

Euro wrap-up

Overview

- Bunds made gains as the flash euro area PMIs remained extremely weak despite a bounce back from April's record low.
- Gilts made more significant gains and saw a negative yield at the 5Y maturity for the first time as the flash UK PMIs remained consistent with a significant drop in economic output despite the improvement in May.
- Friday will bring UK retail sales, consumer sentiment and public finance figures, as well as the account from the ECB's end-April meeting.

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Daily bond market movements

Bond	Yield	Change
BKO 0 03/22	-0.710	-0.017
OBL 0 04/25	-0.691	-0.024
DBR 0 02/30	-0.501	-0.028
UKT 0½ 07/22	-0.043	-0.022
UKT 0% 06/25	-0.005	-0.056
UKT 4% 12/30	0.175	-0.053

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

Euro area

PMIs point to very modest improvement

Like yesterday's [consumer confidence indicator](#), the flash May PMIs pointed to some modest improvement in economic conditions as lockdown measures gradually started to be relaxed across the euro area. Nevertheless, with firms citing ongoing challenges due to social distancing and other Covid-related disruption, all key indices across the euro area unsurprisingly remained at very weak levels and point to an ongoing sharp contraction in activity across the board. For example, while the euro area composite index jumped 16.9pts to 30.5, this was still the second-lowest reading on record and almost 6pts below the trough during the global financial crisis (GFC). The moderation in the pace of contraction was evident in the manufacturing and services sectors alike – indeed, the manufacturing output index rose 17.3pts to 35.4, while the headline services index more than fully reversed the 14.4pt drop last month to 28.7. And the rates of decline in activity similarly eased across euro area member states. In particular, the German composite PMI rose 14pts to 31.4, continuing to signal a relatively milder contraction than elsewhere in the region, while the equivalent French index increased 19.4pts to 30.5. Meanwhile, Markit suggested that the rest of the euro area – particularly Italy and Spain – continued to contract at a steeper rate than the two largest member states.

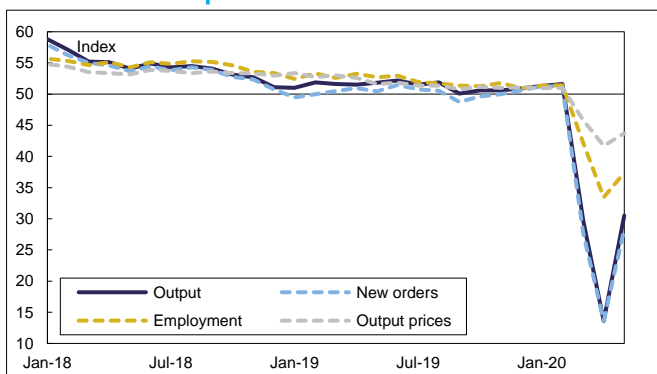
But output still heading for record contraction in Q2

While firms indicated that new orders continued to fall, the relevant composite index rose to a three-month high suggesting that the worst had now passed. Firms were certainly less pessimistic about output over the coming twelve months than they were in April, although the index remained firmly in contractionary territory. And while various wage subsidy schemes had provided support, the survey's employment component remained close to April's record low, with many firms likely to make job cuts further once government support is phased out. So, with labour market slack already weighing on wage growth, and spare capacity having risen considerably, today's survey unsurprisingly suggested that disinflationary pressures remained pronounced. Of course, it is impossible to interpret with any accuracy what the PMIs really imply for the current profile of GDP. But, overall, they continue to point to an extreme drop in economic output so far in the second quarter by the most in the post-War era. This notwithstanding, the modest improvement in May raises cautious optimism that the pace of decline will continue to moderate as lockdown restrictions are further relaxed, as long as a second wave of pandemic is avoided.

The day ahead in the euro area and US

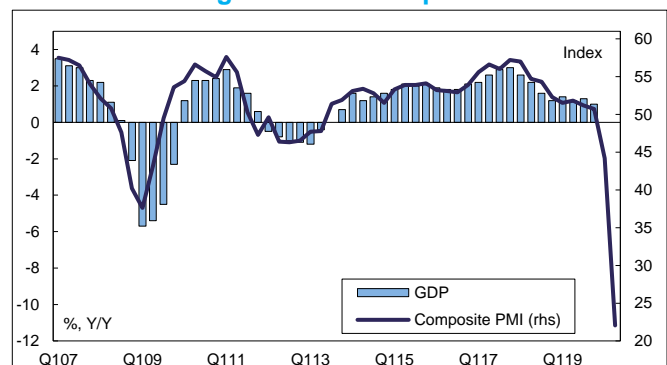
With no economic data scheduled for release, the main focus in the euro area tomorrow will be the publication of the minutes of the end-April ECB Governing Council meeting. At that meeting, the ECB cut the interest rate on the forthcoming TLTRO-iii

Euro area: Composite PMIs



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

Euro area: GDP growth and composite PMI*



*Q220 figure is average of April and May. Source: Markit, Thomson Reuters and Daiwa Capital Markets Europe Ltd.



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operations and launched its additional new PELTRO funding scheme, but left the asset purchase programmes unchanged. ECB Chief Economist Lane will also speak at a virtual event on 'Inflation: Drivers and Dynamics 2020'.

It will be a quiet end to the week for economic news in the US with no data of note due for release.

UK

Flash PMIs suggest a (slightly) softer pace of decline in May

Like in the euro area, the UK's flash PMIs suggested that the pace of decline in economic activity eased somewhat this month as social distancing rules were relaxed very gradually. In particular, the composite output PMI rose 13.8pts to 28.9. But this was still the second-lowest reading on the series and almost 10pts below the trough during the GFC to suggest ongoing extremely deep contraction at an unprecedented pace. And the detail of the survey points to further trouble ahead.

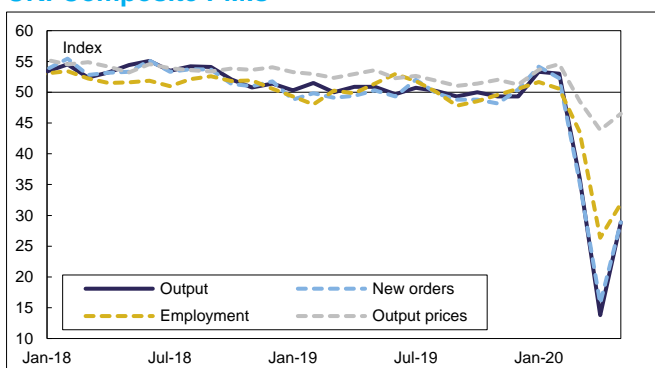
Services sector still in need of intensive care

While the economic downturn remains broad-based, the improvement in the PMI survey was more marked in the manufacturing sector, in which workers were encouraged by the government to return to work this month. Indeed, the output PMI rose almost 19pts to 34.9, still a very low level but at least one back into the bottom of the range of the GFC. The services activity PMI, however, rose just 14.4pts to 27.8, still more than 12pts below the worst reading before the pandemic, with travel, tourism and hospitality inevitably cited by Markit as among the worst afflicted. Among other survey detail, the composite measures of new orders and employment also rose from April. But at 28.9 and 31.9 respectively, they were well below all previous levels bar those in April. Like in the euro area, the low level of output and paucity of new orders meant that backlogs of work declined and permanent job cuts are likely to be made once the government's Job Retention Scheme is phased out. The respective PMIs also suggested that firms in the services sector continue to respond to weak demand by lowering prices – indeed, we expect services CPI inflation to fall to record lows from May onwards.

The day ahead in the UK

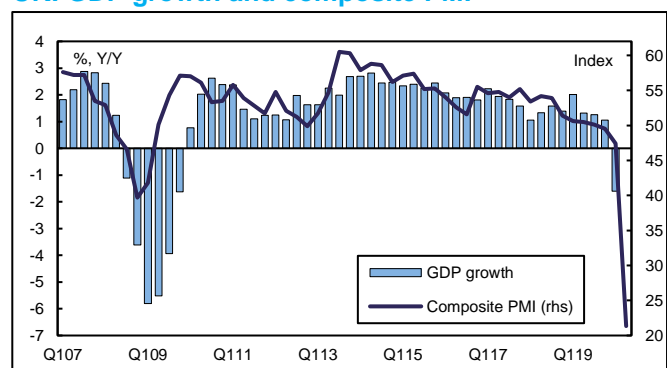
The UK's economic data calendar ends the week with the release of April's retail sales figures, which are expected to reveal a new record drop of more than 10%M/M following the previous decline of 5.8%M/M in March. The preliminary GfK consumer confidence survey is also due and likely to point to only a very modest improvement in conditions in May. In addition, tomorrow will bring public finance figures for April, which will reveal a massive blowout in the deficit, albeit one which is very difficult to predict with accuracy. With the government having extended the Job Retention Scheme to October, and some guarantees on business loans already being called, the OBR last week increased its baseline forecast for public sector net borrowing in the current fiscal year to a record £298.4bn, almost double the previous peak during the GFC and £25.5bn higher than its projection published just a month ago.

UK: Composite PMIs



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

UK: GDP growth and composite PMI*












*Q2020 figure is average of April and May. Source: Markit, 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	 Preliminary manufacturing (services) PMI	May	39.5 (28.7)	38.0 (25.0)	33.4 (12.0)	-
	 Preliminary composite PMI	May	30.5	27.0	13.6	-
Germany	 Preliminary manufacturing (services) PMI	May	36.8 (31.4)	39.0 (24.0)	34.5 (16.2)	-
	 Preliminary composite PMI	May	31.4	33.1	17.4	-
France	 Preliminary manufacturing (services) PMI	May	40.3 (29.4)	36.0 (28.0)	31.5 (10.2)	-
	 Preliminary composite PMI	May	30.5	32.4	11.1	-
UK	 Preliminary manufacturing (services) PMI	May	40.6 (27.8)	37.2 (24.0)	32.6 (13.4)	-
	 Preliminary composite PMI	May	28.9	25.7	13.8	-
	 CBI industrial trends survey, total orders	May	-62	-50	-56	-





Auctions

Country	Auction
Spain	 sold €1.3bn of 0.35% 2023 bonds at an average yield of -0.16%
	 sold €1.75bn of 0% 2025 bonds at an average yield of 0.053%
	 sold €2.5bn of 1.25% 2030 bonds at an average yield of 0.711%
	 sold €1.35bn of 3.45% 2066 bonds at an average yield of 1.691%
UK	 sold £1.25bn of 0.125% 2028 index-linked bonds at an average yield of -2.807%
	 sold £2bn of 4.25% 2032 bonds at an average yield of 0.321%



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's results

Economic data

Country	BST	Release	Period	Market consensus/ Daiwa forecast	Previous
UK	 00.01	Preliminary GfK consumer confidence	May	-	-33
	 07.00	Retail sales including fuel M/M% (Y/Y%)	Apr	-15.5 (-21.2)	-5.1 (-5.8)
	 07.00	Retail sales excluding fuel M/M% (Y/Y%)	Apr	-15.0 (-18.6)	-3.7 (-4.1)
	 09.30	Public sector net borrowing £bn	Apr	42.5	3.1

Events & auctions

Country	BST	Event / Auction
EMU	 12.30	ECB to publish monetary policy account of 29-30 Governing Council meeting
	 15.30	ECB Chief Economist to speak at a virtual conference on inflation

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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