Euro wrap-up

Overview

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- Bunds made further gains despite some solid euro area bank lending data, while 10Y BTP yields fell to a record low below 1% as the Italian President looked set this evening to back a new coalition government.
- Gilts rallied and sterling weakened as UK PM Johnson took steps to close parliament for a prolonged period to limit significantly the ability of MPs to prevent a no-deal Brexit.
- Tomorrow will bring the European Commission's economic sentiment survey and flash CPI estimates from Germany and Spain.

Daily bond market movements

Bond	Yield	Change
BKO 0 09/21	-0.906	-0.005
OBL 0 10/24	-0.905	-0.011
DBR 0 08/29	-0.724	-0.027
UKT 3¾ 09/21	0.350	-0.020
UKT 1 04/24	0.286	-0.037
UKT 1⅞10/29	0.441	-0.060

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

Euro area

Lending to households and businesses continues to rise

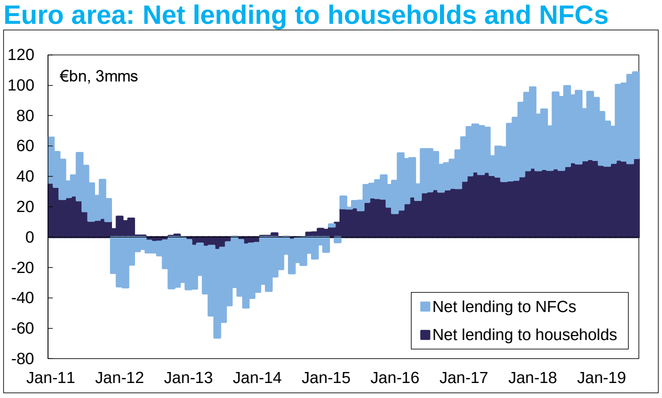
While the ECB's most recent bank lending survey reported a tightening of credit standards on loans to enterprises in Q2 related to increased concerns about the economic outlook, and surveys have signalled a further deterioration in economic sentiment in Q3, today's euro area bank lending data reported another solid increase in net new loans to consumers and businesses alike. In particular, net lending to households was up €20.9bn (adjusted for sales and securitisations), the largest increase for more than eleven years, leaving cumulative lending over the three months to July at a very healthy €52bn and growth in the outstanding stock of loans increasing 0.1ppt to 3.4%Y/Y, the strongest pace since the start of 2009. Similarly, new lending to non-financial corporations (NFCs) accelerated in July, to €21.8bn, to leave the growth in the stock at a still-healthy 3.9%Y/Y.

At the country level, tallying with improved consumer sentiment in the euro area's second largest member state, the net flow of lending to households was firmest in France (€13.5bn), where year-on-year growth rose to 6%Y/Y, matching the near-six-year high reached at end-2017. Lending to German households also remained robust (€6.5bn), with year-on-year growth of 4.2%Y/Y the firmest since the series began in 2004. But while lending to NFCs in France also strengthened in July, to leave the year-on-year growth of 7.7% the strongest for more than a decade, net lending to German NFCs was broadly unchanged to leave annual growth moderating 0.4ppt to 6.6%Y/Y. And despite a pickup on the month, lending to NFCs in Italy (-0.9%Y/Y) and Spain (-1.1%Y/Y) remained well down on a year earlier. Of course, banks in Germany and France account for the lion's share of euro area excess liquidity and thus have been hit most significantly by the ECB's negative rate on excess reserves. So, today's data suggest still that the direct adverse impact of that negative deposit rate on financial conditions remains – at face value – negligible.

German consumers to provide limited support

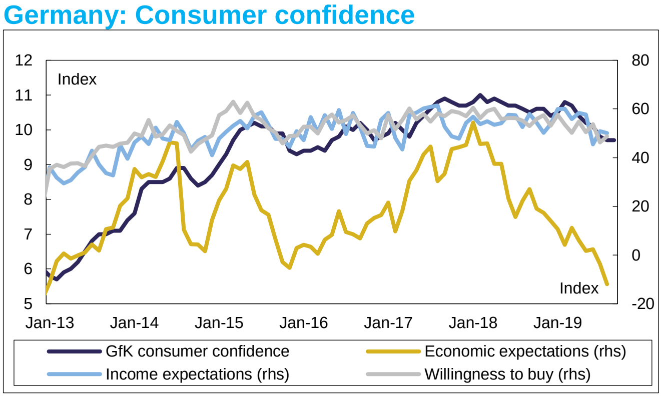
After some broadly satisfactory French economic sentiment surveys yesterday, today's Germany's GfK consumer survey also beat expectations, with the headline index steady at 9.7, a level which nevertheless matched the lowest in 27 months. Within the detail, consistent with strong consumer credit growth, the survey flagged a welcome increase in propensity to buy, albeit at a level still down on this time last year. Income expectations deteriorated only slightly. But tallying with the recent marked worsening in business sentiment, as highlighted starkly in the August ifo indices, consumer optimism with respect to the economic outlook plunged to the lowest in more than 6½ years. Of course, it's a lack of external demand rather than domestic household demand that explains Germany's current economic funk. So, while today's survey suggests that we should not expect consumer spending suddenly to hit the reverse gear, nor does it suggest large-scale support to growth

Euro area: Net lending to households and NFCs



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

Germany: Consumer confidence



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

from the household over the near term. And given the ifo survey, we maintain our forecast of another slight contraction in German GDP in Q3.

Italian consumers and businesses more downbeat

At the time of writing, Italian President Mattarella looked set this evening to give his consent to a new coalition government, led by incumbent Prime Minister Conte and backed by the populist Five Star Movement (M5S) and pro-EU centre-left Democratic Party (PD). A fully articulated policy programme would seem some way off, and the new government will certainly face numerous challenges ahead, not least in making the arithmetic of the 2020 Budget add up. Nevertheless, as it is set to recognise the need to keep Italy's budget deficit within EU limits and avoid confrontation with the European Commission – the best outcome for Italian financial markets and the economy – BTPs rallied further today, with 10Y yields falling to a record low below 1%.

Nevertheless, against the backdrop of the recent increase in political uncertainty, today's sentiment surveys from Italy suggested that households and businesses have felt more uneasy about the economic outlook this month. This was particularly evident in the manufacturing sector, where, despite a reported improvement in order books, firms were increasingly downbeat about the production outlook. Indeed, the headline manufacturing index declined for the tenth month out of the past eleven to 99.7, the lowest since 2014. But there was also a notable deterioration in services sentiment, with weaker order books and a worsening business trend leaving the headline index at its lowest since the start of 2015. So, with retailers and construction firms also more downbeat, the overall business sentiment index fell 2.3pts to 98.9, albeit largely reversing the gain seen in July. At the same time, consumer confidence slipped back too, with the headline index declining 1.4pts to 111.9 as households were more concerned about the current and future economic outlook. Admittedly this series has been volatile from month to month – indeed, today's figure was broadly in line with average so far this year. Overall, however, today's surveys support our view that Italy's economy remains very weak, with output likely to have moved sideways, at best, in Q3.

The day ahead in the euro area and US

It will be a busy day for top-tier euro area economic releases tomorrow, with arguably the most noteworthy the European Commission's business and consumer surveys – which provide a decent guide to euro area GDP growth – for August. With business sentiment set to have remained weak and consumers a touch more downbeat, the headline economic sentiment indicator is expected to report a further decline this month possibly to its lowest level since early 2015. Tomorrow will also bring the first of this week's flash August inflation releases with figures from Germany and Spain. German labour market data for August are also due, along with French consumer spending figures for July and the final reading of French Q2 GDP. In the markets, Italy will sell bonds with various maturities.

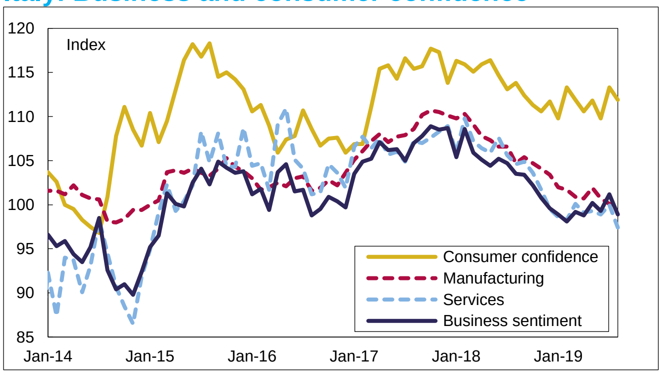
In the US, tomorrow will bring revised Q2 GDP figures, which are likely to confirm annualised growth of around 2%Q/Q, down from 3.1%Q/Q ann. in Q1. But against the backdrop of the ongoing trade war with China, likely of more interest tomorrow will be July's advance goods trade data, along with preliminary inventory and pending home sales figures for the same month. In the markets, the Treasury will sell 7Y notes.

UK

Johnson seeks Parliament suspension in bid to prevent Brexit postponement

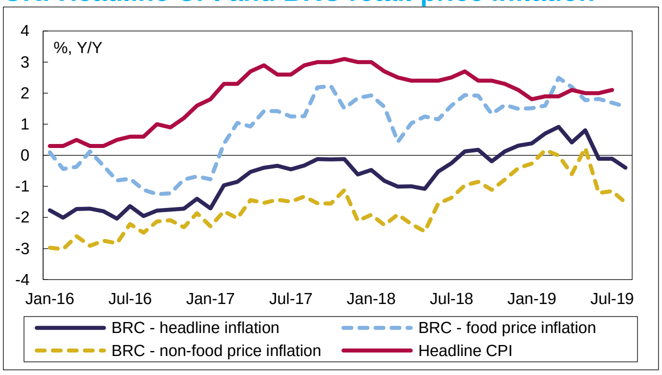
Sterling initially weakened today as PM Johnson announced his intention to close (or 'prorogue') Parliament for an extended period to limit significantly the ability of MPs to prevent a no-deal Brexit. In particular, he confirmed plans to bring the current parliamentary session to an end ahead of next month's scheduled break, from the week commencing 9 September, with the next session only to be convened from 14 October – just three days before a key EU summit at which Brexit will be

Italy: Business and consumer confidence



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

UK: Headline CPI and BRC retail price inflation



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

discussed and barely more than two weeks before the Halloween Article 50 deadline.

Anti no-deal MPs to try to act next week

Johnson's gambit, which required the Queen's approval, takes the UK a step forward to a full-blown constitutional crisis. Indeed, Labour leader Corbyn had requested an exceptional meeting with the monarch to state the case for her to reject Johnson's proposal, while the House of Commons speaker Bercow called it a "constitutional outrage". But while Johnson has no popular mandate to govern, and his Conservative Party has no parliamentary majority, in line with precedent the PM's demand was nodded through with little ado. So, next week, MPs opposed to a no-deal Brexit, among which a parliamentary majority likely exists, will try rapidly to pass legislation to force the PM to request an extension of the Article 50 deadline beyond end-October in the event that the only alternative is a no-deal Brexit. If they fail in that attempt before the parliamentary session comes to an end, and also fail to unseat Johnson as PM in a vote of no confidence and replace his government with an anti-no-deal administration, then the probability of a no-deal Brexit at end-October would likely increase significantly. (By the same token, the probability of a deal might also rise somewhat). However, with much to be determined next week, when sterling might be expected to be buffetted by events in the House of Commons, for now we see a roughly 50-50 chance that the deadline will be extended.

BRC's retail prices decline again

Against the backdrop of softer consumer spending, the BRC's latest shop price index suggested that retail price inflation maintained a downward trend in August. In particular, the headline rate fell 0.2ppt to -0.4%Y/Y, the third consecutive negative reading and largest for fourteen months. While food price inflation remained positive, the 1.6%Y/Y increase was the softest since January. And there was steeper pace of decline in non-food inflation, which fell 0.3ppt to -1.5%Y/Y, with a notable drop in clothing and footwear prices (-8.4%Y/Y) as retailers bought forward end of season discounting.

Not least due to intense competition on the High Street, retail price inflation has been significantly weaker than overall consumer price inflation over recent years. Indeed, in July, the headline CPI rate rose back above 2%Y/Y, while the BRC measure of retail price inflation fell 0.2%Y/Y. But while we would expect consumer price inflation to remain considerably higher than the BRC measure going forward, declining energy prices are likely to more than offset any upwards inflationary pressures from past sterling depreciation, while services inflation is set to remain subdued. As such, we continue to expect the headline CPI rate to fall back below the BoE's 2% target from August. And despite an anticipated brief boost at the start of the coming year, due to persistently subdued economic growth we expect inflation to fall though the second half of next year, averaging just 1½%Y/Y in H220. And as such, even in the absence of a no-deal Brexit, we suspect that the BoE will ease policy, perhaps as early as November.

The day ahead in the UK

Tomorrow will be free of top-tier UK economic data.

European calendar

Today's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
EMU	M3 money supply Y/Y%	Jul	**5.2**	4.7	4.5	-
Germany	GfK consumer confidence	Sep	**9.7**	9.6	9.7	-
Italy	Consumer confidence	Aug	**111.9**	112.7	113.4	113.3
	Business confidence (manufacturing confidence)	Aug	**98.9 (99.7)**	-	101.2 (100.1)	-
UK	BRC shop price index Y/Y%	Aug	**-0.4**	-	-0.1	-

Auctions

Country	Auction
Germany sold	€2.3bn of the 0% 2029 bonds at an average yield of -0.7%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Country	BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
EMU	10.00	Economic sentiment indicator	Aug	102.3	102.7
	10.00	Industrial confidence (services confidence)	Aug	-7.4 (10.6)	-7.4 (10.6)
	10.00	Consumer confidence	Aug	-7.1	-6.6
Germany	08.55	Unemployment rate % (change '000s)	Aug	5.0 (4.0)	5.0 (1.0)
	13.00	Preliminary CPI (EU-harmonised CPI) Y/Y%	Aug	1.5 (1.2)	1.7 (1.1)
France	07.45	GDP – second release Q/Q% (Y/Y%)	Q2	0.2 (1.3)	0.3 (1.2)
	07.45	Consumer spending M/M% (Y/Y%)	Jul	0.4 (0.1)	-0.1 (-0.6)
Italy	09.00	Industrial sales M/M% (Y/Y%)	Jun	-	1.6 (-2.5)
	09.00	Industrial orders M/M% (Y/Y%)	Jun	-	2.6 (-2.5)
Spain	08.00	Preliminary CPI (EU-harmonised CPI) Y/Y%	Aug	0.4 (0.6)	0.5 (0.6)

Auctions

Country	BST	Auction/Event
Italy	10.00	Auction: to sell 1.75% 2024 bonds
	10.00	Auction: to sell 2025 floating-rate bonds
	10.00	Auction: to sell of 1.35% 2030 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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