

Euro wrap-up

Overview

- Bunds largely made modest gains as euro area inflation broadly aligned with expectations, with a notable drop in the headline rate while the core rate ticked slightly higher.
- Shorter-dated Gilts made losses while updated Q1 GDP data showed an upwards revision to private sector capex, while profits outpaced pay.
- The coming week will bring figures for euro area producer prices, inflation expectations, and retail sales, as well as German industrial production and factory orders.

Chris Scicluna
+44 20 7597 8326

Emily Nicol
+44 20 7597 8331

Daily bond market movements

Bond	Yield	Change
BKO 2.8 06/25	3.182	+0.006
OBL 2.4 10/28	2.544	-0.018
DBR 2.3 02/33	2.388	-0.025
UKT 0% 06/25	5.270	+0.036
UKT 1% 10/28	4.659	+0.035
UKT 3¼ 01/33	4.383	+0.003

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

Euro area

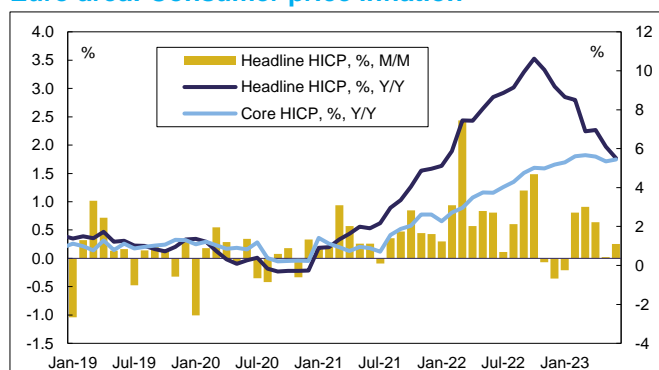
Flash consumer price inflation falls again while core rate ticks up slightly

Today's flash estimates of euro area consumer price inflation in June were broadly in line with expectations. The headline HICP rate fell for the second successive month and by 0.6ppt to 5.5%Y/Y, more than 5ppts below October's peak and the lowest since January 2022. The decline was principally due to the continued easing of the huge shocks to energy and food. Indeed, likely reflecting slight drops in both petrol and household electricity prices, energy inflation dropped to -5.6%Y/Y, the most negative since end-2020. And with the rise in food prices in June close to the seasonal norm in marked contrast to the record rise for the month a year ago, the respective inflation component fell for a third successive month, albeit remaining elevated at 11.7%Y/Y. In terms of the core components, prices of non-energy industrial goods fell for the first time since January, also more closely in line with the seasonal pattern. That pushed annual core goods inflation lower for a fourth successive month, to 5.5%Y/Y, some 1.3ppts below February's peak. However, largely given base effects associated with Germany's super-discounted public transport fares last summer, as well as changes to the basket weights, services inflation was bound to rise this month. But with the monthly increase in services prices only slightly higher than the June average in 2020 and 2021, albeit still above the series mean, the rise in services inflation of 0.4ppt to a new series high of 5.4%Y/Y was less marked than many observers feared. And as a result, core HICP inflation rose just 0.1ppt to 5.4%Y/Y, still down from the series highs reached from February to April.

Core goods and services price momentum moderates while German jobless claims rise

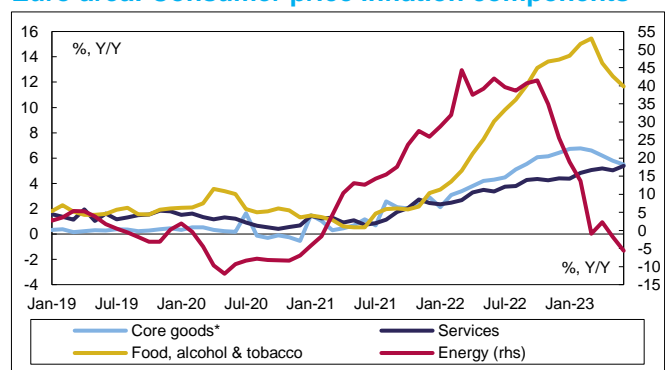
The ECB will certainly not have been surprised by today's data. Indeed, the headline and core rates were both a negligible 0.1ppt below the respective median forecasts on the Bloomberg survey. And they left the Q2 averages for headline (6.2%Y/Y) and core inflation (5.5%Y/Y) bang in line with the ECB's latest projections. So, the figures will definitely not prompt a sudden change of mind at the July Governing Council policy meeting, when a further hike of 25bps is inevitable. The policy decision in September, however, remains a little less clear-cut. Not least given the persistence of the German transport base effect, we expect core inflation to remain close to 5½%Y/Y in July and August too. But in line with global price developments in the manufacturing sector, momentum in core goods prices has now faded significantly. Moreover, services prices have risen more closely in line with seasonal norms over the past two months. Assuming these more benign trends persist, we expect core inflation to fall back from September when the German base effect becomes more favourable. And given further evidence of a broad tightening of financial conditions, and signals of a significant softening of economic activity at the end of Q2 – including the pickup in the German claimant count jobless rate to a two-year high (5.7%) in June reported today – we expect the ECB's updated projections in September to revise down the outlook for both GDP and inflation.

Euro area: Consumer price inflation



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Consumer price inflation components



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

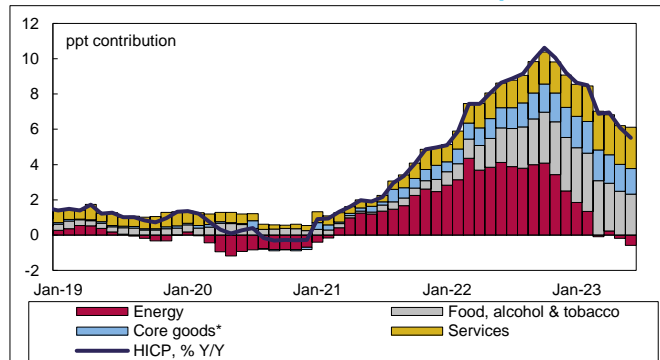
Record low euro area unemployment rate likely to keep ECB hawks on edge

While today's German claims data were indeed worse than expected, the euro area labour market remains tight, with the region's unemployment rate unchanged at the series low of 6.5% in May. So, the Governing Council hawks will continue to worry that an acceleration in wage and unit labour costs might add to inflation persistence over the horizon. And – as suggested yesterday in the FT – they will also still fear finding themselves in a similar position to the BoE, whereby further significant upside surprises to inflation might prompt much louder criticism and a damaging loss of credibility for the ECB. Therefore, we expect the hawks to continue to err on the side of caution at the start of the autumn and press ahead with a further rate hike in September, taking the deposit rate to 4.00%. While that should then mark the terminal rate for this cycle, President Lagarde's comments at Sintra made clear that any cuts from that level might be a long time coming. Indeed, if the economy evolves in line with our expectation, we suspect that any subsequent easing won't start before Q424.

The week ahead in the euro area

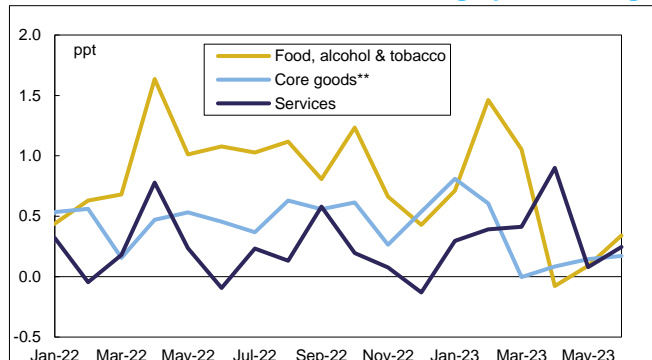
The coming week's dataflow will offer further insight into the near-term inflation outlook, with the release of euro area producer price figures on Wednesday. Due to softer wholesale gas and food prices last month and significant base effects compared with a year ago, the headline PPI rate is expected to have fallen into negative territory for the first time December 2020. That day will also bring the ECB's latest monthly consumer expectations survey for May. The final June PMI surveys – manufacturing (Monday) and services (Wednesday) – are also likely to reaffirm the easing in price pressures flagged in the flash releases, albeit with the services prices charged index remaining firmly above the long-run average. And following the marked slowing in activity in manufacturing and services sectors, the construction PMIs (Thursday) are also expected to signal ongoing contraction in the sector. In contrast, but consistent with a gradual improvement in consumer confidence, euro area retail sales figures (Thursday) are likely to report a return to modest growth in May. Indeed, like in [France](#), despite a further decline in food sales (-1.4%M/M), today's German numbers saw the volume of sales rise in May, by 0.4%M/M. That left German sales trending slightly above the Q1 average while also returning back to the pre-pandemic level. Among the member state data releases in the coming week, focus will be on May reports for German goods trade (Tuesday), factory orders (Thursday) and industrial production (Friday). French and Spanish IP figures are also due (Wednesday). Surveys suggest that the figures are likely to be subdued but orders should be boosted as one-off effects that weighed on the April level wear off. By the same token, German manufacturing output should be supported by a rebound in auto production. But total German IP will also be restrained by a decline in construction, which had temporarily flattered the April data.

Euro area: Contributions to consumer price inflation



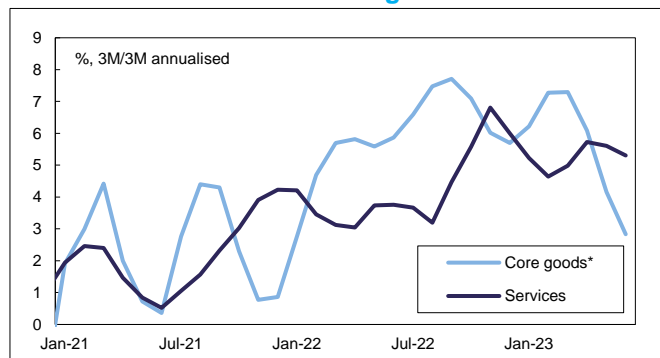
*Non-energy industrial goods. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

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



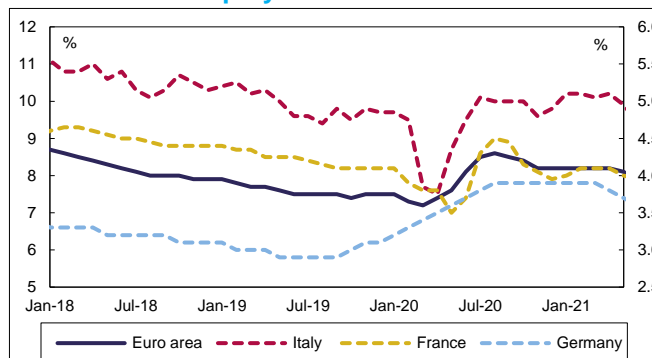
*Deviation from long-run average price change. **Non-energy industrial goods. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Services and core goods momentum



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

Euro area: Unemployment rates



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

UK

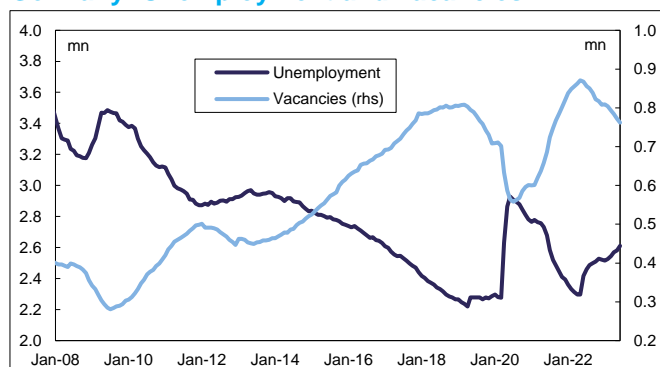
Modest GDP growth confirmed in Q1, as upwardly revised capex offsets wider trade deficit

The UK's full national accounts for Q1 confirmed that GDP rose 0.1%Q/Q for the second successive quarter, to be up a very modest 0.2%Y/Y. Adjusting for population growth, GDP per capita fell 0.3%Y/Y. Within the detail, private consumption stagnated (0.0%Q/Q) as the impact of a drop in real household disposable income of 0.8%Q/Q was offset by a reduction in the saving ratio. Indeed, with interest rates rising steadily, the ONS reported that households made net deposit withdrawals and reduced their stock of secured loans for the first time ever. In terms of other major components of demand, business investment growth was revised up significantly (by 2.6ppts to 3.3%Q/Q) to rise above the pre-Brexit level. The ONS reported anecdotal evidence that firms had accelerated projects to take advantage of the super-deduction tax allowance ahead of its expiration at end-March. Meanwhile, export and import trade volumes were both revised up, albeit with the overall impact being a bigger negative contribution to growth from net trade than previously thought (-1.0ppt). Indeed, the UK's trade deficit was revised up by 0.6ppt to 2.0% of GDP (and 3.0% of GDP when excluding non-monetary gold, which distorts the picture). Offsetting the negative revision from net exports, inventories are now estimated to have boosted growth by a whopping 1.4ppts, seemingly as improved supply chains boosted output ahead of demand. Meanwhile, with prices accelerating, GDP in nominal terms rose 1.2%Q/Q, firmer than previously thought. As businesses were able to take advantage of the inflationary backdrop to boost margins, growth in firms' gross operating surplus (4.1%Q/Q) far outpaced that in employee compensation (1.4%Q/Q) to suggest that profits were a bigger driver of inflation than wages in Q1.

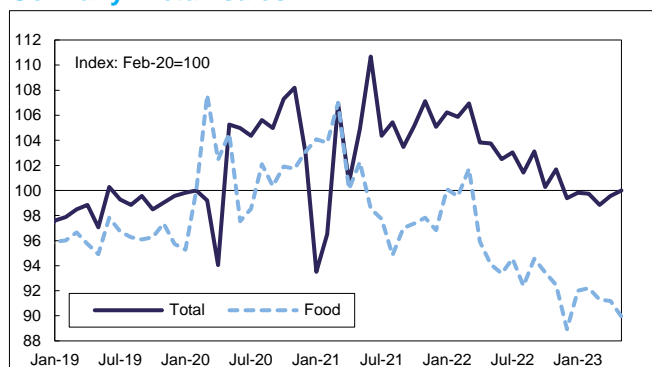
The week ahead in the UK

It should be a relatively quiet week ahead for UK economic releases, with the results from the BoE's latest Decision Maker Panel survey on Thursday and updated inflation and output price expectations of most interest. In the three months to May, year-ahead output price inflation fell very slightly by 0.1ppt to 5.4%Y/Y. But even before the upside surprise to the official inflation data, CPI inflation expectations three-years ahead had ticked slightly higher in May (3.5%Y/Y). The final PMI surveys – manufacturing (Monday), services (Wednesday) and construction (Thursday) – will also offer updates on price pressures. While the flash PMIs implied the first decline in manufacturers' output prices since April 2016, the services prices charged index remained well above the long-run average. Despite falling in June, the flash composite output PMI (52.8) remained in expansionary territory and consistent with modestly positive GDP growth in Q2.

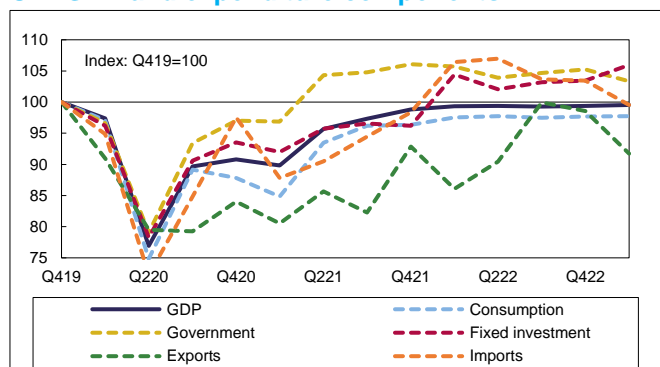
Germany: Unemployment and vacancies



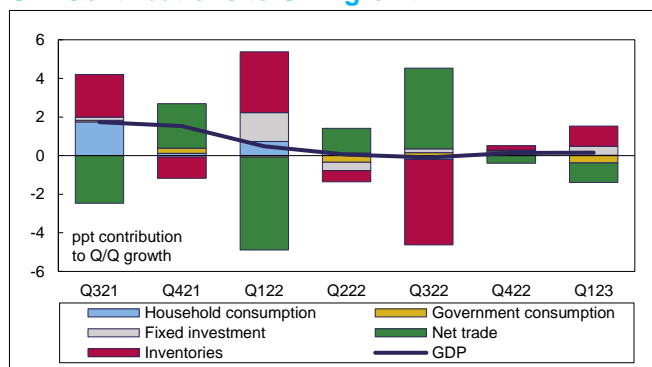
Germany: Retail sales



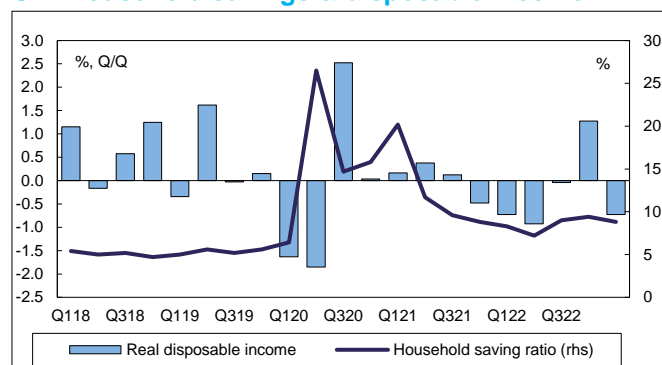
UK: GDP and expenditure components



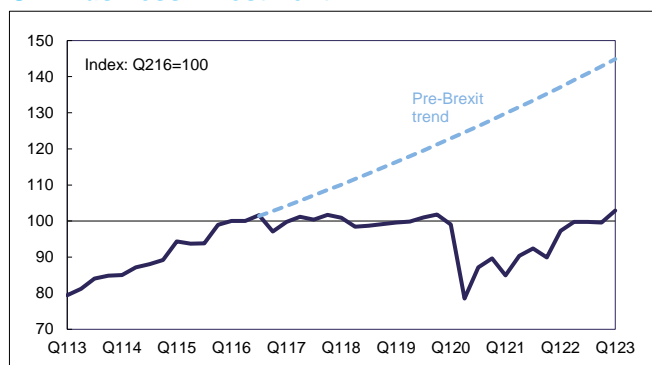
UK: Contributions to GDP growth



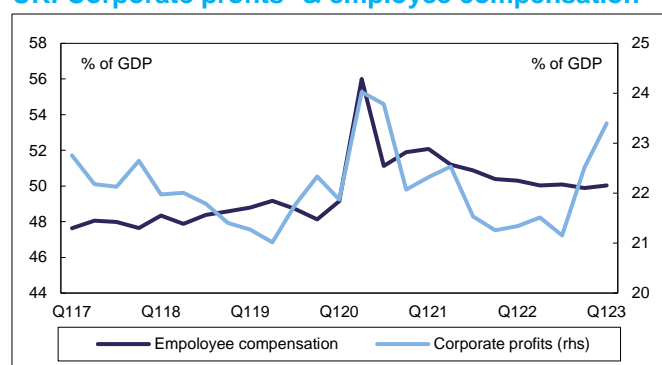
UK: Household savings & disposable income



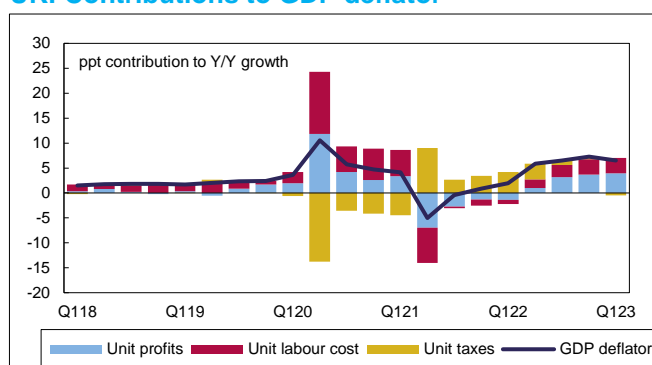
UK: Business investment



UK: Corporate profits* & employee compensation



UK: Contributions to GDP deflator





Daiwa economic forecasts

	2022	2023				2024	2023	2024	2025
	Q4	Q1	Q2	Q3	Q4	Q1			
GDP	%, Q/Q					%, Y/Y			
Euro area	-0.1	-0.1	0.1	0.2	0.1	0.1	0.4	0.7	1.1
UK	0.1	0.1	0.0	0.2	0.0	-0.1	0.3	0.0	0.5
Inflation, %, Y/Y									
Euro area									
Headline HICP	10.0	8.0	6.2	4.3	2.6	2.6	5.2	2.3	1.7
Core HICP	5.1	5.5	5.5	5.0	4.2	3.5	5.0	2.6	1.8
UK									
Headline CPI	10.7	10.2	8.4	6.6	4.5	4.1	7.4	2.9	1.6
Core CPI	6.4	6.1	6.9	6.3	5.6	5.1	6.2	3.3	1.8
Monetary policy, %									
ECB									
Refi Rate	2.50	3.50	4.00	4.50	4.50	4.50	4.50	4.25	3.50
Deposit Rate	2.00	3.00	3.50	4.00	4.00	4.00	4.00	3.75	3.00
BoE									
Bank Rate	3.50	4.25	5.00	5.50	5.75	5.75	5.75	5.25	4.25

Source: Bloomberg, ECB, BoE 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
Monday 03 July 2023						
Euro area		09.00	Final manufacturing PMI	Jun	<u>43.6</u>	44.8
Germany		08.55	Final manufacturing PMI	Jun	<u>41.0</u>	43.2
France		08.50	Final manufacturing PMI	Jun	<u>45.5</u>	45.7
		-	New car registrations* Y/Y%	Jun	-	14.8
Italy		08.45	Manufacturing PMI	Jun	45.4	45.9
		17.00	New car registrations Y/Y%	Jun	-	23.1
Spain		08.15	Manufacturing PMI	Jun	48.0	48.4
		-	New car registrations* Y/Y%	Jun	-	8.3
UK		09.30	Final manufacturing PMI	Jun	<u>46.2</u>	47.1
Tuesday 04 July 2023						
Germany		07.00	Trade balance €bn	May	17.5	17.2
Spain		08.00	Unemployment change '000s	Jun	-	-49.3
Wednesday 05 July 2023						
Euro area		09.00	Final services (composite) PMI	Jun	<u>52.4 (50.3)</u>	55.1 (52.8)
		10.00	PPI Y/Y%	May	-1.4	1.0
Germany		08.55	Final services (composite) PMI	Jun	<u>54.1 (50.8)</u>	57.2 (53.9)
		-	New car registrations* Y/Y%	Jun	-	19.2
France		07.45	Industrial production M/M% (Y/Y%)	May	-0.2 (0.6)	0.8 (1.3)
		08.50	Final services (composite) PMI	Jun	<u>48.0 (47.3)</u>	52.5 (51.2)
Italy		08.45	Services (composite) PMI	Jun	53.3 (51.1)	54.0 (52.0)
Spain		08.00	Industrial production M/M% (Y/Y%)	May	0.1 (-0.4)	-1.8 (-0.9)
		08.15	Services (composite) PMI	Jun	55.7 (54.1)	56.7 (55.2)
UK		09.00	New car registrations Y/Y%	Jun	-	16.7
		09.30	Final services (composite) PMI	Jun	<u>53.7 (52.8)</u>	55.2 (54.0)
Thursday 06 July 2023						
Euro area		08.30	Construction PMI	Jun	-	51.6
		10.00	Retail sales M/M% (Y/Y%)	May	0.2 (-2.7)	0.0 (-2.6)
Germany		07.00	Factory orders M/M% (Y/Y%)	May	1.2 (-9.3)	-0.4 (-9.9)
		08.30	Construction PMI	Jun	-	43.9
France		08.30	Construction PMI	Jun	-	42.6
Italy		08.30	Construction PMI	Jun	-	47.9
UK		09.30	Construction PMI	Jun	51.0	51.6
Friday 07 July 2023						
Germany		07.00	Industrial production M/M% (Y/Y%)	May	0.0 (0.5)	0.3 (1.6)
France		07.45	Trade balance €bn	May	-	-9.7
Italy		09.00	Retail sales M/M% (Y/Y%)	May	-	0.2 (3.2)

*Approximate date of release. Source: Bloomberg and Daiwa Capital Markets Europe Ltd.












The coming week's key events & auctions

Country	BST	Event / Auction
Monday 03 July 2023		
- Nothing scheduled -		
Tuesday 04 July 2023		
Germany 	10.30	Auction: €500mn of 0.10% 2033 index-linked bonds
UK 	10.00	Auction: £2.0bn of 1.50% 2053 bonds
Wednesday 05 July 2023		
Euro area 	09.00	ECB publishes consumer expectations survey
	12.00	ECB's Villeroy scheduled to speak
Germany 	10.30	Auction: €1.0bn of 2.30% 2033 bonds
UK 	10.00	Auction: £4.0bn of 3.50% 2025 bonds
Thursday 06 July 2023		
France 	09.50	Auction: 3.00% 2033 bonds
	09.50	Auction: 2.50% 2043 bonds
	09.50	Auction: 3.00% 2054 bonds
Spain 	09.30	Auction: 0.80% 2029 bonds
	09.30	Auction: 3.55% 2033 bonds
	09.30	Auction: 1.45% 2071 bonds
	09.30	Auction: 0.65% 2027 index-linked bonds
UK 	09.30	BoE publishes Monthly Decision Maker Panel data
Friday 07 July 2023		
Euro area 	09.30	ECB's de Guindos scheduled to speak
	17.45	ECB President Lagarde scheduled to speak
UK 	15.30	BoE's Mann scheduled to speak




Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area 	Preliminary HICP (core HICP) Y/Y%	Jun	5.5 (5.4)	<u>5.4 (5.5)</u>	6.1 (5.3)	-
	Unemployment rate %	May	6.5	6.5	6.5	-
Germany 	Retail sales M/M% (Y/Y%)	May	0.4 (-5.1)	0.0 (-4.9)	0.5 (-8.7)	0.7 (-8.4)
	Unemployment change 000s (rate %)	Jun	28.0 (5.7)	14.0 (5.6)	9.0 (5.6)	13.0 (-)
France 	Preliminary HICP (CPI) Y/Y%	Jun	5.3 (4.5)	5.4 (4.6)	6.0 (5.1)	-
	Consumer spending M/M% (Y/Y%)	May	0.5 (-3.6)	0.7 (-3.6)	-1.0 (-4.3)	-0.8 (-)
	PPI Y/Y%	May	5.8	-	7.0	-
UK 	Lloyds business barometer	Jun	37	-	28	-
	GDP – 3rd estimate Q/Q% (Y/Y%)	Q1	0.1 (0.2)	0.1 (0.2)	0.1 (0.6)	-
	Current account balance £bn	Q1	-10.8	-7.5	-2.5	-
	Nationwide house price index M/M% (Y/Y%)	Jun	0.1 (-3.5)	-0.2 (-4.0)	-0.1 (-3.4)	-

Auctions

Country	Auction
Italy 	sold €3.00bn of 3.80% 2028 bonds at an average yield of 3.81%
	sold €3.25bn of 4.35% 2033 bonds at an average yield of 4.13%
	sold €1.25bn of 5.00% 2034 bonds at an average yield of 4.18%

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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