

Euro wrap-up

Overview

- Bunds were little changed but BTPs made further gains after the EU leaders agreed plans to allow the European Commission to issue €750bn of bonds and disburse a large share in grants.
- Gilts made gains as UK public borrowing in June undershot expectations.
- After a quiet day for economic data from the region tomorrow, Thursday will bring several July economic sentiment survey results from the euro area and UK.

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Daily bond market movements

Bond	Yield	Change
BKO 0 06/22	-0.683	+0.005
OBL 0 10/25	-0.669	+0.000
DBR 0 08/30	-0.464	+0.001
UKT 0½ 07/22	-0.115	-0.008
UKT 0% 06/25	-0.101	-0.019
UKT 4% 12/30	0.136	-0.013

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

Euro area

Recovery package a significant step forward for EU integration

Risk appetite in the euro area received a boost today as the marathon EU summit, which kicked off on Friday, finally reached agreement on the long-awaited recovery package, titled Next Generation EU (NGEU). As long as the European Parliament also gives its approval, in a step forward for EU integration, the European Commission will now be able to issue up to €750bn of bonds by the end of 2026. Up to €390bn of the funds (roughly 3% of EU GDP) will be dished out to member states in grants, with the remaining €360bn to be disbursed in the form of loans. Encouragingly, the disbursements of the grants will be relatively front-loaded: about 70% of the €312.5bn of grants under the main part of NGEU – the Recovery and Resilience Facility (RRF) – will be committed in 2021 and 2022, with the remainder to be committed by end-2023, as long as individual member states' plans are approved by their peers and the Commission. Meanwhile, the bonds to be issued by the Commission will have various maturities to create a yield curve and also help to smooth the profile of repayment, via future EU budgets and possible new revenue-raising mechanisms (e.g. a new levy on plastic waste), from 2028 up to end-2058. Some early repayments by the end of 2027 might also be permitted in certain circumstances.

Allocation criteria skewed to benefit Italy and Spain

While the total amount of grants will be less than the €500bn originally proposed by Germany, France and the Commission, it is substantive nevertheless. Indeed, in nominal terms the total amounts issued and disbursed should be higher than stated given that they are expressed in 2018 prices. Moreover, while the precise amount of funds to be received by individual member states cannot yet be calculated with precision, an amendment to the allocation criteria for disbursements in 2023, to include the magnitude of the declines in GDP this year and next, will benefit Italy and Spain at the expense of countries in Central Europe. So, Italy expects to get 28% of the funds raised, so that it will receive €80bn or more in grants and €125bn or more in loans. And Spain expects to get almost 19% of the total amount, including more than €70bn in grants. As a share of national GDP, Spain, Italy, Poland and Greece will be the biggest beneficiary of grants (all more than 4% of 2019 GDP). Of course, all countries will contribute via their payments to future EU budgets. And today's agreement was only sealed by providing for larger rebates for the so-called "frugal four" (Austria, Sweden, Denmark and Netherlands) from the €1.07trn 2021-27 budget (Multiannual Financial Framework, MFF) which was also agreed today. Also disappointingly, various NGEU proposals, including the provision of funds to recapitalize EU companies (the Solvency Support Instrument) and for research and innovation were either pared back or cut altogether.

Implications for ECB purchases, green bond market

A large share of the issuance by the European Commission will likely be purchased by the ECB under its asset purchase programmes. Indeed, the rules of the PSPP allow the Central Bank to hold 50% of any issue by an eligible supranational institution. And those purchases will, among other things, help to relax concerns about the ECB's holdings of certain national bonds hitting its self-imposed limits. Meanwhile, with projects related to climate objectives to account for 30% of the total NGEU spending and 2021-27 MFF, a similar share of the European Commission's issuance could take the form of green bonds, representing a massive boost to development of that market.

The coming two days in the euro area

While there are no key euro area economic data releases due tomorrow, ECB President Lagarde will participate in an online Washington Post live event. Thursday, meanwhile, will bring the first of the week's sentiment surveys, with most notably the Commission's flash consumer confidence indicator. This is expected to report a further modest recovery in household sentiment despite significant uncertainties regarding the labour market outlook. Germany's GfK consumer and France's INSEE business indicators will also be published.



UK

Government borrowing not quite as high as expected last quarter

While UK public borrowing dropped in June, the budget deficit remains on a sharp upwards trend. Having peaked at a record £72.3bn in April and fallen slightly the following month, the public sector net cash requirement fell by more than £25bn last month to £44.0bn, still some £29bn higher than a year earlier. The somewhat less reliable figure of public sector net borrowing (excluding banks) fell £10bn from a downwardly-revised level in May to a smaller-than-expected £35.5bn. That was still some £28.3bn higher than a year earlier and left the cumulative level of net borrowing in the first three months of the fiscal year at a whopping £127.9bn. However, the OBR acknowledged that the figures imply that total net borrowing currently appears set to fall short of its central scenario of £322bn (more than 16% of GDP) this fiscal year. However, that total will eventually include calls on the government loan guarantees, which have yet to crystallise.

Pressures on both sides of the government accounts

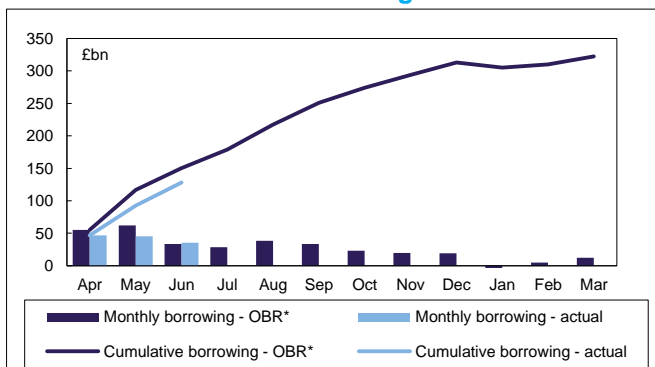
The deterioration in the public finances over the past three months reflects developments on both sides of the ledger. Central government expenditure was up 40%Y/Y over the same period, due principally to the Job Retention and Self-Employment Income Support Schemes, which together had supported the incomes of almost 12 million people by the end of June. Higher spending on public services, not least health care, also played a role. Meanwhile, tax payments were down 35%Y/Y from April to June, largely due to the Government’s VAT deferral scheme. The OBR noted that income tax and National Insurance Contributions (NICs) were surprisingly strong, pointing to a relatively slow shakeout in the labour market so far. But all the evidence, including daily announcements of plans for redundancies from many High Street names, points to a sharp increase in unemployment in the current quarter. Moreover, while net public sector debt was revised down slightly to 99.6% of GDP last quarter, it is bound to rise above 100% of GDP imminently. Of course, most if not all of the new borrowing this fiscal year will be absorbed by the BoE’s net purchases of Gilts.

The day ahead in the UK

Like in the euro area, it is set to be a quiet day for economic releases in the UK tomorrow. Thursday, meanwhile, will bring the CBI’s latest industrial trends survey for July. In addition, that day BoE external MPC member Haskel will discuss the economic effects of Covid-19 at an online event.

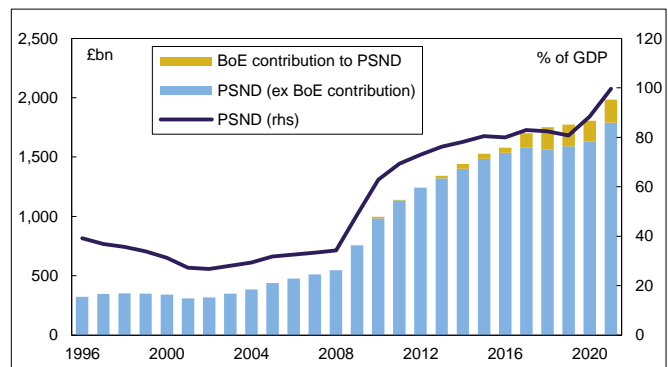
The next edition of the Euro wrap-up will be published on 23 July 2020

UK: Public sector net borrowing – FY20/21



*OBR estimate from July 2020 fiscal sustainability report. Source: OBR, ONS and Daiwa Capital Markets Europe Ltd.

UK: Public sector net debt*



*Annual data except final figure, which is June 2020. Source: ONS and Daiwa Capital Markets Europe Ltd.




European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ Daiwa forecast	Previous	Revised
UK	 Public sector net borrowing, £bn	Jun	34.8	39.9	54.5	44.7


Auctions

Country	Auction
Germany	 sold €4.1bn of 0% 2022 bonds at an average yield of -0.68%
UK	 sold £3bn of 1.5% 2026 bonds at an average yield of -0.064%
	 sold £2.25bn of 0.625% 2050 bonds at an average yield of 0.683%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Yesterday's results

Economic data

Country	Release	Period	Actual	Market consensus/ Daiwa forecast	Previous	Revised
EMU	 Current account €bn	May	8.0	-	14.4	14.3

Auctions

Country	Auction
- Nothing to report -	






Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's data releases

Economic data

Country	BST	Release	Period	Market consensus/ Daiwa forecast	Previous
- Nothing scheduled -					





Auctions and events

Country	BST	Auction / Event
EMU	 10.00	Eurostat to publish government deficit and debt figures for Q1
	 14.15	ECB President Lagarde to speak an at online event
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



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Thursday's data releases

Economic data

Country	BST	Release	Period	Market consensus/ Daiwa forecast	Previous
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)

Auctions and events

Country	BST	Auction / Event
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

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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