# Euro wrap-up

## Overview

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- While euro area GDP in Q1 was revised up and the ZEW survey highlighted investor optimism, Bunds made gains as German industrial production fell back in April.
- Gilts also made gains despite another upbeat UK retail survey.
- Ahead of Thursday's ECB policy announcement, tomorrow will bring German goods trade data for April.

**Daily bond market movements**

| Bond | Yield | Change |
|---|---|---|
| BKO 0 06/23 | -0.679 | -0.005 |
| OBL 0 04/26 | -0.602 | -0.017 |
| DBR 0 02/31 | -0.225 | -0.029 |
| UKT $0^{1}/_{8}$ 01/23 | 0.057 | -0.020 |
| UKT $0^{1}/_{8}$ 01/26 | 0.324 | -0.028 |
| UKT 4¾ 12/30 | 0.768 | -0.038 |

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

# Euro area

## German IP drops in April as supply fails to keep up with uptrend in demand

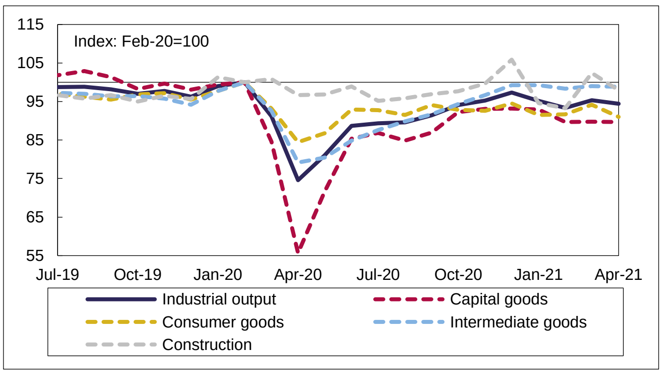
As hinted at by yesterday's weak turnover data, German industrial production fell back at the start of Q2, declining 1.0%M/M in April, in contrast to the Bloomberg median forecast of growth of 0.4%M/M. In addition, growth in March was revised down slightly to 2.2%M/M. So, while production was up 26.4% from a year earlier when output plunged in response to the onset of the pandemic, it was also down 5.6% from the pre-pandemic level in February 2020. That contrasts markedly with the performance of new factory orders, which were almost 10% above the pre-pandemic level in April, suggesting that supply bottlenecks continue to prevent production from satisfying demand.

Within the detail, production excluding energy and construction was down 0.7%M/M, with output of consumer goods down a sharp 3.3%M/M to be 9.0% below the pre-pandemic level. In contrast, production of intermediate goods was down just 0.2%M/M to be just 1.2% below the level in February 2020. And output of capital goods edged down just 0.1%M/M, albeit still 10.6% below the pre-pandemic level. Production of machinery and equipment rose 3.9%M/M to be 0.4% above the level in February 2020. But motor vehicle production extended its recent downtrend, falling 3.3%M/M to be more than 18% below the level at the end of 2020 and almost 24% below the pre-pandemic level – a marked contrast with motor vehicle orders, which were more than 11% above the pre-pandemic level in April. Beyond manufacturing, energy production leapt 6.0%M/M to above the pre-pandemic level for the first time. And that offset much of the impact of the steep drop of 4.3%M/M in construction output back below the pre-pandemic level.

## ZEW survey signals greater investor optimism in German economic conditions

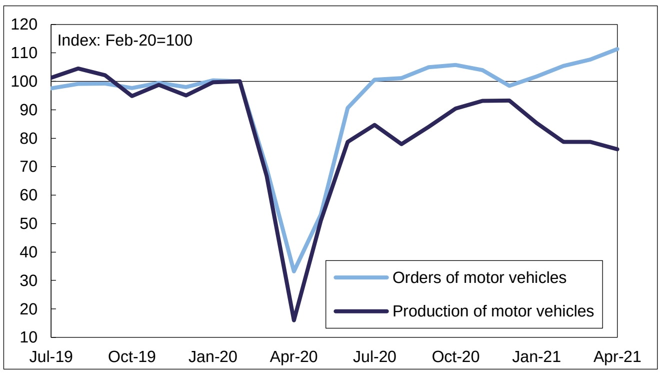
Leading indicators suggest that manufacturing production remained constrained by supply bottlenecks in May while construction activity in Germany seems likely to continue to lag the recovery in other member states. Nevertheless, like yesterday's Sentix survey, the latest ZEW survey of investor sentiment suggested a marked improvement in assessments of current German economic conditions in June. Indeed, the respective index rose by 31pts, the most on the series, to -9.1, the highest since July 2019 albeit still in negative territory. And while it slipped back more than 4pts, at 79.8 the survey index of expectations for the coming six months was the second highest on the series. Within the survey detail, investors remain sanguine about the outlook for profit growth in all sectors, with the improvement most marked for retail and services, due not least to expectations of ongoing relaxation of pandemic containment measures. And despite ongoing concerns about supply challenges, investor perceptions of the profit outlook for mechanical engineering, electronics and autos, among other manufacturing sectors, remain highly favourable. Meanwhile, the ZEW survey measure of investor German inflation

**Germany: Industrial production by sector**




*Source: Refinitiv and Daiwa Capital Markets Europe Ltd.*

**Germany: Autos production and orders**




*Source: Refinitiv and Daiwa Capital Markets Europe Ltd.*

perceptions rose to the highest since December 2016 while long-term interest rate expectations rose to the highest since November 2018.

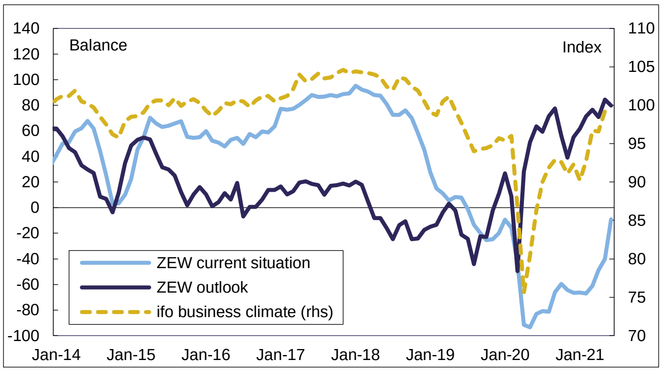
## Drop in euro area GDP in Q1 revised down again highlighting resilience to pandemic

Today’s final estimate of euro area GDP in Q1 revised down the extent of the contraction, by 0.3ppt to -0.3%Q/Q. That was a rate trivially different to the one assumed in the ECB’s March forecast (-0.4%Q/Q) suggesting significant resilience to the intensification of the pandemic at the back end of the quarter. While the level of GDP was down just 1.3%Y/Y, it was nevertheless also some 5.1% below the pre-pandemic level in Q419. The revision to euro area GDP was principally due to Italy, which last week revised its previously estimated drop in GDP of 0.4%Q/Q to positive growth of 0.1%Q/Q. In contrast, GDP fell in Germany (-1.8%Q/Q), France (a minimal -0.1%Q/Q), Spain (-0.5%Q/Q) and most other member states. But despite a sharp drop in household consumption due to the panic, Irish GDP grew an extraordinary 7.8%Q/Q reflecting a surge in exports booked by multinational corporations (MNCs) based in the country for tax purposes. In marked contrast, Irish Gross National Product (GNP) dropped 1.0%Q/Q due to increased MNC profit outflows, highlighting the distortion to the euro area figures caused by the country and the associated difficulty interpreting the aggregate data.

## Household consumption fully explained drop in GDP in Q1 and will return to growth from Q2 on

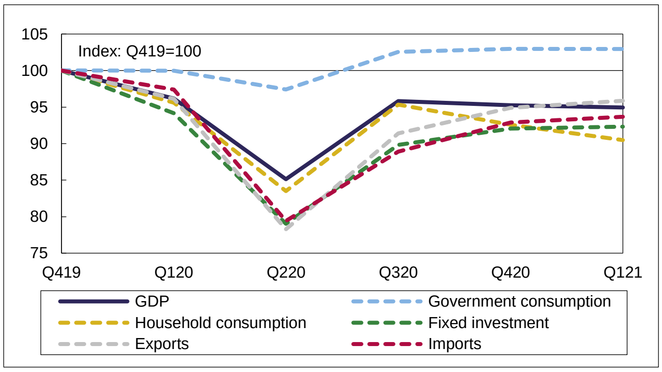
As expected, the tightening of pandemic containment measures weighed most heavily on private consumption in the euro area, which dropped for the second successive quarter and by a chunky 2.3%Q/Q to be 9.5% below the Q419 level and subtract 1.2ppts from GDP growth. Other main expenditure components, however, were either neutral or made a positive contribution to GDP growth in Q1. Despite weakness in the transport component, fixed investment rose 0.2%Q/Q, boosted by spending on construction as well as machinery and equipment. It was, however, down 7.7% from Q419. In contrast, government consumption was unchanged but 3% above the pre-Covid level. Both exports (1.0%Q/Q) and imports (0.9%Q/Q) slowed markedly in the first quarter due to the end of the Brexit transition period, to be down almost 4% and more than 6% below the respective pre-pandemic levels. But thanks no doubt to the contribution from Ireland, net trade managed to add 0.1ppt to GDP growth in Q1. Finally, with spending curtailed by containment measures, inventories added to GDP growth for the second successive quarter and by an increased 0.7ppt. With a gradual easing of restrictions and accelerated vaccination programmes, we expect positive growth in all components bar inventories in the current quarter, with an acceleration likely in the second half of the year. And we project the pre-pandemic level of GDP to be reached in the first quarter of 2022.

### Germany: ifo and ZEW survey indices



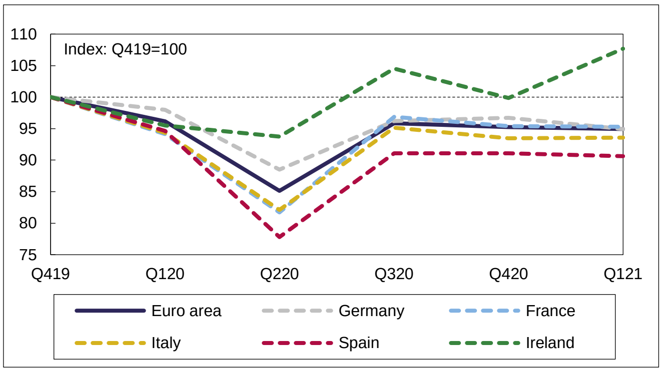

*Source: Refinitiv and Daiwa Capital Markets Europe Ltd.*

### Euro area: GDP expenditure components



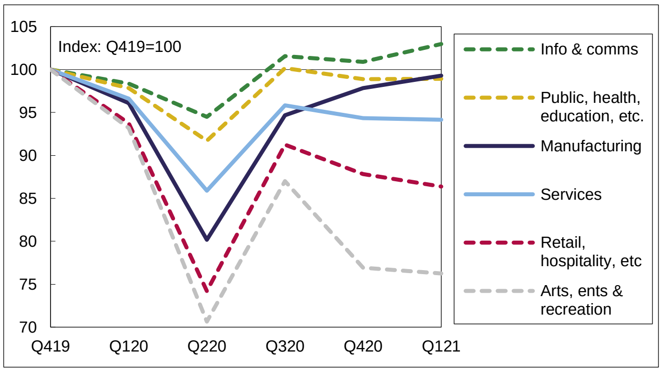

*Source: Refinitiv and Daiwa Capital Markets Europe Ltd.*

### Euro area: GDP by selected member states




*Source: Refinitiv and Daiwa Capital Markets Europe Ltd.*

### Euro area: Selected GDP production components




*Source: Refinitiv and Daiwa Capital Markets Europe Ltd.*

### The coming two days in the euro area

Wednesday will be relatively quiet for new economic data from the euro area, bringing only the release of German trade data for April. On a seasonally adjusted basis, German goods imports are expected to fall back by 1.0%M/M or more having leapt a steep 7.1%M/M in March. But goods exports are expected to rise for a twelfth consecutive month, albeit by only about 0.5%M/M in April, after increasing 1.3%M/M previously.

Of course, Thursday brings the week's main event as the ECB's latest monetary policy meeting concludes. All eyes will be on the Governing Council's wording with respect to the expected pace of asset purchases over the coming quarter, which will be determined by the ECB's updated economic projections as well as an assessment of financial conditions. In terms of the projections, with GDP in Q1 now close in line with the ECB's previous forecast, easing of pandemic restrictions anticipated, implementation of vaccination programmes accelerated, external demand expected to strengthen and economic survey indicators pointing to a firm pickup in activity from this quarter on, the ECB's GDP forecast for this year (4.0%Y/Y) might be little changed while next year's (4.1%Y/Y) could well be revised up. With headline inflation having recently overshot the ECB's expectation, the respective projection for this year (currently 1.5%Y/Y) will also likely be revised up. However, core inflation has weakened somewhat 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. 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.

It is hard to believe that the ECB will not judge that financial conditions remain accommodative. It will consider that the further upwards move in yields since the 11 March policy meeting, when the Governing Council committed to conduct purchases "at a significantly higher pace than during the first months of the year", principally reflects more favourable economic conditions in the euro area, including an increase in market inflation expectations. And it will welcome that real yields have remained very low. Nevertheless, unease about a possible tightening of financial conditions at a time when underlying inflation remains subdued should persuade the majority of members of the Governing Council to argue for leaving the pace of asset purchases little changed over the coming quarter. Some of the hawks might be dissatisfied with that outcome, however, highlighting the likelihood of a more heated discussion in September when the Governing Council will announce conclusions of its strategy review. 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.

Data-wise, Thursday will bring French and Italian industrial production data for April. Unlike in Germany, positive growth is expected in both countries, although production will highly likely remain below the respective pre-pandemic levels.

## UK

### BRC survey points to solid month for UK retail sales in May

Like the CBI survey released late last month, the BRC's retail monitor signalled that sales remained firm in May following the rebound in April related to the reopening of non-essential stores. Following growth of more than 50%Y/Y in April, the survey's headline measure of total sales – which was flattered by the impact of the collapse in sales a year earlier – was up 28.4%Y/Y May. And the measure of like-for-like sales - which attempts to exclude those stores closed during lockdowns - was up a solid 18.5%Y/Y, albeit marking a moderation from growth of 40%Y/Y in April. Within the detail, despite the inclement weather for much of the month, clothing retailers reported a second month of strong sales on the back of pent up demand for in-store shopping and as consumers looked to take advantage of the further relaxation of hospitality restrictions. There was also reportedly a surge in spending on jewellery, footwear and home accessories. As throughout the pandemic, DIY and furniture stores also continued to fare well. And while like-for-like non-food online sales were down compared with a year earlier for the first time since November 2019, the level remained elevated by historical standards, suggesting that many consumers remain reluctant to return to the high street despite the UK's high uptake of vaccinations. Overall, the BRC survey adds to evidence that consumer spending will provide a big boost to GDP growth in Q2.

### The coming two days in the UK

No top-tier UK economic data are due on Wednesday. But Thursday will bring the RICS residential property survey, which is likely to show that house price pressure remains significant against the backdrop of firm demand but weak supply of homes onto the market. Beyond the data, investors will look for clues as to whether the final easing of restrictions in England will go ahead as currently planned on 21 June. With the number of new coronavirus cases per capita in the UK having now overtaken that in Germany and Italy and trending higher as the highly contagious Delta variant continues to spread, media reports of a likely two-week delay to the planned reopening seem credible.

***The next edition of the Euro wrap-up will be published on 10 June 2021***

# European calendar

## Today's results

**Economic data**

| Country | Release | Period | **Actual** | Market consensus/ *Daiwa forecast* | Previous | Revised |
|---|---|---|---|---|---|---|
| EMU | Final GDP Q/Q% (Y/Y%) | Q1 | **-0.3 (-1.3)** | -0.6 (-1.8) | -0.7 (-4.9) | **-0.6 (-4.7)** |
| | Final employment Q/Q% (Y/Y%) | Q1 | **-0.3 (-1.8)** | -0.3 (-1.8) | 0.4 (-1.8) | - |
| Germany | Industrial production M/M% (Y/Y%) | Apr | **-1.0 (26.4)** | 0.3 (29.5) | 2.5 (5.1) | **2.2 (4.8)** |
| | ZEW current assessment balance (expectations) | Jun | **-9.1 (79.8)** | -27.0 (85.5) | -40.1 (84.4) | - |
| France | Trade balance €bn | Apr | **-6.2** | -5.4 | -6.1 | - |
| Italy | Retail sales M/M% (Y/Y%) | Apr | **-0.4 (30.4)** | 0.2 (-) | -0.1 (22.9) | **0.0 (23.5)** |
| UK | BRC retail sales monitor, like-for-like sales Y/Y% | May | **18.5** | - | 39.6 | - |

**Auctions**

| Country | Auction |
|---|---|
| Germany | sold €3.26bn of 0% 2028 bonds at an average yield of -0.37% |
| UK | sold £3bn of 0.375% 2026 bonds at an average yield of 0.465% |
| | sold £1.25bn of 1.625% 2071 bonds at an average yield of 1.153% |

*Source: Bloomberg and Daiwa Capital Markets Europe Ltd.*

## Tomorrow's releases

**Economic data**

| Country | BST | Release | Period | Market consensus/ *Daiwa forecast* | Previous |
|---|---|---|---|---|---|
| Germany | 07.00 | Trade balance €bn | Apr | 16.3 | 20.5 |

**Auctions and events**

| Country | BST | Event |
|---|---|---|
| Germany | 10.30 | Auction: €1.5bn of 0% 2050 bonds |
| UK | 10.00 | Auction: £1bn of 0.125% 2031 index-linked bonds |

*Source: Bloomberg and Daiwa Capital Markets Europe Ltd.*

## Thursday's releases

**Economic data**

| Country | BST | Release | Period | Market consensus/ *Daiwa forecast* | Previous |
|---|---|---|---|---|---|
| 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 (50.7) | 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 | 77 | 75 |

**Auctions and events**

| Country | BST | Event |
|---|---|---|
| EMU | 12.45 | ECB monetary policy announcement |
| | 13:30 | ECB President Lagarde holds press conference |
| Italy | 10.00 | Auction: Up to €3.5bn of 0% 2024 bonds |
| | 10.00 | Auction: Up to €2.5bn of 0.5% 2028 bonds |
| | 10.00 | Auction: Up to €1.75bn of 0.5% 2041 bonds |
| UK | 13.05 | BoE Chief Economist Haldane takes part in a virtual event – 'Macroeconomic consequences of technological change' |

*Source: Bloomberg and Daiwa Capital Markets Europe Ltd.*

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