

# Euro wrap-up

## Overview

- Despite a softer-than-expected rise in German IP, Bunds made losses as ECB Board member Schnabel noted that the euro area recession could be shallower than expected and the Bank of France revised up its assessment of economic output.
- Gilts made modest gains on a quiet day for economic news out of the UK.
- Tomorrow will bring a fiscal policy announcement and labour market survey, both from the UK.

**Chris Scicluna**  
+44 20 7597 8326

**Emily Nicol**  
+44 20 7597 8331

### Daily bond market movements

Bond	Yield	Change
BKO 0 06/22	-0.685	+0.015
OBL 0 04/25	-0.664	+0.019
DBR 0 08/30	-0.427	+0.009
UKT 0½ 07/22	-0.082	-0.001
UKT 0% 06/25	-0.038	-0.006
UKT 4% 12/30	0.183	-0.015

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

## Euro area

### A rather modest rebound in German IP

Like yesterday's [factory orders](#) data, Germany's industrial production figure came in somewhat weaker than expected, with the rise of 7.8%M/M in May leaving it still a whopping 19.0% below February's pre-pandemic level and down a similar rate from the level a year earlier. Manufacturing and mining output rose a faster 10.3%M/M but that left it down more than 22% from February's level. Improvement was led by the autos sector, as production lines came back on stream. But the near-tripling of output of motor vehicles over the month left its level little better than half that ahead of the pandemic. Growth in other sub-sectors was less marked. For example, production of machinery and equipment rose a little less than 10% on the month, to be still down more than 17% from February's level. Metals output rose just 5.4%M/M to be down almost 25% from before the pandemic hit. And output of chemicals and pharmaceuticals fell back. Beyond manufacturing where the initial hit to activity had been more modest, the improvements in May were relatively tepid. Construction output rose just 0.5%M/M to be 4.0% below the February level. And energy production rose 1.7%M/M to be down 13.9% from the pre-pandemic level.

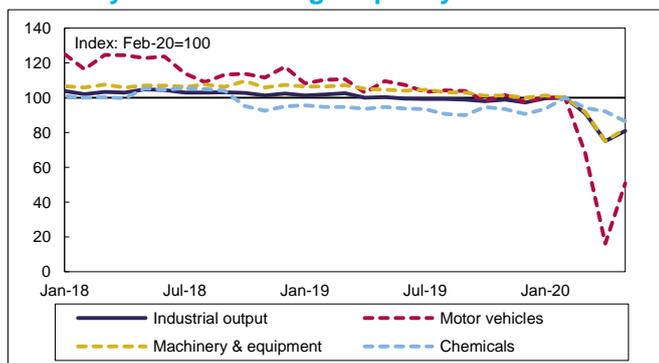
### Recovery in production likely to continue to underwhelm

Car production continued to recover in June – VDA data point to a drop of 20%Y/Y last month compared to the drop of 66%Y/Y in May. So, total German manufacturing output seems bound to have seen significant further growth again last month. That tallies with survey indicators, such as the ifo indices and PMIs, as well as other high-frequency data. However, new orders remain disappointingly subdued. And some high-frequency indicators, such as truck-toll mileage data, point to a notable levelling off in activity over the past few weeks. So, while the cut in VAT to last from July through to year-end, will likely support production for the domestic market, overall we anticipate a notable slowing in production from the current month on, and a shortfall from the February level to persist well into next year, and possibly beyond.

### Bank of France less downbeat about pandemic impact

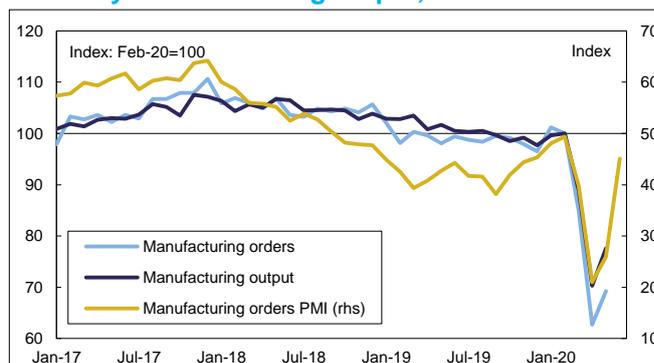
With signs of a swifter-than-expected rebound in spending and broader economic activity in France, the country's central bank has become somewhat more upbeat. While it previously estimated that French GDP was on average down about 17% from the pre-crisis level in May, based on its latest monthly survey, the Bank of France now estimates that the equivalent shortfall in French GDP in June was around 9%. As a result, bang in line with our baseline scenario, the Bank now forecasts a contraction of GDP over Q2 as a whole of about 14%Q/Q, following the drop of 5.3%Q/Q in Q1. The Bank noted that all subsectors of industry had seen stronger-than-anticipated growth in June led by producers of autos, machinery and equipment. And the recovery in construction was judged to be even more marked. In services, however, the picture was mixed. While some subsectors were judged to be returning to 'normal' levels of activity, others (e.g. hospitality) remain far from achieving that status.

### Germany: Manufacturing output by subsector



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

### Germany: Manufacturing output, orders and PMI



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



### A bird’s-wing-shaped recovery?

Looking ahead, many of the subsectors that had seen the weakest levels in activity in June are expected to see the strongest growth in July. But the improvements in the subsectors where the recoveries were already well advanced last month are expected to be modest. Indeed, the Bank of France survey flagged concerns about the low level of orders. And it forecasts that the July level of GDP will still be about 7% below the pre-pandemic level. Assuming a levelling off over the remainder of the quarter, it thus forecasts a rise in GDP of 14% in Q3 as a whole. And it then envisages only a gradual improvement thereafter, marking a “bird’s wing” shape. As such, full-year GDP in 2020 would still drop by about 10%Y/Y – only a little less than our own forecast – and the pre-pandemic level of economic output would be reached only in the second half of 2022.

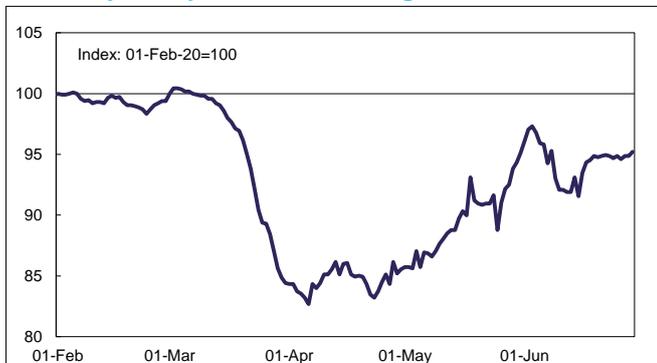
### Italian sales rebound, but plenty of lost ground still to make up

As in the other large member states, and thus also in the [euro area](#) as a whole, retail sales in Italy rebounded at a faster pace than expected in May with an eye-catching increase of 25.2%M/M as lockdown measures eased. That, however, still left sales down 10.5%Y/Y and 13.9% below February’s pre-pandemic peak, with less than 60% of the peak-to-trough decline reversed. Within the detail, growth in non-food items was even stronger, up by two-thirds from April, albeit still more than one fifth below February’s level. Following a surge in March as consumers attempted to stockpile goods, food items fell for a second successive month to be 2.3% below February’s level. A continued shift in favour of online shopping saw internet sales rise by 41.7%Y/Y, a new record high.

### Consumers expect to spend less on services once pandemic has passed

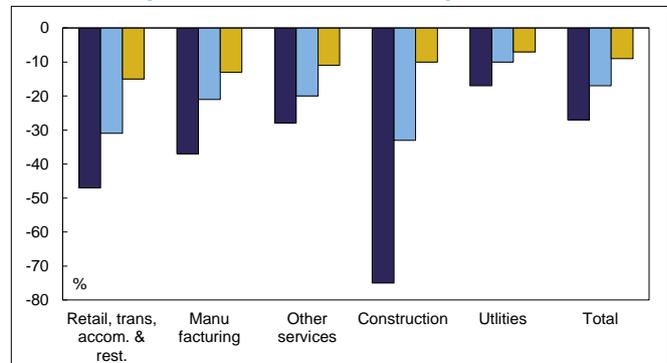
As elsewhere in the euro area, the period of lockdown was met with a jump in savings in Italy, with the household savings rate jumping 4.6ppts in Q1 alone to 12.5%. To some extent that reflects pent-up demand, which will be steadily unwound over coming months to provide a further boost to sales. However, it also reflects a degree of increased precautionary saving, as households guard against an uncertain future. While it improved in June, Italian consumer confidence remained well below the range of the four years before the pandemic hit, as did willingness to make big-ticket purchases. And the results of a special Bank of Italy survey, also released today, suggested that almost half of individuals expect their family income to drop over the coming twelve months. Moreover, about 60% of individuals expect to spend less on travel, holidays, eating out and entertainment than they did before the pandemic even once Covid-19 has fully passed. So, even if retail sales continue to recover, discretionary spending seems likely to remain well down on the pre-pandemic level for a long time to come.

#### Germany: Daily truck-toll mileage



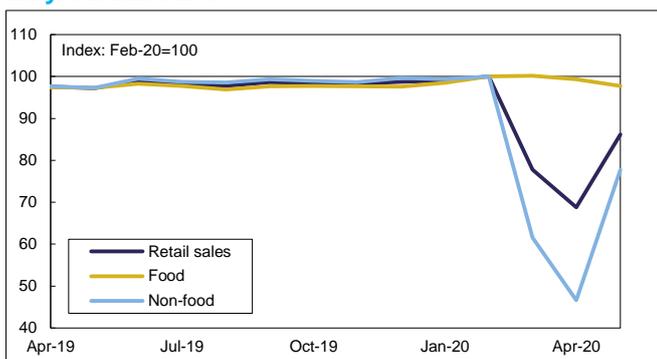
Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

#### France: Impact of Covid-19 on output\*



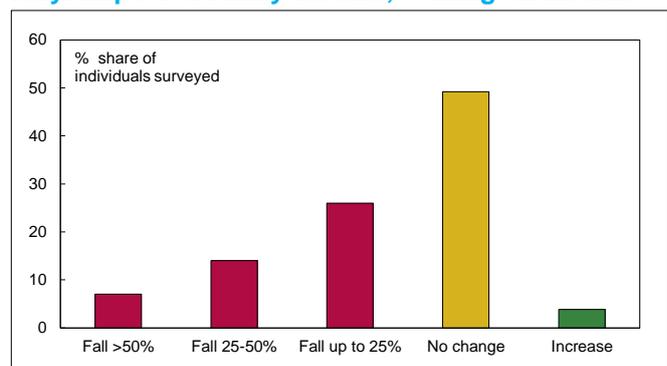
\*Estimated shortfall in GDP compared with the pre-pandemic level. Source: Bank of France survey and Daiwa Capital Markets Europe Ltd.

#### Italy: Retail sales



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

#### Italy: Expected family income, coming 12 months\*



\*Expected change in family income over coming 12 months compared to 12 months before the pandemic. Source: Bank of Italy and Daiwa Capital Markets Europe Ltd.

## The coming two days in the euro area and US

A quiet couple of days for euro area economic releases will bring just German trade figures for May on Thursday. Like today's French report – which showed a notable widening of the trade deficit as imports rose by 20.7%M/M while exports rebounded by a somewhat less vigorous 16.8%M/M – these are likely to see imports and exports reverse only part of the contractions seen in the previous two months, with the improvement in exports likely lagging. Thursday will also see euro area finance ministers hold a virtual Eurogroup meeting to discuss the budgetary situation in the member states and the overall euro area fiscal stance. Meanwhile, ECB Vice President de Guindos will participate in an online conference tomorrow. In the markets, Germany will sell 5Y Bunds.

In the US, tomorrow will bring consumer credit figures for May, followed on Thursday by weekly jobless claims numbers and wholesale trade data for May. Meanwhile, the Fed's Bostic will speak at events on the economy tomorrow and on fiscal policy on Thursday. In the markets, the US Treasury will sell 10Y notes on Wednesday and 30Y bonds on Thursday.

## UK

### The coming two days in the UK

After a day bereft of any UK releases today, Wednesday will bring just the REC/KPMG report on jobs for June, which is expected to paint another a bleak picture of the UK jobs market. May's survey indicated that hiring activity remained weak across the UK, as permanent placements and temporary billings both fell at the second-sharpest rate on record. Recruiters frequently mentioned that the pandemic had led clients to cancel or postpone recruitment plans until the outlook improved. Against this backdrop, Chancellor Sunak will also deliver his economic statement tomorrow. He has appeared to dampen expectations of a significant further fiscal stimulus, hinting to MPs not to expect a big German-style across-the-board cut in VAT. However, reports suggest that he might offer temporary targeted tax cuts, including a stamp duty holiday on purchases of lower-priced homes, and a VAT cut targeted on the hospitality sector. In addition, extra public investment might well be announced along with subsidies for "green" projects. Thursday, meanwhile, will bring the latest RICS residential survey, which is expected to report only a modest easing in the rate at which house prices fell in June. In the markets, the DMO will sell index-linked Gilts on Thursday.

*The next edition of the Euro wrap-up will be published on 09 July 2020*

## European calendar

Today's results						
Economic data						
Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Germany	 Industrial production M/M% (Y/Y%)	May	<b>7.8 (-19.3)</b>	10.0 (-18.0)	-17.9 (-25.3)	<b>-17.5 (-25.0)</b>
France	 Bank of France industrial sentiment	Jun	<b>89</b>	90	83	-
	 Trade balance €bn	May	<b>-7.1</b>	-	-5.0	<b>-5.1</b>
Italy	 Retail sales M/M% (Y/Y%)	May	<b>24.3 (-10.5)</b>	15.0 (-17.0)	-10.5 (-26.3)	<b>-10.7 (-26.7)</b>
UK	 Final output per hour Y/Y%	Q1	<b>-0.6</b>	-2.9	0.3	<b>0.4</b>
Auctions						
Country	Auction					
Germany	 sold: €585mn of 0.5% 2030 index-linked bonds at an average yield of -1.15%					
UK	 sold £3.75bn of 0.125% 2023 bonds at an average yield of -0.034%					
	 sold £2.25bn of 1.25% 2041 bonds at an average yield of 0.626%					

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

### Tomorrow's data releases

#### Economic data

Country	BST	Release	Period	Market consensus/ Daiwa forecast	Previous
- Nothing scheduled -					

#### Auctions and events

Country	BST	Auction / Event
EMU	 09.45	ECB's de Guindos participates in a debate on 'The Pandemic Crisis in Europe: Impact, policy response and recovery'
	 15:00	ECB's de Guindos participates in a virtual meeting
Germany	 10.30	Auction: €5bn of 2025 bonds
UK	 09.30	REC/KPMG Report on Jobs
	 -	Chancellor Sunak's economic statement

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

### Thursday's data releases

#### Economic data

Country	BST	Release	Period	Market consensus/ Daiwa forecast	Previous
Germany	 07.00	Trade balance €bn	May	5.0	3.6
UK	 00.01	RICS house price balance %	Jun	-25	-32

#### Auctions and events

Country	BST	Auction / Event
EMU	 -	Virtual Eurogroup meeting of euro area finance ministers
UK	 10.00	Auction: £900mn of 0.125% 2041 index-linked bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:

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

This research report is produced by Daiwa Securities Co. Ltd., and/or its affiliates and is distributed by Daiwa Capital Markets Europe Limited in the European Union, Iceland, Liechtenstein, Norway and Switzerland. Daiwa Capital Markets Europe Limited is authorised and regulated by The Financial Conduct Authority and is a member of the London Stock Exchange and Eurex Exchange. Daiwa Capital Markets Europe Limited and its affiliates may, from time to time, to the extent permitted by law, participate or invest in other financing transactions with the issuers of the securities referred to herein (the "Securities"), perform services for or solicit business from such issuers, and/or have a position or effect transactions in the Securities or options thereof and/or may have acted as an underwriter during the past twelve months for the issuer of such securities. In addition, employees of Daiwa Capital Markets Europe Limited and its affiliates may have positions and effect transactions in such securities or options and may serve as Directors of such issuers. Daiwa Capital Markets Europe Limited may, to the extent permitted by applicable UK law and other applicable law or regulation, effect transactions in the Securities before this material is published to recipients.

This publication is intended for investors who are not Retail Clients in the United Kingdom within the meaning of the Rules of the FCA and should not therefore be distributed to such Retail Clients in the United Kingdom. Should you enter into investment business with Daiwa Capital Markets Europe's affiliates outside the United Kingdom, we are obliged to advise that the protection afforded by the United Kingdom regulatory system may not apply; in particular, the benefits of the Financial Services Compensation Scheme may not be available.

Daiwa Capital Markets Europe Limited has in place organisational arrangements for the prevention and avoidance of conflicts of interest. Our conflict management policy is available at <http://www.uk.daiwacm.com/about-us/corporate-governance-regulatory>. Regulatory disclosures of investment banking relationships are available at <https://daiwa3.bluematrix.com/sellside/Dislosures.action>.