SUNRISE MARKET COMMENTARY

16 MAR 2005

From KBC Market Research Desk

HIGHLIGHTS

- **Bond Markets:** **US Treasuries disappoint as upside looks capped**

  Bund rebounds
- **Currencies:** **USD encouraged but not convinced by TIC data**
- **News:** **OPEC meeting and UK Brown take center stage**

MARKETS: FIXED INCOME

US: CURVE STEEPENS, BUT IN MT PERSPECTIVE REMAINS LITTLE CHANGED

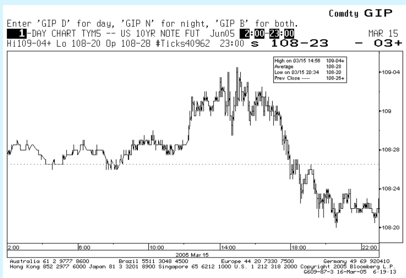
	US yield	-1d
2	3.742	0.0130
5	4.215	0.0100
10	4.543	0.0210
30	4.825	0.0440

R2	109 - 00/32	-1d
R1	108 - 26/32	
T-Bond	**108 12/16**	- 2/16
S1	108 - 20/32	
S2	108 - 12/32	

On Tuesday, Treasuries started the session on a solid footing, but later on retreated, closing the session in the red. The curve re-steepened. The data, retail sales, NY Fed survey … had little impact and the same was true for strong TIC inflow data. Hedge funds being responsible for huge buying of US assets in January didn't inspire confidence as these inflows may have already been reversed (sell-off since mid-February).

In other markets, the dollar soared after the better than expected TIC (inflow) data. The **CRB commodity index** soared to a new record high. Individual commodities like oil, copper and gold were little changed in daily perspective, but oil traded choppy throughout the session and ahead of OPEC meeting (today). **Equities** saw little follow-through after gains seen on Monday and reverted back down.

Intra-day, Treasuries lingered in a sideways range until in late European morning session, prices popped higher without an obvious driver. The better tone held when US traders got involved and this for the second session. Last week, selling invariable occurred as the US began trading.



June Note future (intra-day): Early losses reversed.

The morning data had little effect. Retail sales were slightly weaker than expected, but sharp upward revision of the figures of the previous month raised eyebrows. The NY Fed index was bang in line with expectations. The details a bit mixed. Prices dipped, but rebounded quickly ahead of the TIC data. Inflows were sharply higher than expected, but it seems the buying was due to hedge funds. The dollar skyrocketed on the data, but Treasuries stalled following an initial tick higher despite a sharp rise of inflows into the Treasury market. The strong involvement of hedge funds was looked at suspiciously, as it might explain the sharp sell-off in Treasuries from mid-February. Mr. Greenspan brought no new information to the marketplace in his testimony on social security. Prices slid into sideways trading, but started to falter in the US afternoon session, the longer end leading the way steepening the curve. Disappointment about the inability to rally further following last week's huge losses may have played a role in the selling. Another rally to record highs of the CRB was without doubt another negative.

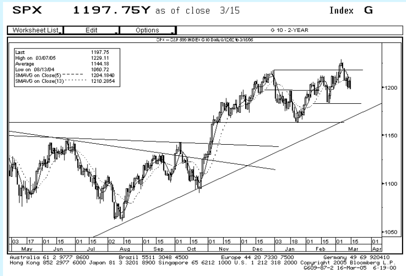
Equities opened somewhat better, but never gave the impression to prolong their rally. So soon enough selling occurred and this continued into the close and left the main indices with substantial losses. Economic data were reasonably positive, but with CRB higher, uncertainty around oil prices and rates, the market lacks conviction to pull equities higher.

The bullish character of the LT **technical picture of the S&P remains intact as the index hit the 1163 level and rebounded swiftly, However, the inability to stage a powerful rally once the index broke through the previous high after the payrolls and instead reverted somewhat lower since, puts question marks behind the ST outlook. The trend has weakened considerably and seems to have transformed itself into a more sideways pattern.**

On Friday, the index dropped below the MT moving average (1210 today) and re-tested this level in vain on Tuesday. The LT picture will be downgraded if the index falls below the 1163 bottom.

Given these elements, we downgrade the MT outlook to neutral. A fall below 1184 (February bottom) would be a disappointment and point to a re-test of the 1163 support.

A break above the previous high (1229) should make levels around 1253 (62% retracement historic high to low) attainable.



S&P: correction resumed.

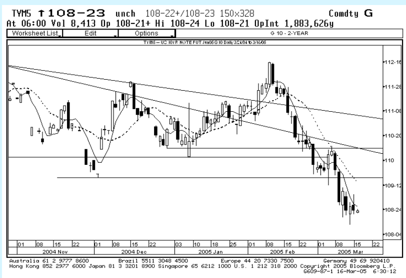
Today's market calendar is interesting as it contains the Q4 current account, the February housing starts and industrial production. Beside these, oil will be in the focus with both the OPEC meeting in Iran and the US inventory data. Any disappointment is probably good for a new high in prices.

Housing starts are expected to decline to a 2040K annual units in February from a 22-year 2154K high in January. Warmer weather and a record high number of permits in January might have supported starts, but given the record high in January, a decline is still most likely. Housing starts do surprise often, but in recent years had very little impact on the market.

Production is expected to have been up 0.4% M/M in February following a flat figure in January. The market most often doesn't react much on the production data, as the survey evidence (ISM and the like) are timelier.

The **Current Account for Q4** is expected to show a new record high deficit of about 183 B USD or a breathtaking 6.1% of GDP. The trade deficit widened (already recorded) and also the income balance should have widened as part of the Microsoft extra dividend was paid out to foreigners. While the outcome shouldn't be a big surprise as such, in the current context of fears about insufficient external financing of the deficit (somewhat alleviated following yesterday's TIC data), it might unnerve investors.

Regarding trading, it was right not to draw conclusions from Monday's positive price action. Yesterday's price action tells us that sentiment remains precarious and little is needed to push Treasuries once more lower. We still haven't seen a final exhaustion move down, which might conclude this sell-off phase. In this respect, on Monday, we pointed out that in both 2003 and 2004, the (only) sell-off phase of the year lasted two months and the price action was at least twice as large as is until now the case (for the 10-year sector). Therefore, we would keep a defensive posture for now, leaving short positions run their course.
The technical picture for all maturities is bearish and regarding curve movements, we expect the 2-to-10-year spread to hover sideways for some more time.
For today, the data may have to take a backseat with attention focussing on the **oil market**. The OPEC will meet and may decide to raise output by 500 000 barrels/day according to some oil Ministers, but it is unclear whether this rise will take place in April or May. Saudi Arabia will raise production, unilaterally if necessary, said its Oil Minister. On top of that, US releases its weekly oil statistics. In case of a negative surprise, we might set new highs, but given the fairly big amount of speculative positions, profit taking is as likely.



March Note future: Nice bearish double top formation lives up to expectations. Disappointing price action yesterday.

The **LT technical picture** of the **June** Note future became outright bearish as the contract dropped below the 110-03, painting a bearish multiple top formation on the charts. This configuration will now guide price action. Afterwards the contract steamed through the 109-19 (Dec low), too.

The multiple top formation with neckline at 110-03/10 has potential targets at 108-06 and 107-28/22. The medium-term moving average is firmly downward oriented and comes in at 109-13+ today. It played its role as resistance well early last week (cf. graph).

Looking to the ST trading, **support** is located at 108-20 (S1, yest. low), at 108-12/10 (S2, reaction low/Boll bottom) at 108-06/05+ (S3, 1st target multiple top/Irreg. C) and at 107-30/28/22 (S4, Starc bottom/targets multiple top).

On the upside, **resistance** stands at 108-26+ (R1, STMA), at 109-00 (R2 daily downtrendline), at 109-04+ (R3, yest. high), at 109-13+ (R4, MTMAy), and 109-31 (R5, 38% retracement).

The contract is in oversold conditions.

EUROPE: BUND REBOUNDS

	DE yield	-1d
2	2.4250	-0.0170
5	3.0280	-0.0270
10	3.7180	-0.0390
30	4.2180	-0.0370

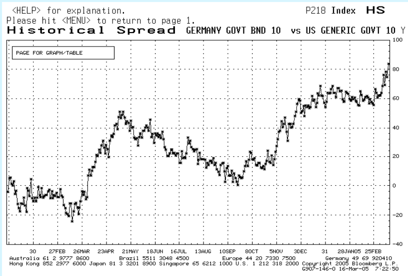
R2	118.08	**-1d**
R1	117.82	
BUND	**117.79**	0.5300
S1	117.51	
S2	117.29	

On Monday, European bonds rebounded in a technically inspired move shrugging off bond unfriendly data, lower US Treasuries and a decline in the euro. In the euro zone, the German ZEW index improved in March instead of an expected decline, while French harmonised inflation rose more than expected in February. During the afternoon, the US data were more or less in line with the expectations, except the stronger than expected TIC data, on which the dollar rallied higher. However, nor the lower euro or the decline in US Treasuries could halt the rebound in European bonds.

The Bund closed the day near the highs at 117.79, a gain of 55 ticks.

Curve-wise, there was a bull flattening of the yield curve with 2-year yields declining 2bp, 5-year yields 4.5bp, 10-year yields 6bp and 30-year yields 6.5bp.

Due to the outperformance of European bonds compared to US Treasuries, the spread between German and US 10-year yields widened from around 74bp to 83bp.



Spread between German and US 10-year yields keeps on widening.

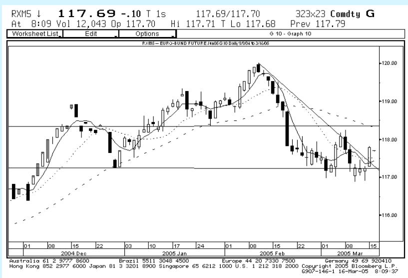
On the supply front, demand was solid for the Italian 5-year BTP 3% Jan 10 with the bid/cover above average at 1.8.

Today, the eurozone February inflation figures will be released.

Based on the national inflation data for February, **euro zone inflation is expected to rise from 1.9% Y/Y to 2.1% Y/Y** (slightly more than market consensus), mainly reflecting higher oil prices. Core inflation is expected to remain stable at 1.6% after the large decline in January, which would signal that no underlying inflationary pressures are building. In this context, the short-term outlook for inflation in the euro zone remains favourable.

On the ECB front, ECB's Caruana will speak at a conference on swaps and derivatives. Yesterday, ECB's Weber repeated the current ECB mantra saying that the short-term outlook for inflation is favourable, while there are upside risks in the medium term, including excess liquidity.

On the supply front, Germany will issue a new 2-year Schatz 2.5% Mar 07 for an amount of EUR 8 bln. The previous Schatz Dec 06 had a bid/cover of 1.8 at its issuance.



Bund rebounds.

Yesterday, the Bund rebounded strongly. Nevertheless, we keep our bearish view on the Bund intact, as long as we remain below the 118.25 (post-Payrolls high) and 118.35-zone (neckline double top formation) and prefer a sell-on-up-ticks strategy.

Today, keep an eye on the oil markets, as the OPEC meets today in Iran and the US oil inventories will be made public.

The longer-term technical picture of the Bund remains bearish despite yesterday's rebound, as the Bund is still under the negative influence of a double top formation with the neckline at 118.35. From a short-term perspective, the picture has become more neutral as the Bund recouped the short term and medium term moving averages.

Intra-day, support in the Bund is seen at 117.51 (broken MTMA), at 117.43 (STMA), at 117.29 (yesterday low), at 116.91-89 (daily Bollinger Bottom – reaction low) and at 116.81 (neckline double bottom formation weekly continuation charts).

On the topside, resistance comes in at 117.82 (yesterday high), at 118.01-08 (daily envelope – 38% retracement from contract high) and at 118.25-35 (previous reaction high – neckline double top formation).

Bund is in neutral territory.

In the UK, the Gilt market slightly outperformed the Bund market, despite the improvement in the RICS house price balance.

Today, the UK labour market report will be released. While the labour market is expected to continue to tighten, average earnings incl. bonus could fall somewhat lower, as in January 2004 earnings growth was boosted by high and early timed bonus payments. However, the market is likely to focus on earnings growth excluding bonus, where no change is expected.

Today, UK Chancellor Brown will present its Budget Report. According to the latest public sector finance data, the Golden Rule (which allows the government to borrow only to invest over the economic cycle) is likely to be met and net cash requirement is likely to remain little changed. **However, major attention will go out to the DMO funding plan, which is expected to announce the issuance of a new 50-year Gilt.** This would be the longest dated Gilt apart from some minor perpetual bonds. The question is still open whether the UK will issue a fixed coupon or an index-linked.

The Budget Report is unlikely to have a major influence on BoE monetary policy.

Nevertheless, if Brown would announce a tax reduction for first-time home buyers in an effort to gain votes at the next election, this could be seen as somewhat negative for the Eurosterling strip curve, as it could boost the UK housing market. Indeed, some press reports suggest that Brown will raise the threshold on stamp duty for first-time home buyers from GBP 60 000 to GBP 100 000.

CURRENCIES: USD ENCOURAGED BUT NOT CONVINCED BY TIC DATA

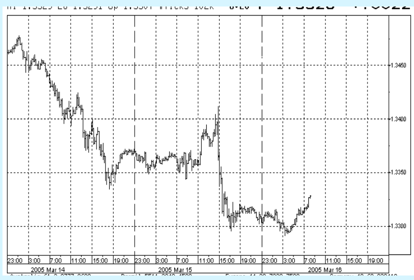
R2	1.3373	**-1d**
R1	1.3358	
EUR/USD	**1.3327**	-0.0036
S1	1.3288	
S2	1.3278	

On Tuesday, the USD lost some ground ahead of the afternoon's data releases. Apparently some market players weren't so sure the data would provide enough dollar support. The key for the forex markets was the TIC data release, but before that, one had to bypass the US retail sales first. These however were more or less in line with expectations and couldn't really move the markets.

The TIC data were very strong at first glance with a 91.5 bln.$ net inflow, with strong net buying of US Treasuries but also equities. The market though had some difficult choosing which side to go after the TIC data. It took some minutes of heavy fighting between dollar bulls and bears to see which view was winning. In the end, the dollar bulls were victorious and thus EUR/USD was dragged lower to the 1.33 area.

But looking into the details of the TIC data there is reason for concern. The data show heavy inflow in Treasuries s originated from the Carribean. These are tax havens where a lot of hedge funds are based. These are known to switch positions at the tip of a hat. So, presently, these inflows may already have become outflows, as recent price action within the Treasuries suggests… Thus the USD may have had that support only for a very brief time. The TIC data in that event are too backward looking and give no guarantees over the longer term financing of the US deficits…in reality missing the very goal the market is using for the moment.

The details of the TIC data thus aren't so dollar positive and we have to wonder whether this weeks' dollar rebound has got any more legs to run. What if today's **current account** data again swells beyond expectations? Then we should again see the dollar doubts resurface…**These are not the right conditions to see a test of last week's break-up area.**



EUR/USD (3 days)
more dollar gains after TIC.

By moving out of the recent sideways zone, above 1.3292 and above the neckline of an inverted Head & Shoulders formation at 1.3278, the pair entered a dollar bearish phase from a technical viewpoint. Now this almost is unwound back to neutral conditions.

Support comes in at 1.3288 (low today), at 1.3278 (neckline inverted H&S formation) and at 1.3247/.39 (break-up daily / Bollinger midline).

Resistance is seen at 1.3358 (daily envelope), at 1.3373 (ST MA), at 1.3411 (top yesterday) and at 1.3370 (daily Bollinger top).

R2	0.6985	**-1d**
R1	0.6972	
EUR/GBP	**0.6958**	-0.0020
S1	0.6941	
S2	0.6921	

The EUR/GBP pair yesterday declined further after missing the break above the 0.70 zone recently**.** The pair slid to the 0.6960 zone. It did so ahead of the EUR/USD move lower, so the impetus also doesn't seem originated from there. Also we didn't notice any increased rate hike expectations over the past days, which could help the sterling. This leads us to deduct this is mostly a technical pullback (see below for details).

The German **ZEW** economic sentiment improved slightly contrary for expectations for a small decline. This, however, had no visible impact on EUR trading.

This morning, the pair is moving in a sideways fashion, awaiting probably fresh input. With UK payrolls data (employment + earnings) and a speech of UK Chancellor Brown on the agenda there is quite some market moving potential out there.

In other FX markets, the **Swedish Riksbank** kept rates unchanged yesterday. In its comments it saw only moderate price rises, keeping it on track to meet its two-year goal. A rate cut though seems ruled out implying of course the next step is a hike, but there is no hurry. EUR/SEK was largely unchanged on the day.

The EUR/GBP pair escaped out of a sideways range recently, but is now questioning this move. The pair is indeed back at the 0.6960 zone. Thus, the technical picture is probably guiding for trading.

Technically speaking, the pair is still unwinding overbought conditions.

Support comes in at 0.6945/.41 (yesterday low / weekly envelope), at 0.6921 (MT MA) and at 0.6906/.01 (LT MA / 62% retracement).

Resistance is seen at 0.6972 (ST MA), at 0.6985 (daily envelope), and at ST high), at 0.7002/.06 (rising wedge top / 62% retracement) and at 0.7024/.27 (weekly envelope / broken daily channel bottom).

EUR/GBP (3 days): pullback.

R2	105.04	**-1d**
R1	104.76	
USD/JPY	**104.33**	-0.5400
S1	104.13	
S2	104.01	

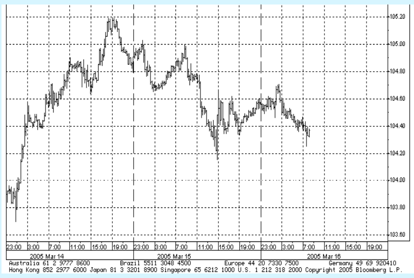
On Tuesday, The US Treasury International Capital flow (TIC) data showed a very solid net inflow into US assets. This comforted USD bulls somewhat and the USD gained on the back of this, moving from the 104.10-area to the 104.60 zone.

The details of the TIC data show that while US Treasury buying was solid, this may have come from les reliable sources (hedge funds?) than the Asian Central bank buying we were used to the past years. The concern to us is that these longer-term and more stable flows are still decreasing and this is a fundamental worry for the US currency.

This should be a concern for the market as well and especially for USD/Asia. The move indeed petered out rather soon yesterday. This morning, the USD/JPY pair even seems to be slowly descending again as it has reached the 104.30 zone at the time of writing…

Today, the market will focus again on the US with the current account data and the industrial production. The CA will contain little new factors though, but it should demonstrate underlying sentiment. We saw a very sceptical market recently. The US payrolls at the start of March couldn't convince the market at the time and the dollar was sold off. Ahead of the trade balance, more of the same was noted. This is still the sentiment we believe and thus the USD should have it difficult to continue to occupy recently gained ground. **This is still a sell-USD-into-strength environment in our book.**

There is a lot of attention for oil prices lately. These seem to have more of an impact on fixed income than on forex markets for now. This could be an important day though for oil with the US oil inventories and the OPEC meeting. To be watched.



USD/JPY (3 days): USD fails to profit from TIC data versus the yen…

Technically, USD/JPY is moving in neutral readings. An important test for the USD could come at the boundaries of the recent sideways range at the 103.60 zone.

Support is seen at 104.13 (daily envelope), at 103.90 (broken daily channel top) and at 103.64/.62 (62% retracement / last week low).

Resistance is seen at 104.76 (daily Bollinger midline), at 105.04 (daily envelope) and at 105.12/.19 (broken daily uptrendline / high 14 Mar).

NEWS

US: GOOD , BUT NO EXCEPTIONAL DATA

The **March NY Empire State survey on manufacturing** was not too far off expectations and **suggests ongoing robust activity**. The headline, general business conditions, index stabilized at 19.6 and remains close to the 6-month average of 21.6. It suggests activity is growing at a steady pace. The stabilization in the face of the most restrictive seasonal adjustment factor of the year is encouraging. However, these adjustment factors obviously played a role in the decline of new orders and shipments to respectively 7.9 (from 17.3) and 21.3 (from 33.3). The slowing in new orders (6-month average stands at 20.3) is probably a seasonal adjustment affair, but needs to be monitored closely as it is the most forward-looking component. The labour market indicators were little changed from February, but clearly below the January levels. Number of employees index rose to 11.4 from 8.9, but the average workweek fell to 8.4 from 9.3. Both prices paid (53.2 from 48.8) and prices received (15.6 from 13.2) were moderately up (to high levels).

The **February retail sales** report was close to slightly above expectations, if the revisions were taken into account. The February results were below expectations, but only after a strong upward revision of the January figures. Headline sales rose 0.5% M/M, slightly below expectations for a 0.6% M/M increase, but the January result was revised to 0.3% M/M from –0.3% M/M. Sales excluding cars rose 0.4% M/M instead of the 0.8% M/M, but the January result was revised to 1% M/M from 0.6% M/M previously reported. Building material sales were surprisingly weak (-1.3% M/M) despite better weather and the rise in gasoline sales (0.9% M/M) was more moderate than expected. Stronger sales of clothing, furniture and stronger electronic store sales are worth mentioning. Based on Jan/Feb sales, real consumption may rise a healthy 3.5% in Q1.

ICSC weekly retail sales were reported up 0.6% in the second week of March, following a 0.4% drop in the first week. On a yearly basis, sales rose 3.4%, slightly up from 3.3% in the previous week. **Redbook retail sales** were up 3.8% Y/Y in the most recent week, which compares to a 3.7% Y/Y rise in the previous week. Analysts noted that sales remained slightly below plan but customer traffic was solid.

Foreign investors bought 91.5 B USD assets in January, surpassing expectations for a 58 B USD purchases and up from 60 B USD in December.

Business inventories rose by 0.9% M/M in January, in line with expectations, while sales were up 0.8% M/M. The inventory-to-sales ratio stabilized at 1.30. Only retail sales inventories up 0.4% M/M was new info. Factory and wholesale figures were already released.

The National Association of Homebuilders index stabilized at a high 69 in March. The February result was revised up one point to 69. Consensus was looking for a result of 68. In the last six months, the index slid slightly, but from record highs (77) and the industry notes that higher mortgage rates has done little to damage homebuilders' enthusiasm about the outlook.

EUROPE:

German economic sentiment improved slightly in March, defying expectations for a small decline. The expectation index actually rose to 36.3 from 35.9 in February, but the difference is statistically irrelevant. The current situation index on the contrary fell to –66 from –58.7 in February. The ZEW survey is based on opinions of financial analysts and institutional investors. It nevertheless has a good correlation with the more important IFO business survey, even if this correlation didn't hold in February when the IFO index declined and the ZEW index improved. The ZEW said that orders and exports may have boosted confidence, but oil prices and euro strength hurt confidence.

Euro area labour costs rose a stronger-than-expected 2.2% Y/Y in Q4, following a 1.8% Y/Y rise in Q3.

16 Mar 2005

10-year	td	- 1d
US	4.54	0.02
DE	3.72	-0.04
BE	3.81	0.05
UK	4.79	-0.05
JP	1.48	-0.02

2 -year	td	- 1d
US	3.74	0.01
DE	2.43	-0.02
BE	2.47	-0.03
UK (3yr)	4.80	0.01
JP	0.26	-0.01

STOCKS		-1d
DOW	10745	-59.34
NASDAQ	2035	-16.06
NIKKEI	11873	52.09
DAX	4388	20.39
DJ euro-50	3084	23.01

IRS	EUR	USD (3M)	GBP
3y	2.808	4.163	5.133
5y	3.183	4.423	5.135
10y	3.793	4.776	5.075

Eonia	2.06	0.00
Euribor-1	2.10	0.00
Euribor-3	2.14	0.00
Euribor-6	2.18	0.00

3-m f.	1st	-1d	2nd
euro	97.810	0.01	97.810
dollar	96.490	-0.01	96.490
sterling	94.910	0.02	94.910

Currencies		-1d
EUR/USD	1.3327	-0.0036
USD/JPY	104.33	-0.54
GBP/USD	1.915	0.0003
AUD/USD	0.7900	0.0016
USD/CAD	1.2063	0.0003

Currencies		-1d
EUR/JPY	139.03	-1.09
EUR/GBP	0.6956	0.00
EUR/CHF	1.5498	0.00
EUR/SEK	9.0853	0.00
EUR/NOK	8.1742	0.00

Commodities	CRB	GOLD	BRENT
	320.5	440.5	54.34
-1d	3.26	0.00	0.32

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Wednesday, 16 March	Consensus	Previous
U S		
13.00 MBA mortgage applications (wk 11/3)		-0.7%
14.30 Current Account Balance (Q4)	-183B	-164.7B
14.30 Housing Starts (Feb)	**2040K**	**2159K**
14.30 Building Permits (Feb)	20670K	2105K
15.15 Industrial Production (Feb)	**0.4%**	**0.0%**
15.15 Capacity Utilization (Feb)	79.2%	79.0%
16.30 DOE US Crude Oil Inventories (wk 11/3)	2000K	3200K
16.30 DOE US Gasoline Inventories (wk 11/3)	-1000K	-200K
U K		
10.30 Unemployment Rate (Feb)	2.6%	2.6%
10.30 Unemployment Change (Feb)	**-5.0K**	**-11.0K**
10.30 Average Earnings incl. Bonus (Jan) 3M/Y	4.30%	4.30%
10.30 Average Earnings excl. Bonus (Jan) 3M/Y	**4.50%**	**4.50%**
10.30 ILO Unemployment Rate (Jan)	4.7%	4.7%
10.30 Manu. Unit Wage Cost (Jan) 3M/Y		-0.5%
E M U		
08.00 New Car Registration (Feb) Y/Y		1.3%
11.00 CPI (Feb) M/M Y/Y	**0.3% / 2.0%**	**-0.6% / 1.9%**
11.00 Core CPI (Feb) Y/Y	1.6%	1.6%
N o r w a y		
14.00 Norges Bank rate decision	**1.75%**	**1.75%**
E v e n t s		
German new Schatz Mar 07 auction (8B)		
Spain details Q2 auction calendar		
Sweden details bond auction on 23 Mar		
UK DMO management report + opining on 50-yr Gilt		
Japanese 20-year bond auction on 17 Mar		
12.00 ECB's Caruana at conference on swaps and derivatives		
13.30 UK Chancellor Brown presents Budget Statement to UK Parliament		
Norges Bank inflation report		
OPEC meeting in Iran		