# Euro wrap-up

## Overview

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- Despite some soft German industrial production data, Bunds followed USTs sharply lower as Q1 data confirmed a pickup in growth of euro area employee compensation but also lower unit profits.
- Gilts also made notable losses in the wake of strong US payroll data.
- The coming week will bring new data on UK GDP, unemployment and wages as well as euro area industrial production and goods trade.

**Daily bond market movements**

| Bond | Yield | Change |
|---|---|---|
| BKO 2.9 06/26 | 3.083 | +0.071 |
| OBL 2.1 04/29 | 2.681 | +0.077 |
| DBR 2.2 02/34 | 2.616 | +0.069 |
| UKT 0⅛ 01/26 | 4.340 | +0.053 |
| UKT 0½ 01/29 | 4.138 | +0.077 |
| UKT 4⅝ 01/34 | 4.258 | +0.086 |

*Change from close as at 4:15pm BST.
Source: Bloomberg

# Euro area

### German IP contracts on weaker construction, but manufacturing output up to a six-month high

Contrasting the accelerated recovery momentum signalled in various indicators – including the PMIs, ifo indices and truck toll mileage – today's industrial production figures suggested a soft start to German economic activity second quarter. In particular, industrial output fell for a second successive month in April, by 0.2%M/M, to leave it down some 3.9%Y/Y and still a whopping 9½% below the pre-pandemic benchmark in February 2020. But this merely left the level of production unchanged from the Q1 average. Moreover, the weakness was fairly predictable, reflecting a further decline in construction activity (-2.1%M/M), which fell for a second successive month as payback for exceptionally strong growth earlier in the year related to unseasonably mild weather. Meanwhile, energy production (1.6%M/M) rose for the first month in four in April. And contrasting markedly with the decline in yesterday's turnover numbers, manufacturing output increased for the third month out of the past four, by 0.3%M/M in April, to its highest level in six months and some 0.6% above the Q1 average

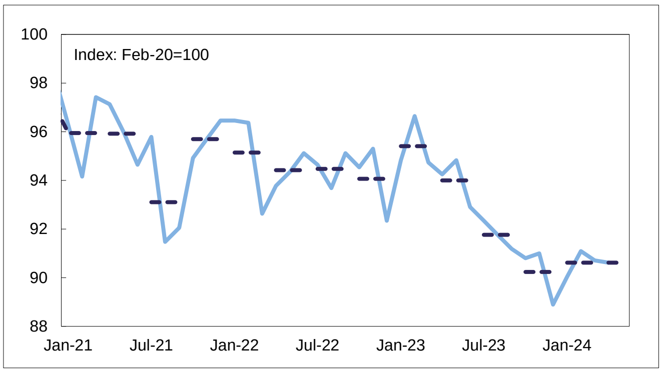
### Car production accelerated to 8-month high, offsetting a drop in machinery and chemicals output

Within the manufacturing detail, growth was driven by another strong month for autos production, which rose more than 4%M/M to an eight-month high. Other transport equipment production slipped back at the start of Q2, although this left the level relatively elevated and unchanged from the Q1 average. Output of computer, electronic & optical products also rose to a six-month high. So, while machinery and equipment production fell to its weakest level since October 2020, production of capital goods was some 1.3% above the Q1 average. And reflecting expectations of increased private consumption, output of consumer goods – led by food – rose for a third month out of four to be almost ½% above the Q1 average. But perhaps unsurprisingly given the strong rebound in Q1 and the recent rise in wholesale gas prices, activity in the energy-intensive chemicals subsector fell back in April (-1.8%M/M) albeit leaving overall production of intermediate goods just ½% lower than the Q1 average.

### German GDP in Q2 to be boosted by manufacturing and services

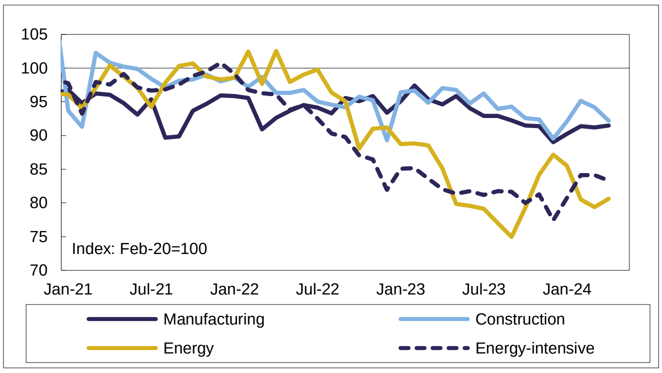
While the decline in truck toll mileage in May (-1.0%M/M) and drop in new factory orders – to the lowest level since the first pandemic-related lockdown – raises some uncertainties about the near-term production outlook, we continue to expect manufacturing to remain supportive to German GDP growth this quarter. Certainly, the weakness in orders at the start of the Q2 in part reflected payback for a pick up in one-off bulk items earlier in the year. And while order backlogs are down some 8% from the peak in mid-2022, they still remain some 20% above the pre-pandemic level and particularly elevated in the electronics and electrical equipment subsectors. Furthermore, the manufacturing output PMI jumped 3½pts in May (48.9),

**Germany: Industrial production***




*Dashed dark blue line represetns quarterly average. Source: Macrobond and Daiwa Capital Markets Europe Ltd.*

**Germany: Industrial production**




*Source: Macrobond and Daiwa Capital Markets Europe Ltd.*

while the ifo manufacturing expectations index was similarly the best in 13 months. And the survey detail suggested an improvement in production expectations in a range of sub-sectors including chemicals, transport equipment (excluding autos), electrical equipment and food and beverages. So, we maintain our view that manufacturing will provide a boost to GDP in Q2 for a second successive quarter, offsetting a likely modest drag from construction. But like in Q1, we expect services to provide the strongest contribution. Indeed, data published today showed that services activity rose 0.9%M/M in March to be some 3% above the level a year ago, implying a positive carry over into this quarter. Moreover, the services PMI in May (54.3) reported the strongest growth in a year. So, consistent with the latest assessment by the Bundesbank, figures so far suggest that German GDP might match the 0.2%Q/Q expansion recorded in Q1.

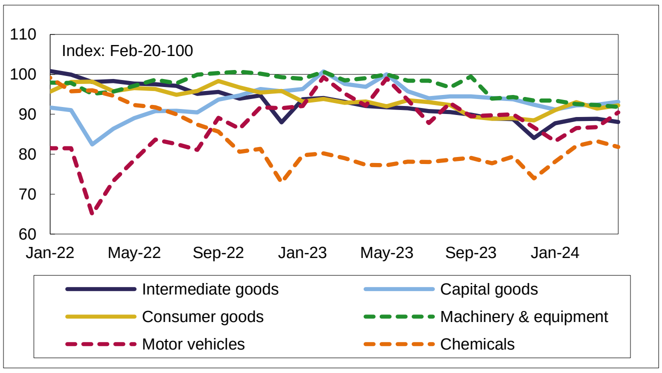
## Q1 GDP growth led by private consumption & trade, but figures distorted by MNE activities

Today's updated estimate of euro area Q1 GDP confirmed growth of 0.3%Q/Q, which was stronger than had originally been expected by the ECB and analysts alike. The pickup in growth followed five quarters of effective stagnation as the region struggled in the face of the record energy price shock, broad-based inflation pressures and rapid ECB tightening. The expenditure detail, published today for the first time, confirmed a fourth successive quarterly increase in household consumption, up 0.2%Q/Q on the back of firm growth in real incomes. The other source of growth in Q1 was net trade, which added a whopping 0.9ppt to GDP growth. Goods trade was relatively steady, with growth in export volumes (0.6%Q/Q) slightly outpacing that of imports (0.4%Q/Q). But services trade was significantly distorted by the activities of large multinational enterprises (MNEs) based in Ireland for tax purposes, with exports surging 3.2%Q/Q, the most since Q321, and imports plunging 2.3%Q/Q, the most since Q122. The activities of large Ireland-based MNEs also distorted the data for fixed investment, which fell in Q1 by the most in three years, 1.5%Q/Q, with the decline in Ireland exceeding 40%Q/Q. In particular, having surged 9.7%Q/Q in Q4, investment in intellectual property reversed in Q1 by 9.0%Q/Q, also the most since Q121. That more than fully offset the weather-assisted boost from construction investment (1.1%Q/Q) and, despite weakness in the transport component, machinery and equipment (0.3%Q/Q). Meanwhile, government consumption (0.0%Q/Q) failed to grow for the first time in a year. But for a third successive quarter, stock-building subtracted from growth (-0.3ppt) as firms sought better to align inventories with orders.

## GDP growth should remain steady as Irish distortions reverse

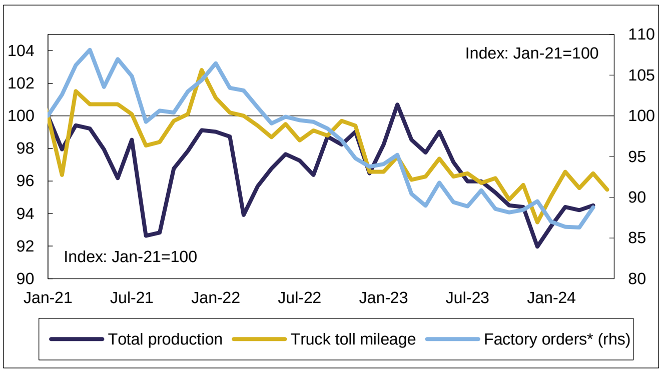
With real incomes stronger, we expect household spending to make another positive contribution to GDP growth in Q2 while government consumption will return to growth and stocks should be less of a drag. In addition, the distortions to fixed investment and imports from Irish-based MNE activities should diminish, so that capex makes a positive contribution but net trade subtracts from growth. Overall, with survey indicators also broadly encouraging, we now think that euro area GDP

### Germany: Manufacturing output



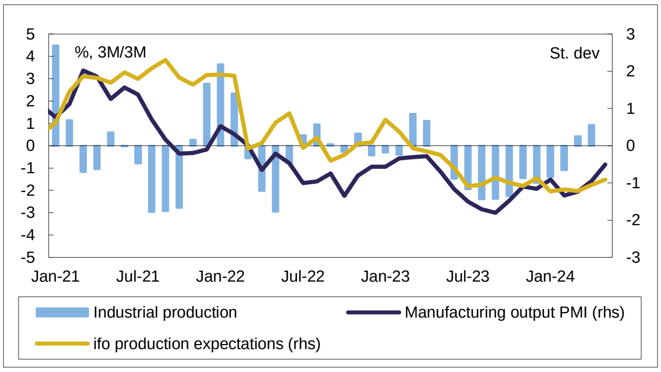

*Source: Macrobond and Daiwa Capital Markets Europe Ltd.*

### Germany: Production, orders & truck toll mileage



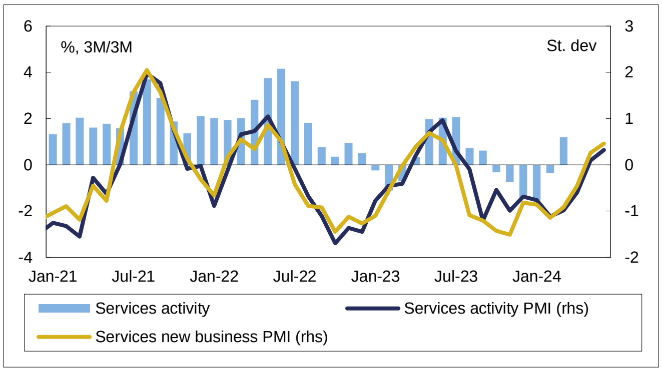

**Excluding major orders. Source: Macrobond and Daiwa Capital Markets Europe Ltd.*

### Germany: Production & sentiment indices




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

### Germany: Services activity & sentiment indices*



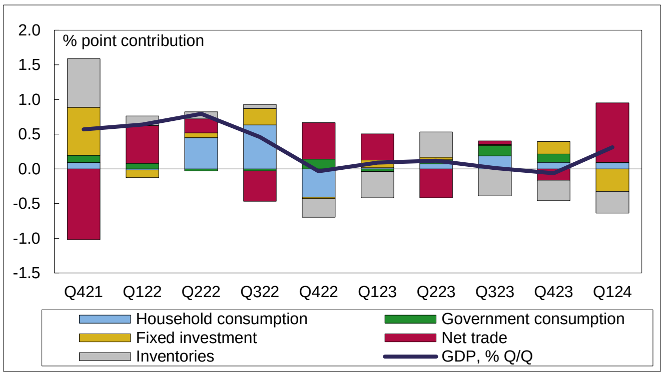

**PMI indices have a one-month lead. Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.*

should increase at roughly the same 0.3%Q/Q rate in each quarter this year. That, however, is 0.1ppt per quarter below the ECB's latest projection presented yesterday.

## Impact on inflation of strong unit labour cost growth reduced by squeezed margins

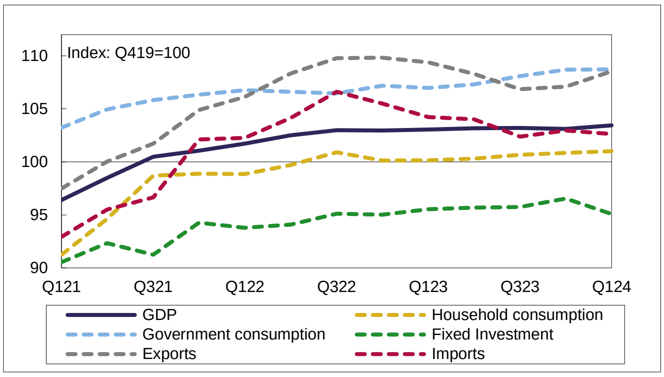
Given the concerns of the ECB's hawks about strong wage growth and its impact on inflation persistence in services, arguably most focus in today's national accounts data for Q1 was on the figures related to labour costs and profits. Employment growth was steady in Q1 at 0.3%Q/Q, the same rate as Q4. But that left the annual rate down 0.2ppt at 1.0%Y/Y, the softest in three years. Labour productivity stabilised from Q4 to be down on a per person basis 0.6%Y/Y and per hour worked by 0.3%Y/Y, the softest rate of decline since Q322. As wage settlements sought to catch up with past high inflation, growth in compensation per employee edged up 0.1ppt from an upwardly revised rate in Q4 to 5.0%Y/Y. While clearly above levels that might be considered consistent with the achievement of the 2.0% inflation target over the medium term, that rate was down 0.3ppt from a year earlier. It was also fully in line with the ECB's latest projection, which foresees a steady moderation in growth in employee compensation to 3.5%Y/Y in two years' time and 3.0%Y/Y at the end of the forecast horizon. Moreover, while growth in unit labour costs per hour worked therefore edged back up to 5.9%Y/Y, that was still 0.7ppt below the recent peak in Q3. And the impact on inflation of strong unit labour cost growth was in part absorbed by lower margins, with unit profits down 0.7%Y/Y, the sharpest decline since the euro crisis a dozen years ago.

### Euro area: GDP growth & contributions



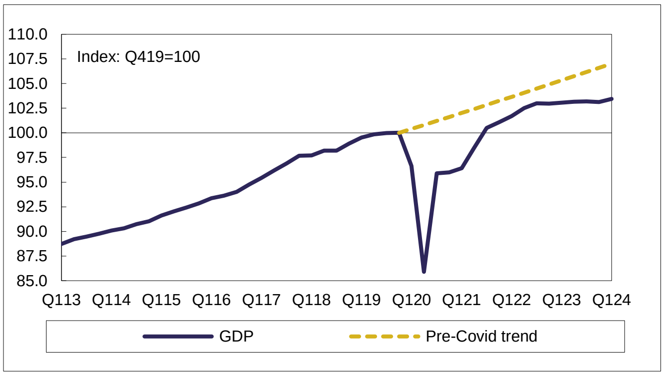

*Source: Macrobond and Daiwa Capital Markets Europe Ltd.*

### Euro area: GDP expenditure contributions



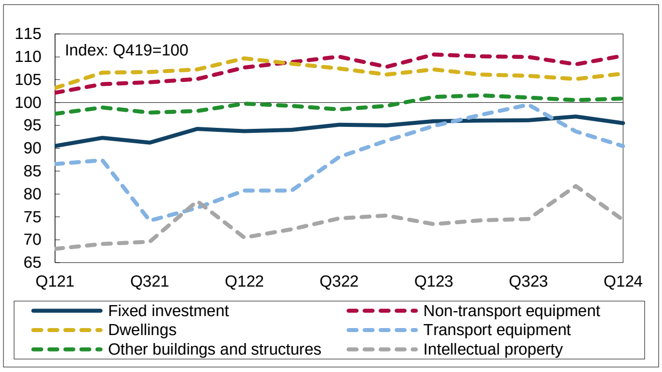

*Source: Macrobond and Daiwa Capital Markets Europe Ltd.*

### Euro area: GDP & pre-pandemic trend



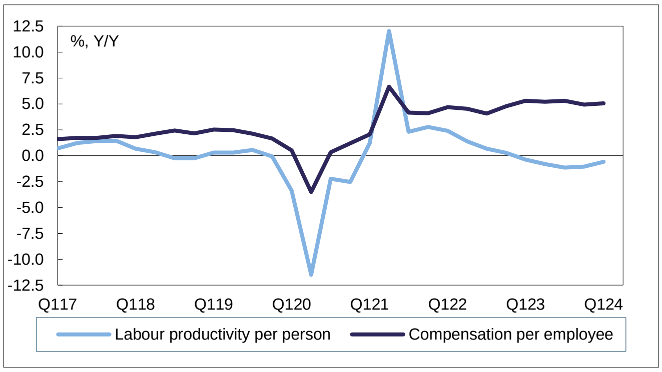

*Source: Macrobond and Daiwa Capital Markets Europe Ltd.*

### Euro area: Fixed investment & components



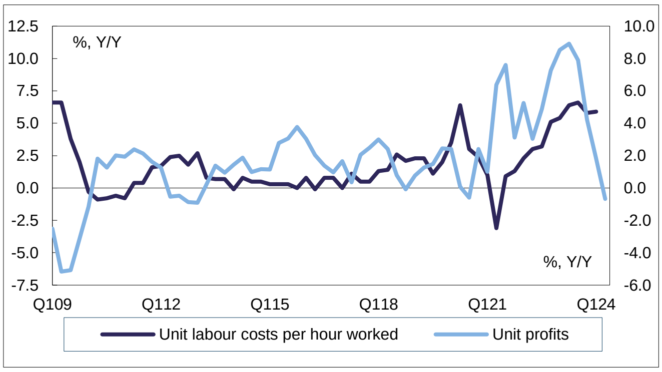

*Source: Macrobond and Daiwa Capital Markets Europe Ltd.*

### Euro area: Productivity & employee compensation




*Source: Macrobond and Daiwa Capital Markets Europe Ltd.*

### Euro area: Unit labour costs & profits




*Source: Macrobond and Daiwa Capital Markets Europe Ltd.*

## The coming week in the euro area

The coming week will be relatively light on top-tier economic releases, with the release of April data for euro area industrial production (Thursday) and goods trade (Friday) arguably most noteworthy. Based on the few national figures published so far – including Germany (0.3%M/M), France (0.5%M/M), Spain (0.3%M/M) and Austria (0.3%M/M) – euro area industrial production (excluding construction) looks set to post a modest increase for a third consecutive month, circa 0.3%M/M. This would leave output roughly 1% above the Q1 average. Of course, much will depend on the highly volatile Irish and Italian numbers, both due Monday. Meanwhile, like today's German figures, the euro area trade balance might well move sideways as an increase in export values is offset by stronger import values. In addition, the Sentix investor survey (Monday) will provide a first insight into confidence at the start of June. And final May inflation figures from Germany (Wednesday), Spain (Thursday) and France (Friday) will bring the more granular detail and therefore provide greater insight into underlying inflationary pressures last month.

Politically, the outcome of the European Parliament elections will also be a focus in the coming week. While there will be an increased presence for far-right and populist parties in the new Parliament, perhaps gaining about one quarter of the vote, the centre-right, centre-left and green parties will maintain a majority. So, the impact on the EU legislation going forward is unlikely to be marked. Indeed, in addition, the far-right parties remain divided and disorganized, limiting their effectiveness to block progress on integrationist, green and economic projects.

# UK

## The coming week in the UK

While it was a quiet Friday with no top-tier UK releases, the coming week will bring notable data in the shape of the latest labour market report (Tuesday) and April GDP data (Wednesday).

In terms of the labour market, we expect the ILO unemployment rate to remain steady at 4.3% in the three months to April with employment again down more than 100k over the same period. That would represent a non-negligible rise of 0.5ppt in the unemployment rate from the end of last year and match the highest since October 2021, but it would also suggest that the UK economy is still running close to full employment. Given the 10% rise in the National Living Wage in April, and a pickup in the Indeed wage tracker that month too, we expect growth in average weekly earnings to tick up from 6.0%3M/Y in the three months to March. The BoE will be watching more closely the detailed figures for private sector regular wage growth, which it forecasts to slow 0.9ppt this quarter to 5.1%3M/Y by June.

Meanwhile, in terms of GDP, we expect payback in April for the jump of 0.4%M/M in March, which represented the strongest in nine months and meant that growth in Q1 reached a surprisingly strong 0.6%Q/Q, the best since Q421. We already know that retail sales were particularly weak in April, dropping 2.3%M/M, the most since December, in part due to bad weather. The early timing of Easter this year possibly contributed to a softer month for certain other services. And we think that manufacturing output likely reversed the growth of 0.3%M/M in March. So, while survey indicators were still upbeat that month – e.g. the composite PMI rose to a 12-month high of 54.1 – we think that GDP contracted in April by about 0.2%M/M. That, however, would leave the three-month rate at 0.6-0.7%3M/3M, pointing to the likelihood of another quarter of relatively firm expansion in Q2.

Among the various survey results due, Monday brings the REC report on jobs. Based on the insights from employment agencies, this should suggest that the labour market continues to soften gradually. Thursday will bring the RICS residential market survey, which should point to a pickup in housing transactions and prices over coming months. And Friday will bring the BoE's quarterly Inflation Attitudes Survey, which should suggest that household inflation expectations are well anchored.

***The next edition of the Euro wrap-up will be published on date 11 June 2024***

# Daiwa economic forecasts

| | 2024 Q1 | 2024 Q2 | 2024 Q3 | 2024 Q4 | 2025 Q1 | 2025 Q2 | 2023 | 2024 | 2025 |
|---|---|---|---|---|---|---|---|---|---|
| **GDP** | %, Q/Q | | | | | | %, Y/Y | | |
| Euro area | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 0.4 | 0.6 | 0.7 | 1.4 |
| UK | 0.6 | 0.3 | 0.3 | 0.2 | 0.2 | 0.3 | 0.1 | 0.8 | 1.0 |
| **Inflation, %, Y/Y** | | | | | | | | | |
| Euro area | | | | | | | | | |
| Headline HICP | 2.6 | 2.5 | 2.2 | 2.5 | 2.3 | 1.7 | 5.4 | 2.4 | 1.8 |
| Core HICP | 3.1 | 2.8 | 2.7 | 2.9 | 2.7 | 1.7 | 4.9 | 2.9 | 1.9 |
| UK | | | | | | | | | |
| Headline CPI | 3.5 | 2.1 | 2.2 | 2.8 | 2.4 | 2.0 | 7.3 | 2.7 | 2.1 |
| Core CPI | 4.6 | 3.5 | 3.2 | 3.2 | 2.7 | 1.7 | 6.2 | 3.6 | 1.9 |
| **Monetary policy, %** | | | | | | | | | |
| ECB | | | | | | | | | |
| Deposit Rate | 4.00 | 3.75 | 3.50 | 3.25 | 3.00 | 2.75 | 4.00 | 3.25 | 2.25 |
| Refi Rate | 4.50 | 4.25 | 3.65 | 3.40 | 3.15 | 2.90 | 4.50 | 3.40 | 2.40 |
| BoE | | | | | | | | | |
| Bank Rate | 5.25 | 5.25 | 5.00 | 4.75 | 4.50 | 4.25 | 5.25 | 4.75 | 3.75 |

*Source: Bloomberg, ECB, BoE and Daiwa Capital Markets Europe Ltd.*

# European calendar

## Today's results

**Economic data**

| Country | Release | Period | **Actual** | Market consensus/ *Daiwa forecast* | Previous | Revised |
|---|---|---|---|---|---|---|
| Euro area | GDP – 3rd estimate Q/Q% (Y/Y%) | Q1 | **0.4 (0.4)** | *0.3 (0.4)* | -0.1 (0.1) | - (0.2) |
| | Employment – 2nd estimate Q/Q% (Y/Y%) | Q1 | **0.3 (1.0)** | *0.3 (1.0)* | 0.3 (1.2) | - |
| Germany | Industrial production M/M% (Y/Y%) | Apr | **-0.1 (-3.9)** | 0.2 (-3.1) | -0.4 (-3.3) | - (-4.3) |
| | Goods trade balance €bn | Apr | **22.1** | 23.4 | 22.2 | - |
| France | Trade balance €bn | Apr | **-7.6** | - | -5.5 | -5.4 |

**Auctions**

| Country | Auction |
|---|---|
| - Nothing to report - | |

*Source: Bloomberg and Daiwa Capital Markets Europe Ltd.*

# The coming week's data calendar

## The coming few week's key data releases

| Country | | BST | Release | Period | Market consensus/ *Daiwa forecast/actual* | Previous |
|---|---|---|---|---|---|---|
| | | | **Monday 10 June 2024** | | | |
| Euro area | | 09.30 | Sentix investor confidence | Jun | -1.7 | -3.6 |
| Italy | | 09.00 | Industrial production M/M% (Y/Y%) | Apr | -0.2 (-2.1) | -0.5 (-3.5) |
| | | | **Tuesday 11 June 2024** | | | |
| UK | | 07.00 | Average earnings (excluding bonuses) 3M/Y% | Apr | 5.7 (6.1) | 5.7 (6.0) |
| | | 07.00 | ILO unemployment rate 3M% (employment change 3M/3M 000s) | Apr | -4.3 (-95) | 4.3 (-178) |
| | | 07.00 | Payrolled employees change M/M 000s | May | - | -85 |
| | | 07.00 | Claimant count rate % (change 000s) | May | - | 4.1 (8.9) |
| | | | **Wednesday 12 June 2024** | | | |
| Germany | | 07.00 | Final HICP (CPI) Y/Y% | May | 2.8 (2.4) | 2.4 (2.2) |
| UK | | 07.00 | Monthly GDP M/M% (3M/3M%) | Apr | *-0.2 (0.5)* | 0.4 (0.2) |
| | | 07.00 | Services activity M/M% (3M/3M%) | Apr | -0.1 (0.7) | 0.5 (0.7) |
| | | 07.00 | Industrial production M/M% (Y/Y%) | Apr | -0.1 (0.3) | 0.2 (0.5) |
| | | 07.00 | Construction activity M/M% (Y/Y%) | Apr | 0.0 (-1.6) | -0.4 (-2.2) |
| | | | **Thursday 13 June 2024** | | | |
| Euro area | | 10.00 | Industrial production M/M% (Y/Y%) | Apr | 0.3 (-1.9) | 0.6 (-1.0) |
| Spain | | 08.00 | Final HICP (CPI) Y/Y% | May | 3.8 (3.6) | 3.4 (3.3) |
| UK | | 00.01 | RICS house price balance % | May | - | -5 |
| | | | **Friday 14 June 2024** | | | |
| Euro area | | 10.00 | Trade balance €bn | Apr | 17.3 | 17.3 |
| France | | 07.45 | Final HICP (CPI) Y/Y% | May | 2.7 (2.2) | 2.4 (2.2) |
| Italy | | 09.00 | Trade balance €bn | Apr | - | 4.3 |
| UK | | 09.30 | BoE/Ipsos household inflation expectations 1Y ahead Y/Y% | May | - | 3.0 |

*Source: Bloomberg and Daiwa Capital Markets Europe Ltd.*

## The coming week's key events & auctions

| Country | | BST | Event / Auction |
|---|---|---|---|
| | | | **Monday 10 June 2024** |
| UK | | 00.01 | REC/KPMG report on jobs |
| | | | **Tuesday 11 June 2024** |
| Euro area | | 12.05 | ECB Chief Economist Lane to participate in a fireside chat |
| | | | **Wednesday 12 June 2024** |
| Euro area | | 14.00 | ECB Vice President de Guindos to discuss euro area growth and inflation outlook |
| Germany | | 10.30 | Auction: €4.0bn of 2.2% 2034 bonds |
| UK | | 10.00 | Auction: £900mn of 0.625% 2045 index-linked bonds |
| | | | **Thursday 13 June 2024** |
| Italy | | 10.00 | Auction: To sell bonds |
| | | | **Friday 14 June 2024** |
| Euro area | | 10.00 | ECB Chief Economist Lane to participate in a panel discussion on central bank decision making |
| UK | | 09.30 | BoE to publish household inflation attitudes survey results for Q2 |

*Source: Bloomberg and Daiwa Capital Markets Europe Ltd.*

## Access our research blog at:
## https://www.uk.daiwacm.com/ficc-research/recent-blogs