Euro wrap-up

Overview

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- Bunds made losses as the ECB cut rates but left its projections little changed and President Lagarde gave no indication that the Governing Council feels any urgency to cut rates again in October.
- Gilts made losses while a UK residential market survey signalled a gradual pickup in sales and house prices ahead.
- Friday will bring data for euro area industrial production, French inflation and UK consumer price expectations.

Daily bond market movements

Bond	Yield	Change
BKO 2.7 09/26	2.216	+0.073
OBL 2½ 10/29	2.020	+0.054
DBR 2.6 08/34	2.147	+0.038
UKT 4⅛ 01/27	3.813	+0.029
UKT 4⅛ 07/29	3.636	+0.025
UKT 4¼ 07/34	3.780	+0.020

*Change from close as at 5.00pm BST.
Source: Bloomberg

Euro area

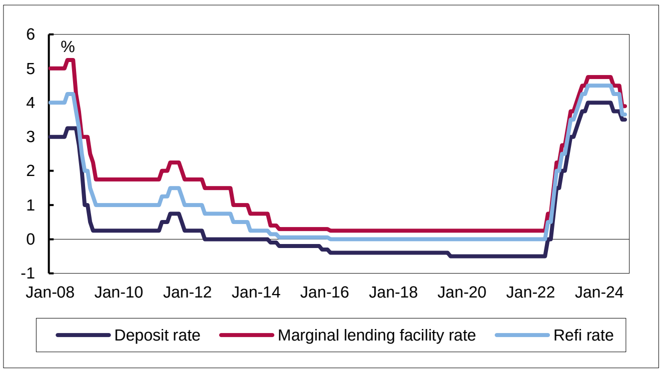
No surprises as ECB cuts by 25bps & leaves projections little changed

In many ways, the conclusion today of the ECB's latest monetary policy meeting was entirely predictable. As was widely expected, the deposit rate was cut by 25bps to 3.50% with the Governing Council's decision unanimous. With the pre-agreed narrowing of its rate corridor confirmed, the refi rate was cut by a larger 60bps to 3.65%. The ECB also inevitably left its forward guidance unchanged, repeating that rates will be kept "sufficiently restrictive for as long as necessary". And it repeated that the Governing Council will "continue to follow a data-dependent and meeting-by-meeting approach" to setting policy, while continuing to rule out pre-committing to any particular rate path. The wholly expected policy decision was accompanied by predictably minimal adjustments to the ECB's macroeconomic projections. While it acknowledged a weakening in the domestic demand outlook, the ECB staff nudged its GDP projection lower by just 0.1ppt in each year. As such, it now expects GDP to rise just 0.8% in 2024, before firmer consumer spending helps growth pickup to 1.3% in 2025 and 1.5% in 2026. And although it increased its core inflation forecast for this year and next by 0.1ppt apiece to 2.9% and 2.3% respectively due to a slightly higher services component, the staff left completely unchanged the projection for headline inflation across the horizon. As such, while the ECB continues to forecast inflation to pick up back above 2½%Y/Y before year-end principally due to energy-related base effects, it also still projects a return to the 2.0%Y/Y target in Q425 and also projects it to fall very slightly to 1.9%Y/Y on average in 2026.

Lagarde refuses to validate market expectations of another rate cut in October

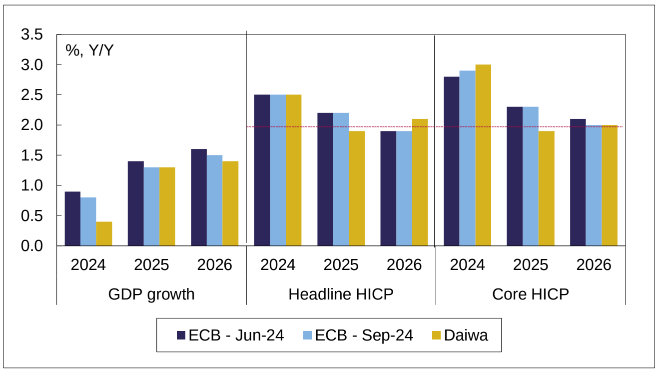
Just as today's monetary policy decision, forward guidance and updated macroeconomic projections were predictable, Christine Lagarde's press conference also failed to excite. Indeed, the ECB President refused to offer clues as to the path for policy ahead. Ahead of today's announcements, however, the OIS market was fully pricing in two further rate cuts of 25bps apiece before year-end. So, Lagarde's dogged refusal to validate such dovish pricing prompted a sell-off in rates, particularly at the short end of the curve, as investors recognised an increased probability that the ECB will leave rates unchanged at the next meeting at end-October. Indeed, in response to questions, she reiterated that key data in determining the path of rates ahead would continue to include wages, profits and productivity. And she noted that there would be little new information available to the Governing Council related to such variables to change officials' minds by the time of the next policy meeting. Of course, her willingness to countenance an upwards shift in market rate expectations might simply be tactical, insofar as such a move might help to helpfully weigh on inflation over the near term. And Lagarde did, at least, acknowledge the downside skew to risks to the GDP outlook. Indeed, given the recent reluctance of consumers to spend and businesses to invest, our own growth projection is now materially softer than that of the ECB's across the horizon. And if there are greater signs that those downside risks to growth are crystallising, and services inflation falls significantly short of expectations in

ECB: Interest rates



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

ECB: GDP & inflation projections



Source: ECB, Macrobond and Daiwa Capital Markets Europe Ltd.

September, a rate cut at the next meeting cannot be ruled out. However, in our view, Lagarde's press conference underscored the greater likelihood that rates would remain unchanged next month, before cuts resume when the ECB next updates its projections in December and perhaps become more frequent in the New Year.

The day ahead in the euro area

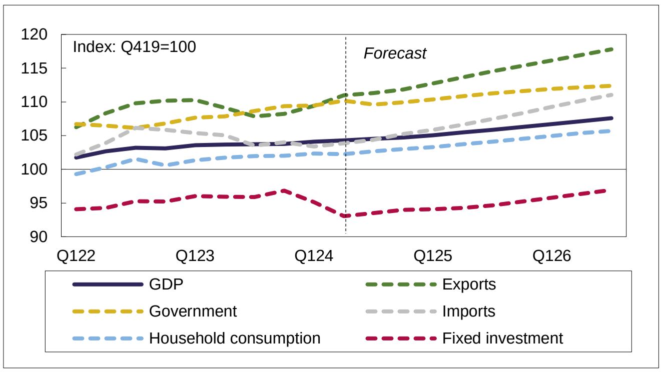
Friday will bring euro area industrial production figures for July. Data for the start of Q3 published so far by the member states have been generally weak, with the largest five reporting notable declines in IP that month. As such, production in the euro area almost certainly dropped that month and might also be expected to fall over Q3 as a whole. The extraordinarily volatile Irish data distort the picture somewhat via the activities of multinational enterprises based there for tax purposes – indeed, IP in Ireland jumped 9.2%M/M, which left it up 5.6%Y/Y. However, based on the data published so far, euro area IP still likely dropped 0.6%M/M to be 0.4% below the Q2 average. Tomorrow will also bring updated estimates of French inflation for August. The preliminary estimates recorded a notable drop in headline inflation last month – by ½ppt to 2.2%Y/Y – due principally to lower energy prices. In contrast, services HICP inflation jumped to a 10-month high (up 0.6ppt to 3.7%Y/Y), with tomorrow's figures likely to confirm that this principally reflected opportunistic pricing by firms in the accommodation and restaurant sectors, as well as high public transport fares, during the Paris Olympics.

UK

Mortgage arrears rise to highest since 2016, but remain historically low

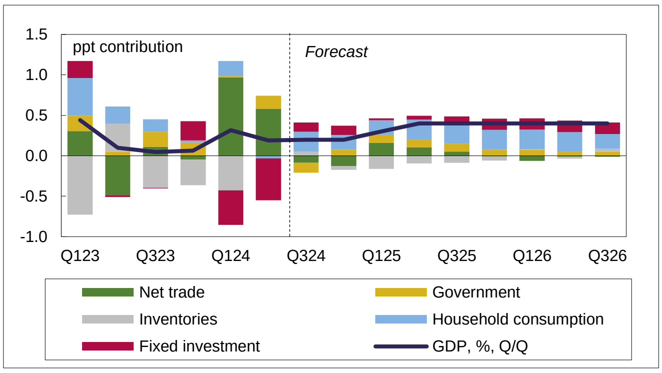
The BoE's restrictive monetary policy stance, and subsequent jump in mortgage rates, has predictably resulted in an adjustment in the UK's housing market over recent years. According to the official ONS figures, national house prices fell more than 3% from the peak in late-2022 to the trough at the start of this year, with a more significant drop in London (-4½%) and the South East (-5½%). Mortgage lending, approvals and residential property transactions also slowed sharply, while new private house-building construction slumped by around a fifth over the same period. Data published in the past week also suggested that the number of mortgages in arrears rose in Q2 to the highest since 2016. But the proportion in arrears relative to all outstanding mortgage balances remained historically low at 1.32%, and still well below the global financial crisis peak above 3.5%. Of course, this share might rise slightly further over coming quarters as the lagged impact of higher rates continues to weigh. About one-third (>3mn) of mortgage holders are still paying a rate of less than 3% and will need to re-mortgage at what is likely to be a significantly higher rate before end-2026. Nevertheless, mortgage rates should continue to ease gradually as the Bank progresses with its monetary easing cycle. And those that borrowed at the peak of the recent cycle should also start to benefit when re-mortgaging in due course.

ECB: GDP expenditure components



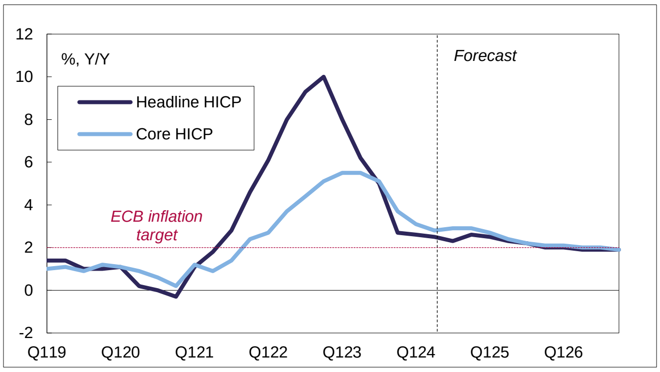
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

ECB: Contributions to GDP growth



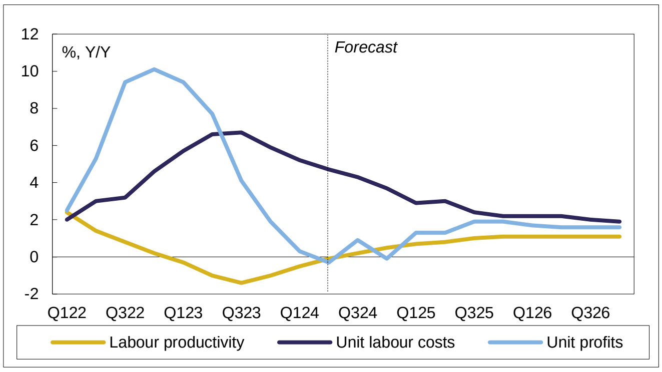
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

ECB: Headline & core inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

ECB: Unit labour costs, profits & productivity

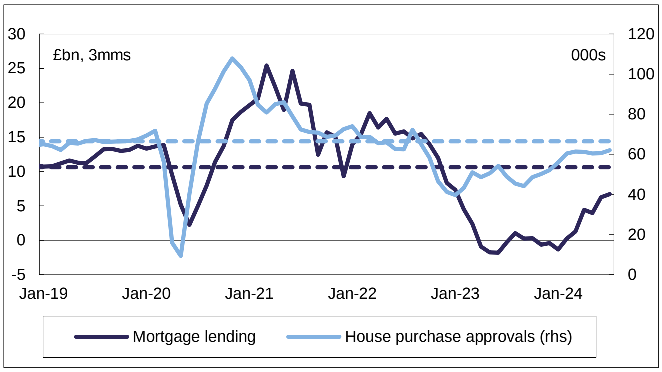


Source: Macrobond and Daiwa Capital Markets Europe Ltd.

RICS survey points to a further pickup in sales and price expectations

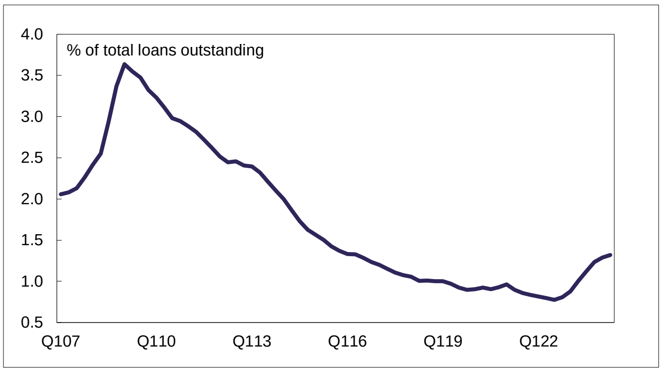
The prospect of lower borrowing rates appears to have buoyed the housing market over the summer, with mortgage lending rising in the three months to July by the most since January 2023, while mortgage approvals at the start of Q3 were the highest since the blow-out in interest rates in October 2022. And recent surveys point to ongoing modest recovery momentum over the coming quarters too. Today's RICS residential survey for August suggested that newly agreed sales rose for the first month in four and by the most since May 2021. Surveyors also reported a pickup in new selling instructions that month, with a more significant increase in new buyer enquiries as the net balance for the latter (+15%) was the highest since October 2021. Against this backdrop, sales expectations for the three months ahead rose to the highest since before the pandemic. Today's survey also reported a much larger-than-expected increase in the headline house price balance (up 19pts), although at +1% it was more consistent with stabilisation rather than a significant increase in price growth over the summer. And while price expectations for the coming three months rose the most in more than two years, we continue to expect the recovery in house prices to be gradual over the near term as affordability remains relatively stretched.

UK: Mortgage lending & approvals



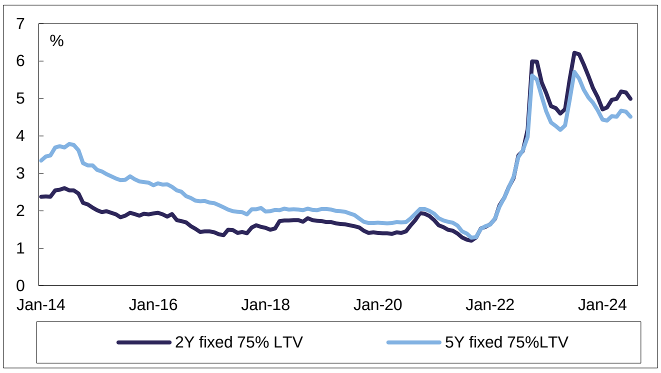
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Mortgage arrears



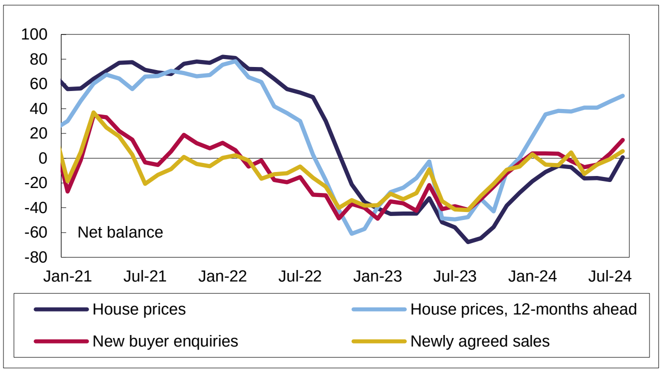
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Mortgage interest rates



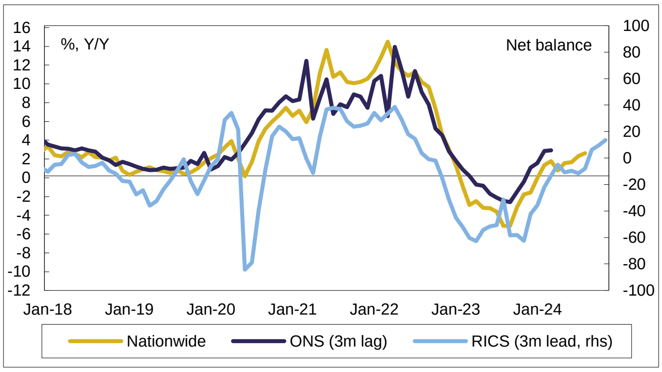
Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

UK: RICS housing market indices



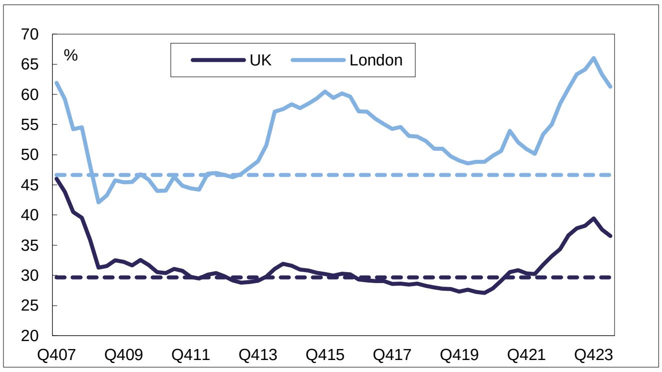
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: House price indicators



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Mortgage payments to earnings ratio*



**First time buyers. Source: Nationwide, Macrobond and Daiwa Capital Markets Europe Ltd.*

The day ahead in the UK

Friday will bring the results of the BoE's latest household inflation expectations survey for Q3. In Q2, household expectations for inflation 12 months ahead eased 0.2ppt to 2.8%Y/Y to its lowest since Q321, while expectations for two years ahead matched the six-quarter low recorded in Q223 (2.6%Y/Y). While the Ofgem household energy tariff cap will rise by 10% in October and is expected to be hiked again in January, we expect both measures to moderate slightly, remaining above the 2% target but nevertheless suggesting that household inflation expectations remain well anchored.

European calendar

Today's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area	ECB Deposit Rate (Refi Rate) %	Sep	**3.50 (3.65)**	*3.50 (3.65)*	3.75 (4.25)	-
Italy	Unemployment rate Q/Q%	Q2	**6.8**	-	7.2	-
Spain	Final HICP (CPI) Y/Y%	Aug	**2.4 (2.3)**	2.4 (2.2)	2.9 (2.8)	-
UK	RICS house price balance %	Aug	**1**	-14	-19	-18

Auctions

Country	Auction
Italy	sold €3.5bn of 3.45% 2027 bonds at an average yield of 2.62%
	sold €3bn of 3.45% 2031 bonds at an average yield of 3.15%
UK	sold £2bn of 0.125% 2026 bonds at an average yield of 3.559%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Euro area	10.00	Industrial production M/M% (Y/Y%)	Jul	-0.5 (-2.4)	-0.1 (-3.9)
France	07.45	Final HICP (CPI) Y/Y%	Aug	2.2 (1.9)	2.7 (2.3)
	07.45	Final wages Q/Q%	Q2	0.6	1.3
UK	09.30	BoE/Ipsos household inflation expectations 1Y ahead Y/Y%	Aug	-	2.8

Auctions and events

- Nothing scheduled -

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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