

UBS Investment Research
The Morning Adviser
Crunch Talks Begin

5 December 2011

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- The week ahead is now shaping up to be the most important of the year. All eyes will be on the Eurozone as **European Leaders meet on Thursday and Friday for a make-or-break summit**. True, it seems that the market has been here before, only to be disappointed at every single turn, but the vibes from Berlin and Frankfurt suggest that the political establishment and the European Central Bank have now reached an understanding on what needs to be done. Perhaps more importantly, the leaders now recognize what is at stake, for the rhetoric on Eurozone breakup by the most pro-European of leaders are now at levels which would have been unthinkable previously. Markets have already rallied in anticipation of good news, and the process has also enjoyed some help from firm data outside of the Eurozone. Friday's payrolls number may have registered a somewhat disappointing headline print at 120k, but the dip in the unemployment rate to 8.6% is welcome news. In addition, the world's other central banks are set to calibrate policy ahead of what may prove to be a challenging 2012. **The ECB will take centre stage of course, but the BoE, BoC, RBA and RBNZ will all be deciding this week**. The **ECB and RBA are expected to deliver rate cuts**, but the pressure to adopt fresh stimulus measures would perhaps be less pressing should the Eurozone's decisions surprise to the upside. **The market may choose to square some positioning in risk ahead of the crunch talks, but the headline risk is also clearly to the positive side and the current squeeze may yet find legs for a few days**. The wires will be filled from Monday as Sarkozy and Merkel meet in Paris to deliver the blueprint for Friday's talks. We remain cautious on the Euro's performance, even if the officials deliver. **Growth next year will underwhelm, and a weaker euro needs to be part of the solution to the currency union's problems as growth drivers remain lacking**.

Key Events

5 December 2011				Source: UBS Global Economics			
Country	GMT	Release/Event	Frequency	UBS	Prev/Revised	Consensus	Actual
Germany	08:55	PMI Services (Nov F)	index	51.4	51.4	51.4	
Euro Area	09:00	PMI Composite (Nov F)	index	47.2	47.2	47.2	
Euro Area		Merkel, Sarkozy meet in Paris					
Euro Area	10:00	Euro-Zone Retail Sales (Oct)	y-o-y	n/a	-1.40%	-0.80%	
Sweden	12:00	Riksbank's Stefan Ingves					
United States	15:00	ISM Non-Manf. Composite (Nov)	index	n/a	52.9	53.5	

Source: Bloomberg, UBS Economics

Research Spotlight
Cheaper Funding Boosts Euro
UBS FX Strategy

- In a surprise but much-needed move, the ECB - in coordination with the Fed, Bank of Canada, BoJ, BoE and SNB - Wednesday cut the cost of its temporary dollar liquidity swaps from OIS + 100bp to OIS + 50bp. Risk, and EURUSD, surged sharply in response. The measures are a shot in the arm for stressed banks, but do nothing for the sovereigns which remain the source of market tension. Now that central banks have acted, the pressure will be on Eurozone governments to act in turn on Dec. 9. For further details, please see "Cheaper Funding Boosts Euro" on www.ubs.com/fxweb.

EUR	Targets: EURUSD 1m 1.35, 3m 1.30
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- German Chancellor Angela Merkel pledged to work towards fiscal union, one which is legally enforceable. Headlines over the past few days suggest that plans are taking shape to set the wheels in motion at Friday's Eurozone summit. However, Merkel has also rejected quick fixes to the current problems, and the ECB will unlikely increase their firepower unless they see structural solutions put in place.
- European Economics Commissioner Rehn warned that "This week, the stable future of the euro and thus the economic recovery in Europe and employment are at stake". He called for a 'convincing' package to come into force at the upcoming summit. He previously warned that time was running to save the euro.
- ECB President Draghi told the European Parliament that a 'fiscal compact' was needed for the Eurozone to regain credibility in markets. He said that 'countries are on the right track to reform but a credible message is needed now'. It is widely assumed that Draghi will be more open to stronger asset purchases once such a 'compact' can be reached.
- According to the Financial Times, the ECB is expected to step up in its response to the crisis by helping the banking sector. This may come in the form of longer refinancing operations, but this does not mean that the ECB will increase its bond purchases.
- German Chancellor Merkel and French President Sarkozy are set to meet on Monday to decide on further Eurozone integration. This would mark the beginning of a week of talks leading up to the European Union Summit on Friday where concrete proposals are expected towards fiscal union. Bond markets have rallied in the hope of agreements but we note that headline risk remains strong.
- We expect the ECB to remain on hold this week, though the market expects a 25bp cut. However, we have cut our 2012 GDP forecasts aggressively and expect another policy move in the first quarter of next year. Otherwise on the data front, Eurozone composite PMI and Eurozone retail sales are due.

GBP	Targets: GBPUSD 1m 1.55, 3m 1.50
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- The Bank of England will decide on policy this week. We expect no change in the asset purchase programme though developments in the Eurozone will have a greater bearing on the UK's domestic conditions, from macro to financial stability.
- UK services PMI is due on Monday, we expect a 51.8 print (cons. 50.5).

CAD	Targets: USDCAD 1m 1.00, 3m 1.05
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- Canadian payrolls came in far weaker than expectations again at -19k, vs. expectations for a 20k rise. However, the breakdown was more favourable than last months' as full time jobs increased by 35k, though this was offset by a 53k drop in part-time numbers.
- The Bank of Canada will decide on policy on Tuesday. Our economists believe the Bank will leave the overnight rate target unchanged at 1.00%. Despite Q3 domestic economic growth which exceeded the Bank's projections (from October Monetary Policy Report), concern has increased regarding the economic outlook due to external factors, primarily potential fallout from the European sovereign debt crisis.

Technical Analysis

EURGBP 0.8620 resistance

EURUSD	BEARISH	Near-term support lies at 1.3417 ahead of 1.3259. Resistance is at 1.3607.
USDJPY	BULLISH	Resistance is at 78.29 ahead of 78.83. Support lies at 77.30.
GBPUSD	BEARISH	Move below 1.5637 would expose 1.5526 next. Resistance is at 1.5795.
USDCHEF	BULLISH	Initial resistance is at 0.9252, a clearance of which would expose 0.9331. Support lies at 0.9066.
AUDUSD	NEUTRAL	Focus is on 1.0337, a break of which would expose 1.0447 while support lies at 1.0151 ahead of 1.0000.
USDCAD	BEARISH	Initial support lies at 1.0055 ahead of 0.9975. Resistance is at 1.0223.
EURCHF	NEUTRAL	Trend is sideways; the near-term directional triggers are at 1.2474 and 1.2131.
EURGBP	BEARISH	Decline through 0.8558 would expose the key support of 0.8519. Key resistance is at 0.8620.
EURJPY	NEUTRAL	Resistance is at 105.97 ahead of 106.74 while support lies at 104.21 ahead of 103.34.

***NOTE:** The trend for each currency pair as defined in the table is determined by our proprietary model and is independent of our discretionary interpretation of price action

Source: FX Technical Strategy

Key Events

5 December 2011				Source: UBS Global Economics			
Country	GMT	Release/Event	Frequency	UBS	Prev/Revised	Consensus	Actual
Australia	22:30	AiG Performance of Service Index (Nov)	index	n/a	48.8	n/a	
Australia	23:30	TD Securities Inflation (Nov)	m-o-m	n/a	0.10%	n/a	
Australia	23:30	TD Securities Inflation (Nov)	y-o-y	n/a	2.60%	n/a	
Australia	00:30	Company Operating Profit (Q3)	q-o-q	0.00%	6.70%	3.00%	
Australia	00:30	ANZ Job Advertisements (Nov)	m-o-m	n/a	-0.70%	n/a	
China	02:30	China Services PMI (Nov)	index	n/a	54.1	n/a	
Germany	08:55	PMI Services (Nov F)	index	51.4	51.4	51.4	
Euro Area	09:00	PMI Composite (Nov F)	index	47.2	47.2	47.2	
Euro Area	09:00	PMI Services (Nov F)	index	47.8	47.8	47.8	
Euro Area	09:30	Sentix Investor Confidence (Dec)	index	n/a	-21.2	-22.0	
UK	09:30	PMI Services (Nov)	index	51.8	51.3	50.5	
Euro Area	10:00	Euro-Zone Retail Sales (Oct)	m-o-m	n/a	-0.60%	0.10%	
Euro Area	10:00	Euro-Zone Retail Sales (Oct)	y-o-y	n/a	-1.40%	-0.80%	
Sweden	12:00	Riksbank's Stefan Ingves					
United States	15:00	ISM Non-Manf. Composite (Nov)	index	n/a	52.9	53.5	
United States	15:00	Factory Orders (Oct)	m-o-m	n/a	0.30%	-0.30%	
United States	17:10	Fed's Evans Speaks					
UK		Halifax House Price (Nov)	3M/year	-0.70%	-1.80%	n/a	
UK		Halifax House Prices sa (Nov)	m-o-m	0.00%	1.20%	n/a	

Source: Bloomberg, UBS Economics