# Euro wrap-up

## Overview

- Bunds made modest gains as weaker euro area labour cost figures contrasted with a pickup in the job vacancy rate.
- While short-dated gilts were little changed, long-dated gilts also made modest gains even as the latest UK inflation data exceeded expectations.
- Thursday will bring final euro area inflation data for May while Friday will bring UK retail sales figures for the same month.

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**Daily bond market movements**

| Bond | Yield | Change |
|---|---|---|
| BKO 0 06/23 | -0.686 | -0.004 |
| OBL 0 04/26 | -0.619 | -0.013 |
| DBR 0 02/31 | -0.249 | -0.015 |
| UKT 0$^1/_8$ 01/23 | 0.073 | +0.002 |
| UKT 0$^1/_8$ 01/26 | 0.327 | -0.001 |
| UKT 4¾ 12/30 | 0.744 | -0.013 |

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

# Euro area

### Labour costs slow in Q1, contained not least by job retention schemes

On a quiet day for economic data from the euro area, among some second-tier data from the labour market, the latest labour cost figures were unsurprisingly soft. Whole economy hourly labour costs slowed 1.3ppts in Q1 to 1.5%Y/Y, the weakest rate since Q416. Hourly labour costs in the business economy eased 1.0ppt to 1.3%Y/Y, also the lowest since the second half of 2016. The pace moderated by the same amount in industry (to 1.2%Y/Y) and services (to 1.3%Y/Y), and by a steeper 1.9ppts to just 0.9%Y/Y in construction. Business economy wage growth slowed 0.9ppt to 2.1%Y/Y, the lowest since Q417, while non-wage costs fell 1.4%Y/Y, the steepest drop on the survey. The slowdown in labour costs was seen in all of the large member states, and among them steepest in Germany (down 1.8ppts to 1.5%Y/Y) and Italy (down 1.1ppts to 0.1%Y/Y). Like other labour market data, these figures were impacted by government job retention schemes, whereby workers remained in employment but experienced pay cuts. So, as economies reopen and staff come off furlough, wage growth will accelerate once again. However, settlements so far suggest little significant upwards pressure. Moreover, unit labour cost growth – which is more important for inflation – will turn negative this year and next in response to the rebound in economic output and productivity. As growth rates in output and employment gradually normalise, however, unit labour cost growth will eventually return to positive territory in 2023, although we doubt very much that the respective rates will generate significant inflationary pressures.

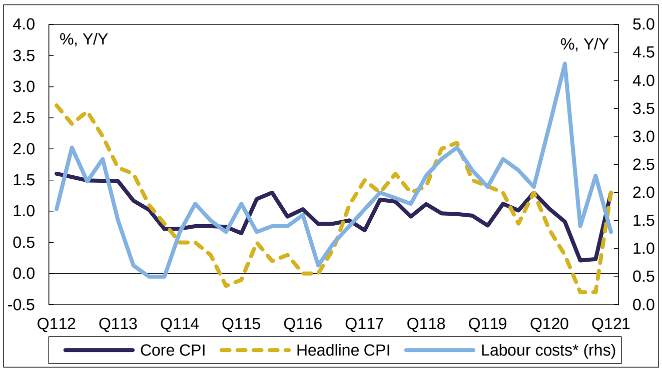
### Vacancy rate returned to pre-pandemic level in Q1

As euro area GDP contracted 0.3%Q/Q for a second successive quarter in Q1, the number of people in employment fell back for the first time since Q220, also dropping 0.3%Q/Q to be down 1.9%Y/Y and 2.1% below the pre-pandemic peak. However, today's job vacancy data suggested that demand for workers picked up last quarter, probably in anticipation of the recovery that now appears underway. Indeed, the euro area job vacancy rate – which measures the number of positions vacant as a share of the total number of jobs – rose 0.2ppt to 2.1%, the highest since the pandemic and a level prevailing until 2018. Recent national data (e.g. in Germany and Spain) already suggest a pickup in employment in Q2, which seems likely to be extended throughout the second half of the year, and extend into 2022 and beyond.

### The coming two days in the euro area

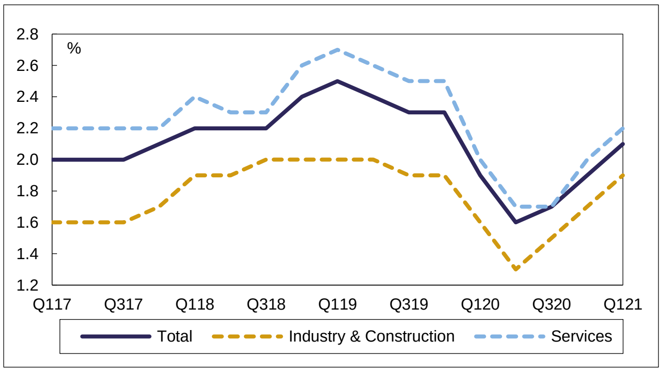
Tomorrow brings the release of final euro area inflation data for May. Despite a slight downwards revision in the Italian data, these are expected to align with the preliminary figures and confirm an increase of 0.4ppt in the headline euro area CPI rate, to 2.0%Y/Y, the highest level since October 2018. The preliminary data revealed that the rise was driven principally by

**Euro area: Hourly labour costs* & inflation**




*Excluding public sector.
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

**Euro area: Job vacancy rate**




Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

energy inflation, which – largely due to base effects – accelerated to (13.1%Y/Y) the highest since October 2008. In contrast, food inflation remained unchanged at 0.6%Y/Y, the lowest rate since November 2016. Prices of non-energy industrial goods rose 0.7%Y/Y, up from April but still a subdued rate to suggest that supply-side pressures were largely absorbed by margins. Services inflation edged up 0.2ppt to 1.1%Y/Y in May, and the preliminary core rate also rose 0.2ppt, to a more subdued 0.9%Y/Y. On Friday, a quiet end to the week will bring May German producer price inflation figures. The headline rate is expected to accelerate 1.2ppts to 6.4%Y/Y in May, which would be the highest level since October 2008.

# UK

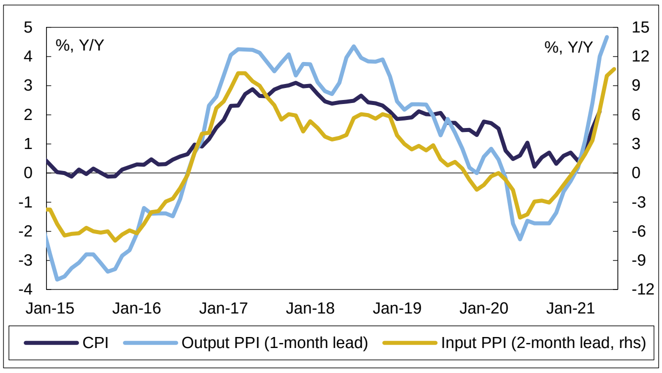
## Headline and core CPI inflation exceeds expectations as economy reopens

As the UK economy continued to reopen gradually, consumer price inflation rose well above expectations in May, with the headline CPI rate up 0.6ppt (twice the consensus) to a 22-month high of 2.1%Y/Y. Several components contributed to the big jump. Energy inflation continued to play an important role, up 2.0ppts to 9.4%Y/Y, with petrol prices rising almost 20%Y/Y, as the impact of a further rise in prices on the month was compounded by  base effects. In addition, the reopening of the hospitality sector helped push up the costs of eating and drinking in restaurants and cafes, for which inflation rose 0.9ppt to 1.7%Y/Y, so that services inflation rose 0.3ppt to a ten-month high of 1.9%Y/Y. And inflation of clothing and footwear rose 2.0ppts to 2.1%Y/Y as consumers looked forward to a return to work and greater spending in hospitality and leisure. Meanwhile, inflation of games and toys jumped 3.3ppts to 2.7%Y/Y, seemingly in part reflecting the composition of the best-seller lists. So, non-energy industrial goods rose 1.2%M/M, the most for any May in more than two decades, to double the respective annual rate up to 2.2%Y/Y, the highest since early 2018. And core inflation rose 0.7ppt (more than double the consensus) to 2.1%Y/Y, the highest since August 2018. A rare offset came from food, prices of which fell for the first time in May for five years to push the respective inflation rate down 0.9ppt to -1.3%Y/Y, with base effects also contributing to the downwards move.

## CPI to rise further, before falling back close to BoE target in H222

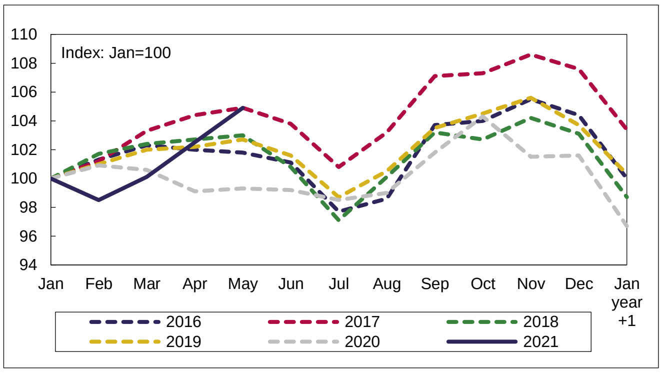
Looking ahead, as elsewhere, the inflation outlook in the UK is highly uncertain. Some of the upwards pressure from games and toys, and also perhaps from clothes – both categories which have been highly volatile throughout the pandemic – could unwind in June. But as and when further reopening continues, services inflation will move higher. And we suspect that the headline and core CPI rates will move broadly sideways until August, when base effects associated with last year's

### UK: Inflation



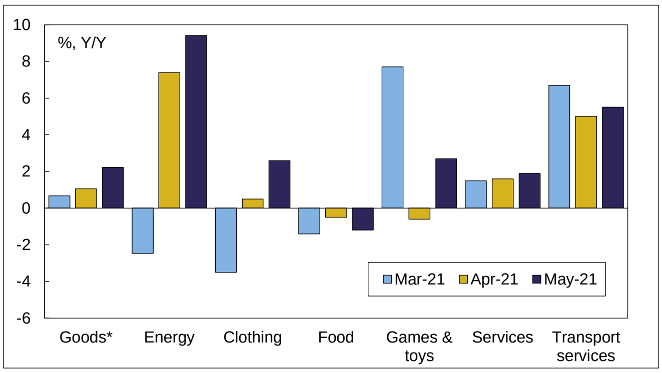

*Source: Refinitiv and Daiwa Capital Markets Europe Ltd.*

### UK: Clothing and footwear CPI



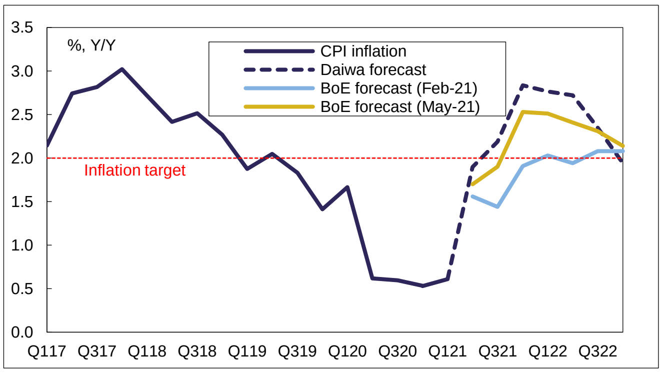

*Source: ONS and Daiwa Capital Markets Europe Ltd.*

### UK: Inflation – selected components




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

### UK: Inflation forecasts




*Source: Bank of England, Refinitiv and Daiwa Capital Markets Europe Ltd.*

hospitality subsidies and VAT cut are likely to see headline inflation take a further step up to 2½%Y/Y or above. A headline rate of 3.0%Y/Y or more before the end of the year seems within reach too. Indeed, at constant tax rates (which admittedly exaggerates the likely impact of the cut in VAT on hospitality prices), the ONS estimated that inflation rose to 3.8%Y/Y in May. With producer price inflation having risen further on supply bottlenecks, some additional pressures on consumer goods prices are possible. Indeed, the headline input PPI rate rose 0.7ppt to 10.7%Y/Y, the highest since 2011, while output PPI inflation rose 0.6ppt to 4.6%Y/Y, also the highest in almost a decade. With sterling firmer (up 6.4%Y/Y in effective terms in May), however, inflation of imported materials and fuels moderated slightly by 0.3ppt to 5.2%Y/Y. And the exchange rate might be expected to take the sting out of some producer price pressures further ahead, while the PPI base effects have now peaked. So, while consumer price inflation likely has further to rise, we expect it to fall back close to and eventually below 2.0%Y/Y in the second half of 2022.

## The coming two days in the UK

The next economic data of note from the UK will come on Friday when retail sales figures for May will be published. With the lockdown measures having eased further on 17 May, allowing pubs, restaurants and cafes to serve indoors, and many indoor entertainment and leisure facilities also able to reopen, retail sales are expected to have remained firm following the rebound in April. We expect to see growth of around 1½%M/M in retail sales excluding petrol, pushing sales up about 15% from the pre-pandemic level in February 2020 and almost 27% above the level a year earlier.

***The next edition of the Euro wrap-up will be published on 18 June 2021***

# European calendar

**Today's results**

**Economic data**

| Country | Release | Period | **Actual** | Market consensus/ *Daiwa forecast* | Previous | Revised |
|---|---|---|---|---|---|---|
| EMU | Labour costs Y/Y% | Q1 | **1.5** | - | 3.0 | **2.8** |
| UK | CPI (core CPI) Y/Y% | May | **2.1 (2.0)** | *1.8 (1.5)* | 1.5 (1.3) | **-** |
| | PPI input (output) prices Y/Y% | May | **10.7 (4.6)** | 10.6 (4.5) | 9.9 (3.9) | **10.0 (4.0)** |
| | House price index Y/Y% | Apr | **8.9** | 12.2 | 10.2 | **9.9** |

**Auctions**

| Country | Auction |
|---|---|
| Germany | sold €4.1bn of 0% 2031 bonds at an average yield of -0.19% |
| UK | sold £2.5bn of 0.625% 2035 bonds at an average yield of 1.115% |

*Source: Bloomberg and Daiwa Capital Markets Europe Ltd.*

## Tomorrow's releases

**Economic data**

| Country | BST | Release | Period | Market consensus/ *Daiwa forecast* | Previous |
|---|---|---|---|---|---|
| EMU | 10.00 | Final CPI (core CPI) Y/Y% | May | 2.0 (0.9) | 1.6 (0.7) |
| | 07.00 | EU27 new car registrations Y/Y% | May | - | 218.6 |
| Italy | 09.00 | Total trade balance €bn | Apr | - | 5.2 |
| Spain | 08.00 | Labour costs Y/Y% | Q1 | - | -0.1 |

**Auctions and events**

| Country | BST | Event |
|---|---|---|
| EMU | - | Euro area finance ministers scheduled to meet |
| France | 10.55 | Auction: 0% 2027 bonds |
| | 10.55 | Auction: 0.75% 2028 bonds |
| | 10.55 | Auction: 0.5% 2025 bonds |
| | 10.55 | Auction: 0.5% 2029 bonds |
| | 10.55 | Auction: 0.1% 2031 index-linked bonds |
| | 10.55 | Auction: 0.1% 2047 index-linked bonds |
| | 10.55 | Auction: 0.1% 2025 index-linked bonds |
| Spain | 09.30 | Auction: 0% 2024 bonds |
| | 09.30 | Auction: 0% 2028 bonds |
| | 09.30 | Auction: 0.85% 2037 bonds |

*Source: Bloomberg and Daiwa Capital Markets Europe Ltd.*

## Friday's releases

**Economic data**

| Country | BST | Release | Period | Market consensus/ *Daiwa forecast* | Previous |
|---|---|---|---|---|---|
| Germany | 07.00 | PPI Y/Y% | May | 6.4 | 5.2 |
| UK | 07.00 | Retail sales including auto fuel M/M% (Y/Y%) | May | 1.6 (28.9) | 9.2 (42.4) |
| | 07.00 | Retail sales excluding auto fuel M/M% (Y/Y%) | May | 1.5 (26.9) | 9.0 (37.7) |

**Auctions and events**

| Country | BST | Event |
|---|---|---|
| UK | 09.30 | BoE publishes May inflation attitudes survey |

*Source: Bloomberg and Daiwa Capital Markets Europe Ltd.*

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