Daiwa Capital Markets

Euro wrap-up

Overview

- Bunds made modest losses while data showed that interest rates on bank loans in the euro area have fallen to a record low.
- Gilts made losses as the UK construction PMI fell less than expected after the referendum vote, albeit still reaching a more than seven-year low.
- Tomorrow brings the final composite PMIs from the euro area and UK, with the latter expected to bring a notable downward revision from the dire flash estimate. Euro area retail sales figures are also due.

Emily Nicol
+44 20 7597 8331

Mantas Vanagas
+44 20 7597 8318

Daily bond market movements

Bond	Yield	Change*
BKO 0 06/18	-0.599	+0.020
OBL 0 10/21	-0.476	+0.037
DBR 0 08/26	-0.029	+0.070
UKT 1¼ 07/18	0.195	+0.029
UKT 1½ 01/21	0.367	+0.046
UKT 2 09/25	0.810	+0.080

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

Euro area

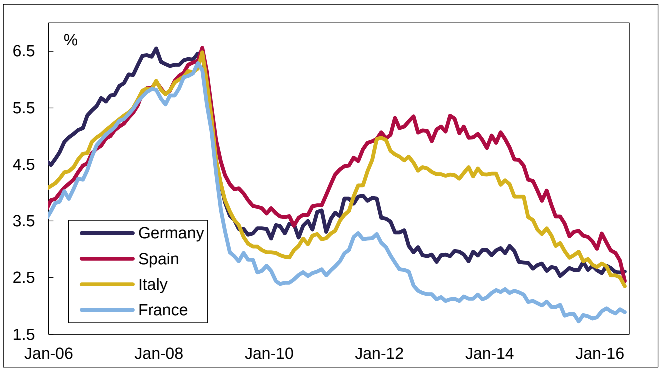
Borrowing costs at record low

With surveys suggesting that economic confidence in the euro area has held up well since the UK referendum result, the ECB can take some satisfaction from recent data. And after the ECB's bank lending survey published a fortnight ago reported continued improvement in credit conditions in the second quarter, there was further evidence in the latest interest rate figures of the positive role played by recent monetary policy initiatives. This was particularly evident in rates on loans to households, with the composite cost of borrowing indicator declining for the fifth consecutive month in June to 1.97%, the first sub-2% reading on the series and a decline of 25bps since the end of last year. While the equivalent indicator of rates on loans to non-financial corporations was broadly unchanged in June, it too has fallen about 20bps over the past six months, and the average rate applied on small short-term loans fell by 26bps in the latest month. There was also a further decline in interest rates on corporate loans in Southern Europe, with the composite cost of business loans in Italy and Spain dropping to record lows. Indeed, such has been the pace of recent declines in interest rates in those countries that, according to these ECB data, it is now cheaper for small businesses in Italy and Spain to borrow than their peers in Germany. Admittedly, despite rising slightly on the month, the overall composite interest rate faced by business borrowers in Germany (1.9%) remains much lower than in Southern Europe. And it certainly remains to be seen whether, against the backdrop of increased uncertainty in the UK, record low interest rates will be sufficient to encourage firms anywhere in the euro area to increase their investment over coming quarters.

Spanish unemployment falls

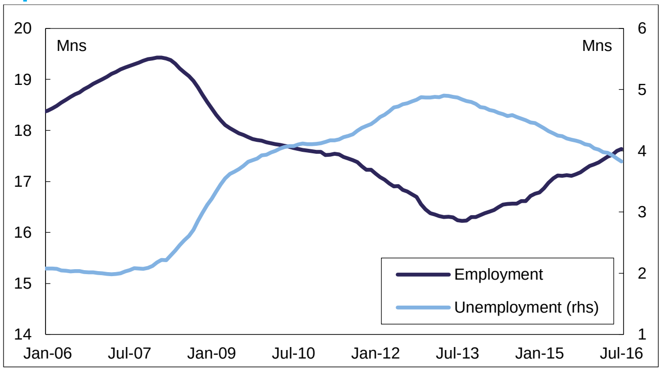
While some recent sentiment indicators in Spain signalled a loss of growth momentum at the start of Q3, the latest labour market figures for that country released today remained consistent with steady economic recovery, reporting another sizeable drop in unemployment in July, falling for the twenty-fourth consecutive month and by almost 50k (seasonally-adjusted basis), to leave it down by 375k compared with a year earlier. So, total employment rose to 17.6mn, up more than 500k over the year and more than 1.4mn higher than the 2013 trough. Admittedly, that remains well below the pre-crisis peak (1.8mn below the level at the start of 2008), suggesting that large amounts of spare capacity persists in Spain's labour market to maintain downwards pressure on labour costs and consumer prices.

Euro area: Interest rates on new SME loans*



**Average interest rate on loans of up to €1mn for up to one year to non-financial corporations. Source: ECB, Thomson Reuters and Daiwa Capital Markets Europe Ltd.*

Spain: Labour market indicators



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

The day ahead in the euro area and US

The data focus in the euro area tomorrow will be the final services and composite PMIs for July, which are expected to confirm that economic conditions held up relatively well at the start of Q3. The flash estimate reported a modest decline in the headline services PMI by 0.1pt to 52.7, while the composite output PMI declined 0.2pt to 52.9. And given the upward revision to yesterday's manufacturing output PMI (by 0.3pt), the flash composite PMI might similarly be revised higher to leave it unchanged on the month at 53.1. Euro area retail sales figures for June are also due and expected to show that sales were flat on the month. Nevertheless, coming on the back of modest growth in April and May, this would leave retail sales up 0.2% over the second quarter as a whole suggesting that private consumption provided modest support to the 0.3%Q/Q GDP growth in Q2.

In the US, tomorrow brings the non-manufacturing ISM for July, as well as the ADP employment report, which is expected to suggest that private non-farm payrolls increased by 170k last month.

UK

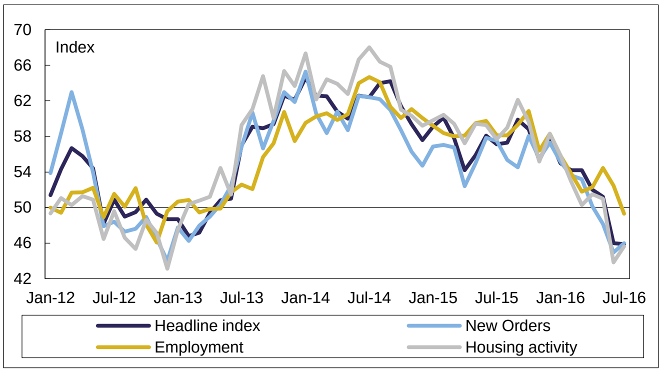
Construction PMI signals little post-Brexit change, but the sector outlook is grim

The construction sector has been a weakening area of the UK economy for a long time, with output growth falling from a peak of more than 9%3M/Y in mid-2014 to -1.7%3M/Y in May, and output having fallen in three of the past four quarters. And the uncertainty ahead of the referendum seems to have accelerated the pace of decline. For example, a sharp fall of foreign investment into the commercial real estate sector was reported at the start of the year, while a deterioration in residential sector surveys was evident in the run up to the referendum. In addition, the housing market saw a sharp fall in transaction levels in spring after the introduction of the Stamp Duty surcharge on second properties in April. Today's release of construction PMIs suggesting that activity continued to shrink in July following the EU was no surprise. But the deterioration in the headline index, which fell by only 0.1ppt to 45.9 was much smaller than expected. The reading was nevertheless the lowest since mid-2009. And the details were hardly encouraging – although the new orders and housing activity indicators recovered partly after a sharp drop in June, all of the major components remained well below the neutral level of 50, suggesting that the sector that was already struggling before the Brexit vote is going to find life even tougher over coming months.

The day ahead in the UK

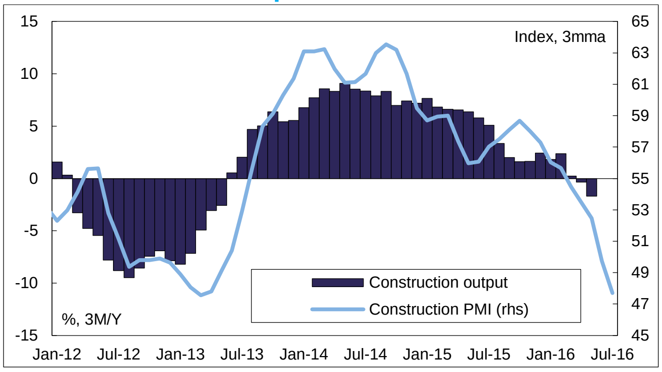
The flow of July PMIs continues tomorrow with the final releases of the services and composite indicators. After a significant downward revision to the headline manufacturing PMI earlier this week, the final reading for services seems likely to come in lower as well, with the flash reading having declined to 47.4 eleven days ago. Meanwhile, the composite index is also likely to be revised down from its flash reading of 47.7.

UK: Construction PMIs



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

UK: Construction output and PMI



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

European calendar

Today's results							
Economic data							
Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	**Revised**
Spain		Unemployment M/M '000s	Jul	**-84.0**	-70.0	-124.3	-
UK		Construction PMI	Jul	**45.9**	44.0	46.0	-
Auctions							
Country		Auction					
UK sold		£2.5bn of 0.5% 2022 bonds (22-Jul-2022) at an average yield of 0.54%					

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's data releases						
Economic data						
Country		BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
EMU		09:00	Final services PMI (final composite PMI)	Jul	52.7 (52.9)	52.8 (53.1)
		10:00	Retail sales M/M% (Y/Y%)	Jun	0.0 (1.8)	0.4 (1.6)
Germany		08:55	Final services PMI (final composite PMI)	Jul	54.6 (55.3)	53.7 (54.4)
France		08:50	Final services PMI (final composite PMI)	Jul	50.3 (50.0)	49.9 (49.6)
Italy		08:45	Services PMI (composite PMI)	Jul	51.0 (52.4)	51.9 (52.6)
Spain		08:15	Services PMI (composite PMI)	Jul	55.2 (54.5)	56.0 (55.7)
UK		00:01	BRC shop price index Y/Y%	Jul	-	-2.0
		09:30	Final services PMI (final composite PMI)	Jul	47.4 (47.7)	52.3 (52.4)
Auctions and events						
Country		BST	Auction / Event			
Germany		10:30	Auction: To sell €5bn of 2018 zero-coupon bonds (14-Sept-2018)			

Source: German debt agency, Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:
http://www.uk.daiwacm.com/research-zone/research-blog

Follow us
@DaiwaEurope