domestic demand (e.g., expectations for a supplementary budget) to continue, they have upgraded their stance on Consumer Staples, Healthcare, and Telecoms to neutral.

Citi analysts are maintaining their end-2012 forecasts of 960 for TOPIX and 11,200 for the Nikkei 225.

Bonds

Some JGB underperformance around the fiscal year-end expected

	Aug 3 2012	Jul 27 2012	Jul 20 2012
2-yr Try:	0.093%	0.102%	0.100%
5-yr Try:	0.162%	0.188%	0.185%
10-yr Try:	0.743%	0.747%	0.744%

Ongoing downgrades to Japan's growth outlook and continued expectations of Bank of Japan (BoJ) bond purchases are supporting JGBs. The divergence between Japanese yields and the other major markets looks overstretched, however, and Citi analysts think that there may be potential for some JGB underperformance around the fiscal year-end. But with policy rates likely to remain near zero for a long time and the BoJ maintaining its duration commitment, Citi analysts believe that calls for a fiscally driven bear-market are premature.

Currencies

JPY: USD/JPY likely to trade sideways

September 2012 forecast		
USDJPY	**EURJPY**	**AUDJPY**
78	95	81.2

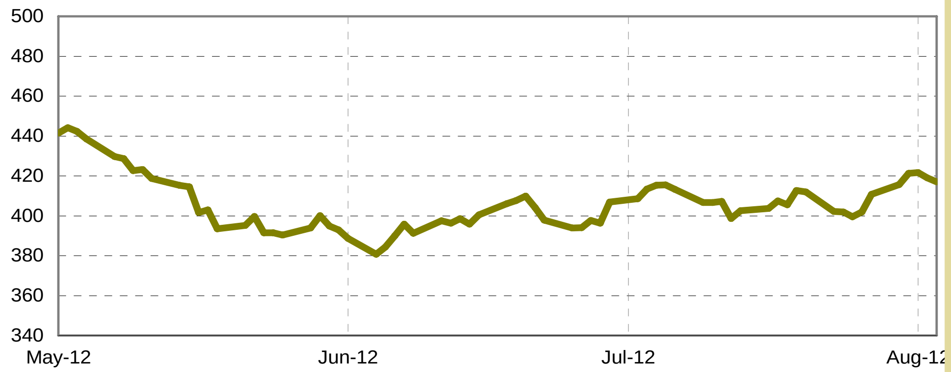
USD/JPY continues to trade mainly sideways, broadly within a 75-85 range. Citi's forecasts essentially see this continuing. Should the Federal Reserve (Fed) move towards QE3, this may temporarily push USD/JPY lower along with other USD crosses. In the current environment of disappointing economic data everywhere (including the US), core bond yields are unlikely to move up much and USD/JPY may drift a bit lower over 0-3 months in line with rate differentials. However, intervention from the Bank of Japan/Ministry of Finance is likely to slow the downside from 76 onwards.

One factor that has supported JPY is the BoJ's stance. Typically, the BoJ is much less aggressive with monetary easing than the Fed. This may be changing slightly with the BoJ finally adopting an inflation target, though significant additional quantitative easing still seems lacking. As such, upside in USD/JPY may be limited by this conservative stance despite a gradual deterioration in other fundamentals such as the trade balance. Citi forecasts USD/JPY at 82 in 6-12 months, which is well within the range since mid-2010.

Source: CR

ASIA PACIFIC EX JAPAN

MSCI Asia ex Japan (1/5/2012 to 3/8/2012)



Source: Bloomberg

The Week Ahead

6/8

- **Indonesia: 2Q12 GDP** growth may have slowed further to 5.95% YoY, from 6.31% YoY in 1Q12.

8/8

- **Malaysia:** June **exports** likely rose 6.2% YoY; **imports** 9.5% YoY. The **trade surplus** probably widened to MYR6.7bn vs. MYR4.6bn in May.

9/8

- **China: CPI** inflation likely fell below 2% in July (1.7% YoY). **PPI** deflation may have widened to -2.6% YoY. **Industrial production** probably remained sluggish amid destocking (10% YoY). **Retail sales** growth likely stayed stable at 13% YoY. **FAI** may have been dragged by property investment (20% YoY).
- **Indonesia:** Bank Indonesia is likely to keep the **O/N FasBI rate** and **BI rate** at 3.75% and 5.75%, respectively.
- **Korea:** Bank of Korea is expected to maintain the **policy rate** at 3.00%.

10/8

- **China:** Trade expansion likely fell back to single digits in July – **exports** 7.2% YoY, **imports** 5.8% YoY. The **trade surplus** probably widened to US$35.8bn vs. US$31.7bn in June.

Economic Outlook

China: July data may underscore the need for sustained policy support

CPI inflation may have fallen below 2% in July, creating room for further policy easing. While Citi analysts see initial signs of demand recovery toward the end of 2Q12, production activity may have remained sluggish as the destocking process accelerated. Policy support is needed to consolidate domestic demand and facilitate a restocking later on. Citi analysts expect an overdue 50 bps reserve requirement ratio (RRR) cut this month, and believe another 25 bps interest rate cut is likely. If the policy space under proactive fiscal policy and accommodative monetary policy is fully utilized, growth could potentially rebound in 2H12.

The People's Bank of China (PBOC) needs to cut the RRR to bring M2 growth to 14%. Without a RRR cut or large-scale reverse repos, M2 growth is likely to fall below 13% in August, if the recent pattern of capital outflow continues. The decline in FX inflow is structural in Citi's view, and the RRR cut may be the more desirable tool to ensure adequate money supply. In addition, another interest rate cut could help consolidate the demand for loans and reduce downside risks, when deposit rates become increasingly positive in real terms due to falling inflation.

Equities

EPS revisions pattern resembles that of prior cycles

	Last week's close	Last week's return	YTD Return
MSCI Asia ex Japan	417.11	+1.57%	+6.19%

August and September have historically been the heaviest months of corporate earnings revisions post the mid-year results. The latest revisions have taken on the same pattern as in prior years. With Institutional Brokers' Estimate System (IBES) expectations still running at 13.8% for this year, Citi analysts see room for disappointment. They expect earnings-per-share (EPS) growth to come in between 4-8% for this year. But markets already appear to be pricing in much weaker earnings revisions than we have seen thus far.

The worst revisions are in Taiwan, China and Thailand. By sector, the worst near term revisions have been with the Material and Energy space. Compared to historical revisions vs. price-to-book, Hong Kong, Singapore, Taiwan and Thailand are all pricing in a significant worsening of revisions. Banks, Real Estate and Technology are pricing in worse revisions than what we have currently, while Consumers are priced for significantly better revisions. Overall investor positioning remains very cautious with the relative performance or risk vs. quality only having been worse in 1997/98, 9/11 and SARS.

Bonds

Opportunities in Indonesia dollar bonds

While there are legitimate concerns about the deterioration in its external accounts and quality of policymaking (especially in relation to FX management adding liquidity risk to holding Indonesian assets), Citi analysts do not anticipate the deterioration in external accounts to be very dramatic – BI could tolerate currency weakness and rising bond yields to offset global de-risking to keep FX reserve coverage at decent levels, still stronger than some EM countries like Turkey. Albeit the negative sentiment on the currency and risk to IDR-denominated government bonds, Citi analysts still believe Indonesia's credit fundamentals remain on sound footing – debt ratios remain very low, and prospects for growth and attracting FDI flows remain strong.

Currencies

AUD: Under pressure
EM Asia: FX as part of overall easing

September 2012 forecasts

AUDUSD	NZDUSD	USDSGD
1.04	0.80	1.25

Citi analysts' short- and long-term valuation models continue to suggest that AUD/USD should be trading around 90-94, and their forecasts is for spot to move towards that over the medium to long term. With AUD likely to come down again, albeit probably not until 4Q12, and with key commodity prices also likely to be weaker, Citi analysts expect a move back below parity in AUD/USD over 6-12 months in the context of generalised USD strength and a stable USD/CNY rate.

Growth weakness within EM Asia relative to expectations has been marked on the back of the Chinese slowdown and export intensive Asian currencies may now underperform. Asian exporters have kept their currencies broadly stable against both USD and CNY but this is unlikely to be sustained if domestic data continues to weaken and USD strengthens as expected over the medium term. There is also a growing recognition that a weaker currency could be desirable as part of broader monetary easing. Considering that China needs to maintain export competitiveness, Citi forecasts USD/CNY at 6.38 over the next three months.

Source: CR

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	13096.17	13338.66	10404.49	+0.16%	+7.19%	+7.19%
S&P 500	1390.99	1422.38	1074.77	+0.36%	+10.61%	+10.61%
Nasdaq	2967.90	3134.17	2298.89	+0.33%	+13.92%	+13.92%
EUROPE						
DJ Euro STOXX	236.03	257.68	194.63	+2.41%	+4.54%	-0.21%
FTSE 100	5787.28	5989.07	4791.01	+2.84%	+3.86%	+4.72%
DAX	6865.66	7194.33	4965.80	+2.63%	+16.40%	+11.11%
JAPAN						
Nikkei 225	8555.11	10255.15	8135.79	-0.13%	+1.18%	-0.91%
TOPIX	723.94	872.42	692.18	-0.34%	-0.64%	-2.69%
ASIA						
MSCI Asia ex Japan	417.11	454.52	353.80	+1.57%	+6.19%	+6.19%
Hong Kong Hang Seng	19666.18	21760.34	16170.35	+2.03%	+6.68%	+6.84%
Shanghai Composite Index	2132.80	2644.58	2100.25	+0.19%	-3.03%	-4.16%
Taiwan Weighted Index	7217.51	8170.72	6609.11	+1.31%	+2.06%	+3.23%
Korea KOSPI	1848.68	2057.28	1644.11	+1.07%	+1.26%	+3.18%
Mumbai Sensex	17197.93	18523.78	15135.86	+2.13%	+11.28%	+6.58%
Singapore Straits Times Index	3051.33	3085.70	2521.95	+1.76%	+15.30%	+20.29%
Kuala Lumpur Composite	1635.04	1647.94	1310.53	+0.62%	+6.81%	+8.67%
Thai Stock Exchange	1197.53	1247.72	843.69	+1.66%	+16.80%	+17.13%
Jakarta Composite Index	4099.81	4234.73	3217.95	+0.38%	+7.27%	+3.61%
Philippines Stock Exchange Index	5285.91	5403.16	3715.01	+1.27%	+20.90%	+26.82%
Australia All Ordinaries	4243.03	4515.00	3829.40	+0.20%	+3.21%	+6.24%
EMEA						
Russia MICEX Index	1421.28	1639.62	1241.62	+1.07%	+1.36%	+1.91%
South Africa JSE All Shares Index	35244.22	35344.18	28305.41	+1.65%	+10.19%	+9.40%
Turkey ISE National 100 Index	65303.64	65444.94	48600.16	+1.45%	+27.38%	+35.23%
LATIN AMERICA						
Mexico Bolsa Index	40998.40	41600.59	31561.51	-1.15%	+10.57%	+17.07%
Brazil Bovespa Index	57255.22	68969.99	47793.49	+1.24%	+0.88%	-7.09%
COMMODITIES						
Gold	1603.48	1921.15	1522.65	-1.20%	+2.54%	+2.54%
Oil	91.40	110.55	74.95	+1.41%	-7.52%	-7.52%
FIXED INCOME						
Citigroup World Government Bond Index	628.56	629.42	596.02	+0.14%	+3.17%	+3.17%

Source: Bloomberg (As at August 3, 2012)

CURRENCY FORECASTS

Currency		6-Aug-12	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14
G10-US Dollar											
Euro	EURUSD	1.24	1.22	1.20	1.18	1.16	1.18	1.22	1.25	1.29	1.3
Japanese yen	USDJPY	78	78	79	80	82	82	83	83	84	84
British Pound	GBPUSD	1.56	1.56	1.55	1.53	1.51	1.53	1.57	1.60	1.64	1.65
Swiss Franc	USDCHF	0.97	0.98	1.00	1.02	1.04	1.02	0.99	0.96	0.93	0.92
Australian Dollar	AUDUSD	1.06	1.04	1.02	1.00	0.98	0.96	0.94	0.92	0.90	0.90
New Zealand	NZDUSD	0.82	0.80	0.79	0.76	0.74	0.71	0.69	0.67	0.65	0.65
Canadian Dollar	USDCAD	1.00	1.01	1.01	1.00	1.00	0.99	0.99	0.98	0.97	0.97
Dollar Index	DXY	82.29	83.22	84.28	85.64	87.06	85.77	83.80	81.97	80.20	79.61
G10 Crosses											
Japanese yen	EURJPY	97	95	95	95	94	97	101	105	108	110
Swiss Franc	EURCHF	1.20	1.20	1.20	1.20	1.20	1.20	1.20	1.20	1.20	1.21
British Pound	EURGBP	0.79	0.78	0.78	0.77	0.77	0.77	0.78	0.78	0.79	0.79
Swedish Krona	EURSEK	8.32	8.49	8.47	8.44	8.41	8.40	8.40	8.40	8.40	8.41
Norwegian Krone	EURNOK	7.40	7.48	7.47	7.44	7.41	7.38	7.36	7.33	7.31	7.30
Norwegian Krone	NOKSEK	1.12	1.13	1.13	1.13	1.14	1.14	1.14	1.15	1.15	1.15
Australian Dollar	AUDNZD	1.29	1.29	1.31	1.32	1.34	1.35	1.36	1.37	1.38	1.39
Australian Dollar	AUDJPY	82.8	81.2	80.9	80.7	80.4	79.4	78.2	77.0	75.9	75.6
EM Asia											
Chinese Renminbi	USDCNY	6.37	6.38	6.37	6.36	6.34	6.30	6.25	6.21	6.16	6.14
Hong Kong Dollar	USDHKD	7.75	7.75	7.75	7.76	7.76	7.76	7.76	7.75	7.75	7.75
Indonesian Rupiah	USDIDR	9468	9452	9502	9568	9634	9649	9649	9649	9649	9639
Indian Rupee	USDINR	55.8	54.3	54.3	54.8	55.2	54.7	54.0	53.2	52.5	52.1
Korean Won	USDKRW	1127	1140	1152	1167	1182	1164	1138	1112	1086	1074
Malaysian Ringgit	USDMYR	3.11	3.15	3.17	3.20	3.22	3.21	3.18	3.15	3.12	3.10
Philippine Peso	USDPHP	41.8	42.4	42.6	42.8	43.0	42.6	42.0	41.5	40.9	40.7
Singapore Dollar	USDSGD	1.24	1.25	1.26	1.27	1.28	1.27	1.26	1.25	1.23	1.23
Thai Baht	USDTHB	31.4	31.5	31.6	31.8	32.0	31.6	31.1	30.5	30.0	29.8
Taiwan Dollar	USDTWD	29.9	30.2	30.4	30.4	30.5	30.1	29.6	29.1	28.6	28.5
EM Europe											
Czech Koruna	EURCZK	25.22	25.36	25.48	25.72	25.95	25.72	25.37	25.03	24.68	24.44
Hungarian Forint	EURHUF	278	293	292	289	286	286	287	288	290	289
Polish Zloty	EURPLN	4.07	4.20	4.26	4.32	4.39	4.30	4.18	4.05	3.93	3.90
Israeli Shekel	USDILS	3.97	4.16	4.20	4.20	4.20	4.16	4.11	4.06	4.01	3.96
Russian Ruble	USDRUB	32.0	33.0	33.9	34.6	35.3	34.9	34.3	33.8	33.2	32.8
Russian Ruble	Basket	35.5	36.3	36.9	37.3	37.7	37.7	37.7	37.6	37.5	37.5
Turkish Lira	USDTRY	1.78	1.79	1.81	1.84	1.87	1.87	1.87	1.86	1.85	1.86
South African Rand	USDZAR	8.16	8.25	8.37	8.52	8.67	8.70	8.71	8.71	8.72	8.80
EM Latam											
Brazilian Real	USDBRL	2.03	1.99	2.00	2.03	2.05	2.04	2.01	1.98	1.96	1.94
Chilean Peso	USDCLP	481	487	493	500	507	504	500	495	491	490
Mexican Peso	USDMXN	13.1	13.2	13.3	13.5	13.7	13.4	13.0	12.7	12.3	12.3
Colombian Peso	USDCOP	1787	1766	1788	1820	1853	1848	1833	1818	1803	1810

Source: CR, Bloomberg (As August 6, 2012; Forecasts as of July 20, 2012)

GENERAL DISCLOSURE