

Euro wrap-up

Overview

- Bunds made losses but BTPs and other periphery sovereign bonds made gains as the European Commission unveiled proposals for €750bn of new longer-term bond issuance to help fund recovery from the Covid-19 crisis.
- Gilts followed Treasuries higher on a quiet day for UK economic news.
- Thursday will bring the European Commission's economic sentiment indices along with flash German and Spanish inflation data, all for May.

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Daily bond market movements

Bond	Yield	Change
BKO 0 03/22	-0.653	+0.013
OBL 0 04/25	-0.616	+0.013
DBR 0 02/30	-0.423	+0.011
UKT 0½ 07/22	-0.029	-0.014
UKT 0% 06/25	-0.004	-0.024
UKT 4% 12/30	0.187	-0.028

*Change from close as at 4:30pm BST.
Source: Bloomberg

Euro area

Commission proposes €750bn fund for recovery

Following the [Franco-German](#) call for a €500bn Recovery Fund financed by new EU bond issuance, today brought the European Commission's formal proposal. Under the suggested new "Next Generation EU" programme, the Commission would issue bonds worth €750bn to be repaid by member state contributions to the EU budget between 2028 and 2058, an encouragingly long-term horizon. Of the funds raised, €500bn would be disbursed in grants. Almost €160bn of those grants would be allocated to Italy and Spain, with €40bn going to France. And net of the future contributions required when the bonds mature, Italy and Spain would gain about €60bn if their current shares in the EU budget were to remain unchanged. On top of those grants, the Commission proposed that a further €250bn would be offered in loans.

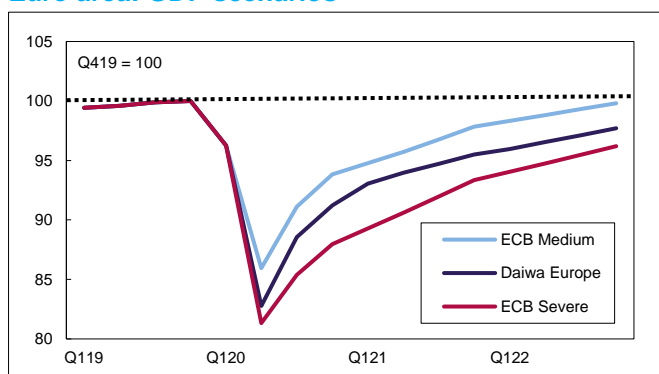
Details to be settled by forthcoming negotiations

The main vehicle for disbursing the funds would be a new Recovery and Resilience Facility with a budget of €560bn to be distributed via grants and loans. Among other new arrangements, a €55bn REACT-EU fund would top up Cohesion Funds for the poorest regions; a €31bn Solvency Support Instrument would take equity stakes in firms hit by the crisis; and an EU4Health fund of €9.4bn would procure medicines and healthcare equipment. Some funds would be disbursed in 2020. But the largest share would come next year, when the first bonds would be issued under the programme. All of these details will now be subject to intense negotiations between the member states over coming months. And the Netherlands, Sweden, Austria and Denmark, as well as central and Eastern European countries, will likely try to reduce the total amount of grants to be disbursed and amend the implied distribution between the different countries. But the final arrangements are still likely to make a useful contribution to supporting government budgets in Italy and Spain over the next few years.

Lagarde provides guide to updated ECB economic outlook

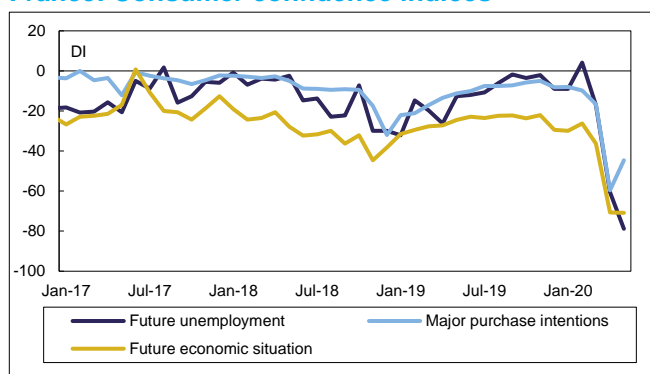
At the ECB's monetary policy meeting next week, the Governing Council will discuss new Eurosystem forecasts, which will be the first to fully reflect the impact of the Covid-19 pandemic on the economic outlook. In her online "Youth Dialogue" today, ECB President Lagarde gave an indication of what to expect from those projections. In particular, referring to the three illustrative [scenarios](#) published by the ECB after the April meeting, she suggested that the updated forecast would probably be "somewhere between" the "medium" and "severe" scenarios. That would imply a forecast full-year contraction in GDP in 2020 somewhere in the range of 8-12%Y/Y, which suggests something very close to our own forecast of a drop of 10.1%Y/Y. It would also imply a failure to return to the pre-crisis level of GDP before 2023, similarly in line with our own view. And, not

Euro area: GDP scenarios



Source: ECB and Daiwa Capital Markets Europe Ltd.

France: Consumer confidence indices



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



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least given the weakness in underlying price pressures that would result from such large-scale economic slack, it would strongly support the case for an extension of the ECB's asset purchases into 2021 and, in due course, beyond.

French economy running about 20% below pre-Covid level

France has been hit far harder than the euro area average by the pandemic in terms of cases and deaths. And its economy has suffered from a lengthy period of lockdown. However, the French statistical institute INSEE today reported a pickup in activity following the relaxation of several controls from 11 May. With the release of pent-up demand, INSEE estimated that consumption in the week following the reopening of non-essential stores was "only" about 6% below the pre-pandemic level. And overall activity was down a little more than 20% on the same basis. That compares with declines in both consumption and total activity at the start of the month of about one third from the respective pre-pandemic levels. Tomorrow, the government is due to announce the details of the second phase of relaxation of restrictions, which will likely allow a reopening of cafés and restaurants from next week. But INSEE judged that French GDP was still likely to contract by about 20%Q/Q in Q2 as a whole, and our own forecast is for a drop of 18%Q/Q. And with INSEE's surveys for May also reporting that business sentiment remained deeply depressed, while households concerns about unemployment had risen further close to series highs, we fully expect the recovery in spending and overall activity throughout Q3 (and beyond) to remain partial.

The day ahead in the euro area and US

The focus will remain on economic sentiment indicators tomorrow with the publication of the European Commission's May confidence survey results. With lockdowns widespread, the headline euro area economic sentiment index registered an extremely sharp fall in April, of more than 27pts to 67.0. However, given the gradual relaxation of restrictions on activity over the past couple of weeks, and increases registered already in the flash consumer confidence index and PMIs, we expect to see a modest improvement in May across all sectors. Nevertheless, taken together, the latest survey data still suggest that the economic recovery across the euro area will be partial and, in aggregate, very subdued, leaving significant amounts of spare capacity to persist for a long time to come. Also scheduled for release tomorrow are Spanish retail sales numbers for April – with the country firmly in lockdown last month, a record year-on-year fall can be expected. Moreover, with demand so weak, and oil prices extremely low, tomorrow's inflation numbers out of Germany and Spain are expected to reveal further declines in May to the lowest rates since 2016. In Germany, the EU-harmonised measure of inflation is expected to fall 0.4ppt to 0.4%Y/Y, while in Spain the same measure is forecast to fall 0.2ppt to -0.9%Y/Y.






Across the Atlantic, the usual weekly claims figures will be accompanied by the release of final Q1 GDP numbers, durable goods orders and pending home sales data for April. Meanwhile, the US Treasury will auction 7Y notes.

UK













The day ahead in the UK

Tomorrow will be another quiet day on the UK economic data front, with no top-tier figures scheduled for release. We may see the publication of the Nationwide house price index for May, which is due out one day this week. Transactions in April would largely have been based on mortgage applications made before the strict lockdown. However, they are still expected to reveal that house prices fell 1.0%M/M in May, leaving them just 2.8% higher compared to a year earlier. In other news, BoE policy board member Saunders will do a webinar about the BoE's response to the economic impact of the pandemic, while the DMO will sell 7Y and 21Y Gilts.

European calendar

Today's results						
Economic data						
Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
France	 Business confidence indicator	May	59	69	62	53
	 Manufacturing confidence (production outlook indicator)	May	70 (-49)	85 (-55)	82 (-78)	68 (-)
	 Consumer confidence	May	93	92	95	-
Auctions						
Country	Auction					
UK	 sold £3.75bn of 0.125% 2023 bonds at an average yield of 0.03%					
	 sold £1.5bn of 1.75% 2057 bonds at an average yield of 0.544%					

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	Economic sentiment indicator	May	70.6	67.0	
		10.00	Industrial confidence (services)	May	-25.7 (-27.9)	-30.4 (-35.0)	
		10.00	Final consumer confidence	May	-18.8	-22.0	
Germany		13.00	Preliminary CPI (EU-harmonised CPI) Y/Y%	May	0.6 (0.4)	0.9 (0.8)	
Italy		09.00	Economic sentiment indicator	May	-	81.7**	
		09.00	Consumer confidence (manufacturing)	May	89.9 (80.0)	101.0 (89.5)**	
Spain		08.00	Retail sales Y/Y%	Apr	-	-14.1	
		08.00	Preliminary CPI (EU-harmonised CPI) Y/Y%	May	-1.0 (-0.9)	-0.7 (-0.7)	
UK		-	Nationwide house price index* M/M% (Y/Y%)	May	-1.0 (2.8)	0.7 (3.7)	
Auctions and events							
Country	BST	Auction / Event					
UK		10.00	Auction: £2.75bn of 1.25% 2027 bonds				
		11.00	BoE Saunders scheduled to speak about Covid-19 and monetary policy				
		11.30	Auction: £2bn of 1.75% 2049 bonds				

*Approximate date of release. **Previous figures are for February. Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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