

# Euro wrap-up

## Overview

- Bunds made gains and BTPs continued to sell off as Italy's main populist parties reached agreement on a seemingly unaffordable programme for government.
- Gilts also made gains on a quiet day for economic news from the UK.
- Attention will remain on Italy in the coming week, while the ECB's latest policy meeting account, flash euro area PMIs and consumer confidence index, and UK inflation, retail sales and GDP data are all due.

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### Daily bond market movements

Bond	Yield	Change*
BKO 0 03/20	-0.586	-0.023
OBL 0 10/22	-0.051	-0.044
DBR 0½ 02/28	0.584	-0.054
UKT 2 07/20	0.819	-0.042
UKT 0¾ 07/23	1.184	-0.055
UKT 4¾ 12/27	1.507	-0.056

\*Change from close as at 4.00pm BST.  
Source: Bloomberg

## Euro area

### Italian populists agree platform for government

At long last, this morning saw Italy's two leading populist parties – Five Star Movement (M5S) and the League – finally publish their agreed “Contract for a Government of Change”, a 58-page planned policy agenda for a new coalition. The “Contract” was promptly submitted to M5S for approval via an online poll, which was set to close at 8pm this evening. And the League was set to vote on the programme in more traditional fashion, at booths in towns across the country, this weekend. Subject to the approval by the rank and file membership of both parties, the two party leaders – Di Maio and Salvini – will then on Monday make their proposal to President Mattarella for the position of Prime Minister, with nominations for cabinet positions and – if all goes to plan – subsequent parliamentary confidence votes then possibly to be held by the end of the coming week.

### An unaffordable programme

As expected, some of the most provocative elements of the draft agreement leaked to the Huffington Post Italia this week, including the demand for a €250bn write-down of Italian sovereign debt held by the ECB, were absent from the final “Contract”. However, it was still chock-full of costly fiscal commitments including cancellation of next year's scheduled sales and excise tax increases (worth €12.5bn); a 15% corporate flat tax and cuts to personal income tax rates to two bands of 15% and 20% (which could cost roughly €50bn); abolition of the ‘Formero’ pension reform which dictated steady increases in the retirement age (which the parties acknowledge will cost about €5bn); and a minimum basic income policy supported by better-resourced active labour market policies (which together could cost €19bn). Yet the “Contract” failed to identify quite how the proposals – which would in total likely cost in excess of €100bn (or more than 6% of GDP) if implemented in full – could be compatible with either the euro area's fiscal rules or the Italian Constitution, the latter of which states that “No recourse shall be made to borrowing except for the purpose of taking account of the effects of the economic cycle or, subject to authorisation by the two Houses approved by an absolute majority vote ... in exceptional circumstances” and that “Any law involving new or increased expenditure shall provide for the resources to cover such expenditure”.

### “Mini-BOTs” wheeze provides extra cause for unease

The “Contract” was not entirely silent on funding matters, however. Indeed, while it committed to finding some public expenditure savings through cutting waste, it acknowledged that there would be some recourse to deficit finance. In addition, it also proposed the issuance of special short-term government bonds secured by future tax receipts (so-called “mini-BOTs”) to pay companies owed money by the state – effectively the introduction of a parallel currency that might represent both a mechanism to try to dodge EU deficit rules and a step to prepare for eventual departure from the euro. Such a wheeze – akin to the “patacones” used by the Buenos Aires government during the Argentine crisis in 2001 – is just the kind of thing that should alarm bond market participants. And looking at the programme in the round, the further weakening of Italian government bonds today – with the 10Y spread of BTPs over Bunds more than 10bps wider again, now back above 160bps – hardly seemed inappropriate. Indeed, while there are numerous reasons why we would not expect much of the programme to be implemented, in the absence of ongoing ECB net asset purchases, the market response to the M5S/League proposals this week might well have been disorderly.

### Euro area trade lost some steam in Q1

Data-wise, the only releases of note today were the latest trade and current account figures. As expected, the euro area merchandise trade surplus inched only very slightly higher in March, by €0.3bn to €21.2bn. In Q1 as a whole, the surplus was also a touch higher than its level in Q4, but both exports and imports remained effectively steady. Indeed, having made the largest contribution to GDP growth in three of last year's four quarters, net trade looks to have made no contribution or subtracted from growth in Q1. Similarly, intra-EA19 trade was broadly unchanged in the first quarter of the year, so overall euro area trade flows appear to have stalled at the start of the year following rapid growth in 2017. Meanwhile, on the balance



of payments basis, the merchandise trade surplus remained below the average Q4 level in March, while both primary (factor income) and secondary (transfers) income account balances deteriorated. So, the overall current account surplus fell to €32bn, a nine-month low. On a twelve-month basis, the current account surplus came in at a sizeable 3.6% of GDP, up from 3.5% a year ago.

### An unsurprising shift from equities to bonds

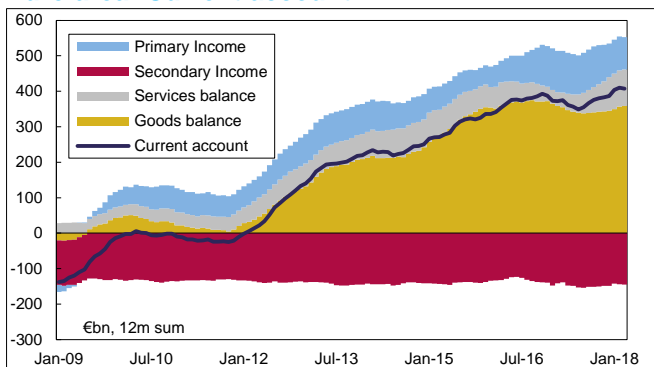
On the other side of the ledger, net purchases of euro area equities by foreign residents, which had been on a steep upward trend since the end of 2016, appear to have weakened in recent months, in line with the downward adjustment in economic and stock market momentum so far this year. This has been partly offset by a slight improvement in equivalent net purchases of euro area debt. Looking ahead, lower euro area growth might help the primary income balance to improve over coming months. However, uncertainty about global trade policy following the imposition of tariffs by the US and China and weaker export orders data imply that trade flows might remain unimpressive compared to recent periods. The likely impact of ongoing Italian political uncertainty on net foreign purchases of euro area securities is more difficult to predict.

### The week ahead in the euro area and US

Attention in the coming week will remain on Italy. But we will also receive some monetary policy news on Thursday when the ECB publishes its account of the most recent Governing Council meeting held on 25-26 April – judging from Draghi's post-meeting press conference, however, this appears to have been a relatively uneventful affair. Data-wise, the focus will shift to survey indicators, which should provide a more up-to-date picture of growth momentum in the euro area. Most notably, on Wednesday we will receive preliminary May PMIs from the euro area, Germany and France. Having declined significantly over the first three months of the year, the euro area composite PMI was little changed in April at a touch above 55, and a similar reading is expected for May, which would suggest that economic sentiment stabilised in Q2 at a level well down on the norms of last year. On the same day, we will receive a preliminary European Commission consumer sentiment reading for May. So far, consumer confidence has held up better than business sentiment this year, mainly thanks to ongoing tightening of the labour market, and this month is expected to have remained broadly unchanged. The similar German GfK consumer sentiment survey is out the following day along with French INSEE business confidence indicators. Finally, on Friday we will receive the German Ifo indicators, which should also signal that economic momentum in the largest euro area member state was broadly stable in the middle of Q2. The only notable hard economic data release will also be from Germany – its second estimate of Q1 GDP is expected to confirm the preliminary reading of 0.3%Q/Q growth. In bond markets, Germany will sell 2020 Bunds.

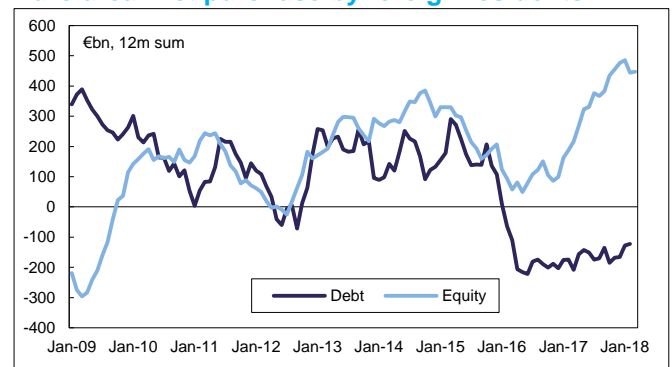
Turning to the US, a mixed bag of releases kicks off with the Richmond Fed's manufacturing survey on Tuesday followed by the flash May manufacturing and services PMI and April new home sales on Wednesday. More notably, Wednesday will also bring the minutes from the April FOMC meeting, perhaps casting some light on prospects for next month's meeting (although they will predate recent softer-than-expected wage and CPI reports). On Thursday, the April existing home sales report will be the main focus along with the usual weekly claims data. The week concludes with the advance durable goods orders report for April and final University of Michigan consumer survey outcome for May. As far as the former is concerned, lower aircraft sales will likely weigh on headline orders. Of greater interest will be core capex orders, which have broadly tracked sideways in recent months following a solid lift in Q317. In the bond market, the Treasury will auction 2-year notes on Tuesday, 2-year FRN's and 5-year notes on Wednesday and 7-year notes on Thursday.

### Euro area: Current account



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

### Euro area: Net purchase by foreign residents



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

## UK

### The week ahead in the UK

The coming week will see several top-tier releases in the UK, and just as many lesser ones. The key event will likely be the April CPI figures on Tuesday. The headline rate could slip by 0.1ppt from March's 2.5%Y/Y, if an easing in the likes of travel fares after the relatively early Easter offset the impact of the higher oil price. The former should allow the core rate to fall by as much as 0.2ppt from March's 2.3%Y/Y. On our forecast, the headline rate is on track to move close to the 2%Y/Y target by the end of the year.
















We expect that the recent easing of inflation on the high street may have done little to encourage spending, and that should be borne out by the April retail sales figures on Thursday. Sales dropped 1.2%M/M in March, and contracted by 0.5%Q/Q in the first quarter. While some of this might reflect the exceptionally harsh weather in February and March, surveys from the BRC and CBI suggest little improvement in April, with the underlying trend in sales emphatically lower than last year. The CBI survey for May, out on Wednesday, will bring more up-to-date insight into the health of the high street.

Friday brings the second estimate of Q1 GDP. While the most recent monthly figures show that construction activity contracted by less than the ONS had initially thought, this was offset by a smaller rise in IP than first gauged. Accordingly, there is little reason to expect a revision from the first estimate of 0.1%Q/Q, barring a significant revision to services output. The latest snapshot of housing market activity will come from the UK Finance April lending data on the same day.

Figures last month confirmed that public sector borrowing, at £42.6bn in FY17/18, undershot the forecasts made at the start of that year by £15bn. April's figures, out Tuesday, will reveal if this trend of improvement continued into FY18/19. On the same day, the CBI Industrial Trends survey will provide insights into whether the manufacturing sector rebounded in May after the recent spell of weakness.

In addition to the data releases, we should receive some new insights into monetary policy making: on Tuesday Mark Carney along with his colleagues from the MPC is scheduled to testify before the Treasury Select Committee, while on Thursday the Governor is scheduled to speak publicly at the BoE Markets Forum and the annual dinner of the Society of Professional Economists.

## Daiwa economic forecasts




	2017		2018				2019		2017	2018	2019
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2			
<b>GDP forecasts %, Q/Q</b>											
Euro area 	0.7	0.7	0.4	0.4	0.4	0.4	0.4	0.4	2.5	2.1	1.7
Germany 	0.7	0.6	0.3	0.5	0.5	0.5	0.5	0.5	2.5	2.0	2.0
France 	0.5	0.7	0.3	0.3	0.4	0.3	0.4	0.4	2.0	1.7	1.5
Italy 	0.4	0.3	0.3	0.2	0.3	0.3	0.3	0.3	1.6	1.2	1.1
Spain 	0.7	0.7	0.7	0.5	0.6	0.6	0.5	0.5	3.1	2.7	2.2
UK 	0.5	0.4	0.1	0.4	0.3	0.3	0.3	0.3	1.8	1.3	1.2
<b>Inflation forecasts %, Y/Y</b>											
Euro area											
Headline CPI 	1.4	1.4	1.3	1.5	1.7	1.5	1.3	1.3	1.5	1.5	1.4
Core CPI 	1.2	0.9	1.0	0.9	1.1	1.2	1.2	1.3	1.0	1.0	1.3
UK											
Headline CPI 	2.8	3.0	2.7	2.5	2.4	2.1	2.1	2.0	2.7	2.4	2.0
Core CPI 	2.6	2.6	2.5	2.2	2.1	2.0	2.0	2.0	2.4	2.2	1.9
<b>Monetary policy</b>											
ECB											
Refi Rate % 	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.25
Deposit Rate % 	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.25	-0.40	-0.40	0
Net asset purchases* 	60	60	30	30	30	5	0	0	60	5	0
BoE											
Bank Rate % 	0.25	0.50	0.50	0.50	0.50	0.75	0.75	0.75	0.50	0.75	0.75
Net asset purchases** 	0	0	0	0	0	0	0	0	0	0	0

\*Monthly target €bn, end of period. \*\*Monthly target £bn, end of period. Source: Bloomberg, ECB, BoE 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	 Current account balance €bn	Mar	<b>32.0</b>	-	35.1	<b>36.8</b>
	 Trade balance €bn	Mar	<b>21.2</b>	21.0	21.0	<b>20.9</b>
Germany	 PPI M/M% (Y/Y%)	Apr	<b>0.5 (2.0)</b>	0.3 (1.8)	0.1 (1.9)	-




#### Auctions

Country	Auction
- Nothing to report -	









Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

### Yesterday's results

#### Economic data














Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
EMU	 EU27 new car registrations Y/Y%	Apr	<b>9.6</b>	-	-5.3	-
	 Construction output M/M% (Y/Y%)	Mar	<b>-0.3 (0.8)</b>	-	-0.5 (0.4)	<b>-0.7 (0.2)</b>
Italy	 Trade balance €bn	Mar	<b>4.5</b>	-	3.1	<b>3.1</b>

#### Auctions

Country	Auction
France sold	 €5.1bn of 0% 2021 bonds (25-Feb-2021) at an average yield of -0.3%
	 €2.4bn of 0% 2023 bonds (25-Mar-2023) at an average yield of 0.1%
	 €907mn of 1.1% 2022 index-linked bonds (25-Jul-2022) at an average yield of -1.63%
	 €220mn of 0.1% 2047 index-linked bonds (25-Jul-2047) at an average yield of -0.11%
	 €619mn of 1.85% 2027 index-linked bonds (25-Jul-2027) at an average yield of -0.83%
Spain sold	 €2.6bn of 0.35% 2023 bonds (30-Jul-2023) at an average yield of 0.443%
	 €744mn of 5.9% 2026 bonds (30-Jul-2026) at an average yield of 1.073%
	 €1.0bn of 1.4% 2028 bonds (30-Apr-2028) at an average yield of 1.37%








Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

## Coming week's data calendar

Key data releases						
Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous	
<b>Monday 21 May 2018</b>						
EMU		14:45	ECB public sector asset purchases €bn	Weekly	<u>4.0</u>	7.9
UK		00:01	Rightmove house prices M/M% (Y/Y%)	May	-	0.4 (1.6)
<b>Tuesday 22 May 2018</b>						
Spain		09:00	Trade balance €bn	Mar	-	-2.2
UK		09:30	Public sector net borrowing excluding interventions £bn	Apr	7.1	-0.3
		11:00	CBI Industrial Trends Survey, total orders	May	2	4
<b>Wednesday 23 May 2018</b>						
EMU		09:00	Preliminary manufacturing PMI	May	56.0	56.2
		09:00	Preliminary services PMI (preliminary composite PMI)	May	54.6 (55.0)	54.7 (55.1)
		15:00	Preliminary consumer confidence indicator	May	0.5	0.4
Germany		08:30	Preliminary manufacturing PMI	May	57.8	58.1
		08:30	Preliminary services PMI (preliminary composite PMI)	May	53.1 (54.6)	53.0 (54.6)
France		06:30	Unemployment rate% (change 000's)	Q1	8.8 (-)	8.9 (205)
		08:00	Preliminary manufacturing PMI	May	53.7	53.8
		08:00	Preliminary services PMI (preliminary composite PMI)	May	57.2 (56.6)	57.4 (56.9)
UK		09:30	CPI (core CPI) Y/Y%	Apr	<u>2.4 (2.1)</u>	2.5 (2.3)
		09:30	Input (output) PPI Y/Y%	Apr	5.8 (2.3)	4.2 (2.4)
		09:30	House price index Y/Y%	Mar	4.4	4.4
		11:00	CBI Distributive Trades survey, retail sales	May	-	6
<b>Thursday 24 May 2018</b>						
Germany		07:00	GDP – second estimate Q/Q% (Y/Y%)	Q1	<u>0.3 (2.3)</u>	0.6 (2.9)
		07:00	GfK consumer confidence indicator	Jun	10.8	10.8
France		07:45	Business sentiment indicator	May	108	108
		07:45	Manufacturing confidence (production outlook) indicator	May	108 (-)	109 (24)
UK		09:30	Retail sales excluding petrol M/M% (Y/Y%)	Apr	0.5 (0.3)	-0.5 (1.1)
		09:30	Retail sales including petrol M/M% (Y/Y%)	Apr	0.9 (0.1)	-1.2 (1.1)
<b>Friday 25 May 2018</b>						
Germany		09:00	Ifo business climate index	May	102.0	102.1
		09:00	Ifo current assessment balance (expectations)	May	105.5 (98.5)	105.7 (98.7)
UK		09:30	UK Finance mortgage approvals 000's	Apr	-	37.6
		09:30	Services activity M/M% (3M/3M%)	Mar	0.1 (0.3)	-0.2 (0.4)
		09:30	GDP – second estimate Q/Q% (Y/Y%)	Q1	<u>0.1 (1.2)</u>	0.4 (1.4)

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

## Coming week's events/auctions calendar

Key events & auctions			
Country	BST	Event / Auction	
<b>Monday 21 May 2018</b>			
- Nothing scheduled -			
<b>Tuesday 22 May 2018</b>			
UK		08:15	BoE's Carney, Ramsden, Saunders and Vlieghe testify before Treasury Select Committee
<b>Wednesday 23 May 2018</b>			
Germany		10:30	Auction: To sell €5bn of 2020 bonds (12-Jun-2020)
<b>Thursday 24 May 2018</b>			
EMU		-	ECB's Praet scheduled to speak in Brussels
		12:30	ECB publishes an account from the latest Governing Council meeting held on 25-26 April
UK		10:30	Auction: To sell £1bn of 0.125% 2036 index-linked bonds 2036 (22-Nov-2036)
<b>Friday 25 May 2018</b>			
EMU		14:15	ECB's Cœuré scheduled to speak in Stockholm
UK		08:15	BoE's Carney scheduled to speak in London

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

***In the absence of significant developments the next edition of the Euro wrap-up will be published on 22 May 2018.***

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