Europe | Economic Research | 25 July 2023

Euro wrap-up

Overview

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- Bunds made modest losses even as the ECB's latest Bank Lending Survey reported a record decline in demand for business loans and Germany's ifo business survey signalled a marked deterioration in current conditions.
- Gilts also made losses as UK manufacturing survey signalled an improvement in business sentiment, output and orders.
- Wednesday will bring the latest results for euro area bank lending and French consumer confidence.

Daily bond market movements

Bond	Yield	Change
BKO 3.1 09/25	3.025	+0.019
OBL 2.4 10/28	2.503	+0.008
DBR 2.6 08/33	2.474	+0.012
UKT 0⅝ 06/25	4.968	+0.043
UKT 1⅝ 10/28	4.362	+0.021
UKT 3¼ 01/33	4.268	+0.015

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

Euro area

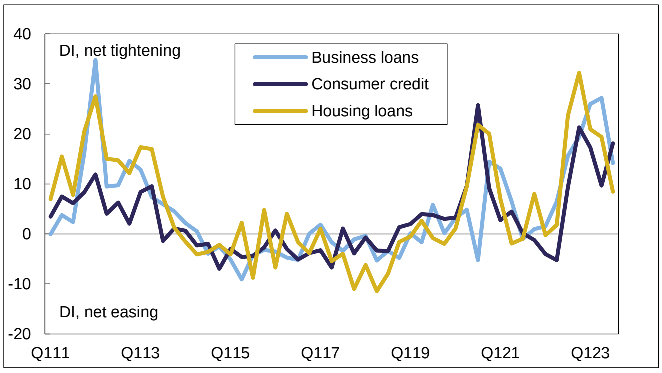
Credit standards tighten further in Q1 amid a deteriorating economic outlook

While this week's ECB monetary policy meeting will certainly deliver a further 25bps increase in its interest rates, the findings from the ECB's latest Bank Lending Survey (BLS), published today, as well as yesterday's disappointing flash PMIs, will provide the Governing Council with plenty to consider with respect to the near-term policy outlook and might well merit a slightly less hawkish tone from President Lagarde in her post-meeting press conference. Certainly, the Q2 BLS further highlighted some of the effects of the ECB's aggressive tightening since last summer, with banks continuing to report a net tightening in credit standards over the past quarter amid increased perceptions of risks with respect to both the economic outlook and firm-specific conditions, as well as banks' lower risk tolerance. Admittedly, the net percentage of banks reporting a tightening of credit standards to non-financial firms (NFCs) last quarter (14%) was smaller than in Q1 when conditions were adversely impacted by intensified financial market turbulence, but were still above the long-run average (9%). And banks reported a further net increase in the share of rejected business loan applications in Q2, the most since the series began in 2015. The share of banks noting tighter credit standards for housing loans also eased slightly in Q2 (8%) but similarly remained above the average. Meanwhile, there was a marked deterioration in credit standards for unsecured household credit (up 8ppts to 18%), as banks' risk tolerance decreased amid the worsening economic outlook and consumers' creditworthiness.

Demand for business loans declines by the most on record

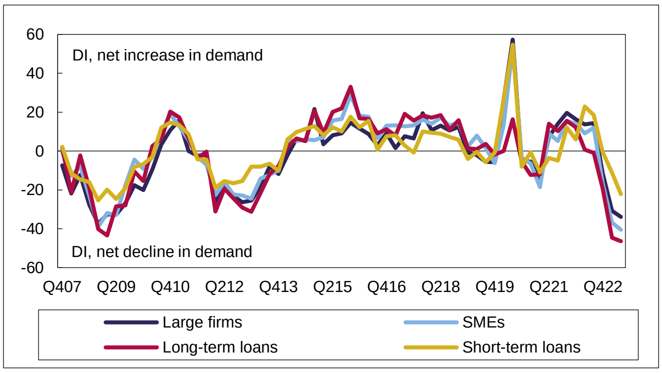
Given higher interest rates, growing economic uncertainties and weaker investment intentions, the most striking – albeit not surprising – feature of today's BLS related to loan demand. Indeed, banks suggested that net demand for business loans in Q2 was substantially weaker than three months earlier, with the decline the steepest since the series began in 2003 as the drop in demand for long-term loans was also the strongest on record. Similarly reflecting higher interest rates, as well low consumer confidence and weaker housing market prospects, the net decrease in demand for housing loans remained strong in Q2 (-47%) and well in excess of the long-run average. While this was slightly less pronounced than in the previous two quarters, on a four-quarter average basis, the net balance (-59%) matched the record low at the height of the global financial crisis. The net decline in demand for consumer credit was also slightly less negative in Q2, reflecting a diminishing drag from a decline in spending on durable goods. However, the decline was still larger than the long-run average. Overall, today's BLS suggested that banks anticipated a further (albeit smaller) tightening of credit standards and weakening in demand for business and household loans over the coming three months.

Euro area: Credit standards



Source: ECB Bank Lending Survey, Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

Euro area: Demand for business loans



Source: ECB Bank Lending Survey, Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

Germany's ifo survey points to a marked deterioration in current conditions in July

Coming on the back of yesterday's disappointing flash PMIs, today's German ifo institute business survey suggested a particularly gloomy economic backdrop for the euro area's largest member state. Indeed, the headline business climate index fell for a third consecutive month in July, by a steeper-than-expected 1.3pts to 87.3, the lowest reading since November and almost 4pts below the Q223 average. The deterioration this month was principally driven by a worsening of current business assessments, for which the respective index fell 2.4pts to 91.3, the lowest since early 2021. And, with the exception of a slight improvement in sentiment among retailers, the weakening in the current situation was broad based. In particular, given the ongoing decline in new orders and with capacity utilisation at its lowest for more than two years, manufacturers were their most downbeat about the current environment since November 2020. Despite tourism and IT activities holding up relatively well, services firms were also the least upbeat about current conditions for 18 months as the transport and logistics sub-sectors continued to struggle. And reflecting the negative effect from higher interest rates and material costs, firms in the construction sector were the most pessimistic since early 2011. The more modest decline in the survey's expectations index (-0.3pt to a seven-month low of 83.5) arguably suggested some stabilisation in the outlook over the coming six months. However, this still left the index some 4½pts below the Q2 average and more than 13pts below the long-run average, raising the risk of a prolonged recession through to the end of the year.

The day ahead in the euro area

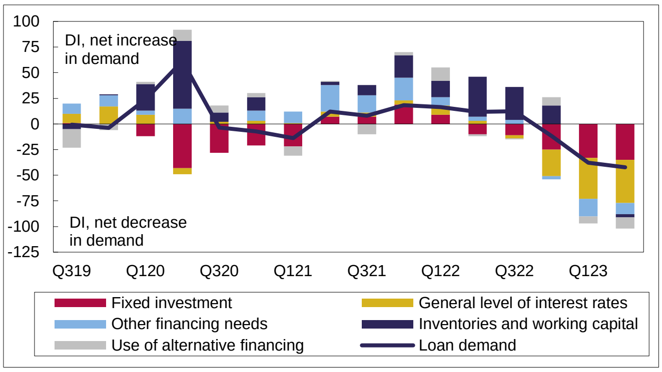
Wednesday will bring the release of the monthly euro area bank lending figures for June. Consistent with the findings from today's quarterly survey, these are expected to confirm that loan growth to businesses and households remained extremely weak at the end of the second quarter. These data are also likely to highlight the ongoing substitution of overnight deposits to higher-yielding time accounts. Tomorrow will also bring the latest French INSEE consumer confidence survey results, which might well report a further modest improvement in headline sentiment but suggest that the share of households considering it a good time to make major purchases remained very weak.

UK

CBI suggests an improvement in manufacturing sentiment, but weaker investment intentions

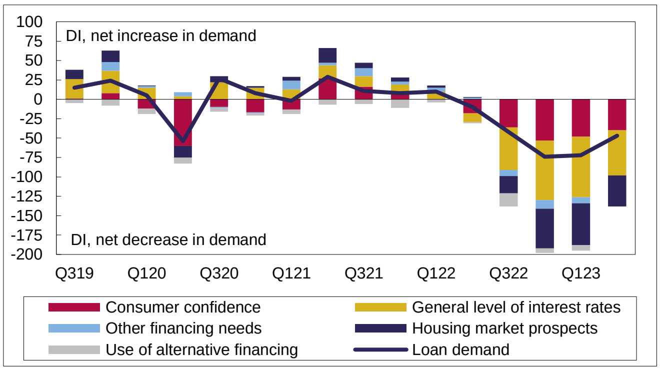
Given the downbeat tone of yesterday's manufacturing PMIs, today's CBI's industrial trends release signalled a surprising improvement in conditions in the sector at the start of Q3. In particular, the survey's measure of output in the three months to July rose to its highest level since November, while the respective new orders balance jumped to its highest since December

Euro area: Factors affecting business loan demand



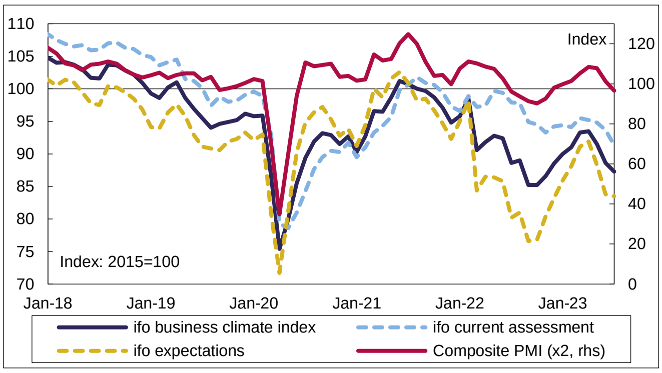
Source: ECB Bank Lending Survey, Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

Euro area: Factors affecting housing loan demand



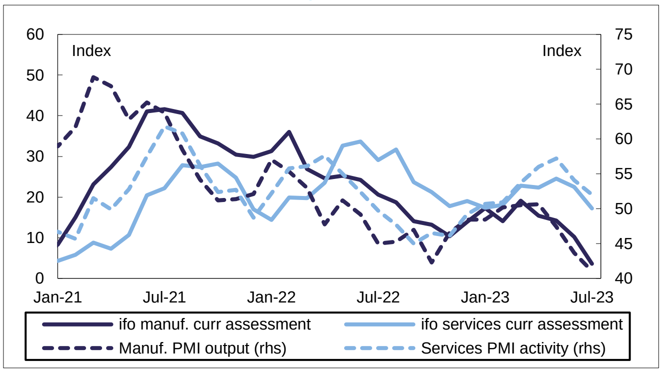
Source: ECB Bank Lending Survey, Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

Germany: Business sentiment indices



Source: Refinitiv Datastream, ifo institute, S&P Global and Daiwa Capital Markets Europe Ltd.

Germany: Manufacturing & services sentiment



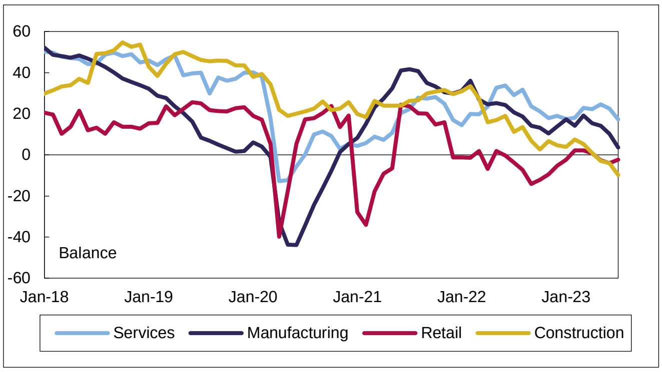
Source: Refinitiv Datastream, ifo institute, S&P Global and Daiwa Capital Markets Europe Ltd.

amid a marked improvement in external demand. As such, the CBI's quarterly survey reported that business optimism was the best since Q421. This notwithstanding, firms were less upbeat about expected orders over the coming three months, while manufacturers' investment intentions for the coming twelve months fell sharply in July, with the respective index falling 15pts to a 2½ year low. This outlook would certainly tally more closely with yesterday's PMIs, which implied a steeper pace of contraction in both output and orders at the start of Q3. Overall, today's CBI survey seems at odds with the current challenging global environment.

The day ahead in the UK

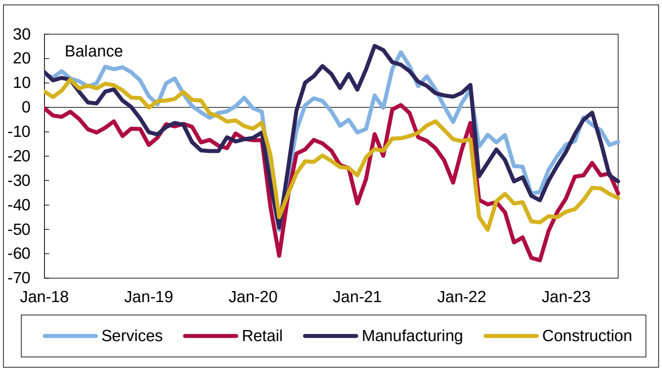
It should be a quiet day ahead for UK economic news with no top-tier data due for release.

Germany: ifo survey current conditions indices



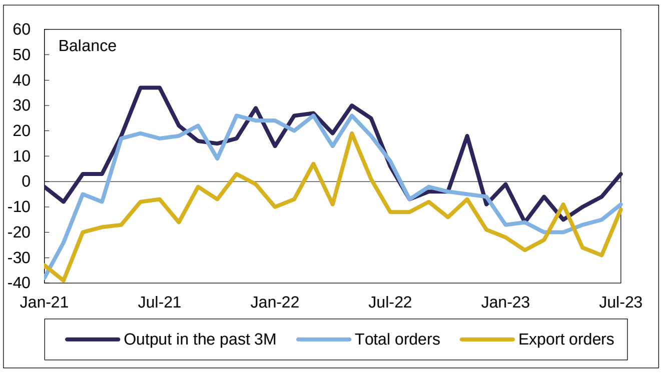
Source: Refinitiv Datastream, ifo institute and Daiwa Capital Markets Europe Ltd.

Germany: ifo survey expectation indices



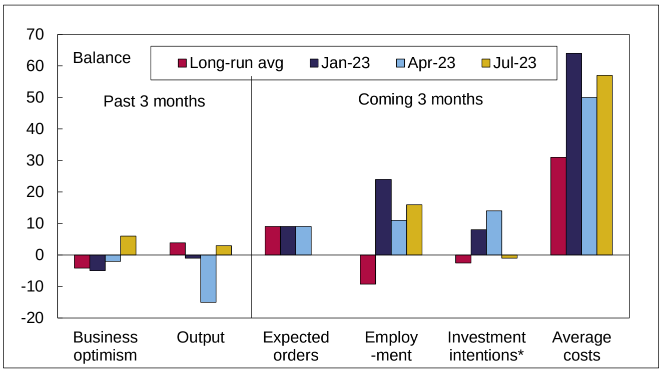
Source: Refinitiv Datastream, ifo institute and Daiwa Capital Markets Europe Ltd.

UK: CBI survey manufacturing output & orders



Source: Refinitiv Datastream, CBI, S&P Global and Daiwa Capital Markets Europe Ltd.

UK: CBI survey manufacturing sector indices



**Coming twelve months. Source: Refinitiv Datastream, CBI 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 business climate	Jul	**87.3**	88.0	88.5	88.6
		Ifo current assessment (expectations) balance	Jul	**91.3 (83.5)**	93.0 (83.4)	93.7 (83.6)	- (83.8)
UK		CBI industry trends survey, total orders (business optimism)	Jul	**-9 (6)**	-17 (3)	-15 (-2)	-
Auctions							
Country		Auction					
Italy		sold €3.75bn of 3.60% 2025 bonds at an average yield of 3.69%					
		sold €1.25bn of 0.10% 2033 index-linked bonds at an average yield of 1.86%					
UK		sold £3.00bn of 3.75% 2038 bonds at an average yield of 4.447%					

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data						
Country		BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Euro area		09.00	M3 money supply Y/Y%	Jun	0.9	1.4
France		07.45	INSEE consumer confidence	Jul	86	85
Auctions and events						
Germany		10.30	Auction: €4.00bn of 2030 bonds			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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