

Euro wrap-up

Overview

- Bunds followed USTs lower while euro area consumer confidence rose to the highest level since the Russian invasion of Ukraine.
- Gilts outperformed as the BoE's MPC left Bank Rate unchanged but opened the door to a cut in August.
- Friday will bring the flash June PMIs as well as UK data on retail sales and consumer confidence.

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Daily bond market movements

Bond	Yield	Change
BKO 2.9 06/26	2.823	+0.021
OBL 2.1 04/29	2.445	+0.028
DBR 2.2 02/34	2.430	+0.028
UKT 0% 01/26	4.123	-0.038
UKT 0½ 01/29	3.900	-0.027
UKT 4% 01/34	4.055	-0.011

*Change from close as at 5.00pm BST.
Source: Bloomberg

Euro area

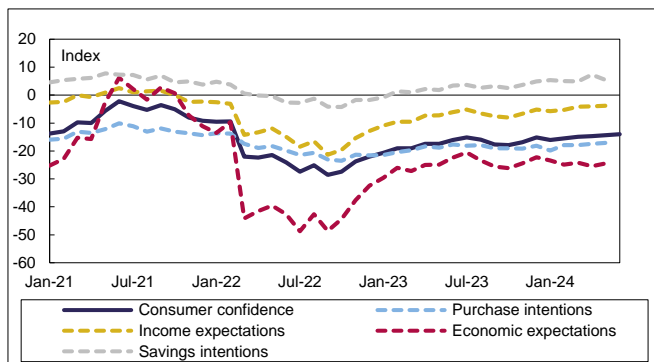
Consumer confidence rises to highest level since February 2022, but car registrations fell again

Despite the recent pickup in oil prices and rise in political uncertainty in France, the Commission's flash estimate of euro area consumer confidence in June signalled that households are the most upbeat since the Russian invasion of Ukraine. In particular, the headline index increased for an eighth consecutive month, by 0.3pt to -14, some 14½pts above the trough in September but nevertheless still below the long-run average (-10.5). While the detailed breakdown will be published in the final survey a week today, national survey results published in Belgium and the Netherlands provided some further insight. Household sentiment in Belgium jumped 6pts to a six-month high in June reflecting improved income and economic expectations as well as a marked decline in concerns about unemployment. But the survey also flagged a willingness to increase savings. This broadly tallied with the findings of the Dutch survey, where the headline index edged down to a four-month low (-23) amid a further weakening in major purchase intentions. Certainly, today's euro area new car registrations figures suggest that spending on big-ticket goods remained subdued across the region in May. According to the ECB's seasonally adjusted figures, car registrations fell for the fifth month out of the past six, by a sizeable 5.3%M/M – the most for sixteen months – to leave them down 3.3%3M/3M, the steepest such drop for two years. Of course, we continue to expect a steady recovery in spending on services to more than offset weakness in goods and so underpin household consumption growth this quarter.

German producer price figures suggest that pipeline pressures remain relatively absent

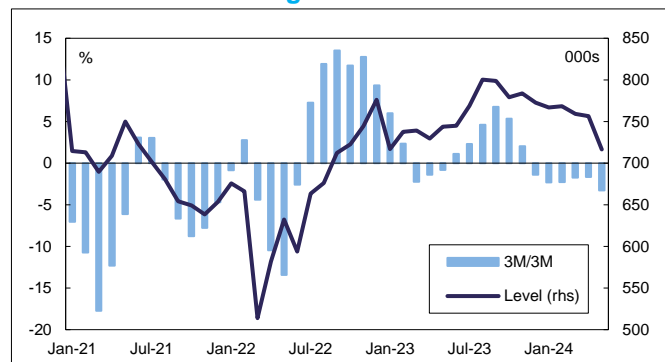
Today's German producer price figures suggested that pipeline pressures in the factory sector remain largely absent, with prices merely moving sideways in May having been expected to rise for a third consecutive month. Admittedly, the pace of decline in the annual rate moderated by more than 1ppt to -2.2%Y/Y, an eleven month high 6.9pppts above September's trough. Moreover, energy remained the principal drag, with prices down (-0.5%M/M) for the seventh month out of eight and the annual rate still firmly in negative territory (-6.4%Y/Y), with base effects sustaining significant negative prints in gas (-16%Y/Y) and electricity prices (-11%Y/Y) to offset higher prices of heating oil charges (13%Y/Y). When excluding energy, German core producer prices rose for a sixth successive month (0.3%M/M). As a result, the annual core PPI rate rose 0.6ppt in May, albeit to just 0.0%Y/Y, therefore suggesting still very weak underlying pressure. Within the detail, intermediate goods prices rose for a fifth month out of six (0.3%M/M). This pushed the annual rate up 1.2ppt to an eleven-month high, albeit still in negative territory at -1.9%Y/Y. Meanwhile, capital goods inflation (2.4%Y/Y) moved sideways at the joint-lowest level since August 2021, while consumer goods inflation edged slightly higher but remained extremely subdued at 0.5%Y/Y. While surveys suggest that the disinflationary trend in the factory sector has faded somewhat, they also suggest that firms remain reluctant to pass on any cost pressures to consumers.

Euro area: Consumer confidence



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: New car registrations



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

The day ahead in the euro area

The highlight in the euro area tomorrow will be the flash PMIs for June. 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. But the French PMIs often underestimate the strength of economic activity. As such, the INSEE business sentiment survey, which also provides an update on conditions in the construction and retail subsectors, will also be closely watched tomorrow.

UK

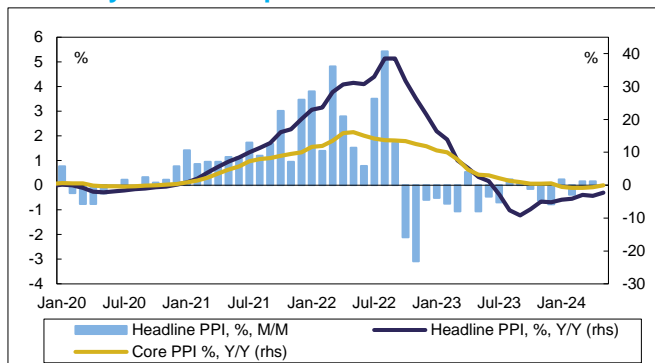
MPC signals possibility of an August rate cut

Inevitably, the BoE's MPC left Bank Rate at 5.25% for the eighth successive meeting. Predictably too, the vote on the committee was also unchanged, with seven members backing the status quo but two – the uber-dove Dhingra and Deputy Governor Ramsden – voting again for a 25bps cut. The principle message from the MPC's policy statement, however, was that the next meeting on 1 August remains live for a BoE rate cut. With committee members still holding a range of views on the extent to which the risks of inflation persistence have dissipated, that next vote will probably be close-run. But the minutes noted that, for "some" of those who voted for no change today, the decision today was already "finely balanced". And those members might well be ready to flip to supporting a rate cut in August.

Some members unperturbed by extra stickiness in services inflation and high pay growth

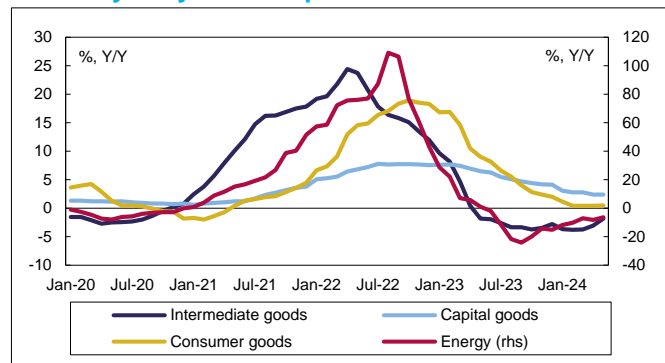
In particular, the MPC members who considered this month's decision to be "finely balanced" judged that the upside surprises in the recent services inflation data, such as that for [May reported yesterday](#), "did not alter significantly the disinflationary trajectory". Instead, they merely reflected temporary factors related to regulated and indexed components (likely referring to sewage charges, rail fares and rents) and items which are typically volatile (likely referring to prices of

Germany: Producer price inflation



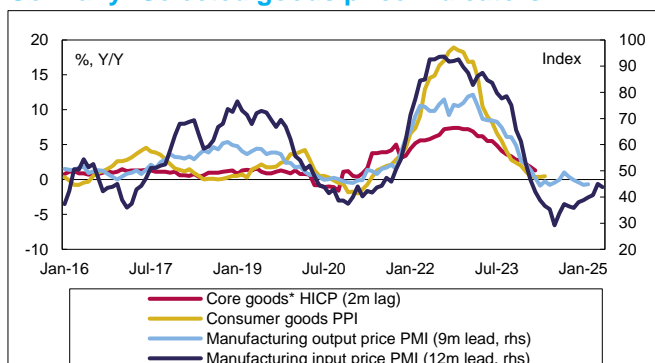
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Key PPI components



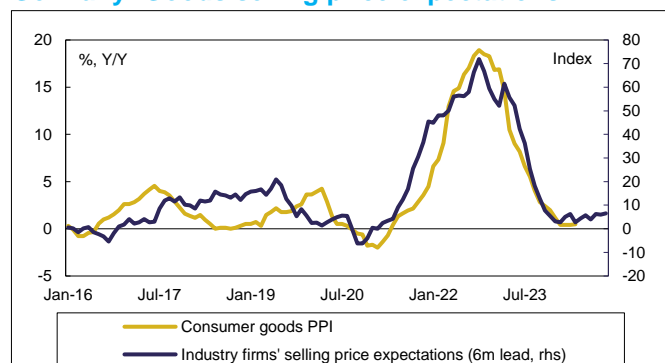
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Selected goods price indicators



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

Germany: Goods selling price expectations



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

package holidays). Those wavering MPC members were also not perturbed by the impact on pay growth from the double-digit percentage hike in the National Living Wage in April, as that was considered likely to fade gradually and so would have little consequence for the medium-term inflation outlook.

Pivotal MPC members to focus on coming month's data and updated projections

We think this pivotal group of MPC members includes BoE Governor Bailey, and perhaps also Deputy Governors Breeden and Broadbent. It might also include Chief Economist Pill. Unfortunately, Broadbent will leave the MPC before the next policy meeting on 1 August. And we can't be confident about the reaction function of his successor Clare Lombardelli. But in the absence of a nasty surprise in the data to be published over the next month, not least the June CPI report on 17 July, we expect the BoE's updated projections in August to suggest again that inflation remains on a path back to (or below) target over the policy horizon. And so, given that most members will also judge the current policy stance to be restrictive, and will be wary of the recent softening in labour demand, we think that a majority on the Committee will back a first rate cut.

MPC watching stronger-than-expected economic activity data

Just as recent data for services inflation and pay have been somewhat stronger than expected, however, so too have economic activity indicators. Indeed, contrary to the flat outturn, the BoE had expected GDP to fall in April as payback for the vigour in Q1. So, Bank staff now expect GDP growth in Q2 to reach 0.5%Q/Q, 0.3ppt stronger than its projection in May. The MPC noted that the firmer-than-expected expansion in the first half of this year should be set against the weaker-than-expected performance in the second half of last year, while surveys pointed to somewhat softer growth in output. That might suggest that the Committee need not be overly concerned about the impact on the inflation outlook. Nevertheless, with firms expecting growth momentum to pick up further through the second half of the year, the MPC flagged the possibility that spare capacity might open up to a lesser extent than it had previously expected. If so, the inflation outlook might be somewhat stronger than expected. As a result, while data related to services inflation, pay and labour market tightness will remain the key variables in the MPC's reaction function, the forthcoming economic activity figures and survey indicators – including tomorrow's flash June PMIs – might yet have a bearing on the August rate decision, particularly if they surprise significantly on the upside.





The day ahead in the UK

It will be a busy end to the week for top-tier UK economic data, including 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.









European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area	 New car registrations Y/Y%	May	-3.9	-	12.8	-
	 Preliminary Commission consumer confidence indicator	Jun	-14.0	-13.8	-14.3	-
Germany	 PPI Y/Y%	May	-2.2	-2.1	-3.3	-
UK	 BoE Bank Rate %	Jun	5.25	5.25	5.25	-














Auctions

Country	Auction
France	 sold €3.31bn of 2.75% 2027 bonds at an average yield of 3.04%
	 sold €2.38bn of 5.50% 2029 bonds at an average yield of 3.03%
	 sold €3.03bn of 2.75% 2030 bonds at an average yield of 3.01%
	 sold €1.78bn of 0% 2032 bonds at an average yield of 3.05%
	 sold €902mn of 1.85% 2027 index-linked bonds at an average yield of 0.9%
	 sold €492mn of 0.1% 2036 index-linked bonds at an average yield of 1.02%
	 sold €553mn of 0.1% 2036 index-linked bonds at an average yield of 1.03%
	 sold €300mn of 0.1% 2053 index-linked bonds at an average yield of 1.01%

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	 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

Auctions and events

- Nothing scheduled -

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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