

Euro wrap-up

Overview

- Ahead of tonight's FOMC announcement, Bunds followed Treasuries higher as euro area Q2 GDP and July inflation slowed.
- Gilts also made gains, as UK household confidence remained subdued despite a pickup at the start of Q3.
- The main event tomorrow will be the BoE's policy announcement and publication of its Inflation Report. Data-wise, tomorrow will bring final manufacturing PMIs for July from the euro area and UK.

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Daily bond market movements

Bond	Yield	Change
BKO 0 06/21	-0.775	-0.013
OBL 0 04/24	-0.750	-0.032
DBR 0¼ 02/29	-0.476	-0.035
UKT 1½ 01/21	0.437	-0.012
UKT 1 04/24	0.386	-0.027
UKT 1 % 10/28	0.614	-0.021

*Change from close as at 4:20pm BST.
Source: Bloomberg

Euro area

Euro area GDP growth moderates in Q2

There were no major surprises from the first estimate of euro area GDP in Q2, which confirmed that economic momentum slowed last quarter, with growth of 0.2%Q/Q half the pace seen in Q1. And that left the annual rate down 0.1ppt at 1.1%Y/Y, the weakest growth on this basis since Q413. No detail was provided on the expenditure breakdown, but the results so far from the member states suggest that household consumption was softer, having been boosted by temporary factors, including a rebound in new car registrations, in the first quarter of the year. While net trade might well have provided a broadly neutral contribution in Q2, the more challenging external environment poses a significant downside risks to the near-term growth outlook. Certainly, recent economic surveys point to a further slowdown at the start of Q3. So, while growth in Q2 aligned with the ECB's forecasts, as Draghi hinted at last week, the Bank's projected acceleration in Q3 and Q4 to 0.3%Q/Q and 0.4%Q/Q seems highly unlikely to materialise.

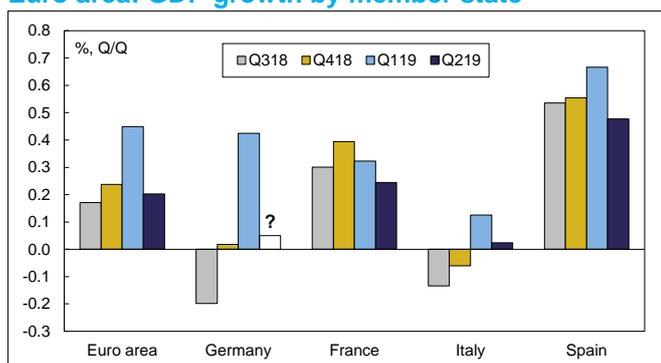
Slowdown in growth widespread across member states

At a country level, and after French economic growth yesterday aligned with our forecast of 0.2%Q/Q, down 0.1ppt from Q1, today's figures from Italy and Spain also showed growth slowing in line with our expectations. In Italy, having eked out a modest increase in Q1, GDP moved sideways in Q2 to leave output unchanged compared with a year earlier. But while quarterly growth in Spain dropped a larger 0.2ppt in Q2 to 0.5%Q/Q, this still marked the twenty-third consecutive increase and the strongest performance of the larger member states. No Q2 GDP data were provided for Germany. But while today's German retail sales surprised significantly to the upside in June, with the 3.5%M/M rise the strongest since 2006, sales were up just 0.1%Q/Q in Q2, a marked slowdown from the 1.7%Q/Q increase in Q1 and consistent with our view that GDP growth slowed notably in Q2 from 0.4%Q/Q. Indeed, given the likely contraction in manufacturing output, there is still a non-negligible risk of negative growth.

Euro area CPI falls more than expected in July

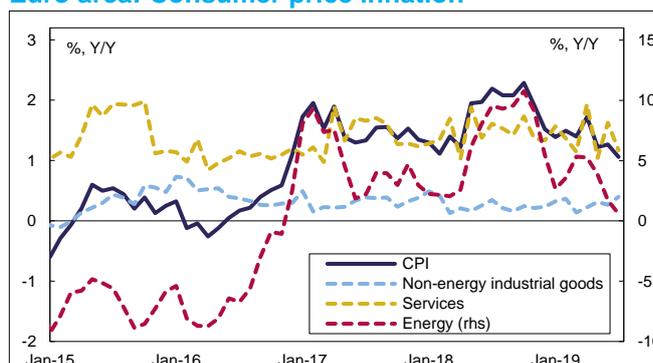
Against the backdrop of slower growth, the first estimate of the euro area's inflation for July came in a touch weaker than expected. In particular, headline CPI fell 0.2ppt to 1.1%Y/Y, the lowest rate for seventeen months. Stronger food price inflation, which rose 0.3ppt to 2.0%Y/Y in July partly offset weaker energy inflation, which fell 1.1ppts to 0.6%Y/Y, the softest growth since November 2016. But while inflation of non-energy industrial goods edged higher by 0.1ppt to 0.4%Y/Y, services inflation eased 0.4ppt to 1.2%Y/Y, to leave the core CPI rate also down 0.2ppt to 0.9%Y/Y. Core inflation is likely to move

Euro area: GDP growth by member state*



*German Q219 GDP figure is Daiwa forecast. Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Euro area: Consumer price inflation



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.



broadly sideways over coming months, to average less than 1.0%Y/Y throughout the second half of the year. And with energy prices set to subtract from inflation, headline CPI should also fall below 1.0%Y/Y by October, further supporting our view that the ECB will unveil a multi-faceted easing package at its September Governing Council meeting.

Euro area unemployment at eleven-year low

Despite the deteriorating economic backdrop, the euro area's labour market remains a source of positive news. Certainly, today's figures showed a further decline in the number of people unemployed in June for the eighth consecutive month, taking the cumulative drop over the past year to more than 1mn. So, the unemployment rate fell 0.1ppt to 7.5% in June (from an upwardly revised reading in May), the lowest for almost eleven years. Germany's unemployment rate remained at a record-low of 3.1%, while there were further improvements in Italy and Spain, where the rates fell 0.1ppt a piece to 9.7% and 14.0% respectively. In contrast, the French unemployment rate edged slightly higher to 8.7%, although this was still 0.3ppt below its level a year ago.

The day ahead in the euro area and US

Tomorrow will bring the final manufacturing PMIs for July. The flash estimates were particularly disappointing, with notable declines in the headline figures for the euro area (down 1.2pts to 46.4), Germany (down 1.9pts to 43.1) and France (down 1.9pts to 50.0), suggesting ongoing weakness in the sector at the start of Q3. In the markets, France will sell fixed-rate and index-linked bonds with various maturities.

The focus in the US will also be on the manufacturing sector, with July's ISM and Markit PMI due to indicate a subdued start to the third quarter. Meanwhile, ahead of Friday's payrolls report, tomorrow will bring the latest Challenger job cuts figures for July and the weekly jobless claims numbers.

UK

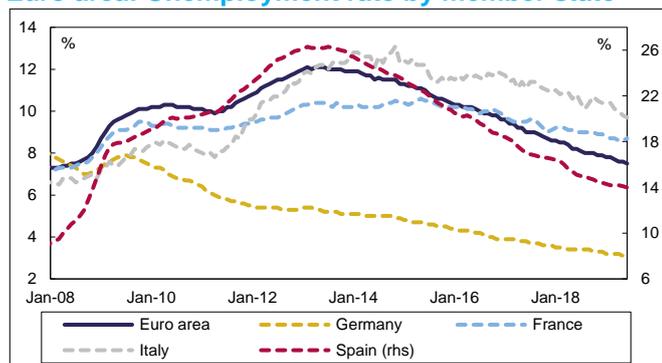
Consumer confidence ticks slightly higher in July

The appointment of Boris Johnson as Prime Minister has predictably prompted an increase in concerns about the prospects of a no-deal Brexit among businesses and financial markets alike. In contrast, however, today's GfK consumer confidence survey suggested a modest improvement in household sentiment in July. In particular, the headline index rose 2pts to -11, with households reportedly more optimistic about their personal finances against the backdrop of lower interest rates and prices. Certainly, today's BRC shop price index suggested that price pressures on the High Street remained very subdued in July, with prices down 0.1%Y/Y for the second successive month. Therefore, the GfK survey suggested that a greater share of households assessed it to be an appropriate time to make major purchases – indeed, the relevant index rose 6pts to +4, a five-month high. Of course, consumer confidence still remains close to the recent trough and well below the levels seen before the 2016 referendum. And with consumer credit having reported the slowest year-on-year growth for more than five years in June, we expect to see subdued household spending growth, at best, through to the Brexit deadline and beyond.

The day ahead in the UK

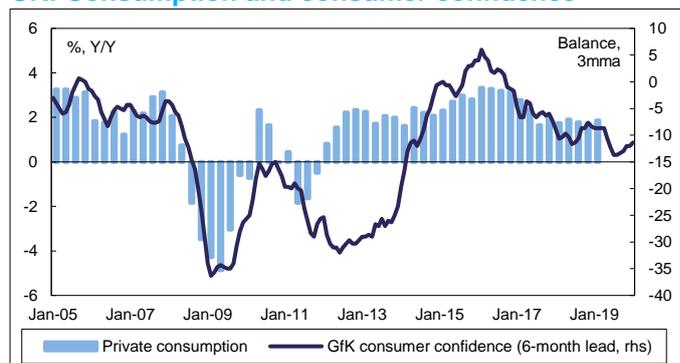
Tomorrow brings the main event in the UK this week, with the BoE's latest monetary policy decision and publication of its August Inflation Report. We expect no changes to policy, with Bank Rate set to be left at 0.75%. But with Carney having recently noted increased downside risks to global and UK GDP growth, we would expect the MPC to be more downbeat about the near-term outlook. And with Bank staff last month having revised down their Q2 GDP forecast from 0.2%Q/Q to 0.0%Q/Q, we expect the Inflation Report to reveal downward revisions to the Bank's GDP growth forecasts and possibly its inflation projection too. Of course, with the appointment of Boris Johnson as Prime Minister increasing the risk of a no-deal

Euro area: Unemployment rate by member state



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: Consumption and consumer confidence



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Brexit on 31 October, the MPC's assessment of the economic effects of Brexit uncertainty will be under the spotlight too. Given heightened downside risks, domestic and overseas alike, it would seem appropriate for the MPC to tweak its forward guidance that "were the economy to develop broadly in line with [the] May Inflation Report projections that included an assumption of a smooth Brexit, an ongoing tightening of monetary policy over the forecast period, at a gradual pace and to a limited extent, would be appropriate".

Tomorrow will also bring the most noteworthy data release of the week, with the July manufacturing PMI. In June, this survey was particularly disappointing, with the headline PMI declining for the third consecutive month and by 1.4pts to 48.0. The weakness in the output PMI was even more striking, down more than 3pts to 47.2. And we expect no improvement at the start of Q3, with the headline indices likely to signal ongoing marked contraction in the sector.

European calendar

Today's results							
Economic data							
Country	Release	Period	Actual	Market consensus/ Daiwa forecast	Previous	Revised	
EMU	 Preliminary GDP Q/Q% (Y/Y%)	Q2	0.2 (1.0)	<u>0.2 (1.0)</u>	0.4 (1.2)	-	
	 Preliminary CPI (core CPI) Y/Y%	Jul	1.1 (0.9)	<u>1.1 (1.0)</u>	1.2 (1.1)	1.3 (-)	
	 Unemployment rate %	Jun	7.5	7.5	7.5	7.5	
Germany	 Unemployment rate % (change '000s)	Jul	5.0 (1.0)	5.0 (2.0)	5.0 (-1.0)	- (0.0)	
	 Retail sales M/M% (Y/Y%)	Jun	3.5 (-1.6)	0.5 (0.6)	-0.6 (4.0)	-1.7 (3.8)	
France	 Preliminary CPI (EU-harmonised CPI) Y/Y%	Jul	1.1 (1.3)	1.1 (1.2)	1.2 (1.4)	-	
Italy	 Preliminary CPI (EU-harmonised CPI) Y/Y%	Jul	0.5 (0.4)	0.5 (0.5)	0.7 (0.8)	0.7 (-)	
	 Preliminary GDP Q/Q% (Y/Y%)	Q2	0.0 (0.0)	<u>0.0 (-0.2)</u>	0.1 (-0.1)	-	
Spain	 Preliminary GDP Q/Q% (Y/Y%)	Q2	0.5 (2.3)	<u>0.5 (2.3)</u>	0.7 (2.4)	-	
UK	 GfK consumer confidence	Jul	-11	-13	-13	-	
	 BRC shop price index Y/Y%	Jul	-0.1	-	-0.1	-	
Auctions							
Country	Auction						
Germany sold		€2.35bn of 0% 2029 bonds at an average yield of -0.41%					

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's data releases							
Economic data							
Country	BST	Release	Period	Market consensus/ Daiwa forecast	Previous		
EMU		09.00	Final manufacturing PMI	Jul	46.4	47.6	
Germany		08.55	Final manufacturing PMI	Jul	43.1	45.0	
France		08.50	Final manufacturing PMI	Jul	50.0	51.9	
Italy		08.45	Manufacturing PMI	Jul	48.0	48.4	
Spain		08.15	Manufacturing PMI	Jul	48.1	47.9	
UK		09.30	Manufacturing PMI	Jul	49.2	48.0	
		12.00	BoE Bank Rate %	Jul	<u>0.75</u>	0.75	
Auctions and events							
Country	BST	Auction / Event					
France		09.50	Auction: to sell 2.75% 2027 bonds				
		09.50	Auction: to sell 2.5% 2030 bonds				
		09.50	Auction: to sell 4.75% 2035 bonds				
		10.50	Auction: to sell index-linked bonds				
UK		12.00	BoE interest rate announcement and publish its quarterly Inflation Report				

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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<https://www.uk.daiwacm.com/ficc-research/recent-blogs>



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