

Euro wrap-up

Overview

- Bunds followed US10s lower while euro area consumer confidence increased only minimally in May and euro area construction output dropped in March but rose over Q1 as a whole.
- Gilts underperformed as a survey suggested that home-sellers' asking prices had risen in May by the most in a year, albeit in line with the usual seasonal pattern, while Bloomberg cited an internal BoE paper suggesting that its QE-related Gilt portfolio might be halved over coming years.
- Tuesday will bring the flash PMIs for May.

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Daily bond market movements

Bond	Yield	Change
BKO 2.8 12/25	2.780	+0.049
OBL 2.2 04/28	2.433	+0.037
DBR 2.3 02/33	2.456	+0.033
UKT 0% 06/25	4.013	+0.097
UKT 1% 10/28	3.880	+0.080
UKT 3% 01/33	4.048	+0.060

*Change from close as at 4:00pm BST.

Source: Bloomberg

Euro area

Consumer confidence very slightly firmer in May

With real disposable incomes under pressure from high inflation, and households seemingly preferring to hold onto their 'excess' savings accumulated throughout the pandemic, private consumption probably contracted for a second successive quarter in Q1. However, with wholesale energy prices having fallen markedly, and the labour market still firm, consumer confidence has steadily improved over recent months, offering hopes of a return to positive private consumption growth in Q2. Indeed, today's flash Commission index of euro area consumer confidence in May marked the eighth successive monthly rise from September's series low (-28.7), albeit by a minimal 0.1ppt. At -17.4, however, it was therefore still the highest since the Russian invasion of Ukraine, and somewhat closer to the long-run average (-10.8) than that record low. And it left the average for the first two months of Q2 more than 2pts (or 10%) above the Q1 average and thus consistent with an increase in consumer spending. There was no detail published by the Commission with its flash estimate. However, the first national surveys to be published, which came from the Netherlands and Belgium and both recorded a modest deterioration in overall confidence, suggested that consumers judged that the economic outlook had deteriorated and saw increased risks of unemployment. Nevertheless, the Dutch survey also reported an increase in consumers' willingness to make major purchases to the highest in twelve months.

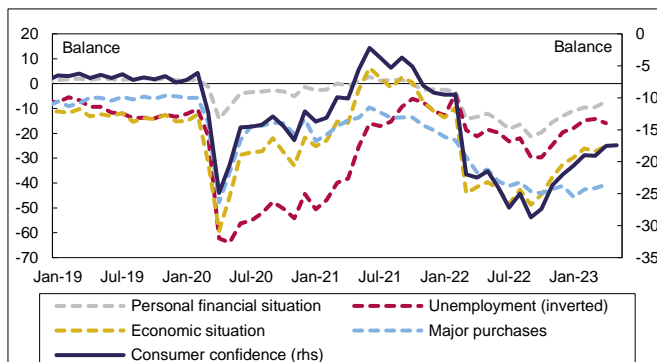
Construction output provided support for GDP growth in Q1 despite March dip

As had been suggested by the data from some of the larger member states, euro area construction output dropped the most in more than two years in March. However, given the firm growth at the start of the year – with the increase in January having been the strongest since March 2021 thanks not least to favourable weather – it still rose over the first quarter at the quickest rate in four quarters. In particular, construction output dropped 2.4%M/M in March but rose 2.5%Q/Q in Q1, with building work up 2.7%Q/Q and civil engineering up 1.9%Q/Q. Among the member states, construction in Germany rose 5.6%Q/Q, thus representing the key reason why overall economic output failed to contract and hence recession was dodged last quarter. Growth in Italian (1.1%Q/Q) and Spanish (1.9%Q/Q) construction also offered support to the expansion in Q1. But the increase in France (0.2%Q/Q) was in line with the modest rise in that country's GDP.

Labour shortages still a restraint but demand for construction is softening too

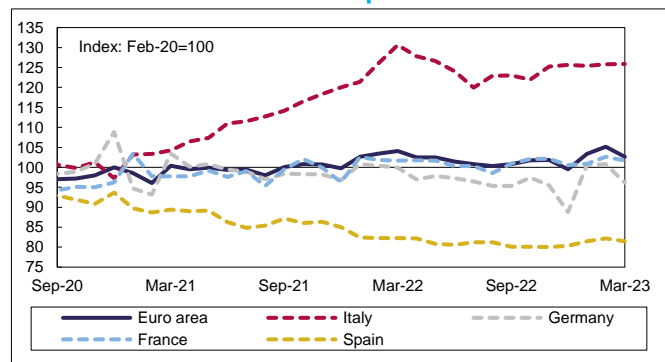
The Commission's business survey suggested that labour shortages were a key restraint on overall construction output in Q1, and remained so at the start of Q2. More happily, shortages of materials due to supply-chain disruption have continued to ease steadily. However, at the same time, order books in the sector in March and April were their lightest in two years, with

Euro area: Consumer confidence



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

Euro area: Construction output



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

an increasing share of firms in the sector reporting a shortfall of demand. And while the Commission survey suggests that the recent steady tightening of financial conditions has yet to take a larger toll on construction activity directly, higher interest rates and more stringent credit standards appear to be restraining both the supply and demand for loans for both business investment and house purchase, and fueling concerns about the outlook for prices in residential and commercial real estate. So, we fully expect euro area building construction to decline in Q2 and continue to trend lower over the remainder of the year. And, despite the support provided by Next Generation EU (NGEU) funds, the near-term outlook for growth in civil engineering activity also appears subdued.

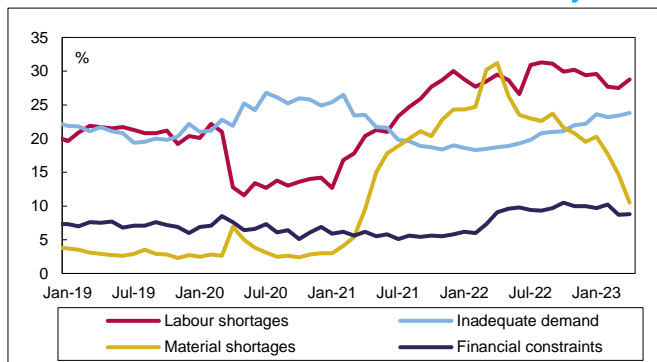
The day ahead in the euro area

The focus tomorrow will remain on sentiment surveys, with the release of the flash PMIs, which probably represent the week's most notable data from the euro area. Following surprising strength over recent months in the services indices, among which the euro area activity index rose to an eleven-month high of 56.2 in April, we might well see a little payback in May. And the manufacturing survey seems likely to signal ongoing stagnation in the sector. Overall, the composite PMI is forecast to slip back very slightly in May, from 54.1 to 53.5, but thus remain comfortably above the Q1 average (52.0) and consistent with a relatively solid pace of expansion in Q2. The prices PMIs should also be consistent with a further moderation in cost pressures, particularly in the manufacturing sector.

The day ahead in the UK

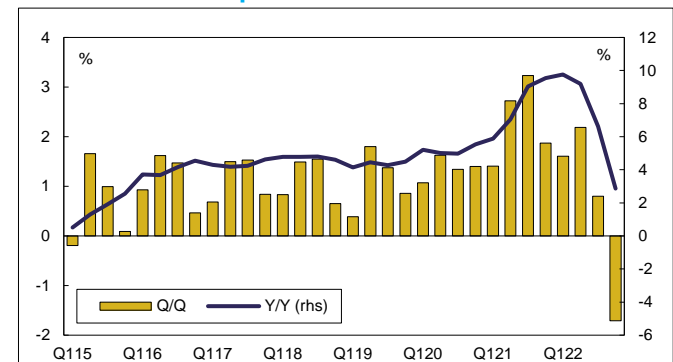
Like in the euro area, tomorrow brings the release of the flash UK PMIs, which are likely to report little change in the composite output index in May (54.9) to imply positive economic growth momentum in the middle of Q2. After the services activity PMI rose in April to a thirteen-month high of 56.25, further support might have come from the additional bank holiday in May. But the manufacturing output PMI is likely to have remained below the key 50 threshold for a third successive month. Also scheduled to be published tomorrow are the April public finances data. Following the fiscal loosening in the recent government budget, net public sector borrowing (excluding banks) is expected to come in close to £19bn in April, below the OBR's forecast of £22.4bn but nevertheless up from £13.7bn in April last year and £11.1bn in April 2019 before the pandemic. Separately, BoE Governor Bailey, Chief Economist Pill and external MPC members Mann and Tenreiro will testify on the BoE's latest Monetary Policy Report before the Treasury Select Committee.

Euro area: Restraints on construction activity



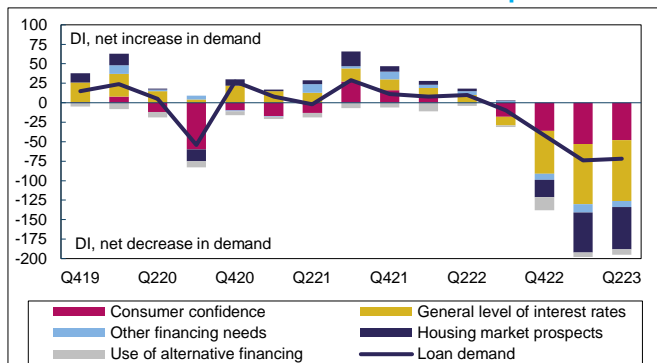
Source: European Commission, Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: House prices



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

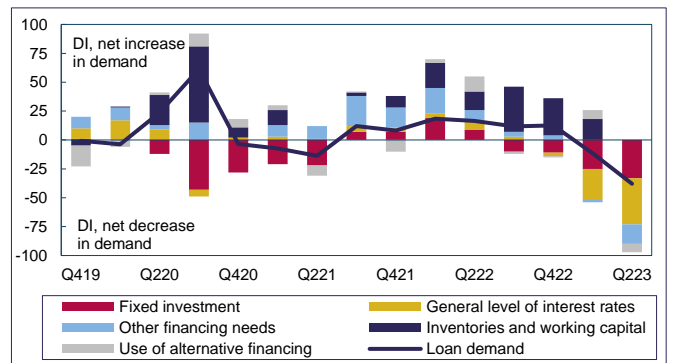
Euro area: Demand for loans for house purchase*



*Reasons for lower demand shown in bars.

Source: ECB and Daiwa Capital Markets Europe Ltd.




Euro area: Demand for business loans*















*Reasons for lower demand shown in bars.

Source: ECB 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
Euro area	 Construction output M/M% (Y/Y%)	Mar	-2.4 (-1.5)	-	2.3 (2.3)	-
	 Preliminary consumer confidence	May	-17.4	-16.7	-17.5	-
UK	 Rightmove house price index M/M% (Y/Y%)	May	1.8 (1.5)	-	0.2 (1.7)	-
Auctions						
Country	Auction					
- Nothing to report -						

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases						
Economic data						
Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous	
Euro area	09.00	 Preliminary manufacturing (services) PMI	May	46.0 (55.5)	45.8 (56.2)	
	09.00	 Preliminary composite PMI	May	53.5	54.1	
Germany	08.30	 Preliminary manufacturing (services) PMI	May	45.0 (55.0)	44.5 (56.0)	
	08.30	 Preliminary composite PMI	May	53.0	54.2	
France	08.15	 Preliminary manufacturing (services) PMI	May	46.0 (54.0)	45.6 (54.6)	
	08.15	 Preliminary composite PMI	May	52.0	52.4	
UK	07.00	 Public sector net borrowing (ex banks) £bn	Apr	- (22.4)	20.7 (21.5)	
	09.30	 Preliminary manufacturing (services) PMI	May	47.9 (55.7)	47.8 (55.9)	
	09.30	 Preliminary composite PMI	May	54.7	54.9	
Auctions and events						
Germany	10.30	 Auction: €6.00bn of 2.800% 2025 bonds				
UK	10.00	 Auction: £750mn of 0.125% 2051 index-linked bonds				
	10.15	 BoE Governor and MPC member to testify on May Monetary Policy Report to Treasury Select Committee				

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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