

# Euro wrap-up

## Overview

- Bunds were little changed today despite an upside surprise to the European Commission's latest economic sentiment index.
- Gilts made gains as UK politics dominated the headlines on a quiet day for domestic economic news.
- Tomorrow will bring French flash inflation figures and German labour market data. UK politics will also continue to dominate the news flow.

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### Daily bond market movements

Bond	Yield	Change*
BKO 0 06/21	-0.641	-
OBL 0 04/24	-0.548	-0.010
DBR 0¼ 02/29	-0.154	-0.010
UKT 1½ 01/21	0.610	-0.019
UKT 1 04/24	0.680	-0.025
UKT 1½ 10/28	0.929	-0.027

\*Change from close as at 4.30pm BST.

Source: Bloomberg

## Euro area

### Commission's ESI surprises on the upside

Following last week's disappointing flash PMIs for May, there was a welcome upside surprise to today's Commission business and consumer survey, which saw the headline euro area economic sentiment index rise for the first month in eleven and by a stronger-than-expected 1.2pts – the most since July 2017 – to 105.1. While improvements were reported among the largest four member states, the most significant increase came from France (4pts) which rose to a nine-month high. Among the subsectors, there was a notable turnaround in the euro area's manufacturing sector, which reported the first increase in sentiment in thirteen months, principally reflecting the largest increase in production expectations in 6½ years. Services firms were also more upbeat, with the relevant index rising to a five-month high, while the improved optimism among consumers previously indicated in the flash estimate was confirmed. Despite this backdrop, retailers saw little change in conditions in May. And there was also a notable drop in construction confidence, which fell by the most in more than three years as firms in the sector were more downbeat about their order books and employment plans. Despite the pickup in the headline indicator, overall, the Commission's survey – which often provides the most reliable guide to euro area economic activity – suggested that economic momentum continued to soften in Q2. Indeed, the ESI was on average in April and May still 1½pts lower than the average in Q1, supporting our view that euro area GDP growth will slow in Q2 to around half the 0.4%Q/Q rate seen in Q1.

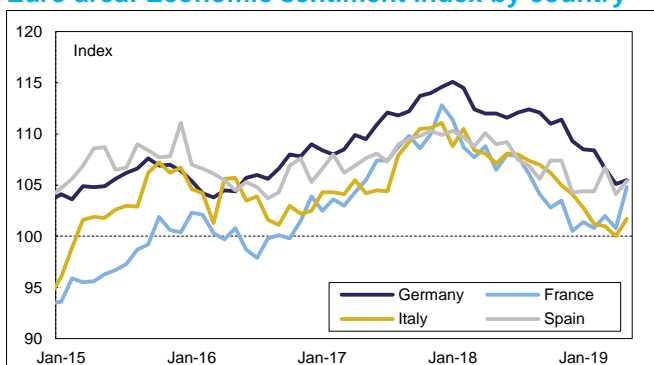
### Bank lending picks up at start of Q2

Like today's ESI, the ECB's latest bank lending figures were somewhat more encouraging at the start of the second quarter than of late. In particular, having slowed notably in March, net new loans to non-financial corporations (NFCs) in April increased to €23.8bn (adjusted for sales and securitisations), the most for fifteen months, leaving growth in the stock of such loans at 3.9%Y/Y, 0.3ppt higher than March and the firmest rate so far this year. Similarly, new lending to households picked up in April, to €19.4bn, the largest single-month increase for eleven years. So, the growth in the stock rose 0.1ppt to 3.4%Y/Y, also the strongest pace for more than a decade. At the country level, the net flow of lending to NFCs remained firmest in Germany and France, and recovered somewhat in Italy. But this follows notable declines in net lending to Italian NFCs over recent months, leaving growth in the stock of such lending in that country at -½%Y/Y. And with loans to NFCs in Spain (-1.3%Y/Y) and the Netherlands (-1.1%Y/Y) still declining, there remains a significant case for incentivizing growth of lending via the pricing of the TLTRO-III loan operations, which will be discussed at next week's Governing Council meeting.

### Elections deliver a more fragmented European Parliament

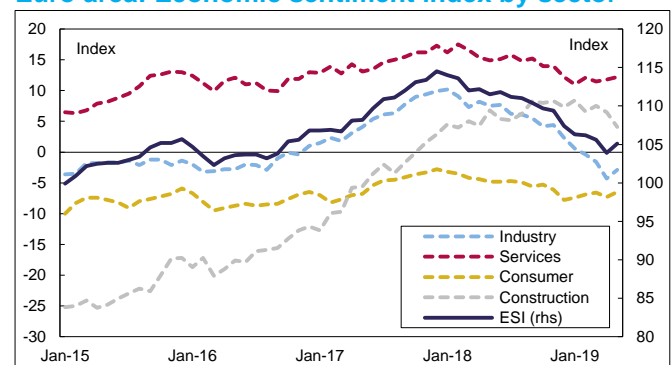
Following the results of last week's European Parliament elections, this evening will see EU leaders meet for the first group discussion on the appointments of the next heads of various EU institutions. Of course, any agreement at this early stage is highly

### Euro area: Economic sentiment index by country



Source: European Commission, Thomson Reuters and Daiwa Capital Markets Europe Ltd.

### Euro area: Economic sentiment index by sector



Source: European Commission, Thomson Reuters and Daiwa Capital Markets Europe Ltd.



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unlikely, not least given the extreme political sensitivities involved with the appointments. And, as for the Commission and Council, there is also a wide field of [potential candidates for the ECB top job](#), meaning that various permutations are possible. Moreover, as had been expected, the elections have left the European Parliament highly fragmented, with no single grouping dominant, suggesting that finding a consensus on the top jobs might well prove to be more challenging and long-winded than usual. While the establishment centre-right and centre-left blocs – respectively the European People’s Party (EPP) and Alliance of Socialists and Democrats (S&D) – remained the largest groups in Parliament, both lost more than 40 seats compared with 2014 – to 180 and 146 respectively – and therefore for the first time failed to win more than half of all 751 seats between them. So, they will not be able to dominate the European Parliament in the same way as before, or just dish out the top EU jobs between themselves. Indeed, while Macron’s ‘La République En Marche’ (LREM) narrowly came second in France to Le Pen’s National Rally party, his party’s seats helped the pro-European centrist bloc – the Alliance of Liberals and Democrats for Europe (ALDE) – take the third largest representation. And he has so far led the charge in opposing the EPP’s lead candidate, German MEP Manfred Weber, for the Commission presidency. With the Green parties’ performance having also exceeded expectations, they too will want a say at the negotiating table.

### Salvini’s significant gain was the outlier of nationalist parties

As expected, in Italy, Deputy PM Salvini’s nationalist League performed very well, winning a little more than one third of the country’s allocation of 73 seats, having won just five in 2014. But nationalist parties failed to make significant gains more generally, and so certainly won’t be a key driver of policy decisions. Against this backdrop, reports yesterday suggested that the Commission was considering proposing a disciplinary procedure for Italy next week over its failure to rein in its debt, triggering a notable sell off in BTPs – 2Y yields peaked above 70bps today, up more than 20bps over the past two days. At the other end of the spectrum, Greek bonds significantly outperformed in the aftermath of the election results as the EPP-aligned New Democracy fared much better than expected, compelling Prime Minister Tsipras (of the governing far-left Syriza) to call a snap election in June.

### The day ahead in the euro area and US

Aside from any updates from tonight’s EU leaders’ discussions, tomorrow will bring the first of this week’s national flash inflation releases for May, with the French figures expected to show that inflation (on the harmonised measure) more than reversed the 0.2ppt increase to 1.5%Y/Y in April, as the Easter effect that boosted prices last month wears off. We will also see French consumer spending figures for April, German labour market figures for May and Italian sentiment surveys for the same month. Meanwhile, potential ECB President candidate Olli Rehn is due to speak in London, while in the markets Germany will sell 5Y bonds.

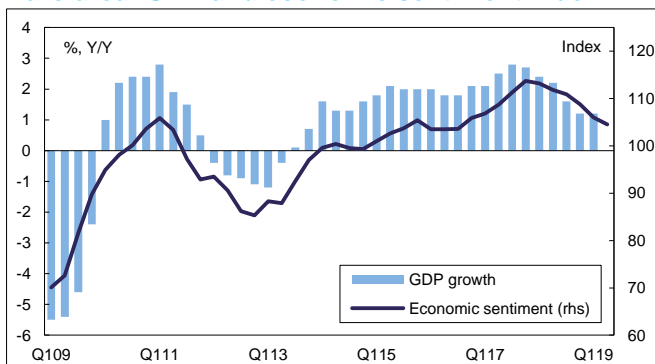
In the US, it should be a quiet day for top-tier releases with just the Richmond Fed Manufacturing Index due for release. Supply-wise, the US Treasury will sell 2Y floating-rate and 7Y fixed-rate notes.

## UK

### The day ahead in the UK

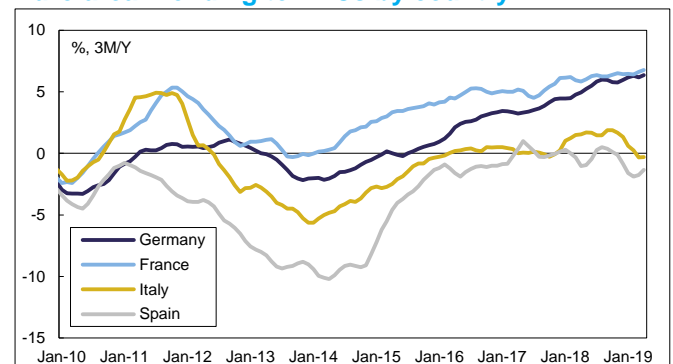
Given the UK’s (admittedly predictable) outcome of the European elections, which saw the Conservative party place fifth to take just four seats, there was plenty of political noise from the UK over the weekend break. Indeed, following Theresa May’s resignation announcement last week, ten potential leadership candidates – with wide-ranging views on how they would deliver Brexit – have so far confirmed their intention to stand. But while Nigel Farage’s Brexit party took the largest share of the vote in the EP elections (almost one third), those Tory leadership candidates might well also be mindful that those parties in favour of another referendum (Liberal Democrats, Greens, SNP, Change UK and Plaid Cymru) took roughly 40% of the vote. Either way, with the EU unlikely to be willing to make any significant amendments to the Withdrawal Agreement, he or she will likely find it no easier than Theresa May to find a path to manage Brexit. With only second-tier releases – the BRC’s shop price index – due tomorrow, we would expect politics to continue to dominate the news flow.

### Euro area: GDP and economic sentiment index\*














\*Q2 19 economic sentiment figure is based on April and May surveys.  
Source: European Commission, Thomson Reuters and Daiwa Capital Markets Europe Ltd.

### Euro area: Lending to NFCs by country









Source: Thomson Reuters, ECB and Daiwa Capital Markets Europe Ltd.

## European calendar

Today's results							
Economic data							
Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised	
EMU	 M3 money supply Y/Y%	Apr	<b>4.7</b>	4.3	4.5	<b>4.6</b>	
	 Economic Sentiment Indicator	May	<b>105.1</b>	103.8	104.0	<b>103.9</b>	
	 Industrial (services) confidence	May	<b>-2.9 (12.2)</b>	-4.3 (11.0)	-4.1 (11.5)	<b>-4.3 (11.8)</b>	
	 Final consumer confidence	May	<b>-6.5</b>	-6.5	-7.3	-	
Germany	 GfK consumer confidence	Jun	<b>10.1</b>	10.4	10.4	<b>10.2</b>	
France	 Consumer confidence	May	<b>99</b>	97	96	-	
UK	 UK Finance, loans for housing 000s	Apr	<b>43.0</b>	-	40.0	<b>40.6</b>	
Auctions							
Country	Auction						
Germany sold	 €3.9bn of 0.0% 2021 bonds at an average yield of -0.65%						
Italy sold	 €2.5bn of zero-coupon 2021 bonds at an average yield of 1.46%						
	 €633mn of inflation-linked 2023 bonds at an average yield of 2.29%						
	 €617mn of inflation-linked 2028 bonds at an average yield of 1.87%						

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			
Germany		08.55	Unemployment rate % (change 000s)	May	4.9 (-6)	4.9 (-12)		
France		07.45	Flash CPI estimate (EU-harmonised measure) Y/Y%	May	1.1 (1.3)	1.3 (1.5)		
		07.45	GDP – third estimate Q/Q% (Y/Y%)	Q1	0.3 (1.1)	0.3 (1.0)		
		07.45	Consumer spending M/M% (Y/Y%)	Apr	-	-0.1 (-1.9)		
Italy		09.00	Business (manufacturing) confidence	May	-	98.7 (100.6)		
		09.00	Consumer confidence	May	110.1	110.5		
UK		00.01	BRC shop price index Y/Y%	May	-	0.4		
Auctions and events								
Country	BST	Auction / Event						
EMU		09:00	ECB's Rehn scheduled to speak in London					
Germany		10:30	Auction: to sell €3bn of 2024 bonds					

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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