Euro wrap-up

Overview

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- Gilts made losses at the short end but gains at the long end as the BoE raised Bank Rate by 50bps and signalled the likelihood of further tightening to come.
- Bunds made losses as euro area consumer confidence beat expectations.
- Friday will bring the results of the flash European PMIs for June, as well as UK consumer confidence and retail sales data.

Daily bond market movements

Bond	Yield	Change
BKO 2.8 06/25	3.192	+0.068
OBL 2.2 04/28	2.623	+0.066
DBR 2.3 02/33	2.482	+0.050
UKT 0⅝ 06/25	5.078	+0.025
UKT 1⅝ 10/28	4.564	-0.028
UKT 3¼ 01/33	4.371	-0.034

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

UK

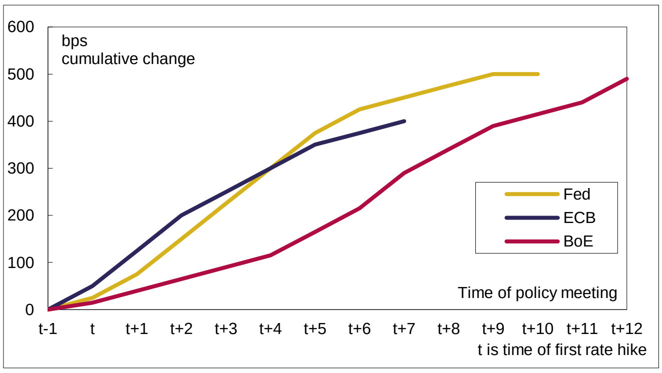
BoE hikes by 50bps and signals likelihood of more tightening to come

Following yesterday's big upside surprise to inflation, and last week's stronger-than-expected labour market figures, the BoE today accelerated the pace of its monetary tightening, hiking rates by 50bps for the first time since February. That took Bank Rate to 5.00%, the highest level since October 2008, and brought the cumulative tightening over the past nine months to 490bps. The decision was not unanimous. But a large majority of seven members of the MPC voted in favour, while the two external doves (Dhingra and the soon-to-depart Tenreyro) were unperturbed by the evidence of increased price pressures and voted for no change. Unsurprisingly, the MPC also left the door open to further tightening over coming meetings by leaving unchanged its forward guidance, which states that "If there were to be evidence of more persistent [inflationary] pressures, then further tightening in monetary policy would be required". That might suggest that further overshooting in services inflation or wage growth relative to expectations would be required to justify additional hikes. But unlike last autumn when market pricing shifted markedly in the wake of the Truss fiasco, the BoE did nothing today to suggest that the past month's big jump in the market-implied future path of Bank Rate – up on average by roughly 150bps over the next three years – was inappropriate.

MPC flags concerns of greater inflation persistence but also notes some downside risks

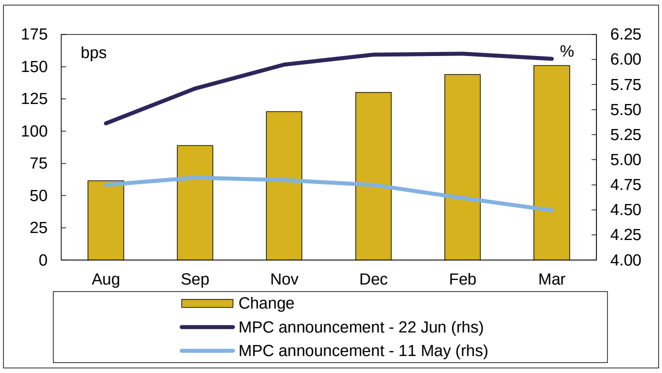
The MPC's statement acknowledged the upside surprises in the variables that it has emphasised are now driving its rate decisions. In particular, it highlighted that services CPI inflation in May of 7.4%Y/Y was 0.5ppt above its forecast published just last month, with core goods inflation also above its expectation. Likewise, it noted that private sector average weekly earnings growth of 7.6%3M/Y was 0.5ppt higher than it anticipated, with employment growth also stronger than projected. So, with surveys suggesting that growth in underlying economic activity remains resilient at around ¼%Q/Q, the MPC flagged concerns of greater persistence in the inflation process. Indeed, the MPC now expects services inflation to remain broadly unchanged over the near term, having previously expected it to moderate to an average 6.5%Y/Y in Q3. But, the MPC also still expects inflation to fall "significantly" this year. While that is principally due to lower energy prices, inflation of core goods and food is also expected to moderate in line with global developments. The MPC also noted that the recent REC/KPMG survey suggested that private sector pay might slow in the second half of the year by more than expected last month, while the Bank's Agents had also reported that pay settlements could be softer in H223. And with the full impact of past increases in Bank Rate still unlikely to be felt for some time, the MPC will still be wary of the risks of tightening too far.

BoE, ECB, Fed: Cumulative policy tightening



Source: BoE, ECB, Fed and Daiwa Capital Markets Europe Ltd.

UK: Market-implied path for BoE Bank Rate*



**Implied by OIS market. Source: Bloomberg and Daiwa Capital Markets Europe Ltd.*

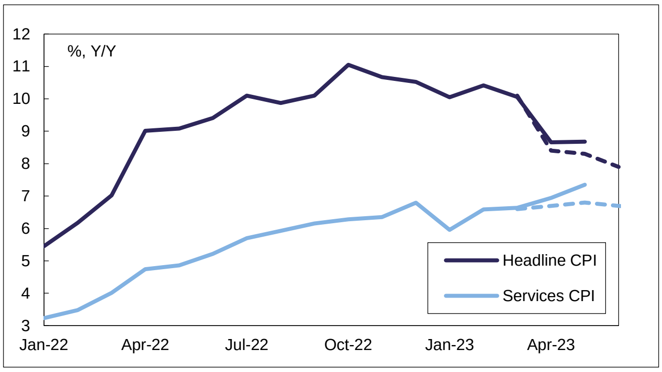
Further hikes to come but market-implied path would likely be recessionary

The wording of the MPC's forward guidance fails to make clear what it will precisely need to see in terms of services prices, core inflation, or wage growth, to persuade it to pause in its tightening cycle. But the MPC's updated projections in August will hopefully provide a little more clarity about whether or not the current market pricing for the path of Bank Rate is reasonable. The BoE will certainly now expect inflation over the near term to be higher than it previously expected, and the MPC will continue to assume an upside skew to the price outlook further ahead. But we think that the Bank's updated mean inflation projection in August based on a market-implied path for rates – which at the time of writing suggested that Bank Rate would rise at least to 6.00% by the end of the year – will still fall below the 2% inflation target by the end of the projection, not least given the likely recessionary toll that such cumulative monetary tightening would take on household consumption. So, we expect the pace of tightening to slow back to 25bps in August. And while we also now pencil in a further 25bps hike in September, which would take Bank Rate to 5.50%, services inflation and private sector wage growth might by November have moderated sufficiently to persuade the MPC then to pause. Given the continued challenges projecting UK economic activity and inflation at this juncture, however, we admit that the near-term path of Bank Rate will remain extremely uncertain for some time. The risks to our rate view are skewed clearly to the upside, with further hikes of 50bps over the near term or additional tightening through to year end certainly not to be ruled out.

The day ahead in the UK

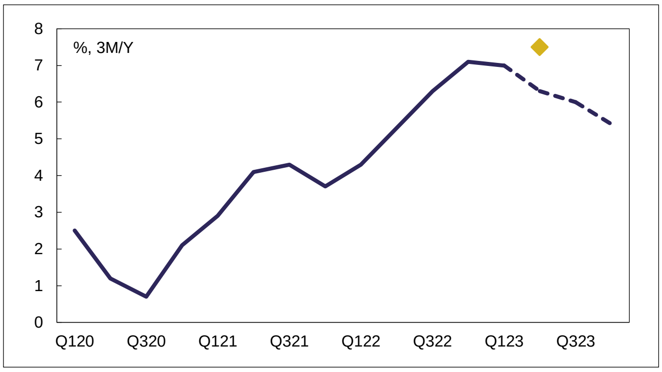
Tomorrow's flash PMIs will provide an insight into economic recovery momentum at the end of Q2. Having jumped to a twelve-month high in April (54.9) but edged slightly lower in May (54.0), the composite PMI is likely to suggest a further moderation in June. However, it should remain consistent with a slight increase in GDP in Q2 on account of growth in the services sector. Moreover, against the backdrop of rising demand and high growth in input costs related not least to wages, the services output price PMI is likely to remain well above the long-run average. In contrast, amid weak demand and falling input costs, the manufacturing output price index is likely to fall to its lowest since late-2020 and fall back close to the long-run average. Friday will also bring retail sales figures for May. 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: Headline and services inflation*



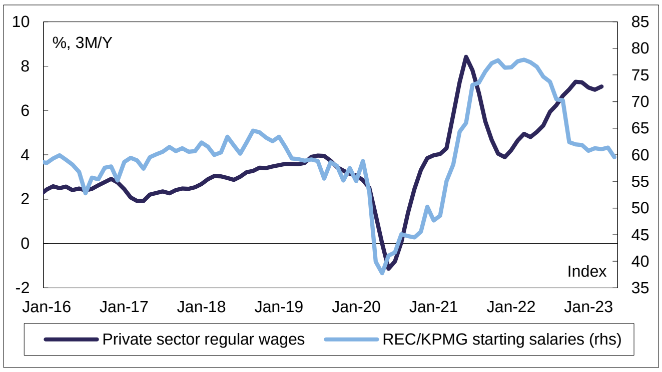
**Dashed lines represent BoE forecast in May MPR. Source: BoE, Refinitiv and Daiwa Capital Markets Europe Ltd.*

UK: Private sector regular pay*



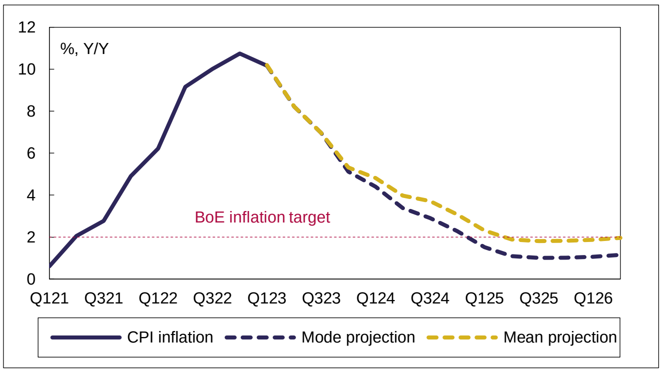
**Dashed line represents BoE forecast in May MPR. Diamond represents April outturn. Source: BoE, Refinitiv and Daiwa Capital Markets Europe Ltd.*

UK: Private sector pay and starting salaries



Source: REC/KPMG, Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: BoE inflation forecast – May-23*



**Based on market implied path for Bank Rate in May MPR, averaging just over 4% over the next three years. Source: BoE, Refinitiv and Daiwa Capital Markets Europe Ltd.*

Euro area

Euro area consumer confidence beats expectations in June

Ahead of tomorrow's flash PMIs, the Commission's flash consumer confidence index for June beat expectations. In particular, the headline indicator rose for the eighth month out of the past nine, by a larger-than-expected 1.3pts to -16.1, the highest level since before Russia's invasion of Ukraine in February 2022 and some 12½pts above September's trough. Admittedly, the improvement in the euro area index this month contrasted with the couple of national survey results for the month. In the Netherlands, the headline sentiment index fell 1pt to -39, with a modest deterioration in expectations for the economic outlook, future financial situation and purchase intentions. That perhaps reflects the ongoing adjustment in the Dutch housing market, where prices in May recorded the steepest annual decline (-5.6%Y/Y) since mid-2014. Meanwhile, headline sentiment in Belgium moved sideways (-9). Nevertheless, we note that the respective sentiment indices for both countries in Q2 were still above their Q1 averages. And while the euro area index was still well below the pre-pandemic level (-6.1) and long-run average (-10.4), it was also on average in Q2 up more than 2½pts, suggesting a welcome return to positive household consumption growth this quarter.

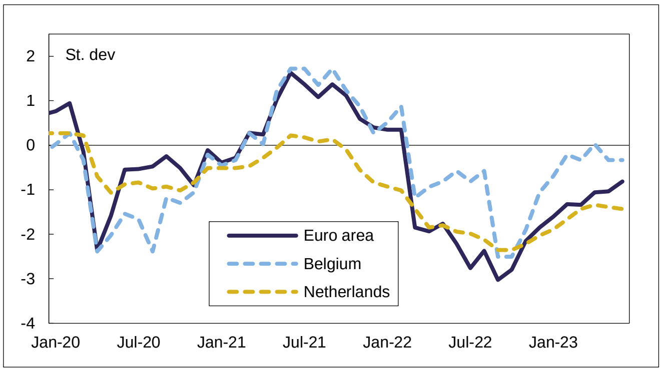
French business surveys suggest modest GDP growth in Q2

While yesterday's French retail sales results suggested that household demand for goods remained subdued in May, today's INSEE business survey signaled a slight improvement in retailers' business conditions in June, with the headline sentiment index in the sector rising to the joint-highest since February 2022. In addition, the headline manufacturing sentiment index reversed the 2pt drop in May back to 101, amid a slight improvement in production expectations and domestic order books, particularly in the auto subsector. But while the business climate stabilised in the services sector at an above-average level (102), the respective index was nevertheless still the joint-lowest since April 2021. And construction sentiment fell for the seventh consecutive month, similarly to its lowest level for more than two years. Overall, the INSEE composite business climate index moved sideways at 100 in June, bang in line with the long-run average. While this was the joint-lowest reading since April 2021 and well below the highs recorded during the post-lockdown bounce in the second half of 2021 (which averaged 111), like the BoF survey, today's survey results were nevertheless broadly consistent with our view for modest French GDP growth at about 0.1%Q/Q in Q2.

The day ahead in the euro area

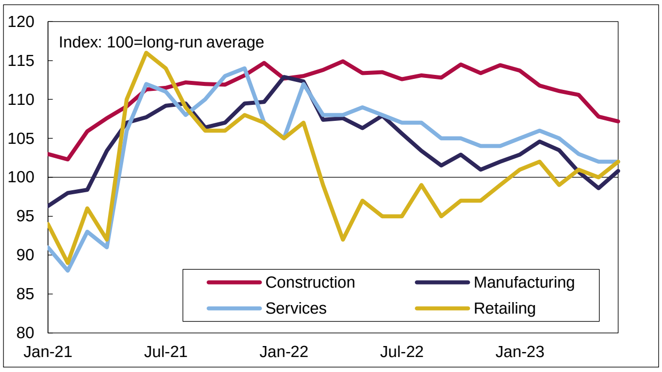
Friday will bring the flash euro area PMI results for June, which will provide an update on economic recovery momentum and price pressures at the end of Q2. Having risen to an eleven-month high in April (54.1) but fallen back in May (52.8), the composite output PMI is expected to have moderated slightly 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. Tomorrow will also bring revised Q1 GDP figures from Spain and the Netherlands. According to the current estimates, Spanish GDP rose 0.5%Q/Q but Dutch GDP contracted 0.7%Q/Q.

Euro area: Consumer confidence



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

France: INSEE business confidence indices



Source: INSEE, Refinitiv 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 preliminary consumer confidence	Jun	**-16.1**	-17.0	-17.4	-
France		INSEE business confidence	Jun	**100**	100	100	-
		INSEE manufacturing (production outlook) confidence	Jun	**101 (-9)**	98 (-11)	99 (-10)	-
UK		BoE bank rate %	Jun	**5.00**	*4.75*	4.50	-

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/ *Daiwa forecast*	Previous
Euro area		09.00	Preliminary manufacturing (services) PMI	Jun	44.8 (54.5)	44.8 (55.1)
		09.00	Preliminary composite PMI	Jun	53.6	52.8
Germany		08.30	Preliminary manufacturing (services) PMI	Jun	43.5 (56.3)	43.2 (57.2)
		08.30	Preliminary composite PMI	Jun	53.3	53.9
France		08.15	Preliminary manufacturing (services) PMI	Jun	45.3 (52.1)	45.7 (52.5)
		08.15	Preliminary composite PMI	Jun	51.0	51.2
Spain		08.00	GDP – second estimate Q/Q (Y/Y%)	Q1	*0.5 (3.8)*	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 (-2.5)	0.5 (-3.0)
		07.00	Retail sales excluding auto fuel M/M% (Y/Y%)	May	-0.3 (-2.0)	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	53.6	54.0

Auctions and events

- Nothing scheduled -

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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