WEEKLY GLOBAL MARKETS REPORT

25 February 2005

From KBC Market Research Desk

HIGHLIGHTS

- **US Treasury market wary about inflation**
- **European yield curve re-steepens**
- **USD hurt**

GRAPH OF THE WEEK

German 10 yr yields confirm end downtrend

CONTENT

FUNDAMENTAL CONTEXT

UNITED STATES

In the last few days, inflation developments caught the eye and impacted the markets. Last Friday, an outside unexpectedly sharp rise in core PPI stoked fears about a building of inflationary pressure. These fears were alleviated on Wednesday when the CPI report showed that price pressures are still relatively benign on the consumer level. In the current phase of the cycle, inflation developments move up on the shortlist of market's preoccupations as they may influence monetary policy in a quite direct way. We elaborate somewhat more in depth on inflation below.

The activity data were somewhat less important. **Consumer confidence** data from the Michigan University and the Conference Board showed some divergence as the former was somewhat weaker and the latter somewhat stronger than expected. However, all in all confidence remains broadly stable, the outperformance of the Conference Board being the result of an improvement in labour market conditions. Indeed, **initial claims** in recent weeks fell to very low levels, just north of 300 000 suggesting that households become more comfortable with the job situation. However, one caveat: the claims statistics are sometimes distorted.

The only other important data released since the previous weekly were the **surveys on manufacturing** of the Philadelphia and Richmond Fed. The headline figures for February were slightly better than those for January, but the underlying picture was a bit mixed. This leaves the impression that manufacturing activity is slowing down at the start of 2005. We should get a better picture of the situation when the February ISM report is published next Tuesday.

The sharp rise in core PPI was without doubt a wake up call on inflation, even if the subsequent CPI report still pointed to benign inflation at the consumer level. This doesn't surprise us. The PPI surprise most likely won't be repeated in the next months, but even before the January PPI report, it was obvious that very gradually inflationary forces were gaining ground. Nothing to get overly concerned about, but nevertheless the rise in inflation will affect monetary policymaking and markets.

Starting with the **PPI release**, it revived inflation concerns, as it suggests that firms have regained some pricing power and use it to pass cost increases through to their customers.
Looking to the details, headline PPI rose by 0.3% M/M and 4.2%Y/Y, in line with expectations and close to the December outcome of 0.3% M/M and 4.1% Y/Y. Food prices dropped 0.1% M/M, and Energy fell 1% M/M.

The surprise was, however, the 0.8% M/M surge in core PPI, which compares with expectations for a 0.2% M/M increase. On a yearly basis, PPI growth accelerated to 2.7% from 2.2% in December. This is the fastest Y/Y increase since November 1995 when PPI rose by 2.8%Y/Y. The sharp rise was due to increases in cigarettes (3.4% M/M), alcohol (2.8% M/M), passenger cars (1.2% M/M) and light trucks (1.2% M/M) and heavy trucks (0.9% M/M). Plunging computer prices (-6.1% M/M) brought some relief.
Pipeline inflation measures, which say something about price evolutions in the early stages of production, were mixed. Intermediate PPI was up 0.4% M/M and 8.7%Y/Y and core intermediate PPI rose 0.8% M/M and 8.5% Y/Y, the fastest since September 1981. Crude PPI and core crude PPI seem to be over the peak. The former fell 2% M/M after a 3% M/M fall in December and is up 10.8% Y/Y, the slowest growth since March 2004. The latter declined by 2.5% M/M following a 1.3% M/M decrease and is up 13% Y/Y.

The much-feared **January CPI report** came out close to expectations and contained little surprises. Headline CPI was a tad below expectations at 0.1% M/M (and 3% Y/Y), but core CPI was exactly in line with expectations at 0.2% M/M and 2.3% Y/Y, the fourth consecutive 0.2% M/M rise and the highest Y/Y reading since August 2002.

Why do we think inflation will rise moderately?

Firstly, following a few years of strong economic growth, **economic slack is dwindling**. In other words, the output gap is been closed gradually. Capacity utilization has risen swiftly, albeit from very low levels and is now closing in on the long-term average. Regarding the labour market, despite all talk about a jobless recovery, the unemployment rate fell to 5.2% from a cycle high of 6.3% in mid 2003.

This hasn't yet been reflected in accelerating wage growth, but given the slowdown in productivity, unit labour costs have nevertheless risen to 1% Y/Y in Q4 2004, admittedly a still low figure, from a 1.8% Y/Y drop in Q1 2002.

Of course, with profit margins at very high levels, firms have the possibility to absorb the higher costs with the profit margins. However, why should they do so? If firms can push through cost increases, they will do so.

Costs are increasing. The rise in commodity prices, the increases in the diffusion price indices in the manufacturing surveys, the higher import prices. While this is especially relevant for prices of goods (PPI), these factors will also affect services, and therefore CPI.

This process will be gradual with from time to time an upward surprise. This does not mean that inflation will become again a big problem. For that to prevent we count on the Fed tightening its policy further like it suggests it will do. To prevent disruptions in the bond market, the Fed should stay ahead of the curve. Inflation expectations are still well anchored and this should facilitate Fed policymaking.

There are little new developments to signal about the Fed since Greenspan's testimony.

EMU

The European data disappointed profoundly this week and oblige us to tone down our rather optimistic view on an economic recovery in EMU. Indeed, business confidence in countries like Germany, Belgium and Italy deteriorated in February. Following a steep drop in November, confidence improved in both December and January. We (and the market) were looking for a confirmation in February, which would have been sufficient evidence to up our expectations. We were taken awry. Sentiment dropped quite substantially and if this is confirmed, the outlook for 2005 growth darkens, while expectations were already for sub-trend growth. It would also brush our expectation for a tightening of monetary policy after the summer off the table.

We dig somewhat deeper into the country data of Germany and France to show that while the overall economic situation in the EMU area is worrisome, there remains an unusual discrepancy between countries like France, Spain and Belgium that perform rather well and countries like Germany and Italy that continue to underperform. The former countries profit for strong domestic demand, which is fuelled by tax breaks (and exemptions) and soaring real estate prices.

The **German IFO survey** for February disappointed indeed. Instead of the slight rise expected, the headline index dropped rather sharply to 95.5 from 96.4 in January. Both the current situation sub-index (94.5 versus 95.3) and the expectations sub-index (96.4 versus 97.5) contributed to the decline. Coming on the heels of an improvement in both December and January, the survey shows that the improvement in the economic climate is still very much subject to uncertainties. It seems the economic performance will linger on without much momentum for longer. We hoped that a third increase in the index would signal that the economy had left the worst behind. Looking to the various sectors, the deterioration was broad-based and included the cyclical manufacturing, the retail and the construction sector. Only the wholesale sector showed a marginal improvement in sentiment.

IFO said that domestic demand is very hesitant, but sees some improvement in the export outlook (recent euro decline). The tax reform hasn't had the expected effect yet, an IFO analyst added. IFO keeps its current 2005 growth forecast at a meagre 1.2%, but doesn't exclude a downward revision later on.

Q4 German GDP was confirmed at –0.2% Q/Q and 0.6% Y/Y, down from 0% Q/Q and 1.2% Y/Y in Q3. However, the details brought quite some surprises. Domestic demand was down 0.8% Q/Q, while net exports rebounded moderately and contributed 0.5% to growth. Looking to domestic demand, private consumption was up 0.2% Q/Q (expected at –0.1% Q/Q), following a revised 0.1% Q/Q, earlier reported as flat. It suggests that consumer spending is recovering slightly. Government spending dropped 0.7% Q/Q, while investment was mixed. Investment in equipment fell by 0.4% Q/Q, but following a very strong 3.4% Q/Q in Q3. Given strong order intake recently, investment might rebound in Q1 2005. Construction investment was up 0.5% Q/Q, but following a 1.4% Q/Q decline.

Q4 French GDP grew by a robust 0.8% Q/Q and 2.2% Y/Y, at the high of the range estimated by INSEE when it released its flash estimate one week ago. The composition was quite encouraging. Domestic demand grew strongly (0.7% Q/Q) helped by both consumption (1.2% Q/Q and 2.5%Y/Y) and investment (0.9%Q/Q and 1.6%Y/Y). Regarding the latter, business investment rebounded 1.2% Q/Q following a 1.1% Q/Q decline in Q3. Household investment in housing remained strong. Government spending rose 0.6%Q/Q and 2%Y/Y. Net export was neutral for growth while inventory building subtracted 0.3%-point from growth. Of course, temporary government measures go some way in explaining the good result in Q4, but nevertheless the report remains encouraging.

French consumer spending surged unexpectedly in January, up 1.5% M/M and 3.8% Y/Y. The December figure was revised lower to –0.4% M/M and +6.2% Y/Y. Despite this downward revision, the January report was much stronger than the expected flat figure. The strength was widespread with only cars down on the month (-2.8% M/M). The positive start of spending in January is a good omen, as spending increased in Q4 already at the strongest pace in four years. Tax cuts may explain the strong spending, while plans to stimulate competition via lower prices might have been positive, too.

Bond Market & Money Market

FUNDAMENTALLY

▪ Global environment

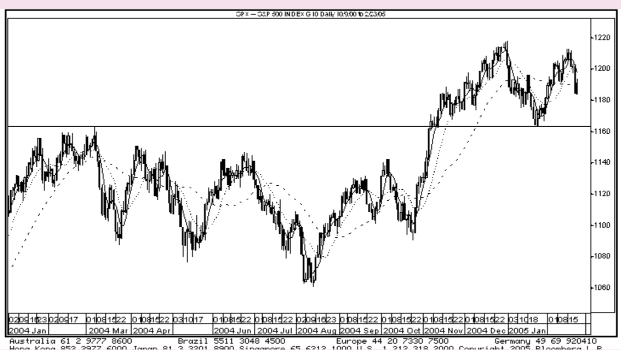
During the week, bond markets remained under downside pressure, as the upward surprise in the US PPI brought the inflation theme back to the forefront. Later on, inflation concern eased on the back of the slightly lower than expected US CPI. Equity markets had to backtrack, as oil prices surged back above the 50 USD-level. Data-wise, the first euro zone business surveys disappointed, but had little impact.

UK Minutes increase likeliness further rate hike

In the UK, the Minutes of the February meeting showed an 8-1 vote to leave rates unchanged at 4.75%, with Tucker voting in favor of an 25bp rate hike. Once the uncertainty about near-term strength of household consumption clears up and the economy evolves in line with the central projection, another rate hike has become very likely now.
In the US, the Minutes of the February meeting added little news to last week's Greenspan testimony. The Fed still considers current rates as fairly low and while core inflation is expected to remain low a further removal of policy accommodation is warranted.
In the EMU, the ECB continued to blow warm and cold signalling that rates cannot remain eternally at this very low level, but that considering the current prospects for inflation and growth in the euro zone the time to move has not yet come. The rapid growth in M3 and credit recently nevertheless remains a reason for concern, but not sufficient to raise rates.

Equity markets decline on higher oil prices

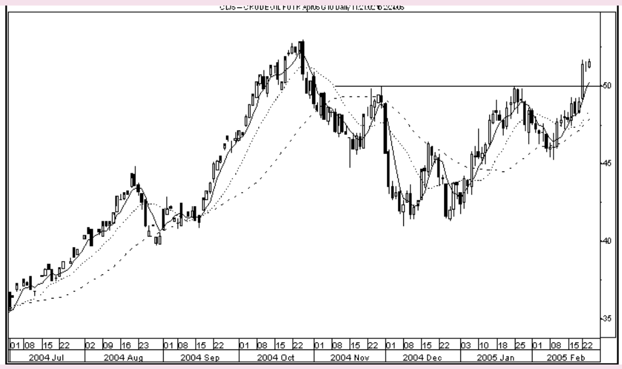
Equity markets around the globe had a rather tough week, as the surge in oil prices above the psychological important 50 USD/barrel-level prevented a test of the highs in the US (S&P). In the euro zone, the decline of the dollar was an additional negative.



S&P 500: no real test of the highs

Commodities break higher

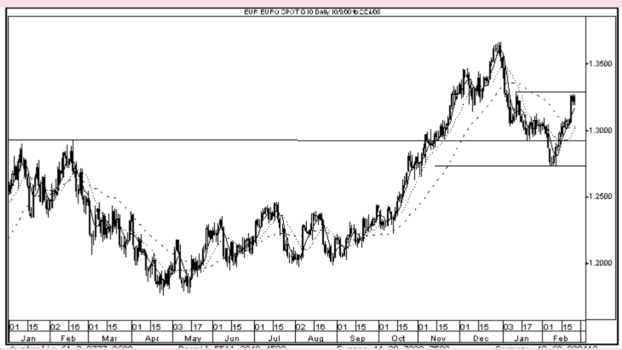
Commodities continued their strong performance, with the general CRB index reaching its highest level since the beginning of the 80s. Oil was a star performer, as it surged back above 50 USD leaving an inverted head & shoulder formation on the charts with targets ranging from 54.70 USD to 58.70 USD. Whether rising oil prices will push bonds higher like last year remains to be seen, as inflation could currently be of greater concern than the growth outlook.



Oil back above the 50 USD/barrel-barrier.

Forex market: Dollar under pressure

The dollar remains under pressure, despite the positive interest rate developments. South-Korea announcing some diversification of its assets put the finger on the spot. EUR/USD moved higher above the 1.32-level and is nearing the top of its sideways range at around 1.33. USD/JPY remained sideways oriented.

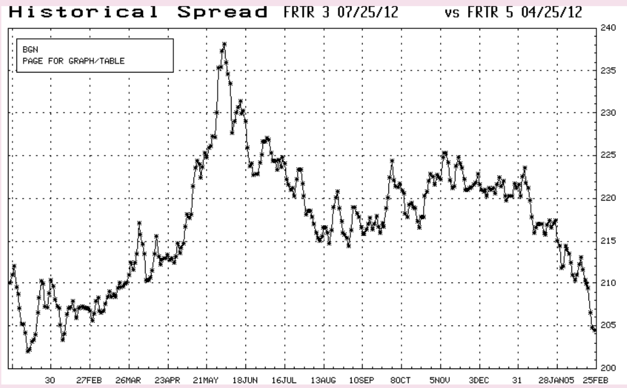


Euro moving towards top sideways range.

European Money and Bond markets

During the week, European yields continued to rise confirming that the downtrend in yields is over for now. Euro zone data however disappointed, as business sentiment deteriorated in Germany, Italy and Belgium instead of an expected improvement.

While the immediate impact of the disappointing business surveys on yields remained negligible, they will nevertheless influence ECB monetary policy. In recent months, the ECB clearly signalled that it would like to start normalising interest rates, once the economy takes off. Growing concern about the recent upturn in M3 money supply and credit even seemed to accelerate this process. However, recent economic data have cooled these expectations again. Indeed, while one still could have downplayed the impact of the weaker-than-expected Q4 growth figures, as being outdated, the more forward-looking indicators, such as the German IFO, suggest that the growth outlook for 2005 remains rather hesitant. At the same time, the inflation outlook for the euro zone has become more favourable. In the short-term, headline inflation is expected to fall below the 2% and long-term inflation expectations have plunged lower recently. Break-even inflation decline from around 2.2% at the end of December to 2.05% currently.

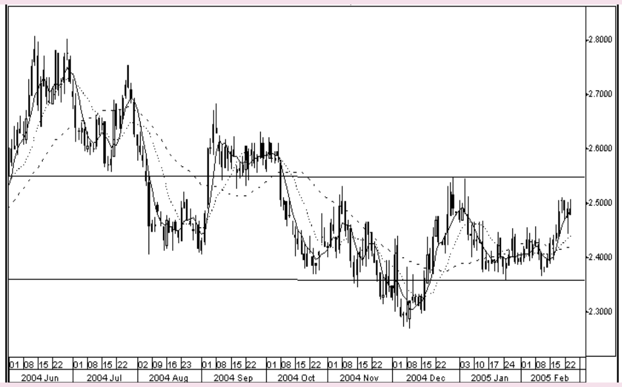


Inflation expectations plunge lower in the euro zone.

In this context, no change in monetary policy should be expected anytime soon. Currently, the first rate hike is still expected somewhere in Q4 of this year, which we think is more reasonable now compared to one week ago, when we preferred a more bearish stance.

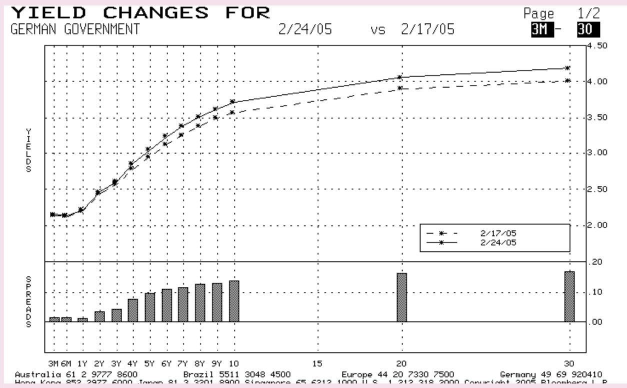
Euribors	24 Feb	17 Feb	10 Feb
Mar 2005	2.15%	2.14%	2.14%
Jun 2005	2.24%	2.24%	2.22%
Sep 2005	2.38%	2.38%	2.33%
Dec 2005	2.54%	2.54%	2.46%
Mar 2006	2.68%	2.67%	2.57%

The status-quo in monetary policy should keep 2-year yields within recent ranges between 2.35% and 2.55%.



2-year yields capped between 2.35% and 2.55%, as ECB wants but cannot raise rates yet.

At the longer end of the curve, yields are much more correlated to what is happening in the US. The surprising rise of the January PPI was a real shock for the bond markets and brought the inflation theme back to the forefront with yields rising rather sharply. The well-contained outcome of the CPI later on could not reassure the market and longer-term yields are still under some upward pressure. Consequently, the European yield curve re-steepened with 2-year yields rising only 3bp, 5-year yields 10bp, 10-year yields 14bp and 30-year yields 17bp.

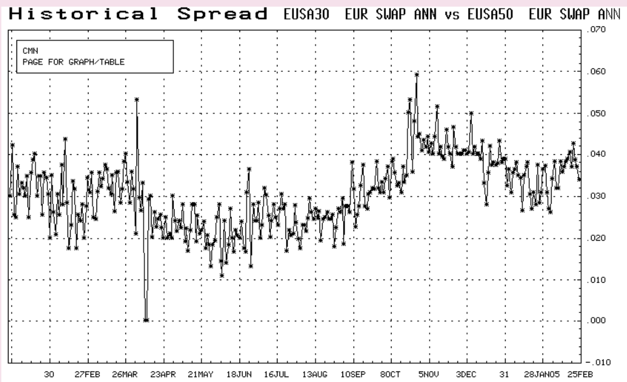


Re-steepening of the yield curve.

From a technical point of view, longer-term yields have confirmed the break above the downtrend channel keeping the outlook for higher yields intact. In 10-year yields the next point of reference comes in at 3.73%, the previous high.

10-year yields rebound sharply off the lows at 3.43%.

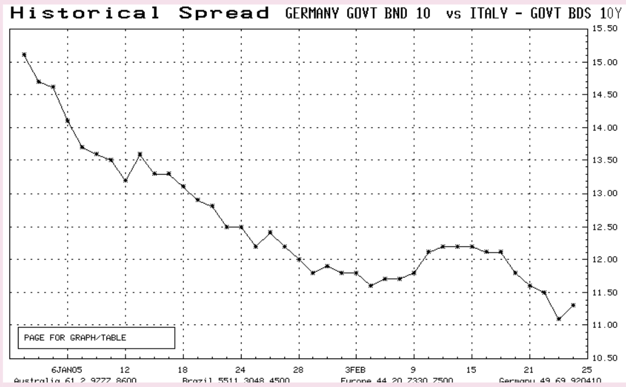
On the supply front, the event of the week was of course the pricing of the new 50-year French OAT. The bond was priced at the bottom-end of the pre-announced range between 3 and 7bp above the 30-year OAT, as demand was very strong with the order book topping EUR 20 bln compared to an amount sold of EUR 6 bln. The spread of 3bp above OAT 4.75% Apr 35 compares to a current spread of 3.5bp between the 30- and 50-year swap yield. However, the comparison is rather tricky, as liquidity is very low at that segment of the swapcurve. The success of the issuance may incite other countries to introduce 50-year bonds, such as Italy, Germany and the UK. This week Greece already announced an extension of its yield curve, as it plans to tap for the first time the 30-year segment instead the expected 5-year segment.



Spread between 30- and 50-year swapyields little changed after successful issuance of new French 50-year OAT.

Today, Italy will tap its 3- and 10-year BTPs and its 7-year CCT for a total amount of EUR 8 bln. Next week, France and Spain will tap the market but no amounts have been announced yet. Net cash flow will nevertheless be highly positive due to redemptions of the Netherlands, Italy and Germany. We however do not expect this to play a major role next week.

From a relative point of view, Italian bonds continue to outperform with the spread on 10-year yields between Germany and Italy narrowing from around 14bp at the start of the year to 11bp currently. Yield hunting is still seen as the major driver behind the move, as the relative performance of the Italian economy is rather weak and hence cannot explain the move.

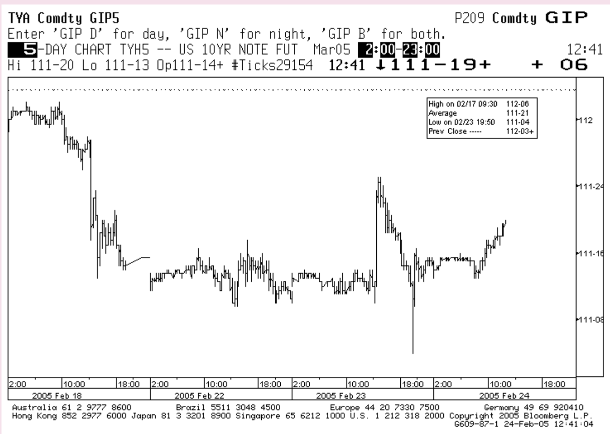


Spread between German and Italian 10-year yields keeps on narrowing.

US Money and Bond markets

What drove the markets this week?

In this shortened trading week, two moves are worth mentioning. Last Friday, a surprise jump in core PPI ignited inflation fears, pushing yields and rates higher, prolonging the movement that had been initiated a week earlier. On Wednesday, the CPI report was close to expectations, but markets clearly feared the worst. This generated a relief rally that was however reversed later in the session. It is an indication to us that the market is still (too) long and investors are still looking for rallies to trim long positions. At the time of writing, (before the US open) Treasuries are testing the upside.



March Note Future (intra-week): Market moves on high core PPI and benign CPI.

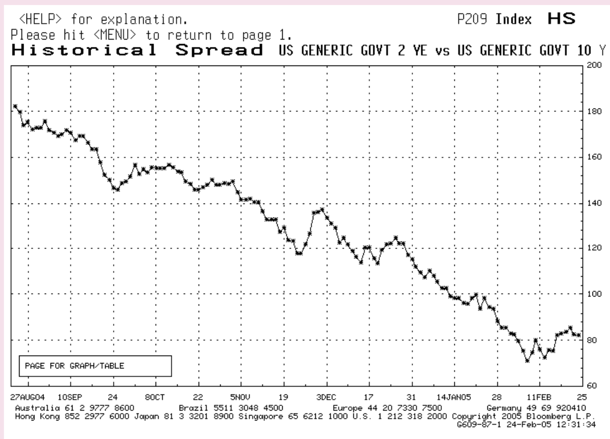
Rate expectations didn't change dramatically this week, contrary to last week (cf. table). The strip curve steepened marginally. Looking into more detail and taking the FF futures into account, the market expects a 25 basis points rate hike during the March, May and June meeting when Fed funds rates are expected to be 3.25%. T

he market discounts a slightly more than 50% chance on an extra 25 basis point rate hike for the August 9 FOMC meeting or stated otherwise 40 basis point rate increases for the 4 meetings following the June 30 meeting.

Euribors	23 Feb	17 Feb	10 Feb
Mar 2005	2.99%	2.99%	2.98%
Jun 2005	3.39%	3.38%	3.28%
Sep 2005	3.70%	3.66%	3.50%
Dec 2005	3.90%	3.84%	3.67%
Mar 2006	4.00%	3.96%	3.76%

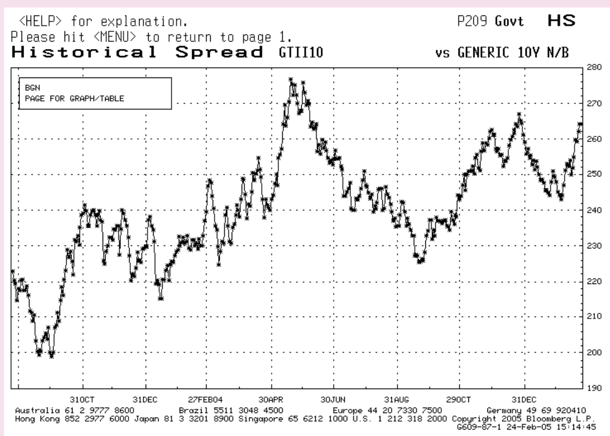
Looking to the Treasury market, yields rose across the curve since last Thursday by 6-to-8 basis points, the shorter end slightly more than the longer end. The graph of the 2-to-10-year spread clearly shows that the shape of the curve stabilized following a corrective steepening in the week before.

The current correction/pause in the flattening might have been due to the combination of Greenspan's little disguised suggestion that long yields were too low and some inflation fears. We think that the flattening has further to go, but are in no hurry to re-install flatteners.

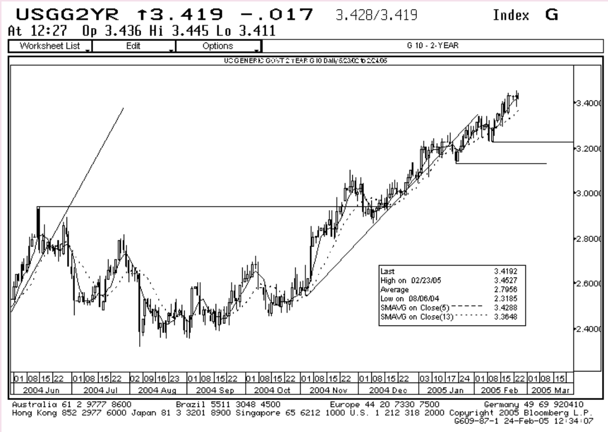


Spread 10/2-year: Stabilized this week, following a corrective widening in the previous week.

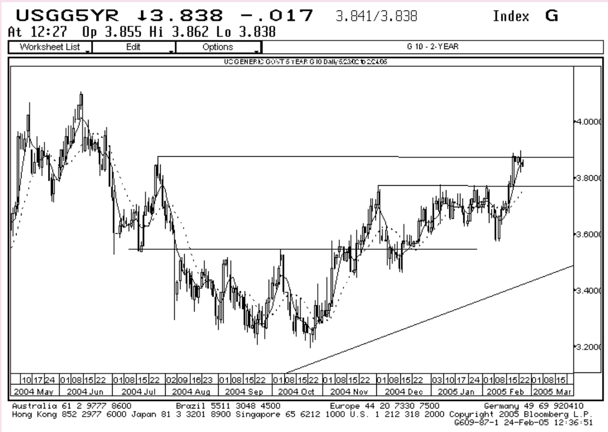
Inflation expectations are again on the rise and are closing in at the cycle highs of about 280 basis points (nominal yield minus inflation-linked 10-year yield). In our fundamental section, we elaborate on inflation and suggest that the underlying trend is for a modest increase in inflation. Should the inflation expectations rise further from here, we think the Fed would become more nervous, but we don't expect them to rise much further…



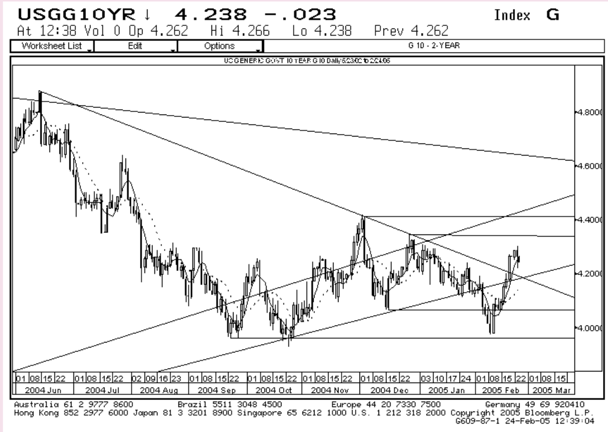
Break-even inflation again on the rise as inflation moves to the forefront



2-year yield (technical): Uptrend still very much intact with higher highs and higher lows. Yield also above MTMA at 3.37%.



5-year yield (technical): 5-year yield left sideways trading range and tests now July 2004 top. Trend is for higher yields as long as above 3.77%



10-year yield (technical): Test of sub-4% levels rejected and again above down- and up-trendline.

Our overall stance is for higher yields across the curve. However, following a sharp rise in recent two weeks, we aren't eager to add to short positions at current levels. A sell-on-up-ticks (prices) strategy looks more appropriate.

Next week, the calendar is quite interesting with the February ISM on Tuesday and the payrolls on Friday the highlights. Given the sharp drop in claims in recent weeks, the risks for the payrolls might be skewed to the upside after payrolls undercut expectations quite often in recent months.

TECHNICALLY

▪ US NOTE FUTURE (1/32): (111.19)

(HOURLY CHARTS): Drop off 113.12+ put contract back below Downtrendline off high and now moving in downchannel off 113.11 (see graph).
Range trading 111.04 (current reaction low off 113.12+) ----112.03 (weekly MT MA↓) as preferred scenario, amid ST oversold readings.
Should 112.03 fail to cap, next Resistances at 112.10 (weekly Bollinger midline), ahead of 112.15+(previous reaction lows): tough and favored to cap.
If wrong on 111.04 as range base, next levels at 111.00 (weekly Bollinger bottom), ahead of 110.23 (MT Dec spike), where ST pause favored to set in.

▪ BUND FUTURE (118.67)

Sharp drop off 120.98 highlights Double Top while below 119.26 (see graph): Range trading 118.22 (current reaction low) --- 119.08 (ST breakdown hourly) as preferred scenario.
If wrong on 119.08 as range top, next levels at 119.26 (see above), ahead of 119.47 (broken weekly MT MA↑ + weekly ST MA↓): favored to cap.
Should 118.22 fail to act as range bottom, next levels at 118.21 (1st target off 119.26), ahead of 118.11/ .03, (Dec 30 low/ 38.2% 113.27 to 120.98) where ST pause expected.

▪ GILT FUTURE (109.71)

Sharp drop off 112.48 highlights Double top off 110.51 (see graph): Range trading 109.21 (current low off 112.65) ----110.12 (weekly Bollinger midline) as preferred scenario.
Failure of 109.21 to act as ST range bottom would see risk opening towards 109.01 (Irreg C wave off 112.48): favored to hold.
1st Resistance at 109.85 (ST breakdown hourly).
Should 110.12 fail to act as ST range top, next level at 110.51 (see graph): tough.

FOREX-MARKET

FUNDAMENTALLY

▪ USD hurt

Last week we signaled a neutral bias versus the dollar, as we saw a sideways pattern evolving between the 1.29 and 1.33 zone as the most likely way to go.

Last Friday, the USD started the day in a more positive tone, with some winding down of overextended geopolitical dollar selling (Iran/Syria stories). The **US PPI** also came out stronger than expected and immediately set speculation in motion for stronger inflation and higher Fed rates. The USD tried to gain on this. The EUR/USD pair indeed went as low as the day lows at the 1.3020 zone, but as we've seen recently on a number of occasions, the dollar bears profited from this kind of moves to set up new dollar shorts, selling USD into strength. The pair was blocked and moved back up to the 1.3060 zone.

On Monday, the FX market took a day off as the US was celebrating **US President's Day**, while its President was on a trip to Europe. The speeches delivered by him and other European dignitaries didn't provide much to guide the market either. So, the EUR/USD pair stuck to a sideways pattern between the 1.3040 and the 1.3080 zone.

EUR/USD (1 week)

As calm as Monday was, as **nervous Tuesday** was! The EUR/USD pair shot higher in the morning, going from the 1.3060 zone to the 1.3160 area. The move was triggered from USD selling in USD/JPY.

Carry trades are still widely popular for the region's currencies as AUD long speculative contracts hit a new record high, while yen short contracts hit a 11 month low, according to CFTC data. Australia has policy rates at 5.25%, New Zealand at 6.5%, while Japan is having a zero % policy target, so the carry is huge.

This sort of **extreme positioning**, of course, is the ideal climate to see some wild corrections and that is just what we saw Tuesday morning in Asia. **USD/JPY** fell from the 105.60-zone to the 104.60 area. On the one hand, the news that **South Korea** was thinking about rebalancing its assets out of USD (in case of further accumulation of reserves, not selling of USD reserves) is dollar negative, while, at the same time, the news that Kim would return to the 6 party negotiations was welcomed as yen positive. Under influence of these events, USD/JPY moved lower and EUR/USD higher.

The impact of the oil price and bearish price action in Treasury markets may have been less in the focus in our weekly comments, but the recent developments (higher oil price, rising rates) are related to dollar weakness, although it is not always clear which is cause and which result. One seems to be feeding of the other to some extent.

On Wednesday morning, there was some good news for the USD, as **Japan** said it had no plans to diversify its foreign exchange reserves and **South Korea** also said it did not mean to convert USD into other assets. They were probably a bit surprised by the violence of the market reaction to the Korean comments made the day before. EUR/USD came off the highs at the 1.3270 area and dropped back to the 1.3240 zone. USD/JPY also moved a bit higher from the 104 zone to the 104.70 area, but the prior day's dollar decline was more dramatic, as it started at the 105.50 zone and went as low as the 103.80 area intraday.

USD/JPY (1 week)

All in all though, this is a very modest reaction of the dollar to the fact that Korea clearly backtracks on its earlier comments. This implies the dollar mood on the market is still biased for dollar losses. Players focus more on dollar negatives than on positives. In this environment it is difficult for the USD to make any sustained comeback.

So, while we still believe that the 1.33 zone should be very difficult to break, there are no imminent signs of any dollar comeback visible at this stage either. The Asian funding issue will be a long-term concern and will keep reports such as the TIC data/ US Treasury

note auctions in the spotlight and influential for FX market sentiment.

Wednesday evening, the **FOMC Minutes** suggested that inflation would be kept in check thanks to its policy for pushing rates higher. This could be regarded as dollar positive, but the Minutes also expressed concern about the US trade deficit, which would remain elevated ('few signs of dollar drop impact') So, all in all, not a clear bias for the USD could be deduced. At around the same time Fed's **Guynn** spoke and he suggested the Fed had still some way to go on the path of rate hikes. The impact on FX was muted though.

EUR/GBP (1 week)

Last week we advised with a certain urgency to close all sterling long positions and instead signalled a shift to sell sterling into strength. The reasoning behind this was clear: the BoE inflation report.

M4 sterling lending data last Friday showed larger than expected money growth. This could be seen as an indication that there is still life in the UK consumer. These kind of consumption related data have become very important, as the BoE has signalled paying a great deal of attention to them to determine next policy steps.

Thus the lending data brought slightly more chance on a rate hike scenario and thus was received as sterling positive on the day. This permitted the **EUR/GBP** pair to drift slightly lower, having started the day at the 0.69 zone and closing at the 0.6880 area.

Monday's higher than expected **Rightmove** house prices also pointed in the same direction, namely an increased likelihood of a BoE rate hike further down the line. Its impact wasn't really noticeable in direct GBP price action, but it may have underpinned sterling sentiment somewhat and made it more resistant to the rise in EUR/USD, which only marginally dragged EUR/GBP along higher on the day.

On Wednesday, the **German IFO business survey** disappointed, but this wasn't to affect the euro much, but there was sterling strength to be noted intraday. This had to do with the **BoE Minutes**. These showed that it was a 8-1 vote (contrary to expectations of a 9-0 to hold rates steady) and rate hikes were discussed. EUR/GBP lost some ground in the aftermath of the Minutes release and fell to the 0.6915 zone, but the move stalled once more.

The data thus were broadly supportive of the sterling over the course of the week, but the market sentiment has been wrecked by the BoE inflation report's dovish stance.

It also needs to be noted that the euro is getting a lot of help from price action in **EUR/USD** for the moment of course. EUR/USD has been moving higher and almost traditionally this dragged EUR/GBP along.

But the story on the BoE inflation stance to us is the main reason for sterling underperformance versus the euro as the dollar came under pressure in almost all crosses. That is why we stick to **a sell-sterling-on-upticks scenario**. It fits well with sentiment and is fundamentally underscored by the fact that the EMU-UK rate differential could have topped out.

TECHNICALLY

■ EUR/USD: (1.3240)

DAILY CHARTS: Good rebound off 1.2729 has broken inverted channel off 1.3292 (see graph) and is reapproaching Jan 12 high of 1.3292 (+ 4th hourly).
Range trading 1.3055 (weekly ST MA↑) ---1.3308 (61.8% 1.3667 to 1.2729) as preferred scenario, amid ST overbought readings.

1st Resistance at 1.3273 (ST high off 1.2729).
Should 1.3055 fail to act as range bottom, next levels at 1.2951 (Feb 15 low), ahead of 1.2896 (break-up daily Feb 11), where pause expected to set in.

If wrong on 1.3308 as ST range top, next levels at 1.3445 (76.4% off 1.3667), ahead of 1.3578 (weekly Bollinger top): favored to cap on first tests.

USD/JPY: (105.05)

Strong rebound off 101.65 has puts pair back above weekly channel off 2002 high but currently back below neckline of ST Double Bottom (105.19: see graph).

Range trading 103.64 (61.8% 101.65 to 106.86) --- 105.88 (Feb 18 high) as preferred ST scenario, amid weekly overbought readings.
1st Resistance area at 105.41 (breakdown hourly).

If wrong on top, next levels at 106.86 (recovery high off 101.65): favored to cap.
Sustained trade below 103.64 would see attraction towards 103.32/ 102.87 (Feb 02/ 76.4% off 106.86), where ST pause likely.

■ EUR/GBP: (.6935)

Good rebound off .6843 has broken daily Downchannel off .7107 (see graph).
Range trading .6903 (ST break-up daily)---- .6968 (previous MT reaction low) as preferred scenario, amid ST overbought readings.

Should .6903 fail to act as range bottom, next levels at .6876 (Feb 21 low), favored to hold.
.6843/ .6839 (current reaction low off .7107 + neckline Double Top: see graph / 50% .6572 to .7107) = key area for MT development: tough.

If wrong on .6968 as ST range top, next levels at .6975 (50% .7107 to .6843), ahead of .7000 (psycho + broken LT daily channel bottom off last July: see graph): favored to cap.

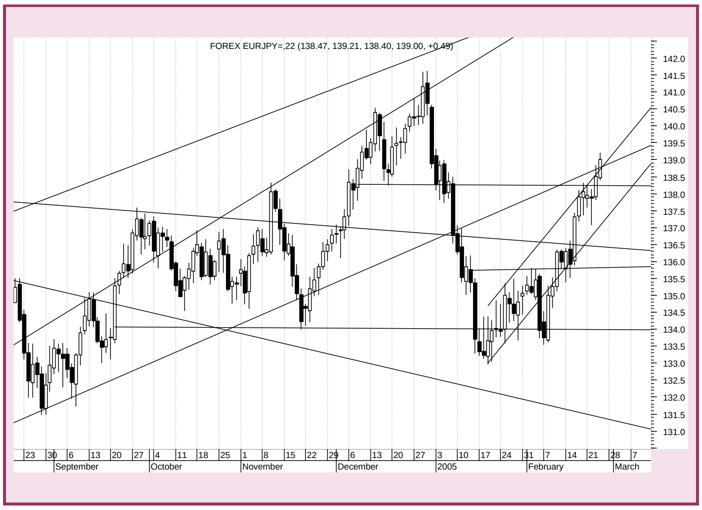
▪ EUR/JPY: (139.05)

Rebound off 132.96 has seen pair trying to sustain back above Uptrendline off 2004 low (see graph).

Range trading 136.60 (break-up daily Feb 15)— 139.56 (76.4% 141.61 to 132.96) as our preferred ST scenario, amid ST overbought readings.
1st Support at 137.37 (weekly ST MA↑).

Should 136.60 fail to act as ST range bottom, downside pressures would see attraction towards 135.38 (Feb 14 low), where ST pause expected to set in.

Should 139.56 fail to act as ST range top, next levels at 140.30/ .58 (1st wave down/ weekly Bollinger top): likely hard nut to crack.



▪ EUR/CHF: (1.5395)

Sharp drop off 1.5634 has retested broken LT daily Downtrendline off 2004 high, with pair trying to recoup above neckline Double top (1.5394: see graph).
Range trading 1.5344 (ST low off 1.5634 + weekly Uptrendline off 1.4490) -----1.5462 (broken weekly MT MA↑) as preferred scenario.
1st Resistance at 1.5428 (ST breakdown daily).
If wrong on 1.5462 as ST range top, next level at 1.5482 (weekly ST MA↓): likely hard on first tests.

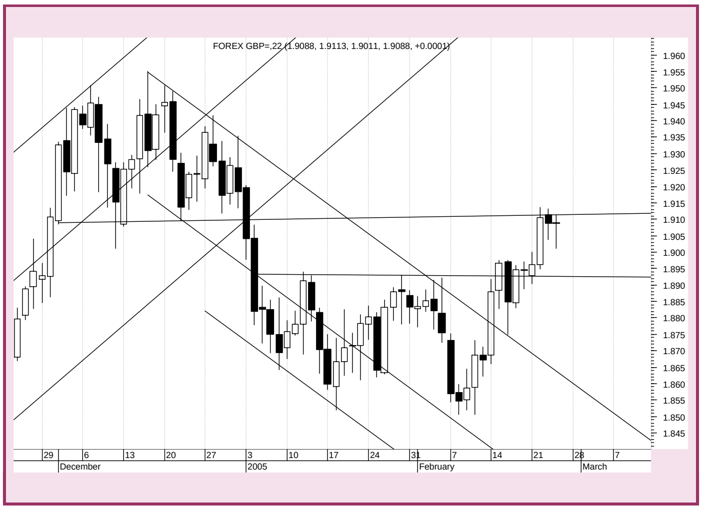
Should 1.5344 fail to act as ST range bottom, next level would come in at 1.5289 (76.4% 1.5076 to 1.5634), where ST pause expected to set in.

▪ GBP/USD: (1.9129)

Strong rebound off 1.8506 extended 1.9139, in an attempt to recoup previous breakdown area (see graph).

Range trading 1.8940 (see graph: neckline Triple bottoms)---- 1.9139 as preferred scenario, amid ST overbought readings.
Should 1.8940 fail to act as ST range bottom, next levels at 1.8860 (weekly Bollinger midline), ahead of 1.8749 (4th hourly), where ST pause expected.

If wrong on 1.9139 as ST range top, next levels at 1.9151/ .9156 (61.8% 1.9550 to 1.8506/ 1st target daily channel break off 1.9550), ahead of 1.9197 (reinstalled MT weekly channel top): likely tough on first test.



10-year	td	-1w		2 -year	td	-1w	STOCKS		-1w	
US	4.25	0.06		US	3.44	0.04	DOW	10611	-223.68	
DE	3.71	0.14		DE	2.47	0.04	NASDAQ	2030	-57.11	
BE	3.71	0.13		BE	2.53	0.04	NIKKEI	11531	-51.57	
UK	4.77	0.14		UK (3yr)	4.74	0.14	DAX	4299	-71.80	
JP	1.41	0.00		JP	0.24	-0.01	DJ euro-50	3028	-40.47	
IRS	EUR	USD	GBP	Eonia	2.06	0.03	3-m f.	1st	-1w	2nd
3y	2.869	3.978	5.093	Euribor-1	2.10	0.03	euro	97.850	-0.01	97.755
5y	3.220	4.207	5.083	Euribor-3	2.14	0.02	dollar	97.008	0.00	96.600
10y	3.793	4.623	5.060	Euribor-6	2.19	0.02	sterling	95.03	-0.05	94.91
Currencies		-1w		Currencies		-1w	Commodities	CRB	GOLD	BRENT
EUR/USD	1.3254	0.0196		EUR/JPY	138.94	1.0900		299.16	435.1	48.12
USD/JPY	104.85	-0.7000		EUR/GBP	0.6947	0.0042	-1w	10.59	8.40	2.45
GBP/USD	1.9075	0.0167		EUR/CHF	1.5396	-0.0081				
AUD/USD	0.7875	0.0006		EUR/SEK	9.072	-0.0279				
USD/CAD	1.2469	0.0165		EUR/NOK	8.2365	-0.1355				

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