

Euro wrap-up

Overview

- Bunds ended the day little changed as the final euro area manufacturing PMI aligned with the flash estimate in May.
- Gilts made gains as the latest UK manufacturing PMI was consistent with a contraction in output in Q2 and mortgage lending fell sharply in April.
- The focus in Europe tomorrow will be the conclusion of the latest ECB Governing Council meeting, which will bring updated economic forecasts.

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Daily bond market movements

Bond	Yield	Change*
BKO 0 06/18	-0.517	-0.003
OBL 0 04/21	-0.384	-0.007
DBR 0½ 02/26	0.133	-0.005
UKT 1¼ 07/18	0.406	-0.029
UKT 1½ 01/21	0.841	-0.059
UKT 2 09/25	1.371	-0.059

*Change from close as at 4.30pm BST.

Source: Bloomberg

Euro area

Euro area manufacturing PMI aligns with flash estimate in May

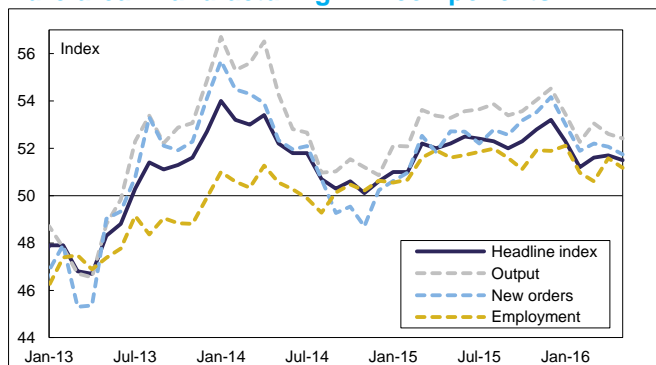
The final euro area manufacturing PMI for May published today came in bang in line with the flash estimate, affirming a modest decline in the headline index by 0.2pt to 51.5 in May, the second-lowest reading in fifteen months. While the survey's output component was similarly unrevised at 52.4, this was down 0.2pt from April and left the average index so far in Q2 0.4pt lower than that in Q1. The most significant change reported today was the downward revision to the new orders PMI, by 0.3pt to 51.7, which left this component at its lowest level since February 2015, suggesting that activity in June will likely remain subdued. At the country level, despite a modest downward revision from the flash estimate, the German manufacturing PMI rose to a four-month high in May (52.1), while the equivalent French PMI posted the largest increase of member states in May, albeit the index (48.4) was only just above the twelve-month low hit in April and – alongside Greece – France was the weakest of the member states by some margin. The weakness in May, however, reflected notable declines in the PMIs of Italy, Spain and Ireland to three-, seven- and thirty-four-month lows respectively. But these all remain comfortably in expansionary territory so far in Q2, albeit signalling a moderation in output growth in the sector from that seen in Q1.

The day ahead in the euro area and US

The focus in the euro area tomorrow will be the conclusion of the ECB's latest Governing Council meeting. Policy is widely expected to be left unchanged not least given the likelihood that the ECB will provide a slightly more upbeat view of the outlook in its updated staff economic forecasts. In particular, given the stronger-than-expected Q1 growth figure (0.5%Q/Q), the GDP forecast might well be nudged up slightly from 1.4% in 2016 and 1.7% in 2017. And with the oil price now well above the previous assumption (\$34.9pb and \$41.2pb for 2016 and 2017 respectively), the inflation forecast also seems likely to see an upwards revision, from 0.1% in 2016 and 1.3% in 2017. So, with the ECB's corporate bond purchases about to get underway and the first TLTRO II operation to be conducted towards the end of June, Draghi will likely maintain a cautiously optimistic tone to his press conference and seems unlikely to hint that further easing is on the horizon.

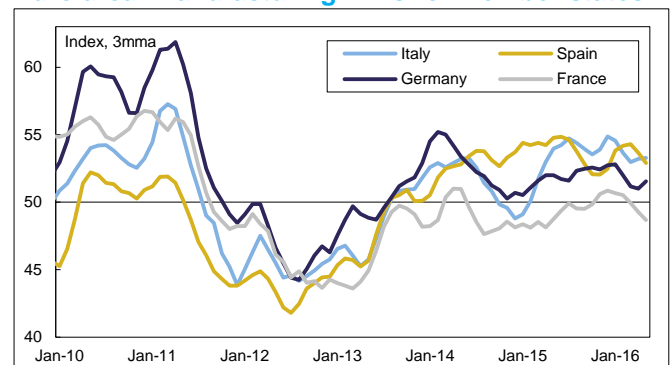
Draghi should, however, have one decision to announce. Following the Eurogroup's decision last week to disburse new funds to Greece in June, the Governing Council should give the green light for the reintroduction of the waiver on Greek bonds allowing their acceptance as collateral in ECB refinancing operations, a measure that would limit the Greek banks' reliance on more costly ELA and could also allow some easing of the Greek capital controls. The Governing Council would also then need to discuss what the Eurogroup's deal might mean for possible eventual eligibility of Greek government bonds for purchase

Euro area: Manufacturing PMI components



Source: Markit, Datastream and Daiwa Capital Markets Europe Ltd.

Euro area: Manufacturing PMIs* of member states



*Headline indices. Source: Markit, Datastream and Daiwa Capital Markets Europe Ltd.



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under the ECB's QE programme too. However, as the most substantive Greek debt relief measures will not come in to play until 2018 at the earliest, the ECB's own debt sustainability analysis might be expected to preclude purchase of Greek debt before then.

In the US, ahead of Friday's non-farm payroll release, attention tomorrow will turn to the release of the ADP's private sector employment report, Challenger Job Cuts data and latest weekly jobless claims figures.

UK

Manufacturing PMIs remain consistent with lower GDP growth in Q2

The start of Q2 marked a significant deterioration in business sentiment in the UK, with perhaps the most striking being April's manufacturing PMI, which declined to 49.4, the first sub-50 reading in more than three years. And while May's manufacturing PMI survey, published today, showed that the headline index rose by a larger-than-expected 0.7pt to 50.1, the underlying growth trend in this sector seems to have remained particularly weak. Within the survey detail, the output index rose by 0.4pt to 50.5, although this was not enough to reverse the decline seen in April. And on average so far in Q2, the output PMI was almost 5pts lower compared with the Q1 average of 55.0, therefore consistent with a significant loss of momentum in the current quarter. And little comfort can be taken from other components either – despite a modest pickup in the total new orders PMI in May, this also remained below the quarterly average at the beginning of the year, while the relevant indices for orders from abroad and employment both remained below 50. So overall, today's survey continued to suggest that growth in manufacturing output has fallen, with the PMI broadly consistent with a quarterly decline of 0.8%Q/Q and therefore suggesting that the sector will once again be a drag on GDP growth in Q2.

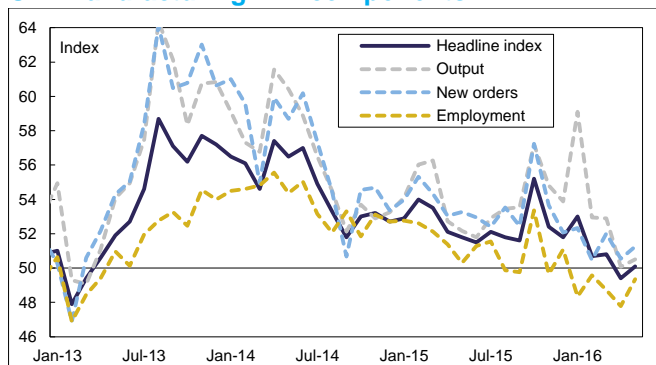
Mortgage lending down after the Stamp Duty tax increase

Meanwhile, the release of the BoE's latest lending figures confirmed that net new mortgage lending fell sharply in April, to £0.3bn from £7.4bn in March, the smallest increase since August 2012. However, recent data have been distorted by the Stamp Duty increase on second properties at the start of April. So, looking through the monthly volatility, the mortgage lending flow remained in line with the recent trend, with its average over the last three months broadly matching the average of the previous six months. But looking ahead, the outlook for the housing market appears relatively subdued, at least in the short term, with uncertainty ahead of the EU referendum likely dampening activity. In line with this assessment, mortgage approvals fell to 66.3k in May, the lowest level in almost a year, while the Nationwide house price index for May today showed a 1.0ppt drop in UK house price growth since March, to 4.7%Y/Y.

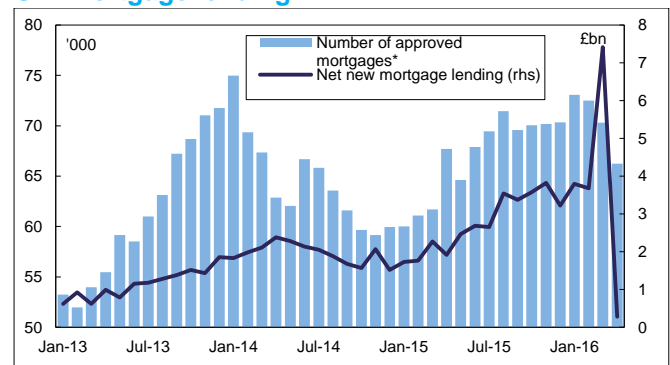
The day ahead in the UK

Tomorrow brings the latest construction PMI survey, which is expected to show the headline index unchanged in May at 52.0, matching its lowest level since June 2013.

UK: Manufacturing PMI components













UK: Mortgage lending





European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
EMU	 Final manufacturing PMI	May	51.5	51.5	51.7	-
Germany	 Final manufacturing PMI	May	52.1	52.4	51.8	-
France	 Final manufacturing PMI	May	48.4	48.3	48.0	-
Italy	 Manufacturing PMI	May	52.4	53.0	53.9	-
Spain	 Manufacturing PMI	May	51.8	52.5	53.5	-
UK	 BRC shop price index Y/Y%	May	-1.8	-	-1.7	-
	 Nationwide house price index M/M% (Y/Y%)	May	0.2 (4.7)	0.3 (4.8)	0.2 (4.9)	-
	 Net consumer credit (net lending secured on dwellings) £bn	Apr	1.3 (0.3)	1.6 (3.8)	1.9 (7.4)	1.8 (-)
	 Mortgage approvals '000s	Apr	66.3	67.9	71.4	70.3
	 Manufacturing PMI	May	50.1	49.6	49.2	49.4






Auctions

Country	Auction
Germany sold 	€3.2bn of 2021 zero-coupon bonds (09-Apr-2021) at an average yield of -0.38%
UK sold 	£2.75bn of 1.5% 2021 bonds (22-Jan-2021) at an average yield of 0.863%











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
EMU		12.45 ECB refinancing rate %	Jun	<u>0.00</u>	0.00
		12.45 ECB deposit rate %	Jun	<u>-0.40</u>	-0.40
		12.45 ECB monthly asset purchase target €bn	Jun	<u>80</u>	80
Spain		08.00 Unemployment M/M '000s	May	-104.8	-83.6
UK		09.30 Construction PMI	May	52.0	52.0

Auctions and events

Country	BST	Auction / Event
EMU		12.45 ECB monetary policy announcement
		13.30 ECB press conference
		15.00 ECB's Draghi scheduled to speak in Vienna
France		09.50 Auction: To sell 2.25% 2024 bonds (25-May-2024)
		09.50 Auction: To sell 0.5% 2026 bonds (25-May-2026)
		09.50 Auction: To sell 3.25% 2045 bonds (25-May-2045)
Spain		09.30 Auction: To sell 0.75% 2021 bonds (30-Jun-2021)
		09.30 Auction: To sell 1.95% 2026 bonds (30-Apr-2026)
		09.30 Auction: To sell 2.90% 2046 bonds (31-Oct-2046)
UK		14.00 BoE's Carney scheduled to speak in Oxfordshire, UK

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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