

# Euro wrap-up

## Overview

- Bunds made gains while flash euro area data revealed a modest drop in GDP in Q1, a rise in headline inflation in April to a two-year high but also a drop in core inflation.
- Gilts were little changed ahead of Monday's UK bank holiday.
- The coming week brings the latest monetary policy announcement and forecasts from the BoE, along with data for euro area retail sales and German and French IP and goods trade.

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### Daily bond market movements

Bond	Yield	Change
BKO 0 03/23	-0.693	-0.004
OBL 0 04/26	-0.578	-0.013
DBR 0 02/31	-0.202	-0.007
UKT 0 <sup>1</sup> / <sub>8</sub> 01/23	0.067	-0.001
UKT 0 <sup>1</sup> / <sub>8</sub> 01/26	0.383	+0.002
UKT 4 <sup>3</sup> / <sub>4</sub> 12/30	0.838	-0.002

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

Source: Bloomberg

## Euro area

### Q1 GDP data close to expectations with modest second quarterly drop in the euro area

According to today's preliminary estimate, euro area GDP dropped a relatively modest 0.6%Q/Q in the first quarter. Following a contraction of 0.7%Q/Q in Q4, that left it down 1.8%Y/Y and a more substantive 5.5% below the pre-Covid level in Q419. The size of the drop in Q1 was minimally larger than that forecast by the ECB (-0.4%Q/Q), and trivially less than our own expectation and the consensus forecast (both -0.8%). The data from most of the member states were not far from expected too. Having grown 0.5%Q/Q in Q4, Germany fared worse than the other large member states, with GDP dropping 1.7%Q/Q, albeit only a touch more than expected. That left it down 3.0%Y/Y and 4.9% below the pre-pandemic level. In France, GDP rose 0.4%Q/Q in Q1. That, however, was insufficient to fully reverse the drop of 1.4%Q/Q in Q4, and left the level of economic output still a substantive 4.4% below the pre-Covid level of Q419. GDP in Italy and Spain fell at a similar pace, down 0.4%Q/Q and 0.5%Q/Q respectively. That left Italian GDP down just 1.4%Y/Y, but – given the big hit from the pandemic at the start of 2020 – a steeper 6.9% below the level in Q419. And Spanish GDP was down 4.3%Y/Y but a hefty 9.4% below the pre-pandemic level.

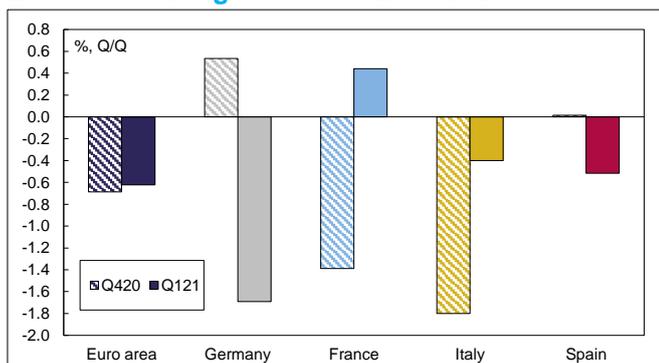
### Household consumption and net trade likely weighed on euro area GDP in Q1

No detail of the expenditure breakdown of euro area GDP in Q1 was published by Eurostat today. While the limited information provided by the member states gave mixed signals about the principal drivers of the contraction, household spending and net trade appear the main culprits. Destatis reported that those components subtracted from growth in Germany, but provided no specific data. But in France, household consumption edged higher, rising 0.3%Q/Q following the steep drop of 5.7%Q/Q in Q4. Fixed investment rose for a third successive quarter, accelerating 2.2%Q/Q. But with exports dropping 1.5%Q/Q and imports only marginally weaker (-0.1%Q/Q), net trade subtracted 0.4ppt. In contrast, in Spain, consumption dropped 0.6%Q/Q while fixed investment fell a steeper 1.9%Q/Q. But with imports down 1.3%Q/Q and exports down just 0.1%Q/Q, net trade added 0.4ppt to GDP growth. In Italy, ISTAT only emphasised the weakness of net trade, which reportedly more than offset a pickup in domestic demand.

### Recovery to build from the current quarter on, pre-pandemic level to be reached in first half of 2022

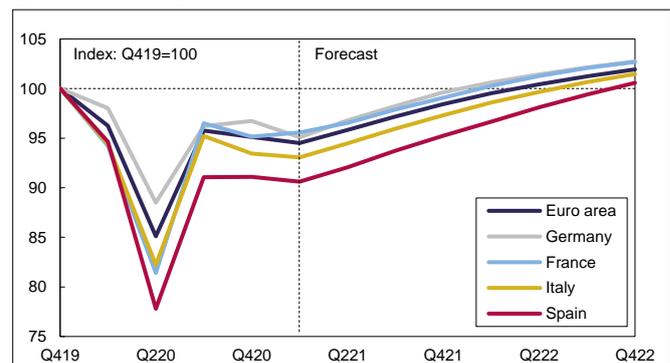
Assuming further reopening of the economies in the large member states from mid-May on, we expect household consumption to start to rebound in Q2, when net trade should provide significant support too. Indeed, given the strength of the [April surveys](#), we expect the level of GDP this quarter to return close to that in Q320, with further growth highly likely in the second half of the year. Assuming that the improved implementation of vaccination programmes allows significant

#### Euro area: GDP growth in Q420 & Q121



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

#### Euro area: GDP forecast



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

normalisation of activity by year-end, the pre-pandemic level of euro area GDP should be surpassed by Q222. We expect that landmark to be reached in Germany and France around the turn of the year. But given the larger amount of lost ground to make up, that might have to wait until Q322 in Italy and the end of next year in Spain.

### Inflation up to two-year high, but core measure remains highly subdued

Broadly in line with what had been suggested by yesterday's equivalent data from Germany and Spain, the flash estimate of euro area inflation in April rose 0.3ppt to 1.6%Y/Y, the highest since April 2019. The rise was driven principally by energy inflation, which – largely due to base effects associated with the plunge in oil prices a year ago – accelerated 6.0ppts to 10.3%Y/Y, the highest since October 2018, contributing 1.0ppt to the headline rate. In contrast, food inflation fell 0.4ppt to 0.7%Y/Y, the lowest since November 2016. Prices of non-energy industrial goods rose 0.5%Y/Y, up 0.2ppt from March but still a subdued rate to suggest that supply-side pressures continue to be largely absorbed by producers' and retailers' margins. And with pandemic restrictions continuing to hit activity, services inflation fell 0.4ppt to a four-month low of 0.9%Y/Y. As a result, core inflation moderated 0.1ppt to 0.8%Y/Y, just 0.1ppt above the average of the preceding twelve months, suggesting that underlying inflation remains highly subdued.

### Headline inflation to rise above 2.0%Y/Y in H221 before falling back sharply next year

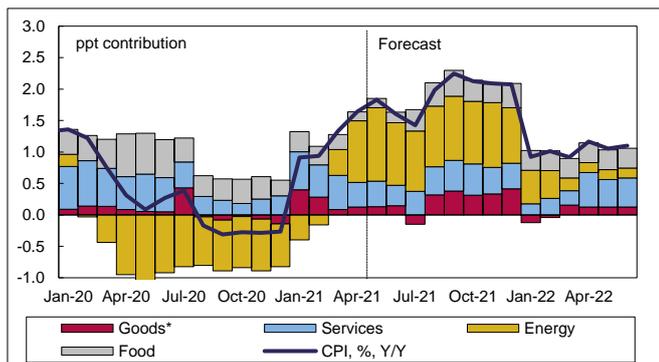
Even without further significant increases in prices, energy inflation will rise again in May, probably to above 12%Y/Y. And so, while core inflation is likely to remain steady, headline CPI will increase again, probably to around 1.8%Y/Y next month. Changes to the timing of sales in certain countries will likely inject some volatility over the subsequent couple of months. But base effects associated with last year's cut in German VAT will likely push inflation up further to 2.0%Y/Y or above between August and December. Thereafter, however, with little evidence that underlying pressures will be passed onto consumers in any substantive way, both headline and core inflation will likely fall back in January, and remain well below the ECB's target of close to 2.0%Y/Y thereafter, meriting ongoing net asset purchases from the central bank throughout next year.

### The week ahead in the euro area

The coming week's economic data calendar kicks off on Monday with the release of German retail sales data. Sales are expected to have risen about 3%M/M in March following February's upwardly revised increase of 2.7%M/M. However, given January's 6.2%M/M decline – when sales were hit by the reversal of the VAT reduction and stricter lockdown measures – sales in March would still be below the level in December and down more than 8%Q/Q in Q1 as a whole, underscoring the likelihood that private consumption detracted from growth in Q1. The start of the week also sees the publication of April new car registrations data from the larger member states, while aggregate figures for euro area retail sales and German factory orders in March will be published on Thursday. On Friday, March IP numbers from Germany, France and Spain will be released, as well as trade figures for Germany and France. Despite ongoing disruption to the supply of semiconductors, surveys point to a firmer end to Q1 for manufacturers, with German IP likely to have risen about 2.0%M/M. Given weakness earlier in the quarter, however, that would leave IP down 0.8%Q/Q in Q1.

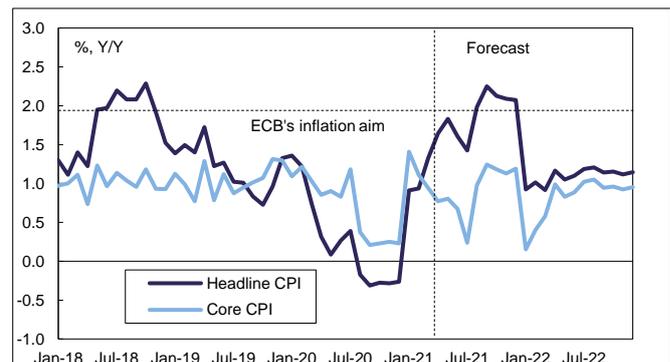
Survey-wise, Monday brings the release of the final manufacturing PMIs, which will be followed on Wednesday by the final services and composite PMIs. All are expected to align with the upbeat picture painted by the flash data. In particular, the flash data revealed that the euro area composite output PMI rose 0.5pt in April to 53.7, a nine-month high well within expansion territory for a second month. It was also the second-highest reading since September 2018. While the euro area manufacturing output PMI rose just 0.1pt, at 63.4 that represented a series high. And the euro area services activity PMI rose 0.7pt to 50.3, the best (and first reading above 50) since August, to suggest significant resilience to the tightening of pandemic restrictions. The detail of the survey pointed to further growth ahead, with the flash PMIs implying the strongest growth in new orders since September 2018, with a record gain in manufacturing and near-stability in services. Meanwhile, if the Commission's survey is anything to go by, Thursday's construction PMIs should also point to an improvement in the

#### Euro area: Inflation forecast



\*Non-energy industrial goods. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

#### Euro area: Inflation forecast



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

building sector in April. We will also hear from a number of ECB Governing Board members in the coming week, including Chief Economist Lane on Wednesday and President Lagarde on Friday.

## UK

### Economic activity in Q1 was not as weak as BoE anticipated

The main event in the UK in the coming week will be the BoE's monetary policy announcement on Thursday, which will be accompanied by updated economic projections in the latest Monetary Policy Report. Recent economic data have largely been stronger than the MPC expected when the last projections were published in February. Indeed, while the BoE forecast a fall in GDP of 4.2%Q/Q in Q1, we currently expect a decline of just 1.5%Q/Q. Thanks to ongoing government support for the labour market, unemployment appears to be undershooting the BoE's projection too. And while CPI inflation, at 0.6%Y/Y in Q1, was slightly below the BoE's forecast, weakness was principally due to clothes discounting, which is likely to prove temporary.

### BoE to revise up near-term GDP outlook next week

There are many reasons for the BoE to be optimistic about the near-term economic outlook too. The rate of new Covid-19 cases has slowed significantly across the UK while progress with vaccinations has been rapid, with more than half of all adults having received at least one dose already. So, the government has been able to ease restrictions at a faster pace than assumed previously by the BoE. In addition, UK fiscal policy this year and next will be more supportive than it had assumed in the February forecasts, not least due to extensions to the government's business support measures to September and the "super-deduction" tax relief for businesses to encourage investment. Prospects for external demand, particularly from the US, have improved too. So, as Governor Bailey suggested in a radio interview ahead of the March MPC meeting, the BoE will likely bring forward the date to Q421 (from Q122) at which it expects the pre-Covid level of GDP to be surpassed.

### BoE projection unlikely to see inflation significantly above target at end of projection horizon

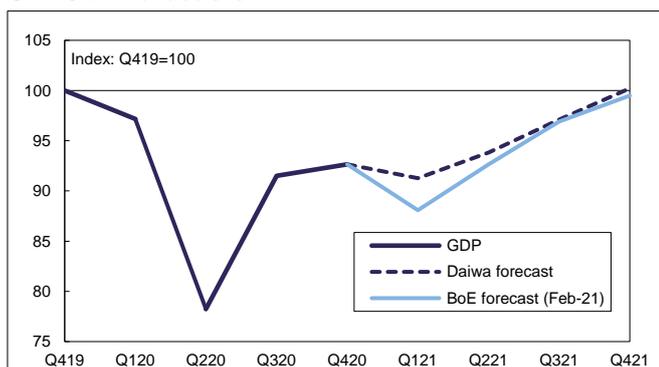
The MPC is unlikely to be complacent about the near-term outlook, however. The emergence of new mutations that render vaccines ineffective remains a key risk. Current waves of pandemic in many countries, not least India, provide a reminder that the global economy is not out of the woods just yet. There are also significant uncertainties with respect to the impact of the phasing out of government support measures later in the year, not least on the labour market, in which the full extent of slack is hard to determine. And looking further ahead into 2023, the BoE will have to anticipate a non-negligible tightening of fiscal policy from FY23/4, which could well weigh significantly on economic activity at the end of its projection period. The inflation projection will also be weighed by the market-implied path for Bank Rate, which is now significantly higher than that used to produce the February projections. Indeed, the BoE might still judge that inflation at the end of its projection is unlikely to be significantly above its 2.0%Y/Y inflation target.

### BoE likely to confirm move to taper Gilt purchases at the June meeting

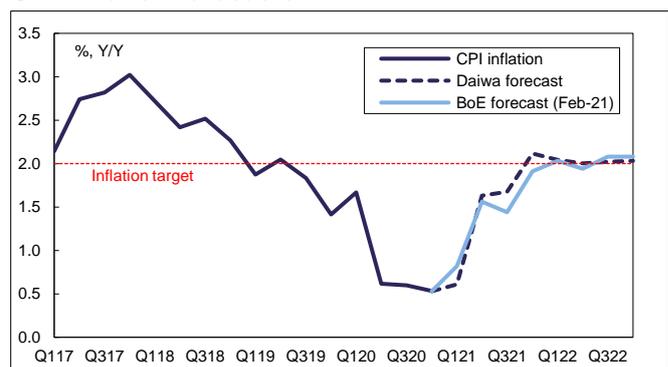
Despite recent upward shifts in market rates, however, the MPC will still judge financial conditions to have remained highly accommodative. By the same token, they will not consider them overly so, and they would not necessarily welcome a significant tightening of conditions just yet. So, with only one member of the MPC (the soon-to-depart Chief Economist Haldane) who might feasibly be considered a hawk, the MPC will probably not yet see the need to taper its Gilt purchases from its current pace of £4.2bn per week. Unlike the Fed, however, it will likely continue to signal its expectation to phase them out gradually before year-end. But a decision to start that process seems most likely to come at the 24 June meeting, which is scheduled just three days after the government currently plans to lift all limits on social contact.

## The week ahead in the UK

### UK: GDP forecasts



### UK: Inflation forecasts



Following Monday's bank holiday, the UK data calendar begins on Tuesday with the release of the latest BoE bank lending figures for March. In February, households continued making net repayments of consumer credit, while borrowing for house purchase remained elevated. Tuesday also brings the release of the final manufacturing PMI for April, which will be followed on Thursday by the release of the final service sector and composite PMIs. The flash release revealed that the composite output PMI rose a hefty 3.6pts to 60, the highest in more than seven years. The services activity PMI similarly jumped to 60.1, to match the highest level since August 2014. And the recovery in manufacturing output (which has up to now lagged that in the euro area this year) reportedly accelerated too, with the respective PMI up to 59.1, an eight-month high albeit lagging services for the first time during the pandemic. Friday's construction PMI, meanwhile, is expected to rise to a high of 62.1 in April, from 61.7 previously. Together, these surveys will be indicative of the likely broad-based recovery to come as restrictions on activity are eased further. Other data published in the coming week include new car registrations for April on Wednesday.

*The next edition of the Euro wrap-up will be published on 5<sup>th</sup> May 2021*

## Daiwa economic forecasts

	2020	2021				2022	2020	2021	2022
	Q4	Q1	Q2	Q3	Q4	Q1			
<b>GDP growth, %, Q/Q</b>									
Euro area 	-0.7	-0.6	1.4	1.4	1.3	1.1	-6.7	3.7	4.4
Germany 	0.5	-1.7	1.8	1.5	1.4	1.0	-5.1	2.7	4.4
France 	-1.4	0.4	1.0	1.4	1.2	1.2	-8.2	5.9	4.4
Italy 	-1.8	-0.4	1.5	1.6	1.4	1.3	-8.9	4.2	5.1
Spain 	0.0	-1.0	1.6	1.8	1.6	1.5	-10.8	4.8	6.2
UK 	1.3	-1.5	2.8	3.5	3.2	1.6	-9.8	6.4	7.7
<b>Euro area</b>									
Headline CPI 	-0.3	1.1	1.7	1.9	2.1	1.0	0.3	1.7	1.1
Core CPI 	0.2	1.2	0.7	0.8	1.2	0.4	0.7	1.0	0.8
<b>UK</b>									
Headline CPI 	0.5	0.6	1.6	1.7	2.1	2.0	0.9	1.5	2.0
Core CPI 	1.3	1.1	1.5	1.5	1.6	1.5	1.4	1.5	1.8
<b>ECB</b>									
Refi Rate % 	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Deposit Rate % 	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50
PEPP envelope* (€bn) 	1850	1850	1850	1850	1850	1850	1850	1850	1850
<b>BoE</b>									
Bank Rate % 	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Bond purchases** (£bn) 	895	895	895	895	895	895	895	895	895

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

# The coming week's data calendar

## The coming week's key data releases

Country	BST	Release	Period	Market consensus/ <i>Daiwa</i> <i>forecast/actual</i>	Previous
<b>Monday 03 May 2021</b>					
EMU		09.00 Final manufacturing PMI	Apr	63.3	62.5
Germany		07.00 Retail sales M/M% (Y/Y%)	Mar	3.3 (-1.6)	2.7 (-6.6)
		08.55 Final manufacturing PMI	Apr	66.4	66.6
France		08.50 Final manufacturing PMI	Apr	59.2	59.3
		- New car registrations* Y/Y%	Apr	-	192
Italy		08.45 Manufacturing PMI	Apr	60.9	59.8
		17.00 New car registrations Y/Y%	Apr	-	497
Spain		08.15 Manufacturing PMI	Apr	58.8	56.9
		- New car registrations* Y/Y%	Apr	-	128
<b>Tuesday 04 May 2021</b>					
UK		09.30 Final manufacturing PMI	Apr	60.7	58.9
		09.30 Net consumer credit £bn (Y/Y%)	Mar	-0.5 (-)	-1.2 (-9.9)
		09.30 Net mortgage lending £bn (approvals '000s)	Mar	5.8 (85.5)	6.2 (87.7)
		09.30 M4 money supply Y/Y%	Mar	-	13.6
<b>Wednesday 05 May 2021</b>					
EMU		09.00 Final services (composite) PMI	Apr	50.3 (53.7)	49.5 (53.2)
		10.00 PPI Y/Y%	Mar	4.1	1.5
Germany		08.55 Final services (composite) PMI	Apr	50.1 (56.0)	51.5 (57.3)
		- New car registrations* Y/Y%	Apr	-	35.9
France		08.50 Final services (composite) PMI	Apr	50.1 (51.7)	48.2 (50.0)
Italy		08.45 Services (composite) PMI	Apr	50.1 (53.0)	48.6 (51.9)
Spain		08.00 Unemployment change '000s	Apr	-	-59.1
		08.15 Services (composite) PMI	Apr	49.6 (51.6)	48.1 (50.1)
UK		09.00 New car registrations Y/Y%	Apr	-	11.5
<b>Thursday 06 May 2021</b>					
EMU		08.30 Construction PMI	Apr	-	50.1
		10.00 Retail sales M/M% (Y/Y%)	Mar	1.0 (9.2)	3.0 (-2.9)
Germany		07.00 Factory orders M/M% (Y/Y%)	Mar	2.0 (27.4)	1.2 (5.6)
		08.30 Construction PMI	Apr	-	47.5
France		08.30 Construction PMI	Apr	-	49.7
Italy		08.30 Construction PMI	Apr	-	56.3
UK		09.30 Final services (composite) PMI	Apr	60.1 (60.0)	56.3 (56.4)
		12.00 BoE Bank Rate %	May	<u>0.10</u>	0.10
		12.00 BoE Gilt purchase target £bn	May	<u>875</u>	875
<b>Friday 07 May 2021</b>					
Germany		07.00 Industrial production M/M% (Y/Y%)	Mar	2.0 (5.6)	-1.6 (-6.4)
		07.00 Trade balance €bn	Mar	20.0	18.2
France		07.00 Trade balance €bn	Mar	-	-5.2
		07.45 Industrial production M/M% (Y/Y%)	Mar	2.0 (15.2)	-4.7 (-6.6)
		07.45 Manufacturing production M/M% (Y/Y%)	Mar	-	-4.6 (-7.1)
Italy		09.00 Retail sales M/M% (Y/Y%)	Mar	-0.6 (-)	6.6 (-5.7)
Spain		08.00 Industrial production M/M% (Y/Y%)	Mar	0.5 (12.6)	0.0 (-2.1)
UK		09.30 Construction PMI	Apr	62.1	61.7

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

## The coming week's key events &amp; auctions

Country	BST	Event / Auction
<b>Monday 03 May 2021</b>		
UK		- Public holiday
<b>Tuesday 04 May 2021</b>		
EMU		09.00 ECB's Villeroy scheduled to speak
Germany		10.30 Auction: €200mn of 0.1% 2046 index-linked bonds
		10.30 Auction: €500mn of 0.1% 2026 index-linked bonds
<b>Wednesday 05 May 2021</b>		
EMU		15.00 ECB Chief Economist Lane scheduled to speak
Germany		10.30 Auction: €4bn of 0% 2026 bonds
UK		10.00 Auction: £2.75bn of 0.25% 2031 bonds
		11.30 Auction: £2bn of 0.875% 2046 bonds
<b>Thursday 06 May 2021</b>		
EMU		09.00 ECB publishes Economic Bulletin
		11.30 ECB's de Guindos participates in online Q&A session
		14.15 ECB's Schnabel scheduled to speak
France		09.50 Auction: 0% 2031 bonds
		09.50 Auction: 0.5% 2040 bonds
		09.50 Auction: 0.75% 2052 bonds
Spain		09.30 Auction: fixed-rate bonds
UK		12.00 BoE monetary policy announcement
		12.00 BoE publishes quarterly Monetary Policy Report
		12.30 BoE Governor Bailey to speak at MPC press conference
		14.00 BoE publishes monthly Decision Maker Panel data
<b>Friday 07 May 2021</b>		
EMU		11.00 ECB President Lagarde scheduled to speak

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

## Today's results

## Economic data

Country	Release	Period	Actual	Market consensus/ Daiwa forecast	Previous	Revised
EMU	 Preliminary CPI (core CPI) Y/Y%	Apr	<b>1.6 (0.8)</b>	<u>1.7 (0.8)</u>	1.3 (0.9)	-
	 Preliminary GDP Q/Q% (Y/Y%)	Q1	<b>-0.6 (-1.8)</b>	<u>-0.8 (-2.0)</u>	-0.7 (-4.9)	-
	 Unemployment rate %	Mar	<b>8.1</b>	8.3	8.3	-
Germany	 Preliminary GDP Q/Q% (Y/Y%)	Q1	<b>-1.7 (-3.3)</b>	<u>-1.0 (-2.7)</u>	0.3 (-2.7)	<b>0.5 (-2.3)</b>
France	 Consumer spending M/M% (Y/Y%)	Mar	<b>-1.1 (18.7)</b>	0.5 (19.7)	0.0 (-0.1)	<b>0.3 (0.0)</b>
	 Preliminary GDP Q/Q% (Y/Y%)	Q1	<b>0.4 (1.5)</b>	<u>0.0 (1.0)</u>	-1.4 (-4.9)	<b>- (-4.8)</b>
	 Preliminary CPI (EU-harmonised CPI) Y/Y%	Apr	<b>1.3 (1.7)</b>	1.3 (1.6)	1.1 (0.7)	-
	 PPI Y/Y%	Mar	<b>4.5</b>	-	1.8	<b>1.9</b>
Italy	 Preliminary unemployment rate %	Mar	<b>10.1</b>	10.3	10.2	-
	 Preliminary GDP Q/Q% (Y/Y%)	Q1	<b>-0.4 (-1.4)</b>	<u>-0.5 (-1.6)</u>	-1.9 (-6.6)	<b>-1.8 (-)</b>
	 Preliminary CPI (EU-harmonised CPI) Y/Y%	Apr	<b>1.1 (1.0)</b>	1.0 (0.9)	0.8 (0.6)	-
Spain	 Preliminary GDP Q/Q% (Y/Y%)	Q1	<b>-0.5 (-4.3)</b>	<u>-1.0 (-4.7)</u>	0.0 (-8.9)	-
	 Retail sales Y/Y%	Mar	<b>14.9</b>	-5.0	-5.9	<b>-6.1</b>
UK	 Lloyds business barometer	Apr	<b>29</b>	-	15	-
	 Nationwide house price index M/M% (Y/Y%)	Apr	<b>2.1 (7.1)</b>	0.5 (5.0)	-0.2 (5.7)	<b>-0.3 (-)</b>

## Auctions

Country	Auction
- Nothing to report -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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