

Euro wrap-up

Overview

- Bund yields followed the global trend higher as oil prices rose on reports that Iran will halt discussions with the US, while European data showed that household inflation expectations remained elevated, the labour market remained resilient but German retail sales fell further.
- Gilts underperformed on a quiet day for UK economic news.
- Tuesday will bring euro area flash inflation estimates for May and UK bank lending figures for April.

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Daily bond market movements

| Bond | Yield | Change |
|---------------|-------|--------|
| BKO 2½ 06/28 | 2.612 | +0.088 |
| OBL 2½ 04/31 | 2.703 | +0.068 |
| DBR 2.9 02/36 | 2.995 | +0.059 |
| UKT 4¾ 03/28 | 4.316 | +0.109 |
| UKT 4¾ 03/31 | 4.445 | +0.095 |
| UKT 4¾ 10/35 | 4.891 | +0.079 |

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

Euro area

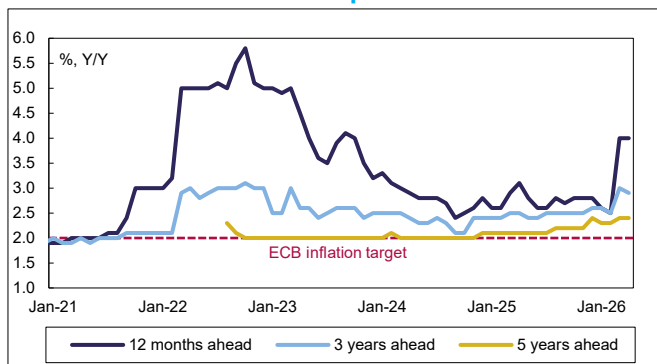
Consumer inflation expectations held steady at start of Q2, but still close to 2022 highs

Ahead of the ECB's forthcoming policy-setting meeting on 11 June, ECB policymakers have repeated their concerns that the energy price shock will be significantly magnified via indirect and second-round effects, particularly if inflation expectations become de-anchored. And while today's European dataflow suggested that risks to economic activity are becoming increasingly skewed to the downside, they also provided a reminder that some measures of inflation expectations have risen significantly since the start of the conflict. So, coupled with today's reports that Iran has halted its exchanges of messages with the US, the figures will likely have reinforced the determination of the Governing Council to raise rates at least twice this year. Certainly, the ECB's own Consumer Expectations Survey (CES) showed that inflation expectations remained elevated at the start of Q2, with the median year-ahead expectation moving sideways in April at March's 2½-year high (4.0%Y/Y). And while this was inflated by an exceptionally high reading in Greece (9.9%Y/Y), expectations crept higher in certain core member states too, including Germany, Belgium and Austria. Some policymakers might take some comfort that the medium-term median expectation for three years ahead – the measure that arguably matters most for policy-setting – edged slightly lower in April, by 0.1ppt to 2.9%Y/Y. But this rate too was still close to its 2022 highs. And while the mean also fell slightly, at 5.2%Y/Y it was the second-highest level in more than three years and underscored that the distribution of inflation expectations has shifted significantly to the right since the outbreak of war. Moreover, the median expectation for five years ahead held steady at the series high, almost ½ppt above the ECB's 2% target, also perhaps raising questions about ECB credibility.

Labour market still resilient despite recent upwards drift in French joblessness

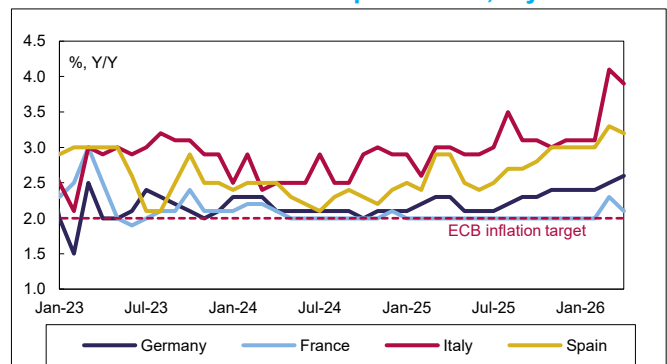
The CES also suggested that the outlook for the labour market remained broadly stable in April. Those currently unemployed saw a greater probability of finding a job in the next three months. In contrast, respondents in employment reported a higher probability of job loss over the near term. And overall, the CES measure of the expected unemployment rate 12 months ahead rose to 8.1%, the highest level since mid-2023. For now, at least, the official data suggest ongoing resilience, with the euro area jobless rate in April moving sideways at 6.3% (upwardly revised from the initial estimate for March by 0.1ppt). This was also unchanged from the level a year ago and just 0.1ppt above the trough in Q424. This in part reflected record low unemployment in Italy, while the Spanish rate remained close to the post-GFC low reached in December. Encouragingly, the ILO measure of German unemployment rate was also revised down in previous months and was unchanged in April at 3.8%. But this was some 0.8pt above the low from mid-2023. Moreover, the French data were revised significantly higher, with the unemployment rate in April (8.2%) ½ppt higher than previously estimated for March and more than 1ppt above the level three years ago.

Euro area: CES inflation expectations*



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

Euro area: CES inflation expectations, 3-yrs ahead*



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

Household expectations of growth dampen, while German retail sales fall further in April

After French GDP contracted modestly in Q126, the CES suggested that French consumers are significantly more downbeat about the economic outlook than most other member states. Admittedly, today's survey also suggested that households in every member state except Spain have become more pessimistic about prospects for growth, with the squeeze on household budgets from higher inflation and a reported tightening of credit conditions dampening spending plans. Separately, today's German retail sales figures raised the prospect of a near-term contraction in the largest member state, with sales volumes down for a fourth successive month in April (-0.3%M/M). While this partly reflected a further sharp decline in sales of auto fuel (-4.2%M/M) in response to the spike in petrol prices, spending on non-fuel and non-food items also fell the most in almost two years (-2.2%M/M). So, while German retail figures are notoriously volatile and subject to significant revision – indeed, the March decline in sales volumes was revised today from -2.0%M/M to -0.3%M/M – sales are currently tracking more than ½% below the Q1 average.

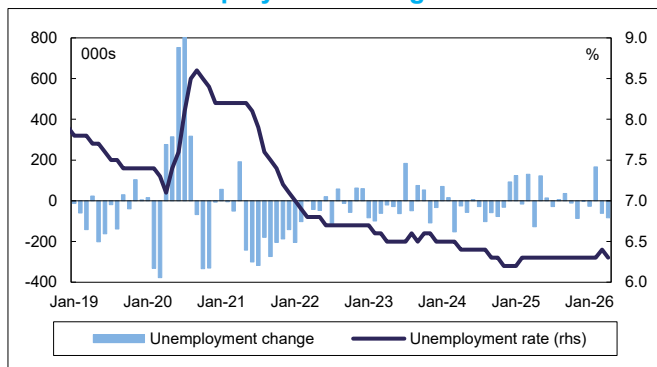
Consumer credit rises further, longer-dated business loan issuance picks up too

Despite tightening financial conditions, today's ECB monetary figures suggested that credit continued to flow steadily to households and businesses in April. Admittedly, the sustained firmness in net lending to households at the start of Q2 (€18bn) in part reflected a pickup in consumer credit, which was the strongest in 16 months (€4.6bn), possibly linked to strained household budgets. But while mortgage lending only moderated slightly in April (€12.7bn), this left net issuance of such loans in the three months to April at the lowest level in seven months. Arguably more surprising in today's release was the strength in new lending to NFCs, which moderated only slightly from March to €24bn. Contrasting the sharp jump in issuance of shorter-dated loans in March, which was likely required to fund working capital and inventories, the rise in April reflected a rebound in the net flow of longer-dated loans – more typically associated with investment – which rose the most in four months (€12.4bn). Admittedly, the ECB's recent Bank Lending Survey suggested that demand for capex-related business loans fell the most in two years in Q1. And unless and until there is a meaningful resolution to reopen the Strait of Hormuz, firms are highly likely to postpone non-essential work, weighing on demand for capex-related loans over coming months.

The day ahead in the euro area

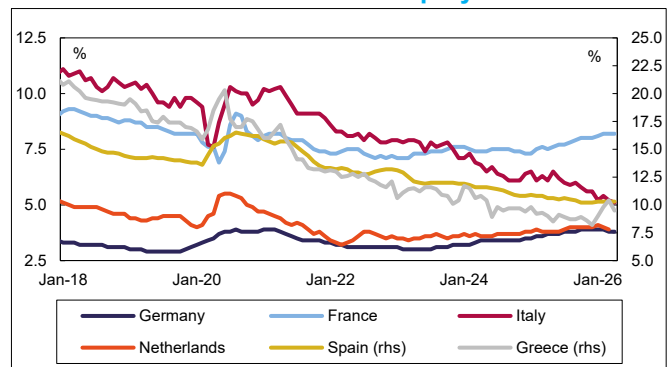
May's flash inflation estimates provide the data highlight in the euro area on Tuesday. With the notable exception of Germany, last week's flash estimates from the member states indicated that headline inflation in the euro area ticked higher once again, above the 31-month high of 3%Y/Y reported in April. For what it's worth, we see the headline HICP rate rising to 3.3%Y/Y in May. On balance, the risks to our forecast are likely to be slightly to the downside, as reflected by the marginally

Euro area: Unemployment change & rate



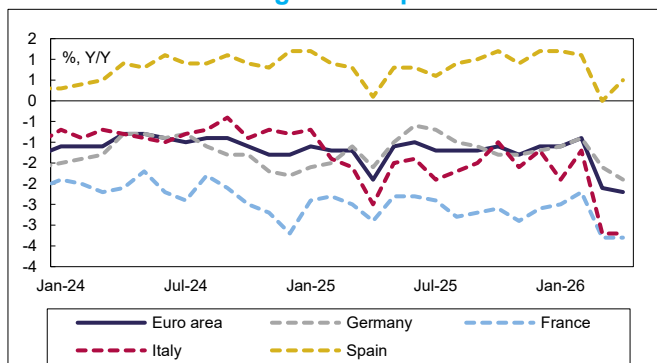
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area member states: Unemployment rates



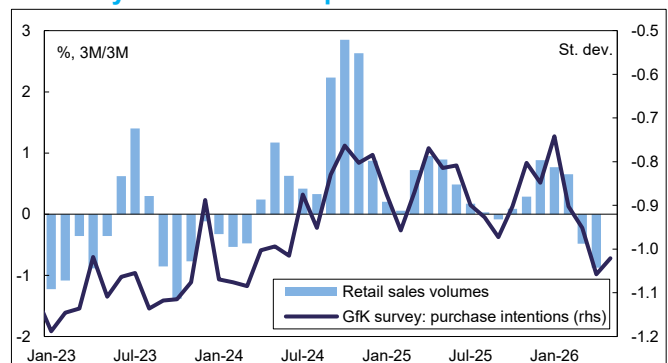
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: CES GDP growth expectations*



*12-months ahead. Mean expectations. Source: ECB, Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Retail sales & purchase intentions



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

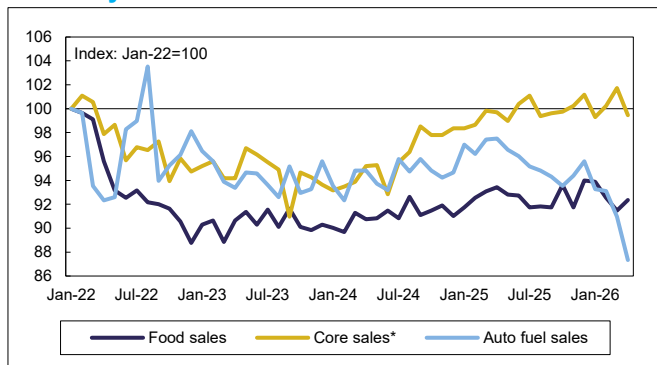
softer Bloomberg consensus estimates. In any case, energy inflation should remain the principal source of upwards pressure. Given a likely relatively tame change in auto fuel prices, a combination of base effects and household energy components likely drove that increase. Likewise, having moderated to a 4½-year low in April, the core HICP rate likely edged back up to its pre-war mark of 2.4%Y/Y. Data from the member states suggest that an increase in the core rate should be principally explained by normalisation in package holidays, which had benefitted from calendar-related distortions in April, and pressure in transport services.

UK

The day ahead in the UK

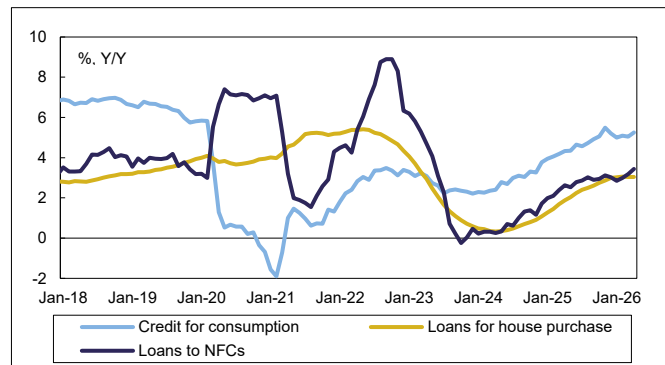
After today's Nationwide release provided another hint as to the depressing effects that higher mortgage rates are having on activity in the housing market, Tuesday's bank lending statistics will provide a more formal indication as to how the tightening of credit conditions caused by the US-Iran war is influencing UK credit flows. Of course, despite the assertions of the housing market surveys, mortgage lending proved surprisingly resilient at the onset of the war. That, perhaps, related to a rush by some households to secure more favourable terms before an anticipated rise in rates. And undeterred by new uncertainties raised by the oil shock, business lending also remained firm, rising at their fastest rate for five years (9.1%Y/Y). The effects of higher borrowing rates, however, should be clearer in April's data. And lending to households, if not simply to offset their strength in March, could be relatively more exposed to some downside, commensurate with the mounting signals of strained demand. Otherwise, in terms of Bank-speak, BoE Governor Bailey is scheduled to make the first of three scheduled appearances, this time before the Lords' equivalent to the Treasury Select Committee in Parliament. External MPC member Greene, who we expect to be among a minority of policymakers to join Chief Economist Pill in voting for additional policy restrictiveness sooner rather than later, is also scheduled to give a speech which will hopefully provide further insights into her positioning ahead of June's MPC meeting.

Germany: Retail sales volumes



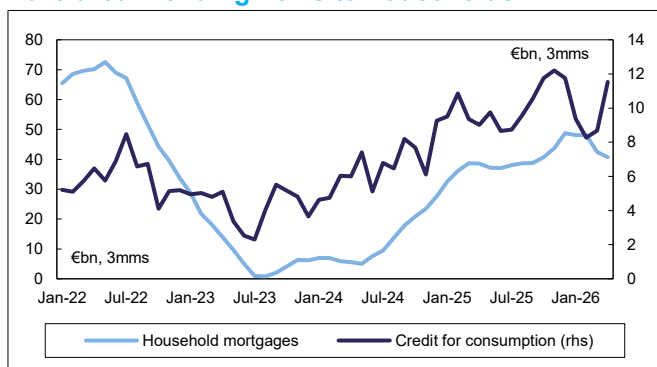
*Non-food & non-fuel sales. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Growth in business & household loans



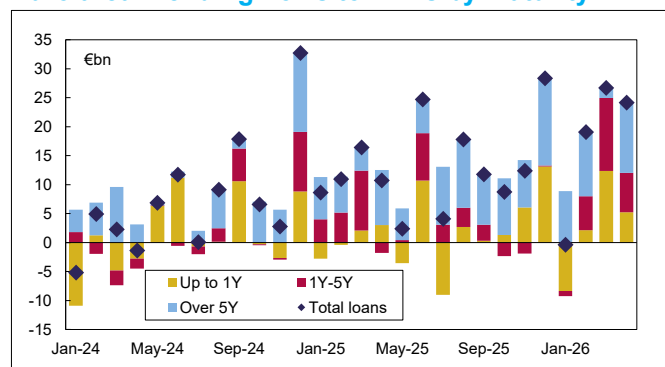
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Lending flows to households



Source: Macrobond and Daiwa Capital Markets Europe Ltd.












Euro area: Lending flows to NFCs by maturity



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 |  ECB consumer expectations survey – 1Y (3Y) ahead CPI Y/Y% | Apr | 4.0 (2.9) | 4.1 (3.0) | 4.0 (3.0) | - | |
| |  M3 money supply Y/Y% | May | 2.7 | 3.1 | 3.2 | - | |
| |  Unemployment rate % | Apr | 6.3 | 6.2 | 6.2 | 6.3 | |
| |  Final manufacturing PMI | May | 51.6 | <u>51.4</u> | 52.2 | - | |
| Germany |  Retail sales M/M% (Y/Y%) | Apr | -0.3 (-2.7) | -0.5 (-1.6) | -2.0 (0.9) | -0.3 (2.7) | |
| |  Final manufacturing PMI | May | 50.1 | <u>49.9</u> | 51.4 | - | |
| France |  Final manufacturing PMI | May | 49.7 | <u>48.9</u> | 52.8 | - | |
| Italy |  Manufacturing PMI | May | 52.9 | 52.0 | 52.1 | - | |
| Spain |  Manufacturing PMI | May | 51.2 | 52.0 | 51.7 | - | |
| UK |  Final manufacturing PMI | May | 53.9 | <u>53.7</u> | 53.7 | - | |
| |  Nationwide house prices M/M% (Y/Y%) | May | -0.6 (1.7) | -0.2 (2.3) | 0.4 (3.0) | - | |
| 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% | May | <u>3.3 (2.4)</u> | 3.0 (2.2) | | |
| Spain |  08.00 | Unemployment (net employment) change 000s | May | - | -62.7 (41.8) | | |
| UK |  09.30 | Net consumer credit £bn (Y/Y%) | Apr | 1.7 (-) | 1.9 (8.9) | | |
| |  09.30 | Net mortgage lending £bn (mortgage approvals 000s) | Apr | 5.4 (62.0) | 6.2 (63.5) | | |
| Auctions and events | | | | | | | |
| Germany |  10.30 | Auction: to sell up to €5bn of 2.5% 2028 bonds | | | | | |
| UK |  10.00 | Auction: to sell £3.25bn of 4.625% 2037 green bonds | | | | | |
| |  15.00 | BoE Governor Bailey appears before the House of Lords Economic Affairs Committee, London | | | | | |
| |  16.00 | External MPC member Greene to give speech on the 'inflation risks of the recent energy shock' at the University of Derby | | | | | |

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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