Euro wrap-up

Overview

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- As optimism regarding the UK referendum boosted risk appetite, Bunds made losses despite some soft euro area construction output data.
- Gilts made significant losses as opinion polls suggested an increase in support for the UK to remain in the EU.
- Tuesday will bring the latest German ZEW investor survey and UK public finance figures, while Draghi will speak at the European Parliament.

Daily bond market movements

Bond	Yield	Change*
BKO 0 06/18	-0.585	+0.024
OBL 0 04/21	-0.466	+0.032
DBR 0½ 02/26	0.060	+0.041
UKT 1¼ 07/18	0.473	+0.082
UKT 1½ 01/21	0.790	+0.095
UKT 2 09/25	1.242	+0.098

*Change from close as at 4.30pm BST.
Source: Bloomberg

Euro area

Construction output soft at start of Q2

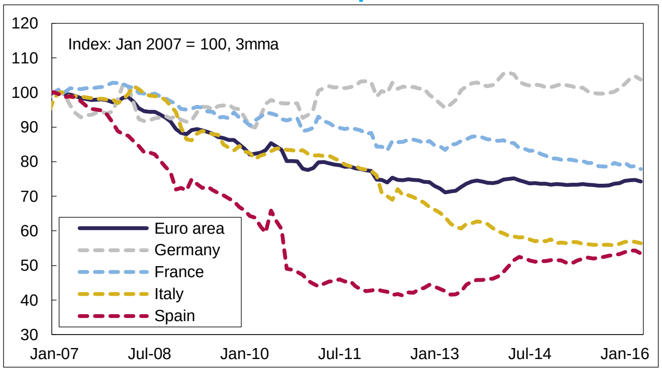
Having grown by more than 1%Q/Q in Q415 and Q116, euro area construction output was soft at the start of the second quarter, falling 0.2%M/M. As such, since the strong start to the year when output rose 2.0%M/M in January thanks not least to favourable winter weather, construction activity has contracted for three consecutive months leaving the level in April more than 1% below the Q116 average and 0.4% lower than a year earlier. The weakness in the latest month related to new building work, which also fell for the third consecutive month, while civil engineering output rose for the first month since January. At the country level, random volatility appeared to be significant as recent trends reversed, with output in the sector down in Germany and Spain following marked gains in the first quarter but activity up in France and Italy following notable drops in the first quarter. However, while growth in the sector looks set to be much weaker than in the previous two quarters, a moderate uptrend in construction output seems likely to resume soon supported by a range of factors including lower interest rates for borrowers, increased lending for house purchase, a gradual rise in home prices and improving labour market conditions. Indeed, other economic data today reinforced expectations of further declines in unemployment over the near term with the euro area job vacancy rate rising in Q1 to 1.7%, the highest for more than a decade among the nineteen countries currently making up the euro area. At the sectoral level, the vacancy rate remained highest in services (2.0%), while among countries it unsurprisingly remained particularly elevated in Germany (2.5%). Indeed, not least given the country's tight labour market, which is generating the euro area's firmest wage growth and supporting the region's fastest house-price inflation, we expect the trend in construction activity to remain most robust in Germany.

The day ahead in the euro area and US

Tuesday brings the first of numerous June economic sentiment survey results due this week in the shape of the German ZEW investor sentiment survey. Given the financial market risk aversion prevailing over the past couple of weeks, the current conditions and expectations measures might both be expected to show a deterioration in investor confidence. Meanwhile, the German Constitutional Court will pronounce its judgment in its proceedings on the legality of the ECB's OMT programme with a ruling broadly in favour of the current asset-purchase arrangements likely. And ECB President Draghi will speak at the European Parliament.

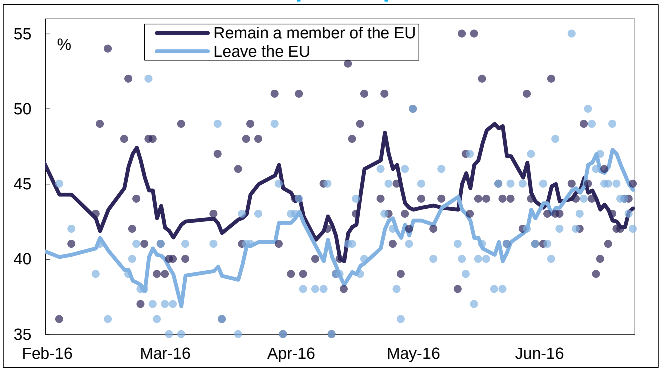
In the US, Fed Chair Yellen will testify on monetary policy to the Senate Banking panel while the Treasury will sell 5Y Notes.

Euro area: Construction output



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: Brexit referendum poll of polls*



**The dots show individual polls and the lines are seven-poll moving averages. Source: whatukthinks.org and Daiwa Capital Markets Europe Ltd.*

Daiwa Capital Markets

UK

Opinions polls show a shift back towards a Remain vote

With new opinion polls out over the weekend suggesting a swing in support back towards the Remain camp, global risk appetite was much improved today. Sterling was on a tear, up by late afternoon by more than 3 cents against the dollar to its highest level since end-May, while 10Y Gilt yields were up 10bps back firmly above 1.2% for the first time in a week and the FTSE closed up almost 3% on the day. And it was a similar story elsewhere, with European Bourses posting sharp gains and periphery sovereign spreads significantly tighter. In terms of the polls themselves, while one published by Opinium/Observer suggested that support for the two sides was running neck and neck at 44% apiece, a Yougov/Sunday times poll gave Remain a one-point lead (44-43) and a poll by Survation/MoS gave Remain a three-point lead (45-42). The shift in support back to the Remain camp appears to be matching the trend of the Scottish referendum whereby there was a swing back towards the status quo in the days ahead of the poll as voters appeared to become more averse to the risks of dramatic change. Of course, an increase in support for Remain might also be partly a reaction to the murder of the (Remain campaign's) MP Jo Cox last week and distaste at the dog-whistle tactics related to immigration employed by some of the Leave campaign, which also today saw a prominent Conservative former Minister switch sides to Remain. However, with polls also having signalled that those in favour of Brexit might on average still be more likely actually to vote, Thursday's referendum is still likely to be close.

The opinion polls indicate that a key factor influencing voting intentions is the potential impact on the economy. And the IMF report on Brexit published on the weekend came up with some familiar-looking estimates on the potential impact of a vote to Leave, e.g. under an 'adverse' scenario UK GDP would be more than 5½% lower by 2019, while the government's finances would be significantly weaker, with deficits persisting across the forecast horizon. Looking at direct spill-overs to other countries, given its significant economic and financial integration with the UK, Ireland is estimated to be worst hit, with GDP almost 2% lower by 2019 under the adverse scenario, while the Netherlands and Belgium would also see GDP more than ½% lower than it otherwise would be by then but other countries less affected. However, the IMF's estimates do not factor in the impact of any re-pricing of risk, which we think might be sizeable across the EU and would more significantly harm the economies of member states in Southern as well as Central and Eastern Europe.

The day ahead in the UK

Away from the referendum, the data flow tomorrow brings the CBI Industrial Trends survey for June and the public finance figures for May, which are expected to show that public sector borrowing in May was £9.5bn, nearly £1bn lower compared to a year ago.

European calendar

Today's results							
Economic data							
Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	**Revised**
EMU		Construction output M/M% (Y/Y%)	Apr	**-0.2 (-0.4)**	-	-0.9 (-0.5)	**-1.0 (0.5)**
		ECB QE net purchases €bn	Weekly	**16.9**	*18.2*	17.7	
Spain		Trade balance €bn	Apr	**-0.6**	-	-0.8	-
UK		Rightmove house price index M/M% (Y/Y%)	Jun	**0.8 (5.5)**	-	0.4 (7.8)	-
Auctions							
Country		Auction					
- Nothing to report -							

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	ZEW survey balance - expectations	Jun	-	16.8
Germany		10.00	ZEW current assessment balance (expectations)	Jun	53.0 (4.8)	53.1 (6.4)
UK		09.30	Public sector net borrowing excluding interventions £bn	May	*9.5*	7.2
		11.00	CBI Industrial Trends survey, total orders	Jun	-10	-8
Auctions and events						
Country		BST	Auction / Event			
EMU		14.00	ECB's Draghi scheduled to speak in Brussels			
Germany		09.00	German Constitutional Court rules on legality of ECB OMT programme			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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