

Euro wrap-up

Overview

- While most European markets were closed for May Day, Gilts made gains as the UK manufacturing PMI declined significantly at the start of Q2.
- Brexit uncertainty was also evident in the latest UK lending figures, with consumer credit also easing further.
- The BoE's MPC decision and Inflation Report will be the UK highlight tomorrow. Final manufacturing PMIs from the euro area and member states are also due for release.

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Daily bond market movements

Bond	Yield	Change*
BKO 0 12/20	-	-
OBL 0 04/24	-	-
DBR 0% 02/29	-	-
UKT 1½ 01/21	0.739	-0.025
UKT 1 04/24	0.881	-0.025
UKT 1½ 10/28	1.150	-0.035

*Change from close as at 4.30pm BST. German markets closed due to national holiday. Source: Bloomberg

UK

Manufacturing loses steam

Over recent months, stockpiling ahead of the original Article 50 deadline had helped to boost UK economic activity. Reflecting this, the manufacturing PMI had risen to a fourteen-month-high of 55.1 in March. But the pick-up seems to have faded fast, with today's survey for April showing a drop in that index to 53.1, a level slightly below the averages in Q1 and the past twelve months. All major survey components fell with the survey highlighting the impact of uncertainty surrounding Brexit as well as the overhang of inventories from recent precautionary stock-building activity and an associated drop in demand from overseas. Most notably, having risen to a record high in March, the PMI for manufacturing stocks fell more than 7pts, although at 58.8 it still remained consistent with an elevated level of inventories. The employment indicator was disappointing, falling to below 50 to highlight downside risks to job growth ahead. Meanwhile, the new orders index dropped by 2.2pts to 53.6, with an even more pronounced deterioration in export orders, for which the relevant index settled at just 48.1, a 4½-year low, amid suggestions that UK firms are increasingly being cut out of EU supply chains. Looking ahead, while the survey remains consistent with continuing expansion, a slowdown in Q2 looks on the cards as production levels are adjusted following decent growth in Q1. And we would not be surprised to see the UK manufacturing PMI moving closer to 50 in May and June.

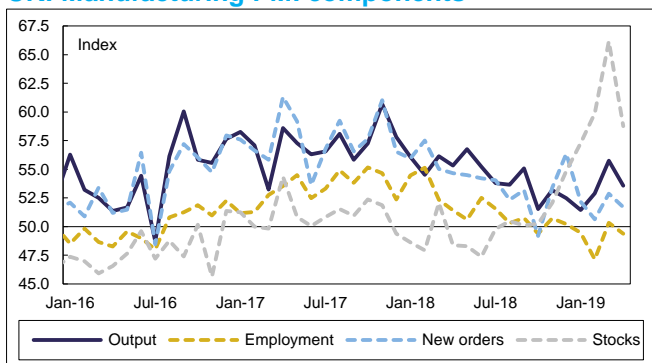
Consumer credit eased further on the back of weaker car finance lending

The effects of Brexit uncertainty were also visible in today's lending data released by the BoE. Most notably, net consumer credit in March was only £0.5bn, well below its recent average and the lowest level since November 2013, with a drop in new borrowing for car finance weighing on the headline number. These figures were consistent with data for new car registrations, which fell 3.4%Y/Y that month. Growth in the stock of consumer credit has been on a downward trend since late 2016 and the dip in new borrowing saw it fall further, to 6.4%Y/Y, the weakest since Q414. With regard to secured lending, the net new mortgage flow was £4.1bn, the highest in five months, but mortgage approvals for house purchase dropped by around 3k to 62.3k, the lowest since December 2017. With Brexit postponed at least until autumn, we think that approvals, and the net consumer credit flow, might rebound somewhat in the near term, although ongoing uncertainty will probably remain an important factor influencing household borrowing decisions.

House prices remain on the upward sloping trajectory

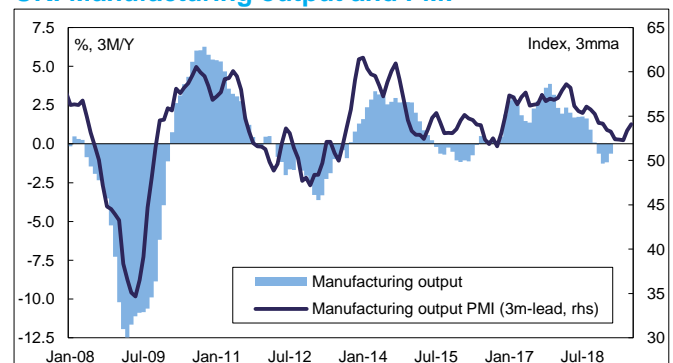
Meanwhile, on the Nationwide index, house prices rose 0.4%M/M last month, leaving them up 0.9%Y/Y and thus extending the pickup in inflation on an annual basis after slowing to just 0.1%Y/Y in January. And with the Article 50 extension having reduced near-term Brexit risks, we might see further recovery in housing market activity over the key spring and summer months. However, against the backdrop of continued dysfunctional politics, the end-October Brexit cliff-edge represents a continued source of uncertainty, which is likely to remain a deterrent to many market participants. And while at the national level home prices might on average continue to rise, prices in London seem likely to remain in reverse for a while yet.

UK: Manufacturing PMI components



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

UK: Manufacturing output and PMI



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



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Discounting curbed retail price inflation in April

Finally, according to the BRC Shop Price index, UK retail prices rose at a softer pace last month. Having followed an upward trend since the middle of last year, the survey reported a drop in this measure of inflation in April, from 0.9%Y/Y, which was the highest level in six years, to 0.4%Y/Y. Food inflation eased by 0.3ppt to 2.3%Y/Y, a level still notably higher compared to recent averages, while non-food inflation returned to negative territory, dropping 0.6ppt from zero in March. Against the backdrop of consumers' reluctance to spend and intense competition among retailers, the survey highlighted a sharp pick up in promotional activity, with a number of discounted product lines more than doubling from the previous month. With yesterday's GfK survey having shown no improvement in consumer sentiment, retailers are unlikely to see a pickup in demand in the coming months, so we think that increased promotional activity is likely to extend into coming months putting some further downward pressure on retail price inflation.

The day ahead in the UK

The main event tomorrow will be the announcement by the BoE of its latest monetary policy decision and publication of its May Inflation Report. We expect no changes to policy, with Bank Rate set to be left at 0.75%. The MPC's forward guidance is also likely to remain little changed, continuing to suggest that monetary policy tightening will be required if the economy evolves in line with the BoE expectations. In the last Inflation Report, conditioned on slightly less than two full 25bp increases in Bank Rate over the forecast horizon, the BoE expected that inflation will eventually settle slightly above its 2% target. Since then, in line with the global trend, market expectations for monetary policy have shifted downwards. And so the new set of projections should be based on barely more than one rate hike over the horizon, which will probably leave the MPC's CPI forecast above-target in coming years. This suggests that the tone of MPC communication – and Governor Carney's press conference – might be slightly on the hawkish side in order to try to align market expectations with its own thinking.

In terms of the outlook for growth, in March the MPC acknowledged that the economic dataflow had been mixed, but also revised up its Q1 GDP forecast to 0.3%Q/Q. We are slightly less optimistic about the pace of expansion last quarter. However, with aforementioned stockpiling ahead of a possible no-deal Brexit having boosted activity, a reading in line with BoE expectations is not impossible. Of course, the MPC's assessment of the economic effects of Brexit uncertainty will be in the limelight too. Having previously conditioned its projections on the assumption of a smooth adjustment to the average of a range of possible outcomes, given the extension to Article 50 until the end of October, the MPC might provide a bit more colour on how the Brexit process is expected to affect the economy in coming quarters.

On the data front, the only UK release of note tomorrow will be the construction PMI for April. Having dipped to below 50 in February and March, the headline PMI might inch back above 50. However, the survey will most likely reaffirm that construction sector momentum remained subdued at the start of Q2.

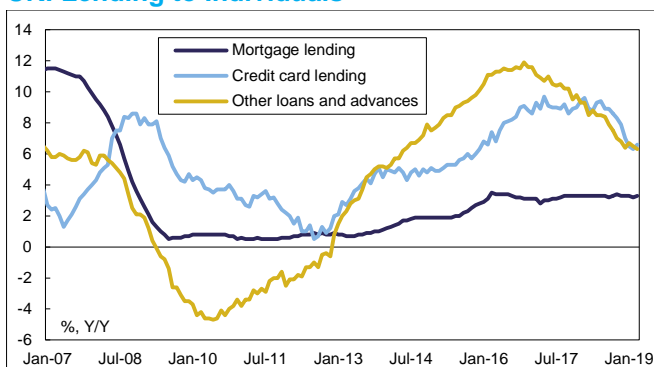
Euro area

The day ahead in the euro area and US

In the euro area, Thursday will bring data for German retail sales in March, which will follow two months of solid gains at the start of the year. In addition, the final manufacturing PMIs for April are due. The flash estimates saw modest increases in the headline figures for the euro area (47.8) and Germany (44.5), while France posted a modest drop (to 49.6), suggesting ongoing weakness in the sector at the start of Q2. In the markets, France will sell 10Y, 15Y and 20Y bonds.

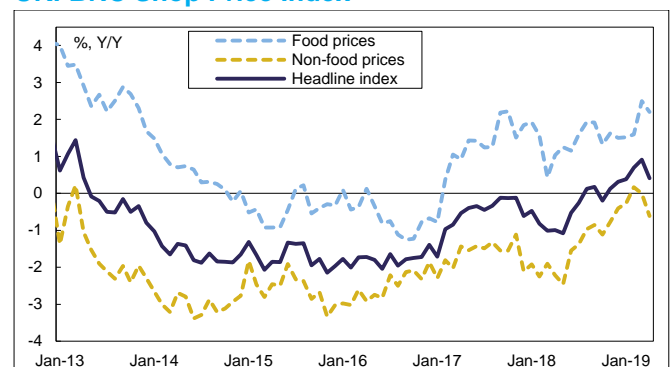
In the US, preliminary estimates for non-farm productivity and unit labour costs in Q1 will be released along with the usual weekly jobless claims numbers. The full factory orders report for March is also due after last week's preliminary durable goods orders data surprised significantly on the upside.

UK: Lending to Individuals








Source: BoE and Daiwa Capital Markets Europe Ltd

UK: BRC Shop Price Index











Source: Thomson Reuters 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	 BRC shop price index Y/Y%	Apr	0.4	-	0.9	-
	 Nationwide house price index M/M% (Y/Y%)	Apr	0.4 (0.9)	0.1 (0.7)	0.2 (0.7)	-
	 Manufacturing PMI	Apr	53.1	53.1	55.1	-
	 Net consumer credit (net mortgage lending) £bn	Mar	0.5 (4.1)	1.0 (3.6)	1.1 (3.5)	1.2 (3.3)
	 Mortgage approvals (000's)	Mar	62.3	64.5	64.3	65.3
Auctions and events						
Country	Auction					
- Nothing to report -						

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	Final manufacturing PMI	Apr	47.8	47.8
Germany		07:00	Retail sales M/M% (Y/Y%)	Mar	-0.5 (2.9)	0.5 (4.7)
		08:55	Final manufacturing PMI	Apr	44.5	44.1
France		08:50	Final manufacturing PMI	Apr	49.6	49.7
Italy		08:45	Manufacturing PMI	Apr	47.8	47.4
Spain		08:15	Manufacturing PMI	Apr	51.2	50.9
UK		09:30	Construction PMI	Apr	50.3	49.7
		12:00	BoE Bank Rate %	May	<u>0.75</u>	0.75
Country	BST	Auction / Event				
France		09:50	Auction: to sell 1.25% 2034 bonds (25-May-2034)			
		09:50	Auction: to sell 0.5% 2029 bonds (25-May-2029)			
		09:50	Auction to sell 1.75% 2039 bonds (25-Jun-2039)			
UK		12:30	BoE's Carney presents Inflation Report at the post-MPC meeting press conference			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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