

Euro wrap-up

Overview

- While the ECB account from May's policy-setting meeting noted that developments in core inflation were broadly seen as worrisome, Bunds made gains as euro area headline inflation took a chunky step down in May to its lowest in fifteen months and core inflation moderated somewhat too.
- Gilts also made gains as UK bank lending data revealed the second largest net mortgage repayment on record.
- The coming week will bring euro area retail sales data for April, updated Q1 GDP figures and final services and construction PMIs for May.

Chris Scicluna
+44 20 7597 8326

Emily Nicol
+44 20 7597 8331

Daily bond market movements

Bond	Yield	Change
BKO 2.8 12/25	2.688	-0.009
OBL 2.2 04/28	2.239	-0.033
DBR 2.3 02/33	2.244	-0.034
UKT 0% 06/25	4.289	-0.042
UKT 1% 10/28	4.051	-0.046
UKT 3¼ 01/33	4.119	-0.062

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

Euro area

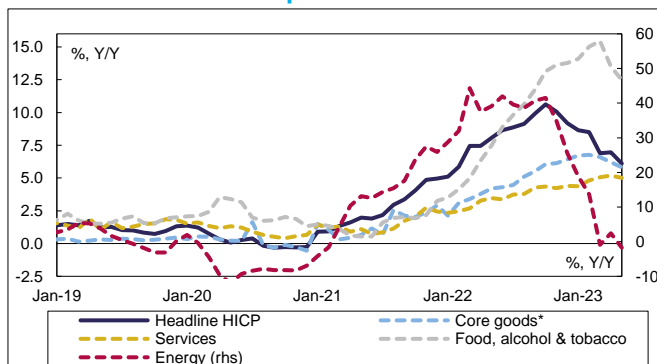
Headline inflation takes step down to 15-month low as core rate falls again

As had been made clear from the national data published over the past couple of days, euro area consumer price inflation took a significant step down in May. Indeed, according to today's flash estimates, HICP inflation fell a chunky 0.9ppt to a 15-month low of 6.1%Y/Y, with the equivalent national rates down in every member state to report bar the Netherlands and Malta. Energy was once again the main driver, with prices down 2.2%M/M thanks to the pass-through of recent declines in wholesale prices to consumers in certain countries, as well as lower prices of auto fuels. Indeed, given a significant base effect too, the annual rate of energy inflation dropped more than 4ppts to a 27-month low of -1.7%Y/Y. With prices of fresh items unchanged on the month, food inflation also now appears to have peaked, with the broader aggregate including drinks and tobacco down 3ppts from the peak to 12.5%Y/Y in May. And most encouragingly, the major core components fell back too. In part reflecting lower prices of public transport, including Germany's new €49 per month public "Deutschlandticket" as well as the pass-through of lower fuel prices to consumers, services inflation slowed for the first time in six months, dropping 0.2ppt from April's series high to 5.0%Y/Y. And the improved global supply-demand balance supported a second successive drop in core goods inflation, which fell 0.4ppt to 5.8%Y/Y. So, core inflation fell 0.3ppt to a four-month low of 5.3%Y/Y, 0.4ppt below March's series high.

Momentum moderates slightly but core rate to remain too high and sticky over the near term

In aggregate, euro area consumer prices were unchanged in May, the first month that they have failed to rise since January. And on a seasonally adjusted three-month basis, momentum slowed for all major components. However, the increases in services, core goods and food prices in May were still slightly above the respective long-run averages for the month. Core inflation at 5.3%Y/Y in May will still feel too high for the ECB's comfort. And 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 temporary impetus to the services component over the summer months. So, we expect core inflation to be sticky over the near term. So, the evidence of a significant and sustained drop in core inflation that the majority of the Governing Council is looking for to justify a pause in the tightening cycle is unlikely to be visible before September. Moreover, while we still expect a further drop in headline inflation of a similar magnitude in June thanks to base effects in non-core items, that would still leave the Q2 outturn bang in line with the ECB's most recent forecast. Therefore, with the euro area unemployment rate confirmed at a series low of 6.5% in April, today's data will certainly not stop the Governing Council from hiking rates again by 25bps in June. And further tightening in July is also still likely in the absence of a sudden deterioration in economic activity that would have to intensify in manufacturing beyond the extent reported in today's final May PMIs and probably have to extend to the services sector too.

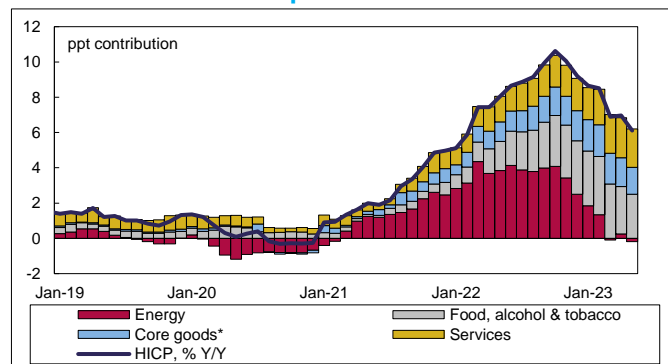
Euro area: Consumer price inflation



*Non-energy industrial goods.

Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Consumer price inflation



*Non-energy industrial goods.

Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

German retail sales tick up in April to hint at more stable quarter for consumption

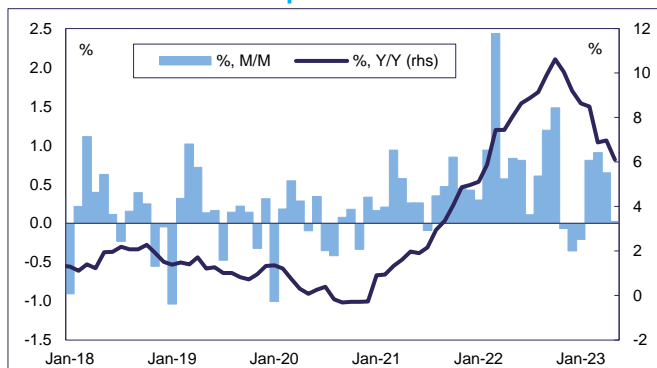
While German household confidence has picked up steadily over the past six months, rising to a 13-month high in May, consumers remain reluctant to spend. Admittedly, having dropped steadily for four successive quarters, German retail sales volumes ticked up at the start of Q2. However, the rise of 0.8%M/M followed a revised fall of 1.3%M/M, and merely left the level unchanged from the Q1 average. And sales volumes were still more than ½% below the pre-pandemic level in February 2020 and down a hefty 8.6%Y/Y. As consumers tried to economise in the face of record food inflation, the volume of sales of such items was down 9.7%Y/Y while non-food sales were down a slightly smaller 8.1%Y/Y. In nominal terms, however, the total value of sales was down just 0.8%Y/Y, with food sales up 3.0%Y/Y but non-food sales down 3.3%Y/Y. While real spending on goods seems highly likely to remain subdued over the remainder of the second quarter, given stronger expenditure on services, we expect German private consumption to return to modest positive growth in Q2 following sharp drops of 1.7%Q/Q and 1.2%Q/Q in Q4 and Q1 respectively.

The week ahead in the euro area

The coming week's economic data calendar sees the release of euro area retail sales for April on Tuesday. Following softer-than-expected national results, including yesterday's sharp drop in French consumer spending on goods and modest increases in Germany and Spain, euro area retail sales are likely to record only modest growth in the first month of Q2, insufficient to reverse the drop in March, as inflationary pressures continued to weigh. Thursday's updated estimate of euro area Q1 GDP might confirm that GDP returned to growth in Q1, albeit only by a very marginal 0.1%Q/Q following a flat Q422. However, the significant downward revision in Germany more than offsets the upwards revisions in Italy and Belgium, and so upwards revisions elsewhere will be required if the growth in the euro area is not to be revised away. The first expenditure breakdown will show that household consumption contracted for a second successive quarter, while government consumption also fell. But modest contributions from fixed investment and net trade should have provided offsets. Euro area producer price inflation numbers on Monday will maintain their downward trend, indicating that inflationary pressures at the factory gate continue to ease. The ECB will also study the findings of its own consumer expectations survey, due Tuesday, which will provide an update on inflation expectations.

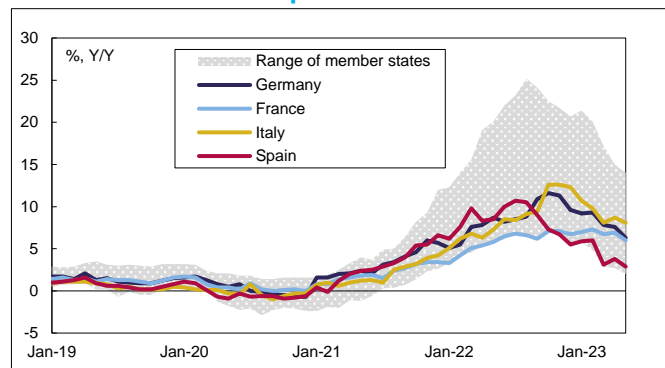
At the country level, German trade figures will be published on Monday, followed by factory orders and industrial production data (Tuesday and Wednesday respectively), which are likely to tally with recent survey results to suggest that conditions remain challenging for manufacturers. French IP figures will be published tomorrow followed by Spanish and Italian industrial output data the following Thursday and Friday respectively. Survey-wise, the final services and composite PMIs (Monday)

Euro area: Consumer price inflation



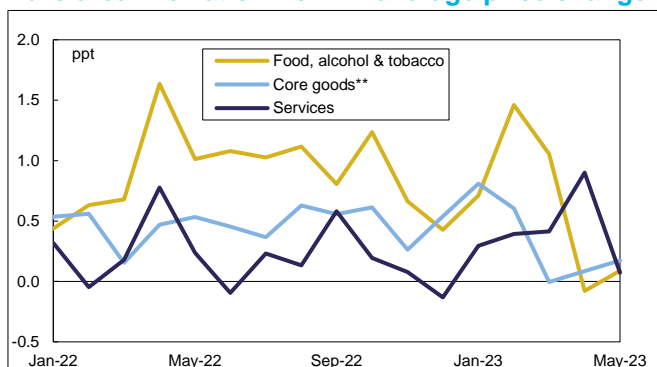
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Consumer price inflation



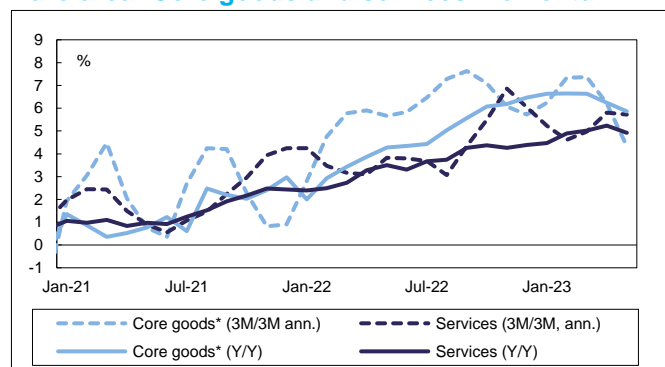
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Deviation from I-r average price change*



* Deviation from long-run monthly price change **Non-energy industrial goods.
 Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Core goods and services momentum



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

will report relatively firm growth in services accompanied by persistent inflation pressures in that sector. The [euro area preliminary services activity PMI](#) edged down just 0.3pt from April's twelve-month high to remain elevated at 55.9.

UK

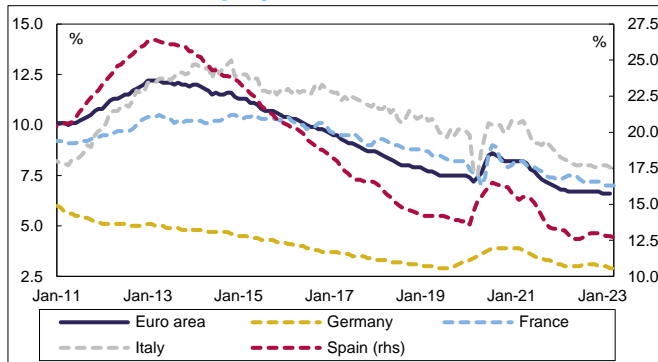
Second largest net mortgage repayment on record, while house prices edge down again

Consistent with the BoE's latest credit conditions survey, which reported a marked tightening in credit standards and a further notable drop in loan demand in response to the marked rise in interest rates, today's bank lending data showed a striking weakening in net mortgage lending in April. In particular, households made the largest net repayment of mortgage debt on record, apart from the policy-related payback in July 2021 associated with the scheduled conclusion of the government's pandemic stamp duty holiday. The net repayment of £1.4bn compared with the average increase of £3.8bn over the previous twelve months. And while the number of mortgage approvals was above the recent low at the start of the year (39.6k), it unexpectedly fell back to 48.7k in April from 51.5k in March and remained well below the pre-pandemic five-year average (66.5k). The impact of higher interest rates on the housing market was also evident in today's Nationwide report. Although the monthly decline was modest at 0.1%M/M, house prices were down 3.4%Y/Y and around 4% below their August 2022 peak. And with numerous lenders withdrawing products in the wake of the recent big upside surprises to inflation and sharp jump in swap rates, the prospects of further monetary policy tightening over coming months will continue to weigh on the housing market. Moreover, with around 1.3mn mortgage borrowers seeing their fixed-rate deals expire before the end of the year, many households face a further big hit to their disposable income over the coming months.

Household deposits continue to rise, but business deposits fall further

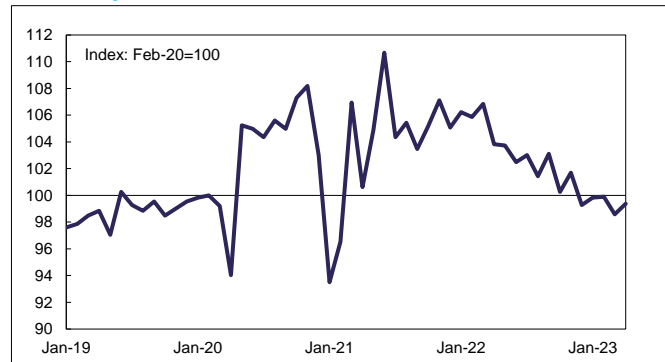
Despite a pickup in interest rates on new household credit – for which the effective rate on such loans rose 50bps in April to 8.29% – demand for unsecured lending remained slightly above the long-run average as many households continued to struggle with the higher cost of living. Admittedly, net consumer credit was broadly unchanged in April, at £1.6bn. Nevertheless, that left the stock of such lending still up 8.8%3M/3M annualised, the second-strongest rate for almost five years, with net credit card lending (£0.7bn) roughly double the long-run average and up 13.8%3M/3M annualised. Like with loans, higher interest rates also continue to impact bank deposits. Sight deposits of households fell for the seventh consecutive month in April, by £10.4bn, taking the cumulative withdrawal since October to £54bn. But this was offset by a notable increase in deposits in ISAs and other time deposits, to leave total household deposits up in April by £3.6bn, still however below the pre-pandemic five-year average (£4.2bn). In contrast, however, the net withdrawal of deposits from businesses rose sharply in April, from £1.3bn in March to £12.0bn in April, taking the cumulative net withdrawal since

Euro area: Unemployment rates



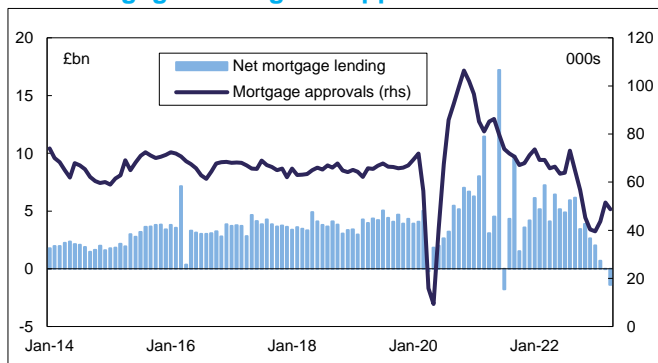
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: Retail sales



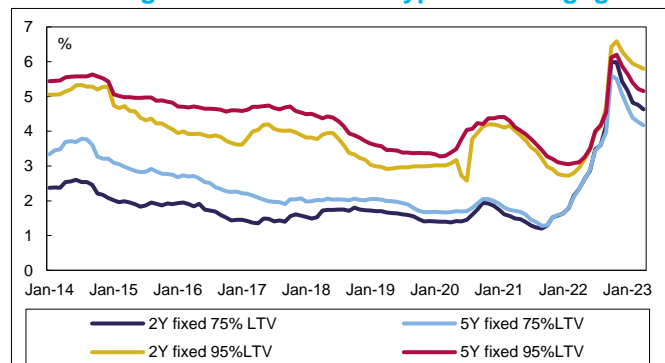
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Mortgage lending and approvals



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

UK: Average interest rates on types of mortgages



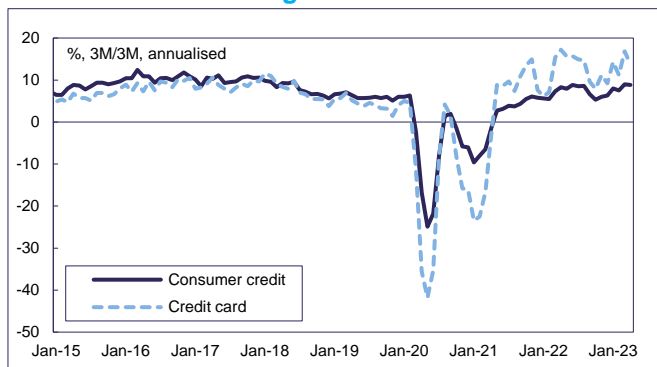
Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

October to £62.4bn. SMEs also remained reluctant to take out bank loans, repaying on net £1.2bn in April and extending the run of monthly declines to 24 months. The net increase in lending to large firms slowed to £1.6bn, albeit remaining above the average over the previous six months (-£0.5bn). Overall, the annual increase in the total outstanding amount of loans to NFCs slowed to just 0.3%Y/Y, the lowest since the start of 2022.

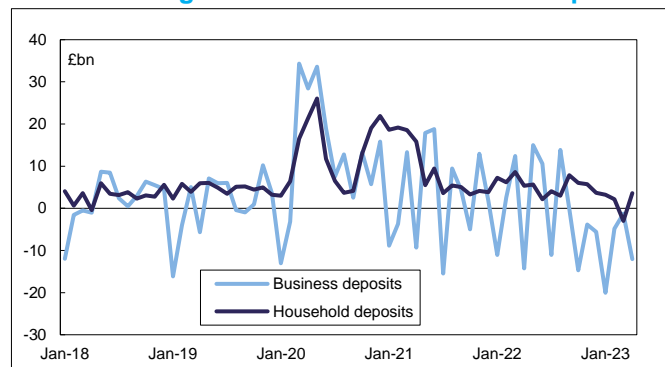
The week ahead in the UK

The coming week is set to be relatively quiet on the UK economic data front, kicking off on Monday with [the final services and composite PMIs](#) for May. Like in the euro area, the flash PMIs suggested that growth in the UK is increasingly reliant on services. The construction PMIs will follow on Tuesday, along with the BRC retail sales monitor for May, which will likely reveal that conditions remain challenging for retailers. The data calendar ends on Thursday with the publication of the RICS house price balance for May. Given renewed increases in interest rates on mortgages, as well as today's weak mortgage lending figures, we might expect to see an increase in the number of surveyors expecting house prices to fall further over coming months.

UK: Consumer credit growth



UK: Net change in household & business deposits



Daiwa economic forecasts

		2022	2023				2024	2023	2024	2025
		Q4	Q1	Q2	Q3	Q4	Q1			
GDP			%, Q/Q					%, Y/Y		
Euro area		0.0	0.1	0.2	0.2	0.2	0.2	0.8	1.1	1.5
UK		0.1	0.1	0.0	0.2	0.2	0.2	0.3	0.7	0.9
Inflation, %, Y/Y										
Euro area										
Headline HICP		10.0	8.0	6.3	4.6	2.9	2.8	5.4	2.3	1.7
Core HICP		5.1	5.5	5.5	4.9	4.1	3.4	5.0	2.5	1.8
UK										
Headline CPI		10.7	10.2	8.2	6.3	4.1	3.8	7.1	2.7	1.6
Core CPI		6.4	6.1	6.6	5.9	5.2	4.7	5.9	3.2	1.8
Monetary policy, %										
ECB										
Refi Rate		2.50	3.50	4.00	4.25	4.25	4.25	4.25	3.25	3.00
Deposit Rate		2.00	3.00	3.50	3.75	3.75	3.75	3.75	2.75	2.50
BoE										
Bank Rate		3.50	4.25	4.75	5.00	5.00	5.00	5.00	4.50	3.50


















Source: Bloomberg, ECB, BoE and Daiwa Capital Markets Europe Ltd.

The next edition of the Euro wrap-up will be published on date 05 June 2023








European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area	 Final manufacturing PMI	May	44.8	44.6	45.8	-
	 Preliminary (core) HICP Y/Y%	May	6.1 (5.3)	6.2 (5.5)	7.0 (5.6)	-
	 Unemployment rate %	Apr	6.5	6.5	6.5	6.6
Germany	 Retail sales M/M% (Y/Y%)	Apr	0.8 (-8.6)	1.0 (-5.8)	-2.2 (-6.2)	-1.3 (-5.8)
	 Final manufacturing PMI	May	43.2	42.9	44.5	-
France	 Final manufacturing PMI	May	45.7	46.1	45.6	-
	 New car registrations Y/Y%	May	14.8	-	21.9	-
Italy	 Manufacturing PMI	May	45.9	45.8	46.8	-
	 Unemployment rate %	Apr	7.8	7.8	7.8	7.9
	 New car registrations Y/Y%	May	23.1	-	29.2	-
Spain	 Manufacturing PMI	May	48.4	47.8	49.0	-
	 New car registrations Y/Y%	May	8.3	-	8.2	-
UK	 Nationwide house price index M/M% (Y/Y%)	May	-0.1 (-3.4)	-0.5 (-3.7)	0.5 (-2.7)	0.4 (-)
	 Final manufacturing PMI	May	47.1	46.9	47.8	-
	 Net consumer credit £bn (Y/Y%)	Apr	1.6 (7.7)	1.5 (-)	1.6 (7.9)	-(7.7)
	 Net mortgage lending £bn (approvals '000s)	Apr	-1.4 (48.7)	0.7 (54.0)	0.0 (52.0)	-(51.5)
	 M4 money supply Y/Y%	Apr	0.3	-	0.4	-

Auctions

Country	Auction
France	 sold €6.39bn of 3.0% 2033 bonds at an average yield of 2.85%
	 sold €2.62bn of 2.5% 2043 bonds at an average yield of 3.37%
	 sold €2.00bn of 3.0% 2054 bonds at an average yield of 3.29%
Spain	 sold €2.21bn of 2.8% 2026 bonds at an average yield of 3.049%
	 sold €2.08bn of 0.8% 2029 bonds at an average yield of 3.076%
	 sold €1.74bn of 1.9% 2052 bonds at an average yield of 3.978%
	 sold €514mn of 0.7% 2033 index-linked bonds at an average yield of 1.131%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
France	07.45	Industrial production M/M% (Y/Y%)	Apr	0.3 (1.4)	-1.1 (-0.1)
	07.45	Manufacturing production M/M% (Y/Y%)	Apr	-	-1.1 (0.7)
Spain	08.00	Unemployment change '000s	May	-	-73.9




























Auctions and events

- Nothing scheduled -

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 05 June 2023					
Euro area		09.00	Final services (composite) PMI	May	<u>55.9 (53.3)</u> 56.2 (54.1)
		09.30	Sentix investor confidence	Jun	- -13.1
		10.00	PPI Y/Y%	Apr	- 5.9
Germany		07.00	Trade balance €bn	Apr	- 14.9
		08.55	Final services (composite) PMI	May	<u>57.8 (54.3)</u> 56.0 (54.2)
		-	New car registrations* Y/Y%	May	- 12.6
France		08.50	Final services (composite) PMI	May	<u>52.8 (51.4)</u> 54.6 (52.4)
Italy		08.45	Final services (composite) PMI	May	- 57.6 (55.3)
Spain		08.15	Final services (composite) PMI	May	- 57.9 (56.3)
UK		09.30	Final services (composite) PMI	May	<u>55.1 (53.9)</u> 55.9 (54.9)
		09.00	New car registrations Y/Y%	May	- -13.1
Tuesday 06 June 2023					
Euro area		08.30	Construction PMI	May	- 45.2
		10.00	Retail sales M/M% (Y/Y%)	Apr	- -1.2 (-3.8)
Germany		07.00	Factory orders M/M% (Y/Y%)	Apr	- -10.7 (-11.0)
		08.30	Construction PMI	May	- 42.0
France		08.30	Construction PMI	May	- 46.0
Italy		08.30	Construction PMI	May	- 49.0
Spain		08.00	Industrial production M/M% (Y/Y%)	Apr	- 1.5 (4.5)
UK		00.01	BRC retail sales monitor, like-for-like sales Y/Y%	May	- 5.2
		09.30	Construction PMI	May	- 51.1
Wednesday 07 June 2023					
Germany		07.00	Industrial production M/M% (Y/Y%)	Apr	- -3.4 (1.8)
France		07.45	Trade balance €bn	Apr	- -8.0
Italy		09.00	Retail sales M/M% (Y/Y%)	Apr	- 0.0 (5.8)
Thursday 08 June 2023					
Euro area		10.00	GDP – second estimate Q/Q% (Y/Y%)	Q1	<u>0.1 (1.3)</u> -0.1 (1.8)
		10.00	Final employment Q/Q% (Y/Y%)	Q1	<u>0.6 (1.7)</u> 0.3 (1.5)
UK		00.01	RICS house price balance %	May	- -39
Friday 09 June 2023					
Italy		09.00	Industrial production M/M% (Y/Y%)	Apr	- -0.6 (-3.2)

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

The coming week's key events & auctions

Country	BST	Event / Auction
Monday 05 June 2023		
- Nothing scheduled -		
Tuesday 06 June 2023		
Euro area	 09.00	ECB publishes its consumer expectations survey
Germany	 10.30	Auction: €400mn of 0.1% 2033 index-linked bonds
	 10.30	Auction: €400mn of 0.1% 2046 index-linked bonds
UK	 10.00	Auction: £2.5bn of 3.75% 2053 bonds
Wednesday 07 June 2023		
Euro area	 08.50	ECB's de Guindos scheduled to speak
	 10.10	ECB's Panetta scheduled to speak
Germany	 10.30	Auction: €1bn of 0% 2025 green bonds
UK	 10.00	Auction: £4bn of 3.5% 2025 bonds
Thursday 08 June 2023		
- Nothing scheduled -		
Friday 09 June 2023		
- Nothing scheduled -		

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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