

Euro wrap-up

Overview

- Despite an easing in German inflation in June, Bunds made notable losses but OATs outperformed as Le Pen's far-right RN party appeared more likely to fall short of an absolute majority despite dominating the first round of voting in the French general election.
- Gilts also made losses while the spread between 2-year and 10-year gilts turned positive for the first time since May 2023, even as UK bank lending slowed in the middle of Q2.
- Tuesday will bring flash June estimates of euro area inflation and unemployment figures for May.

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Daily bond market movements

Bond	Yield	Change
BKO 2.9 06/26	2.915	+0.091
OBL 2.1 04/29	2.582	+0.106
DBR 2.2 02/34	2.602	+0.108
UKT 0½ 01/26	4.160	-0.012
UKT 0½ 01/29	4.102	+0.086
UKT 4% 01/34	4.280	+0.109

*Change from close as at 5.00pm BST.

Source: Bloomberg

Euro area

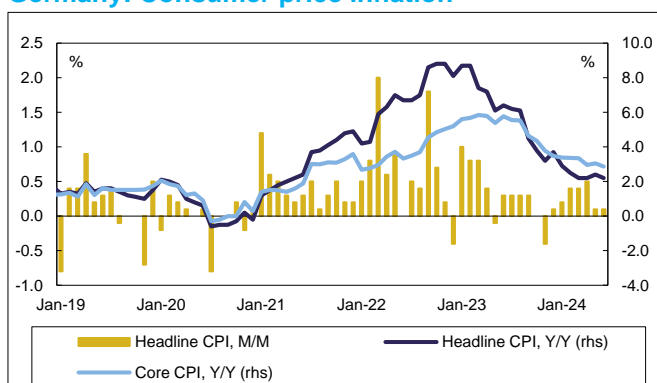
German inflation slips back despite upwards impulses from hospitality and hotel charges

Ahead of tomorrow's euro area figures, and like last week's data from [France and Spain](#), the flash June estimates from Germany suggested that the pickup in inflation in May will prove temporary. Indeed, the EU-harmonised HICP measure of German inflation fell 0.3ppt to 2.5%Y/Y, just 0.2ppt above March's near-three-year low, while the national CPI rate fell 0.2ppt to 2.2%Y/Y, matching the softest reading since April 2021. The limited detail published with the national release suggested the moderation partly reflected another drop in the energy component thanks to lower prices of auto fuel and heating oil, to leave the annual rate of this component firmly in negative territory (-2.1%Y/Y) and provide the largest drag on headline inflation for three months. Core goods inflation also appears to have moderated further in June, with the regional figures revealing further disinflation in a range of goods including furniture, household appliances and clothing. In contrast, while still relatively subdued, food inflation rose 0.5ppt to a five-month high of 1.1%Y/Y. More relevant for near-term policy decisions, services inflation moved sideways at 3.9%Y/Y, the joint-highest level since September, with the regional data suggesting upwards pressure from hospitality and hotel charges perhaps as firms take advantage of tourists visiting for the European football championships. But other erratic items such as package tours and insurance moderated. So, overall, core inflation on the national measure slipped back 0.1ppt to 2.9%Y/Y, the lowest since February 2022. On balance, taken together with the information from the other member states to have already published data, euro area headline inflation still looks to have eased in June by as much as 0.2ppt to 2.4%YY, with the core HICP rate probably down 0.1ppt to 2.8%Y/Y.

French first-round vote delivers hefty defeat for Macron, but absolute majority for RN still unlikely

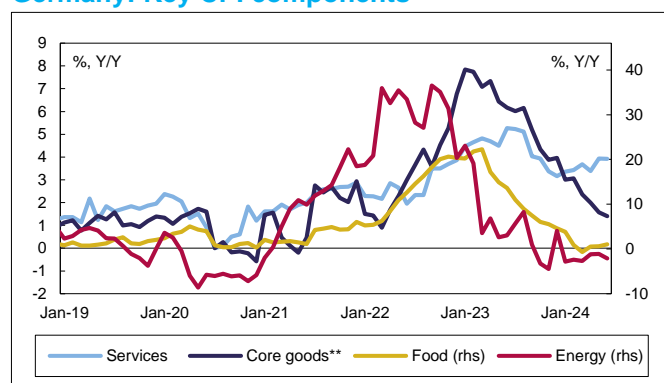
The results of yesterday's first round of voting in the French general election broadly aligned with the opinion polls, with Marine Le Pen's far-right National Rally (RN) dominating the vote, taking the largest share at 33%. The recently formed New Popular Front (NFP) left-wing alliance took the second-largest share at 28%. And, although President Macron's Ensemble party and its allies performed slightly better than had been polled before Sunday, it lagged behind with just 22%. While the outcome of the second vote on 7 July remains uncertain, French government bonds outperformed today as RN appeared more likely to fall short of an absolute majority. In the first round, 76 candidates – including 37 from the RN and 32 from the NFP – won over 50% of their constituency votes to be directly elected to parliament. Of the other 501 constituencies to be contested in a final vote on Sunday, RN qualified in first place in some 296 constituencies, highlighting the possibility that it might win an outright majority (289 seats). But in more than 300 seats, three candidates qualified for the second round. And to increase the chances of preventing an RN absolute majority, NFP has asked its 129 candidates who came in third place to withdraw from the second-round ballot with some centrist candidates set to do likewise. While the second-round voting

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.

intentions of centre-right party supporters are hard to predict with accuracy, on balance we continue to attach the largest probability to a scenario whereby RN has by some margin the largest number of seats in the new Lower Assembly but still fails to win an absolute majority, leading to a prolonged period of policy paralysis but no immediate shift to extreme populist policy-making.

The day ahead in the euro area

Tuesday will bring the aforementioned flash June inflation estimates from the euro area, which are likely to support the view that the pick up in May was temporary. Indeed, the increase in May – the headline HICP rate rose 0.2ppt to a three-month high of 2.6%Y/Y – was driven principally by a jump in services inflation due to a significant base effect associated with the introduction a year ago of the German discounted public transport ticket. Other temporary factors – such as increased accommodation costs in Germany as the Euro 2024 football championship kicked off – will likely keep services inflation elevated this month. But with core goods, food and energy inflation expected to moderate slightly further, we forecast headline HICP inflation to fully reverse the rise in May to fall back to 2.4%Y/Y – the joint-lowest level since July 2021 – while core inflation is expected to decline 0.1ppt to 2.8%Y/Y, to be still 0.1ppt above April's rate. Meanwhile, euro area unemployment figures will provide an update on labour market conditions in the middle of Q2, with the jobless rate expected to tick slightly higher in May, by 0.1ppt to 6.5%.

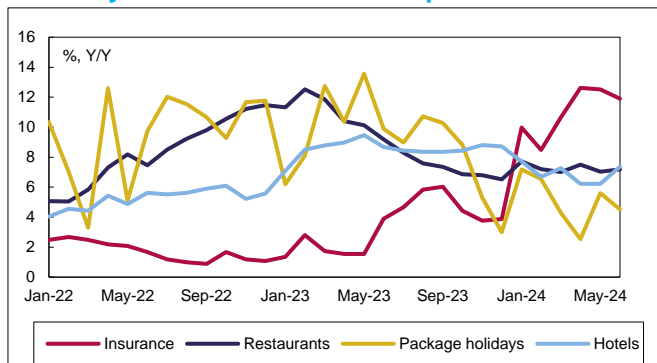
Aside from the data, focus will also turn to the ECB's central bank forum in Sintra, with ECB President Lagarde and Fed Chair Powell due to participate in a policy panel, while ECB Executive Board member Schnabel will chair a panel on 'geopolitical shocks and inflation'.

UK

Mortgage lending remains subdued as expectations for rate cuts pushed back

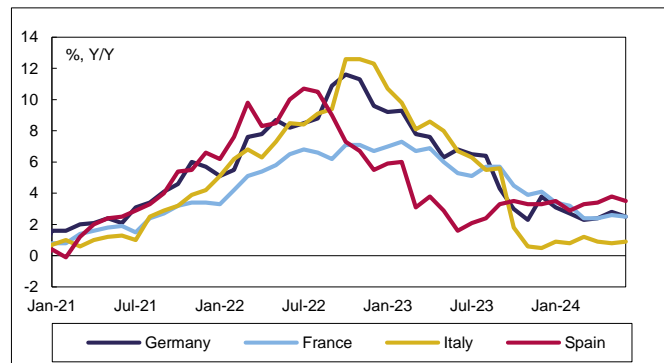
With expectations of the first BoE interest rate cut this cycle having been pushed out to the summer following the release of some stronger-than-expected data and the calling of the snap election this month, and mortgage rates having thus trended gradually higher over recent months, today's monetary data unsurprisingly suggested that households remained reluctant to borrow. Indeed, having risen in April (£2.2bn) at the fastest pace in seventeen months, net new secured lending slowed to £1.2bn in May, above the average of the past six months (£0.5bn) but well below the pre-pandemic five-year average (£3.6bn). Given the lack of lending over the past year or so, annual growth in the stock of such loans remained very weak at just 0.3%Y/Y. While the effective interest rate paid on new mortgages was some 55bps below the November peak, shorter-

Germany: Selected services components in NRW*



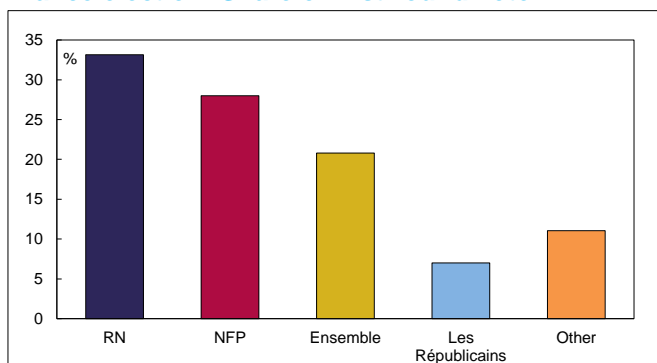
*North-Rhine Westphalia. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area selected member states: Headline HICP



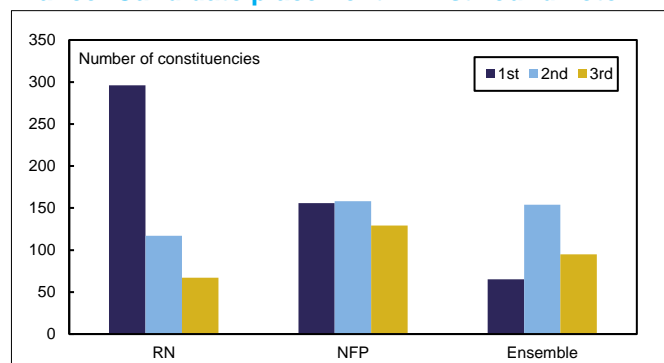
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

France election: Share of first-round vote



Source: French Ministry of the Interior and Daiwa Capital Markets Europe Ltd.

France: Candidate placement in first-round vote



Source: French Ministry of the Interior and Daiwa Capital Markets Europe Ltd.

dated mortgage rates have recently shifted higher – the average rate on a 2-year 75% LTV mortgage rose to a six-month high in May some 50bps above January's low – perhaps prompting the rise in repayments to the highest since January 2023. In addition, the number of mortgage approvals for house purchase edged down to a four-month low (60.0k), with re-mortgaging approvals (29.6k) down to a six-month low.

Mortgage lending to remain subdued as affordability remains relatively stretched

Admittedly, approvals for new purchases in May were still almost 12k above the 2023 average. And today's Nationwide housing report suggested that home prices rose 0.2%M/M in June, to be up a little more than 2½% from last September's trough. But the report also flagged that affordability remains relatively stretched. In particular, the ratio of mortgage payments to earnings for first-time buyers in Q2 (36.5%) was still some 7ppts above the pre-pandemic five-year average despite having eased from the 15-year high of 39.4% in Q423. And with the BoE noting last week that a little more than one third of mortgage holders (>3mn) are still paying a mortgage rate of less than 3%, the majority of which will shift to a higher rate before end-2026 once their fix expires, we continue to expect only a gradual uptick in mortgage lending over coming quarters.

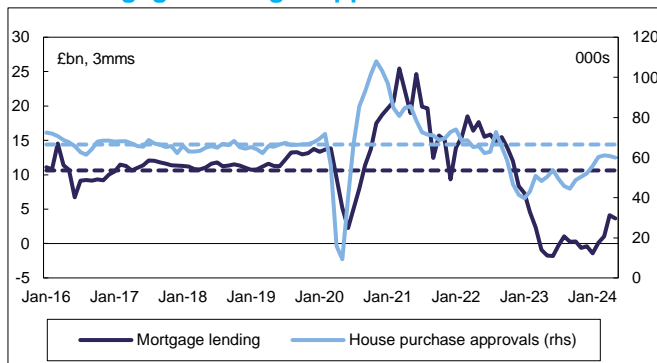
Consumer credit bounced back in May, but business lending still subdued

In contrast, consumer credit bounced back in May, with net unsecured lending of £1.5bn almost double that in April and the strongest since January. Given strong demand over recent years as the cost of living crisis peaked, annual growth in consumer credit remained elevated at 8.3%Y/Y. And while households deposited an additional £5.3bn with banks in May following a record net inflow in April, this marked the softest inflow in six months, arguably tallying with the pickup in [retail sales](#) that month. But the ongoing decline in lending to businesses, which repaid a further net £0.5bn in May for a fourth successive month to leave the stock of such loans up just 0.3%Y/Y, suggests that fixed investment growth might be restrained for the time being.

The day ahead in the UK

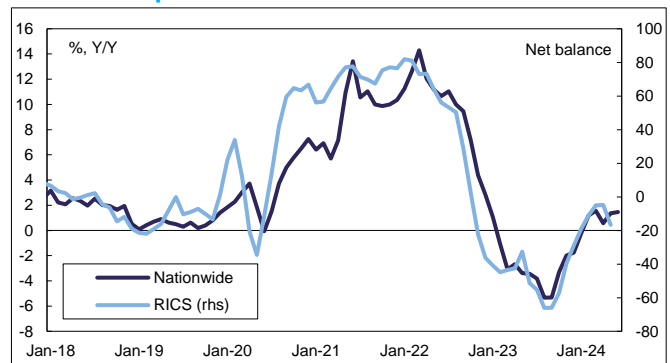
Tuesday should be a relatively quiet day for UK economic releases, with just the BRC shop price monitor likely to suggest that inflation on the High Street remained extremely subdued at the end of Q2 amid strong competition among retailers and subdued domestic demand for goods.

UK: Mortgage lending & approvals*



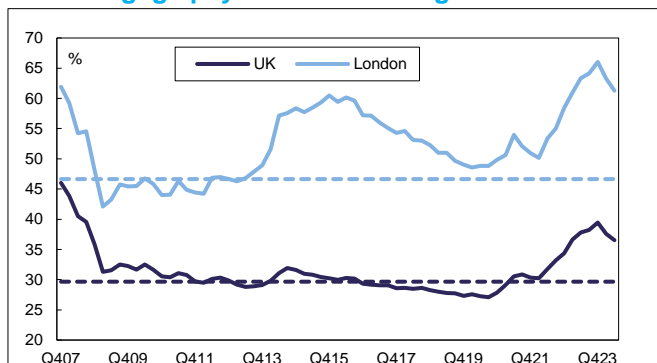
*Dashed lines represent pre-pandemic five-year average. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: House price indicators



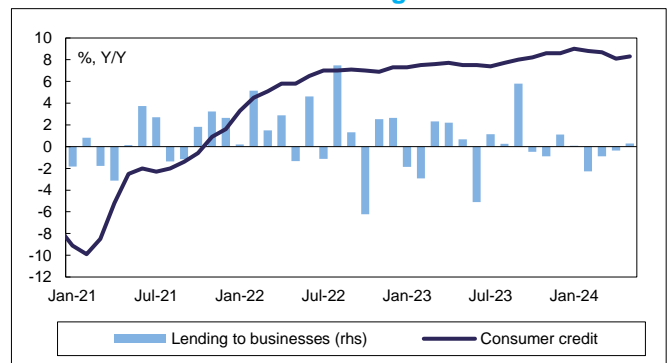
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Mortgage payments to earnings ratio*



*First-time buyers. Dashed lines represent long-run average. Source: Nationwide, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Consumer credit & lending to businesses













Source: Macrobond and Daiwa Capital Markets Europe Ltd.

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro Area	 Final manufacturing PMI	Jun	45.8	45.6	47.3	-
Germany	 Final manufacturing PMI	Jun	43.5	43.4	45.4	-
	 Preliminary HICP (CPI) Y/Y%	Jun	2.5 (2.2)	2.6 (2.3)	2.8 (2.4)	-
France	 Final manufacturing PMI	Jun	45.4	45.3	46.4	-
Italy	 Manufacturing PMI	Jun	45.7	-	45.6	-
Spain	 Manufacturing PMI	Jun	52.3	-	54.0	-
UK	 Nationwide house price index M/M% (Y/Y%)	Jun	0.2 (1.5)	0.0 (1.2)	0.4 (1.3)	-
	 Final manufacturing PMI	Jun	50.9	51.4	51.2	-
	 Net consumer credit £bn (Y/Y%)	May	1.5 (8.3)	1.5 -	0.7 (8.1)	0.8 (-)
	 Mortgage lending £bn (approvals 000s)	May	1.2 (60.0)	1.8 (60.5)	2.4 (61.1)	2.2 (60.8)





Auctions

Country	Auction
- Nothing to report -	





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	 10.00	Preliminary headline (core) HICP Y/Y%	Jun	<u>2.4 (2.8)</u>	2.6 (2.9)
	 10.00	Unemployment rate %	May	6.4	6.4
Spain	 08.00	Unemployment (employment) change 000s	Jun	-	-58.7 (62.5)
UK	 00.01	BRC shop price index Y/Y%	Jun	-	0.6

Auctions and events

Euro area	 -	ECB's de Guindos (08.30), Schnabel (11.30), Lagarde and Fed Chair Powell (14.30) discuss euro area inflation, geopolitics and policy at ECB central bank forum in Sintra				
Germany	 10.30	Auction: €0.5bn of 0% 2030 bonds				
	 10.30	Auction: €0.5bn of 0% 2050 bonds				
UK	 10.00	Auction: £4.0bn of 3.75% 2027 bonds				

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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