

Euro wrap-up

Overview

- Bunds made modest gains despite a jump in core inflation in the euro area.
- Gilts made modest losses despite a fall in UK consumer confidence.
- Sunday will see EU leaders try again to nominate the next ECB President while the coming week brings the final June PMIs for the euro area and UK, as well as data on euro area unemployment, retail sales and bank lending.

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Daily bond market movements

Bond	Yield	Change*
BKO 0 06/21	-0.751	-0.015
OBL 0 04/24	-0.663	-0.013
DBR 0% 02/29	-0.326	-0.006
UKT 1½ 01/21	0.623	+0.023
UKT 1 04/24	0.635	+0.018
UKT 1½ 10/28	0.836	+0.014

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

Euro area

Core inflation rebounds in June

As expected, euro area inflation remained unchanged in June at 1.2%Y/Y, matching the lowest rate since February 2018. Within the detail, energy inflation fell sharply to 1.6%Y/Y, the lowest since late 2016. So, while food inflation edged higher (1.6%Y/Y), core inflation rose 0.3ppt to 1.1%Y/Y, slightly above the average of the past couple of years. The upwards pressure came entirely from services, for which inflation leapt 0.6ppt to 1.6%Y/Y. In contrast, inflation of non-energy industrial goods eased back slightly to 0.2%Y/Y. Looking ahead, we expect services inflation slip back somewhat, and inflation of non-energy industrial goods to remain subdued. So, core inflation seems likely to ease back to remain close to 1.0%Y/Y through the second half of the year. And with energy inflation set to decline further into negative territory, the headline CPI rate also seems likely to fall back close to 1.0%Y/Y or below through to Q4. And while we should see a gradual pickup in both core and headline rates from December, much will depend on broader economic conditions. Certainly, for now, the ECB's inflation forecasts – of 1.4%Y/Y and 1.6%Y/Y in 2020 and 2021 for headline and core rates alike – appear too high. And their likely downward revision in September will likely provide the justification for a 10bp cut in the deposit rate to -0.50% to be agreed by the Governing Council.

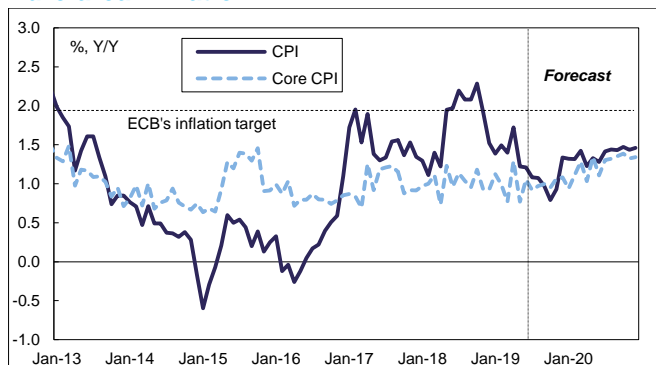
French consumer spending disappoints

The pickup in French consumer confidence this year has raised hopes of a pickup in French private consumption, which was up a relatively subdued 0.8%Y/Y in Q1. However, French consumer spending on goods rose a smaller-than-expected 0.4%M/M in May following downwardly revised growth of 0.3%M/M the prior month. With that total figure boosted by energy (up 0.6%M/M following a surge of 3.3%M/M in April), expenditure on manufactured goods failed to grow at all, having dropped in each of the previous two months. So, average spending on manufactured items in the first two months of Q2 was running 0.4% below the Q1 average, with the equivalent figure for durable goods down 0.9%, weighed not least by autos. Total spending in June seems likely to be boosted by the current heat-wave, with France expected to see its higher-ever recorded temperature today. However, today's figures suggest disappointing growth in private consumption over Q2 as a whole, consistent with our forecast of a slight moderation in GDP growth to 0.2%Q/Q.

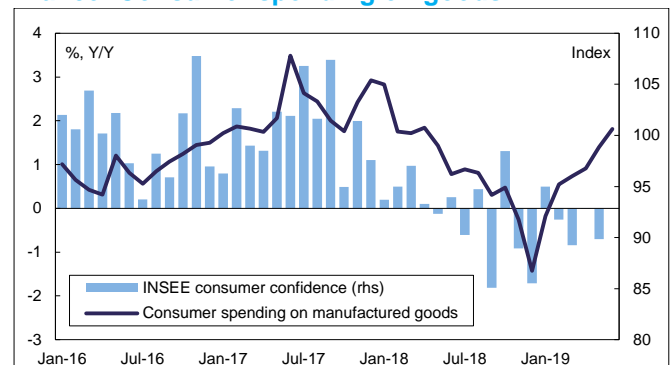
The week ahead in the euro area and US

Sunday will see EU leaders try once again to agree who should be appointed to the Presidencies of the European Commission, European Council and ECB, among other top jobs. As far as the ECB Presidency is concerned, most

Euro area: Inflation



France: Consumer spending on goods



candidates (e.g. the Finns Olli Rehn and Erkki Liikanen, or the French Benoît Cœuré and François Villeroy de Galhau) would represent broad continuity from Mario Draghi's pragmatic leadership. However, given his past opposition to key ECB policies including the OMT programme, and significant doubts that he would want to "do whatever it takes" to preserve the euro, if Bundesbank President Weidmann got the job we would expect euro area government bond yields to rise, BTP spreads to widen, and the euro to appreciate. And given that he also tends to sit at the more hawkish end of the spectrum, President of the Dutch Central Bank Klaas Knot might have a similar, albeit perhaps not quite so marked, impact.

Datawise, the coming week kicks off with the final manufacturing PMIs for June, for which the headline flash euro area index remained very weak at just 47.8. Euro area bank lending and unemployment data for May are also due on Monday. German retail sales figures for May are due on Tuesday and should post a rise following a notable drop in April. The following day brings the final services and composite PMIs for June, for which the flash euro area headline indices rose 0.5pt to 53.4 and 0.3pt to 52.1 respectively, principally due to a better showing in France. Thursday will bring euro area retail sales figures for May, which – as in Germany – should show a return to positive growth. And Friday will bring German factory orders for May and French trade data for the same month. In the markets, Germany will sell 5Y Bunds on Wednesday, while the following day will bring French auctions of 10Y, 15Y and 30Y bonds and Spanish auctions of 5Y, 7Y, 10Y and 30Y bonds.

Obviously, markets will start the week by reacting to the outcome of the Trump-Xi meeting in Osaka. Meanwhile, a busy week for US economic news will kick off with the June ISM manufacturing survey on Monday, with the equivalent non-manufacturing survey coming on Wednesday. With the following day bringing the Independence Day holiday, Wednesday will also bring several other releases, including the weekly jobless claims numbers, the ADP June employment figures, and final durable goods and trade reports for May. Most attention will be on Friday's labour market report for June, with nonfarm payroll growth expected to take a step up from 75k in June close to the average for the year to-date (164k). The unemployment rate, meanwhile, is expected to remain unchanged at 3.6%, while average earnings data will be closely watched too. Beyond the data, Fed Vice Chair Clarida will speak on monetary policy on Monday with NY Fed President John Williams speaking the following day along with Cleveland Fed President Loretta Mester. No UST auctions are currently scheduled.

UK

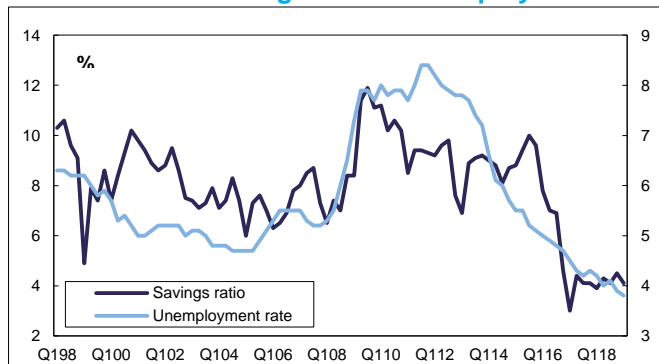
Q1 GDP growth left unrevised

There were few surprises from the final estimates of Q1 GDP, with growth of 0.5%Q/Q unrevised. The expansion was driven principally by consumer spending, up 0.6%Q/Q, the most since Q117. That was possibly boosted by purchases brought forward ahead of the first Brexit Article 50 deadline. While rising real incomes provided support, households also reduced their savings ratio back to 4.1%, close to the bottom of the range of the series which dates back more than fifty years. Precautionary stock-building activity also boosted growth. But its massive contribution to GDP growth of 2.8ppts was more than fully offset by the 3.0ppts drag from net trade, as inventories largely had to be imported. And that weak trade performance was also reflected in a marked widening of the current account deficit, up more than £6bn in Q1 to £30.0bn, the widest in 2½ years. Meanwhile, despite a downwards revision, business investment growth was left in positive territory for the first quarter since Q417. But the quarterly rate of 0.4%Q/Q still left it down 1.5%Y/Y at a time when business investment has been relatively vigorous in the euro area and other major economies. And given the distortion caused by the introduction of new accounting standards, in reality business investment might well have been weaker still.

Consumer confidence slips back

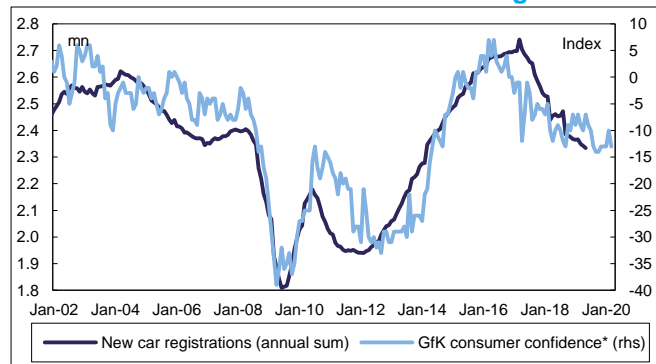
Having risen to a seven-month high of -10 in May, the headline GfK index of consumer confidence fell back to -13 in June, matching the figures recorded from February to April and just 1pt above the bottom of the range of the past six years. Within the detail, most components deteriorated slightly, and the climate for making major purchases was judged to be the least favourable for seven months. So, while real incomes are rising steadily and unemployment remains historically low,

UK: Household savings ratio & unemployment



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: Consumer confidence & new car registrations



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.
















today's survey provided further evidence that households are unlikely to loosen their purse strings significantly further while Brexit-related uncertainty persists. And with households' own precautionary stock-building unlikely to be repeated for a while yet, the weakness in retail sales in Q2 already evident in hard data and surveys seems likely to linger into Q3. And private consumption in Q2 seems bound too have slowed notably from Q1.

The week ahead in the UK

Politics are set to remain prominent in the UK in the coming week as the Conservative leadership contest continues with further hustings between the candidates. But Parliamentary machinations about Brexit will also be back in focus, as the House of Commons will vote on new legislative amendments tabled by MPs opposed to the UK leaving the EU without a deal. The proposals aim to reduce the incentives faced by the government to move to a no-deal Brexit by withholding public expenditure in such an event. But given that there still remains four months to go to the Article 50 deadline, we suspect that the amendments will not find a majority as many MPs will first want to give the next Prime Minister an opportunity to steer a policy course away from no deal before taking draconian legislative action.

Data-wise, the most notable new releases from the UK will be the June PMIs. The headline manufacturing PMI (due Monday) is expected to remain below the key 50.0 mark, having fallen to a near-three year low of 49.4 in May. The construction PMI (Tuesday) is also expected to remain below 50.0, while the services PMI (Wednesday) is expected to move broadly sideways from May's sluggish reading of 51.0. Other data releases in due in the coming week including the BoE's May bank lending figures (Monday), new car registrations for June (Thursday) and Q1 unit labour cost data (Friday). In the bond market, the DMO will sell 6Y and 30Y Gilts on Tuesday.


Daiwa economic forecasts

		2019				2020				2018	2019	2020
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
GDP forecasts %, Q/Q												
Euro area		0.4	0.2	0.3	0.3	0.3	0.3	0.2	0.1	1.8	1.1	1.0
Germany		0.4	0.1	0.3	0.3	0.3	0.3	0.2	0.1	1.4	0.8	1.1
France		0.3	0.2	0.3	0.3	0.3	0.3	0.2	0.2	1.6	1.2	1.2
Italy		0.1	0.0	0.2	0.1	0.1	0.1	0.0	-0.1	0.7	0.1	0.4
Spain		0.7	0.6	0.5	0.5	0.4	0.4	0.4	0.3	2.6	2.3	1.7
UK		0.5	-0.1	0.3	0.2	0.2	0.3	0.2	0.1	1.4	1.2	0.9
Inflation forecasts %, Y/Y												
Euro area												
Headline CPI		1.4	1.4	1.0	1.0	1.4	1.3	1.4	1.5	1.8	1.2	1.4
Core CPI		1.0	1.0	1.0	1.0	1.1	1.2	1.3	1.4	1.0	1.0	1.2
UK												
Headline CPI		1.9	2.0	1.9	1.6	1.9	1.7	1.7	1.7	2.5	1.8	1.8
Core CPI		2.0	1.7	1.6	1.8	1.8	2.0	2.0	2.0	2.1	1.7	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	-0.40	-0.40	-0.40	-0.50	-0.50
Net asset purchases*		0	0	0	0	0	0	0	0	15	0	0
BoE												
Bank Rate %		0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	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

The coming week's key data releases

Country		BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Monday 01 July 2019						
EMU		09.00	Final manufacturing PMI	Jun	47.8	47.7
		09.00	M3 money supply Y/Y%	May	4.6	4.7
		10.00	Unemployment rate %	May	7.6	7.6
Germany		08.55	Final manufacturing PMI	Jun	45.4	44.3
		08.55	Unemployment rate % (change 000s)	Jun	5.0 (0.0)	5.0 (60.0)
France		08.50	Final manufacturing PMI	Jun	52.0	50.6
Italy		08.45	Manufacturing PMI	Jun	48.7	49.7
		10.00	Unemployment rate %	May	10.3	10.2
Spain		08.15	Manufacturing PMI	Jun	49.5	50.1
UK		09.30	Manufacturing PMI	Jun	49.5	49.4
		09.30	Consumer credit (mortgage lending) £bn	May	- (4.2)	0.9 (4.3)
		09.30	Mortgage approvals 000s	May	65.5	66.3
Tuesday 02 July 2019						
EMU		10.00	PPI Y/Y%	May	1.8	2.6
Germany		07.00	Retail sales M/M% (Y/Y%)	May	0.5 (2.7)	-1.0 (4.0%)
Spain		08.00	Unemployment, monthly net change 000s	Jun	-90.0	-84.1
UK		09.30	Construction PMI	Jun	49.2	48.6
Wednesday 03 July 2019						
EMU		09.00	Final services PMI (composite PMI)	Jun	53.4 (52.1)	52.9 (51.8)
Germany		08.55	Final services PMI (composite PMI)	Jun	55.6 (52.6)	55.4 (52.6)
France		08.50	Final services PMI (composite PMI)	Jun	53.1 (52.9)	51.5 (51.2)
Italy		08.45	Services PMI (composite PMI)	Jun	50.0 (49.5)	50.0 (49.9)
Spain		08.15	Services PMI (composite PMI)	Jun	52.7 (51.7)	52.8 (52.1)
UK		00.01	BRC shop price index Y/Y%	Jun	-	0.8
		09.30	Services PMI (composite PMI)	Jun	51.0 (51.0)	51.0 (50.9)
Thursday 04 July 2019						
EMU		10.00	Retail sales M/M% (Y/Y%)	May	0.4 (1.6)	-0.4 (1.5)
UK		09.00	New car registrations Y/Y%	Jun	-	-4.6
Friday 05 July 2019						
Germany		07.00	Factory orders M/M% (Y/Y%)	May	-0.1 (-6.3)	0.3 (-5.3)
France		07.45	Trade balance (current account) £bn	May	-4.9 (-)	-5.0 (-0.8)
Spain		08.00	Industrial production M/M% (Y/Y%)	May	-0.5 (0.6)	1.8 (1.7)
UK		09.30	Unit labour costs Y/Y%	Q1	-	3.1

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.










The coming week's key events & auctions

Country	BST	Event / Auction
Monday 01 July 2019		
- Nothing scheduled -		
Tuesday 02 July 2019		
UK		10.30 Auction: to sell £3bn of 2025 bonds
Wednesday 03 July 2019		
Germany		10.30 Auction: to sell €4bn of 2024 bonds
Thursday 04 July 2019		
France		09.50 Auction: to sell 0.5% 2029 bonds
		09.50 Auction: to sell 1.25% 2034 bonds
		09.50 Auction: to sell 1.5% 2050 bonds
Spain		09.45 Auction: to sell 0.15% 2023 bonds
		09.45 Auction: to sell 0.6% 2029 bonds
		09.45 Auction: to sell 2.70% 2048 bonds
Friday 05 July 2019		
- Nothing scheduled -		

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
EMU	 Flash CPI estimate (core CPI) Y/Y%	Jun	1.2 (1.1)	1.2 (1.0)	1.2 (0.8)	-
France	 Flash CPI estimate (EU-harmonised measure) Y/Y%	Jun	1.4	1.1	1.1	-
	 Consumer spending M/M% (Y/Y%)	May	0.4 (-0.1)	0.3 (0.3)	0.8 (1.2)	0.3 (0.5)
Italy	 Flash CPI estimate (EU-harmonised measure) Y/Y%	Jun	0.8	0.7	0.9	-
Spain	 Retail sales Y/Y%	May	2.4	1.5	1.1	1.3
UK	 GfK consumer confidence	Jun	-13	-11	-10	-
	 Lloyds business barometer	Jun	13	-	10	-
	 GDP – final estimate Q/Q% (Y/Y%)	Q1	0.5 (1.8)	0.5 (1.8)	0.2 (1.4)	-
	 Current account balance £bn	Q1	-30.0	-32.0	-23.7	-

Auctions

Country	Auction
- Nothing to report -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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