Euro wrap-up

Overview

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- While German exports rose for a fourth successive month and the account of the ECB's June policy meeting underscored the Governing Council's desire to keep all options open on the future path for rates, Bunds followed the global trend higher.
- Gilts also made gains while a UK survey pointed to continued weakness in house prices and demand.
- Friday will bring final German and French inflation estimates for June, along with Italian and Irish IP data for May.

Daily bond market movements

Bond	Yield	Change
BKO 2½ 06/28	2.646	-0.057
OBL 2½ 04/31	2.769	-0.046
DBR 3 08/36	3.084	-0.037
UKT 4⅜ 03/28	4.244	-0.089
UKT 4⅛ 03/31	4.430	-0.084
UKT 4¾ 10/35	4.902	-0.076

*Change at 4:30pm BST.
Source: Bloomberg

Euro area

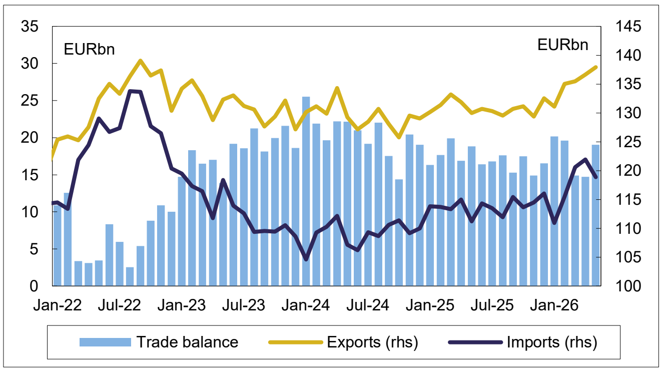
German export values rise for fourth successive month in May

Net trade has repeatedly acted as a drag on German economic growth over recent years. But thanks to pickups in exports of services and goods alike, as well as stagnant import demand, in Q1 net trade contributed a whopping 1.3ppts to quarterly growth, the most in more than five years. While some payback for such a large boost is likely in Q2, today's goods trade data for May tallied with recent improvements in industrial production, factory orders and survey indicators to suggest that export momentum remained positive in Q2. And we continue to forecast net trade to make a positive contribution on a full-year basis in 2026 for the first time since 2021. Indeed, contrary to expectations of a decline, goods export values rose in May for the fourth successive month to mark the longest winning streak since the turn of 2021-22. The increase of 0.9%M/M took the average level in the first two months of Q2 some 2.7% above the Q1 average. And it exceeded the rise in producer export prices (0.5%M/M) to point to ongoing growth in volume terms. Compared to a year earlier, goods export values were up 6.1%Y/Y, well above the increase in export prices (3.4%Y/Y). In contrast, after recent firm growth, goods import values fell 2.5%M/M, the steepest drop since January, despite higher import prices (0.7%M/M). Import values were still trending 3.7% above the Q1 average to point to a possible drag on growth this quarter. But the rate of increase from 12 months earlier (6.9%Y/Y) was just 0.1ppt above the increase in input prices. And having slipped in April to an 18-month low, the German goods trade surplus rose the most in 18 months to €19.1bn, more than €2bn above the average of the prior 12 months.

Strong rebound in shipments to the US close to historical highs, exports to China up too

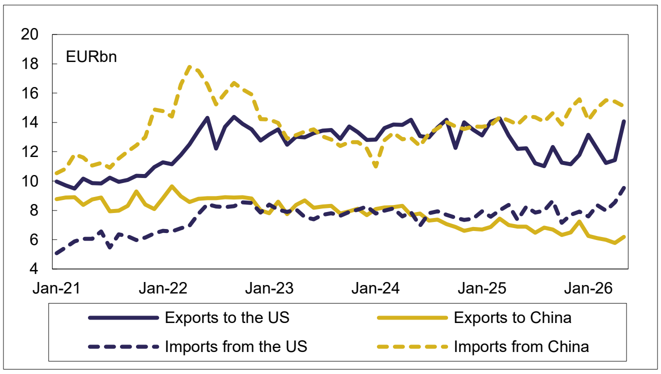
Following firm growth over the prior few months, German goods exports to the rest of the EU slipped back 1.1%M/M in May but were still trending 4% above the Q1 average. After recent weakness, exports beyond the EU leapt 3.6%M/M to be trending roughly ½% above the Q1 average. Growth was led by exports to the US, which jumped more than 23%M/M to the highest level since the pre-Liberation Day surge in March 2025 and close to the top of the historical range. While imports from across the Atlantic also rose sharply, the bilateral trade surplus with the US increased €1.6bn to €4.5bn, a touch above last year's average. German export shipments to China were also stronger in May, up more than 7%M/M, albeit merely to a four-month high. And with imports from China also down 2%M/M, the respective bilateral deficit narrowed. But at a three-month low of €8.9bn, still firmly above last year's average, that imbalance remains a symbol of China's existential competitiveness challenge to German manufacturing. It will also likely continue to bring complaints from policymakers, including ECB President Lagarde, of renminbi weakness. And it will soon bring new protectionist action at the EU level. Regardless, for the time being at least, the positive momentum in German exports will be welcomed. But that appears concentrated largely in intermediate goods. Various drivers appear at play. There is likely to be some gradual normalisation of flows to the US after the initial post-Liberation Day pullback as well as increased shipments of goods related to AI data-

Germany: Goods trade balance, exports & imports*



*Seasonally adjusted values.
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Exports to & imports from US & China*



*Seasonally adjusted values.
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

centre activity. But some of the recent growth in production and exports, e.g. of chemicals and hydrocarbon-related items, appears related to actual and potential disruption of supply from the Middle East. And it remains to be seen whether there will be payback for such activity in the second half of the year.

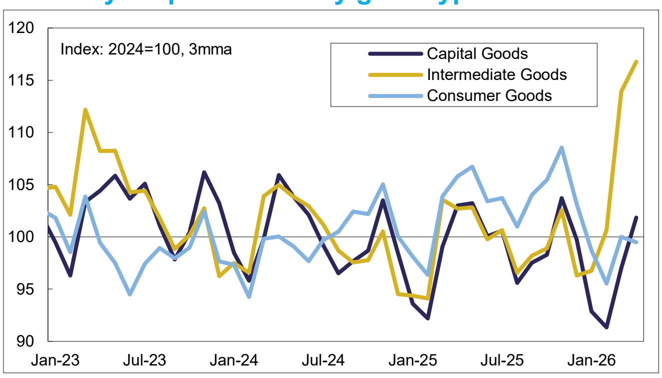
ECB account underscores desire to keep all options open on future path for rates

Unsurprisingly, the ECB's account of its June Governing Council meeting, when rates were hiked by 25bps, provided more detail on the thinking behind the decision to tighten policy but little guidance on the future path ahead. Nevertheless, while conditions in the Middle East and energy markets have evolved since the meeting, the account appeared to have a hawkish tone which at the margin reinforced our baseline expectation that rates will be hiked once more, most likely in September. The importance of refraining from forward guidance was emphasised due to heightened uncertainty. And it was agreed that communication should remain "neutral, neither suggesting that the …decision was the first of a sequence of hikes… nor that it was a one-off". However, the account reported that it was important to acknowledge that almost three rate hikes were embedded in the baseline projections, which foresaw core inflation persisting above target though to the end of the projection horizon. And as insisted by Lagarde in her post-meeting press conference, the notion that the June tightening might be considered a mere "insurance" hike was firmly rejected. Instead, the unanimous policy move was justified on account of the deterioration of the inflation outlook, the larger-than-anticipated energy shock, the surprise pickup in services inflation and "increasingly visible and broad-based indirect effects on non-energy inflation". Indeed, while it was recognized that there were no signs of them yet, second-round effects were considered a "clear possibility, with the likelihood increasing the longer the energy shock persisted". And in part due to the inflexibility of the euro area economy but also the fact that downside risks to growth were considered much smaller than the upside risks to inflation, lower growth was thought unlikely to be sufficient to bring inflation back down to target.

The day ahead in the euro area

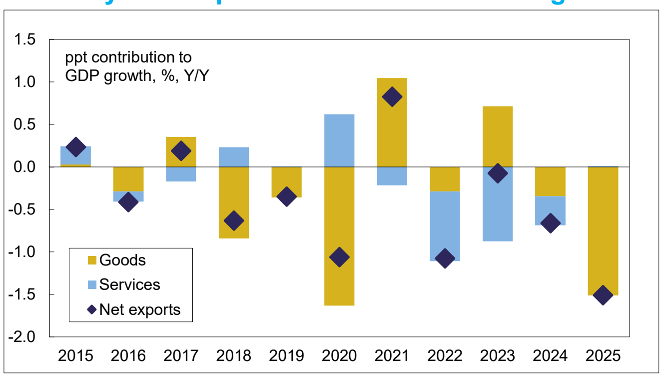
Final June inflation estimates from Germany and France will be the focus of the euro area data on Friday. These are expected to broadly align with their softer-than-expected flash estimates, which had signalled a sizable drop in the respective HICP rates, by 0.3ppt to 2.4%Y/Y and 0.8ppt to 2.0%Y/Y. As the sharp moderation in global oil prices started to feed through to auto fuel prices, the detail should also confirm that softer energy inflation was the principal source of last month's deceleration. But the additional detail will also be of particular interest to identify the sources of further moderation in food inflation, as well as further signs of any indirect effects beyond transport services and package holidays. Meanwhile, Italian and Irish industrial production figures for May are also due, which will further refine expectations ahead of next week's aggregate euro area release.

Germany: Export values by good type*



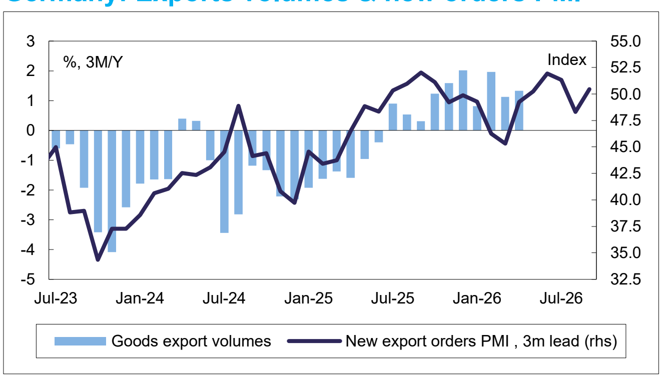
*Non-seasonally adjusted data.
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Net exports contribution to GDP growth



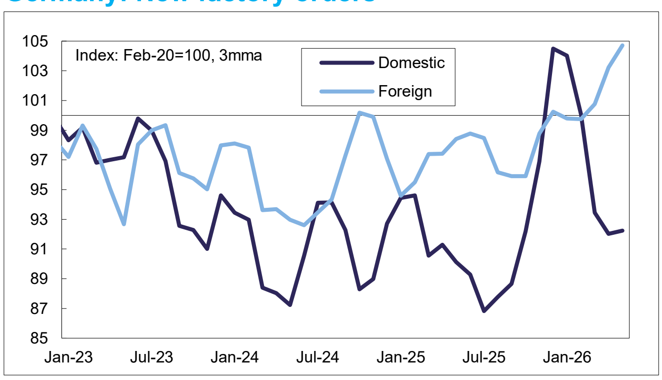
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Exports volumes & new orders PMI



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

Germany: New factory orders*



*Excluding large=scale orders.
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK

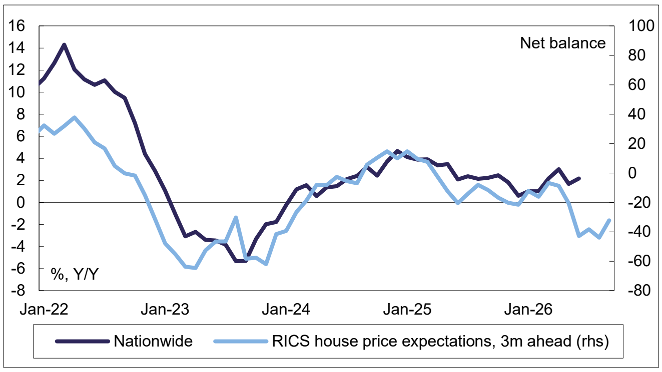
RICS points to continued weakness in house prices & demand but signs of stabilisation ahead?

The tightening in financial conditions following the outbreak of the Iran conflict, combined with ongoing geopolitical and economic uncertainty, has unsurprisingly weighed on the UK housing market. Mortgage approvals dropped sharply in May to the lowest level since January 2024, while lenders anticipated a further tightening in credit availability over the summer. And although the latest RICS Residential Market Survey pointed to some tentative signs of stabilisation, conditions in the housing market remain fragile. Surveyors reported that the flow of new instructions to the market was the weakest in almost four years, suggesting that many prospective sellers are waiting for greater clarity on the outlook. Indeed, the net balance of surveyors reporting falling prices improved only slightly in June, and at -33% was still well below the average in the six months before the escalation of tension in the Middle East (-15%) and the long-run average (+14%). While suggesting that demand remains weak, surveyors reported a slight improvement in new buyer enquiries in June, with the respective balance the highest since February. So, while some surveyors acknowledged an increasing headwind from domestic politics as Andy Burnham looks to become Prime Minister later this month, they were somewhat less pessimistic than in May about the outlook for prices and sales in the coming three months. Looking further ahead, expectations for a gradual recovery in confidence and a moderation in mortgage rates should provide support to the market. As a result, house price growth was expected to pick up over the coming 12 months, albeit the expected pace of acceleration remains materially below the levels envisaged before the outbreak of the conflict.

The day ahead in the UK

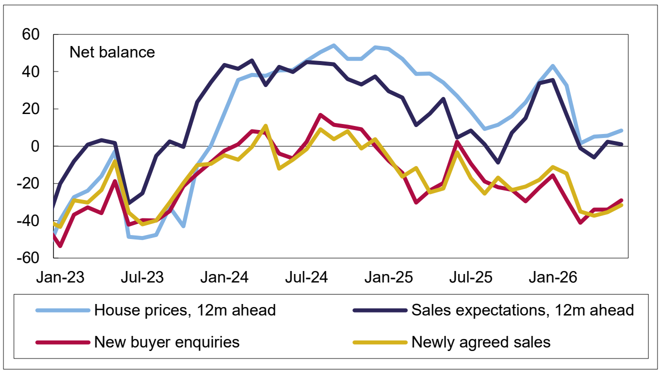
With no notable data or events of note, it should be a relatively quiet end to the week for UK economic news.

UK: House price indicators



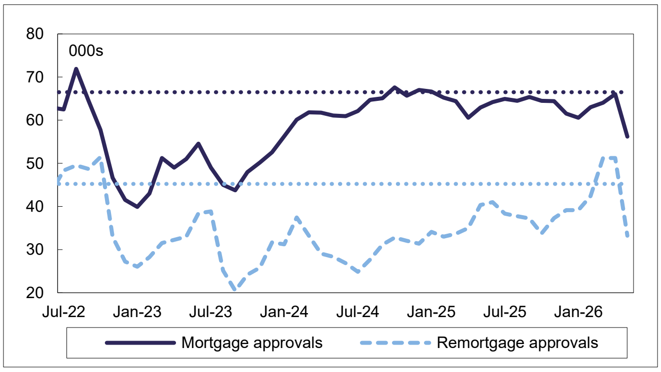
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Selected RICS indices



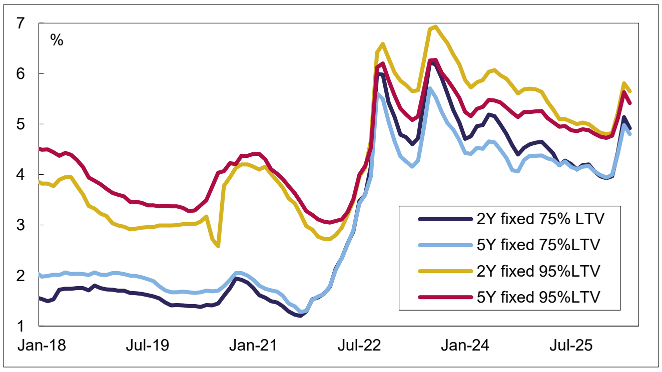
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Mortgage approvals*



**Dotted lines represent pre-pandemic five-year average.*
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Mortgage interest rates



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

European calendar

Today's results

Economic data							
Country		Release	Period	**Actual**	Market consensus/ _Daiwa forecast_	Previous	Revised
Germany		Trade balance €bn	May	**19.1**	14.8	14.5	14.7
UK		RICS house price balance %	Jun	**-33**	-30	-35	-34

Auctions	
Country	Auction
- Nothing to report -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Wednesday's results

Economic data							
Country		Release	Period	**Actual**	Market consensus/ _Daiwa forecast_	Previous	Revised
- Nothing to report -							

Auctions		
Country		Auction
Germany		sold €3.90bn of 3% 2036 bonds at an average yield of 3.09%
UK		sold £750mn of 0.125% 2028 bonds at an average yield of 3.989%
		sold £750mn of 4.75% 2030 bonds at an average yield of 4.358%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data						
Country		BST	Release	Period	Market consensus/ _Daiwa forecast_	Previous
Germany		07.00	Final HICP (CPI) Y/Y%	Jun	_2.4 (2.3)_	2.7 (2.6)
France		07.45	Final HICP (CPI) Y/Y%	Jun	_2.0 (1.8)_	2.8 (2.4)
Italy		09.00	Industrial production M/M% (Y/Y%)	May	-0.2 (1.3)	0.5 (1.3)

Auctions and events			
Italy		10.00	Auction: to sell up to €2.5bn of 3% 2029 bonds
		10.00	Auction: to sell up to €3.5bn of 3.35% 2033 bonds
		10.00	Auction: to sell up to €1.5bn of 3.95% 2041 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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