

Euro wrap-up

Overview

- Bunds made gains despite some relatively encouraging economic surveys from the large euro area member states.
- Gilts also made gains as the UK's Q2 GDP figures surprised on the upside but a retail sector survey added to evidence of a very weak start to Q3.
- Thursday brings the European Commission's economic sentiment survey for July, along with German unemployment and flash inflation data for the same month.

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Daily bond market movements

Bond	Yield	Change*
BKO 0 06/18	-0.620	-0.013
OBL 0 10/21	-0.514	-0.027
DBR 0 08/26	-0.078	-0.050
UKT 1¼ 07/18	0.132	-0.036
UKT 1½ 01/21	0.308	-0.055
UKT 2 09/25	0.738	-0.084

*Change from close as at 4.30pm BST.

Source: Bloomberg

Euro area

Consumer confidence resilient

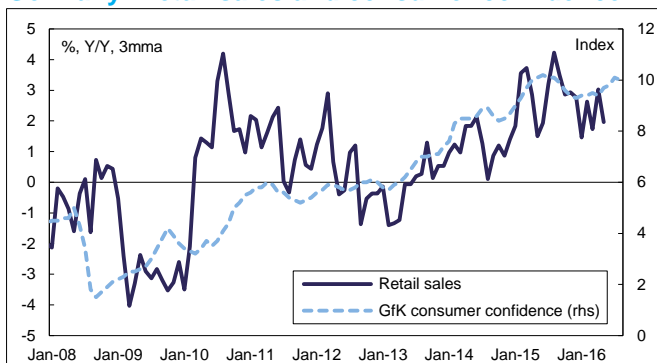
All indications so far are that the economic impact on the euro area of the UK referendum has been very limited. Business confidence and activity appear to have held up well in July while consumer sentiment has been little harmed. Indeed, today's consumer confidence surveys from Germany and France showed only a modest deterioration in the latest month, with the German headline measure slipping back just 0.1pt from the previous month's one-year high to remain well above the long-run average, and the equivalent French index also retreating only slightly to remain one of the highest readings of the past eight years, albeit still below the long-run average. While only 2% of respondents submitted replies to the survey following the Bastille Day atrocity in Nice, the experience of the other recent large-scale terror incidents in France, such as in Paris in November, would suggest only a limited impact on consumer sentiment.

Meanwhile, despite persisting uncertainty regarding (the likely imminent but also probably inadequate) new policy initiatives aimed at tackling the high level of NPLs and associated undercapitalisation of the country's banking sector, consumer confidence in Italy (perhaps surprisingly) picked up in July, albeit having declined steadily over the first six months of the year. Indeed, despite that recent downtrend, Italian consumer confidence remained well above the range of the past couple of years when consumption growth turned positive following several years of retrenchment. Moreover, in Italy, like in Germany and France, consumers signalled an increased readiness to make major purchases. So, today's surveys should provide some reassurance that consumer spending will continue to provide a steady source of economic growth in the euro area over the near term. Moreover, with the ISTAT business confidence survey also posting a surprise improvement with the headline index rising in July to a six-month high and improvement in sentiment in each of the main sectors, overall economic sentiment appears conducive of ongoing expansion in all of the largest member states too.

No fiscal fines for Portugal and Spain

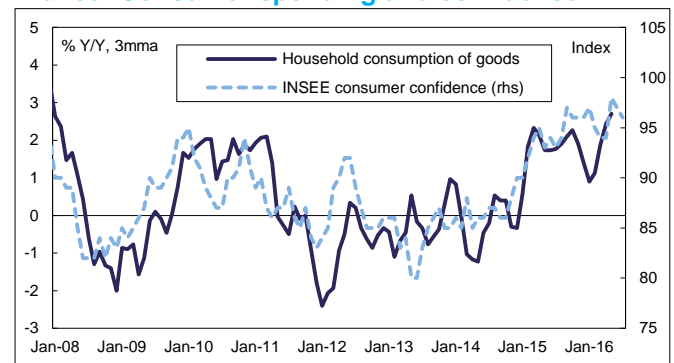
Policy-wise, after Finance Ministers earlier this month concluded that Portugal and Spain had not taken effective action over the past year to 'correct their excessive deficits', the EU's fiscal rules dictated that the Commission had to recommend whether or not to impose fines of up to 0.2% of GDP on the two governments. Thankfully, today the Commission saw sense and exploited the flexibility within the Stability and Growth Pact (SGP) to propose that fines should not be imposed after all. In justifying its decision, the Commission paid lip service to the special pleading of the governments concerned, as well as the current 'challenging' economic conditions, both countries' recent reform efforts and their commitments to comply with the fiscal rules. And it gave Portugal to the end of this year and Spain until 2018 to reduce their deficits below the SGP's 3% of GDP limit from almost 4½% of GDP and more than 5% of GDP respectively in 2015. While in line with the commitments

Germany: Retail sales and consumer confidence



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

France: Consumer spending and confidence



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



announced already by both governments, that still implies a tightening of the fiscal stance in Portugal of about 1% of GDP this year but a broadly neutral fiscal stance in Spain (as is currently planned in the euro area as a whole) in each year from now until 2018. Despite the relatively balanced approach to the issue of fines, the two governments could yet still be punished as the Commission retained the possibility that it might in due course – particularly if its draft budgetary plans to be submitted in the autumn do not pass muster – recommend the suspension of some of the payments scheduled next year of their European Structural and Investment (ESI) Funds. Hopefully, once again, the Commission will see sense and decide not to impose the self-defeating sanction. Indeed, given the current outlook of persistent subdued economic growth and sub-par inflation, the Commission's efforts would be better spent facilitating a meaningful easing of the aggregate euro area fiscal stance, particularly via loosening in countries such as Germany with scope to do so, to bolster the efforts of the ECB in supporting demand.

The day ahead in the euro area and US

Thursday brings the results of the European Commission's economic sentiment survey for July, which often provides the most reliable gauge of economic growth. The headline euro area sentiment index is expected to fall back to the lower end of the range of the past year, albeit still signalling moderate economic growth at the start of the third quarter. Thursday will also bring the first indication of German inflation in July with the EU-harmonised measure of CPI expected to inch up to a six-month high of 0.3%Y/Y. In addition, German unemployment data for July are also due. In the markets, Italy is set to sell 5Y and 10Y regular bonds and 7Y floating-rate bonds. In the US, meanwhile, Thursday will bring June's advance goods trade figures along with July's Kansas City Fed Manufacturing Activity index and the usual weekly claims numbers. The US Treasury will sell 2Y FRNs and 7Y notes.

UK

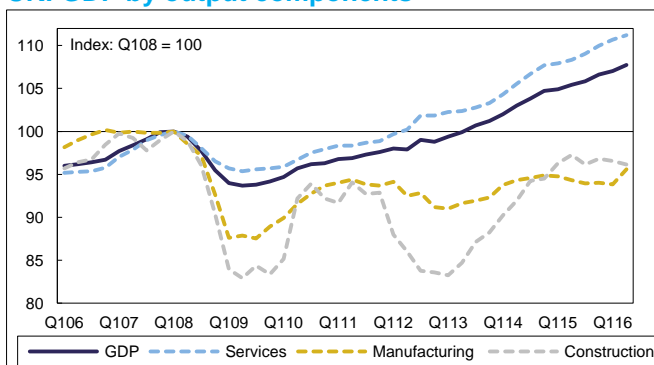
An upside surprise to Q2 GDP...

According to the preliminary estimate, UK GDP growth in Q2 surprised slightly on the upside, with an acceleration of 0.2ppt on the quarter to 0.6%Q/Q to take the annual rate to 2.2%Y/Y, the strongest in a year. Within the detail, growth in services was the softest in four quarters (0.5%Q/Q) due particularly to a slowdown in business services and finance, while construction output fell for the third quarter out of the past four (down 0.4%Q/Q). So, the acceleration in overall economic growth was due entirely to the production sector, which posted its strongest quarter since 1999 (2.1%) thanks to surges in each of manufacturing, energy and the extraction industries, which are highly likely to reflect random and/or temporary factors. These preliminary figures are based on information over the first two months of the quarter – when activity was particularly strong – together with a highly uncertain forecast for June, when activity will have been impacted, perhaps markedly, by the referendum. So, the chances of a revision – most likely to the downside – are non-negligible. Moreover, the relatively strong growth recorded over the quarter as a whole, combined with the less favourable monthly profile in Q2 and evidence of a sharp deterioration since the referendum, makes it all the more likely that GDP in Q3 will contract for the first time since 2012.

...but a terrible start to Q3 for retailers

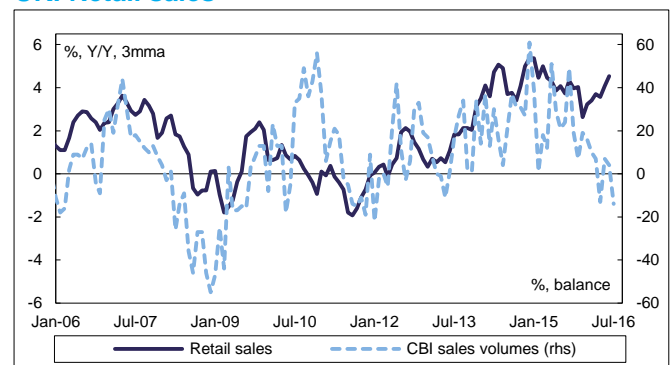
Indeed, economic surveys for the post-referendum period have been universally weak. Most notable were the July flash PMIs, for which the headline composite PMI posted its steepest monthly drop on the series to the lowest level since April 2009. One important sector not captured by the PMIs, however, is retail. But the first guide to activity on the High Street in July – the CBI Distributive Trades survey – provided similarly grim reading. In particular, retailers suggested that the volume of sales fell in July compared to a year ago by the most since the start of 2012, with expectations for August also weak. Moreover, new orders placed with suppliers fell at the sharpest pace since early 2009 and are expected to fall further next month. Broadly matching the findings among retailers, wholesale activity reportedly fell at the fastest pace in more than three years

UK: GDP by output components



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: Retail sales













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

and is expected to fall further in August. And while motor traders suggested that sales growth on an annual basis remained positive in July, they also reported a slowdown and anticipated a drop in sales on the same basis in August. So, while some observers had hoped that households would carry on spending oblivious to the deterioration in business conditions caused by the referendum, if this CBI survey is to be believed the third quarter might well bring the first drop in consumption since 2014 and possibly the steepest since the financial crisis.





The day ahead in the UK

In the UK, Thursday is set to be relatively quiet on the data front although the latest Nationwide indices will provide the first reliable indication of house price movements in July.

European calendar

Today's results							
Economic data							
Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised	
EMU	 M3 money supply Y/Y%	Jun	5.0	5.0	4.9	-	
Germany	 GfK consumer confidence survey	Aug	10.0	9.9	10.1	-	
France	 Consumer confidence survey	Jul	96	96	97	-	
Italy	 Consumer confidence indicator	Jul	111.3	109.2	110.2	-	
	 Manufacturing (economic) confidence	Jul	103.1 (103.3)	102.0 (-)	102.8 (101.2)	102.9 (-)	
Spain	 Retail sales Y/Y%	Jun	5.6	3.6	2.3	-	
UK	 GDP – preliminary release Q/Q% (Y/Y%)	Q2	0.6 (2.2)	<u>0.4 (2.0)</u>	0.4 (2.0)	-	
	 Index of services M/M% (3M/3M%)	May	-0.1 (0.3)	0.1 (0.3)	0.6 (0.5)	-	
	 CBI's Distributive Trades survey, retail sales	Jul	-14	1	4	-	
Auctions							
Country	Auction						
Germany sold	 €0.8bn of 2.5% 2046 bonds (15-Aug-2046) at an average yield of 0.45%						








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	
France	 Jobseekers, M/M 000s	Jun	5.4	-13.0	9.2	-	
UK	 BBA loans for house purchase 000s	Jun	40.1	39.7	42.2	41.8	
Auctions							
Country	Auction						
Italy sold	 €1bn of 0.1% 2022 index-linked bonds (15-May-2022) at an average yield of 0.08%						
	 €2.5bn of 0% 2018 bonds (28-Mar-2018) at an average yield of -0.15%						





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	
EMU		10:00	Economic sentiment indicator	Jul	103.5	104.4
		10:00	Services (industrial) sentiment	Jul	10.3 (-3.4)	10.8 (-2.8)
		10:00	Final consumer confidence	Jul	-7.9	-7.2
Germany		08:55	Unemployment change `000s (rate %)	Jul	-4.0 (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	20.3	21.0
UK		07:00	Nationwide house price index M/M% (Y/Y%)	Jul	0.0 (4.5)	0.2 (5.1)

Auctions and events

Country	BST	Auction / Event
EMU		19:00 ECB's Cœuré scheduled to speak on financial crisis management in New Haven, USA
Italy		10:00 Auction: To sell up to €2bn of 0.45% 2021 bonds (01-Jun-2021)
		10:00 Auction: To sell up to €4.5bn of 1.25% 2026 bonds (01-Dec-2026)
		10:00 Auction: To sell up to €2bn of floating-rate 2023 bonds (15-Jul-2023)

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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