

Euro wrap-up

Overview

- While Spanish inflation fell below 2%, Bunds followed the global trend lower as the flash German inflation estimates confirmed a significant pickup in the headline and core rates.
- Gilts also made losses even as UK households made a second successive net mortgage repayment and withdrew a record amount from deposits.
- Friday will bring preliminary figures for euro area inflation and unemployment, German and French retail sales and UK house prices.

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Daily bond market movements

Bond	Yield	Change
BKO 2.8 06/25	3.172	+0.092
OBL 2.4 10/28	2.559	+0.105
DBR 2.3 02/33	2.411	+0.102
UKT 0% 06/25	5.183	+0.070
UKT 1% 10/28	4.595	+0.049
UKT 3% 01/33	4.359	+0.053

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

Euro area

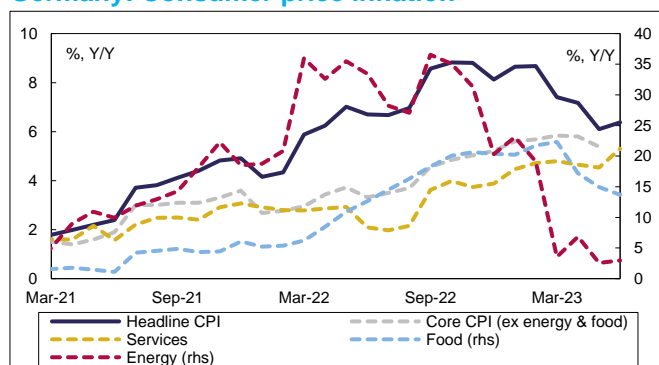
German headline and core inflation predictably pick up on public transport base effect

Ahead of Friday's release of the flash euro area consumer price inflation data for June, today's national data were mixed, albeit not far out of line with expectations. As widely anticipated, German consumer price inflation picked up in June for the first time in four months. In particular, on the EU-harmonised HICP measure, inflation rose 0.3ppt to 6.4%Y/Y. The main cause was the base effect associated with last summer's highly-discounted rail fares, which alone will have boosted inflation by about 0.7ppt. So, while the figures from the states suggest that inflation in hospitality, package holidays and recreation moderated, services inflation rose 0.8ppt to a new high of 5.3%Y/Y. Within the other German detail, food inflation moderated for a third month, but energy inflation picked up slightly. And while core goods inflation overall was softer, on the national CPI measure, core inflation excluding food and energy appears to have risen 0.3ppt to 5.7%Y/Y due to the higher services component. Reflecting differences of weighting, the German core HICP figure is likely to have increased by significantly more than that, contributing to an increase in core inflation in the euro area this month.

Spanish inflation falls below 2% as energy and food components continue to moderate

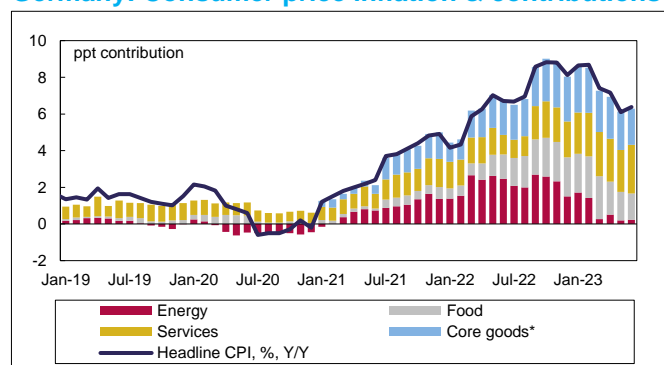
In contrast to the rise in Germany, but also reflecting base effects associated with significant shifts a year earlier, Spanish consumer price inflation predictably continued to fall sharply in June. In particular, Spain's HICP rate dropped 1.3ppts to an eye-catching 1.6%Y/Y, below the ECB's target and the lowest rate since March 2021. Specifically, much smaller increases this month than a year ago in prices of auto fuel, electricity, food and drink was the main explanation for the marked drop in inflation. Spanish core CPI inflation, which excludes energy and fresh (but not processed) food, fell just 0.2ppt to a still-elevated 5.9%Y/Y, still nevertheless a twelve-month low. Elsewhere in the region, CPI inflation in Belgium dropped just over 1ppt to a 21-month low of 4.15%Y/Y. And the HICP rate in Ireland fell almost 0.6ppt to 4.8%Y/Y, similarly the lowest since September 2021. While a further moderation in the food component and an accelerated fall in energy was the main cause, lower services inflation meant that the Belgian core measure (excluding fresh food and energy) fell a little more than 0.4ppt to just below 8.3%Y/Y. But the Irish core measure was unchanged at 5.7%Y/Y. Looked at together with yesterday's drop in Italy, tomorrow's euro area figures still look set to report a drop of approximately ½ppt in the headline HICP rate from 6.1%Y/Y in May. However, core inflation in the euro area also looks set to rise from 5.3%Y/Y last month to around 5½%Y/Y. Much, however, will depend on the French figures, also due for release tomorrow.

Germany: Consumer price inflation*



*Core estimate for June 2023 is estimate. Source: Destatis and Daiwa Capital Markets Europe Ltd.

Germany: Consumer price inflation & contributions



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

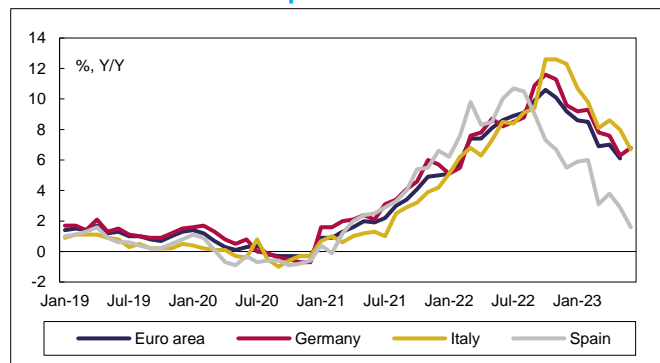
Consumer and business price expectations continue to moderate despite firm labour market

Looking further ahead, the Commission's economic survey results for June also brought some good news. In particular, consumer price expectations for the coming twelve months fell for a third successive month in June to a seven-year low. The respective index fell particularly sharply in France, while those for Italy and Spain were negative. Business price-setting expectations for the coming three months fell in each main sector. In retail and services, the respective indices remained well above the long-run averages, but nevertheless reached the lowest in two years and 21 months respectively. In construction, they fell to the lowest since early 2021. And in industry, they fell below the long-run average to the lowest since late 2020. While the survey appears consistent with continued near-term inflation persistence in services and retail, inflation expectations certainly do not appear particularly de-anchored from a medium-term perspective. Nevertheless, the ECB will remain wary of the tightness in the labour market, and the risks that might further fuel inflation persistence. Indeed, the Commission survey's Employment Expectations Index for the euro area picked up again in June to remain well above the long-run average. The signal of increased labour demand was led by services, with firms in Germany, Italy and Spain all pointing to a desire on aggregate to increase headcount.

Commission survey adds to evidence of loss of economic growth momentum heading into Q3

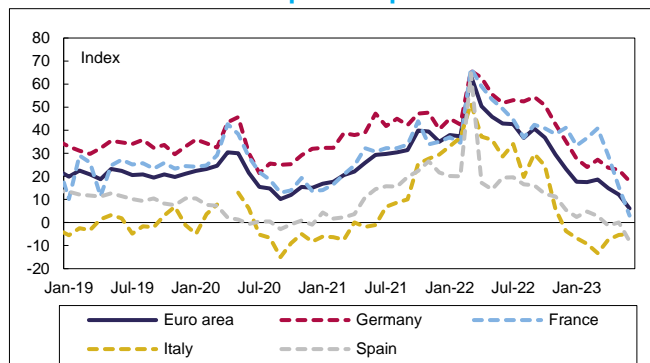
Nevertheless, like the flash PMIs, and certain recent national survey indicators, most of the other detail of the Commission's June survey results was consistent with a loss of growth momentum at the end of Q2. Certainly, the headline sentiment indices for all main sectors deteriorated. Unsurprisingly, with new orders falling in the wake of inventory adjustments and tightening monetary policies, confidence in industry weakened for a fifth successive month to below the long-run average and the most negative since September 2020. Construction sector sentiment also deteriorated to the worst since February 2021 as order books continued to shrink. Confidence in retail fell further below the long-run average to a nine-month low among other things due to rising unsold inventories. And while it remained in positive territory, services sector sentiment softened to a seven-month low as firms revised down their expectations for near-term demand. Reassuringly perhaps, the surprise improvement in consumer confidence to the highest level since the Russian invasion of Ukraine flagged by the flash estimate was confirmed. Indeed, with households a little less downbeat about the economic outlook and prospects for their own personal finances – perhaps thanks to improved inflation expectations – the survey's gauge of readiness to make major purchases over the coming twelve months rose to the highest in fifteen months. Nevertheless, the Commission's headline Economic Sentiment Indicator (ESI) fell for the second successive month and by a larger-than-expected 1.1pt to 95.3, a seven-month low firmly below the long-run average (100). According to the country ESIs, Germany remained the weakest of the larger member states in June. But while it remained below the long-run average the French index rose to a three-month high, while the Italian index remained comfortably above the long-run average despite moderating to a six-month low.

Euro area: Consumer price inflation*



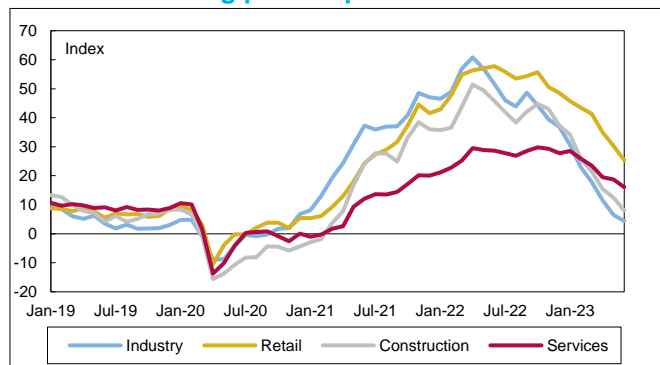
*Harmonised HICP measure. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Consumer price expectations indices*



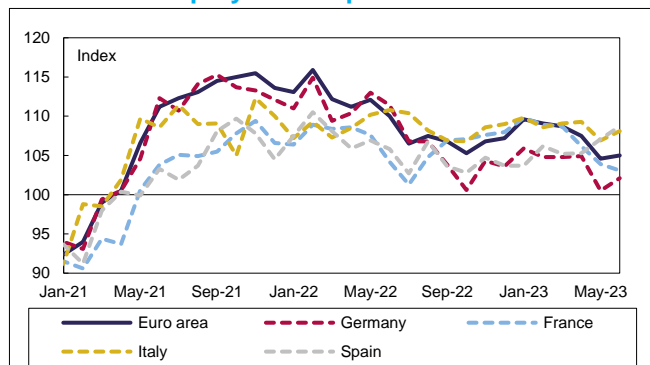
*No Italian survey results for April 2020. Source: EC, Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Selling price expectations indices



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

Euro area: Employment expectations indices



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

The day ahead in the euro area

All eyes tomorrow will be on the aforementioned euro area inflation estimates for June. Given the data published so far, we expect headline euro area inflation to have fallen sharply further this month, by 0.7ppt to 5.4%Y/Y, which would be the lowest rate since January 2022. But given the likely uptick in services due to base effects associated with the German discounted travel pass last summer, core inflation is expected to have risen, by 0.2ppt to 5.5%Y/Y, albeit remaining below March's peak. Friday will also bring unemployment figures from the euro area (May) and Germany (June), as well as the latest results for spending on goods from Germany and France.

UK

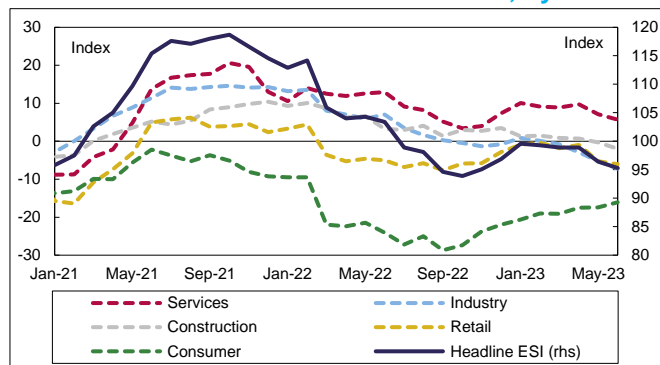
Second successive net mortgage repayment as interest rates rise

Like yesterday's euro area monetary data, the impact of the BoE's aggressive tightening path on both lending and deposits was again evident in today's UK monetary data. Consistent with the drop in loan demand reported in the Bank's credit conditions survey, UK households made a second successive net repayment of mortgage debt in May for the first time since the series began in 1986. Admittedly, the net repayment of £0.1bn was notably smaller than the near-record amount in April (£1.5bn), but nevertheless compared with the average increase of £3.8bn over the previous twelve months. And while the number of mortgage approvals rose more than expected in May, by 50.5k, it was still almost one third below last summer's peak and remained well below the pre-pandemic five-year average (66.5k). Moreover, with numerous lenders having withdrawn products in the wake of the larger hike in Bank Rate this month and the average rate on a two-year mortgage having risen by around a 1ppt since the start of May, many households will likely continue to try to pay down their mortgage debt in fear of even higher rates to come. Indeed, with more than 1mn mortgage borrowers set to see their fixed-rate deals expire before the end of the year, many households are set to face a further big hit to their disposable income over the coming months even in the absence of further BoE rate hikes.

Households withdraw a record amount from deposits

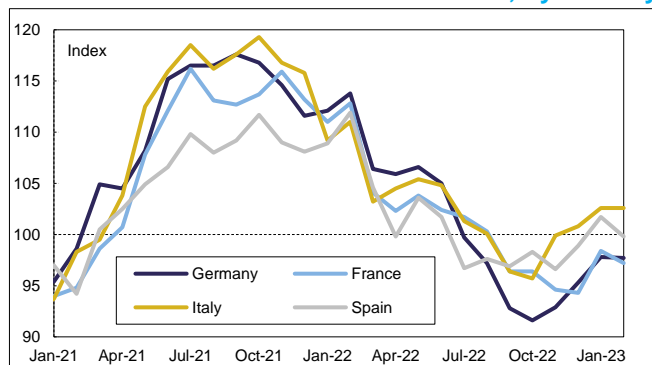
While consumer credit flows were below average in May, with net new loans of £1.1bn being the smallest amount for five months, this still left the stock of such lending up more than 8%3M/3M annualised as many households continued to struggle with the higher cost of living. Indeed, while there was a notable increase in higher-yielding time deposits, there was also a much larger withdrawal in sight deposits, to leave a record net withdrawal in total household deposits (£4.6bn). In contrast,

Euro area: Economic sentiment indices, by sector



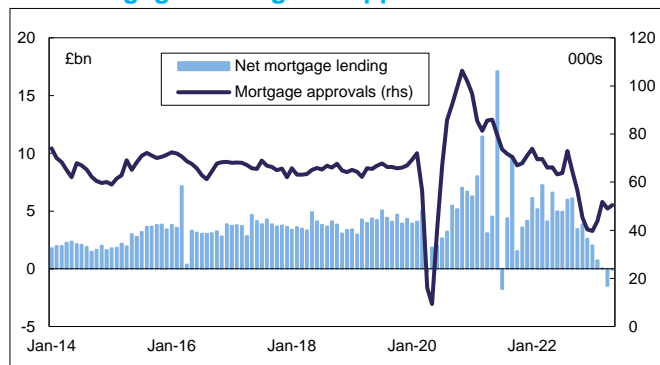
Source: EC, Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Economic sentiment indices, by country



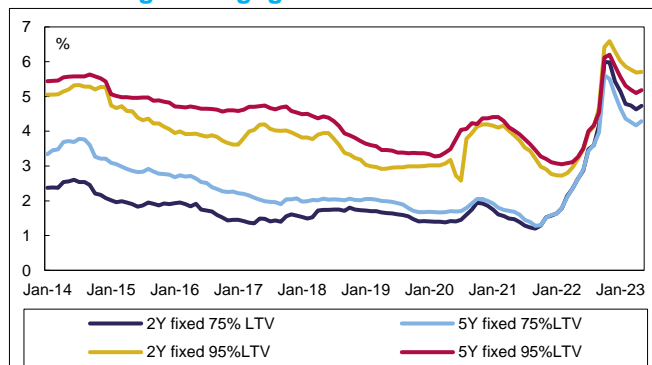
Source: EC, Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Mortgage lending and approvals



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Average mortgage interest rates



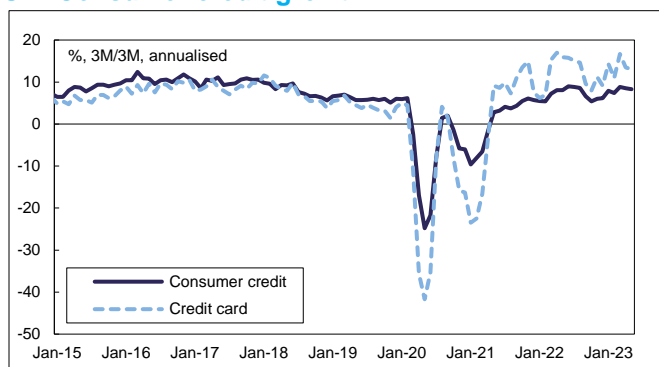
Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

there was a net increase in deposits of businesses for the first month in nine (£9.8bn). However, this still left the cumulative withdrawal since October at £53bn. SMEs also remained reluctant to take out bank loans, repaying on net £1.0bn in May, while the net increase in lending to large firms slowed to £0.4bn. Overall, the annual increase in the total outstanding amount of loans to NFCs rose just 0.6%Y/Y, with loan growth to SMEs down 4.3%Y/Y, the steepest drop since last July.

The day ahead in the UK

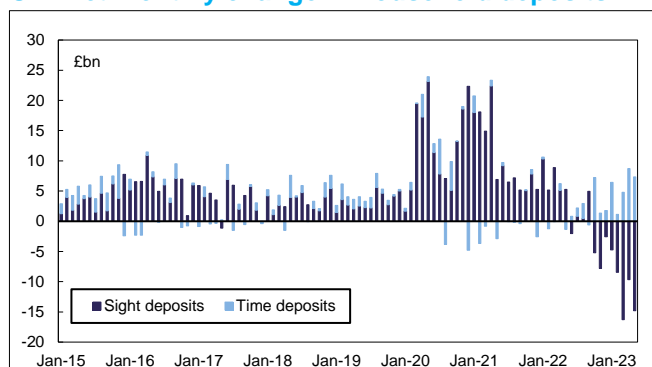
In the context of today's lending figures, tomorrow's release of the June Nationwide house price data will be of interest. Given the jump in mortgage rates and withdrawal of various mortgage deals over recent months, this is expected to report that prices fell for the ninth month out of the past ten to leave them down 4%Y/Y. Car production figures for May will also be published, along with revised Q1 GDP data. These are expected to confirm modest growth of 0.1%Q/Q, as stronger private investment offset a decline in government consumption and lacklustre household consumption. This release will be accompanied by the balance of payments numbers for last quarter, which are expected to report a widening in the current account deficit (by around £5bn to £7.5bn), albeit remaining well below the record high a year ago (£50.5bn).

UK: Consumer credit growth



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

UK: Net monthly change in household deposits



Source: 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	EC Economic Sentiment Index	Jun	95.3	95.7	96.5	96.4
	EC industry (services) confidence	Jun	-7.2 (5.7)	-5.6 (5.1)	-5.2 (7.0)	-5.3 (7.1)
	EC final consumer confidence	Jun	-16.1	-16.1	-17.4	-
Germany	Preliminary HICP (CPI) Y/Y%	Jun	6.8 (6.4)	6.8 (6.2)	6.3 (6.1)	-
Spain	Preliminary HICP (CPI) Y/Y%	Jun	1.6 (1.9)	1.5 (1.7)	2.9 (3.2)	-
UK	Consumer credit £bn (Y/Y%)	May	1.1 (7.5)	1.5 (-)	1.6 (7.7)	1.5 (7.6)
	Mortgage lending £bn (approvals, 000s)	May	-0.1 (50.5)	-0.7 (49.5)	-1.4 (48.7)	-1.5 (49.0)

Auctions

Country	Auction
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- 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
Euro area		10.00 Preliminary HICP (core HICP) Y/Y%	Jun	5.4 (5.5)	6.1 (5.3)
		10.00 Unemployment rate %	May	6.5	6.5
Germany		07.00 Retail sales M/M% (Y/Y%)	May	0.0 (-4.9)	0.5 (-8.7)
		08.55 Unemployment change 000s (rate %)	Jun	14.0 (5.6)	9.0 (5.6)
France		07.45 Preliminary HICP (CPI) Y/Y%	Jun	5.4 (4.6)	6.0 (5.1)
		07.45 Consumer spending M/M% (Y/Y%)	May	0.7 (-3.6)	-1.0 (-4.3)
		07.45 PPI Y/Y%	May	-	7.0
UK		00.01 Lloyds business barometer	Jun	-	28
		07.00 GDP – 3rd estimate Q/Q% (Y/Y%)	Q1	0.1 (0.2)	0.1 (0.6)
		07.00 Current account balance £bn	Q1	-7.5	-2.5
		07.00 Nationwide house price index M/M% (Y/Y%)	Jun	-0.2 (-4.0)	-0.1 (-3.4)

Auctions and events

Italy		10.00 Auction: Up to €3.0bn of 3.8% 2028 bonds
Italy		10.00 Auction: Up to €3.25bn of 4.35% 2033 bonds
Italy		10.00 Auction: Up to €1.25bn of 5.0% 2034 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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