

Euro wrap-up

Overview

- Bunds made modest gains as data suggested the possibility of a second consecutive quarterly decline in euro area IP in Q2.
- Gilts also made gains as the UK Government published its controversial Brexit White Paper.
- The coming week will see the UK Parliament debate two key Brexit Bills. Data-wise, the release of figures for UK and euro area inflation, UK labour market and retail sales will be most notable.

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Daily bond market movements

Bond	Yield	Change*
BKO 0 06/20	-0.636	-0.003
OBL 0 04/23	-0.296	-0.018
DBR 0½ 02/28	0.354	-0.014
UKT 2 07/20	0.736	-0.016
UKT 0¾ 07/23	1.028	-0.019
UKT 4¾ 12/27	1.276	-0.018

*Change from close as at 4.30pm BST.

Source: Bloomberg

Euro area

Euro area IP on track for a further quarter of negative growth?

As had been broadly implied by the data from the large member states, and thanks particularly to a surge in Germany, euro area IP rose by 1.3%M/M in May, the steepest gain since last November, to reverse the 0.8%M/M decline in April. All major components also recorded notable increases, with manufacturing output up by 1.4%M/M, and consumer goods output rising at the fastest rate in 1½ years, by 2.2%M/M. Nevertheless, the average level for Q2 so far is about 0.2% below the Q1 average, suggesting that a drop in June might bring a second successive quarterly decline in the industrial sector, which had represented the key impetus to accelerated GDP last year. That would be consistent with the steady deterioration in sentiment indicators such as the manufacturing PMI, which has been gradually moving lower since the end of last year and in June reached its lowest level since end-2016. And looking further ahead, the risks to the outlook for the sector appear skewed to the downside, with Trump's trade war making manufacturers feel particularly uneasy.

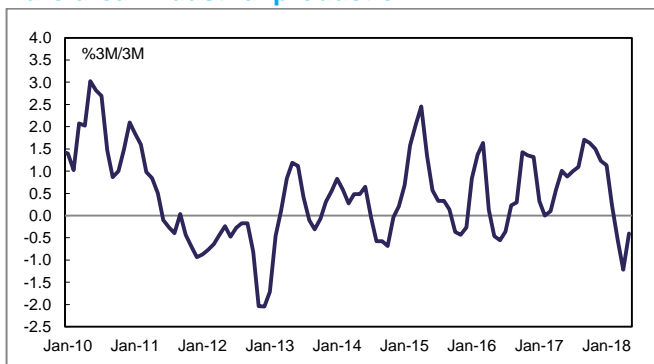
Euro area inflation set to remain unrevised

Today's final release of June inflation figures from Germany brought no surprises, with the headline EU-harmonized rate of confirmed at 2.1%Y/Y, 0.1ppt lower rate than in May. Energy inflation on the national CPI measure rose more than 1ppt to 6.4%Y/Y, continuing to provide an upward impulse to the headline rate. Excluding this effect and that of food prices, core inflation came in at just 1.4%Y/Y (on the national CPI measure), down from 1.6%Y/Y previously. Meanwhile, the equivalent figures from France showed a downward revision of 0.1ppt on the EU-harmonized inflation rate to 2.3%Y/Y, which matched May's reading. Like in Germany, energy prices, up 11.8%Y/Y, were the main driver, but the core rate inched backed down by 0.2ppt to April's level of 0.9%Y/Y. Despite, the revision in the headline French rate, the final euro area figures, due next week, still seem highly likely to confirm the flash estimates, with headline inflation up 0.1ppt from May to 2.0%Y/Y, but core inflation down 0.1ppt to just 1.0%Y/Y, still firmly within the range of the past four years.

The week ahead in the euro area and US

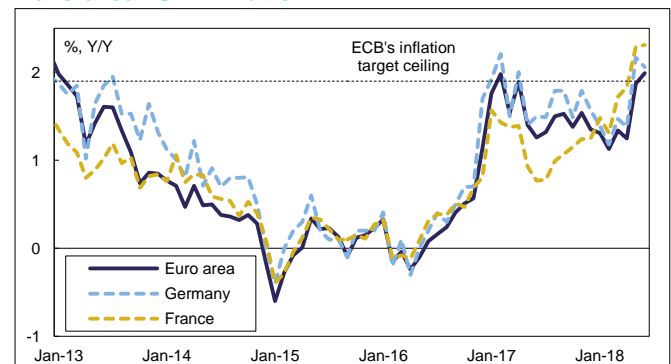
It should be a quiet end to the week in the euro area with only final June inflation data from Spain. And the inflation theme will continue in the coming week, with the aforementioned euro area figures due on Wednesday, when construction output data for June are also due. Otherwise, the latest trade figures will be announced on Monday, while the ECB's euro area balance of payments are due at the end of the week. Ahead of that, Tuesday's new car registration data will be watched for more insights into how private consumption fared in Q2.

Euro area: Industrial production



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Euro area: CPI inflation*



*EU-harmonised measure. Jun-18 reading for the euro area is a preliminary estimate Source: Daiwa Capital Markets Europe Ltd.

In the US, tomorrow brings the latest import and export price indices and the University of Michigan consumer sentiment survey. The coming week will start with June retail sales figures on Monday. After an increase of 0.8%M/M in May, another firm, albeit not as steep, rise is expected. The NY Fed's Empire Manufacturing survey is also due that day. The following day, June industrial production figures also expected to bring a positive message, with output expected to have increased by around ½%M/M. The calibre of new economic data over the following two days will be a bit lower, with Wednesday bringing June housing starts indicators, while the Philly Fed Index and the usual weekly jobless claims are due on Thursday.

UK

Soft Brexit blueprint finally unveiled

The long-awaited White Paper setting out the government's "ambitious" proposal for its relationship with the EU was a detailing of the summary unveiled after last week's Cabinet meeting and offered little new in the way of concessions, be it to pro- or anti-Brexiteers or Brussels. But it has already attracted criticism from all sides. At the centre was the much-touted idea of a free-trade area for goods, with a common rulebook for manufactured and agricultural goods, and a "facilitated customs arrangement" which relies on technology to ensure tariffs are paid on imports at the right rate. Many have queried if the latter is feasible, and the Paper conceded that the mechanism will have to be worked out with EU counterparts (if, indeed, Brussels finds such a proposal amenable). By contrast, the government intends "regulatory flexibility" for the service sector that constitutes 80% of the economy. It concedes that banks, in particular, are set to lose access to EU markets as it backs away from previous plans for both sides to mutually recognise the other's regulations. Instead, in a blow to the financial services sector, it touts an enhanced version of the equivalence scheme that currently exists for third-party countries such as the US. While signalling the end of freedom of movement, it proposes reciprocal visa-free travel for business trips, tourists and research students. Significantly, in a move that will upset Brexiteers, it intends that the European Court of Justice retains final say in the cases of disputes. The paper is pitching the very type of "cherry-picking" of the principles underpinning the EU that Brussels has previously warned against. The new Brexit Minister refused to be drawn on whether this constitutes a set of "red lines" but it is clear that Brussels views it as subject to negotiation. The EU's Chief Negotiator Michel Barnier tweeted that he would analyse the plan in light of the EU's guidelines, with a reminder that the EU already offered an "ambitious" free trade deal. May claims her team will be resuming the negotiations "at pace" with a view to having agreement by October. But Brussels will likely demand concessions, creating further anger amongst pro-Brexit MPs, and retaining the threat of even more spectacular political fireworks.

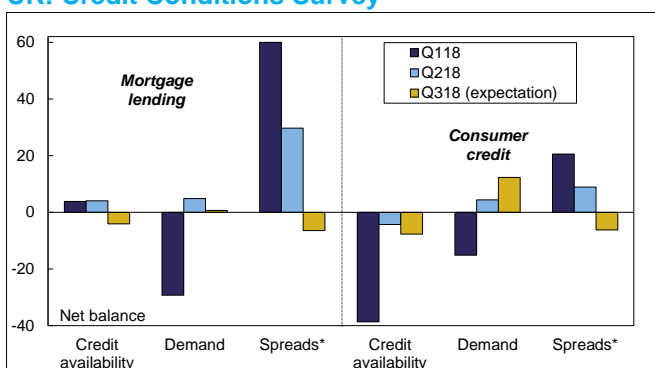
Credit card lending likely to support consumer spending

Far more prosaically, today's BoE Credit Conditions survey for Q2 reported that availability of both secured and unsecured credit to households was broadly stable in the latest quarter. While for the former category this represented a broadly similar result to the previous quarters, the latter nevertheless marked the highest reading in six quarters. A closer look revealed that the proportion of approved applications for unsecured loans declined, but the same indicator for credit card loans rose notably, perhaps signaling that cash-constrained households will be able to get further breathing space against the backdrop of still very subdued real wage growth. Meanwhile, given the high probability of a Bank Rate rise in the near term, demand for remortgaging increased last quarter, however demand for other types of borrowing was unchanged, despite that fact that lenders lowered their spreads on lending to households relative to the policy rate or a swap rate. So, overall, households appear to have remained cautious, but going forward lenders expected that demand for credit card lending will rise, which should support consumer spending.

Sentiment in the housing market stabilises

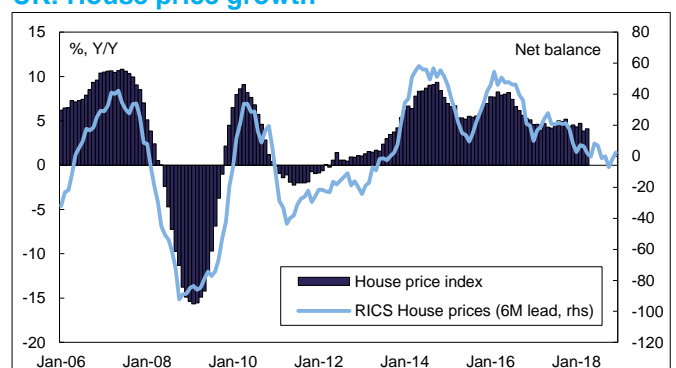
The other data release of note in the UK today focused on another major British preoccupation – house prices. And the RICS Residential Market survey carried a slightly more positive tone than of late. In June, the net balance of survey respondents

UK: Credit Conditions Survey



Source: BoE and Daiwa Capital Markets Europe Ltd.

UK: House price growth



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

reporting price increases turned positive for the first in five months, albeit only rising modestly from -2% to 2%. Near-term price expectations also stabilised, having also been on a downward trend in recent months – the relevant index came in at 0%. This stability was also supported by indications of slightly improved market activity: the indices for new buyer enquiries and new instructions to sell both rose by 5ppts to -1 and 10 respectively, with the former representing the highest reading since the summer of 2013. Nevertheless, the level of agreed sales continued to decline, recording the fifteenth consecutive reading below zero. So overall, while the survey gives some hope of somewhat better housing market momentum in the near term, which would also be consistent with the recent recovery in the retail sales data, the improvement so far appears somewhat limited. And with Brexit uncertainty remaining high, sentiment in the market could easily deteriorate again.
















The week ahead in the UK

In the final week before Parliament breaks for the summer, two key Brexit Bills, governing Taxation and Trade, are to be discussed in the House of Commons on Monday and Tuesday. Whereas once seen as a crucial point for pro-Remain MPs to insist the government seek to remain in a customs union, they are likely in the main to have been appeased by May's proposals. But this customs arrangement may well provoke opposition from Brexiteer MPs who see it as meaning the UK continues to have rules dictated by the EU, although they may not be sufficient in numbers to make an impact.

On the data front, the coming week brings top-tier releases of labour market, inflation and retail sales figures, which will help to set the tone for the coming MPC meeting at the start of next month. Tuesday's jobs market report will probably show that employment growth remained firm, most likely above 100k3M/3M. However, that seems unlikely to be sufficient to lower the headline unemployment rate, which is expected to remain at 4.2% for a fourth consecutive month. With regards to wages, the data also seem unlikely to show any material changes from the recent pattern, with total pay set to continue rising by around 2.5%3M/Y. Wednesday's inflation figures will be equally important for the BoE. We expect that the headline CPI rate, driven by a further rise in energy prices, will increase by 0.2ppt to 2.6%Y/Y. However, the core rate should remain unchanged at 2.1%Y/Y. Meanwhile, June retail sales data are out the following day. The latest BRC survey suggested that activity growth on the High Street eased from May, but boosted by good weather and the World Cup, it remained relatively firm relative to recent months.

In the absence of significant news, the next edition of the Euro wrap-up will be published on 16 July 2018.

Daiwa economic forecasts





	2018				2019				2017	2018	2019
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
GDP forecasts %, Q/Q											
Euro area 	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	2.6	2.0	1.6
Germany 	0.3	0.5	0.4	0.5	0.4	0.5	0.4	0.5	2.5	2.0	1.8
France 	0.2	0.3	0.4	0.3	0.4	0.3	0.4	0.4	2.3	1.7	1.5
Italy 	0.3	0.2	0.3	0.2	0.3	0.2	0.3	0.3	1.6	1.2	1.0
Spain 	0.7	0.5	0.6	0.6	0.5	0.5	0.5	0.5	3.1	2.6	2.2
UK 	0.2	0.4	0.3	0.3	0.3	0.3	0.3	0.3	1.7	1.2	1.2
Inflation forecasts %, Y/Y											
Euro area											
Headline CPI 	1.3	1.7	1.9	1.7	1.5	1.4	1.4	1.5	1.5	1.7	1.5
Core CPI 	1.0	1.0	1.0	1.1	1.1	1.2	1.3	1.4	1.0	1.0	1.3
UK											
Headline CPI 	2.7	2.5	2.3	2.0	2.0	2.0	1.9	1.9	2.7	2.4	2.0
Core CPI 	2.5	2.1	1.9	1.8	1.8	1.9	1.9	1.9	2.4	2.1	1.9
Monetary policy											
ECB											
Refi Rate % 	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Deposit Rate % 	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.25	-0.25	-0.40	-0.40	-0.25
Net asset purchases* 	30	30	30	15	0	0	0	0	60	15	0
BoE											
Bank Rate % 	0.50	0.50	0.50	0.75	0.75	0.75	0.75	0.75	0.50	0.75	0.75
Net asset purchases** 	0	0	0	0	0	0	0	0	0	0	0

*Monthly target €bn, end of period. **Monthly target £bn, end of period. Source: Bloomberg, ECB, BoE and Daiwa Capital Markets Europe Ltd.





European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
EMU	 Industrial production M/M% (Y/Y%)	May	1.3 (2.4)	1.2 (2.4)	-0.9 (1.7)	-0.8 (-)
Germany	 Final EU-harmonised CPI Y/Y%	Jun	2.1	2.1	2.2	-
France	 Final EU-harmonised CPI Y/Y%	Jun	2.3	2.4	2.3	-
UK	 RICS house price balance%	Jun	2	-4	-3	-2

Auctions

Country	Auction
Italy sold	 €2bn of 0.05% 2021 bonds (15-Apr-2021) at an average yield of 1.1%  €2bn of 1.45% 2025 bonds (15-May-2025) at an average yield of 2.31%  €1.25bn of 2.45% 2033 bonds (01-Sep-2033) at an average yield of 3.04%  €1.25bn of 2.95% 2038 bonds (01-Sep-2038) at an average yield of 3.28%


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
- Nothing to report -						


Auctions

Country	Auction
Germany sold	 €3.2bn of 0.25% 2028 bonds (15-Aug-2028) at an average yield of 0.36%


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
Spain	 08:00	Final EU-harmonised CPI Y/Y%	Jun	2.3	2.1

Auctions and events

Country	BST	Auction / Event
UK	 12:00	BoE's Cunliffe speaks in North West England







Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Coming week's data calendar

Key data releases						
Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous	
Monday 16 July 2018						
EMU		14:55 ECB public sector asset purchases €bn	Weekly	<u>5.5</u>	3.0	
Italy		09:00 Trade balance €bn	May	-	2.9	
UK		00:01 Rightmove house prices M/M% (Y/Y%)	Jul	-	0.4 (1.7)	
Tuesday 17 July 2018						
EMU		07:00 EU27 new car registrations Y/Y%	Jun	-	0.8	
Italy		10:00 Final EU-harmonised CPI Y/Y%	Jun	1.5	1.0	
UK		09:30 Claimant count rate % (change '000s)	Jun	-	2.5 (-7.7)	
		09:30 Average weekly earnings (excl. bonuses) 3M/Y%	May	<u>2.5 (2.7)</u>	2.5 (2.8)	
		09:30 ILO Unemployment rate %	May	<u>4.2</u>	4.2	
		09:30 Employment change 3M/3M '000s	May	<u>110</u>	146	
Wednesday 18 July 2018						
EMU		10:00 Construction output M/M% (Y/Y%)	May	-	1.8 (1.8)	
		10:00 Final CPI (final core CPI) Y/Y%	Jun	<u>2.0 (1.0)</u>	1.9 (1.1)	
UK		09:30 CPI (core CPI) Y/Y%	Jun	<u>2.6 (2.1)</u>	2.4 (2.1)	
		09:30 Input (output) PPI Y/Y%	Jun	-	9.2 (2.9)	
		09:30 UK House price index Y/Y%	May	-	3.9	
Thursday 19 July 2018						
UK		09:30 Retail sales excluding auto fuel M/M% (Y/Y%)	Jun	0.3 (3.9)	1.3 (4.4)	
		09:30 Retail sales including auto fuel M/M% (Y/Y%)	Jun	0.2 (3.6)	1.3 (3.9)	
Friday 20 July 2018						
EMU		09:00 Current account balance €bn	May	-	28.4	
Germany		07:00 PPI M/M% (Y/Y%)	Jun	0.2 (2.9)	0.5 (2.7)	
Spain		09:00 Trade balance €bn	May	-	3.1	
UK		09:30 Public sector net borrowing excluding interventions £bn	Jun	-	5.0	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Coming week's events/auctions calendar

Key events & auctions			
Country	BST	Event / Auction	
Monday 16 July 2018			
- Nothing scheduled -			
Tuesday 17 July 2018			
Germany		10:30 Auction: to sell €3bn of 0% 2020 bonds (12-Jun-2020)	
Wednesday 18 July 2018			
Germany		10:30 Auction: to sell €1bn of 1.25% 2048 bonds (15-Aug-2048)	
Thursday 19 July 2018			
France		09:50 Auction: to sell bonds	
		10:50 Auction: to sell index-linked bonds	
Spain		09:30 Auction: to sell bonds	
UK		10:30 Auction: to sell bonds £2bn of 1.75% 2057 bonds (22-Jul-2057)	
Friday 20 July 2018			
- Nothing scheduled -			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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