Euro wrap-up

Overview

- Longer-dated Bunds made gains while final German and French inflation readings confirmed a sharp drop in headline inflation and suggested limited spillover effects from the Iran war beyond the energy components.
- Gilts made modest gains even as BoE Chief Economist Pill maintained his view that interest rates will need to be hiked in the coming year.
- The coming week will bring May data for euro area IP and goods trade alongside UK monthly GDP, and Andy Burnham will succeed Kier Starmer as UK Labour Party leader.

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Daily bond market movements

Bond	Yield	Change
BKO 2½ 06/28	2.642	+0.001
OBL 2½ 04/31	2.758	-0.006
DBR 3 08/36	3.063	-0.016
UKT 4⅜ 03/28	4.216	-0.021
UKT 4⅛ 03/31	4.404	-0.018
UKT 4¾ 10/35	4.869	-0.028

*Change at 5:00pm BST.
Source: Bloomberg

Euro area

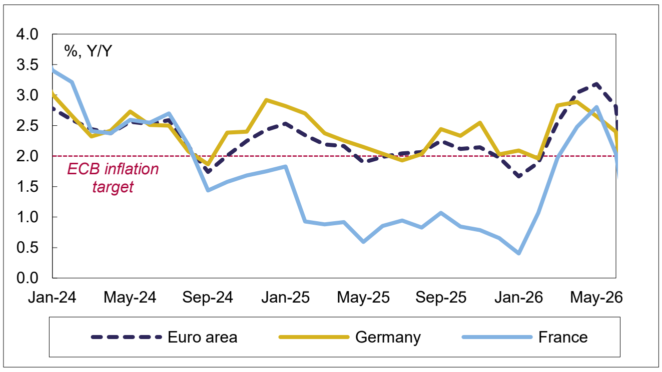
Decline in German inflation in June principally driven by lower energy prices

While yesterday's account of last month's ECB policy meeting highlighted policymakers' concerns about May's inflation uptick, particularly in services, the downside surprise in the flash June euro area inflation estimates may have offered some reassurance. Today's final inflation figures from Germany, however, confirmed that the decline in headline inflation, by 0.3ppt to 2.4%Y/Y (EU-harmonised basis) and 2.3%Y/Y (national basis) was principally driven by energy. Inflation of that component almost halved in June to 3.4%Y/Y, as fuel, heating oil and electricity prices declined for a second successive month. Food inflation also remained subdued (0.4%Y/Y) due to favourable base effects in edible fats, oil and dairy products. By contrast, core goods inflation eased only marginally as higher inflation of phone equipment and a smaller decline in consumer electronics potentially signalled an impact from ongoing component shortages. In contrast to the euro area as a whole, German services inflation held steady (3.1%Y/Y) as stronger price pressures from package holidays and restaurants were offset by lower airfares and insurance costs. As a result, German core CPI inflation was unchanged to one decimal place at 2.5%Y/Y, although to two decimal places it fell 0.09ppt to 2.45%Y/Y, supporting our view that the war's impact on underlying price pressures remains limited. Looking ahead, energy inflation is likely to rebound this month following the expiry of the fuel VAT cut. Indeed, petrol prices rose more than 8%W/W in the first week of July, albeit remaining some 8% below their early-April peak. More broadly, however, surveys suggest that firms have started to scale back their plans to raise prices, offering tentative reassurance that underlying inflationary pressures may prove more contained than previously feared by the Governing Council.

Drop in French inflation flattered by one-off effects, but broader price pressures remain subdued

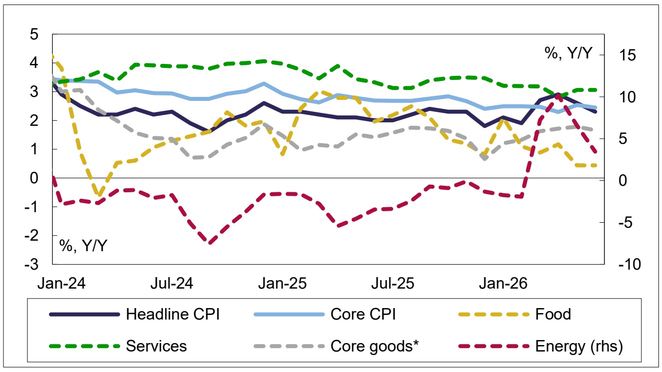
French inflation in June also aligned with the flash release, with the headline HICP rate declining 0.8ppt to 2.0%Y/Y and the national CPI rate down 0.7ppt to 1.8%Y/Y. As in Germany, energy made the largest negative contribution in June, with a double-digit drop in petrol prices pushing energy inflation down by more than 5½ppts. However, the easing in pressures was broad-based. Notably, inflation of food and non-alcoholic beverages fell to a 15-month low (0.9%Y/Y). The drag from manufactured goods (-1.1%Y/Y) was the largest in five months, while services inflation (1.8%Y/Y) almost fully reversed May's increase. As a result, core inflation fell a chunky 0.5ppt to 1.0%Y/Y, its lowest rate in four months. Admittedly, much of the weakness was driven by temporary factors. The timing of summer sales weighed on prices of clothing, electronics and household appliances, while favourable base effects reduced inflation of telecoms bundles and insurance and lower oil prices contributed to a decline in the airfare component. As in Germany, subdued demand should constrain firms' pricing powers over the near term. But risks to cost pass-through remain tilted to the upside. And the ongoing European heatwave

Euro area, Germany & France: HICP inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: CPI inflation & key components



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

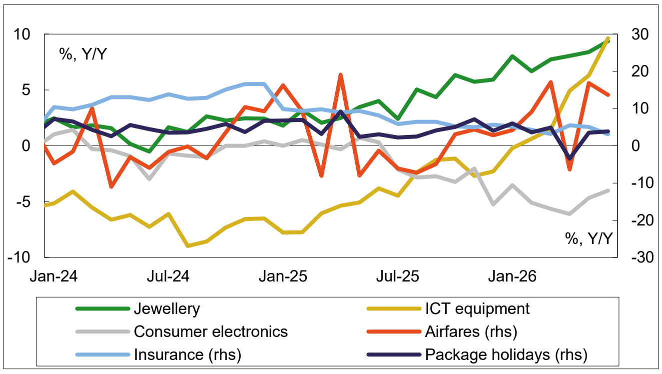
risks higher food inflation across the region later in the year, with the French agricultural ministry having warned that nearly one-third of this year's corn crop may already have been damaged by the extreme weather.

The week ahead in the euro area

Final inflation estimates for June from Italy (Thursday) and Spain (Wednesday) will serve as further precursor for the final euro area detail, when it is eventually released (on Friday). On today's evidence, those will likely match their flash estimates, which saw headline HICP in the euro area moderating by more than expected in June to a three-month low of 2.8%Y/Y. The preliminary release suggested that deceleration was principally led by declining fuel prices, taking energy inflation down around 2ppts from its recent peak to 8.7%Y/Y. But food inflation was softer too, easing to a near-five year low (1.6%Y/Y), albeit with the effects of higher fertiliser prices and extreme weather still in the pipeline. More importantly, moderating services inflation took core inflation down 0.2ppt, back to its pre-war rate of 2.4%Y/Y. The apparent absence of broader pass-through from energy inflation to core components should be of some reassurance to Governing Council members. But the detail will determine its extent, with the data from the member states thus far pointing towards to both fading temporary factors – such as a spike in accommodation in the Netherlands seemingly related to a live music event – but also potentially weaker indirect effects from transport services.

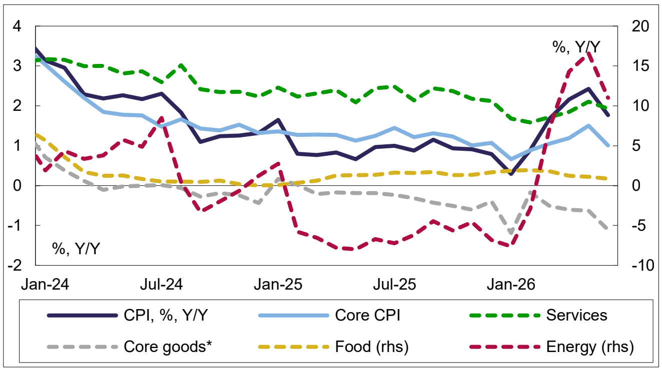
Before the price data, euro area industrial production (Wednesday) and goods trade (Thursday) data will shed some light on activity midway through Q2. While surveys suggested that the impulse from frontloaded orders at the onset of the oil shock might begin to fade, production data from the largest member states were relatively firm. Supported by higher defence spending and AI-related activity, German manufacturing output surprised to the upside (0.8%M/M). Spanish production also rose firmly (1.2%M/M) to an eight-year high, while France and Italy pared back modestly but remained above their respective Q1 averages. However, provisional data from Ireland – which are especially prone to volatility and big revisions – point towards a near-5%M/M drop. So, where we might have expected a fourth consecutive monthly gain in euro area IP, we now see the risks skewed to the downside. Nevertheless, that should still signal a likely rebound from the industrial sector in Q2, with IP trending around 0.5% above the Q1 average. And a fourth-consecutive monthly rise in German goods exports driven

Germany: Selected inflation components



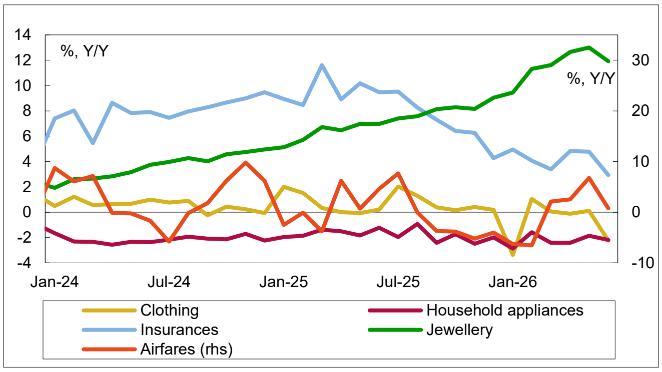
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

France: CPI inflation & key components



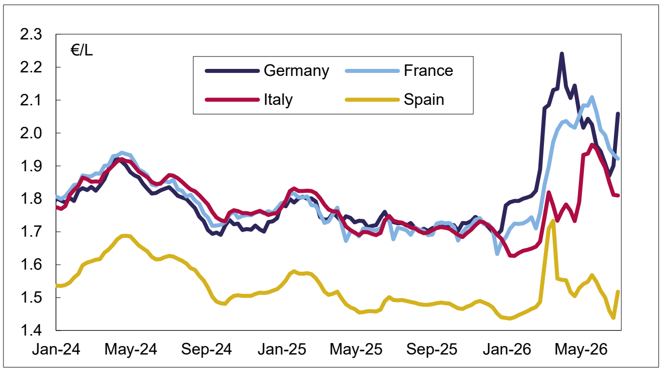
**Non-energy industrial goods.*
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

France: Selected inflation components



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area member states: Weekly petrol prices



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

by increased shipments to the US and China should have supported a further modest widening in the euro area trade surplus, albeit from a low level on account of the higher price of energy inputs.

UK

Burnham's Labour Party takeover to be formally confirmed in the coming week

While the process to confirm the transfer of the Labour Party leadership from Keir Starmer to Andy Burnham will continue and be completed over the coming week, the latter is unlikely to be confirmed as Prime Minister until 20 July. The ballot for nominations from the Parliamentary Labour Party officially closes on Wednesday evening. Burnham currently remains the only person to have fielded their candidacy. His most obvious would-be challengers have ruled themselves out of a contest, likely with an eye to obtaining a favourable ministerial post. And with 322 of 403 Labour MPs having declared support for Burnham by yesterday evening, he is formally just one MP shy of denying any potential challenger the necessary support (of 81 Labour MPs) to be able to contest a vote of party members and affiliates. Indeed, in practical terms it is already impossible for an alternative MP to reach that 81 threshold, so Burnham's position is already insurmountable. According to the current timetable therefore, Burnham looks set to be confirmed as Labour Party leader on Friday, ahead of a visit to Buckingham Palace on Monday 20 July to be formally sworn in as Prime Minister. He has signalled that he will not announce his cabinet members until after that date. And Gilt investors will pay plenty of attention to his chosen Chancellor of the Exchequer. But in practice, it is policies and not personnel that will matter most. And Burnham will remain committed to the current fiscal rules and scope for tax hikes and increased public spending will be constrained by Starmer's election manifesto for the remainder of this parliament, which could last until August 2029.

The week ahead in the UK

On the data front, Thursday's monthly GDP report will mark the sole top-tier data release. After a firm acceleration in Q1 (0.6%Q/Q), growth momentum edged up further in April (0.7%3M/3M) to a near two-year high. However, with the boost from stockpiling and consumption at the onset of the Iran war fading, and growth apparently hindered by disruption to major sporting events in the Middle East, monthly GDP fell back (-0.1%M/M) for just a first month in eight. Unfortunately, a second successive contraction in May cannot be confidently ruled out. In particular, the PMIs point towards a sharp drop in business activity, with the dominant services sector reportedly contracting (49.3) for the first month since April 2025. Consumer-facing services probably fared slightly better in the warm weather, as the firmness of May's retail sales suggests. A separate retail survey from the BRC (Tuesday) will give a hint as to whether high street spending received any further support in June from the moderation in fuel prices and a potential World Cup boost, despite still-subdued consumer confidence. In any case, softer housing market activity should provide some offset, while the effects of tighter financial conditions, rising material costs and, indeed, May's record heatwave, raise downside risks for construction activity. Surveys suggest that manufacturers continued to rebuild inventories and front-run production ahead of possible cost and supply pressures, but the recent strength might cap the extent of additional support. Overall, we expect monthly GDP to have merely sidestepped in May, consistent with a moderation in the three-month growth rate to 0.5%3M/3M. And with activity likely to have remained subdued and base effects rolling off in June, we expect GDP growth in Q2 will eventually be reported as roughly half that figure.

Otherwise, BoE Governor Bailey is also scheduled to deliver a speech at the annual financial services dinner at Mansion House (Tuesday evening). We would typically expect his speech to be geared towards recent financial stability and regulatory developments, and so it should be of limited value in terms of evaluating the possible future path of rates. Indeed, any comments on monetary policy might be expected to underscore the unusually high level of uncertainty.

The next Euro wrap-up will be published on Wednesday 15 July 2026

Daiwa Capital Markets

Daiwa economic forecast

	2026 Q1	2026 Q2	2026 Q3	2026 Q4	2027 Q1	2027 Q2	2026	2027	2028
GDP	%, Q/Q						%, Y/Y		
Euro area	-0.2	0.1	0.1	0.2	0.3	0.4	0.2	1.0	1.4
UK	0.6	0.2	0.1	0.2	0.4	0.4	0.9	1.1	1.4
Inflation, %, Y/Y									
Euro area									
Headline HICP	2.0	3.0	2.8	2.9	2.8	2.2	2.7	2.4	2.0
Core HICP	2.3	2.4	2.5	2.7	2.9	2.8	2.5	2.7	2.2
UK									
Headline CPI	3.1	2.7	3.0	3.0	2.9	2.5	3.0	2.5	2.1
Core CPI	3.2	2.5	2.7	2.9	3.0	3.1	2.8	2.9	2.4
Monetary policy, %									
ECB									
Deposit Rate	2.00	2.25	2.50	2.50	2.50	2.50	2.50	2.25	2.25
Refi Rate	2.15	2.40	2.65	2.65	2.65	2.65	2.65	2.40	2.40
BoE									
Bank Rate	3.75	3.75	3.75	3.75	3.75	3.50	3.75	3.25	3.25

Source: Bloomberg, ECB, BoE 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%	Jun	**2.4 (2.3)**	*2.4 (2.3)*	2.7 (2.6)	-
France	Final HICP (CPI) Y/Y%	Jun	**2.0 (1.8)**	*2.0 (1.8)*	2.8 (2.4)	-
Italy	Industrial production M/M% (Y/Y%)	May	**-0.3 (1.1)**	-0.2 (1.3)	0.5 (1.3)	0.4 (1.1)

Auctions

Country	Auction
Italy	sold €2.5bn of 3% 2029 bonds at an average yield of 2.98%
	sold €3.5bn of 3.35% 2033 bonds at an average yield of 3.50%
	sold €1.5bn of 3.95% 2041 bonds at an average yield of 4.23%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's data calendar

The coming week's key data releases

Country	BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
		Monday 13 July 2026			
		- Nothing scheduled -			
		Tuesday 14 July 2026			
Germany	07.00	Wholesale prices M/M% (Y/Y%)	Jun	-	-0.6 (5.9)
UK	00.01	BRC retail monitor – like-for-like sales Y/Y%	Jun	-	3.4
		Wednesday 15 July 2026			
Euro area	10.00	Industrial production M/M% (Y/Y%)	May	*-0.2 (-0.7)*	0.1 (0.3)
Spain	08.00	Final HICP (CPI) Y/Y%	Jun	*3.6 (3.2)*	3.6 (3.2)
		Thursday 16 July 2026			
Euro area	10.00	Trade balance €bn	May	2.5	1.3
Italy	09.00	Final HICP (CPI) Y/Y%	Jun	*3.1 (3.0)*	3.2 (3.2)
UK	07.00	Monthly GDP M/M% (3M/3M%)	May	*0.0 (0.5)*	-0.1 (0.7)
	07.00	Services output M/M% (3M/3M%)	May	0.1 (0.6)	-0.2 (0.8)
	07.00	Industrial output M/M% (Y/Y%)	May	0.1 (1.3)	0.0 (-0.2)
	07.00	Construction output M/M% (Y/Y%)	May	-0.3 (-1.2)	0.1 (-1.0)
	07.00	Trade (goods trade) balance £bn	May	-5.0 (-22.9)	-8.4 (-26.0)
		Friday 17 July 2026			
Euro area	09.00	ECB current account €bn	May	-	15.7
	10.00	Final headline (core) HICP Y/Y%	Jun	*2.8 (2.4)*	3.2 (2.6)

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions

Country	BST	Event / Auction
		Monday 13 July 2026
Euro area	17.45	ECB Executive Board Member Schnabel to deliver keynote speech and participate in panel discussion, Munster
UK	19.00	BoE Chief Economist Pill speaks at a conference, London
		Tuesday 14 July 2026
Germany	10.30	Auction: to sell up to €6bn of 2028 bonds*
UK	09.45	BoE Governor Bailey to appear before Treasury Select Committee to discuss the Bank's Financial Stability Report
	21.00	BoE Governor Bailey delivers speech to the Annual Financial and Professional Services Dinner at Mansion House, London
		Wednesday 15 July 2026
Germany	10.30	Auction: to sell up to €1bn of 0% 2052 bonds
	10.30	Auction: to sell up to €1bn of 2.5% 2054 bonds
	10.30	Auction: to sell up to €1bn of 2.9% 2056 bonds
UK	19.00	BoE Chief Economist Pill speaks at a conference, London
	18.00	Nominations stage for Labour MPs in leadership election closes
		Thursday 16 July 2026
France	09.50	Auction: to sell up to €14bn of 2.4% 2029, 1.5% 2031, 3.25% 2032 & 3.5% 2033 bonds
	10.50	Auction: to sell up to €1.5bn of 0.1% 2032, 1.8% 2040 & 0.1% 2053 inflation-linked bonds
Spain	09.30	Auction: to sell 2.35% 2029, 3.55% 2033 & 3.95% 2056 bonds
UK	10.00	Auction: to sell £4.25bn of 4.875% 2036 bonds
		Friday 17 July 2026
		- Nothing scheduled -

**Details to be announced. Source: Bloomberg and Daiwa Capital Markets Europe Ltd.*

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