Euro wrap-up

Overview

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- Bunds made modest losses as the ZEW survey suggested that investor optimism with respect to the German economy is the best in almost two years.
- Gilts also made small losses, while Trump signed an executive order to implement the US and UK trade agreement, including an exemption for the UK's aerospace sector and lower tariffs on autos.
- Tomorrow will bring May inflation prints from the euro area and UK.

Daily bond market movements

Bond	Yield	Change
BKO 1.7 06/27	1.862	+0.027
OBL 2.4 04/30	2.140	+0.022
DBR 2½ 02/35	2.534	+0.012
UKT 3¾ 03/27	3.911	+0.014
UKT 4⅜ 03/30	4.046	+0.010
UKT 4½ 03/35	4.546	+0.015

*Change from close as at 4:45pm BST.
Source: Bloomberg

Euro area

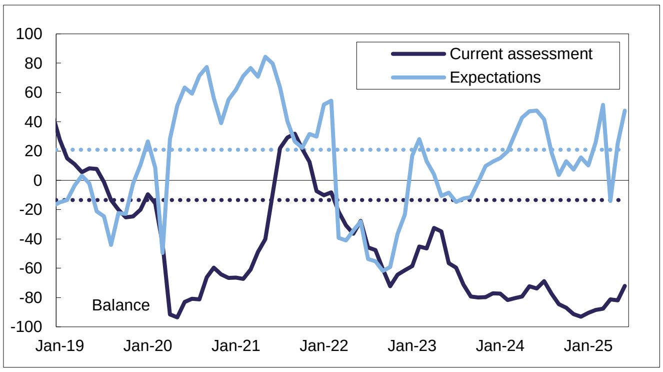
Investor sentiment boosted by German fiscal incentives and ECB interest rate cut

While we caution that most survey responses were likely submitted before Israel launched its missile strikes on Iran, today's German ZEW indices beat expectations. Among other things, investor sentiment was likely boosted by the announcement of the government's tax reform proposals, an eighth interest rate cut from the ECB, and increasing evidence that the economy has proved broadly resilient to the initial US tariff storm. The survey's current conditions index jumped in June by 10pts – the most since February 2023 – to the highest level in 22 months. And that left the Q2 average some 10pts above the Q1 level. Nevertheless, just 2% of respondents considered conditions to be 'good' this month, with roughly three-quarters judging them still to be 'bad'. Moreover, the net balance in June (-72) was still well below the average of the past five years (-54) and substantially lower than the norm in the five years before the pandemic (+54). Investors were also more upbeat about the outlook for the coming six months, with the respective net balance jumping 22pts to an above-average 47.5. But having slumped in April as Trump's reciprocal tariffs were unveiled, the expectations balance remained just below the March peak, with the Q2 average also some 10pts below the Q1 level. This in part reflected weak profit expectations for those sectors most exposed to the highest US tariffs, including autos and steel. But the outlook was considered not as downbeat as in April. And investors expressed greater optimism about the outlook for many other sectors, including electronics, telecoms and IT services. With consumers spending more, retail profit expectations were the most upbeat in 11 months. And while President Lagarde recently stated that the ECB's easing cycle is near or at an end, more than 50% of survey respondents still expect at least one further rate cut ahead, supporting investor optimism with respect to the construction sector too.

Job vacancies fall to a four-year low as labour market becomes less tight

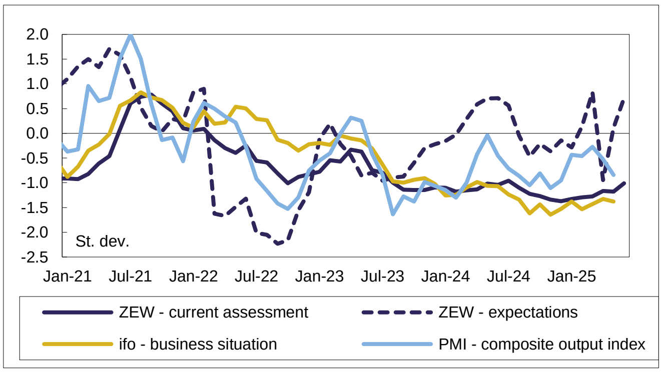
Despite greater optimism about the German economic outlook, the persistent sluggishness of recent quarters continues to be reflected in a range of labour market indicators. In line with signals from business surveys about firms' intentions to reduce headcount, the unemployment claimant count rate has risen steadily, by 0.6ppt over the last two years, to 3.6% in Q125. Waning labour demand has also been reflected in a falling job vacancy rate, down a further 0.2ppt last quarter to a post-pandemic low of 2.8%. As a result, German labour market slack rose to its highest since Q221 (7.0%). While still notably lower than its peers, that increase went counter to the further reduction of slack in the remainder of the euro area's four largest member states. Nonetheless, with vacancies also 0.1ppt lower in France (1.8%) and Italy (1.9%), the overall euro area vacancy rate edged down 0.1ppt in Q1 to a four-year low of 2.4%. So, even with the unemployment rate only slightly above its series low, the vacancies-unemployment ratio was also its lowest in 3½ years, indicative of a labour market that is becoming steadily less tight, supporting ongoing normalisation in wage-setting dynamics consistent with the sustained achievement of target inflation.

Germany: ZEW investor survey indices*



*Dotted lines represent long-run average.
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Sentiment survey indices

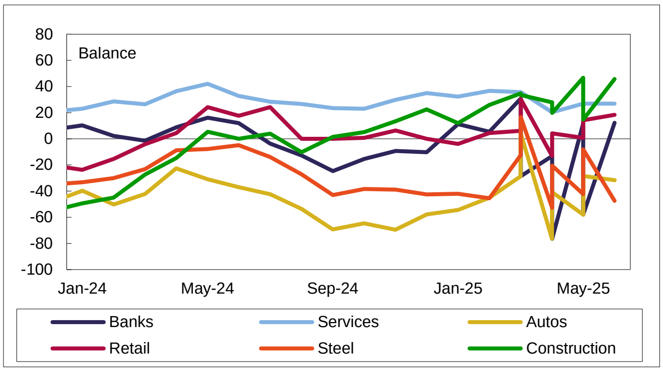


Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

Weakening labour costs led by industrial sector

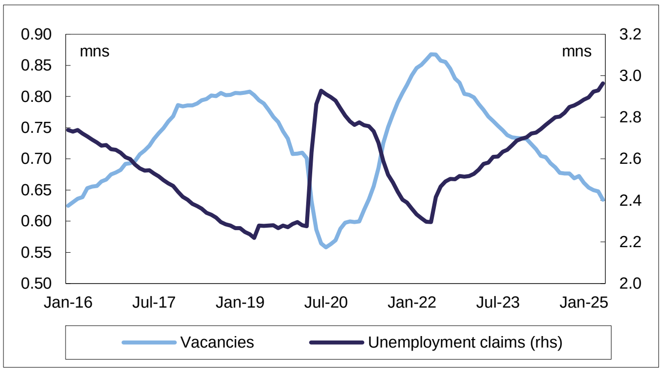
Unsurprisingly, labour costs were also rising in Q1 at a slower rate of 3.4%Y/Y, albeit being 0.2ppt more than the initial estimate but 0.4ppt less than a revised-upwards Q424. Reflecting the more downcast situation in Germany, that softness principally reflected slowing labour costs in the industrial sector. For the euro area, growth shed 1.7ppts to just 2.5%Y/Y, which reflected the 3.7ppts drop to a 0.3%Y/Y contraction in Germany. In line with the flash estimate, labour costs in services rose for a first quarter in four, though by a slightly softer than expected ½ppt, to 4.3%Y/Y. Subsector data showed gains were particularly strong in professional activities, a possible beneficiary of the boost to activity surrounding US tariffs that quarter. Likewise, various minimum wage hikes and easing borrowing conditions could explain the increases in hospitality and real estate respectively. And as the labour market is becoming less tight, we expect to see labour cost growth softening further over coming quarters.

Germany: ZEW survey – profit expectations



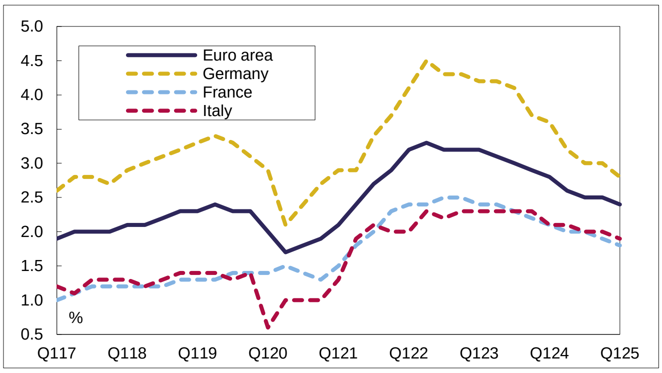
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Unfilled vacancies & jobless claims



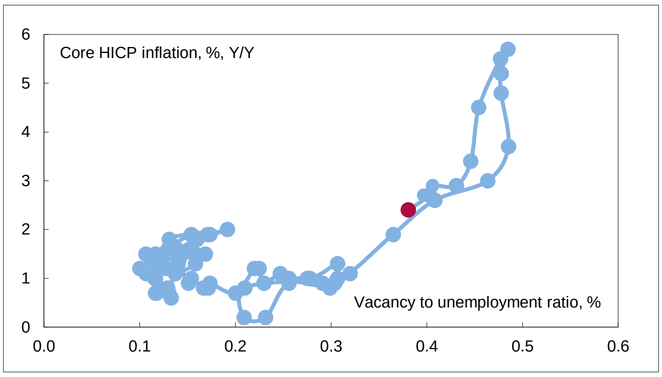
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Job vacancy rates by country



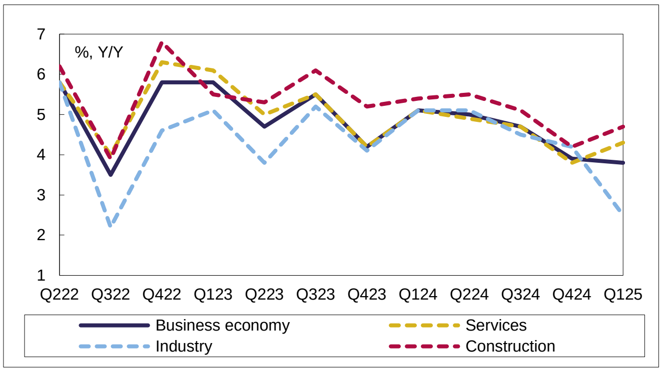
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Phillips curve



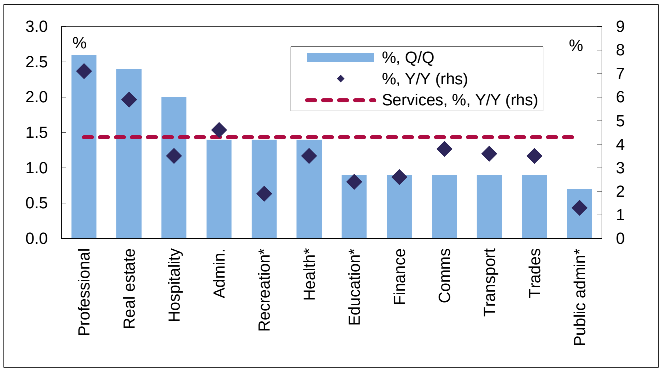
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Labour cost growth by sector



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Labour cost growth in select services



**Subsectors beyond Services of the Business Economy*
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

The day ahead in the euro area

While the escalation of conflict in the Middle East presents a significant upside risk to Europe's inflation outlook, May's final euro area inflation detail will offer temporary encouragement for the ECB. Indeed, since Monday's final Italian HICP rate was revised down to just 1.7%Y/Y, 0.2ppt less than its preliminary estimate, Wednesday's aggregate euro area data should confirm that inflation undershot the ECB's target for just a second month in almost four years. In line with the flash estimates, we expect headline the HICP rate to be confirmed at 1.9%Y/Y, down 0.3ppt from April. Those also showed core inflation at its slowest pace since January 2022, and 0.4ppt softer than the previous month, at 2.3%Y/Y. To a large extent, the Italian release mirrored the key movements observed in the other large member states, with a post-Easter correction to airfares helping to spark a resumption to gradual moderation in services inflation which, along with cheaper fuel prices, offset more subtle pressure from food and core goods. Those patterns will be expected to show in the euro area detail, with underlying inflation measures too likely to reconverge closer to 2% again.

The day ahead in the UK

Like the euro area, the focus of tomorrow's dataflow in the UK will be May's inflation data. The risks to the print are already skewed to the downside given that the ONS' impending correction to April's VED discrepancy looks set to shave a little more than 0.1ppts off the headline rate. But given the timing of the release, heightened uncertainty and expectations for a further uptick in inflation later this year, its impact is almost certain to be inconsequential to the outcome of Thursday's MPC meeting. Nonetheless, we expect the headline CPI rate to soften to 3.3%Y/Y in May, down 0.2ppt from April's number and 0.1ppt below the BoE's own projection. Like the Bank, we expect a moderation in services inflation to provide the principal source of that reduction, particularly as pressures in holiday-related components such as airfares and package holidays related to the timing of Easter start to revert. 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 are also likely to provide a relatively greater source of price pressure, mirroring the rise in the BRC's proxy to a 12-month high in May, and broader trends on the continent. But lower petrol prices – which last month dropped an additional -1.4%M/M, to be down more than 10% versus May 2024 – will continue to weigh on headline rates. April's update to the UK's official house price series is also due.

European calendar

Today's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Germany	ZEW current situation (expectations) balance	Jun	**-72.0 (47.5)**	-75.0 (35.0)	-82.0 (25.2)	-
Spain	Labour costs Y/Y%	Q1	**3.8**	-	3.6	-

Auctions

Country	Auction
Germany	sold €989m of 2.1% 2029 green bonds at an average yield of 2.02%
	sold €495m of 2.3% 2033 green bonds at an average yield of 2.37%
UK	sold £4.5bn of 4.375% 2030 bonds at an average yield of 4.06%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Monday's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro Area	Final labour costs Y/Y%	Q1	**3.4**	*3.2*	3.7	3.8
	Final job vacancy rate %	Q1	**2.4**	*2.4*	2.5	-
Italy	Final HICP (CPI) Y/Y%	May	**1.7 (1.6)**	*1.9 (1.7)*	2.0 (1.9)	-
UK	Rightmove house prices M/M% (Y/Y%)	Jun	**-0.3 (0.8)**	-	0.6 (1.2)	-

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/ *Daiwa forecast*	Previous
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

Auctions and events

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

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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