

Euro wrap-up

Overview

- Bunds made modest losses, despite a dire German ifo survey and strong signals from the ECB that a multi-faceted easing package is now on the cards.
- Gilts followed Bunds lower, despite another weak UK retail sector survey.
- Tomorrow will bring consumer confidence surveys from France and Italy, as well as business confidence indicators from Italy.

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Daily bond market movements

Bond	Yield	Change*
BKO 0 06/21	-0.758	+0.019
OBL 0 04/24	-0.710	+0.017
DBR 0¼ 02/29	-0.404	+0.018
UKT 1½ 01/21	0.505	+0.028
UKT 1 04/24	0.492	+0.028
UKT 1½ 10/28	0.708	+0.030

*Change from close as at 4.30pm BST.

Source: Bloomberg

Euro area

ECB signals easing package on its way

While there were no detailed new initiatives unveiled by the ECB today – with the main policy interest rates left unchanged – there is no doubt that the Governing Council is now more concerned about the near-term economic outlook in the euro area, and policy easing is bound to be forthcoming soon, most likely at its meeting in September. So the market reaction – with Bund yields rising today, while the euro appreciated – was likely only in response to Draghi’s confirmation that an immediate policy easing wasn’t considered at this meeting. Nevertheless, the Governing Council predictably tweaked its forward guidance on interest rates, which are now expected to “remain at their present or lower levels at least through the first half of 2020” – a clear signal that a cut in the deposit rate is imminent. Furthermore, with the ECB having inserted in the policy statement that it is “determined to act in line with its commitment to symmetry in the inflation aim”, the ECB indicated that a multi-faceted easing package is now on the cards. Certainly, the Governing Council tasked the relevant committees to examine options to reinforce its forward guidance, to mitigate the cost of a larger negative rate on the banks – such as the design of a new tiered interest rate system – and for potential new net asset purchases.

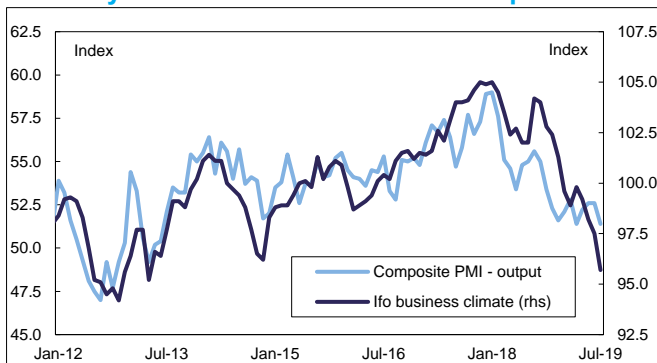
Downside risks materialising

In his press conference, Draghi declined to prejudge the recommendations of these committee discussions with respect to future policy options, merely reinforcing the ECB’s readiness to adjust “all of its instruments as appropriate”. While he suggested that there was no pre-commitment to definitely ease policy, he also implied that the Governing Council would be able to calibrate more precisely their policy response with updated staff economic projections in September. We would expect these to bring downward revisions to both the ECB’s GDP growth and inflation forecasts alike. While Draghi recited familiar risks related to geopolitics and protectionism, and highlighted the heightened possibility of a hard Brexit, he emphasised that the outlook was worsening. Indeed, not least reflecting the ongoing deterioration in the euro area’s manufacturing sector, he noted that the previously anticipated rebound in the second half of the year was now unlikely. Draghi also reemphasised that the Governing Council was aware of the recent marked decline in inflation expectations, referencing in particular the recent decline in inflation expectations in the ECB’s Survey of Professional Forecasters which had previously remained remarkably stable.

Multiple instruments to be adjusted in September

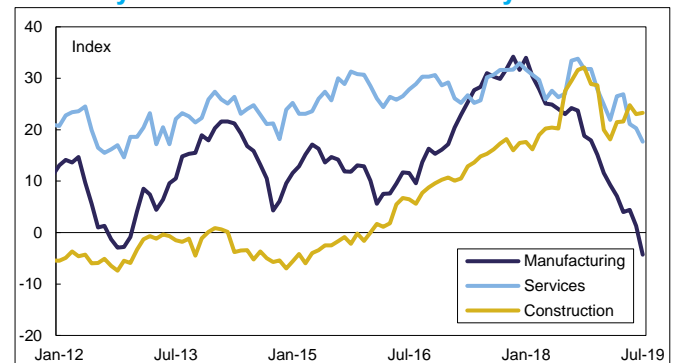
So, we now expect the ECB to announce an extensive package at its meeting on 12 September. In particular, we anticipate a cut of 20bps in the deposit rate to -0.60%. But with the ECB’s latest Bank Lending survey having signalled a tightening

Germany: Ifo business climate and composite PMI



Source: Thomson Reuters, Markit and Daiwa Capital Markets Europe Ltd.

Germany: Ifo business climate index by sector



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.



of credit standards last quarter, this seems bound to be accompanied by a tiered interest rate system – similar to that adopted by the BoJ and Danish, Swedish and Swiss National Banks – to ensure easier financial conditions and support economic sentiment. Given the ECB’s increasing concerns about the downside risks to the growth and inflation outlooks, and its assessment that its asset purchases provided more support to growth and inflation over the past few years than negative rates, we also expect it to announce a new net asset purchase programme, perhaps of circa €50bn per month over nine months to end-June 2020.

German ifo highlights manufacturing woes

Today’s data certainly emphasised the severe economic challenges facing the euro area’s largest member state. After yesterday’s [dire PMIs](#), Germany’s ifo survey today came in much weaker than expected, with the headline business climate index falling for the tenth month out of the past eleven in July and by a steeper 1.8pts to 95.7, the lowest since September 2016. The detail of the survey revealed that firms were increasingly downbeat about current conditions and the near-term outlook alike – indeed, the survey’s expectations balance also declined 1.8pts to 92.2, the lowest for a decade. And mirroring the PMIs, the weakness was most marked in the manufacturing sector, with the relevant business climate index posting the first negative reading since 2012 and the lowest for 9½ years. The equivalent services sector index fell for the third consecutive month in July to 17.7, a more-than six-year low, while the expectations balance posted the first negative reading for a decade. So, it was only thanks to a pickup in the business climate index in the construction sector that the overall decline wasn’t steeper.

The day ahead in the euro area and US

It should be a quieter end to the week in the euro area, with a couple of national confidence surveys. In France, the INSEE’s consumer confidence indicator is expected to have edged slightly higher at the start of the third quarter having risen to a seventeen-month high in June. Meanwhile, Italy’s ISTAT consumer and business sentiment surveys for July are expected to show that conditions remained tough at the start of the third quarter, with the headline consumer confidence index having fallen in June to a near-two-year low, while business confidence was close to the bottom of the recent range. Friday will also see the publication of the ECB’s latest Survey of Professional Forecasters.

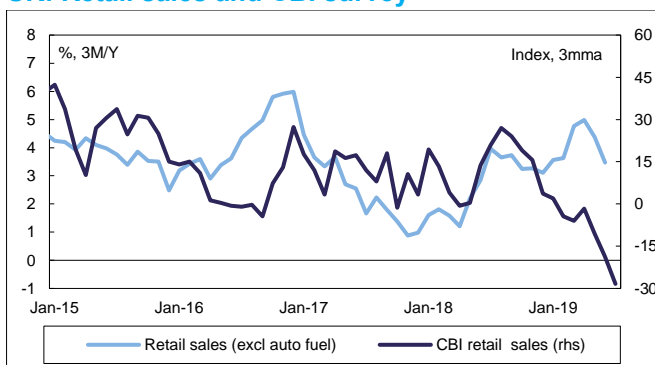
In the US, the focus tomorrow will be the first estimate of Q2 GDP, which is expected to show that growth moderated by around 1ppt to 2.0%Q/Q annualised, which would be the softest increase since Q117.

UK

No further insight into Boris’ Brexit plans

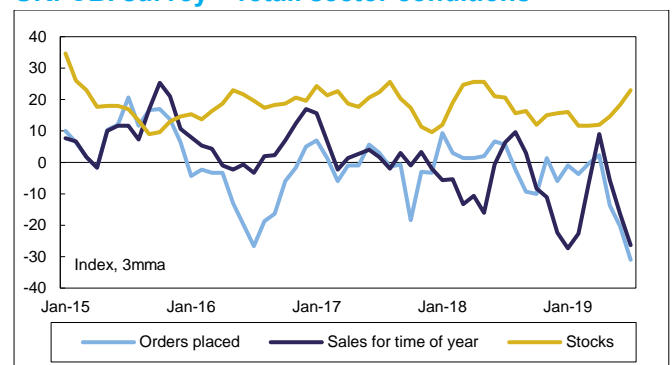
After populist Brexiter Boris Johnson was official appointed Prime Minister yesterday, he delivered a predictably ruthless overhaul of the Cabinet with key roles allotted to his fellow pro-Brexit colleagues, including Sajid Javid as Chancellor of the Exchequer, Priti Patel as Home Secretary and Dominic Raab as Foreign Secretary and defacto Deputy Prime Minister. And as the House of Commons prepared to rise for summer recess Johnson today outlined his priorities in his first Prime Ministerial address to MPs. Unsurprisingly, this contained headline-grabbing promises, including his assumption that it would be “perfectly possible” to renegotiate the Withdrawal Agreement to abolish the Irish backstop. But he also reiterated that Brexit would happen by 31 October, albeit with no meaningful insight into how this will be delivered with or without a deal. And with the House not set to return until 3 September, this will leave just over eight weeks to complete what May’s government was unable to achieve in the past three years.

UK: Retail sales and CBI survey



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: CBI survey – retail sector conditions



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

CBI survey points to ongoing retail weakness

So the ambiguous Brexit outlook will remain a key downside risk to the UK's near-term economic outlook, with businesses and households alike remaining cautious with their spending over the months ahead in the face of persistent and likely heightened uncertainty. Today's CBI Distributive Trades survey certainly presented another downbeat assessment of conditions in the retail sector at the start of the third quarter. In particular, the headline retail sales balance posted the third consecutive negative reading in July (with a net balance of -16%), the longest period of decline since 2011. And while the decline this month was softer than implied in May and June, when smoothing out monthly volatility, the survey's measure of retail sales volumes on a three-month basis posted the sharpest drop for more than a decade. Admittedly, we caution that, not least due to its narrow sample, the CBI survey does not always provide the best guide to spending. Certainly, the weakness it implied over recent months contrasts markedly with the strength seen in the official retail figures. Nevertheless, today's release still strongly suggests weakness at the start of the third quarter.







The day ahead in the UK

It should be a quiet end to the week in the UK with no economic data or political events scheduled.

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
EMU	 ECB Main Refinancing rate %	Jul	0.00	<u>0.00</u>	0.00	-
	 ECB Marginal Lending Facility rate %	Jul	0.25	<u>0.25</u>	0.25	-
	 ECB Main Deposit rate %	Jul	-0.40	<u>-0.40</u>	-0.40	-
Germany	 IFO business climate	Jul	95.7	97.0	97.4	97.5
	 IFO current assessment (expectations)	Jul	99.4 (92.2)	100.3 (94.0)	100.8 (94.2)	101.1 (94.0)
UK	 CBI distributive trades survey - reported retail sales	Jul	-16	-15	-42	-





Auctions

Country	Auction
- Nothing to report -	



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's data releases

Economic data

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
France		07.45 Consumer confidence	Jul	102	101
Italy		09.00 Business confidence (manufacturing confidence)	Jul	- (100.6)	99.3 (100.8)
		09.00 Consumer confidence	Jul	109.5	109.6
		09.00 Hourly wages Y/Y%	Jun	-	1.4

Auctions and events

Country	BST	Auction / Event
EMU		09.00 ECB publishes its Survey of Professional forecasters
Italy		10.00 Auction: to sell fixed-rate and index-linked bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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