

Euro wrap-up

Overview

- Bunds initially made sizeable losses after the flash estimates of euro area July inflation and Q2 GDP beat expectations, despite confirmation that Germany's economy stagnated.
- Shorter-dated Gilts also made modest losses even as UK bank lending figures showed that households saved the least since 2018 but borrowed more amid a squeeze on budgets.
- Thursday will bring the BoE's latest monetary policy announcements, with Bank Rate set to be hiked by 50bps and its plans for active Gilt sales set to be published.

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Daily bond market movements

Bond	Yield	Change
BKO 0.2 06/24	0.235	+0.015
OBL 1.3 10/27	0.519	+0.005
DBR 1.7 08/32	0.818	-0.003
UKT 1 04/24	1.718	+0.024
UKT 1½ 07/27	1.598	-0.003
UKT 4¼ 06/32	1.869	-0.001

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

Source: Bloomberg

Euro area

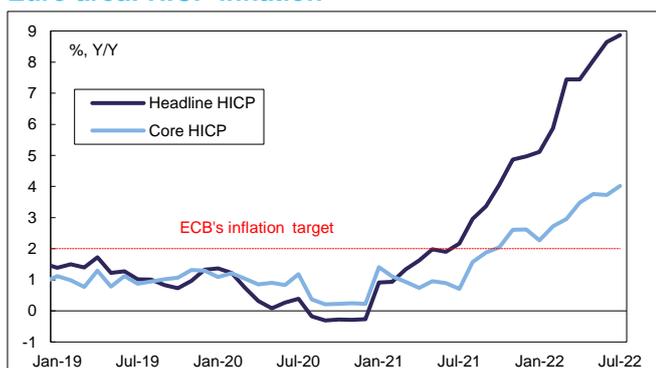
Euro area inflation jumps to a new record high, as food, goods and services rise

After yesterday's German HICP inflation unexpectedly rose, euro area inflation was anticipated to hit a new series high. And with today's figures from France, Italy and Spain also coming in on the upside, the flash July estimate of euro area inflation did just that, with the headline HICP rate rising 0.3ppt to 8.9%Y/Y. Admittedly, with petrol prices lower, there was an easing in energy inflation this month, by 2.3ppts to 39.7%Y/Y, although this component still accounted for almost 45% of total inflation. And this downwards shift was fully offset by the steady upwards drift in the food component, up 0.9ppt to a new series high of 9.8%Y/Y and contributing more than 2ppts to total inflation. But underlying price pressures continued to rise too as increased costs were passed on to customers. Indeed, non-energy industrial goods inflation was up 0.2ppt to 4.5%Y/Y, similarly a new series high. And despite the downwards pull from the German public transport subsidy, the services component also jumped in July, by 0.3ppt to 3.7%Y/Y. As such, core inflation also exceeded expectations, rising 0.3ppt to 4.0%Y/Y, similarly a record high.

Euro area GDP beats expectations in Q2, despite a stagnating German economy

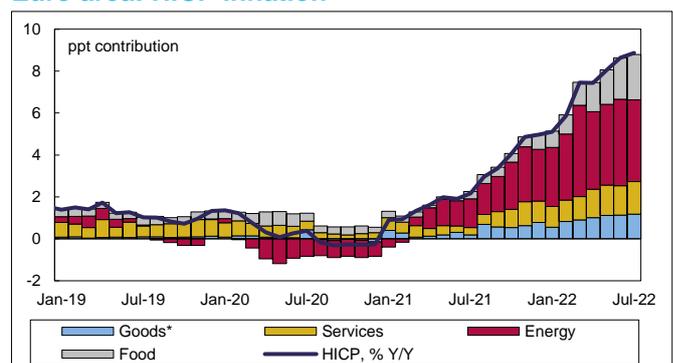
The flash estimates of inflation were not the only data to surprise on the upside today, with the preliminary reading of euro area GDP in Q2 significantly beating expectations. Contrasting with the ECB's expectation for modest growth of 0.2%Q/Q, GDP jumped 0.7%Q/Q to be 4.0% higher than a year earlier. So while growth was revised a touch softer in Q1 (by 0.1ppt to 0.5%Q/Q) this marked the fifth consecutive quarterly increase to take the level of GDP 1.5% above the pre-pandemic peak. Among the large member states, Germany's economic performance was the weak link in Q2, with the economy having stagnated as supply constraints continued to hamper output. But this followed a notable upwards revision to growth in Q1, by 0.6ppt to 0.8%Q/Q, while the contraction previously estimated in Q421 was also revised away, to leave output just 0.2% below the pre-pandemic level. In contrast, following the contraction in Q1, the rebound in French economic output exceeded expectations, with growth of 0.5%Q/Q in Q2 benefitting from the relaxation of Covid-19 and travel restrictions, to leave output 1% above the Q419 level. The performances in Italy and Spain were even more impressive. Italian GDP rose 1.0%Q/Q in Q2 to leave the level of output similarly 1% above the pre-pandemic level. Meanwhile, Spain's growth of 1.1%Q/Q was the strongest of the member states to have published preliminary figures, although the pandemic shortfall remained significant at 2.5%. Together the large four member states accounted for just over half of total euro area GDP growth in Q2. And given modest contractions in Portugal and the Baltics, today's data suggest another sizeable contribution from Ireland after it accounted for roughly half of total growth in Q1.

Euro area: HICP inflation



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: HICP inflation



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

Relaxation of restrictions provides a boost, but net trade likely a drag

While no detail of the expenditure breakdown of euro area GDP was published, the information provided by the member states suggest that the economy benefited from the reopening of the services sector and resumption of international travel last quarter. And despite the increase in uncertainty and cost pressures related to the war in Ukraine, business investment also seemingly provided modest support. While it didn't provide any data, Germany's statistical agency stated that GDP growth was supported mainly by household and government spending, although this was offset by the drag from net trade. In contrast, French GDP growth was almost entirely supported by net trade (accounting for 0.4ppt of the 0.5%Q/Q growth) as spending by overseas visitors (8.6%Q/Q) and transport services (6.3%Q/Q) drove exports. But while spending on services also accelerated, French households scaled back on food and other goods, to leave total consumption a modest drag on growth (-0.2ppt) for the second successive quarter. The rebound in Spanish household consumption was more convincing (3.2%Q/Q), while fixed investment rose for the fourth consecutive quarter. But a surge in goods imports in Spain, more than offset a pickup in exports to leave net trade a drag for the first quarter in four.

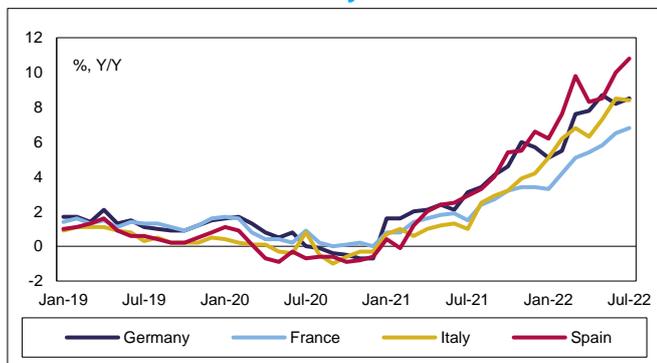
Outlook highly uncertain, with inflation likely to go higher but GDP growth lower

Looking ahead, the outlook for both inflation and economic growth remains extremely uncertain. In terms of inflation, the conclusion of the German temporary support measures in September will add an additional upwards impulse that month, and will likely only partly be offset by similar energy support measures to be introduced by the Spanish government. And the outlook will be further clouded by the recent jump in wholesale gas prices as Russia again squeezed energy supply through the Nord Stream 1 pipeline. With food prices set to remain elevated by the ongoing Ukraine war, and firms continuing to pass on increased cost burdens to consumers, we expect underlying prices pressures to maintain an upwards trend for the time being too. And so there is a strong likelihood that the ECB will again need to revise higher its inflation forecasts in September and therefore press ahead with another sizeable rate hike. Of course, this will diminish further households purchasing power. And with consumers and firms additionally concerned by the prospects of tighter monetary policy to tackle the worsening inflation outlook, the near-term growth prospects are becoming increasingly weak. Certainly, the latest sentiment surveys imply a significant deterioration in conditions in July, with the flash PMIs implying the worst performance in more than two years and modest contraction at the start of Q3.

The week ahead in the euro area

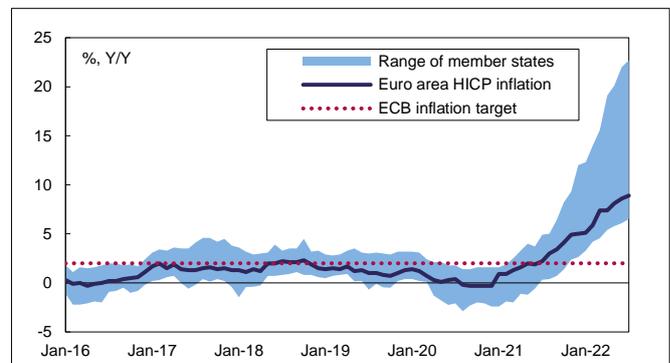
While today's flash euro area GDP estimate provided no additional expenditure breakdown, the coming week's euro area retail sales figures (Wednesday) should provide a little more insight into household spending at the end of the second

Euro area: HICP inflation by member state



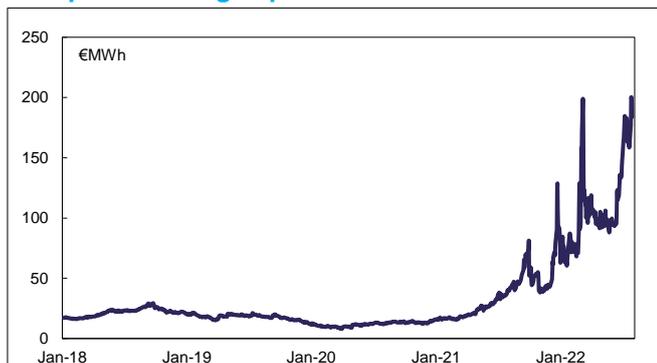
Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Euro area: HICP inflation



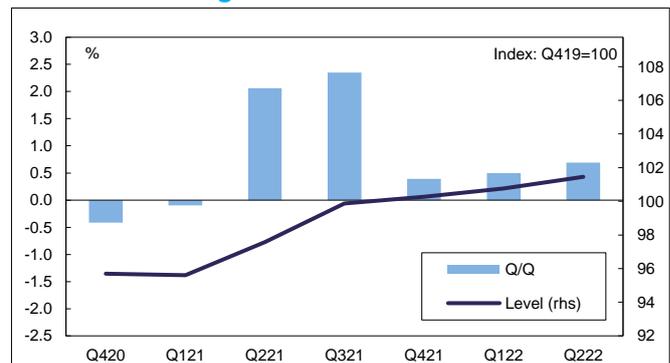
Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Europe: Natural gas price 6 month futures



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Euro area: GDP growth and level



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

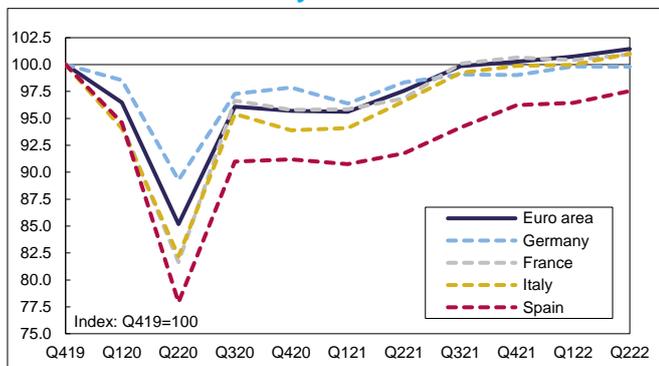
quarter. With consumer confidence having fallen to a record low and willingness to make major purchases at its weakest since April 2020, we expect retail sales to have remained very subdued in June, to leave them down over the second quarter as a whole. Wednesday will also bring euro area PPI data for June, which will show that price pressures remained elevated at the factory gate with evidence that higher input costs were being passed along to consumers. Ahead of this will bring the latest euro area unemployment figures (Monday), which are likely to see the jobless rate move sideways at June's record-low 6.6%. The final July PMI surveys for the euro area and larger member states will also be published – manufacturing (Monday), services (Wednesday) and construction (Thursday) – and are likely to confirm the first contractionary reading in the euro area composite output index (49.7) for more than two years. At the national level, German goods trade numbers for June (Wednesday) will be followed by German factory orders (Thursday) and industrial production data (Friday), which are likely to show that supply constraints continued to hamper the manufacturing sector. Friday will also bring the equivalent IP releases from France, Italy and Spain.

UK

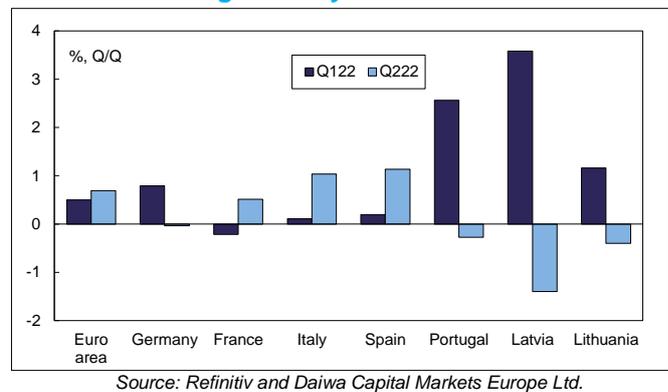
Households save the least amount since April 2018 and increase demand for lending

With UK households facing increasingly squeezed budgets amid higher prices, rising household energy bills, as well as increasing interest rates and declining real incomes, today's BoE bank lending figures suggested that households' ability to save had declined markedly at the end of Q2. In particular, households deposited merely an additional £1.5bn in June, the least amount since April 2018, down from £5.2bn in May, and just 40% of the average in the ten years before the pandemic. While interest rates on new unsecured loans rose to the highest since the start of the pandemic (6.71%), households also borrowed an additional net £1.8bn in consumer credit in June, double the increase in May, the second-strongest rise since April 2018 and above the pre-pandemic ten-year average (£1.0bn). Net credit card borrowing rose £1.0bn in June, to leave the outstanding stock of such lending up more than 12½%Y/Y, the highest since November 2005 (albeit growth remains flattered by pandemic-related weakness a year ago). Despite a further pickup in mortgage rates – e.g. the average interest rate on a 2Y fixed rate 75% loan-to-value mortgage rose 25bps to 2.88%, the highest for more than eleven years – demand for mortgages remained solid too. Net new secured borrowing rose £5.3bn in June, admittedly softer than the £8.0bn increase in May but still above the average in the year prior to the pandemic (£4.3bn). But the number of new approvals (63.7k) was the smallest since June 2020 and below the average in the twelve months to February 2020 (66.7k), suggesting that mortgage lending might well slow over coming months.

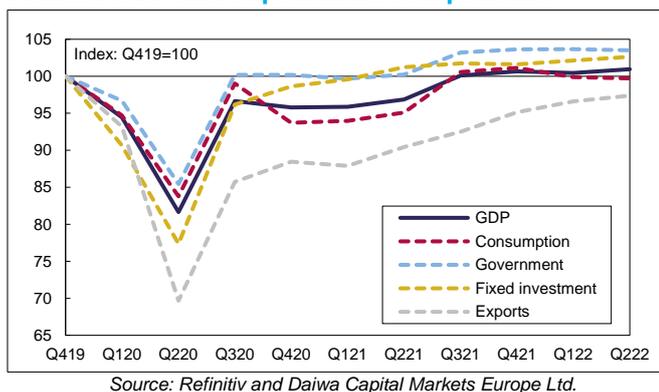
Euro area: GDP level by member state



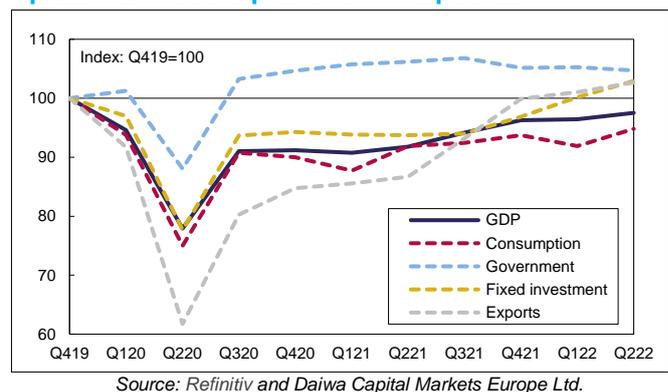
Euro area: GDP growth by member state



France: GDP and expenditure components



Spain: GDP and expenditure components



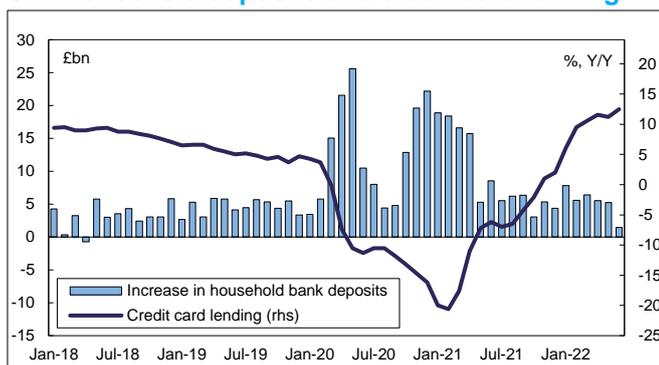
The week ahead in the UK

The main event in the UK in the coming week, will be the BoE monetary policy announcements and latest Monetary Policy Report due on Thursday. While there is no doubt that Bank Rate will be hiked for the sixth consecutive meeting, expectations for the magnitude of increase are split between 25 or 50bps. At the MPC's last meeting in June, the BoE raised Bank Rate by 25bps to 1.25%, with three (external) members of the Committee voting for a bigger hike of 50bps. However, the MPC stated that it "will be particularly alert to indications of more persistent inflationary pressures, and will if necessary act forcefully in response", hinting that hikes of a larger magnitude could gain majority support. And in his Mansion House speech earlier this month, Governor Bailey confirmed that a 50bps rate hike would be considered next week, although he also insisted that it was not a done deal.

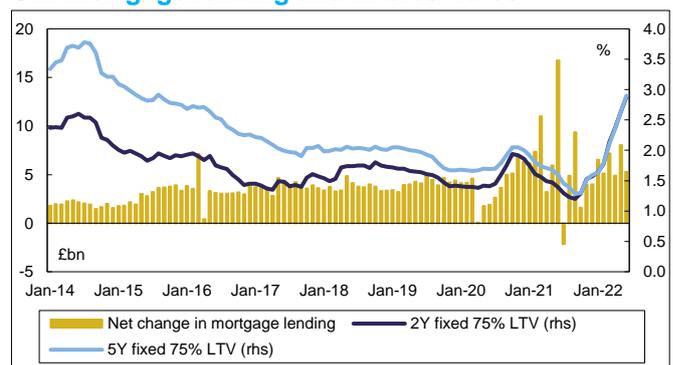
The inflation outlook has clearly deteriorated. June's inflation report saw the headline CPI rate increase 0.3ppt to 9.4%Y/Y, to leave the average in Q2 (9.2%Y/Y) a touch firmer than the Bank previously projected (9.1%Y/Y). And while core inflation eased back slightly it remained elevated at 5.8%Y/Y, while an alternative measure of underlying inflation – the NIESR 10% trimmed mean – rose to 6.2%Y/Y, the highest since 1992. Moreover, the MPC will be fully aware of the ongoing upwards trend in the services PPI and CPI rates, which are typically more sensitive to wage growth and might flag increased risks of inflation persistence due to the tightness in the labour market. While oil prices are only a touch firmer than in the run up to the May Monetary Policy Report (MPR), there has been a notable jump in natural gas prices, with the spot price in the fifteen days to 26 July – the time frame when the Bank's conditional assumptions are calculated – more than one third higher than the equivalent period ahead of the May MPR, with the 6-month futures some 85% higher. And so the BoE's previous assumption for the increase in Ofgem's price cap in October, of 40%, will also need to be revised higher – reports suggest it could rise as much as 65% (with the official announcement reportedly due 26 August). So with the Bank's inflation forecast likely to be revised higher, through to 2023, we think the majority on the MPC will favour a larger rate increase of 50bps to 1.75%, with signals of further monetary tightening ahead too (possibly of a similar magnitude). The BoE will also publish its plans for active Gilt sales, which will likely start in September depending on market conditions – Bailey previously suggested that, combined with redemptions, the BoE will likely aim to reduce its stock of Gilts (currently £847bn) by between £50-100bn in the first year.

Datavise, the UK economic data calendar is relatively light, kicking off with the final July release of the manufacturing and services PMIs (Monday and Wednesday respectively), followed by the construction PMI (Thursday). While the flash PMIs still pointed to expansion at the start of the third quarter, the composite PMI fell 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. Meanwhile, the construction PMI is likely to fall further in July, after June's result indicated the slowest pace of expansion in the sector for eighteen months. Other data due include the Nationwide house price index for July (Tuesday) and new car registrations for the same month (Thursday). And Friday's REC/KPMG Report on Jobs will be watched for any further slowdown in demand, albeit with a lack of supply it will continue to point to a tight labour market.

UK: Household deposits and credit card lending



UK: Mortgage lending and interest rates



Daiwa economic forecasts

	2022				2023		2022	2023	2024
	Q1	Q2	Q3	Q4	Q1	Q2			
GDP	%, Q/Q						%, Y/Y		
Euro area 	0.5	0.7	-0.1	-0.1	-0.2	0.0	2.9	-0.1	0.9
UK 	0.8	-0.1	0.1	-0.1	0.0	-0.2	3.5	-0.2	0.7
Inflation, %, Y/Y									
Euro area									
Headline HICP 	6.1	8.0	8.8	8.1	6.4	4.7	7.8	4.3	1.9
Core HICP 	2.7	3.7	4.1	4.4	4.3	4.1	3.7	3.7	2.1
UK									
Headline CPI 	6.2	9.2	10.0	10.5	9.8	6.6	9.0	6.4	2.4
Core CPI 	5.1	6.0	6.3	6.2	5.7	5.1	5.9	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 CPI M/M% Y/Y%	Jul	0.1 (8.9)	<u>0.5 (8.8)</u>	0.8 (8.6)	-
	Preliminary core CPI Y/Y%	Jul	4.0	<u>3.9</u>	3.7	-
	Preliminary GDP Q/Q% (Y/Y%)	Q2	0.7 (4.0)	<u>0.0 (3.2)</u>	0.6 (5.4)	0.5 (-)
Germany 	Unemployment claimant rate % (change 000s)	Jul	5.4 (48.0)	5.4 (17.0)	5.3 (133)	- (132.0)
	Preliminary GDP Q/Q% (Y/Y%)	Q2	0.0 (1.4)	<u>-0.2 (1.4)</u>	0.2 (3.8)	0.8 (3.6)
France 	Preliminary CPI M/M% (Y/Y%)	Jul	0.3 (6.1)	0.3 (6.0)	0.7 (5.8)	-
	Preliminary EU-harmonised CPI M/M% (Y/Y%)	Jul	0.3 (6.8)	0.2 (6.7)	0.9 (6.5)	-
	Preliminary GDP Q/Q% (Y/Y%)	Q2	0.5 (4.2)	<u>0.2 (3.7)</u>	-0.2 (4.5)	- (4.8)
	Consumer spending M/M% (Y/Y%)	Jun	0.2 (-4.4)	-0.9 (-4.9)	0.7 (-3.4)	0.4 (-3.6)
Italy 	Preliminary GDP Q/Q% (Y/Y%)	Q2	1.0 (4.6)	<u>0.2 (3.7)</u>	0.1 (6.2)	-
	Preliminary CPI M/M% (Y/Y%)	Jul	0.4 (7.9)	0.5 (8.1)	1.2 (8.0)	-
	Preliminary EU-harmonised CPI M/M% (Y/Y%)	Jul	-1.1 (8.4)	-0.9 (8.8)	1.2 (8.5)	-
	PPI M/M% (Y/Y%)	Jun	1.1 (41.9)	-	0.3 (42.7)	-
Spain 	Preliminary CPI M/M% (Y/Y%)	Jul	-0.2 (10.8)	-0.3 (10.4)	1.9 (10.2)	-
	Preliminary EU-harmonised CPI M/M% (Y/Y%)	Jul	-0.5 (10.8)	-0.8 (10.5)	1.9 (10.0)	-
	Preliminary GDP Q/Q% (Y/Y%)	Q2	1.1 (6.3)	<u>0.2 (5.3)</u>	0.2 (6.3)	-
UK 	Lloyds business barometer	Jul	25	-	28	-
	Net consumer credit £bn (Y/Y%)	Jun	1.8 (6.5)	1.0 (-)	0.8 (5.7)	0.9 (5.8)
	Mortgage lending £bn (approvals 000s)	Jun	5.3 (63.7)	5.5 (65.0)	7.4 (66.2)	8.0 (65.7)

Auctions

Country	Auction
- Nothing to report -	

- 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> <u>forecast/actual</u>	Previous	
Monday 01 August 2022						
Euro area		09.00	Final manufacturing PMI	Jul	<u>49.6</u>	52.1
		10.00	Unemployment rate %	Jun	6.6	6.6
Germany		07.00	Retail sales M/M% (Y/Y%)	Jun	0.4 (-8.3)	1.2 (1.1)
		08.55	Final manufacturing PMI	Jul	<u>49.2</u>	52.0
France		08.50	Final manufacturing PMI	Jul	<u>49.6</u>	51.4
		-	New car registrations* Y/Y%	Jul	-	-14.2
Italy		08.45	Manufacturing PMI	Jul	49.1	50.9
		09.00	Unemployment rate %	Jun	8.1	8.1
		17.00	New car registrations Y/Y%	Jul	-	-15.0
Spain		08.15	Manufacturing PMI	Jul	49.9	52.6
		-	New car registrations* Y/Y%	Jul	-	-7.8
UK		09.30	Final manufacturing PMI	Jul	<u>52.2</u>	52.8
Tuesday 02 August 2022						
Spain		08.00	Unemployment change '000s	Jul	-	-42.4
UK		07.00	Nationwide house price index M/M% (Y/Y%)	Jul	0.3 (11.6)	0.3 (10.7)
Wednesday 03 August 2022						
Euro area		09.00	Final services (composite) PMI	Jul	<u>50.6 (49.4)</u>	53.0 (52.0)
		10.00	Retail sales M/M% (Y/Y%)	Jun	0.0 (-1.7)	0.2 (0.2)
		10.00	PPI M/M% (Y/Y%)	Jun	1.0 (35.7)	0.7 (36.3)
Germany		07.00	Trade balance €bn	Jun	0.2	0.9
		08.55	Final services (composite) PMI	Jul	<u>49.2 (48.0)</u>	52.4 (51.3)
		-	New car registrations* Y/Y%	Jul	-	-18.1
France		08.50	Final services (composite) PMI	Jul	<u>52.1 (50.6)</u>	53.9 (52.5)
Italy		08.45	Services (composite) PMI	Jul	50.1 (49.6)	51.6 (51.3)
		09.00	Retail sales M/M% (Y/Y%)	Jun	-	1.9 (7.0)
Spain		08.15	Services (composite) PMI	Jul	52.0 (51.5)	54.0 (53.6)
UK		09.30	Final services (composite) PMI	Jul	<u>53.3 (52.8)</u>	54.3 (53.7)
Thursday 04 August 2022						
Euro area		08.30	Construction PMI	Jul	-	47.0
Germany		07.00	Factory orders M/M% (Y/Y%)	Jun	-1.2 (-9.7)	0.1 (-3.1)
		08.30	Construction PMI	Jul	-	45.9
France		08.30	Construction PMI	Jul	-	46.4
Italy		08.30	Construction PMI	Jul	-	50.4
UK		08.30	Construction PMI	Jul	52.4	52.6
		09.00	New car registrations Y/Y%	Jul	-	-24.3
		12.00	BoE Bank Rate %	Aug	<u>1.75</u>	1.25
Friday 05 August 2022						
Germany		07.00	Industrial production M/M% (Y/Y%)	Jun	-0.4 (-1.2)	0.2 (-1.5)
France		07.45	Trade balance €bn	Jun	-	-13.0
		07.45	Industrial production M/M% (Y/Y%)	Jun	-0.5 (-0.5)	0.0 (-0.4)
		07.45	Manufacturing production M/M% (Y/Y%)	Jun	-	0.8 (2.2)
Italy		09.00	Industrial production M/M% (Y/Y%)	Jun	-0.1 (2.7)	-1.1 (3.4)
Spain		08.00	Industrial production M/M% (Y/Y%)	Jun	-0.3 (4.6)	-0.2 (3.8)

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

The coming week's key events & auctions

Country	BST	Event / Auction
Monday 01 August 2022		
- Nothing scheduled -		
Tuesday 02 August 2022		
UK	 10.00	Auction: £2.75bn of 1% 2032 bonds
Wednesday 03 August 2022		
Germany	 10.30	Auction: €1.5bn of 1% 2038 bonds
Thursday 04 August 2022		
Euro area	 09.00	ECB publishes Economic Bulletin
France	 09.50	Auction: 2% 2032 bonds
France	 09.50	Auction: 1.25% 2034 bonds
Spain	 09.30	Auction: bonds of mixed maturities
UK	 12.00	BoE monetary policy announcement, minutes and Monetary Policy Report to be published
	 12.30	BoE Governor Bailey press conference
	 14.00	BoE publishes Decision Maker Panel survey
Friday 05 August 2022		
UK	 00.01	REC/KPMG report of jobs
	 12.15	BoE Chief Economist Pill scheduled to speak about the Bank's latest interest rate decision and forecasts

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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