

Euro wrap-up

Overview

- Bunds weakened today as the euro area flash PMIs suggested a stabilisation of economic conditions.
- Gilts also made losses as the UK flash PMIs similarly exceeded expectations, suggesting a significant easing in the pace of deterioration in the economy.
- Wednesday will bring the German ifo and French INSEE business sentiment indicators for June.

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Daily bond market movements

Bond	Yield	Change
BKO 0 06/22	-0.676	+0.029
OBL 0 04/25	-0.659	+0.026
DBR 0 08/30	-0.408	+0.034
UKT 0½ 07/22	-0.057	+0.010
UKT 0% 06/25	-0.006	+0.014
UKT 4% 12/30	0.215	+0.022

*Change from close as at 4:30pm BST.
Source: Bloomberg

Euro area

Flash PMIs suggest stabilisation rather than growth

With Covid-related restrictions on activity relaxed, the flash June PMIs inevitably suggested that the pace of deterioration in the euro area economy eased significantly this month. However, overall, they suggested a stabilisation of economic conditions after the recent sharp contraction rather than any meaningful expansion. Indeed, while it rose more than 5pts from May to its highest level since February, and was more than 35pts above the record low reached in April, the euro area composite PMI remained sub-50 at just 47.5. Likewise, the PMIs for services activity (up more than 16pts to 47.3) and manufacturing output (up more than 12pts to 48.2) simply suggested an easing in the pace of deterioration in both main sectors with no hint of anything resembling a V-shaped recovery. The survey detail suggested that new orders from at home and abroad, and work backlogs, continue to decline, albeit not as steeply as over the past few months. So, it also suggested that the pace of decline in employment eased only somewhat, and that input and output prices remain under downward pressure.

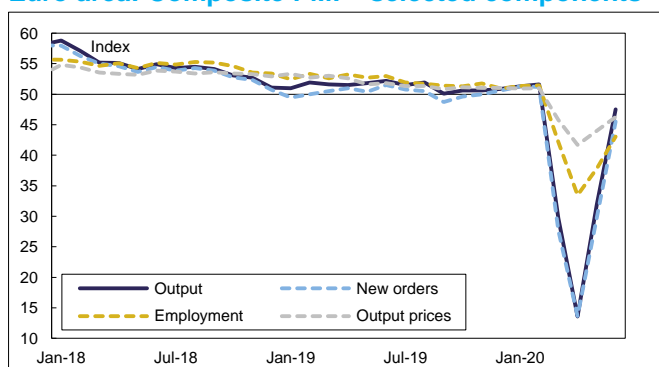
French improvement from major weakness

At the country level, the French flash PMIs registered the most improvement from recent months, with the services, manufacturing and composite indices all rising back above 50 to suggest economic expansion. The most encouragement came from manufacturing, where the French headline PMI rose more than 20pts to 52.1, and the output index rose almost 25pts to 55.5, suggesting the strongest growth rate in the sector in more than two years. The French services PMI also rose by almost 20pts, but at 50.3 suggested that activity in the sector was moving broadly sideways rather than enjoying a meaningful renaissance. So, the French composite PMI rose more than 19pts to a four-month high of 51.3, implying a rather modest step forward following extreme weakness in the prior three months.

German PMIs still sub-par while local lockdown flags ongoing pandemic risks

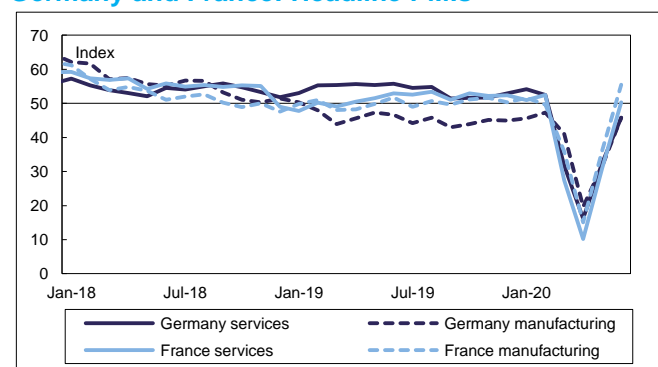
In Germany, where the cumulative decline in output since February was far more moderate, the improvement suggested by the June PMIs was much less notable. Indeed, while it is difficult to believe that economic activity this month will be weaker than in May, none of the headline PMIs returned back above 50 in June that would have suggested expansion. The manufacturing PMI rose "just" 8pts to 44.6, while the equivalent index for services was up more than 13pts to 45.8. As a result, the composite PMI was up 13.5pts to 45.8, a four-month high but one still suggestive of a further weakening of activity. And as in France, the German survey suggested that new orders – from at home and abroad – and employment are still declining. While we would hesitate to draw strong conclusions given the limitations of these indices, more than anything perhaps today's PMIs provided a reminder that economic activity will remain well below the pre-Covid level for some time to come. They also suggest that the recovery in demand will remain vulnerable to the ongoing rise in unemployment, as well as future adverse twists and turns in the pandemic. Indeed, in an attempt

Euro area: Composite PMI – selected components



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

Germany and France: Headline PMIs



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



to contain a new coronavirus outbreak, the authorities in the state of North Rhine-Westphalia have reintroduced local lockdown measures in the Gütersloh district (with a population of more than 360k) to last until the end of the month.

The day ahead in the euro area and US

Wednesday brings more national business sentiment indicators, with the release of the German ifo and French INSEE confidence surveys. Headline indicators for both surveys are expected to have increased, reflecting an improvement in perceptions of current conditions and expectations of the future. Meanwhile, ECB Chief Economist Lane is due to speak at an online event, and in the markets Germany will sell 15Y Bunds.

In the US, tomorrow will bring the FHFA home price index for April, while Charles Evans of the Chicago Fed will discuss the US economy at an online event. Supply-wise, the Treasury will sell 2Y floating-rate and 5Y fixed-rate notes.

UK

UK PMIs point to some stabilisation

With the UK's lockdown measures very gradually easing and businesses finding alternative ways to operate, today's flash PMIs inevitably reported significant progress towards stabilisation over the past month. In particular, the headline manufacturing index rose 9.4pts, while the output component was up almost 16pts, both rising back to just above 50 for the first month in four to imply very moderate economic expansion. But new orders reportedly continued to decline, particularly in the autos and aviation sectors, albeit at a more moderate pace than in May. And while some manufacturing workers had returned from furlough, the employment PMI remained at a relatively weak level (41.0). Meanwhile, the jump in the services PMI was more striking, up 18pts to 47.0, implying that the pace of deterioration had eased significantly in the sector. Indeed, just one-third of respondents reported a decline in activity in June compared with more than 50% in May, although activity was inevitably still hindered by ongoing business closures in the hospitality sector. Overall, the headline composite PMI was up 17.6pts on the month to 47.6, an increase of almost 34pts from April's trough. Of course, like with the euro areas indices, it is impossible to conclude with any confidence what the PMIs really imply for the current profile of GDP, although they clearly remain consistent with a lack of meaningful economic expansion following a period of severe contraction.

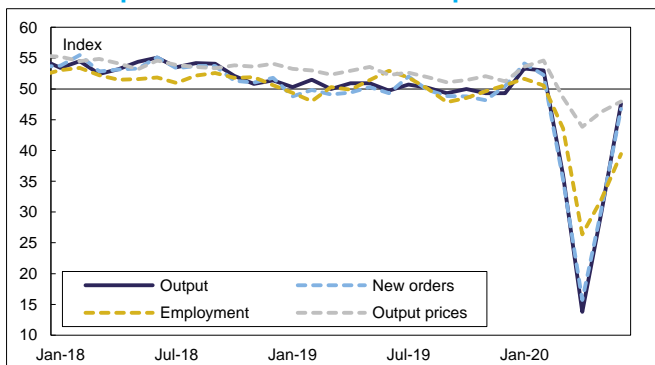
Footfall remains very weak despite reopening of retailers

Of course, the PMIs exclude the retail sector, where non-essential stores were allowed to resume trading at the start of last week. But figures published by Wireless today suggested that despite a notable increase over the past weekend, average national footfall was still down by almost two-thirds compared with pre-Covid levels. As such, the government's announcement today that certain other services subsectors – including hotels, restaurants, cinemas, museums and galleries – can reopen on 4 July with (in many cases highly restrictive) social distancing guidelines in place, might not deliver a sudden surge in activity. And many other indoor activities – including clubs, gyms, swimming pools and beauty facilities – will remain closed too. Certainly, ongoing social distancing, whether compulsory or voluntary, as well as weak demand seems bound to continue to suppress the near-term economic recovery. Indeed, while the PMI survey suggested that firms are seemingly much more upbeat about output prospects over the coming year, with orders – both domestic and external – still falling and firms continuing to scale back their workforces, a V-shaped recovery swiftly back to the pre-crisis output level seems out of the question.

The day ahead in the UK

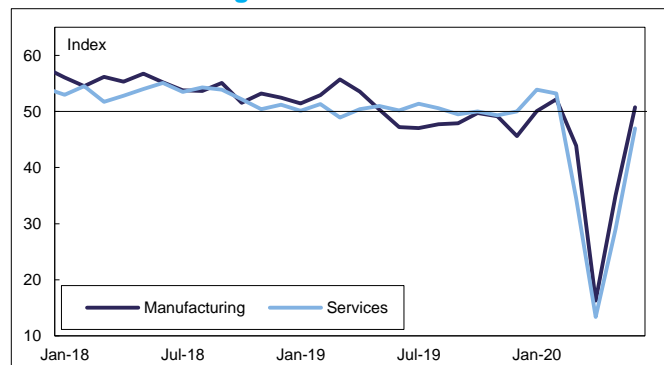
Wednesday should be a relatively quiet day for UK economic news, with no top-tier data scheduled for release. The afternoon will see Debt Management officials appear before the Treasury Select Committee. In the markets, the DMO will sell 2024 and 2054 Gilts.

UK: Composite PMI – selected components



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

UK: 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/ Daiwa forecast	Previous	Revised
EMU	 Preliminary manufacturing (services) PMI	Jun	46.9 (47.3)	45.0 (41.5)	39.4 (30.5)	
	 Preliminary composite PMI	Jun	47.5	43.0	31.9	
Germany	 Preliminary manufacturing (services) PMI	Jun	44.6 (45.8)	42.5 (42.3)	36.6 (32.6)	
	 Preliminary composite PMI	Jun	45.8	44.4	32.3	
France	 Preliminary manufacturing (services) PMI	Jun	52.1 (50.3)	46.0 (45.2)	40.6 (31.1)	
	 Preliminary composite PMI	Jun	51.3	46.8	32.1	
UK	 Preliminary manufacturing (services) PMI	Jun	50.1 (47.0)	45.0 (40.0)	40.7 (29.0)	-
	 Preliminary composite PMI	Jun	47.8	41.2	30.0	-





Auctions

Country	Auction
Germany	 sold €4bn of 0% 2022 bonds at an average yield of -0.69%
UK	 sold £3.25bn of 0.125% 2026 bonds at an average yield of 0.031%
	 sold £3bn of 0.375% 2030 bonds at an average yield of 0.249%






Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's data releases

Economic data

Country	BST	Release	Period	Market consensus/ Daiwa forecast	Previous
Germany	 09.00	Ifo business climate index	Jun	85.0	79.5
	 09.00	Ifo current assessment balance (expectations)	Jun	84.3 (86.0)	78.9 (80.1)
France	 07.45	Business confidence	Jun	73	59
	 07.45	Manufacturing confidence (production outlook)	Jun	76 (-)	70 (-49)

Auctions and events

Country	BST	Auction / Event
EMU	 08.00	ECB's Lane speaks at a webinar event
Germany	 10.30	Auction: €2.5bn of 0% 2035 bonds
UK	 10.00	Auction: £3.25bn of 2.75% 2024 bonds
	 11.30	Auction: £1.5bn of 1.625% 2054 bonds
	 14.30	DMO officials appear before the Treasury Select Committee

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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