

Euro wrap-up

Overview

- Longer-dated Bunds made gains and French OAT spreads narrowed slightly after yesterday's second-round vote in the French election resulted in a hung parliament.
- While the often-hawkish BoE external member Haskel signalled that he will likely vote to keep Bank Rate unchanged at his final MPC meeting in August, Gilts made modest gains.
- The coming few days will bring May figures for Italian and Irish IP and UK GDP.

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Daily bond market movements

Bond	Yield	Change
BKO 2.9 06/26	2.901	+0.022
OBL 2.1 04/29	2.528	+0.003
DBR 2.2 02/34	2.540	-0.011
UKT 0½ 01/26	4.092	-0.012
UKT 0½ 01/29	3.941	-0.018
UKT 4½ 01/34	4.111	-0.013

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

Euro area

French election results in hung parliament with the far-right lagging in third place

As had appeared increasingly likely last week as the left-wing New Popular Front (NFP) coordinated with President Macron's centrist Ensemble party, yesterday's second-round vote in the French assembly election resulted in a hung parliament. Unexpectedly, however, the NFP won the largest number of seats, 182 of the 577-member chamber. And the far-right National Rally (RN party), which had come out on top in the first round, came some way behind in third with 143 seats, lagging behind Ensemble party and its allies, which performed much better than expected with 168 seats. Lengthy negotiations will now begin involving the leaders of the various parties to see whether a coalition government backed by a majority of 289 seats or, more likely, a minority administration capable of withstanding a vote of no confidence, might be established.

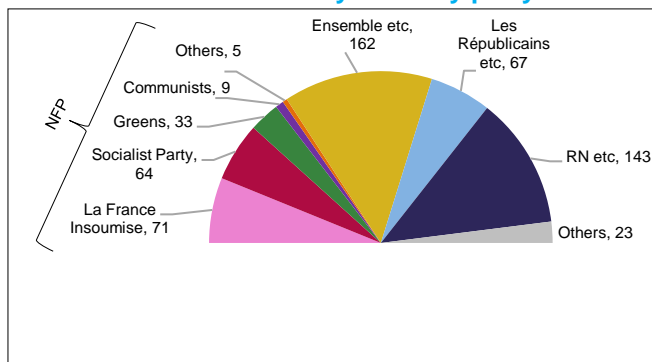
Policy paralysis remains likely even when a new government is eventually formed

Within the NFP, more than 70 seats were won by the far-left La France Insoumise (LFI) party of Jean-Luc Mélenchon, who has rejected a coalition incorporating Ensemble and would seem likely, along with the RN, to try to block in a confidence vote any proposed government in which it was not involved. However, as long as the far-right parties are not participating, the Socialists and Greens with almost 100 seats between them seem less inclined to block a government involving the centrists. And while the centre-right Republicans, with 38 seats, have also suggested that they would not enter any coalition, they and other smaller centre-right parties are less likely to block the formation of a minority government of the centrists and/or moderate left in a confidence vote. Until a new administration is formed, which we expect not to happen until the autumn, the current lame-duck government, led by Macron's protégé Prime Minister Gabriel Attal, will remain in office. But if and when it has been able to survive a confidence vote, the next government and Prime Minister will still struggle to pass difficult reforms, including the budgetary measures required to correct recent fiscal slippage and regain consistency with the EU rules. On balance, as the support of the Socialist party and many of its allies will be required to pass legislation, we might expect a greater emphasis on new tax-raising measures rather than public spending cuts. But broad policy paralysis inconsistent with restoring French fiscal sustainability looks most likely to be the principal theme.

Sentix survey reports deterioration in investor sentiment in part due to French politics

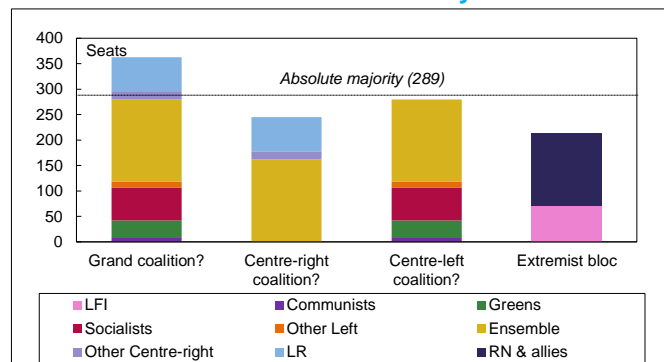
Worries about the implications of French political uncertainty, as well as broader concerns about a loss of economic recovery momentum in Germany and moderation in US economic growth, were all reflected in the July Sentix investor survey results. Having improved for eight successive months, the composite euro area economic index fell by the most in two years,

France: National Assembly seats by party



Source: Ministry of the Interior and Daiwa capital Markets Europe Ltd.

France: Potential National Assembly coalitions



Source: Ministry of the Interior and Daiwa Capital Markets Europe Ltd.

dropping 7.6pts to a four-month low of -7.3, well below the long-run average. The deterioration was reflected in worsening investor perceptions of both current conditions and the economic outlook for the coming six months, which fell respectively to three- and four-month lows. Current economic conditions were judged to be adverse, with the respective index falling further below the long-run average, down 8.8pts to -15.8. However, the drop of a similar margin in the expectations index left it still marginally in positive territory at +1.5, only minimally below its long-run average. We expect a similar deterioration in sentiment to be reported in the ZEW investor survey indices, due next week, as well as the flash PMIs and ifo and INSEE business conditions indicators, all due in the final week of July.

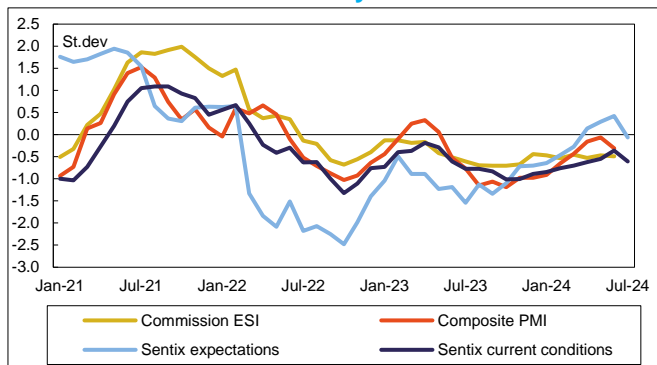
German trade surplus unexpectedly widens in May as slump in imports outpaces drop in exports

Tallying with the weakness in [German manufacturing output](#) and [factory orders](#) in May, today's German goods trade figures reported a marked decline in the value of exports that month, with the 3.6%M/M drop the steepest since December. The weakness was widespread across EU and non-EU countries, but was most notable in China (-10.2%M/M) and UK (-11.7%M/M), with the latter largely reversing a jump at the start of Q2. Bucking the trend, exports to Japan rose for the first month in three. By good-type, shipments of motor vehicles, machinery, electrical equipment and chemicals each fell between 8-10%M/M to the lowest levels in five months. Nevertheless, given the striking decline in the value of imports (-6.6%M/M), the trade surplus unexpectedly widened in May by €2.7bn to €24.9bn, the second-largest on record. With import prices up just 0.1%M/M in May, today's figures suggest that the slump in imports in the middle of the second quarter related to volumes, suggesting a deterioration in domestic demand. Admittedly, having risen to a ten-month high in April following four months of solid growth, today's figures suggest that import volumes were trending a little less than 1% below the Q1 average. And while export prices increased in April (0.4%M/M) and May (0.2%M/M), export volumes similarly reached a 14-month high in April, which should limit the decline over Q2 as a whole. Indeed, while the new export orders PMI signalled ongoing contraction in June (44.1), the quarterly index in Q2 was nevertheless the highest since Q122, while the ifo measure of overseas orders on hand was the least negative in seven months. As such, net trade still appears on track to provide modest support to German GDP growth in Q2 despite a quarterly decline in manufacturing output.

The coming days in the euro area

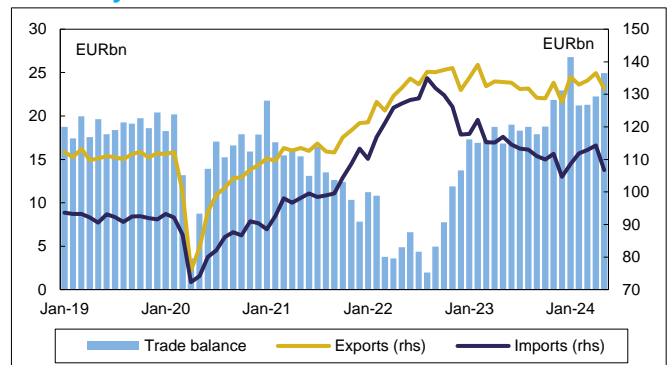
The coming few days will be relatively quiet for top-tier euro area economic data, with just the release of May industrial production figures from various member states, including Italy (Wednesday) and Ireland (tomorrow). Italian output is expected to move sideways after two successive months of declines and no growth since December. Meanwhile, the Irish numbers – which are often volatile and therefore have a non-negligible impact on aggregate euro area figures – might well report some reversal of the near-3½% decline in April. These data will be followed on Thursday by final estimates of German

Euro area: Sentiment survey indices



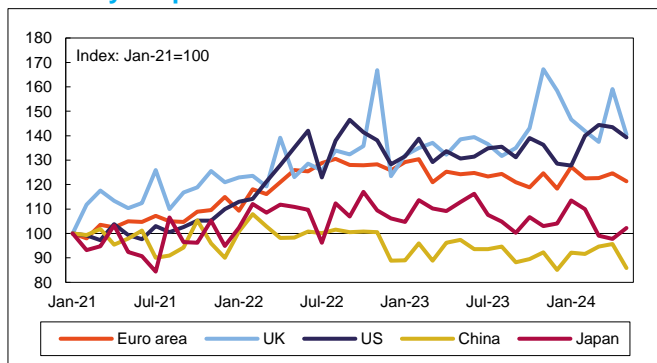
Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

Germany: Goods trade balance*



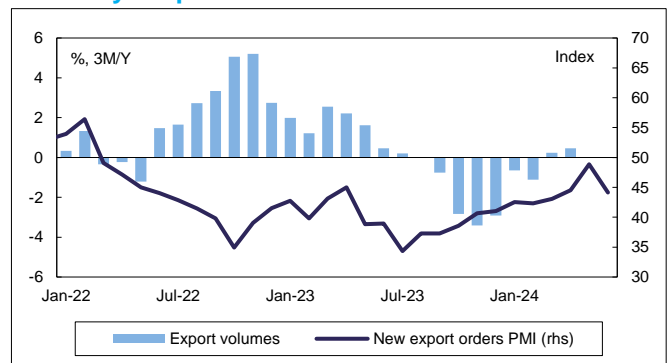
*Seasonally adjusted values. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Export values to selected destinations



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Exports volumes & orders PMI



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

inflation in June, which are likely to confirm that headline HICP inflation fell 0.3ppt to 2.5%Y/Y but failed to fully reverse the increase in May due to stickiness in services inflation. This release will provide the granular detail.

UK

The coming few days in the UK



After a quiet start to the week for top-tier UK economic data, the main focus over coming days will be the May GDP report on Thursday. After economic activity was flat in April, we expect a return to expansion in May with growth of 0.2%M/M, which would keep the three-month rate steady at an above-potential 0.7%3M/3M. With retail sales having jumped a surprisingly strong 2.9%M/M that month, however, there appear non-negligible upside risks to that forecast. But while the manufacturing output PMI jumped to the highest in more than two years (53.4), a 2pt drop in the services activity PMI to a six-month low (52.9) pointed to a loss of momentum in the UK's most important sector. Overall, leading indicators suggest another month of moderate growth (0.2%M/M) in services, and rebounds in the manufacturing and construction following substantive declines in April. Ahead of this, the BRC retail survey – due tomorrow – will provide an update on sales at the end of Q2, while the RICS residential survey and BoE Credit Conditions Survey for Q2 are also due Thursday.

The next edition of the Euro wrap-up will be published on 11 July 2024

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro Area 	Sentix investor confidence index	Jul	-7.3	-0.5	0.3	-
Germany 	Trade balance €bn	May	24.9	20.3	22.2	-


Auctions

Country	Auction
- Nothing to report -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
UK 	00.01	BRC retail monitor – like-for-like sales Y/Y%	Jun	-	0.4


Auctions and events

- Nothing scheduled -



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Wednesday's releases

Economic data

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Italy 	09.00	Industrial production M/M% (Y/Y%)	May	0.0 (-2.5)	-1.0 (-2.9)








Auctions and events

Germany 	10.30	Auction: To sell €0.5bn of 0% 2036 bonds & €1.5bn of 1% 2038 bonds			
UK 	14.30	BoE Chief Economist Pill scheduled to speak			



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Thursday's releases

Economic data

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Germany 	07.00	Final HICP (CPI) Y/Y%	Jun	<u>2.5 (2.2)</u>	2.8 (2.4)
UK 	00.01	RICS house price balance %	Jun	-14	-17
	07.00	Monthly GDP M/M% (3M/3M%)	May	0.2 (0.7)	0.0 (0.7)
	07.00	Services output M/M% (3M/3M%)	May	0.2 (1.0)	0.2 (0.9)
	07.00	Industrial output M/M% (Y/Y%)	May	0.2 (0.6)	-0.9 (-0.4)
	07.00	Construction output M/M% (Y/Y%)	May	0.5 (-1.8)	-1.4 (-3.3)
	07.00	Trade (goods trade) balance £bn	May	-2.0 (-16.0)	-6.8 (-19.6)

Auctions and events

UK 	09.30	BoE to publish quarterly credit conditions survey.			
	10.00	Auction: £3.75bn of 4.0% 2031 bonds			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:

<https://www.uk.daiwacm.com/ficc-research/recent-blogs>

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