Euro wrap-up

Overview

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- Despite some improved French retail and euro area car sales data, Bunds and other euro area govvies made gains as Lagarde stated that the ECB expects to purchase the full PEPP envelope of €1.35trn bonds.
- With equity markets weaker, Gilts also made gains as the latest UK labour market data suggested only modest improvement in conditions last month following marked deterioration in April and May.
- Friday will bring final euro area inflation data for June and the start of the leaders' summit on the EU Recovery Plan.

Daily bond market movements

Bond	Yield	Change
BKO 0 06/22	-0.699	-0.017
OBL 0 10/25	-0.681	-0.022
DBR 0 08/30	-0.473	-0.024
UKT 0½ 07/22	-0.114	-0.019
UKT 0⅝ 06/25	-0.084	-0.028
UKT 4¾ 12/30	0.134	-0.029

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

Euro area

ECB leaves rates and PEPP envelope unchanged

As expected, when its latest Governing Council meeting concluded today, the ECB made no changes to policy in terms of rates, asset purchases and forward guidance. So, for example, it re-committed to keep its key policy rates at the current levels or lower until the inflation outlook has converged back to target. And it reaffirmed the PEPP purchase envelope at €1.35trn, with Lagarde stating that the ECB will purchase the full amount unless there is a significant upside surprise to the economic outlook. (A Bloomberg report subsequently suggested that there was not unanimity on the Governing Council on this point, however.) For now, the Governing Council judged that events were unfolding broadly in line with its forecasts published last month, considering the recovery from a low level of activity to be uneven and partial, and expecting price pressures to remain subdued over the policy horizon. As such, the Governing Council saw the need to maintain its stimulus, with Lagarde noting that the measures taken between March and June were expected to add 1.3% to the level of GDP up to 2022 and 0.8ppt to inflation over that horizon too. While Lagarde acknowledged that the ECB has recently slowed its PEPP purchases to reflect improved bond market stability, she repeated that the Governing Council remained determined to use the full flexibility allowed within the PEPP programme, including with respect to divergences from the capital key.

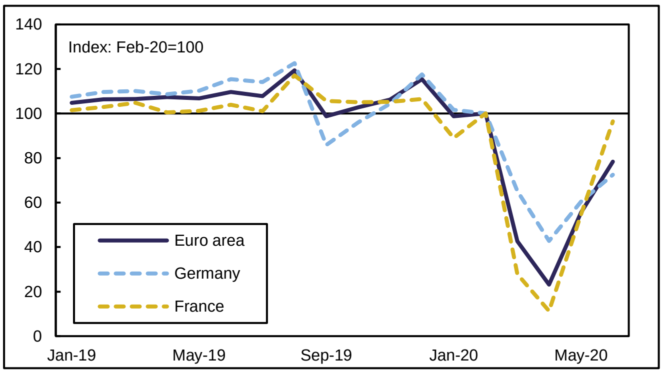
Tiering judged to be working well

In leaving all policy variables unchanged today, contrary to some expectations the ECB also failed to increase its tiering multiplier, a move that would have exempted a larger share of banks' deposits from the negative policy rate. Indeed, despite the recent increase in excess liquidity to a new record high, such a move wasn't even discussed as tiering – like the ECB's asset purchase and TLTRO-iii policies – was judged to be working well. However, Lagarde did not rule out such a move at a future meeting. Indeed, the Governing Council's forward guidance left the door open to future adjustments of all of its instruments, if necessary. And since we expect inflation to fall well short of the ECB's target over the horizon, we expect a further augmentation of the PEPP programme by year-end.

Euro area car registrations still well below pre-pandemic level

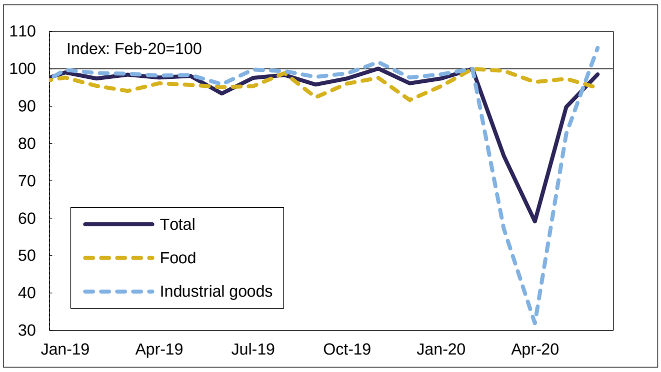
In terms of economic data, today's euro area car registrations figures showed that, despite the reopening of car dealerships across the member states, sales remained at a relatively subdued level in June, with the ECB's seasonally adjusted figures still down by around a fifth from the pre-pandemic level. This left unadjusted sales (published by ACEA) down 22.6%Y/Y. Of course, this was a notable moderation from the declines of more than 50%Y/Y seen in each of the previous three months. This in part reflected a modest increase in France (1.2%Y/Y) – the only member state to record a rise compared to last year – as the government launched new incentives for low-emission vehicles from the beginning of the month. The other large

Euro area: Car registrations



Source: ECB and Daiwa Capital Markets Europe Ltd.

France: Retail sales



Source: Bank of France, Refinitiv and Daiwa Capital Markets Europe Ltd.

member states continued to record double-digit declines – sales were down in Germany by 32.3%Y/Y, Italy by 43.6%Y/Y and Spain by 36.7%Y/Y. And overall, aggregate euro area registrations in the first half of the year were down 39%Y/Y, at 3.7m units, the lowest number since the series began in the late-1980s. We expect further recovery from July on, particularly in Germany where sales will be boosted by the cut in VAT.

French retail sales suggest V-shaped recovery

Consistent with the improvement in car registrations in June, French retail sales also rebounded that month as retailers resumed operations after lockdown. Indeed, sales increased 9.7%M/M to leave them up 5½%Y/Y and just 1½% below the pre-pandemic level. Moreover, sales of industrial goods jumped 28%M/M in June to leave them more than 5½% higher than February's level, as spending on DIY, furniture, consumer electronics and new bikes and autos rebounded. Of course, given the initial sharp retrenchment in the face of the Covid outbreak, total sales were still down almost 10%Q/Q in Q2. Furthermore, they represent less than 40% of household consumption, with spending on services likely to have remained far weaker last month due to the impact of the pandemic. Nevertheless, today's figures were consistent with the more upbeat assessment of the BoF last week, and suggestive of a relatively vigorous rebound in French GDP in Q3.

The day ahead in the euro area

Friday will bring the start of the EU leaders' two-day summit to discuss the European Commission proposals for a €750bn Recovery Plan. Having failed at their videoconference on 19 June to reach agreement on the detail, the leaders' first face-to-face summit since the outbreak of the pandemic might again fall short of sealing a deal, despite new compromise proposals issued last week by EU President Michel. Clearly, the negotiation is highly complicated, with many extremely sensitive political issues needing to be resolved. Non-negligible differences among the member states persist, not least in terms of: (1) the share of funds to be distributed in the form of grants rather than loans; (2) the allocation criteria, which under the Commission's original proposal would have given a particularly large share of funds to Poland even though its economy has been the least affected by coronavirus; (3) the maturities of the bonds to be issued; (4) the timeframe for allocating the funds, which the proposal currently envisages would see the largest share of resources disbursed after the end of next year once the most acute part of the crisis is likely to have passed; and (5) the precise linkages to the next EU seven-year Budget. We have doubts that agreement can be found on all of these items this weekend. So, a further meeting of EU leaders, at a minimum to tie up loose ends, might well be required at the end of the month.

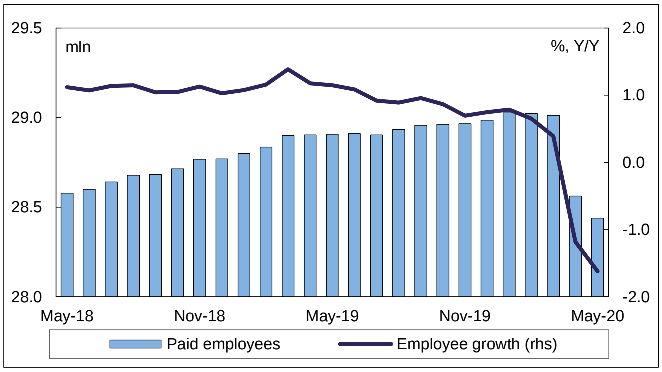
In terms of economic data, tomorrow will bring final euro area inflation figures for June. Today's French inflation figures saw the headline CPI rate revised up 0.15ppt to 0.2%Y/Y, albeit still marking a drop of 0.2ppt from May. But not least due to rounding, on balance, we expect the headline rate of euro area inflation to align with the flash estimate showing a rise of 0.2ppt to 0.3%Y/Y due to a slower pace of decline in energy inflation. In addition, the drop in the core rate of 0.1ppt to 0.8%Y/Y should also be confirmed. Meanwhile, construction output numbers for May are expected to report a notable rebound from the near-15%M/M declines seen in the previous two months.

UK

Initial labour market shock is easing

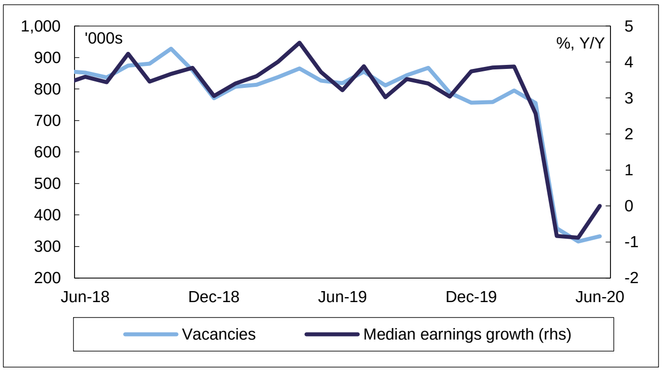
Today's data suggested that the shock of the lockdown on the labour market started to ease somewhat over recent weeks. The number of people in paid employment in June was down a sizeable 649k (2.2%) from March and 546k (1.9%) from a year earlier to the lowest level in almost three years. However, the monthly pace of decline slowed to 74k last month, some 50k less than in May and more than 375k less than in April. The further drop was related to a third successive fall in inflows into paid employment to 372k, while the outflow dropped for a second successive month to 447k, about half April's peak and below the average for the pre-pandemic period. Unfortunately, the number of vacancies in the three months to June fell to a record low of 333k, down almost 60%Y/Y, with drops in all sectors. On a monthly basis, however, the number of vacancies ticked up very slightly last month to suggest a slight improvement in inflows into paid employment over the near term.

UK: Number of employees



Source: ONS and Daiwa Capital Markets Europe Ltd.

UK: Job vacancies and earnings



Source: ONS and Daiwa Capital Markets Europe Ltd.

But a new shock awaits

Of course, without the government's Job Retention Scheme, which was supporting the incomes of 9.3mn employees (with a further 2.6mn on the equivalent scheme for the self-employed) at the end of last month, the increase in joblessness would have been extreme. And while the past few weeks already brought announcements of thousands of job losses from high-profile firms, the phasing out of the government's support from August to October will represent a new shock to the labour market, which seems bound to result in an acceleration of redundancies. While economic activity is expected to pick up further over coming months, the OBR estimated that there will likely still be more than 4mn workers on the Job Retention Scheme when it closes. At that point, a survey by the Resolution Foundation found that 11% of furloughed workers expect to be laid off at that point, with a further 14% judging that to be fairly likely. As a result, the OBR this week predicted that joblessness will rise to the highest since the 1930s, pushing the headline LFS unemployment rate close to 12% at year-end from 4.1% in May.

Wage growth exceptionally weak

With almost 500k people nominally in employment but working no hours and receiving no pay in the three months to May, and the number of self-employed down 178k, the total number of weekly hours worked over that period fell 16.7%3M/Y, the most on record, to the lowest level since 1997. But the monthly profile pointed to a modest improvement in hours worked towards the end of that period. Meanwhile, average weekly labour earnings were down 0.3%3M/Y in May to be 1.3%3M/Y lower in real terms. While the drop was driven by falling bonus payments, down 23.6%3M/Y, regular earnings growth ground to a halt. However, payroll data also point to an improvement in June, with median pay up 1.0%Y/Y having been down 0.9%Y/Y the prior month. The ONS partly attributes that improvement to a compositional effect, in particular the reduced inflow of workers into lower-paid jobs, while the return of some furloughed workers also likely played a part. Nevertheless, the claimant count – which includes those working with low incomes or hours and those who are not working – fell slightly to 2.6mn (down 0.1ppt to 7.3%). All indications, however, are that wages will come under renewed downward pressure over coming months as the number of unemployed workers rises.

Demand for corporate lending expected to fall back

Like the ECB's bank lending survey earlier in the week, the latest BoE credit conditions survey today illustrated the ongoing significant impact of the pandemic on firms' demand for liquidity. With credit availability in the three months to May having been significantly boosted by the central bank's funding support lines, the survey's net balance of firms' demand for loans surged to its highest level since the survey began in 2007, with the net balances for SMEs (90%) marginally higher than large firms (84%) as firms restructured their balance sheets. But while banks anticipated a further modest increase in credit availability in the three months to August, they expected to see a sharp drop in demand for new lending – most notably among medium- and large-sized firms – principally reflecting a further decline in funding needs for capex projects.

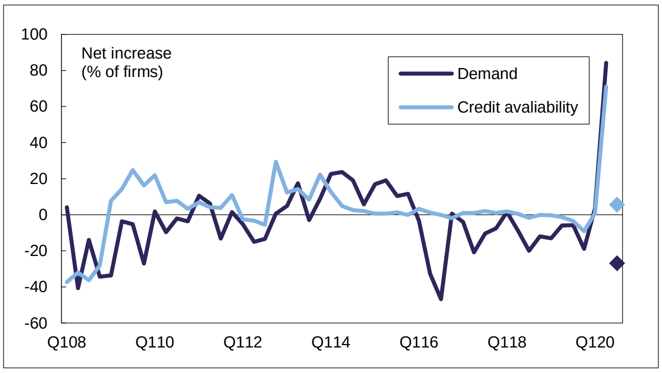
Households set to face tighter lending conditions

In marked contrast to the picture for corporate loans, demand for secured lending to households reportedly fell back sharply in the three months to May as the housing market effectively shut due to containment measures. But while available credit was reportedly expected to fall further in the three months ahead, banks expected renewed demand for loans ahead, by the most for 2½ years. Of course, mortgage demand might well receive a near-term boost by the Chancellor's decision to cut stamp duty temporarily. Similarly, having fallen sharply over the previous three months by the most since the survey began, banks anticipated a jump in demand for consumer credit over the near term. But, perhaps unsurprisingly against the backdrop of heightened economic uncertainty, deteriorating labour market prospects and worsening risk appetite, they also suggested that available credit is likely to be more restricted, with lending conditions set to become more expensive.

The day ahead in the UK

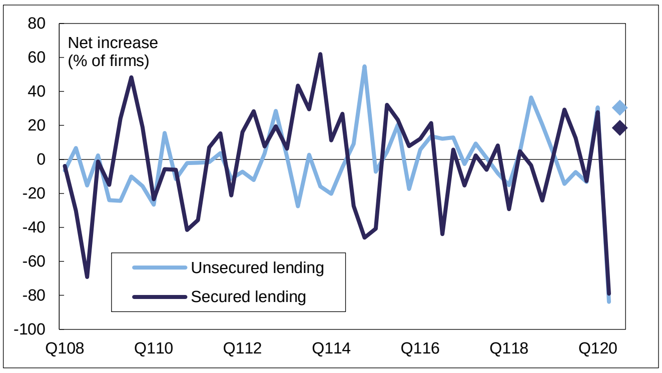
It should be a relatively quiet end to the week, with no top-tier UK data due for release.

UK: Demand and availability of corporate lending*



Diamonds represent expectations for Q320. Source: BoE, Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Demand for household lending*



Diamonds represent expectations for Q320. Source: BoE, Refinitiv and Daiwa Capital Markets Europe Ltd.

European calendar

Today's results

Economic data

Country		Release	Period	Actual	Market consensus/ *Daiwa forecast*	Previous	Revised
EMU		EU27 new car registrations Y/Y%	Jun	**-22.3**	-	-52.3	**-**
		Trade balance €bn	May	**8.0**	-	1.2	**1.6**
		ECB main refinancing rate %	Jul	**0.00**	0.00	0.00	**-**
		ECB deposit rate %	Jul	**-0.50**	-0.50	-0.50	**-**
France		Final CPI (EU-harmonised CPI) Y/Y%	Jun	**0.2 (0.2)**	0.1 (0.1)	0.4 (0.4)	**-**
Italy		Trade balance €bn	May	**5.6**	-	-1.2	**-1.1**
UK		Unemployment claimant count rate (change '000s)	Jun	**7.3 (-28.1)**	-	7.8 (528.9)	**7.4 (566.4)**
		ILO unemployment rate 3M%	May	**3.9**	4.0	3.9	**-**
		Employment 3M/3M '000s	May	**-125**	-253	6	**-**
		Average earnings including bonuses (excluding bonuses) 3M/Y%	May	**-0.3 (0.7)**	-0.4 (0.7)	1.0 (1.7)	**-**

Auctions

Country		Auction
France		sold €2.7bn of 0% 2024 bonds at an average yield of -0.58%
		sold €4.7bn of 0% 2026 bonds at an average yield of -0.45%
		sold €2.0bn of 3.5% 2026 bonds at an average yield of -0.47%
		sold €1.8bn of 2.75% 2027 bonds at an average yield of -0.38%
		sold €456mn of 0.1% 2026 index-linked bonds at an average yield of -0.98%
		sold €390mn of 0.1% 2029 index-linked bonds at an average yield of -0.96%
		sold €149mn of 0.1% 2047 index-linked bonds at an average yield of -0.75%
Spain		sold €1.5bn of 0% 2025 bonds at an average yield of -0.194%
		sold €921mn of 0.6% 2029 bonds at an average yield of 0.272%
		sold €1.4bn of 1.85% 2035 bonds at an average yield of 0.694%
		sold €2.1bn of 1.0% 2050 bonds at an average yield of 1.205%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's data releases

Economic data

Country		BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
EMU		10.00	Construction output M/M% (Y/Y%)	May	-	-14.6 (-28.4)
		10.00	Final CPI (core CPI) Y/Y%	Jun	0.1 (0.8)	0.3 (0.9)
Italy		09.00	Industrial sales M/M% (Y/Y%)	May	-	-29.4 (-46.9)
		09.00	Industrial orders M/M% (Y/Y%)	May	-	-32.2 (-49.0)
Spain		09.00	Trade balance €bn	May	-	1.5

Auctions and events

Country		BST	Auction / Event
EMU		-	EU leaders' summit (17-18 July)
		09.30	ECB's Vice President de Guindos scheduled to speak
		09.30	ECB's Schnabel scheduled to speak at a virtual roundtable event
Italy		14.00	Bank of Italy publishes its quarterly Economic Bulletin
UK		11.00	BoE Governor Bailey scheduled to speak

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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