Euro wrap-up

Overview

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- Bunds followed Gilts higher even as Italian industrial production data beat expectations.
- Gilts made larger gains after the UK labour market reported a slowdown in pay growth and further declines in payrolls and job vacancies.
- The ECB's updated wage tracker will be published on Wednesday, when the UK government will announce its spending review, ahead of Thursday's monthly GDP figures.

Daily bond market movements

Bond	Yield	Change
BKO 1.7 06/27	1.845	-0.014
OBL 2.4 04/30	2.129	-0.025
DBR 2½ 02/35	2.530	-0.032
UKT 3¾ 03/27	3.929	-0.066
UKT 4⅜ 03/30	4.063	-0.070
UKT 4½ 03/35	4.559	-0.071

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

Euro area

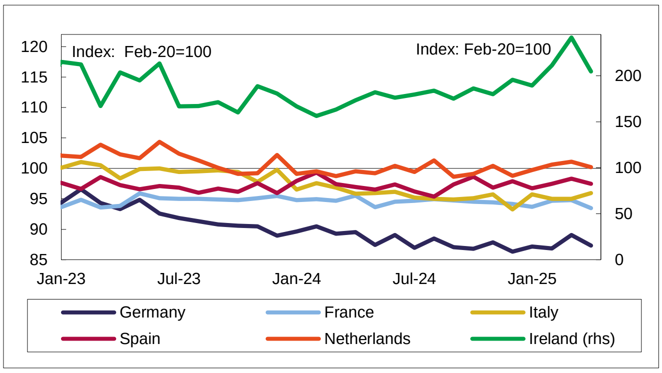
Expansion in Italian IP in April contrasts inevitable marked pullback in Ireland

Tallying with an improvement in business sentiment, and after rising in Q1 (0.6%Q/Q) for the first quarter in six, Italian industrial production rose further at the start of Q2 to suggest that it will provide ongoing support to GDP growth despite the US tariff shock. Total Italian industrial output rose a stronger-than-expected 1.0%M/M in April, the most since January, to push the annual rate just into positive territory for the first time since January 2023. This also took the level of production to a ten-month high and some 0.7% above the Q1 average. Growth in manufacturing output stood at a firmer 1.2%M/M, underpinned by a rebound in production of textiles and clothing, ICT equipment, and coke and refined petroleum products. In contrast, output of transport goods, electrical equipment and pharmaceuticals fell back, with the latter down some 5½%M/M, to a 15-month low. A pullback in pharmaceuticals output following the extreme front-running of US tariffs in Q1 was also likely the cause of the marked decline in yesterday's Irish figures. In particular, having leapt 14.4%M/M in March, Irish industrial production plunged 15.2%M/M in April, the most since July 2023. The decline was led by the so-called 'modern' sector (-14.9%M/M), with a far more modest drop in the 'traditional' sector (-0.9%M/M). But having risen by more than one third between November and March, this still left output up 18%Y/Y and 'just' 4.4% below the Q1 average. Taken together with declines in Germany, France, and Spain, we estimate that aggregate euro area industrial production (excluding construction) – data due Friday – will drop around 2.0%M/M in April. That would not fully reverse the increase in March but would still be broadly in line with the Q1 average, suggesting significant resilience to the new US tariffs so far in Q2.

The coming two days in the euro area

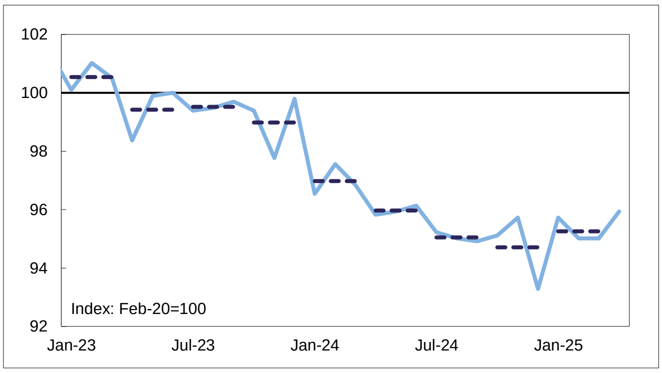
The coming two days will be relatively quiet for top-tier euro area economic data, though Wednesday's post-policy announcement update to the ECB's forward-looking wage tracker tool perhaps marks the exception. While euro area wage growth remains elevated, though moderating, the wage tracker has helped to inform the ECB's growing confidence in a further deceleration through the latter half of its easing cycle. Indeed, with negotiated wages markedly softer in Q1, last week's Governing Council statement added that wage growth was moderating 'visibly'. Consistent with past data, Wednesday's update should signal ongoing moderation in wage settlements later this year. Meanwhile, aside from the minimal dataflow, a number of speaking arrangements from the ECB's Executive Board will also be in focus, most notably a lecture from President Lagarde at the People's Bank of China on Wednesday. But presentations by Chief Economist Lane (Wednesday) and Schnabel (Thursday) will also be of particular interest.

Euro area: Industrial output in member states



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Italy: Industrial output*



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

UK

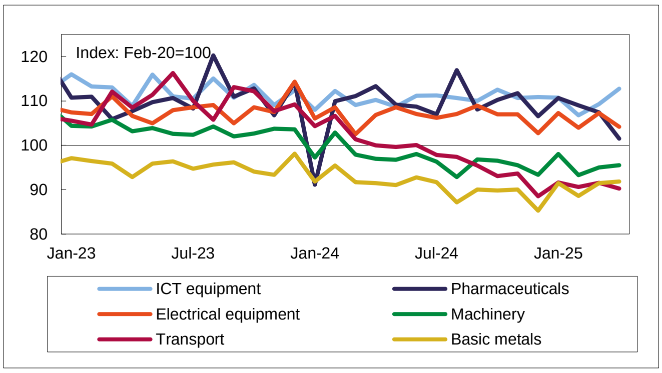
Pay growth slows despite minimum wage hike, with momentum down to a 12-month low

Today's UK labour market report was soft, reporting a greater-than-expected moderation in wage growth and further drop in payrolls, reinforcing our expectation that the BoE's MPC will next cut Bank Rate in August. Indeed, despite the near-7% rise in the National Living Wage (NLW) that month, total pay in the three months to April slowed 0.4ppt on the quarter to a seven-month low of 5.3%3M/Y. Private sector pay growth also moderated to 5.3%3M/Y, with the single-month figure (4.7%Y/Y) down almost 1ppt on the month to the lowest since late-2021. And, most importantly for the BoE, private sector regular pay (excluding bonuses) slowed 0.8ppt on the quarter to 5.1%3M/Y, undershooting the MPC's end-Q2 projection (5.2%3M/Y). The impact of the minimum wage hike was evident in hospitality, wholesaling and retailing, where three-month regular pay growth was the strongest in more than 2½ years. But the respective single-month rate in April was some 2½ppts below February's peak suggesting that the increase in the NLW had been front-loaded. And regular pay in business services, manufacturing and construction, where a smaller share of workers receive the NLW, eased. Moreover, private regular pay on a six-month basis – arguably the best guide to momentum – slowed to a 12-month low of 2.3%6M/6M annualised, reinforcing our assessment that underlying domestically-generated inflation continues to dissipate. Indeed, while some MPC members will no doubt continue to caution that pay growth remains firmly above levels consistent with the achievement of the inflation target over the medium term, Governor Bailey also suggested last week that a more aggressive pace of rate cuts might be warranted if wage growth slows more rapidly than the BoE expects.

Payrolled employees drop the most since the start of Covid, with vacancies down to a 4-year low

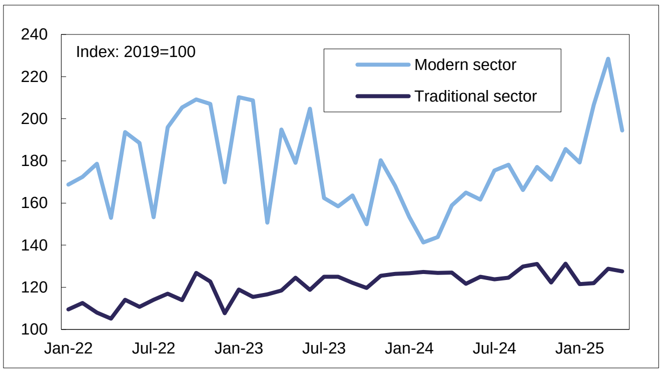
While data inadequacies leave some uncertainty about the current balance between labour supply and demand, on the whole today's report suggested that labour market conditions continue to soften. In particular, the number of payrolled employees fell in May for the seventh successive month and by 109k, the most since the first Covid-19 lockdown. While the flash readings are often revised, this took the cumulative fall in payrolls from October – when the government announced the April increase in the NLW and employers' national insurance contributions – to more than 280K (-0.8%). Roughly half of that drop occurred in hospitality, wholesale and retail, suggesting that higher labour costs have dampened in those sectors. However, there was also a significant drop in payrolls in May in professional, technical and scientific services, healthcare, manufacturing and construction, suggesting that the deterioration in the jobs market might have become more broad-based. Admittedly, lower payrolls contrasted the further increase in the Labour Force Survey's (LFS's) measure of employment, which rose 89k in the three months to April. But this still marked the slowest growth in four months, with a second successive decline in full-time employment. Moreover, the unemployment rate rose 0.2ppt on the quarter to 4.6% in April, the highest

Italy: Manufacturing output by selected subsector



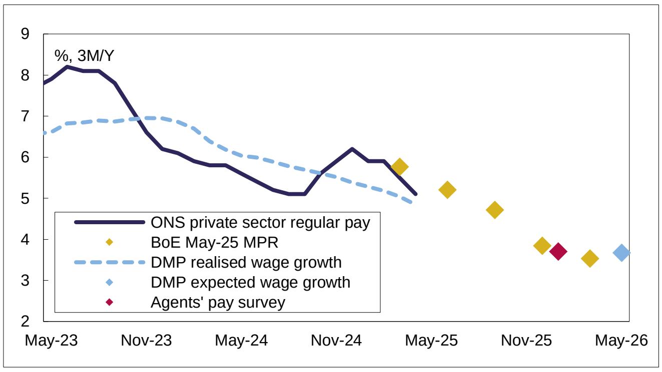
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Ireland: Industrial output



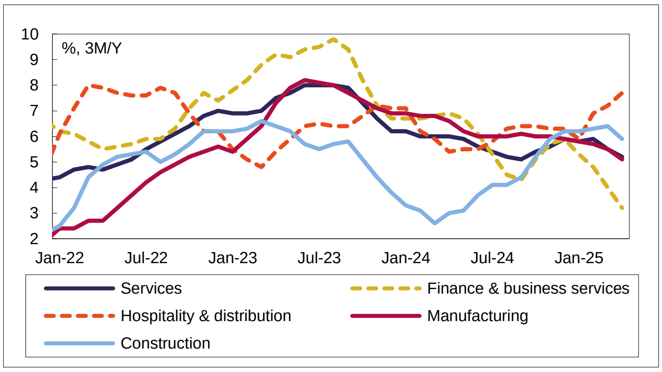
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Measures of pay growth



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Private regular pay growth



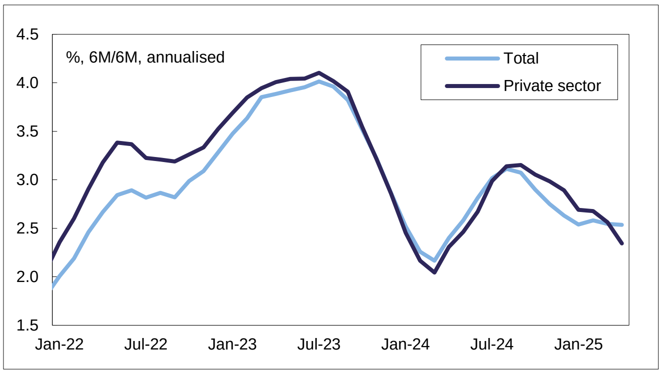
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

since July 2021 and a full percentage point above the low in mid-2022. In addition, job vacancies maintained their downtrend, falling in the three months to May by 63k, the most in almost two years. This left them down more than 40% from the peak three years ago and took the ratio of vacancies to unemployment to a four-year low (0.46) consistent with rising slack in the labour market.

Retail survey signals a marked slowdown in sales in May

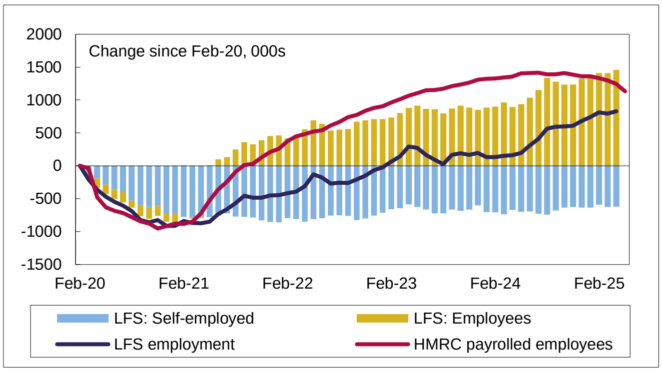
While the labour market has been softening, household consumption has so far been surprisingly firm this year. According to the official ONS data, retail sales rose for a fourth successive month in April, with volumes up 1.2%M/M, the most since January. Demand for outdoor-related items was boosted by warm weather, while food sales were supported by the timing of Easter. But with consumer confidence subdued, it was no great surprise that today's BRC retail monitor suggested that the spending spree came to an end in May. Indeed, the BRC's measure of growth in total sales values slowed 6ppts to a six-month low of 1.0%Y/Y, with growth on a like-for-like basis down 6.2ppts to 0.6%Y/Y. While growth in food sales (3.6%Y/Y) reportedly remained firm over the Bank Holiday weekends, non-food sales declined (-1.1%Y/Y) as weaker demand for fashion and big-ticket items more than offset stronger gaming sales. And with the weather having been mixed so far in June

UK: Regular pay momentum



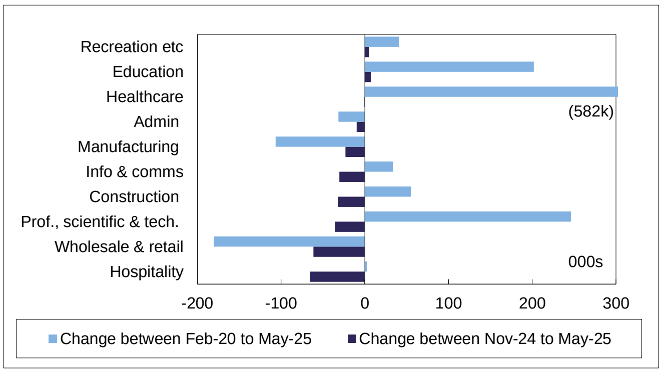
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Employment & payrolled employees



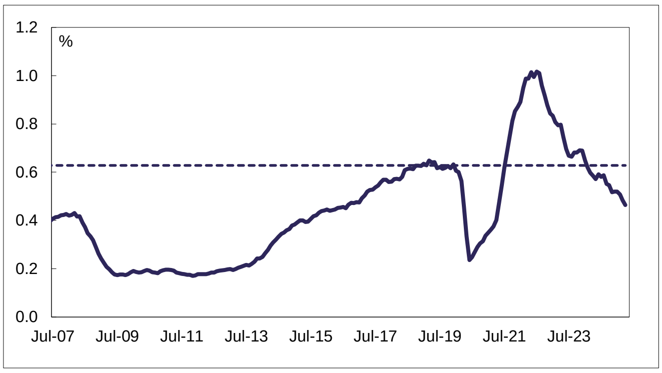
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Change in payrolled employees by sector



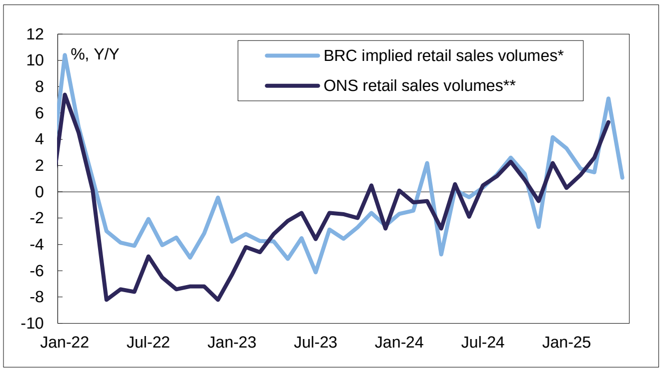
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Vacancies to unemployment ratio*



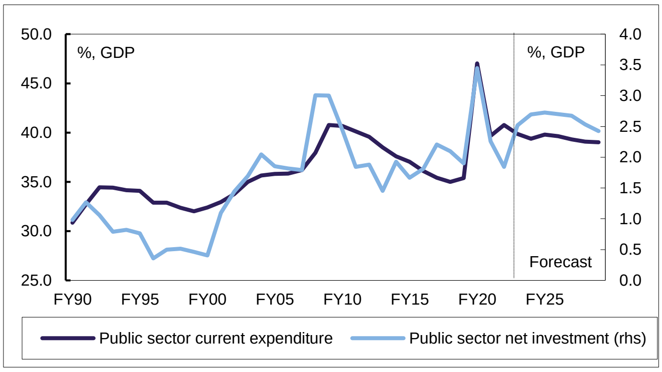
**Dashed line represents 2019 average.*
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Retail sales



**Excluding auto fuel. **Deflated by BRC shop price inflation.*
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Public net investment & current expenditure



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

and surveys suggesting that households remain reluctant to make major purchases, we do not anticipate a significant rebound in spending this month.

The coming two days in the UK

Wednesday's focus in the UK is likely to be the announcement of the government's spending review. This will confirm its allocations for departmental current expenditure for the coming three fiscal years, and public investment budgets for the coming four fiscal years such as new transport infrastructure and green energy projects, including new nuclear power facilities. It should not, however, materially affect the government's plans for total expenditure over coming years, which should remain broadly in line with the levels set in the spring budget in March. Likewise, pensions and welfare spending – where significant political and fiscal pressures exist – should be largely unaffected. There will also be no updated projections published by the independent OBR to assess the overall budgetary and macroeconomic consequences of the decisions. So, there will be no decisions about whether, and if so how, the fiscal stance will need to be tightened to meet the government's fiscal rules. While the government will suggest that the announcement represents an end to fiscal austerity, public sector current expenditure as a share of GDP will remain on track to decline in each of the coming three years. And public sector net investment will remain broadly steady over the horizon, close to the 2.7% of GDP ratio achieved in the last fiscal year. Real-terms increases in public spending will be largest for healthcare and defence, with the latter to confirm plans to boost military expenditure to 2.5% of GDP by 2027 and more beyond that date. Education will also likely benefit from a non-negligible increase. But current spending for most government departments will continue to feel a significant squeeze, with adverse consequences for many public services.

Following Wednesday's spending review, Thursday's monthly GDP release will provide a first official estimate of growth at the start of Q2. Helped by favourable weather and potential tariff-frontrunning, economic growth in Q1 beat expectations (0.7%Q/Q). The monthly GDP series matched that rate (0.7%3M/3M) following a 0.2%M/M rise in March, which marked a fifth month without contraction. However, while the strength of the carry-over from Q1 will probably keep growth constant on a three-monthly basis, we see the likelihood of another monthly increase in GDP in April as notably weaker. Granted, still pleasant weather conditions and the fortuitous timing of Easter meant retail sales volumes in April (1.2%M/M) proved particularly resilient. But the broader hit to business and consumer sentiment from US trade policy that month, as well as the pull-back in manufacturing output and exports after tariff-frontrunning in Q1, all points to a weaker month for GDP. So, having expanded 0.4%M/M in March, we expect services output to have been broadly flat. And we expect GDP to dip, albeit only slightly, for the first time since October.

The next edition of the Euro wrap-up will be published on 12 June 2025

European calendar

Today's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro Area	Sentix investor confidence indicator	Jun	**0.2**	-5.5	-8.1	-
Italy	Industrial production M/M% (Y/Y%)	Apr	**1.0 (0.3)**	-0.1 (-1.1)	0.1 (-1.8)	0.0 (-)
UK	Average wages (excluding bonuses) 3M/Y%	Apr	**5.3 (5.2)**	5.5 (5.3)	5.5 (5.6)	5.6 (5.5)
	Private sector regular wages 3M/Y%	Apr	**5.1**	5.3	5.6	5.5
	Unemployment rate 3M%	Apr	**4.6**	4.6	4.5	-
	Employment 3M/3M change 000s	Apr	**89**	40	112	-
	Payrolled employees M/M change 000s	May	**-109**	-20	-33	-55
	Claimant count rate % (change 000s)	May	**4.5 (33.1)**	-	4.5 (5.2)	4.4 (-21.2)
	BRC retail monitor – like-for-like sales Y/Y%	May	**0.6**	2.6	6.8	-

Auctions

Country	Auction
Germany	sold €3.078bn of 2.4% 2030 bonds at an average yield of 2.14%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Wednesday's releases						
Economic data						
Country		BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
- Nothing scheduled -						
Auctions and events						
Euro Area		04.15	ECB President Lagarde to give lecture at the PBoC, Beijing			
		09.00	ECB to publish updated wage tracker indicators			
		09.00	ECB to publish annual International Role of the Euro report			
		10.30	ECB Chief Economist Lane to give presentation at 2025 Government Borrowers Forum, Dublin			
Germany		10.30	Auction: to sell up to €3bn of 2.5% 2035 bonds			
UK		10.00	Auction: to sell £4.25bn of 4.5% 2035 bonds			
UK		12.30	Chancellor Reeves to deliver spending review to Parliament			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Thursday's releases						
Economic data						
Country		BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Italy		09.00	Unemployment rate %	Q1	*6.0*	6.1
UK		00.01	RICS house price balance %	May	-	-3
		07.00	Monthly GDP M/M% (3M/3M%)	Apr	*-0.2 (0.7)*	0.2 (0.7)
		07.00	Services output M/M% (3M/3M%)	Apr	-0.2 (0.7)	0.4 (0.7)
		07.00	Industrial output M/M% (Y/Y%)	Apr	-0.5 (-0.2)	-0.7 (-0.7)
		07.00	Construction output M/M% (Y/Y%)	Apr	0.1 (2.5)	0.5 (1.4)
		07.00	Trade (goods trade) balance £bn	Apr	-	-3.7 (-19.9)
Auctions and events						
Euro Area		10.00	ECB Executive Board Member Schnabel to give presentation at House of the Euro, Brussels			
Italy		10.00	Auction: to sell up to €2.5bn of 2.65% 2028 bonds			
		10.00	Auction: to sell up to €3bn of 3.25% 2032 bonds			
		10.00	Auction: to sell up to €1.25bn of 4.3% 2054 bonds			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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