

Euro wrap-up

Overview

- Gilts made gains despite a significant upside surprise to UK GDP growth in May.
- Bunds also followed USTs higher as the final German inflation data for June predictably aligned with their flash estimates.
- Friday will bring the final estimates of French and Spanish inflation in June.

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Daily bond market movements

| Bond | Yield | Change |
|---------------|-------|--------|
| BKO 2.9 06/26 | 2.781 | -0.108 |
| OBL 2.1 04/29 | 2.434 | -0.089 |
| DBR 2.2 02/34 | 2.459 | -0.070 |
| UKT 0% 01/26 | 4.028 | -0.065 |
| UKT 0½ 01/29 | 3.915 | -0.059 |
| UKT 4% 01/34 | 4.072 | -0.052 |

*Change from close as at 5.00pm BST.

Source: Bloomberg

UK

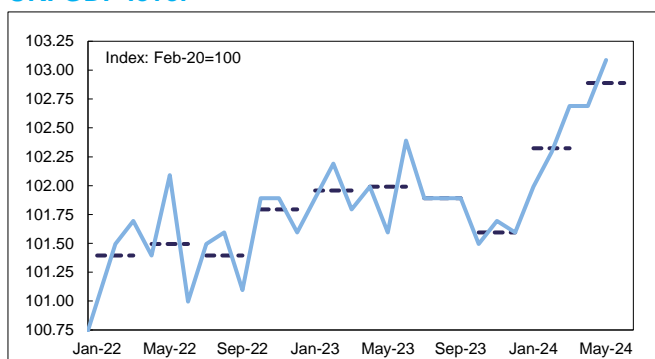
UK GDP beats expectations in May as warmer temperatures boost demand

While the PMI surveys had signalled a slowdown in economic momentum in May, today's monthly GDP figures for that month beat expectations to suggest an accelerated pace of growth. In particular, GDP rose 0.4%M/M in May – double the Bloomberg survey consensus – for the third month out of the past five. This left output up 0.9%3M/3M – the most since January 2022 – to be up 1.4%Y/Y and some 3.1% above the pre-pandemic benchmark in February 2020. Growth was broad based across the key sectors as warmer weather provided a boost to demand. Indeed, services output rose for a fifth consecutive month, by 0.3%M/M, with positive growth in 10 out of the 14 sub-sectors led by a rebound in [retail](#) (2.9%M/M) and hospitality (2.4%M/M, the strongest in thirteen months). As a result, services output was up 1.1%3M/3M, the most on that basis since December 2021. Construction activity also benefitted from more favourable weather conditions, rising 1.9%M/M, with new building work up for the first month in four (2.7%M/M) and repair and maintenance up for the second month in three (0.8%M/M). But this left construction trending some 0.6% below the Q1 average suggesting the sector will be a drag on GDP growth in Q2 for a third consecutive quarter. While manufacturing output returned to modest growth in May (0.4%M/M), only half of the sub-sectors reported an increase in production that month, with a positive contribution from food manufacturers offsetting a third successive contraction in the autos sub-sector. And given the marked decline in manufacturing production at the start of Q2, it was trending almost 1% below the Q1 average.

Net trade to provide a notable drag in Q2 as export volumes fall to near-two-year low

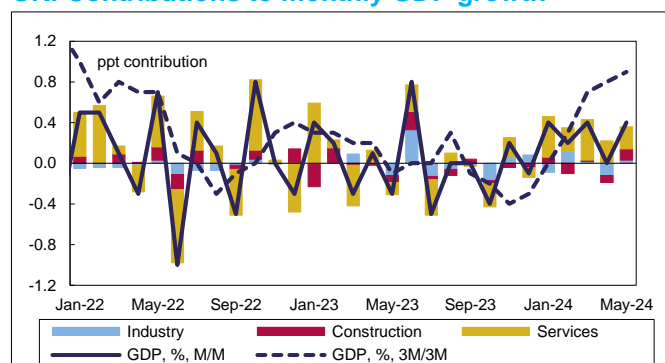
Tallying with the recent manufacturing downtrend, the latest export figures disappointed once again. Admittedly, the trade deficit narrowed from April's near-two-year high by £1.5bn to £4.9bn, albeit this was still almost double the average over the past year. Moreover, this reflected a steeper drop in the value of imports (-2.8%M/M) compared with exports (-0.9%M/M). Adjusting for prices, export volumes recorded their fifth monthly decline out of six in May (-1.0%M/M) to a near-two-year low. This left them down almost 3%YTD/Y in the first five months of the year, with shipments to the EU down a more striking 7%YTD/Y. So, in April and May exports volumes were 2.3% below the Q1 average. And despite a decline in May (-2.8%M/M), import volumes were trending some 4½% above the Q1 average, more than fully reversing the fall of 2.7%Q/Q at the start of the year. When excluding precious metals, which often distort the picture, the moves in April and May were not quite so weak, with exports down 0.9% and imports up 2.6%. While monthly trade figures are highly volatile and subject to revisions, overall today's release strongly suggests that net trade will provide a significant drag on GDP growth in Q2, having added 0.6ppt in Q1. But like in Q1, we expect inventories to provide some offset to the contribution from net trade in Q2 and household consumption – particularly of services – will also provide a solid boost.

UK: GDP level*



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

UK: Contributions to monthly GDP growth



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

GDP set for solid expansion in Q2 despite likely payback in June

While retail sales provided the strongest contribution to GDP growth in May, surveys suggest that the unseasonably wet conditions at the start of June dampened demand. This was the message from the BRC's retail monitor earlier this week, which suggested that retail sales volumes (adjusted using the BRC shop price index) declined almost ½%Y/Y in June, to leave them down around 2%3M/Y in Q2. With the [services and construction PMIs](#) implying a further slowdown in underlying momentum last month, and GDP having risen in four of the past five months by a cumulative 1½%, overall, we expect some modest payback in June. However, we doubt that the decline will be large enough to prevent another quarter of solid expansion in Q2 – indeed, after today's upside surprise, GDP likely grew 0.5%Q/Q in Q2, bang in line with the MPC's most recent projection and arguably above-potential. Against this backdrop, some MPC members will remain reluctant to pull the trigger on a rate cut next month. However, given the pickup in the unemployment rate to a 2½-year high in April, as well as a steady decline in job vacancies and softer employment growth, today's figures arguably point to a long-awaited boost to productivity. So, in the absence of some nasty surprises to the latest inflation and wage figures next week, we continue to think that the majority on the MPC will vote for a first rate cut this cycle at the start of next month.

The day ahead in the UK

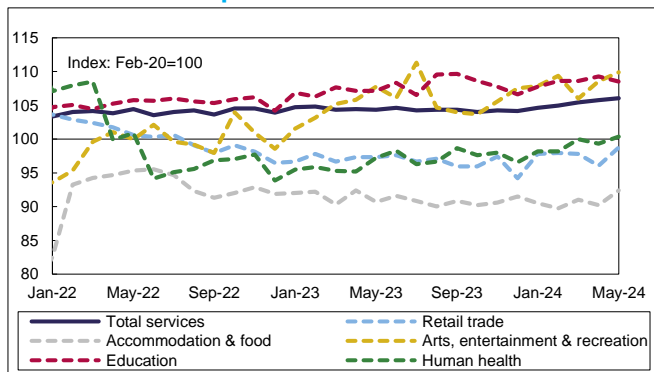
There are no top-tier UK economic data due for release tomorrow.

Euro area

The day ahead in the euro area

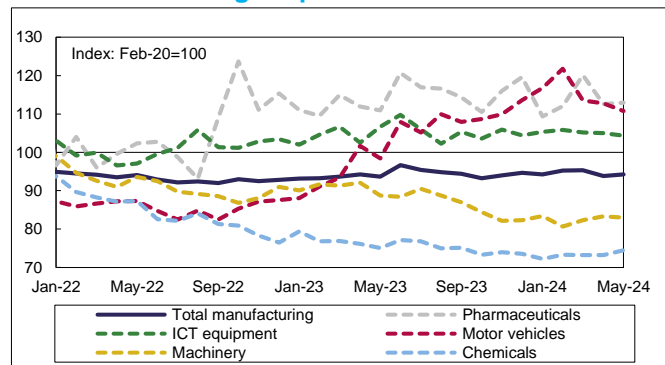
It should be a relatively quiet end to the week for economic releases, with just final June inflation figures from France and Spain to provide more granular detail on price developments that month. The flash estimates saw French headline HICP inflation drop 0.1ppt to 2.5%Y/Y, while the headline CPI measure more than reversed the uptick in May, dropping 0.2ppt to 2.1%Y/Y, the softest since August 2021 due to lower energy and food inflation. Meanwhile, Spanish HICP inflation fell 0.3ppt to 3.5%Y/Y, with the national CPI rate down 0.2ppt to 3.4%Y/Y, principally reflecting a decline in fuel prices.

UK: Services output



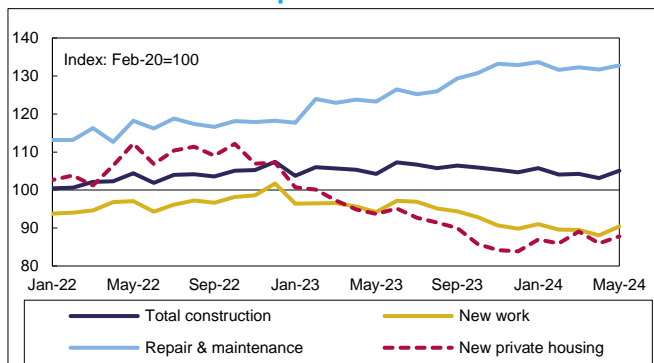
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Manufacturing output



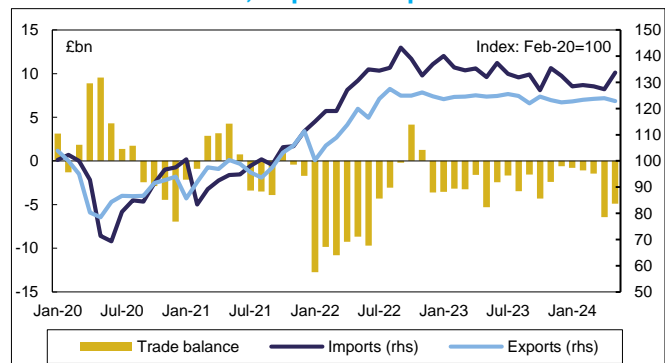
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Construction output



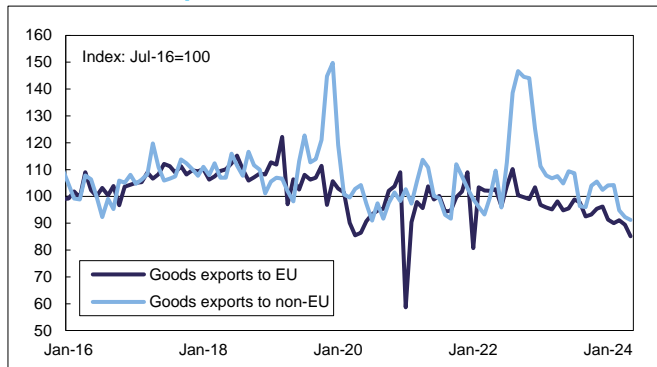
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Trade balance, import & export values



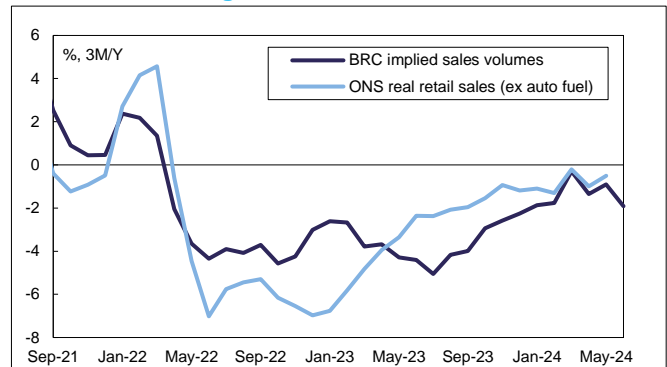
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Goods export volumes



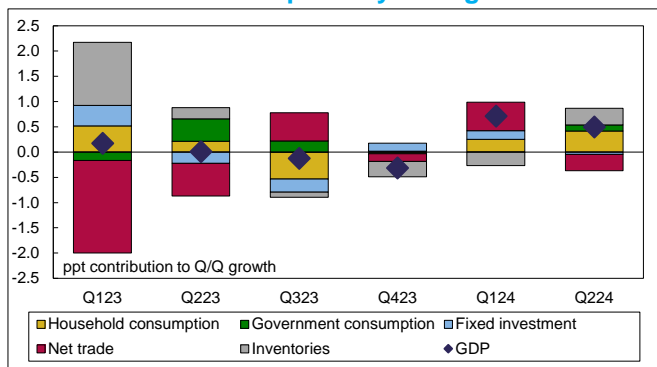
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Retail sales growth



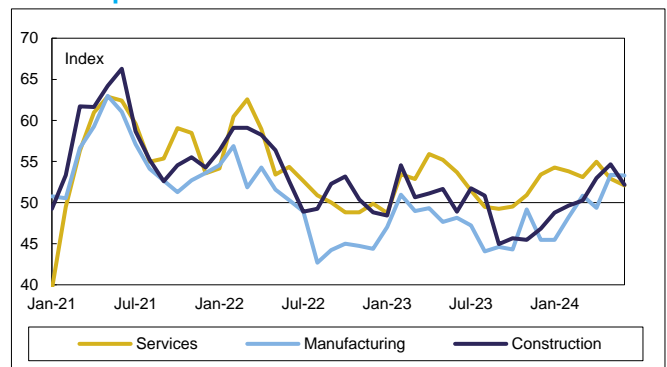
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Contributions to quarterly GDP growth*



*Q224 figures are Daiwa forecast. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Output PMIs



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

European calendar

Today's results

Economic data

| Country | Release | Period | Actual | Market consensus/ Daiwa forecast | Previous | Revised |
|---------|---------------------------------|--------|---------------------|-------------------------------------|--------------|--------------|
| Germany | Final HICP (CPI) Y/Y% | Jun | 2.5 (2.2) | <u>2.5 (2.2)</u> | 2.8 (2.4) | - |
| UK | RICS house price balance % | Jun | -17 | -15 | -17 | - |
| | Monthly GDP M/M% (3M/3M%) | May | 0.4 (0.9) | 0.2 (0.7) | 0.0 (0.7) | - (0.8) |
| | Services output M/M% (3M/3M%) | May | 0.3 (1.1) | 0.2 (1.0) | 0.2 (0.9) | 0.3 (1.0) |
| | Industrial output M/M% (Y/Y%) | May | 0.2 (0.4) | 0.3 (0.6) | -0.9 (-0.4) | - (-0.7) |
| | Construction output M/M% (Y/Y%) | May | 1.9 (0.8) | 0.7 (-1.8) | -1.4 (-3.3) | -1.1 (-2.1) |
| | Trade (goods trade) balance £bn | May | -4.9 (-17.9) | -2.9 (-16.6) | -6.8 (-19.6) | -6.4 (-19.4) |


Auctions

| Country | Auction |
|---------|--|
| Italy | <ul style="list-style-type: none"> sold €1.5bn of 1.1% 2027 bonds at an average yield of 3.23% sold €2bn of 3.45% 2027 bonds at an average yield of 3.24% sold €2bn of 3.45% 2031 bonds at an average yield of 3.57% sold €1.25bn of 0.9% 2031 bonds at an average yield of 3.51% sold €1.75bn of 4.45% 2043 bonds at an average yield of 4.30% |
| UK | <ul style="list-style-type: none"> sold £3.75bn of 4% 2031 bonds at an average yield of 4.074% |



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Yesterday's results

Economic data

| Country | Release | Period | Actual | Market consensus/ <i>Daiwa forecast</i> | Previous | Revised |
|---|-----------------------------------|--------|-------------------|--|-------------|----------|
| Italy  | Industrial production M/M% (Y/Y%) | May | 0.5 (-3.3) | 0.0 (-2.5) | -1.0 (-2.9) | - (-3.0) |


Auctions

| Country | Auction |
|---|--|
| Germany  | sold €457mn of 0% 2036 bonds at an average yield of 2.6% |
|  | sold €1.29bn of 1% 2038 bonds at an average yield of 2.67% |

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tuesday's results

Economic data



| Country | Release | Period | Actual | Market consensus/ <i>Daiwa forecast</i> | Previous | Revised |
|--|---|--------|-------------|--|----------|---------|
| UK  | BRC retail monitor – like-for-like sales Y/Y% | Jun | -0.5 | 0.8 | 0.4 | - |

Auctions

| Country | Auction |
|-----------------------|---------|
| - Nothing to report - | |

Tomorrow's releases

Economic data

| Country | BST | Release | Period | Market consensus/ <i>Daiwa forecast</i> | Previous |
|--|-------|-----------------------|--------|--|-----------|
| France  | 07.45 | Final HICP (CPI) Y/Y% | Jun | <u>2.5 (2.1)</u> | 2.6 (2.3) |
| Spain  | 08.00 | Final HICP (CPI) Y/Y% | Jun | <u>3.5 (3.4)</u> | 3.8 (3.6) |

Auctions and events

- Nothing scheduled -

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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

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