INTESA SANPAOLO

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Weekly

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Viewpoint

Fiscal policy in 2011 will be less favourable in the Euro zone, but far looser than anticipated in the US. Monetary policy will remain accommodative in all the major advanced countries. Global economic growth looks set to slow, but the risk of an early end to the recovery is still minimal. The prospects for inflation are mixed: inflationary pressures are prevailing in the emerging countries, while advanced countries are seeing more complicated trends. Leaving the positive economic repercussions to one side, the fiscal drift in the US and Japan is a much more worrying development as regards the medium-term outlook for the global economy compared with the crises of a few small Euro zone member states.

Eurozone labour market

Over the past two years, the Euro zone labour market has been in decline. Employment fell more steeply for the younger population cohort, for men rather than women and for workers on temporary contracts compared with other forms of contract. Also, the scenario appears to vary widely from one Euro zone country to another. A comparison of employment elasticity with pre- and mid-crisis GDP reveals that structural features and government policies have impacted on the performance of the labour market in Member States.

Forex markets

After the 2008 global economic and financial crisis, exchange rates should start to resume some re-alignment towards macroeconomic fundamentals in 2011. No new market issues are expected to emerge, except for an issue that has remained latent this year: the need to restore the health of public accounts. Coupled with the "peripherals" question this should penalize the euro. Similar considerations apply to sterling. Finally, the yen should reverse its trend and depreciate: next year's decline should however be smaller than the one that had been expected for this year.

The week's market movers

In the Euro area, the December inflation data should confirm the modest trend in the core index and the stability of the headline measure. The EU Commission index is expected to improve, and could hit a new high from October 2007. M3 should accelerate in November. In Germany, the labour market should show a further fall in the jobless total in December, while inflation should be steady on a yearly basis.

In the United States the data should confirm the acceleration in growth around year-end, with positive indications for 1Q11. The ISM and Chicago PMI should show modest gains in December from high November levels. The employment report should show stronger payrolls growth and a fall in the unemployment rate, with a likely upward revision to the November data. Auto sales and consumer confidence should improve further in December. Construction spending should be up slightly in November. The FOMC minutes should show a wider range of views on the economic outlook than transpired in the December statement.

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Viewpoint

Fiscal policy in 2011 will be less favourable in the Euro zone, but far looser than anticipated in the US. Monetary policy will remain accommodative in all the major advanced countries. Global economic growth looks set to slow, but the risk of an early end to the recovery is still minimal. The prospects for inflation are mixed: inflationary pressures are prevailing in the emerging countries, while advanced countries are seeing more complicated trends. Leaving the positive economic repercussions to one side, the fiscal drift in the US and Japan is a much more worrying development as regards the medium-term outlook for the global economy compared with the crises of a few small Euro zone member states.

- Global economic growth still seems robust and set to continue in 2011. As was the case three months ago, there are no signs that excessive inventory levels are being built up, nor are there indications that the order backlog is being depleted. The rise in the price of industrial commodities demonstrates that growth remains strong in global terms, although disproportionally unbalanced in favour of emerging markets, which are gaining yet more market share. All in all, we foresee an increase in World GDP of 4.4%, with the US at 3.1% and the Eurozone at 1.7%.

- Three recent developments in economic policy have, to varying degrees, expansionary implications. Firstly, the US federal administration has reached a compromise with the Republican opposition on a new fiscal stimulus package, based mainly on tax cuts: as a result, in 2011 the US will have a deficit higher than in 2010 despite the improving economy, and thus the fiscal policy stance will be more expansive overall than in 2010. Secondly, the Federal Reserve has launched a wide-ranging new programme to expand the monetary base centred on purchases of government securities, which should in the next few months offset the rising rates due to the improvement in the economic outlook. Thirdly, the ECB has also deferred by another three months the gradual removal of the extraordinary measures of support.

- Our forecast of the direction of fiscal policies in 2011 must therefore be adjusted towards one that strengthens the prospects of economic growth in global terms, although several European countries will deviate widely from this general trend. Conversely, our view that monetary conditions (such as the level of interest rates and trends in lending conditions) will continue to support the recovery still holds, even though such conditions will be made more restrictive in certain emerging countries where domestic demand is more robust.

- Note, however, that the 2011 fiscal measures will not prove sufficient to stabilise the debt/GDP ratio in Europe, and still less in the US or Japan. For the debt to fall steadily in relation to GDP, the primary balance would have to rise by four points in Italy, over five points in Spain and France, 10 points in Ireland and Greece, and some 11 points in the US. We therefore confirm that new sizeable corrective measures are expected in the next few years and, as a consequence, that the medium- and long-term growth rates of advanced economies will end up lower than the average rates seen in the recent phases of economic growth. However, despite the appearance of the first studies on how the US federal budget could be rebalanced in the next ten years, the political outlook makes us suspect that a serious correction attempt will be made before 2013, when debt levels and adjustment costs will be much higher. The situation relating to Japan is even more serious. The country has a level of debt running at over 225% of GDP and a primary balance of -8% of GDP. Whatever the consolidation strategy chosen by the US and Japan (fiscal austerity or inflation), the relevance of the two economies for the rest of the world is such that it will be hard to escape a period of severe turbulence in currencies and foreign trade, when the time comes.

Eurozone labour market

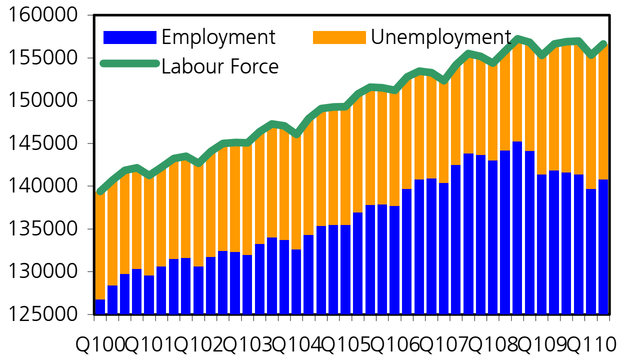
Alessandra Gaia

Over the past two years, the Euro zone labour market has been in decline. Employment fell more steeply for the younger population cohort, for men rather than women and for workers on temporary contracts compared with other forms of contract. Also, the scenario appears to vary widely from one Euro zone country to another. A comparison of employment elasticity with pre- and mid-crisis GDP reveals that structural features and government policies have impacted on the performance of the labour market in Member States.

From 3Q08 to 1Q10, the economic crisis determined a rapid and large fall in employment. According to Eurostat quarterly data, there were nearly 3,400,000 fewer people in employment in 2Q10 compared with pre-crisis levels. Numbers of people seeking work continued to increase in the same period, reaching a peak of about 15,875,100 in 2Q10 and exceeding pre-crisis levels by more than 4 million. Quarterly unemployment therefore rose to 10.1% in spring 2010, more than 2.5 percentage points higher than in 2Q08. On a monthly basis, unemployment hit a more than 12-year high of 10.1% in October 2010.

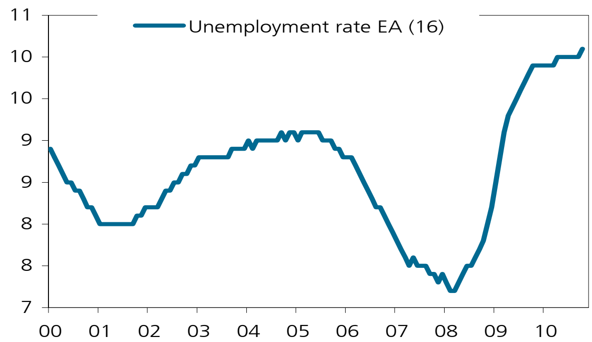
In recent months, however, the labour market seems to have begun to stabilise in the wake of the upturn in the economic cycle. Nevertheless there are marked variations between countries. An analysis of the features of the labour market before and after the economic crisis gives a clearer picture of the changes taking place.

Employment fell by more than 3 million between 3Q08 and 1Q10



Source: Eurostat and Intesa Sanpaolo calculations. Data in thousands.

Unemployment in the Euro zone reached its highest level for more than 12 years in October 2010

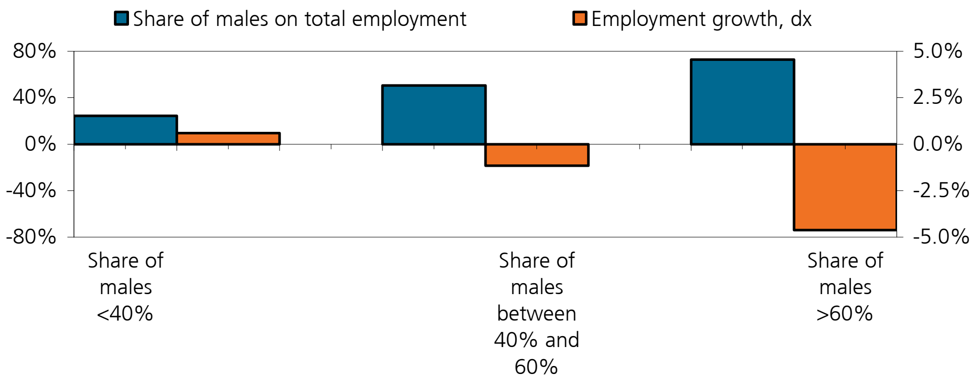


Source: Eurostat and Intesa Sanpaolo calculations. Data in thousands.

Gender differences in the labour market and sector specialisations

The crisis has affected employee demographic groups differently. Firstly we notice that in the Euro zone, employment has fallen more markedly among men than women and among young than older workers. Labour market gender differences however, are partly due to sector specialisations. In fact the crisis has had more impact on sectors employing a higher proportion of men. A comparison of the decline in employment between 2008 and 2009 in the various economic sectors and levels of male employment show that in the three sectors where employment has fallen most, men account for more than 70% of the total workforce. In construction, where men represent 91% of the workforce, employment fell by 7.3% between 2008 and 2009. A similar picture emerges for the mining and minerals sector, where employment fell by 6.3% and where men account for 88% of the workforce, and for manufacturing, where employment fell by 6.1% and the proportion of male employees is 72.3%. Meanwhile, increases in the numbers in employment have been seen in some sectors with predominantly female employees, such as health, social services and education.

Male workers have been hardest hit by the labour market crisis, but the gender difference is mainly due to sector specialisations



Source: Eurostat and Intesa Sanpaolo calculations

Economic activity sector	Male employment on total employmnet	Employment growth
Activities of households as employers; undifferentiated goods- and services-producing activities of households for own use	9.6	-0.2
Human health and social work activities	22.2	2.9
Education	30.9	0.2
Other service activities	32.3	-4.4
Accommodation and food service activities	45.8	-0.3
Administrative and support service activities	48.4	0.1
Real estate activities	48.6	-2.6
Financial and insurance activities	49.7	-0.6
Wholesale and retail trade; repair of motor vehicles and motorcycles	51.4	-1.7
Professional, scientific and technical activities	51.9	-0.7
Activities of extraterritorial organisations and bodies	53.2	-3.9
Arts, entertainment and recreation	53.4	-0.7
Public administration and defence; compulsory social security	54.7	0.0
Agriculture, forestry and fishing	67.0	-1.7
Information and communication	67.2	0.5
Manufacturing	72.3	-6.1
Transportation and storage	77.1	-2.9
Electricity, gas, steam and air conditioning supply	77.9	8.3
Water supply; sewerage, waste management and remediation activities	82.3	3.1
Mining and quarrying	88.4	-6.3
Construction	91.2	-7.3

Source: Eurostat

The crisis has hit young people hardest

Looking at age group differences, we can see a steeper decline in employment among young people (15-24), while the higher age group (55-64) has been least affected. In October, youth (under 25) unemployment in the Euro zone stood at 20.1%. The breakdown by country shows higher unemployment in the young age group by comparison with the other groups, particularly in the Euro zone countries hardest hit by the labour market decline, such as Spain and Ireland. According to the International Labour Organisation's harmonized figure, unemployment among the under-25s in Spain soared (43.2%) in October 2010, at more than double the unemployment level in the 25-74 age group (18.5%). Youth unemployment in Ireland rose to 29.3%, 17 percentage points higher than for the 25-74 age group.

Also Italian condition is dramatic: since July 2008 the figure for the age group 25-74 has not been released, nevertheless, comparing youth unemployment rate (under 25) with unemployment rate 15-74 years old we notice a difference of over 17 percentage points. Unemployment in the age group 15-24 is 26,2% while for the total of workers (15-74 years) it is 8.6%.

A steeper fall in employment among workers on temporary contracts

In the Euro zone, younger people were more affected by the crisis because they were more likely to be employed on temporary contracts. On average, 49.7% of employed people aged 15-24 were on temporary contracts in 2008, compared with 12% for the 25-64 age group (Eurostat average quarterly figures for 2008). Temporary workers recorded the highest job losses during the economic crisis; between 2008 and 2009, temporary employment fell by 7.4%, compared with a 1.8% decline in salaried employment overall. Meanwhile, self-employment fell by very little: barely 0.9% year-on-year in 2009. This employment category also recovered in 2010, rising by 0.6% qoq in the first quarter and by 0.9% qoq in the second quarter. Temporary employment therefore registered the most marked decline. This was partly because there are fewer safeguards in place for this type of employment and because the cost of terminating is lower. Temporary contracts are more likely to vary according to fluctuations in the cycle, dropping more sharply during crises but also rebounding more quickly in periods of recovery[1]. The drop in numbers of temporary employees can also clearly be seen in the figures for temporary contracts as a proportion of total salaried employment. The proportion of temporary contracts, which rose particularly steeply in the period preceding the crisis, declined in all the main Euro zone countries and in the Euro zone as a whole in 2009. The phenomenon was particularly noticeable in Spain.

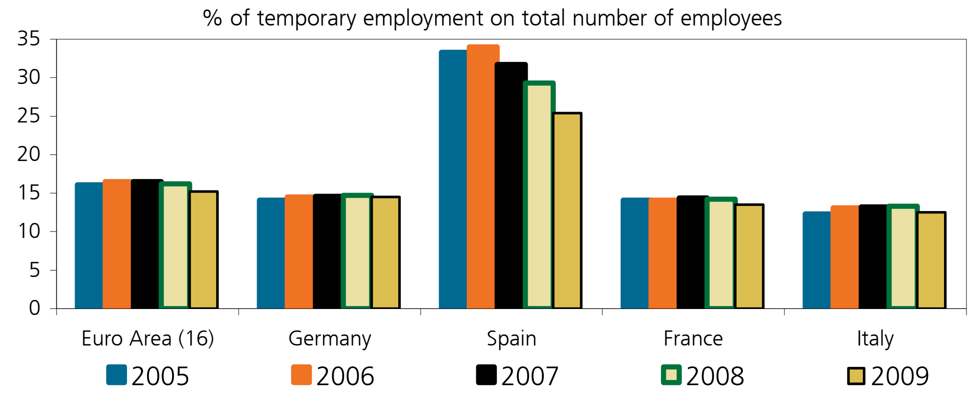
Employment structure by age group and education level

	2009 (thousands)	Percentage change 2008-09	Percentage change 2007-08	Percentage change 2006-07	Percentage change 2005-06	Percentage change 2000-05
Total employment (15 — 64)	139429.7	-1.8%	1.1%	2.0%	2.0%	1.2%
Men	76660.1	-2.9%	0.4%	1.5%	1.6%	0.6%
Women	62769.7	-0.6%	1.9%	2.5%	2.4%	2.1%
Youth employment (15 — 24)	12972.1	-1.8%	1.1%	2.0%	2.0%	1.3%
Men	6967.9	-2.8%	0.4%	1.6%	1.7%	0.7%
Women	6004.2	-0.5%	1.9%	2.6%	2.4%	2.2%
Employment (25 — 54)	108920.3	-5.7%	-2.4%	-0.7%	0.7%	-0.7%
Men	59528.4	-6.6%	-2.5%	-1.1%	0.7%	-1.0%
Women	49391.8	-4.3%	-2.3%	-0.1%	0.8%	-0.2%
Employment (55 — 64)	17537.3	-1.8%	1.4%	2.8%	2.4%	2.0%
Men	10163.7	-2.4%	0.9%	2.7%	2.4%	1.5%
Women	7373.7	-1.0%	2.0%	2.9%	2.5%	2.6%
Low skilled employment	37496.4	-5.7%	-2.4%	-0.7%	0.7%	-0.7%
Men	22477.3	-6.6%	-2.5%	-1.1%	0.7%	-1.0%
Women	15019.1	-4.3%	-2.3%	-0.1%	0.8%	-0.2%
Medium skilled employment	64327.8	-1.8%	1.4%	2.8%	2.4%	2.0%
Men	35064	-2.4%	0.9%	2.7%	2.4%	1.5%
Women	29263.8	-1.0%	2.0%	2.9%	2.5%	2.6%
Hight skilled employment	39510.4	2.2%	4.2%	3.8%	2.6%	4.2%
Men	20380.4	1.2%	3.1%	3.1%	1.5%	3.1%
Women	19130	3.4%	5.4%	4.6%	3.9%	5.5%

Source: Intesa Sanpaolo table from Eurostat data

[1] Source: Labour market and wage developments in 2009, Directorate-General for Economic and Financial Affairs of the European Commission, Brussels 2010.

Temporary employment as a proportion of total salaried employment decreased in 2009



Source: Eurostat

Increase in employment levels among part-time workers

The labour market reaction to the crisis has also varied according to whether employees are part-time or full-time. In fact, while full-time employment decreased between the third quarter 2008 and the beginning of 2010, numbers of part-time workers increased. As a matter of fact, part-time employment as a proportion of the total increased from 19.1% in 2Q08 to 20.1% in 2Q10. On average, part-time employment grew by 0.8% in 2009 compared with the previous year. This change was partly due to the decrease in hours worked on account of the transition from full-time contracts to part-time contracts.

The percentage of workers accepting a part-time contract has in fact risen due to their inability to find full-time work ("involuntary" part-time). In the Euro zone the percentage of "involuntary" part-time workers as a proportion of total part-time employment rose to 26.7% in 2009 from 25.4% in 2008.

A steeper decline in employment for less qualified workers

The effects of the crisis have also varied to some extent according to employee qualifications. The sharpest decline in employment was among the least qualified workers (down 5.7% yoy in 2009), while the intermediate band declined by about 1.8% and the most qualified recorded an increase in employment of about 2.2%. Looking at the unemployment rate in 2Q10, 16.5% of people with no higher than a middle-school leaving certificate were seeking employment, an increase of more than five percentage points compared with early 2008 (11.4% in the first and second quarters 2008). Unemployment grew much less rapidly, by about 2.0%, for workers with high school diplomas (from 6.7% in 2Q08 to 8.7% in 2Q10). For graduates, meanwhile, unemployment increased by just over one percentage point, from 4.1% in 2Q08 to 5.5% in 2Q10.

Euro zone: unemployment by education level

Unemployment rate	Q210	Q110	Q409	Q309	Q209	Q109	Q408	Q308	Q208	Q108	Q407	Q307	Q207
Total (%)	9.9	10.5	9.8	9.4	9.3	9.4	7.9	7.3	7.4	7.6	7.4	7.3	7.4
Pre-primary, primary and lower secondary education (%)	16.5	16.9	15.6	15.0	14.9	14.7	12.5	11.4	11.4	11.4	10.7	10.5	10.7
Upper secondary and post-secondary non-tertiary education (%)	8.7	9.4	8.7	8.3	8.3	8.5	7.1	6.4	6.7	7.2	7.0	6.7	6.9
Tertiary education (%)	5.5	5.9	5.8	5.7	5.1	5.1	4.5	4.3	4.1	4.2	4.4	4.6	4.3

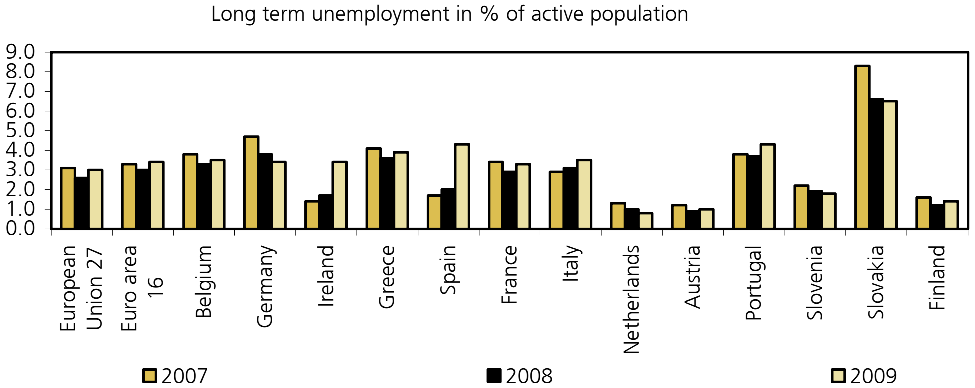
Source: Eurostat

Growth in long-term unemployment

One of the negative effects of the economic crisis on the Euro zone labour market has been a rise in long-term unemployment. This phenomenon is particularly serious given the reinsertion problems encountered by the long-term unemployed. The proportion of long-term unemployed (jobless for more than 12 months) in the Euro zone rose from 3.0% of the working population in 2008 to 3.4% in 2009. The number of people unemployed for two years or more remained stable, however, at 1.5% of the working population between 2008 and 2009. There were significant variations in unemployment duration between countries: it increased substantially in

Ireland and Spain, but decreased in Germany. In Slovakia, despite falling markedly, it remained double that of the Euro zone average.

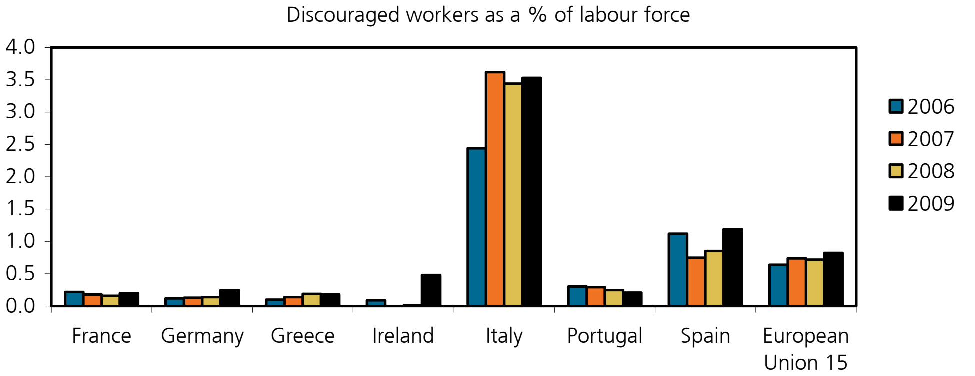
In the Euro zone, long-term unemployment increased in 2009 as a percentage of the total working population...



Source: Eurostat

One adverse effect of long-term unemployment is clear from an anlysis of the increase in the number of discouraged workers (those no longer looking for work): the increasing difficulty of finding work has led discouraged workers to give up the search and withdraw from the labour market. Eurostat figures show that the percentage of discouraged workers has increased in the main Euro zone countries. Particularly steep increases have been recorded in the countries hit hardest by the deterioration in the labour market, such as Spain and Ireland. Note that Italy has an extremely high proportion of discouraged workers, more than four times greater than the EU15 average.

... the number of discouraged workers as a proportion of the total workforce increased in 2009

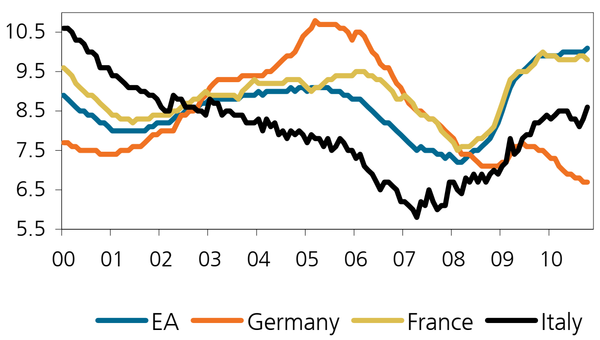


Source: OECD

A widely varying labour market response from country to country

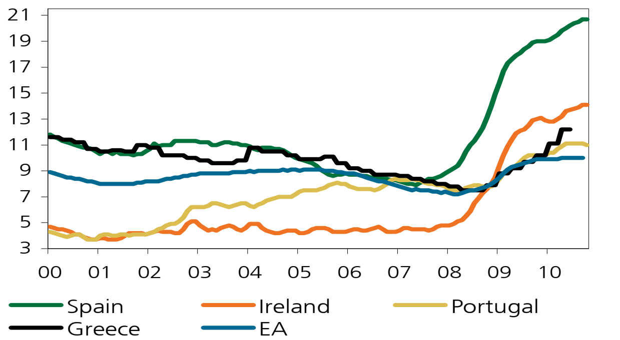
Within the Euro zone, labour market responses to the economic crisis have varied greatly between countries. Eurostat figures show that unemployment has risen to record highs in Spain (20.7% in October 2010, the highest level for 20 years, from 9.0% in early 2008) and in Ireland (to 14.1%, the highest level since the end of 1994, compared with 4.8% in early 2008). Italy and France have seen more moderate increases: in both countries, with unemployment growth of about 2 percentage points between the early months of 2008 and the end of 2010. Unemployment has fallen in Germany, reaching a low of 6.7% in October 2010 (7.5% according to Bundesbank figures).

Changes in unemployment: core and Euro areaoverall…



Source: Eurostat

… peripheral and Euro area overall



Source: Eurostat

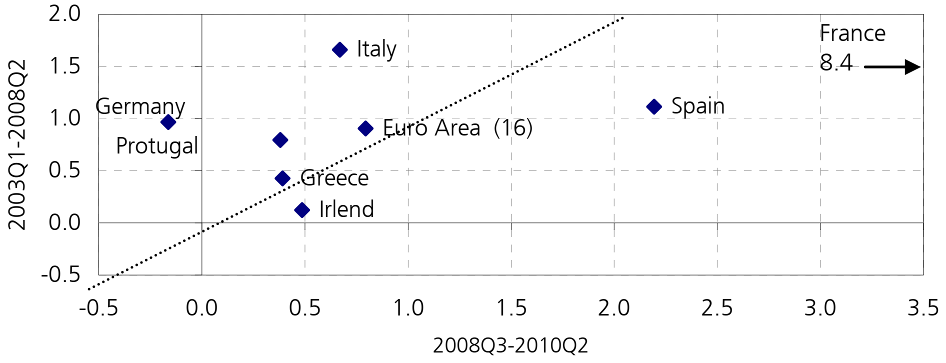
... and employment elasticity to GDP growth varies widely and markedly in the main Euro zone countries

We have compared employment elasticity to GDP growth historically (between 1Q03 and 2Q08) and during the crisis (in the period from 3Q08 to 4Q09). A somewhat different trend emerges for each country: Italy, Germany, Portugal and the Euro zone aggregate are above the 45° line. This means that employment elasticity to GDP was lower for these countries during the crisis period compared with their historical levels. In the case of Germany, elasticity falls from an historical level of around 1 (hence an employment growth response matching GDP growth) into negative figures. Indeed, between the third quarter of 2008 and the end of 2009, the change in employment was positive compared with negative change in GDP. The outcome is even more striking if the historical elasticity is compared with the elasticity calculated in the period 3Q08 - 2Q09. Here too the elasticity rate is negative (and greater than in the period 2Q08-4Q09 alone): consequently, German employment growth cannot be explained by an upturn in the economic cycle; back-to-work policies such as the Government's Kurzarbeit programme seem to account more for the excellent performance of Germany's labour market.

In the case of Italy, too, elasticity has fallen: from around 1.7 in the period 1Q03 - 2Q08, when positive changes in GDP were matched (on account of factors relating to the regularisation of the black economy) by almost twofold increases in employment, to 0.2 in the period 3Q08 - 4Q09 where a sharp decline in GDP led to a fairly modest fall in employment owing to Italy's welfare support system. However, if we extend the period of analysis to the second quarter of 2010 (hence 3Q08-2Q10) elasticity rises again to around 0.7, which indicates that a contraction in GDP determines a fall in employment of roughly two-thirds of the decline in GDP. In this case, the greater elasticity observed when we extend the analysis to mid-2010 could be explained by the delayed response by employment to the economic cycle.

France, Spain, Greece and Ireland recorded greater elasticity in the period 3Q08 to 4Q09 than their historical rates. As the graph shows, these countries are to the right of the 45° line. Spain and France in particular experienced a sharp rise in employment elasticity with respect to GDP in the period 3Q08 - 4Q09 compared with the period 1Q03 - 2Q08. The gap is even greater if we consider the longer timescale (3Q08 - 2Q10). In both countries the contraction in GDP was met with a significantly greater downturn in employment. In the case of France, an employment elasticity with respect to GDP of 8.4 emerges. This figure should however be viewed with caution as it has been distorted by GDP growth in France of close to 0 in the period under consideration. The ratio is therefore pushed to a very high level by the very small denominator for employment elasticity to GDP.

Employment elasticity to GDP growth: a comparison between 2003Q1-2008Q2 and 2008Q3-2010Q2



Source: Eurostat, Oxford Economics, Intesa Sanpaolo calculations

Employment has dropped steeply in Spain

As already mentioned, Spain has seen the steepest fall in employment among the main Euro zone countries. Specialisation in the labor-intensive and highly cyclical construction industry has played an important role in this respect. This sector had a much higher level of employment than in other countries. Due to the bursting of the real estate bubble, job losses were more dramatic than elsewhere. Immigrant employment, which is strongly concentrated in the construction sector, often via temporary contracts, was particularly hard hit. Workers on temporary contracts are the other category hit hardest by the decline in the labour market. As already mentioned, this segment grew strongly in the first few years of the crisis, but subsequently suffered most from the effects of the recession[2].

Labour market reform in Spain

To tackle the crisis in the labour market, in September 2010 the Spanish Government launched a reform of the labour market with the aim of achieving three objectives: 1) reducing duality in the labour market; 2) strengthening internal flexibility within firms; 3) increasing opportunities for job seekers. In order to meet these objectives the following measures were introduced:

- Suspension of collective agreements: employers and their workforce can reach an agreement whereby in the event that an employer is unable to retain staff the salary scheme provided under multi-employer agreements (sector-wide or by business category) may not be applied.
- Reduction in working hours: working hours may be reduced from 10% to 70% for economic, technical, organisational or production reasons.
- "Penalisation of temporary contracts": Contracts become permanent after three years for workers who are hired more than once by the same company or group of companies for the same or a different job. The aim is to prevent employers hiring staff on a succession of temporary contracts designed to avoid permanent contracts.
- Extended application of severance pay for 33 days per year worked in the case of unfair dismissal. The severance liability is therefore less onerous than the 45 days required under standard permanent contracts.
- Creation of a public fund to cover compensation in the event of dismissal.
- Simplification of dismissal procedures for companies with current or forecast losses or showing a persistent drop in income.

[2] Outlook Ref. bi-monthly update, October 2010.

- Scope for dismissal in the event of absenteeism: If absenteeism exceeds an average of 2.5%, a company may dismiss a worker who is absent from the workplace for more than 20 working days over a period of 2 consecutive months or 25% over a period of 4 non-consecutive months within a 12-month period.

The general aim of the new law is to create a more flexible labour market and to reduce the disparity of treatment between workers on a permanent contract and those in temporary employment. The law introduces a new type of permanent contract which entitles the workforce to less compensation in the event of dismissal, restricts recourse to temporary contracts and introduces greater working time flexibility for companies who have more scope to lay off workers in the event of an economic crisis.

The outstanding performance of Germany's labour market continues to surprise

The situation in Spain is contrasted by the surprising resilience of the German labour market. Unlike other European countries, Germany's unemployment rate, calculated according to the ILO standard, has fallen steadily apart from an upward blip between March and June 2009, and currently stands at 6.7%, almost one percentage point below its pre-crisis level. If we look at the aggregate data released by the Bundesbank, the unemployment rate bottomed out at 7.5% in October 2010. This achievement is all the more encouraging considering that employment numbers continued to grow throughout 2009. Behind this success story lie a series of measures introduced by the German government.

Extensive recourse was made to the reduction in working hours. Indeed, the Government's Kurzarbeit programme made it possible to temporarily reduce or partially or fully suspend working hours by compensating workers for loss of wages through the payment of an allowance. Workers on shorter working hours were paid 60% of the salary difference (i.e. the difference between the number of hours normally worked and those actually worked) by the Federal Employment Agency. This amount then rose to 67% of the salary difference for workers with families with a dependent child. The introduction of subsidies for reduced hours played a key part in curbing the potential rise in the unemployment rate, preventing dismissals and avoiding rehiring costs once the economy recovers.

In addition, a raft of guidance and training policies was introduced: support measures were put in place for employment services to bolster staff numbers and provide greater guidance and assistance to job seekers. Moreover, workers under the Kurzarbeit scheme were required to undergo induction and training courses to brush up on their skills. Finally, job placement initiatives were strengthened to target young people, immigrants and the over 50s, and coaching measures were introduced for the jobless to set up their own business.

In the spring of 2009, the Kurzarbeit programme was extended for 24 months until spring 2011. A further extension has been planned for an additional 18 months from late 2010 until mid-2012. However, support for companies initially signed up to the programme had already started to slow by mid-2010. The support provided by the Kurzarbeit programme, therefore, will gradually fade between mid-2010 and mid-2012: the recent slowdown in the rate of decline in unemployment could be due to a weakening of the programme.

Light and shade in Italy

According to the figures supplied by Istat, Italy's unemployment rate started to rise again last October to 8.6% after a fairly stable period between May and September of around 8.3%. To find higher unemployment levels, we would need to look at the quarterly series as far back as early 2003. Two factors may have played an important part in the recent rise in the unemployment rate: on the one hand, the gradual withdrawal of support from the earnings supplement fund (Cassa Integrazione Guadagni) and, on the other hand, the impact of discouraged workers re-entering the workforce.

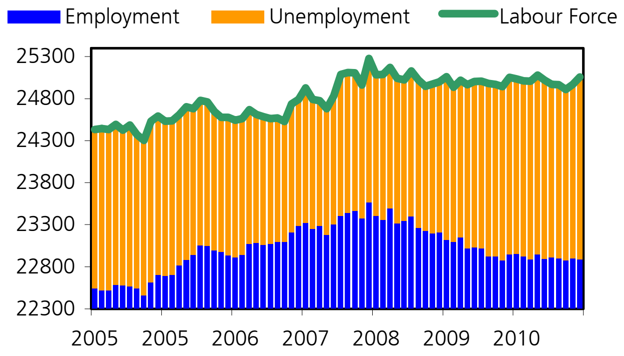
Generally speaking, however, Italy's deterioration of the labour market was less acute than in other European countries. The unemployment rate grew by around two percentage points during the crisis. According to the seasonally adjusted monthly figures supplied by Istat, 688,900 job losses occurred between April 2008 and November 2009. Employment numbers in fact fell from a high of around 23,563,600 employed in April 2008 to a low of 22,874,700 in November of last year. The level then stabilised, with 22,890,000 jobs recorded in October 2010. Job seeker numbers can be seen to have peaked in April 2010 at 2,135,500, roughly 422,400 more than in April 2008. The level has fallen by 64,300 in the past six months, bringing the number of unemployed in October 2010 to around 2,167,000. The fall in unemployed individuals coincides however with a fall in the workforce. In fact, the decline in employment in Italy has resulted in an increase not only in job seekers but also in the inactive population. The trend is worrying given that the transition from employment to inactivity has more serious social and economic consequences than the transition to unemployment. Such a choice is in fact less likely to be reversible as a person has less chance of re-entering the labour market after leaving it. According to the monthly data supplied by Istat, Italy's workforce fell by 221,000 between April 2008 and October 2010. The decline is less significant once the quarterly data are taken into account: in the second quarter of 2010 compared with the second quarter of 2008, the workforce reportedly shrank by 94,000. The participation rate for 15- to 64-year-olds shows a decline between the second quarter of 2008 and the second quarter of 2010 of one percentage point from 63.5% to 62.5%. The shift is significantly greater if account is taken only of the younger population cohort: The participation rate of 15- and 24-year-olds fell during the crisis by more than three percentage points to 28.4% in the second quarter of 2010 from 31.6% in the second quarter of 2008.

By and large, young people have mainly borne the brunt of the deteriorating labour market in Italy as elsewhere in the Euro zone. Looking at the breakdown by age group, in the second quarter of 2010 the unemployment rate for young people aged between 15 and 24 years was 27.9%, more than treble that of the average rate for all age groups and 8 points above the level for the second quarter of 2008. The unemployment rate decreases with age, down to 11.7% for workers aged between 25 and 34 years, and 5.9% in the 55-64 year age group

After a brief stabilization, the Italian unemployment rate has started moving up again in October 2010

Source: ISTAT

Employment, unemployment and labour force trends in Italy before and after the economic crisis

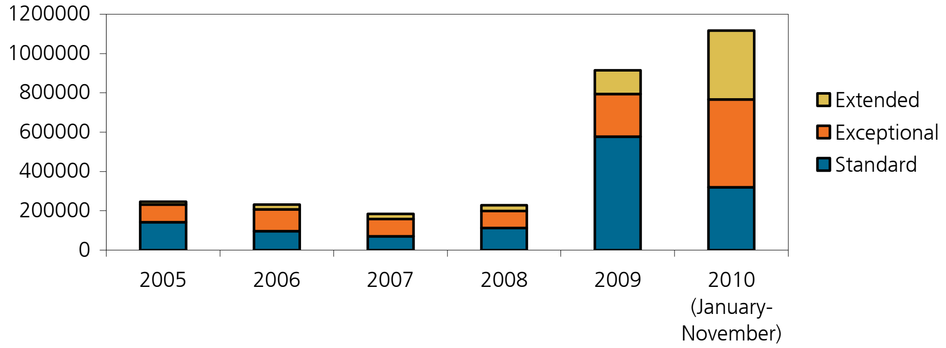


Source: ISTAT, data in thousands

Extensive recourse to the earnings supplement fund (Cassa Integrazione Guadagni)

The resilience of Italy's labour market by comparison with the rest of the Euro zone appears to be due in part to recourse to the "Cassa Integrazione Guadagni" (CIG, "earnings supplement fund"). As the graph shows, the earnings supplement fund was much more intensively used in 2009 and 2010 than in previous years.

Hours compensated through "Cassa Integrazione Guadagni" (thousands)

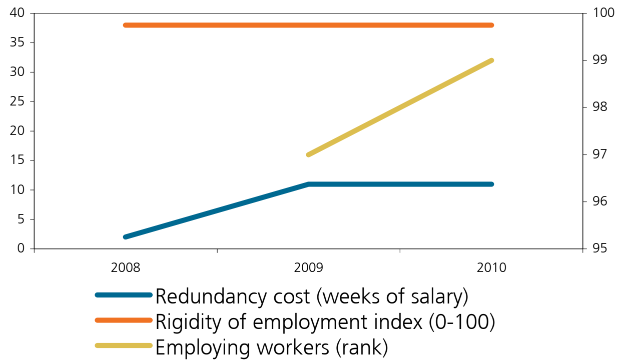


Source: ISTAT, Intesa Sanpaolo calculations

Rigidity of the Italian labour market?

As the recovery starts to take hold, the unresolved structural problems of Italy's labour market are emerging. An interesting analysis was conducted by the World Bank's "Doing Business", a project that looks at business regulations for local firms in 183 countries. Two indices were used to measure the labour market: the first index measures rigidity of employment which includes difficulty of hiring, rigidity of hours and difficulty of firing, while the second index measures redundancy costs. A labour market rigidity index ranking has not been circulated in the report for 2011 because the index is currently under review. The latest figures available relate to 2010 and rank Italy 99 out of the 183 countries studied. The redundancy cost index scored 11, remaining unchanged from the previous year (in 2008 the indicator was 2). Employment rigidity on a scale of 1 to 100 remained the same for the third consecutive year at 38. Labour market rigidity is decidedly greater in the other major European countries: France ranks 155, Spain 157 and Germany 158. Countries instead with a more flexible labour market are Australia, the United States and Singapore.

Italian employment from "Doing business" indices



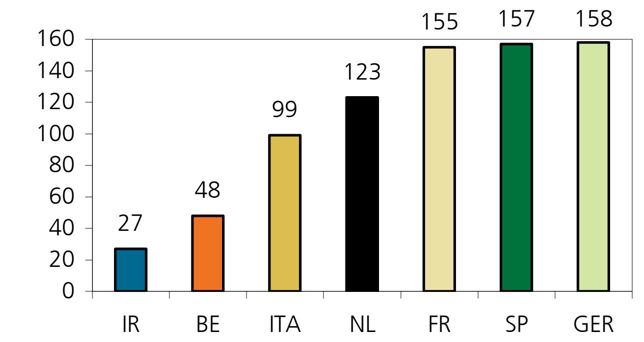
Source: Doing Business database, World Bank. Note: higher values for the indices corresponds to more labour market rigidity in the country considered.

Italy's rankings in the World Bank's "Doing business" indices

	2008	2009	2010
Rank		97	99
Firing cost (weeks of salary)	2	11	11
Rigidity of employment index (0-100)	38	38	38

Source: Doing Business database, World Bank. Note: higher values for the indices corresponds to more labour market rigidity in the country considered.

World labour market rigidity rankings



Source: Doing Business database, World Bank. Note: higher values for the indices corresponds to more labour market rigidity in the country considered.

"Doing Business" sub-indices for major Euro area countries

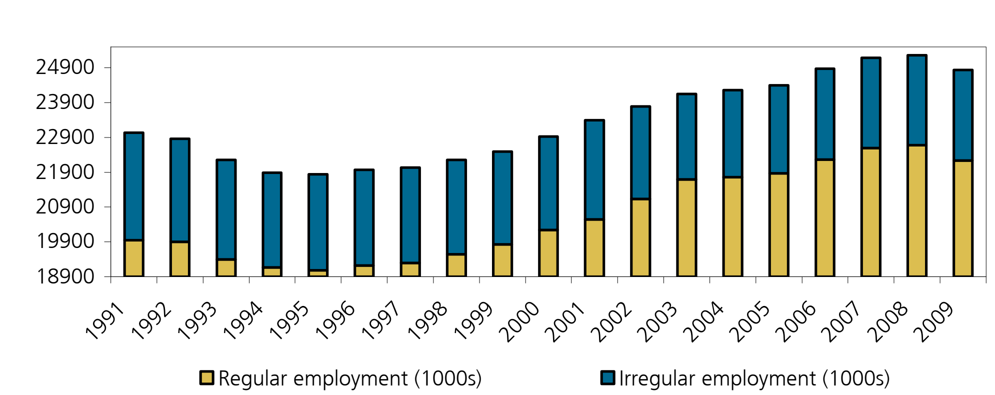
	IR	BE	ITA	NL	FR	SP	GER
Rank	27	48	99	123	155	157	158
Difficulty of hiring index (0-100) 33	11	11	33	17	67	78	33
Rigidity of hours index (0-100) 40	0	40	40	40	60	40	53
Difficulty of firing index (0-100) 40	20	0	40	70	30	30	40
Rigidity of employment index (0-100)	10	17	38	42	52	49	42
Firing cost (weeks of salary)	18	16	11	17	32	56	69

Source: Doing Business database, World Bank. Note: higher values for the indices corresponds to more labour market rigidity in the country considered.

Hidden labour is not subject to crises

An analysis of Italy's labour market calls for consideration of the black labour market. Although the phenomenon is not readily quantifiable, Istat has provided an estimate of the number of moonlighting workers in Italy for the period 1991-2009 and their percentage of total declared and undeclared workers. An analysis of the figures shows that in 2009 undeclared employment remained broadly stable against a decline in official employment. This resulted in an increase in the percentage of undeclared workers out of total workers. The issue of hidden employment is closely linked to the consequences of the economic crisis on the labour market; indeed, the increasing difficulty of finding a job could prompt certain categories of workers to accept some forms of undeclared work. This phenomenon could also be due to the desire of workers on income support benefits to supplement their earnings.

Mild corrections for irregular employment



Source: ISTAT

Forex markets

Asmara Jamaleh

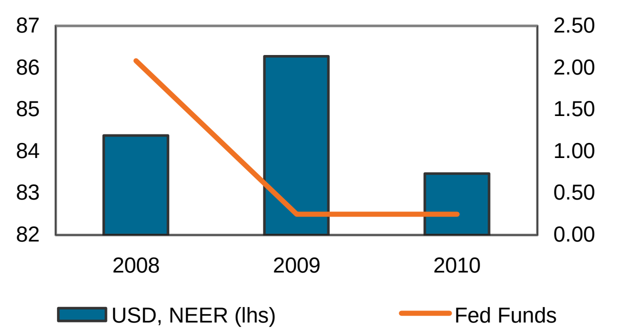
After the 2008 global economic and financial crisis, exchange rates should start to resume some re-alignment towards macroeconomic fundamentals in 2011. No new market issues are expected to emerge, except for an issue that has remained latent this year: the need to restore the health of public accounts. Coupled with the "peripherals" question this should penalize the euro. Similar considerations apply to sterling. Finally, the yen should reverse its trend and depreciate: next year's decline should however be smaller than the one that had been expected for this year.

The year 2011 is not expected to introduce new market stories compared to 2010. In fact, a balance of sorts may be attained, reaching the first stage of the process of solving the problems inherited from the crisis of 2008. However, **there is one particular issue that has remained "latent" this year**, and may surface in 2011: the need to **restore the health of public accounts**. In terms of its effects on the forex markets, this problem is most relevant to the United States, the euro area, the United Kingdom, and Japan.

Dollar

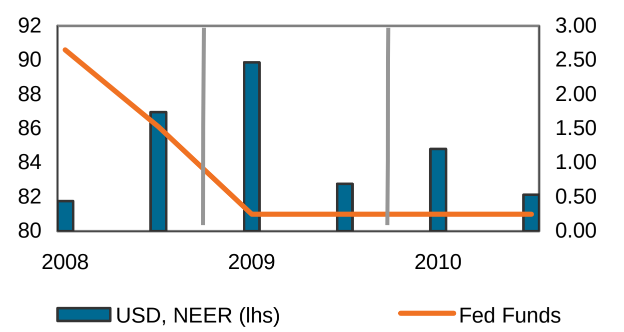
The trend of the dollar next year will continue to be principally guided by the Fed. At the outbreak of the global crisis in 2008, Fed Fund rates dropped almost to zero, which led to a significant appreciation of the US currency between the second half of 2008 and the first half of 2009 (Figs. 1a and 1b), with the adoption of an extremely expansive monetary policy providing "reassurance" on the possibility of a recovery of the US economy.

Fig. - 1a



Source: EcoWin

Fig. - 1b



Source: EcoWin

This year, however, the dollar has weakened on the whole compared to 2009, essentially due to the Fed's explicit intention to keep rates extraordinarily low for an extended period of time, which began to fuel new concern over the recovery in the US. In the meantime, however, the persuasion started to take hold that without a recovery in the United States, the other main economies may not have been able to fare any better. In the euro area, the outbreak of the sovereign debt crisis in peripheral countries seemed to confirm this.

Focusing back on 2011, and on the dollar/Fed correlation, **the recent adoption of QE2 should mark the opening of a new phase. The prospect of further, ample monetary stimulus, possibly being perceived as a "guarantee" of growth, plays to the advantage of the dollar. However, this perception should not go as far as turning into a belief that the dollar will surely experience an uptrend in the course of 2011.**

Indeed, a new factor will be at play compared to 2010: the need to determinedly cut national deficits, through the adoption of new restrictive fiscal policy measures. This will negatively impact the US currency, as (1) the effect on growth is negative (one of the reasons for which the Fed, with no compromise to the central bank's independence from the government, is keeping its monetary policy as expansive as possible), and (2) there is uncertainty over the actual scope – size and distribution – of fiscal restriction, and uncertainty notoriously generates volatility on the markets.

There is also another factor to consider: the rest of the world. In other terms, if the performance of global growth proves to be "acceptable" on the whole, and the markets perceive this, focus will shift back to rate/yield differentials, benefiting emerging and non-emerging currencies that offer higher yields than the dollar, and are less challenged by public accounts than the United States.

Therefore, the overall outcome should be a US dollar at around the same levels as in 2010 (in terms of the annual average), resilient to a drop below those levels.

Euro

In 2011 the trend of the euro will be guided principally by three factors: (1) growth in the euro area, also in relation to US growth, (2) developments of the sovereign debt crisis faced by some peripheral EU countries, and (3) the evolution of Fed and ECB monetary policy management, with particular focus on the Fed at around the mid-year stage.

These three factors should impact the single currency negatively.

(1) Growth. There will be no overtaking of, nor a decoupling from, growth in the United States. Therefore, chances of the euro expressing a clear, sharp uptrend in 2011 seem slim.

(2) Peripherals. At the present stage, re-exacerbation phases of the crisis cannot be ruled out in one or the other of the countries involved. However, beyond specific episodes, this will remain a key issue, latent at times, less so at others. The overall effect will be a compression of the euro's upside potential, making (1) the achievement of new highs over this year's less likely, and (2) the exchange rate more vulnerable to a drop towards 2010 lows, and potentially beyond, i.e. to less than this year's low of EUR/USD 1.18. In such a case, EUR/USD 1.10 may establish itself as a rather robust lower bound. Another factor playing against the euro should be a tendency to amplify downside reactions to negative impulses, and to compress upside reactions to positive ones, resulting in an asymmetrical behaviour of the exchange rate.

(3) Monetary policy. The differences in monetary policy management by the ECB and the Fed, which damaged the dollar against the euro this year, may ease on the whole. The "Fed QE2" factor has already been largely priced in by the market. While it may have some lingering effects, any upswing of the single currency as a reaction to it should prove to be more moderate, or in some cases almost non-existent, barring an overtaking /decoupling of euro area growth, which – as mentioned above – is unlikely.

Since the introduction of EMU, a positive correlation between the exchange rate and growth/growth differentials materialised only once, in 2009, whereas a positive correlation between the exchange rate and euro area interest rates was observed both in 2009 and 2010.

This may suggest that the global economic and financial crisis of 2008 has started to guide the euro back to a path more in line with fundamentals, in terms of the exchange rate trend. In some ways, it could be inferred that the crisis has paradoxically created the opportunity to take on international imbalances more effectively. These imbalances had previously become manifest through extreme currency market trends, as was the case when the euro rose from a 2007 low of 1.28 to a historical high of 1.60 in 2008, immediately prior to the outbreak of the global crisis.

Economic growth and monetary policy management will condition the euro especially in terms of the exchange rate trend.

The issue of peripherals, on the other hand, should have a stronger influence on the levels reached, also contributing to outlining medium-term ranges within which the exchange rate fluctuates (see above, Section 2).

How important will the issue of peripherals be in defining the level of the euro? Probably not much. It was obviously very important this year, at the outbreak of the crisis, when Greece fell into distress, subsequently followed by Ireland. The exchange rate dropped by 15 in the former case, and by seven in the latter. Reaction to the Greek crisis was stronger, as it was unprecedented. Therefore, the impact of the peripherals issue may be estimated at around five hundred pips, and as a result the exchange rate in 2011 may be lower on average by around five hundred pips compared to its quotations in a "normal" situation, i.e. free from concern tied to peripherals. Some simulations we have run show that the impact of peripherals on the euro is statistically not significant, and in any case limited, well below the five hundred pips of the assumption made above. However, these analyses cannot be considered as very reliable, as the historical series available is too short to yield valid results.

How has the global crisis of 2008 affected the euro? The peripherals crisis is nothing but a local emanation of the global economic and financial crisis of 2008, that broke out at a delay. As it is a natural consequence of the 2008 crisis, and having exploded later, based on the transitive property, it could be said that the effect of the global crisis of 2008 on the euro has been negative, in the sense that it has lowered the average level of the single currency, not so much in the immediate term, as in the medium term, which represents the initial approximation of the exchange rate equilibrium level.

In terms of timing, unfavourable factors may concentrate their effects between 2Q11 and 3Q11: (a) in 2Q11, growth could prevail as a theme, specifically with the United States surprising on the upside as opposed to repeated instances of concern over the recovery this year; (b) in 3Q11, a major conditioning factor could be a potential combination of slow growth in the euro area and the risk that the public account adjustment process, both in peripheral and non-peripheral euro area countries, may add to existing downside pressures on growth, possibly even depressing the potential growth rate.

The euro's fluctuation range in 2011 could be similar to this year's, i.e. EUR/USD 1.18-1.45, although the exchange rate may spend more time in the medium-low end of the range. The equilibrium area should be about EUR/USD 1.30-1.35. This year, (1) at the outbreak of the Greek crisis, the exchange rate plunged from EUR/USD 1.33 to 1.18, returning to 1.33 when the situation improved. (2) Similarly, when on occasion of the September FOMC meeting the Fed prepared the markets for a new round of quantitative easing, the euro first reacted by appreciating from EUR/USD 1.35 to 1.43, and then returned to 1.35 once QE2 had begun. The "technical" equilibrium area is EUR/USD 1.27-1.37

Sterling

For sterling, 2011 could prove to be the "moment of truth", with prevailing downside risks. The year now coming to an end has been an electoral year, and has brought an upheaval of the traditional political balance (with a Conservative-led coalition replacing Labour in office). The process of removing the expansive policies adopted to counter the 2008 crisis has therefore been delayed. As a result, the pound's nominal effective exchange rate has averaged the same levels recorded in 2009, both against the dollar and the euro – i.e., it hasn't dropped further after shedding around 25% between 2008 and 2009.

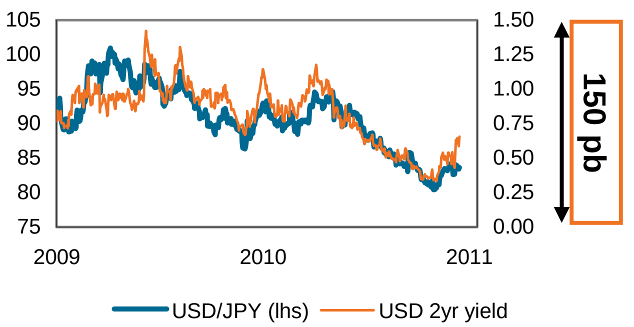
There is essentially a single, major potential downside factor: the need to cure the serious public deficit, estimated by the OBR (Office for Budget Responsibility) at around 10% of GDP this year (see "United Kingdom" section). The government has already announced an extensive austerity plan based on spending cuts, and it is also reasonable to assume that tax hikes will follow. The scope and terms of the process of cutting the deficit, however, are highly uncertain, and this is weighing on monetary policy management, to the point that the Bank of England "suspended" its view on the growth scenario, prospecting a relatively "balanced" picture.

This is taking place at a time when, on the other side of the Ocean, the Fed is inaugurating QE2, generating expectations on the market for a rise in BoE rates already as of 1Q11 (see "United Kingdom" section). As this seems unlikely at the moment, **the balance is skewed on the downside for the British currency, given the risk of the market reviewing its expectations on rates, pushing the initial hike forward in time**. Also, as is often the case, such a revision could turn out not to be gradual, but quite sudden, triggering an equally sudden correction of the pound, both against the dollar and the euro. Considering that the Budget is unveiled in March, the correction phase may be assumed as taking place by the end of the first half of the year, and possibly reabsorbed, at least in part, in the subsequent period. During the correction phase, sterling may drop as far as GBP/USD 1.50-1.45, and the EUR/GBP exchange rate may at least temporarily return to 0.90.

Yen

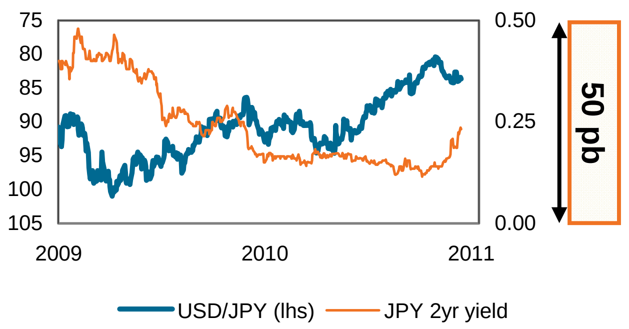
In 2011, the yen should reverse its trend and **depreciate**, after failing to do so this year despite expectations to the contrary. However, next year's decline should be smaller than the one that had been expected for this year. This is because the **USD/JPY exchange rate tracks the trend of the spread between US and Japanese yields**. As rates in Japan have been effectively at zero for years, **the direction of spreads is determined by US yields** (Figures 3a and 3b), which declined in 2010, as opposed to broadly stable Japanese rates. At the present stage, therefore, the potential upside margin from current levels – close to zero – is larger than the downside margin. For what concerns the yen, by contrast, upside potential is virtually non-existent, as (1) the BoJ will maintain a more expansive stance than the Fed, and for a longer period, and (2) the macro scenario for Japan is deteriorating.

Fig. - 2a



Source: EcoWin

Fig. - 2b



Source: EcoWin

However, **the expected depreciation** of the yen should **be limited: the Fed's QE2 will extend the period of time in which Fed Fund rates stay put, and contain the rise of US yields as a result**. In order to approximate the yen's response to the yield spread trend, **we have estimated the correlation between the USD/JPY exchange rate and short-term yields** over the past three years. The result is that **a 25bps widening of spreads corresponds to a rise of the USD/JPY exchange rate by around five hundred pips**.

For instance, moving from the average level recoded in the present quarter, of USD/JPY 82, a 25bp widening of spreads would push up the exchange rate to USD/JPY 87. In 2010, the spread (measured between the extremes touched during the course of the year) narrowed by around 75bps: if fully reabsorbed in 2011, based on the above estimates the USD/JPY exchange rate could rise as far as USD/JPY 95-100. These levels should represent the upper limits of the USD/JPY exchange rate's fluctuation range in 2011.

Exchange rate projections

	23-12-2010	1m	3m	6m	12m	24m
EUR/USD	1.3109	1.3256	1.35	1.27	1.30	1.35
USD/JPY	82.92	84	90	99	98	97
GBP/USD	1.5382	1.54	1.54	1.43	1.50	1.55
EUR/CHF	1.2467	1.28	1.34	1.35	1.40	1.45
EUR/SEK	8.9907	9.05	9.30	9.20	9.00	8.90
EUR/NOK	7.8405	7.95	8.10	8.15	8.20	8.30
EUR/DKK	7.4519	7.45	7.45	7.46	7.46	7.46
USD/CAD	1.0125	0.99	0.98	1.00	1.04	1.12
AUD/USD	1.0028	0.98	0.95	0.88	0.86	0.82
NZD/USD	0.7458	0.75	0.72	0.68	0.65	0.58
EUR/JPY	108.70	111	122	126	127	131
EUR/GBP	0.8522	0.86	0.88	0.89	0.86	0.87
EUR/CAD	1.3273	1.31	1.33	1.27	1.35	1.51
EUR/AUD	1.3072	1.35	1.42	1.44	1.51	1.65
EUR/NZD	1.7577	1.77	1.88	1.87	2.00	2.31

Source: Thomson Reuters and Intesa Sanpaolo elaborations

% Changes: projections

	1m	3m	6m	12m	24m
EUR/USD	1.1%	3.0%	-3.1%	-0.8%	3.0%
USD/JPY	1.3%	8.5%	19.4%	18.2%	17.5%
GBP/USD	-0.2%	0.1%	-6.8%	-2.2%	0.8%
EUR/CHF	2.7%	7.5%	8.3%	12.3%	16.3%
EUR/SEK	0.7%	3.4%	2.3%	0.1%	-1.0%
EUR/NOK	1.4%	3.3%	3.9%	4.6%	5.9%
EUR/DKK	0.0%	0.0%	0.1%	0.1%	0.1%
USD/CAD	-2.2%	-2.8%	-1.2%	2.7%	10.6%
AUD/USD	-2.3%	-5.3%	-12.2%	-14.2%	-18.2%
NZD/USD	0.6%	-3.5%	-8.8%	-12.8%	-21.7%
EUR/JPY	2.4%	11.8%	15.7%	17.2%	21.0%
EUR/GBP	1.3%	2.9%	3.9%	1.4%	2.2%
EUR/CAD	-1.1%	0.1%	-4.3%	1.9%	13.9%
EUR/AUD	3.5%	8.7%	10.4%	15.6%	25.9%
EUR/NZD	0.6%	6.7%	6.3%	13.8%	31.5%

Source: Thomson Reuters and Intesa Sanpaolo elaborations

The week's market movers

In the Euro area, the December inflation data should confirm the modest trend in the core index and the stability of the headline measure. The EU Commission index is expected to improve, and could hit a new high from October 2007. M3 should accelerate in November. In Germany, the labour market should show a further fall in the jobless total in December, while inflation should be steady on a yearly basis.

In the United States the data should confirm the acceleration in growth around year-end, with positive indications for 1Q11. The ISM and Chicago PMI should show modest gains in December from high November levels. The employment report should show stronger payrolls growth and a fall in the unemployment rate, with a likely upward revision to the November data. Auto sales and consumer confidence should improve further in December. Construction spending should be up slightly in November. The FOMC minutes should show a wider range of views on the economic outlook than transpired in the December statement.

Tuesday 28 December

United States

- Consumer confidence as measured by the Conference Board is expected to rise to 56 in December from 54.1 in November. The gain should stem from further improvements in both the coincident index (from 24 in November) and the expectations index (from 74.2 in November), as in the last three months. The expansionary fiscal measures on the way and the end of the uncertainty that has marked the last few months underpin expectations of a further improvement in the index.

Wednesday 29 December

Euro area

- M3 growth should accelerate to 1.4% yoy from 1% yoy in October; the three-month moving average should rise to 1.2% yoy in November from 1.1% in October, on the back of the uptrend in interest rates seen since the end of October. The trend in loans to the private sector should continue its recent, positive trend (+1.4% yoy in October), thanks to robust growth in household loans (+2.9% yoy in October) vs. a persistent contraction in business loans (-0.6% yoy).

- Germany. The preliminary CPI estimate for December should show a change of + 0.9% mom, after +0.1% mom in November. Trend inflation should be steady at 1.5% yoy on the national measure, and at 1.6% yoy on the harmonised index. The month-on-month movement is impacted by the seasonal component, and also by the rise in the oil price coupled with euro depreciation. The data should confirm the absence of significant upward pressures on prices ex energy, as indicated by a core inflation rate below 1% yoy. However, import prices accelerated sharply in November (and more than expected), rising by 1.2% mom (0.8% mom ex oil): the exchange rate effect will have some impact on final prices in the coming months. In January 2011 trend inflation should rise to 2% yoy owing to an adverse base effect with 2010, and then cool in the following months, fluctuating between 1.6% and 1.9% yoy through to June. In the second half of the year, German inflation should be between 2.0% and 2.2% yoy.

Thursday 30 December

Euro area

- Italy. Business confidence is expected to ease to 101.5 in December from 101.6 in November, but without interrupting the uptrend stretching back to March 2009 (from a low of 71.1). The index would remain above the long-term mean ((99.6). In the November survey, conditions as expected by firms showed a slight deterioration in several components (orders, employment, economic outlook) and justify expectations of a small correction.

United States

- The Chicago PMI should remain broadly steady at 62.7 in December, from 62.5 in November. In November the index improved by 1.9 points and all items were up. In December the scope for fresh gains is limited, but the auto sector is showing signs of structural firming: thus, the Chicago survey should remain on an uptrend.

Monday 3 January 2011

United States

- Construction spending is expected to be up 0.2% mom in December, after +0.7% mom in November. In October spending in the private residential sector was up 2.5% mom, its second straight gain: between June and August the effects on the sector of the end of the tax breaks were very negative (the sector was down -9.2% yoy in October). The slow recovery in activity levels should have continued in November, though without signalling an independent uptrend. Non-residential private spending should be down, showing a more limited contraction than in October (-0.7% mom). Public spending should continue the positive trend based on three straight months of gains, although the size of these gains has steadily shrunk.

- The manufacturing ISM should rise to 57 in December from 56.6 in November. The indications from the Philadelphia Fed and Empire surveys were solid and signal possible further gains in the ISM. The Philly Fed index hit a level not seen since 2005. Growth should accelerate both in 4Q10 and in 1Q11, thanks to the actual stimulus and the end of the fiscal uncertainty following the passage of the Obama-Republican package. The various components of the ISM should remain comfortably expansionary; note that the index of prices paid might resume the uptrend that was interrupted in the last two months and show growth from the already high November levels (69.5).

Tuesday 4 January

Euro area

- France. Household confidence in December is expected to be steady at the -32 recorded in November, after four straight gains. Both present conditions and future expectations should stabilise at the November levels.

- Germany. The jobless total is expected to fall by 15k in December, after -9k in November, marking the eighteenth straight fall. The unemployment rate should remain steady at 7.5% in December for the fourth straight month.

- The CPI flash estimate for the Euro area in December should show inflation at 2% yoy, vs. 1.9% yoy in October and November. Month-on-month, the headline index should be up 0.4% mom on a large contribution from energy (which is expected to be up +1.4% mom), due to rising prices and a falling euro. Inflation should be almost steady around 2% in early 2011. Later in the year the inflation rate should dip by a few decimal points, averaging out at 1.8% for the whole of 2011.

United States

- The minutes of the December FOMC meeting should give some information on the spread of views on the economy. The press statement was inflexibly negative on the cycle, despite the clear improvement in retail sales and the expansionary breakthrough in fiscal policy. Bullard (St Louis Fed) said on 20 December that decisions on quantitative easing may be reviewed and changed according to growth, which might prove more robust than the consensus currently anticipates. Bullard said too that the purchase programme should be reviewed "meeting by meeting" and he pointed out that the statement specifically says that the programme is subject to "regular review". This indication will be stressed in the minutes and might prompt the market to think the purchase programme may be limited. The very slow downtrend in the unemployment rate should however leave unchanged the flow of purchases projected in the November statement.

- Vehicle sales are expected to rise to 12.4M units ann. in December, above the November level (12.3M) and 14% higher than sales in December 2009 (11.1M). The auto sales guidance for 2011 is positive: JD Power projects sales of 12.8M units in 2011 (of which 10.4M retail sales) vs. 11.6M expected in 2010, plus a further acceleration in 2012.

Wednesday 5 January

United States

- The ADP estimate of new non-farm payrolls in the private sector is +100k, vs. +93k in November.

- The non-manufacturing ISM is expected to rise to 55.7 in December from 55 in November. The December Beige Book reports expansion in non-financial and professional services in almost all districts; retail activity is buoyant, as borne out by the sales data, and expansion continues in the auto sector. The employment and price components of the survey should be up in December.

Thursday 6 January

Euro area

- The EU Commission confidence index should rise to 106 in December from 105.3 in November. The index would thus confirm the uptrend of the past year, hitting a new high from October 2007: The current divergence between core and peripheral countries is expected to persist. The business confidence index should be up to 2 from 1 in November. The index should be once again above the long term average (-8) and would keep trending up from the low of -38 hit in March 2009. The preliminary estimate of the household confidence could be revised up to -10 from -11, but still below the level seen in November (-9). On the other hand, confidence in the service sector could drop to 9 from 10. We expect a stable and negative index both for the construction sector (-26) and the retail sector (-2). In general the overall index is expected to indicate improvement in most euro-zone countries. So far the national surveys have shown positive signals for businesses, unexpected weakness for consumers.

- Euro area retail sales are expected to be up by 1.1% m/m in November, after a weak +0.1% m/m in October (revised down from +0.5% m/m). On a yearly basis, sales growth would accelerate to 3% y/y, from 1.4% y/y in October. Among the main euro area countries, French sales picked up strongly in November (+2.8% m/m); in Germany, sales could be up (consensus: 1% m/m), while in Spain the data could be negative. In general, in 2011 we expect a moderate and gradual recovery in household consumption in the euro area, in line with the overall trend of confidence indicators.

Friday 7 January

United States

- Non-farm payrolls are expected to be up 150k in December after the disappointing November figure (+39k). Private sector payrolls should be up 160k, after +50k in November. The November figure should be revised sharply up, since it is at odds with all the other labour market indications. The unemployment rate should ease to 9.7% from 9.8% in November. Employment as recorded in the household survey was very negative in October and November, showing a two-month contraction of 503k. The expected growth in payrolls from the establishment survey should also show up in the more volatile employment series as measured with the households survey, with upside risks. The unemployment rate will in any case show a slow decline, given the extremely low participation rate (at mid-1980s levels). Hourly wages should be up 0.1% mom, after zero movement in November.

Calendar of macroeconomic data and events

Calendar of macroeconomic data (27 - 31 December)

Date		Time	Country	Data release	*	Period	Previous		Consensus	Intesa Sanpaolo
Mon	12/27	nd	JAP	Small Business Confidence		DEC	45.8			
Tue	12/28	00.30	JAP	Household Spending (YoY)	*	NOV	-0.4	%	0.7	
		00.30	JAP	Natl CPI YoY	**	NOV	0.2	%	0.1	
		00.30	JAP	Natl CPI Ex-Fresh Food YoY	**	NOV	-0.6	%	-0.6	
		00.30	JAP	Job-To-Applicant Ratio		NOV	0.56		0.57	
		00.30	JAP	Jobless Rate		NOV	5.1	%	5.1	
		00.50	JAP	Industrial Production (MoM) (prelim.)	*	NOV	-2	%	1	
		00.50	JAP	Retail Trade YoY		NOV	-0.2	%	0.9	
		07.30	FRA	Gross Domestic Product (QoQ) (final)		Q3	0.4	%	0.4	
		15.00	USA	S&P/CS Composite-20 YoY		OCT	0.59	%	-0.1	
		16.00	USA	Consumer Confidence	*	DEC	54.1		56	56
Wed	12/29	10.00	EUR	Euro-Zone M3 s.a. (YoY)	*	NOV	1	%	1.6	1.4
		nd	GER	Consumer Price Index (YoY) (prelim.)	*	DEC	1.5	%	1.5	1.5
		nd	GER	Consumer Price Index (MoM) (prelim.)	*	DEC	0.1	%	0.9	0.9
		nd	GER	CPI - EU Harmonised (YoY) (prelim.)	**	DEC	1.6	%	1.6	1.6
		nd	GER	CPI - EU Harmonised (MoM) (prelim.)	**	DEC	0.1	%	0.9	0.9
Thu	12/30	00.15	JAP	Nomura/JMMA Manufacturing PMI		DEC	47.3			
		09.30	ITA	Business Confidence	*	DEC	101.6			101.5
		10.00	ITA	PPI (YoY)		NOV	4	%		
		10.00	ITA	PPI (MoM)		NOV	-0.2	%		
		14.30	USA	Initial Jobless Claims		week		k	420	
		15.45	USA	Chicago Purchasing Manager	*	DEC	62.5		61	62.7

(?) First likely date; (**) very important; (*) important; in column "*Previous*" in parenthesis data before the revision

Source: Intesa Sanpaolo Research Department

Calendar of macroeconomic data (3 – 7 January)										
Date		Time	Country	Data release	*	Period	Previous		Consensus	Intesa Sanpaolo
Mon	1/3	09.15	FRA	PMI Manufacturing (final)		DEC				
		09.45	ITA	PMI Manufacturing	*	DEC				
		09.55	GER	PMI Manufacturing (final)	*	DEC	60.9		60.9	
		10.00	EUR	PMI Manufacturing (final)	*	DEC	56.8		56.8	
		16.00	USA	ISM Manufacturing	**	DEC	56.6		56.9	57
		16.00	USA	Construction Spending MoM		NOV	0.7	%	0.2	0.2
Tue	1/4	08.45	FRA	Consumer Confidence Indicator		DEC	-32			-32
		09.55	GER	Unemployment Rate (s.a)		DEC	7.5	%	7.5	7.5
		09.55	GER	Unemployment Change (000's)	**	DEC	-9	k	-12	-15
		10.30	GB	Net Consumer Credit		NOV	0.3	bln		
		10.30	GB	PMI Manufacturing	*	DEC	58			
		11.00	EUR	Euro-Zone CPI Estimate (YoY)	**	DEC	1.9	%	2	2
		11.00	ITA	CPI - EU Harmonized (MoM) (prelim.)	*	DEC	0	%		
		11.00	ITA	CPI (NIC incl. tobacco) (YoY) (prelim.)	*	DEC	1.7	%		
		11.00	ITA	CPI (NIC incl. tobacco) (MoM) (prelim.)	*	DEC	0	%		
		14.30	ITA	CPI - EU Harmonized (YoY) (prelim.)	*	DEC	1.9	%		
		16.00	USA	Factory Orders		NOV	-0.9	%	0	
		23.00	USA	Total Vehicle Sales		DEC	12.26	mln	12.28	12.4
Wed	1/5	09.15	FRA	PMI Services (final)		DEC				
		09.45	ITA	PMI Services	*	DEC				
		09.55	GER	PMI Services (final)	*	DEC	58.3		58.3	
		10.00	EUR	PMI Composite (final)	*	DEC	55			
		10.00	EUR	PMI Services (final)	*	DEC	53.7		53.7	
		11.00	EUR	Industrial New Orders YoY		OCT	(13.5) 13.4	%		
		11.00	EUR	Industrial New Orders SA MoM		OCT	(-3.8) -4.2	%	1.5	
		11.00	EUR	Euro-Zone PPI (YoY)		NOV	4.4	%	4.4	
		14.30	USA	ADP Employment Change		DEC	93	k	100	
		16.00	USA	ISM Non-Manf. Composite	**	DEC	55		55.5	55.7
Thu	1/6	10.30	GB	PMI Services		DEC	53			
		11.00	EUR	Euro-Zone Consumer Confidence		DEC	-9.4		-9	
		11.00	EUR	Euro-Zone Indust. Confidence		DEC	0.9		1.9	
		11.00	EUR	Euro-Zone Services Confidence		DEC	10.2			
		11.00	EUR	Euro-Zone Economic Confidence	**	DEC	105.3		105.5	106
		11.00	EUR	Euro-Zone Retail Sales (MoM)		NOV	(0.5) 0.1	%	0	1.1
		12.00	GER	Factory Orders MoM (sa)	*	NOV	1.6	%	0.9	
		14.30	USA	Initial Jobless Claims		week				
Fri	1/7	08.00	GER	Trade Balance		NOV	14.2	bln		
		10.00	ITA	Monthly Unemployment Rate SA (prelim.)	*	NOV	(8.6) 8.7	%		
		11.00	EUR	Euro-Zone GDP s.a. (YoY) (final)		Q3	1.9	%	1.9	
		11.00	EUR	Euro-Zone GDP s.a. (QoQ) (final)		Q3	0.4	%	0.4	
		11.00	EUR	Euro-Zone Unemployment Rate	*	NOV	10.1	%	10.1	10.1
		12.00	GER	Industrial Production MoM (sa)	*	NOV	2.9	%	-0.2	
		14.30	USA	Change in Nonfarm Payrolls	**	DEC	39	k	125	150
		14.30	USA	Unemployment Rate	*	DEC	9.8	%	9.7	9.7
		17.00	EUR	Euro-Zone GDP s.a. (YoY) (final)		Q4				

(?) First likely date; (**) very important; (*) important; in column "*Previous*" in parenthesis data before the revision

Source: Intesa Sanpaolo Research Department

Calendar of events (27 - 31 December)

Date		Time	Country	*	Event
Mon	12/27	00:50	JAP	*	BOJ to Release Minutes of Oct. 28 & Nov. 4-5 Meetings

(**) very important; (*) important
Source: Intesa Sanpaolo Research Department

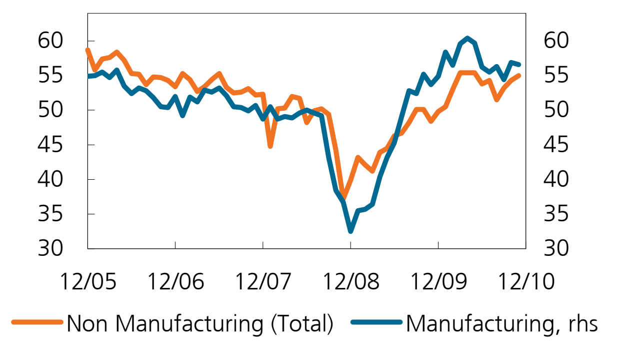
Calendar of events (3 – 7 January)

Date		Time	Country	*	Event
Tue	1/4	20:00	USA		Fed Releases Minutes from Dec. 14 FOMC Meeting
Wed	1/5	19:00	USA		Hoenig Speaks at The Central Exchange in Kansas City
Fri	1/7	15.30	USA	*	Bernanke testifies to Senate Budget Committee on fiscal policy and outlook
		22:30	USA		Fed's Evans Speaks on Monetary Policy in Denver
Sat	1/8	22:30	USA		Fed's Yellen Speaks on Monetary Policy in Denver

(**) very important; (*) important
Source: Intesa Sanpaolo Research Department

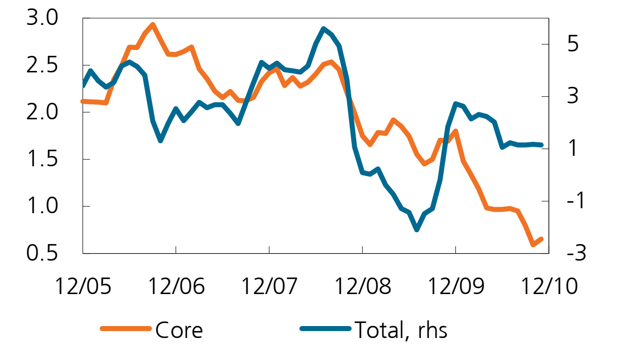
United States

ISM surveys



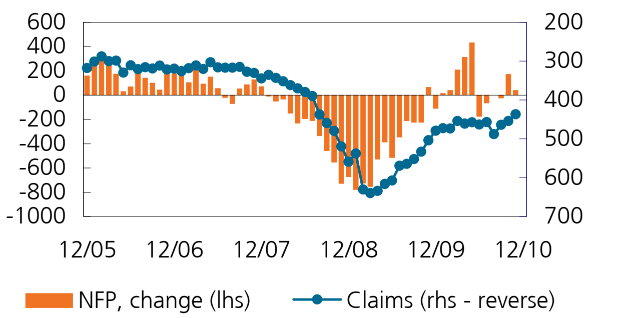
Source: EcoWin

CPI – y/y % change



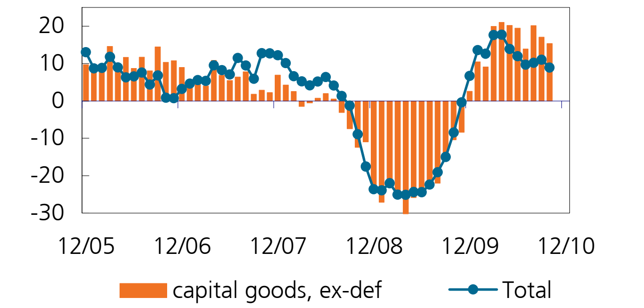
Source: EcoWin

Nonfarm payrolls & jobless claims ('000)



Source: EcoWin

New orders – y/y % change



Source: EcoWin

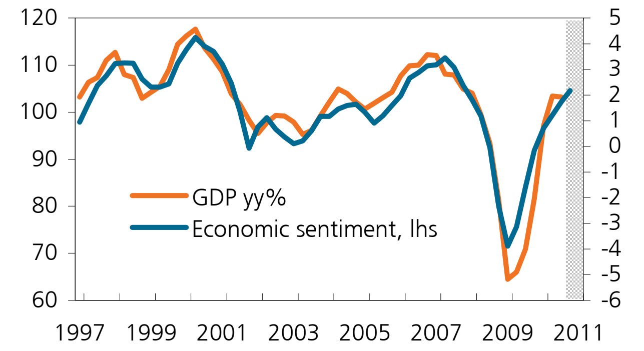
Forecasts Table

				2010				2011			
	2009	2010	2011	1	2	3	4	1	2	3	4
GDP (1996 US$,y/y)	-2.6	2.8	3.1	2.4	3.0	3.2	2.7	2.7	3.2	3.1	3.2
q/q annual rate				3.7	1.7	2.6	3.0	3.6	3.5	2.5	3.4
Private consumption	-1.2	1.8	3.2	1.9	2.2	2.4	3.8	3.3	3.5	2.9	2.9
Fixed investment - nonresid.	-17.1	5.9	11.2	7.8	17.2	10.0	9.5	12.6	11.0	9.0	12.0
Fixed investment - residential	-22.9	-3.1	6.2	-12.3	25.6	-27.3	2.0	13.6	13.6	15.5	14.2
Government consumption	1.6	1.2	1.0	-1.6	3.9	3.9	1.5	0.0	-0.2	-0.1	0.3
Export	-9.5	11.5	7.3	11.4	9.1	6.7	5.6	8.0	7.5	7.7	8.1
Import	-13.8	14.0	9.5	11.2	33.5	16.8	5.1	8.3	7.3	7.0	6.1
Stockbuilding (% contr. to GDP)	-0.6	1.2	0.2	0.6	0.2	0.4	-0.2	0.6	0.2	0.3	-0.2
Current account (% of GDP)	-2.7	-3.5	-4.3	-3.1	-3.4	-3.5	-4.0	-4.2	-4.3	-4.4	-4.5
Federal Deficit (% of GDP)	-9.7	-10.0	-10.4								
Gov. Debt (% of GDP)	84.7	92.7	99.1								
CPI (y/y)	-0.3	1.6	1.7	2.4	1.8	1.2	1.0	1.0	1.9	2.3	1.8
Industrial production	-9.3	5.0	5.0	7.2	7.1	5.2	-4.7	7.0	8.3	9.5	6.6
Unemployment (%)	9.3	9.7	9.7	9.7	9.7	9.6	9.7	9.6	9.7	9.7	9.6

Note: Percentage annualised growth rates over previous period. if not otherwise specified.
Source: EcoWin. Intesa Sanpaolo

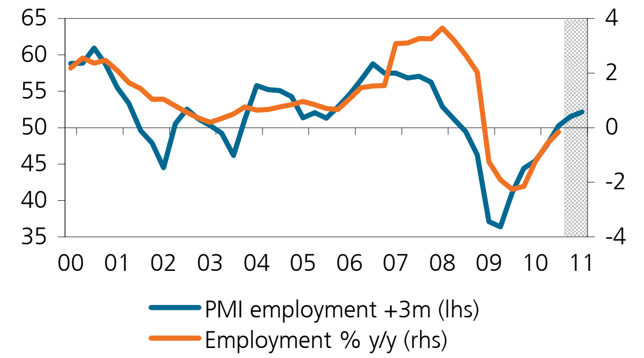
Euro Area

GDP



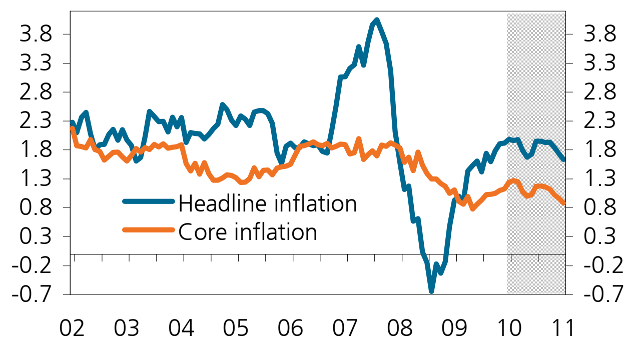
Source: EUROSTAT, UE Commission

Employment



Source: EUROSTAT, Royal Bank of Scotland, Markit Economics

Inflation



Source: Eurostat, Intesa Sanpaolo forecast

Inflation forecasts

%	2009	2010	2011
January	1.1	1.0	2.0
February	1.2	0.9	2.0
March	0.6	1.4	1.8
April	0.6	1.5	1.7
May	0.0	1.6	1.7
June	-0.1	1.4	1.9
July	-0.6	1.7	1.9
August	-0.2	1.6	1.9
September	-0.3	1.8	1.9
October	-0.1	1.9	1.8
November	0.5	1.9	1.7
December	0.9	2.0	1.6

Source: Eurostat

Forecasts Table

				2010				2011			
	2009	2010	2011	1	2	3	4	1	2	3	3
GDP (constant prices, y/y)	-4.0	1.7	1.7	0.8	2.0	1.9	2.1	2.3	1.7	1.6	1.6
- q/q change				0.4	1.0	0.4	0.4	0.5	0.4	0.3	0.3
Private consumption	-1.1	0.8	1.2	0.4	0.6	1.0	1.0	1.1	1.3	1.3	1.3
Fixed investment	-11.3	-1.0	2.2	-4.9	-0.9	0.3	1.8	2.7	1.5	2.2	2.2
Government consumption	2.4	0.7	1.1	1.1	0.6	0.5	0.9	1.1	1.2	1.1	1.1
Export	-13.0	10.0	8.6	5.8	11.8	11.3	11.1	10.8	7.9	8.0	8.0
Import	-11.8	10.4	7.7	4.9	12.3	11.9	12.6	10.1	7.5	7.1	7.1
Stockbuilding (% contr. to GDP)	-0.7	1.4	-0.1	1.0	1.8	1.3	1.5	0.5	0.2	-0.3	-0.3
Current account (% of GDP)	-0.6	-0.6	0.2	-0.7	0.0	-0.2	0.1	0.3	0.0	0.0	0.0
Deficit (% of GDP)	-6.3	-6.3	-4.4								
Debt (% of GDP)	79.1	84.1	86.3								
CPI (y/y)	0.3	1.6	1.8	1.1	1.5	1.7	1.9	1.9	1.8	1.9	1.9
Industrial production (y/y)	-14.8	6.6	2.4	2.3	2.3	0.8	0.5	0.0	0.6	0.9	0.9
Unemployment (%)	9.5	10.0	9.8	9.9	10.0	10.0	10.1	10.0	9.9	9.8	9.8
3-month Euribor	1.2	0.8	1.1	0.7	0.7	0.9	1.0	1.0	1.1	1.1	1.1

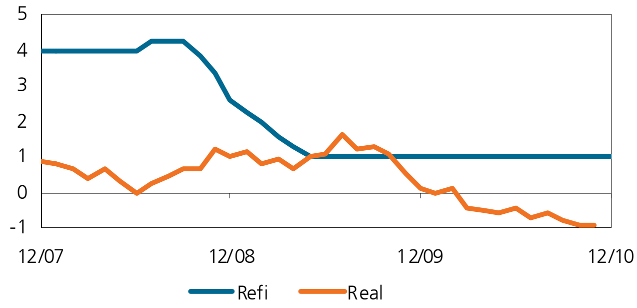
Note: Percentage annualised growth rates over previous period, if not otherwise specified.
Source: EcoWin, Intesa Sanpaolo

Interest Rates Forecasts

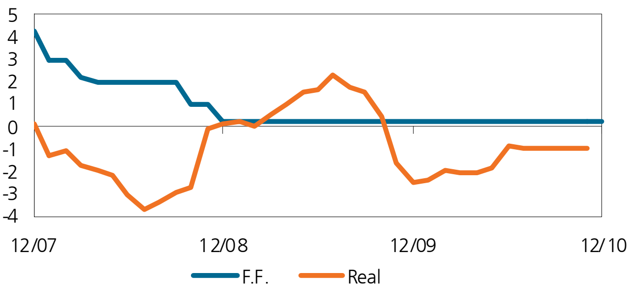
Eurozone	Mar-10	Jun-10	Sep-10	23/12	Mar-11	Jun-11	Sep-11	Dec-11
Refi rate	1.00	1.00	1.00	**1.00**	1.00	1.00	1.00	1.00
1m Euribor	0.40	0.49	0.63	**0.82**	0.91	1.03	1.10	1.10
3m Euribor	0.63	0.77	0.89	**1.02**	1.04	1.10	1.15	1.25

United States	Mar-10	Jun-10	Sep-10	23/12	Mar-11	Jun-11	Sep-11	Dec-11
Fed Funds	0.25	0.25	0.25	**0.25**	0.25	0.25	0.25	0.25
3m Libor USD	0.29	0.53	0.29	**0.30**	0.29	0.29	0.30	0.38

Eurozone



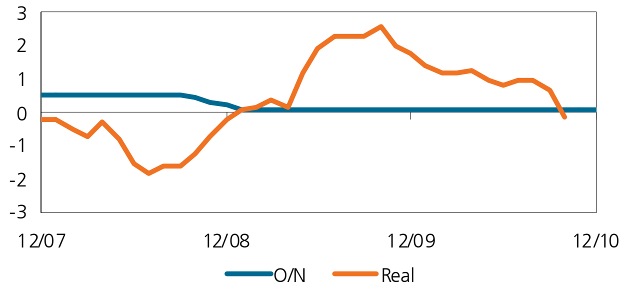
United States



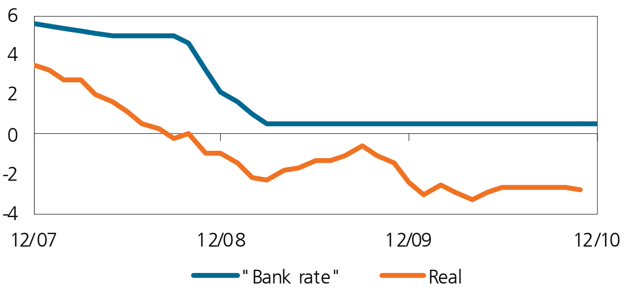
Japan	Mar-31	Jun-30	Sep-30	23/12	Mar-31	Jun-30	Sep-30	Dec-31
O/N target	0.10	0.10	0.10	**0.10**	0.10	0.10	0.10	0.10
3m Libor JPY	0.24	0.24	0.22	**0.19**	0.25	0.40	0.45	0.45

United Kingdom	Mar-31	Jun-30	Sep-30	23/12	Mar-31	Jun-30	Sep-30	Dec-31
Base rate	0.50	0.50	0.50	**0.50**	0.50	0.50	0.50	0.50
3m Libor GBP	0.65	0.73	0.73	**0.75**	0.65	0.75	0.75	0.80

Japan



United Kingdom



Source: Intesa Sanpaolo elaborations on Thomsons Reuters data

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Appendix

Analyst Certification

The financial analysts who prepared this report, and whose names and roles appear on the first page, certify that:

(1) The views expressed on companies mentioned herein accurately reflect independent, fair and balanced personal views;

(2) No direct or indirect compensation has been or will be received in exchange for any views expressed.

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