Euro wrap-up

Overview

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- Shorter-dated Bunds followed USTs higher, while euro area IP slipped back in May but remained on track to support GDP growth in Q2.
- Gilts outperformed as media reports suggested that Prime Minister-in-waiting Burnham was likely to avoid appointing a relatively market unfriendly Chancellor.
- Thursday will bring May data for euro area goods trade and UK GDP.

Daily bond market movements

Bond	Yield	Change
BKO 2.7 09/28	2.728	-0.014
OBL 2½ 04/31	2.830	-0.001
DBR 3 08/36	3.118	+0.007
UKT 4⅜ 03/28	4.305	-0.038
UKT 4⅛ 03/31	4.491	-0.029
UKT 4¾ 10/35	4.934	-0.041

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

Euro area

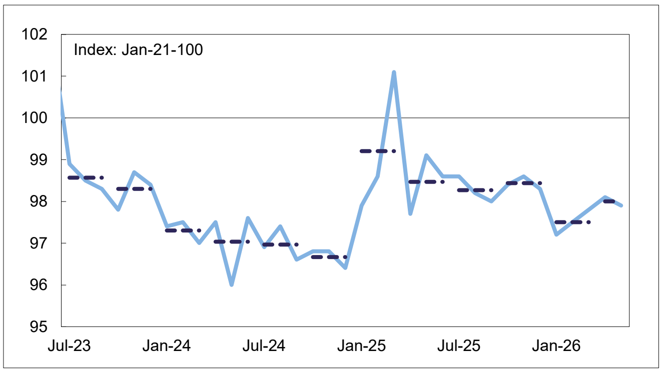
Euro area IP fell back in May as precautionary inventory boost started to fade

Consistent with survey evidence that precautionary stock-building activity following the initial energy shock is beginning to fade, euro area industrial production declined in May for the first month in four (-0.2%M/M). But that followed an upwardly revised increase in April (0.3%M/M). Moreover, the weakness in May was exaggerated by a sharp fall in Ireland (-5.2%M/M). And despite the monthly decline, the broader picture remained relatively upbeat. Output continued to expand in Germany and Spain. And despite flatlining in May, output in France and Italy was also trending in the first two months of Q2 almost 1% above the Q1 average, while production in the Netherlands was almost 2% higher on the same basis. As such, euro area industrial production was trending some ½% above the Q1 level, with manufacturing on track to record the first quarter of growth since Q125 (0.8%). Production of coke and refined petroleum fell for the first time in four months (-2.8%M/M). And output in other energy-intensive subsectors including chemicals, glassware and paper also declined after strong gains over the previous months. In contrast, there was continued growth in fabricated metals. And output of ammunition remained close to record highs, while production of military vehicles jumped to a new series high as higher government defence spending continued to boost activity. Meanwhile, AI-related demand helped production of computer and electronic equipment to trend almost 6% above the Q1 average. In contrast, although autos production rose in May, it was still tracking some 3½% below the Q1 average, illustrating the continued challenges of intense competition and changing consumer preferences.

Near-term production outlook may be restrained by tighter supply constraints

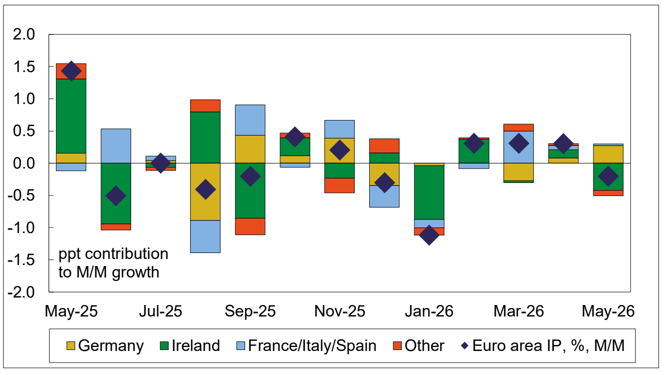
The near-term outlook for manufacturing activity remains highly uncertain. While the manufacturing PMI suggests continued expansion, the Commission surveys points to a further contraction in June, with momentum seemingly weakening across intermediate, capital and consumer goods sectors alike. Delivery delays and shortages of key inputs, in part due to the conflict in the Middle East, suggest that supply constraints are binding more tightly, including in energy-intensive industries. Nevertheless, provided supply bottlenecks ease, prospects for many subsectors appear broadly encouraging. Surveys suggest that orders picked up again in Q2, with the respective Commission index rising to the highest level in four years and the equivalent PMI measure in June broadly in line with the long-run average. German manufacturing order backlogs continue to trend higher across a range of sectors, most notably electrical and ICT equipment, fabricated metals, and non-auto transport equipment. The Commission survey also points to growing optimism among producers of ICT and electrical equipment at the euro area level. And the twin drivers of AI-related investments and government military spending, as well as the likelihood of a rebound in pharmaceuticals after US tariff-related weakness, all point to the likelihood of continued resilience in industrial production through the second half of the year.

Euro area: Industrial production*



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

Euro area: Country contributions to IP growth

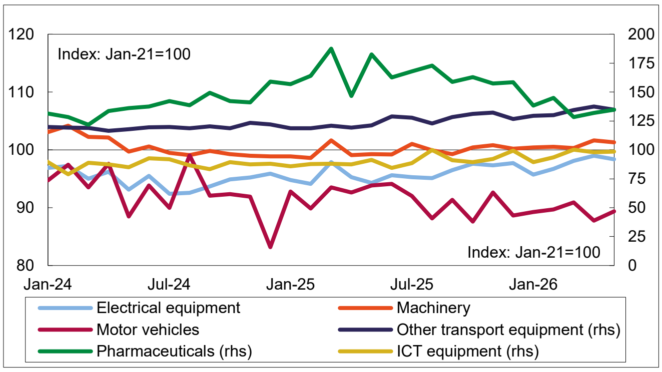


Source: Macrobond and Daiwa Capital Markets Europe Ltd.

The day ahead in the euro area

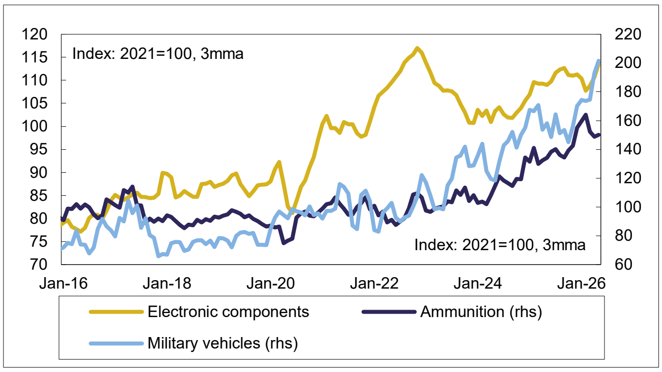
Following on from today's IP release, Thursday's euro area goods trade figures for May will further inform assessments of economic activity last quarter. Goods exports notably subtracted from GDP growth in Q1 after weakening at the end of 2025 amid soft demand from the US and China. More recently, costlier energy imports have further narrowed the region's nominal trade surplus and will continue to do so. But export growth has at least shown resilience, potentially benefitting from the efforts of manufacturers to shore up inventories as a precaution ahead of possible supply disruptions. Indeed, while also supported by higher prices, euro area exports have risen for three consecutive months in value terms, and goods trade data from Germany in May suggest that a fourth-consecutive monthly rise – in this case led by shipments to the US and China – might be on the cards. Otherwise, Italian inflation figures for June will provide the final detail from the largest member states ahead of Friday's equivalent euro area release.

Euro area: Manufacturing production



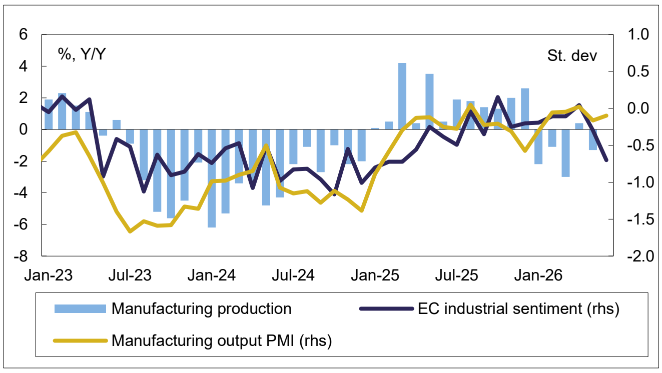
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: AI- & defence-related production



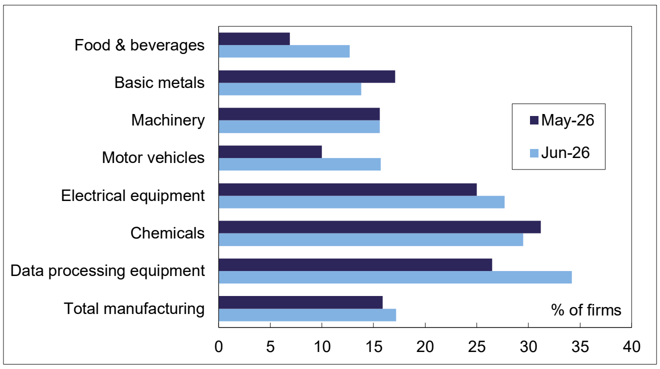
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Manufacturing output & survey indices



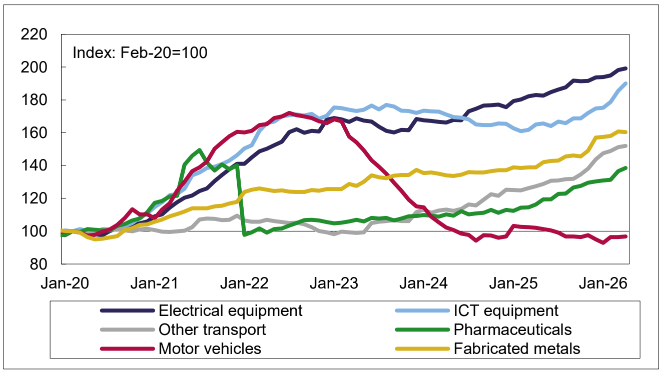
Source: S&P Global, EC, Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Firms reporting material shortages



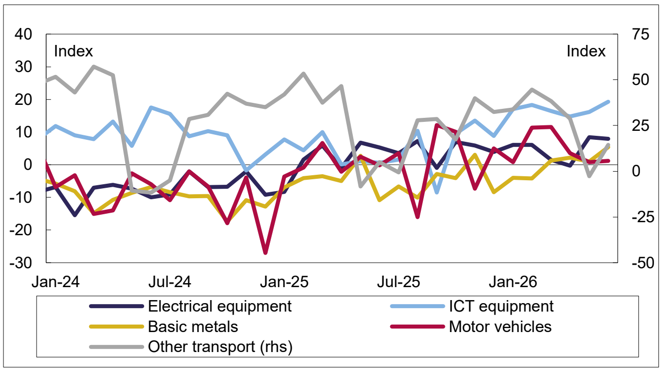
Source: ifo institute and Daiwa Capital Markets Europe Ltd.

Germany: Manufacturing order backlogs



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Production expectations indices*



Source: EC, Macrobond and Daiwa Capital Markets Europe Ltd.

UK

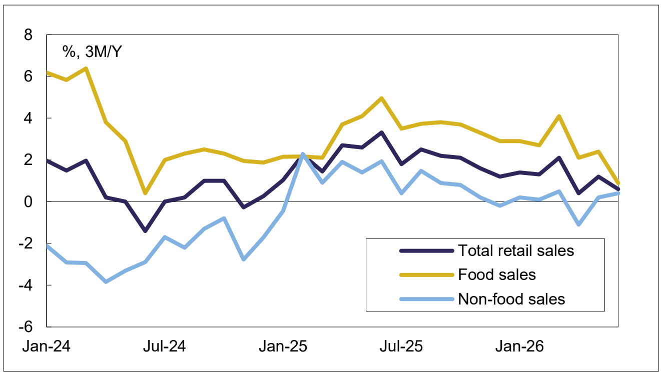
BRC retail sales growth slows despite boost from the heatwave and start of the Football World Cup

Despite a reported boost from the ongoing record heatwave and the start of the Football World Cup, yesterday's BRC retail monitor suggested that sales growth slowed last month. The survey's measure of sales values rose 1.9%Y/Y in June, in line with the average in the previous 12 months, but nevertheless down from 3.7%Y/Y in May. Like-for-like sales growth also slowed sharply, halving to 1.7%Y/Y. Looking through monthly volatility, the picture was softer still. Like-for-like sales growth of 0.6%3M/Y was the second weakest reading in 18 months and more than 1ppt below the average over that period. Growth in food sales was the softest in two years (1.5%3M/Y), while non-food sales on the high street remained lacklustre (0.5%3M/Y). That weakness partly reflected a sharp decline in footfall, as hot weather discouraged trips. By contrast, online non-food sales growth accelerated to 4.5%3M/Y, its fastest pace since February 2025, reflecting strong demand for fans and air conditioners. Today's survey was also flattered by rising prices. When adjusting for the BRC shop price index, total sales volumes rose a modest 0.7%Y/Y. And smoothing for recent monthly volatility, sales volumes were broadly flat (-0.1%3M/Y), while like-for-like volumes fell (-0.5%3M/Y). Looking ahead, with the GfK survey suggesting that household purchase intentions for coming months have not been lower since October 2024, and real incomes set to be squeezed again by higher energy prices, we expect consumer spending on big-ticket items to be lacklustre through to the autumn and likely beyond.

The day ahead in the UK

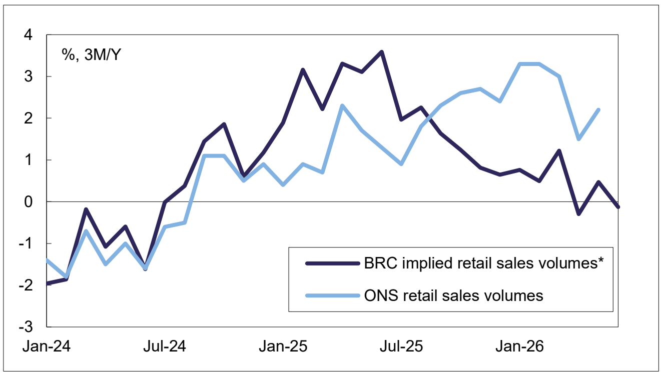
May's UK monthly GDP report will provide the highlight of Thursday's dataflow. GDP growth accelerated 0.6%Q/Q in Q1, the firmest rate in two years. And momentum edged up further in April (0.7%3M/3M) despite a fall in output on the month (-0.1%M/M) as the boost from stockpiling and higher consumption ahead of expected price rises in March faded and disruption to major sporting events in the Middle East further subtracted. Unfortunately, a second successive contraction in May cannot be confidently ruled out. The PMIs were indicative of a sharp drop in business activity, with the dominant services sector reportedly contracting (49.3) for the first month since April 2025. May's retail sales figures suggest that consumer-facing services probably fared slightly better in the warm weather. But softening housing market activity probably provided some offset, while the effects of tighter financial conditions, rising material costs and extreme temperatures raise downside risks for construction activity. Surveys suggest that the manufacturing sector offered ongoing support as firms continued to rebuild inventories and front-run production ahead of possible supply pressures, but the recent strength might limit their support. So, overall, we expect monthly GDP to have flatlined in May, consistent with a moderation in three-month growth to 0.5%3M/3M. And with underlying activity likely still subdued and favourable base effects rolling off in June, we expect GDP growth in Q2 eventually to be printed as roughly half that figure. Finally, in politics, the necessary support for Andy Burnham from affiliated unions and groups will be confirmed, clearing the final hurdle before he is formally announced as Labour Party leader on Friday.

UK: BRC survey retail sales values



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Retail sales volumes



**Adjusted by BRC shop price inflation.*
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Daiwa Capital Markets

European calendar

Today's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area	Industrial production M/M% (Y/Y%)	May	**-0.2 (-1.2)**	*-0.2 (-0.7)*	0.1 (0.3)	0.3 (0.4)
Spain	Final HICP (CPI) Y/Y%	Jun	**3.6 (3.2)**	*3.6 (3.2)*	3.6 (3.2)	-

Auctions

Country	Auction
Germany	sold €759mn of 0% 2052 bonds at an average yield of 3.65%
	sold €753mn of 2.5% 2054 bonds at an average yield of 3.64%
	sold €768mn of 2.9% 2056 bonds at an average yield of 3.64%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tuesday's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Germany	Wholesale prices M/M% (Y/Y%)	Jun	**-0.7 (4.9)**	-	-0.6 (5.9)	-
UK	BRC retail monitor – like-for-like sales Y/Y%	Jun	**1.7**	2.7	3.4	-

Auctions

Country	Auction
Germany	sold €4.22bn of 2.7% 2028 bonds at an average yield of 2.77%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Euro area	10.00	Trade balance €bn	May	2.5	1.3
Italy	09.00	Final HICP (CPI) Y/Y%	Jun	*3.1 (3.0)*	3.2 (3.2)
UK	07.00	Monthly GDP M/M% (3M/3M%)	May	*0.0 (0.5)*	-0.1 (0.7)
	07.00	Services output M/M% (3M/3M%)	May	0.1 (0.6)	-0.2 (0.8)
	07.00	Industrial output M/M% (Y/Y%)	May	0.1 (1.3)	0.0 (-0.2)
	07.00	Construction output M/M% (Y/Y%)	May	-0.3 (-1.2)	0.1 (-1.0)
	07.00	Trade (goods trade) balance £bn	May	-5.0 (-22.9)	-8.4 (-26.0)

Auctions and events

Country	BST	Auction / event
France	09.50	Auction: to sell up to €14bn of 2.4% 2029, 1.5% 2031, 3.25% 2032 & 3.5% 2033 bonds
	10.50	Auction: to sell up to €1.5bn of 0.1% 2032, 1.8% 2040 & 0.1% 2053 inflation-linked bonds
Spain	09.30	Auction: to sell 2.35% 2029, 3.55% 2033 & 3.95% 2056 bonds
UK	10.00	Auction: to sell £4.25bn of 4.875% 2036 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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