Daiwa Capital Markets

Euro wrap-up

Overview

- Bunds were little changed and BTPs made gains at the shorter end of the curve but losses at the longer end despite a survey revealing increased investor pessimism regarding Germany's economic outlook.
- Gilts were little changed as UK jobs growth remained firm but wage growth moderated.
- Wednesday will bring data for euro area employment and IP, and UK inflation, as well as further key Brexit votes in the House of Commons.

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Daily bond market movements

Bond	Yield	Change*
BKO 0 06/20	-0.588	+0.013
OBL 0 04/23	0.139	+0.006
DBR 0½ 02/28	0.490	-0.002
UKT 2 07/20	0.751	+0.007
UKT 0¾ 07/23	1.105	+0.004
UKT 4¼ 12/27	1.400	+0.005

*Change from close as at 4.55pm BST.
Source: Bloomberg

Euro area

Investor confidence in German outlook wanes, French jobs growth slows

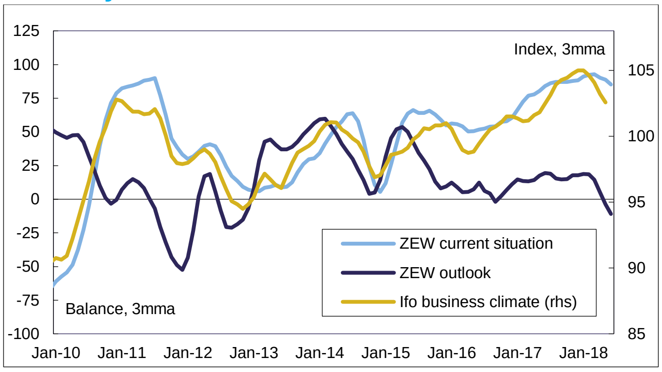
In the wake of the weekend's constructive comments from Italy's Finance Minister Tria, BTPs made further (albeit more limited) gains at the short end of the curve today. However, the notable increase in political uncertainty over the past month – whether related to Italy's future in the euro or fears of a trade war with the US – as well as the continued deterioration of the dataflow, has continued to take their toll on confidence in the euro area. Indeed, today's ZEW survey suggested that investor confidence in the German economic outlook has now weakened to its lowest level since the midst of the euro crisis in early 2012, with the headline index of investor expectations falling for the fourth time in the past five months and to -16.1, signalling that the number of pessimists clearly outweighs the number of optimists. The index of current German conditions also fell to reach the lowest level in more than a year. The June flash PMIs, due at the end of next week, and the Ifo survey due the following week, will indicate whether the increased pessimism has extended to German manufacturers and service-sector companies too.

Moving to France, despite a 0.3ppt increase in the unemployment rate to 8.9% last quarter, today's payrolls data showed ongoing job creation driven by the private sector in Q1, albeit at a more moderate pace than the trend of last year – perhaps unsurprising in light of the softening in the pace of French economic GDP growth in Q1. In particular, total payrolls rose 0.2%Q/Q and 1.2%Y/Y in Q1, down from 0.4%Q/Q and 1.4%Y/Y in Q4. Private sector payrolls also rose 0.2%Q/Q and 1.6%Y/Y, down from 0.6%Q/Q and 1.9%Y/Y previously, with services – in particular hospitality and ICT – as well as construction leading the way. In response to the government's fiscal consolidation agenda, the number of public sector employees was flat on the quarter but lower than a year earlier. With no signs of a significant pickup in economic growth momentum in Q2, we expect French job creation to remain more subdued than last year, albeit at a rate still consistent with a gradual further tightening of the labour market. And that should continue to push French wage growth (which rose to 1.5%Y/Y in Q1 according to preliminary data) gradually higher too. Euro area employment data for Q1 are due tomorrow.

The day ahead in the euro area and US

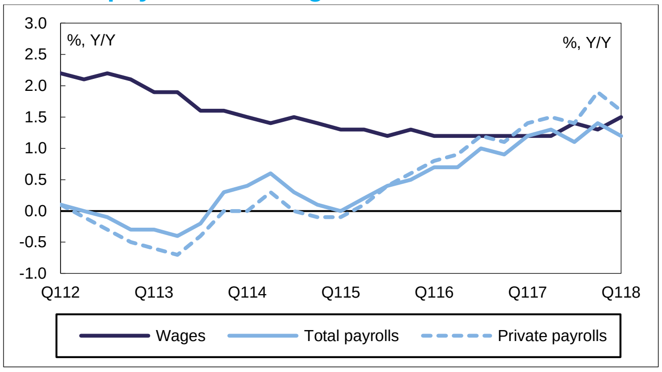
Wednesday will bring euro area IP figures for April. Given the data released from the largest member states, we expect this to show a decrease in output in excess of 1.0%M/M, potentially the steepest in almost two years. Q1 employment data are also due and – like today's French figures – seem likely to show ongoing steady jobs growth, albeit probably a touch down on the 0.4%Q/Q average rate in 2017. Wednesday will also will bring final Spanish inflation figures for May, for which the flash estimate of the headline annual CPI rate on the EU-harmonised measure saw a marked 1.0ppt rise on the month to 2.1%Y/Y, a thirteen-month high. In the bond market, Germany will sell 10Y Bunds while Italy will sell of bonds with a wide range of maturities.

Germany: Sentiment indices



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

France: payrolls and wages



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

The main event on Wednesday will obviously be the conclusion of the FOMC's latest policy meeting. A further 25bp rate hike, lifting the fed funds rate target range to 1.75-2.0%, is fully priced by the market. So, most interest will centre on the Fed's update projections and Chair Powell's post-meeting press conference for clues on how policy is likely to evolve over the remainder of this year. The recent economic data-flow would suggest that the Fed's median forecasts for GDP and inflation this year will be revised up, while the median forecast for the unemployment rate seems likely to be revised down. However, given the deterioration in the external environment over the past quarter, the dot-plots for the fed funds rate at end-2018 might yet prove to be a touch more dovish than those published three months ago. Before the Fed announcement, May's producer price data will likely show a further pickup in pipeline inflation on the back of higher prices of food, energy and core items.

UK

Mixed picture on earnings

After Monday's IP data dispelled the BoE's hopes of an emphatic rebound in GDP growth at the start of Q2, today's labour market figures appear to have contradicted its expectations of faster real earnings growth. Stripping out bonuses, regular pay rose 2.8%3M/Y, down 0.1ppt on March's measure despite evidence of a continued tightening of the labour market. Total earnings growth similarly eased by 0.1ppt, to 2.5%3M/Y in April. While real earnings growth remained in positive territory, it was notable that earnings growth in April (excluding bonuses) alone slowed by 0.5ppt from March to 2.5%Y/Y, reflecting weaker growth in sectors such as retailing and manufacturing in particular, where more subdued activity has been noted. Moreover, the 3M/3M annualised measure of regular pay – which the BoE has previously cited – slowed to 2.4%, its weakest rate for a year. If fragile demand further hampers pay, and jobs, growth in particular in consumer-facing sectors, and if the higher oil price limits inflation's decline, the outlook for stronger real earnings growth this year may be less robust than previously envisaged by the BoE. As such, these numbers reinforce our view that a Base Rate hike is unlikely before November.

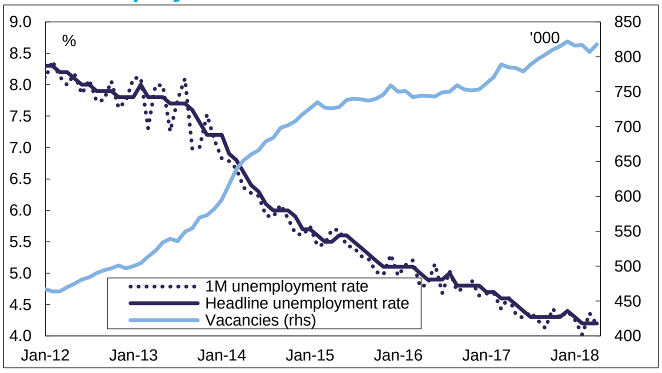
Retail casualties

On the face of it, it was another strong month for employment, with a further 146,000 jobs added in the three months to April. This meant that the employment rate maintained its record high (achieved in March) of 75.6% in April, while the unemployment rate remained unchanged at 4.2%. The majority of the jobs created over the past year, according to the ONS, were full-time and mostly based in the private sector. But fortunes have been mixed across that sector. In line with the growing list of retail failures, reflecting softer demand and structural changes in shopping habits, the ONS reported that the wholesale, retail and motor repairs sector shed 30,000 jobs in the year to March. More up-to-date reports suggest that trend has continued, and could have a greater impact, along with that of pre-Brexit nerves, on the overall employment picture going forward – and as discussed above, earnings growth. The number of vacancies meanwhile was little changed in the three months to May compared to the previous period, remaining at a historically high level (818k, up 33k on a year earlier).

The day ahead in the UK

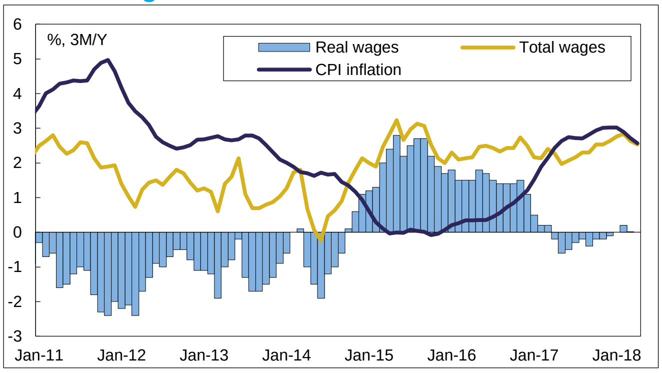
Later on Tuesday, the House of Commons was set to start debating and voting on more than 15 proposed amendments to the EU Withdrawal Bill. The outcome of all of these will not be known until late on Wednesday. Following last-minute compromise amendments put forward by the government and the Labour opposition respectively, it is now expected that the amendments seeking membership of a customs union and EEA stand a strong chance of being defeated. The amendment most likely to be upheld will be that guaranteeing a meaningful final vote on the Brexit deal, by allowing MPs to decide the next course of action if parliament rejects a deal. While embarrassing, a defeat on this is unlikely to destabilise the government. Also on Wednesday, we expect the May CPI inflation release to reveal that the headline rate nudged up by 0.1ppt to 2.5%Y/Y, partly in light of higher fuel prices. But we suspect that core CPI might inch higher too. The rise in oil prices will also impact other parts of the inflation pipeline, boosting both producer price input and output readings, which are due out at the same time.

UK: Unemployment rate and vacancies



Source: Thomson Reuters & Daiwa Capital Markets Europe Ltd.

UK: Earnings & CPI inflation



Source: Thomson Reuters & Daiwa Capital Markets Europe Ltd.

European calendar

Today's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	**Revised**
EMU	ZEW expectations indicator	Jun	**-12.6**	-	2.4	**-**
Germany	ZEW current situation (expectations) indicator	Jun	**80.6 (-16.1)**	85.0 (-14.0)	87.4 (-8.2)	**-**
Italy	Unemployment rate %	Q1	**11.1**	11.1	11.0	**11.1**
UK	Claimant count rate % (change '000s)	May	**2.5 (-7.7)**	-	2.5 (31.2)	**- (28.2)**
	Average weekly earnings (excl. bonuses) 3M/Y%	Apr	**2.5 (2.8)**	*2.6 (2.9)*	2.6 (2.9)	**-**
	ILO Unemployment rate %	Apr	**4.2**	*4.2*	4.2	**-**
	Employment change 3M/3M '000s	Apr	**146**	*110*	197	**-**

Auctions

Country	Auction
	- Nothing to Report -

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's data releases

Economic data

Country	BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
EMU	10:00	Industrial production M/M% (Y/Y%)	Apr	-1.0 (1.9)	0.5 (3.0)
	10:00	Employment Q/Q% (Y/Y%)	Q1	-	0.3 (1.6)
Spain	08:00	Final EU-harmonised CPI Y/Y%	May	2.1	1.1
UK	09:30	CPI (core CPI) Y/Y%	May	*2.5 (2.2)*	2.4 (2.1)
	09:30	Input (output) PPI Y/Y%	May	7.6 (2.9)	5.3 (2.7)
	09:30	UK House price index Y/Y%	Apr	-	4.2

Auctions

Country	BST	Auction / Event
Germany	10:30	Auction: To sell €2bn of 0.5% 2028 bonds (15-Feb-2028)
Italy	10:00	Auction: To sell up to €2bn of 0.05% 2021 bonds (15-Apr-2021)
	16:00	Auction: To sell up to €2.25bn of 1.45% 2025 bonds (15-May-2025)
	16:00	Auction: To sell up to €1.5bn of 3.25% 2046 bonds (01-Sep-2046)
	16:00	Auction: To sell up to €1.5bn of 3.45% 2048 bonds (01-Mar-2048)

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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