

US ECONOMY

Strong Growth, More Jobs, Lower Productivity Gains

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- The US economy is still immersed in its recovery process. After some doubts about the sustainability of the recovery, we do not see any major clouds on the horizon for the time being. The stimuli introduced in the US economy in recent years are clearly bearing fruit and we could see GDP growth of around 4.4% in 2004E. We expect the US GDP growth rate to slow to 3.3% in 2005F.
- Macro conditions clearly favour growth. Bear in mind that Fed funds are at 1.0%, fiscal policy is very expansionary, the trade-weighted dollar index has depreciated, credit spreads are at record lows and the stock market has performed positively since 2Q03. In our view, the support offered so far by both monetary and financial conditions could decline going forward. The increase in long- and short-term interest rates and wider credit spreads could trigger tighter monetary conditions. The effect of tighter monetary and financial conditions, together with a restrictive fiscal policy, should be felt in 2H04E.
- Given the recent strong economic data, we believe the Federal Reserve will begin hiking the Fed funds rate in June 2004. We now expect the Fed to raise rates by 100bp in 2004E and another 175bp in 2005F, leaving the Fed funds rate at 3.75% in December 2005F. Such a move would leave the Fed with a nearly 'neutral' stance at the end of 2005F.
- According to our forecasts, the US economy should grow by around 4.4% in 2004E and by some 3.3% in 2005F. Once again, internal demand should trigger this growth, although the external sector's contribution to GDP growth should be neutral in 2004E, after having been clearly negative in recent years. Inventories should also contribute positively (0.3pp) to GDP in 2004E. As a result, domestic final sales should rise 3.9% in 2004E and 3.1% in 2005F. Private domestic final sales are expected to increase 4.3% in 2004E and 3.4% in 2005F.
- In the context of an improving labour market, we expect a deceleration in productivity gains. We estimate productivity will grow by 3.9% in 2004E and by just 1.4% in 2005F. This deceleration should have significant implications for both consumers and companies. So far, productivity gains have only benefited companies, as the lack of job creation and the modest performance of wages and salaries have boosted margins and profits considerably. In our view, a stronger labour market and, consequently, higher wages and salaries will push unit labour costs up. This process should mean better times for consumers (in terms of employment and income) and a worsening picture for companies (with tighter margins).

US Economy, 2001-05F

	2001	2002	2003	2004E	2005F
GDP	0.5	2.2	3.1	4.4	3.3
CPI	2.8	1.6	2.3	2.2	1.9
Unemployment rate	4.8	5.8	6.0	5.6	5.4
Federal government balance	1.3	-1.5	-3.5	-3.4	-3.3
Current account balance	-3.9	-4.6	-5.2	-5.0	-4.7
Federal funds rate	3.73 (1.75)	1.67 (1.25)	1.10 (1.00)	1.35 (2.00)	3.06 (3.75)
10-year Treasury note yield	4.96 (5.05)	4.53 (3.81)	3.99 (4.24)	4.79 (5.20)	5.30 (5.60)
€/ \$ exchange rate	0.89 (0.89)	0.95 (1.05)	1.14 (1.26)	1.18 (1.13)	1.10 (1.12)

All figures are annual averages. Figures in brackets are year-end numbers.

Source: Datastream and Santander Central Hispano Bolsa estimates and forecasts.

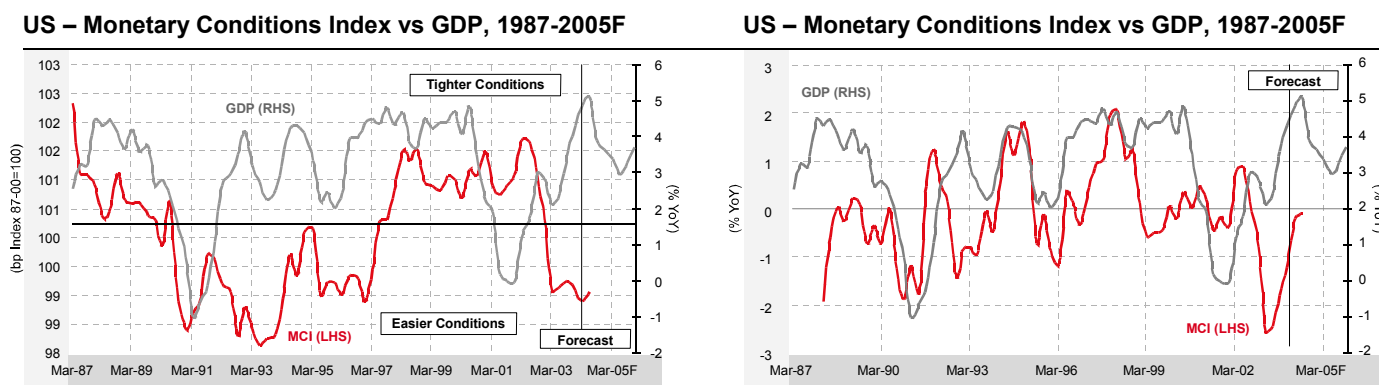
US ECONOMY ON TRACK

The US economy is still immersed in its recovery process. After some doubts about the sustainability of the recovery, we do not see any major clouds on the horizon for the time being. The stimuli introduced in the US economy in recent years are clearly bearing fruit and we could see GDP growth of around 4.4% in 2004E. We expect the US GDP growth rate to slow to 3.3% in 2005F.

STRONG STIMULI STILL PROMOTING GROWTH

Monetary and financial conditions could be tighter in 2H04E

The stimuli introduced in the US economy in recent years has pushed GDP significantly higher to date in 2004. It is worth bearing in mind that Fed funds are at 1.0%, fiscal policy has been very expansionary (with sharp tax cuts implemented in both 2001 and 2003), the trade-weighted dollar index has depreciated, credit spreads are at record low levels and the stock market has performed positively since 2Q03. All of which has clearly been felt in the GDP numbers so far. In our view, however, the economic boost resulting from the easier monetary and financial conditions could moderate in the quarters ahead. The increase in long- and short-term interest rates and wider credit spreads could trigger a tightening in monetary conditions. The effect of stricter monetary and financial conditions, together with a more restrictive fiscal policy, should be felt in 2H04E.



Source: Datastream and Santander Central Hispano Bolsa estimates and forecasts.

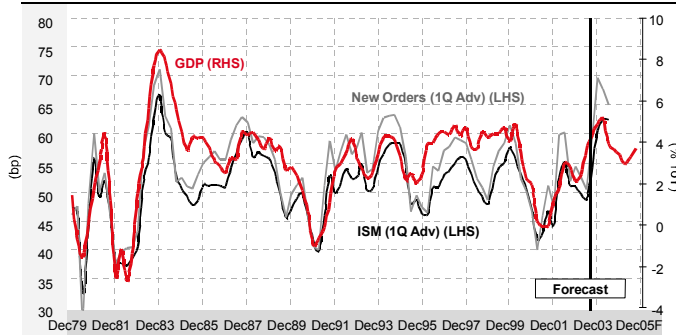
LEADING AND CONFIDENCE INDICATORS REMAIN AT HIGH LEVELS

Leading and confidence indicators point to strong 2Q04E growth

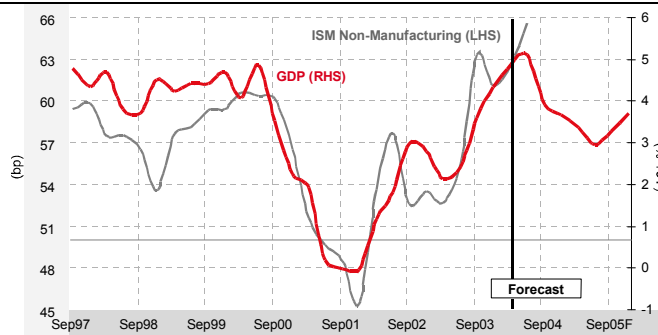
All leading and confidence indicators still point to strong GDP growth in the short run, although some deceleration should be expected in 2H04E. Both the ISM manufacturing and non-manufacturing indices still point to GDP growth of around 4.0% QoQ annualised in 2Q04E. Both indices are at very high levels but, in our view, should show a more moderate performance in the months ahead.



US – ISM Manufacturing Index vs GDP, 1979-2005F



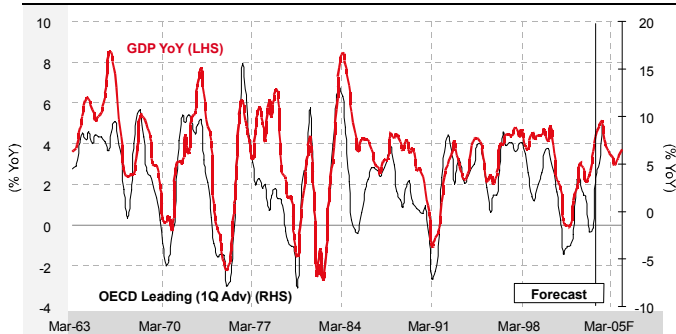
US – ISM Services Index vs GDP, 1997-2005F



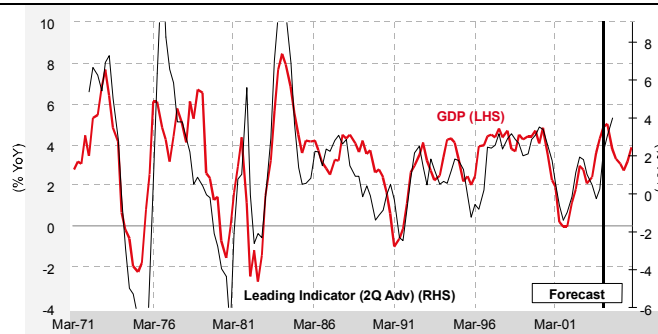
Source: Datastream and Santander Central Hispano Bolsa estimates and forecasts.

Other leading indicators (OECD and Conference Board leading indicators, the Chicago Fed NAI, CB Consumer Confidence) tell the same story: strong growth in the short run and some deceleration in 2H04E. However, it should be noted that none of the indicators point to a contraction in the short run, and the risk could easily be on the upside with 2H04E GDP growth being higher than expected.

US – OECD Leading Indicators vs GDP, 1963-2005F



US – Conference Board Leading Indicators vs GDP, 1971-2005F



Source: Datastream and Santander Central Hispano Bolsa estimates and forecasts.

GDP GROWTH: 4.4% IN 2004E AND 3.3% IN 2005F

Strong 2004E GDP growth driven by firm internal demand

According to our forecasts, the US economy should grow around 4.4% in 2004E, before rising 3.3% in 2005F. The main impetus for growth should come from internal demand, although the external sector's contribution is expected to turn neutral in 2004E, after being clearly negative in past years. Inventories should also contribute positively to growth in 2004E (0.3pp). As a result, domestic final sales should grow 3.9% in 2004E, and 3.1% in 2005F. Private domestic final sales should rise 4.3% in 2004E and 3.4% in 2005F.

US GDP History and Forecast Figures, 2001-05F

		3Q02	4Q02	1Q03	2Q03	3Q03	4Q03	1Q04F	2Q04F	3Q04F	4Q04F	2001	2002	2003	2004F	2005F
Real GDP	QoQ a	3.4	1.3	2.0	3.1	8.2	4.1	4.2	4.0	3.3	3.1					
	YoY	3.0	2.8	2.1	2.4	3.6	4.3	4.9	5.1	3.9	3.7	0.5	2.2	3.1	4.4	3.3
Private consumption (70.1% of GDP)	QoQ a	2.0	2.2	2.5	3.3	6.9	3.2	3.8	2.8	2.6	3.1					
	YoY	3.7	2.7	2.3	2.5	3.7	4.0	4.3	4.2	3.1	3.1	2.5	3.4	3.1	3.6	3.2
Federal government (6.7% of GDP)	QoQ a	4.0	18.2	-0.2	23.4	1.3	0.7	10.1	3.2	4.7	3.8					
	YoY	8.2	10.1	7.9	10.9	10.2	5.9	8.5	3.8	4.6	5.4	3.8	7.9	8.7	5.6	2.6
State and local (10.6% of GDP)	QoQ a	1.7	1.5	-0.5	-0.8	2.0	-0.5	-2.6	0.4	0.8	0.4					
	YoY	2.8	1.6	0.8	0.5	0.5	0.1	-0.5	-0.2	-0.5	-0.3	2.2	1.8	0.5	-0.3	0.7
Business investment (12.0% of GDP)	QoQ a	-1.1	-0.1	-0.6	7.0	12.8	10.9	7.8	7.8	6.1	7.9					
	YoY	-6.4	-2.8	-1.2	1.3	4.6	7.4	9.6	9.8	8.1	7.4	-4.4	-7.1	3.0	8.7	7.6
Structures (2.2% of GDP)	QoQ a	-14.7	-5.5	-4.1	3.9	-1.8	-1.3	-6.6	0.8	2.4	2.8					
	YoY	-22.6	-14.9	-9.8	-5.3	-1.9	-0.9	-1.5	-2.3	-1.2	-0.2	-2.4	-18.4	-4.5	-1.3	3.9
Equip & Software (9.9% of GDP)	QoQ a	3.7	1.7	0.5	8.0	17.6	14.9	11.4	9.5	7.0	9.1					
	YoY	0.1	1.6	1.8	3.4	6.8	10.0	12.9	13.3	10.7	9.2	-5.1	-2.7	5.5	11.5	8.5
Residential inv. (4.4% of GDP)	QoQ a	4.2	6.8	4.6	4.4	21.9	7.9	2.1	2.4	0.8	-3.9					
	YoY	4.7	7.1	6.1	5.0	9.2	9.5	8.8	8.3	3.3	0.3	0.4	4.9	7.4	5.2	-3.6
Inventories	\$ bn	32.8	21.5	1.6	-4.5	-9.1	9.0	15.3	48.0	42.0	35.0					
	Cont. GDP	1.6	-0.4	-0.8	-0.2	-0.2	0.7	0.2	1.2	-0.2	-0.3	-0.9	0.4	-0.1	0.3	-0.1
Exports (11.5% of GDP)	QoQ a	4.3	-3.8	-2.0	-1.1	9.9	20.5	3.2	17.4	21.6	12.6					
	YoY	1.7	3.3	1.7	-0.7	0.6	6.4	7.8	12.6	15.4	13.5	-5.1	-2.2	2.0	12.3	10.0
Imports (15.7% of GDP)	QoQ a	4.1	8.2	-6.8	9.1	0.8	16.4	2.0	14.8	10.0	7.4					
	YoY	6.2	9.4	5.3	3.5	2.6	4.5	6.9	8.3	10.6	8.4	-2.5	3.4	4.0	8.5	5.6
Net external sector	\$ bn	-472	-512	-490	-526	-505	-515	-515	-526	-509	-504					
	Cont. GDP	-0.2	-1.5	0.8	-1.4	0.8	-0.4	0.0	-0.4	0.6	0.2	-0.2	-0.7	-0.4	0.0	0.2
CPI (% YoY)												2.8	1.6	2.3	2.2	1.9
Core CPI (% YoY)												2.7	2.3	1.5	1.6	2.0
Unemployment rate												4.8	5.8	6.0	5.6	5.4
Industrial production (% YoY)												-3.4	-0.6	0.3	5.2	4.6
Productivity (% YoY)												2.3	4.9	4.4	3.9	1.4
Unit labour costs (% YoY)												1.8	-2.5	-1.0	-0.3	1.8
Pretax 'economic' profits (with IVA & Ccadj.) (% YoY)												-5.8	17.4	18.3	17.0	7.7
Budget deficit (% GDP)												1.3	-1.5	-3.5	-3.4	-3.3
Current account (% GDP)												-3.9	-4.6	-5.2	-5.0	-4.7

Note: Cont. GDP= Contribution to GDP. IVA - Inventory valuation adjustment; Ccadj - capital consumption adjustment.
Source: Datastream, Bloomberg and Santander Central Hispano Bolsa estimates and forecasts.

Private Consumption Should Remain Relatively Robust

Private consumption likely to rise, supported by income increases

Private consumption should remain relatively robust in 2004E, decelerating somewhat in 2005F. Our positive opinion regarding private consumption is based on the good performance expected in employment and personal income in the quarters ahead. Our numbers point to personal income increasing by 5.5% in 2004E and 5.8% in 2005F. Disposable income should rise 5.9% in 2004E and 5.7% in 2005F. The income recovery should be triggered by the positive performance of wages and salaries (W&S), which in turn will be boosted by the improvement in the labour market. We expect W&S to increase 5.7% in 2004E and 6.5% in 2005F. In real terms, disposable income should rise 3.8% in 2004E and 3.7% in 2005F.

US – Personal Income Figures, 2003-05F

(QoQa %)	2003				2004E				2005F				Full Year				
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	2001	2002	2003	2004E	2005F
Personal income	3.0	4.4	4.9	4.7	5.6	6.3	5.7	6.6	5.3	4.9	6.1	7.4	2.4	2.4	4.3	6.1	5.9
% change YoY	2.8	2.6	3.5	4.3	4.9	5.4	5.6	6.1	6.0	5.6	5.7	5.9	3.4	2.3	3.3	5.5	5.8
Taxes (\$ bn)	1,009	1,000	939	1,015	988	964	1,046	1,043	1,056	1,069	1,085	1,105	1,244	1,053	991	1,010	1,079
% of personal income	11.2	10.9	10.1	10.8	10.4	10.0	10.7	10.5	10.5	10.5	10.5	10.5	14.3	11.8	10.8	10.4	10.5
Disposable income	5.3	5.4	8.7	1.5	7.7	8.3	2.5	7.5	5.3	4.9	6.1	7.4	3.2	5.5	5.2	6.5	5.9
% change YoY	4.0	3.5	5.4	5.2	5.8	6.5	4.9	6.5	5.9	5.0	6.0	5.9	3.8	5.2	4.5	5.9	5.7
Wage disbursement	2.8	3.1	3.7	3.1	4.8	9.1	8.9	7.8	4.0	5.7	7.2	7.1	0.8	1.3	3.2	7.6	6.0
% change YoY	1.8	2.0	2.8	3.2	3.7	5.2	6.4	7.6	7.4	6.6	6.1	6.0	2.4	0.6	2.4	5.7	6.5
Other personal income	2.6	5.4	5.9	6.5	5.7	2.5	1.2	4.7	6.9	3.5	4.5	7.7	4.3	3.6	5.1	3.5	5.7
% change YoY	3.6	2.9	3.8	5.1	5.9	5.1	3.9	3.5	3.8	4.1	4.9	5.6	4.5	4.0	3.9	4.6	4.6
Savings rate	1.9	2.3	2.4	1.7	1.9	2.6	2.2	2.7	2.6	2.8	3.0	3.3	1.7	2.3	2.1	2.3	2.9
Personal savings (\$ bn)	151	189	199	141	161	228	189	236	238	257	273	308	127	183	170	204	269

Source: Datastream, Bloomberg and Santander Central Hispano Bolsa estimates and forecasts.

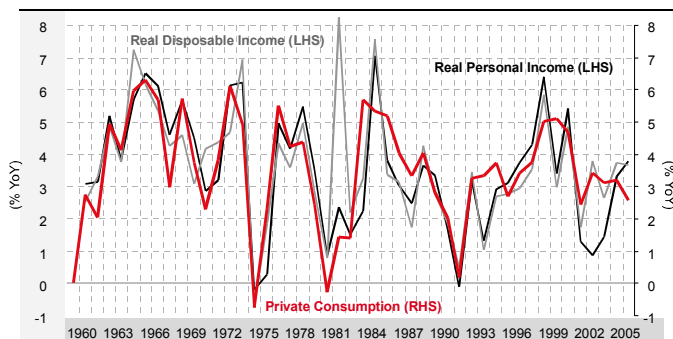


US – Real Personal Income Figures, 2003-05F

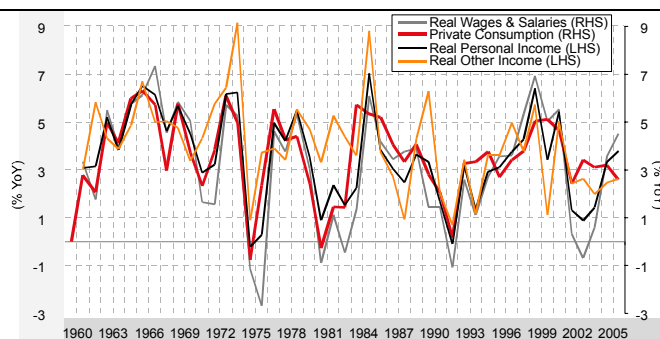
(QoQa %)	2003				2004E				2005F				Full Year				
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	2001	2002	2003	2004E	2005F
Real personal income	0.2	3.8	3.1	3.7	2.4	3.8	3.6	4.0	3.6	3.2	4.0	5.3	0.8	0.6	2.7	3.5	4.0
% change YoY	0.4	0.8	1.8	2.7	3.2	3.2	3.4	3.5	3.8	3.6	3.7	4.0	1.3	0.9	1.4	3.3	3.8
Real disposable income	2.4	4.9	6.8	0.5	4.3	5.7	0.4	5.0	3.6	3.2	4.0	5.3	1.5	3.6	3.7	3.9	4.0
% change YoY	1.6	1.7	3.7	3.6	4.1	4.3	2.7	3.8	3.7	3.1	4.0	4.0	1.8	3.8	2.6	3.8	3.7
Real wage disbursement	0.0	2.6	1.9	2.1	1.5	6.5	6.8	5.2	2.3	4.0	5.1	5.0	-0.9	-0.5	1.6	5.0	4.1
% change YoY	-0.6	0.2	1.1	1.6	2.0	3.0	4.2	5.0	5.2	4.6	4.2	4.1	0.3	-0.7	0.6	3.6	4.5
Real other income	-0.2	4.9	4.0	5.4	2.4	0.1	-0.8	2.2	5.2	1.9	2.4	5.6	2.7	1.7	3.5	1.0	3.8
% change YoY	1.2	1.1	2.1	3.5	4.2	3.0	1.8	1.0	1.6	2.1	2.9	3.8	2.4	2.6	2.0	2.5	2.6
Real savings rate	5.5	5.8	5.8	5.2	5.3	5.9	5.5	5.9	5.8	6.0	6.1	6.3	5.7	6.0	5.5	5.6	6.0
Real personal savings (\$ bn)	418	449	456	407	422	481	442	482	482	497	510	539	416	456	433	457	507

Source: Datastream, Bloomberg and Santander Central Hispano Bolsa estimates and forecasts.

US – Real Personal Income, Disposable Income vs Private Consumption, 1960-2005F



US – Real Personal Income, Other Income and W&S vs Private Consumption, 1960-2005F

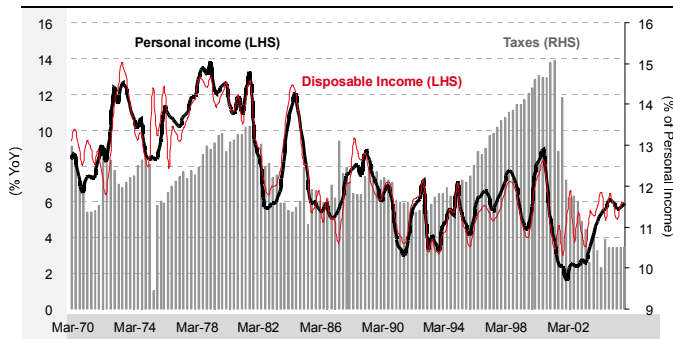


Source: Bloomberg, Datastream and Santander Central Hispano Bolsa estimates and forecasts.

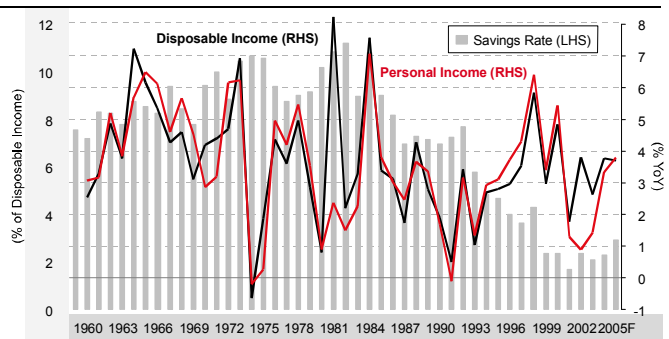
Income and spending gains could lead to a rise in savings

These increases in income and spending could lead to a slight recovery in the savings rate, which we expect to be at 2.3% in 2004E and at 2.9% in 2005F, versus 2.1% in 2003. The impetus for a rise in the savings rate could come from the imbalances still present in households' balance sheets – current levels of net wealth are too low in comparison with the savings rate. We believe that, despite the possibility of seeing an improvement in net wealth through higher values of financial assets and lower increases in liabilities, households will still have to increase savings to close the gap.

US – Personal Income, Disposable Income and Taxes, 1970-2005F



US – Personal Income, Disposable Income and Savings Rate, 1960-2005F



Source: Bloomberg, Datastream, and Santander Central Hispano Bolsa estimates and forecasts.

Business Investment Likely to Surprise on the Upside

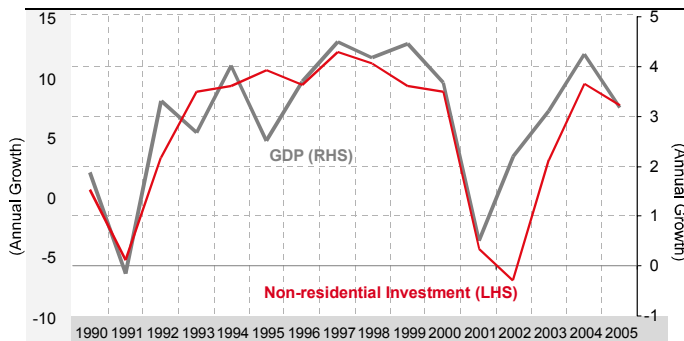
Business investment is likely to rise in 2004E and 2005F

After some years of very negative figures in business investment, we expect a recovery in 2004E. The period of adjustment in the US business structure, initiated by companies due to the supply-side recession of 2001, should be more or less completed during 2004E and 2005F.

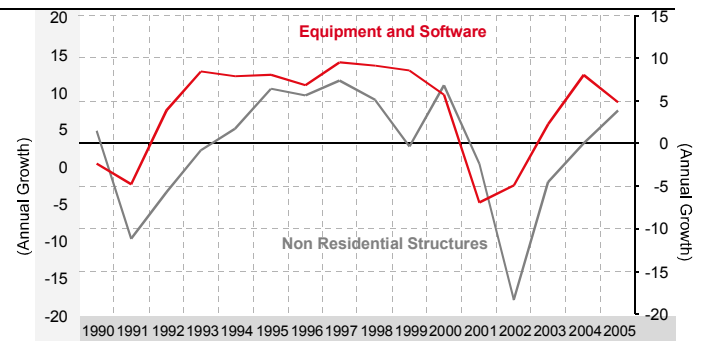
E&S and non-residential structure investment should be positive in 2004E and 2005F

According to our numbers, business investments in the US should rise by around 9.0% in 2004E and 7.6% in 2005F, driven mainly by a strong performance in the equipment and software (E&S) component, for which we expect an increase of 11.5% in 2004E and 8.5% in 2005F. Investment in non-residential structures should remain negative in 2004E (-1.3%), although we expect an increase of 3.9% in 2005F.

US – Business Investment vs GDP, 1990-2005F



US – Business Investment in E&S and Structures, 1990-05F



Source: Datastream and Santander Central Hispano Bolsa estimates and forecasts.

According to our models, all drivers of business investment are pointing to further gains in the quarters ahead. If we look at production, capacity, interest rates and profits, we can conclude that all the conditions needed for a recovery in investments are already in place. (For more information see the *Iberian Macro Observer, Macro Corner* published on April 26).

However, we expect a deterioration in residential investment due to the increase in long-term interest rates. This deterioration should become evident in 2005F, when we expect residential investment to fall 3.6%.

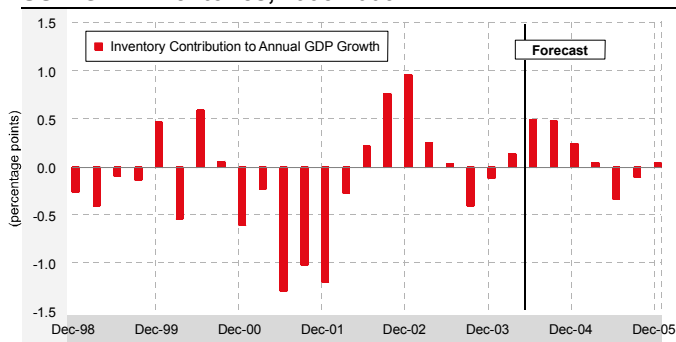
Rebuilding Inventories Should Continue in the Short Run

Business inventories should support growth in 2004E

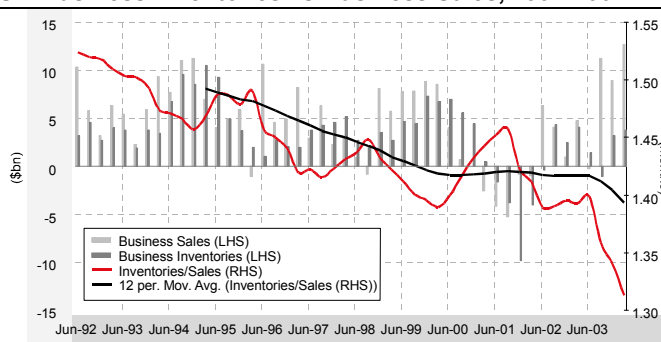
We expect inventories to contribute positively to GDP growth in 2004E (adding 0.3pp) but then to have a negative impact in 2005F (-0.1pp). We expect a positive contribution in the short run because the supply side of the economy clearly lags demand. Sales and consumption are rising considerably, absorbing practically all production. The result would be a decline in the inventory-to-sales ratio. In our view, that should push companies to increase business inventories in the short run to reach more 'normal' levels in relation to current demand.



US – GDP Inventories, 1998-2005F



US – Business Inventories vs Business Sales, 1992-2004E

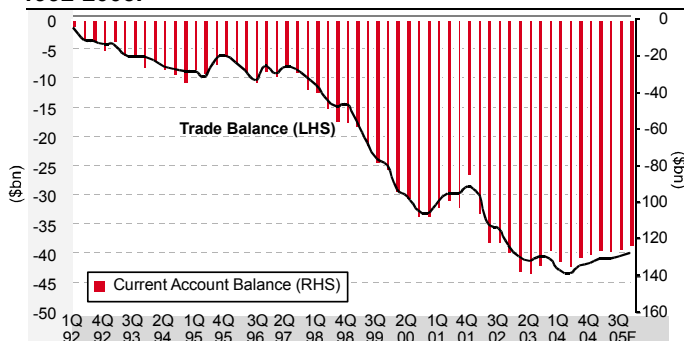


Source: Datastream and Santander Central Hispano Bolsa estimates and forecasts.

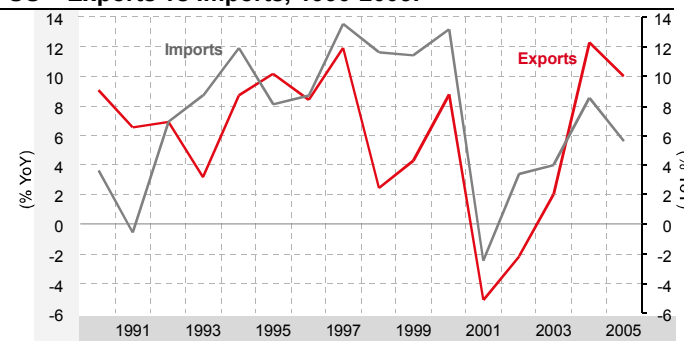
External Sector Improvement Should Be Driven by Exports

The US external sector should benefit from the improvement in world trade activity, global GDP growth and a weaker currency. We see an improvement coming from a significant increase in exports, which are expected to go up 12.3% in 2004E and 10.0% in 2005F. Imports should rise 8.5% in 2004E and 5.6% in 2005F. The contribution of the external sector to GDP will likely be neutral in 2004E (0.0pp) and positive in 2005F (0.3pp).

US – Net Exports vs Current Account Balance, 1992-2005F



US – Exports vs Imports, 1990-2005F



Source: Bloomberg and Santander Central Hispano Bolsa estimates and forecasts.

The improvement of net exports should help to reduce the current account deficit to 5.0% of GDP in 2004E and to 4.7% of GDP in 2005F.

PRODUCTIVITY, EMPLOYMENT AND UNIT LABOUR COSTS ARE THE KEY

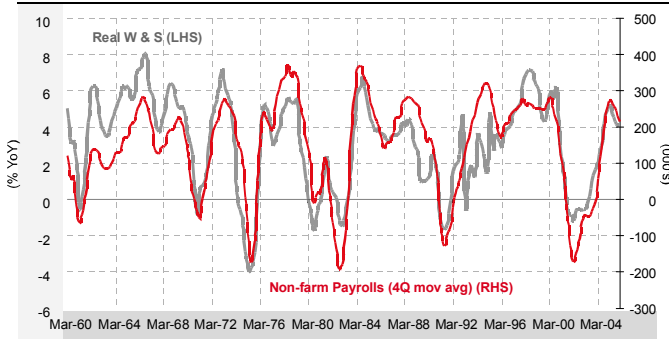
Getting ready for balanced GDP growth in the future

As mentioned above, we expect the US economy to continue to post relatively strong GDP growth in both 2004E and 2005F, anticipating a continuation of the growth cycle in the years ahead (2006F, 2007F, etc). We are expecting a balanced recovery, that is, a growth period in which practically all economic agents have a stable balance sheet and can sustain a prolonged period of GDP growth in the coming years without significant risks.

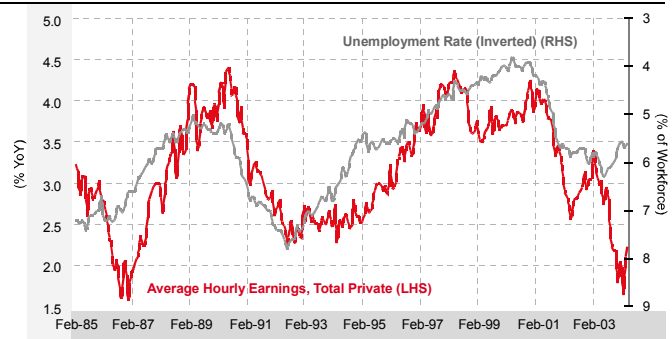
In the consumer sector: Rising W&S may keep consumption high

For consumers, the strengthening labour market (boosted by firm industrial production) should push up personal income through higher W&S. We expect industrial production to rise 5.2% in 2004E and 4.6% in 2005F. The rise in W&S should allow consumers to maintain, or even boost, current private consumption levels without help from tax cuts, mortgage refinancing or increased liabilities.

US – Real Wages and Salaries vs Non-Farm Payrolls, 1960-2005F



US – Average Hourly Earnings vs Unemployment Rate, 1960-2004F

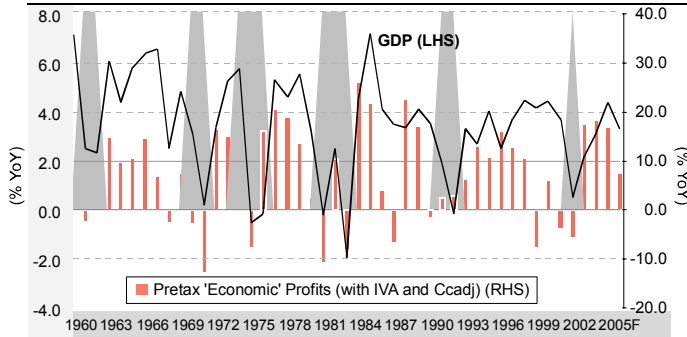


Source: Bloomberg, Datastream, and Santander Central Hispano Bolsa estimates and forecasts.

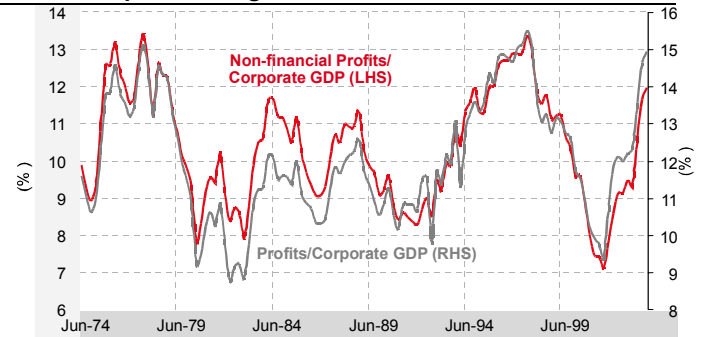
In the business sector: companies enjoy wide margins

In the business sector, we still expect positive news on profits in 2004E and 2005F thanks to sharply higher margins following the corporate restructuring carried out in recent years. We are forecasting an increase in pre-tax ‘economic’ profits of 17.0% in 2004E and 7.7% in 2005F.

US – Pre-tax ‘Economic’ Profits (with IVA & Ccadj) vs GDP, 1960-2005F



US – Corporate Margins, 1974-2003

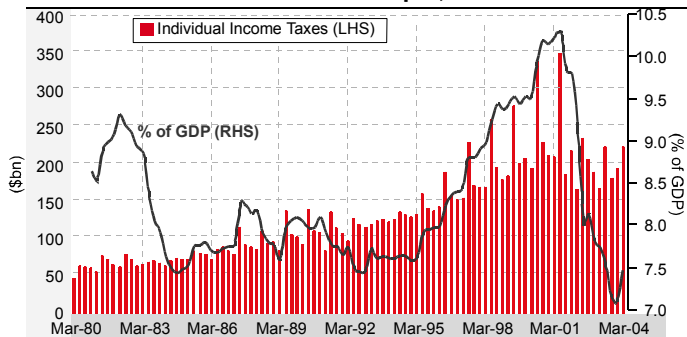


Note: IVA - Inventory valuation adjustment; Ccadj - capital consumption adjustment. Shaded areas correspond to recession periods. Source: Datastream and Santander Central Hispano Bolsa estimates and forecasts.

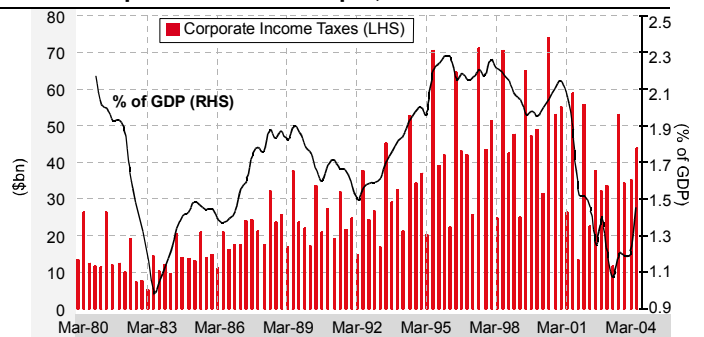
In the public sector: the stronger economy should lift tax collections

We expect the public sector budget deficit to narrow in 2004E and 2005F compared with 2003. We see a deficit of 3.4% of GDP in 2004E and 3.1% of GDP in 2005F. The main driver of the improvement should be an increase in collections. In 1Q04, receipts rose to 16.4% of GDP from 15.9% in 4Q03 (the lowest level since 1975). Moreover, the improvement in collections should come from both individual income and corporate taxes. Receipts from individual income taxes rose to 7.5% of GDP in 1Q04 from 7.1% in 4Q03. Corporation receipts are up to 1.5% of GDP in 1Q04 from 1.2% in the previous quarter. We think government accounts should soon begin to reflect the end of the temporary tax cuts and the increase in collections.

US – Individual Income Tax Receipts, 1980-2004



US – Corporation Tax Receipts, 1980-2004



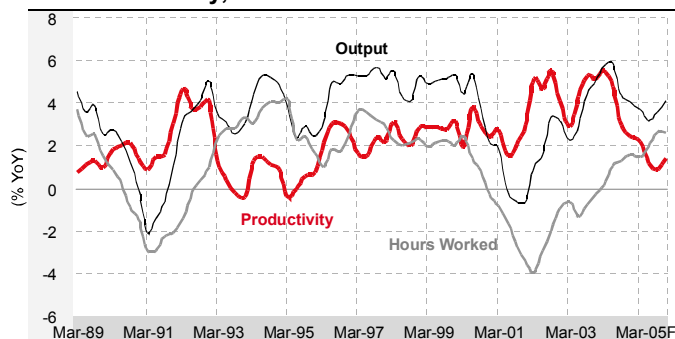
Source: Datastream and Santander Central Hispano Bolsa.



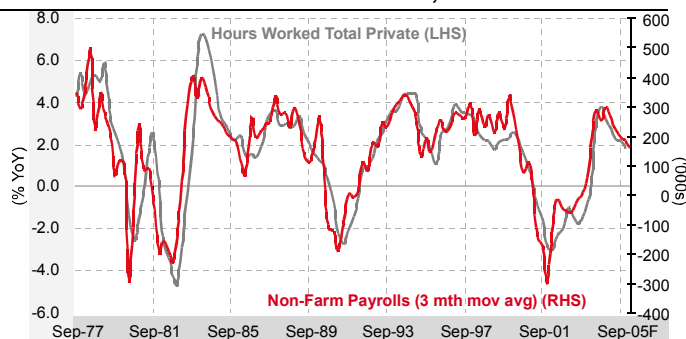
Productivity gains likely to slow in the future

As the labour market improves, we expect to see a deceleration in productivity growth, which should become evident in 2005F. We think productivity will rise 3.9% in 2004E and just 1.4% in 2005F. To understand why productivity would experience such low growth in 2005F, it is worth looking at the productivity levels reached in 2002 (+4.9%) and 2003 (+4.4%). If we take into account that the economy grew just 2.2% and 3.1% in 2002 and 2003, respectively, we can see that the strong productivity gains were mainly driven by job destruction. In our view, these productivity levels are unsustainable in the medium term. In the years ahead, the economy should grow in a more balanced way – driven by stronger employment creation and slower productivity growth (more in line with the long term potential 2.5%-3.0%).

US – Productivity, 1989-2005F



US – Hours Worked vs Job Creation, 1977-2005F

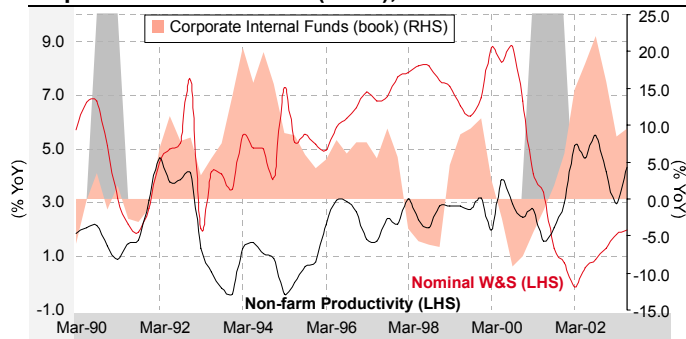


Source: Datastream and Santander Central Hispano Bolsa estimates and forecasts.

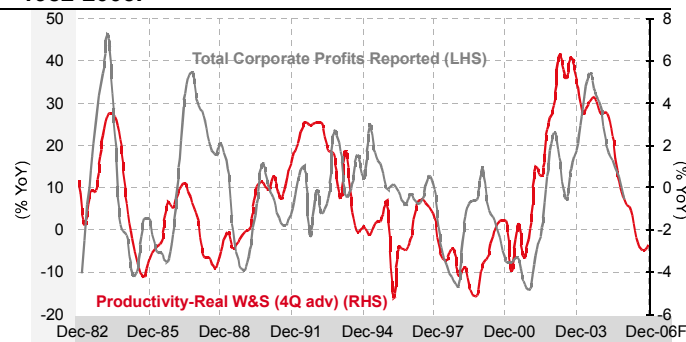
Productivity may start benefiting consumers, not companies

The reduced productivity gains due to an improvement in the labour market will have significant implications for both consumers and companies. Up to now, productivity gains have exclusively benefited companies. The lack of job creation and consequently, the modest performance of W&S have allowed margins and profits to rise sharply. Corporate margins grew around 20% YoY in 4Q03, while profits grew 17.4% in 2002 and 18.3% in 2003. At the same time, W&S advanced just 0.6% in 2002 and 2.4% in 2003. For 2004E and 2005F, we expect a clear change: W&S should rise 5.7% in 2004E and 6.5% in 2005F, while corporate profits should grow 17.0% in 2004E and 7.7% in 2005F.

US – Productivity vs Nominal W&S and Corporate Internal Funds (book), 1990-2003



US – Productivity vs Real W&S and Corporate Profits, 1982-2005F

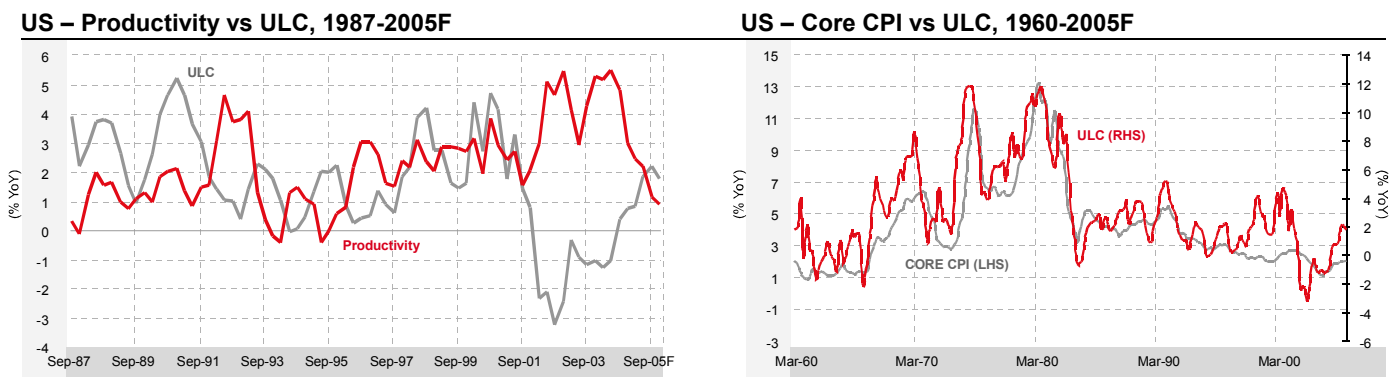


Note: Shaded areas correspond to recession periods.

Source: Federal Reserve, Datastream, NBER and Santander Central Hispano Bolsa estimates and forecasts.

Unit labour costs expected to rise

With productivity rocketing and job creation virtually dead, unit labour costs (ULC) have been in negative territory in the past two years (-2.5% in 2002 and -1.0% in 2003), which contributed to increasing corporate margins and keeping inflationary pressures under control. The recovery of the labour market and the expected increase in W&S should push ULC higher (through both lower productivity and higher hourly compensation). That process should mean better times for consumers (in terms of employment and income) and harder times for companies (with margins narrowing). Moreover, although the worst of the adjustment is expected to be felt by companies, we believe that this situation will be transitory since lower profit growth levels in 2005F should lead to higher and better quality profits in 2006F. The restructured companies should be better adjusted (with still relatively high margins), while growth should come from the top line of the P&L account, due to higher final demand.



Source: Datastream and Santander Central Hispano Bolsa estimates and forecasts.

INTEREST RATES AND CURRENCIES

Fed to Start Raising Rates in June

In November 2003 we saw many reasons for the Fed to hold rates until Jan 2005

Since November 2003, we have held the view that the Federal Reserve would not raise interest rates until January 2005F. Our forecast was based on the belief that: (1) there was significant slack in the economy; (2) structural inflationary pressures were inexistent; (3) consumers still had to redress their balance sheets; (4) it was the best way to control a possible sharp increase in long-term interest rates; and (5) the risks from raising interest rates sooner than necessary were higher than the possible problems created from being behind the curve. Moreover, we believed the government elections scheduled for November were likely to delay any decision on monetary policy.

Recent economic data and Fed's comments point to an immediate rate hike

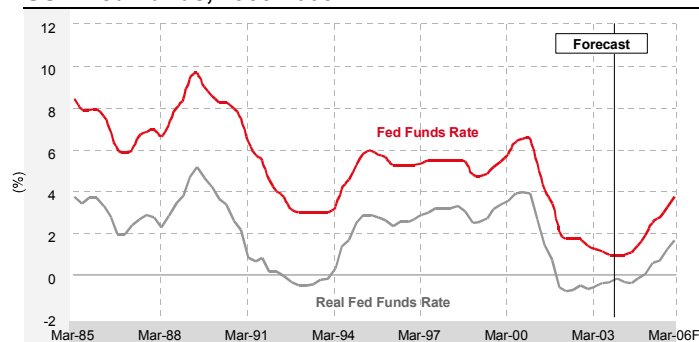
Since then, the Eurodollar market has priced in several rises in Fed funds, sparked mostly by the release of a single monthly economic indicator. Up until now, we had not found any significant reasons (supported by macro economic data) to change our view. However, the release of the last two months' employment figures, and the upward revision of the previous employment data have led us to change our forecasts. Based on the higher-than-expected employment numbers (non-farm payrolls have gone up 217k per month on average in the first four months of 2004), we now believe that the normalisation process of the economy is likely to consolidate. The higher employment levels should lead to higher ULC, which could result in a build-up of inflationary pressures in the years ahead. We believe the Fed will have to raise interest rates sooner rather than later.

100bp in 2004E and 175bp more in 2005F

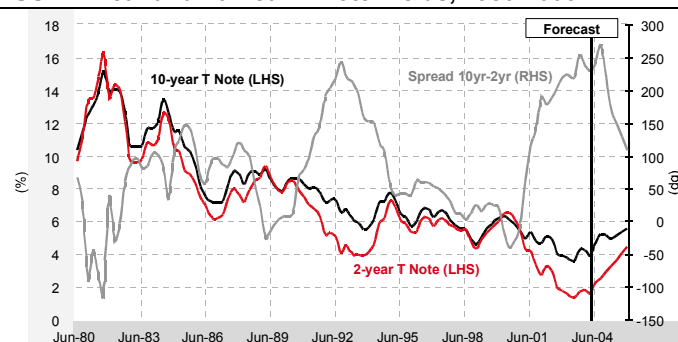
We believe the Fed will begin hiking rates in June 2004. We now expect it to lift rates by 100bp in 2004E and by another 175bp in 2005F, leaving the Fed funds rate at 3.75% in December 2005F. Such a move would leave the Fed with a nearly 'neutral' stance at the end of 2005F, with real Fed funds at 1.68% from -0.36% in 2Q04E.



US – Fed Funds, 1985-2005F



US – 2-Year and 10-Year T-Note Yields, 1980-2005F



Source: Datastream and Santander Central Hispano Bolsa estimates and forecasts.

US – Interest Rates and Exchange Rate Forecasts, 2001-05F

	2001	2002	2003	2004E	2005F
Fed funds rate	3.73 (1.75)	1.67 (1.25)	1.10 (1.00)	1.35 (2.00)	3.06 (3.75)
3-month T-bill yield	3.54 (1.79)	1.72 (1.29)	1.14 (1.09)	1.53 (2.30)	3.38 (4.00)
2-year Treasury note yield	3.70 (3.03)	2.55 (1.60)	1.64 (1.82)	2.39 (3.00)	3.90 (4.50)
10-year Treasury note yield	4.96 (5.05)	4.53 (3.81)	3.99 (4.24)	4.79 (5.20)	5.30 (5.60)
€/ \$ exchange rate	0.89 (0.89)	0.95 (1.05)	1.14 (1.26)	1.18 (1.13)	1.10 (1.12)

Note: All figures are annual averages. Figures in parentheses are year-end.
Source: Datastream and Santander Central Hispano Bolsa estimates and forecasts.

US – Interest Rates and Exchange Rate Forecasts, 2003-05F

	1Q03	2Q03	3Q03	4Q03	1Q04	2Q04E	3Q04E	4Q04E	1Q05F	2Q05F	3Q05F	4Q05F
Fed funds rate	1.25	1.17	1.00	1.00	1.00	1.08	1.42	1.92	2.50	2.75	3.25	3.75
3-month T-bill yield	1.24	1.15	1.08	1.11	1.06	1.11	1.65	2.30	2.80	3.10	3.65	4.00
2-year Treasury note yield	1.56	1.37	1.72	1.89	1.68	2.32	2.55	3.00	3.30	3.70	4.10	4.50
10-year Treasury note yield	3.82	3.57	4.27	4.29	3.98	4.72	5.25	5.20	5.00	5.20	5.42	5.60
€/ \$ exchange rate	1.08	1.15	1.13	1.20	1.24	1.20	1.14	1.13	1.10	1.07	1.10	1.12

Note: All figures are quarterly averages
Source: Datastream and Santander Central Hispano Bolsa estimates and forecasts.

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Key to Investment Codes¹

Buy	Upside of more than 20%.
Hold	Upside of 15%-20%.
Underweight	Upside of less than 15%.

(1) Target prices set from January to June are for December 31 of the current year. Target prices set from July to December are for December 31 of the following year.

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