

# Euro wrap-up

## Overview

- Bunds rallied as euro area consumer confidence fell to the second-lowest level on the series.
- Gilts also made big gains as UK CPI inflation inched to a new multi-decade high but core inflation fell for the first time in eight months.
- The principal European focus on Thursday will be the June flash PMIs, with a UK retail sales survey for the current month also due.

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### Daily bond market movements

Bond	Yield	Change
BKO 0.2 06/24	1.008	-0.104
OBL 0 04/27	1.394	-0.149
DBR 0 02/32	1.614	-0.150
UKT 1 04/24	2.093	-0.187
UKT 1½ 07/27	2.131	-0.192
UKT 4¼ 06/32	2.472	-0.178

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

## Euro area

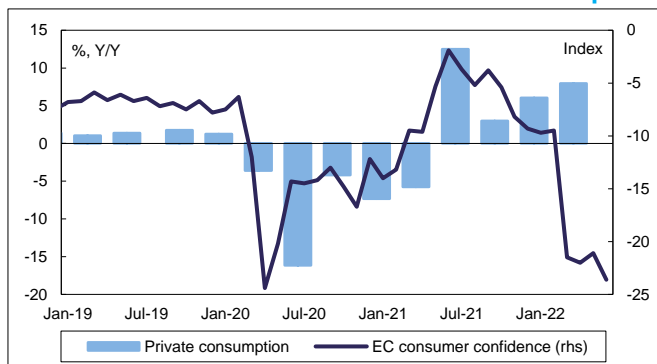
### Euro area consumer confidence falls to second-lowest reading on record

With the war in Ukraine persisting, Russia restricting the supply of natural gas, inflation at a euro-era high, ECB interest rates set to rise imminently, and uncertainty about the global economic outlook mounting, today's flash Commission euro area consumer confidence index suggested a deterioration in sentiment in June. Indeed, while the Bloomberg survey had suggested expectations of a second successive modest improvement, the indicator fell 2.5pts to -23.6, some 13½pts below the long-run average and the second-lowest reading on the series, only marginally above the trough at the onset of the pandemic in April 2020 (-24.4). While we will have to wait for the final release (29 June) to see the detailed breakdown, surveys from the Netherlands and Belgium today offered somewhat contrasting insights. Certainly, consumers in the Netherlands remained extremely downbeat, with the headline index falling 2pts to -50, the lowest since the series began in 1986, and 19pts below the initial pandemic trough. Survey respondents were more downbeat about both the economic outlook and their own expected future financial situation. And so, household willingness for making major purchases fell to the lowest on the series too. However, confidence in Belgium continued to improve in June, with the headline index up for a third successive month as expectations for the economic outlook over the next twelve months picked up. But while at -11 the headline confidence indicator was well above the pandemic trough of -26, it was still below the long-run average having merely reversed one-third of the substantial drop recorded in March over the past three months. And consumers were more inclined to save while also being more fearful of unemployment.

### French retail sales post only modest recovery in May

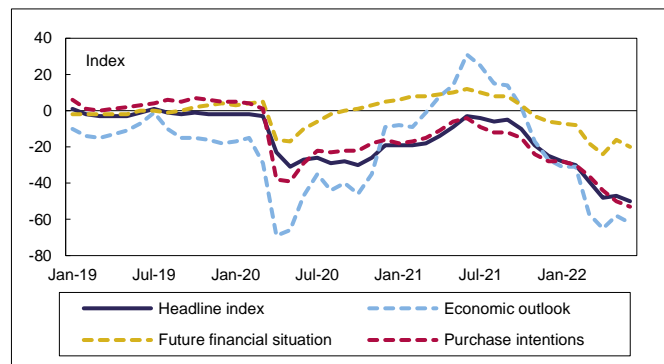
After a weak start to Q2, today's Bank of France retail sales survey results suggested modest improvement in May, with the volume of sales up 0.6%M/M, following a drop of 1.1%M/M in April. Nevertheless, this left them up 1.3%Y/Y and trending 0.8% above the Q1 average. Within the detail, there was a marked increase in sales of clothing (6.9%M/M) and footwear (7.5%M/M), to leave them up some 27%Y/Y and almost one fifth higher than the pre-pandemic level. Meanwhile, new autos sales (which are excluded from the Eurostat retail sales measure) rose for the first time this year (2.2%M/M) but were still down some 20%Y/Y and almost a third from February 2020. In contrast, sales of watches and jewellery were down more than 5%M/M, with household appliances down almost 4%M/M. And with the INSEE survey suggesting a marked recent decline in the share of households considering it a good time to make major purchases, spending on big-ticket items is likely to remain subdued for the time being. Sales in food stores also fell sharply, by 2.8%M/M, the most for a year, no doubt reflecting the ongoing reopening of the hospitality sector. And spending on services more generally seems bound to have been stronger this quarter than in Q1. So, despite the hit to households' real disposable income from high inflation, consumption should support a modest rebound in GDP in Q2, albeit likely merely reversing the 0.2%Q/Q contraction in Q1.

### Euro area: Consumer confidence and consumption



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

### Netherlands: Consumer confidence



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

## The day ahead in the euro area

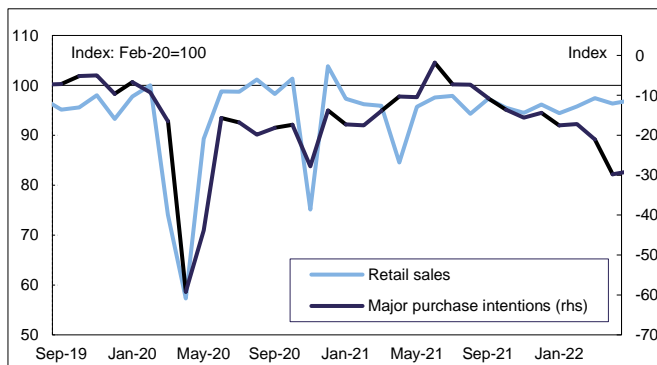
The economic focus in the euro area tomorrow remains on June sentiment surveys with the flash PMIs for June scheduled for release. We expect the headline euro area services activity PMI to remain above 55pts, pointing to ongoing recovery as the sector continues to normalise after the latest pandemic 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. At the country level, the flash PMI results for Germany are likely to point to relatively challenging conditions in the euro area's largest member state, with the composite measure expected to fall 0.7pt to a six-month low of 53.0. In France, the somewhat stronger position of the services sector should maintain the composite PMI above that of its larger neighbour, perhaps close to 56.0 in June, although that would still be about 1pt lower than in May. Separately, INSEE will also publish its detailed French business confidence survey for June.

## UK

### CPI inflation steadier in May, core measure falls for first time since September

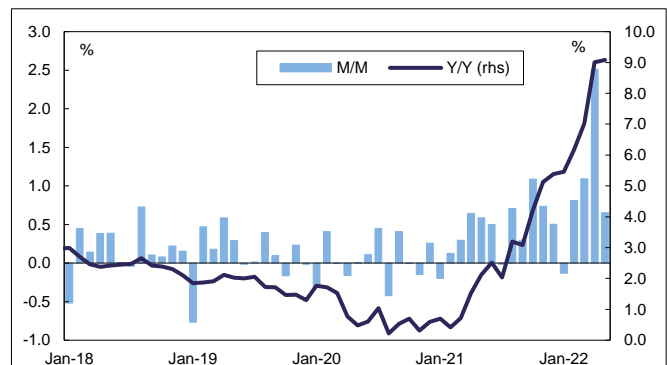
Broadly as expected, UK consumer price inflation steadied somewhat in May, with the headline CPI rate edging up just 0.1ppt – the least since January – to 9.1%Y/Y. Nevertheless, that still represented the worst inflation in the G7 and the highest on the series dating back to 1997, with ONS modelled estimates suggesting that consumer prices were up the most on an annual basis since 1982. Admittedly, the increase last month appeared to be due in part to global factors, exacerbated by sterling weakness, as inflation of food rose almost 2ppts to a new series high of 8.5%Y/Y, and inflation of motor fuels rose more than 1½ppts to 32.8%Y/Y. Modest offsets came from inflation of recreation and culture (down almost 1ppt to 5.0%Y/Y, likely related to the nature of the best-selling items at the time of the survey) and clothing and footwear (down more than 1ppt to 7.0%Y/Y) – the two categories that had provided the biggest impetus a year earlier. So, while several components such as new cars and furniture rose to new highs, inflation of non-energy industrial goods fell back 0.6ppt from the prior month's series high to 7.3%Y/Y. And while inflation of services rose 0.2ppt to a decade high of 4.9%Y/Y despite a decline in inflation in hotels and restaurants likely related to the timing of Easter, core CPI inflation (excluding food, alcohol, tobacco and energy) fell for the first time in eight months, dropping 0.3ppt to 5.9%Y/Y. But notably for the public finances, the RPI rate used to calculate interest payments on inflation-linked gilts jumped 0.6ppt to 11.7%Y/Y, the highest since 1981.

### France: Retail sales and consumer confidence



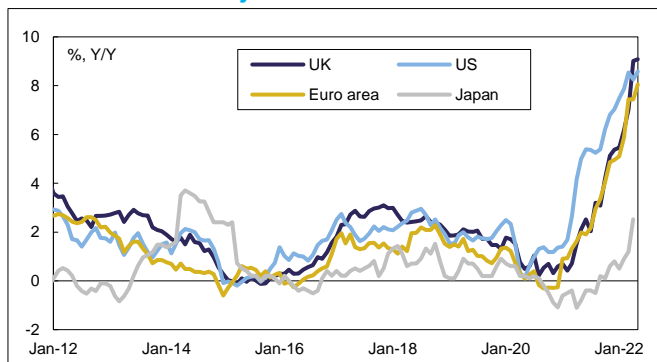
Source: BoF, INSEE, Refinitiv and Daiwa Capital Markets Europe Ltd.

### UK: CPI inflation



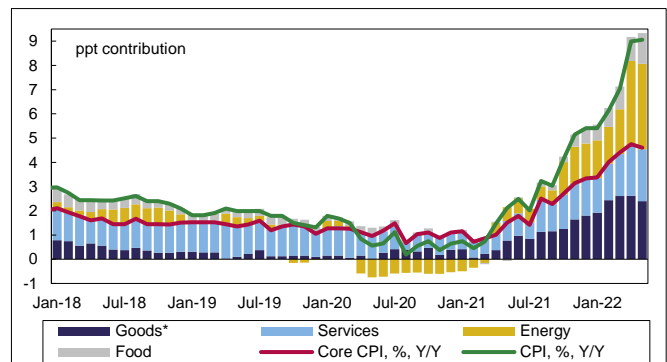
Source: ONS, Refinitiv and Daiwa Capital Markets Europe Ltd.

### CPI inflation in major economies



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

### UK: Contributions to CPI inflation



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

## Record PPI inflation suggests further pass-through to consumers to come

Despite the modest rise in May, CPI inflation has further to rise. Certainly, not least due to the impact of the ongoing conflict in Ukraine as well as foreign exchange market developments, cost growth remains strong and some of these pressures will continue to be passed on to consumers over coming months. With metals prices making the largest contribution, producer input prices accelerated more than 1ppt in May to 22.1%Y/Y, the highest rate on the series dating back to 1985. In addition, as food provided an extra boost, output prices at the factory gate accelerated 1ppt to be up 15.7%Y/Y, the most since 1977.

## Peak likely in October but inflation set to remain firmly above target through 2023

As in the other major economies, energy prices continue to account for the largest share of inflation in the UK – some 3.5ppts in May – and that contribution will rise further over the near term. While government subsidies will absorb some of the pain, household energy prices will likely rise by about 40% in October when Ofgem's regulated price cap is hiked again. Assuming a favourable treatment of government energy subsidies by the ONS, we now forecast CPI inflation to peak around 10½%Y/Y in October. But if energy prices then follow a path broadly in line with futures, headline inflation would then gradually move lower over the course of next year, in good part reflecting substantive base effects. However, domestically-generated inflation – particularly of services – will also likely pickup further for as long as wage growth remains close to current levels. Indeed, not least given diminished competition and shifts in firms' pricing behaviour post-Brexit, as well as post-Covid labour shortages, inflation persistence is a much bigger risk in the UK than in the euro area. And unless the UK economy experiences a recession of sufficient magnitude to push the level of GDP back down to (and probably below) its new lower potential path, inflation would likely remain above 3% by the end of next year and perhaps above target throughout 2024 too.

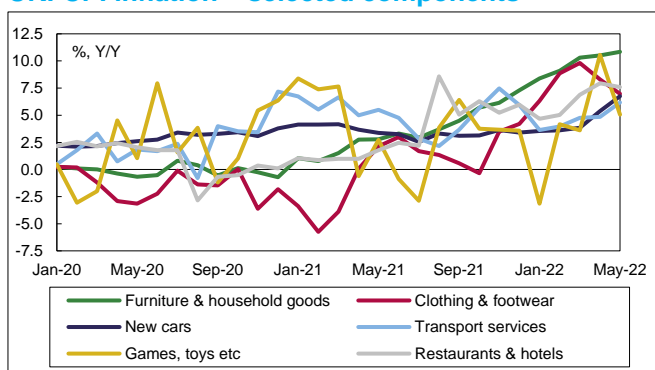
## CBI survey suggests a slowing in manufacturing selling price increases on softer demand

We note, however, that yesterday's CBI industrial trends survey offered a rare hint of a moderation in pressures, suggesting that manufacturers' expectations for selling prices over the coming three months had weakened in June. In particular, the relevant survey balance fell 17ppts to 58%, admittedly still well above the long-run average (14%) but nevertheless the lowest in nine months, suggesting that slowing demand might ease the pace of goods price increases. Indeed, the survey's measure of new orders fell 8ppts to 18%, just below the average reading of the past year, with the volume of export orders falling more sharply – by 18ppts to just 1%. And the survey signalled that output growth in the sector slowed in the three months to June – the index fell 5ppts to 25% – and was expected to ease further over the coming three months. Admittedly, it also suggested that output rose compared with a year earlier in 12 out of 17 sub-sectors, driven by a pickup in autos and aerospace, while the food, drink and tobacco sub-sector made a negative contribution for the first time in over a year.

## The day ahead in the UK

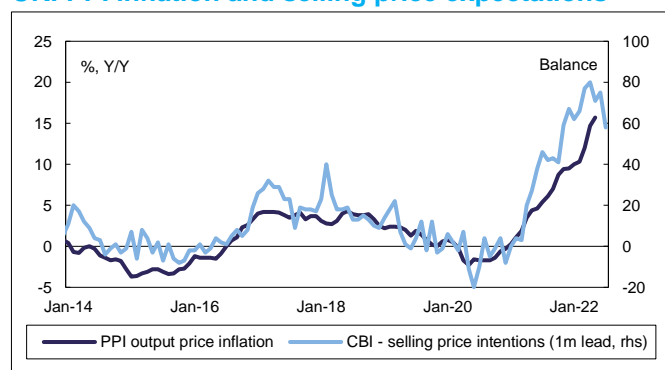
Like in the euro area, the focus in the UK tomorrow will be on the flash PMIs for June, which are expected to suggest some further loss of recovery momentum. In particular, the composite PMI is forecast to decline about ½pt to a 16-month low of 52.4. While these indices have recently given an exaggerated impression of the vigour of economic activity, the June figures should be weighed by the extra bank holiday that month. Similarly, despite the surprise pickup in [retail sales](#) in April, the latest CBI distributive trades survey is likely to point to weakening activity on the high street over the remainder of the second quarter given the increasing squeeze on household budgets from high inflation. Finally, public finance figures for May are also due to be published.

### UK: CPI inflation – selected components



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

### UK: PPI inflation and selling price expectations










Source: ONS, CBI, 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
Euro area	 European Commission's preliminary consumer confidence	Jun	<b>-23.6</b>	-20.5	-21.1	<b>-21.2</b>
France	 Bank of France retail sales M/M% (3M/3M%)	May	<b>0.6 (1.5)</b>	-	-1.1 (1.6)	-
UK	 CPI M/M% (Y/Y%)	May	<b>0.7 (9.1)</b>	<u>0.7 (9.2)</u>	2.5 (9.0)	-
	 Core CPI M/M% (Y/Y%)	May	<b>0.5 (5.9)</b>	<u>0.7 (6.2)</u>	0.7 (6.2)	-
	 PPI input prices M/M% (Y/Y%)	May	<b>2.1 (22.1)</b>	1.8 (19.4)	1.1 (18.6)	<b>2.7 (20.9)</b>
	 PPI output prices M/M% (Y/Y%)	May	<b>1.6 (15.7)</b>	1.2 (14.5)	2.3 (14.0)	<b>2.8 (14.7)</b>
	 House price index Y/Y%	Apr	<b>12.4</b>	-	9.8	<b>9.7</b>

#### Auctions

Country	Auction
Germany	 sold €1.26bn of 1% 2038 bonds at an average yield of 1.91%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

### Yesterday's results

#### Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
UK	 CBI industrial trends survey, total orders (selling prices)	Jun	<b>18 (58)</b>	20 (75)	26 (75)	-













#### 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		09.00 Preliminary manufacturing (services) PMI	Jun	53.8 (55.5)	54.6 (56.1)
		09.00 Preliminary composite PMI	Jun	54.0	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 (-11)	106 (-9)
		08.15 Preliminary manufacturing (services) PMI	Jun	54.0 (57.5)	54.6 (58.3)
		08.15 Preliminary composite PMI	Jun	55.9	57.0
UK		07.00 Public sector net borrowing, excluding banks £bn	May	12.0	18.6
		09.30 Preliminary manufacturing (services) PMI	Jun	53.6 (52.9)	54.6 (53.4)
		09.30 Preliminary composite PMI	Jun	52.4	53.1
		11.00 CBI distributive sales, reported retail sales balance	Jun	-	13

#### Auctions and events

Euro area		08.00 ECB President Lagarde participates in European Council meeting
		09.00 ECB publishes Economic Bulletin

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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