

Euro wrap-up

Overview

- Bunds followed USTs lower, while BTPs outperformed despite some soft Italian industrial production figures for the start of Q2.
- Gilts made modest losses despite some weaker-than-expected UK GDP and manufacturing output data for April.
- Tomorrow will bring UK labour market figures, along with a Bank of France business sentiment survey.

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Daily bond market movements

Bond	Yield	Change*
BKO 0 06/21	-0.670	+0.002
OBL 0 04/24	-0.590	+0.011
DBR 0¼ 02/29	-0.219	+0.038
UKT 1½ 01/21	0.551	+0.016
UKT 1 04/24	0.602	+0.020
UKT 1½ 10/28	0.834	+0.020

*Change from close as at 4.30pm BST.

Source: Bloomberg

Euro area

Italian IP falls short of expectations

After data at the end of last week showed that manufacturing production fell notably in [Germany](#) at the start of the second quarter, today's Italian IP release reported an unexpected decline in output in April. In particular, total production fell 0.7%M/M, following a drop of 1.0% in March to leave output 1½% lower than a year ago. And in the absence of a 3½%M/M rise in energy production, the decline would have been even steeper. Indeed, manufacturing output fell for the second successive month and by 0.9%M/M, with a notable decline in production of capital goods (down 2.5%M/M, to its lowest level since mid-2017) alongside a further weakening in production of intermediate and consumer goods. So, in April, manufacturing output was 1.3% below the average level of output in Q1. The latest manufacturing PMI implied some stabilisation – the output component rose 2.7pts to 49.7. But given heightened risks surrounding the stability of the Italian government as well as the more downbeat global economic outlook, manufacturers will highly likely take a cautious approach to near-term production plans. As such, we wouldn't be surprised to see manufacturing production in Q2 reverse much if not all of the 0.7%Q/Q increase recorded in Q1.

The day ahead in the euro area and US

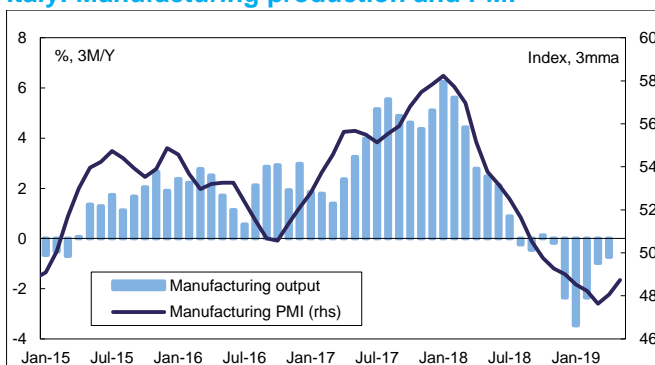
Tomorrow will bring an update on business conditions in France, with the Bank of France's survey for May expected to show the headline industrial sentiment indicator up back to 100, bang in line with the long-run average. And so the survey is likely to remain consistent with GDP growth of 0.3%Q/Q in Q2. In the US, meanwhile, tomorrow's release of the NFIB's small business optimism survey is expected to see the headline indicator fall back towards the bottom of the recent range. The latest PPI figures for May will also be watched ahead of Wednesday's CPI release. In the markets, the US Treasury will sell 3Y notes.

UK

Economic activity declines more than expected in April

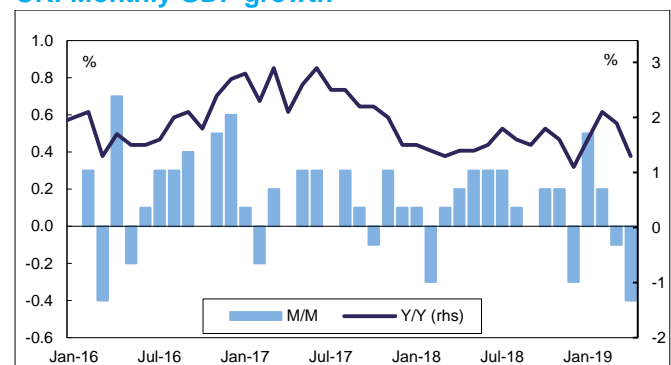
At face value, the UK's economy saw solid expansion at the start of the year, with growth accelerating 0.3ppt to 0.5%Q/Q in Q1. But this principally reflected precautionary stock-building and other preparations to cope with the economic disruption that would have occurred had the UK left the EU without a deal at the end of March. With the related boost seemingly having gone into reverse after the Article 50 deadline was extended, today's monthly activity figures for April provided a pretty bleak assessment of the economy at the start of Q2. In particular, GDP fell a bigger-than-expected 0.4%M/M, following a decline

Italy: Manufacturing production and PMI



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

UK: Monthly GDP growth



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.



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of 0.1%M/M in March, to leave output up just 1.3%Y/Y, down 0.6ppt from March. That principally reflected a dire manufacturing performance, with output falling 3.9%M/M in April, the most since June 2002. There were drops in most manufacturing sub-sectors and a huge fall of 24.0%M/M in autos production as car plants brought forward their annual maintenance shutdowns from the summer. Elsewhere, construction output fell for the second successive month and by 0.4%M.M. And while services output was unchanged following a decline in March, this left growth on a three-month basis (0.2%3M/3M) at the weakest for a year.

GDP likely to contract in Q2

While we expect manufacturing output to rebound somewhat in May, recent surveys have been downbeat. For example, in May, the manufacturing PMI fell to its lowest level since the immediate post-referendum slump in July 2016, and the CBI's industrial trends survey implied a marked decline in new orders. Moreover, the recoveries in other sectors seem likely to be subdued. Certainly, retail sector surveys imply a marked weakening in May as the Easter-boost to spending wore off. As such, we now expect UK GDP to drop over Q2 as a whole, which would mark the first quarterly contraction since 2012. And we have revised down our forecast for coming quarters too, not least as business investment and external demand looks set to remain subdued. Indeed, even in the absence of a no-deal Brexit which would cause a deep and long recession, we now expect full-year growth of just 1.2%Y/Y in 2019 and a further slowing to 0.9%Y/Y in 2020.

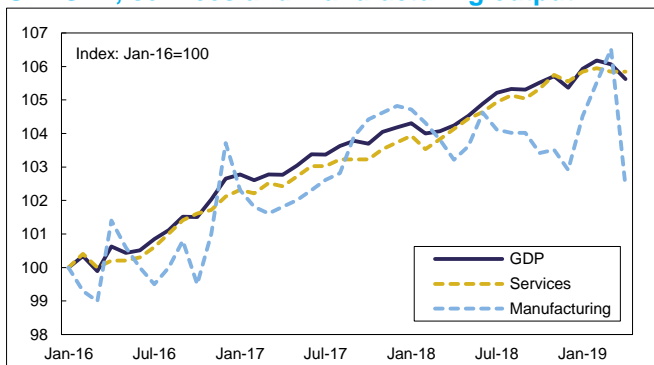
Trade deficit narrows sharply, but imports and exports slump

Today's trade report was, at face value, more encouraging, with the headline trade deficit narrowing a larger-than-expected £3.4bn to £2.7bn in April, the smallest deficit in seven months. But, consistent with the aforementioned pattern of activity around the original Article 50 deadline, as well as Friday's weak export data from [Germany and France](#), this reflected a marked fall of 10.8%M/M in the total volume of imports (down 14.4% for goods imports), the most since the series began more than two decades ago. There was also a sharp drop in exports at the start of Q2 too, with the 5½%M/M overall decline the steepest for seven years, while the near-11%M/M fall in goods exports was the largest since 2006. Export weakness was most pronounced in shipments to the EU – down more than 15½%M/M. Smoothing out monthly volatility, total exports were broadly flat on a three-month basis in April. But with imports up 4½%3M/3M, today's report strongly suggests that net trade continued to provide a significant drag on GDP growth at the start of Q2.

The day ahead in the UK

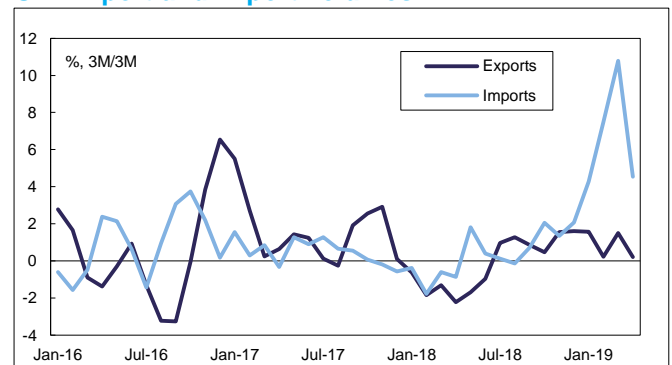
With recent surveys having signalled a further deterioration in the UK's labour market, tomorrow's official labour market figures will also be of interest. Following the marked drop in the number of people employed in February and March, the headline employment figure in April might well report the first 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. Elsewhere, MPC members Ben Broadbent and Michael Saunders will appear before the Treasury Select Committee for their respective reappointment hearings, while Silvana Tenreiro will speak at a conference in Lisbon.

UK: GDP, services and manufacturing output










Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: Export and import volumes










Source: Thomson Reuters 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
Italy	 Industrial production M/M% (Y/Y%)	Apr	-0.7 (-1.5)	0.1 (-0.5)	-0.9 (-1.4)	-1.0 (-1.6)
UK	 GDP M/M% (3M/3M%)	Apr	-0.4 (0.3)	-0.1 (0.4)	-0.1 (0.5)	-
	 Services output M/M% (3M/3M%)	Apr	0.0 (0.2)	0.1 (0.2)	-0.1 (0.3)	-
	 Industrial production M/M% (Y/Y%)	Apr	-2.7 (-1.0)	-1.0 (0.9)	0.7 (1.3)	-
	 Manufacturing production M/M% (Y/Y%)	Apr	-3.9 (-0.8)	-1.4 (2.0)	0.9 (2.6)	-
	 Construction output M/M% (Y/Y%)	Apr	-0.4 (2.4)	0.5 (3.3)	-1.9 (3.2)	-
	 Trade balance (goods trade balance) £bn	Apr	-2.7 (-12.1)	-4.7 (-13.0)	-5.4 (-13.7)	-6.2 (-15.4)
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	
France	 07.30	Bank of France business sentiment	May	100	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)	
	Auctions and events					
Country	BST	Auction / Event				
UK	 10.00	MPC members Broadbent and Saunders to appear before Treasury Select Committee for reappointment hearings				
	 10.00	MPC member Tenreyro scheduled to speak in Lisbon				

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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