

Euro wrap-up

Overview

- Despite some firm German labour market data, Bunds made gains as euro area inflation fell back in June.
- Gilts also made gains while data flagged the jump in UK household savings along with rising business price expectations but also continued intense price pressures on the high street.
- Thursday will bring new data for euro area unemployment, German retail sales, new car registrations in several euro area member states and the final June manufacturing PMIs.

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Daily bond market movements

Bond	Yield	Change
BKO 0 06/23	-0.669	-0.008
OBL 0 04/26	-0.588	-0.023
DBR 0 08/31	-0.206	-0.034
UKT 0 ⁷ / ₈ 01/23	0.053	+0.001
UKT 0 ¹ / ₈ 01/26	0.329	-0.015
UKT 4 ¹ / ₄ 12/30	0.717	-0.019

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

Source: Bloomberg

Euro area

Inflation falls in June as lower services and energy components offset goods price pressures

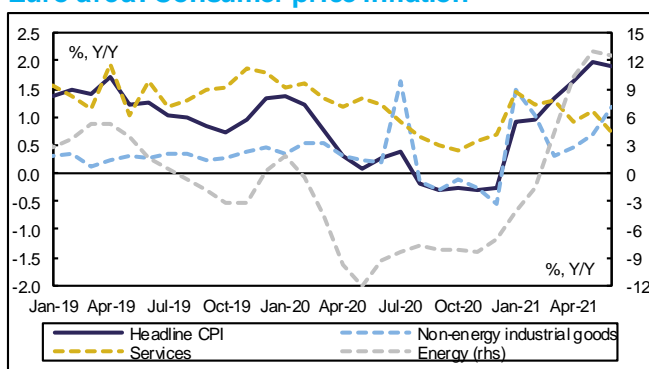
According to today's flash estimates, euro area headline inflation fell in June for the first time since September, albeit moderating just 0.1ppt to 1.9%YY. As expected, energy inflation eased back, dropping 0.6ppt from May's near-10-year high to a nevertheless still elevated 12.5%YY. But inflation of food, alcohol and tobacco ticked up to 0.6%YY. More significant pressure came from non-energy industrial goods inflation, which rose 0.5ppt to a five-month high of 1.2%YY. With prices of such items up 0.2%MM, the first increase in June since the introduction of the single currency, the impact of rising input costs amid supply bottlenecks likely played a role. However, a rebound in clothing prices due to the reopening of services, as well as a delay to summer sales in certain countries this year, was also probably a key factor. Meanwhile, services inflation fell back 0.4ppt to a seven-month low of 0.7%YY, as the monthly increase in such prices (0.3%MM) was less than half the rate in June in each of the past two years. In this instance, lower inflation of package tours is likely to have been a driver, although the replacement of items previously imputed by statisticians with actual prices might also have played a role. With the impact of higher goods inflation offsetting the decline in services, core inflation in the euro area was unchanged at a still-subdued 0.9%YY. At the country level, contrasting the decline in Germany (2.1%YY) and steady reading in Spain (2.4%YY), inflation on the EU-harmonised HICP measure edged up 0.1ppt in France (1.9%YY) and Italy (1.3%YY).

Looking ahead, services inflation might be expected to rebound in July while inflation of non-energy industrial goods will likely initially fall back. But while energy inflation should fall further, base effects associated with last summer's German VAT cut will likely push headline euro area inflation up to around 2½%YY in Q3 and Q4 before falling back to around 1½%YY from January on as the impact wears off. Likewise, euro area core inflation will likely pick up to around 1½%YY in Q4 before falling back at the start of 2022. And with no signs of meaningful upwards pressure on wage growth or inflation expectations, there seems every reason to believe that headline and core inflation will remain below the ECB's current target of close to 2.0%YY over the projection horizon.

German jobless claims and French spending data beat expectations

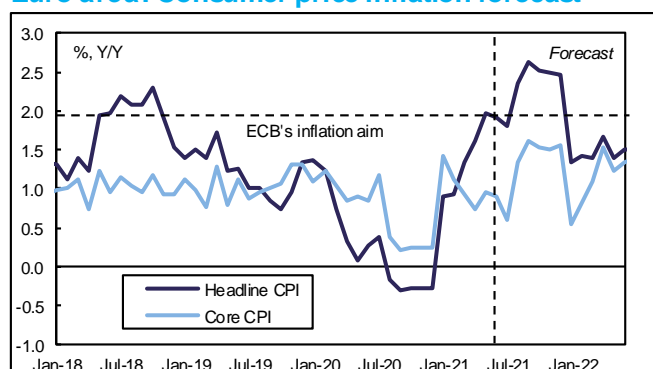
Beyond inflation matters, today's economic activity data were better than anticipated reinforcing expectations of a vigorous rebound in Q2. In Germany, jobless claims dropped for the second successive month in June and by 38k, the most since January. While the claimant count rate was unchanged at 5.9%, the number of workers registered unemployed fell below 2.7mn for the first time since April 2020. And a 25k rise in the number of job vacancies pushed the total to 683k, the highest since March 2020 and above levels prevailing earlier in the last cyclical upswing until the end of 2016. Meanwhile, in France, household consumption of goods rebounded a vigorous 10.4%MM in May after dropping (a larger-than-previously-thought)

Euro area: Consumer price inflation



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Consumer price inflation forecast



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

8.7% M/M in April in response to the third national lockdown, to be just 0.3% below the pre-pandemic level in Q4 19. Spending on manufactured goods leapt a whopping 26.0% M/M, boosted by shop reopening from 19 May. Indeed, expenditure on clothes rose almost 150% M/M in May having more than halved in April, to be 2.2% below the Q4 19 level. And spending on items for the home rose 24.0% M/M having dropped 17.1% M/M the prior month. Spending on transport goods rose a more moderate 2.8% M/M, the first gain in four months but not quite reversing the drop over the prior month. Meanwhile, spending on energy rose 2.6% M/M, as consumers spent more on auto fuel as travel restrictions were lifted earlier in the month.

The day ahead in the euro area

Thursday will bring further insights into the strength of euro area economic activity in Q2. German retail sales figures for May are highly likely to report a firm rebound, albeit not sufficiently strong to reverse fully April's drop of 6.8% M/M, which was the second-steepest of the pandemic. In addition, labour market data are expected to show that the euro area unemployment rate in May was stable at 8.0%. However, with pandemic restrictions easing and government short-time work programmes still providing support, the risks are probably skewed towards a further decline, which would leave the rate at the lowest in a year. Figures for new car registrations in June from France, Italy and Spain are also due for release, as are the final manufacturing PMIs for the same month. According to the [flash estimates](#), manufacturing production accelerated for the first time since March, with the respective output index up 0.2pt to 62.4, less than 1pt below the series high recorded three months earlier. But the indices also signalled a record rise in backlogs of work, a further near-record lengthening of supply delivery times and ongoing price pressures. For the first time Markit will also publish the June survey results from Italy and Spain, which are likely strongly to suggest broad-based growth in the sector at the end of Q2. Beyond the data, ECB President Lagarde will speak to the European Parliament in her capacity as chair of the European Systemic Risk Board, which conducts macro-prudential oversight of the EU's financial system.

UK

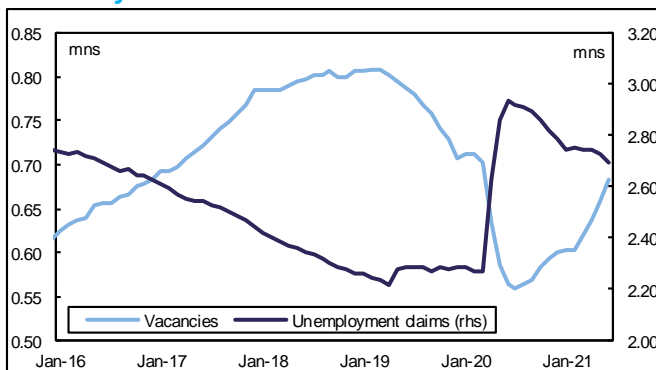
Drop in GDP in Q1 a touch bigger than thought as household savings ratio leapt

The UK's Q1 national accounts confirmed that the contraction in economic output at the start of the year due to tighter pandemic restrictions was relatively modest. Indeed, compared to the plunge of almost 20% Q/Q in response to the first national lockdown in Q2 20, GDP in Q1 21 dropped just 1.6% Q/Q, only 0.1ppt more than previously thought, to be 8.8% below the pre-pandemic peak in Q4 19 and down 6.1% Y/Y. Within the detail, the revisions were somewhat larger, with private consumption now estimated to have dropped 4.6% Q/Q, 0.7ppt more than previously thought. With household gross disposable income up 0.1% Q/Q in nominal terms, the household savings ratio jumped 3.8ppts to 19.9% – the second highest on the series after the peak of 25.9% in Q2 20 during the first lockdown and up from an average of less than 7% in the two years prior to the pandemic – to highlight scope for a strong revival in consumption over coming quarters. Growth in government spending was 1.1ppts softer than thought, at 1.5% Q/Q. And while the decline in business investment was 1.2ppts less than initially estimated, it was still a steep 10.7% Q/Q, which left the component some 17.3% below the pre-pandemic level. All in all, the revisions change little any assessment of the UK economic outlook. Indeed, despite the drop over the quarter as a whole, with the trough in GDP reached in January, economic activity has already been rebounding vigorously for several months led by household consumption. And with the new wave of pandemic caused by the delta variant not leading to a marked spike in hospitalisations or deaths, and the labour market firm, the household savings ratio is likely to fall steadily back close to pre-pandemic levels, delivering particularly vigorous growth in consumption. With business investment also set to revive (at least temporarily) thanks to strong tax incentives, UK GDP should move back above the Q4 19 level in Q4 21 before growth moderates – probably markedly – in 2022 in response to capacity constraints.

Survey evidence of skill shortages but wage and price expectations remain contained

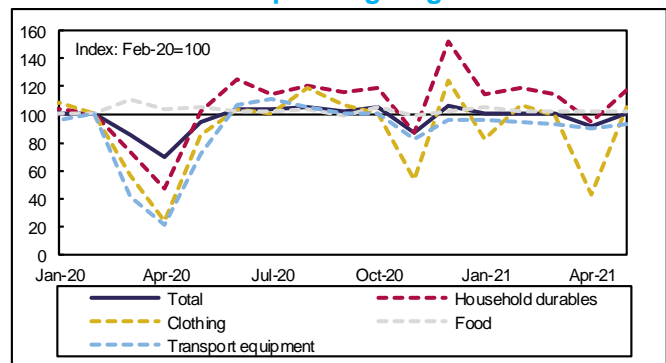
A pair of lesser-watched surveys today provided further insight into economic conditions at the end of Q2. Lloyds' latest UK business barometer remained consistent with vigorous economic growth, suggesting that confidence was steady in June at a

Germany: Jobless claims and vacancies



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

France: Consumer spending on goods



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

3-year high of 33%, above the long-run average but still below the range from the previous cyclical upswing from 2014 through to 2017. At the sectoral level, confidence among services firms rose to its highest level in three years (31%) but retail (36%) and manufacturing (35%) sentiment both eased back somewhat from recent elevated levels. While optimism in the broader economic outlook fell a touch, employment expectations rose to a 2½-year high. But tallying with anecdotal evidence, as well as concerns about the exodus of probably several hundreds of thousands of EU citizens from the UK labour market over the past year or so, almost one fifth of firms reported significant difficulties in finding staff with the appropriate skills and experience. Expectations for pay growth over the coming twelve months, however, remained down on pre-pandemic levels, with the share expecting settlements of 2% Y/Y or more falling slightly on the month and thus remaining below one quarter. And while the Lloyds survey measure of firms' price expectations for the coming year moved higher for a fifth successive month, it merely moved back within the 2019 range.

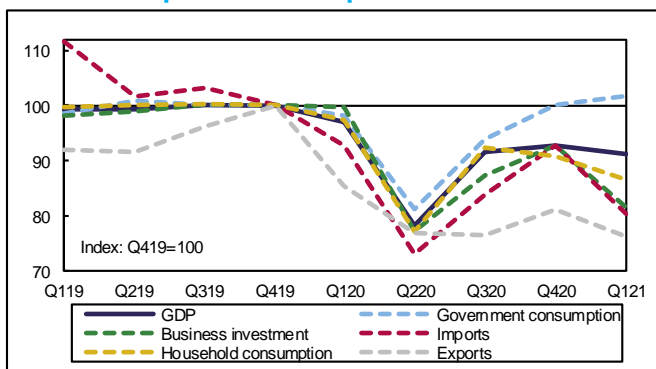
Prices on the high street still under pressure in June

Separately, despite the recent uptrend in CPI inflation, the BRC shop price surveys suggested that prices on the high street remained down on a year ago in June, responding to intense competitive pressures despite the strong rebound in retail sales. The headline BRC price index fell 0.7% Y/Y, 0.1ppt more than in May. Prices of non-food items – particularly clothing – still under significant downwards pressure, falling 1.0% Y/Y. And the BRC measure of food prices fell 0.2% Y/Y. We currently expect the headline and core CPI rates also to drop 0.1ppt in June (to 2.0% Y/Y and 1.8% Y/Y respectively) and fall further in July before moving significantly higher again from August due not least to base effects associated with government policies a year earlier.

The day ahead in the UK

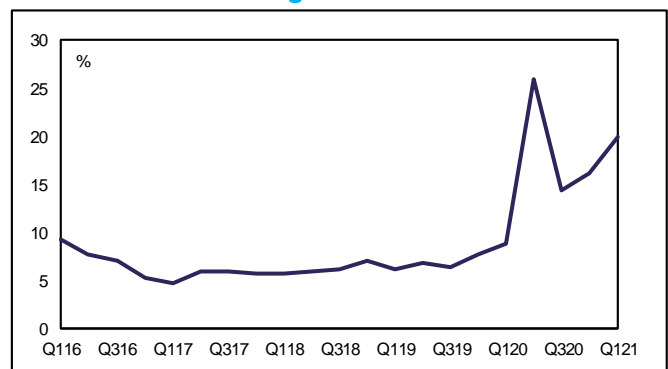
As for the euro area, Thursday will bring the UK's final manufacturing PMIs for June. According to the flash estimates, growth in manufacturing output was reportedly a touch less vigorous with the respective index slipping back 1pt to 62.0. In addition, growth in new orders also reportedly slowed not least due to a softening in export demand. And the adverse impacts of supply bottlenecks reported in the euro area PMIs were also evident in the UK. Beyond the data, BoE Governor Bailey will deliver his annual Mansion House speech in the evening.

UK: GDP expenditure components



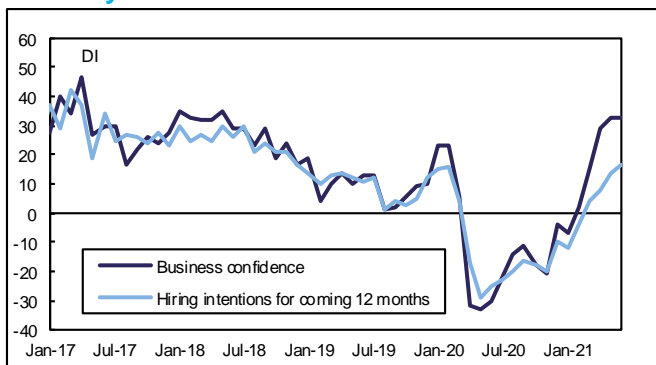
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Household saving ratio



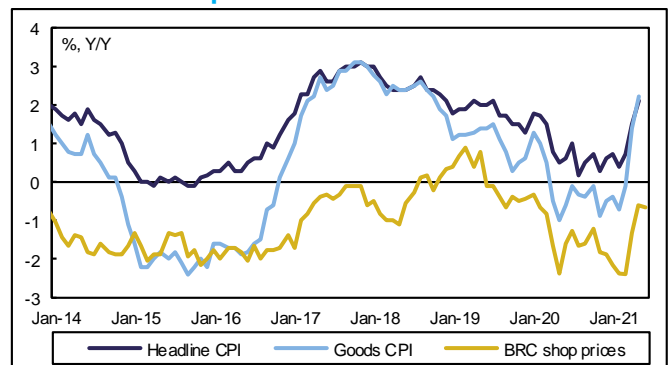
Source: ONS and Daiwa Capital Markets Europe Ltd.

UK: Lloyds business barometer indices



Source: Lloyds, Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Consumer price indices














Source: Bloomberg, Refinitiv 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
EMU	 Preliminary CPI (core CPI) Y/Y%	Jun	1.9 (0.9)	<u>1.8 (0.8)</u>	2.0 (1.0)	-
Germany	 Unemployment change '000s (rate %)	Jun	-38.0 (5.9)	-19.0 (5.9)	-15.0 (6.0)	-19.0 (5.9)
France	 Preliminary CPI (EU-harmonised CPI) Y/Y%	Jun	1.5 (1.9)	1.6 (1.9)	1.4 (1.8)	-
	 PPI Y/Y%	May	7.2	-	7.3	6.7
	 Consumer spending on goods M/M% (Y/Y%)	May	10.4 (7.4)	7.8 (-)	-8.3 (32.0)	-8.7 (31.5)
Italy	 Preliminary CPI (EU-harmonised CPI) Y/Y%	Jun	1.3 (1.3)	1.4 (1.4)	1.3 (1.2)	-
	 PPI Y/Y%	May	10.0	-	7.9	8.2
UK	 Lloyds business barometer	Jun	33	-	33	-
	 BRC shop price index Y/Y%	Jun	-0.7	-	-0.6	-
	 Final GDP Q/Q% (Y/Y%)	Q1	-1.6 (-6.1)	-1.5 (-6.1)	1.3 (-7.3)	-
	 Current account balance £bn	Q1	-12.8	-15.2	-26.3	-








Auctions

Country	Auction
Italy	 sold €3.0bn of 2026 bonds at an average yield of 0.12%
	 sold €1.5bn of 2030 bonds at an average yield of 0.74%
	 sold €1.5bn of 2031 bonds at an average yield of 0.81%














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	 09.00	Final manufacturing PMI	Jun	63.1	63.1
	 10.00	Unemployment rate %	May	8.0	8.0
Germany	 08.55	Final manufacturing PMI	Jun	64.9	64.4
France	 08.50	Final manufacturing PMI	Jun	58.6	59.4
Italy	 08.45	Manufacturing PMI	Jun	62.5	62.3
Spain	 08.15	Manufacturing PMI	Jun	59.5	59.4
UK	 09.30	Final manufacturing PMI	Jun	64.2	65.6

Auctions and events

EMU	 08.00	ECB President Lagarde speaks at the Hearing before Committee on Economic and Monetary Affairs
France	 09.50	Auction: 0.5% 2040 bonds
	 09.50	Auction: 1.25% 2036 bonds
	 09.50	Auction: 0% 2030 bonds
	 09.50	Auction: 0% 2031 bonds
Spain	 09.30	Auction: 0.7% 2033 index-linked bonds
	 09.30	Auction: 2026 bonds
	 09.30	Auction: 1.4% 2028 bonds
	 09.30	Auction: 1% 2050 bonds
	 09.30	Auction: 0.5% 2040 bonds
UK	 09.30	BoE's Monthly Decision Maker Panel data published
	 10.00	Auction: £3.5bn of 0.25% 2025 bonds
	 20.00	BoE Governor Bailey speaks at the Mansion House Financial event

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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<https://www.uk.daiwacm.com/ficc-research/recent-blogs>

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