

# Euro wrap-up

## Overview

- Bunds made losses even as German CPI inflation was confirmed at a 15-month low and the ZEW investor survey offered mixed messages.
- Gilts made massive losses as UK employment and pay growth exceeded expectations, supporting the case for further significant monetary policy tightening.
- Wednesday will bring April figures for euro area industrial production and UK GDP.

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### Daily bond market movements

Bond	Yield	Change
BKO 2.8 06/25	2.954	+0.069
OBL 2.4 10/28	2.469	+0.041
DBR 2.3 02/33	2.421	+0.040
UKT 0% 06/25	4.883	+0.243
UKT 1% 10/28	4.526	+0.180
UKT 3¼ 01/33	4.439	+0.100

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

## Euro area

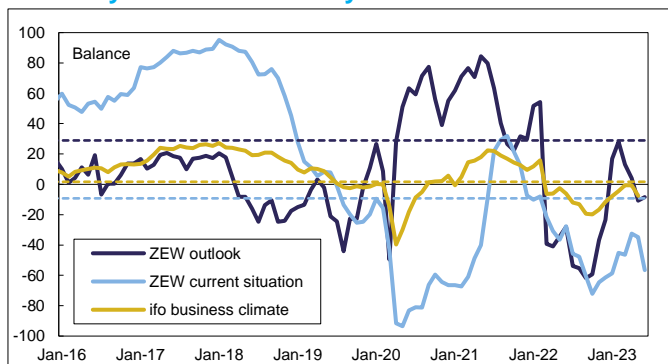
### German investor survey offers mixed messages at the end of Q2

Today's German ZEW survey provided mixed messages about investors' assessment of economic conditions at the end of the second quarter. Arguably most striking in today's release was the deterioration in the assessment of current conditions. Indeed, the respective survey index balance fell for the second successive month in June and by a more substantial 21.7pts to -56.5, a five-month low. However, given the marked improvement in April, the quarterly index for Q2 was still some 9pts above the Q1 average and some 25pts above the Q4 average, suggesting some (admittedly erratic) progress towards stabilisation. Moreover, there was a surprise pickup in the survey's expectations balance in June, by 2.2pts to -8.5. While significantly higher than last year's trough (-61.9), this level remains some 25pts below the Q1 and long-run averages, pointing to expectations of lacklustre recovery momentum through the second half of the year. Encouragingly, investors' inflation expectations for the twelve months ahead were the weakest since April 1994. But while earnings expectations for banks and insurance firms were a touch firmer than in May and remained in positive territory, assessments of profitability in a range of other sub-sectors, including construction, autos, steel, retail and mechanical engineering remained firmly in negative territory.

### German inflation eases to 15-month low, with energy, food and government policy playing a role

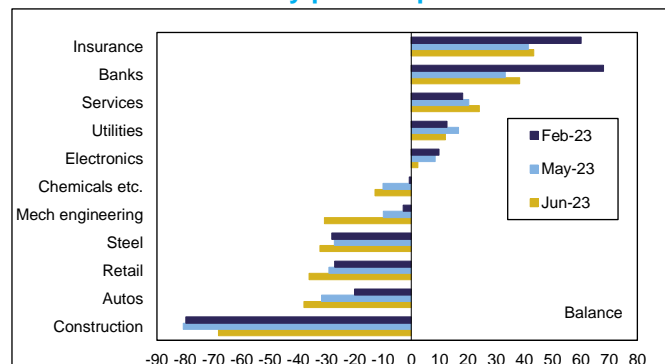
In terms of actual inflation, final German figures today confirmed a notable decline in the headline HICP rate in May, by 1.3ppts to a fifteen-month low of 6.3%Y/Y. The national CPI rate was similarly down 1.1ppt to 6.1%Y/Y, the lowest since March 2022. While there was a broad-based easing in price pressures, the drop in energy prices was again notable, down 1.4%M/M, to take the annual rate of that component down 4.2ppts to 2.6%Y/Y, the lowest since February 2021. Within the detail, while annual increases in electricity and natural gas remained above the norm, they maintained a steady downwards path in May, while prices of heating oil (-30.5%Y/Y) and motor fuels (-14.2%Y/Y) fell sharply. Encouragingly, while food inflation remained a significant source of inflationary pressure, it fell a further 2.3ppts to 14.9%Y/Y, not least reflecting a sharp decline in prices of butter (-23.3%Y/Y). And when excluding food and energy, German core inflation fell 0.4ppt to 5.4%Y/Y. That was due principally to an easing in services inflation on the back of the introduction of the government's €49 per month public transport ticket (the so-called "Deutschlandticket"). Net rents also continued to have a dampening effect. But that was in part countered by strong inflation for the maintenance and repair of dwellings (15.8%Y/Y) and prices for package holidays (13.6%Y/Y). Over the summer, core inflation will rebound due to base effects associated with last year's more heavily discounted (€9 per month) rail ticket scheme as well as the larger basket weight attached to package holidays. But by September, the downtrend in both headline and core inflation in Germany and the euro area should be clear, allowing the ECB to halt its tightening cycle.

### Germany: ZEW & ifo survey sentiment indices\*



\*Dashed lines represent long-run averages. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

### Euro area: ZEW survey profit expectations



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

## The day ahead in the euro area

The euro area data highlight tomorrow will be the publication of euro area industrial production numbers for April. While figures previously published from the largest four member states have been mixed – with zero growth in Germany, modest growth in France (0.8%M/M) and declines in Italy (-1.9%M/M) and Spain (-1.8%M/M) – the sharp rebound in Irish output (21.4%M/M) should ensure we see seemingly-solid growth in production overall. But, while we forecast an increase of almost 1.0%M/M, this will fail to reverse the near-4%M/M drop recorded in March.

## UK

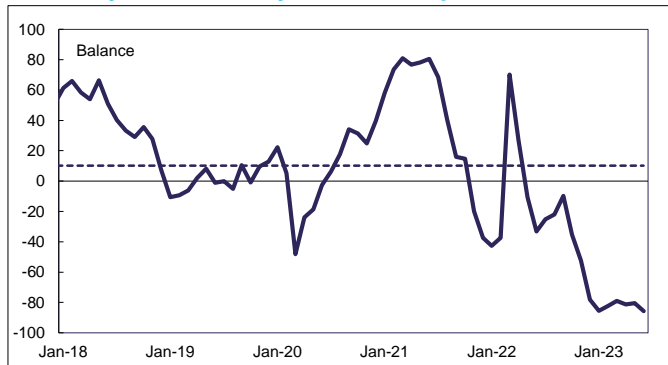
### Employment growth rebounds to suggest new labour market momentum

When it raised Bank Rate to 4.50% at its May policy meeting, the BoE's MPC made clear that future decisions would depend on indications of inflation persistence, including the tightness of the labour market and the behaviour of wage growth. Judging from today's stronger-than-expected labour market data, therefore, the BoE has significant further policy tightening to implement. Among other things, the increase in employment in the three months to April of 250k was the biggest in eleven months, and reflected growth in full-time and part-time work alike. That took the number of employees to a series high and the employment rate up 0.2ppt from the prior quarter to 76.0%. The initial (admittedly oft-unreliable) estimate of payrolls pointed to further job growth in May. While the unemployment rate edged up 0.1ppt over the quarter to 3.8%, it had been expected to rise further to 4.0% and was still 0.2ppt below the pre-pandemic level. And although the inactivity rate fell 0.4ppt over the quarter to the lowest since 2020, the number of people inactive due to long-term sickness continued to rise.

### Pay accelerates markedly, led by the private sector

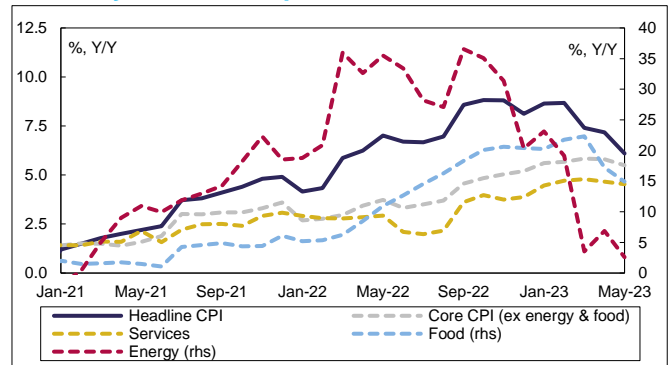
Admittedly, there were again a few signs of cooling in the labour market in the latest data. For example, the number of vacancies fell again in the three months to May to the lowest level since August 2021. Nevertheless, overall, the data pointed to renewed momentum and no significant easing in the balance between labour supply and demand. Indeed, most importantly for the BoE, wages accelerated, with growth in regular pay (i.e. excluding bonuses) in the three months to April up 0.6ppt on the quarter to 7.2%3M/Y, a rate only exceeded once on the series, in June 2021. Moreover, much of the pressure came from private sector regular pay, also up 0.6ppt on the quarter to 7.6%3M/Y, similarly a rate only previously exceeded in the midst of the pandemic, with the three-month annualised rate of total private pay growth up to a seven-month high of 9.1%. A key impetus was the increase in the National Living Wage from 1 April, which amounted to 9.7%Y/Y for the

### Germany: ZEW survey inflation expectations\*



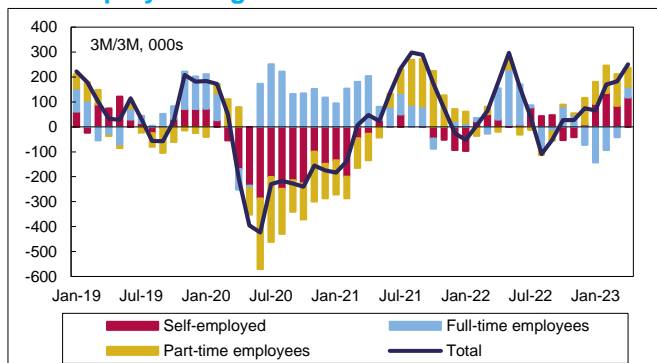
\*Twelve-months ahead. Dashed line represents long-run average.  
 Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

### Germany: Consumer price inflation\*



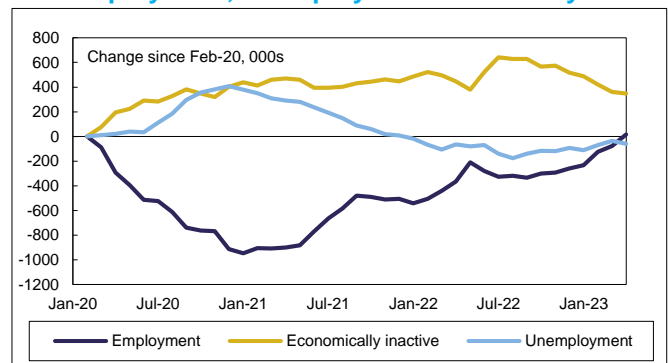
\*National measure. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

### UK: Employment growth



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

### UK: Employment, unemployment & inactivity



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

lowest paid workers of 23 years-plus and the under-21s, and reached 10.9%Y/Y for those aged 21 and 22. But finance and business services saw the strongest regular pay growth rate at 9.2%3M/Y, with significant pressure also in manufacturing (7.0%3M/Y). Against the backdrop of widespread strike action – which in the nine months to April saw more than 3.5mn working days lost to industrial action, the most since 1990 – public sector pay growth strengthened too, up 0.7ppt on the quarter to 5.6%3M/Y. That matched the fastest pace in two decades, although in part the elevated reading reflected base effects, with recent momentum in the public sector easing somewhat.

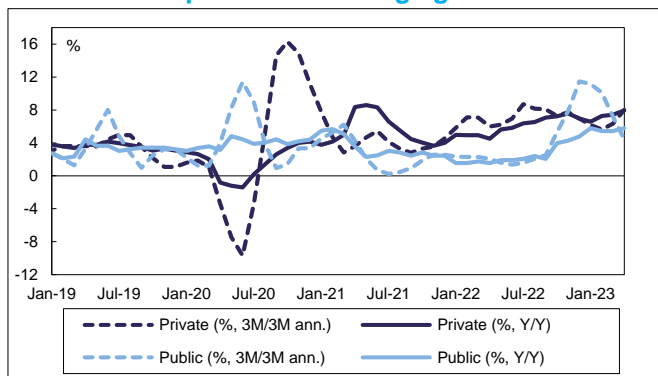
### Wage pressures will force BoE to keep tightening policy even if it risks inducing recession

Given high inflation, in real terms wage growth remained firmly in negative territory, at -2.0%3M/Y for total pay when deflated by the ONS’s preferred CPIH measure. While real pay growth is likely to shift into modest positive territory over coming months as inflation moderates somewhat, the figures underscore that the outlook for private consumption remains subdued at best. Moreover, with core inflation significantly higher than in other G7 economies, and nominal pay accelerating further above levels consistent with achievement of the MPC’s inflation target over the medium term, the BoE appears to have the biggest challenge of all the major central banks to restore price stability. Indeed, the pickup in private sector regular pay in the latest data contrasts with the BoE’s expectation – based in part on survey-based leading indicators as well as earlier evidence of less tightness in the job market – of a gradual moderation to around 5½% by year-end and around 3% by the end of its forecast horizon. While accelerating wages need not imply stronger inflation if firms are willing to absorb the costs in their margins, further rate hikes this month and in August now seem inevitable. Indeed, some MPC members (e.g. external representatives Mann and Haskel) might well again vote for 50bps of tightening next week. And although it would significantly risk inducing recession next year, additional monetary tightening into the autumn to push Bank Rate firmly above 5.00% no longer seems an unreasonable bet.

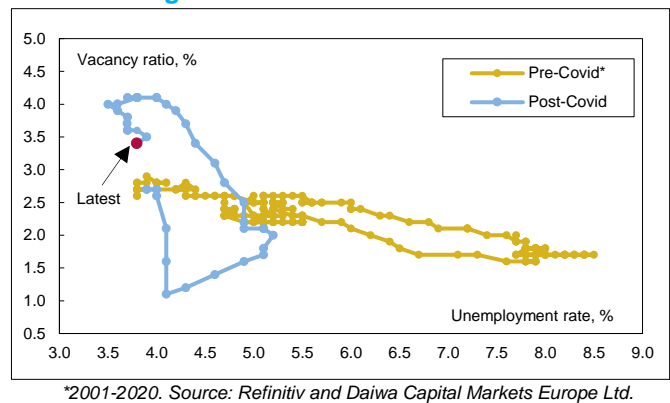
### The day ahead in the UK

Tomorrow will bring the UK’s GDP report for April, which is likely to report a modest rebound of about 0.2%M/M from the drop in output in March (-0.3%M/M), supported by growth in services including [retail sales](#). In contrast, manufacturing output is expected to have edged slightly lower following four consecutive monthly increases, with construction output expected to have moved broadly sideways following solid growth in Q1.

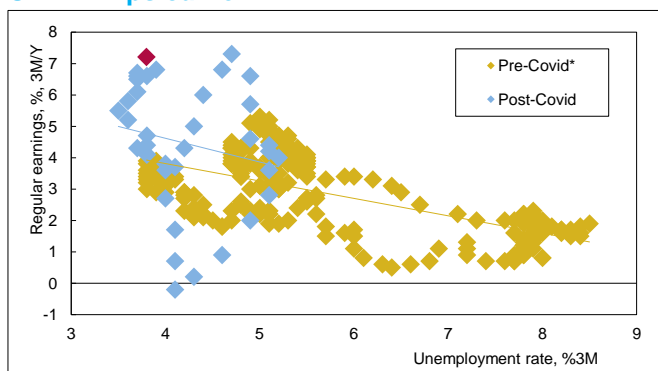
#### UK: Private & public sector wage growth



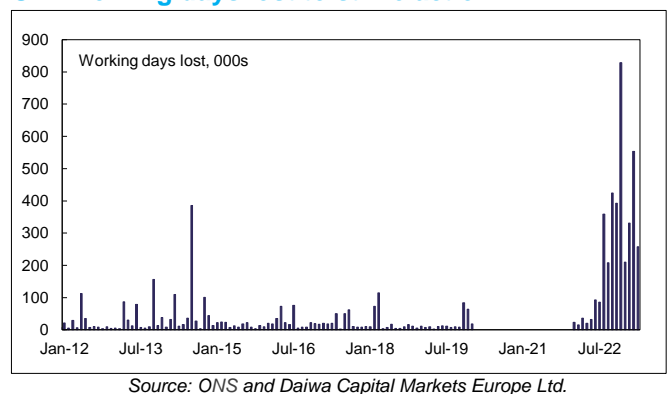
#### UK: Beveridge curve



#### UK: Phillips curve











#### UK: Working days lost to strike action








## European calendar

### Today's results

#### Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Germany	 Final HICP (CPI) Y/Y%	May	<b>6.3 (6.1)</b>	<u>6.3 (6.1)</u>	7.6 (7.2)	-
	 ZEW current assessment (expectations) balance	Jun	<b>-56.5 (-8.5)</b>	-37.6 (-14.0)	-34.8 (-10.7)	-
Spain	 Final HICP (CPI) Y/Y%	May	<b>2.9 (3.2)</b>	<u>2.9 (3.2)</u>	3.8 (4.1)	-
UK	 Payrolled employees monthly change '000s	May	<b>23</b>	-	-136	7
	 Unemployment claimant count rate % (change '000s)	May	<b>3.9 (-13.6)</b>	-	4.0 (46.7)	3.9 (23.4)
	 Average weekly earnings (excl. bonuses) 3M/Y%	Apr	<b>6.5 (7.2)</b>	6.1 (6.9)	5.8 (6.7)	<b>6.1 (6.8)</b>
	 ILO unemployment rate 3M%	Apr	<b>3.9</b>	4.0	3.9	-
	 Employment change 3M/3M '000s	Apr	<b>250</b>	150	182	-








#### Auctions

Country	Auction
Germany	 sold €4.0bn of 2028 bonds at an average yield of 2.41%
Italy	 sold €2.75bn of 3.8% 2026 bonds at an average yield of 3.46%
	 sold €3.25bn 3.7% 2030 bonds at an average yield of 3.75%
	 sold €1.5bn 4.5% 2053 bonds at an average yield of 4.54%
UK	 sold £3.5bn of 3.25% 2033 bonds at an average yield of 4.351%


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	 10.00	Industrial production M/M% (Y/Y%)	Apr	<u>1.0 (0.8)</u>	-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	0.0 (-1.7)	0.7 (-2.0)
	 07.00	Manufacturing production M/M% (Y/Y%)	Apr	-0.2 (-0.9)	0.7 (-1.3)
	 07.00	Index of services M/M% (3M/3M%)	Apr	0.3 (-0.1)	-0.5 (0.1)
	 07.00	Construction output M/M% (Y/Y%)	Apr	0.0 (4.3)	0.2 (4.1)
	 07.00	Total trade balance (goods trade balance) £bn	Apr	-3.7 (-16.5)	-2.9 (-16.4)

#### Auctions and events

Germany	 10.30	Auction: €4bn of 2.3% 2033 bonds
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Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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