

Euro wrap-up

Overview

- Bunds made gains as concerns about coronavirus infections continued to mount, while the ECB's account suggested that the Governing Council would be in a better position to reassess the policy stance next month.
- Gilts also made modest gains on a quiet day for UK economic releases.
- Tomorrow will bring the release of the flash August PMIs and consumer confidence from the euro area and UK, as well as UK retail sales figures.

Emily Nicol

+44 20 7597 8331

Daily bond market movements

Bond	Yield	Change
BKO 0 06/22	-0.688	-0.006
OBL 0 10/25	-0.697	-0.015
DBR 0 08/30	-0.497	-0.032
UKT 0½ 07/22	-0.035	-0.011
UKT 0% 06/25	-0.031	-0.007
UKT 4% 12/30	0.225	-0.011

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

Source: Bloomberg

Euro area

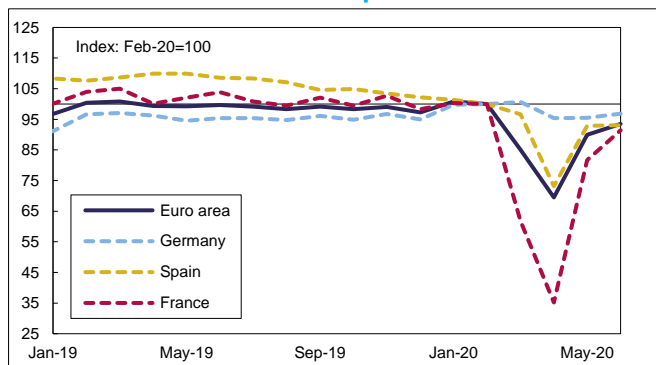
Construction output maintains upward trend

Given the containment measures across much of the euro area and supply-disruption associated with the pandemic, the hit to the construction sector was particularly severe in the second quarter, with activity collapsing 10%Q/Q. This was the steepest quarterly drop on record and almost four times the decline seen in Q1, leaving output down by more than 13½% compared with a year earlier. But, as in other sectors, the easing of lockdowns has seen a resurgence in activity across construction sites, with today's release showing that output in June rose a further 4%M/M, following a jump of 29.4%M/M in May. The improvement was again broad based, with building construction up 4.5%M/M and civil engineering up 2.3%M/M, albeit both remained below their pre-pandemic levels. Indeed, while overall construction had recovered around three quarters of the slump in activity between January and April, output was still more than 7% lower than the peak earlier in the year. Among the larger member states, France once again recorded the strongest growth (up 12%M/M having more than doubled in May) to leave construction output having recovered a little more than 85% of the initial post-Covid decline. But this still left construction activity in France a little more than 8½% lower than this year's peak. The improvement in Spain slowed in June (0.2%M/M), similarly leaving output more than 8% below the pre-pandemic level. And while the recovery in Germany has also been more modest than in France, this followed a much smaller drop through to April.

ECB account suggests full allotment of PEPP envelope is main assumption

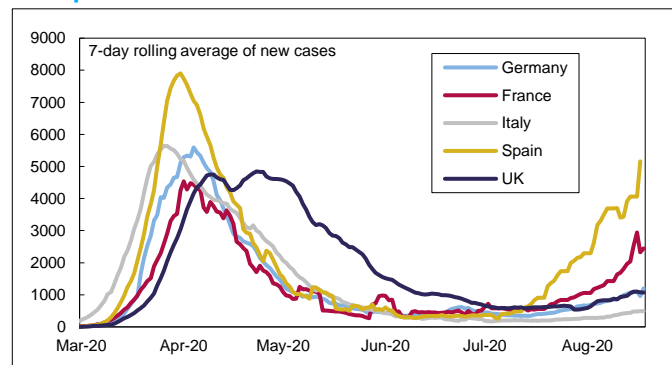
Today also brought the publication of the detailed account of the ECB's July meeting, where its monetary policy measures – re-committing to keeping interest rates at the current levels or lower until the inflation outlook has moved back to target and reaffirming the PEPP purchase envelope at €1.35tn – were left unchanged. But reports subsequently suggested that, in contrast with comments made in Lagarde's press conference, there was not unanimity on the Governing Council with regards to the full allotment of the PEPP programme. And with some data having surprised on the upside and some of the downside risks surrounding the June meeting having receded, the argument was made that the net purchase envelope should be considered a ceiling rather a target. However, while the ECB's baseline scenario presented in June had become more plausible, ECB Chief Economist Lane also cautioned that the initial bounce back was not representative of the longer-term recovery, and all in all members assessed that risks to the growth outlook remained skewed to the downside. As such, the account confirmed that the main presumption in July was that the PEPP envelope would have to be used in full.

Euro area: Construction output



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Europe: Coronavirus cases in selected countries



Source: ECDC and Daiwa Capital Markets Europe Ltd.


 Follow us on twitter [@DaiwaEurope](https://twitter.com/DaiwaEurope)

September forecast update to provide greater insight

Of course, members recognised that there would be greater clarity about the pace of recovery – including new hard data and news on fiscal measures – as well as updated ECB staff projections at the time of the September meeting, with the account noting that the Governing Council would then be in better position to reassess the policy stance and tools. The recent spike in new coronavirus infections in France and Spain in particular (see chart above) seems likely to weigh on the euro area's economic revival over the near term. And the levelling off in recent high-frequency data also suggests that greater caution with respect to the near-term growth outlook might also prevail. Against this backdrop, and with the euro having subsequently risen to a two-year high against the dollar, risks to the medium-term inflation outlook seem bound to be skewed significantly to the downside. So, with Lagarde having previously stated that policy will be determined by the inflation outlook, the Governing Council might well hint at a more pronounced easing bias next month. Certainly, we continue to expect a further policy easing in due course, probably at the December Governing Council meeting, with the PEPP envelope to be increased by a further €650bn to €2.0trn, and the purchases to last at least until end-2021.

The day ahead in the euro area










The economic focus tomorrow will be on the flash releases of the PMIs and the European Commission's consumer confidence indicator for August. With economic activity in many sectors having returned to greater normality as lockdown measures were relaxed over recent months, and after the euro area's composite index jumped to a near-two-year high of 54.9 in July, the surveys are expected to point to ongoing expansion in both the manufacturing and services sectors. However, the resurgence of the pandemic over the past couple of weeks in certain member states has been matched with a levelling off in some high-frequency data. And so, we would not be surprised to see the PMIs fall back from last month. The strengthening of the euro might also weigh on the manufacturing indices. And while household sentiment has also improved following the initial post-Covid outbreak slump, renewed concerns about the rise in coronavirus infections across the region might cause a weakening in the Commission's confidence indicator too.

UK

The day ahead in the UK















After a day bereft of economic data today, tomorrow will be a busy one for UK releases. In terms of hard data, July's retail sales will be most noteworthy, with a further modest increase expected last month as containment measures continued to relax. This notwithstanding, tomorrow's flash GfK consumer confidence survey is likely to point to ongoing pessimism among households not least related to the deteriorating labour market outlook, which is likely to hold back growth in consumption over coming months. Certainly, the preliminary August PMIs might well point to an accelerated pace of job shedding as the phasing out of the government's jobs retention scheme started this month. Nevertheless, with the pandemic relatively well contained in the UK, the headline composite PMI is expected to point to continued expansion, after jumping to 57.0 in July from 47.7 in June. Friday will also bring the CBI's industrial trends survey for August and public finance figures for July.

European calendar


Today's results						
Economic data						
Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
EMU	 Construction output M/M% (Y/Y%)	Jun	4.0 (-5.9)	-	27.9 (-11.9)	29.4 (-10.5)
Germany	 PPI Y/Y%	Jul	-1.7	-1.8	-1.8	-
Auctions						
Country	Auction					
France		sold €1.5bn of 1.75% 2024 bonds at an average yield of -0.59%				
		sold €3.4bn of 0% 2025 bonds at an average yield of -0.57%				
		sold €2.1bn of 1% 2027 bonds at an average yield of -0.45%				
		sold €395mn of 0.1% 2028 index-linked bonds at an average yield of -0.97%				
		sold €231mn of 3.15% 2032 index-linked bonds at an average yield of -1.10%				
		sold €330mn of 0.1% 2036 index-linked bonds at an average yield of -0.99%				
UK		sold £1.1bn of 0.125% 2028 index-linked bonds at an average yield of -2.882%				

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 Preliminary manufacturing (services) PMI	Aug	52.7 (54.5)	51.8 (54.7)
		09.00 Preliminary composite PMI	Aug	55.0	54.9
		15.00 Preliminary consumer confidence	Aug	-15.0	-15.0
Germany		08.30 Preliminary manufacturing (services) PMI	Aug	52.3 (55.2)	51.0 (55.6)
		08.30 Preliminary composite PMI	Aug	55.0	55.3
France		08.15 Preliminary manufacturing (services) PMI	Aug	53.0 (56.3)	52.4 (57.3)
		08.15 Preliminary composite PMI	Aug	57.0	57.3
UK		00.01 Preliminary GfK consumer confidence	Aug	-25	-27
		07.00 Retail sales including fuel M/M% (Y/Y%)	Jul	2.0 (0.1)	-1.6 (13.9)
		07.00 Retail sales excluding fuel M/M% (Y/Y%)	Jul	0.2 (1.5)	13.5 (1.7)
		07.00 Public sector net borrowing £bn	Jul	28.3	34.8
		09.30 Preliminary manufacturing (services) PMI	Aug	54.0 (57.0)	53.3 (56.5)
		09.30 Preliminary composite PMI	Aug	56.9	57.0
		11.00 CBI industrial trends survey, total orders	Aug	-34	-46

Auctions and events

Country	BST	Auction / Event
France		- Moody's to publish latest French sovereign debt rating report

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>.