

# Euro wrap-up

## Overview

- Shorter-dated Bunds made modest gains following a downside surprise to euro area inflation in June.
- Gilts also rose at the short end, while the final UK manufacturing PMI was revised lower but remained consistent with continued growth in the sector.
- Thursday will bring labour market data from the euro area and the BoE's quarterly survey on credit conditions.

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### Daily bond market movements

| Bond          | Yield | Change |
|---------------|-------|--------|
| BKO 2½ 06/28  | 2.504 | -0.017 |
| OBL 2½ 04/31  | 2.596 | +0.004 |
| DBR 2.9 02/36 | 2.875 | +0.018 |
| UKT 4¾ 03/28  | 4.126 | -0.019 |
| UKT 4¾ 03/31  | 4.293 | -      |
| UKT 4¾ 10/35  | 4.759 | +0.002 |

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

Source: Bloomberg

## Euro area

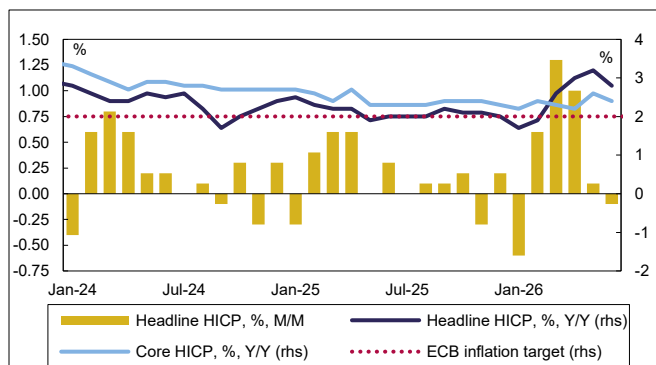
### Euro area inflation eases more than expected, reducing pressure for near-term tightening

When the Governing Council hiked the deposit rate by 25bps at its June meeting, the updated forecast scenarios suggested that further monetary tightening would be required this cycle to bring inflation back to target over the medium term. However, the subsequent sharp decline in oil prices has materially improved the near-term inflation outlook. Together with the undershoot in the June inflation print, this suggests there is little urgency to tighten policy again this month. Today's flash estimate showed euro area inflation slowing more than expected in June, with the headline HICP rate falling by 0.4ppt to 2.8%Y/Y, a three-month low. This left inflation in Q2 at 3.0%Y/Y, still well above target but 0.2ppt below the ECB's June baseline projections. As expected, energy played a key role, with prices falling at the fastest pace in 14 months – likely reflecting lower fuel costs – taking the annual rate down more than 2ppts to 8.7%Y/Y. More importantly, however, there remains little evidence so far of significant indirect pass-through from the oil shock to non-energy components. Indeed, food inflation moderated to the softest level in five years (1.6%Y/Y), with prices declining on the month by the most in any June since 2017. Services inflation also surprised to the downside, falling 0.3ppt to 3.2%Y/Y, slightly below the average in the six months before the Iran war. Meanwhile, inflation of non-energy industrial goods was unchanged at a subdued 0.8%Y/Y. As such, core HICP inflation eased more than expected in June, by 0.2ppt to 2.4%Y/Y.

### Inflation to remain above target through to 2028, pointing one further ECB

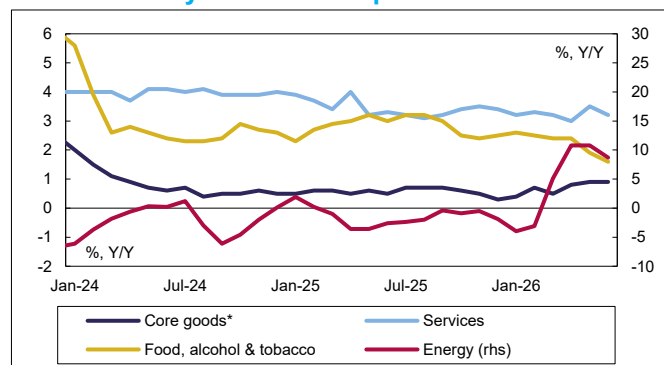
Despite the recent decline in wholesale energy prices, the near-term inflation outlook remains uncertain. The expiry of government support measures – including tax relief in Germany and Italy – will provide a temporary uplift to energy prices in July. And oil and gas price futures curves point to only a modest further easing in energy inflation beyond the summer before favourable base effects drive a sharper decline in March. They also imply that energy prices will remain structurally higher over the medium term, reflecting infrastructure damage, persistent shipping constraints and efforts to rebuild strategic oil reserves and gas levels. Uncertainty also surrounds the extent of indirect effects. While survey evidence suggests firms' pricing power remains constrained by weak demand, input costs have risen sharply since the start of the year. Although producer price data indicate that pipeline pressures are largely contained to early stages of production and today's PMI indices point to easing pressures in June, we expect partial pass-through to final goods prices over coming quarters. Higher fertilizer costs are also likely to add to food inflation in due course. At the same time, policymakers will remain alert to elevated services inflation as firms respond to higher costs, and to the risk that this feeds into stronger wage demands, potentially entrenching inflation dynamics. Overall, we expect headline inflation to remain close to 3%Y/Y into Q127, before gradually returning to target by Q228. But with core inflation likely to stay above 2%Y/Y until late-2028, the Governing Council is still likely to raise the deposit rate to 2.50%, the upper end of the ECB staff's range of its estimates of neutral policy. And we expect this final hike to be delivered in September, when the ECB staff will next update its projections.

### Euro area: Headline & core HICP inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

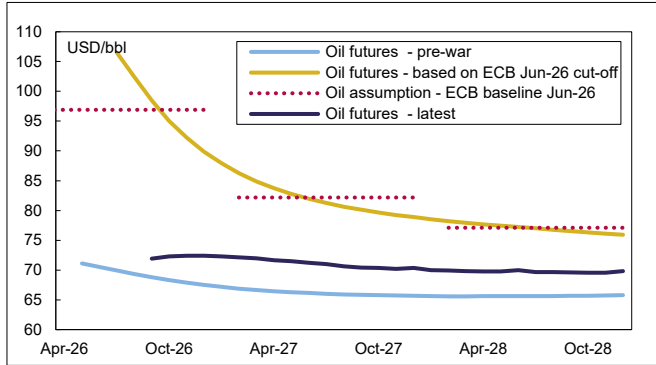
### Euro area: Key inflation components



\*Non-energy industrial goods.

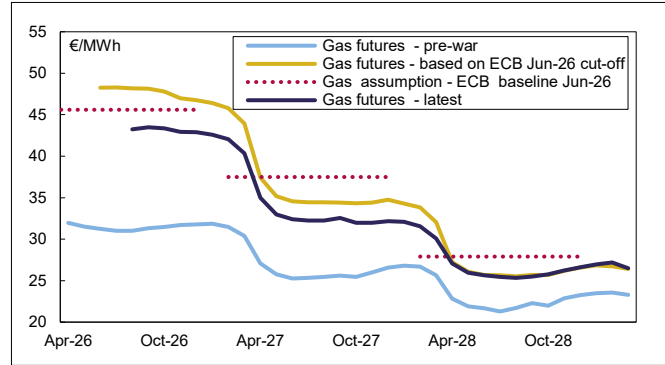
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

**Euro area: Brent crude futures & ECB assumption**



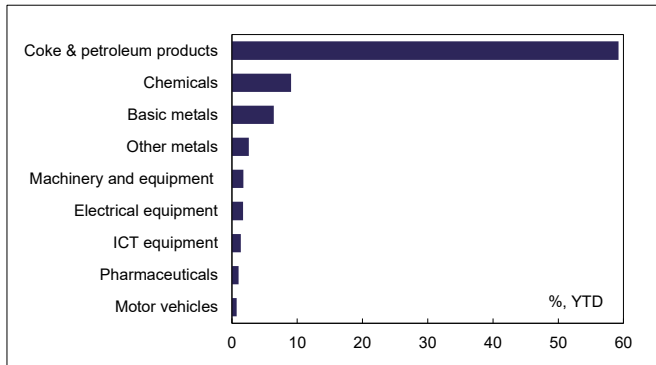
Source: Bloomberg, ECB and Daiwa Capital Markets Europe Ltd.

**Euro area: Natural gas futures & ECB assumption**



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

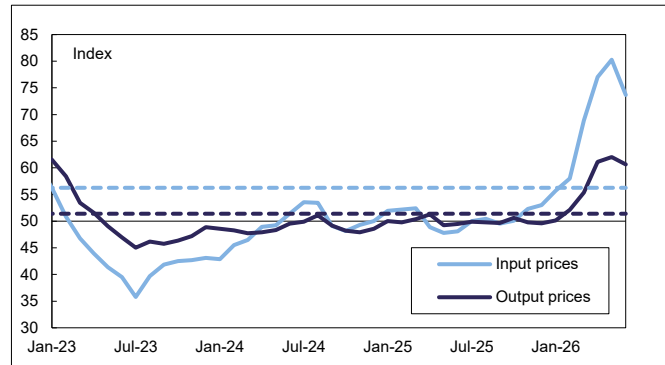
**Euro area: YTD change in producer price levels\***



\*Between January & April 2026.

Source: Macrobond and Daiwa Capital Markets Europe Ltd.

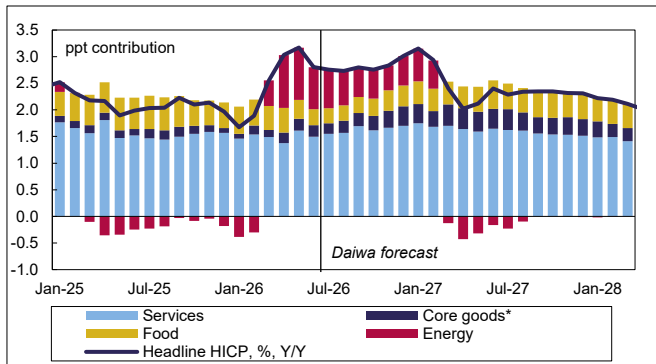
**Euro area: Manufacturing price PMIs\***



\*Dashed lines iares pre-pandemic long-run average.

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

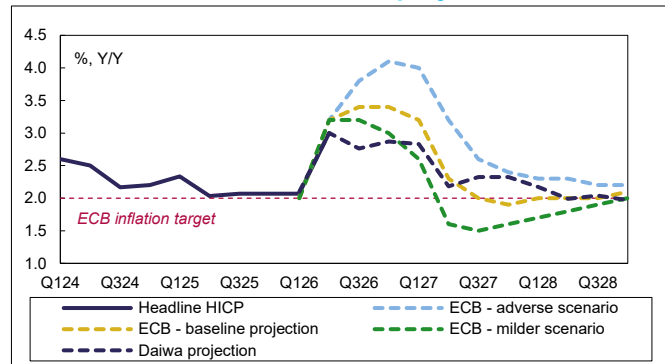
**Euro area: Daiwa HICP inflation forecast**



\*Non-energy industrial goods.

Source: Macrobond and Daiwa Capital Markets Europe Ltd.

**Euro area: ECB HICP inflation projections**



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

**The day ahead in the euro area**

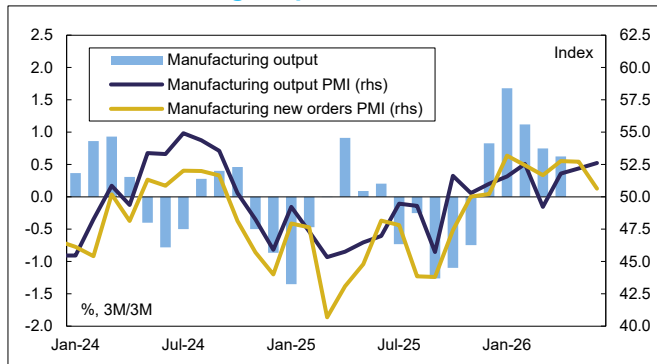
Tomorrow's incoming data will mostly center on the labour market, with euro area unemployment figures providing the most noteworthy release. Given the tentative signs of stabilisation in Germany, and broader resilience elsewhere helping to offset weakness in France, the unemployment rate is expected to move merely sideways in May, at 6.3%, remaining close to its historical lows. Timelier figures from Spain will also provide an update on the state of jobs growth in Southern Europe at the end of Q2. Otherwise, quarterly data on house prices and transactions for Q1 may also be of interest.

## UK

### Manufacturing PMIs signal expansion in Q2 despite downwards revision, but outlook softer

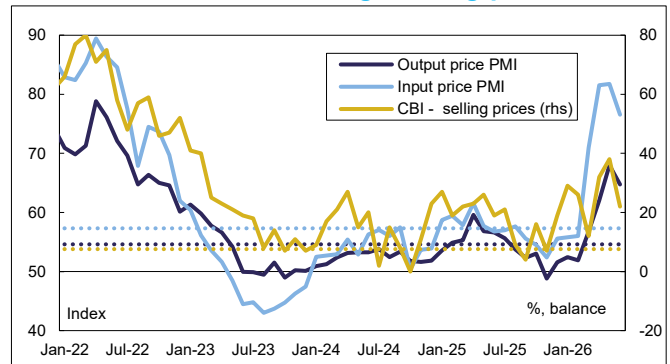
Contrasting little change to the final euro area manufacturing PMIs, today's UK release saw the main indices revised lower from their flash estimates. The headline index was marked down 0.6pt to 52.5, while the revision to the output index was more marked, down a full point to 52.6. However, those revisions did little to change the overall message of the flash survey – that factory production offered ongoing support to GDP at the end of Q2. Indeed, the output index was still at its highest level since September 2024, with the quarterly index in Q2 1.1pts above its Q1 average, affirming manufacturers' efforts to boost stocks and production ahead of expected supply disruption. But demand remains soft, with both the new orders (50.6) and export orders components (50.4) revised down to six-month lows, suggesting that this impulse might fade. Faced with weakening demand and still elevated cost pressures, firms also tempered hiring plans. And while supplier delivery times improved modestly they were still consistent with acute supply chain disruption. As such, input prices pressures remain elevated (76.6), and continue to apply pressure on selling prices (64.8); both indices were still more than 1½ standard deviations above the long-run average. Encouragingly, however, both were revised lower from the flash, and the latter by a non-negligible 1.5pts. And while cost pressures are likely to broaden across the supply chain, falling energy prices now should limit their scope, while weaker demand will reduce firms' ability to pass on costs fully to customers.

#### UK: Manufacturing output & PMIs



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

#### UK: Price PMIs & CBI average selling-prices\*



\*Dotted lines show long-run averages.

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









### The day ahead in the UK

The highlight for UK data on Thursday will be the BoE's quarterly credit conditions and bank liabilities surveys for Q2, for which the former will surely emphasise the meaningful tightening in financial conditions which followed the initial oil shock. Certainly, the deterioration in the economic outlook is likely to have weighed on both the availability of, and demand for, borrowing in Q2, consistent with the softness in Monday's bank lending figures. The survey will also provide an update on banks' expectations for the coming quarter, although these risk being overly pessimistic given that the bulk of the sampling is likely to have preceded the tentative agreement between the US-Iran. Nonetheless, we would expect banks to be downbeat about their lending prospects in Q3, not least given the defacto tightening from repriced expectations for Bank Rate. Indeed, tighter financial conditions was an important factor in the MPC's decision to maintain an 'active hold' in June. External MPC member Catherine Mann was among those who favoured such a hold then, but it was implied that she might favour more restrictiveness at forthcoming decisions. While she will likely maintain a hawkish tone, her comments at an event tomorrow might offer some clues as to whether that switch could come as soon as July's MPC meeting.



## European calendar

### Today's results

#### Economic data

| Country   | Release   | Period | Actual           | Market consensus/<br><i>Daiwa forecast</i> | Previous   | Revised |
|-----------|---|--------|------------------|--|------------|---------|
| Euro area |  Preliminary headline (core) HICP Y/Y% | Jun    | <b>2.8 (2.4)</b> | <u>2.9 (2.5)</u>                           | 3.2 (2.6)  | -       |
|           |  Final manufacturing PMI               | Jun    | <b>51.4</b>      | <u>51.3</u>                                | 51.6       | -       |
| Germany   |  Final manufacturing PMI               | Jun    | <b>50.3</b>      | <u>50.0</u>                                | 50.1       | -       |
| France    |  Final manufacturing PMI               | Jun    | <b>51.2</b>      | <u>50.7</u>                                | 49.7       | -       |
| Italy     |  Manufacturing PMI                     | Jun    | <b>52.2</b>      | <u>52.4</u>                                | 52.9       | -       |
| Spain     |  Manufacturing PMI                     | Jun    | <b>49.7</b>      | <u>51.0</u>                                | 51.2       | -       |
| UK        |  Final manufacturing PMI               | Jun    | <b>52.5</b>      | <u>53.1</u>                                | 53.9       | -       |
|           |  Nationwide house prices M/M% (Y/Y%)   | Jun    | <b>0.0 (2.2)</b> | <u>-0.1 (2.4)</u>                          | -0.6 (1.7) | -       |



#### Auctions

| Country | Auction  |
|---------|--|
| Germany |  sold €2.673bn of 2.5% 2032 bonds at an average yield of 2.68%                    |
| UK      |  sold £1.25bn of 0.125% 2031 inflation-linked bonds at an average yield of 0.933% |






Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

### Tomorrow's releases

#### Economic data

| Country   | BST   | Release                                   | Period | Market consensus/<br><i>Daiwa forecast</i> | Previous     |
|-----------|---|---|--------|--|--------------|
| Euro area |  10.00 | Unemployment rate %                       | May    | 6.3  | 6.3          |
| Spain     |  08.00 | Unemployment (net employment) change 000s | Jun    | -  | -36.3 (63.7) |

#### Auctions and events

|        |   |  |  |  |  |
|--------|---|--|--|--|--|
| France |  09.50 | Auction: to sell up to €14bn of 1.25% 2036, 3.7% 2036, 4.5% 2041 & 4.1% 2046 bonds       |  |  |  |
| Spain  |  09.30 | Auction: to sell 2.6% 2031, 3.25% 2034 & 3.4% 2036 bonds & 1.15% index-linked 2036 bonds |  |  |  |
| UK     |  09.30 | BoE to publish quarterly Bank Liabilities and Credit Conditions surveys for Q226         |  |  |  |
|        |  10.00 | Auction: to sell £3.25bn of 4.625% 2037 green bonds                                      |  |  |  |
|        |  16.45 | BoE external MPC member Mann to participate in fireside chat in London                   |  |  |  |

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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