Euro wrap-up

Overview

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- Bunds followed USTs lower as growth in German factory orders beat expectations but euro area retail sales merely moved sideways and the construction PMIs pointed to persisting contraction.
- Gilts also made significant losses as a BoE survey suggested that businesses upwardly revised their medium-term inflation expectations and also forecast wage growth to remain elevated over the coming year.
- Friday will bring German industrial production data for May.

Daily bond market movements

Bond	Yield	Change
BKO 2.8 06/25	3.284	+0.075
OBL 2.4 10/28	2.747	+0.148
DBR 2.3 02/33	2.622	+0.150
UKT 0⅝ 06/25	5.507	+0.112
UKT 1⅝ 10/28	4.904	+0.120
UKT 3¼ 01/33	4.649	+0.155

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

Euro area

Euro area retail sales fail to grow for a fourth consecutive month

Despite the gradual improvement in consumer confidence over recent quarters, households' willingness to make major purchases of goods has remained low as real disposable incomes continue to be squeezed by inflation. Indeed, despite a second successive month of growth in Germany, today's figures suggested that euro area retail sales volumes merely moved sideways in May, having last increased in January. While this left sales still some 1½% above the pre-pandemic level, they were down 2.7%Y/Y and more than 4% below the pandemic peak in June 2021. Moreover, in the first two months of Q2, sales volumes were trending some 0.3% below the Q1 average raising the probability of a sixth successive quarterly decline. Admittedly, core sales (excluding food and fuel) rose marginally in May for a second successive month (0.1%M/M), but were nevertheless also trending slightly below the Q1 average. But auto fuel sales fell (-0.3%M/M) to the lowest level since January 2022. And food, drinks and tobacco sales fell for a fourth consecutive month (-0.5%M/M) to be trending more than 1% below the Q1 average and down 3.8%Y/Y as inflation of these components remained historically high. Indeed, illustrating the price effect, the value of food sales continued to trend higher in May, to be up more than 8%Y/Y. And the value of total sales also rose again to be up 3.5%Y/Y. While some of the persisting weakness in retail sales volumes will probably be offset by higher spending on services, today's release suggests that the recovery in household consumption remains relatively lacklustre.

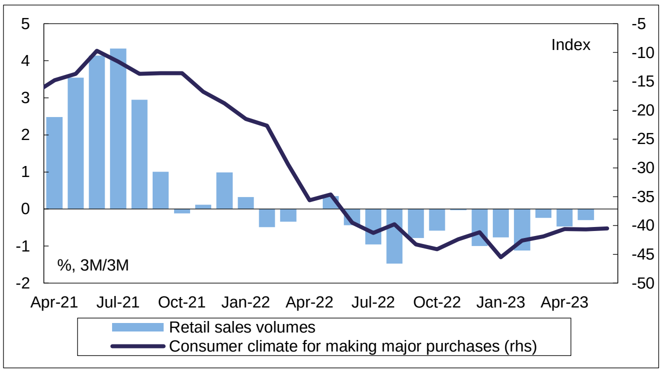
German factory orders rebound further than expected in May

Germany's new factory orders data for May beat expectations with growth of 6.4%M/M more than 5ppts above the median forecast on the Bloomberg survey. New demand from at home and abroad both grew in excess of 6.0%M/M, with new orders from within and outside of the euro area alike also up at a similar pace. In addition, growth in orders in April was revised up, by 0.6ppt, to show modest expansion that month (0.2%M/M). Nevertheless, new orders were still down a substantive 4.3%Y/Y and 1.1% below the pre-pandemic level in February 2020. And given the steep fall in March (-10.9%M/M), the average level for the first two months of Q2 was still 3.0% below that of Q1, strongly suggesting that new factory orders contracted significantly over the second quarter as a whole.

Orders still on track for drop in Q2 in all major components

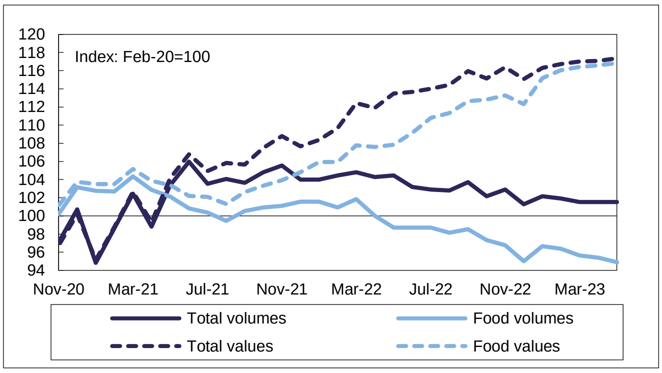
Demand in May was led by autos, for which new orders rose 8.6%M/M, and other transport equipment (including rail, ships, air and spacecraft), which more than doubled thanks to new bulk orders. So, while the electrical equipment component fell

Euro area: Retail sales & consumer confidence



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

Euro area: Retail sales



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

sharply again, capital goods orders overall leapt 12.0%M/M. In the energy-intensive subsectors, there was also some better news, with orders for chemicals up 4.8%M/M and those for basic metals up 6.3%M/M. But new demand for intermediate items (-1.1%M/M) and consumer goods (-0.8%M/M) fell. And, overall, looking through the monthly volatility, all major components with the exception of ICT goods remained on track to fall over the second quarter, tallying with recent surveys that point to a soft near-term outlook for German factory output. However, with manufacturing turnover in May also beating expectations, rising 2.7%M/M following upwardly revised growth of 0.2%M/M the prior month, tomorrow's industrial production data now seem likely to beat the median forecast on the Bloomberg survey (0.0%M/M) despite the likelihood of a weak showing for construction.

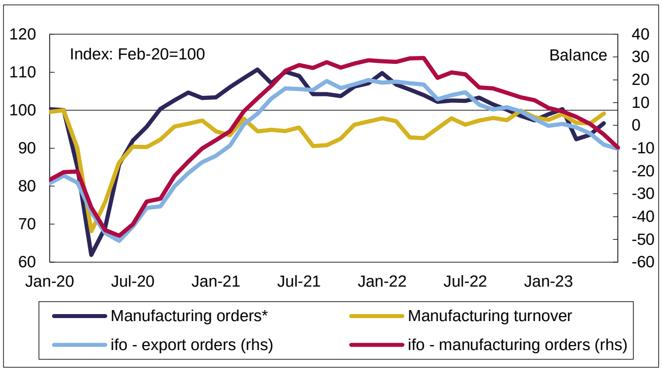
PMIs flag hit to construction sector from tighter monetary policy

Indeed, the steady deterioration of conditions in the German construction sector was flagged in today's June PMIs for that sector. The German construction activity PMI dropped 2.5pts to just 41.4, the lowest since February 2021, to suggest significant contraction. And with the equivalent indices for France (43.7) and Italy (48.6) also still suggestive of a drop in activity, albeit a little firmer on the month, the euro area construction activity PMI fell 0.4pt to 44.2, the lowest level for the year so far. At the sectoral level in the region as a whole, the indices for commercial (unchanged at a five-month low of 44.9) and civil engineering activity (up slightly to 46.0) remained soft. But the weakness was most pronounced in housing, for which the respective index fell 1.5pts to 40.2, close to the bottom of the range since the first wave of Covid-19. That tallies with the inevitable deterioration in conditions in the residential property market in response to rapid monetary tightening and squeezed household real incomes. Indeed, data published yesterday reported a further decline in euro area house prices in Q1 of 0.9%Q/Q following the steep drop of 1.7%Q/Q in Q4. While that left prices still up 0.4%Y/Y, they dropped in several countries including Germany, France, the Netherlands, and Austria, with further declines likely to come. Perhaps unsurprisingly, therefore, the PMIs suggest that new construction orders also fell again last month. And notably perhaps, building firms reportedly cut employment too. In tandem with softer activity and new demand, supplier delivery times shortened too. And more happily, input cost pressures eased to the lowest since 2016.

The day ahead in the euro area

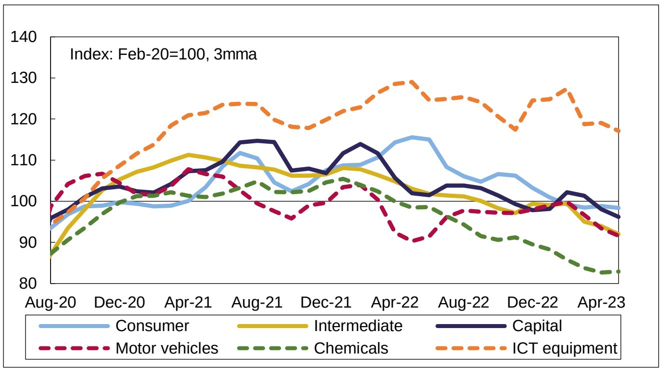
Friday will bring the aforementioned German industrial production data for May. The increase in factory turnover reported today (2.7%M/M) points to a firm pickup in manufacturing output, which rose just 0.1%M/M in April after a steep drop of 2.0%M/M in March. Energy output is also likely to post positive growth following three successive monthly declines. However, construction probably fell in May after the rise of 2.0%M/M in April. Nevertheless, overall, we see significant upside risks to the median forecast on the Bloomberg survey (0.0%M/M).

Germany: Manufacturing orders & turnover



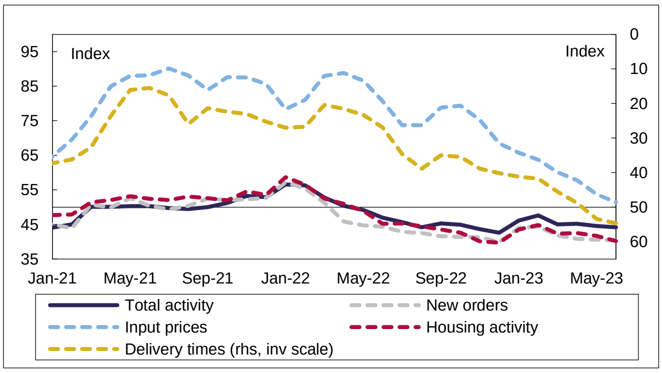
*Excluding major orders.
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: Manufacturing orders



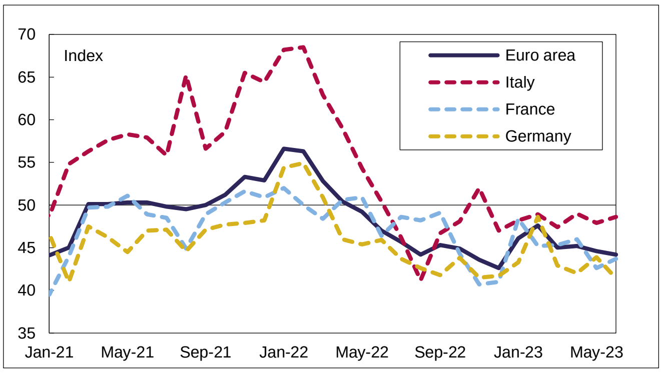
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Construction PMIs



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

Euro area member states: Construction PMIs



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

UK

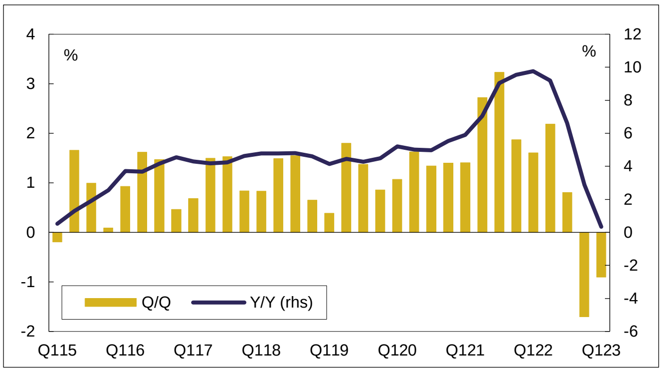
Firms expect own price increases to ease, but nudge up medium term CPI expectations

Having increased Bank Rate by a larger 50bps in June to 5.00%, the MPC left the door open for further tightening ahead amid concerns of persisting inflation pressures. And while BoE Governor Bailey last week noted that future decisions will be evidence-driven, the market-implied path for Bank Rate has shifted significantly higher over recent days, suggesting at least 150bps of additional tightening this cycle to a terminal rate of 6½% or more. While there doesn't appear to have been a specific trigger for this substantial shift, the latest results from the BoE's Decision Maker Panel survey published today nevertheless supported the case for rates to continue to rise, and perhaps by 25bps apiece at each of the remaining four meetings this year. Admittedly, the Bank's survey suggested that firms' expectations for their own output prices over the coming year moderated further in June, by 0.3ppt to 4.9%Y/Y, the lowest rate since February 2022 and some 1.8ppts below the peak last July. And almost a third of businesses cited downwards pressure from competitor prices as the most important factor. Business expectations for consumer price inflation in one year's time also moderated slightly, by 0.2ppt to 5.7%Y/Y, to be almost 2ppts below September's peak. But expectations of CPI inflation three years ahead picked up in June, to a five-month high of 3.7%Y/Y. Moreover, expected wage growth over the coming year remained elevated despite easing slightly in June to 5.3%Y/Y, still well above levels that would be consistent with achievement of the MPC's 2% inflation target over the medium term.

Construction PMI signals significant contraction in residential work

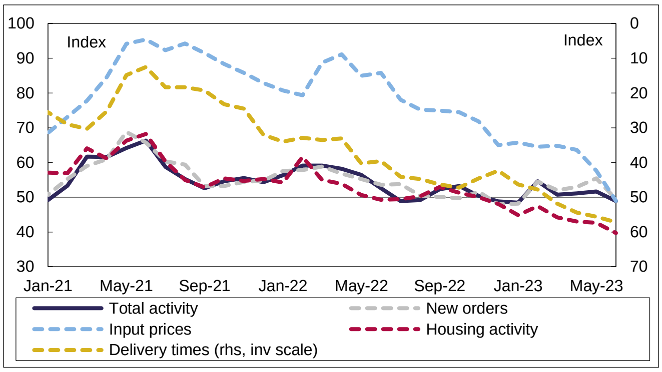
While yesterday's services PMIs implied ongoing expansion in the sector, albeit at a less vigorous pace, at the end of Q2, today's construction survey suggested that, like in manufacturing, activity went into reverse in June as tighter monetary policy took a greater toll on the most rate-sensitive sectors of the economy. In particular, the headline activity index fell 2.7pts to 48.9, a five-month low and more than 5½pts below February's peak. The downturn was unsurprisingly led by a further sharp decline in residential work, with the respective survey component down 3pts to 39.6, the lowest since the initial pandemic slump more than three years ago and the global financial crisis before that, and some 29pts below the pandemic peak two years ago. But amid rising borrowing costs and a weak outlook for the housing market, the survey also suggested a notable deterioration in new orders. And so, in a bid to run down some inventories, construction firms also cut back on purchases of materials for the first time in five months. Taken with easing supply-chain disruption, supplier delivery times reportedly improved by the most in fourteen years. Against this backdrop and with sub-contractor charges increasing at the slowest pace for 31 months, cost burdens in the sector improved markedly further in June, with the respective index implying the first outright decline since January 2010.

Euro area: House prices



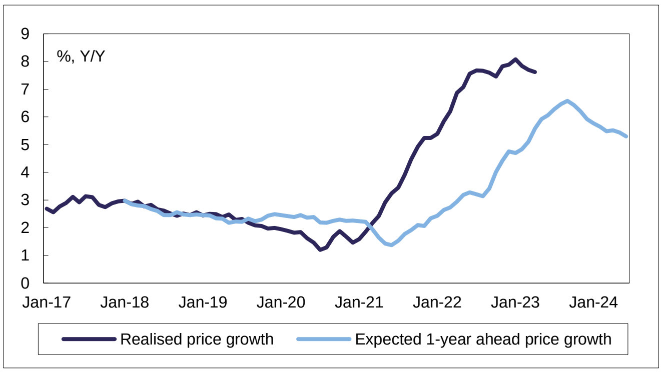
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Construction PMIs



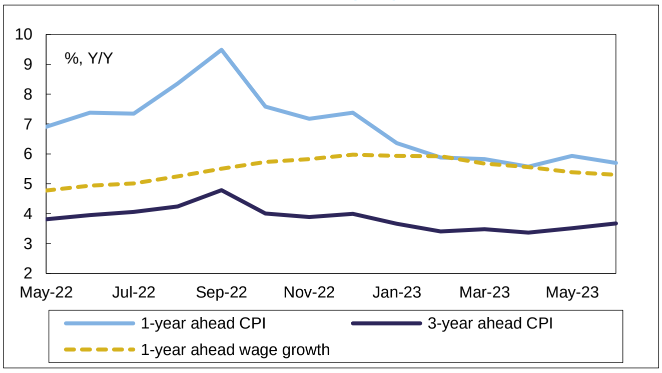
Source: Refinitiv, S&P Global and Daiwa Capital Markets Europe Ltd.

UK: Firms' output price expectations



Source: BoE DMP survey and Daiwa Capital Markets Europe Ltd.

UK: Firms' inflation and wage growth expectations



Source: BoE DMP survey and Daiwa Capital Markets Europe Ltd.

Daiwa Capital Markets

The day ahead in the UK

A quiet end to the week for UK economic data will bring just updated productivity figures for Q1. GDP growth was weak (just 0.2%Y/Y) but employment growth was relatively firm. As a result, according to the current estimate, total output per hour worked fell 0.6%Y/Y, illustrating the weakness in productivity that is contributing to the persistence of inflation despite sluggish economic activity.

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area	Construction PMI	Jun	**44.2**	-	44.6	-
	Retail sales M/M% (Y/Y%)	May	**0.0 (-2.9)**	0.2 (-2.7)	0.0 (-2.6)	**- (-2.9)**
Germany	Factory orders M/M% (Y/Y%)	May	**6.4 (-4.3)**	1.2 (-9.3)	-0.4 (-9.9)	**0.2 (-9.3)**
	Construction PMI	Jun	**41.4**	-	43.9	-
France	Construction PMI	Jun	**43.7**	-	42.6	-
Italy	Construction PMI	Jun	**48.6**	-	47.9	-
UK	Construction PMI	Jun	**48.9**	51.0	51.6	-

Auctions

Country	Auction
France	sold €5.95bn of 3.00% 2033 bonds at an average yield of 3.04%
	sold €2.62bn of 2.50% 2043 bonds at an average yield of 3.35%
	sold €2.70bn of 3.00% 2054 bonds at an average yield of 3.37%
Spain	sold €2.13bn of 0.80% 2029 bonds at an average yield of 3.33%
	sold €2.79bn of 3.55% 2033 bonds at an average yield of 3.554%
	sold €1.59bn of 1.45% 2071 bonds at an average yield of 3.874%
	sold €526mn of 0.65% 2027 index-linked bonds at an average yield of 1.092%

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	Industrial production M/M% (Y/Y%)	May	0.0 (0.5)	0.3 (1.6)
France	07.45	Trade balance €bn	May	-	-9.7
Italy	09.00	Retail sales M/M% (Y/Y%)	May	-	0.2 (3.2)

Auctions and events

Country	BST	Event
Euro area	09.30	ECB's de Guindos scheduled to speak
	17.45	ECB President Lagarde scheduled to speak
UK	15.30	BoE's Mann scheduled to speak

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:
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