



Sunrise Market Commentary

From KBC Market Research Desk - More research on www.kbc.be/dealingroom

- US Treasuries down for third session in a row
- European yields close in to the recent highs
- USD disappoints friends and foes
- Earnings season to spark another positive surprise?

Global overview

S&P	→
Eurostoxx50	↗
Nikkei	↗
Oil	↗
CRB	↗
Gold	↗
2 yr US	↗
10 yr US	↗
2 yr EMU	↗
10 yr EMU	↗
EUR/USD	↗
USD/JPY	↗
EUR/GBP	→

Earnings season to spark another positive surprise?

Last Friday's US payrolls release concluded the important first week of the month. The conclusion after the key eco data published in the major economies is that, at least at this stage, policymakers including the Fed and the ECB succeed very well in their attempts to steer the economy to some kind of soft landing scenario. In general, the economy seems well on track to maintain a decent level of growth without causing too many (demand-driven) inflationary pressures. However, for markets this equilibrium is never guaranteed for a prolonged period of time and with interest rates creeping higher again, the uncertainty seen during most of last month probably will resurface at some point in the weeks to come.

On the markets, the inability of the dollar to regain ground against the single currency remains striking, even after quite a series of good US eco data. Good news or bad news, everything is still a reason for the yen to weaken further. In the interest rate markets, yields gradually move back up coming close to the highs registered earlier last month. With no important eco data on the calendar it will be interesting to see whether these technically important levels on the interest rate markets will do their job.

However, the attention now shifts to the (US) earnings season, with Alcoa's earnings to be published after the closing today still the official start to the earnings' season. Question is whether the improvement in the macro data throughout the second quarter will also be translated into a good earnings season. The odds aren't that bad. The number of profit warnings is reasonably low compared to the same quarter last year, while the expected earnings growth in general is not that high. Of course, the outcome of the data is one factor; the market reaction is always something different. In this respect, it will be interesting to see whether strong earnings, if there were to occur, will be able to overcome the hurdle of higher interest rates as they managed to do several times before over the previous years. The technical picture will have an important say in this debate, with a lot of indices trading very close to key levels.

Quote of the day: "It's very important for the European Commission, the ECB and the European Council itself that the Stability and Growth Pact is respected", ECB's Trichet ahead of this evenings' Eurogroup meeting

Markets: Fixed Income

	US yield	-1d
2	4.9961	0.0296
5	5.103	0.0651
10	5.1972	0.0637
30	5.2818	0.0522
	DE yield	-1d
2	4.5460	0.0360
5	4.6480	0.0460
10	4.6900	0.0420
30	4.8010	0.0300

On Friday, US and EMU bonds were hit for the third, respectively fourth consecutive session, the US market "profiting" from July 4th holiday, leaving yields moderately higher on the day. The culprit was clearly the US payrolls report (cf. news section). The June results were near expectations, but there were robust upward revisions in the net job creation of the previous two months that gave the overall report a positive spin, especially coming on the heels of healthy manufacturing and Non-manufacturing surveys released earlier last week. German factory orders, released at noon were a good deal stronger-than-expected, but the market ignored them. In both the US and EMU the shorter end outperformed, continuing the steepening that has been a theme during the whole trading week. Higher oil prices, also on Friday, were probably responsible for renewed inflation fear. Financial 10-year US inflation expectations jumped 4 basis points in the last two sessions. In a daily perspective, US yields were up another 2 to 4.5 basis points, while German yields edged 2 to 3 basis points higher.

Intra-day, the Bund opened little changed, but soon edged lower, as the ongoing bad sentiment continues to keep the market in its grip. A mi-morning rebound occurred though, leaving the Bund in a sideways tight range below opening levels until the US market opened. Bonds were already slightly further down when the US payrolls hit the screens. Bonds and Bunds immediately plunged lower and the Bund nearly testing the sell-off lows (which stand at 109.66), while in the US yields were also testing important support, albeit not the sell-off lows like in Europe. As these levels held, prices rebounded, but soon met more selling driving the prices again down to intra-day lows. These held again though, but there wasn't any noteworthy buying at these levels, leaving the bonds with clear, but moderate losses in the close.



Bund future (20 days) Tepid rebound short-lived as Bund revisits the contract low following a four days losing streak.

US Treasuries down for third session in a row

R2	104 31+	-1d
R1	104 24+	
T-Bond	104 21/32	- 6/16
S1	104 17+	
S2	104 15+	

Looking ahead to this week's calendar, the economic calendar is quite light at least until Friday when the June retail sales and the July Michigan consumer sentiment reports will be released. Fed appearances include Fed chairman Bernanke on inflation on Tuesday, Fed Warsh on hedge funds and Philly Fed Plosser on policy on Wednesday and Fed Kroszner on Basel 2 and San Francisco Fed Yellen at luncheon on Thursday. While the speech of Bernanke will get all attention and might be interesting, it is unlikely that the Fed will convey some new message to the markets. The recent FOMC statement suggested clearly that while the Fed sees some slowing in core CPI, it is not convinced that it should react on that with lower rates anytime soon. The Treasury will issue a 9 B USD 10 year TIPS on Thursday.

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Technicals Sep T note future:

The MT technical picture of the Sep-Note future is bearish. A massive double top formation with neckline at 106-06+ is visible on continuation chart with targets at 103-01/102-24. A move above 106-06+ (prev. contract low on continuation charts) would be a positive signal suggesting that the sell-off is over for now, while a drop below 103-20+ (contract low), would color the picture deeper black.

Support stands at 104-17+ (S1 last week low/62̄ retracement), at 104-16/15+ (S2 22 June low/ 1 target SR double top) at 104-10/08 (S3, Starc bottom/ Daily envelope/ 2e target), at 104.06+ (76% retracement).

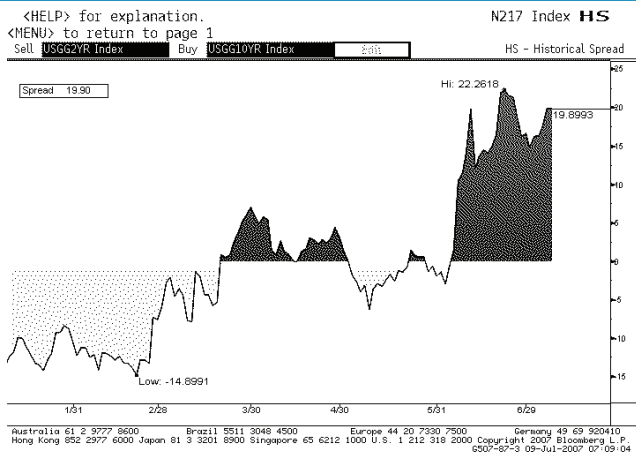
Resistance stands at 104-24+ (R1 daily envelope), at 104-28/31+ (R2, breakdown hourly/ Bollinger mid-line), at 105-04+/06 (R3 neckline double top/ STMA/MTMA), at 105-07 breakdown hourly) and at 105-16/18 (R4, MT reaction high hourly/ gap).

The contract is close to oversold territory.

Regarding the eco data, the consumer credit and wholesale inventories on Monday and Tuesday are no market movers and no data are published on Wednesday. On Thursday, **the initial claims** are expected little changed at 315 000, and while we have no strong feelings about the outcome, it is worth remembering that the traditional early July shutdowns at the carmakers may affect the seasonal adjustment process and result in some kind of a surprise. The May trade balance is expected to widen because of higher oil imports (price effect). Friday is more important in terms of data. The import prices are expected to be up 0.6% M/M, but with upside risks. However, the market will probably ignore the outcome, as it will do with the business inventories. The **June retail sales** are more important though and often surprise. The market expects a flat outcome (0.2% M/M for sales excluding cars). The risks seem to be on the downside, because of four sectors. Building materials and clothing surged in June and some payback should follow in July. Gasoline sales should fall because of lower gasoline prices, as compared to the previous month, while the unit car sales figures for June suggest a fall in car sales. The **Michigan consumer sentiment** should be an offset as a rise is expected with maybe still some upside risks compared to consensus expectations. The ABC consumer comfort index rose 5 points in the most recent week and some improvement in the Michigan series was already apparent in the final June report.

Regarding trading, last week US Treasuries took again a turn for the worst following some corrective gains in the previous week. Stronger eco data, higher oil prices, technical support levels that held, reversing safe haven flows and a good run of equities contributed to the renewed weakness. The whole curve shifted quite substantially higher, with the short end clearly outperforming. The 2-to-10-year yield spread widened again to about 20 basis points, nearing the recent highs, up from 15 basis points early in the week. Inflation expectations as derived from the TIPS widened too.

This week, trading might be technical-oriented, at least until Friday, unless Bernanke surprises us, which is rather unlikely. The market is still captured in a wide range for the 10-year yield of 4.90%/5% till 5.25%/5.32%, with the 5.20% resistance holding on Friday. In terms of the Sep Note future, the range is 103-20+ to 106-10+. In the corrective phase that stopped last week, the 10-year yield tested the 5% on the downside and the 5.20% on the upside, but without success. We would take these levels to orient trading this week, with the wider boundaries as flashing red lights that would signal a resumption of the sell-off (103-20+ or 5.32%) or a change in sentiment for the better (5% or 106-10 Sep Note future). In a longer perspective, we keep a bearish stance, but short term sideways trading may kick in. Shorts could keep their positions open, while a sell-on-up-ticks could be rewarding with the 106 area the ideal entry point



2-to-10 year yield spread widens again coming close to recent highs



10-year Note future : correction over, as Treasuries drop below bearish flag.

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R2	110.27	-1d
R1	110.02	
BUND	109.92	-0.3100
S1	109.77	
S2	109.66	

Technicals September Bund future

The technical picture of the Bund is still bearish, as the Bund fell back into the downtrend channel.

Intra-day, **support** comes in at 109.77 (Friday's low), at 109.66/65 (contract low/daily Bollinger bottom), at 109.54/50 (daily Starc bottom/daily envelope) and at 109.22 (first irregular B)

On the topside, **resistance** stands at 110.02 (daily envelope), at 110.21/27 (Friday's high/STMA), at 110.37/41 (break down/daily Bollinger midline) and at 110.51/58 (MTMA/top downtrend channel).

The Bund contract is again oversold.

European yields close in to the recent highs

Following last week's PMI surveys and ECB meeting, the euro zone calendar will remain very thin this week. The industrial production data are usually no market mover. However, following a weak start of the second quarter, a rebound in the May output data is generally expected.

On the ECB front, there are a number of ECB speeches scheduled, but following last week's press conference, it's unlikely that they will say anything new. As such, impact may remain limited. Last week, the ECB clearly indicated that rates will rise again, but left the timing open between September and October. Given the strength of recent data, we still prefer a rate hike in September, which is also preferred by current market expectations. If growth does not slow abruptly in the second half of the year, a rate hike to 4.50% by the end of the year or early next year can still be expected. This is currently in line with market expectations. For a more profound view we refer to our website www.kbc.be/dealingroom.

This evening, French president Sarkozy will attend the Eurogroup meeting of Ministers of Finance, which will also be attended by ECB president Trichet. Last week, the ECB and Germany clashed with France over its plans to cut taxes and delay their target for a balanced budget from 2010 to 2012. Both fear that such a delay will destroy the revamped Stability and Growth Pact and strongly criticized pro-cyclical fiscal policies, as it may bring about budget problems when the economic cycle turns. Last Thursday, the ECB even warned that such a pro-cyclical fiscal stance increases the upside risks to price stability, which may in turn lead to a more restrictive monetary policy. It's not that easy to pursue such a trade-off but it is important for the ECB to prevent that countries get a free-rider status reaping the benefits of the monetary union, but at the same time refusing the eventual disadvantages.

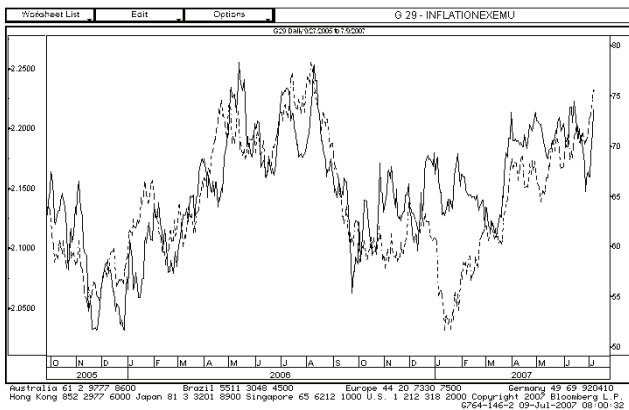
Regarding trading, last week European yields confirmed the break higher above the 2003 highs at 4.50%. This keeps the outlook for yields upwardly oriented. The fundamental picture supports the technical outlook, as growth in the euro zone is still strong and the US data supported the re-acceleration story in the US. Given the thin calendar this week, we expect the bearish sentiment to remain in place. The upside in yields at the short end may however be somewhat limited, which still supports a further re-steepening of the European yield curve. The more in case the euro would break above the lifetime highs.

In the UK, Gilts tracked the European bond market lower following the release of the stronger than expected US Payrolls report.

Today, the PPI will remain rather elevated, but this won't change the outlook for UK interest rates. Currently, the market still expects a further rate hike to 6% in the second half of the year.

<HELP> for explanation.

N172 Index G



Inflation expectation expectations (solid line) back on the rise as oil prices (dotted line) surge higher.

ComdtyG



Bund firmly back in downtrend channel.

Currencies: USD disappoints friends and foes

R2	1.3665	-1d
R1	1.3641	
EUR/USD	1.3595	0.0034
S1	1.3568	
S2		

The **EUR/USD** pair ticked slightly higher on Friday, closing up from the 1.36 zone at the 1.3620 area. This came despite upbeat US data and is worrying as such for the Greenback.

The market awaited the outcome of the **US payrolls**. The outcome was a bit of a wildcard, with contradictory signals throughout the week. The actual outcome was comforting though with a growth of 132K for June and the April and May figures were actually revised higher. Good news for the dollar one would think, but the truth was that the Greenback could not gain on the release.

We don't feel more dollar softness would be warranted if the US data continue to show an economic recovery. Still, the present dollar performance cannot be labeled any differently than a disappointment. **The dollar should have gained over the course of last week, judging by all the positive eco news, including also 2 ISM reports. This hasn't been the case.**

Some disappointment showed on Friday: after the good enough payrolls report, the dollar couldn't gain and new dollar sellers tried to push it the other way of course: what can't go up, must come down, speculators thought about the USD. This helped push EUR/USD from the 1.36 area to the 1.3620 zone.

This week the data are back-loaded, with the **US trade balance** on Thursday and **retail sales** on Friday. This would suggest some range trading until then, capped by the year highs at the 1.3680 zone.

Technicals EUR/USD

The pair is in overbought territory.

Support is seen at 1.3603/1.3595 (ST break-up / daily envelope), at 1.3568 (reaction low) and at 1.3555 (neckline double bottom).

Resistance is seen at 1.3641 (ST high), at 1.3660 (last week high) and at 1.3683 (historic high).



EUR/USD (30 days): sticking close to the highs

R2	123.95	-1d
R1	123.72	
USD/JPY	123.64	0.3700
S1	122.98	
S2	122.76	

Over the past week, the **USD/JPY** pair had a fabulous week erasing all the recent yen gains. The pair popped up from the low 122 to the mid 123's.

Everybody has forgotten everything about the yen revival of last week, with the safe haven theme at that time. Now everybody is seeing good data in the US and the EMU, and the carry trade theme is again the overriding principle to guide the market thinking. **In this sentiment, it is obvious that the logical choice for USD/JPY and EUR/JPY is to the upside.**

EUR/JPY thus gradually rose to fresh record highs at the 168 zone on Friday and seems to be deepening this move this morning. The process is ongoing and continues it would seem. **USD/JPY** is gradually rising from the 123 zone to the mid 123's. This morning the pair seems to be sticking to this direction reaching the 123.60 zone.

There doesn't seem to be a reversal signal available for the yen. The BoJ is not coming to the rescue, markets are wondering about deflation, while other economic areas are showing strength. Also, there is only very limited commotion about the weakness of the yen. This is very strange. The French policy makers over the past week also only lashed out against dollar and yuan, not the yen. This week's EcoFin

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meeting may shed some more light on the situation. French President Sarkozy and his ministers will elaborate their point of view most likely over the coming days.

The US is still focusing on China, with now also Secretary Rice targeting the weak yuan for criticism. This is not having an impact on USD/Asia. It is seen as really limited to the USD/CNY pair and that is ultimately a Chinese choice to manage this FX rate.

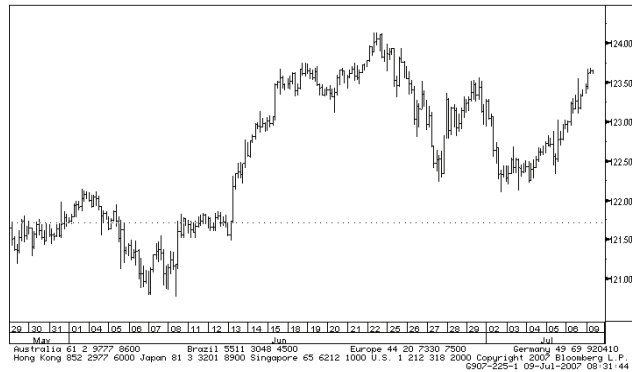
Technicals USD/JPY

The pair is neutral.

Support is seen at 123.14 (MT MA), at 122.98 (daily envelope + ST MA), and at 122.83 (ST low).

Resistance is seen at 123.72 (daily envelope), at 123.95 (MT reaction high) and at 124.14 (year high).

JPY ↑ 123.61 +.27 ANON 123.61/123.61 WACH CurrencyGIP
 At 8:31 Op 123.37 Hi 123.68 Lo 123.35 Prev 123.34 Value 7/11/07
 30-DAY CHART JPY JAPANESE YEN SPOT - CMPN 23:00-22:59 Trade 8:31



USD/JPY (30 days): rising to the top again?

R2	0.6793	-1d
R1	0.6780	
EUR/GBP	0.6773	0.0011
S1	0.6754	
S2	0.6741	

EUR/GBP rose slightly from the 0.6760 zone to the 0.6778 zone last Friday. This morning the pair eased slightly to the 0.6770 zone. The post-BoE/ECB environment hasn't been too kind on the sterling, with some losses recorded since Thursday.

German factory orders rebounded in May rising 3.2% M/M and 7.5% Y/Y. The German industrial sector is still doing very well. In the UK, manufacturing production increased by 0.3% M/M and 1% Y/Y in May. Data suggest the two currency areas are still going strong.

Now the pair is testing the neckline of a triple bottom formation at 0.6780. A break above would signal more sterling losses short-term. As long this is not the case though we are somewhat more sterling favourable, believing such a break would be difficult without any fresh news. There are some UK data scheduled this week with the PPI today and the trade balance tomorrow.

In a longer-term view, we keep a buy-sterling-on-dips bias, as we see a wide rate differential remaining in place in favour of the sterling. The strong UK data, rising house prices and BoE statement itself suggest the BoE is not done either and should respond to potential ECB rate hikes.

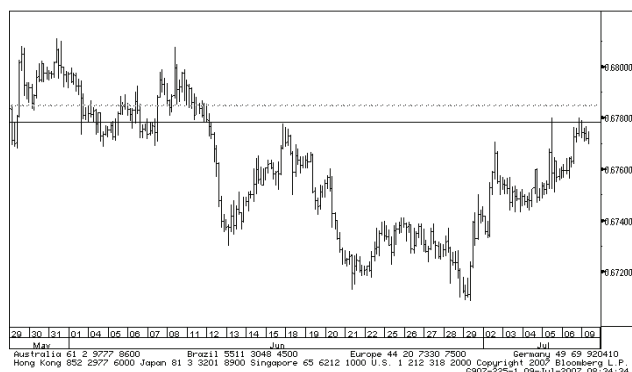
Technicals EUR/GBP

The pair is neutral.

Support is seen at 0.6764 (ST MA), at 0.6742 (ST low) and at 0.6731 (last week low).

Resistance is seen at 0.6779 (last week high), at 0.6787 (50% retracement) and at 0.6806 (62% retracement).

EURGBP ↑ .67720 - .00065 ANON .67720/.67720 HSFY
 At 8:34 Op .67789 Hi .67791 Lo .67699 Prev .67785 Value 7/11/07
 30-DAY CHART EURGBP EUR-GBP X-RATE - CMPN 23:00-22:59 Trade 8:34



EUR/GBP (30 days): testing the neckline of a triple bottom



News

US: Payrolls higher than expected.

Employment as measured by the US BLS in June rose by a slightly higher-than-expected 132K compared to a market expectation for a rise of 125 K. On top of that, the figures for May (190 K versus 157 K) and April (122K versus 80 K) were revised materially higher, making the report materially stronger than expected.

The biggest contribution to job growth came again from the service producing sectors, with education and health (59K), leisure and hospitality (39K) and government (40 K) the most important components. These sectors are of course only loosely related to the business cycle. Retail trade was an outlier, as this sector shed 24K of jobs. In the goods producing sector, manufacturing shed another 18K jobs, but construction was back in positive territory (12 K), so obvious no big fall-out from the crisis in the housing market yet, even if these data become more and more unreliable. The temporary help services sector lost again jobs.

Average hourly earnings rose 0.3% M/M, in line with expectations, but due to an upward revision of the previous months, the Y/Y reading came out at 3.9% (compared to 3.7% expected). The unemployment rate was stable at 4.5%. Average weekly hours worked rose from 33.8 to 33.9. A similar trend was seen for manufacturing hours (41.3 versus 41.1) and in this sector the overtime hours were on the rise as well (4.3 versus 4.2).

In general, the report should be considered as reasonably strong, with wages and overtime hours pointing to some (albeit) moderate underlying inflationary pressures. The report is consistent with other evidence recently that the US economy is again in a rather good shape after the dip in the first quarter.

EMU: German factory orders rebound

German factory orders rebounded in May rising 3.2% M/M and 7.5% Y/Y. The German industrial sector is still doing very well. The strong rise in consumer goods (4% M/M) may indicate that consumer spending is finally improving.

Other: UK industrial production grows at a steady pace

In the UK, **manufacturing production increased by 0.3% M/M and 1% Y/Y in May**. On a three-monthly basis, production was also up 0.3% in three months to May compared with the three months to February. Overall industrial production increased by 0.6% M/M in May and was also up 0.3% on a three monthly basis, as the strong rise in the mining and quarrying sector was partially offset by a large decrease in the energy supply sector. The recent interest rate hikes haven't had a large impact on production output yet.

Calendar

Monday, 09 July		Consensus	Previous
US			
21:00	Consumer Credit (May)	5.5B	2.6B
Japan			
01:50	Machine Orders (May) M/M Y/Y	A 5.9% / -3.1%	2.2% / -9.0%
01:50	Money Supply M2+CD (Jun) Y/Y	A 1.8%	1.4%
01:50	Broad Liquidity (Jun) Y/Y	A 3.6%	3.1%
07:00	Eco Watchers Survey : Current (Jun)	A46	46.8
07:00	Eco Watchers Survey : Outlook (Jun)	A48.4	50.0
UK			
10 :30	PPI Input (Jun) M/M Y/Y	0.9% / 2.1%	1.2% / 1.2%
10 :30	PPI Output (Jun) M/M Y/Y	0.3% / 2.6%	0.4% / 2.5%
10 :30	PPI Output Core (Jun) M/M Y/Y	0.3% / 2.4%	0.2% / 2.4%
Germany			
08:00	Current Account (May)	9.0B	9.6B
08:00	Trade Balance (May)	15.9B	15.0B
12:00	Industrial Production (May) M/M Y/Y	1.9% / 4.4%	-2.3% / 3.8%
Sweden			
10:00	AMS Unemployment Rate (Jun)	3.8%	3.3%
Events			
13:30	BOE's Blanchflower speaks in Berlin at the 'Summer Institute on Entrepreneurship'		
19:00	ECB's Stark speaks in Tuttingen		
US	10-year TIPS announcement for 12 Jul (USD 9B)		
EMU	Eurogroup Meeting		

10-year	td	- 1d	2-year	td	- 1d	STOCKS		- 1d		
US	5.20	0.06	US	5.00	0.03	DOW	13611.60	45.52		
DE	4.69	0.04	DE	4.55	0.04	NASDAQ	2666.51	9.86		
BE	4.77	0.04	BE	4.56	0.03	NIKKEI	18261.98	121.04		
UK	5.60	0.04	UK (3yr)	5.86	0.05	DAX	7987.13	-88.13		
JP	1.95	0.01	JP	1.26	0.01	DJ euro-50	4524.45	32.58		
IRS	EUR	USD (3M)	GBP	Eonia	4.06	0.01	3-m.f.	1st	- 1d	2nd
3y	4.844	5.528	6.351	Euribor-1	4.11	0.00	euro	95.850	0.00	95.615
5y	4.896	5.649	6.288	Euribor-3	4.20	0.01	dollar	93.595	-0.07	94.645
10y	4.991	5.831	6.015	Euribor-6	4.35	0.01	sterling	94.108	0.00	93.820
Currencies		- 1d	Currencies		- 1d	Commodities	CRB	GOLD	BRENT	
EUR/USD	1.3615	0.0034	EUR/JPY	168.3	0.91		320.86	654.5	75.52	
USD/JPY	123.64	0.37	EUR/GBP	0.6772	0.0011	- 1d	2.34	5.80	0.93	
GBP/USD	2.0101	0.0018	EUR/CHF	1.6593	0.0033					
AUD/USD	0.8586	0.0029	EUR/SEK	9.159	0.00					
USD/CAD	1.0464	-0.0093	EUR/NOK	7.9118	0.00					



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