

Euro wrap-up

Overview

- Bunds made gains even as the final estimates of euro area inflation in July suggested that the disinflation process has significantly slowed and construction output rebounded in June.
- Gilts underperformed, being little changed on a quiet day for UK economic news.
- Wednesday will bring flash estimates of euro area labour costs and job vacancies in Q2 and UK public sector borrowing data for July.

Chris Scicluna

+44 20 7597 8326

Daily bond market movements

Bond	Yield	Change
BKO 2.7 09/26	2.397	-0.028
OBL 2½ 10/29	2.137	-0.033
DBR 2.6 08/34	2.212	-0.030
UKT 0½ 01/26	3.676	+0.002
UKT 0½ 01/29	3.730	-0.005
UKT 4% 01/34	3.916	-0.005

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

Source: Bloomberg

Euro area

No major surprises as energy-led pickup in inflation in July is confirmed

The final estimates of euro area inflation in July provided no major surprises, confirming the slight increase in the headline rate and unchanged core measure reported in the flash figures. So, while consumer prices moved sideways on the month, 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. That pickup in inflation in July was largely caused by a 1.0ppt rise in energy inflation to a 12-month high of 1.2%Y/Y, driven by higher electricity and gas tariffs particularly in Italy. In contrast, the component for food, alcohol and tobacco eased a further 0.1ppt in July to 2.3%Y/Y, the lowest since November 2021. Among the core items, despite further weakening in second-hand cars, furniture, furnishings and household appliances, non-energy industrial goods inflation was unchanged at 0.7%Y/Y for a third month principally due to a (likely temporary) pickup in clothing. More importantly perhaps, despite continued pressure in insurance, services inflation moderated for the first month in four, by 0.1ppt to 4.0%Y/Y, thanks to an easing in hotels and package holidays and further weakening in airfares. Nevertheless, core inflation was merely unchanged at 2.9%Y/Y for a third month.

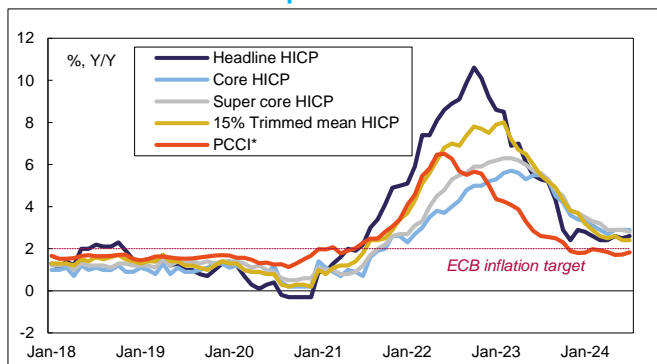
Underlying measures suggest progress with disinflation has slowed

The flattening out of core inflation at 2.9%Y/Y over recent months suggests that progress with disinflation has slowed, and perhaps significantly. Alternative measures of underlying pressures tell a similar story. For example, the 10% and 15% trimmed mean measures were also unchanged in July, albeit 0.5ppt softer than the core rate. The weighted median inflation rate rose 0.2ppt in July, also to 2.4%Y/Y. Admittedly, the ECB's supercore measure – which excludes items that are typically subject to one-off adjustments – edged down to a 30-month low of 2.8%Y/Y. But its principal common component rates, which ECB staff think often provide the best guide to underlying pressures, ticked up slightly to 1.8%3M/Y. Meanwhile, according to the ECB's seasonally adjusted estimates, core inflation momentum ticked up in July, to 3.3%3M/3M annualised. With core goods prices rising the most on an adjusted basis so far this year, momentum of this component picked up to a three-month high, albeit at just 0.4%3M/3M annualised. Services inflation momentum on a three-month annualised basis slowed to a four-month low but remained elevated at 4.9%, certainly more than high enough for the hawks on the Governing Council to remain concerned about persistence.

ECB likely to nudge up its near-term inflation projections next month

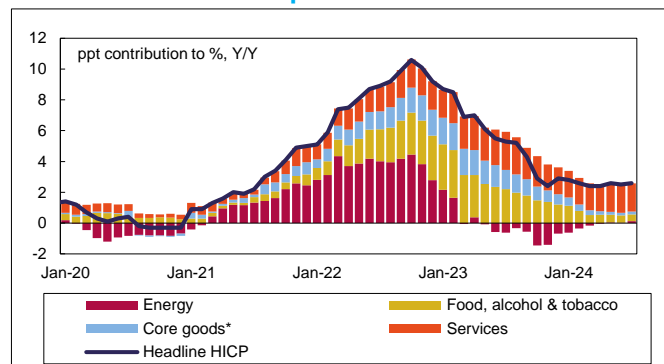
Despite the evidence of a slowing in the disinflation process, euro area headline inflation looks bound to take a further step down in August. That, however, will largely reflect a favourable base effect related to energy prices, which leapt 3.3%M/M a year ago but are currently on track to decline in the current month, pushing the respective annual rate back into negative

Euro area: Consumer price inflation measures



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

Euro area: Consumer price inflation & contributions



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

territory. In contrast, we expect core inflation to remain close to current levels for another six months. Certainly, PPI data, such as the German numbers today which showed industrial producer prices up 0.2%M/M for the fourth month out of the past five, suggest that core goods inflation is close to its trough and will contribute little more to the decline in headline inflation. And while inflation momentum in services should moderate further over coming months, the respective annual rate will remain near current levels until the back end of Q125. Importantly perhaps, the July data suggest that both headline and core inflation will overshoot the ECB’s projections for Q3. And at its September monetary policy meeting, the Governing Council will likely receive upwardly revised inflation projections for the coming two quarters too. Nevertheless, given the recent sluggishness of economic activity, in the absence of nasty surprises in the forthcoming labour cost and negotiated wage data, those projections should continue to suggest that inflation will be back around target by the end of next year and in 2026. They should also provide no obstacle to a further rate cut next month, even if the upwards revisions reinforce the case for a gradualist approach to monetary easing.

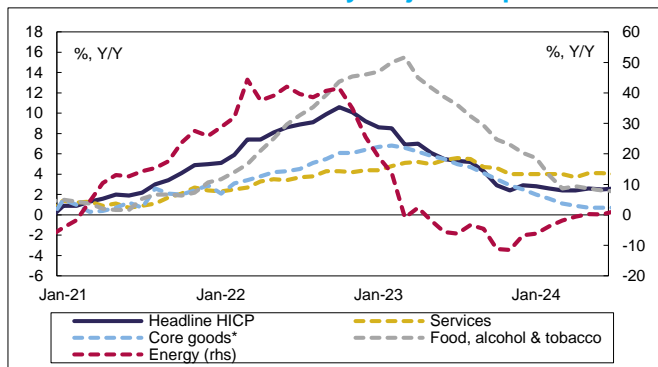
Construction output rebounds in June but down over Q2 as a whole

Euro area construction output returned to growth in June, rising 1.7%M/M – the strongest rate since January 2023 – to be up 1.0%Y/Y at a fourteen-month high. However, that expansion followed three successive months of contraction. So, construction output still fell 0.4%Q/Q over Q2 as a whole following the weather-assisted surge of 0.9%Q/Q in Q1 which had marked the first quarterly growth in one year. With growth in the sector in June relatively broad-based, weakness over Q2 as a whole was centred on specialised construction activity. Civil engineering was flat and, perhaps surprisingly, house-building grew for a second successive quarter. The declines were particularly pronounced in the two largest member states. In Germany, construction output contributed significantly to the 0.1%Q/Q drop in GDP, falling a whopping 2.7%Q/Q after the temporary surge of 2.5%Q/Q in Q1. In France, meanwhile, it contracted for a fourth successive quarter, dropping 1.3%Q/Q in Q2 after the fall of 0.3%Q/Q in Q1. Despite ongoing support from NextGenerationEU funds, with financial conditions still relatively tight, constructor confidence and broader economic sentiment subdued, building permits down and real estate prices still under pressure in the largest member states, we expect construction activity to remain relatively soft throughout the remainder of 2024 and into 2025.

The day ahead in the euro area & UK

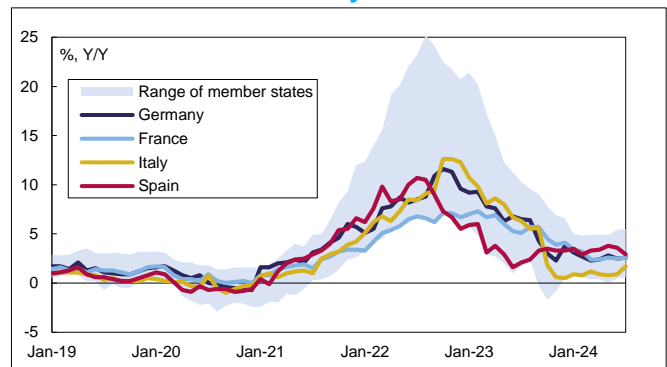
Wednesday will bring the first of this week’s euro area labour market data. Flash figures are likely to show that labour cost growth remained elevated in Q2. However, the preliminary job vacancy figures for Q2 should suggest that the jobs market is becoming gradually less tight, which would be consistent with a moderation in labour cost growth over coming quarters. Meanwhile, in the UK, Wednesday will bring public sector borrowing figures for July.

Euro area: HICP inflation by major component



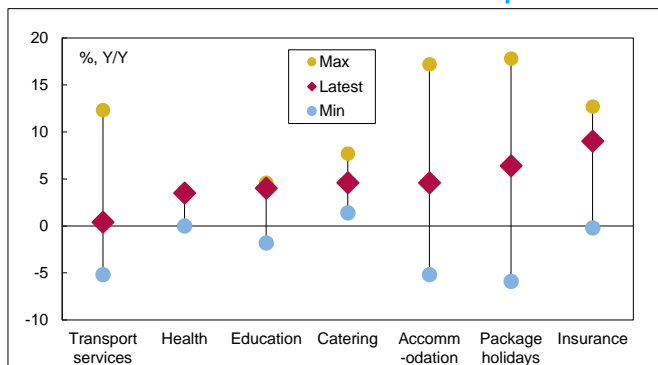
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: HICP inflation by member state



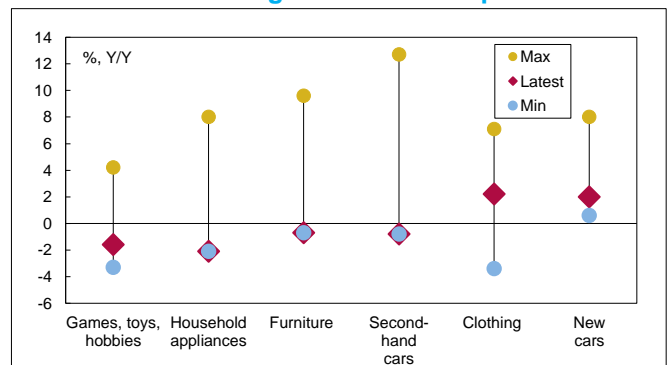
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Selected services HICP components*



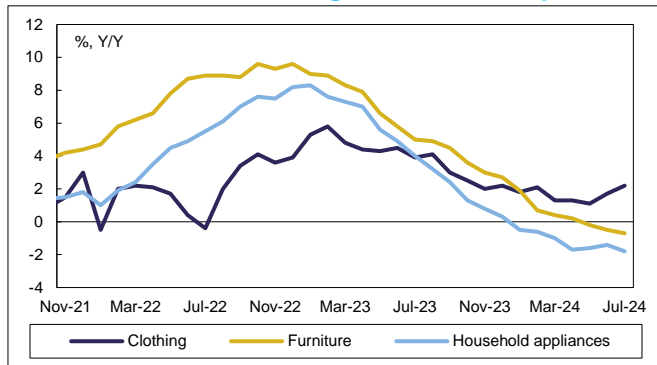
*Maximum & minimum rates of respective inflation components since January 2020. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Selected goods HICP components*



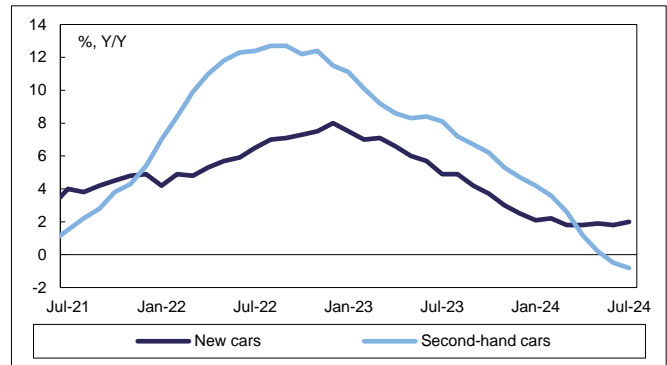
*Maximum & minimum rates of respective inflation components since January 2020. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Selected core goods HICP components



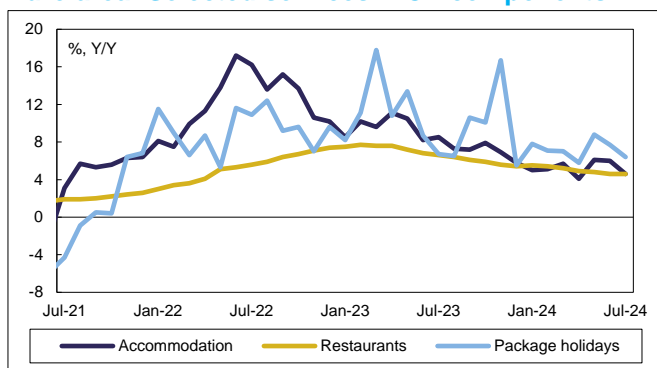
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Car HICP inflation



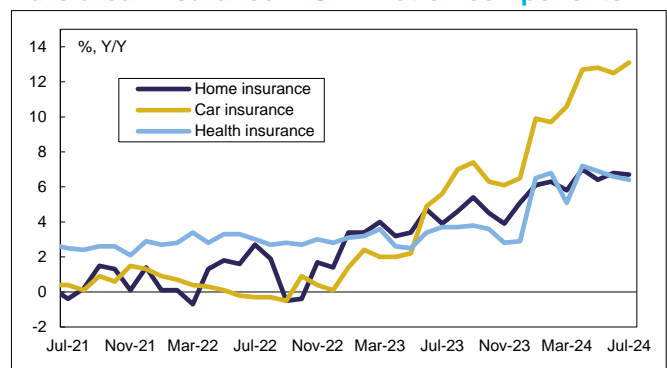
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Selected services HICP components



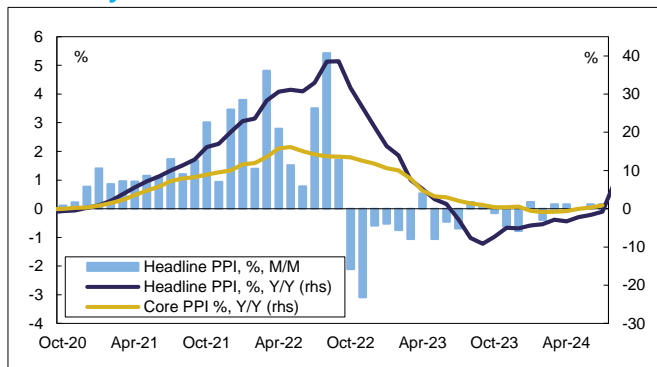
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Insurance HICP inflation components



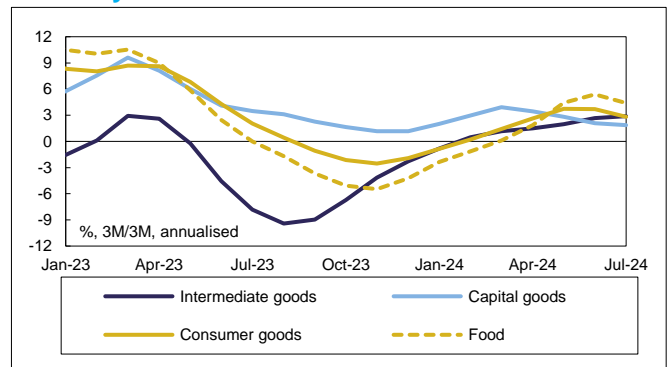
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Industrial PPI inflation



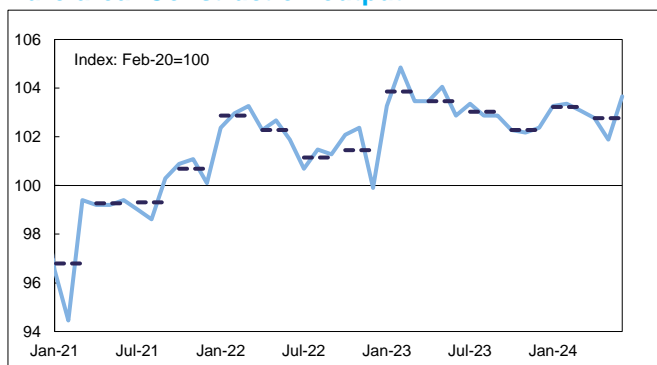
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Industrial PPI inflation momentum



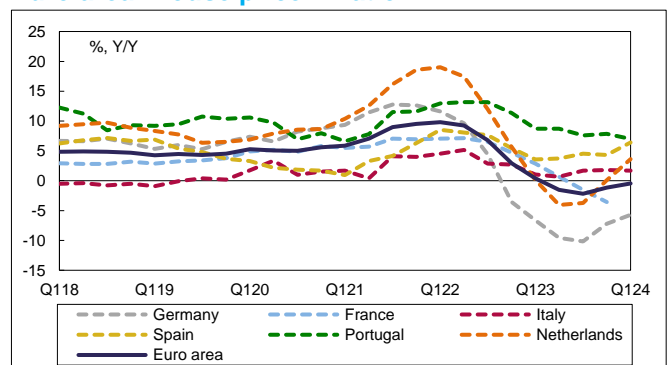
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Construction output*



*Dashed line shows quarterly average. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: House price inflation





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 	Final HICP (core HICP) Y/Y%	Jul	2.6 (2.9)	<u>2.6 (2.9)</u>	2.5 (2.9)	-
	Current account balance €bn	Jun	50.5	-	36.7	37.6
	Construction output M/M% (Y/Y%)	Jun	1.7 (1.0)	-	-0.9 (-2.4)	- (-2.1)
Germany 	PPI Y/Y%	Jul	-0.8	-0.8	-1.6	-


Auctions

Country	Auction
Germany 	sold €734m of 2.3% 2033 bonds at an average yield of 2.16%
	sold €728mn of 0% 2050 bonds at an average yield of 2.42%

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
UK 	Rightmove house prices M/M% (Y/Y%)	Aug	-1.5 (0.8)	-	-0.4 (0.4)	-



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 	10.00	Labour costs – 1 st estimate Y/Y%	Q2	-	5.1
UK 	07.00	Public sector net borrowing £bn	Jul	1.5	14.5

Auctions and events

Germany 	10.30	Auction: to sell €4.5bn of 2.6% 2034 bonds			
UK 	10.00	Auction: to sell £3.75bn of 3.75% 2027 bonds			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:

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

This research report is produced by Daiwa Securities Co. Ltd., and/or its affiliates and is distributed by Daiwa Capital Markets Europe Limited ("DCME"). DCME is authorised and regulated by The Financial Conduct Authority and is a member of the London Stock Exchange. DCME and its affiliates may, from time to time, to the extent permitted by law, participate or invest in other financing transactions with the issuers of the securities referred to herein (the "Securities"), perform services for or solicit business from such issuers, and/or have a position or effect transactions in the Securities or derivatives or options thereof and/or may have acted as an underwriter during the past twelve months for the issuer of such securities. In addition, employees of DCME and its affiliates may have positions and effect transactions in such the Securities or derivatives or options thereof and may serve as Directors of such issuers. DCME may, to the extent permitted by applicable UK law and other applicable law or regulation, effect transactions in the Securities before this material is published to recipients.

This publication is intended only for investors who are professional clients as defined in MiFID II and should not be distributed to retail clients as defined in MiFID II. Should you enter into investment business with DCME's affiliates outside the United Kingdom, we are obliged to advise that the protection afforded by the United Kingdom regulatory system may not apply; in particular, the benefits of the Financial Services Compensation Scheme may not be available.

DCME has in place organisational arrangements for the prevention and avoidance of conflicts of interest. Our conflict management policy is available at <http://www.uk.daiwacm.com/about-us/corporate-governance-regulatory>. Regulatory disclosures of investment banking relationships are available at <https://daiwa3.bluematrix.com/sellside/Disclosures.action>.

Explanatory Document of Unregistered Credit Ratings

This report may use credit ratings assigned by rating agencies that are not registered with Japan's Financial Services Agency pursuant to Article 66, Paragraph 27 of the Financial Instruments and Exchange Act. Please review the relevant disclaimer regarding credit ratings issued by such agencies at:

https://drp.daiwa.co.jp/rp-daiwa/direct/reportDisclaimer/credit_ratings.pdf. If you need more information on this matter, please contact the Research Production Department of Daiwa Securities.

IMPORTANT

This report is provided as a reference for making investment decisions and is not intended to be a solicitation for investment. Investment decisions should be made at your own discretion and risk. Content herein is based on information available at the time the report was prepared and may be amended or otherwise changed in the future without notice. We make no representations as to the accuracy or completeness. Daiwa Capital Markets Europe Limited retains all rights related to the content of this report, which may not be redistributed or otherwise transmitted without prior consent.