Euro wrap-up

Overview

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- As Italian political uncertainty looked set to persist ahead of a parliamentary vote on Wednesday, Bunds made gains but BTPs made losses particularly at the short end of the curve.
- Gilts largely made gains on a quiet end to the week for UK economic data.
- The coming week will see the ECB raise rates for the first time since 2011 and discuss plans for a new anti-fragmentation policy tool, while the dataflow includes the flash July PMIs and UK inflation figures for June.

Daily bond market movements

Bond	Yield	Change
BKO 0.2 06/24	0.414	-0.034
OBL 1.3 10/27	0.812	-0.046
DBR 0 02/32	1.119	-0.051
UKT 1 04/24	1.881	-0.030
UKT 1¼ 07/27	1.789	-0.032
UKT 4¼ 06/32	2.081	-0.017

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

Euro area

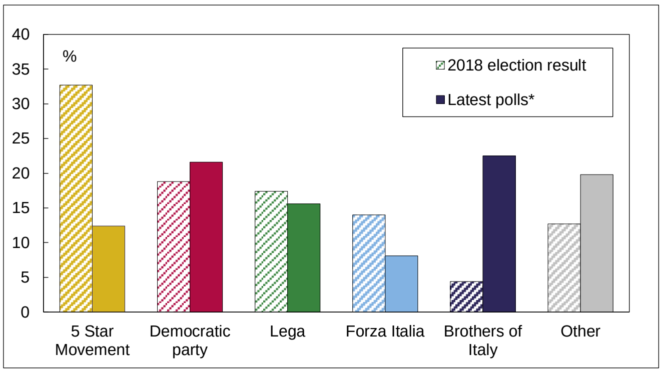
Italian uncertainty persists but we expect Draghi to remain PM into the autumn

BTPs again underperformed today as significant Italian political uncertainty persisted. However, as had seemed most likely, President Mattarella yesterday evening refused to accept Mario Draghi's resignation as Prime Minister, and instead asked him to return to Parliament next week (due on Wednesday) to see whether a majority still exists for his administration. Draghi's resignation offer reflected the decision of the Five Star Movement (which currently has the second-largest number of seats in Parliament) not to support him in a key vote in the Senate, a move that the PM stated he would not tolerate. But the government ultimately won that vote comfortably. And unless Draghi's backers from the right wing – Salvini's League and Berlusconi's Forza Italia – suddenly decide to withdraw their support, our baseline scenario assumes that the PM remains in office through to the autumn to allow him to pass next year's Budget and unlock another tranche of EU recovery funds. Indeed, given the recent rise in the polls of Meloni's nationalist Brothers of Italy as the leading party on the right and main opponent of the supposedly 'national unity' government, neither Salvini nor Berlusconi have a major incentive to pull the plug on Draghi. Moreover, Five Star's recent low ratings – as well as the internal split that saw Foreign Minister Di Maio and dozens of MPs depart to form a new party – suggest that its leader Conte could yet seek a rapprochement with the PM ahead of Wednesday's vote. Of course, given the capricious nature of all the main Italian political protagonists, the risk of damaging early elections this autumn – before that next tranche of EU funds has been secured – cannot be ruled out.

Hawks will try to set high hurdles for access to ECB's new anti-fragmentation tool

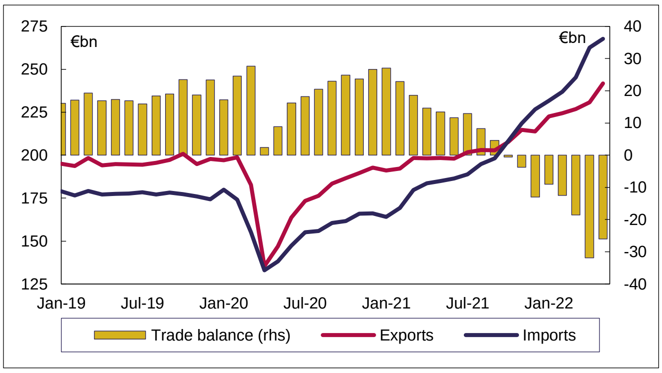
The timing of the latest Italian political shenanigans couldn't be worse, with the ECB Governing Council set next week to discuss proposals for its new anti-fragmentation tool – reportedly to be called the Transmission Protection Mechanism – which will have originally been designed specifically with Italy in mind. The Council's hawks will now, however, feel justified in ensuring that the new instrument has visible safeguards against moral hazard. So, while the doves on the Governing Council will wish to create a policy instrument capable of correcting any big divergence in sovereign spreads from fundamentals that might impair its monetary transmission mechanism, the hawks will want to ensure that the criteria for triggering its activation – related in part to the calculation of the level of spreads consistent with fundamentals – are either ambiguous or rigorous. In addition, while bond purchases conducted under the policy might theoretically be unlimited in size, the hawks will want policy conditionality attached to the use of the new mechanism to be relatively meaningful, and at a minimum linked to full consistency with EU policy guidance. Conditionality seems bound, however, to be looser than that attached to the Outright Monetary Transactions (OMT) instrument, which requires an ESM programme also to be in place. Finally, the Governing Council should also agree how the liquidity impact of any asset purchases conducted under the policy tool will be neutralized

Italy: Political party support*



*Average ratings in the past month. Source: Daiwa Capital Markets Europe Ltd.

Euro area: Goods trade*



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

– in this respect, we expect the ECB to offer a higher interest rate on term deposits, determined at auction, rather than sell bonds of other countries from its portfolio.

ECB to hike by 25bps this month but leave door open to more than 50bps in September

In addition to discussing the plans for the new anti-fragmentation tool, the Governing Council will need to decide the ECB's interest rates, with the first hike to be agreed since the ill-fated tightening in 2011. With the macroeconomic projections presented to the 8-9 June meeting already out of date, as inflation in Q2 of 8.0%Y/Y was already 0.5ppt above the ECB's forecast, there is arguably a case for a large rate hike at this meeting. However, with the Governing Council having already stated last month that it would raise all of its rates by 25bps this month, a decision to hike by more than that would damage the credibility of its guidance in future. So, the deposit rate will be merely hiked to -0.25%, maintaining the incongruity of a negative interest rates after headline inflation reached a new series high of 8.6%Y/Y in June. The Governing Council will nevertheless continue to signal that rates will rise by a larger albeit unspecified increment in September (unless the inflation outlook has markedly improved by then, which seems highly unlikely), maintaining the possibility of a hike greater than 50bps at that meeting. In light of the major uncertainty to the economic outlook, not least related to risks of a lasting interruption to the supply of natural gas from Russia, the Governing Council might say little new regarding the rate profile in Q4 and beyond, likely maintaining its current guidance that it anticipates "a gradual but sustained path of further increases in interest rates".

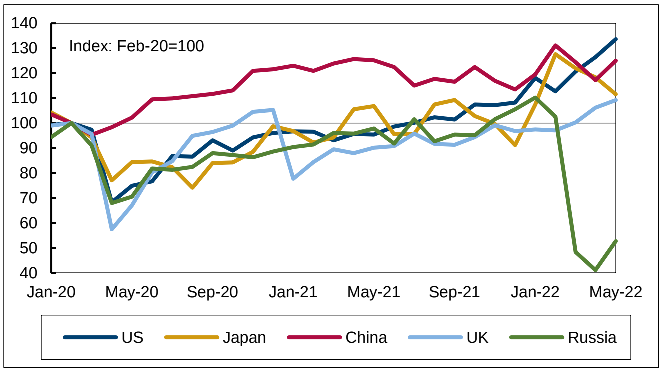
Euro area deficit narrows as exports receive a boost from the lifting of Chinese restrictions

Having deteriorated to a record high at the start of Q2, the euro area's goods trade deficit improved ahead of expectations in May, reflecting a revival in exports. In particular, on a seasonally adjusted basis, the trade deficit narrowed almost €6bn to €26.0bn, nevertheless still the second-largest on the series. The improvement reflected a near-5%M/M increase in the value of exports, as shipments rose to most of the euro area's key export partners, with the exception of Japan. Most notably, the value of exports to the US rose (5.6%M/M) to a series high, while shipments to China rose (6.8%M/M) for the first month in three as Covid restrictions were relaxed. But while exports to Russia increased more than 28%M/M, they were still more than 40% lower than the level in February ahead of the invasion of Ukraine. Despite a drop of 7.3%M/M in imports from Russia, a jump in imports from China (4.1%M/M) and the US (5.6%M/M) saw total import values rise 2%M/M, admittedly a marked slowdown from the near-7%M/M increase in April. With import price growth having slowed to 1.0%M/M in May, the rise in import values likely reflected in part another increase in volumes. So, having surged by more than 4½%M/M in April, we continue to see net goods trade making a negative contribution to GDP growth in the second quarter.

Euro area car registrations post weakest June outturn on record

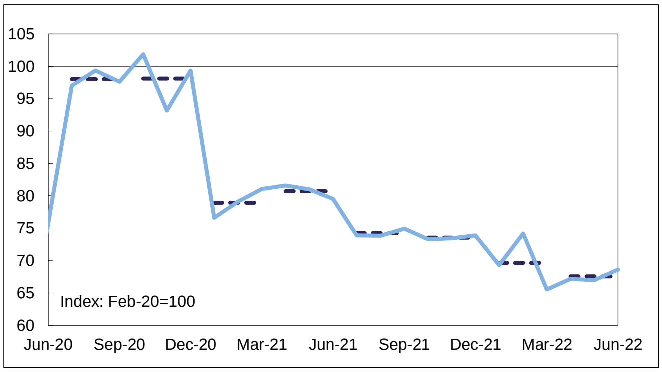
Today's euro area car registrations data attracted headlines for the wrong reasons. According to ACEA, the number of new cars registered in June was 759k, the weakest outturn for any June on the series, albeit the strongest monthly reading (in unadjusted terms) for a year. Indeed, sales were down 15%Y/Y, from what was already a pandemic-weakened level, and roughly 29% below the pre-pandemic five-year average. According to the ECB's seasonally adjusted figures, however, new registrations were up 2½%M/M in June, with growth in Germany (3.5%M/M), France (7.2%M/M) and Italy (4.7%M/M) partly offset by a slump in Spain (-10.0%M/M). However, this follows extreme volatility during the first half of the year, with euro area registrations still down some 3%Q/Q in Q2. While much of this weakness reflects persisting supply-chain issues in the autos sector, the recent slump in consumer confidence amid concerns about higher prices suggests that the weak trend in new car sales may well persist even if supply bottlenecks ease.

Euro area: Export values by destination



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: New car registrations*



**Dashed dark blue line represents quarterly averages.*
Source: ECB and Daiwa Capital Markets Europe Ltd.

The week ahead in the euro area

Turning to the coming week's data calendar, Tuesday will bring the first release of note with an updated estimate for euro area inflation in June. With final national figures having aligned with the preliminary releases, euro area headline HICP inflation is expected to confirm the 0.5ppt increase initially estimated, taking it to a record high of 8.6%Y/Y. But reflecting German policy measures to reduce the cost of public transport, and summer discounting on clothing, core inflation is expected to align with the flash estimate, which declined 0.1ppt to 3.7%Y/Y. This release will also provide the full component breakdown. German PPI numbers for June will follow on Wednesday. July sentiment indicators will be the focus in the second half of the week, with the European Commission's flash consumer confidence index (Wednesday) likely to have fallen closer to the record low logged at the onset of the pandemic in April 2020. Meanwhile, the flash PMIs (Friday) will be watched for a further deterioration in business conditions at the start of the third quarter. Indeed, in June, the euro area composite PMI fell to a sixteen-month low (52.0), with the new business component signalling no growth. The French INSEE business survey will also be published on Thursday. Separately, the ECB will publish its latest quarterly bank lending survey for Q2 on Tuesday, which will likely report a tightening of lending conditions amid expectations of imminent monetary tightening, albeit with demand for mortgages and consumer credit set to have remained positive.

UK

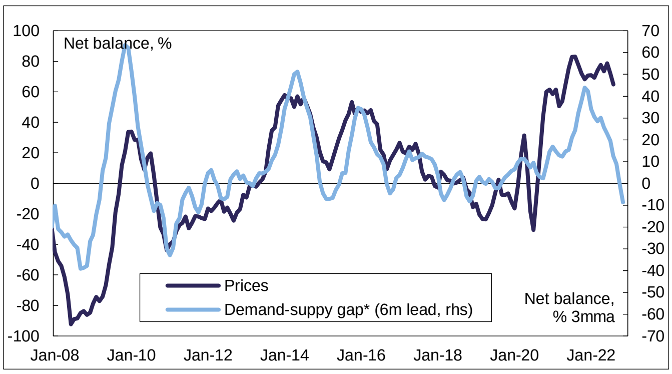
RICS residential survey points to slowing housing market momentum

On a relatively quiet end to the week for UK economic releases, yesterday's RICS residential market survey attracted some attention suggesting that, against the backdrop of record low confidence, declining real incomes and higher lending rates, momentum in the housing market slowed at the start of the summer. According to this survey, new buyer enquiries fell sharply in June, with the net balance (-26) the lowest since April 2020 and well below the long-run average (+1). The volume of sales over the past month also fell for the third consecutive month, with the respective net balance (-13) the most negative since the start of 2021, with surveyors expecting sales to remain weak over the near term too. Admittedly, given the lack of new vendor instructions coming onto the market, survey respondents suggested that the stock of properties on their books remained near a record low, which in turn continued to underpin solid price growth. Nevertheless, the RICS headline price balance fell more than expected in June, down 7pts to 65%, the lowest since February 2021. While this was still well above the long-run average (+13), just a little more than one-third of surveyors were forecasting a rise in prices over the coming twelve months, similarly the lowest share for seventeen months.

Banks signal supply of secured lending fell in Q2 and expected to decline again in Q3

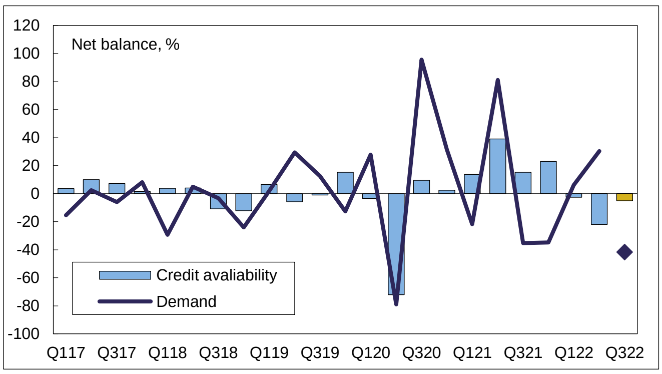
The BoE's latest credit conditions survey suggested that, despite an increase in demand last quarter, the supply of secured credit declined in Q2, as banks cited increased economic uncertainties, reduced appetite for risk, tighter funding costs and lower expectations for house prices. Indeed, the net share of lenders reporting a drop increased more than 19ppts to -22%, the most since the onset of the pandemic, with lenders forecasting a further moderate decline in availability in Q3, while mortgage demand was expected to fall sharply too. Lenders also reported increased demand for unsecured lending in Q2, with the need for credit card loans expected to rise slightly further in Q3 as the higher cost of living eroded households' budgets. But banks suggested that credit availability was likely to fall in Q3, indicating that the share of applications likely to be approved was expected to fall by the most since Q120, as risk appetite diminished and economic uncertainty increased. Separately, banks suggested that demand for and availability of corporate loans was unchanged in Q2.

UK: RICS housing market indicators



**Difference between new buyer enquiries and new vendor instructions.*
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Mortgage lending conditions*



**Gold bar and blue diamond are lenders expectations for Q322.*
Source: Refinitiv, BoE Credit Conditions Survey and Daiwa Capital Markets

The week ahead in the UK

It will be a busy week ahead for top-tier UK economic data, with updated figures on the labour market (Tuesday), CPI inflation (Wednesday) and retail sales (Friday), as well as the first consumer and business sentiment surveys for July (also Friday). June's inflation data will likely attract most attention. Given the surge in petrol prices over the past month, we expect energy inflation to have taken a further step up in June, with food inflation rising to its highest since 2009. As such, we expect headline CPI inflation to have increased 0.3ppt to 9.4%Y/Y, the highest on the series dating back to 1997. But core inflation is expected to have moved sideways at a still-lofty 5.9%Y/Y, as a pickup in services inflation might have been offset by a temporary easing in non-energy industrial goods inflation.

Turning to the labour market, following stronger-than-expected GDP growth in May, employment growth is likely to have remained solid in the three months to May. However, the increase will likely be roughly half the 177k rise record in the three months to April, to leave the unemployment rate unchanged at 3.8%. Given the tightness in the labour market and high competition in retaining and attracting staff, average regular wage growth is expected to have remained above 4%3M/Y in May, with total wage growth above 6%3M/Y, but therefore still in negative territory in real terms. Against this backdrop, surveys suggest that spending on discretionary items remained weak in June. And while food sales were given a boost by the extended bank holiday weekend at the start of the month, the public transport strikes towards the end of the month caused a marked drop in retail footfall. So, we expect total retail sales to have declined further in June. Certainly, Friday's GfK consumer survey is likely to suggest that household confidence remains close to record lows in July with little appetite for major purchases. And the flash PMIs are unlikely to see any improvement in business conditions at the start of Q3 too.

Of course, UK politics will remain in focus, as the number of Conservative party leadership candidates are reduced to the final two, whose names will be submitted to a vote among the party membership over the summer before the result is announced on 5 September. Former Chancellor and more fiscally-conservative Rishi Sunak looks set to reach the final two, although it is yet unclear whether he will then face Trade Minister Penny Mordaunt or Foreign Secretary Liz Truss as the standard-bearer for the party's populist right wing.

Daiwa economic forecasts

	2022				2023		2022	2023	2024
	Q1	Q2	Q3	Q4	Q1	Q2			
GDP	%, Q/Q						%, Y/Y		
Euro area	0.6	0.0	0.2	-0.1	-0.2	0.0	2.6	-0.1	0.9
UK	0.8	-0.1	0.1	-0.1	0.0	-0.1	3.5	-0.2	0.7
Inflation, %, Y/Y									
Euro area									
Headline HICP	6.1	8.0	8.5	7.9	6.2	4.4	7.7	4.2	1.9
Core HICP	2.7	3.7	4.0	4.2	4.1	3.9	3.6	3.6	2.1
UK									
Headline CPI	6.2	9.1	9.9	10.4	9.7	6.5	8.9	6.3	2.5
Core CPI	5.1	6.0	6.4	6.3	5.8	5.1	6.0	4.9	2.5
Monetary policy, %									
ECB									
Refi Rate	0.00	0.00	0.75	1.25	1.50	1.75	1.25	1.75	1.75
Deposit Rate	-0.50	-0.50	0.25	0.75	1.00	1.25	0.75	1.50	1.50
BoE									
Bank Rate	0.75	1.25	2.00	2.50	2.50	2.50	2.50	2.50	2.00

Source: Bloomberg, ECB, BoE and Daiwa Capital Markets Europe Ltd.

The next edition of the Euro wrap-up will be published on 19 July 2022

European calendar

Today's results

Economic data							
Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area		EU27 new car registrations Y/Y%	Jun	**-15.4**	-	-11.2	-
		Trade balance €bn	May	**-26.0**	-	-31.7	-
Italy		Final CPI M/M% (Y/Y%)	Jun	**1.2 (8.0)**	*1.2 (8.0)*	0.8 (6.8)	-
		Final EU-harmonised CPI M/M% (Y/Y%)	Jun	**1.2 (8.5)**	*1.2 (8.5)*	0.9 (7.3)	-
Auctions							
Country		Auction					
		- Nothing to report -					

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Yesterday's results

Economic data							
Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
UK		RICS house price balance %	Jun	**65**	-	73	**72**
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/ *Daiwa forecast/actual*	Previous
			Monday 18 July 2022			
Italy		09.00	Total trade balance €bn	May	-	-3.7
UK		00.01	Rightmove house price index M/M% (Y/Y%)	Jul	-	0.3 (9.7)
			Tuesday 19 July 2022			
Euro area		10.00	Construction output M/M% (Y/Y%)	May	-	-1.1 (3.0)
		10.00	Final CPI M/M% (Y/Y%)	Jun	*0.8 (8.6)*	0.8 (8.1)
		10.00	Final core CPI Y/Y%	Jun	*3.7*	3.8
UK		07.00	Payrolled employees, monthly change '000s	Jun	-	90
		07.00	Unemployment claimant count rate % (change '000s)	Jun	-	4.0 (-19.7)
		07.00	Average weekly earnings including (excluding) bonuses 3M/Y%	May	6.7 (4.3)	6.8 (4.2)
		07.00	ILO unemployement rate 3M%	May	3.8	3.8
		07.00	Employment change 3M/3M '000s	May	110	177
			Wednesday 20 July 2022			
Euro area		09.00	Current account €bn	May	-	-5.8
		15.00	European Commission's preliminary consumer confidence	Jul	-24.7	-23.6
Germany		07.00	PPI M/M% (Y/Y%)	Jun	1.0 (33.3)	1.6 (33.6)
UK		07.00	CPI M/M% (Y/Y%)	Jun	*0.8 (9.4)*	0.7 (9.1)
		07.00	Core CPI Y/Y%	Jun	*5.9*	5.9
		07.00	PPI output prices M/M% (Y/Y%)	Jun	1.0 (16.0)	1.6 (15.7)
		07.00	PPI input prices M/M% (Y/Y%)	Jun	1.3 (23.0)	2.1 (22.1)
		09.30	House price index Y/Y%	May	-	12.4
			Thursday 21 July 2022			
Euro area		13.15	ECB refinancing rate %	Jul	*0.25*	0.00
		13.15	ECB deposit rate %	Jul	*-0.25*	-0.50
France		07.45	INSEE business confidence	Jul	103	104
		07.45	INSEE manufacturing confidence (production outlook)	Jul	106 (-)	108 (-5)
UK		07.00	Public sector net borrowing excluding banks £bn	Jun	22.0	14.0
			Friday 22 July 2022			
Euro area		09.00	Preliminary manufacturing (services) PMI	Jul	51.0 (52.0)	52.1 (53.0)
		09.00	Preliminary composite PMI	Jul	50.9	52.0
Germany		08.30	Preliminary manufacturing (services) PMI	Jul	50.9 (51.4)	52.0 (52.4)
		08.30	Preliminary composite PMI	Jul	50.4	51.3
France		08.15	Preliminary manufacturing (services) PMI	Jul	51.0 (53.1)	51.4 (53.9)
		08.15	Preliminary composite PMI	Jul	51.6	52.5
UK		00.01	GfK consumer confidence	Jul	-42	-41
		07.00	Retail sales including auto fuel M/M% (Y/Y%)	Jun	-0.2 (-5.3)	-0.5 (-4.7)
		07.00	Retail sales excluding auto fuel M/M% (Y/Y%)	Jun	-0.3 (-6.1)	-0.7 (-5.7)
		09.30	Preliminary manufacturing (services) PMI	Jul	52.0 (53.5)	52.8 (54.3)
		09.30	Preliminary composite PMI	Jul	52.5	53.7

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions

Country		BST	Event / Auction
			Monday 18 July 2022
UK		-	BoE's Saunders due to speak at Resolution Foundation event
			Tuesday 19 July 2022
Euro area		09.00	ECB's bank lending survey
Germany		10.30	Auction: €4.0bn of 1.3% 2027 bonds
UK		10.00	Auction: 1.125% 2039 bonds
		18.45	BoE Governor Bailey due to give Mansion House speech
			Wednesday 20 July 2022
Germany		10.30	Auction: €1.5bn of 0% 2030 bonds
France		-	BoF retail survey, June
			Thursday 21 July 2022
Euro area		13.45	ECB President Lagarde's post-meeting press conference
		15.15	ECB President Lagarde presents latest monetary policy decion on ECB podcast
France		09.50	Auction: 0.75% 2028 bonds
		09.50	Auction: 0.75% 2025 bonds
		09.50	Auction: 0.75% 2028 bonds
		10.50	Auction: 0.10% 2028 index-linked bonds
		10.50	Auction: 0.10% 2031 index-linked bonds
		10.50	Auction: 0.10% 2058 index-linked bonds s
Spain		09.30	Auction: 0.00% 2025 bonds
		09.30	Auction: 0.00% 2027 bonds
		09.30	Auction: 2.55% 2032 bonds
UK		10.00	Auction: £3.5bn of 0.25% 2025 bonds
			Friday 22 July 2022
Euro area		09.00	ECB survey of professional forecasters

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:
https://www.uk.daiwacm.com/ficc-research/recent-blogs