

# Euro wrap-up

## Overview

- Bunds made big gains as Spanish inflation surprised on the downside, inflation expectations in the region softened, bank lending continued to slow, and the Commission's business sentiment indices deteriorated.
- Gilts also made gains despite a rise to a series high in May in the BRC's shop price survey measure of inflation.
- A busy Wednesday will bring flash May estimates of inflation from Germany, France and Italy as well as updates on German unemployment, French consumer spending and the ECB's latest financial stability report.

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### Daily bond market movements

Bond	Yield	Change
BKO 2.8 12/25	2.757	-0.106
OBL 2.2 04/28	2.350	-0.104
DBR 2.3 02/33	2.334	-0.096
UKT 0% 06/25	4.434	-0.052
UKT 1% 10/28	4.210	-0.062
UKT 3¼ 01/33	4.247	-0.087

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

Source: Bloomberg

## Euro area

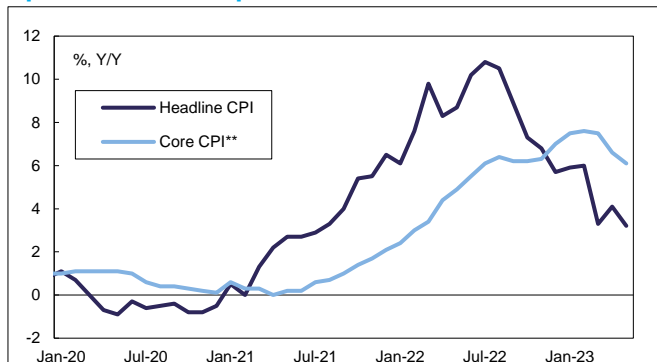
### Spanish inflation drops further than expected in May to give belated boost to Sanchez

The first of the national inflation data releases for May, which came today from Spain, provided some overdue good news with respect to price pressures. In particular, on the EU-harmonised HICP measure, Spanish inflation dropped a larger than expected 0.9pt to a near-two-year low of 2.9%Y/Y, 0.4ppt above the median forecast on the Bloomberg survey. Given that changes in wholesale power prices are typically passed on to consumers more quickly in Spain than elsewhere, it was no surprise that the national statistical agency stated that lower energy inflation was a key driver of the decline from April. However, food inflation also fell back. And encouragingly, the national core CPI measure, which excludes prices of fresh food and energy, fell a non-negligible 0.5ppt to a nine-month low of 6.1%Y/Y. While Spanish inflation has recently been the lowest in the euro area, tomorrow's equivalent data from the region's three largest member states are also expected to report a sizeable drop in the headline inflation rate, but markets will respond mostly to information regarding the core components. In Spain, meanwhile, the data provide a little boost to Prime Minister Pedro Sanchez after yesterday he called a snap general election for 23 July in the wake of his Socialist Party's poor showing in last weekend's regional elections. The Socialists clearly lag the centre-right People's Party in the polls, although the latter would likely need to gain the support of the far-right Vox party to be able to govern with a working majority.

### Consumer and firms' selling price expectations point to improvement in inflation outlook

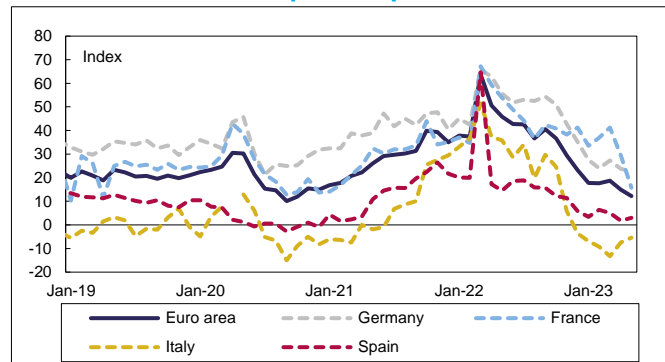
Admittedly, the improvement in Spain's inflation outlook was somewhat at odds with the findings of the latest Commission survey, which reported a pickup in consumer price expectations in that country in May, albeit this still represented the second-lowest reading for more than two years. Moreover, this contrasted with a marked improvement in France, ongoing downtrend in Germany and negative reading in Italy, to leave the aggregate euro area index moderating for the seventh month out of the past eight to its lowest since October 2020 and more than 10pts below the long-run average. More importantly perhaps, and likely reflecting easing supply-side pressures as well as sub-potential demand, the share of firms expecting to increase prices over the coming three months also fell markedly in May. This was again particularly striking in the manufacturing sector, where demand appears most subdued and for which the index fell to its lowest since November 2020 to be some 54pts below last year's peak. The respective construction index was also the lowest for more than two years, while the retail index moved closer to the long-run average than last year's peak. And while the downtrend in services selling price expectations was more marginal, the index still edged down to a nineteen-month low and suggests that the annual services HICP rate of inflation might well be close to its peak.

### Spain: Consumer price inflation\*



\*National measure. \*\*Core CPI excluding fresh food and energy.  
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

### Euro area: Consumer price expectations\*



\*Over coming twelve months. Source: EC, Refinitiv and Daiwa Capital Markets Europe Ltd.

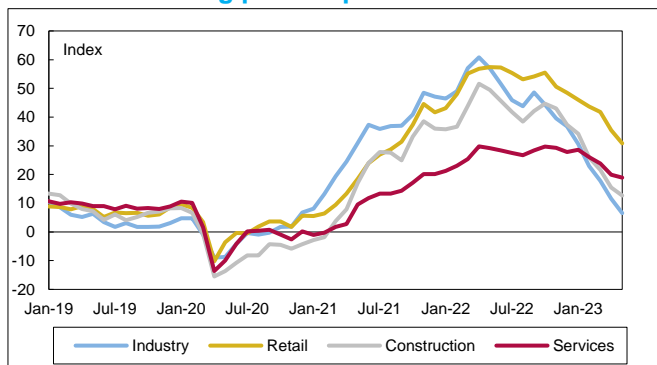
## Commission sentiment index falls to six-month low, with firms across all sectors more downbeat

Contrasting with the pickup in GDP growth this quarter implied by the PMIs, the Commission's economic sentiment indices pointed to a loss of momentum in Q2. Indeed, the headline euro area ESI fell by a larger-than-expected 2.5pts in May to a six-month low of 96.5, 3½% below the long-run average and trending some 1.6pts below the Q1 average. Like the PMIs, today's survey suggested the recent weakness has been driven by the euro area's core countries, with the German ESI down 2.9pts in May to a five-month low and trending so far in Q2 some 0.8pt below the Q1 average. And despite rising in May, the French ESI was trending some 3½pts below the Q1 level. Admittedly, the Italian ESI saw some payback for the strength in April, down 2.3pts in May but nevertheless still up so far in Q2. And the Spanish ESI rose to a four-month high to be some 1½pts above the Q1 average. Notwithstanding the modest improvement in consumer confidence – for which the respective index rose 0.1pt to -17.4 – the deterioration in sentiment in May was widespread at the sectoral level. Perhaps reflecting a slight worsening in households' purchasing intentions, retailers were notably more downbeat, with the respective index dropping by the most since the start of 2021. Services confidence was also the least positive since November amid a worsening in past and expected demand. Despite easing supply constraints, manufacturers were the most downbeat in 2½ years as the production trend was considered to be the worst since the outbreak of the pandemic, order books continued to decline and inventories of finished products were increasingly assessed to be too large.

## Lending to businesses continues to drop as ECB policy tightening takes its toll

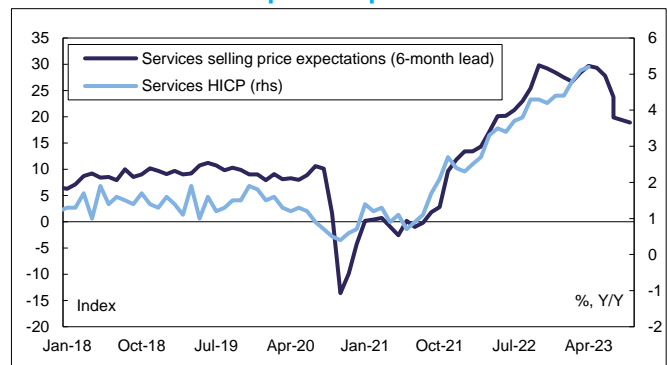
Consistent with the ECB's recent bank lending survey, which reported a marked tightening in credit standards and a significant drop in loan demand in response to the marked rise in interest rates seen since July, today's monetary data showed a fifth negative reading in six months in net bank lending to businesses. Admittedly, when excluding sales and securitisations, the net flow was only slightly negative in April at -€1.8bn. Nevertheless, it took the cumulative drop in the adjusted stock of loans to NFCs since October to a non-negligible €31.7bn. Over that period, the stock of loans to NFCs of up to one-year maturity was down more than €76bn to suggest a fall in borrowing needs for working capital. Net new loans of maturities greater than five years – which account for roughly 60% of the total – fell a more modest €3.1bn, nevertheless still suggestive of weakness in business fixed investment. Given the significant rise in lending earlier last year, the annual rate of growth in loans to NFCs remained in positive territory, albeit slowing to a thirteen-month low of 4.6%Y/Y on an adjusted basis. Meanwhile, consistent with ongoing weakness in the residential property market, the net flow of loans to households for house purchase slowed in April to just €1.75bn, the lowest since July 2017, to leave the cumulative flow on a three-month basis at €14.3bn, down more than €63bn from the peak last summer. And while it rose to a five-month high, the flow of consumer credit remained subdued at €6.3bn in the three months to April, down from the average of more than €10bn in the three years ahead of the pandemic.

### Euro area: Selling price expectations



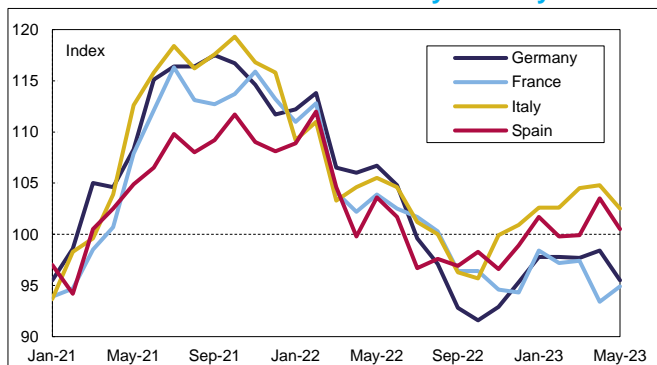
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

### Euro area: Services price expectations



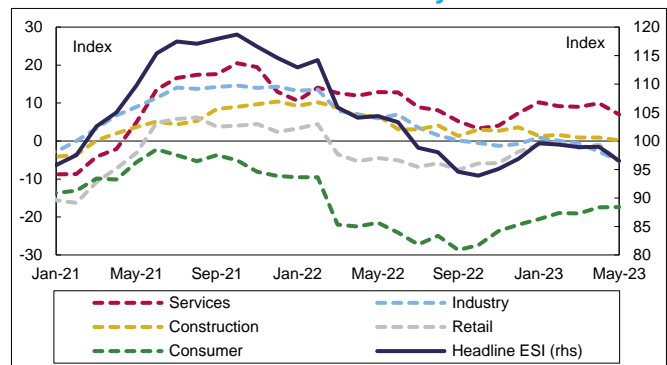
Source: EC, Refinitiv, Bloomberg and Daiwa Capital Markets Europe Ltd.

### Euro area: Economic sentiment by country



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

### Euro area: Economic sentiment by sector



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

## Bank deposits continue to decline in response to rising interest rates

Just as for loans, ECB rate hikes also continue to impact bank deposits. Overnight deposits of households and NFCs, which have barely benefited at all from higher interest rates, dropped in April for the seventh and eighth successive months respectively. And while time deposits with maturities of between three months to two years continued to rise, the overall stock of household deposits fell €14bn to the lowest level since September with that for NFCs down almost €6bn to the lowest level since December. In terms of money supply, M1, which includes currency in circulation and overnight deposits, fell a record 5.2%Y/Y in April. Growth in the broader monetary aggregate M3, which includes time deposits and money market funds among others, slowed to a near nine-year low of 1.9%Y/Y, a level previously considered well below levels consistent with achievement of the ECB's inflation objective over the medium term.

## The day ahead in the euro area

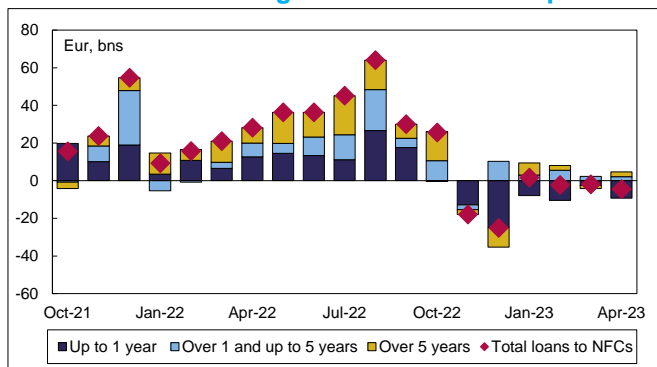
Ahead of Thursday's flash release of the euro area consumer price inflation data for May, the focus tomorrow will be on the equivalent figures from Germany, France and Italy. As with today's Spanish release, these are expected to reveal a welcome slowdown in inflation across the three largest member states. In particular, the German HICP rate is expected to fall 0.9ppt to a fifteen-month low of 6.7%Y/Y, with the French and Italian rates down 0.5ppt and 1.2ppt respectively to an eight-month low of 6.4%Y/Y and twelve-month low of 7.5%Y/Y in May. Among other releases on a busy day, tomorrow will also bring German labour market figures for May and French consumer spending data for April. In addition, after German GDP in Q1 was revised down significantly last week to a contraction of 0.3%Q/Q, the second estimates for France and Italy, which initially estimated growth of 0.2%Q/Q and 0.5%Q/Q respectively, are also due. Meanwhile, the ECB will publish its latest quarterly Financial Stability Review.

## UK

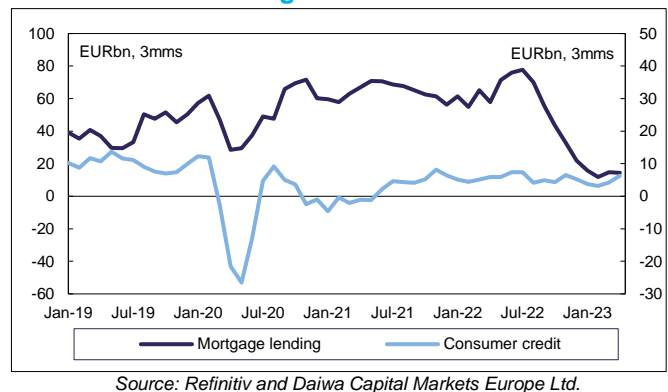
### BRC survey suggests no let-up in inflation on the high street in May

After last week's [inflation](#) data provided extremely bad news for the BoE, with significant upside surprises to both headline and core CPI measures in April, today's BRC shop price survey suggested no relief this month. In particular, the BRC's headline measure of inflation on the UK high street rose 0.2ppt in May to 9.0%Y/Y, a new high on the series dating back to 2005. According to the survey detail, food inflation edged lower, by 0.3ppt to 15.4%Y/Y, as the pace of increase in fresh items passed its peak. However, prices of processed food and non-food items also accelerated, with the latter inflation rate back up 0.3ppt to 5.8%Y/Y, just 0.1ppt below March's series high, even as the BRC cited big discounts in footwear, books

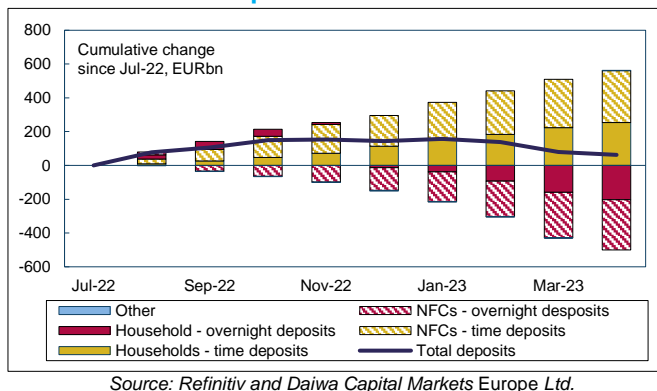
### Euro area: Net lending to non-financial corporations



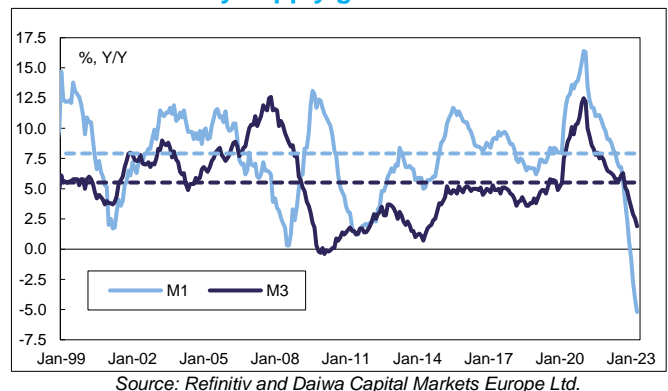
### Euro area: Net lending to households



### Euro area: Bank deposits



### Euro area: Money supply growth

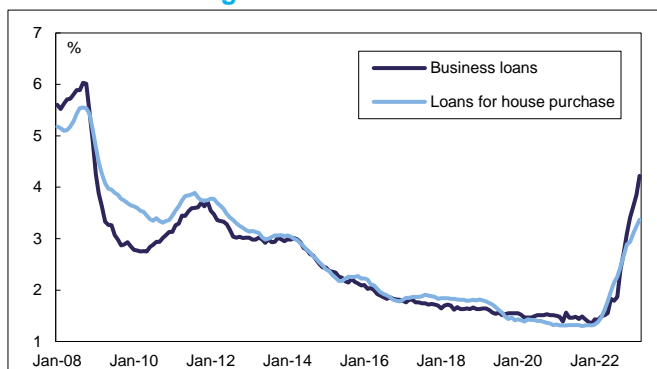


and home entertainment. With concerns about high inflation uppermost in the minds of the electorate, reports suggest that the UK government has been drawing up plans to encourage supermarkets to cap prices of staple food. However, as for other items, high food inflation currently reflects a range of factors, not least the burden of Brexit-related border checks and regulation as well as pressures on costs of energy, transport, and labour. Admittedly, there might well be merits in a stocktake by policymakers of the level of competition among UK supermarkets, with resulting actions potentially capable of weighing on prices at the margin. However, we note that intense competition on the high street was until recently a regular source of significant downwards pressure on UK inflation. And, certainly, the voluntary price controls reportedly mooted by the government appear likely to be more of a presentational gimmick than a substantive solution to the persistence of high inflation.

## The day ahead in the UK

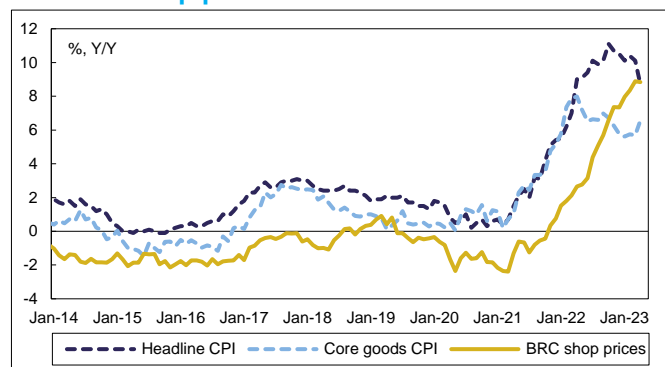
A quiet UK economic data calendar tomorrow brings only the publication of the Lloyds business barometer for May. We will also hear from the very hawkish MPC member Catherine Mann, who is due to speak in the afternoon on 'Central banks, inflation and monetary policy'.

### Euro area: Average interest rates on new loans



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

### UK: BRC shop price 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
Euro area	M3 money supply Y/Y%	Apr	<b>1.9</b>	2.0	2.5	-
	European Commission's ESI	May	<b>96.5</b>	99.0	99.3	99.0
	European Commission's industrial (services) confidence	May	<b>-5.2 (7.0)</b>	-3.1 (10.2)	-2.6 (10.5)	-2.8 (9.9)
	European Commission's final consumer confidence	May	<b>-17.4</b>	-17.4	-17.5	-
Italy	PPI Y/Y%	Apr	<b>-3.5</b>	-	3.0	-
Spain	Preliminary HICP (CPI) Y/Y%	May	<b>2.9 (3.2)</b>	3.3 (3.5)	3.8 (4.1)	-
	Retail sales Y/Y%	Apr	<b>5.5</b>	-	9.5	<b>9.9</b>
UK	BRC shop price index Y/Y%	May	<b>9.0</b>	-	8.8	-










#### Auctions

Country	Auction
Italy	sold €5.0bn of 3.80% 2028 bonds at an average yield of 3.79%
	sold €2.0bn of 4.40% 2033 bonds at an average yield of 4.24%
	sold €2.5bn of 4.35% 2033 bonds at an average yield of 4.32%
	sold €1.5bn of 2028 floating-rate bonds at an average yield of 4.38%




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		08.55 Unemployment change '000s (rate %)	May	15.0 (5.6)	24.0 (5.6)
		13.00 Preliminary HICP (CPI) Y/Y%	May	6.7 (6.4)	7.6 (7.2)
France		07.45 Preliminary HICP (CPI) Y/Y%	May	6.5 (5.5)	6.9 (5.9)
		07.45 PPI Y/Y%	Apr	-	12.9
		07.45 Consumer spending M/M% (Y/Y%)	Apr	0.3 (-3.7)	-1.3 (-4.2)
		07.45 GDP – second estimate Q/Q% (Y/Y%)	Q1	<u>0.2 (0.8)</u>	0.0 (0.4)
Italy		09.00 GDP – second estimate Q/Q% (Y/Y%)	Q1	<u>0.5 (1.8)</u>	0.1 (1.4)
		10.00 Preliminary HICP (CPI) Y/Y%	May	7.6 (7.2)	8.7 (8.2)
UK		00.01 Lloyds business barometer	May	-	33

### Auctions and events

Euro area		09.00 ECB publishes its Financial Stability Review
Germany		10.30 Auction: €3bn of 2.1% 2029 bonds
UK		14.15 BoE Mann scheduled to speak

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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