

Euro wrap-up

Overview

- Bunds were little changed but BTPs and other periphery bonds made gains as the German Federal Constitutional Court gave the green light for the EU recovery funds to go ahead as planned.
- Gilts made modest losses despite a smaller-than-expected rise in UK inflation in March.
- Thursday will bring the latest ECB monetary policy announcements as well as the Commission's flash April consumer confidence indicator and business survey results from France and the UK.

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Daily bond market movements

Bond	Yield	Change
BKO 0 03/23	-0.704	-0.002
OBL 0 04/26	-0.609	-0.001
DBR 0 02/31	-0.263	-
UKT 0 ¹ / ₈ 01/23	0.029	-
UKT 0 ¹ / ₈ 01/26	0.312	+0.002
UKT 4 ³ / ₄ 12/30	0.740	+0.011

*Change from close as at 4:30pm BST.

Source: Bloomberg

Euro area

German Constitutional Court gives green light for EU recovery funds

In a day without new top-tier economic data from the euro area, the most notable news came from Germany's Federal Constitutional Court. In a key judgement, the Court unanimously rejected the application from eurosceptics for a preliminary legal injunction that would have prevented ratification of the EU's Own Resources Decision (ORD) and thus also prevented the go-ahead this year for the EU's recovery funds (Next Generation EU) and the issuance by the European Commission of up to €800bn of bonds over the coming five years. The Court did not, however, throw out the case completely. Instead, it launched a procedure with the promise of a full ruling in due course. Nevertheless, it noted that, based on a summary examination, it "does not appear highly likely that the Court will find a violation of [the German Basic Law]". So, it will allow the German Parliament to ratify the ORD, and the Commission, in due course, to start its issuance programme. In addition, should the Court eventually find that the ORD violates the Basic Law or EU Treaties, it made clear that it would still merely revert the case upwards to the European Court of Justice for guidance. And just as when a similar preliminary decision in 2012 regarding the establishment of the European Stability Mechanism (ESM) was eventually reaffirmed, today's preliminary green light from the Court for Next Generation EU also seems highly likely to be reaffirmed in due course.

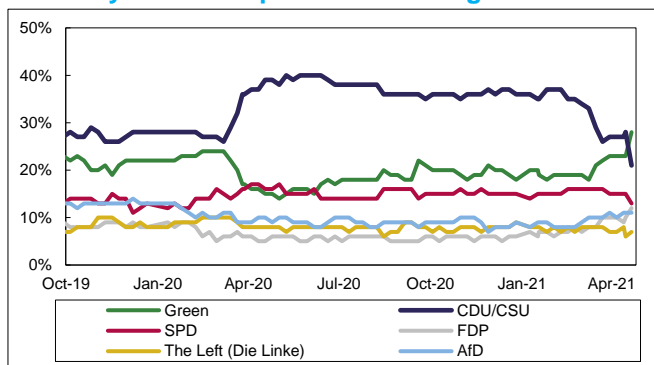
German politics in flux after Laschet and Baerbock nominations

Politics-wise, the difficulty of predicting the outcome of September's German general election was underscored by two opinion polls published yesterday evening in the wake of the confirmation of the identities of the main candidates to replace Angela Merkel as Chancellor, Armin Laschet for the CDU/CSU and Annalena Baerbock for the Greens. Indeed, a phone poll conducted by Forsa after those announcements gave the Greens a significant lead for the first time, with its share up 5ppts to a series high of 28%. And it also gave the CDU/CSU a record low share, dropping 6ppts to 21%. The same poll suggested that 32% of those surveyed now preferred Baerbock as the next Chancellor, more than double the shares preferring either Laschet or the SPD's Olaf Scholz (both just 15%). As ever, we would caution against placing excessive weight on a single opinion poll. Indeed, a separate poll by INSA for Bild – admittedly conducted between 16-19 April, and thus ahead of yesterday's announcement from the CDU/CSU – still gave the lead to the centre-right Union with 27% of support versus 22% for the Greens. However, it now seems near-inevitable that the Greens will play some kind of role in the next government. Whether they lead a coalition or are junior partners, and indeed which other parties will also participate in the next government, is impossible to predict with confidence.

The day ahead in the euro area

Tomorrow's main event will be the conclusion of the ECB's latest monetary policy meeting. However, unlike [last month](#), the Governing Council's announcements should be uneventful. The March decision to accelerate PEPP purchases within the

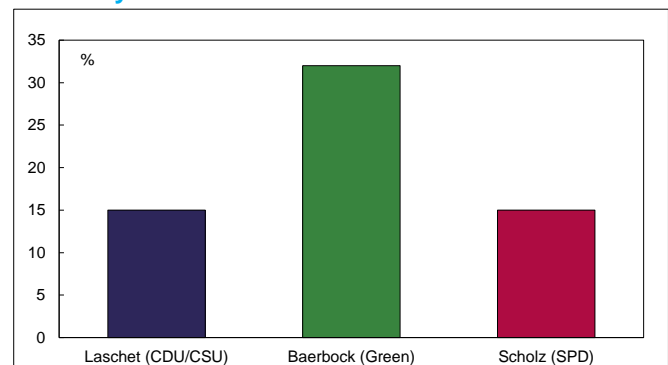
Germany: National parliament voting intention*



*Latest poll conducted 20 April 2021.

Source: Forsa and Daiwa Capital Markets Europe Ltd.

Germany: Preference for next Chancellor*



*Poll conducted on 20 April 2021.

Source: Forsa and Daiwa Capital Markets Europe Ltd.

existing €1.85trn envelope appears to have been the result of a compromise among members of differing views and will not be reopened for debate. Indeed, while, so far, the ECB has not materially accelerated its net purchases, euro area bond yields have not surpassed their peaks for the year reached in late February. So, the Governing Council will have no additional cause for concern about financial conditions, even while lack of clarity about its precise reaction function persists. Meanwhile, although the intensification of the pandemic and associated renewed lockdown measures raise concern about the near-term outlook, the ECB's projections remain credible. The Governing Council will also take comfort from today's announcement from the German Federal Constitutional Court and the recent acceleration in vaccine roll-out in the region. And it will also be encouraged by US fiscal policy, which ECB staff expect will add 0.3% to euro area GDP and 0.15% to euro area inflation over the projection horizon. Overall, therefore, expect no change to ECB policy or forward guidance tomorrow, with the pace of asset purchases to be reviewed by the Governing Council in June alongside updated macroeconomic projections.

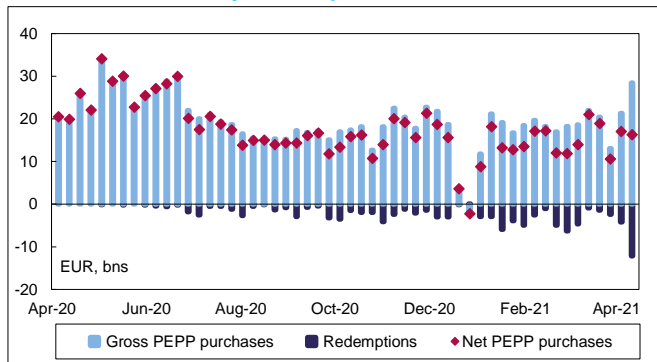
Data-wise, tomorrow will bring the flash Commission estimate of consumer confidence in the current month. Despite the intensification of the pandemic in many member states, we expect little change from last month's reading, which at -10.8 was a thirteen-month high. In addition, the results of the INSEE French business survey for April, also due tomorrow, will give an indication as to what to expect from Friday's flash PMIs. While manufacturing sector confidence is expected to improve to a fourteen-month high close to the long-run average, service sector confidence is likely to have weakened in light of the renewed lockdown measures.

UK

Inflation up less than expected despite higher petrol and clothes prices

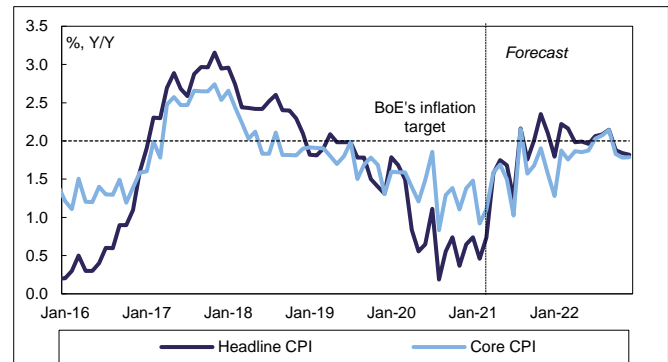
UK inflation rose a touch less than expected in March, increasing 0.3ppt to 0.7%Y/Y to reverse the prior month's decline. Unsurprisingly, prices of motor fuel were a key driver, with petrol inflation rising more than 7ppts to a fourteen-month high of 3.6%Y/Y, as base effects from last year's plunge in oil markets accentuated the impact of a further rise over the month in prices at the pump. So, while electricity and gas components were unchanged, energy inflation rose 3.4ppts to a twelve-month high of -2.5%Y/Y. In contrast, the pace of decline in prices of food and non-alcoholic drinks accelerated 0.8ppt back to -1.4%Y/Y. And while services inflation was unchanged at 1.5%Y/Y, inflation of clothing and footwear again provided volatility, rising 1.8ppts to -3.9%Y/Y and thus reversing most of the prior month's decline. So, core inflation (excluding energy and food) rose 0.2ppt to 1.1%Y/Y. That, however, was still close to the bottom of the range of the past six years.

ECB: PEPP weekly asset purchases



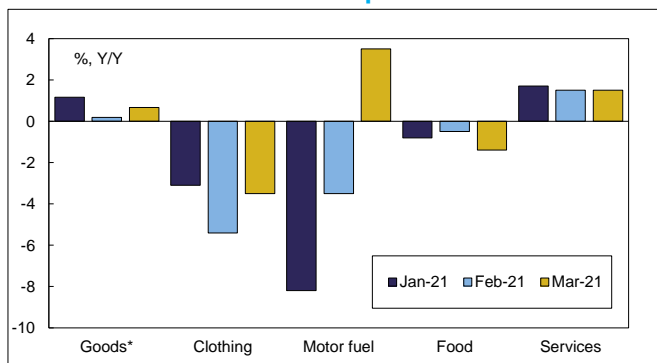
Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

UK: Inflation forecast



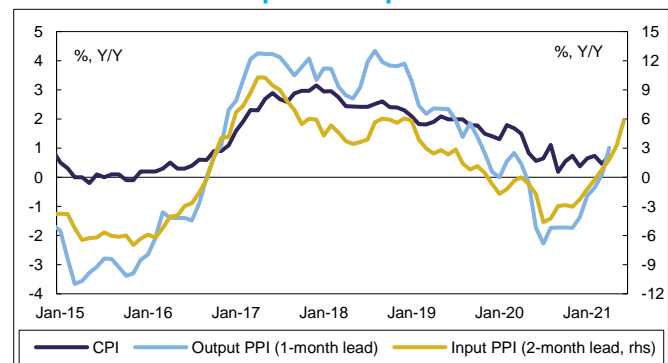
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Inflation – selected components



*Non-energy industrial goods. Source: ONS, Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Consumer and producer price inflation



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.






Inflation to take a further sizeable step up next month and close to target in H221

Looking ahead, energy inflation will accelerate further in April as significantly higher domestic fuel bills, due to the increases by Ofgem in its regulated price caps, compound the impact of higher petrol prices. And inflation of clothing and various other items affected by lockdown will pick up further in response to the reopening of non-essential retail and certain face-to-face services. So, both headline and core inflation will likely to rise to around 1½%Y/Y in April. Moreover, producer price inflation continues to rise due to shifts in energy and commodity markets, the extra costs of Brexit and supply-chain disruption, with input PPI inflation up 2.6ppts in March to 5.9%Y/Y and output PPI inflation up 1.0ppt to 1.9%Y/Y, both the highest in almost two years. And surveys suggest a greater readiness of firms to pass on some of these higher costs to consumers. With the hospitality VAT cut also set to come to an end in the autumn, headline inflation will likely average close to the BoE's 2%Y/Y target in the second half of the year, when the core rate is also likely to average above 1½%Y/Y.

The day ahead in the UK

Thursday will bring the CBI's Industrial Trends Survey for April, which seems likely to signal a pickup in new orders and optimism, but also rising price pressures, in the sector at the start of Q2.










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%	Mar	0.7 (1.1)	<u>0.8 (1.2)</u>	0.4 (0.9)	-
	 PPI input prices (output prices) Y/Y%	Mar	5.9 (1.9)	4.3 (1.7)	2.6 (0.9)	-
	 House price index Y/Y%	Feb	8.6	-	7.5	-
Auctions						
Country	Auction					
Germany	 sold €3.4bn of 0% 2031 bonds at an average yield of -0.25%					
UK	 sold £2.5bn of 0.625% 2035 bonds at an average yield of 1.105%					












Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
EMU		12.45 ECB main refinancing rate %	Apr	<u>0.00</u>	0.00
		12.45 ECB marginal lending facility %	Apr	<u>0.25</u>	0.25
		12.45 ECB deposit facility rate %	Apr	<u>-0.50</u>	-0.50
France		15.00 European Commission preliminary consumer confidence	Apr	-11.0	-10.8
		07.45 INSEE business confidence	Apr	95	97
UK		07.45 INSEE manufacturing confidence (production outlook)	Apr	99 (7)	98 (6)
		09.00 Industrial sales M/M% (Y/Y%)	Feb	-	2.5 (-1.6)
UK		11.00 CBI industrial trends, total orders	Apr	2	-5
		11.00 CBI business optimism	Apr	20	-22

Auctions and events

EMU		12.45 ECB monetary policy announcement			
		13:30 ECB President Lagarde holds press conference			
France		09.50 Auction: 0% 2024 bonds			
		09.50 Auction: 0% 2027 bonds			
		09.50 Auction: 0.5% 2029 bonds			
		10.50 Auction: 0.1% 2026 index-linked bonds			
		10.50 Auction: 0.1% 2036 index-linked bonds			
Spain		10.50 Auction: 0.1% 2047 index-linked bonds			
		09.30 Auction: 0% 2024 bonds			
		09.30 Auction: 1.5% 2027 bonds			
		09.30 Auction: 0.1% 2031 bonds			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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