

## UBS Investment Research

### The Morning Adviser

## Views

Singapore, 31 October 2007

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## G10

### USD: Focus is on the FOMC statement

The US dollar weakened against most currencies bar the yen and the NZD, as soft consumer confidence took its toll. EURUSD traded up to a high of 1.4442 from a European session low of 1.4374, while USDJPY traded between 114.38 and 115.03. The S&P 500 finished 0.6% lower, but was already down heading into the consumer confidence data, while commodities took a beating, with oil in particular down US\$4/bbl. The Vix index climbed up to 21.1 from 19.9 on Monday, while 2-year Treasury yields actually rose by 1bp. The market does not seem overly concerned about the consumer confidence data, at least on the rates side, and indeed the OIS rates have removed any chance of a 50bp rate cut at tonight's meeting following Greg Ip's article in the Wall St Journal earlier in the week. Still, a rate cut today is being treated as a foregone conclusion and so the emphasis will be on the statement and whether it limits the prospects for future rate cuts. The FOMC statement at the September meeting was deliberately vague given the uncertainty at the time, and we suspect they will be similarly vague today regarding their intentions going forward. Tonight, we also get an update on the Chicago PMI, which captures the growth outlook for the manufacturing sector. Manufacturing has been one of the firmer spots in the US economy and any weakness on this front would confirm in investor minds that the US is slipping into a sharp slowdown, if not an all-out recession. Against this backdrop, expectations on Chinese growth and inflationary pressures remain strong and hence speculative flows into CNY remain high, which in turn are likely being diverted to the euro and other non-USD major currencies via subsequent diversification activity. Hence, the outlook for CNY is important for EURUSD. If China were to suddenly revalue such that spec inflows died, then the EUR rally would quickly reverse as official purchases subside. We remain neutral on the US dollar over a 1-month horizon, but do see some prospect for the US dollar to stage a relief rally on a 3-month basis.

### JPY: BoJ board meeting due today

The BoJ board concludes its board meeting today and is expected to keep rates on hold, with a decision typically announced around 0400 GMT. The BoJ also releases its semi-annual outlook at 0600 GMT and is expected to cut its growth and inflation forecasts, while stressing downside risks. The BoJ outlook remains contained and an indirect function of the US economic particularly while domestic growth remains subdued. In that context then, USDJPY is finding it difficult to shift more decisively lower despite the broad-based weakness in the US dollar. However, we think a reduced liquidity environment should keep volatility relatively high and support the safe-haven currency. As such we

target USDJPY at 115 over 1 month and 112 over 3 months.

#### EUR: German employment due

The recent gains of the EUR are leaving many wondering just where the “pain threshold” for European industrials actually stands at this stage. A European business lobby mentioned 1.40 at the beginning of the month, but even greater currency distortion in many Asian currencies against the EUR have allowed the ECB to focus less on specific rates at this stage. Nevertheless, business sentiment is being damaged by a variety of factors, including slow US demand and the strong currency. Hence, we expect the ECB to move towards a more accommodative posture at its November 8 meeting. It is still too soon to expect any sign of an easing bias and tomorrow’s CPI release is actually likely to show headline inflation up slightly for the month of October. On the data front today, German unemployment decreased by 40k, while the unemployment rate ticked down slightly from 8.8% in September to 8.7% in October, in line with expectations. We expect the EUR to remain stable in the short term but expect deteriorating economic and rate sentiment to be damaging in the medium term.

#### SEK: Riksbank hikes

The Riksbank raised the repo rate by 25bp to 4.00% on Tuesday, as expected. The central bank also issued its third and final Monetary Policy Report for the year. The MPR was expected to reflect recent financial market turmoil. However, the report surprised to the upside as the Riksbank’s interest rate outlook remains essentially unchanged. The central bank calls for rates to reach 4.25% in 1H08, in line with current market expectations. With regard to growth, the Riksbank revised its forecast downwards, forecasting a 2.8% y/y increase in 2008 (down from 3% previously), while their 2007 and 2009 forecasts remained unchanged. On the whole, the Riksbank does not appear to have taken lightly threats to global growth. Rather, the central bank expects recent events to somewhat dampen growth in coming quarters. The SEK edged higher across the board upon the release. The SEK also received a boost from stronger than expected retail sales which increased 2.6% m/m in September, well above the consensus estimate of 0.9% m/m. We maintain our 1- and 3-month EURSEK forecasts of 9.15 and continue to look for the NOKSEK cross to move southwards from current levels.

#### CAD: Industrial product prices decline

Canada’s industrial product prices registered a fifth consecutive monthly decrease in September, falling 0.9% m/m, worse than expected. The drop in the IPPI reflected a decrease in prices for motor vehicles, primary metal products, and pulp and paper products, only slightly offset by a jump in petroleum and coal prices. As expected, the monthly decline in industrial product prices largely reflected the appreciation in the Canadian dollar. Statistics Canada notes that excluding the monthly rise in the CAD, the IPPI would have been unchanged in September. Our economists forecast no change to the overnight rate of 4.50% for the remainder of the year. Our 1- and 3-month USDCAD forecasts are 0.96 and 1.00, respectively.

## Emerging FX

#### INR: RBI still focused on inflation

The RBI kept interest rates unchanged at Tuesday’s mid-term monetary policy review, while maintaining its view that the threat of inflation remains dominant and sounding sanguine on growth. However, we see limited INR upside for the short term, although we remain bullish in the medium term. The RBI hiked the cash reserve ratio by 50bp to 7.50%, reflecting its need to absorb some of its recent large intervention in the FX market. We estimate the RBI bought more than US\$16bn in September – the highest on record for a single month – to prevent the INR from strengthening. The RBI kept a growth forecast of 8.5% for 2007/08 but noted that money supply is a lingering concern given strong capital inflows, even as it maintained a target of 5% inflation this fiscal year and 3.0% in the medium term. We believe the government and RBI are cognisant of the squeeze on exporters from the rupee’s 10% appreciation against the USD year-to-date. Anecdotally, we think exporters of lower valued-added goods, such as textiles, are struggling in the face of the stronger INR. This is a separate concern to the positive outlook for the broader economy, especially if one considers that an election will have to be called within the next 18 months. The fall in WPI from a high of 6.7% earlier this year to 3.0% in recent weeks should give the RBI significant room to intervene and keep the INR on a short leash for now, with

more CRR hikes likely on top of the higher limit on MSS issuance to mop up the liquidity intervention would introduce. We would maintain a bullish medium-term view of the INR. M3 growth is currently already above the 17.5% RBI target while inflation is likely to head higher again in Q2 2008 when the high base effects, which have helped to keep headline inflation low, end. With inflows likely to remain strong, we expect the RBI to tolerate a gradually stronger INR to 37.00 vs the USD by end-2008.

#### SKK: Rates unchanged as expected

Yesterday, the NBS MPC voted unanimously to leave the repo rate unchanged. The committee pointed to a lack of demand-side pressures in coming to the rate decision, which was widely expected. The overall tone of comments from central bank governor Ivan Sramko was quite balanced. He viewed the currency as having provided restrictive monetary conditions, which he saw as still in play due to the significant appreciation of the exchange rate in the first quarter. However this impact is expected to diminish gradually as the exchange rate “stabilises”. The bank also said that the economy was not overheating because its dynamic growth was due to an increase in productivity. Wage growth remains moderate and credit growth dynamics are slowing down. Inflation is expected to meet Maastricht criteria in 2007 and 2008 (relative to the reference rate), with upside risks presented by energy prices. We remain bullish on the SKK.

#### BRL: Some caution warranted

On Tuesday, BRL price action was somewhat obscured by the traditional pressure from the month-end PTAX fix, most likely motivated by option barrier defence at 1.75. Note that Brazil's central bank has substantially increased its USD purchases in the last few days. In our view, caution is warranted as the BRL moves towards 1.70 levels to the USD. Although the fundamentals remain strong, recent appreciation has been very fast and positions are somewhat crowded, which increases the chance of short-term profit taking. Furthermore, USD weakness seems to explain a large part of the recent BRL appreciation, making it vulnerable to a USD pullback, which could be triggered by a more hawkish Fed statement tonight. Finally, the flows from IPOs, an important driver of the BRL this month, are expected to be smaller in November. All in all, we continue to have a constructive view on the BRL based on the fundamentals of the Brazilian economy and have a bias to short USDBRL. However, we prefer to wait for a clearer picture following the Fed decision and PTAX fixing to consider increasing exposure. On the data front, IGP-M inflation came in above consensus (1.05% vs 0.89% Bloomberg survey) driven by higher than expected food inflation. Despite the surprise, inflation is still decelerating in relation to last month and should maintain its positive short-term dynamics.

#### CLP: Early signs of weaker economic activity?

The CLP remains well supported by the increase in yield spreads with the US and high copper prices. However, we don't see much upside for the CLP below the 500 levels to the USD since copper prices are losing momentum at the same time that pressures for Chilean imports growth are rising due to higher oil prices and domestic absorption growth. On Tuesday, industrial production was much below expectations (1.3% vs. 4% Bloomberg survey) and unemployment rate was above consensus (7.7% vs. 7.4% Bloomberg survey). Together these indicators support the central bank's case for holding rates as past rate hikes are being transmitted to the economy. The slower economic activity would help curb inflationary pressures.

## Technical FX

<b>EURUSD</b>	<b>BULLISH</b>	<b>Eyes 1.4469 before en route to 1.4530. Trend support at 1.4223</b>
<b>USDJPY</b>	<b>BEARISH</b>	<b>Maintain a bearish bias below 115.04, with focus on 113.26</b>
<b>GBPUSD</b>	<b>BULLISH</b>	<b>Trend is up above 2.0427 support and targets 2.0800.</b>
<b>USDCHE</b>	<b>BEARISH</b>	<b>Bearish below 1.1787 and risks setback towards 1.1484</b>
<b>AUDUSD</b>	<b>BULLISH</b>	<b>Maintain a near-term bullish bias above 0.9078, targets 0.9416 channel top</b>
<b>USDCAD</b>	<b>BEARISH</b>	<b>Vulnerable beneath 0.9825, targeting 0.9478</b>
<b>EURCHF</b>	<b>BULLISH</b>	<b>Holds trend-line support now at 1.6685, focus is back on 1.6828</b>
<b>EURGBP</b>	<b>BULLISH</b>	<b>0.7028 marks key resistance, break would open 0.7108. 0.6937 supports</b>
<b>EURJPY</b>	<b>NEUTRAL</b>	<b>Bounced off 160.48 to extend gains towards 166.47</b>

**\*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.

## Key Events

31 October 2007				Source: UBS Global Economics		
Country	GMT	Release/Event	Frequency	UBS	Previous	Consensus
Australia		New home sales (Sept)	m-o-m	n/a	-8.6%	n/a
<i>Japan</i>		<i>BoJ target rate announcement</i>	<i>%</i>	<i>0.50%</i>	<i>0.50%</i>	<i>0.50%</i>
Australia	0:30	Credit (Sept)	m-o-m	1.5%	1.5%	1.0%
Australia	0:30	Building approvals (Sept)	m-o-m	2.0%	-1.7%	1.0%
New Zealand	2:00	NBNZ Business Confidence (Oct)	index	n/a	-26.5	n/a
Japan	5:00	Housing starts (Sept)	y-o-y	-21.5%	-43.3%	-31.2%
Australia	5:30	RBA Commodity Index (Oct)	y-o-y	n/a	5.4%	n/a
UK	7:00	Nationwide House Prices (Oct)	m-o-m	0.4%	0.7%	0.2%
France	7:45	Consumer Confidence (Oct)	index	-20	-21	-22
France	7:50	Producer Prices (Sept)	m-o-m	-0.2%	0.2%	0.3%
Sweden	8:15	Consumer Confidence (Oct)	index	15.5	16.2	16.0
Eurozone	9:00	Consumer Confidence (Oct)	index	-5	-5	-5
Eurozone	9:00	Industrial Confidence (Oct)	index	1	3	2
<i>Norway</i>	<i>9:00</i>	<i>Retail sales (Sept)</i>	<i>m-o-m</i>	<i>n/a</i>	<i>-0.5%</i>	<i>0.5%</i>
Norway	9:00	Credit Indicator Growth (Sept)	y-o-y	14.7%	14.8%	14.5%
Norway	9:00	Unemployment Rate (AKU) (Aug)	%	2.3%	2.5%	2.5%
Eurozone	10:00	Unemployment Rate (Sept)	%	6.9%	6.9%	6.9%
Eurozone	10:00	Business Climate Indicator (Oct)		1.0	1.09	1.03
Eurozone	10:00	CPI Estimate (Oct)	y-o-y	2.5%	2.1%	2.3%
Eurozone	10:00	Economic Confidence (Oct)	index	106.5	107.1	106.5
Eurozone	10:00	Services Confidence (Oct)	index	17	18	19
Italy	10:00	CPI (NIC incl. tobacco) (Oct)	y-o-y	1.9%	1.7%	2.0%
<i>Switzerland</i>	<i>10:30</i>	<i>KOF Leading Indicator (Oct)</i>	<i>index</i>	<i>2.03</i>	<i>2.14</i>	<i>2.10</i>
UK	10:30	GfK Consumer Confidence (Oct)	index	-9	-7	-8
<i>United States</i>	<i>12:15</i>	<i>ADP Employment Report (Oct)</i>	<i>m-o-m</i>	<i>n/a</i>	<i>58k</i>	<i>58k</i>
Canada	12:30	Gross Domestic Product (Aug)	m-o-m	0.2%	0.2%	0.1%
<i>United States</i>	<i>12:30</i>	<i>GDP (Q3)</i>	<i>q-o-q</i>	<i>2.5%</i>	<i>3.8%</i>	<i>3.1%</i>
<i>United States</i>	<i>12:30</i>	<i>Core PCE (Q3)</i>	<i>q-o-q</i>	<i>1.5%</i>	<i>1.4%</i>	<i>1.5%</i>
<i>United States</i>	<i>12:30</i>	<i>Employment Cost Index (Q3)</i>	<i>q-o-q</i>	<i>n/a</i>	<i>0.9%</i>	<i>0.9%</i>
<i>Norway</i>	<i>13:00</i>	<i>Norges Bank Interest Rate Announcement</i>	<i>%</i>	<i>5.00%</i>	<i>5.00%</i>	<i>5.00%</i>
<i>Norway</i>	<i>13:00</i>	<i>Norges Bank inflation report</i>				
<i>United States</i>	<i>13:45</i>	<i>Chicago PMI (Oct)</i>	<i>index</i>	<i>53.0</i>	<i>54.2</i>	<i>53.0</i>
Eurozone	16:00	ECB's Weber speaks				
<i>United States</i>	<i>18:15</i>	<i>FOMC Rate Announcement</i>	<i>%</i>	<i>4.50%</i>	<i>4.75%</i>	<i>4.50%</i>
UK	19:00	BoE Chief Economist Charles Bean speaks				

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