

# Euro wrap-up

## Overview

- Bunds rose and BTPs made very significant gains as data showed marked declines in German industrial production and exports at the start of Q2.
- Gilts followed USTs higher as a survey pointed to a softening of conditions in the UK labour market.
- The coming week brings data on the UK's GDP and labour market, and euro area IP, as well as a notable Eurogroup meeting and the start of the UK Conservative party leadership contest.

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### Daily bond market movements

Bond	Yield	Change*
BKO 0 06/21	-0.673	-0.016
OBL 0 04/24	-0.605	-0.021
DBR 0% 02/29	-0.257	-0.019
UKT 1½ 01/21	0.525	-0.018
UKT 1 04/24	0.574	-0.017
UKT 1½ 10/28	0.808	-0.018

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

## Euro area

### German production falls sharply

Having risen 0.5%Q/Q over the first quarter of the year, it was no surprise that German industrial production went into reverse in April. But today's figures were much weaker than expected, with the decline of 1.9%M/M the most since 2015, and the drop in manufacturing and mining output steeper still at 2.5%M/M to leave it 2.0% below the Q1 average level. Dispiritingly, production of capital goods was down a hefty 3.3%M/M, similarly the biggest fall in almost four years, while output of intermediate and consumer goods fell too. Energy production was also down (-1.1%M/M) leaving construction – for some time the most buoyant sector in Germany – the sole source of production growth (albeit up just 0.2%M/M). Compared to a year earlier, total IP fell 1.9% with manufacturing and mining output down a marked 3.5%. While we expect to see a return to positive growth in May supported not least by an increase in car production, these data, coupled with yesterday's sluggish factory orders numbers and downbeat surveys, strongly suggest that industrial production will contract over Q2 as a whole for the third quarter in four.

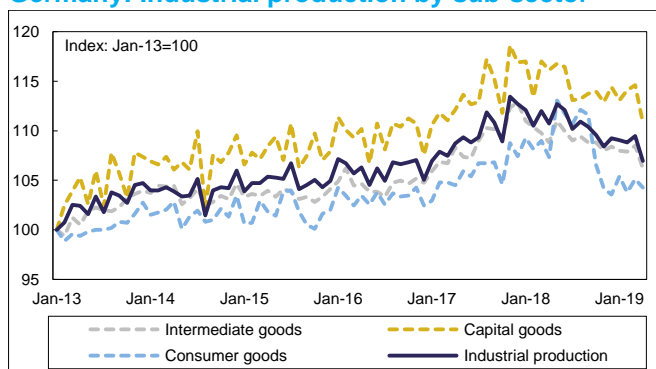
### Exports plunge on Brexit effect

Weakness of external demand is, of course, a key factor behind the ongoing trials in Germany's manufacturing sector, and the April goods trade report was also exceptionally disappointing. The value of exports fell a steeper than expected 3.7%M/M, the most since August 2015. Exports to the euro area were down a moderate 0.5%M/M, and exports to countries outside of the EU rose a firm 4.0%M/M. So, the marked decline in total exports reflected most notably a steep drop in shipments to the UK (down more than 22%Y/Y) as the temporary boost from stock-building ahead of the original end-March Brexit cliff-edge reversed. Meanwhile, the value of imports fell a more moderate 1.3%M/M to leave the goods trade surplus down about €3.0bn on an adjusted basis at a ten-month low of €17.0bn. Adjusting for prices as well as seasonal effects, Bundesbank data showed that the decline in the volume of goods exports (down 3.6%M/M) was much steeper than that of imports (down 1.6%M/M). And so, net goods trade appears on track to subtract from German GDP growth in Q2 having provided modest support in Q1.

### French manufacturing output flat

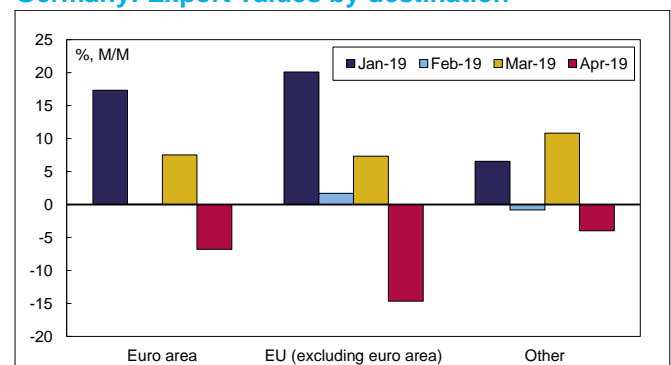
In contrast to the German numbers, French industrial production rose 0.4%M/M in April. That left it more than 1% higher than a year earlier, the strongest annual rate for three months. But this principally reflected a rise of 3.3%M/M in energy production. In contrast, construction output fell for the second successive month and by a substantive 2.3%M/M. And manufacturing output was flat in April, with a further notable drop in production of intermediate and capital goods offset by a rebound in the consumer goods sector. Moreover, coming on the back of a marked decline in March, this left the level of manufacturing output 0.5% below the average level in Q1, with total output down 0.2% on the same basis. Moreover, like in Germany, French goods exports were also weak in April, falling 1.9%M/M, the most in six months. Once again, Brexit appears to have played a role, with exports to the UK plunging by more

### Germany: Industrial production by sub-sector



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

### Germany: Export values by destination



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.



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than 28%M/M (on a seasonally adjusted basis) and almost 6%Y/Y. However, the drop in imports (-2.7%M/M) outpaced that of exports, and so the French trade deficit narrowed somewhat. And having subtracted from French GDP growth in Q1, we expect net trade to be broadly neutral in Q2.

### German labour cost growth still hardly vigorous

Finally, and more positively, Germany's latest labour cost data were at least stronger, with growth in Q1 of 1.1%Q/Q, the most since Q416. That, however, largely reflected payback for weakness the prior quarter (just 0.2%Q/Q) related to non-wage (and in particular sick-leave) costs. On an annual basis, overall labour cost growth picked up 0.5ppt to 2.5%Y/Y, still slightly below the average of the past four years, with wage and non-wage costs rising at a similar rate. That suggests no significant new impetus to underlying price pressures from the (admittedly tight) labour market.

### The week ahead in the euro area and US

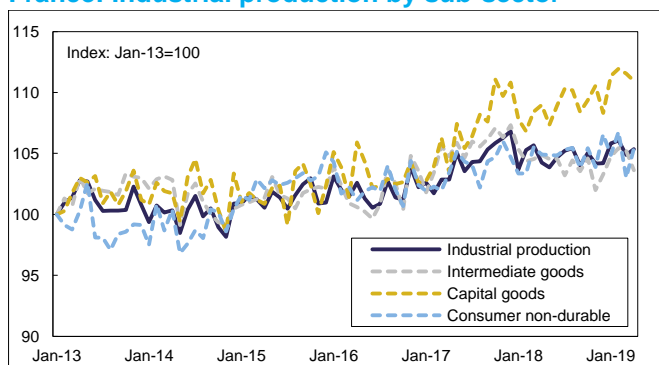
The coming week in the euro area should be much quieter for economic data, with the most noteworthy release the aforementioned euro area industrial production figures on Thursday. Despite the weakness in Germany in April, these are expected to show that IP excluding construction reversed the 0.3%M/M decline recorded in March. More clarity on this outcome will follow Italy's IP release on Monday, while the Bank of France's business sentiment survey (due Tuesday) will provide an update on conditions in May. The second half of the coming week will also bring final inflation figures from the largest member states – including Germany (Thursday), France and Italy (Friday) and Spain (Wednesday) – which are expected to align with the preliminary releases showing a notable drop in headline and core CPI rates as the Easter-related boost to services inflation in April reversed.

Beyond the economic data, the Eurogroup meeting on Thursday will be interesting not least given the Commission's recommendation in the past week to launch a new Excessive Deficit Procedure (EDP) against Italy. Moreover, euro area Finance Ministers are due to reach agreement on the key features of the planned euro area Budgetary Instrument for Convergence and Competitiveness (BICC), which will represent the first common fiscal policy tool for the single currency. The BICC is highly likely initially to be very small in size, and targeted on supporting structural reforms and public investment rather than boosting demand. However, if the design features to be agreed in the coming week are sufficiently flexible in terms of the possible use of funds, and can allow for a significant future increase in size, then the BICC might eventually prove a useful basis for a single euro area budget to be used to support demand in the event of the next recession and/or financial crisis. Indeed, in this context, in his post-Governing Council meeting press conference yesterday, ECB President Draghi emphasised that fiscal policy would have to play a more substantive role in boosting economic activity if and when the downside risks to the economic outlook crystallise. And, if it is designed appropriately, the BICC might eventually have a useful part to play.

Elsewhere, ECB President Draghi and Vice-President de Guindos will speak publicly on Wednesday at an ECB conference, although the focus will be on central, eastern and south-eastern European countries and so might be of little relevance to the debate on the monetary policy outlook. In the markets, Germany will sell 10Y Bunds on Wednesday, while Italy will sell 3Y and 7Y BTPs on Thursday.

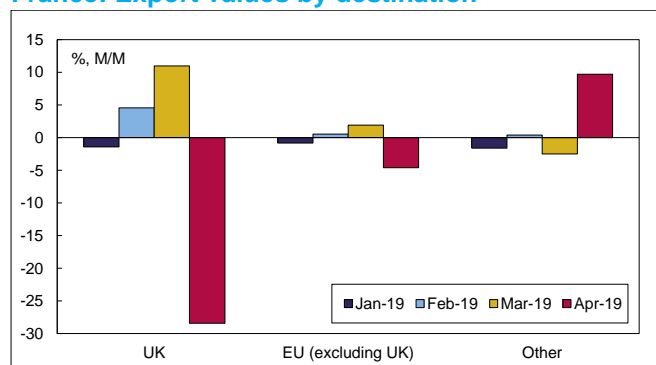
In the US, ahead of the forthcoming FOMC meeting on 20 June, the coming week will bring a number of key economic releases, including May figures for CPI (Wednesday), retail sales and IP (Friday). Against the backdrop of weaker energy inflation, the annual rate of headline CPI is expected to have edged back below 2%Y/Y, while core inflation is likely to have moved sideways at 2.1%Y/Y. Meanwhile, a stronger showing from retail sales is expected, while manufacturing output is anticipated to have posted the first increase for five months. Sentiment surveys will also be closely watched, including the NFIB small business optimism indicator (Tuesday) and the preliminary University of Michigan consumer confidence index (Friday). In the markets, the Treasury will sell 3Y notes on Tuesday, 10Y notes on Wednesday and 30Y bonds on Thursday.

### France: Industrial production by sub-sector



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

### France: Export values by destination



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

## UK

### Another downbeat UK jobs survey
















While recent hard data from the UK labour market have been relatively firm, with the unemployment rate down to a more than four-decade low of 3.8% in the three months to March, economic surveys have been less sanguine about the outlook for job growth. On a relatively quiet end to the week for UK economic data, the KPMG/REC report on jobs maintained a downbeat assessment of near-term labour market prospects. Recruitment agencies reported that permanent placements continued to decline in May and at a faster pace than April, while temporary placements rose at the slowest rate for over six years. Demand for staff remained subdued, with vacancy growth as measured by the survey reportedly close to a multi-year low, while the pool of potential candidates fell too. While many firms have preferred to hire extra staff rather than invest in new capital, Brexit uncertainty has unsurprisingly made them increasingly risk averse, and their willingness to recruit seems to have declined too.

### The week ahead in the UK

Attention in the UK in the coming week will be on politics, as the nomination process for the Conservative party leadership closes on Monday. As things currently stand there are eleven candidates, although we might see this number reduce over the weekend as potential contenders acknowledge the lack of required support to progress. The first ballot among MPs to officially eliminate one candidate will be held on Thursday, with subsequent rounds to be conducted over the following week. When the number of contenders has been whittled down to two, party members will be allowed to vote, with the winner likely to be confirmed in the week commencing 22 July.

It will be a busy week for UK economic data too, with the release on Monday of the monthly activity indicators for April. Most notably, the monthly GDP figure is expected to report a soft start to Q2 following a contraction in March even as consumer spending was boosted by the timing of Easter and warmer weather. Indeed, while services and construction activity might have grown in April, manufacturers likely scaled back production significantly following the inventory-related surge in Q1 and as car factories shut down in the face of possible no-deal disruption. The latest labour market figures, due Tuesday, will also be of interest. Following the marked drop in the number of people employed in February and March, the headline employment figure in April is expected to report the first decline on a three-month basis since October 2017. This notwithstanding, the headline unemployment rate is expected to remain unchanged at 3.8%. Average wage growth, meanwhile, is likely to edge lower to an eight-month low of 3.0%3M/Y. Finally, the RICS house price survey for May is due on Thursday. In the markets, the DMO will sell 30Y Gilts on Wednesday.

## Daiwa economic forecasts









		2019				2020				2018	2019	2020
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
GDP forecasts %, Q/Q												
Euro area		0.4	0.2	0.3	0.3	0.3	0.3	0.2	0.2	1.8	1.2	1.1
Germany		0.4	0.1	0.3	0.3	0.3	0.3	0.2	0.2	1.4	0.8	1.1
France		0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	1.7	1.2	1.2
Italy		0.1	0.1	0.2	0.1	0.1	0.2	0.0	0.0	0.7	0.3	0.4
Spain		0.7	0.6	0.5	0.5	0.4	0.4	0.4	0.4	2.6	2.3	1.8
UK		0.5	0.1	0.3	0.3	0.3	0.3	0.2	0.3	1.4	1.4	1.1
Inflation forecasts %, Y/Y												
Euro area												
Headline CPI		1.4	1.4	1.2	1.1	1.5	1.4	1.4	1.4	1.8	1.3	1.4
Core CPI		1.0	1.1	1.1	1.1	1.2	1.2	1.3	1.3	1.0	1.1	1.2
UK												
Headline CPI		1.9	2.0	1.8	1.5	1.9	1.7	1.6	1.8	2.5	1.8	1.7
Core CPI		1.9	1.7	1.7	1.7	1.8	2.0	2.0	2.0	2.1	1.7	1.9
Monetary policy												
ECB												
Refi Rate %		0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Deposit Rate %		-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40
Net asset purchases*		0	0	0	0	0	0	0	0	15	0	0
BoE												
Bank Rate %		0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75
Net asset purchases**		0	0	0	0	0	0	0	0	0	0	0

\*Monthly target €bn, end of period. \*\*Monthly target £bn, end of period. Source: Bloomberg, ECB, BoE and Daiwa Capital Markets Europe Ltd.

## European calendar

### Today's results

#### Economic data




















Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Germany	 Industrial production M/M% (Y/Y%)	Apr	<b>-1.9 (-1.8)</b>	-0.5 (-0.4)	0.5 (-0.9)	-
	 Labour costs Q/Q% (Y/Y%)	Q1	<b>1.1 (2.5)</b>	-	-0.1 (2.0)	<b>0.2 (2.0)</b>
	 Trade balance (current account) €bn	Apr	<b>17.9 (22.6)</b>	19.5 (-)	22.6 (30.2)	<b>22.6 (30.9)</b>
	 Exports (imports) M/M%	Apr	<b>-3.7 (-1.3)</b>	-0.9 (-0.2)	1.5 (0.4)	<b>1.6 (0.7)</b>
France	 Industrial production M/M% (Y/Y%)	Apr	<b>0.4 (1.1)</b>	0.3 (1.0)	-0.9 (-0.9)	<b>-1.1 (-0.7)</b>
	 Trade balance (current account) €bn	Apr	<b>-5.0 (-0.8)</b>	-4.7 (-)	-5.3 (-1.3)	<b>-5.5 (-2.3)</b>
Italy	 Retail sales M/M% (Y/Y%)	Apr	<b>0.0 (4.2)</b>	-	-0.3 (-3.3)	-
UK	 Halifax house prices M/M% (3M/Y%)	May	<b>0.5 (5.2)</b>	-0.2 (5.0)	1.1 (5.0)	<b>1.2 (-)</b>

#### Auctions

Country	Auction
- Nothing to report -	








Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

## Coming week's data calendar

Key data releases						
Country		BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
<b>Monday 10 June 2019</b>						
Italy		09.00	Industrial production M/M% (Y/Y%)	Apr	0.1 (-0.5)	-0.9 (-1.4)
UK		09.30	GDP M/M% (3M/3M%)	Apr	-0.1 (0.4)	-0.1 (0.5)
		09.30	Services output M/M% (3M/3M%)	Apr	0.1 (0.2)	-0.1 (0.3)
		09.30	Industrial production M/M% (Y/Y%)	Apr	-1.0 (0.9)	0.7 (1.3)
		09.30	Manufacturing production M/M% (Y/Y%)	Apr	-1.4 (2.0)	0.9 (2.6)
		09.30	Construction output M/M% (Y/Y%)	Apr	0.5 (3.3)	-1.9 (3.2)
		09.30	Trade balance (goods trade balance) £bn	Apr	-4.7 (-13.0)	-5.4 (-13.7)
<b>Tuesday 11 June 2019</b>						
France		07.30	Bank of France business sentiment	May	-	99
UK		09.30	ILO unemployment rate 3M%	Apr	3.8	3.8
		09.30	Employment change 3M/3M '000s	Apr	4	99
		09.30	Average weekly earnings (excl. bonuses) 3M/Y%	Apr	3.0 (3.2)	3.2 (3.3)
		09.30	Claimant count rate % (change '000s)	May	-	3.0 (24.7)
<b>Wednesday 12 June 2019</b>						
Spain		08.00	Final CPI (EU-harmonised) Y/Y%	May	0.8 (0.9)	1.5 (1.6)
<b>Thursday 13 June 2019</b>						
EMU		10.00	Industrial production M/M% (Y/Y%)	Apr	-0.3 (-0.5)	-0.3 (-0.6)
Germany		07.00	Final CPI (EU-harmonised) Y/Y%	May	1.4 (1.3)	2.0 (2.1)
UK		00.01	RICS house price balance %	May	-	-23
<b>Friday 14 June 2019</b>						
France		07.45	Final CPI (EU-harmonised) Y/Y%	May	1.0 (1.1)	1.3 (1.5)
Italy		09.00	Industrial sales (orders) Y/Y%	Apr	-	1.3 (-3.6)
		10.00	Final CPI (EU-harmonised) Y/Y%	May	0.9 (0.9)	1.1 (1.1)

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

## Coming week's events/auctions calendar

Key events & auctions			
Country	BST	Event / Auction	
Monday 10 June 2019			
- Nothing scheduled -			
Tuesday 11 June 2019			
- Nothing scheduled -			
Wednesday 12 June 2019			
EMU		09.15	ECB Draghi and de Guidos scheduled to speak in Frankfurt
Germany		10:30	Auction: to sell €3bn of 0.25% 2029 bonds
UK		10.30	Auction: to sell 0 <sup>1</sup> / <sub>8</sub> % 2048 bonds
Thursday 13 June 2019			
EMU		-	Eurogroup meeting
Italy		10.00	Auction: to sell 3Y bonds
		10.00	Auction: to sell 7Y bonds
UK		-	First Conservative leadership ballot to be held
Friday 14 June 2019			
- Nothing scheduled -			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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