

Euro wrap-up

Overview

- Bunds were little changed as euro area economic survey results were consistent with ongoing expansion, albeit at a softer rate than in Q1.
- Gilts were little changed as the UK Treasury set out its downbeat assessment of the near-term economic impact of a vote to leave the EU.
- Tuesday will see euro area finance ministers discuss Greece, BoE Governor Carney in front of the UK Treasury Committee, economic surveys from Germany, France and the UK, and German GDP data.

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Daily bond market movements

Bond	Yield	Change*
BKO 0 03/18	-0.509	-0.001
OBL 0 04/21	-0.348	+0.005
DBR 0½ 02/26	0.182	+0.017
UKT 1¼ 07/18	0.450	+0.006
UKT 1½ 01/21	0.902	+0.009
UKT 2 09/25	1.454	+0.002

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

Euro area

Flash PMIs consistent with Q2 slowdown

Today brought the first top-tier euro area economic survey results for May, with the flash PMIs tallying with our forecast of a slowdown in GDP growth in Q2 to 0.3%Q/Q from 0.5%Q/Q in Q1. In particular, for the second successive month the euro area composite PMI slipped 0.1pt to reach a sixteen-month low of 52.9. Within the detail, the composite new business indicator also fell to the lowest since January 2015, suggesting that activity in June will likely remain subdued. At the sectoral level, the services PMI was unchanged at 53.1 for the third month, likewise the lowest since January 2015, while the manufacturing PMI fell 0.2pt to 51.5, the second lowest level in fifteen months. At the country level, meanwhile, the weakness in the latest month appears to be related to Italy and Spain as the flash composite PMIs of Germany and France rose to five- and seven-month highs respectively. Those increases in the two largest member states were driven by the services sector, although a notable decline in the services new business index in Germany would suggest that the improvement there might well prove fleeting. With respect to inflation, meanwhile, the euro area composite input price PMI rose to a ten-month high, no doubt at least in part due to the higher oil price. Nevertheless, with the survey measure of output prices still consistent with deflation, firms appear unable to pass on fully the increased costs to consumers, with the implication that margins are now being squeezed.

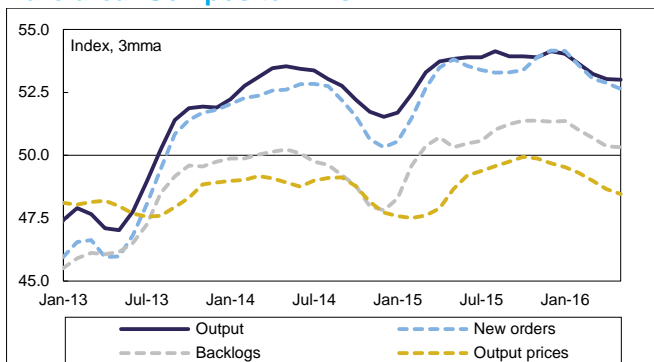
Consumer confidence up to highest since January

In contrast to the PMIs, the flash euro area Commission consumer confidence index beat expectations, rising the most in more than a year to -7.0, the highest level since January. The improvement in the latest month, however, left the average for the first two months of Q2 little different to the Q1 level, which was the lowest since Q414. So, while it suggests that households should continue to support GDP growth, the Commission confidence index is still consistent with a slowdown in consumption in the second quarter. And given the drop in euro area negotiated wage growth in Q1 to a single currency-era low of just 1.4%Y/Y, coupled with the higher inflation outlook related not least to recent gains in oil prices, we expect the slowdown in real disposable income growth to weigh further on consumption growth over coming quarters too.

The day ahead in the euro area and the US

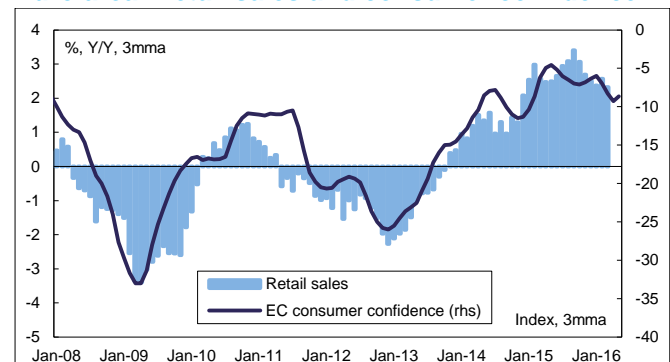
Tuesday afternoon will bring the latest meeting of the Eurogroup of euro area finance ministers, with Greece set to be the principal focus of discussion after its national parliament on Sunday voted, with the backing of 153 out of the 300 lawmakers, to approve another omnibus bill of fiscal reform measures including a range of further tax increases, the establishment of a process for determining further public spending cuts in the event of budgetary shortfalls, and the creation of a new

Euro area: Composite PMIs



Source: Markit, Datastream and Daiwa Capital Markets Europe Ltd.

Euro area: Retail sales and consumer confidence



Source: EC, Datastream and Daiwa Capital Markets Europe Ltd.



independent privatisation agency to which certain state assets would be transferred. Euro area finance ministers will assess whether the new measures qualify for disbursement of the latest tranche of funds to enable the Greek authorities to meet their payments of about €3.5bn due by end-July. In addition, the ministers will discuss certain options to enhance the sustainability of Greece's debt, including longer grace and repayment periods, the transfer of IMF loans to the ESM, the transfer of Eurosystem profits to the Greek authorities, and other measures to reduce the sovereign's liabilities in NPV terms. It remains to be seen, however, how much if any of the relief would be provided immediately or only if and when the current programme has been fully implemented in 2018. And certainly, it is likely to be difficult to reconcile the different positions among member states and the IMF, which a leaked report revealed is seeking the deferral of all principal and interest payments on Greece's debts owed to member states and the EFSF and ESM until at least 2040, and extension of the maturities of those debts to 2080.

Data-wise, Tuesday brings further May survey results, most notably the German ZEW survey of investor sentiment and the French INSEE survey of business confidence. In addition, the second estimate of German GDP in Q1 is due and likely to confirm the flash estimate of growth of 0.7%Q/Q, the strongest rate in two years. The expenditure breakdown will be released for the first time and is set to show that growth was driven by an acceleration in consumer spending growth and firm capital expenditure while net trade subtracted.

In the US, April's new home sales figures are due while the Treasury is scheduled to sell 2Y Notes.

UK

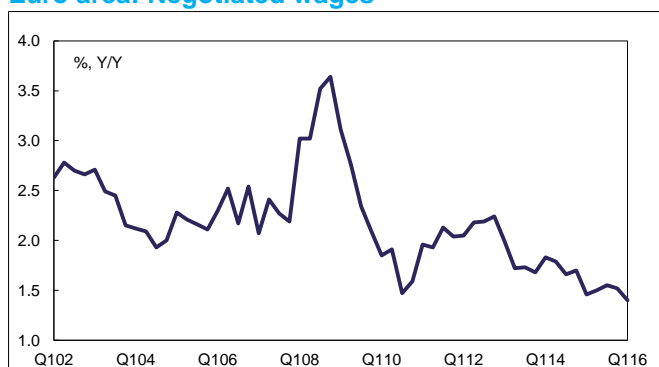
Remain camp on the rise

The past weekend saw the release of further opinion poll results signalling an increase in support to remain in the EU. Most notably, an online survey by Opinium, published in the Observer, suggested a 4pt lead for the 'Remain' camp, reversing the 4pt lead for the 'Leave' camp reported in the equivalent poll in early April, with a notable shift in favour of EU membership among Conservative party supporters. That trend of increased support for 'Remain' might be expected to continue if voters believe the latest credible HM Treasury analysis of the likely short-term impact of Brexit published this morning. In particular, modelling the economic impact via certain channels – including the effect of uncertainty on economic decision-making and the consequences of heightened financial market volatility – the Treasury forecasts that a vote to 'Leave' would trigger four quarters of negative GDP growth, with a relatively subdued path thereafter, leaving the level of GDP somewhere between 3.6-6.0% below where it otherwise would have been by 2018, with inflation significantly higher and house prices 10% or more lower than they otherwise would be.

The day ahead in the UK

After a quiet start to the week on the data front today, the UK data flow picks up tomorrow with the release of public finance figures for April and the CBI's Distributive Trades survey for May. But perhaps more noteworthy will be the testimonies by Mark Carney and other MPC members on the BoE's May Inflation Report before the Treasury Select Committee.

Euro area: Negotiated wages



Source: ECB and Daiwa Capital Markets Europe Ltd.

UK: HMT estimated short-term impact of Brexit vote









	Shock scenario*	Severe shock scenario*
GDP (%)	-3.6	-6.0
Headline CPI (ppts)	+2.3	+2.7
Unemployment rate (ppts)	+1.6	+2.4
Unemployment (level, 000k)	+520	+820
Average real wages (%)	-2.8	-4.0
House prices (%)	-10	-18
Sterling exchange rate index (%)	-12	-15
Public sector net borrowing (£bn)**	+24	+39

Difference from base level (i.e. vote to Remain). *Peak impact over two years. Unemployment level rounded to nearest 10,000. **Fiscal year 2017-18. Source: HM Treasury

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
EMU	 Preliminary manufacturing PMI	May	51.5	51.9	51.7	-
	 Preliminary services PMI (preliminary composite PMI)	May	53.1 (52.9)	53.2 (53.2)	53.1 (53.0)	-
	 ECB QE net purchases €bn	Weekly	16.9	<u>18.2</u>	16.9	-
	 Preliminary consumer confidence	May	-7.0	-9.0	-9.3	-
Germany	 Preliminary manufacturing PMI	May	52.4	52.0	51.8	-
	 Preliminary services PMI (preliminary composite PMI)	May	55.2 (54.7)	54.6 (53.9)	54.5 (53.6)	-
France	 Preliminary manufacturing PMI	May	48.3	49.0	48.0	-
	 Preliminary services PMI (preliminary composite PMI)	May	51.8 (51.1)	50.6 (50.4)	50.6 (50.2)	-







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/ <i>Daiwa forecast</i>	Previous
EMU	 10.00	ZEW survey balance - expectations	May	-	21.5
Germany	 07.00	GDP – second release Q/Q% (Y/Y%)	Q1	<u>0.7 (1.6)</u>	0.3 (1.3)
	 10.00	ZEW current assessment balance (expectations)	May	49.0 (12.0)	47.7 (11.2)
France	 07.45	Business confidence indicator (production outlook)	May	101 (-)	101 (-1)
UK	 09.30	Public sector net borrowing excluding interventions £bn	Apr	6.4	4.8
	 11.00	CBI's Distributive Trades survey, reported sales	May	8	-13

Auctions and events

Country	BST	Auction / Event
EMU	 08.00	ECB's Praet scheduled to speak in Paris
	 14.00	Eurogroup meeting in Brussels
UK	 10.00	BoE's Carney and other MPC members testify before the Treasury Select Committee in Parliament

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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