

Euro wrap-up

Overview

- Bunds were little changed today despite a disappointing German IP release.
- Gilts made modest losses despite a marked deterioration in the first post-referendum UK business sentiment indicator.
- Tomorrow brings the first post-referendum UK consumer confidence indicator, as well as May trade data from the UK and Germany.

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Daily bond market movements

Bond	Yield	Change*
BKO 0 06/18	-0.685	-0.008
OBL 0 04/21	-0.607	-0.004
DBR 0½ 02/26	-0.167	+0.010
UKT 1¼ 07/18	0.147	+0.011
UKT 1½ 01/21	0.355	+0.006
UKT 2 09/25	0.784	+0.018

*Change from close as at 4.30pm BST.

Source: Bloomberg

Euro area

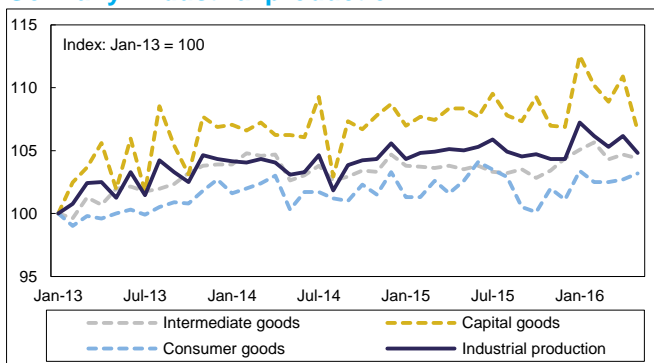
German and Spanish IP disappoints

While household consumption looks to have held up relatively well across the euro area and continued to support economic growth in Q2, the latest manufacturing production figures from the largest member state today raised some concerns that the sector acted as a drag on GDP growth in the second quarter. In particular, German industrial output declined a steeper-than-expected 1.3%M/M in May, the largest monthly drop since August 2014, to leave it down 0.4% compared with a year earlier. And there was an even larger decline in the manufacturing sector (-1.8%M/M), with a near-4% drop in production of capital goods raising concerns about the near-term outlook for capex while the decline in production of consumer durable goods also gave cause for discomfort. Moreover, construction output fell for the third consecutive month. So, it was largely thanks to a near-4% increase in output from the energy sector that total industrial production didn't fall even further in May. On average in the first two months of Q2, German industrial production was more than 1% lower than the average in Q1, and weak factory orders figures (flat in May following a drop of almost 2%M/M in April) suggest that any rebound in output in June might be relatively subdued. There was a similar story with Spanish IP too, with output down for the fourth month out of the past five in May and by ½%M/M. While the weakness was broad based, there was also a notable decline in production of capital goods, down 2%M/M, the sharpest since August 2015. And while overall Spanish industrial production in the first two months of Q2 has been supported by output from the energy sector (which on average is up 3½% compared with Q1), average manufacturing production remains broadly unchanged from Q1. Looking at the euro area as a whole, we were already anticipating a weak second quarter for the industrial sector and had penciled in growth of less than ¼%Q/Q in Q2 following growth of about 1%Q/Q in Q1. Following today's figures, we would certainly not be surprised to see a full-quarter decline in IP in Q2.

ECB recognised bond scarcity risk to APP

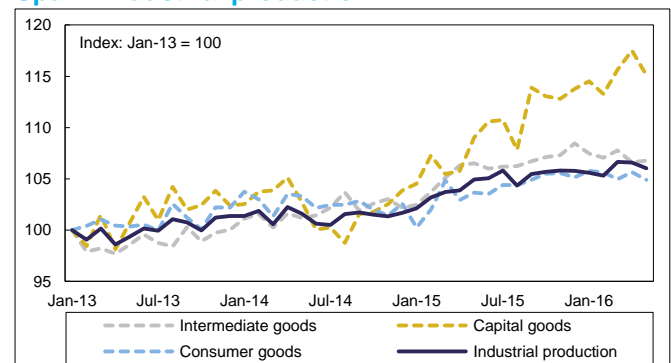
Like the FOMC minutes published on Wednesday, the account of the June ECB Governing Council meeting released today has been largely overtaken by events. While the account noted that the policymakers saw some upside risks to their most recent economic projections from the new policy measures implemented for the first time in June – namely the corporate sector purchase programme (CSPP) and the TLTRO II liquidity programme – they also (unsurprisingly) acknowledged that the shock from the UK referendum could be significant, with negative spillovers to the euro area via a number of channels, including trade and financial markets. Of course, those risks are now starting to crystallise. And, among other things, the resulting rally in lower-risk and more liquid assets is having a potentially harmful impact on the ECB's ability to meet its asset-purchase target: today, sovereign bonds worth more than €1.3trn and a further €270bn of SSA bonds were ineligible to purchase because their yields were below the -0.4% floor. The account of the June meeting recorded that the ECB was aware

Germany: Industrial production*



*Excluding construction. Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Spain: Industrial production*



*Excluding construction. Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.



that some market participants foresaw future challenges for the ECB in sourcing sufficient volumes of public bonds under the present rules of the programme, and that the scarcity of buyable bonds could contribute to increased volatility. But there appears not to have been significant concern among Governing Council members about those risks, with the nature of the debate seemingly academic. However, not least since the ECB will want to respond to the weaker economic outlook by extending the asset purchase programme beyond March 2017, the Governing Council's next meeting, which concludes on 21 July, will need to hold a more substantive discussion on the practical policy options. And so, following that meeting, we suspect that Draghi will announce revisions to the rules of the programme to ensure its QE targets are deliverable.

The day ahead in the euro area and US

Friday brings the latest industrial production figures from France, which are expected to show that output declined ½%M/M in May following a notable increase at the start of Q2. The Bank of France's latest business sentiment survey for June is also due for release, alongside German trade data for May.

Of course, these figures will be overshadowed by the US labour market report, which we expect to show an increase in non-farm payrolls of a little more than 200k (boosted by the return of striking workers at Verizon, whose absence weighed on the numbers in May). Meanwhile, the unemployment rate is expected to edge higher, up 0.1ppt to 4.8%, while annual average hourly earnings growth is expected to rise to 2.7%Y/Y, which would be the strongest since mid-2009.

UK

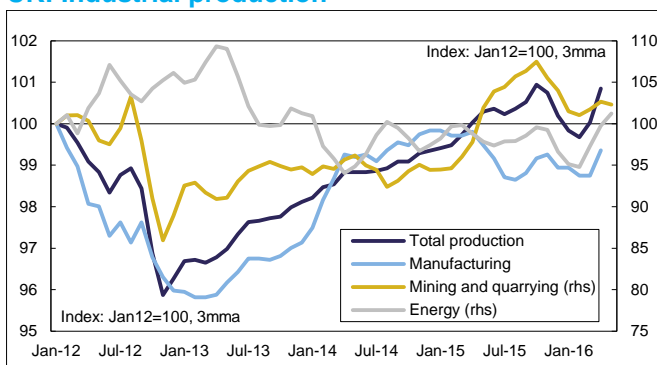
May in pole position after Tory MPs vote

In politics, the second round of the Tory leadership election predictably delivered a comfortable victory to Home Secretary and unenthusiastic Remainer Theresa May, who took 60% of the vote, with Andrea Leadsom (26%) defeating her fellow Brexiteer Michael Gove to make it through to the postal vote among ordinary Conservative Party members. While British politics has been anything but predictable recently, regardless of their passions about Brexit, grass-root Tory Party members might be unlikely to take a leaf out of the Labour Party's playbook and go blatantly against the will of their MPs. And certainly, there are large question marks about Leadsom's suitability for the role of Prime Minister. So, May seems a clear favourite to lead the UK government after the final result is announced in early September. With respect to Brexit policy, while Leadsom wants to recklessly invoke Article 50 as soon as possible to set in train the formal process for leaving the EU, May has made clear that she is in no rush to do so, emphasising the need for a workable negotiating strategy to be put in place first. And certainly, from the perspective of the financial markets, she represents the safest pair of hands on offer. Nevertheless, a May-led government would still mean that uncertainty about the future UK-EU relationship would remain high in the quarters and possibly years to come, weighing heavily on economic activity and asset prices alike.

More signs of panic in commercial property sector

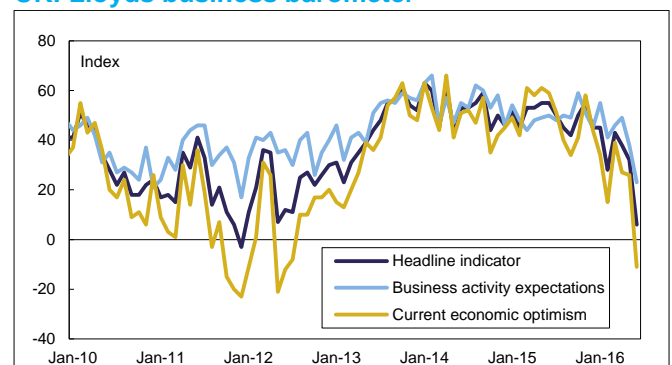
In a further sign of the stresses Brexit uncertainty is generating in the property sector in particular, yesterday saw three more property funds, Henderson (with around £3.9bn of AUM at end-May, making it one of the largest), Columbia Threadneedle (with £1.3bn) and Canada Life (with its six property funds worth roughly £450mn) suspend trading in the face of large redemption requests. Aberdeen took a different approach with its fund, marking valuations down 17% as a disincentive to withdrawals. This came on top of a 5% markdown last week, although with expectations of significant falls in CRE prices it remains to be seen if this will be sufficient to stem redemptions sufficiently. L&G is now the only remaining large fund yet to suspend trading or apply a massive markdown in their funds, although that may only be a matter of time given the nature of what is essentially now a run on commercial real estate funds, which is likely to have wider economic implications. The BoE's research suggests that assets held in these type of funds represent about 7% of total CRE investment, while a 10% fall in CRE prices could reduce total investment in the economy by 1% via its impact on banks' collateral.

UK: Industrial production



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: Lloyds business barometer



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Economic data suggest that growth before the EU referendum remained firm

One irony of the post-referendum problems is that ahead of the vote the economy looked to have been doing ok. Today's figures from the industrial sector for May showed a smaller than expected output fall of 0.5%M/M, which left three-month on three-month growth at 1.9%, the highest level in six years. The industrial sector, therefore, seems to be on track to post strong growth in Q2, even if June proves to be significantly weaker. Overall, we think GDP probably grew by 0.4%Q/Q in Q2, the same as in Q1. But the referendum result has fundamentally altered the economic outlook. Aside from the significant moves in financial markets, data on the impact will begin to drift in over the coming weeks and months. Today saw the release of the Lloyds Business Barometer, a survey with a sample size of about 200 companies, which was conducted in the first few days after the referendum. Its headline index plummeted from 32 to a four-and-a-half year low of 6, while a fall in the current economic optimism indicator was even more pronounced, both suggesting a big hit to business confidence as a result of the referendum. Tomorrow, meanwhile, will see the GfK publish a special survey that will show the change in consumer sentiment following the referendum. Looking ahead, we have compiled a UK economic data calendar (see below). The entries in light blue are data which cover the post-referendum period in part. The dark blue entries, meanwhile, are releases where the data were collected entirely after the referendum result was known. First up, of the top-tier indicators the post-referendum surveys will be announced from the end of this month onwards, with the PMIs due at the start of August. But the first of the hard economic indicators from the ONS will only arrive in the second half of August.

The day ahead in the UK

Aside from the GfK special post-Brexit survey, the DBRS rating agency will announce its credit rating for the UK, which after downgrades from the other major rating agencies, is likely to the loss of its triple-A status with that agency too. Meanwhile, trade data are expected to show that the trade deficit increased in May, having fallen slightly in April.

UK Post-Brexit Economic Calendar







UK economic data releases				
Date	Source	Release	Period	Post-referendum data share*
July 2016				
08/07	GfK	Consumer confidence survey	June	100%
12/07	BCC	Quarterly Economic survey	Q2	None/almost none
12/07	BRC	Retail Sales Monitor	June	18%
14/07	RICS	Residential Market Survey	June	None/almost none
18/07	Rightmove	House price survey	July	100%
19/07	ONS	CPI	June	None/almost none
20/07	BoE	Agents Summary of Business Conditions	July	100%
21/07	ONS	Public finances	June	23%
21/07	ONS	Retail sales	June	30%
25/07	CBI	Industrial Trends survey	July	100%
27/07	CBI	Distributive Trades survey	July	100%
27/07	ONS	GDP – first release	Q2	None/almost none
29/07	GfK	Consumer confidence survey	July	100%
29/07	BoE	Money and Credit	June	None/almost none
August 2016				
1-3/8	Markit	PMIs	July	100%
04/08	SMMT	New car registrations	July	100%
09/08	ONS	Trade	June	23%
09/08	ONS	Industrial production	June	23%
09/08	BRC	Retail Sales Monitor	July	100%
11/08	RICS	Residential Market Survey	July	100%
12/08	ONS	Construction output	June	23%
16/08	ONS	CPI	July	100%
16/08	ONS	House Price Index	June	None/almost none
17/08	ONS	Labour market – Claimant count	July	100%
17/08	ONS	Labour market – Other data	June	23%
18/08	ONS	Retail sales	July	100%
19/08	ONS	Public finances	July	100%
26/08	ONS	GDP – second release	Q2	None/almost none
26/08	ONS	Services output	June	23%
30/08	BoE	Money and Credit	July	100%
September 2016				
07/09	ONS	Industrial production	July	100%
09/09	ONS	Trade	July	100%
09/09	ONS	Construction output	July	100%
13/09	ONS	House Price Index	July	100%
14/09	ONS	Labour market – Other data	July	100%
30/09	ONS	Current account balance	Q2	None/almost none
30/09	ONS	GDP – final release	Q2	None/almost none
30/09	ONS	Services output	July	100%
October 2016				
27/10	ONS	GDP – first release	Q3	100%

*Based on the number of days covered. Source: ONS, Bloomberg 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
Germany	 Industrial production M/M% (Y/Y%)	May	-1.3 (-0.4)	0.1 (1.5)	0.8 (1.2)	0.5 (0.8)
France	 Trade balance €bn	May	-2.8	-4.9	-5.2	-4.8
UK	 Lloyds Business Barometer	Jun	6	-	32	-
	 Industrial production M/M% (Y/Y%)	May	-0.5 (1.4)	-1.0 (0.5)	2.0 (1.6)	-
	 Manufacturing production M/M% (Y/Y%)	May	-0.5 (1.7)	-1.2 (0.4)	2.3 (0.8)	-
	 NIESR GDP 3M/3M%	Jun	0.6	-	0.5	-





Auctions

Country	Auction
France sold	 €3.1bn of 0.5% 2026 bonds (25-May-2026) at an average yield of 0.16%
	 €3.2bn of 1.5% 2031 bonds (25-May-2031) at an average yield of 0.48%
	 €2.1bn of 1.25% 2036 bonds (25-May-2036) at an average yield of 0.73%
	 €1.5bn of 4.5% 2041 bonds (25-Apr-2041) at an average yield of 0.79%
Spain sold	 €1.9bn of 0.75% 2021 bonds (30-Jul-2021) at an average yield of 0.242%
	 €1.4bn of 4.65% 2025 bonds (30-Jul-2025) at an average yield of 1.061%
	 €1.7bn of 1.95% 2030 bonds (30-Jul-2030) at an average yield of 1.521%
	 €421mn of 1.8% 2024 index-linked bonds (30-Nov-2024) at an average yield of 0.413%
UK sold	 £2.25bn of 1.5% 2026 bonds (22-Jul-2026) at an average yield of 0.912%


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
Germany	 Factory orders M/M% (Y/Y%)	May	0.0 (-0.2)	1.0 (0.9)	-2.0 (-0.5)	-1.9 (-0.4)
Spain	 Industrial production M/M% (Y/Y%)	May	-0.5 (1.0)	0.0 (2.2)	0.0 (2.7)	-
UK	 BRC shop price index Y/Y%	Jun	-2.0	-	-1.8	-
	 New car registrations Y/Y%	Jun	-0.8	-	2.5	-

Auctions

Country	Auction
Germany sold	 €3.4bn of 2018 zero-coupon bonds (15-Jun-2018) at an average yield of -0.69%

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	Trade balance €bn	May	23.5	25.7
	07.00	Imports (exports) M/M%	May	0.7 (0.4)	-0.3 (0.1)
	07.00	Current account balance €bn	May	24.6	28.8
France	07.00	Bank of France manufacturing sentiment indicator	Jun	97	97
	07.45	Industrial production M/M% (Y/Y%)	May	-0.5 (0.9)	1.2 (1.9)
UK	00.05	GfK Consumer confidence indicator	end-June	-	-1
	09.30	Visible trade balance £bn	May	-10.7	-10.5
	09.30	Total trade balance £bn	May	-3.6	-3.3
	09.30	Unit labour costs Y/Y%	Q1	1.6	1.3

Auctions and events

Country	BST	Auction / Event
UK	-	DBRS publishes UK sovereign debt rating

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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