

Euro wrap-up

Overview

- Bunds made gains as euro area retail sales and German factory orders figures disappointed, while an ECB survey showed consumer inflation expectations reversing the gain recorded in March.
- Shorter-dated Gilts made losses despite a UK retail survey flagging softer sales growth, while the construction PMIs highlighted the ongoing adjustment in the housing market.
- Wednesday will bring April industrial production data from Germany and Ireland.

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Daily bond market movements

| Bond | Yield | Change |
|---------------|-------|--------|
| BKO 2.8 12/25 | 2.815 | -0.047 |
| OBL 2.2 04/28 | 2.374 | -0.022 |
| DBR 2.3 02/33 | 2.363 | -0.011 |
| UKT 0% 06/25 | 4.472 | +0.030 |
| UKT 1% 10/28 | 4.179 | +0.013 |
| UKT 3% 01/33 | 4.204 | -0.001 |

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

Source: Bloomberg

Euro area

Euro area retail sales dampened by higher food prices

Despite the gradual improvement in consumer confidence over recent months, today's retail sales data suggested that, with purchasing power eroded by higher prices and increased borrowing costs, household consumption of goods remained lacklustre at the start of Q2. In particular, sales volumes merely moved sideways in April at the second-lowest level of the past two years. So, while the decline in March was smaller than previously estimated (-0.4%M/M), sales were still down 0.4%3M/3M and 2.6%Y/Y and just 1½% above the pre-pandemic level in February 2020. Among the larger member states to have reported figures, the weakness was most striking in France, where sales fell 1.3%M/M to the lowest level since May 2021. And while sales rose in Germany (0.8%M/M), this growth failed to reverse the decline in March to leave the level of sales merely in line with the Q1 average. The impact of higher prices was most apparent on food sales for which volumes fell 0.5%M/M (-4.6%Y/Y) in April even as the value maintained an upwards trend (0.3%M/M, 8.6%Y/Y). While auto fuel sales volumes fell to a thirteen-month low, sales of core items (0.5%M/M) were boosted by a jump in online and mail orders. Nevertheless, this still left core sales merely flat compared with Q1. While this is suggestive of subdued consumer spending at the start of Q2, expenditure on services should have provided some support to offset the continued sluggish demand for goods.

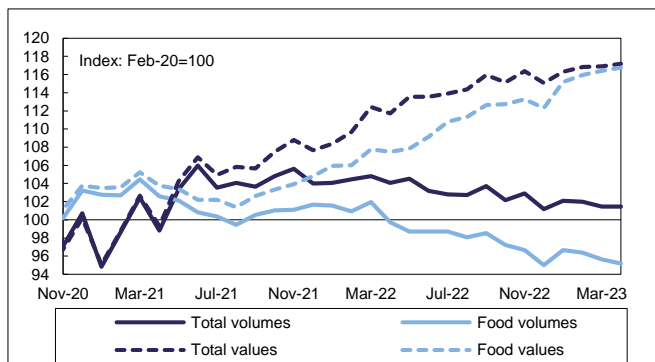
Euro area inflation expectations for the year ahead fall significantly

Today's ECB monthly consumer expectations survey suggested that households are still anticipating nominal income growth to remain very subdued over the coming twelve months (median forecast of just 0.1%Y/Y). Moreover, they revised down expectations for spending twelve months ahead (by ½ppt to 2.5%Y/Y). Given the inflation outlook, this would mean that in real terms growth in household income and spending would remain negative. Today's survey was nevertheless more encouraging with respect to consumer inflation expectations. In particular, households' median forecast for inflation over the next twelve months fell significantly in April, by 0.9ppt to 4.1%Y/Y, more than reversing the rise in March, to reach its lowest rate since February 2022. Households' median inflation expectation for three years' ahead also reversed much of March's increase, down 0.4ppt to 2.5%Y/Y, albeit likely still too high for comfort for the hawks on the Governing Council.

German factory orders disappoint in April, falling to lowest level since June 2020

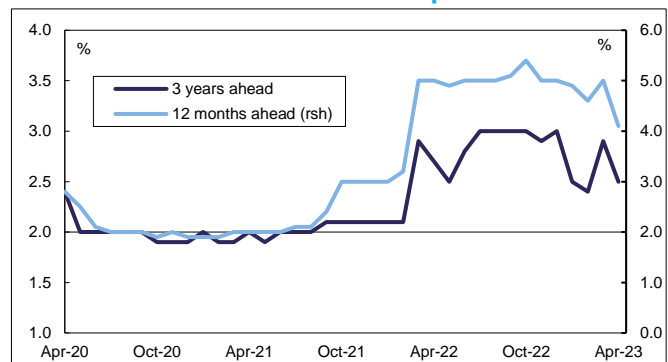
Following the contraction in GDP in Q1, and in particular the marked retrenchment in indicators of activity at the end of the quarter, recent data raise concerns about the direction of momentum in Germany's economy in Q2 too. Certainly, the main message from today's factory orders figures was downbeat, suggesting an ongoing steady adjustment in the manufacturing

Euro area: Retail sales



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Consumer inflation expectations*



*Median forecast. Source: ECB and Daiwa Capital Markets Europe Ltd.

sector. Contrasting with an expected bounce following the double-digit percentage drop in March, total orders fell again in April, albeit by a more modest 0.4%M/M. This left orders down 10%Y/Y and more than 21% below the pandemic peak at their lowest level since June 2020. Admittedly, the weakness was again driven by another slump in new major orders in the 'other vehicle construction' sub-sector (ships, railway, aircrafts, spacecrafts and army vehicles), with a decline of 34%M/M following a drop of 47%M/M in March, amid a further slump in overseas demand. New orders of machinery and equipment also fell (6.2%M/M) to the lowest level since September 2020, to be some 33% below the pandemic peak, with weaker demand at home and abroad. And while there was positive growth in orders in the autos sector (2.4%M/M) this reversed only a fraction of the drop in March to remain at the second-lowest level in almost three years and roughly 8% below the Q1 average. When excluding major items, orders actually rose 1.4%M/M in April, with domestic orders up 0.6%M/M and overseas orders up 1.9%M/M. Nevertheless, given the weakness in March, this still left core orders some 4% below the Q1 average, with total orders down more than 6½% on the same basis.

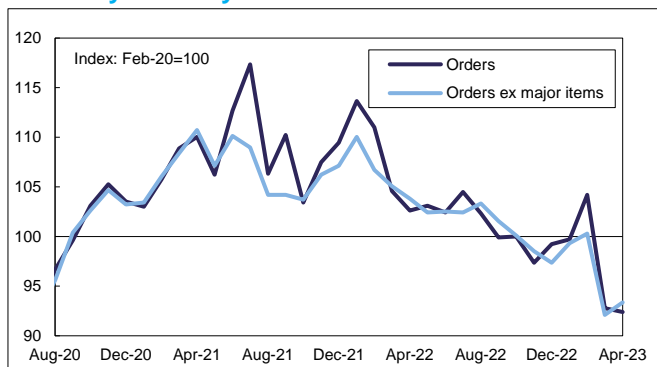
German manufacturing turnover suggests another fall in production in April

While pandemic-related backlogs and easing of supply bottlenecks should continue to support production despite the weakness in new orders, today's figures, like the recent ifo and PMI surveys, point to a lacklustre manufacturing outlook. Moreover, ahead of tomorrow's industrial production release, today's manufacturing turnover numbers suggested a further weakening in activity in the sector at the start of Q2, falling 1.1%M/M in April to the lowest level in eleven months and more than 2% below the Q1 average. Spanish industrial production fell back in April too, with output down a larger-than-expected 2.3%M/M and manufacturing down a steeper 2.9%M/M. This left total Spanish industrial output down 0.9%Y/Y and some 1% below the Q1 average.

Construction PMIs flag notable weakness in housing activity

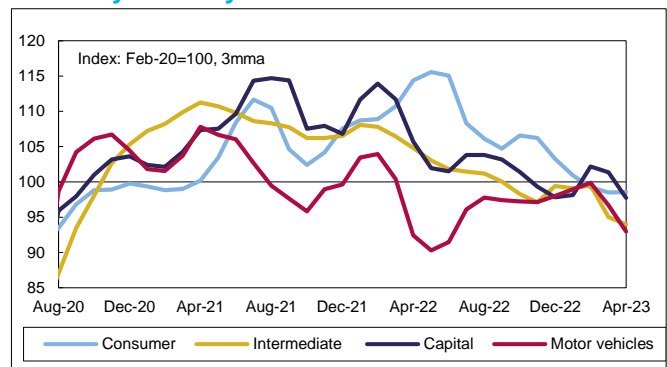
Today's construction PMIs suggested ongoing challenges across the euro area in that sector too. While this survey suggested that supply chains improved for the first time since August 2012, the euro area construction activity index fell 0.6pt to 44.6 in May signaling the steepest contraction in the year to date. With demand for housing loans having fallen significantly since last summer when the ECB embarked on its tightening cycle, the survey's housing component (41.7) again signalled the steepest contraction. Commercial activity (44.9) also fell by the most in five months, while new orders maintained a steady decline, with the index (40.6) the second-weakest since the onset of the pandemic. According to the PMIs, French construction was the weakest in May (42.6), although the German (43.9) and Italian indices (47.9) were also consistent with contraction.

Germany: Factory orders



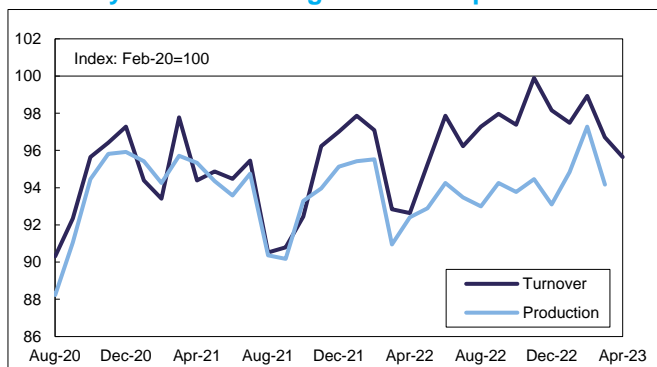
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: Factory orders



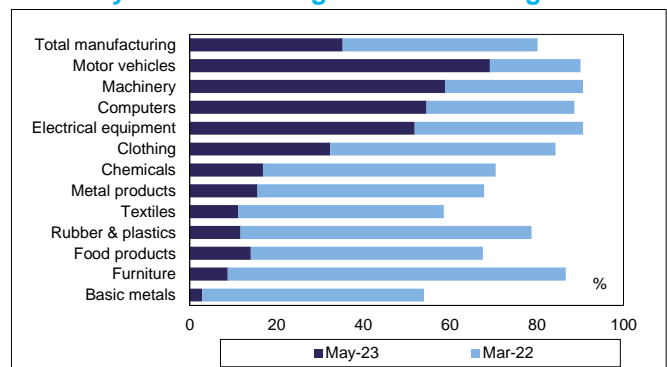
Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Germany: Manufacturing turnover & production



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: Manufacturing material shortages*



*Share of firms reporting shortage of intermediate products. Source: ifo and Daiwa Capital Markets Europe Ltd.

The day ahead in the euro area

Wednesday will bring the aforementioned release of German industrial production data for April. With the PMIs having implied ongoing contraction at the start of Q2, new orders having slumped and today's turnover data maintaining a downwards trend, we see downside risks to the Bloomberg survey consensus forecast for an increase of around ½%M/M. Also due are the Irish production numbers, which are highly volatile and tend to have a non-negligible influence on the aggregate euro area figure. In addition, tomorrow will bring Spanish home price data for Q1.

UK

Retail sales monitor suggests challenging conditions on the High Street in May

Consistent with the downbeat tone of the CBI distributive trades survey, the BRC retail sales monitor suggested that conditions remained challenging on the High Street in May. According to the survey, nominal retail sales growth slowed to its lowest in seven months, by 1.2ppt to 3.9%Y/Y, while like-for-like sales eased to 3.7%Y/Y, both well below the BRC's measure of overall shop price inflation, which rose to 9.0%Y/Y. Boosted by the additional bank holiday, the value of food sales remained relatively strong in May at 9.6%3M/Y. But when adjusting for food inflation – which measured by the BRC shop price survey stood at 15.4%Y/Y in May – food sales were still well down compared with a year earlier. Meanwhile, growth in discretionary spending (0.7%3M/Y in nominal terms) continued to moderate as households' purchasing power continued to be eroded by high prices.

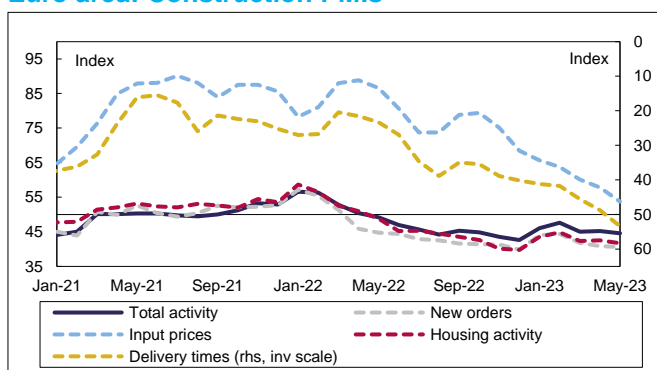
Pickup in construction activity PMI masks ongoing weakness in housing activity

Contrasting with the euro area, today's UK construction PMI was a touch more upbeat, with the headline activity index rising 0.5pt to 51.6, a three-month high. Admittedly, it remained well below the average seen through 2021 and first half of 2022 (57.2). Moreover, the ongoing expansion was underpinned by commercial activity and civil engineering. In marked contrast, the survey's housing component fell for the seventh month out of the past eight, to 42.7, the lowest since the global financial crisis when excluding the initial slump at the start of the pandemic as rising borrowing costs continued to dampen demand. Despite weakness in the residential sector, the survey suggested that new orders rose at the strongest pace for more than a year. This notwithstanding, optimism about the outlook for the coming year fell to a four-month low in May. With supply constraints moderating further, firms signalled a significant easing in cost pressures too, with the input price PMI falling 5.9pts to 57.7, the lowest for three years and back below the pre-pandemic average.

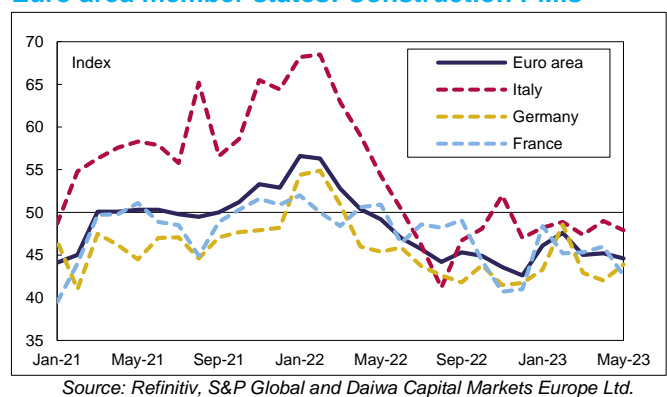
The day ahead in the UK

It should be a relatively quiet day ahead for UK economic news on Wednesday with no top-tier data due for release.

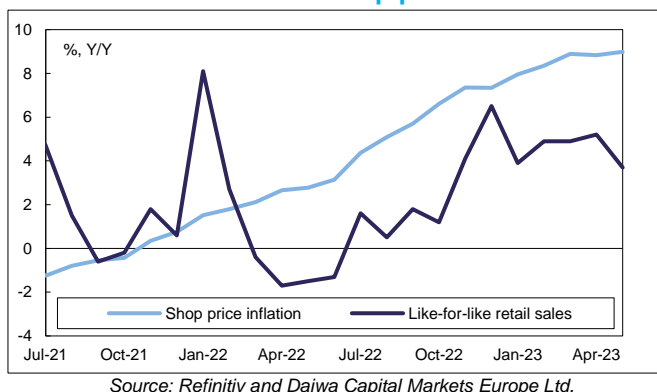
Euro area: Construction PMIs



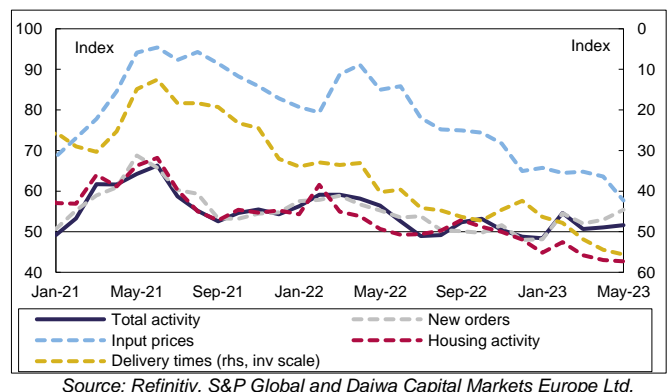
Euro area member states: Construction PMIs



UK: BRC retail sales and shop prices












UK: Construction PMIs






European calendar

Today's results

Economic data

| Country | Release | Period | Actual | Market consensus/ <i>Daiwa forecast</i> | Previous | Revised |
|-----------|--|--------|-------------|--|---------------|---------------|
| Euro area |  Construction PMI | May | 44.6 | - | 45.2 | - |
| |  Retail sales M/M% (Y/Y%) | Apr | 0.0 (-2.6) | 0.2 (-3.0) | -1.2 (-3.8) | -0.4 (-3.3) |
| Germany |  Factory orders M/M% (Y/Y%) | Apr | -0.4 (-9.9) | 2.8 (-8.6) | -10.7 (-11.0) | -10.9 (-11.2) |
| |  Construction PMI | May | 43.9 | - | 42.0 | - |
| France |  Construction PMI | May | 42.6 | - | 46.0 | - |
| Italy |  Construction PMI | May | 47.9 | - | 49.0 | - |
| Spain |  Industrial production M/M% (Y/Y%) | Apr | -1.8 (-0.9) | -0.5 (1.9) | 1.5 (4.5) | 1.3 (4.1) |
| UK |  BRC retail sales monitor, like-for-like sales Y/Y% | May | 3.7 | 5.2 | 5.2 | - |
| |  Construction PMI | May | 51.6 | 50.8 | 51.1 | - |





Auctions

| Country | Auction |
|---------|---|
| Germany |  sold €275mn of 0.1% 2033 index-linked bonds at an average yield of 0.00% |
| |  sold €185mn of 0.1% 2046 index-linked bonds at an average yield of -0.05% |
| UK |  sold £2.5bn of 3.75% 2053 bonds at an average yield of 4.478% |





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%) | Apr | 0.6 (1.5) | -3.4 (1.8) |
| France |  07.45 | Trade balance €bn | Apr | -7.7 | -8.0 |
| Italy |  09.00 | Retail sales M/M% (Y/Y%) | Apr | - | 0.0 (5.8) |
| Spain |  08.00 | House price index Q/Q% (Y/Y%) | Q1 | - | -0.8 (5.5) |

Auctions and events

| | | |
|-----------|---|--------------------------------------|
| Euro area |  08.50 | ECB's de Guindos scheduled to speak |
| |  10.10 | ECB's Panetta scheduled to speak |
| Germany |  10.30 | Auction: €1bn of 0% 2025 green bonds |
| UK |  10.00 | Auction: £4bn of 3.5% 2025 bonds |

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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