Euro wrap-up

Overview

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- Despite an upwards revision to headline euro area inflation, Bunds followed USTs higher as car and construction data suggested a softer Q2 for growth.
- Gilts also made gains, despite an increase in UK core inflation.
- Tomorrow will bring UK retail sales figures for June.

Daily bond market movements

Bond	Yield	Change*
BKO 0 06/21	-0.750	-0.014
OBL 0 04/24	-0.670	-0.031
DBR 0¼ 02/29	-0.333	-0.046
UKT 1½ 01/21	0.539	-0.046
UKT 1 04/24	0.537	-0.055
UKT 1⅝ 10/28	0.759	-0.062

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

Euro area

June inflation revised up, with super-core measure at multi-year high

Following last week's 0.2ppt upwards revision to the equivalent German figure (1.5%Y/Y), the headline rate of euro area inflation in June today was also revised up, by 0.1ppt to 1.3%Y/Y. That marked an increase of 0.1ppt from May, but was still down on the average so far this year. Within the detail, energy inflation (1.7%Y/Y) was a touch stronger than previously thought. In contrast, to one decimal place, the main core rate of inflation was left unrevised at 1.1%Y/Y, up 0.3ppt from May but still only 0.1ppt higher than the average of the past few years. However, rounding from two decimal places masked an upwards revision to core inflation of 0.07ppt, as inflation of non-energy industrial goods (0.3%Y/Y) and services (1.6%Y/Y) were both revised higher by a similar margin. Most notably perhaps, excluding the notoriously volatile package holiday component, "super-core" inflation – which focuses on the most cyclically-sensitive prices – edged up 0.03ppt in June to 1.36%Y/Y, the highest since September 2013. And so, while headline inflation is set to decline below 1.0%Y/Y, today's data strengthen the case for the Governing Council to leave policy unchanged at next week's policy meeting. Indeed, given the decidedly mixed nature of recent economic data from both the euro area and other major economies, we continue to think that the policymakers will wait for updated staff economic forecasts in September before deciding to ease monetary policy further.

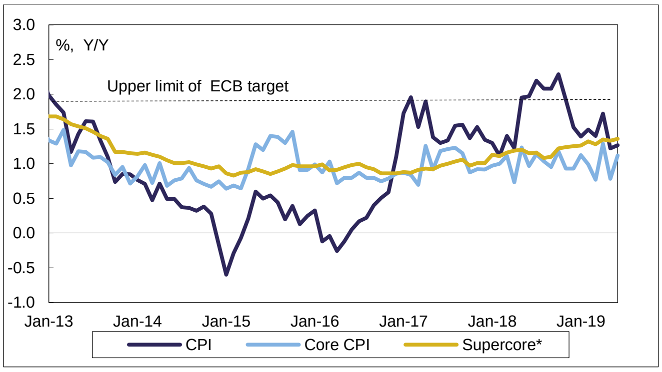
New car registrations down in June but up in Q2

Today's other new economic releases added to evidence of economic slowdown in Q2. New car registrations in the euro area were disappointingly weak in June, falling 6.2%Y/Y, the steepest annual drop since December. Notable declines on the same basis were registered in Germany (-4.7%Y/Y), France (-8.4%Y/Y), Italy (-2.1%Y/Y) and Spain (-8.3%Y/Y). The magnitude of the falls can in part be attributed to the fewer working days in June this year compared to last. However, new car registrations were still down during the first half of the year compared with H118 and by more than 3%Y/Y. Moreover, on a seasonally adjusted basis, in June they dropped a hefty 6.7%M/M, the most since September's precipitous decline related to the introduction of new EU emissions regulations. Nevertheless, that fall followed decent growth in the prior two months. And so, over the second quarter as a whole, registrations rose 1.7%Q/Q, a respectable rate albeit well down on the increase of 7½%Q/Q in Q1.

Construction output on track for Q2 decline

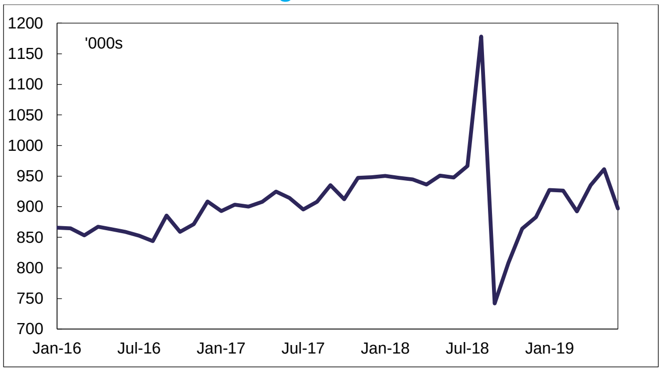
Today's construction output data for May were also subdued. While the decline in the latest month was just 0.3%M/M, it followed steeper falls in each of the prior two months. Both civil engineering (down 0.8%M/M) and building work (0.3%M/M) dropped in May. At the country level, activity in the sector fell notably in Germany (down 2.4%M/M following a drop of

Euro area: Inflation



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd

Euro area: New car registrations*



**Seasonally adjusted data. Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd*

1.8%M/M in April). Compared to a year earlier, euro area construction output was still up 2.0%Y/Y, a respectable rate albeit well down from the recent peak of 7.3%Y/Y in February. But the average level in April and May was 1.0% below the Q1 average. With subsequent activity in some countries likely to have been weighed by the heat-wave in June, construction output seems bound to have subtracted from euro area economic growth in Q2 having increased 1.8%Q/Q in Q1. And the drop in the sector in Germany last quarter was likely particularly marked, adding to evidence that GDP growth in the euro area's largest member state was especially soft in Q2. Nevertheless, confidence in the sector remains elevated by historical standards and order books are reportedly ample. Fundamentals in the housing sector continue to be favourable, with unemployment continuing to fall, household incomes and house prices rising, and mortgage rates historically low. Plans for increased public sector investment should provide new impetus to civil engineering activity. So, we look for a return to positive growth in construction output in Q3.

The day ahead in the euro area and US

Thursday should be a quiet day for euro area economic news with no top-tier data due for release. Supply-wise, France and Spain will sell fixed-rate and index-linked bonds. In the US, along with the usual weekly jobless claims numbers, tomorrow brings the Philly Fed and Conference Board's Leading indices. In the markets, the US Treasury will sell 10Y TIPS.

UK

Headline CPI unchanged at BoE's 2% target

In line with expectations, UK headline inflation moved sideways in June at the BoE's 2.0%Y/Y target. There was, however, a notable drop in energy price inflation (down 2.5ppts to 4.5%Y/Y), while services inflation also edged slightly lower (down 0.1ppt to 2.5%Y/Y) as prices for accommodation services fell this year compared with a rise in June last year. Lower car prices also continued to provide downward pressure on inflation. However, a smaller decline in clothing prices this year than last (in June 2018 prices posted the steepest drop since 2012) saw the year-on-year pace of decline for that category of good ease 1.1ppts to -0.5%Y/Y. As such, non-energy industrial goods inflation increased 0.3ppt to 0.7%Y/Y. So, core CPI was nudged slightly higher in June, by 0.1ppt to 1.8%Y/Y.

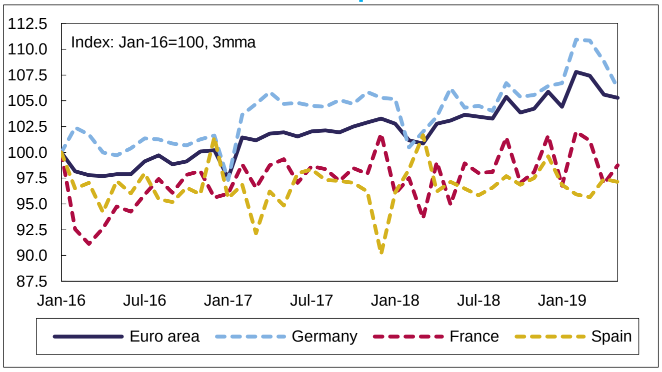
Inflation to move below target despite sterling weakness

Recent events in the foreign exchange market seem likely to impact the near-term inflation outlook. The sterling effective exchange rate is now at its lowest level since September 2017, down 3½% from a year ago and more than 6% from the peak earlier this year. So, non-energy industrial goods inflation is likely to rise on the back of higher import prices. But given the recent loss of momentum in the sector, we expect services inflation to move broadly sideways. And with the contribution from energy inflation set to decline further over coming quarters due to shifts in global energy prices, we continue to expect headline CPI to follow a moderate downward trend through to year-end and remain below the BoE's target throughout 2020 too. Certainly, today's producer price figures signalled limited upward pressures in the pipeline – input prices declined 0.3%Y/Y in June, the first year-on-year drop for three years, while output producer price inflation eased 0.3ppt to 1.6%Y/Y, similarly the lowest rate since 2016.

House price growth moderates further

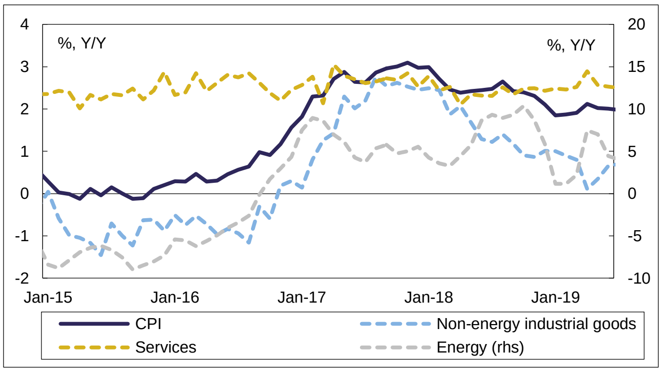
The ONS official house price index today confirmed a slowdown in residential property inflation in May, with national house price growth easing 0.1ppt to 1.2%Y/Y, matching the six-year low recorded in February. There was a steeper pace of decline reported in London, with the 4.4%Y/Y drop the largest since August 2009, while prices in the North East were also down compared with a year earlier. While prices continued to rise on an annual basis in other regions across England, and remained firm in Wales (3.0%Y/Y), Scotland (2.8%Y/Y) and Northern Ireland (3.5%Y/Y), leading indicators suggest that

Euro area: Construction output



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: CPI inflation



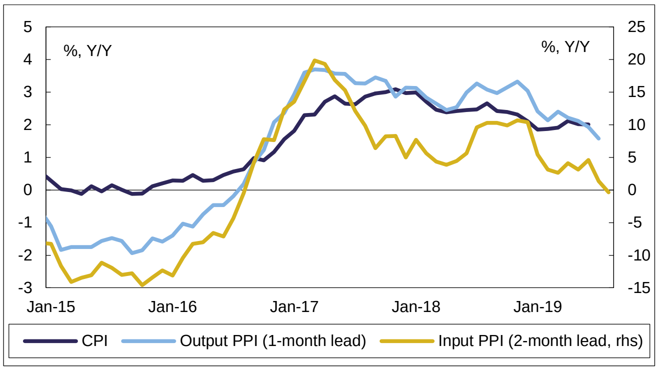
Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

aggregate UK house price growth will continue to ease over coming months. In particular, the RICS housing market survey recently indicated that the downward trend will be maintained through to August. And while it also suggested that house price growth might tick up by year-end, it seems bound to remain well below the rates of the past few years through to the end of the year. Of course, how the UK navigates the end-October Brexit cliff-edge will have a huge bearing on the trajectory of prices from autumn onwards.

The day ahead in the UK

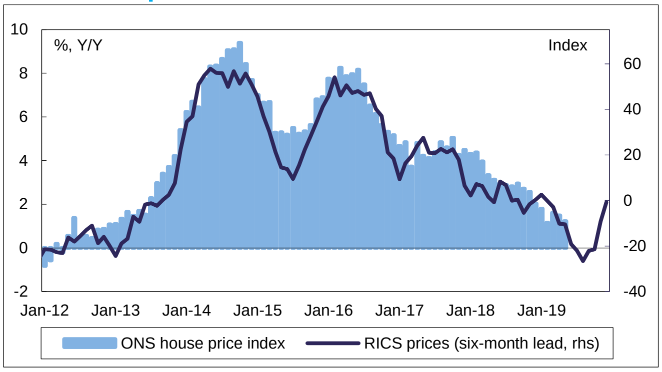
Focus tomorrow turns to the official June retail sales figures for further insight into household consumption in the second quarter. In line with the downbeat messages from various retail sector surveys, tomorrow's figures are expected to report a further decline in sales in June, to leave them down over the second quarter as a whole. The BoE's latest quarterly credit conditions survey is due to be published too, while the OBR's Fiscal Risks report will also be worth watching.

UK: CPI and PPI inflation



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: House price indices



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	EU27new car registrations Y/Y%	Jun	**-7.8**	-	0.1	-
	Final CPI (core CPI) Y/Y%	Jun	**1.3 (1.1)**	*1.3 (1.2)*	1.2 (0.8)	-
	Construction output M/M% (Y/Y%)	May	**-0.3 (2.0)**	-	-0.8 (3.9)	**-1.7 (3.1)**
Italy	Industrial sales M/M% (Y/Y%)	May	**1.6 (0.3)**	-	-1.0 (-0.7)	**-1.1 (-0.8)**
	Industrial orders M/M% (Y/Y%)	May	**2.5 (-2.5)**	-	-2.4 (-0.2)	**-2.2 (-0.2)**
UK	Headline CPI (core CPI) Y/Y%	Jun	**2.0 (1.8)**	*2.0 (1.7)*	2.0 (1.7)	-
	House price index Y/Y%	May	**1.2**	1.3	1.4	**1.5**

Auctions

Country	Auction
Germany	sold €807mn of 1.25% 2048 bonds at an average yield of 0.3%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's data releases

Economic data

Country	BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
UK	09.30	Retail sales including fuel M/M% (Y/Y%)	Jun	-0.3 (2.6)	-0.5 (2.3)
	09.30	Retail sales excluding fuel M/M% (Y/Y%)	Jun	-0.3 (2.7)	-0.3 (2.2)

Auctions and events

Country	BST	Auction / Event
France	09.50	Auction: to sell 0% 2022 bonds
	09.50	Auction: to sell 2.25% 2022 bonds
	09.50	Auction: to sell 0% 2025 bonds
	10:50	Auction: to sell 2028, 2029 and 2036 index-linked bonds
Spain	09.45	Auction: to sell 0.05% 2021 bonds
	09.45	Auction: to sell 0.25% 2024 bonds
	09.45	Auction: to sell 1.95% 2030 bonds
UK	09.30	BoE quarterly credit conditions survey to be published
	09.30	OBR publishes Fiscal Risk report

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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