

Euro wrap-up

Overview

- As leaders met to discuss the EU recovery plan, Bunds made losses as data confirmed a rebound in euro area construction activity and a small uptick in headline inflation.
- Gilts made losses on a quiet day for UK economic news.
- The EU summit will continue tomorrow while economic data due in the coming week include the flash PMIs for July and UK retail sales for June.

Chris Scicluna
+44 20 7597 8326

Emily Nicol
+44 20 7597 8331

Daily bond market movements

Bond	Yield	Change
BKO 0 06/22	-0.682	+0.014
OBL 0 10/25	-0.661	+0.015
DBR 0 08/30	-0.457	+0.013
UKT 0½ 07/22	-0.102	+0.009
UKT 0% 06/25	-0.072	+0.010
UKT 4% 12/30	0.157	+0.021

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

Euro area

Small uptick in headline inflation confirmed

There were no surprises from the final estimates of euro area inflation in June, which today confirmed that the headline rate reversed the 0.2ppt drop seen in May to rise back to 0.3%Y/Y. The detail confirmed that the pickup reflected a moderation in the pace of decline in energy costs, which nevertheless still represented a significant drag (-9.3%Y/Y). In contrast, food inflation fell back further (down 0.2ppt to 3.2%Y/Y), while services inflation fell 0.1ppt to 1.2%Y/Y, matching the ten-month low recorded in April. So, with non-energy industrial goods inflation having moved sideways at a paltry 0.2%Y/Y, core inflation was confirmed to have fallen 0.1ppt to 0.8%Y/Y, a thirteen-month low. We continue to caution that the quality of these inflation figures remain uncertain. Indeed, while significantly improved from the previous two months, estimates of prices of 11% of items, including around 15% of all services and almost 10% of non-energy industrial goods, were imputed by the statisticians or judged to be of low reliability in June.

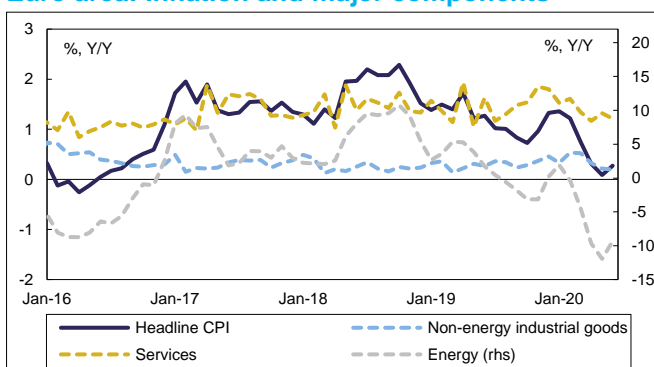
But underlying price pressures to remain weak

While we would expect far fewer items to be imputed over coming months, the inflation outlook remains more uncertain than usual, not least given the unpredictability of the pandemic and the response of businesses and consumers. While some firms will put prices up to cover the costs of social distancing, we would expect many particularly in hospitality and leisure to offer sizeable discounts to try to attract custom over coming months. And the 3ppt VAT cut in Germany through the second half of this year will also provide a modest downwards pull. Furthermore, the deteriorating labour market outlook – with a large share of furloughed workers likely to be made permanently unemployed in due course – seems bound to weigh on wage growth, further weakening domestically-generated inflation. As such, we expect core inflation to fall sharply to end the year close to zero. And with energy set to remain a drag over the near term, we still expect headline inflation briefly to slip into negative territory. Moreover, given the considerable spare capacity that will persist over coming years, as emphasised by ECB President Lagarde yesterday, price pressures will remain subdued over the policy horizon. Bang in line with the ECB's projection, we forecast headline inflation to average 0.8%Y/Y next year and just 1.3%Y/Y in 2022. And we expect core inflation to pick up to no more than 1.0%Y/Y in 2022 too. And today's ECB survey of professional forecasters saw aggregate inflation expectations for 2021 and 2022 revised lower from three months ago, by 0.2ppt to 1.0%Y/Y and 0.1ppt to 1.3%Y/Y respectively.

Construction output rebounded in May

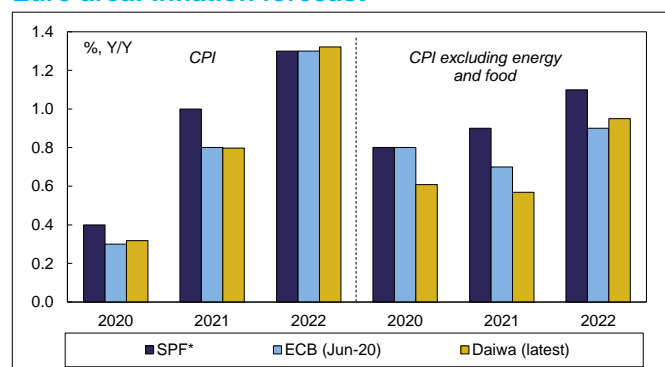
Construction sector output rebounded at a record pace in May, when several member states relaxed the restrictions on activity that had hit the sector hard over the prior two months. Overall production in the sector rose 27.9%M/M, with building

Euro area: Inflation and major components



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Inflation forecast



*ECB survey of professional forecasters. Source: ECB and Daiwa Capital Markets Europe Ltd.



work and civil engineering output rising at a similar rate, to return the highest level since February. That, however, reversed only about 60% of the drop in production caused by the pandemic, with the level still about 13% below January's peak. At the country level, growth was strongest in France and Italy, where output more than doubled from April's level, albeit still remaining more than one fifth below the respective peaks early in the year. In contrast, growth in Germany was minimal, up just 0.5%M/M following a drop of 5.4% the prior month, as the construction sector in that country had initially been little impacted by the restrictions on other forms of economic activity. Surveys suggest a further pickup in activity in the sector in June, particularly in France and Italy. However, they also suggest that new orders and confidence remain subdued. And the outlook for the sector appears downbeat. The pandemic raises existential doubts about the future of many types of commercial real estate, including retail malls, office space, hotels and restaurants. A weak outlook for manufacturing investment raises further doubts about business-related construction. And rising unemployment is likely to weigh on housing demand over coming quarters too.

The coming week in the euro area

The outcome of the EU Summit today and tomorrow could have a bearing on euro area financial markets on Monday, with a positive deal on the recovery package – that would see the European Commission borrow €750bn over the coming years and a sizeable share of the funds to be disbursed in the form of grants in 2021 and 2022 – likely to be supportive of BTPs. Meanwhile, the coming week's euro area economic data calendar will be dominated by July sentiment surveys. Likely of most interest will be Friday's flash PMIs, which are expected to suggest a further improvement in business conditions across member states at the start of Q3 as activity in the manufacturing and services sectors continued to move closer to some form of normality. As such, the euro area's composite PMI is expected to rise back above the key-50 level for the first time since February. This will be preceded by the Commission's preliminary consumer confidence indicator on Thursday, which is similarly expected to report a further modest recovery in household sentiment despite significant uncertainties regarding the labour market outlook. National sentiment surveys include Germany's GfK consumer, France's INSEE business (Thursday) and Italy's ISTAT consumer and business indices (Friday). Meanwhile, a quiet first half of the week brings just the euro area's balance of payments figures for May on Monday. Elsewhere, ECB Vice President de Guindos and Chief Economist Lane are scheduled to speak at separate online events on Monday.

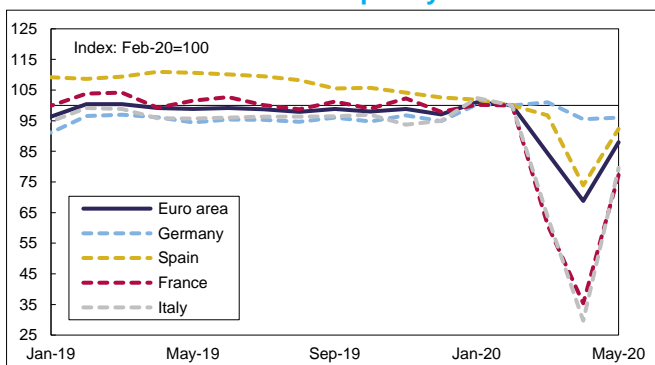
UK

The coming week in the UK

After the past week's [May GDP](#) report fell short of expectations, a key focus in the coming week will be the June retail sales figures on Friday – the first official ONS hard data for last month. With outdoor market stalls having resumed business on 1st on the month, and other non-essential stores allowed to reopen from the 15th, we would expect to see a further notable increase in sales on the month following growth of 10%M/M in May. That day will also bring the GfK's latest consumer confidence survey, as well as the flash PMIs for July. All are expected to show a further improvement in conditions at the start of Q3 as lockdown measures continued to gradually ease. Indeed, we expect the headline composite PMI to rise from 47.7 in June to back above 50 for the first time since February. Other releases due in the coming week include public finance figures for June on Tuesday, as well as the Rightmove house price survey for July on Monday. Elsewhere, BoE Chief Economist Haldane and external MPC member Tenreyro will appear before the Treasury Select Committee on Monday at their re-appointment hearings, while external MPC member Haskel will discuss the economic effects of Covid-19 at an online event on Thursday.

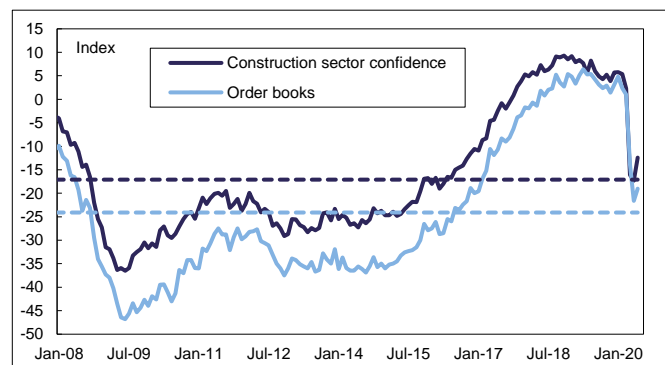
The next edition of the Euro wrap-up will be published on 21 July 2020

Euro area: Construction output by member state


















Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Euro area: Construction confidence and orders*







*Dashed lines are long-run averages. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Daiwa economic forecasts

		2019		2020				2020	2021	2022
		Q3	Q4	Q1	Q2	Q3	Q4			
GDP growth, %, Q/Q										
Euro area		0.3	0.1	-3.6	-11.0	7.5	1.0	-8.0	4.7	3.0
Germany		0.3	-0.1	-2.2	-6.5	3.5	1.0	-5.0	3.6	2.4
France		0.2	-0.1	-5.3	-13.0	12.0	1.5	-9.1	6.2	3.7
Italy		0.0	-0.2	-5.3	-13.0	9.0	0.8	-10.6	5.6	3.9
Spain		0.4	0.4	-5.2	-16.0	11.0	1.0	-11.1	6.5	3.5
UK		0.5	0.0	-2.2	-19.0	13.0	1.5	-10.4	5.0	2.9
Inflation, %, Y/Y										
Euro area										
Headline CPI		1.0	1.0	1.1	0.2	0.0	-0.2	0.3	0.8	1.3
Core CPI		0.9	1.2	1.1	0.9	0.4	0.0	0.6	0.6	1.0
UK										
Headline CPI		1.8	1.4	1.7	0.6	0.2	0.0	0.6	1.2	1.5
Core CPI		1.7	1.6	1.6	1.3	0.8	0.4	1.0	1.2	1.3
Monetary policy										
ECB										
Refi Rate %		0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Deposit Rate %		-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50
Net asset purchases*		0	20	20	140	140	140	140	20	20
BoE										
Bank Rate %		0.75	0.75	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Net asset purchases**		0	0	36	40	17	17	17	0	0

*Monthly target €bn, end of period. **Monthly target £bn, end of period.
Source: Bloomberg, ECB, BoE and Daiwa Capital Markets Europe Ltd.






















European calendar

Today's results							
Economic data							
Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised	
EMU	 Final CPI (core CPI) Y/Y%	Jun	0.3 (0.8)	0.3 (0.8)	0.1 (0.9)	-	
	 Construction output M/M% (Y/Y%)	May	27.9 (-11.9)	-	-14.6 (-28.4)	-18.3 (-31.0)	
Italy	 Industrial sales M/M% (Y/Y%)	May	41.9 (-25.9)	-	-29.4 (-46.9)	-29.8 (-47.2)	
	 Industrial orders M/M% (Y/Y%)	May	42.2 (-34.7)	-	-32.2 (-49.0)	-31.6 (-48.6)	
Auctions							
Country	Auction						
- Nothing to report -							

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Coming week's data calendar

The coming week's key data releases

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Monday 20 July 2020					
EMU		09.00 Current account €bn	May	-	14.4
Germany		07.00 PPI Y/Y%	Jun	-1.8	-2.2
UK		00.01 Rightmove house price index M/M% (Y/Y%)	Jul	-	2.1*
Tuesday 21 July 2020					
UK		07.00 Public sector net borrowing, £bn	Jun	39.9	54.5
Wednesday 22 July 2020					
- Nothing scheduled -					
Thursday 23 July 2020					
EMU		15.00 Preliminary consumer confidence	Jul	-12.0	-14.7
Germany		07.00 GfK consumer confidence	Aug	-4.8	-9.6
France		07.45 Business confidence	Jul	86	78
		07.45 Manufacturing confidence (production outlook)	Jul	84 (-)	77 (-15)
Friday 24 July 2020					
EMU		09.00 Preliminary manufacturing (services) PMI	Jul	49.6 (51.0)	47.4 (48.3)
		09.00 Preliminary composite PMI	Jul	51.0	48.5
Germany		08.30 Preliminary manufacturing (services) PMI	Jul	48.0 (50.2)	45.2 (47.3)
		08.30 Preliminary composite PMI	Jul	50.0	47.0
France		08.15 Preliminary manufacturing (services) PMI	Jul	53.2 (52.3)	52.3 (50.7)
		08./15 Preliminary composite PMI	Jul	53.8	51.7
Italy		09.00 Business (manufacturing) sentiment	Jul	- (85.5)	65.4 (79.8)
		09.00 Consumer confidence	Jul	104.0	100.6
UK		00.01 Preliminary GfK consumer confidence	Jul	-25	-27
		07.00 Retail sales including fuel M/M% (Y/Y%)	Jun	8.0 (-6.0)	12.0 (-13.1)
		07.00 Retail sales excluding fuel M/M% (Y/Y%)	Jun	7.5 (-3.7)	10.2 (-9.8)
		09.30 Preliminary manufacturing (services) PMI	Jul	52.0 (51.0)	50.1 (47.1)
		09.30 Preliminary composite PMI	Jul	51.0	47.7

*Previous figure for April 2020. Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions

Country	BST	Event / Auction
Monday 20 July 2020		
EMU		09.00 ECB's de Guindos scheduled to speak – The European response to the crisis
		15.30 ECB's Lane scheduled to speak at a webinar – Dominant currencies in trade and finance
UK		16.10 BoE's Haldane and Teneyro speak at re-appointment hearings before the Treasury Select Committee
Tuesday 21 July 2020		
EMU		09.00 Eurostat publishes quarterly data on government deficit/debt
Germany		10.30 Auction: €5bn of 0% 2022 bonds
UK		10.00 Auction: £3bn of 1.5% 2026 bonds
		11.30 Auction: £2.25bn of 0.625% 2050 bonds
Wednesday 22 July 2020		
Germany		10.30 Auction: €1.5bn of 1.25% 2048 bonds
UK		10.00 Auction: £3bn of 0.125% 2028 bonds
		11.30 Auction: £500mn of 1.25% 2032 index-linked bonds
Thursday 23 July 2020		
EMU		10.00 ECB's de Guindos scheduled to speak – Let's save tourism
UK		12.00 BoE's Haskel speaks at a webinar – From lockdown to recovery
Friday 24 July 2020		
- Nothing scheduled -		

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:

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

This research report is produced by Daiwa Securities Co. Ltd., and/or its affiliates and is distributed by Daiwa Capital Markets Europe Limited in the European Union, Iceland, Liechtenstein, Norway and Switzerland. Daiwa Capital Markets Europe Limited is authorised and regulated by The Financial Conduct Authority and is a member of the London Stock Exchange and Eurex Exchange. Daiwa Capital Markets Europe Limited and its affiliates may, from time to time, to the extent permitted by law, participate or invest in other financing transactions with the issuers of the securities referred to herein (the "Securities"), perform services for or solicit business from such issuers, and/or have a position or effect transactions in the Securities or options thereof and/or may have acted as an underwriter during the past twelve months for the issuer of such securities. In addition, employees of Daiwa Capital Markets Europe Limited and its affiliates may have positions and effect transactions in such securities or options and may serve as Directors of such issuers. Daiwa Capital Markets Europe Limited may, to the extent permitted by applicable UK law and other applicable law or regulation, effect transactions in the Securities before this material is published to recipients.

This publication is intended for investors who are not Retail Clients in the United Kingdom within the meaning of the Rules of the FCA and should not therefore be distributed to such Retail Clients in the United Kingdom. Should you enter into investment business with Daiwa Capital Markets Europe's affiliates outside the United Kingdom, we are obliged to advise that the protection afforded by the United Kingdom regulatory system may not apply; in particular, the benefits of the Financial Services Compensation Scheme may not be available.

Daiwa Capital Markets Europe Limited has in place organisational arrangements for the prevention and avoidance of conflicts of interest. Our conflict management policy is available at <http://www.uk.daiwacm.com/about-us/corporate-governance-regulatory>. Regulatory disclosures of investment banking relationships are available at <https://daiwa3.bluematrix.com/sellside/Disclosures.action>.