

Euro wrap-up

Overview

- While the flash estimate of euro area inflation in June exceeded expectations, Bunds rallied as the core measure declined for the first time since January and the final manufacturing PMIs hinted at a slight easing of cost pressures.
- Gilts also rallied as the final UK manufacturing PMIs were revised down to suggest the weakest output growth since the first wave of Covid-19.
- The coming week will bring the account of the ECB's 9 June policy meeting and new data on euro area retail sales and IP in the large member states.

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Daily bond market movements

Bond	Yield	Change
BKO 0.2 06/24	0.480	-0.134
OBL 1.3 10/27	0.909	-0.136
DBR 0 02/32	1.222	-0.109
UKT 1 04/24	1.621	-0.200
UKT 1½ 07/27	1.699	-0.185
UKT 4½ 06/32	2.070	-0.156

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

Source: Bloomberg

Euro area

Inflation beats expectations despite downside German surprise

Despite the big downside surprise to the [German](#) figures earlier this week, the flash euro area inflation estimate exceeded expectations, rising 0.5ppt to a new series high of 8.6%Y/Y. As suggested by the national data, the pressures were again led by non-core items. With petrol prices higher, the energy component rose 2.8ppts to 41.9%Y/Y, closing back in on March's series high and accounting for more than 4ppts of total inflation. And the food component jumped 1.4ppts – the most this cycle – to a new series high of 8.9%Y/Y and contributing about 2ppts to total inflation. Meanwhile, non-energy industrial goods prices continued to rise as increased costs were passed on to customers, with the annual rate up 0.1ppt to a new series high of 4.3%Y/Y. So, headline inflation would have been even higher had it not been for a slight softening in services – down 0.1ppt to 3.4%Y/Y – entirely thanks to the big temporary German public transport subsidy. And core inflation edged lower by 0.1ppt to 3.7%Y/Y. To three decimal places, however, that drop in the core measure was a negligible 0.010ppt to 3.745%Y/Y.

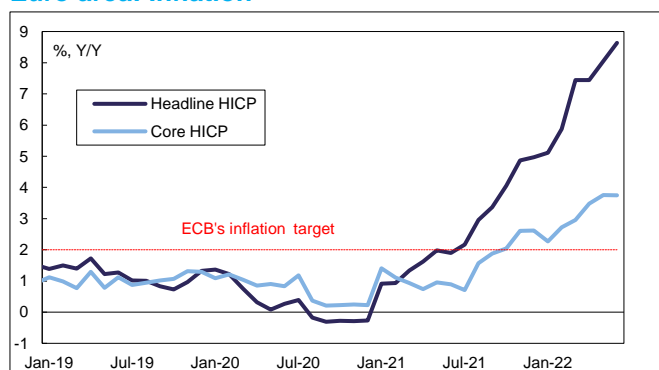
Inflation running well above profile in ECB's June projections, underscoring case for tightening

Most notably perhaps, the increase in headline inflation left the average in Q2 at 8.0%Y/Y, 0.5ppt above the ECB's baseline forecast published just three weeks ago. So, in the absence of substantive news between now and then, expect the ECB's updated forecasts due in September – after the temporary German measures will have expired – to revise up again the near-term inflation outlook. Certainly, while inflation might move broadly sideways over the next couple of months in the absence of a further upwards shift in energy prices, the Q3 average will likely be up about ½ppt from Q2. And while financial market measures of inflation expectations have declined significantly from the recent peak two months' ago, and wage growth remains relatively subdued, the risks to the inflation projections for 2024 are skewed to the upside too. So, given the Governing Council's current forward guidance, a hike of at least 50bps in the deposit rate at the September policy meeting currently looks nailed on. And if the supply of Russian natural gas to the euro area is squeezed significantly further by the time of that meeting, the inflation outlook will be much darker too, perhaps prompting an even bigger rate hike then and additional aggressive tightening beyond.

Flash manufacturing PMIs suggest gradual easing of cost pressures to 15-month low

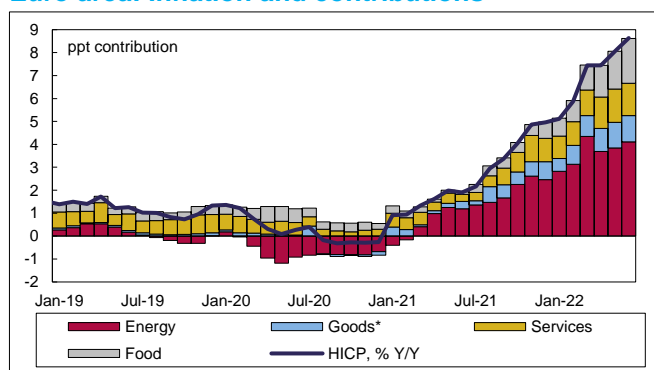
Among the inflation components likely to have a little further to rise is non-energy industrial goods, with the strongest pass-through of pressures from producer to consumer prices typically coming after more than six months. Euro area producer price figures, due on Monday, are likely to post another rise in excess of 1.0%M/M, to leave the annual rate close to 37%Y/Y.

Euro area: Inflation



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Inflation and contributions



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

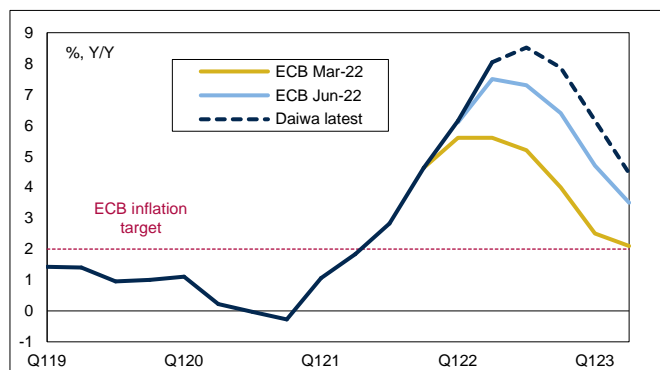
And surveys suggest that cost pressures remained close to historically high levels last month. Nevertheless, tallying with recent (often-marked) declines in the wholesale prices of industrial commodities, today's final euro area manufacturing PMIs for June revised down the survey's price indices from the preliminary estimates. The input cost PMI fell more than 4pt from May to a fifteen-month low of 80.0, with the output price PMI down more than 5pts to a six-month low of 70.9. The news on supply-chain strains was also a little more encouraging than previously thought, with the delivery times PMI (34.2) suggesting the shortest delays since end-2020, while order backlogs (49.3) were down for the first time in almost two years. However, new factory orders (45.2) were even weaker than previously thought, down the most since the first wave of Covid-19. And while it was unchanged from the flash estimate, the euro area output PMI (49.3) suggested that production was cut for the first time in two years. The June PMIs from Italy and Spain, released for the first time, also pointed to declining new orders (43.9 and 49.7 respectively) and minimal growth, if any, in the factory sector at the end of Q2 (50.2 and 49.7).

The week ahead in the euro area

Looking ahead to the coming week, Thursday's account from the ECB's 9 June policy-setting meeting will be of interest, although it remains to be seen if it will provide any additional noteworthy information on the Governing Council's plans for monetary policy normalisation. In particular, the Governing Council pre-committed to increasing its main interest rates by 25bps in July. And it made clear that, unless the medium-term inflation outlook in its updated projections is judged to have improved then, it will raise its key rates by a larger amount – presumably 50bps – in September. It also stated that "a gradual but sustained path of further increases" is likely thereafter, raising the likelihood of at least 50bps – and perhaps 75bps or more – of hikes in Q4 and additional tightening in 2023. Of course, in her press conference following that meeting, President Lagarde failed to offer detail on the Governing Council's intentions with respect to fragmentation risks. But faced with sharply rising spreads on BTPs and other Southern European bonds, the subsequent ad hoc policy meeting on 15 June saw the Governing Council agree to commission plans for a new anti-fragmentation policy tool.

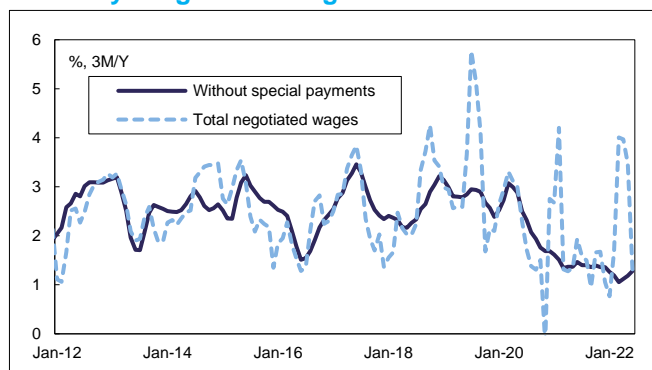
Following today's consumer price inflation estimates, the data calendar kicks off on Monday with the euro area PPI inflation numbers for May, which are likely to confirm still substantive price pressures along the supply chain with another increase of 1.0%/M/M or more to keep the annual rate close to 37%Y/Y. Euro area retail sales figures on Wednesday are likely to report moderate growth in May (0.5%/M/M) insufficient to reverse the decline of 1.3%/M/M in April. At the country level, the focus will be on the manufacturing sector, with May industrial production numbers to be published from France (Tuesday), Spain (Wednesday), Germany (Thursday) and Italy (Friday). We expect the data to illustrate the impact of continued supply challenges facing the sector, with output likely to have been modestly positive at best that month. The May figures for German factory orders – which dropped in each month from February to April – will be published on Wednesday, while trade figures for the same month from Germany and France will be released on Monday and Thursday respectively. Survey-wise, the euro area Sentix investor sentiment indices for July (due Monday) will be followed by the final June services and

Euro area: Inflation forecasts



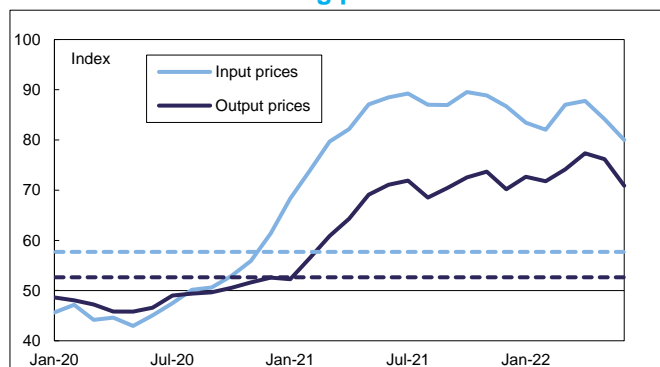
Source: Refinitiv, ECB and Daiwa Capital Markets Europe Ltd.

Germany: Negotiated wages



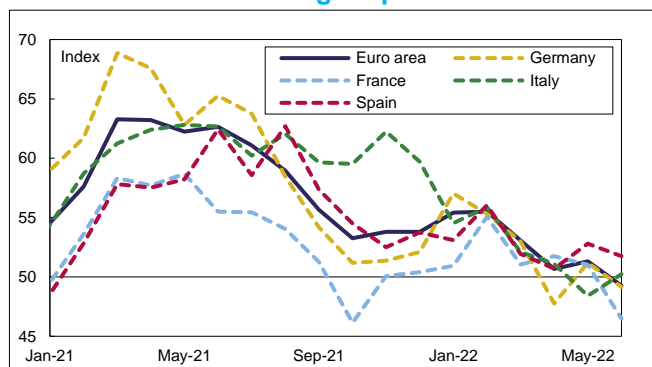
Source: Destatis and Daiwa Capital Markets Europe Ltd.

Euro area: Manufacturing price PMIs*



*Dashed lines are long-run averages. Source: Refinitiv, S&P Global and Daiwa Capital Markets Europe Ltd.

Euro area: Manufacturing output PMIs



Source: Refinitiv, S&P Global and Daiwa Capital Markets Europe Ltd.

composite PMIs (Tuesday) and construction PMIs (Wednesday). ECB policymakers set to speak publicly include Vice President de Guindos (Monday), Chief Economist Lane (Thursday) and President Lagarde (Friday).

UK

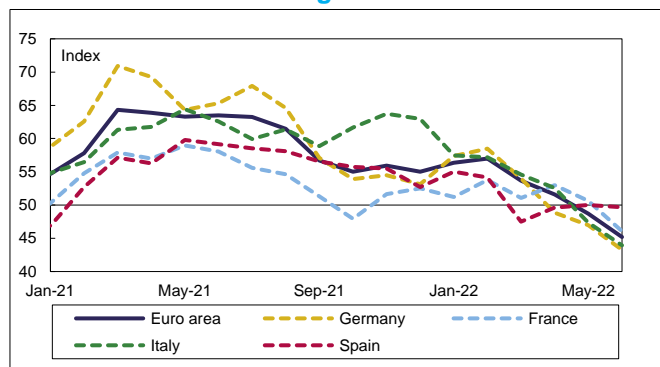
Demand for consumer credit remains subdued, but mortgage lending remains surprisingly strong

With consumer confidence at a record low, inflation at a multi-decade high, interest rates on the up and signs that UK consumers have cut back on non-essential spending, today's BoE bank lending numbers suggested that demand for new consumer credit remained unsurprisingly subdued in May. Net consumer credit increased £0.8bn in May, down from £1.4bn in April and below the twelve-month average ahead of the pandemic (£1.0bn). And while this left the outstanding stock of such lending up 5.7%Y/Y, with credit card lending up 11.2%Y/Y, the highest rates since March 2020, growth was flattered by pandemic-related weakness a year ago. Indeed, consumer credit was still some £23bn (10%) below the pre-pandemic level. Meanwhile, households' deposits with banks rose £5.4bn in May, a touch lower than in April (£5.7bn), and below the average in Q1 (£6.8bn), as the significant increase in the cost of living limited somewhat households' ability to save. In contrast, while the effective interest rate on new secured loans rose a further 13bps in May to 1.95%, some 45bps higher than November's trough, demand for mortgages remained strong. Net new secured borrowing jumped £7.2bn in May, from £4.2bn in April and the most since September 2021 when the government's stamp duty discount expired. And there was a slight increase in the number of new approvals, suggesting mortgage lending will remain solid for the time being. Of course, with mortgage rates set to follow Bank Rate higher over coming months, consumer confidence extremely weak and households' disposable income set to decline for the foreseeable future, we continue to expect the housing market to cool over coming quarters.

Manufacturing PMI points to stagnating output in June and further weakness ahead

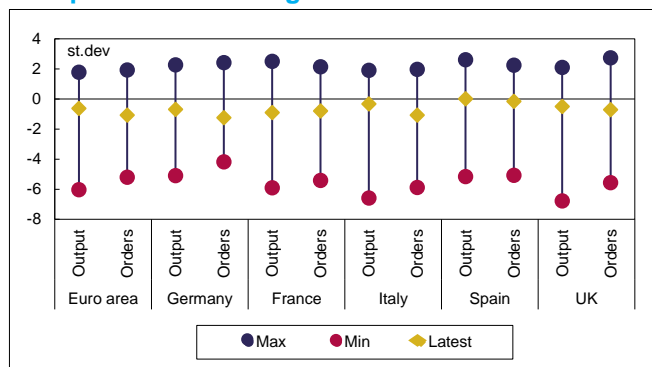
Today's final June manufacturing PMIs offered a more downbeat assessment about conditions in the sector than implied from the flash release, signalling a sharper slowdown in production towards the end of the second quarter amid a marked weakening in demand and greater pessimism about the outlook ahead. In particular, the output PMI was downwardly revised from the flash by 0.9pt to 50.3, consistent with stagnating production in June, and the lowest reading since May 2020. The weakness was again most striking in the consumer goods subsector, with the relevant PMI falling a further 1.6pts to a firmly contractionary 44.1. And the PMIs implied the first decline in new orders since January 2021, with domestic and external demand both weak, hit by raw material shortages and growing global uncertainties. Some respondents also noted that ongoing Brexit-related difficulties had further weighed on orders from the EU. While the input and output price PMIs both eased in June, at 84.6 and 72.1 respectively, they remained extremely elevated by historical standards and suggested that manufacturers continued to absorb some of these additional cost burdens. Overall, manufacturers were unsurprisingly less upbeat about the outlook for the coming year, with the relevant survey index declining to its lowest since May 2020.

Euro area: Manufacturing new orders PMIs



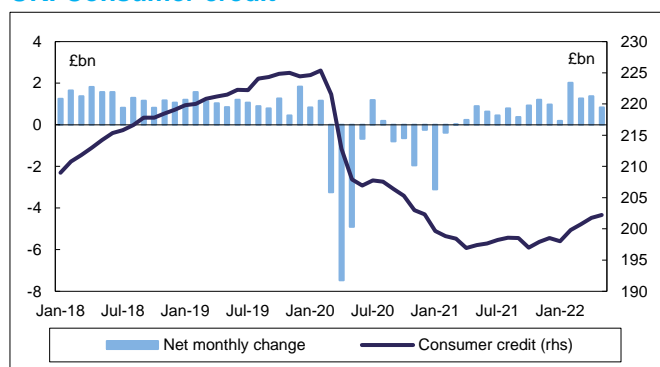
Source: Refinitiv, S&P Global and Daiwa Capital Markets Europe Ltd.

Europe: Manufacturing PMIs



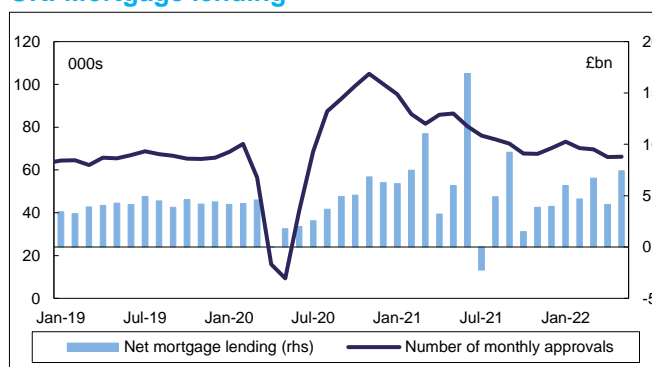
Source: Refinitiv, S&P Global and Daiwa Capital Markets Europe Ltd.

UK: Consumer credit



Source: BoE and Daiwa Capital Markets Europe Ltd.

UK: Mortgage lending

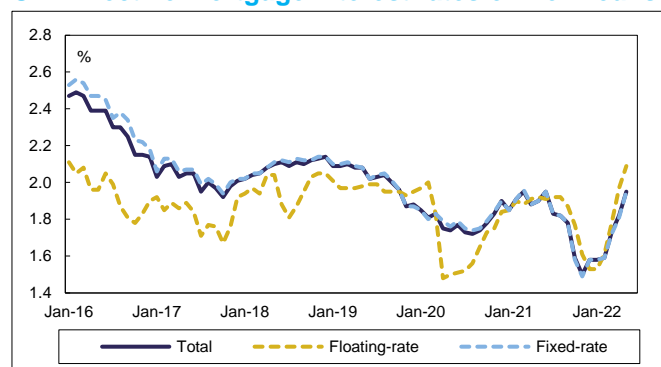


Source: Refinitiv, BoE and Daiwa Capital Markets Europe Ltd.

The week ahead in the UK

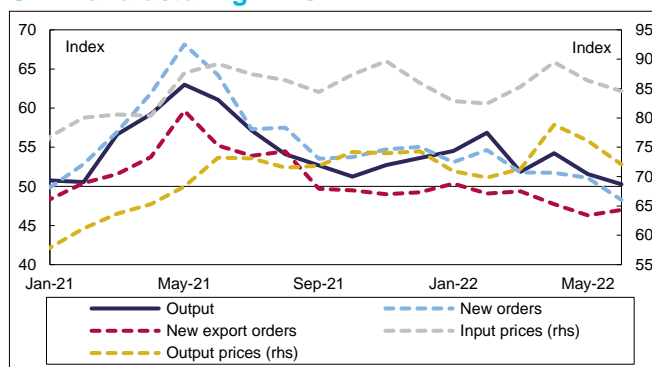
The coming week will be another quiet one on the UK economic data front, with the final services and composite PMIs, along with new car registrations figures for June due on Tuesday. The flash services activity index moved sideways in June at 53.4. Nevertheless, this was still the softest reading since February 2021. And, following the steep declines in the previous two months, it left the index well below the quarterly average in Q1 (59.1). Given the downwards revision to the manufacturing output PMI, the composite PMI is likely to have fallen to its lowest reading for two years, down from the flash reading of 53.1, further supporting our forecast that GDP contracted in Q2. The construction PMIs for June will be published on Wednesday, followed by the BoE's Decision Maker Panel data for June on Thursday. And the following day, the REC/KPMG report on jobs for June will provide an update on the labour market. Separately, the BoE will publish its Financial Stability Report on Tuesday, while MPC members speaking publicly include external member Tenreyro (Tuesday), Chief Economist Pill (Wednesday) and hawkish external member Mann (Thursday).

UK: Effective mortgage interest rates on new loans












Source: BoE and Daiwa Capital Markets Europe Ltd.

UK: Manufacturing PMIs



Source: Refinitiv, S&P Global and Daiwa Capital Markets Europe Ltd.

Daiwa economic forecasts

















		2022				2023		2022	2023	2024
		Q1	Q2	Q3	Q4	Q1	Q2			
GDP		%, Q/Q						%, Y/Y		
Euro area		0.6	0.1	0.3	0.2	0.1	0.2	2.8	0.6	1.1
UK		0.8	-0.3	0.3	-0.3	0.0	-0.1	3.4	-0.2	0.9
Inflation, %, Y/Y										
Euro area										
Headline HICP		6.1	8.0	8.5	7.9	6.2	4.4	7.7	4.2	1.9
Core HICP		2.7	3.7	4.0	4.2	4.1	3.9	3.6	3.6	2.1
UK										
Headline CPI		6.2	9.1	9.9	10.3	9.6	6.5	8.9	6.3	2.4
Core CPI		5.1	6.0	6.5	6.4	5.9	5.1	6.0	4.9	2.5
Monetary policy, %										
ECB										
Refi Rate		0.00	0.00	0.75	1.25	1.50	1.75	1.25	1.75	1.75
Deposit Rate		-0.50	-0.50	0.25	0.75	1.00	1.25	0.75	1.50	1.50
BoE										
Bank Rate		0.75	1.25	2.00	2.50	2.50	2.50	2.50	2.50	2.00

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
Euro area	 Final manufacturing PMI	Jun	52.1	<u>52.0</u>	54.6	-
	 Preliminary CPI M/M% (Y/Y%)	Jun	0.8 (8.6)	<u>0.7 (8.5)</u>	0.8 (8.1)	-
	 Preliminary core CPI Y/Y%	Jun	3.7	<u>3.9</u>	3.8	-
Germany	 Final manufacturing PMI	Jun	52.0	<u>52.0</u>	54.8	-
France	 Final manufacturing PMI	Jun	51.4	<u>51.0</u>	54.6	-
	 New car registrations Y/Y%	Jun	-14.2	-	-10.1	-
Italy	 Manufacturing PMI	Jun	50.9	50.6	51.9	-
	 Preliminary CPI M/M% (Y/Y%)	Jun	1.2 (8.0)	0.6 (7.4)	0.8 (6.8)	-
	 Preliminary EU-harmonised CPI M/M% (Y/Y%)	Jun	1.2 (8.5)	0.8 (7.9)	0.9 (7.3)	-
	 New car registrations Y/Y%	Jun	-15.0	-	-15.1	-
Spain	 Manufacturing PMI	Jun	52.6	52.2	53.8	-
	 New car registrations Y/Y%	Jun	-7.8	-	-10.9	-
UK	 Final manufacturing PMI	Jun	52.8	<u>53.4</u>	54.6	-
	 Net consumer credit £bn (Y/Y%)	May	0.8 (5.7)	1.3 (-)	1.4 (5.7)	-
	 Net mortgage lending £bn (approvals '000s)	May	7.4 (66.2)	4.3 (64.0)	4.1 (66.0)	4.2 (66.1)
	 M4 money supply Y/Y%	May	5.1	-	4.9	-



























Auctions

Country	Auction
- Nothing to report -	

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
Monday 04 July 2022						
Euro area		09.30	Sentix investor confidence	Jul	-20.0	-15.8
		10.00	PPI M/M% (Y/Y%)	May	0.9 (36.5)	1.2 (37.2)
Germany		07.00	Trade balance €bn	May	1.3	3.1
Spain		08.00	Unemployment change '000s	Jun	-	-99.5
Tuesday 05 July 2022						
Euro area		09.00	Final services (composite) PMI	Jun	52.8 (51.9)	56.1 (54.8)
Germany		08.55	Final services (composite) PMI	Jun	52.4 (51.3)	55.0 (53.7)
		-	New car registrations (production)* Y/Y%	Jun	-	-10.2 (24.7)
France		07.45	Industrial production M/M% (Y/Y%)	May	0.5 (0.7)	-0.1 (-0.3)
		07.45	Manufacturing production M/M% (Y/Y%)	May	-	-0.4 (0.8)
		08.50	Final services (composite) PMI	Jun	54.4 (52.8)	58.3 (57.0)
Italy		08.45	Services (composite) PMI	Jun	51.5 (51.0)	53.7 (52.4)
Spain		08.45	Services (composite) PMI	Jun	53.9 (53.8)	56.5 (55.7)
UK		09.30	Final services (composite) PMI	Jun	53.4 (53.1)	53.4 (53.1)
		09.00	New car registrations Y/Y%	Jun	-	-20.6
Wednesday 06 July 2022						
Euro area		08.30	Construction PMI	Jun	-	49.2
		10.00	Retail sales M/M% (Y/Y%)	May	0.4 (-0.3)	-1.3 (3.9)
Germany		07.00	Factory orders M/M% (Y/Y%)	May	-0.5 (-5.0)	-2.7 (-6.2)
		08.30	Construction PMI	Jun	-	45.4
France		08.30	Construction PMI	Jun	-	50.9
Italy		08.30	Construction PMI	Jun	-	54.3
Spain		08.00	Industrial production M/M% (Y/Y%)	May	-0.6 (3.4)	2.1 (2.4)
UK		09.30	Construction PMI	Jun	55.0	56.4
Thursday 07 July 2022						
Germany		08.00	Industrial production M/M% (Y/Y%)	May	0.4 (-2.2)	0.7 (-2.2)
UK		09.30	Final output per hour Y/Y%	Q1	-0.8	0.7
Friday 08 July 2022						
France		07.45	Trade balance €bn	May	-12.5	-12.2
Italy		09.00	Industrial production M/M% (Y/Y%)	May	-1.3 (4.0)	1.6 (4.2)

*Appropriate date of release. Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions

Country	BST	Event / Auction
Monday 04 July 2022		
Euro area 	16.00	ECB's de Guindos scheduled to speak at the Euro Finance Summit
Tuesday 05 July 2022		
Germany 	10.30	Auction: €500mn of 0.1% 2033 index-linked bonds
UK 	10.00	Auction: £2bn of 1.25% 2051 bonds
	10.30	BoE publishes Financial Stability Report
	17.30	BoE's Tenreyro scheduled to speak at global banking conference
Wednesday 06 July 2022		
Euro area 	08.00	ECB's Rehn scheduled to speak
Germany 	10.30	Auction: €5bn of 1.7% 2032 bonds
UK 	09:10	BoE Chief Economist Pill scheduled to speak at global banking conference
	14.00	BoE Deputy Governor Cunliffe scheduled to speak at global banking conference
Thursday 07 July 2022		
Euro area 	10.45	ECB Chief Economist Lane participates in panel on the accelerated green transition in the post-Covid era
	12.30	ECB publishes account of the 9 June policy meeting
France 	09.50	Auction: 2% 2032 bonds
	09.50	Auction: 0.5% 2044 bonds
	09.50	Auction: 2% 2048 bonds
	09.50	Auction: 0.75% 2053 bonds
Spain 	09.30	Auction: 5.9% 2026 bonds
	09.30	Auction: 2.55% 2032 bonds
	09.30	Auction: 1.9% 2052 bonds
	09.30	Auction: 1% index-linked bonds
	09.30	BoE publishes Decision Maker survey
	14.00	BoE's Mann scheduled to speak at forum on the rise of inflation and current global monetary policy issues
Friday 08 July 2022		
Euro area 	12.55	ECB President Lagarde scheduled to speak at a conference in France
	17.45	ECB's Villeroy scheduled to speak at a conference in France
UK 	00.01	KPMG/REC report on UK jobs

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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