Euro wrap-up

Overview

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- Bunds made gains as German and French industrial production fell sharply in May.
- Gilts followed the global trend higher as the Labour Party predictably won a landslide election in the UK general election.
- After Sunday's second round in the French national assembly election, the coming week will bring May data for UK GDP, German goods trade and Italian industrial production.

Daily bond market movements

Bond	Yield	Change
BKO 2.9 06/26	2.890	-0.045
OBL 2.1 04/29	2.533	-0.053
DBR 2.2 02/34	2.555	-0.049
UKT 0⅛ 01/26	4.108	-0.059
UKT 0½ 01/29	3.980	-0.060
UKT 4⅝ 01/34	4.126	-0.069

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

Euro area

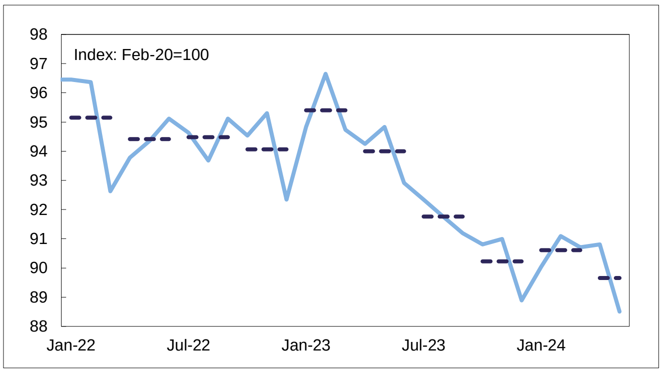
German industrial production falls to a four-year low

Despite the improvement in business survey indicators in May, but tallying with the ongoing downtrend in factory orders, German industrial production disappointed in the middle of Q2, raising a non-negligible risk that the sector was a drag on GDP growth last quarter. Indeed, total industrial production fell a much steeper-than-expected 2.5%M/M in May – the most since December 2022 – to the lowest level since the first Covid-19 lockdown in May 2020 and some 11½% below the pre-pandemic benchmark. And while this left output merely flat on a three-month basis, it was trending in April and May some 1.1% below the Q1 average, on track to more than fully reverse the increase in Q1 (0.4%Q/Q). Within the detail, manufacturing output dropped 2.9%M/M – the most in more than two years – to leave it down 7.1%Y/Y and trending 0.7% below the Q1 average. Meanwhile, construction activity fell for a third consecutive month and by 3.3%M/M to a five-month low, with building work down to the lowest since February 2018. This left construction output trending a hefty 2.4% below the Q1 average, therefore almost fully reversing the weather-assisted boost at the start of the year. And while energy production bucked the trend in May (+2.6%M/M), this too was tracking so far in Q2 some 1½% below the Q1 average.

Widespread manufacturing decline in May, with signs of further weakening ahead

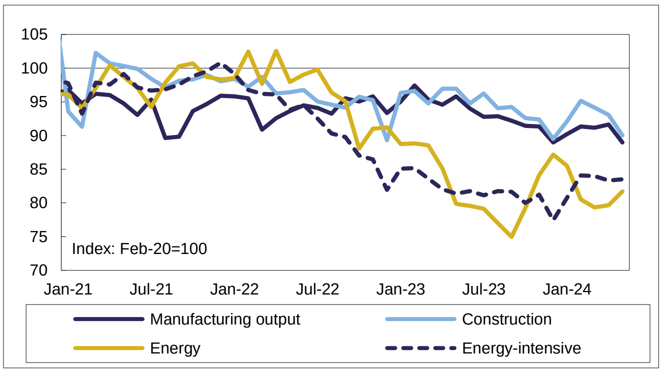
Among the manufacturing sub-sectors, motor vehicle production went into reverse for the first month in four (-5.4%M/M), but was still on track to provide a boost to growth in Q2 (2.7%3M/3M). But production of other transport equipment fell to a six-month low. And production of machinery and electrical equipment fell sharply to the lowest level for four years, to leave capital goods output down 4.0%M/M, the most in eleven months. Despite a pickup in the chemicals subsector, production of intermediate goods fell for a second successive month (-2.7%M/M), while consumer goods moved broadly sideways with a pickup in food and beverages offsetting weakness in clothing and pharmaceuticals. The near-term manufacturing outlook remains uncertain. Indeed, while order backlogs remain elevated in certain sectors such as electrical machinery and computer, electronic and optical products, and were trending gradually higher in other transport equipment, backlogs of car orders have fallen back close to the pre-pandemic level. And according to Germany's auto industry association (VDA), car production declined more than 9%Y/Y in June. Moreover, with truck toll mileage down some 1%M/M in June, the ifo survey pointing to a marked deterioration in production that month, and new orders having continued to fall, manufacturing output seems highly likely to have contracted in Q2. So, while hospitality and accommodation activity should be boosted by overseas visitors during the Euro 2024 football championship, there is a non-negligible risk that German GDP failed to grow in Q2.

Germany: Industrial production*



Dashed dark blue line represents quarterly averages. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Industrial production



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

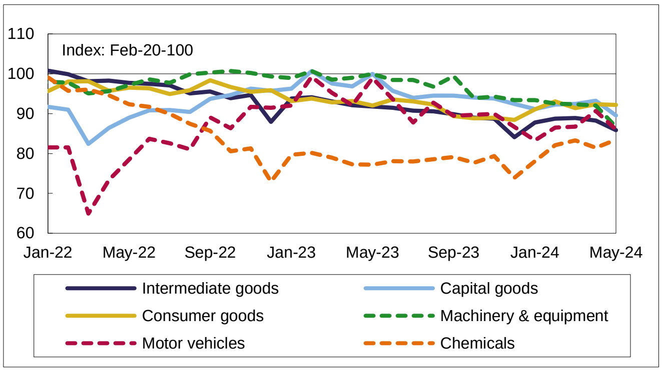
French IP drops sharply despite ongoing growth in construction

French industrial production also fell short of expectations in May, declining 2.1%M/M, the steepest monthly drop and lowest level since October 2022. This left output more than 7% below the pre-pandemic benchmark in February 2020 and down 0.6%3M/3M, suggesting that industry will provide a modest drag on GDP for a third successive quarter. The weakness was driven by the manufacturing sector (-2.7%M/M), with substantial falls in production of autos (-6.6%M/M) and machinery and equipment (-4.6%M/M) to the lowest levels in roughly two years and four years respectively. There were also large declines in the pharmaceuticals, basic metals and chemicals subsectors. Meanwhile, energy production fell for a third month out of four in May (-1.0%M/M). But contrasting with Germany, construction offered some offset, with activity rising for a third consecutive month (1.6%M/M) to leave the average so far in Q2 some 0.9% above the Q1 level. And today's services output figures for April reported a marked rebound at the start of Q2, up 3.6%M/M – the most since February 2022 – to be some 2½% above the Q1 average. So, while surveys point to relatively subdued demand at the end of Q2, we maintain our view that French GDP grew at a similar pace to Q1 (0.2%Q/Q).

Euro area retail sales remain subdued in May as spending on core items slipped back

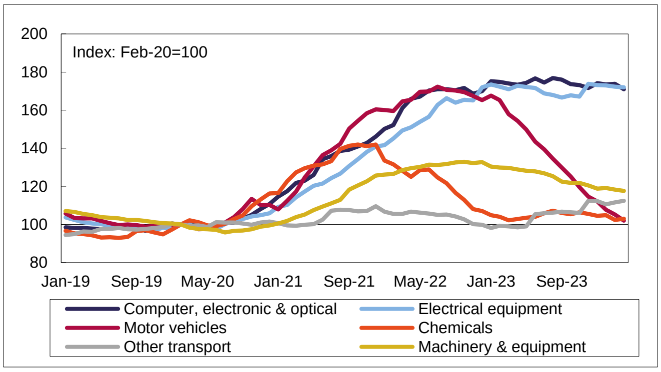
Despite the recent improvement in consumer confidence, today's euro area retail sales figures suggested persisting lacklustre demand for goods in May, with sales rising just 0.1%M/M. Nevertheless, with the decline in April smaller than previously estimated (-0.2%M/M), and given the solid rise in March, this left sales so far in Q2 still some 0.3% above the Q1 average. The modest increase in May was underpinned by spending on non-core items such as food (0.7%M/M) and auto fuel (0.4%M/M) as consumers were able to get more bang for their buck as prices fell back again. In contrast, spending on non-food & fuel items slipped back in May (-0.2%M/M). But having risen in three of the previous four months, this still left core sales so far in Q2 some ½% above the Q1 average. Among the larger member states to have published data, Netherlands recorded the strongest growth in May (0.8%M/M), with Italy also eking out a slight increase (0.1%M/M). But spending in France fell for a third consecutive month (-0.2%M/M) and also declined in Spain (-0.6%M/M). And with Germany yet to publish retail numbers for May, today's figures could be subject to significant revision in due course. The Commission survey signalled a deterioration in retailers' confidence in June, with sales reportedly dropping the most in almost two years. However, increased expenditure on services – turnover of which in April jumped 2%M/M, the most since May 2022 – should again be providing some offset for soft spending on goods.

Germany: Manufacturing production



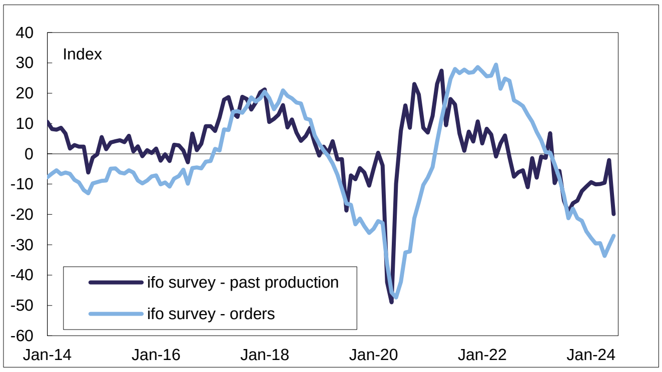
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Manufacturing order backlogs



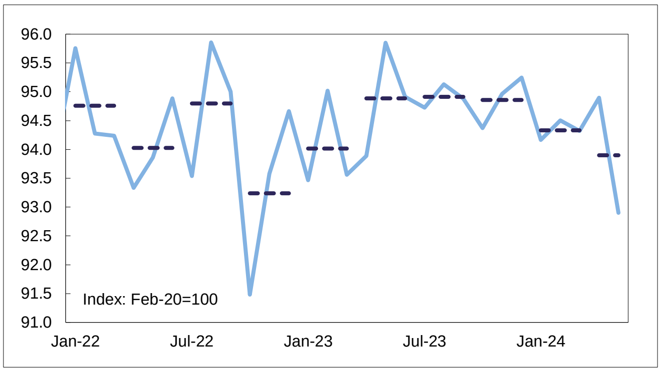
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Manufacturing sentiment indices



Source: ifo, Macrobond and Daiwa Capital Markets Europe Ltd.

France: Industrial production



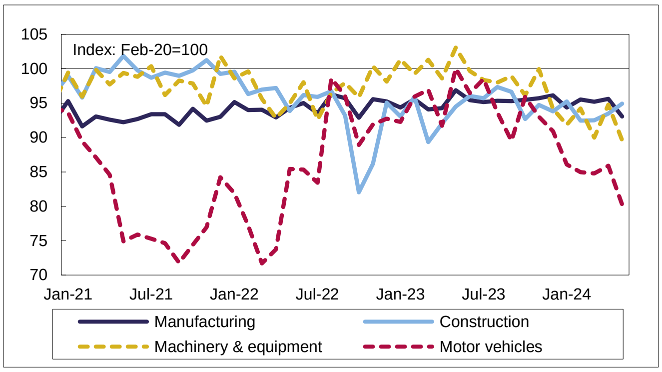
**Dashed dark blue lines represent quarterly average. Source: Macrobond and Daiwa Capital Markets Europe Ltd.*

The week ahead in the euro area

The main notable new information of the coming week will be the result of Sunday's second-round vote in the French lower assembly election. With the left-wing New Popular Front (NFP) and President Macron's centrist Ensemble alliance having coordinated via a so-called 'republican front' to try to keep the far right from power, the latest opinion polls suggest that the National Rally (RN) of Marine Le Pen and its candidate for Prime Minister Jordan Bardella will fall short of an absolute majority. Indeed, while it needs 289 seats to govern with a majority, a Harris Poll conducted earlier this week suggested that RN would have between 190-220 MPs in the new lower assembly, with the NFP on 159-183 and Ensemble on 110-135. Assuming that no party achieves an absolute majority, as the largest party in parliament RN will still likely be invited first by Macron to try to form a government. If so, it could try to form an alliance with certain members of the former establishment centre-right Republicans (LR) to secure backing in a confidence vote. However, if such efforts fail, a grand (albeit perhaps informal) coalition of the moderate left and centre parties, a technocrat-led national unity government or a minority government are also feasible outcomes once the dust eventually settles. Regardless, uncertainty about the outlook for French policymaking is likely to be long-lasting.

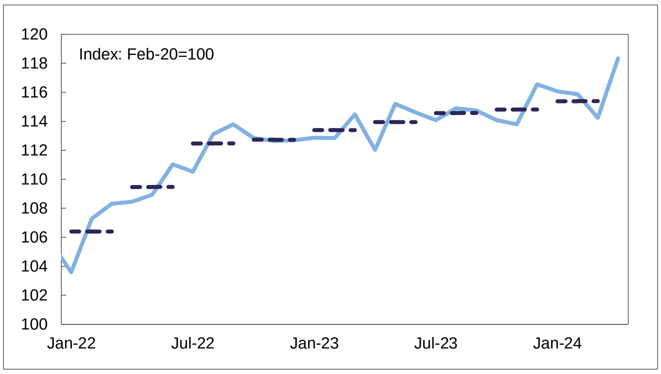
Data-wise, the coming week will be very light on top-tier releases. Monday will bring German goods trade data for May, which are expected to reported declines in the value of both exports and imports following two months of growth. Indeed, preliminary data for German trade with countries outside of the EU already reported a decline in exports in seasonally adjusted terms of 6.4%M/M. That left them down in unadjusted terms by 4.9%Y/Y. Shipments to China were down a steep 14.0%Y/Y, with those to the UK, Turkey and Japan also weak. But shipments to the US provided support, being up 4.1%Y/Y. With the decline in imports expected to be less than that in exports, the trade surplus is expected to slip back by €2bn or more back to about €20bn, which would be a seven-month low. Meanwhile, Italian industrial production figures for May are due on Wednesday and are expectedly to suggest little change in output after two successive months of declines and no growth since December. German retail sales numbers for the same month might be released on Friday but could slip into the following week. And final June inflation data from Germany (Thursday) and France and Spain (Friday) are also due but are highly likely to align with the respective flash estimates. Survey-wise, the Sentix investor survey results for July are due on Monday. We expect a deterioration in investor perceptions of the economic outlook not least due to political events in France.

France: Industrial production



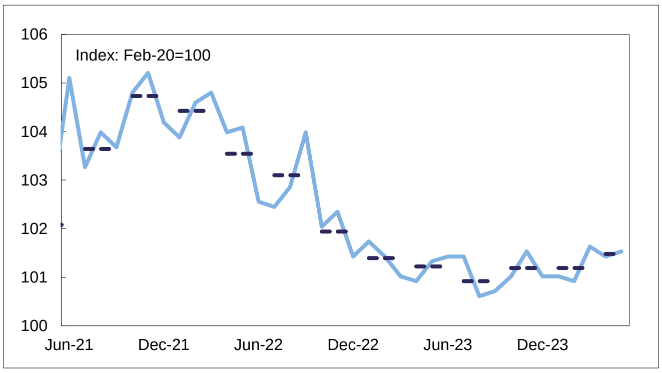
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

France: Services output*



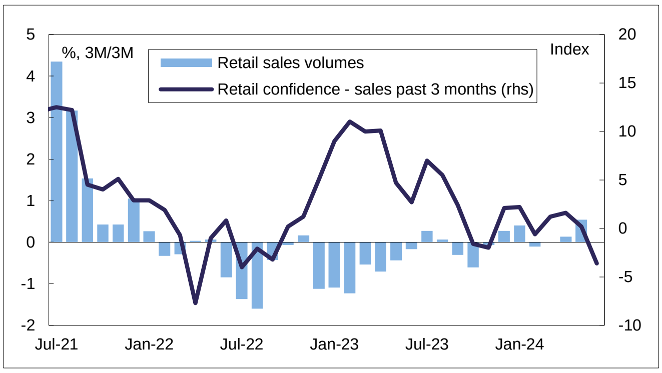
**Dashed dark blue lines represent quarterly average. Source: Macrobond and Daiwa Capital Markets Europe Ltd.*

Euro area: Retail sales*



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

Euro area: Retail sales growth & confidence



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

UK

No election surprises as Labour landslide victory offers more stable policy outlook

The result of the UK general election was broadly in line with the signals of recent opinion polls, with the Labour Party winning a landslide victory to end 14 years of turbulent Conservative rule. With just two seats still to be decided, Labour had won 412 seats out of the 650 in the House of Commons, up 211 from the last parliament. That represents a majority of 174, a number in modern times beaten only by Tony Blair's Labour Party in 1997. Meanwhile, Rishi Sunak's Conservatives lost 250 seats to fall to just 121, their worst ever result. So, Labour's broadly centrist and relatively technocratic leader Keir Starmer is the new occupant of 10 Downing Street as successor to five very different Conservative Prime Ministers in eight years. And former BoE economist Rachel Reeves will take the reins of fiscal policy as the new Chancellor. After those 14 years of Conservative controversy and chaos, which among other things brought Liz Truss's Gilt market crisis and Boris Johnson's harmful Brexit deal, a large Labour majority offers the prospect of more predictable and stable policy-making, hopefully free of drama and more conducive to macroeconomic stability. Indeed, as one first step to avoid future repeats of the Truss debacle, the new government will legislate to empower the independent Office for Budget Responsibility (OBR) to publish a forecast of any major fiscal event making significant tax and public spending changes.

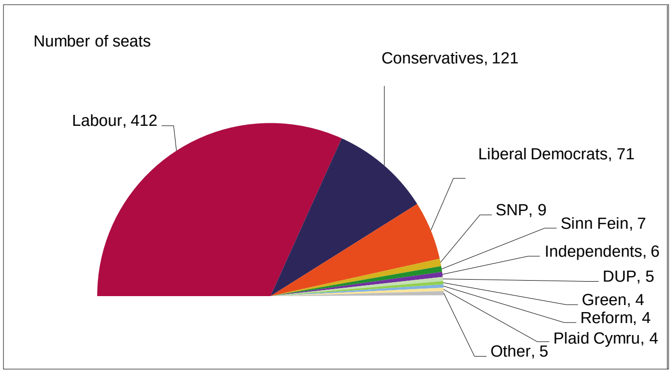
Targeted tax increases likely to come with adjustment to QE/QT accounting rule possible too

Such a commitment to more transparent and predictable fiscal policymaking should provide a more constructive backdrop for the BoE as it sets monetary policy and seeks to maintain financial stability. It should also provide an improved platform for business investment decisions too. And if the new government can implement its manifesto effectively, the UK outlook for fixed investment should also benefit from several reforms. Among these notable measures will include changes to planning regulation to increase housebuilding and boost infrastructure investment: new impetus to the carbon transition including extra finance through a National Wealth Fund and Great British Energy; and improved relations with the EU to open the possibility of somewhat less damaging post-Brexit trading arrangements in certain sectors. At the same time, however, Reeves' fiscal policy rules will limit the government's freedom for manoeuvre. Her commitment to ensure that government debt as a share of GDP is declining by the fifth year of the OBR's projection will constrain scope to boost public investment. And with a pledge also to avoid increasing rates of income tax, National Insurance Contributions and VAT, Starmer has also constrained his ability to increase current public expenditure, despite the fact that the government's public spending projections are unrealistically low. To us, various additional targeted tax-raising measures – perhaps related to capital gains tax and reducing tax relief on savings, and even perhaps some form of windfall tax – seem likely to come in the autumn Budget on top of existing commitments to remove the special 'non-domiciled' tax status, increase stamp duty on purchases of residential property by non-UK residents, apply VAT and business rates to private schools, and examine how to increase tax on carried interest. To make the government's fiscal rules somewhat less binding, we also do not rule out changes to the accounting treatment of the costs of BoE QE and QT, which are currently large (and indeed larger than for other major central banks) and, given the indemnity provided by the Treasury to the Bank, immediately scored onto the public finances.

The week ahead in the UK

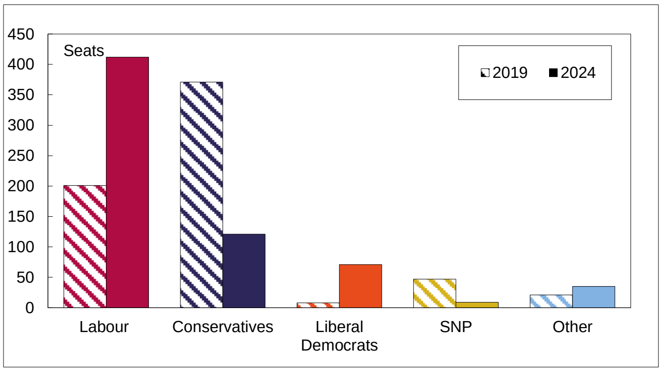
The highlight of the coming week's UK economic data calendar is the May GDP report on Thursday. After economic activity was flat in April, we expect a return to expansion in May with growth of 0.2%M/M, which would keep the three-month rate steady at an above-potential 0.7%3M/3M. With retail sales having jumped a surprisingly strong 2.9%M/M that month, however, there appear non-negligible upside risks to that forecast. But while the manufacturing output PMI jumped to the highest in more than two years (53.4), a 2pt drop in the services activity PMI to a six-month low (52.9) pointed to a loss of momentum in the UK's most important sector. Overall, leading indicators point to another month of moderate growth (0.2%M/M) in services, and rebounds in the manufacturing and construction following substantive declines in April. Separately, survey results due in the coming week include the REC report on jobs (Monday), BRC retail sales survey (Tuesday), RICS residential survey (Thursday) and BoE Credit Conditions Survey for Q2 (also Thursday).

UK: Parliamentary seats 2024



Source: members.parliament.uk and Daiwa Capital Markets Europe Ltd.

UK: Parliamentary seats 2019 vs 2024 election



Source: members.parliament.uk and Daiwa Capital Markets Europe Ltd.

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	0.7	0.4	0.3	0.2	0.2	0.3	0.1	0.9	1.1
Inflation, %, Y/Y									
Euro area									
Headline HICP	2.6	2.4	2.1	2.4	2.1	1.6	5.4	2.4	1.7
Core HICP	3.1	2.8	2.7	2.9	2.5	1.7	4.9	2.9	1.7
UK									
Headline CPI	3.5	2.1	2.1	2.7	2.4	2.0	7.3	2.6	2.1
Core CPI	4.6	3.6	3.3	3.3	2.8	1.7	6.2	3.7	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	Retail sales M/M% (Y/Y%)	May	**0.1 (0.3)**	0.2 (0.1)	-0.5 (0.0)	-0.2 (0.6)
Germany	Industrial production M/M% (Y/Y%)	May	**-2.5 (-6.7)**	0.2 (-4.2)	-0.1 (-3.9)	0.1 (-3.7)
France	Trade balance €bn	May	**-8.0**	-	-7.6	-
	Industrial production M/M% (Y/Y%)	May	**-2.1 (-3.1)**	-1.2 (-1.2)	0.5 (0.9)	0.6 (1.1)
Spain	Industrial production M/M% (Y/Y%)	May	**-0.1 (0.4)**	-	0.3 (0.8)	0.2 (0.2)

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 8 July 2024						
Euro Area		09.30	Sentix investor confidence index	Jul	-0.5	0.3
Germany		07.00	Trade balance €bn	May	20.3	22.2
Tuesday 9 July 2024						
UK		00.01	BRC retail monitor – like-for-like sales Y/Y%	Jun	-	0.4
Wednesday 10 July 2024						
Italy		09.00	Industrial production M/M% (Y/Y%)	May	0.0 (-2.5)	-1.0 (-2.9)
Thursday 11 July 2024						
Germany		07.00	Final HICP (CPI) Y/Y%	Jun	2.5 (2.2)	2.8 (2.4)
UK		00.01	RICS house price balance %	Jun	-14	-17
		07.00	Monthly GDP M/M% (3M/3M%)	May	0.2 (0.7)	0.0 (0.7)
		07.00	Services output M/M% (3M/3M%)	May	0.2 (1.0)	0.2 (0.9)
		07.00	Industrial output M/M% (Y/Y%)	May	0.2 (0.6)	-0.9 (-0.4)
		07.00	Construction output M/M% (Y/Y%)	May	0.5 (-1.8)	-1.4 (-3.3)
		07.00	Trade (goods trade) balance £bn	May	-2.0 (-16.0)	-6.8 (-19.6)
Friday 12 July 2024						
France		07.45	Final HICP (CPI) Y/Y%	Jun	2.5 (2.1)	2.6 (2.3)
Spain		08.00	Final HICP (CPI) Y/Y%	Jun	3.5 (3.4)	3.8 (3.6)

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions

Country		BST	Event / Auction
Monday 8 July 2024			
UK		00.01	REC/KPMG report on jobs
		17.15	BoE's Haskel scheduled to speak in London on "What's done and what's to come"
Tuesday 9 July 2024			
			- Nothing scheduled -
Wednesday 10 July 2024			
Germany		10.30	Auction: To sell €0.5bn of 0% 2036 bonds & €1.5bn of 1% 2038 bonds
UK		14.30	BoE Chief Econoimst Pill scheduled to speak
UKThursday 11 July 2024			
Italy		10.00	Auction: To sell bonds.
UK		09.30	BoE to publish quarterly credit conditions survey.
		10.00	Auction: £3.75bn of 4.0% 2031 bonds
Friday 12 July 2024			
			- Nothing scheduled -

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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