

Euro wrap-up

Overview

- Bunds were little changed as the ECB committed to maintain net PEPP purchases over the coming three months at a significantly higher pace than at the start of the year.
- Gilts made losses as a survey highlighted price pressures and a shortage of property for sale in the UK housing market.
- Friday will bring the first estimate of UK GDP in April and final Spanish inflation data for May.

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Daily bond market movements

Bond	Yield	Change
BKO 0 06/23	-0.691	-0.004
OBL 0 04/26	-0.624	-0.006
DBR 0 02/31	-0.249	-0.004
UKT 0 ¹ / ₈ 01/23	0.064	+0.015
UKT 0 ¹ / ₈ 01/26	0.324	+0.019
UKT 4 ³ / ₄ 12/30	0.753	+0.024

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

Source: Bloomberg

Euro area

ECB PEPP purchases to remain “significantly higher” despite improved GDP outlook

As expected, the ECB left unchanged all of its key policy parameters when its Governing Council meeting concluded today. Most notably, the monetary policy statement confirmed that “the Governing Council expects net purchases under the PEPP over the coming quarter to continue to be conducted at a significantly higher pace than during the first months of the year”. That implies an average monthly pace close to the recent rate of €80bn, up from €60bn between the start of the year to the March meeting, albeit with scope to slow the rate somewhat during August when net issuance will be low. Also as expected, the tone of President Lagarde in her press conference was cautiously optimistic, not least as the slowdown in new coronavirus cases, gradual easing of pandemic containment restrictions and speedier progress in vaccination programmes enabled her to present upwards revisions to the ECB’s GDP forecasts. Indeed, these revisions went a little beyond what might have been anticipated, with the growth projections for both 2021 and 2022 nudged up by a substantive 0.6ppt to 4.6%Y/Y and 4.7%Y/Y respectively. With the growth forecast for 2023 unchanged at 2.1%Y/Y, the projections also suggest that the level of GDP will remain higher than previously thought over the medium term, suggestive of less economic scarring from the pandemic than feared. Moreover, in a further sign of positivity, the risks surrounding the GDP growth outlook were judged to be “broadly balanced” for the first time since end-2018.

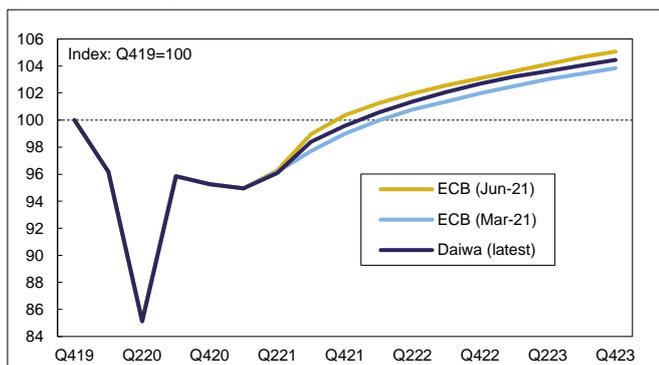
Near-term inflation outlook higher, medium-term inflation outlook barely changed

Given recent price pressures, the ECB also revised up significantly its near-term inflation projections. In particular, the headline inflation forecasts for 2021 and 2022 were revised up by 0.4ppt and 0.3ppt to 1.9%Y/Y and 1.5%Y/Y respectively. However, with the pressures from supply bottlenecks and higher energy prices judged to be transitory, the headline inflation forecast for 2023 was left unchanged at just 1.4%Y/Y (albeit with inflation expected to reach the heady heights of 1.5%Y/Y in Q423). The core inflation forecast for 2023 was nudged up by just 0.1ppt, also to 1.4%Y/Y. It is those inflation forecasts that are most important for determining policy. And with that outlook still inconsistent with the ECB’s target – which remains “close to but below 2%” at least until the strategy review concludes in September – the Governing Council agreed to maintain net PEPP purchases at the recent pace over the coming three months. That decision also recognised that a sustained rise in market rates could yet translate into a “premature” tightening of wider financing conditions that would pose risks to the economic recovery and inflation outlook.

Governing Council now set for September showdown

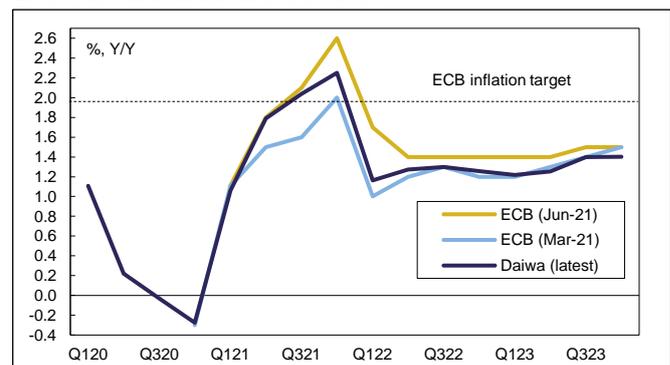
In her press conference, Lagarde insisted that there had been no discussion whatsoever in the meeting over the pace or nature of asset purchases further ahead than the coming quarter. But she admitted that there had been some diverging

Euro area: GDP forecasts



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

Euro area: Inflation forecasts



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

views on the Governing Council over today's decision on the near-term pace of purchases, giving a taste of the potentially acrimonious debates ahead at September's meeting. If the economy rebounds more firmly than anticipated over the summer, it is perfectly possible that the end-point of the ECB's inflation projection will be nudged up further in September to strengthen the case for a meaningful slowdown in the pace of purchases on that occasion. However, much will depend on whether, and if so how, the strategy review redefines the ECB's inflation objective. Indeed, if the majority on the Governing Council push for a Fed-style framework that would seek to overshoot 2% inflation for a period of time, to compensate for the persistent undershooting of the past decade and seek to push inflation expectations higher on a sustained basis, more substantive policy support would be required for longer.

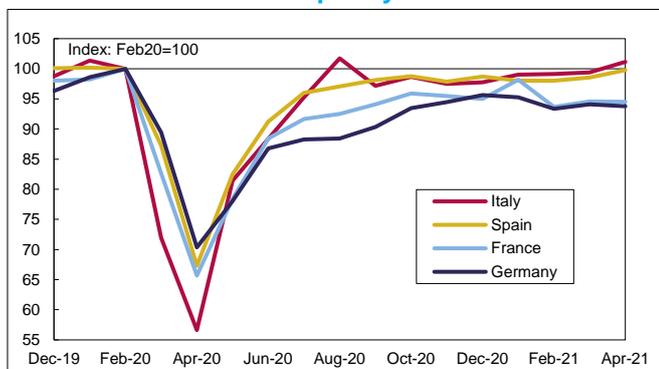
Italian IP rises again but French production weighed by supply bottleneck in autos

Following the drop in [German IP](#) in April announced earlier this week, today's data reported that French industrial production edged down just 0.1%M/M that month following upwardly revised growth of 1.0%M/M in March. That, however, still left it 1.0% below the average in Q1 and 5.5% below the average in February 2020 before the first lockdowns were implemented. Manufacturing production was down a slightly larger 0.3%M/M in April following growth of 0.6%M/M to be 6.6% below the pre-pandemic level. While output of intermediate goods and machinery and equipment edged higher, French car production fell a steep 5.9%M/M for a second successive month, presumably due to supply bottlenecks, to be some 20% below the level at the end of 2020 and more than 23% below the pre-pandemic level. In contrast, Italian industrial production rose for a fifth successive month, up 1.8%M/M, to be 1.2% above the level in February 2020. Indeed, there were few signs of harm from supply bottlenecks in Italy, with production of transport goods, including autos, up 6.7%M/M to be 5.3% above the February 2020 level, and output of electrical equipment up 3.1%M/M to a level 13% above that at the onset of the pandemic. With output also having increased in Spain (1.2%M/M) and several smaller member states, euro area industrial production is likely also to have risen in April, by roughly ½%M/M albeit to a level about 1% below that in February 2020.

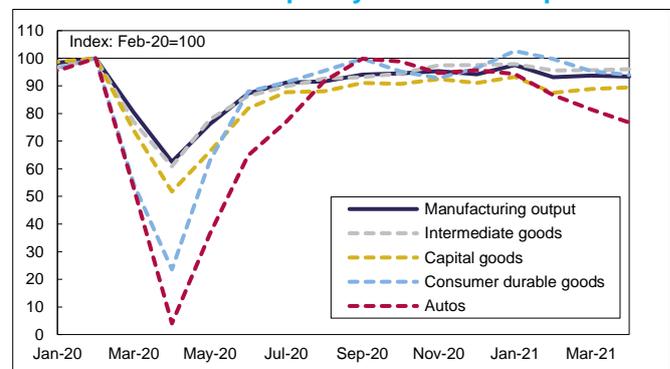
The day ahead in the euro area

The week will end fairly quietly on the euro area economic data front, with only final Spanish CPI figures for May of any interest. The flash release suggested that the EU-harmonised measure of Spanish inflation rose 0.4ppt to 2.4%Y/Y, the highest level since April 2017. On the national measure, the annual headline rate rose 0.5ppt to 2.7%Y/Y. With fuel prices the primary driver, the core rate on the national measure rose a smaller 0.2ppt to just 0.2%Y/Y.

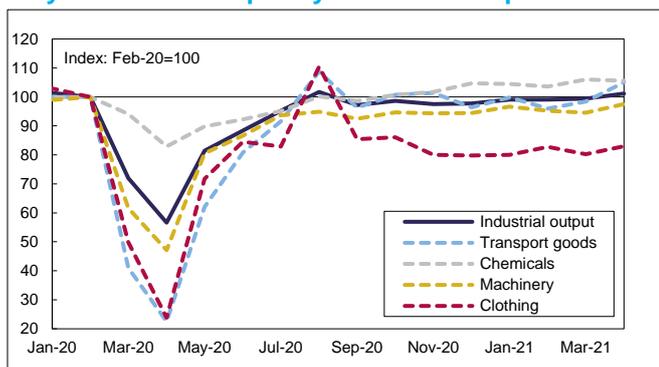
Euro area: Industrial output by member state



France: Industrial output by selected component



Italy: Industrial output by selected component



UK: RICS residential market survey indices*



UK

RICS survey flags continued house price pressures on supply shortage

With UK house price inflation on the Nationwide series having risen in May to 10.9%Y/Y, the highest since 2014, the latest RICS residential market survey shone further light on the ongoing pressures in the market. Indeed, according to the RICS survey, the net balance of surveyors reporting house price growth rose a further 7ppts in May to +83%, the highest in more than 30 years. RICS also reported that the number of surveyors expecting home prices to continue to rise over the coming quarter remained elevated, with the respective net balance down just 2ppts to +45%. And a net balance of +64% of surveyors expects prices to rise over the coming year. The survey reported some moderation in demand, with the net balance of new buyer enquiries down 13ppts from April's 7-month high to +32%, perhaps reflecting the imminent tapering and conclusion in September of the increase in the stamp duty threshold (from £125k to £500k). But the net balance of new instructions from owners looking to sell dropped a further 19ppts to -23%, while the stock of unsold homes reported by estate agents remained down on the autumn and winter months, highlighting the role that a lack of supply is playing in pushing prices higher.

The day ahead in the UK

The week's UK economic data highlight will come tomorrow in the form of the initial estimate of GDP in April. With the reopening of non-essential stores during the course of the month 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 accelerated 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.

European calendar

Today's results						
Economic data						
Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
EMU	 ECB main refinancing rate %	Jun	0.00	<u>0.00</u>	0.00	-
	 ECB marginal lending facility %	Jun	0.25	<u>0.25</u>	0.25	-
	 ECB deposit facility rate %	Jun	-0.50	<u>-0.50</u>	-0.50	-
France	 Industrial production M/M% (Y/Y%)	Apr	-0.1 (43.9)	0.6 (44.9)	0.8 (13.7)	1.0 (14.4)
	 Manufacturing production M/M% (Y/Y%)	Apr	-0.3 (49.3)	1.2 (50.7)	0.4 (15.7)	0.6 (16.5)
Italy	 Industrial production M/M% (Y/Y%)	Apr	1.8 (79.5)	0.3 (72.2)	-0.1 (37.7)	0.3 (38.4)
UK	 RICS house price balance %	May	83	77	75	76
Auctions						
Country	Auction					
Italy	 sold €3.5bn of 0% 2024 bonds at an average yield of -0.22%					
	 sold €2.5bn of 0.5% 2028 bonds at an average yield of 0.46%					
	 sold €1.75bn of 1.8% 2041 bonds at an average yield of 1.55%					

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
Germany	 Trade balance €bn	Apr	15.5	16.3	20.5	20.2
Auctions						
Country	Auction					
Germany	 sold €1.26bn of 0% 2050 bonds at an average yield of 0.31%					
UK	 sold £1bn of 0.125% 2031 index-linked bonds at an average yield of -2.687%					

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases
Economic data

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
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

Auctions and events

- Nothing scheduled -

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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