

Euro wrap-up

Overview

- Bunds were little changed on a quiet day for euro area economic news.
- Gilts were also little changed as Theresa May confirmed her leave date, while UK retail sales figures exceeded expectations.
- The coming week will bring the results of the European Parliament elections, while leaders will discuss who to appoint as Draghi's successor. Data-wise, the Commission sentiment indices are due, alongside flash CPI estimates from euro area member states.

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Daily bond market movements

| Bond | Yield | Change* |
|--------------|--------|---------|
| BKO 0 12/20 | -0.617 | +0.001 |
| OBL 0 04/24 | -0.521 | +0.003 |
| DBR 0¼ 02/29 | -0.117 | +0.003 |
| UKT 1½ 01/21 | 0.641 | -0.005 |
| UKT 1 04/24 | 0.706 | -0.004 |
| UKT 1½ 10/28 | 0.956 | +0.002 |

*Change from close as at 4.00pm BST.
Source: Bloomberg

Euro area

Leaders set for discussion on ECB succession

After yesterday's disappointing euro area flash PMIs and German ifo indices, the week in the euro area ended on a quiet note for economic news with no top-tier releases. Perhaps more notable than the economic dataflow in the coming week (see below) will be Tuesday's informal dinner among EU leaders, where they will start the nomination process for the heads of the EU institutions, including the European Commission, European Council and ECB. As noted by Council President Tusk, the appointments "should reflect geographical balance as well as demography, so that both large and smaller countries are represented in the highest positions in the EU." And the appointments to the EU's two most senior jobs – the Commission and Council Presidents – are likely to be more highly prized by EU leaders than the leadership of the ECB. Whatever their merits, any candidate for the ECB leadership from a country which secures the Commission or Council job will be discarded. And so, sadly, it certainly cannot be assumed that Draghi's successor as ECB President – whose terms should start on 1 November – will be the best qualified person for the job.

Don't expect agreement on Tuesday

Tuesday's dinner seems highly unlikely to reach agreement, so further discussions are likely to be required in June and perhaps even July. That partly reflects the extreme political sensitivities involved with the appointments, and the fact that some leaders this week will be bruised from the European Parliament elections. But as for the Commission and Council, there is also a wide field of potential candidates for the ECB top job, meaning that various permutations are possible.

Several candidates, none a shoe-in

In line with the consensus view, we see the best-placed candidates from the ECB as coming from France, Germany and Finland. None stands head and shoulders over the others. In our opinion, while some innovations to the way the ECB conducts (or at least communicates) policy might be welcome, broad continuity from the Draghi era would be desirable. In particular, we would want to see the next ECB President express an early willingness to use the ECB's existing policy toolkit to the full to get underlying inflation back to target on a sustained basis. And Draghi's successor should also express a willingness to "do whatever it takes" if and when the next crisis (which seems more likely than not to centre on Italy) hits. Sensitivity to the markets, finely tuned communication skills and political acumen are also essential, for what is – given the political and economic complications of setting a single monetary policy for nineteen different countries – the most difficult job in central banking. After all, a single accidental remark from the ECB can risk significant and highly damaging market volatility.

Weidmann a risk not worth taking

Measured against those criteria, Bundesbank President Jens Weidmann – seemingly Germany's preferred candidate – would seem an undesirable successor to Draghi, having previously argued against Draghi's OMT policy and appeared unwilling to embrace the ECB's asset purchase programme. Certainly, if Weidmann gets the job, expect the euro to strengthen, market measures of inflation expectations to fall, and economic confidence indicators weaken. In marked contrast, the French potential candidates appear a good fit. Among other things, Bank of France Governor Villeroy de Galhau is a good communicator who has been an early advocate of the need to be mindful of potential adverse consequences of negative rates. And while she might not want the job, IMF President Christine Lagarde would have the necessary political acumen. But Macron might yet seek and win the Commission President job for Brexit negotiator Michel Barnier. If so, either of the Finnish candidates – current and former central bank Governors Olli Rehn and Erkki Liikanen who both have experience within the European Commission and national politics – might well land the top job, if only by default. Neither is likely to set the markets alight with their dynamism, but both are likely to be safer pairs of hands than their Bundesbank alternative.



The week ahead in the euro area and US

Data-wise, the coming week will bring the first indications of inflation in May, and further top-tier economic sentiment survey results. The flash estimates of May inflation – which are likely to report declines as the Easter effect that boosted prices in April wears off – come from France on Wednesday, Spain on Thursday, and Germany and Italy on Friday. Survey results include the Commission's sentiment indicators on Tuesday, with the headline euro area ESI expected to decline for a thirteenth successive month to a three-year low. Other data due in the coming week include euro area bank lending figures for April (Tuesday), German labour market data for May (Wednesday), and German retail sales numbers for April (Friday). Monday will be free of data, allowing attention to focus on the results of the [European Parliament elections](#), which are likely to produce a fragmented chamber with increased representation of populists but pro-EU parties still with a large majority. Tuesday will see EU leaders meet for the aforementioned first discussion on the appointments of the next heads of various EU institutions, including the ECB. Two leading candidates to succeed Mario Draghi as ECB President – Bank of France Governor Villeroy de Galhau and Bank of Finland Governor Olli Rehn – will speak publicly on Tuesday and Wednesday respectively. Thursday will be a national holiday in many member states for Ascension Day. In the bond markets, Germany will sell 2Y Schatz on Tuesday and 5Y Bunds on Wednesday. Italy will sell a range of bonds on Thursday.

In the US, when markets re-open after Monday's Memorial Day holiday, the dataflow will be dominated by housing market indicators including the FHFA and S&P CoreLogic Case-Shiller home price indices (Tuesday) and pending home sales (Thursday). Thursday will also bring revised figures for Q1 GDP – expected to leave growth little changed from the initial estimate of 3.1%Q/Q annualised – as well as advance goods trade and inventories data for April. Friday will bring the latest monthly personal income and spending figures for April, including the deflators closely watched by the Fed. In the bond market, the Treasury will sell 2Y and 5Y fixed-rate notes on Tuesday and 2Y floating-rate and 7Y fixed-rate notes on Wednesday.

UK

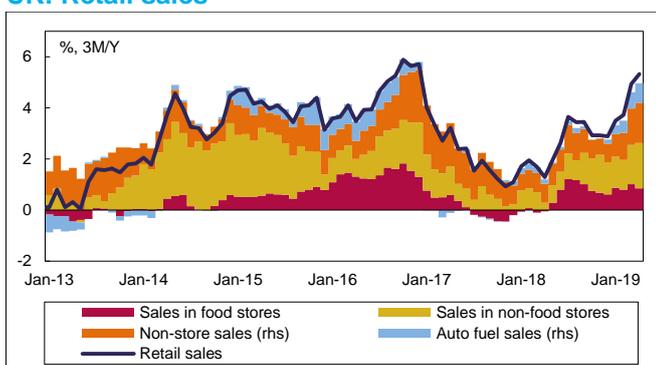
Theresa May confirms resignation timetable

In the face of unrelenting pressure from within her own party – and amid a mutiny by her own Cabinet in recent days – Theresa May finally confirmed her departure as Prime Minister within weeks. In particular, she announced that she would resign as party leader on 7 June, setting in train a leadership contest that, while potentially taking several weeks, should see a new head of the Conservative party installed as Prime Minister before Parliament's summer recess in late July. That provides time for May to host the visit to the UK of Donald Trump in the first week of June, and, for a change, get MPs to pass some legislation. But May's Brexit policy is surely dead.

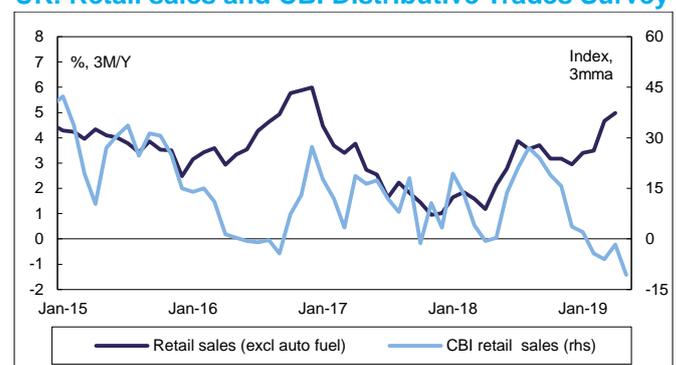
Johnson victory no done deal

Former Foreign Secretary Boris Johnson is by some margin considered most likely to succeed May as Prime Minister. But his numerous flaws are obvious. And we caution that, over recent years, the bookmakers' favourite ahead of Conservative party leadership contests rarely is the eventual victor. There will be several candidates, and an alternative (such as Environment Secretary Michael Gove) certainly can't be ruled out. Whoever the Conservatives choose as their leader will have questionable legitimacy as the nation's Prime Minister, having never won a general election, with a minority in Parliament, and being the head of a party that will likely have seen its national support fall below 10% in the European Parliament elections. And with the EU likely to be unwilling to make any significant amendments to the Withdrawal Agreement, he or she will likely find it no easier than Theresa May to find a path to manage Brexit. We still attach a relatively low probability to a no-deal Brexit, and an extension of the Article 50 deadline beyond 31 October remains our base-case.

UK: Retail sales



UK: Retail sales and CBI Distributive Trades Survey



Retail sales steady in April after Q1 strength

After a surge in retail sales in March took their growth over the first quarter to more than 1½%Q/Q, a softer performance at the start of Q2 always seemed likely. However, today's ONS data were stronger than expected, showing that the overall quantity of goods bought was unchanged from March, and down just 0.2%M/M when auto fuel is excluded. That left total sales up a still-hefty 5.2%Y/Y and almost 1% above the Q1 average. Unseasonably warm weather over the Easter holiday period supported sales, most notably with clothing sales up 2.3%M/M following growth of 1.5%M/M the previous month. Sales in food stores (-0.3%M/M) and household goods stores (-2.5%M/M) were weaker. But online sales posted further growth (0.8%M/M) to take their increase in the three months to April to a record 9.4%3M/3M.

But CBI survey points to a weak May

The strength in sales in the few months to April likely in part reflected precautionary stockpiling ahead of the initial Brexit Article 50 deadlines. And despite the steady performance in April, the CBI's Distributive Trades Survey suggested that sales in the year to May fell the most since October 2017, with a net balance of 27% of firms surveyed suggesting that sales had dropped. The volume of sales for the time of year was considered the worst since March 2009, with the only growth recorded in non-store (i.e. online) retail. Recreational goods sales volumes were flat, whilst other categories shrank. Moreover, the volume of orders placed with suppliers was judged to have "slumped" in May with a net balance of 41% reporting a decline. And the survey suggested that orders are expected to drop again in June, albeit at a softer rate. In addition, wholesalers reported a fall in sales in May for the first time in almost three years and auto sales were down the most on the survey since December 2011, with a further drop expected in June. And with consumer confidence subdued in the face of ongoing political uncertainty, although it is not always the most reliable guide, the CBI survey supports our view that growth in private consumption in Q2 is likely to be significantly softer than the 0.7%Q/Q rate of Q1.

The week ahead in the UK

All eyes in the coming week seem bound to remain on UK politics, not least with the outcome of the European Parliament elections on Sunday evening likely to show a dismal showing for the Tory party with some polls suggesting that not a single Conservative would be elected. Nigel Farage's Brexit party 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. Of course, focus will also be on who will throw their hat into the Tory leadership challenge, with the nomination process set to close in the week commencing 10 June – so far, the number of potential candidates has reached double-digits.

Data-wise, it should be a very quiet week for top-tier economic releases, with the most notable coming on Friday with the GfK consumer confidence and Lloyds business barometer for May. Both are likely to suggest that households and businesses alike considered conditions to remain subdued. Friday will also bring the Bank of England's latest lending figures for April, which will be preceded by the UK Finance figures for the same month on Tuesday. Meanwhile, Wednesday will bring the BRC shop price index for May. There are no Gilt auctions scheduled for the coming week, while Monday will be a Bank Holiday.

*Due to the UK Bank Holiday the next edition of the Euro wrap-up
will be published on 28 May 2019*

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 | 0.2 | 0.2 | 1.4 | 0.8 | 1.1 |
| 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 | 2.0 | 1.8 | 1.5 | 1.9 | 1.7 | 1.6 | 1.8 | 2.5 | 1.8 | 1.7 |
| Core CPI |  | 1.9 | 1.7 | 1.7 | 1.7 | 1.8 | 2.0 | 2.0 | 2.0 | 2.1 | 1.7 | 1.9 |
| 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 |
| UK |  Retail sales excluding auto fuel M/M% (Y/Y%) | Apr | -0.2 (4.9) | -0.5 (4.3) | 1.2 (6.2) | 1.4 (6.3) |
| |  Retail sales including auto fuel M/M% (Y/Y%) | Apr | 0.0 (5.2) | -0.4 (4.5) | 1.1 (6.7) | 1.2 (-) |
| |  CBI distributive trades survey, total retail sales % | May | -27 | 8 | 13 | - |
| 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 27 May 2019 | | | | | | |
| - Nothing scheduled - | | | | | | |
| Tuesday 28 May 2019 | | | | | | |
| EMU |  | 09.00 | M3 money supply Y/Y% | Apr | 4.3 | 4.5 |
| |  | 10.00 | Economic Sentiment Indicator | May | 103.8 | 104.0 |
| |  | 10.00 | Industrial (services) confidence | May | -4.3 (11.0) | -4.1 (11.5) |
| |  | 10.00 | Final consumer confidence | May | -6.5 | -7.3 |
| Germany |  | 07.00 | GfK consumer confidence | Jun | 10.4 | 10.4 |
| France |  | 07.45 | Consumer confidence | May | 97 | 96 |
| UK |  | 09.30 | UK Finance, loans for housing 000s | Apr | - | 40.0 |
| Wednesday 29 May 2019 | | | | | | |
| Germany |  | 08.55 | Unemployment rate % (change 000s) | May | 4.9 (-6) | 4.9 (-12) |
| France |  | 07.45 | Flash CPI estimate (EU-harmonised measure) Y/Y% | May | 1.1 (1.3) | 1.3 (1.5) |
| |  | 07.45 | GDP – third estimate Q/Q% (Y/Y%) | Q1 | 0.3 (1.1) | 0.3 (1.0) |
| |  | 07.45 | Consumer spending M/M% (Y/Y%) | Apr | - | -0.1 (-1.9) |
| Italy |  | 09.00 | Business (manufacturing) confidence | May | - | 98.7 (100.6) |
| |  | 09.00 | Consumer confidence | May | 110.1 | 110.5 |
| UK |  | 00.01 | BRC shop price index Y/Y% | May | - | 0.4 |
| Thursday 30 May 2019 | | | | | | |
| Spain |  | 08.00 | Flash CPI estimate (EU-harmonised measure) Y/Y% | May | 1.2 (1.2) | 1.5 (1.6) |
| |  | 08.00 | Retail sales Y/Y% | Apr | - | 1.7 |
| Friday 31 May 2019 | | | | | | |
| Germany |  | 07.00 | Retail sales M/M% (Y/Y%) | Apr | 0.1 (1.3) | 0.0 (-2.1) |
| |  | 13.00 | Flash CPI estimate (EU-harmonised measure) Y/Y% | May | 1.6 (1.5) | 2.0 (2.1) |
| Italy |  | 09.00 | GDP – second estimate Q/Q% (Y/Y%) | Q1 | 0.2 (0.1) | -0.1 (0.0) |
| |  | 10.00 | Flash CPI estimate (EU-harmonised measure) Y/Y% | May | 1.0 (1.0) | 1.1 (1.1) |
| UK |  | 00.01 | Gfk consumer confidence | May | - | -13 |
| |  | 00.01 | Lloyds business barometer | May | - | 14 |
| |  | 09.30 | Net mortgage lending (consumer credit) £bn | Apr | - | 4.1 (0.5) |
| |  | 09.30 | Mortgage approvals 000s | Apr | - | 62.3 |

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Coming week's events/auctions calendar

| Key events & auctions | | | |
|------------------------------|---|-----------------|--|
| Country | BST | Event / Auction | |
| Monday 27 May 2019 | | | |
| - Nothing scheduled - | | | |
| Tuesday 28 May 2019 | | | |
| EMU |  | - | EU leaders to meet in Brussels |
| |  | 08.30 | ECB's Villeroy scheduled to speak in Paris |
| Germany |  | 10:30 | Auction: to sell €5bn of 0.0% 2021 bonds |
| Wednesday 29 May 2019 | | | |
| EMU |  | 09:00 | ECB's Rehn scheduled to speak in London |
| Germany |  | 10:30 | Auction: to sell €3bn of 2024 bonds |
| Thursday 30 May 2019 | | | |
| Italy |  | 10.00 | Auction: to sell €2.5bn of 2024 bonds |
| |  | 10.00 | Auction: to sell €3bn of 2029 bonds |
| Friday 31 May 2019 | | | |
| - Nothing scheduled - | | | |

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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