

Euro wrap-up

Overview

- Bunds made gains as Draghi made dovish remarks at the ECB's Sintra Forum.
- Gilts also made gains on a quiet day for UK economic news.
- Wednesday brings another key Brexit vote in the House of Commons and a UK industrial sector survey, while Thursday will bring the latest BoE policy announcement and euro area consumer confidence survey.

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Daily bond market movements

Bond	Yield	Change*
BKO 0 06/20	-0.621	-0.004
OBL 0 04/23	-0.256	-0.022
DBR 0½ 02/28	0.372	-0.026
UKT 2 07/20	0.703	-0.017
UKT 0¾ 07/23	1.025	-0.026
UKT 4¾ 12/27	1.284	-0.039

*Change from close as at 4.30pm BST.

Source: Bloomberg

Euro area

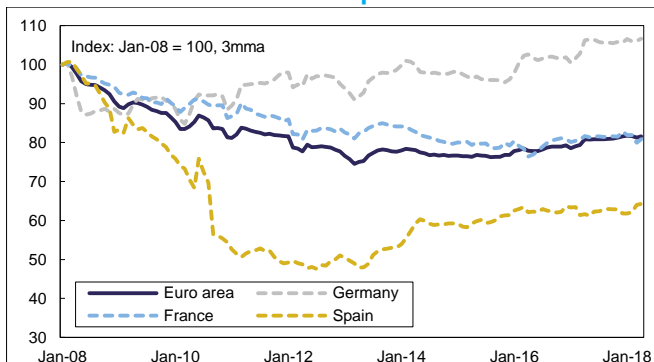
Draghi sounds another dovish note

If there had been any doubt that Draghi had intended to send a dovish signal on the policy outlook at last week's post-Governing Council press conference, that should have been extinguished by his speech today at the ECB's Sintra Policy Forum. Among other things, he emphasised the uncertainty of the economic outlook, and acknowledged concerns about the durability of the expansion raised by recent disappointing economic data. And so, perhaps most notably, he insisted that the ECB "will remain patient in determining the timing of the first rate rise and will take a gradual approach to adjusting policy thereafter", underscoring the risks that – if the dataflow continues to disappoint – rates will remain unchanged beyond (indeed, perhaps well beyond) September 2019. In response, on the whole, euro area government bonds made further gains. But the exception was BTPs, as Italy's Finance Minister Tria insisted that the government was committed to implementing its (costly) economic programme (albeit gradually), and wanted to boost public investment, even while it still wanted to reduce the country's government debt-to-GDP ratio. He also acknowledged that the worsening economic outlook had adversely impacted the outlook for the country's public finances. Tria is set to propose new plans after the summer. But – for the time being – we remain skeptical that he will be able to keep Italy on the fiscal straight and narrow.

Construction output rebounds

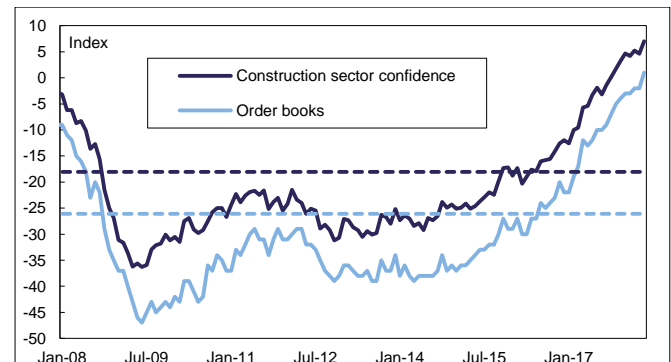
Today's new economic data will certainly not have had a material impact on the ECB's assessment of the economic outlook. Nevertheless, the April construction output figures provided a long overdue upside surprise, strongly suggestive of a return to expansion in the sector in Q2 following a flat first quarter. Following three consecutive monthly declines, euro area construction output rebounded in April by 1.8%M/M, the strongest rate in fourteen months to a level 1.5% above the average in Q1 and 1.8% above the level a year earlier. Growth in the sector was driven by civil engineering activity, up a whopping 4.0%M/M following an extended period of weakness, while building work rose 1.0%M/M. At the country level, growth was vigorous in Germany, France and Italy, but was negative in Spain. Contrasting with the recent deterioration in confidence in manufacturing and services, sentiment in the construction sector remains very strong, with the Commission's survey indicator having risen to a series high in May. And coupled with solid fundamentals in the sector, including steady economic growth, increasing new orders, higher property prices, rising bank loan supply and demand, and historically low interest rates – which look set to persist for quite some time to come – construction output should continue on a moderate uptrend, led by Germany, over coming quarters too.

Euro area: Construction output



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Euro area: Construction confidence and orders



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.



The coming two days in the euro area and US

The ECB's Sintra Forum will remain the principal focus on Wednesday, most notably with the afternoon bringing a 'policy panel' featuring ECB President Draghi, Fed Chair Powell, BoJ Governor Kuroda and RBA Governor Lowe. There will be no top-tier euro area data on Wednesday, although the following day will bring the flash estimate of the European Commission's consumer confidence index for June and the French INSEE business survey, also for the current month. In the markets, Germany will sell 30Y Bunds on Wednesday while France and Spain will sell a range of bonds on Thursday.

In the US, Wednesday will bring May's existing home sales figures and Q1 external current account data, while the following day will bring the Philadelphia Fed manufacturing survey for June and the Conference Board's leading index for May, alongside the usual weekly jobless claims numbers. The Treasury will sell 30Y TIPS on Thursday.

UK

The coming two days in the UK

After a quiet day today, the main focus of Wednesday will be political, with May potentially facing the worst parliamentary defeat of her leadership. That could occur as the EU Withdrawal Bill is discussed again in the House of Commons. MPs will consider another amendment inserted by the House of Lords on a meaningful vote on a Brexit deal that could, crucially, give parliament more influence over the final stages of an agreement. This relates to an initial amendment on a meaningful vote which the government successfully fended off last week after reportedly promising concessions to rebel MPs. However, May allegedly subsequently backtracked on this under pressure from pro-Brexit colleagues, prompting the Lords to attempt to force her hand by inserting this proposal. She, and her colleagues, will have been pressuring MPs not to back this amendment but there is a significant risk she will be defeated. While this would reduce the chances of the UK leaving the EU without a deal, it would also greatly increase the chances of a political crisis, and the removal of May.

Meanwhile, the EU Parliament's Brexit coordinator Guy Verhofstadt will appear in front of a panel of UK MPs, and his words will be closely watched. With negligible progress made since the March EU summit, a deal, as initially hoped, looks virtually impossible before next week's Council meeting. And while our central expectation is for a broad deal to be in place before October's Council meeting, there is a growing fear that the talks may drag on past that date.




Wednesday also sees the publication of the CBI Industrial Trends Survey. Recent surveys have shown manufacturing output slow, with both export and domestic orders faltering. This was mirrored in the recent release of official IP data, which revealed the biggest drop in manufacturing output (of 1.4%M/M) in April in over five years, raising fears that pre-Brexit nerves mean that UK companies are already being squeezed out of global supply chains. May's CBI Survey revealed a pick-up in optimism amongst industrial companies for the months ahead. This survey will reveal if such hopes were well-founded or wishful thinking. In the bond market, the DMO will sell 10Y inflation-linked bonds on Wednesday.

Thursday's main event will be the conclusion of the BoE's MPC meeting. Markets are (appropriately) pricing-in a probability of less than 5% of a rate hike. And our central scenario is for no change until November. However, notwithstanding political risks, the strength of last week's May retail sales figures (up 1.3%M/M) will likely have reaffirmed the BoE's confidence that GDP growth in Q2 will be significantly stronger than in Q1, and that is likely to be reflected in the post-meeting statement. Whether the MPC will feel ready to signal a greater possibility of a rate hike in August, however, remains to be seen. Thursday will also bring the May public finance figures, which should confirm that borrowing continues to improve at this stage compared to last FY, following the lowest April borrowing figures for a decade. Employment has grown considerably faster than assumed by the OBR in recent months, implying stronger income tax revenues in particular. However, the government's plans to spend an extra £20bn on the health service over coming years, without clarity on how that extra spending will be funded, raises new questions about UK fiscal sustainability on top of those posed by the likely big hit to the public finances from the impact of Brexit.


European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
EMU	 Current account balance €bn	Apr	28.4	-	32.0	32.8
	 Construction output M/M% (Y/Y%)	Apr	1.8 (1.8)	-	-0.3 (0.8)	-0.2 (1.2)
Italy	 Current account balance €bn	Apr	3.0	-	3.4	-




Auctions

Country	Auction
Germany sold 	€3.2bn of 0% 2020 bonds (12-Jun-2020) at an average yield of -0.63%

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	 ECB public sector asset purchases €bn	Weekly	3.1	5.3	8.2	-
Italy	 Trade balance €bn	Apr	2.9	-	4.5	-
UK	 Rightmove house prices M/M% (Y/Y%)	Jun	0.4 (1.7)	-	0.8 (1.1)	-



Auctions

Country	Auction
- Nothing to report -	



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's data releases

Economic data

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
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






Auctions

Country	BST	Auction / Event
Germany		10:30 Auction: To sell €1.5bn of 2.5% 2044 bonds (04-Jul-2044)
		10:30 Auction: To sell €1.25bn of 0.125% 2028 inflation-linked bonds (10-Aug-2028)












Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Thursday's data releases

Economic data

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
EMU		15:00 Consumer confidence	Jun	0.0	0.2
France		07:45 Business sentiment indicator (manufacturing confidence)	Jun	106 (108)	106 (109)
Spain		09:00 Trade balance €bn	Apr	-	-0.8
UK		09:30 Public sector net borrowing excluding interventions £bn	May	6.3	7.8
		12:00 BoE bank rate%	Jun	<u>0.5</u>	0.5

Auctions

Country	BST	Auction / Event
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 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)
UK		12:00 BoE monetary policy announcement

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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