Weekly macro wrap

January 20, 2012

Juan Pérez-Campanero
Economic Research
Banco Santander, S. A.
japerezcampanero@gruposantander.com
+34 912 572 296

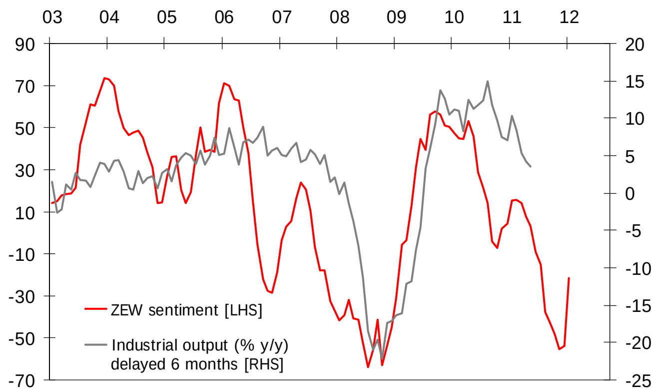
Economic outlook: data review

- **Germany: ZEW index rises sharply.** The ZEW economic sentiment index rose sharply in January, from -53.8 to -21.6. The current situation index also gained 1.4 points to 28.4, the first rise since May. But it is the massive 32.2 point increase in the expectations index for the next six months that is really eye-catching, and appears to underpin the idea that economic conditions in the region are stabilising. Purely financial factors (including the ECB's liquidity operation and the fall in Germany's rates curve) may have played a pivotal role. Indeed, the head of ZEW's financial markets department said "it seems the worst of the euro crisis is over". In this connection, recall that the ZEW is a survey taken mainly among people from the financial industry and does not necessarily translate into better general sentiment among the business community or members of the industrial sector, whose impressions are more accurately gauged by the IFO index. In any event, the index remains very low and this negative value continues to evidence that the investors and analysts surveyed still expect conditions to deteriorate in the next six months. Indeed, the survey data appear to have been collected before the ratings downgrades announced last Friday, and the uncertainty regarding the resolution of the Greek crisis.

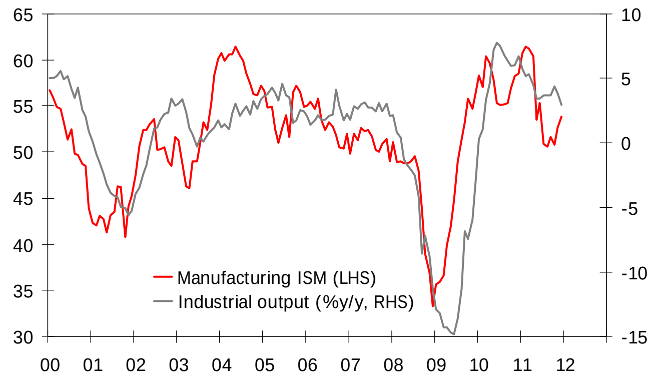
- **US: More signs of strength in the manufacturing sector.** Industrial production rose by 0.4% in December, beating expectations and spearheaded by a sharp rebound of 0.9% m/m in manufacturing production, the sharpest in a year, which more than offset the previous month's decline. Production in the utilities sector fell by 2.7% m/m, driven by an 8.5% fall in natural gas production. Manufacturing production was strong across the board, with motor vehicles and parts up 0.6% m/m, machinery up 2.1% and electronics up 1.0% m/m, helping to boost the capacity utilisation rate by three-tenths of a point to 78.1%. Furthermore, the regional surveys released in the last few days (like the Empire State Manufacturing Survey and the Philadelphia Fed) continue to reflect an underlying improvement in the most recent period. It certainly appears that the flooding in Thailand did not have the disruptive impact on the production chain which had been feared.

- **China: Growth slows moderately.** GDP growth slowed in the final quarter of 2011, but not as much as the market expected, further evidencing the Chinese economy's resilience. GDP rose by 8.9% y/y in the fourth quarter and by 9.2% in 2011 as a whole. In any event, this is the slowest rise in the last ten quarters, and the HSBC flash PMI remained in contraction territory for the third consecutive month in January (although it does not always coincide with the official PMI data), but this is still far from showing a sharp deceleration in activity. Industrial production rose by 13.9% y/y in December, only marginally less than in November. Retail sales actually gathered pace, growing by 18.1% y/y (with food, beverages and tobacco sales up 28.5% y/y) after having risen by 17.3% in November. And urban fixed-asset investment slowed a little, but continued to grow at a strong rate of 23.8% y/y. China still has enough policy flexibility in a context of falling inflation to adopt more pro-growth policies if necessary.

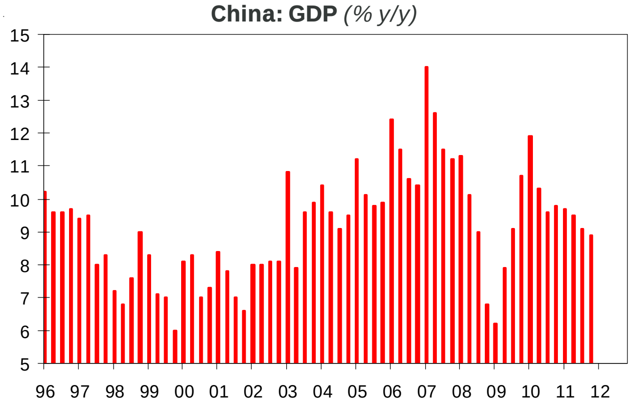
Germany: ZEW *(economic sentiment index)* **and industrial production** *(% y/y, delayed 6 months)*



US: manufacturing ISM and industrial output *(% y/y)*



China: GDP *(% y/y)*



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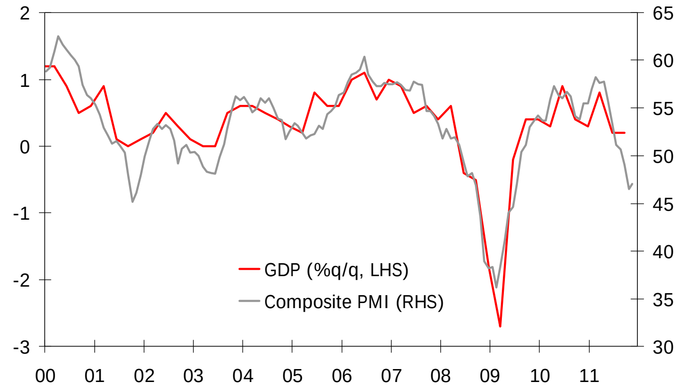
Economic outlook: data preview

- **EURO AREA incoming data:**
  EURO AREA: consumer confidence, flash manufacturing and services PMIs, new industrial orders, money supply (M3)
  GERMANY: flash manufacturing and services PMIs, IFO, consumer confidence, import prices
  FRANCE: flash manufacturing and services PMIs, INSEE business sentiment, unemployment, consumer confidence
  ITALY: retail sales, consumer confidence, hourly wages
  SPAIN: mortgages, producer prices, retail sales, quarterly unemployment
  Next week a batch of significant leading indicators (IFO, INSEE, flash PMIs) are set for release, which could confirm the idea that economic conditions in the Euro area are stabilising. The sharp rise in the ZEW this week could respond to financial factors and will probably not translate into a parallel generalised improvement in sentiment in productive sectors, but it is fair to expect a stabilisation, or perhaps a slight improvement, in indicators following months of sharp decline. Having said that, these indices will likely remain low, at levels compatible with contraction in economic activity.

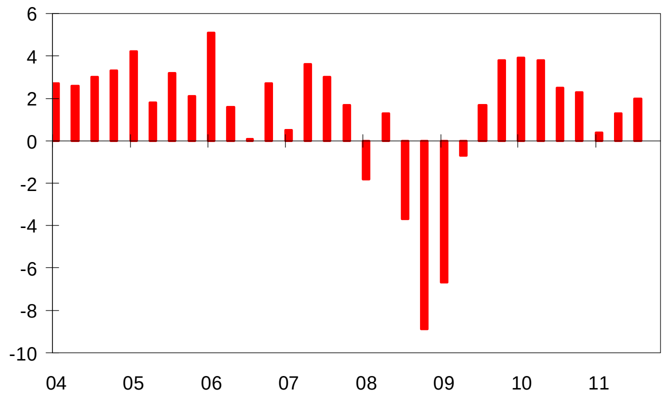
- **US incoming data: Richmond Fed Index, State of the Union Address, house prices, pending home sales, FOMC, Chicago Fed Index, durable goods orders, weekly jobless claims, leading indicators, new home sales, Kansas City Fed Index, 4Q GDP, Michigan University consumer confidence.**
  Even with a more negative performance by the foreign sector, GDP growth probably accelerated in the fourth quarter, buoyed by a more solid performance from internal demand. Housing market indicators may continue to reflect a budding improvement, albeit from very low levels. And durable goods orders, an indicator of industrial activity and a possible future improvement in capital spending (following two consecutive months of declines in capital goods orders excluding aviation and defence), should improve, in light of the performance by other recent industrial activity indicators.

- **JAPAN incoming data: Supermarket sales, Bank of Japan decision, trade balance, corporate service prices, national and Tokyo CPI, retail sales.**
  As well as the inflation indices and the Bank of Japan decision, the highlight this week will be the trade balance figures, in a context in which some other recent indicators (such as Chinese imports or falling sea freight prices) appear to point to the threat of contraction in trade flows.

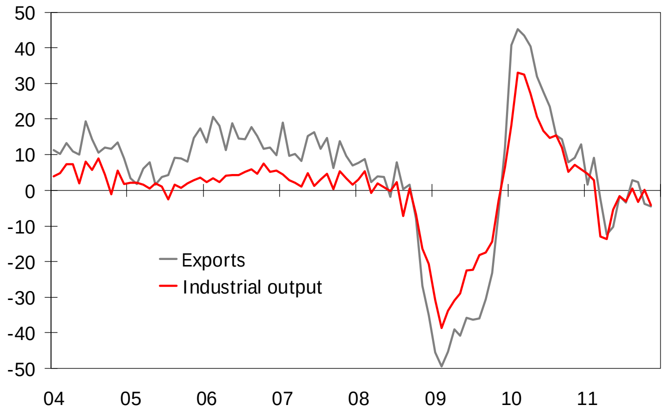
Euro area: composite PMI and GDP *(% q/q)*



US: GDP *(% q/q at an annual rate)*



Japan: exports and IP *(% y/y)*



	2010	2011f	2012f	2013f	10-03	10-04	11-01	11-02	11-03f	11-04f	12-01f	12-02f	12-03f	12-04f
USA														
GDP *(%y/y)*	3.0	1.7	1.8	2.8	3.5	3.1	2.2	1.6	1.6	1.5	1.6	1.8	1.8	2.0
GDP *(%q/q annualized)*					2.5	2.3	0.4	1.3	2.5	1.8	1.0	1.8	2.5	2.8
Unemployment rate (%)	9.6	9.0	8.8	8.2										
Inflation *(CPI, %y/y)*	1.6	3.1	1.7	1.7										
Euro area														
GDP *(%y/y)*	1.8	1.6	0.2	1.7	2.1	1.9	2.4	1.6	1.5	1.0	0.1	0.0	0.1	0.7
GDP *(%q/q annualized)*					1.6	1.1	3.1	0.7	1.0	-0.6	-0.8	0.6	1.2	1.9
Unemployment rate (%)	10.1	10.0	10.0	9.3										
Inflation *(CPI, %y/y)*	1.4	2.4	1.3	1.7										

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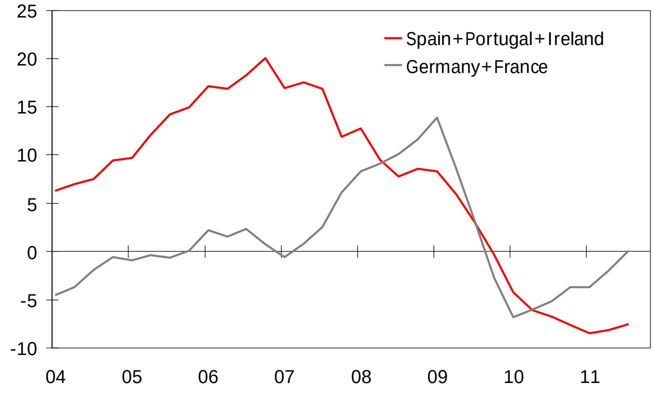
Monetary policy outlook

• **Latest ECB figures on European bank lending.** This week, the ECB released the latest figures on lending by the region's banks (or, to use the ECB jargon, MFIs - monetary financial institutions), referring to November of last year. At aggregate regional level, loans fell by 0.5% y/y, with deceleration in loans to households (from 1.6% to 1.0% y/y) and non-financial corporations (from 0.7% to 0.3% y/y), and a sharper decline in lending to the public sector (-4.8% y/y), insurance companies and pension funds (-7.3% y/y) and other financial intermediaries (-4.3% y/y). Growth in home buyer loans (which account for 33.5% of bank lending) slowed to 1.7% y/y. Loans to non-financial corporations are the other major item, accounting for 34.7% of the total. But perhaps the most interesting information comes from the country-by-country breakdown, due to the divergence in trends from one country to the next. For example, loans to households grew at a rate of 6.5% y/y in France and 4.8% in Italy, inched up by 0.9% in Germany and shrank by 1.0% in Portugal, 2.5% in Spain, 4.4% in Greece and 19.4% in Ireland. Lending to non-financial corporations grew by 8.7% y/y in Finland, 4.8% in France, 4.9% in Italy and 1.3% in Germany, but fell by 2.9% in Portugal, 5.6% in Spain, 6.2% in Greece and 6.3% in Ireland. Much of the difference can be explained by the existence or absence of solvent demand for credit. But, even after adjusting for nominal GDP growth, there is a differential performance between non-core and core European countries with regard to the pace of deleveraging. Other notable data include the surprisingly high lending growth in Italy (lending to non-financial corporations rose by 3.5 points more than nominal GDP in September) or the comparatively low growth in lending in Germany.

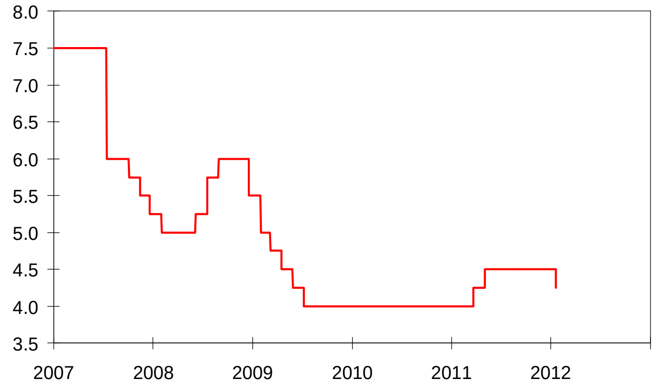
• **An important FOMC meeting.** The Federal Reserve has already announced key changes to the monetary framework at next week's two-day meeting scheduled to end on 25 January. The changes will refer mainly to its communication strategy, including the publication of interest rate forecasts (the Fed Funds rate at the end of the fourth quarter of this year and in the next years), as well as the quarterly Survey of Economic Projections, and qualitative information regarding FOMC members' expectations on the Federal Reserve balance sheet. There could be a more detailed explanation of the inflation and unemployment projections. In view of the recent improvement in economic conditions, these announcements are unlikely to be accompanied by additional monetary easing at this time.

• **The Central Bank of the Philippines joins in the downward rates cycle.** TThe Central Bank of the Philippines this week cut interest rates by 25 basis points to 4.25%, in a decision that was widely expected by the market. This is the first interest rate cut since July 2009, and brings the Philippines' central bank on board the downward cycle, alongside other countries in the region (such as Thailand, Indonesia and Sri Lanka).

Euro area: loans from monetary financial institutions to non financial corporates
(adjusted by nominal GDP, % y/y)



Central Bank of Philippines: overnight reverse repurchase agreement *(% y/y)*



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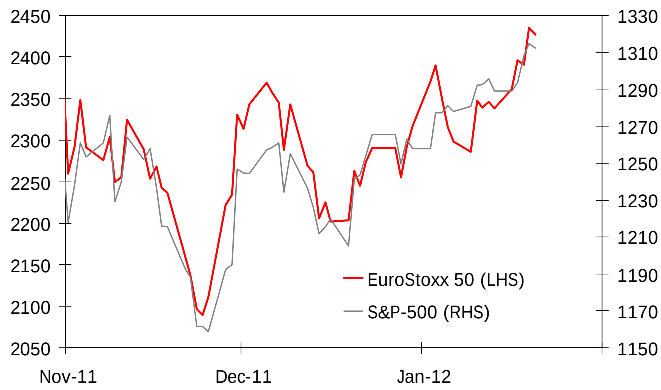
Santander GLOBAL BANKING & MARKETS

Market outlook

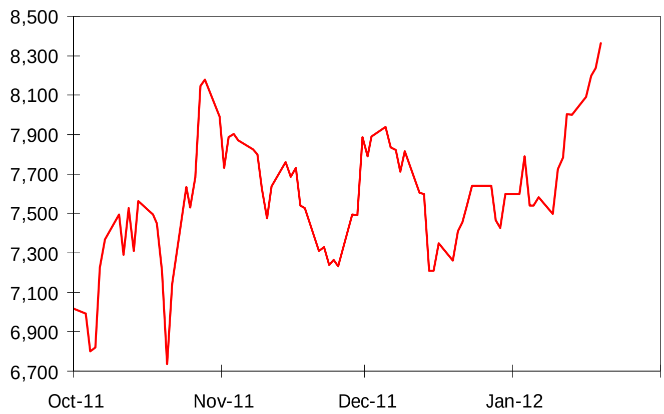
- **Equity markets start the year solidly.** The combination of better economic data in all regions (in the US, the numbers released in the last few weeks have been much more robust in all sectors, with the Economic Surprise Index charging from -42.0 at the end of September to +71.6 this week; in China growth has slowed by less than expected; in Europe the first signs of nascent stabilisation in future activity have emerged) and prospects of an end to the European crisis (buoyed this week by expectations of an agreement on Greek debt restructuring, and rumours of an increase in the International Monetary Fund's fire-power) are boosting tolerance to risk-taking among participants in financial markets, cemented, among other things, in equity market gains (4.4% YTD in the S&P 500, 3.0% for the Footsie-100 and 8.7% for the DAX, for example). Admittedly, the corporate earnings released so far have not been bad (of the 50 S&P-500 names that have released to date, 33 beat consensus expectations according to Bloomberg), but the improvement in sentiment appears to stem more from the perception of more general economic variables than from surprises in earnings.

- **The biggest rise in copper prices at the start of any year since at least 1987.** Another sign of the more positive tone with respect to risk assets is the rise in commodity prices, in particular copper (an especially cyclical commodity), which has posted the sharpest rise at the start of any year since at least 1987. This was helped by the fact that China, which consumes around two-fifths of global copper production, has recorded better-than-expected economic data, and the Chinese authorities have started showing signs of wanting to ease economic policies. However, commodity prices have risen across the board, especially in metals: YTD, Brent crude oil prices are up by 4%, gold by 5.7%, aluminium by 10.5%, nickel by 8%, tin by 13.9%, with a more mixed picture only in agricultural commodity prices (wheat futures down 7% and corn futures down 6.1%, but sugar prices up 6% and frozen concentrated orange juice prices up 24.6%). This performance by commodity prices sends a signal that contradicts some recent international trade data (pointing south) or the Baltic Dry Index (which has continued to fall in the last few sessions). Therefore, this may have a more financial component (hinging upon investors' expectations of improved economic data) and, so, it is not yet clear that it marks the start of an enduring trend. However, if it does consolidate, the rise in commodity prices would again have a negative impact on economic growth.

S&P-500 and EuroStoxx 50 indexes



Copper price in LME *(USD/tonne)*



Interest rates forecast *(money market & swap rates)*

EUR	Current	1Q12	2Q12	3Q12	4Q12
ECB	**1.00**	1.00	1.00	1.00	1.00
3m	**1.20**	1.35	1.25	1.25	1.15
2y	**1.20**	1.30	1.30	1.20	1.60
5y	**1.66**	1.65	1.70	1.75	1.75
10y	**2.36**	2.35	2.33	2.35	2.45
30y	**2.55**	2.40	2.50	2.55	2.60

GBP	Current	1Q12	2Q12	3Q12	4Q12
MPC	**0.50**	0.50	0.50	0.50	0.50
3m	**1.09**	1.05	0.90	0.95	1.00
2y	**1.25**	1.40	1.60	1.60	1.70
5y	**1.58**	1.70	2.05	2.15	2.05
10y	**2.37**	2.50	2.85	2.95	3.10
30y	**3.00**	3.20	3.55	3.80	3.80

USD	Current	1Q12	2Q12	3Q12	4Q12
FOMC	**0.25**	0.25	0.25	0.25	0.25
3m	**0.56**	0.50	0.55	0.60	0.60
2y	**0.59**	0.70	0.80	1.10	1.40
5y	**1.19**	1.25	1.30	1.50	1.80
10y	**2.13**	2.05	2.10	2.30	2.45
30y	**2.79**	2.65	2.70	2.80	2.85

FX forecast

	Current	Q1-12	Q2-12	Q3-12	Q4-12
EUR-USD	**1.2927**	1.28	1.26	1.24	1.20
USD-JPY	**77.14**	80	82	84	88
EUR-GBP	**0.8323**	0.84	0.84	0.84	0.83
GBP-USD	**1.5532**	1.53	1.50	1.48	1.45
EUR-CHF	**1.2071**	1.25	1.30	1.35	1.38

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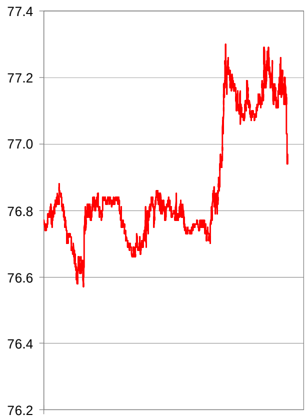
Santander GLOBAL BANKING & MARKETS

This week's markets *(minute by minute)* at a glance

Currencies

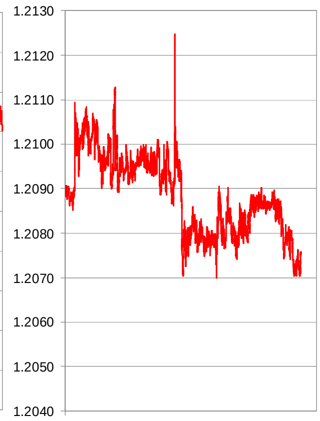
Euro-Dollar

Dollar-Yen



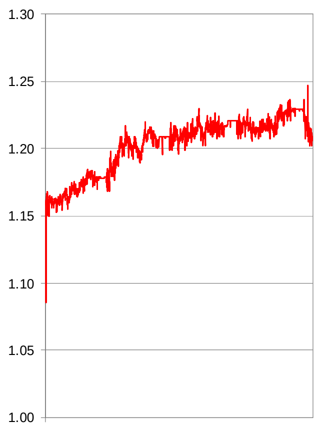
Euro-Sterling

Euro-Swiss Franc

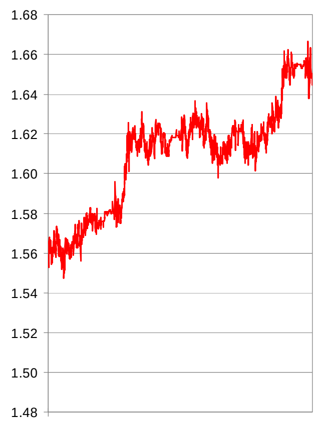


Interest rates *(swaps)*

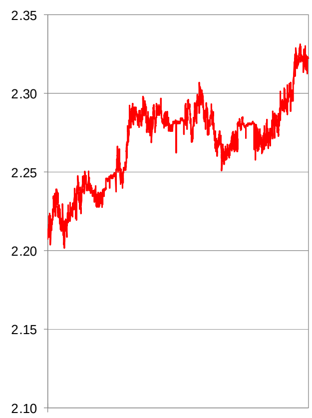
EUR 2 year



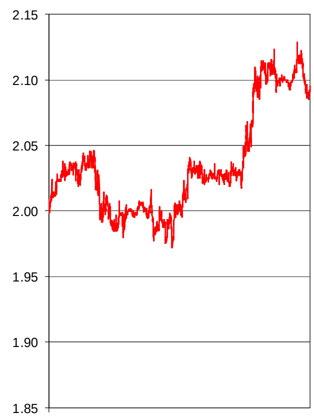
EUR 5 year



EUR 10 year



USD 10 year



Equity indexes *(cash)*

EuroStoxx 50

IBEX 35

S&P-500

Nikkei-225

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Economic calendar

Date	Time	Country	Event	Period	Survey	Prior
Mon 23	6:00	JAP	Supermarket sales	DEC		-2.3% y/y
	8:45	FR	INSEE business confidence	JAN	95.0	94.0
	16:00	EUR	Advanced consumer confidence	JAN	-21.4	-21.1
Tue 24		JAP	BoJ policy meeting			
	9:00	FR	PMI manufacturing (p)	JAN	48.6	48.9
	9:00	FR	Services PMI (p)	JAN	50.0	50.3
	9:00	SP	Mortgages on houses	NOV		-43.6% y/y
	9:30	GE	PMI manufacturing (p)	JAN	49.0	48.4
	9:30	GE	Services PMI (p)	JAN	52.4	52.4
	22-24	GE	Import prices	DEC		0.4% m/m
	10:00	EUR	PMI manufacturing (p)	JAN	47.2	46.9
	10:00	EUR	PMI services (p)	JAN	49.0	48.8
	10:00	EUR	PMI composite (p)	JAN	48.5	48.3
	10:30	UK	PSNB ex Interventions	DEC	GBP 14.9 bn	GBP 18.1 bn
	11:00	EUR	Industrial new orders	NOV	-2.2% m/m	1.8% m/m
	15:00	BEL	Business confidence index	JAN		-10.6
	16:00	US	Richmond Fed manufacturing index	JAN	6	3
Wed 25	0:50	JAP	Trade balance (adjusted)	DEC	JPY -376.5 bn	JPY -537.9 bn
	9:00	SP	Producer prices	DEC	5.2% y/y	6.3% y/y
	25-27	SP	Business confidence index	Q4		-19.0
	9:30	NE	Producer confidence index	JAN	-1.3	-1.3
	10:00	GE	IFO business climate index	JAN	107.5	107.2
	10:00	IT	Retail sales	NOV	-0.2% m/m	0.1% m/m
	10:30	UK	MPC minutes			
	10:30	UK	GDP (a)	Q4	-0.1% q/q	0.6% q/q
	10:30	UK	Index of services	NOV	0.4% 3m/3m	0.2% 3m/3m
	10:30	UK	ILO Unemployment Rate (3mths)	NOV	8.30%	8.30%
	12:00	UK	CBI Trends total orders	JAN	-23.0	-23.0
	13:00	US	MBA Mortgage Applications	20-Jan		
	16:00	US	House price index	NOV	0.1% m/m	-0.2% m/m
	16:00	US	Pending home sales	DEC	-1.0% m/m	7.3% m/m
	18:00	FR	Jobseekers net change	DEC	25.0	29.9
	18:30	US	FOMC rate decision			
Thu 26	0:50	JAP	Corporate service price index	DEC	-0.1% y/y	-0.2% y/y
	0:50	JAP	Japan capital account balance	20-Jan		
	26-31	UK	Nationwide house prices	JAN		-0.2% m/m
	8:00	GE	GfK consumer confidence	FEB	5.6	5.6
	8:45	FR	Consumer confidence	JAN	80	80
	8:45	FR	Business survey overall demand	JAN		2
	10:00	IT	Consumer confidence	JAN	92.0	91.6
	11:00	IT	Hourly wages	DEC		1.5% y/y
	26-31	SP	Budget balance	DEC		EUR -52.39 bn
	12:00	UK	CBI reported sales	JAN	-6	9
	14:30	US	Initial Jobless Claims	21-Jan	365K	352K
	14:30	US	Chicago Fed National Activity index	DEC		-0.37
	14:30	US	Durable goods orders	DEC	2.0% m/m	3.7% m/m
	15:45	US	Bloomberg Consumer Comfort	22-Jan		-47.4
	16:00	US	Leading indicators index (and revisions)	DEC	0.7% m/m	0.5% m/m
	16:00	US	New home sales	DEC	320K	315K
	17:00	US	Kansas City Fed Manufacturing index	JAN		-4
Fri 27	0:30	JAP	Tokyo CPI	JAN	-0.4% y/y	-0.4% y/y
	0:30	JAP	National CPI	DEC	-0.2% y/y	-0.5% y/y
	0:50	JAP	Retail trade	DEC	0.4% m/m	-2.1% m/m
	9:00	SP	Adjusted retail sales	DEC	-5.9% y/y	-7.2% y/y
	9:00	SP	Unemployment (quarterly survey)	Q4	22.2%	21.5%
	10:00	EUR	M3	DEC	2.1% y/y	2.0% y/y
	14:30	US	GDP (a)	Q4	3.0% q/q ann.	1.8% q/q ann.
	15:55	US	U. of Michigan consumer confidence (f)	JAN	74.2	74.0

Important Disclosures

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The views expressed in this report accurately reflected the personal views of the undersigned analyst. In addition, the undersigned analyst has not and will not receive any compensation for providing specific recommendation or view in this report: Juan Perez-Campanero

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DIRECTIONAL RECOMMENDATIONS IN BONDS		DIRECTIONAL RECOMMENDATIONS IN SWAPS	
Definition		Definition	
Long / Buy	Buy the bond for an expected average return of at least 10bp in 3 months (declinte in the yield rate), assuming a directional risk.	**Receive fixed rate**	Enter a swap receiving the fixed rate for an expected average return of at least 10bp in 3 months (decline in the swap rate), assuming a directional risk.
Short / Sell	Sell the bond for an expected average return of at least 10 bp in 3 months (increase in the yield rate), assuming a directional risk.	**Pay fixed rate**	Enter a swap paying the fixed rate for an expected average return of at least 10 bp in 3 months (increase in the swap rate), assuming a directional risk.

RELATIVE VALUE RECOMMENDATIONS	
	Definition
Long a spread / Play ssteepeners	Enter a long position in a given instrument vs a short position in another instrument (with a longer maturity for steepeners) for an expected average return for at least 5bp in 3 months (increase in the spread between both rates)
Short a spread / Play flatteners	Enter a long position in given an instrument vs a short position in other instrument (with a shorter maturity for flatteners) for an expected average return of at least 5bp in 3 months (decline in the spread between both rates)

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