

Euro wrap-up

Overview

- Bunds followed USTs slightly lower at the long end of the curve while the latest consumer confidence surveys from the large euro area member states were mixed but negotiated wage growth in the region picked up to a series high.
- Following recent marked losses, Gilts firmed at the end of the week despite a pickup in UK retail sales.
- The coming week will bring the flash estimates of euro area inflation in May along with new data from the region on bank lending and unemployment.

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Daily bond market movements

Bond	Yield	Change
BKO 2.8 06/25	2.914	+0.033
OBL 2.2 04/28	2.550	+0.026
DBR 2.3 02/33	2.535	+0.016
UKT 0% 06/25	4.472	-0.031
UKT 1% 10/28	4.271	-0.029
UKT 3% 01/33	4.339	-0.024

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

Euro area

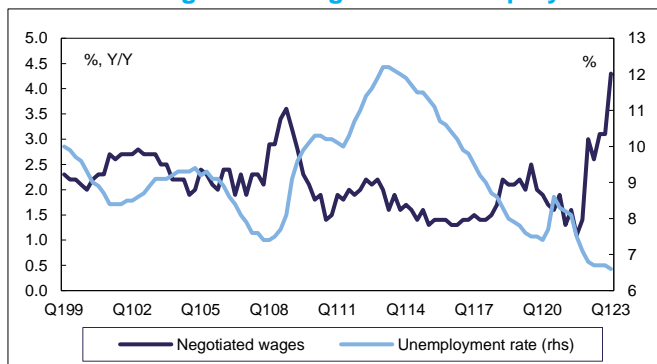
Negotiated wage growth up to series high in Q1

With core inflation having edged down just 0.1ppt from the prior month's series high to remain elevated at 5.6%Y/Y in April, and other measures of underlying inflation also uncomfortably elevated, the ECB unsurprisingly remains wary of second-round effects that might keep inflation persistently above-target over the horizon. While some Governing Council members might take reassurance from recent survey evidence pointing to a moderation in business price expectations (e.g. the drop in the German ifo survey measure noted below), many will be unsettled by the recent rise in financial market inflation expectations. Indeed, not only is it now firmly above levels consistent with the ECB's 2% target, but the 5Y5Y inflation forward swap rate this week rose above 2.50% for only the second time since 2012 to be less than 15bps below the equivalent US rate. The ECB's hawks will also fret about second-round effects on inflation emanating from the tight labour market, where the employment rate has risen to a series high while the unemployment rate (at 6.5% in March) and broader slack are historically low despite recent significant increases in labour force participation well above the pre-pandemic rate. Surveys also suggest that demand for workers remains positive and labour shortages remain a constraint on economic growth. So, after the significant erosion of real incomes as inflation took off, a pickup in wage growth was always to be expected, as workers sought to restore purchasing power. In that context, the acceleration of negotiated wages in Q1 of 1.2ppt to a series high of 4.3%Y/Y was eye-catching but not particularly surprising. With inflation likely to remain above target into 2024, in real terms the increase hardly seems excessive. And, unless firms seek to exploit ample demand to maintain or even boost profit margins, nor should it be considered inherently inflationary.

Germany's economy in technical recession as household consumption contracts

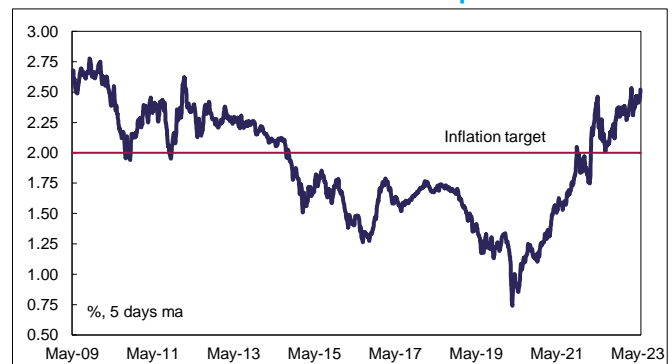
At least in the euro area's largest member states, high inflation appears still to be weighing on economic demand, which should ensure that firms do not get overambitious when setting prices over coming months. Reflecting the slump in activity and spending reported in the March data, yesterday's updated national accounts figures suggested that Germany slipped into a technical recession at the turn of the year, having been previously estimated to have merely stagnated in the first quarter. German GDP is now assessed to have contracted by 0.3%Q/Q in Q1, the third quarterly decline out of the past four, to leave GDP down ½%Y/Y and some ½% below the pre-pandemic benchmark. The contraction partly reflected a second successive sharp drop in household consumption (-1.2%Q/Q) to be more than 3% below the pre-pandemic level, reflecting further erosion of purchasing power as well as the reluctance of households to run down some of their excess savings built up since the start of the pandemic. Consumers spent notably less on food, clothing, furnishings and new cars following the termination of government eco-incentives at the end of last year. Government consumption also declined sharply (-4.9%Q/Q) as spending on pandemic-related schemes drew to a close. And together these two components knocked 1.7ppts off GDP

Euro area: Negotiated wages and unemployment



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

Euro area: Market 5Y5Y inflation expectations



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

growth. This was partly offset by a rebound in fixed investment (3.0%Q/Q), reflecting not least a weather-assisted boost to construction for the first quarter in four, as well as a bounce back in spending on machinery and equipment. Given also a drop in imports due to weak domestic demand, but a modest increase in exports, net trade added a substantive 0.6ppt to GDP growth.

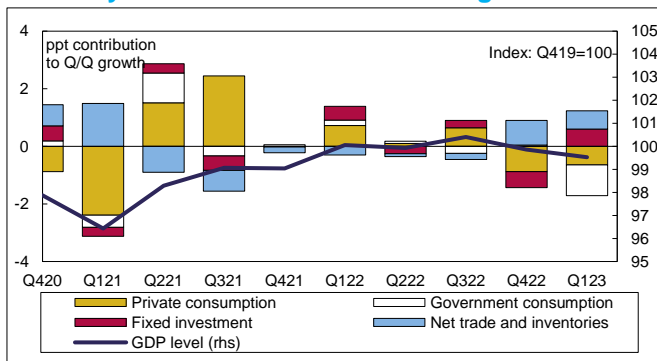
German economic activity looks lacklustre in Q2 but firms’ price expectations moderate too

Looking ahead, survey indicators, including the [ifo institute business indices](#), suggest that Germany’s recovery will remain lacklustre at best in Q2. Certainly, factory orders and truck toll mileage figures suggest a subdued start to the second quarter in the manufacturing sector. Exports to non-EU countries fell sharply further in April, to their lowest level in thirteen months and some 6% below the Q1 average. And according to the ifo institute, firms’ export expectations fell back further in May to their lowest since November, with a notable moderation in the autos subsector. More encouragingly, due in part to weakening demand as well as easing supply-side pressures, the share of firms aiming to increase prices over the coming three months fell in May to the lowest since March 2021, suggesting a notable drop in inflation over coming months. Against this backdrop, the latest consumer survey reported an eighth consecutive monthly increase in the headline sentiment index, by 1.6pts to -24.2, a fourteen-month high and 18½pts above November’s trough. Admittedly, the survey suggested that households’ willingness to buy weakened slightly in May, although the respective index was still trending some 3pts above the Q1 average and therefore suggestive of a modest pickup in consumer spending this quarter.

French data point to a deterioration in conditions in the second quarter

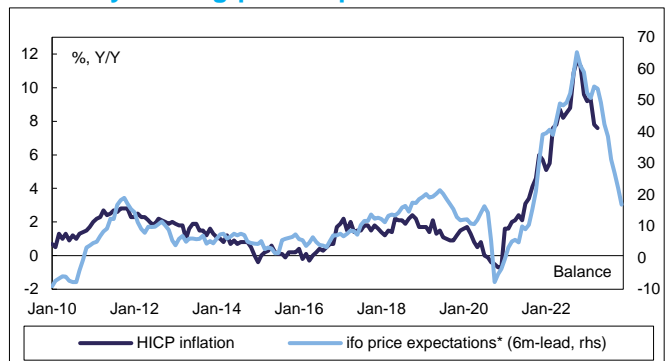
According to the Bank of France’s latest retail sales figures, consumer spending got off to a weak start in the second quarter. Sales volumes fell more than 2%M/M in April, driven not least by sizeable declines in spending on new autos, consumer electronics and furniture. And the latest consumer confidence survey suggests that the outlook for consumption remains weak. While the headline sentiment index moved sideways in May, at 83 it was still well below the long-run average (100). And despite households being the least pessimistic about their future financial situation since the start of 2022 amid an improvement in inflation expectations, the share of households considering it a good time to make major purchases fell further in May, to the lowest on the series excluding the sudden slump at the onset of Covid three years ago. According to INSEE, firms were the most downbeat in more than two years too. In particular, the composite business sentiment index fell for the third consecutive month, by 2pts to 100, admittedly bang in line with the long-run average, but nevertheless some 14pts below the pandemic peak at the end of 2021. The deterioration was widespread across subsectors, with manufacturers more pessimistic for a third consecutive month amid a decline in past production and order books, services sentiment the lowest for more than two years due to rising concerns about the near-term outlook, and construction confidence worsening the most since November 2020 due to weaker activity and order books as well as labour shortages.

Germany: GDP and contributions to growth



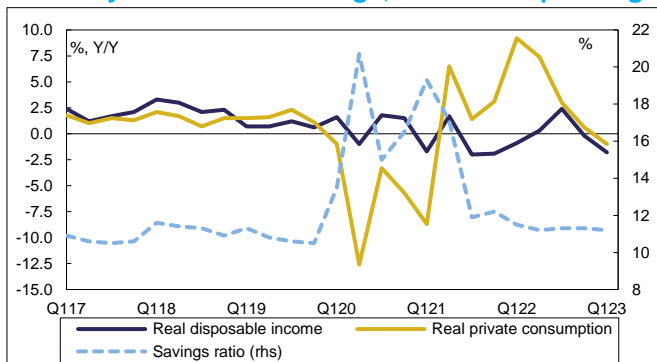
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: Selling-price expectations and inflation



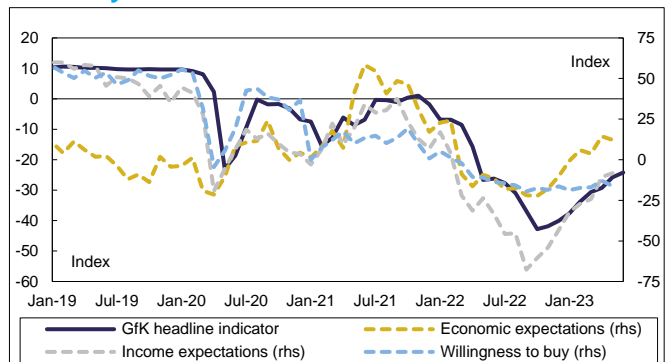
*Unweighted average of manufacturing, services, construction and retail indices. Source: ifo institute, Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: Household savings, income & spending



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: Consumer confidence



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Italian sentiment still above pre-pandemic norms

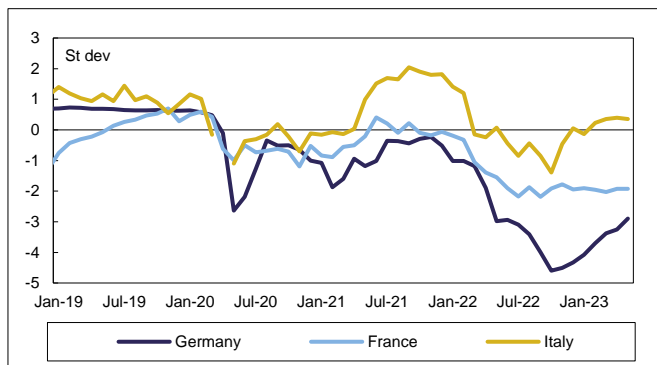
While the euro area's core countries have struggled to grow at the start of the year in the face of the inflation shock, Southern Europe has fared better, benefiting not least from the further release of pandemic related pent-up demand and projects related to EU recovery funds. After Italian GDP rose 0.5%Q/Q in Q1 to be about 2½% above the pre-pandemic level, surveys point to ongoing growth in Q2. According to the latest ISTAT survey, Italian consumer confidence weakened slightly in May. But the drop of 0.4pt in the headline index left it above the pre-pandemic long-run average. And households judged that the economic climate had improved to the best in fifteen months, while consumer willingness to purchase durable goods rose to a nine-month high. Admittedly, business sentiment softened to the weakest since December, with firms in all major sectors somewhat less upbeat. But with the exception of manufacturing where order books appeared less ample and production expectations were revised down, confidence remained well above the pre-pandemic long-run averages too.

The week ahead in the euro area

A key focus in the coming week will be the release of the flash euro area inflation estimates for May on Thursday. Having edged slightly higher in April, we expect headline inflation to have resumed a downwards path this month, with our estimate for a drop of 0.8ppt to 6.2%Y/Y, a fifteen-month low, driven not least by a further moderation in energy and food inflation. But while non-energy industrial goods and services inflation are also expected to have eased very slightly in May, the downwards adjustment in core inflation will be more marginal, with our expectation for a drop of just 0.1ppt to 5.5%Y/Y. Preliminary national inflation releases will offer further insight, with figures from Germany, France and Italy on Wednesday and Spain on Tuesday. The other main focus of the coming week will be a pair of notable publications by the ECB. The account of the 4 May monetary policy meeting is due Thursday, while the latest quarterly Financial Stability Review will be released on Wednesday.

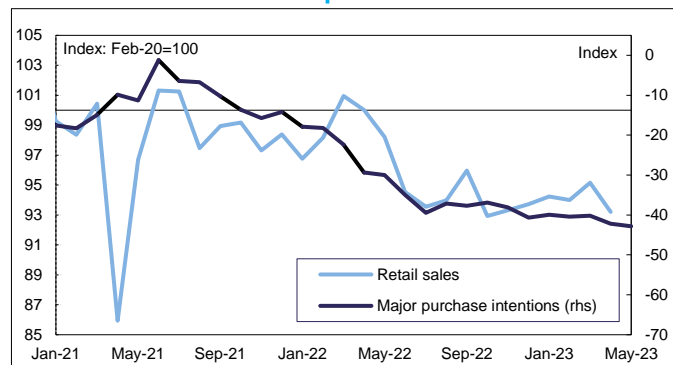
Among other new data releases, Tuesday will also bring the Commission's latest economic survey results, which are likely to report a further moderation in inflation expectations in May among households and firms alike. But they will also likely suggest a slight deterioration in overall economic sentiment in the middle of Q2 amid subdued domestic and overseas demand. Tuesday's euro area monetary figures will provide further evidence on the impact of the ECB aggressive monetary tightening on bank lending and deposits. In addition, Thursday will bring the region's jobless figures for April, with the euro area ILO unemployment rate likely to remain at the series low of 6.5% reached in March. And Wednesday will bring German jobless claims figures for May, which are also likely to remain consistent with a tight labour market. Finally, the final manufacturing PMIs and new car registrations figures for May will also be published on Thursday.

Euro area member states: Consumer confidence



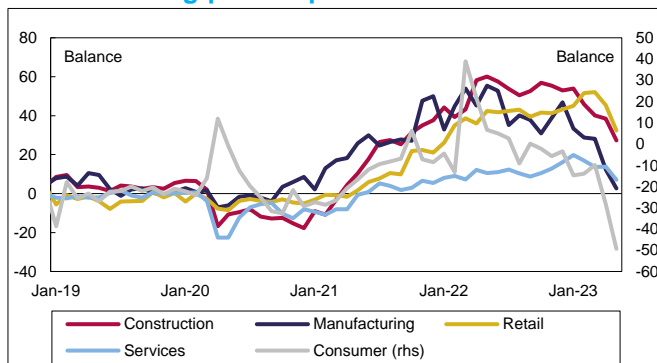
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

France: Retail sales and purchase intentions



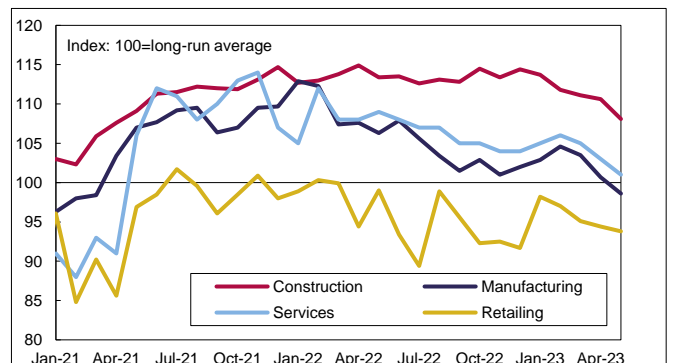
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

France: Selling-price expectations



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

France: Business sentiment



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

UK

Retail sales return to growth in April with firmest momentum in sixteen months

Retail sales volumes rose 0.5%M/M in April, a touch above the median forecast on the Bloomberg survey of 0.3%M/M. But as the drop in March, when sales were hit by extremely wet weather, was revised up to 1.2%M/M, the level of sales in April was broadly in line with expectations. That meant that sales in April were still 0.9% below the pre-pandemic level in February 2020, and marginally below the Q1 average level. Nevertheless, they were also up 0.8%3M/3M, the strongest rate on that basis since August 2021 and suggestive of much improved spending momentum. Excluding auto fuel, sales were even firmer, up 0.8%M/M and 1.0%3M/3M. And given the further significant rise in prices, the nominal value of sales was up 1.7%M/M and 2.4%3M/3M. Within the detail, sales volumes at food stores were up 0.7%M/M but just 0.1%3M/3M as record inflation of staples continued to weigh. Sales at non-food stores rose 1.0%M/M to be up a firm 1.6%3M/3M. Sales of clothing were up 0.2%M/M but were little changed on a three-month basis. In contrast, department store sales rose 1.7%M/M to be up more than 3%3M/3M, but were still down more than 5% from the pre-pandemic level.

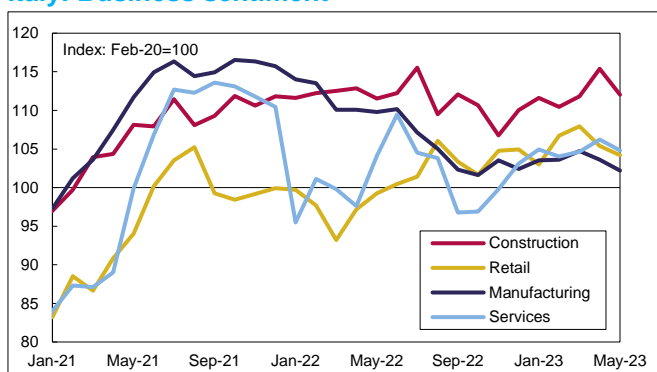
CBI survey points to a soft May, but lower energy bills should support pickup in spending in H2

While retail sales were firmer in April than in March, the CBI's distributive trades survey yesterday suggested that May was more challenging on the high street. Indeed, the survey net balance of retail sales volumes in the year to May fell 15ppts to -10%, the lowest since January, while an increased net share of retailers (18%) reported that sales were disappointing for the time of year. We suspect, however, that the extra national holiday for the King's coronation had a temporary adverse impact. Retailers expected sales to stabilise in June, and also reported the first optimistic three-month outlook on the survey since November 2021. And while the BoE will still be wary that the full impact of its monetary tightening has yet to be felt by households, consumers appear more willing to spend. Yesterday, the energy regulator Ofgem confirmed that the average annual household energy bill will fall by a little more than 17% in July from the current level of £2500. And it will probably drop again by roughly 5% in October, when energy prices should be subtracting more than 1ppt from the annual headline rate of inflation. So, thanks to elevated nominal wage momentum, real disposable incomes should pick up in the second half of the year, allowing for ongoing recovery in private consumption. And given the unwelcome persistence and increasingly broad-based nature of [core inflation](#) in April, the outlook for consumer demand is not going to deter the MPC from voting for further monetary tightening into the second half of the year.

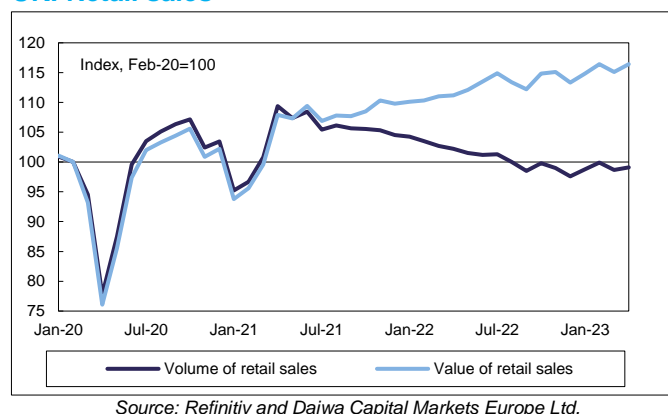
The week ahead in the UK

The coming week in the UK gets off to a quiet start, with financial markets closed on Monday for the late May public holiday. The data highlight comes on Thursday in the form of the BoE's lending data for April, which will likely flag negative impacts from the ongoing tightening in financial conditions. On Tuesday, we will get the BRC's shop price index for May, which will be watched for any hints that inflation on the high street might have peaked following Wednesday's nasty upside surprise to the official estimate of core inflation. The economic data calendar ends on Thursday, with the release of the final manufacturing PMIs for May. The flash PMIs suggested that the manufacturing sector is in retreat, with the output index down 0.9pt to 47.4 to be consistent with contraction for a third successive month.










Italy: Business sentiment



UK: Retail sales



Daiwa economic forecasts




	2022	2023				2024	2023	2024	2025	
		Q4	Q1	Q2	Q3					Q4
GDP		%, Q/Q					%, Y/Y			
Euro area 	0.0	0.1	0.2	0.2	0.2	0.2	0.8	1.1	1.5	
UK 	0.1	0.1	0.0	0.2	0.2	0.2	0.3	0.7	0.9	
Inflation, %, Y/Y										
Euro area										
Headline HICP 	10.0	8.0	6.3	4.6	2.9	2.8	5.4	2.3	1.7	
Core HICP 	5.1	5.5	5.5	4.9	4.1	3.4	5.0	2.5	1.8	
UK										
Headline CPI 	10.7	10.2	8.2	6.3	4.1	3.8	7.1	2.7	1.6	
Core CPI 	6.4	6.1	6.6	5.9	5.2	4.7	5.9	3.2	1.8	
Monetary policy, %										
ECB										
Refi Rate 	2.50	3.50	4.00	4.25	4.25	4.25	4.25	3.25	3.00	
Deposit Rate 	2.00	3.00	3.50	3.75	3.75	3.75	3.75	2.75	2.50	
BoE										
Bank Rate 	3.50	4.25	5.00	5.00	5.00	5.00	5.00	4.50	3.50	

Source: Bloomberg, ECB, BoE 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
France 	INSEE consumer confidence	May	83	84	83	-
Italy 	ISTAT consumer confidence	May	105.1	106.0	105.5	-
	ISTAT business (manufacturing) confidence	May	108.7 (101.4)	- (102.0)	110.5 (103.0)	110.4 (102.8)
UK 	Retail sales including auto fuels M/M% (Y/Y%)	Apr	0.5 (-3.0)	0.3 (-2.8)	-0.9 (-3.1)	-1.2 (-3.9)
	Retail sales excluding auto fuels M/M% (Y/Y%)	Apr	0.8 (-2.6)	0.4 (-2.8)	-1.0 (-3.2)	-1.4 (-4.0)





Auctions

Country	Auction
	- Nothing to report -


Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Yesterday's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Germany 	Final GDP Q/Q% (Y/Y%)	Q1	-0.3 (-0.5)	<u>0.0 (-0.1)</u>	-0.5 (-0.1)	-
	GfK consumer confidence	Jun	-24.2	-24.8	-25.7	-25.8
France 	INSEE business confidence	May	100	101	102	-
	INSEE manufacturing confidence (production outlook)	May	99 (-10)	100 (-)	101 (-4)	-
	Retail sales Y/Y%	Apr	-6.8	-	-5.6	-
Spain 	PPI Y/Y%	Apr	-4.5	-	-1.0	-1.4
UK 	CBI distributive trades (reported retail sales)	May	-10	10	5	-






































Auctions

Country	Auction
Italy 	sold €2.75bn of 3.4% 2025 bonds at an average yield of 3.61%

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> <i>forecast/actual</i>	Previous
Monday 29 May 2023					
- Nothing scheduled -					
Tuesday 30 May 2023					
Euro area		09.00 M3 money supply Y/Y%	Apr	2.0	2.5
		10.00 European Commission's ESI	May	99.0	99.3
		10.00 European Commission's industrial (services) confidence	May	-3.1 (10.2)	-2.6 (10.5)
		10.00 European Commission's final consumer confidence	May	-17.4	-17.5
Italy		09.00 PPI Y/Y%	Apr	-	3.0
Spain		08.00 Preliminary HICP (CPI) Y/Y%	May	3.3 (3.5)	3.8 (4.1)
		08.00 Retail sales Y/Y%	Apr	-	9.5
UK		00.01 BRC shop price index Y/Y%	May	-	8.8
Wednesday 31 May 2023					
Germany		08.55 Unemployment change '000s (rate %)	May	15.0 (5.6)	24.0 (5.6)
		13.00 Preliminary HICP (CPI) Y/Y%	May	6.7 (6.4)	7.6 (7.2)
France		07.45 Preliminary HICP (CPI) Y/Y%	May	6.5 (5.5)	6.9 (5.9)
		07.45 PPI Y/Y%	Apr	-	12.9
		07.45 Consumer spending M/M% (Y/Y%)	Apr	0.3 (-3.7)	-1.3 (-4.2)
		07.45 GDP – second estimate Q/Q% (Y/Y%)	Q1	<u>0.2 (0.8)</u>	0.0 (0.4)
Italy		09.00 GDP – second estimate Q/Q% (Y/Y%)	Q1	<u>0.5 (1.8)</u>	0.1 (1.4)
		10.00 Preliminary HICP (CPI) Y/Y%	May	7.6 (7.2)	8.7 (8.2)
UK		00.01 Lloyds business barometer	May	-	33
Thursday 01 June 2023					
Euro area		09.00 Final manufacturing PMI	May	<u>44.6</u>	45.8
		10.00 Preliminary (core) HICP Y/Y%	May	<u>6.2 (5.5)</u>	7.0 (5.6)
		10.00 Unemployment rate %	Apr	6.5	6.5
Germany		07.00 Retail sales M/M% (Y/Y%)	Apr	1.0 (-5.8)	-2.2 (-6.2)
		08.55 Final manufacturing PMI	May	<u>42.9</u>	44.5
France		08.50 Final manufacturing PMI	May	<u>46.1</u>	45.6
		- New car registrations* Y/Y%	May	-	21.9
Italy		08.45 Manufacturing PMI	May	45.8	46.8
		09.00 Unemployment rate %	Apr	7.8	7.8
		17.00 New car registrations Y/Y%	May	-	29.2
Spain		08.15 Manufacturing PMI	May	47.8	49.0
		- New car registrations* Y/Y%	May	-	8.2
UK		07.00 Nationwide house price index M/M% (Y/Y%)	May	-0.5 (-3.7)	0.5 (-2.7)
		09.30 Final manufacturing PMI	May	<u>46.9</u>	47.8
		09.30 Net consumer credit £bn (Y/Y%)	Apr	1.5 (-)	1.6 (7.9)
		09.30 Net mortgage lending £bn (approvals '000s)	Apr	0.7 (54.0)	0.0 (52.0)
		09.30 M4 money supply Y/Y%	Apr	-	0.4
Friday 02 June 2023					
France		07.45 Industrial production M/M% (Y/Y%)	Apr	0.3 (1.4)	-1.1 (-0.1)
		07.45 Manufacturing production M/M% (Y/Y%)	Apr	-	-1.1 (0.7)
Spain		08.00 Unemployment change '000s	May	-	-73.9

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

The coming week's key events & auctions

Country	BST	Event / Auction
Monday 29 May 2023		
Euro area	 -	Public holiday 'Whit Monday' in various member states
	 16.00	ECB's Hernandez de Cos scheduled to speak
UK	 -	Public holiday
Tuesday 30 May 2023		
Euro area	 16.45	ECB's Villeroy scheduled to speak
Italy	 10.00	Auction: €5.0bn of 3.80% 2028 bonds
	 10.00	Auction: €2.0bn of 4.40% 2033 bonds
	 10.00	Auction: €2.5bn of 4.35% 2033 bonds
	 10.00	Auction: €1.5bn of 2028 floating-rate bonds
Wednesday 31 May 2023		
Euro area	 09.00	ECB publishes its Financial Stability Review
Germany	 10.30	Auction: €3bn of 2.1% 2029 bonds
UK	 14.15	BoE Mann scheduled to speak
Thursday 01 June 2023		
Euro area	 08.55	ECB's Knot scheduled to speak
	 10.30	ECB President Lagarde scheduled to speak
	 12.30	ECB publishes account of 3-4 May policy meeting
	 13.30	ECB's Villeroy scheduled to speak
France	 09.50	Auction: 3.0% 2033 bonds
	 09.50	Auction: 2.5% 2043 bonds
	 09.50	Auction: 3.0% 2054 bonds
Spain	 09.30	Auction: 2.8% 2026 bonds
	 09.30	Auction: 0.8% 2029 bonds
	 09.30	Auction: 1.9% 2052 bonds
	 09.30	Auction: 0.7% 2033 index-linked bonds
Friday 02 June 2023		
- Nothing scheduled -		

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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<https://www.uk.daiwacm.com/ficc-research/recent-blogs>

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