Euro wrap-up

Overview

- Bunds made modest gains despite new surveys suggesting that German firms and consumers have become more upbeat.
- Gilts also made modest gains on a day free of new UK economic data.
- Thursday brings second estimates of Q1 GDP growth from the UK and Spain.

Economic Research Team
+44 20 7597 8326

Daily bond market movements

Bond	Yield	Change*
BKO 0 03/18	-0.510	-0.003
OBL 0 04/21	-0.365	-0.014
DBR 0½ 02/26	0.151	-0.026
UKT 1¼ 07/18	0.475	-0.008
UKT 1½ 01/21	0.926	-0.011
UKT 2 09/25	1.453	-0.019

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

Euro area

Greek drama suspended for the summer

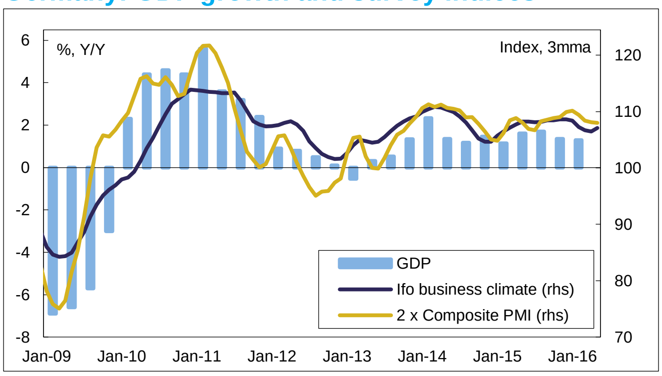
There will be no repeat of last summer's Greek drama after last night's Eurogroup meeting saw finance ministers agree in principal to disburse more funds and put in place a new framework to improve the sustainability of Greek debt. In particular, subject to a final check of the recent reform measures adopted by the Greek authorities, the ESM will disburse €7.5bn next month to allow Greece to meet its repayment spike in July and clear arrears, with a further €2.8bn set to be forthcoming after the summer. Additionally, in terms of debt sustainability, the Eurogroup agreed to maintain Greece's gross financing needs below 15% of GDP over the medium term, and below 20% of GDP thereafter. In terms of precise debt relief measures, the most notable measure over the near term will be a smoothing of the EFSF repayment profile. But, assuming the Greek authorities do what is being asked of them in terms of reform and adjustment, more substantive relief would come after the conclusion of the current programme in 2018 (i.e. once the German, French and Dutch elections are safely out of the way), with the possibility of using ESM resources to allow the early partial repayment of IMF loans as well as additional re-profiling of EFSF amortisation and the capping and deferral of interest payments.

Following last night's deal, we would expect next week's Governing Council meeting to give the green light for the reintroduction of the waiver on Greek bonds allowing their acceptance as collateral in ECB refinancing operations, a measure that would limit the Greek banks' reliance on more costly ELA. And, by implication, the Governing Council would also then need to discuss what the Eurogroup's deal might mean for possible eventual eligibility of Greek government bonds for purchase under the ECB's QE programme too. However, since the most substantive debt relief measures will not come in to play until 2018 at the earliest, the ECB's own debt sustainability analysis might be expected to preclude purchase of Greek debt before then.

German sentiment improves

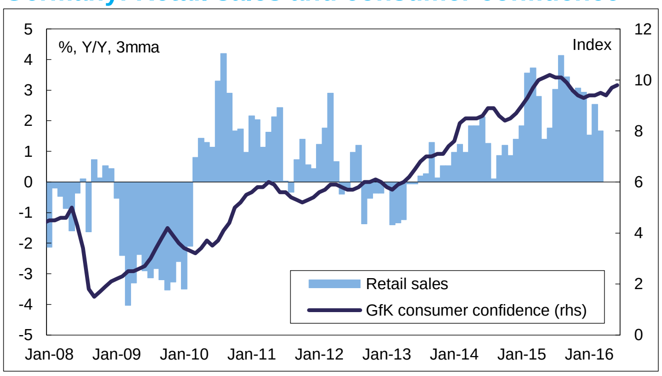
According to the latest sentiment indicators, German economic growth looks to be well maintained in the second quarter. After Monday's flash composite PMI rose more than 1pt to the highest since December, today's Ifo headline business climate index did likewise, rising back to the middle of the range of the past two years. The indicator of current conditions rose to its highest in eight months and close to the top of the range of the past couple of years, but the measure of business expectations only reached the highest since January and remained below the levels prevailing throughout last year. At the sectoral level the improvement was widely felt with manufacturers reportedly the most upbeat since January and the construction indicator rising to a series high. And the improvement in sentiment among retailers signalled by the Ifo survey – with the relevant index

Germany: GDP growth and survey indices



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

Germany: Retail sales and consumer confidence



Source: Datastream and Daiwa Capital Markets Europe Ltd.

up to its highest level since September – tallied with the latest GfK consumer confidence survey, which provided a modest upside surprise with the headline sentiment index edging up to a nine-month high. Within the detail, there was a further improvement in consumers' expectations regarding the near-term economic outlook. And, despite a softening of expectations about future incomes from a very high level, the survey measure of consumers' propensity to buy rose to its highest for a year. So, all the indications are that consumer spending will remain a key driver for German GDP growth over the near term.

The day ahead in the euro area and the US

Thursday brings the final estimate of Spanish GDP in Q1, which is likely to confirm the flash estimate of 0.8%Q/Q and will include the expenditure breakdown for the first time, together with Italian retail sales figures for March. In the markets, Italy will sell 2Y zero-coupon bonds. In the US, meanwhile, Thursday brings April's preliminary durable goods figures, pending home sales numbers for the same month, and the usual weekly jobless claims data. In addition, FOMC voting members Powell and Bullard will speak publicly while the Treasury will sell 7Y Notes.

UK

IFS latest to warn of Brexit impact

The past week has seen a notable shift in the opinion polls suggesting a sizeable shift in public support to remain in the EU, seemingly as the weight of the economic arguments in favour of membership sways voters. Today saw the latest contribution to the debate in the shape of analysis from the independent experts on the public finances, the Institute for Fiscal Studies (IFS), which added to the already-large stock of economic analysis warning of the adverse economic consequences that would result from a vote to 'Leave' the EU in next month's referendum. In particular, assuming a near-term hit to GDP of between 2.1-3.5% by 2019 as estimated by the independent NIESR, the IFS estimated that public sector net borrowing would be between £25-40bn (1.3-2.0% of GDP) higher even after allowing for savings on the approximately £8bn per annum net contribution to the EU budget between now and 2019. By implication, additional austerity measures of a broadly similarly magnitude, if not more, would be required if, despite the negative hit to economic output, the government still intended to meet its objective of a balanced budget by the end of the current parliament or thereabouts.

The day ahead in the UK

Tomorrow brings revised GDP figures, which are likely to confirm the preliminary estimate of growth of 0.4%Q/Q in Q1. But not least due to weaker-than-expected construction output figures and other economic indicators signalling a loss of momentum in early spring, we see a significant probability of a downward revision. The expenditure breakdown, meanwhile, looks set to show that consumption continued to expand at a firm pace of around ½%Q/Q, while the net trade contribution was almost certainly negative for a third consecutive quarter. Also of note tomorrow will be the BBA release of the High Street Banking data for April.

European calendar

Today's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	**Revised**
Germany		GfK consumer confidence survey	Jun	**9.8**	9.7	9.7	**-**
		Ifo business climate index	May	**107.7**	106.8	106.6	**106.7**
		Ifo current assessment balance (expectations)	May	**114.2 (101.6)**	113.3 (100.8)	113.2 (100.4)	**- (100.5)**
Italy		Industrial orders M/M% (Y/Y%)	Mar	**-3.3 (0.1)**	-	0.7 (3.8)	**-**
		Industrial sales M/M% (Y/Y%)	Mar	**-1.6 (-3.6)**	-	0.1 (-0.2)	**-**

Auctions

Country		Auction
Germany sold		€821mn of 2.5% 2044 bonds (04-Jul-2044) at an average yield of 0.88%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's data releases

Economic data

Country		BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Italy		10.00	Retail sales M/M% (Y/Y%)	Mar	-	0.3 (2.7)
Spain		08.00	GDP – second release Q/Q% (Y/Y%)	Q1	*0.8 (3.4)*	0.8 (3.5)
UK		09.30	GDP – second release Q/Q% (Y/Y%)	Q1	*0.4 (2.1)*	0.6 (2.1)
		09.30	Index of services M/M% (3M/3M%)	Mar	*0.2 (0.6)*	0.1 (0.7)
		09.30	BBA loans for house purchase 000s	Apr	44.7	45.1

Auctions and events

Country		BST	Auction / Event
Italy		10.00	Auction: To sell up to €2.5bn of 2018 zero-coupon bonds (28-Mar-2018)

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:
http://www.uk.daiwacm.com/research-zone/research-blog

Follow us
@DaiwaEurope