

# Euro wrap-up

## Overview

- Bunds made significant losses as German industrial production rose for a second successive month thanks to stronger autos output, and the account of the ECB's first June policy meeting made clear that a desire for gradual normalisation should not be interpreted as slow rate hikes in small steps.
- While a BoE survey signalled a further rise in business inflation expectations, Gilts made modest losses as Johnson at last announced his willingness to step down as Prime Minister.
- Friday will bring May data for French goods trade and Italian IP.

**Chris Scicluna**  
+44 20 7597 8326

**Emily Nicol**  
+44 20 7597 8331

### Daily bond market movements

Bond	Yield	Change
BKO 0.2 06/24	0.498	+0.137
OBL 1.3 10/27	0.942	+0.134
DBR 0 02/32	1.289	+0.089
UKT 1 04/24	1.785	+0.068
UKT 1½ 07/27	1.782	+0.050
UKT 4¼ 06/32	2.111	+0.023

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

## Euro area

### German industrial production up in May, but on course for drop in Q2

Germany's industrial production data for May came in a touch softer than expected, although growth of 0.2%M/M at least represented the second successive monthly increase. Nevertheless, it left production about 5% below the pre-pandemic level. Moreover, given the steep drop in March, the average level of IP in the first two months of Q2 was still about 1.3% below the Q1 average. Given the deterioration in survey indicators such as the manufacturing output PMI (down more than 2pts back below 50) and high-frequency data such as the truck-toll mileage index, production seems likely to have fallen back once more in June. And so, the industrial sector appears highly likely to have subtracted from GDP growth last quarter. Within the detail, manufacturing output grew 0.6%M/M to be trending more than 1½% below the Q1 average. Boosted by a second successive month of firm growth in motor vehicle output (up 5.9%M/M), production of capital goods rose 2.2%M/M. But production of consumer (-0.9%M/M) and intermediate (-0.4%M/M) items fell back. And each of these main categories looked on track for a quarterly drop in Q2. Beyond the factory sector, construction output rose 0.4%M/M, but was trending about 2.0% below the Q1 average. In marked contrast, after a surge in wind-generated power in April, energy output fell a steep 5.8%M/M in May, but was still trending 1.0% above the Q1 average.

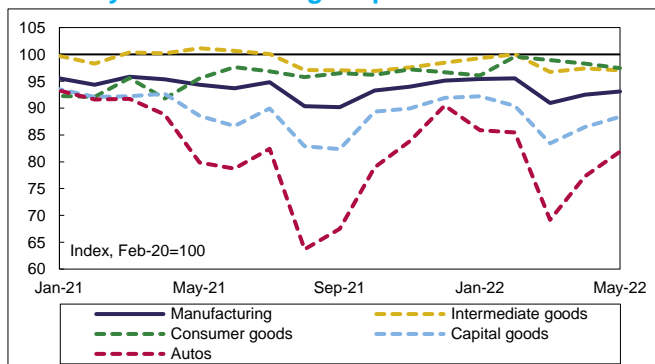
### Production revised up to better reflect growth in electric vehicle output

Encouragingly, today's data revised up significantly the level of production since the start of 2021 in order to reflect more accurately the strong growth in output of electric vehicles. As a result, the level of motor vehicle production was estimated to be some 15% higher than previously thought in April. And so, the level of manufacturing production in April was some 2.3% higher than previously estimated. Nevertheless, despite positive growth in the subsector in both April and May, the average level of autos output in the first two months of Q2 was still trending about 0.8% below the Q1 level, as supply challenges continued to restrain activity.

### Irish production surges in May, but euro area output likely to be much more subdued

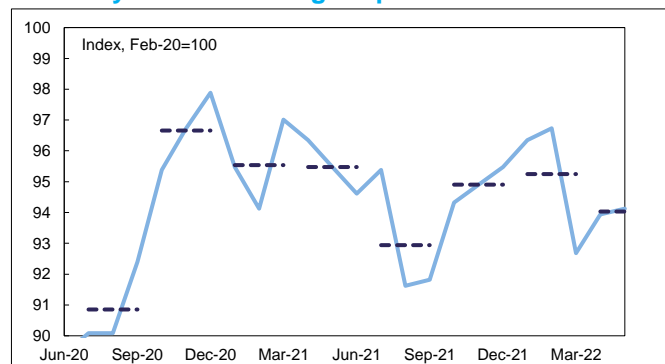
As is often the case, there was a more substantial move in Irish industrial production in May. Following a slump of more than 9½%M/M in April, production surged 13.9%M/M in May, the most since November. And manufacturing production rose a stronger 18.4%M/M, taking the level of output to the highest since last August. Nevertheless, despite the jump in May, manufacturing production was still trending some 4% below the Q1 average, having risen by 12.8%Q/Q that quarter, with total IP down an equivalent 2.4%. Of course, the Irish data are notoriously volatile. Moreover, the trend elsewhere among euro area member states has aligned more with the subdued downturn in Germany. Indeed, based on the figures published so

### Germany: Manufacturing output



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

### Germany: Manufacturing output\*



\*Dashed dark blue line represents quarterly averages. Source: Refinitiv, and Daiwa Capital Markets Europe Ltd.

far – including no growth in France and a slight decline in Spain – aggregate euro area industrial production is likely to have risen just ½%M/M in May, close to the 0.4%M/M increase in April, and therefore suggesting that the sector was on track to provide a modest drag on GDP growth in Q2.

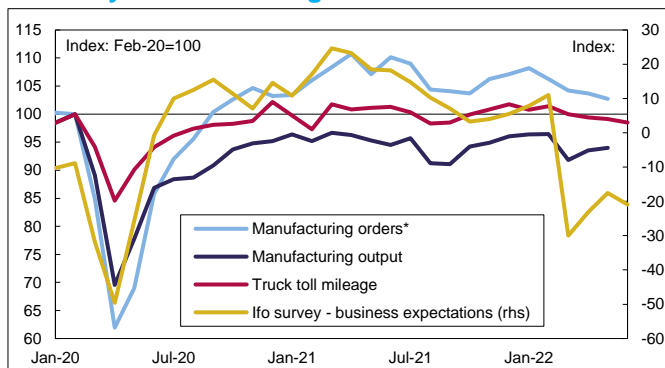
### ECB account reconciles pledge for gradual normalisation with case for hikes of more than 25bps

The account of the ECB's 8-9 June policy meeting, also released today, offered little new in the way of guidance with respect to the future path of interest rates. Instead, it merely provided some more colour on the discussion with respect to the expected profile of rate hikes this quarter. In particular, Governing Council members attempted to reconcile their (arguably inconsistent) commitment to a “gradual” approach to monetary policy normalisation with the strong economic case for returning rates relatively quickly back to (admittedly unobservable) more neutral levels and concerns about the hit to credibility from current high inflation and repeated forecasting errors. Indeed, the account noted agreement that gradualism “did not rule out interest rate steps in increments larger than 25 basis points if and when needed”. With the preconditions for a rate hike having already been met last month, but the need to end net asset purchases first having precluded lift-off before July, “a number of members” wanted to keep the door open to a rate hike of more than 25bps in July, although “most members” judged the smaller magnitude to be a “proportionate first step”. However, to signal the Governing Council's intention to move the deposit facility rate into positive territory, all agreed that rates should rise by more than 25bps in September unless the ECB's updated projections then suggested an improvement in the medium-term inflation outlook.

### Continued lack of clarity on ECB intentions for policy beyond September

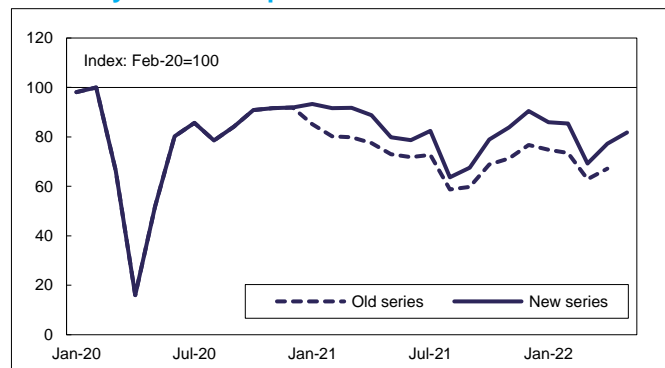
Looking further ahead, the Governing Council “widely agreed” that a gradual but sustained path of further interest rate increases would be appropriate. And it was noted that “it might be helpful for the ECB to communicate at some point on the rate path beyond September to avoid markets overshooting”. But it was also suggested that any acceleration of the monetary policy normalisation process would be conditional on market conditions remaining orderly. That was the only hint in the account that the Governing Council might subsequently agree, at the ad hoc meeting on 15 June, on the need to develop an anti-fragmentation tool. Reports today suggested that the working name for the new tool is currently the Transmission Protection Mechanism. But all of the key detail of the new Mechanism – including how to offset its impact on the money supply, triggers for its activation, and conditions attached for countries to benefit from access – will need to be determined at (probably highly contentious) negotiations at the Governing Council's next meeting on 20-21 July.

#### Germany: Manufacturing indicators



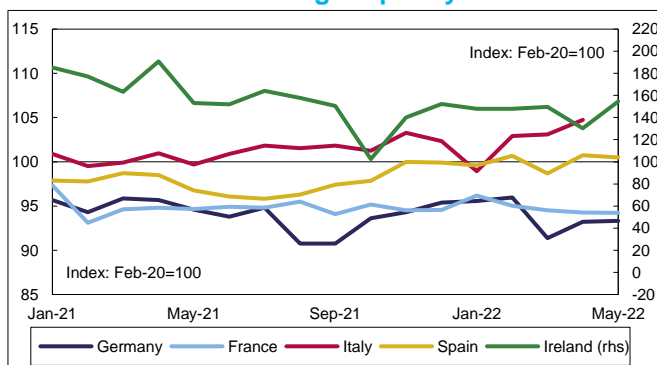
\*Excluding large orders. Source: Refinitiv, Bloomberg, ifo institute and Daiwa Capital Markets Europe Ltd.

#### Germany: Autos output



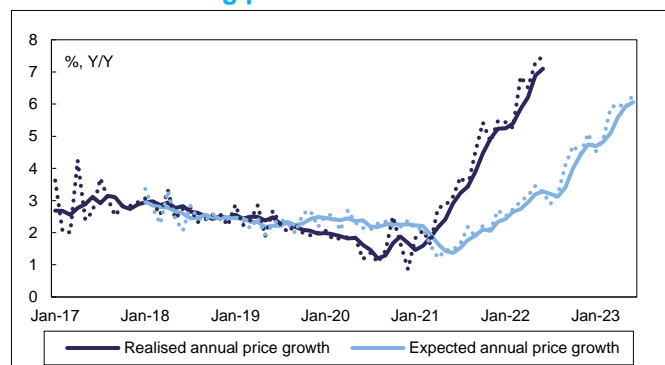
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

#### Euro area: Manufacturing output by member state



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

#### UK: Firms' selling prices



Source: BoE DMP Survey and Daiwa Capital Markets Europe Ltd.

## The week ahead in the euro area

This week will end relatively quietly for euro area top-tier releases, with Italian IP and French trade numbers for May due. And there are only a handful of noteworthy releases due in the coming week. The aforementioned euro area industrial production figures for May will come on Wednesday, which we expect to report growth close to ½%M/M. That day will also see the final release of German, French and Spanish inflation data for June, followed by the Italian numbers on Friday. Due to temporary policy measures, the preliminary estimate of German HICP inflation rate fell back a bigger-than-expected 0.5ppt to 8.2%Y/Y. But this contrasted with the upwards shifts in the other major member states, with the French HICP rate up 0.7ppt to 6.5%Y/Y, Italian inflation up 1.2ppts to 8.5%Y/Y, and Spanish inflation jumping 1.5ppts to 10.0%Y/Y. At the end of the week, euro area goods trade data for May are expected to mirror the notable deterioration in the trade balance recorded in [Germany](#) that month, while euro area new car registrations for June are also due on Friday. At the start of the week, Monday sees the release of Italian retail sales figures for May, followed by the latest German ZEW investor sentiment survey for July and Bank of France economic update in June on Tuesday.

## UK

### Johnson announces intention to quit, but timetable for departure still unclear

With dozens of his party's MPs having resigned from ministerial and other government positions, Boris Johnson finally succumbed to the inevitable and today announced his intention to quit as Prime Minister once a new Conservative leader has been appointed. But there remains plenty of uncertainty, with the 1922 Committee of backbench MPs set only next week to determine the timetable and precise process – which will involve first Tory MPs and then the party's rank-and-file membership – for appointing Johnson's replacement. While Johnson today signalled his preference today for a drawn out process that would allow him to remain in office until October, many of his MPs (as well as the opposition parties) will try to prevent that from happening. There also remains no less uncertainty regarding the identity of his likely successor, with bookies' odds oscillating significantly today but suggesting relatively little difference in the chances of ex-Chancellors Rishi Sunak and Sajid Javid, junior minister Penny Mordaunt and Defence Secretary Ben Wallace. On balance, we currently see Wallace as most likely, if only because – unlike the others – he has so far avoided high-profile faux pas and scandals, and his relatively low profile could encourage his party's electorate to believe he shares their own (rather disparate) views. While his supposed belief in small government might go down well with most Conservatives, his previous advocacy of the case for remaining in the EU ahead of the 2016 Brexit referendum could yet, however, play against him.

### BoE survey suggests inflation will average 4% in three years' time










After BoE Chief Economist Pill indicated that the Bank's Decision Makers Panel (DMP) should be watched closely for key insights into inflation expectations ahead of the MPC's next policy-setting meeting in August, today's survey results reinforced our view that the next hike in Bank Rate will be of a magnitude of 50bps. Against the backdrop of significantly higher input costs, respondents suggested that average prices charged had risen 7.5%Y/Y in June, up 0.2ppt from May. This echoed findings from the ONS' latest business insights survey, which showed that more than 50% of firms had experienced increased input prices over the past month, with roughly one fifth having increased selling prices. And according to the DMP survey, firms expected average output price growth over the coming year to be 6.3%Y/Y, an increase of 0.4ppt since May. Moreover, firms' expectations for CPI inflation one year ahead had risen further too, by 0.5ppt to 7.4%, with their expectations for inflation over the medium-term (3 years ahead) up 0.2ppt to 4%, twice the Bank's inflation target and suggesting that additional (potentially sizeable) monetary tightening might be required over coming quarters to re-anchor expectations. Indeed, having voted at the June MPC meeting to hike Bank Rate by 50bps, external Committee member Catherine Mann today reiterated her preference to front-load hikes if the inflation outlook remains uncertain.

## The week ahead in the UK

While focus in the UK in the coming week will remain on politics – in particular the precise details of the Conservative party's process for determining the identity of Boris Johnson's successor as party leader and Prime Minister – there are some notable economic data releases too, including the estimates of monthly GDP, production, services and trade data for May, which are all due on Wednesday. Having failed to grow in the previous three months, GDP is likely to have remained subdued as household budgets continue to be squeezed by higher prices. Certainly, [retail sales](#) were particularly weak in May, although services activity might well have received a boost from increased tourism. But manufacturing and trade might well remain hampered by ongoing supply challenges. Ahead of the monthly GDP report, Tuesday brings the release of the BRC retail sales monitor for June, which will provide an indication of the impact on spending from the extended bank holiday at the start of the month. Other releases include the RICS residential survey for June and BoE credit conditions survey for Q2 on Thursday. Separately, BoE Governor Bailey is scheduled to speak publicly on Tuesday.











*In the absence of significant developments, the next edition of the Euro wrap-up will be published on 12 July 2022*

## Daiwa economic forecasts






	2022				2023		2022	2023	2024
	Q1	Q2	Q3	Q4	Q1	Q2			
<b>GDP</b>	%, Q/Q						%, Y/Y		
Euro area 	0.6	0.1	0.3	0.2	0.1	0.2	2.8	0.6	1.1
UK 	0.8	-0.3	0.3	-0.3	0.0	-0.1	3.4	-0.2	0.9
<b>Inflation, %, Y/Y</b>									
Euro area									
Headline HICP 	6.1	8.0	8.5	7.9	6.2	4.4	7.7	4.2	1.9
Core HICP 	2.7	3.7	4.0	4.2	4.1	3.9	3.6	3.6	2.1
UK									
Headline CPI 	6.2	9.1	9.9	10.3	9.6	6.5	8.9	6.3	2.4
Core CPI 	5.1	6.0	6.5	6.4	5.9	5.1	6.0	4.9	2.5
<b>Monetary policy, %</b>									
ECB									
Refi Rate 	0.00	0.00	0.75	1.25	1.50	1.75	1.25	1.75	1.75
Deposit Rate 	-0.50	-0.50	0.25	0.75	1.00	1.25	0.75	1.50	1.50
BoE									
Bank Rate 	0.75	1.25	2.00	2.50	2.50	2.50	2.50	2.50	2.00

Source: Bloomberg, ECB, BoE and Daiwa Capital Markets Europe Ltd.

## European calendar

Today's results							
Economic data							
Country	Release	Period	Actual	Market consensus/ Daiwa forecast	Previous	Revised	
Germany 	Industrial production M/M% (Y/Y%)	May	<b>0.2 (-1.5)</b>	0.4 (-1.8)	0.7 (-2.2)	<b>1.3 (-2.5)</b>	
UK 	Final output per hour Y/Y%	Q1	<b>-0.8</b>	-0.8	0.7	-	
Auctions							
Country	Auction						
France 	sold €5.62bn of 2% 2032 bonds at an average yield of 1.92%						
	sold €2.23bn of 0.5% 2044 bonds at an average yield of 2.38%						
	sold €1.46bn of 2% 2048 bonds at an average yield of 2.44%						
	sold €2.69bn of 0.75% 2053 bonds at an average yield of 2.52%						
Spain 	sold €1.17bn of 5.9% 2026 bonds at an average yield of 1.299%						
	sold €2.26bn of 2.55% 2032 bonds at an average yield of 2.454%						
	sold €1.29bn of 1.9% 2052 bonds at an average yield of 3.192%						
	sold €470mn of 1% 2030 index-linked bonds at an average yield of 0.002%						













Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases							
Economic data							
Country	BST	Release	Period	Market consensus/ Daiwa forecast	Previous		
France 	07.45	Trade balance €bn	May	-12.5	-12.2		
Italy 	09.00	Industrial production M/M% (Y/Y%)	May	-1.3 (4.0)	1.6 (4.2)		
Auctions and events							
Euro area 	12.55	ECB President Lagarde scheduled to speak at a conference in France					
	17.45	ECB's Villeroy scheduled to speak at a conference in France					
UK 	00.01	KPMG/REC report on UK jobs					

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.








## The coming week's data calendar

### The coming week's key data releases

Country	BST	Release	Period	Market consensus/ <i>Daiwa</i> forecast/actual	Previous
<b>Monday 11 July 2022</b>					
Italy 	09.00	Retail sales M/M% (Y/Y%)	May	-	0.0 (8.4)
<b>Tuesday 12 July 2022</b>					
Germany 	10.00	ZEW current situation (expectations)	Jul	-	-27.6 (-28.0)
France 	-	Bank of France business trends survey, production outlook*	Jun	2	13
UK 	00.01	BRC retail sales like-for-like Y/Y%	Jun	-	-1.5
<b>Wednesday 13 July 2022</b>					
Euro area 	10.00	Industrial production M/M% (Y/Y%)	May	0.5 (-0.5)	0.4 (-2.0)
Germany 	07.00	Final CPI M/M% (Y/Y%)	Jun	<u>0.1 (7.6)</u>	0.9 (7.9)
	07.00	Final EU-harmonised CPI M/M% (Y/Y%)	Jun	<u>-0.1 (8.2)</u>	1.1 (8.7)
France 	07.45	Final CPI M/M% (Y/Y%)	Jun	<u>0.7 (5.8)</u>	0.7 (5.2)
	07.45	Final EU-harmonised CPI M/M% (Y/Y%)	Jun	<u>0.8 (6.5)</u>	0.8 (5.8)
Spain 	08.00	Final CPI M/M% (Y/Y%)	Jun	<u>1.8 (10.2)</u>	0.8 (8.7)
	08.00	Final EU-harmonised CPI M/M% (Y/Y%)	Jun	<u>1.8 (10.0)</u>	0.7 (8.5)
UK 	07.00	GDP M/M% (3M/3M%)	May	-	-0.3 (0.2)
	07.00	Industrial production M/M% (Y/Y%)	May	-	-0.6 (0.7)
	07.00	Manufacturing production M/M% (Y/Y%)	May	-	-1.0 (0.5)
	07.00	Index of services M/M% (3M/3M%)	May	-	-0.3 (0.0)
	07.00	Construction output M/M% (Y/Y%)	May	-	-0.4 (3.9)
	07.00	Goods trade balance £bn	May	-	-20.9
<b>Thursday 14 July 2022</b>					
UK 	00.01	RICS house price balance %	Jun	-	73
<b>Friday 15 July 2022</b>					
Euro area 	07.00	EU27 new car registrations Y/Y%	Jun	-	-11.2
	10.00	Trade balance €bn	May	-	-31.7
Italy 	09.00	Final CPI M/M% (Y/Y%)	Jun	<u>1.2 (8.0)</u>	0.8 (6.8)
	09.00	Final EU-harmonised CPI M/M% (Y/Y%)	Jun	<u>1.2 (8.5)</u>	0.9 (7.3)

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

### The coming week's key events & auctions

Country	BST	Event / Auction
<b>Monday 11 July 2022</b>		
- Nothing scheduled -		
<b>Tuesday 12 July 2022</b>		
Euro area 	11.15	ECB's Villeroy scheduled to speak
Germany 	10.30	Auction: €5.5bn of 0.2% 2024 bonds
UK 	10.00	Auction: £2.75bn of 1% 2032 bonds
	18.00	BoE Governor Bailey scheduled to speak
<b>Wednesday 13 July 2022</b>		
Germany 	10.30	Auction: €1.5bn of 0% 2052 bonds
Italy 	10.00	Auction: 3Y & 7Y bonds
<b>Thursday 14 July 2022</b>		
UK 	09.30	BoE publishes Credit Conditions Survey Q222
	09.30	BoE publishes Bank Liabilities Survey Q222
<b>Friday 15 July 2022</b>		
Euro area 	11.00	ECB's Rehn scheduled to speak

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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