Euro wrap-up

Overview

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- Bunds made losses as German and French business sentiment surveys indicated a pickup in economic growth momentum.
- Gilts also made losses following an upbeat UK manufacturing survey.
- Wednesday will bring the first estimate of UK GDP in Q2 and consumer sentiment surveys from France and Italy.

Daily bond market movements

Bond	Yield	Change*
BKO 0 06/19	-0.649	+0.004
OBL 0 10/22	-0.145	+0.036
DBR 0½ 08/27	0.567	+0.059
UKT 1¾ 07/19	0.307	+0.029
UKT 0½ 07/22	0.615	+0.043
UKT 4¼ 12/27	1.256	+0.067

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

Euro area

National surveys contradict the PMIs

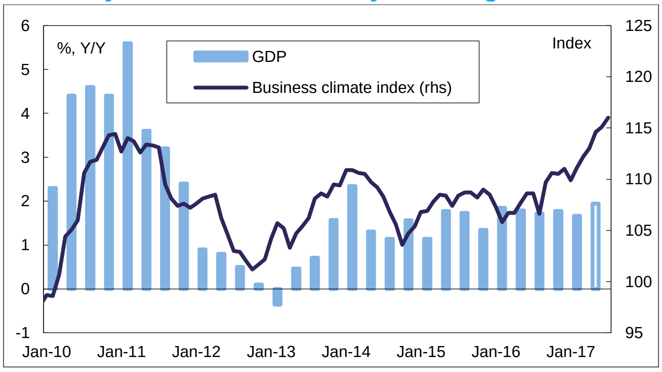
Yesterday's flash PMIs for July implied a moderation of economic growth momentum, with the headline composite indices for the euro area, Germany and France declining to six-month lows. However, this morning's national business surveys from the euro area's two largest member states contradicted those findings, with further improvements in the headline indices to suggest, if anything, acceleration in GDP at the start of the third quarter. In particular, the German Ifo business climate index rose for the sixth consecutive month to a new series high, with the index of current conditions up for the twelfth consecutive month likewise hitting a new peak. Additionally, while firms remained rather more cautious about prospects for the coming six months, the expectations index still rose to its highest in more than three and a half years. At the sectoral level, the improvement in the business climate was led by German construction and manufacturing firms, for whom the Ifo survey suggests have never had it so good. There was also a further notable pick up in sentiment among wholesalers to the best in more than six years. However, having last month similarly been the most optimistic since 2010, retailers were a touch less upbeat, albeit still evidently anticipating solid growth in sales ahead.

Similarly, today's French INSEE business sentiment survey also suggested a further improvement in conditions, with the headline indicator rising for the third consecutive month in July to 108, well above the long-run average and at a more than six-year high. Within the detail, there was a notable improvement in confidence among wholesalers to the highest level since 2007. Retailers were similarly the most upbeat in about a decade, while construction firms assessed conditions to be the most favourable since the collapse of Lehman Brothers. And contradicting the message from yesterday's PMIs, there was also a modest improvement in services sentiment for a second successive month, while conditions in the manufacturing sector reportedly remained stable at their most favourable in six years. In all sectors, the business climate is judged to be far superior to the long-run norm and conducive to firm expansion in output.

The day ahead in the euro area and US

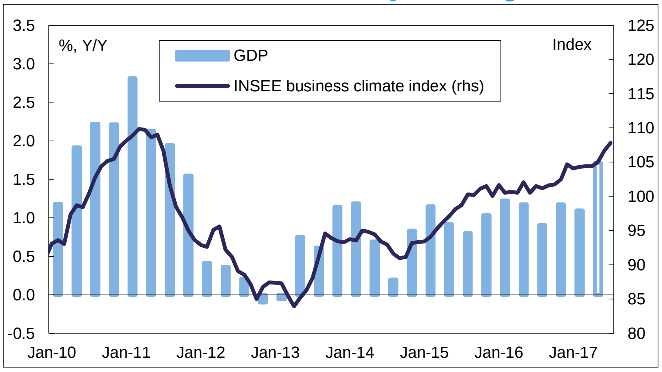
Wednesday will see the focus shift from businesses to households, with the release of the latest national consumer confidence survey results from France and Italy. Last month, perhaps on the back of optimism related to Macron's election victories, the respective survey suggested that French consumers were the most upbeat for a decade. In contrast, the headline Italian consumer confidence indicator merely ticked a little higher having fallen to a more than two-year low in May. The latest ISTAT Italian business sentiment survey results are also due tomorrow. And in the bond markets, Italy will sell 10Y inflation-linked bonds and 2Y zero-coupon bonds.

Germany: Ifo business survey & GDP growth*



** Estimate of GDP growth in Q217 is Daiwa forecast.*
Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

France: INSEE business survey & GDP growth*



** Estimate of GDP growth in Q217 is Daiwa forecast.*
Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Of course, the main event on Wednesday will be the Fed's latest policy announcement. Having raised rates in June and with recent inflation figures having come in softer than expected to prompt Yellen to note that the FOMC will be monitoring price developments closely in the months ahead, when the Fed's meeting concludes tomorrow it is universally expected to leave the range for the Fed Funds Rate unchanged at 1.00-1.25%. But the statement will no doubt be scrutinised for new insight into the likely timing of the next rate hike and commencement of the Fed's balance sheet normalisation process. Data-wise in the US, new home sales figures for June are due. And the Treasury will sell 2Y FRNs and 5Y notes.

UK

Industrial output growth set to recover over the summer months?

Contrasting with expectations that weak sterling will boost UK manufacturers' competitiveness overseas, recent industrial production growth figures have been disappointing with output falling by more than 1.0%3M/3M in May. But today's CBI survey suggested that momentum may have improved notably in recent months. The output growth index for the three months to July rose to the highest level since 1995. Against this backdrop, the survey also reported that manufacturers increased their workforces, with the relevant employment indicator reaching a three-year high, and invested more in plants and machinery. And while total new orders eased, having risen at the strongest pace since the mid-90s in the three months to April, they remained at elevated levels significantly above recent averages, with both domestic and export markets showing a similar pace of growth. Looking ahead, anticipating a strong order flow in the coming three months, manufacturers also expected output growth to remain strong. But with this survey having significantly overestimated the strength of activity in this sector three months ago, the results should be treated with a degree of caution.

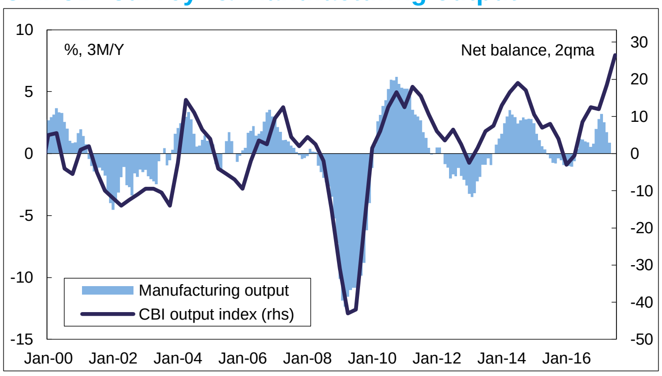
Rising prices continue to squeeze household budgets

While a weaker currency, which has driven inflation higher in recent quarters, should be helping exporters, on the flip side consumers are significantly worse off. For example, the IHS Markit Household Finance Index released yesterday suggested that consumer finances remained under pressure at the start of Q3, with the headline survey index declining by almost 2.0pts to 41.8 in July, signaling the sharpest decline in household financial wellbeing in three years. Unsurprisingly, rising living costs remained the number one concern for households, but job security and subdued wage growth – the index for the former was at the lowest level in a year – seem to have come to the fore too, further suppressing households' appetite for major purchases. Indeed, the relevant index declined to the lowest level since the end of 2013. The survey results were broadly consistent with the GfK consumer confidence indicator, which showed a notable decline in June and is expected to have taken a further step down in July. So, while CPI inflation moderated in June, hinting that inflationary pressure might now be starting to recede, the underlying weakness in consumer spending is likely to have persisted in the current month.

The day ahead in the UK

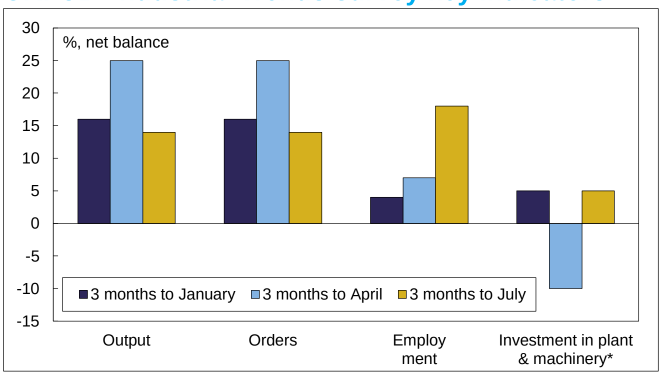
The preliminary Q2 GDP figures, the highlight of the week's UK economic calendar, are out tomorrow. Growth slowed notably at the start of the year from 0.7%Q/Q to 0.2%Q/Q. But more recent economic indicators have been mixed. Most notably, retail sales rebounded in Q2 after a notable drop in Q1 although underlying consumer spending remained relatively weak. Other data have been less positive: for example, new car sales have fallen sharply, while momentum in the housing market has continued to moderate. And while on average the PMIs were broadly unchanged in Q2, industrial production figures for May brought a significant downward surprise, with output down by more than 1.0%3M/3M. So overall, we expect only a small increase in GDP growth to 0.3%Q/Q.

UK: CBI survey* & manufacturing output



** CBI Industrial Trends survey.*
Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: CBI Industrial Trends survey key indicators



** Intentions for the coming 12 months relative to the actual spending in the previous 12 months. Source: 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**
Germany		Ifo business climate index	Jul	**116.0**	114.9	115.1	**115.2**
		Ifo current assessment balance (expectations)	Jul	**125.4 (107.3)**	123.8 (106.5)	124.1 (106.8)	**124.2 (-)**
France		Manufacturing confidence (production outlook)	Jul	**109 (21)**	108 (-)	108 (17)	**109 (16)**
Italy		Industrial sales M/M% (Y/Y%)	May	**1.5 (7.6)**	-	-0.5 (4.0)	**-0.4 (4.1)**
		Industrial orders M/M% (Y/Y%)	May	**4.3 (13.7)**	-	-0.7 (-2.2)	**-0.5 (-)**
UK		CBI Industrial Trends survey, total orders	Jul	**10**	12	16	**-**

Auctions

Country		Auction
UK sold		£2.5bn of 1.5% 2047 bonds (22-Jul-2047) at an average yield of 1.827%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's data releases

Economic data

Country		BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
France		07:45	Consumer confidence survey	Jul	108	108
Italy		09:00	Consumer confidence indicator	Jul	106.3	106.4
		09:00	Manufacturing (economic) confidence	Jul	107.0 (-)	107.3 (106.4)
Spain		08:00	Retail sales Y/Y%	Jun	2.2	2.4
UK		09:30	GDP – 1st release Q/Q% (Y/Y%)	Q2	*0.3 (1.7)*	0.2 (2.0)
		09:30	Index of services M/M% (3M/3M%)	May	0.1 (0.4)	0.2 (0.2)
		09:30	BBA loans for house purchase 000s	Jun	40.0	40.3

Auctions and events

Country		BST	Auction / Event
Italy		10:00	Auction: To sell up to €2bn of 0% 2019 bonds (30-May-2019)
		10:00	Auction: To sell up to €1.25bn of 1.3% 2028 index-linked bonds (15-May-2028)

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.