Euro wrap-up

Overview

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- While the drop in German core inflation in July was largely due to softness in services categories that are typically volatile and might be expected to rebound, Bunds followed USTs higher.
- Gilts also made gains on a quiet day for economic news from the UK.
- Thursday will bring updates on GDP in Q2 and industrial production in June in the euro area and UK.

Daily bond market movements

Bond	Yield	Change
BKO 1.9 09/27	1.929	-0.035
OBL 2.2 10/30	2.254	-0.060
DBR 2.6 08/35	2.679	-0.062
UKT 3¾ 03/27	3.858	-0.017
UKT 4⅜ 03/30	4.010	-0.025
UKT 4½ 03/35	4.591	-0.033

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

Euro area

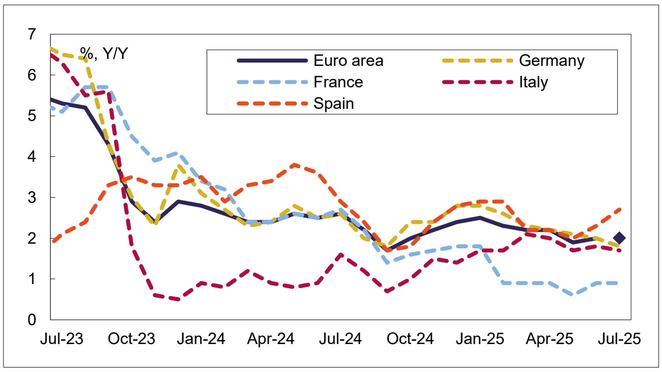
Fall in German core HICP inflation in July reflected weakness in volatile services components

Today's final estimates of German and Spanish inflation in July provided no surprises, aligning with the flash estimates. So, the final euro area figures, due next week, are similarly likely to match the respective preliminary numbers, which showed both headline (2.0%Y/Y) and core inflation (2.3%Y/Y) moving sideways at the start of Q3. The German EU-harmonised HICP measure fell 0.2ppt to 1.8%Y/Y, a ten-month low matching the weakest since February 2021 and softer than originally anticipated ahead of the flash release. The German core HICP rate (excluding food and energy) edged down 0.1ppt to 2.4%Y/Y, the lowest since August 2021, with the improvement due principally to a stepdown of 0.5ppt in the services component to 3.0%Y/Y, the lowest since August 2022. While welcome, we caution that much of that fall was thanks to non-negligible declines in the air fare, train fare and package holiday components, which are typically highly volatile and will likely rebound in due course. In contrast to the softer services component, core goods inflation rose in July, by 0.3ppt to 1.2%Y/Y. Increases in furniture, household appliances and clothing were perhaps in part related to changes in the timing of summer discounting and so might similarly reverse over the near term. Beyond the core components, inflation of food, beverages and tobacco was unchanged at 2.8%Y/Y with significant increases in items such as coffee and chocolate offset by declines in vegetables among others. Energy inflation (-3.4%Y/Y) was little different from in June, with modest changes in the annual rates for household bills and auto fuels alike. Differences in basket weightings, not least for transport services and package holidays, meant that the German national headline and core CPI inflation rates were unchanged in July at 2.0%Y/Y and 2.7%Y/Y respectively. Looking ahead, the profile of the German HICP and CPI rates will be affected by significant base effects. But we expect the trend over the coming year to be broadly sideways around 2.0%Y/Y, albeit with the risks skewed somewhat to the downside.

Energy base effects & transport services drove uptick in Spanish inflation

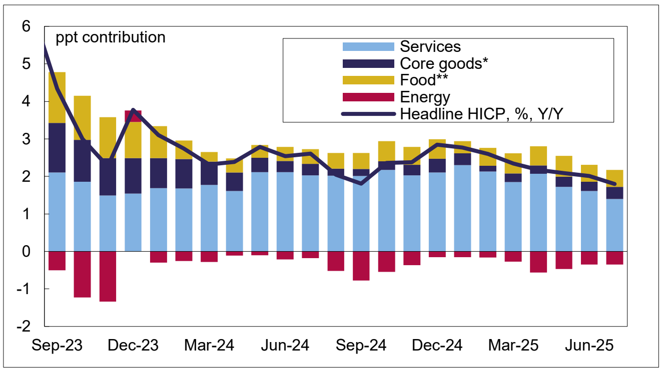
In Spain, headline inflation on both the national and harmonised measures picked up 0.4ppt to 2.7%Y/Y in line with the flash estimates. Due to highly unfavourable base effects relating to household electricity, energy inflation on the national CPI measure rose back to a five-month high of 3.3%Y/Y, almost fully accounting for the rise in headline inflation. The remaining pressure was concentrated in services inflation, which ticked 0.2ppt higher to 3.4%Y/Y, and nudged up the core rate to a three-month high of 2.3%Y/Y. Like the source of some of the downwards pressure in Germany, the upwards pressure in Spanish services principally owed to airfares and public transport services, the latter of which reflected changes to administered prices of certain tickets from the start of the month. By contrast, other services components were broadly unmoved. Given the nature of those increases and evidence of moderate services disinflation elsewhere in the euro area, we certainly don't expect the rise in Spanish inflation to raise concerns on the ECB's Governing Council. Moreover, today's

Euro area: HICP inflation in large member states*



*Diamond shows euro area flash reading for July.
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: HICP inflation & contributions



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Spanish data also hinted at slowing momentum in fresh food prices, while seasonal discounting in clothing (-9.2%M/M) ensured that core goods inflation (0.6%Y/Y) remained negligible.

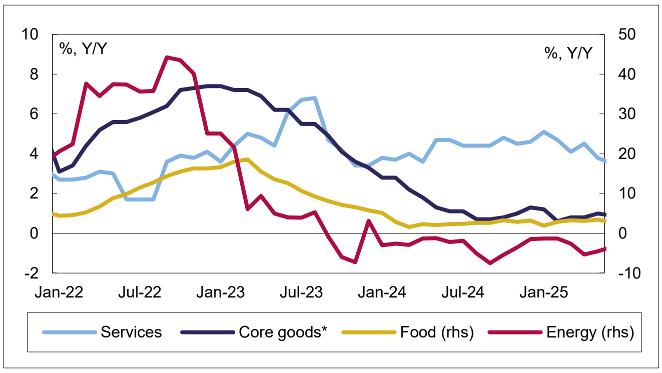
The day ahead in the euro area

Last quarter's euro area activity data will be back in focus on Thursday with June's IP figures accompanied by a second estimate of GDP growth in Q2. Despite the pickup in French (3.8%M/M), Spanish (0.8%M/M) and Belgian (5.1%M/M) production that month, substantial payback in Germany (-2.3%M/M) and Ireland (-11.3%M/M) for strength in Q1 will have provided significant offset. As such, we expect a decline between 1-1½%M/M in the euro area, which would leave it broadly flat in Q2. The falls in Germany and Ireland in June raise the risks of downward revisions to the estimates of GDP growth in those member states, respectively contractions of 0.1%Q/Q and 1.0%Q/Q following firm growth in the first quarter. So, the risks to the preliminary euro area estimate (0.1%Q/Q) similarly seem skewed to the downside. Thursday's second estimate will provide a timely update, though little in the way of additional detail besides an estimate for quarterly employment growth. Employment growth stalled in the core euro area member states in Q2, with Germany (-7k) and France (-31.5k) both paring jobs, the latter for a third-consecutive quarter. But continued absorption of slack across southern Europe, and particularly Spain (156.4k), should have continued to raise employment at the aggregate euro area level, albeit likely by a marginal 0.1%Q/Q.

The day ahead in the UK

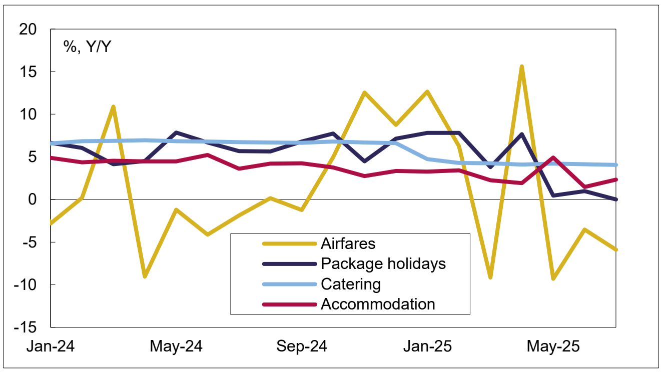
Preliminary estimates for Q2 GDP and June economic output will also dominate Thursday's UK economic news-flow. As observed in the euro area, UK GDP is expected to have slowed significantly in the second quarter after growth in Q1 (0.7%Q/Q) was boosted by several temporary factors. Consequently, we expect the provisional expenditure breakdown to attribute weakness in part to the pullback in net trade and softer fixed investment. Nonetheless, we expect growth to have been positive, and at 0.2%Q/Q to have been marginally stronger than the BoE's August projection (0.1%Q/Q). Indeed, the monthly GDP series has made clear significant carry-over of growth from Q1. Despite contractions in April and May, we expect both the construction and services sectors to have contributed positively to GDP growth in Q2. With regards to June specifically, the recovery in housing market activity, an uptick in retail sales and warm weather should lend themselves to a more upbeat monthly GDP print. Industrial production, being 1.1% below its Q1 level in May after three monthly declines, should also be due to some payback. So, we expect economic output to have picked up 0.2%M/M, to be also consistent with growth on a three-monthly basis of 0.2%3M/3M.

Germany: Major HICP inflation components



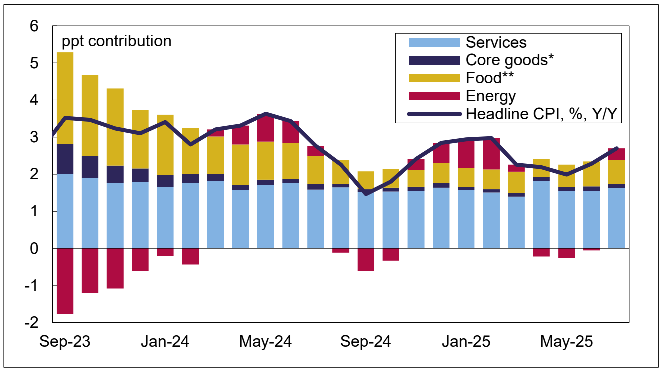
*Non-energy industrial goods.
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Selected HICP services components



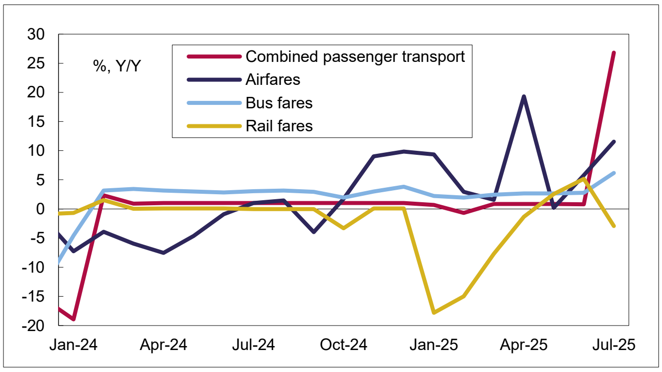
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Spain: CPI inflation & contributions



*Non-energy industrial goods. **Includes alcohol & tobacco.
Source: INE, Macrobond and Daiwa Capital Markets Europe Ltd.

Spain: Transport services inflation



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

European calendar

Today's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Germany	Final HICP (CPI) Y/Y%	Jul	**1.8 (2.0)**	*1.8 (2.0)*	2.0 (2.0)	-
Spain	Final HICP (CPI) Y/Y%	Jul	**2.7 (2.7)**	*2.7 (2.7)*	2.3 (2.3)	-

Auctions

Country	Auction
Germany	sold €3.885bn of 2.6% 2035 bonds at an average yield of 2.69%

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	GDP – second estimate Q/Q% (Y/Y%)	Q2	*0.1 (1.4)*	0.6 (1.5)
	10.00	Employment – first estimate Q/Q% (Y/Y%)	Q2	-	0.2 (0.7)
	10.00	Industrial production M/M% (Y/Y%)	Jun	-1.0 (1.5)	1.7 (3.7)
France	07.45	Final HICP (CPI) Y/Y%	Jul	*0.9 (1.0)*	0.9 (1.0)
UK	00.01	RICS house price balance %	Jul	-	-7
	07.00	GDP – first estimate Q/Q% (Y/Y%)	Q2	*0.2 (1.0)*	0.7 (1.3)
	07.00	Monthly GDP M/M% (3M/3M%)	Jun	*0.2 (0.2)*	-0.1 (0.5)
	07.00	Services output M/M% (3M/3M%)	Jun	0.2 (0.2)	0.1 (0.4)
	07.00	Industrial output M/M% (Y/Y%)	Jun	0.3 (-0.2)	-0.9 (-0.3)
	07.00	Construction output M/M% (Y/Y%)	Jun	0.3 (1.5)	-0.6 (1.2)
	07.00	Trade (goods trade) balance £bn	Jun	-5.8 (-21.9)	-5.7 (-21.7)
	09.30	Preliminary output per hour Y/Y%	Q2	-	-0.2

Auctions and events

- Nothing scheduled -

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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