

Euro wrap-up

Overview

- Bunds and other euro area government bonds rallied as the flash euro area PMIs for July flagged recession risks.
- While the UK flash PMIs were not as weak as their euro area counterparts, Gilts also rallied as UK retail sales fell for a fourth successive quarter in Q2.
- The coming week will bring the flash estimates of euro area inflation in July and GDP in Q2.

Chris Scicluna
+44 20 7597 8326

Emily Nicol
+44 20 7597 8331

Daily bond market movements

Bond	Yield	Change
BKO 0.2 06/24	0.378	-0.238
OBL 1.3 10/27	0.748	-0.263
DBR 1.7 08/32	1.019	-0.195
UKT 1 04/24	1.805	-0.167
UKT 1½ 07/27	1.686	-0.149
UKT 4¼ 06/32	1.930	-0.111

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

Euro area

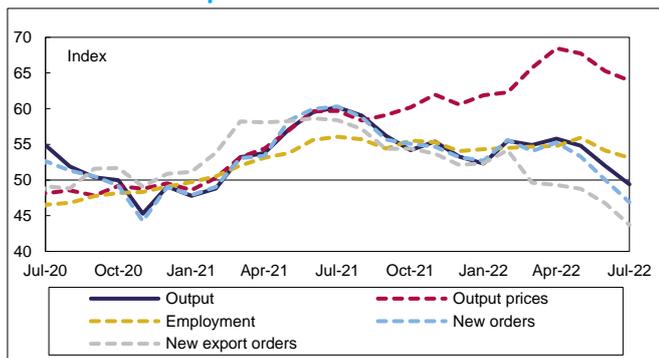
Flash euro area PMIs signal contraction for the first time since February 2021

According to the flash PMIs for July, the euro area economy contracted at the start of Q3 for the first time since February 2021 during the second lockdown, as the erosion of households' purchasing power exacerbated the waning impact of the post-lockdown rebound in demand. Indeed, the euro area composite output PMI dropped for a third successive month and by a larger-than-expected 2.6pts to a seventeen-month low of 49.4, some 6½pts lower than in April and almost 11pts lower than a year ago. While the weakening trend was evident across both sectors, there was a striking decline in the manufacturing output index, by 3.2pts – the most since September 2021 – to 46.1, the lowest for more than two years, with chemicals and autos manufacturers reportedly driving the reversal. And with the exception of lockdown periods, today's survey suggested the steepest contraction in industrial production since December 2012. New factory orders also dropped by the most since the start of the pandemic despite some further signs of easing supply bottlenecks. Today's survey suggested that services activity barely grew at the start of Q3 too, with consumer-facing firms related to tourism, recreation and transportation feeling the pinch having rebounded over recent months. Indeed, the headline services activity PMI fell for the third consecutive month and by 2.6pts to a fifteen-month low of 50.6, with new business also contracting for the first time since April 2021. Overall, the composite new orders PMI (46.9) was the lowest outside of the pandemic lockdown periods for more than nine years. So, while firms hinted at a further very modest easing of price pressures, they again revised down their expectations for the coming twelve months to the lowest since May 2020 and a level that has rarely been seen in the survey history.

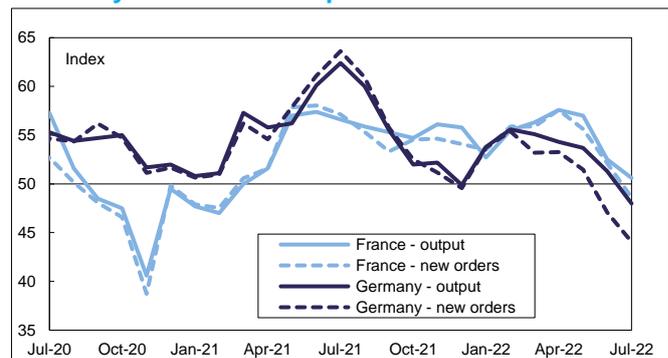
German PMIs signal contraction, with the French PMIs implying near-stagnation too

Among the largest member states, Germany led the deterioration, with the PMIs suggestive of contracting economic activity for the first time this year and the worst performance for more than two years. Indeed, the composite output PMI fell for the fifth consecutive month and by 3.3pts – the most since the start of the third pandemic wave – to 48.0, with new orders contracting at an even steeper pace (44.1) as supply shortages (which risk worsening not least due to the exceptionally low water level in the River Rhine, which will impede important river freight) stretched client budgets and the uncertain outlook weighed on demand. While the manufacturing contraction was more severe – the output index slumped to a 25-month low of 45.4 – services activity also reportedly fell for the first time since December, attributed to staff shortages and waning new business. And S&P Global suggested that expectations for the coming twelve months turned notably negative. The French PMIs also implied a marked slowdown at the start of Q3, as new business fell for the first time since February 2021. Indeed, the composite PMI fell almost 2pts to a sixteen-month low of 50.6, suggesting a broadly stagnating economy as ongoing moderate growth in services (52.1) was offset by a steep slump in manufacturing (44.0). And S&P Global reported that

Euro area: Composite PMIs



Germany & France: Composite PMIs



manufacturing output growth slipped into negative territory in the remainder of the euro area for the first time in two years, while services activity also slowed.

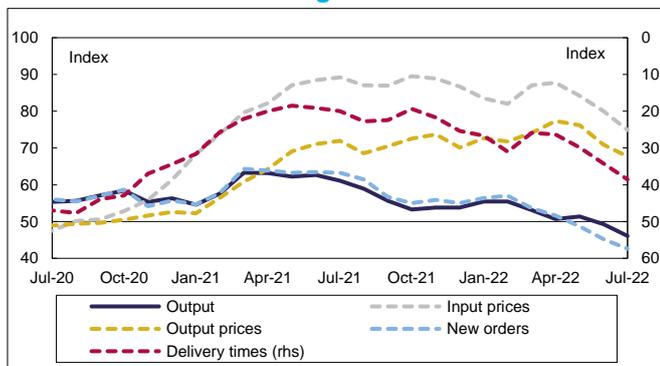
PMIs point to easing price pressures, by forecasters revise higher longer-term expectations

Today's PMIs pointed to a slight easing in price pressures at the start of the third quarter. But they still remained extremely elevated by historical standards. The composite input price index fell 3.5pts to a five-month low of 75.0, with the equivalent manufacturing component down to a seventeen-month low (74.9) and almost 15pts below October's peak. And while today's survey also implied that the rate of output price inflation eased for the third consecutive month, it was still consistent with historically strong rises in selling prices. Moreover, after euro area HICP inflation rose to a euro-era high in June (8.6%Y/Y), today's ECB Survey of Professional Forecasters (SPF) – published today but seen by the Governing Council before its decision to [raise rates by a larger-than-signalled 50bps yesterday](#) – reported an upwards revision to inflation expectations across the forecast horizon. Indeed, the mean headline and core inflation forecasts for this year were revised markedly higher from Q2, and well above the ECB's June forecasts, to 7.3% and 3.6% respectively. But the forecasts for 2023 and 2024 were broadly in line with the ECB's June projections. And while the SPF revised higher the mean forecast for longer-term inflation, by 0.2ppt to a record 2.2%, the median forecast was unchanged at 2.0%Y/Y, bang on target.

The week ahead in the euro area

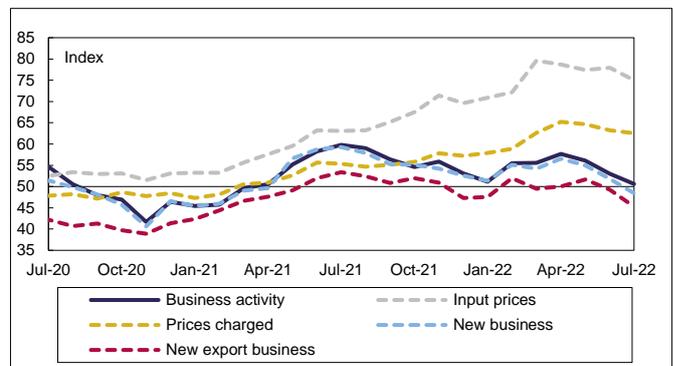
The coming week brings a number of top-tier euro area economic data releases, most notably the flash inflation figures for July and Q2 GDP on Friday. We forecast that the headline HICP rate will remain close to June's 30-year high of 8.6%Y/Y, perhaps edging down just 0.1ppt to 8.5%Y/Y due principally to lower petrol prices. But the risks to that forecasts are skewed to the upside. And we expect the core rate to rise 0.2ppt to 4.5%Y/Y as cost pressures continue to be passed by firms to consumers. The flash data from Germany (Thursday) will give a clue as to what to expect for the euro area as a whole. The end of the week will also bring the first estimates of Q2 GDP data for the euro area and the four largest member states. We forecast that euro area GDP was unchanged on the quarter (+3.2%Y/Y) as household consumption was constrained by high inflation and external demand softened. However, the risks to that forecast are likely skewed to the upside, as spending on tourism and recreational services likely rebounded as pandemic restrictions eased. In Germany, we expect GDP to contract 0.2%Q/Q (+1.4%Y/Y) as the manufacturing sector continued to struggle with supply constraints. But we expect modest growth in France, Italy and Spain thanks to the pickup in consumer-facing services. In terms of more timely indicators of activity, survey data for July include the German ifo business conditions indices (Monday), consumer confidence reports from Germany, France and Italy (Wednesday) and the European Commission's comprehensive economic sentiment indicators on Thursday. And Friday will bring German labour market data for July.

Euro area: Manufacturing PMIs



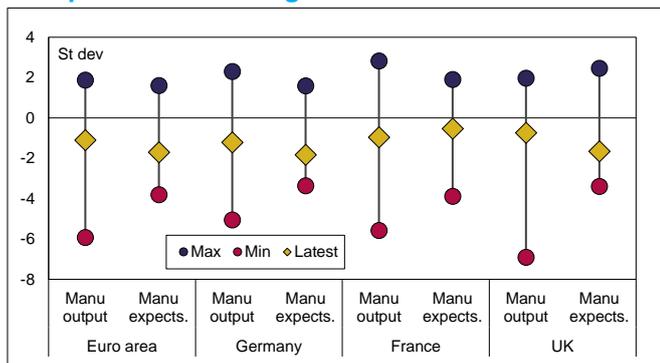
Source: Refinitiv, S&P Global and Daiwa Capital Markets Europe Ltd.

Euro area: Services PMIs



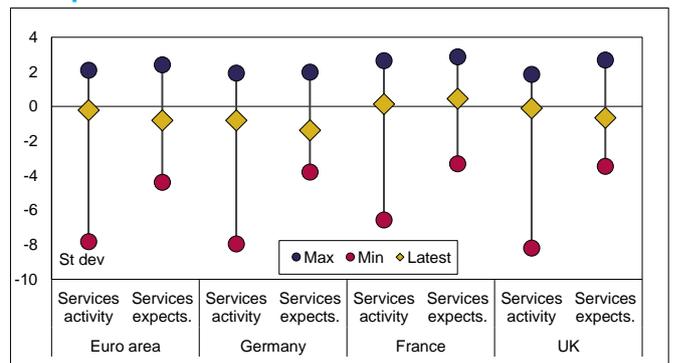
Source: Refinitiv, S&P Global and Daiwa Capital Markets Europe Ltd.

Europe: Manufacturing PMIs



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

Europe: Services PMIs



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

UK

Real retail sales down for fourth successive quarter in Q2 despite modest drop in June

In real terms, retail sales fell a little less than expected in June, declining just 0.1%M/M, which might suggest some resilience in the face of high inflation. Indeed, in part, the drop reflected a sharp fall in auto fuel sales, as many consumers reportedly delayed filling up their tanks in the face of record high petrol prices – excluding fuel, sales unexpectedly rose 0.4%M/M. However, overall sales in June were flattered by an exceptional surge of 3.1%M/M in purchases of food related to the extra bank holiday that month. In contrast, non-food sales fell 0.7%M/M as purchases of clothing fell a steep 4.7%M/M and household goods fell 3.7%M/M, with both components probably impacted by the rail strikes at the end of the month. Most notably, however, while the overall drop in sales in June was modest, the decline over Q2 as a whole was substantive, and represented the fourth successive quarterly fall. In particular, with sales in May revised down (now estimated to have fallen 0.8%M/M), real retail sales dropped 1.2%Q/Q last quarter, with the same pace of decline when auto sales are excluded. Illustrating the pronounced downward trend of the past year, while the level of sales in June was still 2.2% above the pre-pandemic level in February 2020, it was down a steep 5.8%Y/Y. However, with prices higher, in nominal terms, the value of sales was up 4.4%Y/Y in June and also up 2.4%Q/Q in Q2.

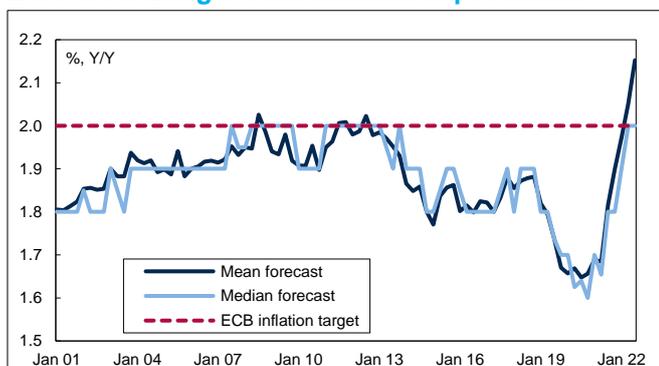
Consumer confidence remains close to series low suggesting that sales will remain weak

Looking ahead, sales seem bound to remain subdued at best. Indeed, the latest GfK consumer confidence survey suggested (unsurprisingly) that household sentiment remains exceptionally weak. While the headline confidence index rose a slight 1pt (to -41) in July, that came from the record low in June. Within the detail, households judged the recent economic performance to have been worse than previously expected, as the impact of higher inflation and rising interest rates continued to weigh. But while there was a very modest improvement in their expected financial situation over the coming twelve months, GfK attributed this to hopes of a cut in taxes once the next Prime Minister – still yet to be determined – takes office in the autumn. This notwithstanding, the relevant survey index remained some 37pts lower than a year ago. And so, households unsurprisingly still considered the climate for making major purchases to be extremely unfavourable – indeed, despite edging up 1pt on the month, at -34 the relevant index was 36pts lower than a year ago and well below the long-run average (-1).

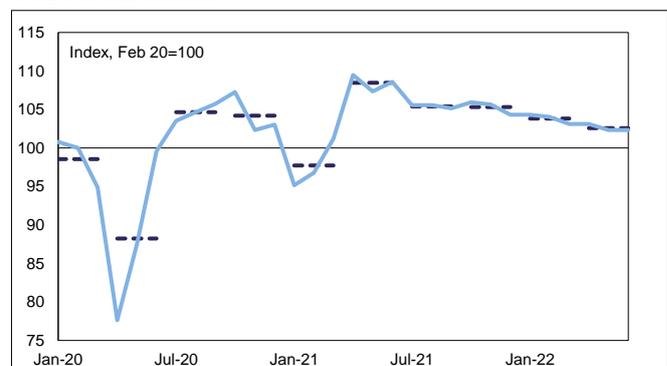
Flash UK PMIs suggest a slowing services expansion, and contraction in manufacturing

Contrasting with the euro area, today's flash UK PMIs still pointed to expansion at the start of the third quarter. Nevertheless, the composite PMI fell in July for the third month out of the past four, by 0.9pt to 52.8, roughly 3pts below the average in the first half of the year and implying the softest growth since February 2021. Despite a boost to spending on travel and leisure services (perhaps reflecting the warmer weather), the headline services activity index more than reversed the surprise increase in June to be down 1pt at 53.3, and 4pts below the average so far this year, albeit still signaling ongoing expansion. In contrast, the survey suggested that industrial production went into reverse for the first time for more than two years. Indeed, the manufacturing output index fell for the third consecutive month, by 0.6pt to 49.7. And softer demand led to the first drop in backlogs since June 2020, while new domestic and overseas fell at a steeper pace than June. So, while there were some signs that cost burdens had eased for a second successive month, firms were still relatively cautious about prospects for production over the coming year, reflecting not least the gloomy global economic outlook. And although some services were hoping the current slowdown would prove temporary, with consumer confidence at record low levels, interest rates set to increase further and household purchasing power eroded by higher prices, we do not expect a meaningful boost to services throughout the second half of the year.

Euro area: Longer-term inflation expectations



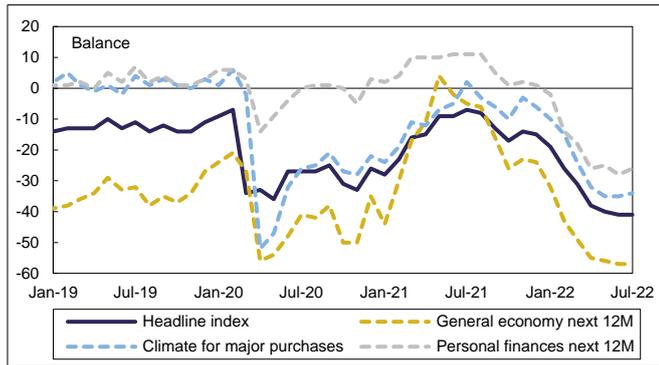
UK: Retail sales*



The week ahead in the UK

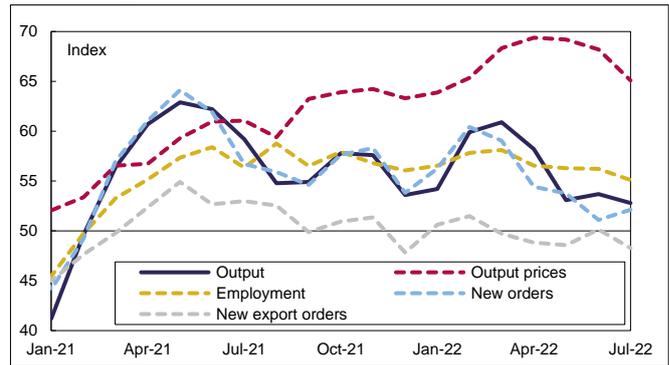
The coming week brings a number of UK economic sentiment surveys, with the CBI's industrial trends report for July due on Monday, followed by its distributive trades survey for the same month on Tuesday. Like today's preliminary manufacturing PMIs the industrial trends survey is expected to suggest some loss of recovery momentum in the sector. The CBI's retail trade survey, meanwhile, is also likely to indicate that conditions remain difficult for retailers, as high inflation squeezes household budgets. Indeed, Wednesday's BRC shop price index for July is likely to rise to a new series high. Other data due in the coming week include the Nationwide house price index on Thursday followed by the Lloyds business barometer and BoE lending data on Friday.

UK: Consumer confidence



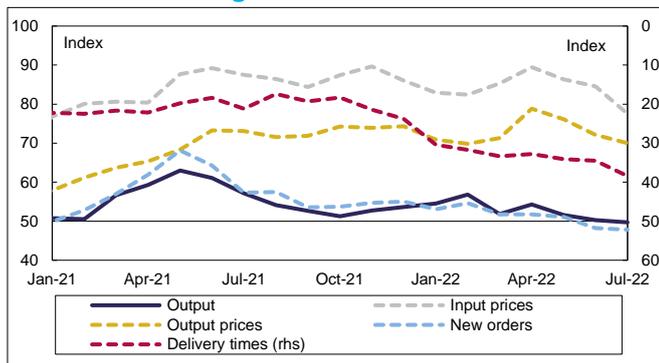
Source: Refinitiv, GfK and Daiwa Capital Markets Europe Ltd.

UK: Composite PMIs



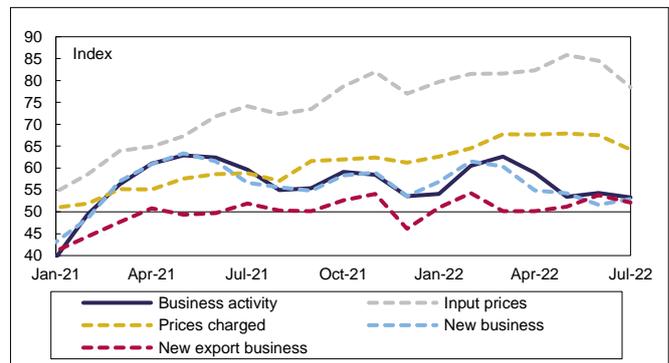
Source: Refinitiv, S&P Global and Daiwa Capital Markets Europe Ltd.

UK: Manufacturing PMIs



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

UK: Services PMIs



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

Daiwa economic forecasts

	2022				2023		2022	2023	2024
	Q1	Q2	Q3	Q4	Q1	Q2			
GDP	%, Q/Q						%, Y/Y		
Euro area 	0.6	0.0	0.2	-0.1	-0.2	0.0	2.6	-0.1	0.9
UK 	0.8	-0.1	0.1	-0.1	0.0	-0.1	3.5	-0.2	0.7
Inflation, %, Y/Y									
Euro area									
Headline HICP 	6.1	8.0	8.5	7.9	6.2	4.4	7.7	4.2	1.9
Core HICP 	2.7	3.7	4.0	4.2	4.1	3.9	3.6	3.6	2.1
UK									
Headline CPI 	6.2	9.1	9.9	10.4	9.7	6.5	8.9	6.3	2.5
Core CPI 	5.1	6.0	6.4	6.3	5.8	5.1	6.0	4.9	2.5
Monetary policy, %									
ECB									
Refi Rate 	0.00	0.00	1.00	1.50	1.75	1.75	1.50	1.75	1.50
Deposit Rate 	-0.50	-0.50	0.50	1.00	1.50	1.50	1.00	1.50	1.25
BoE									
Bank Rate 	0.75	1.25	2.00	2.50	2.50	2.50	2.50	2.50	2.00

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	
Euro area 	Preliminary manufacturing (services) PMI	Jul	49.6 (50.6)	51.0 (52.0)	52.1 (53.0)	-	
	Preliminary composite PMI	Jul	49.4	51.0	52.0	-	
Germany 	Preliminary manufacturing (services) PMI	Jul	49.2 (49.2)	50.7 (51.4)	52.0 (52.4)	-	
	Preliminary composite PMI	Jul	48.0	50.2	51.3	-	
France 	Preliminary manufacturing (services) PMI	Jul	49.6 (52.1)	51.0 (52.8)	51.4 (53.9)	-	
	Preliminary composite PMI	Jul	50.6	51.1	52.5	-	
UK 	GfK consumer confidence	Jul	-41	-42	-41	-	
	Retail sales including auto fuel M/M% (Y/Y%)	Jun	-0.1 (-5.8)	-0.2 (-5.3)	-0.5 (-4.7)	-0.8 (-)	
	Retail sales excluding auto fuel M/M% (Y/Y%)	Jun	0.4 (-5.9)	-0.4 (-6.2)	-0.7 (-5.7)	-1.0 (-5.5)	
	Preliminary manufacturing (services) PMI	Jul	52.2 (53.3)	52.0 (53.0)	52.8 (54.3)	-	
	Preliminary composite PMI	Jul	52.8	52.4	53.7	-	
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> forecast/actual	Previous	
Monday 25 July 2022						
Germany		09.00	ifo business climate index	Jul	90.2	92.3
		09.00	ifo current assessment (expectations)	Jul	97.5 (83.0)	99.3 (85.8)
UK		11.00	CBI industrial trends survey – total orders (selling prices)	Jul	12 (-)	18 (58)
		11.00	CBI industrial trends survey – business optimism	Jul	-	-34)
Tuesday 26 July 2022						
Spain		08.00	PPI M/M% (Y/Y%)	Jun	-	0.9 (43.6)
UK		11.00	CBI distributive trades survey – reported retail sales	Jul	-10	-5
Wednesday 27 July 2022						
Euro area		09.00	M3 money supply	Jun	5.4	5.6
Germany		07.00	GfK consumer confidence	Jul	-29.0	-27.4
France		07.45	INSEE consumer confidence	Jul	80	82
Italy		09.00	ISTAT business (manufacturing) confidence	Jul	- (108.0)	113.6 (110.0)
		09.00	ISTAT consumer confidence	Jul	96.0	98.3
		09.00	Hourly wages M/M% (Y/Y%)	Jun	-	0.1 (0.7)
UK		00.01	BRC shop price index Y/Y%	Jul	-	3.1
Thursday 28 July 2022						
Euro area		10.00	EC economic sentiment indicator	Jul	101.9	104.0
		10.00	EC industrial (services) confidence	Jul	6.0 (13.7)	7.4 (14.8)
		10.00	EC consumer confidence	Jul	-27.0	-23.8
Germany		13.00	Preliminary CPI M/M% (Y/Y%)	Jul	0.6 (7.4)	0.1 (7.6)
		13.00	Preliminary EU-harmonised CPI M/M% (Y/Y%)	Jul	0.4 (8.1)	-0.1 (8.2)
France		07.45	PPI M/M% (Y/Y%)	Jun	-	-0.1 (27.3)
Spain		08.00	Retail sales Y/Y%	Jun	-	1.4
UK		07.00	Nationwide house price index M/M% (Y/Y%)	Jul	-	0.3 (10.7)
Friday 29 July 2022						
Euro area		10.00	Preliminary CPI M/M% Y/Y%	Jul	<u>-0.2 (8.5)</u>	0.8 (8.6)
		10.00	Preliminary core CPI Y/Y%	Jul	<u>3.9</u>	3.7
		10.00	Preliminary GDP Q/Q% (Y/Y%)	Q2	<u>0.0 (3.2)</u>	0.6 (5.4)
Germany		08.55	Unemployment claimant rate % (change 000s)	Jul	5.4 (12.5)	5.3 (133)
		09.00	Preliminary GDP Q/Q% (Y/Y%)	Q2	<u>-0.2 (1.4)</u>	0.2 (3.8)
France		07.45	Preliminary CPI M/M% (Y/Y%)	Jul	0.1 (6.0)	0.7 (5.8)
		07.45	Preliminary EU-harmonised CPI M/M% (Y/Y%)	Jul	0.2 (6.7)	0.9 (6.5)
		07.45	Preliminary GDP Q/Q% (Y/Y%)	Q2	<u>0.2 (3.7)</u>	-0.2 (4.5)
		07.45	Consumer spending M/M% (Y/Y%)	Jun	-0.5 (-4.5)	0.7 (-3.4)
Italy		09.00	Preliminary GDP Q/Q% (Y/Y%)	Q2	<u>-0.1 (3.4)</u>	0.1 (6.2)
		10.00	Preliminary CPI M/M% (Y/Y%)	Jul	0.5 (8.0)	1.2 (8.0)
		10.00	Preliminary EU-harmonised CPI M/M% (Y/Y%)	Jul	-1.0 (8.6)	1.2 (8.5)
		11.00	PPI M/M% (Y/Y%)	Jun	-	0.3 (42.7)
Spain		08.00	Preliminary CPI M/M% (Y/Y%)	Jul	-0.3 (10.4)	1.9 (10.2)
		08.00	Preliminary EU-harmonised CPI M/M% (Y/Y%)	Jul	-1.0 (10.3)	1.9 (10.0)
		08.00	Preliminary GDP Q/Q% (Y/Y%)	Q2	<u>0.2 (5.3)</u>	0.2 (6.3)
UK		00.01	Lloyds business barometer	Jul	-	28
		09.30	Net consumer credit £bn (Y/Y%)	Jun	1.0 (-)	0.8 (5.7)
		09.30	Mortgage lending £bn (approvals 000s)	Jun	6.3 (64.0)	7.4 (66.2)

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

The coming week's key events & auctions

Country	BST	Event / Auction
Monday 25 July 2022		
Euro area 	09.00	ECB publishes Survey of Monetary Analysts
UK 	09.30	BoE publishes Asset Purchase Facility Quarterly Report – Q2
Tuesday 26 July 2022		
Italy 	10.00	Auction: €2.5bn of 1.75% 2024 bonds
	10.00	Auction: 0.1% 2033 index-linked bonds
	10.00	Auction: 2.55% 2041 index-linked bonds
Wednesday 27 July 2022		
Germany 	10.30	Auction: €4.0bn of 0% 2032 bonds
UK 	10.00	Auction: £700mn of 0.125% 2051 index-linked bonds
Thursday 28 July 2022		
Italy 	10.00	Auction: 5Y and 10Y bonds
Friday 29 July 2022		
- Nothing scheduled -		

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:

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

This research report is produced by Daiwa Securities Co. Ltd., and/or its affiliates and is distributed by Daiwa Capital Markets Europe Limited. Daiwa Capital Markets Europe Limited is authorised and regulated by The Financial Conduct Authority and is a member of the London Stock Exchange and Eurex Exchange. Daiwa Capital Markets Europe Limited and its affiliates may, from time to time, to the extent permitted by law, participate or invest in other financing transactions with the issuers of the securities referred to herein (the "Securities"), perform services for or solicit business from such issuers, and/or have a position or effect transactions in the Securities or options thereof and/or may have acted as an underwriter during the past twelve months for the issuer of such securities. In addition, employees of Daiwa Capital Markets Europe Limited and its affiliates may have positions and effect transactions in such securities or options and may serve as Directors of such issuers. Daiwa Capital Markets Europe Limited may, to the extent permitted by applicable UK law and other applicable law or regulation, effect transactions in the Securities before this material is published to recipients.

This publication is intended for investors who are MiFID 2 Professional (or equivalent) Clients and should not therefore be distributed to such Retail Clients. Should you enter into investment business with Daiwa Capital Markets Europe's affiliates outside the United Kingdom, we are obliged to advise that the protection afforded by the United Kingdom regulatory system may not apply; in particular, the benefits of the Financial Services Compensation Scheme may not be available.

Daiwa Capital Markets Europe Limited has in place organisational arrangements for the prevention and avoidance of conflicts of interest. Our conflict management policy is available at <http://www.uk.daiwacm.com/about-us/corporate-governance-regulatory>. Regulatory disclosures of investment banking relationships are available at <https://daiwa3.bluematrix.com/sellside/Disclosures.action>.

Explanatory Document of Unregistered Credit Ratings

This report may use credit ratings assigned by rating agencies that are not registered with Japan's Financial Services Agency pursuant to Article 66, Paragraph 27 of the Financial Instruments and Exchange Act. Please review the relevant disclaimer regarding credit ratings issued by such agencies at: <https://lzone.daiwa.co.jp/l-zone/disclaimer/creditratings.pdf>

IMPORTANT

This report is provided as a reference for making investment decisions and is not intended to be a solicitation for investment. Investment decisions should be made at your own discretion and risk. Content herein is based on information available at the time the report was prepared and may be amended or otherwise changed in the future without notice. We make no representations as to the accuracy or completeness. Opinions [and/or estimates] reflect a judgment as at the date of publication and are subject to change without notice. Daiwa Capital Markets Europe Limited retains all rights related to the content of this report, which may not be redistributed or otherwise transmitted without prior consent.