

# Euro wrap-up

## Overview

- Bunds were little changed despite another upside surprise in German producer price inflation.
- Gilts made gains at the longer end of the curve as the latest UK retail sales data surprised on the downside.
- The coming week brings the latest policy announcement from the BoE as well as plenty of economic survey indicators including the June PMIs.

**Chris Scicluna**

+44 20 7597 8326

### Daily bond market movements

Bond	Yield	Change
BKO 0 06/23	-0.678	-0.002
OBL 0 04/26	-0.592	+0.008
DBR 0 08/31	-0.207	-0.008
UKT 0 <sup>1</sup> / <sub>8</sub> 01/23	0.118	+0.013
UKT 0 <sup>1</sup> / <sub>8</sub> 01/26	0.376	-
UKT 4 <sup>3</sup> / <sub>4</sub> 12/30	0.750	-0.024

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

Source: Bloomberg

## Euro area

### German producer prices again beat expectations, rising the most since 2008

German producer price inflation continues to exceed expectations, rising 2.0ppts in May to 7.2%Y/Y, the highest since October 2008. On a monthly basis, prices rose 1.5%M/M, the most since July 2008. Pressures in prices of intermediate items remained most notable, rising 2.2%M/M, the biggest single-month increase on the series dating back more than 25 years. Compounded by base effects as prices fell throughout the first six months of the pandemic, that left the respective annual rate similarly at a series high, up 2.5ppts to 10.7%Y/Y, with significant gains in prices of metallic items, including steel, basic chemicals and lumber. Base effects and the impact of the German carbon pricing scheme saw energy prices rise 2.6%M/M and 14.9%Y/Y, the latter the most since 2008. But inflation of capital goods (just 0.2%M/M and 1.2%Y/Y), and durable (0.1%M/M and 1.7%Y/Y) and non-durable consumer goods (unchanged on the month to be up just 0.5%Y/Y) remained unperturbed by supply bottlenecks and associated rising input costs. And that suggests that the current high overall rate of producer price inflation will remain transitory. Indeed, base effects suggest that May could represent the peak, both in Germany and the euro area, for which the May data will be published on 2 July.

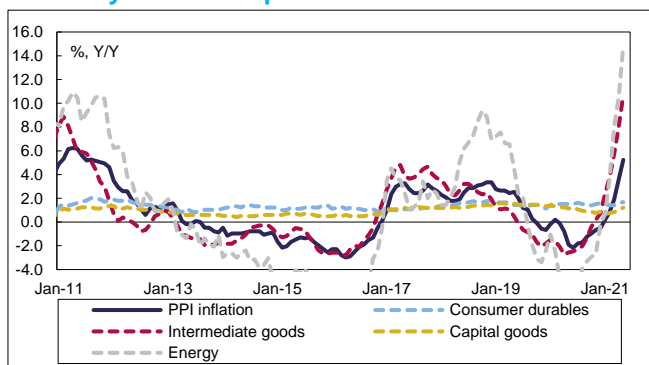
### Few signs of higher input costs being passed on to consumers

As for prices of consumer goods at the factory gates, final consumer prices of non-energy industrial goods remain well-behaved. Yesterday's final euro area HICP data for May confirmed a rise of just 0.2%M/M in that component, to be up 0.7%Y/Y. That was 0.3ppt higher than in April due in part to a rise in clothes inflation back to modestly positive territory, but still merely a three-month high. With services inflation back up 0.2ppt to 1.1%Y/Y as inflation of package holidays and leisure activities rebounded somewhat, core inflation rose 0.3ppt to 1.0%Y/Y. To one decimal place that marked an upwards revision of 0.1ppt from the flash estimate. But, in reality, the revision was a minuscule 0.01ppt to 0.95%Y/Y. And with inflation of food, energy and tobacco slowing 0.1ppt to 0.5%Y/Y, the lowest since 2005, it remains the case that significant pressures remain largely limited to energy inflation, which rose almost 3ppts to 13.1%Y/Y, the most since 2011. That, however, was sufficient to confirm headline inflation at the flash estimate of 2.0%Y/Y, up 0.4ppt from April and the highest since October 2018. Overall, however, there are few signs of higher input costs being passed on by retailers to consumers.

### Inflation to peak in second half of year, before falling back from start of 2022

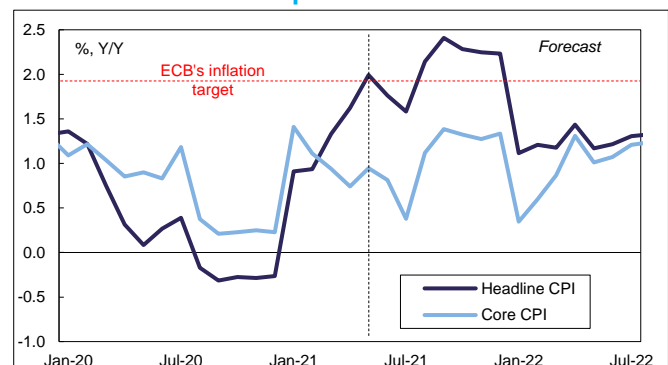
Given base effects, energy inflation has probably now reached its peak. However, headline inflation will likely take another step up in the second half of the year to around 2½%Y/Y due not least to base effects associated with last year's cut in German VAT as well as increases in the prices of certain items related to economic reopening. However, inflation will fall

#### Germany: Producer price inflation



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

#### Euro area: Consumer price inflation



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

back below 2.0%Y/Y from January as the impact of the German VAT changes fall out of the calculation. And many prices affected by economic reopening will in due course level off at 'normal' levels, while supply bottlenecks will eventually ease. And with large amounts of slack likely to persist in the labour market, wage pressures will likely remain subdued limiting second-round effects from the current price pressures. So, after averaging 1.8%Y/Y in 2021, we expect headline inflation to average close to 1¼%Y/Y in 2022 before edging up close to 1½% by end-2023. That projection is close to, but below, that of the ECB, which nevertheless also judges current price pressures to be transitory, and expects the path of underlying inflation to remain below that expected before the pandemic struck.

## The week ahead in the euro area

In the coming week, the economic data calendar brings several top-tier economic sentiment surveys for June, which should all show improved momentum thanks to the continued easing in lockdown measures, the moderation in the number of new coronavirus cases, and the accelerated vaccination programme. The data flow begins on Tuesday with the release of the European Commission's flash consumer confidence index. A further increase to -3.5 – which would be the highest since February 2018 – is expected. The June flash PMIs follow on Wednesday and are expected to point to an acceleration in the pace of economic expansion led by services, for which the euro area activity PMI is expected to rise about 2½ppts to 57.7, which would be the highest since January 2018. Meanwhile, the euro area manufacturing output PMI is expected to remain elevated but edge back down for a third successive month from 62.2 in May. The survey will also likely continue to report backlogs of work close to record highs and continued very strong input price pressures in the sector. Overall, the euro area composite PMI is expected to rise from 57.1 in May to 58.3, which would be the highest since January 2018, underscoring the likelihood of a firm return to positive GDP growth in Q2. Similarly, national business sentiment surveys from Germany, France (Thursday) and Italy (Friday) will also likely suggest that firms are upbeat about business conditions. And German and Italian consumer confidence surveys (also Friday) are expected to reveal increased optimism among households. Other data published in the coming week include final Spanish Q1 GDP numbers on Thursday, which are expected to confirm the decline of 0.5%Q/Q (-4.3%Y/Y), and euro area bank lending data for May on Friday.

## UK

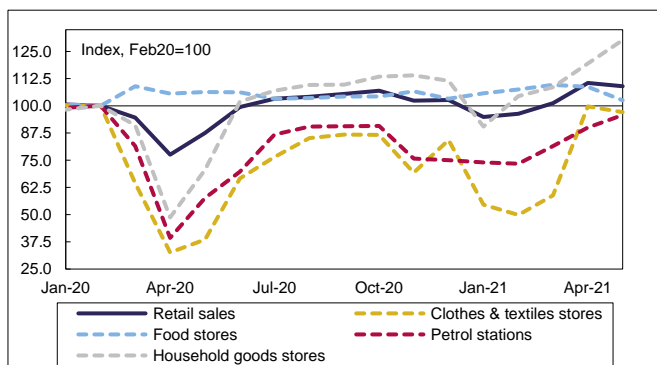
### Retail sales slip back in May but remain well above pre-pandemic levels

Following extremely strong growth (9.2%M/M) in April as non-essential stores reopened, UK retail sales slipped back 1.4%M/M in May contrary to expectations of further growth. Nevertheless, that still left sales 9.1% above the pre-pandemic level in February 2020. And the average level of sales in the first two months of Q2 was more than 12½% above the Q1 average. The biggest contribution to the drop in May came from food stores, where sales fell 5.7%M/M, seemingly hit by the reopening of interior dining at restaurants and bars from mid-month, albeit remaining about 2½% above the pre-pandemic level. In contrast, non-food store sales rose 2.3%M/M to be 8.0% above the pre-pandemic level, with household goods stores reporting growth of 9.0%M/M to be 30% above the pre-pandemic level. With greater mobility, sales at petrol stations rose 6.3%M/M to the highest level since February 2020, albeit remaining only slightly less than 5% below that benchmark. But having leapt almost 70%M/M back close to the pre-pandemic level in April, however, clothes sales slipped back 2.6%M/M in May, perhaps weighed by inclement weather. The share of sales conducted online fell 1.4ppt to 28.5%, albeit with the level of such activity still 58.8% above that ahead of the pandemic. In contrast, in-store sales remained some 1.3% below the February 2020 level.

### Retail sales should remain elevated even as spending on services rebounds

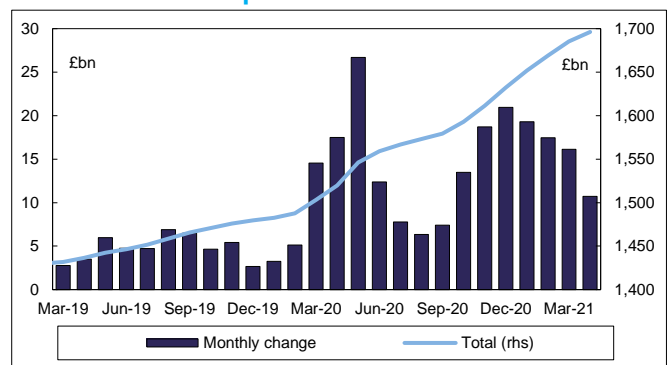
Looking ahead, the greater opportunities for consumers to spend more on services, such as eating out and leisure activities, for which there likely remains significant pent-up demand, might be expected to weigh on spending on goods further over coming months. However, on average, household balance sheets are much stronger than before the pandemic, with lower unsecured debt and a large stock of excess savings. And labour market conditions have improved, with the unemployment

#### UK: Retail sales



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

#### UK: Household deposits



Source: Bank of England and Daiwa Capital Markets Europe Ltd.

rate edging lower and vacancies much higher, supporting a rebound in consumer confidence. So, on balance, we expect retail sales to remain well above pre-pandemic levels and move broadly sideways throughout the second half of the year.












## The week ahead in the UK

The main event in the UK in the coming week will be the BoE's monetary policy announcement on Thursday. Since the BoE published forecasts following its previous MPC meeting on 22 April, economic activity appears to have been broadly in line with expectations. But inflation appears to have picked up a little ahead of the BoE's expectations, having risen above the target to 2.1%Y/Y in May. At last month's meeting, the BoE did not expect that threshold to be passed until much later in the year. At the coming meeting, however, the MPC will likely continue to judge recent price pressure to be transitory and expect inflation will return close to target over the medium term. But it will underscore again that the outlook for the economy, including the relative movements in demand and supply, remains highly uncertain. We do not expect any change to current policy or guidance at the forthcoming meeting. Given his concerns about upside risks to inflation, Chief Economist Haldane – for which this will be his last meeting – will likely vote again for reducing the target stock of asset purchases from £875bn, which will be fulfilled by the end of the year. But he will also likely be the sole MPC to vote for such a reduction. And the MPC will also repeat that it does not intend to tighten monetary policy at least until there is clear evidence that significant progress is being made in eliminating spare capacity and achieving the 2% inflation.

Data-wise, as in the euro area, the UK focus in the coming week will be survey data for June, including the CBI's industrial trends survey (Tuesday), the preliminary PMIs (Wednesday), and GfK consumer confidence and CBI distributive trades surveys (Friday). Like in the euro area, we expect these to be consistent with firm growth this month, despite the UK Government's decision to extend the remaining restrictions on activity for a further four weeks. In particular, the composite PMI is expected to remain close to its record high of 62.0, thanks to robust conditions in both manufacturing and services. Indeed, the headline services index is expected to rise 1.1pts to a series high of 64.0 in June.

*The next edition of the Euro wrap-up will be published on 22<sup>nd</sup> June 2021*

## Daiwa economic forecasts




	2020	2021				2022	2020	2021	2022
	Q4	Q1	Q2	Q3	Q4	Q1			
<b>GDP growth, %, Q/Q</b>									
Euro area 	-0.6	-0.3	1.2	2.4	1.2	1.0	-6.7	4.5	4.6
UK 	1.3	-1.5	3.5	3.2	2.5	1.0	-9.8	6.6	6.2
<b>Inflation</b>									
Euro area									
Headline CPI 	-0.3	1.1	1.8	2.0	2.3	1.2	0.3	1.8	1.2
Core CPI 	0.2	1.2	0.8	1.0	1.3	0.6	0.7	1.1	1.0
UK									
Headline CPI 	0.5	0.6	1.9	2.2	2.8	2.8	0.9	1.9	2.1
Core CPI 	1.3	1.2	1.7	2.0	2.3	2.2	1.4	1.8	1.9
<b>Monetary Policy</b>									
ECB									
Refi Rate % 	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Deposit Rate % 	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50
PEPP envelope* (€bn) 	1850	1850	1850	1850	1850	1850	1850	1850	1850
BoE									
Bank Rate % 	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Bond purchases** (£bn) 	895	895	895	895	895	895	895	895	895

\*Monthly target €bn, end of period. \*\*Monthly target £bn, end of period. Source: Bloomberg, ECB, BoE 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
Germany 	PPI Y/Y%	May	<b>7.2</b>	6.4	5.2	-
UK 	Retail sales including auto fuel M/M% (Y/Y%)	May	<b>-1.4 (24.6)</b>	1.5 (29.3)	9.2 (42.4)	-
	Retail sales excluding auto fuel M/M% (Y/Y%)	May	<b>-2.1 (21.7)</b>	1.4 (27.1)	9.0 (37.7)	<b>9.1 (-)</b>






#### Auctions

Country	Auction
- Nothing to report -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

### Yesterday's results

#### Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
EMU 	Final CPI (core CPI) Y/Y%	May	<b>2.0 (1.0)</b>	2.0 (0.9)	1.6 (0.7)	-
	Construction output M/M% (Y/Y%)	Apr	<b>-2.2 (42.3)</b>	-	2.7 (18.3)	<b>4.1 (20.0)</b>
	EU27 new car registrations Y/Y%	May	<b>53.4</b>	-	218.6	-
Italy 	Total trade balance €bn	Apr	<b>5.9</b>	-	5.2	-
Spain 	Labour costs Y/Y%	Q1	<b>1.4</b>	-	-0.1	-



























#### Auctions

Country	Auction
France 	<ul style="list-style-type: none"> <li>sold €3.15bn of 0% 2027 bonds at an average yield of -0.3%</li> <li>sold €1.88bn of 0.75% 2028 bonds at an average yield of -0.21%</li> <li>sold €3.13bn of 0.5% 2025 bonds at an average yield of -0.51%</li> <li>sold €1.84bn of 0.5% 2029 bonds at an average yield of -0.10%</li> <li>sold €576mn of 0.1% 2031 index-linked bonds at an average yield of -0.76%</li> <li>sold €897mn of 0.1% 2047 index-linked bonds at an average yield of -1.27%</li> <li>sold €751mn of 0.1% 2025 index-linked bonds at an average yield of -1.54%</li> </ul>
Spain 	<ul style="list-style-type: none"> <li>sold €1.97bn of 0% 2024 bonds at an average yield of -0.44%</li> <li>sold €2.16bn of 0% 2028 bonds at an average yield of 0.011%</li> <li>sold €1.39bn of 0.85% 2037 bonds at an average yield of 0.972%</li> </ul>

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

## The coming week's data calendar

### The coming week's key data releases

Country	BST	Release	Period	Market consensus/ <i>Daiwa</i> <i>forecast/actual</i>	Previous
<b>Monday 21 June 2021</b>					
UK		00.01 Rightmove house price index M/M%	Jun	-	1.8
<b>Tuesday 22 June 2021</b>					
EMU		15.00 European Commission preliminary consumer confidence	Jun	-3.5	-5.1
Italy		09.00 Industrial sales M/M% (Y/Y%)	Apr	-	1.6 (38.1)
UK		07.00 Public sector net borrowing, excluding banks £bn	May	24.3	31.0
		11.00 CBI industrial trends, total orders	Jun	18	17
<b>Wednesday 23 June 2021</b>					
EMU		09.00 Preliminary manufacturing (services) PMI	Jun	62.1 (57.8)	63.1 (55.2)
		09.00 Preliminary composite PMI	Jun	58.3	57.1
Germany		08.30 Preliminary manufacturing (services) PMI	Jun	63.0 (55.6)	64.4 (52.8)
		08.30 Preliminary composite PMI	Jun	57.8	56.2
France		08.15 Preliminary manufacturing (services) PMI	Jun	59.0 (59.3)	59.4 (56.6)
		08.15 Preliminary composite PMI	Jun	59.7	57.0
UK		09.30 Preliminary manufacturing (services) PMI	Jun	64.0 (64.0)	65.6 (62.9)
		09.30 Preliminary composite PMI	Jun	62.9	62.9
<b>Thursday 24 June 2021</b>					
Germany		09.00 Ifo current assessment balance (expectations)	Jun	97.5 (104.0)	95.7 (99.2)
France		07.45 INSEE business confidence	Jun	110	108
		07.45 INSEE manufacturing confidence (production outlook)	Jun	110 (-)	107 (18)
Spain		08.00 Final GDP Q/Q% (Y/Y%)	Q1	-0.5 (-4.3)	0.0 (-8.9)
UK		12.00 BoE Bank Rate %	Jun	<u>0.10</u>	0.10
		12.00 BoE Gilt purchase target £bn	Jun	<u>875</u>	875
<b>Friday 25 June 2021</b>					
EMU		09.00 M3 money supply Y/Y%	May	8.5	9.2
Germany		07.00 GfK consumer confidence	Jul	-4.0	-7.0
Italy		09.00 ISTAT economic sentiment	Jun	-	106.7
		09.00 ISTAT consumer (manufacturing) confidence	Jun	112.0 (112.3)	110.6 (110.2)
Spain		08.00 PPI Y/Y%	May	-	12.8
UK		00.01 GfK consumer confidence	Jun	-7	-9
		11.00 CBI distributive trades survey, reported sales	Jun	-	43

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

### The coming week's key events & auctions

Country	BST	Event / Auction
<b>Monday 21 June 2021</b>		
EMU	 15.15	ECB President Lagarde scheduled to speak at the European Parliament
<b>Tuesday 22 June 2021</b>		
EMU	 15.00	ECB Chief Economist Lane scheduled to speak on 'The resilience of the euro'
	 18.30	ECB's Schnabel to give an online presentation
<b>Wednesday 23 June 2021</b>		
EMU	 08.30	ECB Vice President de Guindos scheduled to speak
Germany	 10.30	Auction: €2.5bn of 0% 2036 bonds
UK	 10.00	Auction: £400mn of 0.125% 2065 index-linked bonds
<b>Thursday 24 June 2021</b>		
EMU	 12.30	ECB's Panetta scheduled to speak at an online event 'A digital Euro'
	 16.30	ECB's Schnabel scheduled to speak
UK	 12.00	BoE monetary policy announcement
	12.00	BoE publishes Agents' summary of business conditions Q221
<b>Friday 25 June 2021</b>		
EMU	 -	ECB President Lagarde participates in Euro Summit
Italy	 10.00	Auction: fixed rate and index-linked bonds
UK	 12.00	BoE publishes Quarterly Bulletin Q221

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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