

# Euro wrap-up

## Overview

- Bunds made gains after the flash euro area PMIs disappointed, with significant weakness in Germany's manufacturing sector at the start of Q3.
- Gilts also made modest gains, while populist Brexiter Boris Johnson was officially appointed as the new UK Prime Minister.
- All eyes tomorrow will be on the ECB's policy announcement and Draghi's post-meeting press conference. Data-wise, tomorrow will bring Germany's ifo survey and the CBI's retail sales survey from the UK.

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### Daily bond market movements

Bond	Yield	Change*
BKO 0 06/21	-0.779	-0.006
OBL 0 04/24	-0.729	-0.013
DBR 0¼ 02/29	-0.424	-0.027
UKT 1½ 01/21	0.477	-0.010
UKT 1 04/24	0.461	-0.013
UKT 1½ 10/28	0.676	-0.015

\*Change from close as at 4.15pm BST.

Source: Bloomberg

## Euro area

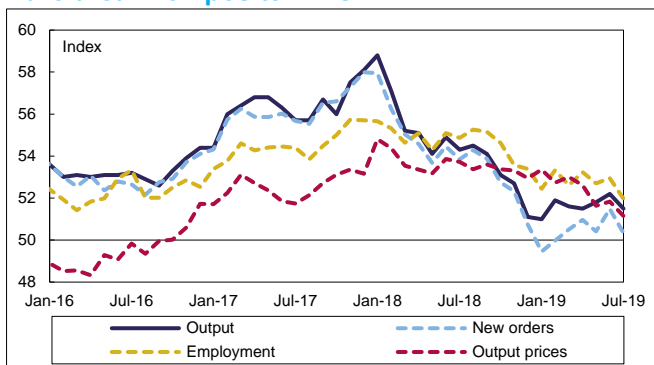
### Euro area PMIs disappointingly weak in July

While June's PMIs had hinted at a slight improvement in economic conditions in the euro area at the end of Q2, with the composite index increasing to a seven-month high, today's flash July PMIs seriously disappointed expectations, reinforcing that risks remain firmly skewed to the downside. In particular, the euro area manufacturing PMI plunged 1.2pts to 46.4, the lowest since 2012, suggesting that the contraction in the sector has deepened. And the key manufacturing components – including output, new orders and employment – all fell further below the key-50 level, with overseas demand remaining a major source of weakness, as the new export orders PMI declined more than 2pts to 44.3, the lowest since late-2011. In contrast, conditions in the services sector appear more stable, with the headline activity index down just 0.3pt to 53.3, a touch firmer than the average over the past year and still consistent with moderate expansion, although the new business PMI fell a steeper 1pt in July to 52.3. Overall, the euro area composite output PMI declined 0.7pt to 51.5, one of the lowest readings of the past six years and consistent with a further moderation in GDP growth at the start of Q3. Certainly, the steep drop in the composite new orders index by more than 1.0pt to 50.3 suggests that the euro area economy is unlikely to regain momentum in the near term. Against the backdrop of slower growth, today's survey also suggested that inflationary pressures were more subdued at the start of the Q3, with the output price PMI down 0.7pt on the month to 51.2, the lowest since November 2016.

### Germany struggles at the start of Q3, France weakens too

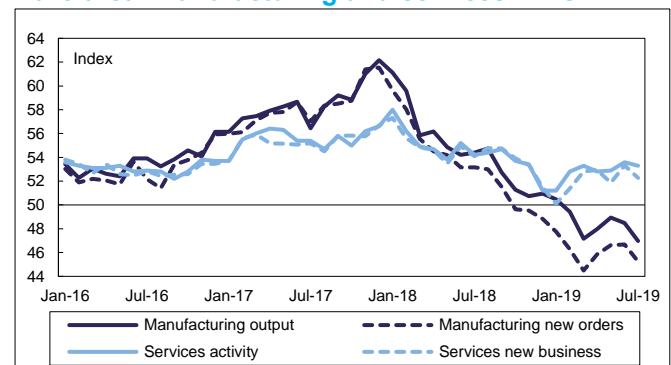
At the country level, the flash PMIs pointed to a further marked deterioration in Germany's manufacturing sector, with the output PMI falling 2.6pts to 44.1, the second-lowest level for seven years and signalling a sharp pace of contraction. New orders were also noticeably weaker, particularly in the autos sector, as overseas orders reportedly declined at their steepest rate for more than a decade – indeed, the export orders PMI was down a whopping 5.0pts to 38.5. And so, the overall manufacturing PMI declined 1.9pts in July to 43.1, a seven-year low. The message from the German services PMI was somewhat more reassuring, with the headline index merely reversing the 0.4pt increase seen in June to leave the index at a still-healthy 55.4. But this nonetheless left Germany's composite PMI 1.2pts lower on the month at 51.4, its joint-weakest level since mid-2013. The French figures were also very disappointing with the manufacturing PMI down 1.9pts at 50.0, with the output and new orders components signalling contraction for the fourth month out of the past five. The services PMI also fell 0.7pt in July to 52.2, although this was still the second-highest reading in eight months. Moreover, the 1.0pt drop in the composite PMI to 51.7 did not fully reverse the rise in June to suggest ongoing modest economic expansion in the second-largest member state. But today's surveys suggested that, like in Germany, the rest of Europe saw growth flag at the start of Q3 to its weakest since late-2013.

### Euro area: Composite PMIs



Source: Markit, Thomson Reuters and Daiwa Capital Markets Europe Ltd.

### Euro area: Manufacturing and services PMIs



Source: Markit, Thomson Reuters and Daiwa Capital Markets Europe Ltd.



## The day ahead in the euro area and US

All eyes tomorrow, of course, will be on the ECB's policy decision. Despite today's disappointing PMIs, we expect no substantive policy adjustment this month but rather a clear signal that further easing is on its way, probably in September. Certainly, recent comments from Governing Council members have left it uncertain whether they judge that the preconditions for easing policy this month have been met. Indeed, economic data – from the euro area and certain other major economies – have been mixed and difficult to interpret with confidence. And as last month's forward guidance did not explicitly flag the near-term possibility of a rate cut, we think the policymakers will want to wait for September before deciding what to do. Assuming they wait until then, they would also be able to calibrate precisely their policy response with updated economic forecasts that better reflect recent events.

Of course, given the ECB's readiness to adjust "all of its instruments, as appropriate", as we [previously detailed](#), if and when it eases policy, a range of policy options will likely be on the table – i.e. a cut in the deposit rate, a new tiered interest rate system and more asset purchases. And Draghi is likely to reiterate this range of options in his post-meeting press conference. Indeed, we might well see the Governing Council announce as early as this week an increase in the issue limits on the QE programme (from 33% to 50%) as a signal of preparedness to restart net asset purchases again if necessary. Draghi will also no doubt be asked about the Bloomberg report last week suggesting that the ECB is studying a [revamp of its inflation goal](#).

With respect to economic data, Germany's ifo sentiment survey is likely to reiterate the extremely downbeat tone of today's flash PMIs, with the headline business climate indicator expected to fall to its lowest level since November 2014.

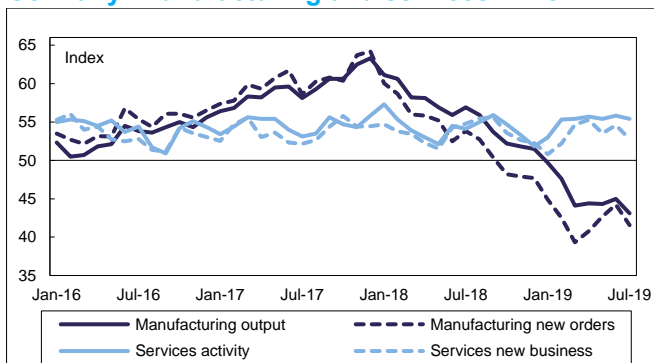
In the US, ahead of Friday's GDP estimate, the focus tomorrow will be on the advance goods trade and durable goods orders data for June. While the value of exports and imports are expected to be weaker that month following the surge in May, a large drop in exports will likely suggest that net trade was a drag on GDP growth in Q2. And while manufacturing orders are likely to be stronger in June, this follows considerable weakness in the previous two months. Thursday will also bring the Kansas Fed manufacturing activity index for July and the latest weekly jobless claims figures.

## UK

### The day ahead in the UK

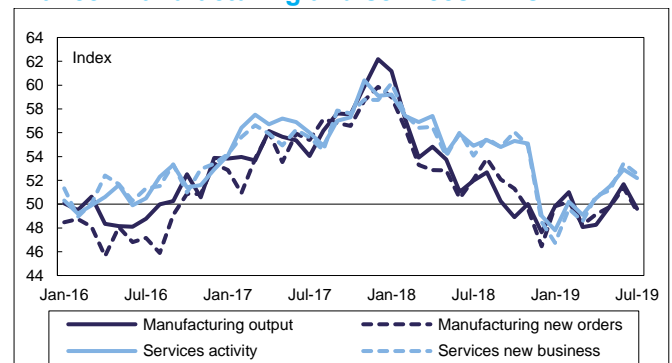
The focus in the UK today was inevitably on the official appointment of Boris Johnson as the new Prime Minister. At the time of writing Johnson had yet to confirm who would fill the key Cabinet positions, although reports unsurprisingly suggested that prominent pro-Brexit MPs were at the forefront of potential candidates. We would expect these announcements to be made ahead of Johnson's statement before the House of Commons tomorrow. But while his first speech from Downing Street reiterated his stance that the UK will leave the EU on 31 October, no 'ifs or buts', like his leadership campaign there was no clarity on how this would be achieved within the next 99 days. And tomorrow's speech before the House of Commons seems unlikely to provide further meaningful insight into his intentions either. Beyond any political news, tomorrow will bring the CBI's latest Distributive Trades survey, which will give a health-check on the retail and wholesale sectors in July. This is expected to show a notable pickup in the headline retail sales indicator, albeit still pointing to ongoing weakness in the sector. Although it should be noted that this survey failed to tally with growth in the official retail sales figures last month.

### Germany: Manufacturing and services PMIs



Source: Markit, Thomson Reuters and Daiwa Capital Markets Europe Ltd.

### France: Manufacturing and services PMIs












Source: Markit, 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	 Preliminary composite PMI	Jul	51.5	52.1	52.2	-
	 Preliminary manufacturing PMI (services PMI)	Jul	46.4 (53.3)	47.6 (53.3)	47.6 (53.6)	-
	 M3 money supply Y/Y%	Jun	4.5	4.6	4.8	-
Germany	 Preliminary composite PMI	Jul	51.4	52.2	52.6	-
	 Preliminary manufacturing PMI (services PMI)	Jul	46.4 (53.3)	45.0 (55.3)	45.0 (55.8)	-
France	 Business confidence (manufacturing confidence)	Jul	105 (101)	106 (102)	106 (102)	-
	 Preliminary composite PMI	Jul	51.7	52.5	52.7	-
	 Preliminary manufacturing PMI (services PMI)	Jul	50.0 (52.2)	51.6	51.9 (52.9)	-
UK	 UK Finance loans approved for house purchase £bn	Jun	42.7	52.6	42.4	42.4

#### Auctions

Country	Auction
- Nothing to report -	

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
EMU	12:45	ECB Main Refinancing rate %	Jul	0.00	0.00
	12:45	ECB Marginal Lending Facility rate %	Jul	0.25	0.25
	12:45	ECB Main Deposit rate %	Jul	-0.40	-0.40
Germany	09:00	IFO business climate	Jul	97.0	97.4
	09:00	IFO current assessment (expectations)	Jul	100.3 (94.0)	100.8 (94.2)
UK	11:00	CBI distributive trades survey - reported retail sales	Jul	3	-42

#### Auctions and events

Country	BST	Auction / Event
EMU	12:45	ECB monetary policy announcement
	13:30	ECB's Draghi to give post-meeting press conference

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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