

# Euro wrap-up

## Overview

- Bunds made further big gains as investors signalled increased pessimism about the economic outlook amid increased concerns about energy supply.
- Gilts also made sizeable gains as a survey signalled further weakness in UK retail sales in June.
- Wednesday will bring May data for euro area industrial production and UK GDP and final June inflation figures from Germany, France and Spain.

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### Daily bond market movements

Bond	Yield	Change
BKO 0.2 06/24	0.319	-0.092
OBL 1.3 10/27	0.754	-0.099
DBR 0 02/32	1.126	-0.113
UKT 1 04/24	1.752	-0.091
UKT 1 1/4 07/27	1.736	-0.106
UKT 4 1/4 06/32	2.066	-0.108

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

## Euro area

### ZEW survey suggests deterioration in expectations for growth and inflation

Like last week's Sentix survey, today's German ZEW indices suggested that investor sentiment about current conditions and the future outlook has deteriorated significantly over the past month, as concerns about near-term recession, disruption to energy supply, higher interest rates and pandemic restrictions in China intensified. Indeed, the survey respondents were notably more downbeat about current conditions compared with last month, with the relevant balance falling a larger-than-expected 18.2pts to -45.8, a fifteen-month low, albeit still well above the pandemic trough in May 2020 (-93.5). Reflecting the increasingly uncertain outlook, both domestic and global, investors were even more gloomy about the coming six months, with the index dropping 25.8pts to -53.8, the lowest since the euro crisis at the end of 2011. Expectations for energy-intensive and export-oriented sectors fared much worse last month, but subdued household demand also weighed on consumer-facing sectors. Meanwhile, the weaker outlook for economic activity was accompanied by expectations of lower inflation ahead, with the relevant survey balance still firmly in negative territory at -25.2 to suggest that ECB concerns about second-round effects from current high inflation are judged to be overblown.

### Concerns about Europe's gas supply mount as Nord Stream 1 shuts down (for now)

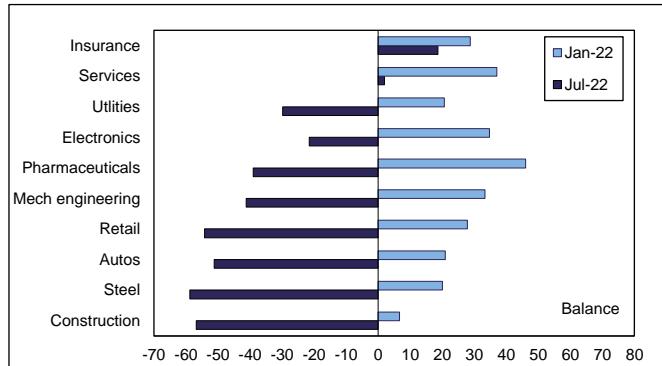
According to the ZEW survey, the balance for profit expectations in the utilities sector fell a substantial 45pts, the largest monthly drop since the series began. This no doubt reflects growing concerns about the impact of further potential energy supply constraints ahead following disruptions to the flow of gas from Russia over the past couple of months ostensibly due to maintenance. Indeed, between the start of May and mid-June, EU natural gas imports from Russia fell by more than 60%, supposedly in part due to a delay in the return of operational parts for the Nord Stream 1 pipeline following maintenance. So in the first week of July, imports were also roughly 60% below the average minimum for that week in the five years ahead of the pandemic, even before the scheduled two-week maintenance shutdown of the pipeline that started yesterday and which many fear will persist for the foreseeable future. In part due to warmer weather earlier in the year, natural gas storage in Germany (64.4%) is currently some 20pts above the level at this time last year, although it remains well below levels seen in the previous two years and short of the target of 80% by 1 November. And with a key US LNG terminal damaged by a fire unlikely to return to full capacity until later this year, while Norway today extended capacity reductions for at least another week sending European gas price futures up again, Europe remains extremely vulnerable to a lasting reduction to Russia's gas supply, which could have marked implications for the outlook for economic growth, inflation and ECB policy.

#### Germany: ZEW investor sentiment indices\*



\*Dashed lines represent long-run averages. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

#### Germany: ZEW investor profit expectations



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

## The day ahead in the euro area

Tomorrow brings the euro area industrial production numbers for May. Despite the surge in Irish production that month (13.9%M/M), production was subdued in Germany, France and Spain and fell by more than 1%M/M in Italy. So, based on national figures published so far, euro area IP likely rose just 0.2%M/M in May, although April's outturn (0.4%M/M) should be revised higher. Wednesday will also bring updated estimates for June inflation from Germany, France and Spain. Due to temporary policy measures, the flash results saw Germany's headline HICP rate fall back a bigger-than-expected 0.5ppt to 8.2%Y/Y. But this contrasted with the upwards shifts in the other major member states, with the French HICP rate up 0.7ppt to 6.5%Y/Y and Spanish HICP rate up 1.5ppts to 10.0%Y/Y.

## UK

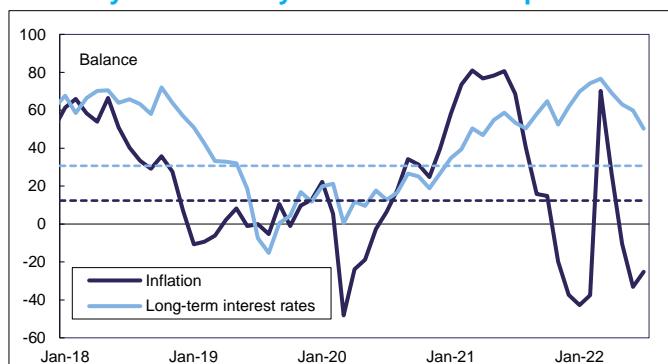
### Retail sales survey illustrated marked hit to discretionary spending amid rising prices

The UK's BRC retail sales monitor for June was predictably weak. Despite a temporary boost to food sales due to the long bank holiday weekend at the start of the month, total sales in June were down for the fourth consecutive month and by 1%Y/Y, with like-for-like sales down 1.3%Y/Y. But while clothing sales were encouraged by the warmer weather, the BRC noted that discretionary spending was hit hard in June, particularly white goods and homeware, amid tighter household budgets. Indeed, like-for-like non-food sales were down more than 4%3M/Y, while food sales were up 1.6%3M/Y, the first such rise in eight months. Admittedly, the year-on-year comparison was likely weakened by a strong reading this time last year when the economy emerged from the second lockdown. But at the same time it was also flattered by rising prices. Certainly, when adjusting with the BRC shop price measure, the retail sales monitor suggested that retail sales in real terms were down more than 4%Y/Y. And so consistent with record low consumer confidence and having declined sharply in May, we expect retail sales to have fallen in Q2 and therefore provide a moderate drag on GDP growth last quarter.

## The day ahead in the UK

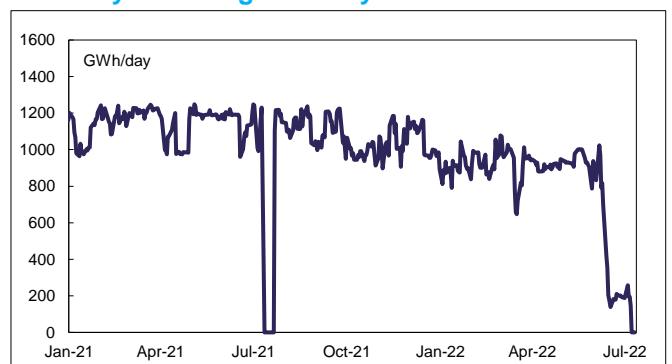
Tomorrow will bring the start of the Conservative Party leadership election, as MPs vote to start reducing the number of candidates to succeed Boris Johnson as Prime Minister. To make the shortlist, candidates require the backing of 20 MPs, with the support of 30 MPs in tomorrow's vote required to qualify for the second round. Before the end of next week – and possibly much sooner than that – the list will be reduced to two final candidates, whose names will be submitted to the party membership for a vote over the summer. The identity of Johnson's successor should then be announced on 5 September. At the time of writing, former Chancellor Rishi Sunak looked odds-on to make it to the second round. There he is most likely to

### Germany: ZEW survey inflation & rate expectations\*



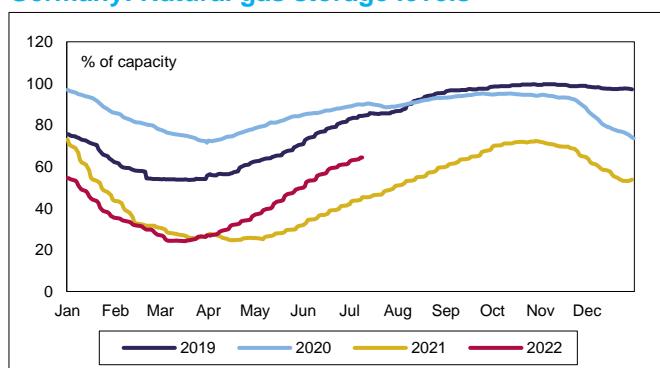
\*Dashed lines represent long-run averages. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

### Germany: Russia gas – daily Nord Stream 1 inflows



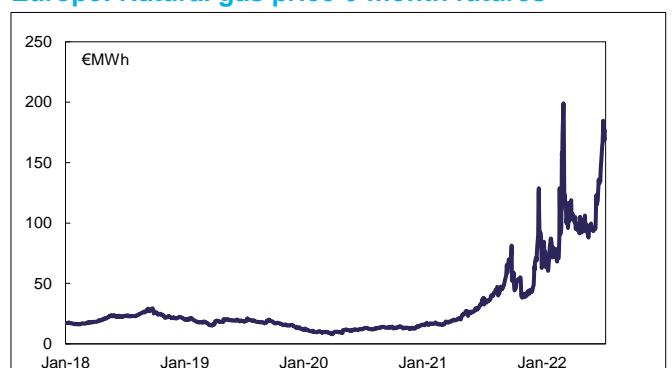
Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

### Germany: Natural gas storage levels



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

### Europe: Natural gas price 6-month futures

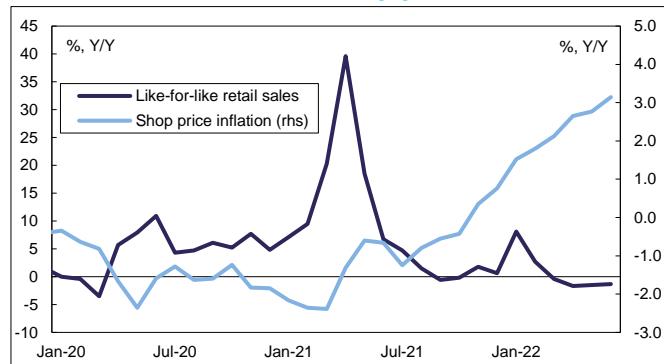


Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

face a challenger from the populist right wing – most likely Foreign Secretary Liz Truss or Trade Minister Penny Mordaunt. While Sunak has argued against any further near-term loosening of fiscal policy, Truss, Mordaunt and several others have argued for unfunded tax cuts, which would arguably be inflationary and would likely lead to more monetary tightening than would be the case under a Sunak premiership.

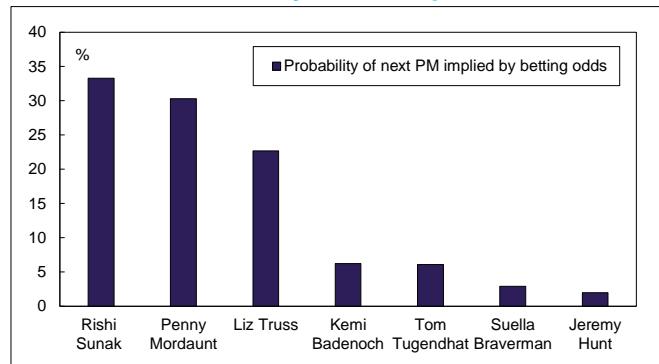
Separately, Wednesday will also bring the week's most notable UK economic data, with the estimates of monthly GDP, production, services and trade data for May due. Having failed to grow in the previous three months, GDP is expected to have remained subdued, with the Bloomberg consensus forecast for a rise of just 0.1%M/M, as household budgets continue to be squeezed by higher prices. Certainly, retail sales were particularly weak in May, although services activity might well have received a boost from increased tourism. But manufacturing, construction and trade might well remain hampered by ongoing supply challenges.

#### UK: BRC retail sales and shop price inflation



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

#### UK: Conservative Party leadership election



Source: Oddschecker, Bloomberg and Daiwa Capital Markets Europe Ltd.

# European calendar

## Today's results

### Economic data

Country	Release	Period	Actual	Market consensus/ <u>Daiwa forecast</u>	Previous	Revised
Germany	ZEW current situation (expectations)	Jul	<b>-45.8 (-53.8)</b>	-	-27.6 (-28.0)	-
UK	BRC retail sales like-for-like Y/Y%	Jun	<b>-1.3</b>	-	-1.5	-
<b>Auctions</b>						
Country Auction						
Germany	sold €4.5bn of 0.2% 2024 bonds at an average yield of 0.34%					
UK	sold £2.75bn of 1% 2032 bonds at an average yield of 2.145%					

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

## Yesterday's results

### Economic data

Country	Release	Period	Actual	Market consensus/ <u>Daiwa forecast</u>	Previous	Revised
Italy	Retail sales M/M% (Y/Y%)	May	<b>1.9 (7.0)</b>	-	0.0 (8.4)	<b>0.3 (8.3)</b>
<b>Auctions</b>						
Country Auction						

- Nothing to report -

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

## Tomorrow's releases

### Economic data

Country	BST	Release	Period	Market consensus/ <u>Daiwa forecast</u>	Previous
Euro area	10.00	Industrial production M/M% (Y/Y%)	May	0.3 (0.3)	0.4 (-2.0)
Germany	07.00	Final CPI M/M% (Y/Y%)	Jun	<u>0.1 (7.6)</u>	0.9 (7.9)
	07.00	Final EU-harmonised CPI M/M% (Y/Y%)	Jun	<u>-0.1 (8.2)</u>	1.1 (8.7)
France	07.45	Final CPI M/M% (Y/Y%)	Jun	<u>0.7 (5.8)</u>	0.7 (5.2)
	07.45	Final EU-harmonised CPI M/M% (Y/Y%)	Jun	<u>0.8 (6.5)</u>	0.8 (5.8)
Spain	08.00	Final CPI M/M% (Y/Y%)	Jun	<u>1.8 (10.2)</u>	0.8 (8.7)
	08.00	Final EU-harmonised CPI M/M% (Y/Y%)	Jun	<u>1.8 (10.0)</u>	0.7 (8.5)
UK	07.00	GDP M/M% (3M/3M%)	May	0.1 (0.0)	-0.3 (0.2)
	07.00	Industrial production M/M% (Y/Y%)	May	-0.0 (-0.3)	-0.6 (0.7)
	07.00	Manufacturing production M/M% (Y/Y%)	May	0.0 (0.3)	-1.0 (0.5)
	07.00	Index of services M/M% (3M/3M%)	May	0.1 (-0.1)	-0.3 (0.0)
	07.00	Construction output M/M% (Y/Y%)	May	0.3 (4.3)	-0.4 (3.9)
	07.00	Goods trade balance £bn	May	-20.6	-20.9

### Auctions and events

Germany	10.30	Auction: €1.5bn of 0% 2052 bonds
Italy	10.00	Auction: €3.25bn of 1.2% 2025 bonds
	10.00	Auction: €2.5bn of 2.8% 2029 bonds
	10.00	Auction: €1.25bn of 3.25% 2038 bonds
UK	18.00	BoE Governor Bailey scheduled to speak at event at OMFIF event

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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