

Euro wrap-up

Overview

- Bunds were little changed as German Q1 GDP data aligned with expectations.
- Gilts made losses despite another subdued retail sector survey as yet another opinion poll signalled increased public support for the UK to remain in the EU.
- Wednesday brings further German business and consumer survey results.

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Daily bond market movements

Bond	Yield	Change*
BKO 0 03/18	-0.507	-0.001
OBL 0 04/21	-0.353	-0.004
DBR 0½ 02/26	0.175	-0.002
UKT 1¼ 07/18	0.483	+0.038
UKT 1½ 01/21	0.937	+0.040
UKT 2 09/25	1.472	+0.023

*Change from close as at 4.30pm BST.

Source: Bloomberg

Euro area

German GDP driven by fixed investment in Q1, survey suggests investor caution in Q2

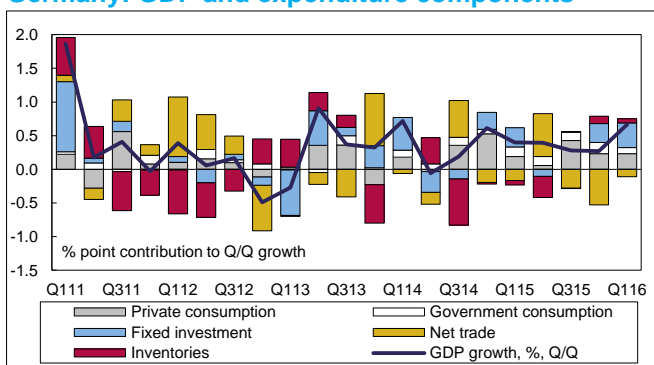
There were no surprises from the second estimate of Q1 German GDP growth, which confirmed the preliminary estimate of 0.7%Q/Q, the strongest in two years. As expected, the expenditure breakdown, which was published for the first time, showed that growth was driven by domestic demand. While household consumption was a touch firmer on the quarter (rising 0.4%Q/Q to add 0.2ppt to GDP growth) the principal engine was fixed investment, which rose the most in two years (almost 2%Q/Q to contribute 0.4ppt). This was due particularly to the mild weather at the start of the year which allowed a surge in construction investment (up more than 2%Q/Q to add 0.2ppt to GDP growth). But, encouragingly, investment in equipment and machinery accelerated to its strongest in a year (almost 2%Q/Q). Meanwhile, although exports rose at the firmest rate in three quarters (1%Q/Q), the stronger rate of import growth (1.4%Q/Q) saw net trade subtract 0.1ppt from GDP growth. Additionally, government consumption again made a small positive contribution for the ninth consecutive quarter.

Looking ahead, not least due to a likely pullback from the construction sector, we expect German GDP growth to slow in Q2 to about 0.3%Q/Q, a touch below the average rate of the past couple of years. And the latest German ZEW survey suggests that investors are unsure about the strength of the outlook for Q2 and beyond. Consistent with the improvement in the German composite PMI, the ZEW's current conditions balance exceeded expectations, rising 5.4pts on the month to a four-month high of 53.1. But this left the average so far in Q2 still almost 4pts lower than in Q1. And investors appeared more downbeat about the future, with some respondents expressing concerns about the uncertainty over the forthcoming EU referendum vote in the UK: the expectations balance declined 4.8pts in May, partly reversing the surge seen in April.

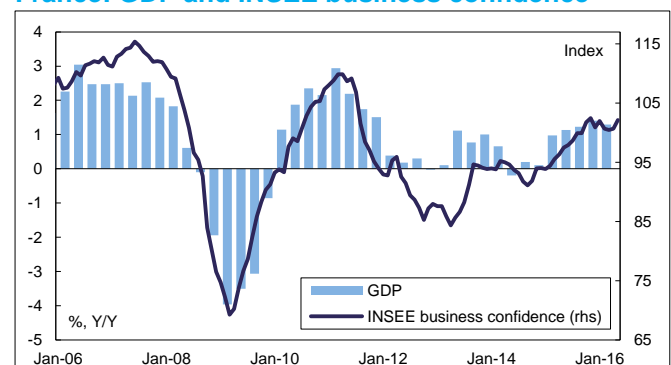
A further modest improvement in French business conditions

Meanwhile, consistent with yesterday's modest increase in the French composite PMI, the INSEE business survey released today also signalled a further slight improvement in the business climate in the euro area's second-largest member state, with the headline indicator rising 1pt to 102, just above the long-run average and the highest since January. Also in line with the equivalent PMI, the INSEE survey reported an improvement in the services sector, with the relevant index up to its long-run average. And retailers' assessment of the outlook saw a notable improvement. Meanwhile, although conditions in the manufacturing sector were a little less favourable, the relevant index was still comfortably above its long-run average with firms relatively upbeat about production prospects and order books above normal levels. And conditions in construction were considered stable albeit still well below the norm for the sector. Overall, the INSEE survey suggests that a further quarter of French GDP growth broadly in line with the recent trend of 0.3%Q/Q is likely to be in order for the second quarter.

Germany: GDP and expenditure components



France: GDP and INSEE business confidence



The day ahead in the euro area and the US

German sentiment indicators will continue to dominate tomorrow's calendar, with most notably the Ifo business and GfK consumer confidence surveys. Italian industrial sales and orders figures for March are also due tomorrow, while ECB Executive Board members Constâncio and Praet are due to speak publicly and Germany will sell 28Y Bunds.

In the US, the most noteworthy data release tomorrow will be April's goods trade report, which will be accompanied by the FHFA house price index for March and flash Markit services and composite PMIs for May. In addition, the Treasury will sell 2Y floating-rate and 5Y regular notes while FOMC (non-voting) members Harker, Kashkari and Kaplan are due to speak.

UK

CBI survey suggested downside risks to retail spending

On the data front, the most notable was the CBI's survey of the retail sector, which suggested a pick-up in sales in May. However, looking through the monthly volatility, sales growth according to this survey remained on a downward trend, with the three-month average falling to its lowest level since mid-2013. Expectations for business volumes in the coming month weakened too, while the index for orders placed with suppliers was at its lowest since March 2009, perhaps reflecting rising stock levels. And while the CBI's survey contrasted with the latest retail sales figures from the ONS, which surprised on the upside showing a significant pickup in growth at the start of Q2, there were strong Easter and weather related effects at play, which might at least in part account for the inconsistencies.

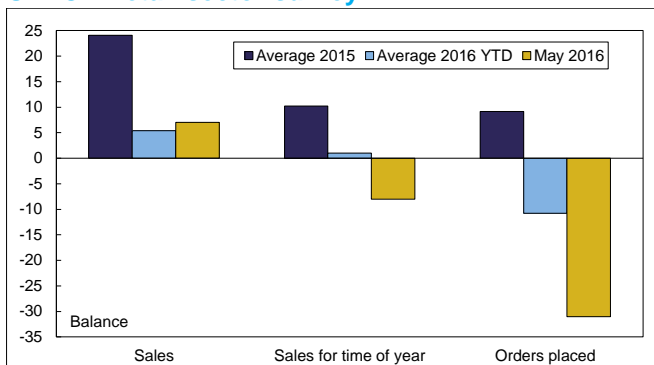
Last financial year's deficit revised higher

The latest public finance figures also released today showed an upward revision to public sector net borrowing in FY15/16 to £76bn, £2bn higher than the initial estimate. So while the government deficit was reduced notably from £91.7bn in the previous financial year, it still overshot the OBR's forecast by £3.8bn and left the net debt to GDP ratio rising to 83.7%. Meanwhile, the public finance figures for April, the first month of FY16/17, remained in line with the trend of a falling deficit, which according to the OBR should be reduced to £55.5bn this financial year. Borrowing of £7.2bn that month was £0.3bn lower compared to April a year ago.

The day ahead in the UK

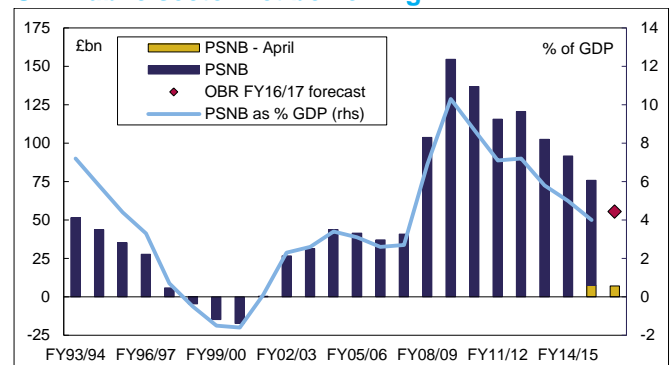
Tomorrow brings no new economic data in the UK.

UK: CBI retail sector survey



Source: Datastream and Daiwa Capital Markets Europe Ltd.

UK: Public sector net borrowing









Source: ONS and OBR

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
EMU	 ZEW survey balance - expectations	May	16.8	-	21.5	-
Germany	 GDP – second release Q/Q% (Y/Y%)	Q1	0.7 (1.6)	0.7 (1.6)	0.3 (1.3)	-
	 ZEW current assessment balance (expectations)	May	53.1 (6.4)	49.0 (12.0)	47.7 (11.2)	-
France	 Business confidence indicator (production outlook)	May	102 (6)	101 (-)	101 (-1)	-
UK	 Public sector net borrowing excluding interventions £bn	Apr	7.2	6.4	4.8	6.7
	 CBI's Distributive Trades survey, reported sales	May	7	8	-13	-






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/ <i>Daiwa forecast</i>	Previous
Germany	 07.00	GfK consumer confidence survey	Jun	9.7	9.7
	 09.00	Ifo business climate index	May	106.8	106.6
	 09.00	Ifo current assessment balance (expectations)	May	113.3 (100.8)	113.2 (100.4)
Italy	 09.00	Industrial orders M/M% (Y/Y%)	Mar	-	0.7 (3.8)
	 09.00	Industrial sales M/M% (Y/Y%)	Mar	-	0.1 (-0.2)

Auctions and events

Country	BST	Auction / Event
EMU	 10.30	ECB's Praet scheduled to speak in Madrid
	 11.30	ECB's Constâncio scheduled to speak in London
Germany	 10.30	Auction: To sell €1bn of 2.5% 2044 bonds (04-Jul-2044)

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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