

Euro wrap-up

Overview

- Despite another set of weak German factory orders data, Bunds followed USTs lower on the back of the stronger US payrolls report.
- Gilts also followed the global downtrend, despite a soft UK jobs survey and a moderation in unit labour cost growth.
- The coming week will bring euro area and German IP figures for May, while the UK's monthly activity and trade indicators for the same month are also due.

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Daily bond market movements

Bond	Yield	Change*
BKO 0 06/21	-0.748	+0.010
OBL 0 04/24	-0.677	+0.021
DBR 0¼ 02/29	-0.359	+0.039
UKT 1½ 01/21	0.571	+0.063
UKT 1 04/24	0.551	+0.067
UKT 1½ 10/28	0.747	+0.071

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

Euro area

German factory orders fall sharply again

The case for imminent easing of ECB monetary policy was strengthened further by the latest German factory orders data, which were significantly weaker than expected. Total orders fell 2.2%M/M, the biggest drop in three months, to stand 8.6% lower than a year earlier – the sharpest annual fall since 2009 – and take the level to its lowest since February 2016. There appear to be no special factors explaining the weakness that month – indeed, excluding bulk items, orders were down a larger 3.0%M/M, the most in five years. The poor performance, however, was related principally to foreign demand (down 4.3%M/M), with orders from within the euro area down 1.7%M/M and those from outside the euro area down a whopping 5.7%M/M. Domestic orders rose 0.7%M/M, but that represented a limp performance after larger declines in each of the first four months of the year. By type of product, new orders of capital goods were down 2.8%M/M, with intermediate goods down 1.5%M/M, and consumer items down 0.7%M/M. And by sub-sector, there were notable renewed sharp declines in orders for chemicals (down 3.6%M/M) and autos (down 3.9%M/M), with metals and other engineered goods down too.

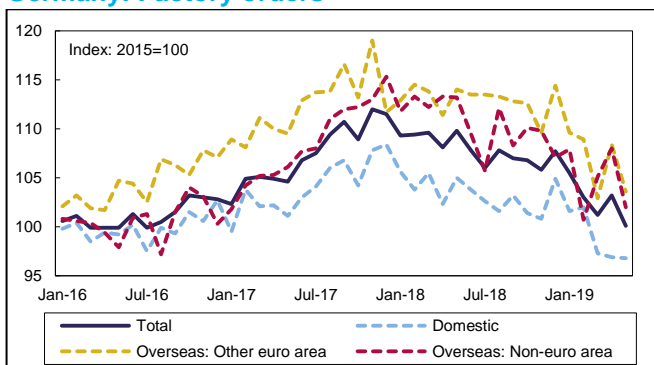
Broad-based declines signal further weakness ahead

Overall, the decline in May left the average level of factory orders in the first two months of Q2 down a hefty 1.6% from the Q1 average. So, after orders already dropped a massive 4.1%Q/Q in Q1, it would take one of the strongest monthly gains of recent years in June to prevent a further sizeable drop over the second quarter as a whole. Sadly, survey indicators, such as the manufacturing new orders PMI (just 44.2 in June to suggest a significant decline), strongly suggest that a rebound is not in the offing. Meanwhile, today's data also showed that manufacturing turnover fell for the second successive month in May and by 1.2%M/M, the most since November. While these data are not always a reliable guide to output in the sector on a month-to-month basis, they point to downside risks to May's industrial production, for which data due Monday are currently expected to show a modest rise on the month. Of course, the factory orders data point to the likelihood of ongoing significant weakness in manufacturing output lasting into the third quarter.

We now expect a 20bps ECB rate cut in September

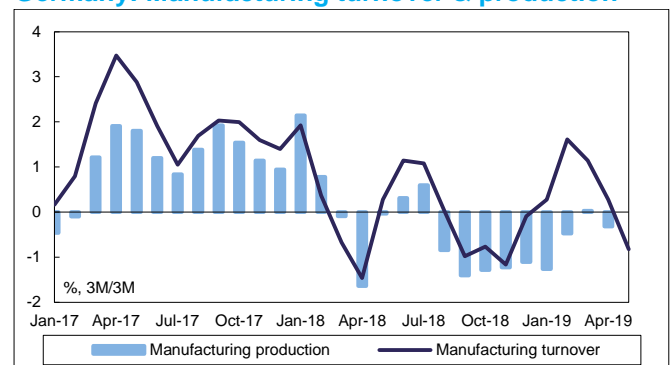
Considered in tandem with this week's seemingly coordinated dovish commentary from a wide range of Governing Council members, today's economic data underscore that the ECB will ease policy very soon. The only questions are when and by how much. While the case for a July cut is non-negligible, the ECB would normally decide to amend policy only when it has

Germany: Factory orders*



*Excluding large-scale orders. Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Germany: Manufacturing turnover & production



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.



updated its economic forecasts, to be able to calibrate precisely the required size of the rate cut and/or size of adjustment on the asset purchase programme. So, we still expect the July Governing Council meeting merely to come up with a very clear signal of imminent easing, with the detail of the change in policy announced in September. However, we now expect a cut of 20bps in the deposit rate to -0.60%, with a tiered framework introduced to mitigate any negative impact on financial conditions. And the Governing Council might also have news on asset purchases, e.g. confirming an increase in the bond issue/issuer limits to signal a possible expansion of QE in due course.

The week ahead in the euro area and US

The manufacturing sector will remain the principal focus of the euro area dataflow in the coming week. Monday will bring the aforementioned German IP report for May, with the risks to the Bloomberg consensus forecast of growth of 0.3%M/M skewed to the downside. German trade data for the same month are also due, as is the Bank of France business sentiment survey for June. Tuesday will be quiet, with only Italian retail sales data for May of any note, with industrial production figures from the same country and France due the following day. The euro area industrial production report for May is due Friday, and currently expected to post a very modest rise following the drop of more than 1½%M/M in April. The coming week also brings final inflation figures for June, with the numbers from Germany and France due Thursday and from those from Spain due Friday. Politics-wise, the Eurogroup meeting on Monday will see Finance Ministers discuss fiscal policy issues, including the euro area fiscal stance. Discussions on Italy will now be inconsequential given the European Commission's decision not to launch a disciplinary procedure. In the markets, Germany will sell index-linked bonds on Tuesday and 10Y Bunds the following day. Italy will auction 3Y and 7Y BTPs on Thursday.

In the US, the coming week will bring a few top-tier economic data releases as well as plenty of public speaking from senior Fed officials. Most notably, after a couple of uneventful days to start the week, Wednesday will see Fed Chair Powell testify to the House Financial Services Panel before repeating his testimony the following day to the Senate Banking Committee. Wednesday will also bring the minutes from the Fed's June policy meeting, when the FOMC became significantly more dovish. On Thursday, the June CPI inflation report will be closely watched while the usual weekly claims numbers and June federal budget statement are also due. Finally, Friday brings June producer price figures. In the markets, the Treasury will sell 3Y Notes on Tuesday and 10Y Notes on Wednesday, with a 30Y Bond auction to be held on Thursday.

UK

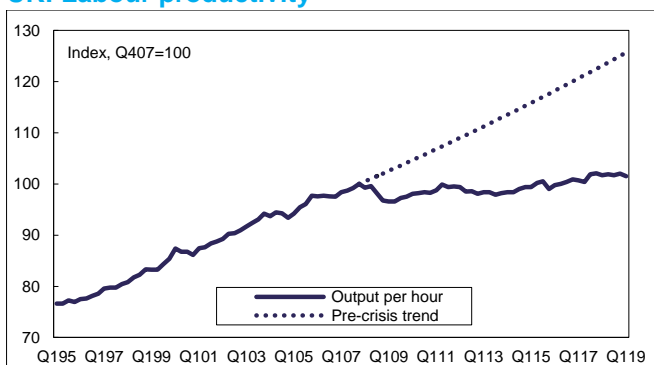
Survey signals loss of labour market momentum

While the PMI surveys earlier this week signalled an (admittedly questionable) acceleration in jobs growth in June despite a likely drop in economic output, today's KPMG and REC report on jobs suggested ongoing sluggishness in recruitment activity at the end of the second quarter. In particular, the number of people placed in permanent roles fell for the fourth successive month, while temporary positions rose at a subdued pace. And unsurprisingly, survey recipients suggested that persistent political and economic uncertainty continued to weigh on job vacancies, with the survey's relevant index remaining close to a multi-year low. As a reflection of current labour market tightness, however, there was also a smaller pool of available candidates. And the survey also suggested that skill shortages continued to drive wages higher.

Productivity falls again, but unit labour costs slow

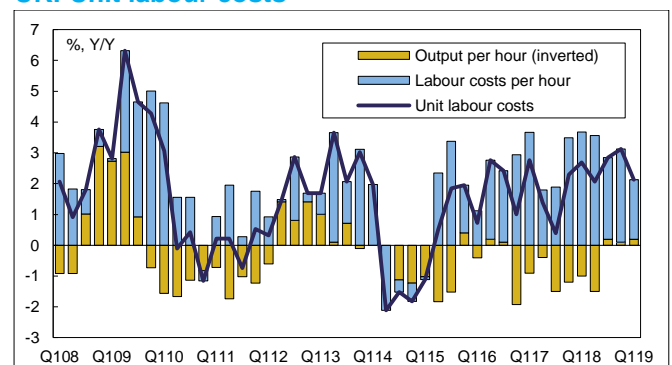
The UK's woeful productivity performance continues. Having barely grown at all since the global financial crisis, labour productivity, measured by output per hour, declined for a third consecutive quarter in Q1, down 0.2%Y/Y. Manufacturing sector productivity was particularly weak, down 0.9%Y/Y, with productivity in the larger services sector up 0.2%Y/Y. With labour costs rising but productivity falling, unit labour costs rose 2.1%Y/Y. That, however, marked a full 1.0ppt slowdown from the five-year

UK: Labour productivity*



*Output per hour. Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: Unit labour costs


















Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

high reached in Q418, and, being slightly below the long-run average, suggested a moderation in underlying price pressure from the labour market. And given survey evidence of a loss of momentum in the labour market, domestic cost pressures might moderate further over the near term supporting our view that the BoE's next move in Bank Rate is likely to be down, regardless of what happens with respect to Brexit. Indeed, given the weaker growth outlook associated with heightened global and domestic uncertainty, we have now pencilled in a 25bps cut at the MPC's November policy-setting meeting, which would take Bank Rate to 0.50%.

The week ahead in the UK

The most notable day in the coming week for UK economic data will be Wednesday, with the monthly output indicators for May due. Following the drop of 0.4%M/M in April, GDP is expected to have risen 0.3%M/M in May. Growth will have been led by a rise in manufacturing output likely to have surpassed 2.0%M/M, driven by a rebound in auto production as car plants returned to normal following Brexit-related closures the previous month. Growth in services, however, is expected to have been subdued, at just 0.1%M/M. And having narrowed the prior month, the trade deficit is expected to have widened once again on stronger imports. Other than Wednesday, the coming week will be quiet for data, with the BRC retail sales monitor (Tuesday) and RICS housing market survey (Friday) for June the only other releases of note. Meanwhile, the BoE will present its latest Financial Stability Report on Thursday while MPC members Tenreyro and Vlieghe will speak publicly on Wednesday and Friday respectively. No Gilt auctions are currently scheduled.

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	0.2	0.2	0.2	0.2	0.2	0.1	1.8	1.0	0.8
Germany 	0.4	0.1	0.2	0.2	0.2	0.3	0.2	0.1	1.4	0.7	0.9
France 	0.3	0.2	0.3	0.3	0.3	0.3	0.2	0.2	1.6	1.1	1.1
Italy 	0.1	0.0	0.0	0.0	0.0	0.1	-0.1	-0.1	0.7	0.1	0.1
Spain 	0.7	0.5	0.4	0.4	0.4	0.4	0.4	0.3	2.6	2.3	1.6
UK 	0.5	-0.1	0.2	0.2	0.2	0.2	0.2	0.1	1.4	1.2	0.7
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	1.8	1.6	1.9	1.6	1.5	1.7	2.5	1.8	1.8
Core CPI 	1.9	1.7	1.7	1.7	1.8	1.9	1.8	1.7	2.1	1.7	1.8
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	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.40	-0.60	-0.60
Net asset purchases* 	0	0	0	0	0	0	0	0	15	0	0
BoE											
Bank Rate % 	0.75	0.75	0.75	0.50	0.50	0.50	0.50	0.50	0.75	0.50	0.50
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
Germany	 Factory orders M/M% (Y/Y%)	May	-2.2 (-8.6)	-0.2 (-6.2)	0.3 (-5.3)	0.4 (-)
France	 Trade balance (current account) £bn	May	-3.3 (0.3)	-4.9 (-)	-5.0 (-0.8)	-4.9 (-1.2)
Spain	 Industrial production M/M% (Y/Y%)	May	0.3 (1.4)	-0.5 (0.6)	1.8 (1.7)	- (1.8)
UK	 Unit labour costs Y/Y%	Q1	2.1	-	3.1	-

Auctions

Country	Auction
- Nothing to report -	




Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key data releases

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Monday 08 July 2019					
Germany		07.00 Industrial production M/M% (Y/Y%)	May	0.3 (-3.2)	-1.9 (-1.8)
		07.00 Trade balance (current account) €bn	May	17.0 (-)	17.9 (22.6)
		07.00 Exports (imports) M/M%	May	1.3 (-)	-3.4 (-0.9)
France		07.30 Bank of France sentiment survey – industrial indicator	Jun	99	99
Tuesday 09 July 2019					
Italy		09.00 Retail sales M/M% (Y/Y%)	May	-	0.0 (4.2)
UK		00.01 BRC retail monitor, like-for-like sales Y/Y%	Jun	-	-3.0
Wednesday 10 July 2019					
France		07.45 Industrial production M/M% (Y/Y%)	May	0.3 (1.6)	0.4 (1.1)
Italy		09.00 Industrial production M/M% (Y/Y%)	May	0.1 (-1.2)	-0.7 (-1.5)
UK		09.30 GDP M/M% (3M/3M%)	May	0.3 (0.1)	-0.4 (0.3)
		09.30 Services output M/M% (3M/3M%)	May	0.1 (0.1)	0.0 (0.2)
		09.30 Industrial output M/M% (Y/Y%)	May	1.4 (1.0)	-2.7 (-1.0)
		09.30 Manufacturing output M/M% (Y/Y%)	May	2.3 (1.1)	-3.9 (-0.8)
		09.30 Construction output M/M% (Y/Y%)	May	0.2 (0.2)	-0.4 (2.4)
		09.30 Trade balance (goods trade) £bn	May	-3.2 (-12.6)	-2.7 (-12.1)
Thursday 11 July 2019					
Germany		07.00 Final CPI (EU harmonised CPI) Y/Y%	Jun	1.6 (1.3)	1.4 (1.3)
France		07.45 Final CPI (EU harmonised CPI) Y/Y%	Jun	1.2 (1.4)	0.9 (1.1)
UK		00.01 RICS house price balance %	Jun	-12	-10
Friday 12 July 2019					
Spain		08.00 Final CPI (EU harmonised CPI) Y/Y%	Jun	0.4 (0.6)	0.8 (0.9)
EMU		10.00 Industrial production M/M% (Y/Y%)	May	0.2 (-1.6)	-0.5 (-0.4)

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions

Country	BST	Event / Auction
Monday 08 July 2019		
EMU	 -	Eurogroup meeting
Tuesday 09 July 2019		
Germany	 10.30	Auction: to sell €500mn of 0.1% 2023 index-linked bonds
	 10.30	Auction: to sell €250mn of 0.5% 2030 index-linked bonds
Wednesday 10 July 2019		
UK	 18.10	BoE MPC member Tenreyro to speak in London
Germany	 10.30	Auction: to sell €4bn of 0% 2029 bonds
Thursday 11 July 2019		
EMU	 12.30	ECB publishes account from 6 June Governing Council meeting
Italy	 10.00	Auction: to sell 3Y and 7Y bonds
UK	 10.30	BoE to publish Financial Stability Report
Friday 12 July 2019		
UK	 09.30	BoE MPC member Vlieghe to speak in London

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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