

Euro wrap-up

Overview

- While data showed that euro area industrial production slipped slightly lower in April, Bunds followed USTs higher but French spreads continued to widen on political concerns.
- Gilts made losses even as a survey suggested that the UK housing market recovery has paused amid diminished expectations for BoE rate cuts this year.
- Friday will bring figures for euro area trade, French inflation and the BoE's latest inflation attitudes survey.

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Daily bond market movements

| Bond | Yield | Change |
|---------------|-------|--------|
| BKO 2.9 06/26 | 2.914 | -0.032 |
| OBL 2.1 04/29 | 2.528 | -0.029 |
| DBR 2.2 02/34 | 2.510 | -0.018 |
| UKT 0% 01/26 | 4.207 | +0.022 |
| UKT 0½ 01/29 | 4.016 | +0.012 |
| UKT 4% 01/34 | 4.146 | +0.021 |

*Change from close as at 4:00pm BST.
Source: Bloomberg

Euro area

Euro area industrial production slips back in April, but near-term outlook remains broadly upbeat

Having provided a drag on GDP growth in Q1 and failed to grow in any quarter since Q123, today's IP figures suggested that euro area factory output had a soft start to the second quarter too. In particular, industrial production fell 0.1%M/M in April to leave it down 3.0%Y/Y and still roughly 2½% below the pre-pandemic level. And in the absence of a rise in energy production (0.4%M/M), the monthly drop would have been steeper. Indeed, manufacturing output fell 0.4%M/M in April to leave it down 3.1%Y/Y but in line with the February 2020 benchmark. But the country breakdown suggested that the overall weakness was caused principally by Ireland (-3.4%M/M) – where the data are distorted by activities of multinational corporations based there for tax reasons – and Italy (-1.0%M/M). In contrast, manufacturing output rose modestly in Germany, France, Spain and the Netherlands. Moreover, the drop in the euro area in April followed two consecutive monthly increases. As such, the level of manufacturing output was still some 0.5% above the Q1 average, with overall industrial production up 0.3% on an equivalent basis. Surveys point to accelerated recovery momentum in May too. In particular, the manufacturing output PMI and Commission production index both jumped last month to their highest levels in over a year, while the new orders PMI rose to a two-year high, supporting our view that the manufacturing sector is likely to provide modest support for GDP growth in Q2.

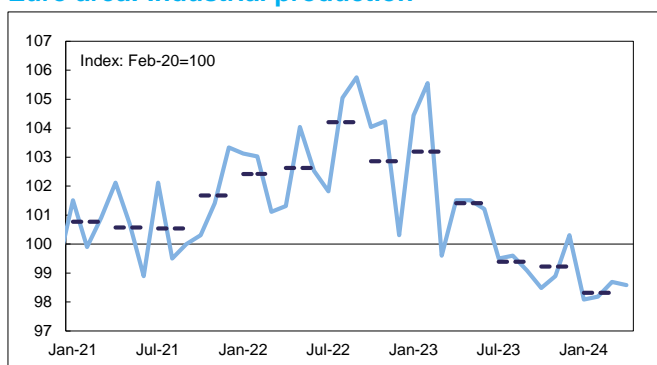
Manufacturing detail suggest stronger outturn in April led by capital and consumer goods

Once again, however, today's release raised questions about the quality of the manufacturing production data, reflecting challenges with seasonal adjustment and distortions created by the Irish figures. The detail suggested that the weakness in April reflected a second-successive monthly drop in production of intermediate goods (-0.4%M/M) as chemicals output fell for the first month in four (-1.8%M/M). In contrast, however, capital goods production rose for a third consecutive month (0.7%M/M) as an acceleration in output of motor vehicles (6.2%M/M) to a five-month high and rise in machinery and equipment offset a drop in other transport equipment. Furthermore, overall output of consumer goods rose for the first month in four and by a sizeable 3.0%M/M – the most in two years – amid firm growth in the pharmaceuticals, clothing and food subsectors. So, if the subsector breakdown is to be believed, manufacturing output would have expanded some 0.8%M/M in April contrasting with the aggregate 0.4%M/M drop reported by Eurostat.

The day ahead in the euro area

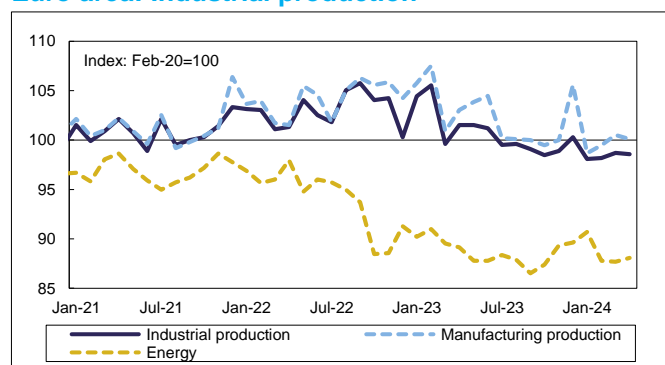
Friday will bring euro area goods trade figures for April. While data released last week reported that the German trade surplus moved broadly sideways, the French goods trade deficit widened a little more than €1bn as export values fell and

Euro area: Industrial production*



*Dashed dark blue lines represent quarterly average. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Industrial production



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

import values rose. As such, the euro area trade surplus might well have narrowed very slightly at the start of Q2. Aside from the data, ECB Chief Economist Lane is scheduled to participate in a panel discussion on central bank decision making.

UK

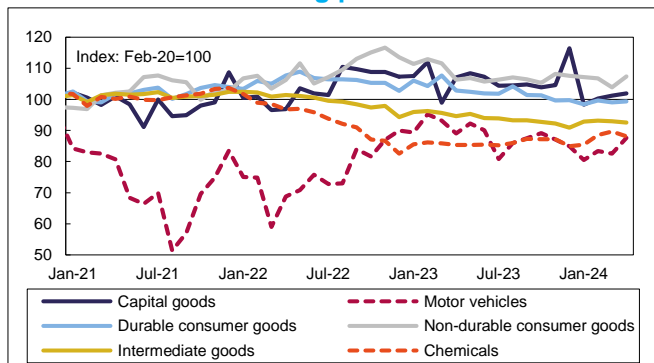
Recovery in housing market pauses reflecting delayed expectations for rate cuts

Despite the acceleration in GDP in Q1 and signs that [economic activity](#) continues to rise at a steady pace in Q2, today's RICS residential survey suggested that the UK's housing market recovery has paused due to the recent uptick in interest rates on new mortgage deals and the scaling back of expectations surrounding BoE policy loosening this year. Indeed, with the average borrowing rate on a 2-year mortgage (with a 75% LTV ratio) having risen in May to a six-month high some 50bps above January's low, surveyors reported that new agreed sales had fallen the most in seven months in May, with the respective net balance down 18ppts – the biggest drop in eleven months – to -13%, to be well below the pre-pandemic five-year average. Despite the recent modest improvement in consumer confidence and rising disposable incomes, respondents also reported that new buyer enquiries were the lowest in six months. So, the headline house price balance fell sharply in May, by a steeper-than-expected 12ppts to -17%, a four-month low. But smoothing for monthly volatility, the house price balance on a three-month basis was still the second highest (-9%) since the blowout in interest rates in November 2022 and well above the average in 2023 (-47%). Moreover, with the number of new instructions coming on the market having also fallen in May – with the respective balance down to a four-month low still well below the pre-pandemic five-year average – the ongoing imbalance between supply and demand should continue to provide some support to house prices ahead. Indeed, while surveyors still expected some downwards pressure over the coming three months, expectations for home prices twelve months ahead rose to the highest level in two years, with the respective balance (+41%) in line with the pre-pandemic average.

The day ahead in the UK

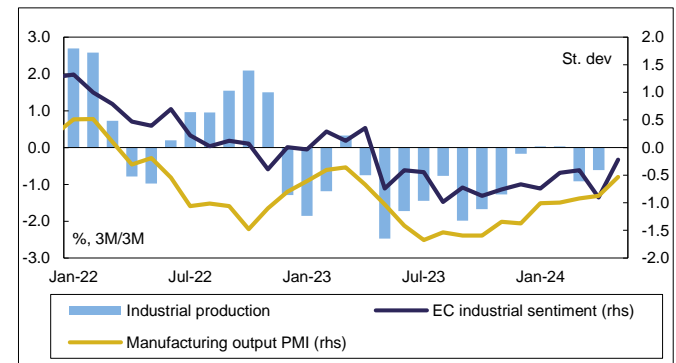
Friday will bring the BoE's inflation attitudes survey for Q2. While household inflation expectations two years ahead moved sideways at an above-target 2.8%Y/Y over the previous three quarters, this still remains 0.6ppt below the peak in Q422 and only a fraction above the long-run average, suggesting that inflation expectations remain well anchored.

Euro area: Manufacturing production



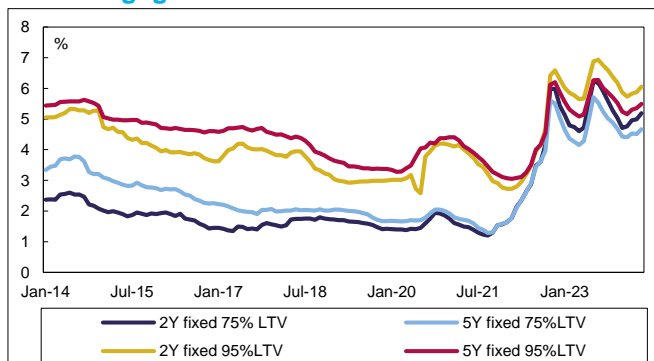
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Selected industrial sector indicators



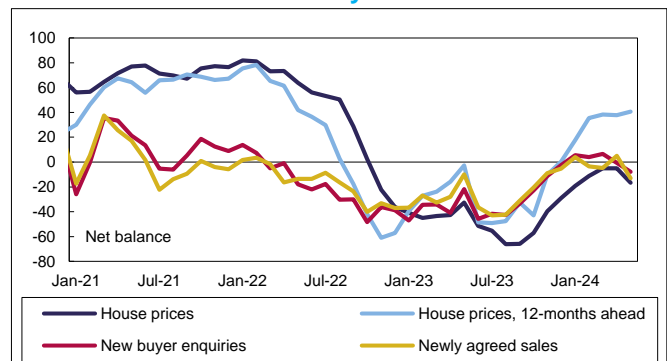
Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

UK: Mortgage interest rates



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

UK: RICS residential survey indices






Source: Macrobond 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  | Industrial production M/M% (Y/Y%) | Apr | -0.1 (-3.0) | -0.2 (-2.2) | 0.6 (-1.0) | 0.5 (-1.2) |
| Spain  | Final HICP (CPI) Y/Y% | May | 3.8 (3.6) | 3.8 (3.6) | 3.4 (3.3) | - |
| UK  | RICS house price balance % | May | -17 | -5 | -5 | - |





Auctions

| Country | Auction |
|---|--|
| Italy  | <ul style="list-style-type: none">  sold €4.0bn of 3.45% 2027 bonds at an average yield of 3.47%  sold €2.5bn of 3.45% 2031 bonds at an average yield of 3.72%  sold €1.25bn of 4.15% 2039 bonds at an average yield of 4.27%  sold €1.25bn of 3.85% 2049 bonds at an average yield of 4.39% |



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  | 10.00 | Trade balance €bn | Apr | 17.3 | 17.3 |
| France  | 07.45 | Final HICP (CPI) Y/Y% | May | 2.7 (2.2) | 2.4 (2.2) |
| Italy  | 09.00 | Trade balance €bn | Apr | - | 4.3 |
| UK  | 09.30 | BoE/Ipsos household inflation expectations 1Y ahead Y/Y% | May | - | 3.0 |

Auctions and events

| | | | | | |
|---|-------|---|--|--|--|
| Euro area  | 10.00 | ECB Chief Economist Lane to participate in a panel discussion on central bank decision making | | | |
| UK  | 09.30 | BoE to publish household inflation attitudes survey results for Q2 | | | |

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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