

Euro wrap-up

Overview

- Bunds were little changed as July's flash euro area PMIs beat expectations, suggesting that economic growth was relatively stable.
- Gilts made gains as July's flash UK PMIs suggested the sharpest economic contraction since the global financial crisis.
- The coming week brings initial estimates of euro area and UK GDP in Q2, the flash estimate of euro area inflation in July, and further economic sentiment surveys from the euro area and UK for the same month.

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Daily bond market movements

Bond	Yield	Change*
BKO 0 06/18	-0.612	+0.003
OBL 0 10/21	-0.488	+0.011
DBR 0 08/26	-0.027	-0.012
UKT 1¼ 07/18	0.134	-0.037
UKT 1½ 01/21	0.349	-0.040
UKT 2 09/25	0.800	-0.034

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

Euro area

Euro area PMIs suggest little impact from Brexit

There has been little evidence so far to suggest any sizeable impact of the UK referendum on the euro area economy. While the ZEW survey suggested that investors are worried about the outlook, consumer confidence appears to have held up relatively well. And today's flash PMIs largely beat expectations, signalling ongoing moderate economic expansion, thus supporting the ECB's judgement that a wait-and-see approach to policy is appropriate at the current juncture. In particular, while it slipped in July to 52.9, the lowest level since January 2015, the decline in the euro area composite PMI was very modest, just 0.2pt, leaving in place the broadly flat current trend in place since February. The euro area composite new orders index also edged down only marginally from the previous month to a level only very slightly below its average for the first half of the year, while the PMIs also suggested that employment picked up at the fastest rate in more than six years and that deflationary pressures eased slightly.

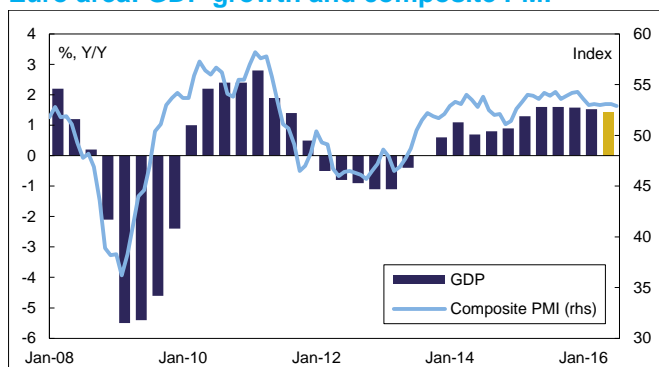
Germany in fine fettle, Italy likely weakens

At the sectoral level, the euro area services PMI fell back just a fraction in July to 52.7, a level consistent with ongoing moderate expansion albeit an eighteen-month low. And while the weakening in the equivalent manufacturing index was larger, almost 1pt, at 51.9 the level was still bang in line with the average of the first half of the year suggesting no particular new cause for concern. At the country level, the German figures gave greatest cause for optimism as the composite PMI jumped above 55 to the highest level so far this year and one of the best readings of the past two years, with notable improvement in services suggesting ongoing firm domestic demand. And, consistent with yesterday's INSEE survey, the French PMIs improved across the board, with the composite index back up to 50 to indicate a stable economy. As such, the slight drop in the euro area figure in July probably reflects a significant weakening in Italy, for which no flash readings were published but where heightened concerns about the health of the banking sector – which attracted particular attention from Draghi following yesterday's ECB Governing Council meeting – are now likely weighing on economic sentiment.

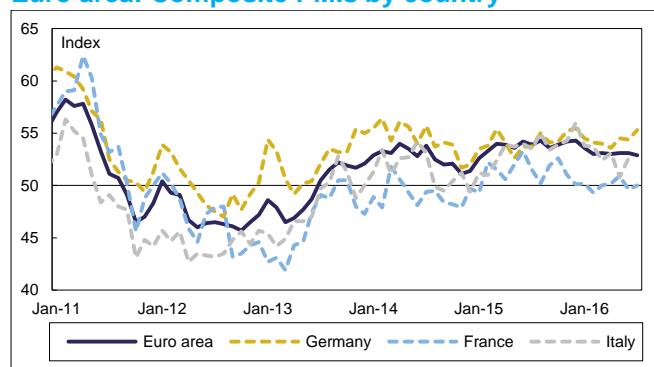
The week ahead in the euro area and US

The coming week will be a busy one for euro area economic data, with numerous top-tier releases including the preliminary estimates of GDP in Q2 and inflation in July (both due Friday). We expect euro area GDP growth to have slowed to 0.3%Q/Q albeit with risks to the downside, with the equivalent figures for France and Spain – the only large member states to be publishing the figures on Friday – also to mark a slowdown to 0.2%Q/Q and 0.7%Q/Q respectively. In addition, we forecast euro area inflation to have edged up to a six-month high of 0.2%Y/Y. The coming week also brings further July economic survey results, including the German Ifo business indices (Monday), consumer confidence indices from the three largest member states (Wednesday) and the Commission economic sentiment indices (Thursday).

Euro area: GDP growth and composite PMI*


 *Forecast for Q2 GDP growth. Flash composite PMI for July 2016.
 Source: Thomson Reuters, Markit and Daiwa Capital Markets Europe Ltd.

Euro area: Composite PMIs by country*


 *German and French flash composite PMIs for July 2016.
 Source: Thomson Reuters, Markit and Daiwa Capital Markets Europe Ltd.


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In the US, all eyes in the coming week will be on the conclusion of the latest two-day FOMC meeting on Wednesday, although the Fed is overwhelmingly expected to keep the FFR range unchanged at 0.25-0.50%. Likely of more interest will be the post-meeting press statement, which will be watched closely for the Committee's assessment of post-UK-referendum risks and therefore any hints about the likely timing for future rate increases. Data-wise, the most noteworthy release comes on Friday with the advance GDP estimate for Q2. Expectations are for growth to have accelerated to an annualised rate of 2½%Q/Q, which would be the firmest rate for a year and a touch stronger than the average since the start of the decade. And the release on Thursday of advance goods trade, wholesale and retail inventories data for June will also be watched. Other data due in the coming week include the Conference Board's consumer confidence survey (Tuesday), durable goods orders (Wednesday) and several housing market indicators. Supply-wise, the Treasury will sell 2Y notes (Monday), 5Y notes (Tuesday), 2Y floating-rate notes (Wednesday) and 7Y notes (Thursday).

UK

Flash PMIs suggest sharpest contraction since the financial crisis

As far as the BoE is concerned, the PMIs provide one of the most reliable guides to economic growth. So, today's special flash figures for July, which suggested that the economy is now contracting at the fastest pace since the global financial crisis, should have removed any lingering doubts that the MPC will ease policy on 4 August. Most notably, the headline composite PMI posted its steepest monthly drop on the series, almost 5pts to 47.7, the lowest level since April 2009. And most of the detail provided troubling reading too. The services sector, which dominates the UK economy, looks to have been hit harder than manufacturing, although activity in both sectors appears to be contracting. In particular, the services activity PMI fell almost 5pts to 47.4, the lowest since March 2009, with the sector's business expectations index falling more than 10pts, another record drop. And the manufacturing PMI fell 3pts to 49.1, the lowest in more than three years despite a rise in the new export orders index to a two-year high on the back of weaker sterling. Indeed, with the overall manufacturing new orders index falling almost 7pts, the most in nearly six years, the composite new orders index also fell close to 7pts, the biggest monthly drop on the series, to foreshadow troubled times ahead. In addition, the relevant indices suggested that firms are cutting back on employment in both services and manufacturing sectors for the first time since 2012. And sterling depreciation's has placed massive pressure on import prices, with the respective PMI posting the steepest monthly rise on the series to the highest level for five years.

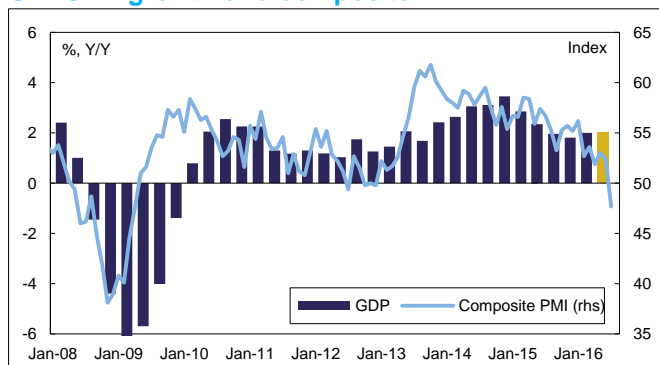
A clear case for substantive monetary easing

If the composite PMI is sustained at the flash July level over the next couple of months, that would suggest a drop in UK GDP in the third quarter of 0.4%Q/Q, bang in line with our current economic forecast. However, since the composite PMI does not factor in developments in the construction sector, which has probably been most adversely affected by the Brexit vote, the deterioration in GDP in the current quarter could be even more marked. And we also expect GDP to fall further in the fourth quarter as firms pare back investment and recruitment in a more considered way and consumers also start to adjust more rationally to the new circumstances. So, despite the inflationary impact of sterling weakness, the likely profile for GDP cries out for monetary stimulus. Indeed, with the composite PMI having fallen to a level that in the past would have triggered a 50bps cut in Bank Rate and/or asset purchases consistent with equivalent easing, the case for the BoE to deliver substantive monetary stimulus on 4 August – including a reduction in Bank Rate perhaps of 40bps to just 0.1% along with other measures (e.g. an expansion of the Funding for Lending Scheme and/or renewed asset purchases) looks to be very strong indeed.

The week ahead in the UK

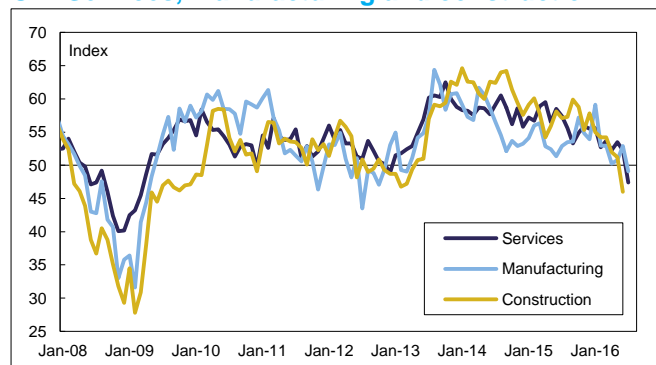
Perhaps most attention in the coming week in the UK will be focused on the advance estimate of Q2 GDP, which following a strong start to the quarter might well show an acceleration from the 0.4%Q/Q growth rate in the first quarter. The coming week also brings further economic surveys to give an indication of economic conditions since the referendum with the CBI Industrial Trends Survey due on Monday, the CBI Distributive Trades Survey due Wednesday, and the GfK Consumer Confidence Survey and Lloyds Business Barometer – both of which had provided initial post-referendum snapshots – due on Friday. In addition, bank lending figures for June from the BBA and BoE are due on Tuesday and Friday respectively.

UK: GDP growth and composite PMI*



*Forecast for Q2 GDP growth. Flash composite PMI for July 2016. Source: Thomson Reuters, Markit and Daiwa Capital Markets Europe Ltd.

UK: Services, manufacturing and construction PMIs*














*Flash services and manufacturing PMIs for July 2016. Source: Thomson Reuters, Markit 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
EMU	 Preliminary manufacturing PMI	Jul	51.9	52.0	52.8	-
	 Preliminary services PMI (preliminary composite PMI)	Jul	52.7 (52.9)	52.3 (52.5)	52.8 (53.1)	-
Germany	 Preliminary manufacturing PMI	Jul	53.7	53.4	54.5	-
	 Preliminary services PMI (preliminary composite PMI)	Jul	54.6 (55.3)	53.2 (53.6)	53.7 (54.4)	-
France	 Preliminary manufacturing PMI	Jul	48.6	48.0	48.3	-
	 Preliminary services PMI (preliminary composite PMI)	Jul	50.3 (50.0)	49.5 (49.2)	49.9 (49.6)	-
Italy	 Industrial sales M/M% (Y/Y%)	May	-1.1 (-2.7)	-	2.1 (0.1)	-
	 Industrial orders M/M% (Y/Y%)	May	-2.8 (-4.2)	-	1.0 (-11.3)	0.9 (-)
	 Retail sales M/M% (Y/Y%)	May	0.3 (-1.3)	-0.2 (1.0)	0.1 (-0.5)	- (-0.6)
UK	 Preliminary manufacturing PMI	Jul	49.1	48.7	52.1	-
	 Preliminary services PMI (preliminary composite PMI)	Jul	47.4 (47.7)	48.8 (49.0)	52.3 (52.4)	-

Auctions






Country	Auction
- Nothing to report -	

Coming week's data calendar

Key data releases						
Country		BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Monday 25 July 2016						
EMU		14:45	ECB QE net purchases €bn	Weekly	<u>16.0</u>	16.3
Germany		09:00	Ifo business climate index	Jul	107.6	108.7
		09:00	Ifo current assessment balance (expectations)	Jul	114.0 (101.5)	114.5 (103.1)
UK		11:00	CBI Industrial Trends survey, total orders	Jul	-6	-2
Tuesday 26 July 2016						
UK		09:30	BBA loans for house purchase '000s	Jun	40.1	42.2
Wednesday 27 July 2016						
Germany		07:00	GfK consumer confidence survey	Aug	9.9	10.1
France		07:45	Consumer confidence survey	Jul	96	97
Italy		09:00	Consumer confidence indicator	Jul	109.1	110.2
		09:00	Manufacturing (economic) confidence	Jul	101.8 (-)	102.8 (101.2)
Spain		08:00	Retail sales Y/Y%	Jun	3.8	2.3
UK		09:30	GDP – preliminary release Q/Q% (Y/Y%)	Q2	<u>0.4 (2.0)</u>	0.4 (2.0)
		09:30	Index of services M/M% (3M/3M%)	May	0.1 (0.3)	0.6 (0.5)
		11:00	CBI's Distributive Trades survey, retail sales	Jul	2	4
Thursday 28 July 2016						
EMU		10:00	Economic sentiment indicator	Jul	103.7	104.4
		10:00	Services (industrial) sentiment	Jul	10.1 (-3.4)	10.8 (-2.8)
		10:00	Final consumer confidence	Jul	-7.9	-7.9
Germany		08:55	Unemployment change '000s (rate %)	Jul	-3.0 (6.1)	-6.0 (6.1)
		13:00	Preliminary EU-harmonised CPI Y/Y%	Jul	0.3	0.2
Spain		08:00	Unemployment rate %	Q2	20.4	21.0
UK		07:00	Nationwide house price index M/M% (Y/Y%)	Jul	0.0 (4.5)	0.2 (5.1)
Friday 29 July 2016						
EMU		10:00	Unemployment rate %	Jul	10.1	10.1
		10:00	Flash CPI estimate Y/Y%	Jul	0.1	0.1
		10:00	Flash core CPI estimate Y/Y%	Jul	0.9	0.9
		10:00	GDP – preliminary release Q/Q% (Y/Y%)	Q2	<u>0.3 (1.5)</u>	0.6 (1.7)
Germany		07:00	Retail sales M/M% (Y/Y%)	Jun	0.0 (1.6)	0.7 (2.6)
France		06:30	GDP – preliminary release Q/Q% (Y/Y%)	Q2	<u>0.2 (1.6)</u>	0.6 (1.3)
		07:45	Preliminary EU-harmonised CPI Y/Y%	Jul	0.4	0.3
		07:45	Consumer spending M/M% (Y/Y%)	Jun	0.1 (2.0)	-0.7 (2.2)
Italy		09:00	Unemployment rate %	Jun	11.4	11.5
		10:00	Preliminary EU-harmonised CPI Y/Y%	Jul	-0.2	-0.2
Spain		08:00	GDP – preliminary release Q/Q% (Y/Y%)	Q2	<u>0.7 (3.1)</u>	0.8 (3.4)
		08:00	Preliminary EU-harmonised CPI Y/Y%	Jul	-0.7	-0.9
		09:00	Current account balance €bn	May	-	2.6
UK		00:05	GfK consumer confidence survey	Jul	-8	-1
		09:30	Net consumer credit (net lending secured on dwellings) £bn	Jun	1.4 (2.7)	1.5 (2.8)
		09:30	Mortgage approvals '000s	Jun	65.8	67.0

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Coming week's events/auctions calendar

Key events & auctions			
Country	BST	Event / Auction	
Monday 25 July 2016			
- Nothing scheduled -			
Tuesday 26 July 2016			
Italy		10:00	Auction: To sell up to €1bn of 0.1% 2022 index-linked bonds (15-May-2022)
		10:00	Auction: To sell up to €2.5bn of 2018 zero-coupon bonds (28-Mar-2018)
Wednesday 27 July 2016			
Germany		10:30	Auction: To sell €1bn of 2.5% 2046 bonds (15-Aug-2046)
Thursday 28 July 2016			
EMU		19:00	ECB's Cœuré scheduled to speak on financial crisis management in New Haven, USA
Italy		10:00	Auction: To sell bonds
Friday 29 July 2016			
- Nothing scheduled -			

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

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