

Euro wrap-up

Overview

- Despite an upside surprise to the flash national measure of German inflation, Bunds made modest gains as the Commission economic sentiment index suggested a further loss of momentum in the euro area.
- Gilts were little changed despite further weak UK car production data.
- Friday will bring the flash estimate of euro area inflation in June and French consumer spending data for May.

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Daily bond market movements

Bond	Yield	Change*
BKO 0 06/21	-0.735	-0.009
OBL 0 04/24	-0.648	-0.017
DBR 0% 02/29	-0.317	-0.016
UKT 1½ 01/21	0.608	-0.001
UKT 1 04/24	0.623	-0.001
UKT 1½ 10/28	0.828	-0.003

*Change from close as at 4.30pm BST.

Source: Bloomberg

Euro area

Commission survey provides more bad news for the ECB

Friday's flash PMIs hinted at an improvement in economic activity at end-Q2, with the euro area composite index up for a second month to a seven-month high of 52.1. However, the improvement appeared limited largely to France. And today's more comprehensive Commission business and consumer survey results painted a far more downbeat picture, with the headline euro area Economic Sentiment Index (ESI) falling a larger-than-expected 1.9pts to 103.3, the lowest in more than three years. Moreover, the ESIs fell in each of the eight largest member states, with the decline in Germany standing out, down 2.9pts to the lowest in almost six years. Perhaps unsurprisingly, the worsening in the euro area was led by a further deterioration in industrial sector confidence – matching the biggest drop in eight years – to its lowest level since September 2013, with production expectations, orders and employment plans notably lower. Contrary to the message of the PMIs, however, optimism in services also declined to match January's more than two-year low. And the drop in consumer confidence reported in the preliminary estimate was confirmed too. More happily, sentiment among retailers and construction firms improved. However, selling price expectations deteriorated in those sectors as well as in industry, with consumer price expectations easing further too. Overall, therefore, the Commission survey provided more bad news for the ECB.

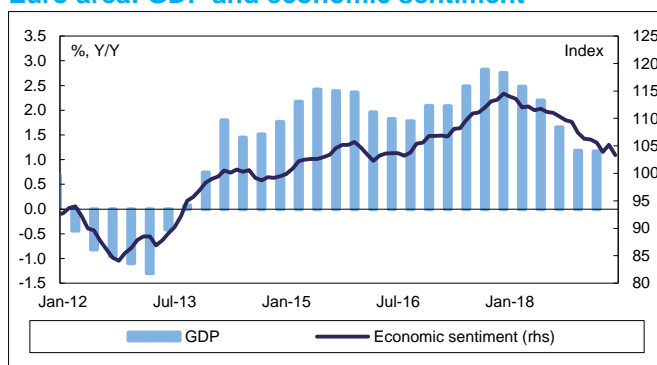
Inflation up in Germany, but only on the national measure

Today's first estimates of inflation in June were a mixed bag. In line with expectations, German inflation on the EU-harmonised measure was unchanged at 1.3%Y/Y in June. On the national measure, however, the German CPI rate surprised on the upside, rising 0.2ppt to 1.6%Y/Y due to higher inflation of services (up 0.8ppt to 2.0%Y/Y) and food (up 0.3ppt to 1.2%Y/Y). In contrast, energy inflation fell 2.0ppts to 2.2%Y/Y, suggesting that German core inflation rose more than the headline rate. In Spain, however, annual CPI rate on the EU-harmonised measure fell a larger-than-expected 0.3ppt to a 2½-year low of 0.6%Y/Y. While detail was lacking, lower energy prices were cited by Spain's Statistical Agency as the driving factor for the drop in inflation.

The day ahead in the euro area and US

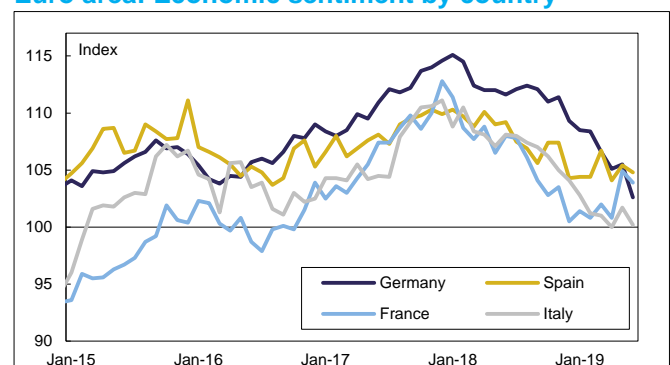
The week will come to an end with the flash June inflation figures from France, Italy and the euro area. Following today's figures from Germany and Spain, we continue to expect the euro area release to show that headline inflation remained unchanged at 1.2%Y/Y but also that the core inflation rate ticked up to 1.0%Y/Y. In addition, data for French consumer spending on goods and Spanish retail sales, both for May, are also due. In the US, the May personal income and spending data, together with the associated PCE deflators, are due along with the final University of Michigan consumer sentiment

Euro area: GDP and economic sentiment



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

Euro area: Economic sentiment by country



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



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survey results for June. Most notably, despite slow job growth last month, personal spending looks set to post solid growth supported by decent growth supported by firm retail and vehicle sales.

UK

Johnson gives more mixed messages on Brexit

The Conservative leadership contest continues, with the most likely victor Boris Johnson continuing to give mixed messages about his Brexit policy. Indeed, like his profligate tax and public spending proposals, to some extent Johnson appears to be making up his Brexit policy as he goes along. After he said on Tuesday that the UK must leave the EU on 31 October “deal or no deal”, “come what may, do or die”, yesterday evening he took a softer line, suggesting the chances are “a million to one against” the UK leaving without a deal. And while he also hinted at (but would not confirm) ruling out proroguing Parliament to prevent MPs blocking a no-deal Brexit if necessary, he also insisted unrealistically that a new deal would be negotiated and ratified before end-October.

Narrow scope for a deal (that would upset the Brexiteers)

As a rule, it's usually best to take everything Johnson says with a pinch of salt. But closer scrutiny of his utterances suggests some, albeit very narrow, scope for a deal to propose to the EU, whereby the Irish border backstop would be replaced by an effectively open-ended implementation period – which can currently last until the end of 2022 in Theresa May's negotiated deal – until new technology (i.e. the so-called ‘alternative arrangements’) can be developed to avoid the need for border infrastructure on the island of Ireland. While it might attract support among some Labour MPs, it must be highly doubtful that many of the hard-line Brexiteers backing his bid for Conservative leader would support such an approach. Nevertheless, not least because of opposition within Parliament, we continue to see the probability of a no-deal Brexit at end-October at significantly less than 50%. Regardless, given the marked negative shock to economic activity that it would cause, it was no surprise yesterday when BoE Governor Carney stated that “it's more likely [than not] that [the MPC] would provide some stimulus” in the event of a no-deal Brexit.

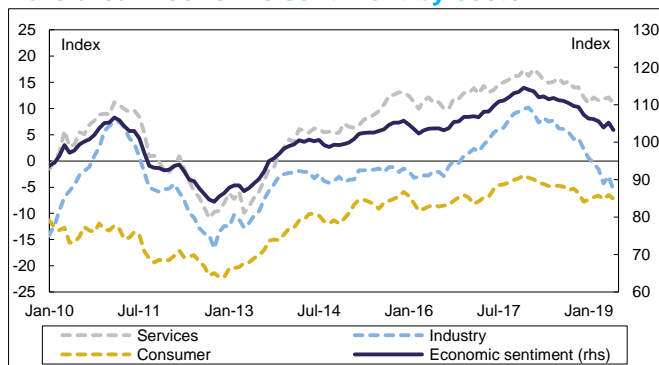
Car production continues to trend lower

While the outlook for Brexit remains highly unclear, the UK economic dataflow remains downbeat. Although production lines returned to normal after closing early for maintenance in April in the face of no-deal Brexit risks, today's SMMT data showed that car output was down 15.5%Y/Y in May, the twelfth successive year-on-year decline. That left them down 21.0%Y/Y in the year to-date with total production on a twelve-month basis down to the lowest since January 2012. Cars produced for the domestic market were down a hefty 25.9%Y/Y (-20.1% on a year to-date basis) while those produced for exports – which account for more than 80% of total output, and more than half of which are destined for the EU – were down 12.6%Y/Y (-21.3% on a year to-date basis). Of course, given the disruption that would be caused to supply chains, a no-deal Brexit would be devastating for the autos industry, which accounts for more than one tenth of UK goods exports, a larger share than any other item.

The day ahead in the UK

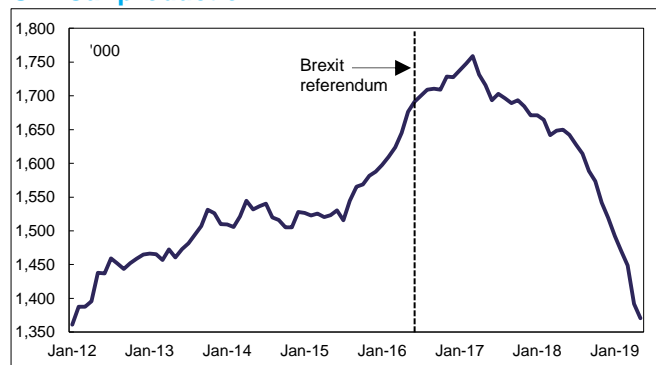
The end of the week will bring the June GfK consumer confidence and Lloyds business barometer surveys, as well as the final Q1 GDP data. The latter seem bound to confirm the current estimate of GDP growth of 0.5%Q/Q boosted by Brexit-related inventory accumulation. A first estimate of the current account deficit is likely show a notable deterioration of £8bn or so to close to the record high of £32.2bn recorded in Q415. Meanwhile, judging from today's Commission survey, the headline GfK index is likely to report a modest deterioration in consumer confidence from May's seven-month high, albeit remaining above the lows registered from November to April.

Euro area: Economic sentiment by sector



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

UK: Car production*



*Twelve-month moving sum. Source: SMMT, 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	Economic sentiment indicator	Jun	104.8	104.8	105.1	105.2
	Industrial (services) confidence	Jun	-5.6 (11.0)	-3.0 (12.4)	-2.9 (12.2)	- (12.1)
	Final consumer confidence	Jun	-7.2	-7.2	-6.5	-
Germany	Flash CPI estimate (EU-harmonised measure) Y/Y%	Jun	1.3	1.3	1.3	-
Italy	ISTAT business (manufacturing) confidence	Jun	99.3 (100.8)	- (101.0)	100.2 (102.0)	- (101.9)
	ISTAT consumer confidence	Jun	109.6	111.4	111.8	111.6
Spain	Flash CPI estimate (EU-harmonised measure) Y/Y%	Jun	0.6	0.7	0.9	-

Auctions

Country	Auction
Italy sold	€2.25bn of 5Y bonds at an average yield of 1.34%
	€2.75bn of 10Y bonds at an average yield of 2.09%
	€1bn of 2025 floating-rate bonds

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
Germany	GfK consumer confidence	Jul	9.8	10.0	10.1	-
France	INSEE consumer confidence	Jun	101	100	99	-
Italy	Government deficit to GDP YTD%	Q1	4.1	-	2.1	-
UK	UK Finance loans for housing 000s	May	42.3	41.0	43.0	42.9

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/ <i>Daiwa forecast</i>	Previous
EMU		10.00 Flash CPI estimate (core CPI) Y/Y%	Jun	1.2 (1.0)	1.2 (0.8)
France		07.45 Flash CPI estimate (EU-harmonised measure) Y/Y%	Jun	1.1	1.1
		07.45 Consumer spending M/M% (Y/Y%)	May	0.3 (0.3)	0.8 (1.2)
Italy		10.00 Flash CPI estimate (EU-harmonised measure) Y/Y%	Jun	0.7	0.9
Spain		08.00 Retail sales Y/Y%	May	1.5	1.1
UK		00.01 GfK consumer confidence	Jun	-11	-10
		00.01 Lloyds business barometer	Jun	-	10
		09.30 GDP – final estimate Q/Q% (Y/Y%)	Q1	0.5 (1.8)	0.2 (1.4)
		09.30 Current account balance £bn	Q1	-32.0	-23.7

Auctions and events

Country	BST	Auction / Event
- Nothing scheduled -		

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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