

Euro wrap-up

Overview

- Bunds made very modest gains as investors took a pause for breath following recent Brexit-related turbulence.
- Following the massive gains of the past few days, Gilts made modest losses as UK political noise continued to dominate.
- Attention on Wednesday will be on the EU leaders' summit, where the UK will be excluded from discussions.

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Daily bond market movements

Bond	Yield	Change*
BKO 0 06/18	-0.665	-0.013
OBL 0 04/21	-0.566	-0.018
DBR 0½ 02/26	-0.120	-0.004
UKT 1¼ 07/18	0.188	+0.037
UKT 1½ 01/21	0.443	+0.039
UKT 2 09/25	0.955	+0.021

*Change from close as at 4.30pm BST.
Source: Bloomberg

UK

UK downgrades....

The dust is still a long way from settling following the Brexit referendum result. Perhaps inevitably, the UK yesterday lost another of its AAA credit ratings, with S&P announcing a two-notch downgrade to AA, while Fitch went for a one-notch cut, likewise to AA. Together with Moody's (Aa1), all three major credit agencies have left their UK rating on negative outlook, suggesting that more downgrades might be on the way in due course. Certainly, the longer that there is no sign of any coherent plan emerging from the victorious Leave side, the greater and more persistent the period of uncertainty and hence the greater the economic damage. And the greater the economic damage, and the more dysfunctional the politics, the more likely it is that further downgrades will follow. Meanwhile, the last of the special repo operations conducted by the BoE around the date of the referendum saw demand soar. Having taken up £370mn at the pre-referendum operation last week, banks were allotted £3.1bn this time.

...while EU Leaders stand firm on what's on offer

Uncertainty over the way ahead for the Brexit negotiations looks set to persist for weeks. A leadership vacuum at the top of government will remain for as long as there is no effective Prime Minister, with the Conservative Party's leadership election not due to be concluded until 2 September. And the two-day EU leaders' summit, which kicked off today, highlighted the extent to which that vacuum is eroding what little bargaining position the UK still has. Prime Minister Cameron certainly has a difficult challenge to explain the UK's post-referendum position and plead for constructive negotiations against a backdrop of hostile attitudes and criticism from other EU leaders. Ahead of the summit German Chancellor Angela Merkel, who the Leave campaign had expected to take a more emollient stance, firmed up her position, making it clear that the UK will not be allowed to enjoy the benefits of EU membership without accepting its rules, a clear signal that Single Market access will require the UK to accept free movement of labour, something that Boris Johnson (laughably) claimed yesterday would not be the case. Overall, the summit will simply expose the weakness of the UK bargaining position, which will be particularly obvious tomorrow when Cameron will be excluded from discussions among the remaining 27 member state leaders.

The day ahead in the UK

All eyes tomorrow in the UK will remain on political developments. On the data front, the latest BoE lending figures for May are due for release. But all pre-referendum data are now largely irrelevant given the monumental shift in the UK's economic prospects in the wake of last week's vote.

Euro area

French consumers a little less optimistic

While it will inevitably be a while before the full economic impact of the UK's referendum result becomes evident, surveys suggest that certain euro area member states had already lost some growth momentum at the end of the second quarter. That is particularly true of France. But while today's French INSEE consumer confidence survey saw the headline index fall back in June by 1pt to 97, to remain below its long-run average, having previously risen to the highest level since October 2007 this still left the average for the second quarter as a whole up 1pt from Q1 at the highest in more than eight years. And while the weakness in June principally reflected a marked fall in the share of households considering it a suitable time to make major purchases, the respective index was still above its long-term average suggesting that household consumption continued to provide support to GDP growth in Q2. Overall, we still forecast a slowdown in French economic output in the second quarter to 0.2%Q/Q.



Italian consumer and business confidence signals softer GDP growth

Italian consumers were also notably less optimistic in June, with the ISTAT headline indicator down for the third consecutive month and by more than 2pts to a ten-month low of 110.2. While the weakness was widespread, there was a marked deterioration in expectations of future economic conditions, with the relevant index down more than 4½pts to its lowest since the start of 2015. Against this backdrop it was perhaps not surprising to see that Italian retailers were also more downbeat in June, with the relevant index down for the seventh month out of the past eight, while other service sector firms also signalled a further deterioration in confidence in June. So, despite a modest improvement in conditions in the manufacturing and construction sectors, the composite business confidence indicator fell by more than 1pt to a three-month low of 101.2. And overall, we continue to expect Italy's GDP growth in Q2 to be the weakest of the largest four member states at just 0.1%Q/Q.

Spain's economy likely remained the top performer in Q2

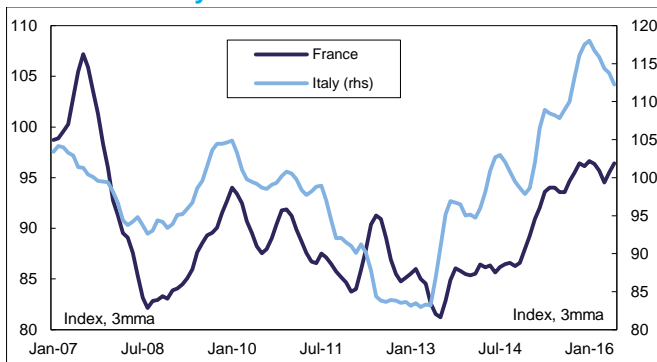
In contrast, the Bank of Spain today suggested that its country's GDP growth in Q2 slowed by just 0.1ppt to 0.7%Q/Q, a rate that is likely again to have been the strongest of all large member states. While the Bank identified a moderation in business investment in the second quarter, it also noted that household consumption had remained firm supported by the ongoing increase in employment, which in May exceeded 17.5mn for the first time for five years and was 1.3mn above the post-crisis low. This notwithstanding, we continue to forecast overall euro area GDP growth in Q2 to ease to about 0.3%Q/Q, close to the average of the economic recovery to-date. And in light of increased uncertainty in the aftermath of last week's UK referendum vote, we might well see a further slowdown in GDP growth over coming quarters too.

The day ahead in the euro area and US

Of course, the main event tomorrow will be the second day of the EU leaders' summit, with talks set to continue among the remaining 27 member state leaders about how to respond to the UK referendum. While data will continue to be of secondary importance at least until we get some figures relating to the post-referendum period, Wednesday brings more sentiment indicators with the Commission's business and consumer surveys for June expected to show that the headline euro area economic sentiment index was unchanged at May's four-month high of 104.7. The latest German consumer sentiment survey is due for release too. Tomorrow also brings the flash estimate of German and Spanish inflation in June, with the former expected to rise to 0.2%Y/Y, which would be the highest since January. In addition, ECB President Draghi and Vice President Constâncio are scheduled to take part in a panel discussion at the ECB's central banking forum.

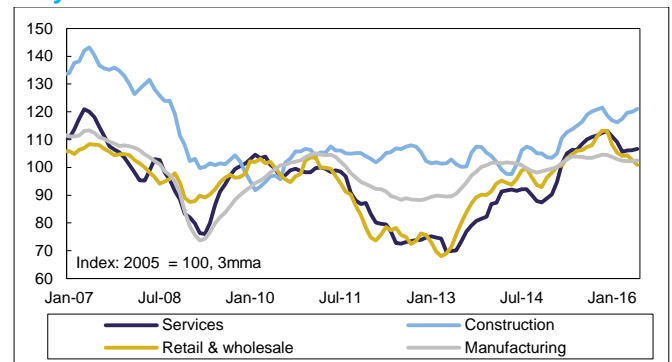
In the US, tomorrow brings the latest personal income, spending and associated deflator figures for May, alongside pending homes sales data for the same month.

France and Italy: Consumer confidence








Source: Thomson Reuters, INSEE, ISTAT and Daiwa Capital Markets Europe Ltd.

Italy: Business confidence












Source: Thomson Reuters, ISTAT and Daiwa Capital Markets Europe Ltd.

European calendar

Today's results						
Economic data						
Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
France	 Consumer confidence survey	Jun	97	97	98	-
Italy	 Consumer confidence indicator	Jun	110.2	112.5	112.7	112.5
	 Manufacturing (economic) confidence	Jun	102.8 (101.2)	102.1 (-)	102.1 (103.4)	-(103.0)
Spain	 Retail sales Y/Y%	May	2.3	-	4.1	4.0
UK	 CBI's Distributive Trades survey, retail sales	Jun	4	-	7	-
Auctions						
Country	Auction					
- Nothing to report -						

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's data releases						
Economic data						
Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous	
EMU	 10.00	Economic sentiment indicator	Jun	104.7	104.7	
	 10.00	Services (industrial) sentiment	Jun	11.0 (-3.4)	11.3 (-3.6)	
	 10.00	Final consumer confidence	Jun	-7.3	-7.0	
Germany	 07.00	GfK consumer confidence survey	Jul	9.8	9.8	
	 13.00	Preliminary EU-harmonised CPI Y/Y%	Jun	0.2	0.0	
Spain	 08.00	Preliminary EU-harmonised CPI Y/Y%	Jun	-1.0	-1.1	
UK	 07.00	Nationwide house price index M/M% (Y/Y%)	Jun	0.0 (4.9)	0.2 (4.7)	
	 09.30	Net consumer credit (net lending secured on dwellings) £bn	May	1.5 (2.2)	1.3 (0.3)	
	 09.30	Mortgage approvals '000s	May	65.3	66.3	
Auctions and events						
Country	BST	Auction / Event				
- Nothing scheduled -						

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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Credit Rating Agencies

[Standard & Poor's]

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[Moody's]

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[Fitch]

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