

Euro wrap-up

Overview

- Bunds followed the global trend lower as tensions in the Middle East intensified, while European producer price inflation rose to the highest level in three years.
- Gilts also made losses, while the final UK composite output PMI was revised notably higher albeit remaining consistent with stagnation.
- Thursday will bring euro area retail sales figures for April and European construction PMIs for May.

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Daily bond market movements

Bond	Yield	Change
BKO 2½ 06/28	2.666	+0.051
OBL 2½ 04/31	2.751	+0.060
DBR 2.9 02/36	3.033	+0.060
UKT 4¾ 03/28	4.366	+0.061
UKT 4¾ 03/31	4.484	+0.062
UKT 4¾ 10/35	4.930	+0.072

*Change from close as at 5.00pm BST.
Source: Bloomberg

Euro area

Producer price pressures still largely contained to direct impact of energy shock, for now

Yesterday's [inflation](#) data offered initial signs that the global energy shock is beginning to leak more broadly into underlying goods and services prices. Today's producer price figures underscored the build-up of pipeline pressures in manufacturing over recent months, with PPI inflation rising a further 3ppts in April to 4.9%Y/Y, the highest rate in three years. Admittedly, the monthly increase in prices in April (0.6%M/M) was markedly smaller than in March (3.4%M/M) reflecting declines in energy prices in France, Italy, the Netherlands and Austria. This nevertheless left energy prices up some 9½% since the start of the year and annual PPI inflation up a chunky 8ppts to 12.4%Y/Y. Moreover, beyond energy, there were signs that underlying pressures are building. Today's release reported a sixth successive increase in prices of non-energy goods – by the most since January 2023 (0.9%M/M) – to push underlying producer price inflation to a near-three-year high (2.3%Y/Y). The detail suggested that pressures were still largely concentrated in the early stages of the production chain and in sectors most exposed to the direct impact of the global energy shock. In particular, the jump in prices of intermediate goods in April – by the most in four years (1.8%M/M) – was principally driven by coke and petroleum (11.1%M/M) and chemicals (6.0%M/M), with the latter the fastest since the series began in 1995 in part due to a spike in prices of fertilizers. In contrast, prices of non-energy-intensive intermediate goods were still relatively well behaved. There was limited evidence of any meaningful upwards pressures on prices of capital and consumer durable goods, which were still up less than 1½% since the start of the year. And not least due to declines in food, prices of consumer non-durables were no higher than at the start of the year.

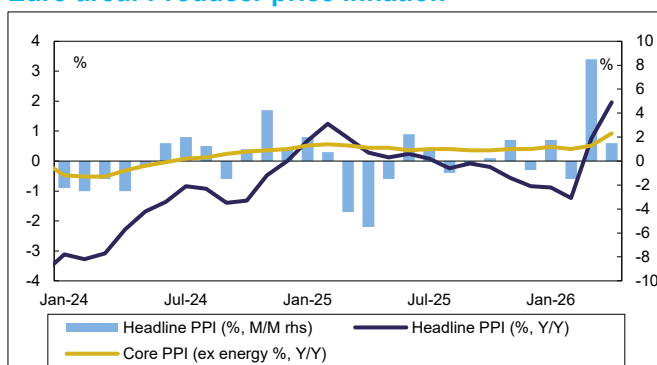
Price PMIs point to growing pipeline pressures, but demand constrains pass-through

The final PMIs indicated a further build up in factory pipeline pressures in May, with the manufacturing input price PMI rising to a near-four-year high (80.1), almost 30pts higher than at the end of last year. But, while elevated relative to the level prevailing before the start of the Middle East conflict, the more moderate rise in the output price index (62.0) suggested that firms' pricing powers remain constrained by subdued demand. This is consistent with the Commission indices that signalled a slight moderation in factory selling-price expectations over the coming three months. Policymakers might also take some comfort from signals in the services sector where the input price index (66.6) was 'just' 7pts higher than end-2025. Moreover, the services output price index was up just 0.1pt in May (55.4) and 3pts higher than in December. Overall, subdued demand conditions in both manufacturing and services should continue to cap underlying consumer price pressures in the near term.

Composite output PMI revised higher in May but still consistent with contraction

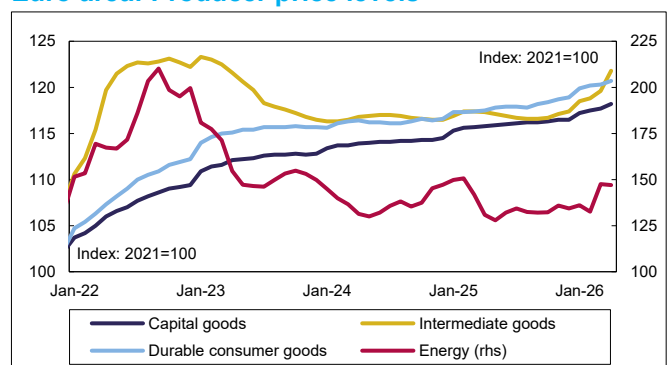
Today's final PMI survey suggested that economic activity in May was not quite as weak as had been implied by the flash reading, with the headline services index revised up 1.3pts to 47.7. But this was just 0.1pt above the level in April and still

Euro area: Producer price inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

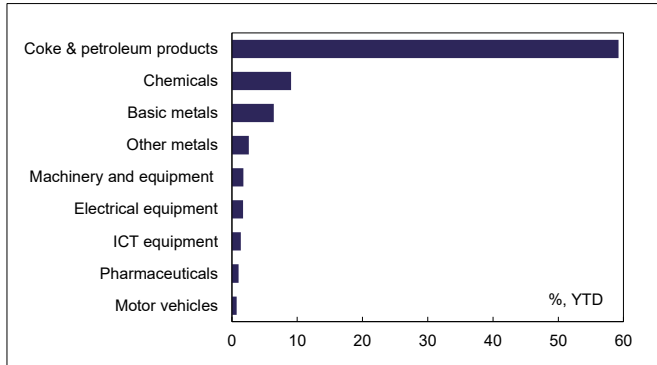
Euro area: Producer price levels



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

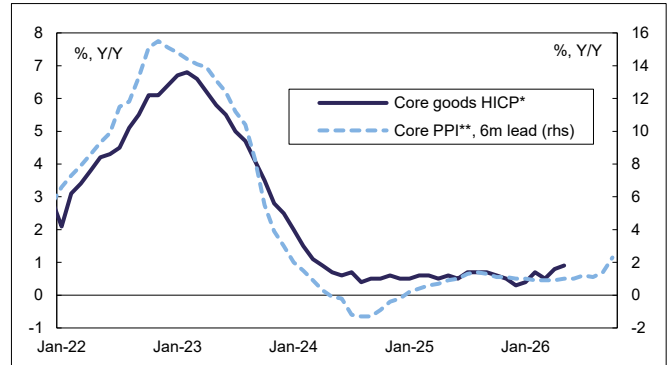
points to the sharpest contraction in the sector since Q121. With backlogs continuing to ease and new export sales declining the most since Covid lockdowns, services firms signalled a cut to headcount for the first time since the start of 2021. The composite output PMI was also revised higher from the flash (by 1pt to 48.5) but remained consistent with a modest contraction in GDP this quarter, by as much as -0.2%Q/Q, and a decline in employment. Of course, this contrasts the mere stagnation implied by the more comprehensive Commission survey, partly due to the substantial negative skew from the French PMIs. Indeed, despite a non-negligible upwards revision to the French composite output index (by 1.4pts), at 44.9 it was still by far the lowest of the surveyed member states and the weakest since January 2024. In contrast, while still in contractionary territory, the German composite PMI (48.8) improved slightly in May due to a recovery in services and continued expansion in manufacturing. The Italian composite PMI (50.4) also signalled ongoing modest growth in May. And while still soft compared with the long-run average and well below the average of recent years, the Spanish composite PMI also partially rebounded in May (50.2) from April's near-three-year low.

Euro area: YTD change in producer price levels



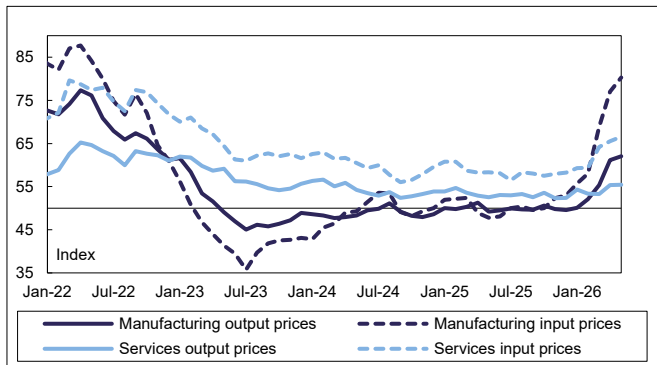
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Core goods HICP & PPI inflation



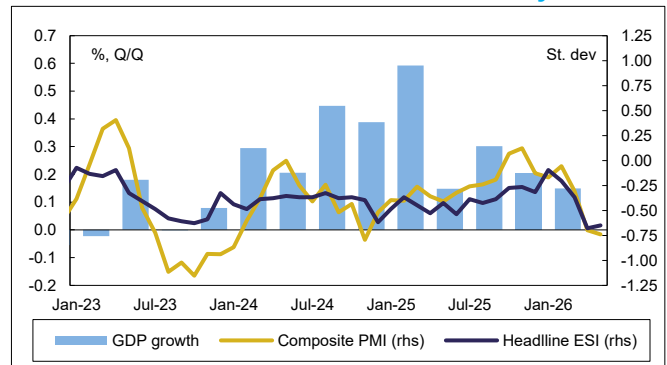
*Non-energy industrial goods. **Excluding energy. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Price PMIs



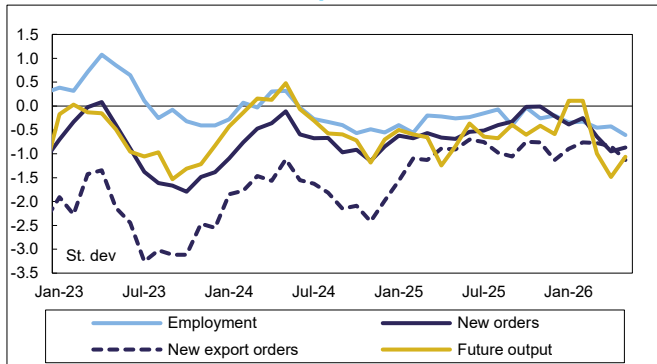
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: GDP Growth & business survey indices



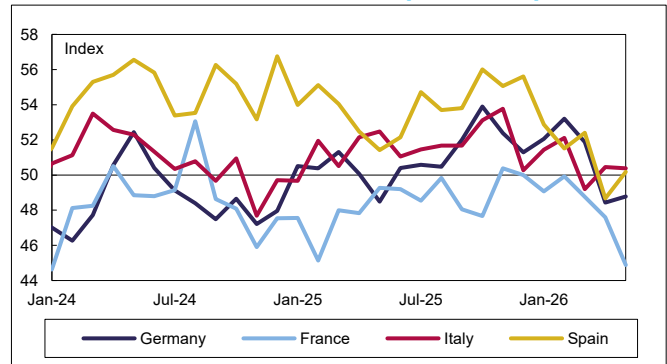
Source: S&P Global, EC, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Selected composite PMIs



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

Euro area member states: Composite output PMIs



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

The day ahead in the euro area

After euro area retail sales volumes slipped back for the first quarter in ten in Q1, data from the member states point towards a further decline at the start of Q2. Larger drops in the likes of Spain (-1.5%M/M) and Belgium (-1.8%M/M) were perhaps exaggerated by their strength in March, which had partially benefitted from higher fuel sales. But those instances of front-

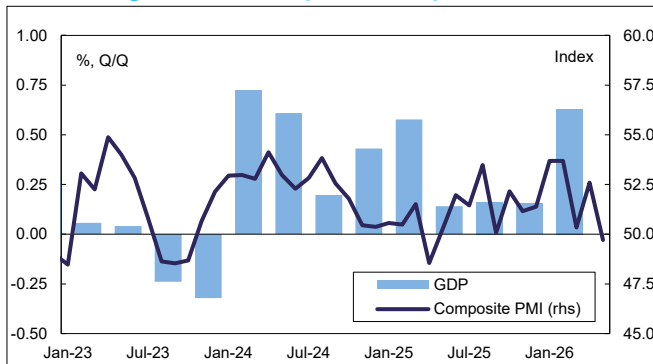
loading were the exception, rather than the rule. And fuel sales are expected to weigh universally in April as households adjust their consumption to higher prices. Indeed, weaker fuel volumes (-4.0%M/M) alongside a sharp drop in core sales (excluding food and fuel, -2.2%M/M) contributed to a fourth consecutive monthly drop in German retail sales (-0.2%M/M). Fuel sales were also down in France, although overall sales defied the weak consumer picture in that member state to provide some offset (0.3%M/M). So, absent the data from Italy, we expect retail sales volumes in the euro area to fall modestly, around -0.3%M/M, which given the subdued nature of consumer confidence implies that a further reduction in retail sales in Q2 remains more likely than not. However, on a less downbeat note, upward revisions to some member states might show that the pullback in Q1, and thereby the potential implications for GDP growth this quarter, were at least less pronounced than feared. Otherwise, while its strength at the end of Q1 arguably raises the likelihood for some payback, April's Spanish IP release will provide the earliest indication from a large member state as to whether the production boost hinted by the business surveys was materializing in the raw production data. The euro area construction PMIs will also be watched for any further signs of weakness to corroborate May's downbeat ESIs for that sector. Lastly, ECB President Lagarde is due to speak publicly ahead of the ECB's pre-Governing Council meeting blackout.

UK

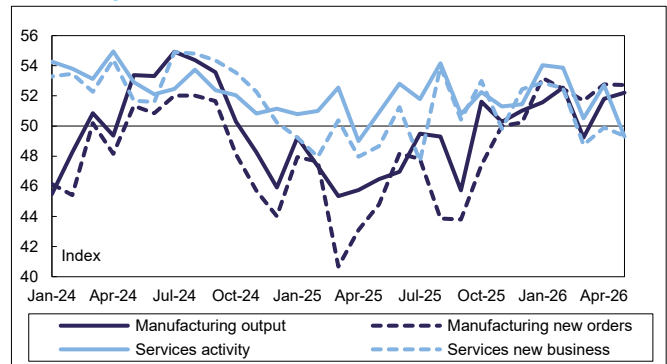
Composite PMI revised higher, but does little to alleviate concerns about the downside risks to GDP

Somewhat unsurprisingly given the extent of their initial decline, the final UK PMIs were noticeably revised up from their flash release. In particular, the final services PMI was marked up by a chunky 1.4pts, to 49.3. While merely the largest flash-to-final revision in three months, we suspect that was influenced in part by the below-par response rate in the flash survey (77%, vs 84% in April). And so, the composite output PMI was also duly revised up, by 1.2pts to 49.7. Otherwise, however, we emphasise that the underlying picture presented by the final PMIs was little different from the flash survey. Although not as marked as first feared – closer to a stagnation than contraction in economic activity – the sharp drop (2.9pts) in the composite output PMI points towards a marked loss of economic growth momentum midway through Q2, 0.8 standard deviations below the trend. While the final manufacturing PMIs confirmed ongoing support from industry – with output (52.2), new orders, and employment all in expansion territory for a second consecutive month – reports of front-loading from some respondents suggest that this could be short-lived. And business activity in the services sector still fell sizably (3.4pts), pointing to a first contraction in 13 months. Amid heightened economic and political uncertainty, business expectations were their most downbeat for 3½ years outside of the announcement of Trump's 'Liberation Day' tariffs. And with new business indicators edging slightly deeper below the 50 threshold, businesses flagged their intentions to cut jobs (46.3) for a 20th consecutive month, and at the most aggressive pace in three. Price pressures also remained extremely acute, respectively some 1½-2 standard deviations above the long-run trend. But they were, at least in the services sector, confirmed to be

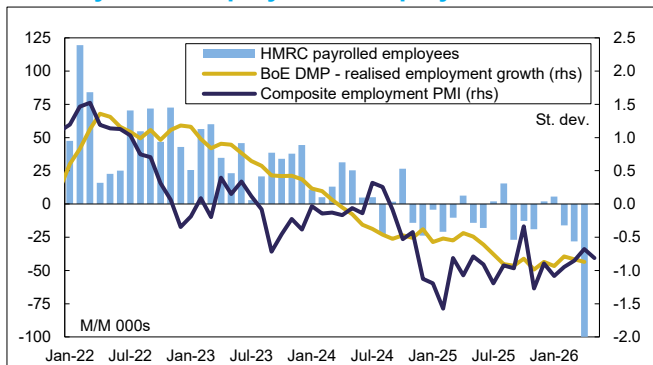
UK: GDP growth & composite output PMI



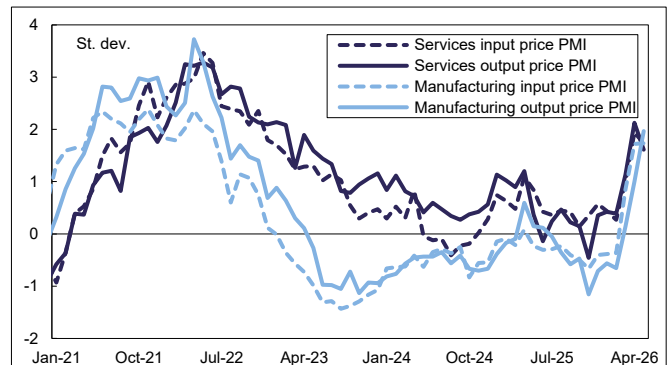
UK: Output & new orders PMIs



UK: Payrolled employees & employment indicators



UK: Price PMIs



rising less aggressively than they had been in April, which is perhaps indicative of consumer-facing firms' limited pricing power in the face of weak demand. And, to the extent that input price growth softened slightly too, it also underscores the value of normalising such pipeline pressures in circumventing a more persistent inflationary impulse.

The day ahead in the UK

Thursday should be another relatively quiet day for UK newsflow. The construction PMIs provide the highlight on the data front, which taken alongside today's composite reading will provide a whole-economy perspective on private sector activity in May. As the effects of higher energy prices, supply-chain constraints and tighter financial conditions continue to feed into business conditions, activity is bound to remain subdued. Notwithstanding the volatility of the series, however, the warmer weather and the extent of April's decline – down almost 6pts to a five-month low of 39.7 – suggest that a slower pace of contraction might be expected. Of course, attention will otherwise be centered on the presence of further input price pressures, having reportedly risen at their sharpest rate since June 2020 (81.4), as well as supply-chain constraints. Albeit to a lesser extent, the softness of the latest payroll numbers in the sector might also increase attentiveness to signs of more pronounced weakness in the employment PMI. Otherwise, BoE Governor Bailey – whose comments thus far have given us little reason to doubt that he will continue to seek to hold policy steady in a couple of weeks' time – is also due to give a speech to a conference in London.

European calendar

Today's results						
Economic data						
Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area	Final composite (services) PMI	May	48.5 (47.7)	<u>47.5 (46.4)</u>	48.8 (47.6)	-
	PPI Y/Y%	Apr	4.9	4.9	2.1	2.0
Germany	Final composite (services) PMI	May	48.8 (48.1)	<u>48.6 (47.8)</u>	48.4 (46.9)	-
France	Final composite (services) PMI	May	44.9 (44.3)	<u>43.5 (42.9)</u>	47.6 (46.5)	-
Italy	Composite (services) PMI	May	50.4 (49.4)	50.0 (49.2)	50.5 (49.8)	-
Spain	Composite (services) PMI	May	50.2 (50.1)	48.9 (48.3)	48.7 (47.9)	-
UK	Final composite (services) PMI	May	49.7 (49.3)	<u>48.5 (47.9)</u>	52.6 (52.7)	-
Auctions						
Country	Auction					
UK	sold £1.6bn of 1.125% 2035 inflation-linked bonds at an average yield of 1.515%					

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	08.30	Construction PMI	May	-	41.7	
	10.00	Retail sales M/M% (Y/Y%)	Apr	-0.3 (0.3)	-0.1 (1.2)	
Germany	08.30	Construction PMI	May	-	42.1	
France	08.30	Construction PMI	May	-	38.1	
Italy	08.30	Construction PMI	May	-	44.8	
Spain	08.00	Industrial production M/M% (Y/Y%)	Apr	-0.1 (1.9)	2.3 (1.8)	
UK	09.00	New car registrations Y/Y%	May	-	24.0	
	09.30	Construction PMI	May	40.5	39.7	
Auctions and events						
Euro area	09.00	ECB President Lagarde to speak in Aix-en-Provence				
France	09.50	Auction: to sell up to €14bn of 3.7% 2036, 4% 2038, 3.6% 2042 & 4.4% 2057 bonds				
Spain	09.30	Auction: to sell 2.35% 2029, 3.1% 2031, 3.5% 2041 bonds & 2.05% 2039 inflation-linked bonds				
UK	16.40	BoE Governor Bailey to give speech at the Investment Association annual conference, London				

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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