Daiwa Capital Markets

Euro wrap-up

Overview

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- Following yesterday's Franco-German proposal for the EU Commission to borrow €500bn to support the recovery from the pandemic, Bunds made losses particularly at the shorter end while Southern European government bonds made further gains.
- Gilts made gains, particularly at the shorter end, as UK jobless claims jumped the most on record while vacancies and wage growth fell.
- Wednesday will bring updates on inflation in the euro area and UK.

Daily bond market movements

Bond	Yield	Change
BKO 0 03/22	-0.689	+0.023
OBL 0 04/25	-0.663	+0.016
DBR 0 02/30	-0.466	+0.005
UKT 0½ 07/22	-0.021	-0.022
UKT 0⅝ 06/25	0.065	-0.020
UKT 4¾ 12/30	0.248	-0.008

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

Euro area

Franco-German proposal helpful but no game-changer

Given the unresolved disagreements over whether or not to issue common euro area 'coronabonds' to meet the fiscal costs of the Covid-19 crisis, yesterday's Macron-Merkel proposal for €500bn of new bond issuance by the European Commission to fund a Recovery Fund is constructive even it's no game-changer. The initiative would still fail to provide a lasting solution to the destabilising vacuum in the euro area policy framework left by the lack of single common fiscal authority. However, as a temporary second-best solution, it could still make a helpful contribution to meeting the budgetary costs of the pandemic in the worst affected countries via large-scale bond issuance by a common institution. And so, it gave further significant support to euro area periphery bonds today. In particular, the Recovery Fund, worth about 4% of EU GDP, would provide grants from EU budgetary expenditure to support the most affected sectors (e.g. tourism, aviation) and regions (disproportionally in Southern Europe). It would also seek to increase investments in the digital and green transitions, and research and innovation. Bond market repayments would be made from within future EU budgets, ideally over a long time horizon.

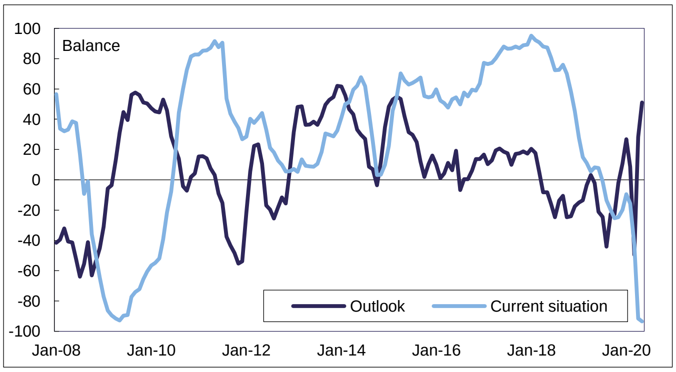
Negotiations should iron out the details and gain support of the naysayers

Unsurprisingly, but still unusually, the leaders of Italy and Spain swiftly gave backing to the proposal. But the leaders of Austria, the Netherlands, Sweden and Denmark insisted that they would only support the Recovery Fund if it dispersed loans rather than grants. Unfortunately, unanimity among member states will be required. Nevertheless, we suspect that the Franco-German proposal will form the basis of the eventual Recovery Fund and that will provide non-negligble budgetary support to Italy and Spain next year. Indeed, the Commission should in due course be able to issue large-scale and long-term bonds, more than half of which could legitimately be purchased by the ECB under its PSPP and PEPP programmes assuming those programmes are extended into 2021 How precisely the proceeds of that issuance will be allocated among the member states – including the final balance between direct grants and loans, as well as the distribution between countries, regions and sectors – will be the key focus of the negotiations over coming months. But we expect the member states that are currently opposed eventually to fall into line.

ZEW expectations balance rises to a five-year high

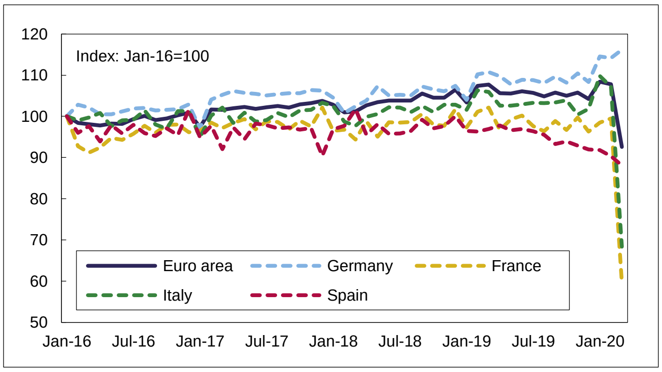
While the German economy is now seeing a pickup in economic activity with the easing of lockdown measures, today's ZEW survey of financial market professionals for May surprisingly reported a further modest deterioration in the assessment of the current situation. In particular, the headline index fell 2pts to -93.5, the lowest reading since mid-2003. Of course, like elsewhere in the euro area, Germany saw a marked weakening in output and spending in March and April, as illustrated by

Germany: ZEW sentiment survey



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Euro area: Construction output by member state



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

the dreadful car production and registrations figures (see below). But some sectors in Germany had already fared better than might have been expected, with construction sector activity continuing despite the need for social distancing. And as a result, the Bundesbank suggested that GDP might have contracted roughly 5%3M/3M in mid-May, a rate that would be at the lower end of the range of expectations. With the gradual lifting of restrictions, the ZEW's expectations balance rose to its highest level for more than five years, with the recovery in economic activity anticipated to be sustained over coming months. Nevertheless, most survey respondents do not expect the pre-Covid-19 level of output to be reached before 2022. And slightly fewer than half of survey respondents expected all restrictions on activity to be lifted before the end of the year.

Euro area construction collapses

The surprising increase in German construction output in March (up 1.8%M/M to be up a very strong 5½%Q/Q in Q1) contrasted markedly with the euro area's other large member states. Indeed, output from the sector in March was down by more than 40%M/M in France and by 36%M/M in Italy. So, today's aggregate figures for the euro area as a whole inevitably reported a record decline of more than 14%M/M, to leave construction activity down almost 15½%Y/Y to its lowest level since the series began in 1995. The weakness was unsurprisingly broad based, with double-digit monthly declines in civil engineering and building work alike. Moreover, the construction PMIs for April point to a further marked drop in April in all member states. Admittedly, Germany's PMI (31.9) remained well above the other member states, suggesting that it will continue to outperform. Indeed, the French and Italian indices plummeted in April to low single-digit figures (3.8 and 4.8 respectively), suggesting that activity was all but nonexistent in those countries last month.

Car registrations report record decline

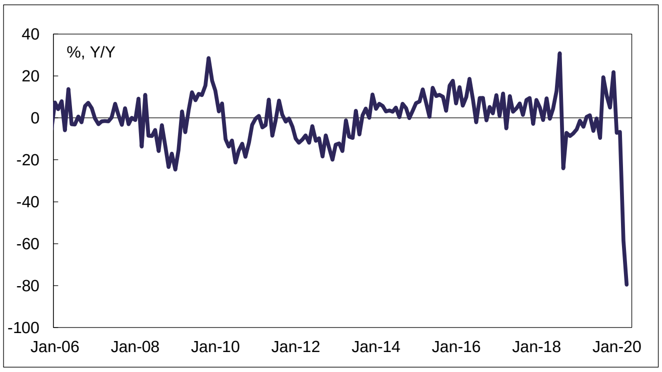
With much of the euro area having remained in lockdown for the whole of April, today's new car registrations figures for that month inevitably reported the steepest decline on record. We already knew that registrations in Italy and Spain had fallen more than 96%Y/Y, while those in France had dropped almost 89%Y/Y and sales in Germany were down 61%Y/Y. And while the pace of decline in some of the smaller member states was somewhat more moderate, today's figures showed that registrations of new cars in the euro area fell a whopping 79.6%Y/Y to just 203k units, the lowest level by a considerable margin on record. So, having declined in each of the first four months of the year, new registrations were down 40%Y/Y in the year-to-date, with sales in France, Italy and Spain all about half their levels over the same period last year. While April is likely to represent the trough, with the relaxation of the lockdown measures across the region only gradual, joblessness astronomical and uncertainty about the economic outlook still high, we expect new car registrations to remain particularly subdued for some time to come.

The day ahead in the euro area and US

Tomorrow brings the final release of euro area inflation figures for April, which are expected to confirm the marked drop related not least to the slump in the oil price and the impact of the coronavirus pandemic. And after downwards revisions to the equivalent final French and Spanish figures, we would expect to see euro area headline inflation nudged lower from the preliminary CPI estimate of 0.4%Y/Y, which itself was 0.3ppt lower than in March and the weakest since September 2016. While the drop in headline inflation from March was due principally to lower oil prices, the flash estimate of the core CPI rate eased 0.1ppt to 0.9%Y/Y. Meanwhile, despite the easing of lockdown measures across much of the region this month, the Commission's preliminary consumer confidence indicator is forecast to suggest that morale weakened further in May. In the markets, Germany will auction €4bn of 10Y bonds, while France will sell index-linked bonds.

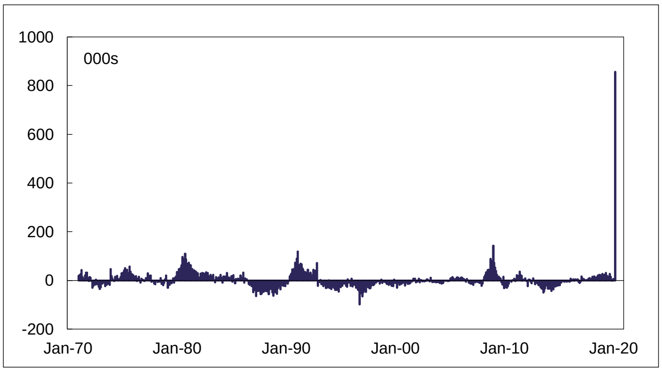
In the US, attention will stay on the Fed tomorrow, with the FOMC scheduled to release its late-April meeting minutes. While the minutes are not expected to provide any fresh clues on the Fed's next moves, they will further illustrate the Fed's gloomy view of the economic outlook, with many officials having recently downplayed the prospects for a speedy recovery. Supply-wise, the Treasury will sell $20bn of 20Y bonds.

Euro area: New car registrations



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: Claimant count



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK

Jobless claims surge in April

A focus in the UK today was the release of the latest labour market data. The headline employment and ILO unemployment data can be quickly ignored as they are both smoothed and out of date. But the jobless claims figures were awful, surging 856.5k in the month to 9 April to more than 2mn, almost ½mn above the peak during the global financial crisis. This saw the claimant count rate jump from 3.5% to 5.8%, the highest since early 1997. And these figures do not include the 7.5mn workers (roughly a quarter of the total) furloughed under the government's Job Retention Scheme. While the economy only went into lockdown towards the end of March, there was also a marked decline in the number of job vacancies that month, which were down more than 50%M/M to just 351k, the lowest for decades (and compared to a peak late last year of more than 900k). The number of weekly hours worked also fell sharply in the final week of the month, to leave the month as a whole marking the steepest annual decrease in ten years. Indeed, the ONS suggested that the total number of hours worked in the final week of March was around 25% lower than in other weeks in the first quarter.

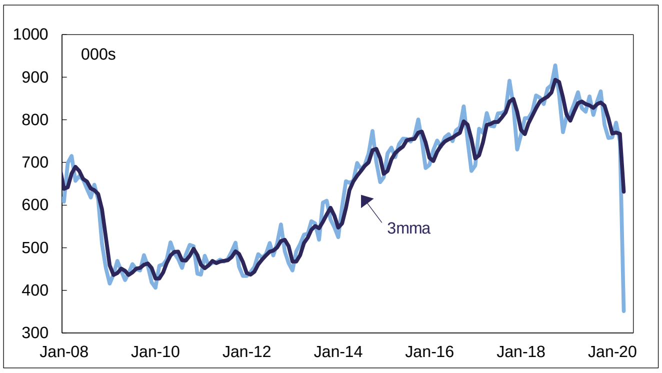
Wages weakened in March

Meanwhile, among the other detail of today's report, there was a further notable weakening in wage growth in the three months to March. In particular, regular earnings growth eased 0.2ppt to 2.7%3M/Y, the softest since mid-2018. And when including bonus payments, total earnings were down to 2.4%3M/Y, the weakest since September 2017. Moreover, the (admittedly always volatile) single-month figures showed a more dramatic slowing that month, with total wage growth of 1.5%Y/Y, a rate last weaker more than five years ago, and private sector earnings down to just 1.1%Y/Y, the softest since August 2014. And with more than one fifth of those in employment having been furloughed and plenty more made permanently unemployed, we expect further significant downwards pressure to be placed on wages over coming quarters too. Indeed, in its Monetary Policy Report, the BoE expected average weekly earnings in Q2 to be around 5% lower than a year earlier – roughly double the steepest decline seen during the global financial crisis.

The day ahead in the UK

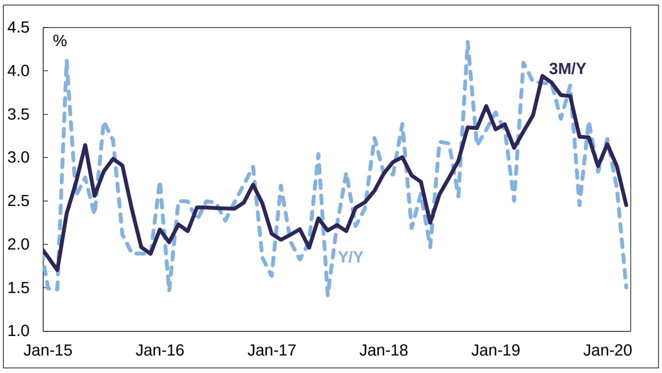
Turning to tomorrow, UK inflation figures for April will likely show a notable drop in the headline CPI rate from 1.5%Y/Y to below 1.0%Y/Y (albeit perhaps only just) for the first time since 2016. While prices of petrol and household energy will lead the decline, core inflation is also expected to fall to 1.4%Y/Y, from 1.6%%Y/Y in March due to very subdued demand. Furthermore, producer price figures, also due to be published tomorrow, are expected to highlight the absence of price pressures down the pipeline, with prices at the factory gate expected to have declined 0.5%Y/Y in April, the first negative reading since mid-2016. In other news, BoE Governor Bailey and Deputy Governors Broadbent and Cunliffe will testify before the Treasury Select Committee on the recent publication of the Bank's Monetary Policy and interim Financial Stability Reports. And in the markets, the DMO will auction 2Y bonds.

UK: Vacancies



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: Average weekly earnings



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

European calendar

Today's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
EMU		EU27 new car registrations Y/Y%	Apr	**-76.3**	-	-55.1	**-**
		Construction output M/M% (Y/Y%)	Mar	**-14.1 (-15.4)**	-	-1.5 (-0.9)	**-0.5 (0.2)**
Germany		ZEW current assessment balance (expectations)	May	**-93.5 (51)**	-80.0 (31.0)	-91.5 (28.2)	**-**
UK		Claimant count rate % (change '000s)	Apr	**5.8 (856.5)**	-	3.5 (12.2)	**- (5.4)**
		Average earning including bonuses (excluding bonuses) 3M/Y%	Mar	**2.4 (2.7(**	2.6 (2.6)	2.8 (2.9)	**-**
		ILO unemployment rate 3M%	Mar	**3.9**	4.4	4.0	**-**
		Employment change '000s 3M/3M	Mar	**210**	1	172	**-**

Auctions

Country	Auction
- Nothing to report -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's data releases

Economic data

Country		BST	Release	Period	Market consensus/ Daiwa forecast	Previous
EMU		10.00	Final CPI (core CPI) Y/Y%	Apr	0.3 (0.9)	0.7 (1.0)
		15.00	Preliminary consumer confidence	May	-23.8	-22.7
UK		09.30	CPI (core CPI) Y/Y	Apr	0.9 (1.3)	1.5 (1.6)
		09.30	PPI input prices (output prices) Y/Y%	Apr	-8.8 (-0.5)	-2.9 (0.3)
		09.30	ONS house price index Y/Y%	Mar	1.5	1.1

Auctions and events

Country		BST	Auction / Event
Germany		10.30	Auction: €4bn of 0% 2030 bonds
France		09.50	Auction: 0% 2023 bonds
		09.50	Auction: 1.75% 2023 bonds
		09.50	Auction: 1% 2025 bonds
		09.50	Auction: 0% 2026 bonds
		10.50	Auction: 0.1% 2025 index-linked bonds
		10.50	Auction: 0.7% 2030 index-linked bonds
		10.50	Auction: 0.1% 2036 index-linked bonds
UK		10.30	Auction: £3.75bn of 0.75% 2023 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.