Euro wrap-up

Overview

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- While French inflation rose to a new multi-decade high and euro area unemployment fell to a new series low, Bunds rallied as German unemployment rose and German retail sales remained soft.
- Gilts also rallied as data confirmed a further consecutive decline in UK real household disposable income and business surveys again pointed to soft momentum in June.
- Friday will bring the flash estimate of euro area inflation in June, which is set to rise to a new series high.

Daily bond market movements

Bond	Yield	Change
BKO 0.2 06/24	0.649	-0.167
OBL 1.3 10/27	1.086	-0.182
DBR 0 02/32	1.358	-0.155
UKT 1 04/24	1.868	-0.164
UKT 1¼ 07/27	1.914	-0.157
UKT 4¼ 06/32	2.250	-0.133

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

Euro area

French inflation rises to new multi-decade high in June on food and petrol prices

In marked contrast to yesterday's downside surprise in Germany (which we attribute entirely to temporary factors), and more consistent with the increases reported in Spain and Belgium, French inflation rose further in June to new multi-decade highs. Broadly in line with expectations, French prices on the national CPI measure rose 0.7%M/M to push the annual rate up by 0.6ppt to 5.8%Y/Y, the highest since 1985. And the French EU-harmonised HICP inflation rate rose 0.7ppt to 6.5%Y/Y. The pressures came again in non-core items. On the national measure, higher petrol prices pushed up energy inflation more than 5ppts to above 33%Y/Y, while food inflation rose 1.4ppts to 5.7%Y/Y. But the services component was steady at 3.2%Y/Y, and the manufactured items component slowed 0.4ppt to 2.6%Y/Y, hinting at a welcome, albeit slight, decline in French core inflation.

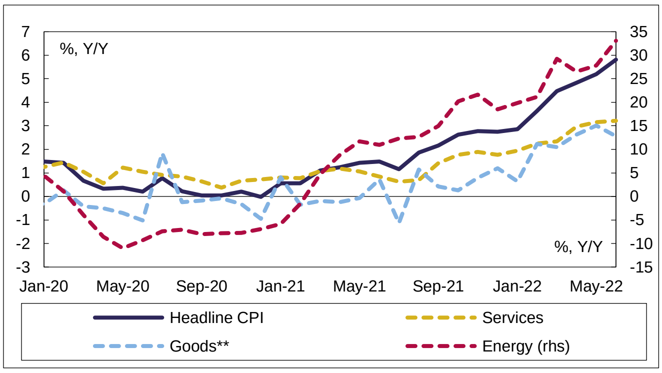
Portuguese figures also higher, and euro area inflation still on track for significant increase too

The flash Portuguese numbers similarly saw headline inflation on the national measure jump in June, by 0.7ppt to 8.7%Y/Y, the highest rate for three decades. But while energy inflation rose (31.7%Y/Y) at the fastest annual pace since 1984, in contrast with France the national core CPI rate also rose, by 0.4ppt to 6.0%Y/Y, the highest since 1993. On the EU measure, headline Portuguese inflation rose 0.9ppt to 9.0%Y/Y. And with Slovenia's headline HICP rate jumping 2.1ppt to 10.8%Y/Y, there are significant upside risks to tomorrow's euro area CPI estimates. Assuming that Italian inflation comes in line with expectations (up 0.6ppt to 7.9%YY), we now expect euro area HICP inflation to rise 0.4ppt to 8.5%Y/Y despite the downwards surprise in Germany. We also expect euro area core inflation to edge slightly higher in June, by 0.1ppt to 3.9%, similarly a new record high.

Modest rise in German and French goods consumption in May won't prevent sharp drop in Q2

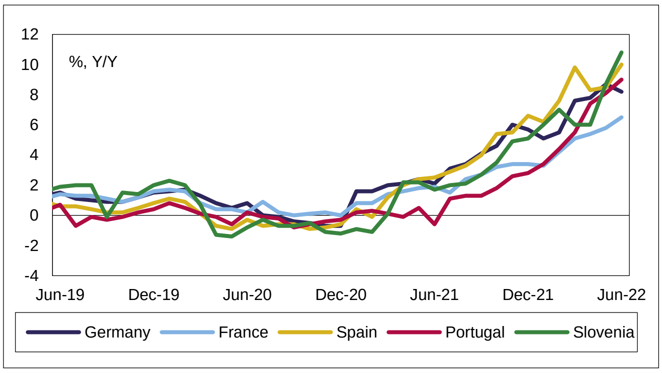
Broadly as expected, German retail sales volumes rose 0.6%M/M in May, a very modest improvement after the drop of 5.4%M/M in April, as high inflation continued to erode purchasing power. In nominal terms, sales rose 2.0%M/M. The modest rebound in May left sales in real terms down 3.6%Y/Y and less than 1.0% above the pre-pandemic level in February 2020. And it meant that the average level of real sales in the first two months of Q2 was almost 4% below the Q1 average, underscoring the inevitability of a marked contraction in spending on goods over the second quarter as a whole. Weakness in May was notable in sales at food stores, where price pressures are particularly intense (inflation in the sector was up above 11%Y/Y last month). Indeed, real food-store sales fell 0.6%M/M while non-food store sales rose 2.9%M/M thanks to stronger sales of clothing and shoes. Likewise, French consumer spending on goods rose 0.7%M/M in May, similarly a

France: CPI inflation*



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

Euro area: HICP inflation in selected member states



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

modest increase following five consecutive declines. The pickup was also driven by a rebound in sales of clothing, which likely benefited from a particularly warm May compared with previous years. And for the same reason, there was a drop in energy consumption. Meanwhile, spending at food stores remained subdued (+0.1%M/M). Overall, French spending on goods was trending almost 1½% below the Q1 average, similarly suggesting a contraction in Q2.

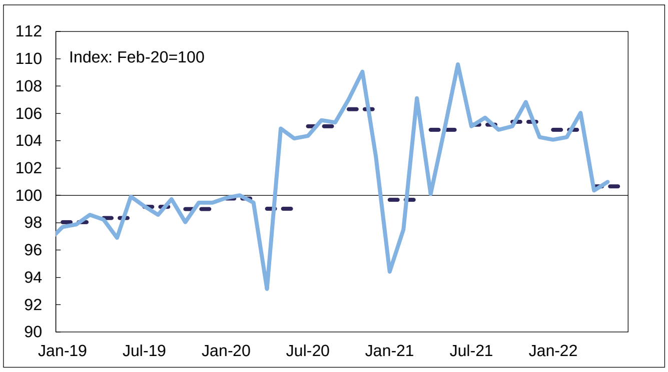
German unemployment picks up as Ukrainian refugees join labour force

At face value, today's German labour market numbers might have appeared concerning. In particular, the number of unemployed people jumped 133k in June, the fourth largest monthly increase since the series began in the early 1990s, to 2.42mn, a seven-month high. As a result, the claimant count rate rose 0.3ppt to 5.3%, similarly the highest since October. Of course, this still remains more than 1ppt below the pandemic peak, with the number of claimants some 259k lower than a year earlier and more than ½mn lower than the high in May 2020. Moreover, the Federal Employment Agency attributed the increase this month principally to the registration of Ukrainian refugees at job centres, rather than a sudden deterioration in labour demand. Certainly, job vacancies remained near last month's record high at 872k. And the Commission's survey suggested that firms' employment intentions remained relatively firm and well above the long-run average in June. Meanwhile, today's jobless figures from the euro area for May were encouraging, maintaining the steady downward trend seen over the past year or so. In particular, the number of jobless workers fell a further 81k last month to 11.00mn, down more than 2mn over the past year. This left the unemployment rate down 0.1ppt to 6.6%, a series low, with Germany's rate (on the ILO measure) similarly declining in May to a new record of 2.8%. While France's unemployment rate was stable (7.2%), there were larger declines in Italy and Spain, by 0.2ppt a piece to 8.1% and 13.1% respectively, admittedly still signaling still significant amounts of spare capacity in Southern Europe's labour market.

The day ahead in the euro area

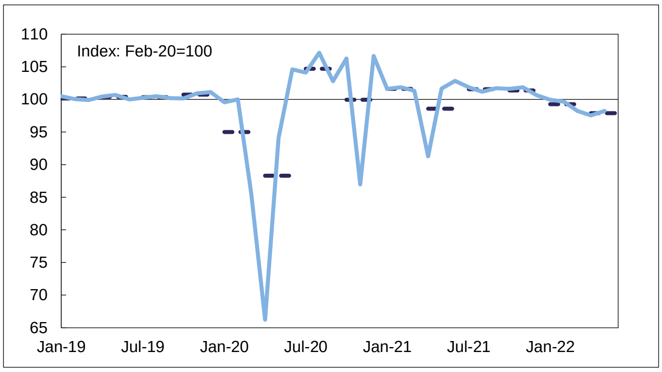
The flow of June inflation data continues tomorrow, most notably with the flash euro area estimates. Despite yesterday's unexpected (but likely just temporary) fall in German inflation, in the absence of a significant surprise to the Italian figures, we forecast headline HICP inflation to rise 0.4ppt to a new series high of 8.5%Y/Y due principally to higher energy and food prices. But while services inflation will have been negatively impacted by Germany's discounted travel pass, we expect core inflation to edge very slightly higher to 3.9%Y/Y, similarly a series high. Separately, tomorrow's final release of the euro area manufacturing PMIs will also likely confirm a decline in the survey's output price PMI to a six-month low. This in part likely reflects firms' response to weakening demand, while the drop of more than 2pts in the manufacturing output PMI to a contractionary 49.3 is also likely to add to evidence that industrial production has shifted into reverse gear for the first time since June 2020. The end of the week will also bring new car registrations figures for June from France, Italy and Spain.

Germany: Retail sales*



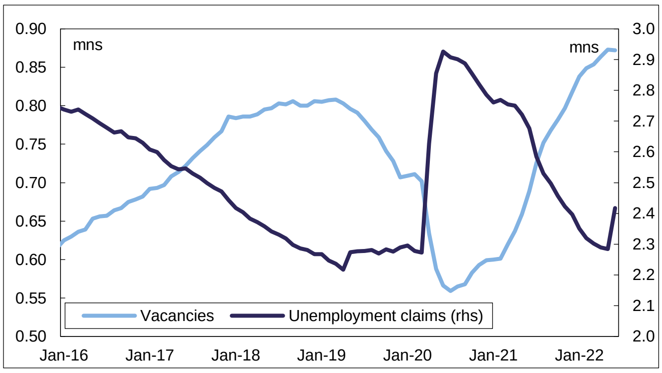
Dashed dark blue lines represent quarterly average. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

France: Consumption of goods*



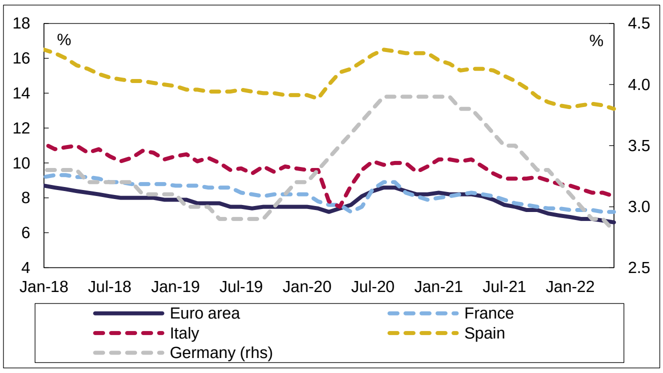
Dashed dark blue lines represent quarterly average. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: Unemployment and vacancies



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Unemployment rates



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK

UK real household disposable income declined for fourth consecutive quarter in Q1

While updated Q1 GDP figures confirmed seemingly solid growth of 0.8%Q/Q and 8.7%Y/Y in the UK's economy at the start of the year, this masked the loss of momentum as the quarter progressed. And while today's release confirmed that private consumption growth was unrevised (0.6%Q/Q), the ONS also noted that real disposable income declined for the fourth consecutive quarter (-0.2%Q/Q), the longest negative run since the series began in 1955, even ahead of the latest leap in inflation, surge in household energy bills and increase in national insurance contributions at the start of Q2. Meanwhile, the drop in business investment was a touch larger than previously thought at 0.6%Q/Q, leaving the level still some 9½% below where it was ahead of the Brexit referendum six years ago.

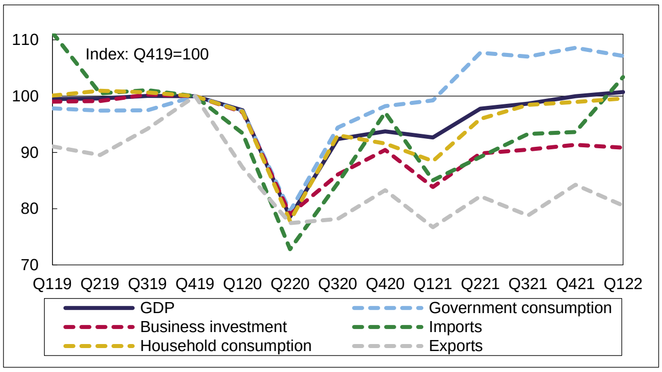
Surveys point to weakening activity towards the end of Q2

Separately, today's ONS business insight survey (BICS) reported that some 15% of respondent firms had reported a decline in domestic demand in May, with roughly one quarter of retailers reporting a drop and one-fifth of firms in accommodation and food services. And the latest Lloyds business barometer aligned with the deterioration seen in other recent UK surveys. In particular, the headline confidence index fell 10pts in June to 28, a fifteen-month low, with firms also moderating their hiring intentions for the coming twelve months slightly too. The declines in confidence were largest in the manufacturing and construction sectors, albeit from an elevated level, while services sentiment also fell sharply to its lowest level for over a year. This was consistent with a slowdown in certain high-frequency indicators at the end of the month, as rail strikes caused a notable drop in retail footfall and restaurant bookings. So, we maintain our view that UK GDP contracted in Q2 amid a weakening in household spending. Furthermore, with consumer confidence at a record low and the BICS indicating that almost one third of all firms (and almost half of firms in the hospitality sector) plan to increase their selling prices in July, the outlook for household spending at the start of Q3 appears extremely weak too.

The day ahead in the UK

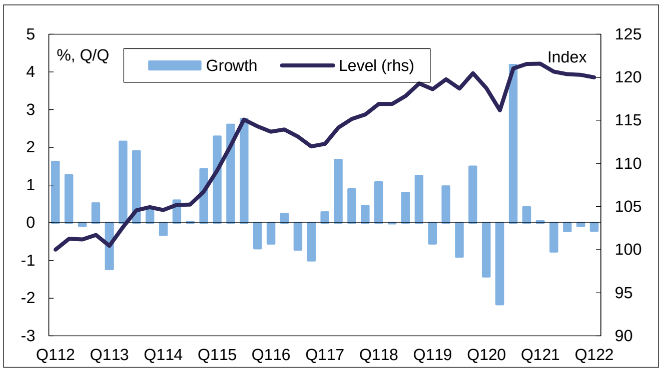
Looking ahead, like in the euro area, tomorrow will bring the final release of the manufacturing PMIs for June, which are expected to confirm the flash data, which reported a drop in the output PMI fell 0.4pt to a fifteen-month low of 51.2, while the new orders PMI fell to a contractionary 49.6, the lowest since January 2021. Friday will also offer an update on bank lending in May, with demand for new consumer credit likely to have remained subdued amid rising interest rates and diminished willingness to spend. Mortgage lending, however, is expected to have remained firm.

UK: GDP levels



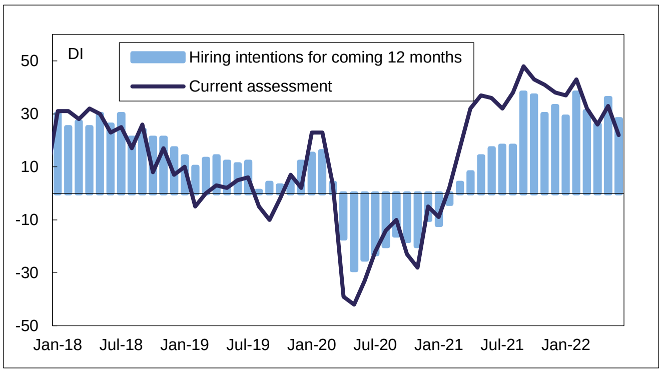
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Real disposable income



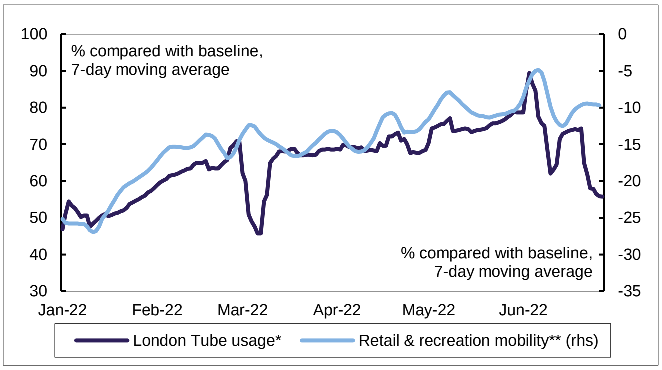
Source: ONS and Daiwa Capital Markets Europe Ltd.

UK: Lloyds business barometer



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Retail visits and London tube usage



**Feb-2019 baseline. ** Baseline is the median value, for the corresponding day of the week, during the five-week period 3 Jan – 6 Feb 2020. Source: Google mobility, Transport for London and Daiwa Capital Markets Europe Ltd.*

European calendar

Today's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area	Unemployment rate %	May	**6.6**	6.8	6.8	**6.7**
Germany	Retail sales M/M% (Y/Y%)	May	**0.6 (0.4)**	1.0 (-1.8)	-5.4 (3.3)	**- (3.3)**
	Unemployment change '000s (rate %)	Jun	**133.0 (5.3)**	-5.0 (5.0)	-4.0 (5.0)	**-5.0 (-)**
France	Preliminary CPI M/M% (Y/Y%)	Jun	**0.7 (5.8)**	0.7 (5.7)	0.7 (5.2)	-
	Preliminary EU-harmonised CPI M/M% (Y/Y%)	Jun	**0.8 (6.5)**	0.9 (6.5)	0.8 (5.8)	-
	PPI M/M% (Y/Y%)	May	**-0.1 (27.3)**	-	0.0 (27.8)	**- (27.9)**
	Consumer spending M/M% (Y/Y%)	May	**0.7 (-3.4)**	0.2 (-3.6)	-0.4 (7.2)	**-0.7 (6.9)**
Italy	Unemployment rate %	May	**8.1**	8.4	8.4	**8.3**
	PPI M/M% (Y/Y%)	May	**0.3 (42.7)**	-	-0.3 (44.1)	-
UK	Lloyds business barometer	Jun	**28**	-	38	-
	Final GDP Q/Q% (Y/Y%)	Q1	**0.8 (8.7)**	*0.8 (8.7)*	1.3 (6.6)	-
	Nationwide house price index M/M% (Y/Y%)	Jun	**0.3 (10.7)**	0.5 (10.8)	0.9 (11.2)	-

Auctions

Country	Auction
Italy	sold €1bn of 2029 floating-rate bonds at an average yield of 0.58%
	sold €4bn of 2.65% 2027 bonds at an average yield of 2.74%
	sold €2bn of 2.5% 2032 bonds at an average yield of 3.47%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Euro area	09.00	Final manufacturing PMI	Jun	*52.0*	54.6
	10.00	Preliminary CPI M/M% (Y/Y%)	Jun	*0.7 (8.5)*	0.8 (8.1)
	10.00	Preliminary core CPI Y/Y%	Jun	*3.9*	3.8
Germany	08.55	Final manufacturing PMI	Jun	*52.0*	54.8
France	08.50	Final manufacturing PMI	Jun	*51.0*	54.6
	-	New car registrations* Y/Y%	Jun	-	-10.1
Italy	08.45	Manufacturing PMI	Jun	50.6	51.9
	10.00	Preliminary CPI M/M% (Y/Y%)	Jun	0.6 (7.4)	0.8 (6.8)
	10.00	Preliminary EU-harmonised CPI M/M% (Y/Y%)	Jun	0.8 (7.9)	0.9 (7.3)
	17.00	New car registrations Y/Y%	Jun	-	-15.1
Spain	08.15	Manufacturing PMI	Jun	52.2	53.8
	-	New car registrations* Y/Y%	Jun	-	-10.9
UK	09.30	Final manufacturing PMI	Jun	*53.4*	54.6
	09.30	Net consumer credit £bn (Y/Y%)	May	1.3 (-)	1.4 (5.7)
	09.30	Net mortgage lending £bn (approvals '000s)	May	4.3 (64.0)	4.1 (66.0)
	09.30	M4 money supply Y/Y%	May	-	4.9

Auctions and events

- Nothing scheduled -

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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