

# Euro wrap-up

## Overview

- While a Reuters report suggested a strong likelihood that the ECB will raise rates in June, Bunds made gains as euro area core inflation was confirmed at a 4-year low and oil prices fell on reports that President Trump hinted a deal with Iran might be near.
- Gilts outperformed as UK inflation surprised to the downside in April and BoE Governor Bailey acknowledged that tighter financial conditions had lessened the need to raise rates.
- Thursday will bring the flash May PMIs and euro area labour cost data.

## Economic Research Team

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### Daily bond market movements

Bond	Yield	Change
BKO 2½ 06/28	2.652	-0.100
OBL 2½ 04/31	2.789	-0.101
DBR 2.9 02/36	3.094	-0.096
UKT 4¾ 03/28	4.360	-0.143
UKT 4¾ 03/31	4.523	-0.141
UKT 4¾ 10/35	4.987	-0.141

\*Change from close as at 5.00pm BST.

Source: Bloomberg

## Euro area

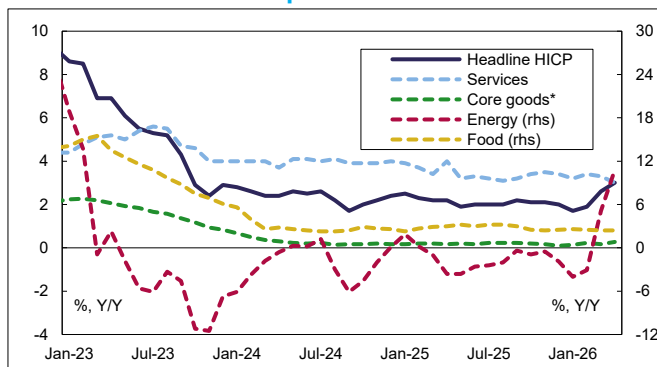
### Core inflation in April confirmed at joint-lowest since late 2021, but easing reflected timing of Easter

As expected, the final estimates of euro area consumer price inflation in April largely aligned with the flash figures. So, the headline HICP rate was confirmed at 3.0%Y/Y, up 0.4ppt from March and the highest since September 2023. And, as previously suggested, core inflation fell slightly for a second successive month to 2.2%Y/Y to match the lowest level since late 2021. The weakness reflected a drop of 0.2ppt in services inflation to 3.0%Y/Y, the lowest in more than four years. But in large part that reflected the timing of Easter, which shifted the package holiday and airfare components significantly into negative territory. The core goods component provided some offset, rising 0.3ppt to 0.8%Y/Y in part due to a pickup in clothing (1.0%Y/Y) and furniture and furnishings (0.5%Y/Y) which nevertheless remained relatively subdued. Of course, most pressures in April were concentrated in energy inflation, which more than doubled to 10.8%Y/Y, just 0.1ppt lower than previously thought. That represented the highest rate in more than three years, driven by higher prices of auto fuel while household energy inflation remained negligible (0.3%Y/Y) despite an uptick in gas and acceleration in heating oil. Finally, inflation of food, alcohol and tobacco was a touch softer than suggested by the flash estimate, remaining unchanged on the month at 2.4%Y/Y, matching the lowest rate since the start of 2025. Higher fruit and vegetable components were offset by continued easing of pressures in items such as meat, coffee and chocolate to tally with the global trend.

### Expect inflation to rebound in May before trending sideways through the summer

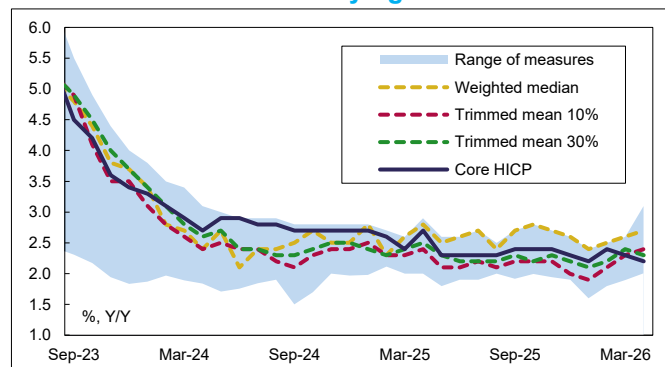
Looking ahead, the risks to the inflation outlook remain firmly biased to the upside. At the very least, in May the services component will largely reverse its Easter-related decline. And increased pressure in airfares should become apparent thereafter. The core goods component is also likely to edge up over time on increased costs. So, we currently expect core inflation to rebound in May and remain higher into the summer. Fresh food prices are also increasingly likely to reflect higher input costs resulting from the conflict in the Middle East. On a brighter note, a fall back in diesel prices this month and the German government's temporary tax cut at the start of this month should help to offset the impact on auto fuels of the termination of fiscal support in Italy. But an unfavourable base effect points to a further modest rise in energy inflation in May. And overall, we expect the flash May estimate due at the start of next month to report a rise in headline inflation of 0.3ppt to a 32-month high of 3.3%Y/Y. Thereafter, of course, all will depend on events at the Strait of Hormuz. Assuming a gradual restoration of freight transit so that the decline in wholesale energy prices implied by forward contracts crystallises, we would expect auto fuel inflation to dissipate gradually and household energy bills to remain contained. Indirect effects on food prices and airfares should eventually fade. And while we would still expect headline inflation to hover around 3.0%Y/Y or more over coming months, given the softening of the labour market, particularly in Germany and France, and well-anchored inflation expectations, second-round effects should be well contained, allowing for significant disinflation this time next year.

### Euro area: Consumer price inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

### Euro area: Selected underlying inflation measures



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

## The day ahead in the euro area

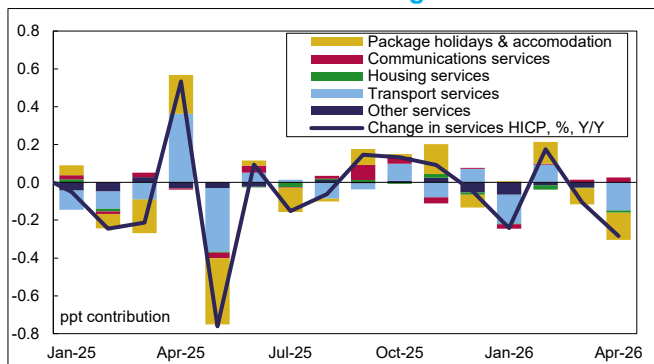
While Thursday's euro area data calendar looks relatively busy, the May flash PMIs will receive by far the most attention, albeit with little change to their overriding message expected. Certainly, the survey will demonstrate that inflation risks remain firmly to the upside. Given the cost pressures caused by sustained disruption to supply from the Middle East, both the euro area composite input (68.3) and output (56.8) price PMIs, at their highest levels in at least three years in April, seem likely to remain elevated. But last month's survey showed clear downside risks to activity too, exemplifying the trade-offs currently facing monetary policymakers. The composite output PMI, down 1.9pts last month, was consistent with its steepest contraction in 17 months (48.7). Softness was concentrated in services activity (47.6) despite surprising resilience from manufacturing output (52.3). While new orders from that sector were also firmer than expected, that support may prove temporary and raises a potential headwind this month. Moreover, while the Commission's flash consumer confidence reading – also due Thursday – could see some modest improvement owing to fiscal support to combat rising energy prices, it will likely remain subdued highlighting downside risks to the outlook for household spending. While we still expect the ECB to tighten policy in June, more pronounced weakness across the first of May's business and consumer surveys could support the case of the more dovish members of the Governing Council. Moreover, the ECB's preliminary labour cost and job vacancy data for Q1 should confirm that relatively looser labour market conditions prevailed at the start of the war.

## UK

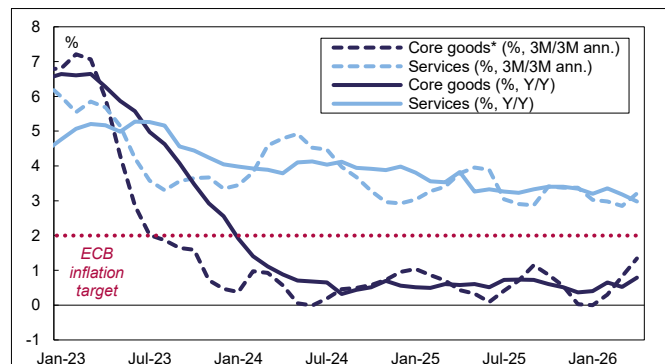
### UK inflation surprises to downside in April while base effects flatter services inflation

Coming on the heels of yesterday's weak [labour market](#) report, today's UK inflation figures also surprised to the downside, reinforcing expectations that the MPC will leave Bank Rate unchanged in June and raising the chances that policy will be left on hold at least until the autumn. While consumer prices rose 0.7%M/M for a second successive month in April, the annual CPI rate fell a sharp 0.5ppt to 2.8%Y/Y, a 13-month low and below the equivalent rates in the US and the euro area. It also undershot by 0.2ppt the BoE's forecast presented at the end of last month. And with little signs of pass-through so far from the new global energy price shock to non-energy components, core inflation fell a larger-than-expected 0.6ppt to 2.5%Y/Y, the softest since mid-2021. The improvement last month in good part reflected favourable developments in certain services components as last year's sharp increases in partially administered prices, as well as the impact of the hike to employers' National Insurance Contributions, fell out of the annual calculation. Indeed, the components of water supply, sewerage and Vehicle Excise Duty alone knocked 0.5ppt off headline inflation. And as in the euro area, declines in inflation of airfares and package holidays related to the timing of Easter also subtracted. In addition, smaller increases in indexed subscriptions this year more than offset a modest upwards inflationary impulse from accommodation services. So, overall, services inflation fell

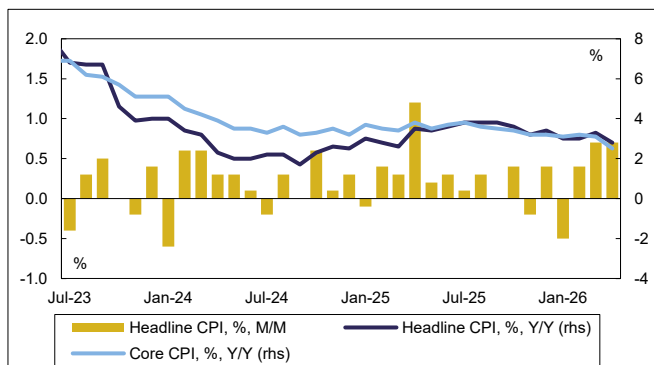
### Euro area: Contribution to change in services HICP



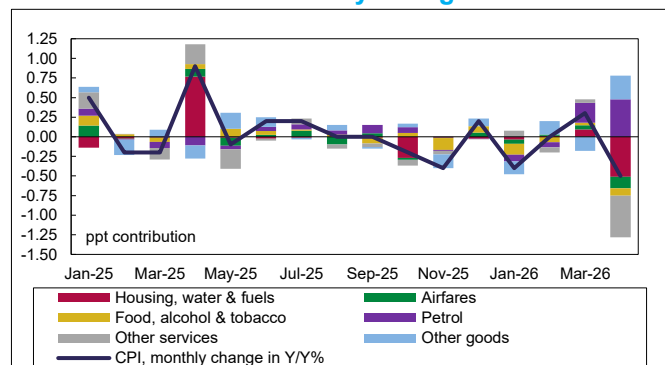
### Euro area: Core inflation momentum



### UK: Headline & core inflation



### UK: Contribution to monthly change in inflation

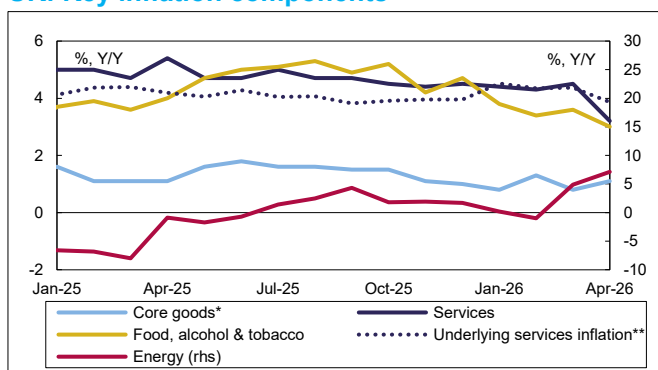


a chunky 1.3ppts – the most since the ‘Eat out to help out’ tax cut in August 2020 – to 3.2%Y/Y, the lowest in more than four years. And even excluding volatile and indexed items, a measure of underlying services inflation watched by the BoE fell to the softest since April 2022 (3.7%Y/Y).

### Energy inflation jumps to 3-year high despite lower household price cap

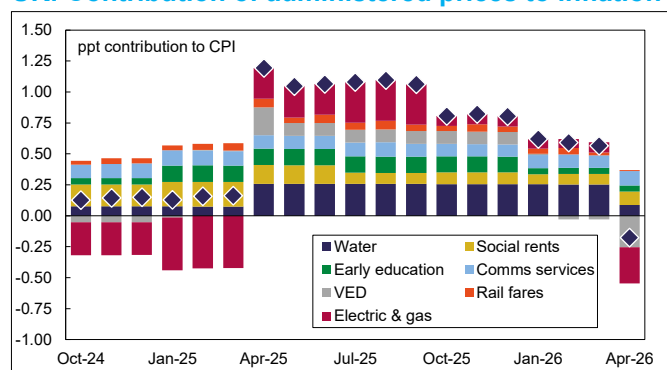
Many goods prices in the UK matched the patterns seen in the euro area. For example, inflation of food, alcohol and tobacco eased to a 16-month low (3.0%Y/Y) in part due to lower chocolate prices. In contrast, after hitting a 17-month low in March, non-energy industrial goods inflation edged up to 1.1%Y/Y in April reflecting a rebound in inflation of clothing, furniture and household appliances. But overall core goods inflation remained below the average of the past 12 months, with computer games and new and used cars weighing. So, as expected, today’s release confirmed that upwards pressure on inflation last month was largely concentrated in energy, for which inflation jumped more than 3ppts to a near-three-year high (7.1%Y/Y). Auto fuel prices surged 14.9%M/M, the most since the series began in 1988, while heating oil prices rose a further 9%M/M having leapt more than 90%M/M in March. Of course, the upwards shift in energy would have been even sharper in the absence of the 6.7% cut in the Ofgem household price cap at the start of Q2, which knocked around 0.4ppt off headline inflation.

#### UK: Key inflation components



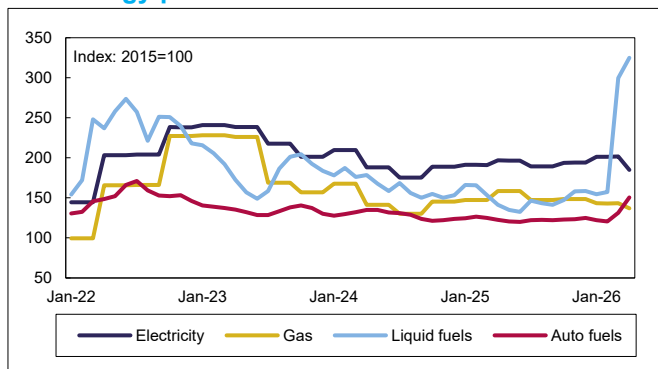
\*Non-energy industrial goods. \*\*Excluding indexed and volatile components. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

#### UK: Contribution of administered prices to inflation



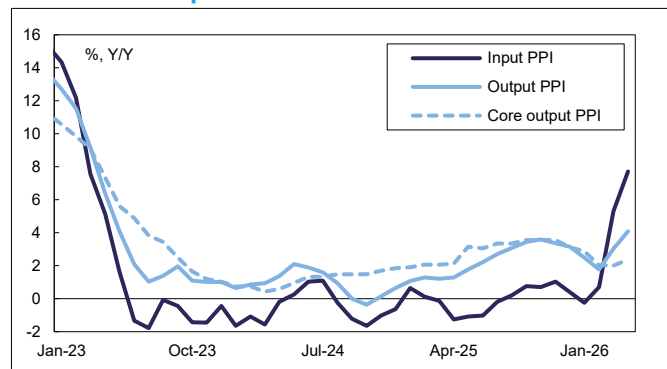
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

#### UK: Energy price levels



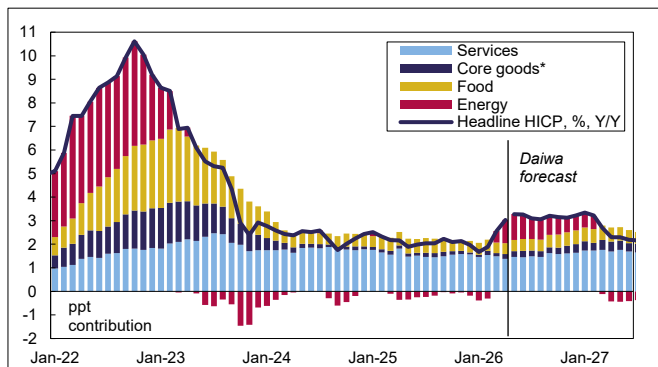
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

#### UK: Producer price inflation



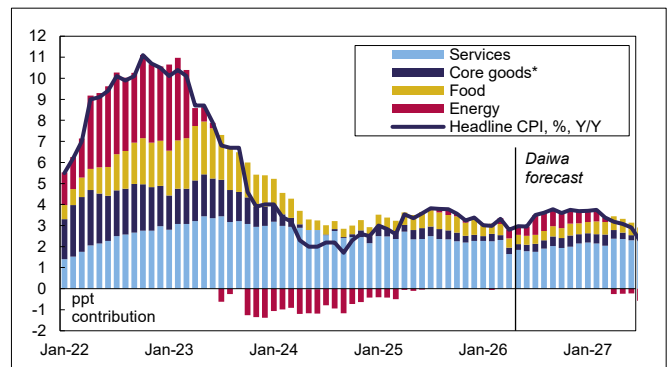
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

#### Euro area: Inflation forecast



\*Non-energy industrial goods. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

#### UK: Inflation forecast



\*Non-energy industrial goods. Source: Macrobond and Daiwa Capital Markets Europe Ltd.







## Inflation to take a step up in Q326 as energy tariffs are hiked & broader price pressures intensify

Looking ahead, with auto fuel prices broadly flat so far this month and household bills capped, energy inflation should remain little changed in May and June. However, when the Ofgem tariff is hiked in July – the announcement of the magnitude is due on 28 May – we expect energy inflation to jump above 15%Y/Y. So, while headline inflation is likely to remain at or below 3.0%Y/Y over the near term, it will take a step up in July to about 3½%Y/Y before oscillating around 3¾%Y/Y through to Q127 as higher input costs are passed on to prices of a range of goods and services. Indeed, rising pipeline pressures were again illustrated in today's factory producer price figures, as input price inflation jumped 7.7%Y/Y, the most in three years. And while manufacturers continued to absorb the bulk of these additional pressures, they increased output prices by the most since mid-2022. So, while lacklustre demand will likely limit pricing power, we expect core goods and food inflation to trend gradually higher over the coming year. And we expect indirect impacts on airfares and second-round effects via wages into 2027. So, we no longer expect a sustained return to the 2% target until 2028.

## The day ahead in the UK

As in the euro area, the flash PMIs will provide a guide to UK activity midway through Q2. Contrasting the euro area, the UK composite output PMI (52.6, up 2.3pts) pointed towards a broad acceleration in growth momentum last month. Order books, however, were largely unchanged. And to what extent April's strength was flattered by temporary effects remains to be seen. So, it seems probable that momentum will slow in May. Inevitably, however, the focus for policymakers will be equally shared with the price PMIs. Indeed, the 13.8pt rise in the input price PMI (75.9) appeared to be reflected in the more significant underlying pressures reported in today's producer price data. And even as the soft CPI headlines temporarily defied the recent uptrend in the output price PMI over the past two months (62.7), policymakers will no doubt be sensitive to further signs of pressure in selling prices. In terms of BoE-speak, Governor Bailey is due to follow his comments at the Treasury Select Committee today with a speech in Sheffield. External MPC member Taylor is also due to speak publicly.

## European calendar

Today's results						
Economic data						
Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area	 Final headline (core) HICP Y/Y%	Apr	<b>3.0 (2.2)</b>	<u>3.0 (2.2)</u>	2.6 (2.3)	-
Germany	 PPI Y/Y%	Apr	<b>1.7</b>	1.5	-0.2	-
UK	 Headline (core) CPI Y/Y%	Apr	<b>2.8 (2.5)</b>	<u>3.1 (2.8)</u>	3.3 (3.1)	-
	 PPI – output (input) prices Y/Y%	Apr	<b>4.0 (7.7)</b>	-	2.6 (5.4)	3.0 (5.3)
	 House price index Y/Y%	Mar	<b>0.0</b>	-	1.2	1.7
Auctions						
Country	Auction					
Germany	 sold €3.845bn of 2.9% 2036 bonds at an average yield of 3.16%					

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

## Tomorrow's releases

### Economic data

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Euro area	09.00	Preliminary services (manufacturing) PMI	May	47.8 (51.8)	47.6 (52.2)
	09.00	Preliminary composite PMI	May	48.8	48.8
	09.00	ECB current account €bn	Mar	-	24.9
	10.00	Construction output M/M% (Y/Y%)	Mar	-	-0.2 (-1.9)
	10.00	Preliminary labour costs Y/Y%	Q1	-	3.3
	10.00	Preliminary job vacancy rate %	Q1	-	2.3
Germany	15.00	Preliminary Commission consumer confidence indicator	May	-20.6	-20.6
	08.30	Preliminary services (manufacturing) PMI	May	47.0 (51.0)	46.9 (51.4)
France	08.30	Preliminary composite PMI	May	48.5	48.4
	08.15	Preliminary services (manufacturing) PMI	May	46.7 (52.1)	46.5 (52.8)
UK	08.15	Preliminary composite PMI	May	47.7	47.6
	09.30	Preliminary services (manufacturing) PMI	May	51.7 (53.0)	52.7 (53.7)
	09.30	Preliminary composite PMI	May	51.6	52.6
	11.00	CBI industrial trends survey – total orders (selling prices) % balance	May	-40 (35)	-38 (32)

### Auctions and events

Euro area	-	European Commission to publish 2026 Spring economic forecasts			
France	09.50	Auction: to sell up to €14bn of 2.4% 2029, 2.75% 2030, 3.25% 2032 and 3.5% 2033 bonds			
	10.50	Auction: to sell up to €1.75bn of 0.6% 2034, 0.1% March 2036, 0.1% July 2036 and 0.1% 2047 inflation-linked bonds			
Spain	09.30	Auction: to sell 2.6% 2031, 3% 2033 and 1% 2050 bonds			
UK	10.00	Auction: to sell £4bn of 4.875% 2036 bonds			
	13.00	External MPC member Taylor to speak in MNI webinar			
	16.00	BoE Governor Bailey to give speech in Sheffield			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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