

Euro wrap-up

Overview

- Bunds made modest losses while euro area construction data pointed to growth in Q2 buoyed by the ongoing uptrend in infrastructure.
- While the MPC kept Bank Rate unchanged and BoE staff revised down their near-term inflation outlook, Gilts underperformed at the short end.
- Focus in the UK on Friday will be on the outcome of the Makerfield by-election, while retail sales, public finances and consumer confidence data are also due.

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Daily bond market movements

Bond	Yield	Change
BKO 2½ 06/28	2.596	+0.014
OBL 2½ 04/31	2.663	+0.007
DBR 2.9 02/36	2.920	-0.006
UKT 4¾ 03/28	4.172	+0.033
UKT 4¾ 03/31	4.300	+0.017
UKT 4¾ 10/35	4.746	-0.004

*Change from close as at 4:30pm BST.
Source: Bloomberg

Euro area

Construction output on track for growth in Q2 buoyed by ongoing uptrend in infrastructure

Having been broadly flat in Q4 and contracted in Q1, construction output looks set to make a positive contribution to euro area GDP growth in Q2 and by the most in five quarters. Total production in construction rose in April for a second successive month and by 0.6%M/M to a 14-month high 1.6% above the average level in Q1. Supported by fiscal policy initiatives, civil engineering activity maintained its firm uptrend, rising 0.8%M/M to an 18-year high some 5% above the Q1 average. Building construction was relatively subdued, edging down 0.1%M/M, but was still 1% above the Q1 average level. Buoyed by increased spending on public infrastructure as well as specialist activity, German construction output rose 2.4%M/M to be more than 4% above the Q1 average. Elsewhere, Spanish output was almost 3% above its Q1 average, although that was flattered by exceptional strength in civil engineering activity, which might be revised down in coming months. And construction output in April was stuck below the respective Q1 averages in France and the Netherlands.

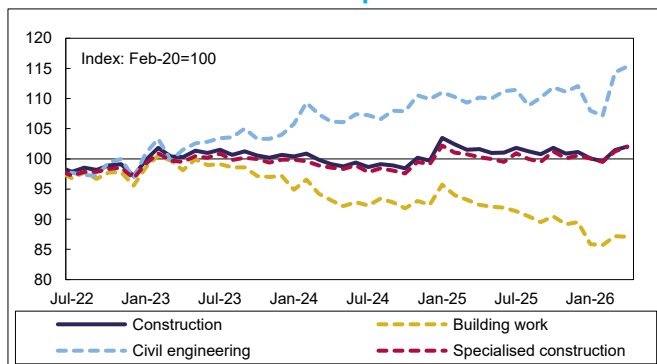
Recovery in sector should be sustained in H26 if US-Iran deal holds & ECB acts with restraint

Not least due to cost and supply pressures from the Middle East and a tightening of financial conditions, confidence in among construction firms – as in other business sectors – has deteriorated over recent months. Indeed, the Commission's construction confidence index fell in May to the lowest level since end-2024. And the headline construction PMI ticked up only slightly last month to suggest a pace of contraction that had only been exceeded once in the past 15 months. However, we expect public infrastructure spending, including projects related to NGEU funds, to sustain growth in the second half of the year. And if the US-Iran deal holds to allow for a sustained normalisation of freight transit through the Strait of Hormuz, energy prices fall and supply constraints ease, and the ECB resists its urge to tighten monetary policy into restrictive territory, then new building activity related to housing and business structures might finally turn for the better before the year is out.

The day ahead in the euro area

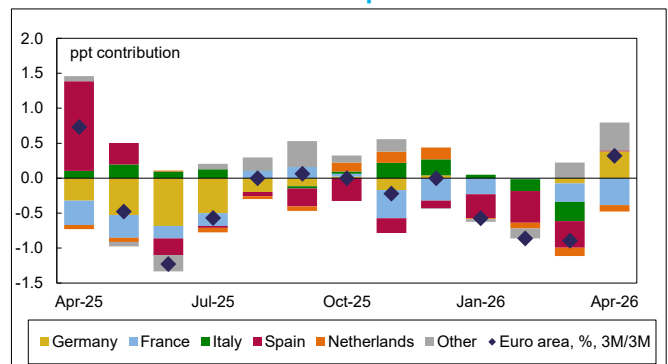
It will be a relatively quiet end to the week for euro area data, with German producer price inflation figures for May marking the sole release from the largest member states. This release will provide the first official view as to whether underlying cost pressures in the industrial sector showed signs of broadening out last month. Producer input prices have risen sharply since the start of the war, lifting PPI inflation by 5ppts to 1.7%Y/Y in April. But those pressures – at least so far – have been largely contained within sectors most directly exposed to the effects of the oil shock and energy-intensive manufacturers. We expect the monthly increase in producer prices in May to be the softest since February. But, a further moderate increase in PPI inflation in May to around 2½%Y/Y looks likely before a slight moderation in June as oil prices receded.

Euro area: Construction output



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Construction output*



*NB Italian data for April 2026 not yet published. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK

BoE's MPC votes 7-2 to keep Bank Rate at 3.75% where it will likely remain into 2027

As was widely anticipated, the BoE's MPC today left Bank Rate unchanged at 3.75%, its level since December. In line with our expectation, the decision was backed by seven members of the Committee, only one fewer than at the previous meeting in April. External member Megan Greene joined Chief Economist Huw Pill in voting for a hike this month. And the minutes suggested that one further external member, Catherine Mann, might be close to voting for tighter policy as she shared many of the hawks' concerns about upside risks to inflation. Among other things, the two who voted for a hike today feared a possible de-anchoring of inflation expectations to the upside and flagged risks that financial conditions might relax excessively in the absence of a rate hike. But perhaps except Mann, the other members seem to have reinforced their confidence that disinflation had been well entrenched before the conflict. And with recent inflation outturns having significantly undershot the BoE's expectation, the Bank staff having reduced their baseline forecast for the next couple of quarters by ¼-½ppt (to under 3%Y/Y and a little over 3¼%Y/Y) and the upside risks to energy prices diminished, the majority thought that underlying disinflation could be sustained and saw no urgency to tighten policy today. Indeed, the tightening of financial conditions since the conflict continues to weigh on underlying price pressures while – as illustrated in today's data – the labour market is probably still loosening. So, inflation might well return to target over the horizon without higher rates. Certainly, given the views of a majority of MPC members expressed today (see table) as well as recent shifts in energy prices, we now think that Bank Rate will be left unchanged into 2027 and that the next move in rates will be down.

BoE June 2026: MPC members' views

MPC member	Vote	Selected quotes from the MPC minutes
Governor Bailey	3.75%	<p>"Our remit recognises that attempting to bring inflation back to the target too quickly may cause undesirable volatility in output. Given the context at present of softness in the real economy and uncertainty around... energy prices, tolerating temporarily above-target inflation... is an appropriate way to approach the trade-off"</p> <p>"I am content at the present time with holding, while accepting that risks to inflation and interest rates are on the upside... I would respond promptly to any signals that an extended period of elevated energy prices could be leading to stronger possible second-round effects."</p>
Deputy Governor Lombardelli	3.75%	"It is too early to draw any conclusions on second-round effects... So far the evidence is mixed and the signal is broadly consistent with standard pass-through... there are risks for inflation in both directions... [if signals] indicate inflation would persist above target, this would require policy to respond more forcefully..."
Deputy Governor Breeden	3.75%	"The economic environment means the chance of material second-round effects is small... The financing conditions facing households and firms have tightened materially since the conflict, leaning against inflationary pressures and leaving us well placed to monitor how the economy evolves."
Deputy Governor Ramsden	3.75%	"I continue to place about equal weight on Scenarios A & B materializing after the summer, but even less weight than before on Scenario C... [Early] indications suggest that second-round effects might be limited, absent further escalation... My reaction function will remain state-contingent on [the conflict] and what that means for the outlook."
Swati Dhingra	3.75%	"Absent the shock, monetary policy would be too restrictive... I see the balance of risks to the upside on prices and downside on activity... If the situation were to worsen, this may warrant some further tightening. But I do not see a compelling case to increase Bank Rate preemptively without new evidence of more intense first-round shocks."
Alan Taylor	3.75%	"Recent data point further against a need for tightening... Policy is restrictive, 75bps above my estimate of neutral... we have tightened a lot just by holding... Absent worse news, I cannot see a case for tightening now, and an active hold is reasonable. If the conflict resolution holds, and risks diminish, lower rates could be preferred."
Catherine Mann	3.75%	"With rapid resolution [in the Middle East], activity rebounds, uncertainty clears, but energy prices remain high with infrastructure and inventory rebuild: an activist hike could be needed... [I have time to evaluate] inflation expectations and financial restrictiveness to determine whether [prices and wages] are on a target-consistent path..."
Megan Greene	4.00▲	"[Given uncertainty about second-round effects], we should pursue a risk management strategy... we should insure against the possibility of larger second-round effects until we have evidence [that] they are not materialising. A proactive hike now in Bank Rate should help anchor inflation expectations."
Chief Economist Pill	4.00%	"Upside risks to the lasting achievement of the 2% inflation target have increased in recent months... raising Bank Rate to 4% continues to be the most robust monetary policy response to the intensification of [inflation] risks... [this would] put the MPC in a good place from which to respond to the evolution of events from here."

▲ Indicates an upwards change in vote since April. Source: BoE (June 2026 Monetary Policy Summary & Minutes) and Daiwa Capital Markets Europe Ltd.

Drop in unemployment flattered by rising inactivity, while vacancies fall & redundancy notices rise

At face value, today's labour market report presented mixed signals, with lower unemployment, hints of stabilisation in payrolls but also further moderation in underlying private pay growth. On balance, however, the data remain consistent with persistent labour market slack, which should limit the risk of second-round inflation effects. Despite a predictable upwards revision to April's payroll estimate, the adjusted drop of 53k still represented the steepest drop since late 2020 to be down 94k over the three months to April. And while the flash May estimate was broadly stable, employment gains were narrowly concentrated in education and administrative and support services, suggesting a lack of momentum in labour demand. Indeed, the LFS measure of employees fell by almost 70k in the three months to April, with the 100k rise in total employment accounted for by self-employment. While this contributed to a 0.3ppt decline in the unemployment rate over the quarter to

4.9%, that remains above the BoE's estimate of equilibrium. Moreover, the decline was flattered by a marked increase in inactivity, particularly among older workers and those with caring responsibilities. Meanwhile, job vacancies continued to edge lower in May to a five-year low, almost 100k below the 2019 pre-pandemic average. And with redundancy notifications in May rising the most since mid-2020, we continue to expect the jobless rate to pick up gradually over coming quarters.

Public sector pay growth temporarily higher, but private regular pay growth softest in 5½ years

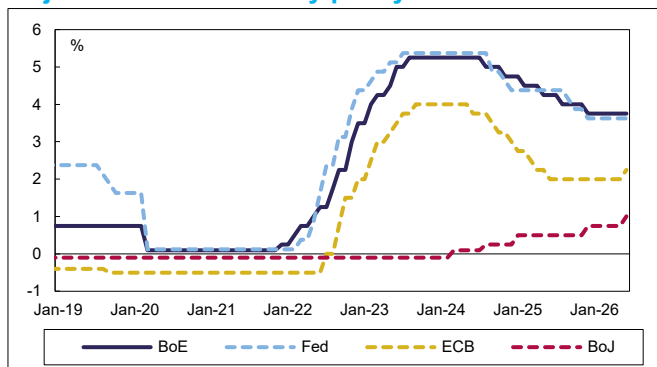
Total pay growth was revised higher in the three months to March and remained unchanged at 4.4%3M/Y in April, 0.3ppt higher over the quarter and in line with the average for the past year. But that was exaggerated by the timing of public sector settlements. And underlying trends continue to point to easing wage pressures. Most importantly, private regular pay growth eased to 2.9%3M/Y, the softest rate since October 2020, slightly below the BoE's projection for Q2 and only about ½ppt above the level (on a composition-adjusted basis) that the BoE judges to be consistent with meeting the inflation target over the medium term. The moderation was broad-based with regular pay growth in services, manufacturing and construction at multi-year lows. Momentum suggests that private pay growth will remain sub-3%Y/Y over the near term. And with inflation set to rise above 3%Y/Y for a while, real regular pay growth – which stood at just 0.1%3M/Y in April – looks set to slip into negative territory, posing a further headwind to household spending.

The day ahead in the UK

While de-escalation in the Middle East might have offered some upside to consumer confidence this month, its impact on Friday's GfK release will likely be muted by the survey's sampling period. And against the backdrop of weak hiring and the erosion of real incomes by higher inflation, consumer confidence will probably have remained broadly downbeat, reinforcing expectations for subdued household consumption growth this quarter. Retail sales volumes already fell sharply in April as households cut back on fuel consumption in response to higher prices (-1.3%M/M) to leave the sector on track to weigh on GDP growth this quarter. A modest rebound in May – reflecting a marginal improvement in fuel sales and firmer footfall in the warmer weather – should be insufficient to compensate for that initial weakness or significantly alter those expectations.

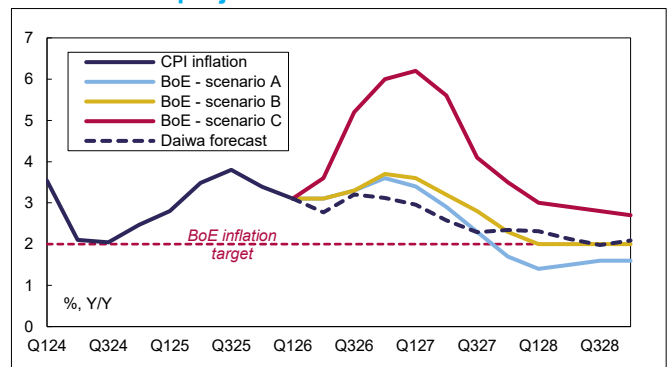
But the biggest story in the UK on Friday will be the outcome of the Makerfield byelection which will have significant bearing on Keir Starmer's future as Prime Minister. The result will be declared in the early hours of the morning. We expect the Labour Party's Greater Manchester mayor Andy Burnham – who at present appears to be Britain's most popular politician – to win the seat and thus secure his route back to Westminster. As we outlined [last week](#), Burnham would then be expected to challenge Starmer for his leadership by Autumn at the latest. Indeed, reports this week suggested that Starmer's grace period might be as short as 72 hours. Broadly, we would characterise Burnham's soft-left (and at times populist) policy

Major central banks: Key policy rates



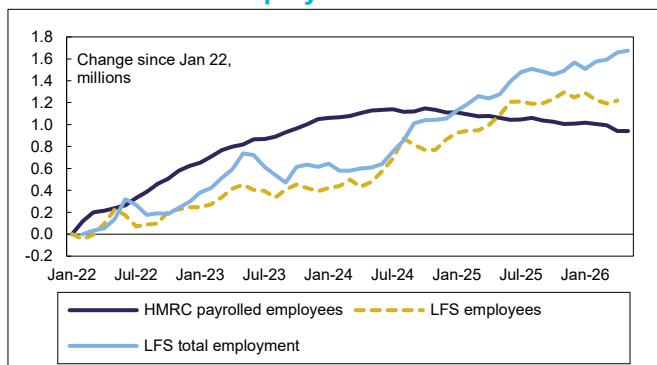
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Inflation projections



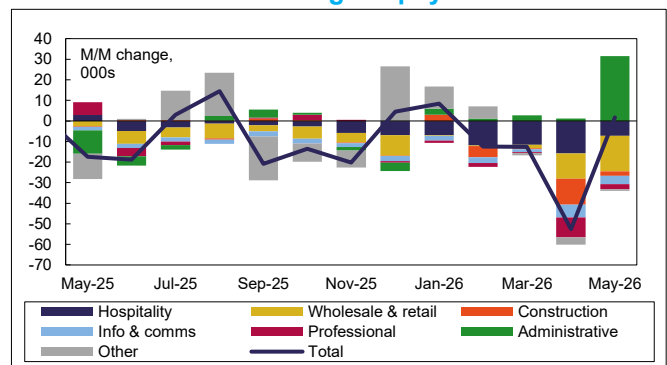
Source: BoE Apr-26 MPR, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Measures of employment



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

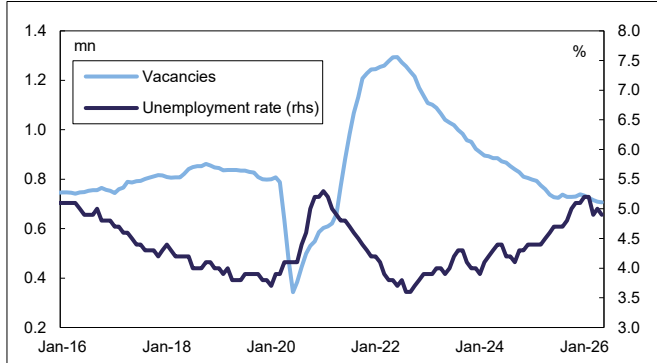
UK: Contribution to change in payrolls



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

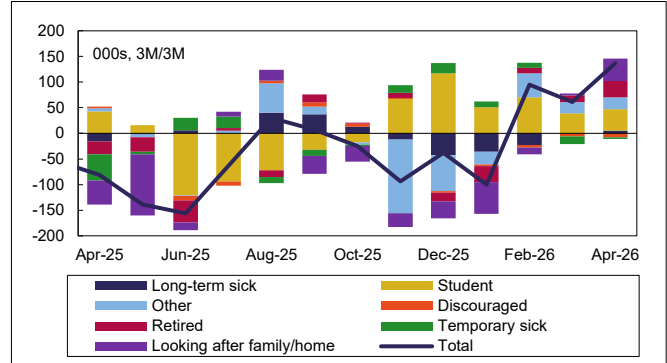
agenda as slightly more interventionist than Starmer's, with greater public control over (if not ownership of) certain utilities. We would expect only limited tweaking of the government's fiscal rules, leaving targeted additional hikes in taxation required to fund increased public spending. For his part, Starmer has reiterated that he would contest any challenge to his leadership. But that doesn't look particularly credible. And given the contrast in their favourability ratings among both the general public and Labour membership, he would certainly struggle to win that hypothetical contest.

UK: Unemployment rate & job vacancies



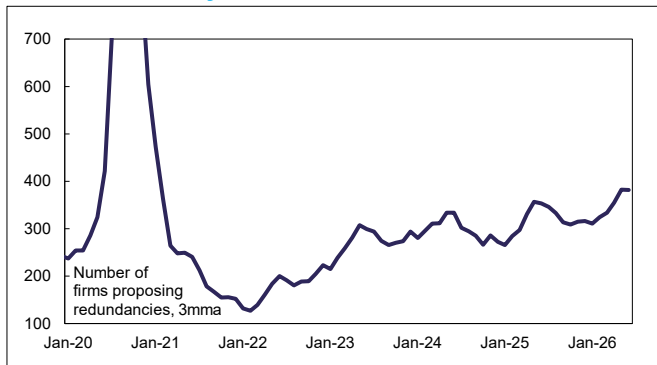
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Reasons for leaving the labour force



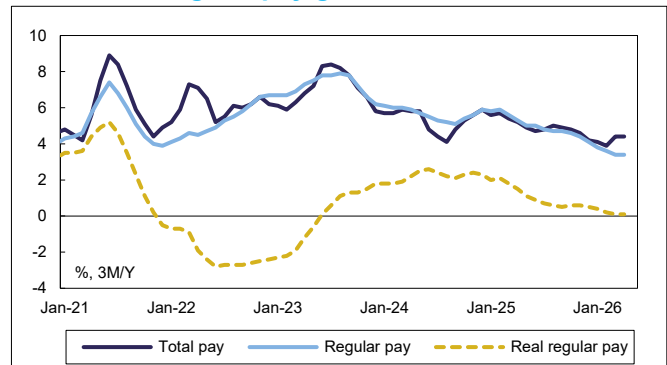
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Redundancy notices



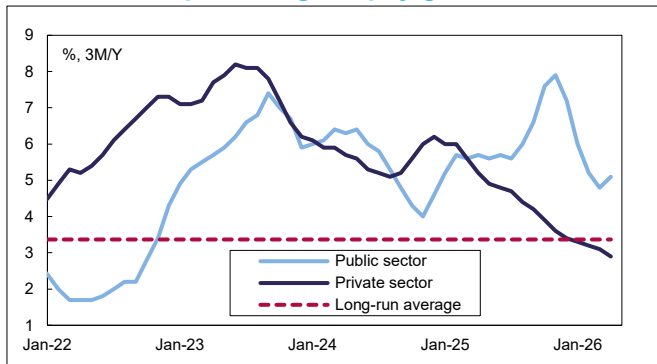
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Total & regular pay growth



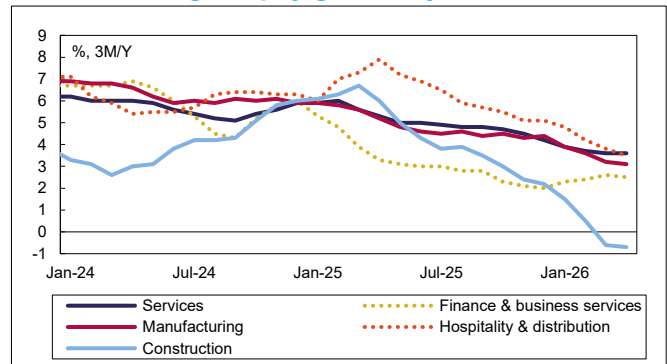
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Private & public regular pay growth



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Private regular pay growth by sector











Source: Macrobond 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	 Construction output M/M% (Y/Y%)	Apr	0.6 (0.9)	-	0.8 (-1.2)	1.7 (0.2)
UK	 BoE Bank Rate %	Jun	3.75	<u>3.75</u>	3.75	-
	 Average wages (excluding bonuses) 3M/Y%	Apr	4.4 (3.4)	4.0 (3.2)	4.1 (3.4)	4.4 (3.1)
	 Private sector regular wages 3M/Y%	Apr	2.9	<u>2.9</u>	3.0	-
	 Unemployment rate 3M%	Apr	4.9	5.0	5.0	-
	 Employment 3M/3M change 000s	Apr	100	73	148	-
	 Payrolled employment M/M change 000s	May	2	-23	-100	-53
	 Claimant count rate % (change 000s)	May	4.5 (31.2)	-	4.4 (26.5)	- (8.3)






Auctions

Country	Auction
France	 sold €4bn of 2.4% 2029 bonds at an average yield of 2.85%
	 sold €5.30bn of 3.25% 2032 bonds at an average yield of 3.13%
	 sold €2bn of 2% 2032 bonds at an average yield of 3.22%
	 sold €2.67bn of 3% 2034 bonds at an average yield of 3.45%
	 sold €465mn of 3.15% 2032 inflation-linked bonds at an average yield of 1.10%
	 sold €465mn of 0.1% 2038 inflation-linked bonds at an average yield of 1.72%
	 sold €328mn of 1.8% 2040 inflation-linked bonds at an average yield of 1.79%
Spain	 sold €1.95bn of 3% 2033 bonds at an average yield of 3.032%
	 sold €2.55bn of 2.4% 2036 bonds at an average yield of 3.383%
	 sold €1.33bn of 4.9% 2040 bonds at an average yield of 3.635%


Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Germany	 07.00	PPI Y/Y%	May	2.5	1.7
UK	 00.01	GfK consumer confidence indicator	Jun	-23	-23
	 07.00	Retail sales – incl. auto fuel M/M% (Y/Y%)	May	0.5 (1.8)	-1.3 (0.0)
	 07.00	Retail sales – excl. auto fuel M/M% (Y/Y%)	May	0.3 (3.1)	-0.4 (1.1)
	 07.00	Public sector net borrowing £bn	May	18.9	24.3

Auctions and events

UK	 -	Results of the Makerfield parliamentary by-election to be announced
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Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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