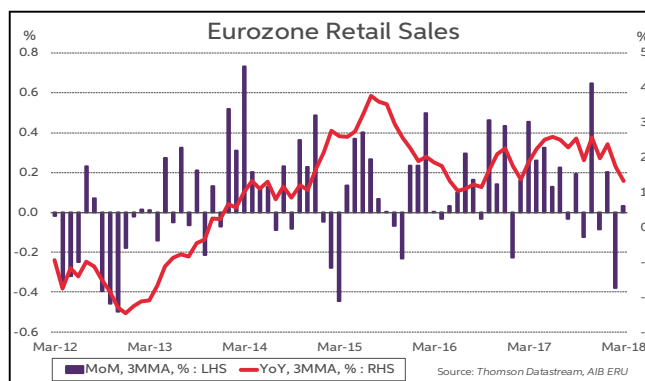


## The Italian Job

- James Carville, who was an adviser to President Clinton, once remarked that were he to be reincarnated, he would chose to return as the bond market; he could then intimidate anyone. **The power of the bond market was in evidence once again in the past week in Italy.** Sovereign yields there soared amidst a political crisis and doubts about Italy's continued membership of the euro. Two year yields climbed from 0.3% to 2.7% in a couple of days, with ten year yields rising by 100bps to 3.4%.
- This prompted quick action. **Politicians scrambled to undo the damage, taking a step back and eventually managing to form a government.** Two opinion polls showing very strong backing by Italians for continued membership of the euro, with less than 25% support for leaving the single currency, also sent a clear message. We saw similar strong support for continued euro membership in opinion polls in Greece and France when the issue of leaving was raised. It is clear that while they may have issues about the EU in general, Eurozone citizens prize the euro as a store of value, as well as for its stability and low interest rates.
- Italian bond yields fell back again from mid-week highs as the crisis abated, but reputational damage has been done.** The new populist Italian government has come to power on a platform of loosening fiscal policy and ignoring EU rules. Thus, despite fresh elections having been avoided, Italian spreads are unlikely to return to their previous lows. Investors will be much more cautious about Italy in future, especially given likely tensions between the new Italian government and the EU. Contagion, though, has been limited, with just a modest rise in yields in other southern European markets. Risk aversion prevails, however, with ten year German bund yields still below 0.4% despite news of a much bigger than expected jump in Eurozone inflation to 1.9% in May.
- In terms of the week ahead, there is a very quiet calendar of data and events on both sides of the Atlantic.** Of the data which do feature, **Eurozone retail sales for April will attract some attention** as markets look for hard data indicators of the economy's performance in Q2. This follows on from Q1's slowdown in GDP growth and somewhat underwhelming Eurozone survey data for April/May. Retail sales have been subdued in recent months, seeing a modest 0.2% fall in Q1. Although, they are forecast to have recorded an encouraging 0.5% increase at the start of the quarter.



- Meantime, April industrial production for Germany and France will be assessed ahead of the following week's Eurozone aggregate data. **Output in the Eurozone's two largest economies is anticipated to have increased by a modest 0.2%.** The Eurozone schedule also includes a first look at the expenditure breakdown of Q1 GDP.
- In the UK, the services PMI (c.80% of GDP) for May is the main release.** The index is forecast to edge up slightly in the month, from 52.8 to 53, while remaining close to Q1's subdued 53.1 average. This suggests that the sector continues to expand at a moderate pace. BRC retail sales data for May could also be of some interest, given the concerns over the weak trend in consumer spending in the UK.
- The non-manufacturing ISM for May is the only release of note on an unusually quiet US calendar.** It is anticipated to have moved up from 56.8 to 57.6. This would indicate that the key sector of the economy (roughly 80% of GDP) continues to expand at a very encouraging pace.

	Interest Rate Forecasts			
	Current	End Q2	End Q3	End Q4
		2018	2018	2018
Fed Funds	1.625	1.875	2.125	2.375
ECB Deposit	-0.40	-0.40	-0.40	-0.40
BoE Repo	0.50	0.50	0.75	0.75
BoJ OCR	-0.10	-0.10	-0.10	-0.10

Current Rates Reuters, Forecasts AIB's ERU

	Exchange Rate Forecasts (Mid-Point of Range)			
	Current	End Q2	End Q3	End Q4
		2018	2018	2018
EUR/USD	1.1678	1.19	1.22	1.25
EUR/GBP	0.8765	0.88	0.87	0.86
EUR/JPY	128.06	130	131	131
GBP/USD	1.3320	1.35	1.40	1.45
USD/JPY	109.65	109	107	105

Current Rates Reuters, Forecasts AIB's ERU

Date	UK & Irish Time (GMT+1)	Release	Previous	Forecast
<b>This Week:</b>	<b>ECB Speakers:</b>	<b>Draghi</b> (Tuesday); <b>Praet</b> (Wednesday); <b>Mersch</b> (Friday)		
	<b>BoE Speakers:</b>	<b>Tenreyro</b> (Monday); <b>McCafferty</b> (Wednesday); <b>Ramsden</b> (Thursday)		
<b>Mon 4th</b>	<b>IRL:</b>	<b>Bank Holiday</b>		
	<b>UK:</b> 09.30	CIPS/Markit Construction PMI (May)	52.5	52.0
	<b>EU-19:</b> 09.30	Sentix Index (June)	19.2	18.4
	<b>EU-19:</b> 10.00	PPI (April)	+0.1% (+2.1%)	+0.3% (+2.4%)
	<b>US:</b> 15.00	Factory Orders (April)	+1.6%	-0.6%
<b>Tue 5th</b>	<b>UK:</b> 00.01	BRC Retail Sales (May)	(-4.2%)	
	<b>CHINA:</b> 02.45	Caixin Services PMI (May)	52.9	
	<b>FRA:</b> 08.50	Final Markit Composite PMI (May)	56.9 / 54.5 (p)	54.5
	<b>GER:</b> 08.55	Final Markit Composite PMI (May)	54.6 / 53.1 (p)	53.1
	<b>EU-19:</b> 09.00	Final Markit Composite PMI (May)	55.1 / 54.1 (p)	54.1
		- Services	54.7 / 53.9 (p)	53.9
	<b>UK:</b> 09.30	CIPS/Markit Services PMI (May)	52.8	53.0
	<b>EU-19:</b> 10.00	Retail Sales (April)	+0.1%	+0.5%
	<b>US:</b> 15.00	Non-Manufacturing PMI (May)	56.8	57.6
		- Business Activity	59.1	
	<b>IRL:</b> 16.30	<b>Exchequer Balance (May)</b>	<b>€383m</b>	<b>€200m</b>
<b>Wed 6th</b>	<b>IRL:</b> 11.00	<b>Unemployment Rate (May)</b>	<b>5.9%</b>	<b>5.8%</b>
	<b>US:</b> 13.30	International Trade Balance (April)	-\$49.0bn	-\$50.0bn
<b>Thurs 7th</b>	<b>JPN:</b> 06.00	Leading Indicators Index (April)	-0.9% / 104.4	
	<b>GER:</b> 07.00	Industrial Orders (April)	-0.9%	+0.7%
	<b>FRA:</b> 07.45	Trade Balance (April)	-€5.26bn	
		- Exports	+0.4%	
	<b>UK:</b> 08.30	Halifax House Prices (May)	-3.1% (+2.2%)	+0.9% (+1.9%)
	<b>EU-19:</b> 10.00	GDP (Q1: Third Reading)	+0.4% (+2.5%) (p)	+0.4% (+2.5%)
	<b>IRL:</b> 11.00	<b>CPI (May)</b>	<b>-0.2% (-0.4%)</b>	<b>+0.5% (+0.3%)</b>
	<b>US:</b> 13.30	Initial Jobless Claims (w/e 2nd June)	221,000	225,000
<b>Fri 8th</b>	<b>CHINA:</b> 02.00	Trade Balance (May)	\$28.8bn	
		- Exports	(+12.9%)	
	<b>JPN:</b> 06.00	Economy Watchers' Poll (May)	49	
	<b>GER:</b> 07.00	Industrial Output (April)	+1.0%	+0.2%
	<b>GER:</b> 07.00	Trade Balance (April)	€22.0bn	€20.5bn
		- Exports	+1.7%	-0.3%
	<b>FRA:</b> 07.45	Industrial Output (April)	-0.4%	+0.2%
	<b>IRL:</b> 11.00	<b>Live Register (May)</b>	<b>-3,100 / 229,600</b>	<b>3,600 / 226,000</b>

◆ Month-on-month changes (year-on-year shown in brackets)

All forecasts AIB ERU, historical data in the Economic Diary derived from publicly available sources

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