Euro wrap-up

Overview

Chris Scicluna
+44 20 7597 8326

Emily Nicol
+44 20 7597 8331

- Bunds were mixed as final euro area inflation estimates confirmed stickiness in services, but alternative measures of underlying inflation moderated.
- While headline UK inflation remained at the 2% target in June, Gilts made losses as services inflation significantly beat the BoE's expectations.
- The ECB will leave its interest rates and forward guidance unchanged tomorrow, while the UK's labour market report and French government bond auctions will also be in focus.

Daily bond market movements

Bond	Yield	Change
BKO 2.9 06/26	2.767	+0.014
OBL 2½ 10/29	2.392	+0.008
DBR 2.6 08/34	2.418	-0.005
UKT 0⅛ 01/26	3.968	+0.024
UKT 0½ 01/29	3.907	+0.026
UKT 4⅝ 01/34	4.074	+0.027

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

Euro area

Final June inflation data confirm stickiness in services

Ahead of tomorrow's ECB monetary policy announcement, today's final euro area consumer price inflation figures for June provided no major surprises, aligning with the flash estimates published at the start of this month. As such, while policy always looked bound to be left unchanged tomorrow, today's figures failed to clarify whether rates are more or less likely to be cut again at the following Governing Council meeting in September. Today's data confirmed that, in line with the original consensus forecast, headline inflation edged down 0.1ppt in June to 2.5%Y/Y, which left the Q2 average bang in line with the ECB's projection, also 2.5%Y/Y. But also in line with the flash estimate, the core rate (excluding all food, tobacco and energy) of 2.9%Y/Y was unchanged from May, 0.2ppt above April's 26-month low and the original expectation. It also left the average core rate in Q2 (2.8%Y/Y) a touch above the ECB's projection. Most notably given the ECB's current reaction function, the stickiness in services inflation in June was also reaffirmed, with the rate of 4.1%Y/Y matching the highest since October. And while services price momentum on a three-month annualised basis moderated 0.4ppt to a three-month low of 5.1%, this was above the flash estimate and remained firmly above the average of the past twelve months.

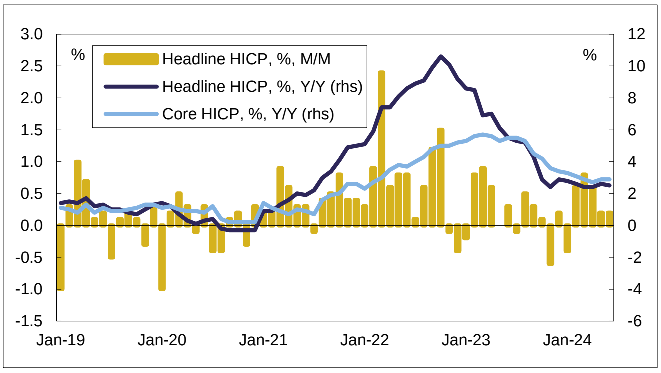
No evidence of new impetus to main sources of services pressure

Today's detailed data, which were published for the first time, suggested that there were no significant new positive impulses to services inflation in June, with inertia the main theme across most of the subcomponents, particularly those that have seen most recent pressures. In terms of consumer-facing activities, inflation of accommodation was steady at a seven-month high (6.1%Y/Y) as a cooling in the hotel category was offset by a pickup in holiday centres and camping. But inflation of restaurants and related venues moderated for the fifth successive month to the lowest in more than two years (4.7%Y/Y). And inflation of package holidays fell 1.0ppt from May's six-month high (7.7%Y/Y). The very slight increase in recreational and cultural services (5.0%Y/Y) likely reflected the impact of one-off events. In terms of remote services, the most notable source of recent pressure – insurance – moderated very slightly for a second successive month (8.8%Y/Y) as a softening of the motor vehicle and healthcare components was largely offset by a pickup in the home-related category.

Goods inflation remains soft in core and non-core components alike

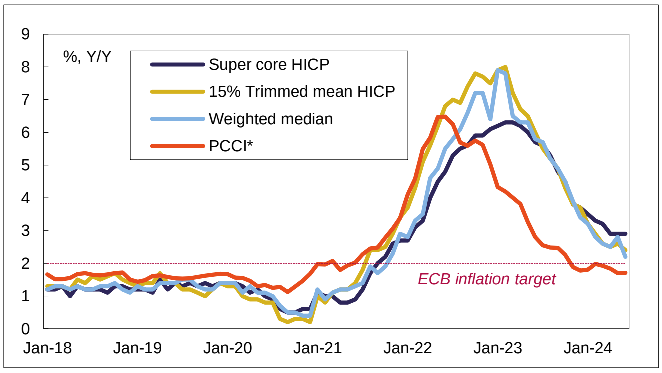
With prices down on the month for the first month in five, core goods inflation was unchanged at a three-year low of 0.7%Y/Y. As a result, however, on a three-month basis, momentum in this category turned slightly negative for the first time since December 2020 to be consistent with recent weakness in producer prices. Within the detail, inflation of cars (1.0%Y/Y) and household furnishings and equipment (0.0%Y/Y) fell to the lowest levels since 2020, offsetting a pickup in clothing and

Euro area: Consumer price inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: elected measures of underlying inflation*



**Persistent and Common Component of inflation. Source: Macrobond and Daiwa Capital Markets Europe Ltd.*

footwear (1.7%Y/Y). Meanwhile, the non-core inflation components both moderated in June. Energy prices fell for the third month out of the past four. With a drop in the auto fuel component more than offsetting a pickup in electricity and gas, energy inflation nudged down 0.1ppt to just 0.2%Y/Y. Finally, the disinflationary trend in food, alcohol and tobacco was a touch stronger than previously estimated, with the respective annual rate down 0.2ppt to 2.4%Y/Y, the softest since November 2021.

Services inflation to remain elevated over the near term but headline rate to fall back in Q3

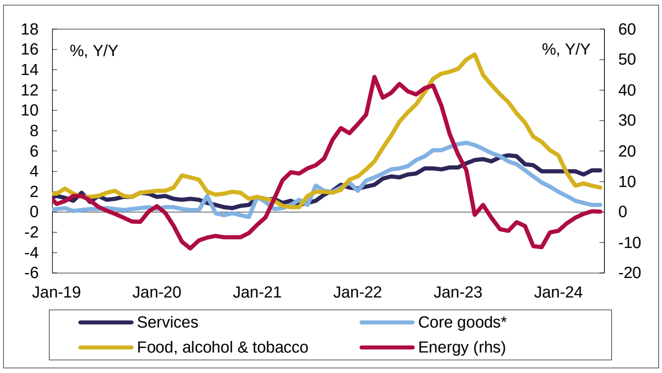
While core inflation was disappointingly steady in June, alternative indicators of underlying price pressures continued to soften. For example, the 15% trimmed mean rate declined 0.2ppt to 2.4%Y/Y, the lowest since September 2021. The weighted median rate declined 0.6ppt to 2.2%Y/Y, the lowest since October 2021. And the share of items in the basket with inflation less than 2.0%Y/Y rose to 50% similarly for the first time since October 2021. However, the near-term inflation outlook remains uncertain, with the Paris Olympics likely to provide a new impetus to prices of certain services, especially hospitality, in July. And with demand seemingly firm and wage growth still strong by historical standards, overall, we expect services inflation to remain close to their current elevated level through to spring next year. Meanwhile, although a range of hard data and leading indicators suggest that factory pipeline pressures remain minimal, we doubt that core consumer goods inflation has much further to fall. So, like the ECB, we expect core inflation to oscillate close to the current rate until the end of the year. The disinflationary path for food might also be close to an end. And while base effects will push energy inflation back into negative territory over the next few months, the profile of household electricity and gas tariffs remains uncertain in many countries including France. So, we expect the headline HICP rate to fall back close to the 2% target in Q3 – to allow for a further rate cut in September – before rebounding temporarily in Q4 and into Q1.

The day ahead in the euro area

The ECB is bound to leave the key deposit rate unchanged at 3.75% when its monetary policy meeting concludes tomorrow. The Governing Council will also repeat the key points of last month's forward guidance, i.e. that it's "not pre-committing to a particular rate path", will keep "rates sufficiently restrictive for as long as necessary" and will also maintain "a data-dependent and meeting-by-meeting approach". While ECB President Lagarde will insist again that the future path of rates will depend on incoming data, she might hopefully also give an indication of the Governing Council's reaction function with respect to those figures. But she probably won't give a clear steer that a rate cut is coming in September.

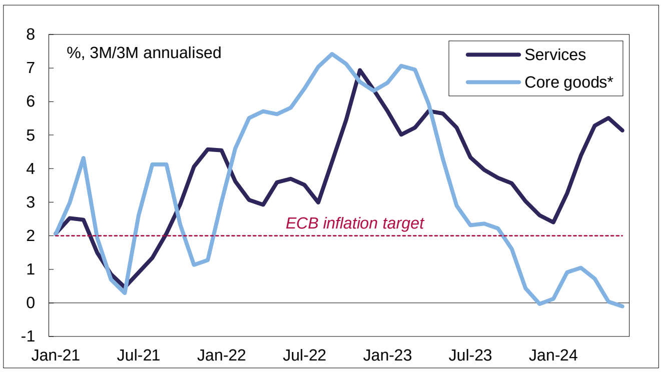
Focus in the euro area tomorrow will also turn to France, where the Treasury plans to sell up to €11.5bn of 2027-2032 bonds, as well as inflation-linked securities, in the first OAT auction since the election resulted in a hung parliament. As with the prior

Euro area: Key HICP components



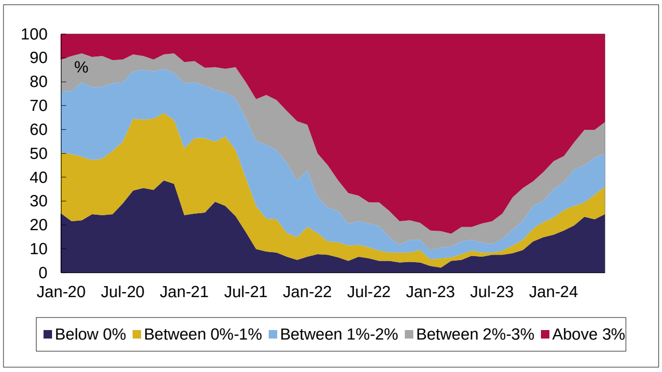
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Core inflation momentum



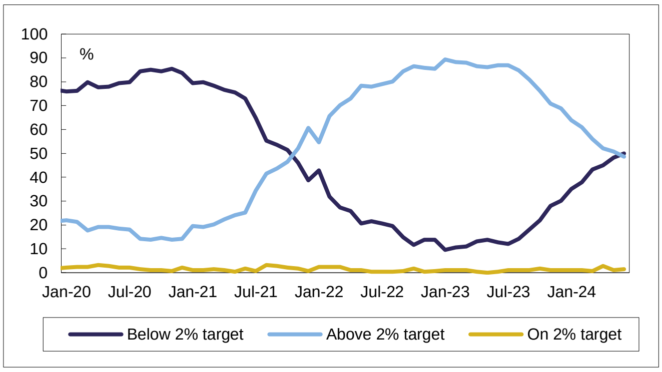
**Non-energy industrial goods. Source: Macrobond and Daiwa Capital Markets Europe Ltd.*

Euro area: Share of HICP basket by inflation rate



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Share of HICP basket above/below target



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

auction on 4 July, we expect demand to be ample albeit with the recent re-pricing of spreads locked in. Attention in France will also be on the French National Assembly, where MPs will meet for the first time since the election to appoint a new President for the chamber. The first two rounds of voting will probably fail to deliver the required absolute majority for any candidate. But with the third-round vote based on a first-past-the-post system, it is likely to result in the appointment as National Assembly President of a member of the left-wing New Popular Front alliance.

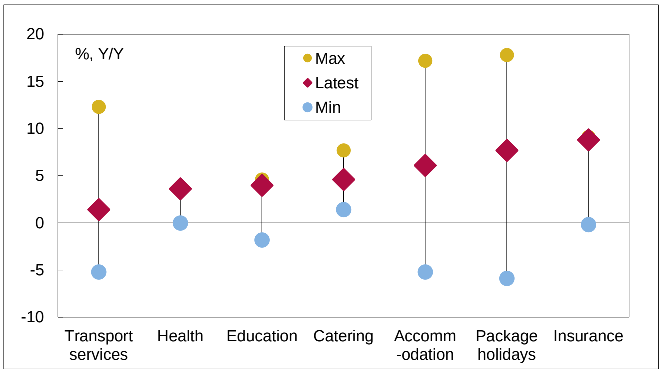
In terms of data, tomorrow will bring euro area construction activity for May. National figures published so far have been mixed, with a steep decline in Germany (-3.3%M/M) contrasting with continued growth in France (1.6%M/M). Meanwhile, euro area new car registration figures are likely to report a return to growth in June following a decline of almost 4.0%Y/Y in May. Indeed, based on national releases – including Germany (6.1%Y/Y), France (5.1%Y/Y) and Italy (15.0%Y/Y) – euro area car registrations are expected to rise 6½%Y/Y, to leave them up 5%YTD/Y.

UK

Headline inflation unchanged at 2% target amid subdued goods inflation

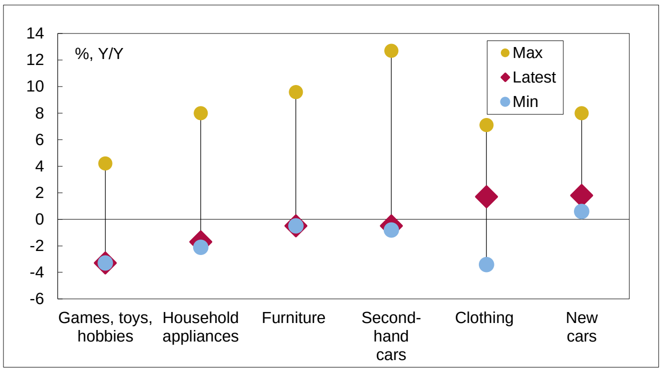
While it remained below the equivalent rates in the US and euro area, UK CPI inflation slightly exceeded expectations in June, with the ongoing stickiness in core inflation and services in particular suggesting that the outcome of the MPC's next policy meeting at the start of August remains too close to call. Headline inflation moved sideways in June at the BoE's 2.0%Y/Y target, in line with Bank's expectation for that month. And, over Q2 as a whole, headline inflation (2.1%Y/Y) was just 0.1ppt above the Bank's projection presented in the May Monetary Policy Report. But recent disinflation relates principally to goods. Food inflation (-0.3ppt to 3.0%Y/Y) moderated in June for a fourteenth consecutive month to its lowest level since October 2021. While it moved sideways in June, energy (-16.0%Y/Y) knocked some 1.1ppts off headline inflation, as base effects from Ofgem's cut in the regulated price cap in April continued to weigh and a decline in petrol offset an uptick in diesel prices. And consistent with global trends, non-energy industrial goods inflation was marginally negative (-0.1%Y/Y) for a second successive month. In this category, a softer pace of deflation in second-hand cars, furniture and electrical appliances offered a modest upwards impulse. But this was offset by a further decline in clothing inflation to the lowest level since October 2021 as prices fell in the month of June for the first time in five years due to inclement weather.

Euro area: Selected services HICP components*



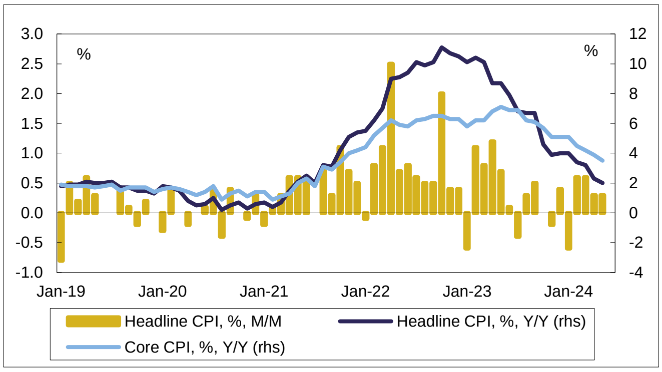
Data range since 2020. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Selected goods HICP components*



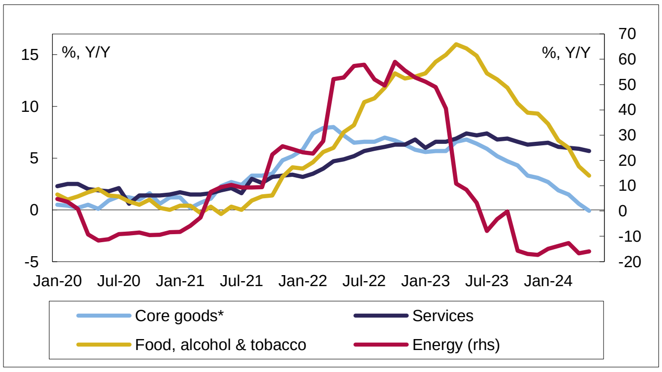
Data range since 2020. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Consumer price inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Key CPI components



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

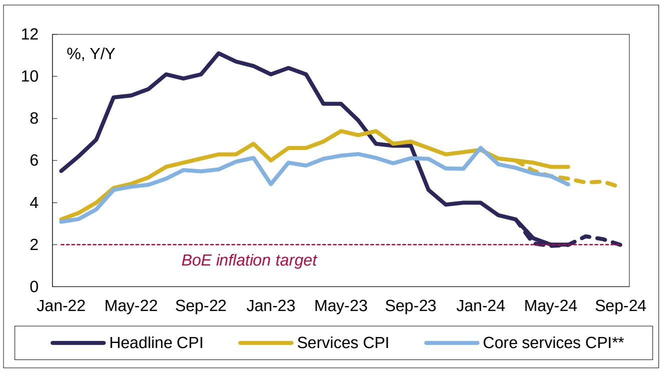
Services inflation remains stubbornly elevated, but underlying price pressures moderating

Despite the absence of core goods pressures, core inflation remained elevated last month at 3.5%Y/Y, above the equivalent rates in the euro area and US. Indeed, contrary to expectations, the gradual downtrend in the services component paused in June, to be unchanged at 5.7%Y/Y (and up 0.06ppt to 5.74%Y/Y to two decimal places). This left services inflation a chunky 0.6ppt above the BoE's projection in June, which might bolster the case for those MPC members wishing to keep rates unchanged for a little longer. But the detail in today's report suggests that the ongoing stickiness might relate to temporary factors. A significant source of upwards pressure came from accommodation services, with prices up for a fifth consecutive month to leave the annual rate of that component at an eleven-month high. Given the date of price collection, we do not share the widely expressed view that this pressure related to the Taylor Swift concerts in the UK. But we do believe that one-off factors were at play. And prices of a range of other services – including concert prices – were better behaved last month, with inflation of package holidays, restaurants and insurance all falling to their lowest rates in around 2-2½ years. Moreover, when excluding airfares, accommodation and rents, we estimate that the BoE's preferred measure of core services inflation eased 0.4ppt to a two-year low of 4.9%Y/Y. The overshoot of the monthly increase in services prices compared with the long-run average (0.3ppt) was also the smallest for three months, suggesting a slight moderation in momentum in the sector. And the share of items in the CPI basket with above-target inflation fell to 50% for the first time since July 2021, while the NIESR trimmed-mean CPI estimate fell to 1.7%Y/Y, similarly the lowest for almost three years.

Near-term inflation profile to remain choppy

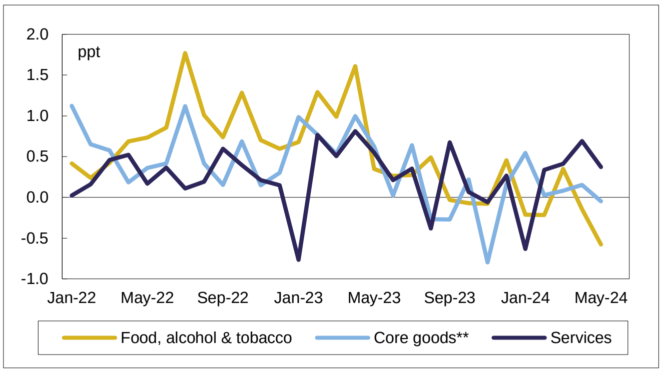
The near-term inflation profile remains uncertain and is likely to be choppy, not least due to the energy component. Despite the further 7.2% cut in Ofgem's household price cap this month the pace of decline in energy inflation will moderate significantly over coming months due to substantial base effects. But while today's producer price figures signal a recent modest pickup in factory sector costs – with core output price inflation rising to a ten-month high of 1.1%Y/Y – core consumer goods inflation will likely remain very subdued for the time being. We also expect food inflation to maintain a downtrend over the near term. Of course, most important for monetary policy will be the outlook for services inflation. While survey indicators such as the PMIs suggest that cost pressures in services are slowing, wage growth remains strong. We do expect services inflation to resume a downtrend this month, although it will likely remain relatively sticky and above 5%Y/Y through to spring 2025. As such, core inflation is likely to move broadly sideways through to year-end, and seems unlikely to fall back to 2% before next summer. Given the lags involved in monetary policy, this outlook could still be consistent with a rate cut next month. But not least given the recent strength of GDP, MPC members will want to take stock of tomorrow's labour market data before deciding how they will vote in August.

UK: Headline & services inflation*



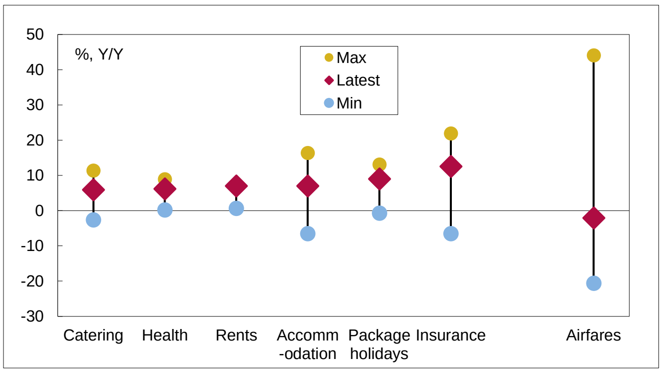
*Dashed lines represent BoE forecast from May Monetary policy Report. **Services excluding airfares, accommodation and rents. Source: BoE, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Deviations from long-run price change*



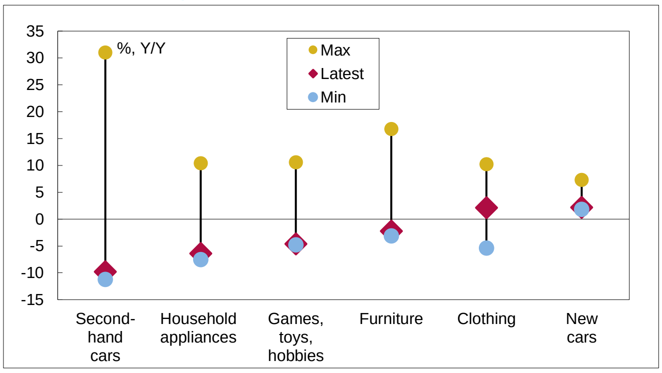
*Monthly change in prices compared to average for the month in the decade before the pandemic. **Non-energy industrial goods. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Selected services CPI components*



*Data range since 2020. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Selected goods CPI components*

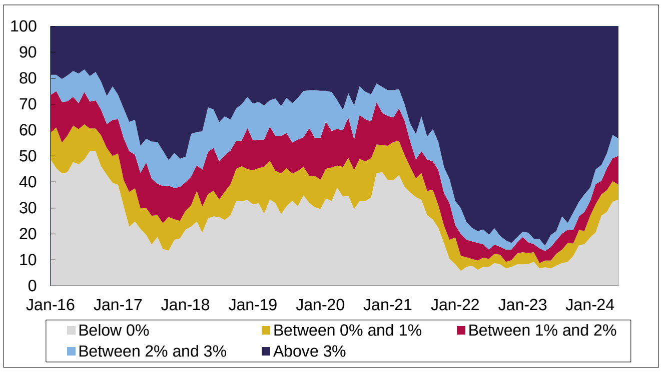


*Data range since 2020. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

The day ahead in the UK

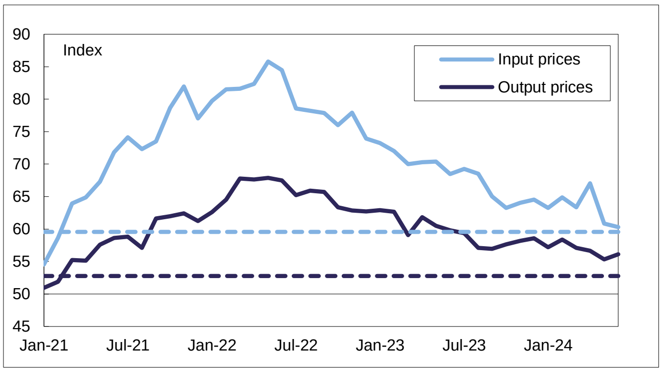
The main focus in the UK's data calendar tomorrow will be the latest labour market report, which is likely to show the unemployment rate remaining steady at 4.4% in the three months to May and employment down over the same period for a fifth consecutive month. That would match the highest unemployment rate since September 2021. Having risen in recent months to reflect the near-10% rise in the National Living Wage in April, we expect growth in average weekly earnings to moderate in the three months to May in part reflecting favourable base effects. The BoE will be watching more closely the detailed figures for private sector regular wage growth, which despite easing in April to a 22-month low of 5.8%3M/Y was tracking well above the Bank's forecast for 5.1% in Q2.

UK: Share of CPI basket by inflation rate



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Services price PMIs*



**Dashed lines represent long-run average. Source: Macrobond, S&P Global 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	Final HICP (core HICP) Y/Y%	Jun	**2.5 (2.9)**	*2.5 (2.9)*	2.6 (2.9)	-
Germany	CPI (core CPI) Y/Y%	Jun	**2.0 (3.5)**	*1.9 (3.5)*	2.0 (3.5)	-
Italy	PPI – output (input) prices Y/Y%	Jun	**1.4 (-0.4)**	1.8 (1.1)	1.7 (-0.1)	- (-0.7)
	House price index Y/Y%	May	**2.2**	-	1.1	-

Auctions

Country	Auction
Germany	sold €0.81bn of 0% 2052 bonds at an average yield of 2.55%
	sold €0.82bn of 2.5% 2054 bonds at an average yield of 2.59%
UK	sold £4.0bn of 4.125% 2029 bonds at an average yield of 4.023%

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	New car registrations Y/Y%	Jun	-	-3.0
	10.00	Construction output M/M% (Y/Y%)	May	-	-0.2 (-1.1)
	13.15	ECB Deposit Rate (Refi Rate) %	Jul	*3.75 (4.25)*	3.75 (4.25)
UK	07.00	Average weekly earnings (excluding bonuses) 3M/Y%	May	5.7 (5.7)	5.9 (6.0)
	07.00	ILO unemployment rate 3M%	May	4.4	4.4
	07.00	Employment change 3M/3M 000s	May	20	-139
	07.00	Payrolled employees change M/M 000s	Jun	-	-3
	07.00	Claimant count rate % (change 000s)	Jun	-	4.3 (50.4)

Auctions and events

Country	BST	Auction
France	09.50	Auction: to sell up to €11.5bn of 1.0% and 2.5% 2027, 2.75% 2030 and 2.0% 2032 bonds
	10.50	Auction: to sell up to €2.5bn of 0.1% 2028, 0.1% 2029, 0.6% 2034 and 0.1% 2053 inflation-linked bonds
Spain	09.30	Auction: to sell up to €6.5bn of 1.25% 2030, 3.45% 2034 and 0.85% 2037 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.