

# Euro wrap-up

## Overview

- Euro area government bonds largely made modest losses at the short end but gains at the longer end of the curve after flash French inflation data for May surprised significantly to the downside.
- Shorter-dated Gilts made bigger losses after a survey of retail businesses suggested that food price inflation rose the most in 12 months in May.
- Wednesday will bring the ECB's April consumer expectations survey and updates on German unemployment in May and French GDP in Q1.

## Economics Research Team

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### Daily bond market movements

Bond	Yield	Change
BKO 1.7 06/27	1.780	+0.009
OBL 2.4 04/30	2.092	-0.002
DBR 2½ 02/35	2.533	-0.024
UKT 3¾ 03/27	4.012	+0.037
UKT 4¾ 03/30	4.150	+0.024
UKT 4½ 03/35	4.668	-0.011

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

## Euro area

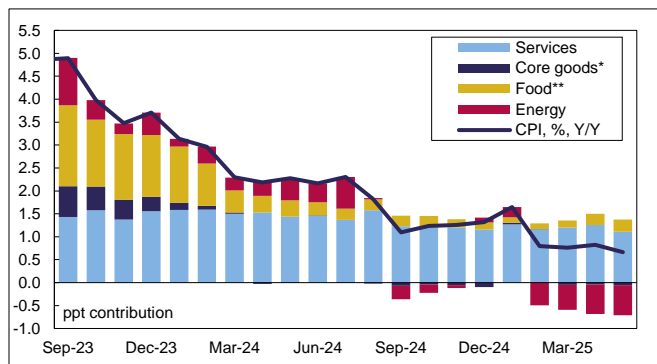
### French inflation surprises on the downside dropping to lowest since end-2020

Today's flash estimates of French inflation in May – the first to come from the euro area member states – significantly undershot the consensus forecasts. In particular, contrary to expectations of no change, the French EU-harmonised HICP measure fell 0.3ppt from April to just 0.6%Y/Y, the lowest since end-2020. While food inflation picked up due to pressures in processed items, that impact was offset by lower energy inflation thanks to falling prices of petrol and gas. Meanwhile, inflation in core goods was steady on the month in mildly negative territory. So, the main driver of the step down in French headline inflation was a decline in the all-important services component, by 0.3ppt to 2.1%Y/Y, the softest in more than three years, thanks to lower prices of transport services and communications. The fall in transport services was no surprise to us, as we had emphasised that the rise in that component in April was due principally to the impact of the timing of Easter on holiday-related items such as airfares. We note that French inflation was already the weakest rate of all member states in April. And with French economic activity among the most subdued of all member states, inflation is likely to have remained weaker than elsewhere in May. Nevertheless, today's data should reinforce expectations that the flash euro area figures – which aren't due until 3 June – will also be consistent with continued disinflation in both the headline and core rates. And as such, we expect the ECB's inflation projection to be revised down on 5 June to flag the likelihood that euro area inflation will fall below target by Q3, and could also fall a little short of 2% over the horizon. That would justify a further 25bps rate cut at the June meeting and also suggest a decent chance of one final 25bps cut this cycle, albeit most likely not until September.

### Euro area ESI points to improvement in sentiment in May but lags behind Q1

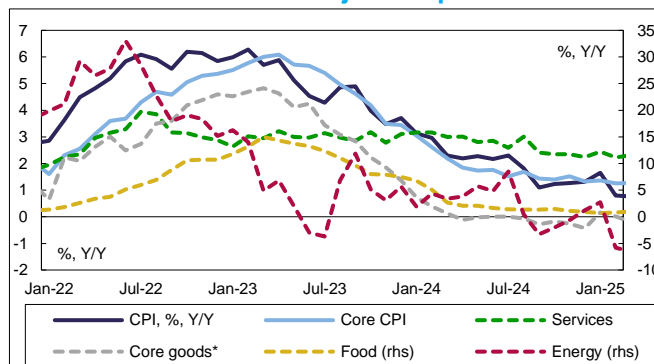
Today's Commission business and consumer survey results were also consistent with moderating price pressures. Firms' selling price expectations for the coming three months moderated across the major sectors in May. Furthermore, the index of consumer price expectations for the coming twelve months fell to a four-month low, only slightly above the long-run average, suggesting that expectations remain relatively well-anchored. Moreover, in terms of activity, the Commission's economic sentiment index (ESI) beat expectations, recording the first monthly increase in three – up 1pt to 94.8 – to provide a more optimistic assessment of conditions than the further decline reported in last week's flash [composite PMI](#). Indeed, consistent with the improvement suggested by the ifo survey, the German ESI (91.5) rose for a fifth successive month in May to a ten-month high. And the Spanish ESI (103.4) was consistent with ongoing outperformance among the larger member states. But while the Italian ESI (98.6) jumped to a three-month high it was still trending almost 2pts below the Q1 average. And the French ESI (93.1) fell 3½pts to a five-month low, similarly more than 2pts below the Q1 level. Overall, given the tariff-related deterioration at the start of the second quarter, despite the improvement in May, the euro area's ESI was still trending 1.2pts below the Q1 average and more than 5% below the long-run average, supporting our expectation for a modest contraction in

### France: CPI inflation & contributions



\*Non-energy industrial goods. \*\*Food, alcohol & tobacco.  
 Source: Macrobond and Daiwa Capital Markets Europe Ltd.

### France: CPI inflation & major components



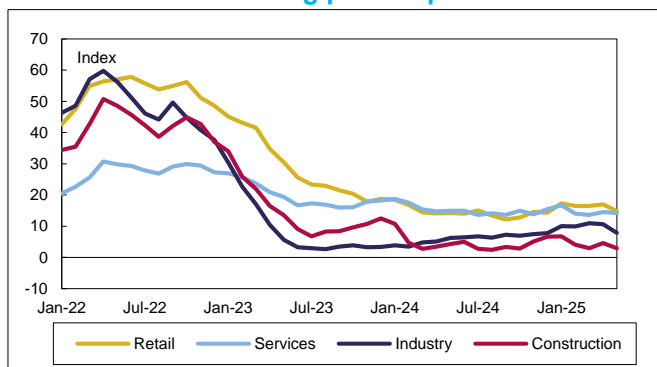
\*Non-energy industrial goods.  
 Source: Macrobond and Daiwa Capital Markets Europe Ltd.

euro area GDP this quarter. Certainly, the judgement by manufacturers that conditions in May were the best in 14 months seems overly sanguine as we expect pay-back this quarter for the surge in production and shipments to front-run US tariffs in Q1. Indeed, despite reports of a depletion of stocks of finished goods and improvement in order books, the Commission survey suggested that firms were still less upbeat about the production outlook than in Q1, supporting our view that a pull-back in manufacturing production in certain sectors – such as autos and pharmaceuticals – will provide a non-negligible drag on GDP growth this quarter.

### Services sentiment slips to a four-year low amid weakening demand

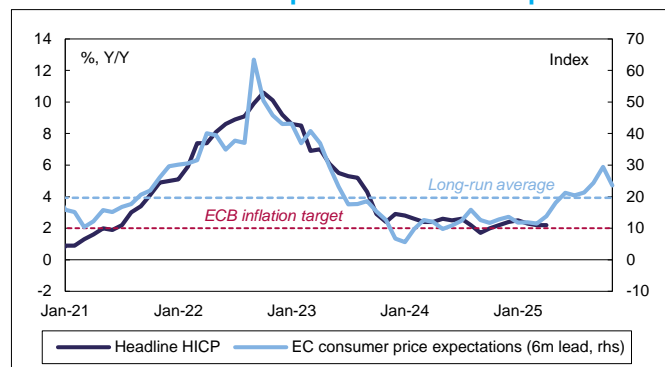
In the other major sectors, despite improved order books, a rebound in construction sentiment this month left it still below the average in Q1 when activity rose a lacklustre 0.1%Q/Q. And despite rising from April's nine-month low, the retail confidence index was no better than the average of the past year, as consumers remained relatively downbeat amid rising unemployment fears. Indeed, despite rising the most since December 2023, the headline consumer confidence index was still the second-lowest of the past 15 months. Arguably most concerning about today's release was the marked deterioration reported in services sentiment, which fell to the lowest since April 2021 and mid-2013 when excluding the Covid-lockdowns distortions, amid a notable weakening in demand. Admittedly, the deterioration was led by France and concentrated to

#### Euro area: Firms' selling price expectations



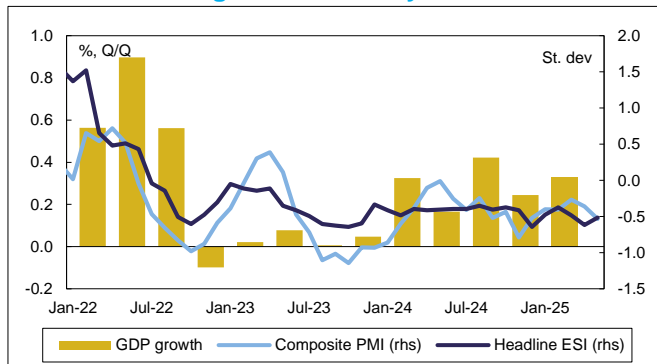
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

#### Euro area: Consumer price inflation & expectations



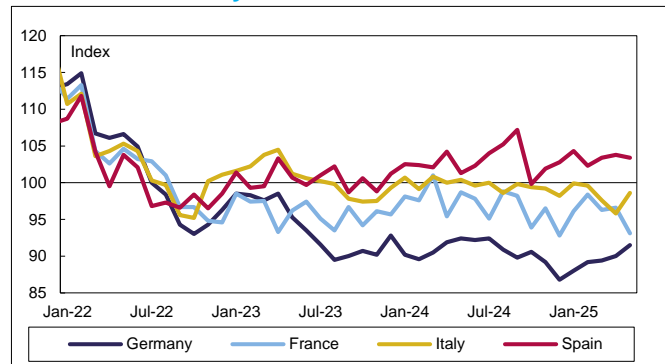
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

#### Euro area: GDP growth & survey indices



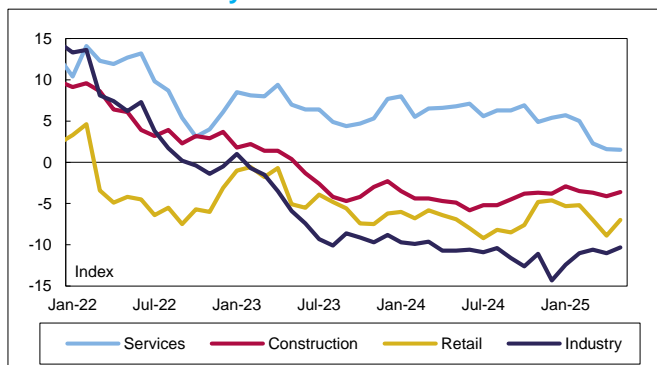
Source: Macrobond, EC, S&P Global and Daiwa Capital Markets Europe Ltd.

#### Euro area: ESIs by member state



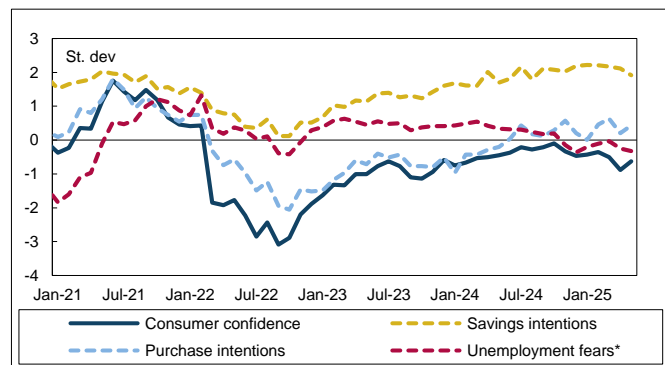
Source: Macrobond, EC and Daiwa Capital Markets Europe Ltd.

#### Euro area: ESIs by sector



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

#### Euro area: Consumer confidence



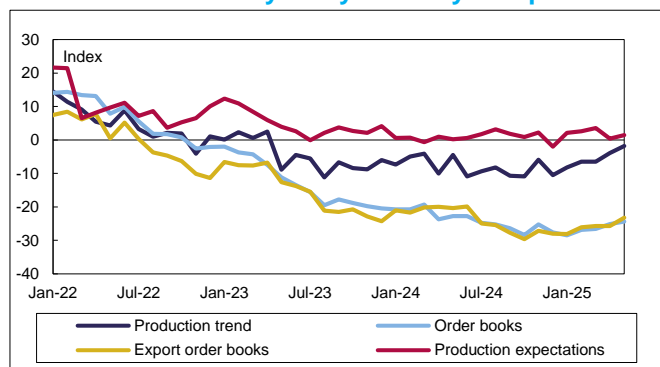
\*Inverted scale. Source: Macrobond, EC and Daiwa Capital Markets Europe Ltd.

certain subsectors, including programming and broadcasting activities, advertising and other professional, scientific and technical activities. In contrast, accommodation and other travel-related sectors improved, suggesting ongoing support for the tourism sector in Southern Europe. Given the more striking deterioration in sentiment, an increasing share of French firms expressed a preference to cut headcount. In contrast, German firms' employment intentions were the least downbeat since August, while businesses in Italy and Spain signalled ongoing job growth.

## The day ahead in the euro area

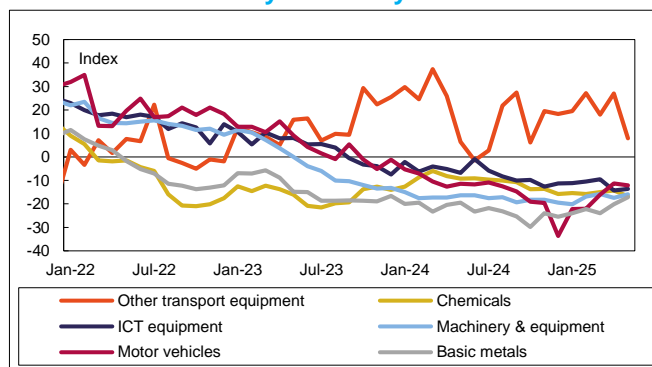
After today's French inflation data suggested strongly that the uptick in inflation in April was merely temporary, tomorrow's ECB consumer expectations survey results should show that household inflation expectations last month were unperturbed. Household income and employment expectations, however, may have been more adversely affected by broader uncertainty instigated by recent trade policy noise. Separately, German jobless claims figures will provide a first view on employment conditions this month. Meanwhile, with respect to the euro area's second largest member state, the final French national accounts for Q1 will be expected to confirm that, despite stagnation in consumption and investment, an accumulation of inventories assisted a relatively modest return to growth in Q1 (0.1%Q/Q). Notably, unlike Germany and Ireland, the data will likely confirm that net trade subtracted from French GDP growth last quarter in the absence of any significant front-running of US tariffs. Finally, April's French consumer spending data will provide insights as to whether rising job insecurity and subdued confidence weighed on consumption at the start of Q2.

### Euro area: EC survey – key industry components



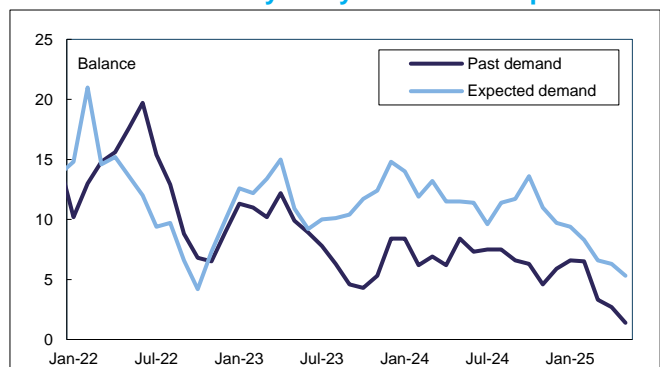
Source: Macrobond, EC and Daiwa Capital Markets Europe Ltd.

### Euro area: EC survey - industry subsector indices



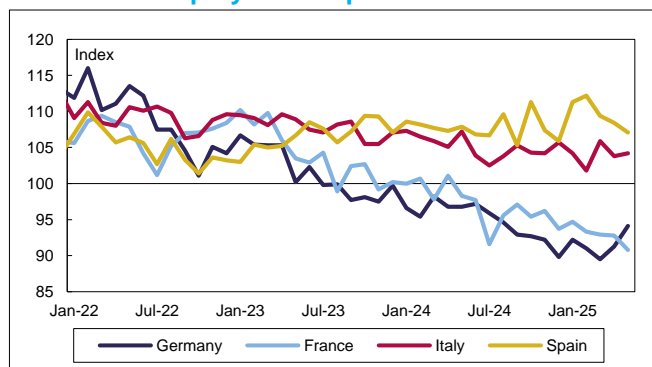
Source: Macrobond, EC and Daiwa Capital Markets Europe Ltd.

### Euro area: EC survey – key services components



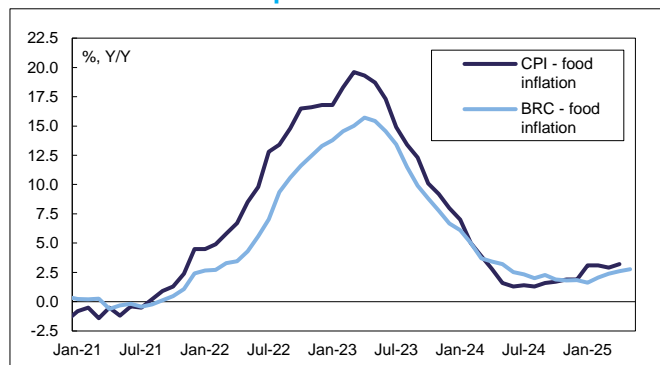
Source: Macrobond, EC and Daiwa Capital Markets Europe Ltd.

### Euro area: Employment expectations indices



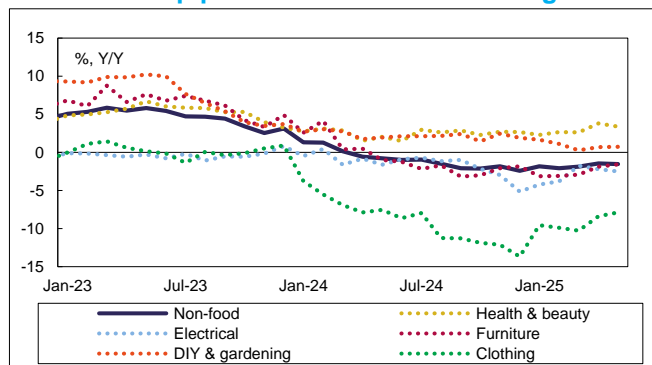
Source: Macrobond, EC and Daiwa Capital Markets Europe Ltd.

### UK: CPI & BRC food price inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

### UK: BRC shop price index - non-food categories



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

## UK

### BRC survey points to further pressure on food prices in May

Following April's step-up in CPI inflation, today's BRC shop price gauge flagged a warning about persistent pressures in May. Indeed, after moving sideways in April, the shop price index picked up 0.2%M/M this month. Notably, that increase was driven by higher food prices, which rose for a second consecutive month, to a 12-month high of 2.8%Y/Y. As the BRC highlighted, May's increase was at least in part related to an increase in wholesale beef prices, contributing to the 0.6%M/M pickup in fresh food prices. But with overall food prices rising a further 0.4%M/M on top of April's increase, those cumulatively left food prices more than 1% up since April's hike in National Insurance Contributions and the National Living Wage. And with food CPI inflation officially having already climbed to 3.2%Y/Y in April, more persistent upwards pressure on food prices will be of concern for those MPC members who have highlighted their salience in influencing households inflation expectations. Those increases in food prices could also present a downside risk to May's retail sales. Certainly, today's CBI survey pointed to a subdued month for sales volumes this month (-27% balance), though the extent of its deterioration was surely exaggerated by the improvement flagged by the survey in April related to the timing of Easter. Still, lower energy costs from July should provide some relief for retailers' costs in the coming months. And despite the uptrend in food prices, recent months have also been characterised by a lack of equivalent pressures in core goods. Indeed, the BRC survey suggested that overall shop prices remained in mild deflationary territory (-0.1%Y/Y) this month, thanks to ongoing weakness from non-food sectors (-1.5%Y/Y). And while today's survey pointed towards the unwinding of promotional prices in certain subsectors (including clothing, furnishings and garden centres), it was still broadly consistent with the ongoing absence of meaningful inflation pressures elsewhere.









### The day ahead in the UK

With the remainder of the week uneventful for UK economic data, the day ahead should be particularly quiet for UK economic news.




## European calendar

### Today's results

#### Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area	 Commission economic sentiment indicator	May	<b>94.8</b>	94.1	93.6	93.8
	 Commission industry (services) confidence indicator	May	<b>-10.3 (1.5)</b>	-10.5 (1.0)	-11.2 (1.4)	-11.0 (1.6)
	 Final Commission consumer confidence indicator	May	<b>-15.2</b>	<u>-15.2</u>	-16.6	-
	 New car registrations Y/Y%	Apr	<b>1.1</b>	-	-1.0	-
Germany	 GfK consumer confidence indicator	Jun	<b>-19.9</b>	-20.0	-20.6	-20.8
France	 Preliminary HICP (CPI) Y/Y%	May	<b>0.6 (0.7)</b>	0.9 (0.9)	0.9 (0.8)	-
UK	 BRC shop price index Y/Y%	May	<b>-0.1</b>	-0.1	-0.1	-
	 CBI distributive trades survey – reported retail sales balance %	May	<b>-27</b>	-	-8	-


#### Auctions

Country	Auction
Italy	 sold €2.75bn of 2.55% 2027 bonds at an average yield of 2.01%
	 sold €1bn of 1.25% 2032 inflation-linked bonds at an average yield of 1.24%
	 sold €1bn of 1.8% 2036 inflation-linked bonds at an average yield of 1.9%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

### Monday's results

#### Economic data




Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Spain	 PPI Y/Y%	Apr	<b>1.9</b>	-	4.9	4.6

#### Auctions




Country	Auction
- Nothing to report -	

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 	09.00	ECB consumer expectations survey – 1Y (3Y) CPI Y/Y%	Apr	2.5 (2.8)	2.9 (2.5)
Germany 	08.55	Unemployment claims rate % (change 000s)	May	6.3 (12)	6.3 (4)
France 	07.45	GDP – final estimate Q/Q% (Y/Y%)	Q1	<u>0.1 (0.8)</u>	-0.1 (0.6)
	07.45	Final private sector payrolls (total payrolls) Q/Q%	Q1	<u>0.0 (-)</u>	-0.3 (-0.3)
	07.45	Consumer spending M/M% (Y/Y%)	Apr	-	-1.0 (-1.5)
	07.45	PPI Y/Y%	Apr	-	-0.6

**Auctions and events**

Germany 	10.30	Auction: to sell up to €1.5bn of 1% 2038 bonds
	10.30	Auction: to sell up to €500m of 4.75% 2040 bonds
UK 	10.00	Auction: to sell £2.75bn of 0.875% 2033 green bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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