

Euro wrap-up

Overview

- Bunds followed USTs higher while the flash estimates of euro area HICP in July showed headline inflation unchanged at 2.0%Y/Y.
- Gilts also made gains on a quiet day for UK economic news.
- The BoE on Thursday is expected to cut Bank Rate by 25bps and maintain its forward guidance, while June figures for euro area retail sales, German factory orders, industrial production and goods trade are also due.

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Daily bond market movements

Bond	Yield	Change
BKO 1.9 09/27	1.922	-0.035
OBL 2.2 10/30	2.257	-0.034
DBR 2.6 08/35	2.675	-0.017
UKT 3½ 03/27	3.784	-0.068
UKT 4½ 03/30	3.935	-0.067
UKT 4½ 03/35	4.523	-0.044

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

Euro area

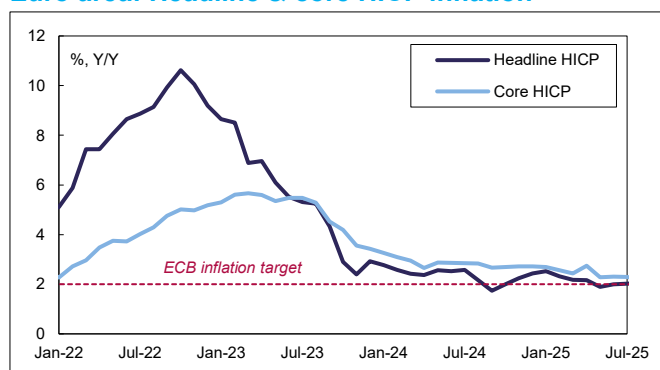
Euro area inflation steady at 2% target in July, reducing the need for further policy easing

While a touch above the Bloomberg consensus forecast, the flash estimates of euro area HICP in July likely reinforced the Governing Council's view that inflation should remain close to target over the horizon with broadly balanced risks, thus supporting our view that the ECB's rate-cutting cycle has now likely come to an end. Indeed, while inflation is now below target in Germany (1.8%Y/Y), France (0.9%Y/Y) and Italy (1.7%Y/Y), the euro area headline rate moved sideways last month bang on 2.0%Y/Y. Within the detail, there was a further increase in food inflation to the highest level for 17 months (3.3%Y/Y). But despite a notable rise in energy prices in July (1%M/M), favourable base effects meant that the respective annual rate was little changed at -2.5%Y/Y. Within the core components, non-energy industrial goods inflation rose to a 15-month high in July (0.8%Y/Y), offsetting a moderation in services inflation (3.1%Y/Y) to the lowest level since March 2022. And so, core inflation similarly moved sideways at 2.3%Y/Y, bang in line with the ECB's projection for Q3 published in June. National and regional data hint that seasonal discounting on clothing may have pushed core goods inflation higher last month. This impulse should prove temporary while imports from China pose downside risks to the outlook for a range of goods prices. And as illustrated by today's final manufacturing PMIs, factory price pressures appear broadly absent for now. While momentum in services prices improved in July, dropping 1ppt to a five-month low (3.1%3M/3M annualised), this remains above the long-run average and a likely bone of contention for Governing Council hawks. Indeed, another strong summer tourism season could yet generate demand-driven price pressures on certain holiday-related items. But overall, core momentum eased back to 2.2%3M/3M ann., suggesting that underlying price pressures remain broadly target-consistent.

Manufacturing PMIs point to softer, but still positive, growth at the start of Q3

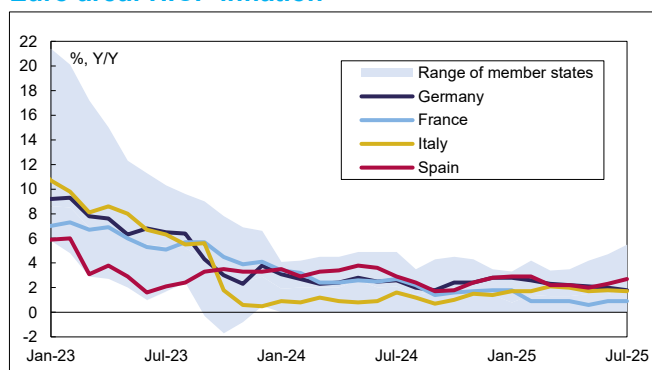
With additional responses to the euro area's July PMI surveys submitted ahead of the confirmation of the EU-US trade deal, there were no significant revisions made to today's final manufacturing survey. Admittedly, the euro area factory output PMI was nudged down slightly from the flash release, by 0.1pt to a four-month low of 50.6. But while this left the index some 0.6pt below the Q2 average, it still pointed to modest expansion at the start of Q3. The slowdown was more striking in Germany, where the output component fell 1.3pts to a five-month low (50.6). But this too was still consistent with modest growth. The respective Irish index encouragingly edged up slightly (54.4) and remained only a touch below the highs earlier in the year when firms significantly boosted production to front-run higher US tariffs, suggesting resilience at the start of Q3. And the Spanish output index (53.0) was also consistent with solid growth. But while the French (48.6) and Italian (49.0) surveys suggested some stabilisation, they continued to imply that manufacturing remains a drag on overall growth. Unsurprisingly given trade uncertainties, the survey signalled that new orders continued to decline at the start of Q3, inventories continued to rise, and manufacturers' expectations for the coming 12 months worsened too.

Euro area: Headline & core HICP inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: HICP inflation

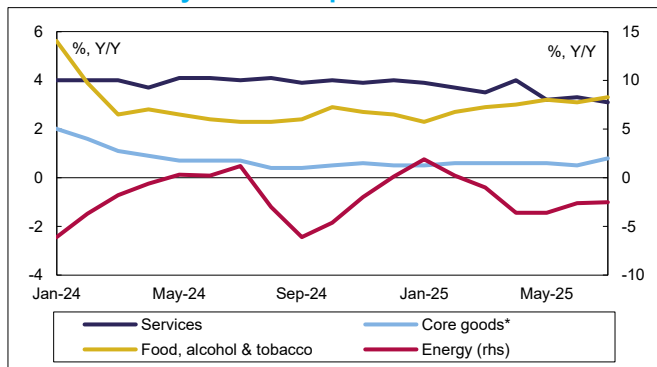


Source: Macrobond and Daiwa Capital Markets Europe Ltd.

The week ahead in the euro area

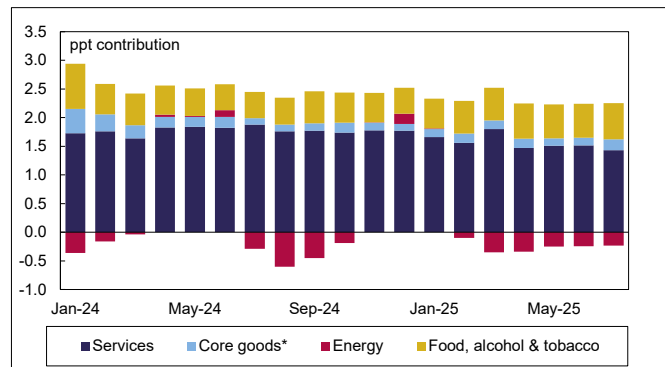
The coming week will bring a host of activity data, principally from the member states. Industrial production figures for June from Germany (Thursday), Italy (Wednesday), France and Spain (Tuesday) will help to form a view of euro area IP in Q2. Over the first two months of the quarter, this proved resilient to tariff headwinds, trending 0.3% above its Q1 level. There remains a good chance that manufacturing added to GDP growth in Germany last quarter. But we might expect some payback there in June to reflect May's strength (1.2%M/M) and a less upbeat ifo survey that month. French and Italian business surveys too point to a negative month for IP, though the former may be due to a rebound following two monthly contractions. Nonetheless, fading trade uncertainty and a domestic bias attached to plans to ramp up defence spending means that expectations for German manufacturers are turning more optimistic. The PMIs too have flagged some resilience in demand, which should be reflected in a pickup in June's factory orders (Wednesday). German goods trade figures (also Thursday), while providing a view of external demand, will inevitably affirm that net goods trade was a contributor to the mild contraction in German GDP in Q2 amid a predictable pullback in exports after strength in Q1. Elsewhere, with today's report of Italian retail sales growth (0.4%M/M) compounding positive contributions from Germany (0.9%M/M) and Spain (1.2%M/M), we expect a modest increase in the euro area in June (Wednesday) to confirm a seventh consecutive quarterly increase in sales volumes. That should reaffirm our view that household consumption continued to grow in Q2 too. And July's final euro area PMIs should underscore that resilience in economic activity extended into Q3. Indeed, the flash composite output PMI picked up to an 11-month high (51.0), likely led by a windfall from tourism-related services in Italy and Spain.

Euro area: Key HICP components



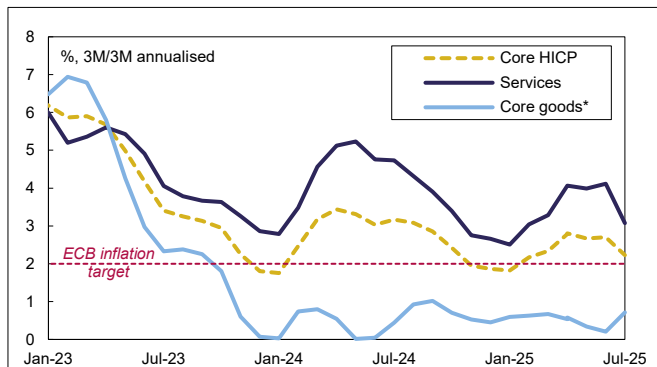
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Contributions to HICP inflation



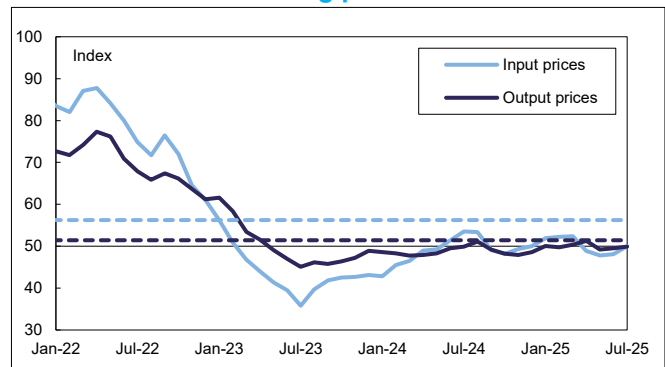
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Core inflation momentum



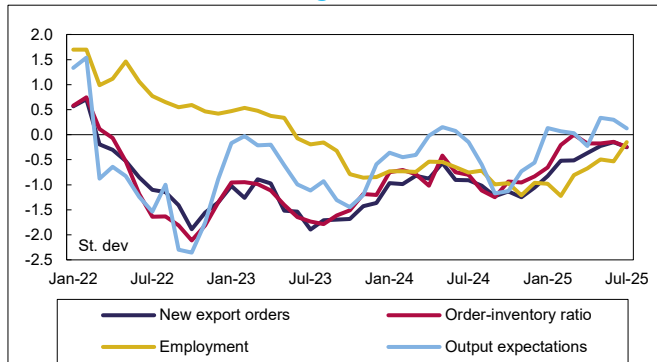
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Manufacturing price PMIs*



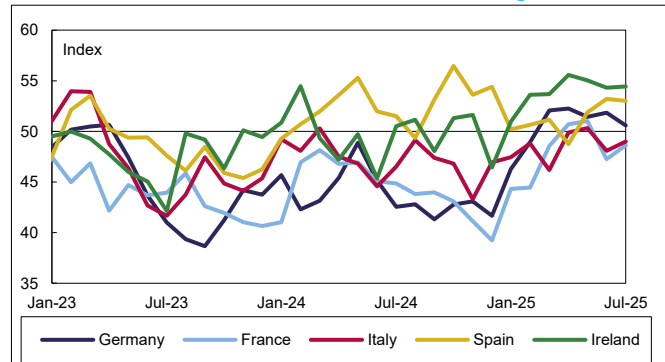
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Manufacturing PMIs



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

Euro area member states: Manufacturing PMIs



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

UK

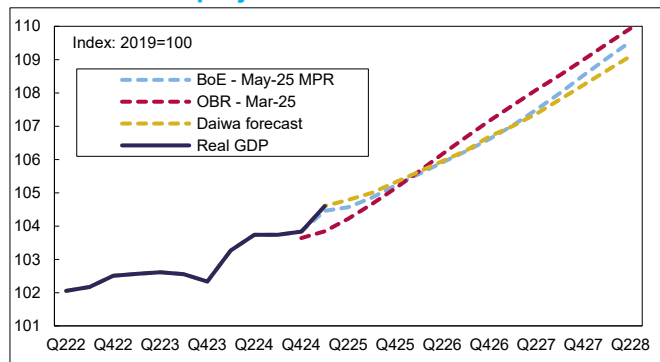
BoE to cut Bank Rate by 25bps on Thursday for the fifth time this cycle, but MPC to be split

Thursday's monetary policy announcement and accompanying update to the BoE's macroeconomic projections will be the coming week's UK highlight. We share the consensus view that the MPC will ease rates by 25bps, maintaining the recent quarterly cadence and marking the fifth such reduction this monetary policy cycle to bring Bank Rate to 4.00%, its lowest level since March 2023. Indeed, as in May – when the MPC last lowered rates despite several new inflationary impulses crystallising in April – we expect the majority on the Committee to judge that the risks of inflation persistence continue to dissipate given the restrictiveness of the Bank's policy stance, subdued underlying economic activity and clear evidence of loosening in the labour market. The MPC will also maintain its forward guidance that “a gradual and careful approach to the further withdrawal of monetary policy restraint remains appropriate”. The decision to cut rates is unlikely to be unanimous, however. We expect external member Mann, and probably also Chief Economist Pill, to remain concerned about potential second-round effects from the current inflation hump and vote for unchanged policy. And while uncertainty about US-UK trade relations has diminished, as in May we would not be surprised to see a three-way split, with the external dove Dhingra, and perhaps also Taylor, voting for a cut of 50bps.

Signs of weakening labour market to persuade majority to vote for continued careful easing

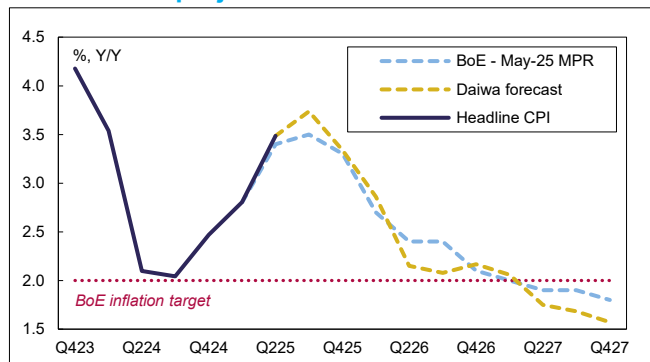
Although inflation data have surprised slightly to the upside in recent months, at 3.5%3M/Y in June the CPI overshoot relative to the Bank's Q2 forecast was minimal at just 0.1ppt. The all-important services component also missed by the same slim margin in June (4.7%Y/Y) with measures of underlying inflation in the sector (i.e. excluding indexed and volatile components) around 4¼%3M/Y and thus well below last year's range. Food inflation, at 4.5%Y/Y in June, was admittedly well above the BoE's forecast, and the MPC's hawks might note some upwards pressure on households' and firms' inflation expectations perhaps as a result. But the broader picture remains consistent with gradual underlying disinflation. Moreover, while GDP appears to have been relatively resilient in Q2 – we expect growth of 0.2%Q/Q following a vigorous 0.7%Q/Q in Q1 – July's flash PMIs were broadly consistent with stagnation in private sector activity at the start of the current quarter amid a further drop in payrolls. Indeed, while there remain concerns about data quality, there is convincing evidence of a sustained loosening in labour market conditions since the autumn. And consistent with a pickup in slack, private sector regular wage growth – the MPC's measure of choice – moderated to its slowest rate in over three years (4.9%3M/Y) in May, some 0.3ppt below the BoE's projection for end-Q2. Surveys signal further moderation in wage growth in coming quarters. So, while it will acknowledge persistent two-sided risks, the majority on the MPC should be sufficiently reassured that normalisation in wage- and price-setting is likely to continue.

UK: GDP level projections



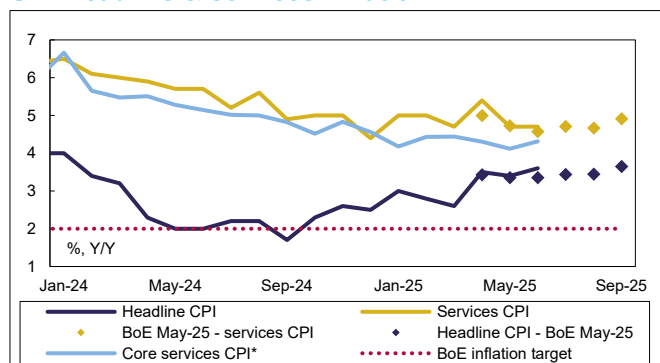
Source: BoE, OBR, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Inflation projections



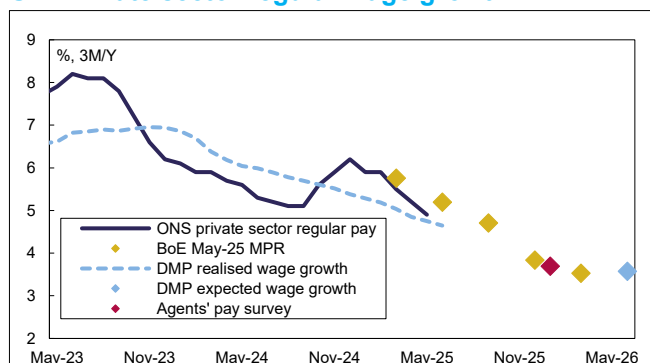
Source: BoE, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Headline & services inflation



*Services excluding indexed & volatile components, rents and foreign holidays measure. Source: Macrobond, BoE and Daiwa Capital Markets Europe Ltd.

UK: Private sector regular wage growth



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

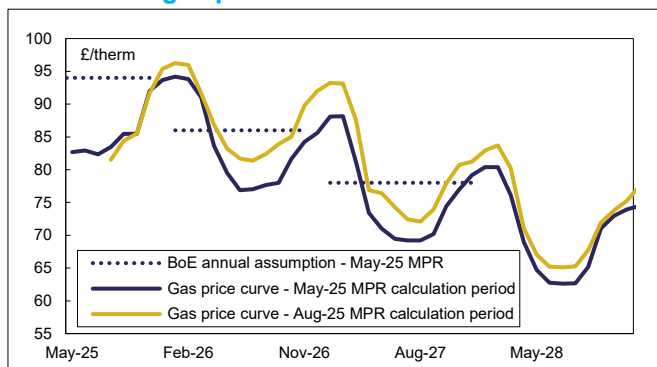
Little change in BoE projections and balance of risks to justify 'gradual' forward-guidance

Indeed, we don't expect to see significant revisions to the BoE's updated macroeconomic projections. While GDP growth in Q1 and Q2 was likely a touch firmer than the BoE forecast in May, the MPC should continue to expect growth close to $\frac{1}{4}\%$ Q/Q in Q3. And thereafter, given the reduction in uncertainty provided by the UK-US trade 'deal', it should continue to project growth close to 0.3% Q/Q or above in each subsequent quarter through to early 2027. Overall, we expect it to nudge its forecast for GDP growth in 2025 slightly higher to $1\frac{1}{4}\%$ Y/Y but leave unchanged its projections for 2026 and 2027 at $1\frac{1}{4}\%$ Y/Y and $1\frac{1}{2}\%$ Y/Y respectively. More importantly for monetary policy, in May inflation was forecast by the BoE to peak at 3.7% Y/Y in Q3. While hotter food inflation as well as a slight uptick in oil prices might call for a near-term upwards revision, the 7% cut in the household energy price cap in July and possibility of a further reduction in October should work in the opposite direction. Thereafter, widening slack in the economy and an associated continued moderation in pay growth should mean that the Bank continues to expect inflation to edge back below 3.0% Y/Y in Q126 and fall steadily back to target by early 2027 and slightly below that level thereafter. And notwithstanding the two-sided risks to that outlook, to be reflected in the BoE's scenario analysis, the baseline projection and assessment that the current policy stance remains restrictive should be sufficient to justify the rate cut this month and further easing at a pace of 25bps per quarter into the first half of next year.

Bailey or Monetary Policy Report to provide clues on September's QT decision?

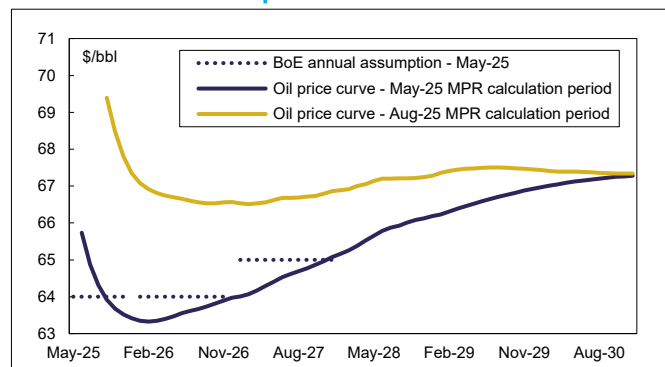
In addition to providing the BoE's updated macroeconomic projections, the August Monetary Policy Report should feature a stock take on Quantitative Tightening (QT), which might offer a clue on that policy's future which will be decided at the September MPC meeting. Not least given the steepening of the yield curve, earlier in the summer Governor Bailey already acknowledged that the decision would be 'more interesting this year' than in September 2024 when the Committee agreed to continue to reduce its Gilt holdings over the coming 12 months by about £100bn. And external member Mann rightly highlighted the potential for QT to unhelpfully counter the transmission of cuts to Bank Rate to longer-term yields. While it will want to defend itself against risks of fiscal dominance, the BoE should also be mindful of the additional challenge that its active bond sales – which are unique among the major central banks – represent for the DMO and HM Treasury. Indeed, while the MPC previously asserted that its QT operations have had a minimal impact on Gilt yields, we expect Mann's view to be widely shared on the Committee. Currently, the BoE's APF holdings amount to little more than £586bn – about £290bn shy of its peak in 2022 – and that amount is set to decline to £558bn by the end of September, just north of the Bank's upper estimate for optimal reserves (between £385bn and £530bn). As such, having made very significant progress in reducing its asset holdings, there is now a good case for slowing the pace of QT by ceasing active Gilt sales and allowing the balance sheet to shrink passively merely via redemptions of maturing bonds. That would allow the BoE greater space to assess the effects on short-term market interest rates as it transitions from an environment of abundant reserves to a new demand-driven, repo-based operating framework.

UK: Natural gas price curves



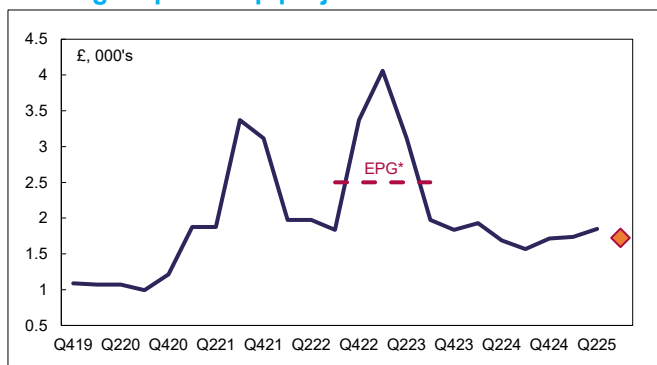
Source: Bloomberg, BoE and Daiwa Capital Markets Europe Ltd.

UK: Brent crude oil price curves



Source: Bloomberg, BoE and Daiwa Capital Markets Europe Ltd.

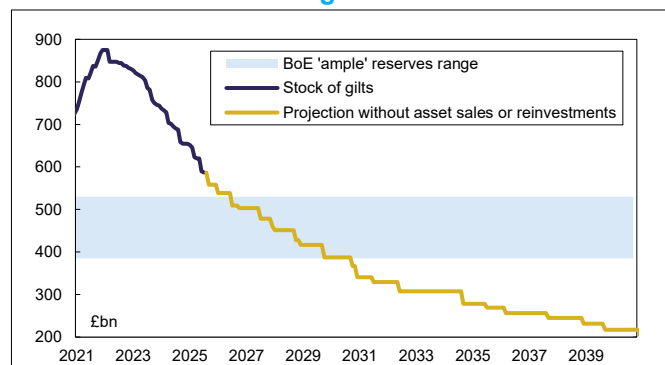
UK: Ofgem price cap projection



*Energy price guarantee.

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

UK: BoE APF Gilt holdings












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

The week ahead for data in the UK

With respect to the economic data, it should be a quiet week for the UK. While July's DMP survey would otherwise prove most consequential, coinciding with Thursday's MPC decision inevitably dampens its attraction. Nonetheless, we expect little change to its core message, which has of late been consistent with gradual moderation in wage growth expectations and a subtle downtrend in output prices. June's hotter inflation print could add an upside risk to the latter, as well as to firms' CPI expectations. Indeed, while July's flash PMIs flagged weaker momentum at the start of Q3 (51.0), output prices were also reportedly a touch firmer (54.9), albeit with pressure still much lower than in April. Tuesday's final composite and services PMIs should provide confirmation of those trends, which also signalled a tenth consecutive month in job shedding (45.1), and at an accelerated pace. The REC's Report on Jobs (Friday) will provide another (likely downbeat) perspective on labour market conditions in July. Finally, July's construction PMIs (Wednesday) will provide an update on activity in that sector, which was its least downbeat year-to-date in June (48.8) after housebuilders reported a first expansion (50.7) in nine months.

The next edition of the Euro wrap-up will be published on 05 August 2025





























Daiwa economic forecast

		2025				2026		2025	2026	2027
		Q1	Q2	Q3	Q4	Q1	Q2			
GDP		%, Q/Q						%, Y/Y		
Euro area		0.6	0.1	0.1	0.2	0.2	0.3	1.2	0.9	1.3
UK		0.7	0.2	0.2	0.3	0.3	0.3	1.2	1.2	1.4
Inflation, %, Y/Y										
Euro area										
Headline HICP		2.3	2.0	1.9	2.1	1.7	1.7	2.2	1.8	1.8
Core HICP		2.6	2.4	2.2	2.3	2.1	1.6	2.4	1.8	1.6
UK										
Headline CPI		2.8	3.5	3.7	3.3	2.9	2.2	3.3	2.3	1.8
Core CPI		3.6	3.7	3.7	3.4	3.1	2.3	3.6	2.4	1.6
Monetary policy, %										
ECB										
Deposit Rate		2.50	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00
Refi Rate		2.65	2.15	2.15	2.15	2.15	2.15	2.15	2.15	2.15
BoE										
Bank Rate		4.50	4.25	4.00	3.75	3.50	3.25	3.75	3.25	3.00

Source: Bloomberg, ECB, BoE and Daiwa Capital Markets Europe Ltd.












The coming week's data calendar

The coming week's key data releases

Country		BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Monday 4 August 2025						
Euro area		09.30	Sentix investor confidence indicator	Aug	6.9	4.5
Spain		08.00	Unemployment change (employment net change) M/M 000s	Jul	-	-48.9 (40.4)
Tuesday 5 August 2025						
Euro area		09.00	Final composite (services) PMI	Jul	<u>51.0 (51.2)</u>	50.6 (50.5)
		10.00	PPI Y/Y%	Jun	0.6	0.3
Germany		08.55	Final composite (services) PMI	Jul	<u>50.3 (50.1)</u>	50.4 (49.7)
France		07.45	Industrial production M/M% (Y/Y%)	Jun	0.6 (-0.6)	-0.5 (-0.9)
		08.50	Final composite (services) PMI	Jul	<u>49.6 (49.7)</u>	49.2 (49.6)
Italy		08.45	Composite (services) PMI	Jul	51.5 (52.5)	51.1 (52.1)
Spain		08.00	Industrial production M/M% (Y/Y%)	Jun	-	0.6 (1.7)
		08.15	Composite (services) PMI	Jul	52.6 (52.5)	52.1 (51.9)
UK		09.00	New car registrations Y/Y%	Jul	-	6.7
		09.30	Final composite (services) PMI	Jul	<u>51.0 (51.2)</u>	52.0 (52.8)
Wednesday 6 August 2025						
Euro area		08.30	Construction PMI	Jul	-	45.2
		10.00	Retail sales M/M% (Y/Y%)	Jun	0.3 (2.6)	-0.7 (1.8)
Germany		07.00	Factory orders M/M% (Y/Y%)	Jun	1.0 (2.1)	-1.4 (5.3)
		08.30	Construction PMI	Jul	-	44.8
France		07.45	Preliminary private sector payrolls Q/Q%	Q2	-	-0.1
		08.30	Construction PMI	Jul	-	41.6
Italy		08.30	Construction PMI	Jul	-	50.2
		09.00	Industrial production M/M% (Y/Y%)	Jun	-	-0.7 (-0.9)
UK		09.30	Construction PMI	Jul	48.9	48.8
Thursday 7 August 2025						
Germany		07.00	Industrial production M/M% (Y/Y%)	Jun	-0.5 (-1.0)	1.2 (1.0)
		07.00	Trade balance €bn	Jun	18.2	18.5
France		07.45	Trade balance €bn	Jun	-	-7.8
		07.45	Preliminary wages Q/Q%	Q2	-	0.7
UK		12.00	BoE Bank Rate %	Aug	<u>4.00</u>	4.25
		14.00	DMP 3M output price (1Y CPI) expectations Y/Y%	Jul	-	3.6 (3.3)
Friday 8 August 2025						
France		06.30	ILO unemployment rate (mainland) %	Q2	7.5 (7.3)	7.4 (7.2)

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.










The coming week's key events & auctions

Country	BST	Event / Auction
Monday 4 August 2025		
- Nothing scheduled -		
Tuesday 5 August 2025		
Germany 	10.30	Auction: to sell €5bn of 1.9% 2027 bonds
UK 	10.00	Auction: to sell £4.5bn of 4.5% 2035 bonds
Wednesday 6 August 2025		
Germany 	10.30	Auction: to sell €1.5bn of 1% 2038 bonds
	10.30	Auction: to sell €1bn of 3.25% 2042 bonds
Thursday 7 August 2025		
Euro area 	09.00	ECB to publish Economic Bulletin 5/2025
France 	09.50	Auction: to sell up to €10.5bn of 1.25% 2034, 1.25% 2036, 0.5% 2040 & 4% 2055 bonds
Spain 	09.30	Auction: to sell 2.4% 2028, 3.2% 2035, 3.45% 2043 bonds and 1% 2030 inflation-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 in post-MPC press conference
Friday 8 August 2025		
UK 	00.01	REC, KPMG & S&P Global UK Report on Jobs for July
	12.15	BoE Chief Economist Pill to brief Bank's Agents on updated macroeconomic projections

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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	2.0 (2.3)	<u>1.8 (2.2)</u>	2.0 (2.3)	-
	Final manufacturing PMI	Jul	49.8	<u>49.8</u>	49.5	-
Germany 	Final manufacturing PMI	Jul	49.1	<u>49.2</u>	49.0	-
France 	Final manufacturing PMI	Jul	48.2	<u>48.4</u>	48.1	-
Italy 	Manufacturing PMI	Jul	49.8	48.7	48.4	-
	Retail sales M/M% (Y/Y%)	Jun	0.6 (1.0)	0.3 (1.6)	-0.4 (1.3)	- (1.4)
Spain 	Manufacturing PMI	Jul	51.9	51.8	51.4	-
UK 	Nationwide house price index M/M% (Y/Y%)	Jun	0.6 (2.4)	0.5 (2.2)	-0.8 (2.1)	-0.9 (-)
	Final manufacturing PMI	Jul	48.0	<u>48.2</u>	47.7	-

Auctions

Country	Auction
- Nothing to report -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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