

Euro wrap-up

Overview

- Despite a slight rise in euro area inflation in July, Bunds made gains as the core rate remained steady and German labour market data weakened.
- Gilts made larger gains ahead of the BoE's rate announcement.
- While the BoE policy announcement will be the main focus, euro area unemployment data and the final manufacturing PMIs for July are also due tomorrow.

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Daily bond market movements

Bond	Yield	Change
BKO 2.7 09/26	2.522	-0.018
OBL 2½ 10/29	2.227	-0.030
DBR 2.6 08/34	2.299	-0.036
UKT 0% 01/26	3.797	-0.060
UKT 0½ 01/29	3.764	-0.076
UKT 4% 01/34	3.972	-0.070

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

Euro area

Modest increase in inflation principally relates to higher energy prices

The flash euro area inflation data for July broadly aligned with expectations. Having risen in the previous six months, consumer prices merely moved sideways on the month. But given an unfavourable base effect related to a modest decline in prices this time last year, the headline HICP rate ticked up slightly, by 0.1ppt to 2.6%Y/Y, bang in line with the average rate in the first half of the year. As a result, there is a non-negligible risk that inflation in Q3 as a whole will overshoot the ECB's projection of 2.3%Y/Y. Nevertheless, the pickup in inflation in July largely related to a rise in energy inflation, by 1.1ppt to a 15-month high of 1.3%Y/Y, in part due to higher regulated prices in Italy. With other major categories relatively well-behaved, the ECB should not be overly concerned by the modest uptick in the headline rate.

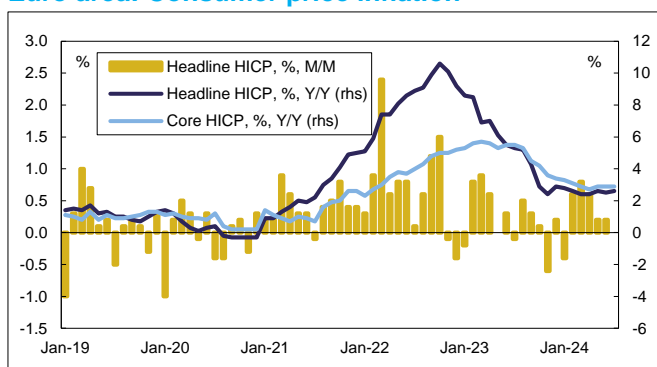
Core inflation moves sideways and services inflation eases to three-month low

Within the rest of the detail, inflation of food, alcohol and tobacco eased marginally further in July, by 0.1ppt to 2.3%Y/Y, the lowest since November 2021. Among the core components, non-energy industrial goods inflation edged up just 0.1ppt to remain subdued at 0.8%Y/Y with national data pointing to a (likely temporary) pickup in clothing. Most importantly, services inflation moderated for the first month in four, by 0.1ppt to 4.0%Y/Y. So, core HICP inflation moved sideways at 2.9%Y/Y. Admittedly, services inflation remains double the 2% target and core inflation in July was some 0.2ppt above the ECB's projection for Q3 as whole (2.7%Y/Y), which will likely ensure that the hawks on the Governing Council maintain their calls for caution. While we will need to await the detailed breakdown in the middle of August for greater insight into underlying price pressures in the services sector, we do not expect to see any significant new pressures despite continued volatility likely in hospitality, recreation and travel, and continued elevated inflation in insurance.

Near-term inflation profile to remain choppy, but we still expect a return to target in 2025

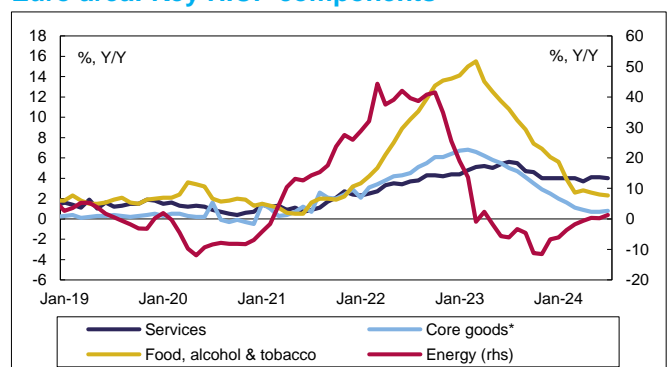
According to the ECB's seasonally adjusted data, services prices rose for a second successive month by just 0.3%M/M, half the rate of increase in April. So, services momentum on a three-month annualised basis slowed to 5.0%, still high but the softest rate in four months. And while the Paris Olympics possibly poses an upside risk, we expect services inflation momentum to take a notable step down in August. The ECB's adjusted measure of core goods prices also rose in July by 0.3%M/M, the most in eleven months, albeit leaving momentum at just 0.5%3M/3M annualised. And a moderation in disinflation in producer prices – perhaps in part associated with increased shipping freight costs – suggests that core goods inflation is likely to move broadly sideways for the time being. So, like the ECB, we expect core inflation also to oscillate around the current rate until the end of the year. But as services price pressures gradually dissipate as the impacts of the

Euro area: Consumer price inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Key HICP components



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

pandemic and war in Ukraine fade significantly further, we continue to expect both headline and core inflation to fall to 2%Y/Y or below as soon as Q225. While the pickup in inflation in July means that the ECB might well nudge higher its inflation projection in September, as it will also need to revise down its projection for GDP we expect it still to expect inflation to return to target by 2026. And that outlook should be sufficient to facilitate a further 25bps rate cut at the Governing Council's September policy meeting.

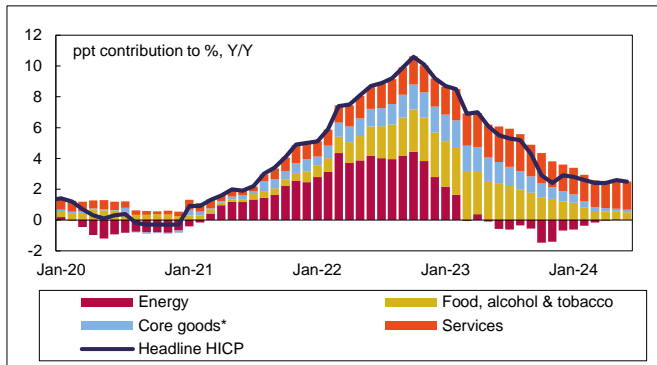
German labour market continues to loosen at the start of Q3

After [German GDP](#) contracted again in Q2 and survey indicators such as the PMIs and ifo indices signalled a further weakening at the start of Q3, today's data reported ongoing softening in the labour market. In particular, jobless claims rose in July for the nineteenth successive month and by a larger-than-expected 18k to 2.80mn, the highest level since November 2020 and a little more than 500k above the pre-pandemic level in February 2020. The claimant count rate remained at 6.0%, up 0.3ppt from a year earlier and 1.0ppt above both the trough in early 2022 and the pre-pandemic level. We expect the claimant count to rise further over coming months. Indeed, the number of job vacancies in July extended its steady downtrend, falling further below the pre-pandemic level. After the German composite employment PMI dropped sharply in July to just 47.0, the lowest since August 2020, today's ifo Employment Barometer was also consistent with much diminished recruitment plans, with manufacturers and retailers in particular signalling a desire to cut headcount. And while services firms reported continued, albeit diminished, plans to hire new staff, we expect employment to shift into reverse over the near term. Other data today reported that German negotiated wage growth ticked back up in July to 4.1%Y/Y and 4.3%Y/Y when excluding one-off payments. But those rates remained below their recent peaks. Looking through recent volatility and excluding one-offs, negotiated wage growth edged down for the second month to 4.4%3M/Y. And consistent with the recent softening in the Indeed wage tracker, and given the continued softening of the labour market, we expect wage settlement and employment compensation growth to trend steadily lower over coming quarters.

The day ahead in the euro area

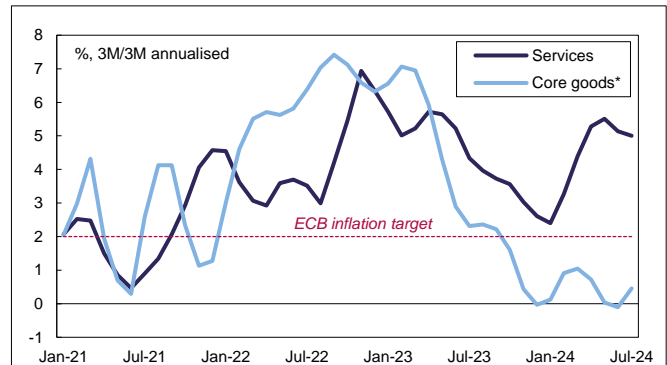
Tomorrow's euro area unemployment figures for June will provide an update on labour market conditions at end-Q2. While surveys have pointed to slower jobs growth over recent months and firms have signalled an intention to cut headcount in Germany and France, the jobless rate is expected to move sideways at the series low of 6.4%, suggesting that the labour market remains tight in the region by historical standards. Thursday will also bring the final manufacturing PMIs for July. The flash release saw the euro area output index drop to a seven-month low (45.3), signaling ongoing contraction in the factory sector, while the output price index remained below 50 suggesting a continued absence of price pressures.

Euro area: Contributions to HICP inflation



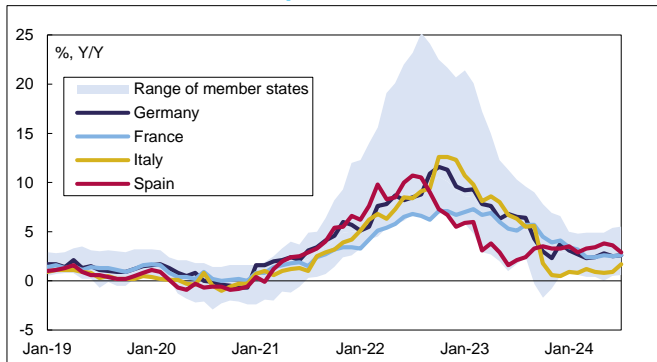
*Non-energy industrial goods. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Core inflation momentum



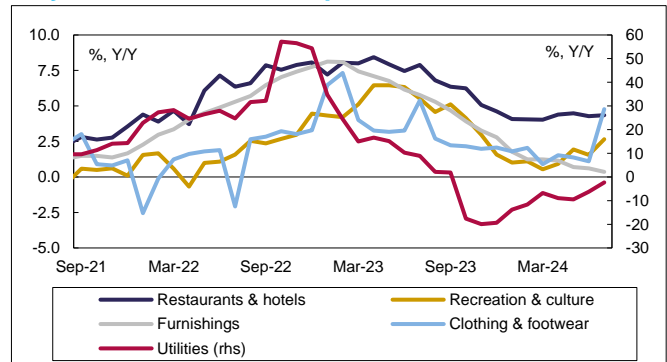
*Non-energy industrial goods. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Consumer price inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Italy: Selected HICP components



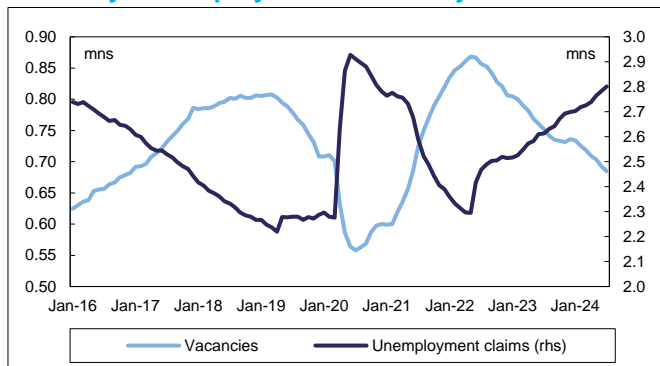
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK

The day ahead in the UK

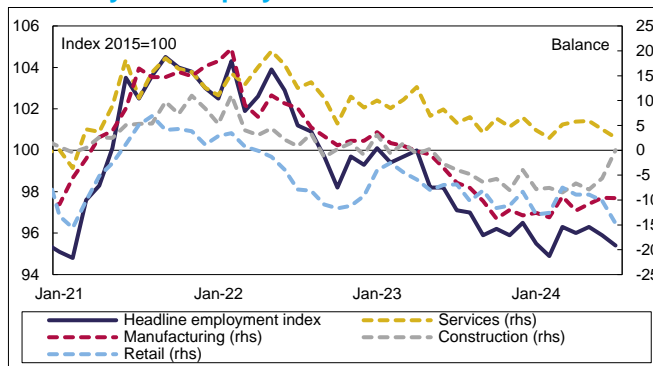
The main event in the UK tomorrow will be the BoE’s policy announcement and publication of its updated macroeconomic projections. With the BoE’s decision to keep policy unchanged in June having been ‘finely balanced’ for several MPC members, the upside surprise in [services inflation](#) in June seemingly related to isolated pressures at certain hotels as well as other temporary factors. And with [private regular pay](#) growth gradually moderating amid a softening labour market, we expect the BoE to cut rates for the first time this cycle, by 25bps to 5.00%. The Bank’s updated economic projections will likely see GDP growth revised higher, but inflation will still be expected to return back to target in 2026. Admittedly, the outcome of this meeting looks too close to call with great conviction. Indeed, commentary from MPC members has been largely absent since the June monetary policy meeting. Moreover, this meeting will be the first for new Deputy Governor Clare Lombardelli, who at the start of this month replaced Ben Broadbent – probably one of the members who judged the decision in June to be “finely balanced” – and whose current reaction function is unknown. But while the decision will certainly not be unanimous, we think that as many as six (out of the nine) members of the MPC might vote in favour of a rate cut.

Germany: Unemployment claims & job vacancies



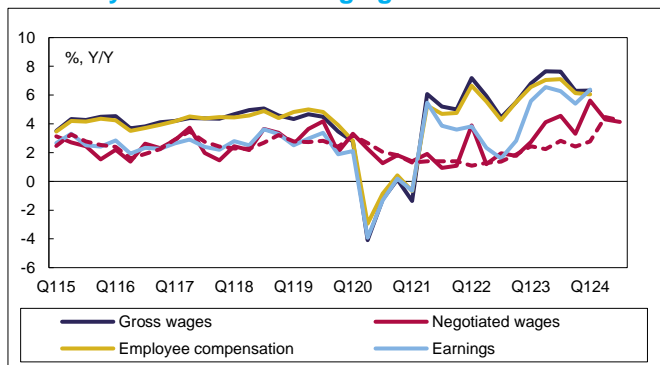
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: ifo Employment indices



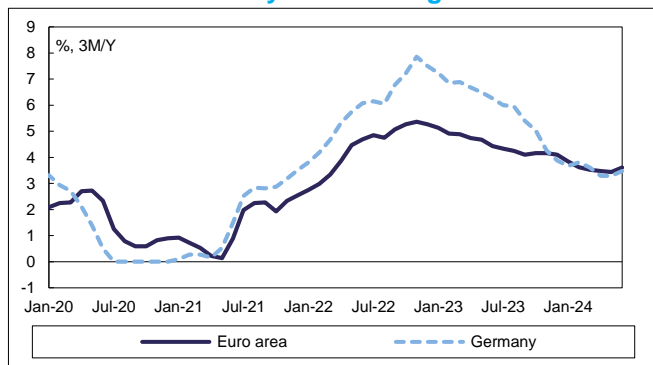
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Measures of wage growth*



*Q324 negotiated wage figure reflects July data. Dashed red line excludes one-off payments. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area & Germany: Indeed wage tracker










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	 Preliminary headline (core) HICP Y/Y%	Jul	2.6 (2.9)	<u>2.5 (2.9)</u>	2.5 (2.9)	-
Germany	 Unemployment rate % (change 000's)	Jul	6.0 (18.0)	6.0 (15.0)	6.0 (19.0)	- (20.0)
France	 Preliminary HICP (CPI) Y/Y%	Jul	2.6 (2.3)	2.8 (2.4)	2.5 (2.2)	-
	 PPI Y/Y%	Jun	-6.0	-	-6.7	-
Italy	 Preliminary HICP (CPI) Y/Y%	Jul	1.7 (1.3)	1.2 (1.1)	0.9 (0.8)	-
	 PPI Y/Y%	Jun	-3.5	-	-4.9	-
UK	 Lloyds business barometer (own price expectations)	Jul	50 (57)	-	41 (53)	-












Auctions

Country	Auction
Germany	 sold €2.47bn of 2.4% 2030 bonds at an average yield of 2.25%







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	Final manufacturing PMI	Jul	45.6	45.8
	 10.00	Unemployment rate %	Jun	6.4	6.4
Germany	 09.00	Final manufacturing PMI	Jul	42.6	43.5
France	 08.50	Final manufacturing PMI	Jul	44.1	45.4
Italy	 08.45	Manufacturing PMI	Jul	46.0	45.7
	 -	Budget balance €bn	Jul	-	-13.4
Spain	 08.15	Manufacturing PMI	Jul	52.5	52.3
UK	 07.00	Nationwide house price index M/M% (Y/Y%)	Jul	0.1 (1.8)	0.2 (1.5)
	 09.30	Final manufacturing PMI	Jul	51.8	50.9
	 12.00	BoE Bank Rate %	Aug	<u>5.00</u>	5.25
	 14.00	DMP 3M output price (1Y CPI) expectations Y/Y%	Jul	-	3.9 (2.8)

Auctions and events

Euro area	 09.00	ECB to publish Economic Bulletin
France	 09.50	Auction: to sell up to €10.5bn of 3.0% 2034, 1.25% 2038, 2.5% 2043 & 4.0% 2055 bonds
Spain	 09.30	Auction: to sell up to €6.0bn of 2.5% 2027, 3.45% 2034 & 5.15% 2044 bonds and up to €750mn of 0.65% 2027 index-linked bonds
UK	 12.00	BoE monetary policy announcement, minutes and Monetary Policy Report to be published
	 12.30	BoE Governor Bailey to present updated macroeconomic projections at press conference
	 17.00	BoE Chief Economist Pill to hold virtual Q&A session

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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<https://www.uk.daiwacm.com/ficc-research/recent-blogs>

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