

Euro wrap-up

Overview

- 10Y Bund yields initially fell to a new record low as the ECB's corporate bond purchase programme got underway.
- Shorter-dated Gilt yields rose slightly as the latest UK industrial production data surpassed expectations.
- Tomorrow brings April trade reports from Germany and the UK.

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Daily bond market movements

Bond	Yield	Change*
BKO 0 06/18	-0.542	-0.001
OBL 0 04/21	-0.414	+0.001
DBR 0½ 02/26	0.059	+0.009
UKT 1¼ 07/18	0.382	+0.018
UKT 1½ 01/21	0.760	+0.008
UKT 2 09/25	1.257	-0.009

*Change from close as at 4.30pm BST.
Source: Bloomberg

Euro area

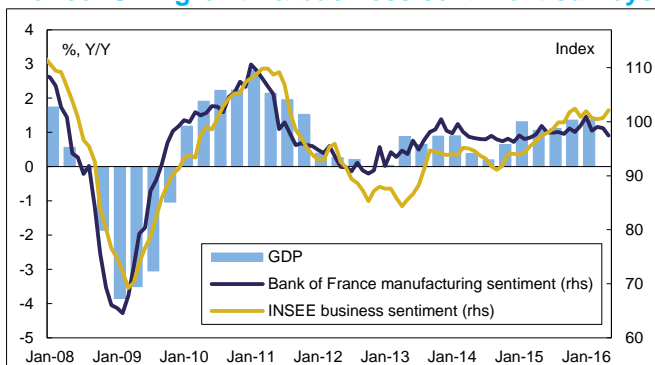
ECB corporate bond purchases finally underway

At last week's uneventful Governing Council meeting, Draghi made clear that the ECB's focus now is merely implementation of existing policy commitments rather than consideration of new initiatives. And today, almost three months following its decision to do so, the ECB finally made its first purchases of non-bank corporate bonds. The first operation under the TLTRO II programme – the last of the new initiatives announced in March yet to get underway – will be conducted on 22 June. And the impact of the ECB's ongoing public sector asset purchase programme was fully evident again today as yields on all Bunds up to 5Y remained below -40bps and thus ineligible for purchase by the ECB, and the scarcity of German bonds saw yields on 10Y Bunds initially touch new record lows below 4bps, before rising back to close broadly unchanged on the day at 6bps. The ECB will want to give time for its full range of measures to work further on broader financial conditions and the outlook for economic growth and inflation before deciding its next moves. So, we now expect no news on policy before December when – if the oil price remains close to current levels – inflation would likely be back close to 1%Y/Y and expected to rise further in early 2017. So, questions would then likely arise as to whether the ECB still dared to taper or even conclude its purchases from March 2017 as is feasible under current forward guidance. We doubt it. Instead, in order to avoid a harmful premature tightening of financial conditions, we would still expect the ECB in December to extend the end of the asset purchase programme by a further six months to end-September 2017 at the earliest.

French GDP moderating in Q2

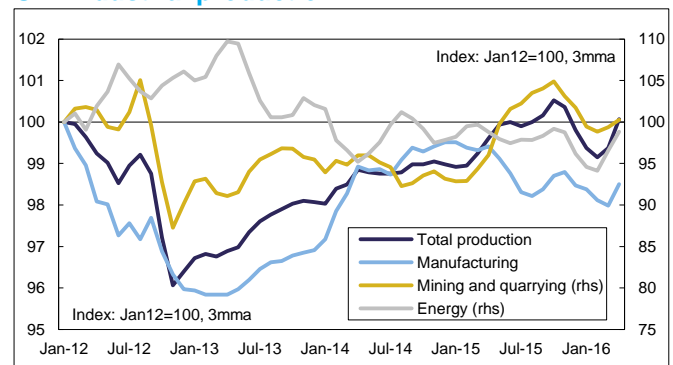
Data-wise, today's most notable release was the latest Bank of France business sentiment survey. As is often the case, the different French economic confidence surveys have given different messages about the recent strength of GDP growth. Following robust economic growth of 0.6%Q/Q in Q1, the PMIs signaled a firming of expansion in the second quarter but the INSEE business sentiment survey implied no notable improvement, albeit from a level of confidence comfortably above the long-run average. And today's Bank of France survey muddled the water a little further, reporting an improvement in confidence in the services sector in May but a deterioration in manufacturing to the lowest level in more than a year, while construction sentiment remained flat at a subdued level. In terms of activity, however, today's release suggested that May saw a solid increase in industrial production (except in the autos and chemicals sub-sectors) and strong growth in services and construction alike. However, June will be particularly difficult to predict: strikes and floods will have hit activity but the influx of foreign visitors and increased spending related to the European football championships, which kick off this Friday and will last

France: GDP growth & business sentiment surveys



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: Industrial production



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.



one month, should give support to demand (most ticket sales, however, were scored to consumption in past quarters). For what it is worth, today's survey reported expectations of a softening of activity in June, as a result of which the Bank of France revised down its GDP growth forecast for Q2 by 0.1ppt to match our own forecast of 0.2%Q/Q, which would represent the softest quarter of French growth in one year.

The day ahead in the euro area and US

Thursday's euro area data focus will be Germany's goods trade report for April, with exports expected to have dipped following two consecutive months of firm growth and the trade surplus highly likely to have retreated from March's record high. In addition, Mario Draghi and other euro area policymakers will be speaking at the Brussels Economic Forum. In the US, April's wholesale trade and inventories data will be published along with Q1 flow-of-funds figures and the usual weekly jobless claims numbers. The US Treasury will sell 30Y Bonds.

UK






Industrial production rose sharply in April

Contrasting markedly with the sharp drop in business sentiment reported in surveys in April, today's release of industrial production figures for that month surprised significantly on the upside. In particular, overall industrial output rose 2.0%M/M while manufacturing production, which accounts for more than two thirds of total IP, was even more impressive, surging 2.3%M/M, similarly the most since July 2012. Within manufacturing, the pharmaceutical subsector reported the strongest growth (8.6%M/M, the most in more than two years) while textiles and transport equipment also saw notable increases. Overall IP was also given a boost from other non-manufacturing sectors, for example energy production increased by almost 4%M/M. Given recent weakness, the annual growth rates were less eye-catching, although IP growth of 1.6%Y/Y matched the top of the range of the past year while manufacturing growth rose by 2.7ppt to a thirteen-month high of 0.8%Y/Y. Of course, production figures are highly volatile and prone to revisions, and some payback can be expected (most obviously in the pharmaceutical sector) in coming months. But given the sharp increase at the start of the quarter, industrial output growth is highly likely to return to positive territory over Q2 as a whole, having posted a decline of 0.4%Q/Q in the first quarter of the year. So, fears of a particularly sharp slowdown in UK GDP growth ahead of the EU referendum might be somewhat overdone. Indeed, the NIESR economic growth estimate for May, also released today, suggested that GDP increased by 0.5%3M/3M, up from 0.4% in Q1.


The day ahead in the UK

Tomorrow brings more data related to the UK's economic performance at the start of Q2, with the latest trade figures due for release. They will probably show that the UK trade deficit remained elevated well in excess of £3bn in April, albeit likely reporting a small improvement from the previous month. Meanwhile, the RICS housing market survey is expected to show that upward pressure on house prices eased somewhat in May.

European calendar

Today's results						
Economic data						
Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
France	 Bank of France business sentiment indicator	May	97	100	99	-
UK	 Industrial production M/M% (Y/Y%)	Apr	2.0 (1.6)	0.0 (-0.4)	0.3 (-0.2)	-
	 Manufacturing production M/M% (Y/Y%)	Apr	2.3 (0.8)	-0.1 (-1.5)	0.1 (-1.9)	-
	 NIESR GDP 3M/3M%	May	0.5	-	0.3	0.4
Auctions						
Country	Auction					
Germany sold	 €4.1bn of 2018 zero-coupon bonds (15-Jun-2018) at an average yield of -0.55%					

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	Trade balance €bn	Apr	22.8	26.2	
	07.00	Imports (exports) M/M%	Apr	1.3 (-0.8)	-2.3 (1.9)	
	07.00	Current account balance €bn	Apr	21.0	30.4	
	07.00	Labour costs Y/Y%	Q1	-	2.1	
UK	00.01	RICS house price balance %	May	35	41	
	09.30	Visible trade balance £bn	Apr	-11.1	-11.2	
	09.30	Total trade balance £bn	Apr	-3.7	-3.8	
Auctions and events						
Country	BST	Auction / Event				
EMU	08.00	 ECB's Draghi scheduled to speak in Brussels				
UK	10.30	Auction: To sell £0.9bn of 0.125% 2036 index-linked bonds (22-Nov-2036)				

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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