

Euro wrap-up

Overview

- While May's series high for euro area inflation was confirmed, Bunds made gains and BTPs continued to outperform following reports that the ECB Governing Council will discuss proposals for its new anti-fragmentation tool as soon as July.
- Shorter-dated Gilts followed USTs lower on a quiet day for economic news from the UK.
- Following Sunday's second round vote in the French legislative elections, the coming week will bring the flash June PMIs as well as UK data for inflation and retail sales in May.

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Daily bond market movements

Bond	Yield	Change
BKO 0.2 06/24	1.060	-0.079
OBL 0 04/27	1.459	-0.075
DBR 0 02/32	1.658	-0.047
UKT 1 04/24	2.181	+0.098
UKT 1½ 07/27	2.201	+0.043
UKT 4¼ 06/32	2.5-4	-0.010

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

Source: Bloomberg

Euro area

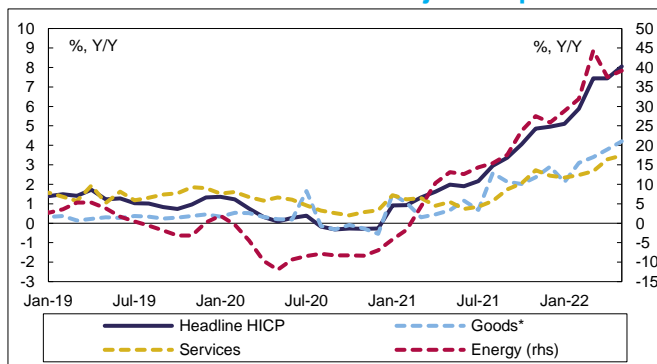
Periphery bonds rally further but anti-fragmentation tool will provide scope for even higher rates

BTPs and other periphery bonds continued to rally at the end of the week on yesterday evening's reports that plans for the ECB's new anti-fragmentation tool should be discussed by the Governing Council as soon as the July monetary policy meeting. While the accelerated timetable is welcome, there remains plenty of uncertainty about the details of the new instrument. We would expect some similarities with the existing (but unused) OMT policy framework, albeit with much lighter conditionality linked merely to existing EU policy rules, conditions and commitments, and also perhaps no ex ante limits in terms of the amounts of bonds to be purchased. Perhaps unsurprisingly, unattributed reports suggest that the impact of the purchases on monetary conditions will be sterilised. Ideally, that would be achieved by the issuance of ECB paper. However, those reports also flagged the possibility that they might be sterilised by sales of ECB holdings of (presumably) core government bonds, a process which could prove somewhat self-defeating if it simply pushed all bond yields higher. Until the new instrument is finally agreed and ready for implementation – which might not be before the September policy meeting or later still – the bringing forward and flexible reallocation of reinvestments of maturing PEPP bonds might free up roughly €10bn per month for supporting shorter-dated periphery bonds. With respect to its main monetary tools, however, by strengthening its efforts to cap periphery spreads, the Governing Council should provide itself with greater room to accelerate the pace of interest rate rises should it wish to do so. In that respect, Latvian Governor Kazaks yesterday advocated 100bps of hikes by September, while Dutch Governor Knot today warned that several hikes of 50bps apiece could be required if the inflation outlook deteriorates.

Record inflation in May confirmed with broad-based pressures in core items

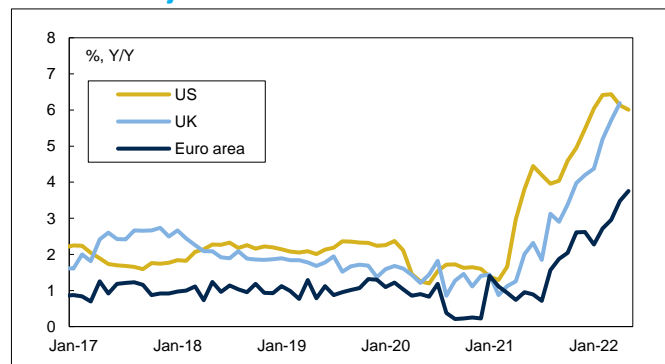
The ECB's updated near-term inflation forecast already looked out of date as soon as it was published last week, as it had failed to account for May's flash estimate, which firmly exceeded expectations. Indeed, if that figure had been applied mechanically, the ECB suggested that the baseline inflation forecast for 2022 would have been some 0.3ppt higher at 7.1%Y/Y. The final May data released today confirmed that preliminary estimate, which represented a series high of 8.1%Y/Y, up 0.7ppt from April. And the inflation rates of the major sub-components were minimally revised, confirming broader-based pressures. The timing of Easter this year should have been favourable, contributing to an easing in the package tour component. But increased prices in May in restaurants and hotels and many other consumer-facing activities pushed services inflation up 0.2ppt to a euro-era record 3.5%Y/Y. And with supply challenges still substantive, and cost pressures seemingly now being more readily passed on to consumers than in the past, prices of non-energy industrial goods

Euro area: HICP inflation and major components



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

Selected major economies: Core inflation*



*Core CPI for US and UK, and core HICP for euro area, all series excluding food and energy. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

rose the most in any May. New highs were reported again in a wide range of items from furniture to electrical appliances and cars, pushing the annual rate of core goods inflation up 0.4ppt to a record 4.2%Y/Y.

Gas supply cuts flag risks of extra pain ahead

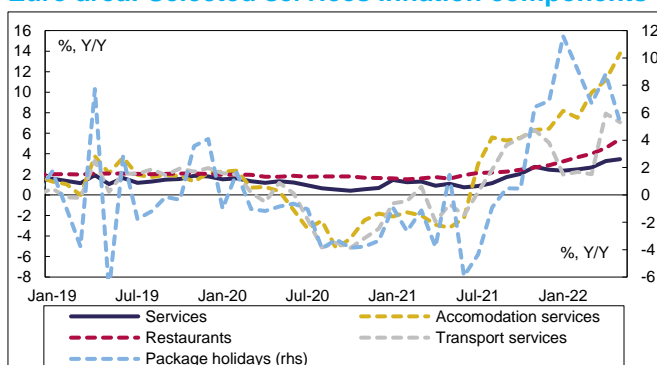
So, overall, the main core inflation rate (excluding energy, food, alcohol and tobacco) rose 0.3ppt to a new high of 3.8%Y/Y. Compared to the US and UK, of course, that is still relatively moderate. However, the 15% trimmed mean rate rose a bigger 0.6ppt to a new high of 6.2%Y/Y. And non-core pressures remain extremely high. Food inflation rose 1.2ppts to a series record of 7.5%Y/Y. And rising petrol prices pushed the annual energy inflation rate up 1.7ppts to 39.2%Y/Y, the second-highest on the series bar March. As a result, food and energy together accounted for 5.5ppts of all inflation. With base effects from past price shifts becoming more favourable, the peak in headline inflation might yet be close. However, there are no signs of a let-up in the conflict in Ukraine, nor of its economic consequences. Indeed, Russia this week cut sharply its gas exports to Germany, Italy, Italy and Slovakia, with knock-on effects for other member states (including France), pushing wholesale natural gas prices sharply higher again. So, prices of energy, food and other commodities and intermediate goods – and hence headline inflation – remains subject to significant, and perhaps increasing, upside risks over coming months.

The week ahead in the euro area

The main euro area data focus of the coming week will be the latest raft of economic sentiment survey results, which include the preliminary PMIs for June on Thursday. We expect the headline euro area services activity PMI to remain above 55pts, pointing to ongoing recovery as the sector continues to normalise after the latest pandemic wave and international travel picks up further. The manufacturing output index, however, is likely to imply still challenging conditions amid persisting supply constraints and elevated costs. Overall, the composite PMI is forecast to fall a little more than ½pt to close to 54, which would be the lowest level in six months albeit one still consistent with economic expansion. Similarly, Germany's ifo business sentiment for June (Friday) is expected to suggest that activity is holding up. French and Italian business confidence data (out on Thursday and Friday respectively) are also expected to broadly tally with the view of cautious optimism. However, we caution that business survey indicators might be exaggerating the strength of growth in production, as high inflation boosts output values even if volumes are weak. Moreover, surveys are likely to continue to suggest that consumers remain very pessimistic. In particular, Wednesday's preliminary Commission consumer confidence indicator is expected to report a minimal improvement for a second successive month, and thus remain relatively close to the series low recorded during the onset of the pandemic in April 2020 and a long way below the pre-pandemic level. The week's data-flow gets off to a relatively quiet start on Monday, with German PPI inflation figures for May expected to confirm another substantive increase in prices at the factory gate, albeit of about 1.5%M/M, about half the monthly rate the prior month. Euro area construction figures for April are also out on Monday.

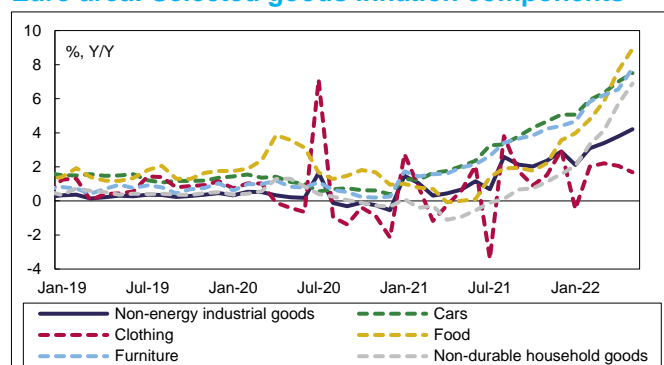
Beyond the economic data, ECB President Lagarde will speak at the European Parliament on Monday, while Chief Economist Philip Lane and dovish Board member Panetta will speak publicly the same evening. Politics-wise, the second round of the French legislative election will take place on Sunday. As previously noted, a poor showing for Emmanuel Macron's "Ensemble!" alliance in last weekend's first round suggests that the President's coalition might struggle to retain its majority. In particular, Ensemble won 25.75% of the vote, less than 0.1ppt above the share taken by the new left-wing alliance NUPES (the New Popular Ecological and Social Union) of Jean-Luc Mélenchon's France Unbowed party as well as the former establishment centre-left Socialists and the Greens. Marine Le Pen's far-right National Rally won just under 18.7%, while the former establishment centre-right Les Républicains and its allies took just over 13.6%. Based on the result, initial projections suggested that the President's coalition might win between 260-295 seats in the new National Assembly, down from 350 in the last Assembly, with 289 seats required for a majority. NUPES was projected to win between 160-210 seats, up from fewer than 60 for its constituent parties in the last Assembly, which suggests significant scope to impede legislative progress on planned reforms to pensions among other things. Finally, Les Républicains were predicted to win between 50-65 seats, down from 130 in the last Assembly, with National Rally forecast to win between 19-44.

Euro area: Selected services inflation components



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Selected goods inflation components



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.










UK

The week ahead in the UK

After a quiet start, with no key economic data releases to look out for on Monday, the UK's data-flow will gradually pickup, with the highlights being May inflation data (Wednesday), the preliminary PMIs for June (Thursday) and retail sales data for May (Friday). We expect the headline CPI rate to edge higher in May, to 9.2%Y/Y, the highest since the series began in 1988. The increase will be driven by a further rise in food inflation, which we expect to rise around 1ppt to 7.1%Y/Y, the highest rate since September 2011. Given higher prices of petrol, energy inflation will probably inch up too, and we also expect a further rise in services inflation. Producer price inflation for both inputs and outputs – also due on Wednesday – will also likely rise to new highs. Thursday's flash manufacturing and service sector PMIs for June are both expected to suggest some further loss of recovery momentum, with the composite PMI forecast to decline about ½pt to a 16-month low of 52.6. While these indices have recently given an exaggerated impression of the vigour of economic activity, the June figures should be weighed by the extra bank holiday that month. Meanwhile Friday's delayed release of May retail sales data, as well as the GfK consumer confidence survey for June, will provide further insight into spending in Q2. We expect to see some adverse payback in retail sales in May – perhaps as much as 1%M/M – for the surprising jump (+1.4%M/M) in April, while consumer confidence could edge down to a new series from last month's dire reading of -40. Among other data releases due in the coming week, the CBI will publish its industrial and retail trade surveys on Tuesday and Thursday respectively. Thursday also brings the release of public sector borrowing figures for May.

In terms of BoE communication, on Monday external MPC members Haskel and Mann – both of whom voted for hikes of 50bps this week – will speak publicly at separate events, while Chief Economist Pill and (the more dovish external) Tenreiro will be in action on Tuesday. On Wednesday we will hear from Deputy Governor Cunliffe, while Pill and Haskel will speak publicly again on Friday.

Daiwa economic forecasts

		2021	2022				2023	2022	2023	2024
		Q4	Q1	Q2	Q3	Q4	Q1			
GDP			%, Q/Q					%, Y/Y		
Euro area		0.2	0.6	0.1	0.3	0.2	0.1	2.8	0.6	1.1
UK		1.3	0.8	-0.3	0.3	-0.3	0.0	3.4	-0.2	0.9
Inflation, %, Y/Y										
Euro area										
Headline HICP		4.6	6.1	7.9	8.1	6.9	5.1	7.3	3.4	1.9
Core HICP		2.4	2.7	3.6	3.6	3.1	2.8	3.2	2.5	2.0
UK										
Headline CPI		4.9	6.2	9.1	9.4	9.7	8.6	8.6	4.9	1.7
Core CPI		3.9	5.1	6.1	6.1	5.7	4.7	5.7	3.3	1.7
Monetary policy, %										
ECB										
Refi Rate		0.00	0.00	0.00	0.75	1.25	1.50	1.25	1.75	1.75
Deposit Rate		-0.50	-0.50	-0.50	0.25	0.75	1.00	0.75	1.50	1.50
BoE										
Bank Rate		0.25	0.75	1.25	2.00	2.50	2.50	2.50	2.50	2.00

Source: Bloomberg, ECB, BoE and Daiwa Capital Markets Europe Ltd.

The coming week's data calendar

The coming week's key data releases

Country	BST	Release	Period	Market consensus/ <i>Daiwa</i> <i>forecast/actual</i>	Previous
Monday 20 June 2022					
Euro area	10.00	Construction output M/M% (Y/Y%)	Apr	-	0.0 (3.3)
Germany	07.00	PPI M/M% (Y/Y%)	May	1.5 (33.5)	2.8 (33.5)
UK	00.01	Rightmove house price index M/M% (Y/Y%)	Jun	-	2.1 (10.2)
Tuesday 21 June 2022					
UK	11.00	CBI industrial trends survey, total orders (selling prices)	Jun	20 (72)	26 (75)
Wednesday 22 June 2022					
Euro area	15.00	European Commission's preliminary consumer confidence index	Jun	-20.5	-21.1
UK	07.00	CPI M/M% (Y/Y%)	May	<u>0.7 (9.2)</u>	2.5 (9.0)
	07.00	Core CPI Y/Y%	May	<u>6.2</u>	6.2
	07.00	PPI input prices M/M% (Y/Y%)	May	1.8 (19.4)	1.1 (18.6)
	07.00	PPI output prices M/M% (Y/Y%)	May	1.2 (14.5)	2.3 (14.0)
	09.30	House price index Y/Y%	Apr	-	9.8
Thursday 23 June 2022					
Euro area	09.00	Preliminary manufacturing (services) PMI	Jun	53.8 (55.5)	54.6 (56.1)
	09.00	Preliminary composite PMI	Jun	54.1	54.8
Germany	08.30	Preliminary manufacturing (services) PMI	Jun	54.0 (54.5)	54.8 (55.0)
	08.30	Preliminary composite PMI	Jun	53.0	53.7
France	07.45	INSEE business confidence	Jun	105	106
	07.45	INSEE manufacturing confidence (production outlook)	Jun	105	106 (-9)
	08.15	Preliminary manufacturing (services) PMI	Jun	53.9 (57.6)	54.6 (58.3)
	08.15	Preliminary composite PMI	Jun	56.0	57.0
UK	07.00	Public sector net borrowing, excluding banks £bn	May	12.1	18.6
	09.30	Preliminary manufacturing (services) PMI	Jun	53.7 (53.0)	54.6 (53.4)
	09.30	Preliminary composite PMI	Jun	52.7	53.1
	11.00	CBI distributive sales, reported retail sales balance	Jun	-	13
Friday 24 June 2022					
Germany	09.00	Ifo business climate	Jun	92.7	93.0
	09.00	Ifo current assessment (expectations) balance	Jun	99.0 (87.4)	99.5 (86.9)
France	07.45	Final wages Q/Q%	Q1	<u>1.1</u>	0.5
Italy	09.00	ISTAT consumer (manufacturing) confidence index	Jun	102.5 (108.5)	102.7 (109.3)
	09.00	ISTAT economic sentiment indicator	Jun	-	110.9
Spain	08.00	Final GDP Q/Q% (Y/Y%)	Q1	<u>0.3 (6.4)</u>	2.2 (5.5)
UK	00.01	GfK consumer confidence	Jun	-41	-40
	07.00	Retail sales including auto fuel M/M% (Y/Y%)	May	-0.7 (-4.4)	1.4 (-4.9)
	07.00	Retail sales excluding auto fuel M/M% (Y/Y%)	May	-1.0 (-5.1)	1.4 (-6.1)

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.




The coming week's key events & auctions

Country	BST	Event / Auction
Monday 20 June 2022		
Euro area	 14.00	ECB President Lagarde to give introductory statement before the Committee on Economic and Monetary Affairs
	 18.00	ECB's Panetta scheduled to speak
	 19.30	ECB's Lane scheduled to speak
UK	 09.00	BoE's Haskel scheduled to speak
	 14.00	BoE's Mann scheduled to speak
Tuesday 21 June 2022		
UK	 08.15	BoE's Pill scheduled to speak
	 13.15	BoE's Tenreiro scheduled to speak
Wednesday 22 June 2022		
Euro area	 08.00	ECB's de Guindos takes part in an online University Q&A session
Germany	 10.30	Auction: €1.5bn of 1% 2038 bonds
UK	 09.40	BoE's Cunliffe scheduled to speak
Thursday 23 June 2022		
Euro area	 08.00	ECB President Lagarde participates in European Council meeting
	 09.00	ECB publishes Economic Bulletin
Friday 24 June 2022		
Euro area	 12.30	ECB's de Guindos scheduled to speak – 'Central banks and inflation'
Italy	 10.00	Auction: Fixed-rate and index-linked bonds
UK	 13.30	BoE's Pill scheduled to speak
	 14.45	BoE's Haskel scheduled to speak

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area	 Final CPI M/M% (Y/Y%)	May	0.8 (8.1)	<u>0.8 (8.1)</u>	0.6 (7.4)	-
	 Final core CPI Y/Y%	May	3.8	<u>3.8</u>	3.5	-
Italy	 Trade balance €bn	Apr	-3.7	-	-0.08	-0.2

Auctions

Country	Auction
- Nothing to report -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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