

Euro wrap-up

Overview

- Bunds made modest gains at the longer end of the curve to push 10Y yields below the ECB deposit rate for the first time, as euro area retail sales fell again and ECB policymaker Rehn made further dovish remarks.
- Gilts also made gains at the longer end as UK car registrations fell again.
- Friday will bring new data for German factory orders, French goods trade and UK unit labour costs.

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Daily bond market movements

Bond	Yield	Change*
BKO 0 06/21	-0.756	-0.002
OBL 0 04/24	-0.695	-0.006
DBR 0% 02/29	-0.397	-0.012
UKT 1½ 01/21	0.505	+0.004
UKT 1 04/24	0.483	-0.009
UKT 1½ 10/28	0.675	-0.015

*Change from close as at 4.15pm BST.

Source: Bloomberg

Euro area

Retail sales down for a second successive month

The most notable release on a relatively quiet day for economic data confirmed a modest drop of 0.3%M/M in euro area retail sales in May. That followed a revised drop of just 0.1%M/M in April to leave the level of sales at the lowest since January. At the country level, sales were again weighed principally by Germany, which also fell for a second successive month (down 0.6%M/M), while French sales rose moderately for a second month (up 0.4%M/M) and Spanish sales rebounded (1.1%M/M) from a drop in April. In terms of type of good, sales at the euro area level were sluggish for most broad categories. Spending on food was down for the second successive month with sales of auto fuel down for a fourth successive month. And sales of non-food items (excluding auto fuel) were down marginally following a flat April, weighed by consecutive monthly declines of sales of clothes and textiles. Compared to a year earlier, overall retail sales growth of 1.3%Y/Y marked the softest annual rate since December. And with the average level for April and May unchanged from the Q1 average, sales growth over Q2 as a whole is set to be notably softer than the 0.7%Q/Q rate of Q1.

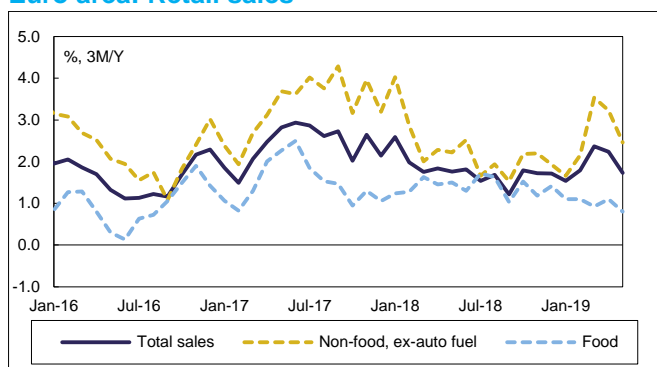
Data point to softer growth in Q2 and beyond

So, tallying with the steady deterioration in consumer confidence over the past year or so, and a rise in the household savings rate in the first quarter to the highest since 2014, private consumption looks on track for a slowdown in Q2 from the 0.5%Q/Q rate of Q1 despite likely steady growth in disposable income. That's consistent with our euro area GDP growth forecast for Q2 of 0.2%Q/Q, which matches the central projection of the ECB. But the Governing Council's June outlook also incorporated an acceleration thereafter. Recent experience and economic data, particularly survey indicators, suggest that acceleration might well fail to materialise.

Rehn adds to chorus of dovish ECB voices

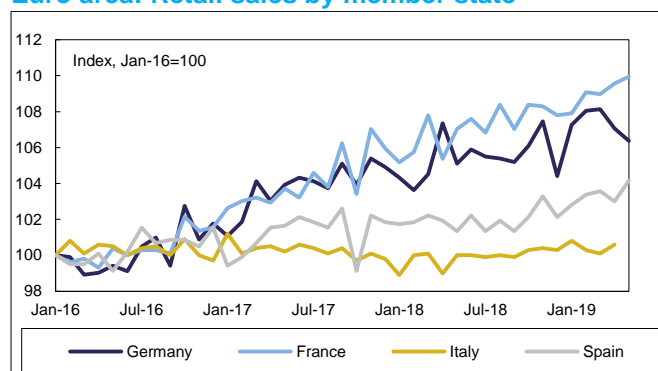
In remarks published today in a German newspaper, the likelihood of a continued sub-par economic performance was acknowledged by influential Bank of Finland Governor Olli Rehn, who added to this week's chorus of dovish voices from the ECB. In particular, Rehn stated that the recent slowdown in growth should not be considered as "a brief temporary dip" but instead was part of "a longer phase of weaker growth." And with inflation underwhelming, and market-based price expectations remaining "far too low" – with the 5Y5Y forward inflation swap rate this week back close to its all-time low near 1.15% – Rehn stated unambiguously that "further monetary stimulus is now needed until there is improvement in economic and inflation prospects". Consistent with recent comments from Mario Draghi and Chief Economist Philip Lane, he noted

Euro area: Retail sales



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Euro area: Retail sales by member state*



*Italian figure for June 2019 not yet published. Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.



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that new initiatives could include a combination of revised rate guidance, a cut to the deposit rate and tiering, and/or the resumption of bond purchases. Judging from these comments, July is a “live” meeting for a possible change in policy. However, we continue to believe that meeting will bring merely a signal that further easing is on its way in September, when updated economic forecasts will allow the policy response to be calibrated precisely, most likely with a cut of at least 10bps in the deposit rate and the introduction of a tiered framework to reduce the costs faced by banks.

The day ahead in the euro area and US

On Friday, attention will shift back to the manufacturing sector with German factory orders data for May. Following considerable weakness at the start of the year, growth in orders of 0.3%M/M in April was disappointingly sluggish. And German factory orders in May are expected to slip back slightly to leave them more than 6.0% lower than a year earlier. French goods trade and Spanish IP data for the same month are also due tomorrow. Most attention on Friday, of course, will be on the US labour market report for June, with nonfarm payroll growth expected to take a step up from 75k in May back 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 obviously be closely watched too.

UK

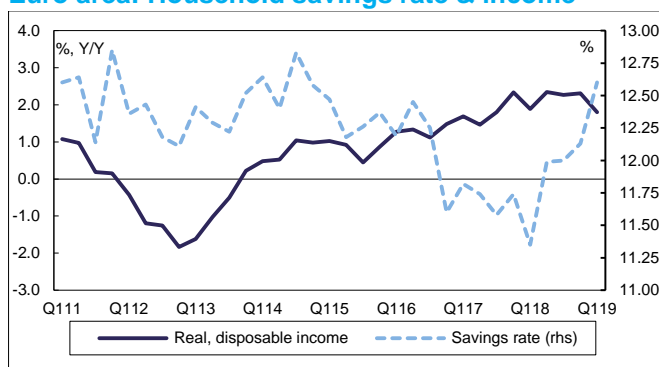
Drop in car registrations accelerates

Solid growth in consumer spending in Q1, up 0.6%Q/Q, in part reflected a jump in outlays on new cars, with anecdotal evidence suggesting that some purchases were brought forward ahead of the potential Brexit cliff-edge at the end of March to avoid risks of higher prices thereafter. Perhaps as payback, car registrations have subsequently been weaker, tallying with the softening of consumer confidence since late last year. Indeed, today's SMMT new car registrations data showed that the pace of decline in new car registrations accelerated in June to 4.9%Y/Y, the second steepest drop since September, when the market contracted very sharply following the introduction of new emissions-testing standards. Over the twelve months to June, new car registrations totalled 2.322mn, the lowest in more than five years. Registrations by individual private buyers were down a similar 4.8%Y/Y in June. And while fleet registrations fell a more moderate 2.5%Y/Y, registrations by businesses (which, admittedly, account for only a small share of the market) were down a whopping 37.1%Y/Y. Overall, therefore, today's car figures support our view that consumers remain reluctant to commit to big-ticket purchases, while businesses remain reluctant to spend too. And following the downbeat CBI distributive trades and BRC retail surveys for June, they add to evidence of weak household spending and a contraction in economic output in Q2.

The day ahead in the UK

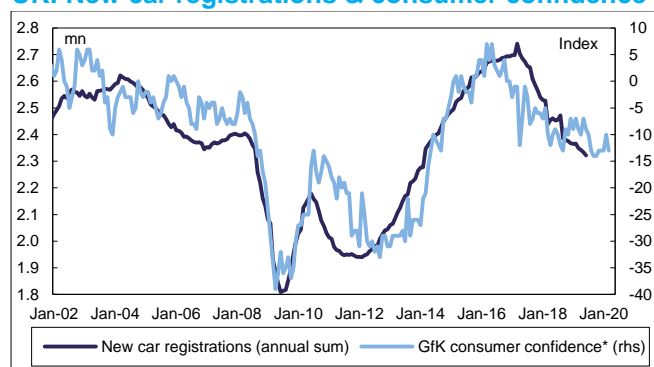
Friday will bring Q1 unit labour cost data from the UK. GDP accelerated in Q1, rising 0.4ppt to 1.8%Y/Y, due to precautionary activity related to the initial Article 50 deadline. However, employment accelerated and wage growth remained relatively firm. As such, having risen to a five-year high of 3.1%Y/Y in Q4, unit labour cost growth seems likely to remain elevated by the standards of the past few years. The June KPMG REC jobs report, which over recent months has pointed to a weakening of the labour market, is also due tomorrow.

Euro area: Household savings rate & income



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: New car registrations & consumer confidence





*Nine-month lead. Source: Thomson Reuters 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	 Retail sales M/M% (Y/Y%)	May	-0.3 (1.3)	0.3 (1.6)	-0.4 (1.5)	-0.1 (1.8)
UK	 New car registrations Y/Y%	Jun	-4.9	-	-4.6	-





Auctions

Country	Auction
France sold	 €5bn of 0.5% 2029 bonds at an average yield of -0.13%  €2.1bn of 1.25% 2034 bonds at an average yield of 0.23%  €3bn of 1.5% 2050 bonds at an average yield of 0.8%
Spain sold	 €400mn of 0.15% 2023 index-linked bonds at an average yield of -1.037%  €480mn of 1.95% 2026 index-linked bonds at an average yield of -0.105%  €1.5bn of 0.6% 2029 bonds at an average yield of 0.257%  €1.5bn of 2.7% 2048 bonds at an average yield of 1.165%


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
Germany	 07.00	Factory orders M/M% (Y/Y%)	May	-0.2 (-6.2)	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

Auctions and events

Country	BST	Auction / Event
EMU	 09.00	ECB's de Guindos scheduled to speak in Madrid

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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