

Euro wrap-up

Overview

- Bunds made significant losses as the ZEW survey emphasised the significant level of investor optimism about the German economic outlook.
- Gilts also made losses as the BRC survey reported a surge in UK retail sales in April.
- Wednesday will bring data for UK GDP in Q1, euro area IP in March, and German and French inflation in April.

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Daily bond market movements

Bond	Yield	Change
BKO 0 03/23	-0.678	+0.026
OBL 0 04/26	-0.552	+0.043
DBR 0 02/31	-0.163	+0.051
UKT 0 ¹ / ₈ 01/23	0.052	+0.023
UKT 0 ¹ / ₈ 01/26	0.348	+0.031
UKT 4 ³ / ₄ 12/30	0.830	+0.044

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

Source: Bloomberg

Euro area

German ZEW survey points to greater optimism as Covid-19 subsides

Like in most other euro area member states, the number of new cases of Covid-19 in Germany is falling steadily. Indeed, the country's disease control center, the Robert Koch Institute, yesterday reported just 6,125 newly confirmed cases yesterday, down more than 11k from a month earlier. Additionally, Germany's vaccine rollout continues to accelerate, with almost one third of the population now having received a first shot and roughly 9% fully vaccinated. With that progress opening the door to a gradual reopening of the economy over coming weeks, today's ZEW investor survey unsurprisingly revealed notably greater optimism about Germany's near-term economic outlook. Indeed, the respective economic expectations index exceeded forecasts in May, rising 13.7pts to 84.4, the highest in more than 21 years.

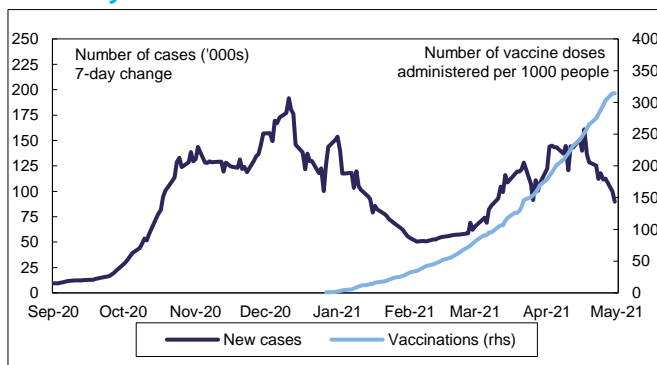
Broad-based improvement in outlook for growth and profits

Among the sectoral detail, the expected improvement over the coming six months was broad based, with investors reporting the greatest optimism with respect to auto firm profits since 2015. And strikingly, the equivalent services balance rose to its highest for a decade, the retail balance reached its highest since re-unification and the banking sector registered its first positive balance since 2010. Tallying with other subdued survey indices for the sector, however, investors were somewhat less upbeat about the construction sector over the coming six months. Meanwhile, there was also a further marked improvement in investors assessment of the current situation, with the headline index rising 8.7pts to -40.1, the strongest reading since the pandemic-induced plunge in sentiment in early 2020. However, having eased somewhat in April, the survey measure of inflation perceptions ticked up again to a level beaten only four times previously on the series, while the index of long-term interest rate expectations rose to the highest since 2018.

ZEW survey echoed findings of the Sentix survey

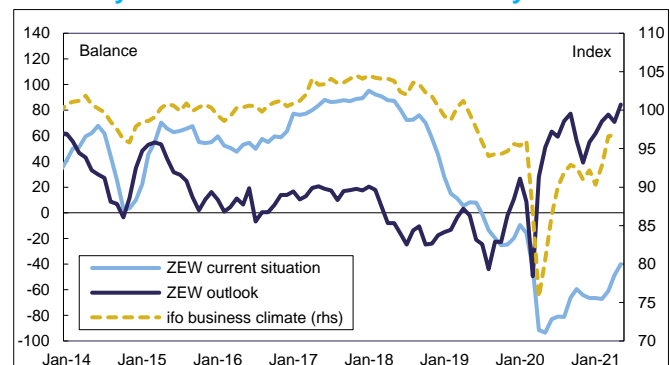
Yesterday's Sentix investor sentiment survey results for the euro area provided a similar upbeat message to that provided by the ZEW survey. Indeed, the headline index beat expectations with a rise of 7.9pts in May to 21.0, the highest in more than three years. The detail revealed a significant improvement in assessments of current conditions, for which the respective index rose more than 12pts to 6.25, the first positive reading since February 2020 and the best since May 2019. While the improvement in expectations was smaller, the 2pt rise took the respective index to a series high of 36.8.

Germany: Covid-19 cases and vaccines



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Germany: ZEW and ifo sentiment surveys



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Italian industrial production ends Q1 on a soft note

As in [Germany and France](#), industrial production in Italy was relatively subdued at the end of Q1. Overall IP dropped 0.1%M/M in March. That left it more than 37% above the level a year earlier and also up 0.9%Q/Q in Q1. But production was still 1.2% below the pre-pandemic level in February 2020, and more than 7% below the pre-pandemic peak registered at the end of 2017. Within the detail, output of intermediate goods rose 0.5%M/M in March to be 2.2% above the pre-pandemic level and up 1.1%Q/Q in Q1. And output of chemicals continued to lead the way, rising 2.4%M/M in March to be 6.0% above the pre-pandemic level and up 2.3%Q/Q. In contrast, production of capital goods was little changed in March, remaining almost 5% below the pre-pandemic level and down marginally over the first quarter as a whole. Production of machinery dropped for a second month and by 1.0%M/M to be down 6.1% from the pre-pandemic level. And while output of motor vehicles rebounded 2.2%M/M at the end of Q1 it was still 2.5% below the pre-pandemic level and down in Q1 as supply-chain problems weighed. Meanwhile, output of consumer goods also dropped in March but rose 1.0%Q/Q in Q1. As in Germany, despite continued supply bottlenecks, survey indicators point to vigorous Italian manufacturing growth in Q2 – for example, Italy's manufacturing output PMI rose in April to 62.4, a level previously beaten only twice on the series, with the new orders PMI (61.8) similarly very close to the record high.

The day ahead in the euro area

Tomorrow brings the release of euro area industrial production figures for March. Following today's Italian figures, euro area IP is likely to rise about ½%M/M to be up more than 11%Y/Y but about 0.8% below February 2020's pre-Covid level. In addition, final German and French inflation data for April are expected to confirm the flash figures. These revealed that German inflation on the EU harmonised measure (HICP) rose 0.1ppt to 2.1%Y/Y, the highest since November 2018, while in France, the HICP rate rose 0.3ppt to 1.7%Y/Y, the highest since December 2018.

UK

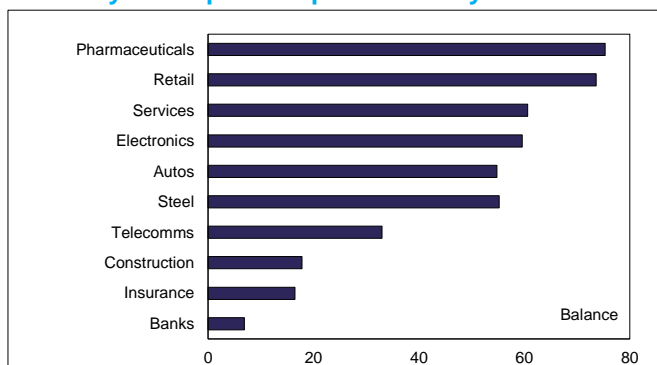
BRC survey predictably points to surge in retail sales in April

There were no surprises from the BRC retail sales monitor for April, which reported a surge in activity on the UK high street after non-essential stores in England and Wales reopened from the 12th of the month. Indeed, given the weakness a year earlier during the first wave, growth in total sales leapt to 51.1%Y/Y in April, from 13.9%Y/Y in March. And while the growth rate in sales compared to the same month in 2019 slowed to 7.3% in April, from 8.3% in March, that moderation reflected the timing of Easter. Sales growth was reportedly particularly strong in non-food items, predominantly clothing, footwear and jewellery, as consumers prepared for the reopening of the hospitality and leisure sector. Despite the strong headline numbers, the BRC cautioned that conditions on the UK high street were still far from favourable, with some 530k workers in the sector still reportedly on furlough. And as the hospitality and leisure sector in England continues to reopen from 17 May – with indoor dining and drinking to be allowed in restaurants and bars, and hotels and most indoor entertainments also to reopen – retailers might well find that consumers divert an increased share of their spending from goods back to services.

Scottish independence risk won't go away

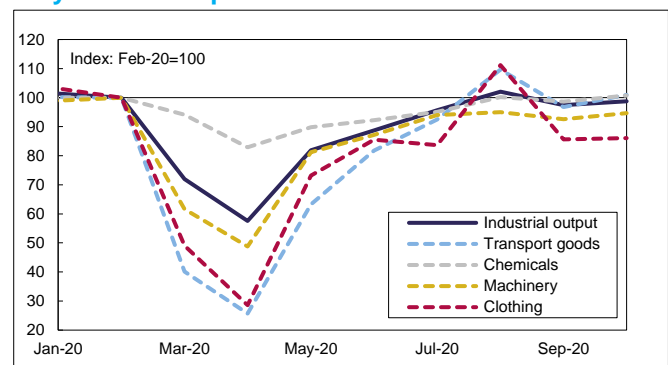
Following the weekend announcement of the results of Thursday's elections to the Scottish Parliament, sterling yesterday rallied in relief to above \$1.41, its highest since February, and today remained above that threshold. News that the Scottish National Party (SNP) had fallen short of winning an outright majority in the Scottish Parliament seemed to allay concerns that a second independence referendum would be imminent. Nevertheless, with the Scottish Greens gaining 8 seats, pro-independence parties now control 72 of the parliament's 129 seats. And that will be more than enough to pass a law to provide for some form of independence referendum, which the SNP manifesto promised to deliver before the end of 2023. So, while the SNP has signalled that it will wait for the Covid crisis to end before setting out its plans for a new plebiscite, and the party might also want to consult EU governments before pressing ahead, the issue is not going to go away anytime soon.

Germany: ZEW profit expectations by sector



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Italy: Industrial production



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Vaccine boosted support for the Union but referendum pressure will ultimately be hard to resist

Recent opinion polls have been inconclusive as to whether a majority of Scots would support independence in principle. While the independence cause received a massive boost from Brexit, support for continued UK membership has risen once again following the rapid Covid vaccination roll-out. Moreover, under current law, it is the UK parliament that has the final say on whether a referendum can have legitimacy. And UK PM Johnson is in no mood to agree to one just yet. With the UK government retaining the option of a Supreme Court challenge to any referendum conducted by the Scottish Parliament, there could well be a constitutional crisis if the SNP presses ahead with a new plebiscite. But Johnson will know that, if the UK government actively seeks to thwart the intentions of the Scottish Parliament via the courts, growing resentment north of the border might simply fuel support for independence. So, at some point, the UK government might find pressure for a new referendum impossible to resist.

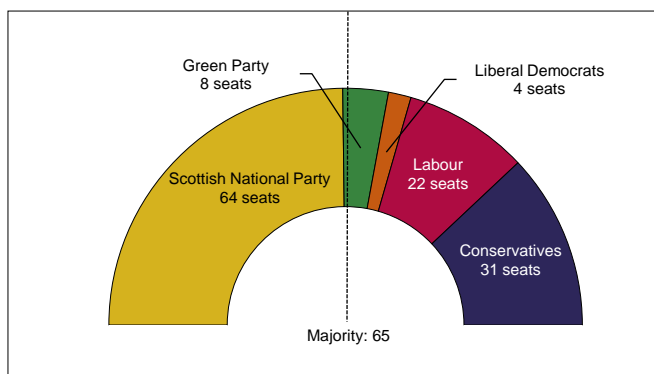
Second Scots referendum likely to come a decade after the first one?

In today's Queen's speech in Westminster, the UK government confirmed its intention to repeal the Fixed Term Parliaments Act, which had set the next UK general election for May 2024. By repealing it, the most likely time for the next UK election now might be spring 2023, just before fiscal policy has shifted decisively from stimulus to a tightening stance (see chart) and some political unpalatable choices on public expenditure will be due. A second referendum sometime between a UK general election in 2023 but before the end of the new Scottish parliament in 2026 – and roughly a decade after the first referendum in 2014 – might now seem a decent bet.

The day ahead in the UK

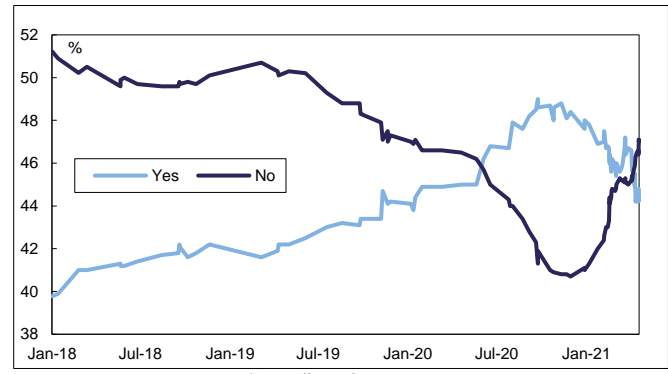
The week's UK economic data highlight comes tomorrow with the first estimates of Q1 GDP due to be published. While we expect March to post growth of 1.3%M/M, the strongest since August last year, weakness at the beginning of the quarter will see GDP contract for the quarter as a whole. We forecast a drop of 1.5%Q/Q (-6.1%Y/Y), following growth of 1.3%Q/Q (-7.3%Y/Y) in Q420 to leave GDP down 8.7% from the pre-pandemic level. Among the components, private consumption and investment are both likely to have fallen last quarter, while declining exports and imports will probably result in a negative contribution from net trade. The contribution from inventories, which had been substantive in the two quarters ahead of the Brexit transition at the start of year, is expected to fall back in Q1.

UK: Scottish election results



Source: Financial Times and Daiwa Capital Markets Europe Ltd.

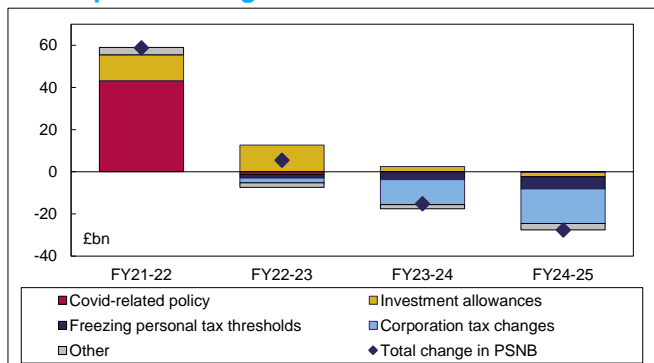
UK: Support for Scottish independence*



*10-poll moving average.

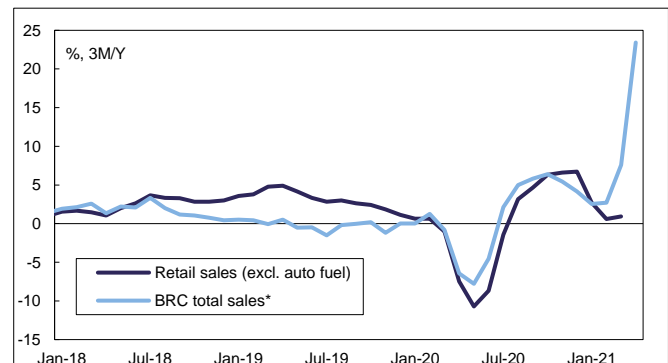
Source: Various opinion polls and Daiwa Capital Markets Europe Ltd.

UK: Impact of Budget 2021 measures on PSNB*



*Change in Public Sector Net Borrowing due to Budget measures.
 Source: BoE, OBR and Daiwa Capital Markets Europe Ltd.




UK: Retail sales indicators





*Adjusted using BRC shop price index. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

European calendar



Today's results

Economic data						
Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Germany	 ZEW current assessment balance (expectations)	May	-40.1 (84.4)	-42.2 (71.5)	-48.8 (70.7)	-
Italy	 Industrial production M/M% (Y/Y%)	Mar	-0.1 (37.7)	0.4 (37.1)	0.2 (-0.6)	0.1 (-0.8)
UK	 BRC retail sales monitor, like-for-like sales Y/Y%	Apr	39.6	-	20.3	-

Auctions	
Country	Auction
UK sold	 £3bn of 0.35% 2026 bonds at an average yield of 0.457%
	 £1.5bn of 0.5% 2061 bonds at an average yield of 1.264%

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
EMU	 Sentix investor confidence indicator	May	21.0	15.3	13.1	-
France	 Bank of France industrial sentiment	Apr	107	106	105	-

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	
EMU	 10.00	Industrial production M/M% (Y/Y%)	Mar	<u>0.5 (11.5)</u>	-1.0 (-1.6)	
Germany	 07.00	Final CPI (EU-harmonised CPI) Y/Y%	Apr	2.0 (2.1)	1.7 (2.0)	
France	 07.45	Final CPI (EU-harmonised CPI) Y/Y%	Apr	1.3 (1.7)	1.1 (1.4)	
UK	 07.00	Preliminary GDP Q/Q% (Y/Y%)	Q1	<u>-1.5 (-6.1)</u>	1.3 (-7.3)	
	 07.00	Monthly GDP M/M%	Mar	1.3	0.4	
	 07.00	Industrial production M/M% (Y/Y%)	Mar	1.0 (2.9)	1.0 (-3.5)	
	 07.00	Manufacturing production M/M% (Y/Y%)	Mar	1.0 (3.7)	1.3 (-4.2)	
	 07.00	Construction output M/M% (Y/Y%)	Mar	1.3 (0.2)	1.6 (-4.3)	
	 07.00	Index of services M/M% (3M/3M)	Mar	1.8 (-1.7)	0.2 (-1.9)	
	 07.00	Goods trade balance £bn	Mar	-14.3	-16.4	

Auctions and events						
Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous	
EMU	 10.05	ECB's Centeno delivers speech on 'How to guarantee economic recovery in a post-pandemic Europe'				
UK	 10.00	BoE Governor Bailey speaks at International Swaps and Derivatives Association event				

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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