

Euro wrap-up

Overview

- Bunds made modest gains despite some firm euro area car registration figures and as euro area inflation figures aligned with expectations.
- Despite some strong UK retail sales data, Gilts were little changed as the BoE warned of the economic consequences of Brexit while opinion polls again suggested more support to 'Leave' the EU than 'Remain'.
- Friday should be quiet for economic news from Europe with euro area labour cost and balance of payments data the most notable new figures.

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Daily bond market movements

Bond	Yield	Change*
BKO 0 06/18	-0.606	-0.010
OBL 0 04/21	-0.500	-0.016
DBR 0½ 02/26	-0.021	-0.010
UKT 1¼ 07/18	0.354	+0.013
UKT 1½ 01/21	0.660	-0.002
UKT 2 09/25	1.115	-0.005

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

Euro area

New car registrations maintain upwards trend

Recent economic data have provided mixed messages about the likely strength of euro area consumer spending in the second quarter. Retail sales were flat in April having fallen the previous month. But a jump in production of durable consumer goods the same month suggested that firms still judged households to be amenable to making big-ticket purchases. After deteriorating earlier in the year, consumer confidence encouragingly jumped in May to its highest level in January. And today's new car registration data implied a continued willingness to spend, with a second successive monthly gain taking the average for the first two months of Q2 above that of Q1. Principally reflecting solid growth through the second half of 2015, registrations in the euro area were up 18%Y/Y and almost 11%YTD/Y. Among the large member states, annual rates were particularly vigorous in Italy (more than 20%YTD/Y) and France and Spain (greater than 10%YTD/Y). In the absence of new economic and financial shocks, ongoing improvement in the labour market and associated rising real household disposable incomes should maintain steady growth in consumption and increases in car sales over coming quarters.

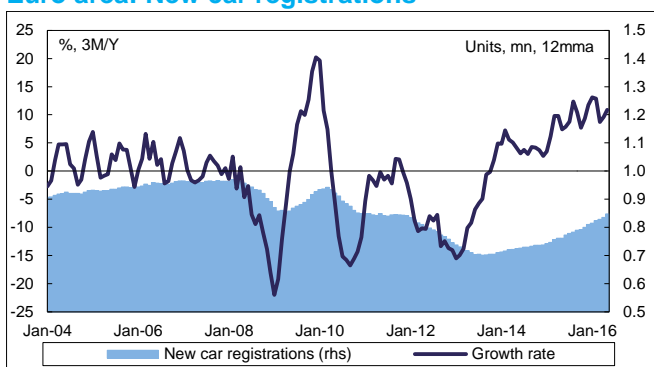
Core inflation remains stubbornly low

There were no surprises from the final estimates of euro area inflation in May. The headline rate aligned with the flash estimate of -0.1%Y/Y, 0.1ppt firmer than in April. And within the detail, most main components were little changed from their preliminary estimates too. Most notably, services price inflation rose 0.1ppt from April to 1.0%Y/Y thanks to the strongest monthly increase in May since 2008. And with non-energy industrial goods inflation confirmed to have remained unchanged at 0.5%Y/Y, the main core measure of CPI similarly aligned with the flash estimate, inching 0.1ppt higher to 0.8%Y/Y, close to the middle of the range of the past two years. Looking ahead, we expect CPI to rise to zero in June and, as the base effects associated with past shifts in the oil price wear off, inch steadily higher through the second half of the year to around 1%Y/Y by end-2016 and higher still into 2017. But with the core measure still subdued, and sluggish wage growth suggesting that it will remain so, we certainly do not expect headline inflation to move back to the ECB's target of close to 2%Y/Y for the foreseeable future.

The day ahead in the euro area and US

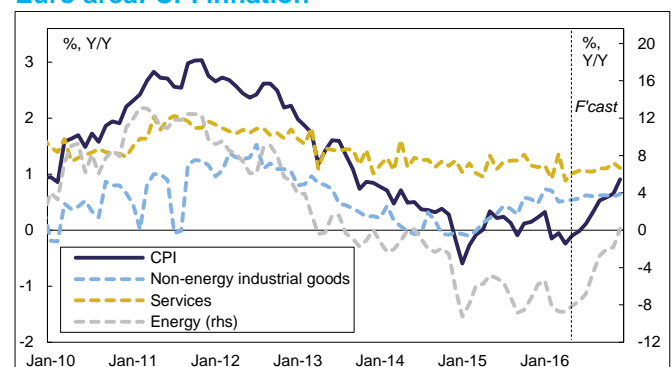
In the euro area, the week will end with Q1 labour cost and April balance of payments data. Most notably, with new wage settlements having remained very weak in most member states (except Germany), overall labour cost growth is likely to remain very subdued in the bottom half of the range of the past six years and well below rates consistent with the

Euro area: New car registrations



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Euro area: CPI inflation



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.



achievement of the inflation target over the medium term. Meanwhile, after the trade surplus was shown earlier this week to have risen to a new series high in April, the euro area's current account surplus might be expected to have done likewise. While ECB President Draghi will speak publicly, the event and his role – the presentation of an award to former German Finance Minister Waigel at a ceremony in Munich – suggests that his remarks will not be market-moving. Remarks from ECB Executive Board member Coeuré at a different event on structural reforms might prove more interesting albeit similarly un-illuminating with respect to the outlook for monetary policy.

In the US, it should be a quiet end to the week for economic news with just May housing starts and building permits figures due.

UK

MPC warns of the consequences of a vote to Leave

The monetary policy decision from the BoE today brought no surprises – Bank rate was left unchanged for the eighty-seventh consecutive month. Of course, with only one week left to go until the EU referendum, of more interest was the MPC's comments about its effect on the economy, although the Committee merely reiterated its earlier clear message that a vote to Leave "could lead to a materially lower path for growth and a notably higher path for inflation". But with regard to the impact of referendum uncertainty to date, policymakers were more balanced. On the one hand, they pointed to lower commercial real estate and M&A transactions, evidence of delayed business investment, as well as more subdued car purchases and housing market activity. And the rising likelihood of a Leave vote they felt was clearly evident in movements in financial markets. However, the Committee also acknowledged that some economic activity data remained firm, making the overall effect on the economy more difficult to assess. More generally, the MPC confirmed that it stands ready to act if needed after the referendum result, and we would expect a cut in interest rates, and possibly more QE, if there is a vote to Leave (and two opinion polls released today showed respectively 6ppt and 3ppt leads in favour of Brexit). And even if the vote is to Remain, a cut is possible if the economy does not rebound as quickly as the MPC expected in its May forecast.

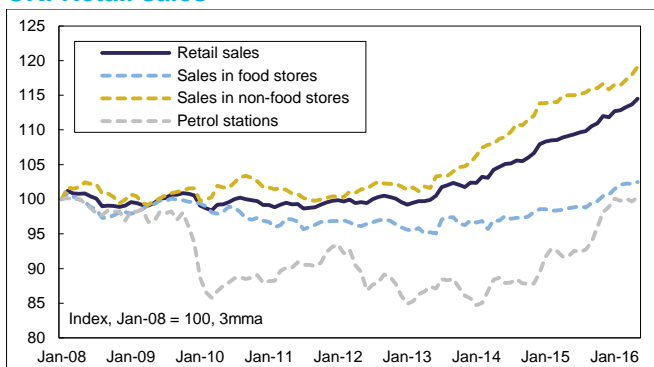
Retail sales figures suggest firm consumer spending growth in Q2

In line with the MPC's remarks that consumer spending remained resilient, the figures from the retail sector released today surprised on the upside, showing that sales rose sharply for a second consecutive month in May, by almost 1%M/M, to leave annual growth at 6.0%Y/Y, the highest pace since last September. While food provided the largest contribution to the monthly increase, stronger sales of clothing and footwear, probably due to the arrival of warmer weather, recorded a 4.3%M/M increase and provided notable support as well. Overall, this left retail sales in April and May on average 1.8% higher compared to Q1. And while the full Q2 number might be lower due to seasonal effects, it is still likely to beat the 1.3%Q/Q growth recorded in the previous quarter. So overall private spending, which has been the main driver of the economic recovery in the UK over recent years, seems to be on track to provide another notable contribution to GDP growth this quarter.

The day ahead in the UK

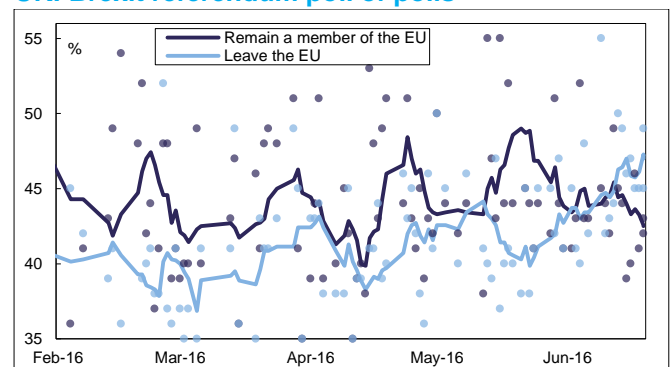
With no major economic data due for release tomorrow, it should be a quiet day on the economics front.

UK: Retail sales



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: Brexit referendum poll of polls*










*The dots show individuals polls and the lines are seven-poll moving averages.
Source: whatukthinks.org 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	 EU27 new car registrations Y/Y%	May	16.0	-	9.1	-
	 Final CPI (core CPI) Y/Y%	May	-0.1 (0.8)	<i>-0.1 (0.8)</i>	-0.2 (0.7)	-
Spain	 Labour costs Y/Y%	Q1	-0.2	-	1.2	-
UK	 Retail sales excluding petrol M/M% (Y/Y%)	May	1.0 (5.7)	0.3 (3.8)	1.5 (4.2)	2.0 (4.8)
	 Retail sales including petrol M/M% (Y/Y%)	May	0.9 (6.0)	0.2 (3.9)	1.3 (4.3)	1.9 (5.2)
	 BoE bank rate %	Jun	0.50	<i>0.50</i>	0.50	-
	 BoE asset purchase target £bn	Jun	375	<i>375</i>	375	-




Auctions

Country	Auction
France sold	 €2.1bn of 0.5% 2019 bonds (25-Nov-2019) at an average yield of -0.33%
	 €2.4bn of 2021 zero-coupon bonds (25-May-2021) at an average yield of -0.19%
	 €1.4bn of 1.75% 2023 bonds (25-May-2023) at an average yield of -0.01%
	 €739mn of 0.1% 2021 index-linked bonds (25-Jul-2021) at an average yield of -0.87%
	 €510mn of 1.85% 2027 index-linked bonds (25-Jul-2027) at an average yield of -0.52%
Spain sold	 €1.6bn of 0.25% of 2019 bonds (31-Jan-2019) at an average yield of 0.137%
	 €1.4bn of 0.75% of 2021 bonds (30-Jul-2021) at an average yield of 0.591%
	 €1.5bn of 1.95% of 2026 bonds (30-Apr-2026) at an average yield of 1.591%
	 €540mn of 4.9% of 2040 bonds (30-Jul-2040) at an average yield of 2.527%


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	Current account balance €bn	Apr	-	27.3
	 10.00	Labour costs Y/Y%	Q1	-	1.3
Italy	 09.00	Trade balance €bn	Apr	-	5.4

Auctions and events

Country	BST	Auction / Event
EMU	 16.00	ECB's Draghi scheduled to speak in Munich

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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