

Euro wrap-up

Overview

- Bunds followed USTs lower, while final euro area inflation estimates confirmed a drop in the headline rate but a slightly larger uptick in core inflation.
- Gilts made sizeable gains as UK inflation eased more than expected in July, albeit core and services inflation eased only slightly.
- Tomorrow will bring July survey results for euro area consumer confidence and French business confidence, along with German producer price figures.

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Daily bond market movements

Bond	Yield	Change
BKO 3.1 09/25	3.035	+0.013
OBL 2.4 10/28	2.504	+0.032
DBR 2.6 08/33	2.427	+0.052
UKT 0% 06/25	4.845	-0.197
UKT 1% 10/28	4.291	-0.164
UKT 3¼ 01/33	4.202	-0.126

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

Source: Bloomberg

Euro area

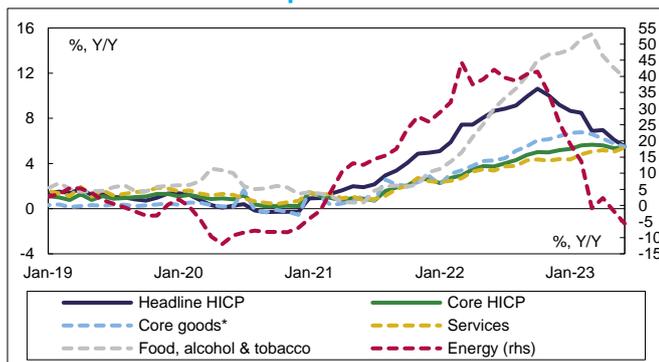
Final euro area inflation confirms drop in headline rate, but core rate nudged slightly higher

Today's final estimates of euro area consumer price inflation in June confirmed that the headline HICP rate fell for a second successive month and by 0.6ppt to 5.5%Y/Y, more than 5ppts below October's peak and the lowest since January 2022. And with the exception of Germany and Croatia, inflation eased across the member states. Admittedly, the decline was principally due to the continued easing in energy and food inflation. Indeed, falling household electricity prices meant that energy inflation dropped to -5.6%Y/Y in June, the steepest decline since end-2020. And with the rise in food prices in June close to the seasonal norm – in marked contrast to the record rise for the month a year ago – the respective inflation component fell for a third successive month, albeit remaining elevated at 11.6%Y/Y. In terms of the core components, prices of non-energy industrial goods fell for the first time since January. That pushed annual core goods inflation lower for a fourth successive month, by 0.4ppt to 5.5%Y/Y, driven by softer inflation of cars and household appliances, which offset upwards pressure from clothing. At the same time, various services components were more favourable in June, with moderations in package holidays, eating out and accommodation services – the latter falling to its lowest since February 2022. But base effects associated with Germany's super-discounted public transport fares last summer, which pushed euro area passenger transport costs up a whopping 57.3ppts to 38.6%Y/Y, meant that services inflation rose in June by 0.4ppt to a series-high of 5.4%Y/Y. And, due principally to rounding, today's release brought a very modest upwards revision to core inflation to leave it up 0.2ppt at 5.5%Y/Y in June, albeit still 0.2ppt below March's record high.

Other measures of underlying inflation eased further in June

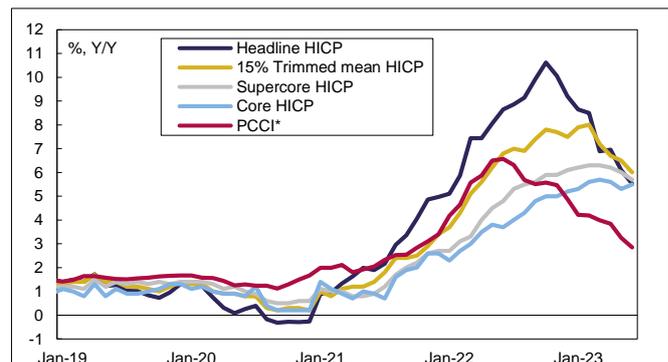
The modest uptick in core inflation, nevertheless, still left the quarterly average (5.5%Y/Y) bang in line with the ECB's projections published last month. Moreover, in line with global developments in the manufacturing sector, momentum in core goods prices has faded significantly. And services prices have risen more closely in line with seasonal norms over the past two months too. Several other measures of underlying price pressures showed further improvement in June. For example, the 15% trimmed mean HICP inflation fell 0.5ppt to a fourteen-month low of 6.0%Y/Y, 2.0ppts below February's peak. And the ECB's supercore measure of the most output gap-sensitive items also fell 0.3ppt to a nine-month low of 5.7%Y/Y, while the persistent and common component measure of inflation dropped 0.4ppt to 2.9%Y/Y, the lowest since October 2021. Of course, base effects associated with the German government's €9 public transport ticket last summer, as well as the increased basket weight on package holidays, will keep services inflation elevated over coming months. And, while the share of items in the CPI basket with inflation of 3% or more eased slightly to a six-month low, it remained at a still-lofty 80%, suggesting still widespread price pressures. As such, while we expect core inflation to take a step down in Q4, it will still likely be double the ECB's 2% target at year-end, and only fall to 2% in late 2024. And so, when the ECB meet in the coming

Euro area: Consumer price inflation



*Non-energy industrial goods. Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

Euro area: Selected measures of inflation



*Persistent and common components of inflation. Source: ECB, Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

week, alongside a further 25bps interest rate hike this month, we continue to expect the Governing Council to signal the likelihood of a further rate increase in September too.

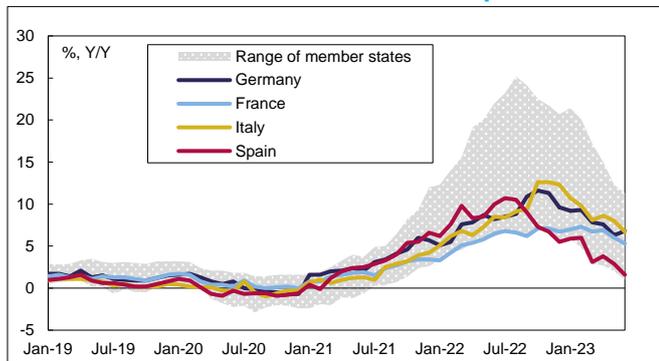
Construction output edged higher in May, but likely to be a drag on GDP growth in Q2

In terms of today's activity data, euro area construction output broadly aligned with expectations, rising a modest 0.2%M/M in May. Given the recent monthly profile – significant growth earlier in the year thanks to favourable weather followed by a cutback in the spring – construction activity was little changed from its level in January and still some 3% above the pre-pandemic level. Nevertheless, having risen by almost 2½%Q/Q in Q1, output was trending so far in Q2 some 1% below the Q1 average, suggesting that it will provide a modest drag on euro area GDP growth last quarter. The performance among member states was mixed, with construction trending below the Q1 average in Germany (-1.0%), Italy (-3.8%) and the Netherlands (-1.2%), but higher in France (1.2%) and Spain (0.9%). The overall weakening in the euro area reflected a further adjustment in building work, which fell for the third consecutive month in May (albeit by a modest -0.1%M/M), to leave it trending 1.2% below the Q1 average. Despite the easing of supply constraints, the outlook for the sector remains relatively downbeat as the impact of tighter lending conditions and economic uncertainties weigh on demand. Indeed, the Commission's latest survey suggested that almost a quarter of firms cited demand as a limiting factor on output, while order books were assessed to be the weakest since early 2021. With building permits down some 19%Y/Y in March, and the housing sector continuing to be impacted by softer price growth and higher borrowing costs, we expect growth in the sector to remain lacklustre over coming quarters.

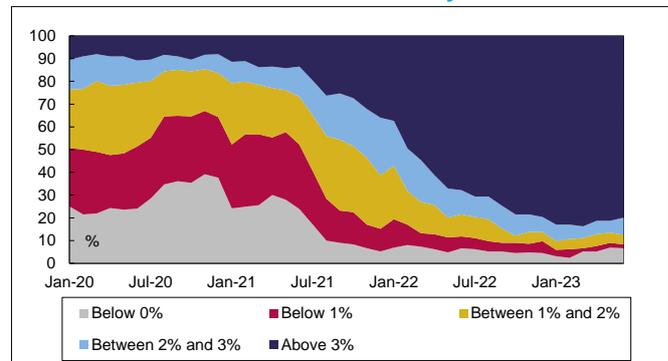
The day ahead in the euro area

Focus in the euro area tomorrow will turn to sentiment, with the European Commission flash consumer confidence estimate for July due to provide some insights into household behaviour at the start of Q3. While the headline sentiment index is forecast to have improved for the ninth month out of the past ten to be some 13pts above September's trough, it will still remain well below the long-run average. The French INSEE business survey, meanwhile, is expected to report that confidence moved sideways in July, with the index (100) bang in line with the long-run average. Finally, Germany's producer price inflation figures will offer further insight into the outlook for core consumer goods inflation over coming quarters.

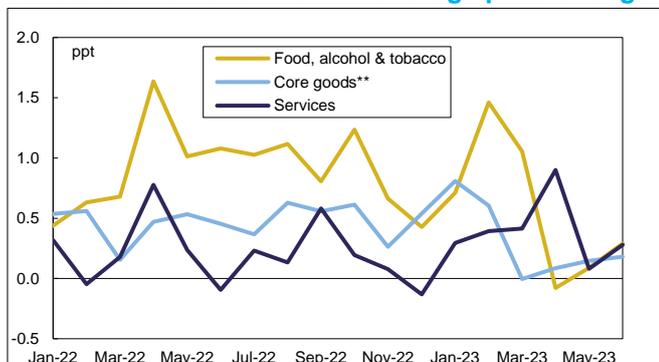
Euro area member states: Consumer price inflation



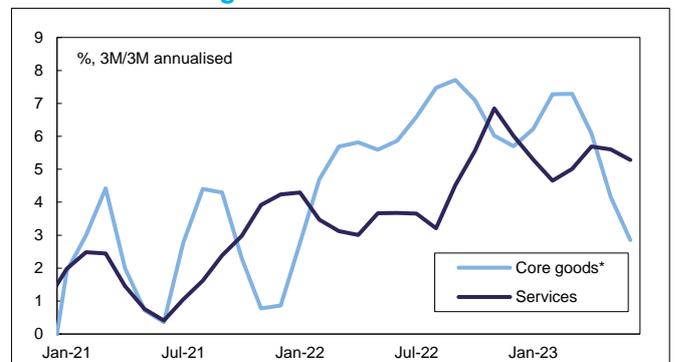
Euro area: Share of HICP basket by inflation rates



Euro area: Deviation from I-r average price change*



Euro area: Core goods and services momentum



UK

UK inflation eases more than expected in June, but still consistent with significant tightening ahead

Having repeatedly exceeded expectations over recent months, today's UK inflation numbers brought a welcome downwards surprise. In particular, the marked slowdown in the monthly increase in consumer prices in June (0.1%M/M) – which was bang in line with the long-run average for the first time in five months – saw the headline CPI rate decline a steeper-than-expected 0.7ppt to 7.9%Y/Y, the lowest for fifteen months and more than 3ppts below October's peak. Importantly for the BoE, with the monthly increase in core prices (0.2%M/M) also the softest for five months, the annual core CPI rate eased for the first time since January, by 0.2ppt to 6.9%Y/Y, having been expected to move sideways at May's three-decade high. The share of items in the basket with rising inflation also fell back sharply to the lowest since late-2020. But while the share of items in the basket with inflation of 3% or more eased to the lowest since February, at 80% it still suggests that price pressures remained widespread. Moreover, despite easing in June, headline inflation was still on average in Q2 (8.4%Y/Y) 0.2ppt above the BoE's forecast in May, with core inflation averaging 6.9%Y/Y, some 0.8ppt higher than in Q1.

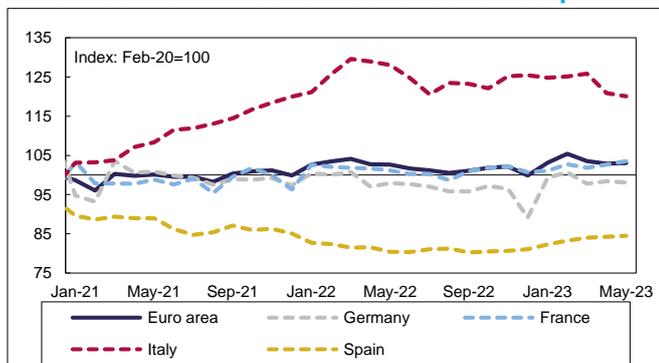
Services inflation eases slightly, but remained well above the BoE's forecast

Within the detail, the downwards shift in headline inflation was largely driven by lower petrol prices (-23%Y/Y), which meant that energy inflation eased more than 5ppts to 3.2%Y/Y, the lowest since March 2021. With the monthly increase in food, alcohol and tobacco prices having eased markedly in June due to lower prices of dairy and eggs, the annual rate of that component (14.9%Y/Y) also moderated for a second successive month, albeit remaining historically high. And with the monthly drop in core goods prices (-0.3%M/M) in line with the seasonal average for the first time since September 2021, inflation of non-energy industrial goods fell 0.4ppt to 6.4%Y/Y, pushed lower by furniture and furnishings, books and pet products. Of course, most focus in today's release was on services, for which inflation edged slightly lower, by 0.2ppt to 7.2%Y/Y, with higher insurance premiums partially offsetting easing accommodation costs. But this still left services accounting for more than 40% of total inflation, and on average in Q2 (7.2%Y/Y) 0.5ppt above the BoE's forecast.

Inflation set to moderate further over coming months but not enough to prevent further tightening

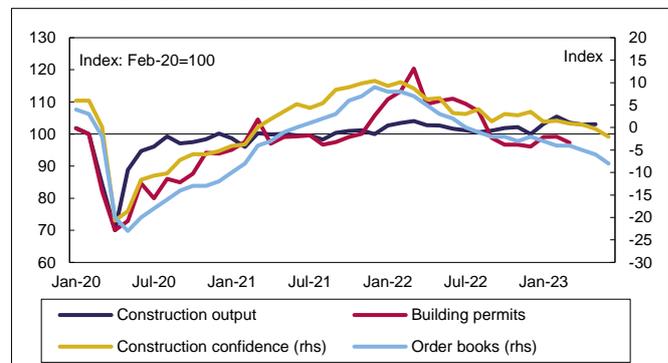
Looking ahead, the cut in the regulated household energy price cap this month will push energy inflation into negative territory at the start of Q3, with base effects likely to support further disinflation in food over coming months too. And a further marked step down in producer core output price inflation in June (down 0.9ppt to a two-year low of 3.0%Y/Y) also suggests that core goods inflation should moderate further. But the further uptick in [private sector wage growth](#) in May suggests that

Euro area member states: Construction output



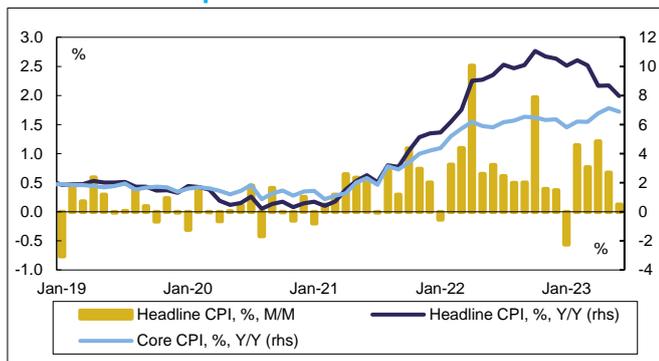
Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Euro area: Construction sector indicators



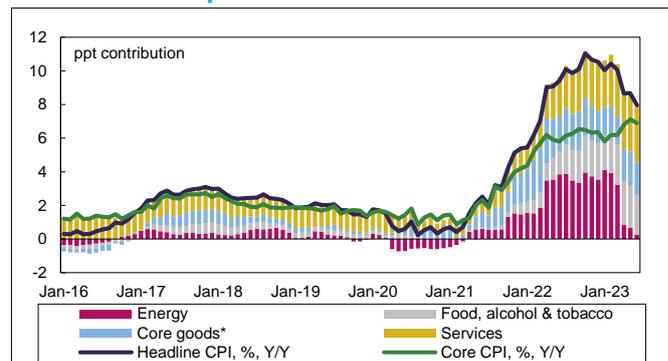
Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

UK: Consumer price inflation



Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

UK: Consumer price inflation



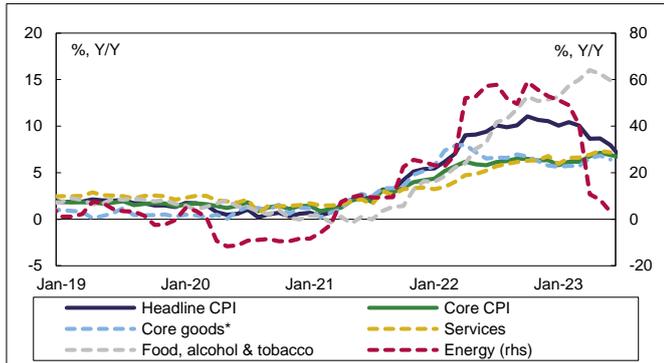
*Non-energy industrial goods. Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

risks to the outlook for services inflation remain skewed to the upside, which will be a significant concern for the MPC. Indeed, we continue to expect core inflation to remain above 5½%Y/Y at the end of this year, with headline and core inflation perhaps unlikely to return to the 2% target before 2025 in the absence of substantive additional tightening. The BoE will need to upwardly revise its inflation projections next month. And while, on balance, today's slightly improved inflation numbers support our view that the MPC will revert to a slower pace of tightening, of 25bps, at its forthcoming policy announcement on 3 August, the decision is likely to be finely balanced and unlikely to be unanimous. Moreover, the MPC will continue to leave the door open for further tightening ahead.

The day ahead in the UK

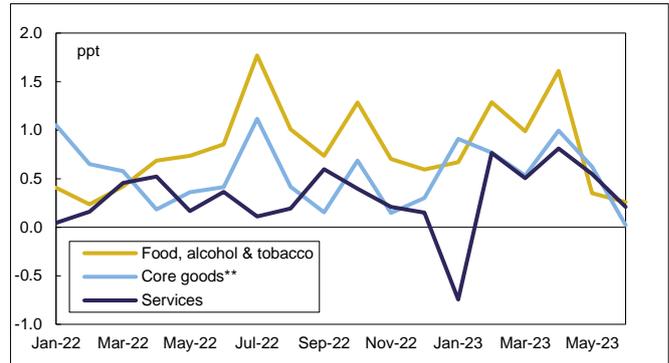
It should be a relatively quiet day ahead for UK economic news, with no top-tier data due for release.

UK: Consumer price inflation



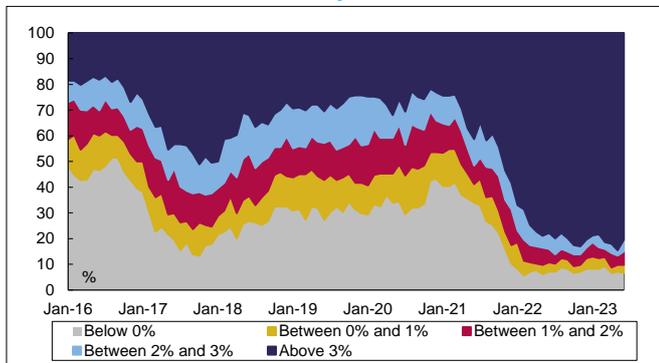
*Non-energy industrial goods. Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

UK: Deviation from I-r average price change*



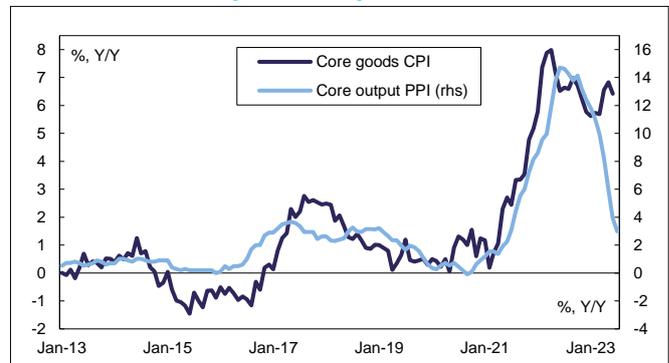
*Deviation from long-run monthly price change **Non-energy industrial goods. Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

UK: Share of CPI basket by inflation rates



Source: ONS and Daiwa Capital Markets Europe Ltd.

UK: Consumer & producer price inflation



Source: Refinitiv Datastream 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	 EU27 new car registrations	Jun	17.8	-	18.5	-
	 Final (core) HICP Y/Y%	Jun	5.5 (5.5)	5.5 (5.4)	6.1 (5.3)	-
	 Construction output M/M% (Y/Y%)	May	0.2 (0.1)	-	-0.4 (0.2)	-0.6 (0.4)
UK	 CPI (core) Y/Y%	Jun	7.9 (6.9)	8.1 (7.0)	8.7 (7.1)	-
	 PPI output (input) prices Y/Y%	Jun	0.1 (-2.7)	0.4 (-1.6)	2.9 (0.5)	2.7 (0.4)
	 House price index Y/Y%	May	1.9	-	3.5	3.2

Auctions

Country	Auction
Germany	 sold €772mn of 0.0% 2052 bonds at an average yield of 2.33%
	 sold €1.20bn of 1.8% 2053 bonds at an average yield of 2.4%
UK	 sold £3.75bn of 4.5% 2028 bonds at an average yield of 4.575%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Yesterday's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
- Nothing to report -						

Auctions

Country	Auction
Germany	 sold €4.96bn of 3.10% 2025 bonds at an average yield of 3.07%
UK	 sold £2.50bn of 3.75% 2053 bonds at an average yield of 4.484%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Monday's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Italy	 Final HICP (CPI) Y/Y%	Jun	6.7 (6.4)	6.7 (6.4)	8.0 (7.6)	-
UK	 Rightmove house price index M/M% (Y/Y%)	Jul	-0.2 (0.5)	-0.2 (0.5)	0.0 (1.1)	-

Auctions

Country	Auction
- Nothing to report -	

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	ECB current account €bn		May	-	3.6
		15.00	European Commission's preliminary consumer confidence		Jul	-15.8	-16.1
Germany		07.00	PPI Y/Y%		Jun	0.0	1.0
France		07.45	INSEE business confidence		Jul	100	100
		07.45	INSEE manufacturing (production outlook) confidence		Jul	100 (-10)	101 (-9)
Auctions and events							
France		09.50	Auction: 2.50% 2026 bonds				
		09.50	Auction: 0.75% 2028 bonds				
		09.50	Auction: 2.75% 2029 bonds				
		10.50	Auction: 0.60% 2034 index-linked bonds				
Spain		09.30	Auction: 2.80% 2026 bonds				
		09.30	Auction: 1.40% 2028 bonds				
		09.30	Auction: 3.90% 2039 bonds				
		09.30	Auction: 1.00% 2050 bonds				

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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