

# Euro wrap-up

## Overview

- Bunds were little changed while data confirmed that euro area IP returned to growth in July and a survey reported continued investor optimism in the German economic outlook.
- Gilts made losses despite a continued moderation in UK private sector pay growth and a slight drop in employee payrolls.
- Wednesday will bring updated figures for inflation in the euro area and UK.

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### Daily bond market movements

Bond	Yield	Change
BKO 1.9 09/27	1.997	-0.017
OBL 2.2 10/30	2.283	-0.010
DBR 2.6 08/35	2.691	+0.001
UKT 3½ 03/27	3.964	+0.020
UKT 4% 03/30	4.083	+0.025
UKT 4½ 03/35	4.645	+0.014

\*Change from close as at 4:45pm BST.  
Source: Bloomberg

## Euro area

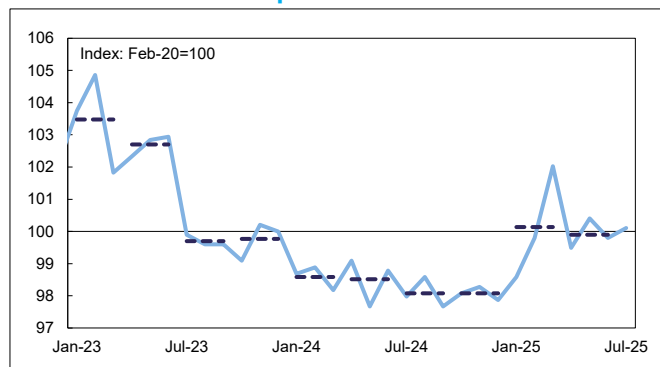
### IP returned to modest growth at the start of Q3

After the inevitable pull-back in the euro area manufacturing sector in Q2 following the front-running of US tariffs earlier in the year, today's data confirmed a return to modest production growth at the start of the third quarter. Thanks principally to a rebound in Germany and Ireland, aggregate euro area industrial output rose 0.3%M/M in July. With the initially reported contraction in June halved (-0.6%M/M), the level of output was up 1.8%Y/Y and 0.2% above the Q2 average. The rebound would have been firmer still in the absence of renewed weakness in energy production (-2.9%M/M). Indeed, despite a negative carry over from June, the increase in manufacturing output (0.7%M/M), left it tracking almost ½% above the Q2 level. The recovery was led by the first rise in output of machinery and equipment (4.7%M/M) in five months to the highest level since February 2024. Production from the autos sector also rose to an eleven-month high. But while there were also partial rebounds in ICT equipment and pharmaceuticals, those levels remained some way below their respective peaks earlier in the year. Encouragingly, surveys signalled a more pronounced recovery in production over the summer, with the manufacturing output PMI implying the strongest growth in 3½ years in August. And although new export orders reportedly fell again, the PMIs and Commission surveys point to an improvement in domestic demand, while production expectations for consumer durables were the strongest in 15 months. We caution that these survey indicators have recently provided a mixed guide to overall output. Furthermore, they flagged renewed weakness in the near-term production trends for intermediate and investment goods in August. So, amid residual uncertainties surrounding the US-EU trade deal, the manufacturing sector seems likely to offer only modest support to euro area GDP growth this quarter and next.

### ZEW survey signals increased investor optimism in the German outlook, centred on ICT & services

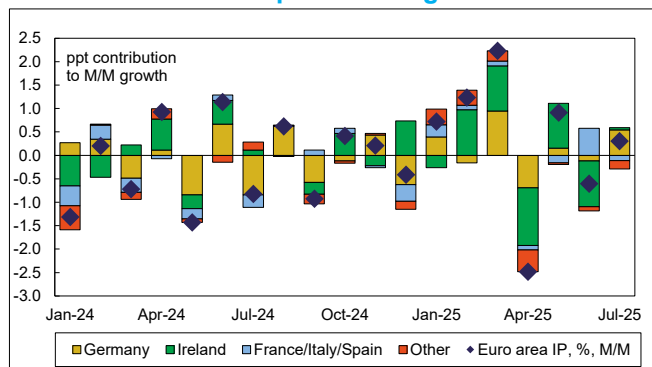
Consistent with the findings of last week's Sentix indices, today's ZEW survey suggested that investors feel that conditions in the German economy have deteriorated at the end of Q3. Indeed, the ZEW current conditions index fell more than 8pts in September to -76.4, the lowest level since May when uncertainty regarding the EU-US trade relationship remained extremely high. Indeed, more than three quarters of survey recipients judged that German economic conditions are currently 'bad'. However, contradicting the downbeat message from the Sentix survey, the ZEW survey also indicated that investors are more upbeat the outlook for the coming six months, with the respective index up 2½pts to +37.3, a level firmly above the long-run average for the fifth successive month. Almost half of all survey respondents considered the outlook to be 'good', with barely more than 10% taking the opposite view. A key driver of the optimism likely remains German fiscal policy, not least expectations that increased infrastructure and military spending will crowd-in private investment. The resulting upwards pressure on the German budget is, however, expected to put further upwards pressure on Bund yields, with almost half of recipients expecting long-term interest rates to pick up further over coming months and fewer than 10% expecting them to

### Euro area: Industrial production\*



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

### Euro area: Industrial production growth



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

decline. Nevertheless, investors remain unperturbed about inflation. More than 80% of respondents expect inflation to fall or move sideways over the coming six months. And almost three-quarters anticipate ECB rates being left unchanged. Finally, with respect to the profit outlook, investors remain particularly upbeat about firms in IT and telecoms, and take a positive view of most other services, including financial firms. But despite somewhat greater clarity about the US-EU trade relationship, the investor mood regarding most manufacturing subsectors remains negative, contrasting the more upbeat tone from the respective PMIs and Commission survey indices

## The day ahead in the euro area

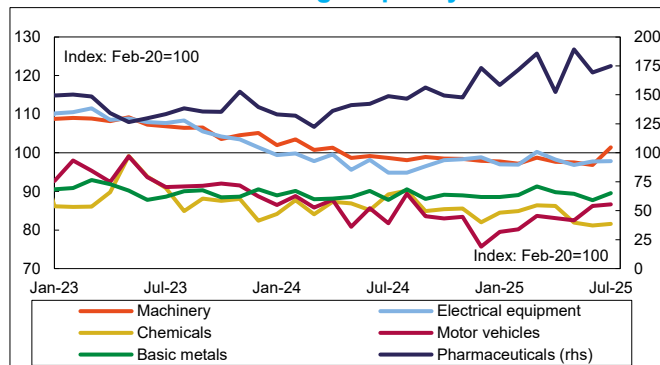
Wednesday will bring the final estimates of euro area inflation in August. The flash estimates reported a slight uptick in the headline HICP rate, by 0.1ppt to 2.1%Y/Y. But to two decimals places, the headline rate was soft (2.05%Y/Y). And the downwards revision in today's updated Italian figures (by 0.1ppt to 1.6%Y/Y) raises the possibility of a downward tweak to the euro area rate. The pickup in the initial reading reflected a smaller drag from the energy component as the decline in auto fuel prices was smaller than a year earlier. More importantly, 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.

## UK

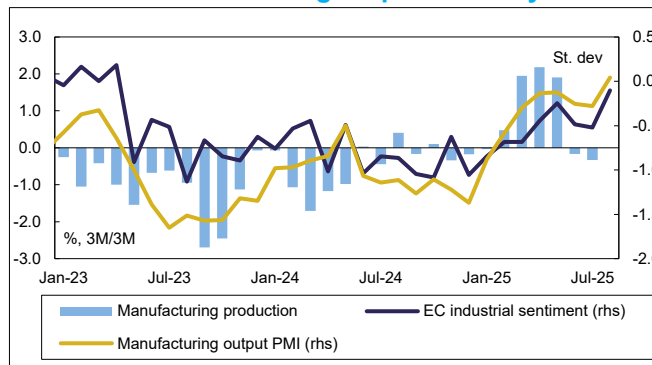
### Moderating pay growth leaves door open for a November Bank Rate cut

While the BoE will leave Bank Rate on hold at 4.00% on Thursday, the MPC is also widely expected to maintain its forward guidance that a 'gradual and careful approach to the further withdrawal of monetary policy restraint remains appropriate'. Of course, the minutes seem bound to flag a range of views on the MPC, with some members likely to remain more concerned about upside risks to the price outlook and potential second-round effects from the recent uptick in inflation. But others on the Committee – including Governor Bailey – might again place most weight on the state of the labour market, with evidence of rising slack and moderating pay growth supporting the case for further gradual easing in future. As such, today's labour market figures left open the possibility of a rate cut in November. Admittedly, total pay growth edged slightly higher in the three months to July, by 0.1ppt to 4.7%3M/Y. But, when excluding bonus payments, regular pay growth moderated 0.2ppt to 4.8%3M/Y, the softest since mid-2022. Moreover, the BoE's preferred measure of private sector regular wage growth – which undershot significantly the MPC's expectations in Q2 – edged down further for a fifth successive month to 4.7%3M/Y in July. And the single-month measure fell to 4.5%Y/Y, the lowest level since end-2021 and 0.4ppt below the rate three months ago. The moderation in the aggregate rate reflected notable softening in hospitality, manufacturing and construction. It also suggests that the BoE's forecast for pay growth in September (4.6%3M/Y) is again a little too high.

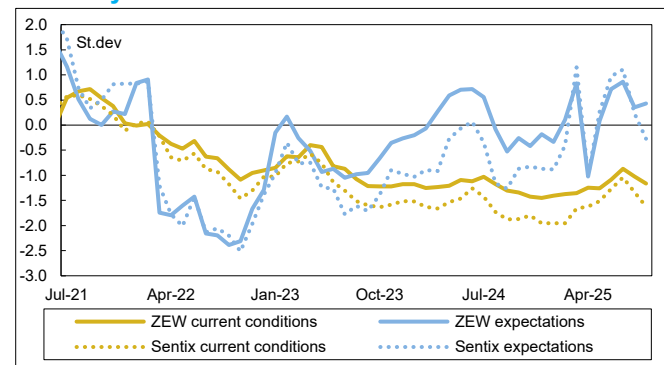
### Euro area: Manufacturing output by subsector



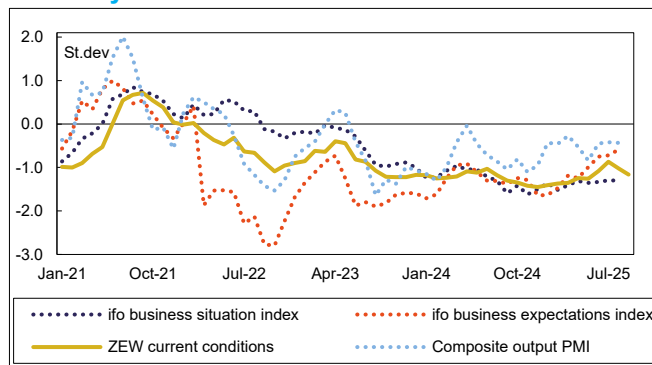
### Euro area: Manufacturing output & survey indices



### Germany: Investor sentiment indices



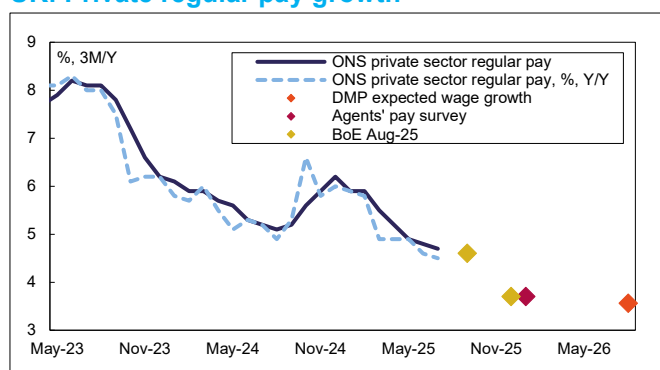
### Germany: Economic sentiment indices



## Payrolled employees fell for a seventh successive month, suggesting weak labour demand

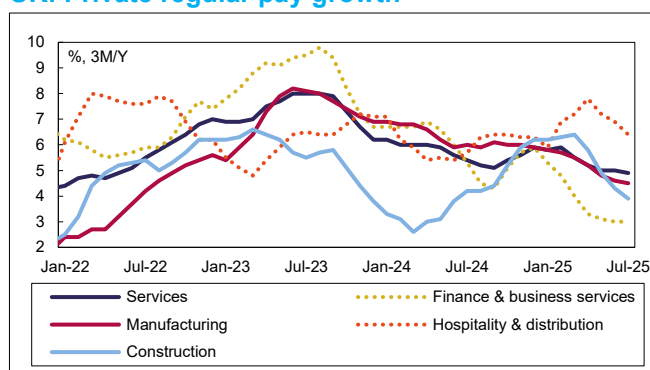
In terms of economic slack, today's labour market data provided a further reminder that, due to data inadequacies, the balance between the supply and demand for workers remains difficult to gauge with any certainty. For example, if the Labour Force Survey (LFS) is to be believed, employment maintained a steady uptrend in the three months to July, up more than 230k to be more than 650k higher than a year earlier. While most of those increases were explained by employees rather than the self-employed, these data contrast markedly with the findings of surveys like the REC report on jobs and PMIs that have signalled a steady reduction in labour demand over the past year or so. Moreover, contrasting the LFS, the number of workforce jobs (based on alternative government surveys) was reportedly cut by 182k in Q2. And today's HMRC measure of payrolled employees reported a seventh successive monthly drop in August (-8k) to the lowest level in almost two years. This left the number of payrolled employees down some 127k compared with a year earlier, with the biggest cut made to headcount in hospitality, which accounted for roughly three-quarters of the drop, while those in wholesale and retail, professional, scientific and technical services and manufacturing also fell. While the number of job vacancies rose slightly last month, it was still down 119k compared with a year earlier and some 44% from the peak, pointing to ongoing weak labour demand. So, while the unemployment rate was unchanged at 4.7% in the three months to July, the ratio of vacancies to jobless workers – a helpful guide to overall labour market slack – was the joint lowest since 2015, outside of the pandemic period.

### UK: Private regular pay growth



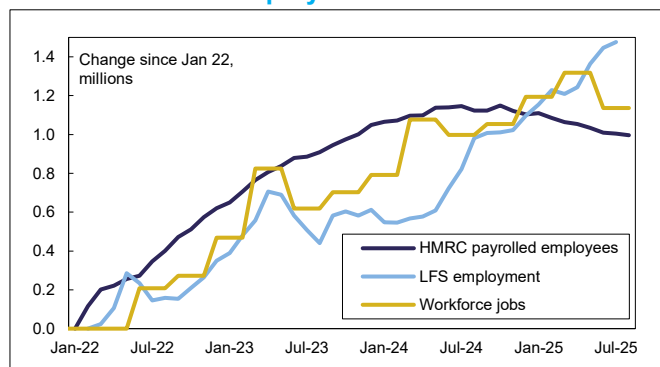
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

### UK: Private regular pay growth



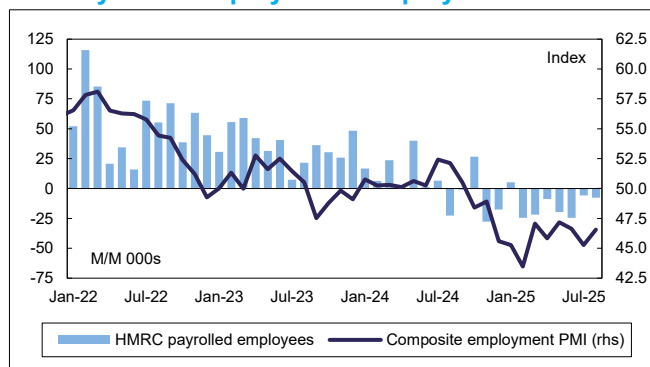
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

### UK: Measures of employment



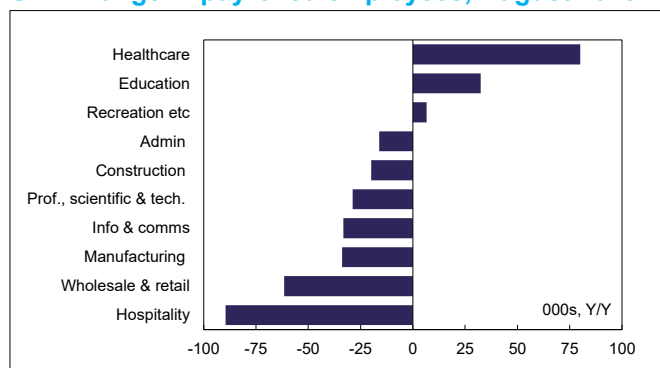
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

### UK: Payrolled employees & employment PMI



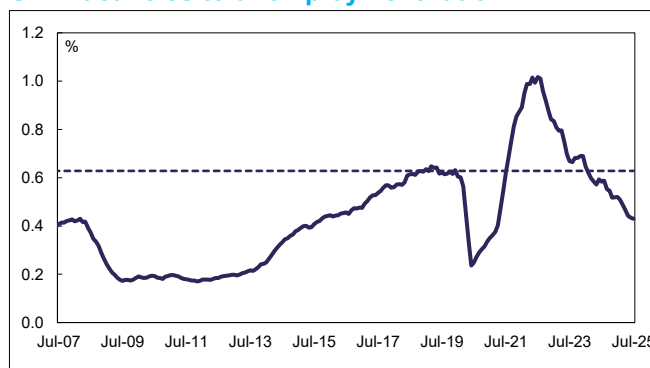
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

### UK: Change in payrolled employees, August 2025



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

### UK: Vacancies to unemployment ratio\*



\*Dashed line represents 2019 average.

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.











## The day ahead in the UK

Ahead of Thursday's MPC announcement, the key UK data focus tomorrow will be inflation in August. Contrasting the Bloomberg survey consensus, we expect headline inflation to tick slightly higher, by 0.1ppt to 3.9%Y/Y, a touch above the BoE's most recent projection. The upwards impulse will principally reflect unfavourable base effects in the energy component, to push the annual rate up to the highest level in over two years. Food inflation is also expected to remain elevated at more than 5%Y/Y. But while non-energy industrial goods inflation is expected to edge slightly higher, we expect services inflation to partially reverse the increase in July, which was seemingly boosted by seasonal pricing relating to the earlier timing of school summer holidays. As such, we expect core inflation to move sideways at 3.8%Y/Y.



## European calendar

### Today's results

#### Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area	 Industrial production M/M% (Y/Y%)	Jul	<b>0.3 (1.8)</b>	<u>0.3 (1.7)</u>	-1.3 (0.2)	-0.6 (0.7)
	 Final labour costs Y/Y%	Q2	<b>3.6</b>	<u>3.7</u>	3.4	-
Germany	 ZEW current situation (expectations) balance	Sep	<b>-76.4 (37.3)</b>	-73.0 (25.0)	-68.6 (34.7)	-
Italy	 Final HICP (CPI) Y/Y%	Aug	<b>1.6 (1.6)</b>	<u>1.7 (1.6)</u>	1.7 (1.7)	-
UK	 Average wages (excluding bonuses) 3M/Y%	Jul	<b>4.7 (4.8)</b>	4.7 (4.8)	4.6 (5.0)	
	 Private sector regular wages 3M/Y%	Jul	<b>4.7</b>	4.7	4.8	
	 Unemployment rate 3M%	Jul	<b>4.7</b>	4.7	4.7	
	 Employment 3M/3M change 000s	Jul	<b>232</b>	223	238	
	 Payrolled employees M/M change 000s	Aug	<b>-8</b>	-11	-8	-6
	 Claimant count rate % (change 000s)	Aug	<b>4.4 (17.4)</b>	-	4.4 (-6.2)	4.3 (-33.3)




#### Auctions

Country	Auction
Germany	 sold €3.49bn of 2.2% 2030 bonds at an average yield of 2.29%
UK	 sold £3.0bn of 4.375% 2040 bonds at an average yield of 5.048%





Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

### Tomorrow's releases

#### Economic data

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
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

#### Auctions and events

Euro area	 08.30	ECB President Lagarde to introduce the 10 <sup>th</sup> annual ECB research conference, Frankfurt			
	 09.00	ECB to publish updated wage tracker			
Germany	 10.30	Auction: to sell €1bn of 1.25% 2048 bonds			
	 10.30	Auction: to sell €1.5bn of 2.9% 2056 bonds			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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