

# Euro wrap-up

## Overview

- Bunds made gains as euro area Q1 GDP was revised to confirm a very mild technical recession at the turn of the year.
- Shorter-dated Gilts also made gains as the REC survey suggested a further easing in UK labour market tightness.
- The main event in the coming week will be Thursday's ECB announcement, where we expect a further 25bps hike in interest rates. Updates on euro area inflation, and the UK labour market and GDP are due.

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### Daily bond market movements

Bond	Yield	Change
BKO 2.8 06/25	2.896	-0.009
OBL 2.2 04/28	2.437	-0.030
DBR 2.3 02/33	2.420	-0.029
UKT 0% 06/25	4.529	-0.042
UKT 1% 10/28	4.242	-0.014
UKT 3¼ 01/33	4.263	+0.012

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

## Euro area

### Q1 GDP revised to confirm mild technical recession at turn of the year

Following significant downwards revisions to the figures for certain member states, the estimate of euro area GDP in Q1 was today predictably revised down. In particular, while GDP was previously thought to have risen by 0.1% on the quarter, it is now judged to have contracted by 0.1%Q/Q. Therefore, given the drop of the same magnitude in Q4, the euro area economy experienced a technical recession around the turn of the year, albeit by the smallest possible margin. Indeed, despite the very slight drop in economic output in both quarters, GDP in Q1 was still up 1.0%Y/Y and 2.2% above the pre-pandemic level in Q419. And in the round, the economic data are more consistent with stagnation than recession.

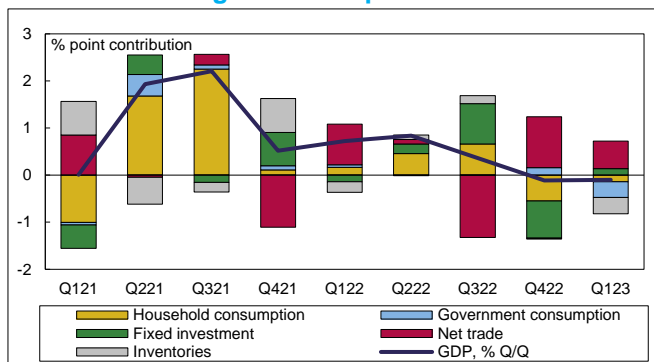
### Consumption subtracted from GDP in Q1 but capex and net trade provided support

As household disposable incomes remained under pressure, household spending was a key source of weakness in Q1. But with consumer confidence improving as wholesale energy prices fell, the pace of decline of private consumption moderated to 0.3%Q/Q last quarter following the (revised) drop of 1.0%Q/Q in Q4. Government consumption fell for the first quarter in three, dropping a marked 1.6%Q/Q in part due to a marked reduction in German Covid-19 health-related expenditure. In contrast, following a contraction in Q4, fixed investment rose in Q1 by 0.6%Q/Q, as increased spending on machinery and equipment, as well as a weather-assisted rebound in construction, more than offset drops in investment in transport items and research and development. With the decline in imports (-1.3%Q/Q) far outpacing that in exports (-0.1%Q/Q), net trade made a sizeable positive contribution to GDP growth (+0.7ppt) for a second quarter. However, inventories subtracted 0.4ppt from growth. On the production side, services activity rose 0.3%Q/Q in Q1 thanks to increases in a range of sub-sectors including entertainments, retail and ICT. In contrast, value added in manufacturing contracted for the first quarter in five and by 0.9%Q/Q.

### GDP would have risen in Q1 excluding the impact of Ireland-based multinationals

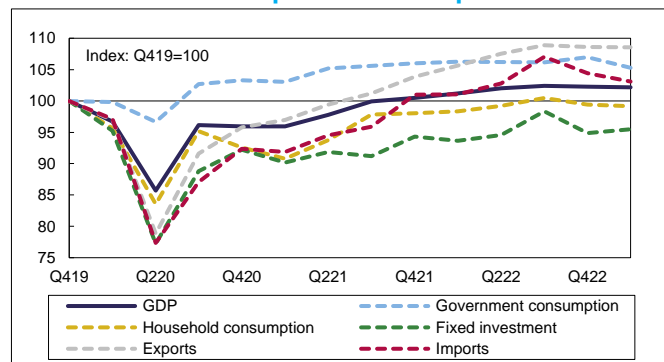
At the country level, economic growth in Q1 was encouragingly firm in most of the Southern periphery, particularly Portugal (1.6%Q/Q), Italy (0.6%Q/Q) and Spain (0.5%Q/Q). Despite a weakening in sentiment and industrial unrest in response to Macron's pension reform, GDP also rose in France (0.2%Q/Q). So, the contraction in euro area GDP in Q1 was in part due to weakness elsewhere in the euro area's core countries, particularly Germany which contracted by 0.3%Q/Q due not least to the aforementioned drop in government consumption as well as a drop in car sales related to the termination of a tax incentive. In addition, economic output in the Netherlands contracted 0.7%Q/Q. However, most striking, Irish GDP fell a sharp 4.6%Q/Q, entirely due to the activities of multinational enterprises registered there for tax purposes, excluding which

### Euro area: GDP growth & expenditure contributions



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

### Euro area: GDP & expenditure components



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

so-called 'modified domestic demand' rose 2.7%Q/Q. Excluding the Irish figures, euro area GDP would have risen by 0.1%Q/Q in Q1, but would also have been just 1.5% above the pre-pandemic level.

### ECB likely to revise down modestly its GDP projection for 2023 and 2024

The contractions in both Q4 and Q1 represented slightly weaker outturns than the ECB's forecasts of 0.0%Q/Q and 0.1%Q/Q respectively published in March. However, given the extreme magnitude of the shock to energy and food prices of the past year, as well as the exceptional factors in Ireland and Germany explaining the drop in euro area GDP in Q1, the Governing Council might still consider economic activity to have been relatively resilient and not a major source of concern. They will certainly note the strength in the Southern periphery. Moreover, while admittedly mixed, on balance economic surveys point to a modest and uneven resumption of economic growth in Q2, driven by the continued expansion in services while manufacturing retreats due particularly to the softening of global demand. Importantly, the labour market has remained firm across the euro area, with employment up 0.6%Q/Q in Q1 and the unemployment rate down to a series low of 6.5% in April. So, while retail sales weakened in March, consumer spending should tick up in Q2. And despite the tightening of financial conditions which is weighing significantly on demand for business loans and mortgages, as well as uncertainty about the outlook for external demand, firms still appear set to boost capex over coming quarters. When the ECB publishes updated macroeconomic projections at the conclusion of its policy meeting next Thursday, we expect it to revise down its full-year GDP forecast for 2023 (currently 1.0%), perhaps by about 0.3ppt, and its forecast for 2024 (currently 1.6%) more marginally.

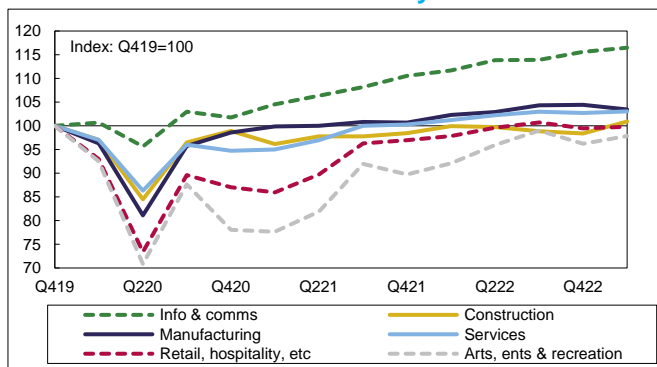
### ECB could nudge down headline inflation forecast for 2023

As far as ECB policy is concerned, however, the outlook for inflation matters more than GDP. Reassuringly perhaps, the downside surprise to the flash May estimate of inflation, which fell 0.9ppt to 6.1%Y/Y, means that the ECB's forecast of 6.0%Y/Y for Q2 looks broadly on track despite the upside surprise in April. So, given the steeper than expected drop in wholesale energy prices, signs of a softening in food inflation, stronger euro exchange rate and slightly weaker GDP outlook, the ECB's headline inflation projection of 5.1%Y/Y over 2023 as a whole could well be nudged lower. However, despite evidence of a further cooling in global goods prices, the Governing Council's hawks will remain concerned about stickiness in core prices, particularly in services where price momentum still appears strong.

### Core inflation projection to remain above target at the end of the horizon

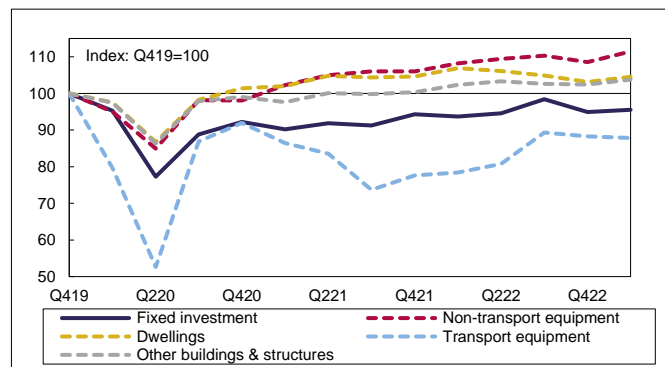
Certainly, the hawks will note that the tightness of the labour market generated record (if not unreasonably high) growth in negotiated wages in Q1 at 4.3%Y/Y. Moreover, firms expect wage costs to rise at a faster pace than non-wage costs in the

#### Euro area: Gross Value Added by sector



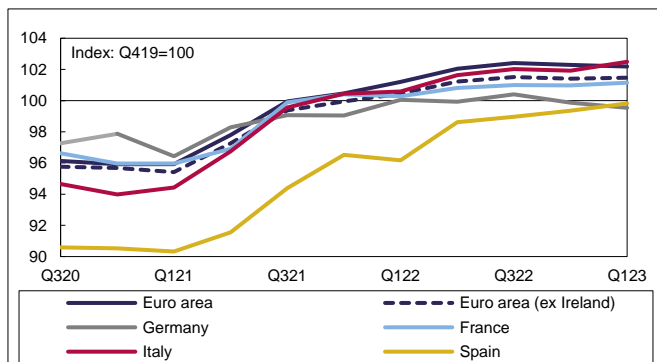
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

#### Euro area: Fixed investment



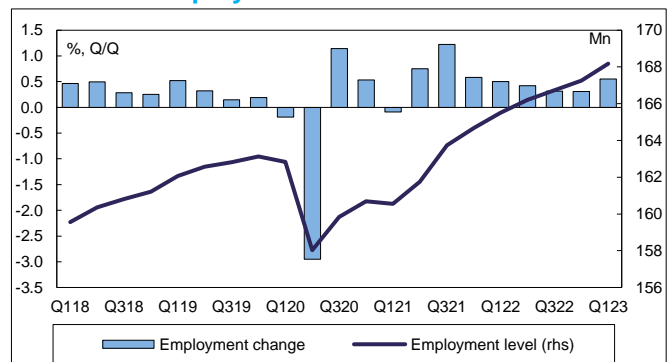
Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

#### Euro area member states: GDP levels



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

#### Euro area: Employment



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

coming year to keep inflation firmly above target. Indeed, the ECB's latest Survey on the Access to Finance of Enterprises, released yesterday, suggested that firms expect their selling prices and wage costs respectively to increase on average by 6.1% and 5.4% over the coming year. While the ECB survey measures of consumer inflation expectations have also fallen as the headline HICP rate has moderated, the three-year ahead indicator of 3.0%Y/Y also remains too high for the comfort of the hawks. So, despite the softening in non-core prices, the ECB might well see the need to revise up its forecast for core inflation of 4.6% in 2023. The ECB's forecasts for headline and core inflation in 2024, of 2.9% and 2.5% respectively, might be little changed. And while headline inflation will be expected to fall below the 2.0% target in 2025, the ECB will maintain its projections for both the headline and core measures to remain on average above 2.0% that year.

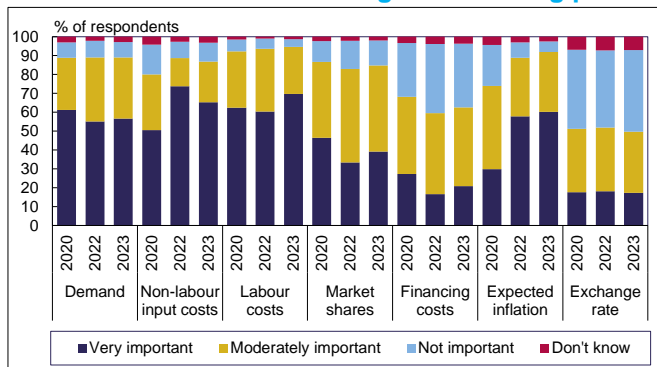
**Rates bound to rise by 25bps this month, with a signal of further hike in July highly likely too**

With the ECB likely to expect core inflation to remain above target in 2025, there is no doubt that the Governing Council will again vote to tighten policy again on Thursday. Indeed, recent public comments from President Lagarde and other key policymakers have made that clear. Having slowed the pace of rate hikes to 25bps in May, another increase of that magnitude in all main interest rates – taking the deposit rate to 3.50% is inevitable. Moreover, while it will continue to insist that policy will be data-dependent, the Governing Council's forward policy guidance is highly likely to signal that a further hike of 25bps is expected to come in July, but that the path for rates thereafter will be guided by the following set of macroeconomic projections due in September.

**Accelerated pace of balance sheet reduction to be felt disproportionately at the periphery**

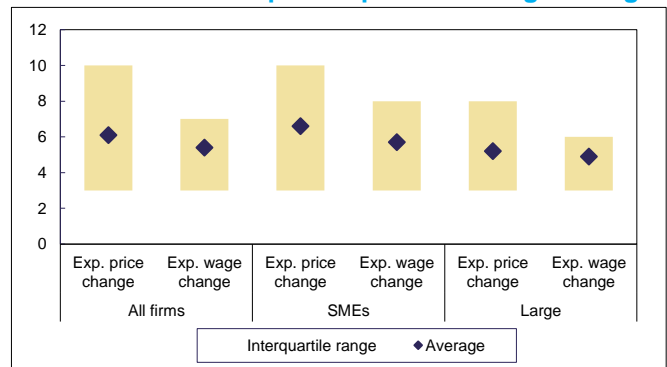
In terms of the ECB's balance sheet, the Governing Council will confirm that reinvestments of the proceeds of maturing APP securities will cease from the start of July. That will result in a reduction of €188bn in its holdings of public sector bonds and almost €240bn in its total bond holdings over the coming nine months. And while euro area banks are set to repay a whopping €468bn of TLTRO-iii funds later this month, the ECB will not announce any offsetting action given its determination to reduce excess liquidity to support the transmission of its monetary policy over coming quarters. However, we note that about 30% of the TLTRO-iii repayment this month will be made by Italian banks. And for many of them, the amounts to mature will exceed their excess reserves, requiring new borrowing from the ECB's regular operations or the markets. And while the ECB will maintain in full its reinvestments of proceeds of maturing PEPP bonds through to end-2024, in their totality, the efforts to shrink the balance sheet could risk a disproportionate further tightening of financial conditions at the euro area periphery and, ultimately, an excessive tightening of financial conditions for the region as a whole.

**Euro area: Factors influencing firms' selling prices**



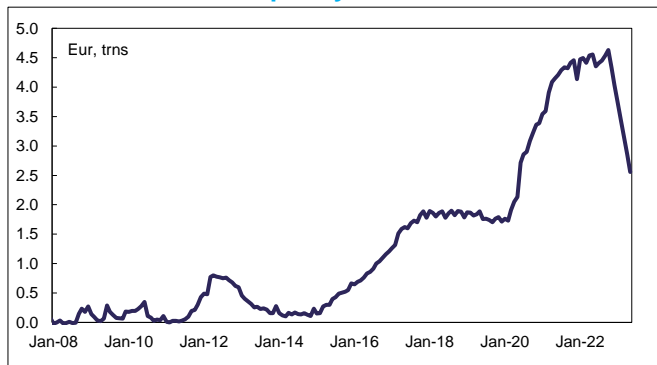
Source: ECB Survey on Access to Finance of Enterprises and Daiwa Capital Markets Europe Ltd.

**Euro area: Firms' expected price and wage changes\***



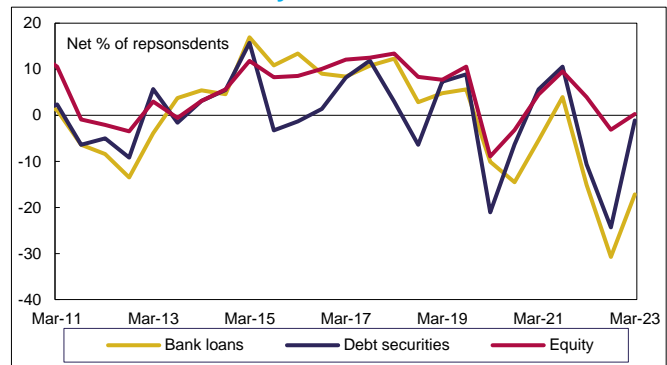
\*Over coming year. Source: ECB Survey on Access to Finance of Enterprises and Daiwa Capital Markets Europe Ltd.

**Euro area: Excess liquidity**



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

**Euro area: Availability of external finance**



Source: ECB Survey on Access to Finance of Enterprises and Daiwa Capital Markets Europe Ltd.

**The data week ahead in the euro area**

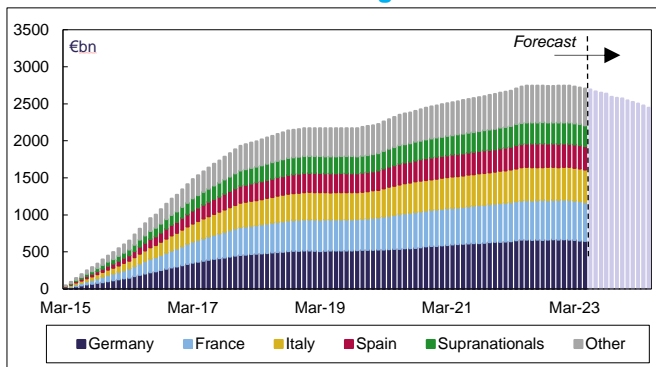
Following the ECB announcement, Friday’s release of final euro area inflation estimates for May and labour force survey results for Q1 will be of note. The headline HICP rate is likely to confirm the 0.9ppt drop to a fifteen-month low of 6.1%Y/Y, in part reflecting the steepest fall in energy inflation since the start of 2021 as well as a moderation in food inflation to an eight-month low. The flash estimate of core inflation also surprised on the downside, falling 0.3ppt to a four-month low of 5.3%Y/Y. Friday’s numbers will provide a more granular breakdown, along with various measures of underlying price pressures watched by the ECB. Meanwhile, Friday’s labour survey is likely to report that slack in the euro area remained close to a record low in the first quarter of the year. Meanwhile, having reached a record high at the end of 2022 (5.7%Y/Y), labour cost growth might well have moderated slightly in Q1, despite a pickup in negotiated wage growth. Final inflation estimates are also due from Germany and Spain (Tuesday) and France (Thursday). In addition, euro area industrial production (Wednesday) and trade figures for April (Thursday) are also due, while Germany’s ZEW investor survey for June (Tuesday) is likely to echo the downbeat findings from this week’s sentix survey.

**UK**

**REC survey suggests a further easing in labour market tightness**

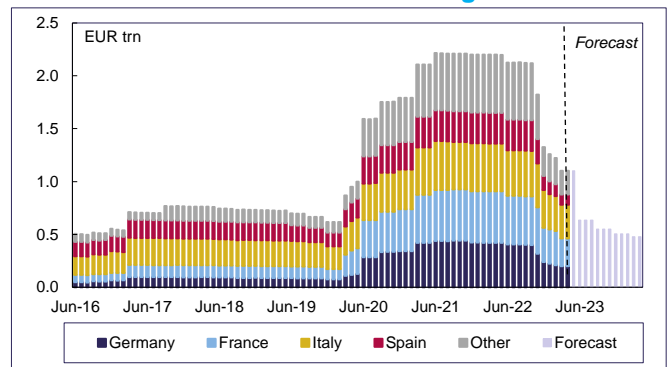
With labour market tightness and persisting wage pressures an ongoing concern for BoE officials, the pickup in the latest Indeed wage tracker figures attracted some attention today. In particular, these suggested that UK starting salaries rose the most on the (admittedly short) series beginning in 2019, by 7.2%3M/Y in May. But single-month growth edged slightly lower from April (down 0.3ppt to 7.2%Y/Y). Moreover, the findings from the latest REC/KPMG survey, which the BoE follows more closely, suggested that the increase in starting salaries for permanent staff, while still elevated by historical standards, was the softest for more than two years. Meanwhile, pay growth for temporary staff was the lowest since April and the second-weakest reading in two years. This appeared to reflect weaker jobs growth amid ongoing economic uncertainties, with the survey measure of permanent staff placements falling for the eighth consecutive month and by the most since the start of 2021. Temporary billings rose only marginally and at the softest pace since October. Furthermore, there was the largest increase in the availability of candidates since late-2020, which recruitment consultants attributed to an upturn in redundancies and reduced hiring activity. And the outlook for the jobs market was more downbeat, with growth in permanent job vacancies reportedly the weakest for five months and the number of temporary posts rising at the slowest rate for almost three years.

**Euro area: PSPP bond holdings**



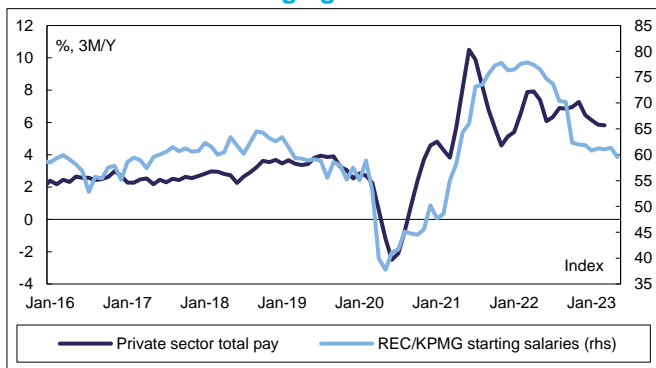
Source: ECB and Daiwa Capital Markets Europe Ltd.

**Euro area: TLTRO loans outstanding**



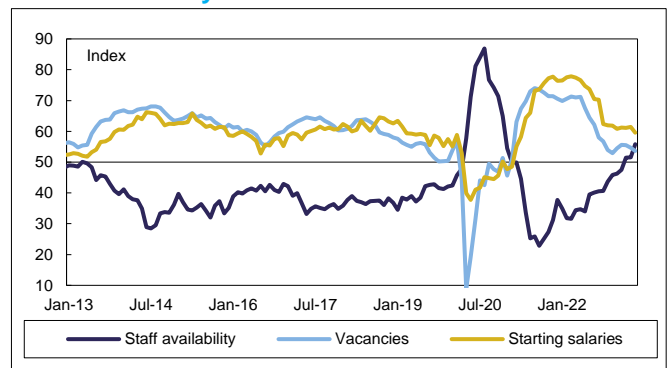
Source: ECB and Daiwa Capital Markets Europe Ltd.

**UK: Private sector wage growth**



Source: REC, KPMG, S&P Global, Refinitiv and Daiwa Capital Markets Europe Ltd.

**UK: REC survey labour market indices**



Source: REC, KPMG, S&P Global, Refinitiv and Daiwa Capital Markets Europe Ltd.

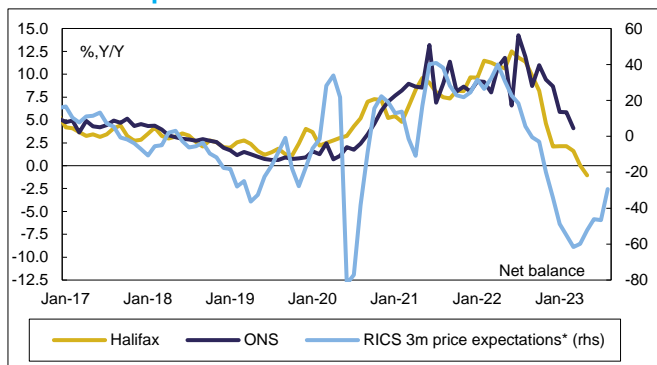
## RICS housing survey less downbeat, but still consistent with declining prices

While the Halifax house price index yesterday suggested the first annual drop in prices (-1.0%Y/Y) since December 2012, and the Nationwide index earlier this month suggested the steepest drop on the same basis since 2009, today's RICS residential survey offered a less downbeat assessment of conditions in the UK's housing market than of late. According to the RICS, the net balance of surveyors reporting a decline in new buyer enquiries was the least negative in the past year, rising 16ppts to -18%, with the net balance for new sales (-7%) also the least negative since May 2022. And the house price balance (-30%) was the least negative since November and much improved from February's trough (-46%), albeit still well below the long-run average (+12%). However, while surveyors reported diminishing pessimism about the outlook for the coming three months, the weakness in mortgage lending and recent withdrawal of mortgage deals by various lenders given the prospect of higher BoE interest rates will continue to dampen housing market activity for several quarters to come.

## The day ahead in the UK

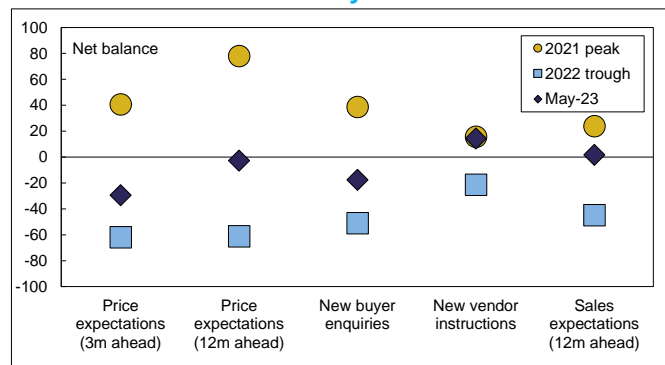
The coming week's data calendar will bring several releases of note ahead of the BoE's next policy decision on 22 June, with arguably most notable being Tuesday's labour market numbers. With the number of payrolled employees having fallen sharply in April for the first since February 2021 and surveys signalling a slowing jobs market, we expect to see a slight moderation in employment growth in the three months to April. However, the figure will remain flattered by a strong increase in February. Meanwhile, the unemployment rate is likely to have moved sideways at best from the fourteen-month high of 3.9% recorded in the three months to March. Of course, this remains low by historical standards and consistent with ongoing tightness in the labour market. As such, we continue to expect wage growth to remain close to the 5.8%3M/Y rate recorded in March with private sector pay growth in particular still too high for the BoE's comfort. In terms of economic activity, Wednesday's release of the April GDP report is likely to report a modest rebound from the drop in output in March (-0.3%M/M), supported by growth in services including [retail sales](#). In addition, Friday will bring the BoE's household inflation attitudes survey, which will be watched for evidence of a further easing in medium-term expectations, which in Q1 eased to 3.0%Y/Y, the lowest for six quarters.

### UK: House price indices



\*Three-month lead. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.










### UK: RICS residential survey indices



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

The next edition of the Euro wrap-up will be published on 13 June 2023

## Daiwa economic forecasts




	2022	2023				2024	2023	2024	2025	
		Q4	Q1	Q2	Q3					Q4
<b>GDP</b>		<b>%, Q/Q</b>					<b>%, Y/Y</b>			
Euro area 	-0.1	-0.1	0.2	0.2	0.2	0.2	0.5	1.1	1.5	
UK 	0.1	0.1	0.0	0.2	0.2	0.2	0.3	0.7	0.9	
<b>Inflation, %, Y/Y</b>										
Euro area										
Headline HICP 	10.0	8.0	6.1	4.2	2.5	2.4	5.1	2.2	1.7	
Core HICP 	5.1	5.5	5.4	4.7	4.0	3.2	4.9	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	
<b>Monetary policy, %</b>										
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	4.75	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
Euro area 	GDP – second estimate Q/Q% (Y/Y%)	Q1	<b>-0.1 (1.0)</b>	<u>0.1 (1.3)</u>	-0.1 (1.8)	-
	Final employment Q/Q% (Y/Y%)	Q1	<b>0.6 (1.6)</b>	<u>0.6 (1.7)</u>	0.3 (1.5)	-
UK 	RICS house price balance %	May	<b>-30</b>	-39	-39	-

#### 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
Italy 	09.00	Industrial production M/M% (Y/Y%)	Apr	-	-0.6 (-3.2)























#### Auctions and events

- Nothing scheduled -

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
<b>Monday 12 June 2023</b>					
- Nothing scheduled -					
<b>Tuesday 13 June 2023</b>					
Germany		07.00	Final HICP (CPI) Y/Y%	May	<u>6.3 (6.1)</u> 7.6 (7.2)
		10.00	ZEW current assessment (expectations) balance	Jun	-37.6 (-14.0) -34.8 (-10.7)
Spain		08.00	Final HICP (CPI) Y/Y%	May	<u>2.9 (3.2)</u> 3.8 (4.1)
UK		07.00	Payrolled employees monthly change '000s	May	- -136
		07.00	Unemployment claimant count rate % (change '000s)	May	- 4.0 (46.7)
		07.00	Average weekly earnings (excl. bonuses) 3M/Y%	Apr	- 5.8 (6.7)
		07.00	ILO unemployment rate 3M%	Apr	4.0 3.9
		07.00	Employment change 3M/3M '000s	Apr	- 182
<b>Wednesday 14 June 2023</b>					
Euro area		10.00	Industrial production M/M% (Y/Y%)	Apr	1.6 (0.0) -4.1 (-1.4)
UK		07.00	GDP M/M% (3M/3M%)	Apr	0.2 (0.1) -0.3 (0.1)
		07.00	Industrial production M/M% (Y/Y%)	Apr	- 0.7 (-2.0)
		07.00	Manufacturing production M/M% (Y/Y%)	Apr	- 0.7 (-1.3)
		07.00	Index of services M/M% (3M/3M%)	Apr	- -0.5 (0.1)
		07.00	Construction output M/M% (Y/Y%)	Apr	- 0.2 (4.1)
		07.00	Total trade balance (goods trade balance) £bn	Apr	- -16.4 (-17.9)
<b>Thursday 15 June 2023</b>					
Euro area		10.00	Trade balance €bn	Apr	- 17.0
		13.15	ECB Deposit (Refi) Rate %	Jun	<u>3.50 (4.00)</u> 3.25 (3.75)
France		07.45	Final HICP (CPI) Y/Y%	May	<u>6.0 (5.1)</u> 6.9 (5.9)
Spain		09.00	Trade balance €bn	Apr	- -0.2
<b>Friday 16 June 2023</b>					
Euro area		10.00	Final (core) HICP Y/Y%	May	<u>6.1 (5.3)</u> 7.0 (5.6)
		10.00	Labour costs Y/Y%	Q1	- 5.7
Italy		09.00	Final HICP (CPI) Y/Y%	May	<u>8.1 (7.6)</u> 8.7 (8.2)

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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

Country	BST	Event / Auction
<b>Monday 12 June 2023</b>		
UK 	15.00	BoE's Mann scheduled to speak
<b>Tuesday 13 June 2023</b>		
Germany 	10.30	Auction: €5bn of 2028 bonds
Italy 	10.00	Auction: 3Y & 7Y bonds
UK 	10.00	Auction : £3.5bn of 3.25% 2033 bonds
	10.00	Incoming BoE external MPC member Megan Green to testify before Treasury Select Committee
	15.00	BoE Governor Bailey testifies to Economic affairs committee on how independence is working for the central bank
<b>Wednesday 14 June 2023</b>		
Germany 	10.30	Auction: €4bn of 2.3% 2033 bonds
<b>Thursday 15 June 2023</b>		
Euro area 	13:15	ECB monetary policy announcement
	13.45	ECB President Lagarde holds press conference following the Governing Council meeting
France 	09.50	Auction: fixed rate and index-linked bonds
Spain 	09.30	Auction: fixed rate bonds
UK 	16.35	BoE Deputy Governor Cunliffe scheduled to speak
<b>Friday 16 June 2023</b>		
UK 	09.30	BoE publishes quarterly inflation attitudes survey

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:

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

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