

Euro wrap-up

Overview

- Bunds made modest gains at the long end of the curve despite an upwards revision to euro area core inflation.
- Gilts made more significant gains as the Brexit talks between the Government and Labour party finally collapsed.
- The coming week brings the May flash euro area PMIs and German ifo survey, April UK inflation data and ECB policy meeting account, and European Parliament elections.

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Daily bond market movements

Bond	Yield	Change*
BKO 0 12/20	-0.622	+0.008
OBL 0 04/24	-0.514	-0.008
DBR 0¼ 02/29	-0.104	-0.010
UKT 1½ 01/21	0.699	-0.016
UKT 1 04/24	0.796	-0.026
UKT 1½ 10/28	1.039	-0.035

*Change from close as at 4.30pm BST.

Source: Bloomberg

Euro area

Core inflation revised up

There were few surprises from the final euro area inflation figures for April. With inflation on the EU-harmonised measure having been revised up 0.1ppt in France (to 1.5%Y/Y), down 0.1ppt in Italy (1.1%Y/Y), and left unchanged from the preliminary estimates in Germany (2.1%Y/Y) and Spain (1.6%Y/Y), the euro area's headline CPI rate was confirmed at the flash estimate of 1.7%Y/Y, up 0.3ppt from March and a five-month high. Within the detail, however, services inflation was revised up slightly and non-energy industrial goods was effectively unchanged. So, euro area core inflation was revised up 0.1ppt from the flash estimate to 1.3%Y/Y, marking a sharp rise of 0.5ppt from March and the highest rate in two years. Of course, we attribute much of April's 0.8ppt rise in services inflation to 1.9%Y/Y to the impact of the timing of the Easter holiday, particularly on tourism-related items. As such, we expect the increase in headline inflation to more than fully reverse in May and the annual rate of CPI to continue to decline through the second half of the year to around 1.0%Y/Y by October. Base effects associated with shifts in oil prices, as well as increased services inflation related to wage growth, are likely to push headline inflation higher again from December on. But while our forecast for headline inflation in 2019 is above that of the ECB, the opposite is true for 2020 and 2021, and we are similarly more downbeat than the ECB with respect to the outlook for core inflation.

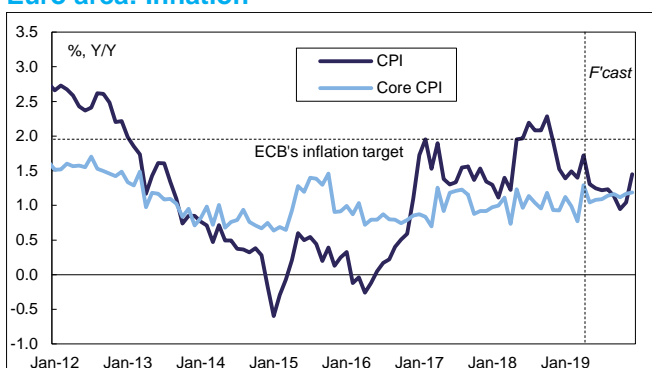
New car registrations rebound

Euro area new car registrations rose 0.5%Y/Y in April, the first positive annual reading since August. Given weakness in prior months, new registrations in the euro area were still down 2.6% over the first four months of the year compared to the same period of 2018. On a seasonally adjusted basis, however, following two consecutive months of declines, new car registrations rose a firm 4.7%M/M to their highest level since August, thus renewing the uptrend in place since the sharp decline in September related to the introduction of new car emissions regulations. Nevertheless, having risen more than 7%Q/Q in Q1 following a drop of more than 11%Q/Q in Q4, growth in euro area new car registrations looks set to be far more modest in Q2. At the country level, while registrations in Germany were down 1.1%Y/Y in April, they were up in France (0.4%Y/Y), Italy (1.5%Y/Y) and Spain (2.6%Y/Y). In Europe as a whole, new car registrations were down 0.5%Y/Y, weighed in April by the UK (down 4.1%Y/Y).

Strong growth in construction in Q1

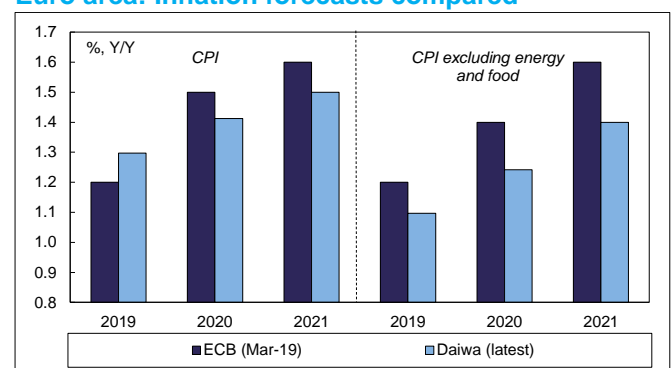
Construction output fell 0.3%M/M in the euro area in March. But that followed vigorous growth of 3.0%M/M in February. Looking at Q1 as a whole, construction output rose 2.0%Q/Q, marking the fourth successive quarter of growth in the sector

Euro area: Inflation



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Euro area: Inflation forecasts compared



Source: ECB and Daiwa Capital Markets Europe Ltd.



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and the strongest since 2013 to stand an impressive 4.9% higher than a year earlier. At the country level, construction output accelerated sharply in the first quarter in Germany (up 3.9%Q/Q and 8.9%Y/Y) and France (up 1.3%Q/Q and 3.8%Y/Y), but contracted in Spain (down 2.7%Q/Q and 4.3%Y/Y). And civil engineering activity (up 2.6%Q/Q and 8.6%Y/Y) outpaced building work (up 1.6%Q/Q and 0.9%Y/Y). While confidence in the sector has moderated slightly over recent months, it remains very high by historical standards and order books are ample. Fundamentals in the housing sector remain favourable, with household incomes and house prices rising, and mortgage rates are very low. And plans for increased public sector investment look set to provide further support for civil engineering activity. So, while it is difficult to believe that the rapid pace of growth in the sector in Q1 will be repeated, and we might well see negative payback in Q2, construction output looks well set to make a positive contribution to GDP growth over 2019 as a whole.

The week ahead in the euro area and US

The coming week will bring first top-tier economic survey results for May including, on Thursday, the flash PMIs. In April, the euro area composite PMI fell 0.3pt to 51.3, below the Q1 average, to suggest a slight loss of momentum at the start of Q2. In particular, the euro area services PMI fell 0.8pt to 52.5 while the manufacturing PMI rose 0.4pt but remained very weak at 47.9. Thursday will also bring the May business surveys from the German Ifo Institute and France's INSEE. Other May survey results include the European Commission's flash consumer confidence index on Tuesday. Among the additional data releases due in the coming week, Monday will bring the ECB's euro area balance of payments data for March while Thursday will also bring the final estimates of German Q1 GDP including publication for the first time of the expenditure components. Thursday will also bring the publication of the account of the Governing Council's April monetary policy meeting. ECB President Draghi will speak publicly on Wednesday. And, politics-wise, the elections to the European Parliament, to be held from Thursday to Sunday, will be watched for any further significant increase in representation of populist and nationalist parties which could impede future EU policymaking and impact the appointments of the next heads of the EU institutions, which are due to be made shortly. In the bond market, Germany will sell 10Y Bunds on Wednesday.

In the US, the coming week will be lighter than of late for economic data. Monday brings just the Chicago Fed National Activity indices for April, while the following day will bring April existing home sales data. The minutes from the May FOMC policy meeting are due on Wednesday. Along with the usual weekly claims figures, Thursday will bring new home sales data for April, and the preliminary Markit PMIs and Kansas City Fed manufacturing indices for May. And the preliminary durable goods orders figures for April are due on Friday. Meanwhile, Fed Chair Powell will speak at the Atlanta Fed Financial Markets Conference on Monday evening. In the bond market, the Treasury will sell 10Y TIPS on Thursday.

UK

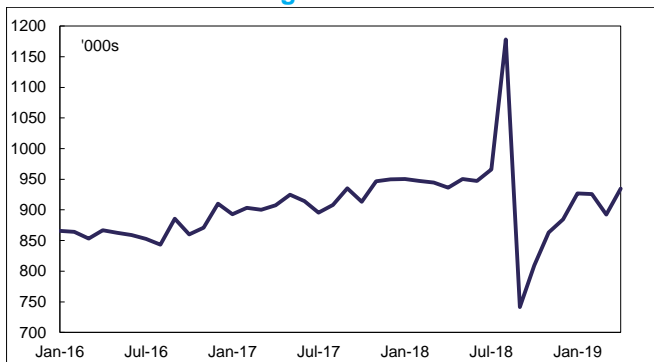
Theresa May edges closer to Downing Street departure

As expected, yesterday's meeting between Theresa May and her party's senior backbenchers of the 1922 Committee Executive took the Prime Minister one step closer to leaving 10 Downing Street for good. The post-meeting statement noted May's determination to see MPs approve her Brexit legislation in an initial vote (a 'second reading') in the week commencing 3 June and then try to provide safe passage of the Withdrawal Agreement Bill to allow the UK to leave the EU by the summer. But the Committee noted that, shortly after the second reading – whatever the result – it will agree with May a precise timetable for the election of a new Conservative Party leader.

Cross-party talks end without agreement

The clear implication is that, if and when she is defeated on that parliamentary vote in June, May will announce her resignation. With the PM's fate at stake, Labour MPs will have even less of an excuse to vote in favour of (or even merely

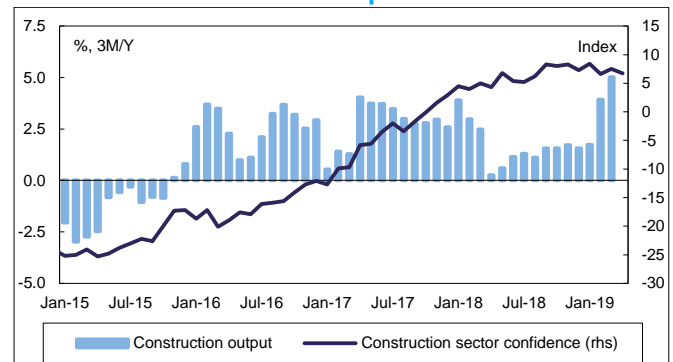
Euro area: New car registrations*



*Seasonally adjusted data.

Source: Bloomberg, ECB and Daiwa Capital Markets Europe Ltd.

Euro area: Construction output and confidence*



*European Commission euro area construction confidence index.

Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

abstain on) the PM's Bill in the second reading. And so, it was no surprise that the talks between the Government and Labour, aimed at finding a compromise, ended today without agreement. Among other things, leader of the opposition Jeremy Corbyn cited the PM's lack of authority, contradictory statements from Cabinet ministers, and 'important policy gaps' between the two sides as reasons to pull the plug on the talks. Corbyn did appear content for Parliament to hold a series of indicative votes to test MPs support on different Brexit scenarios, perhaps as early as next week. But it is not clear that these will prove any more capable of finding a majority in favour of anything than the previous indicative votes held in March.

Tory hardliners unlikely to give May a lifeline

In all likelihood being unable to rely on opposition votes, May's future will therefore depend principally on the support of those Conservative hard-line Brexiters who have long been keen to remove her, many of whom are now lining up to try to replace her. While one (Daniel Kawczynski) changed his position to support the Bill today, it is difficult to believe that enough of them will do likewise. Instead, most will likely relish the opportunity to provide the final blow to her premiership. So, we fully expect May to be forced to confirm her resignation early next month. She would then, however, remain as caretaker Prime Minister until a replacement has been elected by her party. And the precise timetable for the election campaign is unclear.

Expect another Article 50 extension
















Theoretically, Conservative MPs could concertina the leadership contest to have the new Prime Minister installed in Downing Street before MPs head off for their summer vacations. But with no single MP capable of bridging the deep divisions in the party, and the number of candidates seemingly now in double-digits, an acrimonious contest taking six to eight weeks seems more likely to be required. So, it's possible that the new PM won't be in place until the Conservative Party Conference commencing 29 September. None of the candidates appears up to the task of finding the workable route to implementing Brexit which repeatedly eluded May. And regardless of the intentions of the next Prime Minister, MPs would likely act to try to block a no-deal Brexit too. So, unless by some miracle the Tory Brexiters give May a surprise victory in the second reading next month, her successor as Prime Minister will be forced to ask the EU to agree to a further extension of the Article 50 deadline beyond end October.

The week ahead in the UK

Politics will continue to hog the lime-light in the UK in the coming week, with a series of indicative Brexit votes possibly to be held in Parliament on Wednesday ahead of the European Parliament election on Thursday, which looks set to see Theresa May's Conservatives humiliated. Given its deep divisions on Brexit, the party has not even agreed a manifesto for the election, and opinion polls suggest the party will come in a poor fourth with less than 15% of the vote. Nigel Farage's Brexit party – which, with the exception of advocating a no-deal Brexit, similarly has no policies – is set to take the largest share of the vote, albeit of less than 30%, very similar to the showing of his UKIP party at the previous EP election in 2014. Labour is on track for second place with less than 25% – a poor showing for a main opposition party and a damning verdict for its fence-sitting on Brexit. And the pro-remain Lib-Dems should pip the Tories to third.




Data-wise, the most notable releases of the coming week will be April's figures for inflation and retail sales, due Wednesday and Friday respectively. We expect the core CPI rate to 0.2ppt to an eight-month high of 2.0%Y/Y due principally to an increase in services inflation related to the timing of Easter. And we forecast a larger increase in headline inflation of 0.3ppt to a five-month high 2.2%Y/Y due also to higher retail energy prices related to the increase in Ofgem's regulated price cap at the start of the month. Meanwhile, after strong growth in March of 1.0%M/M, which capped a vigorous rebound over the first quarter as a whole, retail sales likely got a further boost in April from the timing of the Easter holiday and unseasonably warm weather. Other economic data due in the coming week include the CBI's industrial trends survey for May (Tuesday), ONS house price figures for March and the public finances report for May (both on Wednesday). BoE Deputy Governor Broadbent will give a speech on Tuesday while he, Governor Carney and certain other MPC members will testify on the May Inflation Report to the House of Commons Treasury Committee on Wednesday. In the bond market, the DMO will sell 2028 inflation-linked Gilts on Thursday.

Daiwa economic forecasts

		2019				2020				2018	2019	2020
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
GDP forecasts %, Q/Q												
Euro area		0.4	0.2	0.3	0.3	0.3	0.3	0.2	0.2	1.8	1.2	1.1
Germany		0.4	0.2	0.3	0.3	0.3	0.3	0.3	0.3	1.4	0.8	1.2
France		0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	1.6	1.2	1.2
Italy		0.2	0.1	0.2	0.1	0.1	0.2	0.0	0.0	0.8	0.3	0.4
Spain		0.7	0.6	0.5	0.5	0.4	0.4	0.4	0.4	2.6	2.3	1.8
UK		0.5	0.1	0.3	0.4	0.3	0.3	0.4	0.4	1.4	1.4	1.3
Inflation forecasts %, Y/Y												
Euro area												
Headline CPI		1.4	1.4	1.2	1.1	1.5	1.4	1.4	1.4	1.8	1.3	1.4
Core CPI		1.0	1.1	1.1	1.1	1.2	1.2	1.3	1.3	1.0	1.1	1.2
UK												
Headline CPI		1.9	2.1	1.9	1.6	2.0	1.7	1.6	1.8	2.5	1.9	1.8
Core CPI		1.9	2.0	1.9	2.0	2.1	2.0	2.0	2.0	2.1	1.9	2.0
Monetary policy												
ECB												
Refi Rate %		0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Deposit Rate %		-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40
Net asset purchases*		0	0	0	0	0	0	0	0	15	0	0
BoE												
Bank Rate %		0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75
Net asset purchases**		0	0	0	0	0	0	0	0	0	0	0
























*Monthly target €bn, end of period. **Monthly target £bn, end of period. Source: Bloomberg, ECB, BoE 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%	Apr	-0.4	-	-3.9	-
	 Construction output M/M% (Y/Y%)	Mar	-0.3 (6.3)	-	3.0 (7.6)	-
	 Final CPI (core CPI) Y/Y%	Apr	1.7 (1.3)	1.7 (1.2)	1.4 (0.8)	-
Auctions						
Country	Auction					
-Nothing to report-						











Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Coming week's data calendar

Key data releases						
Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous	
Monday 20 May 2019						
EMU		09:00 Current account balance €bn	Mar	-	26.8	
Germany		07:00 PPI M/M% (Y/Y%)	Apr	0.4 (2.4)	-0.1 (2.4)	
UK		00:01 Rightmove house prices M/M% (Y/Y%)	May	-	1.1 (-0.1)	
Tuesday 21 May 2019						
EMU		15:00 Flash consumer confidence indicator	May	-7.7	-7.9	
Spain		09:00 Trade balance €bn	Mar	-	-2.6	
UK		11:00 CBI Industrial Trends Survey, total orders %	May	-7	-5	
Wednesday 22 May 2019						
UK		09:30 CPI (core CPI) Y/Y%	Apr	2.2 (1.9)	1.9 (1.8)	
		09:30 House Price Index Y/Y%	Mar	-	0.6	
		09:30 Public sector net borrowing excluding interventions £bn	Apr	6.1	1.7	
Thursday 23 May 2019						
EMU		09:00 Preliminary manufacturing PMI	May	48.1	47.9	
		09:00 Preliminary services PMI (composite PMI)	May	53.0 (51.7)	52.8 (51.5)	
Germany		07:00 Final GDP Q/Q% (Y/Y%)	Q1	0.4 (0.7)	0.0 (0.6)	
		08:30 Preliminary manufacturing PMI	May	44.8	44.4	
		08:30 Preliminary services PMI (composite PMI)	May	55.2 (51.9)	55.7 (52.2)	
		09:00 Ifo business climate index	May	99.2	99.2	
		09:00 Ifo current assessment balance (expectations)	May	103.6 (95.2)	103.3 (95.2)	
France		07:45 Business sentiment indicator	May	105	105	
		07:45 Manufacturing confidence (production outlook) indicator	May	101 (-2)	101 (-2)	
		08:15 Preliminary manufacturing PMI	May	50.1	50.0	
		08:15 Preliminary services PMI (composite PMI)	May	50.7 (50.2)	50.5 (50.1)	
Friday 24 May 2019						
UK		09:30 Retail sales excluding auto fuel M/M% (Y/Y%)	Apr	-0.5 (4.3)	1.2 (6.2)	
		09:30 Retail sales including auto fuel M/M% (Y/Y%)	Apr	-0.4 (4.5)	1.1 (6.7)	
		11:00 CBI distributive trades survey, total retail sales %	May	8	13	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Coming week's events/auctions calendar

Key events & auctions			
Country		BST	Event / Auction
Monday 20 May 2019			
EMU		09.00	ECB's Praet scheduled to speak in London
UK		17.30	BoE's Broadbent scheduled to speak in London
Tuesday 21 May 2019			
UK		09.30	BoE's Carney, Broadbent, Tenreyro and Saunders testify at House of Commons Treasury Committee
EMU		10.00	ECB's Guindos speaks in London
Wednesday 22 May 2019			
EMU		08:00	ECB's Draghi scheduled to speak in Frankfurt
		10:30	ECB's Praet scheduled to speak in Frankfurt
Germany		10:30	Auction: to sell €3bn of 0.25% 2029 bonds
Thursday 23 May 2019			
EMU		12.30	ECB releases account of its April Monetary Policy Meeting
UK		10:30	Auction: to sell £1.25bn of 0.125% of index-linked 2028 bonds
		-	Election to the European Parliament
Friday 24 May 2019			
- Nothing scheduled -			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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