

Euro wrap-up

Overview

- While the ZEW survey suggested that investors have tempered their optimism in the German economic outlook, Bunds made losses.
- Despite a further moderation in private sector pay growth and falling job vacancies in the UK, Gilts made larger losses on mixed signals on employment.
- Wednesday will bring final data for German and Spanish inflation in July.

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Daily bond market movements

Bond	Yield	Change
BKO 1.9 09/27	1.964	+0.005
OBL 2.2 10/30	2.316	+0.030
DBR 2.6 08/35	2.743	+0.049
UKT 3¼ 03/27	3.873	+0.019
UKT 4% 03/30	4.033	+0.035
UKT 4½ 03/35	4.621	+0.059

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

Euro area

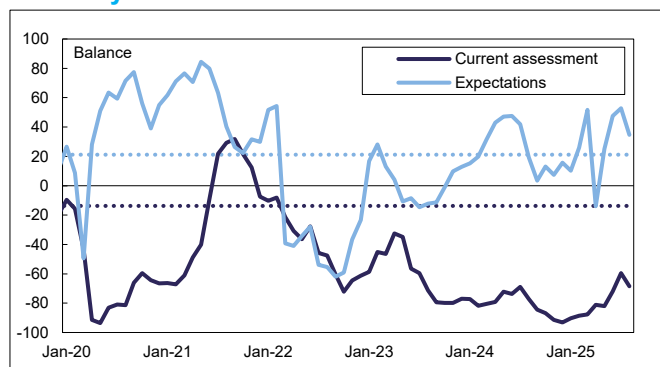
ZEW survey suggests investors are tempering their optimism regarding German economic outlook

Mirroring the deterioration in investor sentiment flagged by August's Sentix indicator, today's ZEW survey predictably followed suit and by a touch more than expected. In particular, the ZEW indices for current German economic conditions (down 9.1pts to -68.6) and the six-month outlook (down 18pts to 34.7) dropped for the first month in three and four months respectively. Nevertheless, the expectations index remained above its long-run average for the sixth month in seven. And with greater clarity on the EU's trading relationship with the US, profit expectations in several subsectors – particularly services, including financial services, telecoms and IT – remained firmly positive. Constructors were slightly less upbeat, possibly reflecting the lower probability of further ECB policy easing, as only a minority of survey respondents predicted a rate cut over the coming six months for the first time since December 2023. Nonetheless, while the EU-US trade agreement avoided a 'worst-case' scenario for key sectors, the 15% tariff rate agreed for autos and auto parts failed to improve confidence in that sector, with the mood also deteriorating with respect to chemicals, steel and machinery.

The day ahead in the euro area

Ahead of the release next week of the detailed data for euro area inflation in July, Wednesday's final estimates from Germany and Spain will provide clues, albeit with contrasts between the two member states. Indeed, the flash releases reported that Spanish HICP inflation rose more sharply in July, by 0.4ppt to 2.7%Y/Y, driven particularly by a greater contribution from energy and probably some tourism-adjacent services. Meanwhile, moderation in services inflation in Germany contributed to the downside surprise in that member state (down 0.2ppt to 1.8%Y/Y on the EU-harmonised measure), undershooting the ECB's target for the first month in ten. Ultimately, neither member state is expected to deviate significantly from their preliminary estimates, just as Monday's final Italian print offered little in the way of a surprise. In line with the flash estimates, headline Italian HICP inflation was confirmed to have softened a touch, down 0.1ppt to 1.7%Y/Y, with favourable energy base effects (-3.5%Y/Y) helping to offset a further increase in fresh food prices (5.9%Y/Y, an 18-month high). And with services inflation sidestepping at 3.0%Y/Y, core inflation also held steady, at 2.1%Y/Y.

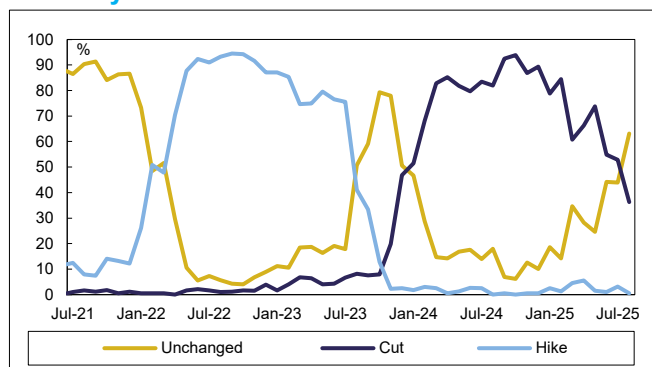
Germany: ZEW – headline indices*



*Dotted lines show long-run averages.

Source: Macrobond and Daiwa Capital Markets Europe Ltd.

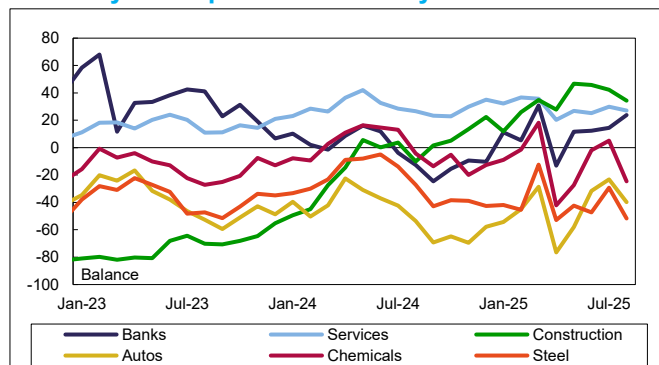
Germany: ZEW – short-term interest rates*



*6-month ahead expectations.

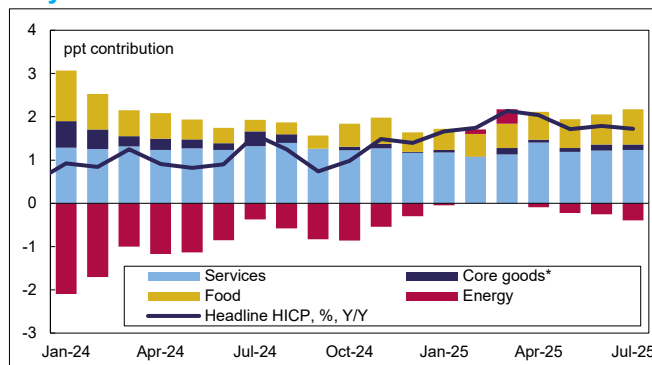
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: ZEW profit situation by subsector



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Italy: HICP inflation contributions



*Non-energy industrial goods.

Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK

Vacancies at lowest level since 2014 outside the pandemic to suggest labour demand keeps falling

At his post-MPC press conference on Thursday, BoE Governor Bailey suggested that recent developments in the labour market, including evidence of rising slack and moderating pay growth, had justified the further [25bps cut to Bank Rate](#). Today's labour market data provided mixed signals, to provide a reminder that – in part due to data quality challenges – the balance between the supply and demand for workers remains difficult to gauge accurately. However, consistent with recent indications from the DMP and REC surveys, the detailed wage data suggested further slowing in private sector pay. And a sixteenth successive monthly decline in the number of job vacancies in July to the lowest level in more than a decade bar the pandemic, and well below the 2019 level, pointed to ongoing weakening of labour demand. So, while the unemployment rate was unchanged at 4.7% in the three months to June, the ratio of vacancies to jobless workers fell that month to the lowest level since 2015 outside of the pandemic. And – given the July vacancies data – it is likely to have fallen further last month to suggest rising labour slack. Overall, therefore, the balance of views on the MPC is unlikely to have changed materially after today's figures.

Private sector pay growth continues to moderate to point to ongoing disinflation

In some respects, today's labour market data were stronger than expected. Coinciding with the unchanged unemployment rate, the LFS measure of employment jumped 238k in the three months to June marking the biggest increase in nine months. But data quality concerns associated with low survey response rates, which are far inferior to the much-maligned US equivalents, mean that figure cannot be fully trusted. Indeed, the rise in employment in the three months to June was almost fully accounted for by a pickup in the number of full-time employees (238k), which was inconsistent with the sixth successive monthly decline in the HMRC figure for payrolled employees (and eighth decline in the past nine months) in July to the lowest level since October 2023. So, we continue to place most weight on the pay data. The BoE's preferred measure of private sector regular wage growth – which undershot significantly its May projection over recent months – edged down slightly on a three-month basis to 4.8%3M/Y. But that masked a more significant fall of 0.4ppt in the single-month measure to 4.5%Y/Y, the lowest level since end-2021, reflecting notable softening in hospitality, finance and other services. So, it suggested that the downtrend in private sector pay growth remains intact. And the BoE's updated forecast for pay growth in September (4.6%3M/Y) already looks a little too high. Moderating pay growth should imply ongoing disinflation. However, with headline inflation up from April due to higher administered prices and taxes and set to remain elevated into the autumn, real total wage growth slowed in June to a two-year low of just 0.5%3M/Y, a development which similarly seems likely to be sustained to restrain household spending growth over the near term at least.

Slowing real incomes amid stubborn inflation risk underwhelming retail sales in Q3

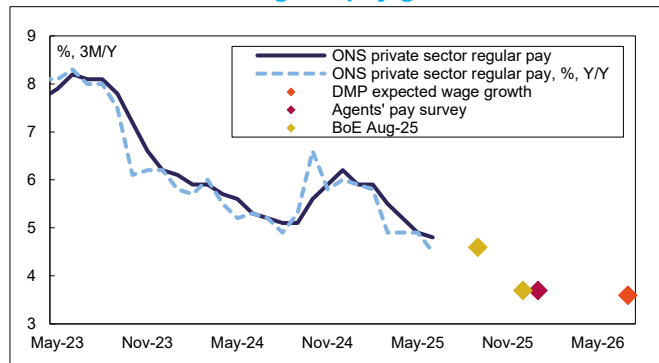
While the official ONS measure of retail sales volumes edged up last quarter (0.2%3M/3M), economic uncertainty weighed on spending, particularly in May when sales fell the most since end-2023. Looking ahead, we see further downside risks from slowing wage growth, stubborn inflation and household concerns about falling labour demand. Indeed, July's GfK consumer survey reported a spike in savings intentions to their highest level since late-2007. So, perhaps unsurprisingly, today's BRC retail monitor – often a good proxy to the official retail sales series – hinted at an underwhelming start to Q3 for retailers. Total (2.5%Y/Y) and like-for-like retail sales values (1.8%Y/Y) slowed in July, by 0.6ppt and 0.9ppt respectively, albeit maintaining a faster annual pace than May's low. So, deflated by the BRC's gauge of shop price inflation, the slowdown in like-for-like retail sales was more pronounced, with growth more than halved to just 1.1%Y/Y perhaps in part as due to the impact of high inflation on real incomes. Mirroring the detail of the CPI data, the BRC's food price inflation measure picked up to a 17-month high last month. So, while like-for-like food sales were still up 3.5%3M/Y in value terms, potentially benefitting from another month of warm weather, in real terms growth stalled (0.0%3M/Y) for the first month this year. By comparison, sales volumes of non-food items were more resilient (1.6%3M/Y), helped by persistent deflation in

clothing, electronics and furniture. But with that impetus its weakest in 12-months (-1.0%Y/Y) and growth in non-food sales values broadly softer, that also marked a six-month low. With weaker support from sales of auto fuel also likely in July, we expect July's retail sales (data due 22 August) to flag an underwhelming start to Q3.

The day ahead in the UK

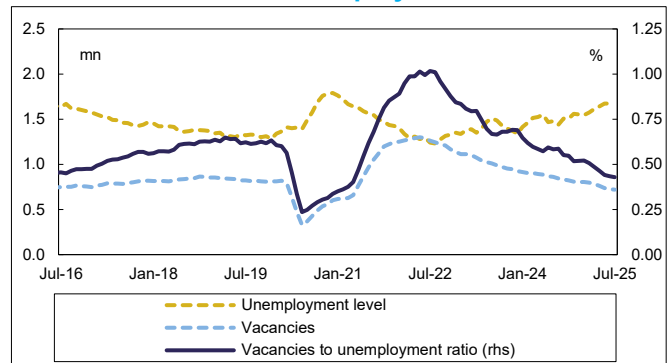
Ahead of Thursday's GDP data for June and Q2, Wednesday should be a quiet day for the UK economic news flow.

UK: Private sector regular pay growth



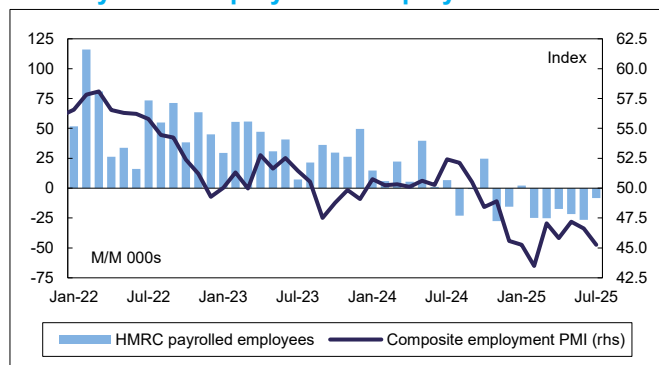
Source: BoE, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Job vacancies & unemployment



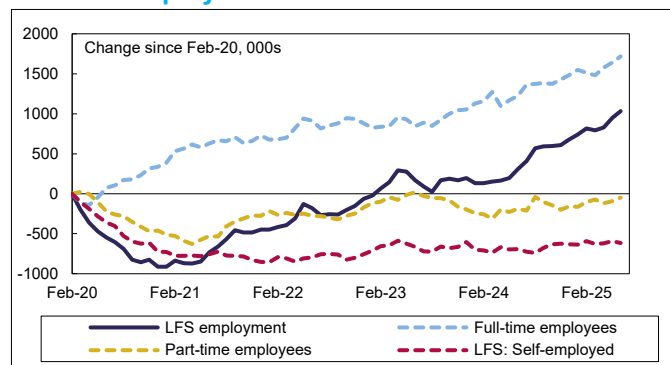
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Payrolled employees & employment PMI



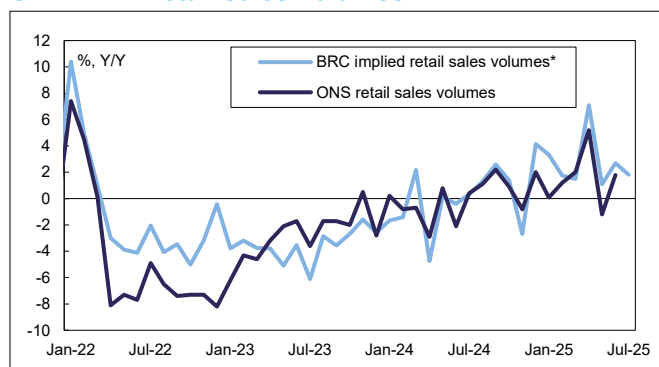
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: LFS employment



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

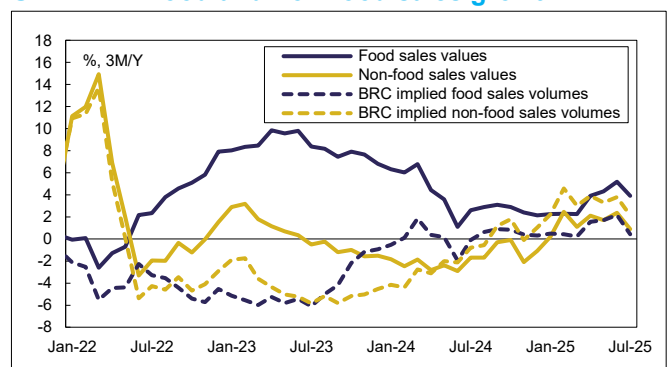
UK: BRC – retail sales volumes



*Deflated by the BRC shop price index.

Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: BRC – food and non-food sales growth











Source: Macrobond and Daiwa Capital Markets Europe Ltd.


European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <u>Daiwa forecast</u>	Previous	Revised
Germany	 ZEW current situation (expectations) balance	Aug	-68.6 (34.7)	-67.0 (39.5)	-59.5 (52.7)	-
UK	 Averages wages (excluding bonuses) 3M/Y%	Jun	4.6 (5.0)	4.7 (5.0)	5.0 (5.0)	-
	 Private sector regular wages 3M/Y%	Jun	4.8	4.8	4.9	-
	 Unemployment rate 3M%	Jun	4.7	4.7	4.7	-
	 Employment 3M/3M change 000s	Jun	238	185	134	-
	 Payrolled employees M/M change 000s	Jul	-8	-20	-41	-26
	 Claimant count rate % (change 000s)	Jul	4.4 (-6.2)	-	4.5 (25.9)	4.4 (-15.5)
	 BRC retail monitor – like-for-like sales Y/Y%	Jul	1.8	2.0	2.7	-


Auctions

Country	Auction
UK	 sold £4.75bn of 4.375% 2030 bonds at an average yield of 4.022%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <u>Daiwa forecast</u>	Previous	Revised
Italy	 Final HICP (CPI) Y/Y%	Jul	1.7 (1.7)	<u>1.7 (1.7)</u>	1.8 (1.7)	-



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/ <u>Daiwa forecast</u>	Previous
Germany	 07.00	Final HICP (CPI) Y/Y%	Jul	<u>1.8 (2.0)</u>	2.0 (2.0)
Spain	 08.00	Final HICP (CPI) Y/Y%	Jul	<u>2.7 (2.7)</u>	2.3 (2.3)

Auctions and events

Germany	 10.30	Auction: to sell €5bn of 2.6% 2035 bonds
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Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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