

Euro wrap-up

Overview

- Bunds made gains despite the release of more economic data suggesting that the euro area continued to grow steadily in the second quarter.
- Gilts also made gains as the BoE took action to support financial stability but concerns rose about the UK commercial real estate sector.
- The coming two days bring industrial sector data from Germany and the UK, the account of the ECB's most recent monetary policy meeting and another round of voting in the UK's Conservative Party leadership election.

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Daily bond market movements

Bond	Yield	Change*
BKO 0 06/18	-0.682	-0.011
OBL 0 04/21	-0.605	-0.027
DBR 0½ 02/26	-0.181	-0.040
UKT 1¼ 07/18	0.133	-0.016
UKT 1½ 01/21	0.343	-0.030
UKT 2 09/25	0.786	-0.047

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

Euro area

Further signs of steady expansion ahead of referendum

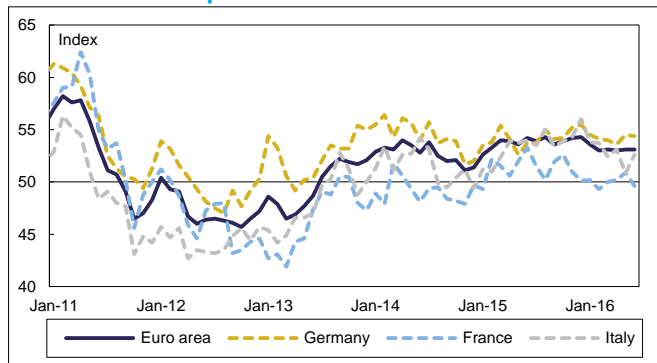
The dataflow continues to suggest that euro area economic growth was relatively well maintained in the second quarter, albeit far from vigorous. Retail sales rose for the second consecutive month in May, up 0.4%M/M to stand 1.6% higher than a year earlier, driven again by sales of non-food products. That, however, left the average level of sales in the first two months of the second quarter little changed from the Q1 average, suggesting a slowdown in consumption growth following a firm start to the year. Meanwhile, like the manufacturing index released at the end of last week, thanks to a better showing in Germany the final euro area services PMI was revised up from the flash estimate, by 0.4pt to 52.8, a level consistent with continued moderate growth in the sector albeit a seventeen-month low. As a result, the composite PMI was also revised up, by 0.3pt from the flash estimate to 53.1, the same level as in May, leaving intact the sideways trend in place since February and consistent with our forecast of economic growth of 0.3%Q/Q in Q2, close to the average of the past three years. At the country level, the composite PMIs for Germany and Spain (both consistent with ongoing steady economic expansion) and France (still consistent with a stagnant economy) were practically unchanged on average in the second quarter from Q1, while Italy's composite PMI fell to a five-quarter low suggesting a moderation in the pace of recovery. With all of the responses to the manufacturing survey and 90% of those related to the services sector survey submitted before the UK referendum, however, the June PMIs cannot provide any reliable indication of any impact from that shock. So, all eyes will be on the July surveys for signs that the increased uncertainty in the UK is weighing on activity in the euro area.

The coming two days in the euro area and US

Data-wise, the coming two days in the euro area will focus on the industrial sector, with Germany's factory orders and IP figures for May due on Wednesday and Thursday respectively and Spain's IP figures for the same month due on Wednesday. French goods trade data for May are also due on Thursday, when the account of the most recent ECB Governing Council meeting is also scheduled for publication. In the markets, Germany will sell 2Y Bunds on Wednesday while France and Spain will sell a range of bonds on Thursday.

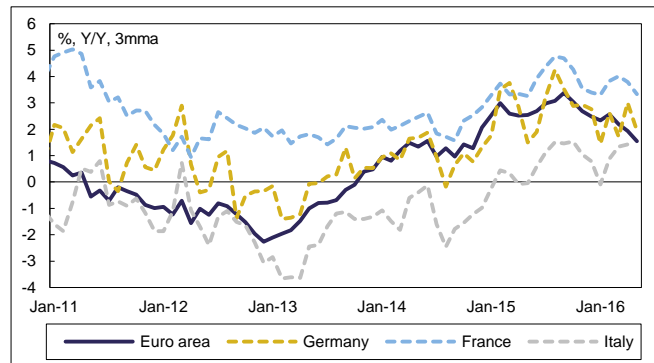
In the US, the June non-manufacturing ISM and May final goods trade report are due on Wednesday along with the June FOMC meeting minutes. The June ADP employment report, Challenger job cuts data and usual weekly claims numbers are due on Thursday.

Euro area: Composite PMIs



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

Euro area: Retail sales



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.



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UK

FPC takes action to mitigate risks after the Brexit vote

As had been widely expected in the wake of the EU referendum vote the Financial Policy Committee (FPC), which met last week and whose Financial Stability Report was published today, announced that it had decided to reverse its earlier decision to force banks to increase their countercyclical capital buffers by 0.5%, reducing regulatory capital buffers by £5.7bn from the previous target, a move that could potentially release an additional £150bn of lending. The decision was taken in the wake of the uncertainty caused by the referendum result and the additional threats that poses to financial stability. This move can be seen as the first of what are likely to be several actions by the BoE to support the economy, with a cut in Bank Rate looking very likely when the MPC meets next week, and further measures on the cards in August too.

Real Estate funds frozen on redemptions

One risk highlighted by the FPC as a channel through which financial stability could be hit was in the commercial real estate sector, where foreign investors have accounted for 45% of inflows since 2009, driving prices up very rapidly to previously unreach levels. But these inflows fell sharply in the run up to the referendum, while news over the past 24 hours that Standard Life, M&G and Aviva had all frozen redemptions on their commercial property funds demonstrated the extent to which money has flowed out of the sector following the referendum vote. This "gating" of the funds came in the wake of a mark down last week by 5% in the valuation of the assets of the three largest funds, of which M&G and Standard Life are two. It can be expected that other funds are seeing similar outflows, which may force them also to freeze redemptions as well as look at selling holdings, which will put further downward pressure on commercial property prices at the same time that foreign investors remain largely absent.

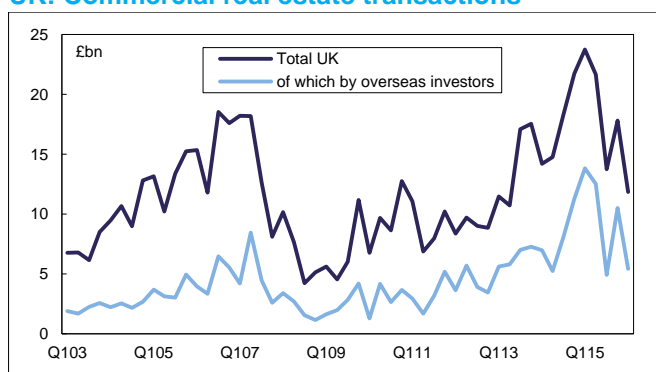
Falling property values biggest risk to banks

The risk is, of course, that falling property prices hit the banking sector as collateral values decline. But the BoE was at pains to point out that the UK banking system is in much better shape to deal with potential losses than previously. In particular, the major UK banks have raised more than £130bn of additional capital over the past eight years. The liquid assets they hold, meanwhile, stand at about £600bn, around four times the level before the financial crisis. As such, the UK banks are now, in aggregate, undoubtedly in a much better position to weather losses than they were in the financial crisis. But with the uncertainty over Brexit likely to persist for years and the economy likely to slip into recession through the second half of this year, the downward pressure on collateral prices could be larger and more prolonged than during the crisis. The banks may therefore need a lot of that additional capital.

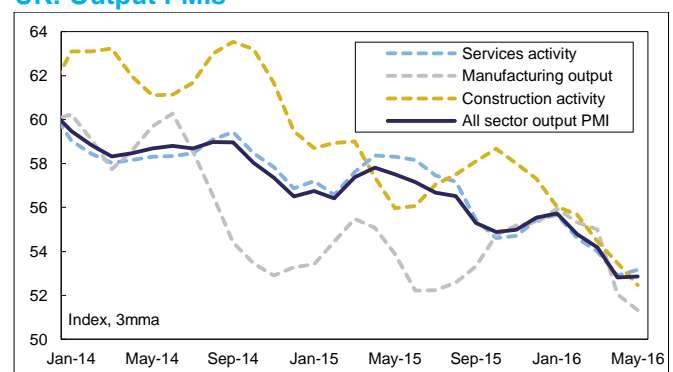
PMIs suggest UK economy is going downhill

On the data front, after a much steeper-than-expected decline in yesterday's UK construction PMI, which fell by more than 5pts to 46.0 in June, its lowest level since mid-2009, the focus today was on the equivalent services survey. This also disappointed on the downside, with the headline index dropping by 1.2pts to 52.3, the joint lowest level since early 2013. And with only 11% of the responses collected after the referendum result was known, the weakness mainly reflects uncertainty ahead of the referendum. Looking at Q2 as a whole, the PMIs suggest GDP growth of only 0.2%Q/Q, which is somewhat lower than the output growth data at the start of that quarter have indicated. And, of course, the UK economic outlook has deteriorated markedly following the referendum, and we expect negative GDP growth in Q3. The first reliable data on how the UK economy reacted to the referendum will be available from the start of next month, when the July PMIs and other survey data are released.

UK: Commercial real estate transactions



UK: Output PMIs












The coming two days in the UK




It should be relatively quiet day tomorrow, with only the BRC retail price index and new car registration data due for release. Thursday, meanwhile, brings the latest industrial production figures, which are set to show that output fell in May, likely by about 1%M/M, having increased by 2%M/M in the previous month. In politics, the focus over coming days should remain on the Tory leadership election, with Conservative MPs due to vote once again on Thursday to whittle down the list of the four candidates that will remain after today's first vote round.

The next edition of Euro wrap-up will be published on 7 July 2016.

European calendar

Today's results							
Economic data							
Country	Release		Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
EMU		Final services PMI (final composite PMI)	Jun	52.8 (53.1)	52.4 (52.8)	53.3 (53.1)	-
		Retail sales M/M% (Y/Y%)	May	0.4 (1.6)	0.4 (1.7)	0.0 (1.4)	0.2 (-)
Germany		Final services PMI (final composite PMI)	Jun	53.7 (54.4)	53.2 (54.1)	55.2 (54.5)	-
France		Final services PMI (final composite PMI)	Jun	49.9 (49.6)	49.9 (49.4)	51.6 (50.9)	-
Italy		Services PMI (composite PMI)	Jun	51.9 (52.6)	50.4 (-)	49.8 (50.8)	-
Spain		Services PMI (composite PMI)	Jun	56.0 (55.7)	55.0 (54.6)	55.4 (54.8)	-
UK		Services PMI (composite PMI)	Jun	52.3 (52.4)	52.8 (52.0)	53.5 (53.0)	-
Auctions							
Country	Auction						
Germany sold		€345mn of 0.1% 2046 index-linked bonds (15-Apr-2046) at an average yield of -0.76%					
UK sold		£2.5bn of 1.5% 2021 bonds (22-Jan-2021) at an average yield of 0.377%					





Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Yesterday's results						
Economic data						
Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
EMU	 ECB QE net purchases €bn	Weekly	9.7	<u>17.8</u>	17.1	-
Spain	 Unemployment M/M '000s	Jun	-124.3	-100	-119.8	-
UK	 Construction PMI	Jun	46.0	50.7	51.2	-
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
Germany		07.00 Factory orders M/M% (Y/Y%)	May	1.0 (0.9)	-2.0 (-0.5)
Spain		08.00 Industrial production M/M% (Y/Y%)	May	0.0 (2.2)	0.0 (2.7)
UK		00.01 BRC shop price index Y/Y%	Jun	-	-1.8
		09.00 New car registrations Y/Y%	Jun	-	2.5






Auctions and events

Country	BST	Auction / Event
EMU		08.00 ECB's Draghi, Constâncio and Praet scheduled to speak in Frankfurt
Germany		10.30 Auction: To sell €4bn of 2018 zero-coupon bonds (15-Jun-2018)











Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Thursday's data releases

Economic data

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Germany		07.00 Industrial production M/M% (Y/Y%)	May	0.1 (1.5)	0.8 (1.2)
France		07.45 Trade balance €bn	May	-4.9	-5.2
UK		09.30 Industrial production M/M% (Y/Y%)	May	-1.0 (0.5)	2.0 (1.6)
		09.30 Manufacturing production M/M% (Y/Y%)	May	-1.2 (0.4)	2.3 (0.8)
		15.00 NIESR GDP 3M/3M%	Jun	-	0.5

Auctions and events

Country	BST	Auction / Event
EMU		12.30 ECB publishes account of the Governing Council meeting
		17.00 ECB's Constâncio scheduled to speak in Madrid
France		09.50 Auction: To sell 0.5% 2026 bonds (25-May-2026)
		09.50 Auction: To sell 1.5% 2031 bonds (25-May-2031)
		09.50 Auction: To sell 1.25% 2036 bonds (25-May-2036)
		09.50 Auction: To sell 4.5% 2041 bonds (25-Apr-2041)
Spain		09.30 Auction: To sell 0.75% 2021 bonds (30-Jul-2021)
		09.30 Auction: To sell 4.65% 2025 bonds (30-Jul-2025)
		09.30 Auction: To sell 1.95% 2030 bonds (30-Jul-2030)
		09.30 Auction: To sell 1.8% 2024 index-linked bonds (30-Nov-2024)
UK		10.30 Auction: To sell £2.25bn of 1.5% 2026 bonds (22-Jul-2026)

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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