

# Euro wrap-up

## Overview

- Bunds made modest gains at the longer end of the curve while periphery bonds outperformed as the take-up at the ECB's latest TLTRO-iii operation was broadly in line with expectations.
- Gilts made losses, particularly at the long end of the curve, as the BoE agreed to buy an extra £100bn of bonds at a slower pace than of late.
- Friday will bring updates on retail sales and public borrowing in the UK and the euro area balance of payments, while EU leaders will discuss the Commission EU Recovery Plan.

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### Daily bond market movements

Bond	Yield	Change
BKO 0 06/22	-0.673	+0.003
OBL 0 04/25	-0.648	-0.002
DBR 0 08/30	-0.415	-0.015
UKT 0½ 07/22	-0.053	+0.016
UKT 0% 06/25	-0.001	+0.016
UKT 4% 12/30	0.222	+0.035

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

## Euro area

### TLTRO-iii take-up in line with expectations

With no top-tier economic data due for release, attention in the euro area today was on the outcome of the ECB's fourth operation under the TLTRO-iii facility, the first to be conducted since the ECB increased the attractiveness of these long-term loans. However, take-up of €1.31trn, shared among 742 banks, was well in line with expectations. So, the news had relatively little market impact: while periphery bonds outperformed today, bank shares underperformed. Nevertheless, net of the early repayments from the TLTRO-ii operations of €214bn announced last week, as well as the €603bn of TLTRO-ii and "bridge" LTRO funds set to mature next week, today's result implied a net injection of new liquidity of €548bn. Surveys suggest that this liquidity will eventually be primarily used to support lending to non-financial companies, growth in the stock of which already accelerated to 6.6%Y/Y in April from just 3.0%Y/Y in February. Indeed, the cumulative flow of loans to NFCs reached a record €194bn in March and April. And given that massive increase in business lending, most if not all participating banks will qualify for the most generous interest rate on today's loans, at 50bps below the deposit rate until 23 June 2021. So, that implies opportunity for near-term carry trade activity too.

### The day ahead in the euro area and US

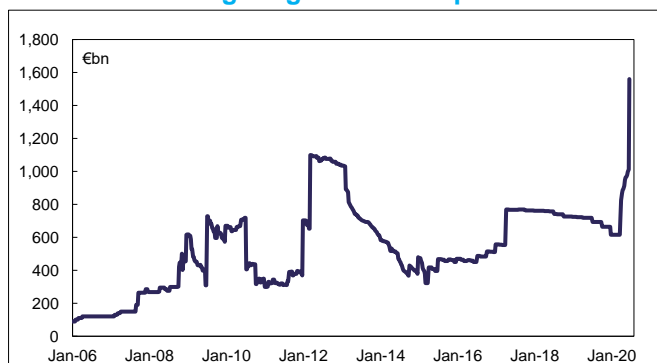
Looking ahead, it should be a relatively quiet end to the week for euro area economic releases, with just the ECB's balance of payments figures for April and German PPI data for May due for release. However, EU leaders will hold a videoconference to discuss the European Commission's [€750bn Recovery Plan](#), based on large-scale bond issuance to provide grants and loans to the regions and sectors most affected by the coronavirus. The US data calendar also ends with no key releases scheduled, while the Fed's Powell, Mester, Quarles and Rosengren are all due to speak publicly at virtual events.

## UK

### BoE to buy a further £100bn of bonds at a slower pace

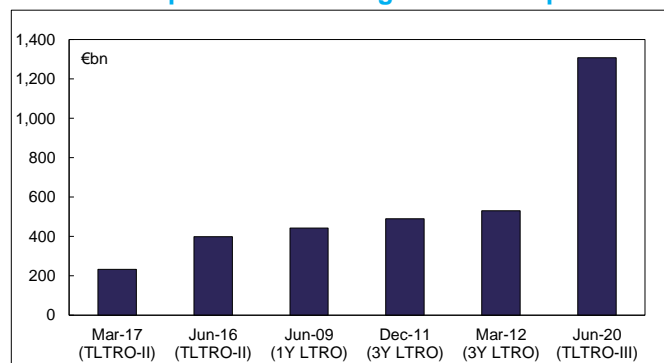
In line with expectations, the BoE's MPC today voted to keep Bank Rate unchanged at 0.1% and add an extra £100bn of Gilts and investment grade sterling non-financial corporate bonds to its asset purchase programme. That took the total of its holdings to £745bn, with the extra purchases to be conducted by the end of the year. Also including principal reinvestments of a maturing bond, the pace of Gilt purchase through to early August will now be roughly half the recent rate at £6.7bn per week. The decision to increase the asset purchase programme was not unanimous, however, with Chief Economist Andy

### ECB: Outstanding long-term loan operations\*



\*Includes all TLTRO and LTRO funds. Source: ECB and Daiwa Capital Markets Europe Ltd.

### ECB: Take up at selected long-term loan operations



Source: ECB and Daiwa Capital Markets Europe Ltd.



Haldane voting against. And while recent weeks had seen BoE officials discuss the possibility that further rate cuts might eventually be considered, the decision to leave Bank Rate unchanged this month was unanimous and seemingly made without debate. Certainly, Governor Bailey confirmed that neither negative rates nor yield curve control policies had been discussed. So, in response to the various announcements, Gilts made losses, albeit particularly at the long end of the curve.

### Contraction in Q2 likely to be smaller than BoE expected last month

In its post-meeting statement, the MPC noted that recent data suggest that the contraction in global and UK GDP in Q2 is likely to be somewhat smaller than it anticipated last month. Indeed, the minutes revealed that the BoE now thinks that the level of UK GDP in Q220 might be 20% below the peak reached in Q419, compared to the 27% projection in the May Monetary Policy report. (We currently forecast a slightly smaller cumulative drop, of a little more than 18% in Q220 compared to Q419.) But it also judged it difficult to conclude what that means for the outlook.

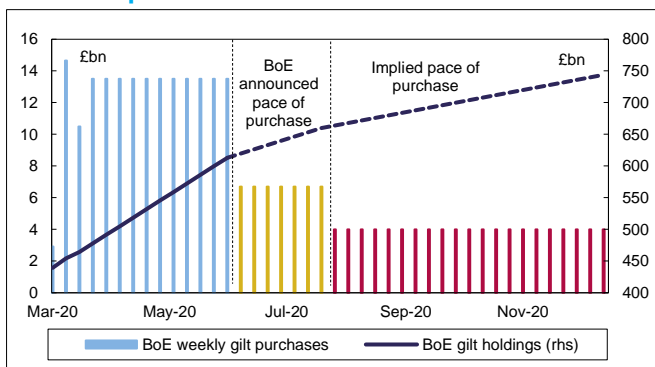
### MPC majority concerned about deterioration in labour market

In justifying his vote against the new round of asset purchases, Haldane noted that if the relative improvement in economic conditions seen over recent weeks persists, cumulative output losses over the coming few years could be half what had been previously anticipated by the BoE, with a knock-on positive effect on the inflation outlook. He also judged the risks to the outlook now to be less skewed to the downside than before. In contrast, however, the majority of members were concerned by risks that the path of unemployment will now be higher than expected last month, particularly if it proves difficult to reabsorb furloughed workers back into employment. Some also noted that risks management concerns still justified prompt action too. Indeed, despite Haldane's opposition, the decision to increase the asset purchase target appears to have been relatively uncontroversial. And as we think that the labour market will deteriorate significantly further in the three months to October as and when the government's Job Retention Scheme is phased out, and also that – notwithstanding risks from Brexit – inflation will remain below target over the forecast horizon – we expect a further increase in the BoE's asset purchase target to be made before year-end, most probably at the November MPC meeting.

### The day ahead in the UK

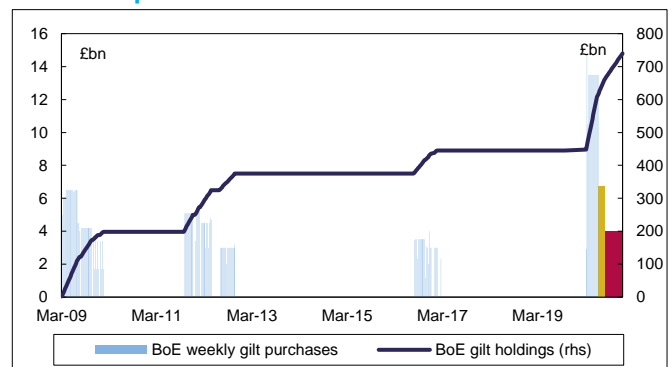
As restrictions to activity eased only gradually and all non-essential stores remained closed that month, Friday's retail sales figures are likely to show only very modest recovery in May, following a record drop of 18%M/M in April. Nevertheless, the GfK's flash consumer confidence survey for June seems likely to show some improvement in sentiment as lockdown measures were further relaxed over the past couple of weeks, although the headline index will undoubtedly remain well down on the pre-pandemic levels as higher unemployment and uncertainties about the economic outlook continue to take their toll. Finally, May's public finance figures will reveal another month of massive borrowing, probably only ever surpassed by April's record level.

#### BoE: Gilt purchases















Source: BoE and Daiwa Capital Markets Europe Ltd.

#### BoE: Gilt purchases\*










\*Announced pace of purchases between 23 June and 6 August. Implied pace of purchases thereafter. Source: BoE and Daiwa Capital Markets Europe Ltd.

## European calendar

Today's results							
Economic data							
Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised	
Italy	 Total trade balance €bn	Apr	-1.2	-	5.7	-	
UK	 BoE Bank Rate %	Jun	0.10	0.10	0.10	-	
	 BoE gilt and corporate purchase bond target £bn	Jun	745	745	645	-	
Auctions							
Country	Auction						
France	 sold €2.2bn of 0% 2023 bonds at an average yield of -0.56%						
	 sold €3.0bn of 0% 2025 bonds at an average yield of -0.48%						
	 sold €3.2bn of 0% 2026 bonds at an average yield of -0.4%						
	 sold €2.6bn of 0.75% 2028 bonds at an average yield of -0.25%						
	 sold €2.4bn of 0.1% 2026 index-linked bonds at an average yield of -0.8%						
Spain	 sold €2.2bn of 0% 2023 bonds at an average yield of -0.242%						
	 sold €1.6bn of 0% 2025 bonds at an average yield of -0.075%						
	 sold €1.0bn of 5.9% 2026 bonds at an average yield of 0.083%						
	 sold €1.0bn of 1.25% 2030 bonds at an average yield of 0.528%						

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			
EMU		09.00	Current account balance €bn	Apr	-	27.4		
Germany		07.00	PPI Y/Y%	May	-0.3 (-2.1)	-1.9		
UK		00.01	Preliminary GfK consumer confidence	Jun	-	-36		
		07.00	Retail sales including fuel M/M% (Y/Y%)	May	6.3 (-16.4)	-18.1 (-22.6)		
		07.00	Retail sales excluding fuel M/M% (Y/Y%)	May	4.1 (-14.9)	-15.2 (-18.4)		
		07.00	Public sector net borrowing £bn	May	49.3	61.4		
Auctions and events								
Country	BST	Auction / Event						
EMU		09.00	EU leaders hold video conference to discuss the Commission's recovery fund and a new EU long term budget					

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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