

Euro wrap-up

Overview

- As concerns about the spread of the delta variant persisted, Bunds rallied despite survey evidence of an increase in business demand for bank loans and a rise in German producer price inflation to the highest since 1982.
- On a quiet day for UK news, Gilts reversed initial gains to end the day little changed.
- The next main focal point is the ECB policy announcement on Thursday when the Bank's forward guidance will be revised, with data for UK public borrowing and Italian industrial sales coming first on Wednesday.

Chris Scicluna
+44 20 7597 8326

Daily bond market movements

Bond	Yield	Change
BKO 0 06/23	-0.726	-0.024
OBL 0 04/26	-0.695	-0.035
DBR 0 08/31	-0.415	-0.027
UKT 0 7/8 01/23	0.077	+0.005
UKT 0 1/8 01/26	0.274	+0.002
UKT 4 4% 12/30	0.559	-

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

Source: Bloomberg

Euro area

ECB survey reports pickup in loan demand from businesses

Ahead of Thursday's Governing Council meeting, today's ECB bank lending survey results are unlikely to change the dynamic of the monetary policy debate, being consistent with broad stability in the sector as economic growth momentum turned for the better last quarter. Among other things, banks reported an increase in demand for loans by firms and households last quarter, with the increase in demand from enterprises being the first reported since the surge in Q220. And while that increase was concentrated principally in France and Spain, and moderate overall with a net balance of 8% up from -15% in Q1, it suggests a pickup in growth in lending to firms in the current quarter. Moreover, for the first time since Q319, firms' financing needs for fixed investment contributed positively to loan demand. Debt refinancing, restructuring and M&A activity also played a role in boosting loan demand. But despite a pickup in orders, financing needs for working capital were unchanged against the background of large liquidity buffers and improved revenues. Encouragingly perhaps, a much larger net balance of 31% of banks expects to see increased loan demand in the current quarter.

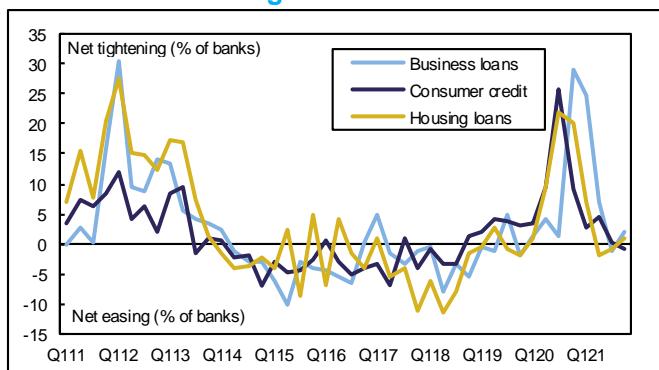
Increased demand for housing loans and consumer credit too

Tallying with strong actual growth in such lending, and buoyed by favourable housing market prospects and historically low mortgage interest rates, the increase in household demand for housing loans reported in Q2 was widespread across the member states and elevated, with a net balance of 36%, up from -7% in Q1. The pickup reported in demand for consumer credit was also relatively widespread (with the exception of France) but more moderate, with the net balance of 11%, up from -19% in the prior quarter, supported by improved consumer confidence and increased spending on durable goods. Banks evidently expected such positive drivers to be maintained – in Q3 they expect to see a further net increase in demand for housing loans (12%) and a much larger net increase in demand for consumer credit (31%).

Little change in credit standards on loans to firms

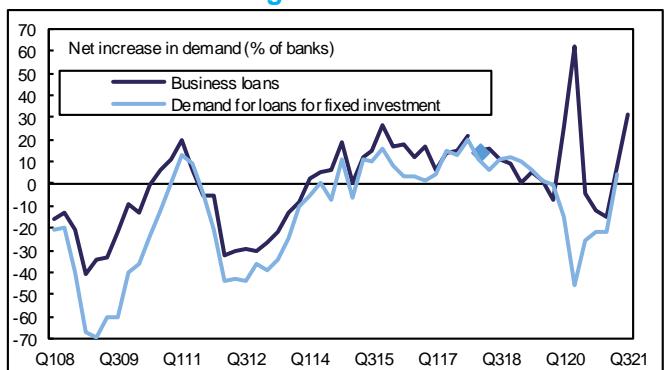
On the supply side, the survey suggested that financial conditions – the key current focus of ECB policy – were neither significantly more nor less favourable last quarter. Having tightened significantly last year and a little further in Q1, credit standards on loans to firms were little changed in Q2, with the net percentage of banks reporting a tightening down to -1% in Q2 from +7% in Q1. Credit standards were broadly unchanged for SMEs and eased slightly for large firms. Among the large member states, they eased in Germany but were unchanged in France, Spain and Italy. Ample liquidity, in part provided by the ECB's TLTRO III operations, provided a favourable impact on credit standards on business loans. Banks also reported broadly unchanged credit standards for housing loans and consumer credit. But while standards on housing loans and

Euro area: Net change in credit standards*



*Q321 figure is survey forecast. Source: ECB, Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Net change in demand for loans



*Q321 figure is survey forecast. Source: ECB, Refinitiv and Daiwa Capital Markets Europe Ltd.

consumer credit are expected to be little changed in Q3, banks expect a slight net tightening of credit standards on loans to firms. And after banks reported a tightening of standards in Q2 on loans to firms that did not benefit from government guarantees, the phasing out of such policy support might raise concerns of further such tightening ahead.

German producer prices maintain upwards pressure

Broadly in line with expectations, German producer price inflation accelerated 1.3 ppts in June to 8.5% Y/Y, the fastest since January 1982. On the month, prices rose 1.3% M/M, down just 0.2 ppt from May's thirteen-year high and well above the average since pressures first emerged in December. Given developments in oil markets, and exacerbated by Germany's carbon-pricing scheme, energy prices rose a further 2.2% M/M and 16.9% Y/Y, the highest annual rate since 2008. Excluding energy prices, however, PPI inflation still increased 1.0 ppt to a record 6.0% Y/Y. That was due to another big rise in prices of intermediate goods, up 1.8% M/M and a series high of 12.7% Y/Y, with broad-based pressures led by metals and timber (both up more than 80% Y/Y) and chemicals (18.8% Y/Y). But crucially, pass-through to producer prices of capital goods (up 0.2% M/M and 1.3% Y/Y) and consumer durables (0.2% M/M and 1.8% Y/Y) remained relatively limited. And while producer prices of consumer non-durables rose a relatively firm 0.7% M/M, that took the annual rate to a still moderate 1.5% Y/Y, with food inflation up to 1.9% Y/Y. Overall, therefore, this morning's data suggest that manufacturers continue largely to absorb higher input costs within their margins, rather than passing them on in terms of higher prices of finished goods.

The coming two days in the euro area

The focus is now firmly on Thursday's ECB meeting, where the Governing Council will adjust its forward guidance to take account of its recent [strategic policy review](#) conclusions including the 2% symmetric inflation target. Unlike the agreement on the strategic review, the new policy guidance will not need to be unanimous. So, the dovish majority will not need to make concessions to the hawks. With inflation still not expected to return to target before 2024, and concerns about the current spread of the delta variant, we expect the new guidance to underscore the need for policy to be "forceful" and "persistent" over the horizon. The Governing Council might 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. signalling the likelihood of no rate hikes before 2023 at the earliest. While the Governing Council will also 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 add new guidance as to the nature of the net purchases to be conducted once the PEPP has concluded. A signal that the post-pandemic purchases would retain the flexibility of the PEPP to allow for 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.

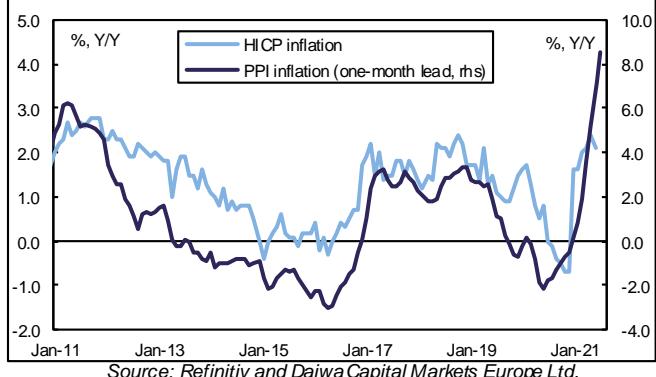
Data-wise, after a quiet day in the euro area tomorrow with only Italian industrial sales data for May scheduled, Thursday brings the European Commission's flash consumer confidence index. While this is expected to rise to a two-decade high, the spread of the delta variant and recent extreme flooding in Germany and other countries pose downside risks. Separately, the French INSEE survey of business conditions in July will give a guide as to what to expect from Friday's flash PMIs.

UK

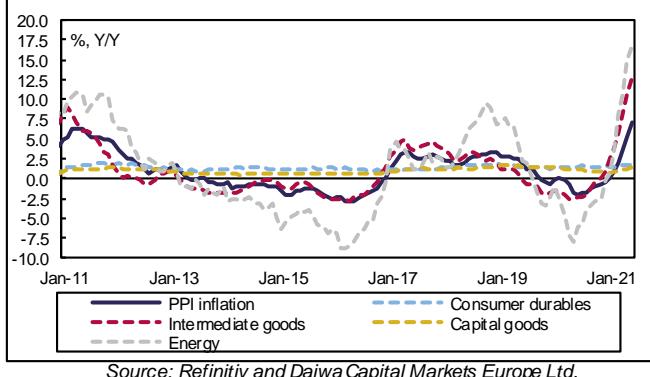
The coming two days in the UK

After an uneventful day in the UK, tomorrow brings public sector borrowing figures for June, with the CBI's industrial trends survey following on Thursday. In May, UK public sector net borrowing again undershot expectations at £24.3bn (excluding banking groups), more than £4bn below the OBR's most recent forecast. Meanwhile, with the pandemic re-intensifying in the UK, supply bottlenecks and labour shortages binding, and recent export demand disappointing, the CBI industrial trends survey might suggest that manufacturing sector optimism has peaked. Finally, following the hawkish comments (from [Saunders and Ramsden](#)) and dovish comments (from [Haskel and Mann](#)) over recent days, Thursday's speech by BoE Deputy Governor Broadbent on the inflation outlook will be closely watched to gauge the balance of views on the MPC.

Germany: Consumer and producer price inflation



Germany: Producer price inflation by type of good



European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <u>Daiwa forecast</u>	Previous	Revised
Euro area	Current account balance €bn	May	11.7	-	22.8	22.1
Germany	PPI M/M% (Y/Y%)	Jun	1.3 (8.5)	1.2 (8.6)	1.5 (7.2)	-

Auctions

Country	Auction
Germany	sold €3.349bn of 0% 2028 bonds at an average yield of -0.58%
UK	sold £1.25bn of 1% 2071 bonds at an average yield of 0.861%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	BST	Release	Period	Market consensus/ <u>Daiwa forecast</u>	Previous
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

Auctions and events

Germany	10.30	Auction: €1.5bn of 1.25% 2048 bonds
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Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Thursday's releases

Economic data

Country	BST	Release	Period	Market consensus/ <u>Daiwa forecast</u>	Previous
Euro area	12.45	ECB refinancing rate %	Jul	0.00	0.00
	12.45	Marginal lending facility rate %	Jul	0.25	0.25
	12.45	Deposit rate %	Jul	-0.50	-0.50
	15.00	Commission's preliminary consumer confidence indicator	Jul	-2.6	-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)

Auctions and events

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

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The next edition of the Euro wrap-up will be published on 22 July 2021

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