

Euro wrap-up

Overview

- After yesterday's dovish ECB tightening, Bunds largely made gains despite a pickup in euro area labour cost growth to a five-year high.
- Gilts also made gains as politics continued to dominate in the UK.
- The coming week will see Draghi speak at the ECB's Sintra Forum, and bring the flash June euro area PMIs, the BoE's latest policy announcement and further key Brexit votes in the UK parliament.

Chris Scicluna

+44 20 7597 8326

Daily bond market movements

Bond	Yield	Change*
BKO 0 06/20	-0.621	+0.005
OBL 0 04/23	-0.231	-0.015
DBR 0½ 02/28	0.398	-0.026
UKT 2 07/20	0.713	-0.011
UKT 0¾ 07/23	1.047	-0.010
UKT 4¾ 12/27	1.317	-0.018

*Change from close as at 4.15pm BST.

Source: Bloomberg

Euro area

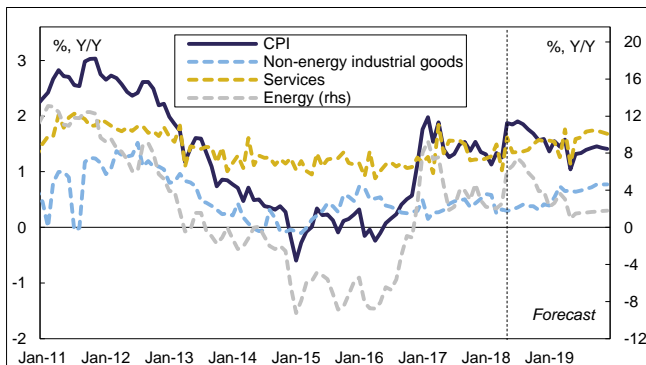
Pick up in labour costs gives ECB encouragement

As euro area government bond markets continued to respond to yesterday's dovish ECB tightening, with BTPs most notably making substantive gains, it was a busy end to the week on the euro area data front. Admittedly, there was no major surprise from the final estimates of May inflation, which confirmed a rise in the annual rate of CPI to 1.9%Y/Y, the highest since April 2017, from (an upwardly revised) 1.3%Y/Y in April. As foreshadowed by the flash estimates, the increase was partly due to higher oil prices, with energy inflation up 2.5ppts to a thirteen-month high of 6.1%Y/Y. And services inflation rose too, up 0.6ppt to 1.6%Y/Y, the highest since August. And so, core inflation rose 0.3ppt to 1.1%Y/Y, the highest since September. Headline inflation looks set to remain close to May's level through to the autumn, when energy inflation should start to subside. However, while core inflation might seem unlikely to accelerate notably over the near term, the ongoing tightening of the labour market should, by year-end, add a further impulse to inflation, which might start to offset the diminished impact from oil prices. Indeed, in this respect, the ECB will have been encouraged by other figures released today which showed total business economy labour costs up 2.3%Y/Y in Q1, the most in more than five years, driven by the services sector (2.5%Y/Y) where non-wage cost growth was particular vigorous. Growth in labour costs picked up in each of the four largest member states, with Germany and France leading the way (up 2.6%Y/Y in the business economy in both countries). A cut in employer social security contributions in 2019, however, will suppress overall labour cost growth in 2019.

Trends in exports and car sales weaken

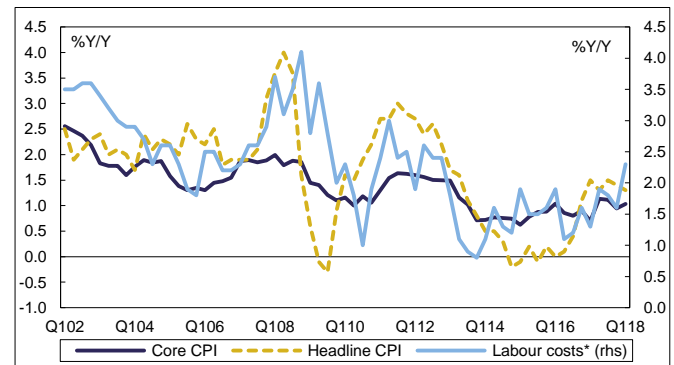
The softening in momentum in economic activity, which was evident in today's other new data releases, represents a downside risk to the inflation outlook. One source of weakening relates to external demand, which had provided a substantive boost to GDP growth in 2017. Just as recent economic surveys had flagged a deterioration in new export orders, today's goods trade figures confirmed a notable softening in the export trend since the turn of the year. While export values inched higher in April, up for the second month and by 0.3%M/M, that still left them down 2.2%3M/3M, the first drop on this basis in eight months and the steepest since 2015. Like exports, imports also rose in April (up 1.4%M/M) but fell on a three-month basis (1.5%3M/3M), with the trade surplus (on an adjusted basis) down €1.7bn to a six-month low of €18.1bn. Domestic demand for new cars also appears to have softened significantly. New car registrations fell 0.6%Y/Y in May. That still left them up 3.8%YTD/Y, and, on a seasonally adjusted basis, they rose 2.1%M/M. However, that rise came from a low base, and, on the same basis, left the level still some way below the multi-year peaks reached at the turn of the year. Indeed, looking through recent volatility, new car registrations were down 1.0%3M/3M in May, a marked deterioration from the 3.4%3M/3M

Euro area: Inflation



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Euro area: Inflation and labour costs*



*Excludes public sector labour costs. Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.



reached in January. And with the average level in April and May standing 1.2% below the Q1 average, having supported consumer spending in the first quarter, car sales look set to act as a drag in Q2.

The week ahead in the euro area and US

The euro area's main event in the coming week will be the ECB's Sintra Forum on Central Banking (its equivalent to the Fed's Jackson Hole Symposium) from Monday evening through to Wednesday. The main theme is price- and wage-setting. Draghi will offer opening remarks on Monday evening, give the introductory speech on Tuesday morning, and participate on a 'policy panel' with Fed Chair Powell, BoJ Governor Kuroda, and RBA Governor Lowe on Wednesday. Data-wise, the most notable new releases are due at the end of the week, with the Commission flash estimate of consumer confidence in June out on Thursday and the flash PMIs for June due Friday. After the euro area composite PMI fell in May to 54.1, the lowest since November 2016, the June figures will be watched for hints of an improvement, perhaps more in hope than expectation. Other data due in the coming week will largely be of second-tier importance, but include euro area construction output for April and the balance of payments for the same month (both on Tuesday), and the French INSEE business sentiment survey for June (Thursday).

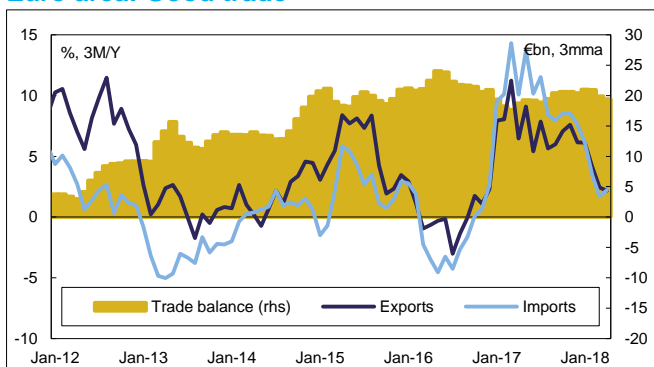
In the US, the focus in the early part of the coming week will be on the housing market, beginning with the June NAHB housing index on Monday and May housing starts and permits on Tuesday. The existing home sales report for May follows on Wednesday. On Thursday, the Philadelphia Fed will publish its manufacturing survey for June and the Conference Board's leading index for May will also be released. A relatively quiet week for US data concludes on Friday with the flash Markit manufacturing and service sector PMIs for June, which generally attract much less market attention than their European counterparts. In the bond market the US Treasury will auction 30-year TIPS on Thursday.

UK

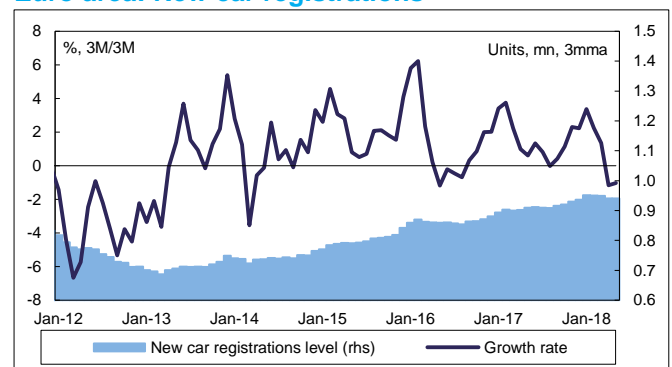
The day ahead in the UK

Brexit is set to continue to dominate attention in the coming week. And political confusion continues to reign, with the government's compromise proposal on whether Parliament should have a 'meaningful vote' on the final withdrawal agreement – and crucially what to do if there is no agreement – rejected by Conservative Party 'remainer' rebels. Key votes, in the House of Lords on Monday, and the House of Commons on Wednesday, could trigger a political crisis. Meanwhile, in terms of the regular economics news-flow, after a busy week for top-tier releases – which painted a mixed picture of activity in Q2 – the week ahead is set to be quieter. The main event in this respect will be the BoE's MPC meeting, with the policy decision to be announced on Thursday. Markets (appropriately) see a probability of less than 10% of a rate hike. Our central scenario is for no change until November. However, notwithstanding political risks, the strength of the May retail sales figures (up 1.3%M/M) has increased the chances of a hike at the time of August's Inflation Report. The statement accompanying this month's meeting may give some insight into MPC's latest thinking on the strength and sustainability of the rebound in Q2 growth. On the same day, the May public finance figures should confirm that borrowing continues to improve compared to last FY. Following the dismal ONS April manufacturing output figures, the May CBI industrial trends survey, out Wednesday, will provide evidence on whether the malaise in that sector continued.

Euro area: Good trade









Euro area: New car registrations*


















In the absence of significant news, the next edition of the Euro wrap-up will be published on 19 June 2018.

European calendar

Today's results						
Economic data						
Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
EMU	 EU27 new car registrations Y/Y%	May	0.8	-	9.6	-
	 Trade balance €bn	Apr	18.1	20.0	21.2	19.8
	 Final CPI (final core CPI) Y/Y%	May	1.9 (1.1)	<u>1.9 (1.1)</u>	1.2 (1.1)	1.3 (-)
	 Labour costs Y/Y%	Q1	2.0	-	1.5	1.4
Italy	 Final EU-harmonised CPI Y/Y%	May	1.0	<u>1.1</u>	0.6	-
Spain	 Labour costs Y/Y%	Q1	0.7	-	0.7	-
Auctions						
Country	Auction					
- Nothing to report -						



















Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Daiwa economic forecasts

	2017		2018				2019		2017	2018	2019	
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2				
GDP forecasts %, Q/Q												
Euro area		0.7	0.7	0.4	0.4	0.4	0.4	0.4	0.4	2.5	2.0	1.6
Germany		0.7	0.6	0.3	0.5	0.4	0.5	0.4	0.5	2.5	2.0	1.8
France		0.5	0.7	0.2	0.3	0.4	0.3	0.4	0.3	2.3	1.7	1.5
Italy		0.4	0.3	0.3	0.2	0.3	0.2	0.3	0.2	1.6	1.2	1.0
Spain		0.7	0.7	0.7	0.5	0.6	0.6	0.5	0.5	3.1	2.6	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
Inflation forecasts %, Y/Y												
Euro area												
Headline CPI		1.4	1.4	1.3	1.7	1.8	1.6	1.5	1.3	1.5	1.6	1.4
Core CPI		1.2	0.9	1.0	1.0	1.0	1.1	1.1	1.2	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	2.0	1.9	1.9	1.9	2.4	2.1	1.9
Monetary policy												
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	-0.4	-0.40	-0.40	-0.25
Net asset purchases*		60	60	30	30	30	5	0	0	60	15	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.

Coming week's data calendar

Key data releases					
Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Monday 18 June 2018					
EMU		14:45 ECB public sector asset purchases €bn	Weekly	<u>5.3</u>	8.2
Italy		09:00 Trade balance €bn	Apr	-	4.5
UK		00:01 Rightmove house prices M/M% (Y/Y%)	Jun	-	0.8 (1.1)
Tuesday 19 June 2018					
EMU		09:00 Current account balance €bn	Apr	-	32.0
		10:00 Construction output M/M% (Y/Y%)	Apr	-	-0.3 (0.8)
Italy		09:00 Current account balance €bn	Apr	-	3.4
Wednesday 20 June 2018					
Germany		07:00 PPI M/M% (Y/Y%)	May	0.4 (2.6)	0.5 (2.0)
UK		11:00 CBI Industrial Trends Survey, total orders	Jun	-	-3
Thursday 21 June 2018					
EMU		15:00 Consumer confidence	Jun	0.0	0.2
France		07:45 Business sentiment indicator (manufacturing confidence)	Jun	106 (108)	106 (109)
		12:45 Production outlook indicator	Jun	-	15
Spain		09:00 Trade balance €bn	Apr	-	-0.8
UK		09:30 Public sector net borrowing excluding interventions £bn	May	-	7.8
Friday 22 June 2018					
EMU		09:00 Preliminary manufacturing PMI	Jun	55.0	55.5
		09:00 Preliminary services PMI (preliminary composite PMI)	Jun	53.7 (53.9)	53.8 (54.1)
Germany		08:30 Preliminary manufacturing PMI	Jun	56.2	56.9
		08:30 Preliminary services PMI (preliminary composite PMI)	Jun	52.2 (53.4)	52.1 (53.4)
France		07:45 GDP – third estimate Q/Q% (Y/Y%)	Q1	0.2 (2.2)	0.2 (2.2)

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Coming week's events/auctions calendar

Key events & auctions		
Country	BST	Event / Auction
Monday 18 June 2018		
EMU		18:30 ECB's Draghi speaks at Sintra conference
Tuesday 19 June 2018		
EMU		09:00 ECB's Draghi speaks in Sintra
Germany		10:30 Auction: To sell €5bn of 0% 2020 bonds (12-Jun-2020)
Wednesday 20 June 2018		
EMU		14:30 ECB's Draghi speaks on policy panel in Sintra
Germany		10:30 Auction: To sell €1.5bn of 2.5% 2044 bonds (04-Jul-2044)
UK		10:30 Auction: To sell bonds
		10:30 Auction: To sell €1.25bn of 0.125% 2028 inflation-linked bonds (10-Aug-2028)
Thursday 21 June 2018		
France		09:50 Auction: To sell 0% 2021 bonds (30-Jul-2021)
		09:50 Auction: To sell 3% 2022 bonds (25-Apr-2022)
		09:50 Auction: To sell 2024 bonds (25-Mar-2024)
		10:50 Auction: To sell index-linked bonds
		10:50 Auction: To sell 1.85% 2027 index-linked bonds (25-Jul-2027)
		10:50 Auction: To sell 0.1% 2028 index-linked bonds (1-Mar-2028)
		10:50 Auction: To sell 0.1% 2047 index-linked bonds (25-Jul-2047)
Spain		09:45 Auction: To sell 0.35% 2023 bonds (25-Feb-2023)
		09:45 Auction: To sell 1.6% 2025 bonds (30-Apr-2025)
		09:45 Auction: To sell 2.35% 2033 bonds (30-Jul-2033)
		09:45 Auction: To sell 5.15% 2044 bonds (31-Oct-2044)
Friday 22 June 2018		
- Nothing scheduled -		

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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