Euro wrap-up

Overview

Chris Scicluna
+44 20 7597 8326

- Bunds followed USTs higher while euro area retail sales fell more than expected and German car production and registrations remained well below pre-pandemic levels.
- Gilts made significant gains despite strong surveys of the UK's labour market and construction sector.
- The coming week brings the latest ECB monetary policy meeting as well as new monthly data on UK GDP and German factory orders, production and trade.

Daily bond market movements

Bond	Yield	Change
BKO 0 06/23	-0.684	-0.003
OBL 0 04/26	-0.598	-0.016
DBR 0 02/31	-0.212	-0.026
UKT 0$^{1}/_{8}$ 01/23	0.060	-0.018
UKT 0$^{1}/_{8}$ 01/26	0.334	-0.032
UKT 4¾ 12/30	0.790	-0.049

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

Euro area

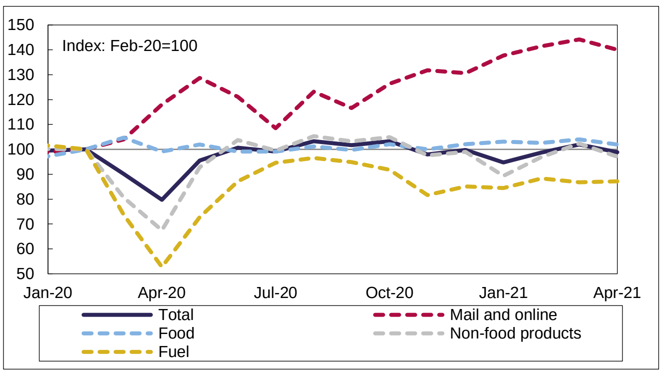
Retail sales drop in April on lockdowns back to middle of recent range

Having risen to a five-month high in March, euro area retail sales reversed almost all of that gain in April, falling a larger-than-expected 3.1%M/M. Given the steep drop a year earlier during the first lockdown, sales were still up 23.9%Y/Y. However, they were also close to the average of the past couple of quarters and 1.2% below the pre-pandemic level of February 2020. The principal cause of the drop in April was the tightening of lockdown restrictions in Germany and France, where sales fell 5.5%M/M and 6.0%M/M respectively. By type of good, sales of non-food items (excluding auto fuel) fell 5.1%M/M to be 2.9% below the pre-pandemic level. Sales of food items fell 2.0%M/M but were still 1.9% above the level in February 2020. And while auto fuel sales rose slightly, they were down 12.9% from the pre-pandemic level. Unusually given the tighter pandemic containment measures, sales by internet and mail order fell in April, but the drop of 2.9%M/M still left the respective level 40% above the level in February 2020. With non-essential stores having reopened in Germany and France earlier this month, May is bound to see a strong rebound in sales, tallying with high-frequency data for mobility and shopping-centre footfall. And, the pandemic permitting, we expect sales to remain elevated through the summer, even as and when consumers spend more on services, as the household savings rate declines to more normal levels.

Construction PMIs point to ongoing growth led by housing

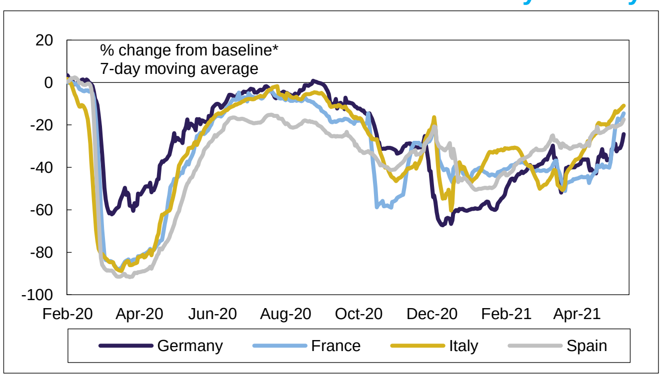
For the past couple of quarters, euro area construction output has seen moderate growth close to ½%Q/Q, nonetheless with activity remaining slightly below the pre-pandemic level. Today's construction PMIs suggested that activity has continued to increase in Q221, albeit with growth far from vigorous. Indeed, the euro area composite activity PMI edged up in May to 50.3, the highest since February 2020 but only just in expansion territory. Residential work remains the main source of growth, with the respective PMI up to 53.2, similarly a fifteen-month high. With the pandemic easing, the pace of decline in commercial work appears to have eased, with the respective index up more than 2pts in May to 49.6, likewise the best since February 2020. But, if this survey is to be believed, work on civil engineering projects remains subdued, with the respective PMI dropping more than 2pts to a three-month low of 45.9, suggesting an urgent need to get Recovery Fund-financed infrastructure projects underway. As suggested by other surveys, the PMIs underscore that Italy continues to lead the way in the construction recovery, with the country's headline activity PMI up again to 58.3, the highest in more than fourteen years. But while the equivalent French index rose more than 1pt to a 20-month high of 51.1, Germany's fell to a three-month low consistent with ongoing contraction (44.5). Among the other survey detail, new orders in the sector grew at the strongest rate since February 2019 to point to further growth in the second half of 2021. Indeed, Italian new orders rose at the sharpest rate in two decades, while those in France were up the most in three years. But German orders remain in decline. Finally, as in

Euro area: Retail sales



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Travel for retail & recreation by country*



** The baseline is the median value, for the corresponding day of the week, during the five-week period 3 Jan – 6 Feb 2020.*
Source: Google mobility indicators and Daiwa Capital Markets Europe Ltd.

manufacturing, supply-side challenges appear to be acting as a restraint on construction output, with supplier delivery times the longest on the series, and input prices rising at the fastest rate on the series.

German car sales and production trending well below pre-pandemic norms

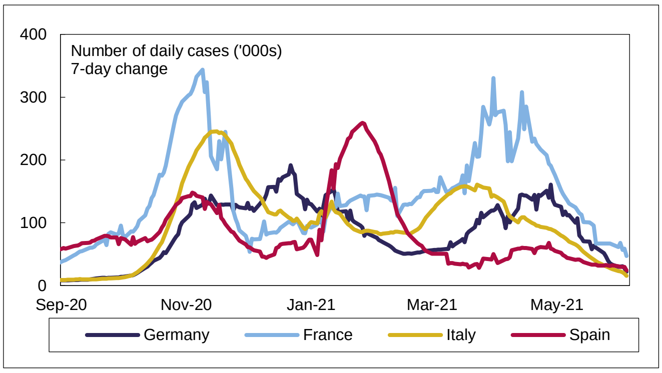
German car sales and production in May were unsurprisingly well above their levels a year ago but still significantly below their norms for the month. In particular, according to the VDA, car production was up 58%Y/Y in May to be up 25%YTD/Y while new car registrations rose 37%Y/Y to be up 13%YTD/Y. However, with supply-chain disruption weighing as much as demand, production was still some 22% below the level two years earlier and about one third below the average level for May over the decade ahead of the pandemic. Likewise, new car registrations were 26% below their level two years earlier and about one fifth below their average May level in the decade ahead of the pandemic. The latest ifo survey suggested that firms in the auto sector expect to slow production ahead, with somewhat softer growth in order books and weaker export expectations playing a role while concerns about the shortage of semi-conductors persist.

The week ahead in the euro area: ECB to maintain asset purchases at recent pace?

The coming week's main event will be the conclusion of the ECB's latest monetary policy meeting on Thursday. At this meeting, the Governing Council will review the pace of its asset purchases on the basis of a fresh assessment of financial conditions and updated economic projections. With the contraction in Q1 only slightly deeper than the ECB previously forecast, ongoing easing of restrictions anticipated, implementation of vaccination programmes accelerated, external demand stronger, and economic survey indicators – such as the May PMIs – pointing to a firm pickup in activity this quarter and acceleration into Q3, the ECB might be tempted to make little change to its GDP forecast for this year (4.0%Y/Y) and revise up slightly its projection for next year (4.1%Y/Y). On the inflation side, however, the headline rate – which rose to 2.0%Y/Y in May according to the flash estimate – has recently overshot the ECB's expectation, meriting an upwards revision to the projection for this year (currently 1.5%Y/Y). However, despite the upside surprise in the flash May figure – up 0.2ppt to 0.9%Y/Y – core inflation has weakened since the start of the year. Indeed, while manufacturing supply bottlenecks persist amid survey evidence of rising input prices, there have been few signs of firms passing increasing cost pressures onto consumers. And pandemic restrictions continue to weigh on prices of many consumer-facing services.

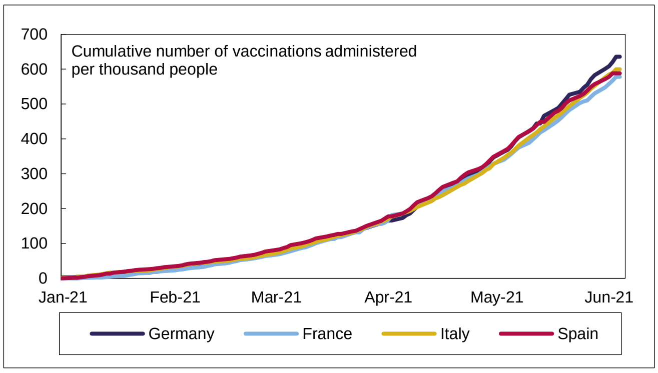
As such, while we expect President Lagarde to be cautiously optimistic about the outlook for economic growth, we also expect her to emphasise that the recent increase in price pressures is likely to be transitory, and that the outlook for inflation remains subdued and incompatible with the ECB's objectives. Indeed, the ECB's forecast for headline inflation in 2022 (1.2%Y/Y) and 2023 (1.4%Y/Y) might be little changed. Moreover, although financial conditions on the whole will be judged to remain accommodative, the further upwards move in yields since the 11 March policy meeting when the Governing

Euro area: New Covid-19 cases by country



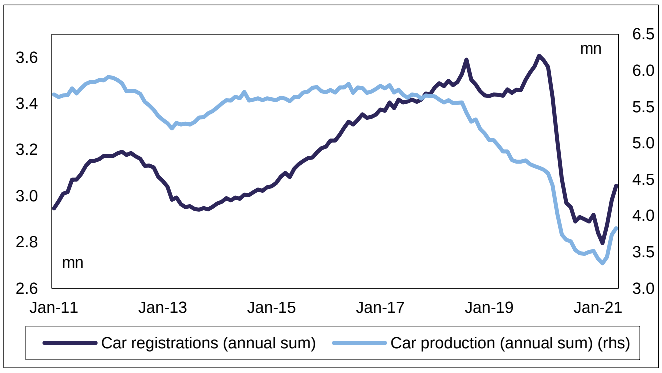
Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Euro area: Covid-19 vaccine doses given by country



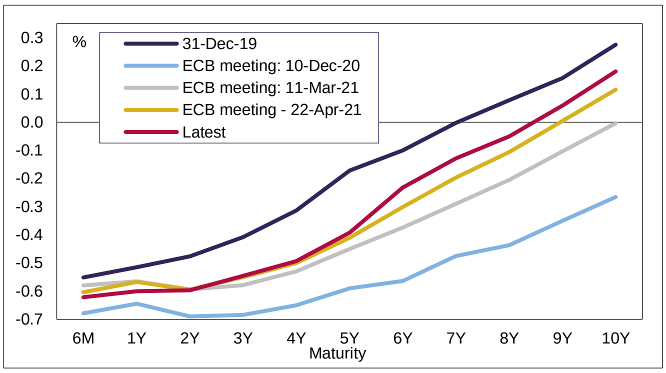
Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Euro area: Inflation



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: GDP-weighted sovereign yield curve



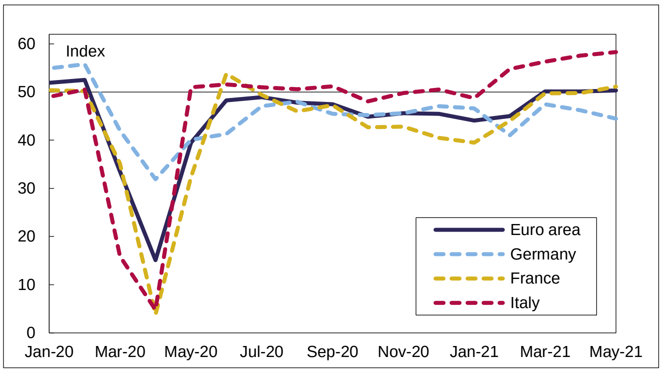
Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Council committed to conduct purchases "at a significantly higher pace than during the first months of the year" will provide additional food for thought. Admittedly, the increase in yields will be judged to reflect the more favourable economic conditions in the euro area, including an increase in market inflation expectations while real yields have remained very low. Nevertheless, unease about a possible tightening of financial conditions at a time when underlying inflation remains subdued will likely persuade the majority of members of the Governing Council to argue for leaving the pace of asset purchases unchanged over the coming quarter. Some of the hawks might be dissatisfied with that outcome, however. And assuming that economic growth does indeed rebound over the summer, and the Fed signals more clearly its plans to taper by then, we would expect a slowing in the pace of purchases to be discussed – and likely agreed – in September.

Beyond the ECB, the coming week brings further data from the manufacturing sector, with April industrial production figures from Spain and Germany due out on Monday and Tuesday respectively, followed by the French and Italian numbers on Thursday. After a disappointing end to the first quarter for euro area manufacturers, these latest data will reveal to what extent supply-chain challenges, related to semiconductors among other items, have continued to weigh on production. However, survey data, such as the rise in the euro area manufacturing output PMI to a series high of 63.1 last month, suggest 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. Indeed, German factory orders data, due out on Monday, are expected to reveal a further increase in April to well above their pre-pandemic levels. Meanwhile, French and German trade figures – to be published on Tuesday and Wednesday respectively – will provide an insight into the strength of external demand at the start of this quarter.

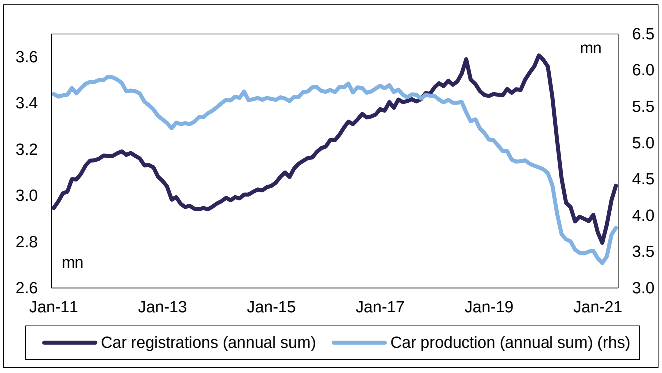
Separately, the euro area Sentix investor confidence index for June will be published on Monday, with the similar German ZEW investor survey indices due the following day. Tuesday will also bring the release of final euro area Q1 GDP figures, which are expected to confirm the preliminary estimate (-0.6%Q/Q and -1.8%Y/Y). The expenditure breakdown of euro area Q1 GDP is likely to show that household consumption again subtracted significantly from growth in the first quarter due to ongoing containment restrictions. And the end of the Brexit transition period hit the recovery in exports, so that net trade is also expected to have had a negative impact on GDP growth. Meanwhile, inventories and to a lesser extent fixed investment will likely provide some offset.

Euro area: Construction activity PMIs



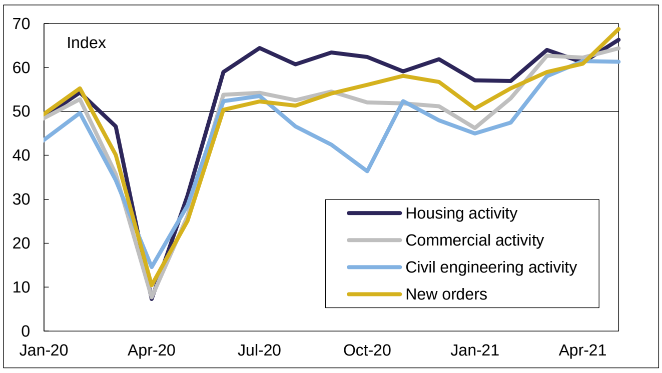
Source: Markit, Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: Car production and registrations



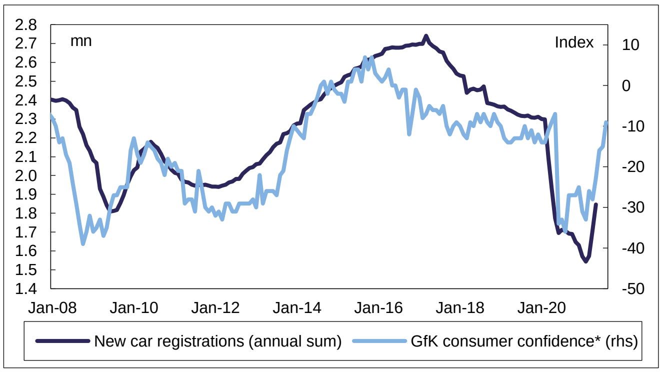
Source: VDA, Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Construction PMIs



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

UK: Consumer confidence & new car registrations



**Consumer confidence has 3-month lead.*
Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

UK

Survey points to strong labour demand and diminished staff supply in May

All survey indicators point to a strong rebound in UK economic activity in the second quarter. Among them, today's KPMG and REC Report on Jobs survey of recruitment and employment consultancies made clear that the continued reopening of the economy also led to a significant tightening of conditions in the labour market over the past month. Indeed, according to this survey, growth in permanent staff appointments and temporary staff billings rose at the strongest rate on the series dating back to the late 1990s, with overall demand for workers similarly rising at the fastest rate in more than 23 years. With 3.4mn workers still on furlough at end-April, the KPMG/Survey also reported a significant deterioration in staff supply last month, with overall candidate availability reportedly falling at the sharpest rate in four years. Diminished labour supply and rising vacancies – not least in IT and hospitality – generated accelerated increases in starting pay for both permanent and temporary staff, the former at the fastest pace since September 2018. Even assuming that the resumption of the rise in new coronavirus cases associated with an Indian variant does not prevent further reopening of the economy over coming weeks, it remains to be seen how labour supply and pay will evolve as and when the Job Retention Scheme is tapered from next month and brought to an end in September. With the survey reporting diminished availability of candidates from the EU following the end of the Brexit transition, staff shortages in many sectors might be expected to persist acting as a restraint on economic growth while adding pressure to wage costs. Whether that would translate into higher consumer prices, however, is debatable.

Construction PMIs point to accelerated growth

Rounding off a very strong set of UK May PMIs, the construction survey signalled the strongest output growth in the sector since September 2014 with the headline index up 2.6pts to a highly elevated 64.2. With house prices last month rising more than 10.9%Y/Y – the most since mid-2014 – according to the Nationwide index, perhaps unsurprisingly residential work (66.3) continues to lead the way. But the PMI for commercial work (64.4) rose to its highest since 2007, with civil engineering activity also strong (61.3). Moreover, growth in new construction orders was reportedly the firmest on the series dating back to the late 1990s while job creation in the sector was the strongest since mid-2014. Once again, however, supply-side challenges in the sector intensified. Suppliers' delivery times lengthened sharply at the second-highest rate on the series while steep rises in raw material prices saw overall input price inflation rise to a series high.

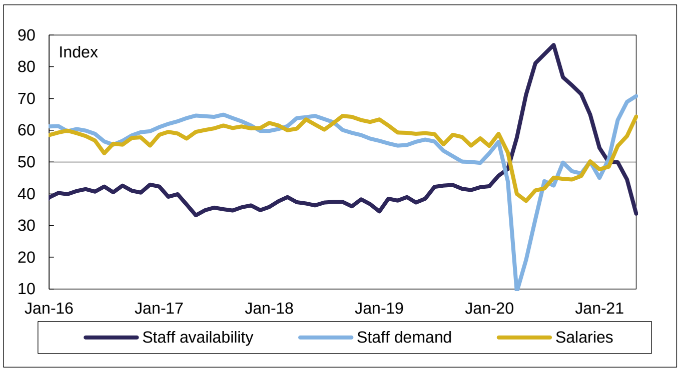
New car registrations remain well down on pre-pandemic norms

According to the Society of Motor Manufacturers and Traders (SMMT), UK new car registrations leapt more than 670%Y/Y in May. Such an extreme growth rate, of course, principally reflects the collapse in sales a year earlier when showrooms were shut during the first wave of pandemic. Indeed, new registrations of more than 156.7k were still almost 15% below the level in the same month two years earlier, and more than 13% below the May average over the decade ahead of the pandemic, similar to the position in April. The further improvement in consumer confidence last month to a fifteen-month high and above the range in 2019, however, points to a pick-up in car sales over coming months. Indeed, like other big ticket-items, spending on cars should be supported by a reduction in the stock of consumers' "excess" savings accumulated over the past year or so.

The week ahead in the UK: April GDP data the focus

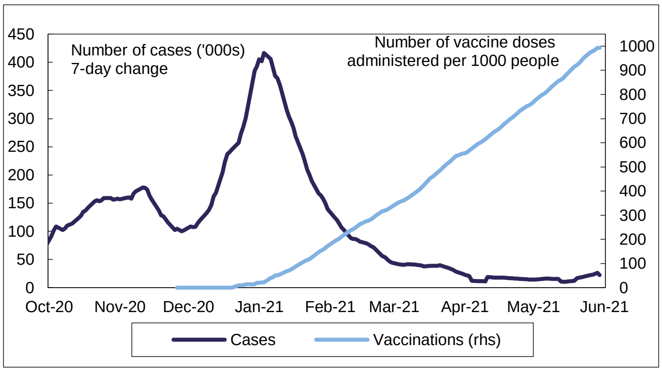
All eyes in the coming week will watch closely the trend in new coronavirus cases in the UK, with the current upturn associated with an Indian variant risking a delay to the next stage of economic reopening due from 21 June. The economic data highlight will be the initial estimate of GDP in April (on Friday), which will offer the first official estimate of the impact of the first-phase easing of lockdown restrictions. With the reopening of non-essential stores having contributed to a rapid rise in retail sales (9.2%M/M), and restrictions on many other services having eased somewhat, GDP is likely to have

UK: KPMG/REC Report on Jobs survey indices*



*Indices for permanent staff.
Source: Markit, Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: New coronavirus cases & vaccine doses given



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

accelerated somewhat following growth of 2.1%M/M in March. Meanwhile, although likely not quite as firm as growth in services, industrial production is expected to have risen about 2.0%M/M. Stronger import growth, however, might well lead to a widening of the goods trade deficit. The other noteworthy release due in the coming week will be the BRC retail sales survey for May, out Tuesday, which will likely further highlight the boost to spending from the reopening of non-essential stores in April.

Daiwa economic forecasts

	2020	2021				2022	2020	2021	2022
	Q4	Q1	Q2	Q3	Q4	Q1			
GDP growth, %, Q/Q									
Euro area	-0.7	-0.6	1.4	1.8	1.2	1.0	-6.7	3.9	4.3
Germany	0.5	-1.8	1.8	1.5	1.4	1.0	-5.1	2.6	4.4
France	-1.5	-0.1	1.0	1.6	1.4	1.2	-8.0	5.5	4.7
Italy	-1.8	-0.4	1.5	1.7	1.4	1.3	-8.9	4.3	5.1
Spain	0.0	-1.0	1.6	2.0	1.6	1.5	-10.8	4.9	6.2
UK	1.3	-1.5	3.5	3.2	2.5	1.0	-9.8	6.6	6.2
Euro area									
Headline CPI	-0.3	1.1	1.8	2.0	2.3	1.1	0.3	1.8	1.2
Core CPI	0.2	1.2	0.8	1.0	1.3	0.5	0.7	1.1	0.9
UK									
Headline CPI	0.5	0.6	1.7	1.8	2.5	2.4	0.9	1.6	2.0
Core CPI	1.3	1.1	1.3	1.4	1.8	1.7	1.4	1.4	1.7
ECB									
Refi Rate %	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Deposit Rate %	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50
PEPP envelope* (€bn)	1850	1850	1850	1850	1850	1850	1850	1850	1850
BoE									
Bank Rate %	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Bond purchases** (£bn)	895	895	895	895	895	895	895	895	895

**Monthly target €bn, end of period. **Monthly target £bn, end of period. Source: Bloomberg, ECB, BoE and Daiwa Capital Markets Europe Ltd.*

European calendar

Today's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
EMU	Retail sales M/M% (Y/Y%)	Apr	**-3.1**	-0.8 (25.5)	2.7 (12.0)	
	Construction PMI	May	**51.7**	-	50.4	-
Germany	Construction PMI	May	**44.5**	-	46.2	-
	New car registrations Y/Y%	May	**37.0**	-	90.0	-
France	Construction PMI	May	**51.1**	-	49.8	-
Italy	Construction PMI	May	**58.3**	-	57.6	-
UK	New car registrations Y/Y%	May	**674.1**	-	3176	-
	Construction PMI	May	**64.2**	-	61.6	-

Auctions

Country	Auction
- Nothing to report -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's data calendar

The coming week's key data releases

Country		BST	Release	Period	Market consensus/ *Daiwa forecast/actual*	Previous
			Monday 07 June 2021			
EMU		09.30	Sentix investor confidence	Jun	25.5	21.0
Germany		07.00	Factory orders M/M% (Y/Y%)	Apr	0.5 (77.9)	3.0 (27.8)
Spain		08.00	Industrial production M/M% (Y/Y%)	Apr	0.5 (44.4)	0.4 (12.4)
			Tuesday 08 June 2021			
EMU		10.00	Final GDP Q/Q% (Y/Y%)	Q1	-0.6 (-1.8)	-0.7 (-4.9)
Germany		07.00	Industrial production M/M% (Y/Y%)	Apr	0.6 (29.5)	2.5 (5.1)
		10.00	ZEW current assessment balance (expectations)	Jun	-27.0 (85.5)	-40.1 (84.4)
France		07.45	Trade balance €bn	Apr	-	-6.1
Italy		09.00	Retail sales M/M% (Y/Y%)	Apr	0.2 (-)	-0.1 (22.9)
UK		00.01	BRC retail sales monitor, like-for-like sales Y/Y%	May	-	39.6
			Wednesday 09 June 2021			
Germany		07.00	Trade balance €bn	Apr	16.0	20.5
			Thursday 10 June 2021			
EMU		12.45	ECB main refinancing rate %	Jun	*0.00*	0.00
		12.45	ECB marginal lending facility %	Jun	*0.25*	0.25
		12.45	ECB deposit facility rate %	Jun	*-0.50*	-0.50
France		07.45	Industrial production M/M% (Y/Y%)	Apr	0.6 (44.9)	0.8 (13.7)
		07.45	Manufacturing production M/M% (Y/Y%)	Apr	1.2 (-)	0.4 (15.7)
Italy		09.00	Industrial production M/M% (Y/Y%)	Apr	0.3 (72.2)	-0.1 (37.7)
UK		00.01	RICS house price balance %	May	76	75
			Friday 11 June 2021			
Italy		09.00	Unemployment rate %	Q4	10.5	9.2
Spain		08.00	Final CPI (EU-harmonised CPI) Y/Y%	May	2.7 (2.4)	2.2 (2.0)
UK		07.00	GDP M/M% (3M/3M)	Apr	2.5 (1.6)	2.1 (-1.6)
		07.00	Industrial production M/M% (Y/Y%)	Apr	1.2 (30.5)	1.8 (3.6)
		07.00	Manufacturing production M/M% (Y/Y%)	Apr	1.5 (42.2)	2.1 (4.8)
		07.00	Construction output M/M% (Y/Y%)	Apr	1.0 (83.4)	5.8 (6.0)
		07.00	Index of services M/M% (3M/3M%)	Apr	2.8 (1.2)	1.9 (-2.0)
		07.00	Goods trade balance £bn	Apr	-11.7	-11.7

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions

Country		BST	Event / Auction
Monday 07 June 2021			
			- Nothing scheduled -
Tuesday 08 June 2021			
Germany		10.30	Auction: €4bn of 0% 2028 bonds
UK		10.00	Auction: €1.25bn of 1.625% 2071 bonds
Wednesday 09 June 2021			
Germany		10.30	Auction: €1.5bn of 0% 2050 bonds
UK		10.00	Auction: 0.125% 2031 index-linked bonds
Thursday 10 June 2021			
EMU		12.45	ECB monetary policy announcement
		13:30	ECB President Lagarde holds press conference
Italy		10.00	Auction: 3Y and 7Y bonds
UK		13.05	BoE Chief Economist Haldane takes part in a virtual event – 'Macroeconomic consequences of technological change'
Friday 11 June 2021			
			- Nothing scheduled -

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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