Daiwa Capital Markets

Euro wrap-up

Overview

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- While German producer prices fell for first month in four and an ECB survey suggested that wage and price expectations remained broadly anchored, longer-dated Bunds followed the global trend lower.
- As markets awaited the appointment of a new UK Chancellor, Gilts underperformed as UK Prime Minister Andy Burnham stated that he will use 'any flexibility' available within the fiscal rules.
- Tuesday will bring the latest German ZEW and ECB bank lending survey results, alongside UK labour market and public finance data.

Daily bond market movements

Bond	Yield	Change
BKO 2.7 09/28	2.783	+0.005
OBL 2½ 04/31	2.871	+0.016
DBR 3 08/36	3.148	+0.026
UKT 4⅜ 03/28	4.397	+0.056
UKT 4⅛ 03/31	4.577	+0.067
UKT 4¾ 10/35	5.034	+0.085

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

Euro area

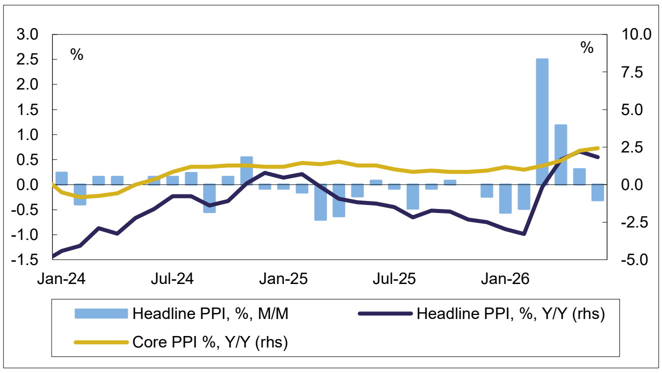
German producer prices fall in June, with limited evidence of pass-through from energy shock

Ahead of Thursday's ECB policy decision, Governing Council members are likely to take some reassurance from today's data, which suggested that the indirect pass-through of the recent energy shock to prices of other items remained limited last month and that there should be no urgency to tighten policy further this week. German producer prices fell 0.3%M/M in June for the first month in four, largely reflecting the drop in energy prices (-1.8%M/M). But while energy prices remained more than 5½% above their level at the end of last year, underlying price pressures remained relatively subdued. Prices of non-energy goods rose for a seventh successive month in June, but the pace of increase (0.2%M/M) was one third that in May. Moreover, although the annual rate of core PPI inflation edged up to a three-year high (2.4%Y/Y), pressures were largely concentrated in the early stages of the production chain and in sectors most exposed to the direct impact of the energy shock, notably chemicals and rubber. There were some signs of upward pressure on ICT equipment prices seemingly linked to the global AI investment boom. But capital goods inflation remained modest in aggregate, with prices having risen just 1% over the first half of the year. Meanwhile, prices of consumer durables were unchanged on the month to be up just ½% since December. And despite the spike in fertilizer prices, lower food prices meant that producer prices of consumer non-durables were only marginally higher than at the start of the year. Indeed, producer price inflation of consumer goods was the most negative since 2009 (-1.7%Y/Y). Overall, despite the renewed pickup in wholesale prices this month today's figures suggest that, for now at least, the recent energy shock has yet to generate the broad-based pipeline pressures that would call for an immediate hike.

ECB survey signals no de-anchoring of inflation expectations or wage price spiral ahead

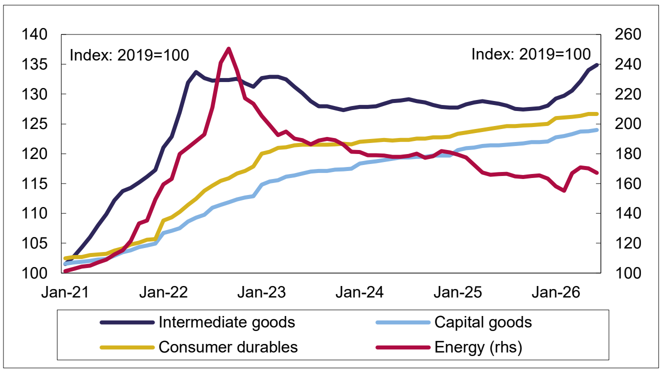
The ECB's quarterly Survey on Access to Finance of Enterprises (SAFE) provided a further update on firms' price and wage expectations in Q2 and similarly overall offered little cause for concern about the risks of second-round effects from the energy price shock. Indeed, firms revised down their expectations for selling prices, non-wage costs and wage growth compared with three months earlier. Admittedly, expected growth in non-wage input costs over the coming 12 months remained elevated at more than 5%Y/Y, well above levels before the Iran conflict. However, wage growth expectations moderated a further 0.3ppt to 2.5%Y/Y. Firms' own selling-price growth expectations for the coming 12 months moderated back close to levels in Q4 (3.5%Y/Y). And after rising to a five-quarter high in Q1, firms' median one-year ahead expectations for consumer price inflation were unchanged at 3.0%. Three-year median consumer price inflation expectations also held steady for a tenth successive quarter at 3.0%. So, these results suggest no need for the ECB to panic about a de-anchoring of inflation expectations or a wage-price spiral. Nevertheless, a modest rise in five-year ahead expectations to 3.1%, the highest level since Q423, together with a more pronounced upside skew, suggests that concerns about longer-term inflation risks have not disappeared entirely.

Germany: Producer price inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Producer price levels



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

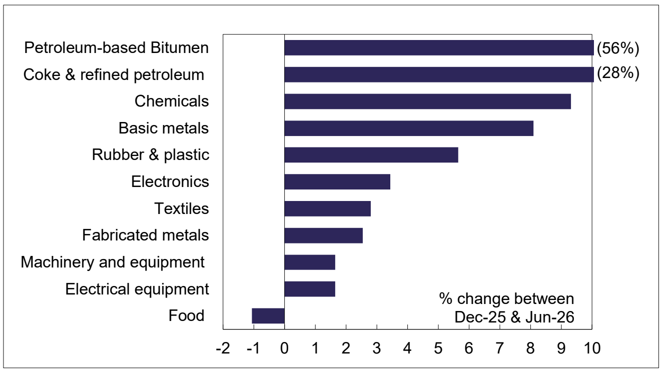
Construction to provide notable boost to euro GDP growth in Q2

Data continue to point to resilience in the euro area economy. Part of that resilience reflects unexpectedly robust growth in the construction sector, where output rose for a third consecutive month in May (0.4%M/M) to the highest level in more than a year. As a result, despite a downwards revision to April's reading, activity over the first two months in Q2 was tracking some 1.4% above the average level in Q1 to suggest meaningful support to GDP growth for the first quarter in five. The increase in May was underpinned by specialised construction, where output rose 1.4%M/M to the highest level in 8½ years. By contrast, building activity remained subdued in May (-0.7%M/M), with higher borrowing costs and economic uncertainty continuing to weigh on demand. Nevertheless, production in the subsector was still trending more than ½% above the Q1 average, supported by a strong carryover from March. Likewise, civil engineering was tracking almost 4½% above the Q1 average, underpinned in part by increased spending on public infrastructure in Germany. Indeed, in aggregate, German construction activity in April and May was averaging some 2½% above the Q1 level, on track to match the strongest quarterly growth in five years. Despite flatlining in May, Italian construction output was also some 2% higher so far in Q2. And notwithstanding a significant pullback in May (-2.8%M/M) and downwards revisions in four of the previous five months, Spanish construction output was still trending more than ½% above the Q1 level. By contrast, despite strong growth in May, construction output was broadly stagnant in France and slightly weaker in the Netherlands relative to Q1.

Near-term construction outlook remains mixed

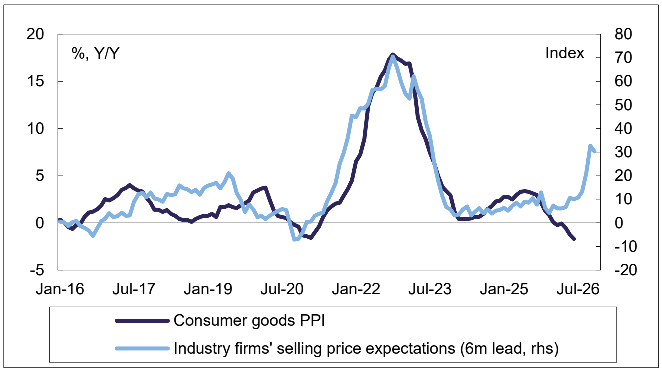
Looking ahead, the construction outlook appears mixed. Confidence in the sector has deteriorated in recent months amid rising input costs and tighter financial conditions. Indeed, the European Commission's construction confidence indicator fell sharply in June to its lowest level in almost two years, while firms reported the smallest order books since mid-2024. With the ECB likely to tighten policy further in September, demand will remain under pressure in the near term. Moreover, while firms reported some easing in supply constraints in June, renewed tensions in the Middle East risk tightening bottlenecks once again. Nevertheless, recent growth in building permits suggests that the medium-term outlook for construction remains relatively favourable. This is particularly evident in France, where residential permits have risen to a four-year high. While less pronounced, non-residential permits across the euro area have increased by almost 10% from their trough a year ago. And public infrastructure and defence spending, including projects financed through the NGEU programme, should continue to provide support to activity in the second half of the year.

Germany: Change in producer price levels*



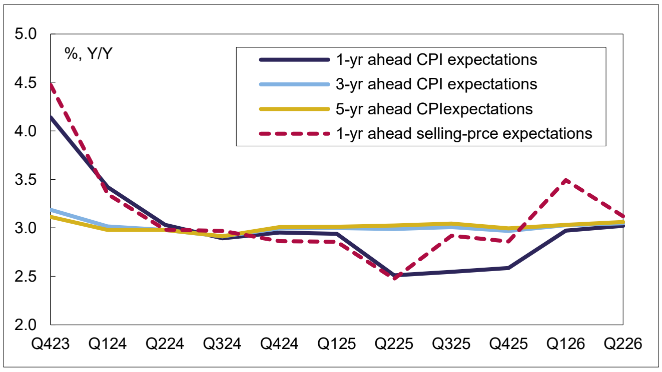
*Since December 2025.
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Consumer goods PPI & selling prices



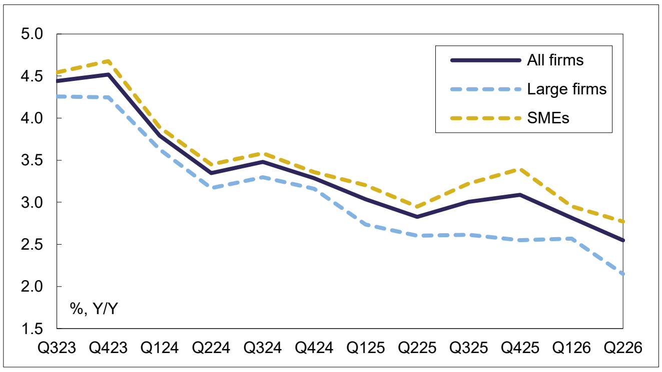
Source: EC, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Consumer & selling price expectations*



*12 months ahead. Source: ECB SAFE, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Wage growth expectations*



*12 months ahead. Source: ECB SAFE, Macrobond and Daiwa Capital Markets Europe Ltd.

The day ahead in the euro area

As well as reporting on firms' wage and price expectations, today's SAFE survey suggested that credit conditions tightened further in Q2. Tomorrow's quarterly ECB Bank Lending Survey will provide a cross-check on that assessment from the perspective of lenders but similarly seems bound to report tighter lending standards and expectations of continued restrictiveness this quarter. And while bank lending has remained resilient since the onset of the US-Iran war, the survey will likely report that heightened uncertainty continues to weigh on demand for credit. Tuesday will also bring the first of this week's deluge of monthly sentiment indicators, with the release of the German ZEW survey results for July. Despite renewed tensions in the Middle East, investor sentiment is expected to have improved slightly at the start of Q3.

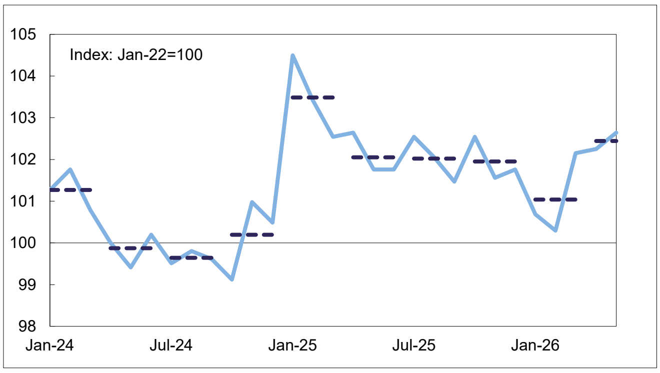
UK

The day ahead in the UK

Today's UK news flow was dominated by the formal appointment by the King of Andy Burnham as Prime Minister. Attention over the near term will turn to the details of his governing agenda and key Cabinet appointments, most notably Chancellor of the Exchequer after the resignation of investor-friendly incumbent Rachel Reeves was confirmed this afternoon. Reports up to now have suggested that Burnham will seek to avoid media or market controversy in making his Chancellor appointment. But while he today promised to present a new 10-year economic plan that might make constructive proposals (e.g. abolition of the pensions triple-lock and a further increase in the pension age) to enhance longer-term fiscal sustainability, his comment that the government will seek to use "any flexibility" available in the existing fiscal rules hit Gilts.

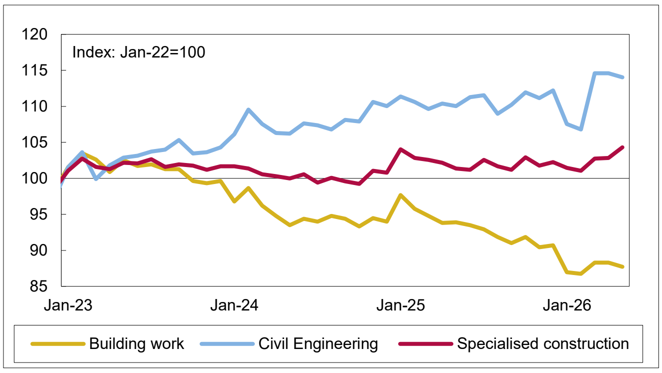
On the data front, Tuesday's public finance figures for June are likely to underscore the challenge in meeting those existing budgetary targets. Meanwhile, ahead of the BoE's forthcoming policy-setting meeting, the latest labour market report will be also closely watched. The risks to the unemployment rate (4.9%3M) seem skewed modestly to the upside. And while the BoE's preferred measure of private sector pay growth should be unchanged (2.9%3M/Y), that remains a 5½-year low and leaves pay growth on track to undershoot the BoE's most recent forecast. That said, BoE policymakers will be hesitant to attach too much weight to any of the single-month data in the Labour Force Survey. Indeed, the ONS has acknowledged that the quality of this LFS round will be impaired by an operational issue.

Euro area: Construction output



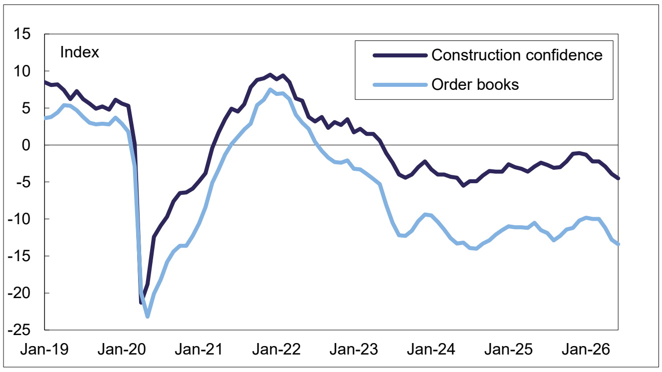
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Construction output by sector



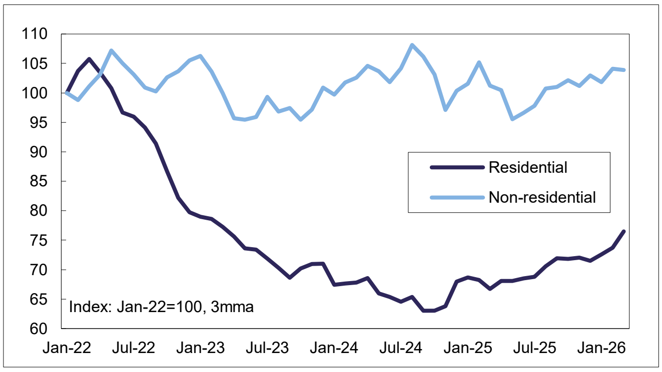
Source: EC, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Construction confidence indices



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

Euro area: Building permits



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area	Construction output M/M% (Y/Y%)	May	**0.4 (1.2)**	-	0.6 (0.9)	0.1 (0.2)
Germany	PPI Y/Y%	Jun	**1.8**	1.8	2.2	-
UK	Rightmove house prices M/M% (Y/Y%)	Jul	**-1.0 (-0.4)**	-	-0.6 (-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/ *Daiwa forecast*	Previous
Germany	10.00	ZEW current situation (expectations) balance	Jul	-77.3 (17.0)	-81.0 (10.5)
UK	07.00	Average wages (excluding bonuses) 3M/Y%	May	4.5 (3.4)	4.4 (3.4)
	07.00	Private sector wages ex. bonuses 3M/Y%	May	*2.9*	2.9
	07.00	Unemployment rate 3M%	May	4.9	4.9
	07.00	Employment 3M/3M change 000s	May	80	100
	07.00	Payrolled employment M/M change 000s	Jun	-6	2
	07.00	Claimant count rate % (change 000s)	Jun	-	4.5 (31.2)
	07.00	Public sector net borrowing £bn	Jun	18.0	23.3

Auctions and events

Country	BST	Event
Euro area	09.00	ECB to publish quarterly Bank Lending Survey (BLS) for Q226
Germany	10.30	Auction: to sell up to €6bn of 2031 bonds
UK	10.00	Auction: to sell £5bn of 4% 2029 bonds

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.