

Euro wrap-up

Overview

- Bunds followed the global trend higher, while German industrial production returned to modest growth in April underpinned by a strong rebound in construction.
- Gilts also made gains, while a UK retail survey suggested that a rebound in sales values in May was boosted by higher prices and a temporary heatwave.
- On Thursday, the ECB will raise its key policy rates by 25bps and revise higher its inflation projections.

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Daily bond market movements

Bond	Yield	Change
BKO 2½ 06/28	2.679	-0.022
OBL 2½ 04/31	2.772	-0.015
DBR 2.9 02/36	3.055	-0.004
UKT 4¾ 03/28	4.337	-0.036
UKT 4¾ 03/31	4.470	-0.033
UKT 4¾ 10/35	4.915	-0.028

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

Euro area

German IP returns to growth in April underpinned by strong construction rebound

As expected, today's German industrial output data for April showed a return to growth (0.4%M/M) for the first time since November. Some firms might have been trying to front-load production, particularly in sectors most exposed to supply risks and rising costs. There were also signs of support from increased government spending on defence and infrastructure. And data revisions suggested that the rate of contraction in Q1 (-0.6%Q/Q) was just half that initially estimated. Nevertheless, the increase in total industrial production in April only partially reversed the cumulative 1.2% drop over the previous four months. Moreover, manufacturing output merely flatlined in April, 0.3% below the Q1 level. So, it was only thanks to the strong recovery in construction following the cold snap earlier in the year that overall IP didn't stagnate at the start of Q2. Indeed, construction activity rose to a 15-month high in April (2.4%M/M), more than 4% above the Q1 average level. And a sharp rebound in civil engineering work propelled it to a near-series high.

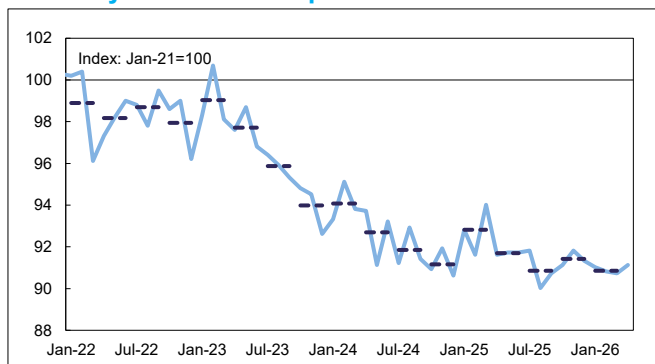
Signs of manufacturing front-loading & policy-related support in April, but autos output drags

The manufacturing detail suggested a mixed performance across the various subsectors. But the weakness was principally concentrated in autos, where output dropped to an eight-month low (-4.7%M/M) amid soft foreign demand. In contrast, other transport equipment maintained an uptrend on strong aerospace production. Electrical machinery output rose to the highest level since January 2024, while fabricated metals rebounded, partly supported by a pickup in ammunition production. Chemicals output reached the highest level in a year on gains in basic organic chemicals, plastics and explosives. So, alongside increases in basic metals and paper, production in energy-intensive industries rose for a fourth successive month (1.0%M/M) to a 13-month high despite the energy price shock. And with industrial gas consumption in May higher than a year earlier, output from these subsectors might well have risen further still last month.

Exports flattered by higher prices, but shipments to China fall to lowest level in over a decade

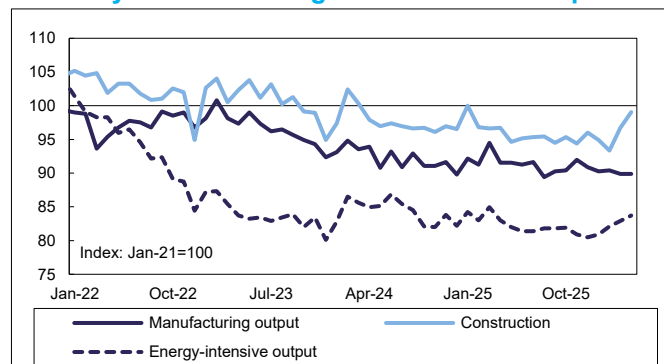
Given ongoing geopolitical uncertainty, a persistent energy shock, the prospect of higher borrowing costs and subdued global demand, the near-term outlook for German production remains tilted to the downside. Nevertheless, today's goods trade data reported a third successive increase in export values in April (0.9%M/M) to the highest level in 3½ years. However, with export prices increasing at a similar pace, volumes appear to have been broadly flat at the start of Q2. The April gain was also flattered by a partial rebound in shipments to OPEC members after the plunge in March. But exports to the UK fell to a six-month low, with those to the US close to the bottom of the recent range. Most notably, the ongoing downtrend in shipments of autos and machinery to China continued. And the total value of exports to China fell to its lowest

Germany: Industrial output*



*Dashed dark blue lines represents quarterly average.
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Manufacturing & construction output



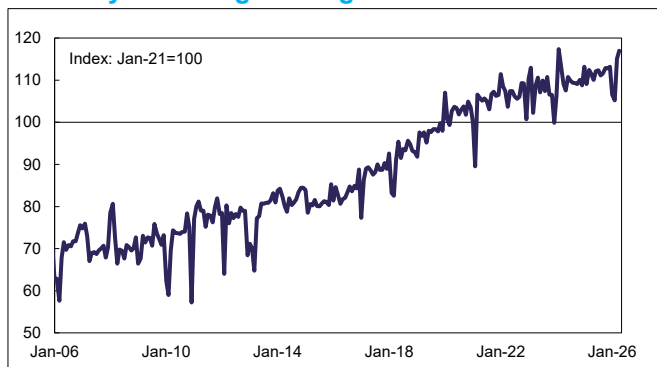
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

level in more than a decade, pushing the bilateral trade deficit to a record high. Overall, given the sharper rise in import values (1.2%M/M) in April, Germany's total trade surplus fell to an 18-month low (€14.5bn).

Outlook for German car manufacturers downbeat, but orders backlogs elsewhere to offer support

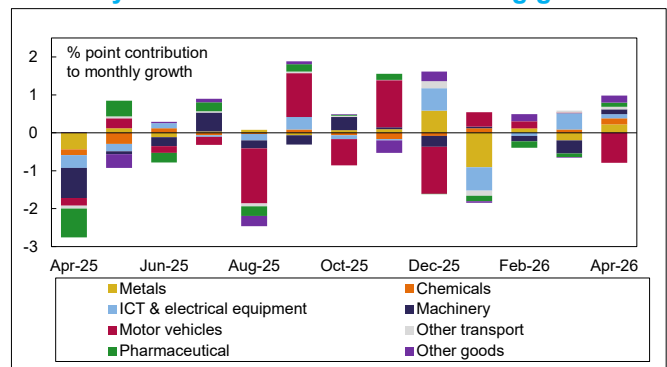
The latest car production figures published by Germany's auto association (VDA) point to ongoing challenges in the sector, as manufacturers grapple with weak competitiveness and shifting consumer preferences. Admittedly, the sharp decline in car production in May (-18%Y/Y) was exaggerated by fewer working days than a year earlier. But production in the first five months of the year was still down some 5%YTD/Y reflecting weaker exports, which account for roughly three-quarters of output. Subdued domestic demand also illustrates changing market dynamics. While electric vehicles still account for less than one third of new registrations in Germany, they were still up more than 30%Y/Y in the year-to-date. And registrations of cheaper foreign-made cars continued to rise (10%YTD/Y), contrasting the broadly flat trend in German-made cars. Meanwhile, order backlogs stagnated over the past two years and the latest ifo survey suggested that auto manufacturers' production expectations for the coming three months remain subdued. Thankfully, this pessimism is not mirrored across manufacturing as a whole. Production expectations in subsectors that have seen significant growth in order backlogs over recent months – such as non-auto transport equipment, ICT equipment, electrical machinery and fabricated metals – remain broadly positive, raising cautious hopes that the German economy will avoid a significant contraction over the near term.

Germany: Civil engineering work



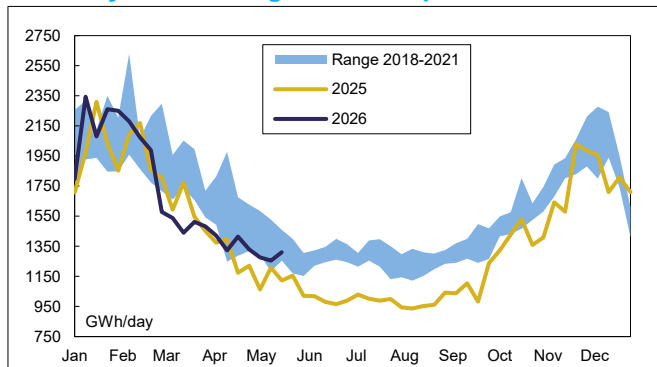
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Contribution to manufacturing growth



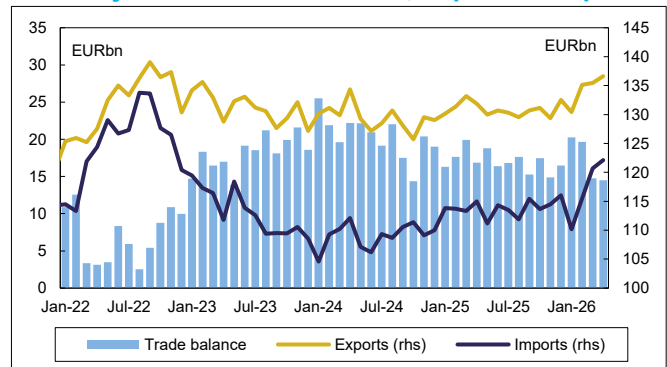
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Industrial gas consumption



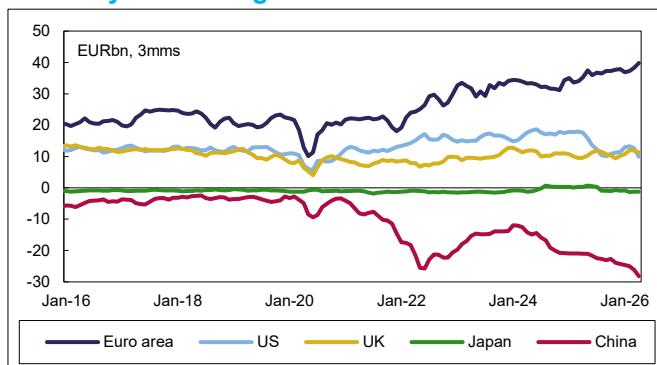
Source: Bundesnetzagentur and Daiwa Capital Markets Europe Ltd.

Germany: Goods trade balance, imports & exports



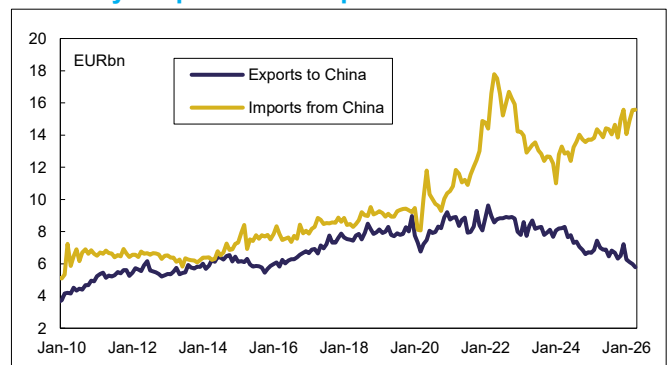
Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Germany: Bilateral goods trade balances



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Exports to & imports from China



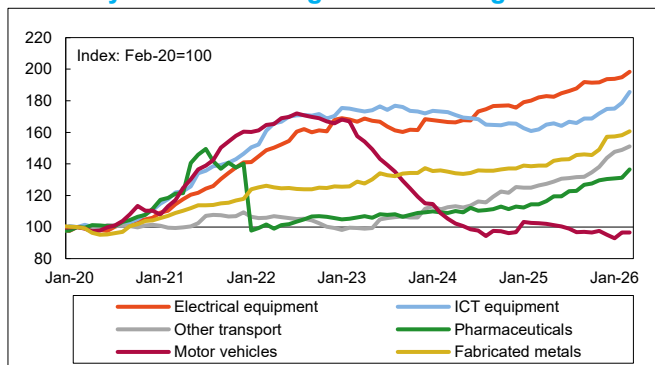
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

The coming two days in the euro area

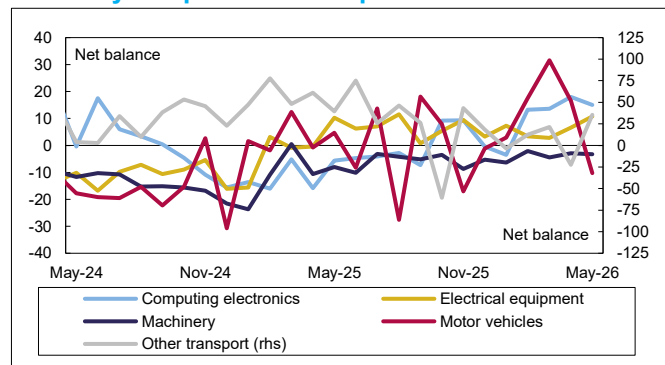
Wednesday's update on Italian IP aside, all eyes in the euro area now turn to Thursday's ECB's decision, at which President Lagarde is widely expected to announce a 25bps increase in the ECB's key interest rates, taking the deposit rate back to its level 12 months ago, 2.25%. Of course, she will insist that decisions will remain data-dependent and are not on a predetermined path given the fluidity of events in the Middle East. But after rates were left unchecked in April, Lagarde's tone implicitly had a hawkish bias, emphasising the intensifying upside risks to inflation over signs of weakening economic activity. The monetary policy account of that meeting also reported that "a number of" ratesetters were already sympathetic to a rate hike then. And more recent comments from Governing Council members (see our full ECB preview in [Friday's Euro wrap-up](#)) make clear that support for further restrictiveness this month is likely to be unanimous.

While fiscal measures have temporarily dampened inflation in some member states and natural gas futures – more important for regional electricity prices – remain reassuringly close to the ECB's hastily-made assumption in March, the prolonged disruption to the Strait of Hormuz means that the shock to crude oil prices is larger and more persistent than the Governing Council than anticipated in its previous baseline forecast. So, the ECB's updated projections will revise the profile of inflation higher. Its baseline will likely remain above 3%Y/Y through year-end. And updated 'adverse' and 'severe' scenarios will incorporate more persistence, both in terms of the duration of supply disruption and greater indirect and second-round inflation effects. At the same time, the shock will be expected to weigh on activity for longer, albeit only in the severe scenario sufficient to inflict two successive negative quarters of GDP growth. The ECB will not attach specific probabilities to the various scenarios. But, in our view, the progress towards a US-Iran deal and sufficiently loose labour market should mean that the baseline and adverse scenarios will be most realistic. And in both cases, we would expect the path for policy priced by the market – around 2½ hikes – to be sufficient enough to return inflation close to target by the end of the projection period. That would reinforce our expectation that the ECB will hike just once more this year, albeit with risks of an extra one too. The severe scenario, on the other hand, will project inflation to remain above target at end-2028, suggesting that significant additional tightening would need to be priced if events in the Middle East escalate or supply disruption persists long enough.

Germany: Manufacturing order backlogs



Germany: ifo production expectations indices



UK

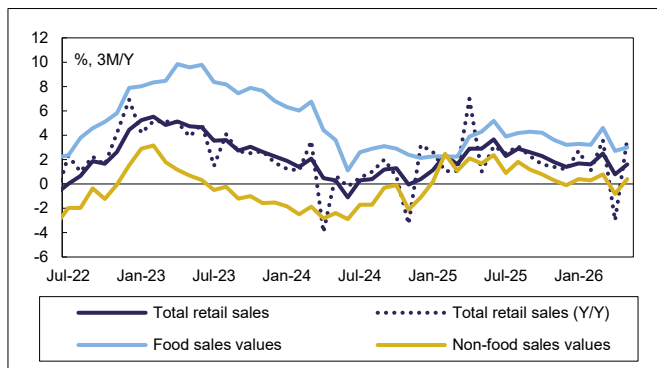
Strength in BRC retail survey flattered by prices and temporary heatwave in May

The headline message from today's BRC retail survey results was positive, suggesting that a slight improvement in consumer confidence and above-average temperatures in May had given a boost to sales on the high street last month. Growth in the value of sales jumped 6.7ppts to 3.7%Y/Y, with like-for-like sales up 3.4%Y/Y, both suggesting the fastest growth in 13 months. Growth in food sales (3.9%Y/Y) was similar to prior months. But non-food sales were notably stronger, up 3.5%Y/Y compared with a year-on-year decline in May 2025, as the heatwave seemingly boosted demand for outdoor furniture and goods and summer apparel this year. But today's survey was also flattered by rising prices. Indeed, when adjusting for the BRC shop price index, total sales volumes rose a more modest 2.5%Y/Y. And when smoothing for recent monthly volatility, sales volumes were more subdued (0.5%3M/Y), with like-for-like sales broadly flat (0.1%3M/Y). Indeed, with the GfK survey suggesting that household purchase intentions for coming months fell to a 16-month low in May, and real incomes set to be squeezed again by higher energy prices, we expect consumer spending on big-ticket items to remain lacklustre over coming months.

The coming two days in the UK

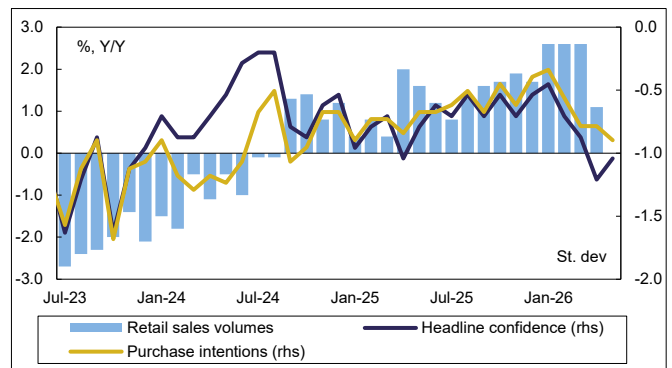
Given the lack of top-tier data, it should be a quiet couple of days for UK economic news. The sole release to note will be May's RICS survey (due Thursday) which, somewhat predictably given how the survey has soured following the increase in new mortgage rates caused by the oil shock, is expected to provide another roundly downbeat assessment of activity in the housing market. But we do see some scope for some modest improvement, given the signs of a temporary pickup in lending which may also yet be evident in April's monthly GDP report (Friday).

UK: BRC retail sales values



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Retail sales volumes & consumer confidence



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

The next Euro wrap-up will be published on Thursday 11 June 2026

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Germany	Industrial production M/M% (Y/Y%)	Apr	0.4 (-0.5)	0.4 (-1.1)	-0.7 (-2.8)	-0.1 (-3.4)
	Trade balance €bn	Apr	14.5	15.9	14.3	14.7
UK	BRC retail monitor – like-for-like sales Y/Y%	May	3.4	0.8	-3.4	-

Auctions

Country	Auction
Germany	sold €487mn of 2.3% 2033 green bonds at an average yield of 2.86%
	sold €453mn of 2.5% 2035 green bonds at an average yield of 2.98%
	sold €816mn of 1.8% 2053 green bonds at an average yield of 3.57%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Wednesday's releases

Economic data

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Italy	09.00	Industrial production M/M% (Y/Y%)	Apr	0.0 (0.5)	0.7 (1.5)



Auctions and events

Germany	10.30	Auction: to sell up to €5bn of 2.9% 2036 bonds
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Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Thursday's releases

Economic data

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Euro area 	13.15	ECB Deposit (Refinancing) Rate %	May	<u>2.25 (2.40)</u>	2.00 (2.15)
UK 	00.01	RICS house price balance %	May	-32	-34

Auctions and events

Euro area 	13.15	ECB monetary policy announcement			
	13.45	ECB President Lagarde holds post-Governing Council meeting press conference			
	13.15	ECB to publish updated Eurosystem staff macroeconomic projections			
Italy 	10.00	Auction: to sell up to €4bn of 3% 2029 bonds			
UK 	10.00	Auction: to sell £5bn of 4% 2029 bonds			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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