

Euro wrap-up

Overview

- While euro area IP data were subdued, and French inflation was revised down, Bunds made losses in the wake of the higher-than-expected US inflation report.
- Gilts also followed USTs lower as UK GDP data for Q1 suggested resilience to lockdown and a firm pickup in activity in March.
- A quiet end to the week for economic data from Europe will bring a UK housing market survey tomorrow and final Spanish inflation data on Friday.

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Daily bond market movements

| Bond | Yield | Change |
|---|--------|--------|
| BKO 0 03/23 | -0.666 | +0.011 |
| OBL 0 04/26 | -0.523 | +0.030 |
| DBR 0 02/31 | -0.128 | +0.035 |
| UKT 0 ¹ / ₈ 01/23 | 0.095 | +0.041 |
| UKT 0 ¹ / ₈ 01/26 | 0.396 | +0.045 |
| UKT 4 ³ / ₄ 12/30 | 0.883 | +0.052 |

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

Source: Bloomberg

Euro area

Manufacturing output flat in March, but Q2 promises an acceleration

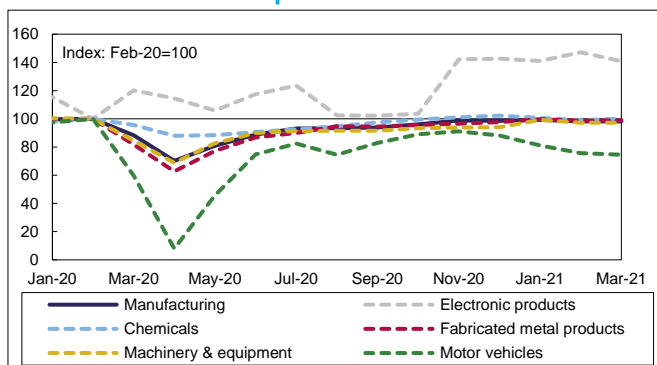
Despite extremely upbeat survey indicators, euro area industrial production (excluding construction) was a damp squib at the end of Q1, rising just 0.1%M/M in March with manufacturing output unchanged. As a result, industrial and manufacturing production both rose just 0.8%Q/Q in Q1, a notable slowdown from growth above 4%Q/Q in Q4 and in excess of 16%Q/Q in Q3. Within the detail, production of capital goods declined for the second successive month in March, dropping 1.0%M/M, albeit rising 0.6%Q/Q in Q1. There was significant variation within the category, however, with machinery output unchanged in March but up a firm 4.3%Q/Q in Q1 to augur well for the near-term outlook for business investment. In contrast, supply-chain impediments saw output of motor vehicles drop for a second successive month in March to be down a hefty 13.7%Q/Q in Q1. Among other items, output of chemicals ended the quarter down 0.9%Q/Q. But, overall, production of intermediate goods grew 1.3%Q/Q. In addition, despite growth in March of 1.6%M/M, the strongest since September, output of consumer goods was unchanged in Q1 as a whole.

After production failed to match expectations in Q1, there will obviously be concerns that supply bottlenecks will continue to weigh heavily in the current quarter too. And certainly, supply-chain issues related to semiconductors, among other items, will act as a brake on production for a while yet. However, survey evidence – such as the rise in the euro area manufacturing output PMI to a series high of 63.4 last month – suggests strongly that production has been accelerating firmly in the current quarter. And with production backlogs building and orders replenished, output is likely to continue to grow for several quarters to come.

French inflation revised down, as data highlight subdued nature of core consumer prices

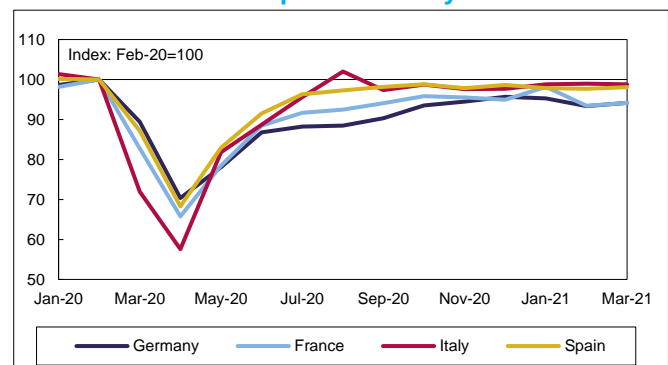
Despite plenty of concern that underlying inflation might be stirring, and undeniable pressures at the producer level and in commodity markets, the final April CPI data from the two largest member states illustrated the continued lack of significant pressure in core consumer prices. The German numbers aligned with their flash estimates. So, for example, Germany's EU-harmonised measure (HICP) rose 0.1ppt to a two-year high of 2.1%Y/Y, with the national measure up 0.3ppt to 2.0%Y/Y. As suggested by the limited information provided with the flash estimates, the pressure came principally from energy, inflation of which accelerated more than 3ppts to 7.9%Y/Y with prices of motor fuels up 23.3%Y/Y. Indeed, excluding energy, German inflation was unchanged at 1.4%Y/Y for a fourth month. And also excluding prices of food, core inflation fell 0.1ppt to 1.3%Y/Y, the lowest since December. Moreover, in contrast to the German figures, French inflation was revised down slightly from the flash estimates, e.g. the HICP measure is now estimated at 1.6%Y/Y in April, up 0.2ppt from March but 0.1ppt lower than previously thought. And the French national measure was revised down 0.1ppt to 1.2%Y/Y, up just 0.1ppt from March,

Euro area: Industrial production



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Industrial production by member state



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

albeit the highest since February 2020. Energy inflation was similarly the main source of upwards pressure in France, rising more than 4ppts to 8.8%Y/Y. Food inflation fell sharply into negative territory due to base effects from last year's pandemic-related surge in prices. And while French core inflation on the national measure rose 0.2ppt, it remained subdued at just 1.0%Y/Y.

The coming two days in the euro area

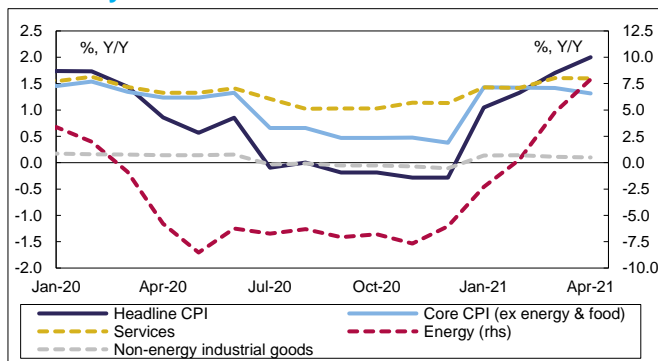
The euro area economic data calendar for the remainder of the week will be quiet, with no new top-tier releases scheduled in the coming two days. The one release of some interest comes on Friday, with final Spanish inflation data for April to be published. The preliminary release suggested that Spanish HICP inflation leapt a marked 0.7ppt to 1.9%Y/Y, the highest since October 2018, with the national CPI rate up 0.9ppt to 2.2%Y/Y. According to the Spanish statistical agency, however, inflation was driven higher by prices of electricity and fuel, accentuated by base effects. And core inflation on the national measure fell back 0.3ppt to zero percent.

UK

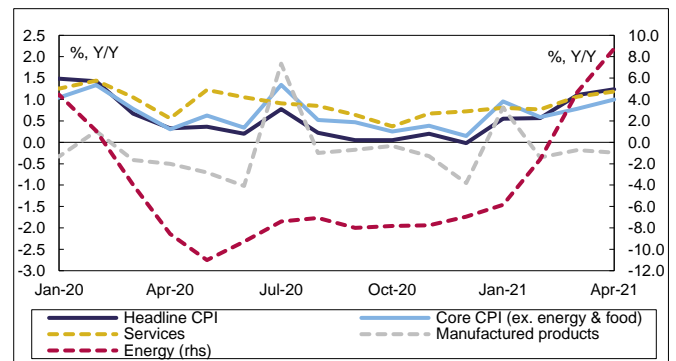
Drop in Q1 GDP meets expectations but firmer March points to Q2 rebound

In line with expectations, according to the preliminary estimate, UK GDP contracted in Q1 by 1.5%Q/Q. That more than reversed the growth of 1.3%Q/Q in Q4 to leave the level of output down 6.1%Y/Y and 8.7% below the pre-pandemic level in Q419. However, the trough came in January when GDP dropped 2.5%M/M in response to new lockdown measures. Monthly growth in February (revised up 0.3ppt to 0.7%M/M) and March (an above-consensus 2.1%M/M, as households and firms adjusted to the restrictions) left economic output at the end of Q1 down a more moderate 5.9% from the pre-pandemic level. And with all indicators pointing to solid growth from April on as the economy reopens, growth in the current quarter should comfortably surpass 3%Q/Q to leave the level of GDP in the current quarter at the highest in five quarters. Indeed, the drop in GDP in Q1 was due principally to the closure of schools and non-essential stores, which have now reopened, as well as hospitality, which is set to reopen fully from next week. In particular, education output dropped a steep 11.8%Q/Q, with accommodation and food services down 18.2%Q/Q and wholesale and retail activity down 5.9%Q/Q. While healthcare provided support (up 1.8%Q/Q), the pandemic restrictions meant that services output fell 2.0%Q/Q to be 8.7% below the pre-Covid peak. In contrast, the drop in manufacturing output was relatively modest (0.7%Q/Q to be 3.4% below the pre-pandemic level), with the decline caused largely by the transport equipment sector (down 1.1%Q/Q). And construction output rose 2.6%Q/Q, albeit remaining 3.4% below the pre-pandemic level.

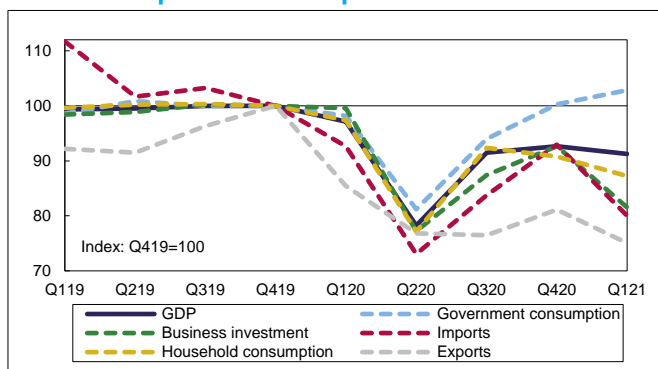
Germany: Inflation*



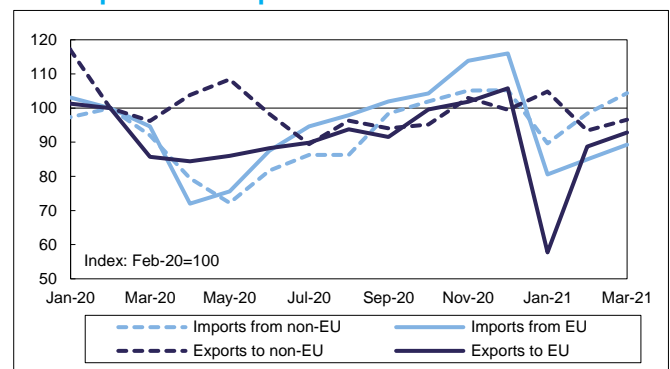
France: Inflation*



UK: GDP expenditure components



UK: Imports and exports



Households and businesses subtracted from growth, public spending and net trade gave support

On the expenditure side, with diminished opportunities to spend, household consumption fell for the second successive quarter in Q1, down 3.9%Q/Q to be a steep 12.8% below the pre-pandemic level. And business investment fell even more abruptly, plunging 11.9%Q/Q to be down 18.4% from Q419. But increased public sector activity meant that total fixed investment fell a smaller 2.3%Q/Q. And extra spending on test-and-trace and vaccinations meant that government consumption rose 2.6%Q/Q. Following the precautionary stock accumulation ahead of the end of the Brexit transition, inventories subtracted 1.4ppts from growth last quarter. But while trade volumes were hit on both sides of the ledger at the start of the year, imports (down 13.9%Q/Q) fell faster than exports (down 7.5%Q/Q), and so net trade made a positive contribution for the first time in three quarters, adding 2.2ppts to GDP growth in Q1.

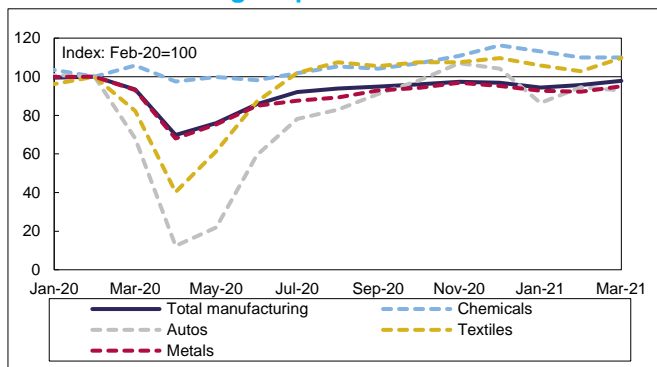
Trade with EU continues to recover, but still down on Q420 levels with imports notably lagging

Due to the new barriers to trade from Brexit, as well as payback for stockpiling at end-2020, the value of goods imports from the EU fell a particularly steep 21.7%Q/Q in Q1. In marked contrast, merchandise imports from outside the EU dropped only 0.9%Q/Q, to exceed those from the EU for the first time on the series dating back to 1997. Similarly, goods exports to the EU plunged 18.1%Q/Q, a marked contrast to the increase of 0.4%Q/Q in exports to other countries. Of course, most of the hit to goods trade with the EU came at the start of the quarter, with positive growth in exports and imports of goods in both February and March, not least with respect to machinery and transport equipment and chemicals. However, the level of goods exports to the EU in March was still down 3.3% from the Q4 average, with imports from the EU still down a whopping 17.5% on the same basis. In contrast, imports from beyond the EU were up 7.5% in March from the Q4 average suggestive of supply-chain adjustments to the new trade barriers, while exports to countries outside of the EU were up 3.0% on that basis.

The coming two days in the UK

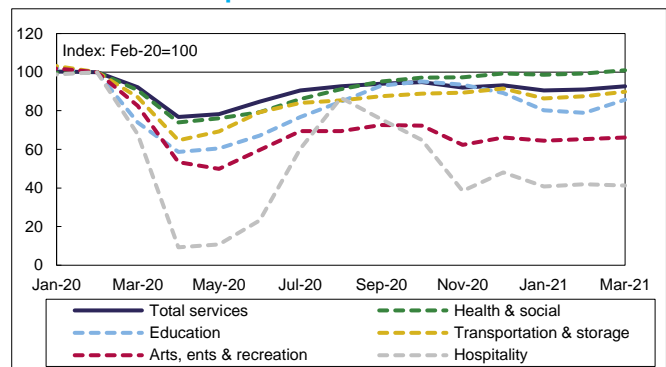
Like in the euro area, the week will end quietly on the UK economic data front with just the RICS house price survey for April due tomorrow. This is expected to reveal an increase in the number of surveyors reporting increases in house prices, with the net balance forecast to rise to 62% in April, from 59% in March. In other news, BoE Governor Bailey and Deputy Governor Cunliffe are due to speak at separate events on Friday.

UK: Manufacturing output



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Services output













Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

The next edition of the Euro wrap-up will be published on 14 May 2021

European calendar

Today's results

Economic data

| Country | Release | Period | Actual | Market consensus/ <i>Daiwa forecast</i> | Previous | Revised |
|---------|--|--------|--------------------|--|-------------|-------------------|
| EMU |  Industrial production M/M% (Y/Y%) | Mar | 0.1 (10.9) | 0.8 (11.8) | -1.0 (-1.6) | -1.2 (-1.8) |
| Germany |  Final CPI (EU-harmonised CPI) Y/Y% | Apr | 2.0 (2.1) | 2.0 (2.1) | 1.7 (2.0) | - |
| France |  Final CPI (EU-harmonised CPI) Y/Y% | Apr | 1.2 (1.6) | 1.3 (1.7) | 1.1 (1.4) | - |
| UK |  Preliminary GDP Q/Q% (Y/Y%) | Q1 | -1.5 (-6.1) | -1.5 (-6.1) | 1.3 (-7.3) | - |
| |  Monthly GDP M/M% | Mar | 2.1 | 1.5 | 0.4 | 0.7 |
| |  Industrial production M/M% (Y/Y%) | Mar | 1.8 (3.6) | 1.0 (2.9) | 1.0 (-3.5) | - |
| |  Manufacturing production M/M% (Y/Y%) | Mar | 2.1 (4.8) | 1.0 (3.7) | 1.3 (-4.2) | 1.5 (-4.2) |
| |  Construction output M/M% (Y/Y%) | Mar | 5.8 (6.0) | 1.3 (0.2) | 1.6 (-4.3) | 2.3 (-3.3) |
| |  Index of services M/M% (3M/3M) | Mar | 1.9 (-2.0) | 1.8 (-1.7) | 0.2 (-1.9) | 0.6 (-2.1) |
| |  Goods trade balance £bn | Mar | -11.7 | -14.3 | -16.4 | -10.5 |


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 |
|---------|---|----------------------------------|--------|--|----------|
| UK |  | 00.01 RICS house price balance % | Apr | 62 | 59 |


Auctions and events

| | | |
|-------|---|---|
| Italy |  | 10.00 Auction: €3bn of 0% 2024 bonds |
| |  | 10.00 Auction: €1.75bn of 1.7% 2051 bonds |
| UK |  | 13.00 BoE Deputy Governor Cunliffe speaks on digital currencies |
| |  | 17.00 BoE Governor Bailey speaks on a citizens' panel |

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Friday's releases

Economic data

| Country | BST | Release | Period | Market consensus/ <i>Daiwa forecast</i> | Previous |
|---------|---|--|--------|--|-----------|
| Spain |  | 08.00 Final CPI (EU-harmonised CPI) Y/Y% | Apr | 2.2 (1.9) | 1.3 (1.2) |

Auctions and events

- Nothing scheduled -

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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