

Euro wrap-up

Overview

- Despite strong gains in equity markets in the region, Bunds lacked direction on a day of little substantive economic news from the euro area.
- Gilts made losses as UK inflation data exceeded expectations.
- Thursday will bring the latest monetary policy announcements from the ECB and UK labour market data.

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Daily bond market movements

| Bond | Yield | Change |
|--------------|--------|--------|
| BKO 0 06/22 | -0.681 | -0.006 |
| OBL 0 10/25 | -0.657 | +0.001 |
| DBR 0 08/30 | -0.446 | +0.002 |
| UKT 0½ 07/22 | -0.095 | +0.018 |
| UKT 0% 06/25 | -0.041 | +0.017 |
| UKT 4% 12/30 | 0.163 | +0.016 |

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

UK

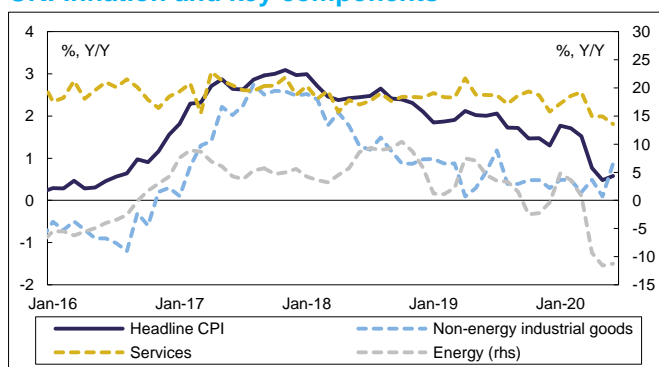
A surprise pickup in inflation

UK inflation was stronger than expected in June, with the headline CPI rate rising 0.1ppt to 0.6%Y/Y and the core inflation up 0.2ppt to 1.4%Y/Y. The upwards pressure came principally from inflation of non-energy industrial goods, which jumped 0.8ppt to 0.9%Y/Y, an eleven-month high. That was partly due to higher prices of computer games and consoles, which possibly reflected increased demand related to the lockdown as well as usual volatility. And prices of clothing rose too, as some recent special discounting reversed with the reopening of stores and apparent revival in sales. Despite the pickup in the oil price, energy inflation remained the largest drag, rising just 0.3ppt to -11.3%Y/Y. Meanwhile, food price inflation reversed the jump seen in May (down 0.6ppt to 1.4%Y/Y). And with activity in the hospitality sector still largely impeded by containment measures, restaurant and hotel prices pushed overall services inflation down 0.2ppt to 1.8%Y/Y, a series low. Given the need for statisticians to impute data for several items, however, the true level of services inflation might be lower than that. Indeed, prices accounting for 16% of the inflation basket – primarily those related to transport services – had to be imputed on the basis of past relationships. Excluding such items, the ONS stated that headline inflation would have been 0.1ppt lower at 0.5%Y/Y.

But price outlook still subdued

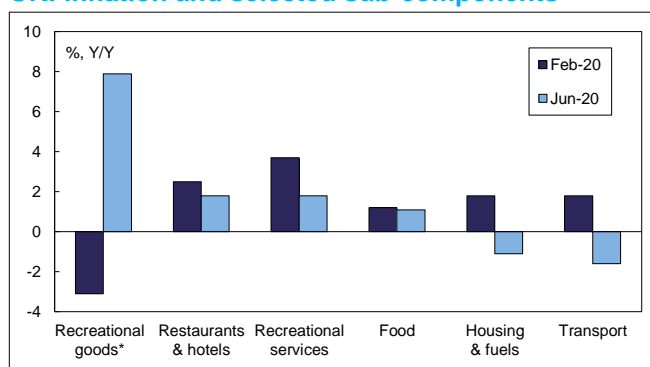
The negative impact on headline inflation from energy is set to diminish steadily over coming months. However, notwithstanding today's upside surprise, a persistent shortfall of demand for non-energy industrial goods and services, as well as the temporary reduced VAT rate for hospitality and entertainments effective for six months from today, will likely push inflation lower through the second half of the year close to or beyond zero. But from January, the imposition of significant new non-tariff barriers between the UK and EU, and quite possibly new tariffs too, represents an upside risk to inflation. At the same time, given the significant deterioration of the labour market underway, wage growth seems set to fade further, and so domestically-generated price pressures seem likely to remain weak. As a result, underlying inflation seems likely to remain sub-target over the horizon. So, the next move in monetary policy from the BoE is more likely to be to ease further rather than to tighten. Indeed, in a speech today, external MPC member Tenreyro stated that she expected disinflationary pressures to persist, and so signalled a continued readiness to vote for further monetary easing. She also reiterated that a future shift to negative rates remained very much a live issue, judging that the experience with such policies elsewhere had been largely positive.

UK: Inflation and key components



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Inflation and selected sub-components



*Games, toys and hobbies. Source: ONS and Daiwa Capital Markets Europe Ltd.



Rebound in demand to fall short of supply on a lasting basis

Despite yesterday's disappointingly [weak GDP report](#), Tenreiro asserted in her speech that there was evidence of a sharp recovery in purchases of items that had been restricted only because of mandated business closures. And today's Visa consumer spending indices complimented yesterday's Barclaycard report to support that judgement, suggesting a notable pickup in spending in June as lockdown measures relaxed. In particular, the headline index suggested that expenditure rose a record 16.6%M/M last month, following an increase of more than 11%M/M on the same basis in May. That left Visa expenditure down 'just' 6.5%Y/Y, following a drop of almost 20%Y/Y previously. Within the detail, spending on food and beverages continued to rise sharply (27%Y/Y), while there was also a further jump in expenditure on household goods (30%Y/Y). In contrast, however, spending on recreation and culture continued to fall (-6.0%Y/Y), with the hospitality sector faring much worse – spending was down 56%Y/Y following declines of almost 70%Y/Y and 80%Y/Y in May and April respectively. Tenreiro judged that the release of pent-up demand would continue to support vigorous growth in Q3 and Q4. But due to continued risk aversion, voluntary social distancing and increased unemployment, the V-shaped recovery would be interrupted and incomplete leaving a persistent shortfall of demand relative to supply. That view tallies with our own, and is also likely to align with the majority on the MPC.

The day ahead in the UK

Tomorrow's labour market figures are likely to show a further deterioration in conditions, although the pickup in the number officially unemployed in the three months to May will again have been limited by the government's Job Retention Scheme, which was supporting the incomes of more than 8½mn workers at the end of that period. Wage growth over the same period is expected to have moderated to below 1.0%Y/Y, its weakest rate since 2014. The most timely data – the Claimant Count in June – will include workers on very low incomes as well as those unemployed, and seems bound to report a significant further rise following the 1.5ppt increase to a 25-year high of 7.8% in May. Thursday will also bring the BoE's latest quarterly credit conditions survey for Q2, while BoE Governor Bailey will speak publicly on a webinar, although the subject matter – financial education – suggests no new insights into the future path of monetary policy.

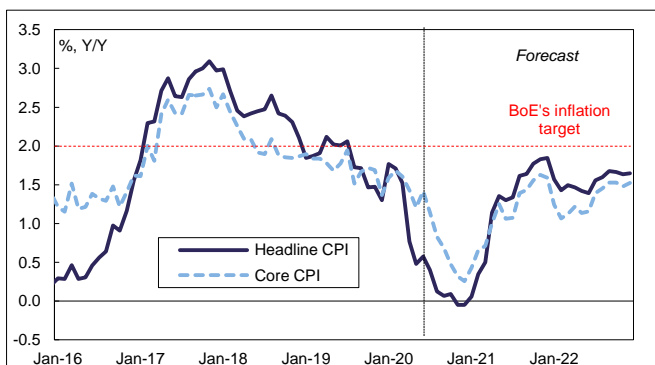
Euro area

The day ahead in the euro area

The main focus tomorrow will obviously be the ECB's monetary policy announcement, although we expect no major new policy initiatives. After all, at [the last meeting](#) in early June the Governing Council agreed to increase the envelope on the PEPP purchase programme by €600bn to up to €1.35trn, extend the horizon for the net purchases at least until the end of June 2021, and reinvest payments under the programme at least until the end of 2022. So, it bought itself several months to sit back and watch how the economic recovery evolves before deciding whether or not to increase the envelope further. Moreover, the easing of pressure on periphery bond spreads, particularly those of BTPs, as well as diminished bond market volatility, allowed the ECB last week to reduce its net purchases to €17½bn, the lowest since the programme was launched more than three months ago. The Governing Council should also be encouraged by recent economic data, which suggest that GDP might not contract quite so much as the 8.7%Y/Y central forecast published last month. Nevertheless, this meeting might not be completely uneventful. In particular, with excess liquidity having leapt to a new record high close to €2.8trn following the latest [TLTRO-iii operation](#), we expect the Governing Council to agree to increase the tiering multiplier to exempt a larger share of bank reserves (currently six times each credit institution's minimum reserve requirement) from the -0.50% deposit rate.

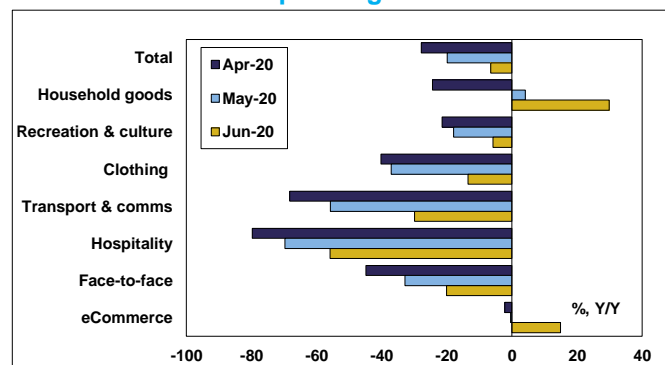
In terms of economic data, after an uneventful day for new releases today, Thursday will bring euro area car registrations data for June. With the exception of France, figures from the large member states suggested ongoing weakness despite a considerable moderation in the annual pace of decline. And overall, they all showed that registrations were still down by around 50%YTD/Y. Euro area trade figures for May and final French CPI numbers for June are also due for release.

UK: Inflation forecast



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Visa consumer spending






Source: Visa 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 |  Final CPI (EU-harmonised CPI) Y/Y% | Jun | -0.2 (-0.4) | -0.2 (-0.4) | -0.2 (-0.3) | - |
| UK |  CPI (core CPI) Y/Y% | Jun | 0.6 (1.4) | 0.5 (1.2) | 0.5 (1.2) | - |
| |  PPI input prices (output prices) Y/Y% | Jun | -6.4 (-0.8) | -6.3 (-1.1) | -10.0 (-1.4) | -9.4 (-1.2) |











Auctions

| Country | Auction |
|---------|---|
| Germany |  sold €4.1bn of 0% 2030 bonds at an average yield of -0.46% |
| UK |  sold £3.25bn of 2.25% 2023 bonds at an average yield of -0.069% |
| |  sold £1.5bn of 1.75% 2057 bonds at an average yield of 0.608% |















**Previous figure is for March 2020. 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 |  07.00 | EU27 new car registrations Y/Y% | Jun | - | -52.3 |
| |  10.00 | Trade balance €bn | May | - | 1.2 |
| |  12.45 | ECB main refinancing rate % | Jul | 0.00 | 0.00 |
| |  12.45 | ECB deposit rate % | Jul | -0.50 | -0.50 |
| France |  07.45 | Final CPI (EU-harmonised CPI) Y/Y% | Jun | 0.1 (0.1) | 0.4 (0.4) |
| Italy |  09.00 | Total trade balance €bn | May | - | -1.2 |
| UK |  07.00 | Unemployment claimant count rate (change '000s) | Jun | - | 7.8 (528.9) |
| |  07.00 | ILO unemployment rate 3M% | May | 4.0 | 3.9 |
| |  07.00 | Employment 3M/3M '000s | May | -253 | 6 |
| |  07.00 | Average earnings including bonuses (excluding bonuses) 3M/Y% | May | -0.4 (0.7) | 1.0 (1.7) |

Auctions and events

| Country | BST | Auction / Event |
|---------|---|---|
| EMU |  13.30 | ECB President Lagarde to hold press conference following Governing Council announcement |
| France |  09.50 | Auction: 0% 2024 bonds |
| |  09.50 | Auction: 0% 2026 bonds |
| |  09.50 | Auction: 3.5% 2026 bonds |
| |  09.50 | Auction: 2.75% 2027 bonds |
| |  10.50 | Auction: 0.1% 2026 index-linked bonds |
| |  10.50 | Auction: 0.1% 2029 index-linked bonds |
| |  10.50 | Auction: 0.1% 2047 index-linked bonds |
| Spain |  09.45 | Auction: 0.0% 2025 bonds |
| |  09.45 | Auction: 0.6% 2029 bonds |
| |  09.45 | Auction: 1.85% 2035 bonds |
| |  09.45 | Auction: 1.0% 2050 bonds |
| UK |  09.30 | BoE credit conditions survey |
| |  12.15 | BoEGovernor scheduled to speak at a webinar on financial education |

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:

<https://www.uk.daiwacm.com/ficc-research/recent-blogs>

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