

Euro wrap-up

Overview

- While the flash August estimate of euro area inflation offered little surprise, Bunds made losses following a global sell-off at the long-end of the curve.
- The Gilt curve also steepened on a quiet day for UK economic data.
- Wednesday will bring the final European composite PMIs for August and euro area PPI data for July, while BoE monetary policy-setters, including Governor Bailey, will testify before a parliamentary committee.

Emily Nicol
+44 20 7597 8331

Edward Maling
+44 20 7597 8030

Daily bond market movements

Bond	Yield	Change
BKO 1.9 09/27	1.977	+0.022
OBL 2.2 10/30	2.315	+0.038
DBR 2.6 08/35	2.791	+0.044
UKT 3% 03/27	3.990	+0.024
UKT 4% 03/30	4.179	+0.046
UKT 4½ 03/35	4.808	+0.057

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

Euro area

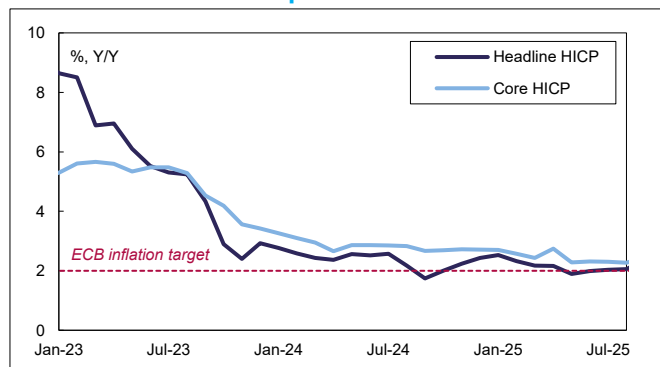
Euro area inflation edges marginally higher in August due to energy and fresh food

The flash euro area inflation estimates for August provided no major surprises, with the headline HICP rate edging marginally higher by 0.1ppt to 2.1%Y/Y, a four-month high. To two decimal places, inflation was up just 0.01ppt to 2.05%Y/Y. And the upwards impulse principally reflected a smaller drag from energy inflation (-1.9%Y/Y), which rose to a five-month high given a sharper drop in fuel prices a year earlier. Despite a modest decline in prices last month, fresh food inflation also rose to the highest in 19 months (5.5%Y/Y). But given a moderation in processed food inflation, the overall food, alcohol and tobacco component eased slightly (down 0.1ppt to 3.2%Y/Y). The core components were well behaved in August, with the increase in prices of non-energy industrial goods bang in line with the long-run average to leave the annual inflation rate unchanged at just 0.8%Y/Y. Furthermore, favourable base effects pushed services inflation slightly lower, by 0.1ppt to 3.1%Y/Y, the softest reading since March 2022, to be tracking broadly in line with the ECB's expectations in Q3. So, while the core rate came in slightly above the Bloomberg survey consensus, it was unchanged at 2.3%Y/Y for a fourth consecutive month, bang in line with the ECB's macroeconomic projections published in June. (And to two decimal places it came in on the soft side, easing 0.04ppt to 2.27%YY).

ECB to revise up headline inflation projections over the near-term, justifying unchanged policy

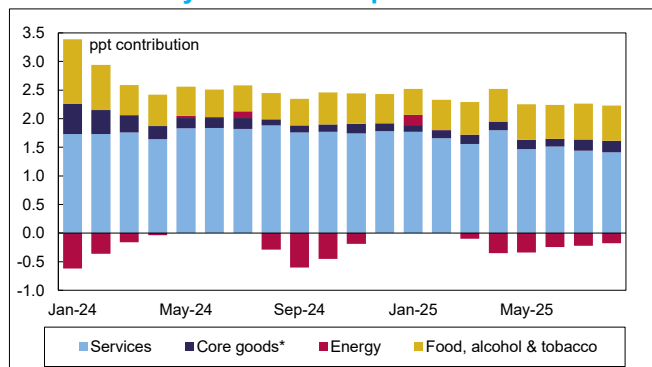
Given the uptrend in food inflation over the summer and the smaller drag from energy, the headline HICP rate is tracking so far in Q3 some 0.3ppt above the ECB's forecast published in June (1.9%Y/Y). So, when the Governing Council publishes updated macroeconomic projections alongside its policy announcement on 11 September, we also expect the profile for headline inflation over coming quarters to be nudged higher. Certainly, with the oil price averaging some 5% higher than three months ago, the ECB will need to revise down the drag from energy over coming quarters and revise up slightly the contribution from food inflation. But a stronger euro and diverted trade flows from Asia will help to keep a lid on core goods price pressures. Services inflation will also likely trend lower in early 2026, supported by the ongoing slowdown in wage growth. But while we also expect headline inflation to edge back just below the 2%Y/Y target at the turn of the year, the ECB's previously anticipated trough of 1.4%Y/Y in Q126 seems bound to be revised higher. And while there remain significant uncertainties about the near-term outlook, influential Executive Board hawk Schnabel today reiterated her view that inflation risks are tilted to the upside. It remains to be seen whether that stance is shared more widely by those on the Governing Council. Either way interest rates seem bound to be left unchanged next week.

Euro area: Consumer price 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.

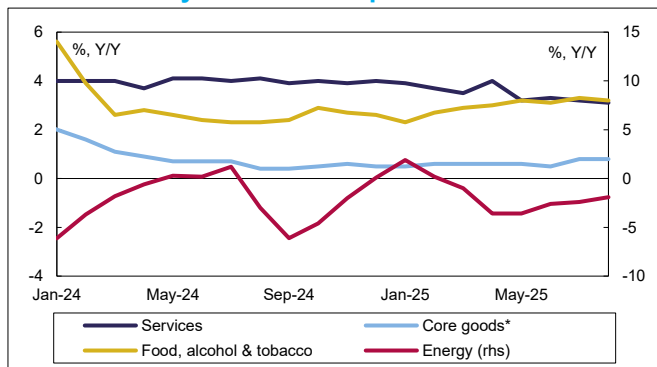
Lower euro area unemployment should not be an obstacle to further services disinflation

Though our expectations for a continued moderation in services inflation remain underpinned by further gradual loosening in the labour market, the hawks will no doubt flag ongoing resilience as illustrated in yesterday's euro area jobless numbers. Indeed, these showed that the number of people in unemployment fell 170k in July – the most since January 2022 – to a year-to-date low of 10.81mn. That nudged the unemployment rate back to a series-low of 6.2% for the first month since November 2024. This was in spite of upwards revisions to the French data, which despite moving sideways in July suggested that the jobless rate in the euro area's second largest member state (7.6%) was 0.3ppt higher than at the start of the year. Even though it was unchanged in July for a fourth month (3.7%), structural challenges in Germany have also seen the unemployment rate rise 0.7ppt over the past two years. But unemployment in both countries reportedly rose just 6k combined in July. And a decrease in [German jobless claims](#) in August gives a tentative signal that loosening in Germany's labour market may be slowing, albeit with labour demand still soft. But Southern Europe once again led the way in terms of job gains at the start of the summer, with unemployment rates in Italy (6.0%), Greece (8.0%) and Spain (10.4%) respectively their lowest since the Global Financial Crisis. Consistent with continued net employment gains in Spain in August, job creation in the euro area periphery is expected to continue apace. And given the extent of labour slack in those economies, a record low unemployment rate in the euro area should be able to continue without reviving wage growth pressures.

The day ahead in the euro area

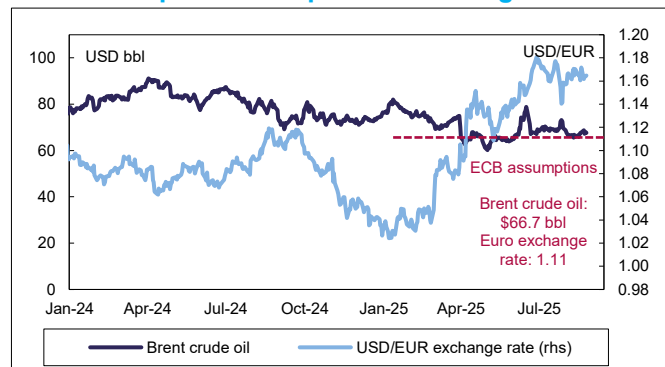
The markup to the final euro area and German manufacturing output PMIs on Monday should, in the absence of major changes to the service readings tomorrow, bode favourably for August's final composite PMIs. Even though those [flash](#) readings had signalled only a modest pickup in growth momentum (51.1), they nonetheless marked the fastest expansion in the euro area composite PMI for 15 months. And despite being constrained by stagnation in German services activity last month (50.1), the German composite PMI (50.9) was similarly the second-highest since May 2023. With regards to July's euro PPI data, energy base effects and falling intermediate goods prices should underscore the absence of underlying pressures to core goods inflation. Headline PPI inflation is expected to soften, possibly returning to negative territory for a first month in eight.

Euro area: Key inflation components



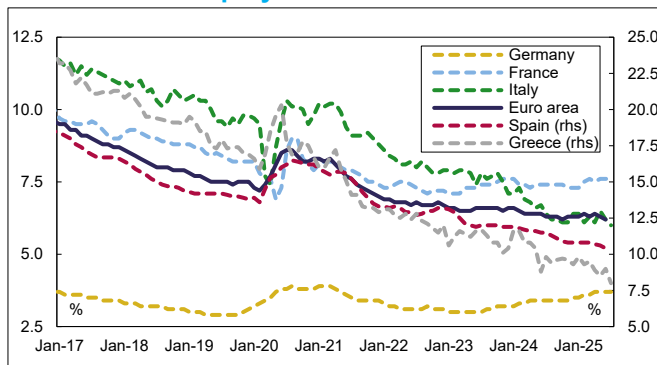
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

ECB assumptions – oil price & exchange rate



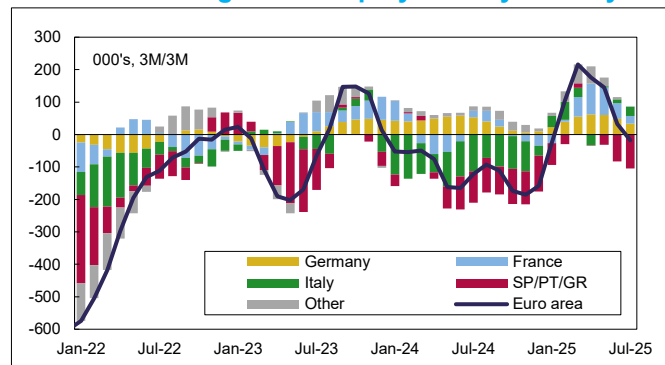
Source: Bloomberg, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Unemployment rates



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Change in unemployment by country



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK

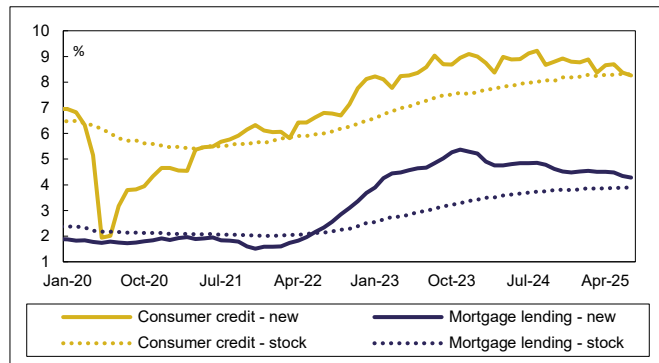
Less restrictive policy appears to be feeding through to bank lending

While the BoE suggested last month that the dampening effects of past interest rate hikes on economic activity had begun to peak, they acknowledged that its effects had weakened as its policy stance had recently become less restrictive. While there will be a wide range of opinions on the MPC on the extent of current policy restrictiveness, yesterday's effective interest rate data showed a further decline in the cost of new borrowing for firms and households, now some 80-140bps below their respective peaks, which appears to have supported an ongoing improvement in UK bank lending. Indeed, after the retrenchment in April following the policy-led surge in net mortgage lending in March (£13.2bn), lending has steadily recovered, rising at the start of Q3 by a net £4.5bn. New mortgage approvals also increased to a six-month high (65.4k), suggesting that underlying demand remains strong. Consumer credit flows also improved to a three-month high (£1.6bn), to leave the growth in overall loans to households up to a near 2½-year high of 3.4%Y/Y. Meanwhile, following a net repayment by firms in June, business lending picked up again in July (£5.0bn), taking the annual growth rate up to 5.5%Y/Y, matching the pace in May and February 2021 before that. While proportionately driven by larger businesses, net lending to SMEs was encouragingly its strongest since March 2021 (£0.67bn).

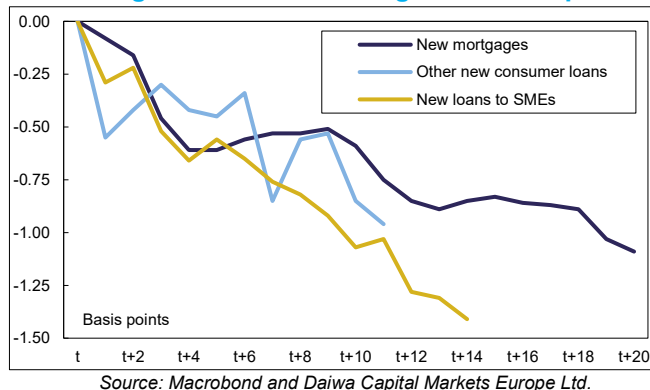
The day ahead in the UK

Wednesday's highlight will likely be the quarterly appearance of BoE Governor Bailey and fellow monetary policy setters Lombardelli, Greene (both of whom preferred to hold policy in August) and Taylor (who joined the Governor in voting for a 25bps cut) before the Treasury Select Committee to discuss the Bank's latest macroeconomic projections presented in the August Monetary Policy report. Indeed, with market expectations about the prospects for a further rate cut this year fading, their comments will be closely followed to gauge the likelihood of an extended pause in the Bank's easing cycle. Meanwhile, August's final composite PMIs will mark the sole economic data release. Notwithstanding a marginally larger contraction in the final manufacturing output index amid more subdued demand in that sector, the pickup in services activity signalled by the flash release (53.6) will be expected to lead the firmest expansion in private sector business activity for 12 months (53.0).

UK: Effective interest rates on loans to households



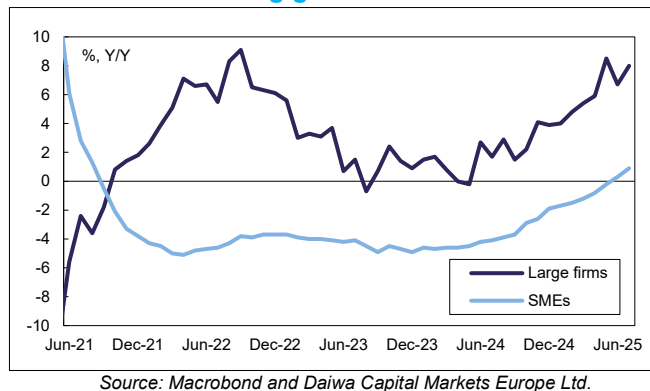
UK: Change in effective lending rates since peak



UK: Mortgage lending and approvals



UK: Business lending growth



European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area	Preliminary headline (core) HICP Y/Y%	Aug	2.1 (2.3)	<u>2.1 (2.3)</u>	2.0 (2.3)	-
Italy	PPI Y/Y%	Jul	2.4	-	3.9	-
Spain	Unemployment (net employment) change 000s	Aug	21.9 (29.8)	-	-1.4 (31.1)	-

Auctions

Country	Auction
Germany	sold €3.552bn of 1.9% 2027 bonds at an average yield of 1.96%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Monday's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area	Final manufacturing PMI	Aug	50.7	<u>50.5</u>	49.8	-
	Unemployment rate %	Jul	6.2	6.2	6.2	6.3
Germany	Final manufacturing PMI	Aug	49.8	<u>49.9</u>	49.1	-
France	Final manufacturing PMI	Aug	50.4	<u>49.9</u>	48.2	-
Italy	Manufacturing PMI	Aug	50.4	49.8	49.8	-
Spain	Manufacturing PMI	Aug	54.3	52.1	51.9	-
UK	Net consumer credit £bn (Y/Y%)	Jul	1.6 (7.0)	1.3 (-)	1.4 (6.7)	1.5 (6.8)
	Net mortgage lending £bn (mortgage approvals 000s)	Jul	4.5 (65.4)	3.5 (64.0)	5.3 (64.2)	5.4 (64.6)
	Final manufacturing PMI	Aug	47.0	<u>47.3</u>	48.0	-
	Nationwide house prices M/M% (Y/Y%)	Aug	-0.1 (2.1)	0.0 (2.7)	0.6 (2.4)	0.5 (-)

Auctions

Country	Auction
- Nothing to report -	

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	09.00	Final composite (services) PMI	Aug	<u>51.1 (50.7)</u>	50.9 (51.0)
	10.00	PPI Y/Y%	Jul	-0.1	0.6
Germany	08.55	Final composite (services) PMI	Aug	<u>50.9 (50.1)</u>	50.6 (50.6)
France	08.50	Final composite (services) PMI	Aug	<u>49.8 (49.7)</u>	48.6 (48.5)
Italy	08.45	Composite (services) PMI	Aug	51.6 (52.1)	51.5 (52.3)
Spain	08.15	Composite (services) PMI	Aug	54.9 (54.5)	54.7 (55.1)
UK	09.30	Final composite (services) PMI	Aug	<u>53.0 (53.6)</u>	51.5 (51.8)

Auctions and events

Euro area	09.30	ECB President Lagarde to give welcome address to European Systemic Risk Board conference
Germany	10.30	Auction: to sell €5bn of 2.6% 2035 bonds
UK	14.15	BoE Governor Bailey, Deputy Governor Lombardelli & external members Taylor & Greene to appear before the Treasury Select Committee

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:

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

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