

# Euro wrap-up

## Overview

- Bunds were little changed and periphery bonds outperformed while German producer price inflation rose to a ten-year high and euro area construction output rebounded.
- Gilts made gains, particularly at the short end of the curve, despite an upbeat UK manufacturing survey.
- Friday will bring the flash May PMIs along with UK retail sales data for April.

**Chris Scicluna**  
 +44 20 7597 8326

| Daily bond market movements |        |        |
|-----------------------------|--------|--------|
| Bond                        | Yield  | Change |
| BKO 0 03/23                 | -0.663 | +0.001 |
| OBL 0 04/26                 | -0.502 | +0.008 |
| DBR 0 02/31                 | -0.110 | +0.002 |
| UKT 0 1/8 01/23             | 0.043  | -0.024 |
| UKT 0 1/8 01/26             | 0.359  | -0.012 |
| UKT 4 4% 12/30              | 0.839  | -0.007 |

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

## Euro area

### Construction output rebounded in March to deliver modest growth in Q1

After a weak start to the first quarter, euro area construction output rebounded in March, rising 2.7%M/M to the highest level since August. But it was still 1.7% below the pre-pandemic level in February 2020. And having grown 0.8%Q/Q in Q4, it rose just 0.3%Q/Q in Q1, with building work up 0.4%Q/Q and civil engineering activity down 0.3%Q/Q. Among the member states, the rise in construction output in March was led by Germany, although the leap of 10.8%M/M was insufficient to prevent a decline of 4.0%Q/Q in Q1 as a whole. In contrast, French construction output dropped 7.3%M/M in March but rose 2.5%Q/Q in Q1. And Italian production in the sector rose for a third successive month to end Q1 up a firm 5.4%Q/Q and more than 7% above the pre-pandemic level. According to surveys, supply-side factors, such as inclement weather and the availability of materials and labour, acted as an important restraint on activity at the start of the year. Demand-side constraints, however, were less binding, although the rise in VAT in Germany led to the pullback in that country in January and February.

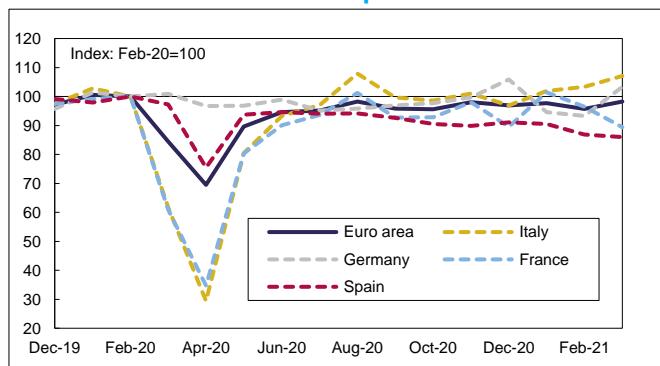
### Orders and surveys point to further growth in Q2

While lingering pandemic restrictions will likely have weighed on activity in April, broader sentiment in the sector as well as firms' assessments of order book levels point to a marked acceleration of activity in Q2. And surveys suggest that Italy should continue to lead the way. With euro area growth in lending for house purchase solid at a thirteen-year high of 5.0%Q/Q in March, interest rates still close to record lows, and consumer confidence – including in employment – improved, residential building work should pick up further, as should commercial activity associated with expansion of production facilities. But retail and office development will remain impacted by shifts in ways of working and the continued rise of internet shopping throughout the pandemic.

### German producer price inflation up to decade high

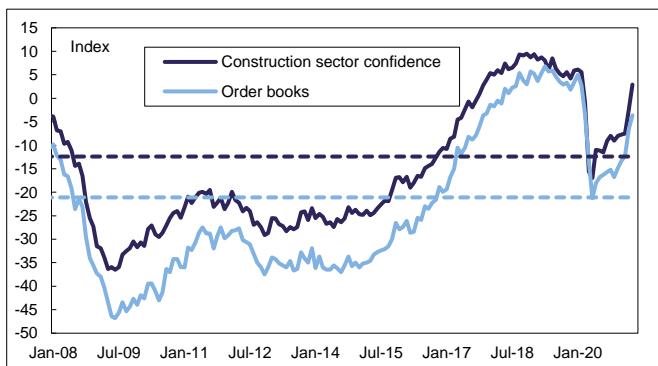
German industrial producer price inflation continued to rise in April. With prices up 0.8%M/M, the annual rate of PPI inflation rose a steep 1.5pp to a near-ten-year high of 5.2%Y/Y. Given the sharp drop in oil prices a year earlier, and the additional pressure from Germany's carbon pricing scheme, unsurprisingly energy inflation rose further, up 2.6pp to 10.6%Y/Y. However, excluding energy, core producer price inflation still rose 1.2pp to 3.6%Y/Y, similarly the highest since 2011, as intermediate goods inflation leapt 2.5pp to 8.2%Y/Y. That principally reflected higher prices of metals due to firmer demand, increased global prices of iron ore, and supply bottlenecks. Among other intermediate items, however, inflation of electronic components weighed (prices of integrated circuits were down 13.9%Y/Y). And of the other major categories, inflation of durable consumer goods rose just 0.2pp (1.6%Y/Y), with inflation of capital goods (1.0%Y/Y) and non-durable consumer

#### Euro area: Construction output



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

#### Euro area: Construction confidence & orders\*



\*Dashed lines represent euro era averages.

Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

goods (-0.6%Y/Y) including food (-1.3%Y/Y) also still subdued. With last year's trough in energy prices reached last May, energy price base effects will push producer price inflation higher still over the near term. Indeed, tomorrow's flash PMIs will likely suggest a record pace of input price pressure in Germany's (and the euro area's) manufacturing sector. But the pressures continue largely to be absorbed by firms' margins, e.g. German consumer price inflation of durable goods fell 0.2ppt in April to a modest 1.1%Y/Y. And as base effects fade and supply bottlenecks ease, producer and consumer price inflation will ease back, particularly in 2022.

## The day ahead in the euro area

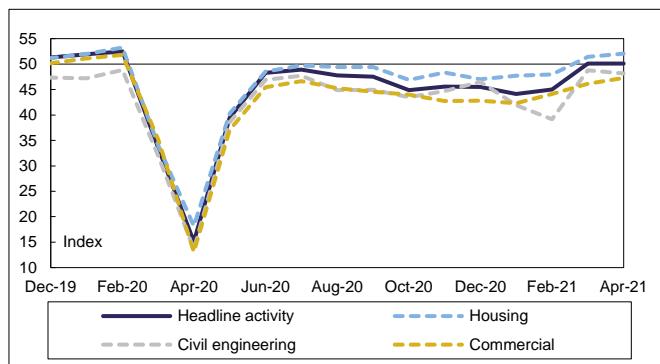
The focus tomorrow will be on May's flash PMIs. These are expected to point to an acceleration in the pace of expansion in services with the euro area activity PMI for the sector forecast to rise about 2pts to 52.5, the highest since July 2020. That would illustrate the impact of an easing in lockdown measures across certain member states, the moderation in the number of new coronavirus cases, and the accelerated vaccination programme now firmly underway. Meanwhile, the euro area manufacturing output PMI is expected to remain close to the record highs above 63 recorded in March and April. But the survey will also likely report backlogs close to record highs and continued very strong price pressures in the sector too. The euro area composite PMI is expected to rise from 53.8 in April to around 55, which would be the highest since the first half of 2018, underscoring the likelihood of a firm return to positive GDP growth in Q2. Also scheduled for release tomorrow is the European Commission's preliminary euro area consumer confidence index, which seems likely to report an improvement in optimism this month reflecting the drop in new Covid-19 cases and accelerated progress with vaccination programmes.

## UK

### CBI survey flags firm recovery despite lagging export orders and rising prices

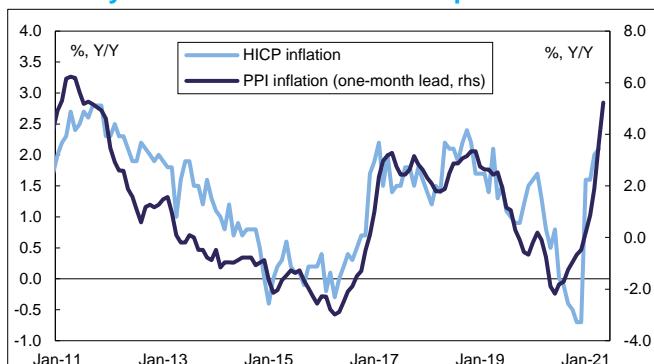
As a taster for what to expect from tomorrow's flash PMIs, today's CBI industrial trends survey for May indicated strong recovery momentum in the UK manufacturing sector, albeit with export orders still lagging and price pressures up again. In particular, the survey suggested that manufacturing output in the three months to May grew at the fastest rate since December 2018, with the respective net balance rising 15pppts to +18%. Production reportedly rose in 12 of the 17 sub-sectors, led by chemicals, electronic engineering, and metal products. Total order books were judged to be the best since December 2017, and "above normal" for the first time since February 2019, with the respective net balance up 25pppts to +17%. But despite the improved outlook for global demand, export orders continue to lag – perhaps due to the impact of Brexit-related trade barriers – with the net balance of -17% up just 1ppt from April albeit the best in fifteen months. Nevertheless, with firms suggesting that inventory levels were the least adequate since July 2017 (a net balance down 11pppts to -6%), manufacturers still expect production to accelerate further over the coming three months (the respective net balance dropped a modest 3pppts from the prior month's four-year high to +33%). Unsurprisingly, expected output prices are expected to pick up rapidly in the coming quarter by the most since January 2018 (up 11pppts to +38%).

#### Euro area: Construction PMIs



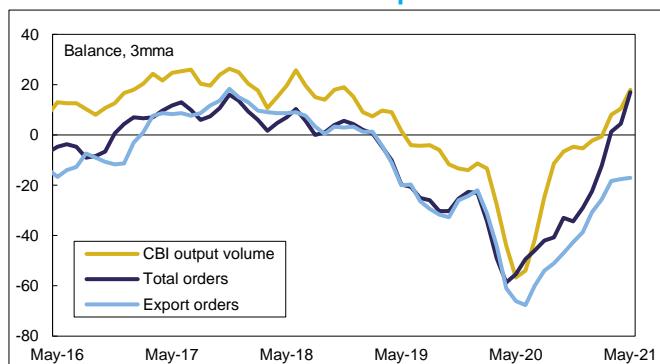
Source: Markit, Refinitiv and Daiwa Capital Markets Europe Ltd.

#### Germany: Producer and consumer price inflation



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

#### UK: CBI Industrial trends – output & orders



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

#### UK: CBI Industrial trends – price expectations



\*Expected price of domestic orders. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

## The day ahead in the UK

In terms of hard economic data, tomorrow sees the release of retail sales figures for April. With surveys such as that of the [BBC](#) having been upbeat, consumer confidence improving and non-essential stores having reopened in England from the 12<sup>th</sup> of the month, we expect to see growth of about 5%M/M in retail sales (both including and excluding auto fuel) in April. This would push the level of sales close to October's pandemic-era high, up about 6½% from the pre-pandemic level in February 2020 and some 38% above the level a year earlier. And with the economy continuing steadily to reopen – pubs, restaurants and cafes are now open indoors as well as many entertainment and leisure facilities – the flash UK May PMIs (also due tomorrow) should suggest a pickup in growth this month. Indeed, the composite PMI is likely to rise further above April's 6½-year high of 60.7, thanks not least to ongoing improvement in the services sector. Today's CBI survey also points to the possibility of a series high on the manufacturing PMI too.

## European calendar

| Today's results |   |        |            |  |             |             |
|-----------------|---|--------|------------|--|-------------|-------------|
| Economic data   |   |        |            |  |             |             |
| Country         | Release   | Period | Actual     | Market consensus/<br><i>Daiwa forecast</i> | Previous    | Revised     |
| EMU             | EU ECB current account balance €bn  | Mar    | 17.8       | -  | 25.9        | -           |
|                 | EU Construction output M/M% (Y/Y%)  | Mar    | 2.7 (18.3) | -  | -2.1 (-5.8) | -2.0 (-5.4) |
| Germany         | DE PPI Y/Y%   | Apr    | 5.1        | 5.2  | 3.7         | -           |
| UK              | GB CBI industrial trends survey, total orders                                 | May    | 17         | 0  | -8          | -           |
| Auctions        |   |        |            |  |             |             |
| Country         | Auction   |        |            |  |             |             |
| France          | FR sold €3.29bn of 0% 2027 bonds at an average yield of -0.19%                |        |            |  |             |             |
|                 | FR sold €4.79bn of 0% 2024 bonds -0.53%                                       |        |            |  |             |             |
|                 | FR sold €2.40bn of 0.75% 2028 bonds at an average yield of -0.03%             |        |            |  |             |             |
|                 | FR sold €2.03bn of 0.1% 2032 index-linked bonds at an average yield of -1.01% |        |            |  |             |             |
|                 | FR sold €950mn of 0.1% 2036 index-linked bonds at an average yield of -0.96%  |        |            |  |             |             |
| Spain           | ES sold €1.72bn of 0% 2024 bonds at an average yield of -0.356%               |        |            |  |             |             |
|                 | ES sold €1.67bn of 0% 2028 bonds at an average yield of 0.171%                |        |            |  |             |             |
|                 | ES sold €1.98bn of 0.1% 2031 bonds at an average yield of 0.598%              |        |            |  |             |             |

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

| Tomorrow's releases |       |   |   |  |             |  |
|---------------------|-------|---|---|--|-------------|--|
| Economic data       |       |   |   |  |             |  |
| Country             | BST   | Release   | Period  | Market consensus/<br><i>Daiwa forecast</i> | Previous    |  |
| EMU                 | 09.00 | Preliminary manufacturing (services) PMI              | May   | 62.5 (52.5)                                | 62.9 (50.5) |  |
|                     | 09.00 | Preliminary composite PMI                             | May   | 55.1                                       | 53.8        |  |
|                     | 15.00 | European Commission's preliminary consumer confidence | May   | -6.5                                       | -8.1        |  |
| Germany             | 08.30 | Preliminary manufacturing (services) PMI              | May   | 65.9 (52.0)                                | 66.2 (49.9) |  |
|                     | 08.30 | Preliminary composite PMI                             | May   | 57.1                                       | 55.8        |  |
| France              | 08.15 | Preliminary manufacturing (services) PMI              | May   | 58.5 (53.0)                                | 58.9 (50.3) |  |
|                     | 08.15 | Preliminary composite PMI                             | May   | 53.7                                       | 51.6        |  |
| UK                  | 00.01 | GfK consumer confidence                               | May   | -12  | -15         |  |
|                     | 07.00 | Retail sales including fuel M/M% (Y/Y%)               | Apr   | 4.5 (36.8)                                 | 5.4 (7.2)   |  |
|                     | 07.00 | Retail sales excluding fuel M/M% (Y/Y%)               | Apr   | 4.4 (31.7)                                 | 4.9 (7.9)   |  |
|                     | 09.30 | Preliminary manufacturing (services) PMI              | May   | 60.8 (62.2)                                | 60.9 (61.0) |  |
|                     | 09.30 | Preliminary composite PMI                             | May   | 61.9                                       | 60.7        |  |
| Auctions and events |       |   |   |  |             |  |
| EMU                 | EU    | -   | Euro area finance ministers and central bank governors meet (two-day event) |  |             |  |

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. 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 MiFID 2 Professional (or equivalent) Clients and should not therefore be distributed to such Retail Clients. 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/Disclosures.action>.