Euro wrap-up

Overview

Chris Scicluna
+44 20 7597 8326

Emily Nicol
+44 20 7597 8331

- Bunds made losses even as euro area consumer price expectations for the coming year moderated and producer price inflation dropped into negative territory, while the final euro area composite PMI was revised lower to suggest stagnation.
- Gilts made larger losses as the UK PMIs remained consistent with ongoing expansion and sticky services inflation.
- Thursday will bring data for euro area retail sales, German factory orders and UK business inflation expectations.

Daily bond market movements

Bond	Yield	Change
BKO 2.8 06/25	3.212	+0.010
OBL 2.4 10/28	2.606	+0.010
DBR 2.3 02/33	2.479	+0.029
UKT 0⅝ 06/25	5.375	+0.062
UKT 1⅝ 10/28	4.776	+0.090
UKT 3¼ 01/33	4.491	+0.079

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

Euro area

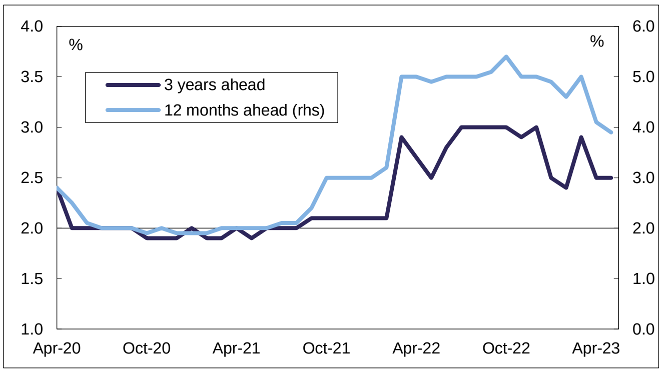
Consumer inflation expectations for the coming year decline

While core consumer price inflation remains sticky, falling headline rates of inflation are encouraging euro area households to revise down their inflation expectations for the coming year. The ECB's Consumer Expectations Survey for May reported a second successive drop in the median expectation for inflation over the coming twelve months to 3.9%Y/Y, 1.5ppts down from the peak last October and the lowest since the Russian invasion of Ukraine. The decline was led by French consumers. And, of the larger member states, only in the Netherlands were twelve-month ahead expectations notably higher. Further ahead, inflation expectations remain relatively well anchored, with the median expectation of inflation three years ahead unchanged on the month at 2.5%Y/Y. While that is 0.4ppt above the level before the Russian invasion, it is also 0.4ppt below the post-invasion peak. Admittedly, however, the distribution of inflation expectations remains skewed to the upside, with the mean inflation expectation for the three years ahead rising to 4.0%Y/Y, illustrating that a non-negligible share of households anticipates intense price pressures to persist. Among the other survey detail, over the coming twelve months, households expect growth in their own incomes (with a median expectation unchanged on the month at just 0.1%Y/Y) to severely lag that of consumer prices. So, they expect to slow their spending growth over the coming twelve months to half the rate of the past year. But their perceptions of the labour market improved, with expectations for the unemployment rate revised down.

Industrial goods price shock reversing with annual PPI rate negative for 1st time since 2020

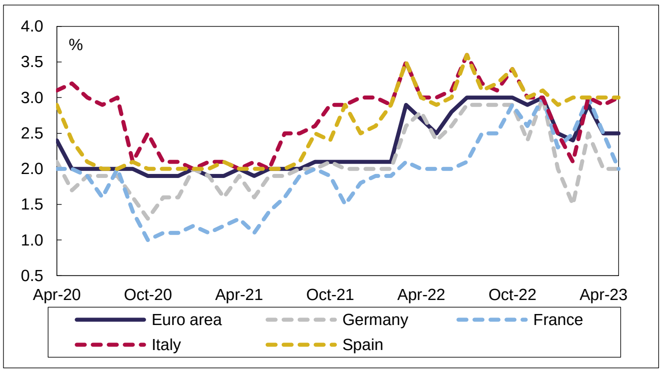
Meanwhile, according to today's PPI inflation data, the reversal of last year's shocks to industrial producer goods prices continued in May. Producer prices fell for a fifth successive month in May and by 1.9%M/M to be down 1.6%Y/Y, marking the first annual decline since end-2020. And that left them a substantive 12.5% below September's peak. Unsurprisingly, energy prices again led the way, falling 5.1%M/M to be down 13.3%Y/Y. But prices of industrial non-energy goods fell for a second month and by 0.5%M/M. Reflecting an easing of supply-chain strains and softening global goods demand, prices of intermediate goods fell for the sixth month out of seven and by 1.0%M/M – the most since 2009 – to be down 1.5%Y/Y and 2.5% below their peak. Thanks to lower food costs, prices of consumer nondurables also fell on the month to push the annual rate below 10%Y/Y for the first time in fifteen months. And prices of capital goods rose just 0.1%M/M, the least in more than two years, so that the respective annual rate slowed to a 16-month low of 5.7%Y/Y. Given developments in wholesale markets and survey indicators – including the final June manufacturing PMIs for input costs (a 14-year low of 39.5) and output prices (a three-year low of 47.0) – producer price inflation seems bound to become more negative over coming months, and consumer core goods, energy and food inflation should all fall significantly further too. Of course, for the time being, however, the ECB will remain troubled by persistent services inflation, which will likely persuade the Governing Council to hike rates again in September as well as July.

Euro area: Consumer price expectations*



Median expectations. Source: ECB consumer expectations survey and Daiwa Capital Markets Europe Ltd.

Euro area: Consumer price expectations*



Median expectations three years ahead. Source: ECB consumer expectations survey and Daiwa Capital Markets Europe Ltd.

Services cost pressures remain historically high but starting to ease

According to the final PMIs for June, the outlook for services inflation was nevertheless slightly improved at the end of Q2, with the survey suggesting that average prices charged rose at the softest pace in 20 months. But the respective index (56.3) was still well above the pre-pandemic average (50.0), with operating cost pressures also stickier than in manufacturing. Indeed, the input price index, at 61.3, suggests that services firms are likely to try to pass on costs to customers for a while longer. And with businesses continuing to report solid employment growth, potential second-round inflationary effects will remain a source of concern for the ECB. The final June PMIs did, however, reaffirm a marked slowdown in the euro area's recovery momentum at the end of the second quarter, which could help to suppress cost pressures over the near term. In particular, the final PMIs saw the composite output index downwardly revised from the flash by 0.4pt to 49.9, to leave it down almost 3pts on the month, more than 4pts below April's peak and the first sub-50 reading this year. Admittedly, given the strength at the start of the quarter, the average output index in Q2 of 52.3 was still marginally firmer than in Q1 and a level that before the pandemic would have been consistent with GDP growth of 0.2-0.3%Q/Q.

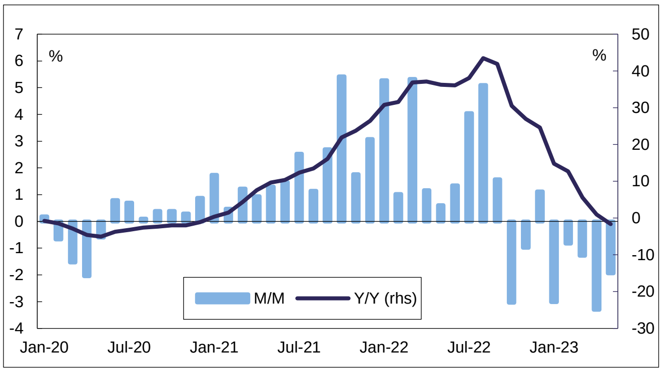
Services recovery slowed sharply at the end of Q2

While the manufacturing survey suggested that output from the sector provided an increasing drag on the economy, the services survey merely implied waning recovery momentum in June. In particular, the services activity PMI was down more than 3pts to a five-month low of 52.0, albeit still averaging in Q2 some 1½pts above the Q1 level. While this in part reflected a substantial deterioration in the French services index, for which the final reading was (unusually) unrevised at 48.0, a 28-month low and down 4.5pts from May, the survey also implied a less vigorous recovery momentum across the member states. Admittedly, the French composite PMI (47.2) was the only one to suggest a significant contraction in June, which contrasts with other national survey releases. But the German (50.6) and Italian (49.7) composite indices were merely consistent with stagnation. And so, today's survey implied that the Spanish economy remained the outperformer last quarter, albeit the respective composite PMI also eased to a five-month low (52.6). Given the implied step down at the end of Q2, and with demand for new business having weakened markedly too, the outlook for euro area GDP growth in Q3 across the member states remains highly uncertain.

French manufacturing output on track for growth in Q2 as strikes became less restrictive

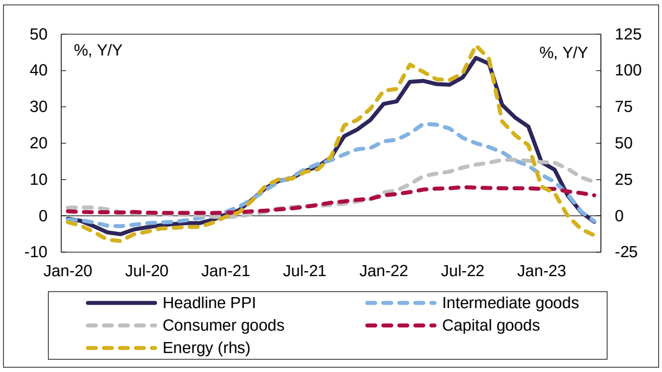
Having contracted in both Q4 and Q1, French factory output is on track to make a positive contribution to GDP growth in Q2. Indeed, contrary to expectations, manufacturing production rose for a second successive month in May and by a firm 1.4%M/M to be trending so far in Q2 about 1.3% above the Q1 level. Growth was encouragingly broad-based in the sector in

Euro area: Producer price inflation



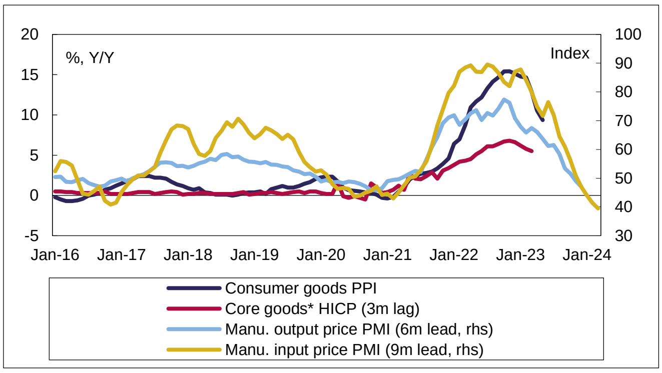
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Producer price inflation



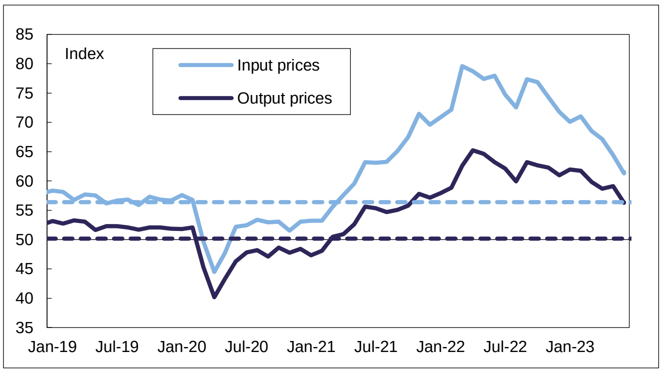
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Selected inflation indices



**Non-energy industrial goods. Source: Refinitiv, S&P Global and Daiwa Capital Markets Europe Ltd.*

Euro area: Services price PMIs



**Dashed lines represent pre-pandemic averages. Source: Refinitiv, S&P Global and Daiwa Capital Markets Europe Ltd.*

May, but was led by a renewed upswing in the autos sector, where output rose 5.8%M/M to a nine-month high, benefiting from a further easing of supply-chain strains. That left it trending almost 3% above the Q1 level, albeit still almost 4.5% below the pre-pandemic level in February 2020. Among other major categories, output of machinery and equipment rose 1.5%M/M to leave the average level in the first two months of Q2 more than 2.0% higher than in Q1. And production of coke and refined petroleum leapt more than 45%M/M after growth of more than 20%M/M in April, as output continued to normalize following the end of strikes. There was also an improved showing for production of chemicals and related items (3.6%M/M) as well as other energy-intensive products including metals (1.8%M/M). However, as in Germany, manufacturers have adjusted significantly over the past year to higher prices of electricity and gas, and production of energy-intensive goods remains well down on levels a year ago, with particularly sharp adjustments in basic iron and steel, and pulp and paper. And while manufacturing production overall appears to have rebounded somewhat in Q2 as industrial action by labour unions and supply-chain constraints became less restrictive, surveys point to a subdued Q3.

German auto production maintains recovery but expectations sour on softening demand

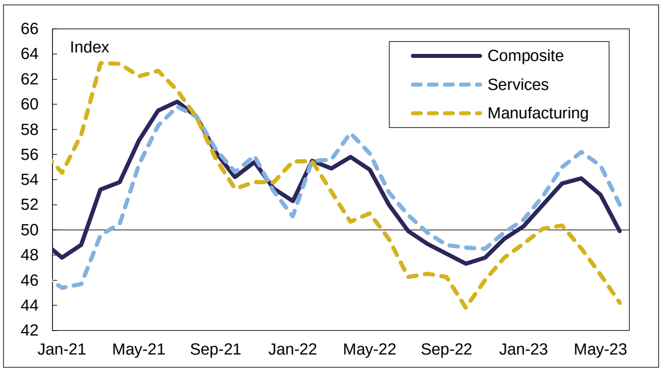
Finally, according to the latest data from Germany's Automobile Industry Association (VDA), German car production also continued to benefit from diminished supply-chain challenges in June. Car production rose 32%Y/Y last month enabling new car registrations to accelerate 6ppts to 25%YY. And the ifo institute's latest business survey reported that auto manufacturers enjoyed a marked improvement in business conditions in June, with the respective index (37.5) up to the highest since August 2021. Nevertheless, with new demand disappointing, particularly from abroad, their expectations for the coming six months deteriorated for a fifth successive month to the lowest level since 2008. Nevertheless, the ifo institute reported that auto firms intend to raise prices again, albeit principally in the electric vehicle and premium market.

The day ahead in the euro area

One focus on Thursday will be euro area retail sales data for May. Given the national data released so far, these are likely to report positive growth in sales for the first time since January. With food sales falling further in response to recent sharp price increases, however, growth in sales is expected to be modest at about 0.2%M/M, which would leave sales on course for a sixth successive quarterly decline in Q2.

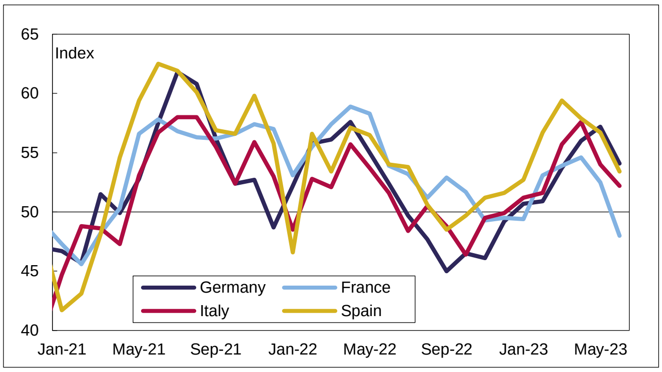
German new factory orders figures for May are also due tomorrow. New orders plunged a whopping 10.9%M/M in March and a further 0.4%M/M in April. While surveys have flagged ongoing weakness in orders throughout Q2, a rebound of about 1.0%M/M is anticipated in May, if only to reflect payback for volatility associated with bulk orders in April. However, perhaps even more than usual given the size of the drop in March, the range of feasible outturns in May is exceptionally wide.

Euro area: Output PMIs



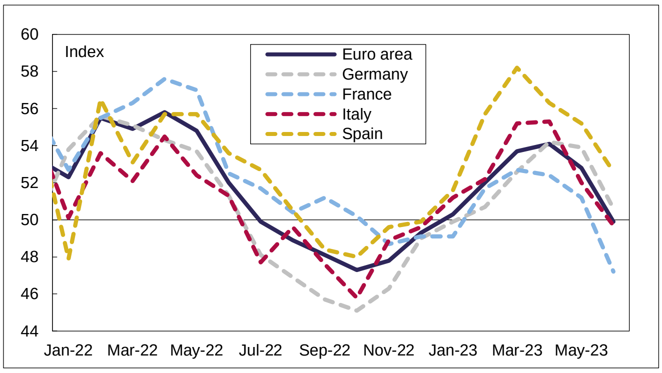
Source: Refinitiv, S&P Global and Daiwa Capital Markets Europe Ltd.

Euro area member states: Services activity PMIs



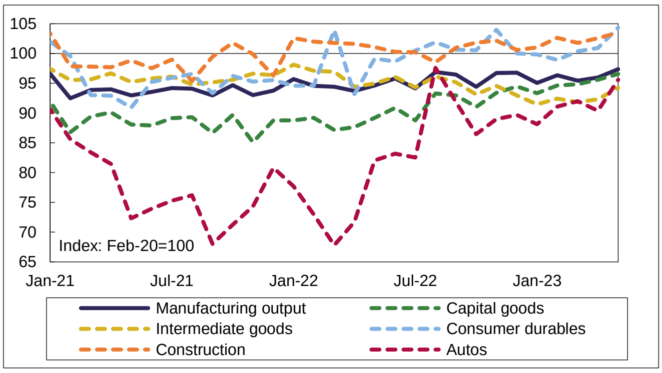
Source: Refinitiv, S&P Global and Daiwa Capital Markets Europe Ltd.

Euro area member states: Composite PMIs



Source: Refinitiv, S&P Global and Daiwa Capital Markets Europe Ltd.

France: Industrial production



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Finally, the June construction PMIs are likely to signal contraction in the sector at the end of Q2, as recent monetary tightening takes its toll on both residential and commercial activity. The survey's euro area activity index fell in May to 44.6, the lowest level so far this year, and a further decline in June would not be surprising.

UK

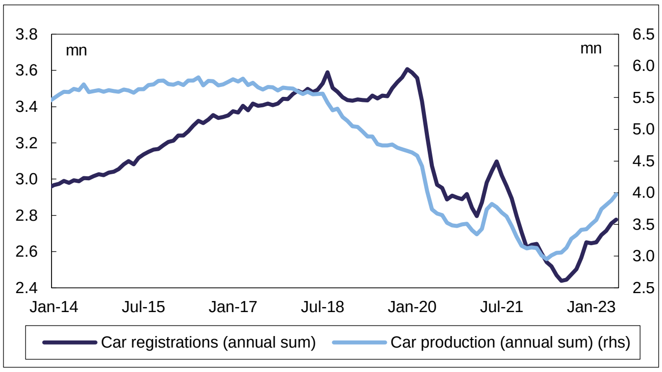
Services price PMIs remain historically high despite easing slightly in June

Like in the euro area, the services PMIs continued to flag stubbornly high price pressures in the sector. According to today's final survey, the moderation in the increase in operating costs was smaller than initially suggested, with the respective input price PMI (68.5) still historically high as firms overwhelmingly cited higher salary pressures. But while the increase in prices charged also eased slightly as some firms offered discounts in the face of softer demand, the respective PMI component (59.2) remained well above the pre-pandemic average (52.6), which firms attributed to additional labour costs and higher-than-expected inflation. Today's survey confirmed a slowing pace of economic expansion, which should help to dampen price pressures in due course. But the decline in the headline services activity index was less pronounced than in the euro area, down 1.5pts in June to a three-month low of 53.7, to leave it still on average in Q2 more than 3pts above the Q1 average. And despite ongoing contraction in the manufacturing sector, the composite PMI remained firmly in expansionary territory despite easing to a five-month low of 52.8. Indeed, over the second quarter as a whole, like in the euro area, the composite index was consistent with GDP growth of 0.2-0.3%Q/Q. Nevertheless, the survey cited weakening demand in the real estate sub-sector amid rising interest rates. And demand for new business in services slowed sharply, with the respective index down to a five-month low. This notwithstanding, with firms also reporting solid jobs growth in the sector – the employment PMI jumped to a nine-month high (53.5) – the survey might also suggest, for the time being at least, little moderation in private sector pay growth over the near term, which will remain a greater concern for the BoE.

The day ahead in the UK

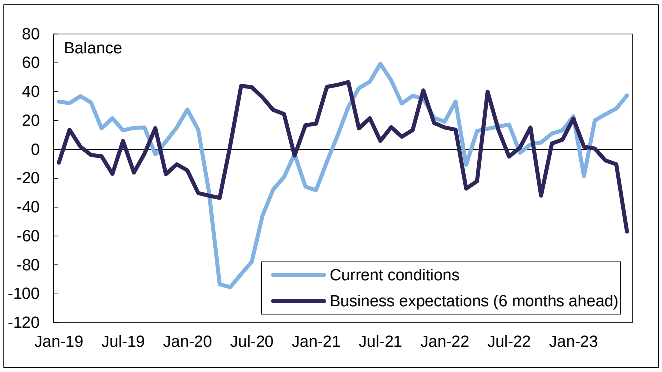
UK business inflation expectations will be in focus on Thursday with the BoE's Decision Maker Panel survey results for June. In the prior month, firms' expectation for CPI inflation one year ahead rose to a three-month high of 5.9%Y/Y while the expectation for inflation three years ahead edged up 0.1ppt to 3.5%Y/Y, still nevertheless 1.3ppt down from the peak in September. Meanwhile, the UK construction PMIs are expected to remain consistent with expansion in the sector in June for a fifth successive month, albeit probably with a moderation in the headline activity index from 51.6 in May.

Germany: Car production & registrations



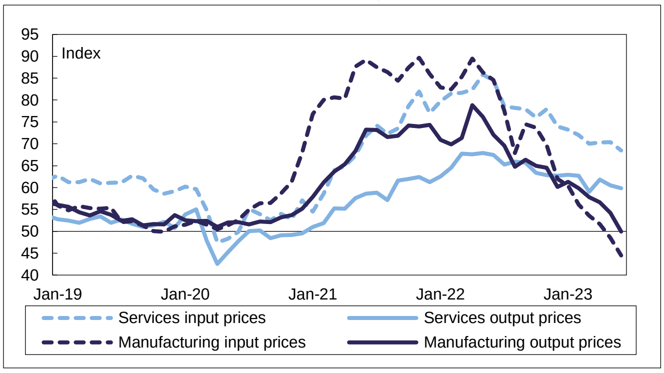
Source: VDA, Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: ifo autos sentiment indices



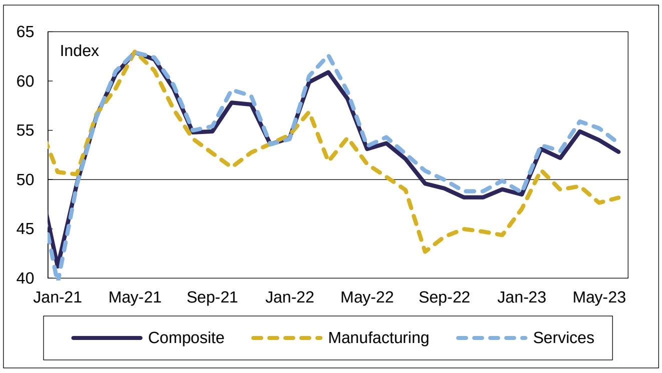
Source: ifo institute, Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Services & manufacturing price PMIs



Source: Refinitiv, S&P Global and Daiwa Capital Markets Europe Ltd.

UK: Output PMIs



Source: Refinitiv, S&P Global 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		Final services (composite) PMI	Jun	**52.0 (49.9)**	*52.4 (50.3)*	55.1 (52.8)	-
		PPI Y/Y%	May	**-1.5**	-1.3	1.0	**0.9**
Germany		Final services (composite) PMI	Jun	**54.1 (50.6)**	*54.1 (50.8)*	57.2 (53.9)	-
		New car production (registrations) Y/Y%	Jun	**32.8 (10.0)**	-	24.0 (19.2)	-
France		Industrial production M/M% (Y/Y%)	May	**1.2 (2.6)**	-0.2 (0.6)	0.8 (1.3)	**- (1.7)**
		Final services (composite) PMI	Jun	**48.0 (47.2)**	*48.0 (47.3)*	52.5 (51.2)	-
Italy		Services (composite) PMI	Jun	**52.2 (49.7)**	53.3 (51.1)	54.0 (52.0)	-
Spain		Industrial production M/M% (Y/Y%)	May	**0.6 (-0.1)**	0.4 (-0.4)	-1.8 (-0.9)	**-1.9 (-1.0)**
		Services (composite) PMI	Jun	**53.4 (52.6)**	55.7 (54.1)	56.7 (55.2)	-
UK		New car registrations Y/Y%	Jun	**25.8**	-	16.7	-
		Final services (composite) PMI	Jun	**53.7 (52.8)**	*53.7 (52.8)*	55.2 (54.0)	-

Auctions

Country		Auction
Germany		sold €979mn of 2033 index-linked bonds at an average yield of 2.39%
UK		sold £4.0bn of 3.50% 2025 bonds at an average yield of 5.668%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country		BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Euro area		08.30	Construction PMI	Jun	-	44.6
		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	1.0 (-9.7)	-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

Auctions and events

Country		BST	Event
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

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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