Euro wrap-up

Overview

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- Bunds made losses as the flash estimate of German HICP inflation in May surprised slightly on the upside, albeit likely due to one-off factors.
- Gilts also made significant losses on a quiet day for UK economic news.
- Thursday will bring new data on euro area unemployment, flash inflation figures from Spain, and the Commission's economic sentiment survey results.

Daily bond market movements

Bond	Yield	Change
BKO 2.9 06/26	3.093	+0.041
OBL 2.1 04/29	2.711	+0.070
DBR 2.2 02/34	2.682	+0.091
UKT 0⅛ 01/26	4.529	+0.046
UKT 0½ 01/29	4.282	+0.101
UKT 4⅝ 01/34	4.388	+0.109

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

Euro area

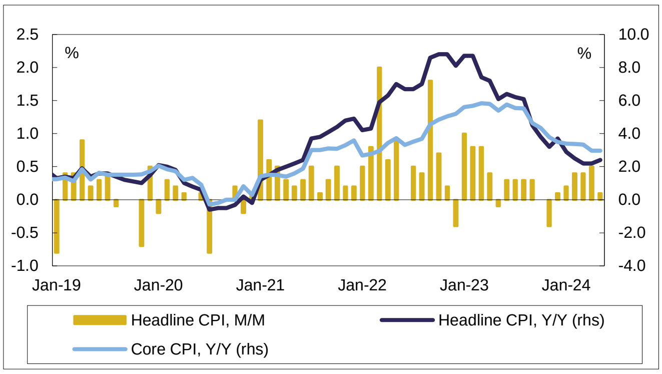
Rise in German inflation in May driven by one-offs so won't prevent a rate cut in June

The flash estimate of German inflation in May came in a touch above expectations, with the EU-harmonised HICP measure up 0.4ppt to a four-month high of 2.8%Y/Y, 0.1ppt above the Bloomberg survey median forecast. The national CPI rate was in line with the consensus expectation, however, rising 0.2ppt to a three-month high of 2.4%Y/Y. And the detail of that measure, including those published by the German states, suggest that the rise in inflation from April is nothing to be overly concerned about, seemingly being driven by one-off effects. Indeed, the pickup was almost entirely driven by the services component (up 0.5ppt to 3.9%Y/Y), principally reflecting a base effect related to the introduction of the Deutschland public transport ticket a year ago. Another typically erratic item – package tours – also looks to have been stronger. But while elevated, insurance prices were stable. Hospitality inflation appears to have moderated. And, despite the jump in services inflation, German core CPI inflation was unchanged at 3.0%Y/Y, matching the lowest in more than two years as a range of goods components – including clothing and furniture – continued to cool. Moreover, despite the withdrawal of government support and further jump in petrol prices, energy inflation remained firmly in negative territory (up 0.1ppt to -1.1%Y/Y). And food inflation remained very weak too (up 0.1ppt to 0.6%Y/Y). So, while the rise in German headline inflation will on Friday contribute to a slight pickup in the equivalent euro area rate – in our view probably up 0.2ppt to 2.6%Y/Y – it will not prevent a rate cut when the ECB's Governing Council meets next week.

Bank lending growth remains highly subdued amid restrictive monetary conditions

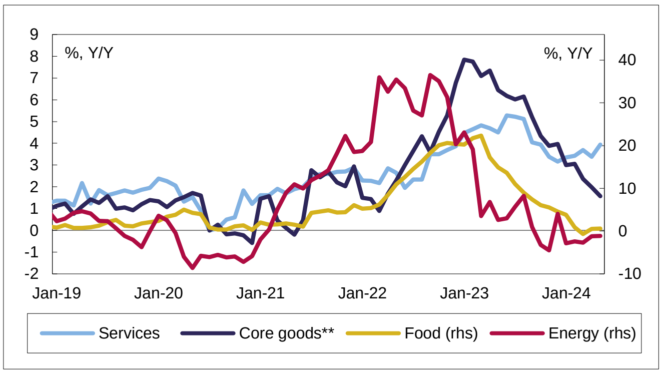
Consistent with the restrictive current level of ECB interest rates, today's monetary data highlighted that bank lending in the euro area remained highly subdued at the start of Q2. Indeed, the monthly flow of lending to non-financial corporations on an adjusted basis slipped back into negative territory for the first time in three months in April (-€3.9bn). As a result, the annual growth in the stock of such loans slowed slightly to just 0.3%Y/Y, consistent with a non-negligible decline in real terms. And net new lending on a three-month basis was minimal at just €2.0bn. More positively, however, growth on an unadjusted basis was concentrated in longer-term loans (i.e. those with a maturity of more than five years), which are typically related to fixed investment needs. Indeed, net new issuance of longer-term lending rose in the three months to April to €6.8bn, the highest since November 2022, to raise hopes of a modest upturn in private capex. Meanwhile, net lending to households slowed slightly to €8.9bn on an adjusted basis in the three months to April. But that left it up just 0.2%Y/Y, again consistent with a significant decline in real terms. Growth in consumer credit (3.0%Y/Y) was arguably consistent with a minimal uptick in spending amid gradually rising (albeit still subdued) household confidence. That offset weakness in lending for home purchase (-0.2%Y/Y) and other household loans related to debt consolidation and education (-3.1%Y/Y). Finally, money supply growth picked up to a 12-month high in April. But the M3 rate rose 0.4ppt to just 1.3%Y/Y, still thus in negative

Germany: Consumer price inflation*



National measure. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Key CPI components*



*National measure. **Non-energy industrial goods. Source: Macrobond and Daiwa Capital Markets Europe Ltd.*

territory in real terms and consistent with sluggish activity and an absence of price pressures. The pickup in broader money growth was largely explained by a moderation of 0.6ppt in the pace of decline in the narrow M1 aggregate to -6.0%Y/Y reflecting a slowdown in the shift of overnight deposits to term deposits that had been motivated by higher interest rates.

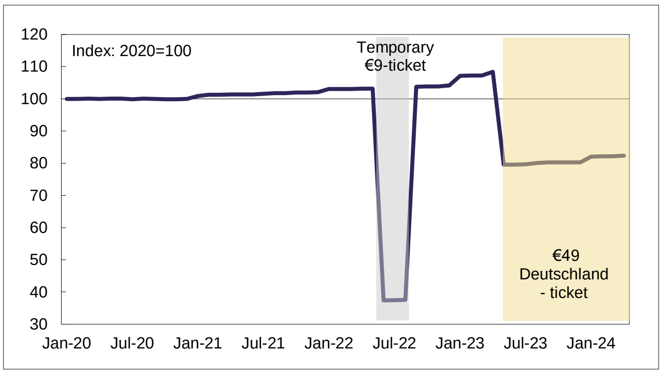
German consumers more upbeat about economic and income outlook

Tallying with the improvement in business sentiment reported in the ifo indices and flash PMIs, today's GfK survey results suggested that German consumers were similarly more upbeat in the middle of Q2, reinforcing our view that the economy will register a second successive quarter of positive growth supported by a pickup in consumer spending. Indeed, the headline consumer sentiment index – presented as a forecast for June – rose for a fourth consecutive month and by 3.1pts to -20.9, the highest since April 2022. This left the Q2 average almost 4pts above the respective Q1 figure and roughly equidistant between the long-run average (+2) and the trough in October 2022 (-43). Households were the most upbeat about their own incomes since the start of 2022, with the respective index rising close to the long-run average. That seems appropriate, coming on the back of the strongest quarter of real wage growth – up 2ppts to 3.8%Y/Y in Q1 in part reflecting one-off payments to compensate for recent high inflation – since the series began in 2008. Meanwhile, reflecting greater confidence that the euro area's largest economy has finally passed a turning point, consumers were the most optimistic about the general economic outlook for twelve months, with the respective index back above the long-run average. But despite the increase in purchasing power, households remained relatively cautious about making major purchases, with the respective index still well below the values recorded during the pandemic-related lockdowns and still a whopping 67pts below the pre-pandemic five-year average. Nevertheless, saving intentions also fell back sharply this month, with the respective index down 10pts to the lowest level (+5) since August 2023. So, having been a drag on growth in Q1, household consumption, particularly of services, is likely to be gathering momentum and should provide a boost to GDP growth this quarter and through the second half of the year.

French consumer confidence remains subdued, but purchase intentions rise to 2-year high

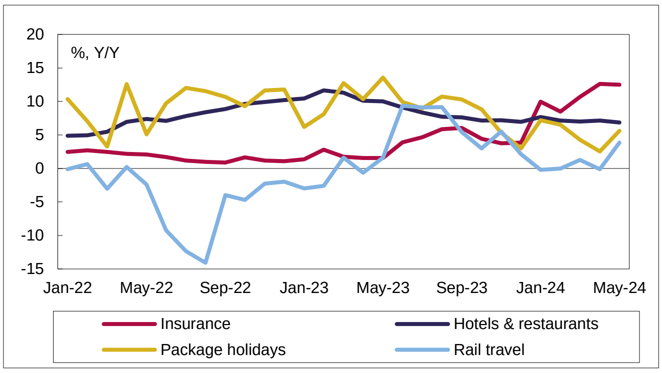
In marked contrast, but consistent with subdued French business sentiment so far this quarter, consumers in the euro area's second-largest member state considered conditions to be little improved in May, with the headline confidence index moving sideways at 90, a touch below the Q1 average and a marked 10% below the long-run average. Households were reportedly more downbeat about prospects for their own incomes for the coming year, perhaps reflecting the ongoing downturn in the housing market, with home prices having declined for a fifth consecutive quarter in Q1 to be down 5.2%Y/Y, the steepest annual drop since the global financial crisis. Expectations for the general economic outlook also remained muted, with the respective index averaging some 7pts below the Q1 outturn. This notwithstanding, these components along with the

Germany: Combined transport services price level



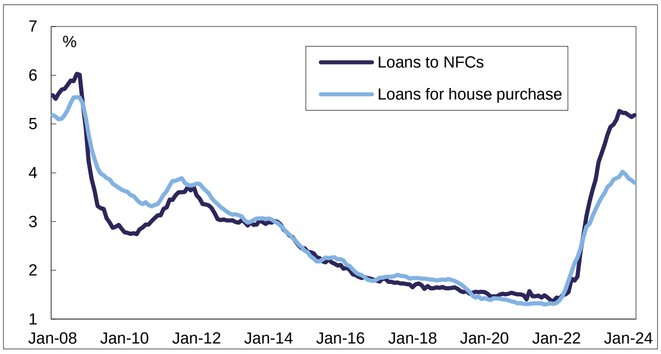
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Selected NRW state CPI components



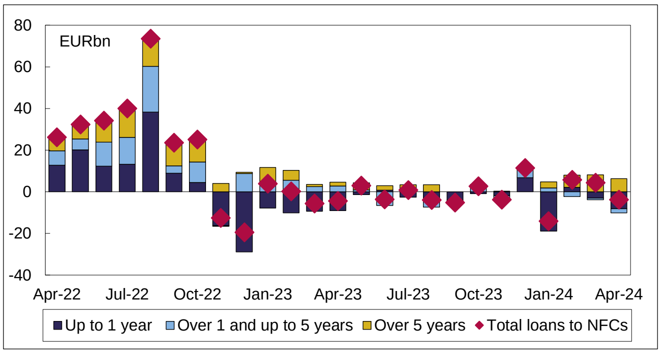
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Composite cost of borrowing



Source: ECB, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Loans to NFCs*



**Unadjusted data. Source: Macrobond and Daiwa Capital Markets Europe Ltd.*

composite confidence index were still comfortably above the average through 2022 and 2023. Moreover, the share of households considering it a good time to make major purchases rose for a third consecutive month in May, with the respective index up to the highest for two years, suggesting that private consumption should continue to provide modest support to GDP growth this quarter and beyond.

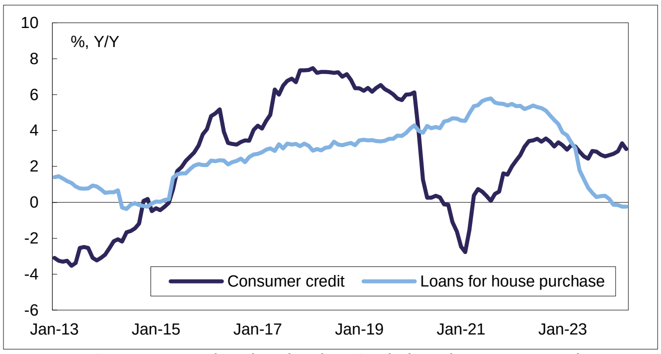
Italian surveys provide mixed messages about economic momentum

Finally, the latest Italian ISTAT surveys provided mixed messages about economic momentum in May. On the positive side, consumer confidence rose for the first month in three, up 1.2pts to 96.4, to match the Q1 average and remain comfortably above the long-run average. And while households were reportedly more downbeat about the economic outlook and their own incomes, purchase intentions were little changed, suggesting that consumption should again provide a modest boost to GDP growth this quarter. But ISTAT's business survey implied a softening in recovery momentum in the middle of Q2. In particular, the headline business confidence index fell 0.7pt to 95.1, a six-month low and trending some 1.4pts below the Q1 average. The deterioration was led by construction, with sentiment down to a 2½-year low, as new orders fell to a 19-month low reflecting the phase-out of the government's 'superbonus' fiscal inventive scheme to encourage energy-saving home renovations. Services firms were again more downbeat – the respective index fell to a six-month low – as they revised down their expectations for demand. In contrast, however, manufacturers were a touch less pessimistic as production expectations improved on the back of a pickup in new orders and ongoing decline in inventories. But with the exception of manufacturing, sentiment of the key business subsectors was still some way above the respective long-run averages. As such, GDP growth has likely remained positive in Q2, albeit likely moderating from the pace of 0.3%Q/Q in Q1.

The day ahead in the euro area

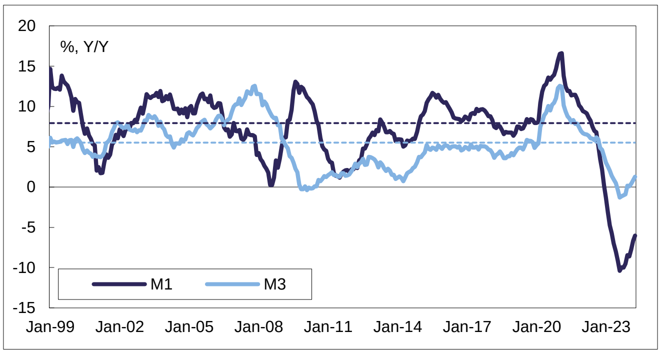
The flow of sentiment indicators concludes tomorrow with the European Commission's business and consumer surveys, which will provide a cross-check on last week's upbeat flash May PMIs. But while the preliminary euro area consumer confidence index rose to the highest since Russia's invasion of Ukraine, we note that the Commission's business indices were more downbeat than the PMIs in April. And while Monday's German ifo business survey saw the headline business climate index rise slightly to a twelve-month high, the French INSEE composite business index moved broadly sideways while the Italian ISTAT business component fell to a six-month low. The survey's price measures will likely suggest that selling-price expectations in services and retail continue to moderate, while household inflation expectations should remain well anchored. Meanwhile, flash May inflation estimates from Spain, Belgium and Ireland will provide further insight into what to expect from the euro area figures due Friday. And the latest labour market figures are likely to show that the euro area unemployment rate remained at a series low of 6.5% for a sixth successive month in April.

Euro area: Loans to households



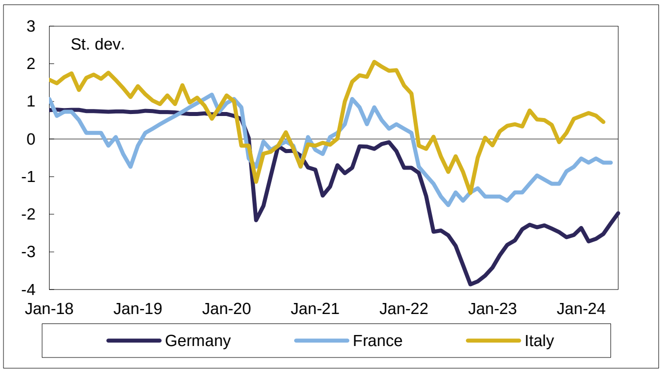
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Money supply*



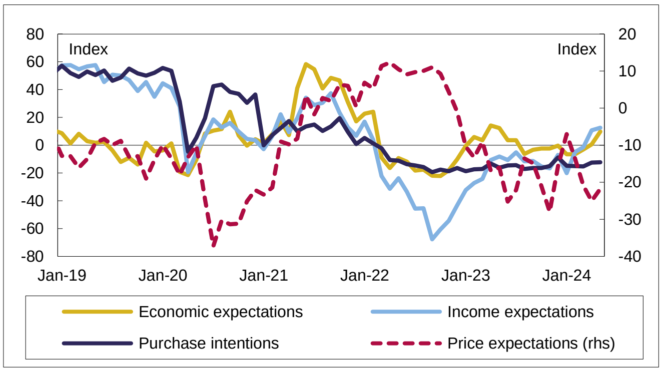
**Dashed lines represent long-run averages. Source: Macrobond and Daiwa Capital Markets Europe Ltd.*

Euro area member states: Consumer confidence



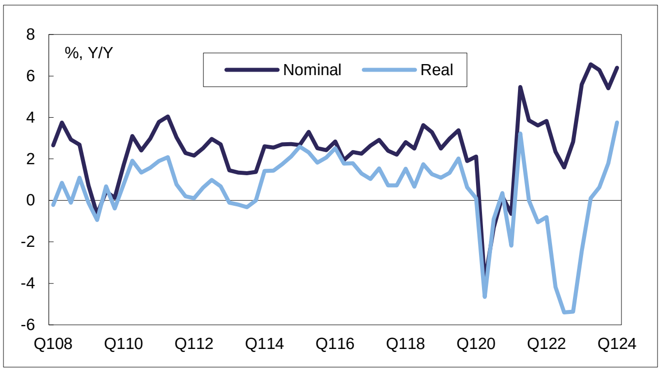
Source: GfK, INSEE, ISTAT, Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: GfK consumer confidence indices



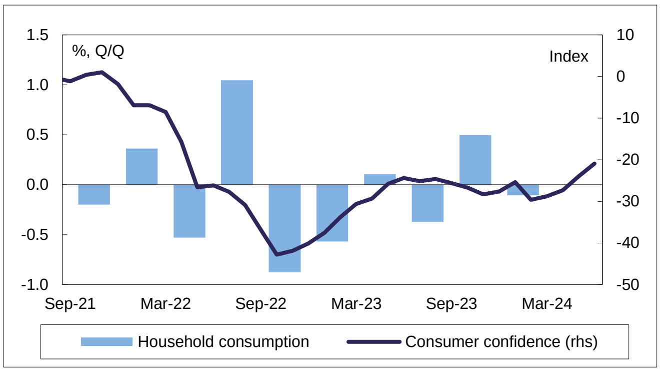
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Wage growth



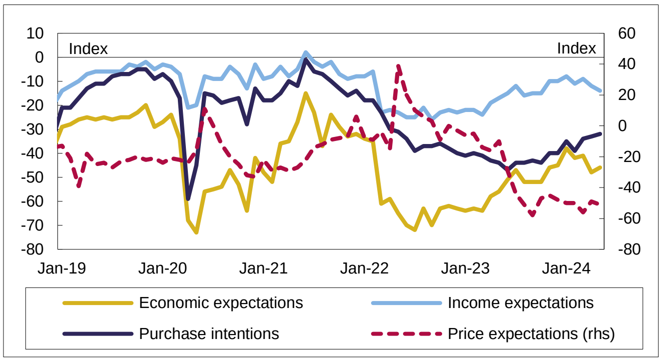
Source: Destatis, Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Consumer confidence & consumption



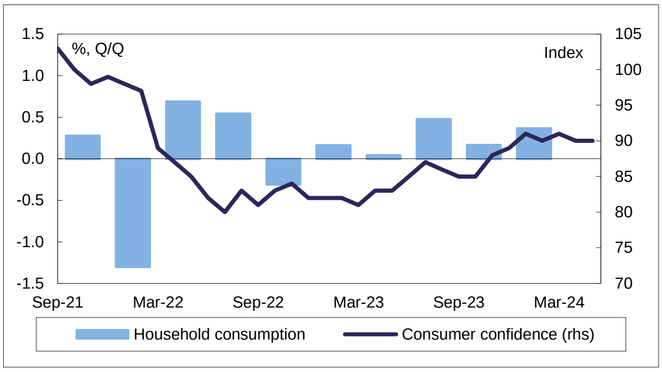
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

France: INSEE consumer confidence indices



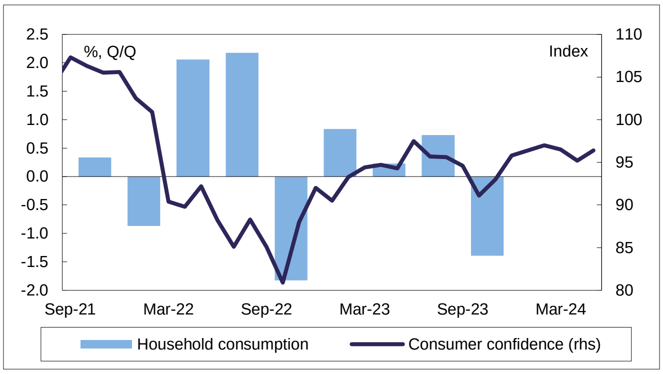
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

France: Consumer confidence & consumption



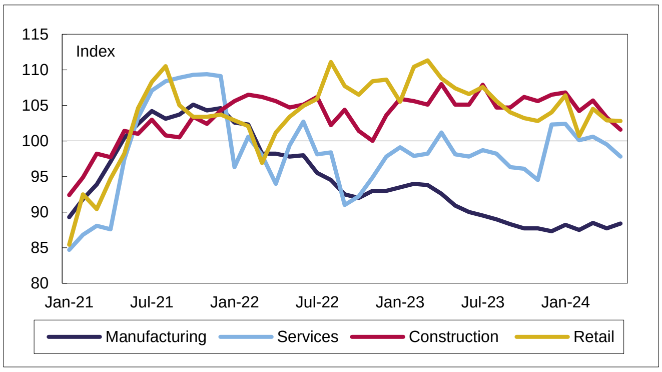
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Italy: Consumer confidence & consumption



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Italy: ISTAT business confidence indices



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK

The day ahead in the UK

Following a day bereft of top-tier data, Thursday will be another quiet day economic releases.

European calendar

Today's results

Economic data

Country		Release	Period	Actual	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area		M3 money supply Y/Y%	Apr	**1.3**	1.4	0.9	-
Germany		GfK consumer confidence indicator	Jun	**-20.9**	-22.0	-24.2	-24.0
		Preliminary HICP (CPI) Y/Y%	May	**2.8 (2.4)**	2.7 (2.4)	2.4 (2.2)	-
France		INSEE consumer confidence indicator	May	**90**	91	90	-
Italy		ISTAT consumer confidence indicator	May	**96.4**	-	95.2	-
		ISTAT business (manufacturing) confidence indicator	May	**95.1 (88.4)**	-	95.8 (87.6)	- (87.7)
Spain		Retail sales Y/Y%	Apr	**0.3**	-	0.6	0.9

Auctions

Country		Auction
Germany		sold €400mn of 1% 2038 bonds at an average yield of 2.75%
		sold €1.2bn of 2.6% 2041 bonds at an average yield of 2.8%
UK		sold £1.0bn of 0.125% 2039 index-linked bonds at an average yield of 1.051%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country		BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Euro area		10.00	Commission's Economic Sentiment Indicator rate %	May	96.1	95.6
		10.00	Commission's industrial (services) confidence indicator	May	-9.7 (6.7)	-10.5 (6.0)
		10.00	Commission's final consumer confidence indicator	May	-14.3	-14.7
		10.00	Unemployment rate %	Apr	6.5	6.5
Spain		08.00	Preliminary HICP (CPI) Y/Y%	May	3.7 (3.6)	3.4 (3.3)

Auctions and events

- Nothing scheduled -

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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