

Euro wrap-up

Overview

- Despite a downside surprise to German retail sales and moderation in services inflation to a 13-month low, Bunds ended the day little changed while euro area bank lending remained resilient at the start of Q2.
- Shorter-dated Gilts made losses on a quiet day for UK economic releases.
- The ECB is expected to cut the deposit rate by 25bps to 2.00% but remain non-committal about the future path for policy. German IP, factory orders and goods trade data are likely to illustrate a tariff-related pullback in April.

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Daily bond market movements

Bond	Yield	Change
BKO 1.7 06/27	1.768	+0.008
OBL 2.4 04/30	2.062	-0.004
DBR 2½ 02/35	2.498	-0.007
UKT 3¾ 03/27	4.009	+0.022
UKT 4¾ 03/30	4.138	+0.016
UKT 4½ 03/35	4.644	-0.001

*Change from close as at 5.00pm BST.

Source: Bloomberg

Euro area

German inflation moderates less than expected, but services inflation down to 13-month low

Today's flash May inflation figures from Germany, Italy and Spain mirrored the improvement seen in the [French numbers](#) earlier this week, to suggest that headline inflation in the euro area will return to the ECB's 2% target for the first time since October and just the third time since mid-2021. Moreover, they reinforced our view that the uptick in core inflation in April will prove temporary as the Easter-related distortion to services dissipated this month. Despite coming in a touch firmer than expected, headline HICP inflation eased in Germany by 0.1ppt to an eight-month low of 2.1%Y/Y. On the national measure, headline CPI held steady at 2.1%Y/Y. This in part reflected a smaller decline in energy inflation (up 0.8ppt to -4.6%Y/Y), while our estimate of non-energy industrial goods inflation rose to a four-month high (1.5%Y/Y). More encouragingly, services inflation more than reversed the jump in April, falling 0.5ppt to a 13-month low of 3.4%Y/Y, as prices of package tours and airfares normalised. As such, core CPI inflation resumed a disinflationary trend this month, down 0.1ppt to 2.8%Y/Y, albeit remaining above March's near-four-year low of 2.6%Y/Y. With the past week's German PPI figures illustrating an ongoing absence of underlying goods price pressures down the pipeline, however, we expect core inflation to moderate further over coming months.

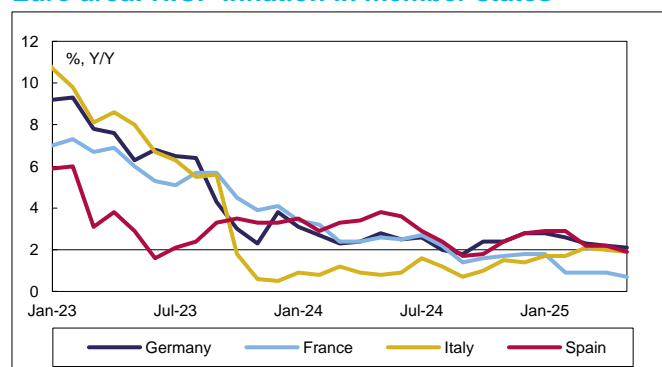
Italian and Spanish inflation back below target as services and energy inflation moderates

Flash Italian HICP inflation also eased 0.1ppt to 1.9%Y/Y, a three-month low. But, like in France, the Spanish figures undershot expectations, with the HICP rate falling 0.3ppt to a seven-month low of 1.9%Y/Y. While food inflation accelerated in France and Italy, energy inflation weakened. But, like in Germany, services inflation moderated. Although not fully reversing the increase in April, the Italian core HICP rate dropped 0.3ppt to 1.9%Y/Y, while the Spanish core CPI rate fell 0.3ppt to 2.1%Y/Y. Taken together with the flash estimates from Belgium, Portugal and Ireland, we maintain our view that the euro area headline HICP rate likely fell 0.2ppt to 2.0%Y/Y. While we also expect the core rate to moderate in May, we see a more modest drop compared to the Bloomberg survey consensus – by 0.2ppt to 2.5%Y/Y – due to a pickup in core goods inflation.

German retail sales disappoint in April after strong growth in March

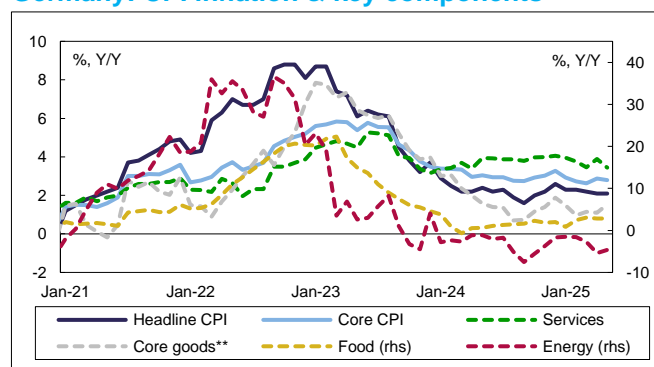
According to April's GfK survey, despite weak overall confidence, German consumers had signalled an improvement in purchase intentions at the start of Q2. Against this backdrop, today's retail figures disappointed, with sales volumes declining a steeper-than-expected 1.1%M/M in April, the most since August 2023. The weakness in April was broad based, with non-food sales (-1.3%M/M) down the most in 19 months, while food sales fell (-1.1%M/M) after strong growth in March. But the decline in overall sales in April followed three consecutive months of growth, including a notable upwards revision to

Euro area: HICP inflation in member states



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: CPI inflation & key components*



*National measure. **Non-energy industrial goods.

Source: Macrobond and Daiwa Capital Markets Europe Ltd.

spending in March (by 1.1ppt to 0.9%M/M). So, smoothing for monthly volatility, sales volumes were still up $\frac{1}{2}\%$ 3M/3M. And compared with the Q1 average, retail sales were down a modest $\frac{1}{2}\%$. While raising the likelihood of a first quarterly contraction in five in Q2, the recovery in consumer confidence in May to a six-month high and anticipation of further improvement in June should help to limit the likely drag on GDP growth this quarter.

Bank lending growth remains resilient in April despite heightened economic uncertainties

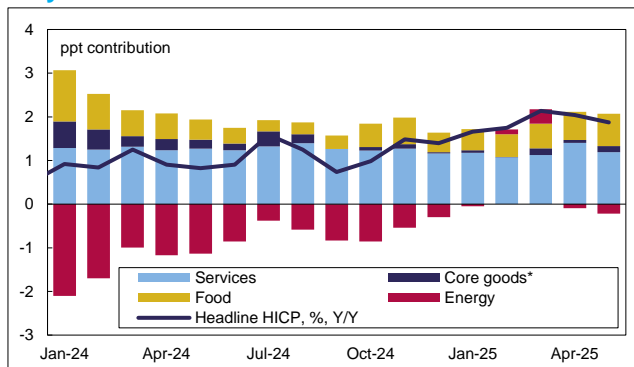
Despite heightened economic uncertainties and signals from banks that they expected to tighten credit standards further this quarter, today's monetary data suggested ongoing resilience in bank lending growth at the start of Q2. Admittedly, on an adjusted basis, the monthly net flow of loans to households moderated to €15.4bn in April. But this was bang in line with the average of the past six months and took the annual growth in such loans to a near-two-year high (1.9%Y/Y). This principally reflected a further pickup in mortgage lending, to leave annual growth in that component at 1.9%Y/Y, the highest since July 2023. And growth in consumer credit rose to 4.3%Y/Y, the highest since the onset of the pandemic in February 2020. While the monthly flow of lending to non-financial corporations (NFCs) halved to a three-month low of €9.9bn, the annual growth of such loans rose for a sixth successive month to 2.6%Y/Y, the firmest since June 2023. And encouragingly, the monthly flow was more than fully accounted for by loans with a maturity of greater than 5 years, which are typically more closely correlated with business fixed investments.

ECB to cut rates as updated projections to lower near-term GDP and inflation profile

When the ECB's Governing Council meets in the coming week, it will be presented with updated economic projections, which should revise down the near-term profiles of GDP growth and inflation. In terms of economic activity, however, that will in part reflect the stronger-than-expected growth in the first quarter. After [German growth](#) was last week revised up to a 10-quarter high, we expect the euro area figure for Q1 to be nudged up to 0.4%Q/Q, double the ECB's previous forecast. But that figure will be flattered by the marked jump in production and exports of certain items such as pharmaceuticals in an attempt to front-run US tariffs. And production and exports of such goods will fall back this quarter, subtracting significantly from GDP growth.

More importantly perhaps, whereas the ECB's previous projections in March were conditioned merely on the relatively modest bilateral tariffs between the US and China that had taken effect by 19 February, its updated forecasts will likely be conditioned on the tariff configuration prevailing earlier this week ahead of the ruling of the US Court of International Trade. So, the projections will likely for the first time include a 10% baseline US tariff as well as higher tariffs on autos, steel and aluminium. As such, the ECB will revise down its projection of US demand for euro area goods. The recent appreciation of

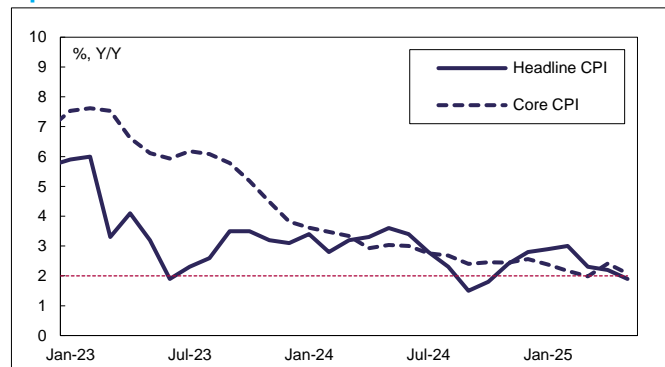
Italy: Contributions to HICP inflation



*Non-energy industrial goods.

Source: Macrobond and Daiwa Capital Markets Europe Ltd.

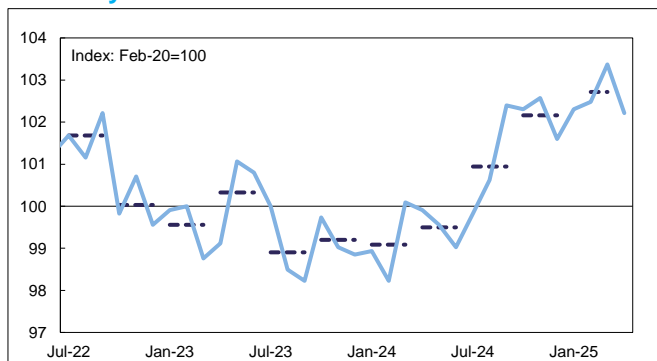
Spain: Headline & core CPI inflation*



*National measure. Core CPI excludes unprocessed foods and energy.

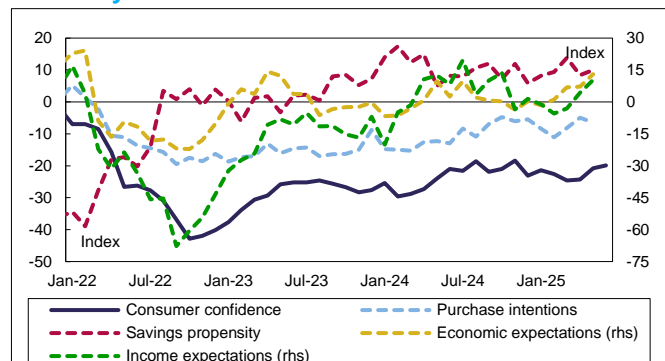
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Retail sales*



*Dashed line represents quarterly average. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Consumer confidence



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

the euro – both against the US dollar and in trade-weighted terms – will also be estimated to weigh on euro area exports. And the ECB will judge that heightened uncertainty and unease related to US tariffs is likely to take a toll on business investment and household consumption over the near term.

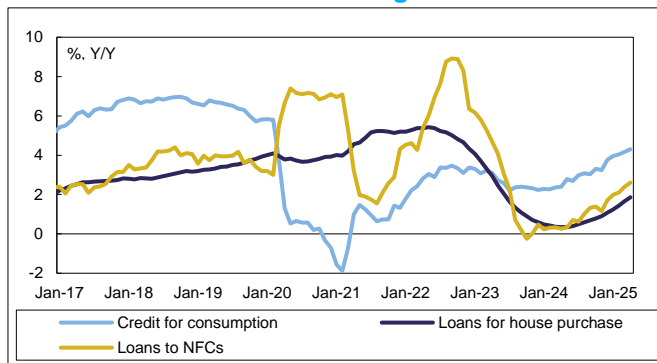
As a result, the ECB is likely to nudge lower its forecasts for GDP in Q2 and Q3 from 0.2%Q/Q apiece. But it will still expect growth to pick up by year-end. And so, given also the stronger-than-expected start to the year, its growth projection for 2025 as a whole will likely be nudged down only slightly, if at all, from its previous estimate of 0.9%Y/Y. It will also likely continue to expect euro area GDP to grow by about 1¼%Y/Y in 2026 and 2027, supported in part by a pickup in public investment.

The near-term profile of inflation will also need to be revised down not least due to shifts in certain market variables since the ECB's projections were last updated. Most notably, prices of oil and wholesale gas have fallen sharply, weighing on energy inflation. And the euro has appreciated significantly against the dollar and on a trade-weighted basis, helping to keep core goods inflation well contained. Admittedly, food price pressures have picked up again. And core inflation in the current quarter looks set to exceed the ECB's previous projection due to the strength of services inflation in April. But we put that down in good part to the timing of Easter. And with wage growth moderating significantly, we expect core inflation to be back on track in the second half of the year. So, we think the ECB should project headline inflation to be back on target or below by Q3. And it should continue to project core inflation to slightly undershoot its target in 2027, justifying a further easing of monetary policy at this meeting.

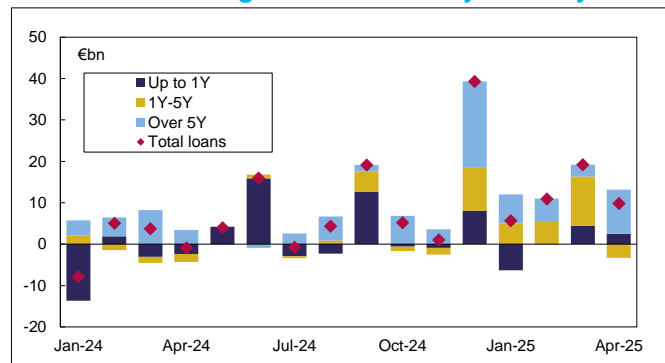
ECB policy outlook to be conditional on trade negotiations and incoming data

Certainly, a further 25bps rate cut next week, taking the ECB's deposit rate to 2.00%, now looks a done deal. But the Governing Council will underscore that US trade policy and the economic outlook remain extremely uncertain. It will also not be sure whether its current monetary policy stance remains restrictive, has become accommodative or is broadly neutral. The Governing Council's forward guidance therefore will restate that policy will continue to be determined on a meeting-by-meeting basis and will remain data dependent. But we would also not be surprised if, in her press conference, President Lagarde suggests that – conditional on the EU avoiding a notable increase in US tariffs when Trump's self-imposed current negotiation period supposedly ends on 9 July – the Governing Council might expect to wait for a little longer to take stock of the impact of recent rate cuts before deciding whether to adjust policy further. The implication could be that the end-July meeting might not be 'live' for a further adjustment to policy. If so, it could also suggest that the end of the easing cycle is in sight. Indeed, the next round of projection updates in September might ultimately determine whether – as we still expect – the ECB that month cuts the deposit rate further to 1.75% or 2.00% will be the terminal rate for this cycle.

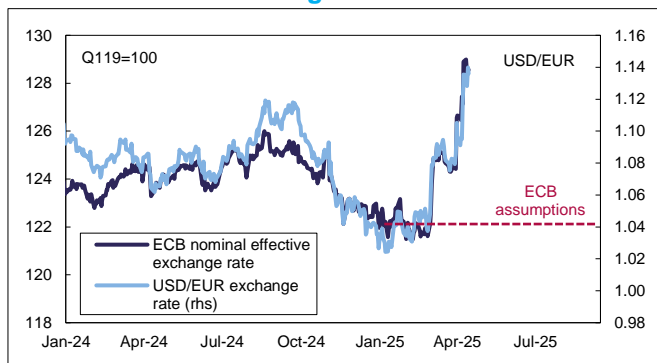
Euro area: Private sector loan growth



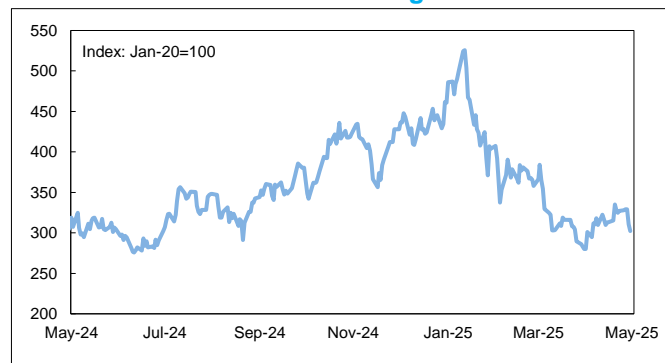
Euro area: Lending to businesses by maturity



Euro area: Euro exchange rate



Euro area: Netherlands natural gas – 1m forward



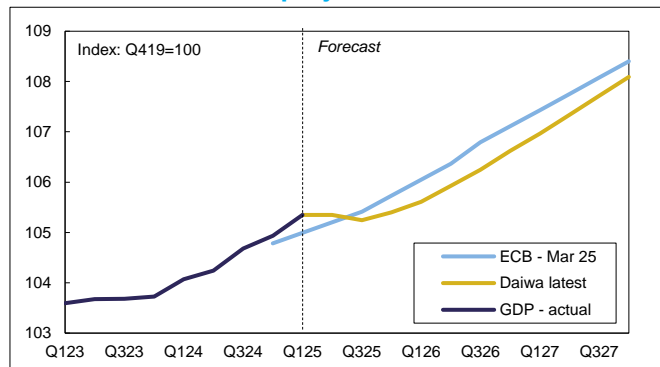
The data week ahead in the euro area

Ahead of the ECB's announcement on Thursday, the aforementioned flash May euro area inflation release (Tuesday) should provide the Governing Council with further reassurance that the disinflation process remains on track. We, like the consensus, expect headline euro area inflation to fall 0.4ppt to 2.0%Y/Y, the lowest since October, as price pressures in holiday-sensitive services categories normalise and energy prices continue to fall. Consequently, we also expect core inflation to soften, by 0.2ppt to 2.5%Y/Y, albeit not fully reversing April's rise. Lower energy prices should lead a reduction in April's euro area PPI figures (Thursday). That release should also continue to demonstrate an absence of underlying goods cost pressures.

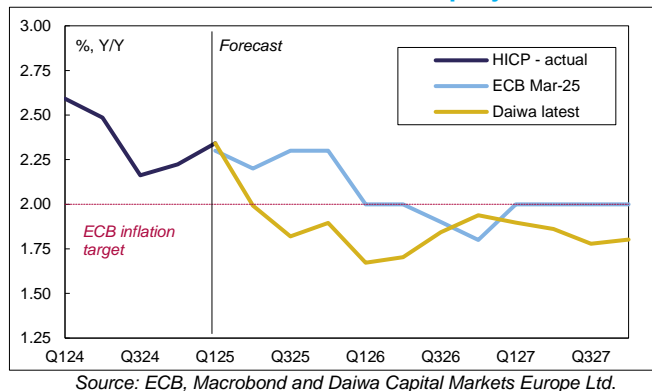
With respect to activity data, last week's upward revision to [German GDP](#) growth in Q1 should help take Friday's final euro area print back up to 0.4%Q/Q, in line with its first estimate. Of course, that assumption is conditional on the absence of significant revisions elsewhere, most notably in Ireland (data due Thursday). But we note that, as in Germany, the strength of March's exports (7.5%M/M) implies upside risks to Irish GDP growth (3.2%Q/Q). The euro area numbers will include an expenditure breakdown for the first time Based on detail from member states household consumption likely added to growth for a third successive quarter. And, despite subtracting in France and Italy, the surge in German and Irish exports to the US should result in a first positive contribution from net trade in three quarters.

Given the extent of frontloading of production and shipments in certain sectors in Q1, we expect some pullback in Q2 as broader US tariffs start to weigh. This is likely to be evident in April's industrial production and goods trade data from various member states in the coming week. Certainly, with German IP jumping the most in almost 3½-years in March (3.0%M/M), we expect a drop in April (data due Friday). The extent of that weakness might be relatively conservative, however, with the PMIs pointing to ongoing positive growth. Factory orders (Thursday) are also expected to decline after a jump in demand for pharmaceutical and machinery products in March. French (Friday) and Spanish (Wednesday) IP figures are also due. On the trade front, and based on today's advanced US release that recorded a near-20%M/M plunge in imports to that country, a reduction in US-bound exports in April will serve as a headwind to German exports (Friday). In addition, the final PMIs will provide a more timely assessment of private sector activity in the euro area. The flash release flagged a further deterioration in May's composite PMI (due Wednesday) as the dominant services sector slipped into contraction (-1.2pts to 48.9), but the manufacturing output index (Monday), somewhat surprisingly, was unchanged at its three-year high (51.5). Italian and Spanish PMIs will also be released, while Thursday will bring May's construction PMIs.

Euro area: GDP level projection



Euro area: Headline HICP inflation projection



UK










The week ahead in the UK

After a particularly quiet week for UK economic news, the week ahead will bring releases of note. Of those, the May results from the BoE's Decision Maker Panel survey (Thursday) should attract most attention, given the weight attached by the MPC to firms' judgements of wage- and price-setting dynamics. April's survey will have been encouraging, as moderation across output prices and inflation expectations were accompanied by the softest current and forward-looking wage growth measures for three years. Notwithstanding the upside surprise to April's CPI print, the BoE will hope to see inflation expectations remain well-behaved, and further evidence of decelerating wage growth. More pronounced reductions in wage growth and ongoing easing in price expectations would serve to challenge the stance of some MPC members who favoured keep rates unchanged earlier this month. Appearances from a number of MPC members, including external members Mann (Monday), Greene (Thursday) and BoE Deputy Governor Breeden (also Thursday), may offer more insights about the reaction function of those rate setters.

Meanwhile, May's final set of manufacturing (Monday), services and composite (Wednesday) PMIs will also be in focus. While the flash release showed some improvement from April's sudden contraction, the composite output index (49.2) nevertheless continued to flag a notable slowdown in private sector activity midway through Q2. The improvement was driven by a modest recovery in services sector activity (by 1.2pts), though at 50.2, that too merely signalled stagnation in the sector. Manufacturing output, by comparison, fell to a 19-month low (44.8). May's construction PMI (Thursday) is also due, while the start of the week will bring bank lending data for April (Monday). We expect the latter release to show a significant pullback in mortgage lending last month after exceptional borrowing in March was exaggerated by the change in Stamp Duty thresholds. Meanwhile, heightened economic uncertainty in April likely served as a headwind to new business and household lending.









The next edition of the Euro wrap-up will be published on 3 June 2025

Daiwa economic forecast

		2025				2026		2025	2026	2027
		Q1	Q2	Q3	Q4	Q1	Q2			
GDP		%, Q/Q						%, Y/Y		
Euro area		0.4	0.0	-0.1	0.2	0.2	0.3	0.8	0.7	1.3
UK		0.7	-0.1	0.2	0.3	0.3	0.3	1.0	1.1	1.4
Inflation, %, Y/Y										
Euro area										
Headline HICP		2.3	2.0	1.8	1.9	1.7	1.7	2.0	1.8	1.8
Core HICP		2.6	2.4	2.2	2.1	1.9	1.4	2.3	1.7	1.6
UK										
Headline CPI		2.8	3.5	3.6	3.4	3.0	2.0	3.3	2.2	2.0
Core CPI		3.6	3.7	3.6	3.6	3.3	2.1	3.3	2.2	1.8
Monetary policy, %										
ECB										
Deposit Rate		2.50	2.00	1.75	1.75	1.75	1.75	1.75	1.75	1.75
Refi Rate		2.65	2.15	1.90	1.90	1.90	1.90	1.90	1.90	1.90
BoE										
Bank Rate		4.50	4.25	4.00	3.75	3.50	3.25	3.75	3.25	3.00

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
Euro area	 M3 money supply Y/Y%	Apr	3.9	3.7	3.6	3.7
Germany	 Preliminary HICP (CPI) Y/Y%	May	2.1 (2.1)	2.0 (2.1)	2.2 (2.1)	-
	 Retail sales M/M% (Y/Y%)	Apr	-1.1 (4.0)	0.2 (-1.8)	-0.2 (0.3)	0.9 (1.3)
Italy	 Preliminary HICP (CPI) Y/Y%	May	1.9 (1.7)	1.9 (1.7)	2.0 (1.9)	-
	 GDP – final estimate Q/Q% (Y/Y%)	Q1	0.3 (0.7)	0.3 (0.6)	0.2 (0.6)	-
	 PPI Y/Y%	Apr	3.8	-	5.4	-
Spain	 Preliminary HICP (CPI) Y/Y%	May	1.9 (1.9)	2.0 (2.1)	2.2 (2.2)	-
UK	 Lloyds business barometer (own price expectations)	May	50 (63)	-	39 (68)	-
Auctions						
Country	Auction					
- Nothing to report -						

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.


The coming week's data calendar

The coming week's key data releases

Country	BST	Release	Period	Market consensus/ <i>Daiwa</i> <i>forecast/actual</i>	Previous
Monday 2 June 2025					
Euro Area	09.00	Final manufacturing PMI	May	<u>49.4</u>	49.0
Germany	08.55	Final manufacturing PMI	May	<u>48.8</u>	48.4
France	08.50	Final manufacturing PMI	May	<u>49.5</u>	48.7
Italy	08.45	Manufacturing PMI	May	49.6	49.3
Spain	08.15	Manufacturing PMI	May	48.4	48.1
UK	07.00	Nationwide house price index M/M% (Y/Y%)	May	0.0 (2.8)	-0.6 (3.4)
	09.30	Net consumer credit £bn (Y/Y%)	Apr	1.2 (-)	0.9 (6.1)
	09.30	Net mortgage lending £bn (mortgage approvals 000s)	Apr	1.4 (62.8)	13.0 (64.3)
	09.30	Final manufacturing PMI	May	<u>45.1</u>	45.4
Tuesday 3 June 2025					
Euro Area	10.00	Preliminary headline (core) HICP Y/Y%	May	<u>2.0 (2.5)</u>	2.2 (2.7)
	10.00	Unemployment rate %	Apr	<u>6.2</u>	6.2
Spain	08.00	Unemployment (net employment) M/M change 000s	May	-	-67.4 (69.2)
Wednesday 4 June 2025					
Euro Area	09.00	Final composite (services) PMI	May	<u>49.5 (48.9)</u>	50.4 (50.1)
Germany	08.55	Final composite (services) PMI	May	<u>48.6 (47.2)</u>	450.1 (49.0)
France	08.50	Final composite (services) PMI	May	<u>48.0 (47.4)</u>	47.8 (47.3)
Italy	08.45	Composite (services) PMI	May	-	52.1 (52.9)
Spain	08.00	Industrial production M/M% (Y/Y%)	Apr	-	0.9 (1.0)
	08.15	Composite (services) PMI	May	52.2 (53.0)	52.5 (53.4)
UK	09.30	Final composite (services) PMI	May	<u>49.4 (50.2)</u>	48.5 (49.0)
Thursday 5 June 2025					
Euro Area	08.30	Construction PMI	May	-	46.0
	10.00	PPI Y/Y%	Apr	1.2	1.9
	13.15	ECB Deposit (Refinancing) Rate %	Jun	<u>2.00 (2.15)</u>	2.25 (2.40)
Germany	07.00	Factory orders M/M% (Y/Y%)	Apr	-1.5 (2.4)	3.6 (3.8)
	08.30	Construction PMI	May	-	45.1
France	08.30	Construction PMI	May	-	43.6
Italy	08.30	Construction PMI	May	-	50.1
	09.00	Retail sales M/M% (Y/Y%)	Apr	-	-0.5 (-2.8)
UK	09.00	New car registrations Y/Y%	May	-	-10.4
	09.30	Construction PMI	May	47.2	46.6
	09.30	DMP 3M output price (1Y CPI) expectations Y/Y%	May	3.8 (3.2)	3.8 (3.1)
Friday 6 June 2025					
Euro Area	10.00	GDP – final estimate Q/Q% (Y/Y%)	Q1	<u>0.4 (1.2)</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 – final estimate Q/Q% (Y/Y%)	Q1	<u>0.3 (0.8)</u>	0.1 (0.7)
	10.00	Retail sales M/M% (Y/Y%)	Apr	0.2 (1.5)	-0.1 (1.5)
Germany	07.00	Industrial production M/M% (Y/Y%)	Apr	-0.9 (-1.0)	3.0 (-0.2)
	07.00	Trade balance €bn	Apr	20.0	21.2
France	07.45	Trade balance €bn	Apr	-	-6.2
	07.45	Industrial production M/M% (Y/Y%)	Apr	0.0 (-0.3)	0.2 (0.2)
Spain	08.00	House price index Q/Q% (Y/Y%)	Q1	-	1.8 (11.3)

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions

Country	BST	Event / Auction
Monday 2 June 2025		
UK		22.30 BoE MPC External Member Mann to speak at FRB conference, Washington D.C.
Tuesday 3 June 2025		
Germany		10.30 Auction: to sell up to €4.5bn of 1.7% 2027 bonds
UK		10.00 Auction: to sell £1.25bn of 4% 2063 bonds
Wednesday 4 June 2025		
UK		10.00 Auction: to sell £4.75bn of 4.375% 2028 bonds
Thursday 5 June 2025		
Euro Area		13.15 ECB monetary policy announcement
		13.45 ECB President Lagarde to hold post-Governing Council meeting press conference, Frankfurt
		14.45 ECB to publish updated macroeconomic projections
France		09.50 Auction: to sell up to €12bn of 3.2% 2035, 1.25% 2036 & 3.75% 2056 bonds
Spain		09.30 Auction: to sell 2.4% 2028, 2.7% 2030, 0.7% 2032 bonds & 2.05% inflation-linked bonds
UK		08.45 BoE MPC External Member Greene to give opening remarks to ECONDAT conference, London
		09.30 BoE Deputy Governor Breeden to speak in Odgers webinar on 'H2 economic trends'
Friday 6 June 2025		
Italy		09.00 ISTAT to publish 2025-26 economic outlook

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:

<https://www.uk.daiwacm.com/ficc-research/recent-blogs>

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