

Euro wrap-up

Overview

- Bunds made gains and BTPs rallied as German new factory orders fell for a third successive month in April to a fifteen-month low.
- After 148 of Johnson's MPs voted against him in yesterday's no-confidence vote, Gilts also made gains as a BRC survey signalled weak UK retail sales in May but the services PMIs were revised up.
- Wednesday will bring German industrial production data for April, final euro area GDP and jobs figures for Q1, and the UK construction PMIs.

Chris Scicluna

+44 20 7597 8326

Daily bond market movements

Bond	Yield	Change
BKO 0.2 06/24	0.639	-0.014
OBL 0 04/27	1.014	-0.030
DBR 0 02/32	1.281	-0.036
UKT 1 04/24	1.722	-0.032
UKT 1 ¼ 07/27	1.835	-0.024
UKT 4 ¼ 06/32	2.214	-0.031

*Change from close as at 4:00pm BST.

Source: Bloomberg

Euro area

German factory orders drop for third month as external demand weakens

Contrary to the consensus expectation of a return to positive growth, German new factory orders dropped for the third successive month in April, falling a steep 2.7% M/M in real terms following a revised decline of 4.2% M/M in March to reach the lowest level since January 2021. As in the prior two months, the cause of the weakness in April was external demand, with orders from elsewhere in the euro area down 5.6% M/M and those from outside of the euro area down 3.0% M/M. Excluding bulk items, orders similarly fell for a third successive month, albeit by a smaller 1.2% M/M. And orders for all major categories of good were lower in April. Capital goods orders dropped 4.3% M/M, with orders of motor vehicles falling 8.7% M/M to be more than 20% below their level in January and more than 25% below their peak a year earlier. In addition, orders of consumer goods fell 2.6% M/M but those of intermediate items were down a more modest 0.3% M/M. The fall left the level of real factory orders in April almost 6% below the Q1 average, strongly suggestive of a non-negligible decline over Q2 as a whole. The orders data tally with the manufacturing new orders PMI, which dropped below 50 in April to signal contraction, and fell further in May to a 25-month low of 46.6 suggestive of a further notable deterioration in demand last month. A little more happily, however, other data released today reported a rise of 0.5% M/M in manufacturing turnover in April. While that followed a plunge of 5.1% M/M in March and so left turnover almost 3.5% below the Q1, it also tallies with expectations that tomorrow's industrial production figures for April will report a return to growth, probably close to 1% M/M, following the drop of almost 4% M/M in March.

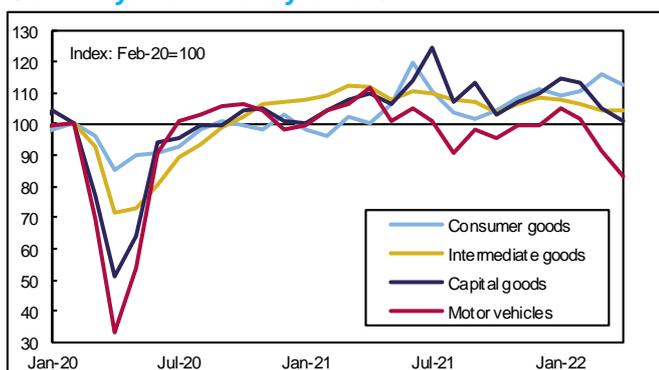
Sentix survey suggests modest pickup in confidence but expectations still in euro-crisis range

Today's Sentix investor sentiment survey results – the first gauge of economic confidence in June to be published so far – suggested an improvement for the first time since February. However, the rise in the survey's current assessment index of a little more than 3pts was modest and left the index at the second-lowest level in more than a year and firmly in negative territory (-7¼). And the larger improvement of 10pts in the expectations index left it merely at a three-month high of -24, still below levels in the initial waves of Covid and within the range last seen during the euro crisis. So, overall, the survey continues to signal widespread expectations of troubled times ahead.

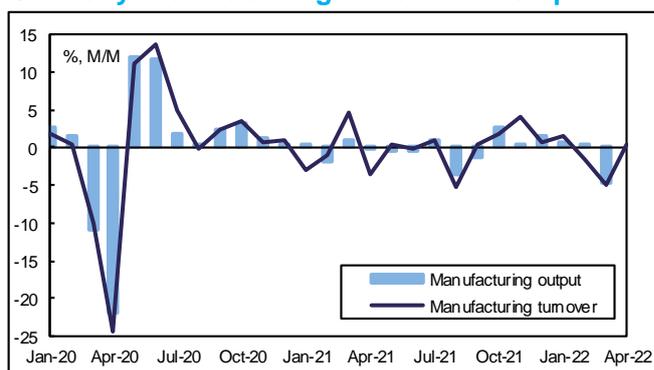
Construction PMIs suggest a clear turn for the worse in May

The euro area construction PMIs took a clear turn for the worse in May, with the headline activity index dropping 1.2pts to 49.2, the lowest level since February 2021 to signal a contraction in the sector. The future activity index also suggested ongoing deterioration, dropping to a nineteen-month low of just 45.5, with the new orders index falling below 45. S&P Global

Germany: New factory orders



Germany: Manufacturing turnover and output*



reported that firms cited increased raw material prices and supply-chain disruptions as the principal cause of the drop in activity, even though the detail of the survey suggested that such pressures might just have passed their peaks. Notably perhaps, negative momentum was reported in house-building, commercial work and infrastructure alike. Among the member states, however, the weakness was again led by Germany, whose headline PMI fell 0.6pt to 45.4, also the lowest since February 2021 and a level suggestive of significant contraction. In contrast, the equivalent French index was unchanged at 50.9 to suggest modest growth in the middle of Q2. And while it fell almost 5pts from April, at 54.3 Italy's headline construction PMI remained consistent with expansion, after the sector made a substantive contribution to GDP growth over recent quarters including Q1.

The day ahead in the euro area

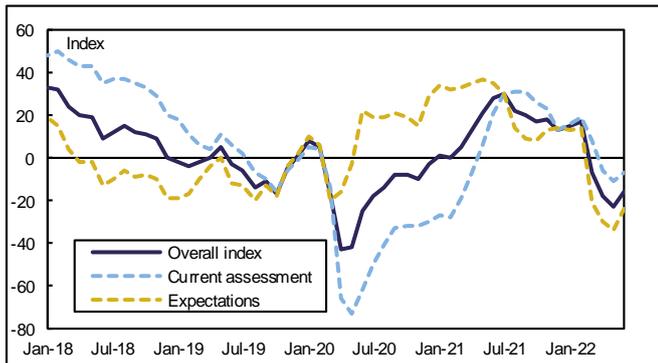
Ahead of Thursday's ECB announcements, tomorrow's economic data will not be without interest even if they are unlikely to influence discussions on the path of monetary policy normalisation. With French economic output having been revised down but Italian economic output revised up, updated euro area GDP data are forecast to confirm growth of 0.3%Q/Q in Q1, unchanged from the pace in Q4 and a touch firmer than the ECB's forecast. That would also leave GDP up 5.1%Y/Y and around ½ppt above the pre-pandemic level in Q4 19. Last week's Irish figures, which reported growth of 10.8%Q/Q in Q1, suggest risks of an upwards revision. Tomorrow's euro area national accounts release will also bring the official expenditure breakdown. National data suggest that household consumption subtracted from growth but fixed investment (not least in construction) provided a boost. Meanwhile, final euro area job figures for Q1 are expected to confirm solid growth after the preliminary data suggested that employment rose 0.5%Q/Q (752k) and 2.7%Y/Y (4.29mn). Among the member states, the aforementioned German industrial production figures for April (for which we expect growth of 1.0%MM or more) will be published along with data for French goods trade and Italian retail sales for the same month.

UK

BRC survey suggests renewed drop in retail sales in May

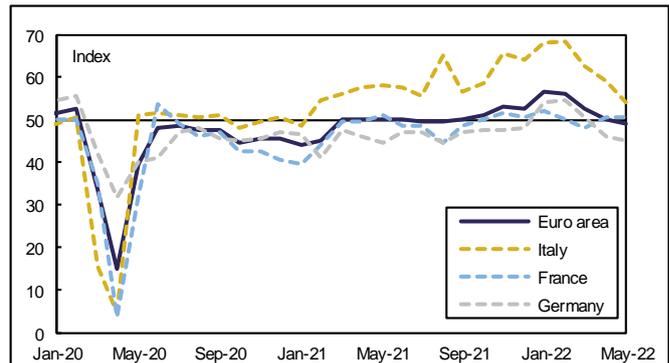
According to the BRC's latest survey, UK retail sales were very weak in May, dropping 1.1%Y/Y in nominal terms – the most since the lockdowns in January 2021 – despite high inflation on the high street. Like-for-like sales were down on a year ago for the third month running, dropping 1.5%Y/Y to be down 1.1%3MY, the biggest fall on that basis since the first Covid lockdowns in March 2020. Like-for-like food sales were down 1.3%3MY, while non-food sales were down a similar 1.0%3MY, weighed by furniture, electronics and other items that have recently seen significant price increases. While retail

Euro area: Sentix investor survey indices



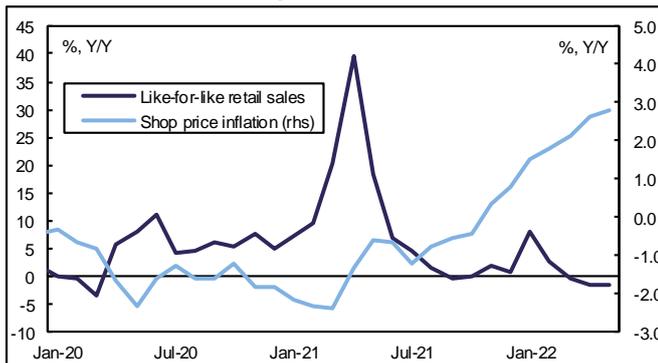
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Construction PMIs



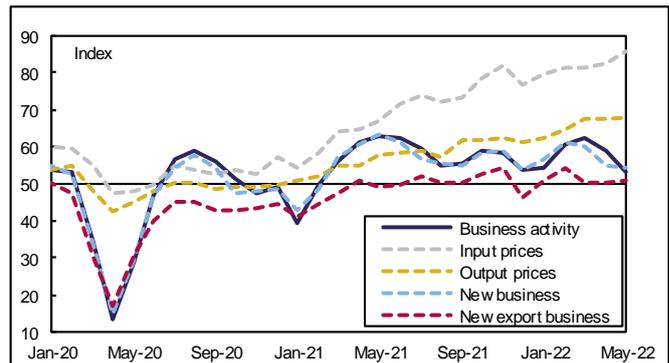
Source: S&P Global, Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: BRC retail survey indicators



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Services PMIs



Source: S&P Global, Refinitiv and Daiwa Capital Markets Europe Ltd.

footfall appears to have received a boost from the long jubilee holiday weekend, real private spending appears likely to decline over Q2 as a whole as households cut back on a range of discretionary items to make room to meet higher energy and food costs. Indeed, Barclaycard suggested that spending on its cards at restaurants and bars, as well as expenditure on digital content and subscriptions, were among the categories to register declines last month as consumers sought savings. In contrast, card spending on household utilities rose by more than one third from a year earlier. Spending on international travel was also much stronger (up almost 190% Y/Y) reflecting the easing of restrictions as the summer vacation period approaches.

Upwardly revised services PMIs suggest ongoing GDP growth in Q2

The UK's services PMIs also confirmed a loss of momentum in May, although today's final figures were significantly better than the preliminary estimates. In particular, the headline services activity PMI was revised up 1.6pts from the flash estimate to 53.4, still nevertheless the lowest since February 2021. Most of the survey detail appeared more favourable than initially suggested too, e.g. with the new business PMI revised up 1.5pts to 54.3 (albeit still a five-month low), and business expectations and employment intentions also stronger than implied by the flash estimates. Less fortunately, however, the survey measures for input costs (85.8) and output prices (67.9) were also revised up, hitting new series highs. Given the improvement in the services activity index, despite a slight downwards revision to the equivalent manufacturing PMI, the composite output PMI was revised up more than 1pt from the flash estimate to 53.1 – similarly the softest since February 2021 but nevertheless suggestive of positive economic growth in Q2.

Johnson survives but perhaps for not much longer

PM Boris Johnson survived yesterday evening's vote of no-confidence among Conservative MPs. But he has suffered a major loss of authority, raising questions about his ability to pass contentious legislation in parliament where fewer than 40 Conservative MPs can vote against measures to block them. And his future remains extremely uncertain. The winning margin, of 211 to 148, laid bare his unpopularity amongst his colleagues across the full spectrum of their political views, making clear that the lion's share of his MPs not in government positions want him to step down. Moreover, similar margins of victory in the past were followed by eventual resignations of former PMs Margaret Thatcher (very swiftly) and Theresa May (after about six months). While the circumstances in those cases were dissimilar in several ways to those affecting the current PM, and Conservative rules suggest that Johnson can now avoid challenge for twelve months, in practice Johnson remains extremely vulnerable.

Leadership rules could yet be changed to allow for a further challenge this year

In particular, Tory MPs know well that their party is increasingly unpopular, and – as illustrated by jeering at his appearances at the royal jubilee celebrations – their leader is highly and probably irredeemably so. They need no reminding of precedents that suggest that they would have a far stronger chance of surviving the next general election – due by January 2025 – if they replaced Johnson. The Conservatives are also set to take huge beatings – to Labour and the Liberal Democrats – in two contrasting by-elections on 23 June. Johnson has yet to face a cross-party inquiry by MPs into his recent misconduct and allegations that he misled Parliament. And with only part of the increase in household energy prices scheduled for October set to be offset by government support, economic conditions look set to deteriorate further before they improve. So, the pressures for Johnson's removal by his MPs will hardly go away. Credible reports suggest that, had Theresa May not resigned when she did, Conservative MPs had prepared to change the rules governing leadership challenges to force her out immediately in more humiliating circumstances. We suspect that, in the autumn, the current crop of Tory MPs might well do likewise to remove Johnson. In the meantime, of course, expect Johnson to maintain his populist policy agenda. Among other things to be watched, draft legislation will soon be published that would seek to override parts of the Northern Ireland Protocol of the Brexit Treaty, which if implemented could ultimately risk a damaging trade war with the EU. And budgetary policy seems likely to see a greater emphasis on tax cuts perhaps with less regard to fiscal sustainability, something that could ultimately lead the BoE to tighten monetary policy further than otherwise would be the case.

The day ahead in the UK

Tomorrow brings the release of the UK construction PMI survey results for May, which are expected to suggest that activity in the sector continues to hold up well despite ongoing supply-side restraints and cost pressures. The headline construction activity PMI is expected to moderate about 1.5pts from 58.2 in April to a four-month low.

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <u>Daiwa forecast</u>	Previous	Revised
Euro area	 Construction PMI	May	49.2	-	50.4	-
	 Sentix investor confidence	Jun	-15.8	-21.2	-22.6	-
Germany	 Factory orders M/M% (Y/Y%)	Apr	-2.7 (-6.2)	-0.3 (-4.1)	-4.7 (-3.1)	-2.9 (-4.2)
	 Construction PMI	May	45.4	-	46.0	-
France	 Construction PMI	May	50.9	-	50.6	-
Spain	 Industrial production M/M% (Y/Y%)	Apr	2.1 (2.4)	0.5 (-0.1)	-1.8 (0.1)	-2.0 (0.0)
UK	 BRC retail sales monitor, like-for-like sales Y/Y%	May	-1.5	-	-1.7	-
	 Final services (composite) PMI	May	53.4 (53.1)	51.8 (51.8)	58.9 (58.2)	-

Auctions

Country	Auction
UK	 sold £3.0bn of 0.25% 2025 bonds at an average yield of 1.951%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Yesterday's results

Economic data

Country	Release	Period	Actual	Market consensus/ <u>Daiwa forecast</u>	Previous	Revised
UK	 New car registrations Y/Y%	May	-20.6	-	-15.8	-

Auctions

Country	Auction
- Nothing to report -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	BST	Release	Period	Market consensus/ <u>Daiwa forecast</u>	Previous
Euro area		10.00 Final GDP Q/Q% (Y/Y%)	Q1	<u>0.3 (5.1)</u>	0.3 (4.7)
		10.00 Final employment Q/Q% (Y/Y%)	Q1	<u>0.5 (2.6)</u>	0.4 (2.1)
Germany		07.00 Industrial production M/M% (Y/Y%)	Apr	1.2 (-2.4)	-3.9 (-3.5)
France		07.45 Trade balance €bn	Apr	-	-12.4
Italy		09.00 Retail sales M/M% (Y/Y%)	Apr	0.1 (-)	-0.5 (5.6)
UK		09.30 Construction PMI	May	56.6	58.2

Auctions and events

Euro area		10.00 OECD publishes economic outlook
Germany		10.30 Auction: €4.0bn of 0% 2032 bonds
UK		10.00 Auction: £2.5bn of 1% 2032 bonds

Source: 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>.

Explanatory Document of Unregistered Credit Ratings

This report may use credit ratings assigned by rating agencies that are not registered with Japan's Financial Services Agency pursuant to Article 66, Paragraph 27 of the Financial Instruments and Exchange Act. Please review the relevant disclaimer regarding credit ratings issued by such agencies at:

<https://lzone.daiwa.co.jp/l-zone/disclaimer/creditratings.pdf>

IMPORTANT

This report is provided as a reference for making investment decisions and is not intended to be a solicitation for investment. Investment decisions should be made at your own discretion and risk. Content herein is based on information available at the time the report was prepared and may be amended or otherwise changed in the future without notice. We make no representations as to the accuracy or completeness. Opinions [and/or estimates] reflect a judgment as at the date of publication and are subject to change without notice. Daiwa Capital Markets Europe Limited retains all rights related to the content of this report, which may not be redistributed or otherwise transmitted without prior consent.