

Euro wrap-up

Overview

- Bunds made losses as German manufacturing production surprised to the upside in May, offsetting a notable drag from construction.
- Gilts followed the global trend lower on a quiet day for UK economic news.
- Tuesday will bring German and French trade data for May, along with the final estimate of Q1 Irish GDP.

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Daily bond market movements

Bond	Yield	Change
BKO 1.7 06/27	1.829	+0.022
OBL 2.4 04/30	2.157	+0.034
DBR 2.6 08/35	2.640	+0.035
UKT 3% 03/27	3.853	+0.015
UKT 4% 03/30	4.002	+0.016
UKT 4½ 03/35	4.577	+0.025

*Change from close as at 4:15pm BST.
Source: Bloomberg

Euro area

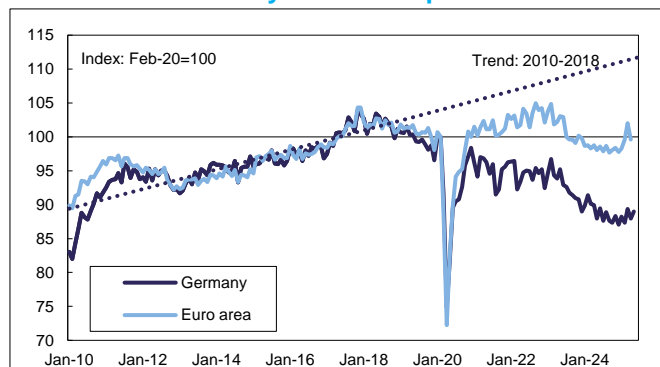
German manufacturing surprises to the upside in May, offsetting a sizeable drag from construction

Consistent with broadly positive survey signals and contrasting markedly the unwelcome decline in turnover reported on Friday, German industrial production in May beat expectations, unexpectedly rising 1.2%M/M. So, while the extent of the drop in April was revised up (-1.6%M/M), output was still up a respectable 1.0%Y/Y and trending above the Q1 average. While energy output (10.8%M/M) rose to an 11-month high, manufacturing production (1.4%M/M) also provided support, trending a little more than ½% above the Q1 level. Despite an outsized US tariff on the sector, the rebound in May was principally driven by a fourth successive and particularly marked increase in autos production (4.9%M/M) to a nine-month high. Output of other transport equipment was boosted by railway-related items, which rose to a near-2½-year high. And there was also modest growth in output of consumer goods as a partial rebound in pharmaceuticals offset a pull-back in food and certain electronic items. In contrast, intermediate goods output fell to the lowest level since the first Covid-19 wave, with notable weakness in chemicals and precious metals. Moreover, construction activity fell a steep 3.9%M/M to the lowest level since late-2015 to be trending some 2½% below the Q1 average. So, while the construction PMI in Q2 was the best in more than two years, today's data strongly suggest that the sector was a drag on GDP growth last quarter. But overall, in the absence of a marked decline in June, today's data suggest that total industrial output provided a positive contribution.

Surveys remain broadly upbeat about near-term outlook, despite a likely pullback in autos output

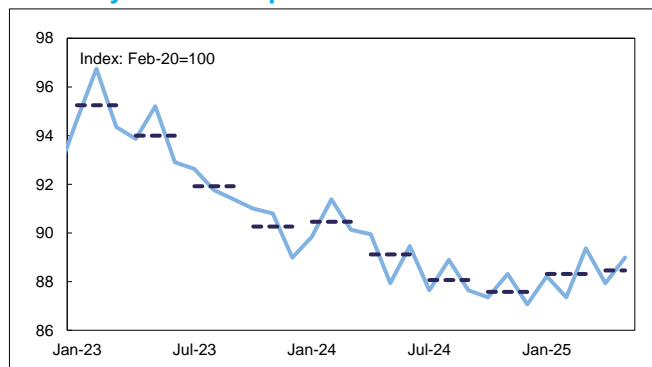
Surveys provide mixed messages about the near-term outlook for German manufacturing. The factory output PMI edged slightly higher in June (51.9) to be above 50 for the four successive months for the first time since March 2023. But the ifo survey suggests that manufacturers were less upbeat last month as demand weakened. That deterioration was largely driven by pessimism in autos who reported the biggest slump in overseas orders since the global financial crisis. In contrast, manufacturers of other transport goods, ICT equipment and metals were the most upbeat in over a year. Happily, truck toll mileage – often a proxy for industrial production – looks on track to rise around ¾% in June. Smoothing for monthly volatility, new factory orders are now at their highest level since early 2024. And as inventories have continued to be run down, output should get further support over coming months as firms tackle an increase in work backlogs. According to the ifo survey, in June, manufacturers' expectations for the coming six months were the most favourable for more than two years. Today's Sentix survey suggests that that improved investor optimism has been maintained at the start of Q3 too, with the current German business situation judged to be the best since May 2023. And supported by the Cabinet's approval of increased public spending plans for the coming four years, investor expectations for the near-term German outlook are at the top end of the range of recent years and well above the long-run average. While the EU-US trade relationship remains highly uncertain, other drivers should allow a gradual pickup in growth momentum towards year-end and into 2026.

Euro area & Germany: Industrial production



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Industrial production*



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

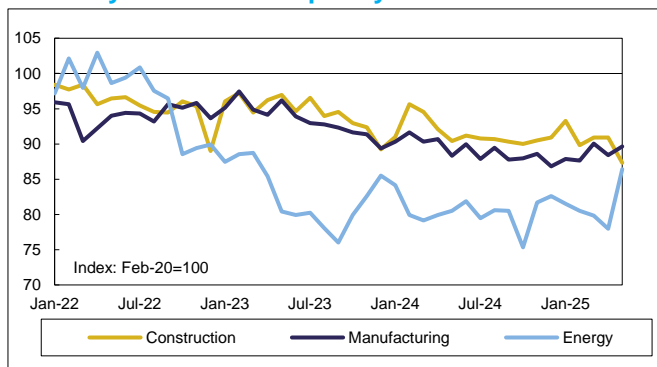
Euro area retail sales dip in May but remains on track for 7th successive quarter of growth in Q2

Broadly in line with expectations, euro area retail sales volumes fell in May by a chunky 0.7%M/M, the most in 21 months. But that marked the first decline since December. So, sales were still up a relatively healthy 1.8%Y/Y. And with the average level in the first two months of Q2 some 0.3% above the Q1 average, sales appear on track for a seventh successive quarter of growth. The weakness in May was broad-based, with sales of food, fuel, and core (i.e. non-food and non-fuel) items all down, and online sales lower too. Sales also fell in most member states, including Germany (-1.7%M/M), France (-0.2%M/M) and Italy (-0.4%M/M). But Spain, Portugal and Ireland remained exceptions, with the growth trend in Iberia remaining particularly strong. Just as sales on the high street took a step down in May, so too did new car registrations, which fell 1.1%M/M on a seasonally adjusted basis. However, they were still trending 0.6% above the Q1 average level to be similarly on track for growth in Q2 after contracting in Q1.

Services output falls at start of Q2 but should also grow over quarter as a whole

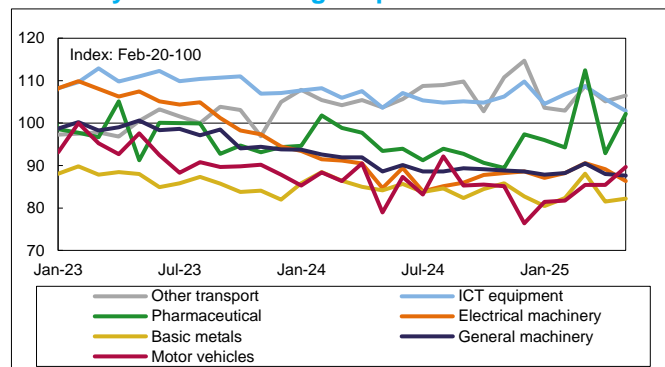
Somewhat less encouragingly, euro area services production in April was soft, falling 0.3%M/M. But that followed growth of 0.8%M/M in March, which was the strongest in more than a year. And the level of services production remained marginally above the Q1 average. While survey indicators suggest a loss of services growth momentum over recent months, a sideways trend over the remainder of Q2 would deliver a sixth successive quarter of expansion in the sector. The primary cause of the decline in April was IT and communications, where a drop of 1.9%M/M likely reflected temporary payback for

Germany: Industrial output by sector



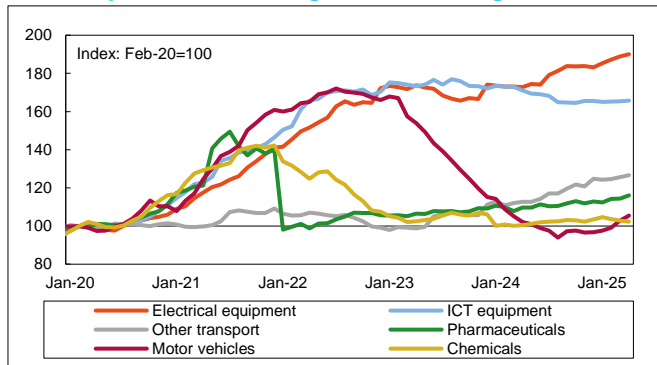
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Manufacturing output in selected sectors



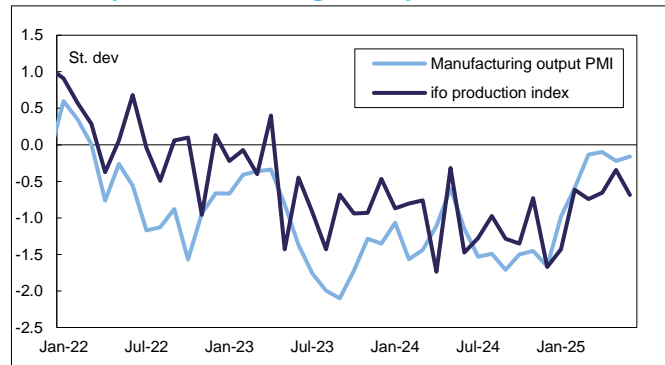
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Manufacturing order backlogs



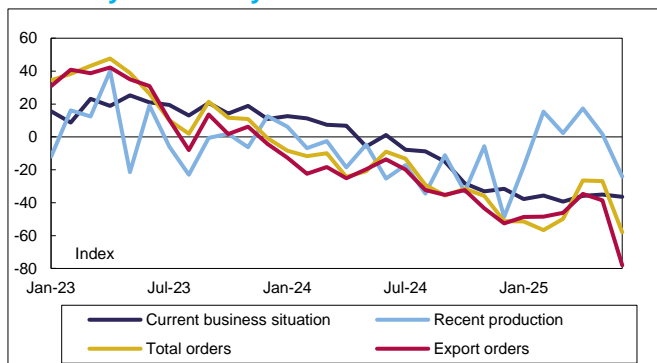
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Manufacturing survey indices



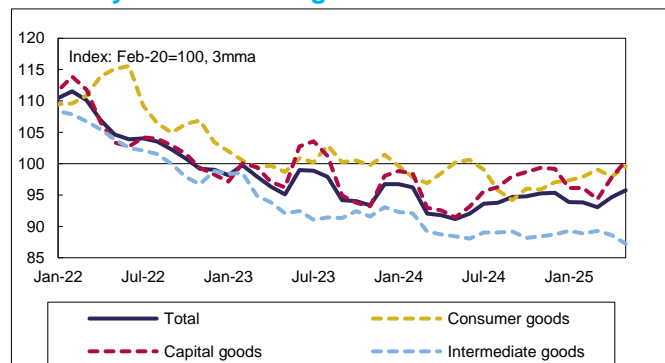
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: ifo survey – autos sector indices



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Manufacturing orders



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

significant strength the prior month. In contrast, hospitality growth was vigorous (1.1%/M/M). And evidence points to continued strong growth in tourism this summer, which should help to extend the uptrends in both consumption and services output.

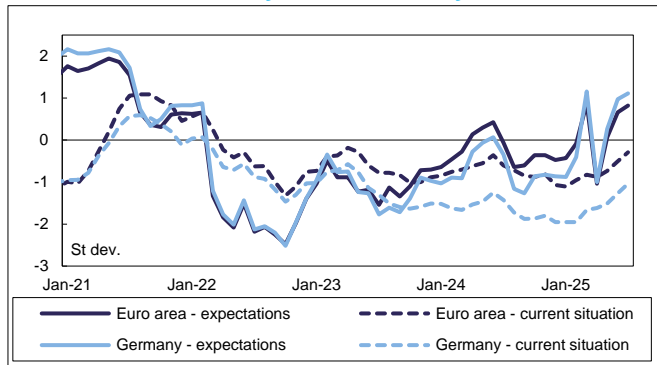
The day ahead in the euro area

While markets await news of a potential 'agreement in principle' between the EU and US ahead of Wednesday's deadline, German and French trade figures for May will be Tuesday's data focus. After front-loading of shipments in Q1, German exports to the US fell 10.5%/M/M in April, precipitating a decline in overall exports (-1.7%/M/M) to their lowest level in three months. But despite the imposition of higher tariffs in early April, US imports data for May suggest a slight pickup in German exports (1%/M/M) led by autos and pharmaceuticals. And with surveys also pointing to resilient overseas demand, we expect German exports to rebound somewhat. By contrast, French exports to the US likely continued to normalise. The US imports data suggest another drop of about 20%/M/M, principally due to weaker shipments of aerospace goods, cosmetics and pharmaceuticals, to roughly one-third below March's peak.

The day ahead in the UK

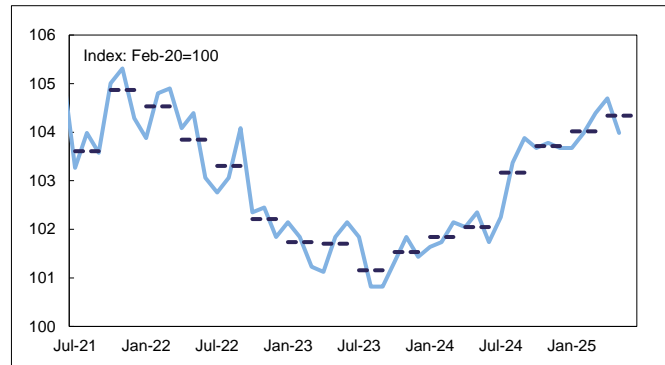
With no top-tier data scheduled for the UK, Tuesday should be another quiet day for UK economic news.

Euro area & Germany: Sentix survey indices



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

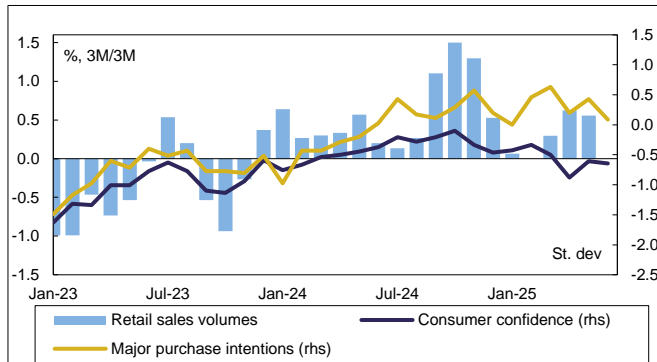
Euro area: Retail sales volumes*



*Dashed dark blue lines represent quarterly average.

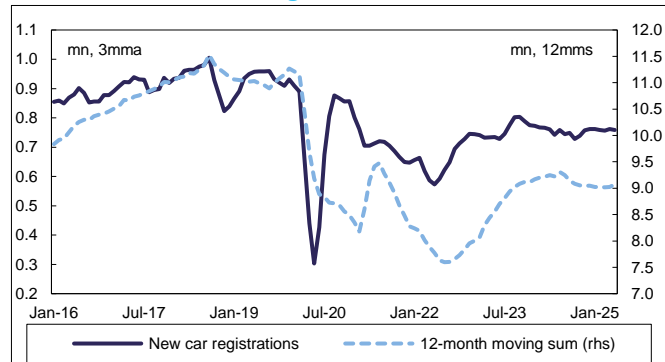
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Retail sales & consumer confidence



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

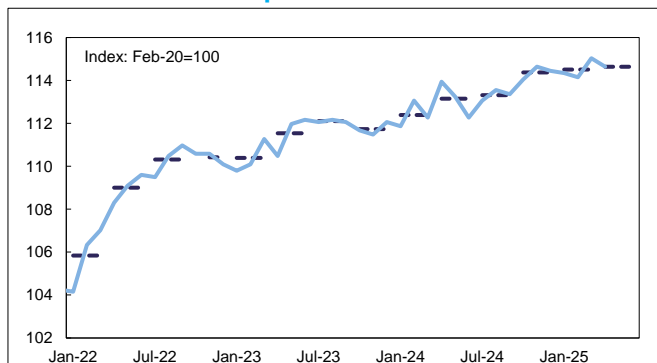
Euro area: New car registrations*



*Seasonally adjusted data.

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

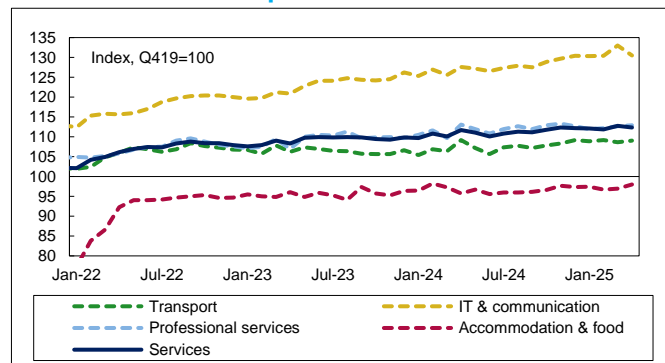
Euro area: Services production*



*Dashed dark blue line represents quarterly average.

Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Services production






Source: Macrobond and Daiwa Capital Markets Europe Ltd.

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro Area	 Retail sales M/M% (Y/Y%)	May	-0.7 (1.8)	-0.6 (1.4)	0.1 (2.3)	0.3 (2.7)
	 Sentix investor confidence indicator	Jul	4.5	1.0	0.2	-
Germany	 Industrial production M/M% (Y/Y%)	May	1.2 (1.0)	-0.2 (-0.3)	-1.4 (-1.8)	-1.6 (-2.1)



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
Germany	 07.00	Trade balance €bn	May	18.0	14.5
France	 07.45	Trade balance €bn	May	-	-8.0

Auctions and events

Germany	 10.30	Auction: to sell €5bn of 2.2% 2030 bonds
	 15.00	Bundesbank President & ECB Governing Council's Nagel to speak alongside former BoJ Deputy Governor Nakaso, Frankfurt
UK	 10.00	Auction: to sell £900m of 1.875% 2049 inflation-linked bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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