

# Euro wrap-up

## Overview

- Apart from at the super-long end, Bunds made losses as the ECB predictably left its policy and guidance unchanged but gave a stronger impression that rates have now reached their terminal levels for this cycle.
- Gilts made gains as a survey flagged a weakening in conditions in the UK housing market, likely in part due to ongoing fiscal policy uncertainty.
- Friday will bring UK GDP data for July and final estimates for German, French and Italian inflation in August.

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### Daily bond market movements

Bond	Yield	Change
BKO 1.9 09/27	1.979	+0.033
OBL 2.2 10/30	2.252	+0.030
DBR 2.6 08/35	2.653	+0.004
UKT 3½ 03/27	3.922	-0.010
UKT 4½ 03/30	4.039	-0.013
UKT 4½ 03/35	4.605	-0.025

\*Change from close as at 5:00pm BST.  
Source: Bloomberg

## Euro area

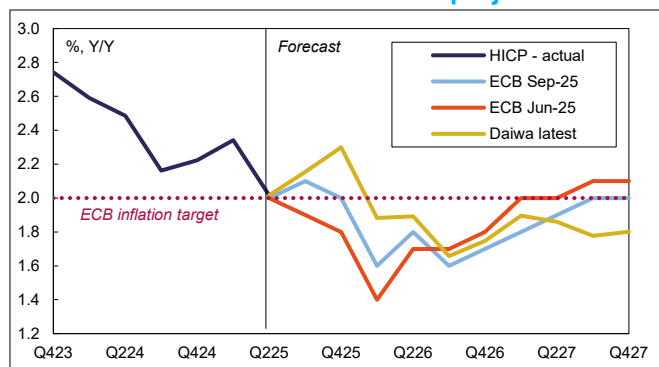
### ECB expects inflation to remain close to target, reinforcing view that rates have reached terminal

As expected, the ECB left its interest rates and forward guidance unchanged when the Governing Council's monetary policy meeting concluded today. So, its key deposit rate was maintained at 2.00%, within the ECB's staff range of estimates of neutral policy. And while President Lagarde repeated in her press conference that policy remains in 'a good place', the Council statement reiterated that rates are not on a pre-set path and future decisions will remain data dependent and taken on a meeting-by-meeting basis. The ECB's updated projections revised up the near-term profile of inflation, principally to reflect higher food pressures. But given the stronger euro, they also revised down the price outlook for the second half of the projection period. The downwards revision to the 2027 forecasts for headline and core inflation to below target rates (1.9%Y/Y and 1.8%Y/Y respectively) arguably suggested that a further rate cut still can't be ruled out. But those full-year figures masked the fact that the ECB still expects headline and core inflation to return to 2.0%Y/Y and 1.9%Y/Y respectively by the end of that year. And with Lagarde also judging that the disinflation process has now ended and risks to the price outlook remain two-sided, her comments supported our (consensus) view that the ECB has now probably reached its terminal rate for the cycle. Indeed, with the price outlook still considered to be 'more uncertain than usual', Lagarde added that minimal deviations of inflation from target would not merit policy adjustments. It will likely require a non-negligible shock to merit a further rate cut over the coming quarters.

### Risks to growth now more balanced, reinforcing case for steady monetary policy

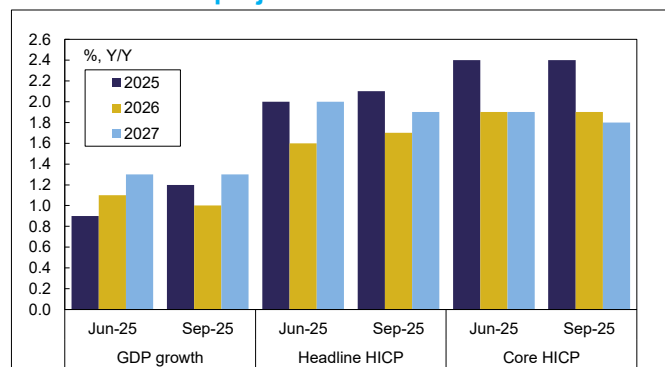
Like Lagarde's comments and its revised inflation outlook, the ECB's updated view on economic output also suggested diminished need for further policy easing. With activity in the first half of the year having been stronger than the staff had previously expected, and underlying growth momentum judged recently to have picked up, its full-year forecast for GDP growth in 2025 was revised up by a substantive 0.3ppt to 1.2%Y/Y. Reflecting some modest payback for that strength, it nudged down its 2026 projection slightly to 1.0%Y/Y. But it also left unchanged its view that increased spending on infrastructure and defence will promote an acceleration in 2027 to 1.3%Y/Y. Most importantly perhaps, having previously seen the risks to growth as skewed to the downside, the Governing Council considered those risks to 'have become more balanced'. In part, that reflects reduced uncertainty about trade as well as the resilience of domestic demand. But Lagarde also seemed relatively unperturbed about developments in France, noting that sovereign bond market adjustments have remained orderly and do not (yet) represent a material tightening of financial conditions. Of course, there remain non-negligible two-sided risks to the outlooks for both growth and inflation, including those posed by politics and geopolitics. And significant further euro appreciation or a marked deterioration in the external environment (e.g. if the US slid into recession) could yet prompt renewed policy easing. But the ECB's updated projections are now very close to our own. And we share the view, implied by market pricing, that the probability of further easing is now less than it seemed just three months ago.

### Euro area: Headline HICP inflation projections



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

### Euro area: ECB projections – GDP & inflation

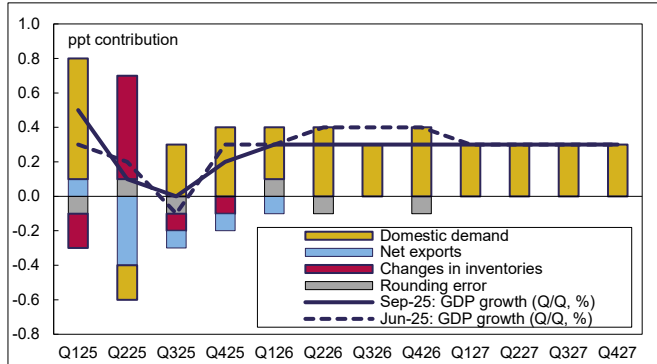


Source: ECB, Macrobond and Daiwa Capital Markets Europe Ltd.

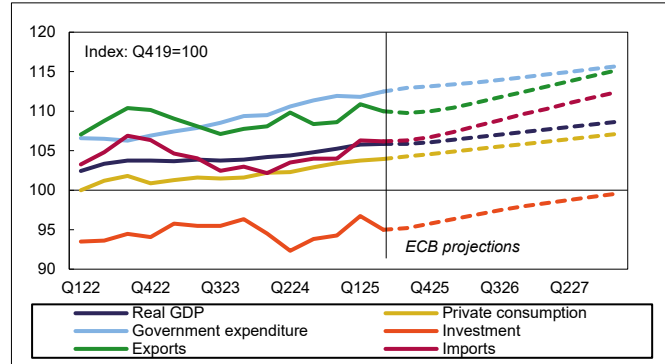
## The day ahead in the euro area

Friday's inflation data detail from Germany, France and Spain will provide greater clarity into the drivers behind the slight step-up in the euro area headline rate in August to 2.1%Y/Y. According to the flash figures, that principally reflected the rise in Germany (up 0.3ppt to 2.1%Y/Y) amid a pickup in food and energy inflation, the latter likely providing the largest impulse given unfavourable fuel-related base effects. In contrast, the flash releases showed that headline inflation moved sideways in Spain (2.7%Y/Y) and eased 0.1ppt in France (0.8%Y/Y). France's softer reading was likely driven by lower transportation prices, bringing services inflation in that member state to its lowest rate since January 2021.

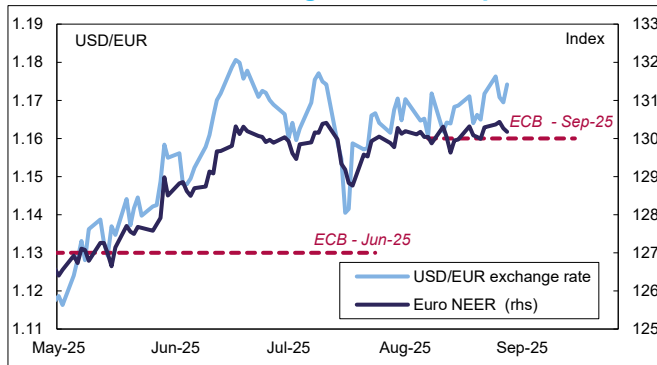
### Euro area: ECB GDP & contribution projections



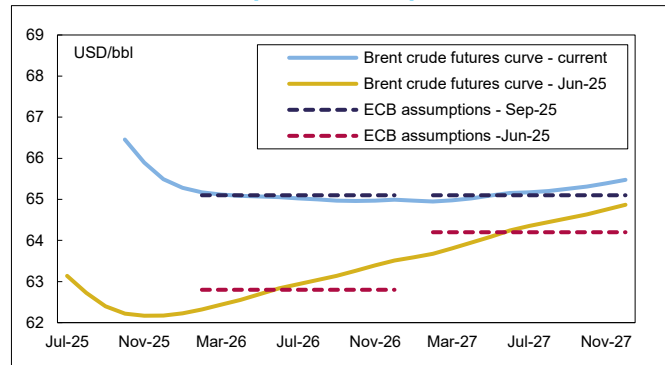
### Euro area: ECB GDP level projections



### Euro area: ECB exchange rate assumptions



### Euro area: ECB oil price assumptions



## UK

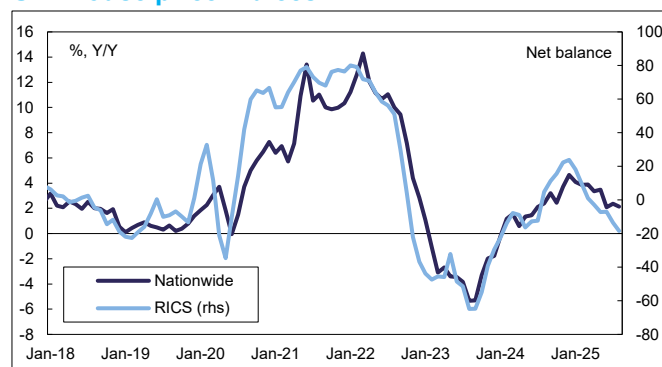
### RICS flags how policy concerns are weighing on housing market

The UK housing market was distorted significantly earlier in the year as residential buyers brought forward transactions ahead of April, when the government restored its stamp duty thresholds to levels previously relaxed in September 2022. Indeed, mortgage lending surged in Q1 (£21bn) at one of the fastest rates on the series dating back more than three decades. After some inevitable payback in April, mortgage lending recovered somewhat heading into the summer, while mortgage approvals rose back close to the pre-pandemic five-year average. But, despite the further cut in interest rates last month, other housing market data have been less encouraging, likely in part reflecting new uncertainties related to potential tax reforms to come in the autumn budget. At this stage, possible changes to the tax treatment of capital gains and stamp duty on higher-value properties, as well as council tax, are merely a matter of speculation. And they could prove a political and fiscal minefield. But at least in part due to this speculation, the latest RICS residential survey, published overnight, was downbeat. Tallying with the further decline in the Nationwide house price index in August – for the fourth month out of the past six – the RICS house price balance fell to a 19-month low (-19%), with substantial declines in the Southwest (-46%) and Southeast England (-25%). Against this backdrop, surveyors suggested that new instructions fell for the first time since June 2024. And with new buyer enquiries down for an eighth successive month and at a steeper pace than in July, newly agreed sales reportedly fell at the fastest pace since May. Given concerns about the nature and magnitude of potential tax hikes, surveyors expect little improvement in house prices over the coming twelve months, with sales expectations for the year ahead similarly the lowest since October 2023. Separately, but perhaps reflecting the renters' reform bill due to be implemented in early 2026, today's survey also suggested that rental listings dropped last month by the most since the first Covid-19 lockdown, underscoring the downbeat tone to the residential market.

## The day ahead in the UK

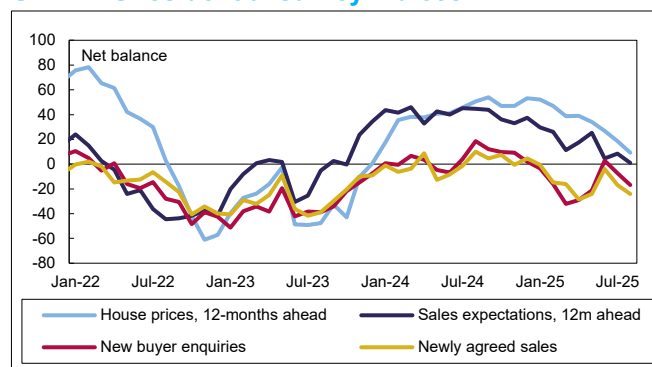
Having risen a firm 0.4%M/M in June, tomorrow's monthly GDP data for July are likely to report a moderation in growth at the start of Q3. In particular, the composite PMI declined ½pt to 51.5 that month as an improvement in manufacturing output to a nine-month high failed to fully offset softer momentum in services. The construction PMI posted a much larger decline in July to a five-year low (44.3) suggestive of a large pullback, although we caution that this index has proved a less than reliable guide to activity in that sector. In terms of hard data, the ONS's revised retail sales series signalled that consumer spending remained firm. Given also the early start of the school holidays, that should bring some upside to services. And despite the decline in the PMIs, we note that the composite output figure was still above its average for the preceding quarter and consistent with positive, albeit relatively subdued, growth. Overall, we expect growth of 0.2%M/M, to the high side of market forecasts. That would also leave the three-month rate trending sideways at 0.3%3M/3M. But we acknowledge that the risks to our call are skewed to the downside. After a pickup in production in Q2, manufacturing output might pose a downside risk not least given the unpredictable impacts of summer maintenance and US tariffs. However, with respect to the latter, we note that timelier US trade data suggest that goods imports from the UK rose to a four-month high in July.

### UK: House price indices



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

### UK: RICS residential survey indices



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

## European calendar

### Today's results

#### Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area	ECB Deposit (Refinancing) Rate %	Sep	<b>2.00 (2.15)</b>	<u>2.00 (2.15)</u>	2.00 (2.15)	-
UK	RICS house price balance %	Aug	<b>-19</b>	-10	-13	-

#### Auctions

Country	Auction
Italy	sold €3.25bn of 2.35% 2029 bonds at an average yield of 2.44%
	sold €1.5bn of 4% 2030 bonds at an average yield of 2.76%
UK	sold £1.25bn of 0.5% 2029 bonds at an average yield of 3.841%
	sold £1bn of 4.25% 2032 bonds at an average yield of 4.206%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

### Wednesday's results

#### Economic data





Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Italy	Industrial production M/M% (Y/Y%)	Jul	<b>0.4 (0.9)</b>	0.1 (-0.1)	0.2 (-0.9)	- (-0.7)
Spain	Industrial production M/M% (Y/Y%)	Jul	<b>-0.5 (2.5)</b>	-0.2 (2.6)	1.0 (2.3)	- (1.9)

#### Auctions

Country	Auction
Germany	sold €603m of 4.75% 2040 bonds at an average yield of 2.96%
	sold €1.167bn of 2.6% 2041 bonds at an average yield of 3.03%
	sold £4bn of 4% 2031 bonds at an average yield of 4.208%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

**Tomorrow's releases**
**Economic data**

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Germany 	07.00	Final HICP (CPI) Y/Y%	Aug	<u>2.1 (2.2)</u>	1.8 (2.0)
France 	07.45	Final HICP (CPI) Y/Y%	Aug	<u>0.8 (0.9)</u>	0.9 (1.0)
Spain 	08.00	Final HICP (CPI) Y/Y%	Aug	<u>2.7 (2.7)</u>	2.7 (2.7)
UK 	07.00	Monthly GDP M/M% (3M/3M%)	Jul	<u>0.2 (0.3)</u>	0.4 (0.3)
	07.00	Services output M/M% (3M/3M%)	Jul	0.0 (0.3)	0.3 (0.4)
	07.00	Industrial output M/M% (Y/Y%)	Jul	0.0 (1.1)	0.7 (0.2)
	07.00	Construction output M/M% (Y/Y%)	Jul	-0.2 (1.9)	0.3 (1.5)
	07.00	Trade (goods trade) balance £bn	Jul	-4.1 (-21.9)	-5.0 (-22.2)
	09.30	BoE/lpsos inflation attitudes survey – 1Y ahead CPI Y/Y%	Q3	-	3.2

**Auctions and events**

- Nothing scheduled -

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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