Euro wrap-up

Overview

Emily Nicol
+44 20 7597 8331

Edward Maling
+44 20 7597 8030

- Bunds made subtle gains at the long end, as final estimates of euro area inflation was confirmed at the 2% target inflation print.
- Shorter-dated Gilts made losses even as the latest labour market data flagged further decline in wage growth and payrolls.
- The end of the week will bring data for euro area construction output in May and German producer prices in June.

Daily bond market movements

Bond	Yield	Change
BKO 1.9 09/27	1.854	+0.007
OBL 2.2 10/30	2.225	-0.002
DBR 2.6 08/35	2.672	-0.013
UKT 3¾ 03/27	3.897	+0.051
UKT 4⅜ 03/30	4.083	+0.044
UKT 4½ 03/35	4.653	+0.015

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

Euro area

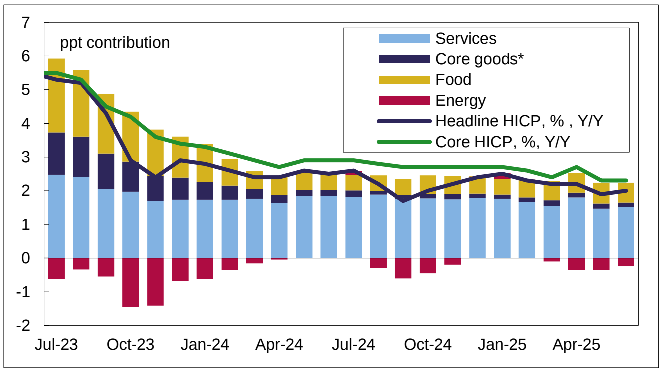
Euro area inflation at the 2% target in June, despite upside pressures on energy prices

Despite marginal upwards revisions across several member states, the final June estimates of euro area inflation offered no surprises. As expected, headline HICP inflation was confirmed at 2.0%Y/Y, up 0.1ppt from May, leaving the quarterly average (2.0%) bang in line with the ECB's projection. The accompanying detail also confirmed that the monthly change in headline inflation was largely accounted for by a smaller drag in the energy component (up 1ppt to a three-month high of -2.6%Y/Y), which was pushed higher by motor fuel costs and less favourable base effects. In contrast, inflation of food, alcohol and tobacco moderated from May's 16-month high. Core inflation held steady at 2.3%Y/Y, the joint-lowest since January 2022. Granted, the sideways move came despite a marginal increase in services inflation, up 0.1ppt to 3.3%Y/Y, albeit this still represented the second-softest in more than three years. But this likely reflected some seasonal volatility in accommodation and package holiday costs, with prices in most other services categories relatively well-behaved. Certainly, recent sources of persistence in services such as insurance flagged continued moderation (down to an 18-month low and 3ppts below its peak). Furthermore, core goods inflation was nudged down to a five-month low (0.5%Y/Y), likely benefitting from recent euro appreciation and a continued lack of pricing pressures in a range of goods, including major household appliances. Other measures of underlying inflation published today also offered encouragement about fading inflation persistence, with the 10% and 20% trimmed mean HICP rates down respectively to their lowest in nine months and more than 3½ years.

Inflation expected to undershoot target in Q325, but bar for a further rate cut appears to be rising

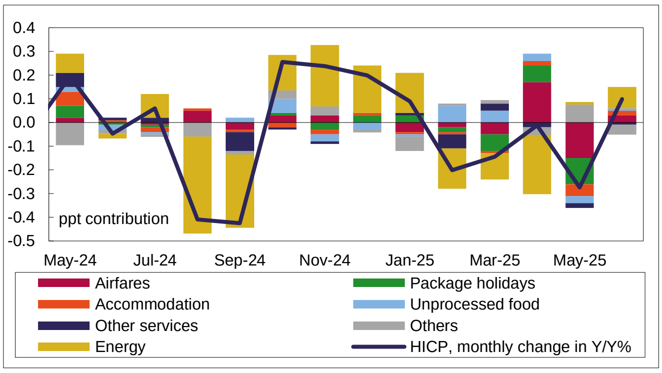
Looking ahead, we expect headline inflation to fall back below the 2% target this month and next, in part due to a renewed decline in energy prices. Notwithstanding some likely upwards pressures on certain tourism-related components, services inflation is also expected to ease further over the near term. And while it might edge slightly higher towards the back end of the year, services inflation should take a more sizeable step-down next spring as moderating labour cost growth maintains downwards pressures and those items with infrequent repricing start to normalize. Subdued demand in the face of ongoing uncertainties should also limit firms pricing powers. And with supply ample and euro appreciation weighing significantly on prices of imported, core goods inflation should remain lacklustre. As such, while the outlook remains subject to significant uncertainties, we continue to see a risk that both headline and core inflation undershoot the ECB's target in 2026 and 2027. Indeed, while the ECB's projections in June saw a return to target in 2027, we currently forecast headline inflation to rise a more moderate 1.8%Y/Y, with core inflation expected to ease further to 1.6%Y/Y. While this would arguably justify one final rate cut this cycle at the September Governing Council meeting, we might well need to see further notable euro strengthening – recent ECB speak has inferred €1.20/$ as one potential threshold – or a negative growth shock to get the more hawkish members on board.

Euro area: Contributions to headline HICP inflation



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

Euro area: Monthly change in annual HICP inflation

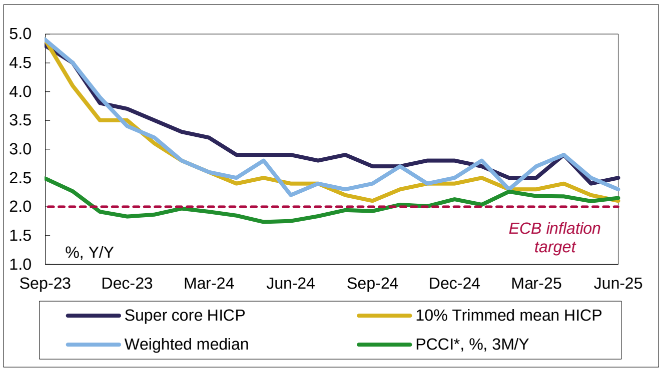


Source: Macrobond and Daiwa Capital Markets Europe Ltd.

The day ahead in the euro area

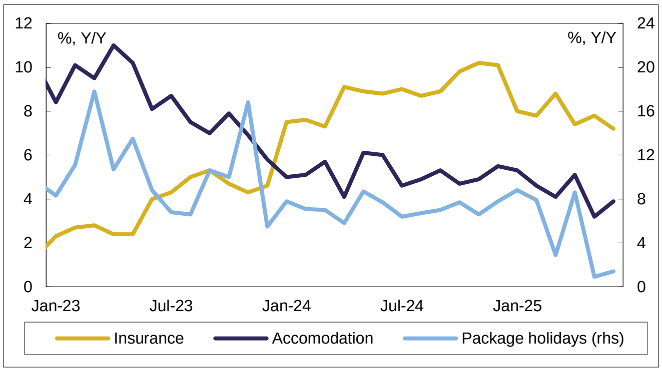
The end of the week in the euro area will bring data for aggregate euro area construction output in May and German producer prices in June. The latter will provide insights into pipeline pressures, and as evident in today's CPI release, the effects of the spike in the oil price the energy component last month, which has been a drag for the past six months. But broader input prices are expected to have remained relatively stable, which alongside factors including a stronger euro, should provide greater reassurance about the absence of underlying goods price pressures. Elsewhere, the euro area construction figures seem likely to report a decline in activity in May, following a drop in Germany (-3.9%M/M), France (-0.5%M/M) and the Netherlands (-1.8%M/M) that month. We also note that April's reading – which reported a sizeable expansion for the euro area (1.7%M/M) – might be revised, with downwards revisions in Germany and France but an incomprehensibly large, and likely erroneous, upwards revision in Spain (40%M/M).

Euro area: Measures of underlying inflation



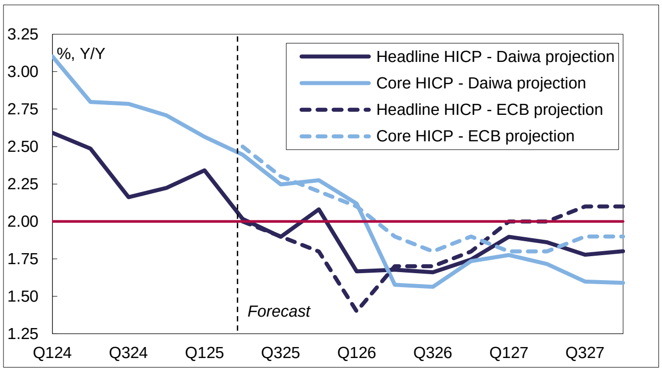
*Persistent and common component of inflation.
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Selected services HICP components



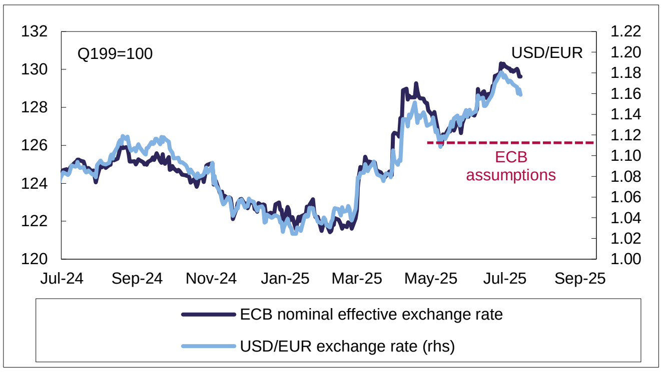
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Inflation projections



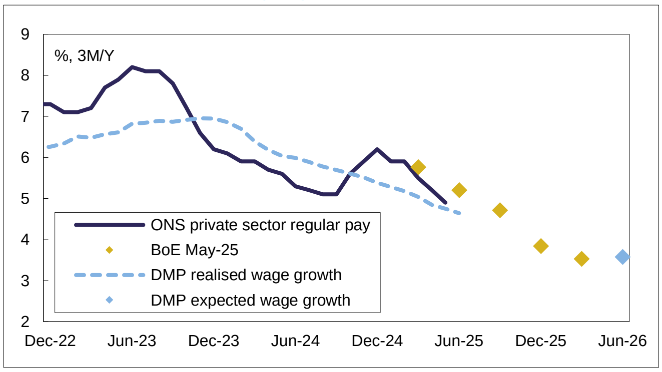
Source: ECB, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Exchange rates



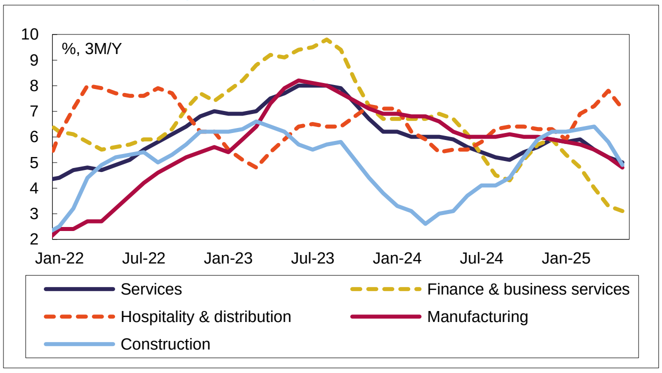
Source: ECB, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Measures of wage growth



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Private regular pay growth



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK

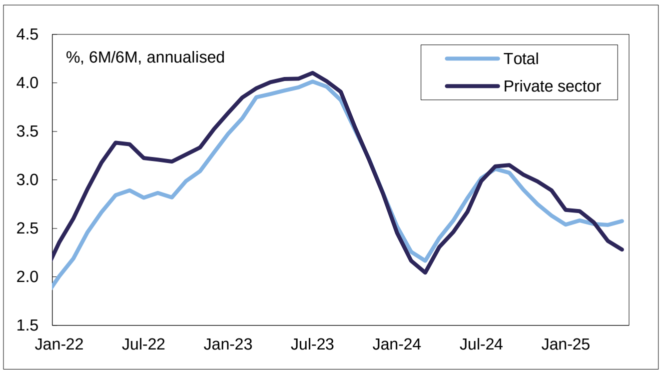
Private regular pay growth softest for more than three years

Today's UK labour market report was once again soft, reporting a further moderation in wage growth and continued weakening in labour demand, to reinforce our expectation that the BoE's MPC will cut Bank Rate next month and maintain their forward guidance in favour of a continued gradual removal of policy restraint thereafter. Indeed, total pay in the three months to May slowed 0.7ppt on the quarter to an eight-month low of 5.0%3M/Y. Private sector pay growth also moderated to 4.9%3M/Y, down 0.8ppt on the quarter and the joint-lowest since January 2022. And, most importantly for the BoE, private sector regular pay (excluding bonuses) slowed a full percentage point on the quarter to 4.9%3M/Y, the lowest since spring 2022 and comfortably undershooting the MPC's end-Q2 projection (5.2%3M/Y). Moreover, despite the jump in the National Living Wage in April, private regular pay on a six-month basis – arguably the best guide to momentum – slowed to a 13-month low of 2.3%6M/6M annualised, reinforcing our assessment that underlying domestically-generated inflation continues to dissipate.

Payrolled employees maintain steady downtrend, with vacancies down to a 4-year low

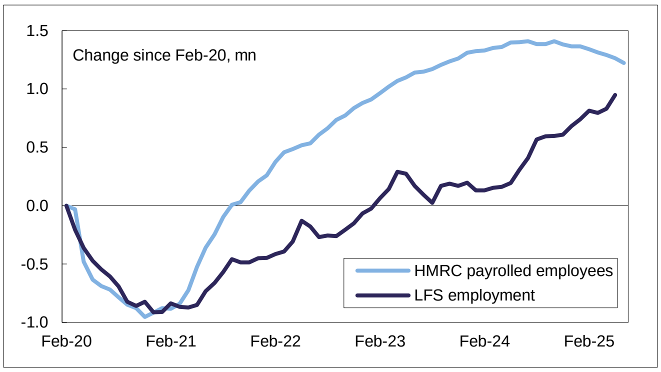
While data inadequacies leave some uncertainty about the current balance between labour supply and demand, on the whole today's report suggested that labour market conditions continue to weaken. Admittedly, the decline in payrolled employees in May was revised significantly, from -109k to -25k, to leave the quarterly drop at 75k, suggesting a less severe deterioration in the jobs market than initially feared. But consistent with various survey signals, today's preliminary data for June nevertheless reported a seventh monthly decline out of eight, by 41k, taking the cumulative fall in payrolls from October – when the government announced the April increase in the NLW and employers' national insurance contributions – to 185k. While much of that drop relates to the hospitality, wholesale and retail sectors, suggesting that higher labour costs have dampened demand, a further fall in payrolls in June in professional, technical and scientific services, manufacturing and construction is suggestive of a broader deterioration. Admittedly, lower payrolls contrasted markedly the further increase in the Labour Force Survey's (LFS) measure of employment, which rose 134k in the three months to May. Nevertheless, the unemployment rate still rose 0.3ppt on the quarter to 4.7% in May, a four-year high. In addition, job vacancies maintained their steady downtrend, falling in the three months to June by 56k, with a decline in 14 out of 18 industries. This left them down some 45% from the peak three years ago and took the ratio of vacancies to unemployment to a four-year low (0.44) consistent with rising slack in the labour market.

UK: Regular pay momentum



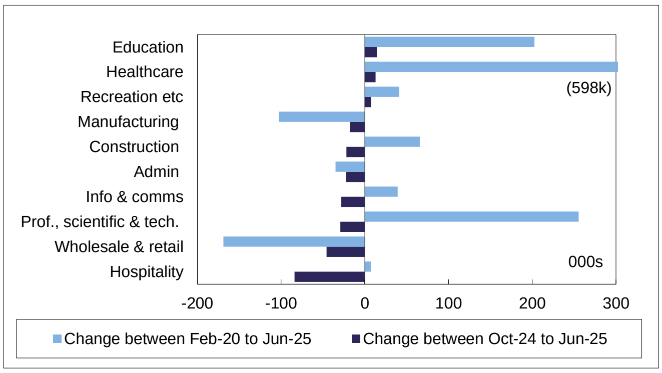
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Employment & payrolled employees



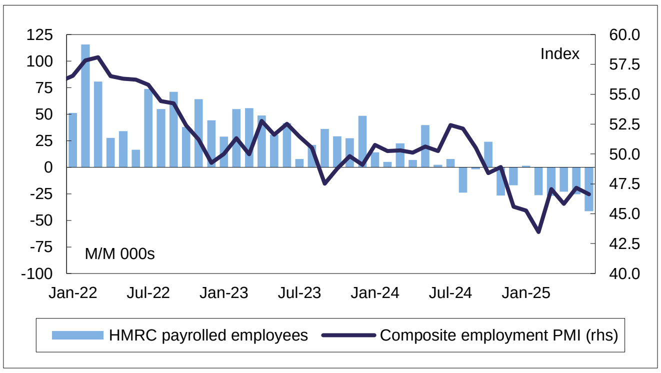
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Payrolled employees



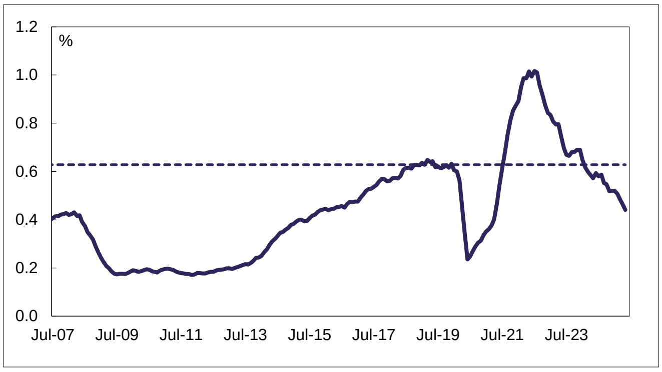
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Payrolled employees & employment PMI



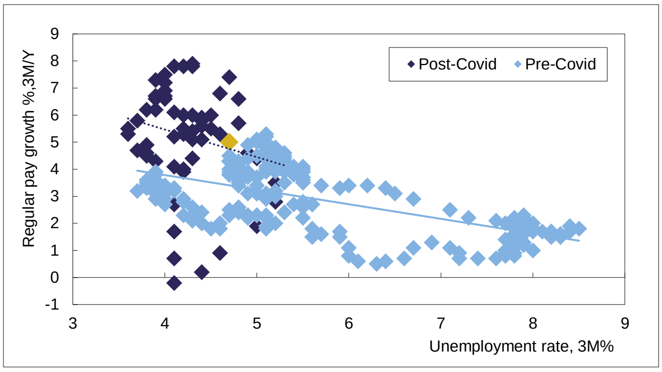
Source: Macrobond, S&P Global and Daiwa Capital Markets Europe Ltd.

UK: Vacancies to unemployment ratio*



*Dashed line represents 2019 average.
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Phillips curve*



*Gold diamond represents latest figures for May-25. Pre-Covid refers to Jan 2001 – Feb 2020.Source: Macrobond and Daiwa Capital Markets Europe Ltd.

The day ahead in the UK

With no data releases scheduled for Friday, it should be a relatively quiet end to the week for UK economic news.

European calendar

Today's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ Daiwa forecast	Previous	Revised
Euro Area		Final headline (core) HICP Y/Y%	Jun	**2.0 (2.3)**	2.0 (2.3)	1.9 (2.3)	-
UK		Average earnings (excluding bonuses) 3M/Y%	May	**5.0 (5.0)**	5.0 (4.9)	5.3 (5.2)	5.4 (5.3)
		Private sector regular wages 3M/Y%	May	**4.9**	4.8	5.1	5.2
		Unemployment rate 3M%	May	**4.7**	4.6	4.6	-
		Employment 3M/3M change 000s	May	**134**	46	89	-
		Payrolled employees M/M change 000s	Jun	**-41**	-35	-109	-25
		Claimant count rate % (change 000s)	Jun	**4.5 (25.9)**	-	4.5 (33.1)	- (15.3)

Auctions

Country		Auction
France		sold €3.953bn of 2.4% 2028 bonds at an average yield of 2.27%
		sold €2.833bn of 2.5% 2030 bonds at an average yield of 2.58%
		sold €5.213bn of 2.7% 2031 bonds at an average yield of 2.74%
		sold €823m of 0.6% 2034 inflation-linked bonds at an average yield of 1.32%
		sold €432m of 0.1% 2038 inflation-linked bonds at an average yield of 1.64%
		sold €185m of 0.55% 2039 inflation-linked bonds at an average yield of 1.70%
Spain		sold €1.746bn of 2.7% 2030 bonds at an average yield of 2.479%
		sold €2.392bn of 3.2% 2035 bonds at an average yield of 3.303%
		sold €1.546bn of 2.7% 2048 bonds at an average yield of 3.965%
UK		sold £4.75bn of 4.375% 2030 bonds at an average yield of 4.078%

Tomorrow's releases

Economic data

Country		BST	Release	Period	Market consensus/ Daiwa forecast	Previous
Euro Area		08.00	ECB current account €bn	May	-	19.8
		10.00	Construction output M/M% (Y/Y%)	May	-	1.7 (3.0)
Germany		07.00	PPI Y/Y%	Jun	-1.3	-1.2

Auctions and events

- Nothing scheduled -

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:
https://www.uk.daiwacm.com/ficc-research/recent-blogs

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.