# FINANCIAL MARKET ANALYSIS

**Volume 12, Issue 27** **July 16, 2012**

## Markets edge higher on stimulus hopes and better-than-expected US earnings

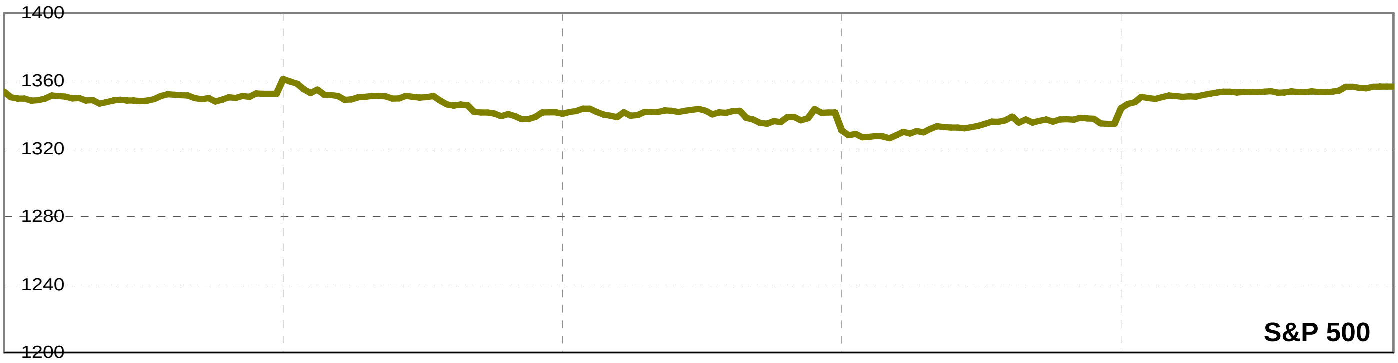
US and European equity markets continued their march higher last week despite further evidence of a China slowdown. Markets hung on to hopes of further stimulus by policymakers in China and the developed world, while better-than-expected corporate earnings results out of the US added to the positive sentiment. The S&P 500 index climbed 1.7% on Friday to end the week up 0.2% (to 1,356.78), while the Stoxx Europe index managed a weekly gain of 0.82% to close at 226.12. Focus this week is likely to be on Fed Chairman Bernanke's mid-week congressional testimony and the EuroGroup meeting of Euro Area Finance Ministers on Friday which will discuss the Spanish bank bailout. US data releases include Retail Sales, Empire State Manufacturing and Business Inventories on Monday, CPI and Industrial Production on Tuesday, Housing Starts on Wednesday, Existing Home Sales, Philadelphia Business Survey and Leading Indicators on Thursday. In Europe, we have Euro Area HICP and Trade Balance (Monday); Germany ZEW Economic Expectations and UK CPI (Tuesday); UK Claimant Count Unemployment and LFS Unemployment (Wednesday); UK Retail Sales (Thursday); Germany Producer Prices and UK Public Sector Net Borrowing (Friday). Data in Asia include India WPI (Monday); Singapore NODX (Tuesday); CPI from India and Malaysia (Wednesday); Hong Kong Unemployment (Thursday); Taiwan Export Orders (Friday).

| | Jul 13 Close | Last week's return | YTD Return | YTD return (USD) |
|---|---|---|---|---|
| **S&P 500:** | 1356.78 | +0.16% | +7.89% | +7.89% |
| **Stoxx Europe:** | 226.12 | +0.82% | +0.15% | -5.48% |
| **Nikkei 225:** | 8724.12 | -3.29% | +3.18% | +0.30% |
| **MSCI Asia ex Japan:** | 402.60 | -2.58% | +2.50% | +2.50% |

**In this issue:**

- *US economy: Modestly better 2H expected*
- *Europe equities: Reducing DJ Stoxx end-2012 target to 275*
- *Asia Pacific ex Japan equities: Singapore: Mixed bag for 2Q12, with more misses than beats expected*

# TAKING STOCK




## Monday Jul 9

| | |
|---|---|
| S&P: | -0.16% |
| STOXX: | -0.33% |
| Nikkei: | -1.37% |
| MSCI Asia ex Japan: | -1.61% |

**US:** Consumer credit rose US$17.117bn (+8.0% annualized) to US$2.572.8tn, vs. +US$9.950bn in Apr, well above market expectations for a +US$8.500bn increase.

**EU:** German goods trade surplus narrows more than expected, to EUR15.3bn in May from and upwardly revised EUR16.2bn in Apr (Prev. EUR16.1bn), as a 3.9% MoM climb in exports is overwhelmed by a 6.3% MoM increase in imports.

**JP:** May private machinery orders ex ships and power plants (private core orders) declined -14.8% MoM (+1.0% YoY) after +5.7% MoM (+6.6% YoY) in Apr.

**JP:** The current account posted a seasonally adjusted surplus of ¥282.2bn in May, vs. consensus of ¥401.4bn.

**AP:** China CPI fell -0.6% MoM in Jun, and rose 2.2% YoY (Consensus 2.3% YoY). PPI declined -0.7% MoM and YoY deflation increased from -1.4% YoY in May to -2.1% in Jun (Consensus -2.0% YoY).

**AP:** Taiwan exports fell -3.2% YoY in Jun (May -6.3%, Consensus +2.3%). Imports fell -8.4% YoY (May -10.5%, Consensus -1.5%). The trade surplus widened to US$2.58 bn (May US$2.26 bn).

**Others:** OECD composite leading indicators for May showed a slight easing to 100.3 from 100.4 in Apr, with that for the Eurozone holding steady at 99.6, suggesting a slowdown, and that for the US down at 100.9 from 101.1 in Apr, pointing to a growth moderation. The Japan measure eased to 100.7 from 100.8 in Apr, whilst that for China dipped to 99.2 from 99.4 in Apr.

## Tuesday Jul 10

| | |
|---|---|
| S&P: | -0.81% |
| STOXX: | +0.77% |
| Nikkei: | -0.44% |
| MSCI Asia ex Japan: | +0.01% |

**US:** NFIB Small Business Optimism fell to 91.4 in Jun (lowest since Oct '11), vs. 94.4 in May and below market expectations of 93.3. Only 1 of 10 measured categories saw growth in Jun, coming in the form of slightly less negative credit conditions (-8% from -10% in May). Plans to hire pushed lower (+3%, down from +6%).

**EU:** UK May industrial output rebounded by 1.0% MoM (Consensus -0.2% MoM) on a 1.2% MoM surge in manufacturing output. Apr IP was revised down to -0.4%, from a previous flat reading, with manufacturing for Apr also revised lower to -0.8% from -0.7% previously. So despite the rebound in May IP, the 3mth/3mth trend remains weak, at -0.3% in the 3mths to May, vs. -0.4% in the 3mths to Apr.

**EU:** UK goods trade deficit narrowed to -£8.4bn in May from -£9.7bn in Apr.

**AP:** China exports expanded by 11.3% YoY in Jun, down from 15.3% YoY in May, but beating market expectations of 10.6% YoY. YoY import growth fell significantly to 6.3% from 12.7% in May, lower than expectations of 11.0%. As a result, the trade surplus reached US$31.7bn vs. US$18.7bn in May. In 1H12, exports and imports grew by 9.2% and 6.7% YoY, respectively, and cumulative surplus reaches US$68.9bn.

## Wednesday Jul 11

| | |
|---|---|
| S&P: | +0.00% |
| STOXX: | -0.10% |
| Nikkei: | -0.08% |
| MSCI Asia ex Japan: | +0.15% |

**US:** The May trade deficit narrowed to -US$48.7bn from -US$50.6bnin Apr, in line with consensus of -US$48.6bn. Exports increased 0.2% MoM (Apr -0.9%), while imports fell -0.7% MoM (Apr -1.6%). The real dollar goods balance narrowed to -US$48.0bn from -US$48.7bn in Apr.

**US:** Wholesale inventories rose 0.3% MoM in May (Apr 0.5%, Consensus 0.3%). The rise in inventories stemmed entirely from gains seen in durable goods (0.6% MoM), partially offset by a decrease in non-durable goods (-0.2% MoM). Wholesale sales fell -0.8% MoM, vs. +0.6% MoM in Apr, leading to an increase in the inventory/sales ratio of 1.18 mths (from 1.17 mths).

**EU:** German Jun CPI (final) fell -0.1% MoM (+1.7% YoY), confirming the prelim reading.

**EU:** French May current account deficit narrowed to -€4.1bn in May, compared with -€4.4bn in Apr.

**AP:** Australia housing finance approval numbers to owner-occupiers fell by -1.2% in May, going against market expectations for a 0.8% rise.

**AP:** Australia consumer sentiment increased by 3.7% in Jul to an almost neutral level of 99.1 points.

**AP:** Korea's seasonally-adjusted jobless rate held steady at 3.2% in Jun.

**AP:** Malaysia May industrial production rose 7.6% YoY (Apr 3.2% YoY), above consensus of 4.6% YoY. Official seasonally-adjusted data showed a sequential expansion of 3.0% MoM SA (Apr -1.7% MoM SA).

## Thursday Jul 12

| | |
|---|---|
| S&P: | -0.50% |
| STOXX: | -0.91% |
| Nikkei: | -1.48% |
| MSCI Asia ex Japan: | -2.10% |

**US:** Initial jobless claims for the week ending 7 Jul fell by -26K to 350K (lowest since Mar '08), below market expectations of 372K. The 4-week average fell to 376.5K from 386.3K.

**US:** Import prices fell -2.7% MoM (-2.6% YoY) in Jun. Ex-petroleum import prices fell -0.3% MoM (-0.2% YoY), the biggest YoY decline since Dec '09.

**US:** Jun budget deficit was -$59.7bn (+38.7% YoY), vs. -$43.1bn in Jun '11, in line with market expectations of -$60.0bn. Fiscal YTD, the budget deficit (-$904.2bn) remains -6.8% YoY below that at this point in 2011.

**EU:** May Eurozone industrial production rose 0.6% MoM (Apr -1.1%, Consensus 0%).

**JP:** Bank of Japan left the total size of the asset purchase program unchanged at ¥70trn but changed the composition.

**AP:** Australia Jun employment fell -27K vs. market expectations of +2.5K, Apr was revised down to +28K from +39K; hours worked fell -1.2%; the participation rate eased 2pts to 65.2; the unemployment rate rose to 5.2% from 5.1%.

**AP:** China M2 grew 13.6% in Jun, the fastest pace since Dec '11 and close to PBOC's 14% forecast. M1 grew 4.7% from 3.5% in May. New RMB lending reached 920bn, and RMB credit outstanding was 16% higher than that of Jun '11.

**AP:** Bank Indonesia left the FasBI rate at 3.75% and BI rate 5.75%.

**AP:** Bank of Korea cut the policy rate by 25 bps to 3%.

## Friday Jul 13

| | |
|---|---|
| S&P: | +1.65% |
| STOXX: | +1.41% |
| Nikkei: | +0.05% |
| MSCI Asia ex Japan: | +0.98% |

**US:** Jun producer prices rose +0.1% MoM (+0.7% YoY), vs. -1.0% MoM (+0.7% YoY) in May, well above market expectations of -0.4% MoM (+0.2% YoY). PPI ex-food and energy came in at +0.2% MoM (+2.6% YoY), similar to May +0.2% MoM (+2.7% YoY), in line with market expectations.

**US:** Reuters/Michigan sentiment estimate for Jul fell to 72.0 (lowest since Dec '11) from 73.2 in Jun, below market expectations of 73.5.

**EU:** Moody's cut Italy's rating by 2 notches to Baa2, maintained negative outlook.

**EU:** UK ONS reported a fall in construction output (-6.3% YoY) in May, causing the Mar-May 3mth rate to fall by -7.4% YoY, dragged by a -22.9% fall in new public housing work.

**AP:** China GDP growth slowed from 8.1% YoY in 1Q12 to 7.6% YoY in 2Q12, in line with market expectations of 7.7% YoY. Seasonally adjusted annualized growth accelerated from 6.6% in 1Q12 to 7.4% in 2Q12.

**AP:** China FAI grew 20.4% YoY in 1H12, vs. 20.1% in the first five months. Retail sales growth decelerated slightly from 13.8% YoY in May to 13.7% YoY in Jun. Industrial production decelerated from 9.6% YoY in May to 9.5% YoY in Jun.

**AP:** Advance estimates for Singapore 2Q12 GDP declined -1.1% QoQ SAAR, although rising +1.9% YoY (1Q12 +9.4% QoQ SAAR, +1.4% YoY), below market expectations (+0.6% QoQ SAAR, +2.3% YoY).

**AP:** Singapore May retail sales slowed to 0.5% YoY (Apr 2.1%, Consensus 2.6%).

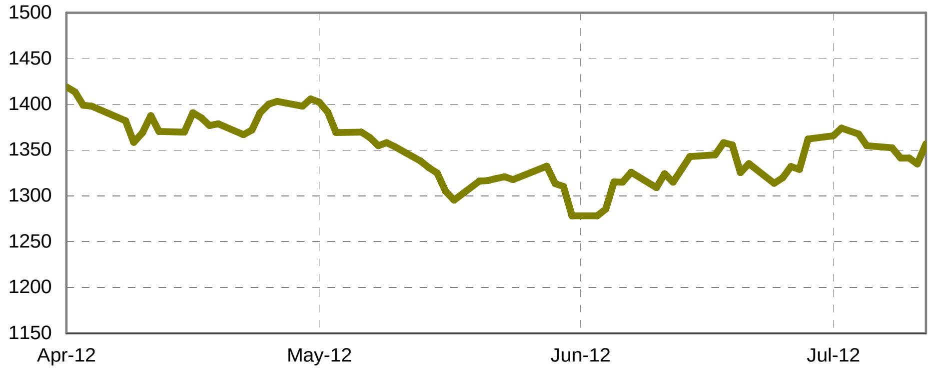
## Over the Weekend Jul 14 and Jul 15

**Others:** --

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

# US/NORTH AMERICA

**S&P 500 (2/4/2012 to 13/7/2012)**




*Source: Bloomberg*

## Economic Outlook

**Modestly better 2H expected**

Federal Reserve (Fed) Chairman Bernanke is likely to reaffirm this week that the Fed is prepared to offer additional support amid signs that the economy ended 2Q12 on a down note. A third straight month of subpar job growth has resolved some of the puzzle between earlier strong hiring and modest output, but a wider array of healthier labour data leaves unanswered questions for policymakers. Barring major financial market setbacks, additional quantitative easing (QE) in August seems unlikely and clearer policy assessments may still be months away.

Citi analysts still see 2H12 growth on a 2% track with two-sided risks around that, reflecting upside from housing counterbalanced by anecdotal reports that businesses are wary of major new commitments ahead of elections. Suspicions that seasonal factors have obscured monthly employment patterns may be tested in July as seasonal adjustment plays a very limited role this month. Near-term recovery will depend importantly on continued modest growth in consumer spending. The earlier drop in the savings rate appears to have corrected in part and an anomalous weakening in labour income has reversed sharply in June, reinforcing the view that key data have been distorted temporarily.

## The Week Ahead

*16/7*

- **Retail sales** probably increased at a moderate pace (0.2%) in June after two successive declines.

*17/7*

- Citi analysts look for only a modest increase in June **consumer prices** (0.1%), as soft food prices and lower gasoline costs weighed on the index.
- **Industrial production** probably edged higher in June (0.1%), signalled by gains in manufacturing hours worked.

*18/7*

- **Housing starts** likely climbed in June to 740K, as single-family starts continued to trend gradually higher and multifamily ground breakings partially recovered from the large drop in May.

*19/7*

- **Initial jobless claims** for the week ending July 14 probably rebounded by 20K to 370K following a drop related to special factors surrounding the annual auto factory retooling season.
- June Conference Board's **leading economic index** likely fell for the first time in nine months (-0.2%).

## Equities

**Latest institutional client poll shows investor nervousness has returned**

| | Last week's close | Last week's return | YTD return |
|---|---|---|---|
| **S&P 500** | 1356.78 | +0.16% | +7.89% |
| **DJIA** | 12777.09 | +0.04% | +4.58% |
| **Nasdaq** | 2908.47 | -0.98% | +11.64% |

As opposed to a fairly bullish stance in the early April survey, Citi's latest institutional client poll shows investors seem a bit more cautious currently with expectations for an essentially flat S&P 500 by year-end. Indeed, the market's swoon in May, weak economic data and concerns surrounding government policy have led to a pickup in average cash holdings as a percent of assets under management. Yet, investors overwhelmingly do not expect a US recession in 2012 even as corporate confidence has fallen and a majority of clients believe gold prices will fall further this year (which is consistent with forecast greenback strength).

In terms of sectors, clients continue to like the Technology sector for outperformance (commensurate with a style preference for Growth over Value) though Materials have overtaken Utilities for the sector voted most likely to underperform. In addition, the Financials sector has reversed the prior three quarters of outperformance expectations, with investors now considering underperformance potential.

## Bonds

**Preference for high-grade corporates and emerging market debt**

| | Jul 13 2012 | Jul 6 2012 | Jun 29 2012 |
|---|---|---|---|
| **2-yr Try:** | 0.238% | 0.270% | 0.301% |
| **5-yr Try:** | 0.620% | 0.643% | 0.718% |
| **10-yr Try:** | 1.488% | 1.549% | 1.645% |

**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 continue**

**September 2012 forecasts**

| EURUSD | USDJPY | USDCAD |
|---|---|---|
| 1.24 | 80 | 1.03 |

USD strength continues to be Citi analysts' central forecast, reflecting potential US cyclical outperformance as well as periodic bouts of risk aversion. Higher bond yields relative to other G10 countries may also support USD.

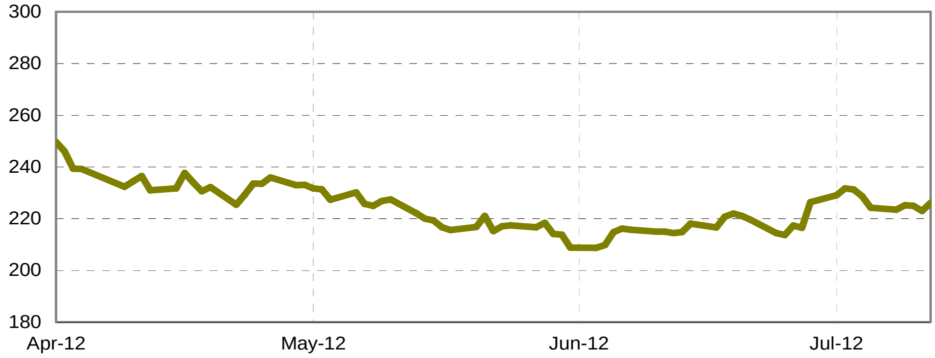
Medium term, risk stem from the so called "fiscal cliff" and US policy paralysis after the Presidential Elections in November. Citi analysts however expect this to be contained.

All in all, Citi forecasts anticipate further USD gains medium-term, especially relative to G10 majors with EUR/USD potentially falling through 1.20 and AUD towards 0.95.

*Source: CR*

# EUROPE

**STOXX (2/4/2012 to 13/7/2012)**




*Source: Bloomberg*

## Economic Outlook

**Germany: Facing low growth but no recession expected**

The slowdown in economic sentiment indicators highlights that the German economy is not immune to the Euro Area crisis. While Citi analysts expect that increasing domestic demand is likely to prevent a recession, Germany is facing a period of low growth ahead.

With the 2013 general elections coming closer, political decision making is likely to get more difficult. This is likely to affect Germany's willingness to go ahead with further support measures in the sovereign debt crisis. The outstanding verdict of the constitutional court might introduce additional restrictions to the German sovereign's ability to support its Euro Area partners.

The potential liabilities of the German sovereign to the European Rescue Mechanisms have increased substantially to about €400bn and on top of this, the Bundesbank has an exposure of about €290bn to the periphery countries, if the euro does not completely break up or Germany leaves the monetary union. The private sector has started to reduce its exposure to the periphery countries in recent years but still holds assets worth around €700bn.

## The Week Ahead

*16/7*

- **Euro Area:** Citi analysts expect that **core consumer prices** (ex food and energy) were unchanged on a monthly basis in June (-0.1% MoM, 2.3% YoY).

*17/7*

- **Germany:** Citi analysts expect **ZEW business expectations** to fall to -20 for a third consecutive month in July.

*18/7*

- **UK:** The **claimant count jobless** ticked up in May after two months of declines, and could rise again in June given the recent weakness in the economy (+5,000 MoM, 4.9% Rate).

*19/7*

- **UK:** Citi analysts anticipate a small drop in June **retail sales** (-0.4% MoM, 1.3% YoY).

*20/7*

- **Germany:** Falling prices for oil and other commodities probably mainly contributed to the fall in **producer prices** on a monthly basis in June (-0.6% MoM, 1.4% YoY).

## Equities

**Reducing DJ Stoxx end-2012 target to 275**

| | Last week's close | Last week's return | YTD Return |
|---|---|---|---|
| **STOXX** | 226.12 | +0.82% | +0.15% |
| **FTSE 100** | 5666.13 | +0.06% | +1.68% |
| **DAX** | 6557.10 | +2.29% | +11.17% |

Despite relentless macro risk, European equities have performed well, posting the same positive YTD returns as the US (+8%). Nevertheless, growth is likely to remain sluggish over the next 12-18 months and risks are downside skewed. As such, Citi analysts are reducing their end-2012 Stoxx target from 285 to 275. This implies 7-8% upside to year-end and based on 0% earnings growth this year would imply an end-2012 trailing P/E of 12x. They have also established an end-2013 Stoxx target of 285, which is based on earnings growth expectations of 0-10% in 2013 and no re-rating from end-2012. This implies total returns of 15-20% from European equities over the next 12-18 months.

Citi analysts continue to back the structural themes of growth, strong balance sheet and attractive dividends. Overweights are more international and have stronger balance sheets: Health Care, Food & Beverage, Personal & Household Goods, Insurance, Chemicals, Basic Resources. Underweights have more European exposure and leverage: Retail, Construction, Media, Utilities, Real Estate, Travel & Leisure.

## Bonds

**Favour UK Gilts vs German Bunds**

| | Jul 13 2012 | Jul 6 2012 | Jun 29 2012 |
|---|---|---|---|
| **2-yr Try:** | -0.042% | -0.010% | 0.124% |
| **5-yr Try:** | 0.309% | 0.340% | 0.611% |
| **10-yr Try:** | 1.260% | 1.327% | 1.583% |

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.

Conversely, the UK Gilt curve has bull-steepened, due to the reduction in QE and higher-than-expected inflation data. Market indicators show that inflation expectations have since retreated. Citi analysts find the long end of the UK curve attractive.

## Currencies

**EUR: Downward pressures remain**
**GBP: Renewed BoE easing a GBP negative**

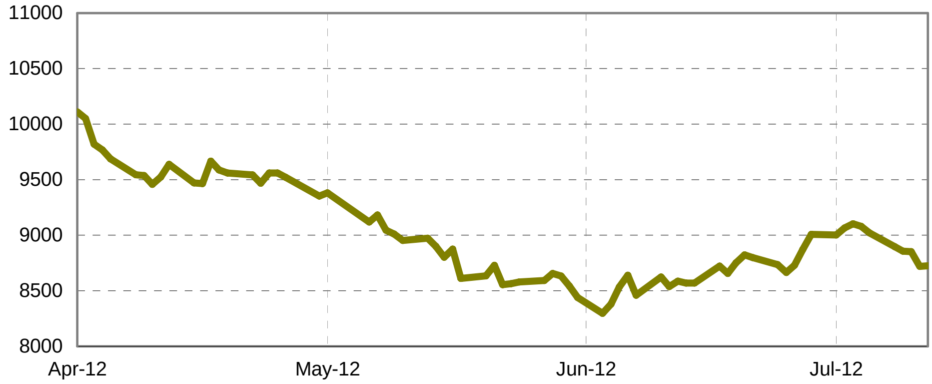
| September 2012 forecasts | | |
|---|---|---|
| **GBPUSD** | **USDCHF** | **EURGBP** |
| 1.55 | 0.97 | 0.80 |

Within G10, EUR is expected to be notably weak, potentially falling on all major crosses as further European Central Bank rate cuts, long-term refinancing operations (LTROs) and the ongoing rise in risk premia undermine the single currency. Citi forecasts EUR/USD consolidating in a 1.20-1.30 band for the next few months before trending through the lower level of this band over 6-12 months with a 1.10-1.20 trading range then possible.

The Bank of England (BoE) has acknowledged that the UK economy is likely to stay weak and signalled that further quantitative easing (QE) may be forthcoming. Citi analysts expect QE to be expanded markedly further over time, reaching a total of about £500bn. Considering that previous QE expectations had weighed on GBP, Citi analysts have lowered their GBP/USD forecasts to 1.55 in 0-3 months and 1.46 in 6-12 months. EUR/GBP is forecasted to be broadly stable at 0.79 in 6-12 months.

*Source: CR*

**Nikkei 225 (2/4/2012 to 13/7/2012)**




*Source: Bloomberg*

## The Week Ahead

*19/7*

- Citi analysts expect a -0.4% MoM drop in May **all industry activity index** (April +0.1% MoM), based on a -3.1% MoM fall in industrial production and a +0.7% MoM rise in the tertiary industry activity index for the month. The construction industry activity index likely rose +4.5% MoM in May along with no change in the government services index. If the May estimates are on the mark, the average all industry activity index in April and May is estimated to stand 0.3% below the 1Q12 average (-0.1% QoQ in 1Q12).

## Economic Outlook

**Reflecting the consumption tax hike into the economic outlook**

Now that the consumption tax hike bill, calling for the tax rate hike to 8% in April 2014 from the current 5% and then to 10% in October 2015, is likely to be approved by the Upper House in August, Citi analysts are reflecting the tax hike into their economic forecasts. They expect GDP growth in fiscal 2013 to be pushed up to 2.5% (previously 1.3%) by a frontloading in spending ahead of the tax hike. GDP growth in fiscal 2014 may slow sharply due to a payback to frontloaded spending and erosion in real household disposable income driven by tax hikes. Citi analysts expect virtually zero growth in fiscal 2014, which in turn might make the second tax hike politically difficult to implement. The tax hike is likely to have a significant impact on monetary policy. The Bank of Japan (BoJ) is expected to leave policy rates unchanged through fiscal 2014 given the likely sharp slowdown in the economy in that year. Moreover, if the government should forgo the second tax hike due to consideration for the economy, it could make the BoJ's rate hike in 2015 quite difficult.

## Equities

**Changes in how Japanese companies spend their money**

| | Last week's Close | Last week's return | YTD return |
|---|---|---|---|
| **Nikkei** | 8724.12 | -3.29% | +3.18% |
| **Topix** | 746.34 | -3.30% | +2.43% |

There are four primary ways companies can use their cash holdings: 1) to pay down debt; 2) for capex; 3) on merger and acquisition (M&A); and 4) for shareholders' return. Citi analysts believe capex and in particular, in-out M&A are likely to increase in FY12.

In the Bank of Japan's Tankan survey, manufacturers say they plan to increase capex by 7.2% in FY12. Management sentiment deteriorated in the wake of the March 11 disaster, resulting in capex being held below depreciation costs. However, management sentiment has since improved, and capex is likely to rise, in part as a rebound after previous curtailment.

Indeed, the number of in-out M&A by Japanese firms appears to be recovering. If the pace seen since the start of the year continues, in-out M&A numbers would hit a record level in 2012. Citi analysts see three main reasons for the increase in in-out M&A: 1) management sees the need to make forays overseas from the standpoint of long-term growth as the domestic population is declining; 2) the yen is strong at around ¥80/$; and 3) the emergency facility to combat yen strength set up by the government in August 2011 is being used.

## Bonds

**Some JGB underperformance around the fiscal year-end expected**

| | Jul 13 2012 | Jul 6 2012 | Jun 29 2012 |
|---|---|---|---|
| **2-yr Try:** | 0.105% | 0.105% | 0.114% |
| **5-yr Try:** | 0.186% | 0.200% | 0.220% |
| **10-yr Try:** | 0.778% | 0.800% | 0.837% |

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** |
| 80 | 99 | 80.0 |

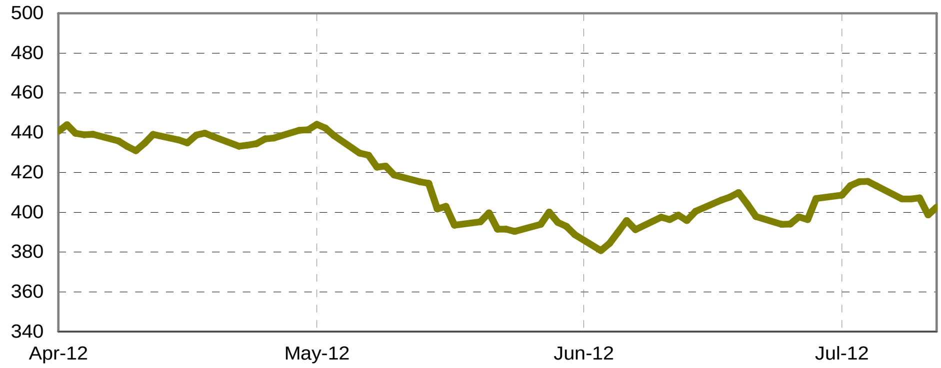
In risk-off periods, both USD and JPY tend to be beneficiaries, though the exchange rate tends to move moderately lower. But for now at least, 75-76 seems to be the line in the sand for Ministry of Finance/Bank of Japan (BoJ) intervention. As such, the bottom part of the range could hold for the short- to medium-term, absent a serious deterioration in global growth and risk appetite.

One factor that has supported JPY is the BoJ's stance. Typically, the BoJ is much less aggressive with monetary easing than the Federal Reserve. This may be changing slightly with the BoJ finally adopting an inflation target, though significant additional quantitative easing still seems lacking. The recent political breakthrough on the sales tax may be slightly positive for JPY as it implies fiscal sustainability medium-term and suggests that pro-cyclical fiscal tightening may be avoided short-term and thus there may be less need for significant additional BoJ easing. Nonetheless, two new doves recently joined the BoJ Board, so some easing is possible and may be combined with intervention if USD/JPY slips to the lower end of the trading range.

*Source: CR*

# ASIA PACIFIC EX JAPAN

**MSCI Asia ex Japan (2/4/2012 to 13/7/2012)**




*Source: Bloomberg*

## The Week Ahead

*16/7*

- **India: WPI** inflation likely inched up to 7.6% in June as INR weakness likely offset the fall in commodity prices.

*17/7*

- **Singapore:** June **NODX** growth probably declined -0.2% YoY (May 3.2%). This implies a -0.3% MoM SA decline (May -2.1%), supported by the 1.3% depreciation in the SGD in June from May.

*18/7*

- **Malaysia:** June **CPI** inflation likely remained stable at 1.7% YoY, rising 0.2% MoM (May 1.7% YoY, 0.2% MoM), helped by a petrol price cut at the start of the month.

*19/7*

- **Hong Kong:** The **unemployment rate** likely retraced from 3.2% sa to 3.4% sa during the period of March-June.

*20/7*

- **Taiwan: Export orders** likely stayed sideways in June on weak global demand, with YoY growth improving slightly to -2.7% from -3.0% in May.

## Economic Outlook

**Singapore: Rising odds of MAS easing on sequential fall in 2Q12 GDP**

Advance estimates for 2Q12 GDP fell -1.1% QoQ SAAR, but rose 1.9% YoY (1Q12 1.4% YoY, +9.4% QoQ SAAR), below Citi's (+2% QoQ SAAR, 2.4% YoY) and market expectations (+0.6% QoQ SAAR, 2.3% YoY). Citi analysts earlier noted that the risk of Monetary Authority of Singapore (MAS) easing could rise if average quarterly GDP growth for the rest of 2012 is weaker than the 2-3% QoQ SAAR growth rate (which would have brought 2012 GDP to 3%) that MAS' April policy decision was implicitly based on. That risk appears to be materializing with the positive output gap having narrowed in 2Q, although this is not a forgone conclusion with 3Q growth and inflation data needed to make a firmer call. While still elevated inflation at near 4% in 2H12 remains a concern, the October 2011 easing suggests this need not be an insurmountable obstacle. A slope reduction may be warranted if a narrowing positive output gap and lagged impact of past tightening set the stage for disinflation in 2013. Even so, with supply constraints from tighter foreign worker quotas, desire to keep inflation expectations anchored, and the need to accommodate a faster pace of medium term structural REER appreciation, any easing steps could be finely calibrated – for example a slope reduction, but not to neutral (as in October 2011).

## Equities

**Singapore: Mixed bag for 2Q12, with more misses than beats expected**

| | Last week's close | Last week's return | YTD Return |
|---|---|---|---|
| **MSCI Asia ex Japan** | 402.60 | -2.58% | +2.50% |

At 2,995, the STI is currently trading at 14.2x forward price-to-earnings (P/E) (vs. historical mean of 15.1x) and 1.40x forward price-to-book (P/B). Year to date, the STI has gained more than 12%, led by strong performances from the Developers (+28%), Banks (+22%) and Offshore Marine (+22%).

In Singapore, the corporate earnings revisions count have turned back into the mildly negative zone after turning positive in April, with 12 months of negative revisions before that.

During the 1Q12 results season, while there were positive corporate earnings revision trends from Industrials and Financials (similar to early 2009), the commodity-linked sectors have deviated from trends in early 2009.

As the 2Q12 results season approaches, Citi analysts expect on balance more misses than beats – exacerbated by the weak advance GDP figures that were announced last week.

## 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: A flat CNY**

| September 2012 forecasts | | |
|---|---|---|
| **AUDUSD** | **NZDUSD** | **USDSGD** |
| 1.00 | 0.79 | 1.25 |

Citi's cautious view on risk assets going forward suggests that AUD could give back some of the recent gains. A downshift in Chinese growth is likely to generate AUD weakness. Domestic monetary policy is also unlikely to provide a boost to the currency given that the Reserve Bank of Australia is forecast to cut rates again this year.

On average, EM Asia currencies are forecast to be modestly higher versus USD in the near term but flat further out. Heavy management in EM Asian FX (ex INR) has tended to mean that currencies are lower beta to global forces than either CEEMEA or Latam. Current account surpluses, and for the most part, good reserve ratios, have reinforced this relative resilience. Yet Asian economies and exchange rates are sensitive to developments in China, and are also the most open/export-reliant economies in EM. The combination of fresh (if modest) monetary easing in China and significant prospective falls in local inflation rates from lower oil prices creates room for easier monetary conditions. Citi forecasts USD/CNY at 6.33 over the next three months, and 6.35 in the medium term.

*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 | 12777.09 | 13338.66 | 10404.49 | +0.04% | +4.58% | +4.58% |
| S&P 500 | 1356.78 | 1422.38 | 1074.77 | +0.16% | +7.89% | +7.89% |
| Nasdaq | 2908.47 | 3134.17 | 2298.89 | -0.98% | +11.64% | +11.64% |
| **EUROPE** | | | | | | |
| DJ Euro STOXX | 226.12 | 274.78 | 194.63 | +0.82% | +0.15% | -5.48% |
| FTSE 100 | 5666.13 | 5989.07 | 4791.01 | +0.06% | +1.68% | +1.95% |
| DAX | 6557.10 | 7382.80 | 4965.80 | +2.29% | +11.17% | +4.92% |
| **JAPAN** | | | | | | |
| Nikkei 225 | 8724.12 | 10255.15 | 8135.79 | -3.29% | +3.18% | +0.30% |
| TOPIX | 746.34 | 872.42 | 692.18 | -3.30% | +2.43% | -0.42% |
| **ASIA** | | | | | | |
| MSCI Asia ex Japan | 402.60 | 491.88 | 353.80 | -2.58% | +2.50% | +2.50% |
| Hong Kong Hang Seng | 19092.63 | 22808.33 | 16170.35 | -3.58% | +3.57% | +3.69% |
| Shanghai Composite Index | 2185.90 | 2826.96 | 2132.63 | -1.69% | -0.61% | -2.06% |
| Taiwan Weighted Index | 7104.27 | 8819.93 | 6609.11 | -3.59% | +0.46% | +1.48% |
| Korea KOSPI | 1812.89 | 2174.73 | 1644.11 | -2.44% | -0.70% | -0.05% |
| Mumbai Sensex | 17213.70 | 18944.60 | 15135.86 | -1.75% | +11.38% | +7.55% |
| Singapore Straits Times Index | 2995.56 | 3227.28 | 2521.95 | +0.57% | +13.20% | +16.00% |
| Kuala Lumpur Composite | 1626.38 | 1635.96 | 1310.53 | +0.36% | +6.25% | +5.61% |
| Thai Stock Exchange | 1210.29 | 1247.72 | 843.69 | +0.85% | +18.04% | +18.04% |
| Jakarta Composite Index | 4019.67 | 4234.73 | 3217.95 | -0.88% | +5.17% | +1.46% |
| Philippines Stock Exchange Index | 5214.52 | 5403.16 | 3715.01 | -2.76% | +19.27% | +24.86% |
| Australia All Ordinaries | 4118.33 | 4681.00 | 3829.40 | -1.92% | +0.18% | -0.13% |
| **EMEA** | | | | | | |
| Russia MICEX Index | 1416.50 | 1741.72 | 1241.62 | +0.16% | +1.02% | -0.42% |
| South Africa JSE All Shares Index | 33792.75 | 34808.92 | 28305.41 | -1.27% | +5.65% | +3.18% |
| Turkey ISE National 100 Index | 62662.16 | 63616.88 | 48600.16 | -0.19% | +22.23% | +27.22% |
| **LATIN AMERICA** | | | | | | |
| Mexico Bolsa Index | 40498.47 | 40582.57 | 31561.51 | +1.67% | +9.23% | +14.16% |
| Brazil Bovespa Index | 54330.51 | 68969.99 | 47793.49 | -1.92% | -4.27% | -12.29% |
| **COMMODITIES** | | | | | | |
| Gold | 1589.68 | 1921.15 | 1522.65 | +0.37% | +1.66% | +1.66% |
| Oil | 87.10 | 110.55 | 74.95 | +3.14% | -11.87% | -11.87% |
| **FIXED INCOME** | | | | | | |
| Citigroup World Government Bond Index | 628.28 | 628.38 | 583.51 | +0.43% | +3.13% | +3.13% |

*Source: Bloomberg (As at July 13, 2012)*

# CURRENCY FORECASTS

| Currency | | 16-Jul-12 | Sep-12 | Dec-12 | Mar-13 | Jun-13 | Sep-13 | Dec-13 | Mar-14 | Jun-14 | Sep-14 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **G10-US Dollar** | | | | | | | | | | | |
| Euro | EURUSD | 1.22 | 1.24 | 1.21 | 1.18 | 1.15 | 1.19 | 1.23 | 1.26 | 1.3 | 1.3 |
| Japanese yen | USDJPY | 79 | 80 | 81 | 81 | 82 | 83 | 83 | 84 | 84 | 84 |
| British Pound | GBPUSD | 1.56 | 1.55 | 1.52 | 1.49 | 1.46 | 1.51 | 1.55 | 1.60 | 1.65 | 1.65 |
| Swiss Franc | USDCHF | 0.98 | 0.97 | 0.99 | 1.02 | 1.04 | 1.01 | 0.98 | 0.95 | 0.92 | 0.92 |
| Australian Dollar | AUDUSD | 1.02 | 1.00 | 0.99 | 0.97 | 0.96 | 0.94 | 0.93 | 0.91 | 0.90 | 0.90 |
| New Zealand | NZDUSD | 0.80 | 0.79 | 0.77 | 0.75 | 0.73 | 0.70 | 0.68 | 0.65 | 0.63 | 0.63 |
| Canadian Dollar | USDCAD | 1.01 | 1.03 | 1.02 | 1.01 | 1.00 | 0.99 | 0.98 | 0.98 | 0.97 | 0.97 |
| Dollar Index | DXY | 83.31 | 83.14 | 84.69 | 86.26 | 87.70 | 85.54 | 83.50 | 81.60 | 79.85 | 79.85 |
| **G10 Crosses** | | | | | | | | | | | |
| Japanese yen | EURJPY | 97 | 99 | 97 | 96 | 95 | 98 | 102 | 106 | 109 | 109 |
| Swiss Franc | EURCHF | 1.20 | 1.20 | 1.20 | 1.20 | 1.20 | 1.20 | 1.20 | 1.20 | 1.20 | 1.20 |
| British Pound | EURGBP | 0.79 | 0.80 | 0.80 | 0.79 | 0.79 | 0.79 | 0.79 | 0.79 | 0.79 | 0.79 |
| Swedish Krona | EURSEK | 8.62 | 8.99 | 8.88 | 8.76 | 8.65 | 8.61 | 8.57 | 8.54 | 8.50 | 8.50 |
| Norwegian Krone | EURNOK | 7.47 | 7.50 | 7.48 | 7.47 | 7.45 | 7.42 | 7.40 | 7.37 | 7.35 | 7.35 |
| Norwegian Krone | NOKSEK | 1.15 | 1.20 | 1.19 | 1.17 | 1.16 | 1.16 | 1.16 | 1.16 | 1.16 | 1.16 |
| Australian Dollar | AUDNZD | 1.28 | 1.26 | 1.28 | 1.30 | 1.32 | 1.35 | 1.37 | 1.40 | 1.43 | 1.43 |
| Australian Dollar | AUDJPY | 80.9 | 80.0 | 79.5 | 79.1 | 78.7 | 77.9 | 77.1 | 76.3 | 75.6 | 75.6 |
| **EM Asia** | | | | | | | | | | | |
| Chinese Renminbi | USDCNY | 6.38 | 6.33 | 6.34 | 6.34 | 6.35 | 6.30 | 6.25 | 6.20 | 6.15 | 6.15 |
| Hong Kong Dollar | USDHKD | 7.76 | 7.75 | 7.75 | 7.76 | 7.76 | 7.76 | 7.75 | 7.75 | 7.75 | 7.75 |
| Indonesian Rupiah | USDIDR | 9484 | 9405 | 9489 | 9571 | 9650 | 9650 | 9650 | 9650 | 9649 | 9649 |
| Indian Rupee | USDINR | 54.9 | 54.0 | 54.5 | 55.0 | 55.5 | 54.6 | 53.8 | 53.1 | 52.3 | 52.3 |
| Korean Won | USDKRW | 1147 | 1140 | 1149 | 1157 | 1164 | 1142 | 1121 | 1100 | 1080 | 1080 |
| Malaysian Ringgit | USDMYR | 3.18 | 3.10 | 3.11 | 3.13 | 3.14 | 3.09 | 3.04 | 2.99 | 2.95 | 2.95 |
| Philippine Peso | USDPHP | 41.9 | 42.1 | 42.2 | 42.4 | 42.5 | 42.0 | 41.6 | 41.2 | 40.8 | 40.8 |
| Singapore Dollar | USDSGD | 1.27 | 1.25 | 1.26 | 1.27 | 1.27 | 1.26 | 1.24 | 1.23 | 1.21 | 1.21 |
| Thai Baht | USDTHB | 31.6 | 30.7 | 31.1 | 31.5 | 31.9 | 31.4 | 30.9 | 30.4 | 29.9 | 29.9 |
| Taiwan Dollar | USDTWD | 30.0 | 30.3 | 29.8 | 29.3 | 28.8 | 28.7 | 28.6 | 28.6 | 28.5 | 28.5 |
| **EM Europe** | | | | | | | | | | | |
| Czech Koruna | EURCZK | 25.41 | 25.91 | 26.02 | 26.14 | 26.23 | 25.84 | 25.45 | 25.07 | 24.69 | 24.69 |
| Hungarian Forint | EURHUF | 288 | 275 | 280 | 285 | 290 | 290 | 290 | 290 | 290 | 290 |
| Polish Zloty | EURPLN | 4.20 | 4.22 | 4.33 | 4.44 | 4.54 | 4.38 | 4.21 | 4.05 | 3.90 | 3.90 |
| Israeli Shekel | USDILS | 3.96 | 3.95 | 3.97 | 3.98 | 4.00 | 4.00 | 4.00 | 4.00 | 4.00 | 4.00 |
| Russian Ruble | USDRUB | 32.6 | 33.4 | 34.2 | 34.9 | 35.6 | 34.9 | 34.3 | 33.6 | 33.0 | 33.0 |
| Russian Ruble | Basket | 35.9 | 37.0 | 37.4 | 37.7 | 38.0 | 37.9 | 37.7 | 37.6 | 37.5 | 37.5 |
| Turkish Lira | USDTRY | 1.81 | 1.78 | 1.82 | 1.85 | 1.88 | 1.87 | 1.86 | 1.86 | 1.85 | 1.85 |
| South African Rand | USDZAR | 8.27 | 8.41 | 8.56 | 8.71 | 8.85 | 8.85 | 8.85 | 8.85 | 8.86 | 8.86 |
| **EM Latam** | | | | | | | | | | | |
| Brazilian Real | USDBRL | 2.04 | 2.01 | 1.99 | 1.97 | 1.95 | 1.92 | 1.90 | 1.87 | 1.85 | 1.85 |
| Chilean Peso | USDCLP | 491 | 493 | 498 | 503 | 507 | 503 | 498 | 494 | 490 | 490 |
| Mexican Peso | USDMXN | 13.3 | 13.4 | 13.5 | 13.6 | 13.7 | 13.3 | 12.9 | 12.6 | 12.2 | 12.2 |
| Colombian Peso | USDCOP | 1776 | 1764 | 1783 | 1802 | 1820 | 1815 | 1810 | 1805 | 1801 | 1801 |

*Source: CR, Bloomberg (As July 16, 2012; Forecasts as of June 27, 2012)*

## GENERAL DISCLOSURE



Sources: Reuters, Bloomberg, Thomson Reuters/Jeffries Citigroup Investment Research & Analysis.