

Euro wrap-up

Overview

- Bunds followed USTs notably higher while German factory orders data disappointed but euro area retail sales rebounded sharply in May.
- Gilts similarly made gains despite an upside surprise to the UK construction PMI, which signalled the strongest growth in the sector for 24 years.
- Tomorrow will bring German industrial production data and UK unit labour costs figures.

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Daily bond market movements

Bond	Yield	Change
BKO 0 06/23	-0.686	-0.015
OBL 0 04/26	-0.624	-0.037
DBR 0 08/31	-0.272	-0.058
UKT 0 ¹ / ₈ 01/23	0.048	-0.008
UKT 0 ¹ / ₈ 01/26	0.276	-0.037
UKT 4 ³ / ₄ 12/30	0.631	-0.082

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

Source: Bloomberg

Euro area

Euro area retail sales rebound sharply in May

In line with strong sales growth in [Germany](#) and [France](#), and supported by the easing of lockdown restrictions across the euro area, today's retail sales figures predictably confirmed a solid rebound in May. Indeed, growth of 4.6%M/M was the firmest for eleven months. So, despite a steeper pace of decline than previously thought in April (-3.9%M/M), sales were up 9%Y/Y and almost 3½% above the pre-pandemic level. The rebound was driven by sales of non-food items (excluding auto fuel), which increased 8.8%M/M to be more than 5% above the pre-pandemic level as consumers spent more on clothing as well as items for the home. Auto fuel sales also jumped by more than 8%M/M, while sales by internet and mail order rose 2.0%M/M, partly reversing the 3.1%M/M decline in April. So, despite the weakness in April, in the first two months of Q2 sales were trending more than 2% above the Q1 average. And with consumer confidence having risen to its highest level since 2017, we expect sales to remain elevated through the summer despite greater opportunities for spending on services.

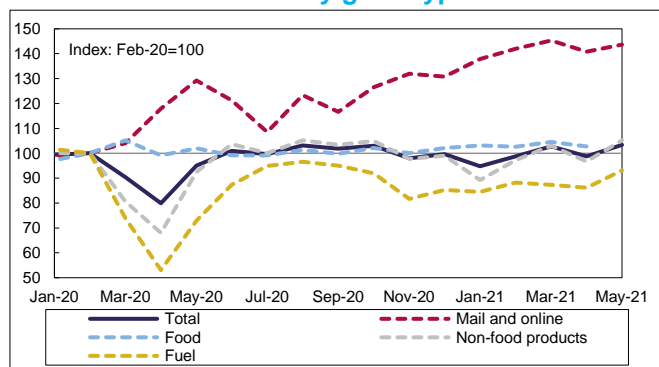
German factory orders disappoint with marked drop in May

After yesterday's [French IP](#) numbers disappointed, with evidence that supply bottlenecks were severely dampening autos production, today's German factory orders figures were also significantly weaker than expected, reporting a decline of 3.7%M/M in May, the steepest since April 2020. Admittedly this followed upwardly revised growth of 1.2%M/M in April and a cumulative increase of more than 6½% in the first four months of the year. As such, orders were still more than 6% higher than the pre-pandemic level. With domestic orders up 0.9%M/M (albeit this was more than fully accounted for by large one-off orders), the weakness in May reflected a sharp decline in overseas orders (-6.7%M/M), with those from the euro area down 2.3%M/M and new orders from elsewhere down 9.3%M/M. And this was driven by weak export demand for autos, of which foreign orders were down by 13.9%M/M. So, overseas capital goods orders were down 8.8%M/M, compared with a rise of 3.3%M/M in domestic orders of such goods. Meanwhile, orders of intermediate goods were down for the second successive month (-3.6%M/M), with weakness evident in both domestic and external demand. More happily, new orders for consumer goods were up 3.9%M/M, to their highest level since mid-2018, supported by a rebound in overseas demand.

German turnover weakens, but Spanish IP grows strongly

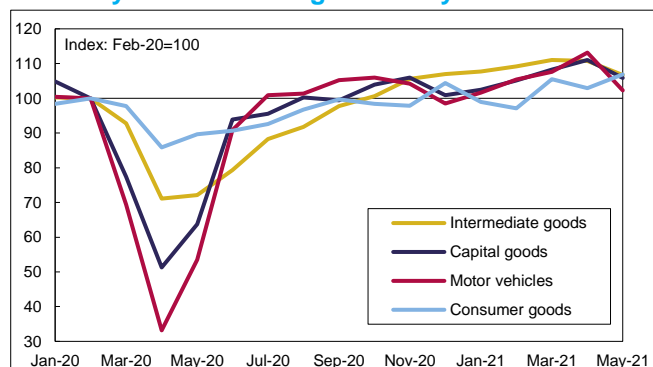
Looking ahead to tomorrow's German IP data, today's manufacturing turnover figures raise some downside risks to the consensus expectation of an increase of ½%M/M in production. In particular, turnover fell 0.5%M/M to leave it still almost 5½% lower than the pre-pandemic level. Nevertheless, with recent growth in orders having far outpaced production, and backlogs of work – particularly in autos – sky-high, German manufacturing output should return to firm growth as soon as

Euro area: Retail sales by good type



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: Manufacturing orders by subsector



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

supply bottlenecks – particularly in semiconductors – ease. Indeed, in marked contrast to developments in Germany and France, Spanish IP data exceeded expectations in May, with output jumping 4.3%M/M, the third consecutive monthly increase to leave it almost 4% higher than the pre-pandemic high. This was in spite of a significant decline in production of motor vehicles (-16.1%M/M). Indeed, production of electrical products and equipment jumped in May, supporting a 12.7%M/M increase in overall output of consumer durable goods.

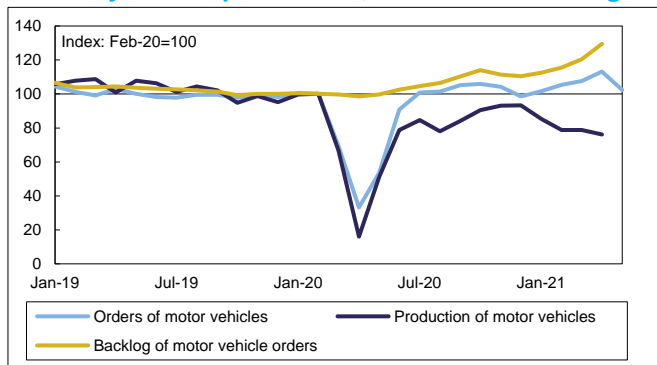
German ZEW survey reports a notable improvement in current conditions

Despite ongoing supply-side constraints, German manufacturers remain upbeat about the outlook. And today's German ZEW survey of financial investors reported a further significant improvement in perceptions of the current economic situation, with the relevant balance up in July by a whopping 31pts to 21.9, the first positive reading for two years. And while it slipped back by a larger-than-expected 16.5pts, at 63.3 the survey index of expectations for the coming six months remained elevated. Indeed, despite ongoing concerns about supply challenges, the survey detail showed that investors remain sanguine about the outlook for profit growth in all sectors. Moreover, having previously risen to the highest since 2016, the survey's measure of German inflation perceptions encouragingly fell back in July to its lowest level for six months.

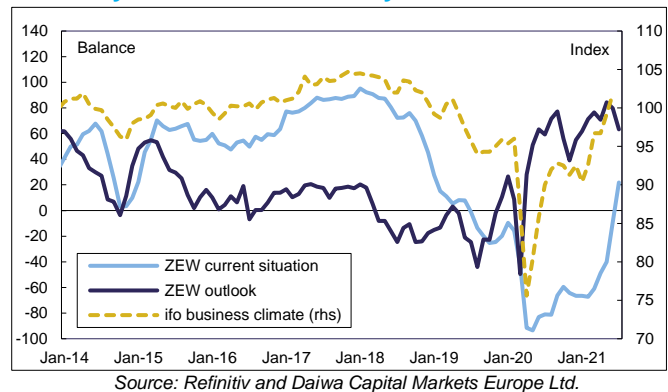
Construction PMIs flag rising price pressures

Today's euro area construction PMIs flagged the impact that supply constraints are having on that sector too. Construction firms in Germany and France reported that building activity was hit as input materials had been difficult to source and delivery times lengthened significantly. Declines in civil engineering and commercial projects continued to be reported in the largest two member states, while there was a modest improvement in euro area home building for the fourth consecutive month. Italian firms, meanwhile, indicated the sharpest rise in commercial activity since the start of 2007. Overall, the euro area construction PMI moved broadly sideways at 50.3, suggestive of modest growth, for the third consecutive month. But respondents from all three countries suggested that new orders appeared to be dampened by rising price pressures, which was particularly evident in Germany where new business fell at the fastest pace for a year. Indeed, Markit reported that average cost burdens faced by euro area constructors increased at a substantial pace during June, with the rate of cost inflation the fastest on record.

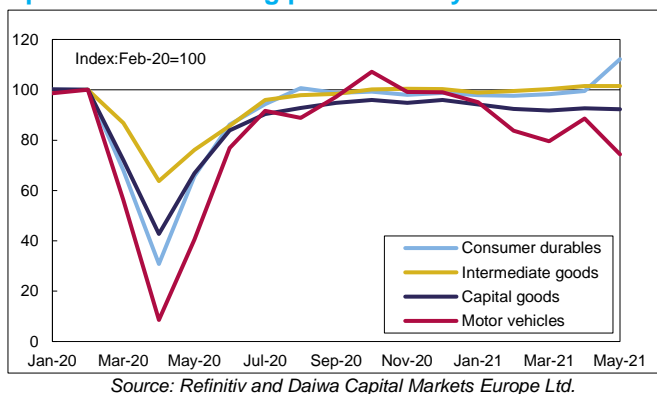
Germany: Autos production, orders and backlogs



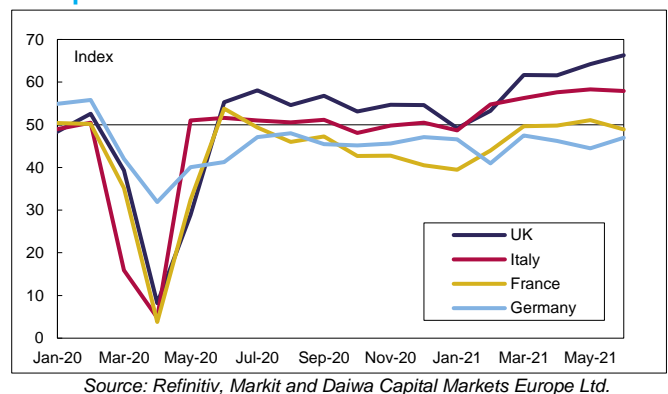
Germany: ZEW and ifo survey indicators



Spain: Manufacturing production by subsector



Europe: Headline construction PMIs



The day ahead in the euro area

Tomorrow brings the aforementioned German industrial production data for May, which might well show that output declined for the fourth month out of the past five, which would still leave production down by more than 6% from the pre-pandemic peak. Wednesday will also bring French trade figures for May.

UK

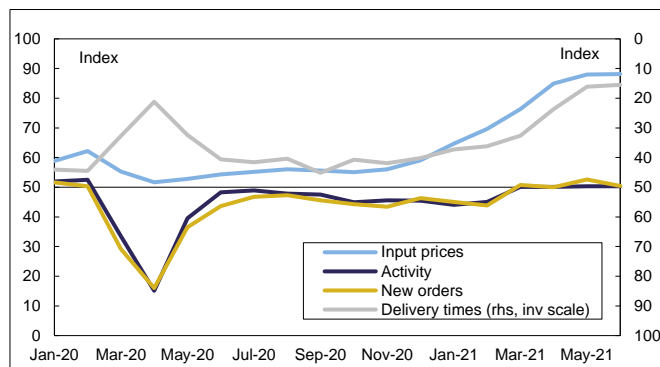
UK construction PMI reports strong growth, but also higher prices

In contrast to the euro area, today's UK construction PMI suggested that output growth in the sector hit a 24-year high in June, with the headline activity index rising 2.1pts to 66.3. This was underpinned by accelerating growth in housing and commercial building, while there was also another sharp rise in new orders. And so construction firms indicated another month of strong jobs growth. But as across the large euro area member states, UK firms reported growing struggles with supply bottlenecks, with a little more than three-quarters of survey respondents reporting longer supplier lead times due to shipping and haulage delays, especially with products sourced from the EU. And so, imbalances between supply and demand, combined with rising contractor wage costs, saw input price inflation rise at the steepest pace since the survey began.

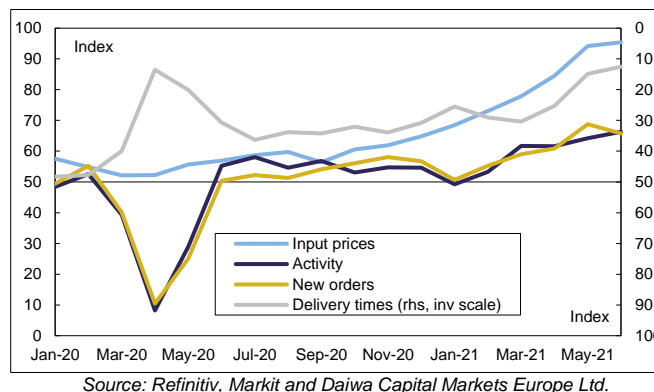
The day ahead in the UK

Wednesday will bring productivity and unit labour costs figures for Q1.

Euro area: Construction PMI



UK: Construction PMI



European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area	Construction PMI	Jun	50.3	-	50.3	-
	Retail sales M/M% (Y/Y%)	May	4.6 (9.0)	4.2 (8.2)	-3.1 (23.9)	-3.9 (23.3)
Germany	Factory orders M/M% (Y/Y%)	May	-3.7 (54.3)	1.2 (59.4)	-0.2 (78.9)	1.2 (80.2)
	Construction PMI	Jun	47.0	-	44.5	-
	ZEW current assessment balance (expectations)	Jul	21.9 (63.3)	5.0 (75.0)	-9.1 (79.8)	-
France	Construction PMI	Jun	48.9	-	51.1	-
Italy	Construction PMI	Jun	57.9	-	58.3	-
Spain	Industrial production M/M% (Y/Y%)	May	4.3 (26.0)	0.4 (21.7)	1.2 (48.2)	-
UK	Construction PMI	Jun	66.3	64.0	64.2	-

Auctions

Country	Auction
Germany	sold €310mn of 0.1% 2033 index-linked bonds at an average yield of -1.58%
	sold €165mn of 0.1% 2046 index-linked bonds at an average yield of -1.38%
UK	sold £2.75bn of 0.25% 2031 bonds at an average yield of 0.819%
	sold £1.5bn of 0.5% 2061 bonds at an average yield of 1.127%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Germany	07.00	Industrial production M/M% (Y/Y%)	May	0.7 (17.7)	-1.0 (26.4)
France	07.45	Trade balance €bn	May	-6.1	-6.2
Italy	09.00	Retail sales M/M% (Y/Y%)	May	3.0 (10.8)	-0.4 (30.4)
UK	09.30	Final output per hour Y/Y%	Q1	1.0	-0.7
	09.30	Unit labour costs Y/Y%	Q1	-	7.2

Auctions and events

Euro area	10.00	European Commission publishes Summer Economic Forecasts
Germany	10.30	Auction: €5bn of 0% 2026 bonds
UK	10.00	Auction: £600mn of 0.125% 2051 index-linked bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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