

# Euro wrap-up

## Overview

- Shorter-dated Bunds made modest losses even as the German ifo indices were less upbeat than the PMIs, suggesting lacklustre growth momentum.
- Gilts made substantial losses after UK inflation significantly exceeded all expectations despite easing to a 13-month low, and core inflation jumped to a new 31-year high, supporting the case for additional monetary policy tightening.
- The coming two days will bring survey results for German, French and Italian consumer confidence, as well as UK retail sales data.

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### Daily bond market movements

Bond	Yield	Change
BKO 2.8 06/25	2.806	+0.015
OBL 2.2 04/28	2.446	-
DBR 2.3 02/33	2.451	-0.013
UKT 0% 06/25	4.355	+0.210
UKT 1% 10/28	4.118	+0.125
UKT 3¼ 01/33	4.195	+0.035

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

## Euro area

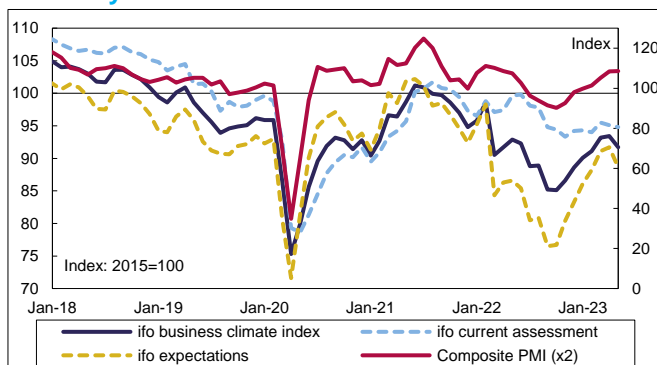
### German ifo survey less upbeat than PMIs, suggesting little improvement in growth momentum

While yesterday's [flash PMIs](#) suggested that conditions in the euro area's largest member state remain consistent with growth, today's German ifo institute business indices offered a somewhat gloomier assessment. In particular, the ifo survey suggested little improvement in economic momentum and sub-par growth in the second quarter, and also flagged increased concerns of a deteriorating outlook over the coming six months. Indeed, the headline business climate index fell for the first time in seven months in May and by 1.7pts to 91.7, more than 5% below the long-run average. Admittedly, the drop in the current conditions index was modest (down 0.3pt to 94.8), and left it trending just 0.4pt above the Q1 average when GDP merely moved sideways. And happily, consistent with the findings of the PMIs, the ifo survey reported another solid improvement in services, for which the current conditions index rose more than 2pts to the highest level in nine months. In contrast, retailers were the most downbeat in five months, while pessimists outweighed optimists in the construction sector for the first time since 2015. And despite a further easing in supply bottlenecks, manufacturers judged that current conditions had deteriorated for a second successive month as incoming orders continued to decline.

### Manufacturers significantly more downbeat amid softer demand

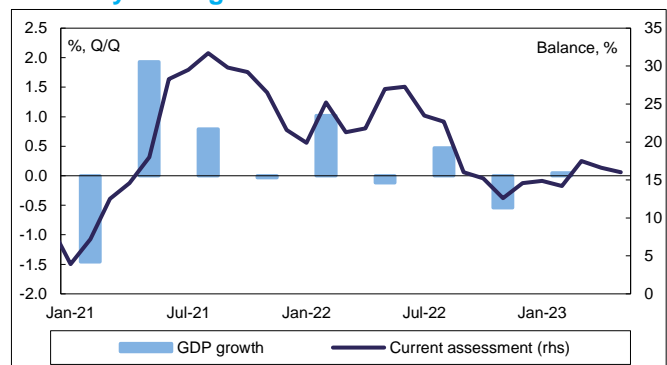
But it was firms' pessimism about the coming six months that was most striking in today's survey. This was particularly true of manufacturers, for which the respective balance fell (-11.5pts) by the most since March 2022 to a four-month low, with the ifo institute noting a weakening in nearly all sub-sectors, while export expectations also fell markedly amid softening external demand. Firms in the services and retail sectors were also more downbeat, with no improvement seen in the construction sector either. Overall, the composite expectations index fell for the first month in eight, by more than 3pts to a three-month low of 88.6, more than 8% below the long-run average. However, this was still more than 12pts above September's trough and was still trending some 1.7pts above the Q1 average. So, while the ifo survey provides a reminder that risks to the German economic outlook are skewed to the downside, and that economic growth in the second half of the year is likely to be at-best lacklustre due to weakness in manufacturing and construction, renewed recession concerns appear overdone. Moreover, reflecting relatively subdued demand and easing supply-side constraints, the ifo institute suggested that its price expectations survey (due to be published tomorrow) will report a further drop in the share of companies aiming to increase prices over the coming three months, suggesting a welcome moderation in inflation over the summer.

### Germany: ifo and PMI business sentiment indices



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

### Germany: GDP growth & ifo business sentiment



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

## The coming two days in the euro area

Sentiment surveys will continue to dominate the euro area dataflow over the remainder of the week, with national consumer confidence indicators coming from Germany (tomorrow), France and Italy (Friday). Like the Commission's flash euro area indicator published earlier this week, these are likely to report a further modest improvement in household sentiment in May to the highest levels since Russia's invasion of Ukraine in February 2022, albeit remaining well below the post-lockdown bounce in 2021 and the long-run averages. National business surveys from France (tomorrow) and ISTAT (Friday) are expected to signal a slight loss of recovery momentum in May, albeit remaining consistent with ongoing expansion in the second quarter. Thursday will also bring updated German national accounts data for Q1, which will include for the first time an official expenditure breakdown. GDP growth is expected to align with previous the estimate which reported stagnation, but also confirm that declines in household and government consumption were offset by firmer capex, particularly construction, and a positive contribution from net trade.

## UK

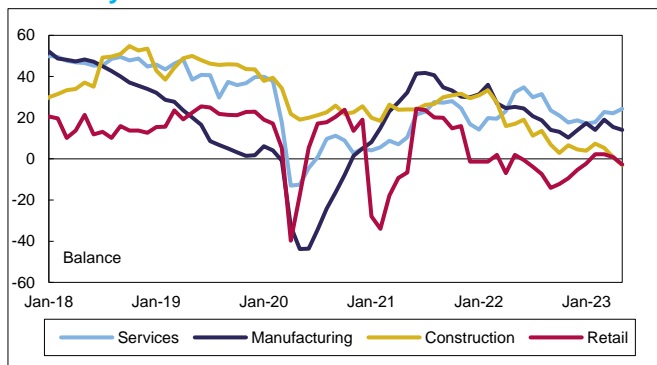
### Inflation down to 13-month low but big upside surprise reinforces case for tightening

The UK's April inflation data provided yet another nasty shock to the BoE, surprising significantly to the upside and exceeding every single forecast on the Bloomberg survey as well as that of the MPC, to raise the likelihood of further rate hikes into the second half of the year. Headline CPI inflation fell 1.4ppts from March to a 13-month low. But at 8.7%Y/Y, that was 0.3ppt above the BoE's forecast published less than a fortnight ago and 0.5ppt above the median forecast on the Bloomberg survey. And the decline was more than fully accounted for by base effects associated with the jump in energy prices a year ago following the Russian invasion of Ukraine. Indeed, with electricity and gas prices alone subtracting 1.4ppts from headline inflation, and motor fuel inflation also lower, energy inflation slowed almost 30ppts, admittedly still remaining elevated at 10.8%Y/Y. Food inflation also turned down, albeit marginally, falling just 0.1ppt to 19.1%Y/Y. Indeed, prices of food rose further on the month, by the second-largest overshoot from the long-run price change since the series began, to cause continued grief for consumers. And crucially, all other major inflation components rose.

### Marked rise in core inflation suggests unwelcome shift in price-setting behaviour

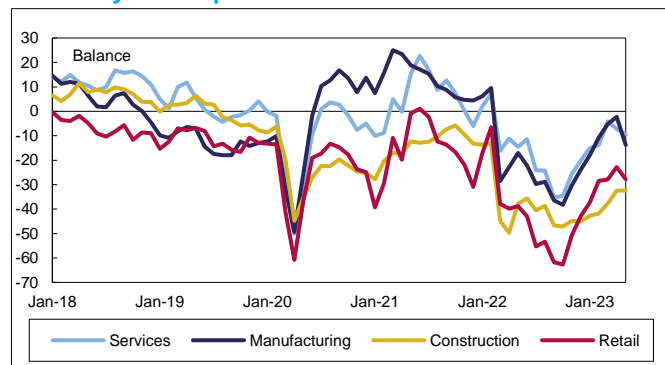
Notably, the sources of upwards inflation pressure in April were very broad-based. Fiscal policy contributed to the rise in the headline CPI rate via the first increase in tobacco duty for 18 months. More importantly, while supply-chain strains have eased, and surveys and producer price inflation data point to a more stable cost environment within the manufacturing

#### Germany: ifo current assessment indices



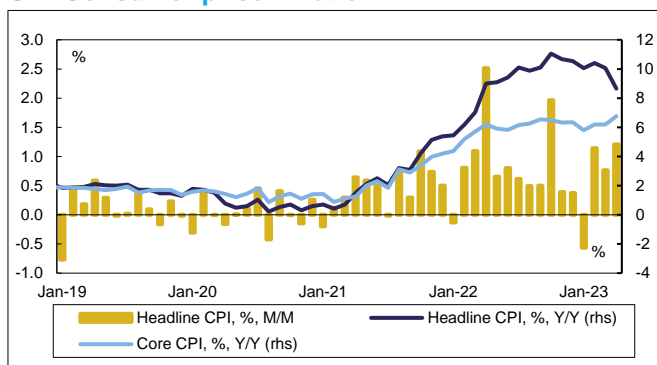
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

#### Germany: ifo expectations indices



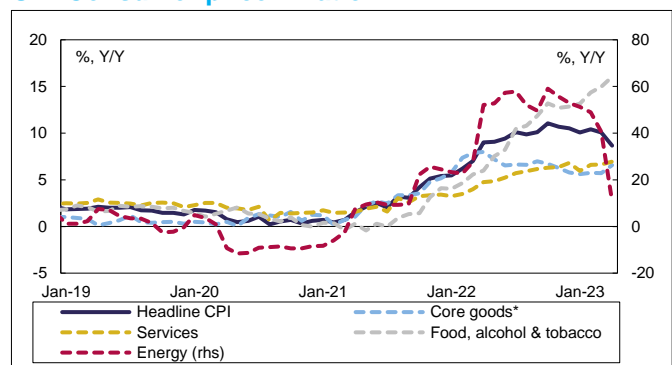
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

#### UK: Consumer price inflation



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

#### UK: Consumer price inflation



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

sector, higher prices in recreational goods, children’s clothes and second-hand cars, among others, pushed non-energy industrial goods inflation up by the most in more than a year (0.9ppt) to 6.6%Y/Y. Indeed, the monthly rise in core goods prices was a full percentage point higher than the long-run average for the month of April, representing the largest such deviation for nine months. Moreover, services inflation – a key focus of concern for the BoE – rose 0.3ppt to a series high of 6.9%Y/Y, with additional impetus coming from a diverse range of items including telecoms, housing rents, car maintenance and repair, and water and sewerage. So, the core CPI rate also exceeded all forecasts on the Bloomberg survey, leaping 0.6ppt to 6.8%Y/Y, the highest since March 1992. And, underscoring the strength and persistence of underlying inflation, the NIESR 10% trimmed mean CPI rate estimate rose 0.3ppt to a new high of 10.2%Y/Y, while the share of items in the basket with rising inflation rose to a seven-month high.

**BoE now likely to keep hiking rates into the second half of the year**

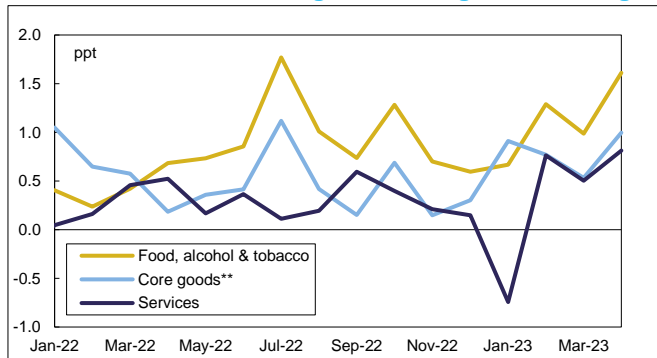
So, overall, today’s data suggest that firms across a wide range of sectors still feel comfortable passing on costs to consumers. In many cases, firms appear to be taking advantage of the generalized rise in inflation, pickup in demand, and diminished level of competition in the post-Brexit UK economy to bolster margins. Certainly, today’s figures were dreadful for consumers and the BoE, with the credibility of the latter now increasingly being called into question given the repeated upside inflation surprises of recent quarters. So, the MPC now seems more likely than not to keep hiking into the second half of the year, and will continue to do so until there is clear evidence that price- (and wage-) setting behavior has normalised. As well as tightening monetary policy again next month, we also now expect a further hike of 25bps in August. And, unless today’s upside surprises to inflation are followed over coming months with downside surprises, we cannot rule out a further upwards shift to the BoE’s inflation forecast in August, and additional tightening – which would undoubtedly take a significant toll on economic growth – thereafter too.

**The coming two days in the UK**

The dataflow in the UK over the coming two days will focus on the retail sector. Like with yesterday’s [manufacturing PMIs](#), the CBI’s distributive trades survey (tomorrow) is likely to show that activity on the UK high street was negatively impacted by a decline in footfall around the time of the King’s coronation. And while the official retail sales figures for April (Friday) will likely report some bounce back from the weather-dampened weakness in March, the expected increase of less than ½%M/M will fail to reverse just half the decline previously.

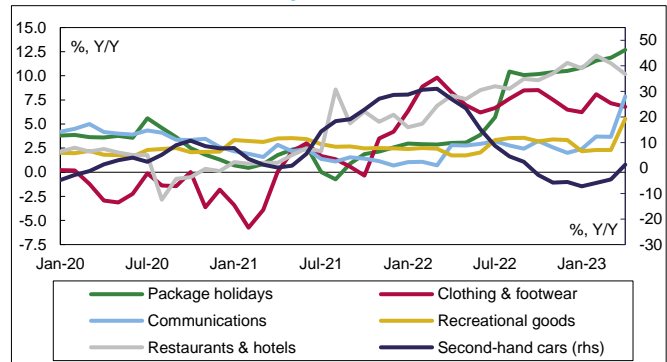
*The next edition of the Euro wrap-up will be published on 26 May 2023*

**UK: Deviations from long-run average M/M change**



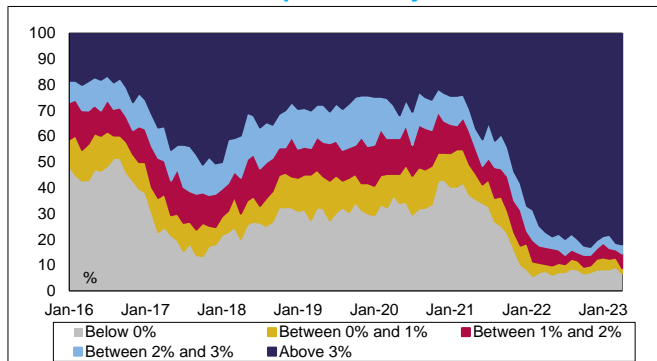
\*\*Non-energy industrial goods. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

**UK: Selected CPI components**



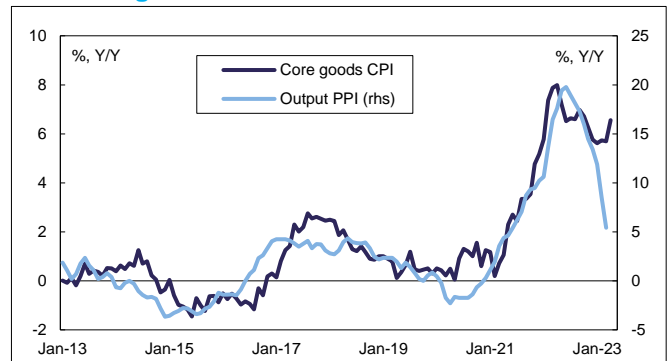
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

**UK: Share of CPI components by inflation rate**



Source: ONS and Daiwa Capital Markets Europe Ltd.

**UK: Core goods CPI and PPI inflation**









Source: Refinitiv 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	 ifo business climate index	May	91.7	93.0	93.6	93.4
	 ifo current assessment (expectations) balance	May	94.8 (88.6)	94.5 (91.7)	95.0 (92.2)	95.1 (91.7)
UK	 CPI (core CPI) Y/Y%	Apr	8.7 (6.8)	8.0 (6.1)	10.1 (6.2)	-
	 PPI output (input) prices Y/Y%	Apr	5.4 (3.9)	-	8.7 (7.6)	8.5 (7.3)
	 House price index Y/Y%	Mar	4.1	-	5.5	5.8
	 CBI industrial trends survey, total orders (selling prices)	May	-17 (21)	-	-20 (23)	-







#### Auctions

Country	Auction
Germany	 sold €1.18bn of 1.000% 2038 bonds at an average yield of 2.64%
	 sold €801mn of 4.750% 2040 bonds at an average yield of 2.66%
UK	 sold £3.00bn of 0.875% 2033 bonds at an average yield of 4.239%




Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

### Tomorrow's releases

#### Economic data

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Germany	 07.00	Final GDP Q/Q% (Y/Y%)	Q1	0.0 (-0.1)	-0.4 (0.9)
	 07.00	GfK consumer confidence	Jun	-24.8	-25.7
France	 07.45	INSEE business confidence	May	101	102
	 07.45	INSEE manufacturing confidence (production outlook)	May	100 (-5)	101 (-4)
France	 -	Retail sales Y/Y%	Apr	-	-5.6
UK	 11.00	CBI distributive trades (reported retail sales)	May	10	5






#### Auctions and events

Euro area	 10.00	ECB's de Guindos scheduled to present ECB Annual Report 2022 to European Parliament's Economic Committee
Italy	 10.00	Auction: €2.75bn of 3.4% 2025 bonds
UK	 17.30	BoE's Haskel scheduled to speak


Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

### Friday's releases

#### Economic data

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
France	 07.45	INSEE consumer confidence	May	84	83
Italy	 09.00	ISTAT consumer confidence	May	105.0	105.5
	 09.00	ISTAT business (manufacturing) confidence	May	- (102.0)	110.5 (103.0)
UK	 07.00	Retail sales including auto fuels M/M% (Y/Y%)	Apr	0.3 (-2.8)	-0.9 (-3.1)
	 07.00	Retail sales excluding auto fuels M/M% (Y/Y%)	Apr	0.4 (-2.8)	-1.0 (-3.2)

#### Auctions and events

Euro area	 10.00	ECB Chief Economist Lane to participate in panel discussion on "How quickly will inflation return to target?"
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Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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