

# Euro wrap-up

## Overview

- Bunds made losses as the rise in euro area inflation to back above zero in June was confirmed.
- Gilts made losses despite some weak UK construction and exports data.
- In the coming week we expect the ECB Governing Council to extend its asset purchase programme beyond March 2017 while flash July PMIs for the euro area and UK are due for release.

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### Daily bond market movements

Bond	Yield	Change*
BKO 0 06/18	-0.649	+0.012
OBL 0 04/21	-0.554	+0.020
DBR 0 08/26	0.004	+0.044
UKT 1¼ 07/18	0.161	+0.020
UKT 1½ 01/21	0.403	+0.027
UKT 2 09/25	0.832	+0.039

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

## Euro area

### Economic impact of Nice atrocity should be modest

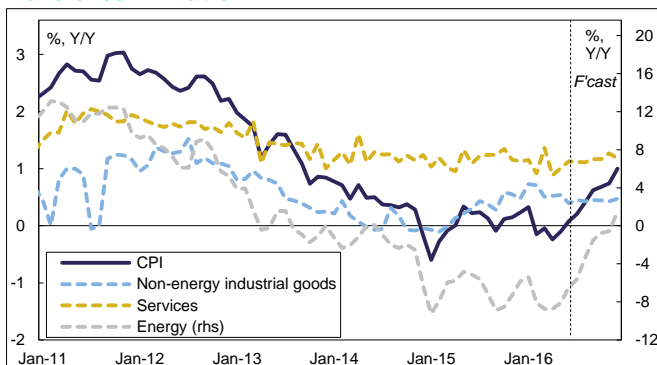
Unsurprisingly, the horrific terror incident in Nice on Thursday evening was the main focus in Europe at the end of the week, with related economic concerns of far less relevance than the human costs. Yet, with the French economy having proved to be resilient last year to the Bataclan incident, the economic consequences should not be marked. Not least with France boasting the world's largest tourism sector, certain services, including restaurants and hotels, might see a modest negative near-term impact during the peak season which has only just begun. But last year's example would suggest that consumer confidence will remain firm. And we will not be altering our French economic growth forecast, which sees GDP growth levelling off circa 0.2%Q/Q from Q216 on.

### No surprises on the data front

Meanwhile, on the data front, there were no particular surprises from the handful of new releases. For example, the final numbers for euro area inflation in June saw the main aggregates left unchanged from the flash estimates and minimal revisions made to the detail. In particular, therefore, the figures confirmed that headline CPI rose in June to 0.1%Y/Y, the highest level in five months as energy prices fell at the slowest annual rate (down 6.4%Y/Y) since the start of the year while services inflation ticked up to 1.1%Y/Y, the highest since March. But with inflation of non-energy industrial goods slipping to a nine-month low of 0.4%Y/Y, the narrowest core measure of inflation remained low at just 0.9%Y/Y, consistent with a continued absence of meaningful price pressure. As the impact of past declines in energy prices eventually wear off, we expect headline CPI to rise close to 1%Y/Y by year-end. But given the subdued growth outlook, inflation is likely to remain below 1.5%Y/Y throughout 2017 and into 2018, justifying the extension of the ECB's asset purchase programme.

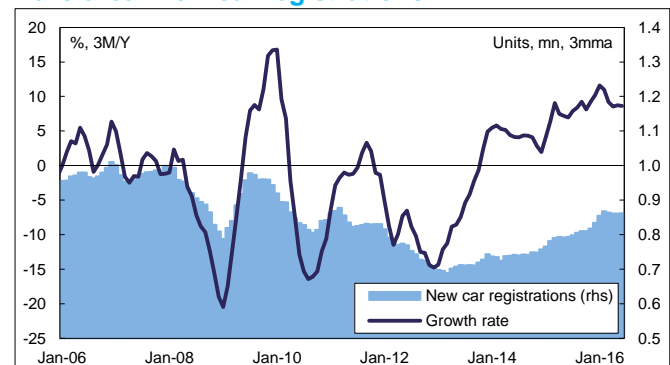
Having grown steadily throughout 2015, new car registrations appeared to level off in the first quarter of the year. And that flat trend appears to have continued in the second quarter. While today's numbers showed an increase of 6.9%Y/Y in June to 1.06mn, the highest level in more than six years, leaving them up more than 10%YTD/Y in the first half of 2016, adjusting for seasonal and working-day effects, they were broadly flat following a dip in May adding to evidence from retail sales data of a softer contribution to GDP growth in Q2 from the consumer. The French data were most disappointing, showing a notable slowdown in the annual rate of growth to less than 1%Y/Y, while the equivalent figures for Germany (registrations up more than 8%Y/Y), Italy and Spain (still above 10%Y/Y) were more buoyant.

### Euro area: Inflation



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

### Euro area: New car registrations\*



\*Seasonally and working-day adjusted data. Source: Bloomberg, ECB and Daiwa Capital Markets Europe Ltd.



Finally, as foreshadowed by the national data, which for example revealed a notable drop in the German surplus, today's euro area trade report for May likewise showed a decline in the surplus from the record high reached in April. However, the drop to €24.5bn on a seasonally adjusted basis in May, from a downwardly revised €25.4bn the previous month, was smaller than anticipated. The value of exports fell almost 2%M/M and more than 4½%Y/Y to the lowest level since end-2014. Meanwhile, imports slipped back 1½%M/M and more than 7½%Y/Y to the lowest level since 2010. And with the decline in import prices (down 2.5%Y/Y in May) explaining only part of the weakness, the drop in imports might well see net trade in Q2 making a positive contribution to GDP growth for the first quarter in one year.

## The week ahead in the euro area and US

The main event in the euro area in the coming week will be the conclusion of the ECB Governing Council meeting on Thursday. It is possible that this meeting, like the BoE's MPC yesterday, will be a non-event. However, with Draghi having recently assessed that the euro area economic outlook has likely deteriorated slightly in response to the Brexit vote, we expect the Governing Council to decide to extend the asset purchase programme beyond next March, probably by six months to September 2017. And given that it currently faces a shortage of bonds that it can buy under its asset purchase programme – as the yields on a large share of securities that would otherwise be eligible have now fallen below the floor of -0.40% – the Governing Council also ought to start reviewing the rules governing the ECB's QE programme. Options should include a change to the allocation of bond purchases based on the ECB's capital key to one based on the total stock of outstanding debt; abolition of the issue limit applied to any particular bond and/or the yield floor on bond purchases; and the addition of other assets to the list of securities that the ECB is willing to buy. However, it remains to be seen whether agreement on any amendments can be reached just yet.

Datawise, the coming week brings first survey results for July, including the German ZEW investor survey (Tuesday), the preliminary Commission euro area consumer confidence survey (Wednesday), the French INSEE business sentiment survey (Thursday) and the flash PMIs (Friday). We expect to see a modest deterioration in the main indices including most notably a drop in the euro area composite PMI to its lowest level in more than a year. Other figures out in the coming week include May's euro area construction output (Tuesday) and balance of payments (Wednesday). In the markets, Germany will sell 5Y Bunds on Wednesday while France will sell bonds on Thursday.

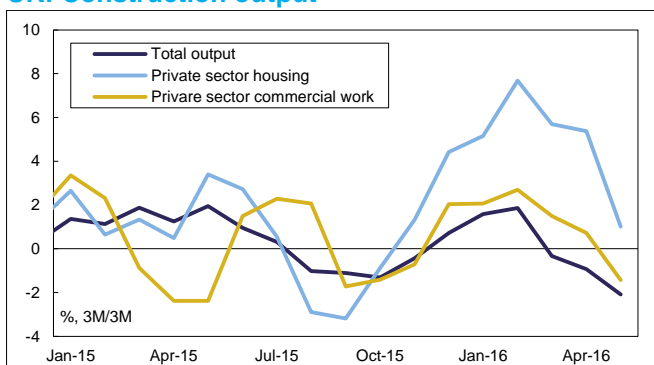
In the US, in a relatively quiet week for top-tier releases, the data calendar will be dominated by housing market indicators, including the NAHB housing index (Monday), housing starts (Tuesday), existing home sales and the FHFA house price index (both due Friday). Monday also brings May capital inflows data. In addition, Thursday brings the latest Chicago Fed national activity and Philly Fed indices while the Conference Board's leading indicators are due on Friday. In the UST market, a 10Y TIPS auction will be conducted on Thursday.

## UK

### No construction output recovery on the horizon

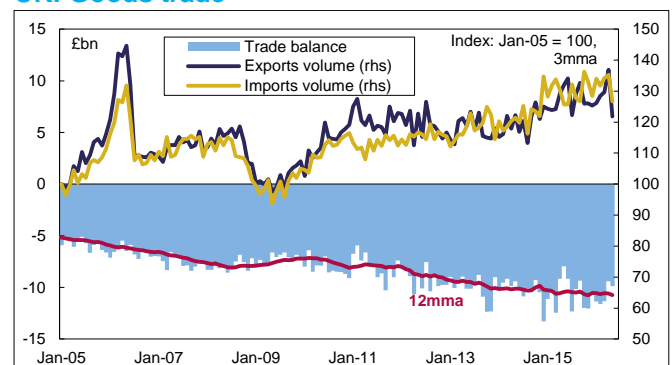
While the impact of Brexit on the UK economy will take a long time to play out fully, one of the sectors where the financial market risks were quick to crystallise was commercial real estate, as investors bolted for the exit. The outlook for the housing market, as indicated by yesterday's RICS survey, has suffered significantly too. Against this backdrop, a drop in output in construction in the quarters ahead seems almost inevitable. But today's data for May confirmed that activity in this sector was weak even before the referendum, with output falling by 2.1%M/M, the sharpest monthly drop since August 2012, and 1.9%Y/Y. Although the annual rate was a touch firmer than expected due to an upward revision to activity in previous months, the construction sector is likely to have weighed on GDP growth in Q2, with the average level in April and May 0.3% lower than in Q1 and activity in June likely to have been weak too.

### UK: Construction output



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

### UK: Goods trade



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

## Exports plunged in May, but net trade likely supportive in Q2

Meanwhile, further detail on May's trade performance showed that UK exporters had their worst month since mid-2006, with the volume of goods exports falling by 11%M/M. However, imports were also weak, down by 6.4%M/M. And on average over the first two months of the second quarter compared to Q1, while exports saw a 1% increase, imports were 1.8% lower. Therefore, despite the dire export figures for May, the weakness of imports means that net trade likely provided a positive contribution to UK GDP growth in Q2.






## The week ahead in the UK

The focus in the UK in the coming week should turn back to economic data, with new releases including figures for inflation (on Tuesday), labour market (Wednesday), retail sales and public finances (both on Thursday). However, those data will relate to the months preceding the EU vote, which seems bound to have marked the starting point of a new downbeat trend in many UK economic data series. However, the flash July PMIs, which will be released as a special one-off on Friday, will be closely watched as a useful snapshot of how UK business have reacted to the Brexit vote.

Meanwhile, MPC member Weale is scheduled to make a speech on Monday. Weale, who will be leaving the MPC following the August policy meeting, has been known as one of the more hawkish members of the committee, and, therefore, his views about the appropriate monetary policy response to Brexit might not represent the consensus among the policymakers. Indeed, they might well contrast, at least to some extent, with the comments released today by another MPC member Haldane, which left little uncertainty that he will vote for 'muscular' monetary policy easing when the committee meets in three weeks' time.

































*The next edition of Euro wrap-up will be published on 19 July 2016.*

## European calendar

Today's results						
Economic data						
Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
EMU	 EU27 new car registrations Y/Y%	Jun	<b>6.9</b>	-	16.0	-
	 Trade balance €bn	May	<b>24.5</b>	25.0	28.0	<b>25.4</b>
	 Final CPI (core) Y/Y%	Jun	<b>0.1 (0.9)</b>	0.1 (0.9)	-0.1 (0.8)	-
Italy	 Trade balance total €bn	May	<b>5.0</b>	-	4.5	-
UK	 Construction output M/M% (Y/Y%)	May	<b>-2.1 (-1.9)</b>	-1.2 (-3.5)	2.5 (-3.7)	<b>2.8 (-0.6)</b>
Auctions						
Country	Auction					
- Nothing to report -						
















Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

## Coming week's data calendar

Key data releases					
Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
<b>Monday 18 July 2016</b>					
EMU		14:45 ECB QE net purchases €bn	Weekly	<u>17.0</u>	16.1
UK		00:01 Rightmove house price index M/M% (Y/Y%)	Jul	-	0.8 (5.5)
<b>Tuesday 19 July 2016</b>					
EMU		10:00 Construction output M/M% (Y/Y%)	May	-	-0.2 (-0.4)
Germany		10:00 ZEW current assessment balance (expectations)	Jul	51.5 (9.0)	54.5 (19.2)
UK		09:30 CPI (core) Y/Y%	Jun	<u>0.4 (1.2)</u>	0.3 (1.2)
		09:30 House Price Index Y/Y%	May	<u>7.5</u>	8.2
<b>Wednesday 20 July 2016</b>					
EMU		09:00 Current account balance €bn	May	-	36.2
		15:00 Preliminary consumer confidence	Jul	-8.0	-7.3
Italy		09:30 Current account balance €bn	May	-	4.7
UK		09:30 Average earnings incl. bonuses (excl. bonuses) 3M/Y%	May	<u>2.2 (2.3)</u>	2.0 (2.3)
		09:30 ILO unemployment rate 3M%	May	<u>5.0</u>	5.0
		09:30 Employment change 3M/3M '000s	May	<u>60</u>	55
		09:30 Claimant count rate % (changed 000s)	Jun	2.2 (3.0)	2.2 (-0.4)
<b>Thursday 21 July 2016</b>					
EMU		12:45 ECB refinancing rate %	Jul	<u>0.00</u>	0.00
		12:45 ECB deposit rate %	Jul	<u>-0.40</u>	-0.40
		12:45 ECB asset purchase target €bn	Jul	<u>80</u>	80
France		07:45 Business confidence indicator (production outlook)	Jul	99 (-)	100 (1)
Spain		09:00 Trade balance €bn	May	-	-0.6
UK		09:30 Retail sales excluding petrol M/M% (Y/Y%)	Jun	-0.6 (4.8)	1.0 (5.7)
		09:30 Retail sales including petrol M/M% (Y/Y%)	Jun	-0.5 (5.1)	0.9 (6.0)
		09:30 Public sector net borrowing excluding interventions £bn	Jun	9.5	9.7
<b>Friday 22 July 2016</b>					
EMU		08:00 Preliminary manufacturing PMI	Jul	52.0	52.8
		08:00 Preliminary services PMI (preliminary composite PMI)	Jul	52.3 (52.6)	52.8 (53.1)
Germany		08:30 Preliminary manufacturing PMI	Jul	53.4	54.5
		08:30 Preliminary services PMI (preliminary composite PMI)	Jul	53.3 (53.7)	53.7 (54.4)
France		08:00 Preliminary manufacturing PMI	Jul	48.0	48.3
		08:00 Preliminary services PMI (preliminary composite PMI)	Jul	49.5 (49.2)	49.9 (49.6)
Italy		09:00 Industrial sales M/M% (Y/Y%)	May	-	2.1 (0.1)
		09:00 Industrial orders M/M% (Y/Y%)	May	-	1.0 (-11.3)
		10:00 Retail sales M/M% (Y/Y%)	May	-0.1 (1.0)	0.1 (-0.5)
UK		09:30 Preliminary manufacturing PMI	Jul	47.5	52.1
		09:30 Preliminary services PMI (preliminary composite PMI)	Jul	48.7 (48.5)	52.3 (52.4)

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

## Coming week's events/auctions calendar

Key events & auctions			
Country		BST	Event / Auction
<b>Monday 18 July 2016</b>			
EMU		09:00	EU Foreign Ministers hold meeting in Brussels
UK		09:15	BoE's Weale scheduled to speak in London
<b>Tuesday 19 July 2016</b>			
EMU		09.00	ECB publishes the Euro area Bank Lending Survey
UK		10:40	BoE announces Indexed long-term repo operations results
<b>Wednesday 20 July 2016</b>			
Germany		10:30	Auction: To sell €5bn of 2021 bonds (08-Oct-2021)
UK		10:30	Auction: To sell £1.5bn of 4.25% 2039 bonds (07-Sept-2039)
<b>Thursday 21 July 2016</b>			
France		09:50	Auction: To sell 0% 2019 bonds (25-Feb-2019)
		09:50	Auction: To sell 0% 2021 bonds (25-May-2021)
		09:50	Auction: To sell 4.25% 2023 bonds (25-Oct-2023)
		10:50	Auction: To sell 0.1% 2025 index-linked bonds (01-Mar-2025)
		10:50	Auction: To sell 0.7% 2030 index-linked bonds (25-Jul-2030)
Spain		10:50	Auction: To sell 1.8% 2040 index-linked bonds (25-Jul-2040)
		09:30	Auction: To sell 0.25% 2019 bonds (31-Jan-2019)
		09:30	Auction: To sell 0.75% 2021 bonds (30-Jul-2021)
		09:30	Auction: To sell 2.9% 2046 bonds (31-Oct-2046)
<b>Friday 22 July 2016</b>			
- Nothing scheduled -			

Source: ECB, BoE, Bloomberg and Daiwa Capital Markets Europe Ltd.

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