

Euro wrap-up

Overview

- Bunds were little changed as data showed that German car sales and production in June remained well down on last year's levels, and OATs made modest losses as French President Macron replaced his Prime Minister.
- Gilts were little changed ahead of tomorrow's reopening of English pubs and restaurants.
- The coming week brings plenty of manufacturing and retail sales data from the euro area and a UK fiscal policy announcement.

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Daily bond market movements

Bond	Yield	Change
BKO 0 06/22	-0.699	-0.007
OBL 0 04/25	-0.687	-0.007
DBR 0 08/30	-0.435	-0.003
UKT 0½ 07/22	-0.092	+0.014
UKT 0% 06/25	-0.042	+0.013
UKT 4% 12/30	0.188	+0.005

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

Euro area

Legal challenge to ECB PSPP safely diffused

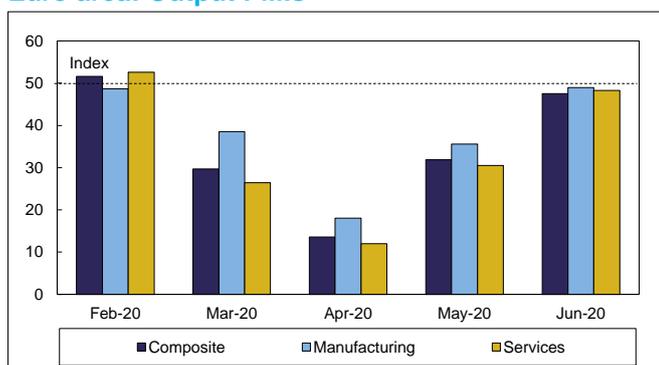
As we had long expected, the legal threat to the Bundesbank's participation in the ECB's Public Sector Purchase Programme (PSPP), posed by the 5 May ruling of the German Federal Constitutional Court (BVerfG), has been diffused. With support from the opposition Greens and Free Democrats, as well as the ruling coalition parties (CDU, CSU and SPD), the Bundestag concluded yesterday evening that the ECB had fulfilled the demands of the BVerfG in demonstrating the proportionality of the PSPP, under which the central bank has now amassed more than €2.2trn of securities. The ECB had recently provided the Bundesbank with unpublished documents regarding the Governing Council's discussions on the PSPP when it was first agreed in 2015, as well as further documents previously submitted to the ECJ ahead of its unambiguously favourable ruling on the legality of the PSPP in 2018. The Bundesbank had then passed these documents to the Federal Government, which in turn submitted them to the Bundestag and communicated its satisfaction that the ECB had met the BVerfG's demands. That should have come as no surprise – it had always seemed absurd to suggest that the Governing Council did not always, as a matter of course, evaluate the potential side effects and overall proportionality of its monetary policy measures.

The positive statement from the Bundestag allows the Bundesbank to take a similarly favourable position, well within the three-month BVerfG deadline, and thus continue its participation in the PSPP beyond 5 August. There will, of course, be further German legal challenges to the ECB's asset purchases to come. Indeed, the far-right AfD has already lodged a challenge to the legality of the new €1.35trn PEPP, encouraged by the BVerfG's emphasis on the importance of the ECB's self-imposed issue and issuer limits, as well as the significant divergence from the capital key in determining the purchases under the new programme. However, as demonstrated by the length taken to conclude the dispute of the PSPP, the initial challenge on which was first lodged in 2015, the resolution of such new disputes will take years, likely well beyond the end of the current pandemic.

Services PMIs revised up, but little clarity on strength of rebound

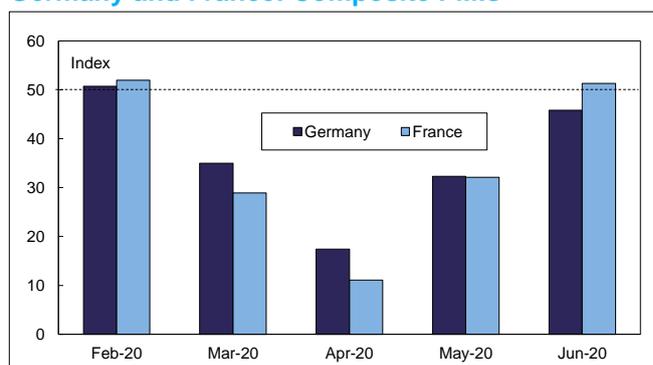
Like the [manufacturing](#) indices released earlier this week, today's final June services PMIs for Germany, France and the euro area were revised higher to suggest further improvement as the month went on. Nevertheless, like the flash estimates, the final figures still signalled broad stabilisation in the sector rather than significant expansion. The headline euro area services PMI was revised up 1pt from the flash estimate to 48.3, up more than 17pts from May and more than 36pts from April's trough. Also like the manufacturing surveys, the services PMIs suggested that France leads the way among the

Euro area: Output PMIs



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

Germany and France: Composite PMIs



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



member states, with the respective headline index revised up to 50.7, more than 40pts up from April. Spain's services PMI also edged slightly above 50. But, while much improved from recent months, the equivalent indices from Germany (47.3) and Italy (46.4) suggested ongoing moderate contraction.

The composite PMIs suggested a similar pecking order, with France at the front of recovery and Germany at the rear. The latter finding seems highly dubious, particularly in light of the vigorous rebound in [German retail sales](#) to a record high in May. And that raises question-marks over the value of the PMIs as a guide to economic growth at this stage in the recovery, particularly given the highly variable impact of the pandemic on various sub-sectors. However, at least the euro area composite PMI was revised up by 1pt from the flash estimate to 48.5, up almost 35pts from April. And the survey findings of continued weakness in new orders, particularly from abroad, were probably reliable, as was the message that job losses persist across the region but that confidence about the outlook for the coming twelve months is much improved. Meanwhile, the PMIs suggested that input prices rose in June for the first time since February. But they also implied that firms had to absorb the higher costs, with soft demand resulting in ongoing disinflationary pressure on output prices.

German car registrations down by about one third in June

While German retail sales outperformed expectations in May, car sales in June appear not to have done so. Today's official figures from KBA showed that German new car registrations fell 32.3%Y/Y in June following a decline close to 50%Y/Y in May. While French registrations fared better in June, the overall performance in Germany (-34.5%YTD/Y) was superior to that in [France, Italy and Spain](#) over the first six months of the year. With demand weak, car production remained relatively subdued too, down 20%Y/Y following a decline of 66%Y/Y in May, according to the VDA. We expect domestic German car sales to pick-up significantly over the near term thanks to the cut in VAT to last from this week through to the end of the year. Meanwhile, with commercial sales slightly stronger than private sales in June, German registrations of trucks and buses in Germany were both down close to 28%Y/Y. But motorcycle registrations surged, leaping close to 50%Y/Y following growth of more than one fifth in May, presumably as many individuals decided to reduce their reliance on public transport.

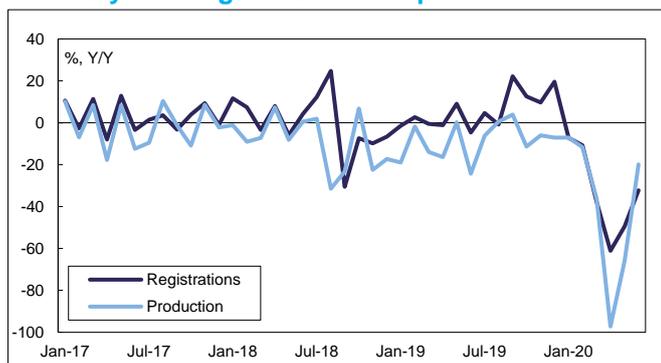
Macron replaces his (more popular) PM

In last weekend's local elections, President Macron's La République en Marche (LREM) party failed to win control of any of France's large cities, while the green Europe Ecologie Les Verts (EELV) boasted greatest success. So, looking to reinvigorate his Presidency ahead of the 2022 election, Macron today replaced his centre-right Prime Minister Édouard Philippe – whose popularity ratings are far superior to the President's and had never joined LREM – with Jean Castex, similarly from the centre-right but also mayor of a small town in southern France and a civil servant, who had led Macron's push to ease the country's pandemic lockdown measures. At the time of writing, the futures of other cabinet members were unclear, although the replacement of several ministers was likely. The implications for French government policy are also unclear, but probably very limited. With Castex installed as Prime Minister, Macron seems likely to take a far more hands-on role than during Philippe's tenure. But a need to offer more to green voters will have to be balanced by an ongoing commitment to sustain economic recovery from the shock of the pandemic, while Macron has also signalled a desire to maintain his push for controversial reforms, such as those to pensions. Philippe will now revert to his role as mayor of the northern city of Le Havre, which will give him a platform to develop as a future Presidential candidate, and indeed a possible threat to Macron should the President's troubles worsen. For now, consistent with the opinion polls, our baseline expectation is that Macron will again find himself up against the far-right Marine Le Pen in the 2022 Presidential run-off.

The week ahead in the euro area and US

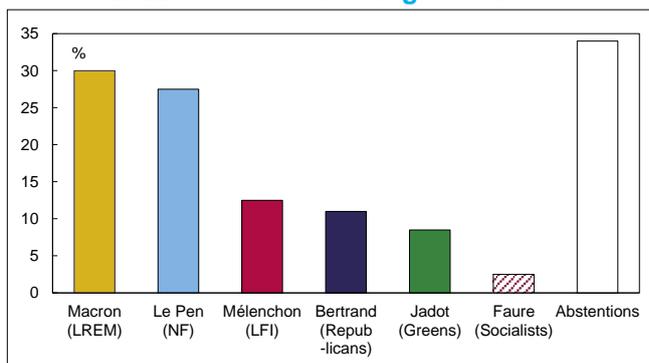
Turning to the week ahead, euro area retail sales data for May (on Monday) will provide further insight into economic activity in Q2. We expect to see a sharp rebound in aggregate euro area spending, as indicated by the various national data. But while retail sales jumped back above the pre-pandemic level in Germany, they remained well below the equivalent level in France and Spain. And so, euro area sales will similarly have remained well below February's peak.

Germany: Car registrations and production



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

France: 2022 Presidential voting intentions*



*First round voting intentions. Source: Elabe polling results, 30 Jun-1 Jul 2020

Manufacturing sector releases also feature in the coming week and will also show a bounce back in output in May across the euro area, as many firms were able to restart production with social distancing rules in place. German factory orders data, to be published on Monday, are expected to show a solid increase in May, albeit reversing only a fraction of the declines seen in recent months. These will precede the release of the equivalent German IP data (Tuesday), while Spanish IP figures are due Monday, with French, Italian and Dutch IP figures following on Friday. Manufacturing output is expected to have risen at a double-digit monthly rate in May in each member state, albeit leaving production still well below February's level. While French and German trade figures for May, published on Tuesday and Thursday respectively, are expected to highlight the ongoing weakness in external demand, the Bank of France business sentiment survey (due Wednesday) is likely to report a further improvement in conditions at the end of the second quarter. Other sentiment surveys include the construction PMIs for June and euro area Sentix indicator for July, on Monday.

In other news, euro area finance ministers will hold a virtual Eurogroup meeting on Thursday to discuss the budgetary situation in the member states, and the overall euro area fiscal stance, as well as the Commission's summer interim economic forecasts. Meanwhile, ECB President Lagarde will speak at an online conference tomorrow, while Vice President de Guindos will be speaking at virtual events on Wednesday and Friday. In the markets, Germany will auction index-linked bonds on Tuesday, followed by mid-dated bonds on Wednesday.

In the US, the data calendar kicks off on Monday with the release of the final services and composite PMIs and non-manufacturing ISM indices for June. Job openings data from JOLTS will be published on Tuesday, followed May consumer credit numbers on Wednesday. The usual weekly jobless claims figures will be published on Thursday, alongside wholesale trade figures for May. On Friday, the June PPI data are scheduled for release. There are no UST bond auctions scheduled in the coming week.

UK

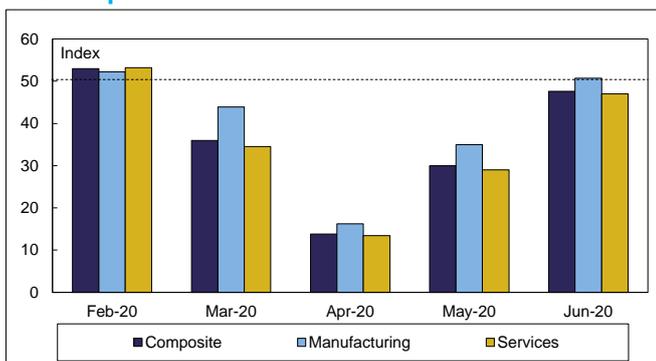
Services PMIs improve ahead of tomorrow's pubs reopening

Unlike the euro area, the final UK services PMIs saw minimal changes from the flash estimates, with the headline index revised up just 0.1pt to 47.1. That was still more than 18pts higher than in May and more than 33pts above April's record low, suggesting broad progress towards stabilisation following the easing of lockdown measures over recent weeks. However, given the differential impacts of the pandemic on various sub-sectors – with face-to-face services still severely impacted last month – Markit reported that about one third of firms surveyed signalled a drop in business activity in June (down from 54% in May and 79% in April) while 28% signalled an expansion. The survey detail also suggested a slowing in the pace of decline of new orders in services, although – as in manufacturing – export orders remained significantly weaker. In addition, while recent days have brought announcements of thousands of job cuts at high-profile firms – the services PMIs suggested that the rate of redundancies eased to its slowest since March. And slightly more than half of responding companies expect to see an increase in business activity over the coming twelve months while a little more than one fifth anticipate a decline. As in the euro area, firms point to ongoing disinflation of output prices despite little change to input prices. The improvements in the services and manufacturing output (50.7) PMIs saw the final composite PMI rise more than 17pts from May to 47.7 in June.

Retail footfall still well down on last year

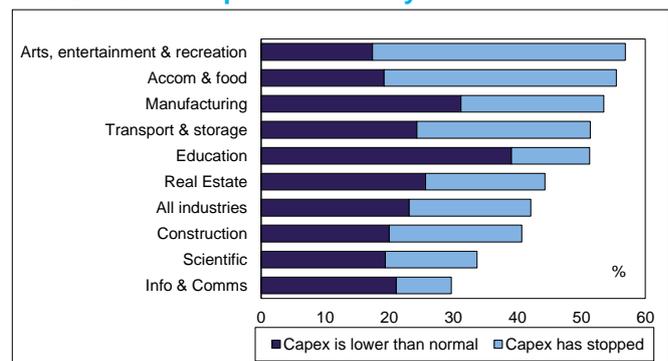
Like in the euro area, the PMIs probably tell us little about the precise extent of growth in the UK economy at end-Q2. But with a further easing of English lockdown measures occurring tomorrow ("Super Saturday") with the reopening of pubs, restaurants and cinemas, total economic activity should post further improvement this month and beyond, as long as the local flare-ups in the pandemic remain well-contained. However, social distancing rules, and reticence on behalf of consumers, will limit the extent of the recovery in demand. That appears to have been the case in the retail sector, where

UK: Output PMIs



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

UK: Business capex affected by Covid-19*



*Share of firms continuing to trade, 1 June – 14 June. Source: ONS and Daiwa Capital Markets Europe Ltd.

non-essential stores in England were allowed to reopen from 15 June. Having dropped about 80%Y/Y in mid-March, by last weekend footfall in retail parks had recovered to be down only about 30%Y/Y. But footfall in shopping centres was still under half its equivalent level that time last year, and that in high streets was still down more than 60%Y/Y. Meanwhile, yesterday's ONS experimental business survey results suggested that 40% or more of firms in hospitality, arts, entertainment and recreation had stopped trading by the first two weeks of June, while more than half of them still operating in those subsectors had stopped or reduced capital expenditure.

The week ahead in the UK

The coming week brings a somewhat quieter economic data calendar from the UK beginning with the release on Monday of the construction PMIs and new car registrations for June. Like in the manufacturing and service sectors, the headline construction PMI is expected to jump in June, from 28.9 previously, as an easing in lockdown measures in mid-May enabled firms to be operational for the whole month (albeit under social distancing rules) for the first time since February. With car dealerships having reopened on 1 June, we would also expect to see a notable improvement in new car registrations last month, following the near-90%Y/Y and 98%Y/Y declines recorded in the previous two months. Other economic releases of some note next week will be the REC/KPMG report on jobs on Wednesday, followed by the RICS Residential survey for June, which is expected to report only a modest easing in the rate at which house prices are falling. Of course, attention in the coming week will be on Chancellor Sunak's economic statement on Thursday, although he has appeared to dampen expectations of a significant further fiscal stimulus, hinting to MPs not to expect a big German-style cut in VAT. In the markets, the DMO will sell long-dated bonds on Monday, followed by index-linked bonds on Thursday.

Daiwa economic forecasts

		2019		2020				2019	2020	2021
		Q3	Q4	Q1	Q2	Q3	Q4			
GDP growth, %, Q/Q										
Euro area		0.3	0.1	-3.6	-11.0	7.0	1.6	1.2	-8.0	4.8
Germany		0.3	-0.1	-2.2	-7.0	3.5	1.5	0.6	-5.4	3.8
France		0.2	-0.1	-5.3	-14.0	9.5	2.5	1.5	-10.8	5.1
Italy		0.0	-0.2	-5.3	-13.0	7.0	1.0	0.3	-11.5	4.6
Spain		0.4	0.4	-5.2	-15.0	10.0	3.0	2.0	-10.7	7.2
UK		0.5	0.0	-2.0	-17.0	8.6	3.3	1.4	-10.1	4.7
Inflation, %, Y/Y										
Euro area										
Headline CPI		1.0	1.0	1.1	0.2	0.0	-0.2	1.2	0.3	0.8
Core CPI		0.9	1.2	1.1	0.9	0.4	0.0	1.0	0.6	0.4
UK										
Headline CPI		1.8	1.4	1.7	0.7	0.3	0.3	1.8	0.8	0.8
Core CPI		1.7	1.6	1.6	1.3	0.9	0.5	1.7	1.1	0.5
Monetary policy										
ECB										
Refi Rate %		0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Deposit Rate %		-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50
Net asset purchases*		0	20	20	140	140	140	20	140	20
BoE										
Bank Rate %		0.75	0.75	0.10	0.10	0.10	0.10	0.75	0.10	0.10
Net asset purchases**		0	0	36	40	17	17	0	17	0

*Monthly target €bn, end of period. **Monthly target £bn, end of period.
Source: Bloomberg, ECB, BoE and Daiwa Capital Markets Europe Ltd.

European calendar

Today's results							
Economic data							
Country	Release	Period	Actual	Market consensus/ Daiwa forecast	Previous	Revised	
EMU	 Final services (composite) PMI	Jun	48.3 (48.5)	47.3 (47.5)	30.5 (31.9)	-	
Germany	 Final services (composite) PMI	Jun	47.3 (47.0)	45.8 (45.8)	32.6 (32.3)	-	
France	 Final services (composite) PMI	Jun	50.7 (51.7)	50.3 (51.3)	31.1 (32.1)	-	
Italy	 Services (composite) PMI	Jun	46.4 (47.6)	47.0 (46.9)	28.9 (33.9)	-	
Spain	 Services (composite) PMI	Jun	50.2 (49.7)	45.9 (45.4)	27.9 (29.2)	-	
UK	 Final GfK consumer confidence survey	Jun	-27	-29	-30	-	
	 Final services (composite) PMI	Jun	47.1 (47.7)	47.0 (47.6)	29.0 (30.0)	-	
Auctions							
Country	Auction						
- Nothing to report -							

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Coming week's data calendar

The coming week's key data releases							
Country	BST	Release	Period	Market consensus/ Daiwa forecast	Previous		
Monday 06 July 2020							
EMU		09.30 Sentix investor confidence	Jul	46.5	-24.8		
		10.00 Retail sales M/M% (Y/Y%)	May	15.0 (-7.5)	-11.7 (-19.6)		
Germany		07.00 Factory orders M/M% (Y/Y%)	May	15.0 (-26.0)	-25.8 (-36.6)		
		08.30 Construction PMI	Jun	-	40.1		
Spain		08.00 Industrial production M/M% (Y/Y%)	May	15.6 (-22.5)	-21.8 (-33.6)		
UK		09.30 New car registrations Y/Y%	Jun	-	-89.0		
		09.30 Construction PMI	Jun	46.0	28.9		
Tuesday 07 July 2020							
Germany		07.00 Industrial production M/M% (Y/Y%)	May	10.0 (-18.0)	-17.9 (-25.3)		
France		07.45 Trade balance €bn	May	-	-5.0		
Italy		09.00 Retail sales M/M% (Y/Y%)	May	15.0 (-17.0)	-10.5 (-26.3)		
UK		09.30 Final output per hour Y/Y%	Q1	-2.9	0.3		
Wednesday 08 July 2020							
France		07.30 Bank of France industrial sentiment	Jun	90	83		
Thursday 09 July 2020							
Germany		07.00 Trade balance €bn	May	5.0	3.6		
UK		00.01 RICS house price balance %	Jun	-25	-32		
Friday 10 July 2020							
France		07.45 Industrial production M/M% (Y/Y%)	May	15.0 (-24.5)	-20.1 (-34.2)		
		07.45 Manufacturing production M/M% (Y/Y%)	May	- (-20.8)	-21.9 (-37.1)		
Italy		09.00 Industrial production M/M% (Y/Y%)	May	21.5 (-30.7)	-19.1 (-42.5)		

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions

Country	BST	Event / Auction
Monday 06 July 2020		
- Nothing scheduled -		
Tuesday 07 July 2020		
Germany 	10.30	Auction: €750mn of 0.5% 2030 index-linked bonds
UK 	10.00	Auction: £3.75bn of 0.125% 2023 bonds
	11.30	Auction: £2.25bn of 1.25% 2041 bonds
Wednesday 08 July 2020		
EMU 	09.45	ECB's de Guindos participates in a debate on 'The Pandemic Crisis in Europe: Impact, policy response and recovery'
	15:00	ECB's de Guindos participates in a virtual meeting
Germany 	10.30	Auction: €5bn of 2025 bonds
UK 	09.30	REC/KPMG Report on Jobs
Thursday 09 July 2020		
EMU 	-	Virtual Eurogroup meeting of euro area finance ministers
UK 	10.00	Auction: £900mn of 0.125% 2041 index-linked bonds
	-	Chancellor Sunak's economic statement
Friday 10 July 2020		
Italy 	14.00	Italian sovereign debt rating update from Fitch

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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