Europe | Economic Research | 14 June 2024

Euro wrap-up

Overview

- While new data suggested that euro area goods trade exports continue to pick up gradually, Bunds rallied and French sovereign spreads widened further as political concerns persisted.
- Gilts made gains as a survey suggested that UK consumer price expectations remain well anchored.
- The BoE is highly likely to leave Bank Rate unchanged on Thursday while the flash June PMIs and updates on UK and euro area inflation are also due in the coming week.

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Daily bond market movements

Bond	Yield	Change
BKO 2.9 06/26	2.756	-0.109
OBL 2.1 04/29	2.370	-0.108
DBR 2.2 02/34	2.358	-0.110
UKT 0⅛ 01/26	4.143	-0.040
UKT 0½ 01/29	3.939	-0.052
UKT 4⅝ 01/34	4.054	-0.068

*Change from close as at 5:00pm BST.
Source: Bloomberg

Euro area

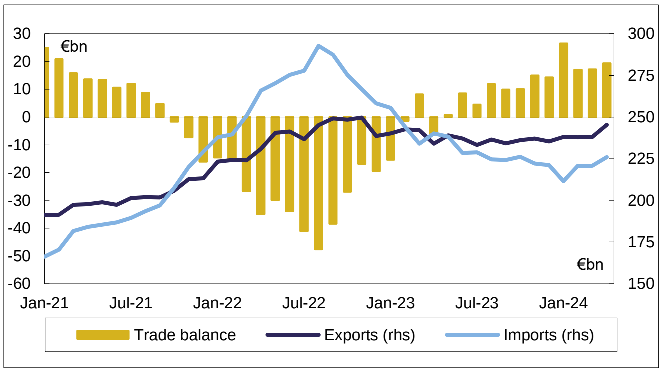
Goods trade maintains gradual recovery at the start of Q2

While wild swings in imports of services related to intellectual property and the activities of Irish-based multinationals accounted for most of the bumper 0.9ppt contribution of net trade to GDP growth in Q1, the contribution from the goods sector was marginally positive. Moderate growth in goods export volumes (0.6%Q/Q) slightly outpaced that in imports (0.4%Q/Q) with both rates the strongest in six quarters, tallying with survey evidence of a gradual turn for the better in the manufacturing sector. Today's euro area goods trade data suggested that the positive trend continued at the start of Q2. In value terms, growth in exports of 3.1%M/M was the strongest since August 2022, left them up 1.5%3M/3M and took the level to the highest since November 2022. The rise in imports of 2.3%M/M was the second-firmest of the past year, left them up 1.9%3M/3M and took the level to a six-month high. While the deflators are not yet available, both exports and imports likely posted strong growth in volume terms – indeed, import prices overall rose 0.8%M/M that month. With export values growing more vigorously than imports, the trade balance on an adjusted basis rose €2.2bn to €19.4bn. Bar January's record (€26.4bn), that marked the euro area's largest goods trade surplus since February 2021.

Record bilateral surpluses with US and UK, while chemicals balance also reaches a new high

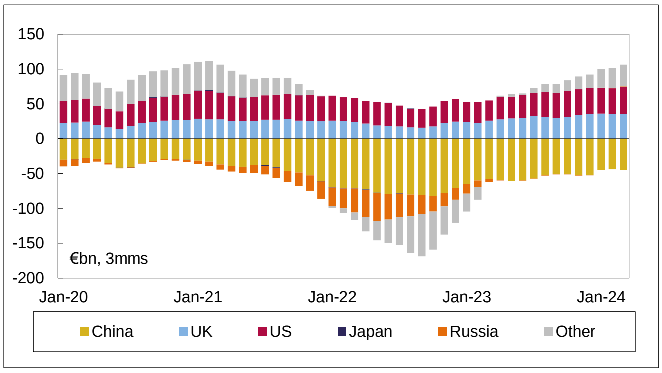
The improvement in the goods trade balance in April in part reflected new record surpluses with the US (€15.4bn) and UK (€13.0bn). In addition, the deficit with China narrowed from March's five-month high to €16.7bn, just below the average of the past year. Within the sectoral detail, despite the existential fears triggered by the recent energy crisis, today's data confirmed a new record surplus in the chemicals subsector (€22.0bn). At the same time, having declined in Q1 to the smallest in 2½ years on the back of lower wholesale gas prices, the energy deficit widened back in April to a four-month high (€25.8bn). But the trade balance in machinery and transport equipment rose back to a three-month high (€19.1bn) and second-highest level in four years. Nevertheless, the bilateral deficit with China in that subsector widened to a five-month high (€8.7bn). Of course, concerns about the growing threat to European automakers' domestic market share led the Commission earlier this week to announce sharply increased tariffs on Chinese electric vehicle (EV) imports of up to 48%, depending on the extent of cooperation of the firms concerned. While well below the equivalent tariffs imposed by the US last month, the Commission's actions bring the risk of retaliation across a range of European exports from autos to food products unless negotiations unlock alternative remedies. At the same time, given their low cost and increasingly high profile – illustrated by BYD's status as official sponsor of the Euro 2024 football championship which kicks off today – we doubt that the tariffs would wholly restrain growth in Chinese EV exports to Europe even if they are made definitive later this year.

Euro area: Goods trade balance*



*Seasonally-adjusted values terms. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Trade balance by export partner



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

The coming week's data in the euro area

The most notable new data of the coming week in the euro area will be the first top-tier survey results for June, including the flash PMIs (Friday). The euro area PMIs for May were broadly encouraging, pointing to continued economic recovery momentum as well as a further easing of price pressures in Q2. We expect the June surveys to suggest that the favourable trends extended to the end of the quarter with little change in the headline indicators. According to the final May estimates, the headline euro area composite index rose 0.5pt to a 12-month high of 52.2, consistent with a second successive quarter of GDP growth of 0.3%Q/Q in Q2. The detail suggested that growth is still being led by services, for which the headline index edged down only marginally from April's 11-month high to 53.2. But the manufacturing output PMI rose to a 14-month high of 49.3, pointing to a broad stabilisation of production after the past year's downtrend. While the expansion was strongest beyond the two largest member states, the German composite PMI rose to a 12-month high thanks to broad-based improvement, and only the French PMIs were weak. The euro area PMIs also implied that services cost growth in May was the lowest in three years while manufacturing costs rose the least in 15 months. And with the spread between the input and output price PMIs the largest since end-2022, firms appeared increasingly willing to absorb cost pressures within their margins.

Other June survey indicators due in the coming week include the Commission's flash estimate of euro area consumer confidence (Thursday) and the ZEW investor sentiment indices (Tuesday). In May, the Commission indicator rose to -14.3, suggesting that households were the most upbeat since the Russian invasion of Ukraine. And the ZEW index of investor expectations for German economic conditions rose for the tenth successive month to a 28-month high of 47.1. As for the flash PMIs, we do not expect any meaningful weakening in the June estimates.

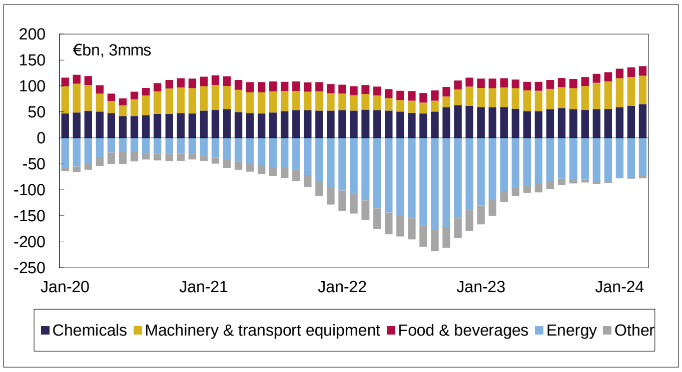
Beyond the surveys, the final May euro area consumer price inflation data (Tuesday) and April construction output numbers (Thursday) are also due. While French inflation was today revised down 0.1ppt from the flash estimate to 2.6%Y/Y, the final euro area inflation figures are expected to confirm the preliminary numbers, whereby the headline inflation rate rose 0.2ppt from April to 2.6%Y/Y, and the core rate also increased by 0.2ppt, to 2.9%Y/Y. Of course, both figures had initially beaten expectations. The main cause of higher inflation was the all-important services component, which rose 0.4ppt to a seven-month high of 4.1%Y/Y. The detail of the final estimates will confirm the extent to which that increase in services inflation was related to temporary factors, such as base effects on German transport subsidies and random volatility in package holidays, or reflected more broad-based pressures. Finally, given the declines of 2.1%M/M in Germany and 1.0%M/M in France, euro area construction output seems bound to decline in April and by more than 1.0%M/M. That, however, would follow the modest increase of 0.1%M/M, which represented the fourth successive month of expansion and took three-month growth in sector up to 1.3%3M/3M, the strongest in eleven months.

UK

Anchored inflation expectations point to diminishing risks of second-round effects

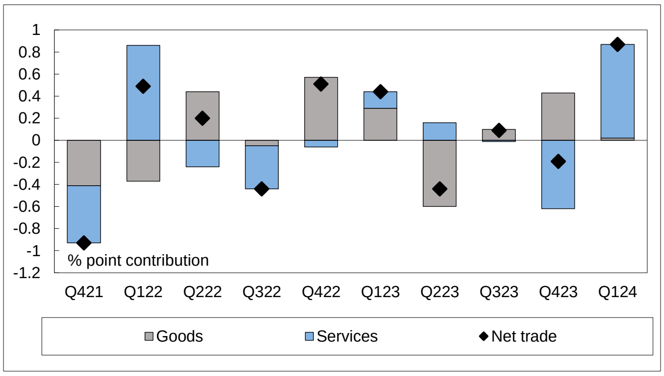
Ahead of the forthcoming monetary policy announcement on Thursday, the BoE received some encouraging news from its latest quarterly consumer survey to bolster its assessment that the risks of inflation persistence continue gradually to ease. Certainly, the survey suggested that household inflation expectations remain relatively well anchored. In particular, consumers' median expectation for inflation over the coming twelve months fell for a third successive quarter and by 0.2ppt to 2.8%Y/Y, the lowest on the survey in 11 quarters. The median expectation two years ahead dropped for the first time in a year, also down 0.2ppt to 2.6%Y/Y, matching the lowest since Q421. Expectations for five years' time were unchanged at 3.1%Y/Y, merely in line with the average of the past couple of years and above the BoE's inflation target. But that rate was also the bottom of the range in the four years before the pandemic, while expectations for 24 months ahead were below the equivalent benchmark. The YouGov/Citigroup survey similarly suggests that inflation expectations are well anchored. Indeed,

Euro area: Trade balance by type of good



Source: Macrobond & Daiwa Capital Markets Europe Ltd.

Euro area: Contribution to GDP growth



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

on that survey, the five-to-ten year ahead measure fell in May, 3.2%Y/Y, its lowest in more than three years, while the expected rate twelve months ahead fell to 3.1%Y/Y, the lowest since July 2021. According to the BoE's DMP survey, firms' inflation expectations continued to trend lower last month, with the measures for both one (3.0%3M/Y) and three years ahead (2.6%3M/Y) down on a three-month basis to new lows on the relatively short series. And according to the BoE's Financial Participants' survey, median expectations three and five years ahead remained unchanged in May at the 2.0% target, albeit with an upside skew to the distribution.

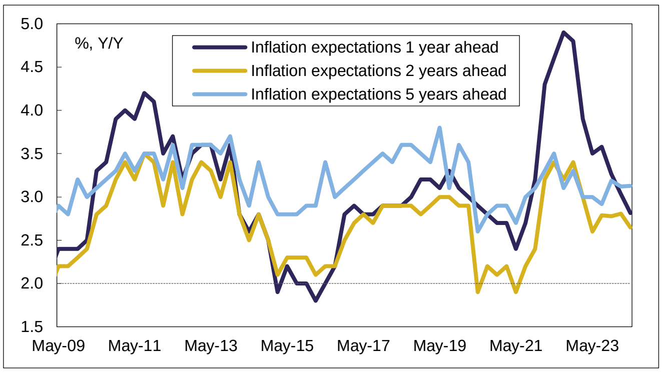
BoE set to leave rates unchanged on mixed data & political distraction

Looking ahead, on Thursday, the BoE's MPC seems bound to leave Bank Rate unchanged at 5.25% for the eighth successive monetary policy meeting. As in May, two members (Deputy Governor Ramsden and uber-dove Dhingra) will likely vote for a cut while the other seven members are likely to support the status quo. The MPC's statement last month made clear that future rate decisions would be data-dependent, with a cut considered likely to come in future if and when the evidence suggests that the risks of inflation persistence have further receded. In his press conference, Governor Bailey implied that, if the economy evolves in line with the BoE's May projection, Bank Rate was likely to be cut more rapidly than has recently been priced into the markets. However, the current general election campaign period means that any evidence that the risks of inflation persistence have receded will need to be particularly compelling to justify a rate cut this month. And we don't think that such a high bar has been met.

Labour market softens & inflation could be on target in May, but services component still too high

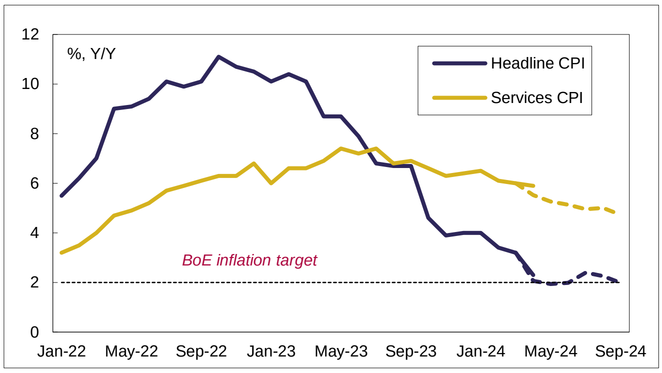
Indeed, recent key data related to the BoE's policy reaction function have been mixed. This week's labour market data reported an increase in the unemployment rate to a 2½-year high, a further decline in vacancies and a slight moderation in private regular pay growth to a 22-month low. While some alternative measures of job growth remain firm, surveys suggest that the labour market has become less tight. However, despite the flat reading for April, after an upside surprise in Q1 GDP again looks on track to exceed the BoE's projection in Q2. And most importantly, while CPI inflation fell in April to 2.3%Y/Y, the lowest since May 2021, the services component fell just 0.1ppt to 5.9%Y/Y, some 0.4ppt above the MPC's projection. We expect data due on Wednesday to show that headline and core inflation as well as the services component moderated in May. Indeed, we forecast the CPI rate to drop 0.3ppt to 2.0%Y/Y, matching the BoE's inflation target for the first time in almost three years. But services inflation will almost certainly again exceed the BoE's projection (5.3%Y/Y). And it could remain frustratingly high above 5.0%Y/Y over the remainder of the year. Certainly, a huge downside surprise in the May inflation data would now be required to persuade any more members of the MPC to vote for a rate cut this month. But if our

UK: Consumer inflation expectations*



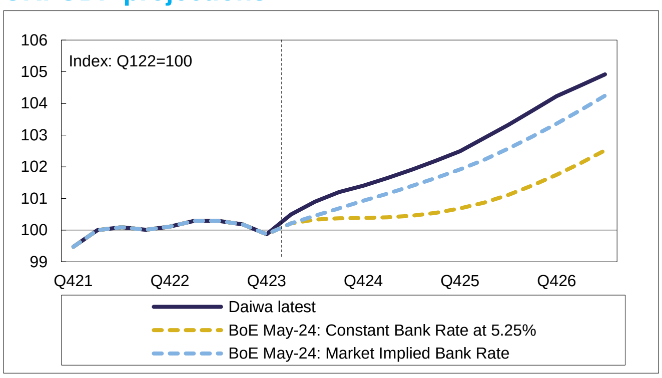
*Median expectation. Source: Macrobond & Daiwa Capital Markets Europe Ltd.

UK: CPI inflation: Actual & BoE projections*



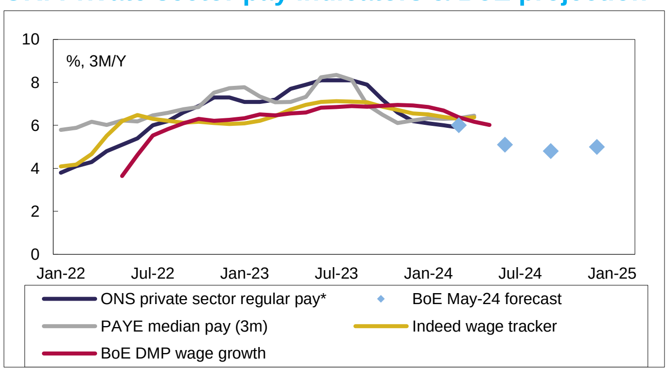
*BoE May projection shown in dashed lines. Source: BoE, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: GDP projections



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

UK: Private sector pay indicators & BoE projection



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

projections are correct, the incoming economic data over coming weeks should provide sufficient comfort for a first rate cut of 25bps at the August MPC meeting, once the distraction of the UK general election is out of the way.

The coming week's data in the UK

The May inflation figures will be the principal focus ahead of the MPC announcement. But the day after the BoE policy meeting, Friday will also bring top-tier data, most notably the June flash PMIs, May retail sales report and June consumer confidence indices. In terms of the flash PMIs, in contrast to the euro area, the May results reported an unexpected drop of 1.1ppt from April's 12-month high, back below the long-run average to 53.0. The weakening reflected a decline in the services activity index to a six-month low (52.9) while the manufacturing output index rose to the highest in more than two years (53.4). As in the euro area, the price PMIs suggested a moderation in inflationary pressures. We expect the flash June PMIs to point to a modest pickup in momentum in services but a moderation in manufacturing, leaving the composite output index up only a few tenths of a percentage point. Meanwhile, after retail sales fell in April by 2.3%M/M, the most in four months, due to bad weather, we expect a rebound in May, albeit by only about 1.5%M/M to remain below the level at end-Q1. And we expect a modest increase in the headline GfK consumer confidence index in June, perhaps of just 1pt to -16, which would be the highest since end-2021.

The next edition of the Euro wrap-up will be published on 18 June 2024

Daiwa economic forecasts

	2024				2025		2023	2024	2025
	Q1	Q2	Q3	Q4	Q1	Q2			
GDP	%, Q/Q						%, Y/Y		
Euro area	0.3	0.3	0.3	0.3	0.3	0.4	0.6	0.7	1.4
UK	0.6	0.4	0.3	0.2	0.2	0.3	0.1	0.8	1.1
Inflation, %, Y/Y									
Euro area									
Headline HICP	2.6	2.5	2.2	2.5	2.3	1.7	5.4	2.4	1.8
Core HICP	3.1	2.8	2.7	2.9	2.7	1.7	4.9	2.9	1.9
UK									
Headline CPI	3.5	2.1	2.2	2.8	2.4	2.0	7.3	2.7	2.1
Core CPI	4.6	3.5	3.2	3.2	2.7	1.7	6.2	3.6	1.9
Monetary policy, %									
ECB									
Deposit Rate	4.00	3.75	3.50	3.25	3.00	2.75	4.00	3.25	2.25
Refi Rate	4.50	4.25	3.65	3.40	3.15	2.90	4.50	3.40	2.40
BoE									
Bank Rate	5.25	5.25	5.00	4.75	4.50	4.25	5.25	4.75	3.75

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

Today's results

Today's results								
Economic data								
Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area		Trade balance €bn	Apr	**19.4**	17.3	17.3	17.2
France		Final HICP (CPI) Y/Y%	May	**2.6 (2.3)**	2.7 (2.2)	2.4 (2.2)	-
Italy		Trade balance €bn	Apr	**4.8**	-	4.3	-
UK		BoE/Ipsos household inflation expectations 1Y ahead Y/Y%	May	**2.8**	-	3.0	-
Auctions							
Country		Auction					
		- Nothing to report -					

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's data calendar

The coming few week's key data releases						
Country		BST	Release	Period	Market consensus/ *Daiwa forecast/actual*	Previous
			Monday 17 June 2024			
Euro area		10.00	Labour costs – 2nd estimate Y/Y%	Q1	4.9	3.4
Italy		10.00	Final HICP (CPI) YY%	May	0.8 (0.8)	0.9 (0.8)
			Tuesday 18 June 2024			
Euro area		10.00	Final HICP (core HICP) Y/Y%	Mayr	2.6 (2.7)	2.4 (2.9)
Germany		10.00	ZEW current situation (expectations) balance	May	-65 (49.5)	-72.3 (47.1)
			Wednesday 19 June 2024			
Euro area		10.00	Construction output M/M% (Y/Y%)	Apr	-	0.1 (0.1)
UK		07.00	CPI (core CPI) Y/Y%	May	<u>2.0 (3.4)</u>	2.3 (3.9)
		07.00	PPI – input (output) prices Y/Y%	May	-0.2 (1.7)	-1.6 (1.1)
		07.00	House price index Y/Y%	Apr	-	1.8
			Thursday 20 June 2024			
Euro area		07.00	New car registrations Y/Y%	May	-	12.8
		15.00	Preliminary Commission consumer confidence indicator	Jun	-13.8	-14.3
Germany		07.00	PPI Y/Y%	May	-2.1	-3.3
UK		12.00	BoE Bank Rate %	May	*<u>5.25</u>*	5.25
			Friday 21 June 2024			
Euro area		09.00	Preliminary manufacturing (services) PMI	Jun	47.9 (53.5)	47.3 (53.2)
		09.00	Preliminary composite PMI	Jun	52.5	52.2
Germany		07.45	Preliminary manufacturing (services) PMI	Jun	46.4 (54.4)	45.4 (54.2)
		09.00	Preliminary composite PMI	Jun	52.8	52.4
France		07.00	Preliminary manufacturing (services) PMI	Jun	46.9 (50.0)	46.4 (49.3)
		07.00	Preliminary composite PMI	Jun	49.7	48.9
		07.45	INSEE business (manufacturing) confidence indicator	Jun	99 (99)	99 (99)
UK		00.01	GfK consumer confidence indicator	Jun	-16	-17
		07.00	Retail sales, including auto fuel M/M% (Y/Y%)	May	1.6 (-0.6)	-2.3 (-2.7)
		07.00	Retail sales, excluding auto fuel M/M% (Y/Y%)	May	1.3 (-0.7)	-2.0 (-3.0)
		07.00	Public sector net borrowing £bn	May	14.5	19.6
		09.30	Preliminary manufacturing (services) PMI	Jun	51.3 (53.0)	51.2 (52.9)
		09.30	Preliminary composite PMI	Jun	53.2	53.0

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions			
Country		BST	Event / Auction
Monday 17 June 2024			
Euro area		09.00	ECB Chief Economist Lane scheduled to speak at a Reuters event
Tuesday 18 June 2024			
Germany		10.30	Auction: €4.0bn of 2039 bonds
UK		10.00	Auction: To sell 2029 bonds
Wednesday 19 June 2024			
Germany		10.30	Auction: €2.0bn of 2054 bonds
Thursday 20 June 2024			
Euro area		09.00	ECB Economic Bulletin to be published
France		09.50	Auction: To sell fixed-rate and index-linked bonds
UK		12.00	BoE monetary policy announcement and minutes to be published
Friday 21 June 2024			
- Nothing scheduled -			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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