

Euro wrap-up

Overview

- Bunds made modest losses as a report suggested the ECB would tolerate above-2% inflation when its strategy review concludes and a survey showed euro area consumer confidence at its highest since January 2018.
- Gilts also made modest losses as a UK manufacturing survey signalled a strong rebound in output, orders and selling price expectations, and public borrowing fell short of expectations again.
- Tomorrow brings the flash June PMIs from the euro area and UK.

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Daily bond market movements

Bond	Yield	Change
BKO 0 06/23	-0.658	+0.004
OBL 0 04/26	-0.559	+0.005
DBR 0 08/31	-0.165	+0.010
UKT 0 ¹ / ₈ 01/23	0.103	-0.012
UKT 0 ¹ / ₈ 01/26	0.386	+0.011
UKT 4 ³ / ₄ 12/30	0.780	+0.013

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

Source: Bloomberg

Euro area

Report suggests ECB will tolerate above-2% inflation, but no agreement yet on precise objective

After the ECB's Governing Council spent the weekend discussing issues related to its strategy review, a Reuters report citing three unattributed sources today suggested that significant progress had been made on certain second-tier issues. In particular, the report noted agreement on how to reflect climate change concerns in its policy-making, presumably in the asset purchase programme and collateral rules. And it also suggested that there was agreement on the need to consider owner-occupied housing costs in the assessment of inflation, an issue that raises practical challenges given the absence of reliable monthly data in that regard, but would be expected to boost inflation above rates currently measured by the existing HICP measure. However, there were reportedly still differences of opinion with respect to the top-tier issue of the definition of price stability and how to achieve it. Importantly, the report stated that "there was general consensus ... that the ECB could tolerate inflation exceeding its new goal, to be set at 2%... [but] had yet to agree on how to phrase that message and how specific it should be about the extent to which inflation would be allowed to overshoot and for how long." It is therefore unclear whether the ECB will simply commit to a symmetric target range above and below 2%, and/or will make an explicit Fed-style pledge to exceed 2% for some time to compensate for persistent sub-target inflation over the past decade. The precise definition of the commitment will have a key bearing on the monetary policy stance to be adopted over the coming year. The outcome of the strategy review is still expected to be announced by the Governing Council on 9 September, when the pace of net PEPP purchases in the fourth quarter will also be determined.

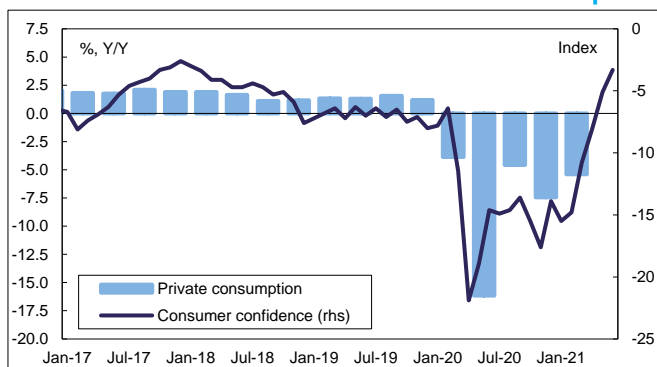
Consumer confidence jumps to the highest since start of 2018

Ahead of tomorrow's flash PMIs, and consistent with some national sentiment indices already published, today's European Commission preliminary euro area consumer confidence index reported a predictable improvement in June as lockdown measures continued to be relaxed and the vaccination programme gained traction. In particular, the index rose for the fifth consecutive month in June and by 2.8pts to -3.3, the highest reading since the start of 2018 and more than 14pts above the low at the end of last year when the third Covid wave commenced. So, while retail sales and spending on certain services in April were still hindered by ongoing Covid restrictions, today's survey strongly signals a solid rebound in private consumption over the second quarter as a whole.

The day ahead in the euro area

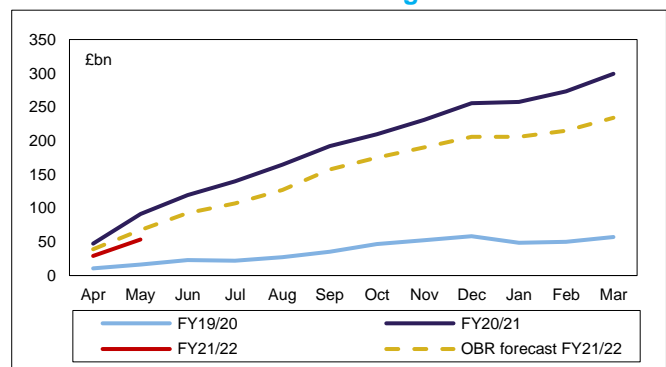
The flow of euro area economic sentiment surveys continues tomorrow with the release of the June flash PMIs, which are expected to point to an acceleration in the pace of economic expansion led by services, for which the euro area activity PMI

Euro area: Consumer confidence and consumption



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Public sector net borrowing



Source: ONS, Refinitiv, OBR and Daiwa Capital Markets Europe Ltd.

is expected to rise 2.8ppts to 58.0, which would be the highest since January 2018. Meanwhile, the euro area manufacturing output PMI is expected to remain elevated but edge back down for a third successive month from 62.3 in May. The survey will also likely continue to report backlogs of work close to record highs and continued very strong input price pressures in the sector. Overall, the euro area composite PMI is expected to rise from 57.1 in May to 58.8, which would be the highest since January 2018, underscoring the likelihood of a firm return to positive GDP growth in Q2.

UK

UK public borrowing undershoots expectations again

As repeatedly has been the case over recent months, UK public sector net borrowing again undershot expectations in May, coming in at £24.3bn (excluding banking groups), more than £1bn below the consensus forecast and more than £4bn below the OBR's most recent forecast. Most notably, it was down markedly from the record May reading of £43.8bn a year earlier. In addition, net borrowing in April was also revised down £2.6bn from the initial estimate. So, cumulative net borrowing in the first two months of the fiscal year of £53.4bn was more than £14bn below the OBR's forecast of £67.5bn. The drop in borrowing from a year earlier reflects the firm economic recovery, which has helped give a boost to government revenues and ease pressure on public spending. Indeed, despite increased spending on procurement, due in part to the NHS track and trace and vaccine programmes, central government spending was down £10.9bn (11.7%) from May 2020, with more than two-thirds of this drop due to reduced contributions to the job retention scheme. Meanwhile, central government receipts were up £7.5bn (15.2%) in May from a year earlier, with VAT contributions accounting for roughly one-third of the increase and a further £2bn accounted for by higher PAYE income tax and social contributions. While it might mean that some workers will remain on furlough for longer than otherwise would have been the case, the four-week delay in the easing of final restrictions on activity to 19 July seems unlikely to impact significantly the health of the public finances. And while public spending will at some point have to absorb losses from the state-backed emergency loan guarantee schemes, public sector net borrowing seems likely to remain well below the OBR forecasts over the course of the year. Indeed, cumulative net borrowing in FY21/22 as a whole might reasonably be expected to come in 10% or more below the OBR's current forecast of £233.9bn, and thus well down from the record £299.2bn (14.3% of GDP) in FY20/21.

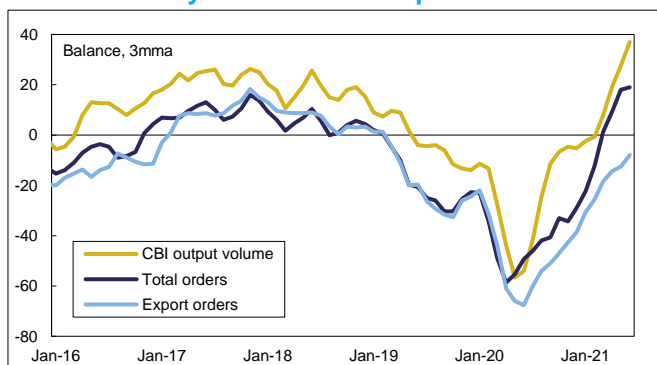
CBI survey imply strong rebound in output and orders, but also prices

Ahead of tomorrow's flash PMI surveys, today's CBI industrial trends survey predictably signalled firm recovery in the sector, with the survey's index of manufacturing output in the three months to June – up 19ppts to 37% – implying the fastest pace of annual growth since the survey began in 1975. Of course, this remains flattered by base effects from a year earlier when the economy was largely in lockdown. Nevertheless, 15 out of 17 subsectors reported rising output, underpinned by the autos and food and drink industries. And manufacturers remained upbeat about the near-term outlook, thanks to a further improvement in domestic demand pushing the survey's index of order books to the highest since 1988. Indeed, while overseas orders were their least weak in more than two years they continue to significantly lag those from at home, highly likely reflecting to some extent the impact of Brexit. Manufacturers also continued to express concern about supply bottlenecks, with the survey's measure of stock sufficiency at the weakest on record and the index of expected selling prices over the coming three months up to the highest since the early 1980s.

The day ahead in the UK

Like in the euro area, the focus in the UK tomorrow will be on the preliminary June PMIs, which we expect to be consistent with firm growth this month, despite the UK government's decision to extend the remaining restrictions on activity for a further four weeks. In particular, the composite PMI is expected to remain close to its record high of 62.9, thanks to robust conditions in both manufacturing and services.

UK: CBI survey measures of output and orders







UK: CBI selling expectations and PPI



European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
EMU	 European Commission preliminary consumer confidence	Jun	-3.3	-3.1	-5.1	-
Italy	 Industrial sales M/M% (Y/Y%)	Apr	3.3 (105.1)	-	1.6 (38.1)	1.7 (37.9)
UK	 Public sector net borrowing, excluding banks £bn	May	24.3	25.5	31.7	28.3
	 CBI industrial trends, total orders	Jun	19	18	17	-


Auctions

Country	Auction
- Nothing to report -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Yesterday's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
UK	 Rightmove house price index M/M%	Jun	0.8	-	1.8	-









Auctions

Country	Auction
- Nothing to report -	




Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
EMU	 09.00	Preliminary manufacturing (services) PMI	Jun	62.3 (58.0)	63.1 (55.2)
	 09.00	Preliminary composite PMI	Jun	58.8	57.1
Germany	 08.30	Preliminary manufacturing (services) PMI	Jun	63.0 (55.7)	64.4 (52.8)
	 08.30	Preliminary composite PMI	Jun	57.6	56.2
France	 08.15	Preliminary manufacturing (services) PMI	Jun	59.0 (59.5)	59.4 (56.6)
	 08.15	Preliminary composite PMI	Jun	59.0	57.0
UK	 09.30	Preliminary manufacturing (services) PMI	Jun	64.0 (62.8)	65.6 (62.9)
	 09.30	Preliminary composite PMI	Jun	62.5	62.9

Auctions and events

EMU	 08.30	ECB Vice President de Guindos scheduled to speak
Germany	 10.30	Auction: €2.5bn of 0% 2036 bonds
UK	 10.00	Auction: £400mn of 0.125% 2065 index-linked bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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