

# Euro wrap-up

## Overview

- Bunds made gains as data reported a drop in German manufacturing due to a plunge in autos output, while the French government flagged concerns of a new fourth wave of Covid-19 caused by the delta variant.
- Gilts also made gains on a quiet day for economic news from the UK.
- Thursday will bring the publication of the account of the ECB's June monetary policy meeting, while the FT has reported that the conclusions of the ECB's strategic policy review might also be announced.

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### Daily bond market movements

Bond	Yield	Change
BKO 0 06/23	-0.684	+0.002
OBL 0 04/26	-0.594	-0.007
DBR 0 08/31	-0.292	-0.022
UKT 0 <sup>7</sup> / <sub>8</sub> 01/23	0.055	+0.016
UKT 0 <sup>1</sup> / <sub>8</sub> 01/26	0.254	-0.019
UKT 4 <sup>3</sup> / <sub>4</sub> 12/30	0.602	-0.030

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

Source: Bloomberg

## Euro area

### German manufacturing production drops on auto weakness

As foreshadowed by the drop in factory [turnover](#) reported yesterday, German manufacturing output fell for a second successive month in May and by 0.5%MM to be more than 6.5% below the pre-pandemic level in February 2020. Within the detail, the weakness was driven principally by autos, production of which remains worst affected by supply bottlenecks and so fell for a fifth successive month and by a hefty 7.2%MM. That left autos output more than 22% below the level at the end of last year and almost 28% below the pre-pandemic level. In addition, output of machinery and equipment was down 3.4%MM although remained up from the end of 2020 and was only a little more than 2% below the pre-pandemic level. Among other major items, however, production of intermediate items rose for a third successive month and by 0.6%MM, to return close to the pre-pandemic level, supported by a rise of almost 5.0%MM in chemicals. And consumer goods output rebounded 4.1%MM to a new pandemic-era high.

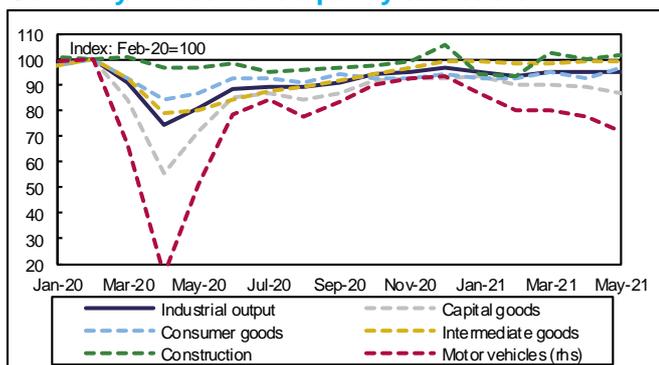
### Manufacturing subtracting from German GDP growth in Q2, construction providing support

The decline in German manufacturing output in May left the average level in the first two months of Q2 0.7% below the Q1 average. Given the weakness of [car production in June](#) (-19%YY), the autos sub-sector looks set to cause a further decline in overall manufacturing production that month and over the second quarter as a whole. Indeed, the likelihood of a softening of IP in June is also reflected in the truck-toll-mileage index, which throughout the month has remained well down on levels in April and May. Moreover, despite ever-growing backlogs, with supply bottlenecks expected to persist, the Association of German Automobile Manufacturers this week cut its full-year production forecast for 2021 by 10% to 3.6mn, up about 1mn from last year but down more than 1mn from 2019. So, despite elevated orders and strong sentiment such as reflected in the ifo survey, the recovery in manufacturing output in H221 is likely to be restrained. More happily, after a drop of 4.2%Q/Q in Q1 and despite some subdued surveys, the construction sector has returned to growth, rising 1.3%MM in May to leave the average so far in Q2 some 4.5% above that in Q1. And while energy production dropped 2.1%MM to leave total IP down 0.3%MM in May, it was trending some 3.8% above the Q1 average in the first two months of Q2. So, despite the weakness in manufacturing, with the reopening services sector providing the principal source of momentum, we therefore maintain our German GDP forecast of 2.0%Q/Q in Q2 and stronger still in Q3, so that the pre-pandemic level is surpassed in Q4.

### French goods exports drop, significantly lag recovery in imports

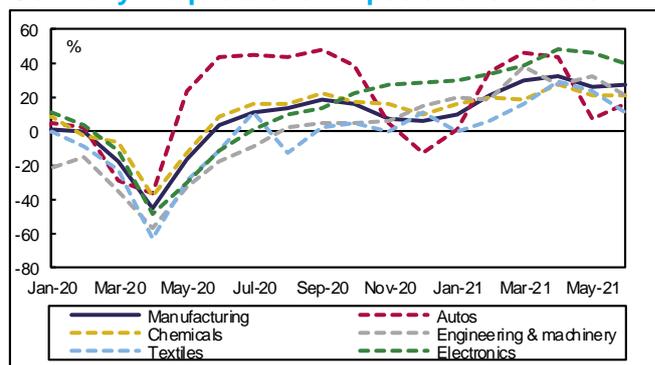
Ahead of tomorrow's German goods trade data – which will highly likely see exports still weighed by shipments of cars – the equivalent French figures showed that both exports and imports fell back in May following two successive months of solid

### Germany: Industrial output by sub-sector



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

### Germany: ifo production expectations indices\*


 \*Expectations for the coming six months.  
 Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

growth. On an adjusted basis, the value of French goods exports fell 3.0%MM to be 7.4% below the pre-pandemic level in February 2020. Looking through the monthly volatility, in the three months to May exports were still about 6% below the average level in 2019. Shipments of intermediate goods were still above their level in 2019. But – weighed by production constraints not least in the transport sector – exports of capital goods were trending almost 20% below the 2019 level. By destination, there also remained significant differences in export performance. Shipments to China, certain other Asia-Pacific markets and the Middle East continued to trend well above 2019 levels. But those to other EU countries in the three months to May were still down a little more than 4% on the same basis. And shipments to the UK and US were down about 18% from the 2019 average. The drop in exports in May was again more pronounced than that of imports, which fell 1.6%MM to be just 2.1% below the pre-pandemic level of February 2020. And looking through the monthly volatility, the three-month average level of imports was similarly down 2.2% from the 2019 average. So, the French trade deficit in goods rose €0.5bn in May to €6.8bn, the biggest since August and indeed a level rarely exceeded in the past.

## The day ahead in the euro area

The main focus on Thursday will be the ECB. With discussions on the Governing Council continuing, an FT report today suggested that Christine Lagarde might announce the conclusions of its strategy review as soon as tomorrow in an ad hoc press conference. If so, a key focus will be the ECB's inflation target. That is bound to be set at 2.0% (up from the current target of close to but below 2.0%) over a medium-term time horizon. And the Governing Council will also make clear that the target is symmetric, as it has done for some time since Mario Draghi's term as President. However, it remains to be seen whether the Governing Council agrees to set a specific tolerance range around that rate, and if so how wide that will be. And we should also watch to see whether the ECB will seek to mimic the Fed with an explicit average inflation targeting framework, and/or makes any commitment to try to exceed the target over the near term to compensate for recent undershooting. Such a commitment would suggest that policy would be more accommodative for longer. However, we doubt that it will make it. Among other things, the ECB will likely also express an intention to take into account housing costs in setting policy, and encourage Eurostat to develop more robust inflation data to measure such costs more accurately and on a timely basis. Finally, Christine Lagarde would seem bound to announce the ECB's intention to take greater account of climate change risks in its policy-making, including by "greening" its asset purchases and collateral rules.

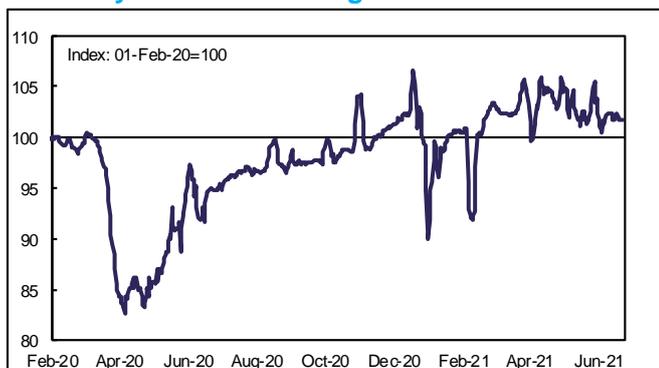
Beyond the strategy review, the publication of the account of the ECB's [June monetary policy meeting](#) is certainly scheduled for tomorrow. At that meeting, the ECB published updated macroeconomic projections, which strongly suggested that current price pressures would be transitory, and thus committed to maintain net PEPP purchases over the coming three months at a significantly higher pace than at the start of the year. That policy decision was not unanimous, however, and the account will therefore reflect the range of views among Governing Council members. Data-wise, Thursday will bring German trade figures for May, and the Bank of France's latest business sentiment survey is also scheduled for release.

## UK

### The day ahead in the UK

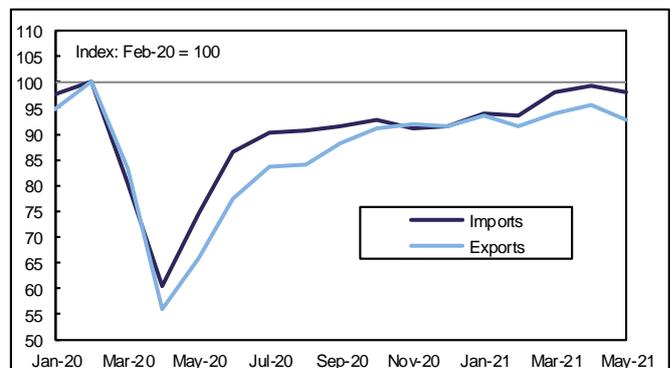
Following a quiet day in the UK for top-tier data, tomorrow will bring just the RICS residential survey for June, which is expected to show that the house price balance remained at an extremely elevated level in the final month of the Stamp Duty holiday.

### Germany: Truck-toll-mileage index



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

### France: Goods trade\*



\*Value terms, seasonally adjusted.

Source: Refinitiv 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%)	May	<b>-0.3 (17.3)</b>	0.7 (17.7)	-1.0 (26.4)	<b>-0.3 (27.6)</b>
Italy	 Retail sales M/M% (Y/Y%)	May	<b>0.2 (13.3)</b>	3.0 (10.8)	-0.4 (30.4)	<b>-0.1 (-)</b>
UK	 Final output per hour Y/Y%	Q1	<b>0.9</b>	1.0	-0.7	-
	 Unit labour costs Y/Y%	Q1	<b>5.0</b>	-	7.2	-
Auctions						
Country	Auction					
Germany	 sold €3.949bn of 0% 2026 bonds at an average yield of -0.59%					
UK	 sold £600mn of 0.125% 2051 index-linked bonds at an average yield of -2.137%					

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases						
Economic data						
Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous	
Germany	 07.00	Trade balance €bn	May	15.1	15.2	
France	 -	Bank of France industrial sentiment	Jun	108	107	
UK	 00.01	RICS house price balance %	Jun	79	83	
Auctions and events						
Euro area	 12.30	ECB publishes account of 9-10 June monetary policy meeting				

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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