Euro wrap-up

Overview

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- Bunds made losses even as euro area headline inflation was revised slightly lower in August, while most measures of underlying price pressures continued to improve.
- Gilts bucked the global trend making modest gains on a quiet day for UK economic news.
- Wednesday will bring figures for UK consumer prices, German producer prices and euro area construction output.

Daily bond market movements

Bond	Yield	Change
BKO 3.1 09/25	3.276	+0.030
OBL 2.4 10/28	2.763	+0.034
DBR 2.6 08/33	2.736	+0.033
UKT 3½ 10/25	4.998	-0.028
UKT 4½ 06/28	4.541	-0.034
UKT 3¼ 01/33	4.347	-0.039

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

Euro area

Final August inflation revised slightly lower, falling to 19-month low despite higher fuel prices

While euro area inflation initially exceeded expectations in August, today's updated HICP figures brought a modest downwards revision. Indeed, the headline inflation rate is now estimated to have moderated 0.1ppt on the month to 5.2%Y/Y, the lowest since the start of 2022 and less than half the peak in October. Admittedly, this was largely due to rounding, and to two decimal places the revision was negligible at -0.02ppt to 5.24%Y/Y. As highlighted in the preliminary release, the downwards inflationary trend in August was slowed by a pickup in energy prices, which jumped 3.3%M/M – the most since last October – reducing the annual rate of decline in that component by almost 3ppts and halving the drag to -0.3ppt. In particular, annual inflation of motor fuels recorded the first positive reading in six months as the higher price of crude oil was passed on to consumers. In contrast, and contrary to the initial estimate of a modest rise, food prices moved sideways on the month, pushing the respective annual rate down for the fifth consecutive month to a fourteen-month low (9.7%Y/Y).

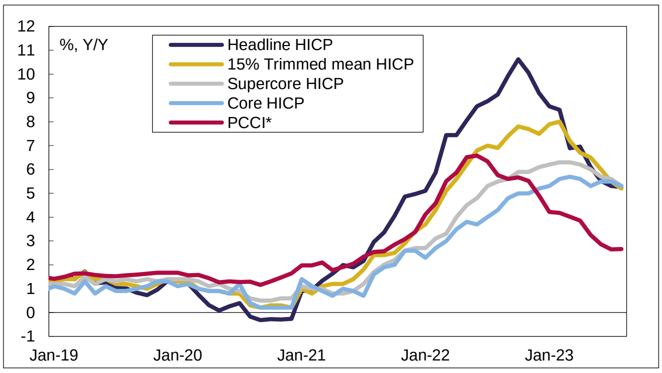
Core goods inflation moderates further but services component still sticky for now

With the ECB's Governing Council focused principally on assessing underlying pressures, developments in the core components remain most important for determining the outlook for monetary policy. And in August, core goods prices continued to benefit from reduced supply constraints and lower input costs. Indeed, non-energy industrial goods inflation moderated 0.3ppt – slightly more than previously thought – to a 13-month low of 4.7%Y/Y. Within the detail, inflation of second-hand cars and household appliances slowed to rates not seen since before Russia's invasion of Ukraine. But as highlighted by the flash release, services inflation remained relatively sticky in August, edging down just 0.1ppt to 5.5%Y/Y. Among the notable components, rents inflation increased to a 26-year high (2.8%Y/Y) while the transport services component remained inflated by base effects associated with last year's discounted German travel pass. Despite the higher oil price, however, inflation of airfares edged slightly lower, as did package holidays and hospitality. Overall, core HICP inflation (excluding energy and all food and related items) was unrevised from the flash estimate at 5.3%Y/Y, down 0.2ppt on the month and 0.4ppt below March's peak.

Underlying price pressures continue gradually to ease

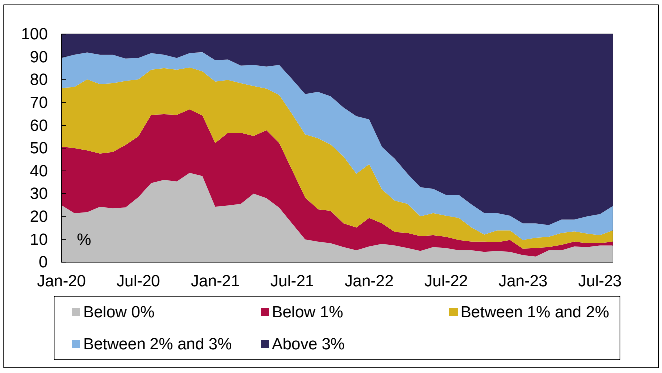
The decline in core inflation should accelerate this month, not least as the distortion from Germany's super-discounted travel pass will drop out of the calculation. And perhaps given the weakening demand outlook, there are signs that momentum in other components of services inflation is moderating as firms appear less confident that they can pass on costs to consumers. Certainly, the monthly increase in services prices in August (0.2%M/M) was in line with the long-run norm for that

Euro area: Consumer price inflation measures



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

Euro area: Share of CPI basket by inflation



Source: Eurostat and Daiwa Capital Markets Europe Ltd.

month for the first time in a year, while the 3M/3M annualised rate fell to an eleven-month low of 4.3%. And while momentum in core goods inflation ticked slightly higher to 3.2%3M/3M annualised, this was still almost 5ppts below last year's peak. Other measures of underlying price pressures showed further improvement too. The 15% trimmed mean HICP rate fell 0.3ppt to a seventeen-month low of 5.2%Y/Y, while the supercore measure of the most output gap-sensitive items edged down 0.3ppt to a thirteen-month low of 5.3%Y/Y. The share of items in the HICP basket with inflation above 2% fell to the lowest this year, albeit still lofty at 86%. And the share of items with increasing inflation fell to just 26%, the lowest for three years. However, the ECB's model-based measure of persistent and common component of inflation (PCCI), which the Bank believes can provide one of the most reliable guides to future inflation, was unchanged above levels consistent with the inflation target, at 2.7%Y/Y.

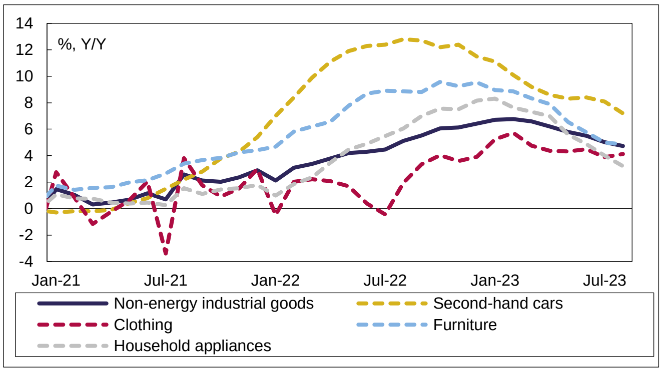
Weaker economic activity to support a faster return to the 2% target than envisaged by the ECB?

The steady upwards trend in the price of Brent crude oil to above $95 per barrel will pose some upside risks to energy inflation over the near term. But this component should continue to provide a negative contribution to headline inflation over coming quarters. Base effects from food inflation will gather pace over coming quarters, subtracting as much as 1.3ppts off headline inflation by next summer. Various indicators of core goods prices – including producer price inflation, manufacturing price PMIs and firms' selling-price expectations – suggest that the disinflationary trend in that component will continue over coming quarters, with weaker global demand helping to tame pipeline pressures. While ongoing resilience in the labour market and strong wage growth will remain a concern for some hawks on the Governing Council, the inflationary consequences will be restrained by the recent loss of demand momentum. Like the ECB, we expect core inflation to remain above 4%Y/Y at the end of this year. But given our expectation of a weaker GDP growth profile, we forecast a faster return of inflation to target. In particular, we think that core inflation should be back below 2.0% in H224 – allowing for a first rate cut in Q3 – and headline inflation back on target at the start of 2025.

The day ahead in the euro area

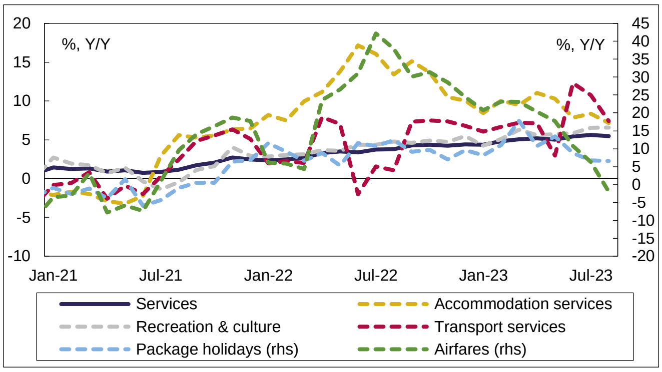
Tomorrow's release of German producer price inflation numbers for August will provide further insight into disinflationary pressures in the goods sector over the summer. Despite the uptick in energy prices, headline PPI inflation is forecast to report the first double-digit decline on record reflecting base effects from last year's spike in energy and food prices. In terms of economic activity, Wednesday's data calendar includes the release of euro area construction output figures for July and new car registrations data for August. Consistent with the partial rebounds in Germany (2.6%M/M) and France (0.6%M/M), we expect euro area construction activity to have risen in July, reversing the 1%M/M contraction in June.

Euro area: Selected goods inflation components



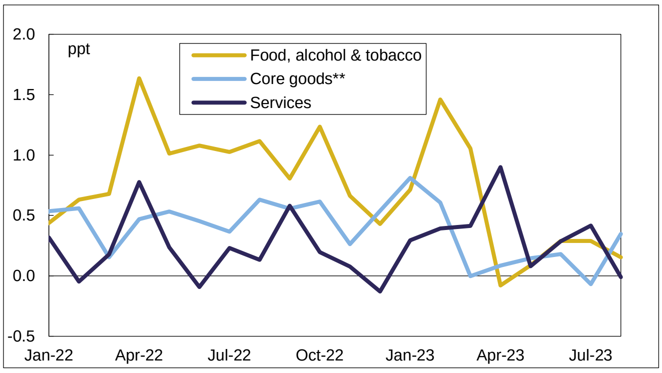
Source: Eurostat, Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

Euro area: Selected services inflation components



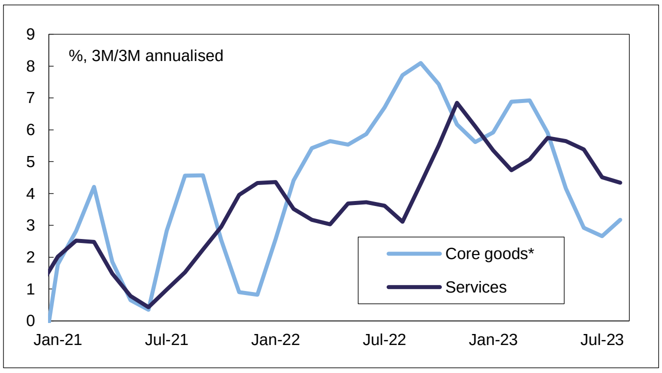
Source: Eurostat, Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

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



**Deviation in M/M rate of price increase from the long-run average for the month. **Non-energy industrial goods. Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.*

Euro area: Services and core goods* inflation



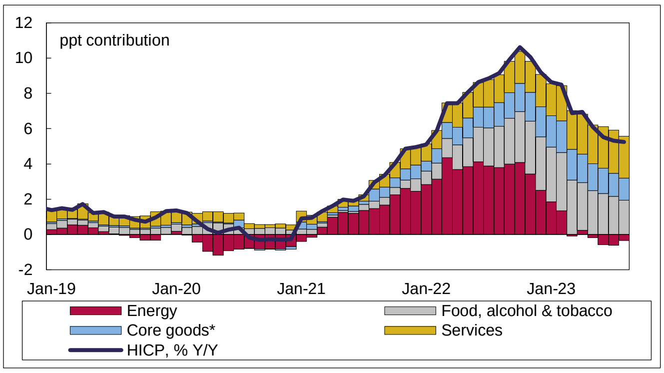
**Non-energy industrial goods. Source: ECB and Daiwa Capital Markets Europe Ltd.*

UK

The day ahead in the UK

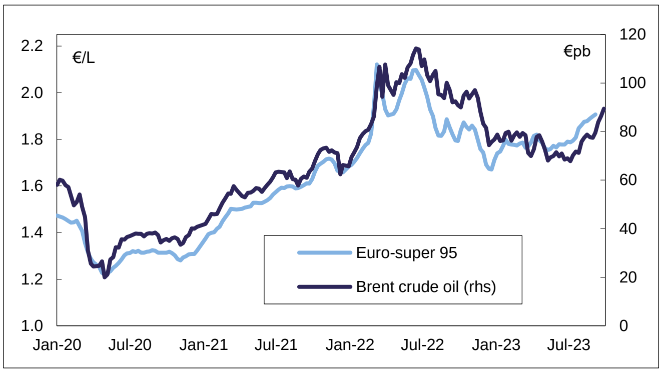
Ahead of the BoE's monetary policy announcement on Thursday, a key focus in the UK tomorrow will be the release of the August CPI report. Given the recent rise in the price of Brent crude oil and associated pick up in petrol prices, headline inflation is likely to have edged slightly higher last month, with our expectation for an increase of 0.3ppt to 7.1%Y/Y. That would still be the second-lowest reading since the Russian invasion of Ukraine and roughly 4ppts below last October's peak. But while we think that services inflation merely moved sideways at a still-lofty 7.4%Y/Y, above the BoE's forecast of 7.1%Y/Y, a further moderation in non-energy industrial goods inflation should see the core CPI rate ease back slightly, by 0.2ppt to a five-month low of 6.7%Y/Y. Despite the recent pickup in energy prices, figures for producer price inflation are also likely to show a continued disinflationary trend at the factory gate. In addition, the latest ONS house price data for July are expected to reveal that the annual rate of growth slowed to just 0%Y/Y, which would be the weakest outturn since spring 2012, with more timely measures of housing market activity suggesting a steeper pace of house price declines going forward too.

Euro area: Contributions to consumer price inflation



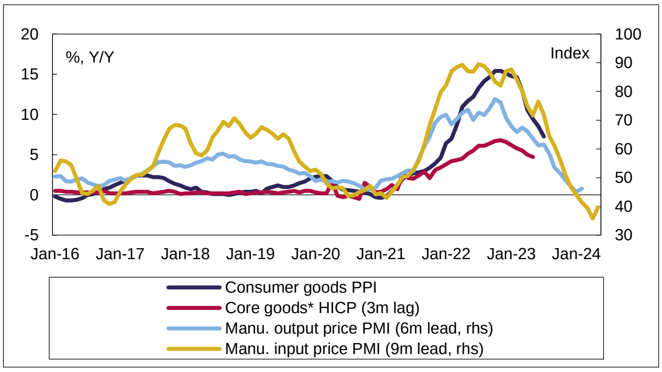
*Non-energy industrial goods. Source: Eurostat, Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

Euro area: Weekly oil and petrol prices*



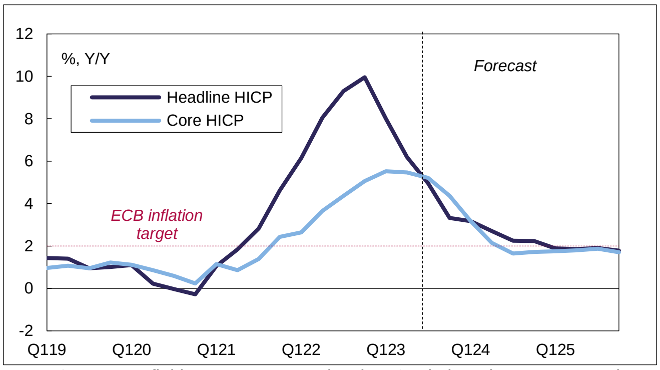
*Oil price has one-week lead. Source: Eurostat, Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

Euro area: Goods price indicators



*Non-energy industrial goods. Source: Refinitiv Datastream, S&P Global and Daiwa Capital Markets Europe Ltd.

Euro area: Consumer price inflation forecast



Source: Refinitiv Datastream and Daiwa Capital Markets Europe Ltd.

European calendar

Today's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area	ECB current account balance €bn	Jul	**20.9**	-	35.8	-
	Final CPI (core) Y/Y%	Aug	**5.2 (5.3)**	*5.3 (5.3)*	5.3 (5.5)	-

Auctions

Country	Auction
- Nothing to report -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Yesterday's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
UK	Rightmove house price index M/M% (Y/Y%)	Sep	**0.4 (-0.4)**	-	-1.9 (-0.1)	-

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/ *Daiwa forecast*	Previous
Euro area	07.00	EU-27 new car registrations Y/Y%	Aug	-	15.2
	10.00	Construction output M/M% (Y/Y%)	Jul	-	-1.0 (-0.3)
Germany	07.00	PPI Y/Y%	Aug	-12.6	-6.0
UK	07.00	CPI (core) Y/Y%	Aug	*7.1 (6.7)*	6.8 (6.9)
	07.00	PPI output (input) Y/Y%	Aug	-0.6 (-2.6)	-0.8 (-3.3)
	09.30	House price index Y/Y%	Jul	-	1.7

Auctions and events

- Nothing scheduled -

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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