

Euro wrap-up

Overview

- While a German investor survey suggested a slight moderation of pessimism regarding the outlook, euro area government bonds made losses as Dutch national bank Governor Knot made predictably hawkish remarks underscoring the need for the ECB to keep raising rates in H222.
- Gilts outperformed again at the short end as UK unemployment ticked up and real regular wage growth fell sharply.
- Wednesday will bring April data for euro area IP and goods trade and the final estimates of French inflation in May.

Chris Scicluna

+44 20 7597 8326

Daily bond market movements

Bond	Yield	Change
BKO 0.2 06/24	1.192	+0.063
OBL 0 04/27	1.553	+0.068
DBR 0 02/32	1.734	+0.108
UKT 1 04/24	2.093	-0.002
UKT 1½ 07/27	2.219	+0.002
UKT 4½ 06/32	2.570	+0.044

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

Source: Bloomberg

Euro area

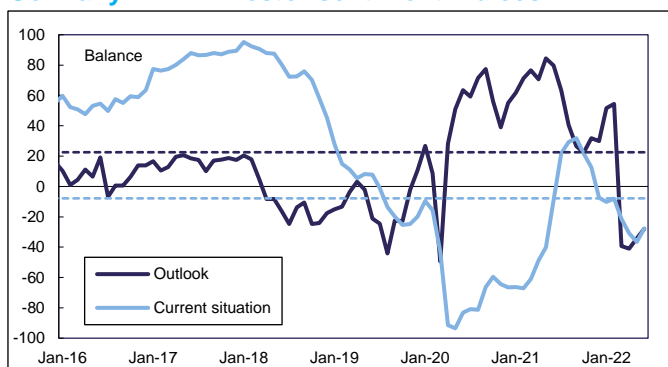
ZEW survey signals slight tempering in investor pessimism

Many surveys suggest that sentiment in some sectors in the euro area – not least business-facing services – has remained far from negative. However, confidence among consumers and investors has been undeniably downbeat. But today's ZEW survey of investors for June reported a first improvement in perceptions of current German economic conditions in three months. Nevertheless, the rise of almost 9pts in the respective index to -27.6 left it still well below levels prevailing before Russia's invasion of Ukraine and also far below the long-run average. Investors' assessment of the outlook for the coming six months also rose, and for the second successive month, up more than six points to a similar level of -28. But expectations remain very weak by historical standards and point to a marked worsening in economic conditions over coming quarters. Perhaps surprisingly, the survey's index of inflation perceptions was negative for the second successive month, and by the most since the onset of the pandemic in March 2020, suggesting hopes that price pressures might be peaking. And expectations for longer-term yields moderated for the third successive month. Investor perceptions of profitability inevitably continue to vary markedly from sector to sector – positive for banks, insurers, IT, services and utilities, but negative for various manufacturers (e.g. autos, steel, and electronics) and much weaker for construction firms and retailers. But with the survey largely conducted ahead of last week's ECB policy announcement, US inflation data, and the subsequent bond- and equity-market sell-offs, actual sentiment is now likely to be much weaker than the ZEW survey suggest.

The day ahead in the euro area

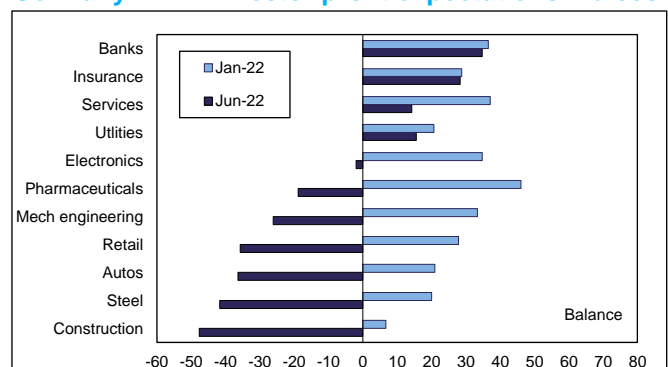
The main focus on Wednesday could well be ECB President Lagarde, who in the evening will be in conversation with former BoE Deputy Governor Shafik at the London School Economics. The data focus tomorrow will be on the manufacturing sector, with euro area industrial production numbers for April due. Country data published over the past couple of days now point to a return to growth at the start of Q2 following a decline of 1.8%M/M in March. In particular, an extreme drop in Ireland (-9.6%M/M) and some modest weakness in France (-0.1%M/M) will be more than offset by positive data elsewhere, including in Germany (1.3%M/M, excluding construction), Spain (2.1%M/M), and Netherlands (where manufacturing output rose 5.3%M/M). Meanwhile, euro area goods trade data are expected to reveal a narrowing in the trade deficit in April (to €14.5bn), albeit remaining large by historical standards and relatively close to the record deficit of €17.6bn recorded in March. Finally, France will publish final consumer price inflation figures for May, which are expected to confirm the flash release, whereby the headline HICP measure rose 0.4ppts to 5.8%Y/Y.

Germany: ZEW investor sentiment indices



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: ZEW investor profit expectations indices



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK

Unemployment turns higher as GDP weakens

The last top-tier UK economic data released before the BoE's MPC meets suggested that weaker economic activity is now starting to take a toll on the labour market. Indeed, the unemployment rate in the three months to April ticked up 0.1ppt from March to 3.8%, marking the first increase since the end of 2020. That left it still 0.2ppt below the rate three months earlier and 0.1ppt below the pre-pandemic rate in February 2020. However, the single-month rate for April jumped a steep 0.7ppt – the most since June 2020 during the first wave of Covid and a margin never previously exceeded on the series – to a five-month high of 4.2%. In addition, the single-month unemployment level rose 237k from March to above 1.43mn, the highest since August. Similarly, the employment rate fell 1ppt on a single-month basis with the number of people in work (admittedly a volatile series) down more than 250k on the month. On a three-month basis, the employment rate (for workers aged 16-64 years) was unchanged at 75.6%, but that was also still 1.0ppt down from the pre-pandemic level in February 2020 and the number of people in work was down more than 350k against that benchmark.

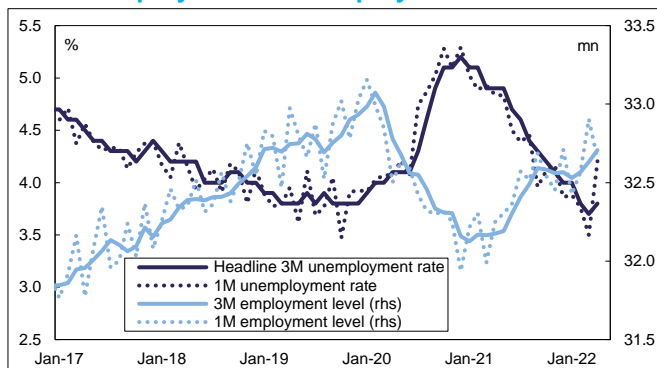
Some positive signs while lower inactivity can ease labour market strains

The MPC will still note some signs of persisting strength in the data. For example, the redundancy rate fell in the three months to April to a record low. And the number of job vacancies in the three months to May rose to a new record high of 1.3mn, close to the number of unemployed workers. But the growth rate of vacancies slowed again to just 20k from the previous three-month period and the number of vacancies on a single-month basis declined. And due to the ease of advertising new job openings, we question the reliability of the number of vacancies as a guide to the firmness of demand. Moreover, the inactivity rate – an important source of recent labour market tightness – edged down on a three-month basis to a six-month low, principally reflecting increased participation of students – a trend that might be expected to continue – which should help to make job openings easier to fill. While the number of employees on payrolls rose 90k in May, these data are frequently revised down significantly – indeed on average by 90k – and have often given a misleading guide to overall employment not least due to structural shift from self-employment to employee status.

No sign of wage-price spiral as real regular pay falls most in two decades

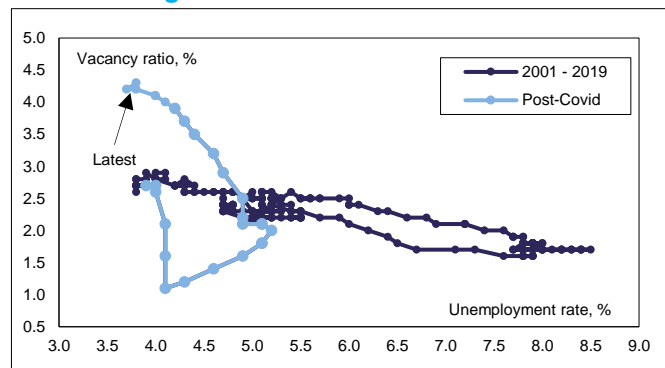
Importantly, growth in employees' average total labour earnings slowed 0.2ppt to 6.8%3M/Y in the three months to April. And with that figure skewed higher by special payments, particularly in the finance and business sector, regular pay (excluding bonuses) rose a more moderate 4.2%3M/Y, unchanged from the prior month. While that still points to basic pay growth

UK: Unemployment and employment



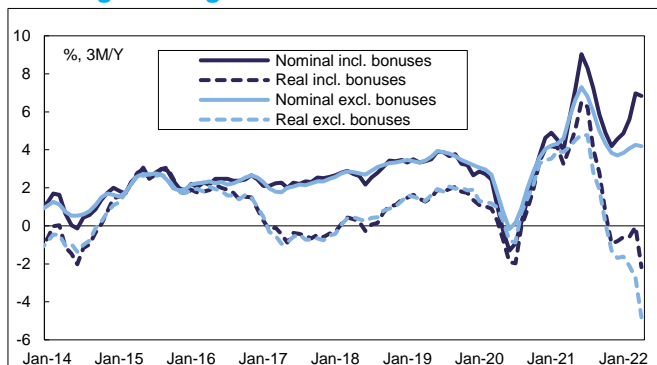
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Beveridge curve



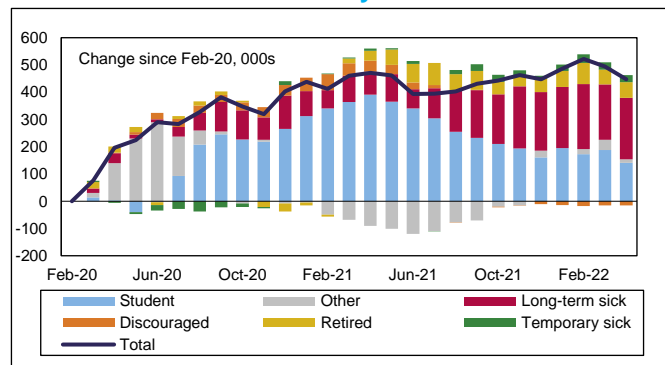
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Regular wages*



*Real series deflated by CPI inflation. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Labour market inactivity















Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

above the pre-Covid range, it also suggests no big cause for alarm about wage-price spirals. Indeed, in real terms (deflated by the ONS's preferred CPIH measure), while growth in total pay remained positive at 0.4%3M/Y, regular pay was down 2.2%3M/Y, the most on the series dating back to 2021. That, of course, will weigh on spending – and ultimately demand for labour – over coming quarters. So, having provided evidence of a softening of both economic demand and labour market conditions, overall, this week's data suggest that on Thursday the MPC is more likely to announce another hike in Bank Rate of just 25bps to 1.25%, rather than the larger magnitude of hikes being contemplated by the Fed. And we continue to think that the BoE will ultimately tighten by less than is currently priced into the markets.









The day ahead in the UK

Tomorrow looks set to be a quiet day in the UK, with no top-tier economic data scheduled for release. As such, market participants will be gearing up for Thursday's MPC announcement. We suspect that all of the Committee members are likely to support a further rate hike this month, but with the majority probably favouring a hike in Bank Rate of just 25bps to 1.25%, and perhaps just three members (all externals) likely to vote for a larger hike of 50bps.

European calendar

Today's results						
Economic data						
Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Germany	 Final CPI M/M% (Y/Y%)	May	0.9 (7.9)	<u>0.9 (7.9)</u>	0.8 (7.4)	-
	 Final EU-harmonised CPI M/M% (Y/Y%)	May	1.1 (8.7)	<u>1.1 (8.7)</u>	0.7 (7.8)	-
	 ZEW current assessment (expectations)	Jun	-27.6 (-28.0)	-27.5 (-31.0)	-36.5 (-29.5)	-
UK	 Unemployment claimant count rate % (change '000s)	May	4.0 (-19.7)	-	4.1 (-56.9)	(-65.5)
	 ILO unemployment rate 3M%	May	3.8	<u>3.6</u>	3.7	-
	 Employment change '000s, 3M/3M	Apr	177	103	83	-
	 Average earnings including (excluding) bonuses 3M/Y%	Apr	6.8 (4.2)	7.2 (4.0)	7.0 (4.2)	-
Auctions						
Country	Auction					
Germany	 sold €4.52bn of 0.2% 2024 bonds at an average yield of 1.18%					
Italy	 sold €2.5bn of 2.8% 2029 bonds at an average yield of 3.75%					
	 sold €2bn of 1.2% 2025 bonds at an average yield of 3.04%					
	 sold €748mn of 3.85% 2049 bonds at an average yield of 4.20%					
	 sold €752mn of 2.15% 2052 bonds at an average yield of 4.27%					

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	Industrial production M/M% (Y/Y%)	Apr	<u>-1.1 (-2.7)</u>	-1.8 (-0.8)	
	 10.00	Trade balance €bn	Apr	-14.5	-17.6	
France	 07.45	Final CPI M/M% (Y/Y%)	May	<u>0.6 (5.2)</u>	0.4 (4.8)	
	 07.45	Final EU-harmonised CPI M/M% (Y/Y%)	May	<u>0.7 (5.8)</u>	0.5 (5.4)	
Auctions and events						
Euro area	 13.30	ECB's De Cos scheduled to speak at online academic event				
	 14.00	ECB's Panetta gives introductory statement at European Parliament hearing on digital euro				
	 14.15	ECB's Knot scheduled to speak at online academic event				
	 17.00	ECB President Lagarde participates in an event at London School of Economics				

Source: Bloomberg and Daiwa Capital Markets Europe Ltd

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