

Euro wrap-up

Overview

- Bunds and other euro area government bonds sold off as the flash German and Spanish estimates of inflation in May significantly beat expectations.
- Gilts followed Bunds lower on a quiet start to the week for UK economic news.
- Tuesday's focus will be the flash estimates of euro area inflation in May, with data for German jobless claims and UK bank lending also due.

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Daily bond market movements

Bond	Yield	Change
BKO 0.2 06/24	0.419	+0.098
OBL 0 04/27	0.751	+0.098
DBR 0 02/32	1.040	+0.083
UKT 1 04/24	1.452	+0.048
UKT 1½ 07/27	1.597	+0.048
UKT 4¼ 06/32	1.979	+0.064

*Change from close as at 4:15pm BST.
Source: Bloomberg

Euro area

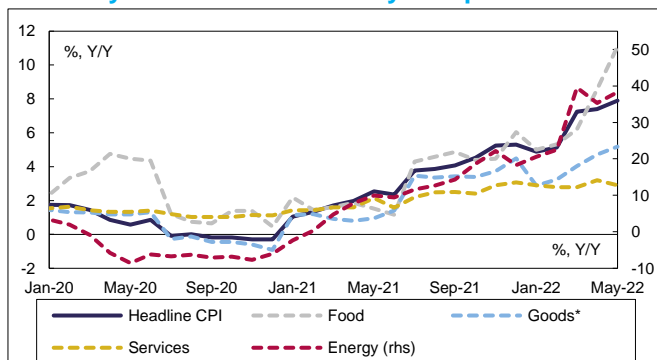
German inflation jumps to highest since 1973 on higher energy and food prices

Ahead of tomorrow's flash euro area estimates of inflation in May, today's equivalent figures from Germany, Spain and Belgium will have made the ECB feel extremely uneasy, coming in well above expectations. In particular, German inflation on the EU-harmonised HICP measure rose 0.9ppt to 8.7%Y/Y with the national CPI measure up 0.5ppt to 7.9%Y/Y, the highest since the first oil crisis in the winter of 1973. Continuing to reflect price pressures associated with the war in Ukraine, the upwards shift was due to higher prices of fuel and food in May, with energy inflation up 3ppts to 38.3%Y/Y largely reversing April's temporary drop. Indeed, petrol prices in the first four weeks of May were some 3½% higher than in April to be up roughly 37%Y/Y. In addition, food inflation jumped 2.5ppts to a series-high 11.1%Y/Y. And together these components accounted for more than 60% of total inflation. According to our estimates, non-energy industrial goods inflation was also firmer, up 0.5ppt to 5.2%Y/Y, with data from the states suggesting that higher prices of household appliances and furniture, likely at least in part reflecting persisting supply-chain disruption, played a role. But services inflation fell back in May, by 0.3ppt to 2.9%Y/Y, largely reflecting the timing of Easter this year on the prices of hotels, leisure and entertainment. And so, core inflation likely edged very slightly lower (or sideways at worst) from April's high of 3.8%Y/Y. Looking ahead, the planned cut in German petrol (by 29.55 cents per litre) and diesel duty (14.04 cents per litre) from June to August, as well as the introduction of a nationwide flat price of €9 per month for public transport, should provide downward pressure on headline inflation over the summer months.

Spanish inflation unexpectedly rises too, with food, fuel and core inflation up

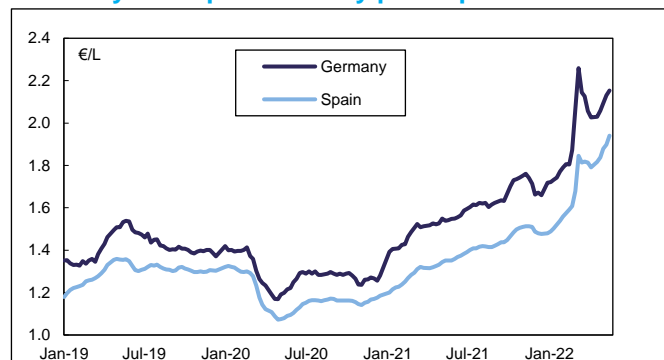
Today's Spanish inflation figures also beat expectations, with the headline HICP rate unexpectedly rising 0.2ppt in May to 8.5%Y/Y, albeit still 1.3ppts lower than March's peak. On the national measure, headline inflation rose 0.4ppt to 8.7%Y/Y, with the Spanish statistical agency (INE) attributing the rise to higher food and fuel prices. Indeed, despite the 20 cents per litre reduction in petrol duty, in the first four weeks of May euro super 95 petrol prices were up some 4½% compared with the April average, while prices of diesel and heating gas oil up were around 2%. But reflecting the fast pass-through of wholesale energy market developments, INE noted that electricity prices fell for the second successive month. And lower electricity prices will remain the norm for the time being, given the government's agreement with the European Commission to cap gas prices for Spanish electricity producers for twelve months. This notwithstanding, there were further signs that price pressures were broadening in Spain, with core CPI rising 0.4ppt to 4.9%Y/Y, the highest since 1995. Meanwhile, Belgian CPI inflation also rose 0.7ppt to 9.0%Y/Y in May, the highest since August 1982. And while energy and food inflation (56.8%Y/Y and 6.3%Y/Y respectively) accelerated and still accounted for the lion's share, core inflation also rose 0.3ppt to 4.4%Y/Y. Overall, given today's data, we now expect headline euro area inflation in May to rise 0.4ppt to 7.9%Y/Y but maintain our forecast of a modest 0.1ppt increase in the core measure to 3.6%Y/Y.

Germany: CPI inflation and key components**



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

Germany and Spain: Weekly petrol prices



Source: European Commission and Daiwa Capital Markets Europe Ltd.

Price expectations ease somewhat but remain very high

While euro area inflation is likely to have risen again in May, survey indicators suggest that it should be close to its peak. Indeed, although today's Commission survey results for the current month reported a further increase in consumer perceptions of price developments over the past twelve months to the highest since 2008, their price expectations for the coming twelve months fell back slightly for the second successive month. And selling-price expectations for the coming three months edged down in industry, services and construction. However, retail price expectations rose for a fifth successive month to a new series high. Moreover, all of the price expectations indices remained very high by historical standards, suggesting that high inflation is widely anticipated to persist even after it peaks. Nevertheless, the slight drop in the survey measures of inflation expectations tallies with the past few weeks' moderation in financial market-implied measures of inflation expectations, such as the 5Y5Y forward rate which today was close to 2.12% from the peak at the start of the month close to 2.50%, and the 2Y break-even on inflation-linked Bunds, which today was close to 4.11%, 160bps below April's peak.

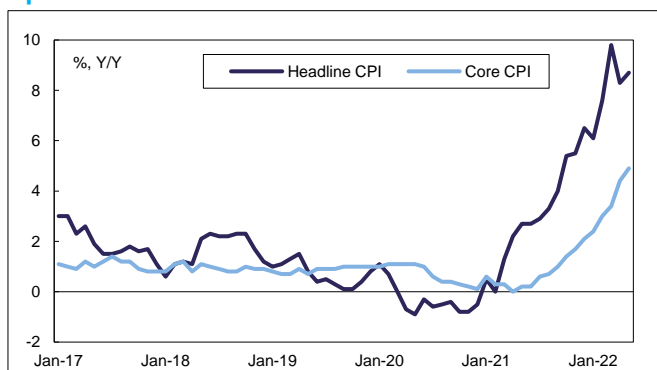
German wage growth exaggerated by special payments

As well as persistently high price-setting expectations, the ECB is also fearful of second-round effects from high inflation on wages. But while last week's euro area figures reported an acceleration in negotiated wages in Q1 – up 1.2ppts to 2.8%Y/Y, the strongest in more than a decade – today's German data provided a reminder that this growth principally reflected special payments. Overall, German negotiated wages rose 4.0%Y/Y in Q1, well below the rate of consumer price inflation (5.8%Y/Y). And strikingly, growth was led by the public sector, with education (5.0%Y/Y), and public administration, defence and social security (4.6%Y/Y) particularly strong. These figures were flattered by deals for special "Covid premiums", excluding which underlying pay growth was less than 1.0%Y/Y. Moreover, while total wages in manufacturing rose 4.8%Y/Y, this rate was also boosted by special payments, particularly in the metal and electrical sub-sectors, excluding which growth was similarly less than 1.1%Y/Y. Overall, German negotiated wages excluding special payments in Q1 was just 1.1%Y/Y, the lowest since Q111. And early data for April suggested that overall wage growth fell back to just 1.5%Y/Y as those special payments fell out of the calculation, while underlying pay growth remained subdued at just 1.3%Y/Y.

Commission survey detail points to ongoing growth in output and employment

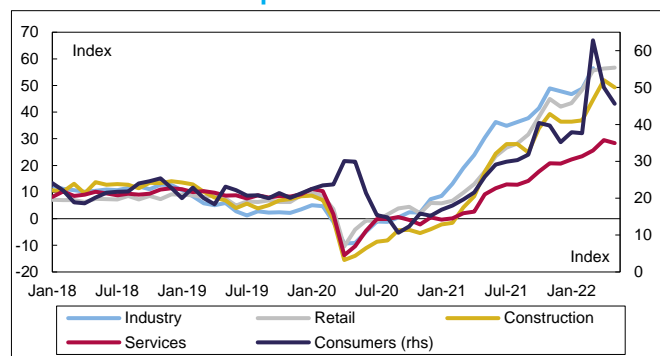
Encouragingly, the Commission survey's detail suggested that economic growth in the euro area remains positive despite the hit to confidence since the Ukraine war and leap in inflation. The headline economic sentiment indicator (ESI) was little changed in May, rising 0.1pt to 105.0, still above the long-run average and a level that in the past has been consistent with

Spain: Headline and core CPI inflation*



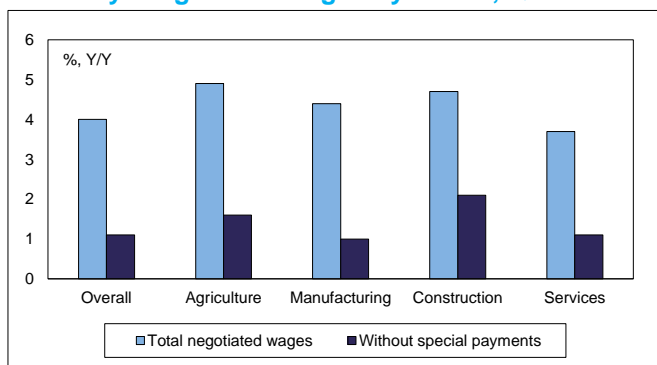
*National measure. Source: Bloomberg, INE and Daiwa Capital Markets Europe Ltd.

Euro area: Price expectations indices*



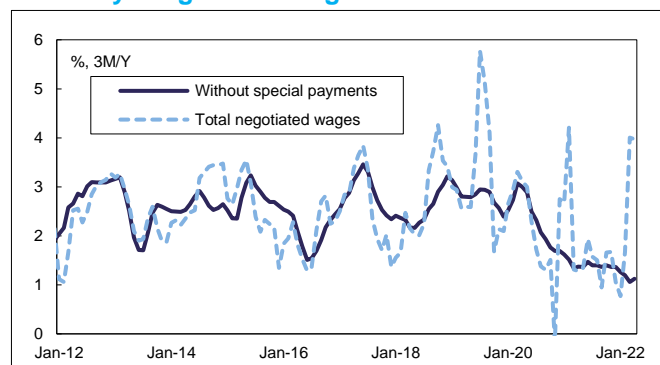
*12-month expectations for consumers; 3-month sale-prices expectations for firms. Source: EC, Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: Negotiated wages by sector, Q122



Source: Destatis and Daiwa Capital Markets Europe Ltd.

Germany: Negotiated wages



Source: Destatis and Daiwa Capital Markets Europe Ltd.

expansion. And the survey's employment expectations index rose back close to historical highs as firms in most sectors signalled an increased willingness to recruit. Sentiment in all business sectors remained above the long-run average, and was brightest in services, where confidence remained steady despite a weakening of demand expectations. Retail confidence broadly stabilised after two months of marked deterioration, nevertheless edging down slightly to the lowest level in more than two years. Construction sentiment was also little changed from April's eight-month low, but firms gave hints of a slight easing of supply constraints in the sector. In contrast, industrial firms became less confident for a third successive month, with the respective index falling to a fifteen-month low, as order books were judged to have deteriorated the most in two years and production expectations worsened slightly.

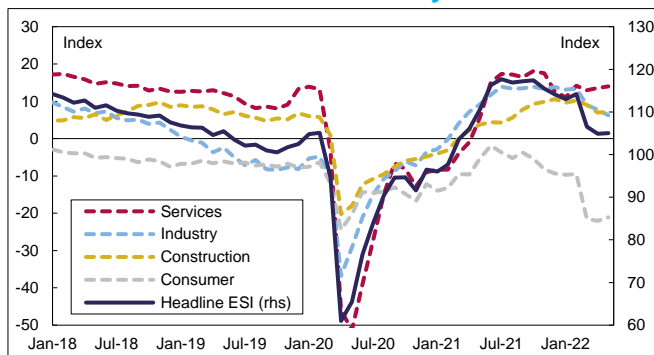
In contrast to the above-average levels of business sentiment, consumer confidence remained close to the survey's historical lows. Nevertheless, as suggested by the flash estimate, consumer confidence improved to a three-month high, with the detail reporting that perceptions of the outlook for the economy and personal finances ticked higher. They were supported by slightly diminished concerns about unemployment and perhaps those aforementioned lower price expectations.

Finally, by member state, Spain saw the most notable improvement in sentiment, likely buoyed by the boost to services from the rebound in tourist activity, with a similar effect visible in Italy and to a lesser extent France. The improvement in confidence in Germany was minimal, however, as weaker orders weighed on sentiment in the all-important manufacturing sector.

The day ahead in the euro area

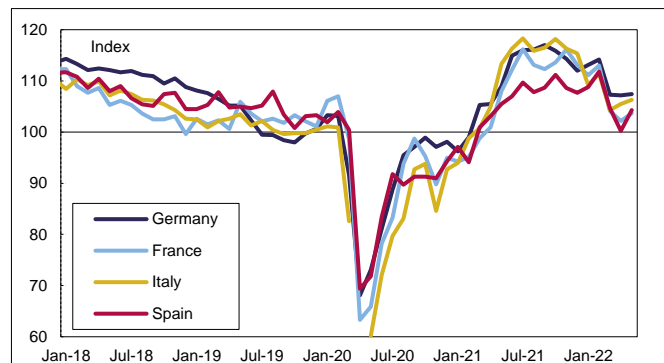
The key euro area data focus tomorrow will be the flash aggregate inflation estimate for May. Following today's upside surprises, particularly from Germany, we expect the euro area headline HICP rate to have risen yet again in May, by 0.5ppt to a fresh series high of 7.9%Y/Y, due not least to higher food inflation and still elevated energy prices. We also expect the core HICP measure to rise 0.1ppt to a new high of 3.6%Y/Y. Tomorrow will also bring German unemployment claims figures for May and French consumer spending numbers for April. Updated Q1 GDP estimates from France and Italy are also due – the initial estimates suggested that the French economy stagnated in the first quarter, while Italy's output contracted by 0.3%Q/Q.

Euro area: Economic sentiment by sector



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

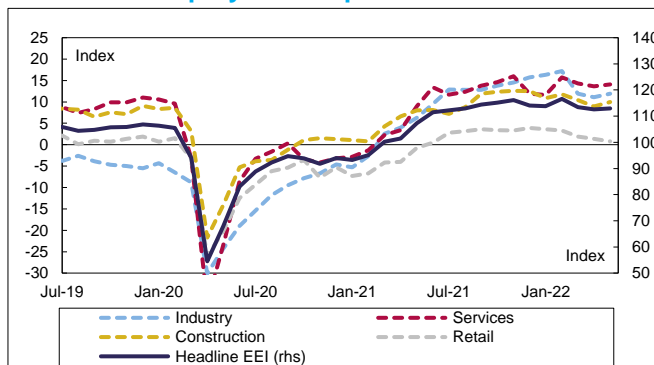
Euro area: Economic sentiment indices*



*No survey results for Italy in April 2020.

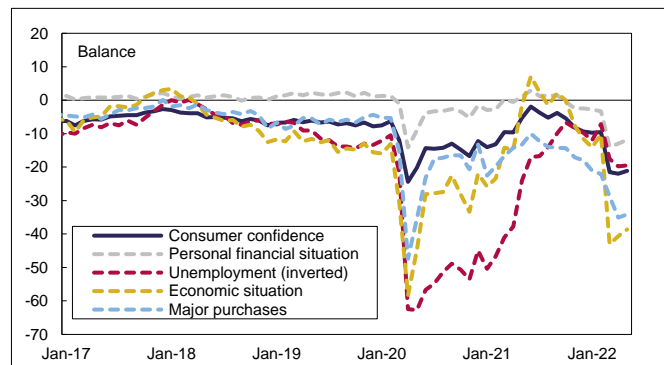
Source: EC, Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Employment expectations



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

Euro area: Consumer confidence



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

UK








The day ahead in the UK

After a quiet start to the week for UK economic news, tomorrow brings arguably the most noteworthy of this week's UK data, the BoE's latest bank lending release for April. The figures are expected to confirm that demand for consumer credit remained strong at the start of the second quarter, while, despite the recent uptick in interest rates, mortgage lending will likely have remained buoyed by the robust housing market. The Lloyds business barometer for May is also due.

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area	 EC's Economic Sentiment Indicator	May	105.0	104.9	105.0	104.9
	 EC's industrial (services) confidence	May	6.3 (14.0)	7.5 (13.7)	7.9 (13.5)	7.7 (13.6)
	 EC's final consumer confidence	May	-21.1	-21.1	-22.0	-
Germany	 Preliminary CPI M/M% (Y/Y%)	May	0.9 (7.9)	0.5 (7.6)	0.8 (7.4)	-
	 Preliminary EU-harmonised CPI M/M% (Y/Y%)	May	1.1 (8.7)	0.4 (8.1)	0.7 (7.8)	-
Spain	 Preliminary CPI M/M% (Y/Y%)	May	0.8 (8.7)	0.6 (8.4)	-0.2 (8.3)	-
	 Preliminary EU-harmonised CPI M/M% (Y/Y%)	May	0.7 (8.5)	0.7 (8.3)	-0.3 (8.3)	-














Auctions

Country	Auction
- Nothing to report -	






Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Euro area		10.00 Preliminary CPI M/M% (Y/Y%)	May	<u>0.7 (7.9)</u>	0.6 (7.4)
		10.00 Preliminary core CPI M/M% (Y/Y%)	May	<u>0.3 (3.6)</u>	1.0 (3.5)
Germany		08.55 Unemployment rate % (change '000s)	May	5.0 (-15.0)	5.0 (-13.0)
France		07.45 Preliminary CPI M/M% (Y/Y%)	May	0.5 (5.1)	0.4 (4.8)
		07.45 Preliminary EU-harmonised CPI M/M% (Y/Y%)	May	0.6 (5.6)	0.5 (5.4)
		07.45 Consumer spending M/M% (Y/Y%)	Apr	1.0 (7.6)	-1.3 (-2.4)
		07.45 GDP – 2 nd estimate Q/Q% (Y/Y%)	Q1	0.0 (5.3)	0.7 (5.4)
Italy		09.00 GDP – 2 nd estimate Q/Q% (Y/Y%)	Q1	-0.2 (5.8)	0.6 (6.2)
		10.00 Preliminary CPI M/M% (Y/Y%)	May	0.4 (6.3)	-0.1 (6.0)
		10.00 Preliminary EU-harmonised CPI M/M% (Y/Y%)	May	0.5 (6.7)	0.4 (6.3)
UK		00.01 Lloyds business barometer	May	-	33
		09.30 Net consumer credit £bn (Y/Y%)	Apr	1.2 (-)	1.3 (5.2)
		09.30 Net mortgage lending £bn (approvals '000s)	Apr	5.4 (70.5)	7.0 (70.7)

Auctions and events

Euro area		08.00 ECB's Villeroy scheduled to speak
Germany		10.30 Auction: €3bn of 0% 2027 bonds
Italy		10.00 Auction: €2.5bn of 2.5% 2032 bonds
		10.00 Auction: €3bn of 1.1% 2027 bonds
		10.00 Auction: €1.25bn of 0.4% 2030 floating-rate bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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