



# FINANCIAL MARKET ANALYSIS

Volume 10, Issue 21

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## Spanish bank woes lead Euro zone fears while tension brews in Korean peninsula

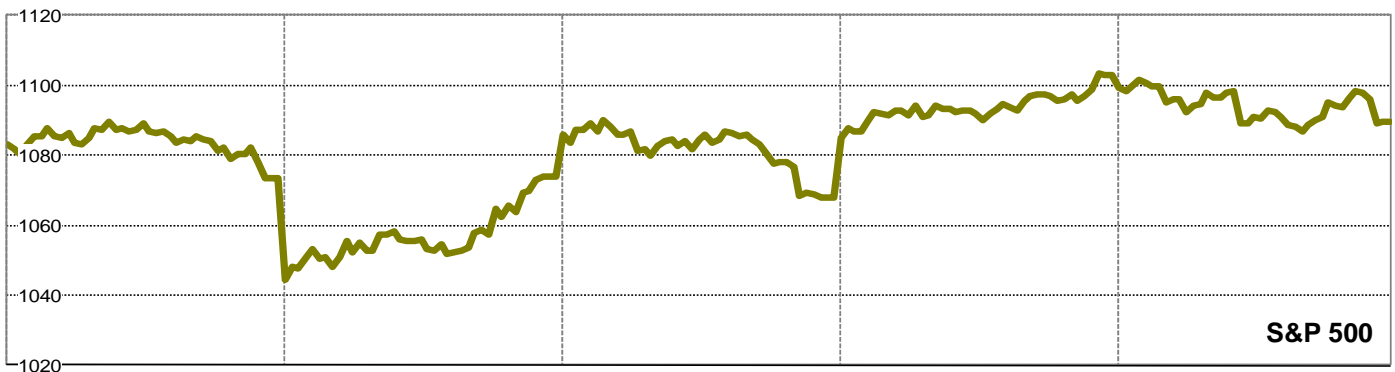
It was another week of wild swings as markets fretted about Europe's continuing sovereign debt crisis and mounting military tensions in the Korean peninsula. The spotlight in Europe was squarely on Spain after a small regional savings bank was bailed out by policymakers, highlighting the fragility of the banking sector across the continent. A narrow parliamentary victory for much-needed austerity measures in Spain did little to boost sentiment, which was dealt another blow at the end of the week by a ratings downgrade of the country's sovereign bonds. Adding to the mix were rumours that the crisis has prompted China to review its holdings of Euro zone sovereign debt, though these were swiftly dismissed by Beijing. Markets were further stressed by growing hostility between North and South Korea over the sinking of a South Korean warship. While appearing for now to be more brinkmanship than actual aggression, this is likely to remain a worry for markets until a proper resolution is found. This week, a slew of key US data, including Friday's employment report for May, may grab the market's attention – yet anxieties about the Euro zone are far from done.

	May 28 Close	Last week's return	YTD Return	YTD return (USD)
<b>S&amp;P 500:</b>	1089.41	+0.16%	-2.30%	-2.30%
<b>DJ Euro STOXX:</b>	249.80	+1.71%	-9.08%	-21.80%
<b>Nikkei 225:</b>	9762.98	-0.22%	-7.43%	-5.80%
<b>MSCI Asia ex Japan:</b>	379.99	+3.28%	-8.77%	-8.77%

### In this issue:

- *US economy: Good news on the economy challenged by financial turmoil*
- *Europe economy: Spanish bank woes highlight fragility of Europe's financial sector*
- *Japan economy: Above-trend growth ahead even with as exports slow*

# TAKING STOCK



Monday May 24	Tuesday May 25	Wednesday May 26	Thursday May 27	Friday May 28
S&P: -1.29%	S&P: +0.04%	S&P: -0.57%	S&P: +3.29%	S&P: -1.24%
STOXX: -0.45%	STOXX: -2.94%	STOXX: +2.02%	STOXX: +3.29%	STOXX: -0.10%
Nikkei: -0.27%	Nikkei: -3.06%	Nikkei: +0.66%	Nikkei: +1.23%	Nikkei: +1.28%
MSCI Asia ex Japan: +1.05%	MSCI Asia ex Japan: -4.33%	MSCI Asia ex Japan: +2.20%	MSCI Asia ex Japan: +2.38%	MSCI Asia ex Japan: +2.11%
<p><b>US:</b> Existing home sales jump 7.6% to an annualised 5.77m-unit pace in Apr. But inventory rises unexpectedly.</p> <p><b>US:</b> A National Association for Business Economics survey sees US GDP growing 3.2% in 2010, higher than the 3.1% forecast earlier. The poll expects unemployment to fall to 9.4% by year-end, and 8.5% by end-2011.</p> <p><b>EU:</b> 4 Spanish banks seek to merge to form the nation's No. 5 financial group. This comes after the Bank of Spain bailed out a small regional bank over the weekend. EUR tanks amid concerns about the health of Europe's banks.</p> <p><b>EU:</b> The IMF says Spain urgently needs far-reaching structural reforms. It says recovery will be weak and fragile with medium-term growth at 1.5%-2%, below the 3% assumed by Madrid.</p> <p><b>EU:</b> UK Chancellor Osborne announces £6.2b of spending cuts this year, the 1st step towards deficit reduction by the incoming government.</p> <p><b>EU:</b> EU Commission President Barroso says Germany's call to toughen sanctions on countries that violate budget rules as naive.</p> <p><b>EU:</b> Italy's government unveils measures to cut its deficit by €24b, 1.6% of GDP.</p> <p><b>AP:</b> Inflation in Singapore doubles to 3.2% in Apr, helped in part by a low base last year. <i>Imported inflation may ease going forward, but not housing and wage inflation, with CPI to continue rising above 3% into 3Q10.</i></p>	<p><b>US:</b> The Dow Jones Industrial index dives below 10,000 though a late rebound erases most of the losses. 3m USD Libor hits 0.54%, the highest since Jul 09, after rising for 11 straight days.</p> <p><b>US:</b> The Conference Board's consumer confidence index rises more than expected from 57.7 in Apr to 63.3 in May, a 2-year high.</p> <p><b>US:</b> The S&amp;P/Case-Shiller 20-city home price index slips 0.5% in Mar.</p> <p><b>US:</b> Minutes of the Fed's Apr policy meeting show 3 of the 12 Fed presidents wanted to raise the emergency loan rate by 25 bps to 1%.</p> <p><b>EU:</b> Germany's Finance Ministry proposes to expand a temporary ban on naked short selling of selected German financial stock to a permanent law covering all German equities and EUR derivatives.</p> <p><b>EU:</b> Real UK GDP growth in 1Q10 is revised up from 0.2% QoQ to 0.3%, as expected. Nominal GDP remains strong, rising about 2%.</p> <p><b>EU:</b> Euro zone industrial orders surge 5.2% in Mar, well above expectations, after Feb's strong 1.9% rise. New orders rise 2.7% in 1Q10, a 4th straight gain, and are up almost 20% since Mar 09.</p> <p><b>AP:</b> North Korea cuts all ties with South Korea, just as it is reported to have put its military on combat alert. This follows sanctions by Seoul against the North for sinking one of its warships. KRW dives, reportedly prompting Bank of Korea intervention.</p>	<p><b>US:</b> Durable goods orders rise 2.9% in Apr, more than expected.</p> <p><b>US:</b> New homes sales surge 15% to an annual pace of 504,000 in Apr. <i>Strong sales in Mar and Apr were likely boosted by a rush to close deals before a homebuyer tax credit expires end-Apr.</i></p> <p><b>EU:</b> The ECB says its USD liquidity tender finds 3 takers, receiving US\$5.4b at 1.23%. It allots just €12.2b for the 3-month LTRO, with just 35 banks using this longer-term funding facility.</p> <p><b>EU:</b> The Financial Times reports that China is reviewing its holding of Euro zone government bonds.</p> <p><b>EU:</b> Mortgage approvals by major UK banks totalled 35,729 in Apr, up from 35,044 in Mar and up 15.5% YoY.</p> <p><b>AP:</b> Industrial production in Singapore outperforms for a 5th straight month, jumping 51% in Apr, after Mar's 46.6% surge. MoM data shows gathering momentum, with production 24.3% higher in Apr than in Mar. <i>While likely boosted by one-off capacity additions, production seems set for another strong quarter, with 2Q10 GDP possibly topping 1Q10's 15.5% jump. Full-year growth may exceed 10%, reaching even 14%.</i></p> <p><b>Others:</b> The OECD raises its 2010 global GDP growth forecast to 4.6% from 3.4% in Nov. 2011 growth is tipped at 4.5%, up from 3.7%. The changes were due mostly to an improved outlook for emerging markets. 2010 Euro zone growth, previously seen at 0.9% is forecast at 1.4%.</p>	<p><b>US:</b> GDP growth for 1Q10 is revised from an advance estimate of 3.2% to 3%.</p> <p><b>US:</b> Initial jobless claims fall 14,000 to 460,000, reversing a troubling 28,000 rise the prior week. The 4-week moving average rises to 457,000 from 454,000.</p> <p><b>US:</b> Corporate operating profits rise 5.5% in 1Q10 from 4Q09. Domestic industry profits rise 4.5%, with non-financial profits up 6%. Profits earned abroad surge 9.6%.</p> <p><b>EU:</b> Spain's recently announced austerity package is approved in parliament by 1 vote. <i>Yet the narrow win highlights the political risks in implementing fiscal consolidation.</i></p> <p><b>EU:</b> A Confederation of British Industry poll finds UK retail spending slipping in May, amid high inflation.</p> <p><b>EU:</b> Greece's labour unions threaten to strike in Jun to protest pension reform. They are also trying to mobilize workers across Europe to take joint action against austerity measures.</p> <p><b>JP:</b> Real exports decrease 0.7% in Apr after a 0.6% gain in March, a 0.5% drop in February and a 7.5% jump in January. <i>The inventory rebuilding phase is almost over and exports may start to moderate going forward.</i></p> <p><b>AP:</b> China denies a Wed news report that said it is reviewing its holdings of Euro zone government bonds.</p> <p><b>AP:</b> Capital expenditure in Australia slips unexpectedly, down 0.2% in 1Q10.</p>	<p><b>US:</b> The Chicago PMI falls to 59.7 in May from 63.8 in Apr. <i>While still solidly in outright expansion, the data adds to other reports showing slowing gains in manufacturing.</i></p> <p><b>US:</b> The University of Michigan consumer sentiment index for May is revised up to 73.6 from 73.3.</p> <p><b>US:</b> Real disposable income is up 0.5% in Apr, after Mar's 0.3% gain. Real wages rise 0.4% after a 0.2% increase. Real wages have risen at a 3.2% annualized rate YTD amid remarkably low inflation. Real consumer spending is unchanged in Apr, after 2 consecutive 0.5% gains.</p> <p><b>EU:</b> Fitch cuts Spain's credit rating by 1 notch to AA+ as austerity measures are likely to slow GDP growth.</p> <p><b>EU:</b> Talks with unions and business to overhaul Spain's rigid labour laws are going badly, says a government spokesman.</p> <p><b>EU:</b> Switzerland's KOF economic barometer rises more than expected to 2.16 in May, from 2.05 in Apr.</p> <p><b>JP:</b> The unemployment rate inches up to 5.1% in Apr, higher than expected.</p> <p><b>JP:</b> The nationwide CPI falls 1.5% in Apr, more than Mar's 1.2% decline. But core CPI narrows its decline to 1.6%, from 1.9% in Mar.</p> <p><b>JP:</b> Retail sales surge 4.9% in Apr, accelerating from Mar's 4.7% gain. But a household survey shows real consumer spending falling surprisingly, down 0.7% in Apr after Mar's 4.4% gain.</p>

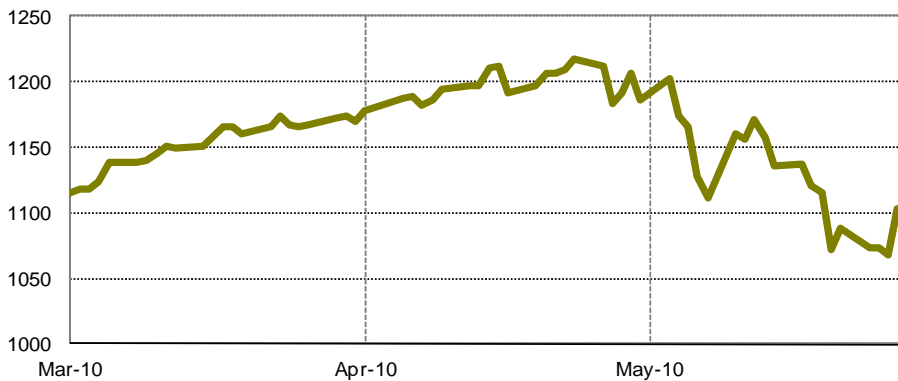
## Over the Weekend May 29 and May 30

**EU:** ECB executive board member Jurgen Stark says the central bank may start a gradual exit from ultra-loose monetary policies as soon as Jul.

**EU:** France admits that keeping its top-notch credit rating may be "a stretch" without some tough budget decisions. This comes after Germany hints that taxes may have to be raised to help bring down its deficit.

# US/NORTH AMERICA

## S&P 500 (1/2/2010 to 28/5/2010)



Source: Bloomberg

## Economic Outlook

### Good news on the economy challenged by financial turmoil

The economy has been progressing along a familiar path to sustainable recovery. However, financial turmoil emanating from Europe has triggered a pullback in US financial conditions that now threatens this otherwise brightening outlook.

The concern for the US economy is that tensions in Europe's funding markets may continue to worsen and spill over into a more pronounced hit to US financial markets. The increase in market volatility and slump in equity values in the past week highlight this risk. A parallel retreat in corporate credit conditions reinforces concern. At this point, it is hard to tell how much of the disturbance will cross the ocean. While financial markets in the US have been unsettled by Europe's crisis, the effects thus far have not been excessive.

Barring further deterioration in financial conditions, Citi analysts expect the labour market to support the recovery process. They look for the recent healthy job gains to be sustained and for the associated rise in income to feed back to demand.

## The Week Ahead

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- The **May purchasing managers' index** likely dipped to 58.5, consistent with most regional surveys, but nevertheless still in solid territory.
- **April construction spending** probably dipped again (-0.3%), despite a rebound in residential spending.

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- **Motor-vehicle sales** likely rose in May to 11.4 million SAAR from 11.2 million SAAR in April.

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- **Initial jobless claims** for the week ending 29 May probably fell by 20,000 to 440,000, after two weeks of elevated readings.
- **Manufacturing orders** likely rose 1.9% in April, mainly due to a swell in orders for durable goods.
- The **ISM nonmanufacturing index** is likely to hover in the mid-50s again in May.

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- **Non-farm payrolls** likely surged to 550,000 in May with a huge contribution coming from the hiring of 2010 Census workers.
- The **unemployment rate** likely fell to 9.7% in May from 9.9% in April.

## Equities

### Stocks of small, domestically focused firms hurt as well by Europe's debt woes

	Last week's close	Last week's return	YTD return
<b>S&amp;P 500</b>	1089.41	+0.16%	-2.30%
<b>DJIA</b>	10136.63	-0.56%	-2.79%
<b>Nasdaq</b>	2257.04	+1.26%	-0.53%

While investors have begun to consider the effects of a slower European economy and the currency impact of a weaker EUR, it is unclear that investors have differentiated much between allegedly illiquid smaller-cap stocks and their larger-cap peers. The S&P 500 is down slightly less than the Russell 2000 from the April highs, suggesting international issues have not benefited the often more domestically oriented smaller-cap names. This suggests a broader sell-off has occurred rather than a major de-risking, targeting specific asset classes.

Meanwhile, analyses which look at both sentiment and lead indicators for stock price performance send mixed signals. Citi's sentiment analysis, modelled on likely forward 12-month performance outcomes, suggests the Russell 2000 is likely to slide, in line with a generally cautious near-term stance on the S&P 500. But the leading indicator model contends that small caps should outperform the S&P 500 over the next six to nine months. This suggests macro aspects are likely to stay in the forefront, overshadowing micro stories.

Source: CIRA

## Bonds

### High-grade corporate debt valuations still attractive, especially in Financials

	May 28 2010	May 21 2010	May 14 2010
<b>2-yr Try:</b>	0.766%	0.764%	0.782%
<b>5-yr Try:</b>	2.092%	2.022%	2.156%
<b>10-yr Try:</b>	3.292%	3.238%	3.453%

**Treasuries:** US Treasury rates have significantly benefited from a flight to quality due to contagion fears in the European markets. Given the situation in Europe, Citi analysts believe US rates are likely to be supported at current levels.

**High-grade corporates:** Despite much lower spreads than a year ago, corporate bonds still present attractive value, particularly in the financial sector.

**High-yield corporates:** Citi analysts remain constructive on high yield due to positive technical factors and improving fundamentals.

**EMD:** Citi analysts favour Asian and Latin American sovereign credits as improved market liquidity and healthy risk appetite persist.

## Currencies

### USD: US asset market, economic outperformance may sustain dollar rally

September 2010 forecasts		
EURUSD	USDJPY	USDCAD
1.21	94	1.00

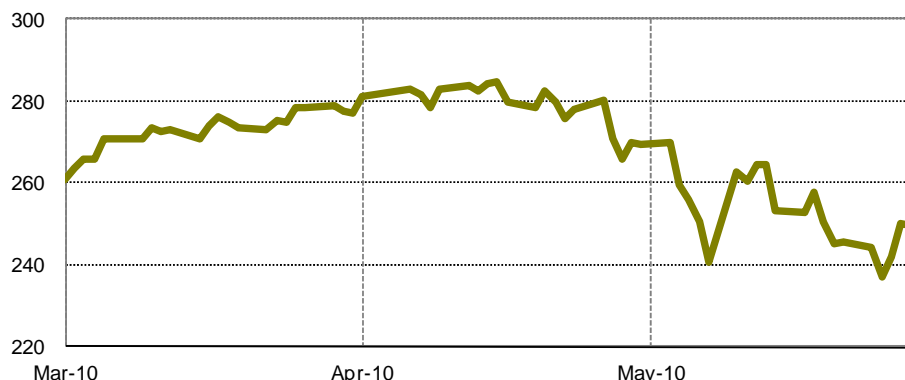
The USD index has continued on an upward trend that began late last year, with net speculative positioning remains significantly long USD. While the net short in EUR is large, fears over fiscal developments in the Euro area periphery countries continue to impact the market.

Other factors, such as cyclical and asset market outperformance, may sustain the USD rally against other G10 currencies (including EUR) over the next few months.

But further down the road, concerns about the US twin deficits may return to weaken USD as markets rotate focus, possibly around the time of mid-term elections in November.

# EUROPE

STOXX (1/2/2010 to 28/5/2010)



Source: Bloomberg

## Economic Outlook

### Spanish bank woes highlight fragility of Europe's financial sector

The take-over of a small saving bank by the Bank of Spain has caused a resurfacing of worries about the fragility of Europe's banking sector – and the potentially large repercussions this may have on sovereign debt. The fate of Spanish banks, especially of regional saving institutions, is highly interconnected with the prospects of the country's real estate sectors. Citi analysts believe house prices are still only about half-way through the adjustment process. Together with an ongoing shrinking of real estate and construction activities, this imposes significant strains on bank balance sheets and hence on Spain's sovereign credit risk.

Spain's banking sector is about to experience a significant overhaul over the next few weeks, as policymakers have decided to step up their efforts to force banks to "come clean" and to kick-off restructuring. The news flow on Spain should remain intense, keeping the level of uncertainty elevated. Sovereign credit risk is likely to stay high too.

## The Week Ahead

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- **Euro Area:** YoY M3 growth is likely to remain in negative territory in April for a fifth month out of the past six (-0.4% YoY, -0.3% 3-M YoY).

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- **Euro Area:** After stabilizing at 10.0% in March, Citi analysts expect the **unemployment rate** to continue increasing in April (10.1%).

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- **Euro Area:** Higher energy prices likely contributed to an expected increase in area-wide **industrial producer prices** in April.

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- **Euro Area:** After a likely downward revision of the March reading, Citi analysts expect a modest gain in April **retail sales** (+0.1% MoM).

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- **Euro Area:** Citi analysts expect a confirmation of the **1Q10 GDP** flash estimate (+0.2% QoQ, +0.5% YoY).

## Equities

Sell-off may offer buying opportunities for long term investors with 12-18 month view

	Last week's close	Last week's return	YTD Return
STOXX	249.80	+1.71%	-9.08%
FTSE 100	5188.43	+2.48%	-4.15%
DAX	5946.18	+2.01%	-0.19%

The return of classic 2008 market fears — rising Libor and bank funding concerns — has helped to drive a flight to safety across financial markets. This has driven some government bond yields to multi-century lows, along with a sharp sell-off and de-rating across equity markets.

Overall, Citi analysts believe the current sell-off may provide long-term investors with a buying opportunity for the next 12 to 18 months, and are sticking with an end-2010 DJ Stoxx 600 target of 280. Assuming no change to current corporate earnings estimates, that would put European equities on a 2010E and 2011E price-to-earnings of 12.6x and 10.4x respectively. Not excessive, in their view.

Meanwhile, volatility has spiked alongside the equity risk premium, with the VIX index breaching the 40 level. This has happened only five times previously in the past 25 years. Historical data suggests the most profitable time to buy European equities, using the VIX index as a guide, is when the VIX breaches the 40 level.

Source: CIRA

## Bonds

Wary of contagion among weak periphery nations

	May 28 2010	May 21 2010	May 14 2010
2-yr Try:	0.519%	0.512%	0.556%
5-yr Try:	1.572%	1.519%	1.652%
10-yr Try:	2.682%	2.666%	2.860%

Citi analysts remain wary of the weak periphery nations, which are likely to suffer contagion effects. Even if the outcome in Greece is constructive, they look for only a modest increase in Bund rates into next year. Meanwhile in the UK, Gilts have benefited from a flight to quality bias. With concerns about fiscal reform due to a hung parliament and a possible ratings downgrade, Gilts are likely to be the worst performer in the G4.

## Currencies

EUR: Still bearish after rescue package  
GBP: Near-term policy is unfriendly

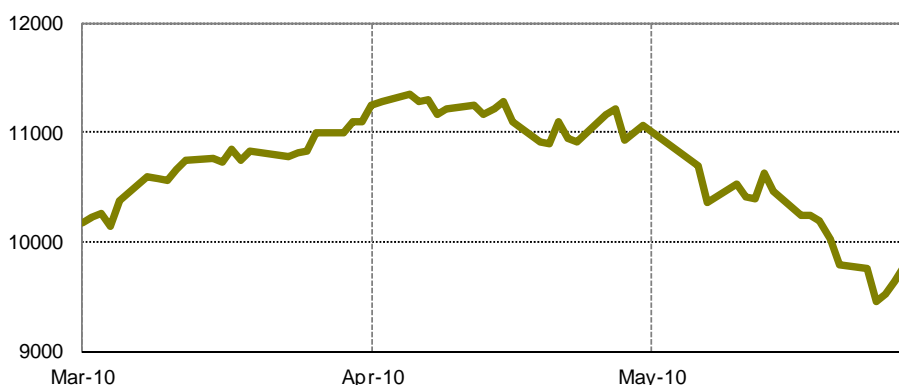
September 2010 forecasts		
GBPUSD	USDCHF	EURGBP
1.42	1.13	0.85

EUR remains near the lows for this cycle despite the EU's rescue package for Euro zone financial markets. EUR's core problems continue to haunt markets. The region is less productive than the US, which may mean relative economic and asset market underperformance. There is also pressure for immediate fiscal tightening that is likely to further dampen growth. The market is also worried the ECB may be monetising government debt via its bond market interventions, though the impact of that on currencies is uncertain.

The new UK coalition government promises spending cuts and higher taxes to reduce the budget deficit, which is positive for GBP in the long term. But for now, easy money and tight fiscal policy point to GBP weakness though it may trade sideways against an also-weak EUR.

# JAPAN

Nikkei 225 (1/2/2010 to 28/5/2010)



Source: Bloomberg

## Economic Outlook

### Above-trend growth ahead even as exports slow

The Japanese economy is expected to continue growing at a higher-than-potential pace (around 1% annualized) even as industrial production momentum may decelerate in 1H11 as export demand slows. This is because domestic private demand, that is business and residential investment and consumer spending, are tipped to continue expanding and help pick up the slack.

On a quarterly or semi-annual basis, Citi analysts forecast real GDP to grow 1.9% QoQ annualized in 2Q10, followed by an average 2.6% annualized gain in 2H10, a 1.6% rise in 1H11 and a 1.9% increase in 2H11. Even with a plausible moderation due to slower exports in the first half of 2011, real GDP growth is likely to maintain a higher-than-potential pace.

As for consumer prices, core CPI is expected to return close to zero in April 2011 as effects from old policy decisions wear out while new moves, including a tobacco price hike, kick in. If these special factors are excluded, core CPI is likely to remain in negative territory. Thus, the policy interest rate is expected to remain at the current level of 0.10% throughout fiscal 2011.

## The Week Ahead

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- **Industrial production** probably rose 2.0% MoM in April, accelerating from March's 1.2% increase.
- **Housing starts** likely rose 4.8% YoY in April, the first increase since October 2008. However, the seasonally adjusted annual rate of housing starts is expected to decline 3.3% MoM to 830,000 units, after surging 7.5% in March.

## Equities

### Correction of excessive optimism may be nearly done for Japanese equities

	Last week's Close	Last week's return	YTD return
Nikkei	9762.98	-0.22%	-7.43%
Topix	878.52	-0.13%	-3.20%

The current pullback by global equities appears to be a correction of excessive optimism, given the massive 79.9% rebound from the March 2009 low to the April 2010 high. Indeed, a 10% to 20% correction off that high was probably difficult to avoid, as markets have risen a long way in a short time.

Beyond this correction, global equities are still expected to rise as there has been no change to the tenor of the global economic recovery, led by the US and China. Valuations are also undemanding.

It is also worth noting that global stock markets have not been falling as far as is popularly assumed. The S&P Global Equity Index fell 12.4% from its April 15 high to its May 25 low. YTD, the decline is just 4.6%.

TOPIX fell 14% from its April 15 high to its May 26 low, suggesting that the correction by Japanese stocks may be almost done. Bearish undertones will probably persist in the near term but a turnaround in June is looking increasingly likely. A sustained global recovery, strong corporate earnings and a turnaround in domestic demand are expected to support Japanese equities.

Source: CIRA

## Bonds

### Looking to recovery as fiscal stimulus bolsters economy

	May 28 2010	May 21 2010	May 14 2010
2-yr Try:	0.165%	0.164%	0.165%
5-yr Try:	0.440%	0.425%	0.464%
10-yr Try:	1.259%	1.245%	1.305%

Investors have taken the nosedive in Japan's GDP in their stride as the result had been fully priced into the bond market.

While second-quarter growth is likely to be slightly negative, the worst of the downturn appears to be over. Japanese consumer spending is expected to benefit from government incentives to purchase big-ticket items such as cars and appliances, while the overall economy should benefit from increased government spending on infrastructure projects.

As a result, Japanese government bond yields could potentially trade between 1.3% and 1.5% over the next several months, as monetary policy remains steady.

## Currencies

### JPY: Following broader USD strength trends

	September 2010 forecast		
USDJPY	EURJPY	AUDJPY	
94	114	82.7	

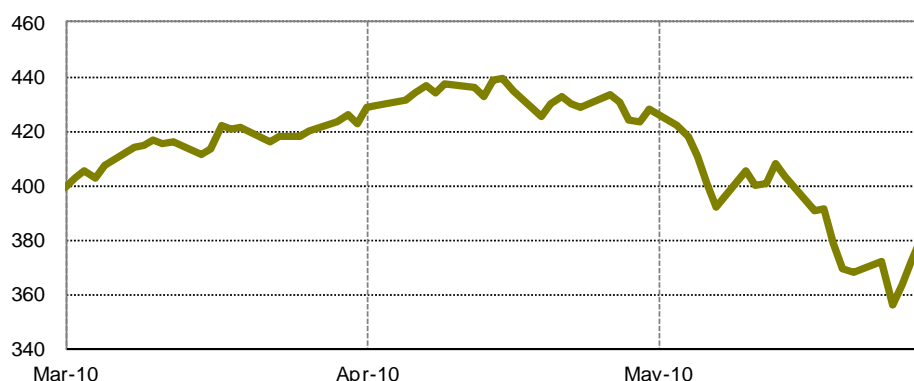
USDJPY has moved broadly sideways over the past six weeks although the rate did fall sharply on May 6 when risk aversion spiked after the ECB failed initially to act on the periphery crisis in Europe. Still, since bottoming around 85 in late November, USDJPY has been rising slowly in line with a generalised USD rally.

Recent economic news from Japan has been a little mixed though JPY movements do not always track these economic variables. Generally, JPY weakens as household and business confidence picks up because repatriation flows ease and the carry trade to foreign assets increases.

USDJPY is expected to rise slightly over the next 12 months but this trend is unlikely to really gather momentum until the Fed starts to tighten policy. Bouts of risk aversion would likely see sharp corrections anyway.

# ASIA PACIFIC EX JAPAN

MSCI Asia ex Japan (1/2/2010 to 28/5/2010)



Source: Bloomberg

## Economic Outlook

### Asia's fallout from Europe's sovereign debt crisis

Fiscal austerity and potential strains in banking systems are likely to be a drag for Euro zone growth, but this is not yet expected to have a significant impact on Asia. Nonetheless, momentum appears to have peaked on both external demand risks and China's more aggressive move to slow property investment. Growth in Singapore, Taiwan, Hong Kong, Malaysia, Korea and Thailand are more sensitive to Euro area growth, while domestic-demand driven economies of India, Indonesia, China and the Philippines are relatively more insulated.

On the policy front, rate hikes in the region are likely to be delayed as the Fed is expected to push back the start of its rate tightening cycle, to 2Q11 from 4Q10. Indonesia, Taiwan and Thailand are now expected to make their first hikes in 1Q11, rather than 2H10 as estimated previously, with the Philippines' moving in 4Q10 instead of 3Q10. The quantum of rate increases may also be reduced. For instance, the Bank of Korea is tipped to raise rates by 25 bps this year, instead of 50 bps, and China, by 54 bps, instead of 81 bps.

This more muted outlook also tempers expectations for CNY appreciation. While Citi analysts still expect an imminent move, CNY has already strengthened on a trade-weighted basis with the EUR's sharp sell-off. This, coupled with growth concerns, suggests the authorities may prefer a slower pace of appreciation than previously anticipated.

## The Week Ahead

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- **India: GDP** probably rose 8.3% in 4QFY10, up from 6% the prior quarter.
- **Korea: Industrial production** likely rose 18.4% in April.
- **Korea: Exports** likely jumped 35.5% in May, up from April's 30% surge.
- **Thailand: Exports** probably rose 35% in April as **manufacturing production** rose 21.8%.

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- **China: The PMI** likely declined to 51.5 in May on a deteriorating macro environment and seasonal slowdown.
- **Hong Kong: Retail sales** growth likely slowed in April to 15.4%.
- **Indonesia: Headline inflation** may have risen to 4.2% in May from 3.9%.
- **Korea: CPI inflation** probably rose to 2.8% in May, from 2.6% in April.

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- **Thailand: The policy rate** is expected to be kept at 1.25%.

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- **Philippines: The policy rate** is expected to be kept at 4%.

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- **Indonesia: The policy rate** is expected to be kept at 6.5%.
- **Korea: GDP** likely surged 7.8% in 1Q10, up from 6% in 4Q09.
- **Malaysia: Exports** probably rose 37% in April, after March's 36.4% rise.

## Equities

Little value in the crowded consumer and materials space

	Last week's close	Last week's return	YTD Return
MSCI Asia ex Japan	379.99	+3.28%	-8.77%

Consumer and materials stocks are starting to look expensive, relative to the market, being well held in Asia ex Japan. But the real estate sector is starting to look attractive though headwinds persist.

While there is little doubt about the long-term potential of the Asian consumer, much of that appears priced in at this stage. This suggests that the consumer sector at some stage may become a funding source for investments in another sector. Also appearing overpriced are materials stocks, which have underperformed as a strong USD stymies deflation.

Looking more interesting is the real estate sector, which is not well owned. Much of the bad news seems to be priced in already but near term risks, mostly from policy intervention in China and Hong Kong dominate. Longer-term, though, there appears to be value in the longer term and may drive outperformance once the liquidity environment improves.

Source: CIRA

## Bonds

Lack of fundamental focus gives rise to volatile trading environment

Extreme volatility in past weeks saw some Asian credits reaching 'oversold' levels, but the market appears to be back to levels where directional calls are difficult to make.

Fundamentally, sovereign debt pressure in Europe is not expected to cause a global meltdown, and the EU-IMF €750 billion package looks like a game changer. But Asian-based investors appear to have underestimated and underpriced global financial regulatory risks and were caught out by the speed at which the US Senate passed the reform bill.

Yet fundamentals rarely matter when the market is simply scared, and negative price action feeds on itself. Lack of liquidity on the downmarket also shows up the constraints of Asia's credit market. The relief rally may continue in the short-term, but the technical trading environment and the lack of fundamental focus make directional calls from current levels difficult. On balance, Citi analysts expect the market to finish the year tighter than present levels, and so prefer to remain overall long. But investors should continue to focus on liquidity, quality, and valuation.

## Currencies

AUD: Volatile sideways action expected  
EM Asia: Smaller gains anticipated

September 2010 forecasts		
AUDUSD	NZDUSD	USDSGD
0.88	0.71	1.37

AUD has corrected sharply and may continue to fall even below 0.80 vs USD. While rising carry trade is a positive for AUD, the unit has become overvalued and over-owned. Notably, it has not made new highs since November, even as interest rates in Australia have been raised six times. More fundamentally, potential policy tightening in China amid overheating concerns is a drag.

Most Emerging Asia currencies have resumed an appreciation trend against USD after a broad sell-off in early May. But their gains may not be as large as previously thought. Europe's debt crisis has diverted attention from anticipation for a CNY revaluation while strength in USD, to which CNY is pegged, reduces pressure for aggressive CNY appreciation.

# WORLD MARKETS AT A GLANCE

	Previous Week's Close	52-Week High	52-Week Low	Weekly Return	YTD Return	YTD Return (USD)
<b>UNITED STATES</b>						
Dow Jones Industrial Average	10136.63	11258.01	8087.19	-0.56%	-2.79%	-2.79%
S&P 500	1089.41	1219.80	869.32	+0.16%	-2.30%	-2.30%
Nasdaq	2257.04	2535.28	1727.05	+1.26%	-0.53%	-0.53%
<b>EUROPE</b>						
DJ Euro STOXX	249.80	285.75	210.54	+1.71%	-9.08%	-21.80%
FTSE 100	5188.43	5833.73	4096.08	+2.48%	-4.15%	-13.98%
DAX	5946.18	6341.52	4524.01	+2.01%	-0.19%	-14.20%
<b>JAPAN</b>						
Nikkei 225	9762.98	11408.17	9050.33	-0.22%	-7.43%	-5.80%
TOPIX	878.52	1001.77	809.24	-0.13%	-3.20%	-1.50%
<b>ASIA</b>						
MSCI Asia ex Japan	379.99	441.75	305.07	+3.28%	-8.77%	-8.77%
Hong Kong Hang Seng	19766.71	23099.57	17185.96	+1.13%	-9.63%	-10.01%
Shanghai Composite Index	2655.77	3478.01	2481.97	+2.80%	-18.96%	-19.01%
Taiwan Weighted Index	7295.32	8395.39	6100.08	+0.80%	-10.90%	-11.04%
Korea KOSPI	1622.78	1757.76	1350.31	+1.41%	-3.56%	-7.91%
Mumbai Sensex	16863.06	18047.86	13219.99	+2.54%	-3.45%	-3.08%
Singapore Straits Times Index	2739.70	3037.97	2211.81	+1.43%	-5.45%	-5.29%
Kuala Lumpur Composite	1269.16	1349.92	1028.14	-1.29%	-0.28%	+4.09%
Thai Stock Exchange	737.28	820.09	552.14	-3.69%	+0.37%	+3.00%
Jakarta Composite Index	2713.92	2996.42	1878.47	+3.46%	+7.09%	+9.56%
Philippines Stock Exchange Index	3252.63	3342.31	2352.75	+2.30%	+6.55%	+6.51%
Australia All Ordinaries	4479.00	5048.60	3710.10	+3.54%	-8.27%	-13.55%
<b>EMEA</b>						
Russia MICEX Index	1309.09	1539.63	852.41	+3.49%	-4.45%	-6.39%
South Africa JSE All Shares Index	27202.72	29565.10	21457.97	+3.60%	-1.68%	-4.63%
Turkey ISE National 100 Index	55233.68	59771.82	33264.78	+2.07%	+4.56%	-0.45%
<b>LATIN AMERICA</b>						
Mexico Bolsa Index	31547.55	34223.87	22955.98	+3.00%	-1.78%	-0.39%
Brazil Bovespa Index	61946.99	71989.18	48261.84	+2.80%	-9.68%	-13.61%
<b>COMMODITIES</b>						
Gold	1214.38	1249.40	905.10	+3.17%	+10.71%	+10.71%
Oil	73.97	87.15	58.32	+5.61%	-6.79%	-6.79%
<b>FIXED INCOME</b>						
Citigroup World Government Bond Index	572.93	575.36	538.93	-0.27%	+2.78%	+2.78%

Source: Bloomberg (As at May 28, 2010)

# CURRENCY FORECASTS

Currency		31-May-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12
<b>G10-US Dollar</b>											
Euro	EURUSD	1.23	1.21	1.21	1.24	1.27	1.3	1.31	1.32	1.33	1.34
Japanese yen	USDJPY	91	93	94	95	95	95	95	95	95	95
British Pound	GBPUSD	1.45	1.43	1.42	1.46	1.50	1.54	1.57	1.61	1.65	1.68
Swiss Franc	USDCHF	1.15	1.14	1.13	1.11	1.08	1.07	1.07	1.08	1.08	1.08
Australian Dollar	AUDUSD	0.85	0.88	0.88	0.87	0.87	0.87	0.86	0.86	0.85	0.85
New Zealand	NZDUSD	0.68	0.71	0.71	0.71	0.71	0.70	0.68	0.66	0.64	0.62
Canadian Dollar	USDCAD	1.05	1.02	1.00	0.99	0.99	1.00	1.01	1.02	1.03	1.04
Dollar Index	DXY	86.52	87.35	87.61	85.73	83.97	82.85	82.30	81.76	81.24	80.72
<b>G10 Crosses</b>											
Japanese yen	EURJPY	113	113	114	117	121	123	124	125	126	127
Swiss Franc	EURCHF	1.42	1.38	1.36	1.37	1.38	1.39	1.40	1.42	1.43	1.45
British Pound	EURGBP	0.85	0.85	0.85	0.85	0.85	0.84	0.83	0.82	0.81	0.79
Swedish Krona	EURSEK	9.62	9.50	9.31	9.15	8.98	8.88	8.85	8.82	8.79	8.76
Norwegian Krone	EURNOK	7.96	7.69	7.63	7.60	7.57	7.58	7.63	7.68	7.73	7.78
Norwegian Krone	NOKSEK	1.21	1.24	1.22	1.20	1.19	1.17	1.16	1.15	1.14	1.13
Australian Dollar	AUDNZD	1.24	1.24	1.24	1.23	1.23	1.24	1.27	1.30	1.33	1.37
Australian Dollar	AUDJPY	77.6	82.2	82.7	82.7	82.7	82.4	81.9	81.5	81.0	80.5
<b>EM Asia</b>											
Chinese Renminbi	USDCNY	6.83	6.80	6.75	6.70	6.67	6.62	6.55	6.50	6.45	6.45
Hong Kong Dollar	USDHKD	7.79	7.77	7.76	7.75	7.75	7.75	7.75	7.75	7.75	7.75
Indonesian Rupiah	USDIDR	9168	9050	9150	9175	9200	9150	9150	9125	9100	9100
Indian Rupee	USDINR	46.5	45.0	44.0	43.5	42.5	41.5	41.0	40.5	40.0	40.0
Korean Won	USDKRW	1198	1120	1080	1090	1040	1040	1050	1050	1040	1040
Malaysian Ringgit	USDMYR	3.25	3.19	3.17	3.14	3.14	3.14	3.12	3.12	3.09	3.06
Philippine Peso	USDPHP	46.3	43.9	44.0	43.0	43.3	43.5	43.8	43.0	43.0	43.3
Singapore Dollar	USDSGD	1.40	1.38	1.37	1.35	1.34	1.33	1.32	1.32	1.30	1.29
Thai Baht	USDTHB	32.5	32.0	31.9	31.7	31.9	32.0	32.1	32.2	32.2	32.5
Taiwan Dollar	USDTWD	32.0	31.6	31.5	31.2	30.8	30.5	30.2	30.2	30.2	30.2
<b>EM Europe</b>											
Czech Koruna	EURCZK	25.65	25.66	25.63	25.290	24.96	24.70	24.5	24.30	24.1	23.90
Hungarian Forint	EURHUF	275	276	276	278	279	280	280	280	280	280
Polish Zloty	EURPLN	4.08	3.96	3.87	3.82	3.77	3.73	3.69	3.66	3.62	3.58
Israeli Shekel	USDILS	3.82	3.76	3.74	3.72	3.71	3.69	3.68	3.67	3.66	3.64
Russian Ruble	USDRUB	30.7	30.4	29.7	28.4	27.2	26.5	26.4	26.3	26.2	26.1
Russian Ruble	Basket	33.9	33.4	32.5	31.5	30.5	30.0	30.0	30.0	30.0	30.0
Turkish Lira	USDTRY	1.57	1.54	1.54	1.55	1.56	1.57	1.58	1.60	1.61	1.63
South African Rand	USDZAR	7.58	7.48	7.50	7.71	7.90	8.10	8.30	8.50	8.70	8.90
<b>EM Latam</b>											
Brazilian Real	USDBRL	1.82	1.75	1.80	1.80	1.80	1.80	1.85	1.85	1.85	1.85
Chilean Peso	USDCLP	530	525	525	525	528	530	532	535	535	535
Mexican Peso	USDMXN	12.9	12.2	12.3	12.3	12.4	12.5	12.5	12.6	12.6	12.6
Colombian Peso	USDCOP	1972	1950	1940	1940	1950	1980	2000	2000	2000	2000

Source: CIRA, Bloomberg (As at May 31, 2010; Forecasts as of May 14, 2010)

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