

Euro wrap-up

Overview

- Longer-dated Bunds made gains as Draghi's comments were on the dovish side, despite a modest upward revision to the ECB's near-term economic forecasts.
- Gilts also made gains as the construction PMI hit a new multi-year low.
- Tomorrow brings final services and composite PMIs from the euro area and the UK, while euro area retail sales data are also due.

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Daily bond market movements

Bond	Yield	Change*
BKO 0 06/18	-0.519	-0.005
OBL 0 04/21	-0.384	-0.003
DBR 0½ 02/26	0.111	-0.025
UKT 1¼ 07/18	0.381	-0.027
UKT 1½ 01/21	0.816	-0.029
UKT 2 09/25	1.345	-0.028

*Change from close as at 4.30pm BST.
Source: Bloomberg

Euro area

No surprises from the ECB

Today's ECB meeting delivered no surprises, with policy left unchanged. At the accompanying press conference Draghi, also unsurprisingly, struck a relatively dovish tone. While there was a modest upward revision to the GDP growth forecast for 2016, to 1.6%Y/Y from 1.4% in March, the forecasts for 2017 and 2018 were left broadly unchanged. Similarly, while there was a modest upward revision to the CPI forecast for 2016 (to 0.2%Y/Y, from 0.1%) the forecasts for 2017 and 2018 were left unchanged. And with inflation in 2018 expected to be just 1.6%Y/Y, well below the ECB's target, and Draghi arguing that the risks to growth remain tilted to the downside, albeit with that balance of risks now looking a little more favourable, he repeated that the Governing Council stood ready to act if required "using all the instruments available within its mandate". As such, we continue to expect that, at a minimum, the asset purchase programme will eventually be extended beyond the current March 2017 end date.

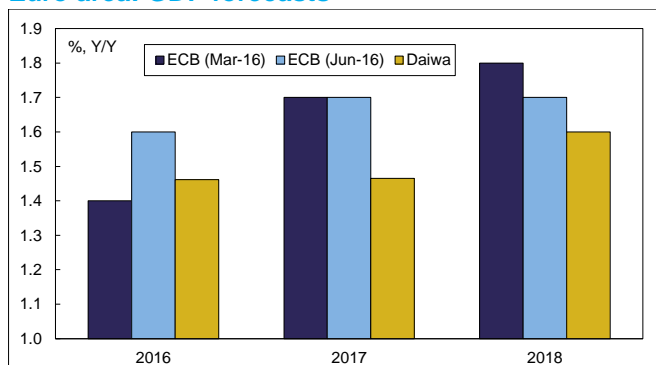
Elsewhere, the Governing Council confirmed that its corporate sector bond purchase programme (CSPP) will start on 8 June, while the first of the TLTRO operations announced in March will take place on 22 June. These operations will provide four-year financing for banks at rates possibly as low as the deposit rate (-40bps). But the Governing Council failed to agree to reinstate the waiver on allowing Greek government bonds as collateral, although provided the Greek Government meets the "prior actions" required of it under its bailout framework, that looks as though it will be a formality.

The day ahead in the euro area and US

The end of the week brings the final services and composite PMIs for the euro area and the member states. The aggregate euro area figures are likely to confirm the flash estimates, which showed that the index for services was unchanged in May for a second consecutive month, while the composite indicator inched down to 52.9, the lowest level since the start of 2015. Meanwhile, euro area retail sales are expected to have risen by 2.1%Y/Y in April, an unchanged pace from the previous month.

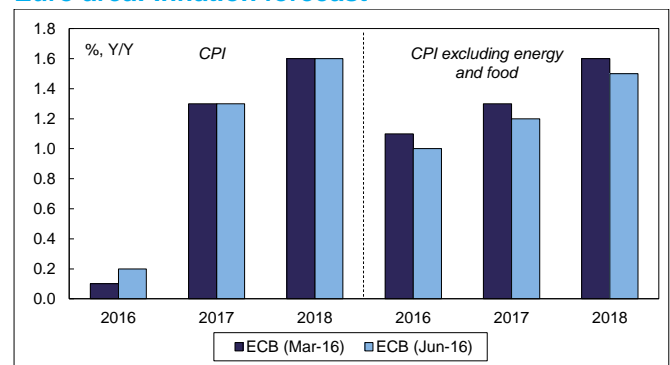
In the US, all eyes tomorrow will be on the latest labour market report for May. The market expectation is for a 160k rise in non-farm payrolls, which would match the seven-month low recorded in April. However, May's figure will be distorted by an employee strike and, if it were adjusted for that effect the like-for-like reading would be closer to 200k. Meanwhile, the unemployment rate is likely to have edged down by 0.1ppt to 4.9%, while earnings growth is expected to have remained unchanged at 2.5%Y/Y. Beyond the labour market, other notable US data releases tomorrow include the non-manufacturing ISM for May, and total trade and factory orders figures for April.

Euro area: GDP forecasts



Source: ECB and Daiwa Capital Markets Europe Ltd.

Euro area: Inflation forecast



Source: ECB and Daiwa Capital Markets Europe Ltd.



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UK

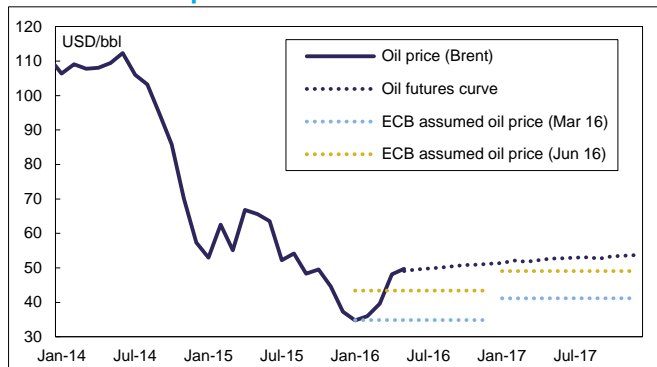
Construction sector outlook gets even more subdued

The latest activity data from the construction sector showed that output in March was 4.5% lower compared to the same month a year ago. And today's construction PMI survey for May provided little evidence that this downward trend will be reversed in the near future. Indeed, the headline PMI fell from 52.0 to 51.2, the lowest level since mid-2013, with all major components weak too. For example, the new orders indicator slipped below 50 for the first time in thirty-seven months, and the indices for different types of activity – housing, commercial and civil engineering – all posted falls. Of course, some of the weakness is likely to be due to uncertainty ahead of the EU referendum and, therefore, some improvement might be expected in the second half of the summer in the case of a Remain vote. But with the outlook for the housing market looking relatively uncertain even without the referendum, underlying construction output growth does not look set to return to its previous highs anytime soon.

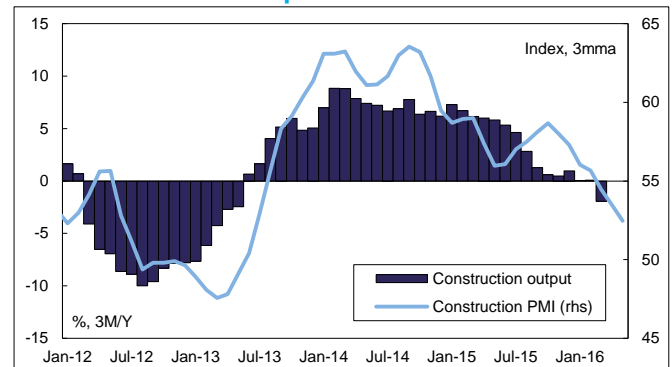
The day ahead in the UK

The flow of May PMIs continues tomorrow with the releases of the services and composite indicators. The headline services activity index looks set to have inched up only slightly from a more-than three-year low of 52.3 in April, while the composite index is expected to have followed suit.

Euro area: Oil prices








UK: Construction output and construction PMI









European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
EMU	 ECB refinancing rate %	Jun	0.00	0.00	0.00	-
	 ECB deposit rate %	Jun	-0.40	-0.40	-0.40	-
	 ECB monthly asset purchase target €bn	Jun	80	80	80	-
Spain	 Unemployment M/M '000s	May	-119.8	-104.8	-83.6	-
UK	 Construction PMI	May	51.2	52.0	52.0	-








Auctions

Country	Auction
France sold	 €2.5bn of 2.25% 2024 bonds (25-May-2024) at an average yield of 0.16%
	 €4.1bn of 0.5% 2026 bonds (25-May-2026) at an average yield of 0.49%
	 €2.2bn of 3.25% 2045 bonds (25-May-2045) at an average yield of 1.44%
Spain sold	 €2.0bn of 0.75% 2021 bonds (30-Jun-2021) at an average yield of 0.492%
	 €2.1bn of 1.95% 2026 bonds (30-Apr-2026) at an average yield of 1.498%
	 €803mn of 2.90% 2046 bonds (31-Oct-2046) at an average yield of 2.722%

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	 09.00	Final services PMI (final composite PMI)	May	53.1 (52.9)	53.1 (53.0)
	 10.00	Retail sales M/M% (Y/Y%)	Apr	0.4 (2.1)	-0.5 (2.1)
Germany	 08.30	Final services PMI (final composite PMI)	May	55.2 (54.7)	54.5 (53.6)
France	 08.00	Final services PMI (final composite PMI)	May	51.8 (51.1)	50.6 (50.2)
Italy	 08.45	Services PMI (composite PMI)	May	51.5 (52.5)	52.1 (53.1)
Spain	 08.15	Services PMI (composite PMI)	May	54.0 (54.2)	55.1 (55.2)
UK	 09.30	Services PMI (composite PMI)	May	52.5 (52.3)	52.3 (51.9)

Auctions and events

Country	BST	Auction / Event
- Nothing scheduled -		

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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