

Euro wrap-up

Overview

- Bunds made sizeable losses even as euro area PPI inflation fell for the first time in two years, Germany reported a goods trade deficit for the first time since 1991, and a survey flagged expectations of recession ahead.
- Gilts also made large losses on a quiet day for noteworthy UK economic news.
- Tuesday brings the final June European services PMIs, German auto production and sales numbers, and French IP data for May.

Chris Scicluna
+44 20 7597 8326

Emily Nicol
+44 20 7597 8331

Daily bond market movements

Bond	Yield	Change
BKO 0.2 06/24	0.594	+0.112
OBL 1.3 10/27	1.027	+0.113
DBR 0 02/32	1.326	+0.100
UKT 1 04/24	1.804	+0.129
UKT 1¼ 07/27	1.856	+0.132
UKT 4¼ 06/32	2.197	+0.113

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

Euro area

Euro area PPI inflation eases for the first time in two years

Today's euro area producer price inflation data were a little softer than expected, but unsurprisingly still suggested significant pressures up the supply chain in May. Perhaps encouragingly, the month-on-month increase in the producer price index of 0.7%M/M was the softest since February 2021, only a little more than half the pace in April and well down on March's record surge (5.3%M/M). And so the headline annual rate moved lower in May for the first time for two years, by 0.9ppt, albeit to a still-lofty 36.3%Y/Y, while the aggregate producer price level appeared to flatten off somewhat. With wholesale prices of many industrial commodities having fallen over recent weeks, that might suggest that price pressures at the factory gate are peaking. However, the decline in May principally reflected the second successive monthly drop in energy prices (a mere 0.2%M/M), which left the annual rate down 4.6ppt to 94.4%Y/Y, still extraordinarily high and accounting for almost three-quarters of total inflation. And, of course, the near-term outlook for energy prices remains clouded by the persisting war in Ukraine and risks that Russia will reduce sharply further its shipments of natural gas to EU risking rationing of supply and extreme new pressures on power prices. Certainly, wholesale forward power prices are increasingly suggestive of a further price shock to come this coming winter.

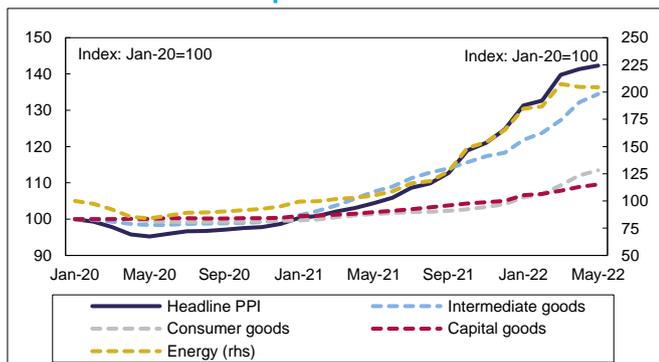
Given lags, producer prices to maintain impulse on consumer prices into the autumn

The pace of price increase of certain items further along the supply chain, however, was also smaller in May than in previous months. In particular, prices of intermediate goods rose 1.7%M/M in May, compared with the record 3.8%M/M in April, to leave the annual rate down very marginally at 25.0%Y/Y. Nevertheless, capital goods price inflation (up 0.3ppt to 7.5%Y/Y) rose to a new series high, not least due to higher inflation of machinery and equipment (up 0.7ppt to 8.8%Y/Y). And producer inflation of consumer goods prices increased 1.0ppt to 11.9%Y/Y, also a record high, with producer food prices increasing more than 16½%Y/Y, of which prices of grains and oils were up around 40%Y/Y. Even if producers continue to absorb a sizable portion of their extra input costs, the lagged effects of recent pressures are still likely to be felt on consumer price inflation over the coming couple of quarters.

Germany's first trade deficit since 1991 reflects price shifts and ongoing export weakness

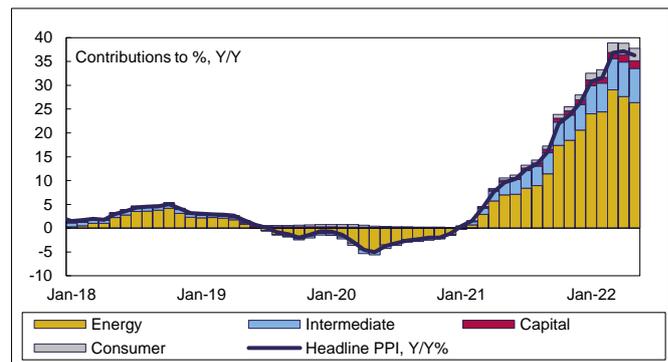
Not least given the ongoing hit to its terms of trade from the shock to prices of energy, commodities and other inputs, Germany's trade balance deteriorated markedly further in May. Indeed, for the first time since 1991, Germany ran a goods trade deficit on a seasonally adjusted basis, with the shortfall of €1.0bn the largest since reunification. The value of exports dropped 0.5%M/M in May but was still up 2.7%3M/3M. However, on the same basis, imports rose 2.7%M/M to be up a

Euro area: Producer price index levels



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Contributions to PPI inflation



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

whopping 9.4%3M/3M. By destination, exports to other EU countries fell 2.8%M/M, but shipments to the US (Germany's number one market) rose 5.7%M/M and those to China rose 0.5%M/M. Imports from the rest of the EU rose 2.5%M/M and those from the US rose almost 10%M/M, while those from China (Germany's number one source of imports) fell 1.6%M/M. Imports from Russia fell almost 10%M/M. With the annual pace of increase in German import prices in May (30.6%Y/Y) almost twice the rate of export prices (15.9%Y/Y), Germany's trade balance was always bound to deteriorate. However, adjusting for shifts in relative prices, ongoing weakness in export volumes, in part related to supply constraints, has also played a role. Indeed, export volumes fell 1.0%M/M in May to be more than 5½% below the pre-pandemic level in February 2020. In contrast, import volumes rose 1.8%M/M to be close to the pre-pandemic level. And that meant that the average level of exports in the first two months of Q2 was just 0.1% above the Q1 average, but imports were up 2.8% on the same basis. So, there is a strong likelihood that net trade subtracted from German economic growth in Q2, and adding to the risks that German GDP contracted last quarter.

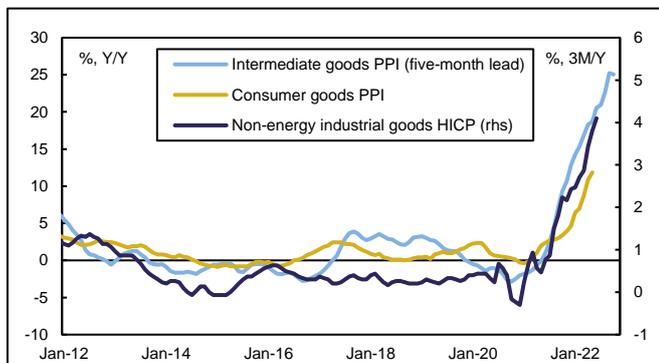
Sentix survey flags investor expectations of recession ahead

As might have been expected given last week's marked rally in government bonds, the latest Sentix investor survey, which was conducted from 30 June to 2 July, suggested a marked deterioration in expectations for the economic outlook over the coming six months. Indeed, the euro area expectations index signalled widespread expectations of recession, dropping more than 10pts to -35.8, a level that has only been lower between October and December 2008 shortly after the collapse of Lehman Brothers. Likewise, the German measure also fell more than 10pts to a series low of -34.8 as survey respondents worried about risks of energy rationing as Russia cuts shipments of natural gas. The survey balances for current conditions fell too, with the respective euro area index down more than 9pts to a sixteen-month low of -16.5, consistent with a weakening in investor perceptions of economic activity at the start of Q3.

The day ahead in the euro area

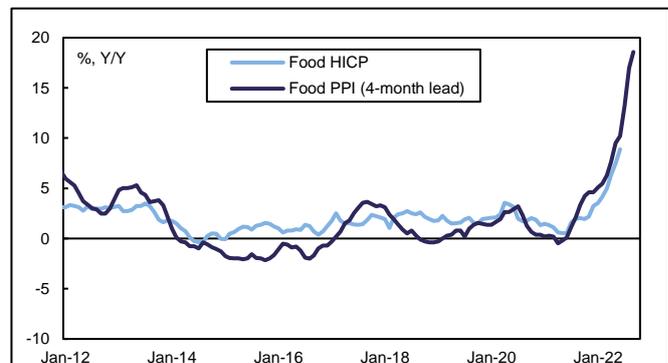
Tuesday will bring the final euro area services and composite PMIs for June. The flash survey reported a marked decline in the headline activity index, by 3.3pts to 52.8, with firms reporting a marked slowdown in new business too, with the relevant index down to 51.9, similarly a fourteen-month low. The flash German and French activity PMIs also fell sharply, to 52.4 and 54.4, while tomorrow's surveys will also provide an update on services activity Italy and Spain. With respect to the manufacturing sector, Tuesday will bring the first of this week's national industrial production figures from France, which are expected to report little to no growth in the sector despite three consecutive monthly declines previously. Meanwhile, Germany's auto association (VDA) is set to publish its latest car production and sales numbers for June.

Euro area: PPI and CPI inflation



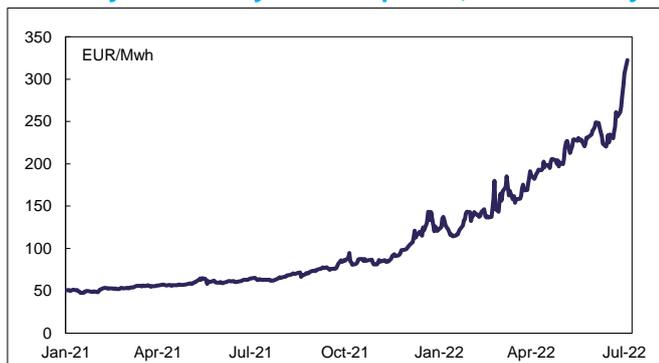
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Producer and consumer food inflation



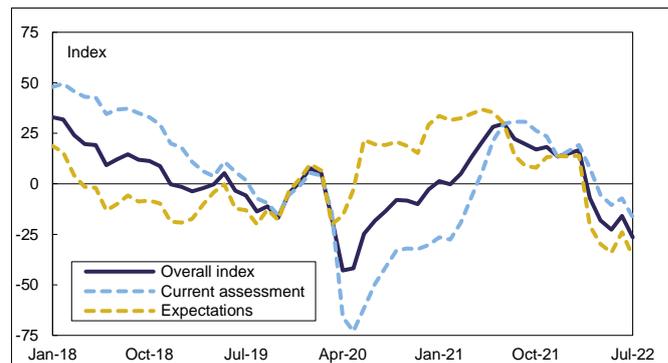
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: Electricity forward prices, 2023 delivery



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Euro area: Sentix investor sentiment indices



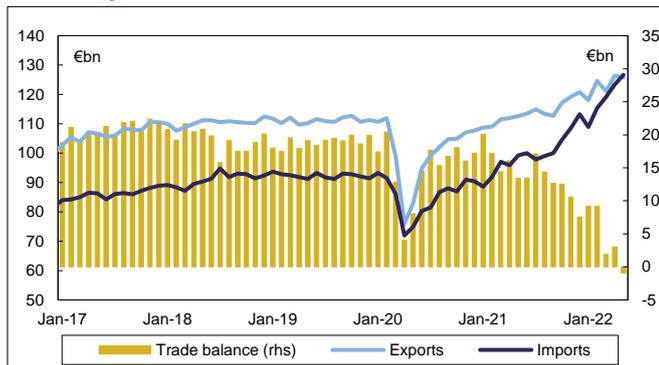
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK

The day ahead in the UK

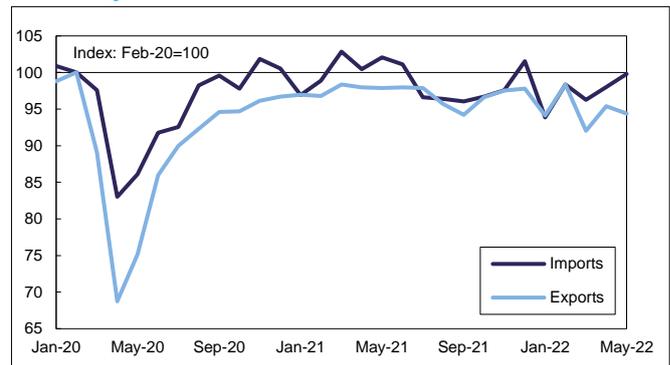
After a quiet start to the week for top-tier UK economic releases, tomorrow brings the final services PMIs. The flash services activity index moved sideways in June at 53.4, nevertheless still the softest reading since February 2021. And, following the steep declines in the previous two months, it left the index well below the quarterly average in Q1 (59.1). Given the downwards revision to the manufacturing output PMI, the composite PMI is likely to have fallen to its lowest reading for two years, down from the flash reading of 53.1, further supporting our forecast that GDP contracted in Q2. New car registrations numbers for June are also due tomorrow. Separately, the BoE will publish its Financial Stability Report, while external MPC member Silvana Tenreyro will speak on a panel discussing monetary and fiscal policy interactions.

Germany: Goods trade balance*



*Seasonally adjusted values. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: Goods trade volumes*



*Seasonally adjusted. Source: 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	 Sentix investor confidence	Jul	-26.4	-20.0	-15.8	-
	 PPI M/M% (Y/Y%)	May	0.7 (36.3)	0.9 (36.6)	1.2 (37.2)	-
Germany	 Trade balance €bn	May	-1.0	1.6	3.5	3.1

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	Final services (composite) PMI	Jun	52.8 (51.9)	56.1 (54.8)
Germany	 08.55	Final services (composite) PMI	Jun	52.4 (51.3)	55.0 (53.7)
	 -	New car registrations (production)* Y/Y%	Jun	-	-10.2 (24.7)
France	 07.45	Industrial production M/M% (Y/Y%)	May	0.0 (0.3)	-0.1 (-0.3)
	 07.45	Manufacturing production M/M% (Y/Y%)	May	0.3 (1.7)	-0.4 (0.8)
	 08.50	Final services (composite) PMI	Jun	54.4 (52.8)	58.3 (57.0)
Italy	 08.45	Services (composite) PMI	Jun	51.5 (50.7)	53.7 (52.4)
Spain	 08.45	Services (composite) PMI	Jun	53.5 (53.6)	56.5 (55.7)
UK	 09.30	Final services (composite) PMI	Jun	53.4 (53.1)	53.4 (53.1)
	 09.00	New car registrations Y/Y%	Jun	-	-20.6

Auctions and events

Germany	 10.30	Auction: €500mn of 0.1% 2033 index-linked bonds
UK	 10.00	Auction: £2bn of 1.25% 2051 bonds
	 10.30	BoE publishes Financial Stability Report
	 17.30	BoE's Tenreyro scheduled to speak at global banking conference

*Approximate date of release. Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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