Euro wrap-up

Overview

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- Gilts made gains as Theresa May requested a short extension of the Article 50 deadline amid a deepening political crisis in the UK.
- Bunds made very modest gains at the longer end of the curve on a quiet day for economic news from the euro area.
- Thursday will see EU leaders discuss the Article 50 extension request, while the BoE will make its latest policy announcement, and data on UK retail sales and euro area consumer confidence are due.

Daily bond market movements

Bond	Yield	Change*
BKO 0 12/20	-0.552	-0.006
OBL 0 04/24	-0.329	-0.006
DBR 0¼ 02/29	0.084	-0.012
UKT 1½ 01/21	0.742	-0.008
UKT 1 04/24	0.905	-0.020
UKT 1⅝ 10/28	1.157	-0.030

*Change from close as at 5.00pm GMT.
Source: Bloomberg

UK

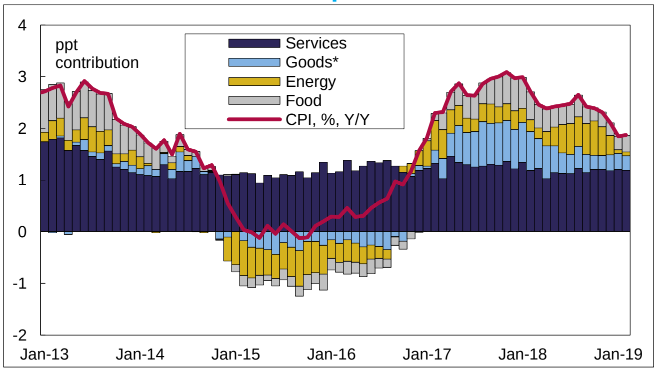
May finally requests Brexit delay

After Parliament voted last week to demand a delay to Brexit, this morning Theresa May finally wrote to the EU to request an extension to the Article 50 deadline. But her letter only served to deepen the turmoil in Cabinet, the Conservative Party, and within Parliament. And it also irritated EU leaders, upon whose goodwill she is wholly reliant if her request is to be met. In particular, following an acrimonious special Cabinet meeting yesterday, the Prime Minister decided to ask only for a short extension – to end-June – to avoid a mutiny from her Brexiter Minister colleagues. That, she argued, would provide time for a further meaningful vote (MV3), to secure approval of her deal by MPs, which she intends to be conducted within the coming week. But that approach had been described just last week by May's effective Deputy Prime Minister, David Lidington, as "downright reckless and completely at odds" with the House of Commons decision to rule out a no-deal Brexit in all instances. And while some Cabinet members had seemingly threatened to resign if May proved unable to deliver Brexit according to her proposed new timetable, and indeed May hinted that her future as PM would also be at stake in that event, the likelihood remained that she would indeed lose the further meaningful vote if and when it's conducted.

EU to agree to conditional extension tomorrow?

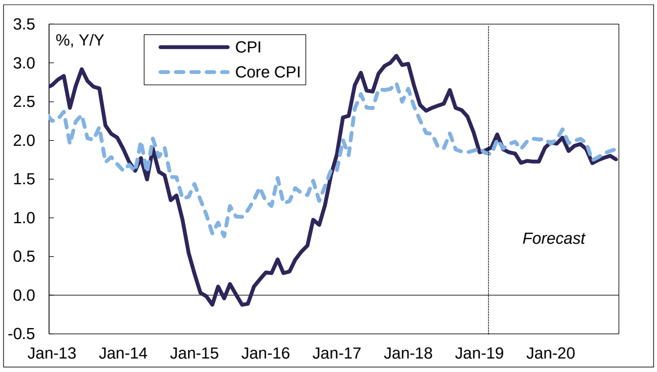
Perhaps more notable today, however, was the response from the EU, with a hardening of positions apparent amid clear frustration with Theresa May. For example, the French Government reportedly expressed scepticism as regards to the desirability of granting any Article 50 extension. And a leaked European Commission paper – which reportedly echoed remarks made by Commission President Juncker in a phone call to Theresa May before she sent her letter this morning – suggested that a delay to 30 June would not be desirable. Instead, it noted that there should instead be a "binary" choice between a short extension to 23 May or a long extension to year-end or beyond, with this latter scenario requiring UK participation in the forthcoming European Parliament elections, for which UK legislation would likely need to be adopted by 12 April. And the message of that paper was broadly echoed by comments late in the day from European Council President Tusk, who stated that May's proposed new deadline raised several legal and political questions that leaders would have to discuss tomorrow. Nevertheless, he accepted that a short extension would likely be acceptable to the EU, but only if the UK Parliament was able to agree on a deal first. If, however, a deal could not be endorsed by MPs over the coming few days, then he stated that he would be ready to convene a further EU Summit next week to agree on an alternative way forward.

UK: CPI inflation and components



**Excluding food and energy. Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.*

UK: CPI inflation forecast



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Ball to be back in MPs' court by the weekend

So, while EU leaders tomorrow will likely agree to a short extension of the Article 50 deadline – perhaps to late May – that would likely be conditional on the response of MPs over the coming days. At the time of writing, May was scheduled this evening to meet with other UK political party leaders, with rumours also that she would make a formal statement later on. There were also some suggestions that the House of Commons might convene as soon as Saturday to debate Brexit alternatives, and other reports that MV3 would be conducted next Tuesday or Wednesday. On balance, although it could be close, we would still expect May's deal (or a variant thereof) to be rejected again in MV3. And so, we would then also expect the EU to agree later next week to a longer extension, which would be implemented in UK legislation via a statutory instrument before 11pm on 29 March to avoid a no-deal Brexit. But there will certainly be plenty more twists and turns – and the UK's political crisis will surely deepen further – before then.

Inflation settles below the BoE's target

Having eased notably last year from 3.0%Y/Y at the start of 2018 to 1.8%Y/Y in January this year, CPI inflation in the UK seems to have broadly stabilised. Today's figures showed that the headline rate ticked up to 1.9%Y/Y in February. But looking at the details, there was no sense that underlying inflationary pressures are strengthening, with the core rate inching 0.1ppt lower back to 1.8%Y/Y, a level last seen in November. Among the major core components, services price inflation remained unchanged at 2.5%Y/Y, matching its average over the past six months, while goods inflation dipped 0.1ppt to 0.9%Y/Y, the joint lowest since Q117. Smaller monthly increase in prices of clothing and footwear compared to last year provided a negative contribution, which was partly offset by higher prices of computer games. So, the increase in the headline rate was driven primarily by prices of food. Energy price inflation was virtually unchanged at just above 1.0%Y/Y, but with oil prices having recently been on a gradual upward trend, we might see somewhat higher rates in this category in March and April. Core inflation might also rise over the near term due to the timing of Easter, but the effect will be temporary – with the economic outlook remaining subdued, we do not think the core rate will be materially higher in the second half of the year and this view underpins our expectation that the BoE will not change monetary policy this year. Of course, developments with respect to Brexit might at some point alter the situation significantly.

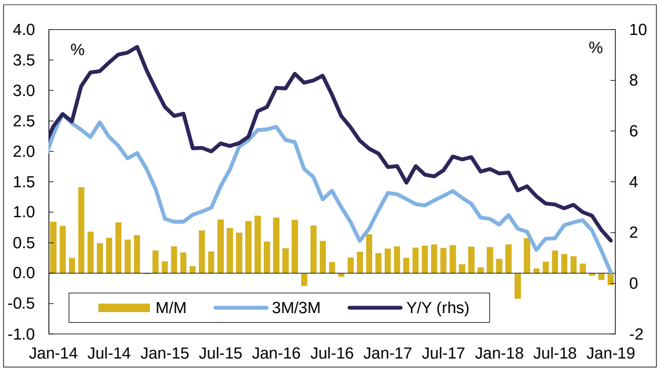
House prices wilting under Brexit pressure?

The official ONS/Land Registry house price indices echoed similar indicators released recently, suggesting that residential property prices are on average now starting to wilt. The index posted a second consecutive monthly decline to leave the level of prices in the three months to January unchanged compared to the previous three months. As a result, the annual pace of increase of national house prices moderated by 0.4ppt to 1.7%Y/Y, a five-and-half-year low. And house prices in London decreased at a similar rate, which represented the weakest reading since the global financial crisis. More timely indicators of house prices have reported further weakening in February and March, and it is clear that Brexit uncertainty is taking a significant toll on the market.

CBI survey highlighted Brexit damage once again

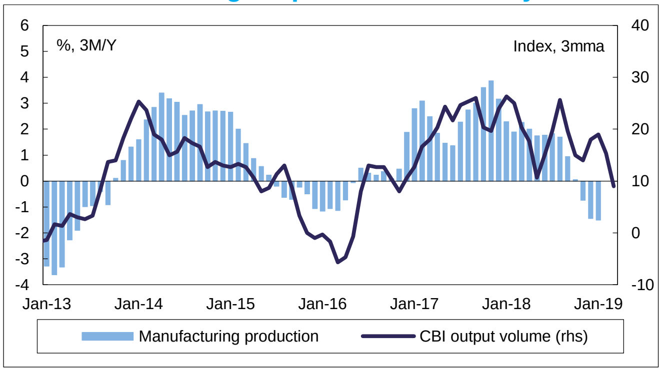
Against the backdrop of high Brexit uncertainty, the CBI Industrial Trends survey painted a picture of a subdued but stable manufacturing sector. Output growth reportedly weakened this quarter, with a net balance of only 4% of respondents – down from 7% in February and one of the lowest levels in recent years – reporting that production is rising. Nevertheless, the survey's order books indicator eased only slightly and so remained above its long-term average, while the export orders index rose to the second highest level since last summer to match its average in the last two years. Responding to an additional question on the impact of Brexit uncertainty, some manufacturers cited lower investment and weaker demand. And a quarter of them stated that they had increased inventories, tallying with the survey's specific indicator for stocks, which for the second month in a row, was well above the levels prevailing in the second half of last year.

UK: House Price Index



Source: ONS, Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: Manufacturing output and CBI Survey



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

The day ahead in the UK

Of second-order importance compared to the EU summit discussion on Brexit, tomorrow the BoE will announce its latest monetary policy decision. At February's meeting the MPC left policy unchanged and reaffirmed its forward guidance that limited and gradual policy tightening will be required over the coming years if the economy evolves in line with expectations. However, Carney's tone in the press conference was quite dovish, acknowledging that the outlook for the UK economy had deteriorated. With no new economic forecasts due at this point and with Brexit uncertainty weighing ever more heavily on the economy, MPC members will not want to make any adjustments to their policy stance at this point, so we expect tomorrow's announcements to be uneventful. With regard to Brexit, a couple of external members of the Committee have recently expressed their personal opinion that, in a no-deal scenario, a cut to Bank Rate would be more likely than an increase. But not all MPC members are of a similar opinion. And while last week's House of Commons votes significantly reduced the likelihood of such a disorderly Brexit, we would expect the Committee to reaffirm its readiness to change policy in either direction in such a scenario, depending on the balance of the impact to supply, demand and the exchange rate.

As well as the announcement from the BoE, we will receive the latest official data on retail sector activity. Surveys suggest that, after a stronger performance in January, growth stalled in February, as many retailers introduced new-season items at full price. So, having risen to a two-year high of 4.2%Y/Y in January, retail sales growth is set to have softened in February, likely to around 3%Y/Y.

Euro area

The day ahead in the euro area and US

In addition to Brexit, the two-day EU summit, which gets underway tomorrow, will see leaders discuss the future development of the Single Market, the Capital Markets Union and (perhaps contentiously) industrial policy, as well as climate change and preparations for the upcoming EU-China summit. Data-wise, tomorrow will bring the Commission's flash consumer confidence indicator for March. This is expected to have posted another modest improvement for a third consecutive month, albeit still leaving the index on average in Q1 roughly ½pt below the average in Q4. The ECB will also publish its latest Economic Bulletin, while in the markets France and Spain will issue bonds with various maturities.

In the US, aside the weekly jobless claims figures, tomorrow will see the release of the Philly Fed survey and Conference Board's leading indicators for February. In the markets, the Treasury will sell 10Y TIPS.

European calendar

Today's results							
Economic data							
Country		Release	Period	Actual	Market consensus/ *Daiwa forecast*	Previous	Revised
Germany		PPI M/M% (Y/Y%)	Feb	**-0.1 (2.6)**	0.2 (2.9)	0.4 (2.6)	**-**
UK		CPI (core CPI) Y/Y%	Feb	**1.9 (1.8)**	*1.8 (1.9)*	1.8 (1.9)	**-**
		UK House Price Index Y/Y%	Jan	**1.7**	2.4	2.5	**2.2**
		CBI Industrial Trends Survey, total orders %	Mar	**1**	5	6	**-**
Auctions and events							
Country		Auction					
Germany sold		€3.2bn of 0% 2024 bonds (05-Apr-2024) at an average yield of -0.32%					

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's data releases						
Economic data						
Country		GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
EMU		15:00	Flash consumer confidence indicator	Mar	-7.1	-7.4
Spain		09:00	Trade balance €bn	Jan	-	-3.2
UK		09:30	Public sector net borrowing excluding interventions £bn	Feb	0.7	-14.9
		09:30	Retail sales excluding auto fuel M/M% (Y/Y%)	Feb	-0.4 (3.5)	1.2 (4.1)
		09:30	Retail sales including auto fuel M/M% (Y/Y%)	Feb	-0.4 (3.3)	1.0 (4.2)
		12:00	BoE Bank Rate%	Mar	*0.75*	0.75
Auctions and events						
Country		GMT	Auction / Event			
France		09:50	Auction: to sell 1% 2025 bonds (25-Nov-2025)			
		09:50	Auction: to sell 0% 2024 bonds (25-Mar-2024)			
		09:50	Auction: to sell 0% 2022 bonds (25-May-2022)			
		09:50	Auction: to sell 0% 2022 bonds (25-Feb-2022)			
		10:50	Auction: to sell €2.5bn of 0.1% 2029 index-linked bonds (01-Mar-2029)			
Spain		09:45	Auction: to sell 0.05% 2021 bonds (31-Oct-2021)			
		09:45	Auction: to sell 1.45% 2029 bonds (30-Apr-2029)			
		09:45	Auction: to sell 4.9% 2040 bonds (30-Jul-2040)			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.