

Euro wrap-up

Overview

- While the flash euro area PMIs weakened unexpectedly to suggest a drop in GDP in Q2, Bunds followed USTs lower as euro area consumer confidence improved slightly.
- Longer-dated Gilts made modest gains as the UK flash PMIs deteriorated significantly to suggest a services-led contraction in economic output in Q2.
- Friday will bring the May German ifo and French INSEE business survey results while UK retail sales, consumer confidence and public finance data are also due.

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Daily bond market movements

Bond	Yield	Change
BKO 2½ 06/28	2.681	+0.029
OBL 2½ 04/31	2.803	+0.013
DBR 2.9 02/36	3.097	+0.003
UKT 4¾ 03/28	4.370	+0.009
UKT 4¾ 03/31	4.519	-0.004
UKT 4¾ 10/35	4.965	-0.022

*Change from close as at 5.00pm BST.

Source: Bloomberg

Euro area

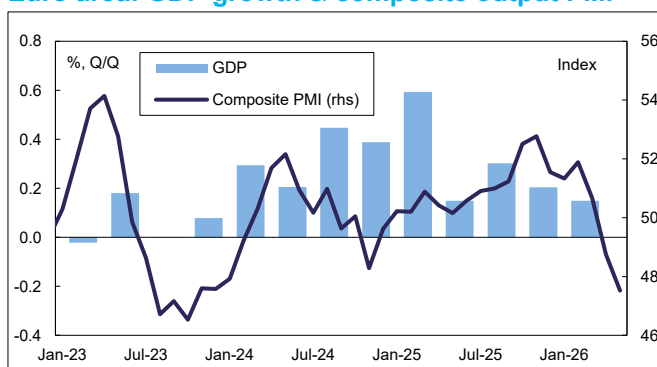
Flash PMIs signal contraction in euro area GDP worse than ECB's 'adverse' scenario

While comments from Governing Council members and yesterday's sourced Reuters report suggest that the ECB is likely to raise rates at its June policy meeting, the May flash PMIs strengthened the case for a pause as they flagged an unexpected further significant weakening in economic activity in the middle of Q2. Having slipped into contraction territory in April, the headline euro area composite PMI fell more than 1pt to 47.5, the lowest since October 2023 and a level suggestive of a drop in GDP of at least 0.2%Q/Q in Q2. That would suggest that economic output this quarter is following a path somewhere between the ECB's 'adverse' and 'severe' scenarios, and notably weaker than its 'baseline' projection of growth of 0.1%Q/Q. The deterioration was particularly marked in France, where the composite PMI fell the most in almost two years to just 43.5, the lowest since the Covid lockdowns in 2020. But while we regularly caution that the French PMIs can sometimes provide a flawed signal of activity, the headline indices for Germany (48.6) and the rest of the euro area (49.0) were also consistent with contraction. As in April, the survey suggested that the weakening was more pronounced in services where activity (46.2) and new business (46.3) reportedly fell the most in more than five years. While the manufacturing output PMI also retreated significantly, at 51.0 it was merely a four-month low and still consistent with modest growth in production. Nevertheless, the survey signalled a drop in new factory orders and backlogs in May while supplier delays increased the most since June 2022 in the aftermath of Russia's invasion of Ukraine.

Input costs rising most in 4 years but selling-price pressures less acute as firms cut headcount

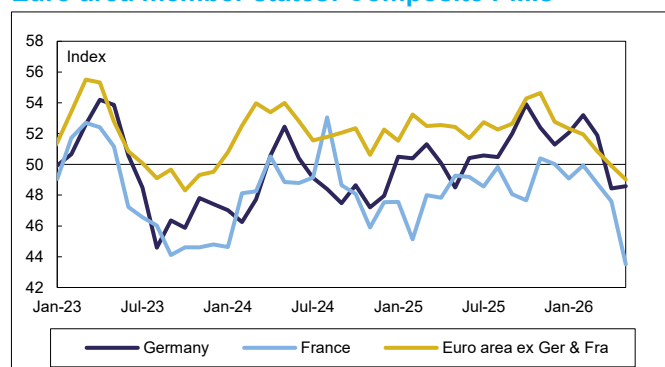
In its attempts to assess the propagation of the shocks from the Middle East on the euro area inflation outlook, the ECB has flagged the cost and price PMIs among the various indices to be most closely watched. In this respect, today's survey results inevitably flagged a further significant increase in input prices in May. Indeed, the respective PMIs suggested that cost pressures in the factory sector were the most intense in four years while those in services were the highest in early 2023. But while that might be a cause for concern at the ECB, the survey suggested that firms in both major sectors were still striving to absorb much of those cost pressures. The PMI for output prices in manufacturing (61.9) was still more than 15bps below the 2022 peak. And the same index for services (55.3) was no higher than in April and almost 10pts below the peak after the Russian invasion of Ukraine. Moreover, firms in both major sectors appear to be looking to cut costs through reductions in headcount, with the composite employment PMI consistent with the most job cuts in the euro area since 2020. Other data today reported that labour cost growth in Q1 (3.4%YY) matched the lowest rate in more than three years. And the softening labour market – which has already been reflected in rising unemployment across the euro area's core member states over the past year – should help to restrain pay demands, delivering the downtrend in pay growth already signalled by the ECB's trackers and reducing the risks of substantive second-round effects on inflation.

Euro area: GDP growth & composite output PMI



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

Euro area member states: Composite PMIs

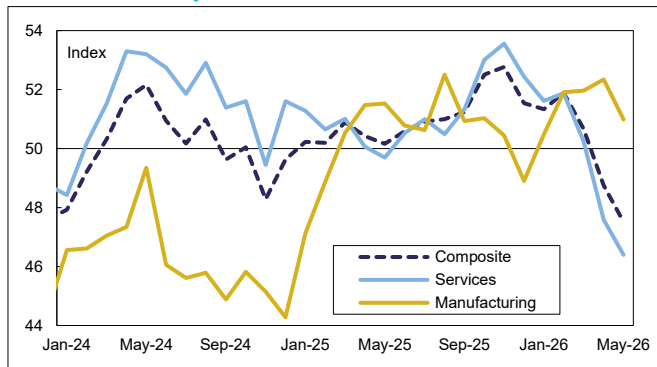


Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

Consumer confidence rises in May but on track for worst quarter since Q422

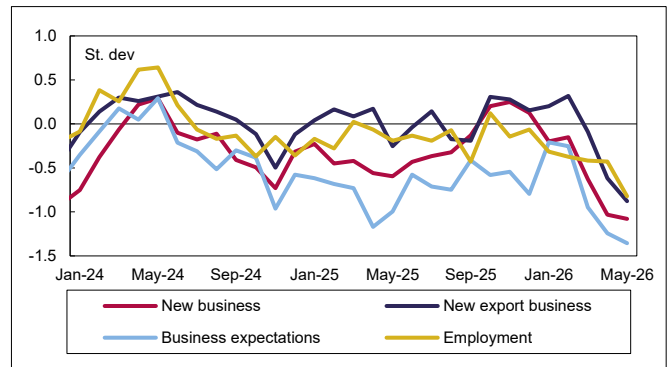
Contrasting the deterioration in the flash PMIs, today's preliminary Commission euro area consumer confidence index for May reported a modest improvement in sentiment. However, that followed a severe deterioration over the prior two months. And so, while the increase (1.6pt) was the biggest in twelve months, the consumer confidence index (-19.0) was still the second-lowest in more than three years and a level rarely worse outside of crisis periods. While no survey detail was published by the Commission, the national Dutch and Belgian surveys – which both reported a deterioration in May – provided little reassurance. Indeed, consumer confidence in Belgium worsened on a sharp increase in fears of unemployment. And the weakening in sentiment in the Netherlands – which in part thanks to the success of ASML has been one of the euro area's better-performing economies over recent years – reflected a significant downwards revision in households' spending intentions. Certainly, with consumer confidence in the euro area in April and May tracking some 6pts below the Q1 average and set to mark the worst quarter since Q422 when private consumption declined a sharp 0.9%Q/Q, we brace ourselves for a pullback in household spending in Q2.

Euro area: Output PMIs



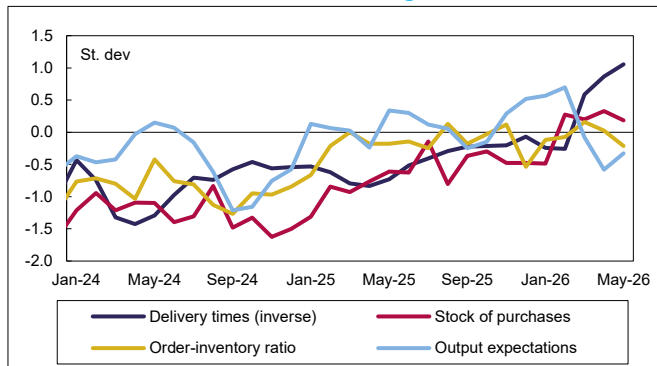
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Select services PMIs



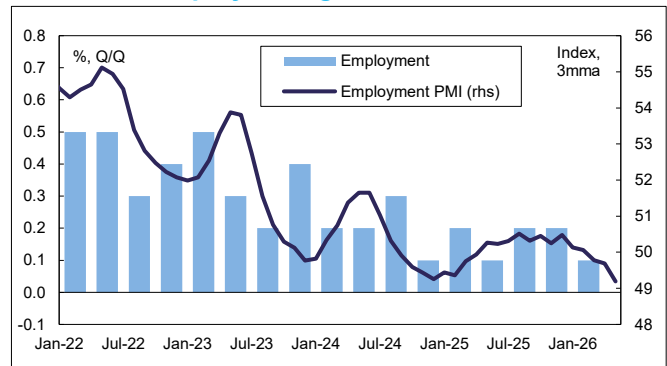
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Select manufacturing PMI



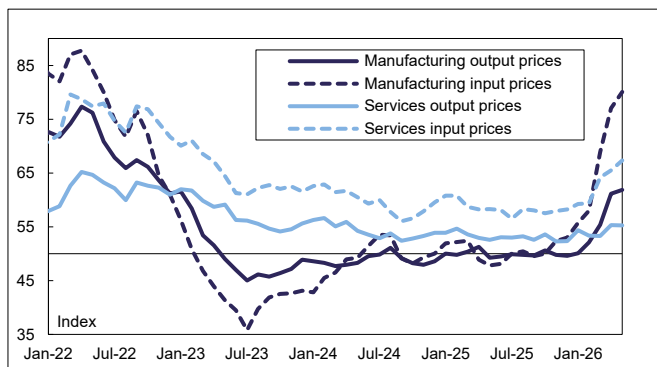
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Employment growth & PMI



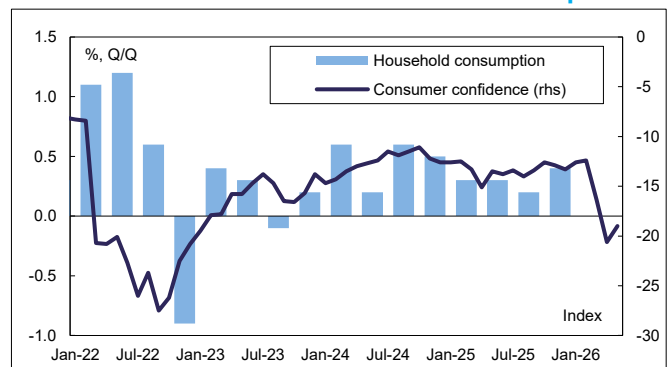
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Price PMIs



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

Euro area: Consumer confidence & consumption



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

The day ahead in the euro area

May's business surveys will stay in focus in the euro area through to the end of the week, with the German ifo and French INSEE indices providing a cross-check on the respective flash PMIs. As always, the initial ifo release will provide some limited sectoral insights into German activity. But the standout weakness of the flash French PMIs – and their susceptibility to random volatility – should place the spotlight on the latter.

Friday will also bring the final estimates for German Q1 GDP, which will be accompanied by a first breakdown by expenditure. Contrasting expectations for a modest deceleration, the preliminary release suggested that economic growth sustained its momentum at the firmest pace in four quarters (0.3%Q/Q). Contractions in industry (-2.8%M/M) and retail (revised to -0.8%M/M) at the end of the quarter raise risks of a downwards revision. In terms of the expenditure contributions, consumption from both public and private sources likely remained the key drivers. A sharp drop in import volumes and recovery in goods exports might also support a positive contribution from net trade for a first quarter in four. Fixed investment, after growth of 1%Q/Q in Q425, was probably a source of weakness.

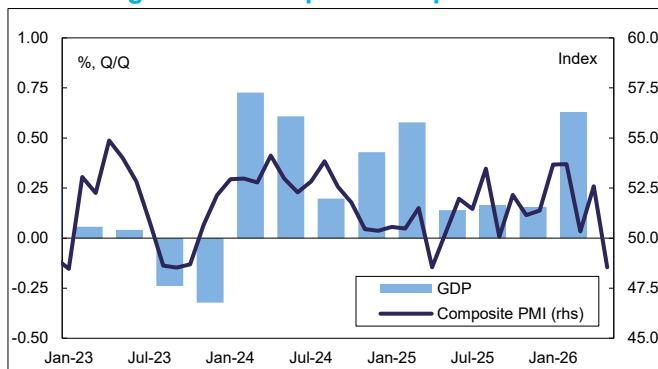
Lastly, the ECB's updated negotiated wage growth indicator will also be of interest. We expect the figures to provide further reassurance about the limited likelihood of a wage-price spiral. Preliminary releases from Germany (2.8%Y/Y, down 0.1ppt) and France (1%Y/Y, down 0.4ppt) suggest that wage settlements in Q1 likely slowed from 2.9%Y/Y at the end of last year, while the ECB's wage tracker continues to predict settlements of around 2½%Y/Y by year-end.

UK

Composite PMI falls the most in four years, with services activity the weakest since Jan-21

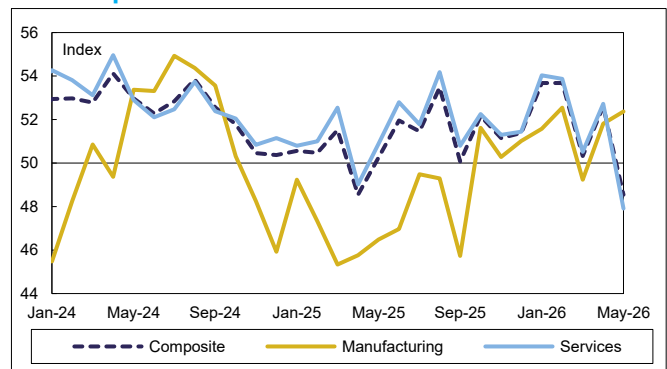
Contrasting the improvement in economic conditions implied by the survey at the start of Q2 but like today's euro area indices, today's flash UK PMIs for May were exceptionally weak. In particular, the headline composite output index fell a sharp 4.1pts in May – the most in four years – to 48.5, the worst in 13 months and more than a full standard deviation below the long-run average. So, while revisions between the flash and final estimates over the past year have averaged a non-negligible 0.7pt, today's survey is consistent with the UK economy contracting by around 0.2%Q/Q, well below the BoE's expectation of underlying GDP growth of 0.1%Q/Q. Like in the euro area, the deterioration was services-led, with the activity index dropping a sharp 4.8pts to 47.9, the lowest since the second Covid lockdown as new business weakened the most in 10 months. Indeed, expectations for activity in the sector over the coming twelve months were the worst since Trump's Liberation Day announcement, and firms signalled continued job cuts in the sector. In contrast, the manufacturing survey

UK: GDP growth & composite output PMI



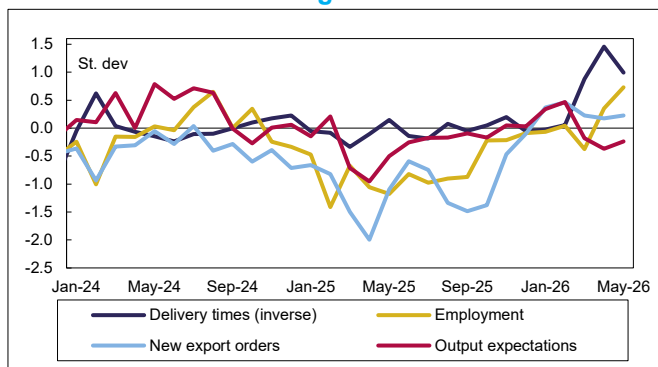
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Output PMIs



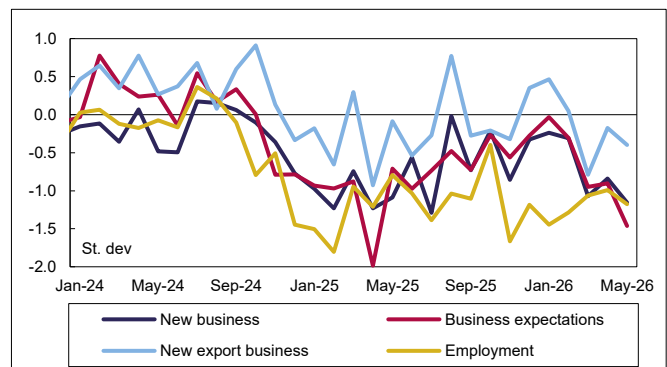
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Select manufacturing PMIs



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

UK: Select services PMIs



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

suggested continued efforts to frontload production and stockpile inputs as a precaution against possible more severe supply bottlenecks over coming months. And while new factory orders slowed they reportedly continued to rise thanks not least to ongoing investment in AI and data centres, allowing manufacturers to increase headcount by the most in almost four years. Admittedly, today's manufacturing PMIs contradict the findings of the CBI industrial trends survey, which suggested that order books were 'below normal' to the greatest extent since September 2020.

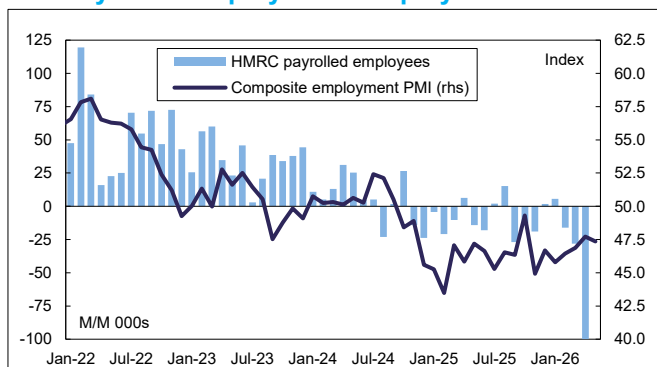
Price PMIs flag a slight moderation in cost pressures & limited pricing power

The weak underlying momentum signals from business and consumer surveys are likely to deter policymakers from placing too much weight on the stronger-than-expected [GDP outturn in Q1](#). Signs of growing slack in the [labour market](#) should also temper concerns about potential significant second-round effects on wage demands and inflation. And after the downside surprise to April's [inflation](#) print, today's survey suggested that price pressures in May are no worse than a month ago, which might further support the views of certain MPC members – including external policymaker Alan Taylor today – that the impact of the current supply shock on inflation will be much less profound or long-lasting than the energy shock in 2022. Indeed, while today's flash PMIs suggest that cost pressures continued to rise at a pace significantly above the range of the past 3½ years, businesses were seemingly struggling to pass them on to customers. Indeed, while notably higher than the long-run average, the composite output price PMI (61.6) fell slightly on the month, with a more significant easing in the respective services index (60.6) too. And at the margin, Chancellor Reeves' announcement today of a temporary cut in the rate of VAT from 20% to 5% on attractions and children's restaurant meals will provide some very modest relief to services inflation over the summer.

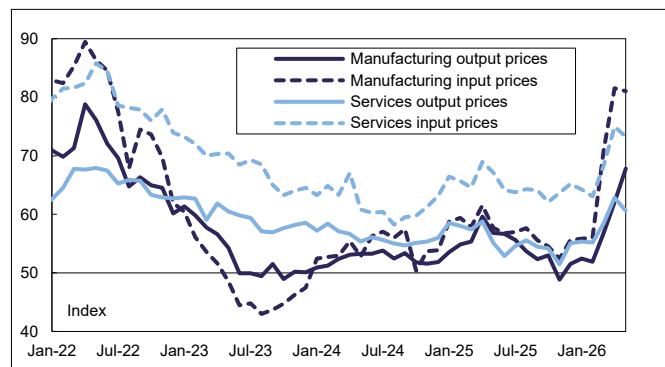
The day ahead in the UK

As in the euro area, the end of the week will also bring a handful of notable data releases from the UK including April's retail sales figures, public finance statistics and latest consumer confidence reading. To recap, the retail sector showed encouraging signs of momentum in Q1, with sales accelerating to the fastest pace in five years (1.6%Q/Q). But the spillovers from the latest energy shock last month skew the risks firmly to the downside. Indeed, at the very least, we expect to see a rollback in fuel sales volumes for the strength which flattered sales in March. Retail surveys – from both the CBI and BRC – pointed towards an abysmal month for sales volumes, with the latter of those also exemplifying the risks posed by post-Easter payback and base effects. And the deterioration in consumer confidence to a 2½-year low last month (-25) also suggests that the war might be reinforcing greater caution amongst households. As such, a decline in retail sales volumes in April appears highly likely. And on the basis of today's PMIs and in expectation of another subdued consumer confidence reading in May, we currently expect retail sales growth to decelerate markedly over Q2 as a whole. Meanwhile, April's public finances update will also be closely watched for a first update on government borrowing in the new financial year.

UK: Payrolled employees & employment PMI
















UK: Price PMIs















European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area	 Preliminary services (manufacturing) PMI	May	46.4 (51.4)	47.8 (51.8)	47.6 (52.2)	-
	 Preliminary composite PMI	May	47.5	48.8	48.8	-
	 Preliminary Commission consumer confidence indicator	May	-19.0	-20.6	-20.6	-
	 Construction output M/M% (Y/Y%)	Mar	0.8 (-1.2)	-	-0.2 (-1.9)	-0.8 (-3.0)
	 Preliminary labour costs Y/Y%	Q1	3.4	-	3.3	3.4
	 Preliminary job vacancy rate %	Q1	2.2	-	2.3	-
Germany	 Preliminary services (manufacturing) PMI	May	47.8 (49.9)	47.0 (51.0)	46.9 (51.4)	-
	 Preliminary composite PMI	May	48.6	48.5	48.4	-
France	 Preliminary services (manufacturing) PMI	May	42.9 (48.9)	46.7 (52.1)	46.5 (52.8)	-
	 Preliminary composite PMI	May	43.5	47.7	47.6	-
UK	 Preliminary services (manufacturing) PMI	May	47.9 (53.7)	51.7 (53.0)	52.7 (53.7)	-
	 Preliminary composite PMI	May	48.5	51.6	52.6	-
	 CBI industrial trends survey – total orders (selling prices) % balance	May	-41 (38)	-40 (35)	-38 (32)	-












Auctions

Country	Auction
France	 sold €2.88bn of 2.4% 2029 bonds at an average yield of 2.94%
	 sold €3.118bn of 2.75% 2030 bonds at an average yield of 2.99%
	 sold €5.60bn of 3.25% 2032 bonds at an average yield of 3.25%
	 sold €2.40bn of 3.5% 2033 bonds at an average yield of 3.48%
	 sold €426mn of 0.6% 2034 inflation-linked bonds at an average yield of 1.24%
	 sold €370mn of 0.1% March 2036 inflation-linked bonds at an average yield of 1.86%
	 sold €441mn of 0.1% July 2036 inflation-linked bonds at an average yield of 1.49%
	 sold €303mn of 0.1% 2047 inflation-linked bonds at an average yield of 2.03%
Spain	 sold €2.59bn of 2.6% 2031 bonds at an average yield of 2.959%
	 sold €2.20bn of 3% 2033 bonds at an average yield of 3.164%
	 sold €1.27bn of 1% 2050 bonds at an average yield of 4.115%
UK	 sold £4bn of 4.875% 2036 bonds at an average yield of 5.026%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Euro area	 10.00	Negotiated wages Y/Y%	Q1	2.5	2.9
Germany	 07.00	GDP – final estimate Q/Q% (Y/Y%)	Q1	<u>0.3 (0.5)</u>	0.2 (0.5)
	 07.00	GfK consumer confidence indicator	Jun	-34.0	-33.3
	 09.00	ifo current assessment (expectations) indicator	May	85.1 (83.5)	85.4 (83.3)
France	 09.00	ifo business climate indicator	May	84.2	84.4
	 07.45	INSEE business (manufacturing) confidence indicator	May	94 (99)	94 (100)
UK	 07.45	INSEE production outlook (own-company) indicator	May	-17 (6)	-18 (7)
	 00.01	GfK consumer confidence indicator	May	-28	-25
	 07.00	Retail sales – incl. auto fuel M/M% (Y/Y%)	Apr	-0.6 (1.3)	0.7 (1.7)
	 07.00	Retail sales – excl. auto fuel M/M% (Y/Y%)	Apr	-0.3 (1.7)	0.2 (1.7)
	 07.00	Public sector net borrowing £bn	Apr	20.9	12.6

Auctions and events

- Nothing scheduled -

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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