Euro wrap-up

Overview

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- While data confirmed that euro area factory output and exports fell back sharply in April having surged in Q1, euro area government bonds made losses as oil prices jumped in response to Israel's air strikes on Iran.
- Gilts also made losses on a quiet end to the week for UK economic news.
- In the coming week, the BoE will leave Bank Rate unchanged while the dataflow will bring updates on inflation and retail sales in the UK and inflation, labour costs and consumer confidence in the euro area.

Daily bond market movements

Bond	Yield	Change
BKO 1.7 06/27	1.844	+0.039
OBL 2.4 04/30	2.128	+0.051
DBR 2½ 02/35	2.526	+0.054
UKT 3¾ 03/27	3.924	+0.068
UKT 4⅜ 03/30	4.052	+0.073
UKT 4½ 03/35	4.539	+0.064

*Change from close as at 4:00pm BST.
Source: Bloomberg

Euro area

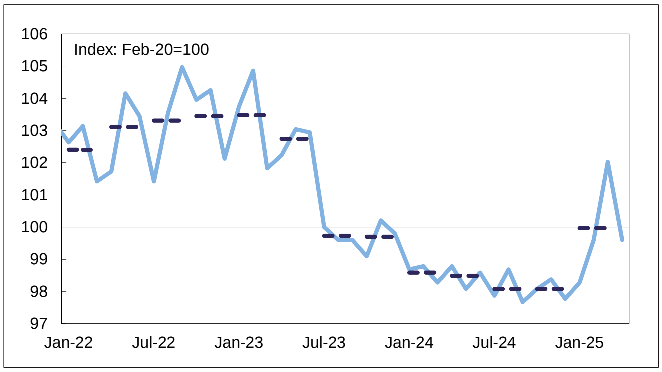
Manufacturing output drops in April by most in almost two years after Q1 surge

Having surged in Q1 as firms aimed to front-run US tariffs in certain sub-sectors, euro area factory output inevitably pulled back at the start of Q2. After it jumped 1.7% in Q1 to mark the strongest quarter since Q420, manufacturing production dropped 2.2%M/M in April, the most in almost two years. That, however, left it just 0.2% below the Q1 average, suggesting that the sector should represent only a modest drag on overall economic output this quarter. Most sub-sectors registered a drop in production in April, but the extent of the declines were predictably largest where growth in prior months had been strongest. Most notably, having grown more than 20% between October and March, production of pharmaceuticals dropped 13.4%M/M in April to be alost 7% below the Q1 average level. But in other subsectors production was more stable in April. And the production levels in a range of important subsectors from autos to electrical machinery and chemicals remained above the respective Q1 averages. Overall, production of machinery and equipment was bang in line with the Q1 average in April with energy-intensive production little changed against that benchmark too. With pharmaceuticals most affected by the tariff-related production shifts, industrial production in Ireland predictably saw the sharpest decline, falling more than 15%M/M to account for a little more than half of the decline in the euro area as a whole. Given more limited front-running of tariffs in Q1, the pullback in output in April in Germany (-1.9%M/M) and France (-1.4%M/M) was far more moderate, while Italian production rose (1.0%M/M).

Exports to the US fall by almost one third in April with chemicals & pharma shipments near-halved

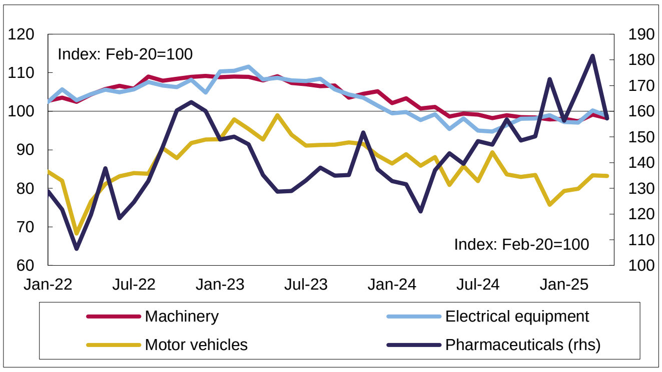
Just as manufacturing output fell back in April, so too did goods exports. Indeed, the value of euro area goods exports fell 8.2%M/M, the most since the first wave of Covid-19 five years earlier, to be 4.7% below the Q1 average. And while goods imports also fell (-3.0%M/M), the goods trade surplus more than halved, narrowing by €14.8bn from March's record high to a three-month low of €14.0bn. That, however, was close to last year's average to suggest a return to normality rather than an extreme dip. Indeed, the narrowing of the trade surplus was more than fully explained by the US. The value of euro area exports to the US fell by more than 31%M/M (€19.3bn) in April to be some 18% below the elevated Q1 average, albeit more than 4% above the Q4 benchmark. As such, the euro area's surplus with the US shrank €19.5bn to a six-month low of €16.0bn. The decline in shipments of chemicals (including pharaceuticals) of almost 50%M/M (more than €16bn) accounted for the lion's share of the drop in total exports to the US, with machinery and autos (15.8%M/M) accounting for most of the remainder of the shortfall. Given the retrenchment in shipments to the US, exports of chemicals to all markets were down a little more than one quarter in April with shipments of machinery and transport equipment down a more moderate 3.4%M/M.

Euro area: Industrial production*



Dashed lines show quarterly averages.
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Manufacturing output by selected good

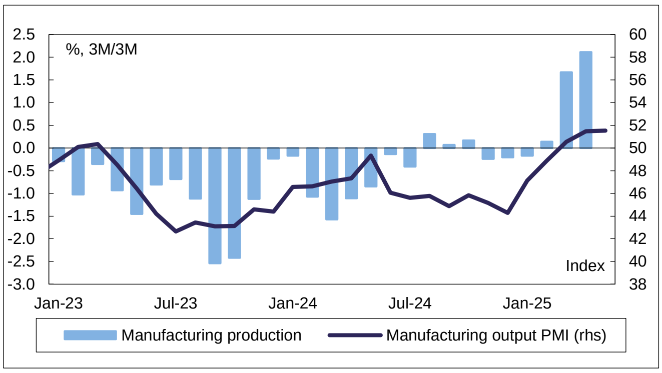


Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Notwithstanding risks of new shocks, production & exports should return to expansion trend by Q3

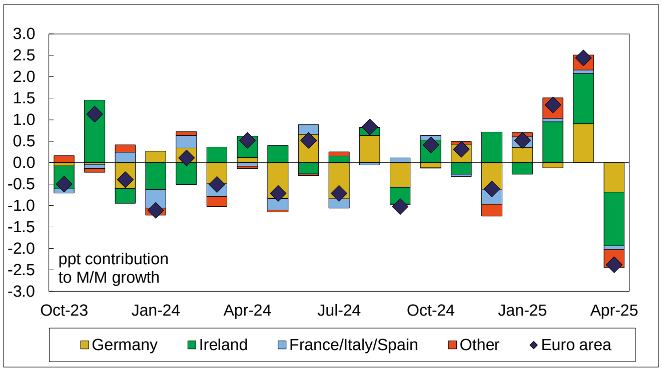
Following the surge in Q1, it remains to be seen whether further retrenchment will be required over the near term to restore production and exports to a sustainable level. While new baseline tariffs and sectoral tariffs for autos, steel and aluminium are now in place, the threat of additional tariffs in the absence of progress in the negotiations between the US and EU might still incentivise some acceleration of shipments across the Atlantic, particularly of pharmaceuticals which remaining subject to negligible tariffs. And survey indicators flag the possibility of a resumption of growth before the end of Q2. Indeed, the euro area manufacturing output PMI edged up in May to the best in three years (51.5). And the indices for total and foreign new orders (close to 50) were consistent with broad stability in demand while inventories of finished goods were the least excessive in three years. In our view, manufacturing output is probably more likely to track sideways over the near term to leave it down over Q2 as a whole. And with exports to the US also unlikely to pickup significantly for a while yet, both IP and net trade will subtract from euro area GDP growth in Q2. However, we expect both to support a return to modest growth in Q3. And notwithstanding the risks of additional tariff barriers if the US-EU trade talks break down, or indeed a more extreme spike in oil and gas prices in the event of marked escalation of events in the Middle East, we expect production and exports to support a firmer expansion in GDP towards year end.

Euro area: Manufacturing production & output PMI



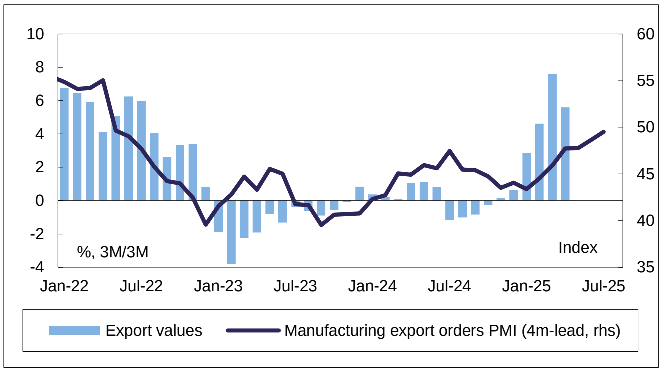
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Industrial production growth



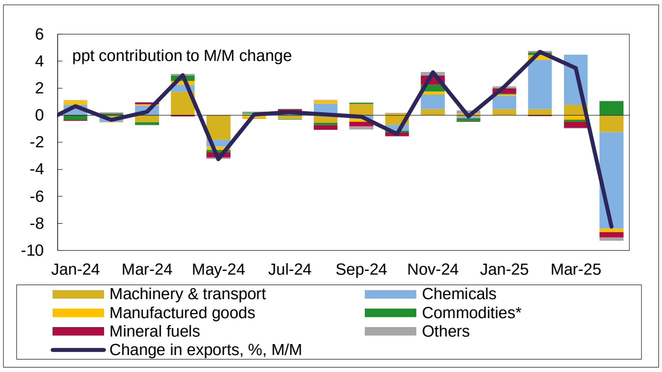
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Goods exports & export new orders PMI



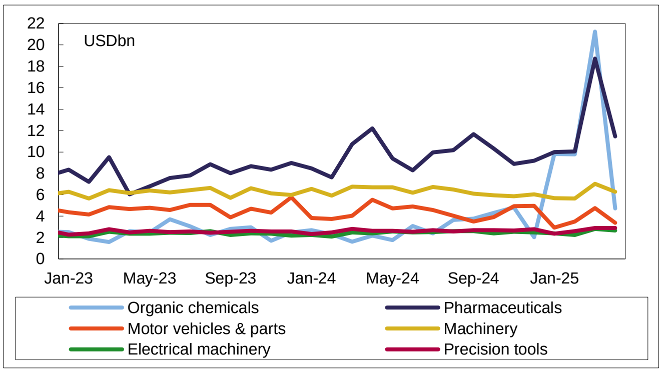
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Contribution to export growth by good



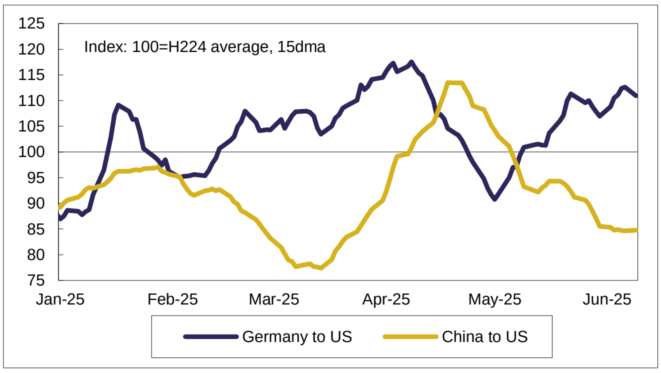
**And other unclassified. Source: Macrobond and Daiwa Capital Markets*

Euro area: US imports by type of good



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

Container freight tonnage bound for the US



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

National inflation data confirm that April's increase was exaggerated by timing of Easter

Today's final May inflation numbers provided little in the way of surprise. In line with their flash estimates, headline HICP inflation was shown to have moderated by 0.1ppt in Germany (2.1%Y/Y) and 0.3ppt in France (0.6%Y/Y). Core inflation in those countries was also confirmed at the lowest levels since Q321, down 0.4ppt to 2.7%Y/Y and 0.2ppt to 1.1%Y/Y respectively. Admittedly, the final Spanish estimates were nudged up slightly from their preliminary estimates (0.1ppt), but nonetheless showed that headline inflation fell 0.2ppt to 2.0%Y/Y, bang in line with the ECB's target. As we expected, the granular detail confirmed that April's spike in holiday-adjacent categories was mostly temporary. In Germany, for example, national CPI estimates showed that inflation of package holidays declined 6.8ppts to 2.4%Y/Y, while often volatile airfares shed a chunkier 27.1ppts to be down -8.0%Y/Y. So, while German services inflation saw renewed pressure in May from a couple of sources, such as hotels (up 3.1ppts to 5.1%Y/Y), that component resumed its disinflationary trend, falling to a 13-month low (3.4%Y/Y). And at 2.1%Y/Y, services inflation in France was also its weakest since January 2022.

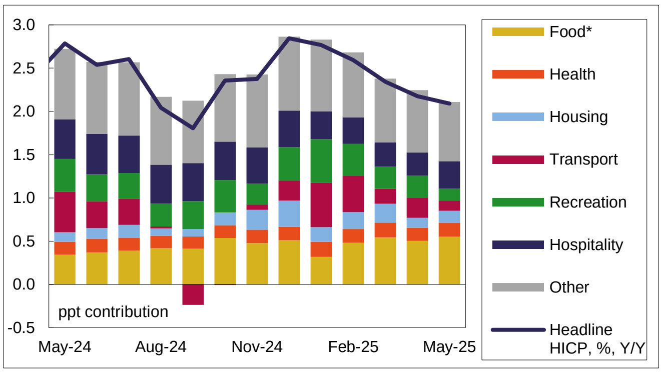
Energy prices weighing on the inflation outlook, but risks are still two-sided

Of course, cheaper transport fuels and lower electricity prices also continued to weigh on headline inflation in each member state in May. As Executive Board Member Schnabel reiterated this week, the ECB expects energy prices to keep headline inflation temporarily below the ECB's 2% target over the next 12 months or so. But she also acknowledged that those assumptions about energy costs were subject to risks, of which today's surge in oil prices following Israel's strikes on Iran provides an apt reminder. She also downplayed the potential disinflationary effects from diverted goods trade flows from China to the euro area. And with food inflation having continued to edge higher in most member states, fiscal policy in Germany and certain other countries set to loosen, and lack of clarity about whether the ECB's current monetary stance is accommodative or merely neutral, the Governing Council is still mindful that upside risks to inflation could build over the monetary policy horizon.

The week ahead in the euro area

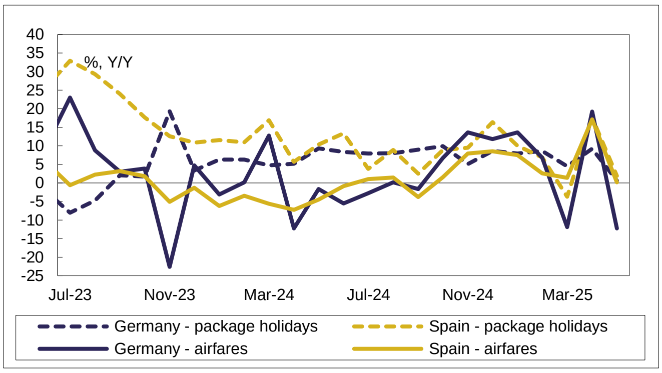
The revision to Spanish inflation, while adding an upside risk, should prove insufficient to make a material difference to the final euro area inflation reading. So, while we will have an eye on Monday's Italian release, we still expect May's euro area details (on Wednesday) to match the preliminary estimates. So, the headline HICP rate should be confirmed at 1.9%Y/Y, down 0.3ppt from April, for just the second sub-target print in little shy of four years. Core inflation, down 0.4ppt to its lowest level since January 2022 (2.3%Y/Y), should offer similar encouragement to the ECB. In line with today's detail, we expect that to reflect the resumption of services disinflation which, supported by lower fuel prices, should provide sufficient riposte to the steady rise in food and core goods prices. Those patterns should also see most measures of underlying inflation draw

Germany: Contributions to HICP inflation



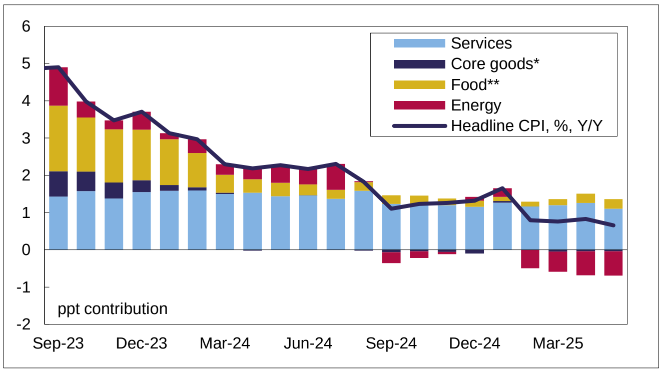
*Non-energy industrial goods.
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany & Spain: select HICP inflation rates



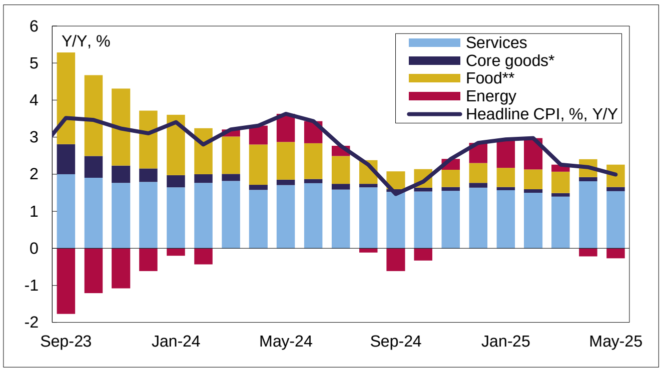
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

France: Contributions to CPI inflation



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

Spain: Contributions to CPI inflation



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

closer to the ECB's 2% target. In part, Monday's final estimates of labour costs in Q1 should, with the preliminary growth estimate softening ½ppt to 3.2%Y/Y, provide another datapoint to suggest diminished risks of inflation persistence. And confirmation of falling vacancies (also Monday) should be consistent with ongoing moderation in wage growth. Meanwhile, with respect to the core goods inflation pipeline, May's German PPI data (Friday) should show that industrial prices continue to be dulled by falling energy prices.

Resumed disinflation and the ECB's recent monetary easing should lend further support to the coming week's sentiment surveys. So, we expect Friday's preliminary release of the Commission consumer confidence indicator to show further modest improvement in June, albeit remaining downbeat. Germany's ZEW survey (Tuesday) too might be expected to mirror the more notable improvement reported by the Sentix indices earlier this week. INSEE's business confidence survey for June (Friday) will also provide insights into sentiment for firms in Europe's second largest economy. Elsewhere, the transmission of less restrictive monetary policy to financial conditions will likely help sustain the recovery in bank lending in May (Friday). That too should benefit the construction sector, with the uptrend in mortgage lending improving prospects for housebuilders. Indeed, construction output in Germany (1.4%M/M) and France (0.7%M/M) advanced in April. So, we expect euro area construction output (Thursday) to have risen at the start of Q2, perhaps by ½%M/M.

UK

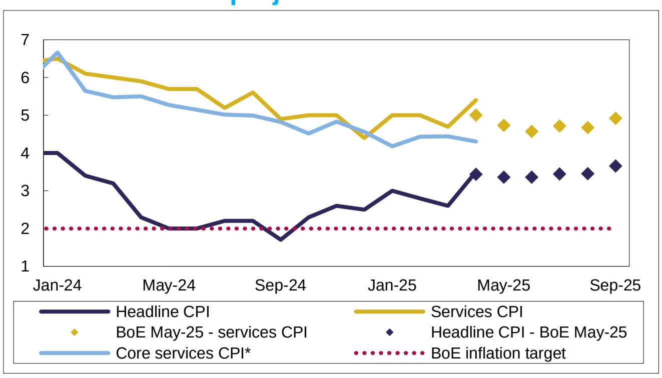
MPC to leave policy unchanged on Thursday, awaiting greater clarity over the summer

Notwithstanding the softness in this week's activity and labour market data, on Thursday the BoE's MPC seems bound to leave policy unchanged, holding Bank Rate steady at 4.25%. Unlike the three-way split in May when policy was eased by 25bps, we expect seven out of nine members to back the status quo and only the two doves (Dhingra and Taylor) to vote for a further cut. We also expect the MPC to maintain its forward guidance that 'a gradual and careful approach to the further withdrawal of monetary policy restraint remains appropriate'. We interpret that guidance to be consistent with one cut of 25bps per quarter into next year. While the MPC's GDP growth and inflation projections were revised down last month, headline inflation was still expected to rise over the near term and peak at 3.7%Y/Y in September, reinforcing the reluctance of the majority to cut rates at a faster pace for fear of second-round effects. And recent data suggest that those projections remain broadly intact. Indeed, while inflation in April (3.5%Y/Y) came in slightly above the BoE's forecast, the cause was erroneous Vehicle Excise Duty numbers, which will be corrected by the ONS in the May estimate. Today's BoE Inflation Attitudes Survey reported a drop in consumers' inflation expectations for the coming year and relatively well-anchored expectations for the medium term. And while wage growth appears to be slightly undershooting the MPC's expectation, the majority will not respond to just one month's labour market figures, which can be susceptible to random volatility and data quality problems. So, with hopes that uncertainty about global trade will ease over the summer, the majority on the MPC will want to await another cycle of data, clarity on events in the Middle East and their consequences for energy prices, and updated staff projections before deciding in August whether to cut rates again.

The data week ahead in the UK

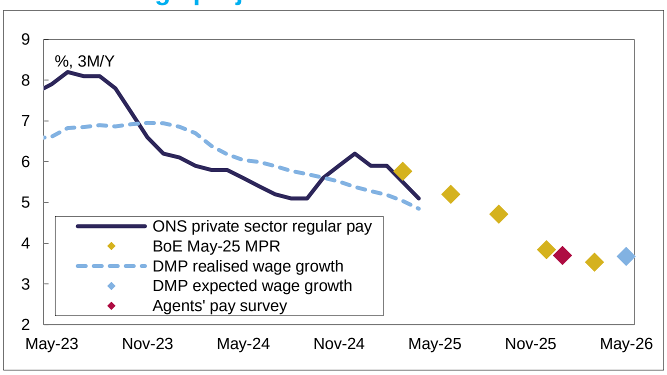
While May's inflation print is due the day ahead of the MPC's announcement, it is highly unlikely to have a major impact on the rate decision. Nonetheless, the likelihood of a softer print has been increased by the need to correct April's VED discrepancy. We expect headline inflation to soften to 3.3%Y/Y in May, down 0.2ppt on the month and 0.1ppt below the BoE's projection. Like the Bank, we expect a moderation in services inflation to provide the principal source of that reduction, as pressures in holiday-related components such as airfares and package holidays related to the timing of Easter correct. As a result, we also expect core inflation to drop 0.3ppt to 3.5%Y/Y, despite a possible uptick in core goods inflation. Food prices will provide a relatively greater source of price pressure. But falling petrol prices (-1.4%M/M) will continue to provide some offset. With regards to underlying price pressures, we also note that Wednesday's release continue to be void of PPI data. After being postponed due to quality concerns in January, an update is scheduled for some time this summer. The ONS

UK: BoE inflation projections



*Services excluding indexed and volatile components, rents and foreign holidays measure. Source: BoE, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: BoE wage projections & indicators



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

having cautioned that their amendments, when released, may in due course also bring revisions for the UK national accounts and international trade data. Meanwhile, following the BoE announcement, Friday will bring data for retail sales in May and consumer confidence in June. The latter improved last month, reclaiming much of the previous month's decline sparked by Trump's major tariff announcements. But this week's BRC survey suggested that consumer spending was markedly weaker in May, and payback is surely in order due to the outsized growth in April's retail sales (1.2%M/M) and growth throughout Q1. So, we expect retail sales to decline in May, for a first month in four. Diminished concerns about tariffs may lend some support to June's headline consumer confidence number, but with the deteriorating labour market providing a headwind, we expect that to move broadly sideways.

The next edition of the Euro wrap-up will be published on Tuesday 17 June 2025

Daiwa economic forecast

	2025				2026		2025	2026	2027
	Q1	Q2	Q3	Q4	Q1	Q2			
GDP	%, Q/Q						%, Y/Y		
Euro area	0.6	-0.1	0.1	0.2	0.2	0.3	1.1	0.8	1.3
UK	0.7	-0.1	0.2	0.3	0.3	0.3	1.0	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	2.0	1.9	1.4	2.2	1.6	1.6
UK									
Headline CPI	2.8	3.4	3.5	3.3	2.8	1.9	3.3	2.2	2.0
Core CPI	3.6	3.6	3.4	3.4	3.1	2.0	3.5	2.2	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.

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro Area	Industrial production M/M% (Y/Y%)	Apr	**-2.4 (0.8)**	-1.7 (-1.2)	2.6 (3.6)	2.4 (3.7)
	Trade balance €bn	Apr	**14.0**	18.3	27.9	28.8
Germany	Final HICP (CPI) Y/Y%	May	**2.1 (2.1)**	*2.1 (2.1)*	2.2 (2.1)	-
France	Final HICP (CPI) Y/Y%	May	**0.6 (0.7)**	*0.6 (0.7)*	0.9 (0.8)	-
Spain	Final HICP (CPI) Y/Y%	May	**2.0 (2.0)**	*1.9 (1.9)*	2.2 (2.2)	-
UK	BoE/Ipsos inflation attitudes survey – 1Y ahead CPI Y/Y%	Q2	**3.2**	-	3.4	-

Auctions

Country	Auction
- Nothing to report -	

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 16 June 2025			
Euro Area	10.00	Final labour costs Y/Y%	Q1	*3.2*	3.7
	10.00	Final job vacancy rate %	Q1	*2.4*	2.5
Italy	09.00	Final HICP (CPI) Y/Y%	May	*1.9 (1.7)*	2.0 (1.9)
UK	00.01	Rightmove house prices M/M% (Y/Y%)	Jun	-	0.6 (1.2)
		Tuesday 17 June 2025			
Germany	10.00	ZEW current situation (expectations) balance	Jun	-74.0 (35.0)	-82.0 (25.2)
Spain	08.00	Labour costs Y/Y%	Q1	-	3.6
		Wednesday 18 June 2025			
Euro Area	10.00	Final headline (core) HICP Y/Y%	May	*1.9 (2.3)*	2.2 (2.7)
UK	07.00	CPI (core CPI) Y/Y%	May	*3.3 (3.5)*	3.5 (3.8)
	09.30	House price index Y/Y%	Apr	-	6.4
		Thursday 19 June 2025			
Euro Area	10.00	Construction output M/M% (Y/Y%)	Apr	-	0.1 (-1.1)
UK	12.00	BoE Bank Rate %	Jun	*4.25*	4.25
		Friday 20 June 2025			
Euro Area	10.00	M3 money supply Y/Y%	May	4.0	3.9
	10.00	Preliminary Commission consumer confidence indicator	Jun	-14.5	-15.2
Germany	07.00	PPI Y/Y%	May	-1.1	2.2 (2.1)
France	07.45	INSEE business (manufacturing) confidence indicator	Jun	97 (98)	96 (97)
	07.45	Final wages Q/Q%	Q1	*0.7*	0.4
	-	BdF retail sales Y/Y%	May	-	0.4
UK	00.01	GfK consumer confidence indicator	Jun	-20	-20
	07.00	Public sector net borrowing £bn	May	18.0	20.2
	07.00	Retail sales – including auto fuel M/M% (Y/Y%)	May	-0.3 (1.7)	1.2 (5.0)
	07.00	Retail sales – excluding auto fuel M/M% (Y/Y%)	May	-0.6 (2.0)	1.3 (5.3)

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week’s key events & auctions

Country	BST	Event / Auction
		Monday 16 June 2025
		- Nothing scheduled -
		Tuesday 17 June 2025
Germany	10.30	Auction: to sell up to €1bn of 2.1% 2029 green bonds
	10.30	Auction: to sell up to €500m of 2.3% 2033 green bonds
UK	10.00	Auction: to sell up to £4.5bn of 4.375% 2030 bonds
		Wednesday 18 June 2025
Germany	10.30	Auction: to sell up to €1bn of 2.5% 2046 bonds
	10.30	Auction: to sell up to €1.5bn of 2.5% 2054 bonds
		Thursday 19 June 2025
Euro Area	08.30	ECB President Lagarde to deliver virtual keynote at NBU/NBP research conference, Kyiv
France	09.50	Auction: to sell up to €12bn of 2.4% 2028, 2.75% 2030 & 2.7% 2031 bonds
	10.50	Auction: to sell up to €1.75bn of 0.1% 2028, 0.6% 2034 & 0.1% 2038 inflation-linked bonds
Spain	09.30	Auction: to sell 1.95% 2030, 3.15% 2033 & 3.2% 2035 bonds
UK	12.00	BoE monetary policy announcement and minutes to be published
	12.00	BoE to publish quarterly Agents’ summary of business conditions (Q225)
		Friday 20 June 2025
Euro Area	09.00	ECB to publish Economic Bulletin 4/2025

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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