

Euro wrap-up

Overview

- Bunds made modest gains as German GDP fell short of expectations in Q2 but flash euro area Q2 GDP and July inflation surprised on the upside.
- Gilts also made modest gains on a quiet day for UK economic news.
- The coming week will bring the BoE's latest monetary announcement and updated economic forecasts. Data-wise, euro area retail sales and national IP releases for June will be accompanied by the final July PMIs and car registrations figures.

Emily Nicol
+44 20 7597 8331

Chris Scicluna
+44 20 7597 8331

Daily bond market movements

Bond	Yield	Change
BKO 0 06/23	-0.769	-0.003
OBL 0 10/26	-0.745	-0.006
DBR 0 08/31	-0.461	-0.008
UKT 0 ¹ / ₈ 01/23	0.049	-0.018
UKT 0 ¹ / ₈ 01/26	0.262	-0.012
UKT 4 ³ / ₄ 12/30	0.590	-0.007

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

Euro area

Euro area GDP exceeds expectations in Q2

According to today's preliminary GDP estimate, the euro area's economic recovery gathered momentum in the second quarter, with GDP increasing a stronger-than-expected 2.0%Q/Q, and fully reversing the contractions recorded in Q420 (-0.6%) and Q121 (-0.3%). This left GDP up a sizeable 13.7%Y/Y, admittedly flattered by the extremely low base a year ago. The size of the increase exceeded most forecasts, including that of the ECB (+1.4%Q/Q). And together with previous back revisions, today's outturn suggested that the level of output was now 1.7% higher than at the end of 2020, more than twice the pace assumed in the ECB's June macroeconomic projections. This notwithstanding, GDP still stood 3% below the pre-Covid level in Q419. (As a comparison, yesterday's US GDP release confirmed that output in Q2 was now 0.8% above its pre-pandemic level.) While the recent rise in coronavirus cases associated with the delta variant and supply bottlenecks have threatened to disrupt the recovery momentum this quarter, the [Commission's survey](#) yesterday revealed that euro area economic sentiment had risen to an all-time high in July. So although risks are skewed to the downside, we continue to expect solid growth this quarter and next, with euro area GDP on track to return to its pre-pandemic level by the start of 2022.

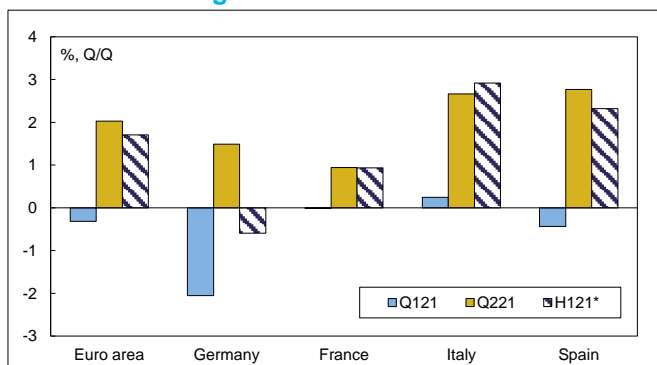
German GDP falls short of expectations, but Italian and Spanish GDP jumps in Q2

The recovery was also evident among the euro area's largest member states, albeit with varying degrees of momentum. Germany's performance was somewhat disappointing, with the 1.5%Q/Q increase softer than anticipated and following a steeper-than-previously-estimated decline in Q1 (-2.1%Q/Q). As such, Germany was the only member state (of those reporting initial results) to have output still below the Q420 level; and it remained a sizeable 3.9% below Q419's pre-pandemic level. In France, GDP rose 0.9%Q/Q in Q2 – the softest growth of the larger member states – while the previously estimated contraction in Q1 (-0.1%Q/Q) was revised away. That left the level of output up a substantial 18.7%Y/Y, but still 3.3% below the pre-Covid level of Q419. Meanwhile, GDP in Italy and Spain exceeded expectations, rising 2.7%Q/Q and 2.8%Q/Q respectively. That left Italian GDP 3.8% below the level in Q419, but – given the big hit from the pandemic in the first half of 2020 - Spanish GDP still a hefty 6.8% below the pre-pandemic level. There were also stronger outturns in Portugal (4.9%Q/Q), Austria (4.3%Q/Q) and Belgium (1.4%Q/Q).

Household consumption likely driver of euro area GDP in Q2

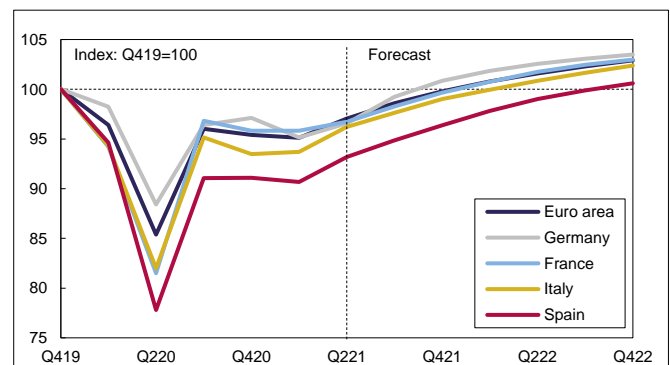
No detail of the expenditure breakdown of euro area GDP in Q2 was published by Eurostat today. But the limited information provided by the member states suggested that household consumption was the principal driver of growth. Destatis reported

Euro area: GDP growth in selected member states



*Q221 GDP level compared with Q420 level. Source: Refinitiv, Eurostat and Daiwa Capital Markets Europe Ltd.

Euro area: GDP level in selected member states



Source: Refinitiv, Eurostat and Daiwa Capital Markets Europe Ltd.

that this component plus government expenditure boosted growth in Germany, but provided no specific data. In France, household consumption accelerated (0.9%Q/Q) as lockdown restrictions eased over the quarter, with a sizeable rebound in spending on hotel and accommodation services (48%Q/Q) and stronger consumption of transport services (11.4%Q/Q) due to the recovery of mobility. Fixed investment rose for a fourth successive quarter (1.1%Q/Q) to return back above its pre-pandemic level for the first time. But with imports (1.9%Q/Q) outpacing exports (1.5%Q/Q), net trade remained a modest drag. In Spain, consumption jumped 6.6%Q/Q to more than fully account for growth. But fixed investment fell for a second successive quarter (-1.5%Q/Q), while net trade subtracted 0.7ppt from GDP growth as imports rose 2.9%Q/Q and exports were up just 0.4%Q/Q. In Italy, ISTAT noted that domestic and external demand supported growth.

Headline inflation jumps to an above-target 2.2%Y/Y in July

Broadly in line with what had been suggested by yesterday's equivalent data from Germany and Spain, today's flash estimate of euro area inflation in July jumped 0.3ppt to 2.2%Y/Y, the highest for three years. The rise was driven principally by energy inflation, which – largely due to base effects associated with the plunge in oil prices a year ago – increased 1.5ppt to 14.1%Y/Y, the highest since August 2008, contributing 1.3ppt to the headline rate. Food inflation also increased 1.1ppt to 1.6%Y/Y, an eight-month high. But prices of non-energy industrial goods fell sharply in July, with inflation of such goods down 0.5ppt to 0.7%Y/Y, fully reversing the jump in June. So, while services inflation edged slightly higher, by 0.2ppt to 0.9%Y/Y, core inflation moderated 0.2ppt to 0.7%Y/Y, bang in line with the average of the preceding twelve months, suggesting that underlying inflation remains highly subdued.

Inflation to move temporarily higher, but then fall back next year

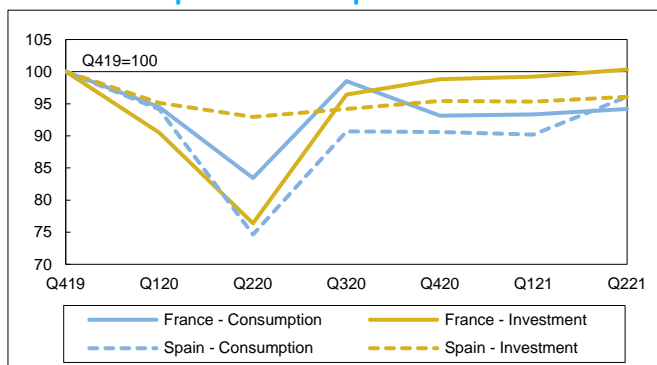
Looking ahead, the breach of the ECB's new target looks set to persist over coming months. The moderation in non-energy goods inflation this month was likely triggered in part by the recent volatility in clothing inflation caused by the different timings of summer sales in certain countries and should therefore prove temporary. The impact of rising input costs amid supply bottlenecks might be expected to play a bigger role over the near term, while base effects associated with last summer's German VAT cut will likely push headline euro area inflation up too. And with energy inflation expected to be temporarily boosted by higher petrol prices and services inflation likely to tick higher, we expect headline CPI to rise to 3%Y/Y this quarter and core inflation to rise above 1½%Y/Y. But not least due to base effects, we expect headline and core inflation to fall back at the start of 2022. And while today's euro area labour market numbers reported a steeper drop in unemployment in June, declining a further 423k on the month, the level was still more than 1mn above the pre-pandemic level. The unemployment rate fell 0.3ppt to 7.7%, a thirteen-month low, albeit higher than the pre-pandemic low (7.1% in Mar-20). So with excess amounts of capacity in the labour market and therefore no signs of meaningful upwards pressure on wage growth or inflation expectations, there seems every reason to believe that headline and core inflation will remain below the ECB's 2.0%Y/Y target over the projection horizon.

The week ahead in the euro area

After the confirmation today of a return to positive GDP growth in Q2, the coming week's hard data flow will provide more clarity into sectoral performances at the end of the second quarter. In particular, euro area retail sales figures for June – due for release Wednesday – are expected to show that spending on goods rose for the second successive month, albeit likely at a softer pace than the 4.6%M/M surge seen in May as consumption on services resumed. Certainly, this was the case in the BoF retail sales figures for that month (which rose 1.5%M/M following growth of 5.2%M/M in May). The equivalent German sales numbers are due for release on Monday. The first half of the week will also bring July car registration figures from the largest four member states, which are expected to show that sales were up compared with a year earlier, although they remain subdued compared with pre-Covid trends as production continues to be impeded by supply difficulties.

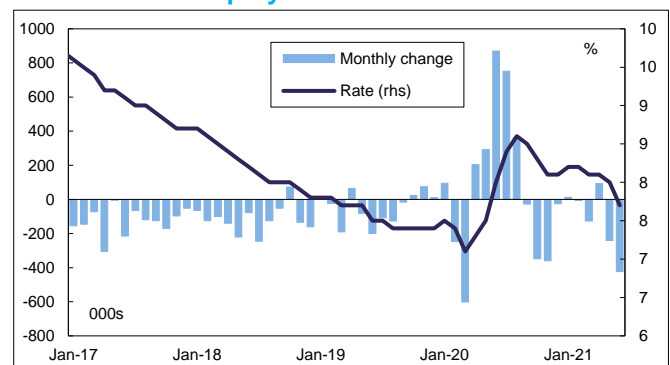
Focus at the back end of the week will turn to manufacturing, with German factory orders data due on Thursday and German IP numbers on Friday, with the latter expected to show that output posted a modest increase in June. But this seems unlikely

France and Spain: Consumption and investment



Source: Refinitiv, Eurostat and Daiwa Capital Markets Europe Ltd.

Euro area: Unemployment



Source: Refinitiv, Eurostat and Daiwa Capital Markets Europe Ltd.

to have offset weakness earlier in the quarter, to leave output down in Q2 compared with Q1. June production figures are also due from France (Thursday), Italy and Spain (Friday), with French trade figures also scheduled (Friday). Meanwhile, following today's flash CPI estimate, the coming week's euro area PPI figures (Tuesday) might provide further insight into price pressures at the factory gate at the end of Q2.

In terms of survey indicators, final manufacturing and services PMIs are due on Monday and Wednesday respectively, with the euro area composite PMI expected to align with the 1.1pt increase to 60.6 – the best since 2000 – recorded in the preliminary release, as the flash services PMI rose more than 2pts to 60.4, the best on the survey in 15 years but the manufacturing output PMI fell 1.7pts to a 5-month low of 60.9. Thursday, meanwhile will bring the July construction PMIs from the euro area and various member states.

UK

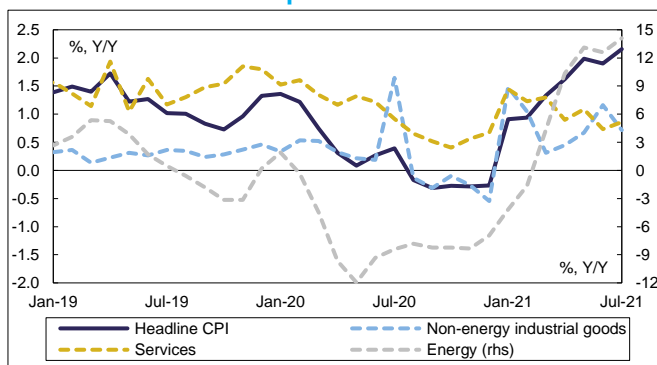
The week ahead in the UK

After a quiet end to the week for UK economic news, the main event in the UK in the coming week will be the BoE's latest monetary policy announcement on Thursday, which will be accompanied by updated macroeconomic projections. Hawkish noises from two MPC members – Deputy Governor Ramsden and, in particular, external member Saunders – recently suggested that there was a risk that the QE programme might be brought to an early end at this meeting. However, since then, Deputy Governor Broadbent, and external members Haskel and Vlieghe – the latter for whom this will be the final MPC meeting – have suggested that they see no need to tighten policy yet. And so, we expect the asset purchase target to be left unchanged at £895bn, with the full amount to be reached before the end of the year. The MPC will also maintain its forward guidance, stating that it “does not intend to tighten monetary policy at least until there is clear evidence that significant progress is being made in eliminating spare capacity and achieving the 2% inflation target sustainably”. The decision not to curtail QE early will reflect the BoE's updated forecasts. While both the near-term profile for GDP and inflation will be revised higher than expected in May, the BoE will continue to forecast GDP to slow and inflation to fall back in 2022 to be close to target by the end of the projection horizon.

It is possible – but far from certain – that, on Thursday, the BoE will also announce the outcome of its review of its tightening strategy. Up to now, the Bank has stated that it would not start to unwinding quantitative easing before Bank Rate has reached 1.5%. It is possible that the Bank could lower that threshold for Bank Rate, while maintaining rate hikes as the primary tool for tightening policy. Alternatively, it could announce a more flexible approach, giving itself scope to adjust the mix and sequence of rate hikes and reductions in the stock of purchased assets according to how economic and financial market conditions unfold.

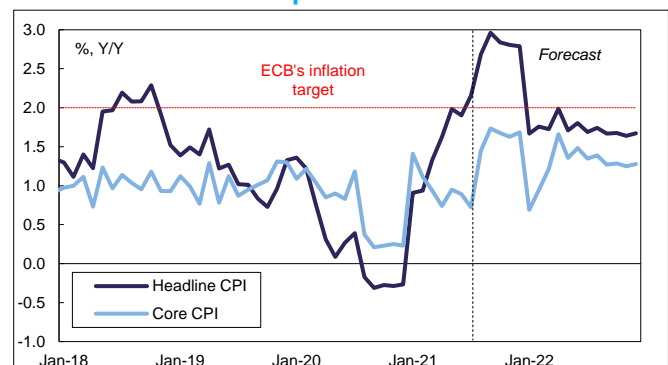
In terms of data, the coming week brings the final July manufacturing and services PMIs (on Monday and Wednesday respectively). In contrast to the euro area, the preliminary surveys revealed a further notable drop in the manufacturing and services output indices, suggesting that growth momentum might have passed its peak. Indeed, the flash composite PMI fell a sizeable 4.5pts to 57.7 in July, a four-month low, with a slowing in growth of new orders and difficulties associated with supply bottlenecks and staff shortages. Thursday will bring the equivalent construction PMI, which might also see the headline activity index fall back from the 24-year high (66.3) recorded in June. That day will also see the release of car registrations numbers for July, which are likely to show another solid month of annual growth due to base effects but may also highlight how ongoing supply constraints continue to limit sales.

Euro area: Consumer price inflation














Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Consumer price inflation forecast



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Daiwa economic forecasts






	2020	2021				2022	2020	2021	2022
	Q4	Q1	Q2	Q3	Q4	Q1			
GDP growth, %, Q/Q									
Euro area 	-0.6	-0.3	2.0	1.6	1.2	1.0	-6.5	4.6	4.4
UK 	1.3	-1.6	4.4	2.5	2.3	1.0	-9.8	6.7	5.9
Euro area									
Headline CPI 	-0.3	1.1	1.8	2.6	2.8	1.7	0.3	2.1	1.7
Core CPI 	0.2	1.2	0.9	1.3	1.7	1.0	0.7	1.2	1.3
UK									
Headline CPI 	0.6	0.6	2.0	2.7	3.4	3.4	0.9	2.2	2.2
Core CPI 	1.3	1.2	1.8	2.5	2.9	2.8	1.4	2.1	2.1
ECB									
Refi Rate % 	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Deposit Rate % 	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50
PEPP envelope* (€bn) 	1850	1850	1850	1850	1850	1850	1850	1850	1850
BoE									
Bank Rate % 	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Bond purchases** (£bn) 	895	895	895	895	895	895	895	895	895

*Monthly target €bn, end of period. **Monthly target £bn, end of period. Source: Bloomberg, ECB, BoE and Daiwa Capital Markets Europe Ltd.

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ Daiwa forecast	Previous	Revised
EMU 	Flash CPI (core CPI) Y/Y%	Jul	2.2 (0.7)	<u>2.0 (0.7)</u>	1.9 (0.9)	-
	Preliminary GDP Q/Q% (Y/Y%)	Q2	2.0 (13.7)	<u>1.2 (12.9)</u>	-0.3 (-1.3)	-
	Unemployment rate %	Jun	7.7	7.9	7.9	8.0
Germany 	Preliminary GDP Q/Q% (Y/Y%)	Q2	1.5 (9.2)	<u>2.0 (9.5)</u>	-1.8 (-3.1)	-2.1 (-)
France 	Preliminary GDP Q/Q% (Y/Y%)	Q2	0.9 (18.7)	<u>1.0 (17.8)</u>	-0.1 (1.2)	0.0 (1.7)
	Consumer spending M/M% (Y/Y%)	Jun	0.3 (-2.4)	0.7 (-2.1)	10.4 (7.4)	10.6 (7.6)
Italy 	Preliminary CPI (EU-harmonised CPI) Y/Y%	Jul	1.2 (1.6)	1.0 (1.4)	1.5 (1.9)	-
	Unemployment rate %	Jun	9.7	10.6	10.5	10.2
	Preliminary GDP Q/Q% (Y/Y%)	Q2	2.7 (17.3)	<u>1.2 (15.3)</u>	0.1 (-0.8)	0.2 (-0.7)
Spain 	Preliminary CPI (EU-harmonised CPI) Y/Y%	Jul	1.8 (0.9)	1.6 (1.0)	1.3 (1.3)	-
	Preliminary GDP Q/Q% (Y/Y%)	Q2	2.8 (19.8)	<u>2.2 (19.0)</u>	-0.4 (-4.2)	-
	Retail sales Y/Y%	Jun	1.4	10.0	19.6	19.7






































Auctions

Country	Auction
- Nothing to report -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.














The coming week's data calendar

The coming week's key data releases

Country	BST	Release	Period	Market consensus/ <i>Daiwa</i> <i>forecast/actual</i>	Previous	
Monday 02 August 2021						
Euro area		09.00	Final manufacturing PMI	Jul	62.6	63.4
Germany		07.00	Retail sales M/M% (Y/Y%)	Jun	1.8 (3.0)	4.6 (-1.8)
		08.55	Final manufacturing PMI	Jul	65.6	65.1
France		08.50	Final manufacturing PMI	Jul	58.1	59.0
		-	New car registrations* Y/Y%	Jul	-	-14.7
Italy		08.45	Manufacturing PMI	Jul	61.5	62.2
		17.00	New car registrations Y/Y%	Jul	-	12.6
Spain		08.15	Manufacturing PMI	Jul	59.5	60.4
		-	New car registrations* Y/Y%	Jul	-	17.1
UK		00.01	Lloyds business barometer	Jul	-	33
		09.30	Final manufacturing PMI	Jul	60.4	63.9
Tuesday 03 August 2021						
Euro area		10.00	PPI Y/Y%	Jun	10.3	9.6
Spain		08.00	Unemployment change '000s	Jul	-	166.9
Wednesday 04 August 2021						
Euro area		09.00	Final services (composite) PMI	Jul	60.4 (60.6)	58.3 (59.5)
		10.00	Retail sales M/M% (Y/Y%)	Jun	1.5 (4.6)	4.6 (9.0)
Germany		08.55	Final services (composite) PMI	Jul	62.2 (62.5)	57.5 (60.1)
		-	New car registrations* Y/Y%	Jul	-	24.5
France		08.50	Final services (composite) PMI	Jul	57.0 (56.8)	57.8 (57.4)
Italy		08.45	Services PMI (composite)	Jul	58.3 (59.1)	56.7 (58.3)
		09.00	Retail sales M/M% (Y/Y%)	Jun	-	0.2 (13.3)
Spain		08.15	Services (composite) PMI	Jul	63.3 (63.0)	62.5 (62.4)
UK		09.30	Final services (composite) PMI	Jul	57.8 (57.7)	62.4 (62.2)
Thursday 05 August 2021						
Euro area		08.30	Construction PMI	Jul	-	50.3
Germany		07.00	Factory orders M/M% (Y/Y%)	Jun	2.0 (22.4)	-3.7 (54.3)
		08.30	Construction PMI	Jul	-	47.0
France		07.45	Industrial production M/M% (Y/Y%)	Jun	0.5 (7.6)	-0.3 (20.5)
		07.45	Manufacturing production M/M% (Y/Y%)	Jun	-	-0.5 (22.3)
		08.30	Construction PMI	Jul	-	48.9
Italy		08.30	Construction PMI	Jul	-	57.9
UK		09.00	New car registrations Y/Y%	Jul	-	28.0
		09.30	Construction PMI	Jul	64.0	66..3
		12.00	BoE Bank Rate %	Aug	<u>0.10</u>	0.10
		12.00	BoE Gilt purchases target £bn	Aug	<u>875</u>	875
Friday 06 August 2021						
Germany		07.00	Industrial production M/M% (Y/Y%)	Jun	0.5 (7.9)	-0.3 (17.3)
France		07.45	Trade balance €bn	Jun	-	-6.8
Italy		09.00	Industrial production M/M% (Y/Y%)	Jun	0.8 (12.8)	-1.5 (21.1)
Spain		08.00	Industrial production M/M% (Y/Y%)	Jun	0.7 (14.1)	4.3 (26.0)

*Approximate date of release. Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions

Country	BST	Event / Auction
Monday 02 August 2021		
- Nothing scheduled -		
Tuesday 03 August 2021		
UK		10.00 Auction: £2bn of 1.25% 2051 bonds
Wednesday 04 August 2021		
Germany		10.30 Auction: €4bn of 0% 2026 bonds
Thursday 05 August 2021		
Euro area		09.00 ECB publishes Economic Bulletin
France		09.50 Auction: 1.5% 2031 bonds
		09.50 Auction: 1.25% 2034 bonds
		09.50 Auction: 5.75% 2032 bonds
Spain		09.30 Auction: 0% 2024 bonds
		09.30 Auction: 0% 2026 bonds
		09.30 Auction: 0.5% 2031 bonds
		09.30 Auction: 1% 2030 index-linked bonds
UK		12.00 BoE monetary policy announcement and publication of Monetary Policy Report
		12.00 BoE publishes monthly Decision Maker Panel data
Friday 06 August 2021		
UK		12.15 BoE Deputy Governor Broadbent hosts online briefing for businesses

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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