

Euro wrap-up

Overview

- While some ECB Governing Council members left open the door to further rate cuts, Bunds made losses across the curve.
- Gilts also followed the global trend lower despite a loss of GDP growth momentum in July.
- The BoE is expected to leave rates unchanged on Thursday but will announce an updated path for QT in the coming 12 months.

Economic Research Team

+44 20 7597 8326

Daily bond market movements

Bond	Yield	Change
BKO 1.9 09/27	3.974	+0.052
OBL 2.2 10/30	4.089	+0.050
DBR 2.6 08/35	4.670	+0.065
UKT 3½ 03/27	2.014	+0.035
UKT 4% 03/30	2.305	+0.053
UKT 4½ 03/35	2.713	+0.060

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

Source: Bloomberg

Euro area

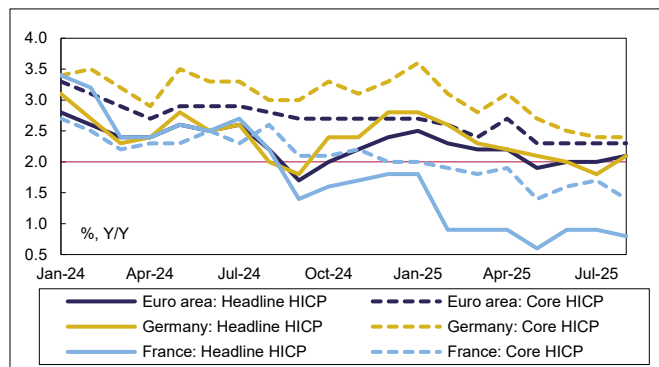
Underlying inflation target-consistent, but some ECB members see scope for a further rate cut

Yesterday's ECB decision to leave policy unchanged was unanimous among the Governing Council members. But in her press conference, President Lagarde admitted that she should not 'overstretch the general agreement in the room'. There are inevitably differences of opinion on the Council about the appropriate path of policy ahead. And several members are unwilling yet to declare that the easing cycle has already concluded. Among those members still mindful of potential downside risks to inflation from sources such as euro strength and redirected imports from China is French Governor Villeroy, whose judgement will be shaped in part by the continued absence of inflationary pressures in his home country. Indeed, today's final August inflation estimates showed the French headline rate remained well below target (0.8%Y/Y) with core goods inflation close to zero for a fourth consecutive month. French services inflation also took a step down in August (2.0%Y/Y) to the joint-lowest level since January 2022, temporarily impacted by favourable base effects in package holidays and underground and tram prices, with the latter having been hiked a year ago during the Paris Olympics. Overall, today's figures suggest that underlying price pressures remain well behaved across the region, albeit still broadly consistent with inflation being sustained at target rather than below 2.0%Y/Y. In Germany, core inflation moved sideways at 2.4%Y/Y, the softest rate for four years, with services inflation down to a three-year low as hospitality inflation maintained a gradual downtrend. Today's figures confirmed that the increase in German inflation (by 0.3ppt to 2.1%Y/Y) reflected a smaller drag from the energy component, as well as a renewed pickup in food inflation. At the margin, this might strengthen concerns among certain ECB hawks about potential second-round effects from higher food prices on services inflation and expectations. And certainly, with two-sided risks to the inflation outlook, we think the swaps market is currently correct to price the probability of a further rate cut over the coming 12 months at somewhat less than 50%.

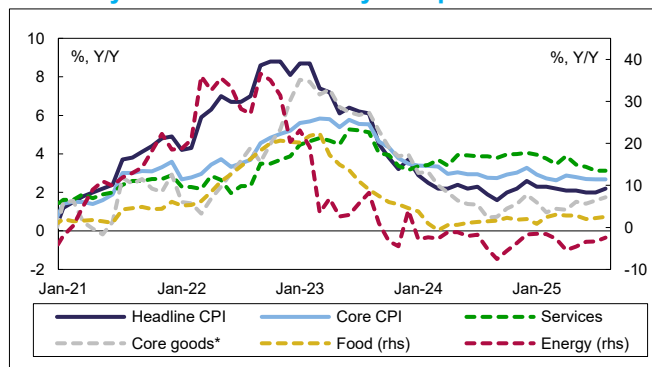
The week ahead in the euro area

With no significant revisions made to the data from the largest member states, the final euro area inflation figures for August (due Wednesday) are expected to align with their flash estimates. These reported a slight uptick in the headline HICP rate, by 0.1ppt to 2.1%Y/Y. But this reflected a smaller drag from the energy component as the decline in auto fuel prices was smaller than a year earlier. More importantly perhaps, services inflation moderated slightly to 3.1%Y/Y, the softest rate since March 2022. And with non-energy industrial goods inflation still subdued (0.8%Y/Y), core inflation moved sideways at 2.3%Y/Y. In the coming week, German producer price figures (Friday) are likely to imply a continued absence of underlying pipeline pressures in the factory sector over the summer. Meanwhile, final labour cost data for Q2 (Tuesday) are expected to confirm the slight pickup in growth last quarter, but job vacancy data (Monday) will likely confirm a further pullback in vacancies to their lowest level since Q121 consistent with an easing in the tightness of the jobs market.

Euro area: Headline & core HICP inflation



Germany: CPI inflation & key components



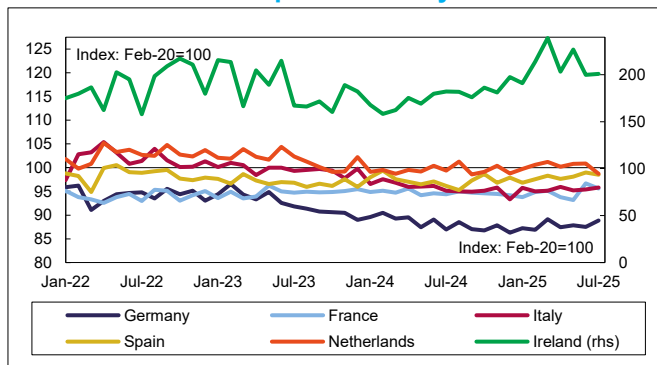
The coming week will also provide more insight into euro area economic growth momentum at the start of Q3, with July figures for goods trade (Monday), industrial production (Tuesday) and construction activity (Thursday). The data published by the member states have been mixed, with extra-euro area exports from Germany down that month (-2½%M/M), but those from France up (3½%M/M). Despite a rebound in Germany and Ireland – production increased 1.5%M/M in both countries – declines in France, Spain and the Netherlands suggest that aggregate euro area industrial output likely posted only modest growth in July – up ½%M/M at most – to leave it broadly flat compared with Q2. Meanwhile, a slight pickup in Germany and France suggests that euro area construction activity posted very modest growth in July. But a further adjustment in Spain as payback for rampant growth earlier in the year might dampen the extent of the recovery in the sector in the euro area at the start of Q3. In addition, several surveys will give an update on sentiment at the end of the third quarter. Like the past week's Sentix survey, the German ZEW investor survey (Tuesday) might well flag a deterioration in sentiment surrounding conditions and expectations in September, perhaps in part reflecting the weaker August US payrolls report. Finally, ahead of the flash PMIs (due 23 September), the French INSEE business survey (Friday) will be watched for signs of ongoing economic resilience at the end of Q3 despite heightened political uncertainty.

UK

Despite expansion in services & construction, growth momentum moderates in July on IP pullback

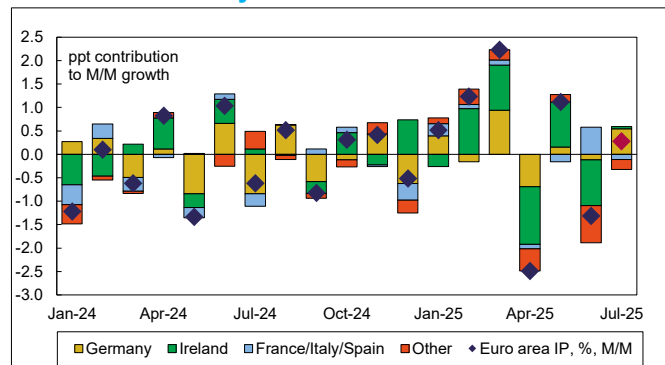
GDP growth momentum moderated at the start of Q3, with the three-month rate easing 0.1ppt from Q2 to 0.2%3M/3M. That reflected a broadly flat level of output in July relative to the prior month, but the annual growth rate was unchanged at 1.4%Y/Y to match the strongest in the year to-date. The all-important services sector continued to expand (0.1%M/M and 0.4%3M/3M) thanks not least to a policy-led boost from healthcare (2.5%3M/3M). Legal, R&D and computer programming and consultancy services also all continued to grow firmly on a three-month basis (more than 3.0%3M/3M) reflecting firm demand from businesses. But while accommodation (1.7%3M/3M) benefited from the early start to the school holidays, output from consumer-facing services dropped (-0.6%3M/3M). Meanwhile, despite weaker signals from surveys, the construction sector also remained a source of growth (0.2%M/M and 0.6%3M/3M) with new private housebuilding rising to a two-year high (1.0%3M/3M). So, the weakness in July was centred on industrial production, which fell to an eight-month low (-1.2%M/M and -1.3%Y/Y). Manufacturing (-1.1%3M/3M) was weighed by autos (-5.3%3M/3M), metals (-2.7%3M/3M) and chemicals (-3.5%3M/3M), which had all surged in Q1 as firms front-ran US tariffs. Mining and quarrying (-1.8%3M/3M) was also weak, which – as for some factory sub-sectors – might reflect summer maintenance. Surveys suggest that manufacturing output remained subdued in August but also that momentum picked up in services to a 16-month high. So, we maintain our expectation that GDP growth in Q3 remained at least as firm as the 0.3%Q/Q in Q2.

Euro area: Industrial production by member state



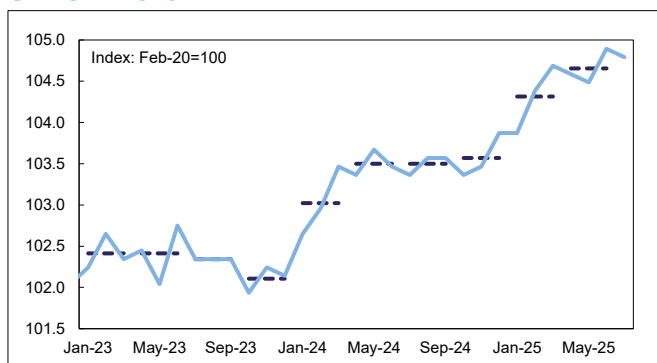
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Country contributions to IP*



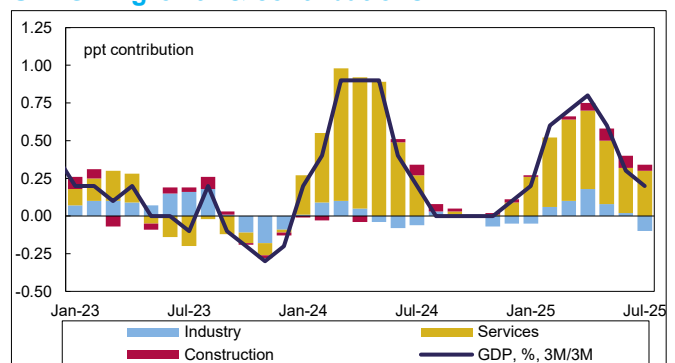
*Red diamond for July is Daiwa forecast of the euro area output figure.
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: GDP level*



*Dashed dark blue line represents quarterly average. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: GDP growth & contributions

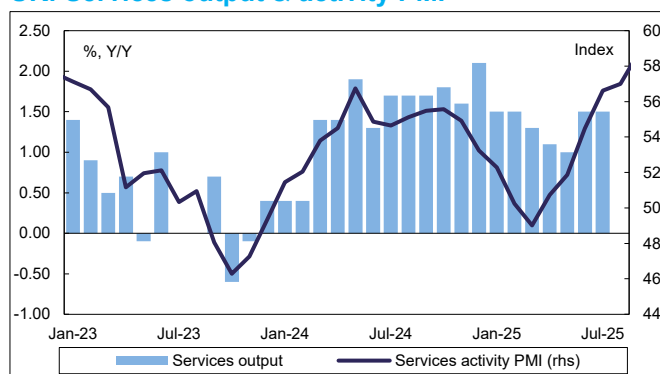


Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Underlying trade deficit widens to 2-year high despite pickup in shipments to the US

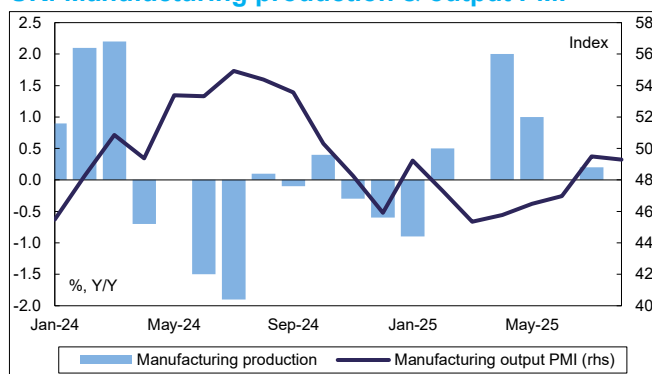
The disappointing performance of factory output in July was matched by a deterioration in the UK trade balance that month. The overall trade deficit rose just £0.2bn to a five-month high (£5.3bn). But that was flattered by shipments of precious metals including non-monetary gold, which are typically extremely volatile and distort the underlying trend. Excluding such items, the underlying trade deficit rose to a 12-month high (£4.2bn), with the goods deficit on the same basis rising to the highest level in more than two years (£21.2bn). Due to firm growth in imports, the worsening of the underlying deficit occurred despite a pickup in goods exports in both value (6.6%M/M) and volume terms (5.2%M/M). Shipments to the US picked up to a four-month high, led by raw materials, chemicals and transport equipment. But they remained well down on levels in Q424 and Q125, which were flattered by tariff front-running. According to an ONS survey, the largest share of UK goods-exporting firms affected by US tariffs in August reported passing on the additional costs to customers, but a non-negligible share chose to pause or cease shipments to the US altogether. Of course, the value of UK services exports is worth about 50% more than that of goods exports. And despite a modest decline on the month, the trend of services exports remained firm (2.1%3M/3M) in July.

UK: Services output & activity PMI



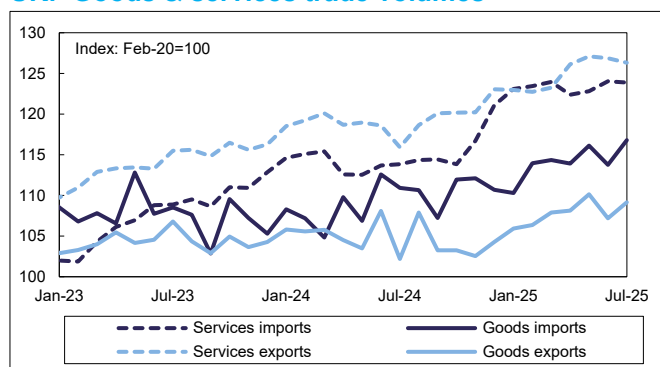
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Manufacturing production & output PMI



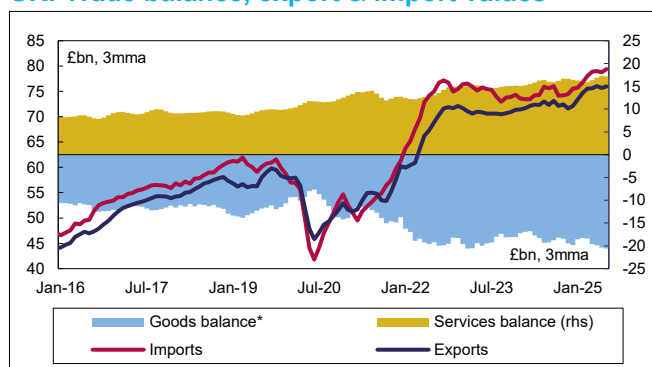
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Goods & services trade volumes*



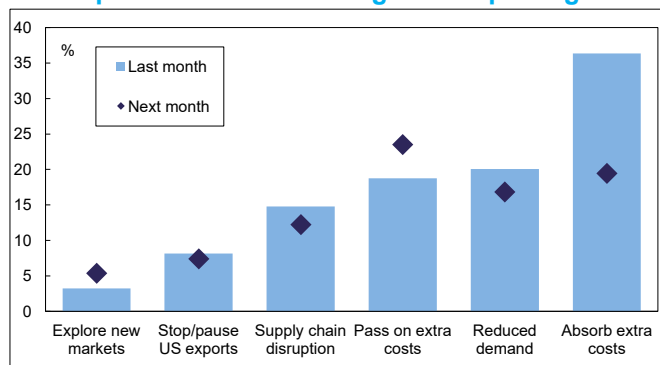
*Excluding precious metals. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Trade balance, export & import values*



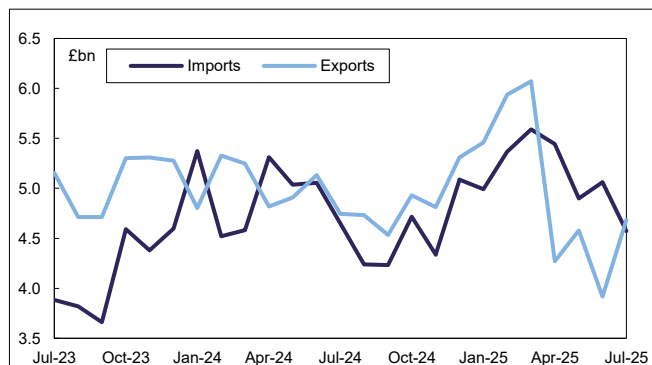
*Excluding precious metals. Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Impacts of US tariffs on goods exporting firms*



*Excludes other, not sure. Shares of all 10+ employee businesses expecting an impact. Source: ONS and Daiwa Capital Markets Europe Ltd.

UK: Goods trade with the US*



*Non-seasonally adjusted data. Source: ONS and Daiwa Capital Markets Europe Ltd.

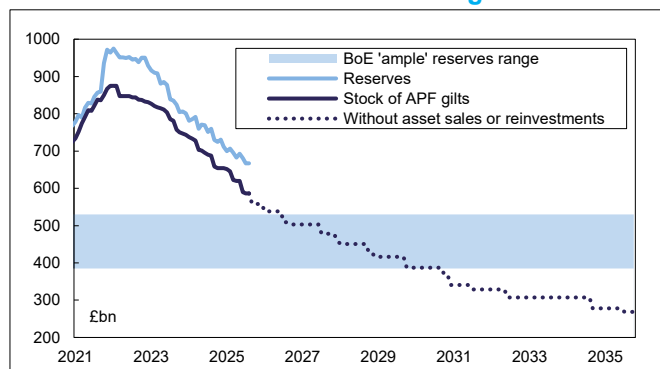
BoE to hold rates on Thursday, but guidance to leave door open to another cut by year-end

Like the ECB yesterday, the BoE looks certain to leave interest rates on hold when the MPC's latest policy decision is announced on Thursday. Contrasting the [three-way split](#) in August, we expect at least seven of the nine rate-setters to favour holding Bank Rate at 4.00%, with question marks only about whether the dovish external member Taylor, and perhaps also Dhingra, will dissent again in favour of less restrictive policy. The decision to leave rates unchanged after August's cut would remain consistent with the MPC's guidance that a 'gradual and careful approach to the further withdrawal of monetary policy restraint remains appropriate'. And we expect Thursday's policy statement to retain that guidance, leaving open the possibility of a rate cut in Q4 if incoming data allow. But as with the new information made available in the five weeks since August's decision, the data scheduled ahead of Thursday's policy announcement seem unlikely to provide greater clarity as to the likelihood of another rate cut before year-end. In the run up to an expected peak in September, August's CPI release (Wednesday) will reaffirm that inflation remains uncomfortably high, with continued stubbornness in services due not least to administered prices as well as pressures in food to maintain the concerns among many MPC members of second-round effects. But while we expect the headline CPI rate to edge up to 3.9%Y/Y, a 19-month high 0.1ppt above the BoE projection, the increase might principally reflect unfavourable energy base effects. And separately, surveys remains suggestive of another weak round of labour market figures (Tuesday), and the LFS measure of private sector pay growth – the BoE's preferred metric – seems highly likely to decelerate further in July. So, while the policy statement in August acknowledged that the upside risks to inflation have risen, the MPC should this month again assert that ongoing wage moderation remains consistent with underlying disinflation, which, if it continued, would justify future policy easing.

Pace of QT to be slowed, but active sales to continue despite good case for their end

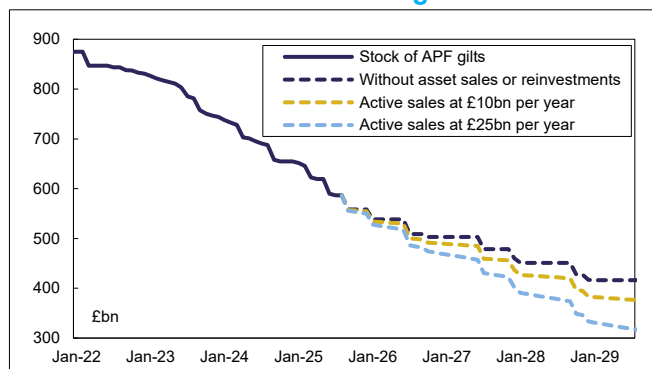
With no change expected in Bank Rate, of most interest next Thursday will be the MPC's decision with regards to Quantitative Tightening (QT). Since reserve balances peaked at £975bn in January 2022, the BoE has markedly reduced the size of its balance sheet through a combination of roll-off and, unlike its central bank peers, active sales of bonds. The reduction has been primarily led by an approximate £300bn decline in its holdings of gilts, to £558bn today. The BoE is widely expected to announce a slower pace of QT for the coming 12 months, with the median forecast of market participants in June suggesting a reduction of £75bn in its gilt holdings compared to the reduction of £100bn over the past 12 months. We note, however, that the majority of the reduction over the past year reflected redemptions of £87bn. In contrast, redemptions will slow to just £49bn over the coming 12 months. We doubt whether the BoE will seek to compensate for that shortfall by ramping up active sales. Our expectation is that the BoE will announce a reduction in its Asset Purchase Facility (APF) of around £60bn, maintaining a similar pace of active sales as conducted over the past 12 months. But we would not be overly surprised if the BoE were to slow the pace of QT to about £50bn, thereby ending active gilt sales altogether and

UK: BoE reserves and stock of APF gilts



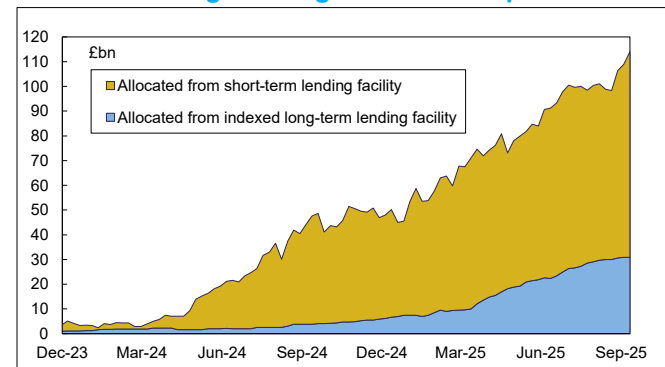
Source: Macrobond, BoE and Daiwa Capital Markets Europe Ltd.

UK: Scenarios for stock of APF gilts



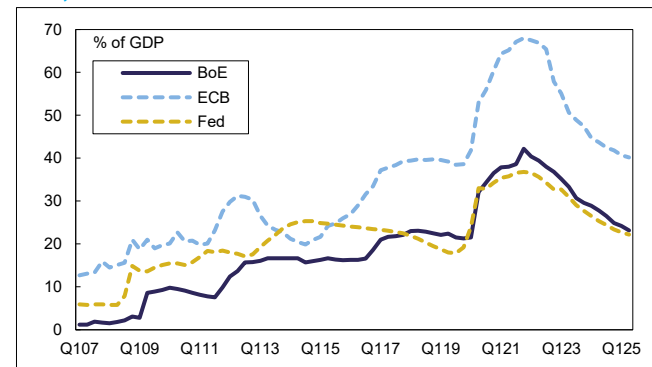
Source: Macrobond, BoE and Daiwa Capital Markets Europe Ltd.

UK: Outstanding drawings from BoE repo facilities



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

BoE, ECB & Fed: Balance sheet to GDP












Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

aligning its strategy more closely with the passive roll-off preferred by the Fed and ECB. Certainly, at the risk of encouraging accusations of 'fiscal dominance', we think the BoE should take into account HM Treasury and DMO concerns about the impact of its QT policy on gilt yields, which Bank staff estimate at about 15-25bps. Current market conditions would seem to merit greater caution about that impact, particularly as QT will crystallise fiscal losses from QE and add to future debt interest costs over coming years. A few MPC members have also recently expressed concerns about QT's potentially disruptive effects on the BoE's monetary policy transmission, at a time when the BoE is attempting gradually to withdraw restrictiveness through cuts to Bank Rate. Finally, we note that roughly half of the £79bn outstanding in the BOE's SME lending facility (TFSME) is due to be repaid by banks in Q425, with the amount of such loans outstanding to drop further to at most £15bn by 2028. While the overall effect that will have on the BoE's balance sheet is unclear, the repayments that we expect over the coming 12 months could bring the stock of bank reserves much closer to Bank staff upper estimates of the optimal 'ample' range (£530bn), similarly meriting a cautious approach.

The week ahead in the UK

Following the BoE, the end of the week will also bring August's retail sales and public sector finance statistics, as well as GfK's consumer confidence survey for September. While the previous retail sales release brought revised down the strength of retail sales growth in the first half of the year, it also signalled firmer than expected performance at the beginning of Q3. And along with the improvement in consumer confidence that month, this week's BRC retail survey also pointed towards a solid monthly increase in August. Thursday's public finance statistics will also mark another data point to frame the extent of the Chancellor's challenges ahead of the Nov 26 budget, with July's release confirming that public sector borrowing remained on track with the OBR's forecast through four months of the fiscal year.

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	0.3	0.3	1.3	1.0	1.4
UK		0.7	0.3	0.4	0.3	0.3	0.4	1.4	1.3	1.5
Inflation, %, Y/Y										
Euro area										
Headline HICP		2.3	2.0	2.2	2.3	1.9	1.9	2.2	1.8	1.8
Core HICP		2.6	2.4	2.3	2.5	2.3	1.8	2.5	1.9	1.6
UK										
Headline CPI		2.8	3.5	3.9	3.7	3.3	2.6	3.5	2.6	1.9
Core CPI		3.6	3.7	3.8	3.6	3.5	2.7	3.7	2.7	1.7
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	3.25

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

Economic calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Germany	 Final HICP (CPI) Y/Y%	Aug	2.1 (2.2)	<u>2.1 (2.2)</u>	1.8 (2.0)	-
France	 Final HICP (CPI) Y/Y%	Aug	0.8 (0.9)	<u>0.8 (0.9)</u>	0.9 (1.0)	-
Spain	 Final HICP (CPI) Y/Y%	Aug	2.7 (2.7)	<u>2.7 (2.7)</u>	2.7 (2.7)	-
UK	 Monthly GDP M/M% (3M/3M%)	Jul	0.0 (0.2)	<u>0.2 (0.3)</u>	0.4 (0.3)	-
	 Services output M/M% (3M/3M%)	Jul	0.1 (0.4)	0.0 (0.3)	0.3 (0.4)	-
	 Industrial output M/M% (Y/Y%)	Jul	-0.9 (0.1)	0.0 (1.2)	0.7 (0.2)	-
	 Construction output M/M% (Y/Y%)	Jul	0.2 (2.4)	-0.2 (1.9)	0.3 (1.5)	-
	 Trade (goods trade) balance £bn	Jul	-5.3 (-22.2)	-4.1 (-21.9)	-5.0 (-22.2)	-
	 BoE/Ipsos inflation attitudes survey – 1Y ahead CPI Y/Y%	Q3	3.6	-	3.2	-















Auctions

Country	Auction
- Nothing to report -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.




























The coming week's data calendar

The coming week's key events & auctions

Country	BST	Event / Auction
Monday 15 September 2025		
- Nothing scheduled -		
Tuesday 16 September 2025		
Euro area	 12.30	ECB Executive Board member Schnabel to give speech at the EIB chief economists meeting, Luxembourg
Germany	 10.30	Auction: to sell up to €4.5bn of 2.2% 2030 bonds
UK	 10.00	Auction: to sell £3bn of 4.375% 2040 bonds
Wednesday 17 September 2025		
Euro area	 08.30	ECB President Lagarde to introduce the 10 th annual ECB research conference, Frankfurt
	 09.00	ECB publish updated wage tracker indicators
	 18.00	ECB Governing Council member and Bundesbank President Nagel to give speech on the German economy, Frankfurt
Germany	 10.30	Auction: to sell €1bn of 1.25% 2048 bonds
	 10.30	Auction: to sell €1.5bn of 2.9% 2056 bonds
Thursday 18 September 2025		
Euro area	 09.00	ECB Vice-President de Guindos to speak at an MNI event on the 'euro area growth & inflation outlook'
France	 09.50	Auction: to sell up to €11.5bn of 0.75% 2028, 2.4% 2028, 2.7% 2031 & 3.5% 2035 bonds
	 10.50	Auction: to sell up to €1.5bn of 0.6% 2034, 0.1% 2038 & 0.55% 2039 inflation-linked bonds
Spain	 09.30	Auction: to sell 2.4% 2028, 3.2% 2035 & 4% 2054 bonds
UK	 12.00	BoE monetary policy announcement and minutes to be published
	 12.00	BoE to publish quarterly Agents' summary of business conditions (Q325)
Friday 19 September 2025		
- Nothing scheduled -		

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key data releases

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Monday 15 September 2025					
Euro area		10.00 Trade balance €bn	Jul	12.0	2.8
		10.00 Final job vacancy rate %	Q2	<u>2.3</u>	2.4
UK		00.01 Rightmove house prices M/M% (Y/Y%)	Sep	-	-1.3 (0.3)
Tuesday 16 September 2025					
Euro area		10.00 Industrial production M/M% (Y/Y%)	Jul	0.3 (1.7)	-1.3 (0.2)
		10.00 Final labour costs Y/Y%	Q2	<u>3.7</u>	3.4
Germany		10.00 ZEW current situation (expectations) balance	Sep	-74.0 (26.3)	-68.6 (34.7)
Italy		09.00 Final HICP (CPI) Y/Y%	Aug	<u>1.7 (1.6)</u>	1.7 (1.7)
UK		07.00 Average wages (excluding bonuses) 3M/Y%	Jul	4.7 (4.8)	4.6 (5.0)
		07.00 Private sector regular wages 3M/Y%	Jul	4.7	4.8
		07.00 Unemployment rate 3M%	Jul	4.7	4.7
		07.00 Employment 3M/3M change 000s	Jul	223	238
		07.00 Payrolled employees M/M change 000s	Aug	-11	-8
		07.00 Claimant count rate % (change 000s)	Aug	-	4.4 (-6.2)
Wednesday 17 September 2025					
Euro area		10.00 Final headline (core) HICP Y/Y%	Aug	<u>2.1 (2.3)</u>	2.0 (2.3)
UK		07.00 Headline (core) CPI Y/Y%	Aug	<u>3.9 (3.8)</u>	3.8 (3.8)
		09.30 House price index Y/Y%	Jul	-	3.7
Thursday 18 September 2025					
Euro area		09.00 Current account €bn	Jul	-	35.8
		10.00 Construction output M/M% (Y/Y%)	Jul	-	-0.8 (1.7)
UK		12.00 BoE Bank Rate %	Sep	<u>4.00</u>	4.00
Friday 19 September 2025					
Germany		07.00 PPI Y/Y%	Aug	-1.7	-1.5
France		07.45 INSEE business (manufacturing) confidence indicator	Sep	95 (96)	96 (96)
		07.45 Retail sales Y/Y%	Aug	-	-1.9
		07.45 Final wages Q/Q%	Q2	<u>0.5</u>	0.7
UK		00.01 GfK consumer confidence indicator	Sep	-18	-17
		07.00 Retail sales – incl. auto fuel M/M% (Y/Y%)	Aug	0.4 (0.6)	0.6 (1.1)
		07.00 Retail sales – excl. auto fuel M/M% (Y/Y%)	Aug	0.7 (0.8)	0.5 (1.3)
		07.00 Public sector net borrowing £bn	Aug	12.5	1.1

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:

<https://www.uk.daiwacm.com/ficc-research/recent-blogs>

This research report is produced by Daiwa Securities Co. Ltd., and/or its affiliates and is distributed by Daiwa Capital Markets Europe Limited ("DCME"). DCME is authorised and regulated by The Financial Conduct Authority and is a member of the London Stock Exchange. DCME and its affiliates may, from time to time, to the extent permitted by law, participate or invest in other financing transactions with the issuers of the securities referred to herein (the "Securities"), perform services for or solicit business from such issuers, and/or have a position or effect transactions in the Securities or derivatives or options thereof and/or may have acted as an underwriter during the past twelve months for the issuer of such securities. In addition, employees of DCME and its affiliates may have positions and effect transactions in such the Securities or derivatives or options thereof and may serve as Directors of such issuers. DCME may, to the extent permitted by applicable UK law and other applicable law or regulation, effect transactions in the Securities before this material is published to recipients.

This publication is intended only for investors who are professional clients as defined in MiFID II and should not be distributed to retail clients as defined in MiFID II. Should you enter into investment business with DCME's affiliates outside the United Kingdom, we are obliged to advise that the protection afforded by the United Kingdom regulatory system may not apply; in particular, the benefits of the Financial Services Compensation Scheme may not be available.

DCME has in place organisational arrangements for the prevention and avoidance of conflicts of interest. Our conflict management policy is available at <http://www.uk.daiwacm.com/about-us/corporate-governance-regulatory>. Regulatory disclosures of investment banking relationships are available at <https://daiwa3.bluematrix.com/sellside/Disclosures.action>.

Explanatory Document of Unregistered Credit Ratings

This report may use credit ratings assigned by rating agencies that are not registered with Japan's Financial Services Agency pursuant to Article 66, Paragraph 27 of the Financial Instruments and Exchange Act. Please review the relevant disclaimer regarding credit ratings issued by such agencies at: https://drp.daiwa.co.jp/rp-daiwa/direct/reportDisclaimer/credit_ratings.pdf. If you need more information on this matter, please contact the Research Production Department of Daiwa Securities.

IMPORTANT

This report is provided as a reference for making investment decisions and is not intended to be a solicitation for investment. Investment decisions should be made at your own discretion and risk. Content herein is based on information available at the time the report was prepared and may be amended or otherwise changed in the future without notice. We make no representations as to the 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.