Euro wrap-up

Overview

- Bunds ended the day little changed as German and French inflation surprised to the downside in June but consumer spending strengthened in May.
- Despite soft signals from a UK shop price survey, Gilts made losses as the Government outlined its plans to increase defence spending.
- Wednesday will bring flash euro area inflation data for June while ECB President Lagarde and BoE Governor Bailey will appear on the flagship policy panel at the ECB's central banking forum.

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Daily bond market movements

Bond	Yield	Change
BKO 2½ 06/28	2.527	-0.006
OBL 2½ 04/31	2.598	+0.002
DBR 2.9 02/36	2.863	+0.007
UKT 4⅜ 03/28	4.155	+0.039
UKT 4⅛ 03/31	4.299	+0.033
UKT 4¾ 10/35	4.761	+0.046

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

Euro area

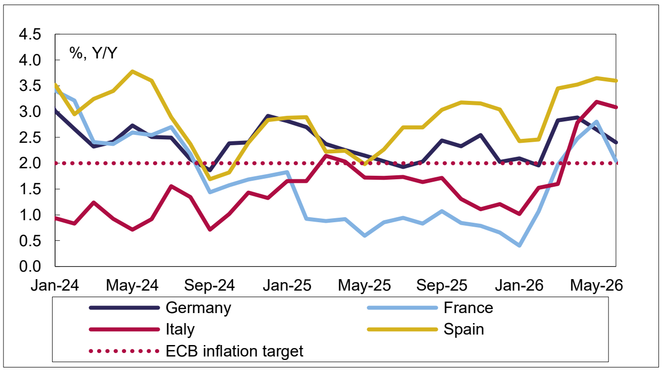
German inflation eases more than expected in June as energy pressures unwind

As the ECB's annual forum in Sintra got underway, several senior policymakers – including President Lagarde and Chief Economist Lane – warned that the full effects of the recent energy shock have yet to feed through. While the sharper-than-expected decline in wholesale energy prices is supportive for the near-term inflation outlook, policymakers remain alert to lagged second-round effects from the four months of higher oil prices to food and services price-setting. However, the flash June inflation estimates from the larger member states provide little evidence so far of any meaningful indirect effects. Indeed, today's data were overall softer than expected. In Germany, headline inflation on both the EU-harmonised and national measures fell for a second month, by 0.3ppt to 2.4%Y/Y and 2.3%Y/Y respectively, to a four-month low. The limited national detail published showed the decline was almost entirely driven by a further sharp drop in energy inflation, by more than 3ppts to 3.4%Y/Y. Encouragingly, prices of food fell for a second successive month, leaving inflation of that component unchanged at 0.4%Y/Y, the joint-lowest level in more than two years. Services inflation also held steady at 3.1%Y/Y, despite regional data suggesting a notable upwards impulse from hotels and restaurants, inflation of which moderated sharply in May. Meanwhile, there was a modest easing in our estimate of non-energy industrial goods inflation from May's nine-month high. But, overall, core inflation remained broadly unchanged at 2.5%Y/Y, albeit in line with the average in the year to date.

Broader moderation in French and Italian inflation

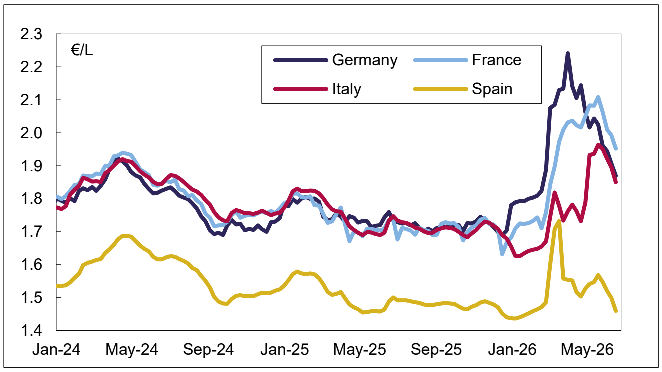
Among the other larger member states to publish data today, French headline HICP inflation fell sharply by 0.8ppt to 2.0%Y/Y, while Italian inflation also edged unexpectedly lower by 0.1ppt to 3.1%Y/Y. But contrasting Germany, these releases suggested a broader moderation in underlying price pressures. Admittedly, in France, the sharp drop in energy inflation – driven by lower auto fuel prices – by more than 5ppts accounted for roughly half the drop. But food inflation also moderated to a 15-month low (0.9%Y/Y). And with services inflation (1.8%Y/Y) reversing the increase in May and manufacturing goods inflation (-0.9%Y/Y) the most negative in six months, core inflation likely fell back close to 1%Y/Y. Certain core components appear to have been flattered by favourable base effects. Specifically, goods prices were reportedly impacted by additional sales days included in this year's sample, while prices of hospitality services a year ago were inflated by the additional bank holiday that fell in June 2025. But today's Italian data also showed that core inflation fell back below 2%Y/Y in June, with services inflation (down 0.2ppt to 2.5%Y/Y) benefiting from a softer rise in hospitality prices. Meanwhile, non-energy industrial goods inflation remained largely absent (0.5%Y/Y). And so, in the absence of an upwards impulse from energy as inflation of household utilities jumped, headline HICP inflation would have fallen further. Overall, despite ongoing stickiness in Spain and Portugal, we now expect euro area headline inflation to decline in June by 0.3ppt, to 2.9%Y/Y. We also forecast core inflation to ease 0.1ppt to 2.5%Y/Y, broadly in line with the ECB's projection, but with risks skewed to the downside.

Euro area member states: Headline HICP inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area member states: Weekly petrol prices

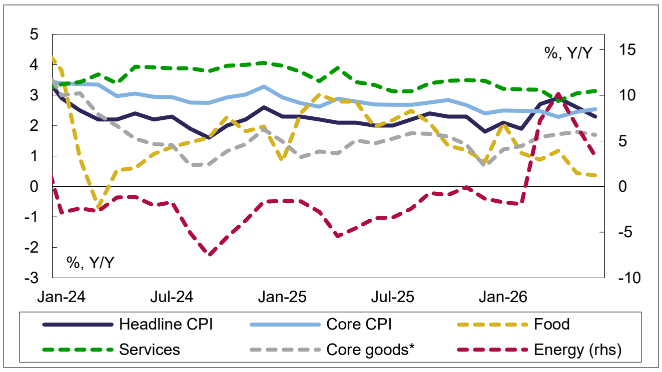


Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Lower prices give boost to consumer spending in May, but still tracking broadly sideways in Q2

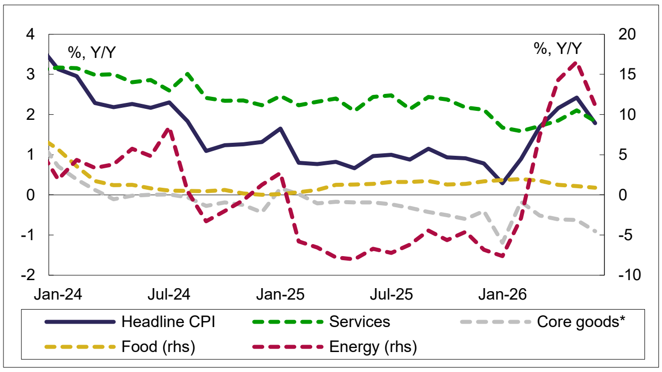
Despite the squeeze on household incomes since the onset of the energy shock, government support measures and lower oil prices appear to have provided some support to consumption in the middle of Q2. In Germany, retail sales rose a stronger-than-expected 1.1%M/M in May, the largest increase in 11 months, lifting the level to a four-year high. This was driven by a rebound in fuel sales (3.5%M/M), which benefitted from the near-5½% decline in prices at the pump following the temporary VAT cut. However, after sharp declines in March and April, fuel sales in the current quarter were still around 5% below their Q1 average. Elsewhere, softer price pressures also supported a second successive rise in food sales and a third rise in four for core sales (non-food and -fuel items), both up a little more than 1%M/M. Nevertheless, overall retail sales were trending little better than sideways in the first two months of Q2. A similar pattern was evident in France. Today's data showed that despite strong growth in spending on energy, autos and other durable goods, total spending on goods merely reversed the decline in April (0.5%M/M) and remained slightly below the Q1 average. Looking ahead, the outlook for consumption remains subdued. Although consumer confidence edged higher in June, weak purchase intentions point to continued caution among households. And while unemployment claims fell slightly further in June, stagnation in German job vacancies is unlikely to ease concerns about conditions in the labour market, suggesting that spending is likely to remain restrained over the summer.

Germany: CPI inflation & key components



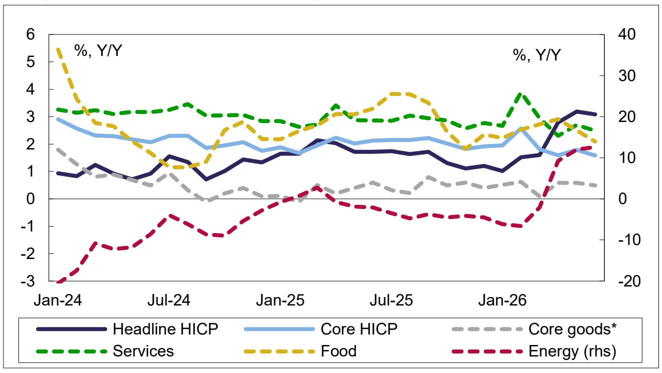
*Non-energy industrial goods.
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

France: CPI inflation & key components



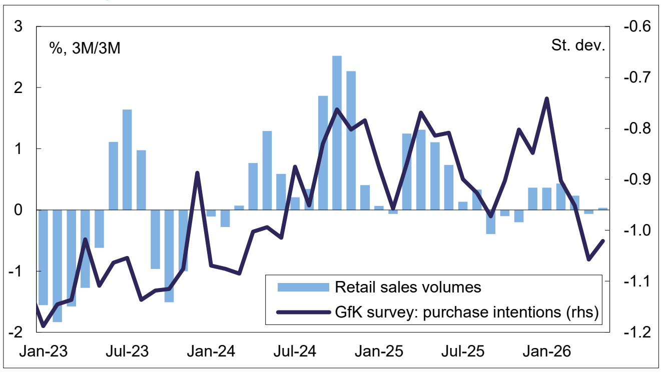
*Non-energy industrial goods.
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Italy: HICP inflation & key components



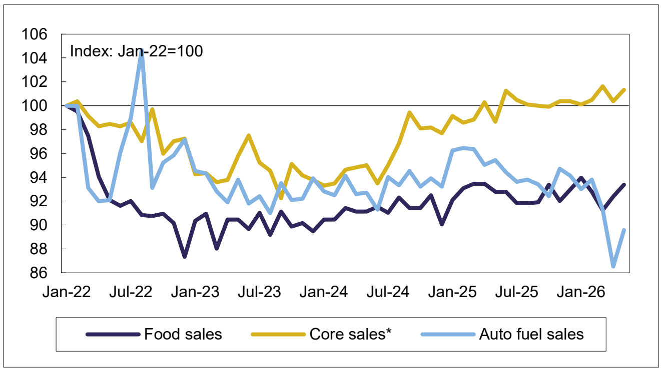
*Non-energy industrial goods.
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Retail sales & consumer confidence



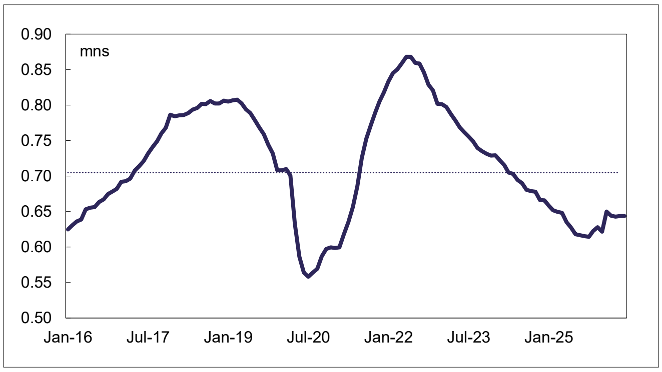
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Retail sales volumes



*Non-food & non-fuel sales.
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Job vacancies*



*Dashed line shows pre-pandemic 5Y average.
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

The day ahead in the euro area

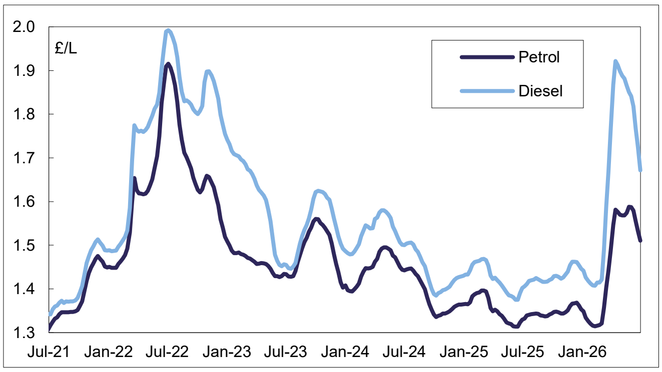
The key economic release in the euro area on Wednesday will be the aforementioned flash estimate of inflation for June. Having risen to a 13-month high in May of 3.2%Y/Y, we expect headline HICP inflation to have eased in June by 0.3ppt to 2.9%Y/Y, a three-month low. This would leave the quarterly rate in Q2 at 3.0%Y/Y, some 0.2ppt below the ECB's forecast published at the start of this month. Given the decline in petrol prices, we expect energy inflation to provide a meaningful source of downward pressure on headline inflation, while food inflation likely maintained a steady disinflationary trend. And while the moderation in services and non-energy industrial goods inflation will be more modest, the core HICP rate is also expected to drop 0.1ppt to 2.5%Y/Y. Wednesday will also bring the final euro area manufacturing PMIs for June, which are expected to point to lower input costs, but also softer factory production growth at the end of Q2. Aside from the data, focus will likely turn to the policy panel at the ECB's forum in Sintra, with ECB President Lagarde to be joined by new Fed Chair Warsh and BoE Governor Bailey.

UK

Lower fuel prices to provide some relief to inflation, while shop price pressures still largely absent

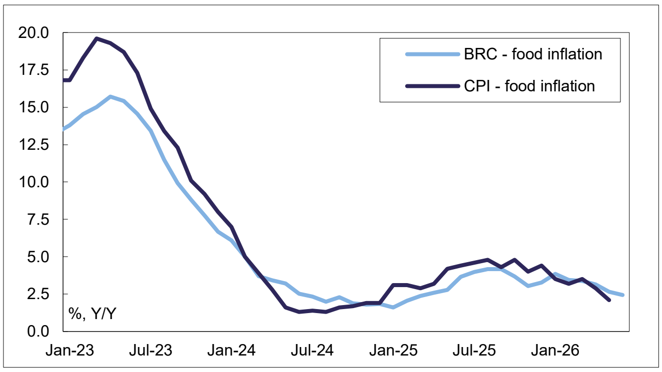
As in the euro area, the recent decline in wholesale commodity prices should lend some immediate relief to inflation in the UK. Today's official weekly fuel price data confirmed that – while still comfortably above pre-war levels – petrol prices have fallen almost 5% since peaking at the start of June, with diesel down close to 10% over the same period. So, having risen to three-year high in May, energy inflation should fall back this month supporting a moderation in headline inflation in June, closer to 2½%Y/Y. While CPI will rise back to around 3%Y/Y from the start of Q3 as regulated household energy tariffs adjust, indicators suggest that cost pressures are less acute than during the 2022 energy shock, with the extent of indirect and second-round effects likely to be constrained by weak demand (see below). In this regard, today's BRC survey suggested that shop price inflation was little changed in June, moving sideways at just 1.2%Y/Y. Encouragingly, the BRC's measure of food inflation moderated to a 15-month low (2.4%Y/Y), supposedly helped by strong competition amongst retailers. And despite costlier energy inputs and extreme weather, that softness was led by a smaller rise in fresh food prices. Promotions also supported a further decline in clothing inflation to a six-month low. In contrast, price pressures were more pronounced in electricals, for which inflation rose to a 2½-year high, which could be reflective of the rising memory costs relating to AI-related demand. Overall, the BRC suggested that non-food inflation edged up only 0.1ppt, to 0.6%Y/Y, suggest that broader inflation risks posed by the oil shock remain nascent (for now).

UK: Weekly retail fuel prices



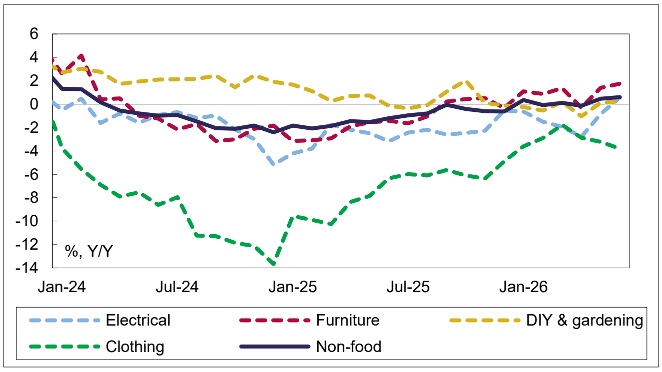
Source: Bloomberg, DBEIS and Daiwa Capital Markets Europe Ltd.

UK: Food price inflation



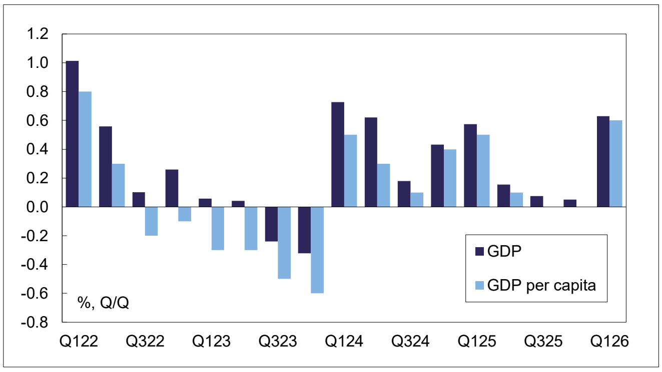
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: BRC non-food inflation & select components



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Quarterly GDP & GDP per capita growth



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

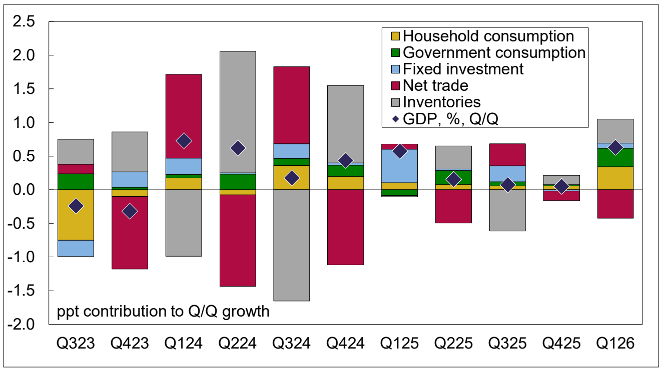
Acceleration in Q1 GDP confirmed following downwardly revised growth in H225

With regards to potential second round effects, today's updated national accounts data provided a reminder of the context with which firms looking to raise prices will have to contend with. At face value, the growth figures were impressive, confirming that UK GDP growth accelerated last quarter, to a four-quarter high of 0.6%Q/Q, the strongest expansion of the G7 economies. However, this followed downward revisions to growth in the second half of 2025 – which included 0.1ppt markdowns to Q325 and Q425, to just 0.07%Q/Q and 0.05%Q/Q respectively – to push the annual growth rate in Q1 down to 0.9%Y/Y. Growth in real GDP per capita was similarly below trend at 0.7%Y/Y, having flatlined in the second half of last year. Moreover, the BoE continues to think that underlying growth is much weaker than the headline figures imply.

But household consumption and private investment likely to slow

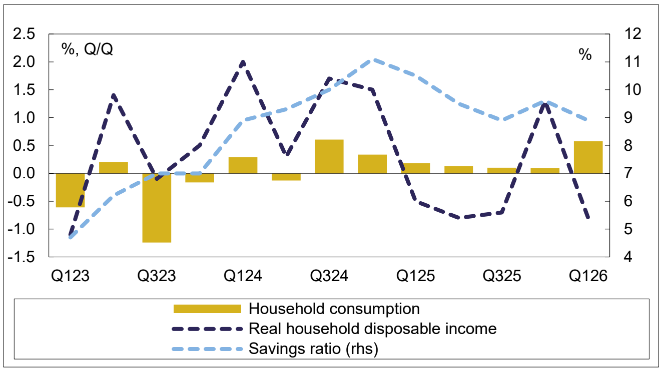
In terms of expenditure components in Q1, the impulse from government spending was revised considerably higher to report its strongest growth since Q223 (1.3%Q/Q), reflecting higher spending on defence, health and social care. Public investment also contributed to the 1ppt markup in fixed investment, now shown to have risen 0.4%Q/Q. A larger drag from imports provided the offset. Meanwhile, despite a further decline in real disposable incomes (-0.8%Q/Q) for a fourth quarter in the previous five, household consumption rose the most 0.6%Q/Q in six quarters, reflecting higher spending on restaurants and hotels, as well as utilities and housing. But this was funded to a large part by a notable drop in the household savings ratio to the joint-lowest in nine quarters (8.9%). With confidence having deteriorated in Q2, job growth having weakened and real wage growth having slowed close to zero, we expect household consumption to weaken in Q2 and remain subdued over coming quarters. And while government consumption and investment are likely to remain source of support, persisting uncertainty and higher costs will pose a headwind to private investment over the near term.

UK: Expenditure contributions to GDP growth



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Consumption, real incomes & savings ratio



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

The day ahead in the UK

From a data standpoint, Wednesday will bring just a couple of releases from the UK. Consistent with the flash release, June's final UK manufacturing PMIs are likely to signal that the sector continued to offer support to GDP growth in Q2. Given that final responses will have been submitted after the US-Iran agreement, we could see positive revisions to growth and price pressures. The final indices, however, are still likely to signal that the support from new orders was beginning to moderate as front-loading support began to wane. Otherwise, the warnings signals of slowing momentum behind May's mortgage lending numbers suggest that June's Nationwide series is likely to report another monthly decline in house price growth, providing further evidence of the subduing effects of higher mortgage rates. In terms of Bank speak, Governor Bailey is due to speak alongside his counterparts from the ECB, Fed and Canada at the flagship policy panel of the ECB's forum in Sintra.

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ *Daiwa forecast*	Previous	Revised
Germany	Preliminary HICP (CPI) Y/Y%	Jun	**2.4 (2.3)**	2.5 (2.6)	2.7 (2.6)	-
	Retail sales M/M% (Y/Y%)	May	**1.1 (1.8)**	-	-0.3 (-2.7)	-0.4 (-)
	Unemployment claims rate % (change 000s)	Jun	**6.3 (-1)**	6.3 (5)	6.3 (-12)	-
	Import prices M/M% (Y/Y%)	May	**0.7 (6.8)**	0.4 (6.5)	1.2 (5.3)	-
France	Preliminary HICP (CPI) Y/Y%	Jun	**2.0 (1.8)**	2.3 (2.0)	2.8 (2.4)	-
	Consumer spending M/M% (Y/Y%)	May	**0.5 (0.3)**	0.3 (0.1)	-0.5 (-0.4)	-
	PPI Y/Y%	May	**3.0**	-	2.1	2.3
Italy	Preliminary HICP (CPI) Y/Y%	Jun	**3.1 (3.0)**	3.2 (3.1)	3.2 (3.2)	-
	PPI Y/Y%	May	**9.1**	-	8.8	-
UK	BRC shop price index Y/Y%	Jun	**1.2**	1.3	1.2	-
	GDP – final estimate Q/Q% (Y/Y%)	Q1	**0.6 (0.9)**	*0.6 (1.1)*	0.2 (1.0)	-
	GDP – private consumption Q/Q%	Q1	**0.6**	*0.6*	0.1	-
	GDP – government spending Q/Q%	Q1	**1.3**	*0.4*	0.1	-
	GDP – gross fixed capital formation Q/Q%	Q1	**0.4**	*-0.6*	-0.1	-
	GDP – exports (imports) Q/Q%	Q1	**0.2 (1.4)**	*0.1 (0.6)*	-0.3 (0.6)	-
	Current account balance £bn	Q1	**-22.1**	-21.3	-18.4	-27.2

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/ *Daiwa forecast*	Previous
Euro area	09.00	Final manufacturing PMI	Jun	*51.3*	51.6
	10.00	Preliminary headline (core) HICP Y/Y%	Jun	*2.9 (2.5)*	3.2 (2.6)
Germany	08.55	Final manufacturing PMI	Jun	*50.0*	50.1
France	08.50	Final manufacturing PMI	Jun	*50.7*	49.7
Italy	08.45	Manufacturing PMI	Jun	52.4	52.9
Spain	08.15	Manufacturing PMI	Jun	51.0	51.2
UK	07.00	Nationwide house prices M/M% (Y/Y%)	Jun	0.1 (2.5)	-0.6 (1.7)
	09.30	Final manufacturing PMI	Jun	*53.1*	53.9

Auctions and events

Country	BST	Event
Euro area	11.30	ECB Chief Economist Lane chairs panel on 'Europe's role in the new global trade landscape' in Sintra
Euro area/UK	14.30	ECB President Lagarde, BoE Governor Bailey, Fed Chair Warsh & BoC Governor Macklem participate in policy panel in Sintra
Germany	10.30	Auction: to sell up to €3.5bn of 2.5% 2032 bonds
UK	10.00	Auction: to sell £1.25bn of 0.125% 2031 inflation-linked bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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