

Euro wrap-up

Overview

- Bunds ended the day little changed despite stronger than expected sentiment surveys from the euro area and its largest member states.
- Following last night's terrorist attack, Gilts made modest gains as a UK retail sales survey surprised on the downside.
- The coming two days will be light for data with a German consumer confidence survey due tomorrow and revised GDP data from Spain and the UK due Thursday.

Emily Nicol

+44 20 7597 8331

Mantas Vanagas

+44 20 7597 8318

Daily bond market movements

| Bond | Yield | Change* |
|--------------|--------|---------|
| BKO 0 03/19 | -0.672 | -0.001 |
| OBL 0 04/22 | -0.334 | -0.001 |
| DBR 0¼ 02/27 | 0.402 | +0.005 |
| UKT 1¼ 07/19 | 0.100 | -0.004 |
| UKT 0½ 07/22 | 0.505 | -0.013 |
| UKT 4¼ 12/27 | 1.072 | -0.016 |

*Change from close as at 4.30pm BST.

Source: Bloomberg

Euro area

Euro area flash PMI remains at six-year high

After the Commission's survey last week signalled that consumers are the most upbeat for a decade, the May flash PMIs today suggested that business conditions remained buoyant in the middle of the second quarter too. Indeed, while the headline services index edged slightly lower in May, it was still the second highest level of the past six years. And with the manufacturing output index having risen to its best reading since April 2011, the euro area headline composite PMI was unchanged at a six-year high. That left the average composite index so far in Q2 more than 1pt higher than the average for Q1 at a level consistent with GDP growth accelerating from the 0.5%Q/Q rates of the previous two quarters. While the survey suggested that new order growth moderated slightly, the relevant index remained elevated, particularly in the manufacturing sector where external demand remained strong. The PMIs also suggested that firms are recruiting at one of the fastest rates of the past decade, with manufacturers seemingly adding more new jobs than at any time in the survey's twenty-year history. And they suggested that output price pressures remain relatively strong, with the relevant index the second-highest since mid-2011. But there was a slight easing in the survey measure of input cost pressures, probably associated with lower oil prices earlier in the month and the recent appreciation of the euro, which has risen by more than 3% against the dollar since the start of the month and by almost 7% since the start of the year.

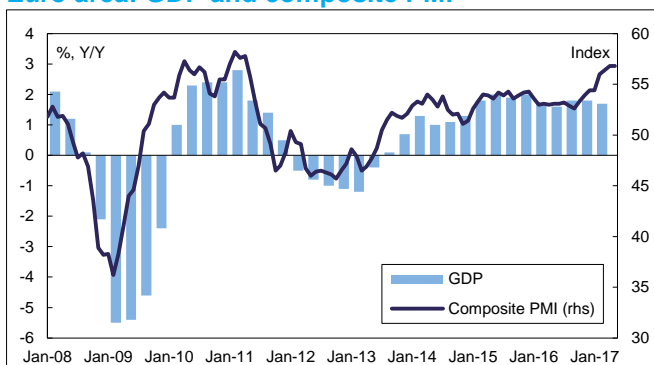
German business sentiment at 'all-time' high

The upbeat sentiment reflected in the euro area PMIs was visible in the latest surveys of business conditions in the two largest member states. Indeed, the preliminary German composite PMI rose to its strongest reading (57.3) for more than six years in May, with new orders reportedly boosted by the strongest export demand in seven years and the employment index similarly buoyant. And the German PMIs tallied with the Ifo survey, which saw the composite business climate indicator rise to its highest level since the series began in 1991. While this in part reflected a further improvement in current conditions, which were also assessed to be the most favourable since reunification, firms were more optimistic about the outlook too, with the relevant index at a more than three-year high. At the sectoral level, like with the PMIs, German manufacturers were notably more upbeat and planned to ramp up production over the near term, while construction firms assessed current conditions to be their most favourable since early 1990s. And although confidence among retailers moderated slightly in May, the respective business climate index was still close to the top of the recent range. So, taken together with other recent indicators, today's surveys were consistent with our view that German GDP growth will be maintained at a rate of 0.6%Q/Q in Q2.

French business sentiment at six-year high

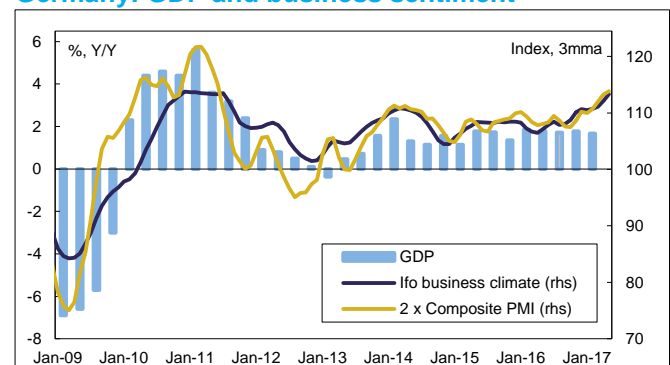
With the outcome of the French Presidential election having provided no nasty surprises, it is perhaps not surprising to see that businesses in the second largest member state also remain upbeat. Indeed, there was a notable upward surprise to the flash French services PMI survey, with the headline index rising to its highest level for six years. And so, despite a modest

Euro area: GDP and composite PMI



Source: Markit, Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Germany: GDP and business sentiment



Source: Markit, Thomson Reuters and Daiwa Capital Markets Europe Ltd.



easing in the headline manufacturing index, the composite PMI similarly rose to a six-year high, and at 57.6 exceeded the equivalent German index for the first time since August 2011. The PMIs broadly echoed the message from today's French INSEE business survey, which showed the headline indicator rising in May to match its highest level since mid-2011 and remain well above the long-run average. While sentiment in the manufacturing sector was little changed in May, the respective survey component was still at its highest for almost six years and firms were reportedly more upbeat about production prospects. Meanwhile, confidence in the construction sector rose to a level last seen five years ago, while retailers were also more upbeat about conditions in the middle of the quarter. And although the headline services sector index slipped back slightly in May it remained comfortably above the long-run average. Overall, today's surveys further support our view that France's economic expansion gathered pace in the second quarter of the year, with our expectation for GDP growth to rise 0.2ppt to 0.5%Q/Q.

The coming two days in the euro area and US

The flow of sentiment indicators continues tomorrow with the German GfK consumer sentiment survey expected to confirm that confidence remained close to the top of the recent range in Q2. Tomorrow will also see the ECB publiksh its latest Financial Stability Review, while Draghi is scheduled to speak in Spain. Thursday, meanwhile, will bring the second estimate of Spanish Q1 GDP, which is expected to confirm growth of 0.8%Q/Q, as well as Italian industrial sales and orders data for March. Supply-wise, Germany will sell 10Y Bunds. In the US, the main focus on Wednesday will be the FOMC minutes from the early-May meeting, which will be watched closely for any further insight into the likelihood of a June rate hike. Data-wise, tomorrow will bring the FHFA house price index for March and existing home sales figures for April, while Thursday will see the release of the April advance goods trade report and wholesale inventories data along with the weekly jobless claims numbers. In the markets, the US Treasury will sell 2Y floating-rate notes and 5Y notes on Wednesday and 7Y notes on Thursday.

UK

Weak consumption growth in Q2

Following a weak Q1, activity on the High Street recovered sharply in April, with one-off factors, notably the Easter holidays, providing support. But today's CBI Distributive Trades survey suggested that the recovery was short lived. The survey indicator for sales growth declined sharply in May from 38% to 2%, a level 1ppt lower than its average for Q1. The equivalent index adjusted for seasonal effects also showed a large, albeit less steep fall of 12ppts to 1%. And with retailers expecting only a small increase in sales next month, the weaker survey readings are consistent with our view that private consumption growth, which slowed notably at the start of the year, is likely to have remained unimpressive in the second quarter too as inflation continues to rise – the survey reported that average prices rose at the fastest pace in six years – and wage growth remains subdued.

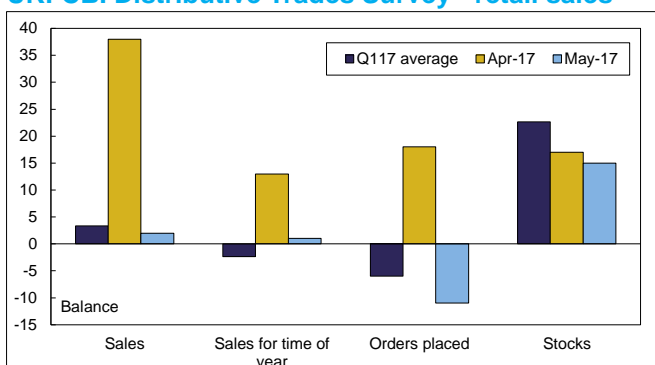
Elsewhere, the public finances figures for April showed public net borrowing was £10.4bn, £1.0bn and £1.2bn higher than in the same month in 2015 and 2016. While obviously early days, this was consistent with the almost 20% rise in net borrowing to £58.3bn the OBR expects in this financial year overall.

The coming two days ahead in the UK

It will be a quiet day in the UK tomorrow, with no major economic data releases scheduled. On Thursday, the second release of Q1 GDP is expected to confirm the preliminary reading of growth of 0.3%Q/Q (2.1%Y/Y). Meanwhile, the expenditure breakdown will most likely show that consumption increased at the same rate, which would be less than half the average pace seen in 2016. And other major expenditure components should be similarly weak: the level of investment is likely to have decreased, while net exports is expected to have subtracted from growth. The BBA lending figures from major High Street banks are also coming out on Thursday.

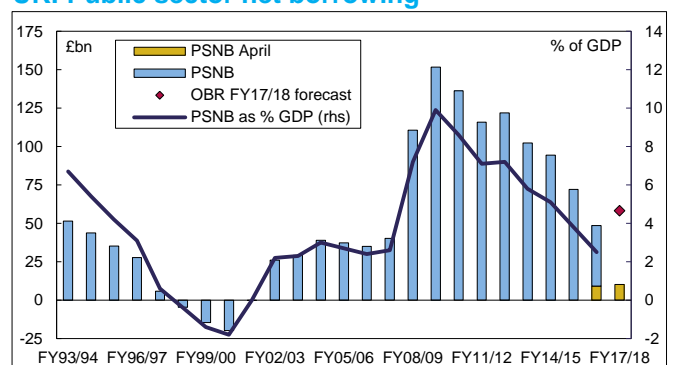
In the absence of any significant developments, the next edition of the Euro wrap-up will be published on 25 May 2017.

UK: CBI Distributive Trades Survey - retail sales



Source: CBI, Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: Public sector net borrowing*


















*Excluding public sector banks.
Source: ONS and Daiwa Capital Markets Europe Ltd.

European calendar

Today's results




Economic data

| Country | Release | Period | Actual | Market consensus/ Daiwa forecast | Previous | Revised |
|----------------|--|--------|----------------------|-------------------------------------|---------------|------------------|
| EMU |  Preliminary manufacturing PMI | May | 57.0 | 56.5 | 56.7 | - |
| |  Preliminary services PMI (preliminary composite PMI) | May | 56.2 (56.8) | 56.4 (56.7) | 56.4 (56.8) | - |
| Germany |  GDP – second release Q/Q% (Y/Y%) | Q1 | 0.6 (1.7) | <u>0.6 (1.7)</u> | 0.6 (1.7) | - |
| |  Preliminary manufacturing PMI | May | 59.4 | 58.0 | 58.2 | - |
| |  Preliminary services PMI (preliminary composite PMI) | May | 55.2 (57.3) | 55.5 (56.6) | 55.4 (56.7) | - |
| |  Ifo business climate index | May | 114.6 | 113.1 | 112.9 | 113.0 |
| |  Ifo current assessment balance (expectations) | May | 123.2 (106.5) | 121.0 (105.4) | 121.1 (105.2) | 121.4 (-) |
| France |  Business confidence indicator (production outlook) | May | 105 (7) | 105 (-) | 104 (1) | - |
| |  Preliminary manufacturing PMI | May | 54.0 | 55.2 | 55.1 | - |
| |  Preliminary services PMI (preliminary composite PMI) | May | 58.0 (57.6) | 56.7 (56.6) | 56.7 (56.6) | - |
| Spain |  Trade balance €bn | Mar | -1.5 | - | -2.6 | - |
| UK |  Public sector net borrowing excluding interventions £bn | Apr | 10.4 | 8.8 | 5.1 | 3.1 |
| |  CBI Distributive Trades survey, retail sales | May | 2 | 10 | 38 | - |
| Country | Auction | | | | | |
| Germany sold |  €4bn of 0% 2019 bonds (14-Jun-2019) at an average yield of -0.65% | | | | | |
| UK sold |  £850mn of 0.125% 2036 index-linked bonds (22-Nov-2036) at an average yield of -1.783% | | | | | |

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's data releases







Economic data

| Country | BST | Release | Period | Market consensus/ Daiwa forecast | Previous |
|----------------------------|---|---|--------|-------------------------------------|----------|
| Germany |  07:00 | GfK consumer confidence survey | Jun | 10.2 | 10.2 |
| Auctions and events | | | | | |
| Country | BST | Auction / Event | | | |
| EMU |  13:45 | ECB's Draghi scheduled to speak in Madrid | | | |
| Germany |  10:30 | Auction: To sell €3bn of 0.25% 2027 bonds (15-Feb-2027) | | | |

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Thursday's data releases



Economic data

| Country | BST | Release | Period | Market consensus/ Daiwa forecast | Previous |
|----------------------------|---|-----------------------------------|--------|-------------------------------------|-----------|
| Italy |  09:00 | Industrial sales M/M% (Y/Y%) | Mar | - | 2.0 (4.6) |
| |  09:00 | Industrial orders M/M% (Y/Y%) | Mar | - | 5.3 (7.8) |
| Spain |  08:00 | GDP – final release Q/Q% (Y/Y%) | Q1 | <u>0.8 (3.0)</u> | 0.7 (3.0) |
| UK |  09:30 | GDP – 2nd release Q/Q% (Y/Y%) | Q1 | <u>0.3 (2.1)</u> | 0.3 (2.1) |
| |  09:30 | Index of services M/M% (3M/3M%) | Mar | 0.0 (0.3) | 0.2 (0.5) |
| |  09:30 | BBA loans for house purchase 000s | Apr | 40.8 | 41.1 |
| Auctions and events | | | | | |
| Country | BST | Auction / Event | | | |
| - Nothing scheduled - | | | | | |

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Yesterday's results

Economic data

| Country | Release | Period | Actual | Market consensus/ Daiwa forecast | Previous | Revised |
|---------|---|-----------------------|-----------|-------------------------------------|-----------|---------|
| EMU |  ECB public sector asset purchases €bn | Weekly | 11.6 | 11.5 | 12.0 | - |
| UK |  Rightmove house price index M/M% (Y/Y%) | May | 1.2 (3.0) | - (2.0) | 1.1 (2.2) | - |
| Country | Auction | - Nothing to report - | | | | |

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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