Daiwa Capital Markets

Euro wrap-up

Overview

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- Despite a downside surprise to UK GDP in May, Gilts made modest losses as the economy remains on track for modestly positive growth in Q2.
- Bunds also made modest losses as ECB hawk Schnabel downplayed the risks of undershooting the inflation target over the medium term and suggested the bar for another cut is very high.
- The coming week will bring the latest figures for euro area IP and goods trade, UK inflation and labour market, while BoE Governor Bailey will deliver his Mansion House speech.

Daily bond market movements

Bond	Yield	Change
BKO 1.7 06/27	1.898	+0.016
OBL 2.4 04/30	2.285	+0.016
DBR 2.6 08/35	2.720	+0.018
UKT 3¾ 03/27	3.853	+0.007
UKT 4⅜ 03/30	4.042	+0.020
UKT 4½ 03/35	4.624	+0.031

*Change from close as at 4:00pm BST.
Source: Bloomberg

UK

UK GDP surprises to the downside in May, but remains on track for modestly positive growth in Q2

While today's UK GDP numbers for May came in slightly softer than expected, they reinforced our view that growth likely remained positive in Q2, albeit slowing sharply from the surge in Q1 (0.7%Q/Q) which benefited from several temporary factors. Contrasting expectations of a return to modest growth, GDP fell for a second successive month in May (-0.1%M/M). But with economic output in March having been revised higher (by 0.2ppt to 0.4%M/M), it was still up 0.7%Y/Y and trending 0.1% above the Q1 average. As such, we maintain our forecast that GDP growth slowed to 0.1%Q/Q in Q2. However, while the PMIs provided a poor guide to GDP growth in Q1, they showed some further welcome signs of recovery in June, not least in services, with the composite PMI up to a nine-month high. As such, we see the risks to out Q2 GDP forecast as skewed to the upside.

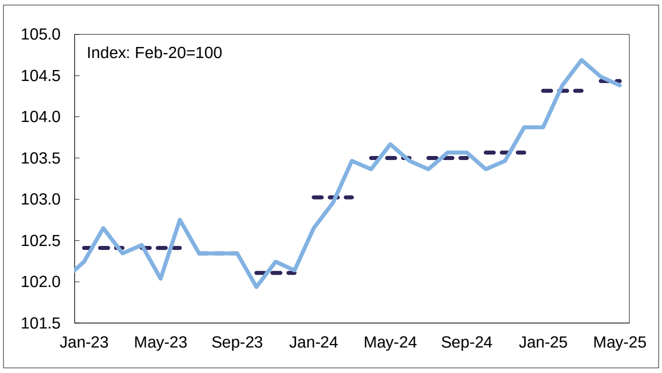
Manufacturing pull-back in May led by pharmaceuticals and autos

The weakness in May was unsurprisingly led by the manufacturing sector, as the pull-back from the front-running of higher US tariffs in Q1 continued. Manufacturing output fell for a third consecutive month and by an accelerated 1.0%M/M, the most in ten months. This left it flat compared with a year earlier and trending just ½% below the Q1 level, following growth of 1.1%Q/Q in Q1. So, looking through the volatility, the data still point to relative resilience to US tariff uncertainty. Admittedly, factory output declined in nine out of the 13 subsectors in May with the fall led by pharmaceuticals (-4.2%M/M). Autos production also fell further in May taking the cumulative drop since March to 13% and the level to a two-year low. And basic metals also contributed negatively. In contrast, however, there was a notable rebound in output of machinery (3.4%M/M) to the highest level since August 2023. And while there was only modest growth in iron and steel production in May following a drop in April, substantial upward revisions earlier in the year left it trending some 6% above the Q1 level, when output in the subsector grew a whopping 14½%Q/Q.

Exports show signs of resilience but still point to a significant drag from net trade in Q2

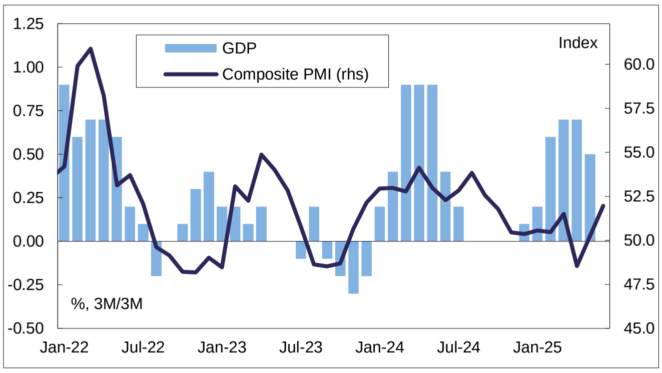
Notwithstanding the further drop in manufacturing output, today's trade report also suggested relative resilience to higher US tariffs. In particular, the value of total exports rose 1.2%M/M in May, with goods exports up more than 2%M/M. The pickup in part reflected an increase in shipments to the EU, which rose to an 11-month high in May. But there was also a recovery in goods exports to the US, which rose 7%M/M (£0.4bn) on a seasonally adjusted basis, reflecting a rebound in shipments of cars and pharmaceuticals. Following a record drop in April (£1.7bn), this still left the value of goods exports to the US trending more than 25% below the Q1 average. And overall, total goods exports were trending 8% lower on the same basis,

UK: GDP level*



*Dashed lines represent quarterly average.
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: GDP growth & composite output PMI



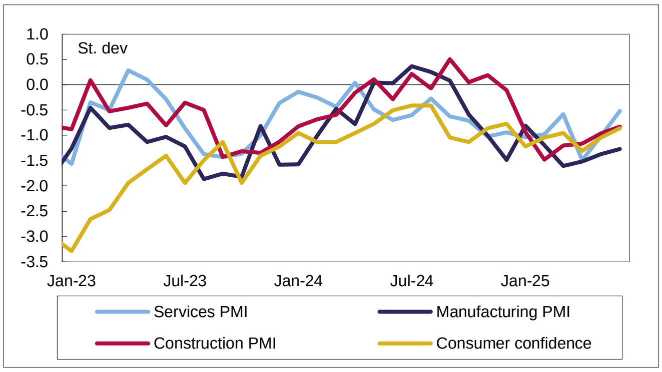
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

with total exports down 3%. When excluding price effects, the deterioration appears to have been less marked, with goods export volumes trending some 3½% below the Q1 average. But with services exports moving higher, total export volumes were down 'just' 1% on the same basis. Nevertheless, import volumes maintained an upwards trend in May too. So, having added 0.4ppt to GDP growth in Q1, net trade seems bound to subtract significantly in Q2.

Services activity returned to growth in May despite slump in retail sales

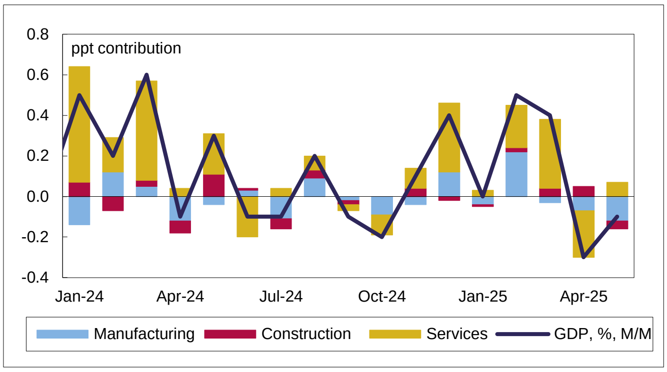
Given a non-negligible drop in retail sales, and declines in sports- and travel-related subsectors, activity in consumer-facing services fell 1.2%M/M in May. But following three consecutive months of growth, consumer-facing services output was still tracking some 0.2% above the Q1 average, with a stronger pace of growth in accommodation and restaurant services in the first two months of Q2. And given an improvement in business services – reflecting not least strong growth in info and communications and legal activities – total services activity returned to modest growth in May (0.1%M/M) for the fifth month out of the past seven to be trending just above the Q1 average. More disappointingly, but not necessarily surprising following three months of strong growth, construction output fell 0.6%M/M in May. Nevertheless, this still left it more than 1% above the Q1 average, suggesting that the sector also provided a non-negligible boost to GDP growth last quarter.

UK: Business & consumer survey indices



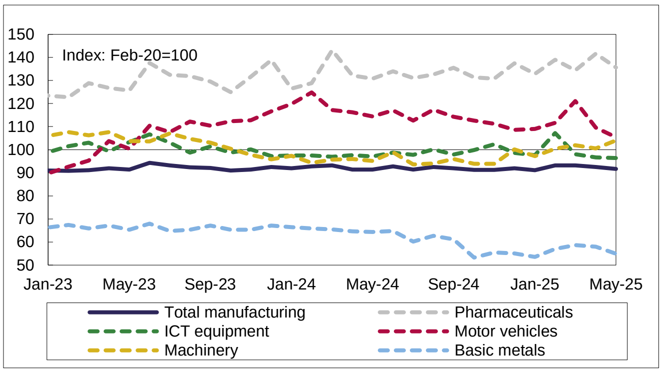
Source: Macrobond, S&P Global, GfK and Daiwa Capital Markets Europe Ltd.

UK: Sectoral contributions to M/M GDP growth



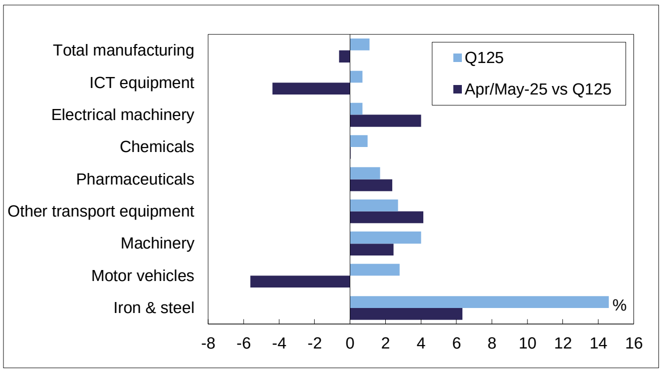
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Output levels in selected manufacturing sectors



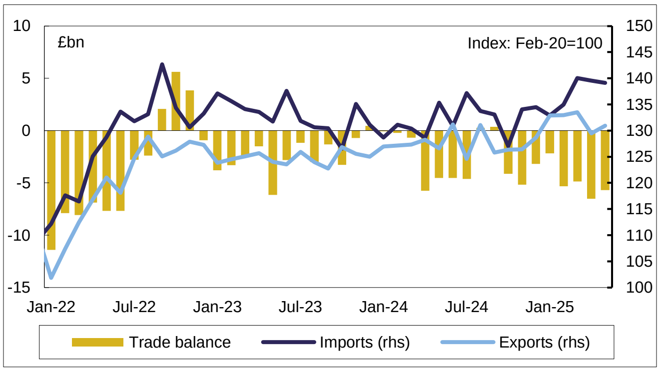
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Growth in selected manufacturing sectors



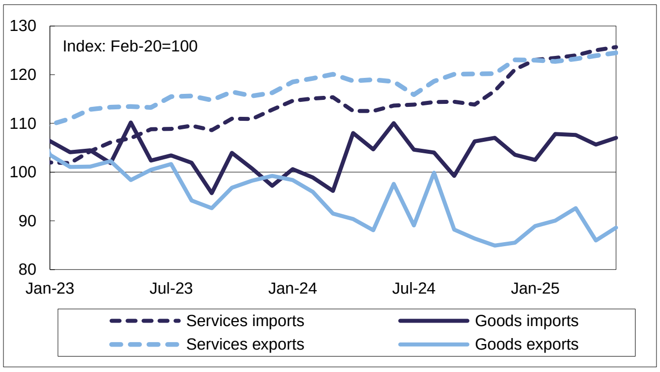
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Trade balance, export & import values



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Export & import volumes



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

The week ahead in the UK

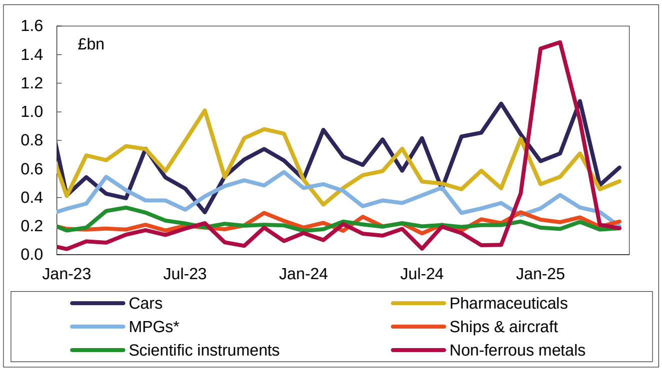
The UK focus in the coming week will be June inflation (Wednesday) and the latest batch of labour market data (Thursday) each representing their final readings ahead of the August MPC meeting. Inflation has tracked close to the BoE forecasts in recent months. Indeed, both headline (3.4%Y/Y) and services (4.7%Y/Y) inflation in May aligned with its projection. We, like the BoE, expect headline inflation in June to move sideways. But with the uptick in fuel prices late last month bound to decrease the drag from energy, the BoE may not be surprised by a slight surprise on the upside. We also note the upside risks from food, with the BRC survey flagging more pressure in that component in June after it already overshot the Bank's projection significantly in May. Ultimately, however, we see more downside risks in the services categories to underpin our expectations for June's sidestep in the headline CPI rate despite the possibility of a slight uptick in core goods inflation.

The latest labour market figures will perhaps be more consequential from a monetary policy standpoint, bearing in mind the growing sensitivity of some on the MPC, including Governor Bailey, towards recent downbeat data. May's payroll report flagged a seventh consecutive month of net job losses for employees and at the fastest pace in the five years since the pandemic (-109k) to be cumulatively down 276k since October's budget. Vacancies have extended a recent downtrend too. The loosening of the labour market is feeding steadily through into wage-setting dynamics. Private sector wage growth in April (5.1%3M/Y) undershot the BoE's expectations for end-Q2 by 0.1ppt, and in May seems likely to fall below 5%3M/Y for the first time since February 2022. Beyond the inflation and labour market data, the BRC's retail monitor (Tuesday) will provide insights into consumer spending at end-Q2. BoE Governor Bailey's Mansion House speech on Tuesday evening will also attract attention for any further insights into near-term monetary policy decisions.

The week ahead in the euro area

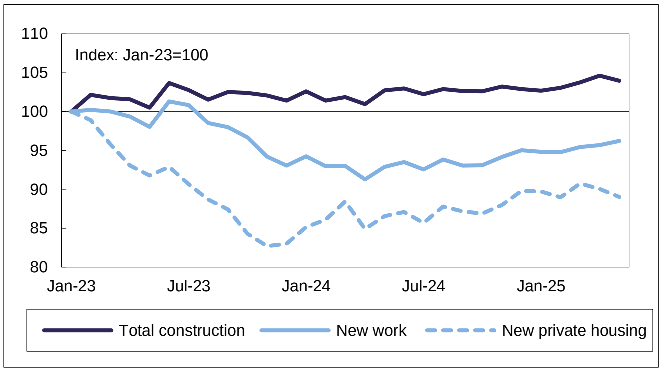
Today's final estimates of French inflation in June revised up the EU-harmonised HICP rate by 0.1ppt from the flash figure to 0.9%Y/Y, reversing in full the prior month's 0.3ppt dip. Nevertheless, the coming week's final euro area inflation estimates (Thursday) are still expected to confirm June's on-target reading. The flash release reported a subtle uptick in headline inflation last month (up 0.1ppt to 2.0%Y/Y), principally due to a weaker drag from energy prices. But core inflation merely moved sideways (2.3%Y/Y), and we expect the granular detail to suggest that services components remained broadly stable and consistent with an ongoing disinflation trend. Stabilisation in food inflation, which in May peaked at a 15-month high (3.2%Y/Y), should also offer encouragement. And core goods price pressures should also remain particularly muted, continuing to trend around ½%Y/Y. Indeed, while we expect last month's short-lived spike in energy prices to be a source of upwards pressure to June's German PPI (Friday) – the first key member state release ahead of the respective euro area data – factors including a stronger euro and imports from China likely helped to further dampen input costs more broadly to provide reassurance about the absence of underlying inflationary pressures.

UK: Goods export values to the US



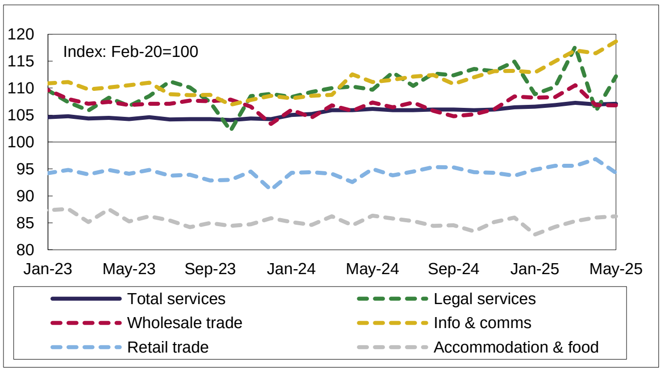
**Mechanical Power Generators.*
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Construction output levels



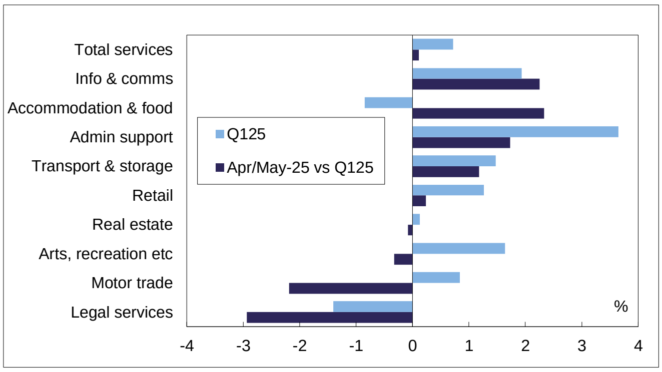
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Output levels in selected services sectors



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

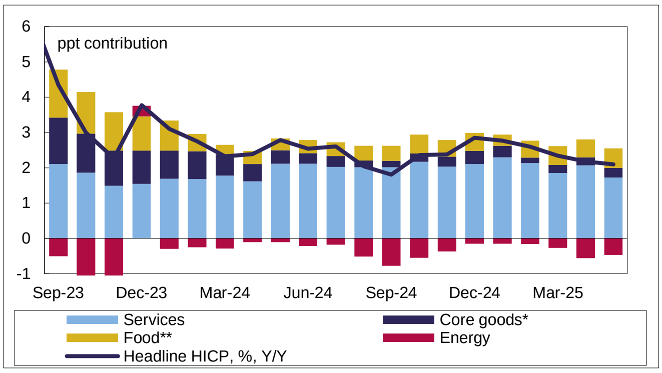
UK: Growth in selected services sectors



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

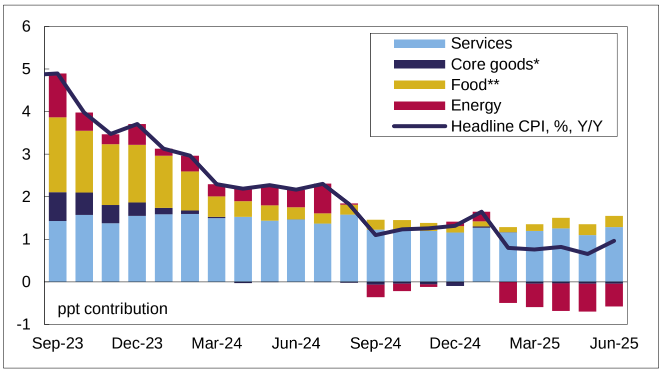
Price data aside, the coming week's activity figures will likely be of most interest. May's industrial output report (Tuesday) should demonstrate some stabilisation after IP dropped the most in 21 months in April (-2.4%M/M). Data from the member states suggest that this should be the case, with healthy expansion in Germany (2.2%M/M) and Spain more than compensating for declines in France and Italy. But a bounce-back in Irish IP (12.4%M/M), likely reflecting the ongoing boost from pharmaceuticals and chemicals, left overall output there only marginally below March's level. And so, we now expect a sizeable increase in euro area IP in May of about 1½%M/M. That would also leave IP trending more than 0.5% above the Q1 average, pointing towards a likely positive contribution from industry to economic growth in Q2. Notwithstanding the uncertainty surrounding the Irish trade data, however, May's German and French figures strongly suggest that net trade subtracted from GDP growth last quarter. But the euro area trade surplus (Wednesday) is likely to have widened in May as the decline in imports outstripped that of exports. Meanwhile, accelerated declines in German (-3.9%M/M) and French (-0.5%M/M) construction output lend themselves to a fall in May's aggregate euro area figures (Friday). Downward revisions in both of those countries in the previous month also imply that April's strong performance (1.7%M/M) may be adjusted lower. Finally, July's ZEW survey (Tuesday) will also be expected to report a further uptick in economic sentiment in Germany, mirroring the above-expectations improvement reported by July's Sentix.

Germany: Contributions to HICP inflation



*Non-energy industrial goods. **Includes alcohol & tobacco.
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

France: Contributions to CPI inflation



*Non-energy industrial goods. **Includes alcohol & tobacco.
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Daiwa economic forecast

	2025				2026		2025	2026	2027
	Q1	Q2	Q3	Q4	Q1	Q2			
GDP	%, Q/Q						%, Y/Y		
Euro area	0.6	0.1	0.1	0.2	0.2	0.3	1.3	0.9	1.3
UK	0.7	0.1	0.2	0.3	0.3	0.3	1.2	1.1	1.4
Inflation, %, Y/Y									
Euro area									
Headline HICP	2.3	2.0	1.9	2.1	1.6	1.7	2.1	1.7	1.8
Core HICP	2.5	2.4	2.2	2.2	2.1	1.5	2.3	1.7	1.6
UK									
Headline CPI	2.8	3.4	3.5	3.3	2.9	1.9	3.3	2.2	2.0
Core CPI	3.6	3.6	3.4	3.2	2.8	1.8	3.4	2.0	1.8
Monetary policy, %									
ECB									
Deposit Rate	2.50	2.00	1.75	1.75	1.75	1.75	1.75	1.75	2.00
Refi Rate	2.65	2.15	1.90	1.90	1.90	1.90	1.90	1.90	2.15
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.

The next Euro wrap-up will be published on Tuesday 15 July 2025

European calendar

Today's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
France	Final HICP (CPI) Y/Y%	Jun	**0.9 (1.0)**	*0.8 (0.9)*	0.6 (0.7)	-
UK	Monthly GDP M/M% (3M/3M%)	May	**-0.1 (0.5)**	*0.1 (0.4)*	-0.3 (0.7)	-
	Services output M/M% (3M/3M%)	May	**0.1 (0.4)**	0.1 (0.4)	-0.4 (0.6)	-0.3 (-)
	Industrial output M/M% (Y/Y%)	May	**-0.9 (-0.3)**	-0.1 (0.2)	-0.6 (-0.3)	- (0.3)
	Construction output M/M% (Y/Y%)	May	**-0.6 (1.2)**	0.2 (1.6)	0.9 (3.3)	0.8 (3.6)
	Trade (goods trade) balance £bn	May	**-5.7 (-21.7)**	-4.6 (-21.0)	-7.0 (-23.2)	-6.5 (-22.4)

Auctions

Country	Auction
Italy	sold €3.5bn of 2.35% 2029 bonds at an average yield of 2.47%
	sold €3.5bn of 3.25% 2032 bonds at an average yield of 3.17%
	sold €1.75bn of 3.85% 2029 bonds at an average yield of 4.03%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Thursday's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Germany	Final HICP (CPI) Y/Y%	Jun	**2.0 (2.0)**	*2.0 (2.0)*	2.1 (2.1)	-
Italy	Industrial production M/M% (Y/Y%)	May	**-0.7 (-0.9)**	-0.2 (0.4)	1.0 (0.3)	0.9 (0.1)
UK	RICS house price balance %	Jun	**-7**	-9	-8	-7

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 €1.135bn of 2.6% 2041 bonds at an average yield of 3.0%
	sold €794m of 2.5% 2044 bonds at an average yield of 3.04%
UK	sold £4.5bn of 4.5% 2035 bonds at an average yield of 4.635%

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/ *Daiwa forecast*	Previous
			Monday 14 July 2025			
			- Nothing scheduled -			
			Tuesday 15 July 2025			
Euro Area		10.00	Industrial production M/M% (Y/Y%)	May	*1.5 (3.3)*	-2.4 (0.8)
Germany		10.00	ZEW current situation (expectations) balance	Jul	-66.0 (50.7)	-72.0 (47.5)
Spain		08.00	Final HICP (CPI) Y/Y%	Jun	*2.2 (2.2)*	2.0 (2.0)
UK		00.01	BRC retail monitor – like-for-like sales Y/Y%	Jun	1.0	0.6
			Wednesday 16 July 2025			
Euro Area		10.00	Trade balance €bn	May	13.0	14.0
Italy		09.00	Final HICP (CPI) Y/Y%	Jun	*1.7 (1.7)*	1.7 (1.6)
UK		07.00	Headline (core) CPI Y/Y%	Jun	*3.4 (3.4)*	3.4 (3.5)
		09.30	House price index Y/Y%	May	-	3.5
			Thursday 17 July 2025			
Euro Area		10.00	Final headline (core) HICP Y/Y%	Jun	*2.0 (2.3)*	1.9 (2.3)
UK		07.00	Average earnings (excluding bonuses) 3M/Y%	May	5.0 (4.9)	5.3 (5.2)
		07.00	Private sector regular wages 3M/Y%	May	4.8	5.1
		07.00	Unemployment rate 3M%	May	4.6	4.6
		07.00	Employment 3M/3M change 000s	May	43	89
		07.00	Payrolled employees M/M change 000s	Jun	-41	-109
		07.00	Claimant count rate % (change 000s)	Jun	-	4.5 (33.1)
			Friday 18 July 2025			
Euro Area		08.00	ECB current account €bn	May	-	19.8
		10.00	Construction output M/M% (Y/Y%)	May	-	1.7 (3.0)
Germany		07.00	PPI Y/Y%	Jun	-1.3	-1.2

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions

Country		BST	Event / Auction
			Monday 14 July 2025
UK		00.01	REC, KPMG & S&P Global UK Report on Jobs for June
			Tuesday 15 July 2025
Germany		10.30	Auction: to sell €5bn of 2027 bonds
UK		10.00	Auction: to sell £1bn of 4.25% 2032 bonds
		21.00	BoE Governor Bailey to deliver speech at the Annual Financial and Professional Services dinner at Mansion House, London
			Wednesday 16 July 2025
Germany		10.30	Auction: to sell €1.5bn of 2.9% 2056 bonds
		10.30	Auction: to sell €1bn of 1.25% 2048 bonds
UK		10.00	Auction: to sell £1.5bn of 4.5% 2034 bonds
			Thursday 17 July 2025
France		09.50	Auction: to sell up to €12bn of 2.4% 2028, 2.5% 2030 & 2.7% 2031 bonds
		10.50	Auction: to sell up to €1.5bn of 0.6% 2034, 0.1% 2038 & 0.55% 2039 inflation-linked bonds
Spain		09.30	Auction: to sell 2.7% 2030, 3.2% 2035 & 2.7% 2048 bonds
UK		10.00	Auction: to sell £4.75bn of 4.375% 2030 bonds
			Friday 18 July 2025
			- Nothing scheduled -

**Details forthcoming. Source: Bloomberg and Daiwa Capital Markets Europe Ltd.*

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