CitiFX Strategy Weekly

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In this week's issue:

- **It's official, reserve managers are back**
  - EUR has remained resilient despite investor positioning and cross asset weakness. Private investment flows continue to pile into Asian FX and G10 carry. High and low frequency reserve accumulation points to strongest growth since Q1 2012. In Q1, the reserves story focused on China, CNY weakness and rebalancing - now it has spread to a broad cross section of EM countries. Correlation of high-frequency reserve accumulation and EUR/USD is improving.
- **A perfect storm for EURJPY?**
  - The downside pressure on EURJPY could increase as we move closer to September. A combination of new ECB easing measures and Japanese exporters' hedging could weigh on EUR and support JPY. Recent assets underperformance could weigh on demand for EUR-denominated assets. The impact from a new BoJ QE before could be more than offset by more aggressive easing measures by the ECB in coming months.
- **China's Japan investments under Abenomics**
  - China's investment in Japan appears to have slowed since the start of Abenomics. If its foreign currency reserves continue to grow at the current pace, China's investment in Japan could grow by some USD15bn per year. However, we do not expect Chinese investment in Japan to exert strong upward pressure on JPY as it did in 2010 and 2011.
- **G10 Week Ahead – Humphrey-Hawkins, BoC, BoJ, UK inflation**
- **Carry on this summer?**
  - Up to now the Fed has been conveying to the market a consistent desire to remain "behind the curve." So while data have been good, they are not yet good enough for Fed Chair Yellen to deliver her "Carney moment". Next week's Humphrey-Hawkins testimony will certainly not be the moment. Aggressive re-pricing of US rates and a stronger USD will have to wait. Unless we get major risk aversion stemming from weak corporate earnings, it still makes sense to have a bias to receive carry in EM.
- **Asia – India: A brave budget, but not inspiring**
- **CEEMEA – 25bp hike to reinforce SARB's credibility**
- **Latam – What now, Brazil?**

It’s official, reserve managers are back

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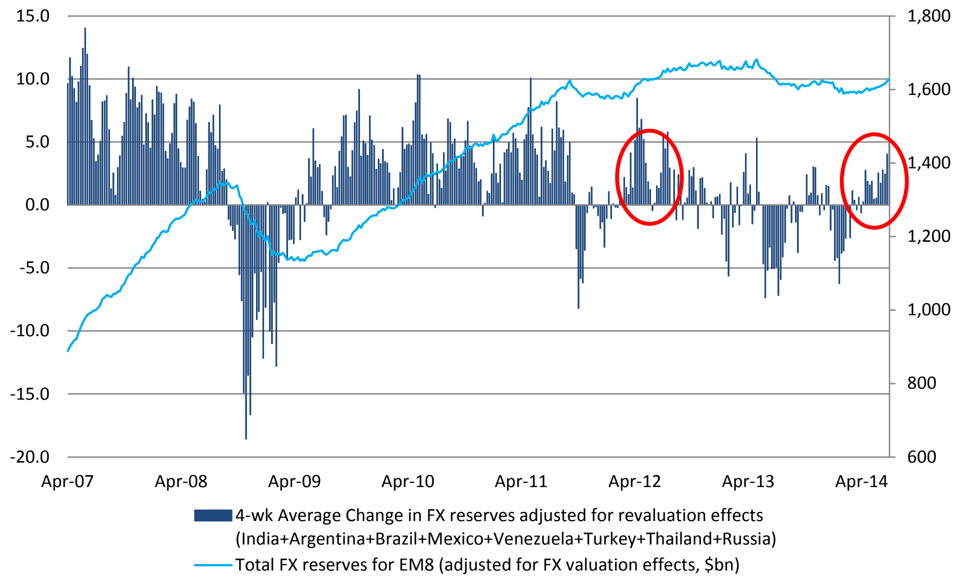
- EUR has remained resilient despite investor positioning and cross asset weakness.
- Private investment flows continue to pile into Asian FX and G10 carry.
- High and low frequency reserve accumulation points to strongest growth since Q1 2012.
- In Q1, the reserves story focused on China, CNY weakness and rebalancing - now it has spread to a broad cross section of EM countries.
- Correlation of high-frequency reserve accumulation and EUR/USD is improving.

Why the EUR resilience?

Outside of the immediate bank and Eurozone equity weakness, EUR sentiment has been negative all year and various metrics reflect sizable short positions (i.e. selling EUR is and has been a consensus view).

Figure 1. Weekly EM reserve accumulation at its strongest since 2012

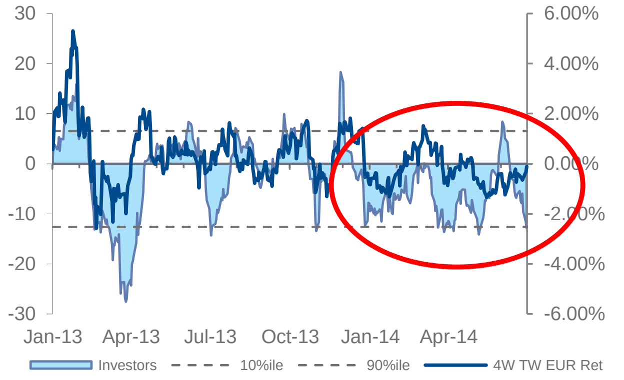


Source: BoJ, CitiFX

Data from Citi’s FX Access platform (CFPIEUR <go>) shows funds have been short EUR to various degrees nearly all year. Current reading is -1.75, of a maximum -3.

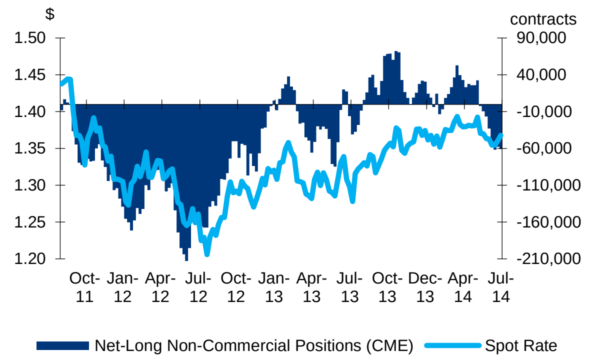
- CitiFX Global Flows, reflecting a larger and more diverse sample of clients, tells a similar story. According to our data, investors (an aggregate of all hedge fund, CTA and real money accounts) have been net EUR sellers since January (Figure 2).
- The publically well-known IMM Commitment of Traders Report highlights speculators are short $10.4bn EUR (roughly 60k contracts). CTA’s moved from long positioning to short in May (Figure 3).

Figure 2. Investors dominant flow has been selling EUR for most of 2014



Source: CitiFX Global Flows

Figure 3. EUR/USD Non-commercial positions, short EUR since May



Source: CitiFX, CFTC, Bloomberg

Three separate sources of data all reach the same conclusion. Still EUR refuses meaningfully adjust lower – implying there is another client type in the market selling enough USDs to offset the investors mentioned above. Evidence is building reserve growth and rebalancing is in play.

The return of Global Reserve Managers (it's not just China)

In September 2013 we introduced a "high frequency" measure of global reserves. The series aggregates daily and weekly reporting into a timely series and in our view is as close to a real time accumulation of reserve changes as possible (see Reserve Rebalancing).

- Eight reserve managers make up the index (India, Argentina, Brazil, Mexico, Venezuela, Turkey, Thailand and Russia).
- Collectively they represent about 30% of non-G10, non-China reserves.
- The high frequency measure holds an 80% correlation to an aggregate of 50+ countries which report their reserves on a monthly basis.

Currently, these eight countries have seen their FX reserve portfolios grow by USD38bn, or USD33bn after valuation effects. We note this is the strongest reserves growth captured from this spectrum of countries since Q1 2012. Extrapolating up to the larger universe of EM countries implies USD195bn of reserve accumulation after FX adjustments – implying 50bn of USD rebalancing over the past few months. This amount would be enough to offset investors order flow, and explains where we are, but should we expect it to continue?

From what we can tell, investors are not letting up

In its simplest form: Reserve growth = Trade + FDI + Private portfolio flows + Valuation effects

To forecast future rebalancing we concentrate on private portfolio flows. Trade and FDI are generally lagged by 1-2 months, while portfolio valuation is simply a function of price (so also historical).

We can proxy private portfolio flows with our own proprietary data. As a firm, Citibank sees 16% of the global turnover of the FX market – one of the largest FX volumes on the street. In general our order flow is as good real time measure of portfolio investment as can be found.

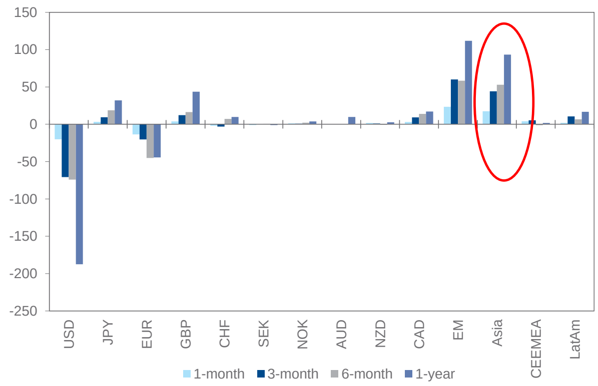
As our weekly report highlights – Emerging Markets, and specifically EM Asian currencies, have been the dominant recipient of FX investments for well over 1-year (Figure 4).

Two conclusions are worth pointing out:

1. 20% of the cumulative yearly inflows were in the past 4-weeks
2. By a wide margin the largest recipient of the flow has been EM Asia

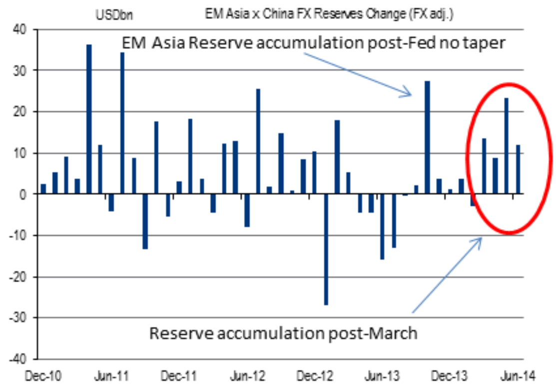
When the WSJ reports on annual Asian reserve growth (Currency reserves swell in Asia), a combination of price and our flow allows us to approximate it in real time, thereby accounting for rebalancing dynamics more accurately.

Figure 4. The Long View - Investors cumulative flows headed predominantly to EM Asia



Source: CitiFX Global Flows
Note: Investors = Cumulative Leveraged + Cumulative Real Money FX orderflow. Please see our report for greater details on the index.

Figure 5. EM Asia-ex China Reserve change (FX adj.)



Source: CitiFX, CFTC, Bloomberg
Note: EM Asia-xChina = Taiwan, Korea, India, Singapore, Hong Kong, Malaysia, Thailand, Philippines

From high frequency to low frequency, and even outside Asia - the story remains the same

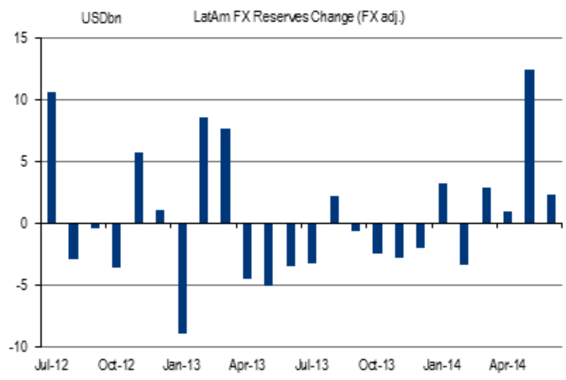
It is well known that China has been accumulating reserves in record amounts and the combination of CNY weakness and reserve accumulation was a dominant Q1 story.

Figure 5 focuses on EM Asian –xChina reserve accumulation and highlights the story has grown to include a much broader section of Asian countries in Q2. The cumulative 55bn of reserve accumulation from March-June is the strongest growth since October 2013, the month that EM rallied heavily after the Fed held off on QE tapering.

Historically, the EM Asia-xChina reserve growth holds the strongest correlation to EUR/USD, greater than either LatAm or Oil Producing countries or China. What gives us confidence there is a greater story at hand is these regions are seeing similar reserves growth as well, so adding to our bottom line (Figure 6, 7 below).

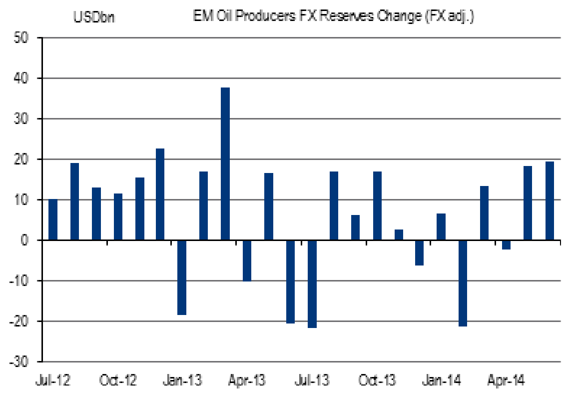
So long as capital flows remain EM bound and volatility low, reserve accumulation is likely to continue, implying USD buying/EUR selling will remain a long hard slog.

Figure 6. LatAm FX Reserves (FX adj.)



Source: CitiFX, Bloomberg
Note: LatAm = Mexico, Brazil, Venezuela, Argentina, Chile, Peru

Figure 7. Oil Producing FX Reserves (FX adj.)



Source: CitiFX, Bloomberg
Note: Oil Producing = Russia, Mexico, Malaysia, Algeria, Indonesia, Libya, Nigeria, Venezuela, Saudi Arabia, UAE, Morocco, Kazakhstan, Kuwait, Yemen, Oman, Angola, Sudan, Eq Guinea

Greater details on how we measure global reserves on either a high or low frequency basis, or Citi's proprietary flow analysis is available on request. Please speak with your sales representative.

A perfect storm for EURJPY?

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- The downside pressure on EURJPY could increase as we move closer to September. A combination of new ECB easing measures and Japanese exporters' hedging could weigh on EUR and support JPY. Recent assets underperformance could weigh on demand for EUR-denominated assets.
- The impact from a new BoJ QE before could be more than offset by more aggressive easing measures by the ECB in coming months.

Shift in the relative policy outlook for the BoJ and ECB

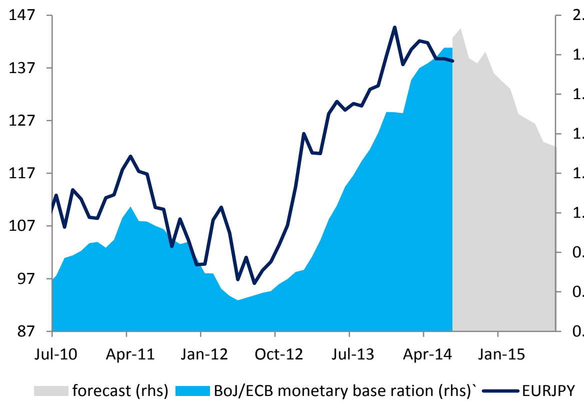
The BoJ still seems in no hurry to announce new additional easing measures. In addition, it seems that, with USDJPY having appreciated by close to 30% since late 2012, the officials may even perceive further aggressive yen depreciation as increasing the risks of uncomfortably high imported inflation. The latter could erode real incomes some more, weigh on domestic demand and weigh on growth.

Citi's call is for the BoJ to announce more measures in Q4 on the back of renewed weakness in growth and inflation. This could be reflected in less constructive economic assessment to be released in October. Until then, however, Citi expects the bank would likely remain in data dependent mode. Our recent client meetings in Japan further seems to suggest that absent significant weakness in Japanese stocks (e.g. Nikkei slipping below 14000), the BoJ may not bring forward 'QE2'.

At the same time, weaker data out of the Eurozone and worries about the outlook of the banking sector could increase the chances of more ECB measures as soon as September. These would come on the back of the already announced T-LTRO measures and could boost the size of ECB's balance sheet. In particular, Citi economists expect the governing council to announce a target for ABS purchases. The measures could be followed by outright QE as soon as December.

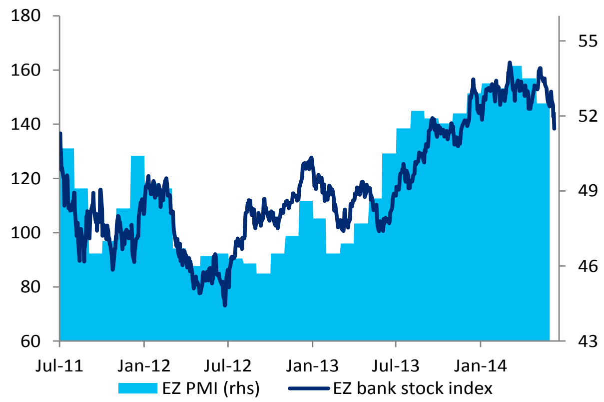
All that could mean the BoJ/ECB monetary base ratio could soon reverse course and start falling, underpinning the long-term negative outlook for EURJPY (Figure 1). For more details on the forecasts presented can be found in the Appendix.

Figure 1. EURJPY close to topping out as the BoJ/ECB monetary base ratio expected to stabilize and ultimately decline



Source: CitiFX, BoJ, Bloomberg

Figure 2. Bank stocks selling off as evidence mounts that the EZ business cycle is starting to turn again



Source: CitiFX, Bloomberg

Assets underperformance could weigh on demand for EUR-assets

Eurozone assets are underperforming again. Widening spreads in the periphery and weak bank stocks have attracted investors' attention. Heavy fines imposed on European lenders by the US authorities and expectations of more regulatory actions seem to have triggered the initial selloff recently. We suspect, however that the reasons for the undeperformance could be rooted in the disappointing Eurozone data of late (Figure 2).

The underperformance of the European assets could be compounded by fears about the impact of bank deleveraging ahead of AQR and the bank stress tests on the real economy and peripheral government bonds. In turn, this could tests foreign investors' appetite for EUR-denominated paper. Recent BoP data seems to suggest that portfolio outflows out of the Eurozone have intensified sharply at the start of Q2 (Figure 3).

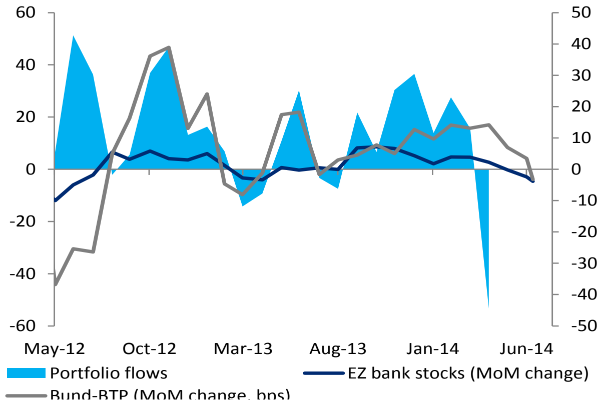
If the above trends are sustained and we see a prolonged pause in foreign investors purchases of Eurozone assets, this could undermine EUR across the board. Given that Japanese investors represent an important part of the portfolio inflows into the Eurozone, less active involvement from here could remove an important support for EURJPY.

Japanese corporates selling EURJPY

Flow wise, we have concerns on EUR selling from Japanese corporates could intensify going forward. Exporters, who have set the forward hedging ratio at unusually low levels over the last year, are under-hedged at present. **Most of them recently set their budget rate for EURJPY at 135, revising up for last half year. A few companies have even set the rate at 140 (Figure 4). Following the pair's drop below 140, the 138 level could become an attractive entry point for new hedging. Corporates tend to step up their hedging activities as we move closer to mid-fiscal year in September.**

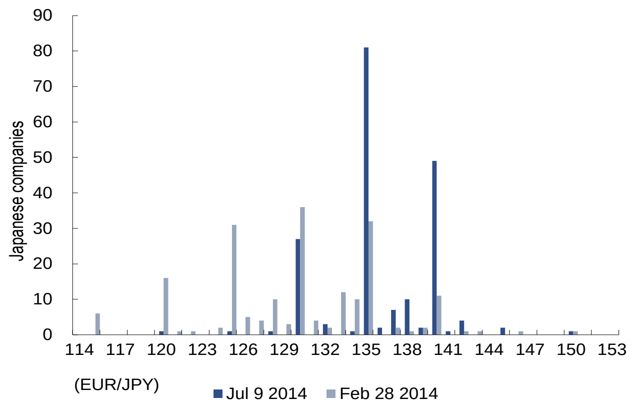
EURJPY could be more vulnerable to corporate hedging activities than USDJPY. In the case of the latter, we can expect a number of buyers such as Japanese importers or investors. Given that Japan is currently running a trade deficit and that most of Japanese imports are denominated in USD, the dollar inflows could be larger than outflows.

Figure 3. Weak performance of EZ assets maybe starting to erode foreign investors' appetite (3m MA of MoM changes)



Source: CitiFX, Bloomberg.

Figure 4. The budget rate for EURJPY among Japanese companies



Source: CitiFX, Astra managers

In addition, Japanese lifers and other investors are showing some interests in potentially lowering the FX hedging ratio. We believe USDJPY will be supported once the pair falls below 100. On the other hand however, we cannot expect such potential buyers for EURJPY. Therefore, even If EURJPY breaks below 135 the JPY appreciation won't be stopped by spontaneous JPY selling as far as USDJPY stays above 100.

We expect some renewed JPY weakness going into yearend, when the BoJ's additional actions and the GPIF reforms are expected, and the policy makers in Japan try to push up the growth rate and the markets (especially Nikkei and USDJPY) before the final decision on the 2nd round tax increase by Prime Minister Abe this December. If anything, however, we expect both JPY and EUR to lose ground against the dollar especially as more unconventional ECB measures keep the headwinds for euro in place across the board (see also Figure 1).

Appendix

We simulate that BoJ/ECB balance sheet ratio assuming that:

1/ The ECB's balance sheet expands by 250bn as a result of the two T-LTRO tranches in September and December 2014. We further assume that about 150bn of T-LTRO would be taken up by banks in the periphery and (partly) used to repay LTRO loans. The T-LTRO take-up is assumed to increases by 100bn in March and June 2015.

2/ The ECB balance sheet grows by additional EUR50bn of unsterilized ABS purchases in September and EUR1tn of unsterilized government bond purchases from January spread across 2015.

3/ The BoJ will continuously increase its base money by JPY 5.8tn per month (annually 70tn) till Oct 2014. It will then add JPY 2tn JGB purchase per month (annually 24tn) and ETF purchase by 2tn annually from Nov 2014. As a result it will be purchasing JPY8tn per month (annually 96tn). The purchase will continue till the end of 2016

China's Japan investments under Abenomics

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- China's investment in Japan appears to have slowed since the start of Abenomics
- If its foreign currency reserves continue to grow at the current pace, China's investment in Japan could grow by some USD15bn per year
- However, we do not expect Chinese investment in Japan to exert strong upward pressure on JPY as it did in 2010 and 2011

China's investment in Japan has slowed since the start of Abenomics last year. If its foreign currency reserves continue to grow at the current pace, China's investment in Japan could grow by some USD15bn per year. However, we do not expect marked appreciation of the Japanese currency as occurred in 2010 and 2011, partly because of Chinese investment in Japan.

Figure 1 shows the inbound and outbound portfolio investment statistics by country that the BoJ releases once a year. The outstanding of foreign portfolio investment into Japan grew from JPY180.5tn at end-2012 to JPY251.8tn at end-2013. The main driver was investment in Japanese equities. Investment in bonds grew by only JPY4tn, from JPY96.9tn to JPY100.9tn, while that in equities rose by JPY67.4tn, from JPY83.5tn to JPY150.9tn. Given that the 55% gain by TOPIX would have resulted in appraisal gains of around JPY46tn, we estimate new investment at around JPY21tn in 2013.

Figure 1. The outstanding of the inbound/outbound portfolio investments

Unit: JPY Bn

		Outward Portfolio Investment	Inward Portfolio Investment (Dec 2013)					Inward Portfolio Investment (Dec 2012)				
				Equity Securities	Debt Securities	Bond/Note	TB etc		Equity Securities	Debt Securities	Bond/Note	TB etc
Total		**359,215**	**251,861**	**150,947**	**100,914**	**51,543**	**49,371**	**180,504**	**83,556**	**96,948**	**49,504**	**47,444**
Asia		**9,848**	**34,442**	**8,778**	**25,664**	**10,535**	**15,129**	**37,442**	**6,986**	**30,456**	**12,370**	**18,087**
	China	1,091	17,540	3,203	14,337	3,599	10,738	24,643	4,149	20,494	6,599	13,895
	Hong Kong	1,723	3,919	2,657	1,262	903	358	2,532	1,169	1,364	1,009	355
	Taiwan	277	250	85	165	117	48	232	36	196	192	4
	South Korea	2,732	1,282	535	747	684	63	880	131	749	711	38
	Singapore	1,559	7,789	2,156	5,633	3,554	2,079	5,633	1,457	4,177	2,348	1,828
	Thailand	469	2,438	9	2,429	619	1,810	2,458	10	2,448	558	1,890
	Indnesia	591	30	2	28	3	25	73	1	72	8	64
	India	492	54	1	53	53	0	25	1	25	23	2
North America		**130,339**	**85,953**	**74,073**	**11,880**	**10,124**	**1,756**	**50,144**	**40,491**	**9,653**	**8,113**	**1,540**
	USA	124,499	79,903	68,997	10,905	9,291	1,615	45,661	37,052	8,610	7,222	1,388
	Canada	5,841	6,050	5,075	975	833	142	4,483	3,439	1,044	892	152
Latin America		**64,184**	**7,795**	**1,653**	**6,142**	**4,025**	**2,116**	**6,339**	**797**	**5,543**	**3,697**	**1,846**
	Mexico	1,597	161	141	20	20	0	0	0	0	0	0
	Brazil	2,044	30	1	29	23	6	21	1	20	14	6
	Cayman Islands	55,833	5,691	1,010	4,682	3,278	1,403	4,950	468	4,482	2,991	1,491
Oceania		**14,765**	**3,442**	**1,737**	**1,705**	**297**	**1,408**	**2,152**	**807**	**1,345**	**323**	**1,022**
	Australia	14,046	3,027	1,606	1,420	157	1,263	1,731	742	990	238	751
	New Zealand	702	389	129	260	118	142	390	64	326	62	264
Europe		**127,671**	**97,706**	**57,160**	**40,545**	**20,599**	**19,947**	**67,911**	**31,099**	**36,812**	**19,720**	**17,092**
	UK	21,068	33,404	27,089	6,315	6,087	228	23,188	14,317	8,871	7,432	1,440
	Russia	284	0	0	0	0	0	0	0	0	0	0
Middle East		**368**	**14,552**	**7,153**	**7,398**	**3,802**	**3,596**	**9,244**	**3,119**	**6,126**	**3,733**	**2,392**
	Saudi Arabia	0	6,174	3,486	2,688	2,639	49	3,969	1,717	2,251	2,144	108
	U.A.E.	90	5,733	2,372	3,360	331	3,029	2,787	743	2,044	366	1,678
Africa		**724**	**301**	**47**	**254**	**246**	**8**	**269**	**26**	**243**	**216**	**26**
	South Africa	447	36	11	25	25	0	7	7	0	0	0
International Organization		**11,318**	**7,671**	**346**	**7,325**	**1,915**	**5,410**	**7,002**	**232**	**6,770**	**1,332**	**5,438**

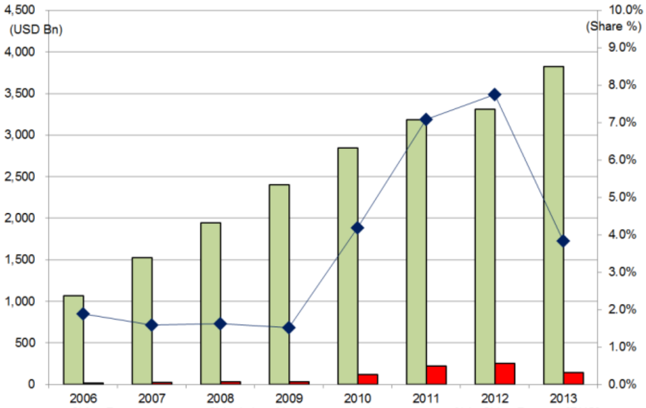
Source: BoJ, CitiFX

During that year, Chinese portfolio investment in Japan fell by JPY7.1tn, from JPY24.6tn to JPY17.5tn. Investment in bonds fell by JPY6.1tn, and that in equities by JPY1tn. Chinese investment in Japanese bonds grew by JPY7.0tn in 2010, JPY7.4tn in 2011 and JPY2.5tn in 2012. The appreciation of JPY during this period was probably supported by Chinese investment in Japan. If we suppose that all Chinese investment in Japanese bonds represents foreign currency reserves, the raid growth probably represented an increase in the weighting of JPY assets within its total reserves, which had previously been very low (Figure 2). We estimate that the weighting of Japanese bond investment in China's foreign currency reserves exceeded 7% in 2011 and 2012 as a result.

The share of JPY in global foreign currency reserves is stable at around 4%, according to the IMF's COFER data. In this respect, the weighting of JPY assets in China's foreign currency reserves was raised from a previously underweight level to an overweight level. Chinese reserves are not in the 'allocated' component of the COFER data, so COFER is not necessarily be an appropriate benchmark for China's foreign currency reserves. There is no compelling market reason for China to invest excessively in JPY assets, given that JPY interest rates are among the lowest in the world.

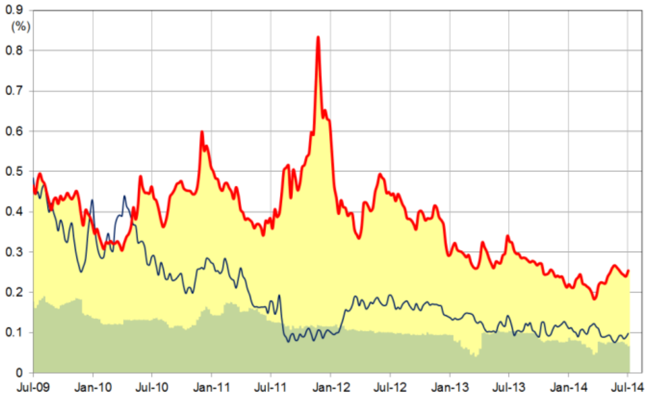
Indeed, some of the rapid growth in Chinese investment in Japanese debt securities during this period may have been short-term bond investment using funds raised in JPY. Because of the European sovereign debt crisis, the environment for raising USD funds tightened worldwide in 2011 and 2012, causing a rapid expansion in the USD premium (basis swap) in the current swap market. This meant that JPY funds raised via a USD sell-buy trade in the currency swap market could be invested in Japanese bonds at a much higher yield than US treasury bills (Figure 3). Effectively, no JPY needed to be bought, but this trade drove rapid growth in the headline figure for China's investment in Japanese debt securities. This could well be what increased the weighting of investment in Japanese bonds within China's foreign currency reserves in 2011 and 2012.

Figure 2. The outstanding of China's foreign reserve and portfolio investments to Japanese debt securities



Source: BoJ, PBoC, Bloomberg, Citi FX

Figure 3. The return of the JGB investment funded by JPY cash raised by USD sell/buy trade in the currency swap markets



Source: Bloomberg, Citi FX

However, the basis swap has contracted in 2013 thanks to the end of the European sovereign debt crisis. So there is smaller benefit in investing in short JGBs with hedges. We think this is one reason for the decline in China's investment in Japanese bonds, mainly short bonds. As a result, the weighting of Japanese bond investments in Chinese foreign currency reserves has recently settled at around the 4%, typical of the COFER data. Over the past five years, China's foreign currency reserves have grown by an average of around USD375bn annually. If the weighting of JPY assets is continuously to be maintained at around 4%, this would mean investment in Japan of some USD15bn annually. So while Chinese investment in

Japan is likely to put downward pressure on USDJPY, the pressure will not be nearly as strong as in 2011, when investment in Japanese bonds grew by more than USD100bn.

Another focus is the decline in Chinese investment in Japanese equities by around JPY1tn, from about JPY4tn in 2012 to JPY3tn in 2013. TOPIX rose around 55% during this period, so the value of Chinese holdings of Japanese equities should have grown by some JPY6tn even without any new investment. This points to selling of some JPY3tn worth of Japanese equities. The decline in Chinese investment in Japanese equities stands out, given the growth in investment from almost all other countries. It would suggest that Chinese investors are less than impressed with the policies of Abenomics aimed at boosting the Japanese equity market.

G10 Week Ahead – Payrolls, ECB, Riksbank

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- In the US, Fed Chair Yellen's Humphrey-Hawkins Testimony next Tuesday and Wednesday will be the focus. Data wise, we have retail sales on Tuesday and housing starts on Thursday. In Canada, market focus will be on the BoC meeting on July 16 once we get past labor market data tomorrow.
- The coming week could be fairly quiet in Europe with the ZEW Tuesday and final June inflation release Thursday. UK inflation and labor data will be released Tuesday and Wednesday, respectively. Finally, Riksbank minutes on Wednesday will be worth watching for insight into the 50bp cut.
- In Asia RBA meeting minutes will be released on Tuesday, though they will likely be seen as dated given recent speech from Governor Stevens. Q2 CPI will be the highlight for New Zealand. BoJ meeting is scheduled for July 14-15, but no policy change is expected. Key China data releases next week include fixed asset investment, retail sales, IP, and Q2 GDP.

North America

The big event next week is Fed Chair Yellen's Humphrey-Hawkins Testimony next Tuesday and Wednesday. So far the Fed has been persistently dovish, confounding investors, and it seems likely that investors will go into the testimony fearing some hawkish tilt. The recent Minutes and speeches suggested that the FOMC was not sufficiently concerned about the inflation surge and asset prices to alter monetary policy and that seems the most likely outcome from the testimony. In consequence the US side will probably be USD negative and risk positive. Otherwise the big release is retail sales on Tuesday. After a disappointing May, investors are looking forward to a robust June – 0.6%m/m on headline, and 0.5% on ex-autos and control. Unless there is a big upside surprise combined with revisions, a weaker number will do more good for bond prices than a strong number will do harm. By contrast housing starts on Thursday are expected at 1020k, but a number north of 1080 would be read in the market as indicating a strong housing updraft.

In Canada, once we get past the Friday labor market data (expected 20k) the focus of investors will be the BoC rate decision on July 16. The run-up in CAD over recent months probably will weigh heavily on BoC comments, even if policy is unlikely to shift materially. For CAD, it makes a big difference if the BoC labels the inflation run-up as 'noise' or makes however subtle a reference to its single mandate of keeping prices stable. Next Friday Canadian CPI will be a big post-BoC pivot as it will underline whether the BoC's biggest problem is inflation or the value of CAD. Headline expected to nudge up to 2.3% y/y, core to stay flat at 1.7% y/y.

Steven Englander

Europe

The coming week could be fairly quiet in Europe with the ZEW Tuesday and final June inflation release Thursday. While the Eurozone aggregate may have bottomed last month, after the lower release in France this week there could be some modest downside risks to the release. Further undershoots here could see markets increase bets of further action on the part of the ECB, increasing short positions in EUR. Outside the data, investors seem likely to pay close attention to European asset markets, where a wobble in financial stocks has capped the bounce more recently.

With GBP backing up a little from the highs, investors will watch next week's inflation and labour market data released Tuesday and Wednesday respectively. After the low prints over recent months, markets look for a bounce in June inflation to 1.7% on headline and 1.8% on core. As much could downplay skepticism the BoE will be confident hiking rates persistently throughout next year. On the labor market release, while unemployment could take the main focus, it could be wage figures that instead carry bearing on hike timing.

Riksbank minutes post Monetary Policy Report meetings tend to generate less noise given the degree of detail in the reports. They're worth watching Wednesday however for insight into the decision and shedding light on continuous points for dissenters Ingves and Af Jochnick. The minutes could also add clarity on how policy might accommodate missing objectives from here. Consensus is that further disinflation would be met with a flatter path, despite the small easing bias in the report. Indications we have not yet reached the lower bound would be dovish. While particularly unlikely, discussion of asset purchases has potential to weaken SEK further. Outside of surprises, the impact could otherwise be fairly muted.

Josh O'Byrne

Asia

There are few economic releases of note in Australia in the coming week, save for the Minutes of the July RBA policy meeting. While the Minutes would typically be a major focus for investors, they are likely to be viewed as dated given the more recent speech from RBA Governor Stevens. Governor Stevens offered greater depth on the Bank's forward guidance and concern on FX than was evident in the policy statement. As such, we doubt that the Minutes will mark a major turning point for AUD.

In NZ, the CPI release for 2Q will be the highlight. Interest rate expectations have recently seen some pressure, but this appears to be more a reflection of external developments and swings in broader sentiment since there has been little new information on the domestic economy. We believe this gives rise to risk for NZD appreciation, should the CPI surprise on the upside and reinforce the likelihood for a relatively steep upward trajectory from NZ interest rates.

In addition to the above Australian and NZ releases, several key indicators are due from China, including fixed asset investment, retail sales, IP and 2Q GDP. Strength from these indicators could provide a boost to AUD and NZD since it would help to prop up risk appetite.

The highlight in Japan next week is the BoJ's monetary policy meeting scheduled on July 14-15. The central bank is expected to leave policy unchanged and Governor Kuroda is unlikely to change his position on the economy and inflation. In fact, he just repeated the bank's official outlook when he delivered a speech at the quarterly conference for the bank's branch chiefs this Monday. We suspect some fast money could take on JPY longs before the meeting, anticipating optimistic comments. USDJPY will continue to face downward pressure.

Todd Elmer, Osamu Takashima

Carry on this summer?

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The most striking aspect of the current price action is the resilience with which emerging markets are now trading. Whether one considers the surprisingly strong NFP print last week or recent equities underperformance or the policy effects from hawkish (Asia) or dovish (CEEMEA) central banks – we continue to rally across the board in EM.

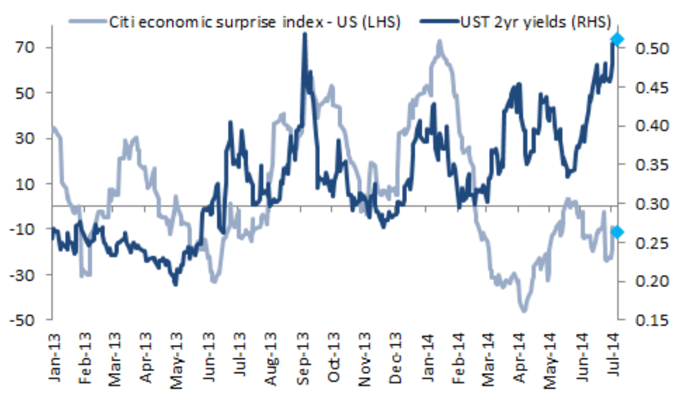
Although US labor market dynamics continues to be strong, the market appears to still be searching for more evidence of broad based growth acceleration; note that Citi's US economic surprise index is still in negative territory (Figure 1). For instance, in the UK a broad based and aggressive pick-up in economic activity was what led to a spike in front-end rates. Although 2-year yields have moved up since early June, the front end still fails to price the Fed's "dots". While recent data have been good, they're not good enough to push for more aggressive re-pricing of US rates and hence the USD languishes.

Against such a backdrop, Fed chair Yellen has been delivering to the market a consistent desire to remain "behind the curve." In every area where the market has justifiably feared potential hawkishness from the Fed, be it unemployment, inflation, or financial stability, the Fed's core has consistently sided with dovishness—slack remains elevated, inflation objective is still not met, macro-prudential measures are more suitable than monetary policy, etc. If one thinks hard in Yellen's shoes, despite recent string of stronger data, her "Carney moment" has not yet arrived and may still be some time away.

Investors have heeded the Fed's message. Carry trades have been popular and they have continued to perform. According to our proprietary platform data, investor flows into EM have continued unabated. (Figure 2) A similar phenomenon has taken place in the high-yielding rates and bond curves in EM. The fact that we have seen absolutely no capitulation despite a strong NFP print and extended short USD positioning is a testament to the thirst for carry.

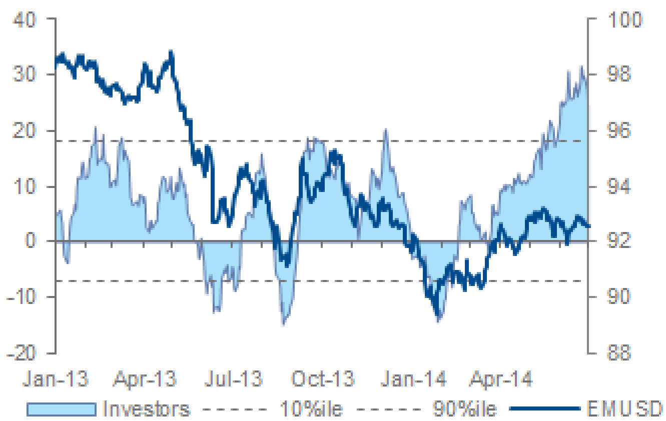
So how long do we stay in this goldilocks environment? Low volatility will eventually give way to turbulence, but some sort of trigger is needed. Recent communication from the Fed has told the market as much that next week's Humphrey Hawkins testimony is likely not it. In the absence of a clear catalyst, enjoy the last days of the World Cup, the summer, and EM carry.

Figure 1: UST 2yr vs. US economic surprise index



Source: Bloomberg and Citi

Figure 2: EMFX flows – real money + leveraged



Source: Bloomberg and Citi

EM FX and Rates View

In Asian FX, we retain a broadly based short-USD exposure. The core exposure remains in CNH, KRW and MYR. The first of these is supported by signals from the official mid-point fixings, while in Korea we remain comfortable that the current account and portfolio flows will more than offset the effect of the MPC edging closer to a reluctant rate cut. In Malaysia, the BNM delivered a rate hike (albeit with a slightly more cautious guidance than some expected). We also continue to support tactical exposure to THB and PHP. But we reduced exposure to Indonesia in our bond portfolio (including the FX overweight) on the back of election-related uncertainty, and we continue to find risk-reward in INR unappetizing after the government delivered a brave but uninspiring budget.

In Asian rates, we remain sidelined. We continue to prefer a long duration exposure in Korea, and find also that the balance of risks probably now favors receivers even in Malaysia (where we expect the market to now price in only one rate hike at a time at most), India (where fiscal stance turned out more conservative than feared), and Thailand (where investors have been too quick to price back rate hike expectations). In Singapore we remain comfortable collecting carry in the 3y part of the curve, but we remain underweight bonds in Philippines.

In CEEMEA FX, we remain in an environment of dovish central banks (even the Fed remains extremely reluctant to signal any aggressive stance), global low vols (VIX recently hit the lowest level since 2007) and still not a broad based economic recovery out of US. This continues to be conducive of carry strategies for now. We would expect further inflows in high yielding currencies where the ‘carry cushion’ remains attractive like TRY. We are long TRY vs USD + EUR basket. We remain bearish HUF as the NBH remains committed to keep rates much lower in Hungary – the currency will have to give way.

In CEEMEA rates, we still like long duration in the better credits like Czech and Poland long-end however we do note that valuations in some of the CE curves are now getting stretched. We like the POLGB long-end and are again positioned in the Oct 23s on the back of stronger European flows and strong borrowing strategy completion. However we are especially cautious on the HUF long-end which remains extremely vulnerable to foreign bond flows and nervous trading in USTs. HUF curve is trading at very low premiums to the PLN curve and this move looks rather extended to us. We like paying HUF vs PLN long-end in rates. In South Africa, we feel that the unthreatening global backdrop and favorable FX carry-conditions will provide the SARB with some wriggle room to not be very aggressive with their hiking cycle – we are receiving ZAR 1y1y on the back of this. In Turkey, the curve is pricing in aggressive rate cuts, which we don’t think will materialize over the summer with such poor inflation dynamics. We like paying the 1yr 3m forward in TRY X-ccy curve.

We took profit on our only Latam FX trade. Despite good carry/vol characteristics, there is a reasonable chance that the BCRP could cut rates by 25bp and it might result in FX weakness. COP has done well in spite of the increased intervention, but risk reward only becomes attractive on spikes in USDCOP. BCB intervention should keep BRL range bound. Similar to COP, selling USDBRL on spikes remains a viable strategy as long as the global low volatility environment persists. We are cautious on MXN given the low carry on offer. CLP should outperform MXN given that China fears are being priced out and market friendly changes have been made to the tax reform, which should improve business confidence.

In Latam rates, we hold the 1-year UF/CLP receiver despite slightly lower than expected CPI. Inflation breakevens are too low and the central bank may cut now with inflation having turned. We receive Jan16 in Brazil as a surprise cut has become more plausible. We are still overweight Brazil and Peru in our EM bond portfolio. We want to go underweight Colombia once the index inflows have progressed further.

Asia – India: A brave budget, but not inspiring

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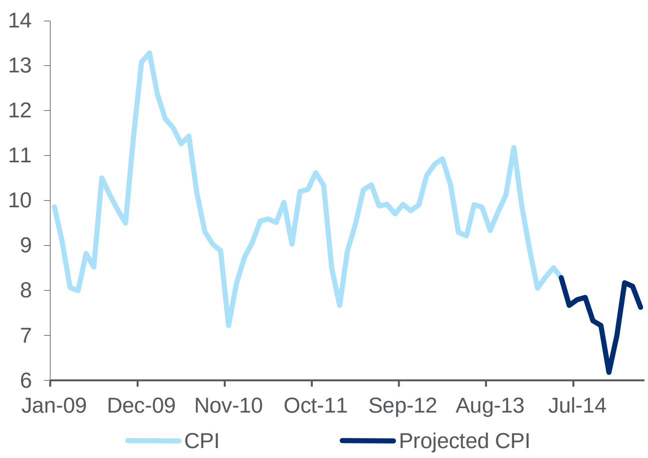
- Budget anti-climax as government opts for incrementalism rather than bold vision
- Commitment to fiscal targets is admirably brave, but fiscal slippage remains a risk for later
- With both fiscal & monetary policy contractionary, curve flatteners remain preferred trade
- INR should be well supported medium-term, but positioning is a risk in the short-run

In the first budget presentation of the Modi government, finance minister Arun Jaitley chose to be incremental rather than visionary, and chose bravely to risk credibility instead of revising targets to pragmatic levels. Investors should cheer the finance minister's commitment to the previous government's ambitious fiscal targets, but may be disappointed at the lack of policy vision.

Fixed income markets should be encouraged that fiscal consolidation will continue. Many investors were expecting a revision to a more pragmatic target; they will likely first cheer the fact that issuance plans remain mostly unchanged, and only later question revenue assumptions. In our experience, expectations of deficit slippage are usually not priced in at this early stage of the financial year. The plan to allow international settlement of bonds will likely also keep alive hopes of India's eventual inclusion into global bond indices, although we believe it remains very premature to position for such a development.

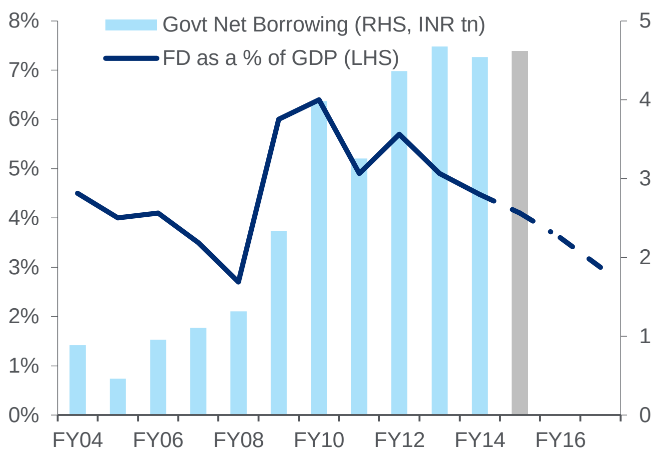
Along with fresh measures to contain food prices, this fiscal thrust should also help restrict the inflationary impulse and allow the RBI wider latitude to consider monetary support for growth. But note that although this meets a necessary condition for RBI easing, it is not by itself sufficient – it remains likely that RBI rate cuts will lag CPI inflation.

Figure 1: If food prices are contained, CPI may downshift



Source: Haver; Citi projection (not forecast); data as of 10 Jul 2014

Figure 2: Fiscal trajectory targeted for rapid correction



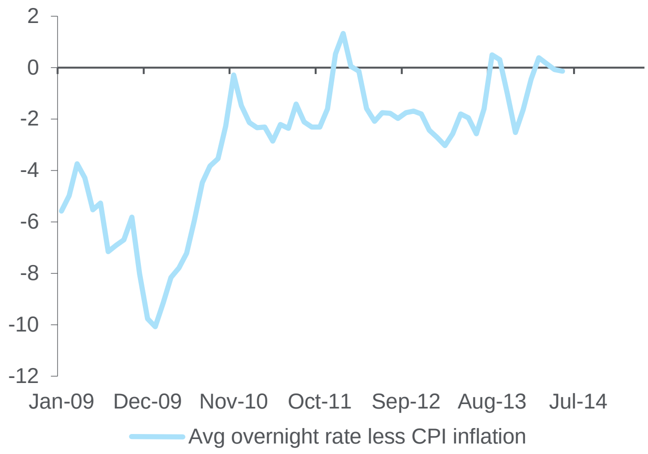
Source: Ministry of Finance, CAG, Citi; data as of 10 Jul 2014

As real rates are thus likely to rise simultaneously with contractionary fiscal impulse, we reckon curve flatteners remain a better trade (at least for as long as investors indulge the government its aggressive ~20% tax revenue target) relative to receivers at the short-end of the yield curve.

While we remain constructive on the currency, the short-term outlook is less compelling. The lack of an exciting new policy vision to buy into may dampen equity market sentiment, especially given elevated expectations and considerable positioning. But the focus on fiscal prudence, the continuation of gold import duties, and restraint from adventurism would suggest that the improvement in the current account over the past year will persist. As the investment cycle picks up (on the back of political certainty, and expectations of more decisive policymaking), capital flows should also continue to grow. Thus, we retain a constructive view on INR over the medium-term.

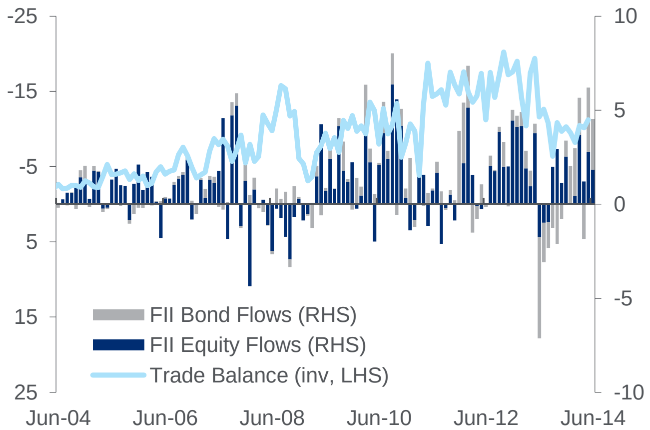
But in the short-run, we remain comfortable with a neutral position in INR, based on RBI's recent pace of reserve accumulation and the risks from crowded positioning. We are also concerned that with the budget now out of the way, investors no longer have a specific event to look forward to for guidance: more mundane news flow may tempt some into booking (considerable) profits.

Figure 3: Real rates will likely drift to positive territory



Source: Bloomberg, Haver; Citi; data as of 10 Jul 2014

Figure 4: Smaller trade deficit, and stronger flows (USD bn)



Source: CEIC, SEBI, Bloomberg, Citi; data as of 10 Jul 2014

CEEMEA – 25bp hike to reinforce SARB's credibility

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- We expect the SARB to hike the repo rate by 25 bps next week (17 July). It is a question of credibility and we think a 25 bps hike at this juncture will provide the SARB with some breathing room while it will have a negligible impact on the local growth trajectory.
- Although we do not think that a 25 bps increase will provide much direct support to the ZAR (a move of this magnitude is fully discounted in the FRA space), we do think it could minimize ZAR slippage when market volatility picks up (or normalise).

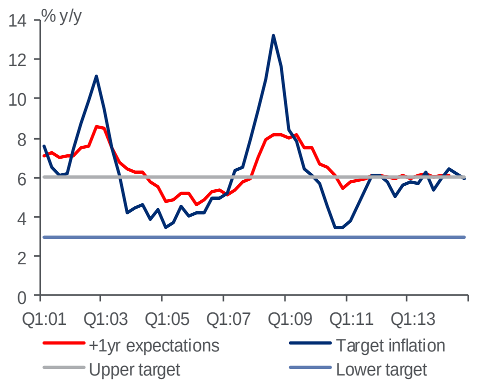
We expect the SARB to hike rates by 25bps at next week's meeting

The last MPC Statement highlighted that "[i]nflation is currently at uncomfortable levels and a marked deterioration in the outlook may require action that we will not hesitate to take". We still think the inflation trajectory could be flatter than the SARB's most recent forecast — with a local peak in Q2:14 and not in Q4:14 as the Bank projects — so a marked deterioration, on an already relatively bearish view, seems very unlikely to us. But, we still expect the SARB's MPC to raise the repo rate by 25 bps at the conclusion of next week's meeting (15-17 July). Why? Because inflation remains at uncomfortable levels, surveyed inflation expectations for Q2:14 did not surprise to the upside but we think they remain too high for monetary policy complacency and, the compression in SA's current account deficit in Q1:14 should not be extrapolated. It is a question of credibility and we think a 25 bps hike at this juncture will provide the SARB with some breathing room while it will have a negligible impact on the local growth trajectory.

Inflation expectations remain sticky

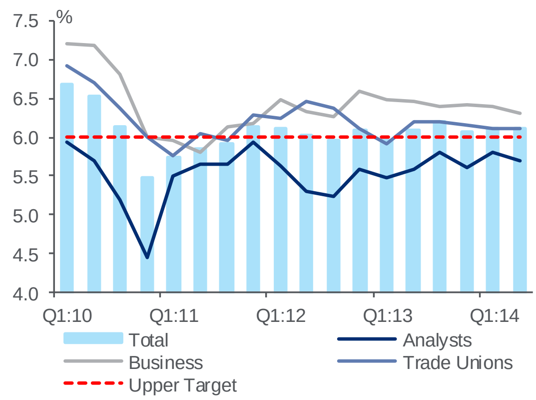
One-year ahead surveyed target inflation expectations have averaged above the upper band when calculated from 2001 (first full year of surveyed expectations) to date (6.4%) — see Figure 1. From this angle, one might argue that inflation expectations are embedded around the upper end of the target band. The fact remains that inflation is well above the target band; will be out for a while still; and inflation expectations of key price setters (Business and Trade Unions) remain sticky at a time when wage strikes are tripping up the local economy — see Figure 2.

Figure 1: Target inflation & year-ahead surveyed expectations



Source: Stats SA; BER; Citi

Figure 2: Year-ahead surveyed expectations



Source: BER

Credible monetary tightening could minimize the effects of further ratings actions

Has monetary policy credibility been undermined? We think the rate hike in January (+50 bps) reversed some concerns about credibility and a relatively favorable global backdrop kept remaining concerns under the radar. Recent adverse rating action (change to negative outlook by Fitch and one notch downgrade of SA's long-term local and foreign currency ratings by S&P) and the risk of further downgrades before year-end, might remain a risk factor (from a ZAR and, hence, inflation perspective) that the MPC might want to minimize at this juncture.

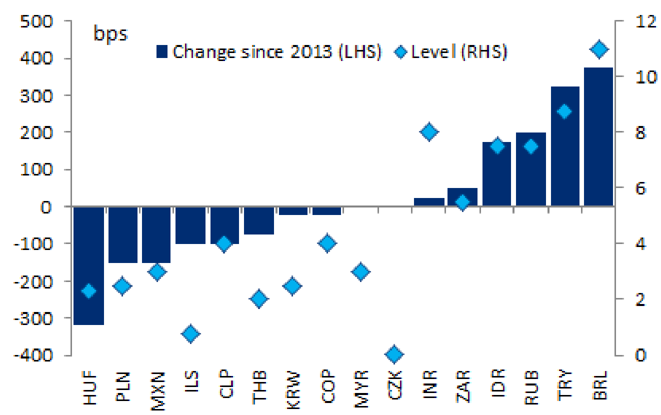
The divergence in inflation dynamics within CEEMEA has been apparent between the EUR and USD centric curves for a while now. While the CE curves continue to find themselves in a goldilocks-like environment of stronger growth and benign inflation, the USD-centric curves like South Africa, Russia and Turkey continue to face challenging inflation outlooks. This further increases the policy challenges for these economies, which because of sticky inflation; find it difficult to justify a more easy monetary policy framework despite the rally in asset prices and benign fixed income environment globally (See Figure 3)

Divergence in monetary policy between EUR and USD centric curves has a lot to do with inflation

This is not a dilemma that CE economies today face and hence it is no surprise that most CE central banks are either excessively easing or have a dovish bent. Inflation break-evens in Poland have collapsed for most of this year having rallied about 70bps or so YTD as inflation expectations have considerably reduced to about 0.2% YoY. It's a very similar picture in the rest of CE, with Czech CPI printing 0% in June and Hungary has seen dis-inflation over the past two months.

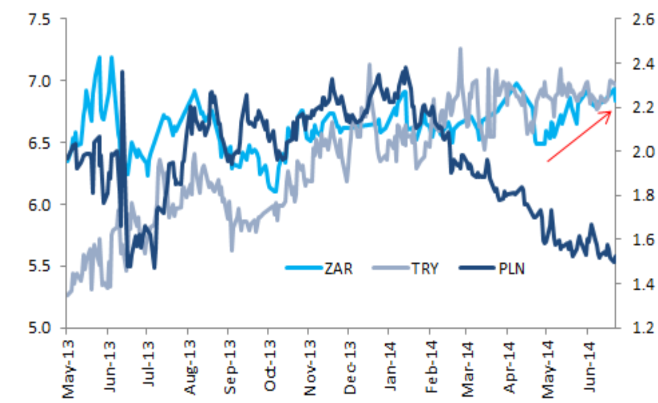
Meanwhile break-evens remain elevated in South Africa and Turkey (See Figure 4). While Turkey break-evens remain stable at higher levels, there has been a recent pick up in South African break-evens following the move in CPI which is now at 6.6% (above the 6% upper target band). This obviously raises questions for the SARB and increases pressure on the central bank to hike (even if it is a nominal one of 25bps) in order to reinforce its credibility. Although we do not think a 25 bps rate hike at next week's meeting will provide much support to the ZAR (a move of this magnitude is fully discounted in the FRA space), we do think it could minimize ZAR slippage when market volatility finally picks up (or normalises).

Figure 3: EM policy rates and changes since 2013



Source: Citi and Bloomberg

Figure 4: Break-even inflation in CEEMEA



Source: Citi and Bloomberg

Latam – What now, Brazil?

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- Dilma to give back gains in polls but the economy will be the main driver of her re-election chances. Brazil's World Cup loss would matter if prospects for jobs and inflation worsen.
- Peru Soberanos, especially those in the belly and back end, should rally further if BCRP cuts rates today.

"It's the economy, stupid"

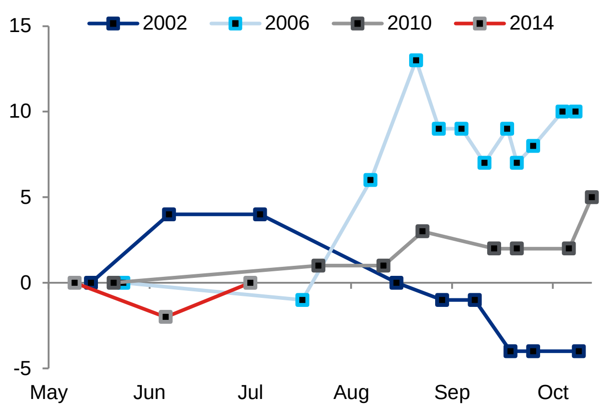
In the wake of Brazil's dramatic exit from the World Cup, many now ask how much the loss would cost Dilma in her re-election chances. When the tournament began, we wrote a piece on the impact of Brazil's performance on government approval. ("Will Neymar Win It for Dilma?", June 12) Thus far the organization and logistics of the games have unfolded smoothly as we believed they would. So have approval ratings, at least up to the last set of polls when Brazil was still in —we found that ratings typically don't worsen during the games.

Government approval ratings to move back to levels before the World Cup started.

The massive unrest that some anticipated with an early exit has so far not materialized. Will the loss hurt Dilma's re-election chances? Quite likely, at least she is expected to lose the gains recorded in the last poll. The equity markets reacted positively to the prospects of weaker support for the president—Petrobras ADR was up 3.5% when the local market was closed yesterday and Bovespa was up 1.7% today at the time of writing. The loss is far from sealing the election outcome, however. Past poll numbers may give us some clues, although we are mindful of the many dissimilarities with this World Cup held on home soil. In 2006 and 2010, government approval ratings rose after Brazil bowed out at the quarter-finals. (Figure 1) Paradoxically, in the run-up to the 2002 election approval fell after Brazil won the championship. This shows that what happens after the tournament matters more than the outcome of the tournament. Figure 2 shows the trajectories of annual inflation in each of those years. Clearly Brazil was plagued with high and worsening inflation in 2002, mirroring the move lower in public support for the government. The opposite happened in 2006, when low and improving inflation boosted support for Lula's administration.

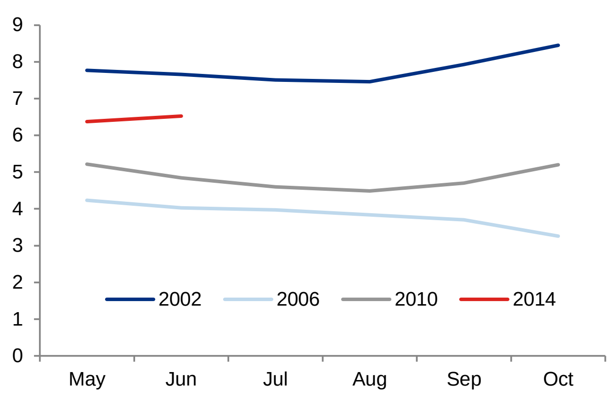
What happens after the World Cup matters more for polls than the outcome.

Figure 1: Government approval ratings (excellent/good in Datafolha polls) in World Cup years



Source: Datafolha and Citi

Figure 2: Annual CPI in the run-up to Brazil's presidential elections



Source: Bloomberg and Citi

Brazil's loss does matter for Dilma's chances, but only if the economy and inflation worsen further

Of course the analogy with past World Cups is far from perfect. Previous World Cups were far less politicized than the current one. Losing on home soil in a dramatic fashion after so much has been invested—socially, financially, and emotionally—will certainly generate an outsized impact on the country compared to the past. But after the last whistle is blown and the trophy handed out, life will move on and the daily economic realities will take over as the main driver of Dilma's chances. If, in the next few months, we see a much slower economy, gloomier job prospects, and higher inflation, the World Cup loss would matter—it would compound and exacerbate the negativity and pessimism surrounding the economy and the government. But for now, Neymar has not lost the election for Dilma. And the phrase "It's the economy, stupid" is just as apt for Dilma's campaign today as it was for Bill Clinton in his successful 1992 election bid.

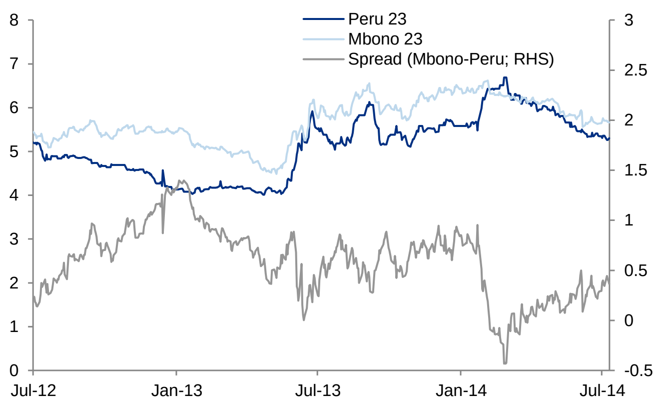
Although BRL was weaker in the first day of trading after Brazil's loss, we expect it to remain range bound given central bank support. Selling USDBRL on spikes is still a viable strategy as long as the current low volatility environment persists. Our outstanding Jan16 DI receiver should continue to benefit from disappointing economic data and increasing odds of no rate hikes next year.

Will the BCRP deliver a rate cut?

Further rally in Soberanos if BCRP cuts rates today

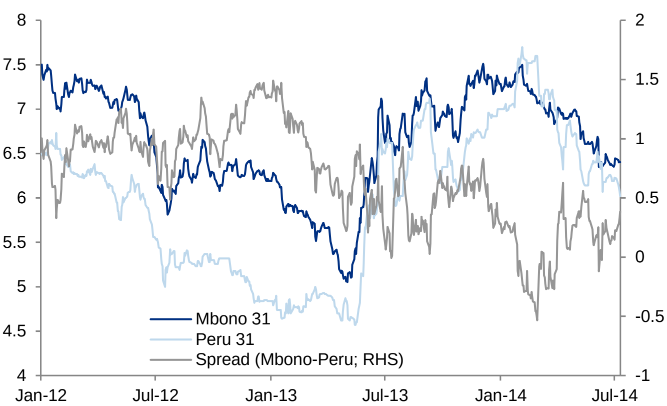
The BCRP will announce rate decision after market close today. Expectations for a rate cut have significantly increased since the last meeting, when the statement explicitly referred to the use of "additional easing measures" if necessary. Soberanos across the curve have rallied, in line with bond rallies seen across much of EM. Our economists are calling for a 25bp cut sometime this quarter. A rate cut today should benefit Soberanos further, especially those further out the curve that did not rally as much as the front end. Figures 3 and 4 show spreads of Soberanos vs. Mbonos of similar maturities. Spreads still remain at attractive levels for both 23's and 31's. At the same time we took profit on our short USDPEN trade by letting the NDF mature at the fix. Given reasonable chances of move we decided to avoid the event risk and reassess PEN after the decision.

Figure 3: Mbono-Perugb 2023 spread



Source: Bloomberg and Citi

Figure 4: Mbono-Perugb 2031 spread



Source: Bloomberg and Citi

G10— Short-Term Outlook

	FX
United States	Although we are medium-term USD bulls, reserves diversification, carry trades, market dynamics and Fed dovishness continue to create headwinds for the USD over the short-term. The recent FOMC has kept yields capped and has put some downward pressure on the USD. Nevertheless, we think US labor markets are tightening quicker than the Fed forecasts which will lead to tighter Fed policy and a stronger USD as we approach 2H14.
Eurozone	The ECB exceeded market expectations on all major points – they announced a new TLTRO program, hinted at QE and aggressively expanded bank liquidity. The Governing Council also delivered rate cuts and negative deposit rates. We continue to see risks for EUR on the downside. We think that the single currency could lose more ground against higher yielding currencies like AUD as well as GBP where the tightening cycle beckons.
United Kingdom	GBP remains a conviction long amongst investors, with little motivation to cut at this point. Macroprudential measures introduced recently are unlikely to significantly impact the monetary policy outlook. We maintain our constructive long-term view on the pound, and Citi expects more aggressive, earlier tightening in the UK than the market. EURGBP downside remains our favorite for GBP longs.
Switzerland	SNB policy remains on hold for the foreseeable future and CHF remains sensitive to asset markets more broadly. On the margin, inflation undershoots can continue to lengthen investor expectation for the CHF cap and zero rates. While rates among advanced economies remain low and the current account surplus remains strong, CHF could continue to exhibit limited volatility with a modest bid.
Norway	After the dovish revisions from the Norges Bank and surprise move at the Riksbank, markets now price a high chance of a rate cut in Norway within the next 12 months. It would take a marked slowdown in domestic momentum from here for such a move to materialize, especially while inflation remains very close to target. Subsequently we continue to expect a bounce in NOK.
Sweden	The Riksbank overdelivered in July, cutting 50bp and lowering the rate path dramatically. While about half of the SEK weakness has reversed over subsequent sessions, lower rates and FX are likely to provide positive impulses to inflation. While this may mark the end of the easing cycle in Sweden, there is now a much wider differential vis-à-vis Norway, underpinning our constructive view on the cross.
Japan	Delayed expectations on BoJ easing should keep USDJPY trading range bound over the next couple of months. Recent strength has been a result of flattening of the US curve and overall tighter rates. However, once there is a clearer picture on the timing of easing from the BoJ, we expect USDJPY to trade to the 108-110 level.
Australia	AUD has shrugged off the decline in commodity prices as reserves recycling has more than offset any negative impact. While the slowdown in China has been associated with lower commodities and declines in sentiment, reserves accumulation has continued apace. We expect this trend to continue to support AUD moving forward and believe the currency will be an attractive target for investors seeking carry in the low volatility environment given the domestic economic pick-up.
Canada	CAD has performed well over the last couple of months as data has continued to print better than expected. However, at its June policy meeting the BoC looked through the improving inflation picture and noted that downside risks to the inflation outlook were as important as before. So while CAD could do well against a positive risk backdrop, we maintain a cautious outlook.

Asia Short-Term Outlook

	Rates	FX
China	Neutral: Better economic data is leading to the pricing out of expectations of aggressive monetary easing, but the PBoC is likely to leave liquidity conditions flush for the foreseeable future. We see little value in IRS.	Bullish: A simple momentum trading rule based on the daily midpoint fixing continues to send a short-USD trading signal. Together with better economic data and improving external balances, this keeps us long CNH.
Hong Kong	Neutral on rates as a spread to US.	Neutral: USD peg will stay near term so we prefer to buy USDHKD around 7.75.
India	Neutral: Unexpectedly conservative fiscal stance will, together with rising real interest rates, encourage the yield curve to continue flattening. A poor monsoon could yet damage inflation expectations, so we advise against receivers at the front end of the curve.	Tactically neutral: Heavy positioning together with RBI's reserve accumulation deters short-term exposure. But our fundamental constructive view remains intact, especially with oil prices fading back. An investment recovery will further fuel INR-bullish momentum.
Indonesia	Neutral: We do not expect monetary policy to tighten, and fears of a larger fiscal slippage have eased. But the Presidential election remains unfinished until one candidate concedes. Uncertainty persists at least until official results in about two weeks.	Neutral: A clear result in the Presidential election is needed to set investor sentiment for the short-run. For now, positioning remains relatively unhedged, and risks appear still asymmetrically biased towards USDIDR upside.
Korea	Bullish: BoK might not cut rates either quickly enough or deeply enough. With rate cuts already priced, we avoid the front-end of the curve, and continue to prefer long-duration that is also supported by domestic bids.	Bullish: Strengthening current account balances should get further support from pick up in exports. Inflows into equities likely to be strong. Smoothening intervention and a more dovish BoK are unlikely to alter the trend
Malaysia	Neutral: The MPC raised rates as expected, but made future moves conditional upon incoming data. We expect more rate hikes, but think investors will only price in one additional hike at a time. Current pricing isn't far from such a scenario.	Bullish: Improving external balances, better data from China, and a hawkish central bank all lend support to MYR. But a higher susceptibility of MYR to global risk sentiment persists – the ringgit will remain a high-beta play on global sentiment towards EM.
Philippines	Bearish: The unexpected SDA rate hike will encourage expectations for more hikes given still strong loan growth, flush liquidity and rising CPI momentum. Yields will rise, with the curve steepening as extended positioning adjusts.	Bullish: SDA rate hike reinforces the case for PHP to outperform on the back of expectations of tighter policy. The first rate hike typically exaggerates fear of more tightening, which should help PHP, especially as equity markets have remained robust.
Singapore	Neutral on rates as a spread to US.	Bullish: SGD should trade on the strong side of NEER band on a rebound in underlying macro data. A recovery in real money demand also bodes well.
Taiwan	Neutral: Economic strength is underpinned by domestic demand while external sector remains soft. Inflation momentum has picked up. But capped US yields will likely restrict the weakness in local rates.	Neutral: Pick-up in portfolio inflows amidst improving data from China is a key support. Political noise warrants monitoring, and CBC reserve accumulation persists. We continue to prefer KRW to TWD.
Thailand	Neutral: Investors have been quick to reprice expectations of eventual policy normalization, but that will take a long while. With residual positioning having been cleaned, we no longer advise short-duration exposure or IRS payers.	Cautiously bullish: Short positioning, resumption of fiscal spending and shift in MPC stance should support further THB outperformance. Tourist arrivals are picking up, further boosting the current account in the short run. BoT agree that THB 'isn't expensive'.

CEEMEA Short-Term Outlook

	Rates	FX
Czech Rep	Bullish bonds. The front-end of the CZK curve is likely to be anchored by the dovish policies of the CNB and zero bound rates, but as central banks remain accommodative, we will see more foreign inflows in the long-end of good credit curves like CZGB.	Neutral CZK. The consistently low CPI prints and fragile economic data are likely to keep EURCZK elevated above 27.00 for now.
Hungary	Pay long-end rates. Despite the dovish policies of the NBH (swap facility today trying to depress points further) and the on-going rate cuts, we believe that the HUF curve is becoming very vulnerable to nervous trading in USTs. Positioning is also extremely received in this curve. We like paying the long-end. We are paying HUF 10yr vs PLN 10yr in our portfolio.	Bearish HUF. We continue to believe that the NBH will halt its easing cycle only when EURHUF pushes its hand. This is becoming likely with the aggressive stance on the FX debt plan which will make investors more nervous. We are now Long EURHUF 3m call spreads in our portfolio.
Poland	Bullish bonds. The trend of disinflation and dovish central banks in CE has anchored front-ends. Better fundamentals, good borrowing strategy and further easing by the ECB are keeping POLGBs supported. We are again back in the curve. We are long POLGB 10yr and rec PLN 10yr vs HUF 10yr.	Bullish PLN. We still believe that economic fundamentals remain extremely supportive of the polish Zloty and political noise has been overdone. As the government wins the no confidence vote, we believe there is further room for PLN to rally. Albeit one caveat is the already long positioning in the currency.
Russia	Favour bull steepening. RUB curve has been adversely affected by the recent geo-political stress but as Russia de-couples from the situation in Ukraine and FX price action gets better, we feel there might be room for the CBR to consider rate cuts later in the year. We could see some bull steepening in the curve.	Neutral RUB. RUB trading dynamics have been affected by a politically challenged landscape and weak economy. Since positioning was stretched and locals were positive, we have seen a decent rebound in RUB but we still feel that as the focus shifts more towards local economics – RUB trading will be negatively affected again. .
South Africa	Neutral/Bearish. We are not in an SAGB-friendly environment. We recommend a bond position that is short versus benchmark duration. We remain tactically received in 1y1y.	Neutral ZAR. ZAR continues to face challenges with mining strikes and much lower mining and manufacturing production data which is likely to not bode well for further growth prints. We maintain a short ZAR position in Citi's overlay portfolio.
Turkey	Pay front-end rates. CBT has cut rates by 125bps already in the past few months and is expected to continue in the next meeting. But they haven't yet cut the upper corridor, which tells us that they want to keep the flexibility of higher rates open. Given the challenged inflation outlook, we find it hard to believe that CBT can aggressively cut rates from here. We are paying TRY X-ccy 1yr 3m fwd in our portfolio.	Bullish TRY. Despite the recent cut, CBT has enough carry cushion and they could also further tighten intraday liquidity with the upper band of the rates corridor at 12%. We are long TRY vs EUR + USD basket in our portfolio.
Israel	Buy long-end bonds. Given the recent up-tick in economic growth and inflation dynamics progressing in line with expectations – we find the case for a rate cut in the next meeting slightly difficult for now. However inflows into long-end will continue to support the curve.	Bearish ILS. We are bearish shekel on the back of currently stretched valuations and the likelihood of more aggressive measures by the BOI on FX.
Romania	Bullish bonds. ROMGBs have underperformed the rest of EM rates rally recently and with inflation significantly surprising to the downside and ECB easing, we feel there is more room for these bonds to rally.	Neutral RON. RON tends to escape the negative EM sentiment with the CB capping the market. With the renewed bullish sentiment on EMFX, RON is likely to trade in sync with the rest of the region.

Latam Short-Term Outlook

	Rates	FX
Argentina	Neutral – Risks of a default are still high but at the same time the possibility of a deal with the hold-outs has risen.	Neutral on ARS – After the seasonal benefit from the harvest international reserves are likely to fall again, and the depreciation has to be speeded up. On the other hand, a potential settlement with the hold-outs would lead to an expectation of large foreign inflows, extending the current rally.
Brazil	Receive Jan 16 – Recent positive inflation news and weak growth enabled the central bank to end the hiking cycle. The market is still pricing a second leg for the cycle post elections. This leg is not as likely as the market perceives it, suggesting a receiving bias in the Jan16 to Jan 17 area.	Bullish bias on BRL – China fears are mostly in the price. And the central bank has signaled that it is not concerned about currency strength even close to 2.20. This suggests that BRL can appreciate more in a low volatility environment, and barriers at 2.15 may well be taken out.
Chile	Receive 1yr real rates – The BCCh is still dovish and further cuts are likely later this year. Inflation breakevens are too low given the dovish central bank and inflation pressures from a weaker CLP. Oil is under upward pressure again due to geopolitics.	CLP to outperform – China growth fears have been mostly priced by the market. And China is engaging in stealth easing. The interest rate cuts are being pushed out. Market friendly changes to tax reform should boost business sentiment.
Colombia	Neutral on TES – We exited our long TES 2024 bond trade just before Colombia's weight was increased in JPM's GBI-EM index. Judging from past history, bonds usually sell off after the inclusion event. We still think more inflows will come in, but the pension fund reform to encourage more offshore investments remains an overhang.	Bullish bias on COP – COP should benefit from remaining flows due to JP's index rebalancing, The central bank is also in a hiking cycle. Intervention has been increased, but remains manageable.
Mexico	Neutral on TIIE – The Mexican curve is steep, leading to attractive roll-down and carry. But the central bank implemented its last cut and flatteners are crowded trades.	Bearish bias on MXN – The two main drivers for a bullish view are reforms and return to better growth. Reforms are not leading to positive surprises anymore and growth has not yet sufficiently improved. In the aftermath of the last Banxico cut MXN is now a funding currency
Peru	Bullish Soberanos – The curve is relatively steep and the central bank has a dovish bias. Spread to Mbonos also looks attractive.	Neutral on PEN – Carry is high, especially relative to the low vol. The range for USDPEN is likely to remain tight given central bank activity on either side. However, a rate cut, if it happens, will weigh on the currency in the short run.

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