Euro wrap-up

Overview

- While the ECB cut rates in line with expectations, Bunds made losses as Lagarde repeatedly stated that the end of the rate-cut cycle is approaching, while German factory orders and Irish GDP surprised to the upside.
- Gilts made modest losses despite an admission from the ONS that April's inflation figure was erroneously high.
- Friday will bring April figures for euro area retail sales, German IP and goods trade, as well as a likely sizeable upwards revision to euro area Q1 GDP growth.

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Daily bond market movements

Bond	Yield	Change
BKO 1.7 06/27	1.864	+0.078
OBL 2.4 04/30	2.168	+0.075
DBR 2½ 02/35	2.576	+0.052
UKT 3¾ 03/27	3.999	+0.004
UKT 4⅜ 03/30	4.122	+0.012
UKT 4½ 03/35	4.614	+0.010

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

Euro area

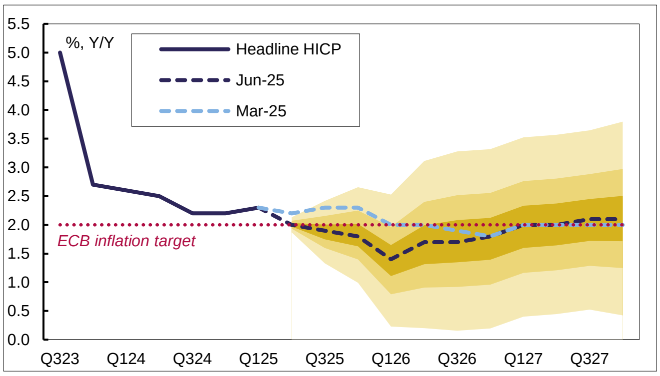
ECB eases by 25bps again, but Lagarde states that end of rate cut cycle is approaching

Inevitably, the ECB today cut rates by 25bps for the eighth time this cycle, taking the deposit rate to 2.00%. President Lagarde stated that only one Governor Council member – surely the Austrian hawk Holzmann – failed to back the cut. Also predictably, the Council's forward guidance offered few clues on the path of policy ahead. Not least given what it judged to be 'exceptional uncertainty', it maintained its commitment to 'follow a data-dependent and meeting-by-meeting approach' to setting policy. But in her press conference, Lagarde repeatedly stated that the end of the current rate cycle was approaching and that policy was now in a 'good position' to navigate current and incoming uncertainties. And that message was reinforced by the ECB's updated baseline inflation projections. The ECB revised down its projection of headline inflation this year and next by 0.3ppt to 2.0%Y/Y and 1.6%Y/Y respectively. And it expects the trough to come around the turn of the year, when it projects headline inflation to be a touch below 1½%Y/Y with a roughly one-in-three probability that inflation will be as low as 1%Y/Y or less. But that weakness reflects the impact of the stronger euro and lower energy prices. In contrast, the ECB's core inflation projection was left broadly unchanged, at 1.9%Y/Y in 2026 and 2027. And so, the ECB left unchanged its projection for headline inflation in 2027 at 2.0%Y/Y, tallying with its assessment that underlying measures suggest that inflation will likely settle close to target on a sustained basis over the medium term.

GDP projection for 2025 unchanged despite new US tariffs

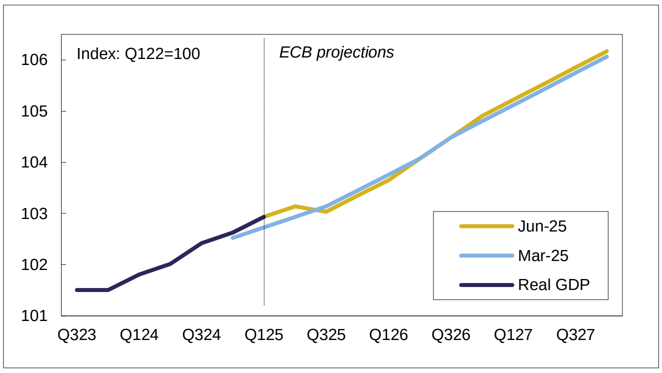
Unlike its previous projections, which assumed only extra bilateral tariffs between the US and China, the ECB's latest projections were based on the new tariffs in place last month between the US and EU and other countries. As such, while it still forecasts positive euro area GDP growth in the current quarter, the ECB also expects a modest dip in economic output in Q3 due to weaker exports, before a resumption in the expansion from Q4 on. However, growth in Q1 (current estimate of 0.3%Q/Q) was stronger than the ECB had been expecting in March. So, despite the newly expected contraction in Q3, it left its full-year growth forecast for 2025 unchanged at a respectable 0.9%Y/Y. Moreover, Lagarde acknowledged that tomorrow's updated Q1 euro area figures could bring an upwards revision. Indeed, new estimates of growth in Germany (to 0.4%Q/Q) and especially Ireland (to an astonishing 9.7%Q/Q) due to the front-running of tariffs suggest an upwards revision of 0.3ppt or more to the euro area figure of at least 0.6%Q/Q. If so, however, we would expect negative payback over the near term, pushing growth back to negative territory as soon as this quarter and little impact on the full-year 2025 figure. Meanwhile, given the comfort provided not least by the resilient labour market and strong private balance sheets, the ECB still expects steady growth in 2026. Indeed, it nudged down its GDP projection for next year by just 0.1ppt to 1.1%Y/Y. And reflecting its sanguine assessment of the likely impact of extra government investment in defence and infrastructure on the medium-term outlook, it left unchanged its GDP projection for 2027 at 1.3%Y/Y.

Euro area: ECB projections – HICP inflation*



*Shaded areas show 30%, 60% & 90% confidence intervals.
Source: ECB, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: ECB projections – GDP levels



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

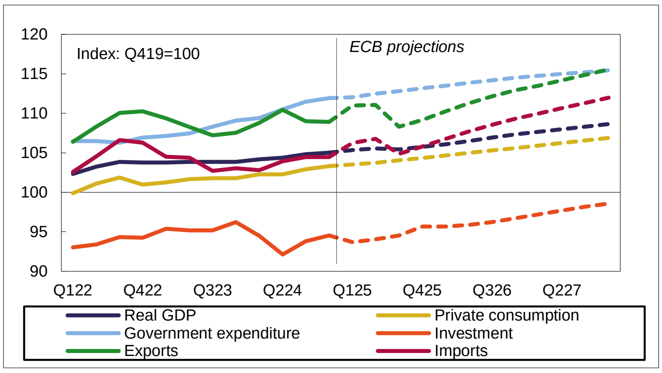
Intensified trade tensions or ongoing euro strength would justify further cut in September

Given continued elevated uncertainty about the global tariff landscape, the ECB also considered the impact of alternative tariff scenarios. Under a 'severe' scenario whereby trade tensions intensify, it judged that GDP might be pushed some 1% below the baseline by 2027 and inflation down to 1.8% that year. In contrast, if trade tensions were resolved with a reduction in tariffs, it judged that inflation could be above-target in 2027. In our view, however, that upbeat scenario seems less likely than the ECB's central projection whereby higher tariffs between the EU and US persist into the medium term. Moreover, not least as we anticipate the euro exchange rate to remain stronger than the ECB's assumption for 2026 and 2027 ($1.13), we also expect it to have to nudge down slightly its 2027 inflation forecast again in September, justifying a further – but probably final – rate cut for the cycle then. And even in the event of a modest easing of current tariffs, significant further appreciation of the euro against the dollar might yet ensue as global asset managers continue to diversify their portfolios away from the US and/or if and when the Fed eases policy. If so, the ECB might yet have to cut the deposit rate to 1.50% or below to avoid more significant undershooting of its inflation target over the medium term.

German factory orders surprise to the upside in April despite higher US tariffs

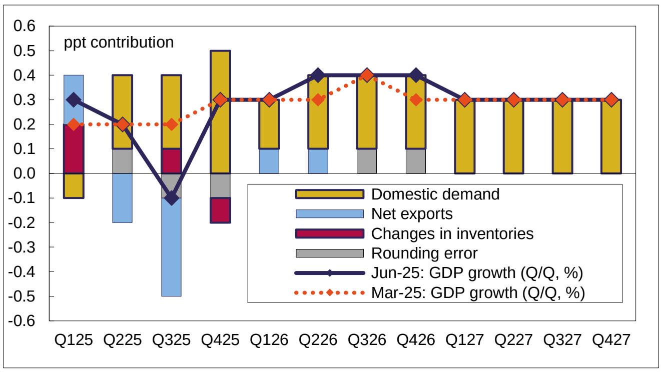
In terms of economic data, today's German factory orders data came in firmer than expected, resonating with the ECB's assessment that the euro area economy is resilient to the tariff shock and tallying with recent stronger-than-expected manufacturing surveys. Contrasting the anticipated decline, total orders rose for a second successive month in April, by 0.6%M/M, to a four-month high. This left orders up 4.8%Y/Y – the strongest annual rate since October – and some 2.9% above the Q1 average. The positive development principally reflected a surge in orders for computer, electronic and optical products (21%M/M), including a bulk order for communications equipment. And while a third consecutive increase in other transport equipment orders (7.1%M/M) was boosted by orders of leisure boats, autos orders also rose to a more than two-year high. When excluding major items, core orders rose for a second month (0.3%M/M) to the highest level since August 2023 to be more than 2% above the Q1 average. Demand was strongest from other euro area economies at the start of Q2, with core orders at the highest level since end-2022. Having risen a cumulative 6½% in the previous two months, orders from non-euro countries edged only slightly lower in April (-0.3%M/M). But, perhaps reflecting the impact of persisting economic uncertainties on underlying domestic demand, core national orders fell in April to be some ½% below the Q1 average. And total domestic orders were higher only due to large orders.

Euro area: ECB projections – GDP levels



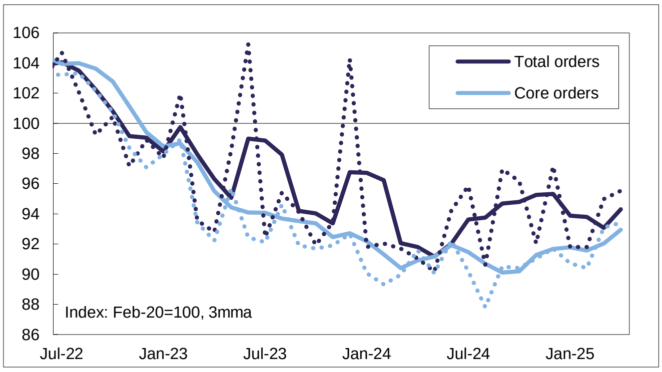
Source: ECB, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: ECB projections – GDP growth



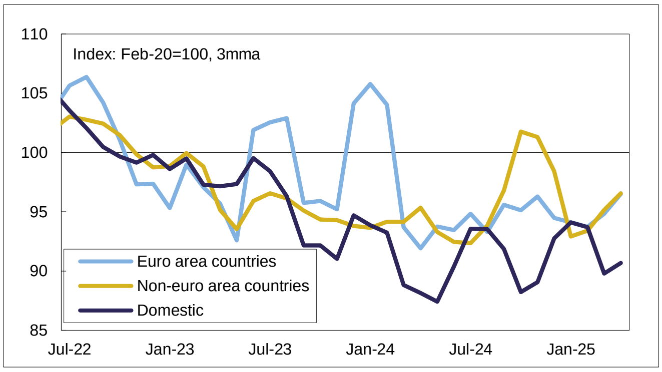
Source: ECB, Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Factory orders*



**Dotted lines are unsmoothed data. Core orders excludes major items.*
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Factory orders



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

The day ahead in the euro area

While April’s factory orders data defied softer overseas demand, the outsized strength in German industrial production during March’s pre-tariff hike push (3.0%M/M) should still lend itself to a decline at the start of Q2. Admittedly, survey indicators – including the PMIs and ifo indices – have pointed to resilience in the sector at the start of Q2. And while today’s manufacturing turnover data reported a non-negligible drop in April (-1.5%M/M), this followed a larger rise in March (2.3%M/M), suggesting the pullback in production didn’t fully reverse that month’s growth. But despite today’s firmer-than-expected orders data, softer US demand for German goods will likely weigh across April’s trade data. Indeed, today’s US figures reported a 13.6%M/M decline in imports from Germany in April. French industrial production and trade figures for April are also due tomorrow.

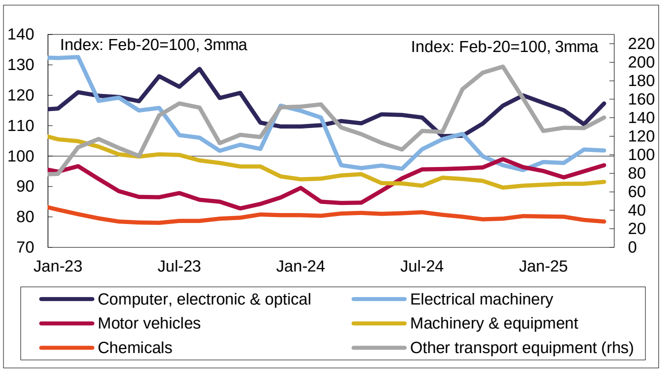
Friday will also bring the aforementioned updated estimates for euro area GDP in Q1. The latest release saw GDP growth rounded down – albeit by just 0.02ppt – to 0.3%Q/Q. But we expect this figure to be revised markedly higher. Indeed, today’s Irish figures saw GDP growth revised up by a whopping 6.5ppts to 9.7%Q/Q, the most in four years. As such, Ireland alone is now estimated to add 0.4ppt to aggregate euro area growth in Q1. And taken together with the doubling in the German growth rate, we now expect euro area GDP growth to be as strong as 0.7%Q/Q in Q1, the fastest in 11 quarters and taking the year-on-year rate to 1.5%Y/Y. Friday’s estimates will also bring the first official expenditure breakdown. Consistent with those aforementioned member states, we expect net trade to have contributed positively (and substantially) for the first quarter in three. Household consumption, supported by continued recovery in real wages growth, also likely supported growth for a third consecutive quarter. Meanwhile, April’s retail sales, also due tomorrow, will provide an early indication to household expenditure at the start of Q2.

UK

Inflation in April was in line with BoE projection after all, but ONS will only correct its error from May

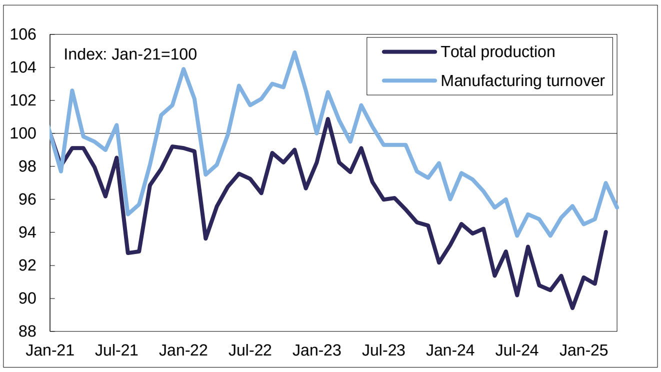
Once again, the ONS has messed up. The ONS today confessed that its estimate of inflation in April – which had significantly exceeded expectations – was erroneously high. In particular, while CPI inflation rose more than 0.9ppt in April to 3.528%Y/Y to three decimal places, the ONS today belatedly (and only after an FT online article flagged the possible problem) admitted that the correct figure should have been 3.402%Y/Y, closer to the original consensus forecast of 3.3%Y/Y and in line with the BoE’s staff projection. Likewise, the ONS’s estimate of RPI inflation (4.5%Y/Y in April) – used for determining debt interest payments on inflation-linked Gilts and only published to one decimal place – had also been overstated by 0.1ppt. The source of the error was related to Vehicle Excise Duty (VED), which that month had been doubled

Germany: Factory orders by subsector



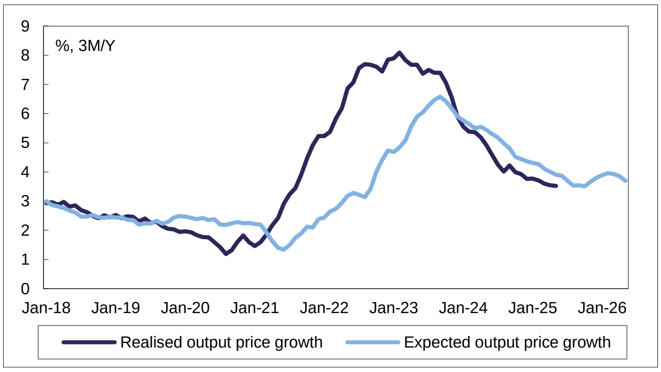
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Factory production & turnover



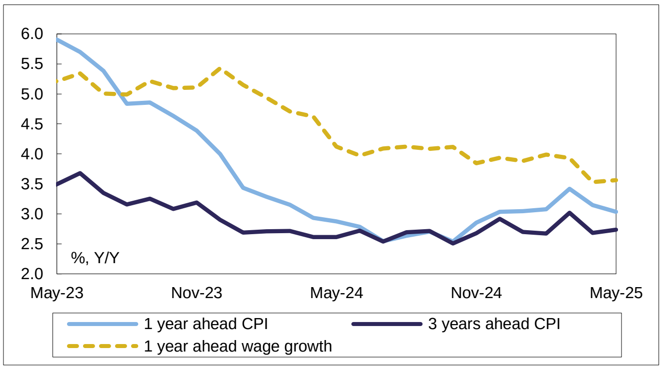
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Firms’ output price expectations



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

UK: Firms’ CPI & wage growth expectations



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

for most vehicles in their first year while electric vehicle and hybrids saw smaller increases. The sharp increase in such costs had contributed significantly to pressures in the CPI subcomponents for transport (up 2.1ppts to 3.3%Y/Y) and, most importantly, services (up 0.4ppt to 5.8%Y/Y).

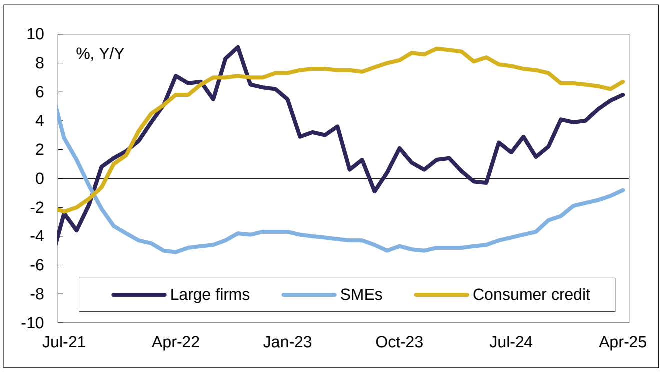
Persistently sub-standard data quality risks monetary and fiscal policy errors

The ONS blamed the error on figures provided by the Department of Transport on the numbers of vehicles in different VED categories, and committed to using correct data for the respective category from May. But rather absurdly, albeit in line with its existing policy, it decided that it would not revise the April figure. So, we now expect headline CPI inflation to dip 0.1ppt in May to 3.4%Y/Y, which again would be bang in line with the BoE's projection. And given the base effect, inflation in April 2026 will be a touch softer than it otherwise would have been. Of course, coming on top of significant concerns about quality related to the labour market, productivity, producer prices and trade, today's admission of yet another flaw in key macroeconomic data illustrates the major challenge faced by the BoE, HM Treasury and market participants in trying to understand precisely what is going on in the UK economy and how policy and market variables should ideally respond. To some extent, the BoE is driving blind, which on top of the heightened uncertainty related to US tariffs and inflation persistence risks, helps to explain the three-way voting split on the MPC in May.

Firms' inflation expectations remain well anchored, with wage growth to moderate further

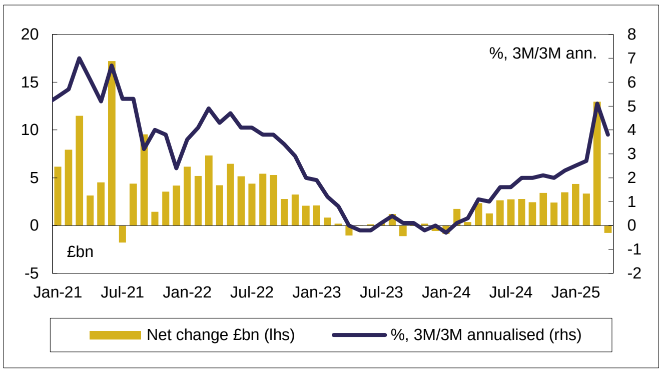
MPC members should at least be broadly encouraged by the results of the BoE's latest Decision Maker Panel survey, with firms expecting wage growth to ease further over coming quarters and inflation expectations remaining well anchored. In particular, having moderated to a more than 3½-year low in March, the survey measure of realised output price growth moved sideways in the three months in April (3.5%3M/Y). And while businesses expected output price inflation to be marginally higher in twelve months' time (3.7%3M/Y), this was still the softest such forecast since last November. Firms' CPI inflation expectations were also little changed from March, with an anticipated decline to 3.2%3M/Y one year ahead and 2.8%3M/Y three years ahead. And while the hike in employer National Insurance Contributions and minimum wage in April pushed labour cost growth higher, firms still saw a more favourable outlook for wage growth over the year ahead – down to a three-year low – which might ease some concerns at the BoE about the risks of potential second-round effects on services inflation.

UK: Business lending & consumer credit growth



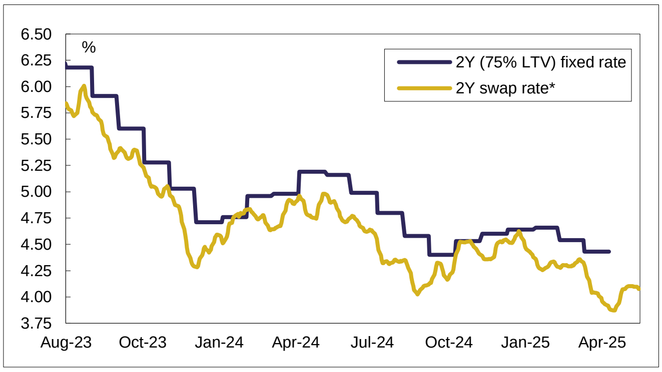
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Mortgage lending



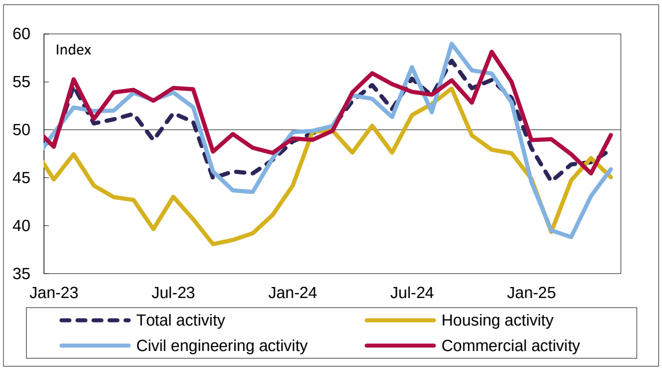
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: 2Y mortgage & swap rates



**5-day moving average.*
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Construction PMIs by subsector



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

Mortgage lending drop exaggerated by tax changes

Although April's bank lending figures (released on Monday) showed that the steady uptrend in business lending and consumer credit should continue to support economic activity, the mortgage numbers occupied the headlines. Indeed, contrasting rather optimistic expectations for a rise, net new borrowing fell in April (-£800mn) for the first time in 15 months. But the pullback was relatively modest after the race to finalise transactions in March, before more favourable stamp duty thresholds expired at the end of that month, significantly boosted mortgage lending. Indeed, the net change in March (£13bn) was its largest since June 2021, a date that was similarly affected by stamp duty changes. Mortgage approvals also fell for a fourth consecutive month to a 14-month low (60.3k), albeit still broadly in line with the average in the previous four years, which may continue to weigh on lending over the coming months. As market surveys have hinted, subdued confidence and heightened economic uncertainty may constrain mortgage demand further. But the recent decline in mortgage rates through May should provide some support. There was also a surprise uptick in house prices in May reported by Nationwide (0.5%M/M) perhaps implying some normalisation to market conditions. Demand resilience, accompanied by a gradual decline in Bank Rate, should also brighten the outlook for housebuilders. In that respect, May's construction PMIs showed steady improvement (up 1.3pts to 47.9). Admittedly, housebuilding lagged among the subsectors (45.1). But commercial work broadly stabilised, while the decline in new construction orders was the smallest since January. So, while constructors reported the sharpest reductions in headcount since the pandemic, their expectations for the year ahead, though subdued, also showed signs of bottoming out.

The day ahead in the UK

It should be a quiet end to the week for economic news, with no top-tier data from the UK due on Friday.

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro Area	ECB Deposit (Refinancing) Rate %	Jun	**2.00 (2.15)**	*2.00 (2.15)*	2.25 (2.40)	-
	PPI Y/Y%	Apr	**0.7**	1.1	1.9	-
	Construction PMI	May	**45.6**	-	46.0	-
Germany	Factory orders M/M% (Y/Y%)	Apr	**0.6 (4.8)**	-1.5 (3.9)	3.6 (3.8)	3.4 (3.7)
	Construction PMI	May	**44.4**	-	45.1	
France	Construction PMI	May	**43.1**	-	43.6	
Italy	Construction PMI	May	**50.5**	-	50.1	
	Retail sales M/M% (Y/Y%)	Apr	**0.7 (3.7)**	-	-0.5 (-2.8)	
UK	DMP 3M output price (1Y CPI) expectations Y/Y%	May	**3.7 (3.0)**	3.8 (3.2)	3.8 (3.1)	3.9 (-)
	Construction PMI	May	**47.9**	47.3	46.6	-
	New car registrations Y/Y%	May	**1.6**	-	-10.4	-

Auctions

Country	Auction
France	sold €6.734bn of 3.2% 2035 bonds at an average yield of 3.17%
	sold €2.476bn of 1.25% 2036 bonds at an average yield of 3.27%
	sold €2.789bn of 3.75% 2056 bonds at an average yield of 3.95%
Spain	sold €2bn of 2.4% 2028 bonds at an average yield of 2.118%
	sold €2.045bn of 2.7% 2030 bonds at an average yield of 2.386%
	sold €1.443bn of 0.7% 2032 bonds at an average yield of 2.72%
	sold €534m of 2.05% 2039 inflation-linked bonds at an average yield of 1.678%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Country		BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Economic data						
Euro Area		10.00	GDP – final estimate Q/Q% (Y/Y%)	Q1	*0.7 (1.5)*	0.2 (1.2)
		10.00	GDP – household consumption Q/Q%	Q1	-	0.4
		10.00	GDP – government expenditure Q/Q%	Q1	-	0.5
		10.00	GDP – fixed investment Q/Q%	Q1	-	0.7
		10.00	Employment – final estimate Q/Q% (Y/Y%)	Q1	*0.3 (0.8)*	0.1 (0.7)
		10.00	Retail sales M/M% (Y/Y%)	Apr	0.2 (1.5)	-0.1 (1.5)
Germany		07.00	Industrial production M/M% (Y/Y%)	Apr	-1.0 (-1.0)	3.0 (-0.2)
		07.00	Trade balance €bn	Apr	19.1	21.2
France		07.45	Industrial production M/M% (Y/Y%)	Apr	0.0 (-0.3)	0.2 (0.2)
		07.45	Trade balance €bn	Apr	-	-6.2
Spain		08.00	House price index Q/Q% (Y/Y%)	Q1	-	1.8 (11.3)
Auctions and events						
Italy		09.00	ISTAT to publish 2025-26 economic outlook			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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