Euro wrap-up

Overview

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- Having made gains early in the day after a weaker German survey, Bunds subsequently followed USTs lower to close the day little changed.
- While Gilts were little changed by some mixed UK labour market data, cable fell to a two-year low after likely next UK PM Boris Johnson seemingly reduced further scope for a Brexit deal with the EU.
- Tomorrow brings June inflation figures from the euro area and UK, as well as euro area car registrations and construction output data.

Daily bond market movements

Bond	Yield	Change*
BKO 0 06/21	-0.736	+0.001
OBL 0 04/24	-0.640	-
DBR 0¼ 02/29	-0.294	-
UKT 1½ 01/21	0.578	+0.007
UKT 1 04/24	0.585	-
UKT 1⅝ 10/28	0.813	+0.013

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

Euro area

Surplus rebounds in May, but net trade likely weak in Q2

Following the steepest fall in the value of exports for almost two years in April (down 2.5%M/M) – and associated marked decline in the trade surplus – today's euro area trade report for May inevitably brought some positive payback. Indeed, the improvement in the trade balance was greater than anticipated, with the adjusted surplus rising €4.5bn to €20.2bn, the second highest in fourteen months. And the value of exports rose 1.4%M/M to leave it more than 4% higher than a year earlier. This in part reflected a surge in exports to Korea (with the 12½%Y/Y increase the strongest since September 2017), as well as a much softer pace of decline in exports to the UK (down just 0.9%Y/Y compared with the 11.2%Y/Y drop in April). However, not least given the weakness in shipments to the UK at the start of the quarter, total export values were still on average in the first two months of Q2 almost 1% lower than in Q1. And despite a second successive monthly fall in May, the value of imports was trending just ½% below the first-quarter average. Data for euro area export volumes have yet to be released and relative price shifts might have distorted the picture somewhat. However, we note that the average level of German export volumes was down more than 2% in April and May compared to Q1. And, on the whole, the data currently suggest that net trade is on track to provide a drag on euro area GDP in Q2, supporting our view that overall growth eased last quarter to just 0.2%Q/Q, half the pace seen in Q1.

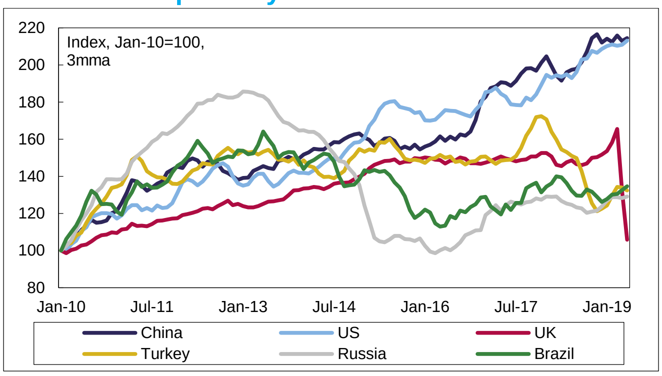
German ZEW signals further deterioration

Today's German ZEW survey of financial market analysts was hardly encouraging about economic sentiment towards the largest member state, where global uncertainties continue to cloud prospects for the manufacturing sector. In particular, the survey's current conditions index fell a larger-than-expected 8.9pts in July to -1.1, the first negative reading for more than nine years and a whopping 73.5pts below its reading a year ago. There was a further deterioration in the expectations balance too, declining 3.4pts to -24.5, its weakest reading since October and well below the long-run average. While the ZEW is one of the first sentiment indicators to be released each month it is not necessarily the best guide to GDP growth in Germany. Indeed, it tends to be more highly correlated with equity market performance, and can also be a more reliable guide to what to expect from the ifo business survey. Nevertheless, as the Governing Council gets ready to meet next week, it still provides a reminder that a sudden turnaround in economic confidence in the current quarter seems unlikely.

The day ahead in the euro area and US

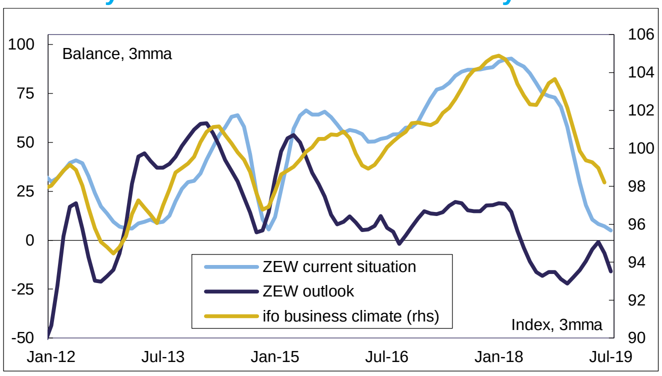
With an eye on next week's ECB meeting, tomorrow's focus will be on the euro area's final inflation figures for June. Like in France and Spain, today's figures from Italy aligned with the flash estimates, which showed the headline harmonised CPI rate

Euro area: Exports by destination



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Germany: ZEW and ifo sentiment surveys



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

edging down 0.1ppt to 0.8%Y/Y. Nevertheless, given the upside surprise to Germany's final inflation release – with the harmonised measure up 0.2ppt from the flash to 1.5%Y/Y – we expect the euro area's headline CPI rate to be nudged up from the flash estimate of 1.2%Y/Y, which was unchanged from May. Risks to the preliminary core inflation rate – which increased 0.3ppt to 1.1%Y/Y – are also skewed to the upside. Tomorrow will also bring the latest car registrations figures for June, as well as construction output data for May. In the markets, Germany will sell 30Y Bunds.

In the US, tomorrow will see the release of housing starts figures for June, which, despite a favourable interest rate environment, are likely to show a further fall at the end of the second quarter. Wednesday will also bring the Fed's Beige Book.

UK

Employment growth moderating…

Despite the slowdown in economic activity and steady deterioration in business sentiment, the UK's labour market has remained a 'good news' story over recent months. But having risen to a record high in April, employment predictably fell in May, by 135k, to leave the three-month employment growth up just 28k, the weakest increase since October. And this increase was more than fully accounted for by those in self-employment (up 123k), while the number of employees fell in the three-months to May (down 85k) by the most since November 2011. There was also a further drop in the number of vacancies, driven by a reduction in the manufacturing and information and communications sectors. But, in aggregate, these still remain at historically elevated levels, with still high levels of vacancies reported in the retail and healthcare sectors in particular. Despite the drop in employment in May, a larger fall in the number of those economically inactive took the (admittedly volatile) one-month unemployment rate down 0.3ppt to 3.7%, the lowest since the series began in the early 1990s. This left the headline ILO unemployment rate unchanged at a multi-decade low of 3.8% in the three months to May. But the one-month-ahead claimant count rate rose for the second successive month in June to 3.2%, its highest for more than four years, to extend the clear uptrend seen over the past two years.

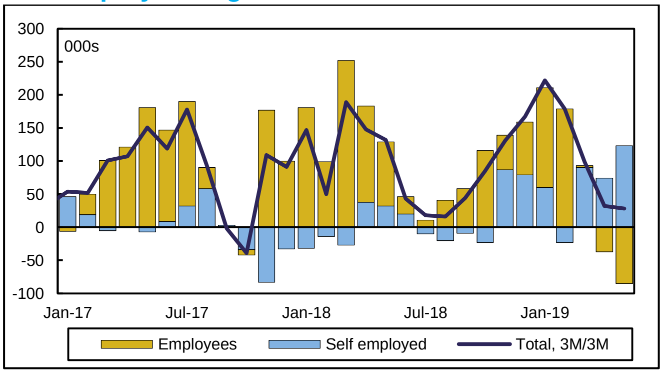
…but wage growth picks up

Despite softer jobs growth, today's data provided a positive surprise in the latest wage figures. Having slowed to a seven-month low in April, average weekly pay growth accelerated 0.2ppt to 3.4%3M/Y in May. And when excluding bonus payments, earnings growth jumped to 3.6%3M/Y, the strongest pace since mid-2008. The improvement in regular wage growth reflected a pickup in both the private sector, up 0.2ppt to 3.8%3M/Y, and the public sector, up 0.6ppt to 3.5%%3M/Y, with the latter an eight-year high. And when including bonuses, public sector pay growth (the strongest since June 2010) exceeded that in the private sector for the second successive month. However, the pickup in public sector pay growth appears to have been related to a change in timing of pay increases of some NHS staff this year compared with last. As such, we would expect growth in public sector pay to moderate somewhat over coming months. Certainly, private sector wage growth has eased from three months ago. And as GDP growth takes a notable step down in the second quarter and political uncertainties persist, we would expect job and wage growth to be more subdued over coming quarters.

The day ahead in the UK

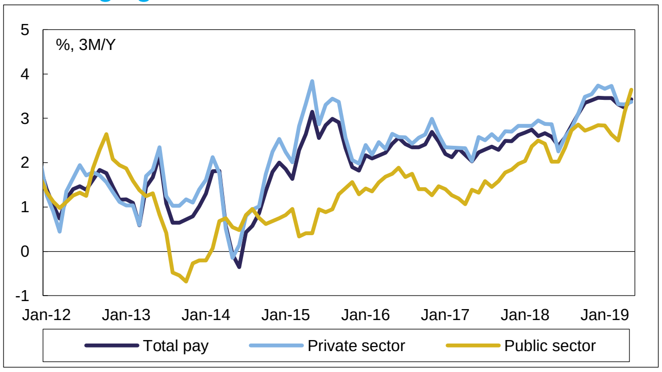
The flow of top-tier releases continues tomorrow with June's inflation figures, which are expected to show the headline and core CPI rates moving sideways in June at 2.0%Y/Y and 1.7%Y/Y respectively. Wednesday will also bring the ONS's latest house price index for May, as well as the BoE's latest quarterly credit conditions survey.

UK: Employment growth



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: Wage growth



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

European calendar

Today's results

Economic data

Country		Release	Period	Actual	Market consensus/ *Daiwa forecast*	Previous	Revised
EMU		Trade balance €bn	May	**20.2**	17.0	15.3	**15.7**
		ZEW expectations indicator	Jul	**-20.3**	-	-20.2	**-**
Germany		ZEW current situation (expectations) indicator	Jul	**-1.1 (-24.5)**	5.0 (-22.0)	7.8 (-21.1)	**-**
Italy		Final CPI (EU-harmonised CPI) Y/Y%	Jun	**0.7 (0.8)**	0.8 (0.8)	0.8 (0.9)	**-**
UK		Claimant count rate % (change '000s)	Jun	**3.2 (38.0)**	-	3.1 (23.2)	**- (24.5)**
		Average weekly earnings (excl. bonuses) 3M/Y%	May	**3.4 (3.6)**	3.1 (3.5)	3.1 (3.4)	**3.2 (-)**
		ILO unemployment rate 3M%	May	**3.8**	3.8	3.8	**-**
		Employment change 3M/3M '000s	May	**28**	45	32	**-**

Auctions

Country		Auction
UK sold		£2.25bn of 1.75% 2037 bonds at an average yield of 1.275%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Yesterday's results

Economic data

Country		Release	Period	Actual	Market consensus/ *Daiwa forecast*	Previous	Revised
UK		Rightmove house prices M/M% (Y/Y%)	Jul	**-0.2 (-0.2)**	-	0.3 (0.0)	**-**

Auctions

- Nothing to report -

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's data releases

Economic data

Country		BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
EMU		07.00	EU new car registrations Y/Y%	Jun	-	0.1
		10.00	Final CPI (core CPI) Y/Y%	Jun	*1.3 (1.2)*	1.2 (0.8)
		10.00	Construction output M/M% (Y/Y%)	May	-	-0.8 (3.9)
Italy		09.00	Industrial sales M/M% (Y/Y%)	May	-	-1.0 (-0.7)
		09.00	Industrial orders M/M% (Y/Y%)	May	-	-2.4 (-0.2)
UK		09.30	Headline CPI (core CPI) Y/Y%	Jun	*2.0 (1.7)*	2.0 (1.7)
		09.30	House price index Y/Y%	May	1.2	1.4

Auctions and events

Country		BST	Auction / Event
Germany		10:30	Auction: to sell €1bn of 1.25% 2048 bonds (15-Aug-2048)

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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