

# Euro wrap-up

## Overview

- Gilts made significant gains as Conservative MPs appeared to be in revolt against Theresa May's leadership and UK core inflation data surprised on the downside.
- Bunds also made gains on a quiet day for economic news from the euro area.
- Thursday brings the flash euro area PMIs and German ifo survey for May, and the account of the ECB's April policy meeting.

**Chris Scicluna**

+44 20 7597 8326

### Daily bond market movements

Bond	Yield	Change*
BKO 0 12/20	-0.604	-
OBL 0 04/24	-0.502	-0.013
DBR 0% 02/29	-0.084	-0.021
UKT 1½ 01/21	0.695	-0.047
UKT 1 04/24	0.779	-0.061
UKT 1½ 10/28	1.019	-0.064

\*Change from close as at 4.30pm BST.

Source: Bloomberg

## UK

### Theresa May on her last legs

Gilts rallied and sterling took another step down today as rumours swirled that the end of Theresa May's time as Prime Minister was imminent. Certainly, the response of MPs from across the political spectrum to [yesterday's initiative](#) to try to break the Brexit deadlock in Parliament was overwhelmingly negative. Some of those proposals, such as the options on customs arrangements which would be voted upon by MPs, went nowhere near far enough to appeal to Labour, but simultaneously went too far to be acceptable to many Conservatives who had previously backed May's deal. And so indications were that her Withdrawal Agreement Bill would have no chance of being approved if and when the House of Commons was given the opportunity to vote on it. At the time of writing, May still intended to publish the Bill on Friday ahead of a 'second reading' parliamentary vote in early June. But given the overwhelming evidence that she would face a humiliating huge defeat if she followed that path, reports suggested that several Cabinet members were discussing ways to force her to resign, possibly as soon as this evening to try to 'lance the boil' before tomorrow's European Parliament elections. The backbench 1922 Committee Executive, which had earlier this month agreed that May would resign if and when the Withdrawal Agreement Bill was rejected at the second reading, was also meeting to discuss options.

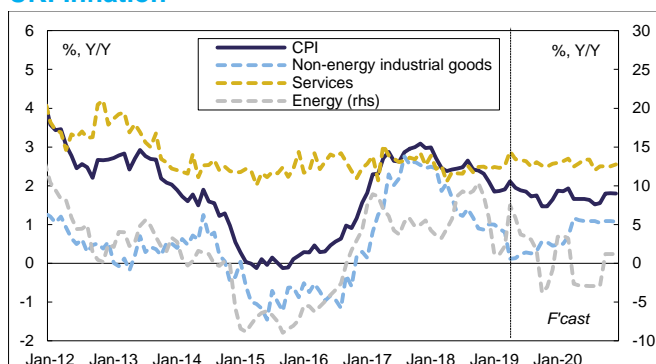
### Only a matter of time before resignation is confirmed

Precisely when May decides to fall on her sword remains to be seen. If she can survive until then, the announcement on Sunday evening of the results of the European Parliament elections – which at least one opinion poll suggests could see the Conservatives lose all of their seats bar one – might prove to be the straw that breaks the camel's back. But after a Conservative Party leadership contest that might last six to eight weeks, her eventual replacement as Prime Minister – probably a populist Brexiteer such as former Foreign Secretary Boris Johnson or former Brexit Secretary Dominic Raab – will not find life any easier to manage Brexit. Certainly, a new Prime Minister will not change the parliamentary arithmetic, whereby there appears to be no majority for any one specific form of Brexit. And while the next PM might talk up the option of leaving with no deal during their leadership campaign, civil servants will in due course make it clear that such a path will be both economically suicidal and harmful from the perspective of domestic security. At the same time, the EU will not be minded to renegotiate the Withdrawal Agreement reached with Theresa May, being only willing to reopen the Political Declaration on the future relationship. So, with time rapidly running out before the current end-October Brexit deadline is reached, we strongly expect May's successor eventually to have to ask for a further Article 50 extension. And a general election and/or second referendum will eventually be required to break the ongoing policy deadlock.

### Core inflation remains sub-target

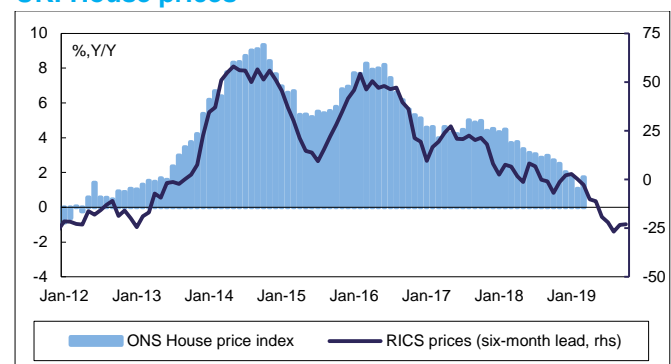
Headline CPI inflation rose 0.2ppt in April to a four-month high of 2.1%Y/Y. An increase had been expected, not least given higher electricity and gas prices resulting from Ofgem's increase in its six-month regulated price cap, which came into effect from 1 April

### UK: Inflation



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

### UK: House prices



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.



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2019. Indeed, energy inflation rose more than 5ppts to a five-month high of 7.5%Y/Y. Services inflation also picked up, rising 0.5ppt to 2.9%Y/Y, the highest rate since November 2017, principally reflecting higher transport prices – notably air fares – related not least to the timing of the Easter holidays. Mobile phone charges and car insurance prices also had a positive impact on this category. In contrast, prices of non-energy industrial goods fell the most in any April this century to leave the annual rate at just 0.1%Y/Y, the lowest in more than two years. Computer games and clothing – the latter of which has been subtracting from inflation since September – made significant negative contributions. And, as a result, contrary to expectations of an increase, for a third successive month core inflation remained at 1.8%Y/Y.

With some of the temporary factors that affected inflation in April set to wear off, we expect inflation of services and energy to be softer over the coming months. So, we expect core inflation to take a small step down in May and move broadly sideways thereafter through to the end of the year. We also forecast the headline CPI rate to move back slightly below 2.0%Y/Y in May, and fall gradually thereafter to reach a trough around 1½%Y/Y in Q4 when the domestic energy price cap is likely to be reduced. The profile of inflation, however, will of course be impacted significantly by politics, with shifts in sterling and – in the (still unlikely) event of a disorderly no-deal Brexit at end-October – supply shocks capable of having a marked impact.

### House price inflation remains subdued

Meanwhile, according to the official ONS indices, UK house price inflation in March rebounded 0.4ppt from February's six-year low to 1.4%Y/Y. That, however, was still some 2.6ppts below the rate a year earlier, and the national price level was still down on the Q4 average. Within the detail, the rate of decline of prices in London eased only moderately to 1.9%Y/Y, with prices also down on a year earlier in the South East and North East England. Elsewhere, the picture is not so bleak, e.g. price rises remained firm at 3.0%Y/Y or more in Wales, Yorkshire and the West Midlands, and accelerated to a similar rate in Scotland. Nevertheless, surveys suggest that average price increases at the national level will remain minimal over coming months. For example, the RICS Residential Market survey's national house price net balance moved sideways in April at -23%, only 4ppts above the eight-year low of -27% seen in February while the respective index for London declined to -66%, below the average of the past six months. With new buyer enquiries reportedly down again and overall market activity subdued, the survey's forward-looking indices pointed to ongoing weakness in prices both in the capital, and on average at the national level, over the near term. Given the damaging impact of Brexit uncertainty, that's hardly a surprise.

### The day ahead in the UK

With no economic data due, politics will remain at the forefront of attention tomorrow. Theresa May might well have announced her resignation by then, while UK voters go to the polls in the European Parliament (EP) elections. As elsewhere in the EU, no results will be available before Sunday night. One outcome, however, seems certain – the humiliation of Theresa May's Conservatives. Opinion polls suggest the party is on track for its worst performance ever, perhaps ending behind the Greens in fifth place with less than 10% of the vote. And that would likely mean it would lose all but one of its current tally of 18 EP seats, out of a total of 73 held by the UK. Nigel Farage's Brexit party – which, with the exception of advocating a no-deal Brexit, shares the Tories' policy vacuum – is set to take the largest share of the vote, perhaps with more than 30%. So, its performance is likely to beat that of Farage's former UKIP party at the previous EP election in 2014. Meanwhile, the pro-remain Lib-Dems appear on track to beat Labour to second place, to provide a damning public verdict on the main opposition party's fence-sitting Brexit policy. In the bond market, the DMO will sell 10Y inflation-linked Gilt.

## Euro area

### Elections to result in a fragmented European Parliament

Today was quiet for new economic data from the euro area, with no top-tier figures released. That will change tomorrow, when the May flash PMIs, in particular, will be closely watched. Thursday also marks the start of the European Parliament elections, which will be conducted across the member states through to Sunday. The results, which will not be announced until polls have closed on Sunday evening, will likely have a bearing on the effectiveness of EU policymaking over the coming five years. And they could also impact the appointments of the next heads of the EU institutions, for which leaders will start the nomination process at an informal dinner on Tuesday evening. Most notably, however, the election seems bound to leave the European Parliament highly fragmented, with no single grouping dominant. Indeed, the establishment centre-right and centre-left blocs – respectively the European People's Party (EPP) and Alliance of Socialists and Democrats (S&D) – which took more than 400 of the 751 seats in the 2014 election, will for the first time fail to win more than half of all seats between them. So, they will not be able to dominate the European Parliament in the same way as before, or be able to carve up the top EU jobs between them. They will, however, still represent the two largest parties, with the remainder of seats likely to be split between at least six other main groups.

### Salvini to prove primacy in Italy

Unsurprisingly, some populist parties look set to perform well. Most notably, in Italy, Deputy PM Salvini's nationalist League will likely win more than one third of the country's allocation of 73 seats, having won just five in 2014. So, it will comfortably beat its national coalition partner, the populist 5 Star Movement, which might slip to third behind the centre-left Democrats. Should the share of the vote of other right-wing parties (including Forza Italia of Silvio Berlusconi, who will be elected to the European Parliament for the first time) hold up, Salvini could be tempted to engineer a collapse in Italy's national government and force an early general election in the autumn to secure its domestic primacy.

## But centrists to fare better elsewhere

In many other member states, however, the nationalists seem unlikely to make significant gains. For example, since last weekend, scandal has engulfed Austria's far-right Freedom party (FPÖ). In France, Marine Le Pen's National Rally party could lose seats and come second to President Macron's 'La République En Marche' (LREM). And, at the EU level, centrists and (e.g. in Germany) green parties look set to perform well. So, if it was to link up formally with LREM after the election, the pro-European centrist bloc – the Alliance of Liberals and Democrats for Europe (ALDE) – would likely have the third largest representation in the EP with more than 100 seats. Therefore, while some commentators might be tempted to present the results merely as representing a further marked shift in support towards the populists, the number of seats to be won by pro-EU parties will still comfortably exceed those taken by eurosceptics, most likely by a margin of significantly more than 200 seats. Moreover, due to matters of both ideology and personality, the populist parties are unlikely to act as a wholly coherent bloc in future, limiting their impact on policymaking.

## The day ahead in the euro area and US

Data-wise, Thursday brings the most notable euro area economic data of the week with the May results of several top-tier business surveys, including the flash PMIs as well as the German ifo and French INSEE indices. 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. 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 final estimate of German GDP in Q1 (initial growth estimate of 0.4%Q/Q), which for the first time will include an expenditure breakdown, which is likely to show broad-based growth led by domestic demand.




In addition, the ECB will publish its account of the April monetary policy meeting, when the Governing Council's forward guidance – that its key rates are expected to remain at current levels “at least through the end of 2019” – was left unchanged. On that occasion, Draghi also confirmed that the pricing of the forthcoming TLTRO-III operations would be announced in June when the Governing Council would also “consider whether the preservation of the favourable implications of negative interest rates for the economy requires the mitigation of their possible side effects, if any, on bank intermediation”. In the markets, finally, Spain will sell 5Y, 10Y and 15Y bonds.

In the US, Thursday will bring new home sales data for April, the preliminary Markit PMIs and Kansas City Fed manufacturing indices for May, and the usual weekly claims figures. In the bond market, the Treasury will sell 10Y TIPS on Thursday.


# European calendar

## Today's results

### Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
UK	 CPI (core CPI) Y/Y%	Apr	<b>2.1 (1.8)</b>	2.2 (1.9)	1.9 (1.8)	-
	 ONS House Price Index Y/Y	Mar	<b>1.4</b>	-	0.6	<b>1.0</b>
	 Public sector net borrowing excluding interventions £bn	Apr	<b>5.8</b>	6.1	1.7	<b>-0.1</b>












### Auctions

Country	Auction
Germany sold 	€2.4bn of 0.25% 2029 bonds at an average yield of -0.07%







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 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)

### Auctions and events

Country	BST	Auction / Event
EMU		12.30 ECB releases account of its April Monetary Policy Meeting
Spain		09.40 Auction: to sell €1bn of 0.25% 2024 bonds
		09.40 Auction: to sell €1.8bn of 1.45% 2029 bonds
		09.40 Auction: to sell €1.3bn of 1.85% 2035 bonds
UK		10:30 Auction: to sell £1.25bn of 0.125% of index-linked 2028 bonds
EU		- Election to the European Parliament held in the member states on various days from 23-26 May

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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