Daiwa Capital Markets

Euro wrap-up

Overview

- Bunds made modest gains while euro area GDP growth in Q2 beat expectations and flash data from Germany and Spain reported a pickup in inflation in July.
- Gilts rallied particularly at the short end of the curve as Governor Bailey insisted that the BoE is not edging towards a rate hike despite a smaller majority in favour of today's decision to leave policy unchanged.
- Friday will bring the flash estimate of euro area inflation, German labour market data and an update on UK house prices, all for July.

Economics Research Team
+44 20 7597 8326

Daily bond market movements

Bond	Yield	Change
BKO 2.7 09/28	2.758	-0.053
OBL 2.9 10/31	2.882	-0.034
DBR 3 08/36	3.153	-0.006
UKT 4⅜ 03/28	4.330	-0.109
UKT 4⅛ 03/31	4.525	-0.088
UKT 4¾ 10/35	4.983	-0.051

*Change from close as at 5:00pm BST.
Source: Bloomberg

Euro area

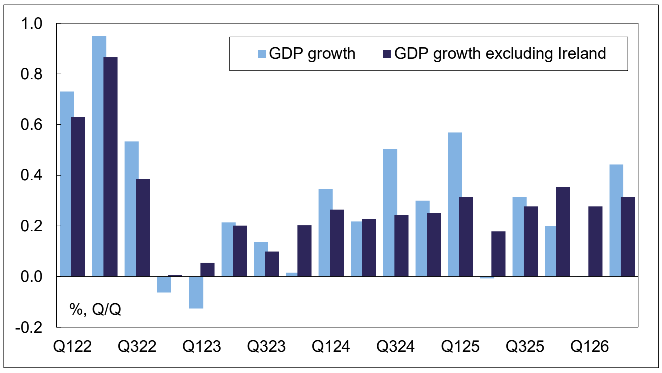
GDP growth beat expectations in Q2 despite shocks from the Middle East conflict

Euro area economic activity in Q2 remained resilient to the shocks from the Middle East conflict. According to today's preliminary estimate, having been unchanged in Q1, GDP rose last quarter by a stronger-than-expected 0.4%Q/Q, the best rate in five quarters. While Irish GDP exaggerated the sluggishness of euro area activity in Q1 when it contracted 7.0%Q/Q, it flattered growth in Q2 by expanding 3.9%Q/Q. So, GDP growth in the euro area excluding Ireland – a measure which gives a better guide to underlying growth in the region – was unchanged in Q2 from Q1 at 0.3%Q/Q, broadly in line with supply potential. While there was no expenditure detail published for the region today, the early indications from the member states suggest that private and public consumption and net trade provided support. But fixed investment might well have contracted again as firms paused capex plans in the face of higher energy prices and heightened uncertainty. Among the largest member states, Germany, France and Italy each grew 0.2%Q/Q in Q2. For Germany, that was the third successive quarter of growth to mark the longest expansion since 2022. But the pace was half that in Q1. And according to Destatis, consumption was subdued and fixed investment fell for a second quarter, leaving German growth reliant on net exports. France more than reversed its slight drop in Q1, as consumption and net trade offset weakness in capex. But growth was again strong and broad-based in Spain (0.7%Q/Q), as all major expenditure components made a positive contribution. Growth was also firm in Portugal (0.8%Q/Q), Finland (0.9%Q/Q) and the Netherlands (0.4%Q/Q) but absent in Belgium and Austria (0.0%Q/Q).

Broad-based pickup in economic sentiment in July but conflict & heatwave pose downside risks

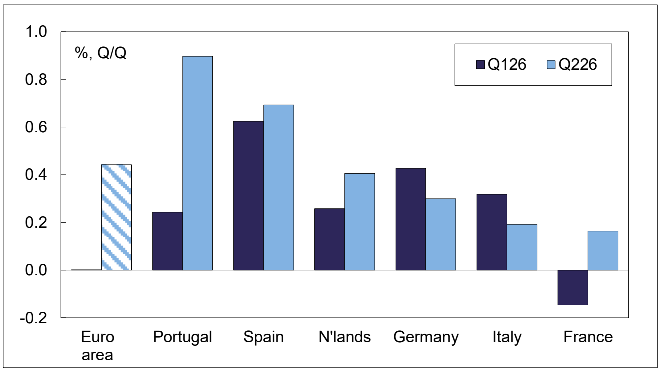
So far, the initial surveys for July point to a continuation of economic growth in Q3. According to last week's flash estimate, the euro area composite PMI this month rose the most in more than four years to an eight-month high (51.9). That signal of a broad-based increase in momentum was broadly echoed in today's Commission survey results, for which the headline Economic Sentiment Index (ESI) rose the most since January to a five-month high (96.9), still nevertheless below the long-run average (100). Among the sectors, the rise in the industrial confidence to the highest level in more than three years was most striking. The recent production trend was judged to have been the firmest in four years and order books the best since 2023. So, while growth in factory output has been boosted by precautionary inventory accumulation, production expectations remained positive and were the most upbeat since February. Perhaps unsurprisingly after the ECB's rate hike last month and expectations of further monetary tightening to come, signals from construction firms were more downbeat, with pessimism in the sector the worst in almost two years. But that was the exception, with services firms and retailers the most upbeat since March and February respectively. That in part likely reflects greater optimism among households, as the rise in consumer confidence to a five-month high was driven by increased willingness to make major purchases despite higher saving intentions likely also related to ECB rate. And among the member states, the improvement in the ESIs at the start of Q3 was

Euro area: GDP growth



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area member states: GDP growth in H126



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

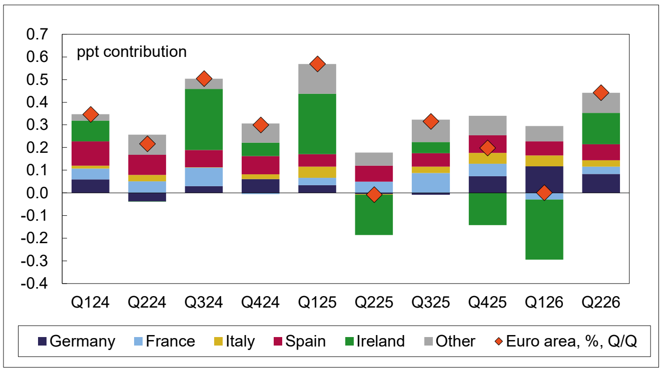
Daiwa Capital Markets

similarly widespread. Indeed, greater confidence was registered in each of the five largest member states. Overall, therefore, the Commission survey provides cause for optimism. We caution, however, that the improvement in sentiment might well reverse somewhat in August due to the re-escalation of conflict in the Middle East and associated rise in energy prices. The extremely hot European summer – causing extremely damaging wildfires, hitting transportation of freight and tourist activity on the region's major rivers, and hitting agricultural yields among other things – might also weigh on confidence and overall economic output in Q3.

German & Spanish inflation rise amid renewed energy-price pressures & unwinding fiscal support

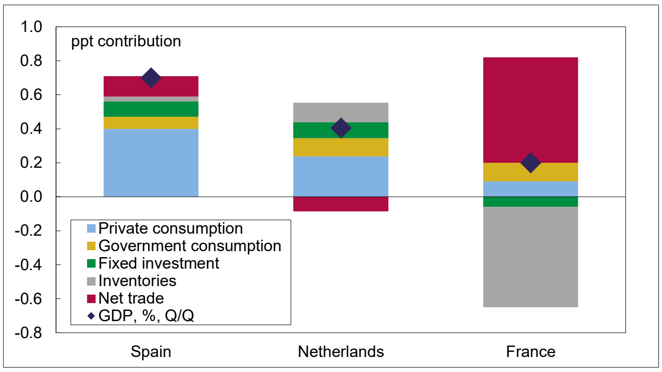
Today's flash July inflation estimates from some of the member states suggest that risks to tomorrow's euro area print are tilted slightly to the upside. In Germany, the EU-harmonised HICP rate rose 0.4ppt to a three-month high of 2.8%Y/Y, while in Spain the equivalent rate increased 0.2ppt to 3.8%Y/Y, matching the highest rate since February 2023. As in recent months, however, those upward impulses were largely concentrated in energy, partly reflecting the unwinding of fiscal support measures as well as a pickup in wholesale energy prices. In Germany, the national detail showed energy inflation jumping almost 5ppts to 8.3%Y/Y on the reversal of the temporary cut on fuel VAT. And Spain's statistical agency noted a stronger rise in prices of auto fuels and electricity compared to a year earlier in part due to the adjustment of some of the

Euro area: Country contributions to GDP growth



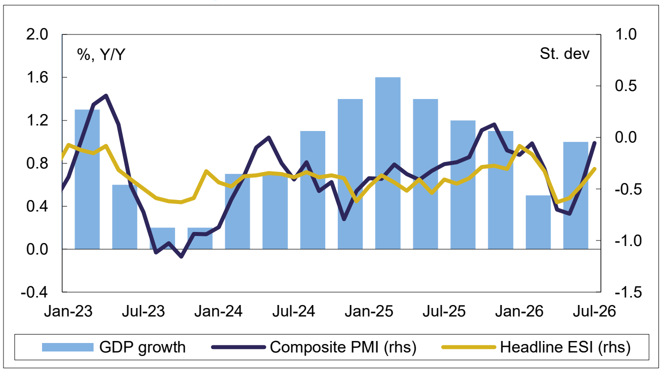
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area member states: GDP contributions in Q2



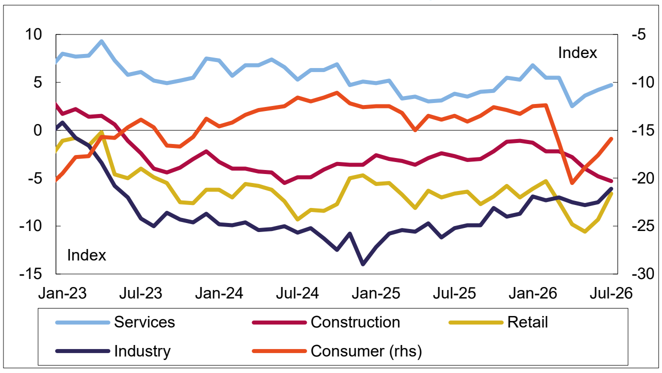
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: GDP growth & sentiment indicators



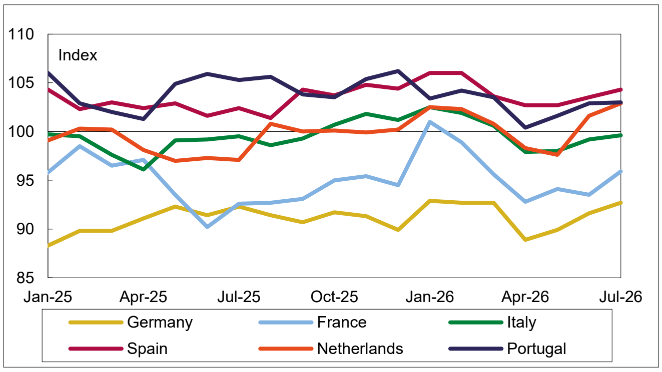
Source: S&P Global, EC, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Economic sentiment by sector



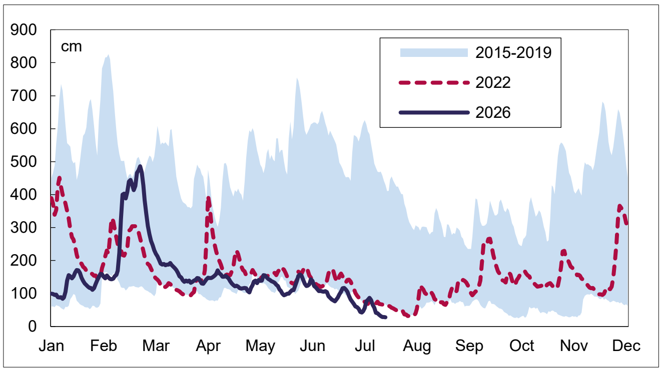
Source: EC, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Economic sentiment by country



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

Germany: River Rhine water levels



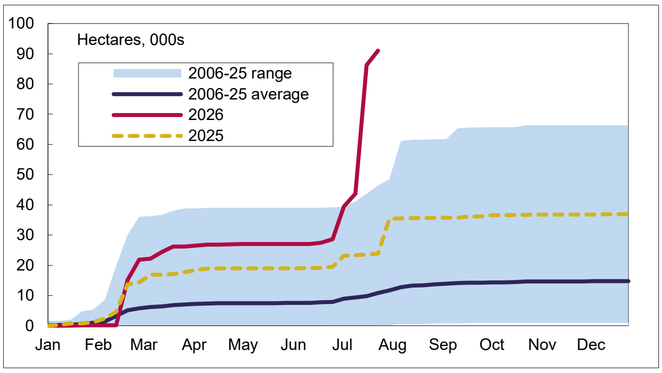
Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

government's support measures. Weekly data had reported averaged increases in petrol prices in the first few weeks of July of some 11½%M/M in Germany and 5%M/M in Spain, compared with negligible monthly changes in France and Italy. By contrast, food inflation in Germany remained extremely subdued at 0.4%Y/Y for a third consecutive month. And services inflation fell to a three-month low of 2.9%Y/Y, with figures from the German Länder suggesting that easing hospitality inflation offset higher package holiday costs. With non-energy industrial goods inflation also remaining well behaved, the German core CPI rate edged down 0.1ppt to 2.4%Y/Y. So, while the recent pickup in wholesale energy prices and the prolonged heatwave poses further upside risks to inflation over the second half of the year, indirect effects from the energy shock appear to remain relatively well-contained.

Price expectations moderate further, while soft employment intentions to keep lid on pay pressures

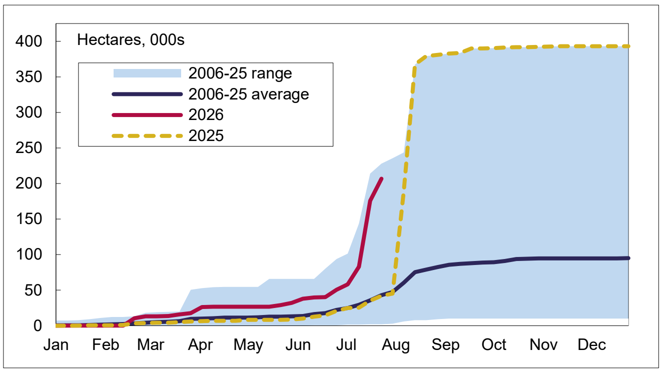
Unsurprisingly, near-term inflation expectations remain above levels seen before the onset of the Iran conflict. But policy-makers may take comfort from signs that firms and households have recently revised down their expectations. The Commission survey index of consumer price expectations 12 months ahead fell to a five-month low in July (30.3), almost 19pts below April's peak and just 5pts above the average in the six months to February. Business selling-price expectations

France: Cumulative YTD weekly burnt land area



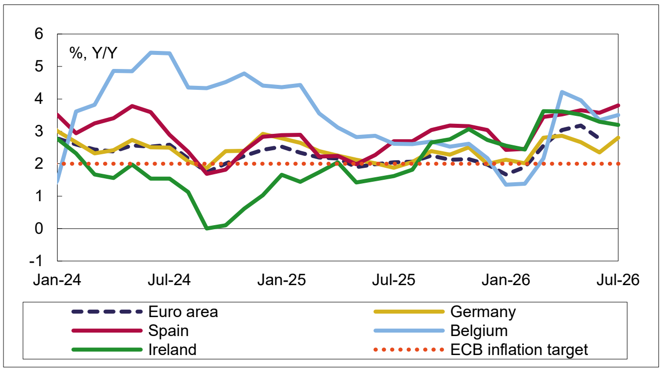
Source: EU Copernicus Emergency Management Service and Daiwa Capital Markets Europe Ltd.

Spain: Cumulative YTD weekly burnt land area



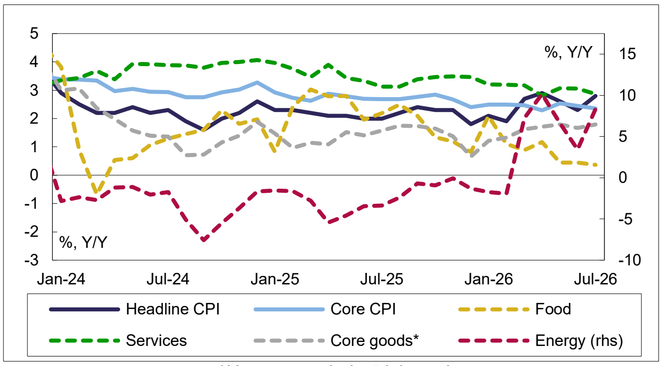
Source: EU Copernicus Emergency Management Service and Daiwa Capital Markets Europe Ltd.

Euro area: HICP inflation in member states



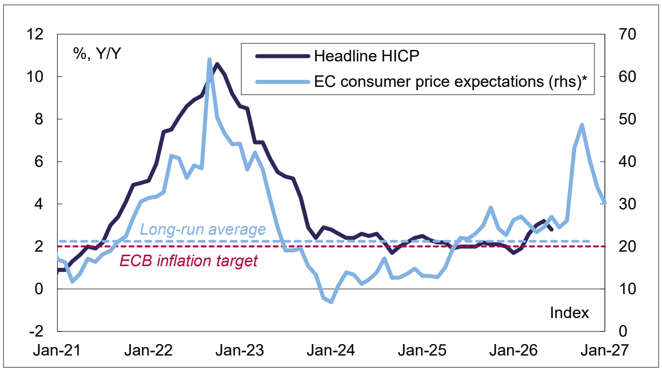
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: CPI inflation & key components



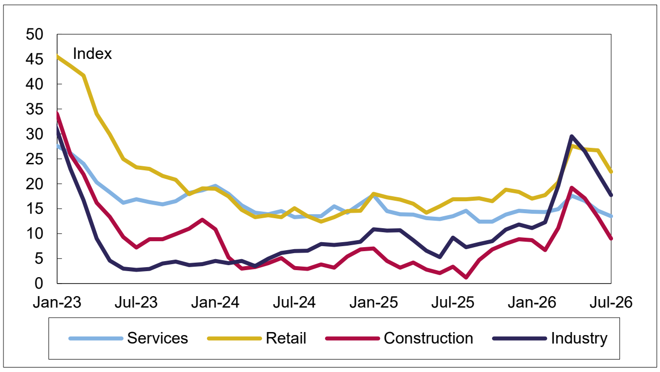
**Non-energy industrial goods. Source: Macrobond and Daiwa Capital Markets Europe Ltd.*

Euro area: Consumer HICP & price expectations**



**6-month lead. **12 months ahead. Source: EC, Macrobond and Daiwa Capital Markets Europe Ltd.*

Euro area: Firms' selling-price expectations*



**3 months ahead. Source: EC, Macrobond and Daiwa Capital Markets Europe Ltd.*

across the major sectors also retreated further in July from the multi-year highs hit in April. Most notably, the services sector measure fell to its lowest level since October 2025, suggesting limited evidence of indirect effects from the energy shock. And the ECB's updated wage tracker, which continues to indicate stable negotiated pay pressures and a projected trajectory no stronger than in February, points to a continued absence of second-round effects. While underlying wage growth (excluding one-off payments) is expected to rise from 2.3%Y/Y in June to 2.8%Y/Y in March 2027, that would still be broadly consistent with inflation returning to target over the medium term. Moreover, although the euro area unemployment rate in June (6.3%) remained close to its series low, the Commission's employment expectations indicator (EEI) continued to point to reductions in headcount in Germany and France. So, while employment intentions were increasingly positive in Italy and Spain, softer labour demand should continue to keep a lid on pay pressures in the euro area's core.

The day ahead in the euro area

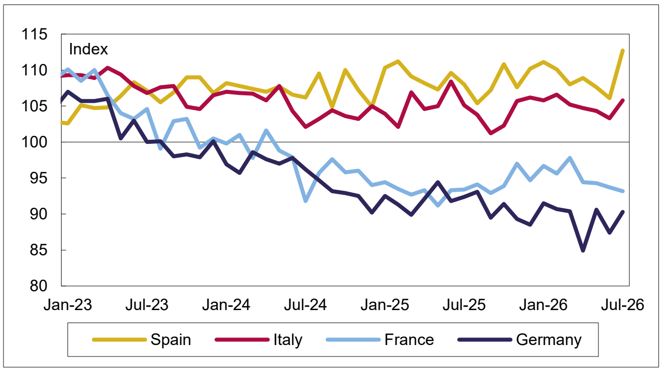
The European data highlight on Friday will be the flash euro area inflation estimates for July. After June's softer-than-expected print, we expect headline inflation to edge slightly higher in July by 0.1ppt to 2.9%Y/Y, while core inflation will likely move sideways 2.4%Y/Y. Energy inflation will largely reverse June's decline, reflecting rising wholesale prices and the expiration of fiscal support in Germany and Spain. But food inflation looks set to remain very soft. While resurgent energy prices could have added to core components including airfares and package holidays, underlying inflation should remain well contained. Friday will also bring German labour market figures for July. These are expected to report a modest increase in jobless claims numbers for the first month in three, albeit leaving the claimant count rate unchanged at 6.3%.

UK

BoE holds Bank Rate unchanged with smaller majority, but overall message is dovish

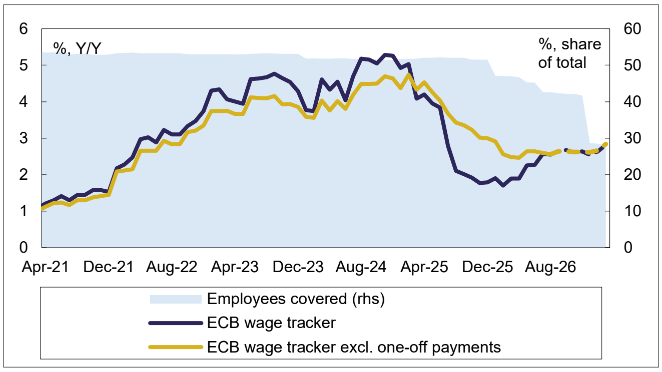
As expected, the BoE today left Bank Rate unchanged at 3.75% where it has been since December. There was a slight surprise as the majority in favour of the decision narrowed, with the MPC voting 6-3 compared to 7-2 last month. In particular, Catherine Mann joined Chief Economist Huw Pill and Megan Greene in voting for a 25bp hike. That might have given today's decision a more hawkish gloss. However, Mann is a particularly independent thinker whose views on rates rarely intersect in full with the policymakers (including Governor Bailey) currently holding the balance of power on the Committee. And the main message from today's various communications from the BoE was relatively dovish, helping Gilts to rally, particularly at the short end of the curve.

Euro area: Employment expectations indices



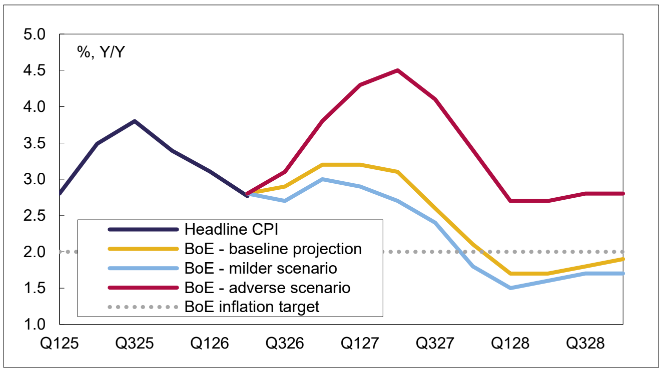
Source: EC, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: ECB wage tracker



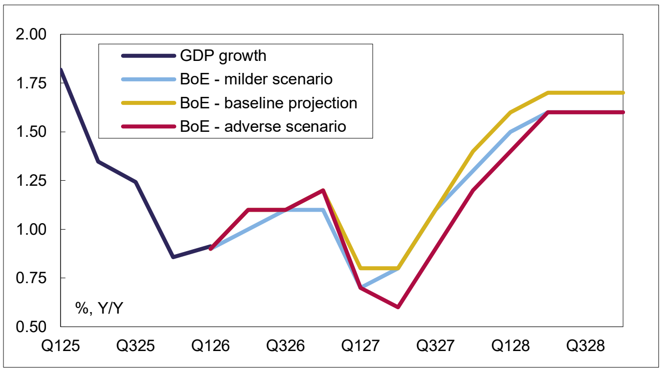
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: BoE inflation projections



Source: BoE MPR Jul-26, Macrobond and Daiwa Capital Markets Europe Ltd.

UK: BoE GDP growth projections



Source: BoE MPR Jul-26, Macrobond and Daiwa Capital Markets Europe Ltd.

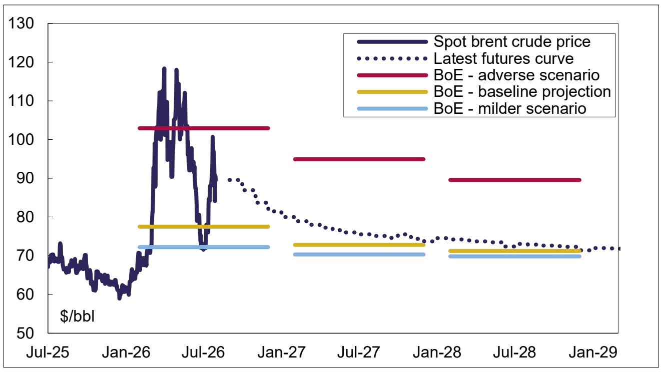
While inflation risks remain skewed to the upside, BoE judges that underlying disinflation continues

All MPC members agreed that, so far, there was little evidence of second-round effects on inflation from the energy shock. And with firms' margins playing an important role in absorbing costs, some members thought there was a likelihood of only limited second-round effects to come. Indeed, Bailey acknowledged that inflation had recently undershot the BoE's expectations, not least due to softer food prices. And it was recognised that there were clear signs of ongoing underlying disinflation. While inflation is likely to pick up back above 3%Y/Y in the second half of this year, labour slack, subdued underlying economic growth and the tightening of financial conditions since the start of the conflict were expected by most members to reduce inflation over time. And tariff-related trade redirection was also perhaps adding downside pressure to prices of core goods. Of course, due to events in the Middle East, as well as (to a lesser) extent El Nino and AI-related global demand, there was a widespread acknowledgement that the risks to the inflation outlook remain skewed to the upside. And those risks would be greater the longer that higher energy prices persist. But unless and until those risks crystallise, the comments of MPC members published today (see table) suggest that a majority should be happy to sit on their hands and leave policy unchanged.

Bailey insists that MPC isn't edging towards a rate hike

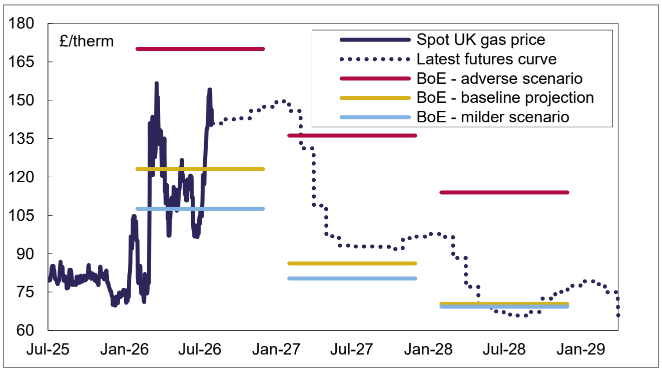
That certainly was the message of the BoE's updated projections. Admittedly, under a plausible new 'adverse' scenario, which envisages repeated re-escalations of the conflict in the Middle East, persistently higher energy prices and much stronger second-round effects, the inflation outlook and various policy rules would imply that significant tightening – perhaps as much as 100bps – would eventually be required. But under the BoE's new baseline projection (re-established to imply an assessment of a reduction in uncertainty compared to three months ago) and an alternative new 'milder' scenario, the inflation outlook would appear not to merit any tightening at all. Indeed, there might in due course be scope for an eventual rate cut. Perhaps as a result, in the press conference, one bellwether MPC member, Deputy Governor Lombardelli, insisted that her vote today to hold rates was not at all a close decision. And Governor Bailey argued that no one should be under the impression that "the BoE is edging towards a hike". Indeed, given the need for a risk premium to reflect the current upside skew to the inflation outlook, he judged that the upwards-sloping sterling swap curve was fully consistent with the consensus expectation among market analysts – expressed in the BoE's market participants survey – that Bank Rate would be left unchanged over the remainder of the year. He added that such an expectation was perfectly reasonable. And as one of those market participants to contribute to that survey, we note that we fully share that consensus view.

UK: Brent crude futures & BoE assumptions



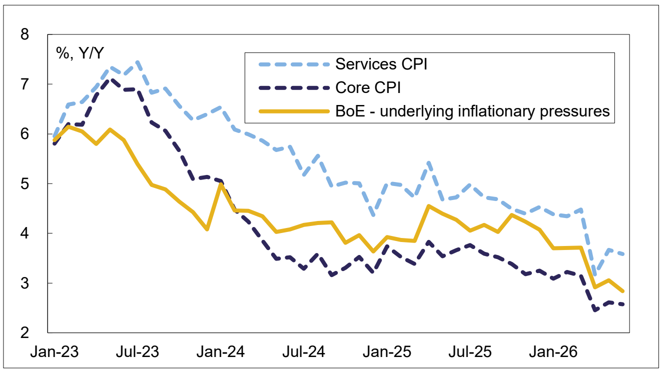
Source: BoE MPR Jul-26, Bloomberg and Daiwa Capital Markets Europe Ltd.

UK: Natural gas futures & BoE assumptions



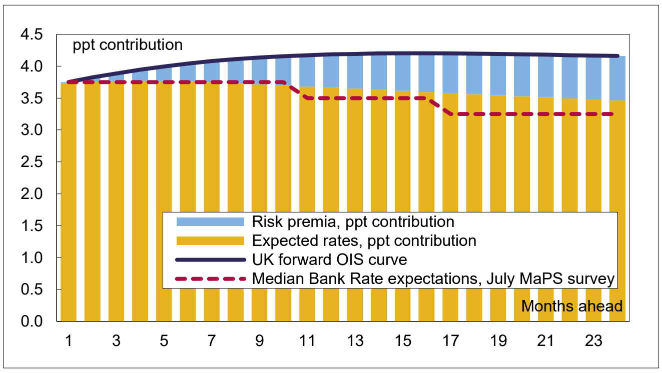
Source: BoE MPR Jul-26, Bloomberg and Daiwa Capital Markets Europe Ltd.

UK: Inflation measures



Source: BoE MPR Jul-26 and Daiwa Capital Markets Europe Ltd.

UK: BoE decomposition of forward OIS rates



Source: BoE MPR Jul-26 and Daiwa Capital Markets Europe Ltd.

BoE July 2026: MPC members' views

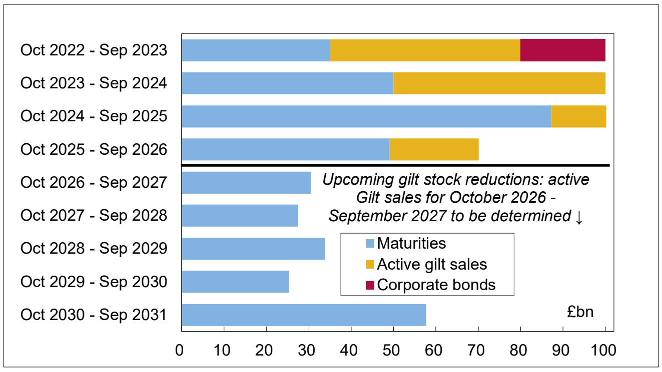
MPC member	Vote	Selected quotes from the MPC minutes
Governor Bailey	3¾%	"The possibility of repeated resumptions of conflict…lower than usual European gas stock levels and a fall in global refining output, mean that risks to energy prices lie to the upside…[but] the process of underlying disinflation that was intact prior to the conflict remains in train… inflation persistence may be weaker than had been presumed…" "There is little evidence yet of second-round effects, although it is too early to take much comfort from that. Financial conditions have tightened… Holding Bank Rate is appropriate as global conditions look to be more uncertain and inflationary, while domestic conditions are on balance more benign" "Please do not leave this room thinking that the BoE is edging towards a hike." (From MPC press conference)
Deputy Governor Breeden	3¾%	"While my confidence around the domestic inflationary environment has increased, risks to global prices have shifted to the upside…" "Financial conditions facing households and businesses have tightened materially since the onset of the conflict, and consistent with the baseline, provide sufficient restrictiveness for now… I will continue to focus on how second-round effects are likely to evolve."
Deputy Governor Ramsden	3¾%	"…I see clear upside risks to inflation from the global environment… [while] domestic developments point to a more benign inflationary outlook…" "The policy stance is currently delivering the restrictiveness necessary… If [upside risks] crystallise, a hike in Bank Rate may be warranted. If the risks were to subside and the underlying disinflation process continued, I would consider resuming the cutting cycle."
Deputy Governor Lombardelli	3¾%	"Indirect and second-round effects […] remain a concern… [and] take time to appear…" "The stance of monetary policy is restrictive, more so once broader financial conditions and the further underlying disinflation are factored in… Policy would need to be adjusted were there to be evidence of risks of significant second-round effects..."
Swati Dhingra	3¾%	"An increase in Bank Rate now would be disproportionate as, unlike 2022, the starting point for this shock is much softer and the policy stance is more restrictive." "I continue to see value in waiting for a clearer read on the energy shock …We will learn more about first-round energy effects and 2027 wage-setting towards the end of this year. This would still allow time for monetary policy to mitigate second-round effects as needed…"
Alan Taylor	3¾%	"…[External risks] justify an upside-skewed scenario. But they are not the only risks that matter…the possibility of downside surprises, and painful trade-offs, remains relevant… For me, the more likely outcomes sit between the baseline and milder scenario, albeit with a long right tail; keeping Bank Rate on hold, at a higher level now than the pre-conflict implied path, gives insurance for now, before resuming cuts when and if geopolitical uncertainty clears."
Catherine Mann	4%▲	"The key change in the environment for my decision is the collapse of the US-Iran [MoU]… [Research] concludes that Bank Rate should be higher than 3.75% to return inflation to the 2% target… [and others emphasise] that the costs of leaning against upside risks that fail to materialise would be smaller than the cost of leaning too little…"
Megan Greene	4%	"[Some recent surveys] have been collected during a peace deal and a conflict, making it difficult to parse signal from noise… I expect some [second-round effects] to emerge…Other supply risks loom as well, including a second energy choke point in the Red Sea, El Niño and supply constraints for AI-related hardware…." "I believe a risk management strategy is appropriate…a proactive hike in Bank Rate may reduce the probability that second-round effects set in."
Chief Economist Pill	4%	"…I remain concerned about more insidious second-round effects driven by catch-up dynamics in wage and price setting…Structural shifts in the economy have rendered the UK more vulnerable to such…" "…it is appropriate to raise Bank Rate now, thereby cutting through noise in commodity and asset price developments to offer a clear and unambiguous signal of our willingness and ability to address upside risks to inflation…"

▲Indicates an upwards change in vote since June. Source: BoE (July 2026 Monetary Policy Summary & Minutes), post-MPC meeting press conference and Daiwa Capital Markets Europe Ltd.

BoE increases estimate of QT impact on yields but still likely to extend programme in September

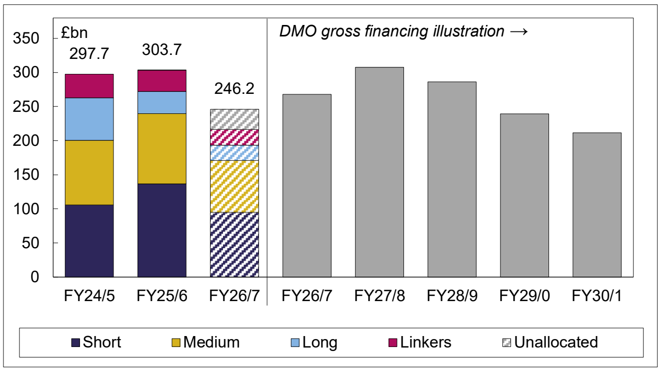
Finally, ahead of September's decision by the MPC on the pace and composition of its future Gilt sales, the Monetary Policy Report gave an update of the Bank's view on the impact of its quantitative tightening (QT) programme on yields. For the second year in a row, the staff revised up its estimate of the total increase in 10Y Gilt yields caused by its QT announcements and auctions since 2022, albeit only by 5bps to 20-30bps. Compared to the increase in term premia over that period, that is very small beer. But for a government with limited fiscal headroom, a lengthy wish-list of new public spending projects to fund, and a gross issuance requirement of about £250bn this fiscal year, that still represents an unwanted additional source of debt interest costs over the remainder of the parliament. Regardless, despite the recent arrival of yet another new Prime Minister in Downing Street, and consistent with the Bank's past concerns about the risks of fiscal dominance as well as its view that bank reserves remain above their equilibrium level, we certainly don't expect the BoE to change course on its QT programme to accommodate any concerns in the government. In line with the consensus to date, we expect the MPC in September to slow the annual pace of reduction in the stock of its Asset Purchase Facility Gilt holdings from £70bn in the past year to £50bn. But that reduction will be principally due to a slower pace of redemptions, not due to concerns about the market's capacity to absorb the additionally supply of Gilts.

UK: APF maturities & sales profile



Source: BoE MPR Jul-26 and Daiwa Capital Markets Europe Ltd.

UK: Gilt issuance and gross financing projections



Source: UK DMO and Daiwa Capital Markets Europe Ltd.

The day ahead in the UK

A quieter end to the week for UK data will bring just the Nationwide house price report for July. Despite BoE monetary figures yesterday showing that mortgage lending rose in June by the most in 14 months (£7.7bn) as borrowing costs declined further below April's peak, the Nationwide house price measure is expected to have broadly stalled at the start of the summer, with lingering economic uncertainty continuing to weigh on buyer demand. Separately, BoE Chief Economist Pill will brief the Bank's Agents on the latest monetary policy decision and updated macroeconomic projections but is unlikely to give further insight into his decision to vote again for a 25bps rate hike.

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area	GDP – first estimate Q/Q% (Y/Y%)	Q2	**0.4 (1.0)**	*0.3 (0.5)*	-0.2 (0.3)	0.0 (0.5)
	Commission economic sentiment indicator	Jul	**96.9**	96.0	95.0	95.4
	Commission services (industrial) confidence indicator	Jul	**4.7 (-6.1)**	3.8 (-7.0)	3.2 (-7.7)	4.2 (-7.5)
	Final Commission consumer confidence indicator	Jul	**-15.9**	*-15.9*	-17.7	-
	Unemployment rate %	Jun	**6.3**	6.2	6.2	6.3
Germany	GDP – first estimate Q/Q% (Y/Y%)	Q2	**0.2 (0.9)**	*0.3 (0.8)*	0.3 (0.5)	0.4 (0.8)
	Preliminary HICP (CPI) Y/Y%	Jul	**2.8 (2.8)**	2.8 (2.7)	2.4 (2.3)	-
France	GDP – first estimate Q/Q% (Y/Y%)	Q2	**0.2 (0.7)**	*0.2 (0.8)*	-0.1 (0.9)	- (0.8)
	Consumer spending M/M% (Y/Y%)	Jun	**0.4 (0.1)**	-0.1 (0.1)	0.5 (0.3)	0.3 (0.1)
	Preliminary private sector payrolls Q/Q%	Q2	**-0.1**	-0.1	-0.1	-
Italy	GDP – first estimate Q/Q% (Y/Y%)	Q2	**0.2 (1.0)**	*0.1 (0.8)*	0.3 (0.8)	-
	PPI Y/Y%	Jun	**6.8**	-	9.1	-
Spain	GDP – first estimate Q/Q% (Y/Y%)	Q2	**0.7 (2.7)**	*0.9 (2.9)*	0.6 (2.7)	-
	Preliminary HICP (CPI) Y/Y%	Jul	**3.8 (3.5)**	3.7 (3.2)	3.6 (3.2)	-
UK	BoE Bank Rate %	Jul	**3.75**	*3.75*	3.75	-

Auctions

Country	Auction
Italy	sold €3bn of 3.15% 2031 bonds at an average yield of 3.39%
	sold €1.25bn of 1.45% 2036 bonds at an average yield of 3.95%
	sold €1.75bn of 3.8% 2036 bonds at an average yield of 4.00%
	sold €2bn of 2036 floating bonds at an average yield of 3.30%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Wednesday's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Germany		Import prices M/M% (Y/Y%)	Jun	**-0.7 (6.1)**	-0.7 (6.0)	0.7 (6.8)	-
Italy		Hourly wages Y/Y%	Q2	**2.4**	-	2.4	-
UK		Net consumer credit £bn (Y/Y%)	Jun	**1.8 (9.1)**	-	1.7 (8.9)	- (9.0)
		Net mortgage lending £bn (approvals 000s)	Jun	**7.7 (58.2)**	3.9 (57.1)	2.9 (56.2)	3.3 (56.6)

Auctions

Country		Auction
Germany		sold €4.497bn of 3% 2036 bonds at an average yield of 3.13%

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	Preliminary headline (core) HICP Y/Y%	Jul	*2.9 (2.4)*	2.8 (2.4)
Germany		08.55	Unemployment claims rate % (change 000s)	Jul	6.3 (5)	6.3 (-1)
France		07.45	Preliminary HICP (CPI) Y/Y%	Jul	2.0 (1.8)	2.0 (1.8)
		07.45	PPI Y/Y%	Jun	-	3.0
Italy		09.00	Istat economic (manufacturing) confidence indicator	Jul	-	95.2 (88.4)
		09.00	Istat consumer confidence indicator	Jul	92.8	92.4
		10.00	Preliminary HICP (CPI) Y/Y%	Jul	2.9 (2.8)	3.0 (3.0)
UK		07.00	Nationwide house prices M/M% (Y/Y%)	Jul	0.1 (1.9)	0.0 (2.2)

Auctions and events

UK		12.15	BoE Chief Economist Pill to brief the MPC's national agents on updated macroeconomic projections

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research reports at:
https://www.uk.daiwacm.com/ficc-research/research-reports