Euro wrap-up

Overview

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- Bunds followed USTs lower as German industrial production and shipments to the US jumped at end-Q1 as firms seemingly front-ran US tariff hikes.
- While the BoE cut Bank Rate by 25bps, revised down its inflation projection and signalled the likelihood of further monetary easing to come, Gilts made bigger losses after two MPC members voted to keep rates unchanged and the US agreed a deal to reduce tariffs on imports of UK cars and steel.
- The coming week will confirm a pickup in GDP growth in the euro area and UK in Q1 (Thursday), while new data on euro area IP and goods trade and the UK labour market are also due.

Daily bond market movements

Bond	Yield	Change
BKO 2.2 03/27	1.766	+0.059
OBL 2.4 04/30	2.077	+0.066
DBR 2½ 02/35	2.530	+0.059
UKT 3¾ 03/27	3.915	+0.125
UKT 4⅜ 03/30	4.022	+0.097
UKT 4½ 03/35	4.543	+0.087

*Change from close as at 5.00pm BST.
Source: Bloomberg

Euro area

German industrial production rose the most since October 2021 ahead of US tariff hikes

While German industrial production has been choppy over the past year or so, today's figures for March significantly beat expectations, with the 3%M/M rise the largest since October 2021 as exporters seemingly attempted to front-run higher US tariffs. Indeed, while IP was still a touch below its level a year ago and well below the peak in 2017, it was nevertheless up a striking 1.5%3M/3M in Q1, raising the possibility of a modest upwards revision to German GDP growth in the first quarter (0.2%Q/Q). A partial rebound left construction activity up 0.6%3M/3M, while manufacturing recorded the first quarterly rise in a year (1.8%3M/3M) and the strongest since Q421. Growth in manufacturing in March was broad-based, but led by sectors with a high share of exports to the US. Strikingly, production in the pharmaceutical subsector jumped 19.6%M/M, coinciding with a surge in imports to the US that month, to leave output up a little more than 10%3M/3M. But the rise in the autos sector (8.1%M/M) likely in part reflected payback for weakness at the end of last year, with limited evidence of front-loading of shipments to the US. And despite an acceleration at the end of the quarter, production of electrical and general machinery was up a more modest 1-1½%3M/3M in Q1. Meanwhile, despite increasing in March, output of other transport equipment was down 4½% in Q1.

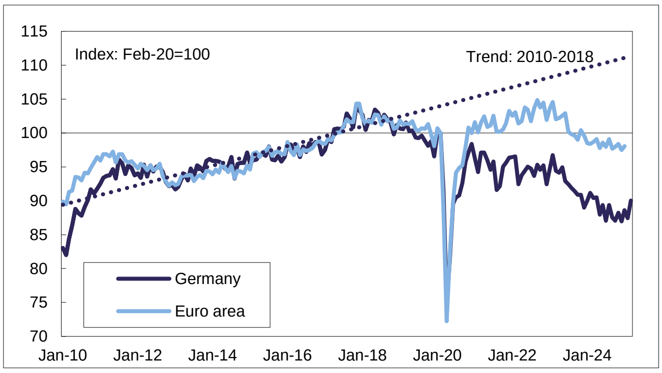
Manufacturing output likely to fall in Q2 amid higher US tariffs and weak demand

Given the new US tariffs on imports from the EU, we expect some payback at the start of Q2. But, for now at least, surveys suggest that manufacturers maintained production last month. Indeed, the output PMI implied the strongest production growth in more than two years in April. And truck-toll mileage – often a proxy for manufacturing activity – fell only marginally. But businesses do anticipate conditions to worsen over coming quarters, with the ifo survey flagging a deterioration in production expectations in the pharmaceutical, machinery and autos subsectors. Certainly, yesterday's factory orders data implied ongoing weakness of underlying demand for German goods. And there would seem to be further downside risks to German manufacturing if the region is flooded with cheap Chinese goods redirected from the US. Overall, we expect manufacturing to subtract from German GDP growth this quarter and possibly next too. And while construction activity might continue to benefit from lower borrowing costs and the recovery in the housing market, we expect GDP to contract in Q2 and do not rule out a modest technical recession over the summer.

German exports in Q1 boosted by US demand

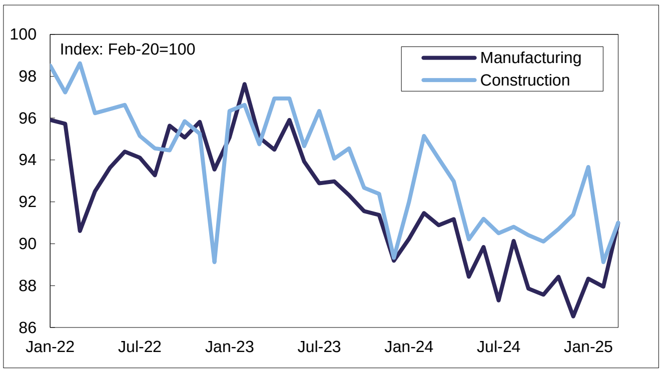
Consistent with the boost to IP, German goods trade statistics reported a fifth-consecutive monthly increase in export values, by a non-negligible 1.1%M/M, to an 11-month high. That left exports in Q1 some 2.7% higher than at the end of last year, the

Euro area & Germany: Industrial production



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Manufacturing & construction output



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

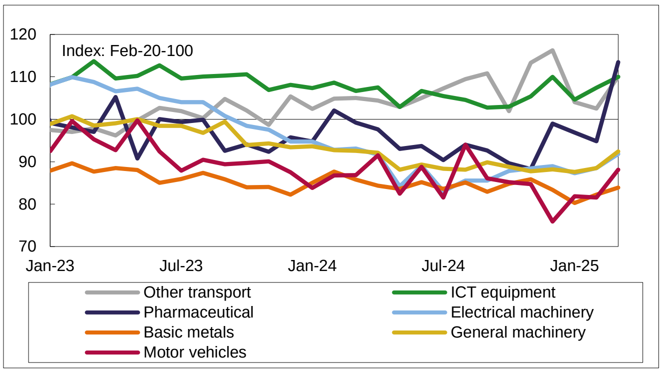
strongest quarterly increase since Q322. But, with that quarterly rate of increase matched by imports – despite a decline in March (-1.4%M/M) – net trade probably provided negligible support to GDP growth in Q1. The geographical breakdown predominantly attributed the widening trade surplus (€21.1bn) in March to intra-euro area trade flows. Indeed, Germany's bilateral surplus with the member states widened €4.1bn in March, to a record €13.2bn, while narrowing slightly with the US. Yet, as in February, US-bound exports continued to point towards signs of front-loading of orders. Those climbed to a new monthly high in March to be some 5% higher over Q1 as a whole. In the absence of granular data from European sources, timelier US data flag the significance of pharmaceuticals to that drive, which more than doubled in Q1. Exports to China also rose to a nine-month high, to be up 3½%3M/3M. But, this was still almost 10% below its level a year ago. Today's data also showed a pick up in imports from China to their highest in almost 2½ years. And the cumulative effects of significantly higher US levies applied to China last month increases the likelihood of a clearer diversion of its goods to Germany, and Europe more generally, in Q2.

The week ahead in the euro area

The coming week will bring an updated estimate of euro area Q1 GDP on Thursday. We expect growth to align with the preliminary estimate of 0.4%Q/Q, double the rate in Q4 and the ECB's Q1 projection published in March. Despite the acceleration in GDP in the first quarter and another quarter of strong jobs growth in Spain, euro area employment figures (also Thursday) are likely to report a more modest increase similar to the 0.1%Q/Q rise in Q4. These releases will be accompanied by monthly industrial production figures, which are likely to report another sizeable increase in March as exporters attempted to front-run higher US tariffs. Indeed, after today's German numbers, we also expect strong growth in Italy and particularly Ireland – March data for both are due tomorrow. Similarly, euro area goods trade figures for March (Friday) are likely to report a further sizeable increase in exports as firms expedited shipments to the US. Meanwhile, after a significant deterioration at the start of Q2, the German ZEW survey (Tuesday) will provide an update on investor perceptions of economic conditions at the start of May – like the past week's Sentix indicators, we expect the ZEW expectations index to partially reverse the decline in April.

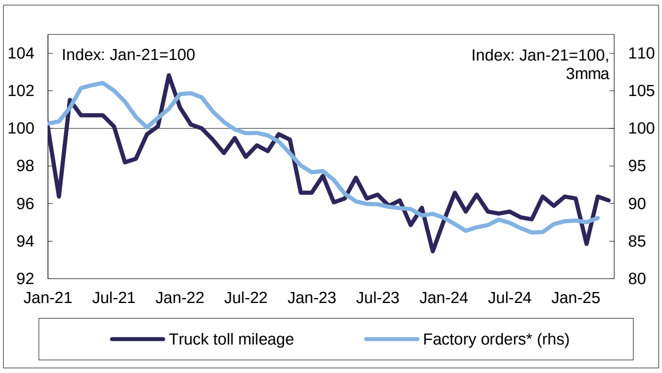
In terms of inflation, updated April figures will be published from Germany, Spain (both due Wednesday), France (Thursday) and Italy (Friday). The flash estimates showed headline HICP rates moderating slightly in Germany (2.2%Y/Y) and France (0.8%Y/Y) and remaining steady in Italy (2.1%Y/Y) and Spain (2.2%Y/Y). But core inflation rose in most member states as the services component ticked higher. The detail should confirm that much of the upwards pressure related to holiday-related components amid unfavourable base effects around the timing of Easter this year. Finally, the Commission will also publish its Spring economic forecast update (Friday), which seems bound to bring downward revisions to the growth outlook in light of heightened global trade uncertainties and geopolitical risks.

Germany: Manufacturing output by sector



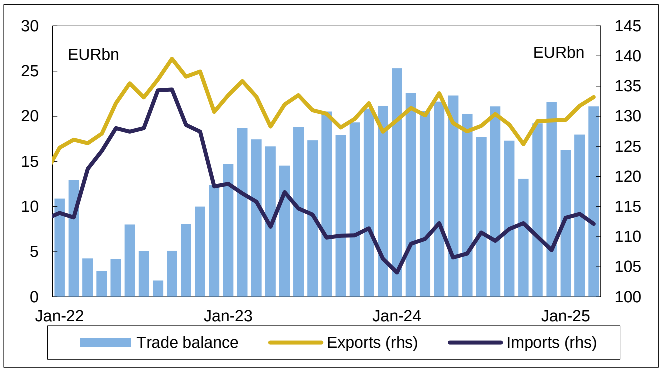
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Factory orders & truck toll mileage



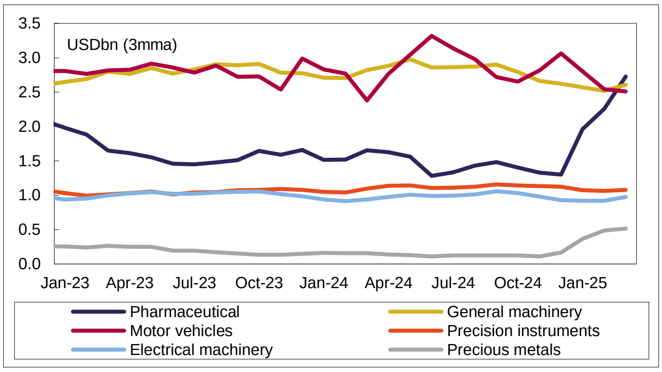
**Core orders excluding major items.*
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Goods trade balance



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Exports to the US by subsector



Source: Macrobond, US Census Bureau and Daiwa Capital Markets Europe Ltd.

UK

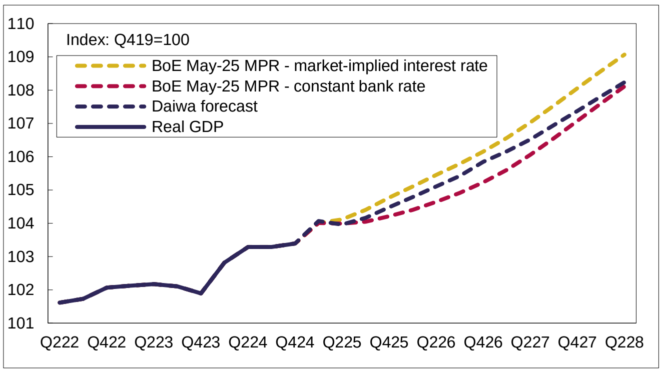
BoE cuts Bank Rate by 25bps, retaining "gradual & careful" approach to easing

As expected, the BoE cut Bank Rate by a further 25bps to 4.25%, taking the cumulative easing over the past four quarters to 100bps. Somewhat less expected was the outcome of the MPC's vote, as only five out of nine members voted in favour of the decision. But the dissenters were split evenly between those preferring a larger cut of 50bps (external members Taylor and Dhingra) and those preferring no change (Chief Economist Pill and external member Mann). That hawkish minority probably explains the weakening of Gilts after the announcement. But, as we expected, the MPC also retained its guidance that "a gradual and careful approach to the further withdrawal of monetary policy restraint remains appropriate". We still interpret that guidance to imply ongoing cuts to Bank Rate of 25bps each quarter into 2026, a somewhat less dovish scenario over the remainder of this year than was priced by the swaps market ahead of the announcement. But the MPC also continued to emphasise the uncertainty of the outlook, which meant that the risks to inflation were still two-sided. And so, it also repeated that "policy is not on a pre-set path". However, as the MPC revised down its baseline inflation projection over the horizon despite a significant downwards revision of more than 50bps by Q126 to its assumption for the path of Bank Rate, we maintain our own baseline view that Bank Rate will be cut to 3.25% by Q226.

GDP growth revised down over coming 4 quarters due to Trump shock, but no recession envisaged

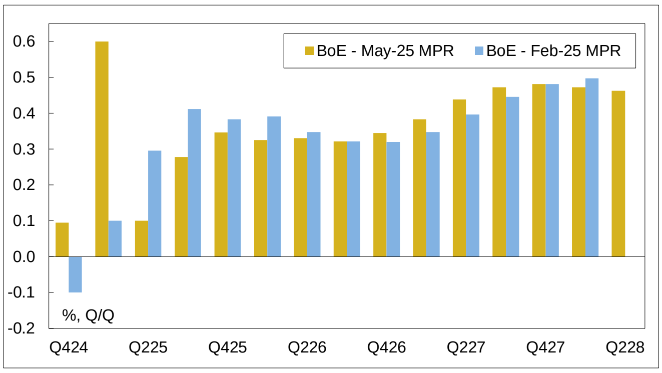
Of course, not least due to Trump tariff uncertainty, the BoE appeared bound to revise down its profile for GDP growth from this quarter on. But given recent upwards revisions to the profile of UK GDP in 2024, as well as the surprising strength of growth in the first two months of Q125, the BoE had to increase significantly its estimate of growth last quarter by a chunky 0.5ppt to 0.6%Q/Q (still nevertheless 0.1ppt softer than our own view). It attributed that strength to erratic factors not least affecting the manufacturing sector, presumably due to the frontloading of production and shipments to the US to evade new tariffs. Excluding such distortions, strikingly, Bank staff judged that underlying GDP growth in Q1 was probably zero, while high-frequency data pointed to a slowdown in actual growth to just 0.1%Q/Q in Q2. And while it expects growth to pick up thereafter, given the persisting impact of uncertainty and distortions regarding the global tariff landscape on both domestic and external demand, the BoE revised down its cumulative GDP growth forecast from Q225 to Q226 by almost ½ppt, with a negative impact of about 0.3% on the level of GDP to persist over the medium term. That, however, would still result in growth of about 1% this year – the same as in 2024 and ¼ppt stronger than previously projected. And growth next year would be 1¼%, ¼ppt less than anticipated in the last Monetary Policy Report.

UK: BoE projections – GDP level



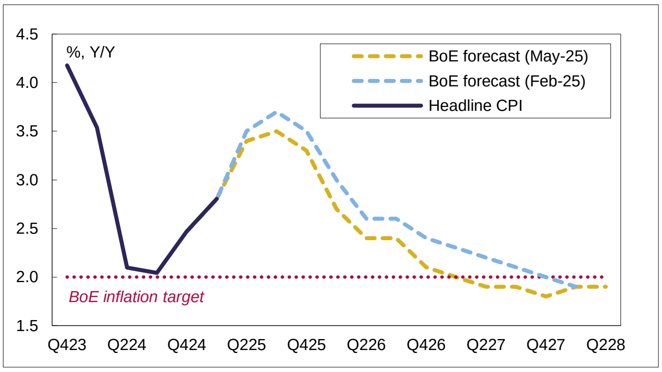
Source: BoE, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: BoE projections – GDP growth



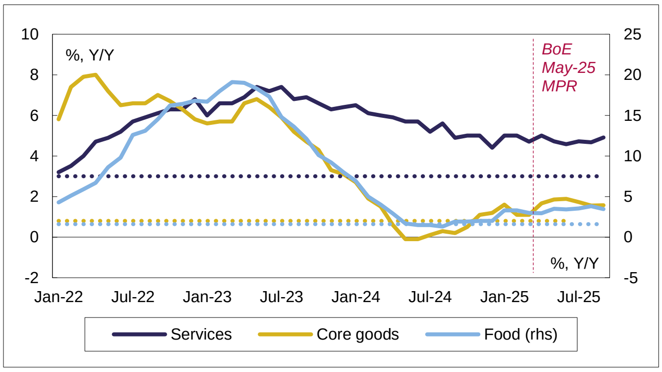
Source: BoE, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: BoE projections – CPI inflation



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

UK: BoE projections – key inflation components*



**Dotted lines show 2010-19 averages.*
Source: BoE, Macrobond and Daiwa Capital Markets Europe Ltd.

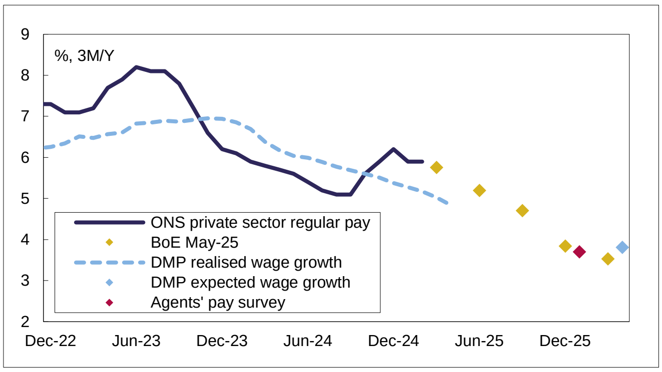
Inflation projection revised down across the horizon to below target in 2027

Meanwhile, in terms of price-setting behaviour, the MPC already sees substantial progress on disinflation across wages and prices of services and other items. Unsurprisingly, it also thinks that its restrictive policy stance continues to curb second-round effects from past inflation and – as suggested again by today's softer DMP survey results – to have stabilised longer-term inflation expectations. So, it thinks that additional second-round effects from the rise in headline inflation to about 3.4%Y/Y in April and perhaps as high as 3.7%Y/Y in September – related to increases in administered, indexed and regulated prices such as energy and water tariffs – will be limited too. Meanwhile, with the labour market judged to have weakened recently, Bank staff estimated that a margin of slack – of roughly ½% of GDP – has already opened up. And given the softer GDP growth outlook, they expect slack to increase to ¾% next year and remain at that magnitude into the medium term, continuing to weigh on underlying inflation. As such, while it conditioned its updated projections on cuts in Bank Rate to less than 3.60% from Q126 to Q427, it revised down its inflation projection by about ¼ppt each quarter over the projection horizon. Overall, it expects inflation to round out at 2%Y/Y at end-2026, and to fall below target from Q127 on to 1¾%Y/Y by the end of that year, justifying rate cuts in line with, and ultimately perhaps beyond, those presented in the BoE's market-based assumption.

Targeted US trade deal welcome but trade barriers & uncertainty to persist for many sectors

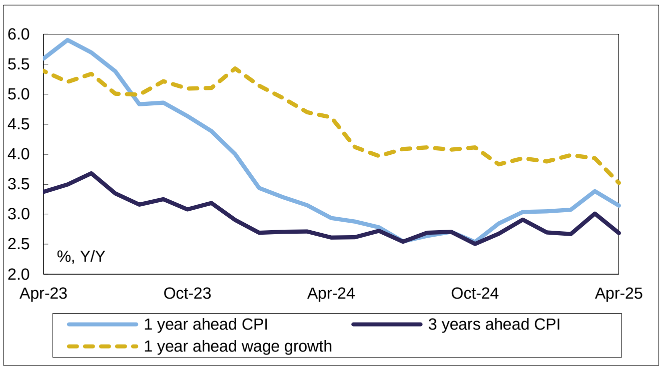
The BoE's projections were finalised and the MPC rate decision taken before this afternoon's confirmation of a UK-US trade deal. The detail of that deal will only be agreed in coming weeks. But according to the limited information announced today by President Trump and the UK government, US tariffs on the first 100k imported cars from the UK – which represented the UK's largest export category and some 15% of its goods exports to the US and 2.5% of total UK goods exports in 2024 – will be cut from 27.5% to 10%. The 100k quota approximates the 101k cars imported by the US from the UK last year. In addition, US tariffs on imports of steel from the UK were cut from 25% to zero. Subject to quotas, reciprocal tariffs on beef exports in both directions were removed. And the tariff on US exports of ethanol into the UK were reduced to zero. For other goods, the 10% baseline US tariff will remain in place, as will the UK's digital services tax. But according to the UK government, the US agreed that the UK would get preferential treatment in any further tariffs imposed as part of its ongoing Section 232 investigations into other important sectors such as pharmaceuticals. And coming after yesterday's agreement of a UK-India trade deal, today's announcements imply a targeted reduction of certain trade barriers as well as a welcome reduction of uncertainty for many firms. Nevertheless, the persisting 10% baseline tariff will have a negative impact on US demand for UK goods. And in his press conference, Governor Bailey acknowledged that barriers to trade between the UK and US were only one source of uncertainty, with the exorbitant tariffs between the US and China, as well as the full global tariff landscape, perhaps equally important. Indeed, according to one of two new scenarios considered, the Bank staff

UK: Private sector regular pay



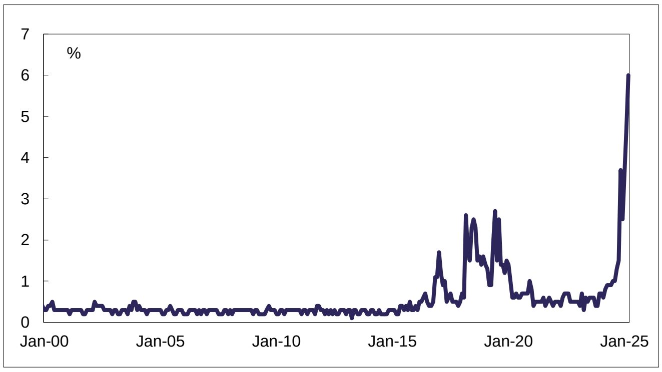
Source: BoE, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Firms' CPI & wage growth expectations



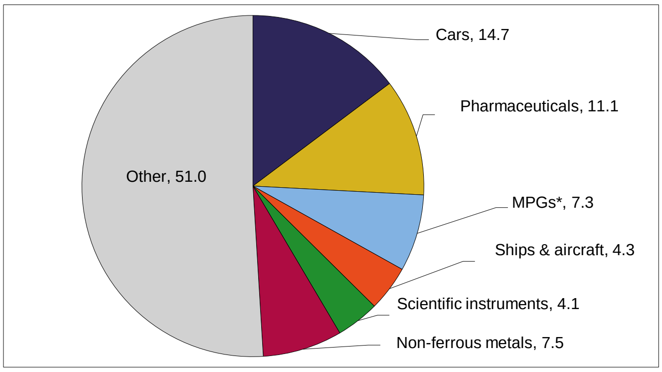
Source: DMP, Macrobond and Daiwa Capital Markets Europe Ltd.

Global trade policy uncertainty index



Source: BoE and Daiwa Capital Markets Europe Ltd.

UK: Share of goods exports to the US (% of total)



**Mechanical power generators.*
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

estimate that additional trade-related uncertainty risks weighing more heavily on consumption and investment than already reflected in its baseline projection, perhaps reducing inflation by an extra 0.3ppt in the first year of the projection period and 0.2ppt by the end of the horizon.

The week ahead in the UK

A key focus in the UK in the coming week will be the first estimate of Q1 GDP on Thursday, which will be accompanied by monthly output figures for March. Following solid growth at the end of 2024, GDP surprised to the upside in early 2025, taking three-month growth in February to 0.6%3M/3M, the strongest since last May. Retail sales also beat expectations in March as the return of the sunshine boosted spending on summer attire and at garden centers. And we expect the above-average temperatures that month to have supported sales in other consumer-facing services too, while activity at estate agents might have been boosted by a rush to complete purchases ahead of April's change to Stamp Duty. Front-loading of manufacturing production and shipments in certain industries will also provide a sizeable contribution to GDP growth in March. So, while surveys point to a marked slowdown in construction that month, we expect a fourth monthly increase in economic output out of the past five. Indeed, in the absence of revisions to previous months, an increase in GDP of just 0.1%M/M in March will deliver quarterly growth of 0.7%Q/Q, a touch firmer than the BoE's updated projection.

The latest labour market figures will also be of interest to policymakers. We expect total pay growth to have moderated further in the three months to March, from 5.6%3M/Y previously. Private regular wage growth – closely watched by the BoE – is also likely to have edged slightly lower, albeit remaining above the rate for total pay and still well above the long-run average (3½%). But the timelier HMRC PAYE numbers for April will likely see an uptick, reflecting the near-10% hike in the National Living Wage that month. While employment growth is likely to have slowed from 206k in the three months to February, it will still likely remain inconsistent with the steady decline in job vacancies and signals from various surveys, including the REC report on jobs, for which the latest results for will be published on Monday. Finally, the BRC retail sales monitor (Tuesday) will provide further insight into retail conditions at the start of Q2, with a likely rebound in annual growth in April to have been flattered by the later timing of Easter this year.

Daiwa economic forecast

	2025				2026		2025	2026	2027
	Q1	Q2	Q3	Q4	Q1	Q2			
GDP	**%, Q/Q**						**%, Y/Y**		
Euro area	0.4	-0.1	-0.1	0.2	0.2	0.3	0.7	0.7	1.3
UK	0.7	-0.1	0.2	0.3	0.3	0.3	0.9	1.1	1.4
Inflation, %, Y/Y									
Euro area									
Headline HICP	2.3	2.0	1.8	1.9	1.7	1.7	2.0	1.8	1.8
Core HICP	2.6	2.4	2.1	2.1	1.9	1.4	2.2	1.7	1.6
UK									
Headline CPI	2.8	3.3	3.4	3.2	2.7	1.9	3.2	2.2	2.0
Core CPI	3.6	3.3	3.2	3.2	2.9	2.1	3.3	2.1	1.8
Monetary policy, %									
ECB									
Deposit Rate	2.50	2.00	1.75	1.75	1.75	1.75	1.75	1.75	1.75
Refi Rate	2.65	2.15	1.90	1.90	1.90	1.90	1.90	1.90	1.90
BoE									
Bank Rate	4.50	4.25	4.00	3.75	3.50	3.25	3.75	3.25	3.00

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

The next edition of the Euro wrap-up will be published on 13 May 2025

European calendar

Today's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Germany		Industrial production M/M% (Y/Y%)	Mar	**3.0 (-0.2)**	1.0 (-2.7)	-1.3 (-4.0)	- (-4.1)
		Trade balance €bn	Mar	**21.1**	19.1	17.7	18.0
Spain		Industrial production M/M% (Y/Y%)	Mar	**0.9 (1.0)**	-	0.7 (-1.9)	-
UK		BoE Bank Rate %	May	**4.25**	*4.25*	4.50	-
		DMP 3M output price (1Y CPI) expectations Y/Y%	Apr	**3.8 (3.1)**	4.0 (3.5)	3.9 (3.4)	-
		RICS house price balance %	Apr	**-3**	-4	2	-

Auctions

Country		Auction
Spain		sold €2.26bn of 2.4% 2028 bonds at an average yield of 2.086%
		sold €2.28bn of 2.7% 2030 bonds at an average yield of 2.375%
		sold €1.63bn of 4% 2054 bonds at an average yield of 3.974%
		sold €672m of 1% 2030 inflation-linked bonds at an average yield of 0.741%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country		BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Italy		09.00	Industrial production M/M% (Y/Y%)	Mar	0.5 (-1.9)	-0.9 (-2.7)

Auctions and events

Country		BST	Event
UK		09.40	BoE Governor Bailey to give keynote speech at Reykjavik economic conference
		12.15	BoE Chief Economist Pill to brief Bank's Agents on updated macroeconomic projections

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/ *Daiwa forecast*	Previous
			Monday 12 May 2025			
			- Nothing scheduled -			
			Tuesday 13 May 2025			
Germany		10.00	ZEW current situations (expectations) balance	May	-	-81.2 (-14.0)
UK		00.01	BRC retail monitor – like-for-like sales Y/Y%	Apr	-	0.9
		07.00	Average wages (excluding bonuses) 3M/Y%	Mar	-	5.6 (5.9)
		07.00	Private sector regular wages 3M/Y%	Mar	-	5.9
		07.00	Unemployment rate 3M%	Mar	-	4.4
		07.00	Employment 3M/3M change 000s	Mar	-	206
		07.00	Payrolled employees M/M change 000s	Apr	-	-78
		07.00	Claimant count rate % (change 000s)	Apr	-	4.6 (18.7)
			Wednesday 14 May 2025			
Germany		07.00	Final HICP (CPI) Y/Y%	Apr	*2.2 (2.1)*	2.3 (2.2)
Spain		08.00	Final HICP (CPI) Y/Y%	Apr	*2.2 (2.2)*	2.2 (2.3)
			Thursday 15 May 2025			
Euro area		10.00	GDP – second estimate Q/Q% (Y/Y%)	Q1	*0.4 (1.2)*	0.2 (1.2)
		10.00	Employment – first estimate Q/Q% (Y/Y%)	Q1	-	0.1 (0.7)
		10.00	Industrial production M/M% (Y/Y%)	Mar	-	1.1 (1.2)
France		07.45	Final HICP (CPI) Y/Y%	Apr	*0.8 (0.8)*	0.9 (0.8)
UK		07.00	GDP – first estimate Q/Q% (Y/Y%)	Q1	*0.7 (1.2)*	0.1 (1.5)
		07.00	Monthly GDP M/M% (3M/3M%)	Mar	*0.1 (1.0)*	0.5 (0.6)
		07.00	Services output M/M% (3M/3M%)	Mar	-	0.3 (0.6)
		07.00	Industrial output M/M% (Y/Y%)	Mar	-	1.5 (0.1)
		07.00	Construction output M/M% (Y/Y%)	Mar	-	0.4 (1.6)
		07.00	Trade (goods trade) balance £bn	Mar	-	-2.0 (-20.8)
		09.30	Preliminary output per hour Y/Y%	Q1	-	-0.8
			Friday 16 May 2025			
Euro area		10.00	Trade balance €bn	Mar	-	21.0
France		06.30	ILO unemployment rate (mainland) %	Q1	-	7.3 (7.1)
Italy		09.00	Final HICP (CPI) Y/Y%	Apr	*2.1 (2.0)*	2.1 (2.0)

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions

Country		BST	Event / Auction
			Monday 12 May 2025
UK		00.01	REC, KPMG & S&P Global UK Report on Jobs for April
		-	BoE Deputy Governor Lombardelli & MPC External Members Greene, Mann & Taylor speak at BoE conference, London
			Tuesday 13 May 2025
Germany		10.30	Auction: to sell up to €4.5bn of 1.7% 2027 bonds
Italy		10.00	Auction: to sell bonds*
UK		08.15	BoE Deputy Governor Breeden to give keynote address at ISDA's annual general meeting, Amsterdam
		09.45	BoE Chief Economist Pill to speak at LSE conference, London
		10.00	Auction: to sell up to £1bn of 0.625% 2045 inflation-linked bonds
		16.00	BoE Governor Bailey speaks in fireside chat with DnB Governor Knot at the Foreign Bankers' Association AGM, Amsterdam
			Wednesday 14 May 2025
Germany		10.30	Auction: to sell up to €1.5bn of 1.25% 2048 bonds
		10.30	Auction: to sell up to €1bn of 2.5% 2054 bonds
UK		10.00	Auction: to sell up to £4.25bn of 4.5% 2035 bonds
			Thursday 15 May 2025
UK		15.00	BoE MPC External Member Dhingra to speak at New Economics Foundation conference, Brussels
			Friday 16 May 2025
Euro area		-	European Commission to publish 2025 Spring economic forecasts
Euro area/UK		16.00	ECB Chief Economist Lane and BoE Deputy Governor Lombardelli join panel at Fed research conference, Washington D.C.

**Details to be announced. Source: Bloomberg and Daiwa Capital Markets Europe Ltd.*

Access our research blog at: https://www.uk.daiwacm.com/ficc-research/recent-blogs