

Euro wrap-up

Overview

- Bunds made large gains as German inflation unexpectedly declined in June, although equivalent data from Spain and Belgium surprised significantly on the upside.
- Gilts also made gains while a UK survey showed shop price inflation rising to the highest since 2008 as food prices jumped.
- Thursday brings the French flash inflation estimates for June, and euro area unemployment and German retail sales data for May.

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Daily bond market movements

Bond	Yield	Change
BKO 0.2 06/24	0.808	-0.112
OBL 1.3 10/27	1.256	-0.138
DBR 0 02/32	1.496	-0.124
UKT 1 04/24	2.021	-0.094
UKT 1½ 07/27	2.058	-0.085
UKT 4¼ 06/32	2.367	-0.098

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

Source: Bloomberg

Euro area

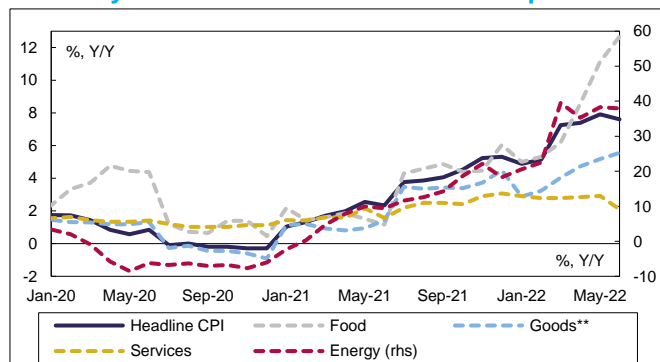
German inflation unexpectedly falls thanks to (temporary) policy measures

Euro area government bonds rallied today as the flash estimates of June inflation from Germany, and earlier in the day its states, fell back contrary to expectations. In particular, the national CPI measure fell 0.3ppt to 7.6%Y/Y while the EU-harmonised HICP rate fell 0.5ppt to 8.2%Y/Y. However, the cause of the decline appears to be the temporary policy measures implemented to soften the impact of high energy prices, which took effect at the start of the month and will expire at the end of August. And although there is insufficient detail at this stage to be able to calculate the full impact of these policies with precision, there was nothing in today's figures to suggest that underlying inflation softened in June. Indeed, non-core pressures were still evident in food inflation, which rose 1.6ppts on the national measure to 12.7%Y/Y. And although the auto fuel tax rebate helped push down the price of petrol over the month, energy inflation overall eased a negligible 0.3ppt to 38.0%Y/Y. Moreover, persistent underlying pressures were reflected in our estimate of non-energy industrial goods inflation, which rose a further 0.4ppt to a new high of 5.6%Y/Y. So, the drop in inflation was explained by lower services inflation, which dropped 0.8ppt to a twelve-month low of 2.1%Y/Y. The detail published by the states suggests that decline was driven by lower prices of transportation, almost certainly reflecting the highly-subsidised national rail pass, priced just €9 per month, introduced only for the summer months.

Spanish inflation surprises on the upside, with headline inflation highest since 1985

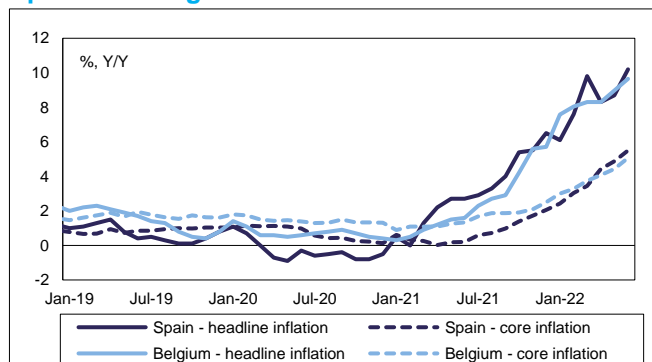
In marked contrast to the German data, today's Spanish figures surprised massively on the upside, with the headline HICP rate jumping 1.5ppts to 10.0%Y/Y, while the median forecast on the Bloomberg survey had predicted a rise of just 0.2ppt. The national CPI measure similarly rose 1.5ppts to 10.2%Y/Y, the highest since August 1985. While there was no detailed breakdown published with this preliminary release, the Spanish statistical office (INE) noted that the latest rise was principally driven by higher fuel and food prices. Indeed, according to the Commission's weekly oil price bulletin, in the first three weeks of June, Spanish petrol prices were up almost 10½% compared with the average in May, with heating gas oil prices up an equivalent 11½%M/M. But with prices of certain services – notably hotels, cafes and restaurants – having been boosted by the rebound in the tourism sector, INE also stated that the national core CPI measure rose 0.6ppt to 5.5%Y/Y, the highest since August 1993. Spain was not the only member state today to report a significant jump in inflation in June, with Belgian CPI inflation rising 0.7ppt to 9.7%Y/Y. As in Spain, higher energy and food prices explained some of the rise. However, core inflation also leapt 0.7ppt to 5.1%Y/Y, with prices of telecoms services, rents and cars highlighted by the Belgian statistical agency among the key drivers.

Germany: CPI inflation and selected components*



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

Spain and Belgium: Headline and core CPI inflation*



*National measure. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Price expectations ease again in June

With Germany having likely been the outlier this month, we continue to forecast a rise in euro area inflation in June. But the latest survey indicators gave some cause for optimism regarding the inflation outlook. Certainly, the European Commission survey measures of selling-price expectations for the coming three months eased for the second successive month in June in industry, services and construction, with the former to a four-month low. In contrast, however, retail price expectations rose for a sixth successive month to a new series high. And the survey also reported a further increase in consumer perceptions of price developments over the past twelve months to the highest on the series. But encouragingly, consumer price expectations for the coming year fell for the third consecutive month, with the relevant index at 42.6, some 20pts higher than the long-run average but nevertheless some 20pts below March's peak. Of course, all the survey's pricing expectations indices remain very high by historical standards, suggesting that inflation will remain elevated even after it peaks.

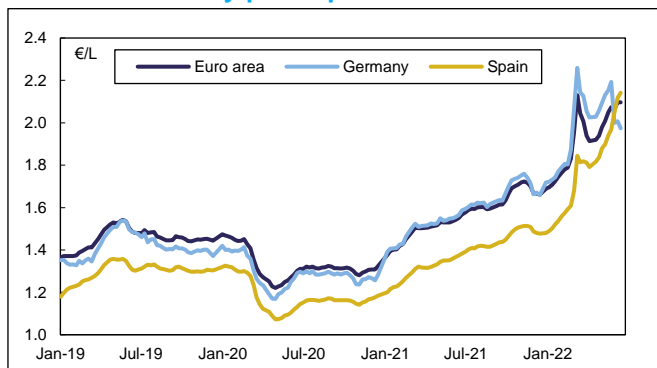
Consumers increasingly downbeat on concerns about the year ahead

Despite lower inflation expectations, households' expectations for their personal finances over the coming year fell to the lowest on the series. With consumers considering the general economic outlook also to have worsened, they were less inclined (or able) to save, and therefore considered it a less favourable time to make major purchases. Indeed, the relevant index was the second-weakest on the series and only some 8pts above the initial post-pandemic trough, suggesting that household spending might have weakened heading into the summer. Overall, consistent with the flash release, the headline consumer sentiment indicator fell 2.4pts to -23.6, just a fraction above the survey low (-24.5) recorded in April 2020. Given also the increased opportunities to spend on services, retailers were similarly more downbeat in June, as the outlook for sales was considered to be as weak as at the start of the second pandemic wave in November 2020.

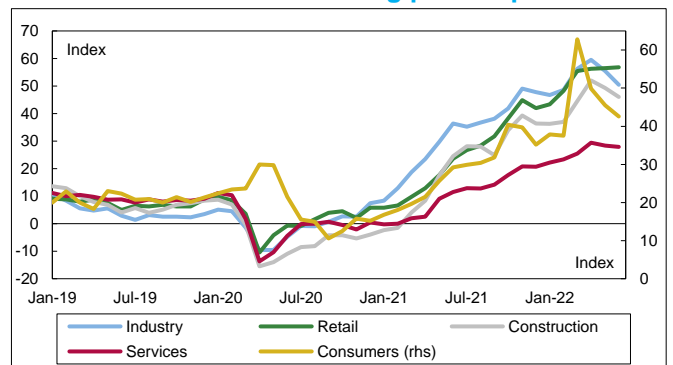
Manufacturers and services a touch more upbeat, but headline ESI down to a 15-month low

Encouragingly, the other detail of the Commission business survey was somewhat stronger than had been suggested by the flash PMIs. For example, while the PMIs signalled a contraction in manufacturing output in June, the Commission's sentiment index edged slightly higher this month (up 0.9pt to 7.4, admittedly still the second-lowest since April 2021), in part as firms judged their recent output to have been stronger and also as they were more upbeat about their near-term production plans thanks to easing supply constraints and near-record orders. Services sentiment also rose to a seven-month high (up 0.7pt to 14.8), reflecting the strongest perceived demand since the pandemic. Less happily, firms in the sector were the least optimistic about their demand expectations for fourteen months. Overall, the Commission's headline economic sentiment indicator (ESI) fell 1pt in June to 104, a fifteen-month low, suggesting a modest loss of growth momentum in the

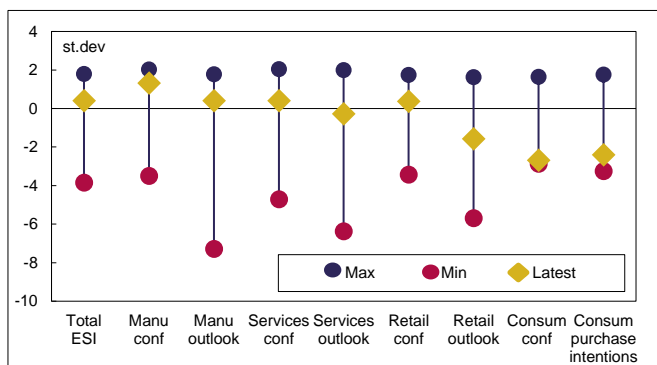
Euro area: Weekly petrol prices



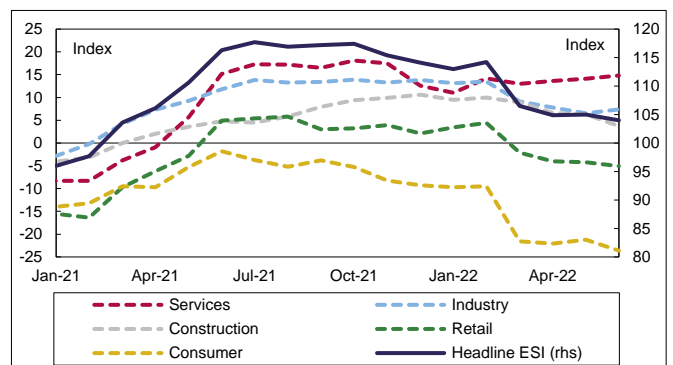
Euro area: Commission selling price expectations



Euro area: Selected Commission sentiment indices



Euro area: Selected Commission sentiment indices



euro area in June. However, this is still above the long-run average and a level that in the past has been consistent with expansion. Among the member states, Germany recorded the most notable deterioration, with its ESI down 1.9pts to 105.2, the lowest since February 2021 albeit similarly still consistent with positive growth.

Households continue to stash deposits, but consumer credit picks up slightly to support spending

While consumers are increasingly uneasy about the economic outlook and real incomes are being squeezed by high inflation, Christine Lagarde yesterday recalled that the ECB expects private spending growth to be supported in part by drawdown of savings accumulated throughout the pandemic. There was little evidence of that in today's monetary data, however. Indeed, households accumulated an extra €30.9bn in new bank deposits in May – just above the average of the prior twelve months – suggesting a preference to save rather than spend. Nevertheless, with the net flow of consumer credit rising €1.8bn to a six-month high of €4.1bn, some households appear to be resorting to new borrowing to fund spending. But while that pushed the annual rate of consumer credit growth up 0.5ppt to 3.5%Y/Y, the highest since March 2020, it remained more than 3ppts below the average rate in the three years before the pandemic. Borrowing for house purchase, meanwhile, remained strong, with the net flow of €27.3bn in May taking the three-month total to a twelve-month high (€72.8bn) and leaving the annual rate unchanged at 5.3%Y/Y, 2ppts above the average in the three years before the pandemic.

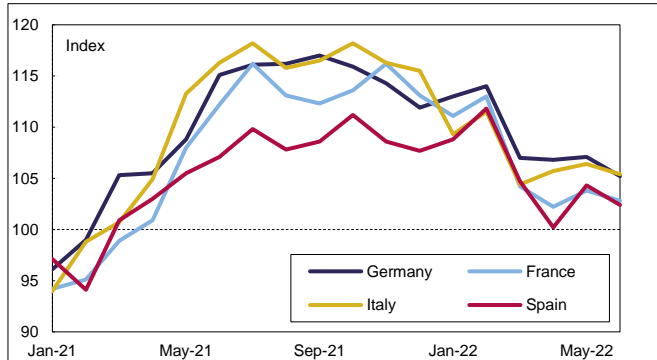
Firms reduce savings a touch while longer-term borrowing picks up to hint at increased capex

Unlike households, non-financial corporations (NFCs) did reduce slightly their stock of bank deposits in May, with the outflow largest (€9bn) in term deposits, for which interest rates are still firmly negative. Lending to NFCs was stronger too, with the flow of €29.5bn the highest in six months. Indeed, the flow of longer-term loans (i.e. those with a maturity of more than five years) was the strongest in ten months, perhaps suggestive of a welcome pickup in investment spending.

The day ahead in the euro area

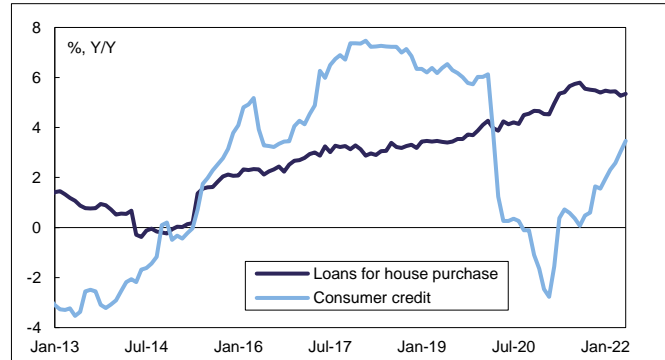
The flow of June inflation data continues tomorrow with the preliminary French figures to be published. The EU-harmonised HICP measure is expected to rise 0.9%M/M in June, pushing up the annual growth rate by 0.7ppt to a new high of 6.5%Y/Y. In contrast to today's softer German figures – following the introduction of policies to shield consumers from rising energy costs – there are risks that the upside surprise in the Spanish data could be mirrored in France, which would tally with our view that inflation in the euro area has yet to peak. Meanwhile, the latest euro area jobless figures are expected to reveal

Euro area: Selected Commission sentiment indices



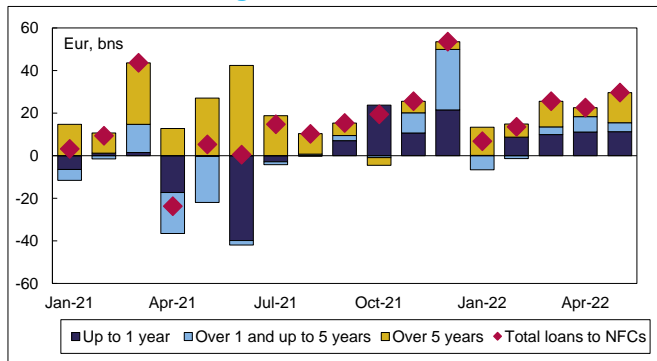
Source: Refinitiv, European Commission and Daiwa Capital Markets Europe Ltd.

Euro area: Lending to households



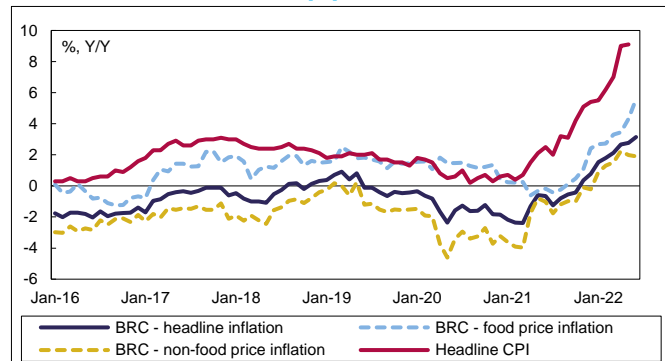
Source: Refinitiv, ECB and Daiwa Capital Markets Europe Ltd.

Euro area: Lending to NFCs



Source: ECB and Daiwa Capital Markets Europe Ltd.

UK: Consumer and shop price inflation



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

that the region's unemployment rate remained at a series low of 6.8% in May, while German retail sales and French consumer spending numbers will give a guide to private expenditure in the same month. In Germany, retail sales are forecast to have risen 1.0%M/M in May, reversing only a small part of April's 5.4%M/M decline and leaving sales down 1.8%Y/Y, while French consumer spending is expected to rise 0.2%M/M in May, offsetting only part of April's 0.4%M/M decline and leaving sales down a steeper 3.6%Y/Y.

UK











UK shop price inflation at highest since 2008 as food price inflation jumps

Like in the euro area, the main data focus in the UK today was on inflation, with the BRC's shop price index unsurprisingly maintaining an upwards trend in June. In particular, its headline measure of inflation rose for the eighth consecutive month and by 0.3ppt to 3.1%Y/Y, the highest since 2008. Despite fierce competition among retailers and a drive to expand their value ranges, once again the upwards inflationary impulse was reflected in the survey's measure of food inflation, up 1.3ppt to 5.6%Y/Y, the highest for eleven years, with fresh food prices up more than 6%Y/Y, the most since 2009. In contrast, non-food inflation edged slightly lower (down 0.1ppt to 1.9%Y/Y), with clothing inflation (-3.7%Y/Y) seemingly impacted by summer discounting. While retailers continue to absorb a large share of their additional costs, we expect pressures to be increasingly passed on to consumers of a wide range of goods over coming months. But, not least due to the exclusion of prices of energy, cars and services, the BRC survey measure of shop price inflation will continue to track well below CPI inflation.

The day ahead in the UK













Looking ahead to tomorrow, the final release of Q1 GDP should confirm growth of 0.8%Q/Q and 8.7%Y/Y, although this masks the steady weakening as the quarter progressed. Other data due include the Lloyds business barometer and Nationwide house price index for June, which is likely to report that annual residential property price inflation remained in double-digits. While last month's sentiment survey from Lloyds Bank signaled an improvement in business conditions, with the headline balance rising 5ppts to 38%, the details suggested that confidence among retailers had deteriorated to be the least favourable since March 2021, when non-essential shops were still closed due to pandemic restrictions. We expect conditions for consumer-facing firms to remain challenging for the foreseeable future as suppliers seek to pass on cost pressures but household disposable incomes continue to be squeezed.

European calendar




Today's results							
Economic data							
Country	Release		Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area		M3 money supply Y/Y%	May	5.6	5.8	6.0	6.1
		European Commission's economic sentiment indicator	Jun	104.0	103.0	105.0	-
		European Commission's industrial (services) confidence	Jun	7.4 (14.8)	4.8 (12.5)	6.3 (14.0)	6.5 (14.1)
		European Commission's final consumer confidence	Jun	-23.6	-23.6	-21.1	-
Germany		Preliminary CPI M/M% (Y/Y%)	Jun	0.1 (7.6)	0.4 (7.9)	0.9 (7.9)	-
		Preliminary EU-harmonised CPI M/M% (Y/Y%)	Jun	-0.1 (8.2)	0.4 (8.8)	1.1 (8.7)	--
Spain		Preliminary CPI M/M% (Y/Y%)	Jun	1.8 (10.2)	0.5 (8.8)	0.8 (8.7)	-
		Preliminary EU-harmonised CPI M/M% (Y/Y%)	Jun	1.8 (10.0)	0.8 (8.7)	0.7 (8.5)	-
		Retail sales Y/Y%	May	1.4	2.0	1.5	1.6
UK		BRC shop price index Y/Y%	Jun	3.1	-	2.8	-
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 Unemployment rate %	May	6.8	6.8
Germany		07.00 Retail sales M/M% (Y/Y%)	May	1.0 (-1.8)	-5.4 (3.3)
		08.55 Unemployment change '000s (rate %)	Jun	-5.0 (5.0)	-4.0 (8.4)
France		07.45 Preliminary CPI M/M% (Y/Y%)	Jun	0.7 (5.7)	0.7 (5.2)
		07.45 Preliminary EU-harmonised CPI M/M% (Y/Y%)	Jun	0.9 (6.5)	0.8 (5.8)
		07.45 PPI M/M% (Y/Y%)	May	-	0.0 (27.8)
		07.45 Consumer spending M/M% (Y/Y%)	May	0.2 (-3.6)	-0.4 (7.2)
Italy		09.00 Unemployment rate %	May	8.4	8.4
		10.00 PPI M/M% (Y/Y%)	May	-	-0.3 (44.1)
UK		00.01 Lloyds business barometer	Jun	-	38
		07.00 Final GDP Q/Q% (Y/Y%)	Q1	<u>0.8 (8.7)</u>	1.3 (6.6)
		07.00 Nationwide house price index M/M% (Y/Y%)	Jun	0.5 (10.8)	0.9 (11.2)

Auctions and events

Italy		10.00 Auction: €1bn of 2029 floating-rate bonds
		10.00 Auction: €4bn of 2.65% 2027 bonds
		10.00 Auction: €2bn of 2.5% 2032 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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