

Euro wrap-up

Overview

- Bunds made gains despite new German survey results suggesting improved consumer willingness to spend and export expectations.
- Gilts followed USTs higher as new UK survey results suggested that retailers expect sales to remain weak and that a large share of businesses are cutting investment.
- Friday will bring data on euro area bank lending, French and Italian sentiment and Spanish retail sales.

Chris Scicluna

+44 20 7597 8326

Daily bond market movements

Bond	Yield	Change
BKO 0 06/22	-0.710	-0.015
OBL 0 04/25	-0.712	-0.026
DBR 0 08/30	-0.473	-0.027
UKT 0½ 07/22	-0.086	-0.003
UKT 0% 06/25	-0.052	-0.024
UKT 4% 12/30	0.152	-0.033

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

Euro area

German consumers (somewhat) more confident

According to the latest GfK sentiment survey, German consumers continue to feel more optimistic about the economic outlook and are increasingly willing to spend too. In particular, the forward-looking headline confidence index, for July, rose a larger-than-expected 9pts to -9.6. That, however, was still almost 12pts below the level just three months ago and also well below levels recorded during the global financial crisis and subsequent euro crisis. Within the survey detail, most encouraging was a rise in the measure of willingness to buy (up almost 14pts to a three-month high of 19.4). While that seemingly benefited from the government's plans for additional stimulus, including a 3ppt cut in the main VAT rate to 16% (and 2ppt cut in the reduced rate to 5%) from 1 July, and €300 "Kinderbonus" for families, it remained well below the range prevailing in the decade before the pandemic hit. Similarly, while expectations for the economic outlook rose above the long-run average to the highest in more than a year, household income expectations remained well below the range of the past decade. Indeed, with unemployment rising and millions of workers still on reduced (or zero) working hours, GfK reported that many households expect to see a drop in income over coming months, with the self-employed also flagging concerns in this respect.

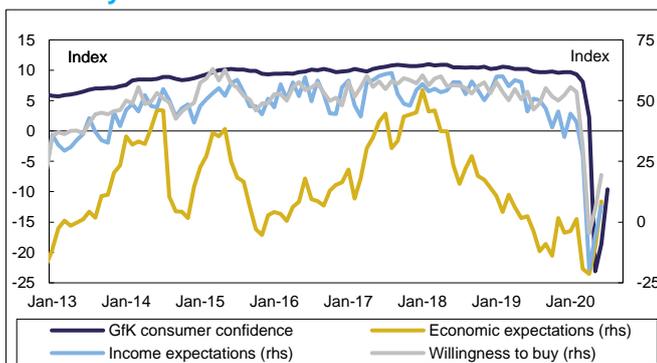
Manufacturers (largely) more upbeat about export outlook

Yesterday's [ifo business climate indices](#) suggested that German firms are also feeling rather more upbeat about the economic outlook. Reporting notable improvements in expectations for the coming six months, the survey suggested that confidence was most improved among manufacturers. The ifo Institute today provided a little more colour, reporting a record monthly rise in confidence among goods exporters, with the respective index up more than 24pts to -2.3, only a four-month high but still close to the middle of the range in the twelve months before the pandemic. Among the various subsectors, manufacturers of autos and pharmaceuticals expect to see significant growth in exports over coming months. Chemicals firms expect exports to remain steady, an upgraded assessment from recent months. However, consistent with other survey indicators, and a downbeat outlook for global business investment, the electrical and mechanical engineering sub-sectors expect exports to fall, and by more than they previously expected.

ECB account suggests PEPP envelope is a ceiling, but will still likely be raised

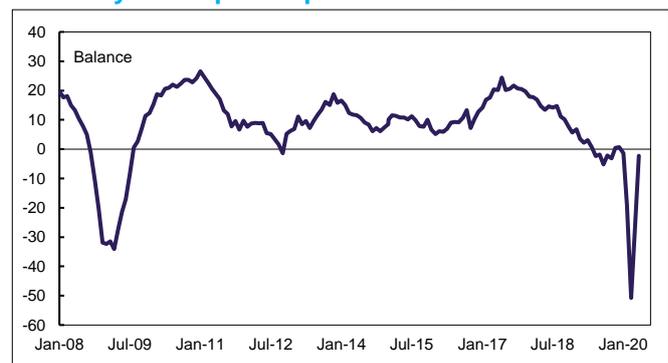
Today also brought the publication of the account of the [ECB's June policy meeting](#), at which the PEPP envelope was increased by €600bn to €1.35trn, the horizon for the net purchases was extended at least until the end of June 2021, and the Governing Council also decided to reinvest payments under the PEPP until at least the end of 2022. The document offered

Germany: Consumer confidence



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

Germany: ifo export expectations index



Source: ifo Institute and Daiwa Capital Markets Europe Ltd.



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few clues to the likely future path of policy. But, not least as inflation was expected to remain below target over the medium term, deflation was “no longer a low probability event”, but financial conditions were judged still to be tighter than before the pandemic hit, it confirmed that all members agreed on the need to add stimulus. There were, however, “some reservations expressed about the precise timing and proposed scale of the expansion of the PEPP”, with a range of preferences for either a larger or smaller envelope. The account also noted that “the envelope should be understood as a ceiling, which implied that in the event of significant upside surprises to the outlook, the full envelope would not need to be used”. But as such an outcome looks highly unlikely, and inflation is expected on the ECB’s base case to remain below 1.5% even by the end of 2022, we continue to expect the ECB both to complete the €1.35trn envelope, and also to increase it before the end of the year. We should also expect deviations of PEPP purchases from the ECB’s capital key to persist for some time to come, not least as the account also confirmed that the minimum duration for the reinvestment horizon of the PEPP was set at least until the end of 2022 to reduce the need to reduce such deviations over the near term.

Account also presents defence of PEPP for the German Constitutional Court

Perhaps unsurprisingly, the drafting of the account appeared to have been aimed partly at the German Federal Constitutional Court, which last month called for the ECB to produce a proportionality analysis of its pre-pandemic Asset Purchase Programme in order to allow the Bundesbank to continue to purchase securities for monetary policy purposes. Indeed, it incorporated an explanation from Chief Economist Philip Lane of how both “the PEPP and the APP were proportionate measures under the current conditions for pursuing the price stability objective, with sufficient safeguards...built into the design to limit potential adverse side effects”. And following the publication of the account, the ECB’s press office tweeted examples from academic economic literature demonstrating the effectiveness of asset purchases in helping to maintain price stability. With the Governing Council also reportedly set to provide confidential edited documents, previously submitted to the ECJ in 2018, via the Bundesbank to the German Parliament to demonstrate the proportionality of its asset purchase policy, we continue to be unperturbed by May’s judgement and see minimal risk that the Bundesbank will eventually be prevented from participating in the programmes.

The day ahead in the euro area and US

Friday, meanwhile, brings the latest ECB bank lending figures for May, which are expected to show continued strong growth in new loans to non-financial corporations, but ongoing moderation in demand for new lending from consumers. INSEE will publish its latest French consumer confidence indices while ISTAT will publish its Italian economic sentiment survey, similarly for June. And, in terms of hard data, Friday sees the release of Spanish retail sales figures for May, which are expected to confirm some rebound from extreme weakness in April albeit leaving them still well below the pre-Covid level.

In the US, tomorrow will bring personal income and consumption data for May, together with the final University of Michigan consumer sentiment survey for June.

UK

CBI survey flags ongoing weakness of consumer demand

Data released at the end of last week reported that [retail sales](#) rebounded somewhat more vigorously than expected in May but remained a long way below their pre-pandemic level. According to today’s CBI distributive trades survey results, retail sales at the start of this month remained well down on a year ago, albeit not quite as far as they were a month ago. The headline balance of sales in the year to June of -37% was up from -50% last month, with the improvement attributed to stronger sales of food and drink. While the cut-off date for the survey was just prior to the reopening of non-essential stores from 15 June, the CBI reported that a steeper pace of decline was still expected in the year to July, with the respective balance at -48%, as softer sales of grocery items was expected to more than offset a pickup in sales of other items. And the volume of orders placed on suppliers fell at a moderately slower pace in the year to June (balance of -42%, from -56% in May), and is expected to see a similar shortfall next month (-44%). The rather limited improvement in shopping centre footfall over the past weekend supports the view that total sales will remain well below pre-pandemic levels for a while yet, even if online sales are expected to continue to outpace in-store sales. And in response to a special question on the survey, the CBI noted that the largest share of firms (62%) cited lack of demand as the greatest operational challenge for re-starting their business as restrictions on activity are relaxed.

A very gradual pace of economic normalisation

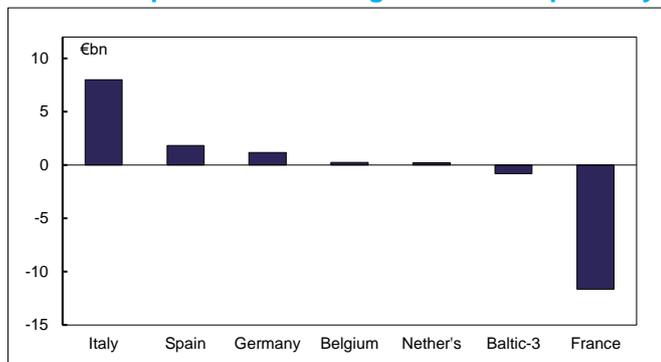
The latest snapshots from the ONS’s various special surveys related to the impact of the coronavirus provided further colour on the gradual pace of improvement as restrictions on activity are gradually eased. Among other things, these reported that 64% of businesses trading over the first two weeks of the month reported that their turnover was still below normal expectations for this time of year. And 43% of those businesses continuing to trade reported that their capital expenditure had either stopped or had been reduced because of the pandemic. Nevertheless, over the past two weeks, 7% of the workforce had returned from furlough. And in the week to 19 June, there had been a modest pickup in the number of advertised job vacancies to a little more than 50% the 2019 level, with the number in the hard-hit catering and hospitality sub-sector rising a larger 7ppts, albeit merely to 27% of the 2019 level. The data also reported a pickup in transport activity, e.g. 44% of workers travelled to work in the second half of last week, up 3ppts from the previous week, while the number of

ships visiting UK ports rose about 10% from the previous week, albeit remaining more than 12% down from the pre-pandemic peak. Looked at in the round, while the number of new coronavirus cases and deaths in the UK remains well above the levels in the EU, the pace of economic normalisation in the UK also appears to be similarly significantly lagging that in the rest of Western Europe.

The day ahead in the UK

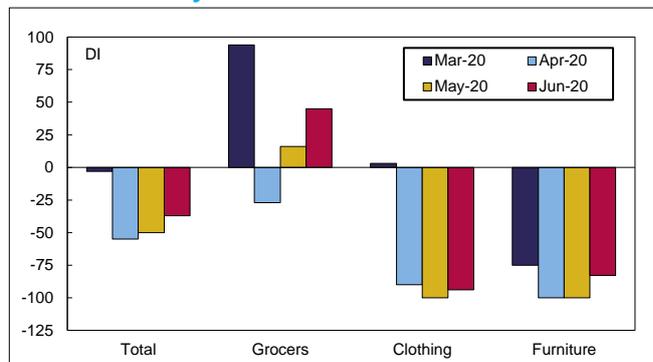
No key UK economic data are scheduled for tomorrow, but the BoE's Quarterly Bulletin will be released.

ECB PEPP purchases: Divergence from capital key*



*As of May 2020. Source: ECB and Daiwa Capital Markets Europe Ltd.

UK: CBI Survey – Volume of sales*



*Volume of sales in the year to the month in question. Source: CBI, 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
Germany	GfK consumer confidence	Jul	-9.6	-12.0	-18.9	-18.6
UK	CBI distributive trades survey, total reported retail sales	Jun	-37	-38	-50	-

Auctions

Country	Auction
Italy	sold €3.5bn of 0% 2022 at an average yield of 0.102%
	sold:€2bn 0.65% 2026 index-linked bonds at an average yield of 0.56%
UK	sold £1.1bn of 0.125% 2029 index-linked bonds at an average yield of -2.794%

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 M3 money supply Y/Y%	May	8.7	8.3
France		07.45 Consumer confidence	Jun	94	93
Italy		10.00 Economic sentiment indicator	Jun	-	51.1
		10.00 Consumer (manufacturing) confidence	Jun	97.5 (76.0)	94.3 (71.2)
Spain		08.00 Retail sales Y/Y%	May	-19.8	-31.6

Auctions and events

Country	BST	Auction / Event
UK		12.00 BoE publishes its Q2 Quarterly Bulletin

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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