

# Euro wrap-up

## Overview

- Bunds made gains at the long end as euro area IP data disappointed.
- Gilts more than reversed yesterday's losses as investors focused on the likelihood of a BoE rate cut tomorrow.
- On Thursday we expect the BoE to cut Bank Rate by at least 25bps.

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### Daily bond market movements

Bond	Yield	Change*
BKO 0 06/18	-0.676	-0.009
OBL 0 04/21	-0.599	-0.022
DBR 0 08/26	-0.079	-0.051
UKT 1¼ 07/18	0.108	-0.080
UKT 1½ 01/21	0.330	-0.086
UKT 2 09/25	0.739	-0.090

\*Change from close as at 4.45pm BST.  
Source: Bloomberg

## Euro area

### Euro area IP weaker than expected

After a stronger performance in the euro area's manufacturing sector at the start of the second quarter, the latest IP release confirmed a notable retrenchment in May. For example, production of capital goods was down more than 2%/M/M, the steepest drop since September 2012, while production of consumer and intermediate goods fell 0.4%/M/M. And with energy output declining more than 4% on the month, this left overall industrial production down a steeper-than-expected 1.2%/M/M in May to leave it just 0.5% higher than a year earlier. Admittedly, the increase in April was a touch firmer than previously thought at 1.4%/M/M. Nevertheless, the average over the first two months of Q2 was still 0.2% lower than the average in Q1. And while the increase in the manufacturing PMI in June to a six-month high suggests that production rebounded last month, in the absence of an increase in excess of 1½%/M/M, the manufacturing sector will have been a drag on GDP growth in Q2 for the first quarter since Q314.

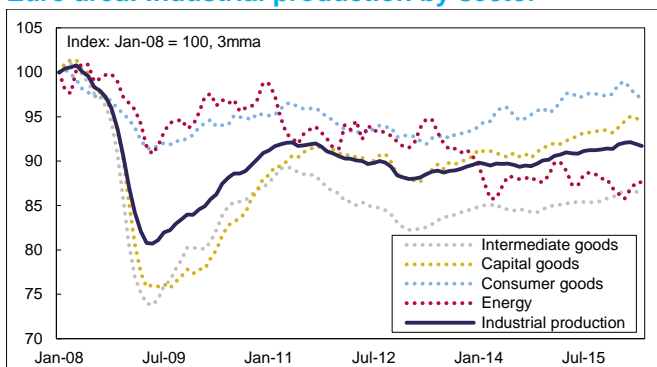
### Final estimate of euro area inflation in June likely to be unrevised

Ahead of Friday's release of the final euro area aggregate CPI data for June, today brought the equivalent figures from several member states. In France, the EU-harmonised CPI rate was confirmed at the flash estimate of 0.3%/Y/Y, up from 0.1%/Y/Y in May and a rate last exceeded in November 2014. Spanish CPI (on the same basis) was also unrevised from the preliminary reading of -0.9%/Y/Y, similarly 0.2ppt higher than in May and the firmest since January. However, there was a modest upward revision to the initial estimate of Italian CPI by 0.1ppt to -0.2%/Y/Y. This notwithstanding, after data published yesterday confirmed the flash German CPI rate of 0.2%/Y/Y, we expect the final reading of euro area CPI similarly to be confirmed at the preliminary estimate of 0.1%/Y/Y, up from -0.1%/Y/Y in May. And with the national measures of core CPI in the largest members having remained subdued – in France core CPI was unchanged at 0.7%/Y/Y, while Italian and Spanish core CPI moderated by 0.1ppt to 0.5%/Y/Y and 0.6%/Y/Y respectively – there is a risk that euro area core CPI will be revised down from the flash estimate by 0.1ppt to 0.8%/Y/Y.

### The day ahead in the euro area and US

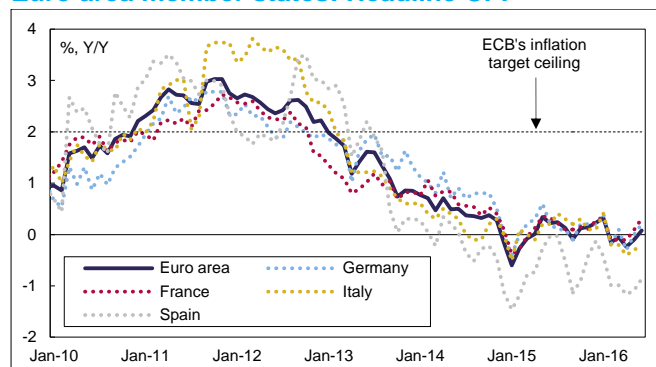
It should be a relatively quiet day for economic news from the euro area tomorrow with no data due for release. In the US, meanwhile, Thursday brings PPI data for June along with the latest weekly jobless claims figures.

### Euro area: Industrial production by sector



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

### Euro area member states: Headline CPI\*



\*Euro area figure for June is flash estimate.  
Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

## UK











### Credit supply remains little affected by Brexit

Echoing yesterday's comments from BoE Governor Mark Carney and other FPC members, the Credit Conditions Review released today by the BoE alongside the Credit Conditions Survey suggested that the UK financial system has been resilient in the face of the Brexit shock. Admittedly, the survey data were collected before the EU referendum and, therefore, were not particularly informative. But the report added some anecdotal evidence from major UK lenders collected at the end of June, and those suggested that the supply of credit is not expected to decrease, despite the increased uncertainty after the Brexit vote. One exception where some notable problems were identified was, unsurprisingly, commercial real estate: credit availability in that sector had fallen in Q216 for the first time since Q212. Overall, although funding spreads have increased since the referendum, they are expected to be offset by the recent fall in swap rates to leave the borrowing costs faced by households and companies broadly unchanged.





### The day ahead in the UK

There is little doubt that the most exciting event tomorrow will be the BoE's announcement of its latest monetary policy decision. Since the surprise vote to leave the EU, financial conditions have tightened and the UK economic outlook has darkened with early indications of a marked deterioration in economic sentiment and anecdotal evidence that firms are putting investment and recruitment decisions on ice. Against this unsettling backdrop – and notwithstanding that Sterling's marked depreciation will be inflationary over the near term and the appointment of Theresa May as Prime Minister has restored a modicum of confidence in British politics and poise to the financial markets – we expect the MPC to cut Bank Rate tomorrow by at least 25bp to 0.25% or less, having maintained Bank Rate at 0.5% at each of the previous eighty-eight meetings. While there might well be some members of the MPC preferring to leave policy unchanged for now, a cut would be consistent with Carney's comments on 30 June when he noted that "some monetary policy easing will likely be required over the summer". Moreover, when the BoE announces new economic forecasts early next month, additional monetary policy easing, potentially via the resumption of purchases of certain assets, is also possible.

## European calendar

Today's results						
Economic data						
Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
EMU	 Industrial production M/M% (Y/Y%)	May	<b>-1.2 (0.5)</b>	-0.8 (1.3)	1.1 (2.0)	<b>1.4 (2.2)</b>
France	 Final EU-harmonised CPI Y/Y%	Jun	<b>0.3</b>	0.3	0.1	-
Italy	 Final EU-harmonised CPI Y/Y%	Jun	<b>-0.2</b>	-0.3	-0.3	-
Spain	 Final EU-harmonised CPI Y/Y%	Jun	<b>-0.9</b>	-0.9	-1.1	-
Auctions						
Country	Auction					
Germany sold	 €4bn of 2026 zero-coupon bonds (15-Aug-2026) at an average yield of -0.05%					
Italy sold	 €2bn of 0.1% 2019 bonds (15-Apr-2019) at an average yield of -0.04%					
	 €2.5bn of 0.95% 2023 bonds (15-Mar-2023) at an average yield of 0.63%					
	 €1.25bn of 1.65% 2032 bonds (01-Mar-2032) at an average yield of 1.57%					
	 €1.75bn of 2.25% 2036 bonds (01-Sep-2036) at an average yield of 1.88%					
UK sold	 £1.25bn of 0.125% 2026 index-linked bonds (22-Mar-2026) at an average yield of -1.578%					

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	
UK	 00:01	RICS house price balance %	June	10	19	
	 12:00	BoE bank rate %	Jul	<u>0.25</u>	0.50	
	 12:00	BoE asset purchase target £bn	Jul	<u>375</u>	375	
Auctions and events						
Country	BST	Auction / Event				
UK	 12:00	Monetary policy announcement and MPC minutes				

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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