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All Signal, No Noise

MARKET ANALYSIS

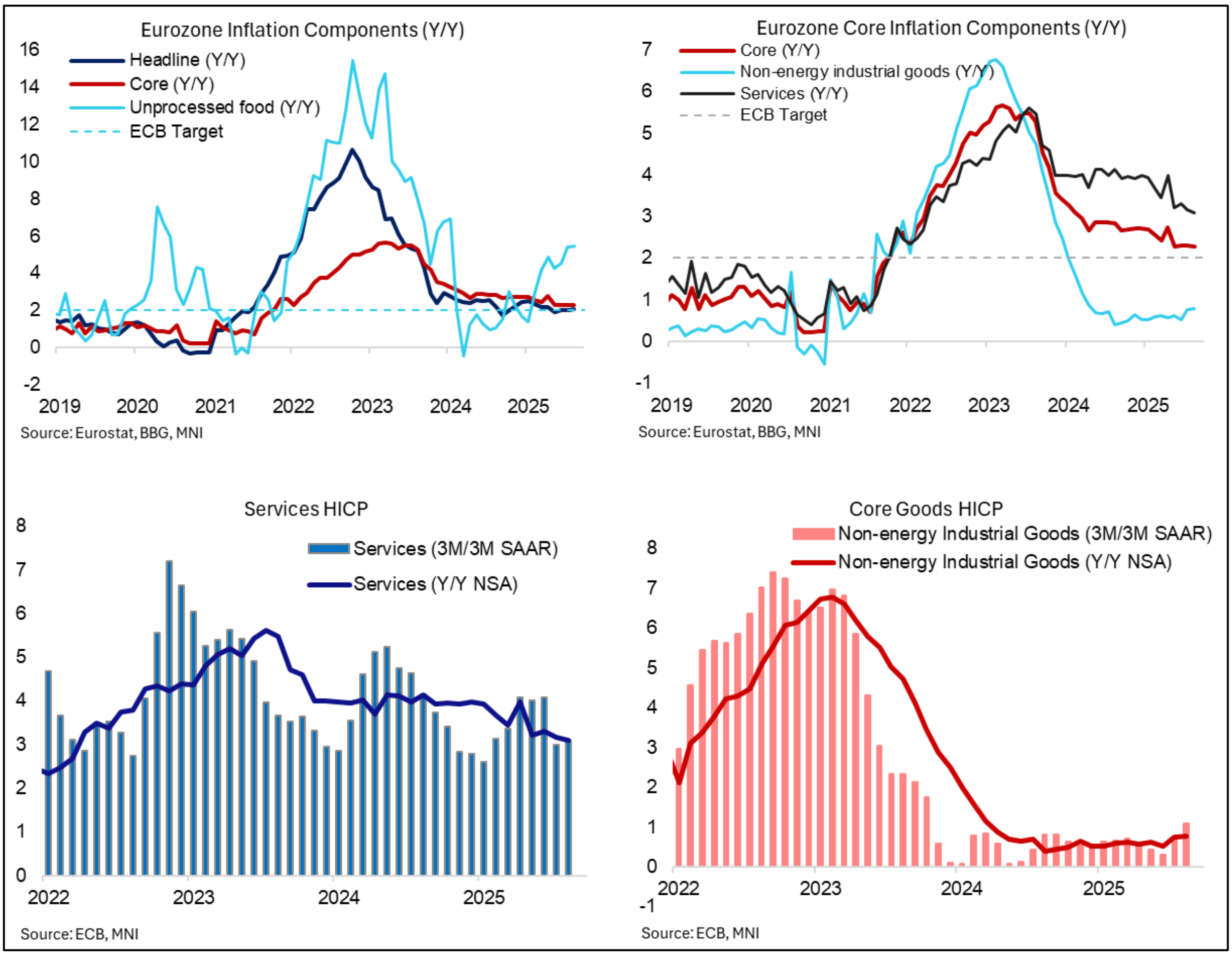
The following offers a succinct look at the main macroeconomic developments across inflation, activity indicators and the labour market since the last ECB decision. It's part of the full MNI ECB Preview (here).

Macro Developments Since The July 24 ECB Decision: General Resilience

Developments over the summer have done little to push back on Lagarde's relatively hawkish signalling at the July press conference. Economic indicators such as the PMIs continue to gradually improve, the unemployment rate is at all-time lows, and inflation remains very close to the 2.0% medium-term target albeit with core still a little above target. The main takeaway is one of general resilience amidst trade policy induced uncertainty.

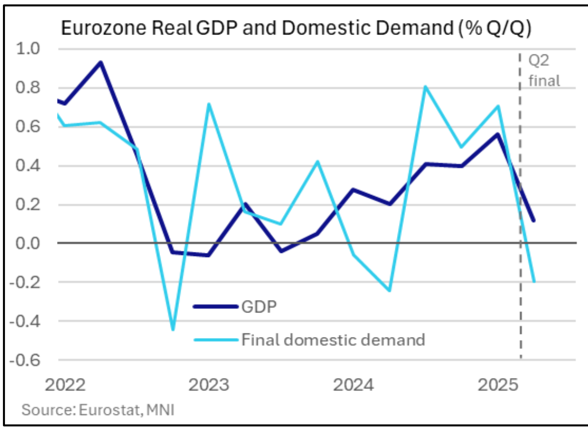
HICP Inflation: Headline At Target, Core Stabilising A Little Above and Services Moderation Continues

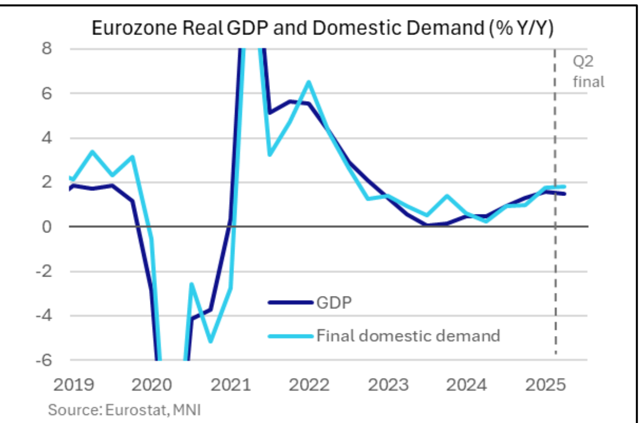
The two months of HICP data have been mixed from a headline inflation perspective whilst core inflation has continued to track at a near identical Y/Y pace to that ahead of the July ECB decision. Specifically, July headline inflation came in on the high side of analyst expectations at 2.04% Y/Y (Bloomberg median 1.9) before only just rounding to the 2.1% expected in the preliminary flash release at 2.05% Y/Y. Core inflation ticked down to 2.27% Y/Y in August as it continues some stabilization after two months at 2.31% through June-July and 2.28% in May. The much-eyed services component has seen some disinflation however, with 3.10% Y/Y in August and 3.15% in July after the 3.32% Y/Y in June known ahead of the July meeting. As for 3m/3m momentum metrics using the ECB's seasonally adjusted data, core momentum firmed from 2.2% in July to 2.4% annualized in August but remains below the 2.7% seen in June. Similarly, services inflation momentum currently stands at 3.1% annualized in August after 3.0% in July, still elevated but at least comfortably below the >4% readings seen the three months prior. One area we'll be watching is whether there is a more widespread discussion around the continued re-acceleration of food inflation, as noted by Schnabel, with something similar seen in BOE commentary in the UK.



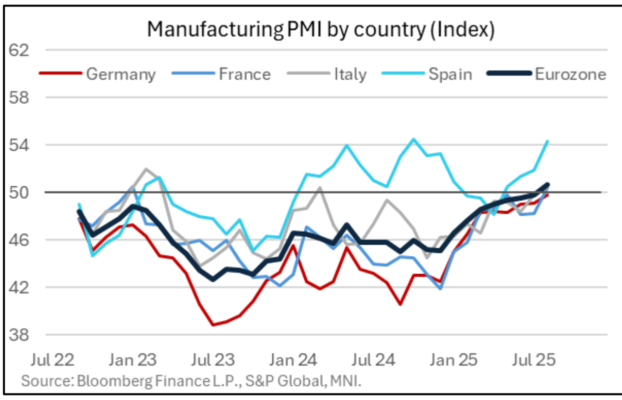
Growth: Domestic Demand Gives Back Some Recent Robustness, Mfg PMIs Firm Further

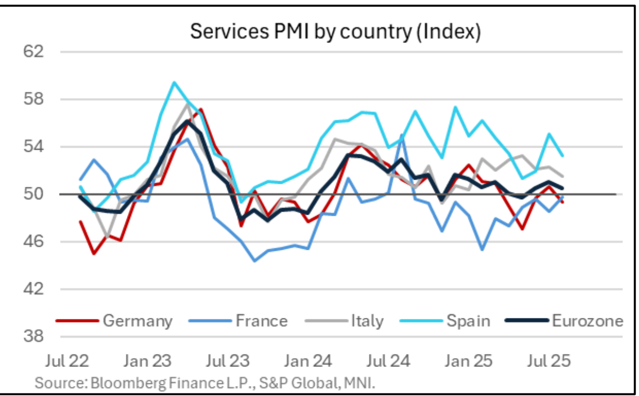
Released shortly after the July ECB meeting, real GDP growth was a little better than analysts expected in the Q2 advance release at 0.1% Q/Q (cons 0.0) after a strong 0.6% Q/Q in Q1. Subsequent revisions haven't materially altered this trend, if anything marginally on the stronger side with the Y/Y rounding up to 1.5% Y/Y. The recent final release put real GDP growth at 0.12% Q/Q in Q2, helped by a large +0.5pp coming from change in inventories whilst final domestic demand dragged -0.2pps for its joint largest decline since late 2022. The latter points to a marked cooling in underlying demand although it does follow a strong 0.7pp in Q1 and 0.6pp averaged in 2H24. As such, final domestic demand growth at 1.8% Y/Y remained a little above that of real GDP growth.
The final report also showed that nominal GDP grew 0.8% Q/Q (vs 0.7% prior) and 4.0% Y/Y (vs 3.9% prior) in Q2. On a sequential basis, Q2 nominal growth was mostly inflationary – real growth was 0.1% Q/Q while GDP deflator growth was 0.7% Q/Q. However, on an annual comparison there is a growing contribution from real growth to nominal GDP, reflecting a gradual recovery in activity as ECB past rate cuts feed through the system (real growth was 1.5% Y/Y in Q2, versus deflator growth of 2.5% Y/Y). We calculate that profits contributed 0.6pp to annual nominal GDP growth after just 0.1pp in Q1 and negative contributions in the three quarters prior, with the impact of US tariffs on Eurozone exporters' profits key to watch in the quarters ahead.





As for soft indicators, the August PMIs were mixed by sector relative to July with manufacturing continuing to improve but services unwinding the previous month's improvement. It saw the composite PMI increase 0.1pt to 51.0 for its joint highest since May 2024. Within that, the manufacturing survey increased for an eighth consecutive month to a 38-month high, even if that's only just back into expansionary territory at 50.7. Nevertheless, that's still showing some relative resilience compared to potential scenarios envisaged under aggressive US trade policy.
Press release: "*While the pace of expansion ticked up to a one-year high, it remained sluggish overall. The service sector held back overall growth, with output rising only marginally. Nevertheless, for the first time since May 2024, private sector firms reported greater volumes of incoming new work and employment growth was its quickest in 14 months*".





Labour Market: U/E Rate At Lows After More Revisions, Comp Per Employee Cools By Less Than Expected

The Eurozone unemployment rate printed at 6.2% in July as expected, a joint series low, but revisions have again altered recent trends. The data have quite often been revised and June saw a fairly typical 0.1pp upward revision to 6.3%, although the +0.2pp to 6.4% in May was more surprising. It leaves a trend of recent improvement but with question marks over the data. What had been seen as three months at joint cycle lows of 6.2% through Apr-Jun, tying with 6.2% in Oct-Nov 2024, Eurostat now estimate a latest pattern of 6.3% in Apr, 6.4% in May, 6.3% in Jun and 6.2% in July, tying with 6.2% only in Nov 2024. ECB’s Lagarde has pointed to these at-the-time historically low unemployment rates when citing the health of the labour market in recent meetings. Outright employment growth remains subdued however, with just 0.1% Q/Q and 0.6% Y/Y in Q2.

As for inflationary pressures stemming from the labour market, Eurozone unit labour costs grew 3.1% Y/Y in Q2, down from 3.3% in Q1 for the seventh consecutive annual deceleration. This was above the ECB's 2.9% projection made in June, seemingly driven the smaller-than-expected deceleration in total compensation per employee growth (3.9% Y/Y vs 4.0% prior, 3.4% ECB). While a declaration in ULC growth has allowed the ECB to deliver 200bps of easing this cycle, the data is too lagged to help determine whether further fine-tuning of the policy stance is necessary. Given the modest upward surprise to compensation per employee growth, it argues in favour of steady rates at 2.00% for now. ULC growth may have moderated at a steadier pace than the ECB forecast but its forward looking wage tracker released earlier in the inter-meeting process points to a continued decline in negotiated wage growth. Now with estimates out to 1Q26, it eyes wage growth excluding one-off payments at 2.6% Y/Y in 1Q26 after 3.1% in 4Q25. Overall, the results are consistent with a further softening in services inflation pressures in the coming years, in line with ECB signalling.