

## Highlights of the Week

*Risk appetite gathered momentum last week*

*Risk currencies rally*

*Positive economic surprises on the increase*

*All eyes on Europe ahead on Oct 23rd meeting*

*Citi analysts do not expect resolution at EU summit*

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## FX

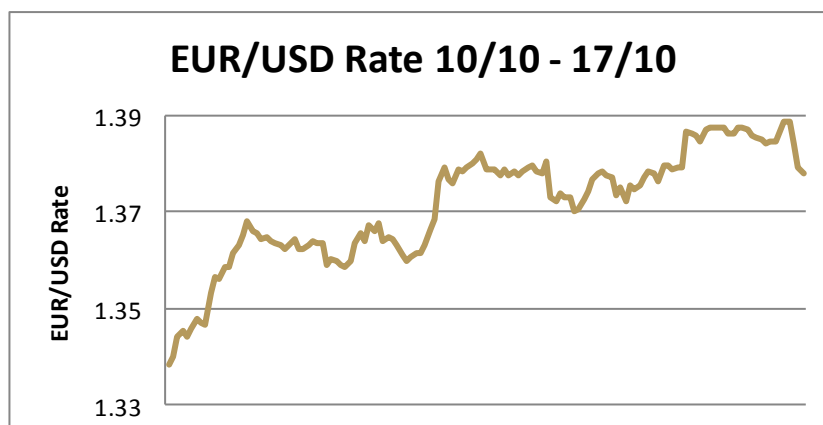
### *Risk appetite gathered momentum last week*

Risk appetite picked up last week, sending the dollar broadly lower against major currencies. Investors were optimistic that a solution to the Eurozone issues may be near following statements from Merkel & Sarkozy that they will deliver a comprehensive plan by the end of the month.

### *Risk currencies rally*

The Euro rallied, as did most risk currencies. Downgrades of some peripheral European sovereign ratings were shrugged off as the focus was on developments in formulating the bank recapitalization plan. Slovakia finally voted in favour of increasing the EFSF powers while Sterling also rallied as investors viewed the recent Quantitative Easing announcement as the right policy for the struggling economy.

Friday's US September retail sales came in well above consensus at 1.1% with sharp gains in motor vehicles and gasoline. Core retail sales also increased by 0.6%, which was also well above consensus. Following Friday's retail sales release, the Citi US Economic Surprise Index (ESI) has risen to 2.2. This is the first positive reading since 29 April.



### *Positive surprises on the increase*

The rise has been driven by the accumulation of small, but consistent positive surprises in recent weeks. While in absolute terms, US economic releases are still far from suggesting a robust expansion, the improvement does suggest that the bearishness of forecasters had gone too far. Since 28 September, 14 data releases have gone into the calculation of the US ESI, 13 of them better than expected.

The improvement in US data surprises though is unlikely to sway the Fed from changing its policy stance anytime soon. The positive ESI would make it much harder for the doves within the Fed argue in favor of QE3. Markets though have factored little in terms of QE3 so the fact that it would now be much more difficult to propose additional easing should not move markets.

On the other hand, the combination of upside data surprises in the US amid a Fed on hold for the foreseeable future would in itself be supportive of risk assets and therefore negative for USD. But given that euro zone events currently overshadow everything else, the current risk supportive US data is likely to be of secondary importance until the euro zone headlines start to show signs of some real progress on key issues.

## FX

### *All eyes on Europe ahead on Oct 23rd meeting*

The announcement by Angela Merkel and Nicolas Sarkozy that they would present a comprehensive package to address the euro area sovereign debt and banking crises by the end of the month has created a new dynamic at the political level. This has raised expectations for the Council meeting of the EU Heads of State and Government on 23rd October. The G20 country heads met over the weekend with no further details arising in relation to the plan to resolve the Eurozone issues. While Citi analysts expect progress in many areas to come from the October 23<sup>rd</sup> meeting, including debt sustainability in Greece, bank capitalisation, support for the Italian and Spanish sovereign bond markets and euro area governance, they do not expect that summit will be able to end the crisis.

### *Citi analysts do not expect resolution at EU summit*

Coming up this week, it's a busy week of US data, with industrial production Monday, PPI Tuesday, CPI and building data Wednesday and the Philly Fed Thursday. Earnings season is also in full swing, with big players among those reporting.

Citi analysts remain overall cautious given the euro zone events looming in the background and think the current risk rally against USD may be close to being overstretched. As a result, risk currencies may struggle to maintain momentum against the funding currencies (USD and JPY) ahead of the October 23 EU meeting that now looms as the key risk event for the euro zone. Our CitiFX Technical team agrees and notes the present path of the USD Index continues to closely follow the path seen in 2008, suggesting the correction down may have come to an end and the uptrend may resume.

## Citi FX Forecasts—September 2011

		Forecasts			
		spot	0-3 mos	6-12 mos	long-term
<b>G10</b>					
Euro	EURUSD	1.38	1.29	1.25	1.30
Japanese yen	USDJPY	77	75	76	78
British Pound	GBPUSD	1.57	1.52	1.51	1.65
Swiss Franc	USDCHF	0.90	0.95	0.95	1.04
Australian Dollar	AUDUSD	1.03	0.95	1.02	0.95
New Zealand Dollar	NZDUSD	0.80	0.76	0.83	0.63
Canadian Dollar	USDCAD	1.01	1.06	1.00	0.95
Dollar Index*	DXY	77.03	80.84	82.08	79.36
<b>G10 Crosses</b>					
Japanese yen	EURJPY	106	97	95	101
Swiss Franc	EURCHF	1.24	1.23	1.19	1.35
British Pound	EURGBP	0.88	0.85	0.83	0.79
Swedish Krona	EURSEK	9.16	9.35	9.00	8.80
Norwegian Krone	EURNOK	7.74	7.90	7.75	7.70
Norwegian Krone	NOKSEK	1.18	1.18	1.16	1.14
Australian Dollar	AUDNZD	1.28	1.25	1.23	1.51
Australian Dollar	AUDJPY	79	71	78	74
<b>Asia</b>					
Chinese Renminbi	USDCNY	6.37	6.30	6.12	5.87
Hong Kong Dollar	USDHKD	7.78	7.78	7.76	7.75
Indonesian Rupiah	USDIDR	8873	9300	8900	8650
Indian Rupee	USDINR	49.0	49.5	47.5	46.0
Korean Won	USDKRW	1142	1200	1140	1050
Malaysian Ringgit	USDMYR	3.11	3.20	3.06	2.89
Philippine Peso	USDPHP	43.1	43.7	42.8	41.5
Singapore Dollar	USDSGD	1.26	1.30	1.24	1.17
Thai Baht	USDTHB	30.6	30.7	30.0	29.5
Taiwan Dollar	USDTWD	30.1	30.8	29.5	28.2
<b>EMEA</b>					
Czech Koruna	EURCZK	24.8	25.3	24.8	23.8
Hungarian Forint	EURHUF	294	335	330	300
Polish Zloty	EURPLN	4.30	4.65	4.30	3.90
Israeli Shekel	USDILS	3.66	3.80	3.60	3.40
Russian Ruble	USDRUB	30.8	32.9	34.2	31.3
Russian Ruble Basket		36.1	37.2	38.0	35.5
Turkish Lira	USDTRY	1.85	1.86	1.88	1.79
South African Rand	USDZAR	7.91	8.00	8.50	8.75
<b>LATAM</b>					
Brazilian Real	USDBRL	1.75	1.82	1.80	1.70
Chilean Peso	USDCLP	499	520	530	490
Mexican Peso	USDMXN	13.3	13.2	13.0	12.2
Colombian Peso	USDCOP	1889	1850	1850	1850

Spot rates end of day 14th October 2011, FX Forecasts as of 23rd September 2011

## G10 Data Releases

### USD:

- Oct. 17, Richmond Fed President Lacker to speak on economic outlook in Maryland.**
- Oct. 17, Chicago Fed President Evans to speak on monetary policy and the economic outlook in Michigan.**
- Oct. 18, Fed Chairman Bernanke to speak at Boston Fed conference on the long term effects of the great recession.**
- Oct. 18, Atlanta Fed President Lockhart to speak on the economic outlook in Tennessee.**
- Oct. 19, Boston Fed President Rosengren to speak at Boston Fed conference on long term effects of the great recession.**
- Oct. 19, Atlanta Fed President Lockhart to moderate panel discussion on Latin American growth.**
- Oct. 20, St. Louis Fed President Bullard to give opening remarks at Fall Research Policy conference in St. Louis.**
- Oct. 20, Atlanta Fed President Lockhart moderates discussion on the economic crisis at the World Affairs Council in Atlanta.**
- Oct. 20, Cleveland Fed President Pianalto to speak to conference on the Midwest economy in Toledo.**
- Oct. 20, Minneapolis Fed President Kocherlakota to speak to Minnesota Council on Economic Education.**
- Oct. 21, Minneapolis Fed President Kocherlakota to speak to the Harvard Club of Minnesota.**
- Oct. 21, Fed Vice Chairman Yellen to speak on the outlook for the U.S. economy and economic policy in Denver.**
- Oct. 17, September Industrial Production and Capacity Utilization (Percent Chg. Unless Noted): Citi. 0.0 %, August 0.2 %, July 0.9 %, June 0.1 %; Capacity Utilization – Citi. 77.1 %, August 77.4 %, July 77.3 %, June 76.7 % - Citi analysts anticipate no change in industrial production in September, as another weather-related drop in utilities output offsets small gains elsewhere. Factory output probably increased, but not by much given the loss of 13,000 manufacturing payrolls**
- Oct. 18, September Producer Price Index (Percent Change): Total – Citi. 0.3 %, August 0.0 %, July 0.2 %, June -0.4 %; Ex. Food & Energy – Citi. 0.2, August 0.1, July 0.4, June 0.3 - Producer prices probably reaccelerated after last month's flat reading. But the fundamentals are swinging toward softer wholesale prices in coming months. Crude petroleum prices have fallen sharply, first on WTI and now even Brent seems to be headed lower. In addition, many non-energy commodity prices have fallen sharply recently.**
- Oct. 19, September Consumer Price Index (Percent Change): Total – Citi. 0.3 %, August 0.4 %, July 0.5 %, June -0.2 %; Excl. Food & Energy – Citi. 0.2, August 0.2, July 0.2, June 0.3 - Citi analysts look for another energy-led jump in overall CPI in September, but core CPI probably remained tame. **Note 1:** Apparel prices have soared in the four months to August at the fastest pace in the post-WWII era. The 5% cumulative rise (not annualized) followed nearly a decade of stagnant prices. Given the lack of demand and tremendous slack in the economy, Citi analysts have a hard time trusting that this is a new trend. Seasonal factors look for more than a 4% rise in prices in September. Citi analysts think the price increase will fall short of seasonals, especially starting from such elevated levels, yielding a decline in apparel prices this month. **Note 2:** Barring a reversal of the recent drop in energy prices, September could be the peak in overall CPI inflation.**
- Oct. 19, September Housing Starts and Permits (Thousands): Total – Citi. 580, August 571, July 601, June 615, May 553; Building Permits – Citi. 615, August 625, July 601, June 617, May 609 - Housing starts likely remained in the tight range in place since the end of the recession. Single-family housing construction has been especially weak during this period, while multifamily housing shows some signs of a rebound. **Note:** Multi-unit starts are probably being spurred by the falling rental vacancy rate and the corresponding rise in rent prices.**
- Oct. 20, September Existing Home Sales (Millions of Homes): Citi. 4.95, August 5.03, July 4.67, June 4.84, May 4.81 - Existing home sales likely retreated slightly in September after a small pickup in August. Single-family home sales have been trapped in a tight range in 2011, with no signs at this point of a breakout. **Note:** Although mortgage rates have fallen to a historic low below 4% on 30-year fixed loans, and the housing affordability index remains near record highs, these are not the driving factors for housing at this time. Mortgage credit availability remains tight and potential buyers are now expected to amass larger down payments, which takes time.**
- Oct. 20, October Philadelphia Business Survey: Citi. -10.0 %, September -17.5 %, August -30.7 %, July 3.2 % - Although Citi analysts look for some more improvement in the Philadelphia business gauge, the report probably will be downbeat again. **Note:** The Philly Fed index has been all over the map this year and not very reflective of economic activity. At the start of spring, the index jumped to the highest reading in a quarter century, only to plunge to one of its lowest readings by mid-summer. The economy and other measures of activity exhibit none of these extremes. So, while Citi analysts expect the Philly measure to settle down to levels consistent with ongoing modest growth in coming months, Citi analysts take this business gauge with a grain of salt.**

## G10 Data Releases

### EUR:

**Oct 18, German ZEW Economic Expectations, Oct Forecast: -48 Prior: -43.3** - Despite the recent rebound in equity markets, the ongoing uncertainty regarding the sovereign debt crisis is likely to lead to an eighth consecutive fall in ZEW business expectations to the lowest reading since November 2008. With the ongoing reduction in unemployment, the current business situation is likely to stabilize around the September reading of 43.6. However, the combined index of the current situation and business expectations is likely to fall from 0.2 in September to -2.2 in October, the first negative reading since March 2010.

**Oct 20, Euro zone Consumer Confidence, Oct Flash Forecast: -21 Prior: -19.1** - Citi analysts expect a fourth consecutive fall in consumer sentiment in October. In addition to ongoing tightening in financing conditions the continuing sovereign debt crisis is likely to cause a further deterioration in consumer confidence in October. Citi analysts expect a fall to the lowest reading since August 2009.

**Oct 21, German Ifo Business Climate, Oct Forecast: 105 Prior: 107.5** - Citi analysts expect a fourth consecutive fall in the Ifo business climate. Citi analysts expect a fall in business expectation from 98 in September to 95 in October, the lowest reading since June 2009. Furthermore, after remaining pretty stable in September, the assessment of the current business situation will probably drop from 117.9 in September to 115.3 in October, the lowest reading since August 2010. The decline in business confidence is probably greater in export-oriented sectors.

### GBP:

**Oct 18, Consumer Prices, Sep Forecast: 0.3% MM, 4.8% YY Prior: 0.6% MM, 4.5% YY; CPI Ex Food, Drink, Tobacco, Energy, Sep Forecast: 0.7% MM, 3.2% YY Prior: 0.7% MM, 3.1% YY; Retail Prices, Sep Forecast: 0.5% MM, 5.3% YY Prior: 0.6% MM, 5.2% YY; RPIX – Excludes Mortgages, Sep Forecast: 0.5% MM, 5.4% YY Prior: 0.6% MM, 5.3% YY** - Increases in energy prices probably will send CPI inflation higher this month, heading up to a peak of about 5.0% YY in coming months. There is some uncertainty over the timing of the pass through of energy prices, and Citi analysts assume increases of about 5% MM in energy prices for both September and October.

**Oct 20, Retail Sales Volumes, Sep Forecast: 0.0% MM, 0.7% YY Prior: -0.2% MM, 0.0% YY** - Retail sales volumes have been roughly flat since late 2009 and, with housing weak and real wages falling, retail sales will probably remain stagnant in coming months. Nominal spending is not very weak, but this is all being eaten up by higher inflation.

**Oct 21, Public Sector Net Borrowing, Sep Forecast: £14.5 Billion Deficit, £65.9 Billion Deficit Fiscal Year To Date (Figures Exclude Costs of Financial Intervention) Year Ago: £15.5 Billion Deficit, £70.8 Billion Deficit Fiscal Year To Date** - The fiscal deficit is falling slowly, and rather more slowly than implied by the Office for Budget Responsibility's (OBR) forecast. Their forecast for the deficit over the full year (£121.8bn) requires the deficit to fall by £15bn over the fiscal year (an average drop of £1.2bn per month). In practice, the deficit has fallen by £3.9bn over the first five months of the year, an average drop of £0.8bn per month, only about 60% of the required pace. The deficit is likely to overshoot the OBR's forecast by £5-£6bn over the full year.

### AUD:

**18 Oct, RBA Board Minutes, Oct** - The RBA will publish the Minutes of the October board meeting.

### CAD:

**Oct. 21, Consumer Prices: CPI, m/m – Citi. 0.2%, Previous 0.2%; CPI, y/y – Citi. 3.1%, Previous 3.1%; CPI-X, m/m – Citi. 0.4%, Previous 0.4%; CPI-X, y/y – Citi. 1.9%, Previous 2.1%**