Daiwa Capital Markets

# Euro wrap-up

## Overview

- Bunds made losses as German inflation resumed an upwards trend, but the Commission survey measures of price expectations fell back as headline sentiment in the euro area dropped to the lowest level since February 2021.
- Gilts made sizeable losses while UK bank lending figures suggested that demand for consumer credit rose despite a further rise in interest rates.
- Wednesday brings flash euro area inflation and German labour market data for August. The UK ONS is due to announce its statistical treatment of government support to reduce household energy bills, with implications for the outlook for inflation and index-linked Gilts.

**Chris Scicluna** +44 20 7597 8326
**Emily Nicol** +44 20 7597 8331

**Daily bond market movements**

| Bond | Yield | Change |
|---|---|---|
| BKO 0.4 09/24 | 1.117 | +0.053 |
| OBL 1.3 10/27 | 1.319 | +0.026 |
| DBR 1.7 08/32 | 1.503 | +0.006 |
| UKT 1 04/24 | 2.919 | +0.094 |
| UKT 1¼ 07/27 | 2.671 | +0.105 |
| UKT 4¼ 06/32 | 2.707 | +0.105 |

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

# Euro area

### German inflation resumes upwards trend and set to rise notably further over coming months

Ahead of the euro area's flash inflation estimate tomorrow, today's German figures broadly aligned with expectations, with the EU-harmonised HICP inflation rate rising for the second successive month in August, by 0.3ppt to a new series high of 8.8%Y/Y. The national CPI measure of inflation also resumed an upwards trend, similarly increasing 0.3ppt to 7.9%Y/Y, matching the post-reunification peak reached in May ahead of the implementation of the government's temporary energy-related support initiatives. Indeed, despite the further decline in petrol prices over the past month (4½%M/M) taking the cumulative drop since May to more than 16%, energy inflation on the national measure edged only very slightly lower, by 0.1ppt to a still-lofty 35.6%Y/Y. And this was more than offset by another jump in food prices (1.3%M/M), which were therefore up a record 16.6%Y/Y. There were signs of a further broadening in price pressures among other goods too, with a notable uptrend in our estimate of non-energy industrial goods inflation, by 1.2ppts to 8.9%Y/Y. And despite the ongoing negative influence of the discounted travel pass, services inflation also ticked higher, by 0.2ppt to 2.2%Y/Y, admittedly still some 0.7ppt lower than the level in May before the introduction of the travel pass. Overall, today's numbers suggest that German core CPI inflation rose 0.4ppt to 3.8%Y/Y, in line with the recent high in April and May. And when the temporary support initiatives come to an end this month, headline and core inflation seem bound to jump in September, and rise further still when the new gas levy is likely to be introduced from October.

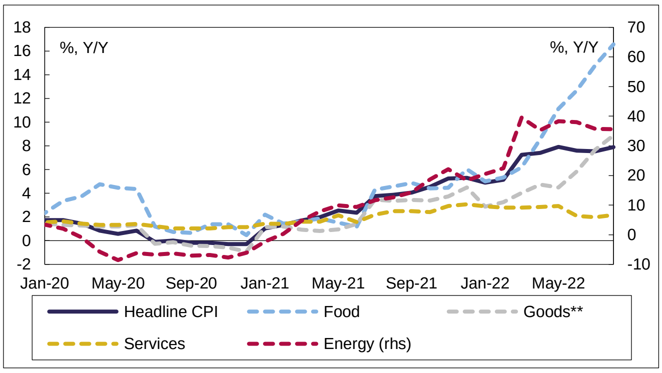
### Spanish headline inflation falls, but core inflation continues to rise

Contrasting Germany, but in line with expectations, Spain's headline inflation eased slightly in August, by 0.4ppt to 10.3%Y/Y on the HICP measure and 10.4%Y/Y on the national CPI measure. Spain's statistical office attributed the drop principally to declining fuel prices, although this was countered to some extent by higher prices of electricity, food, restaurants and holiday packages. Indeed, when excluding food and energy, core inflation rose for the fourteenth consecutive month, by 0.3ppt to 6.4%Y/Y, the highest since the start of 1993. Flash inflation figures from Belgium also suggested an intensification of price pressures in August, with the headline inflation rate up 0.3ppt to 9.9%Y/Y, the highest since March 1976. And while energy inflation is close to 50%Y/Y, Belgian core inflation also trended higher, by 0.2ppt to 5.7%Y/Y.

### Consumer and business inflation expectations moderate to multi-month lows

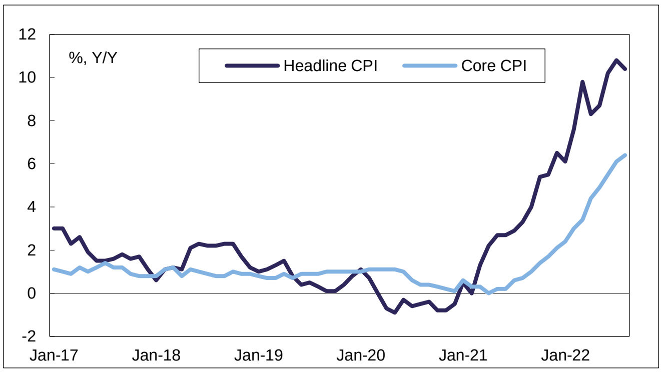
While euro area inflation looks to have risen again in August, and is likely to increase further over the near term, today's Commission survey results suggested that risks of significant second-round effects via expectations are diminishing somewhat. Indeed, the survey's index of consumer price expectations for the coming twelve months dropped in August for

**Germany: Consumer price inflation***




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

**Spain: Consumer price inflation***




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

the fourth month in the past five to the lowest level since December. Notably perhaps, at 36.8, the price expectations index was closer to the long-run average (23.0) than it was to March's peak (62.8). Moreover, firms' price expectations also moderated further, falling to multi-month lows in every major sector. Indeed, price expectations fell to the lowest level since March in services, February in retail and construction, and October in industry, likely reflecting some easing of supply challenges as well as expectations of softer demand and a reduced capacity to pass on increased costs to customers.

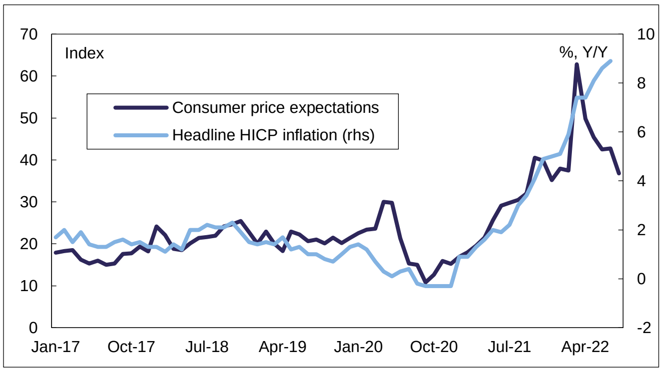
## Economic sentiment deteriorates again despite further evidence of easing supply challenges

The moderation in inflation expectations tallied with the further deterioration in confidence reported by the Commission survey, with the headline euro area Economic Sentiment Index (ESI) dropping for the fifth month in the past six to the lowest level since the lockdowns in February 2021 and almost 2½ppts below the long-run average. Confidence deteriorated in each of the three largest member states but ticked a little higher in Spain, albeit remaining below the respective long-run average. Consistent with last week's flash PMIs, the deterioration was led by industry and services. Optimism in the former sector declined to an 18-month low as new orders fell sharply and firms reported ample inventories. And confidence in the latter dropped to a 15-month low as the pent-up demand that supported growth earlier in the summer appeared to fade. Sentiment in retail and construction stabilised, but at least in part only as shops suggested that stocks of goods were less hard to come by and builders reported an easing of shortages of materials and/or equipment for a fourth successive month. Meanwhile, with firms' employment expectations stabilising above the long-run average, the slight improvement in consumer confidence reported in the preliminary estimate was confirmed as households' fear of unemployment diminished slightly. Consumers' willingness to make major purchases also ticked higher, albeit remaining the second-weakest since the lockdowns of the first wave of Covid-19.

## The day ahead in the euro area

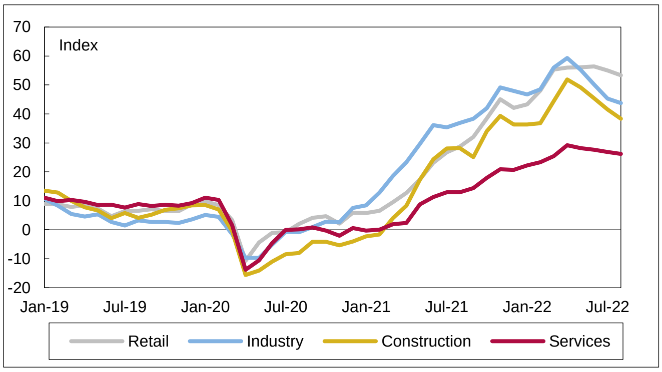
The flow of flash inflation estimates continues tomorrow with the aggregate euro area figures to be accompanied by data from various member states, including France, Italy and Portugal. Despite expectations of a modest easing in France and Italy, following today's stronger German outturn we now expect the euro area headline HICP rate to edge slightly higher in August to above 9.0%Y/Y for the first time, from July's reading of 8.9%Y/Y. We expect the core HICP measure also to rise to a new high above 4.0%Y/Y as price pressures continue to broaden. Meanwhile, German labour market data are expected to reveal a further increase in the claimant count in August, to leave the unemployment claims rate up 0.1ppt to 5.5%, the highest in a year. The increase, however, principally reflects the registration of Ukrainian refugees into the labour force. Updated Q2 GDP figures are due to be published from several member states, including France, Belgium and Portugal, while French consumer spending numbers for July will provide a further insight into spending activity at the start of Q3.

### Euro area: Consumer price inflation & expectations



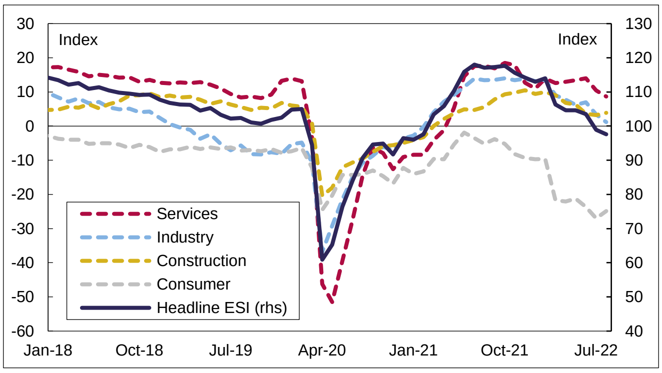

*Source: EC, Refinitiv and Daiwa Capital Markets Europe Ltd.*

### Euro area: Business price expectations



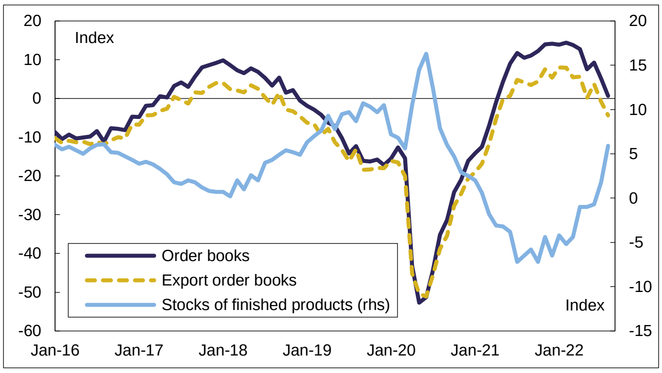

*Source: EC, Refinitiv and Daiwa Capital Markets Europe Ltd.*

### Euro area: Economic sentiment




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

### Euro area: Factory orders & inventories




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

# UK

## UK lending continues to rise despite higher interest rates

With UK households facing sharp declines in real incomes amid rapidly rising energy bills and elevated inflation of countless other items, the BoE's latest bank lending figures suggested that, despite interest rates on credit cards rising to the highest since 1998, the outstanding stock of credit card debt increased 13.0%Y/Y in July, the strongest rate since 2005. Admittedly, growth remains flattered by pandemic-related weakness a year ago. Indeed, the additional net £0.7bn in credit card borrowing in July was down slightly from June (£0.9bn) and merely in line with the average of the past twelve months, albeit almost double the pre-pandemic five-year average. Overall, consumer credit rose a net £1.4bn in July, down from June (£1.8bn) but nevertheless firmer than the average in the previous twelve months (£1.1bn), to leave the stock of such lending up 6.9%Y/Y. The increase in interest rates also encouraged (for those able to save) another strong inflow into household time deposits in July, by the most since November 2010. But with flows into sight deposits still weak, the monthly increase in total household deposits (£4.3bn) remained below the average monthly net flow (£5.5bn) in the year ahead of the pandemic.

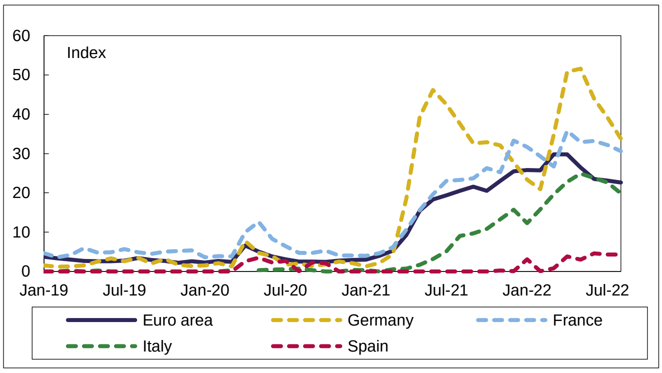
## Mortgage lending remains steady (for now)

Despite a further pickup in mortgage rates – e.g. the effective interest rate on new mortgages increased 18bps to 2.3% in July, with the average interest rate on a 2Y fixed rate 75% loan-to-value mortgage up 63bps to 3.51%, the highest for almost a decade – demand for mortgages remained solid too. Net new secured borrowing rose £5.1bn in July, admittedly softer than the £6.0bn average increase in the previous six months but still above the average in the five years prior to the pandemic (£3.8bn). But the number of new approvals (63.8k) was the second-smallest since June 2020 and below the average in the twelve months to February 2020 (66.8k), suggesting that mortgage lending might well slow over coming months.

## The day ahead in the UK

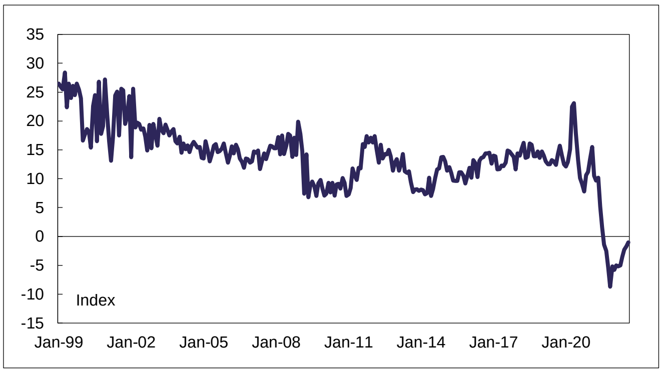
Tomorrow brings the BRC's shop price index for August, which seems bound to flag continued elevated price pressures on the High Street. Not least due to higher food prices, the survey's headline rate seems highly likely to have risen further above July's series-high of 4.4%Y/Y. In terms of the inflation outlook, much focus on Wednesday will be the ONS's announcement of its statistical treatment of the government's energy support payments to households. In particular, the ONS will confirm whether the payments will be treated as income or a price adjustment, and therefore what impact it may have to temporarily reduce inflation – perhaps by 2ppts or more – and government debt interest payments related to inflation-linked Gilts over coming months. Also due is the Lloyds business barometer for August.

### Euro area: Construction supply shortages*



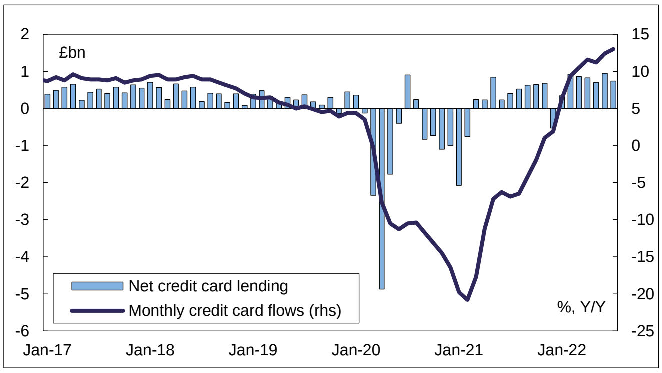

**Share of construction firms reporting shortages of materials and/or equipment as a factor limiting their activity. Source: EC, Refinitiv and Daiwa Capital Markets Europe Ltd.*

### Euro area: Retail inventories



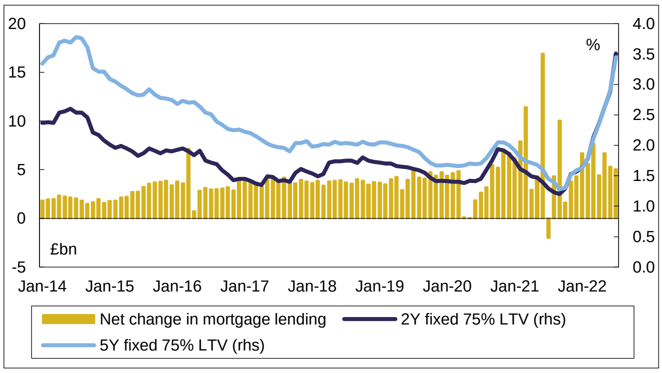

*Source: EC, Refinitiv and Daiwa Capital Markets Europe Ltd.*

### UK: Consumer credit




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

### UK: Mortgage interest rate and lending




*Source: BoE, Bloomberg 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 | | European Commission's economic confidence | Aug | **97.6** | - | 99.0 | **98.9** |
| | | European Commission's industrial (services) confidence | Aug | **1.2 (8.7)** | - | 3.5 (10.7) | **3.4 (10.4)** |
| | | European Commission's final consumer confidence | Aug | **-24.9** | *-24.9* | -27.0 | - |
| Germany | | Preliminary CPI M/M% (Y/Y%) | Aug | **0.3 (7.9)** | 0.2 (7.8) | 0.9 (7.5) | - |
| | | Preliminary EU-harmonised CPI M/M% (Y/Y%) | Aug | **0.4 (8.8)** | 0.2 (8.6) | 0.8 (8.5) | - |
| Spain | | Preliminary CPI M/M% (Y/Y%) | Aug | **0.1 (10.4)** | - | -0.3 (10.8) | - |
| | | Preliminary EU-harmonised CPI M/M% (Y/Y%) | Aug | **0.1 (10.3)** | - | -0.6 (10.7) | - |
| | | Retail sales Y/Y% | Jul | **-0.5** | - | 1.0 | **0.7** |
| UK | | Net consumer credit £bn (Y/Y%) | Jul | **1.4 (6.9)** | - | 1.8 (6.5) | **- (6.6)** |
| | | Net mortgage lending £bn (approvals '000s) | Jul | **5.1 (6.8)** | - | 5.3 (63.7) | **- (63.2)** |

**Auctions**

| Country | | Auction |
|---|---|---|
| Italy | | sold €3.25bn of 2.65% 2027 bonds at an average yield of 3.09% |
| | | sold €1.25bn of 3.50% 2030 bonds at an average yield of 3.30% |
| | | sold €2.25bn of 2.50% 2032 bonds at an average yield of 3.76% |
| | | sold €1.25bn of 2030 floating-rate bonds at an average yield of 1.04% |

*Source: Bloomberg and Daiwa Capital Markets Europe Ltd.*

## Tomorrow's releases

**Economic data**

| Country | | BST | Release | Period | Market consensus/ *Daiwa forecast* | Previous |
|---|---|---|---|---|---|---|
| Euro area | | 10.00 | Preliminary HICP M/M% (Y/Y%) | Aug | *0.4 (9.0)* | 0.1 (8.9) |
| | | 10.00 | Core HICP Y/Y% | Aug | *4.1* | 4.0 |
| Germany | | 08.55 | Unemployment change '000s (rate %) | Aug | 27.5 (5.5) | 47.0 (5.4) |
| France | | 07.45 | Preliminary CPI M/M% (Y/Y%) | Aug | 0.6 (6.1) | 0.3 (6.1) |
| | | 07.45 | Preliminary HICP M/M% (Y/Y%) | Aug | 0.6 (6.7) | 0.3 (6.8) |
| | | 07.45 | Final GDP Q/Q% (Y/Y%) | Q2 | *0.5 (4.2)* | -0.2 (4.8) |
| | | 07.45 | Consumer spending M/M% (Y/Y%) | Jul | -0.2 (-3.9) | 0.2 (-4.4) |
| | | 07.45 | PPI M/M% (Y/Y%) | Jul | - | 1.3 (27.0) |
| Italy | | 10.00 | Preliminary CPI M/M% (Y/Y%) | Aug | 0.6 (8.1) | 0.4 (7.9) |
| | | 10.00 | Preliminary HICP M/M% (Y/Y%) | Aug | 0.0 (8.2) | -1.1 (8.4) |
| UK | | 00.01 | Lloyds business barometer | Aug | - | 25 |
| | | 00.01 | BRC shop price index Y/Y% | Aug | - | 4.4 |

**Auctions and events**

- Nothing scheduled -

*Source: Bloomberg and Daiwa Capital Markets Europe Ltd.*

Access our research blog at:
https://www.uk.daiwacm.com/ficc-research/recent-blogs