Euro wrap-up

Overview

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- Bunds made gains as German goods trade data disappointed expectations.
- Gilts made gains as doubts were raised over the macroeconomic boost from yesterday's new UK fiscal policy package and a survey suggested ongoing downwards pressure on house prices.
- Friday will bring data on French and Italian industrial production.

Daily bond market movements

Bond	Yield	Change
BKO 0 06/22	-0.694	-0.011
OBL 0 04/25	-0.672	-0.016
DBR 0 08/30	-0.466	-0.023
UKT 0½ 07/22	-0.102	-0.016
UKT 0⅝ 06/25	-0.065	-0.019
UKT 4¾ 12/30	0.155	-0.024

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

Euro area

German export volumes about one quarter below pre-pandemic level in May

Having fallen off a cliff over the previous two months, German goods trade inevitably rebounded somewhat in May in response to the easing of lockdown restrictions both at home and abroad. However, growth in the value of both exports (9.0%M/M) and imports (3.5%M/M) was weaker than expected, tallying with the extremely modest rebound in production that month. Indeed, exports were still a hefty 23.1% below their February peak and down 29.7%Y/Y. And imports were 18.2% below their February peak and down 21.7%Y/Y. By country, exports to China again held up best, down just 12.3%Y/Y in May. In contrast, exports to the rest of the euro area were down 25.2%Y/Y while those to the US were down 36.5%Y/Y. And given the lagged relaxation of lockdown, exports to the UK were down a whopping 46.9%Y/Y. Adjusting for prices, the Bundesbank estimates that export volumes similarly rose 9.1%M/M in May to be still down 25.8% from February's peak. And import volumes rose 3.1%M/M to be 13.9% below February's peak. With new orders from abroad still more than 37% below their pre-pandemic peak in May, and global demand for capital goods and autos set to remain very subdued, it will be a very long time before German exports fully recover all of their lost ground.

Hotels still hard-hit

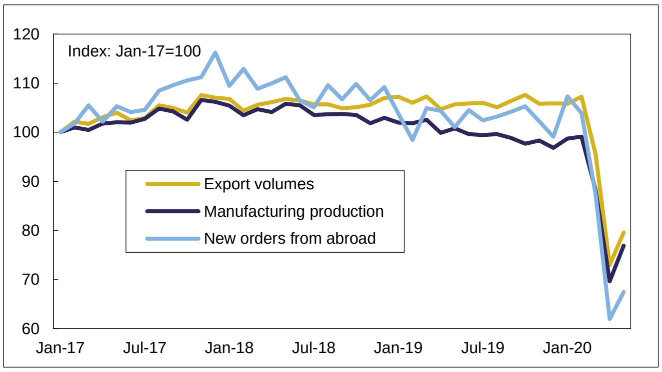
As elsewhere, the hit to Germany's hospitality industry has been more pronounced than other sectors. The number of overnight stays in hotels and campsites dropped by almost three-quarters from a year earlier (-74.8%Y/Y) to 11.2mn in May even as guests travelling for reasons other than business were permitted in many states from the second half of the month. Admittedly, that was an improvement from April, when the number of overnight stays was down 89.3%Y/Y to 4.3mn. But it left the number down by almost one half (-48.7%) in the first five months of the year compared to the same period of 2019. The number of such stays by visitors from abroad was down 90.9%Y/Y in May and 55.6%YTD/Y.

The day ahead in the euro area and US

Friday will see the release of French, Italian and Dutch industrial production data for May. Output in France and Italy is expected to have jumped at a double-digit monthly rate in May, after large declines were posted in March and April. However, like the figures from Germany, where the bounce back was less than expected, French and Italian industrial production are bound to remain well below February's pre-pandemic levels and are likely to be down by around a quarter from their respective levels a year earlier.

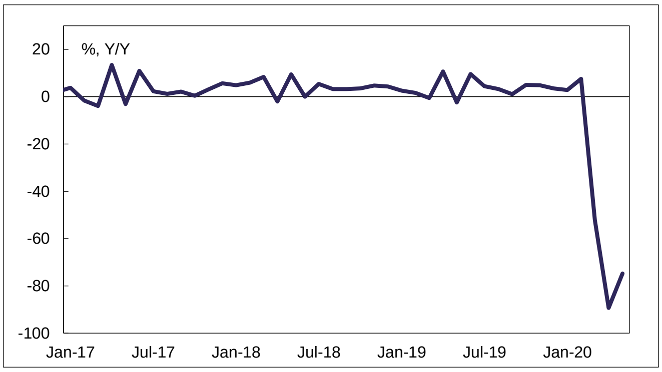
In the US, Friday will bring producer price figures for June. Higher energy costs are expected to have pushed overall pipeline prices up on the month, albeit leaving the annual rate still in negative territory.

Germany: Exports, orders and production



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: Overnight stays in accommodation



Source: Destatis and Daiwa Capital Markets Europe Ltd.

UK

New fiscal package met with underwhelming market response

With Gilts stronger, sterling about a cent firmer and stocks largely weaker, the markets appear to have been relatively underwhelmed by yesterday's announcement of extra targeted government support despite the price tag of up to £30bn (about 1.4% of GDP). To try to soften the blow of the tapering of the government's Job Retention Scheme from next month, the new policies included a wage subsidy of £1k per worker for employers who bring back previously-furloughed employees and employ them until at least January; and subsidized 6-month work placements for the under-25s. To support the worst-affected sectors, VAT on hospitality and attractions was cut by 15ppts to 5% for six months, while the government will also subsidise consumers' restaurant meals on the first three days of each week next month. Among other measures, to support the housing market and promote spending on furniture and appliances, the government cut stamp duty on home purchases up to £500k through to end-March. On top of all that, the Treasury revised up by more than £30bn the estimated cost of its other measures announced since March, largely due to extra spending on healthcare.

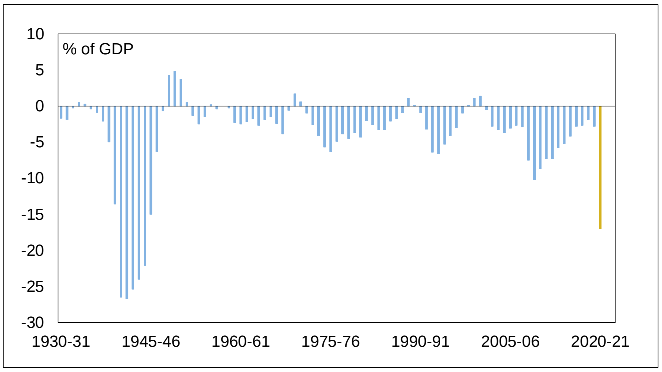
A modest economic boost from a big widening in the deficit?

The OBR will not opine on the government's announcement until next week. And even then it will likely have insufficient information to analyse the state of the public finances comprehensively. But the government's deficit is now highly likely to rise well above £350bn (16% of GDP) this fiscal year, more than seven times the OBR's estimate in March. Even if the MPC does not increase further its asset purchase target, the BoE will still fund most of that amount, a key reason why the Gilt market was unperturbed by yesterday's news. Nevertheless, despite the new incentives to spend, hospitality-sector demand is likely to remain constrained by social distancing and fears of Covid-19. And the new job subsidies could end up simply supporting the salaries of workers who would have returned to work anyway, rather than encouraging firms to retain furloughed workers who might otherwise be let go once the Job Retention Scheme expires. Indeed, today brought announcements of more than 5000 job cuts from two major UK retailers, the latest in a series of such reports from the sector. And it was revealed that senior government officials questioned the value-for-money of the package. Certainly, the overall macroeconomic boost will likely be modest compared to the current huge shortfall in demand relative to the pre-pandemic level. And a large share of the 9.3mn workers on the Job Retention Scheme at the end of last month will still, in due course, be made redundant. So, while the deficit as a share of GDP will be the highest since the Second World War, pressures for additional fiscal stimulus will persist into the autumn and beyond.

House prices expected to keep falling

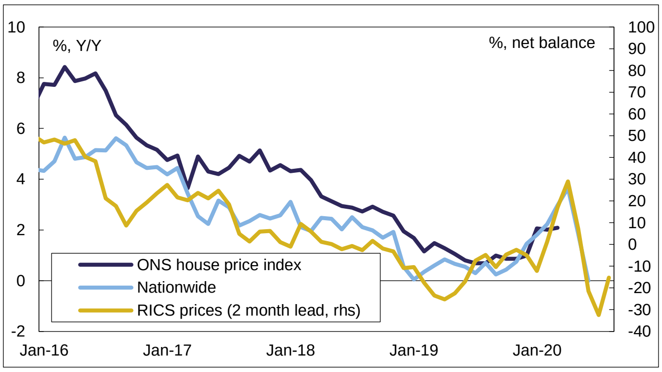
Today's RICS residential survey suggested some initial signs of recovery in the housing market in June with a notable increase in the number of enquiries, as new buyers and sellers returned to the market. But while the number of agreed sales also rose sharply – with the relevant survey component jumping to its highest since late-2013 – this principally reflected an easing of the backlog of sales delayed by lockdown. Indeed, while surveyors were more upbeat about expected sales over the near term, the average stock of properties on their books remained close to all-time lows. While the pace of decline on average moderated from May, surveyors continued to report that average house prices were down compared with a year earlier, with London agents reporting the steepest pace of decline of all the regions. In addition, price expectations for the coming twelve months remained negative. Of course, this survey was conducted ahead of the Chancellor's announcement yesterday of his temporary cut in stamp duty on house purchases up to £500k. But while this might well provide some near-term support to the market, we continue to expect housing market activity to remain relatively subdued against the backdrop of economic uncertainty and deteriorating labour market prospects.

UK: Public sector net borrowing*



*Gold represents forecast for 2020-21.Source: OBR and Daiwa Capital Markets Europe Ltd.

UK: House price indicators



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

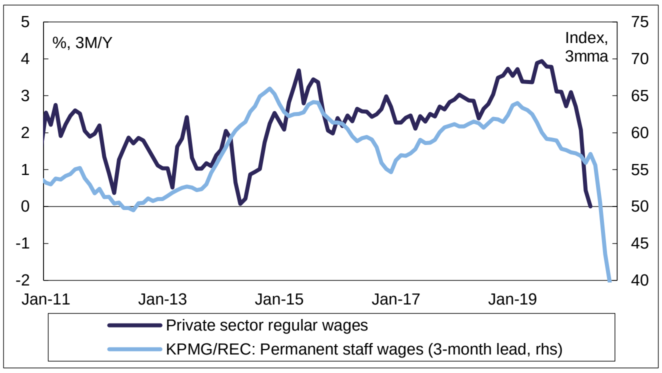
Downward pressure on pay

Yesterday's REC/KPMG report on jobs, which provides insights from job recruitment and employment consultancies, shone light on the troubled conditions in one section of the UK labour market. In particular, the survey reported another fall in hiring activity for both permanent and temporary staff last month, as firms continued to put on ice or shrink their recruitment plans due to the impact of the pandemic on economic activity. However, the pace of decline was much more moderate than in the prior two months, which saw record weakness. Overall demand for staff also fell at a somewhat softer pace. At the same time, however, labour supply increased at the sharpest rate since the global financial crisis in 2009, as newly-redundant and furloughed workers sought work. And despite the Chancellor's new initiatives, this seems bound to worsen as the Job Retention Scheme comes to an end in October – indeed, an Opinium and Bright Blue survey published earlier in the week suggested that roughly half of the 500 firms surveyed expected to let go of furloughed staff when the scheme ends, while a quarter of businesses implied they would struggle to increase their share of employee salaries when support will start to be phased out from next month. The Bank of England will also note the finding of the REC survey that the glut of labour supply from jobless and furloughed workers added significant downward pressure on pay.

The day ahead in the UK

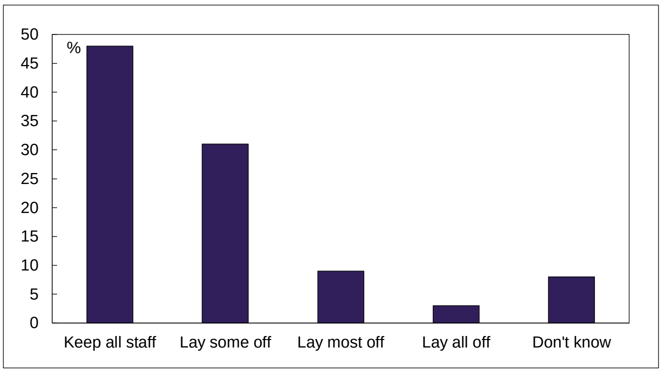
A quiet end to the week has no key UK economic data scheduled for release.

UK: Wage indicators



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Firms' outlook for furloughed workers



Source: Opinium and Bright Blue and Daiwa Capital Markets Europe Ltd.

European calendar

Today's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Germany		Trade balance €bn	May	**7.1**	7.0	3.5	**3.6**
UK		RICS house price balance %	Jun	**-15**	-25	-32	**-**

Auctions

Country		Auction
UK		sold £900mn of 0.125% 2041 index-linked bonds at an average yield of -2.436%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Yesterday's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
- Nothing to report -							

Auctions

Country		Auction
Germany		sold €4.215bn 2025 bonds at an average yield of -0.66%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's data releases

Economic data

Country		BST	Release	Period	Market consensus/ Daiwa forecast	Previous
France		07.45	Industrial production M/M% (Y/Y%)	May	15.4 (-24.0)	-20.1 (-34.2)
		07.45	Manufacturing production M/M% (Y/Y%)	May	22.8 (-23.6)	-21.9 (-37.1)
Italy		09.00	Industrial production M/M% (Y/Y%)	May	24.0 (-30.7)	-19.1 (-42.5)

Auctions and events

Country		BST	Auction / Event
Italy		14.00	Italian sovereign debt rating update from Fitch

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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