

# Euro wrap-up

## Overview

- Bunds were little changed as falls were confirmed in euro area IP in April and German inflation in May.
- Gilts made gains as populist Brexiteer Boris Johnson came first by a large margin in the first round of the Conservative party leadership contest.
- Friday will bring final May inflation figures from France and Italy, as well as Italian April industrial sales and orders data.

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### Daily bond market movements

Bond	Yield	Change*
BKO 0 06/21	-0.676	+0.002
OBL 0 04/24	-0.593	+0.003
DBR 0% 02/29	-0.242	-0.006
UKT 1½ 01/21	0.590	-0.018
UKT 1 04/24	0.622	-0.028
UKT 1½ 10/28	0.836	-0.031

\*Change from close as at 4.30pm BST.  
Source: Bloomberg

## Euro area

### IP off to weak start in Q2

Euro area industrial production (excluding construction) had a weak start to the second quarter, declining 0.5%M/M in April following a fall of 0.4%M/M in March. Output was supported by firm growth in energy production, up 1.4%M/M. In contrast, manufacturing production dropped 0.8%M/M, the most so far this year. Output of capital goods fell 1.4%M/M, the most since November, with production of consumer durables down 1.7%M/M and intermediate goods down 1.0%M/M. At the country level, the drop primarily reflected the marked declines of 2.3%M/M in Germany and 1.7%M/M in the Netherlands – partly related to the plunge in exports to the UK following a surge in shipments in Q1 – as well as a moderate retreat in Italy (0.7%M/M). Substantial growth in Ireland (3.6%M/M) and Spain (1.7%M/M), and a modest increase in France (0.4%M/M) provided some offsetting support. The decline in April left overall industrial production down 0.4%Y/Y (with output of capital and intermediate goods alike down 1.2%Y/Y) and 0.7% below the Q1 average. Surveys suggest that firms have reduced stocks and backlogs, but that the trend in output has remained negative against the backdrop of persistently weak new orders. So, while we expect a moderate rebound in May led by Germany, we also expect a decline of about ½%Q/Q in production over Q2 as a whole following growth of 0.9%Q/Q in Q1.

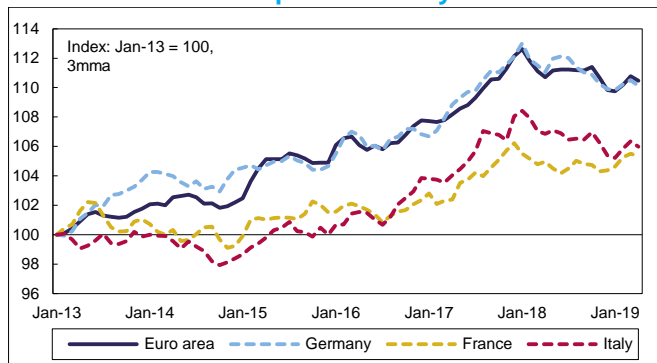
### No surprises from final German inflation data

The final German inflation figures for May predictably aligned with preliminary release, confirming the 0.8ppt drop in the EU-harmonised rate to 1.3%Y/Y, a thirteen-month low, with the headline rate on the national measure dropping 0.6ppt to 1.4%Y/Y. Within the detail on the national measure, the most notable downward pressure related to prices of package holidays, with a drop of 9.0%Y/Y following the Easter-related surge in April (+11.2%Y/Y). As such, services inflation declined 0.9ppt to 1.2%Y/Y. So, while goods inflation moved sideways at 1.8%Y/Y, the core CPI rate on the national measure fell 0.5ppt to 1.3%Y/Y. We expect a modest increase in the EU-harmonised measure of inflation to 1.5%Y/Y in June before a further decline close to 1.0%Y/Y through Q3 related not least to shifts in energy prices.

### The day ahead in the euro area and US

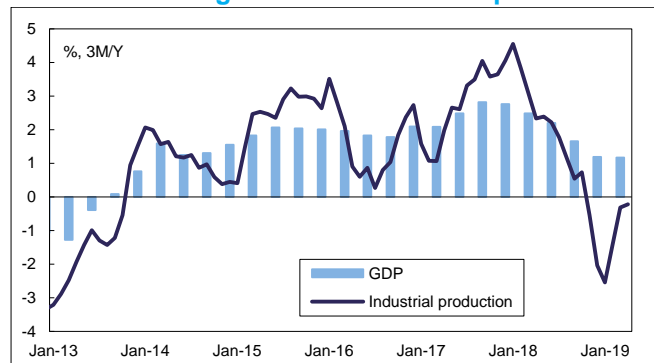
The week in the euro area will conclude with final May inflation data for France and Italy, as well as Italian industrial sales and orders data for April. Like in Germany, the inflation figures are expected to align with the flash readings, which saw the EU-harmonised CPI rates decline 0.4ppt to 1.1%Y/Y in France and 0.2ppt to 0.9%Y/Y in Italy.

### Euro area: Industrial production by member state



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

### Euro area: GDP growth and industrial production



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.



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In the US, Friday will bring some further top-tier data releases that will be studied closely at the Fed, including the May reports for retail sales and industrial production and the preliminary June University of Michigan consumer confidence survey. The retail report will likely confirm a boost from autos but also a drag from service stations due to lower gasoline prices. Sales of other items seem likely to be subdued. Likewise, the IP report will likely show a fifth consecutive subdued reading for manufacturing output. And weaker equity markets and the ongoing trade war might weigh on consumer confidence, after the headline index rose to an eight-month high in May.

## UK

### Johnson on track for Downing Street

Today's first-round vote in the Conservative Party leadership election firmly consolidated the position of former Foreign Secretary and populist Brexiteer Boris Johnson as most likely to succeed Theresa May as Prime Minister. Further rounds of votes among MPs will be held next week in order to whittle down the number of candidates to two. And that pair will then be subjected to the decisive poll among the party's rank and file members, the result of which will be announced later next month. In today's first round, which featured ten candidates, Johnson won the backing of 114 of the 313 Conservative MPs – already surpassing the threshold of 105 votes that will be required next week to qualify as one of the two names to be submitted to party members. So, in the absence of the emergence of a new scandal (which, of course, can never be entirely ruled out), he is bound to make it to that final stage. It's by no means clear who he would face, with either current Foreign Secretary Jeremy Hunt (with 43 votes today) or Environment Secretary Michael Gove (with 37 votes today, but whose own chances have suffered from his confession of cocaine use) most likely. However, opinion polls suggest that Johnson will easily win that head-to-head contest. For example, a poll published today by Conservative Home suggested that Johnson was the first choice of 54% of party members, some 43pts ahead of his nearest rival (the centrist Rory Stewart).

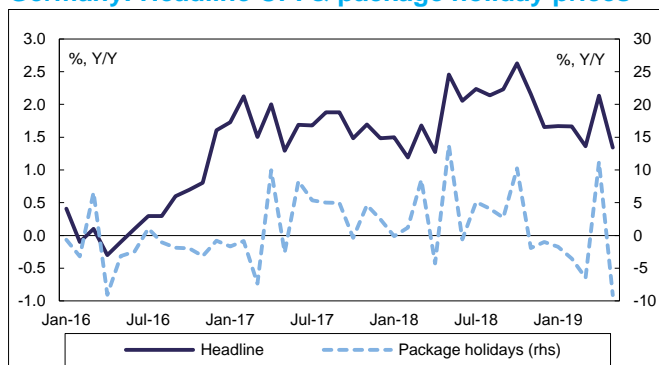
### Should investors believe what Johnson says?

Johnson's public comments throughout this leadership campaign have frequently been rhetorical and he has tried to keep public scrutiny to a minimum. Specific policy commitments have often been vague, not least on Brexit, where he simply insists that the UK must leave the EU by 31 October with or without a deal. And other commitments appear undeliverable or ill thought through, such as his pledge for a big increase in the top-rate income tax threshold. Of course, history suggests that much of what he says should anyway be treated with a big pinch of salt – the populist, gaffe-prone, talisman of the Brexit campaign in 2016 has in the past twice been sacked for lying.

### No-deal Brexit still unlikely?

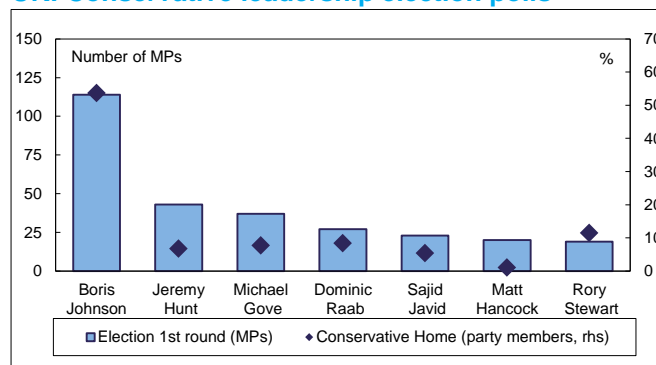
So, assuming he wins the Conservative leadership contest, we cannot be at all sure what Johnson would do. On Brexit, however, we would expect him initially to try to renegotiate Theresa May's deal. But he is highly unlikely to find significant support for substantive amendments among the EU leaders, who already view him with significant mistrust. Given the lack of principal evident in his flip-flopping in previous votes on the draft Withdrawal Agreement, we do not rule out the probability that he would agree minimal cosmetic changes to May's proposals, largely to the Political Declaration, before submitting them for a vote in Parliament. Coupled with a threat of an early General Election in the event of a defeat, that could suffice for the Withdrawal Agreement finally to be endorsed by MPs and the UK to leave the EU. But if that deal is rejected, or no new agreement with the EU is reached, we would still see the probability of an Article 50 extension and new election (or even second referendum), as greater than the probability of a no-deal Brexit. Yesterday, the House of Commons rejected a proposal with cross-party support for a new process to prevent the UK leaving without a deal, prompting a weakening of sterling. But the timing and vagueness of that proposal contributed to that negative outcome. And, if Prime Minister Johnson decided to press for no deal, we would still expect MPs to block his progress, prompting a new General Election if necessary.

### Germany: Headline CPI & package holiday prices\*



\*EU-harmonised measure. Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

### UK: Conservative leadership election polls



Source: Conservative Home and Daiwa Capital Markets Europe Ltd.

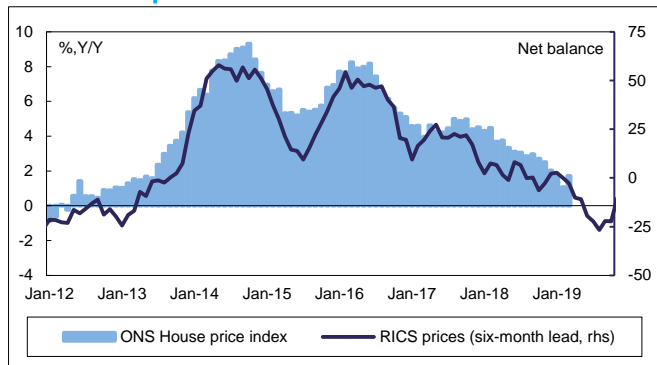
## Housing market more stable after Article 50 extension

Data-wise, the latest RICS house price survey suggested a slightly more stable residential property market in May, probably supported by the avoidance of a no-deal Brexit and Article 50 extension to end-October. For the first time in ten months, there was only a minimal drop in new buyer enquiries, although agreed sales reportedly continued to decline significantly and expectations are for a further fall over the coming three months. New sales instructions also declined for an eleventh successive month to suggest a continued lack of new supply. While the survey's headline national house price balance remained in negative territory, at -10.2% it was the best since October. The regional detail suggested a fourth consecutive monthly moderation of downwards pressure in London where price declines have up to now been steepest, with the South East now the primary source of weakness. Looking ahead, national price expectations remain slightly negative for the coming three months (net balance of -14%), but positive for the coming year (+22%), with lower mortgage rates, rising real incomes and stable consumer confidence likely to provide support as long as a no-deal Brexit is again avoided.

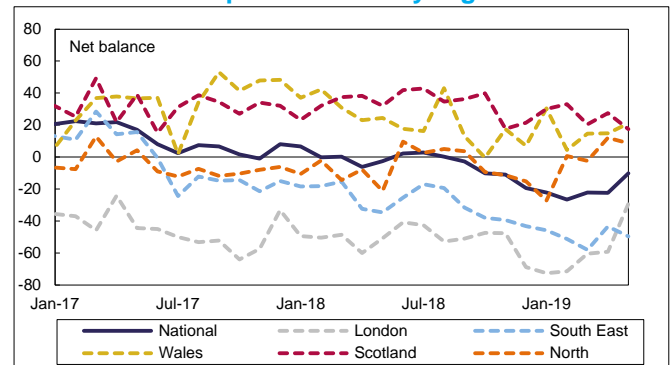
## The day ahead in the UK

It should be a quiet end to the week for economic news from the UK, with no new data due on Friday. While BoE Governor Carney will speak publicly, the nature of the occasion (an awards ceremony), as well as the formal purdah period ahead of next week's MPC meeting, strongly suggests that he will avoid any discussion of monetary policy.

### UK: House price indices






### UK: RICS house price indices by region






## European calendar

### Today's results

#### Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
EMU	 Industrial production M/M% (Y/Y%)	Apr	<b>-0.5 (-0.4)</b>	-0.5 (-0.6)	-0.3 (-0.6)	<b>-0.4 (-0.7)</b>
Germany	 Final CPI (EU-harmonised) Y/Y%	May	<b>1.4 (1.3)</b>	1.4 (1.3)	2.0 (2.1)	-
UK	 RICS house price balance %	May	<b>-10</b>	-21	-23	<b>-22</b>




#### Auctions

Country	Auction
Italy sold	 €2.75bn of 1.0% 2022 bonds at an average yield of 1.05%  €1.51bn of 2.1% 2026 bonds at an average yield of 1.96%  €741mn of 3.35% 2035 bonds at an average yield of 1.88%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

### Yesterday's results




#### Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Spain	 Final CPI (EU-harmonised) Y/Y%	May	<b>0.8 (0.9)</b>	0.8 (0.9)	1.5 (1.6)	-
Germany sold	 €2.6bn of 0.25% 2029 bonds at an average yield of -0.24%					
UK sold	 £700mn of 0.125% 2048 index-linked bonds at an average yield of -1.908%					

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
France	 07.45	Final CPI (EU-harmonised) Y/Y%	May	1.0 (1.1)	1.3 (1.5)
Italy	 09.00	Industrial sales (orders) Y/Y%	Apr	-	1.3 (-3.6)
	 10.00	Final CPI (EU-harmonised) Y/Y%	May	0.9 (0.9)	1.1 (1.1)

#### Auctions and events

Country	BST	Auction / Event
- Nothing scheduled -		

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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