

Euro wrap-up

Overview

- Bunds made losses as German producer price inflation rose to a new series high, while French OATs underperformed only slightly after Macron lost his party's national assembly majority.
- Gilts also made losses, as external MPC member Catherine Mann reiterated her preference for a faster pace of BoE rate hikes to tackle growing inflationary pressures, not least those related to sterling weakness.
- After a quieter day on Tuesday, Wednesday will bring the flash June euro area consumer confidence indicator as well as UK inflation data for May.

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Daily bond market movements

Bond	Yield	Change
BKO 0.2 06/24	1.102	+0.054
OBL 0 04/27	1.516	+0.069
DBR 0 02/32	1.726	+0.073
UKT 1 04/24	2.293	+0.097
UKT 1½ 07/27	2.301	+0.099
UKT 4¼ 06/32	2.596	+0.099

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

Euro area

German PPI inflation edges to a new series high

Today's German producer price inflation data broadly aligned with expectations, suggesting ongoing significant upwards pipeline pressures in May. Admittedly, the monthly increase in producer prices slowed to 1.6%M/M from 2.8%M/M in April and a record 4.8%M/M in March. But that pushed the annual rate up a further 0.1ppt to 33.6%Y/Y, a new series high. Unsurprisingly, energy remained the principal source of inflationary pressure, with prices up a further 2½%M/M in May, although this was less than half the average increase over the past year. And so the annual energy PPI inflation rate eased very slightly by 0.2ppt to a still-lofty 87.1%Y/Y, accounting for roughly half of all producer inflation. The annual increase in the price of natural gas eased 6.7ppts but was still close to 150%Y/Y, with power plants paying more than 240% than a year earlier (down from more than four times in April), but electricity prices rose 2.8ppts to 90.4%Y/Y.

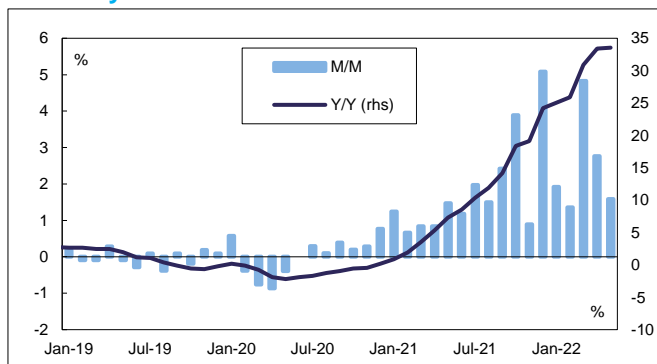
Producer price pressures to continue to feed through into CPI inflation over remainder of the year

While supply disruption associated with the Ukraine war continued to push prices higher further along the value chain, today's release similarly suggested that the impact was smaller than in previous months. In particular, the monthly increase in prices of intermediate goods rose 'just' 1.5%M/M in May, compared with the record 4.1%M/M in April, to leave the annual rate down by 0.9ppt to 25.1%Y/Y and suggesting that we might have reached the peak in this component. Nevertheless, capital goods price inflation (up 0.4ppt to 7.1%Y/Y) rose to the highest since September 1975. And producer inflation of consumer goods prices increased 1.3ppts to 14.0%Y/Y, as the food component rose to 19.2%Y/Y and furniture prices were up 11.9%Y/Y. So, while producers continue to absorb a sizable portion of their extra input costs, given the lagged effects of pass-through to consumers of six months or more, pipeline pressures look set to provide an inflationary impulse to the German CPI rate over the remainder of the year and probably into 2023. More happily, the implementation of the government's energy price relief measures, including a cut in fuel duty and €9 travel pass, should help to ease some pressures in German consumer price inflation this month. Indeed, weekly petrol prices in the first two weeks of June were down almost 6% from the average in May.

Euro area construction fell back at the start of Q2

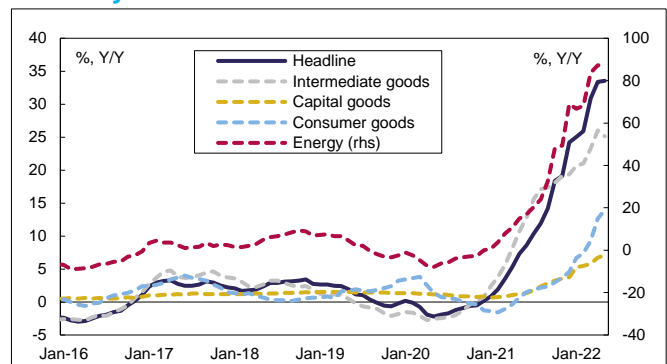
Euro area construction activity figures for April reported the first monthly drop in output in the sector this year. Indeed, total construction production fell 1.1%M/M due principally to a near-6%M/M decline in civil engineering activity, while building work moved broadly sideways (0.1%M/M). This left construction output trending some 0.7% below the Q1 average, with civil engineering more than 3½% lower but building work 0.2% higher on the same basis. The weakening at the start of Q2 tallies

Germany: PPI inflation



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: PPI inflation



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

with recent survey indicators such as the latest PMI surveys, which also point to a deteriorating outlook for the sector. Indeed, the euro area construction output PMI index fell 1.2pts in May to 49.2, the lowest level since February 2021, with the future activity index dropping to a nineteen-month low. Among the country detail, the weakness in April was driven by Germany, with output down for the third consecutive month (-2.1%M/M) and by the most since last July. Likely in part reflecting supply bottlenecks, Italian activity fell for the first month in nine (-1.3%M/M), albeit leaving it still more than 25% higher than the pre-pandemic level. In contrast, French construction output largely reversed the weakness in March (+1.2%M/M), while there was only a modest pickup in Spain (0.2%M/M) to leave activity there still more than 16½% below the pre-pandemic trend.

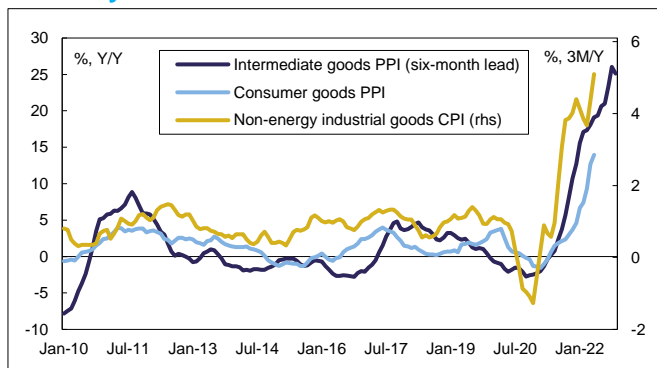
OATs modestly underperform as Macron loses assembly majority

Ahead of Sunday's second-round vote in the French legislative election, opinion polls had already flagged the possibility that Macron's alliance, Ensemble, could lose its national assembly majority. In the event, however, the President's group fared worse than expected, winning just 245 seats out of 577, down 102 from the last election and thus a sizeable 44 seats short of a majority. The new left-wing alliance NUPES (the New Popular Ecological and Social Union including the far-left La France Insoumise, the Greens and former establishment Socialists) collectively came second, with 131 seats, more than 70 above the number won by its constituent parts five years ago but below the level projected before the vote. So, it was the far-right RN (National Rally) of Marine Le Pen who outperformed expectations, with 89 seats, representing a roughly ten-fold increase from the previous assembly and making it the largest single-party opposition. Les Républicains (LR), the right-wing former establishment party, took 61 seats, barely more than half of its previous total. While Macron's new Prime Minister Élisabeth Borne won her seat, she now risks appearing a lame duck. And a number of ministers lost their seats and will therefore now leave government.

Will Macron seek coalition with Les Républicains to avoid policy paralysis?

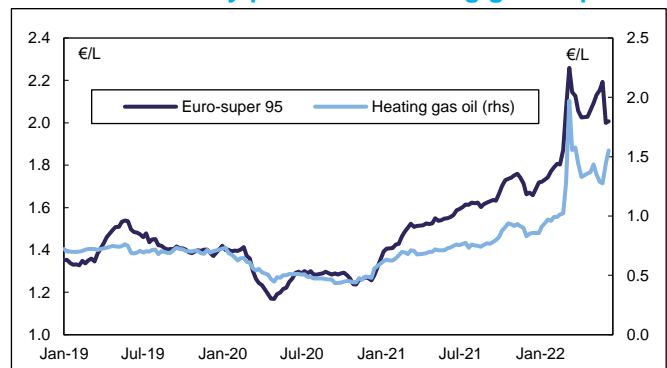
The result was undeniably bad news for Macron, whose government now risks an uphill struggle to deliver his economic reform plans. Indeed, NUPES and RN seem highly likely instinctively to oppose (almost) everything proposed by the executive in the new assembly. So, the government will frequently have to seek common ground with Les Républicains. While a commonality of views might exist on some measures, e.g. increases to the retirement age, on others large differences exist. And the government will certainly not be able to take for granted the right-wing party's support on any particular policy unless and until a formal coalition agreement is sought and finalised. Moreover, with the make-up of the cabinet having seemingly been targeted by voters from the left, some changes of personnel – including of Prime Minister – might also be required to bring LR on board. Admittedly, the government could, in certain circumstances, choose to use

Germany: PPI and CPI inflation



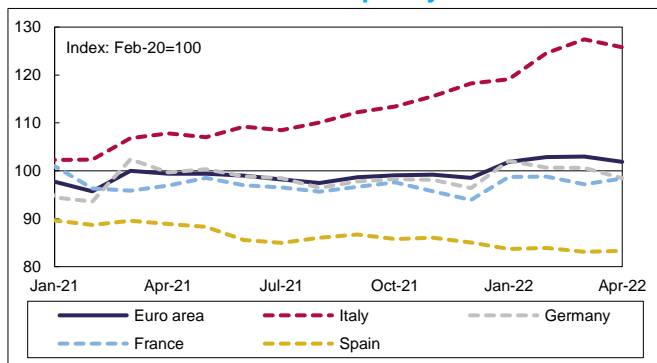
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Weekly petrol and heating gas oil prices



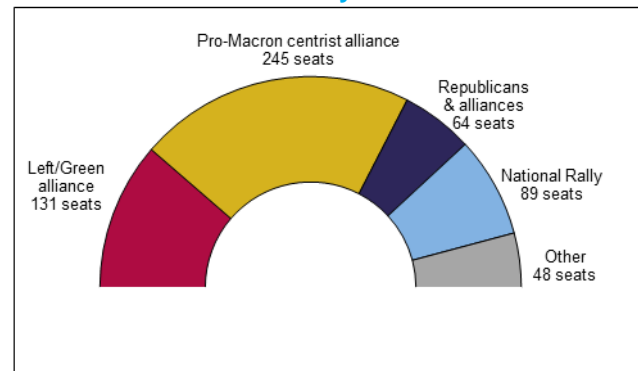
Source: European Commission's weekly oil bulletin and Daiwa Capital Markets Europe Ltd.

Euro area: Construction output by member state



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

France: National Assembly election results



Source: Ministry of Interior and Daiwa Capital Markets Europe Ltd.

Article 49.3 of the Constitution to impose the adoption of a legislative text without assembly approval, a measure used by Macron's previous Prime Minister Edouard Philippe in 2020 to force through an earlier pension reform. However, expectations for French fiscal policy and structural reforms will now likely need to be significantly revised.

The coming two days in the euro area

Tomorrow should be an exceptionally quiet day in the euro area, with no economic data scheduled for release. On Wednesday, the first of this week's sentiment survey results will come in the form of the European Commission's preliminary consumer confidence indicator. This is expected to report only a minimal improvement in June 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 headline index is forecast to edge up to -20.5, from -21.1 in May.

UK




The coming two days in the UK

The UK data highlight of the coming two days will be Wednesday's May inflation release. 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 to the highest rate since September 2011. Given increased prices of petrol, energy inflation will probably inch up too. But core inflation should edge down from 6.2%Y/Y in April. Producer price inflation for both inputs and outputs – also due on Wednesday – will also likely rise to new highs.




Ahead of the inflation data, and coming before the preliminary manufacturing PMIs on Thursday, tomorrow brings the release of the CBI's industrial trends survey for June which is expected to suggest some loss of recovery momentum in the sector. The total orders index is expected to fall back to 21 in June, from 26 in May. The CBI's selling price index is expected to remain unchanged at 75 in June, still close to the recent high of 80 recorded in March and well above the long-run average of 14, suggesting that cost pressures remain acute. In terms of BoE communication, Chief Economist Pill and the least hawkish external member Tenreyro will be in action tomorrow, while Deputy Governor Cunliffe will speak on Wednesday.

The next edition of the Euro wrap-up will be published on 22 June 2022

European calendar

Today's results						
Economic data						
Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area	 Construction output M/M% (Y/Y%)	Apr	-1.1 (3.0)	-	0.0 (3.3)	0.1 (3.4)
Germany	 PPI M/M% (Y/Y%)	May	1.6 (33.6)	1.5 (33.5)	2.8 (33.5)	-
UK	 Rightmove house price index M/M% (Y/Y%)	Jun	0.3 (9.7)	-	2.1 (10.2)	-
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	
UK		11.00 CBI industrial trends survey, total orders (selling prices)	Jun	21 (75)	26 (75)	
Auctions and events						
UK		08.15 BoE's Pill scheduled to speak				
		13.15 BoE's Tenreyro scheduled to speak				




Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Wednesday's releases

Economic data

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Euro area 	15.00	European Commission's preliminary consumer confidence	Jun	-20.5	-21.1
UK 	07.00	CPI M/M% (Y/Y%)	May	<u>0.7</u> (9.2)	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	1.5 (14.7)	2.3 (14.0)
	09.30	House price index Y/Y%	Apr	-	9.8

Auctions and events

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

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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