

# Euro wrap-up

## Overview

- Bunds made modest gains as the ECB account revealed Governing Council concerns about the strength of the euro.
- Gilts also made modest gains as the latest UK retail sales figures suggested no underlying improvement in consumer spending growth.
- The end of the week will bring only the latest euro area current account and construction output figures.

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### Daily bond market movements

Bond	Yield	Change*
BKO 0 06/19	-0.702	+0.004
OBL 0 10/22	-0.258	-0.010
DBR 0½ 08/27	0.429	-0.015
UKT 1¼ 07/19	0.223	-0.009
UKT 0½ 07/22	0.500	-0.012
UKT 4¼ 12/27	1.089	-0.016

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

## Euro area

### Inflation showing few signs of life

The final estimates of euro area inflation in July provided no surprises, with headline and core CPI left unrevised from the respective flash figures. So, in particular, headline CPI remained unchanged from June at 1.3%Y/Y, thus matching the lowest rate so far this year. And core CPI inflation rose 0.1ppt from June to 1.2%Y/Y, thus matching April's near-two-year high. It is certainly far too soon to judge whether that might represent the start of any meaningful uptrend in underlying price pressures. Indeed, while services inflation was revised up slightly from the preliminary estimate to 1.6%Y/Y, matching June's rate and remaining close to the top of its range of recent years, upwards pressure in that category in the past couple of months was related not least to the timing of national holidays, with prices of accommodation, package holidays and air transport the three items making the largest impact on headline CPI. And while inflation of non-energy industrial goods was confirmed at 0.5%Y/Y, similarly back at the top of the range of the past year or so, over coming months prices of those items will be held back by the strength of the euro, which since the start of the year has appreciated more than 10% against the US dollar and more than 5% in trade-weighted terms to levels well above those assumed in the ECB's economic forecasts.

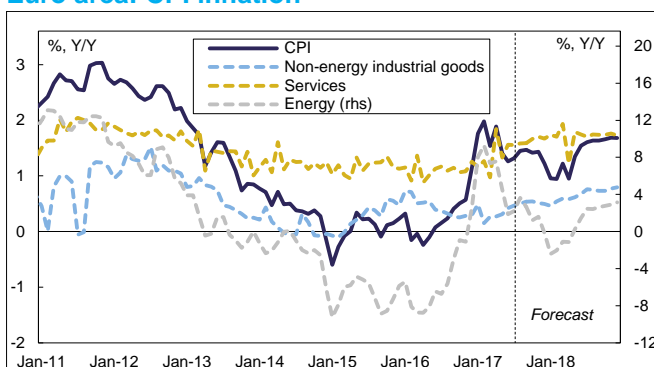
### Inflation to move broadly sideways over coming months

Looking ahead, we forecast only a small increase in headline CPI in August, principally on account of higher oil prices. And given the limited signs of life in the main components, we expect it subsequently to remain little changed over the remaining months of the year to average 1.5%Y/Y in 2017, with core inflation likewise moving broadly sideways to average 1.1%Y/Y. Given past shifts in oil prices, we then expect headline CPI to decline in the first quarter of 2018, before a gentle uptrend in core components related to the tightening labour market and continued firm demand eventually pushes inflation higher. Overall, we forecast headline inflation of 1.4%Y/Y and core CPI of 1.3%Y/Y over 2018 as a whole, the latter only a touch weaker than currently projected by the ECB.

### Strong euro increasingly a concern

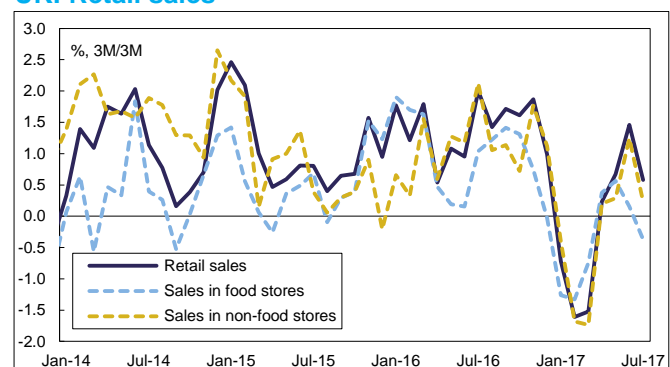
Much, however, will depend on events to a lesser or greater extent beyond the control of policymakers, including developments in financial markets such as the path of the euro. Indeed, the ECB's account of its July monetary policy meeting, also published today, revealed that the exchange rate has become a key topic of debate for the Governing Council. Some recent euro appreciation was considered possibly in part to reflect an improvement in the relative fundamentals of the euro area vis-à-vis the rest of the world. Nevertheless, concerns were also expressed about 'the risk of the exchange rate

### Euro area: CPI inflation



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

### UK: Retail sales



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.



overshooting', something that could jeopardise an eventual sustained adjustment of inflation back to the ECB's target. Should the euro resume an appreciation trend over coming weeks, expect expressions of concern from members of the Governing Council to become louder and increasingly frequent. And ultimately, if indeed the inflation outlook deteriorates materially for whatever reason – a further strengthening of the euro, a sharp drop in oil prices, a bond market taper tantrum, or any other adverse shock – then expect the ECB to wait until December to decide the next steps for its QE programme and to reduce its rate of asset purchases only very gradually from the start of 2018.

### **The day ahead in the euro area and US**

Friday in the euro area will bring June's output data from the construction sector, which is likely to resume its recovery trend following a dip in May. In addition, the ECB's July balance of payments figures for the euro area are also scheduled for release. In the US, Friday will bring the preliminary University of Michigan consumer confidence survey results for August.

## **UK**

### **Mixed signals for consumer spending growth**

The latest economic indicators have provided mixed messages about consumer spending. While surveys reported decent activity on the High Street last month, consumer confidence has continued to fall. And today's retail sector data did not bring much more clarity either. Sales increased by 0.3%M/M, an unchanged pace from a downwardly revised June figure, which was previously reported at 0.6%M/M. But the increase was driven entirely by food sales, which recovered from two successive months of decline and rose by 1.5%M/M. Meanwhile, all other major categories, arguably representing less essential consumption, saw sales fall in July, and left the headline three-month rate dropping from 1.5%3M/3M in Q2 to 0.6%. Although this rate appears somewhat stronger than the norm during the first half of the year, when sales were broadly unchanged compared to the previous six months, it is consistent with a notable slowdown since last year, when sales grew on average by 1.4%3M/3M. Against this backdrop and with other indicators suggesting ongoing weakness in other relevant indicators – new car sales continued to decline in the latest month, while housing market sentiment remains particularly fragile – we expect that the subdued trend in consumer spending seen in the first half of the year will continue over coming months and quarters.






### **The day ahead in the UK**

There are no major UK economic data releases due tomorrow.

## European calendar

### Today's results

#### Economic data

Country	Release	Period	Actual	Market consensus/ Daiwa forecast	Previous	Revised
EMU	 Final CPI (core CPI) Y/Y%	Jul	<b>1.3 (1.2)</b>	<u>1.3 (1.2)</u>	1.3 (1.1)	-
	 Trade balance €bn	Jun	<b>22.3</b>	20.3	19.7	<b>19.0</b>
France	 Unemployment rate %	Q2	<b>9.5</b>	9.5	9.6	-
UK	 Retail sales excluding petrol M/M% (Y/Y%)	Jul	<b>0.5 (1.5)</b>	0.1 (1.2)	0.9 (3.0)	<b>0.6 (2.8)</b>
	 Retail sales including petrol M/M% (Y/Y%)	Jul	<b>0.3 (1.3)</b>	0.2 (1.4)	0.6 (2.9)	<b>0.3 (2.8)</b>

#### Auctions

Country	Auction
- Nothing to report -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

### Tomorrow's data releases

#### Economic data

Country	BST	Release	Period	Market consensus/ <u>Daiwa forecast</u>	Previous
EMU	09:00	Current account balance €bn	Jun	-	30.1
	10:00	Construction output M/M% (Y/Y%)	Jun	-	-0.7 (2.6)
Italy	09:00	Current account balance €bn	Jun	-	3.3

#### Auctions and events

Country	BST	Auction / Event
- Nothing scheduled -		

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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