

Euro wrap-up

Overview

- Bunds made gains as euro area inflation was confirmed to have eased slightly in June and exports fell in May.
- Gilts reversed yesterday's losses on a quiet day for UK economic news.
- The coming week will bring the ECB's latest Governing Council meeting, which will bring amended forward guidance to take account of its strategic policy review. Flash PMIs and consumer confidence indices for July are also due.

Chris Scicluna
+44 20 7597 8326

Emily Nicol
+44 20 7597 8331

Daily bond market movements

Bond	Yield	Change
BKO 0 06/23	-0.691	-0.006
OBL 0 04/26	-0.642	-0.014
DBR 0 08/31	-0.354	-0.018
UKT 0 ¹ / ₈ 01/23	0.122	-0.024
UKT 0 ¹ / ₈ 01/26	0.332	-0.027
UKT 4 ³ / ₄ 12/30	0.629	-0.035

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

Euro area

ECB to adjust guidance to ensure consistency with new strategy

The main event of the coming week will be the ECB's monetary policy announcement on Thursday. What had at one stage looked likely to be a non-event is now very much live, with the Governing Council set to adjust its forward policy guidance to take account of its [strategic policy review](#) conclusions announced last week. As expected, the review confirmed a new symmetric 2% medium-term inflation target, slightly higher and less ambiguous than the previous stated aim to achieve inflation "below but close to" 2%. And while the ECB refrained from following the Fed with a deliberate average inflation targeting strategy and an explicit desire to overshoot 2% for a while, it noted that when the economy is close to the lower bound monetary policy will need to be "especially forceful or persistent to avoid negative deviations from the inflation target becoming entrenched". In her press conference on the review, Christine Lagarde suggested that the ECB's reaction function would not change in response to the new strategy. However, in an interview on Sunday, she made clear that the forward policy guidance would be rewritten at the forthcoming policy meeting, implying the potential for market-moving news.

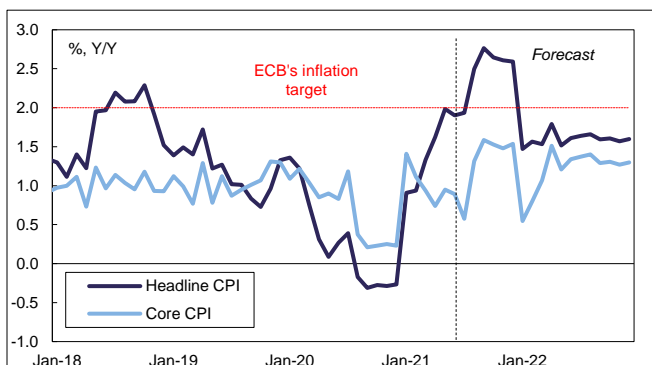
Lengthy and wordy guidance provides plenty of scope for revisions

The ECB's current forward guidance is multifaceted and wordy. Among other things, it states that the Governing Council "expects the key ECB interest rates to remain at their present or lower levels until it has seen the inflation outlook robustly converge to a level sufficiently close to, but below, 2% within its projection horizon, and such convergence has been consistently reflected in underlying inflation dynamics". It notes that the ECB will continue to conduct net asset purchases under the PEPP programme "with a total envelope of €1.85trn until at least the end of March 2022 and, in any case, until it judges that the coronavirus crisis phase is over." Moreover, the ECB "will continue to reinvest the principal payments from maturing securities purchased under the PEPP until at least the end of 2023" and net purchases under the regular APP (currently €20bn per month) will "run for as long as necessary to reinforce the accommodative impact of its policy rates, and to end shortly before it starts raising the key ECB interest rates". In addition, the ECB will "continue reinvesting, in full, the principal payments from maturing securities purchased under the APP for an extended period of time past the date when it starts raising the key ECB interest rates". So, there is plenty of scope for simplification and amendment of the guidance at the forthcoming meeting. Whether the changes will be market-moving, however, will obviously depend on the detail.

Inflation outlook incompatible with target

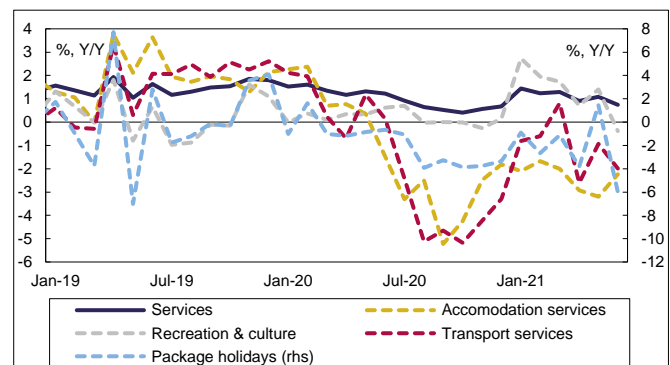
The revised guidance will also depend on the Governing Council's assessment of the inflation outlook. However, it will not be presented with updated economic projections. While there remain near-term price pressures (see below), there is no

Euro area: Headline and core inflation



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Services inflation



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

significant evidence of second-round effects on wages and expectations. And uncertainty remains high with the pandemic having taken a turn for the worse once again. So, while Executive Board member Schnabel said this week that inflation could converge to target “maybe sooner than some people expect at the moment”, the most recent forecasts presented last month – which foresee inflation remaining below target by the end of the projection horizon in 2023 – remain valid.

New guidance to call for “forceful and persistent” monetary policy over the horizon

Unlike last week’s agreement on the strategic review, the coming week’s deal on new policy guidance will not need to be unanimous, and a minority of Governing Council members (most likely from the national banks of Germany, Austria and Netherlands) are likely to dissent. As such, the ECB’s revised guidance will be able to be dovish at the margin, underscoring the need for policy to remain “forceful” and “persistent” over the horizon. So, the Governing Council might be expected to state that the key ECB interest rates are expected to remain at their present or lower levels until it has seen the inflation outlook robustly converge to 2% within its projection horizon. And it might add guidance on the expected timeframe for that expectation, e.g. perhaps signalling the likelihood of no rate hikes before 2023 at the earliest. In addition, while the Governing Council will likely reaffirm that net PEPP purchases are expected to be maintained until at least the end of March 2022 and until it judges that the coronavirus crisis phase is over, it might give new guidance as to the nature of the net purchases to be conducted once the PEPP has concluded. In this context, a signal that the post-pandemic purchases would retain much of the flexibility of the PEPP, to allow for continued mitigation of fragmentation risks, would clearly benefit periphery bonds. With respect to the immediate path of policy, however, we expect the Governing Council to leave to the September meeting the decision as to whether to maintain the PEPP purchases at a significantly higher pace than at the start of the year. Likewise, we do not expect to see new guidance on the total magnitude of net purchases to come, whether a revision to the existing PEPP envelope or a new commitment with respect to post-PEPP purchases.

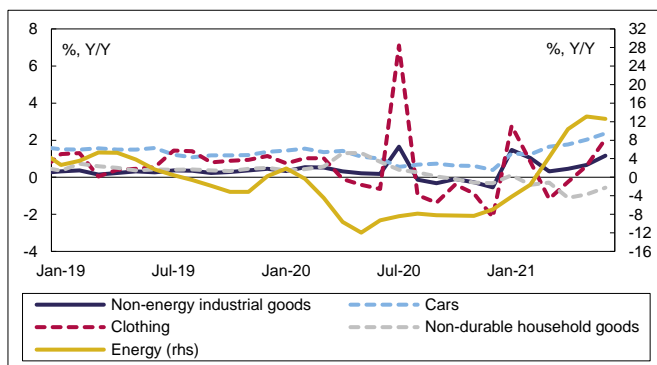
Euro area inflation confirmed at 1.9%Y/Y in June

Today’s final euro area inflation figures for June predictably made no significant changes from the flash estimates, and thus confirmed the 0.1ppt drop in the preliminary headline estimate to 1.9%Y/Y. Likewise, as in the initial estimate, core inflation dropped 0.1ppt to 0.9%Y/Y. Within the detail, energy inflation eased back a little less than initially estimated, dropping 0.5ppt from May’s near-decade high to a still-elevated 12.6%Y/Y, to account for more than half of annual inflation. Meanwhile, bang in line with the preliminary release, services inflation fell 0.4ppt to 0.7%Y/Y, principally due to weakness in the transport sector, with inflation of package tours down almost 7½ppts to -6.0%Y/Y and air transport costs down -7.3%Y/Y, a drop of 1½ppts on the month. But the decline in the price of accommodation services eased slightly in June, perhaps reflecting the further relaxation of hospitality restrictions. Meanwhile, non-energy industrial goods inflation jumped 0.5ppt to 1.2%Y/Y in June (unchanged from the flash release), the highest since January, driven principally by higher clothing inflation, up 1.4ppts to 2.1%Y/Y, partly due to the timing of summer discounting. Inflation of non-durable household goods also ticked higher, while car inflation rose 0.4ppt to 2.4%Y/Y, a series high.

Inflation set to move temporarily higher through H21

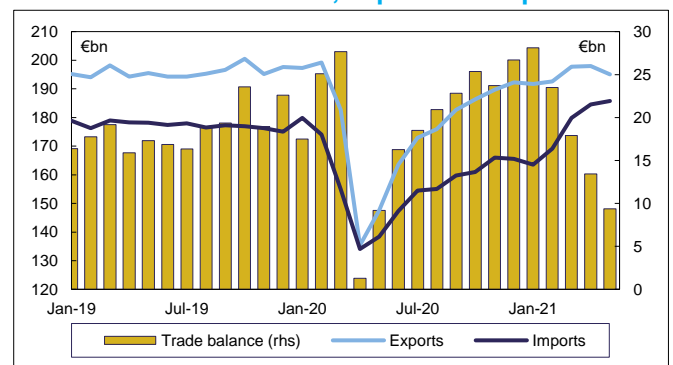
Like elsewhere, the outlook for inflation in the euro area remains highly uncertain due not least to the recent surge in coronavirus cases and some re-imposition of pandemic restrictions, extreme weather events in various member states, and ongoing supply bottlenecks of numerous items. Admittedly, with higher inflation of clothing due in part to changes in the timing of seasonal discounting, the pick-up in that component in June is unlikely to be long-lasting. But base effects associated with Germany’s VAT cut last year will push a range of items higher from this month. Surveys suggest that producer input costs rose significantly higher in July. And given recent developments in the oil market, there was a further sizeable uptick in petrol prices in the first two weeks of July. As such, we have now pushed back to the start of next year the anticipated easing in energy inflation related to pandemic base effects. And with core inflation likely to remain relatively elevated over the near term, headline inflation will rise above 2½%Y/Y through the second half of 2021 and could surpass 3.0%Y/Y. This notwithstanding, given the lack of evidence of second-round effects related not least to still significant amounts of spare capacity in the labour market, we maintain our view that this period of higher inflation will prove transitory.

Euro area: Goods inflation



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Trade balance, export and import values*



*Seasonally adjusted. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Headline inflation is likely to fall back below 2% from January 2022 and remain below the ECB's target over the coming two years too.

Euro area exports dragged lower in May

While there was limited evidence of higher producer prices being passed on to consumers, today's euro area trade data for May seemingly further highlighted the impact of supply bottlenecks on exports as [manufacturing production](#) remained impeded. In particular, the value of exports fell 1.5%M/M in May, the first monthly drop in four and the steepest since April 2020. And while this left the average level so far in Q2 more than 1% higher than the Q1 average, exports were still 2% below their pre-pandemic peak. Exports to numerous countries, including the US, China, Japan and Turkey were markedly weaker in May, but exports to the UK ticked up after a prolonged period of weakness. In marked contrast, growth in the value of imported goods rose for the fourth consecutive month (0.7%M/M), to leave them trending a whopping 8½% higher than the Q1 average and more than 6½% higher than the February 2020 level. Consequently, the euro area's merchandise trade surplus on an adjusted basis narrowed to a twelve-month low of €9.4bn. Admittedly, the value of imports remains boosted by relative price changes. Indeed, prices of imported manufactured goods rose 0.8%M/M in April, the fifth successive monthly increase, to be up 5.7%Y/Y, the most in more than a decade.

The coming week in the euro area

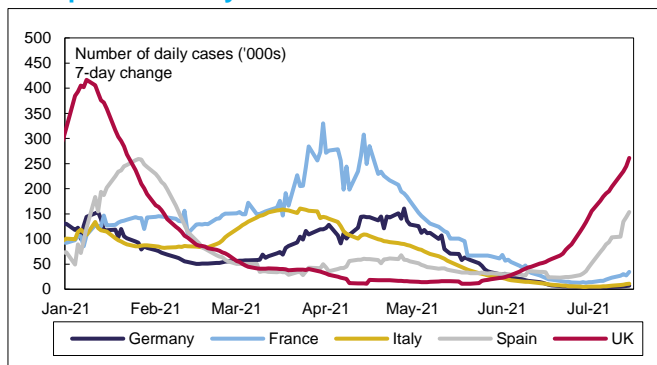
While the aforementioned ECB announcements on Thursday will be the main event in the coming week, the most notable economic data in the euro area will also come in the second half of the week, with the Commission's preliminary euro area consumer confidence indicator for July due for release on Thursday and the flash PMIs for the same month due on Friday. These surveys are expected to suggest continued strengthening of recovery momentum thanks to the easing in lockdown measures and accelerated vaccination programmes. We note, however, the risks of a weakening in both surveys, but particularly the flash PMIs, due to an increase in the number of new coronavirus cases in many member states (in particular Spain and the Netherlands) which has brought a tightening of restrictions in certain countries, as well as the extremely severe flooding currently impacting Germany, Belgium and the Netherlands. The European Commission's flash consumer confidence index is expected to increase by 0.8pt to -2.5, which would be the highest in two decades. In addition, the flash euro area services activity PMI is expected to rise 1.7pts to 60.0, which would similarly be the highest in more than two decades. However, the euro area manufacturing PMI is expected to fall back by almost 1pt from the prior month's series high, albeit remaining elevated at 62.5. That survey also seems bound to continue to report backlogs of work close to record highs and ongoing strong input price pressures in the sector. Overall, the euro area composite output PMI is expected to rise ½pt to 60.1, which would be the highest since June 2006, underscoring the likelihood of a firm return to positive GDP growth in Q2. Ahead of these survey indicators, euro area construction output figures for May are due on Monday with external current account data for the same month due on Tuesday. That day will also bring the ECB's latest quarterly bank lending survey as well as German producer price data for June, which will provide further insight into price pressures at the factory gate. In May, the German PPI rose 7.2%Y/Y, the fastest rate of growth since October 2008.

UK

The coming week in the UK

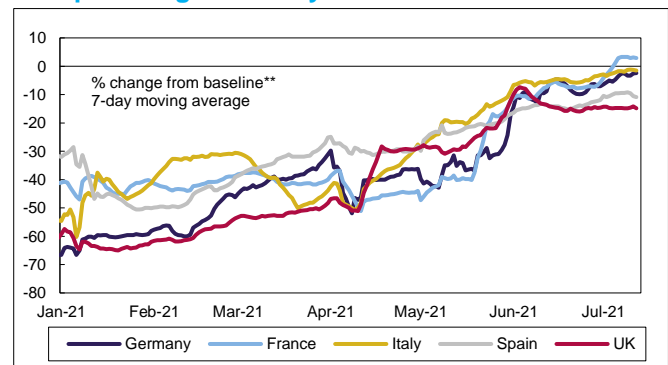
While the number of new coronavirus cases per capita in the UK is once again now among the world's highest, the start of the coming week will see the removal of almost all of the remaining Covid-19 restrictions in England. With many firms already struggling to maintain output in the face of labour shortages exacerbated by the revival in the pandemic, and the vulnerable also likely to become more cautious, the further removal of restrictions could yet have a negative net impact on UK economic activity.

Europe: New daily coronavirus cases



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Europe: Google mobility trends*














*Travel for recreation and retail purposes. **The baseline is the median value, for the corresponding day of the week, during the five week period 3 Jan – 6 Feb 2020. Source: Google Mobility Report and Daiwa Capital Markets Europe Ltd.

Data-wise, like in the euro area, the focus will be on survey data for July, including the CBI's industrial trends survey (Thursday), and the preliminary PMIs and GfK consumer confidence survey (Friday). We expect these to be consistent with firm growth this month, although given the growing number of coronavirus cases, we may see some levelling off in business optimism. The composite PMI is expected to remain close to June's record high of 62.2, thanks to robust conditions in both manufacturing and services. Also of interest on Friday are retail sales data for June, which are likely to reveal that spending received a boost from the European football championships, not least related to items such as televisions, food and drink. We expect to see growth of at least ½%M/M in retail sales excluding petrol, leaving sales up about 11% from the pre-pandemic level in February 2020. Consequently, retail sales will be around 1.4% higher in Q2 compared with Q1. Among other data to be published in the coming week, Wednesday sees the release of public sector borrowing figures for June.




In other news, BoE speak in the coming week will also be of interest given the recent [hawkish tone](#) from MPC members Ramsden and Saunders. Among other MPC members, the thoughtful Jonathan Haskel will give a speech about the impact of Covid-19 on the UK economy on Monday, while Deputy Governor Broadbent will be discussing the mismatch induced by the pandemic and outlook for inflation on Thursday.

Daiwa economic forecasts

	2020	2021				2022	2020	2021	2022
	Q4	Q1	Q2	Q3	Q4	Q1			
GDP growth, %, Q/Q									
Euro area 	-0.6	-0.3	1.2	2.4	1.2	1.0	-6.7	4.5	4.6
UK 	1.3	-1.6	4.4	2.5	2.3	1.0	-9.8	6.7	5.9
Euro area									
Headline CPI 	-0.3	1.1	1.8	2.4	2.6	1.5	0.3	2.0	1.6
Core CPI 	0.2	1.2	0.9	1.2	1.5	0.8	0.7	1.2	1.2
UK									
Headline CPI 	0.6	0.6	2.0	2.7	3.4	3.4	0.9	2.2	2.3
Core CPI 	1.3	1.2	1.8	2.5	2.9	2.8	1.4	2.1	2.1
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
PEPP envelope* (€bn) 	1850	1850	1850	1850	1850	1850	1850	1850	1850
BoE									
Bank Rate % 	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Bond purchases** (£bn) 	895	895	895	895	895	895	895	895	895

*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	
Euro area 	EU27 new car registrations Y/Y%	Jun	10.4	-	53.4	-	
	Final CPI (core CPI) Y/Y%	Jun	1.9 (0.9)	1.9 (0.9)	2.0 (1.0)	-	
	Trade balance €bn	May	9.4	-	9.4	13.4	
Italy 	Trade balance €bn	May	5.6	-	5.9	-	
Spain 	Trade balance €bn	May	0.1	-	-1.3	-	
Auctions							
Country	Auction						
- Nothing to report -							

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's data calendar

The coming week's key data releases

Country	BST	Release	Period	Market consensus/ <i>Daiwa</i> forecast/actual	Previous
Monday 19 July 2021					
Euro area		10.00 Construction output M/M% (Y/Y%)	May	-	-2.2 (42.3)
UK		00.01 Rightmove house prices M/M%	Jul	-	0.8
Tuesday 20 July 2021					
Euro area		10.00 Current account balance €bn	May	-	22.8
Germany		07.00 PPI Y/Y%	Jun	8.5	7.2
Wednesday 21 July 2021					
Italy		09.00 Industrial sales M/M% (Y/Y%)	May	-	3.3 (105.1)
UK		07.00 Public sector net borrowing, excluding banking groups £bn	Jun	21.5	24.3
Thursday 22 July 2021					
Euro area		12.45 ECB refinancing rate %	Jul	<u>0.00</u>	0.00
		12.45 Marginal lending facility rate %	Jul	<u>0.25</u>	0.25
		12.45 Deposit rate %	Jul	<u>-0.50</u>	-0.50
		15.00 Commission's preliminary consumer confidence indicator	Jul	-2.5	-3.3
France		07.45 INSEE manufacturing confidence (production outlook)	Jul	107 (28)	107 (27)
UK		11.00 CBI industrial trends survey, total orders (business optimism)	Jul	16 (35)	19 (38)
Friday 23 July 2021					
Euro area		09.00 Preliminary manufacturing (services) PMI	Jul	62.5 (59.5)	63.4 (58.3)
		09.00 Preliminary composite PMI	Jul	60.0	59.5
Germany		08.30 Preliminary manufacturing (services) PMI	Jul	64.1 (59.5)	65.1 (57.5)
		08.30 Preliminary composite PMI	Jul	60.7	60.1
France		08.15 Preliminary manufacturing (services) PMI	Jul	58.2 (59.0)	59.0 (57.8)
		08.15 Preliminary composite PMI	Jul	58.5	57.4
UK		00.01 GfK consumer confidence	Jul	-8	-9
		07.00 Retail sales, including auto fuel, M/M% (YY%)	Jun	0.3 (9.3)	-1.4 (24.6)
		07.00 Retail sales, excluding auto fuel, M/M% (YY%)	Jun	-0.2 (7.4)	-2.1 (21.7)
		09.30 Preliminary manufacturing (services) PMI	Jul	62.5 (62.0)	63.9 (62.4)
		09.30 Preliminary composite PMI	Jul	62.0	62.2

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions

Country	BST	Event / Auction
Monday 19 July 2021		
UK		11.00 BoE MPC member Haskel to give a speech on "Will the pandemic scar the economy"
Tuesday 20 July 2021		
Euro area		09.30 ECB bank lending survey
Germany		10.30 Auction: €4bn of 0% 2028 bonds
UK		10.00 Auction: £1.25bn of 1% 2071 bonds
Wednesday 21 July 2021		
Germany		10.30 Auction: €1.5bn of 1.25% 2048 bonds
Thursday 22 July 2021		
Euro area		12.45 ECB monetary policy announcement
		13.30 ECB President Lagarde speaks at post-Governing Council press conference
UK		09.30 BoE Deputy Governor Broadbent will discuss the mismatch induced by the pandemic and its impact on inflation
Friday 23 July 2021		
- Nothing scheduled -		

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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

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