Daiwa Capital Markets

Euro wrap-up

Overview

- Bunds made losses as a euro area consumer confidence survey remained consistent with ongoing growth in household spending.
- Gilts made losses as a BoE report gave detail on economic conditions since the referendum and UK labour market data remained firm.
- Thursday brings the conclusion of the latest ECB policy meeting, which is likely to see Draghi in dovish mode but policy left unchanged. Data-wise, UK retail sales and a French business sentiment survey are due.

Economic Research Team
+44 20 7597 8326

Daily bond market movements

Bond	Yield	Change*
BKO 0 06/18	-0.629	+0.015
OBL 0 04/21	-0.549	+0.017
DBR 0 08/26	-0.012	+0.018
UKT 1¼ 07/18	0.184	+0.011
UKT 1½ 01/21	0.411	+0.021
UKT 2 09/25	0.840	+0.040

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

Euro area

Consumer confidence edges lower

Ahead of the conclusion tomorrow of the latest ECB monetary policy meeting, the Governing Council might well have taken some comfort from today's flash estimate of euro area consumer confidence in July, which provided the first barometer of household sentiment in the single currency area since the UK referendum. It was no surprise that confidence slipped back for the second successive month. But the drop of 0.7pt was relatively modest and left the index slightly above the average for the first half of the year, albeit still some way below the norms throughout most of 2015. As such, while consumption likely slowed in the second quarter from the relatively vigorous pace of 0.6%Q/Q in Q1, today's survey signalled the likelihood of continued moderate support for economic growth from household spending in the second half of the year.

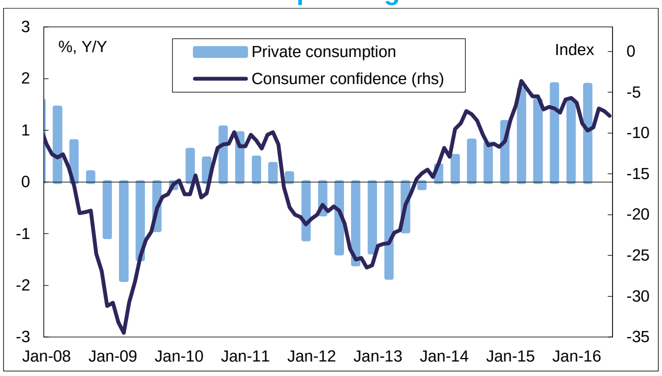
Current account surplus remains high

Meanwhile, the latest balance of payments figures reported a sharper-than-expected drop in the current account surplus in May, with the unadjusted balance more than halving to a three-month low of €15.4bn. On an adjusted basis, however, the narrowing was far less marked from the record €36.4bn in April to a still huge €30.8bn. The decline in that measure reflected a moderation in both the goods and services trade surpluses, to €30.6bn and €5.9bn respectively, while the primary income surplus largely reversed the jump seen in April. Nevertheless, this still left the cumulative twelve-month current account surplus at a record high of €347bn, 3.3% of GDP and 0.5ppt higher than a year earlier, reflecting the persistent and increasing excess of domestic savings over investment.

The day ahead in the euro area and US

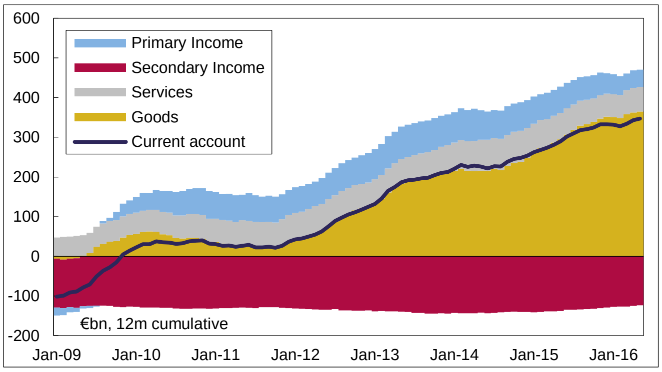
Thursday brings the main economic event this week with the conclusion of the ECB Governing Council meeting. Following the BoE's decision last week to leave policy unchanged, this meeting might well be a non-event policy-wise, with the Governing Council perhaps content to wait until September's meeting – when it will have new updated forecasts – before deciding whether to act again. However, with Draghi already having judged that the euro area economic outlook has likely deteriorated somewhat in response to the Brexit vote, he is likely to strike a dovish tone. And we have little doubt that the Governing Council will eventually decide to extend the ECB's asset purchase programme beyond next March, probably by six months to September 2017. Moreover, given that the ECB currently faces a shortage of bonds that it can buy, as the yields on more than €1.3trn of securities that would otherwise be eligible are currently below the floor of -0.40%, the Governing Council also ought to start reviewing the rules governing the programme although agreement on any amendments would seem unlikely to be reached just yet.

Euro area: Consumer spending and confidence



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Euro area: Current account



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Data-wise, tomorrow brings the INSEE French business sentiment survey for July, which is expected show a deterioration in the headline confidence index to the lowest level in a year. In the markets, France and Spain will sell a range of bonds. In the US, Thursday will be the busiest day of the week for new data with the release of existing home sales figures for June, the FHFA house price indices for May, the Philly Fed index for July and Chicago Fed National Activity index for June, as well as the usual weekly claims figures. Additionally, in the markets, the Treasury will sell 10Y TIPS.

UK

BoE Agents provide more colour on the post-referendum shock

When the BoE's MPC met last week, it received a summary of its Agents' July report on business conditions. So, as the MPC meeting minutes noted, the committee was already made aware of the Agents' finding that there had been no clear evidence yet of a sharp slowing in activity and that many firms had only just begun to formulate new business strategies in response to the referendum. Additionally, the MPC had already learned that a third of companies anticipate a negative impact on their capital spending. Nevertheless, the full report from the Agents, which was finally published today, provided additional colour. The lack of contingency planning by most companies meant that – for better or worse – they were simply "in a mode of seeking to maintain 'business as usual'". But there were also reports of planned inward foreign direct investment being postponed and a number of companies were considering alternative European locations for aspects of their business, while large international firms expected their continental European operations to receive a greater share of future investment than their UK operations. Moreover, business services companies reported reductions in deal-making activity while firms involved in property markets were also (understandably) more cautious. Meanwhile, while the evidence of negative consequences for employment and pay seems to have been limited so far, firms were expecting to lower their hiring intentions for coming months and quarters. The report was also clear that prices were expected to rise now, although intense competition among retailers might dampen the hit on consumer wallets.

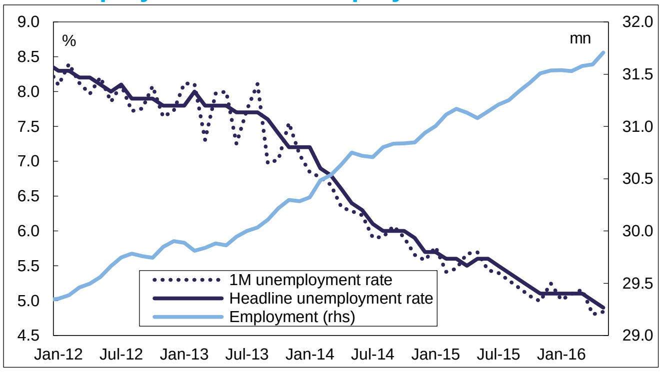
Another downbeat household survey

Separately, the Markit Household Finance Index (HFI) – another survey that is often overlooked but merits attention in these post-referendum days – tallied with the GfK's flash consumer confidence report signalling a significant deterioration in perceptions of the outlook for personal finances to the worst in two and a half years. Workers in the private and public sector alike were more downbeat. Moreover, workplace activity was reported to fall in July for the first time in more than four years contributing to an increase in concerns about job security to the highest since August 2013. Overall, these were findings were probably not surprising, but still support our view that consumer spending is set to slow.

Labour market continued tightening in Q2

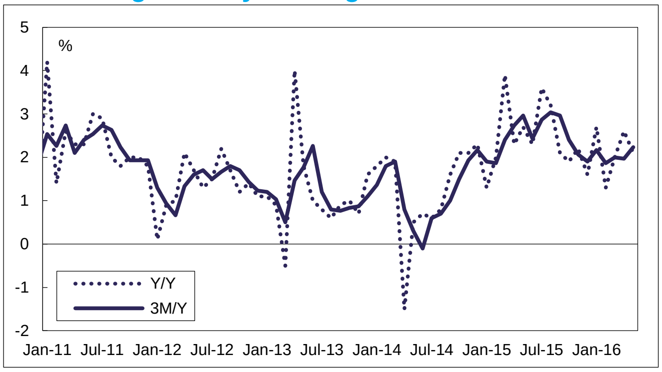
Nevertheless, in line with other stronger-than-expected economic indicators for April and May released previously, the latest labour market figures suggested that the UK economy maintained firm momentum in Q2, despite uncertainty ahead of the EU vote. Most notably, the figures reported that total employment increased by 112k in May, representing the steepest rise in two years, to leave the headline three-month on three-month employment growth at the highest level so far this year of 176k. The strong employment gains contributed to a drop in the unemployment rate, which fell by 0.1ppt to 4.9%, the lowest level since 2005. Meanwhile, wage growth developments were positive as well, with the headline pace picking up by 0.3ppt to 2.3%3M/Y. However, that three-month rate masks the monthly changes, which were weaker than might appear in May. For example, the one-month growth rate actually eased from 2.6%Y/Y to 2.1%Y/Y, and the pace moderated in almost all major sectors. And even accounting for the month-to-month volatility, the three-month rate remained well below the most recent peak rates of 3.0%3M/Y recorded in 2015. Against the backdrop of today's data, we still think that GDP growth in Q2

UK: Employment and unemployment rate



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: Average weekly earnings



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

remained at the 0.4%Q/Q rate of Q1. But it seems bound to slow sharply over the near term. And – despite the intense competition on the High Street alluded to by the BoE Agents – inflation looks set to increase steadily due to sterling depreciation. So, with wage growth likely to remain subdued and the unemployment rate likely to rise, as implied by the Markit HFI, real household disposable income growth looks set to slow markedly, weighing on consumption growth over coming quarters.

The day ahead in the UK

While May's retail sales data surprised on the upside, with the rise of almost 1%M/M taking the annual rate of growth to a fifteen-month high of 6.0%Y/Y, tomorrow's figures for June are expected to show a drop in sales on the month and a moderation in the annual rate to about 5.0%Y/Y. Public finance figures for June are also due tomorrow. Today PM May confirmed that the Government has abandoned its previous plan to balance the public budget by the end of the current Parliament, ostensibly relieving immediate pressures to cut the deficit. And while new Chancellor Phillip Hammond might be considered a fiscal hawk from the typical Conservative mould, public borrowing now seems likely to stop falling over the near term, not least given the deterioration in economic outlook since the Brexit vote and its effect on government revenues.

European calendar

Today's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ _Daiwa forecast_	Previous	**Revised**
EMU	Current account balance €bn	May	**30.8**	-	36.2	**36.4**
	Preliminary consumer confidence	Jul	**-7.9**	-8.0	-7.3	**-7.2**
Italy	Current account balance €bn	May	**3.2**	-	4.7	**-**
UK	Average earnings incl. bonuses (excl. bonuses) 3M/Y%	May	**2.3 (2.2)**	_2.2 (2.3)_	2.0 (2.3)	**-**
	ILO unemployment rate 3M%	May	**4.9**	_5.0_	5.0	**-**
	Employment change 3M/3M '000s	May	**176**	_60_	55	**-**
	Claimant count rate % (changed 000s)	Jun	**2.2 (0.4)**	2.2 (3.5)	2.2 (-0.4)	**- (12.2)**

Auctions

Country	Auction
Germany sold	€3.4bn of 0% 2021 bonds (08-Oct-2021) at an average yield of -0.51%
UK sold	£1.5bn of 4.25% 2039 bonds (07-Sept-2039) at an average yield of 1.639%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.ma

Tomorrow's data releases

Economic data

Country		BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
EMU		12.45	ECB refinancing rate %	Jul	*0.00*	0.00
		12.45	ECB deposit rate %	Jul	*-0.40*	-0.40
		12:45	ECB asset purchase target €bn	Jul	*80*	80
France		07.45	Business confidence indicator (production outlook)	Jul	99 (-)	100 (1)
Spain		09:00	Trade balance €bn	May	-	-0.6
UK		09:30	Retail sales excluding petrol M/M% (Y/Y%)	Jun	-0.6 (4.8)	1.0 (5.7)
		09:30	Retail sales including petrol M/M% (Y/Y%)	Jun	-0.6 (5.0)	0.9 (6.0)
		09:30	Public sector net borrowing excluding interventions £bn	Jun	9.5	9.7

Auctions and events

Country		BST	Auction / Event
EMU		12.45	ECB monetary policy announcement
		13.30	ECB press conference
France		09:50	Auction: To sell 0% 2019 bonds (25-Feb-2019)
		09:50	Auction: To sell 0% 2021 bonds (25-May-2021)
		09:50	Auction: To sell 4.25% 2023 bonds (25-Oct-2023)
		10:50	Auction: To sell 0.1% 2025 index-linked bonds (01-Mar-2025)
		10:50	Auction: To sell 0.7% 2030 index-linked bonds (25-Jul-2030)
		10:50	Auction: To sell 1.8% 2040 index-linked bonds (25-Jul-2040)
Spain		09:30	Auction: To sell 0.25% 2019 bonds (31-Jan-2019)
		09:30	Auction: To sell 0.75% 2021 bonds (30-Jul-2021)
		09:30	Auction: To sell 2.9% 2046 bonds (31-Oct-2046)

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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