Daiwa Capital Markets

Euro wrap-up

Overview

- Bunds made losses as a German investor sentiment survey was stronger than expected.
- Gilts also made losses as UK inflation hit its highest level since November 2014 and as the BoE's latest purchase operation was well covered.
- There are no notable data releases due in the euro area tomorrow, so the European data focus will be solely on UK labour market figures.

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Daily bond market movements

Bond	Yield	Change*
BKO 0 09/18	-0.611	+0.002
OBL 0 10/21	-0.499	+0.020
DBR 0 08/26	-0.029	+0.044
UKT 1¼ 07/18	0.172	+0.034
UKT 1½ 01/21	0.223	+0.050
UKT 2 09/25	0.581	+0.051

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

Euro area

Investor sentiment bounces back

Most surveys released after the UK referendum suggested that business and consumers alike remained relatively upbeat about conditions in the euro area. The ZEW survey of investor sentiment bucked this trend, reporting in July that their assessment of current conditions in the euro area had slipped to the lowest in a year, while the survey's expectations balance dropped (-35pts) by the most in any single month, taking the series to its lowest level since the peak of the euro crisis. But today's survey for August suggested that this was a knee-jerk reaction – the current situations index almost fully reversed the decline in July, while the expectations balance was up more than 19pts, albeit still at the second lowest level since October 2014. Investor assessment of current conditions in Germany was also markedly improved in August, with the relevant index more than offsetting the decline last month to leave it at its firmest in almost a year. So taken together with the more positive Commission survey and PMIs in July, today's survey supports our view that euro area GDP growth remained stable at 0.3%Q/Q in Q3, with German GDP growth also likely to be maintained at 0.4%Q/Q.

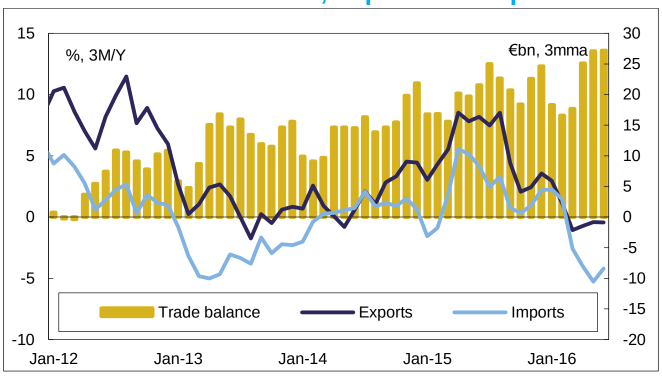
Euro area trade surplus record high in Q2

Meanwhile, as foreshadowed by the national data, today's euro area trade report for June similarly showed that the headline surplus jumped at the end of the second quarter by €4bn to €29.2bn, to leave the surplus in Q2 at a record high €27.2bn, around €5½bn higher than a year earlier. However, when adjusting for seasonal effects, the trade surplus declined for the second successive month from €24.6bn to €23.4bn, albeit this was only just off April's record high. The weakness reflected a near-1½M/M increase in the value of imports that month, while the value of exports was up ½%M/M. But this still left imports down more than 2%Q/Q and 4%Y/Y in Q2, with only a little more than half of the year-on-year decline reflecting price effects. And with the value of exports having declined just 0.2%Q/Q (-0.4%Y/Y) in Q2, today's report suggests – in line with various national GDP releases – that net trade provided some support to GDP growth for the first quarter in four.

The day ahead in the euro area and US

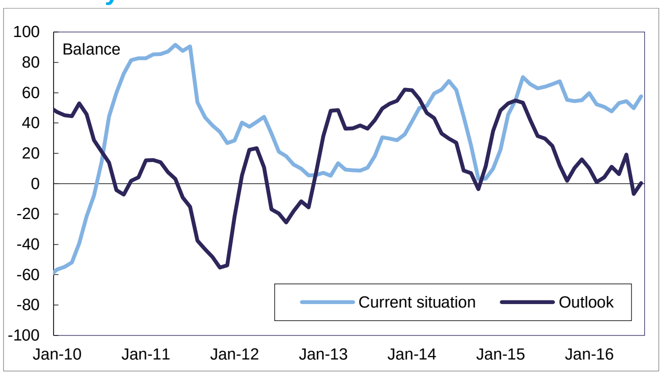
It should be a relatively quiet day for economic news from the euro area with no data of note due for release. In the US, the focus will be on the release of the FOMC minutes from the 26-27 July meeting. While the post-meeting statement saw the FOMC revise up its economic assessment somewhat, adding a sentence to note that 'near-term risks to the economic outlook have diminished', the minutes might shed further light on whether some members considered the risks to more balanced or even favourable and therefore will be analysed closely for further insights into the likelihood of a rate hike in September. FOMC voting member Bullard is also due to speak at a conference.

Euro area: Trade balance, export and import values



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Germany: ZEW business confidence indicators



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK

Higher food and energy prices push inflation to up to a new high

The July CPI figures, which represented the first full-month release of hard data since the Brexit vote, suggested that the subsequent sharp sterling depreciation has yet to have any meaningful impact on prices. While the headline inflation rate surprised on the upside, rising by 0.1ppt to 0.6%Y/Y, the highest since November 2014, the core rate was down by the same margin to 1.3%Y/Y. So that left food and energy inflation accounting for the stronger headline figure, and to a large extent that was due to base effects in both categories. But, of course, inflation is set to pick up sharply in the months ahead when the lagged effects of the weakening in the currency feed through to prices. And otherdata are already suggesting that cost pressures have increased sharply since the Brexit vote. In particular, input prices were up more than 3%M/M in July – the most since 2010 – to leave the year-on-year rate up 4.3%, the first annual increase since September 2013. And the inflationary impact of weaker sterling was evident in the price of imported materials, which rose 6½%Y/Y despite a sharp fall in the oil price that month. So it is only a matter of time until prices further down the pipeline rise to alleviate pressure on profit margins. Therefore, we expect consumer price inflation to start picking up more sharply in the months ahead, rising to 1.2%Y/Y in Q4, before increasing above the BoE's 2% target from the second quarter of next year. This, however, will not stop the BoE from easing monetary policy further later in the year if the growth outlook does not improve markedly.

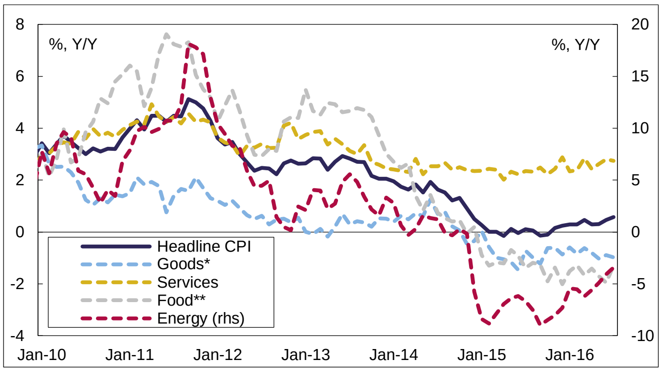
House prices continued to rise ahead of the referendum

Meanwhile, the UK house price index, released alongside the CPI figures, suggested that house price growth continued to rise in June despite higher uncertainty ahead of the referendum and lower activity in the market after the increase in the Stamp Duty on second properties in April. Headline growth picked up from an upwardly-revised 8.5%Y/Y to 8.7%Y/Y, the highest pace since October 2014. However, with uncertainty much higher and consumer confidence much lower after the referendum, we would expect that monthly house price growth went into reverse in July.

The day ahead in the UK

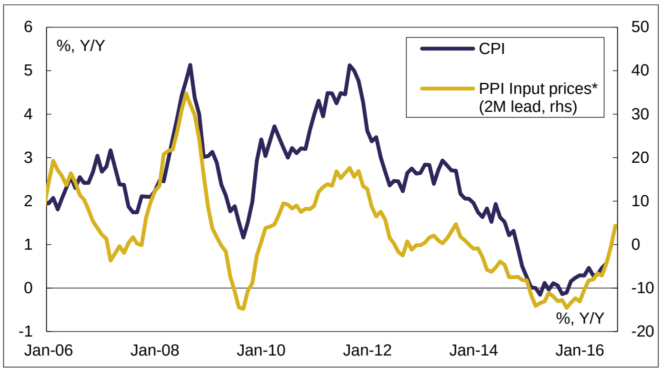
Tomorrow brings the latest labour market figures. Having increased by the largest margin in two years in the previous month, we expect employment to have remained little changed ahead of the referendum in June, to leave headline three-month employment growth at around 130k, down from 176k previously. And while the headline unemployment rate is expected to be unchanged at 4.9%, average earnings growth looks set to have inched slightly higher to reach a nine-month high of around 2½%Y/Y. The less reliable claimant count numbers, meanwhile, will provide the first official post-Brexit labour market data. Jobless claims are expected to have risen 9k in July, leaving the claimant count unemployment rate at 2.2%.

UK: CPI inflation



*Excluding food and energy. **Including alcohol and tobacco.
Source: ONS, Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: CPI and PPI inflation



*Manufacturing - materials and fuels purchased.
Source: ONS, Thomson Reuters and Daiwa Capital Markets Europe Ltd.

European calendar

Today's results

Country		Release	Period	Actual	Market consensus/ *Daiwa forecast*	Previous	Revised
Economic data							
EMU		Trade balance €bn	Jun	**23.4**	25.3	24.5	**24.6**
Germany		ZEW current assessment balance (expectations)	Aug	**57.6 (0.5)**	50.2 (2.0)	49.8 (-6.8)	-
UK		CPI (core) Y/Y%	Jul	**0.6 (1.3)**	*0.5 (1.3)*	0.5 (1.4)	-
		PPI input prices M/M% (Y/Y%)	Jul	**3.3 (4.3)**	1.0 (2.0)	1.8 (-0.5)	**1.7 (-)**
		House price index Y/Y%	Jun	**8.7**	-	8.1	**8.5**
Auctions							
Country		Auction					
		- Nothing to report -					

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Yesterday's results

Country		Release	Period	Actual	Market consensus/ *Daiwa forecast*	Previous	Revised
Economic data							
EMU		ECB QE net purchases €bn	Weekly	**11.4**	*14.0*	12.4	-
UK		Rightmove house price index M/M% (Y/Y%)	Aug	**-1.2 (4.1)**	-	-0.9 (4.5)	-
Auctions							
Country		Auction					
		- Nothing to report -					

Source: Bloomberg and Daiwa Capital Markets Europe Ltd

Tomorrow's data releases

Country		BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Economic data						
UK		09:30	Average earnings incl. bonuses (excl. bonuses) 3M/Y%	Jun	*2.4 (2.3)*	2.3 (2.2)
		09:30	ILO unemployment rate 3M%	Jun	*4.9*	4.9
		09:30	Employment change 3M/3M '000s	Jun	*135*	176
		09:30	Claimant count rate % (change 000s)	Jul	2.2 (9.0)	2.2 (0.4)
Country		BST	Auction / Event			
UK		10:30	Auction: To sell £1.25bn of 4.25% 2055 bonds (7-Dec-2055)			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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