Daiwa Capital Markets

Euro wrap-up

Overview

- Following Wednesday's substantive gains in US Treasuries, Gilts opened higher and rose further as investors awaited EU leaders' decision, subsequently reached, to extend Article 50 and avoid a no-deal Brexit next week.
- Bunds also made gains despite a further increase in the Commission's consumer confidence index.
- Friday will bring the flash euro area PMIs for March.

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Daily bond market movements

Bond	Yield	Change*
BKO 0 12/20	-0.566	-0.016
OBL 0 04/24	-0.362	-0.033
DBR 0¼ 02/29	0.041	-0.042
UKT 1½ 01/21	0.699	-0.049
UKT 1 04/24	0.825	-0.084
UKT 1⅝ 10/28	1.064	-0.093

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

UK

EU leaders agree to avoid no-deal Brexit next week

After Theresa May yesterday wrote to request an extension of the Article 50 deadline beyond 29 March to allow time to find a parliamentary majority for a Brexit deal and adopt the legislation for its implementation, today's EU Summit saw leaders meet to discuss how to respond. Agreement proved difficult to reach, with the meeting overrunning by more than four hours. Crucially, however, leaders agreed to an extension to avoid a no-deal Brexit next week. But rather than setting the new deadline as 30 June as May had hoped, they consented to a shorter extension, until 22 May, conditional on the House of Commons approving the Withdrawal Agreement next week. And if approval of a deal is not reached over coming days, the extension will be shorter still, to 12 April – the date at which the UK would need to set legislation if it is to participate in May's European Parliament elections – with the UK by then having to indicate a clear alternative way forward for EU leaders to consider.

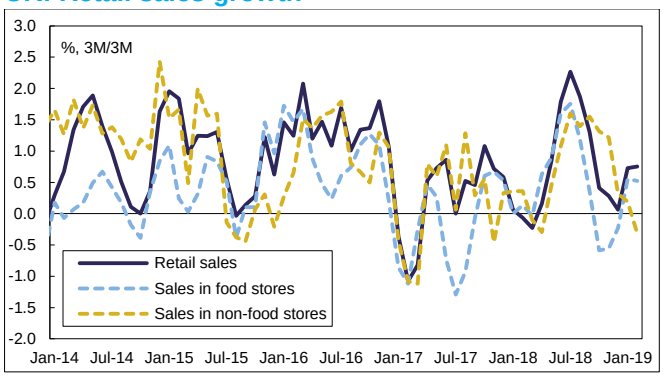
May's time looks to be up

Even if the House of Commons Speaker allows it to go ahead, we strongly doubt that Theresa May can win a majority in favour of her deal next week. Her antagonistic statement to the public on Wednesday evening, when she demonised MPs for their intransigence – seeking to distract attention from her incompetent negotiating strategy, reckless delay tactics, and uncompromising approach in Parliament – seems to have made that task near-impossible, alienating those MPs whose votes she will need to win, and losing the confidence of key Cabinet colleagues (reportedly including her all-important Chief Whip) too. And, on the evidence of today's events, EU leaders have also lost all confidence in May. So, while she might try to fight on, we now see a strong probability that May's end as Prime Minister is rapidly approaching – there is a good chance that she will be forced to step down within a week.

MPs now to take control?

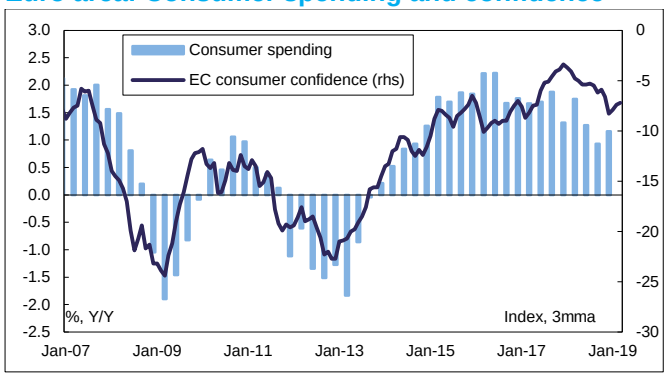
With May's deal, and term as Prime Minister, seemingly dying, 12 April would now seem to be the decisive date. If the UK cannot find a new workable way forward by then – to earn the right to a further extension (and the obligation to participate in the European Parliament elections) – a no-deal Brexit could yet occur. But, we think the EU would, if necessary, show further flexibility to avoid that prospect. Moreover, we also expect an alternative path for Brexit to be found. Most notably, the House of Commons on Monday is seemingly now set to vote on a variant of the Cooper-Letwin proposal, narrowly defeated last week, to allow MPs to launch a new process (perhaps as soon as Wednesday) to try to find a new compromise – which might encompass a softer Brexit or second referendum – to unlock a longer extension and eventually find a resolution to the current impasse.

UK: Retail sales growth



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Euro area: Consumer spending and confidence



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

BoE inevitably leaves policy unchanged

Against the backdrop of highly elevated Brexit uncertainty, it was inevitable that the BoE would leave policy unchanged today. And indeed, the MPC voted unanimously to leave Bank Rate at 0.75%, just as it has done at each meeting since tightening policy in August. The BoE's guidance on future rates was left unchanged too. The MPC continued to judge that, if the economy developed broadly in line with its February Inflation Report projections, an ongoing gradual tightening of monetary policy – perhaps no more than two rate hikes – would be appropriate over the coming few years. But it also acknowledged again that the nature and timing of Brexit would be all-important, and continued to suggest that rates could move either up or down in response, depending on the impact on demand, supply and sterling.

Q1 GDP to be firmer than previously expected?

In its post-meeting statement, the MPC judged that the recent economic dataflow had been mixed, but nevertheless felt that the February Inflation Report projections appeared to remain broadly on track. Yet, while the anticipated broad-based softening in global demand and trade had continued, it now expected UK GDP growth to be slightly stronger in Q1 than previously thought, at 0.3%Q/Q. Given the various temporary effects of Brexit uncertainty on the economy, however, the current dataflow was considered to provide an unreliable guide to the economic outlook, and thus arguably offered little insight to the appropriate next steps for policy. However, while employment growth had remained firm, the MPC noted the deterioration in the findings of recent labour market surveys. And while unit wage costs had picked up, it recognised that domestically generated inflation remained modest. Indeed, the meeting minutes stated that the relationship between wages and prices might not be as strong as previously thought, suggesting that upside risks to the inflation outlook might not be as significant as some MPC members previously thought. Overall, therefore, today's announcements from the BoE gave us no cause to revise our forecast that Bank Rate will remain unchanged over the coming few years.

Retail sales up again last month

Against the backdrop of intense competition and the ever-increasing threat from online activity, like UK firms in many other sectors, High Street retailers have faced additional pressures from Brexit, with uncertainty weighing on demand and sterling weakness boosting costs. But the official figures from the ONS suggest that the sector had a better start to the year than might have been expected. After sales rose by 1.0%M/M in January as consumers sought bargains amid New Year discounting, they grow further in February, a month when retailers normally start introducing new-season items at full-price. Indeed, beating expectations, total sales were up by 0.4%M/M to leave the annual pace of growth at 4.0%Y/Y, only a touch lower than the previous month and still one of the highest rates in the last two years. Food store sales fell for the first time since September, declining by 1.2%M/M, the steepest drop since the end of 2016 and more than reversing an increase of 0.9%M/M in January. But non-food sales rose 0.9%M/M, the most since November's Black Friday boost. This left the three-month growth rate in total sales at 0.8%3M/3M, a five-month high and up from only 0.1% in Q4. Admittedly, this was flattered by vigorous growth in sales at petrol stations (up 2.5%M/M) – excluding automotive fuel, sales were up a less vigorous 0.3%3M/3M, a touch below the equivalent rate in January. Nevertheless, while retail sales are not always a reliable guide to total household spending, overall, the figures appear to be consistent with a pick-up in private consumption growth this quarter. While that would appear to be in contradiction with the message from recent weak consumer sentiment surveys, it would tally with the firm labour market and, also perhaps, some households partaking in the precautionary Brexit stock-building that has been particularly prevalent in the business sector. And it would also be consistent with today's judgement from the MPC that GDP growth in Q1 might reach 0.3%Q/Q, up 0.1ppt from Q4.

The day ahead in the UK

The economic data calendar for tomorrow contains no notable UK releases. So, attention will be firmly on the political fallout from today's EU Summit discussions on Brexit.

Euro area

Consumer confidence up for third successive month

On another relatively quiet day for new economic data from the euro area, the European Commission's flash estimate of consumer confidence in March provided some good news. Having deteriorated steadily throughout 2018, according to the Commission indicator, sentiment among households improved for the third successive month in March, edging up 0.2pt to a four-month high of -7.2. That, however, left it still below the Q4 average, with the average for Q1 as a whole representing the lowest quarterly reading in two years. As such, while cause for cautious optimism, today's flash indicator suggests that private consumption is unlikely to accelerate markedly over the near term, having slowed to a relatively subdued 0.2%Q/Q and 1.0%Y/Y in Q418. National consumer confidence survey results are due for release next week. But we suspect that the improvement in the Commission's euro area index was once again driven by France, benefiting from President Macron's policy stimulus measures, and nationwide 'grand débat' town-hall debates, launched in response to the Gilets Jaunes protests, which nevertheless appeared to re-intensify last weekend. Meanwhile, confidence in Germany seems likely to have remained stable at a relatively elevated level, benefiting from the continued firm labour market.

The day ahead in the euro area and US

Friday will bring the most notable new economic data of the week in the shape of the March flash PMIs. Having ticked up in February, the composite PMIs for the euro area, Germany and France might edge up again this month. However, their averages in Q1 might remain below the equivalent figures for Q4, to hint at a moderation of economic growth this quarter. And the manufacturing indices for Germany and the euro area as a whole might be expected to remain in contractionary territory. Meanwhile, the EU summit will continue with a discussion with ECB President on the economic situation as well as a stocktake on the future development of the Single Market, the Capital Markets Union and industrial policy.

In the US, the week will conclude with the February existing home sales and January wholesale trade reports, as well as the (lesser watched) preliminary PMIs for March.

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ *Daiwa forecast*	Previous	Revised
EMU	Flash consumer confidence indicator	Mar	**-7.2**	-7.1	-7.4	**-**
Spain	Trade balance €bn	Jan	**-4.5**	-	-3.2	**-**
UK	Public sector net borrowing excluding interventions £bn	Feb	**0.2**	0.7	-14.9	**-13.3**
	Retail sales excluding auto fuel M/M% (Y/Y%)	Feb	**0.2 (3.8)**	-0.4 (3.5)	1.2 (4.1)	**1.1 (4.0)**
	Retail sales including auto fuel M/M% (Y/Y%)	Feb	**0.4 (4.0)**	-0.4 (3.3)	1.0 (4.2)	**0.9 (4.1)**
	BoE Bank Rate%	Mar	**0.75**	*0.75*	0.75	**-**

Auctions and events

Country	Auction
France sold	€1.7bn of 1% 2025 bonds (25-Nov-2025) at an average yield of -0.02%
	€3bn of 0% 2024 bonds (25-Mar-2024) at an average yield of -0.17%
	€2.3bn of 0% 2022 bonds (25-May-2022) at an average yield of -0.38%
	€2bn of 0% 2022 bonds (25-Feb-2022) at an average yield of -0.38%
	€2bn of 0.1% 2029 index-linked bonds (01-Mar-2029) at an average yield of -0.81%
Spain sold	€1.6bn of 0.05% 2021 bonds (31-Oct-2021) at an average yield of -0.182%
	€1.2bn of1.45% 2029 bonds (30-Apr-2029) at an average yield of 1.1%
	€610mn of 4.9% 2040 bonds (30-Jul-2040) at an average yield of 1.947%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's data releases

Economic data

Country	GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
EMU	09:00	Current account balance €bn	Jan	-	16.2
	09:00	Preliminary manufacturing PMI	Mar	49.5	49.3
	09:00	Preliminary services PMI (composite PMI)	Mar	52.7 (52.0)	52.8 (51.9)
Germany	08:30	Preliminary manufacturing PMI	Mar	48.0	47.6
	08:30	Preliminary services PMI (composite PMI)	Mar	54.8 (52.8)	55.3 (52.8)
France	08:15	Preliminary manufacturing PMI	Mar	51.4	51.5
	08:15	Preliminary services PMI (composite PMI)	Mar	50.6 (50.7)	50.2 (50.4)
Italy	09:00	Current account balance €bn	Jan	-	4.2

Auctions and events

Country	GMT	Auction / Event
- Nothing scheduled -		

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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