Euro wrap-up

Overview

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- Bunds posted modest losses as euro area inflation rose to its highest level in almost three years, but German retail sales recorded their steepest decline in five years.
- While UK bank lending weakened, Gilts underperformed after a survey suggested shop price inflation accelerated to a seven-month high.
- Thursday will bring euro area PPI inflation data for July and final services PMIs for August.

Daily bond market movements

Bond	Yield	Change
BKO 2.7 09/28	2.957	+0.026
OBL 2.9 10/31	3.085	+0.024
DBR 3 08/36	3.341	+0.019
UKT 4 05/29	4.602	+0.088
UKT 4⅛ 03/31	4.704	+0.089
UKT 4⅞ 07/36	5.219	+0.081

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

Euro area

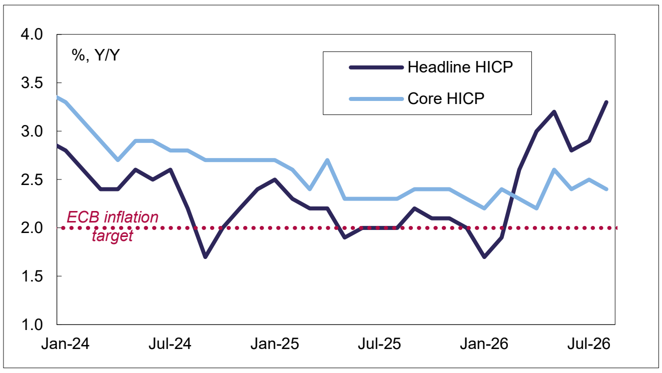
Headline inflation jumps in August to a near-3-year high underlying pressures still appear limited

Following the upside surprise to euro area GDP in Q2 and signs of firm growth momentum over the summer, today's flash inflation estimates reinforced expectations that the Governing Council will raise the deposit rate again at next week's ECB policy meeting to 2.50%. Headline euro area HICP inflation jumped in August by 0.4ppt to 3.3%Y/Y, the highest rate in almost three years and 1.4ppts above February's rate before the escalation of the Middle East conflict. Nevertheless, to two decimal places it was on the low side (3.26%Y/Y) and the average rate for July and August was 0.2ppt below the ECB's June baseline projection for Q3. Moreover, the increase was driven entirely by energy, with such prices rising the most since April to push the respective inflation component up 4ppts to 14.1%Y/Y, the most since January 2023. Encouragingly, there remained little evidence that higher energy costs are feeding through to the broader inflation basket. Prices of food, alcohol and tobacco were again unchanged in August so the annual rate (1.2%Y/Y) matched the lowest in five years. Indeed, despite the extended summer heatwave, three-month momentum in fresh food inflation was the weakest in more than two years. In addition, while volatility in package holidays and air fares might have played a role, services prices rose the least in any August in six years, pushing the respective inflation rate down to a four-month low (3.0%Y/Y). And the limited country detail suggests that the uptick in non-energy industrial goods inflation to a 2½-year high of 1.2%Y/Y partly reflects the timing of summer discounting of clothing and furniture. Overall, core inflation moderated 0.1ppt to 2.4%Y/Y to be consistent with the ECB's baseline projection.

Upside risks to inflation outlook support September rate hike, and possibly further tightening ahead

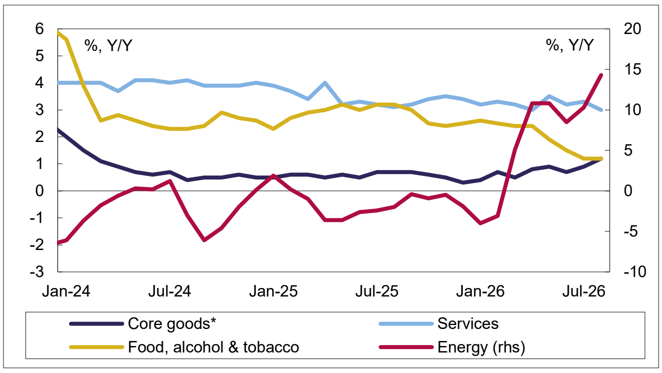
Encouragingly, survey evidence suggests that households and firms have scaled back their inflation expectations from the spikes seen earlier in the year. Nevertheless, while recent inflation undershoots may prompt the ECB to trim its near-term projection, the jump in wholesale energy prices since June, a possible resumption of food price pressures due to the summer drought and a broader pass-through of input costs along supply chains all imply a less favourable outlook from early next year. As a result, the updated staff forecasts to be published next week will likely continue to show core inflation slightly exceeding the 2% target at the end of the horizon in 2028, despite being conditioned on at least one further 25bp rate hike to 2.75%. That said, the Governing Council will not pre-commit to further rate increases. And the more dovish members will be able to point to the labour market as a reason why second-round inflation risks will remain well-contained. In this respect, today's data revised up the euro area unemployment rate to 6.4% in five of the six months to July, some 0.2ppt above the Q424 low and the ECB's June projection for Q2 and Q3. Moreover, despite tentative signs of stabilisation in labour demand, German negotiated wage growth eased back below 2.0%3M/Y in July, suggesting that domestic wage pressures remain subdued.

Euro area: Headline & core inflation



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Key inflation components

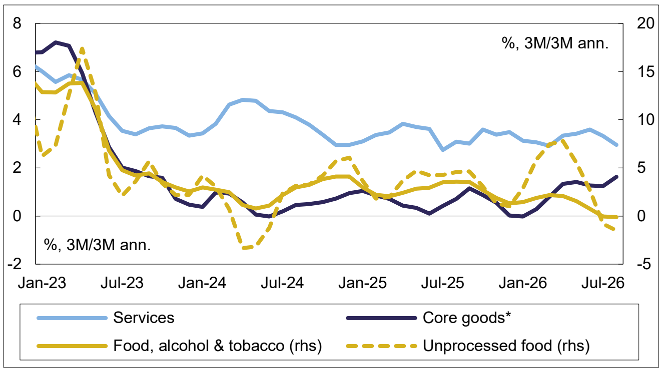


**Non-energy industrial goods.*
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

German retail sales slump at the start of Q3 as fuel tax cut was reversed

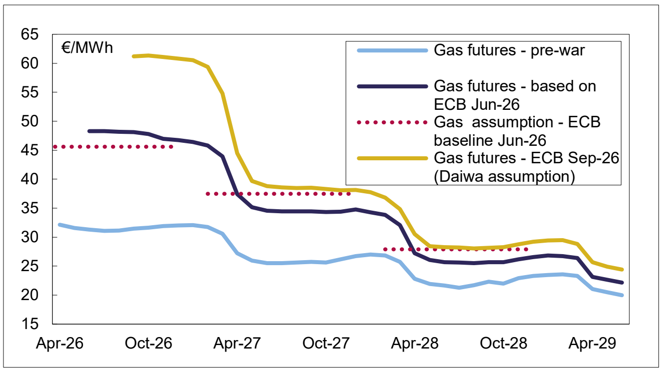
Notwithstanding recent upbeat surveys, some policymakers might also flag concerns about potential downside risks to the growth outlook. The squeeze on demand from higher prices was evident in today's German retail sales data, with volumes falling sharply at the start of Q3 following the reversal of the government's temporary fuel tax cut. In particular, total sales volumes dropped 3.4%M/M in July, the most in five years and twice the pace of the fall in sales values, leaving them down 2.5%Y/Y and at their lowest level since December 2024. The weakness was driven by auto fuel sales, which plunged 9.1%M/M to their lowest level since early 2013. But spending softness was not confined to fuel. Food sales fell for a second successive month (-0.8%M/M). And disappointingly, core sales (i.e. those of non-food and non-fuel items) slumped 4.8%M/M to a near-two-year low, perhaps reflecting a broader reluctance to spend amid renewed upward pressure on energy prices. Admittedly, German retail sales volumes are notoriously volatile and subject to sizeable revisions. Moreover, the near-term outlook for household consumption might not be quite so gloomy. The latest GfK survey reported a rise in consumer confidence to a six-month high, supported by a marked improvement in income expectations. Signs of labour market stabilisation might also help to support spending. And although the improvement in sentiment in the sector in August was led by household electrical goods, on average retailers were the most upbeat about the outlook for the coming six months since before the Iran conflict.

Euro area: Selected inflation momentum



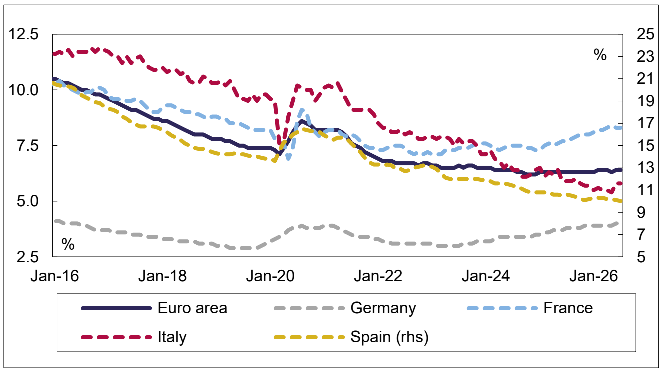
*Non-energy industrial goods.
Source: ECB, Macrobond and Daiwa Capital Markets Europe Ltd.

Euro area: Natural gas futures & ECB assumption



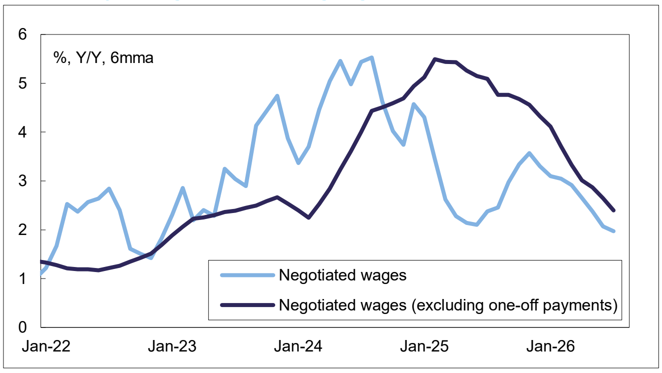
Source: ECB, Bloomberg and Daiwa Capital Markets Europe Ltd.

Euro area: Unemployment rates



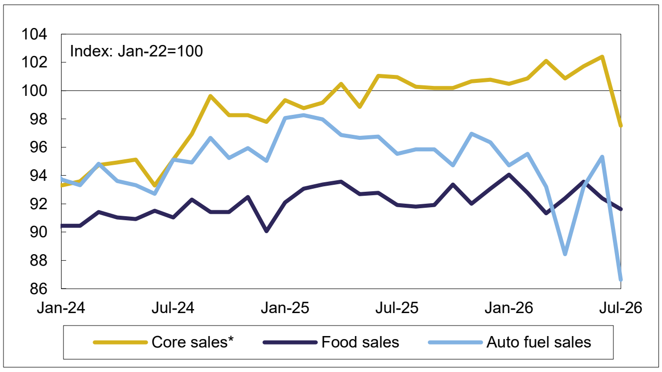
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Negotiated wage growth



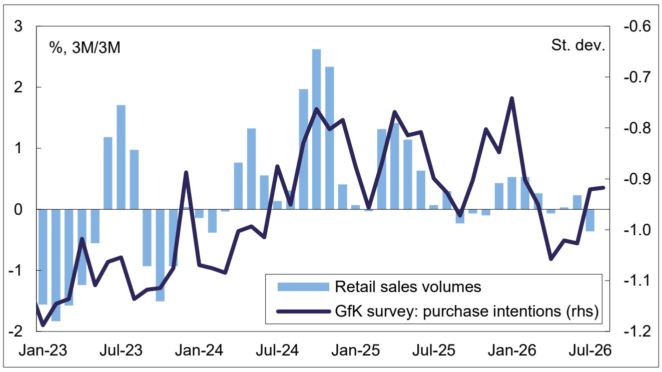
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Retail sales volumes



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

Germany: Retail sales & consumer confidence



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

The coming two days in the euro area

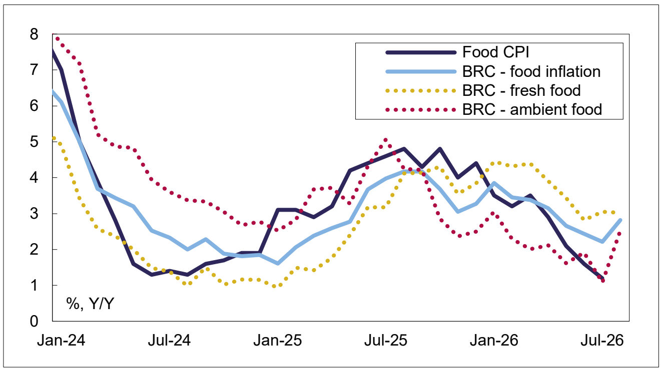
With just a couple of data releases scheduled across the member states on Wednesday, the next focus for euro area data will be the release of August's final composite and services PMIs and euro area producer price data on Thursday. Like today's inflation release, higher wholesale oil and gas prices are likely to have pushed headline PPI inflation back above 5%Y/Y in July, virtually reversing its drop in June. But business surveys, including today's final manufacturing PMIs, have offered some reassurance about the propagation of those costs to broader selling prices even as economic activity shows signs of continued resilience. Indeed, the flash PMIs flagged the weakest expansion in output prices for five months in August (54.0), while the composite output PMI picked up to a nine-month high (52.1). The latter was seemingly led by strength in the periphery, perhaps indicating another good summer for tourism, which is sure to be reflected in either (or both) of the Italian and Spanish surveys. By contrast, the flash PMIs showed German and French services activity slipping slightly further into contractionary territory. But given their relatively better fairing in alternative surveys last month, as well as the August PMIs' vulnerability to seasonal swings, forthcoming revisions for those PMIs might not be surprising. And if those are accompanied by a less dovish assessment of price pressures in Germany, we could also see the aggregate euro area price indices revised up in due course too.

UK

BRC shop price inflation jumps as energy prices start to feed through and AI-pressures persist

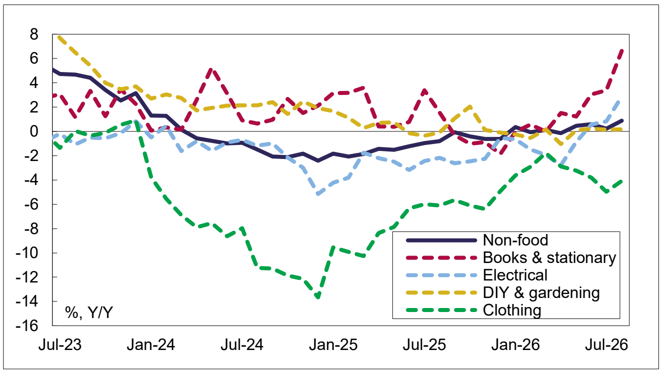
While Governor Bailey used his airtime at Jackson Hole to reiterate his reluctance to tighten monetary policy, the upside risks to inflation have certainly grown more acute since the MPC last convened in July. Even before the latest escalation in the Middle East over the bank holiday weekend, shifts in wholesale oil and gas prices had rendered the BoE's baseline projections unrealistic. Higher oil prices have pushed up petrol prices, which will contribute to a hotter CPI print for August (16 September). And the unabetted increase in natural gas futures suggests that household energy bills will rise significantly further from the start of 2027, compounding the 4% increase announced already by Ofgem for Q4. Higher input costs also risk amplifying indirect inflation effects, which alongside the impact of this summer's heatwave promises to spur food inflation as a key driver later this year and into next. In that respect, today's BRC survey – which often provides a bellwether for price pressures on the high street ahead of the official data – suggests that cost pressures could be beginning to feed through. The headline shop price index rose an unseasonably firm 0.8%M/M in August – an advance surpassed only in 2022 on the 20 years long series – which pushed shop price inflation up 0.6ppt to a seven-month high (1.5%Y/Y). Pressures were visible across the BRC gauges for both food and non-food inflation. Despite a modest deceleration in fresh food inflation, the former jumped to a four-month high (2.8%Y/Y) following a sharp 1½ppt increase in so-called 'ambient' foods. And inflation of other

UK: Food inflation



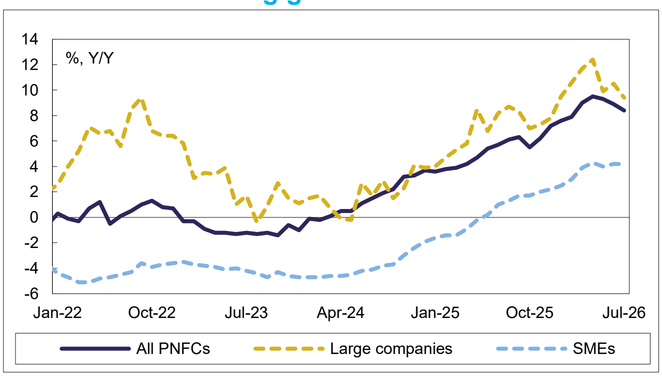
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: BRC – selected non-food inflation components



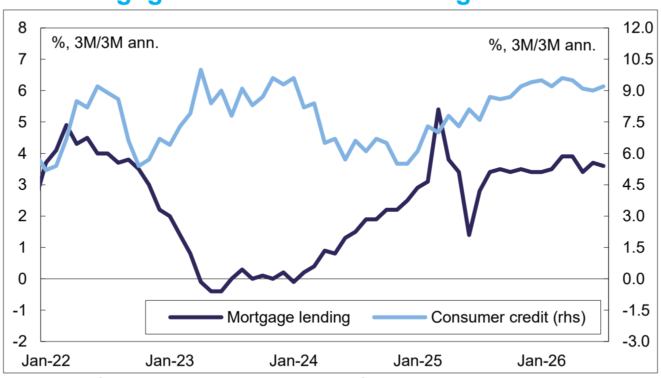
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Business lending growth



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Mortgage and consumer credit growth



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

goods rose to its fastest pace since February 2024 (0.9%Y/Y). Clothing, furnishings & DIY inflation remained subdued, but with the AI buildout continuing to push up cloud storage costs and chip prices, electricals prices were rising at their fastest rate on the series. The same was also true for books, which perhaps counterintuitively might also be indicative of AI-related activity.

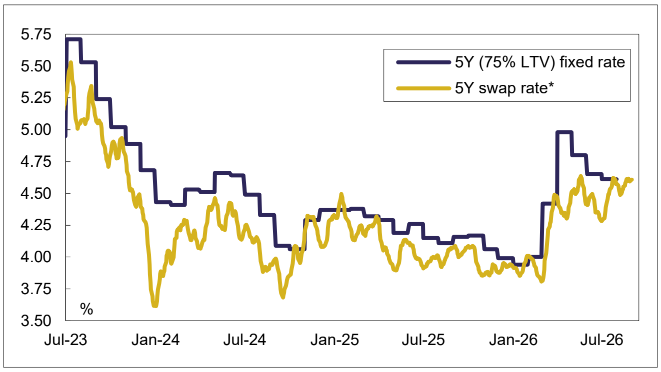
Tighter financial conditions lean against bank lending, with mortgage approvals at a 2½-year low

Policymakers will be wary of those price developments in the coming months, but they will not prompt any action as soon as September. Second-round effects have thus far been absent; the labour market is still loose and evidence of a potential pickup in real activity is tentative at best. So, a majority on the MPC should maintain that the current policy stance offers sufficient restrictiveness, particularly ahead of autumn's wage settlements. They will also be reassured by the additional restrictiveness provided by still-tight financial conditions. At least in places, July's monetary figures suggest they are a headwind to bank lending activity. Businesses raised close to no finance in net in July and while new loans edged up to a three-month high (£1.8bn) they remained subdued by recent standards, taking the annual growth rate of such loans down to a five-month low (8.4%Y/Y, down 0.5ppt). Admittedly, growth in consumer credit remained solid despite higher interest rates (9.2%Y/Y, up 0.1ppt), with new advances at an eight-month high (£2.0bn). But having been boosted in June – likely opportunistically, given the short-lived détente between the US and Iran – mortgage lending fell back to a more reserved level (£4.3bn), slightly below its pre-war trend. With interest rate swaps still around their six-month highs and new mortgage rates 50-100bps higher than their pre-war levels, new mortgage approvals were also the lowest for 2½ years in July (56.1k), pointing towards a subdued outlook for lending over coming months. Indeed, while the Nationwide house price index rose in August for the first time since April (0.2%M/M), the annual rate increased to a softer-than-expected 1.6%Y/Y, with downwards revisions to the series hardly reminiscent of strong buyer demand.

The coming two days in the UK

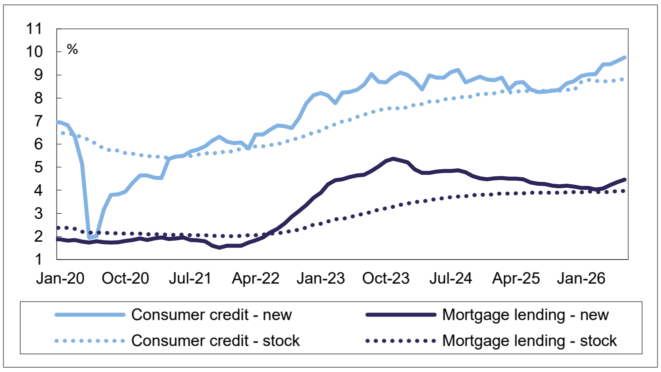
Today's UK manufacturing PMIs were relatively little changed from their flash release. While the output index was revised up 0.9pt to 52.1, that was still the lowest since April and so offered little to counter suspicions that the boost to activity from stockpiling efforts which proliferated at the start of the oil supply shock might be beginning to wane. But despite the weaker flash manufacturing survey, the preliminary composite output PMI still crept up to a six-month high (52.5) thanks to firmer activity from the services sector (52.8), reportedly helped by the hot weather, ICT projects and improving confidence. The final services and composite PMIs will look to affirm that stronger momentum. But close attention will also be paid to any revisions to the PMIs signals on prices and employment conditions ahead of Friday's DMP survey. Indeed, the flash services PMIs notably teased some stabilisation in labour demand – with the composite employment index showing its weakest contraction in 10 months – alongside a modest acceleration in both cost pressures and price setting intentions.

UK: Interest swap & mortgage rates



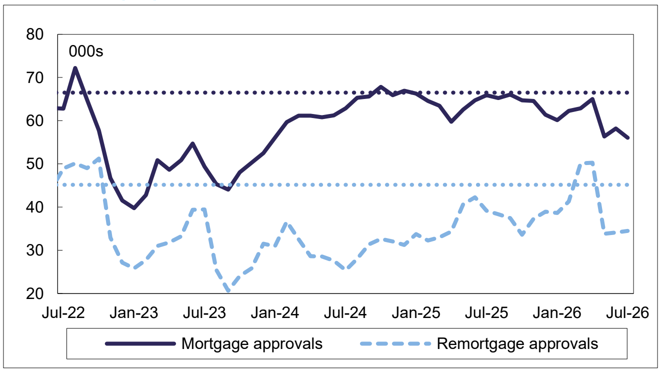
*5-day moving average.
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Effective interest rates on household loans



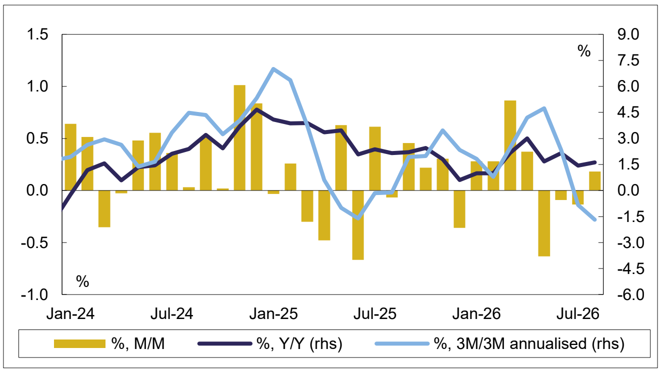
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Mortgage approvals*



*Dotted lines show pre-pandemic 5Y averages.
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

UK: Nationwide house prices



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

The next Euro wrap-up will be published on Thursday 3 September 2026

European calendar

Today's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area		Preliminary headline (core) HICP Y/Y%	Aug	**3.3 (2.4)**	*3.3 (2.5)*	2.9 (2.5)	-
		Unemployment rate %	Jul	**6.4**	6.3	6.3	6.4
		Final manufacturing PMI	Aug	**52.7**	*52.8*	51.9	-
Germany		Retail sales M/M% (Y/Y%)	Jul	**-3.4 (-2.5)**	0.5 (0.7)	-0.7 (0.0)	0.0 (0.6)
		Final manufacturing PMI	Aug	**54.3**	*54.1*	52.2	-
France		Final manufacturing PMI	Aug	**51.1**	*51.5*	49.8	-
Italy		Preliminary HICP (CPI) Y/Y%	Aug	**3.2 (3.3)**	3.4 (3.3)	2.9 (2.9)	-
		Manufacturing PMI	Aug	**49.6**	51.5	51.3	-
		GDP - final estimate Q/Q% (Y/Y%)	Q2	**0.2 (1.0)**	*0.2 (1.0)*	0.3 (0.7)	-
Spain		Manufacturing PMI	Aug	**49.5**	50.5	50.2	-
UK		BRC shop price index Y/Y%	Aug	**1.5**	0.9	0.9	-
		Final manufacturing PMI	Aug	**51.7**	*51.5*	51.9	-
		Net consumer credit £bn (Y/Y%)	Jul	**2.0 (9.2)**	-	1.8 (9.1)	1.9 (-)
		Net mortgage lending £bn (approvals 000s)	Jul	**4.3 (56.1)**	5.7 (59.4)	7.7 (58.2)	-
		Nationwide house prices M/M% (Y/Y%)	Aug	**0.2 (1.6)**	0.1 (2.1)	0.1 (1.8)	-0.1 (1.4)

Auctions

Country		Auction
Germany		sold €4.281bn of 2.9% 2031 bonds at an average yield of 3.09%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Monday's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Germany		Preliminary HICP (CPI) Y/Y%	Aug	**2.9 (2.9)**	3.1 (3.0)	(2.8) 2.8	-

Auctions

Country	Auction
- Nothing to report -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Wednesday's releases

Economic data

Country		BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Italy		09.00	PPI Y/Y%	Jul	-	6.8
Spain		08.00	Unemployment change (employment net change) 000s	Aug	-	19.5 (79.6)

Auctions and events

- Nothing scheduled -

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	Aug	*52.1 (51.7)*	52.0 (51.7)
		10.00	PPI Y/Y%	Jul	5.4	4.6
Germany		08.55	Final composite (services) PMI	Aug	*51.0 (48.5)*	51.3 (49.8)
France		08.50	Final composite (services) PMI	Aug	*48.8 (48.4)*	49.4 (49.6)
Italy		08.45	Composite (services) PMI	Aug	53.1 (53.4)	52.5 (52.5)
Spain		08.15	Composite (services) PMI	Aug	57.4 (58.8)	56.5 (58.3)
UK		09.30	Final composite (services) PMI	Aug	*52.5 (52.8)*	52.2 (52.1)
Auctions and events						
France		09.50	Auction: to sell up to €13.5bn of 1.25% 2036, 3.7% 2036, 0.5% 2040 & 4.1% 2046 bonds			
Spain		09.30	Auction: to sell 2.35% 2029, 2.6% 2031, 3.3% 2036 & 2.05% 2039 bonds			
UK		10.00	Auction: to sell £900mn of 1.875% 2049 inflation-linked bonds			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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