

Euro wrap-up

Overview

- As German inflation undershot expectations in May, Bunds followed the global trend higher on continued optimism for a potential resolution to the conflict in the Middle East.
- Gilts also made gains after Governor Bailey reiterated that the BoE could tolerate a temporary inflation target overshoot until circumstances in the Middle East and the impact of the energy shock become clearer.
- The coming week will bring euro area inflation & unemployment estimates & surveys of inflation expectations from the euro area & UK.

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Daily bond market movements

Bond	Yield	Change
BKO 2½ 06/28	2.525	-0.027
OBL 2½ 04/31	2.631	-0.029
DBR 2.9 02/36	2.931	-0.029
UKT 4¾ 03/28	4.205	-0.027
UKT 4¾ 03/31	4.348	-0.021
UKT 4¾ 10/35	4.810	-0.004

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

Euro area

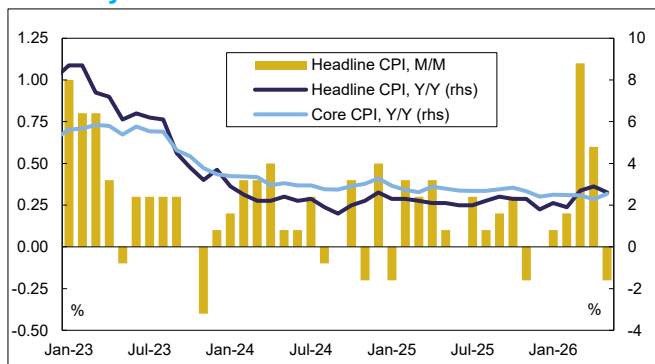
German inflation undershot expectations in May thanks in part to tax-driven drop in auto fuel

Today's flash May inflation estimates from various member states gave a guide as to what to expect from the euro area figures to be published on Tuesday. As in recent months, the price shock from the Middle East continued to be reflected in energy components, albeit in some countries cushioned by government support measures. And while a lack of detail in today's releases makes it difficult to fully assess underlying drivers or account for calendar-related distortions, a modest pickup in core inflation and the services components arguably supported the case for an ECB rate hike at the policy meeting on 11 June. Admittedly, today's German figures surprised to the downside, with consumer prices falling in May for the first time in several months. As a result, headline inflation on the national CPI measure fell 0.3ppt to 2.6%YY, while the EU-harmonised HICP rate eased 0.2ppt to 2.7%YY. But both rates remain more than ½ppt above their respective levels at the onset of the Iran War. And the detail published with the national measure confirmed that the drop was driven in part by the temporary tax cut to auto fuel, which helped push energy inflation down 3½ppts to 6.6%Y/Y. Encouragingly, prices of food and non-alcoholic beverages also fell the most since July 2020, taking inflation of that component to the lowest level in more than two years (0.4%Y/Y). And while services inflation rose 0.3ppt to 3.1%Y/Y, this was still below the range in Q4 and Q1. Regional data suggest a notable upwards impulse from package holidays, inflation of which fell temporarily in April due to the timing of the Easter holidays. There was also a further modest uptick in our estimate of non-energy industrial goods inflation to a nine-month high. But overall, core CPI inflation merely reversed the 0.2ppt drop in April to 2.5%Y/Y, bang in line with the average in the year to date.

Inflation up in France, Italy & Spain on bounce back in services

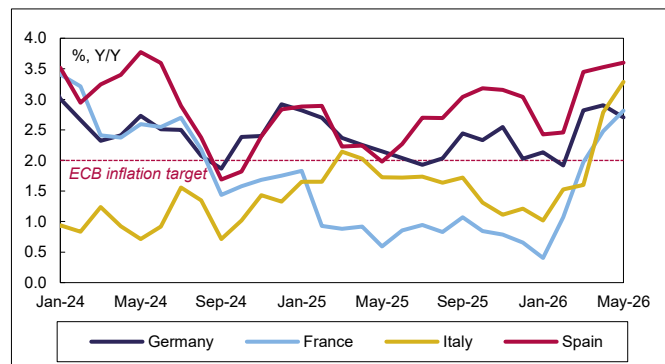
In contrast to Germany, headline inflation in the other larger member states ticked higher in May. HICP inflation rose modestly in France by 0.3ppt to 2.8%Y/Y and Spain by 0.1ppt to 3.6%Y/Y, both the firmest rates in two years. And Italian inflation rose to the highest level since September 2023, up 0.5ppt to 3.3%Y/Y. The limited detail published with the flash releases suggests that energy caused the increases in France and Italy. A sharp rise in gas prices pushed French energy inflation up 2½ppts to the highest level since late-2022. And the conclusion of the temporary tax cut on petrol prices pushed up Italian energy inflation almost 3ppts to a near-three-year high. But energy price pressures appear to have been more contained in Spain, where reduced VAT rates on electricity and gas as well as auto fuel are set to continue through to the end of June. The Spanish statistical office reported increases in certain services components, including transport and recreational activities, more than offsetting a drag from clothing. French services inflation also rose to a five-month high, while Italian services inflation reversed April's moderation due to a step up in transport and hospitality costs. But while there was a jump in prices of fresh foods in France and Italy, overall food inflation there moved sideways and moderated in Spain

Germany: Headline & core CPI



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area member states: Headline HICP



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

too. And contrasting the upwards drift in Germany, core goods inflation remained lacklustre elsewhere. Overall, taken together with modest easing in inflation in Belgium, Portugal and Ireland, we expect euro area headline inflation to edge only slightly higher in May, by 0.3ppt to 3.3%Y/Y. We also forecast core inflation to rise 0.2ppt to 2.4%Y/Y.

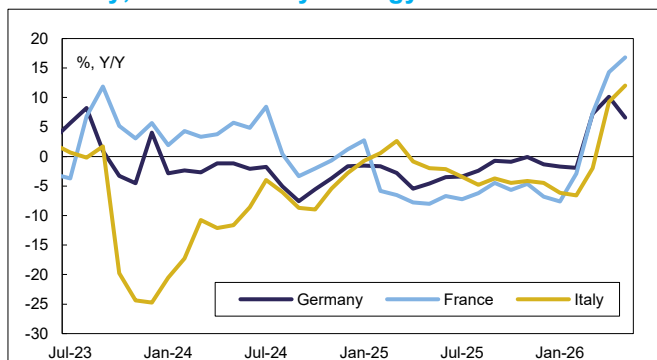
Italian unemployment rate at record low, while German jobless claims ease as firms hoard labour

While business surveys had reported that, on average, firms have looked to cut headcount as the Iran conflict dragged on, a non-negligible share have signalled a readiness to hoard labour in the hopes of a swift resolution. And the latest data suggest that the labour market has remained broadly resilient at the start of Q2. Italian firms added 123k jobs in April, pushing the employment rate up 0.3ppt to a series high 63.1% and the unemployment rate down 0.1ppt to 5.1%, a full percentage point below the level a year ago and the lowest since the series began in 1983. There were also declines in the equivalent ILO measures of Dutch and Irish unemployment rates in April to eight- and five-month lows respectively. So, the euro area aggregate rate (due Monday) might remain at its series low (6.2%). Admittedly, the recent uptrend in France might provide an upside risk. And German jobless claims numbers that month also picked up (+19k). But today's German claims figures for May beat expectations, falling 12k to push the claimant count rate back down to 6.3%, the same level a year earlier. While the number of German job vacancies was little changed in May, it was still above the average of the past 12 months. And according to yesterday's Commission survey, the share of German firms looking to hoard labour in May rose to the highest in more than two years.

The week ahead in the euro area

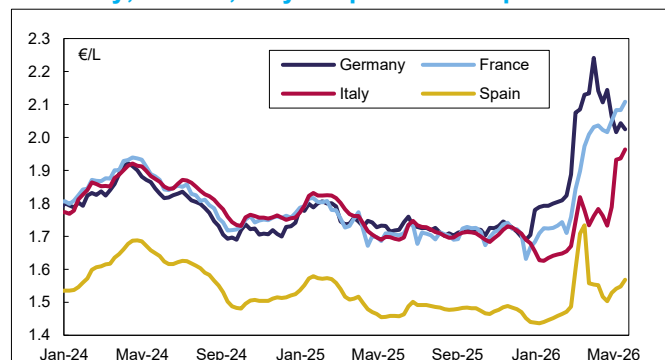
The penultimate week before the ECB's next policy decision will be a busy one for euro area data. The aforementioned flash May inflation estimates (Tuesday) should grab most headlines. Like the consensus, we see headline HICP rising to 3.3%Y/Y, up 0.3ppt from April's 31-month high. Today's estimates from the member states suggest that energy inflation remained the principal source of upwards pressure, albeit in this instance led by a combination of base effects and household energy after a relatively tame monthly change in auto fuel prices. And the core HICP rate likely rose back to its pre-war mark of 2.4%Y/Y, from its 4½-year low in April, due in part to normalisation in package holidays and pressure in transport services. Core goods, however, appear to have fared better. And while euro area PPI data (Wednesday) will report a further increase in pipeline cost pressures in April, the detail should at least show that they were [concentrated](#) in a few sectors. That might help to temper concerns about the rate at which supply-chain pressures feed into broader consumer prices. Meanwhile, notwithstanding the surprising decline in German jobless claims in May, we see risks of a slight pickup in the euro area unemployment rate in April to 6.3% (Monday) given the latest signs of weakness in [France](#). And a looser labour market should be consistent with ongoing moderation in labour cost growth going forward.

Germany, France & Italy: Energy inflation*



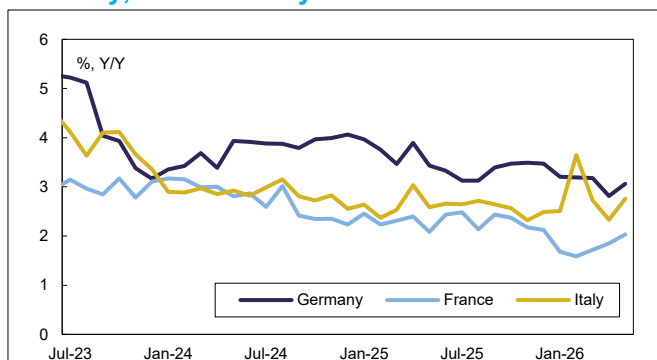
*National measures. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany, France, Italy & Spain: Petrol prices



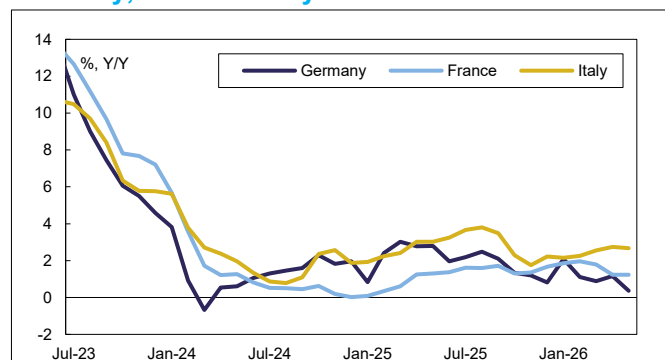
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany, France & Italy: Services inflation*



*National measures. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany, France & Italy: Food inflation*

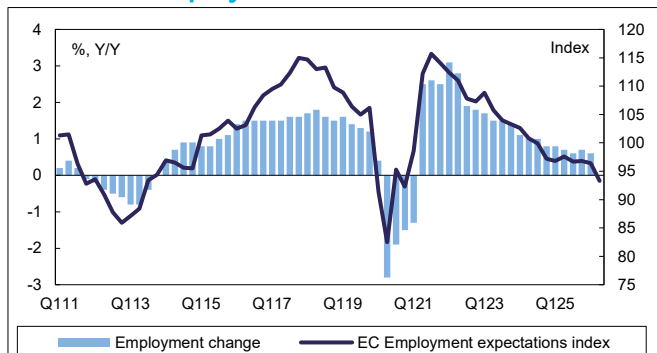


*National measures. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

The May inflation data aside, the most consequential release for the ECB could be its own Consumer Expectations Survey (Monday). Ultimately, the Governing Council determined that inflation expectations were 'broadly anchored' at April's Governing Council meeting. But the 'number' of members who would have been happy to raise rates in April were unsettled by the upwards shift in consumers' inflation expectations given their potential implications for second-round effects. Year-ahead inflation expectations rose sharply in March, up 1.5ppts to a 2½-year high of 4.0%Y/Y, while medium-term expectations also rose close to their 2022 highs. A modest moderation is unlikely to dent expectations of a rate hike at the ECB's upcoming meeting in June. And further increases in consumer inflation expectations would surely reinforce the hawkishness of some ratesetters. Otherwise, the survey will also provide an update on household economic expectations for the coming 12 months. Those were little changed at the onset of the conflict. But a more downbeat picture might emerge soon, highlighting downside risks to household spending. Indeed, while data from Germany (Monday) will refine predictions, euro area retail sales volumes (Thursday) probably contracted sharply in April, raising the likelihood of a second consecutive quarterly drop in Q2. And while its extent is bound to be exaggerated by efforts to cut back on fuel, we expect core sales, excluding fuel and food, to have fallen back too.

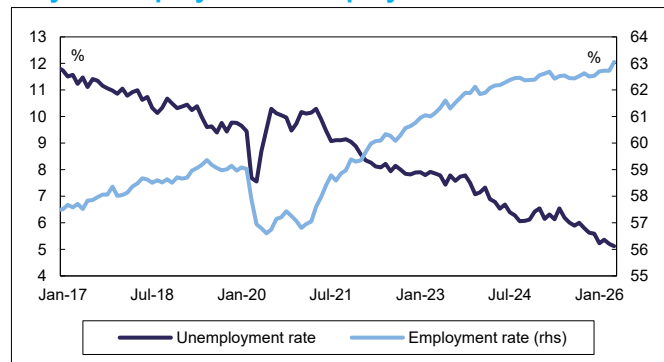
Among other releases, IP data from France (Friday) and Spain (Thursday) will also give a first indication as to whether efforts of manufacturers to front-run potential supply chain disruption, as flagged by the PMIs, translated into the raw data. The final May PMIs (Monday and Wednesday) will be watched for confirmation of significant weakening in services, particularly in France. To the extent that the weakness was not apparent in the INSEE business survey, we expect the final French and euro area services and composite PMIs to be revised up. Finally, with today's revisions to French and Italian GDP largely offsetting, final GDP estimates for the euro area (Friday) are likely to confirm that growth slowed to 0.1%Q/Q at the start of the year, the softest since Q2'24. An upwards revision, however, cannot be completely ruled out, not least while final estimates from Ireland (Thursday) are still pending. In any case, the first breakdown by expenditure components should confirm that private consumption slowed considerably and fixed investment contracted, underscoring the weakness of domestic private demand. Net trade, on the other hand, looks set to make a first positive contribution since Q1'25, before the introduction of Trump's tariffs.

Euro area: Employment & EEI*



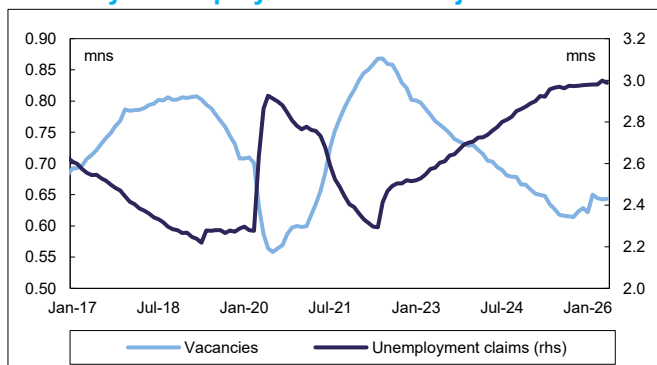
*Employment expectations index. Latest figure based on average of April & May surveys. Source: EC, Macrobond and Daiwa Capital Markets Europe Ltd.

Italy: Unemployment & employment rates



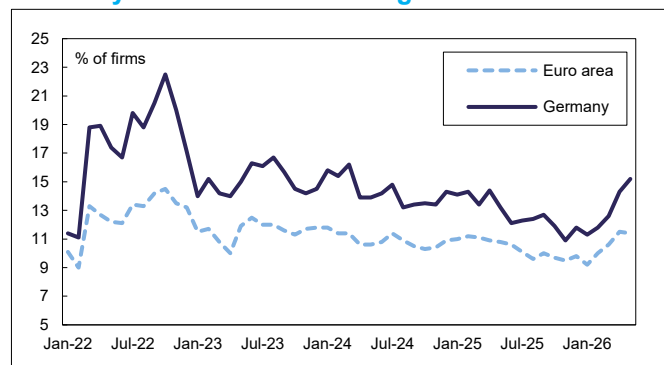
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Unemployment claims & job vacancies



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Share of firms willing to hoard labour



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










UK

The week ahead in the UK

As BoE Governor Bailey reinforced in his speech in Reykjavik today, a majority of MPC members seem willing to tolerate a temporary inflation overshoot until circumstances in the Middle East, as well as the strength of any indirect and second-round inflationary effects, become clearer. But a hawkish minority will vote for a hike in June. And in doing so, they will likely cite the BoE's latest Decision Maker Panel survey (Friday). In April, year-ahead inflation expectations had already risen 1ppt since the outbreak of the war, and seem likely to remain elevated at around 4%Y/Y. And three-months ahead selling-price intentions, which are reported as a three-monthly average, are likely to rise further this month and might broaden beyond the communications sector. But medium-term inflation expectations remained more stable in April, just 0.1ppt higher than at the start of the year. And wage intentions were also largely unperturbed against the backdrop of weak labour demand, suggesting that the risks of second-round effects were still limited. In our view, a deterioration in those indicators would be required to bring forward any expectations of tightening by the BoE, at least before Q3. Several appearances from MPC members – including a number from Governor Bailey (Tues, Thurs & Fri), as well as external members Greene (Tuesday) and Dhingra (Friday) – will perhaps shed some more light on how the MPC views the balance of risks.

Elsewhere, May's final PMIs (Monday and Wednesday) should reaffirm signals of a moderation in growth, led by what the flash release suggested was the sharpest contraction in the services sector since January 2021. The construction PMIs (Thursday) will also provide a signal as to whether input price pressures, as in services and manufacturing, experienced any moderation. Besides surveys, the week ahead will also bring April's monetary statistics (Tuesday). To the extent that the resilience in UK bank lending at the start of the war reflected efforts to get ahead of any rate hikes or escalation in the Middle East, we suspect that subsequent tightening of financial conditions will be reflected in April's borrowing numbers. Commensurately, we also see the risks to Nationwide's indicator of house price growth (Monday) skewed to the downside.

Daiwa economic forecast

		2025		2026			2027	2026	2027	2028
		Q4	Q1	Q2	Q3	Q4	Q1			
GDP		%, Q/Q						%, Y/Y		
Euro area		0.2	0.1	0.0	0.1	0.2	0.3	0.6	1.0	1.4
UK		0.2	0.6	0.1	0.1	0.2	0.4	1.0	1.1	1.4
Inflation, %, Y/Y										
Euro area										
Headline HICP		2.1	2.0	3.2	3.1	3.1	3.0	2.8	2.4	2.0
Core HICP		2.4	2.3	2.3	2.5	2.7	3.0	2.5	2.8	2.0
UK										
Headline CPI		3.4	3.1	2.9	3.6	3.7	3.6	3.3	2.9	1.9
Core CPI		3.3	3.2	2.6	2.9	3.2	3.3	3.0	3.2	2.3
Monetary policy, %										
ECB										
Deposit Rate		2.00	2.00	2.25	2.50	2.50	2.50	2.50	2.25	2.25
Refi Rate		2.15	2.15	2.40	2.65	2.65	2.65	2.65	2.40	2.40
BoE										
Bank Rate		3.75	3.75	3.75	4.00	4.00	4.00	4.00	3.50	3.50

Source: Bloomberg, ECB, BoE 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	
Germany	Preliminary HICP (CPI) Y/Y%	May	2.7 (2.6)	2.8 (2.9)	2.9 (2.9)	-	
	Unemployment claims rate % (change 000s)	May	6.3 (-12)	6.4 (10)	6.4 (20)	-(19)	
	Import prices M/M% (Y/Y%)	Apr	1.2 (5.3)	1.1 (5.3)	3.6 (2.3)	-	
France	Preliminary HICP (CPI) Y/Y%	May	2.8 (2.4)	2.9 (2.5)	2.5 (2.2)	-	
	Consumer spending M/M% (Y/Y%)	Apr	-0.5 (-0.4)	-0.2 (-0.3)	0.7 (0.5)	0.9 (0.3)	
	GDP – final estimate Q/Q% (Y/Y%)	Q1	-0.1 (0.9)	<u>0.0 (1.1)</u>	0.2 (1.2)	-	
	Total (private sector) payrolls Q/Q%	Q1	0.0 (-0.1)	-0.1 (-0.1)	-0.1 (-0.1)	-	
Italy	Preliminary HICP (CPI) Y/Y%	May	3.3 (3.2)	3.3 (3.1)	2.8 (2.7)	-	
	GDP – final estimate Q/Q% (Y/Y%)	Q1	0.3 (0.8)	<u>0.2 (0.7)</u>	0.3 (0.9)	-	
	Unemployment rate %	Apr	5.1	5.3	5.2	-	
Spain	Preliminary HICP (CPI) Y/Y%	May	3.6 (3.2)	3.6 (3.3)	3.5 (3.2)	-	
Auctions							
Country	Auction						
- Nothing to report -							







































Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's calendar

The coming week's key events & auctions			
Country	BST	Event / Auction	
Monday 1 June 2026			
Euro area	00.10	ECB's Schnabel to give speech and participate in policy dialogue at a BOK conference, Seoul	
Tuesday 2 June 2026			
Germany	10.30	Auction: to sell up to €5bn of 2.5% 2028 bonds	
UK	10.00	Auction: to sell £3.25bn of 4.625% 2037 green bonds	
	15.00	BoE Governor Bailey appears before the House of Lords Economic Affairs Committee, London	
	16.00	External MPC member Greene to give speech on the 'inflation risks of the recent energy shock' at the University of Derby	
Wednesday 3 June 2026			
UK	10.00	Auction: to sell £1.6bn of 1.125% 2035 inflation-linked bonds	
Thursday 4 June 2026			
Euro area	09.00	ECB President Lagarde to speak in Aix-en-Provence	
France	09.50	Auction: to sell up to €14bn of 3.7% 2036, 4% 2038, 3.6% 2042 & 4.4% 2057 bonds	
Spain	09.30	Auction: to sell 2.35% 2029, 3.1% 2031, 3.5% 2041 bonds & 2.05% 2039 inflation-linked bonds	
UK	16.40	BoE Governor Bailey to give speech at the Investment Association annual conference, London	
Friday 5 June 2026			
UK	14.40	External MPC member Dhingra to give speech at University College London	
	19.00	BoE Governor Bailey to participate in discussion celebrating the 250 th anniversary of the Wealth of Nations in Kirkcaldy, Scotland	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key data releases

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous	
Monday 1 June 2026						
Euro area		09.00	ECB consumer expectations survey – 1Y (3Y) ahead CPI Y/Y%	Apr	4.1 (3.0)	4.0 (3.0)
		09.00	M3 money supply Y/Y%	May	3.1	3.2
		09.00	Final manufacturing PMI	May	<u>51.4</u>	52.2
		10.00	Unemployment rate %	Apr	6.2	6.2
Germany		07.00	Retail sales M/M% (Y/Y%)	Apr	-0.5 (-1.6)	-0.8 (2.1)
		08.55	Final manufacturing PMI	May	<u>49.9</u>	51.4
France		08.50	Final manufacturing PMI	May	<u>48.9</u>	52.8
Italy		08.45	Manufacturing PMI	May	-	52.1
Spain		08.15	Manufacturing PMI	May	-	51.7
		07.00	Nationwide house prices M/M% (Y/Y%)	May	-0.2 (2.2)	0.4 (3.0)
UK		09.30	Final manufacturing PMI	May	<u>53.7</u>	53.7
Tuesday 2 June 2026						
Euro area		10.00	Preliminary headline (core) HICP Y/Y%	May	<u>3.3 (2.4)</u>	3.0 (2.2)
Spain		08.00	Unemployment (net employment) change 000s	May	-	-62.7 (41.8)
UK		09.30	Net consumer credit £bn (Y/Y%)	Apr	1.7 (-)	1.9 (8.9)
		09.30	Net mortgage lending £bn (mortgage approvals 000s)	Apr	- (61.5)	6.2 (63.5)
Wednesday 3 June 2026						
Euro area		09.00	Final composite (services) PMI	May	<u>47.5 (46.4)</u>	48.8 (47.6)
		10.00	PPI Y/Y%	Apr	3.9	2.1
Germany		08.55	Final composite (services) PMI	May	<u>48.6 (47.8)</u>	48.4 (46.9)
France		08.50	Final composite (services) PMI	May	<u>43.5 (42.9)</u>	47.6 (46.5)
Italy		08.45	Composite (services) PMI	May	-	50.5 (49.8)
Spain		08.15	Composite (services) PMI	May	-	48.7 (47.9)
UK		09.30	Final composite (services) PMI	May	<u>48.5 (47.9)</u>	52.6 (52.7)
Thursday 4 June 2026						
Euro area		08.30	Construction PMI	May	-	41.7
		10.00	Retail sales M/M% (Y/Y%)	Apr	-0.3 (0.3)	-0.1 (1.2)
Germany		08.30	Construction PMI	May	-	42.1
France		08.30	Construction PMI	May	-	38.1
Italy		08.30	Construction PMI	May	-	44.8
Spain		08.00	Industrial production M/M% (Y/Y%)	Apr	-	2.3 (1.8)
UK		09.00	New car registrations Y/Y%	May	-	24.0
		09.30	Construction PMI	May	-	39.7
Friday 5 June 2026						
Euro area		10.00	GDP – final estimate Q/Q% (Y/Y%)	Q1	<u>0.1 (0.8)</u>	0.2 (1.2)
		10.00	GDP – household consumption Q/Q%	Q1	-	0.4
		10.00	GDP – government expenditure Q/Q%	Q1	-	0.5
		10.00	GDP – fixed investment Q/Q%	Q1	-	0.7
		10.00	Employment – second estimate Q/Q% (Y/Y%)	Q1	<u>0.1 (0.5)</u>	0.2 (0.7)
France		07.45	Industrial production M/M% (Y/Y%)	Apr	-	1.0 (0.9)
		07.45	Trade balance €bn	Apr	-	-6.9
UK		08.00	DMP – 3M output price (1Y CPI) expectations Y/Y%	May	<u>4.1 (4.0)</u>	3.8 (4.0)

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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