

Euro wrap-up

Overview

- While the euro area unemployment rate remained at a series low and senior ECB officials suggested they need more information on the outlook for services prices before cutting rates again, shorter-dated Bunds made modest gains as headline inflation moderated in June.
- Gilts also made gains as a UK retail survey reported a further decline in shop price inflation to its lowest since October 2021.
- The coming two days will bring final June services PMIs, the ECB account from the 6 June meeting and the UK general election.

Chris Scicluna
+44 20 7597 8326

Emily Nicol
+44 20 7597 8331

Daily bond market movements

Bond	Yield	Change
BKO 2.9 06/26	2.903	-0.011
OBL 2.1 04/29	2.581	-0.001
DBR 2.2 02/34	2.608	+0.006
UKT 0% 01/26	4.165	+0.005
UKT 0½ 01/29	4.090	-0.012
UKT 4% 01/34	4.259	-0.021

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

Euro area

Headline inflation moderates on softer energy & food components

The flash euro area inflation data for June were somewhat mixed. In line with expectations and proving that the pickup in May was temporary, the headline rate fell 0.1ppt to 2.5%Y/Y. But core inflation beat expectations, moving sideways at 2.9%Y/Y to remain 0.2ppt above April's 26-month low. As a result, on average over Q2, headline inflation (also 2.5%Y/Y) was bang in line with the ECB's projection, but core inflation (2.8%Y/Y) exceeded the ECB's forecast by 0.1ppt. Indeed, the moderation in inflation at the end of Q2 was driven by non-core components, with energy prices falling for the third month out of the past four thanks to lower prices of auto fuel and heating oil, to leave the respective annual rate down 0.1ppt at just 0.2%Y/Y. The disinflationary trend in food, alcohol and tobacco was also maintained, similarly down 0.1ppt to 2.5%Y/Y, the softest since November 2021.

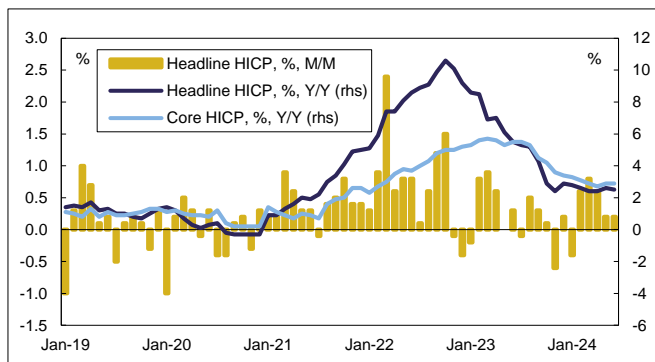
Services inflation remains sticky but signs momentum starting fade

Among the core items, inflation of non-energy industrial goods was unchanged in June, but still remained very subdued at 0.7%Y/Y. Indeed, prices of core goods fell for the first month in five, and on a seasonally-adjusted basis core goods momentum turned slightly negative for the first time since December 2020. While services inflation was also unchanged in June, it was still well above the core goods rate at 4.1%Y/Y, the joint-highest since last October and more than double the ECB's 2% inflation target. And while services momentum on a three-month annualised basis dropped 0.5ppt to a three-month low, at 4.9% it remained above the average of the past twelve months. Yesterday's data from the German regions and some of the member states suggested that persisting services stickiness last month reflected further upwards pressure in components such as hotels and restaurants, which probably in part reflected temporary factors. But at least until the full details are published in a few weeks' time, and probably for some time after that, the ECB hawks will remain concerned about generalised persistence in the services component.

Near-term inflation profile to remain choppy

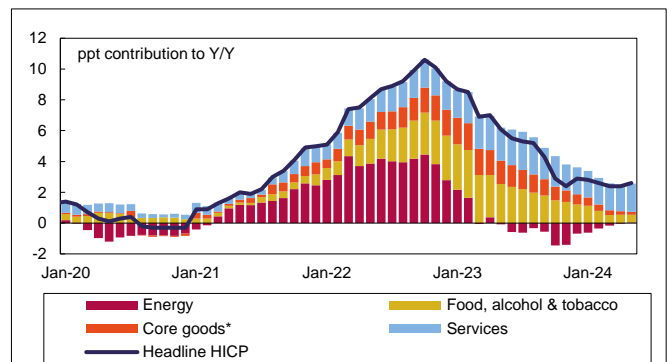
The near-term outlook for services inflation remains uncertain, with the Paris Olympics likely to provide a further new impetus to hospitality prices this month and next. But, overall, we expect services inflation to remain close to current levels through to spring next year. And while indicators suggest that factory pipeline pressures remain below average, we doubt that core consumer goods inflation has much further to fall. Indeed, the recent spike in shipping costs and longer delivery times might well provide a positive impulse over coming months. So, like the ECB, we expect core inflation to oscillate around the current rate until the end of the year, before taking a step down below 2% in Q225, and the profile for headline inflation will remain

Euro area: Headline & core HICP inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Contributions to HICP inflation



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

choppy too. While the disinflationary path for food appears to have largely run its course, energy inflation will likely slip back into negative territory for three months from August. So, the headline HICP rate might well fall back close to the 2% target over coming months before rebounding somewhat in Q4. And like core inflation, we forecast headline inflation to fall below the 2% target from Q2 next year – two quarters ahead of the ECB’s expectation – before easing a little further to around 1½%Y/Y over the second half of the year.

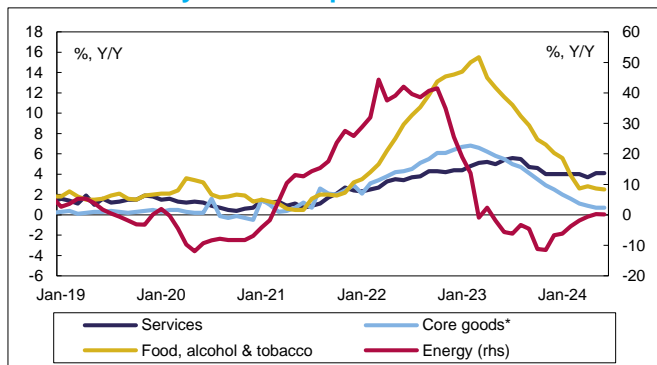
Unemployment rate remains at series low, so ECB won’t rush another rate cut this month

In his Bloomberg interview this morning, ECB Chief Economist Lane noted how the June inflation data left the outlook for the services component still particularly uncertain. Additionally, in her Sintra speech yesterday evening, President Lagarde emphasised uncertainty related to the broader outlook for profits, wages and productivity, as well as possible new supply-side shocks, which she felt meant that the risks of persistent above-target inflation had not necessarily passed. She also flagged the resilience of the labour market, which was illustrated today as the euro area unemployment rate was unchanged at the series low of 6.4% in May. The equivalent rates in Italy and Spain remained at their lowest levels since mid-2008, with the Irish rate matching the lowest since 2001 and the Greek the lowest in almost 15 years. But while labour market conditions are still firm at the periphery, momentum at the core appears a little less favourable. Indeed, the unemployment rates in May in Germany, France, Netherlands, Belgium and Austria were between 30-60bps above their respective lows reached over the past year or two. And more than fully accounted for by increased joblessness in the core, the number of persons unemployed in the euro area rose 38k in May from the prior month’s series low to 11.078mn. Overall, however, the Governing Council will share Lagarde’s view that the low euro area unemployment rate means it has no need to rush to ease policy further following last month’s rate cut. So, we certainly expect rates to remain unchanged at the ECB’s next monetary policy meeting on 18 July. By the time of the 12 September policy meeting, however, the inflation data for July and August, as well as estimates of Q2 GDP and labour costs, should alleviate concerns of inflation persistence a little further, to provide sufficient cover for another 25bps rate cut.

The coming two days in the euro area

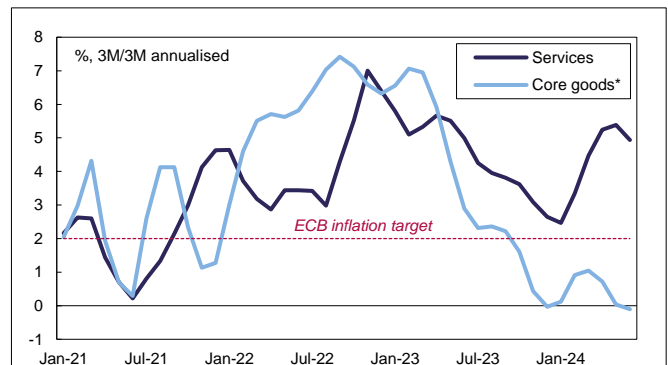
On Wednesday, euro area producer price inflation figures for May are likely to suggest that pipeline pressures in the factory sector remain extremely subdued, with prices expected to decline for a seventh successive month in May (-0.1%/M/M). Due to base effects, the annual rate is expected to rise to an eleven-month high, albeit remaining firmly in negative territory. The inflationary components of the final services PMIs for June will provide further information about price pressures – according to the flash release, the input costs and priced charged components fell to the lowest for more than three years. The headline services activity PMI also unexpectedly fell to a three-month low (52.6), albeit consistent with ongoing expansion.

Euro area: Key HICP components



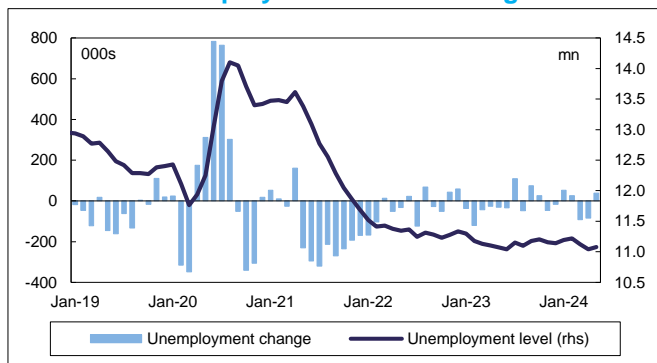
*Non-energy industrial goods. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Core inflation momentum



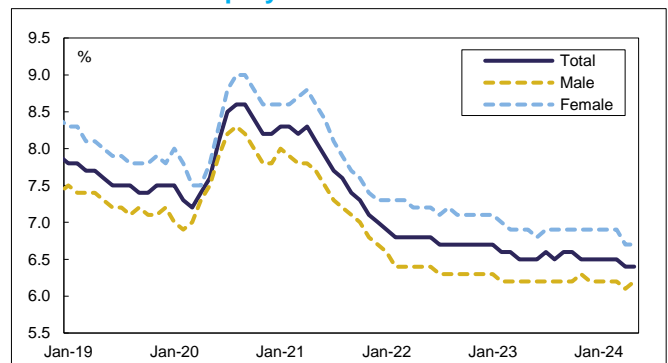
*Non-energy industrial goods. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Unemployment level & change



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Unemployment rates



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

The June construction PMI surveys will follow on Thursday, along with German factory orders figures for May. Having declined for a fourth successive month in April, we expect factory orders to rise in May.

Aside from the data, ECB Chief Economist Lane will chair a panel discussion on the drivers of equilibrium interest rates at the Sintra central banking forum on Wednesday. And the account of the 6 June Governing Council meeting, when the ECB cut interest rates for the first time this cycle, will be published on Thursday.

UK

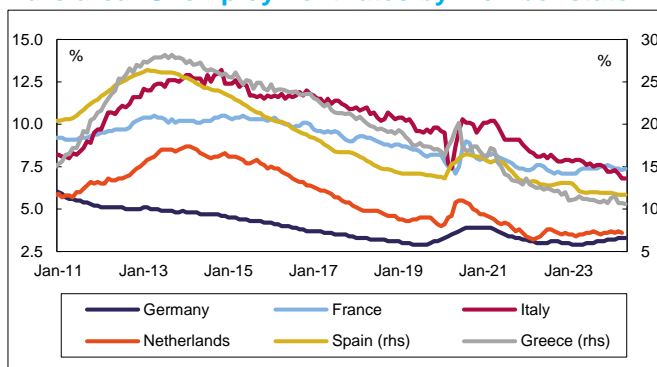
Shop price inflation eases to lowest since October 2021

Today's BRC shop price monitor further illustrated the absence of any significant price pressures on the High Street as retailers contend with strong competition and relatively subdued demand for goods. According to the BRC, shop prices fell for a third month out of four in June, by 0.2%M/M, to leave the annual rate down 0.3ppt to just 0.2%Y/Y, the lowest since October 2021. The drop in part reflected ongoing disinflation in the food component, which fell 0.7ppt to 2.5%Y/Y in June, the softest since December 2021. But deflation in the non-food category intensified at the end of Q2 (-1.0%Y/Y). Notable discounting in clothing, furniture and electrical items more than offset a slight pickup in inflation of DIY and gardening-related items, which perhaps reflected the improvement in weather conditions in the second half of the month. The pickup in manufacturing input costs over recent months, related not least to higher shipping rates, and higher energy prices might well feed through to retailers in due course. But the relative softness of goods demand will likely continue to limit pass-through of those costs to consumers.

The coming two days in the UK

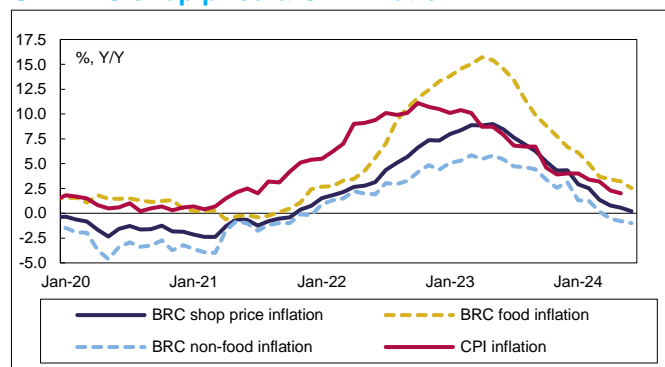
Wednesday will bring final services PMIs for June. The preliminary release implied a further notable drop in the headline activity index, by 1.7pts to 51.2, a seven-month low. The survey also disappointingly reported a pickup in the input price PMI, while the output prices charged index rose to its highest since March, with both remaining well above the long-run average. Thursday's release of the BoE's June Decision Maker Panel survey results will also provide an update on firms' inflation and wage expectations. In May, the median forecast for headline CPI one year and three years ahead moved sideways at 2.9%Y/Y and 2.6%Y/Y respectively suggesting that inflation expectations remain well anchored. Of course, the main event on Thursday will be the [general election](#). A large majority for the Labour Party, to send its broadly centrist and relatively technocratic leader Keir Starmer to Downing Street as the successor to five very different Conservative Prime Ministers over the past eight years, should have long been fully priced by the financial markets.

Euro area: Unemployment rates by member state



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: BRC shop price & CPI inflation







Source: Macrobond and Daiwa Capital Markets Europe Ltd.

The next edition of the Euro wrap-up will be published on 04 July 2024




European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro Area	 Preliminary headline (core) HICP Y/Y%	Jun	2.5 (2.9)	<u>2.4 (2.8)</u>	2.6 (2.9)	-
	 Unemployment rate %	May	6.4	6.4	6.4	-
Spain	 Unemployment (employment) change 000s	Jun	-46.8 (31.3)	-	-58.7 (62.5)	-
UK	 BRC shop price index Y/Y%	Jun	0.2	-	0.6	-








Auctions

Country	Auction
Germany	 sold €493mn of 0% 2030 bonds at an average yield of 2.47%
	 sold €494mn of 0% 2050 bonds at an average yield of 2.74%
UK	 sold £4.0bn of 3.75% 2027 bonds at an average yield of 4.441%



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	Final services (composite) PMI	Jun	<u>52.6 (50.8)</u>	53.2 (52.2)
	 10.00	PPI Y/Y%	May	-4.2	-5.7
Germany	 08.55	Final services (composite) PMI	Jun	<u>53.5 (50.6)</u>	54.2 (52.4)
France	 08:50	Final services (composite) PMI	Jun	<u>48.8 (48.2)</u>	49.3 (48.9)
Italy	 08.45	Services (composite) PMI	Jun	56.5 (-)	54.2 (52.3)
Spain	 08.15	Services (composite) PMI	Jun	53.9 (-)	56.9 (56.6)
UK	 09.30	Final services (composite) PMI	Jun	<u>51.2 (51.7)</u>	52.9 (53.0)






Auctions and events

Euro area	 -	ECB's de Guindos (09.00), Cipollone (10.00), and Chief Economist Lane (11.30) discuss monetary policy, euro area productivity and equilibrium interest rates in Sintra.
Germany	 10.30	Auction: €5bn of 2034 bonds






Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Thursday's releases

Economic data

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Germany	 07.00	Factory orders M/M% (Y/Y%)	May	0.8 (-6.0)	-0.2 (-1.6)
	 08.30	Construction PMI	Jun	-	38.5
UK	 09.00	New car registrations Y/Y%	Jun	-	1.7
	 09.30	Construction PMI	Jun	54.0	54.7
	 09.30	DMP 3M output price (1Y CPI) expectations Y/Y%	Jun	-	3.9 (2.9)

Auctions and events

Euro area	 12.30	ECB publishes account of June monetary policy meeting
France	 09.50	Auction: to sell 3% 2033, 1.25% 2034, 0.75% 2053 and 1.75% 2066 bonds
Spain	 09.30	Auction: to sell 2.5% 2027, 3.1% 2031 and 1.85% 2035 bonds and 0.7% 2033 index-linked bonds
UK	 -	General Election – polling day
	 09.30	BoE to release Q2 credit conditions and bank liabilities surveys.

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:

<https://www.uk.daiwacm.com/ficc-research/recent-blogs>

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