

Euro wrap-up

Overview

- Bunds made modest losses as the ZEW survey pointed to renewed investor optimism in the German economic outlook despite a continued downbeat assessment of current conditions.
- Despite another upbeat signal on UK retail sales, Gilts made gains at the short end of the curve as payrolls continued to fall and private regular pay growth moderated a touch further than the BoE expected.
- Wednesday will bring final German and Spanish inflation data for April.

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Daily bond market movements

| Bond | Yield | Change |
|---------------|-------|--------|
| BKO 2.2 03/27 | 1.925 | +0.010 |
| OBL 2.4 04/30 | 2.239 | +0.020 |
| DBR 2½ 02/35 | 2.674 | +0.028 |
| UKT 3% 03/27 | 3.964 | -0.023 |
| UKT 4% 03/30 | 4.120 | +0.001 |
| UKT 4½ 03/35 | 4.662 | +0.021 |

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

Euro area

Expectations about the German economic outlook normalise following initial tariff shocks

After Trump's Liberation Day tariff shock had precipitated an inevitable slump in investor sentiment about the German economic outlook last month, today's ZEW survey showed welcome signs of normalisation in response to the US administration's subsequent backtracking. Admittedly, investors' perceptions of the current macroeconomic situation remained extremely weak, close to the series' floor. Indeed, the respective survey index slipped an additional 0.8pt in May to -82.0, most likely reflecting the ongoing bite from the still-imposed baseline and sector-specific tariff rates. Early political hiccups for new Chancellor Merz's coalition government might also have played a role. But given the softening US trade stance and progress in its negotiations with third parties if not the EU, the ZEW index of economic expectations rebounded by almost 40pts to 25.2. That increase was failed to offset in full the drop of more than 65pts last month. But it still lifted economic expectations back above its long-run average (20.9), and to a level more compatible with the initial sentiment boost ahead of February's German election.

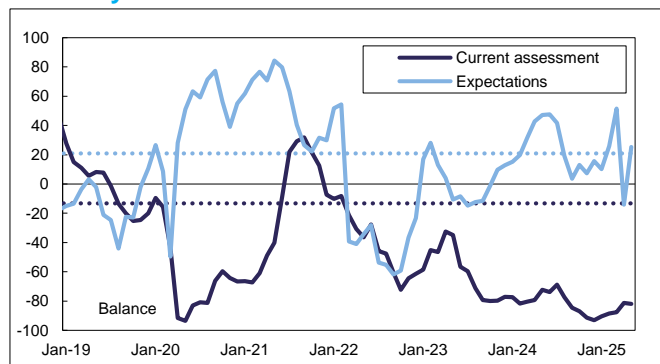
Investor assessments of profitability vary significantly from one sector to another

Prospects of continued monetary easing by the ECB are supporting the upbeat expectations. Certainly, with the ECB having signalling its readiness to cut rates further after April's announcement, an increasing share of respondents (72pts) expect further easing ahead. For construction – among the sectors most sensitive to monetary policy, and insulated to some extent from trade effects – the effects of cumulative and anticipated easing led to the firmest investor assessments of the profit outlook in six years. Indeed, with the exception of telecoms, an improved profit outlook was observed across all sub-sectors, though almost all were still considerably more downbeat than they had been in March. Unsurprisingly, those sectors most exposed to US sector-specific tariffs – namely autos and steel – remained weakest.

The day ahead in the euro area

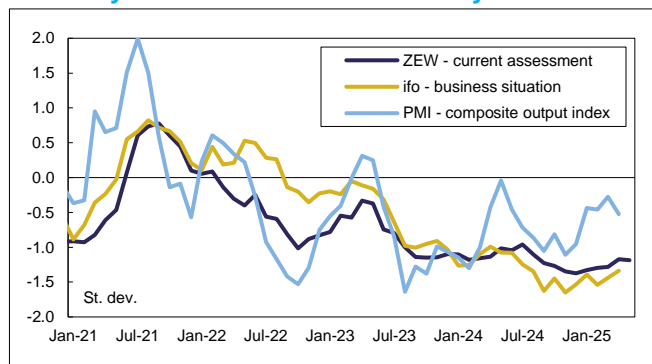
Tomorrow's main release will be the final data for German and Spanish consumer price inflation in April. The flash releases for both countries on the EU-harmonised HICP measure printed at 2.2%Y/Y. That marked a sideways movement in Spain, but edged Germany 0.1ppt closer to target at a seven-month low. The accompanying detail is expected to reflect a broader euro area trend, namely falling energy prices sufficient to offset an uptick in core inflation. The rise in core inflation also likely reflected a temporary boost to specific leisure- and travel-related components associated with the later timing of Easter holidays this year, as opposed to a resurgence in underlying price pressures.

Germany: ZEW – headline indices



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Business sentiment surveys



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK

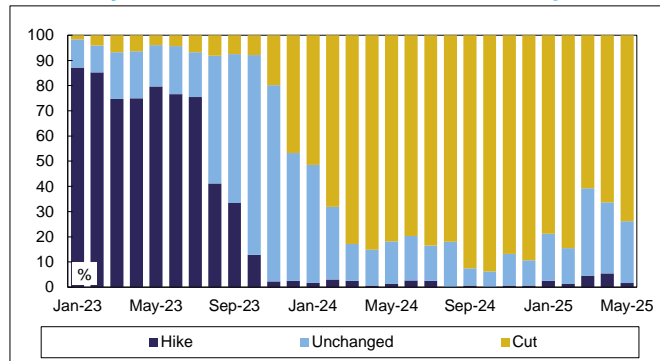
Labour market continues to soften as payrolls & vacancies extend downward trends

The UK labour market continues to soften in the face of subdued underlying demand and rising business costs. Most strikingly, according to the preliminary estimate, the number of payrolled employees fell in April by 32.5k, marking the third successive monthly drop and fifth decline in the past six months to be down 0.4%Y/Y, the most since May 2021. The cumulative fall in payrolls from October, when the increases in employer National Insurance Contributions and the National Living Wage that took effect last month were initially announced, rose above 150k (0.5%), highlighting the increasingly negative momentum. Almost half of that drop over the past six months occurred in the hospitality sector, with wholesalers and retailers accounting for a further quarter, suggesting that the higher costs of employing lower-skilled workers has played a role in softening labour demand. However, the drop in payrolls on the month in April alone was more than fully accounted for by professional, technical and scientific services and construction, hinting that the weakening in labour market conditions has become more broad-based. Critics will argue that the increase in labour costs has simply provided an incentive to shift workers off payroll. But while there also remain concerns about the Labour Force Survey's (LFS's) accuracy, its unemployment rate rose 0.2ppt on the quarter to 4.5% in Q1, while its employment measure edged down on the three months to March for the first time in more than a year. In addition, the jobless claimant count picked up in April. Notably too, job vacancies maintained their downtrend, falling in the three months to March by 42k, the most in more than a year, to be down more than 40% from the peak three years ago. With the composite employment PMI having weakened more than 1ppt in April to 45.8, firmly below the average of the past six months, we expect the downtrend in job vacancies to continue for a while yet.

Regular pay growth moderates slightly below BoE's projection despite higher minimum wage

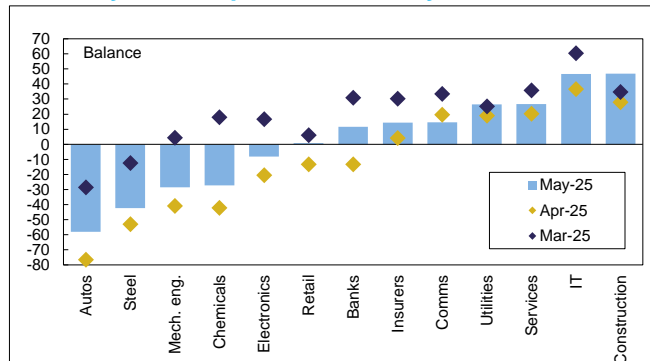
With labour demand softer, average pay growth continues to moderate despite last month's 7% rise in the National Living Wage. Total pay slowed in the three months to March by 0.6ppt on the quarter and 0.4ppt on a year earlier to 5.5%3M/Y. Private sector pay slowed 0.9ppt on the quarter to 5.4%3M/Y. And, most importantly for the BoE, private regular pay (i.e. excluding bonuses) slowed 0.6ppt on the quarter to 5.6%3M/Y. Strikingly too, private regular pay momentum slowed to a 14-month low of 0.9%3M/3M. Admittedly, the higher minimum wage contributed to an increase in regular pay growth in hospitality of more than 1ppt from December to a 2½-year high of 6.9%3M/Y, with construction pay also accelerating. But in other services, manufacturing and finance regular pay slowed. And notably, private sector regular pay slightly undershot the BoE's MPR forecast by 0.2ppt and also undershot the consensus. While MPC members Lombardelli, Greene and Mann this week continued to caution that pay growth remains firmly above levels consistent with the sustained achievement of the

Germany: ZEW – 6m-ahead interest rate expectation



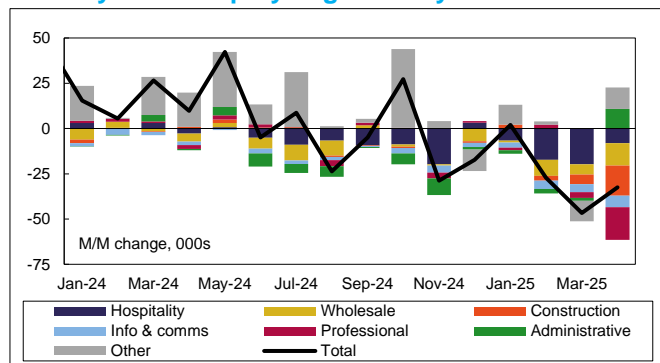
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: ZEW – profit outlook by sector*



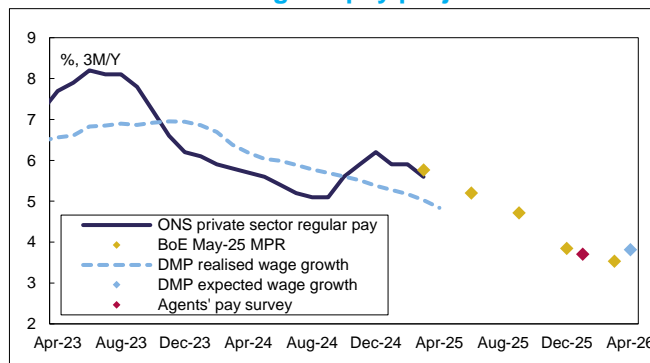
*Assessment of 6-month profit outlook. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Payrolled employee growth by sector



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Private sector regular pay projections



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

BoE's inflation target, survey measures point to a continued downtrend in pay over coming quarters. For example, the BoE agents' survey measure – which is valued by MPC dove Taylor – suggests a moderation to 3.7%3M/Y by the start of 2026. The DMP survey suggests a similar easing to 3.8%3M/Y in a year's time, which likewise points to a steady easing in underlying domestically-generated inflation.

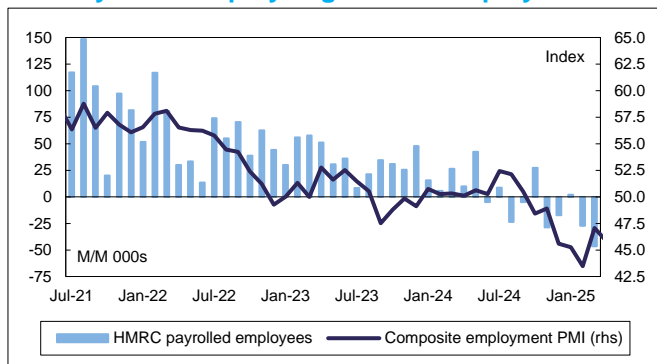
BRC reports strong retail sales in April as sunshine brought out the shoppers

While the labour market has been softening, economic activity has recently been surprisingly firm. Indeed, we expect the Q1 GDP data on Wednesday to show that growth accelerated 0.6ppt to a four-quarter high of 0.7%Q/Q. A significant contribution to that growth was retail activity, with the ONS's estimate of sales volumes having jumped 1.6%Q/Q (and 1.9%Q/Q excluding auto fuel), marking the strongest quarter for the sector since Q221. In part, that strength was related to unseasonably fine weather, which attracted footfall and encouraged spending on clothing, garden equipment and other outdoor-related items. And according to today's BRC survey results, the sunniest April on record was unsurprisingly another good month for retailers, with the survey measure of total sales values up 7.0%Y/Y, the most in more than three years. Admittedly, that figure was flattered by the impact on the timing of Easter on food sales, and followed a softer BRC sales figure in March. But looking through the Easter-related volatility and on a like-for-like basis, sales values were up 2.7%3M/Y, the most since November 2023. On the same basis, food sales were up 3.7%3M/Y, the best in twelve months, while non-food sales were up 1.9%3M/Y. With the BRC's shop price inflation measure still in negative territory in April, the BRC survey measure of real like-for-like sales rose to 3.1%3M/Y, the best since August 2021. And with May having been blessed with warm sunshine so far, we expect retail activity to remain relatively firm this month too, despite the deteriorating job market.

The day ahead in the UK

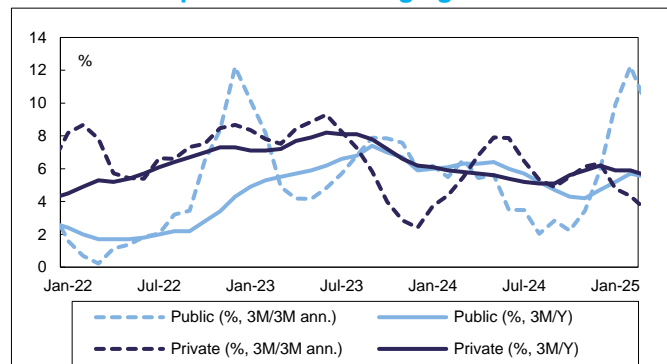
With no data releases scheduled for Wednesday, it should be a relatively quiet day for UK economic news. BoE Deputy Governor Breeden is due to deliver a speech at ISDA's annual general meeting in Amsterdam, though her comments are expected to pertain more to her financial stability role and are likely to steer clear of last week's monetary policy announcement.

UK: Payrolled employee growth & employment PMI



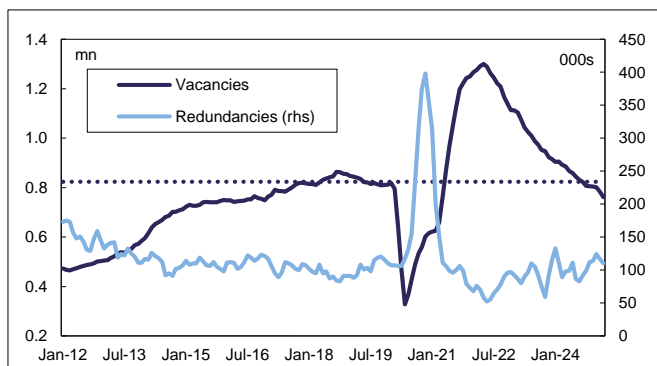
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Public & private sector wage growth



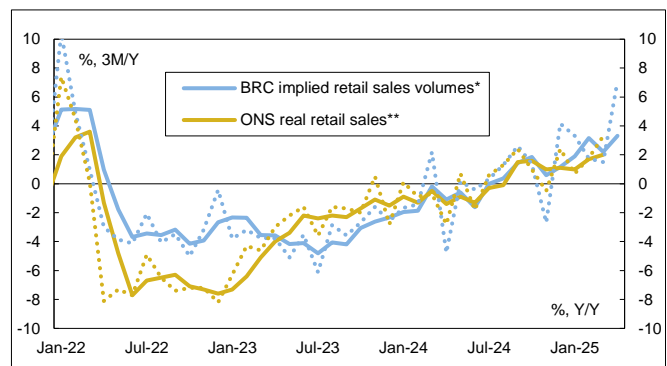
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Job vacancies & redundancies*



*Dotted line shows 2019 average vacancies.
 Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Retail sales indices











Dotted lines show single-month figures on the right-hand axis. *Sales values deflated by the BRC shop price index. **Sales excluding auto fuel. Source:






European calendar

Today's results

Economic data

| Country | Release | Period | Actual | Market consensus/ <i>Daiwa forecast</i> | Previous | Revised |
|---------|---|--------|---------------------|--|---------------|-------------|
| Germany |  ZEW current situations (expectations) balance | May | -82.0 (25.2) | -77.0 (11.3) | -81.2 (-14.0) | - |
| UK |  Average wages (excluding bonuses) 3M/Y% | Mar | 5.5 (5.6) | 5.2 (5.7) | 5.6 (5.9) | 5.7 (-) |
| |  Private sector regular wages 3M/Y% | Mar | 5.6 | 5.7 | 5.9 | - |
| |  Unemployment rate 3M% | Mar | 4.5 | 4.5 | 4.4 | - |
| |  Employment 3M/3M change 000s | Mar | 112 | 115 | 206 | - |
| |  Payrolled employees M/M change 000s | Apr | -33 | -32 | -78 | -47 |
| |  Claimant count rate % (change 000s) | Apr | 4.5 | - | 4.6 (18.7) | 4.5 (-16.9) |
| |  BRC retail monitor – like-for-like sales Y/Y% | Apr | 6.8 | 2.3 | 0.9 | - |



Auctions

| Country | Auction |
|---------|---|
| Germany |  sold €3.401bn of 1.7% 2027 bonds at an average yield of 1.94% |
| Italy |  sold €3.5bn of 2.65% 2028 bonds at an average yield of 2.4% |
| |  sold €2.5bn of 3.25% 2032 bonds at an average yield of 3.28% |
| |  sold €1.5bn of 4.45% 2043 bonds at an average yield of 4.26% |
| UK |  sold £1bn of 0.625% 2045 inflation-linked bonds at an average yield of 2.235% |





Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

| Country | BST | Release | Period | Market consensus/ <i>Daiwa forecast</i> | Previous |
|---------|---|-----------------------|--------|--|-----------|
| Germany |  07.00 | Final HICP (CPI) Y/Y% | Apr | <u>2.2 (2.1)</u> | 2.3 (2.2) |
| Spain |  08.00 | Final HICP (CPI) Y/Y% | Apr | <u>2.2 (2.2)</u> | 2.2 (2.3) |

Auctions and events

| | | |
|---------|---|--|
| 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 |  08.15 | BoE Deputy Governor Breeden to give keynote address at ISDA AGM, Amsterdam |
| |  10.00 | Auction: to sell up to £4.25bn of 4.5% 2035 bonds |

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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