Euro wrap-up

Overview

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- After strong US CPI data, Bunds followed USTs lower while euro area IP figures beat expectations, a French survey suggested modest GDP growth in Q2, and final German inflation figures for June confirmed the drop caused by temporary policy measures.
- Gilts were little changed as UK GDP data for May beat expectations but the underlying trade deficit reached a new record high.
- Thursday will bring UK surveys on credit conditions and the residential property market while Friday will bring euro area goods trade data.

Daily bond market movements

Bond	Yield	Change
BKO 0.2 06/24	0.429	+0.103
OBL 1.3 10/27	0.834	+0.074
DBR 1.7 08/32	1.145	+0.019
UKT 1 04/24	1.796	+0.008
UKT 1¼ 07/27	1.754	+0.001
UKT 4¼ 06/32	2.060	-0.017

*Change from close as at 4:15pm BST.
Source: Bloomberg

Euro area

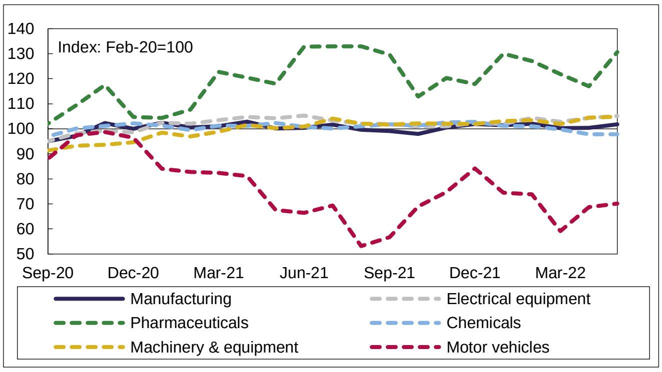
Euro area IP beats expectations in May, but still on track for no growth in Q2

While manufacturing output in the four largest member states was subdued, today's euro area industrial production figures exceeded expectations. In particular, IP rose 0.8%M/M in May while growth in April was revised up 0.1ppt to 0.5%M/M. And although energy output fell by more than 3%M/M in May, manufacturing production rose 1.4%M/M, the firmest such pace since November 2021. Within the detail, there were notable rebounds in the pharmaceuticals (11.7%M/M) and computer, electronic and optical products (8.9%M/M) subsectors, while autos production rose for the second successive month (2.1%M/M), to leave it trending so far in Q2 around ½% above the Q1 average albeit still some 30% lower than the pre-pandemic level. But while total manufacturing output was 1.8% higher than in February 2020, the average level in April and May was a touch weaker than in Q1 (-0.2%). And in the absence of a production surge in Ireland (13.9%M/M), euro area IP would have been broadly flat in May and trending some 0.4% lower than the Q1 average. Moreover, with the PMIs having suggested that output contracted in June for the first time since June 2020, the manufacturing sector looks to have been a modest drag on euro area GDP growth in Q2. In addition, with new orders notably weaker, the near-term outlook for factory output looks at best subdued, with additional marked downside risks should Russian natural gas shipments via the Nord Stream 1 pipeline not resume after the current two-week break for maintenance.

BoF survey suggests steady activity in June, modest growth in Q2, and less pressure on prices

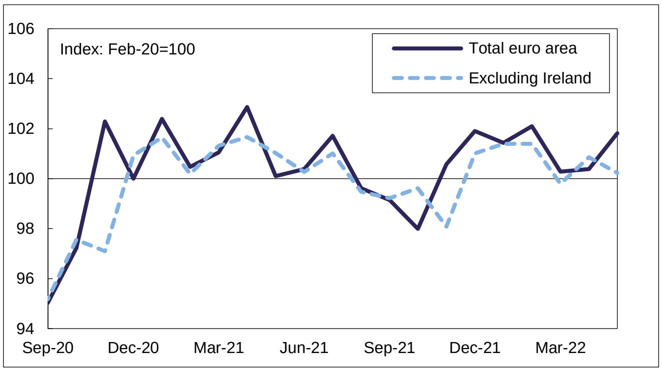
Based on its latest business survey conducted at the turn of the month, the Bank of France judged French economic activity in June to have been broadly stable after modest growth in April and May. As a result, in line with our own forecast, it estimates GDP growth of about ¼%Q/Q in Q2, barely reversing the contraction of 0.2%Q/Q in Q1. By sector, industrial production was estimated to have been little changed in June, with growth in pharmaceuticals but contraction in machinery and chemicals. The survey also reported modest expansion in services, thanks to growth in business services, and construction. While the Bank of France reported that supply constraints had eased slightly, they also appear to have remained substantive, with 59% (-2ppts on the month) of firms in industry and 52% (-3ppts) of firms in construction reporting that they were a barrier to activity. Moreover, labour shortages appear to have become more problematic, with recruitment difficulties cited by 58% (+3ppts) of firms, particularly those in services. Notably perhaps, however, the share of firms suggesting that they were increasing their selling prices (36%) fell for the second successive month, reportedly in part due to lower commodity prices.

Euro area: Manufacturing production



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Manufacturing production



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

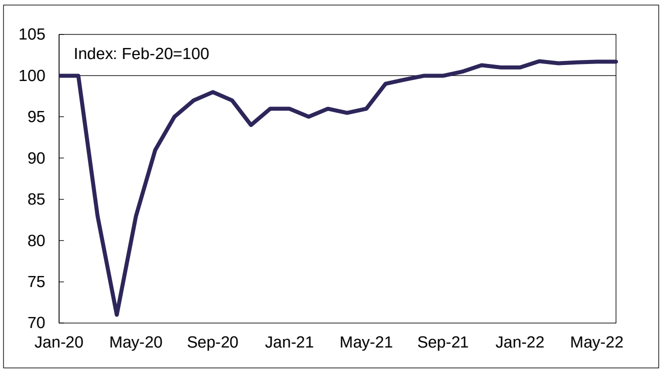
Final German inflation unrevised as temporary policy measures drove a marked drop in June

While there had been surprises in the flash estimates, today's final June inflation figures from Germany, France and Spain fully aligned with expectations. So, there were no revisions in Germany, where the EU-harmonised HICP rate dropped ½ppt to 8.2%, while the national CPI measure fell 0.3ppt to 7.6%Y/Y. Those declines principally reflected temporary policy measures, with the introduction of the €9 monthly travel ticket and fuel discounts causing inflation in the transport sector to drop 8ppts to 8.3%Y/Y, as ticket prices fell more than 60% both on the month and from a year earlier. While Destatis noted that the precise impact of the fuel discount was difficult to quantify, without the support measures – i.e. if prices for fuel and public transport had remained unchanged in June – headline CPI inflation would have increased 0.7ppt to 8.6%Y/Y. Nevertheless, Germany's energy inflation eased only slightly, by 0.3ppt to 38.0%Y/Y, with prices of natural gas up more than 60%Y/Y and heating oil more than doubling in price. Meanwhile, food inflation jumped 1.6ppt to 12.7%Y/Y, a fresh record high. But while the non-energy industrial goods component rose in June (up 0.4ppt to 5.6%Y/Y), the lower public transport fares meant that services inflation fell 0.8ppt to 2.1%Y/Y, a twelve-month low, despite a jump of 16½%M/M in package tour prices. As such, core inflation also edged lower, by 0.6ppt to 3.2%Y/Y, a four-month low. Of course, these downwards pressures will likely prove temporary, with inflation set to rebound in the autumn when the relief measures elapse.

French and Spanish inflation higher in June, in line with the flash estimates

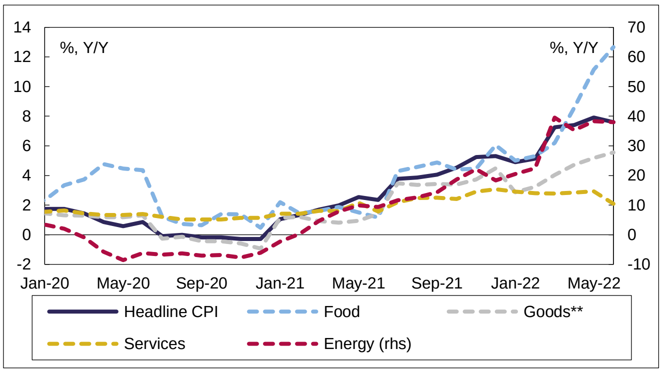
The French inflation figures were similarly unrevised from the flash data, confirming that the headline HICP rate increased 0.7ppt to 6.5%Y/Y, with the national CPI measure up 0.6ppt to 5.2%Y/Y. This reflected a further acceleration in energy inflation (up 5.3ppts to 33.1%Y/Y), with food inflation up 1.5ppts to 5.8%Y/Y, the highest since July 2008. But while the services component edged slightly higher (up 0.1ppt to 3.3%Y/Y), the manufactured goods rate eased (by 0.5ppt to 2.5%Y/Y) due to a drop in clothing inflation on the back of summer discounting. So, while core inflation moved sideways (3.7%Y/Y), this will likely resume an upwards trend this month as the apparel component normalises. Meanwhile, Spanish HICP inflation jumped 1.5ppts to 10.0%Y/Y, with the national rate similarly up 1.5ppts to 10.2%Y/Y, the highest since April 1985. Energy remained the key inflationary source, up 6.7ppts to 40.8%Y/Y, while food inflation jumped 1.8ppts to 11.9%Y/Y, the highest since January 1994. Despite a downwards influence from clothing as in France, non-energy industrial goods inflation rose 0.6ppt to 4.2%Y/Y, a series high. And with services (3.8%Y/Y) at a 14½-year high, core inflation rose 0.6ppt to 5.5%Y/Y, the highest since 1993.

France: BoF survey - estimated level of GDP



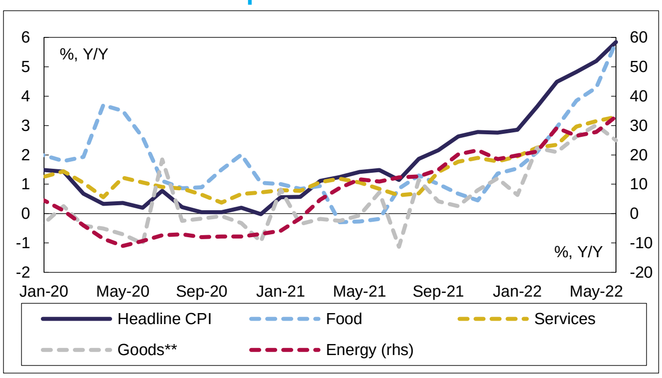
Source: BoF and Daiwa Capital Markets Europe Ltd.

Germany: Consumer price inflation*



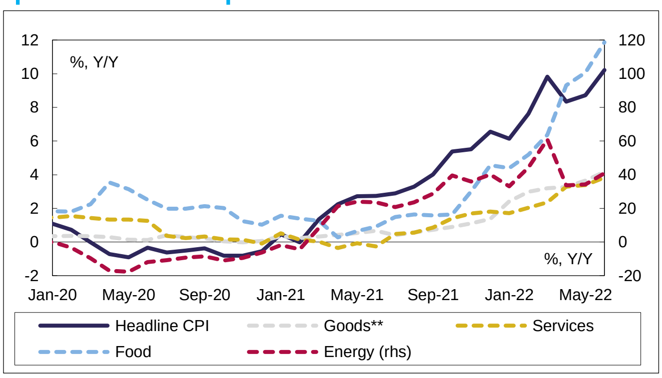
**National measure. **Non-energy industrial goods. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.*

France: Consumer price inflation*



**National measure. **Non-energy industrial goods. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.*

Spain: Consumer price inflation*



**National measure. **Non-energy industrial goods. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.*

The coming two days in the euro area

Thursday will be a quiet day for euro area data releases. On Friday, euro area goods trade figures for May are likely to mirror the notable deterioration in the trade balance recorded in Germany that month, while euro area new car registrations data for June are also due.

UK

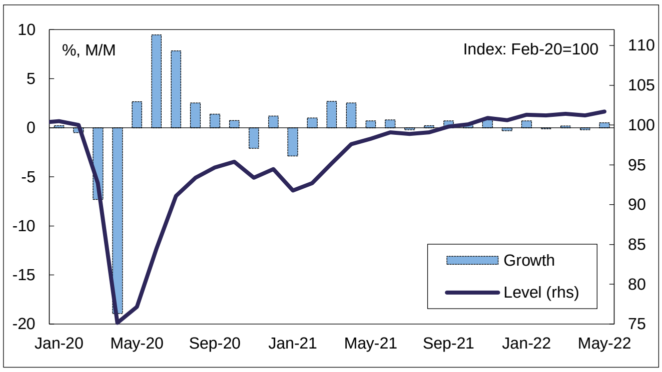
GDP confounds gloomy expectations with rebound in May, but drop still possible in Q2

Contrary to the consensus expectation of minimal growth, UK GDP rebounded a much stronger-than-expected 0.5%M/M in May. That followed a revised drop of 0.2%M/M in April, which was 0.1ppt less than previously thought. As a result, economic output rose 1.7% above the pre-pandemic level in February 2020 and more than 1% above the pre-pandemic peak in October 2019. The average level of GDP in the first two months of Q2 was 0.1% above the average in Q1. So, with no additional signs of weakness in economic output, the data reinforce expectations that the BoE will hike Bank Rate by 50bps to 1.75% in August. But a contraction in GDP in June remains highly likely, not least due to the impact of the extra bank holiday and public transport strikes that month. Given the additional non-negligible probability of a downwards revision to the May estimate, we expect GDP growth to be close to zero over Q2 as a whole, with a negative print still perfectly feasible.

Services activity boosted by doctor appointments, with manufacturing and construction firm too

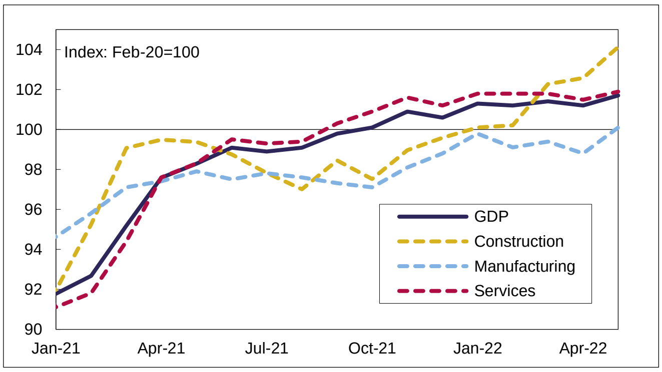
The detail of today's data suggest that UK GDP growth in May was also relatively broad-based. However, as has frequently been the case throughout the pandemic, there were some unusual and sizeable shifts among the various sub-components. Growth in services output was stronger-than-expected at 0.4%M/M. But that was principally thanks to a very sharp rise (15%M/M) in the number of doctor appointments, as routine medical services returned to a greater normality, which more than offset the impact of a further drop in Covid-related healthcare activity. Less happily, despite much stronger tourism activity (up 11.0%M/M), due to a drop in retail trade (-0.5%M/M), output in consumer-facing services fell 0.1%M/M to be still some 4.7% below the pre-pandemic level. But manufacturing output significantly beat expectations, rising 1.4%M/M to surpass the pre-pandemic level for the first time thanks to growth in pharmaceuticals, food products, electrical equipment and certain other items. And construction activity rose for the seventh successive month, up 1.5%M/M to be more than 4% above the pre-pandemic level.

UK: GDP growth and level



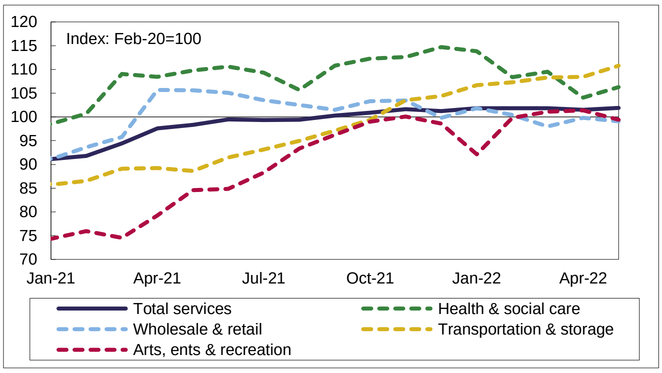
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: GDP and output components



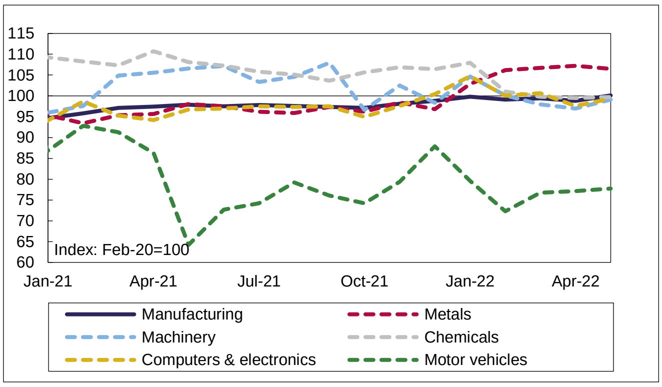
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Services output by selected subsector



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Manufacturing output by selected subsector



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

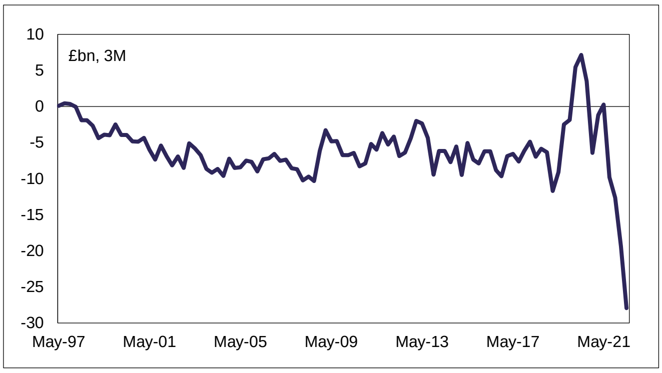
Trade deficit hits new record on three-month basis flagging alarming post-Brexit trend

Recent sterling weakness has been easy to understand in light of the marked deterioration in the UK's external position since the start of the year. In the first quarter of 2022, the goods trade deficit jumped about 4½ppts to 11.0% of GDP, the total trade deficit (also including services) rose by a similar margin to 5.4% of GDP, and the current account deficit rose more than 7ppts to a record 8.3% of GDP. Unfortunately, today's trade data for May reported no notable improvement in the trend in the second quarter, suggesting that the UK's external performance post-Brexit – likely impaired by weak business investment and the gradual separation from EU supply chains since the referendum – should be a major concern for policymakers. Excluding precious metals, which distort the underlying picture, goods imports (up £2.2bn) rose by a similar amount to goods exports (up £2.3bn) in May. But looking through the month-to-month volatility, the goods trade deficit (excluding precious metals) widened on a three-month basis by a hefty £9.5bn to £63.1bn, as goods imports rose £20.2bn (14.6%3M/3M) but exports increased by £10.7bn (12.6%3M/3M). Shipments both to the EU and beyond the EU still lagged imports from the respective destinations. And with the services surplus improving by less than £1bn, on the same basis the overall deficit in trade in goods and services widened by £8.6bn to £27.9bn. While it might be tempting to attribute the deterioration in the trade balance to unfavourable relative price shifts amid high inflation of energy, food and other commodities, in volume terms the total trade deficit also widened in the three months to May, by almost £2.2bn to a record £25.7bn.

The coming two days in the UK

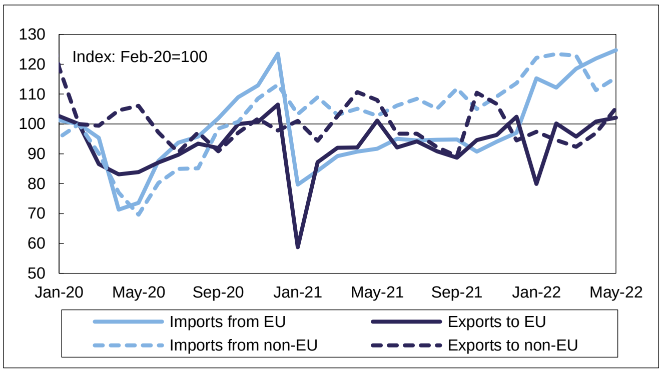
Tomorrow will bring the latest RICS residential survey for June, which will likely suggest that house prices are expected to remain elevated by the persisting supply-demand imbalance. Nevertheless, the headline price balance is forecast to have eased to its lowest this year, reflecting greater uncertainty about the near-term economic outlook, rising mortgage rates and record low consumer confidence. Separately, the BoE's quarterly Credit Conditions Survey (also due tomorrow) will likely report a tightening of lending conditions, albeit with demand for mortgages set to have remained firm while demand for consumer credit remained more subdued. There are no UK economic data of note due on Friday.

UK: Total trade balance*



*Goods and services balance excluding precious metals, 3-month basis.
Source: ONS and Daiwa Capital Markets Europe Ltd.

UK: Export and import goods volumes



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

The next edition of the Euro wrap-up will be published on 15 July 2022

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area	Industrial production M/M% (Y/Y%)	May	**0.8 (1.6)**	0.3 (0.3)	0.4 (-2.0)	**0.5 (-2.5)**
Germany	Final CPI M/M% (Y/Y%)	Jun	**0.1 (7.6)**	*0.1 (7.6)*	0.9 (7.9)	-
	Final EU-harmonised CPI M/M% (Y/Y%)	Jun	**-0.1 (8.2)**	*-0.1 (8.2)*	1.1 (8.7)	-
France	Final CPI M/M% (Y/Y%)	Jun	**0.7 (5.8)**	*0.7 (5.8)*	0.7 (5.2)	-
	Final EU-harmonised CPI M/M% (Y/Y%)	Jun	**0.9 (6.5)**	*0.8 (6.5)*	0.8 (5.8)	-
Spain	Final CPI M/M% (Y/Y%)	Jun	**1.9 (10.2)**	*1.8 (10.2)*	0.8 (8.7)	-
	Final EU-harmonised CPI M/M% (Y/Y%)	Jun	**1.9 (10.0)**	*1.8 (10.0)*	0.7 (8.5)	-
UK	GDP M/M% (3M/3M%)	May	**0.5 (0.4)**	0.1 (0.0)	-0.3 (0.2)	**-0.2 (0.3)**
	Industrial production M/M% (Y/Y%)	May	**0.9 (1.4)**	-0.0 (-0.3)	-0.6 (0.7)	**-0.1 (1.6)**
	Manufacturing production M/M% (Y/Y%)	May	**1.4 (2.3)**	0.0 (0.3)	-1.0 (0.5)	**-0.6 (1.3)**
	Index of services M/M% (3M/3M%)	May	**0.4 (0.1)**	0.1 (-0.1)	-0.3 (0.0)	**-0.2 (0.2)**
	Construction output M/M% (Y/Y%)	May	**1.5 (4.8)**	0.3 (4.3)	-0.4 (3.9)	**0.3 (3.1)**
	Goods trade balance £bn	May	**-21.4**	-20.6	-20.9	**-21.5**

Auctions

Country	Auction
Germany	sold €1.33bn of 0% 2052 bonds at an average yield of 1.41%
Italy	sold €3.25bn of 1.2% 2025 bonds at an average yield of 1.84%
	sold €2.5bn of 2.8% 2029 bonds at an average yield of 2.76%
	sold €1.25bn of 3.25% 2038 bonds at an average yield of 3.45%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
UK	00.01	RICS house price balance %	Jun	-	73

Auctions and events

Country	BST	Event
UK	09.30	BoE publishes Credit Conditions Survey Q222
	09.30	BoE publishes Bank Liabilities Survey Q222

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Friday's releases

Economic data

Country	BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Euro area	07.00	EU27 new car registrations Y/Y%	Jun	-	-11.2
	10.00	Trade balance €bn	May	-	-31.7
Italy	09.00	Final CPI M/M% (Y/Y%)	Jun	*1.2 (8.0)*	0.8 (6.8)
	09.00	Final EU-harmonised CPI M/M% (Y/Y%)	Jun	*1.2 (8.5)*	0.9 (7.3)

Auctions and events

Country	BST	Event
Euro area	11.00	ECB's Rehn scheduled to speak

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:
https://www.uk.daiwacm.com/ficc-research/recent-blogs