

# Euro wrap-up

## Overview

- Bunds made gains particularly at the longer end of the curve and BTPs outperformed as euro area labour cost growth moderated and various measures of euro area underlying inflation improved slightly.
- Gilts made losses despite a moderation in UK inflation expectations.
- The coming week will bring the BoE's latest policy announcements as well as new data on UK inflation and the flash PMIs.

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### Daily bond market movements

Bond	Yield	Change
BKO 2.8 06/25	3.090	-0.008
OBL 0 10/28	2.761	-0.017
DBR 2.3 02/33	2.459	-0.039
UKT 0% 06/25	4.935	+0.027
UKT 1% 10/28	4.563	+0.032
UKT 3¼ 01/33	4.401	+0.018

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

Source: Bloomberg

## Euro area

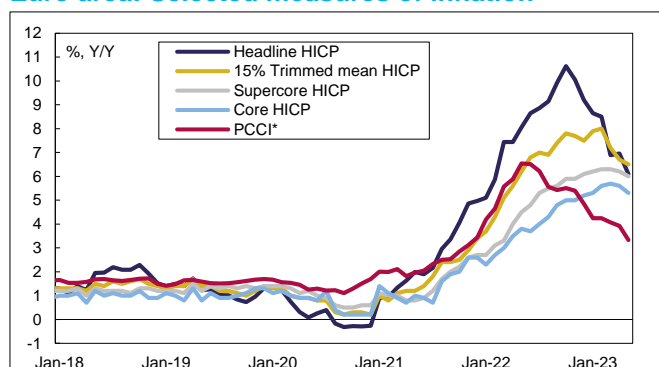
### Broad-based drop in inflation to a 15-month low confirmed

In her post-Governing Council meeting press conference yesterday, [ECB](#) President Lagarde insisted that underlying inflation remained too high, and that labour cost growth and the tight jobs market posed upside risks to the inflation outlook, all of which justified further monetary tightening. Today brought new data related to each of those issues. With respect to prices, today's final estimates of consumer price inflation in May brought no surprises, broadly confirming the findings of the flash release albeit with slight amendments to the detail. So, with prices on average unchanged on the month, the 0.9ppt decline in the headline HICP rate to a 15-month low of 6.1%Y/Y was confirmed. And given revisions at the national level, HICP inflation fell in every member state bar the Netherlands. Energy was once again the main driver of the fall in inflation, with prices down 2.1%M/M thanks to the pass-through of recent declines in wholesale prices to consumers in certain countries, as well as lower prices of auto fuels. Given the significant base effect too, the annual rate of energy inflation dropped more than 4ppts to a 27-month low of -1.8%Y/Y. With prices of fresh items unchanged on the month, food inflation also now appears to have peaked, with the broader aggregate including drinks and tobacco down 3ppts from the peak and 1ppt on the month to 12.5%Y/Y in May. And most encouragingly, the major core components fell back too. In part reflecting lower prices of public transport, including Germany's new €49 per month public "Deutschlandticket", services inflation slowed for the first time in six months, dropping 0.2ppt from April's series high to 5.0%Y/Y. And the improved global supply-demand balance in the manufacturing sector supported a second successive drop in core goods inflation, which fell 0.4ppt to 5.8%Y/Y. So, core inflation (excluding energy, food, alcohol and tobacco) fell 0.3ppt to a four-month low of 5.3%Y/Y, 0.4ppt below March's series high.

### Underlying inflation momentum moderates but core rate to remain sticky over the near term

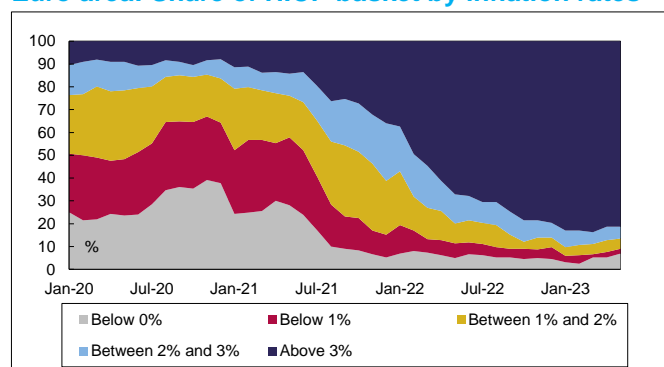
Although the monthly increases in services, core goods and food prices in May were still slightly above the respective long-run averages for the month, momentum slowed for all major components. Moreover, like the core inflation rate, several other measures of underlying price pressures showed improvement in May. For example, the 15% trimmed mean HICP inflation fell a further 0.2ppt to a 12-month low of 6.5%Y/Y, 1.5ppts below February's peak. The ECB's supercore measure of the most output gap-sensitive items also fell 0.2ppt to a six-month low of 6.0%Y/Y, while the persistent and common component measure of inflation dropped 0.6ppt to 3.3%Y/Y, the lowest since March 2022. But the share of items in the CPI basket with inflation of 3% or more merely moved sideways having eased slightly in each of the previous three months. And importantly perhaps, base effects associated with the German government's €9 public transport ticket last June, July and August, as well as the increased basket weight on package holidays, will provide temporary impetus to services inflation over the summer months. So, while lower global goods price momentum should still help core inflation continue to edge lower over coming

### Euro area: Selected measures of inflation



\*Persistent and consistent components of inflation. Source: ECB, Refinitiv and Daiwa Capital Markets Europe Ltd.

### Euro area: Share of HICP basket by inflation rates



Source: Eurostat and Daiwa Capital Markets Europe Ltd.

months, we suspect that it will not fall below 5.0%Y/Y until September, which could prove too late to allow for a pause in the monetary tightening cycle that month.

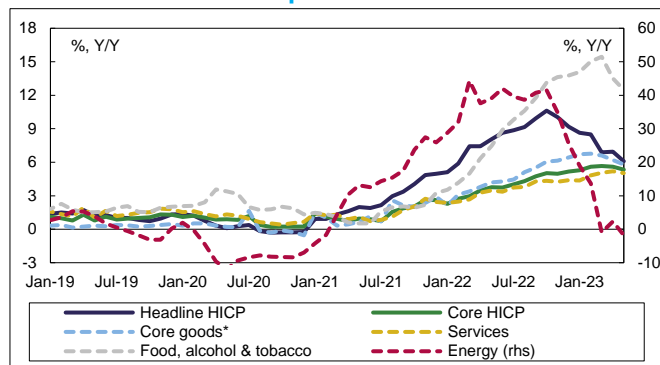
### Labour cost growth also moderates but slack falls to new low

In her press conference, Lagarde flagged concerns about the strength of negotiated wage growth and the risks that labour costs could contribute to inflation persistence, particularly in services, over coming quarters. However, like headline inflation, growth in labour costs has moderated somewhat since the end of last year. Growth in hourly labour costs in the market economy – which include gross wages and salaries as well as employers' social contributions and taxes net of subsidies related to employment – slowed 0.6ppt in Q1 from a downwardly revised figure for Q4 to 5.0%Y/Y. The equivalent rates also slowed in each of the euro area's three largest member states. Nevertheless, the euro area figure was still the second-highest rate in fifteen years. And, by historical standards, the labour market undoubtedly looks tight. Just as the unemployment rate dropped to a series low of 6.5% at the end of Q1, broader labour market slack similarly fell last quarter to the lowest on the series while the employment rate rose to a new high. With surveys reporting no significant let-up in firms' desire to recruit and retain staff despite subdued economic activity, the ECB yesterday again revised down its projection for unemployment over the horizon. And so, it also revised up its projections for employee compensation and unit labour cost growth. While the lower unemployment rate likely in part reflects positive structural factors, including a downward shift in the sustainable rate thanks to the economic reforms of the past decade or so, it is hardly surprising that the Governing Council is erring on the side of caution.

### The week ahead in the euro area

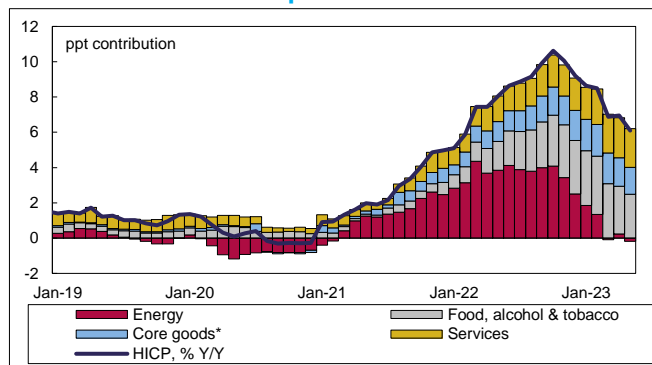
The euro area economic data highlights of the coming week will be the flash June European Commission consumer confidence indicator (Thursday) and PMIs (Friday), which will provide an update on economic recovery momentum and price pressures at the end of Q2. Having risen to an eleven-month high in April (54.1) but fallen back in May (52.8), the composite PMI is expected to have moderated slightly further in June, albeit remaining consistent with positive GDP growth in Q2. The services PMIs will similarly imply ongoing expansion thanks not least to the release of pent-up demand, but the manufacturing indices will also again signal contraction reflecting softer demand for goods at home and abroad. The survey's price indices will also continue to illustrate divergence in inflationary pressures between the sectors, with ongoing persistence in services but a further cooling in manufacturing. Other data due in the coming week include INSEE's French business confidence survey results on Thursday, and euro area construction output figures for April and German PPI figures for May on Tuesday.

#### Euro area: Consumer price inflation



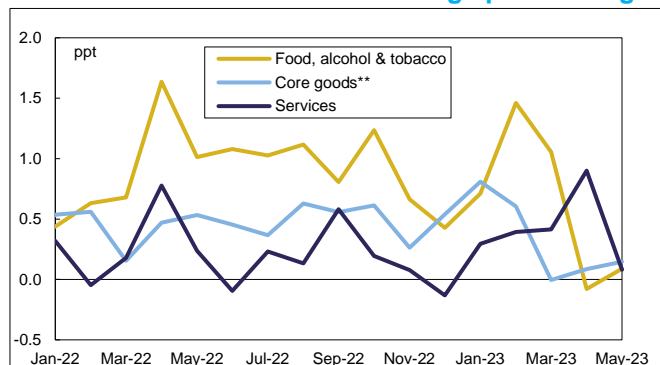
\*Non-energy industrial goods. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

#### Euro area: Consumer price inflation



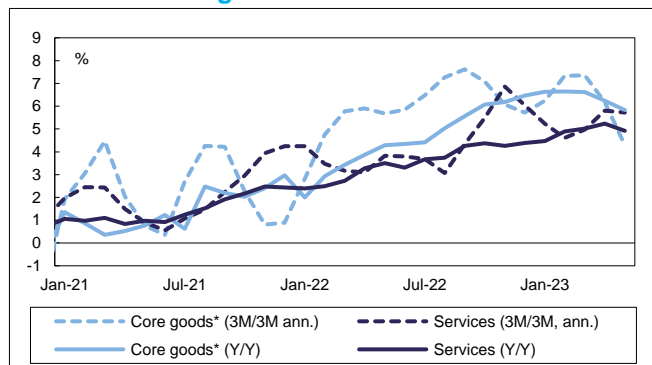
\*Non-energy industrial goods. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

#### Euro area: Deviation from l-r average price change\*



\*Deviation from long-run monthly price change \*\*Non-energy industrial goods. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

#### Euro area: Core goods and services momentum



\*Non-energy industrial goods. Source: ECB and Daiwa Capital Markets Europe Ltd.

## UK

### BoE bound to raise Bank Rate again on 22 June after run of bad data

The main event in the UK in the coming week will be the BoE's monetary policy decision on Thursday. At the MPC's last meeting in May, the Committee maintained its forward guidance that "if there were to be evidence of more persistent pressures, then further tightening in monetary policy would be required". In particular, it 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. Unfortunately, last week's [labour market figures](#) were much stronger than expected, with a particularly unwelcome acceleration in private sector pay in the three months to April which contrasted with the BoE's expectation of a moderation this quarter. Moreover, the [April CPI data](#) released less than a fortnight after the last MPC meeting also surprised significantly to the upside, with a marked jump in core inflation of 0.6ppt to 6.8%Y/Y, a new 41-year high, and services inflation (6.9%Y/Y) coming in 0.2ppt higher than BoE staff had forecast in its May Monetary Policy Report. So, the MPC is bound to hike rates again in the coming week. But the magnitude of tightening, as well as the guidance on future policy, is uncertain. Indeed, given the most recent economic data, the expected path of Bank Rate implied by market pricing has shifted significantly higher since the last MPC meeting to levels that would raise the strong likelihood of recession next year. Will the BoE seek to validate or challenge those hawkish market expectations?

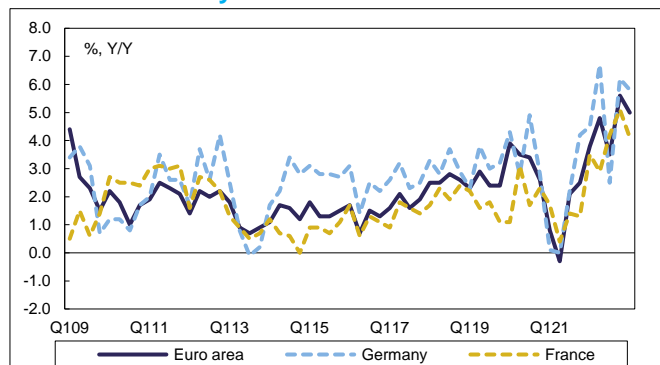
### Inflation expectations moderate and core CPI should ease slightly in May

The BoE at least received some better news today from its household inflation attitudes survey, which suggested a moderation in price expectations – one- and two-years ahead – to the lowest rates since 2021. Indeed, the rate for two-years ahead (2.6%Y/Y) eased back below the long-run average. While the expectation for five-years ahead moved sideways, at 3.0%Y/Y, this too was below the survey average. But more important for next week's MPC decision will be the May CPI figures (due Wednesday). We expect these to report a further moderation in headline inflation, by 0.4ppt to 8.3%Y/Y. More importantly, we also expect a modest easing in core CPI in May, by 0.1ppt to 6.7%Y/Y. If we are right, in line with the consensus, we would also expect the MPC to vote for a further 25bps increase in Bank Rate to 4.75%, taking the cumulative tightening so far this cycle to 465bps.

### Will MPC guidance validate or challenge market pricing of the future path of Bank Rate?

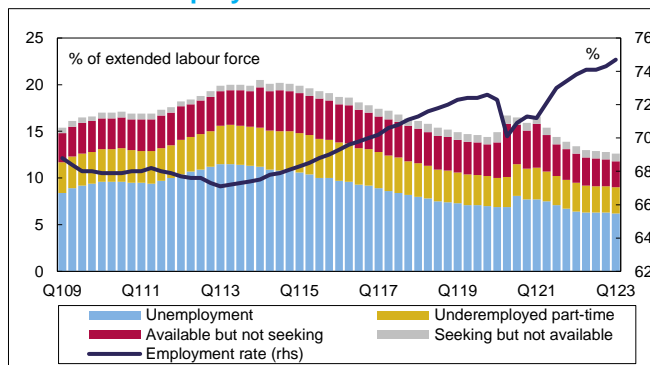
The MPC's decision next week is unlikely to be unanimous, however. Most notably, the more hawkish external members – Mann and possibly Haskel – will want to consider a larger hike of 50bps. And should the May CPI report again surprise

#### Euro area: Hourly labour costs\*



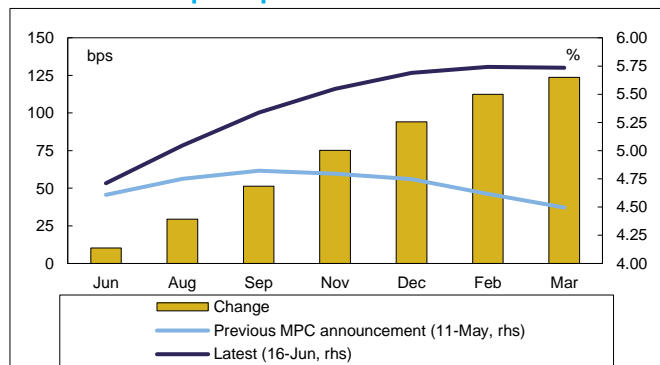
\*Market economy. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

#### Euro area: Employment & labour market slack



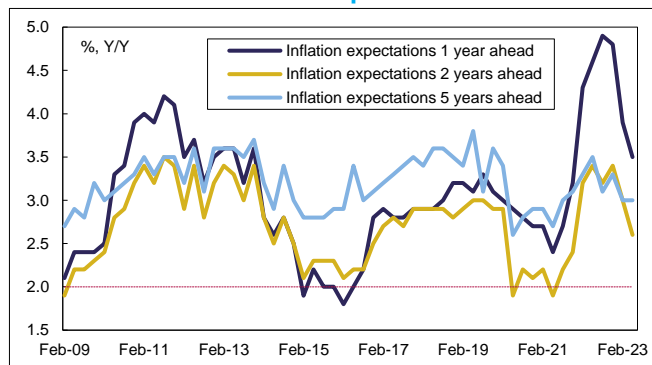
Source: Eurostat, Refinitiv and Daiwa Capital Markets Europe Ltd.

#### UK: Market-implied path for Bank Rate



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

#### UK: Household inflation expectations



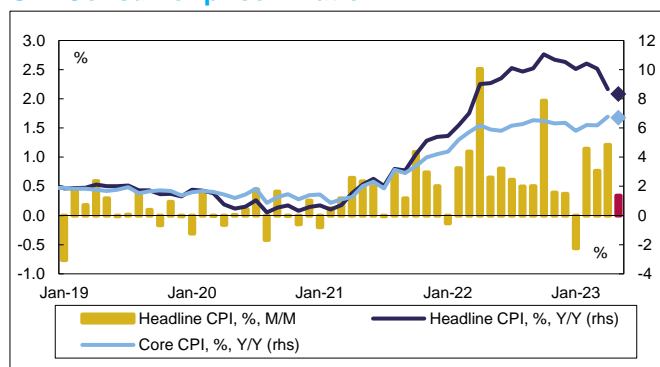
Source: BoE and Daiwa Capital Markets Europe Ltd.

significantly on the upside, we wouldn't rule out the majority voting for a 50bps hike too. Moreover, regardless of the detail of the CPI report, the MPC will certainly leave the door open to additional tightening over the summer. Indeed, the precise wording of its guidance might be little changed from May. However, if it retains some confidence in its expectation that inflation will fall steadily over coming quarters, and is also wary that the tightening of financial conditions currently being delivered by the markets might be economically damaging, in the absence of another nasty inflation surprise on Wednesday the MPC might seek to challenge current market pricing. If so, like late last autumn, the MPC statement could suggest that, although further tightening is likely to be required, the Committee expects the peak in Bank Rate to be lower than that currently priced into financial markets. However, having significantly underestimated the strength and persistence of inflation over recent quarters, it might not dare to do so this time around.

### The data week ahead in the UK

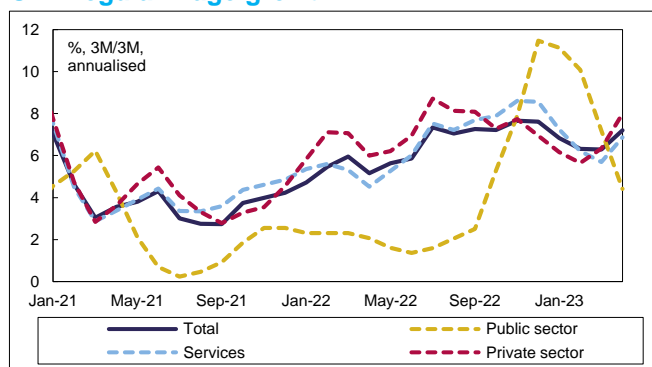
Aside from the CPI (and PPI) figures on Wednesday, it will be a busy end to the week for top-tier UK data releases too, with data for retail sales in May, and consumer confidence and the flash PMIs for June all due on Friday. Like in the euro area, the composite PMI is likely to suggest a slightly moderation in recovery momentum in June, although remain consistent with a slight increase in GDP growth in Q2, supported by the services sector. Meanwhile, despite a likely boost to food store sales, we suspect that the extra national holiday for the King's coronation will have had an adverse effect on retail spending in May. And while the latest GfK survey is expected to report a further modest improvement in consumer confidence in June, the headline sentiment index will remain well below the long-run average and therefore still consistent with subdued private consumption.

#### UK: Consumer price inflation\*



\*Diamonds and red bar represent Daiwa forecast for May 2023. Source: BoE, Refinitiv and Daiwa Capital Markets Europe Ltd.










#### UK: Regular wage growth



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




**The next edition of the Euro wrap-up will be published on 21<sup>st</sup> June 2023**

## Daiwa economic forecasts

	2022	2023				2024	2023	2024	2025
	Q4	Q1	Q2	Q3	Q4	Q1			
<b>GDP</b>	% Q/Q					% Y/Y			
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	4.4	2.7	2.6	5.2	2.3	1.7
Core HICP 	5.1	5.5	5.4	4.9	4.2	3.5	5.0	2.6	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	3.75	3.00
Deposit Rate 	2.00	3.00	3.50	3.75	3.75	3.75	3.75	3.25	2.50
BoE									
Bank Rate 	3.50	4.25	4.75	5.25	5.25	5.25	5.25	4.75	3.75

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		Final (core) HICP Y/Y%	May	6.1 (5.3)	<u>6.1 (5.3)</u>	7.0 (5.6)	-
		Labour costs Y/Y%	Q1	5.0	-	5.7	5.6
Italy		Final HICP (CPI) Y/Y%	May	8.0 (7.6)	<u>8.1 (7.6)</u>	8.7 (8.2)	-
Auctions							
Country	Auction						
- Nothing to report -							

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 19 June 2023</b>					
UK		00.01 Rightmove house prices M/M% (Y/Y%)	Jun	-	1.8 (1.5)
<b>Tuesday 20 June 2023</b>					
Euro area		10.00 Construction output M/M% (Y/Y%)	Apr	-	-2.4 (-1.5)
Germany		07.00 PPI Y/Y%	May	1.7	4.1
<b>Wednesday 21 June 2023</b>					
Euro area		07.00 EU27 new car registrations Y/Y%	May	-	17.2
France		- BoF retail sales Y/Y%	May	-	-6.8
UK		07.00 CPI (core CPI) Y/Y%	May	<u>8.3 (6.7)</u>	8.7 (6.8)
		07.00 PPI output (input) prices Y/Y%	May	3.2 (1.2)	5.4 (3.9)
		07.00 Public sector net borrowing, excluding banks £bn	May	20.0	25.6
		09.30 House price index Y/Y%	Apr	-	4.1
		11.00 CBI industrial trends survey, total orders (selling prices)	Jun	-	-17 (21)
<b>Thursday 22 June 2023</b>					
Euro area		15.00 European Commission's preliminary consumer confidence	Jun	-17.0	-17.4
France		07.45 INSEE business confidence	Jun	100	100
		07.45 INSEE manufacturing (production outlook) confidence	Jun	98 (-)	99 (-10)
UK		12.00 BoE bank rate %	Jun	<u>4.75</u>	4.50
<b>Friday 23 June 2023</b>					
Euro area		09.00 Preliminary manufacturing (services) PMI	Jun	44.8 (54.4)	44.8 (55.1)
		09.00 Preliminary composite PMI	Jun	52.5	52.8
Germany		08.30 Preliminary manufacturing (services) PMI	Jun	43.8 (56.2)	43.2 (57.2)
		08.30 Preliminary composite PMI	Jun	53.4	53.9
France		08.15 Preliminary manufacturing (services) PMI	Jun	45.2 (52.0)	45.7 (52.5)
		08.15 Preliminary composite PMI	Jun	50.9	51.2
Spain		08.00 GDP – second estimate Q/Q (Y/Y%)	Q1	<u>0.5 (3.8)</u>	0.4 (2.9)
UK		00.01 GfK consumer confidence	Jun	-26	-27
		07.00 Retail sales including auto fuel M/M% (Y/Y%)	May	-0.2 (-2.6)	0.5 (-3.0)
		07.00 Retail sales excluding auto fuel M/M% (Y/Y%)	May	-0.4 (-2.2)	0.8 (-2.6)
		09.30 Preliminary manufacturing (services) PMI	Jun	46.8 (54.8)	47.1 (55.2)
		09.30 Preliminary composite PMI	Jun	53.7	54.0

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.



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

Country	BST	Event / Auction
<b>Monday 19 June 2023</b>		
Euro area	 09.00	ECB publishes survey of monetary analysts
	 12.00	ECB Chief Economist Lane scheduled to speak
	 12.40	ECB's Schnabel to chair a session on 'New challenges for the Economic and Monetary Union in the post-crisis environment'
	 14.00	ECB's Villeroy scheduled to speak
<b>Tuesday 20 June 2023</b>		
Euro area	 18.10	ECB's de Guindos scheduled to speak
Germany	 10.30	Auction: €5.50bn of 2.8% 2025 bonds
UK	 10.00	Auction: £3.75bn of 4.5% 2028 bonds
<b>Wednesday 21 June 2023</b>		
Euro area	 14.45	ECB's Schnabel scheduled to speak on a panel – 'Inflation – too sticky for comfort'
Germany	 10.30	Auction: €1.0bn of 0.0% 2050 bonds
	 10.30	Auction: €1.5bn of 0.0% 2052 bonds
<b>Thursday 22 June 2023</b>		
Euro area	 10.15	ECB's Panetta scheduled to speak
UK	 12.00	BoE monetary policy announcement, summary and minutes published
	 12.00	BoE publishes Agents' summary of business conditions
<b>Friday 23 June 2023</b>		
- Nothing scheduled -		

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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