

# Euro wrap-up

## Overview

- Gilts made losses as the UK government belatedly announced new fiscal support for households to cope with the impact of higher energy prices, part-funded by a levy on oil and gas firm profits.
- Bunds largely made losses but BTPs made gains even as Italian consumer confidence improved.
- Friday will bring new data on euro area bank lending.

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### Daily bond market movements

Bond	Yield	Change
BKO 0.2 06/24	0.314	-0.007
OBL 0 04/27	0.672	+0.022
DBR 0 02/32	0.990	+0.043
UKT 1 04/24	1.427	+0.023
UKT 1½ 07/27	1.589	+0.041
UKT 4¼ 06/32	1.966	+0.058

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

Source: Bloomberg

## UK

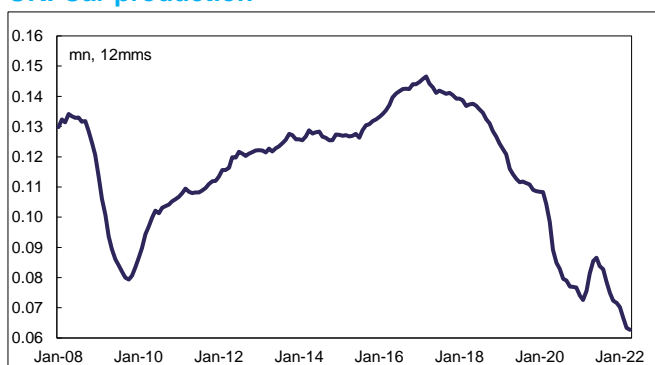
### New fiscal support to offset some of impact of higher energy costs on household budgets

Given last week's warning by the energy regulator Ofgem that its energy price cap in October is on track to jump by a further £800 to £2,800, an increase of 42% on top of April's 54% rise, the government today unveiled new fiscal measures to try offset some of the impact on household budgets. In particular, the additional package of about £15bn (just under 2½ of Q1 GDP) of spending measures almost doubled the amount of support announced in the Spring Statement just two months ago, and was appropriately focussed primarily on those most severely impacted by the cost of living crisis. The measures include a one-off cost of living payment to more than 8mn low-income households worth £650; the doubling of the discount on October's energy bills to £400 and scrapping of the prior requirement to repay it over five years; and top-ups for disabled individuals of £150 and pensioner households of £300. Overall, these measures will deliver on average an increase in support of a little more than £800 per household. Of course, given the substantial rise in energy bills in April, the net impact of utility prices on UK household budgets this year will still be significantly negative. And with inflation still expected to rise to around 10%Y/Y in October, real disposable income is still forecast to decline significantly in 2022. However, at the margin, today's spending measures will mean that the anticipated hit to consumer spending in Q4 should be somewhat smaller than previously expected, including by the BoE. And so, today's announcement suggests that the MPC might well feel more confident than before to increase Bank Rate further in Q4 and into 2023 if required. Today's package will be part-funded by a temporary new Energy Profits Levy on oil and gas companies, charged at the rate of 25%, which is estimated to raise around £5bn over the coming year. An additional investment allowance in the levy aims to minimise the impact on capital spending in the sector, by reducing their tax bill by 91p for every £1 the affected firms invest.

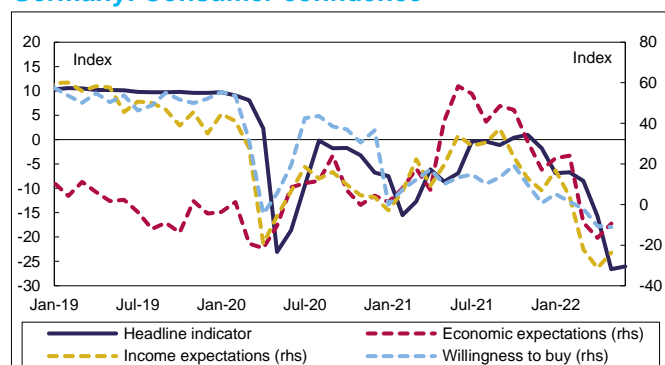
### UK car production remains in reverse

Given the ongoing global semi-conductor shortage and further supply-chain disruption caused by the Ukraine war, UK car production remained extremely weak in April, with manufacturers producing just 60.6k units, down 11.3%Y/Y and the second-lowest April outturn since the series began. Admittedly, there was a pickup in production for domestic sales, up 60.1%Y/Y to 12.8k, although this year-on-year comparison was flattered by a weak showing last year when the economy was still operating under pandemic restrictions. Indeed, home production was still some 6½% lower compared with April 2019 and roughly 45% below the five-year pre-pandemic average for that month. Meanwhile, production for overseas markets was down 20.8%Y/Y, with the weakness in part reflecting the impact of the closure of the Honda plant in Swindon last July. Over the first four months of the year, more than 100k fewer units were produced than over the same period last year (-28.5%YTD/Y).

### UK: Car production



### Germany: Consumer confidence



## The day ahead in the UK

It should be a quiet end to the week, with no top-tier UK releases scheduled for Friday.

## Euro area

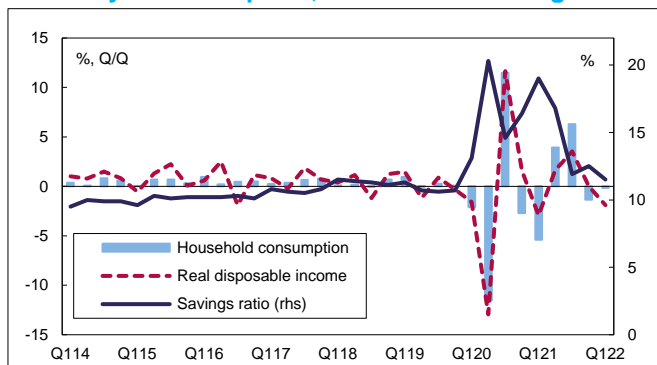
### German consumer confidence signals subdued household spending in Q2

While the flash PMIs and ifo survey earlier in the week flagged a possible strengthening of German GDP growth this quarter, yesterday's GfK consumer confidence survey provided a strong reminder that German household spending is likely to be highly subdued over the near term. Admittedly, the headline sentiment index increased, but the rise of just 0.6pt came from the prior month's series low (-26.6). So this still remained some 19pts lower than before the Russian invasion and 27pts off the recent peak reached in November. While there was a modest improvement in economic expectations this month, consumers were nevertheless still concerned that the economy will slip into recession, and the relevant survey index was still a whopping 68pts lower than last summer's peak. The income expectations balance also remained close to April's near-20-year low not least due to persistently high inflation. As such, households' willingness to spend edged even lower in May, with the index down a further 0.5pt to -11.1, the weakest since the global financial crisis in 2008. And so, while there appears to be scope for increased spending on services – not least hospitality, transport and recreation – as the economy continues to normalise following the latest Covid wave, the slump in consumer confidence combined with a sharp decline in real disposable income in Q1 and a further drop in the savings ratio back close to pre-pandemic norms, might well suggest that household consumption will fail to grow for the third consecutive quarter in Q2, having declined by 0.1%Q/Q in Q1.

### German Q1 GDP growth underpinned by construction

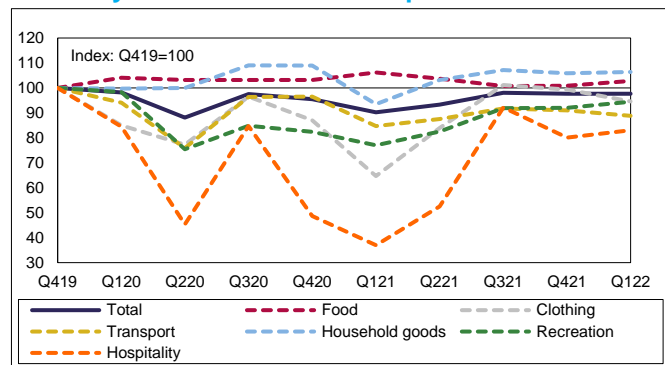
Overall, Germany's economy avoided a contraction in Q1, with yesterday's updated national accounts data confirming growth of 0.2%Q/Q. But output still remains some 0.9% below the pre-pandemic level. And the composition of growth in the first quarter further raises concerns about the capacity for expansion over the near term. Despite elevated prices, growth in Q1 was underpinned by construction investment (4.6%Q/Q) which benefited from unseasonably mild weather at the start of the year. Given persisting supply-side constraints, a recent deterioration in sentiment in the sector, and the prospect of higher mortgage rates on the horizon, there is a strong likelihood of payback this quarter at least. And while investment in machinery and equipment rose in Q1 for the second successive quarter (2.5%Q/Q), this too seems likely to be further impacted by supply chain disruptions. Certainly, supply bottlenecks in the autos sector continued to adversely impact Germany's trade performance at the start of the year, with exports down by more than 2.0%Q/Q. Meanwhile, with total

#### Germany: Consumption, income and savings ratio



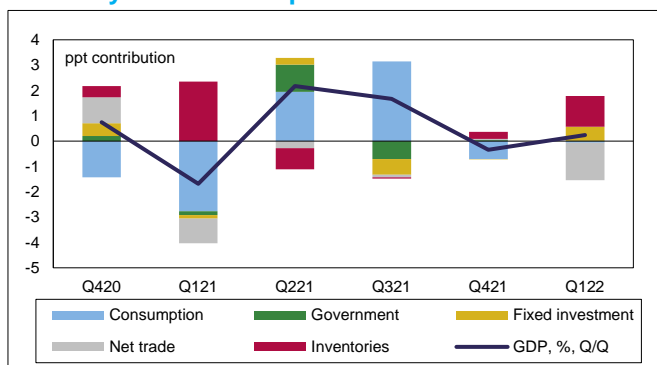
Source: Refinitiv, Destatis and Daiwa Capital Markets Europe Ltd.

#### Germany: Households consumption



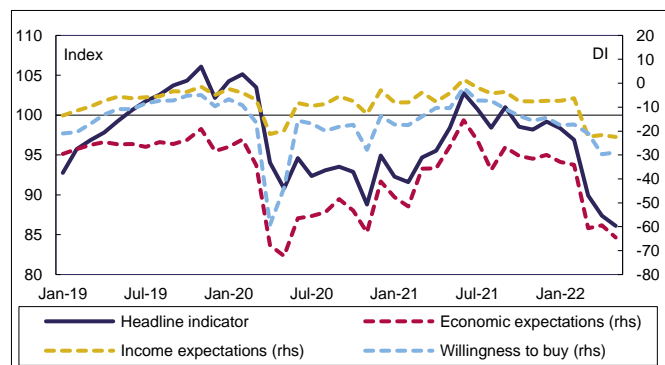
Source: Destatis and Daiwa Capital Markets Europe Ltd.

#### Germany: GDP and expenditure contributions



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

#### France: Consumer confidence



Source: Refinitiv, INSEE and Daiwa Capital Markets Europe Ltd.

imports up 0.9%Q/Q as international travel and tourism resumed, net trade subtracted a sizeable 1½ppts from growth in Q1. Given the slump in exports to Russia late in the quarter, as well as weak demand from China and heightened global uncertainty, a pickup in exports is unlikely over the near term. Finally, a marked increase in private inventories in Q1 (adding 1.2ppts to GDP growth) seems highly unlikely to be repeated in Q2. On balance, therefore, despite this week's improved ifo and PMI surveys, there remains a non-negligible risk that Germany's economy will contract in Q2.

### French consumer confidence falls to lowest since 2014

After [consumption](#) fell sharply in France in the first quarter of the year, the latest French INSEE consumer survey reported a further loss of confidence in May, with the headline index down a further 1pt to 86, the lowest since September 2014, and well below the long-run average (100). Given high inflation, households considered their financial situations to have deteriorated again in May and assessed the opportunity to save to have diminished too, while the share of those expecting financial conditions to improve over the coming twelve months fell to the lowest since May 2020. And so there was little improvement in the share of households judging it a good time to make major purchases in May, with the respective balance up just 1pt above April's near-2-year low and well below the long-run average.

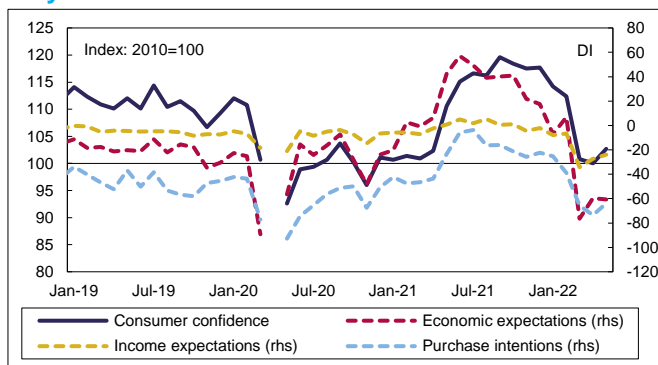
### Improved Italian consumer confidence boosts services sentiment

In contrast, today's survey results saw Italian consumer confidence beat expectations in May. In particular, the headline sentiment index rose 2.7pts to 102.7, reflecting an improvement in households' assessments of current economic conditions and income expectations. And so consumers were also a touch less downbeat about their current purchase intentions, albeit the relevant survey indicator was still some 60pts lower than last summer's peak. And overall, consumer confidence remained well below the highs seen during the second half of 2021, consistent with still subdued household spending. This notwithstanding, the improvement in consumer sentiment coincided with a recovery in service sector conditions this month, with the relevant survey sentiment index rising 6.4pts to its highest since December, in part reflecting the greatest optimism in the tourism sector seen since September. In contrast, however, the headline manufacturing and construction sentiment indices slipped slightly as expectations for new orders weakened. Overall, like in Germany and France, business sentiment rose in May, with the respective index up 2.5pts to 110.9, back to its level in February, but nevertheless still some way below the average seen in the second half of last year (116).

### The day ahead in the euro area

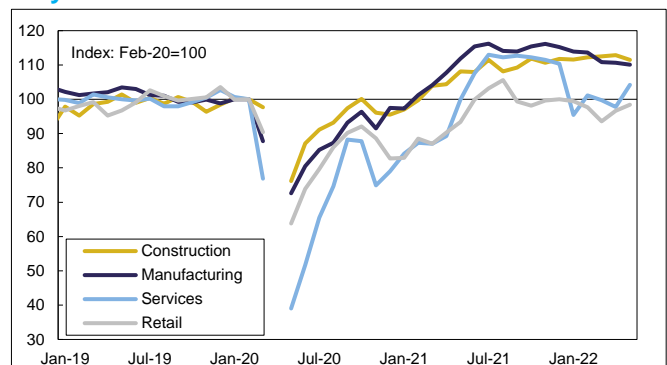
Tomorrow brings the latest ECB bank lending numbers for April, along with Spanish retail sales numbers for the same month. Given the recent rise in the cost of living, we would expect demand for consumer credit to have risen, but mortgage lending might well remain steady despite recent increases in interest rates on new loans.

#### Italy: Consumer confidence\*



\*No survey results for April 2020. Source: Refinitiv, ISTAT and Daiwa Capital Markets Europe Ltd.

#### Italy: Business confidence\*





\*No survey results for April 2020. Source: Refinitiv, ISTAT 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
Italy	 ISTAT business (manufacturing) confidence	May	<b>110.9 (109.3)</b>	- (109.0)	105.5 (110.0)	<b>108.4 (109.9)</b>
	 ISTAT consumer confidence	May	<b>102.7</b>	99.9	100.0	-





#### Auctions

Country	Auction
Italy	 sold €2.25b of 0% 2033 bonds at an average yield of 0.77%
	 sold €1.25b of 0.1% 2033 index-linked bonds at an average yield of 0.86%


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
Germany	 GDP – second estimate Q/Q% (Y/Y%)	Q1	<b>0.2 (3.8)</b>	0.2 (3.7)	-0.3 (1.8)	-
	 GfK consumer confidence	Jun	<b>-26.0</b>	-25.5	-26.5	<b>-26.6</b>
France	 INSEE consumer confidence	May	<b>86</b>	89	88	<b>87</b>
Spain	 PPI M/M% (Y/Y%)	Apr	<b>1.6 (45.0)</b>	-	6.6 (46.6)	<b>6.7 (47.0)</b>



#### Auctions

Country	Auction
Germany	 sold €1.72bn of 1% 2038 bonds at an average yield of 1.15%


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	M3 money supply Y/Y%	Apr	6.3	6.3
Spain	 08.00	Retail sales Y/Y%	Apr	-2.0	-4.2

#### Auctions and events

Euro area	 12.35	ECB Chief Economist Lane takes part in policy panel discussion – 'New dimensions and frontiers in central banking'			
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Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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