

Euro wrap-up

Overview

- As equities fell sharply, euro area government bonds rallied as steep drops in Italian production and French payrolls were confirmed, while the French government announced new fiscal policy support.
- Gilts also followed USTs higher as the latest UK housing market survey signalled expectations of price declines ahead.
- Friday will bring updates on UK GDP and euro area industrial production in April and French and Spanish inflation in May.

Chris Scicluna
+44 20 7597 8326

Emily Nicol
+44 20 7597 8331

Daily bond market movements

Bond	Yield	Change
BKO 0 06/22	-0.667	-0.036
OBL 0 04/25	-0.641	-0.065
DBR 0 02/30	-0.421	-0.086
UKT 0½ 07/22	-0.050	-0.003
UKT 0% 06/25	-0.007	-0.031
UKT 4% 12/30	0.198	-0.070

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

Euro area

Italian output at a more-than four-decade low

After falling by a record 28½%M/M in March, Italian industrial production declined a somewhat more “modest” 19.1%M/M in April. Nevertheless, this left output down a record 42.5% compared with a year earlier and at its lowest level since 1969. Among the steepest declines, production of textiles and clothing was down a further 40%M/M to be down more than 80%Y/Y. This was closely followed by transport equipment (-38.4%M/M, -74%Y/Y), with overall production of consumer durables down a whopping 65½%M/M, 85%Y/Y. Meanwhile, output of machinery and equipment was down by more than a fifth having dropped by 40%M/M in March, to leave the level of capital goods production about half that a year ago. Indeed, as in other countries, the only manufacturing sub-sector to register any growth in April was pharmaceuticals, although the 2%M/M increase merely offset some of the decline in March.

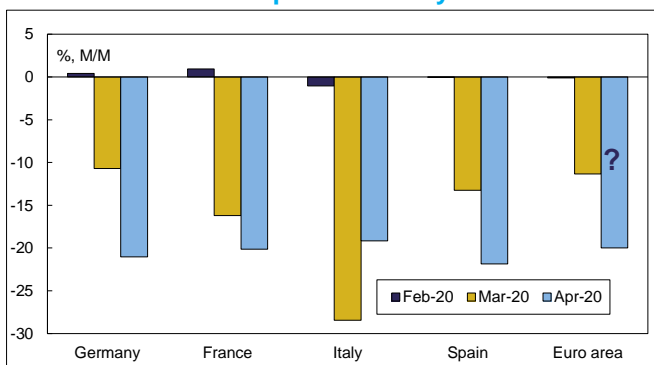
French production fell at a record rate in April

Yesterday's data reported a record decline in French production in April. In particular, manufacturing output in the euro area's second-largest member state plunged a further 21.9%M/M in April having already dropped 18.3%M/M in March to be down 37.1%Y/Y at the lowest level on the 30-year series. Among the steepest declines, production of transport equipment was down a further 47.5%M/M after dropping 35.0%M/M in March, with output motor vehicles and trailers down 88.0%M/M following a decline of “just” 45.1%M/M previously. So, the level of consumer durables production was down about three-quarters from its level a year earlier. In addition, output of machinery and equipment was down 24.6%M/M having slumped 21.0%M/M the prior month to leave the level of capital goods output only about half the level a year earlier. And contrasting markedly from Germany where the sector remained resilient, construction output fell 32.7%M/M in April having already dropped 42.2%M/M in March, to be down more than 60%Y/Y.

French production capacity improved slightly in May

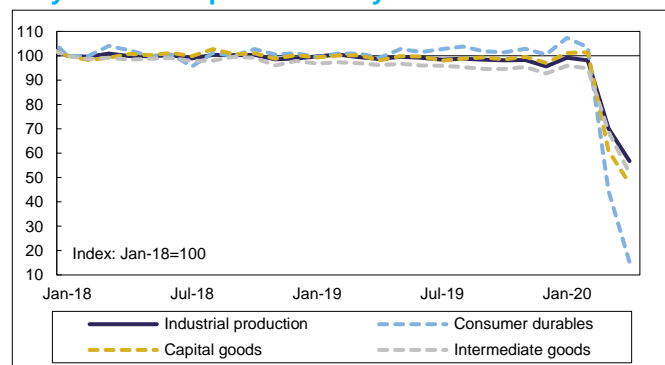
With the easing of lockdown restrictions, the level of output will certainly have rebounded somewhat in all member states in May. Indeed, the Bank of France earlier this week suggested that French capacity utilisation in the industrial sector was back to about 61% at the end of the month, from 78% before the crisis. But there remained significant variation among the sub-sectors, from 36% capacity in autos to 79% in pharmaceuticals, a pattern that was also likely repeated in the other large member states. Surveys also point to further improvement in June. But with orders having taken a massive hit from the pandemic (while the French and Italian manufacturing new orders PMIs picked up last month, at just 31.7 and 35.9 they

Euro area: Industrial production by member state



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Italy: Industrial production by sub-sector



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.



were still at levels seen during the global financial crisis), and expectations decidedly weak, the level of production seems bound to remain well below covid levels into next year and probably beyond.

French payrolls posted record drop already in Q1

Given the hit to activity as the economy entered lockdown in March, French payrolls dropped at the end of Q1 by a record 2.0%Q/Q and 502.4k, to the lowest level since Q417. The decline was almost entirely concentrated in the private sector, where the number of jobs dropped by 2.5%Q/Q and by more than 497k. Given decent job creation ahead of the pandemic, compared to a year earlier, payroll employment was down by a somewhat more moderate 1.2%Y/Y and 304.7k. Net job losses in France in Q1 came principally from the marketed services sector, where the decline of 468k and 3.7%Q/Q was more than four times the size of the largest quarterly drop on the series dating back almost 50 years. Perhaps inevitably, payrolls in the hospitality sector were among the worst hit. Of course, these figures exclude the impact of the government's partial unemployment furlough support scheme, which by end-Q1 was already providing support to roughly 4mn workers, and now has more than 13mn workers registered.

French government to provide extra support

With the labour market impact of the crisis increasingly felt, the French government today announced a third fiscal stimulus programme to support economic activity over the remainder of the year. In total, the special policies aimed at tackling the crisis will now amount to €136bn (a little more than 5½% of GDP), €26bn more than previously planned. The partial unemployment scheme is now expected to cost the government €31bn, while €41bn of direct support will be provided to hard-hit sectors, including tourism, autos and aviation. Additional funds will be provided to SMEs and local governments. The government now forecasts GDP to fall 11%Y/Y in 2020, with consumption down 10%Y/Y and business investment down by more than twice that rate. As a result, the general government budget deficit is expected to reach 11.4% of GDP, pushing gross debt up to 121% of GDP. However, as in other member states, as and when credit guarantees are called, the eventual hit to public debt from the crisis is likely to be even larger than these figures suggest.

The day ahead in the euro area and US

The data flow remains focused on the manufacturing sector tomorrow, with the release of the overall euro area industrial production numbers for April. Following the record falls in manufacturing output recorded in the large euro area member states this week, the aggregate measure is expected to reveal a massive drop of about 20%M/M in production, following a fall of 11.3%M/M in March, leaving it roughly 29% lower compared to a year earlier. And while survey data suggest that industrial output was able to rebound somewhat last month as controls were eased and factories tentatively reopened, with demand set to remain very subdued over coming months, we expect euro area production to remain well down from its pre-coronavirus level well into next year and likely beyond. Meanwhile, final May CPI data for France and Spain, also due tomorrow, are expected to confirm the flash estimates, which showed that inflation fell further on the back of lower energy prices. On the EU-harmonised measure, French inflation fell 0.2ppt to 0.2%Y/Y while Spanish inflation also fell 0.2ppt to -0.9%Y/Y, both the lowest since the first half of 2016.

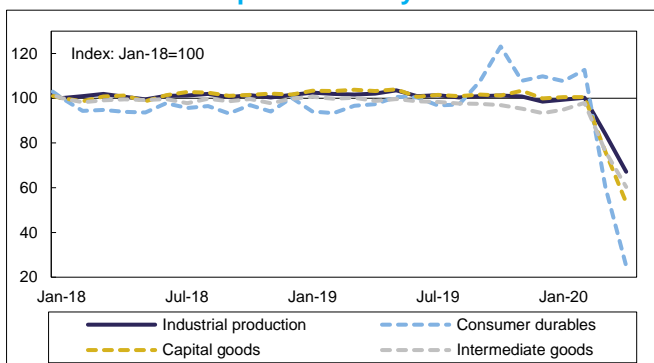
In the US, import and export price data will be released, as well as the University of Michigan's preliminary consumer confidence survey results for June and Fed's flow of funds figures for Q1.

UK

House prices to fall despite increased market stability

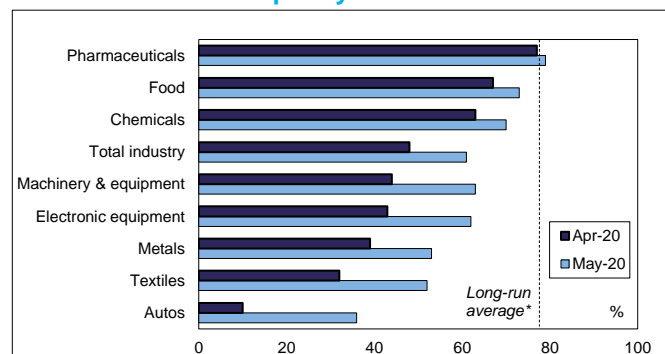
The latest RICS Residential Market Survey pointed to greater stability in the housing market after estate agents in England were able to reopen from 13 May. However, the sector remains unsettled by the pandemic, and further price declines are

France: Industrial production by sub-sector



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

France: Industrial capacity utilisation



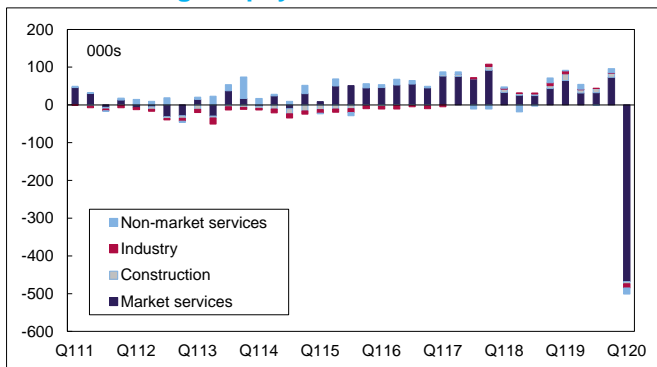
*Long-run average of total industry (78%). Source: Bank of France and Daiwa Capital Markets Europe Ltd.

expected over the coming year. Moreover, the housing markets in Scotland, Wales and Northern Ireland, where estate agents remain closed due to lockdown rules, remain firmly in the doldrums. At least demand conditions in England now appear more 'normal', with the survey index of new buyer enquiries up from the record low of -94% in April to a near-neutral -5% last month. On the supply side, the net balance of new sale instructions rose 77pts to -20%. While it remained more deeply in negative territory, the index of newly agreed sales rose almost 60ppts to -35%. Moreover, the survey measure of near-term sales expectations rose 54ppts to a broadly-neutral -4%. And 12-month sales expectations now suggest modest growth, with the respective index up 16ppts to show a net balance of +10% of respondents forecasting a pick-up in transactions. In terms of house prices, however, the survey's headline price indicator, which reflects changes over the past three months, fell 10ppts to -32%, the weakest since 2010. Expectations of price declines over the coming three months moderated somewhat, with the respective net balance up 30ppts to a still-deeply negative -43%. And twelve-month price expectations also remain negative, with a net balance of -16% (up 10ppts from April) of surveyors forecasting price declines over the coming year.

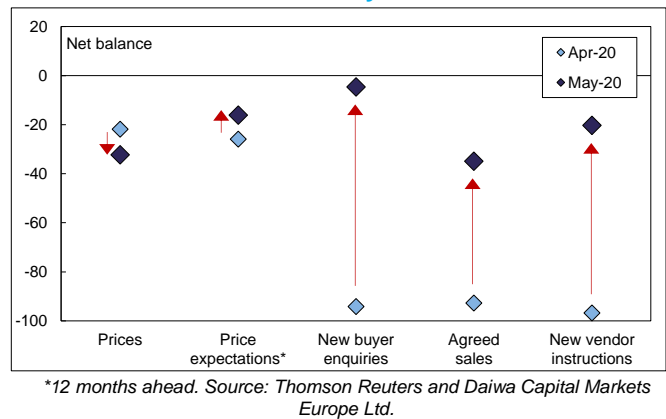
The day ahead in the UK

After a quiet week on the UK economic data front, tomorrow brings the publication of the April GDP report, which will be closely watched. These figures are bound to show a massive hit to activity across the services, manufacturing and construction sectors alike, as the country remained in lockdown. Following a drop of 5.8%M/M in March, GDP might well have fallen by four times that rate in April. The gradual lifting of containment measures over recent weeks means that April will prove to be the trough. Nevertheless, with the impact of the pandemic in the UK having been more severe and longer-lasting than in most other major economies, the hit to GDP in Q2 is likely to have been larger too. Even in the absence of a second wave of infection and lockdown, we think that the rebound in Q3 will be highly partial. And the recovery in subsequent quarters will be relatively moderate or worse, weighed not least by the impact of Brexit. April's trade figures, also due on Friday, will flag the negative impact of the pandemic on both domestic and external demand, as well as international supply chains. As in other European countries, expect exports and imports to post record declines. Finally, the BoE will publish its inflation attitudes survey tomorrow too.

France: Change in payrolls






UK: RICS Residential survey








European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
France	 Total (private sector) payrolls Q/Q%	Q1	-2.0 (-2.5)	-	0.4 (0.5)	-
Italy	 Industrial production M/M% (Y/Y%)	Apr	-19.1 (-42.5)	-20.0 (-40.0)	-28.4 (-29.3)	- (-29.4)
UK	 RICS house price balance %	May	-32	-24	-21	-22



Auctions

Country	Auction
Italy	 sold €5.0bn of 0.3% 2023 bonds at an average yield of 0.46%
	 sold €2.5bn of 0.85% 2027 bonds at an average yield of 1.1%
	 sold €2.0bn of 1.45% 2036 bonds at an average yield of 1.91%
UK	 sold £3.25bn of 1% 2024 bonds at an average yield of -0.041%
	 sold £3.25bn of 0.125% 2028 bonds at an average yield of 0.111%


Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Yesterday's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
France	 Industrial production M/M% (Y/Y%)	Apr	-20.1 (-34.2)	-20.0 (-33.1)	-16.2 (-17.3)	-
	 Manufacturing production M/M% (Y/Y%)	Apr	-21.9 (-37.1)	-18.1 (-35.3)	-18.2 (-19.3)	-18.3 (-19.4)










Auctions

Country	Auction
UK	 sold £900mn of 0.125% 2036 index-linked bonds at an average yield of -2.55%

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	Industrial production M/M% (Y/Y%)	Apr	-20.0 (-26.6)	-11.3 (-12.9)
France	 07.45	Final CPI (EU-harmonised CPI) Y/Y%	May	0.2 (0.2)	0.3 (0.4)
Spain	 07.45	Final CPI (EU-harmonised CPI) Y/Y%	May	-1.0 (-0.9)	-0.7 (-0.7)
UK	 07.00	Monthly GDP M/M% (3M/3M%)	Apr	-17.5 (-10.0)	-5.8 (0.1)
	 07.00	Industrial production M/M% (Y/Y%)	Apr	-14.3 (-19.3)	-4.2 (-8.2)
	 07.00	Manufacturing production M/M% (Y/Y%)	Apr	-15.3 (-20.1)	-4.6 (-9.7)
	 07.00	Construction output M/M% (Y/Y%)	Apr	-25.0 (-30.0)	-5.9 (-7.1)
	 07.00	Index of services M/M% (3M/3M%)	Apr	-20.0 (-10.6)	-6.2 (-1.9)
	 07.00	Total trade balance (goods trade balance) £bn	Apr	-5.5 (-11.0)	-6.7 (-12.5)

Auctions and events

Country	BST	Auction / Event
- Nothing scheduled -		

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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