Europe | Economic Research | 24 April 2017

# Euro wrap-up

## Overview

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- Bunds made significant losses and French government bonds made major gains as Macron's victory in yesterday's French election gave a big boost to risk appetite in the euro area.
- Gilts made losses as a survey signalled favourable conditions in the UK manufacturing sector.
- Tuesday brings the latest surveys on euro area bank lending survey and French business conditions, and UK public finances data.

**Daily bond market movements**

| Bond | Yield | Change* |
|---|---|---|
| BKO 0 03/19 | -0.691 | +0.098 |
| OBL 0 04/22 | -0.347 | +0.092 |
| DBR 0¼ 02/27 | 0.336 | +0.082 |
| UKT 1¾ 07/19 | 0.089 | -0.001 |
| UKT 0½ 07/22 | 0.509 | +0.015 |
| UKT 4¼ 12/27 | 1.061 | +0.026 |

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

# Euro area

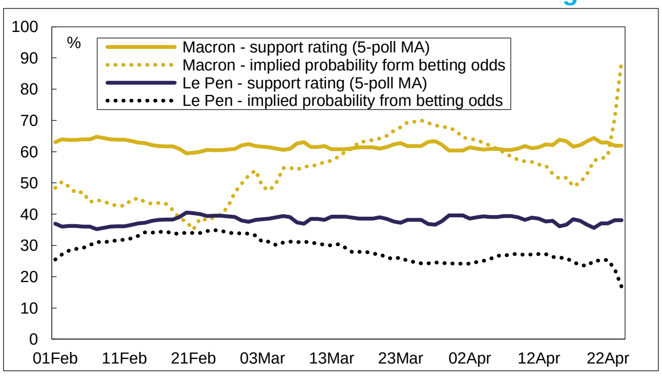
### Focus shifts to economic fundamentals

With Sunday's French election first round going just as the opinion polls had predicted, the second round on 7 May should see the centrist Emmanuel Macron comfortably beat the extremist Marine Le Pen by at least 20ppts. Policy-wise, that should mean incremental progress with economic reform in France despite Macron being highly unlikely to win a majority at June's National Assembly election. And it also raises the prospect of further gradual progress to develop the policy framework for the single currency in a more rational way once September's German election is out of the way. So, while there remain no shortage of European political events of significance over coming weeks (including a meeting of EU27 leaders on Saturday to discuss their Brexit strategy, and the first-round primary of the leadership election for former Italian PM Matteo Renzi's Democrat Party the following day), for the time being financial markets can shift their attention back to economic fundamentals and the outlook for monetary policy. And, in this respect, ahead of Thursday's scheduled policy announcement from the ECB's Governing Council, today's German Ifo business climate indices maintained the flow of upbeat surveys to suggest a notable strengthening of economic recovery in the first half of the year.

### Ifo signals strong German growth

In particular, the Ifo current conditions index rose for the eighth successive month in April and by the most since September to 121.1 – like other recent German business sentiment gauges such as the PMIs a near-six-year high, and a level rarely surpassed since reunification. And while the outlook index slipped back for the first month in three to suggest a greater degree of caution – perhaps related to the French election – the headline business climate index also rose to the highest since July 2011. The reported improvement in current conditions was again broad-based, with manufacturers upbeat about prospects for future production, wholesalers and retailers also happier, and the business climate index for construction rising to another new series high. Given recent data and surveys, we think that German GDP in Q1 rose 0.6%Q/Q, the most for a year, and if these Ifo indices are anything to go by, a similar rate might well be in store for Q2 too. And with the flash estimate of German inflation in April, due on Thursday, forecast to show a notable rebound of 0.4ppt to 1.9%Y/Y, we expect Bundesbank President Weidmann this week to lead the calls on the Governing Council for a change in the ECB's forward policy guidance. The majority of members, including Draghi, are highly likely to object, and so the policy statement will likely reaffirm that the Governing Council continues to expect rates "to remain at present or lower levels for an extended period of time, and well past the horizon of our net asset purchases". However, once the ECB has updated – and probably upgraded – its economic forecasts in June, that wording seems highly likely to be revised.

**French Presidential Election: 2nd round ratings***




*Moving average of head-to-head ratings from Harris, BVA, OpinionWay, Ifop-Fiducial, Ipsos, Elabe, Le Terrain, Kantar Sofres & Odoxa surveys, and implied probability of victory based on Oddschecker betting odds.
Source: Bloomberg, polling companies and Daiwa Capital Markets Europe Ltd.

**Emmanuel Macron: Selected policies**

- Cut tax burden on households & firms by €20bn over 5 years, including
  - Reducing the corporation tax rate from 33.3% to 25%
  - Reforming the wealth tax, local housing tax and social security contributions
- Cut public spending by €60bn over five years, including by
  - Reducing number of public sector jobs by 50k over 5 years
  - €50bn extra public investment (e.g. on training & transport) to boost growth
- Structural reforms, including
  - Reforms to wage bargaining arrangements & to cut employer labour costs
  - Extend unemployment benefits to new groups (e.g. the self-employed)
- Keep France's budget deficit below 3% of GDP in line with EU rules
- Establish a Budget and Ministry of Finance for the euro area

Source: En Marche! and Daiwa Capital Markets Europe Ltd.

## The day ahead in the euro area and US

Tuesday should be relatively quiet for economic news from the euro area. Data-wise, the ECB's latest quarterly bank lending survey is likely to show continued easy financial conditions and increased demand for loans in Q1, while the French INSEE business climate indices are likely to show ongoing improvement in sentiment in the euro area's second-largest member state at the start of Q2. In addition, Germany will sell 2Y bonds. In the US, several housing market indicators are due for release including March new home sales figures and the February FHFA and Case-Shiller house prices indices. In addition, the Conference Board's latest consumer confidence survey is due, and is expected to slip back only very slightly from the post-crisis high reached in March. In the markets, the US Treasury will sell 2Y notes.

# UK

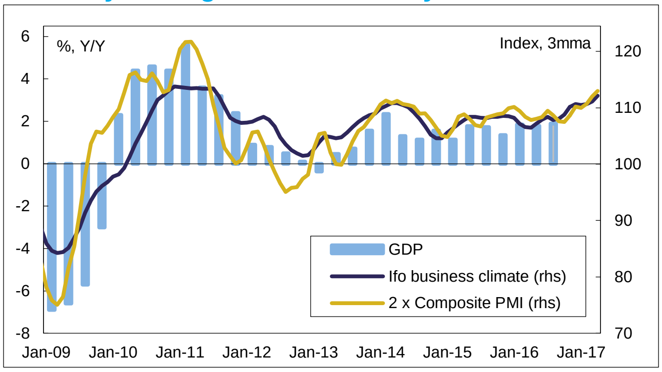
## Weak pound supports manufacturing, for now at least

Financial markets took a dim view of Brexit in the wake of the referendum last year, with sterling – the bellwether of how harmful to UK competitiveness separation from the EU is expected to be – depreciating sharply. But, for the time being, that depreciation has placed many UK manufacturers in a fortuitous position, boosting price competitiveness while Brexit and its implications for trade barriers are still slightly less than two years away, and possibly further ahead if the UK government and the EU strike a transitional deal. As a result, manufacturers saw output growth hit a six-year high of 4.2%Y/Y in December and, although the pace moderated in the first months of 2017, today's CBI Industrial Trends survey was upbeat suggesting that export-led growth in the sector is set to continue. Indeed, for the three months to April, the survey measure of export orders rose to a six-year high, while the index for output increased to the best reading in almost three years. But while the index of export prospects for the year ahead strikingly hit the highest level since 1973, domestic demand was expected to weaken in the near term, and therefore manufacturers assessed that output growth is likely to moderate. And with manufacturers unwilling to increase their production capacities – indeed, there was a notable softening in investment plans, in particular in building, plants and machinery – the survey suggests that they perceive the current boost to demand to be very much a temporary phenomenon.

## The day ahead in the UK

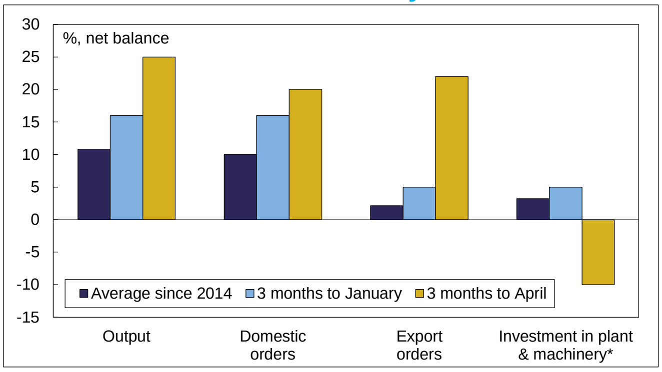
As the political parties draft their election manifestos, hopefully with the intention of shining light on how they would intend to tackle the UK's fiscal challenges, the latest public finance figures, due tomorrow, are likely to show that the full-year deficit for FY16/17 was slightly lower than the OBR envisaged in its most recent forecasts published last November. Public sector net borrowing in March is expected to come in below the £4.2bn level for the same month last year, to leave the full-year figure about £1bn lower than the forecast level of £51.7bn.

### Germany: GDP growth and survey indices




*Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.*

### UK: CBI Industrial Trends Survey




**Intentions for the coming 12 months relative to actual spending in the previous 12 months.*
*Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.*

# European calendar

## Today's results

**Economic data**

| Country | | Release | Period | **Actual** | Market consensus/ Daiwa forecast | Previous | **Revised** |
|---|---|---|---|---|---|---|---|
| EMU | | ECB public sector asset purchases €bn | Weekly | **11.1** | *11.5* | 12.5 | **-** |
| Germany | | Ifo business climate index | Apr | **112.9** | 112.4 | 112.3 | **112.4** |
| | | Ifo current assessment balance (expectations) | Apr | **121.1 (105.2)** | 119.2 (105.9) | 119.3 (105.7) | **119.5 (-)** |
| UK | | Rightmove house price index M/M% (Y/Y%) | Apr | **1.1 (2.2)** | - | 1.3 (2.3) | **-** |
| | | CBI Industrial Trends survey, total orders | Apr | **4** | 6 | 8 | **-** |
| **Country** | | **Auction** | | | | | |
| Italy sold | | €2bn of 0% 2018 bonds (28-Dec-2018) at an average yield of -0.075% | | | | | |
| | | €738mn of 0.1% 2022 index-linked bonds (15-May-2022) at an average yield of 0.14% | | | | | |
| | | €512mn of 1.25% 2032 index-linked bonds (15-Sep-2032) at an average yield of 1.36% | | | | | |

*Source: Bloomberg and Daiwa Capital Markets Europe Ltd.*

## Tomorrow's data releases

**Economic data**

| Country | | BST | Release | Period | Market consensus/ *Daiwa forecast* | Previous |
|---|---|---|---|---|---|---|
| France | | 07:45 | Business confidence indicator (production outlook) | Apr | 104 (3) | 104 (3) |
| UK | | 09:30 | Public sector net borrowing excluding interventions £bn | Mar | 3.1 | 1.8 |

**Auctions and events**

| Country | | BST | Auction / Event |
|---|---|---|---|
| EMU | | 09:00 | ECB publishes the euro area Bank Lending Survey |
| Germany | | 10:30 | Auction: To sell €4bn of 0% 2019 bonds (15-Mar-2019) |

*Source: Bloomberg and Daiwa Capital Markets Europe Ltd.*

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