Euro wrap-up

Overview

Chris Scicluna
+44 20 7597 8326

Emily Nicol
+44 20 7597 8331

- While euro area inflation ticked higher in June, Bunds made gains as several ECB Governing Council members flagged concerns about the strong euro.
- Gilts also made gains as UK house prices fell for the third month in four.
- Wednesday will bring new data on euro area unemployment while the account of the ECB's June policy meeting is due Thursday.

Daily bond market movements

Bond	Yield	Change
BKO 1.7 06/27	1.839	-0.014
OBL 2.4 04/30	2.141	-0.026
DBR 2½ 02/35	2.568	-0.034
UKT 3¾ 03/27	3.812	+0.003
UKT 4⅜ 03/30	3.926	-0.020
UKT 4½ 03/35	4.447	-0.040

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

Euro area

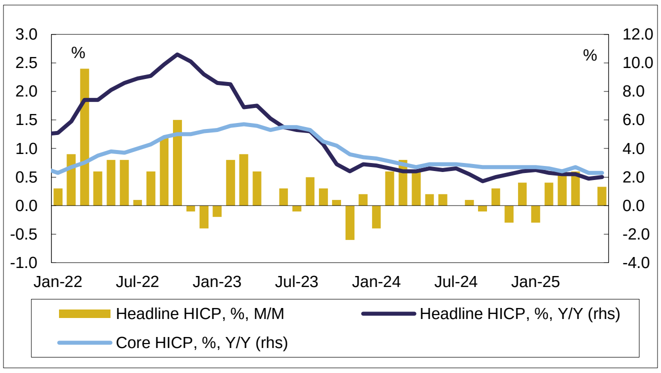
Inflation back on target in June with core rate steady

According to today's flash estimate, in line with the consensus, euro area HICP inflation edged up 0.1ppt in June back to the ECB's 2.0%Y/Y target. That also left the Q2 average at 2.0%Y/Y, in line with the ECB's projection published early last month. There were no nasty surprises in the detailed data. Core inflation was steady at 2.3%Y/Y, matching the lowest rate since January 2022 and leaving the quarterly average slightly below the ECB's projection at 2.4%Y/Y. Having dropped a steep 0.8ppt in May to the lowest level in more than three years, the all-important services component ticked just 0.1ppt higher to 3.3%Y/Y. But that impact was offset by continued softness in prices of non-energy industrial goods, which fell on the month for the first time since January to push core goods inflation down to a six-month low (0.5%Y/Y). Beyond the core items, an easing of pressures in the processed component allowed inflation of food, alcohol and tobacco to moderate slightly (3.1%Y/Y). But that was more than offset by a jump in the energy component to a three-month high (-2.7%Y/Y) as an unfavourable base effect combined with higher prices of auto fuel and household utility prices in certain member states due to the impact of events in the Middle East on wholesale market prices.

Strong euro weighing on inflation, strengthening case for a final rate cut in September

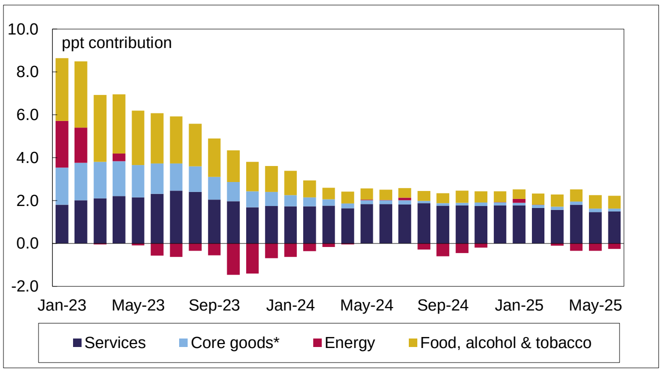
Looking ahead, we expect euro area inflation to drop back below 2.0%Y/Y in July and August. While evidence points to another strong summer for tourism in Southern Europe, overall demand for both services and goods appears to remain tepid as uncertainty related to US tariffs and geopolitics persists. So, services inflation should resume a gradual downtrend as labour cost growth moderates further. And with supply ample and euro appreciation weighing significantly on prices of imported goods – which in Germany excluding energy have fallen for three successive months – core goods inflation should fall to the lowest level since 2020. The trajectory of inflation from the autumn onwards will in part depend on whether, and if so how, uncertainties are resolved. Our baseline projection, which is predicated on the current US tariff landscape remaining in place, foresees growth remaining sub-potential in the second half of the year and inflation remaining slightly below the ECB's target from year-end over the horizon. But energy and food prices will have an important bearing as will exchange rate developments. Indeed, several members of the Governing Council today conspicuously flagged concerns about the potential impact of further significant euro appreciation. The euro is already overshooting the path in the ECB's alternative scenario whereby both GDP growth and inflation would be 0.3ppt lower than its baseline by the end of the forecast horizon. And as intimated today by Vice President Guindos, a move in the euro firmly above $1.20 – now within reach – would likely be of material concern to policymakers. Of course, the Governing Council will sit on its hands at the July policy meeting and await greater clarity on the outlook. And the path of rates thereafter will be data dependent. But in our view, euro appreciation will indeed likely prove sufficient for the ECB's majority to justify a further, probably final, rate cut in September.

Euro area: Headline & core HICP inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Contributions to HICP inflation



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

The coming two days in the euro area

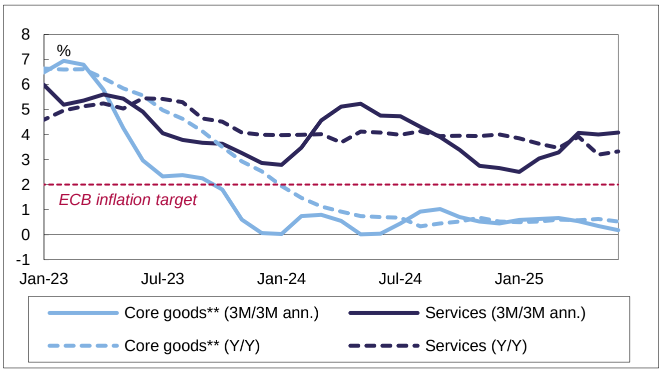
Aptly, given June's on-target flash inflation print and signs of easing wage growth, the ECB's account of its June monetary policy meeting (due Thursday) should play down the risks of inflation persistence in the euro area. Indeed, we expect the account to reiterate that the ECB remains well positioned following the latest cut, with interest rates now broadly at the lower bound of most Eurosystem estimates of the neutral rate. It will also no doubt underscore that heightened uncertainty relating to geopolitics and Europe's future trading relationship with the US remains a risk to the growth outlook. And while the risks to the inflation outlook clearly remain two-sided – recently evidenced on the upside by the temporary spike in oil prices and on the downside by marked ongoing euro appreciation – the account will likely suggest that the skew of risks is to the downside. Nonetheless, Lagarde hinted in her press conference that the ECB is approaching the end of its monetary easing cycle. While implying that July is likely not 'live' for a rate cut, focus should be on the conditions that might call for action in September. Ahead of the release of the ECB's meeting account, Wednesday will bring further data on labour market conditions. Contrasting with the further uptick in jobless claims in Germany reported today, Spain likely continued to add jobs at a significant rate in June. Despite signals of gradual loosening, the euro area unemployment rate likely moved sideways at the series low of 6.2% in May. Finally, in line with the flash release, June's final euro area services and composite PMIs should suggest that private sector activity in the bloc at the end of Q2 was broadly stagnant (with the euro area composite activity index at 50.2) despite further gradual improvement in Germany (up 1.9pts to 50.4).

UK

Shop price inflation jumps to a 13-month high as food inflation trends higher

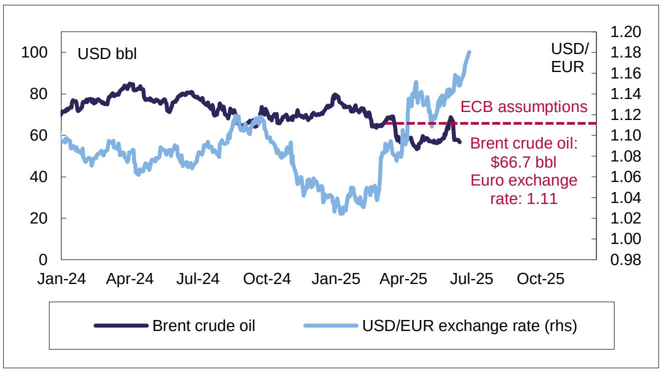
While BoE Governor Bailey has continued to reiterate that he doubts that the recent pickup in inflation to well above the Bank's 2% target will be persistent, today's BRC shop price survey flagged the uncomfortable ongoing uptrend in food inflation. According to the BRC, food prices jumped 0.7%M/M in June, the most for that month since 2022 and the joint-highest increase in any month for more than two years. This pushed the annual rate of food price inflation up 0.9ppt to a 15-month high of 3.7%Y/Y. Fresh food inflation increased to a 16-month high, with recent dry weather reportedly impacting fruit and vegetable harvests while meat prices continued to increase too. And inflation of ambient food also rose to the highest level in 13 months. In contrast, prices of non-food items remained well behaved, with declines in furniture and electrical goods perhaps reflecting retailers attempts to reduce excess stock after the slump in sales in May. But the pace of decline in non-food inflation (-1.2%Y/Y) was the softest in 11 months. As such, total shop price inflation jumped 0.5ppt to 0.4%Y/Y, the firmest rate since May 2024 but nevertheless still well below the peak (9.0%Y/Y) in May 2023. While today's survey might point to a further pickup in non-energy industrial goods CPI inflation from May's 15-month high (1.6%Y/Y), given still

Euro area: Core inflation momentum*



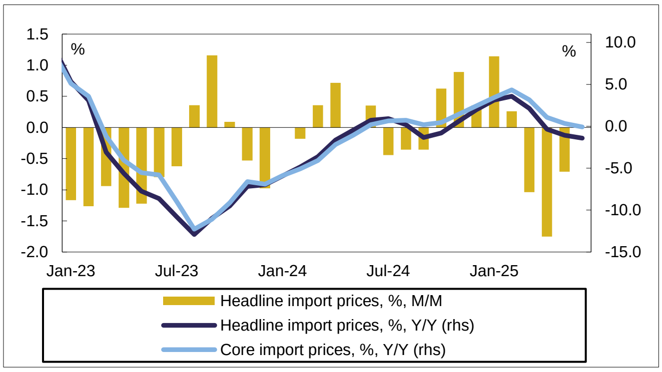
*Seasonally adjusted data. **Non-energy industrial goods.
Source: ECB, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Oil price & euro exchange rate



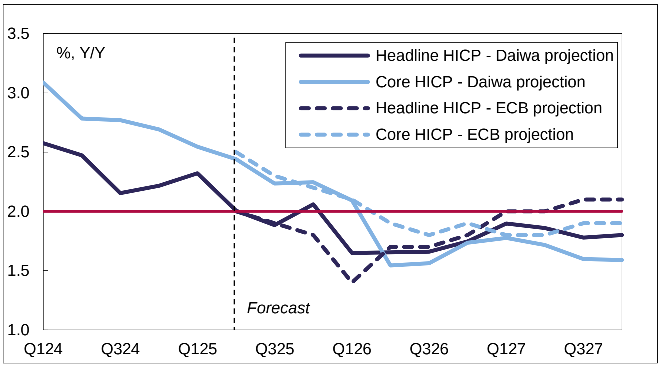
Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Germany: Import price inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: HICP inflation projections



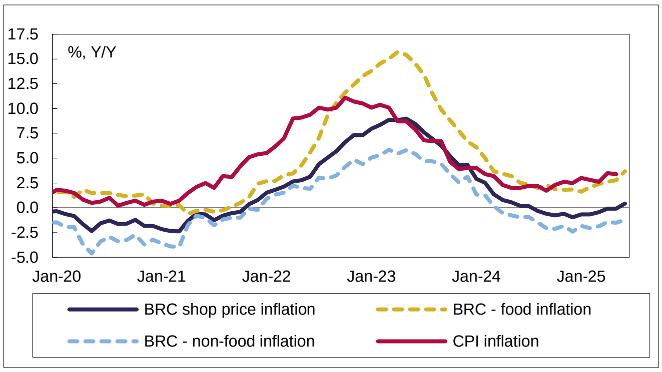
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

relatively subdued purchase intentions, intense competition on the high street and the impact of sterling appreciation, we continue to expect any meaningful underlying goods price pressures to remain absent.

Nationwide house price index declines the most since February 2023

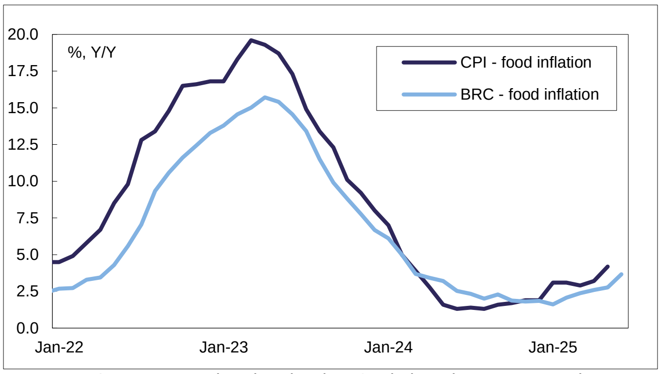
Today's Nationwide housing market survey unexpectedly reported a decline in house prices in June as the hit to demand from April's tweaks to the Stamp Duty thresholds and ongoing economic uncertainties continued to take their toll. According to Nationwide, house prices fell in June for a third month out of the past four and by the most since February 2023 (-0.8%M/M). This pushed the annual rate down 1.4ppts to an 11-month low (2.1%Y/Y), less than half the rate of growth at the end of 2024. Given signs of improvement in underlying conditions in the housing market, this downturn should prove temporary. Certainly, the increase in mortgage approvals in May points to a further pickup in new mortgage lending over coming months. And while the effective interest rate on the stock of mortgage lending continues to trend higher, rates on new lending have taken a step down – indeed, the average interest rate on a 2-year fixed mortgage with a LTV ratio of 75% fell to 4.19% in May, the lowest rate since before the Truss-related blowout in borrowing costs in September 2022, some 200bps below the peak in August 2023. Taken together with rising earnings, and notwithstanding the recent pickup in joblessness, housing affordability appears to be the best for several years. And with borrowing costs likely to fall further as the BoE continues to cut Bank Rate, we continue to expect a gradual recovery in house price growth over coming quarters.

UK: Headline CPI & BRC shop price inflation



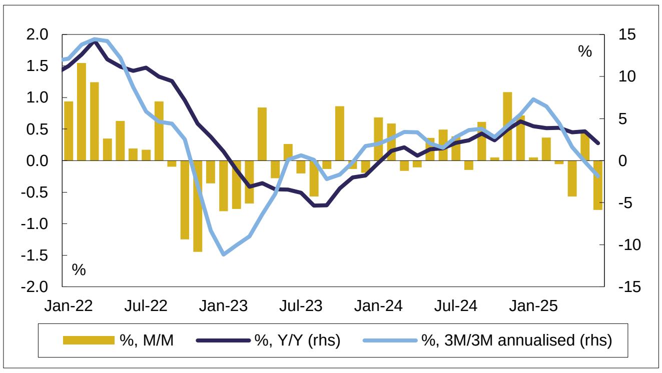
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Food price inflation



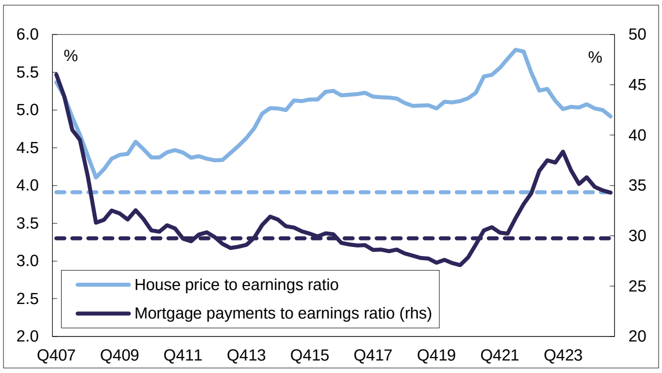
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Nationwide house price growth



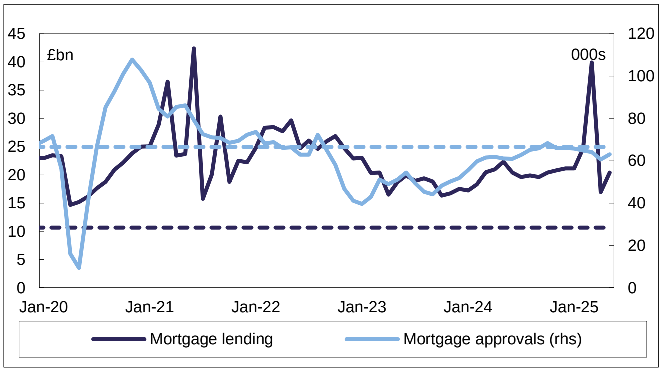
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Housing affordability*



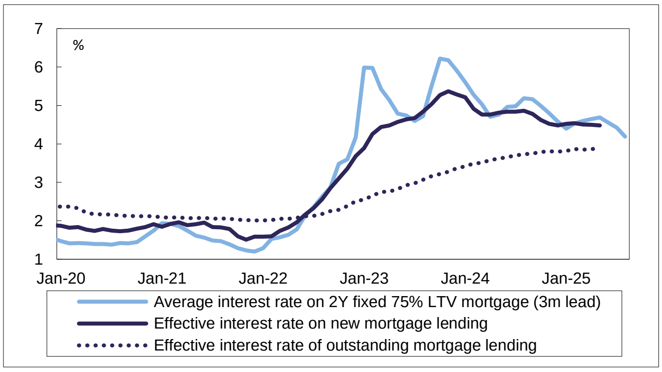
**Dashed lines represent long-run average.*
Source: Nationwide, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Mortgage lending & approvals*



**Dashed lines represent long-run average.*
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Mortgage interest rates



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

The coming two days in the UK

Besides an appearance from MPC external member Taylor on a panel in Sintra on Wednesday, tomorrow should be a relatively quiet day for UK economic news. So, our focus will be on Thursday's dataflow, and particularly June's BoE Decision Maker Panel survey. With services inflation still elevated (4.7%Y/Y) and diminished trust in the ONS's LFS wage data, the DMP has been a key source of reassurance for the MPC as it gradually loosens policy. We expect June's survey to continue to flag the likelihood of further continued gradual moderation in wage- and price-setting behaviour over coming months. Inflation expectations, having edged up since October, could also slow as businesses look through the impact of April's one-off cost increases. That might be consistent with the moderation displayed by the PMI price indices, with June's flash survey having signalled the smallest expansion in the output price PMI for the services sector since February 2021. With respect to output, Thursday's final composite PMIs will also be expected to suggest a modest uptick in activity (50.7) at the end of Q2. That, however, would still be broadly consistent with stagnant private sector growth over the quarter as a whole. Meanwhile, with market interest rates for new loans edging gradually lower, the BoE's quarterly credit conditions survey will provide a view of lenders' assessments of potential credit demand in Q3.

The next edition of the Euro wrap-up will be published on Thursday 3 July 2025

Today's results

Economic data

Country	Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro Area	Preliminary headline (core) HICP Y/Y%	Jun	**2.0 (2.3)**	*1.9 (2.2)*	1.9 (2.3)	-
	Final manufacturing PMI	Jun	**49.5**	*49.4*	49.4	-
	ECB consumer expectations survey – 1Y (3Y) CPI Y/Y%	May	**2.4 (2.8)**	-	3.1 (2.5)	-
Germany	Final manufacturing PMI	Jun	**49.0**	*49.0*	48.3	-
	Unemployment claims rate % (change 000s)	Jun	**6.3 (11)**	6.4 (15)	6.3 (34)	- (33)
France	Final manufacturing PMI	Jun	**48.1**	*47.8*	49.8	-
Italy	Manufacturing PMI	Jun	**48.4**	49.5	49.2	-
Spain	Manufacturing PMI	Jun	**51.4**	50.5	50.5	-
UK	Final manufacturing PMI	Jun	**47.7**	*47.7*	46.4	-
	BRC shop price index Y/Y%	Jun	**0.4**	0.2	-0.1	-
	Nationwide house price index M/M% (Y/Y%)	Jun	**-0.8 (2.1)**	-0.1 (3.1)	0.5 (3.5)	0.4 (-)

Auctions

Country	Auction
UK	sold £2bn of 1.5% 2053 green bonds at an average yield of 5.169%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Wednesday's releases

Economic data

Country	BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Euro Area	10.00	Unemployment rate %	May	6.2	6.2
Spain	08.00	Unemployment change (employment net change) 000s	Jun	-	-57.8 (20.8)

Auctions and events

Country	BST	Event
Euro Area/UK	11.30	ECB Chief Economist Lane chairs panel featuring BoE MPC external member Taylor on central bank communications, Sintra
Germany	10.30	Auction: to sell €6bn of 2035 bonds
UK	10.00	Auction: to sell £5bn of 4.375% 2028 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Thursday's releases

Economic data

Country		BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Euro Area		09.00	Final composite (services) PMI	Jun	*50.2 (50.0)*	50.2 (49.7)
Germany		08.55	Final composite (services) PMI	Jun	*50.4 (49.4)*	48.5 (47.1)
France		08.50	Final composite (services) PMI	Jun	*48.5 (48.7)*	49.3 (48.9)
Italy		08.45	Composite (services) PMI	Jun	51.6 (52.5)	52.5 (53.2)
Spain		08.15	Composite (services) PMI	Jun	51.2 (51.0)	51.4 (51.3)
UK		09.30	Final composite (services) PMI	Jun	*50.7 (51.3)*	50.3 (50.9)
		09.30	DMP 3M output price (1Y CPI) expectations Y/Y%	Jun	3.5 (3.0)	3.7 (3.0)

Auctions and events

Country		BST	Event
Euro Area		11.30	ECB to publish monetary policy account of June 4-5 Governing Council meeting
France		09.50	Auction: to sell up €12bn of 3.2% 2035, 3.6% 2042 & 3.75% 2056 bonds
Spain		09.30	Auction: to sell 1.15% 2026, 2.4% 2028, 3.15% 2035 & 3.5% 2041 bonds
UK		09.30	BoE to publish quarterly Bank Liabilities and Credit Conditions surveys for Q225

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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