

Euro wrap-up

Overview

- Bunds made modest gains, and euro area periphery sovereign bonds outperformed again, as the Commission's sentiment survey reported only a modest improvement but German and Spanish inflation fell further.
- Gilts made modest losses while Governor Bailey restated that the BoE is considering further easing options, including cutting rates into negative territory.
- Friday will bring the flash estimate of euro area inflation in May along with German and French spending data for April.

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Daily bond market movements

Bond	Yield	Change
BKO 0 03/22	-0.656	-0.005
OBL 0 04/25	-0.621	-0.010
DBR 0 02/30	-0.424	-0.008
UKT 0½ 07/22	-0.022	+0.001
UKT 0% 06/25	0.013	+0.010
UKT 4% 12/30	0.211	+0.018

*Change from close as at 4:30pm BST.
Source: Bloomberg

Euro area

Commission survey suggests modest improvement in sentiment

Given the gradual easing of social distancing measures, and consistent with the [flash PMIs](#), today's European Commission business and consumer surveys suggested that economic sentiment has picked up slightly in the current month but remains very weak. The Commission's headline euro area Economic Sentiment Indicator (ESI) inched up 2.6pts from April's series low to 67.5, still very close to the earlier trough reached during the global financial crisis in 2008-9. Among the largest member states, sentiment improved most in the countries that had been less affected by the pandemic (Germany and the Netherlands) while it edged only slightly higher in Spain and dipped slightly in France. Meanwhile, Italy's confidence indices were published for the first time since March and fell sharply across the board – the headline ESI fell more than 20pts to a record low of just 63.0.

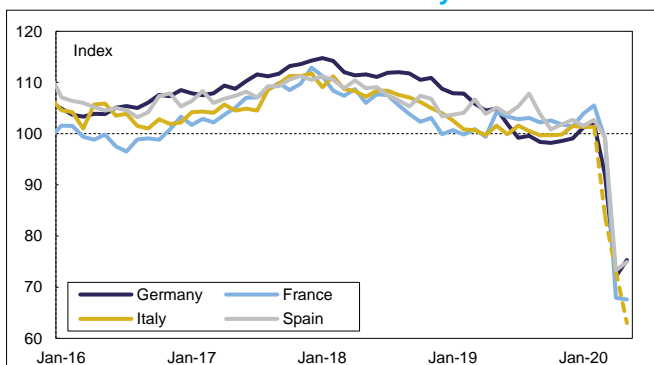
Industrial confidence improved, services even more downbeat

Among the various sectors, the survey suggested that industrial sector sentiment saw the largest rebound, reversing about one fifth of the cumulative decline since the pandemic took hold. Nevertheless, the level of orders in the sector was judged to have fallen further. Moreover, confidence in the larger services sector deteriorated further to a new record low despite improved demand expectations. Retail confidence was only very slightly improved from April's series low. And sentiment in the construction sector weakened, albeit remaining well above historical lows. The modest pickup in the consumer sentiment index flagged in the preliminary estimate (up 3.2pts to -18.8) was confirmed, with an increase in willingness to make major purchases. Most encouragingly perhaps, the Employment Expectations Indicator rose a sizeable 11.3pts from April's series low, with improvement reported across the sectors. Nevertheless, at just 70.2, this remained at a historically low level, with retail and services still signalling expectations of extremely weak labour market conditions. Moreover, selling price expectations improved only very lightly, but remained at levels consistent with very significant disinflationary pressures. So, overall, there will have been nothing in today's survey to change perceptions at the ECB that the euro area economy would benefit from additional stimulus.

Inflation edged lower in May

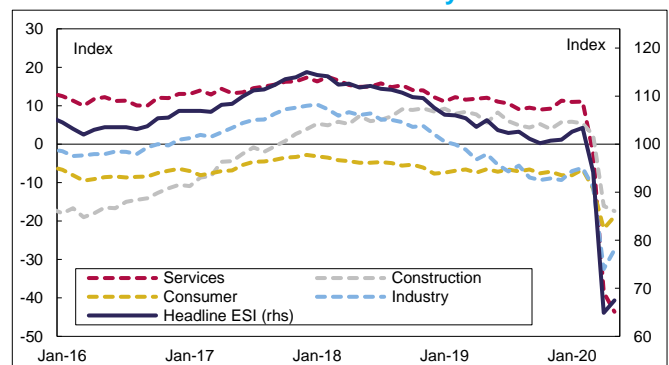
Indeed, while data collection continues to prove challenging due to disruption from Covid-19, the first of the May inflation releases from member states today showed that price pressures continued to diminish. In particular, Germany's headline harmonised inflation rate fell 0.3ppt to 0.5%YY, with the CPI rate on the national measure similarly down 0.3ppt to 0.6%YY, the lowest since summer 2016. Admittedly, the fall this month principally reflected a further drop in energy inflation, while

Euro area: EC sentiment indices by member state*



*April's figure for Italy estimated. Source: European Commission, Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Euro area: EC sentiment indices by sector



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



food prices also moderated somewhat. In contrast, the rates of non-energy industrial goods and services inflation were little changed. The Spanish figures painted a similar picture, with the 0.2ppt drop in the harmonised and national headline CPI measures to -0.9%Y/Y and -1.0%Y/Y largely due to lower fuel prices. So, when the aggregate euro area numbers are published tomorrow, we expect to see headline inflation fall closer to zero from 0.4%Y/Y previously, but only a modest drop in the core CPI rate.

Spanish retail sales inevitably slump

With Spain having undergone one of the most stringent lockdowns, forcing the closure of all non-essential retailers, and unemployment having surged in April, today's retail sales figures for that month were inevitably extremely weak. In particular, sales were down 20.4%M/M, unsurprisingly the sharpest drop on the series following the decline of 15.5%M/M in March. This left them down 31.6%Y/Y, also a record annual fall. Sales in all major sectors dropped. Sales of personal equipment declined more than 60%M/M following a 55%M/M drop in the previous month, with sales of household goods also down 40%M/M. Sales of petrol also continued to tank (down 41%M/M) as residents remained confined to their homes. And having jumped 8½%M/M the prior month, food store sales dropped 8.6%M/M in April. So, while sales are likely to have recovered somewhat this month as lockdown measures started to ease, we still anticipate a significant contraction in private consumption in Q2, far exceeding the 7.3%Q/Q drop in Q1.

The day ahead in the euro area and US

Looking ahead, tomorrow brings euro area bank lending figures for April, which are expected to show a further notable increase in demand for business loans as companies responded to increased liquidity strains caused by lockdowns. Friday also sees the release of monthly German and French expenditure data for April. Like today's dire numbers from Spain, we expect these to suggest that, in the face of widespread shop closures and country lockdowns, consumption contracted at record rates in the largest two member states at the start of Q2. Friday will also bring updated Q1 GDP readings from France and Italy. The preliminary Q1 GDP estimates revealed that growth fell 5.8%Q/Q (-5.4%Y/Y) in France, while in Italy it was down 4.7%Q/Q (-4.8%Y/Y). Meanwhile, the flow of inflation data also continues tomorrow with the publication of preliminary figures for May from Italy and France as well as the aggregate euro area estimate. Headline euro area inflation is expected to fall 0.3ppt to 0.1%Y/Y, principally due to weaker energy prices. The core measure of inflation is expected to fall a modest 0.1ppt to 0.8%Y/Y. In the markets, Italy will sell €2.5bn of 5Y bonds, €4bn of 10Y bonds and €1bn of short-dated FRNs.

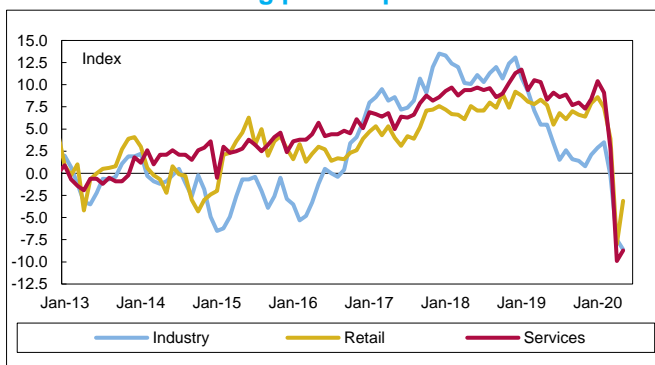
In the US, advanced goods trade data for April are due tomorrow, together with personal income and spending numbers for the same month, as well as the Chicago PMI and final University of Michigan consumer sentiment survey for May.

UK

UK economic sentiment index deteriorates further

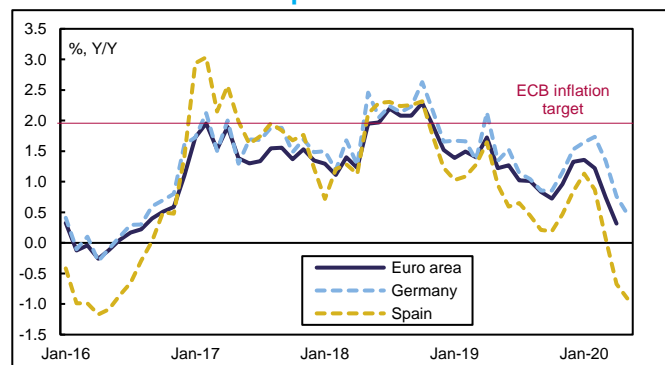
Contrasting with the euro area's ESI and the message from other recent UK surveys including the flash PMIs, today's Commission survey suggested that economic sentiment deteriorated further in May. Indeed, the headline ESI fell 0.7pt to 61.7, the second-lowest reading on record and just 1pt above the trough during the global financial crisis. The weakness was particularly evident among retailers, with the sector's headline index falling 11.4pts to a record-low -50.7 due principally to the marked drop in sales over the past three months. While conditions will remain challenging over coming months as retailers have to adapt operations to abide by social distancing rules, the survey suggested that they were somewhat less downbeat about the outlook for sales, orders and employment over the coming three months than they were in April. While the monthly decline in the headline services sentiment index was less severe in May (down 8.5pts to -67.3, still the weakest reading on record by some margin), the survey suggested firms in the sector remained more downbeat about the outlook

Euro area: EC selling price expectations



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

Euro area: Consumer price inflation*



*German and Spanish figures for May are flash estimates.
 Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

ahead, particularly so in the accommodation and food and beverage services subsectors. Perhaps unsurprisingly given that manufacturers were encouraged back to work in the middle of the month, firms reported an increase in expectations for future production and employment. Overall, however, today's survey remains consistent with sharp contraction in output across all sectors and still very subdued output over the coming three months too.

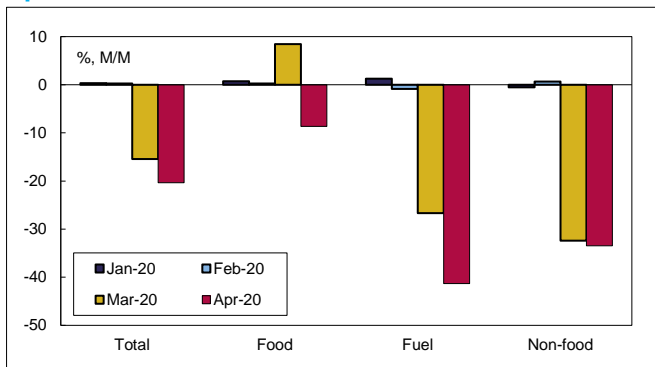
Many workers to remain furloughed even as firms restart trading

The ONS's latest experimental data on the impact of the pandemic provided further colour. Among other things, this suggested that 79% of firms had now applied for wage subsidies under the government's Job Retention Scheme, while 15% had applied for government-backed loans. And 46% of firms did not have sufficient cash reserves to last six months. With the relaxation of lockdown restrictions, 14% of firms were able to report that they were intending to restart trading in the next two weeks. But, of those firms, a little less than one third of staff were likely to return from furlough leave. And only a further 10% of firms expected to restart in the following two-week period. Meanwhile, the ongoing shock to the labour market was illustrated by data which showed that the number of online job vacancies was still down more than 50% from early March. Compared to the 2019 average, vacancies in retail were down about 75%, with those in hospitality down further still.

The day ahead in the UK

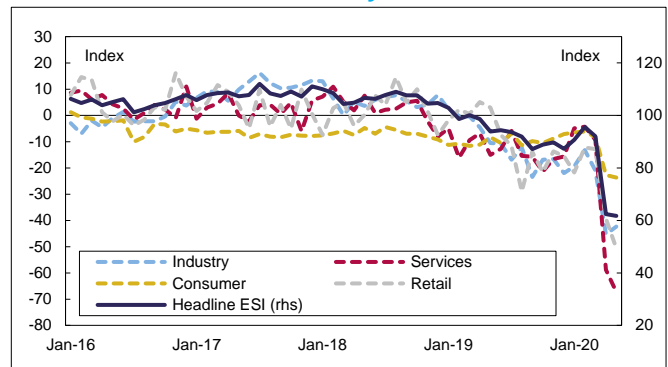
A quiet day on the data front in the UK tomorrow will bring just the release of the Lloyds business sentiment survey for May, which is expected to further highlight the ongoing devastating impact of the coronavirus pandemic on businesses.

Spain: Retail sales



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: EC sentiment indices by sector











Source: European Commission, 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
EMU	 Economic sentiment indicator	May	67.5	70.6	67.0	64.9
	 Industrial confidence (services)	May	-27.5 (-43.6)	-25.7 (-27.9)	-30.4 (-35.0)	-32.5 (-38.6)
	 Final consumer confidence	May	-18.8	-18.8	-22.0	-
Germany	 Preliminary CPI (EU-harmonised CPI) Y/Y%	May	0.6 (0.5)	0.6 (0.4)	0.9 (0.8)	-
Italy	 Economic sentiment indicator	May	51.1	-	81.7*	-
	 Consumer confidence (manufacturing)	May	94.3 (71.2)	89.9 (80.0)	101.0 (89.5)*	-
Spain	 Retail sales Y/Y%	Apr	-31.6	-	-14.1	-14.2
	 Preliminary CPI (EU-harmonised CPI) Y/Y%	May	-1.0 (-0.9)	-1.0 (-0.9)	-0.7 (-0.7)	-











Auctions

Country	Auction
UK	 sold £2.75bn of 1.25% 2027 bonds at an average yield of 0.025%
	 sold £2bn of 1.75% 2049 bonds at an average yield of 0.604%




*Previous figures are for February. 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
EMU	09.00	 M3 money supply Y/Y%	Apr	8.2	7.5
	10.00	 CPI estimate (core CPI) Y/Y%	May	0.1 (0.8)	0.4 (0.9)
Germany	07.00	 Retail sales M/M% (Y/Y%)	Apr	-12.0 (-14.0)	-4.0 (-1.2)
France	07.45	 Preliminary CPI (EU-harmonised CPI) Y/Y%	May	0.3 (0.3)	0.3 (0.4)
	07.45	 Consumer spending M/M% (Y/Y%)	Apr	-14.7 (-32.2)	-17.9 (-18.1)
	07.45	 Final GDP Q/Q% (Y/Y%)	Q1	-5.8 (-5.4)	-0.1 (0.9)
Italy	09.00	 Final GDP Q/Q% (Y/Y%)	Q1	-4.8 (-4.7)	0.1 (-0.3)
	10.00	 Preliminary CPI (EU-harmonised CPI) Y/Y%	May	-0.1 (-0.2)	0.0 (0.1)
UK	00.01	 Lloyds business barometer	May	-	-32
	-	 Nationwide house price index* M/M% (Y/Y%)	May	-1.0 (2.8)	0.7 (3.7)

Auctions and events

Country	BST	Auction / Event
Italy	10.00	 Auction: €2.5bn of 1.85% 2025 bonds
	10.00	 Auction: €1bn of 2023 floating-rate bonds
	10.00	 Auction: €4bn of 0.95% 2030 bonds

*Approximate date of release. Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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