

Euro wrap-up

Overview

- Bunds made significant gains as the flash estimates of May inflation in Germany and France surprised on the downside.
- Gilts also made big gains on a quiet day for UK economic data.
- Thursday will bring the flash euro area inflation estimates for May, along with new data for euro area unemployment, German retail sales and UK bank lending, and the account of the ECB's May monetary policy meeting.

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Daily bond market movements

| Bond | Yield | Change |
|---------------|-------|--------|
| BKO 2.8 12/25 | 2.685 | -0.075 |
| OBL 2.2 04/28 | 2.262 | -0.089 |
| DBR 2.3 02/33 | 2.267 | -0.069 |
| UKT 0% 06/25 | 4.303 | -0.106 |
| UKT 1% 10/28 | 4.080 | -0.117 |
| UKT 3¼ 01/33 | 4.170 | -0.069 |

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

Source: Bloomberg

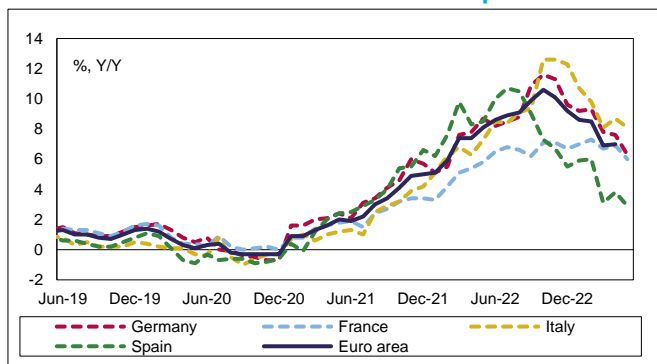
Euro area

Inflation takes further step down in the largest member states, but core drop likely relatively modest

Following yesterday's downside surprise in the flash Spanish inflation figures for May, today's equivalent data from the other large member states similarly reported significant declines in headline inflation. While energy was once again the main driver, thanks to base effects related to household bills and lower prices of auto fuels, food inflation appears to have peaked. And certain core components fell back too, seemingly in part reflecting the pass-through of lower energy prices to transport services as well as the improved supply-demand balance for core goods.

- In Germany, the EU-harmonised HICP measure of inflation fell a steeper-than-expected 1.3ppts in May to a 14-month low of 6.3%Y/Y, 0.4ppt below the median forecast on the Bloomberg survey. The limited detail published for the national CPI rate, which fell 0.8ppt to 5.1%Y/Y, suggested that all major components subtracted from inflation this month. Still benefiting from government support measures as well as lower heating oil and auto fuel prices, energy inflation fell 4.2ppts to 2.6%Y/Y, the lowest since February 2021. Only in part due to a base effect, food inflation slowed for the second month and by more than 2ppts to a nine-month low of 14.9%Y/Y. Thanks not least to the government's new €49 per month public transport ticket (the so-called "Deutschlandticket"), services inflation moderated 0.2ppt to 4.5%Y/Y. And our calculations suggest that core goods inflation might have slowed by about 0.6ppt to 6.6%Y/Y. As a result, we think that German core inflation on the national measure eased by about 0.3ppt to 5.5%Y/Y. However, we note that base effects associated with the German government's €9 public transport ticket last June, July and August, as well as an increased basket weight on package holidays, will provide a significant albeit temporary boost to services and core inflation over the summer months.
- In France, HICP inflation fell a larger-than-expected 0.9ppt in May to a 12-month low of 6.0%Y/Y. Encouragingly, the limited detail published for the national CPI rate, which fell 0.8ppt to 5.1%Y/Y, suggested that all major components subtracted from inflation this month. Unsurprisingly, energy inflation fell the most, down 4.8ppts to 2.0%Y/Y, with lower petrol prices providing impetus. Thanks to a slowing in both the fresh and processed sectors, food inflation slowed 0.9ppt to 14.1%Y/Y. With transportation prices falling, and other items in the category slowing, services inflation moderated 0.2ppt to 3.0%Y/Y, a rate hardly suggestive of significant second-round effects on inflation. And inflation of manufactured goods slowed 0.5ppt to 4.1%Y/Y as prices in the sector were judged now to be stable. French core inflation appears to have slowed by about 0.3ppt from April's high, to 3.4%Y/Y.

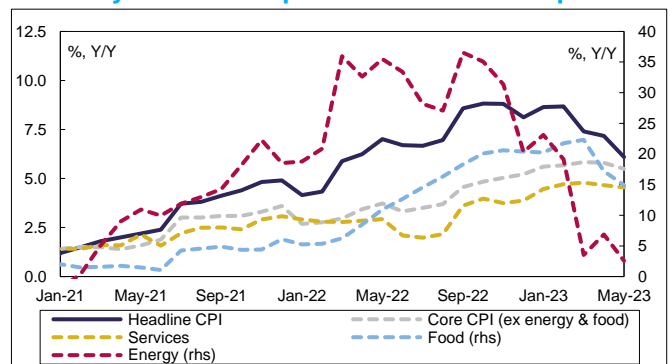
Euro area member states: Consumer price inflation*



*EU-harmonised HICP rate.

Source: Refinitiv & Daiwa Capital Markets Europe Ltd.

Germany: Consumer price inflation* & components



*National CPI measure. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

- In Italy, the 0.6ppt decline in HICP inflation to 8.1%Y/Y merely reversed the increase in April. The causes of the decline, however, were similar to in France. On the EU-harmonised measure, energy inflation dropped almost 5ppts, albeit remaining more elevated than in the other large member states at 11.9%Y/Y. Thanks to a softer processed component, inflation of food, alcohol and tobacco eased 0.1ppt to 10.9%Y/Y. Non-energy industrial goods inflation moderated 0.2ppt to 5.3%Y/Y. But despite a softening in transport and hospitality, services inflation was unchanged at 5.1%Y/Y. And so, core inflation on the EU measure eased just 0.1ppt to a still-elevated 5.2%Y/Y.

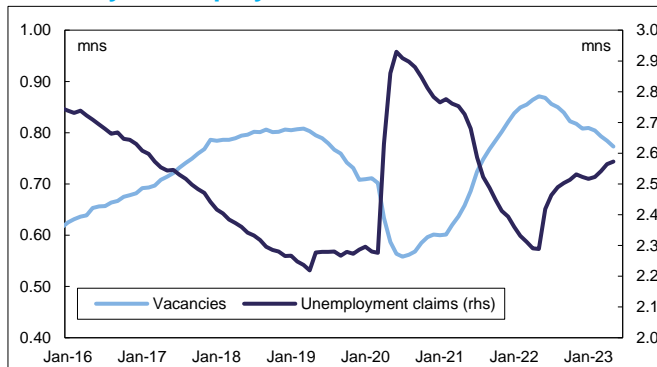
Beyond the largest member states, HICP inflation fell 1.5ppts in Portugal and 0.9ppt in Ireland, to 5.4%Y/Y in both countries, representing 15- and 16-month lows respectively. But data released yesterday reported a smaller drop in the national measure in Belgium (down 0.4ppt to 5.2%Y/Y), but no change in Slovenia (9.4%Y/Y). So, we expect euro area HICP inflation to fall 0.9ppt to 6.1%Y/Y. But the detail released so far suggests that the core measure might have fallen just 0.2ppt from April's series high to 5.4%Y/Y, which would certainly not be sufficient to stop the ECB raising rates again on 15 June.

German labour market stable, French spending weak, but Italian GDP revised up

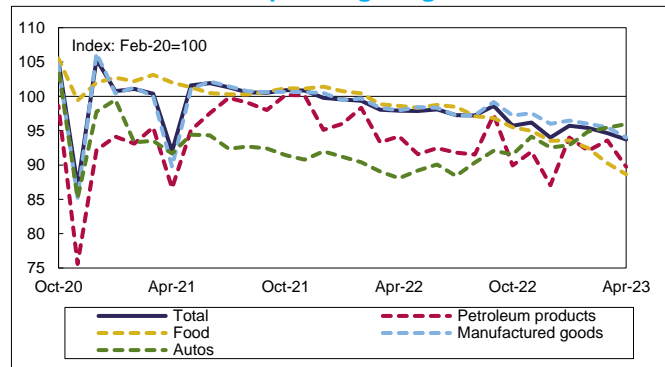
Beyond the flash inflation, today's other new economic data from the largest member states were a mixed bag. In particular:

- Despite concerns about a continued lack of economic recovery momentum in Germany, the country's labour market remains broadly resilient, albeit somewhat softer than a year ago. Jobless claims rose for the fourth successive month in May. But the increase of just 9k (to 2.573mn) was less than expected and below the average (14k) over this losing sequence. And it left the unemployment claims rate at 5.6% for a third month, up just 0.6ppt from a year earlier and the pre-pandemic level, despite the increase of almost 377k in the number of registered Ukrainian jobseekers in the year to April. The number of vacancies also dropped in May for a fourth successive month to 773k, almost 100k lower than a year earlier, but still about 60k above the pre-pandemic level in February 2020. Employment continued to rise in April, albeit by just 15k, the least in nine months.
- Recent surveys suggest that French consumer confidence is particularly downbeat, with the INSEE survey measure down roughly 20% from the long-run average since the start of the year. And while the release of pent-up demand saw households increase consumption of services by 0.6%Q/Q in Q1, their spending on manufactured goods dropped 0.8%Q/Q (further than initially estimated) as real disposable income fell. Today's data also reported a bigger than expected decline in consumption of goods at the start of Q2. Indeed, overall household consumption on goods fell 1.0%M/M, the most in six months. That left it at a two-year low, more than 1½% below the Q1 average and more than 6% below the pre-pandemic level in February 2020. With supply blockages easing, spending on

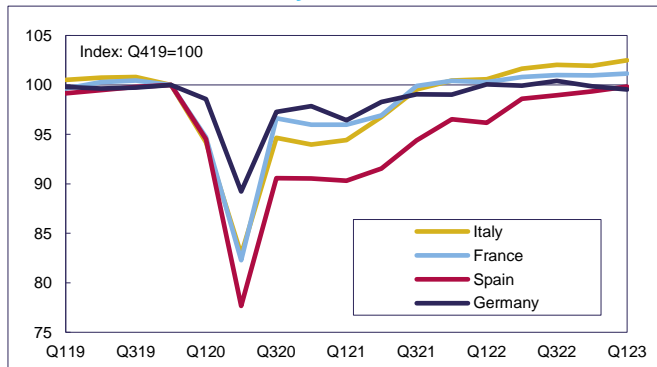
Germany: Unemployment claims & vacancies



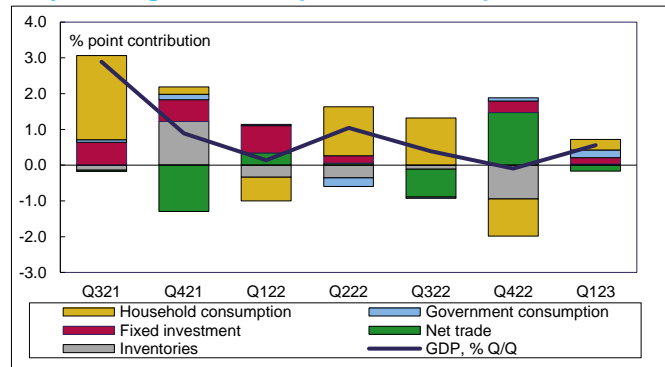
France: Consumer spending on goods



Euro area: GDP level by member state



Italy: GDP growth & expenditure components



autos rose for a fourth month to the highest level since January 2021, to be 4.1% below the pre-pandemic level. But spending on household durables (-0.8%M/M), food (-1.8%M/M) and energy including auto fuel (-1.9%M/M) was particularly weak.

- Due not least to a sharp drop in German public spending on Covid vaccines, the estimate of German GDP in Q1 had last week been revised down from flat to a contraction of 0.3%Q/Q. In contrast, however, Italian GDP growth was today revised up, by 0.1ppt to a surprisingly strong 0.6%Q/Q. As a result, euro area GDP growth might yet avoid a downwards revision from the current estimate of 0.1%Q/Q when the final estimate is published on 8 June. Ireland's revisions (due Friday), which can often be substantive, could well be the determining factor. Despite the shock to real incomes from high inflation, Italian growth in Q1 was encouragingly driven by domestic demand, with household consumption up 0.5%Q/Q, government consumption up 1.2%Q/Q and fixed investment up 0.8%Q/Q. While the euro area's core countries appear to be trading water again in Q2, surveys point to continued positive Italian growth, benefiting not least from projects related to the EU recovery funds.

The day ahead in the euro area











All eyes tomorrow will be on the flash euro area inflation estimates for May. In line with the national data released over the past two days, we expect headline euro area inflation to drop about 0.9ppt to 6.1%Y/Y, a fifteen-month low. The risks to that view are skewed to the downside. The fall will be led by a further decline in energy and food inflation. Non-energy industrial goods and services inflation are also expected to have moderated somewhat too. But the decline in core inflation will be more marginal, perhaps just 0.2ppt to 5.4%Y/Y. April figures for the euro area unemployment rate and German retail sales will also be published, with the former likely to remain unchanged at the series low of 6.5%. Final manufacturing PMIs and new car registrations figures for May are also due. Also of note tomorrow will be the publication of the ECB's account of the [4 May monetary policy meeting](#), when the Governing Council slowed the pace of rate hikes to 25bps but also signalled a likely acceleration in the pace of Quantitative Tightening from July.

UK

The day ahead in the UK

The UK data focus tomorrow will be the BoE's lending data for April, which will likely flag negative impacts from the ongoing tightening in financial conditions. In particular, net mortgage lending is expected to remain subdued, coming in around £0.6bn in April, compared with £4.1bn in April last year. We will also get the release of the final manufacturing PMIs for May and Nationwide house price indices for May. The flash PMIs suggested that the manufacturing sector is in retreat, with the output index down 0.9pt to 47.4 to be consistent with contraction for a third successive month.


















European calendar

| Today's results | | | | | | | |
|-----------------|--|--------|--------------------|-------------------------------------|-------------|-------------|--|
| Economic data | | | | | | | |
| Country | Release | Period | Actual | Market consensus/ Daiwa forecast | Previous | Revised | |
| Germany |  Unemployment change '000s (rate %) | May | 9.0 (5.6) | 15.0 (5.6) | 24.0 (5.6) | 23 (-) | |
| |  Preliminary HICP (CPI) Y/Y% | May | 6.3 (6.1) | 6.7 (6.4) | 7.6 (7.2) | - | |
| France |  Preliminary HICP (CPI) Y/Y% | May | 6.0 (5.1) | 6.5 (5.5) | 6.9 (5.9) | - | |
| |  PPI Y/Y% | Apr | 7.0 | - | 12.9 | 12.8 | |
| |  Consumer spending M/M% (Y/Y%) | Apr | -1.0 (-4.3) | 0.3 (-3.7) | -1.3 (-4.2) | -0.8 (-3.4) | |
| |  GDP – second estimate Q/Q% (Y/Y%) | Q1 | 0.2 0.9 | <u>0.2 (0.8)</u> | 0.0 (0.4) | - | |
| Italy |  GDP – second estimate Q/Q% (Y/Y%) | Q1 | 0.6 (1.9) | <u>0.5 (1.8)</u> | 0.1 (1.4) | - | |
| |  Preliminary HICP (CPI) Y/Y% | May | 0.6 (1.9) | 7.6 (7.2) | 8.7 (8.2) | - | |
| UK |  Lloyds business barometer | May | 28 | - | 33 | - | |
| Auctions | | | | | | | |
| Country | Auction | | | | | | |
| Germany |  sold €2.50bn of 2.1% 2029 bonds at an average yield of 2.23% | | | | | | |












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 |  | 09.00 | Final manufacturing PMI | May | <u>44.6</u> | 45.8 |
| |  | 10.00 | Preliminary (core) HICP Y/Y% | May | <u>6.2 (5.5)</u> | 7.0 (5.6) |
| |  | 10.00 | Unemployment rate % | Apr | 6.5 | 6.5 |
| Germany |  | 07.00 | Retail sales M/M% (Y/Y%) | Apr | 1.0 (-5.8) | -2.2 (-6.2) |
| |  | 08.55 | Final manufacturing PMI | May | <u>42.9</u> | 44.5 |
| France |  | 08.50 | Final manufacturing PMI | May | <u>46.1</u> | 45.6 |
| |  | - | New car registrations* Y/Y% | May | - | 21.9 |
| Italy |  | 08.45 | Manufacturing PMI | May | 45.8 | 46.8 |
| |  | 09.00 | Unemployment rate % | Apr | 7.8 | 7.8 |
| |  | 17.00 | New car registrations Y/Y% | May | - | 29.2 |
| Spain |  | 08.15 | Manufacturing PMI | May | 47.8 | 49.0 |
| |  | - | New car registrations* Y/Y% | May | - | 8.2 |
| UK |  | 07.00 | Nationwide house price index M/M% (Y/Y%) | May | -0.5 (-3.7) | 0.5 (-2.7) |
| |  | 09.30 | Final manufacturing PMI | May | <u>46.9</u> | 47.8 |
| |  | 09.30 | Net consumer credit £bn (Y/Y%) | Apr | 1.5 (-) | 1.6 (7.9) |
| |  | 09.30 | Net mortgage lending £bn (approvals '000s) | Apr | 0.7 (54.0) | 0.0 (52.0) |
| |  | 09.30 | M4 money supply Y/Y% | Apr | - | 0.4 |

Auctions and events

| | | | |
|-----------|---|-------|---|
| Euro area |  | 08.55 | ECB's Knot scheduled to speak |
| |  | 10.30 | ECB President Lagarde scheduled to speak |
| |  | 12.30 | ECB publishes account of 3-4 May policy meeting |
| |  | 13.30 | ECB's Villeroy scheduled to speak |
| France |  | 09.50 | Auction: 3.0% 2033 bonds |
| |  | 09.50 | Auction: 2.5% 2043 bonds |
| |  | 09.50 | Auction: 3.0% 2054 bonds |
| Spain |  | 09.30 | Auction: 2.8% 2026 bonds |
| |  | 09.30 | Auction: 0.8% 2029 bonds |
| |  | 09.30 | Auction: 1.9% 2052 bonds |
| |  | 09.30 | Auction: 0.7% 2033 index-linked bonds |

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

Access our research blog at:

<https://www.uk.daiwacm.com/ficc-research/recent-blogs>

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