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- The **EUR** regained some composure in European trade on Monday supported by a higher-than-expected increase in Germany's November exports. However, the common currency remains vulnerable as the sovereign debt crisis stays in the epicenter of market attention.
- **Greek Prime Minister Lukas Papademos is set to meet today with Antonis Samaras, the leader of the main opposition party New Democracy**, to discuss mainly the labor market reforms which the troika has reportedly highlighted as, among others, necessary before a new loan agreement can be finalized. According to local press reports, these reforms include additional measures to enhance wage flexibility in the private sector with an aim to reduce labor costs further and boost competitiveness.

Latest Developments/News & Macro releases

The US' non-farm payrolls report for the month of December showed that the economy generated 200k new jobs, the biggest rise in three years and higher than 150k expected, adding to market optimism about a tentative improvement in labor market conditions. US President Barack Obama welcomed the positive December non-farm payrolls report and urged Congress to extend a two-month payroll tax cut through 2012 to help sustain the recovery. Nearly all of the job gains came from the private sector where payrolls rose 212k in December, the highest in three months. Adding to the overall positive tone of the report, the unemployment rate dropped unexpectedly to 8.5%, the lowest level since February 2009, against expectations for an unchanged reading at the prior month's level of 8.7%.

German Chancellor Angela Merkel and French President Nicolas Sarkozy will hold a bilateral summit in Berlin today to talk about a range of amendments to the proposals agreed at the December 9 EU Council. As a reminder, all 17 euro area members plus six EU states (Bulgaria, Denmark, Latvia, Lithuania, Poland and Romania) reached an intergovernmental agreement at the December Summit. The so-called "fiscal compact" encompasses a set of rules to strengthen fiscal integration and enhance economic governance. The deadline for finalizing the draft of the agreement is March 2012. Until then, a number of important details on the agreed fiscal compact remain to be clarified, including, among others, the legal status of the intergovernmental agreement and the extent to which it can use EU institutions to ensure compliance with the fiscal rules. Moreover, EU leaders agreed to reassess the adequacy of the overall ceiling of the EFSF/ESM by March 2012.

Measures to boost economic growth in eurozone countries, enhance competitiveness and increase employment, are also expected to be included on today's agenda. The two leaders could also discuss the financial transaction tax, the "Tobin tax", which has been resisted by Britain unless it would be adopted on a global scale. The meeting comes after the French President vowed on Friday to implement the tax even if EU partners are not on board. The French President and the German Chancellor will meet again with Italian Prime Minister Mario Monti on January 20 ahead of the next EU Summit which will take place on January 30.

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labor costs further and boost competitiveness. Purportedly, some of the main issues under consideration include: a reduction in the minimum wage set in the latest national collective labor agreement by at least €100/month (from €751/month, currently); significant cuts in (or even abolition of) the 13th and 14th wage installments; and lower social security contributions for both employees and employers. The Greek Prime Minister will reportedly meet later this week with PASOK President George Papandreu and LAOS President George Karatzaferis. / According to **German news magazine Der Spiegel**, the IMF considers the current restructuring plan insufficient to fix the debt crisis in Greece and has proposed three possible solutions: i) Greece to introduce further austerity measures, ii) a write-down of more than 50% by private creditors on their Greek debt holdings, or iii) greater loan support from the EU official lenders. The document echoes recent comments by an adviser to German Finance Minister Wolfgang Schaeuble, who said on Saturday that the planned 50% write-down of Greek government bonds held by private creditors as part of a debt swap won't be enough to make the country's debt sustainable.

Equity markets

Asian equity markets kicked off the week on a weaker tone pressured by renewed worries over the eurozone sovereign credit crisis. **Fitch downgraded Hungary** by one notch to junk status with a negative outlook. Separately, a report in German magazine Der Spiegel suggested that the IMF considers the current restructuring plan insufficient to render the Greek debt sustainable. Against this environment, the positive US non-farm payrolls report for December released on Friday, failed to support market sentiment. Japanese markets are closed on Monday for a public holiday. On the flipside, **major European shares** edged up in early trade on Monday supported by Germany's November exports data which showed a higher-than-expected increase of 2.5%mom, triggering an unexpected widening in the country's trade surplus. However, cautiousness prevails ahead of the meeting between the German Chancellor and the French President as well as the US' Q4 earnings season which commences today. Investors will also likely closely scrutinize Italian and Spanish sovereign bond auctions on Thursday and Friday.

FX markets

The **EUR** regained some composure in European trade on Monday lifted by Germany's positive exports data. After falling to a 16-month low of 1.2665 earlier today, the EUR/USD was hovering around 1.2770/75 at the time of writing. Despite its latest upside attempt, the pair remained below levels around 1.3000 recorded early last week as the sovereign debt crisis remains in the epicenter of market attention. Worries over the state of the European banks, also weigh on the common currency. Moreover, sovereign credit rating concerns linger. S&P put the long-term sovereign credit ratings of 15 eurozone nations on negative watch last month and is expected to announce any rating changes "as soon as possible" after the December 9 EU Summit failed to deliver a comprehensive solution to the debt crisis. Separately, Fitch placed last month on credit watch negative –which traditionally signals the possibility of a downgrade within three months- the sovereign credit rating of six eurozone countries –Belgium, Cyprus, Ireland, Italy, Slovenia and Spain- citing that "the systemic nature of the eurozone. Against this background, there is little to suggest that the EUR/USD is poised for further significant and lasting gains in the coming sessions. Technically, crucial support lies at 1.2600 Fibonacci, roughly the 76.4% retracement of its June 2010 to May 2011 rally while only a sustainable move above 1.3200 (Dec. 21 high) could point to an improved EUR/USD near term outlook.

Government bond markets

German government bonds were weaker in European trade on Tuesday pressured by modestly firmer European equity markets. But losses proved limited as the ongoing eurozone debt crisis continues to support demand for the relative safety of German debt. Long-dated Bunds underperformed with the 10-year yield standing close to 1.88% at the time of writing after ending at a one-week low of 1.85% in the prior session. Against this environment, the 2/10-yr Bund yield curve undertook some bearish steepening with the corresponding spread hovering around 171bps, some 2bps wider relative to Friday's close. Elsewhere, yield premiums of Eurozone periphery sovereign bonds vs. their German peers undertook some widening on Monday. **Greece underperformed** with the **10-year Greek/German Bund yield spread** hovering around a two week high of 3,338bps in early European trade, some 30bps wider relative to the settlement in the prior session. Elsewhere, **US Treasuries** were modestly weaker pressured by the positive employment report. With long-dated bonds underperforming, the **2/10-UST yield curve** undertook some bearish steepening. The corresponding spread stood close to 172bps at the time of writing, ca 2bps wider compared to the settlement in the prior session.

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