

# Euro wrap-up

## Overview

- Bunds rallied as the final euro area services PMIs reaffirmed the impression of a loss of momentum in June, while French IP and German auto output and sales data remained subdued.
- While the UK services PMIs were revised up substantively, Gilts made gains as the BoE stated that the economic outlook has “deteriorated markedly” and UK car sales registered their weakest June since 1996.
- Wednesday will bring euro area retail sales and German factory orders data for May, as well as the construction PMIs for June.

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### Daily bond market movements

Bond	Yield	Change
BKO 0.2 06/24	0.406	-0.190
OBL 1.3 10/27	0.848	-0.184
DBR 0 02/32	1.176	-0.151
UKT 1 04/24	1.636	-0.130
UKT 1½ 07/27	1.703	-0.132
UKT 4¼ 06/32	2.051	-0.142

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

## Euro area

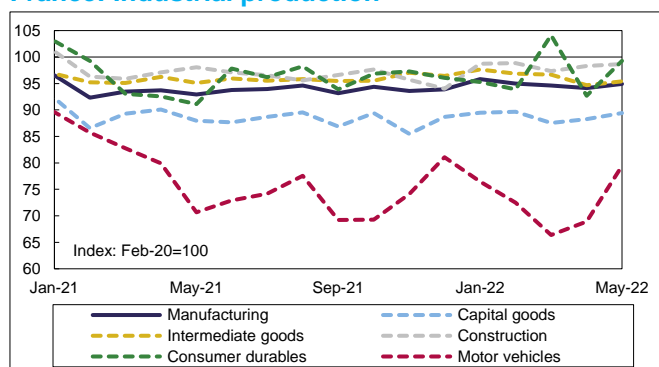
### French IP on track for Q2 contraction despite uptick in May and stronger car output

Following three successive monthly declines, French manufacturing output rose in May to restore the broadly sideways trend of the past year and a half. But the increase of 0.8%M/M, following a revised drop of 0.5%M/M in April, left it still below the levels in the first two months of the year, and indeed still more than 5% below the pre-pandemic level in February 2020. Perhaps encouragingly, the production of motor vehicles grew for the second successive month, rising 15.3%M/M in May after growth of 3.8%M/M the prior month to reach its highest level since December, albeit still more than 20% below the pre-pandemic level. Unsurprisingly, changes in other components were typically more moderate, e.g. output of machinery and equipment was up 0.6%M/M after a larger drop in April. But production of coke and refined petroleum was up a steep 5.9%M/M. Output of consumer durables rose 7.1%M/M, while growth in intermediate (0.8%M/M) and capital goods (1.3%M/M) was less vigorous. And, with food and drink production falling on supply woes, output of consumer non-durables dropped slightly (-0.3%M/M). Meanwhile, as nuclear-generated power remained extremely subdued by the standards of recent years, energy output dropped 4.4%M/M to the lowest level since the first wave of Covid-19 in April 2020. But other utilities were stronger, and construction output grew for a second successive month. So, overall industrial production was unchanged on the month in May. That, however, left the average level of production in the first two months of Q2 a little more than 1.0% below the Q1 average. So, with surveys suggesting a weak June – the manufacturing output PMI dropped 4.5pts to an eight-month low of 46.5 – the industrial sector looks highly to have subtracted from French GDP growth last quarter.

### German car production and sales remain well below pre-pandemic levels

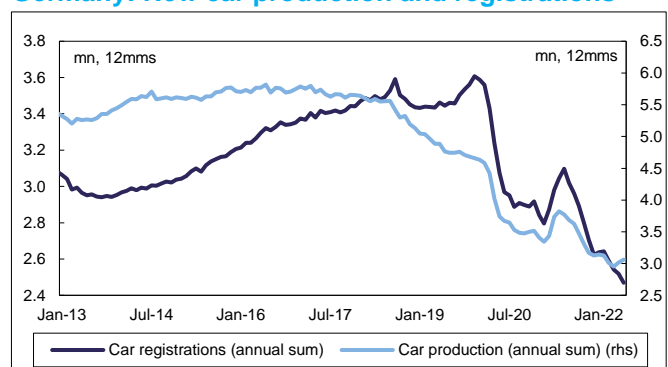
According to an ifo institute survey, the business situation for Germany's autos manufacturers improved somewhat in June, with the relevant index up to the highest since January. And at face value, today's production figures for last month from Germany's auto association (VDA) were more encouraging, with growth of 19%Y/Y. But this was flattered somewhat by the low level last year, with the unadjusted level moving broadly sideways, and still about 38% below the June average in the five years before the pandemic. Contrasting with the production figures, German new car registrations remained well down on levels a year ago, with just 225k units sold in June, down 18%Y/Y and roughly 30% lower than the average for that month in the five years before the pandemic. While automakers planned to increase production over coming months, rating their order books to be significantly improved, the ifo survey also suggested that car manufacturers were not overly optimistic about overall prospects in the sector despite continuing to command high sales prices. Suppliers for the sector were also more downbeat about both current and future business, noting that they expect to cut back on production. Of course, while the weakness in production has principally reflected supply bottlenecks, the recent slump in consumer confidence might well become an increasingly negative impact on demand over coming months too.

### France: Industrial production



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

### Germany: New car production and registrations



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

## Final euro area services PMIs signals a significant loss of momentum in June

Having significantly missed expectations on the preliminary release, today's final services PMIs for June offered no major surprises, still signaling a notable loss of momentum at the end of Q2. Despite a modest upwards revision from the flash, the euro area services activity PMI declined for the second successive month and by more than 3pts – the most since the second pandemic wave in November 2020 – to 53.0, a level that is typically consistent with expansion but was nevertheless the softest since January. There was also a marked weakening in new business, from both at home and abroad. With concerns about persistently high inflation – the survey's measures of input costs and prices charged remained close to the series highs despite easing slightly in June – and heightened global economic uncertainty, services firms revised down their expectations for the coming twelve months to the lowest since October 2020. The weakening trend was evident across all of the large member states, with the headline PMIs declining between 2-4½pts from May, taking the respective indices in Germany (52.4), France (53.9), Italy (51.6) and Spain (54.0) to the lowest since January's Omicron wave of Covid-19.

## Composite PMIs suggest euro area growth stagnated in Q2

Like the services index, the euro area's composite output PMI was nudged insignificantly higher from the flash. And with the [manufacturing survey](#) signalling that production had gone into reverse at the end of Q2, the composite index still fell 2.8pts in June to 52.0, a sixteen-month low. This left the quarterly euro area composite PMI (54.2) unchanged from Q1, perhaps suggesting that the economy stagnated in Q2. However, the respective performances among member states was mixed. In Germany, the composite PMI in June (51.3) fell to a six-month low, to leave the Q2 average a sizeable 1.7pts lower than in Q1, supporting our view that the euro area's largest economy contracted last quarter. In contrast, the equivalent French and Italian quarterly composite PMIs were 0.9pt higher in Q2, while the Spanish index jumped 2.5pts following a drop of more than 4pts in Q1.

## The day ahead in the euro area

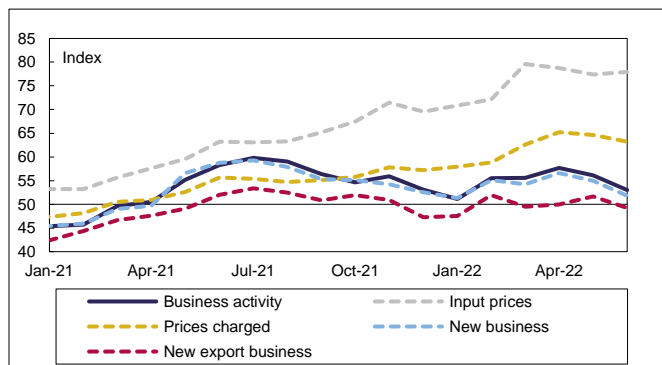
The euro area's data highlight tomorrow will be May's retail sales figures, which are likely to report moderate growth (0.5%M/M) insufficient to reverse the decline of 1.3%M/M in April. We will also get further data from the manufacturing sector including German new factory orders, which are expected to have declined for the fourth successive month in May due to weak external demand – the Bloomberg consensus is for a drop of 0.5%M/M, following April's fall of 2.7M/M in April, to leave them down 5%Y/Y. Spanish IP data for May are also expected to report that output declined. In addition, the construction PMIs for June will provide an update on activity in the sector in Germany, France and Italy, with the former having previously pointed to ongoing contraction but the latter ongoing solid expansion. Overall, the euro area construction PMI seems likely to signal a pause in growth in the sector as a whole at the end of Q2.

## UK

### Despite upwards revision, UK services PMIs still well down from levels earlier in the year

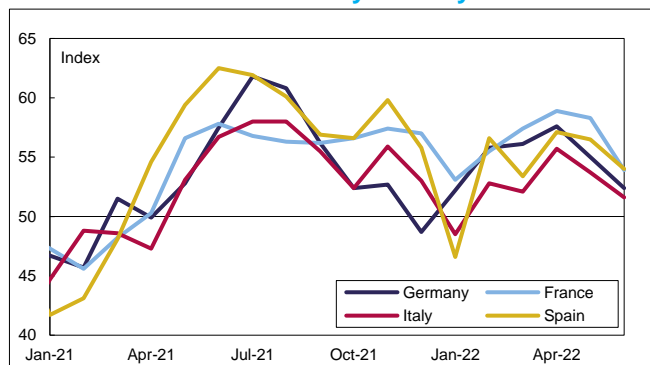
Today's upwards revision to the UK services activity PMI for June was surprising, particularly as survey responses for the week of national rail strikes was included. Having been initially estimated as unchanged on the month, the headline activity index was upwardly revised by 0.9pt in June to 54.3. S&P Global noted a rise in consumer spending on travel, leisure and events, although there were also many reports of lower spending on discretionary items amid increasingly squeezed household budgets. And despite the slight improvement on the month, the headline PMI still marked a substantial slowdown from the peaks seen earlier in the year, with the quarterly average some 3.5pts lower in Q2 and the June reading more than 8pts lower than in March. Although export sales were boosted by a resumption of international travel, domestic demand remained very subdued, with the survey's new business component down for the fourth consecutive month and by 2.6pts to 51.6, the lowest since February 2021. Meanwhile, more than two-thirds of respondents reported a rise in cost burdens in

**Euro area: Services PMIs**



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

**Euro area: Services PMIs by country**



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

June, linked in particular to energy, fuel and wage costs, and Global S&P noted that some firms had reported mid-year pay increases. So, prices charged by services providers also reportedly continued to rise at a rapid pace, with around 37% of survey respondents indicating an increase in June. Given concerns about persistently elevated inflation, risks of recession, and the impact of rising interest rates, firms in the sector were the least upbeat about expected business activity over the year ahead since May 2020. Overall, while the composite PMI was similarly revised higher in June, at 53.7 it remained more than 7pts lower than in March, with the quarterly average more than 3pts lower in Q2 too.

### New car registrations have worst June since 1996

According to the SMMT, new car sales maintained their woeful run in June. With demand weighed by record-low consumer confidence and – seemingly more importantly for now – production impeded by ongoing supply-chain challenges, new car registrations fell 24.3%Y/Y to 141k, the lowest level for the month since 1996. That left sales in the first half of the year down 11.9%YTD/Y to 802k, the second-lowest level in three decades, only beating the Covid-afflicted sales of H120 over that period. There remained strong growth in electric and hybrid sales, however. Indeed, new registrations of battery electric vehicles were up 56.0%YTD/Y, taking the market share to 14.4% from 8.1% over the same period last year.

### BoE flags deteriorating economic outlook in Financial Stability Report

Gilt received a boost today as the BoE's Financial Stability Report acknowledged unambiguously that the "economic outlook for the UK and globally has deteriorated materially" as inflationary pressures have "intensified sharply" and global financial conditions have "tightened significantly". It added that the "outlook is subject to considerable uncertainty and there are a number of downside risks that could adversely affect UK financial stability". But while that assessment generated headlines, however, it was broadly consistent with the messages of the past couple of Monetary Policy Committee (MPC) statements and the May Monetary Policy Report. So, it does not necessarily suggest that the MPC's reaction function will have become any more dovish since its last meeting on 16 June.

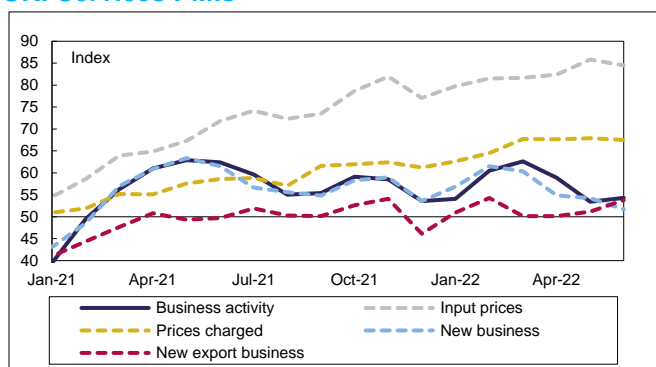
### FPC raises Countercyclical Capital Buffer rate to 2%, but willing to cut it again if necessary

Indeed, while the BoE acknowledged that the rise in inflation and interest rates will put increased pressure on UK consumer finances, it also assessed that the share of households with high debt-servicing ratios – who are typically more likely to experience repayment difficulties – is unlikely to increase substantially this year, in part thanks to the government's fiscal support measures announced in May. Despite significant cost pressures for sectors exposed to energy prices, it also judged that debt-servicing remained affordable for most UK businesses. And given stronger balance sheets and the greater preponderance of fixed-rate borrowing, Deputy Governor Cunliffe suggested in the post-FPC press conference that Bank Rate might have to rise above 5% – at least 2ppts above the terminal level currently priced by the market – for debt-servicing costs to reach levels seen during the financial crisis 14 years ago. Moreover, the Financial Policy Committee (FPC) judged that major UK banks have considerable capacity to support lending to households and businesses over coming months even with the deterioration in the economic outlook. So, today the FPC confirmed its preliminary decision from December to raise the UK's Countercyclical Capital Buffer (CCyB) rate from 1% to 2% from July 2023, reflecting its judgement that domestic financial sector vulnerabilities remain broadly at their pre-pandemic level. However, the FPC added that if economic conditions deteriorate significantly more than currently expected – in a manner that might lead banks to restrict lending – the FPC will be prepared to cut the UK CCyB rate once again.

### The day ahead in the UK

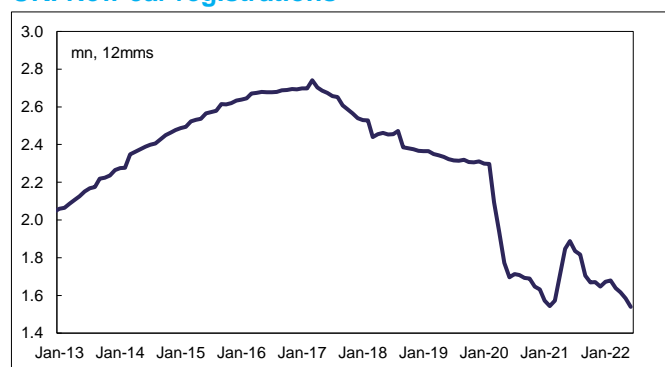
In contrast to the euro area, the UK's construction PMI is expected to suggest continued growth in the sector, albeit with the headline index easing somewhat to 55.0 in June, from 56.4 previously.

#### UK: Services PMIs



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

#### UK: New car registrations













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



# European calendar

## Today's results

### Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area	 Final services (composite) PMI	Jun	<b>53.0 (52.0)</b>	52.8 (51.9)	56.1 (54.8)	-
Germany	 Final services (composite) PMI	Jun	<b>52.4 (51.3)</b>	52.4 (51.3)	55.0 (53.7)	-
	 New car registrations (production) Y/Y%	Jun	<b>-18.1 (19.2)</b>	-	-10.2 (24.7)	-
France	 Industrial production M/M% (Y/Y%)	May	<b>0.0 (-0.4)</b>	0.0 (0.3)	-0.1 (-0.3)	<b>-0.3 (-0.6)</b>
	 Manufacturing production M/M% (Y/Y%)	May	<b>0.8 (2.2)</b>	0.3 (1.7)	-0.4 (0.8)	<b>-0.5 (0.5)</b>
	 Final services (composite) PMI	Jun	<b>53.9 (52.5)</b>	54.4 (52.8)	58.3 (57.0)	-
Italy	 Services (composite) PMI	Jun	<b>51.6 (51.3)</b>	51.5 (50.7)	53.7 (52.4)	-
Spain	 Services (composite) PMI	Jun	<b>54.0 (53.6)</b>	53.5 (53.6)	56.5 (55.7)	-
UK	 Final services (composite) PMI	Jun	<b>54.3 (53.7)</b>	53.4 (53.1)	53.4 (53.1)	-
	 New car registrations Y/Y%	Jun	<b>-24.3</b>	-	-20.6	-









### Auctions

Country	Auction
Germany	 sold €416mn of 0.1% 2033 index-linked bonds at an average yield of -0.9%
UK	 sold £2bn of 1.25% 2051 bonds at an average yield of 2.531%





Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

## Tomorrow's releases

### Economic data

Country	BST	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
Euro area	 08.30	Construction PMI	Jun	-	49.2
	 10.00	Retail sales M/M% (Y/Y%)	May	0.5 (-0.1)	-1.3 (3.9)
Germany	 07.00	Factory orders M/M% (Y/Y%)	May	-0.5 (-5.0)	-2.7 (-6.2)
	 08.30	Construction PMI	Jun	-	45.4
France	 08.30	Construction PMI	Jun	-	50.9
Italy	 08.30	Construction PMI	Jun	-	54.3
Spain	 08.00	Industrial production M/M% (Y/Y%)	May	-0.5 (3.3)	2.1 (2.4)
UK	 09.30	Construction PMI	Jun	55.0	56.4

### Auctions and events

Euro area	 08.00	ECB's Rehn scheduled to speak
Germany	 10.30	Auction: €5bn of 1.7% 2032 bonds
UK	 09:10	BoE Chief Economist Pill to give keynote speech at global banking conference
	 14.00	BoE Deputy Governor Cunliffe to participate in digital currency panel at global banking conference

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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<https://www.uk.daiwacm.com/ficc-research/recent-blogs>

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