

Euro wrap-up

Overview

- While the Commission survey flagged an uptick in services and consumer inflation expectations, Bunds made modest gains as euro area business sentiment deteriorated and bank lending remained subdued.
- Gilts had a mixed performance on a quiet day for UK economic data.
- Friday will bring flash June inflation estimates from France, Italy and Spain, as well as updated UK national accounts figures.

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Daily bond market movements

Bond	Yield	Change
BKO 2.9 06/26	2.801	-0.016
OBL 2.1 04/29	2.440	-0.012
DBR 2.2 02/34	2.445	-0.003
UKT 0% 01/26	4.207	-0.013
UKT 0½ 01/29	4.007	+0.007
UKT 4% 01/34	4.129	-0.001

*Change from close as at 5.00pm BST.
Source: Bloomberg

Euro area

Euro area economic sentiment slips slightly in Q2, despite strong increases in Germany and Spain

While not as sizeable as the downside surprise to last week's [flash euro area PMIs](#), today's Commission survey results also came in on the soft side, with the headline Economic Sentiment Indicator (ESI) down 0.2% to 95.9 in June, around the middle of the range since the start of the year. That was more than 4% below the long-run average and left the Q2 average slightly below the Q1 level. In contrast, despite the drop in June, the quarterly composite PMI had risen in Q2 to 51.6, the best in three quarters. Overall, however, both the ESIs and the PMIs probably point to steady GDP growth of 0.3%Q/Q in Q2. Among the larger member states, the ESIs edged lower in June in Germany (92.1), France (97.2) and Italy (99.6). And this left the Q2 indices in France and Italy down from their respective Q1 levels. But while the German ESI remained some 8% below the long-run average in Q2, it was the best in four quarters and pointed to accelerated recovery momentum this quarter. Following upwardly revised GDP growth in Q1 (0.8%Q/Q), the Spanish ESI predictably suggested another solid economic performance in Q2, while the increases in the quarterly ESIs in Greece, Austria, Portugal, the Netherlands and Belgium suggest that recovery momentum is relatively widespread across the region.

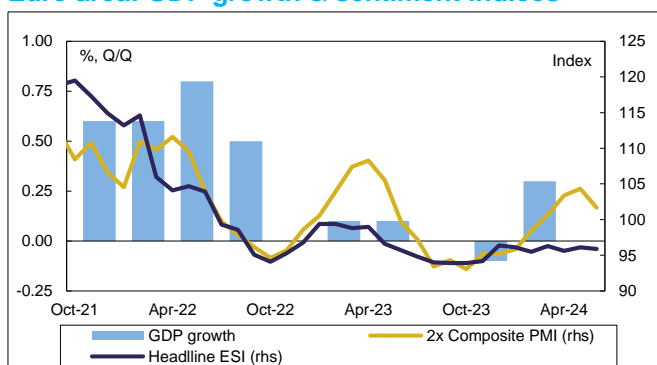
Widespread deterioration in business sentiment, while consumers were more upbeat

The deterioration in sentiment reported in June was widespread across the business subsectors and left the respective ESIs firmly below the first-quarter average. Similar to the PMIs, sentiment was firmest in the services sector as firms judged the recent business situation to be the best since summer 2022, with greatest optimism in tourist-related subsectors. In contrast, firms in industry assessed recent production trends to be the weakest since mid-2020, in part reflecting a notable drop in the transport equipment subsector amid falling orders. Services firms also judged the demand outlook to have weakened at the end of Q2. Construction firms were the modest downbeat about conditions since September 2020, with a lack of demand and bad weather cited as the main constraints on activity. Retailers were also the most pessimistic for almost two years, with firms noting a drop in sales for the first time since February. This was somewhat at odds with the steady improvement in consumer confidence, which rose to the highest level since the Russian invasion of Ukraine as households signalled increased willingness to spend. But consumers might well remain cautious as they also reported increased concerns about the labour market, with the survey's respective indicator declining to the lowest level since March 2021.

Services selling price expectations sticky, while consumer expectations tick higher too

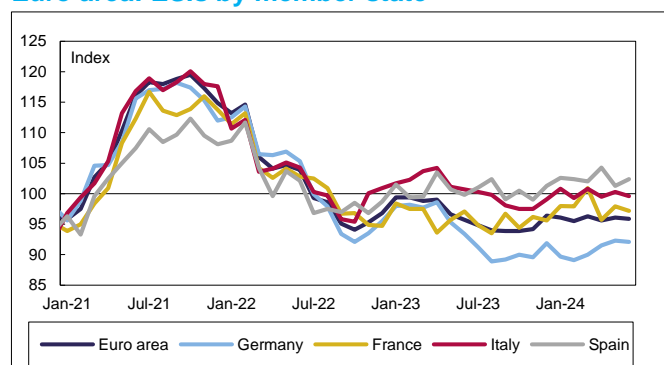
Like its signals on economic growth, the Commission survey gave mixed messages on price expectations at the end of Q2. Perhaps in a bid to entice customers, selling price intentions for the three months ahead in the retail sector maintained a

Euro area: GDP growth & sentiment indices



Source: EC, Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

Euro area: ESIs by member state



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

steady downtrend in June, with the respective indicator dropping to its lowest level in more than three years. And having jumped to a thirteen-month high in May, selling price expectations in industry fell further below the long-run average. But less encouragingly, the respective indicator for services ticked up to a three-month high in June, still well above the long-run average implying ongoing stickiness in sector. Against this backdrop, the survey measure of 12-month consumer inflation expectations picked up to a four-month high above the range in the second half of last year. But it was still a little below the pre-pandemic average to be arguably broadly consistent with the ECB's target. And within the country detail, the increase was led by Germany and Spain, both of which in part likely reflects the recent uptick in consumer price inflation driven by adjustments to government policy.

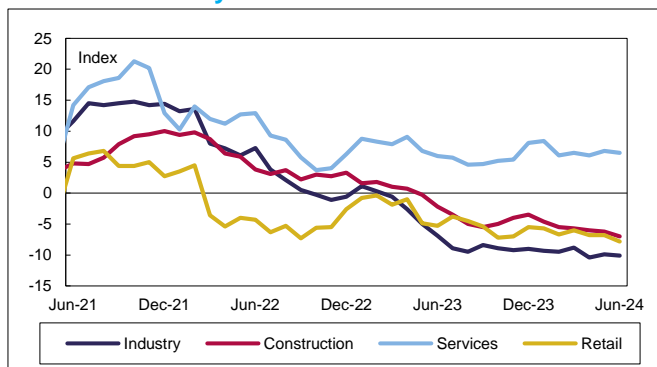
Bank lending remained subdued ahead of ECB's first rate cut

Today's monetary data highlighted that bank lending in the euro area remained subdued ahead of the ECB's first rate cut at the start of this month. Indeed, while the monthly flow of lending to non-financial corporations on an adjusted basis returned to positive territory in May (€5.2bn), it was insufficient to reverse fully the drop in April (-€5.4bn). As a result, the annual growth in the stock of such loans edged back up to just 0.3%Y/Y, still within the range since the start of this and consistent with a non-negligible decline in real terms. Net new lending on a three-month basis slowed slightly (€2.2bn), with the unadjusted figures suggesting such loans were concentrated in longer-term loans (i.e. those with a maturity of more than five years), which are typically related to fixed investment needs. Meanwhile, net lending to households also slowed slightly on an adjusted basis in the three months to May (€8.2bn). As a result, the annual rate edged up, also to just 0.3%Y/Y, thus similarly firmly negative in real terms. Growth in consumer credit (2.9%Y/Y) was consistent with a negligible uptick in spending. In addition, growth in lending for home purchase (0.4%Y/Y) returned to positive territory for the first time this year while growth in other household loans related to debt consolidation and education remained firmly negative (-3.1%Y/Y).

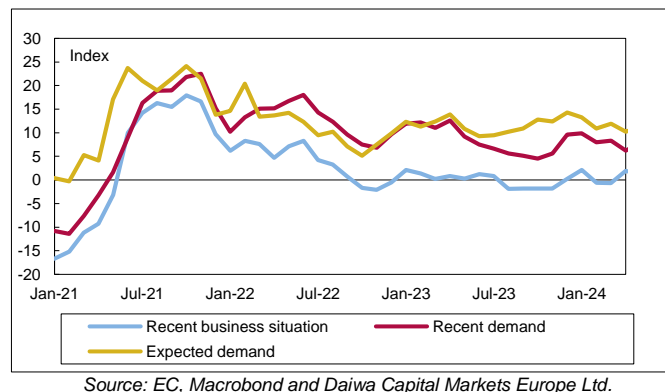
Drag on growth from credit conditions starting to moderate but monetary stance still restrictive

Meanwhile, money supply growth picked up to a 14-month high in May. The M3 rate rose for a fourth successive month and by 0.3ppt, albeit remaining low by historical standards at 1.6%Y/Y, still thus in negative territory in real terms and consistent with very sluggish activity and an absence of price pressures. The pickup in broader money growth was largely explained by a moderation of 1.0ppt in the pace of decline in the narrow M1 aggregate to a still sharply negative -6.0%Y/Y. That reflected a further modest pickup in the total of overnight deposits held by certain institutional investors while those held by NFCs and households fell again. Overall, today's money and lending data illustrate how monetary conditions in the middle of Q2 remained restrictive, even as interest rates on loans and deposits had already started to fall back from their peak in anticipation of the start of the ECB's easing cycle. Indeed, while the drag on economic activity from credit conditions (i.e. the

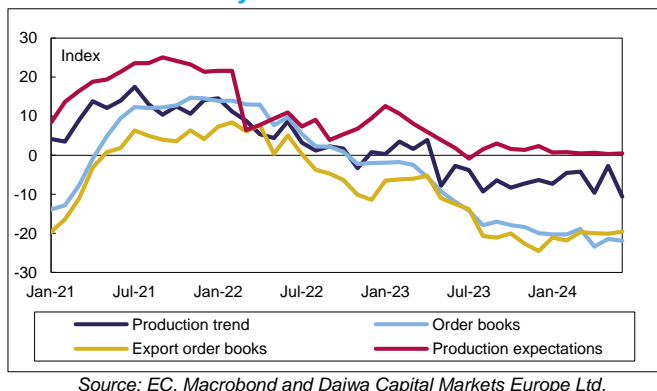
Euro area: ESI by sector



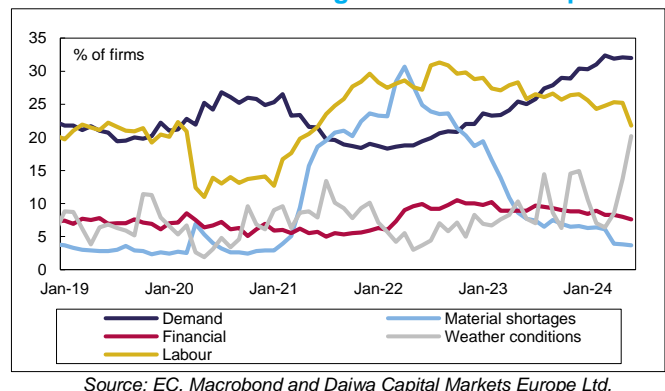
Euro area: Services sentiment indices



Euro area: Industry sentiment indices



Euro area: Factors limiting construction output



negative credit impulse) is moderating somewhat, the decision to cut rates this month is unlikely to have provided a significant boost to economic activity with the overall monetary stance still evidently restrictive.

RN extends lead in polls but still looks on track to fall short of absolute majority

Ahead of Sunday's first round of voting, opinion polls continue to suggest that the outcome of the two-stage French assembly election is too close to call with confidence. Marine Le Pen's far-right National Rally (RN) appears to remain on track to be the largest party. And some polls now suggest that the RN and its allies could yet win an absolute majority, which would propel its party President Jordan Bardella to be Prime Minister. But most point to the greater likelihood that the far right will fall short of the 289 seats required by 30 seats or more. Likewise, the New Popular Front (NFP) left-wing alliance, including the radical Jean-Luc Mélenchon as well as the more social democratic former President Hollande, trails RN on average by about 70 seats. And Macron's Ensemble party (MP), led by current Prime Minister Gabriel Attal, remains well behind in third place. So, our baseline continues to assume that no overall majority will emerge from the election's second round on 7 July. However, the result of the first round this Sunday will provide a significant test of that view.

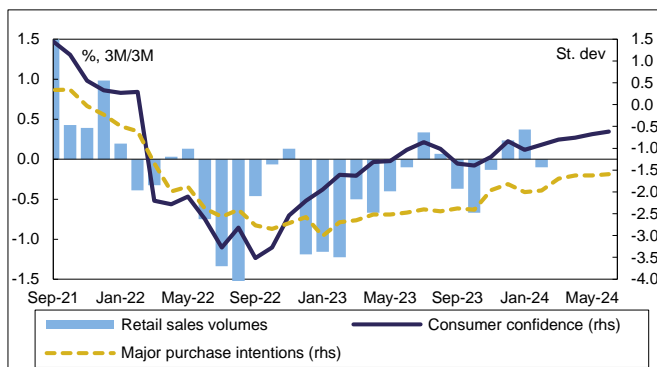
RN attempts to mollify investor concerns but doubts should remain about its intentions

The RN has recently tried to downplay concerns that, if it won a majority, its fiscal policy would be reckless. Bardella claims to have learned lessons from the Liz Truss crisis in the UK and Meloni's more stable and orthodox record in government in Italy. And reports today suggested that he would intend to appoint a technocrat as Finance and Economy Minister. But RN's budgetary plans lack detail. Its aspirations and rhetoric have undoubtedly been incompatible with any notion of fiscal responsibility let alone the multi-year consolidation now required of France by the EU's fiscal rules. And not least given its objective to redefine the relationship between France and the EU, it would deliberately aim to provoke confrontation with the Commission. So, if Sunday's first-round vote suggests an increased probability of an RN-led government, in our view French sovereign spreads over Bunds still ought to remain close to current levels if not a touch wider. Given NFP's reckless fiscal plans and investors' greater scepticism with respect to its instincts, a significantly increased likelihood that it will eventually win an outright majority might be expected to push French spreads wider.

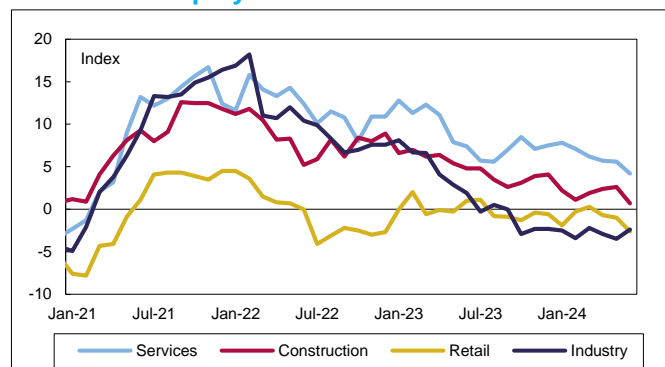
A range of possible outcomes exists if no party can form a majority government

If Sunday's results reinforce expectations that no party will be able to form a government after the second round, the market response will depend on the detail. Some modest spread-tightening might yet be in order if the centre appears to have held up significantly better than expected to raise the possibility that a deal might eventually be made between Ensemble with

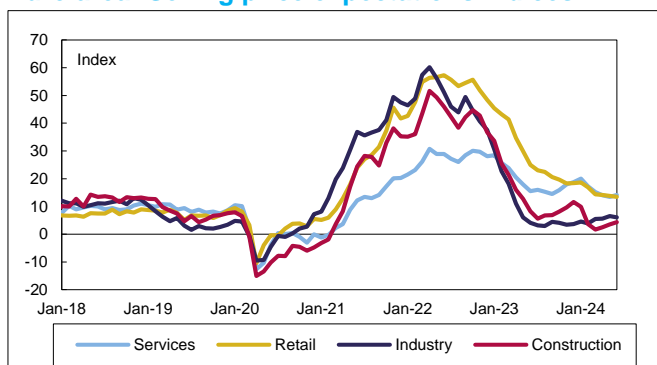
Euro area: Retail sales & consumer confidence



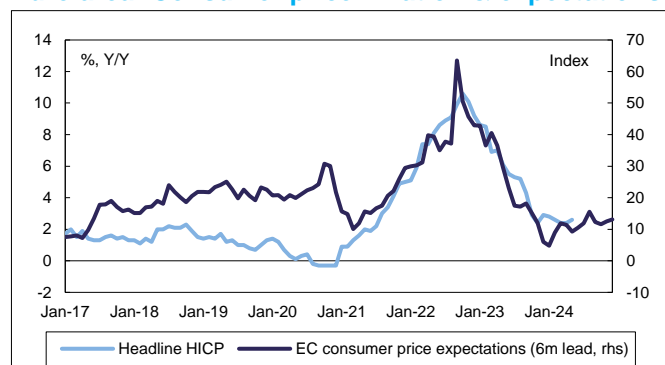
Euro area: Employment intentions indices



Euro area: Selling price expectations indices*



Euro area: Consumer price inflation & expectations*



moderates on the soft left and centre-right. Indeed, in the event that no workable coalition government can be created after the second round and subsequent horse-trading, President Macron could still appoint a temporary government to stay in place for the coming twelve months with limited powers to set budgets. That might possibly take the form of the current Attal government, or more likely a new national unity government led by a technocrat outsider or a familiar politician, including perhaps former President Hollande. Of course, at the same time, we also see risks that ongoing stalemate amid constitutional arguments after the second round could eventually lead to the more destabilizing possibility that Macron himself might resign, bringing forward a new Presidential election, which would likely see French spreads blow out further still.

The day ahead in the euro area

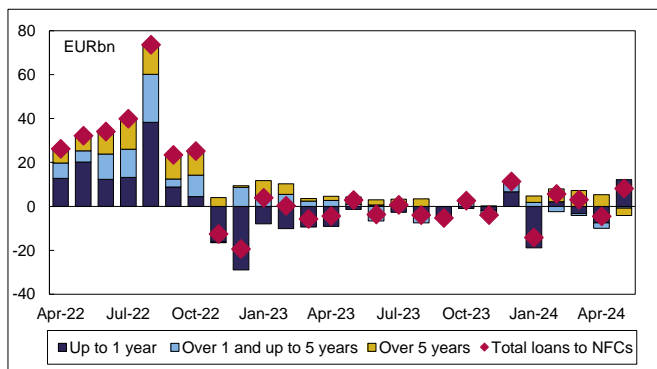
Ahead of the coming week’s euro area flash June consumer price inflation estimates, and following today’s figures from Belgium – where the headline HICP rate jumped a further 0.6ppt to a 17-month high of 5.5%Y/Y – the main data focus on Friday will be equivalent inflation figures from France, Italy and Spain. Having increased in May, headline HICP inflation in France and Spain are expected to edge lower this month, by 0.1ppt to 2.5%Y/Y and 0.3ppt to 3.5%Y/Y respectively. And while the equivalent Italian HICP rate is forecast to tick slightly higher it is expected to remain extremely weak at 0.9%Y/Y. Meanwhile, the ECB’s consumer survey for May will likely suggest that household inflation expectations three years ahead remain relatively well anchored close to the 2.4%Y/Y recorded in April, with equivalent rates for Germany and France at 2.1%Y/Y that month, just above the ECB’s 2% target. In addition, German labour market figures will provide an update on jobless claims and job vacancies in June.

UK

The day ahead in the UK

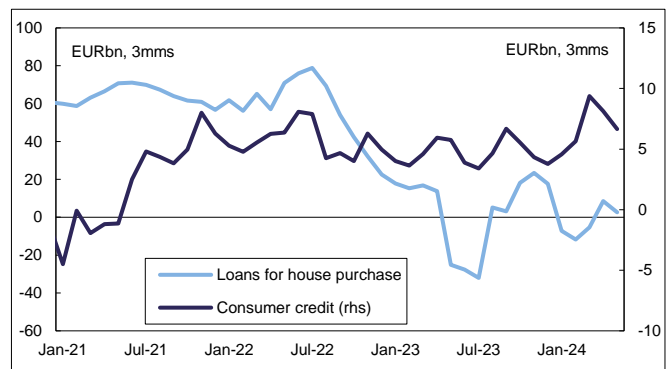
After a quiet day for top-tier UK economic data, Friday will bring updated national accounts figures for Q1. The preliminary release brought an upside surprise to GDP, which accelerated 0.6%Q/Q following the technical recession in the second half of last year, to mark the fastest quarterly expansion since Q421. Growth was principally led by domestic demand, of which the rise in fixed investment was the strongest for four quarters and accounted for half of GDP growth. But net trade also provided a boost as the decline in imports outpaced exports. As such, the current account deficit is expected to have narrowed slightly in Q1 from £21.2bn in Q4.

Euro area: Loans to NFCs



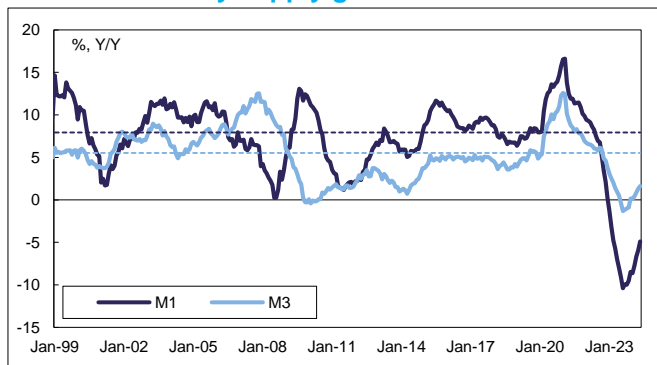
Source: ECB, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Loans to households



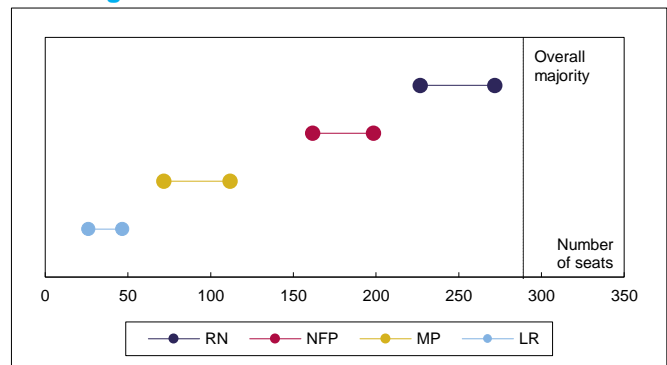
Source: ECB, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Money supply growth



Source: ECB, Macrobond and Daiwa Capital Markets Europe Ltd.

France general elections: Predicted seat share*











*Average range of seat projections calculated using the latest survey results from Harris International, Ifo, Cluster17. RN includes allies. Source: Harris International, Ifo, Cluster17 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
Euro area	 M3 money supply Y/Y%	May	1.6	1.5	1.3	-
	 Commission Economic Sentiment Indicator	Jun	95.9	96.1	96.0	96.1
	 Commission industrial (services) confidence indicator	Jun	-10.1 (6.5)	-9.6 (6.3)	-9.9 (6.5)	- (6.8)
	 Commission final consumer confidence indicator	Jun	-14.0	<u>-14.0</u>	-14.3	-
Italy	 ISTAT consumer confidence indicator	Jun	98.3	97.0	96.4	-
	 ISTAT business (manufacturing) confidence indicator	Jun	94.5 (86.8)	- (88.6)	95.1 (88.4)	- (88.2)
	 PPI Y/Y%	May	-4.9	-	-8.1	-8.0
Spain	 Retail sales Y/Y%	May	0.2	0.7	0.3	-

Auctions

Country	Auction
Italy	 sold €3.5bn of 3.35% 2029 bonds at a yield of 3.55%
	 sold €1.75bn of 2032 floating bonds at a yield of 5.04%
	 sold €3.5bn of 3.85% 2034 bonds at a yield of 4.01%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Euro area	09.00	ECB consumer expectations survey – 1Y CPI (3Y CPI) Y/Y%	May	2.8 (2.4)	2.9 (2.4)
Germany	08.55	Unemployment rate % (change 000's)	Jun	5.9 (15)	5.9 (25)
France	07.45	Preliminary HICP (CPI) Y/Y%	Jun	2.5 (2.2)	2.6 (2.3)
	07.45	PPI Y/Y%	May	-	-6.8
	07.45	Consumer spending M/M% (Y/Y%)	May	0.2 (-0.2)	-0.8 (0.2)
Italy	10.00	Preliminary HICP (CPI) Y/Y%	Jun	0.9 (1.0)	0.8 (0.8)
Spain	08.00	Preliminary HICP (CPI) Y/Y%	Jun	3.5 (3.4)	3.8 (3.6)
UK	00.01	Lloyds business barometer (own price expectations)	Jun	45 (-)	50 (61)
	07.00	GDP - final estimate Q/Q% (Y/Y%)	Q1	0.6 (0.2)	0.6 (0.2)
	07.00	Current account balance £bn	Q1	-17.6	-21.2

Auctions and events

- Nothing to report -

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:

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