Daiwa Capital Markets

Euro wrap-up

Overview

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- Bunds made modest gains even as the latest German and French business surveys beat expectations.
- Gilts made more significant gains as the BoE's MPC left its policy and forward guidance unchanged, and Haldane remained the only member to vote to reduce the asset purchases target.
- Friday will bring euro area bank lending data along with further economic surveys from Germany, Italy and the UK.

Daily bond market movements

Bond	Yield	Change
BKO 0 06/23	-0.662	-0.001
OBL 0 04/26	-0.574	-0.003
DBR 0 08/31	-0.188	-0.008
UKT 0$^1/_8$ 01/23	0.062	-0.015
UKT 0$^1/_8$ 01/26	0.352	-0.027
UKT 4¾ 12/30	0.746	-0.033

*Change from close as at 4:00pm BST.
Source: Bloomberg

Euro area

German ifo survey beats expectations, with current conditions and expectations both improved

Like yesterday's flash June PMIs, today's national business survey results from Germany and France pointed to accelerated economic expansion at the end of Q2 despite ongoing challenges posed by supply bottlenecks. Indeed, like the German flash PMIs, the ifo business climate indices significantly exceeded expectations. In particular, with new cases of Covid-19 falling to the lowest levels since August, more than half of the population having received at least one vaccine dose and pandemic restrictions easing, the ifo index of current conditions rose almost 4pts to 99.6, above the pre-pandemic level and indeed the highest since July 2019. Moreover, the index of expectations for the coming six months rose more than 1.0pt to 104.0, the best reading since December 2010. As a result, the survey's headline business climate index rose 2.6pts to 101.8, firmly above the long-run average and the highest since October 2018.

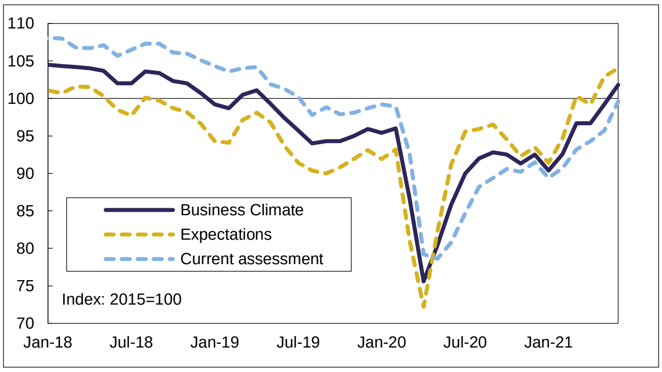
Broad-based improvement in German business confidence

The improvement this month was again broad-based, with the indices of current conditions increasing in every sector. Tallying with the rebound in the manufacturing PMI, and despite concerns of supply bottlenecks, manufacturers signalled that conditions in June were the best since September 2018, while those in wholesaling were the most favourable since February of that year. In both sectors, conditions were judged to be far superior to the respective long-run averages. With further relaxation of pandemic restrictions, current conditions in services were judged to be the best since February 2020 just ahead of lockdown, with IT and logistics firms reporting strong demand. And with the reopening of non-essential stores, current conditions for retailers improved the most on the series to be the most favourable since mid-2019 and better than the long-run average. Admittedly, construction firms reported only a marginal improvement in June, albeit judging the situation still to be favourable by historical standards.

Expectations improving markedly in services and retail

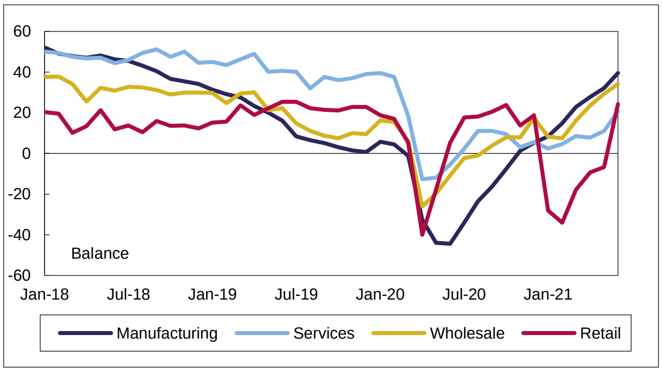
Looking ahead, with all members of the population aged 12 and over now able to book a vaccine, the anticipation of further progress back to normal gave a big boost to sectors most harmed by the pandemic. Indeed, expectations for the coming six months in services were the most favourable on the series – with firms in hospitality notably more optimistic – and expectations in retail were judged on balance to be favourable for the first time since November 2017. Wholesalers were the most upbeat about the outlook since early 2018. And while they were on balance still downbeat about the outlook, expectations among construction firms were the least adverse since the onset of the pandemic. Finally, while concerns about the implications of supply shortages of intermediate items weighed on expectations somewhat, most manufacturing sub-sectors were very upbeat, not least producers of machinery and equipment and electrical and electronic items.

Germany: ifo business climate indices



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: ifo current conditions indices



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

INSEE French business climate index best since 2007

While the French flash PMIs had suggested a slight moderation of momentum in June, today's INSEE survey results aligned with the improvement in the German survey indicators, reporting a marked improvement in business confidence. Indeed, the headline INSEE index rose a larger-than-expected 5pts to 113, not just well above the long-term average and pre-pandemic level but the highest since July 2007. As in Germany, the improvement in sentiment was driven by a marked improvement in services and retail sentiment. Indeed, not least thanks to much greater optimism in hospitality, but with several other sub-sectors (including ICT, freight transport, and estate agents) also very upbeat, the balance of opinion on the general outlook for services over the coming three months rose to the highest since September 2000, well above the long-run average. And the equivalent index for retailers rose to the best since January 1991. Construction firms reported a big improvement in activity over the past few months and remained upbeat about the future thanks to increased order books.

Factory price expectations at series high, transport goods output continues to lag

Sentiment in the manufacturing sector stabilised at an elevated level, with firms reporting much improved production expectations above the long-run average. News on order books, including demand from abroad, was also positive. Strikingly and uniquely, however, the French transport goods sub-sector continued to report significant weakness in production, impeded by supply constraints, over recent months. And selling price expectations in manufacturing rose to the highest on the survey dating back more than three decades. More happily, the INSEE survey reported an improvement in the overall employment climate index to 104, above its long-term average and only marginally shy of the pre-pandemic level in February 2020. And firms also signalled a greater willingness to invest.

The day ahead in the euro area

Tomorrow, focus will remain on national economic sentiment data, with Italy's ISTAT due to publish its latest business and consumer survey results. Following on from today's stronger-than-expected German and French business surveys, the Italian manufacturing confidence indicator is expected to rise further after reaching its highest level in more than a decade in May. And we look for further significant improvement in confidence in the services sector and among Italian consumers too. Likewise, the German GfK consumer survey should also signal increased optimism among households heading toward the second half of the year. Other euro area data due tomorrow include bank lending and deposit figures for May.

UK

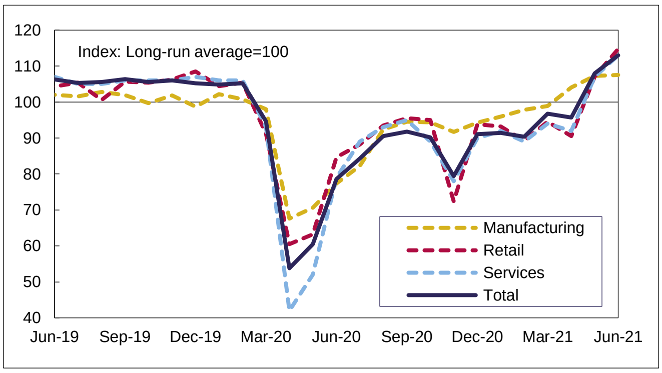
BoE leaves policy unchanged as Haldane departs the MPC as lone hawk

In line with expectations, the BoE's MPC today left its policy stance unchanged. So, it agreed to continue with its gilt purchase programme, leaving the respective target at £875bn and the total asset purchase target at £895bn. With the total stock of assets held in the Asset Purchase Facility having earlier this week reached £823bn, including £78bn of the £150bn programme of gilt purchases announced last November, and the recent pace of purchases to be maintained at least until the August meeting, the targets are still expected to be fulfilled by the end of the year. Once again, the only member of the Committee to vote to reduce the target stock of gilt purchases – by £50bn – was Chief Economist Andy Haldane, for whom this was his final MPC meeting before leaving the BoE. Haldane's successor has yet to be nominated. One credible candidate would be Gertjan Vlieghe, who is currently scheduled to leave the MPC at the end of August and – having a more balanced assessment of the outlook than Haldane – this month again voted for no change to policy. Moreover, Vlieghe's nominated replacement as an external MPC member – Catherine Mann – was instinctively dovish when she was previously Chief Economist of the OECD. So, on balance, the make-up of the Committee going forward might prove to be marginally less hawkish.

Inflation now expected to rise above 3%

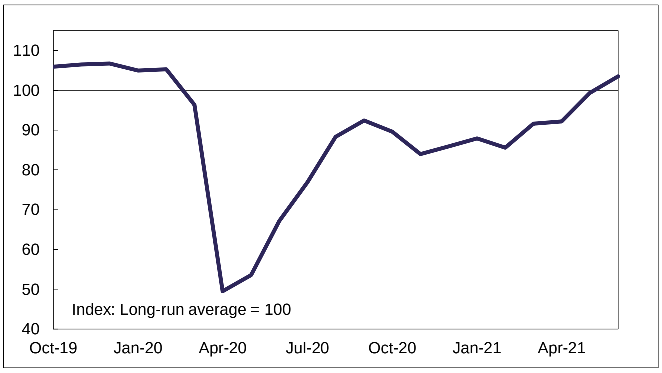
Just like the current policy stance, the MPC also left its forward policy guidance unchanged, repeating that "the Committee does not intend to tighten monetary policy at least until there is clear evidence that significant progress is being made in

France: INSEE business climate indices



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

France: INSEE employment climate index



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

eliminating spare capacity and achieving the 2% inflation target sustainably." However, the policymakers acknowledged that the economic data – both in the UK and abroad – had been stronger than expected when the BoE had published updated forecasts just last month. In particular, with evidence of a rebound in consumer spending reflected in retail sales and high-frequency data, Bank staff had revised up their expectations for the level of GDP in the current quarter by around 1½%. So, despite the pick-up in new coronavirus cases and delay to further relaxation of pandemic restrictions, output in June is now expected to be only around 2½% below the level in Q419. In addition, the number of furloughed jobs – which the ONS's latest coronavirus business survey results today suggested had fallen to about 6% or around 1.5mn workers in early June – had declined faster than expected. Inflation of 2.1%Y/Y in May had been 0.3ppt above the BoE's forecast. And inflation was now expected by the BoE to rise above 3%Y/Y later this year.

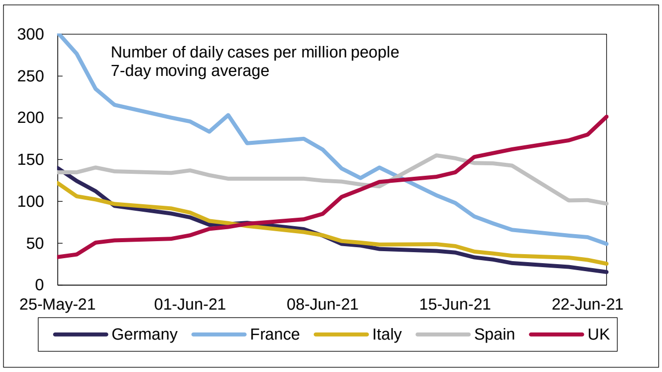
Rise in inflation still expected to be transitory

While the likely near-term path of GDP and inflation was thus now higher than it previously thought, the BoE noted that underlying pay growth was still likely to be around pre-Covid rates. And inflation expectations were thought to remain well-anchored. So, echoing the judgements of other major central banks, the MPC also stated that it expects the current price pressures to be "transitory". And it asserted that after "a temporary period of strong GDP growth and above-target CPI inflation... growth and inflation will fall back." Indeed, while the MPC acknowledged that near-term upwards price pressures could prove larger than expected, it also saw downside risks to the inflation outlook. And it reiterated that policy should be determined by the medium-term inflation outlook rather than transient factors, as well as the need to "lean strongly against downside risks… and ensure that the recovery [is] not undermined by a premature tightening in monetary conditions". So, today's policy decision is likely to have been a straightforward one for the vast majority of MPC members (indeed, probably all bar Haldane). And while the uncertainty of the outlook means that we cannot rule out that the MPC will eventually opt to raise Bank Rate as soon as next year, in our view the medium-term focus means that take off is still more likely to come in 2023.

The day ahead in the UK

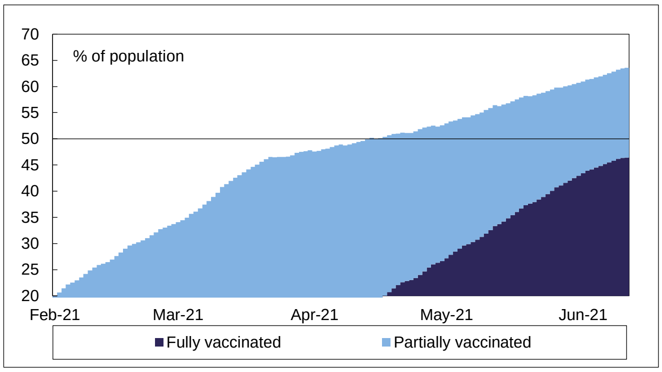
The week in the UK will end with the release of the latest GfK consumer confidence and CBI distributive trades surveys, which are highly likely to remain consistent with firm growth this month, despite the UK Government's decision to extend the remaining restrictions on activity for a further four weeks. The headline GfK consumer confidence indicator is expected to rise a further 2pts to -7 in June, to match its February 2020 pre-pandemic level.

Coronavirus cases



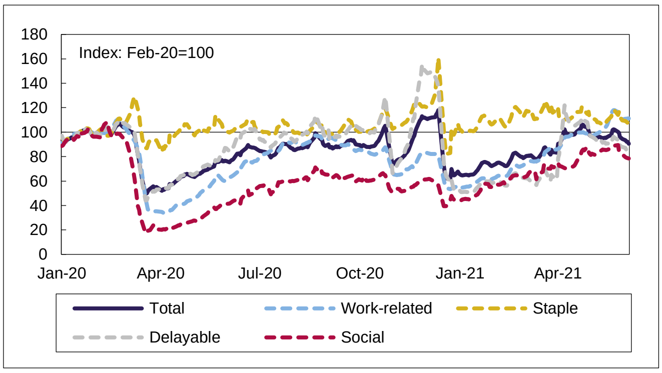
Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

UK: Vaccination progress



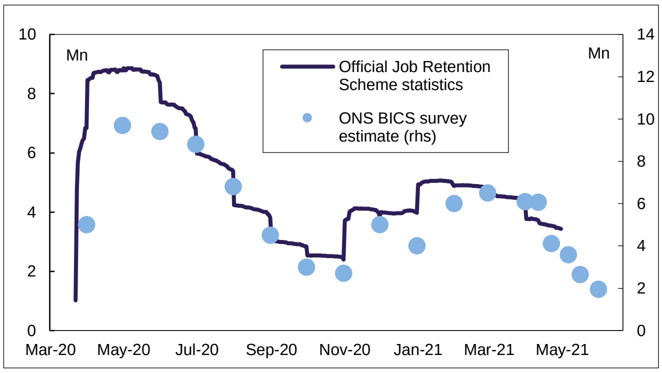
Source: Our World in Data and Daiwa Capital Markets Europe Ltd.

UK: Credit/debit card spending



Source: BoE, ONS and Daiwa Capital Markets Europe Ltd.

UK: Workers on furlough



Source: UK Government Coronavirus Job Retention Scheme statistics, ONS and Daiwa Capital Markets Europe Ltd.

European calendar

Today's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Germany	Ifo current assessment balance (expectations)	Jun	**99.6 (104.0)**	97.5 (104.0)	95.7 (99.2)	-
France	INSEE business confidence	Jun	**113**	110	108	-
	INSEE manufacturing confidence (production outlook)	Jun	**107 (27)**	108 (20)	107 (18)	**- (19)**
Spain	Final GDP Q/Q% (Y/Y%)	Q1	**-0.4 (-4.2)**	-0.5 (-4.3)	0.0 (-8.9)	-
UK	BoE Bank Rate %	Jun	**0.10**	*0.10*	0.10	-
	BoE Gilt purchase target £bn	Jun	**875**	*875*	875	-

Auctions

Country	Auction
- Nothing to report -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
EMU	09.00	M3 money supply Y/Y%	May	8.5	9.2
Germany	07.00	GfK consumer confidence	Jul	-4.0	-7.0
Italy	09.00	ISTAT economic sentiment	Jun	-	106.7
	09.00	ISTAT consumer (manufacturing) confidence	Jun	112.0 (112.0)	110.6 (110.2)
Spain	08.00	PPI Y/Y%	May	-	12.8
UK	00.01	GfK consumer confidence	Jun	-7	-9
	11.00	CBI distributive trades survey, reported sales	Jun	-	43

Auctions and events

Country	BST	Event
EMU	-	ECB President Lagarde participates in Euro Summit
Italy	10.00	Auction: €1bn of 0.15% 2051 index-linked bonds
	10.00	Auction: €2.75bn of 0% 2022 bonds
UK	12.00	BoE publishes Quarterly Bulletin Q221

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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